**EGP Concentrated Value Fund**

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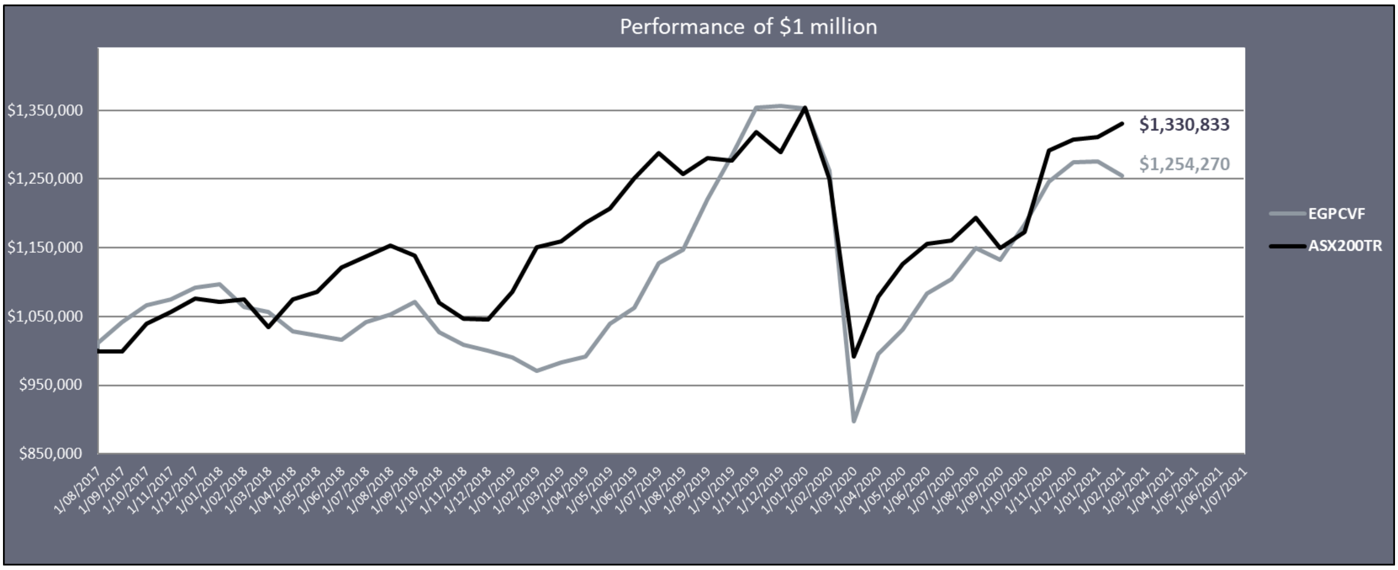
# EGP Concentrated Value Fund – 28 February 2021

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%) |
| EGPCVF FY21 | 1.9% | 4.1% | (1.5%) | 4.6% | 5.3% | 2.2% | 0.1% | (1.7%) | | | | | 15.72% |
| Benchmark FY21 | 0.5% | 2.8% | (3.7%) | 1.9% | 10.2% | 1.2% | 0.3% | 1.5% | | | | | 15.20% |

*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 fell 1.7% in February. Our benchmark rose 1.5%.

We suffered heavily at the hand of a few concentrated positions this month. Redbubble (RBL) alone cost the fund 2.2%, National Tyre (NTD) 0.7% and Dicker Data (DDR) 0.5%. Smartpay (SMP) also fell 20% intra-month on no news. Furthermore, an outstanding outcome for Site Group (SIT) was largely shrugged off by the market. We will talk a little about the puzzling nature of some of these matters below.

Redbubble was easily the most mystifying of the responses to our December results reports. The myopic response of the market to a modestly lower (and well explained by management) EBITDA result, whilst ignoring all the forward markers of burgeoning business strength and durability has reinforced the reasoning that caused us to commence the "Eleven Figures" series to arm our unitholders, ensuring they are better equipped to understand the reasons they own a business and ignore the short-term gyrations of market participants.

Our own forecasts were easily the most bullish of any published forecasts we saw pre-results. In the [November update](.pdf) we posited a revenue number for the December half of $345m and EBITDA of $64.5m:

> We are modelling something roughly like this for the FY21 year:
>
> Q1 = $147.5m revenue ($68.4m pcp) = $25.7m EBITDA ($1.4m pcp) (**n.b. these are the actuals from Q1**)
>
> Q2 = $197.5m revenue ($109.8m pcp) = $38.8m EBITDA ($6.4m pcp)
>
> Q3 = $130m revenue ($65.6m pcp) = $18.5m EBITDA (-$3.3m pcp)
>
> Q4 = $125m revenue ($103.3m pcp) = $17.0m EBITDA ($8.4m pcp)
>
> FY2021 = $600m revenue ($348.9m pcp) = $100m EBITDA ($15.3m pcp)

What RBL delivered was revenue of $352.8m (2.3% above our estimate) and EBITDA of $55.2m (14.4% below our estimate):

| Reconciliation of reported results to non-IFRS [1] numbers | 31-Dec-20 $'m [2] | 31-Dec-19 $'m [2] |
|---|---|---|
| **Total reported revenue from services** | **417.6** | **213.5** |
| Less Artists' margin | (64.8) | (33.5) |
| **Marketplace revenue** | **352.8** | **180.0** |
| Fulfiller expenses | (208.8) | (113.8) |
| **Gross profit** | **144.0** | **66.1** |
| Gross profit margin on Marketplace revenue | 40.8% | 36.7% |
| Paid acquisition costs | (44.2) | (19.9) |
| **Gross Profit After Paid Acquisition costs (GPAPA)** | **99.8** | **46.3** |
| **GPAPA% (on MP Revenue)** | **28.3%** | **25.7%** |
| **Cash Operating Expenses** | | |
| Employee and contractor costs (excluding share based payments) | (30.0) | (23.7) |
| Marketing expenses (excluding paid acquisition costs shown above) | (1.6) | (1.7) |
| Operations and administration costs | (13.0) | (10.8) |
| **Cash Operating Expenses** | **(44.6)** | **(36.2)** |
| **Operating (Cash) earnings before interest, tax, depreciation and amortisation (Operating EBITDA)** | **55.2** | **10.1** |
| Share based payments | (3.7) | (5.2) |
| Other expenses | (2.7) | (0.6) |
| **Earnings before interest, tax, depreciation and amortisation (EBITDA)** | **48.8** | **4.3** |
| Depreciation and amortisation | (7.0) | (6.3) |
| **Earnings before interest and tax (EBIT)** | **41.8** | **(1.9)** |

Market participants seemed to focus exclusively on the retraction in margins relative to the September 2020 quarterly results, rather than the "escape velocity" that is now built into the operating leverage of the business.

The >10% year on year increase of GPAPA margin is likely only the beginning as the company continues to scale. The self-reinforcing value of scale in this business should by now be self-evident. Every time RBL incrementally grows, it enables them to place new fulfilment closer to the end customer. This in turn improves delivery times (customer experience), reduces logistic costs, which are shared between the business (improving margins) and the customer (lower prices). The continued growth further ensures new artists will be attracted to the RBL platform as it gives them the greatest exposure to the largest customer/product set, maximising the earning potential from their designs.

With the foregoing in mind, it should be no surprise that with the logistical difficulties experienced (market-wide) because of the massive shift to online purchasing COVID-19 triggered in the 2020 holiday sales period; that the company chose to “eat” some costs associated with express shipping, ensuring the timeliest possible deliveries to ensure the many thousands of new RBL customers did not have a negative first experience. Instead, “analysts” confidently sitting behind their spreadsheets imputed the one-off lower margins into perpetuity…

Other positive lead indicators included mask revenue falling to 7% of total revenue, meaning the concerns about how easily RBL can cycle the FY2021 revenue numbers should have eased. Furthermore, capitalised development costs fell from $4.5m to $2.7m in the half, while revenue was doubling on the prior period. This indicates to us that the quality of the earnings is improving as the accounting becomes more conservative.

All things considered, post the December 2020 result, we are more confident that the $850m-1,050m revenue range we posited for FY2024 in our November piece is now more, rather than less probable, likewise the $155m-215m EBITDA result that accompanied such revenue figures.

A $1.25b enterprise valuation (as RBL had at the end of February) for a negative working capital business that has achieved scale; has a multibillion-dollar growth runway and the realistic prospect of generating EBIT exceeding $300m within 5 years is kind of crazy which one does not come across too often in markets that are “efficient”.

We wrote about NTD in the August report (.pdf). In it, we posited a “baseline” expectation of $28.1m of EBITDA in FY22 and that such an outcome should accompany a share price of “$1.50-1.80”. The company just released H1FY20 results of $15.4m EBITDA, indicating the business is already traveling ~10% ahead of our FY22 baseline, before even starting into realising the cost synergies that are available from the combination of the Tyres4U business.

Along with currency, tyre consumption and margin tailwinds have taken hold in the business; the realisation of even most of the synergies available should see NTD earn closer to $40m of EBITDA in FY22 (42% above our admittedly conservative August target). Such a result, depending on swings in working capital would see NTD produce something in the order of 20c per share of cashflow, which should be quite sustainable in forward years.

On the 88.5c share price which NTD ended February; this implies a 22.6% free cashflow yield. People are complaining about the low-interest rate environment!

The reason NTD fell in February was to do with the acquisition of their largest single supplier (Coopers) by Goodyear. The market’s response (down 30% at one point from pre-announcement pricing) was swift and savage. Understandable when considering the relationship speaks for about a quarter of revenues, but as the company pointed out, the contracted exclusivity runs for more than 6 further years by which time if the revenue/relationship is lost, a suitable strategy to replace the lost earnings should have been well formulated and executed.

What the market failed to consider is that an expanded relationship with Goodyear (NTD has a much larger distribution footprint in Australia) is also a possibility, meaning the “shoot first and ask questions later” response by the market to the Coopers announcement may well have been an even larger mistake than it first appeared.

The DDR fall in February was more modest and given the business trading nearer to the company’s fair value is more understandable. The upside of the new factory will be large; but the pricing of the stock requires continued growth which we fully expect DDR management will deliver. An 80% warehouse space expansion to a severely space constrained distributor must surely bring good things…

The markets treatment of SMP is also curious. We have not commented on SMP post their recent operational updates which show a business that is absolutely, squarely ensconced in the sweetest of sweet spots. The graphic they release with their last quarterly update shows the business is adding almost 1,000 new acquiring terminals per quarter, and that these terminals are operating at a revenue run-rate of >$3,600 each.

Ignoring the obvious acceleration in the number of terminals they are putting into the market; 4,000 terminals per annum at $3,600 per terminal imputes adding $14.4m of revenue to the acquiring business. The EBITDA margin on these terminals is likely to exceed 50%, meaning the business is likely adding >$7m of EBITDA to the Australian business annually, and that rate appears to be accelerating.

The market capitalisation of SMP was $175m at the close of February. The NZ assets were bid for at a NZ$70m valuation at the start of last year with the private equity bidder (understandably) attempting to use COVID-19 to attempt to get a lower sale price. The board demurred and SMP still owns the NZ assets. In our view, the strong performance of that business through COVID has only bolstered the case for an even fuller valuation. The bid is likelier to be contested next time, in our view the NZ$70m originally offered is now likely to be a floor price.

There would be transaction costs for the sale of the NZ business, but the current market capitalisation effectively imputes a valuation on the Australian SMP business of ~$100m-110m. If the base expectation on the prior page is met, and the $7m of EBITDA the business can add was valued at 10x EV/EBITDA, that implies a $100m business capable of adding $70m to its valuation annually as a base expectation. If one thinks the current run rate of 4,000 terminals per annum can be increased; then the incremental value that the business can add each year is likewise increased. As I described with RBL, the "efficient market" is sometimes breathtakingly myopic when the opportunity does not closely resemble something that can be used as a valuation analog.

Finally, in looking at the announcement released by SIT on the last day of the month, one must be dumbfounded by the way the market can sometimes completely miss the obvious.

SIT has been hamstrung by the Australian education business for several years. The business has been loss-making and given they are in a dispute with industry authorities and therefore unable to grow the revenues of the business to bridge this gap. These cash outflows have meant the business has been unable to fund the two opportunities that exist and where the real valuation upside lies: the international business, and the Clark property asset.

With the sale of the business for what is highly likely to end up being $4.44m (the earnouts are based on revenue, which unshackled from the legal issues of the parent should be easy to achieve in the coming construction and mining boom) is a spectacularly good result for two reasons.

Firstly, it will staunch the outflow of cash the Australian business was causing under its handicapped state. Secondly, management focus will enable fuller exploitation of the international business opportunity and on realising value from the Clark asset.

The international business is a highly prospective one that has been substantially hamstrung by the pandemic. The tendering pipeline for SIT's international business is enormous, particularly through the Middle East where the company has a long history of successfully winning and completing contracts.

But the real latent upside in SIT will come from unlocking the ~30-hectare property the company has in the Clarke special economic zone in The Philippines. I wrote about that opportunity in the August 2019 update (.pdf) and remain strongly of the opinion that an asset worth multiples of the current market capitalisation is primed and ready to capitalise on if management can find the right partner. If the target F.A.R (floor area ratio) of 6x can be achieved, the G.D.V (gross development value) of the project would be at least AU$6-10B.

One seldom sees a listed business with an asset with an observable valuation at least six times the market capitalisation of the company, but that is exactly the situation we face with SIT, showing why valuations in frontier markets are less reliable than in developed economies.

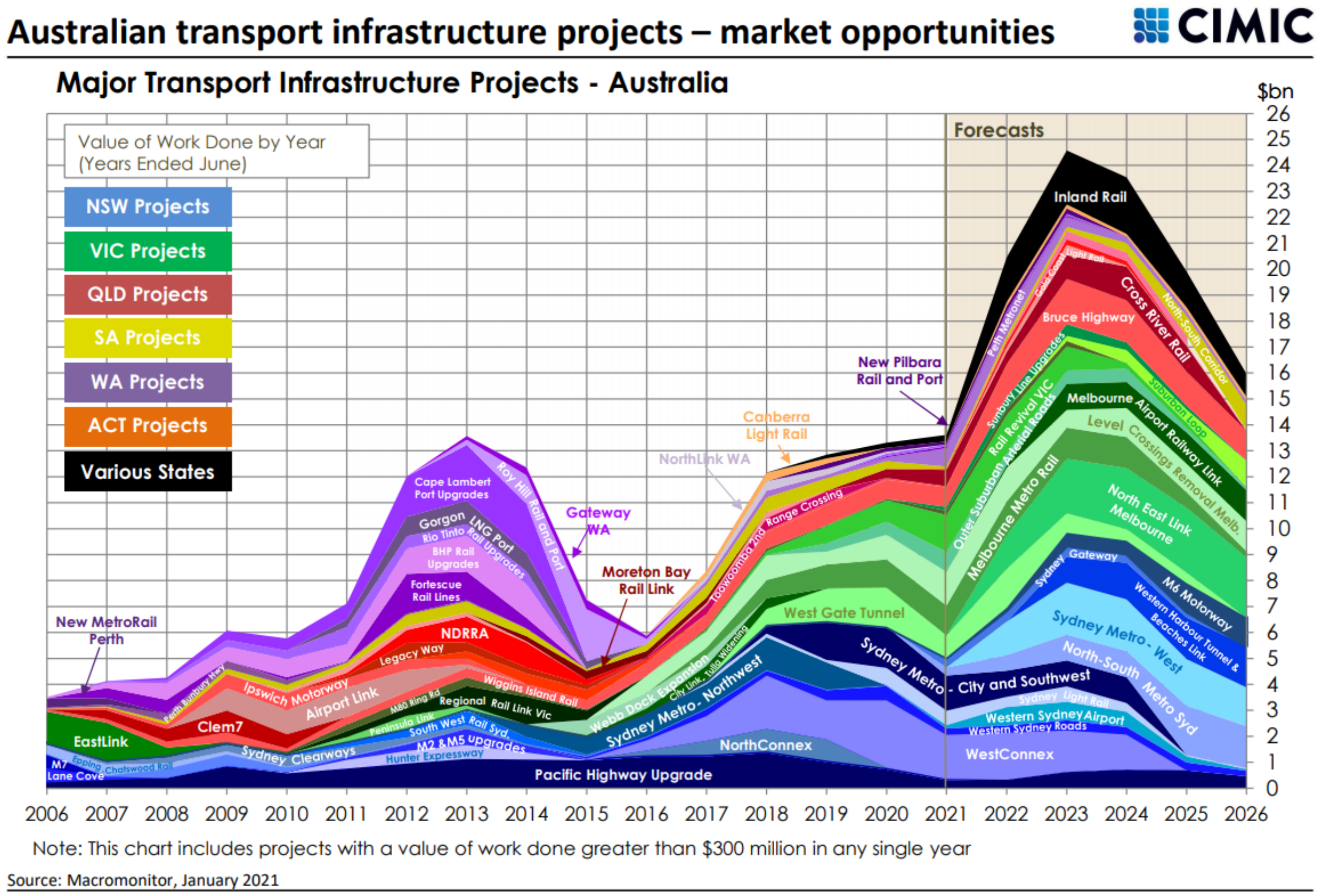
What the company desperately needs to persuade the market of the bona fides of the Clark opportunity is an "earn-in" style agreement with a deep pocketed partner that is obviously capable of fully maximising the asset's value.

**Anatomy of a Poor Outcome: -**

We discussed in last month's newsletter our intention to trim smaller, lower-conviction positions to better focus our efforts on those investments we expect to have the best chance of providing the best risk/return profiles from the companies we know and understand.

As part of this process, we eliminated a holding that was 1.2% of the fund, and there might be some merit in talking through why.

There has been a graphic circulating for a few years that sets out the impending boom in infrastructure spending. Most recently sighted in the Cimic annual results presentation:




We do not really invest "thematically" at EGP but did spend some time looking for companies that might be able to benefit from the infrastructure wave pictured above to meaningfully increased profitability. One we settled on was Saunders Limited (SND.ASX), which we started to build a position from about September 2017 starting at 50c per share. As traditionally happens immediately after we acquire a position in a contractor, they ran into contract issues and suffered a series of major profit downgrades. We gingerly added to our position in late 2019 at prices between 25 and 27 cents. We exited the position this month.

SND delivered a 9.13% IRR since our first purchase. The IRR of the ASX200TR through the holding period was 9.48%, so the holding slightly detracted value from our target of outperforming our benchmark.

The important thing when assessing any investment idea (whether you hold it or not), is will this investment deliver a better return on investment over the examined period than the other ideas I have? In the case of SND, it trades at an FY21 EV/EBIT of about 7x. This is inexpensive, particularly considering the opportunity set graphed above for the next few years. But as an example, we have SRG Limited (SRG) in the portfolio that has a similar EV/EBIT multiple based on expected FY21 earnings, similar, or better exposure to the wave of projects graphed and a variety of other adjacent opportunities.

## Searching for Eleven Figures. Part Four: -

This month, the company we examine for the "11-figures" series is the smallest of the five companies we will explore. Tellus Holdings is a company we have talked about previously, firstly here in an April 2018 blog and most recently on pages 5 and 6 of the June 2020 report (.pdf). In the June 2020 piece, we said we thought the company was cheaper at $1.75 per share in June 2020 than it was at $1.20 per share when we first purchased it in March 2018. We backed this sentiment up with action this month, increasing out holding by two-thirds at $2 per share.

At $2 per share, Tellus Holdings has a fully diluted (all outstanding options are in the money, so reasonable to account for them) market capitalisation of about $340m (there was also net-debt of ~$50m on 30 June 2020, which will be somewhat higher as further cost was incurred finishing Sandy Ridge post that date). To have a $10b capitalisation, it would therefore need to grow the valuation of the equity by almost 30 times to qualify for 11-figures consideration.

We believe not only can this be done, but it could potentially be done within about a decade if the stars align for the business.

Tellus is a Geological Repository business. Their website is excellent with deep resources to help the investor (and prospective investor) understand what they do. A recent video update (https://youtu.be/J0dPl5XaISU) shows the maiden pit being mined and gives a brief outline of how a repository works.

The primary near-term driver of value for Tellus will be fully realising the operating potential at the flagship Sandy Ridge project shown in the video. The first 100ktpa facility at Sandy Ridge should be capable of producing close to $70-80m of EBITDA at full-flight operation. The company has faced unwanted challenges in the "ramp-up" phase, with COVID border closures slowing the process. This is primarily due to delays in client capacity to do their site due-diligence before committing to long-term take-or-pay contracts.

The company had set expectations around a four-year build to 100ktpa at Sandy Ridge and despite the start being slowed by COVID, the enormous latent demand should ensure that still happens on a similar timeline. The company has also publicly expressed their intention to apply for a licence expansion to 200ktps (.pdf). If successful in the Sandy Ridge licence expansion, we estimate the CAPEX to double the capacity of Sandy Ridge would be something in the order of $15-20m (compared to ~$80m+ for the CAPEX for the first 100ktpa). Tellus has apparently already received waste from various states since opening, so the ramp up is real, and is happening.

To get to our estimate of $80m EBITDA at 100ktpa, we estimate the annual revenues would be in the order of $110-115m and that OPEX, including corporate overheads might be about $30-35m. Our estimate is that at 200ktpa, the revenue number should roughly double to ~$225m, but the OPEX costs should show outstanding operating leverage, with OPEX, including corporate overheads, unlikely to exceed $50m.

I will give my usual caution that the calculations made herein are done on a best endeavours' basis and for a variety of reasons will inevitably end up being very wrong, but our constant refrain is that to reasonably value an asset, we must decide what it can earn, otherwise we are just speculating (gold, bitcoin – we are looking at you…).

The implicit EBITDA for Tellus solely operating Sandy Ridge at 200ktpa is therefore ~$175m. It is not unreasonable to expect this capacity run rate could be filled on a five-year time frame. The current model for waste into Sandy Ridge involves trucking the waste to site. This will likely involve ~3,000 B-Doubles per year at 200ktpa, or roughly ten vehicles per day to site, which is not an aggressive rate of waste acceptance to build toward over five years.

Running in parallel to the scaling up of operations at Sandy Ridge will be the approval process for the Blue Bush project near Broken Hill (.pdf). The Sandy Ridge project took about five years to gain approval, but the asset was conceptually unique. Despite bitter experience with Government approval timelines (including the still pending wharf at Smith Bay on Kangaroo Island!), we expect that with a safe and effective operating precedent in Sandy Ridge providing secure employment and prosperity for folk in a remote area, that the approval for Blue Bush should happen on a much shorter timeline. It is hard to estimate a date, but it would be disappointing if it took more than three years, given it has already been granted "State Significant Development" status. The project would likely take 18-24 months to construct once approval was granted meaning a ~5-year timeframe is likely also achievable for Blue Bush to commence operations.

The Blue Bush project will have a slightly different operating model (primarily the employment of a "transfer station" model we understand) than Sandy Ridge and will therefore cost a little more to construct than Sandy Ridge did. Mid-point estimate is for ~$125-150m of CAPEX to achieve 200ktpa versus <$100m of CAPEX for Sandy Ridge to achieve the same capacity. The OPEX for Blue Bush will evidently also be somewhat higher, so the ~$175m of EBITDA Sandy Ridge will be capable of at 200ktpa might be moderated to more like ~$150-155m at Blue Bush.

The simplistic calculation though is that the combined Sandy Ridge/Blue Bush operation at 200ktpa each should be capable of producing something in the order of $330m of EBITDA, possibly inside of a 7-year timeline if there are no operational issues to prevent that happening.

From a valuation viewpoint, the recent takeover bid for Bingo Industries at 20x EV/EBITDA provides an effective "upper-bound" for our valuation expectations (despite our view that the Tellus assets at this level of operational performance are meaningfully better assets than the Bingo assets). Twenty times $330m of EBITDA would imply a $6.6b valuation roughly seven years hence if the timeline discussed above worked out. That price of course includes "takeover premium". In our estimation assets with the characteristics described above would trade at a 15x EV/EBITDA every day of the week, which is a ~$5b valuation. Assuming no dilution (there would almost certainly be some equity dilution if such a tight timeline were to be achieved) between now (at $340m equity value) and 7-years' time; the range ($5b-6.6b equity value range) implies an IRR of 46.8% p.a. at the lower bound and 52.7% p.a. at the upper bound from current valuation. Figures of that sort of eye-watering outcome are often targeted, but seldom achieved. The highly prospective economics, when combined with the structural demand for such services, provides an incredible margin of safety in our estimation and is the reason that we have committed more of the EGPCVF's capital to the opportunity this month.

The foregoing is an "all works well" perspective. The key risks to Tellus are now in execution. Even with poorer execution, it is hard to imagine Tellus is not generating at least $120m of EBITDA seven years out, perhaps exclusively from Sandy Ridge if nothing else worked in that timeframe. If we assume market participants put that figure on a (VERY) modest 10x EV/EBITDA multiple at that stage, you still get an EV of >$1.2b and a return from current equity prices of ~20% annually. There would need to be a major malfunction in the future of Tellus not to achieve a strong economic return from the current ~$340m equity valuation.

What the foregoing calculation does not do however is achieve a $10b valuation the "Eleven Figures" series was created to consider. To get the rest of the way from the $5-6.6b posited above after 7 years, we need to consider the growth options the Tellus business will still have at its fingertips beyond the 400ktpa out of Blue Bush and Sandy Ridge:

1. The 400ktpa run rate discussed for Tellus above speaks for less than 10% of (current) annual Australian production of the types of waste that cannot be safely isolated in current landfill solutions. We will not further outline the strong environmental benefits of properly isolating hazardous wastes, but it bears considering what an enormous tailwind the operation of the Sandy Ridge and Blue Bush facilities will have once opened. As industry realises it finally has a viable means of isolating their hazardous waste, thereby removing the liabilities from their balance sheets we would anticipate considerable pressure exerted to expand the waste handling capacity of these facilities apace.
2. The kaolin formation that houses the Sandy Ridge project is ~100 kilometres x 20 kilometres in size, the current Blue Bush prospective site is similarly large and the number of other geological formations suitable for a geological repository are ample enough that additional capacity if the market demands it and the authorities allow it, will not be hard to accommodate. The 10-years it has taken Tellus to get to the current point of commercialisation provide an excellent defence against a competitor seeking to replicate their business model.
3. Tellus has in furtherance of its growth ambitions developed the "Chandler" project. Chandler is a proposed 400ktpa facility in the Northern Territory. The positives include proximity to rail facilities (rail transport is meaningfully cheaper than trucking, meaning lower price to the customer and higher captured margin to Tellus) and approval to handle international waste (not that the additional demand from international is likely to be required) and the fact the project is salt rather than clay, improving the economics by providing a more highly saleable by-product. The key negative is it requires a ~$600m CAPEX based on the last update. If Tellus can get anywhere near the aforementioned $330m EBITDA run rate before commencing Chandler; the build would either consume a couple of years of cash flow or could be financed by debt, given the highly bankable cashflow stream at that point.
4. Speaking of proximity to rail, there is a non-zero possibility that if demand responds strongly to the Sandy Ridge facility that a spur/siding out to the project could make economic sense. Particularly if there was a "lower-value" waste (see point 5 below) that was made meaningfully more economically viable by the lowered transport costs such a facility created.
5. The "Elephant in the Room" of the Australian hazardous waste market is the PFAS and other bulk contaminants. The median value of waste isolated at Sandy Ridge will be extremely high, with "NORM – Naturally Occurring Radioactive Materials" costing ~$1,500 per tonne to isolate with "LLW – Low Level Waste" such as medical isotopes at even higher prices to isolate. Contaminated soils will be much lower value. What they lack in value, they make up for in VOLUME! This excellent document about hazardous waste (.DOC – 10.9MB) outlines an estimated 7,782,000 tonnes of PFAS contaminated soil (78 years' worth of Sandy Ridge's initial capacity), and that almost 3 million tonnes of contaminated soil are moved/disposed annually. That 3m

tonne figure of course contains soils with very modest levels of contaminations. While this document (.PDF) estimates that ~330ktpa of "N119/120/121" (otherwise classified as Category A/B/C contaminated soil) moved in Victoria over the seven years to 2014. The takeaway is there is a lot of contaminated soil to dispose and it could be an enormous opportunity for Tellus to profitably augment their high-value hazardous waste business with a lower-value hazardous waste business.

6. Tellus has also pegged tenements strategic locations throughout Australia, meaning the numerated growth options above are augmented by many other prospective projects. The pandemic has shown us that state borders are more real than anyone had previously imagined, so it is therefore possible that Governments within some states would prefer an in-state solution to isolating of their hazardous wastes so as not to rely on the capricious behaviour of neighbouring Premiers.
7. Part of the original feasibility study for Sandy Ridge involved the construction of a kaolin processing plant to sell the quality kaolin that will be taken from the pit voids. The IRR on the construction of such a facility is evidently below 40% and as such, given the much higher returns on other investment opportunities the company has available, committing capital to such opportunities is something the company will look to once the much higher returning opportunities have been exploited.

Those interested in looking at similar businesses internationally might look at US Ecology (ECOL.NSDQ) which supports an enterprise valuation of ~US$2b with EBITDA of ~US$125m (16x EV/EBITDA) and Heritage-Crystal Clean (HCCI.NSDQ) which supports an enterprise valuation of ~US$800m with EBITDA of ~US$30m (~27x EV/EBITDA). Unfortunately the publicly listed universe for such businesses is shallow, so the best guide for valuation is likely to be the traditional waste businesses though we believe the characteristics of the Tellus model are meaningfully more attractive than any traditional waste business.

**What should management do: -**

There has been a meaningful change in senior executives at the business recently, with founding CEO Duncan van der Merwe handing over the CEO's reins to Nate Smith. Duncan did an excellent job taking an entrepreneurial concept to an operating business. Much of the value creation we outline above will rest on how well Nate and his team can turn the early entrepreneurial spirit of Tellus into equivalent operational excellence. First order of business has been for Nate to surround himself with an excellent team, which should provide a great springboard for delivering on Tellus' potential.

Our primary concern is whether the board and management are fully cognisant of the prospective value creation machine they sit atop and that an opportunistic suitor might potentially make a bid at some stage which on the surface looks like a compelling offer (large premium to relatively modest early earnings for example), but which gives away too much in unachieved potential. The best way to avoid this issue is to ensure the businesses execution occurs swiftly, turning prospective earning potential into actual earnings that a suitor would need to pay for.

Alternatively, an IPO could be considered, but assets without a clear comparator sometimes become orphaned in public markets. With that said, APA and TCL have demonstrated that once the ASX participants figure out the investment case for a unique and hard to replicate set of assets with structural growth, they will pay a big price for them (~64x EV/NPAT in the case of APA and ~20x EV/EBITDA in the case of TCL). So provided there was appetite there, a listing could create a liquidity event for long-term shareholders, whilst enabling those of us that would like to still own the assets in a decade to do so.

The pathway to ~$330m EBITDA was outlined at the start of this piece. One or more of the seven additional growth options outlined could easily provide the final impetus to get the last leg of the value creation required for a $10b valuation. For example, assuming 400ktpa at Chandler could be filled at similar economics to the Sandy Ridge and Blue Bush projects, along with the incremental price rises in the interim, a business delivering $700m of EBITDA is quite conceivable. The multiple required on earnings of this quantum for a $10b valuation is ~14x, which would be modest for a business that had gone from $0-700m EBITDA in about a decade and was still probably only capturing at most a low double-digit proportion of the addressable market.

**The ZFC update: -**

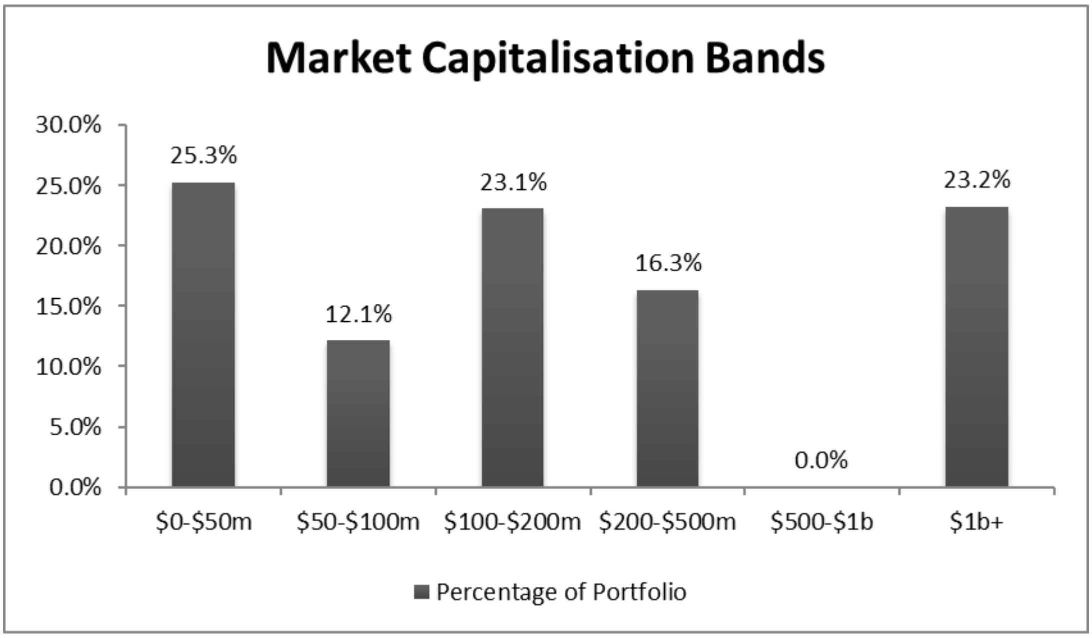
CEO of The ZFC, Brad Hughes (brad.hughes@thezfc.com.au) and I are in advanced talks with a very large Asset Allocator regarding model and funding of ZFC and we anticipate an update in the near future. Brad will be contacting interested parties with an anticipated announcement when able. We have confirmed our Investment Committee. Further work on website and ZFC structure is ongoing. As always, prospective investors or managers who are willing to operate with a ZFC compliant fee-structure are invited to contact Brad or myself or if anyone is aware of prospective investors or managers please have them contact Brad.

**Key Portfolio Information: -**

Our top 10 holdings on 28 February 2020 were:

| Rank | Holding | Percentage Equity Weighting | Percentage Portfolio Weighting |
|---|---|---|---|
| 1 | United Overseas Australia (UOS.ASX) | 10.6% | 9.9% |
| 2 | Redbubble (RBL.ASX) | 7.7% | 7.2% |
| 3 | Smartpay (SMP.ASX) | 6.7% | 6.3% |
| 4 | PPK Group (PPK.ASX) | 5.0% | 4.7% |
| 5 | Dicker Data (DDR.ASX) | 4.9% | 4.6% |
| 6 | Undisclosed | 4.9% | 4.6% |
| 7 | Tellus (Unlisted) | 4.1% | 3.9% |
| 8 | Undisclosed | 3.9% | 3.6% |
| 9 | National Tyre & Wheel (NTD.ASX) | 3.8% | 3.5% |
| 10 | LawFinance (LAW.ASX) | 3.6% | 3.4% |

Our largest 5 holdings now comprise 34.9% of our invested capital, our top 10 holdings are 55.3% and our top 15 represent 71.9%. Cash and cash equivalents are 6.6% of the portfolio. The median market capitalisation is $141m. Weighted average market capitalisation is $420.0m.




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 | $50,000 | Sharpe Ratio[1] | -0.16 |
| Additional investments | $5,000 (Minimum)<br>$200,000 (Maximum) | Sortino Ratio[1] | 0.69 |
| Applications/redemptions | Monthly | Annualised Standard Dev. – EGP<br>Annualised S/D - Benchmark | 19.57%<br>16.37% |
| Distribution | Annual 30th June | Largest Monthly Loss – EGP<br>Largest Monthly Loss - Benchmark | -28.9%<br>-20.7% |
| Management fee | 0% | Largest Drawdown – EGP<br>Largest Drawdown - Benchmark | -33.9%<br>-26.7% |
| Performance fee (<$50m)<br>Performance fee (>$50m) | 20.5% (inc GST)<br>15.375% (inc GST) | % Of Positive Months – EGP<br>% Of Positive Months - Benchmark | 65.1%<br>67.4% |
| Auditor | Ernst & Young | Cumulative return[2] – EGP<br>Cumulative return[2] – Benchmark | 25.4%<br>33.1% |
| Custodian/PB | NAB Asset Services | 1-year return[2] – EGP<br>1-year return – Benchmark | (0.6%)<br>6.5% |
| Responsible Entity | Fundhost Limited | 3-year annualised return[2] – EGP<br>3-year annualised – Benchmark | 5.6%<br>7.4% |
| Fund Size | $80m | 5-year annualised return[2] – EGP<br>5-year annualised – Benchmark | N/A<br>N/A |
| Mid-Price for EGPCVF Units<br>Accumulated Franking per Unit | $1.1003<br>$0.0045 | Buy Price for EGPCVF Units<br>Sell Price for EGPCVF Units | $1.1019<br>$1.0986 |

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 1: -

Combined funds cumulative return since inception: