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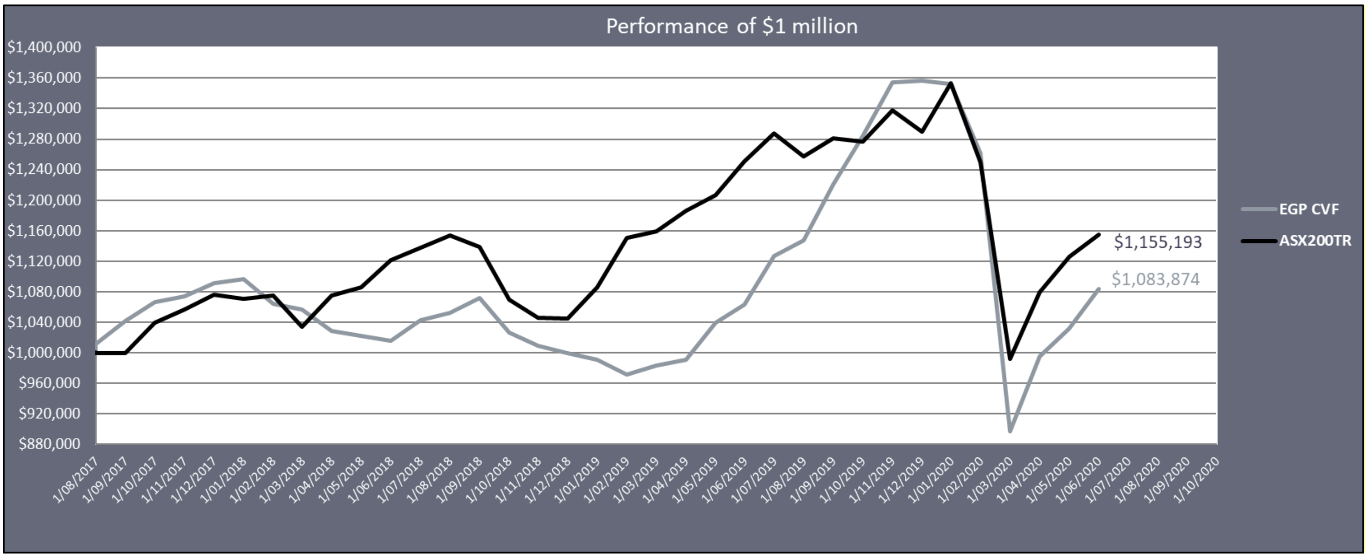
Erik A. (Tony) Hansen – Investment Manager 30 June 2020

Please find below a cumulative table, which will demonstrate over time what Albert Einstein called ***"the most powerful force in the universe"*** – compound interest. The intention is that over time, relatively modest advantages over the benchmark will accumulate to a substantially superior overall performance (it has been a tough few years in this regard…):

Since Inception Annualised Comparison Tables:-

Financial Year	EGP Concentrated Value Fund (after fees & costs)	Benchmark ASX200TR	Outperformance/ (Underperformance)
2018*	**1.58%**	**12.18%**	**(10.60%)**
2019	**4.63%**	**11.55%**	**(6.92%)**
2020	**1.99%**	**(7.68%)**	**9.66%**
Cumulative	**8.39%** [1]	**15.53%** [1]	**(7.14%)**

* 2018 is the 10.5 month period from 15 August 2017 (EGPCVF inception) to 30 June 2018
1 Assumes reinvestment of dividends/distributions



The General Market:-

The ***S&P/ASX 200 Annual Total Return Index*** (hereafter referred to as '**the benchmark**') was at 70,291.79 points before the opening of trading on 01 July 2019. Including reinvestment of dividends earned, the benchmark finished FY2020 at 64,892.86 points. The average Australian investing experience in the stock market during FY2020 was therefore a **LOSS** of (7.68%).

The 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 most fellow Australian investors when they seek exposure to equities.

The benchmark was selected in advance and represented a logical choice in our view. It covers about $2 trillion in market capitalisation and over 80% of Australian listed stocks by value; it 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 greater detail and is available on our website: www.egpcapital.com.au.

We have explained in considerable detail in previous monthly and annual reports why we selected our benchmark rather than an alternative (the ASX200 is the highest quality Australian equity index). In our view equities focused fund managers that use other benchmarks are usually setting themselves up to earn bigger fees than they probably deserve.

Since the original EGP fund inception in April 2011 the combined EGP funds have generated an annualised return of 11.78% per annum. By way of comparison, our benchmark has delivered 7.04% p.a., the Small Ordinaries (Total Return) has delivered 2.16% p.a. (6424.92 - 7826.39) and the Emerging Companies Index has delivered a **LOSS** of (2.25%) p.a. (2341.49 – 1897.22). The choice of one of these alternatives to the ASX200 would clearly have cost our investors in the form of considerably higher accrued performance fees.

Many fund managers have lately moved to RBA +2 or 3%, which also seems likely to work out a poor deal for investors incurring much higher performance fees than warranted in most environments, given the tailwind of equities has historically been a good deal better than that (about 7-8% per annum through the cycle in Australia). Should rates return to nearer their historic averages, you can be sure there will be a stampede to change to a benchmark that is easier to outperform or to revert to an equities benchmark (given equities will likely perform poorly in a rising interest rate environment).

When deciding which fund manager to allocate your hard-earned savings to, the largest portion of time should be allocated to deciding whether they possess the requisite skillset to deliver good returns in a variety of market conditions. Once you have decided they possess the investment skill, the second largest portion of time should be spent deciding whether the way they have structured the fees and incentives for the performance of their fund management business in a way that is likely to share a fair proportion of the investment outcome with **YOU** as the investor.

Our Experience:-

EGP Concentrated Value Fund (hereafter referred to as '**EGPCVF**' or '**the fund**') commenced 01 July 2019 at $0.9662 per unit after payment of the FY2019 distribution. EGPCVF closed FY2020 at $0.9854.

This resulted in a gain of 1.99% after allowing for all expenses, no fees were earned by the fund manager as despite outperforming the benchmark by 9.66%, we fell short of recouping the shortfall arising from previous two years underperformance.

The EGPVCF uses the same investment strategy that we have had in place since our original fund that has operated since 2011. The graph and table on the front page set out the performance history of EGPCVF which was created 15 August 2017. A combined history of both funds EGP has operated since 2011 is set out in **Appendix 1** and should be considered for completeness when assessing performance.

FY2020 was good in relative terms. Most fund managers, if asked at the start of the year whether they would be happy to lock in a near double digit outperformance of their benchmark would almost certainly take it. Despite this apparently particularly good relative result, we feel somewhat deflated in reporting only a 1.99% total return given we were up 27.63% at the halfway mark (and 24.56% ahead of the benchmark for the year at that point) of the financial year. There is an old saying "Man plans, and God laughs". Whether you are a believer or not, all would acknowledge that the sentiment of that saying was felt keenly in FY2020. The graph in **Appendix 1** amply demonstrates how much more exciting FY2020 was than the decade preceding it.

Calendar 2020 started fast with plans going awry as substantially the entire plantation forest at one of our largest holdings Kangaroo Plantation Timbers (KPT) suffered fire damage. This has meaningfully changed the investment thesis with KPT and been a stern reminder of tail-risk. We had always entertained and acknowledged the risk of fire to the forest asset KPT owned. The business had suffered some damage in 2007 and further modest bushfire damage last year. Damage to 95% of the forest we had not really entertained as probable given most of the forest asset was broken into smaller plantations, with minimal contiguous forest. Unfortunately, the conditions on Kangaroo Island were so severe in January that ash and embers were carrying uncommon distances and starting spot fires far and wide meaning the result was catastrophic.

The value of our holding in KPT fell by two-thirds in FY2020 and cost the fund ~4.2%. The temptation is to use post-hoc analysis to retroactively decide the allocation to KPT was too high. We try to be unemotional in reviewing investments that work out poorly, such as KPT has after the realisation of a highly improbable event. We still believe that ex-ante the KPT investment was attractive enough at this point last year that size of the allocation was justifiable. The market capitalisation at this time last year was $126m, with growing cashflows in the event of a successful wharf approval likely to run in the ~$27.5m+ annual range. Assuming a post-construction EV of ~$175m, the starting cashflow yield would have exceeded 15%, when mature assets of this type and size were transacting at single digit (6-8% capitalisation rates) prices. Even if one had modelled the risk of an outcome this catastrophic as highly as 5% (we do not think even ex-post it was this high), the probability weighted investment case stacked up easily.

Once the tail-risk event has passed, we must instead unemotionally assess, "is there value now?". In the case of KPT, the land is demonstrably valuable, despite the obviously increased perception of fire risk, Kangaroo Island is a spectacularly good environment for growing trees. If the wharf approval is successful, forestry and a variety of other uses become viable for the land. The agreement by the board and management to performance rights based on the attainment of a share price as high as $1.75 (more than twice the current price) provides some framework for assessment of value as they would not likely agree to targets unachievable based on KPT's present situation.

Our investment in LPE also cost the fund ~2.1% in FY2020. A combination of over-promising and underdelivering combined with some internal management issues has hurt this investment. This negative result in the share price belies the remarkable growth the business has delivered. FY2021 will be the first year of profit for the business now that a revenue base exceeding $50m has been constructed, sufficient to defray all operating costs. This means that all incremental revenue is now additive to earnings. This is structurally quite like the position Smartpay (SMP - see below) was in at this same point last year (notwithstanding they had a 2nd cashflow generative business to support the growing one).

Another notable negative contributor in FY2020 was SRG Limited (SRG), which cost the fund ~2%. SRG was severely impacted by the COVID-19 lockdown in New Zealand where they had to stand down a large maintenance workforce with only cursory government support. The larger Australian business was less severely impacted (or more to the point, better government supported through the government-imposed lockdown). SRG looks stunningly cheap unless their balance sheet has suffered a much more severe COVID shock than we are modelling. The first half results revealed a $737m portfolio of work in hand and a $5.7b tender pipeline, with contract wins post announcement likely to have at least replaced any work completed in the half. The SRG business should comfortably earn at least $40-50m of EBITDA under normalised conditions, the mid-point of that range if achieved in FY21 would imply an EV/EBITDA multiple of less than 2.5x which is uncommonly low for what is demonstrably a well-regarded portfolio of businesses within the industries in which they operate.

Given a positive return was generated in FY2020 despite the cumulative handicaps outlined in the previous paragraphs, some things obviously also went right in the portfolio. The takeover of Konekt Limited (KKT) was a big contributor in FY2020, adding ~4.6% to the portfolio after posting a 312% gain between the 30 June 2019 price and the completion of the takeover in December 2019. SMP posted a 213% gain over the course of FY2020, after the fund roughly doubled its position in September, October and November 2019, the holding added ~5.2% to the fund in FY2020. A smaller holding in Dreamscape was taken over in October 2019 at a ~74% premium to the FY2019 closing price, adding ~1% to the value of the fund. Between dividends and share price appreciation, our large position in Dicker Data added ~1.6%. Other portfolio movements were generally less significant.

In Search of Asymmetry:-

The entirety of a successful investing program is constructed around asymmetry. In simple terms, we are trying to embed more reward in the portfolio that we have paid for in risk by the prices of the securities we acquire.

Asymmetry presents in two primary ways in our view. The first one is what Charlie Munger terms "heads I win, tails I don't lose much". We view the most obvious example of this in our portfolio is our largest holding United Overseas Australia (UOS). UOS will remain nicely profitable in the June half in our view, despite the (temporary) loss of large portions of their recurring revenues, such as those generated by parking and hotels. It is highly unlikely to need to make valuation write-downs as substantially all other listed commercial real estate owners have done. This is a consequence of the incredibly conservative accounting adopted by management. Instead of screwing every basis point out of the capitalisation rates of their portfolio, they take a much more conservative approach. This explains virtually every asset disposal of size undertaken by the company (including when they dispose of Plant and Equipment) is accompanied by a gain on sale. At 70c, the capitalisation of UOS is $1.04b, the attributable assets were valued at $1.58m at last reporting and have grown ~11% per annum for the last five years and ~16% per annum for the last ten years.

When an asset can be acquired at 70c on the dollar and earns 15% per annum, the growth attributable to the price paid is 21.4% per annum. Best of all, the conservatism of the accounting means the assets are worth a good deal more than the stated $1,575m. We believe the land bank if it were disposed of (which it obviously will not be as that's where the future development profits lie), at least 10% would be added to the asset base. We also believe that despite the weakness caused by COVID-19, that were an orderly sell-down of the property portfolio conducted, at least a further 10% would be added to the attributable assets.

This being the case, we believe we are holding an asset in UOS that is at ~54c on the true NTA dollar, with a realistic prospect of delivering a double-digit return on the full NTA value. UOS is Mungerian asymmetry writ large.

The other type of asymmetry involves a more significant prospect of real loss but accompanied by the prospect of upside usually measured in multiples. This might be described as "heads I lose, tails I win very, very big". This is sort of how venture capital funds work on a portfolio of investments with highly asymmetric outcomes. A VC fund might make twenty investments, with twelve a total, or near total loss, perhaps five that experience either of a modest loss or gain and three that do very well, often returning twenty, fifty or one-hundred times the investment.

A ten-year VC fund of twenty investments that lost everything on twelve, recouped its investment on five and made an average of fifty times its investment on the last three would return nearly 23% per annum (before the manager took their slice…), so properly constructed, that type of asymmetry can be a highly profitable strategy even if you lost often.

We have a couple of situations that resembled a "heads I lose, tails I win very, very big" outcome structure at the time we made the investments. Not quite VC like, but a highly variable range of likely outcomes, nonetheless. I thought I'd talk about one of these here, partly as the downside risk has now begun to diminish and partly because it is an unlisted holding of reasonable size that we have revalued upward at 30 June 2020 and as such warrants an explanation.

We discussed our investment in Tellus Holdings in the April 2018 update. At the time, the equity was valued at $1.20. We have revalued the equity to $1.75 in June, to match the last traded price in the "grey market" in the stock (a price graph is available here: https://tellusholdings.com/investors/why-invest-in-tellus/). In the 11th paragraph of the linked blog, we said that if the investment at Sandy Ridge performed as expected, we could make as much as 26% annually from our investment in Tellus. We have made ~20% annually since that post at the current valuation, but we now consider the investment to be cheaper at $1.75 per share than it was at $1.20 when we purchased it.

The reason we think this is because the Sandy Ridge facility that was yet to be funded two years ago will open its gates next month. There existed funding risk, construction risk, regulatory risk and myriad other risks that have been subsequently solved or reduced. There was even a small risk that the perceived demand for disposal of hazardous waste would not materialise at the expected level. Recent discussions with management have thoroughly assuaged this concern, the main concern of potential customers is that they will be unable to get anywhere near the allocation they would prefer to enable the disposal of as much waste as they would like each year.

The linked Tellus blog points out that the introduction of Sandy Ridge to the Australian hazardous waste disposal market creates a disposal solution for perhaps 2% of the current annual Australian production of hazardous waste. The estimate given in that blog of $25m per annum of cashflow grossly underestimates the profitability of geological repositories. The investor presentation created for the capital raised in early 2019 to fund Sandy Ridge indicated the EBITDA the 100,000 tonne per annum (100ktpa) facility would produce at full production would be $60m.

The presentation estimated it would take about 5 years to reach full capacity but given the enormous level of inbound inquiry this seems unlikely. We estimate that subject to governmental approval (and why would governments not prefer hazardous waste properly disposed?) that Sandy Ridge could quintuple within ten years and still only be disposing circa 6% of Australian hazardous waste.

The economics on subsequent expansions at Sandy Ridge are meaningfully more attractive than the first 100ktpa facility. Now that the site is largely constructed, a relatively simple expansion of the facility is required. The first 100ktpa was delivered at a capital cost of ~$80m. We estimate each 100ktpa expansion is unlikely to exceed $30m to develop. Furthermore, because of the level of fixed operating cost in the business, once capacity on subsequent expansions can be filled, we estimate they would likely deliver at least $80m of EBITDA each.

If we can conceive of a 500ktpa facility in ten years' time running at full capacity, we can conceive of a Tellus Holdings capable of delivering ~$450m EBITDA. A highly cash-generative business with low capital requirements and enormous avenues for growth that has gone from $0-450m of EBITDA in 10 years and still only captures 6% of a fast growing annual market is likely to be valued at **least** 12-15x EV/EBITDA. If we assume zero dilution between now and then and zero debt (both unlikely), that business would have an equity value of $5,400m - $6,750m, which is 16 – 20 times the current equity value.

We should be clear the preceding paragraph is not a forecast. Scaling a business five-fold in ten years is an enormous task, particularly one with the prickly regulatory environment of hazardous waste. We simply consider it representative of what could happen if the stars align for the business. Tellus are currently drilling for sites like Sandy Ridge in the Eastern States and have a massive deep geological waste repository project providing storage in a deep underground salt formation under development at the Chandler site in the Northern Territory. So even if a quintupling of capacity in ten-years at Sandy Ridge proved impossible, Tellus' Australia wide development program could provide an avenue to still get to something like 500ktpa of annual storage capacity. Chandler has a budgeted 400ktpa of waste storage.

Tellus is indicative of what we are seeking in highly asymmetric investments. Where when they work out, perhaps twenty or thirty times the original investment can be realised over a decade or so. They come with higher risk than "UOS" style investments, hence their individually smaller allocations, but when we correctly identify good ones, they can materially positively affect the performance of the portfolio and when they don't work out, the diminution in portfolio value is manageable.

On Evidence Based Policy:-

The most stunning thing to me to come out of the COVID-19 pandemics rapid spread was the lack of evidence-based policymaking. It was obvious early on that COVID-19 presented a huge risk to older people. We know now that roughly one in five persons aged over 80 that has tested positive for COVID-19 has died, this number is trending down as better treatment protocols have been developed, but our most elderly remain most at risk.

Furthermore, about 90% of all fatalities so far globally have been in over 70's with more than 50% of victims over 80 years of age. Even though the data out of China was (correctly – credible estimates indicate China may have under-reported cases and death by a factor of 40) treated with scepticism, very early on out of Italy, the data very clearly demonstrated that the substantial mortality risk of the disease rested with the very sick and the very old.

Despite this, time and again a cavalier attitude to securing the health of this most at risk group was taken. In New York for example, over 4300 recovering COVID-19 patients were sent to nursing homes to "free up space" in hospitals. This "executive order" was taken on March 25th when around 8,000 deaths had already been recorded in Italy, substantially amongst the very elderly. To be fair to the decision-makers, there was some possibility that the deaths came quickly in the old, and that mortality would eventually be higher in all age categories. But people had been dying in large numbers for a month in Italy when the New York decision was taken, if there was going to be a delayed increase in the mortality of younger cohorts, it should have begun to show in the data. There was no evidence at that stage, aside from isolated cases of younger deaths which were usually accompanied by multiple comorbidities and/or extremely high levels of exposure (usually medical staff) resulting in particularly virulent cases.

Sending recuperating COVID-19 patients to nursing homes to free up hospital space was a potentially acceptable strategy, but if that is the path you are going to take, there was one extra step that had to be part of the policy. The first thing that should have been done was to consolidate all your elderly care home residents into facilities with other elderly (but COVID-19 negative) folk. Then you can free up a whole facility that can be used exclusively to treat recuperating COVID-19 victims. But to shift folk with a disease that is demonstrably fatal to the old into old folks' homes was ex-ante an obviously disastrous choice.

The demonstrable case by late-March when countries started to introduce lock-down measures of various types was that the mortality rate in over 75's was at least 150 times higher than in under 45's and that the deaths in the 45-75 age bracket were also a tiny fraction of the rate in over 75's and most commonly accompanied by multiple comorbidities. The foregoing being the case, the obvious and evidence based policy for Governments to take that best served the twin goals of protecting as many of their citizens from an unnecessary death and avoiding the wholesale destruction of their economy should have been fairly obvious.

Rather than apply stringent criteria on large crowds, the elderly, care homes, and advising those with multiple risk factors to secure themselves and to take extreme precautions against contracting the disease due to their heightened risk of death, almost universally, Western Countries instead applied an incredibly economically destructive near complete lockdowns of varying durations.

The only countries that seemed to take paths remotely resembling "evidence based" were Sweden, and to some extent, Japan. South Korea also handled their outbreak relatively adeptly without imposing too many draconian lock-down measures. Australia has had an admittedly great outcome out of the quite extreme policy we took in terms of low case numbers and deaths compared to global levels, but our small population and global remoteness gives us a competitive advantage that makes comparison with most others countries moot in any case. No European country for example had any hope of getting a result anything like Australia, New Zealand, or various Pacific Islands.

Sweden has a left-wing government, but the fact they pursued a policy that relied primarily on the adherence of their citizenry with relatively modest enforced movement restrictions saw sections of the media label them "far-right" as a slur. Any leader suggesting the economic harms of allowing citizens to decide for themselves the level of risk they were willing to take was similarly slurred, with the catchy line "they'd let Grandma die for the Dow" being used to insult anyone with the temerity to suggest that a functioning economy was somehow important or valuable.

Value is placed on people and the economy by governments every day, the world over. When they decide at what level pensions are set, or unemployment, or disability payments, a price, or value is being placed on people. One can argue the price is too high, or too low, but the fact a value has been placed on people is inarguable.

Every day we expect our government to make policy that inherently place dollar values on life. The very relaxed policy that Sweden adopted saw 500 of their citizens per million die, with their deaths attributed to coronavirus[1]. The rest of Europe almost uniformly adopted much harsher lockdown policies, with the result a meaningfully lower death count of 251 citizens per million[2].

The economic result of the two different strategies on the respective economies could not have been starker. The Swedish economy **grew** by 0.1% in the March quarter[3], the Euro area **contracted** by (3.8%) in the March quarter[4]. Furthermore, while the Swedish economy is forecast to contract[5] (9.2%) in the June quarter, the Euro area is forecast to fall[6] by (12.5%). If Sweden were not an

[1] https://www.worldometers.info/coronavirus/#countries (retrieved 23 June 2020)
[2] https://www.worldometers.info/coronavirus/#countries (retrieved 23 June 2020)
[3] https://tradingeconomics.com/sweden/indicators (retrieved 3 June 2020)
[4] https://tradingeconomics.com/euro-area/gdp-growth (retrieved 3 June 2020)
[5] https://tradingeconomics.com/sweden/forecast (retrieved 3 June 2020)
[6] https://tradingeconomics.com/euro-area/forecast (retrieved 3 June 2020)

economy so reliant on exports, their excellent handling of the pandemic would see an even better result than this. Unfortunately, the collapse of their major export partners economies resulting from their draconian lock-down measures means that despite a mild economic hit to Sweden internally, they will still suffer substantial economic degradation due to a huge export downturn.

If we assume the June quarter represents the bottom and growth returns in the second half of 2020, the Swedish economy will have lost 9.11% of its GDP in the first 6 months. The Euro area will have lost 15.83%. Any investor will tell you it is easier to avoid losses than to make gains. In order to return their GDP to the level of December 31st 2019, Sweden will need to grow their economy by 10.02%. To achieve the same feat, the Euro area will require cumulative growth from the bottom of 18.81%.

Let us parse what Governments globally should have been able to do in real time. The Swedish economy was roughly US$575b at the end of 2019. A contraction of 9.11% will see it at ~US$522.6b. Had they implemented the same lockdown policy as the rest of the Euro area, with the same GDP contraction, the result would have seen the economy contract to ~US$484b.

If we ignore the fact that the more you lose, the harder it is to get back to square one and assume the one-off loss is the only economic cost. We convert the difference into AU$ to make it easier for our (predominantly) Australian readership. The path Sweden took prevented AU$59.4b of economic destruction. There are 10.23m Swedes, and their "excess deaths" from their more relaxed strategy were 2,547 (10.23*{500-251}). This very rudimentary calculation places an economic cost on each additional life saved by the European strategy compared to the Swedish strategy of $23,321,555.

The Swedish and European deaths from COVID-19 were broadly like global figures with the median victim being in their early 80's. The life expectancy of Sweden was last reported (2017) as 82.3 years, a little higher than Europe more broadly. This would imply that the median shortening of life was about 1 or 2 years. We know however, from actuarial tables that an 81-year-old on average will live more than a year or two. The median expectation for an 81-year-old is a closer to 90 years. We could therefore estimate 9 years loss of life per "excess death" was incurred by the more liberal and evidence based Swedish policy. This is being incredibly generous, credible estimates that about half of all victims attributed to COVID-19 would not have lived another full year have been made.

That being the case, we can approximate that at a median of 9 years, every life year the European approach saved when compared to the Swedish approach cost just shy of $2.6m in avoidable economic loss (and a good deal more depending on how long cumulatively it takes the Euro-zone economy to catch up to the Swedish economy in returning to pre-COVID levels of GDP). Based on the damage the Swedish economy avoided in comparison to the wider European economy, Sweden clearly chose a more appropriate path. There are very few citizens for whom a society could justify spending $2.6m to extend their life by a year. It should be noted at this point that the Swedish government have themselves acknowledged flaws in their own policy, saying they should have been more aggressive in securing their elderly. With that said, based on the economic outcomes, Swedish citizens have much to thank their government for.

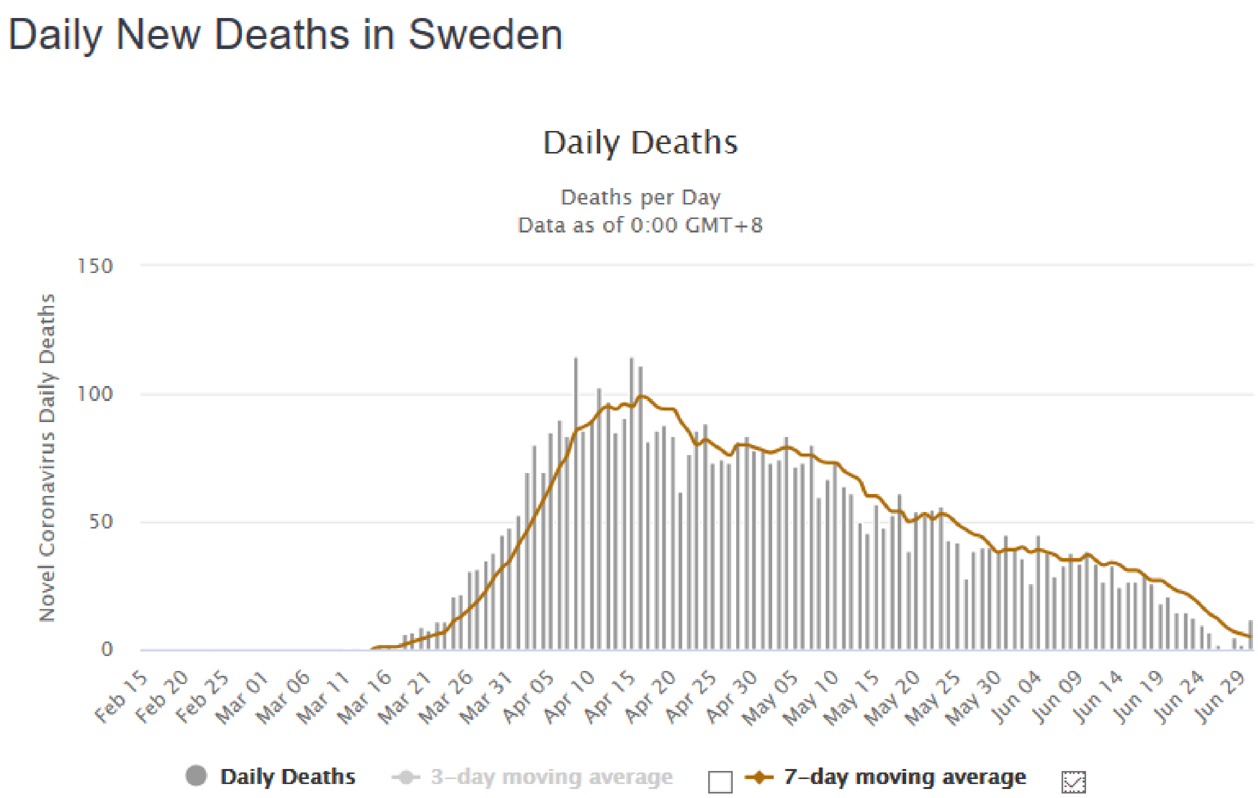
There is potentially a more important reason why the Swedish approach was a superior path to take than that chosen by the majority of Europe, and that is the value of personal liberty. Given the path chosen by the Swedish, aside from restrictions on gatherings of more than 50 people, how carefully people behaved in respect of their risk of the risks to their health was mostly up to them. If I was a Swedish citizen particularly concerned about my levels of risk from COVID-19, I was absolutely entitled to live an entirely hermitic lifestyle until such time as the perceived risks had passed to my satisfaction.

If, however, I was a young Swedish migrant with limited financial means or accumulated wealth, and I felt my risk of significant health issues in the event I contracted COVID-19 was low, I was free to continue pursuing my own economic goals and needn't have worried that enforced restrictions by my Government would potentially destroy my financial situation for many years to come.

The cavalier attitude the most financially comfortable in the wealthiest countries took in destroying the livelihoods of the poorest and least able to cope financially was quite frankly sickening to watch. Waiting out the lockdown in their beachfront weekenders, conducting remote meetings facilitated by technology while the young and the poor whose employment had no such capability had their livelihoods destroyed was the ultimate act of elitist disdain.

If you were on the side of the good and the great, advocating longer/stronger lockdowns, I hope the 1,800 words preceding this paragraph will make you behave differently when the next pandemic (and there will almost inevitably be others as we are increasingly global citizens) comes around.

If the graph shown below looks to you like a country that was ever in any way "out of control", then you might want to look at whether it is facts or ideology driving your view. For context, Sweden has had between 89k-93k deaths each of the past 10 years and is just shy of 50k at June (which is within the margin of error for the half year point in the past decade)[7]:



The intended point of this section was not entirely related to COVID-19. Properly costed, evidence-based policy should be the foundation of a well-governed society. Whether that is in the form of a data-driven response to a pandemic, a properly costed National Broadband Network or an energy policy that properly allows for the cost of carbon. Rather than calls to emotion and what "feels" right, if we allow ourselves to be driven by evidence, the outcomes will inevitably serve the greatest good.

[7] https://www.statista.com/statistics/525353/sweden-number-of-deaths/ (retrieved 30 June 2020)

Such evidence-based policy will likely mean that a higher number of people will die in a future pandemic response, but at a meaningfully reduced economic cost that more than offsets the human cost (as hideous as the second half of that sentence sounds, life does have an economic value). As an aside here, more than a few elderly folk I discussed the pandemic with told me they would happily have taken on a higher level of risk (of death it should be noted) if it meant that the considerable economic harms being involuntarily thrust upon the younger generation were reduced. It is selfless thinking like that John F. Kennedy asked folk for when he said, “Ask not what your country can do for you – ask what you can do for your country”.

Such evidence-based policy would have resulted in a National Broadband Network being rolled out to the areas with the highest and most profitable use-case first, rather than to the three regional electorates with extremely marginal use-cases, enabling a more highly functioning network to be delivered at a more reasonable cost.

Such evidence-based policy would likely result in Generation VI nuclear energy being given serious and unemotional consideration to support the base-load shortcomings of a predominantly renewable electricity generation future.

I could list dozens of other issues where political popularity and emotions overriding reason have seen sub-optimal economic outcomes, but in the interest of brevity I will not. It is easy for us to forget, but the reason we can spend so much of our time in the modern world worrying about social issues is because our modern economy functions so well compared to how humanity have lived for most of our existence. If we neglect to place an appropriate value on the economy, we will not have the same capacity to worry about the pointy end of Maslow’s hierarchy as we will instead revert to suring up the base. A wave of disaffected youth poorly educated about history and unaware of how unpleasant most of human history is might want to tear down the way the global economy operates in 2020. I for one will not be taken back to a Hobbesian world where life is once again “Nasty, brutish and short” without pointing out the error in such thinking.

Distributions:-

A distribution based on FY2020 of ~4.5 cents per unit (cpu) will shortly be paid to all unitholders, there will be ~1.3cpu of franking credits distributed along with it. The distribution was again larger than you should expect in future years due to the settlement of a number of takeovers in the first half of FY2020, which had fully-franked dividends paid as part of the consideration.

Given we will distribute ~1.3cpu of franking credits FY2020, our pre-tax return is therefore more like 3.33%. To compare like for like, we must also use the ASX200 return that allows for franking. For FY2020, that index returned (6.26%), which was 1.42% better than the total return index. This means that on a pre-tax basis, the Funds FY2020 result outperformed the pre-tax benchmark by 9.59%, which is not materially different than our post-tax result against the post-tax benchmark but is nonetheless a more intellectually honest result. I would prefer to use our pre-tax performance against the pre-tax benchmark, but our administrators prevented us from doing this on the launch of EGPCVF.

We always have, and always will seek to generate the best results we can on a pre-tax basis, we leave it to you to organise your tax affairs to best benefit from this.

Imputation:-

We pushed for these fully franked payouts on your behalf. We have always viewed pre-tax returns as the primary measure that investors should consider. If you own a property that cost $1m and after all running costs, the net rental received was $35,000. Your return from this investment was 3.5% on cost pre-tax (i.e. you will pay tax on the rental stream). If you own a portfolio of dividend paying stocks that you likewise spent $1m to acquire, and it pays $35,000 in dividends, most investors would describe that as the same outcome as the previously described property owner (3.5% yield on cost-base). If the dividend stream is fully franked however, the true pre-tax return would be 5% as the 30% corporate tax that had already been paid on the companies' earnings would be passed through.

Assuming the same entity is receiving both income streams described in the previous paragraph, and their tax-rate is 30%, the true post-tax earnings of the property would be 2.45% (after the Government received the 30% tax that had not yet been paid on the rental stream), whereas it would remain 3.5% for the dividend stream, with the tax credit passed through by the companies that had already paid their taxes on the earnings.

I would have commented on franking credits in last year's newsletter, but franking was a hot-button issue in the 2019 Australian Federal Election and given the surprise outcome of that election, the issue was still raw for some voters. Now that time has passed, it should be said that the imputation system was a visionary improvement in the Australian Taxation system introduced by an excellent treasurer (Paul Keating), who worked together cooperatively with his political opposition in a way that's seldom been seen since to introduce imputation and a number of other measures which have helped Australia to be one of the best performing advanced economies globally ever since.

If the government would like to capture more revenue for itself, changing the imputation system is close to the worse place to start. The problem is not with the imputation system, it is with the marginal rates our system allows some people to use. If you imagine three people in different tax situations, one each whose marginal rate is 15%/30% & 45%. If they each get a $7,000 fully-franked dividend, the 15% taxpayer will receive a $1,500 refund, the 30% payer will neither pay tax nor be refunded and the 45% taxpayer will need to send off $1,500 to meet the remainder of their tax obligations. Everyone ends up paying the tax appropriate to their situation and there has been no inefficient double-taxation to prevent optimal capital allocation.

Imputation is used in only a few countries, is an outstanding improvement in tax-efficiency and should be employed more widely globally. Double taxation is a cancer that causes misallocation as companies with poor investment prospects retain earnings that should be distributed. The higher level of dividend payouts an imputation system facilitates sees capital more easily flowing to the best PRESENT opportunities, rather than be hogged by the companies with the best HISTORIC opportunities to deploy the capital to good effect.

There are indisputably weaknesses in our taxation system. They would be much better corrected by improving these specific areas of weakness rather than crippling imputation, one of the few efficient parts of the taxation system. For example, a cap on the tax-free component available from superannuation at some level near the median income sounds perfectly reasonable. If someone has successfully compounded their SMSF assets to an incredibly large figure, they should be congratulated. What they should not be able to do is draw a massive tax-free stream from that pool. That was not the purpose for which the superannuation system was created.

The Zero-Fee Collective:-

We announced our intention to launch a fund-of-funds style product earlier in FY2020. We were in tending a launch of The ZFC between October 2020 and January 2021. Unfortunately, the market dislocations caused by the COVID-19 pandemic caused us to put the project on hold. We still believe that there is an enormous opportunity for a group of fund managers with more ethical fee-structures to take a big share of investment flows in Australia.

We have more than ten managers interested/eligible to be part of The ZFC who are running way less capital than they deserve, and who as a group have massively outperformed over the pandemic period, as well as over 1, 3 and 5 years.

Once EGP Concentrated Value Fund is firmly back in front of our benchmark, and we have again closed off to new investors, we will rekindle plans for The ZFC and the way Australian families invest in equities will be forever changed.

The final word:-

Financial 2020 was a year of uncommon volatility. Those of us that operate in equity markets are accustomed to volatility, but if you went back to the start of this year and asked even the most bearish fund managers whether it was likely that 2020 would see a drawdown exceeding 50% over the space of 5 weeks in 2020, they would have universally said that was hard to conceive. This drawdown from the 17 February 2020 peak in the S&P/ASX Emerging Companies Index (the index which most closely resembles the construction of EGPCVF) to the 23 March 2020 low was 53.32%.

I will reiterate my repeated statements in monthly updates that no one, absolutely no one has any reliable ability to predict accurately the movements of the market in the short or medium term, “run for your life from anyone who says they know what direction the market is headed. That sentence is the leper’s bell of an approaching charlatan” is my unapologetic refrain.

We remain largely pleased with our record of outperforming our benchmark since inception by 4.74%, but are underwhelmed as I imagine fellow EGP investors are with our 5-year record of only out-performing the benchmark by only 1.98%, we target 3-5% outperformance over 5 year periods and in fact consider only meeting this goal as a disappointment. Our aim is to set goals then deliver results exceeding those goals. The fact we have just posted a 3-year long period of **underperforming** our benchmark (by 1.65%) is especially galling, and something we intend to rectify in FY2021. Given our focus is on microcaps, and that microcaps have sharply underperformed large cap businesses for the past few years, we have had a considerable headwind. With that said, we have a go-anywhere mandate and it is our job to deliver outperformance and to find that opportunity wherever it may exist.

I always end my communications with an offer to make contact if you have any questions. Feel free to call (0418 278 298), email (tony@egpcapital.com.au) or drop by the office if something is on your mind. I pride myself on being transparent and freely available to all investors who have placed their faith and future wealth into my hands.

Best Regards,

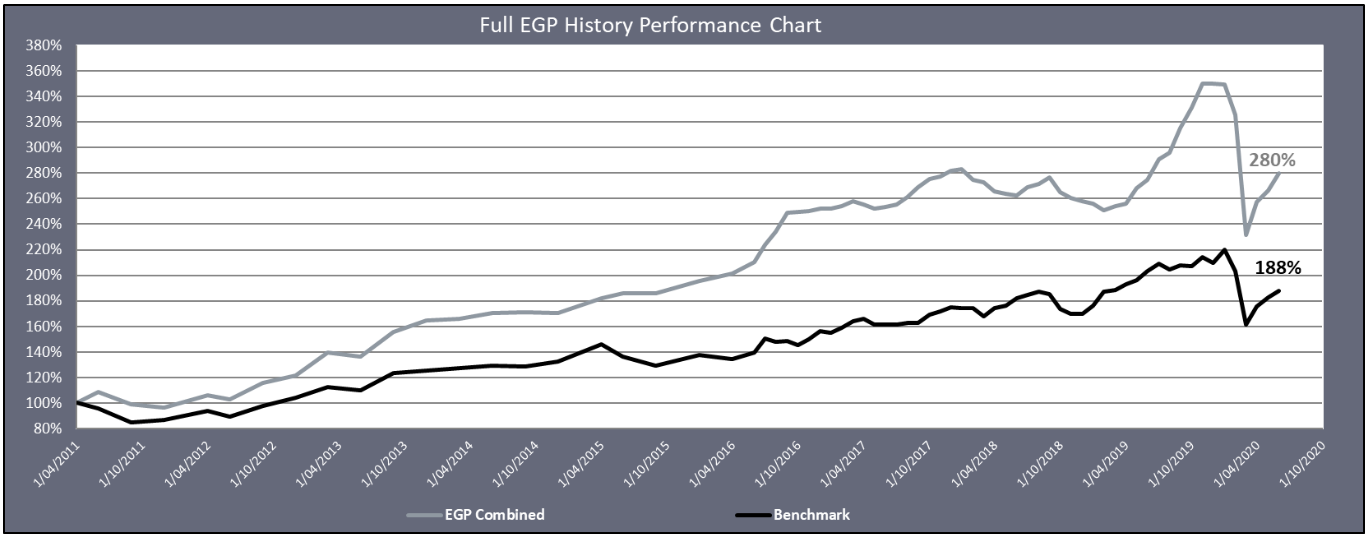
Erik A. (Tony) Hansen
Chief Investment Officer
EGP Capital

Appendix 1:

Combined performance of EGP Fund No. 1 (operating from 01 April 2011 to 15 August 2017) and EGP Concentrated Value Fund (operating since 15 August 2017):

Financial Year	Combined Funds (after fees)	Benchmark	Outperformance/ (Underperformance)
2012*	2.99%	(10.46%)[1]	13.45%
2013	32.58%[1]	22.75%[1]	9.83%
2014	24.71%[1]	17.43%[1]	7.28%
2015	9.04%[1]	5.68%[1]	3.36%
2016	13.19%[1]	2.13%[1]	11.06%
2017	20.75%[1]	15.89%[1]	4.86%
2018	3.39%[1&2]	13.01%[1&3]	(9.62%)
2019	4.63%[1]	11.55%[1]	(6.92%)
2020	1.99%[1]	(7.68%)[1]	9.66%
Annualised	11.78%[1]	7.04%[1]	4.74%
Cumulative	180.00%[1]	87.67%[1]	92.33%

* 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/distributions
2 Comprises the 1.78% earned by EGP Fund No. 1 Pty Ltd between 1 July 2017 – 15 August 2017 & the 1.58% earned by EGPCVF between 16 August 2017 – 30 June 2018
3 Comprises the 0.75% earned by the benchmark between 1 July 2017 – 15 August 2017 & the 12.18% earned between 16 August 2017 – 30 June 2018
Past performance is not a reliable indicator of future performance.



	One Quarter	1-Year	3-Years	5-Years	Inception Annualised
Combined EGP Funds	20.85%	1.99%	3.56%	8.56%	11.78%
Benchmark*	16.48%	(7.68)%	5.21%	6.59%	7.04%
Value Added	4.37%	9.67%	(1.65%)	1.97%	4.73%

*ASX200TR Index

Appendix 2:

EGPCapital

EGP Concentrated Value Fund

Address: Suite 2, Level 16, 56 Pitt Street
Sydney, NSW, 2000

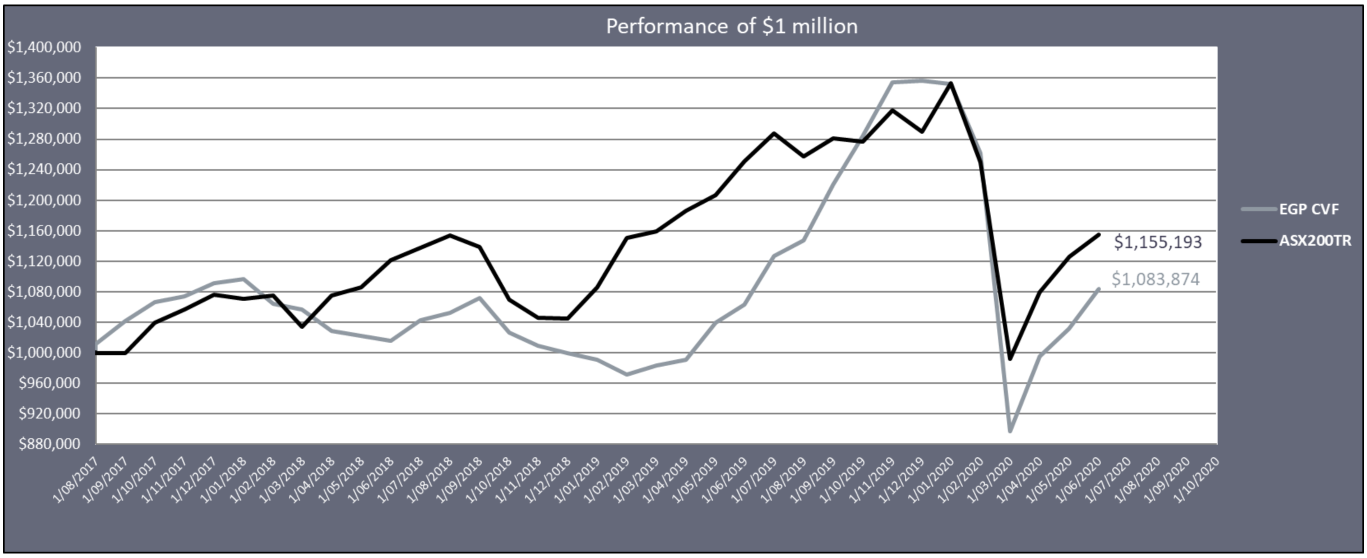
Mobile: 0418 278 298

EGP Concentrated Value Fund – 30 June 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%	5.1%	1.99%
Benchmark FY20	2.9%	(2.4%)	1.8%	(0.4%)	3.3%	(2.2%)	5.0%	(7.7%)	(20.7%)	8.8%	4.4%	2.6%	(7.68%)

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



The fund rose 5.1% in June. Our benchmark rose 2.6%.

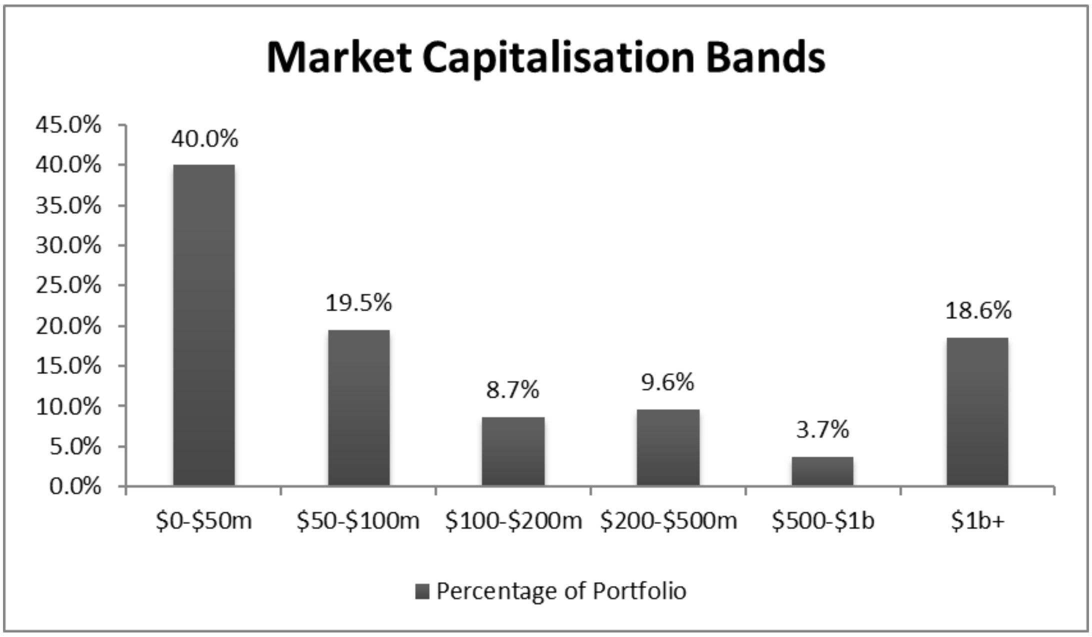
The fund outperformed the benchmark by 9.66% in FY20, but this was insufficient to recover the underperformance from the two prior years. Despite the good relative result, the portfolio looks incredibly good value in our estimation. If FY21 does not result in meaningful outperformance, the manager will likely consider winding up the fund as three years of underperformance in four years would indicate the intended value-add is not arising.

Our top 10 holdings at 30 June 2020 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	11.7%	10.7%
2	Smartpay (SMP.ASX)	7.5%	6.9%
3	Site Group International (SIT.ASX)	6.5%	6.0%
4	LawFinance (LAW.ASX)	6.2%	5.7%
5	Dicker Data (DDR.ASX)	5.2%	4.8%
6	Undisclosed	4.2%	3.9%
7	Redbubble (RBL.ASX)	3.7%	3.4%
8	WOTSO	3.1%	2.8%
9	PPK Group (PPK.ASX)	2.9%	2.7%
10	Undisclosed	2.7%	2.5%

Our largest 5 holdings now comprise 37.2% of our invested capital, our top 10 holdings are 53.9% and our top 15 represent 66.6%. Cash and cash equivalents are 9% of the portfolio. The median market capitalisation is $93.6m. Weighted average market capitalisation is $288m.

The market capitalisation graph is set out below:



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

EGP Concentrated Value Fund FY2020 Performance Letter

Fund Features		Portfolio Analytics	
Min. initial investment	$50,000	Sharpe Ratio[1]	-0.25
Additional investments	$5,000 (Minimum) $200,000 (Maximum)	Sortino Ratio[1]	0.51
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	21.23% 17.02%
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	62.9% 62.9%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	8.4% 15.5%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	2.0% (7.68%)
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	N/A N/A
Fund Size	$70.4m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	N/A N/A
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.9854 $0.0130	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.9868 $0.9839

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.