EGP Concentrated Value Fund

Address: P.O. Box 1873,
Macquarie Centre, NSW, 2113

Mobile: 0418 278 298

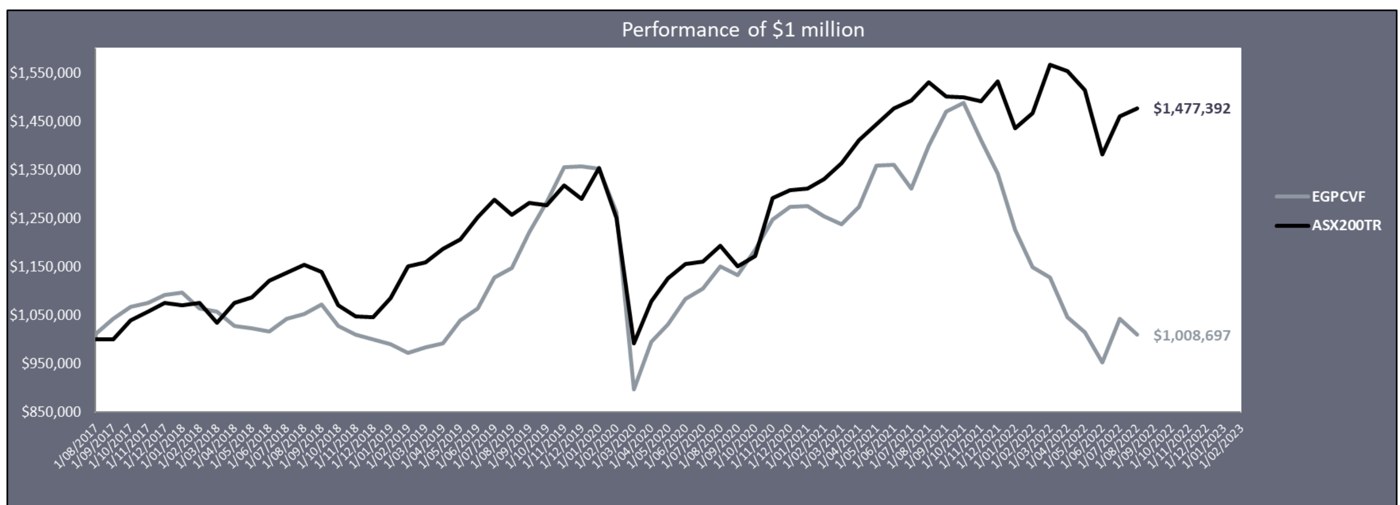
Email: tony@egpcapital.com.au

EGP Concentrated Value Fund – 31 August 2022

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%	5.1%	1.2%	(5.2%)	(4.8%)	(8.7%)	(6.2%)	(1.9%)	(7.3%)	(3.0%)	(6.0%)	(29.96%)
Benchmark FY22	1.1%	2.5%	(1.9%)	(0.1%)	(0.5%)	2.8%	(6.4%)	2.1%	6.9%	(0.9%)	(2.6%)	(8.8%)	(6.47%)
EGPCVF FY23	9.4%	(3.2%)											5.86%
Benchmark FY23	5.8%	1.2%											6.99%

*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 3.2% in August. Our benchmark rose 1.2%. The fund was harmed by a handful of late negative quotational movements in some larger, less liquid holdings, along with a couple of negative reactions to earnings reports we will discuss below.

The close of August and beginning of September have seen some of our most aggressive buying in many months. We are always focused on when we have a valid "variant perception" that gives confidence that the market is mispricing a stock for reasons that will be proven incorrect, we have found a couple of situations where we feel very strongly this is the case and have been backing this view with our cash holdings. We will also commence September with a tailwind in the form of our pre-IPO White Graphene investment being marked higher this month when the equity issuance they are currently conducting closes, discussed further below.

The September report (next month's) will host a comprehensive review of the investment theses for our largest holdings. This will be used as the basis for our quarterly videoconference as the number of questions in the Q&A each quarter has lately diminished, so I will create a monthly report which we can use as the basis for discussions next month.

Earnings Season Review: -

Given the highly volatile movements of the share prices of many of our holdings and the highly unusual business conditions over the preceding year, there were few significant price movements on the results day for our portfolio holdings. With that said, the month ended up being a very poor one in relative terms, which is at odds with how we viewed many of the results. I will discuss a few below before the more detailed update next month.

The most significant movement on results day (and since) came from RedBubble (RBL). We have owned RBL since 2017 and it is a business market participants have always had difficulty pricing. RBL's initial public offering was conducted at $1.33 per share in mid-2016. The share price roughly halved over the next year, despite the business posting consistently strong revenue growth. This was around when EGP first became interested in RBL as despite the business not yet being profitable, it was clearly growing very quickly into an enormous addressable market and the attractive negative working capital business model meant it would be better able to fund itself on the path to self-sustaining commercialisation than many pre-profit businesses.

The share price promptly more than doubled by early 2018 from our 2017 purchase price, before halving again over the next year as the TeePublic acquisition was digested. The share price then again more than doubled over 2019 as market participants started to realise what a powerful business the combined RBL/Teepublic was becoming, before falling about 75% in the covid panic in early 2020. From lows of around 50c per share in March/April 2020, the share price rocketed to highs of ~$7 as the lockdown fuelled online retail boom flowed through the results. RBL was producing cashflows exceeding $100m per annum as the incredible operating leverage and explosive earnings growth the business is capable of at scale became visible.

The realisation that much of the revenue gained in the COVID boom would prove transitory saw the share price again collapse to June 2022 lows of about 75c per share. Prices then surged in the early part of this financial year to highs around $1.40 this month, apparently driven in part by a research report that pointed out what a substantial business RBL had grown into despite the many challenges it has faced and what an incredibly low valuation it carries relative to global peers.

Results day saw RBL's share price fall from $1.495 at the previous close to as low as 89c, it has continued falling since. The reason for the latest reversal in market sentiment about RBL appears to be the newly enlarged operational expenditure (OPEX) levels that have been put in place to support the doubling of revenue management are targeting over the next four or five years. Despite the expanded OPEX, management were unwilling to give revenue guidance for FY23 other than "a return to growth". The return to growth should be a lock given the revenue elements that comprised the Covid fillip have now been fully cycled. Management announced on the earnings call that the apparel business had grown by 6% in FY22, the drop in revenue was entirely attributable to masks and homewares. The resignation of the CFO not long after the results announcement has likely not helped shareholder confidence.

What exists now with RBL is a very binary situation, whereby should revenue grow anywhere approaching the ~20% annual average before the Covid, the stock is remarkably cheap. Alternatively, with the newly inflated OPEX base,

should the expected revenue not arrive, the $89m cash balance may not be enough to see them to sustainably cashflow positive.

We still hold the shares and therefore believe that the former outcome is more likely than the prior. Management has stated that the current OPEX level can carry the business to its medium-term aspiration of $1.25b marketplace revenue. If that is true, the business at that scale should be roughly capable of earning $130-170m of EBITDA. If it can be achieved in the guided timeline (FY26/27), that earnings scale and the attractive economics RBL possess would likely attract an EV/EBITDA valuation multiple of around 20x, for a valuation at the midpoint of about $3b. The current enterprise valuation is about $110m, meaning if they execute exactly to plan without requiring further dilution, the upside is around 27 times. Annualised over five years, that amounts to a 93% internal rate of return (IRR). My view is that this gives an enormous amount of wiggle room for missteps against the aspirational target whilst still offering a very attractive risk/reward proposition. Such risk reward is seldom available, which is why we retain the position, but probability weighting the two ends of the range of outcomes ex-ante is extraordinarily hard to do. At a 50/50 probability, a portfolio of such investments would be enormously profitable. If we can see evidence that a return to trend growth is occurring, we will buy aggressively if the price does not move ahead of that news.

Li-S Energy (LIS) was another holding that hurt the fund substantially in the month, with the share price falling from above 70c to about 50c throughout August. One of the few positive days trading for the month was in fact the day of the results before the downward trajectory resumed. Market participants are in no mood to award any significant valuation to almost any pre-profit business at present, no matter how enormous the potential end market is. LIS has the best currently known technology to supersede Lithium-Ion batteries for applications where power to weight and battery life are critical (anything that moves basically, think motorcycles/cars/buses/trucks/aircraft primarily). Since listing, save for some modest delays in equipment delivery, the company has delivered every promised advancement in the project. Along the way, deals have been inked with companies associated with Boeing and NASA, for whom due diligence is thorough, and who generally do not work with second rate operators. If LIS continue to execute as per their promises, this is easily a multi-billion-dollar business in the making.

PPK Holdings (PPK) likewise fell sharply in the month, not attributable to any untoward announcement, but rather the general malaise for high-tech businesses that have not yet developed their commercial offering. I will expand further on this next month but consider this. At $1.50 per share, with PPK you get for $134m of market capitalisation:

1. 45.4% of Li-S Energy valued at **$146.8m** at August closing price; and
2. Between 51.8%-55.3% of White Graphene Limited (depending on the total amount raised see Information Memorandum [.PDF]) valued at **$40.5m**. As an aside, the fact this announcement (.PDF) about the efficacy of adding White Graphene to gelcoat was not received with a significant valuation uplift for PPK is indicative of how sceptical market participants are at present about technologies requiring further development and commercialisation. The announcement clearly sets out that (amongst other benefits) adding White Graphene to gelcoat causes a reduction in friction co-efficient by as much as 50% is potentially the biggest development in carbon emissions reduction since the fracking revolution made the United States the global leader in emissions reductions. This article is an explainer on why super hydrophobic surfaces have been the (unachievable) holy grail in shipping for years. Contemplate the global emissions reduction if adding White Graphene to gelcoat led to just a 10% reduction in shipping emissions via increased fuel efficiency; and
3. A 45% interest in Craig International Ballistics which given the fast growth since acquisition and growing profitability the stake would be saleable for at least **$10m** in my estimation; and
4. Interests in BNNT Precious Metals Limited; Strategic Alloys Pty Ltd; 3D Dental Technology Pty Ltd; Advanced Mobility Analytics Group Pty Ltd; Ballistic Glass Pty Ltd and Survivon Pty Ltd that are collectively worth at least **$20m** (AMAG alone could easily be worth way more than that, it is a truly revolutionary technology)**;** and
5. The jewel in the crown, BNNT Limited that is in my estimation likely to be the most valuable of all PPK's investments as applications for BNNT are further developed, but for the sake of conservatism, imagine it is worth only what White Graphene is, i.e. **$40.5m**.

There readily identifiable investment value of **$257.8m**, which can presently be purchased on market at a 48% discount. Furthermore, the valuations for the opportunities are themselves grossly understated, each of LIS, White Graphene and BNNT are likely to be billion-dollar businesses if the early application successes with their technologies are remotely commercialisable.

Cettire (CTT) was another result market participants had difficulty parsing on results day. The results presentation declared the post-IPO loss-making period used to achieve scale had passed and the business was now operating profitably ($2m EBITDA in July with a similar result expected in August). Shares promptly rose about 15 or 16% on open before sliding back and trending lower ever since. The reversal was presumably due to the very poor FY22 financials, but as mentioned, that period was being used to scale the business, which is now done. Savings CTT have been able to extract using their new scale are primarily in the logistic area, they are moving around ten times as much freight as they were before the IPO, you can imagine what significant improvements in terms they have been able to use this volume to achieve. Another large saving is in removing their website from the Shopify platform and building their own storefront, meaning the margin they were paying away to Shopify will disappear too alongside reductions in fees to credit card and BNPL companies as higher volumes enable negotiation of better terms. This will be very welcome in a business that is presently paying away 4.8% of sales revenues in merchant fees!

On the results call, CEO Dean Mintz said another thing that I suspect investors overlooked. Revenues were up a further 67% in July year on year, but he said unpaid traffic was up about 300%. He explained this further in a separate call I had with management that rather than type "Prada handbag" for example into Google and following a (very expensive) link to Cettire to purchase the desired product, now that a relationship has been established, many previous customers are simply typing www.cettire.com into their browser, or opening the Cettire App on their telephone to find the product they wish to purchase.

If this trend continues, it will dramatically change the economics of the business. Management have already said they earned $2m of EBITDA in the seasonally low month of July, and that they see CTT as a business that should be earning at least double-digit EBITDA margins. Given they generated $209m of revenue in the year just gone and were up 67% in July, $300m seems an achievable FY23 target. 10% EBITDA margin achieved on that revenue would generate $30m of EBITDA. The current enterprise valuation of below $250m does not price in a company growing revenues at 50%+ and earning EBITDA of ~$30m. The current pricing is more likely to imply that market participants expect FY23 to resemble FY22 and a view that more equity capital could be required.

The ZFC update: -

The launch of Cipher Fund is now expected in 2023.

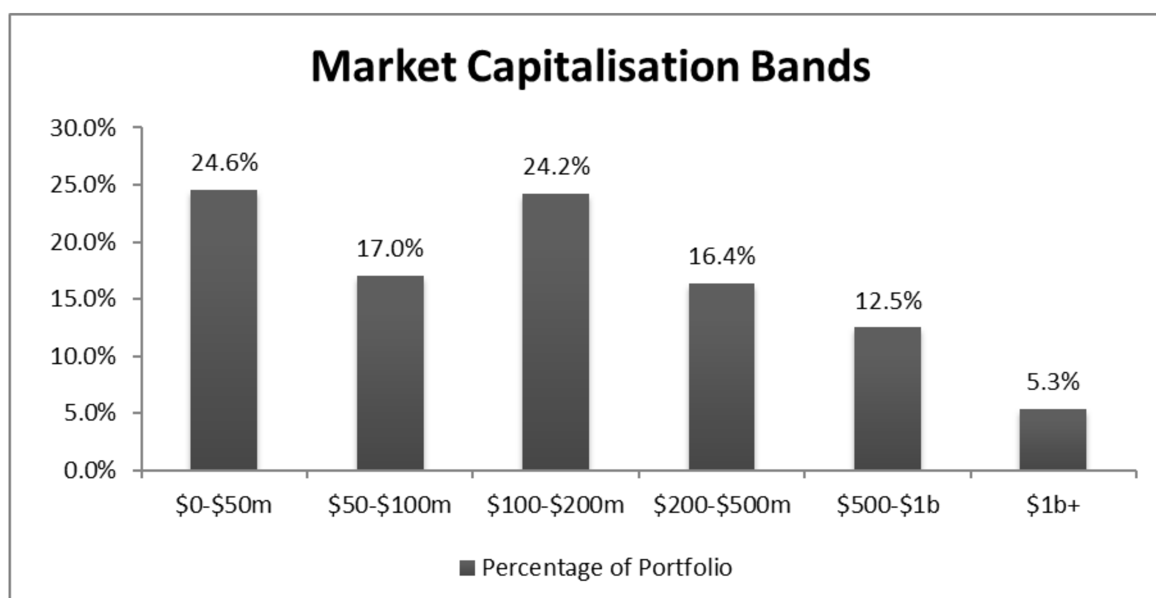
Prospective managers and investors are invited to contact CEO of ZFC, Brad Hughes (brad.hughes@thezfc.com.au) or myself.

Key Portfolio Information: -

Our top 10 holdings on 31 August 2022 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	12.5%	11.5%
2	Smartpay (SMP.ASX)	8.7%	8.0%
3	Shriro Holdings (SHM.ASX)	7.0%	6.4%
4	Tellus (unlisted)	5.8%	5.3%
5	PayGroup (PYG.ASX)	5.4%	4.9%
6	Dicker Data (DDR.ASX)	5.3%	4.9%
7	SRG Global (SRG.ASX)	4.9%	4.5%
8	Blackwall Limited (BWF.ASX)	4.7%	4.3%
9	PPK Group (PPK.ASX) inc. White Graphene pre-IPO holding & PPKME	3.9%	3.5%
10	SDI Limited (SDI.ASX)	4.0%	3.7%

Our largest 5 holdings comprise 39.4% of our invested capital, our top 10 holdings are 62% and our top 15 represent 77.6%. Cash and cash equivalents are 8.4% of the portfolio. The median market capitalisation is $137.2m. Weighted average market capitalisation is $315.6m.



As always, investors with any questions, suggestions, comments, or investment ideas should feel free to call (0418 278 298), or send me an email – Tony@egpcapital.com.au

Fund Features		Portfolio Analytics	
Min. initial investment	Fund Closed	Sharpe Ratio[1]	-0.17
Additional investments	Fund Closed	Sortino Ratio[1]	0.02
Applications/redemptions	Redemptions only, monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	19.3% 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	57.4% 65.6%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	0.9% 47.7%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	(27.9%) (3.4%)
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	(4.2%) 5.5%
Fund Size	$50m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	0.0% 8.1%
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.7964 $0.0008	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.7976 $0.7952

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: