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Erik A. (Tony) Hansen – Investment Manager 31 March 2016

Financial Year 2016 – Quarter 3:

The General Market:-

The ***S&P/ASX 200 Franking Credit Adjusted Annual Total Return Index (Tax-Exempt)*** (hereafter referred to as '**the benchmark**') commenced financial year 2016 (FY2016, July 1st 2015 – June 30th 2016) at 50922.68 points. Including reinvestment of dividends, the benchmark finished Q3 of FY2016 at 50033.99 points.

The average Australian investing experience in the stock market during the first three quarters of FY2016 was a loss of 1.75% including reinvestment of dividends.

The chosen benchmark over a period of years will approximate the median result of leading investment companies before fees & charges. Such investment companies are the most probable alternative investments for the majority of fellow EGP investors when they seek exposure to equities.

The benchmark was selected in advance and represented a logical choice in our view. It covers more than $1.5 trillion in market capitalisation and over 80% of Australian listed stocks by value. The benchmark presents no pushover. After fees; nearly 80% of active managers will fail to exceed the benchmark over the medium-term. A research report was included in the FY2015 annual letter explaining this fact in more detail.

Our Experience:-

EGP Fund No. 1 Pty Ltd (hereafter referred to as '**the fund**') commenced FY2016 at $1.57872. The fund finished the third quarter of FY2016 at $1.71233, gaining 8.46% after allowing for all fees and expenses. As explained in the last quarterly report, the quality of the results of the fund in FY2016 to date have been excellent, valuation gains largely stem from our investee businesses performing as anticipated. We augmented our results with a couple of arbitrage events and the use of options to capture some predictable profits from opportunities observed. Once again, we maintain our view that despite putting a wide gap on the market over the first 9 months of FY2016, the intrinsic valuation of our holdings is at least as good relative to the market as it was at the start of the financial year.

Results should really be considered over the longer term, preferably 3 – 5 years. The fund has today completed its 5th full year of operation. We have generated 15.03% annually after all fees and expenses. The benchmark over this period delivered 6.03% annually. The 9.00% annual advantage we have generated to date has exceeded our target of 3-5%; we hope to continue to deliver satisfactory outperformance measured over a reasonable period. Full performance history is set out in Appendix 1. Current opportunities in the market to deploy capital into high quality stocks at reasonable valuations still remain satisfactory in our view.

As always, fellow investors in EGP should remember that any year when the benchmark declined by 35% and the fund declined by 20% would be viewed as a substantially superior year to one in which both advanced by 15%. Ordinarily, we expect our best chance of outperformance to come in periods of substantial decline. In the event of a sharp rise, we will generally be happy just to keep pace.

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 the type of outperformance described above that we will be chasing. The expectation that over a reasonable period, outperformance of the benchmark will lead to very satisfactory results has borne out so far. You should also expect at least one in six periods to result in a negative return for the benchmark and that the fund is unlikely to be completely immune should this happen.

The fund ended the period with holdings numbering 25. We received cash from the completion of the Coffey (COF.ASX) takeover and from the winding up of the NSX listed Premium Income Fund (PIN.NSX). Premium Income Fund taught a valuable lesson about how hard NTA can be to judge in a winding up situation. We were anticipating about 1.3 cents per share in cash, but received 0.71 cents. Some enormous expenses eroded the difference. The expenses included more than $1.3m to run the share register for the approximately two thirds of the year the fund operated. This juicy charge had me considering branching out into the registry business. I've been keeping EGP's register free of charge for 5 years…

25 holdings is the most concentrated we have been for a while, over the course of Q3 FY2016, we added a couple of larger and more liquid stocks. We are researching other larger stocks too, which appear to be very good value. This is not a departure from our core skill in ferreting out small, illiquid microcap situations, more an indication that we will roam wherever we see opportunity.

Our top 5 holdings currently comprise 60.4% of our stock portfolio (excluding cash holdings). Our top 10 comprise 79.5% and our top 15, 90.9%. We remain well concentrated in our best ideas.

After the March 2016 investor intake, we hold about 16.5% cash. As pointed out previously, the cash levels aren't held at a predetermined level, though 10% has proven a happy level for us historically. If there are many good ideas, we will use up the cash. If there are fewer good ideas, the cash will trend higher. We have a number of our existing holdings we would happily add to at current prices. As mentioned, we also have what appear to be a couple of good quality opportunities we are further investigating.

Dividends:-

We have distributed 18 cents per share (cps) since inception, or 25.714 cent including the franking credits. At the end of the period, we have accumulated a little over 2.5 cps in franking credits, which means we are likely to pay a fully franked dividend of about 6.0 cps at the end of May.

We will retain our very simple dividend policy unless there is a very good reason to change it. We simply return whatever franking credits are held at the end of the tax year to our investors as a fully franked dividend. Given we have investors ranging from low-tax rate SMSF's to high-tax rate individuals, we are happy to listen to any ideas about how best to deploy the Franking Credits. If you have a better idea than 'pay them out in full every year', let me know.

Reprising The Ugly:-

In the last quarterly in a section titled "The Good, the Bad and the Ugly", I recounted one of our big 2015 investment mistakes in NRW Holdings (NWH). I described it as a diabolical mistake in hindsight, having fallen about 80% over calendar 2015. NWH roughly tripled in the last quarter, it has been a big tailwind over the quarter just completed. Bear in mind if something falls by 4/5ths and then triples, you are still down 40% on your starting point.

They won a large contract, just like the contract dispute that led to 2015's difficulties; the big contract win was a tough outcome to predict. It is the reasons holdings such as NWH tend to be among the smallest in our portfolio. The range of possible outcomes is much wider than some of the very good businesses we have larger allocations in.

Ch Ch Ch Changes:-

Vale David Bowie, the loss of this wonderful artist who did things so very differently was one of a number of unfortunate events happening in Q3. I was always a big fan of Bowie's work, particularly due to his originality. Despite possessing no musical talent myself, I do have some of Bowie's penchant for the unconventional, having always sought to do things differently if the status quo looks like it can be improved. The establishment of the fund was an unconventional way to run money, but it was created out of a sense that the alignment in the funds management industry often seemed to be misplaced. If you feel you have a particular skill for managing money, you should 'back yourself' by having the lowest possible underlying fee, with the great bulk of your earnings coming via delivering good results to the people who have entrusted you their money. Your capital should likewise be almost exclusively invested alongside the people who have committed their savings to you, to remind you daily of your fiduciary duty in preserving the assets.

After 5 years of running the fund, there will be some changes. The sharper-eyed among you will have noticed that the address listed at the top of the first page of the letter has changed. Because I am such an incorrigible cheapskate, I have run the fund from my home for five years, as I boot-strapped it into a business with sufficient scale to operate as something that more closely resembles a regular managed fund. From April, Eternal Growth Partners will be taking a desk in the city. In April, May and June, the cost of this new space will be covered from my own pocket. From July onwards, the fund will bear this cost.

Since inception, the fund has averaged operating costs slightly below 0.1% annually. Because we have grown considerably in scale, our costs in FY2016 will actually approach 5 basis points (0.05%). With the addition to the operating costs of the office, and assuming no growth in Funds Under Management (FUM), operating costs will rise to approximately 0.22% in FY2017. There is a very simple way the operating costs can come back to 0.1%, the fund grows FUM by 2.2 times, so tell your friends...

The fund has grown FUM by over 60% annually since inception, so if this growth rate holds, sometime in FY18, the costs will be back to historic levels.

There will be tangible benefits for the fund operating out of the Bligh Street office. Not the least of which will be our co-tenants. At present two other excellent fund managers are operating out of the same space, Harness Asset Management and Samuel Terry Asset Management. The principals of these funds, Nigel Littlewood and Fred Woollard are excellent fund managers you would do well to keep your eye on. Spending time with such intelligent people of high integrity will make for an enjoyable working environment. These are among the better investment thinkers I know too. I expect regular exposure to their inquiring minds will only improve the results of the fund.

The concept is an evolving one. Other changes and opportunities will be investigated as time passes. One other change being considered is the FUM cap of $20m, which I have previously indicated is the point at which the fund would be closed to external investors. It is now my view that a number much larger than that can be managed with satisfactory returns still being maintained. The fund is now likely to close to external investors at $50m FUM. If it takes us 5 years to get to $50m FUM and if our historic return levels are maintained, it would take about another 15 years to turn $50m into $400m of FUM. By 2036, if I continue to improve as an investor, $400m for a fund focussed on the small end of the market will not be unmanageable.

As I have suggested to a number of our investors previously, once EGP Fund No. 1 Pty Ltd is closed to new investment, we are likely to open an international fund. If the interest is strong enough, we will consider opening it sometime before that. If you're looking to diversify into some international investment, keep in mind we may be able to assist in that respect in the next couple of years.

In April 2011, EGP Fund No. 1 Pty Ltd commenced operation with $480,000 of FUM. From this modest beginning which more than one person advised me against undertaking; we have grown to more than $5.4m in assets and have created about $1.5m in wealth for our investors. The extent of our marketing campaign to date has been $1,725 invested in Google AdWords. So virtually all of this growth has come from existing members letting their friends know about the good results the fund has delivered them. I am enormously grateful for the continuing support of our investors. The faith you have placed in Eternal Growth Partners to help grow your wealth fills me with both pride and an extraordinary sense of responsibility.

<u>Audit and Member Audit:-</u>

Our Member Audit for the December 2015 results was completed on February 1 2016. The finalised per share NTA after a minor adjustment was $1.66258 (as against the $1.66153 we reported on December 31). If you would like to discuss the audit process, let me know and I can put you in touch with our last Member Auditor.

We have a volunteer for the 30 June 2016 Member Audit, to affirm the valuations alongside our ordinary annual external audit.

We also have a volunteer for the 31 December 2016 Balance Date, but do not yet have any volunteers beyond that, if you think overseeing a future Member Audit is something you'd like to do, get in touch. Again, unless we have unusually strong interest, we will likely revert to an annual Member check-up aligning with the traditional financial year audit as conducted by our regular accountants at the June 30 Balance Date.

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

Best Regards,

Erik A. (Tony) Hansen

Disclaimer: the content of this letter should not be relied on as financial advice. Where numbers are provided, every effort was made to ensure their accuracy. Do your own research and seek financial advice where appropriate.

Appendix 1:

Investment Comparison Tables:

As explained recently, Standard and Poors developed a new index in late 2014 that adjusts the ASX200 Total Return (i.e. with dividends reinvested) for Franking Credits. Franking Credits are an important component of the investment proposition for Australian investors holding Australian shares. The ASX200 has a dividend yield of around 4%, which is customarily Franked to roughly 70%. This means the Franked component of the return on an investment in ASX200 stocks would amount to around 1% in any given year.

If you can assume that over the medium term Australian shares were to return about 8% annually (this has been the approximate historic case), 1% uplift via Franking therefore adds about 12.5% to the prospective return. This is significant and must obviously be factored into the measurement for fairness. We have adopted this index as our benchmark as at 1 July 2015.

For reference, as at 31 March 2016, the S&P/ASX 200 Franking Credit Adjusted Annual Total Return Index (Tax-Exempt) was down 1.75%, whereas the S&P/ASX 200 Total Return Index was down 3.26%, meaning the value of Franking Credits in the first 3 quarters of FY2016 has been 1.51%.

Performance Tables, instructive for comparison:

	Year by Year Performance		
Financial Year	**ASX200TRGU (Benchmark)**	**EGP Fund No 1 (after fees/costs)**	**EGP Fund No. 1 (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
2015	5.68%	9.04%#1	9.87%#1
2016Q3	-1.75%	8.46%	11.02%

* 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. The hope is that over time, small advantages over the benchmark will accumulate to a substantially superior overall performance:

	Cumulative (compounded) Performance		
Financial Year	**ASX200TRGU (Benchmark)**	**EGP Fund No 1 (after fees/costs)**	**EGP Fund No. 1 (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
2015	5.68%	9.04%	9.87%
2016Q3	-1.75%	8.46%	11.02%
Cumulative	34.02%	101.39%#1	115.20%#1
Annualised	**6.03%**	**15.03%#1**	**16.57%#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