EGP Concentrated Value Fund

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

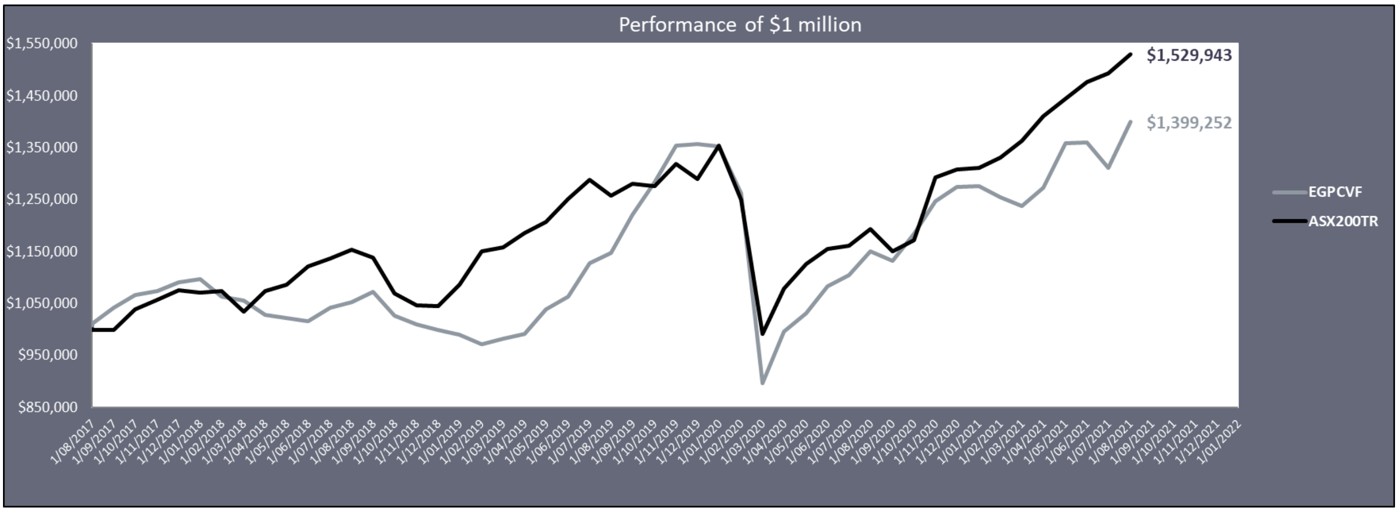
Mobile: 0418 278 298

EGP Concentrated Value Fund – 31 August 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%)	(1.3%)	2.9%	6.7%	0.1%	25.50%
Benchmark FY21	0.5%	2.8%	(3.7%)	1.9%	10.2%	1.2%	0.3%	1.5%	2.4%	3.5%	2.5%	2.3%	27.80%
EGPCVF FY22	(3.6%)	6.7%											2.86%
Benchmark FY22	1.1%	2.5%											3.63%

*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 6.7% in August. Our benchmark rose 2.5%. It was a very good month for the fund in absolute and relative terms. Reporting season provided some of that momentum, but a good portion of the performance was simply the reversal of some unwarranted falls in July, serving as a reminder that any single month cannot be viewed in isolation.

Examining some holdings with notable moves, Redbubble began the month at $3.24 per share. On the day of the earnings announcement, it fell as low as $2.62 before trading as high as $4.48 (+71%) in the following days. Such wild swings happened in several cases through earnings season as market participants struggled hard with how to value stocks strongly affected by COVID induced business changes.

I remain very positive about the medium-term prospects of RBL, now that the marketplace has reached scale, the key decisions are around how to deploy cashflows in search of business optimisation. Each new time I hear CEO Mike Ilczynski discuss his strategy, I am more convinced he has a very clear vision for how best to position the business. In the "Searching for Ten Figures" piece I wrote in the November newsletter (.PDF), we posited AU$600m marketplace revenue figure for FY21. The final MP revenue figure was only AU$521.7m, which was well short of our expectations, even though falls in currency account for a some of the shortfall.

The 2024 targets the CEO has laid out would be very close to the "Near Perfect Execution" trajectory of our original piece, and if they can get anywhere near that target, the share price would be multiples of the current price, implying enormous market scepticism about the likelihood of achieving these goals. The business trades on a trailing EV/EBITDA below 20x compared to industry leader ETSY which trades at ~55x EV/EBITDA. I would back RBL to organically outgrow ETSY (i.e. ignoring acquisitions of which ETSY makes many) in revenue and earnings over the next few years, so the disparity is unwarranted. On an EV/GP basis, ETSY trades at ~16x versus <5x for RBL, ETSY could pay twice the current price to acquire RBL and the transaction would still be handsomely accretive. That is the greatest risk to RBL in our view, being taken over before they can fully demonstrate the value of the marketplace they have built.

Dicker Data (DDR) was another significant mover for the fund in August. This was prompted more by the announcement of an acquisition than by anything unexpected about the financial performance. The financial performance was (as usual) very sound, adding >9% to PBT over the same half last year that was itself >30% above the prior corresponding half with the positive effects of the "work from home" movement the original COVID lockdowns caused. Rather, it was the announcement at the start of the month of the acquisition of the NZ based Exeed business for $68m, accompanied by about $15m of EBITDA that caused the share price to rocket.

Throughout the month, the share price traded as high as $16.60, up from the $11.60 it closed last month. At the highs for the month, this meant ~$860m of value had been synthesised by the acquisition, or ~12x the $68m purchase price. The acquired business will almost inevitably be meaningfully more profitable in the DDR stable, removal of duplicated costs and cross-selling opportunities virtually guarantee that, but the share price reaction was still breathtaking and demonstrates the value the market will place on relentlessly excellent execution (the valuation multiples of other relatively simple businesses such as Reece and ARB Corporation trade at confirm this).

The sharp rise in price was probably best explained by something of a short squeeze. Only 2.55% of the stock was sold short the day before the announcement but given David Dicker and Fiona Brown collectively owned 67.1% of the business, this effectively meant ~7.8% of the available stock was sold short, which made it one of the most shorted stocks on the ASX (along with RBL interestingly…). Shorting a business that has generated an earnings per share compound annual growth rate of 23% annually since listing a decade ago despite paying out almost all of earnings as dividends is not a strategy we understand despite the lofty valuation.

In industry parlance, DDR is "priced for perfection", but on our side, execution since the 2011 IPO has resembled something very much like perfection, so the lofty valuation could still prove logical. Nonetheless, we trimmed our holding through the month, such a decision has historically led to regret, this time sure to be the same, but at >40x earnings, on a risk adjusted basis, we feel there are superior opportunities for our capital. The day after we completed our trimming, CEO David Dicker himself sold 1.6% of the company, which is likely to have been absorbed in large part by short sellers closing out their positions to spend some time licking their wounds/seeking more sensible targets/reviewing their process. The stock subsequently traded down as low as $12.54 per share, barely up on the month.

Our largest holding PPK Group (PPK) hit a series of new all-time highs through the month after a sharp drawdown last month. The movements in the price did not seem to be driven by specific announcements, but more a growing realisation of the imminent commercialisation of a series of technologies that are likely to change the world. The share price exceeded $20 for the first time in August after closing July at $13.15. Anyone curious why PPK (and subsidiaries) is such a large holding for the fund should read and contemplate the first four pages of the Executive Chairman's Report in the PPK Annual Report (.PDF)

The IPO of PPK's first spin-off, Li-S Energy (LIS) business was delayed into September after the ASX were unable to complete their compliance obligations in time for the 30 August target listing date. The IPO should ensure a good September for the fund as all components (institutional, priority and public offers) of the IPO were massively oversubscribed and had to be closed early, with massive scale back. This should ensure aftermarket trading in LIS is very strong, I shall be surprised if the stock ever trades below $1 per share (the IPO price is 85c). Executed properly, this is a multi (multi)-billion-dollar opportunity.

The scale of the prospective market for the Li-Sulphur batteries enabled by boron nitride nanotubes (BNNT) are obvious to anyone with even a modest understanding of the first generation of Li-S Energy batteries and the market into which they will be commercialised. News such as this Bloomberg article about the issue of fires in the current generation of Li-Ion batteries should only serve to create more urgency for the rollout of Li-S batteries as they are likely to substantially solve this problem. Less cars catching fire can only be a good thing…

The other important piece of news from PPK was the continuing success of the White Graphene (.PDF) subsidiary's development. The most important element of that announcement was the following table:

IFM INSTITUTE FOR FRONTIER MATERIALS — DEAKIN UNIVERSITY

WHITE GRAPHENE PROJECTS

KEY BENEFITS	Concrete Floor Coatings	Acrylic & PU Timber Coatings	Paint	Glass Fibre Reinforced Epoxy	PU (Faux) Leather	Ballistics	Wire Sheaths & Coatings
Compressive strength	•				•		
Compressive modulus	•				•		
Compressive strain	•				•		
Tensile strength		•		•	•	•	•
Tensile modulus		•		•	•	•	•
Tensile strain		•		•	•	•	•
Flexural strength				•		•	•
Flexural modulus				•		•	•
Flexural strain				•		•	•
Hardness	•	•	•	•	•		•
Adhesion		•	•				
Wear resistance	•	•			•		•
Friction coefficient	•	•			•		•
Wettability/Contact angle	•	•	•	•	•		•
Colour change	•	•	•		•		
Thermal stability	•	•	•	•	•	•	•
Fire retardancy	•		•	•	•		•
Water vapor permeability		•	•		•		
Anti-bacteria	•	•	•		•		
Thermal conductivity				•	•		•
Electrical insulation							•
UV aging resistance	•	•	•	•	•		•
Microstructure analysis	•	•	•	•	•	•	•
Cleanability			•				
Water & oil absorption	•			•			

These are just the seven most obvious near-term opportunities for the application of boron nitride nanosheets (BNNS, or White Graphene). Some of these opportunities are of a truly massive scale:

1. Concrete floor coating is estimated to be a US$1.8b annual global market by 2027.
2. Wood coating is estimated to be a US$12.3b annual global market by 2027.
3. Paint is a ~$3.2b industry in Australia and is estimated to be a US$218b annual global market by 2028.
4. Fibreglass is estimated to be a US$25.5b annual global market by 2028.
5. Faux leather is estimated to be a US$57b annual global market by 2028.
6. Ammunition is estimated to be a US$28.4b annual global market by 2028.
7. Wires and cables are estimated to be a US$273.7b annual global market by 2028.

The first handful of applications for BNNS that have come to mind therefore amount to a US$617b revenue opportunity. This is not a set of idle claims, the table above specifically addresses the areas of benefit that the addition of BNNS is expected to provide for the product. The most exciting prospective application contemplated so far in my view is wire sheaths and coatings (working as I did in a prior life as a project accountant in the electricity industry). Primary benefits of adding BNNS to cabling are likely to be the improved electrical insulation and thermal conductivity outcomes. With these elements improved, the quantity of copper required in many cabling applications is likely to be reduced. The reduction in copper is likely to mean the BNNS enabled cables achieve the dual goals that capitalism relentlessly seeks, cheaper AND better. Thinner, lighter cabling will improve a great many applications - consider commercial aircraft which have thousands of kilometres of cabling amounting to as much as 2% of the dry weight of some craft. Such facilitation of reduction in the amount of copper that needs to be mined to transition to an electrified future will have those investors for whom ESG factors are important falling over themselves to own White Graphene.

The US$218b paint industry is also a staggeringly large prospective market. The combination of fire retardancy, anti-bacterial and resistance to UV will have the research and development departments of major paint manufacturers doing backflips with excitement. Not captured in the global paint market is another ~US$12b annual market in the automotive paint industry, where hardness, thermal stability and UV aging resistance will have massive value to car makers.

The most obvious risk for BNNS is how defensible the production method is. Production of BNNT is an incredibly intricate and complex process, dozens of leading research organisations have tried to synthesise BNNT more cheaply and none have been able to produce the quality and quantity at low cost that PPK have successfully done. My sense is that the process for BNNS is simpler, the process developed by White Graphene is cheaper and better than anything else currently available, but it remains possible that on a reasonable timeline, if White Graphene proved up a large addressable market that competitors would enter the market and the very high margins I expect BNNT to earn may end up much lower for BNNS. With that said, what "might" be lost in margin should be made up for in scale. There are ~25 billion litres of paint produced per annum globally, if only ten percent of the global paint market ended up using just 5 grams of White Graphene per litre, it would require 12,500 tonnes per annum of White Graphene annually.

The best investor I know (and fellow PPK/LIS/WGL shareholder) described his version of the big risk for Li-S Energy and White Graphene (and therefore PPK) thusly "they can go up on the dream but will run into the gravitational pull of fundamentals". The managements of each business need to be careful about ensuring their investors are properly kept appraised of the prospects of each business. This is incredibly hard to do with prospectively world-changing technologies. As such, given we are committed to the prospects of PPK, Li-S Energy and White Graphene, we will need to accept these holdings are likely to introduce a higher level of volatility into the portfolio than we have traditionally been exposed to. In my experience, unitholders have an incredibly strong disposition when facing upside volatility, but seldom possess the same level of fortitude for downside volatility. Forewarned is forearmed, volatility ≠ risk, hopefully the past two months have demonstrated this and prepared my fellow unitholders for the type of investment experience we can expect from our exposure to these holdings.

The ZFC update: -

Following on from my last update that Cipher Fund was targeting an October 2021 launch; subject to funding. There have been some developments.

Launch is predicated on funding of an initial amount of at least $400 million being secured and this remains the plan. Any amount below this will see operating expense too high relative to the size of the fund.

A recent meeting has confirmed that we are now identifying options for the final tranche of institutional investment sourced to augment funds from the foundational Superannuation Fund investors.

The "Your Super Your Future" legislation has meant reduced appetites for risk in the very short term; as the legislative changes flow through operationally; with a further side effect involving the planned merger of several major Superannuation Funds; with consequent focus on their merged models.

Brad and I are examining alternative potential institutional investors to provide this comfort in the short term and in the absence of above short-term funding, it is likely that launch will be delayed until Q2 2022 following settling of Superannuation Regulatory changes.

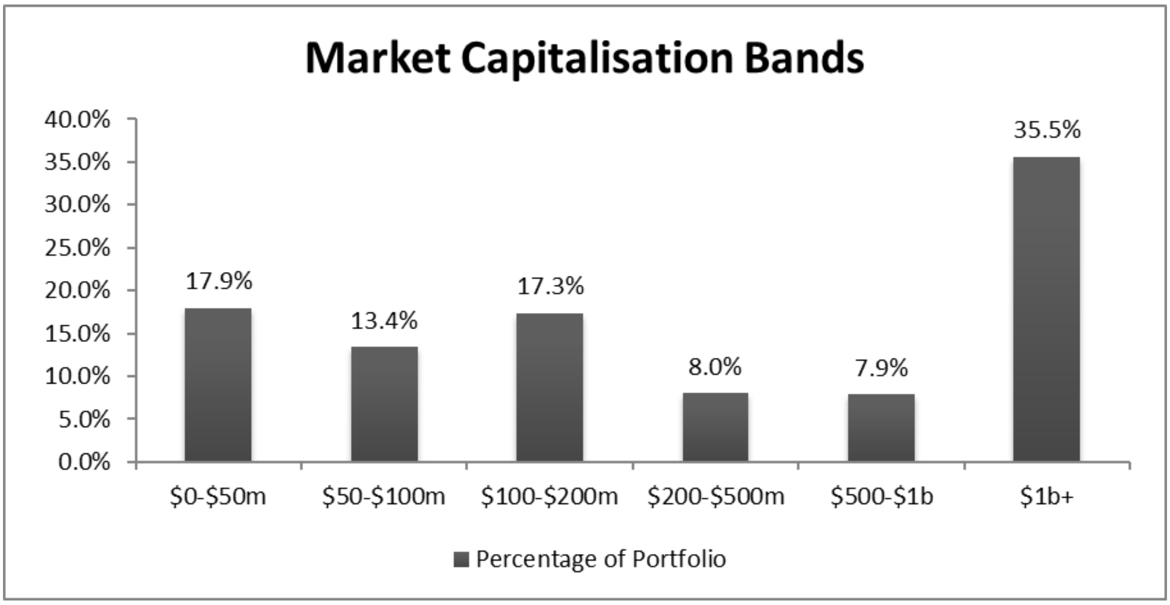
Brad will be contacting current prospective Managers to outline above further, and Managers can as always contact Brad or I directly. Prospective managers and investors are invited to contact CEO of ZFC, Brad Hughes (brad.hughes@thezfc.com.au) or myself.

Key Portfolio Information: -

Our top 10 holdings on 31 August 2021 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	PPK Group (PPK.ASX) inc. Li-S Energy & White Graphene pre-IPO holdings	16.0%	15.0%
2	United Overseas Australia (UOS.ASX)	9.4%	8.8%
3	Cettire (CTT.ASX)	7.9%	7.4%
4	Redbubble (RBL.ASX)	6.1%	5.8%
5	Smartpay (SMP.ASX)	5.9%	5.5%
6	Shriro Holdings (SHM.ASX)	5.0%	4.7%
7	National Tyre & Wheel (NTD.ASX)	4.9%	4.6%
8	Dicker Data (DDR.ASX)	4.0%	3.8%
9	Tellus (Unlisted)	3.8%	3.5%
10	SRG Global (SRG.ASX)	3.4%	3.2%

Our largest 5 holdings now comprise 45.3% of our invested capital, our top 10 holdings are 66.3% and our top 15 represent 80.3%. Cash and cash equivalents are 6.2% of the portfolio. The median market capitalisation is $249.6m. Weighted average market capitalisation is $674.8m.



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]	-0.12
Additional investments	$5,000 (Minimum) $200,000 (Maximum)	Sortino Ratio[1]	0.71
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	19.0% 15.4%
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	65.3% 71.4%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	39.9% 53.0%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	21.7% 28.2%
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	10.0% 9.9%
Fund Size	$84.7m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	N/A N/A
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$1.1451 $0.0010	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$1.1468 $1.1434

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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Appendix 1: -

Combined funds cumulative return since inception: