

DNR Capital Australian Emerging Companies Fund

Performance Report – December 2021

Performance

The DNR Capital Australian Emerging Companies Fund increased 2.33% (net of fees) in December, outperforming the S&P/ASX Small Ordinaries Accumulation Index by 0.92%. Over the last 12 months the Fund increased by 34.87%, outperforming the Index by 17.97% (net of fees).

Market review

Overall, the market posted a solid performance during December, with the market prepared to look through the disruption that the Omicron variant is having on the global economy. However, under the surface a different story is revealed, with a wide dispersion in share price performance across various sectors of the market.

One of the risks we have highlighted in recent months has been the significant dispersion in both quality and valuation across the Australian small cap universe, with the gap between high and low priced companies having reached a multi-decade high. With monetary stimulus set to be gradually withdrawn over the coming years, and the prospect of higher interest rates, in our view it has never been more important to stay disciplined on quality and valuations. This includes avoiding the areas of the market with questionable business models and excessive valuations, as these are likely to be most vulnerable to higher interest rates.

December saw this risk unfolding, with many of those companies excessively priced for growth coming under pressure. Worst hit were some of the more speculative business models in the Index, which are frequently characterised by a lack of earnings or cash flow. This includes companies in sectors like biotech, online, software and mining exploration. We have been avoiding these areas of the market, staying cautious on companies with unproven business models lacking any tangible sign of generating profits. We have also been trimming or exiting positions in recent months where valuations have moved ahead of fair values.

Leading the market during December were some of the more value and cyclical areas of the market, where significant future growth is not being reflected in current valuations. This includes Resources shares, and a number of high quality Industrials, where we see strong cash generation, prudent balance sheets and a more positive outlook for earnings.

As we look ahead to the 2022 calendar year, our outlook for the market and Fund positioning remains unchanged. We continue to look for strong bottom-up investment opportunities, in high quality companies trading on attractive valuations. We expect that market leadership going forward could come from a narrower selection of companies, which will require a more concentrated and fairly benchmark agnostic approach to managing the Fund.

Fund overview

APIR Code	PIM4357AU
Investment bias	Style neutral with a quality focus
Designed for	The Fund is designed for investors seeking a medium-longer term investment focused on achieving growth, with less focus on generating excess income. The investor is prepared to accept higher volatility in pursuit of higher growth.
Investment objective	The Fund's investment objective is to invest in a portfolio of Australian emerging companies that aims to outperform the Benchmark over a rolling five-year period. The investment objective is not a forecast of the Fund's performance.
Benchmark	ASX/S&P Small Ordinaries Accumulation Index
Investable universe	Australian equities and cash
Investment constraints	The Fund will not invest in derivatives
Investment guidelines	Maximum exposure to an individual security is 15% of Fund NAV
Asset allocation	Australian Equities - 80-100% Cash - 0-20%
Risk level	High
Number of securities	Min 20 - max 45
Minimum suggested investment timeframe	5 years
Buy/sell spread	+0.25% /- 0.25%
Management fee	1.15% p.a. of the NAV of the Fund (inclusive GST and RITC)
Performance fee	20% of outperformance of the Fund relative to the Fund's Benchmark (after the management fee)
Minimum initial application amount	\$20,000
Minimum further application amount	\$5,000
Minimum withdrawal amount	\$5,000
Valuation and unit pricing frequency	Each business day
Distribution frequency	Semi-annual
Responsible entity	The Trust Company (RE Services) Limited as part of the Perpetual Limited group of companies
Entry/exit fees	Nil

Net active return as at 31 December 2021

	1mth %	3mth %	6mth %	1yr % p.a.	2yr % p.a.	3yr % p.a.	Incep.* % p.a.
Emerging Companies Fund	2.33	4.79	10.81	34.87	26.71	29.48	18.89
S&P/ASX Small Ordinaries Accumulation Index	1.41	2.03	5.54	16.90	12.99	15.71	8.99
Excess return	0.92	2.76	5.27	17.97	13.72	13.77	9.90

* Inception Date—August 2018

Source: Mainstream Fund Services and DNR Capital

Past performance is not an indication of future performance. Total return shown for the DNR Capital Australian Emerging Companies Fund has been calculated using exit prices after taking into account all of the product's ongoing fees and assuming reinvestment of distributions. No allowance has been made for entry fees or taxation.

To take advantage of these opportunities, the Fund is currently positioned across 24 holdings, with limited overlap versus the Index. Although this means that returns could differ more materially from the Index in the short-term, we believe this approach will better position the Fund to take advantage of the opportunities the current market is likely to present.

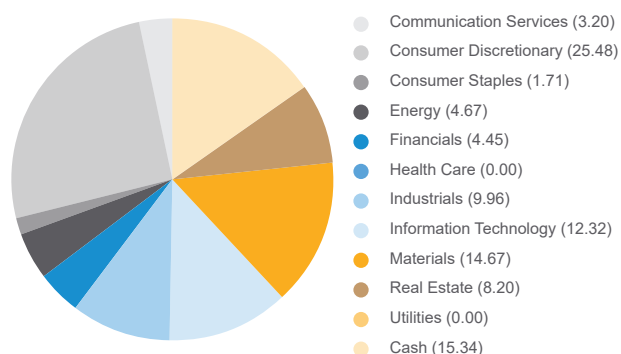
Key positions in the Fund include a number of industry leaders, which benefit from strong pricing power to pass through greater inflationary pressures. We are positive on a number of high quality commodity producers, generating strong cash flow and where the supply/demand outlook remains attractive. We also like a number of re-opening opportunities, where we expect earnings to bounce back sharply as the disruption from the pandemic recedes. The Fund's weighting in cash is more elevated at 15%, which should provide flexibility to take advantage of the greater volatility we anticipate going forward.

Top 3 active holdings (alphabetical order)

IPH
Iress
PEXA Group

Source: Mainstream Fund Services and DNR Capital

Sector weightings %



Source: DNR Capital

Attribution

The key stocks contributing to the Fund's monthly relative performance include:

Contributors

- **PEXA Group (PXA)** shares rose after its major shareholder Link Administration Holdings (LNK) entered into a deed with Dye & Durham under which it will acquire 100% of the share capital of LNK. As part of the transaction, Dye & Durham will also indirectly acquire LNK's 43% ownership stake in PXA. Dye & Durham is a Canadian software firm and was one of the potential trade buyers for PXA before its IPO in July 2021.
- **Reece (REH)** shares continue to rise after its first quarter update of FY22 that saw group sales up 13%. Positive commentary from peers during the month highlights supportive market conditions in the US, with broad based strength nationally and across end markets from new residential to repair and maintenance work.
- **NOVONIX (NVX) (no holding)** shares fell and the funds nil holding added to relative performance.

Detractors

- **City Chic Collective (CCH)** shares traded lower as new COVID-19 strains cause rolling lockdowns and economic disruptions. Notwithstanding this near term uncertainty the company is well positioned with strong inventory and balance sheet to capitalise on the ensuing recovery.
- **IPH (IPH)** underperformed in December on no significant news flow. IPH's revenue exposure to the USD likely played a part in the weaker performance, with the AUD strengthening during the period against the USD.
- **Lovisa Holdings (LOV)** shares traded lower as new COVID-19 strains cause rolling lockdowns and economic disruptions. During the month we saw buying from two LOV directors. John Charlton purchased \$388k shares on market and recently appointed CEO Victor Herrero purchased \$1m shares on market.

Monthly - top contributors and detractors

Top 3 contributors

PEXA Group
Reece
NOVONIX (no holding)

Top 3 detractors

City Chic Collective
IPH
Lovisa Holdings

Investment strategy

DNR Capital's security selection process has a strong bottom-up discipline and focuses on buying quality emerging businesses at reasonable prices. The process involves comprehensive company and industry research, company visits and meetings, and detailed valuation analysis and modelling. This information is used to assess the quality of a business, and the expected return.

The portfolio construction process considers stock weightings based on the risk versus the expected return. It is also influenced by a top-down economic appraisal, sector exposures and liquidity considerations.

The investment strategy of the Fund is intended to result in a concentrated portfolio that is high conviction and invests for the medium to long-term.

Investment philosophy

DNR Capital believes a focus on quality will enhance returns when combined with a thorough valuation overlay. DNR Capital seeks to identify good quality emerging businesses that are mispriced by overlaying DNR Capital's quality filter, referred to as the 'quality web', with a strong valuation discipline.

Platform access

- AMP MyNorth
- BT Panorama
- CFS FirstWrap
- HUB24
- Macquarie Wrap
- Mason Stevens
- Netwealth
- Praemium

Disclaimer

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