EGP Fund No. 1 Pty Ltd
4 35/37 Booth Street
Marsfield, NSW, 2122
Telephone: 0418 278 298

Erik A. (Tony) Hansen – Investment Manager 30 June 2014

Financial Year 2014:

The general market:-

The ***Standard and Poors ASX200 Total Return Index*** (hereafter referred to as '**the benchmark**') commenced financial year 2014 (FY2014) at 39163.27 points. Including reinvestment of dividends, the benchmark finished FY2014 (July 1st 2013 – June 30th 2014) at 45991.23 points.

The investment experience of the Australian investing public in the stock market generally in FY2014 was a gain of 17.43%. The very good returns of the last 2 years have started to slow in the last 6 months. This is not a bad thing, steady modest growth in the market is desirable and for most people, a good deal easier to cope with than wildly swinging results, even if they finish in the same place.

The 17.43% figure quoted above of course exclude management fees and costs which on average would trim between 1.5 to 2 percentage points off such a result (annually) for persons having their money professionally managed – in years when the returns are high, people will happily pay such fees, but in a year of substantial decline, it is particularly galling to most investors to pay these fees. This is why the EGP structure requires both a positive return and a market beating performance in order to earn a fee.

The chosen benchmark over a period of years will approximate the results of leading investment companies before fees & charges. Such investment companies are the most probable alternative investments for the majority of fellow EGP investors.

Our benchmark was selected in advance and represents the most logical choice in my view. It covers nearly $1.5 trillion in market capitalisation and over 80% of Australian listed stocks (by value). The chosen benchmark presents no pushover and I estimate that after fees, at least 80% of equities focused investment funds will fail to exceed the benchmark over the medium-term.

Our experience:-

EGP Fund No. 1 Pty Ltd (hereafter referred to as '**the fund**') commenced FY2014 at $1.33220. The fund finished FY2014 at $1.56145 after paying a 10c dividend (7c plus 3c franking credit), for a gain of 24.71% after allowing for all fees and expenses.

The second half of FY2014 saw a return of 3.69%, as compared to the benchmark return in the same period of 3.04%, the results should really be considered over the longer term, preferably 3 – 5 years. Our 17.81% annualised return to our holders exceeds by 9.64% the 8.17% annualised performance of our benchmark.

Despite the fully valued levels of the general market, we continue to find a few opportunities that look likely to provide well above-average returns over the medium term, we discuss these in slightly more detail below.

This comparison has been made before and we expect to do so in every report so it will not go unheeded, but a year when the benchmark declined by 35% and the fund declined by 20%

would be viewed as substantially superior year than one in which both advanced by 15%. The more years that go by without a substantial decline, inevitably the closer we are to a year when such an event will occur.

If the concept of holding an investment capable of substantial decline in the short-term makes you uncomfortable, you would be well-advised to have the majority of your wealth and investments outside of the stock-market, for it is precisely this type of out-performance we will be chasing (with the expectation that over a reasonable period, outperformance of the benchmark will lead to very satisfactory results). You should also expect approximately one in six periods to result in a negative return for the market and that EGP is unlikely to be completely immune should this happen.

Performance Tables, instructive for comparison:

Year by Year Performance			
Australian Financial Year	S&PASX200(TR)	EGP Fund No 1 Pty Ltd (A-Shares after performance fees)	EGP Fund No. 1 Pty Ltd (gross results)
2012*	-10.46%	2.99%	2.99%
2013	22.75%	32.58%[#1]	35.07%[#1]
2014	17.43%	24.71%[#1]	26.83%[#1]

* 2012 is the 15 month period from 1 April 2011 (fund inception) to 30 June 2012 (first full financial year)
#1 Assumes reinvestment of dividends

We include below a cumulative table, which we hope will demonstrate over time what Albert Einstein called “the most powerful force in the universe” – compound interest. My hope is that over time, small advantages over the benchmark will accumulate to a substantially superior overall performance:

Cumulative (compounded) Performance			
Australian Financial Year	S&PASX200(TR)	EGP Fund No 1 Pty Ltd (A-Shares after performance fees)	EGP Fund No. 1 Pty Ltd (gross results)
2012*	-10.46%	2.99%	2.99%
2013	22.75%	32.58%[#1]	35.07%[#1]
2014	17.43%	24.71%[#1]	26.83%[#1]
Cumulative	29.07%	70.36%[#1]	76.42%[#1]
Annualised	**8.17%**	**17.81%**[#1]	**19.09%**[#1]

* 2012 is the 15 month period from 1 April 2011 (fund inception) to 30 June 2012 (first full financial year)
#1 Assumes reinvestment of dividends

We have added one stock in the last quarter, bringing the number of our holdings to 24. Our largest (and best) 3 holdings currently comprise 48.3% of our stock portfolio (i.e. excluding cash holdings). Our smallest comprises 0.44%. After some new investors joining us at June 30 2014, we hold just over 10% cash. We dipped below 10% cash for the first time in a long time as some rare opportunities presented themselves in the last quarter. Our portfolio turnover (total of sales divided by average portfolio) in FY2014 was less than 6%. I expect it will average around 10% over time and only exceed 20% in periods of uncommon opportunity, where sales are necessary to make the most of these opportunities. There will be some meaningful reshaping of the portfolio in the first quarter or half of FY2015, I state in the ‘Investment Principles’ document ‘we do not expect to hold any more than 25 individual issues’, I would like to get back 20 or below in FY2015. Though nothing we are holding looks overvalued; a tighter focus on our best ideas will be the aim through FY2015.

Dividends:-

We distributed a 10c (7c dividend plus 3c FC) dividend 31 May 2014. We expect to maintain (and hopefully grow) the dividend in future financial years, subject to the level of Franking Credits held (we will only pay dividends to the extent we can fully frank them).

Current opportunities:-

The third quarter report discussed new holdings we began adding in Q3. We (mostly) completed acquiring these in Q4. These investments were mostly made on the second tier Australian exchange, the ‘National Stock Exchange of Australia’.

The reason we can make these unusual investments is due to the permanent nature of the majority of our capital. My Wife and I directly control about two-thirds of the assets of EGP Fund No. 1 Pty Ltd. With people closely associated with us, or who for one reason or another have an unusual amount of faith in myself, our control extends to more like three-quarters.

On any given day, I could comfortably liquidate about half of our stock portfolio despite some illiquid holdings without adversely affecting received prices. EGP could be around two-thirds cash at a day’s notice. Despite holding some unusual and illiquid stocks, we could liquidate enough to pay out all external holders more than two times over in a day.

Despite the security of this control over EGP’s capital, it is my ardent desire to think of the whole of our fund as permanent capital. Those of you who would like to time into and out of investments are encouraged to have another holding or holdings external to EGP in which you do that, either through index funds or through your own investments in individual stocks.

The illiquid holdings and the low-turnover is where a large portion of our outperformance has been and will be generated. Restricted to the ASX200, we could still generate outperformance, but the more we are able to work around the inefficient fringes of the market, the better our returns.

As promised in the Q3 letter, I still intend to give thorough backgrounds and thoughts on valuations for the NSX businesses we now own, once we’ve fully completed acquiring the stakes EGP is chasing. There is still a small amount of work to do in this area, but the first of a series of blogposts will be made in late August or September.

Limiting our size will ensure we can stay around the market’s most profitable fringes for as long as possible. As discussed previously, that is what we will do. Once we achieve our stated maximum of $20 million of externally contributed capital, we will close to new investors. As an incentive to current investors to spread the good word about our strong performance to date, I will also reduce the performance fee by ¼ (from 20% of outperformance to 15%) once the fund closes to new investments. So the sooner we hit that figure, the sooner the already unusually low EGP fees will be reduced.

Member Audit:-

The first member audit will be conducted based on the assets as held by the fund on 30 June 2014. The member auditor will be asked to write a short report acknowledging that the assets add up to the per share value as calculated internally. The member will be able to ask for anything they believe will help them properly assess that value.

Despite my offer in the Q3 letter to have other members conduct future audits, I have had no further applications, so call me or send me an e-mail if you want the job. It should be pointed out it won’t take a huge amount of your time to do this if you’re interested, perhaps a few hours, spread over a few weeks.

Let me hear from you regarding any questions you may have on any aspects of this letter or anything else regarding our fund that you would like to know.

Best Regards,

Erik A. (Tony) Hansen.
Tony@eternalgrowthpartners.com