**EGP Concentrated Value Fund**

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

Mobile: 0418 278 298

Email: tony@egpcapital.com.au

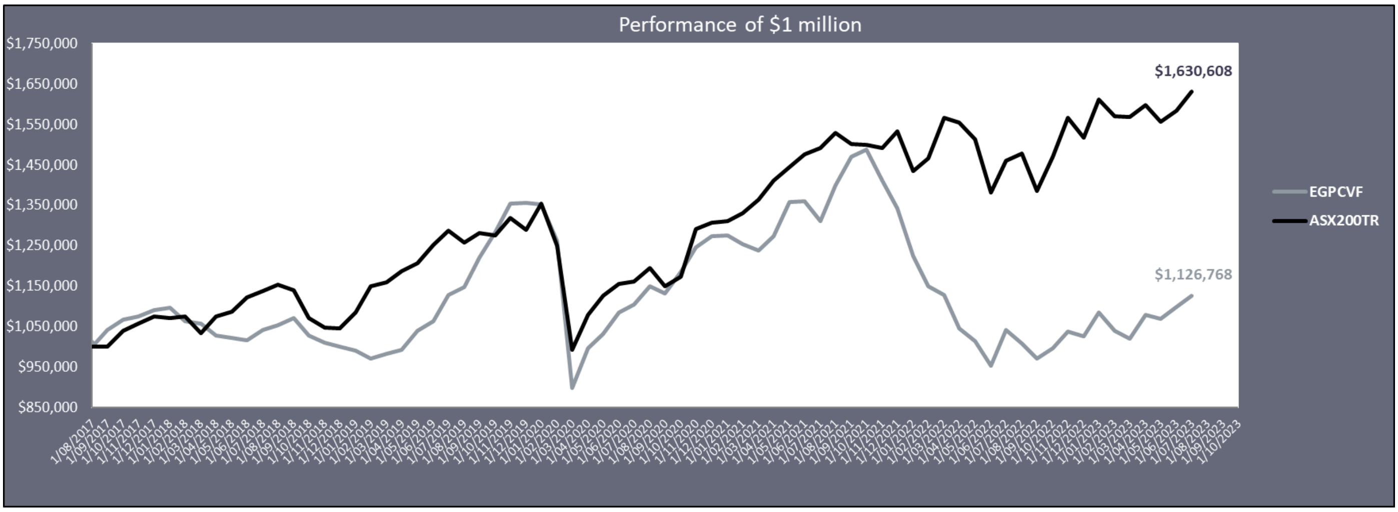
EGPCapital

# EGP Concentrated Value Fund – 31 July 2023

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%) | (3.8%) | 2.6% | 4.3% | (1.1%) | 5.6% | (4.0%) | (2.0%) | 5.7% | (0.9%) | 2.7% | 15.21% |
| **Benchmark FY23** | 5.8% | 1.2% | (6.2%) | 6.0% | 6.6% | (3.2%) | 6.2% | (2.4%) | (0.2%) | 1.9% | (2.5%) | 1.7% | 14.78% |
| **EGPCVF FY24** | 2.6% | | | | | | | | | | | | 2.64% |
| **Benchmark FY24** | 2.9% | | | | | | | | | | | | 2.88% |

*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 gained 2.6% in July. Our benchmark gained 2.9%. The Small Ordinaries delivered outperformance against the ASX200 for what feels like the first time in a long time. Unfortunately, the same stocks that have anchored our recent good performance stretch caused a drag in what was otherwise a good first month of FY2024.

We have commenced the process of re-opening the fund to new investments, targeting 1 January 2024 for the first intake. First order of business is getting updated pricing for our administration services, Fundhost currently provide these services to the fund and are therefore in the box seat, but as a matter of fulfilling our fiduciary obligations to unitholders, we are conducting a tender process to confirm our operational costs are as low as practicable.

The hysterical reporting and policy debacle that was Covid has massively eroded any latent trust reasonable observers had in anything produced by Government bodies or mainstream media. Unperturbed, these players spent the whole of July breathlessly reporting on various wildfires occurring through the Northern Hemisphere summer. It was interesting to read this article late in the month that looked at data on the matter. Media particularly will need to make a concerted effort to get back to reporting rather than manufacturing news if they ever again hope to be trusted.

**Portfolio Update: -**

Smartpay (SMP) and Cettire (CTT) drove the strong June quarter the fund recently delivered but were a drag on performance in July as the market attention shifted to some of the beaten down businesses that have caused the small cap index to severely underperform of late. They ended July 12.8% and 20.2% below their intra-month highs respectively and because of their large position sizing (¬20% of invested assets combined) caused the fund to underperform our benchmark despite numerous other very strong monthly performers. SMP had their AGM and the rate of terminal deployment was below market expectations, but that should have been trumped by the confirmation that 2024 will see the NZ acquiring commence and that the NZ opportunity is not confined to their own customer set.

We also reduced the carrying value of our Tellus position in July from $1.80 per share to $1.75 per share following a letter from the company pinpointing that price as a reasonable one in current conditions, given there has been no recent trading in the ”grey market”. In recent communication with Tellus management, some encouraging signs are appearing in that business as they have been running at cash-flow breakeven in the months leading into the end of financial year and will receive a significant R&D tax refund to further enhance their cash situation. For a business that is likely to need further capital, it is imperative they demonstrate the commercial bona fides of the operation to minimise the dilution required to fund the “cell 2” expansion at Sandy Ridge.

The start performer for the fund in July was Shriro Holdings (SHM), which released an earnings downgrade (.pdf) towards the end of the month only to see its share price climb about 20% afterwards. The nexus of the strong share price response was likely twofold. Firstly, they announced a 30 June 2023 cash balance of $32.8m, which at the pre-announcement valuation left an enterprise value of ~$36m. Based on the $17.6m EBITDA in the announcement, this meant the business was trading at an astonishing 2x EV/EBITDA. Management had guided that the exit of the kitchen appliances business would augment the cash balance, but the level achieved was well above the year end cash holdings most who follow the company had anticipated.

Secondly, those who follow the business understand CFO Shane Booth’s penchant for early and aggressive action in reducing costs and understand the $17.6m figure likely wore above the line expenses in shutting warehousing and making redundancies in respect of the shuttered business. The 24 March announcement of the exit of the kitchen appliance business stated the exit would not negatively impact group profitability from FY24 onwards. If this proves to be the case, ~$17.6m of EBITDA if replicated in FY2024 would likely produce an NPAT of $9-10m (we will need to see the final accounts to better understand the likely depreciation charge going forward) which even on the enlarged post-announcement enterprise value of ~$48.5m, produces a lowly ~5x multiple to NPAT. The corollary of this is a ~20% post-tax return, or a staggering pre-tax return exceeding 28%.

Even mediocre businesses usually command earnings multiples closer to 10x. The fact is that the SHM business post the kitchen appliances exit is a much better business. The core asset is the dominant Casio business, and the other assets are much higher margin and more capital light than the exited businesses. The export business has a demonstrated history of strong growth and while the BBQ market will find growth difficult in FY24, export sales will be augmented by the wider distribution of the Pizza Oven meaning export sales should still grow in FY24.

Flat earnings year on year accompanied by re-rating to 10x EV/NPAT would see about 50c added to the share price, which is ample upside to justify our current position sizing. The results announcement is likely to include a significant fully franked dividend. The franking balance at 30 June should be large enough to support a ~14c final/special dividend, despite the constant guidance on the company intention to distribute excess cash, such an announcement would likely create a fillip in the share price as certain franking credit junkies are unable to resist their siren song. This is understandable enough as franking is significantly more valuable to some shareholders compared to others. Pension phase SMSF's and charitable foundations are among this privileged group.

The other significant portfolio mover in the fund in July was Redbubble (RBL). The share price was up about 88% for the month, which serves to highlight how difficult it can be to time your way into small and micro-cap stocks.

There was nothing announced that would have caused such a massive re-rating, they won a court decision relating to copyright infringement, but litigation of such matters is very much ordinary course of business for RBL. We have been patiently waiting for accounting evidence that the largesse's triggered by the Covid revenue explosion have been dealt with seriously enough that the business will either be able to self-fund, or if equity is required it won't be prohibitively expensive/dilutive.

Such savage price moves really alter the investment calculus. If your central thesis was that a stock if it hit certain milestones was likely to triple over the next three years, that equates to a ~44% annual return. The same story after an 88% rise is reduced to a 16.8% annual return. I wrote at length in our annual report this year that good investment opportunities are seldom "missed" because the valuation has increased as there is often accompanying news that also adds to the valuation estimate. That is different in situations such as RBL in July, where nothing to change the assessed value has occurred, the business simply became 88% more expensive than it was a month prior.

People are often sceptical of such share price moves, attributing "insider information", which I feel likely occurs far less often than the average retail investor suspects. What is more likely is that a "hive mind" has arrived at a revised valuation and other structural factors (such as the end of tax loss selling) combine for a sudden movement. If you were close enough to some RBL employees to know that there had been some savage cost-cutting and combined that with the website traffic data for the June quarter (which looks pretty strong, particularly for the TeePublic business), you might arrive at the view that the turnaround has been sufficiently strong that the market pricing is incorrect, you might be willing to buy stock to profit from that view. With the market capitalisation getting down below $100m in June, it does not take too many buyers to reach for the phone to their broker to cause a sudden change in valuation.

If a take-over bid or some other corporate action were to occur in the next few weeks, this would make a lie of the prior paragraph, but the fact remains that mispricing in microcaps can be so severe that timing an entry is more art than science. If you thought RBL at 60c last December was an attractive risk/reward opportunity (after all the shares were over $7 each just 3 years earlier), less than 6 months later, you had lost half your investment. Then, with nothing fundamental announced, you are sitting on an attractive profit just one month after that.

One other interesting July announcement came from UOA Development Berhad (UOADB), the Malaysian listed 72.3% owned subsidiary of United Overseas Australia (UOS). That business has historically paid a similarly parsimonious dividend to the parent company. This is what has caused the mountains of cash to build up on both the subsidiary and parent company balance sheets.

The purse strings were opened at UOADB in July with the announcement of that company's inaugural "interim" dividend. For the past 2 years, UOADB has paid a 10 sen final dividend. They announced an interim of 20 sen, in July, which if replicated with the final dividend would see a quadrupling of the dividend year on year.

The intentions of the company in doing this will be interesting. Over the past 5 years, UOS has crept from 69.58% ownership of UOADB to 72.33% as they reinvest their dividends whilst most Malaysian shareholders take the cash. If they again reinvest, it will just be a case of the parent trying to get ownership of the subsidiary back more swiftly. If they choose to take the cash, it would be more bullish as it would imply that they have located sufficiently attractive opportunities at the parent level to want to move the cash into that entity.

UOS management has also previously stated that the dividend policies across UOADB and UOS would be mirrored, and for the past couple of years, they have been. If they reintroduce an interim dividend with the results announcement in August, the sharp increase in yield will surprise the market.

It is almost certain CS & Jim Kong will continue to reinvest their UOS dividend. The reinvestment by CS Kong of the recent dividend amounted to almost $23m! It is hard to understand how a CEO buying $22,691,978.86 (.pdf) of his own stock does not draw more attention than it does in Australian financial press, but such is the undiscovered nature of UOS.

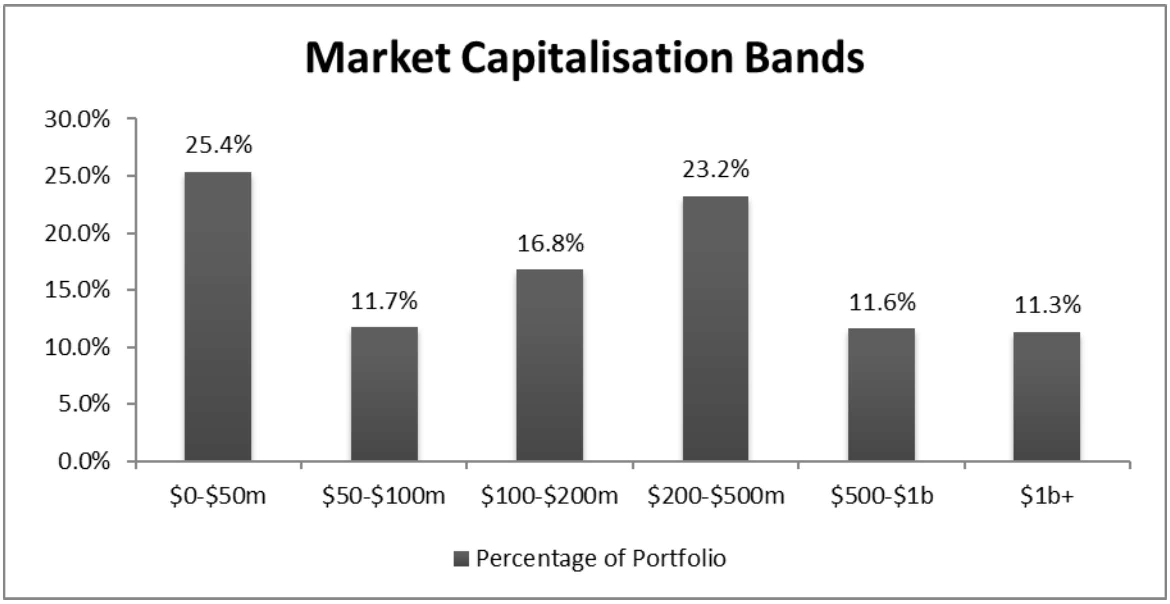
If management significantly increase the dividend at UOS and continue to reinvest, it will cause an aggressive acceleration in the rate at which management are acquiring the business from their minority shareholders. An ignorant Australian investing public are allowing this to happen, simply by having such a prodigiously profitable and wealth creating business trade at such a large and persistent discount to the NTA.

**Key Portfolio Information: -**

Our top 10 holdings on 31 July 2023 were:

| Rank | Holding | Percentage Equity Weighting | Percentage Portfolio Weighting |
|---|---|---|---|
| 1 | Smartpay (SMP.ASX) | 11.9% | 11.3% |
| 2 | United Overseas Australia (UOS.ASX) | 11.6% | 11.1% |
| 3 | Shriro Holdings (SHM.ASX) | 7.8% | 7.4% |
| 4 | Cettire (CTT.ASX) | 6.9% | 6.6% |
| 5 | Tellus (unlisted) | 6.6% | 6.3% |
| 6 | PPK Group (PPK.ASX) inc. White Graphene pre-IPO holding & PPKME | 5.3% | 5.0% |
| 7 | Blackwall Limited (BWF.ASX) | 4.8% | 4.5% |
| 8 | SRG Global (SRG.ASX) | 4.7% | 4.5% |
| 9 | SDI Limited (SDI.ASX) | 4.6% | 4.4% |
| 10 | Dicker Data (DDR.ASX) | 4.4% | 4.2% |

Our largest 5 holdings comprise 44.8% of our invested capital, our top 10 holdings are 68.5% and our top 15 represent 84.7%. Cash and cash equivalents are 5% of the portfolio. The median market capitalisation is $171m. Weighted average market capitalisation is $355m.




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] | -0.16 |
| Additional investments | Fund Closed | Sortino Ratio[1] | 0.19 |
| Applications/redemptions | Redemptions only, monthly | Annualised Standard Dev. – EGP<br>Annualised S/D - Benchmark | 18.4%<br>15.2% |
| 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 | 56.9%<br>63.9% |
| Auditor | Ernst & Young | Cumulative return[2] – EGP<br>Cumulative return[2] – Benchmark | 12.7%<br>63.1% |
| Custodian/PB | NAB Asset Services | 1-year return[2] – EGP<br>1-year return – Benchmark | 8.1%<br>11.7% |
| Responsible Entity | Fundhost Limited | 3-year annualised return[2] – EGP<br>3-year annualised – Benchmark | 0.7%<br>12.0% |
| Fund Size | $41m | 5-year annualised return[2] – EGP<br>5-year annualised – Benchmark | 1.6%<br>7.5% |
| Mid-Price for EGPCVF Units<br>Accumulated Franking per Unit | $0.8674<br>$0.0000 | Buy Price for EGPCVF Units<br>Sell Price for EGPCVF Units | $0.8687<br>$0.8661 |

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: