EGP Concentrated Value Fund

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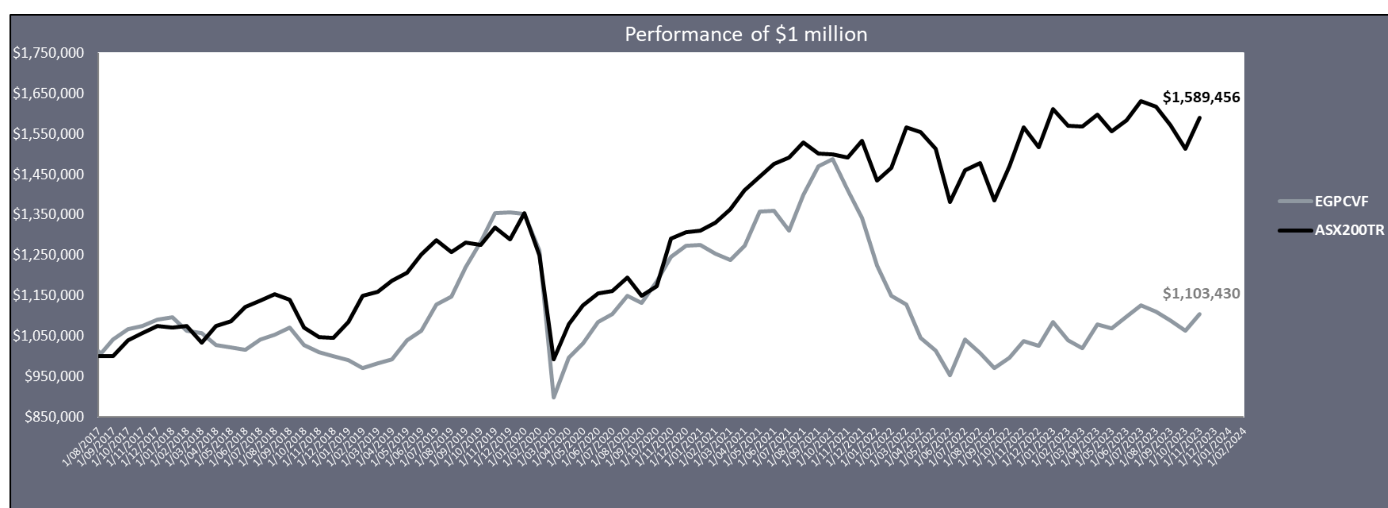
EGP Concentrated Value Fund – 30 November 2023

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%	(1.5%)	(2.0%)	(2.4%)	3.9%								0.51%
Benchmark FY24	2.9%	(0.7%)	(2.8%)	(3.8%)	5.0%								0.29%

*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 3.88% in November. Our benchmark gained 5.03%.

I will start this newsletter with a mention of the passing of Charlie Munger this month, barely a month shy of his 100th birthday. Simply one of the greatest minds I have come across in my lifetime. No book has impacted my life more than the collection of writings and speeches in "Poor Charlie's Almanack", a book which I have both gifted and lent very widely. The world is a poorer place for the loss of this fine man.

The product disclosure statement (PDS) for the fund will be reactivated sometime in December. I will send a separate email to alert investors and prospective investors when it is again active. I will explain in that communication why we have re-opened, but readers of the past few newsletters will already have a sense of my view of the deep undervaluation available at the smaller end of the ASX market capitalisation spectrum.

The underperformance by the fund this month came down to late movements in 4 positions (SmartPay - SMP, Cettire - CTT, National Tyre – NTD and SDI Limited – SDI) which I will discuss briefly in the next section. If these 4 had held their mid-month pricing, we would have instead reported meaningful outperformance for November, such is the capricious nature of the current market it was not to be. As I will outline below, the negatives that led to these price movements mostly have very little impact on the long-term value of these investments, which is what we care about.

Portfolio Update: -

The most interesting portfolio news this month came not from a market sensitive announcement, but the decision by the UOS founding directors to take the newly reinstated interim dividend as cash. I pointed out in this report a couple of months ago that the decision to pay a large inaugural interim dividend at Malaysian listed UOA Development Berhad (UOADB) could be a turning point in the capital allocation choices of the company. I mentioned it may signal an intention to accelerate the "takeover by stealth" that has been underway at both UOS and UOADB by way of the dividend reinvestment plan (DRP), but this now appears not to be the case.

We come to this conclusion by noting the September decision for UOS to take as cash the dividend payment from UOADB. The payment amounted to RM348.3m to UOS (~$113m). The parent has taken every dividend since the DRP was initiated in UOADB as shares up to that point. This has enabled our company to grow its stake in UOADB from 67.4% in 2012 to 72.3% in 2022. There are liquidity rules (public spread) on Bursa Malaysia but given their size (>RM4.2b), they are only required to ensure the parent shareholding stays below 85%, meaning they could probably keep participating in the DRP for another decade before that became a consideration.

Given it was not for public spread compliance, there were three other obvious possibilities for why they were taking the cash. The first is that the opportunity set at the parent company was better than what was at UOADB itself and the migration of cash was to accelerate these opportunities, such as the highly successful foray into Vietnam. The second was that CS & Jim Kong simply wanted some cash from their investment. Aside from their salaries, the last cash they have seen from their ~80% stake in UOS was from the capital return conducted after UOADB listed more than 10 years ago.

The third possibility is that the founders are building a cash war chest to privatise the portion of UOS they do not already own. The company is a prodigious producer of capital and the likelihood of them ever tapping capital markets is minuscule, particularly with the valuation awarded by the market being as insanely low as it is. That being the case, the inconvenience of the scrutiny that reporting as a public company creates would surely be something the founders would rather not have do, this is largely solved by taking the company private.

This dividend was the first time in more than 15 years of following the company that the founding directors were diluted by not fully participating in the UOS DRP. They were due >$23.5m from the interim dividend and reinvested only <$3m of the payment, meaning they trousered more than $20m in cash. They were issued 5,848,820 out of the 10,862,859 shares that were created by the DRP or about 53.8% of the shares issued, which is meaningfully lower than the ~80% I estimate they own collectively; hence diluted.

Should they want to conduct a buyback of the ~20% they do not own, if they were to pay NTA, it would require them to produce about $350m in cash. Readers are probably thinking "the $20m they just received from the dividend still leaves them $330m short of the required cash!". But my thinking is as follows:

1. The consolidated business had $827m cash on 30 June 2023.

2. Deconsolidation of the accounts indicates the UOS parent cash balance exceeded $100m on 30 June 2023.
3. The 20 sen dividend received post 30 June 2023 was ~$113m.
4. Less the ~$20m the directors took as cash.

These indicate to me that UOS is likely to be holding somewhere in the vicinity of $200m in cash at the parent level come 31 December 2023. If they repeat the 20 sen dividend from UOADB and UOS takes cash, that will see the cash balance exceed $300m early in 2024.

Then, to affect a takeover of the ~20% they do not already own, CS & Jim Kong would simply need to take out some form of bridging finance using the cash they have recently extracted in cash dividends from the parent as downpayment, then once they complete the takeover, they can simply extinguish that debt using the cash assets already sitting in the parent they now control completely.

If they take this path, they might be tempted to try to get the assets for less than NTA, given the steep and persistent discount to this valuation the shares trade for on market, but given how honourably they have behaved in the more than 30 years UOS has been listed, I would find it surprising if they were not fair and decent if they undertook such a transaction (particularly when considering the incredibly conservative NTA figure as I have pointed out regularly).

The DUO Tower development I discussed in the August newsletter (.PDF) will be smaller than I had posited, but the economic outcome will likely still follow the outline described in the newsletter. I have tabled the explosive growth at UOADB in “Other Income” and “Unbilled Sales” twice in the past 6 months in these newsletters. I shan’t post these tables again but will point out that other income now exceeds RM100m per quarter, up more that 50% year on year (YOY) and that unbilled sales at RM322.8m is up more than 78% YOY as the sales cadence accelerates with the larger number of new releases occurring this year. This all points to salad days ahead and would leave us a reluctant seller even at NTA should the founders follow the suggested path set out in prior paragraphs. The business is truly the type of capital compounder rarely found in public markets.

Depending on currency movements and other factors, the per share NTA for UOS will be in the ballpark of $1.14 at 31 December 2023, which is a 117% premium to the traded price at the time of writing, and even though we consider the future to be bright for UOS and subsidiaries, it would be difficult to ignore such a premium and let the traded price revert to the responsibility of the imbecilic ASX traders looking for the next Isignthis or Big Un and studiously ignoring businesses like UOS that metronomically grow assets and earnings without fanfare.

SMP traded as high as $1.50 in November, before the AGM update, which had some disappointing elements. The rate of terminal deployment held up reasonably well, with an estimated 3300 terminals deployed in the half as against ~3500 in the prior corresponding period (pcp). Given there was a significant increase in sales personnel, this was below my expectations.

What did change was the rate of churn, which meant net additions were only ~2000 in the half against almost 2900 in the pcp. The more difficult economic conditions mean more businesses are shuttering, but we temper this with managements view that they still speak for only 7% of their addressable market, so the runway remains long and lucrative. Revenue per terminal also declined marginally.

Revenues still grew +33% against pcp and normalised (stripping out the cyber/ransomware incident in June) profit before tax was up 68%. It is incredible that such figures could disappoint, but market participants have always had difficulty looking through short-term business disruptions.

The fact remains that even if the lower 2k net terminal deployment were to hold for this half and the modestly lower revenue per terminal also holds, the Australian business will still exit FY24 with a ~$92m run rate, which is more than 45% higher than the revenue figure delivered in FY2023. In my view, the current valuation is comfortably below my assessed intrinsic value of the Australian opportunity alone, the introduction of the SMP acquiring offering into the New Zealand market, which will commence in 2024 feels like an option we are being paid to hold at these levels.

CTT fell more than 10% on the last trading day of the month as the second largest shareholder conducted a block trade for 30% of their holding. Clearly, who owns the stock has zero effect on the fundamental value of the business and Black Friday trading was reputedly up almost 8% against 2023 figures, so unless CTT stumble in their execution through this critical period, strong growth should hold for the December quarter. The only constraint CTT seems to have faced is containing their growth rate to a manageable level.

Nonetheless, like every block trade CEO Dean Mintz has conducted, the share price immediately plummeted through the block trade price ($3.30) to trade as low as $2.86. It makes one wonder about the trading talents of the institutions who paid $3.30, when they allowed almost as much volume to go through the ASX the next day at an average price about 10% below what they paid. CTT traded back above the block trade price on December 1st…

NTD released an announcement that Goodyear were conducting a strategic review of the Dunlop assets the shares traded down more than 23% in subsequent days. The announcement less than two months prior they had secured the Dunlop logo had driven the reversal of sentiment for NTD. Lost in the announcement was the following line, which I think was very important "NTD also advises that YTD 1H24 earnings is on-track with 2H23 earnings". NTD earned almost 5cps of (underlying) NPATA in H2FY23. If the performance from that line at the bottom of the Dunlop strategic review announcement holds, then NTD will earn as much as 10c in FY24 NPATA per share, which makes the current price in the 70c range look very attractive. In fact, unless one thinks there is a reason earnings should fall sharply in following years, any price below $1 per share looks cheap. If the Dunlop distribution deal proceeds, in much the same vein as SMP, it feels like and option that we are being paid to hold.

SDI held their AGM and reported a meaningful (7%) sales decline against pcp. Such falls are seldom well received. The fillip in amalgam revenue that occurred in FY23 with two key competitors closing reversed and was responsible for more than 2/3 of the decline. Gross margin improvement from 56.8% - 59% if it holds for the remainder of the half would see gross profit down more modestly at ~3%. The business is not currently priced like a growth stock in any case, but it is unsurprising that investors would like to see earnings rise rather than fall.

The bulk of SDI's revenues come in the second half of the financial year, and they have released several products which they expect to create revenue tailwinds, so our hope of FY24 earnings exceeding FY23 remain, but with the dreaded "weighting to the second half" feature.

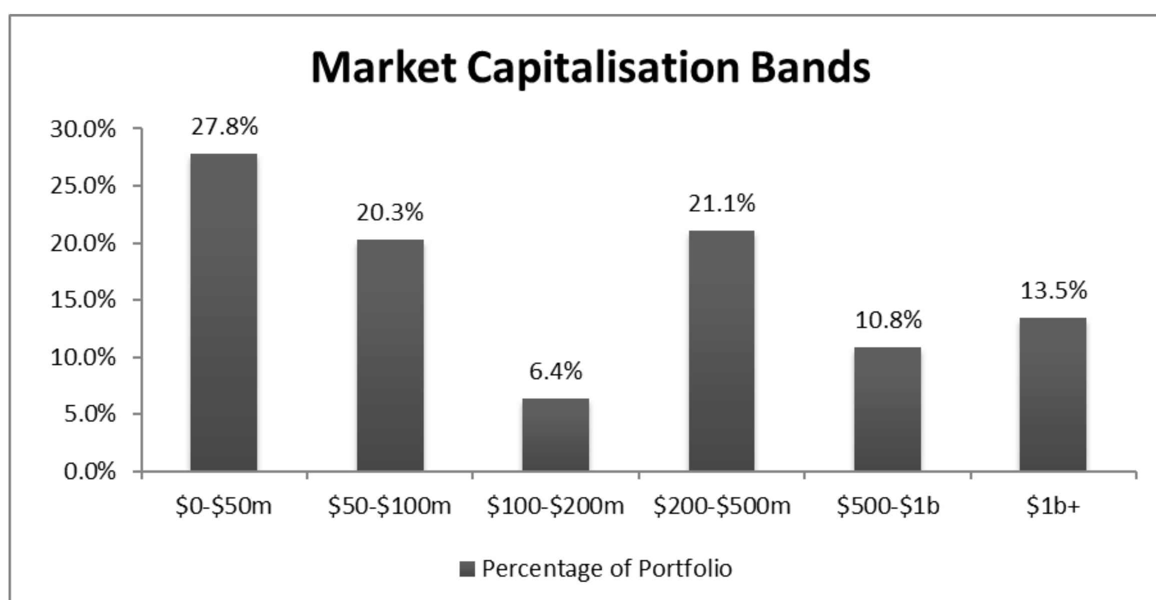
The AGM presentation set out in more detail some of the operational efficiencies the business has begun to extract with their newly expanded warehouse footprint. Even if FY24 does not show earnings growth, I remain confident that the earnings for SDI will be meaningfully higher a few years hence and if this proves correct, we should benefit from the twin tailwinds of growth in earnings per share and multiple expansion as the current valuation does not appear to price earnings growth, which I think is virtually assured.

Key Portfolio Information: -

Our top 10 holdings on 30 November 2023 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	10.8%	10.5%
2	Smartpay (SMP.ASX)	9.8%	9.5%
3	Shriro Holdings (SHM.ASX)	7.3%	7.1%
4	Tellus (unlisted)	7.3%	7.1%
5	Dicker Data (DDR.ASX)	6.8%	6.6%
6	Cettire (CTT.ASX)	6.7%	6.5%
7	PPK Group (PPK.ASX) inc. White Graphene pre-IPO holding & PPKME	4.7%	4.6%
8	Undisclosed	4.5%	4.4%
9	Blackwall Limited (BWF.ASX)	4.4%	4.3%
10	SDI Limited (SDI>ASX)	4.4%	4.2%

Our largest 5 holdings comprise 42.1% of our invested capital, our top 10 holdings are 66.8% and our top 15 represent 85.9%. Cash and cash equivalents are 3.0% of the portfolio. The median market capitalisation is $134.4m. Weighted average market capitalisation is $399m.



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]**	**-0.18**
Additional investments	**Fund Closed**	**Sortino Ratio[1]**	**0.16**
Applications/redemptions	**Redemptions only, monthly**	**Annualised Standard Dev. – EGP** **Annualised S/D - Benchmark**	**18.0%** **15.1%**
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**	**55.3%** **61.8%**
Auditor	**Ernst & Young**	**Cumulative return[2] – EGP** **Cumulative return[2] – Benchmark**	**10.3%** **58.9%**
Custodian/PB	**NAB Asset Services**	**1-year return[2] – EGP** **1-year return – Benchmark**	**6.3%** **1.5%**
Responsible Entity	**Fundhost Limited**	**3-year annualised return[2] – EGP** **3-year annualised – Benchmark**	**(4.0%)** **7.2%**
Fund Size	**$37m**	**5-year annualised return[2] – EGP** **5-year annualised – Benchmark**	**1.8%** **8.7%**
Mid-Price for EGPCVF Units **Accumulated Franking per Unit**	**$0.8494** **$0.0038**	**Buy Price for EGPCVF Units** **Sell Price for EGPCVF Units**	**$0.8507** **$0.8482**

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: