EGP Concentrated Value Fund

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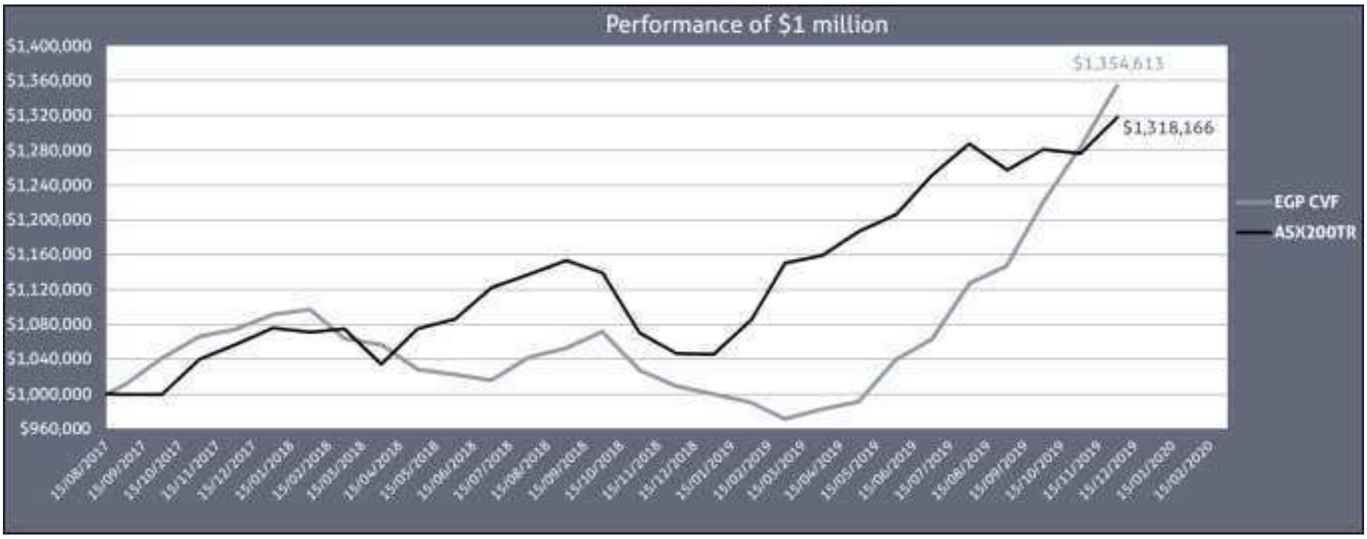
EGP Concentrated Value Fund – 30 November 2019

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%	4.8%	2.3%	4.63%
Benchmark FY19	1.4%	1.4%	(1.3%)	(6.1%)	(2.2%)	(0.1%)	3.9%	6.0%	0.7%	2.4%	1.7%	3.7%	11.55%
EGPCVF FY20	6.1%	1.8%	6.4%	5.2%	5.5%								27.46%
Benchmark FY20	2.9%	(2.4%)	1.8%	(0.4%)	3.3%								5.34%

*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 rose by 5.5% in November. Our benchmark rose by 3.3%.

The rises in the fund were again fairly broad-based, leading to our 9th consecutive positive month. Despite strong performance and strong monthly inflows and a number of takeovers injecting cash into the fund, our cash level hit an all-time low of 6.1% at the close of this November; we're finding plenty of good, productive places to put the capital to work. With the KKT takeover settling this month and our November inflows received in December, if we do nothing in December, our cash levels will lift to 17%, which is very near our 10 year average of 18%.

The Next Phase for Zero Management Fee Investing:-

We indicated an intention to close EGPCVF at $90m in last month's newsletter, promising an explanation this month. The reason is that we intend to reserve the final $10m of room in the fund for the next phase of the broadening of zero management fee fund management.

There was a lengthy discussion in the FY2018 annual letter (.PDF pages 7-13) about our hopes for making the investor aligned model of zero management fee fund management more commonplace. It was our stated intention to introduce new funds regularly to steadily widen the number of zero-fee products available to investors.

We have had a small change in thinking about the best way to do that. It is now our intention to create a zero management fee "fund of funds" style vehicle. Ordinarily, we consider a fund of funds to be a sub-optimal structure, as it layers a set of fees over the top of a series of sets of fees in the underlying funds. We think our product will solve that structural problem, given the fund will be a zero management fee fund and the underlying managers will be zero management fee funds.

My friend Chris Cuffe has shown what an excellent product a fund of funds can be with his Third Link Growth Fund (.PDF - linking to Third Links' last performance report) generating 12.8% per annum since February 2012 with remarkably low volatility, handsomely outperforming all Australian equities indices. Third Link is closed, but has demonstrated what a potentially useful investment product a fund of funds can be.

The working name for the fund is the "Zero Fee Collective" (ZFC) as it aims to help smaller fund managers willing to operate on a zero-management fee basis launch with more investor aligned structures. The "collective" component is because to the extent possible, ZFC will seek to provide administrative assistance to our investee funds, to help keep their operating costs lower, making operating without a guaranteed fee-income possible.

You have probably figured out by now that the final $10m of EGPCVF's capacity will be directed into this vehicle, hence our reason for closing at $90m, rather than the intended $100m.

The final structure is subject to some further investigation, but the ZFC will likely be an unlisted Managed Investment Scheme (as EGPCVF is), but potentially more suitable vehicles/structures will be investigated between now and the eventual launch of the ZFC (hopefully in 2020).

It is our intention for the ZFC management company to be 20% owned by EGPCVF as a means of rewarding our foundational investors who have helped us popularise zero management fee investing by supporting EGP as we've grown into what we are today.

Subject to his agreeing to be involved, I also hope to have Chris Cuffe hold an equity interest in the ZFC management company; given his long and very successful history in selecting fund managers capable of delivering outperformance; his imprimatur will be enormously valuable to prospective investors as regards the quality of the fund managers selected.

There are a number of potentially very attractive features for ZFC:

- The underlying managers will generally operate with very different styles; meaning to an investor in ZFC, incredible diversification will be available through a single vehicle/investment. I have consistently told investors in EGPCVF that despite my having 100% of my family's investable net worth in the fund, that to anyone having their investments professionally managed, 4 – 6 managers with different investment philosophies should be considered an absolute minimum. My view is that depending on the stage of your investment lifecycle that a product such as we intend to create with the ZFC could speak for a very substantial portion of the investments you intend to expose to the equity market.

- The capacity for ZFC will be immeasurably larger than for an individual fund such as EGPCVF. The only limitation will be the number of fund managers we can find to operate on a zero fee basis. We think we will have at least 8 managers available when the fund is launched. We're confident that there will be more who follow once the pathway is well established. In 10 years' time, we don't see any reason why we won't have 30 – 50 zero management fee funds to choose from/allocate to.
- We can control the quantum of our investments in each fund to best suit their capacities. We will likely try to never speak for more than a quarter to a third of the total investment in any fund. This will allow us to grow as the underlying managers grow their funds.
- As discussed in the 2018 annual letter, we would expect the ZFC to eventually become a significant competitive advantage, whereby the best fund managers, when looking to launch a fund will consider partnering with us. This will enable us to accelerate the change the industry so badly needs, steadily increasing the alignment within the financial industry between investors and the managers to whom they entrust their wealth.
- Participation in the ZFC will be a useful marketing tool for the fund managers involved. We will make investments in the underlying funds, but will then introduce the funds directly to our investors, explaining why we like their style and expect them to outperform. If any of the investors in our rapidly expanding network are interested in any one or more of the underlying funds, they will be able to invest directly with them.
- The ZFC will be suitable for large institutional investment. EGPCVF has refused several approaches from sizeable institutional money as we did not wish to create a "concentration risk" where a single investor held a dominant position in the fund. The ZFC will have no such issue, and will be very suitable for large institutional investors.

The ZFC is likely to initially be restricted to "Wholesale/Sophisticated Investors", unless we are swamped by retail investor interest. Enabling retail investment is significantly more expensive, restrictive and requires considerable additional compliance. If the ZFC Fund performs as well as I expect and grows quickly, we may add a retail investment option at some point in the future as part of EGP's mission is to democratise access to quality, aligned investment options. Unfortunately, the current environment makes this difficult to do at prices/costs that make sense.

We will likely market the ZFC initially to the investors of EGPCVF and those who are more widely associated with EGP, such as those who receive our newsletter or follow us on social media, but haven't invested directly with us yet. We would hope to raise at least $50m for the ZFC initially as the costs for operating such a vehicle become more viable at around this scale or higher.

We will then allocate those funds to our initial group of managers, with the expectation we will spend a couple of years proving the concept does what we expect it to do (strong, above market returns, with low market correlation and below market volatility).

Once the fund has built a strong track record and proven the bona fides of the concept, we will seek to substantially increase the scale of the ZFC. In the intervening period, we will be doing a lot of work trying to broaden the range of managers operating on a zero management fee basis that are available for the ZFC to invest in, as well as growing our initial group of managers to increase the potential scale of investing we can do with each of them.

At this stage, timing is hard to estimate, we're expecting the ZFC Fund will become available to investors sometime in the second half of 2020.

To potential investors in the ZFC Fund, please send an email to ZFCInvestors@egpcapital.com.au, tell us whether you qualify as wholesale/sophisticated, or are retail and give an estimate of the approximate amount of capital you'd expect to allocate to the ZFC product once it's available.

To potential zero fee fund managers, please also get in touch via ZFCManagers@egpcapital.com.au, to let us know about your interest. What we will need for prospective managers is for a vehicle to be established with an audited track record of at least 3 years in order to be eligible to be included in consideration as a potential ZFC investee fund once the fund is established.

Given our investor skew initially will be to styles similar to EGPCVF (due to the types of investors we have built relationships with over the preceding 10 years or so), of particular interest will be funds proposing to do something meaningfully different from what EGP does. Without wanting to seem like I'm promoting "affirmative action" (an idea I detest as I prefer a pure meritocracy), we will shamelessly preference prospective female zero-fee managers, as the dearth of female fund managers has always been an unexplainable puzzlement to us as the fund management industry would seem to be an ideal industry for women.

We will also likely favour funds who intend to have an "ethical" or "ESG" focus. Without wanting to be too scathing of our fund management competitors, those purporting to be "ethical", are often amongst the most egregious fee chargers in the industry. We intend to remind the participants in the "ethical" fund space that one of the seemingly forgotten pillars of their ethical frameworks seems to be ethics in the way they treat their customers…

To give our readers a flavour of the types of fund managers we are looking to provide capital to via the ZFC, we have appended the November monthly report written by Peter Phan, portfolio manager at Castlereagh Equity. I have known Peter for about 10 years, and his "pre-CE" record is even better than the impressive 18.13% annualised pre-fee performance the report presents, so it's definitely a repeatable investing edge in our view. We have binders full of fund managers with similarly impressive records that are willing to operate on a zero management fee basis. The ZFC will allow us to bring these deserving money managers to market.

The Future for EGPCVF:-

EGPCVF will operate exactly as I have set out previously. We will shortly close to new investors; monthly maximum additions will be reduced to $20,000. We intend to reopen once a year to replace redemptions and distributions paid out, but other than that, expect the investors who are with us when the fund closes will be the group we will take forward for as long as the fund lasts. To this end, if you want to be part of EGPCVF, you have a potentially very short window as between current FUM and committed investments coming in through December, there remains below $5m of available capacity, barring a significant drawdown in the equity market, we would anticipate this filling fairly swiftly.

My suggestion is that if you are interested to be part of EGPCVF that you should commit the $50k minimum across any entities you'd like to be invested in EGPCVF. We will be the opposite of the Eagles Hotel California once we have closed, ***"You can leave any time you want, but you can never check-in"***. But once you have your foot on a spot in the fund, you will be able to grow it when we replace redemptions and distributions, or slowly by the $20k monthly maximum addition.

Portfolio Developments:-

Over the course of November, counterbids for Konekt Limited (KKT) kept coming. As my friend the Swiss Sage says "Never look the horse in the mouse mit the present", which is his personal interpretation of the old saying "Never look a gift horse in the mouth". Luck, both good and bad inevitably contribute to your investing results and it is fair to say we're getting our share of "the rub of the green" lately. KKT, along with a few other things performing well has meant that November was again a good month for the fund.

The following was written about 10 days before the end of the month. I have left it unedited, despite the underlying investment changing significantly as I will explain afterwards:

I attended a Rask Invest conference in Sydney this month, which was a good and interesting evening. I was asked for an investment idea and given it is not one we have discussed in our newsletters, we thought it only fair that an outline of the thesis be provided this month as it has crept into our top ten holdings this month through a combination of our aggressively adding to the position over recent weeks/months, with the recent rise in share price providing the assist.

Smartpay Holdings (SMP) is now our 9th largest position. We have owned a little of the business since before EGP Fund No. 1 was rolled into EGPCVF. I always thought CEO Bradley Gerdis had a clear vision of what he was trying to execute, but wanted to see the signs that the execution warranted an increase in the size of the holding.

The execution has been improving at an accelerating rate and we have more than doubled our position over the course of September/October/November 2019 as it became apparent to us that the much vaunted "inflection point" investors seem to look for has been passed.

Since SMP became eligible to provide "acquiring" services to its Australian clientele, they have, under considerable capital constraints been steadily rolling out their acquiring fleet as demonstrated by this slide from their AGM pack:

In short, we think they are capable of continuing to roll out about 250+ terminals per month. At 250 terminals per month, we think they add about $10m of annualised revenue per annum to the business (the chart above indicates just shy of $3000 of revenue per terminal, but a growth lag must be allowed for, we think $3200-3500 is the likelier figure).

We estimate the incremental EBITDA margin of this revenue is at least 40% and that the incremental "depreciation and amortisation" is unlikely to exceed 10%. Our "back of the envelope" estimate is that at the current terminal rollout rate that the incremental EBIT from the rollout is circa $3m per annum. Even at the newly increased market capitalisation of about $45m, we think a business capable of adding an incremental $3m of EBIT is very cheap, especially given the $40m tax shield the business carries in the form of accumulated losses.

We also believe that as the capital constraints ease, with the company becoming steadily more profitable, that the rate of rollout will likely considerably accelerate. If they could lift the rollout rate to say 400, assuming not too much increase in the incremental customer acquisition cost for the extra 150 terminals per month, the additional annualised EBIT at this rate would likely be close to $5m annualised. The Australian terminal fleet exceeds 1 million units and several years of rolling out at this rate would see SMP still with less than a 2% market share.

This demonstrable opportunity and undervaluation, in combination with the impending IPO of Tyro Payments (TYR), we think a new group of investors are likely to be attracted to consider the investment prospects of SMP and will find it very attractive in absolute terms and especially in comparison to TYR. Aside from Tyro and Square, the key competition is the Big 4 banks, and to say they are not difficult to outcompete is to be incredibly kind.

The business has been substantially funded by their "cash-cow" in the New Zealand operations. The NZ business is materially inferior in our view, as it's the "acquiring" business in Australia that is exciting, the NZ business is essentially a terminal rental business. Nonetheless, the NZ business will substantially fund the amortisation of the debt over time and also assists with growth capital for the Australian business.

In simple terms, at a $45m market capitalisation, we think you are paying less than the Australian business is worth and getting the NZ business for free.

The preceding was intended to be a shallow look at why we liked the SMP business. A couple of days after that was written, the company announced they had agreed to sell the NZ business for NZ$70m (about AU$67m), which was more than 1.5x the entire market cap of the business.

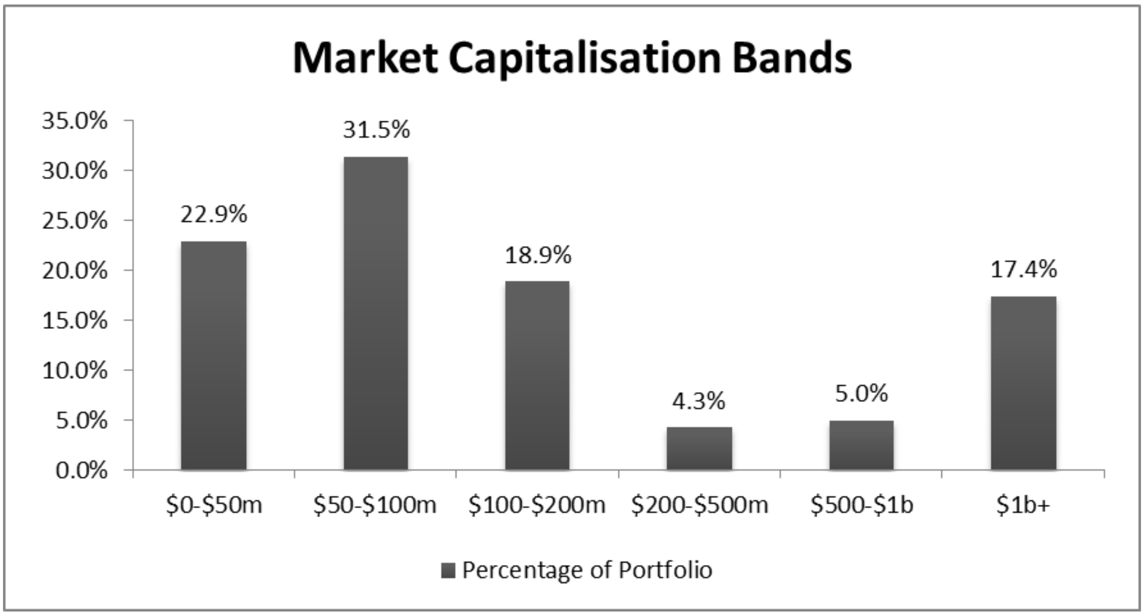
At the end of the month, the market capitalisation of SMP was about $77m; with about $67m coming through the door once the NZ business settles (less any costs/taxes). In simplistic terms, you're paying about a $10m market capitalisation for a materially better business than the one that just transacted for $70m. To say we still think the current market capitalisation of SMP materially undervalues the business is to significantly understate our view of things.

Key Portfolio Information:-

Our top 10 holdings at 30 November 2019 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	11.1%	10.4%
2	Site Group International (SIT.ASX)	9.3%	8.8%
3	Kangaroo Plantation (KPT.ASX)	6.1%	5.4%
4	Konekt (KKT.ASX)	5.4%	5.0%
5	Undisclosed Holding	5.0%	4.7%
6	Smartpay (SMP.ASX)	4.8%	4.5%
7	LawFinance (LAW.ASX)	4.0%	3.7%
8	Dicker Data (DDR.ASX)	3.5%	3.3%
9	Locality Planning (LPE.ASX)	2.9%	2.7%
10	Undisclosed Holding	2.9%	2.7%

Our largest 5 holdings now comprise 36.9% of our invested capital, our top 10 holdings are 54.9% and our top 15 represent 67.1%. Cash and cash equivalents are 6.1% of the portfolio. The median market capitalisation is $79.9m. Weighted average market capitalisation is $404.5m.



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]	1.29
Additional investments	$5,000 (Minimum) $200,000 (Maximum)	Sortino Ratio[1]	0.94
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	9.57% 9.03%
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	64.3% 64.3%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	35.5% 31.8%
Custodian/PB	NAB Asset Services	1 year return[2] – EGP 1 year return – Benchmark	34.2% 26.0%
Responsible Entity	Fundhost Limited	3 year annualised return[2] – EGP 3 year annualised – Benchmark	N/A N/A
Fund Size	$78.1m	5 year annualised return[2] – EGP 5 year annualised – Benchmark	N/A N/A
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$1.2315 $0.0099	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$1.2333 $1.2296

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.

Appendix:

To: **Investor Partners of Castlereagh Equity Pty Ltd**

From: **Peter Phan**

Date: **30 November 2019**

Re: **Monthly Update**

	CE	CE ex-fees	XAOA	CE ex fees vs XAOA	XAO	CE vs XAO	CE Net Asset Value
1/11/13 to 30/11/19	151%	131.4%	66%	65.4%	28%	123%	226 cents*
1/11/13 to 31/1/15	6.2%	6.2%	7.7%	-1.5%	2.4%	3.8%	106.2 cents
1/2/15 to 29/1/16	19.4%	16.4%	-4.7%	21.1%	-9.2%	28.6%	126.8 cents
1/2/16 to 31/1/17	19.7%	16.3%	17%	-0.7%	12.5%	7.2%	151.8 cents
1/2/17 to 31/1/18	9%	8.3%	13%	-4.7%	8.3%	0.7%	146 cents
1/2/18 to 31/1/19	0%	0%	0.6%	-0.6%	-3.4%	3.4%	139 cents
1/2/19 to 30/11/19	62%	49.5%	21.5%	28%	17%	45%	226 cents

To aid in understanding the tables above:

1. CE commenced on 1 November 2013 with shares issued at $1 per share, backed by $1 of cash per share.
2. The first row of the table above provides a summary of CE's performance since its commencement on 1 November 2013 until the date of this memorandum. It also compares CE's performance with the benchmark All Ordinaries index (XAO) and the All Ordinaries Total Return Index (XAOA) over the same period.
3. The second row of the table provides a summary of CE's performance for its first reporting period (15 months period from 1 November 2013 to 31 January 2015).
4. The third row of the table (and subsequent rows) provides a summary of CE's performance for its reporting period (12 months period from 1 February to 31 January).
5. The last row of the table provides a summary of CE's performance for its current reporting period (period commencing 1 February 2019 to the date of this memorandum).
6. *CE NAV is after payment of dividend and director fees in Feb 2017 and Feb 2018. These payments "reset" the NAV from 1.52 to 1.34 in Feb 2017, from 1.46 to 1.39 in Feb 2018, and from 1.39 to 1.39 in Feb 2019.

The XAO started at 5420 on 1 November 2013 and ended at 6948 on 29 November 2019. In percentage terms, the XAO gained 28% for the 73 months period since the start of the CE fund.

The XAOA started at 44054.2 on 1 November 2013 and ended at 73201 on 29 November 2019. In percentage terms, the XAOA gained 66% for the 73 months period since the start of the CE fund.

CE's performance over the same 73 months period is 151%.

For the month of November 2019, the XAO gained 2.6% and the XAOA gained 3.1%. CE gained 20% for the month.

The cash component of the CE fund is 25%.

As I have mentioned last month, our portfolio companies held their AGMs and provided trading updates in November. It was much better than expected, with positive outlooks and upgraded guidances for a majority of CE's major holdings. The CE portfolio performance in November was mainly dominated by movements in our large positions.

We initiated a 6% position in a new name in November. The idea was gifted to us by the legendary Tony Hansen of EGP. I shamelessly accepted with a thousand thanks. This company operates in the payments services space. We were very fortunate that less than 9 days after we bought our position, the company announced a sale of one of its business divisions for a very attractive price. Once settlement proceeds are received, the company will return a significant portion to shareholders, which will effectively leave our holding at a near zero cost base. The more exciting consideration is that the company now has the capital to execute its plans in the rapidly growing Australian market.

Despite buying a new position above, we were net sellers in November. Accordingly, in spite of a not-insignificant rise in CE portfolio value, our cash component as a percentage of portfolio has also gone up.

In relation to our quasi-cash positions, there were also some good news.

Salmat (SLM) announced the sale of one of its business divisions. Once settlement occurs in January 2020, the company will have $80m of cash, and still retain a business which is profitable and still growing at a rapid clip. We are currently up by 30% on this holding, and we remain confident to achieve further gains on this position once the dust settles.

Silverchef (SIV) sold its hospitality business, and the remaining business is now in rundown mode. Once again, the company will be cashed up and we now wait patiently for the process to complete and money to be returned to us. Unfortunately, we do expect to record a modest loss with this position, unless our most optimistic scenario plays out to allow us to escape with a few points of gains.

Clydesdale Bank (code changed to VUK) announced its yearly results with PPI provisions being less than expected and NIM squeeze not as severe as expected going forward. The banking business is proving to be very resilient, showing modest growth in a challenging market. The cost cutting program continues to be on target. We bought our holding at prices which implied imminent demise. This is our second bite of the cherry with VUK, and our holding is currently up by 50%. We remain confident of quite a bit more upside to come from this position. The only regret at this stage is the error on my part in not buying more at prices below $2. It is inexcusable to be right and not win big.

Thank you for your trust and confidence in us.

Regards
Peter Phan
Director, Castlereagh Equity Pty Ltd