EGP Concentrated Value Fund

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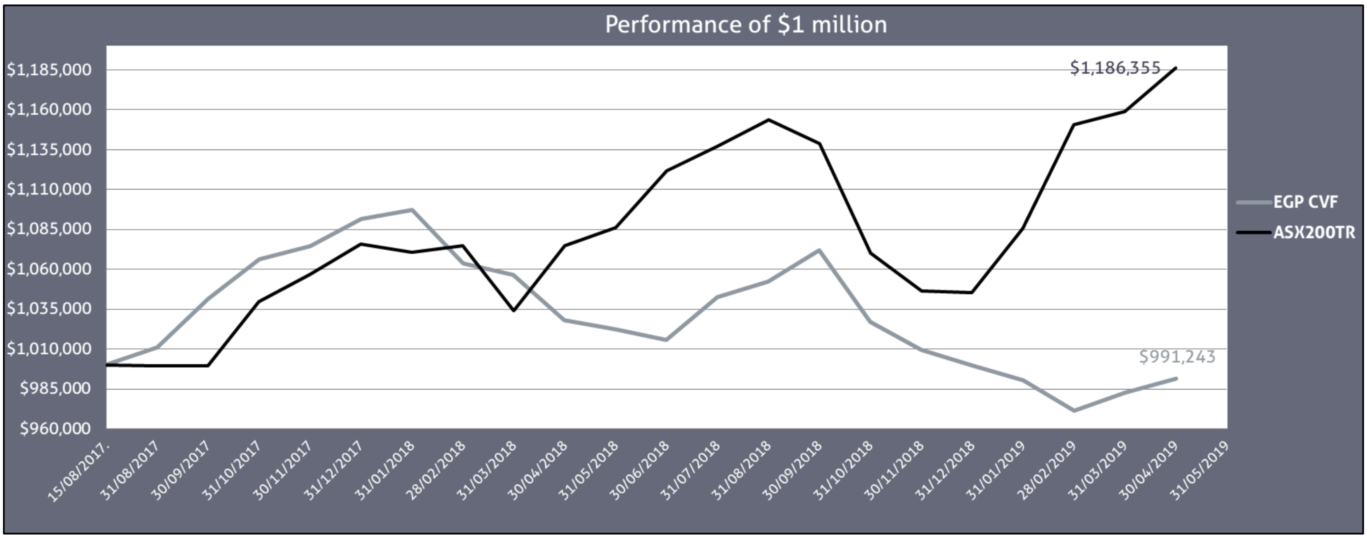
EGP Concentrated Value Fund – 30 April 2019

EGP Concentrated Value Fund is a managed investment scheme focused primarily on owning Australian listed businesses. It targets 3 – 5% annual outperformance of Australia's preeminent ASX200 index over the long term. Managed by a performance oriented co-owner, we run a portfolio that is genuinely different. The sole objective is to deliver the strongest possible risk adjusted returns. The fund manager has their entire investable asset base in the fund, meaning focus on risk is unusually intense.

	Jul	Aug*	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
EGPCVF FY18	N/A	1.1%	3.0%	2.4%	0.8%	1.6%	0.5%	(3.0%)	(0.7%)	(2.7%)	(0.6%)	(0.7%)	1.58%
Benchmark FY18	N/A	(0.1%)	(0.0%)	4.0%	1.6%	1.8%	(0.5%)	0.4%	(3.8%)	3.9%	1.1%	3.3%	12.18%
EGPCVF FY19	2.6%	1.0%	1.8%	(4.2%)	(1.7%)	(1.0%)	(0.9%)	(1.9%)	1.2%	0.9%			(2.42%)
Benchmark FY19	1.4%	1.4%	(1.3%)	(6.1%)	(2.2%)	(0.1%)	3.9%	6.0%	0.7%	2.4%			5.76%

*August 2017 is the period from August 15th-31st for both the fund and the benchmark in the above tables.



The Month That Was:-

The fund gained 0.9% in April. Our benchmark gained 2.4%.

We were having a much better month than it ended up being as sharply negative movements in a couple of our holdings late in the month offset the excellent result we had with the resolution of the APN Regional Property Fund transaction we have mentioned in previous newsletters.

We will talk about APN and some of the other significant movers for the month in the shorter than usual monthly update that follows.

Portfolio Update:-

We purchased 2,185,507 units of the NSX listed APN Regional Property Fund (APN RPF) for $1.15 each in March 2018. The fund was the subject of a long-mooted restructuring event that would enable long-time investors to exit and new investors to be brought aboard. The workout took a little longer than we'd expected, but on 16 April 2019, we received the consideration of $1.4055 per unit to withdraw our interest in the fund.

In the time of our ownership, we received 5 distributions of 2.375c per unit and a small 'make-up' distribution of 0.3301 with the withdrawal consideration. Our Internal Rate of Return from the investment was 31.41% after costs, looking like this:

APN RPF	
$(2,521,627.05)	20/03/2018
$ 51,905.79	29/03/2018
$ 51,905.79	25/06/2018
$ 51,905.79	24/09/2018
$ 51,905.79	21/12/2018
$ 51,905.79	30/04/2019
$ 7,214.36	30/04/2019
$ 3,071,730.09	16/04/2019
31.41%	IRR

The IRR on the transaction was very nice, but the most important feature was the risk/reward characteristics. We owned a portion of a couple of very good properties in Newcastle that were generating an 8.23% distribution yield on our cost basis.

Knowing the assets well as we did, we were confident they were worth at least what they were carried in the books for and that in the event the restructuring to deliver our investment back failed, we would have little difficulty finding buyers of the assets for prices at or above book value.

Transactions such as the APN RPF one are infrequent, but offer excellent opportunities to put a meaningful amount of capital to work for a respectable rate of return, with minimal risk. We remain vigilant for any further such opportunities.

We discussed SRG Global last month, mentioning we would look seriously at putting some of the proceeds of APN RPF into the business if prices remained depressed. SRG closed March at 30.5cps; unfortunately the stock traded as much as 33% higher in the first week or two of April, before we received the APN RPF proceeds. The example of what caused the rise is instructive in thinking about investor psychology I think. On 5 April, SRG announced an extension to an existing contract with Evolution mining. Granted the contract extension was a substantial one, but SRG were the presumptive winner of the work given they were already on site.

The rally in SRG stock really got underway by 9 April when they announced an $18m contract extension with KCGM. The key element to the announcement was this line:

"KCGM has awarded the ground support works to SRG Global's Geotech business, who have been performing a range of services at the mine since 1997"

Once again, given they'd been working on the site for more than 20 years; the win should have been part of the ordinary course of business. These two announcements and the sharp share price reactions to them show the market for SRG was anything but efficient. Sentiment was so poor that even winning work which any reasonable observer should reasonably have expected they would win caused the share price to rise by about a third. The business did not become one third more valuable in the first half of April.

SRG has weakened again as May begins, we may ultimately get a chance to deploy some of the APN RPF proceeds into the stock. Based on midpoint FY19 guidance (EBITDA $34.5m), SRG is trading on an EV/EBITDA multiple (at 35cps) of 3.97x. If they can return in FY20 to earning the circa $50m of EBITDA the combined businesses earned in FY18 then the business is trading at barely more than 2x FY20's EV/EBITDA (after allowing for the cash that will come back to the business over the period). That is cheap compared to the circa 6-7x EV/EBITDA multiple the business has commanded.

Another stock that performed well for the fund in April was Locality Planning Energy (LPE). To be sure the current price is well down on our average purchase price, but it was still well up over the month of April. In the February Update, I posited the March cashflows required for the market to return to believing the LPE growth story were $8.8m (+/- 5%):

	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21
Receipts from customers	$8.8m	$10m	$10.7m	$14.9m	$18.6m	$14.9m	$15.4m	$20.9m	$25.4m	$19.8m

The actual cashflow produced was $8.5m, well within the range and up 22.8% on the December quarter and up more than 47% on the March quarter in 2018. The strong growth gives credence to management's explanation that it was capital constraints (along with lower wholesale/network pricing) in the first half of the year that were the primary cause of the slower than expected growth. If they can meet or exceed the $10m figure for the June quarter, the return to growth story will be doubly validated, particularly if they return to operating cashflow positive with the costs associated with investigating M&A opportunities not recurring.

Legend Corporation (LGD) traded lower for most of April; we were responsible for a good portion of the buying. We think LGD is incredibly cheap, we suspect the reason is that market watchers disagree with our view that this is a significantly less cyclical business than it has been historically. At around 7x FY19 P/E and 4.5x FY19 EV/EBITDA, and what we suspect will be a good few years ahead, we think LGD will provide a valuable portfolio tailwind for years as participants steadily realise this is a much better business than they had assumed.

The three major negatives that resulted in April not being as strong as it might have been were:

1. Redbubble (RBL) delivered a 4C on the final day of the month that was very poorly received and caused the share price to plummet. The troubles with organic search have persisted and now after almost 5 months, market participants are clearly beginning to think they will be unable to resolve the matter anytime soon. I remain of the view that RBL are building a strong sustainable business that has all the hallmarks of the type of business we like to own for years on end. The shares have recovered considerably into May.

2. Bidenergy (BID) had its share price fall about 30% over the course of April. When we outlined our reasons for owning BID in the July 2018 update, the price was the split adjusted equivalent of about 35c. We stated valuation was difficult and we would allow a maximum portfolio position sizing for the holding and trim when it exceeded that. We subsequently sold stock at prices between 88.5c and $1.335 between August and January. We have sold more than 76% of the shares we originally purchased for more than 4 times the total amount invested. Yet at the start of April, our BID holding was still more than 1% of the fund despite having already fallen. This shows that despite careful portfolio management, marking to market still causes pain even in positions where all of your original investment has been recouped by sales. The share price is being adversely affected at present by disharmony between the current board and the ex-chairman James Baillieu and by the prospect a capital raising may be necessary now the share price trades below the option conversion price that was expected to provide needed capital. We remain of the view that if they successfully deliver their excellent robotic process automation product into the global market that the business could be worth multiples of the current share price. With that said, the range of potential outcomes is very wide, which is why we've consistently kept the position at a sensible size.

3. Lawfinance (LAW) fell about 10% over the course of the month. We introduced the investment last month and explained the risks associated with the business. We will attend the AGM in mid-May and hopefully the risks we covered in our update will be addressed. The NHF business is an amazing business and if they can solve the cashflow issues that they face over the next 12 months, we believe we could make 5 to 8 times the current share price over the next 3 or 4 years. The 4% position sizing is larger than we'd normally allocate to a business with such meaningful risks, but we think very highly of Diane Jones and her team and remain confident they will successfully navigate the issues. If they do so, the returns to equity will be incredible.

United Overseas Australia Annual General Meeting:-

I will attend the AGM in Kuala Lumpur this month of our largest investment United Overseas Australia (UOS). Regular readers will be very familiar with this business, I ask anyone who might be attending to let me know so they can join me on the tour I undertake each year of the various properties. The annual report released in March moved forward the completion date of their AU$1 billion megadevelopments United Point and Sentul Point, I will be keen to hear what impact the completion of these projects will have on profitability over the next year or two.

I will cover UOS quite extensively in the May update as this business will be responsible for a large component of how well the fund does in coming months and years and as such, you should be continuously updated on why we have allocated such a meaningful portion of the portfolio to this wonderful business.

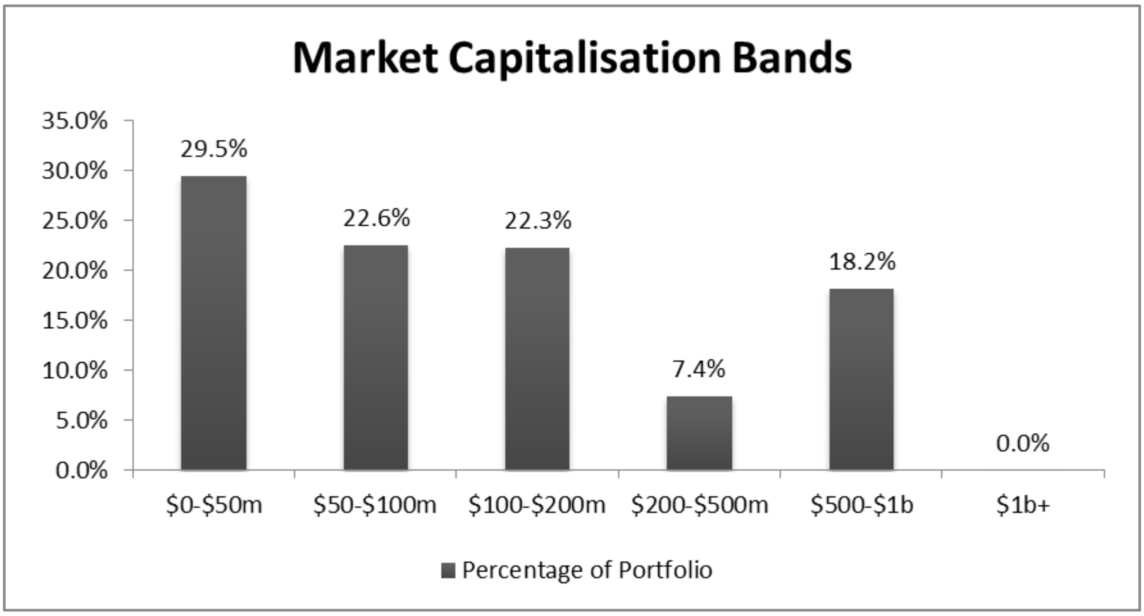
Key Portfolio Information:-

Our top 10 holdings at 30 April 2019 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	13.9%	11.5%
2	Kangaroo Plantation (KPT.ASX)	9.3%	7.6%
3	Legend Corporation (LGD.ASX)	9.2%	7.4%
4	LawFinance (LAW.ASX)	5.0%	4.1%
5	Undisclosed	4.8%	3.9%
6	Dicker Data (DDR.ASX)	4.2%	3.4%
7	Blackwall Limited (BWF.ASX)	4.0%	3.3%
8	Locality Planning (LPE.ASX)	3.7%	3.0%
9	SRG Global (SRG.ASX)	3.5%	2.8%
10	SDI Limited (SDI.ASX)	3.4%	2.7%

Our largest 5 holdings now comprise 42.1% of our invested capital, our top 10 holdings are 60.8% and our top 15 represent 74.0%. Cash and cash equivalents are 18.5% of the portfolio.

The market capitalisation graph is set out below. This month, the median market capitalisation is $84.4m.



As always, investors with any questions, suggestions, comments or investment ideas should feel free to drop me a line – Tony@egpcapital.com.au

Fund Features		Portfolio Analytics	
Min. Initial investment Max. Initial investment	$50,000 $2,000,000	Sharpe Ratio[1]	0.35
Additional investments	$5,000 (Minimum) $200,000 (Maximum)	Sortino Ratio[1]	0.29
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	6.75% 9.56%
Distribution	Annual 30th June	Largest Monthly Loss – EGP Largest Monthly Loss - Benchmark	-4.2% -6.1%
Management fee	0%	Largest Drawdown – EGP Largest Drawdown - Benchmark	-9.4% -9.4%
Performance fee (<$50m) Performance fee (>$50m)	20.5% (inc GST) 15.375% (inc GST)	% Of Positive Months – EGP % Of Positive Months - Benchmark	51.2% 61.0%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	(0.9%) 18.6%
Custodian/PB	NAB Asset Services	1 year return[2] – EGP 1 year return – Benchmark	(3.6%) 10.4%
Responsible Entity	Fundhost Limited	3 year annualised return[2] – EGP 3 year annualised – Benchmark	N/A N/A
Fund Size	$55.3m	5 year annualised return[2] – EGP 5 year annualised – Benchmark	N/A N/A
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.9534 $0.0069	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.9548 $0.9520

1 Sharpe and Sortino Ratios calculated using the Monthly Benchmark ASX200 Total Return Index

2 Return is net of all fees and costs and assumes reinvestment of dividends. 1, 3 and 5 year figures are rolling annualised figures.

Past performance is not an indicator of future performance.

The information in the below table is provided for shareholders in EGP Fund No. 1, and does not relate to the EGPCV Fund.

EGP Fund No. 1 Pty Ltd Equivalent Price	$1.9561
