EGP Concentrated Value Fund

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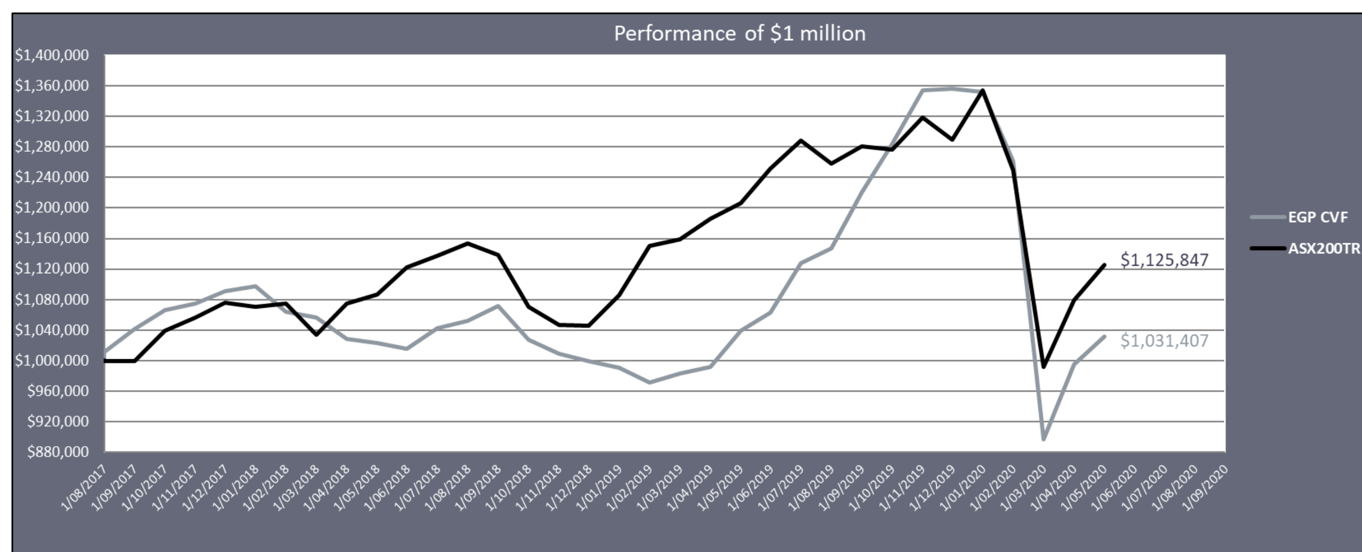
EGP Concentrated Value Fund – 31 May 2020

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%	0.1%	(0.3%)	(6.7%)	(28.9%)	11.0%	3.6%		(2.95%)
Benchmark FY20	2.9%	(2.4%)	1.8%	(0.4%)	3.3%	(2.2%)	5.0%	(7.7%)	(20.7%)	8.8%	4.4%		(10.03%)

*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 3.6% in May. Our benchmark rose by 4.4%.

The "V-shaped" recovery seems to be well underway, at least in equities if not in economies. We still view this outcome as somewhat detached from the economic reality that is likely to prevail. Productive capacity is much easier to lose in an economy than it is to revive. Even if the global economy does recover swiftly, people after years of employment are often prone to using their newfound unemployment as an opportunity to reassess their options. Those with the economic means to support a period of unemployment will often choose to do so. That

being the case, even if the reason for their unemployment no longer exists, it does not guarantee their immediate return to work. Furthermore, economic crises often provides the impetus that business needed to eliminate corporate excess, which puts its own anchor on the growth an economy can generate.

Economist John Kenneth Gailbraith coined a term "The Bezzle" to describe "The level or proportion of financial sector activity that consists of hidden embezzlement, varying in step with the business cycle". The Bezzle does not necessarily consist of true "embezzlement", its more often that good times generate a lack of urgency in driving down costs and improving efficiency. Contracts get rolled with their attendant CPI increases when a competitive tender would have seen a better, or cheaper alternative contract in place. Staff are employed to keep up with increasing workloads when reorganisation of roles, or divisions would often enable the work to be completed without the need for extra staff.

Occasionally "The Bezzle" gets closer to what could properly be described as genuine embezzlement, such as grossly underemployed persons usually within large organisations. A favourite example of this include a Spanish socialist who didn't work at all for at least six and possibly as many as fourteen years, but still felt entitled to collect his salary. A German civil servant who did nothing for fourteen years and thirty French public servants who were paid for as long as twenty five years to do nothing after the city of Toulon privatised the services they had previously been responsible for providing are also strong examples of "The Bezzle" in action.

In any case, economic shocks such as the one we have just experienced globally often provide the impetus to uncover and resolve "The Bezzle" that did not exist in the good times. I have been told numerous stories over the past couple of months of "cost-cutting" drives undercovering all sorts of cost savings in several different organisations and industries that would likely have gone unnoticed if the good times had continued.

If "The Bezzle" consisted of just 3% of all economic activity (I would hazard it's much higher), and an economic shock removed even a third of it, that's 1% of economic activity that will not return even if everything else returns to normal. Given the growth of most major economies was running at barely 2% prior to the shock, this would imply that a full return to the previous economic output, and then another six months to recover impact of "The Bezzle" that was lost would be required even once the true productive capacity had been regained.

One thing that absolutely cannot be suggested as the cause for the return to "bullishness" in global equities is the level of control over the COVID-19 outbreak globally. In the last week of April, 576,746 cases were reported globally. In the last week of May, that number was 762,755, a more than 32% increase in weekly cases in only one month. What could well be helping the recently improved economic sentiment is the incredible downturn in the mortality the disease is generating. There were 39,860 deaths attributed to COVID-19 in the last week of April, whereas there were "only" 27,270 attributed to COVID-19 in the last week of May (while 27,000 deaths sounds like an unspeakably large number, roughly 1m to 1.2m people who die globally weekly). Despite a 32% increase in the number of cases, there was a concomitant **fall** of almost 32% in the number of deaths being reported.

The improvement in the effectiveness of treatment protocols for a newly discovered virus is not surprising, but the scale of the improvement is very impressive when one considers the virus is now quite rampant in countries which would not have especially well regarded health systems. It is probably a small mercy that the virus emerged first after escaping China in the more economically advanced countries, enabling the best healthcare systems to develop the best treatment protocols before the virus became widespread in countries with less advanced healthcare systems.

Our view is that most advanced economies will take at least two years to reach the previous levels of GDP, even with the incredible monetary support most major economies are being provided with. As to the effect of this slow period for the economy on equity prices, that is much less certain. Given that stock prices theoretically price in all future cashflows discounted to today's value, the swift recovery in equity probably reflects a combination of how rapidly the COVID-19 death rate has declined and an expectation that low interest rates are likely to be with us for the foreseeable future.

Portfolio Update: -

There was not a lot of company specific news in the portfolio this month. Among our larger holdings, Smartpay raised capital that will enable them to aggressively pursue the significant opportunity they face in the Australian market. They had previously intended to use the funds from the sale of the New Zealand business for this purpose, but the withdrawal of the Verifone bid late last month meant that was not going to happen in time to use those funds. The newly bolstered balance sheet will also put the business in a strong position to renegotiate the sale of the New Zealand assets. In the meantime, the shift away from the use of cash has developed an extra tailwind in a post-COVID world.

Dicker Data also raised equity, largely to retire debt used to fund the currently under construction warehouse and office facility at Kurnell. I said in the March report that Dicker Data was our holding most likely to benefit from the changes triggered by COVID. We only modestly added to our holding in March and participated in the May capital raising. In hindsight, we should have been much more aggressive, this was an obvious one.

The subject of last months report PPK announced a small contract for their recently acquired Craig Ballistics division and commenced a pre-IPO funding round for their 65% owned Li-S Energy business, which is the first of a range of commercialisation opportunities they are developing via their partnership with Deakin University.

Finally, Site Group raised $750,000 of fresh equity with a Share Purchase Plan running in conjunction with the offer. We modestly added to our position in the raising under the condition that small shareholders be given an opportunity to participate on the same terms. The need for some equity was a combination of a couple of things we have previously outlined. The first was withdrawal in March of the convertible note offer that was announced on 31 December 2019. The second thing is the expense associated with the legal battle with ASIC/ASQA. There is a large potential prize at the end of these legal proceedings, so they are worth pursuing in our estimation.

Site announced an update in respect of their aims for the Clark property. The centrepiece of the proposal developed by Palafox for Site Group is an increase in the Floor Area Ratio (FAR) to 6x from the current 1.25x. This is because the section of Clark where the Site Property sits is now intended to be part of the CBD.

A property's gross Gross Development Value (GDV) is its expected value at completion when sold. The current average transaction price for commercial property in the Philippines is about US$4,000sqm. Based on an approval for a 6x FAR, the GDV of the property would be in the vicinity of US$7 billion. Exactly what value would be attributable to the property component of such a GDV is hard to say, but it is certainly multiples of the sub-$30m valuation currently being attributed to the equity of Site Group. The old developers' rule-of-thumb is that land is one-third of GDV, but we doubt that will be the case in respect of Site Group's Clark landholding. We do not need 33% of the value to the land, 3% would be a perfectly excellent outcome.

The Zero Fee Collective: -

Despite the remarkable response we've had in respect of The ZFC, in practical terms, it is now unlikely we will launch a new vehicle until we have recovered the losses the fund has suffered in the COVID-19 crisis. This is likely to mean this project will drag out until at least 2021. Once we have returned EGPCVF ahead of our benchmark and recovered the recent falls, I will employ a CEO for The ZFC business to take it to launch.

We will continue to register interest and remain fully committed to eventually launching this much needed product to widen the mainstream prevalence of fund managers available with a more investor friendly fee-structure.

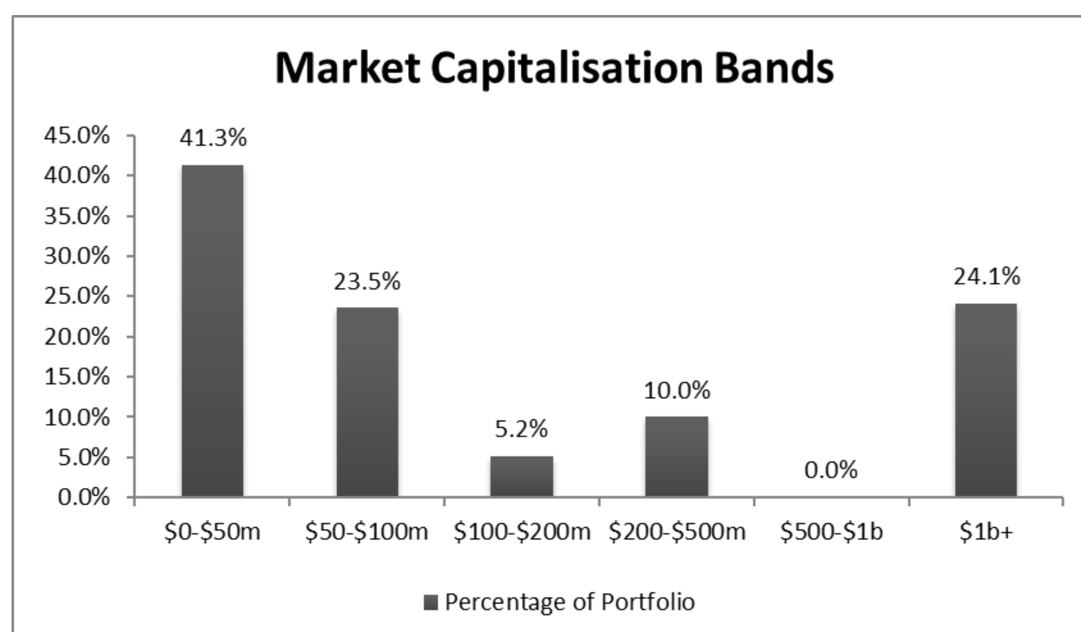
The November 2019 newsletter (.PDF) gave a more detailed outline of what we have in mind for The ZFC. Please keep sending emails expressing interest to ZFCInvestors@egpcapital.com.au to ensure you're kept abreast of developments. We remain committed to a launch at some point in the future, but much will hinge on how swiftly EGPCVF returns its performance to more appropriate levels. Fund managers interested in being part can continue to contact us ZFCManagers@egpcapital.com.au so we can discuss how you might be part of the initiative.

Key Portfolio Information: -

Our top 10 holdings at 31 May 2020 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	11.9%	10.6%
2	LawFinance (LAW.ASX)	6.7%	5.9%
3	Smartpay (SMP.ASX)	6.4%	5.7%
4	Dicker Data (DDR.ASX)	6.2%	5.5%
5	Site Group International (SIT.ASX)	6.1%	5.4%
6	PPK Group (PPK.ASX)	4.1%	3.6%
7	Undisclosed	3.7%	3.3%
8	WOTSO	3.3%	2.9%
9	Kangaroo Plantation (KPT.ASX)	3.1%	2.7%
10	SDI Limited (SDI.ASX)	3.0%	2.6%

Our largest 5 holdings now comprise 37.4% of our invested capital, our top 10 holdings are 54.4% and our top 15 represent 65.1%. Cash and cash equivalents are 12% of the portfolio. The median market capitalisation is $70.8m. Weighted average market capitalisation is $319m.



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	Sharpe Ratio[1]	-0.29
Additional investments	$5,000 (Minimum) $200,000 (Maximum)	Sortino Ratio[1]	0.29
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	21.36% 17.23%
Distribution	Annual 30th June	Largest Monthly Loss – EGP Largest Monthly Loss - Benchmark	-28.9% -20.7%
Management fee	0%	Largest Drawdown – EGP Largest Drawdown - Benchmark	-33.9% -26.7%
Performance fee (<$50m) Performance fee (>$50m)	20.5% (inc GST) 15.375% (inc GST)	% Of Positive Months – EGP % Of Positive Months - Benchmark	61.8% 61.8%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	3.1% 12.6%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	-0.7% -6.7%
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	N/A N/A
Fund Size	$68m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	N/A N/A
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.9377 $0.0127	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.9391 $0.9363

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.

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