EGP Concentrated Value Fund

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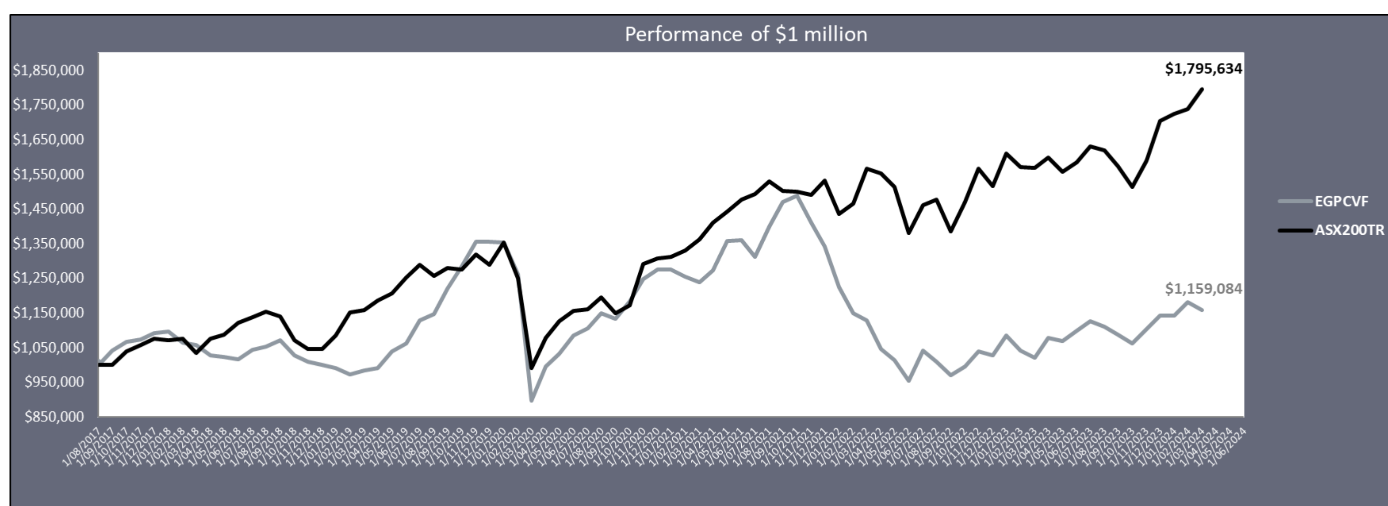
EGP Concentrated Value Fund – 31 March 2024

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%	3.6%	0.0%	3.5%	(2.0%)				5.58%
Benchmark FY24	2.9%	(0.7%)	(2.8%)	(3.8%)	5.0%	7.3%	1.2%	0.8%	3.3%				13.30%

*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 (2.0%) in March. Our benchmark gained 3.3%. Our benchmark, the ASX200 Total Return index closed above 100,000 points for the first time (100,869.62 points). Valuations for most ASX200 constituent stocks look stretched, but we began accumulating what is our only holding from the universe against which we benchmark ourselves in March. I expect to discuss that holding in coming months once it hits the targeted portfolio allocation.

The smallcaps indexes again outperformed our benchmark in March, the small capitalisation revival story appears to be holding, but unfortunately passed us by this month as we paid the price for concentration. Our 3rd, 4th, and 6th largest holdings entering March (Cettire (CTT), Dicker Data (DDR) and Shriro Holdings SHM) all hurt us this month.

CTT began the month with a founder selldown. We have previously noted repeated selldowns by CEO Dean Mintz are the primary reason we have not sized the CTT position larger. The incredible progress and enormous opportunity size of the business are both abundantly clear, why the person who knows it best is so keen to own less of it is obviously unclear (I have posited to others that perhaps he does not regard himself a billionaire until he possesses $1b in cash?). Unlike previous selldowns, the stock traded above the block-trade price afterwards. It was media articles later in the month that presumably caused some who were persuaded by the articles to sell the stock off (discussed below). CTT cost the fund ~1.4% in March.

DDR also had a founder sell-down. CEO David Dicker apparently needed funds to finalise a divorce. Given the much more proven business model of DDR (compared to CTT) it was surprising to see the market react so poorly to the selldown, but anytime almost 10% of a company changes hands in a block, it clearly will eat into some of the near-term buying appetite that was supporting price. I would anticipate the share price will be back above the levels before the block trade once the recent positive business trajectory is next confirmed. DDR cost the fund ~1.0% in March.

SHM likewise cost the fund ~0.8% in performance in March despite no news to which such a move in a positive month for the market could be attributed.

Portfolio Update: -

Tellus released another update in March (.PDF) that demonstrates the accelerating momentum in the business. In the "Capital Requirements and Liquidity" section, they mention managing budgeted projects with organic cashflows. This is good for shareholders, the more strongly they can demonstrate the commerciality of the business the higher the valuation they are likely to get when they next choose to raise equity for expansion.

As mentioned in the opening section, early in the month, there were some articles in the Australian Financial Review, that sought to throw stones at our portfolio holding CTT. The articles were so cringingly bad I will not give them credence they do not deserve by recounting them here. Nonetheless, they had the effect I am sure the writers sought when the share price was down sharply before market participants slowly realised just how baseless most of the inferences in the articles were and prices recovered somewhat.

My earliest advice to our CEO Dean Mintz was to ignore inbound interest from media. There is seldom any good can come of it, instead focus your time on things that will add value to the franchise you are building. I could not be more pleased that he continues to steadfastly ignore journalists information requests and instead focuses on creating shareholder value. We used the share price volatility to make some short-term trading gains intra-month but retain the same CTT shareholding we entered the month with.

Journalists (from the AFR especially) expect CEO's to answer their requests immediately and are prone to petulance when they do not get a reply. That you take umbrage at a CEO's failure to respond does not turn you into Joe Aston, finding genuine executive/corporate shortcomings is the pathway to good investigative journalism, throwing mud and hoping some sticks just makes you look petty.

There have been other journalists and a couple of bloggers also taking up the AFR's baton of late, but again the criticisms generally show a deep lack of understanding for how the CTT business model works. The most damning allegation I have seen so far is that the company may be overdue on remitting their sales tax to the Texan comptroller. When your business operates in dozens of countries with different duty and sales tax regimes, including the US where ~40 of the 50 states tax clothing (CTT's primary revenue generator), then from time to time having an overdue tax payment would seem almost inevitable in the ordinary course of business.

One of our smaller portfolio holdings IMEXHS (IME) raised a small amount of capital in March. We applied for enough stock to avoid dilution. In my estimation, the digital business is probably worth at least 2x the current market capitalisation. The services business had a rough 2023, but when it rebases rates to allow for the inflation that blindsided earnings in the year just gone, it will also be a profitable and valuable business. The upside if the momentum from 2023 continues is significant here, but the wide splay of possible outcomes leaves us sizing the position quite modestly (20th largest holding at present).

There were some interesting media articles about our United Overseas Australia (UOS) holding in March. The first expanded on their Joint Venture with Capitaland. The JV on Capitaland's Sycamore development is for most of the higher density elements of the project based on the December announcement (.PDF). It remains to be seen what the longer-term intentions of the JV are, but UOS have moved slowly and carefully into the project as we have come to expect of them. Their second directly owned Vietnam project will also commence in 2024 according to the update in the preliminary final report.

The second UOS update was the announcement of the 2,517 unit Bamboo Hills Residences project, which will sit "atop a 2 ½ storey retail podium, which UOA Development will own and manage" (more lovely recurring income). The project has a stated GDV of RM1.4b (~AU$454m) and confirms my expectation that 2024 will be the biggest year for project launches in a decade. The speed at which the profitability of UOS will accelerate we expect to surprise most market participants. Such is the advantage of having observed the company as a shareholder for more than 16 years.

What is now in the public domain, courtesy of the release of the annual report this month is the poultice of recurring cash-flows from the parking/rental/hotels and other sections of the business… This fast-growing revenue stream coupled with the accelerating pace of development should see earnings accelerate sharply in coming years. As to whether market participants awaken to see the incredible value creating machine that is UOS, we expect sanity at some point will prevail.

6. PROFIT FROM ORDINARY ACTIVITIES

	CONSOLIDATED	
	2023 $'000	2022 $'000
(i) Other revenues		
Rental revenue	88,917	77,737
Parking fee revenue	15,685	12,782
Management fee received	-	30
Hotel operations revenue	39,056	23,452
Dividends received from investments – other corporations	265	546
Other services	12,774	10,763
= >25%+ Year on Year	156,697	125,310

Stealth Group Revisited: -

As promised at the end of last month's newsletter, I wanted to revisit our investment thesis for Stealth Group (SGI) which I last contemplated in detail in March 2022 (.PDF). The share price has more than doubled since then and on the surface, the business performance looks to be on a trajectory below that posited in the 2022 piece. This prompted me to trim the position a little recently and to log a call with CEO Mike Arnold post the December 31st 2023 results release in February. As I mentioned in the last newsletter, after recalibrating our expectations for the business, we have ceased selling stock after our expectation for forward earnings sharply rose when we rolled our model forward.

We think the industry SGI serve is an excellent place compete, the largest competitor is the Wesfarmers owned Blackwoods, which is easily the worst business in the Wesfarmers stable. This "behemoth" of the industry speaks for a single-digit percentage of market share and generates woeful returns on capital employed. The industry make-up is reminiscent of the plumbing segment before Reece became the uber-efficient sector leader. It is simply crying out for an efficient operator to step in and do what good capitalism does, share the available efficiency gains between the best business in the sector and its customers.

The trailing 12-month (TTM) price to earnings (P/E) ratio is ~24x at the valuation at the time of writing, which is not "cheap" in comparison to the valuations of other similarly sized microcap businesses (we own multiple companies trading on less that 10x using the same calculation), but as per the rest of the piece below, it serves to underscore what a dubious valuation technique the P/E ratio can be, particularly when earnings are expected to accelerate with

significant explosiveness. Part of the reason for the newly "full" valuation is that SGI has made about 7 acquisitions and the accounts have generally had "normalisations" and it has been very hard to get a read on the true earning power of the business foundation that has been built and the veracity of the oft-stated revenue and margin targets in the out-years. These concerns have been largely answered by the cleanest set of accounts since listing (December 2023's) and the newly explained clarity of how the forecast revenue figures can be achieved.

A reading of the recent company presentation (.PDF) surfaced the fact that the $200m FY2025 revenue target had been removed/replaced with a $300m FY2028 figure. To be fair, the same document references a ~$125m revenue expectation for FY24 and a >$60m "pipeline of organic new annual revenue" for FY25, which sums to $185m meaning if these figures are taken at face, only another ~8% revenue growth is needed to hit the original $200m target figure in FY25.

Our CEO does an excellent job of explaining the investment thesis in crisp, clear investor webcasts that are held a few times each year. The last one is linked in this announcement (.PDF). The $200m revenue target was affirmed in this presentation and an 8% EBITDA margin target was also affirmed. The main aspect of the pathway to the ~60% revenue uplift that would be required in FY25 to get near the $200m revenue target is described at around the 6-minutes 40 seconds mark of the presentation. Most of the revenue is expected to come from consolidating 3 main suppliers who currently directly supply >50 independent stores in the SGI "buying group" with the revenue instead being directed via SGI. This aims to create a win/win/win situation, whereby the suppliers get to deal with a single customer, of more secure financial status rather than >50 micro-stores, the stores likewise consolidate more of their buying through a single source and SGI get to add scale, which is critical to the success of any distribution business.

To get a sense of the "step-change" in revenues and earnings coming, the TTM revenue at the half was $115m and EBITDA was $5.8m for a little over 5% EBITDA margin. I frequently talk about "operating leverage" as being key to good business models, the report for the half shows that in spades (modest growth at the revenue line led to much higher growth rates down the P&L):

Year ended 31 December ($m)	1H FY24	1H FY23	Var %
Revenue	56.5	52.4	7.8%
Gross Profit	16.6	15.2	9.3%
Earnings before interest, tax, depreciation and amortisation	2.8	2.3	23.7%
Earnings before interest and tax	1.4	0.8	71.3%
Profit before tax	0.7	0.3	121.0%
Net profit after tax	0.5	0.3	49.1%
Basic earnings per share (cps)	0.45	0.31	48.4%
Return on capital employed (%)	11.8%	6.6%	77.3%

Because the ~$60m of revenue that is expected from the "centralised buying" activities, the gross profit of the business will be significantly reduced from the almost 30% level currently being achieved. With that said, the incremental cost required to service this lower margin revenue will be modest, creating management's confidence that EBITDA margins comparable to the 8% targeted for the rest of the business can be achieved from the "centralised buying". This new revenue will also have a meaningfully lower inventory and working capital impost.

My estimate of the impact of putting the stated FY25 revenue and EBITDA margin targets into the P&L indicate the arrival of operating leverage into SGI's reports is likely to be a permanent and perhaps accelerating feature of future reports:

	FY23	FY24*	Var%	FY25**	Var%
Revenue	$111m	$122.5m	+10.4%	$200m	+60%
Gross Profit	$32.6m	$36.1m	+10.5%	$48.5m*	+34%
EBITDA	$5.5m	$7.1m	+29.1%	$16m	+125%
EBIT	$2.6m	$4.1m	+57.7%	$12m	+193%
PBT	$1m	$3m	+200%	$10m	+233%
NPAT	$0.7m	$2.1m	+200%	$7m	+200%
EPS (cps)	0.6cps	2.1cps	+250%	7.0cps***	+250%
ROCE (%)	5.8%	12.7%	+119%	~26%****	+105%

*My forecast

** Based on $200m @ 8% EBITDA

***Assumes no dilution, though the company may well recommence its acquisition program given the more sensible recent share price

****Estimates an inventory/working capital impost of ~$20m to service the revenue growth, mostly debt funded.

The tabled quantum of earnings growth indicated above is so massive as to be almost inconceivable. The approximate tripling of earnings from FY23 to FY24 to be followed by another tripling into FY25! If anything remotely close to this were achieved, the shares would likely trade for at least 20x earnings, which implies a truly ridiculous $1.40 valuation around 18 months hence, which is a more than 5-fold valuation gain. Whilst acknowledging the inconceivability, we must likewise point out that portfolio holding CTT has seen its share price rise approximately 5-fold over the past 18 months, so such a move in valuation if business conditions support it is not without precedent.

The FY25 outcome above sets out the company's "target", if we were to assume they managed "only" to get halfway there on the revenue (i.e. only ~$30m of the targeted $60m of "centralised buying" is achieved) and to "only" get to 7% on EBITDA margin, the figures would look more like:

	FY23	FY24*	Var%	FY25**	Var%
Revenue	$111m	$122.5m	+10.4%	$161m	+31%
Gross Profit	$32.6m	$36.1m	+10.5%	$41.3m	+14.4%
EBITDA	$5.5m	$7.1m	+29.1%	$10.5m	+48%
EBIT	$2.6m	$4.1m	+57.7%	$7.5m	+83%
PBT	$1m	$3m	+200%	$6.0m	+100%
NPAT	$0.7m	$2.1m	+200%	$4.4m	+110%
EPS (cps)	0.6cps	2.1cps	+250%	4.4cps***	+110%
ROCE (%)	5.8%	12.7%	+119%	~19.5%****	+54%

*My forecast

** Based on getting halfway to the FY25 $200m @ 8% EBITDA target

***Assumes no dilution, though the company may well recommence its acquisition program given the more sensible recent share price

**** Estimates an inventory/working capital impost of ~$12m to service the revenue growth, mostly debt funded.

This quantum of growth would still likely see the business awarded a decent P/E multiple, perhaps 16x, which still implies a 70c share price and just shy of a tripling in valuation over the next 18 months if achieved. The calculations set out in the preceding tables will give unitholders a sense of why we recently ceased trimming our SGI position.

The fact is, we seldom look only 18 months forward with our models (as the above tables do). My investing "base case" for my view of the low end of fair value of SGI using a 5-year outlook assumes they fall well short of the $300m FY28 target, getting only to $250m by FY29. And fall well short on EBITDA margin, getting only to 6.5% (very conservative at that scale!).

These figures would generate $16.25m EBITDA in 5 years. If we further assume there is a 30% increase in equity to fund some acquisitions and net-debt roughly triples to ~$15m with these extra costs and also assuming the current cost discipline weakens, the business would generate ~$6m of NPAT, at a modest 12x P/E multiple (modest for a business that had averaged 17.5% EPS CAGR for the previous 4 years), the implicit share price is ~55.5c. From 25c to 55.5c in 4 years is a 22.1% equity CAGR, ignoring the dividend management have committed to commencing at the end of FY24.

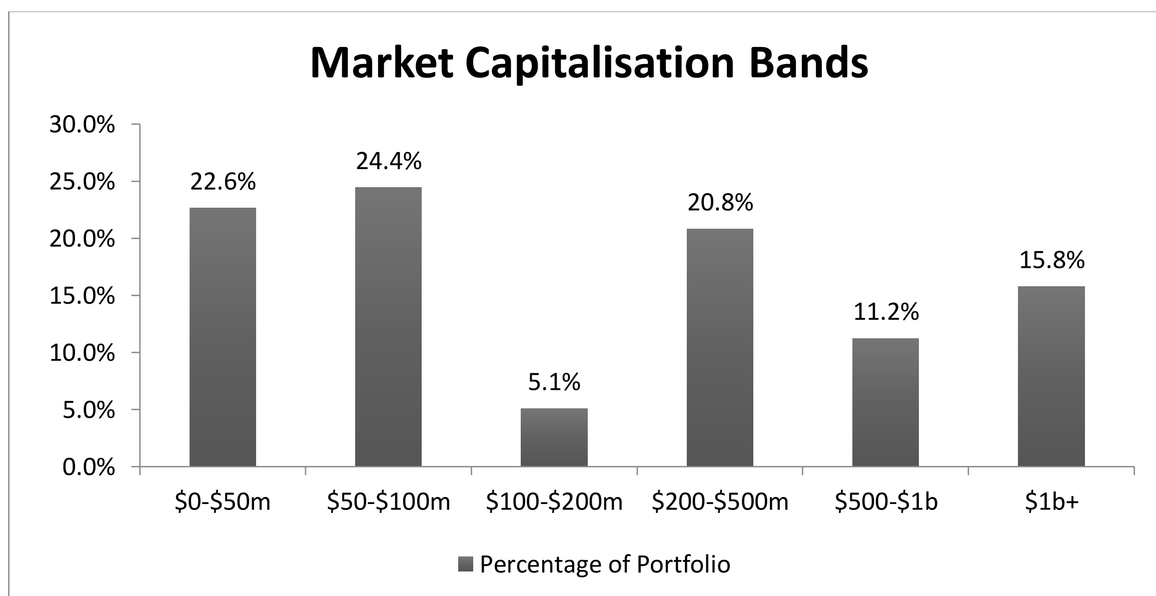
Business is unpredictable, but with I estimate the outcome described above is an ~80% confidence interval, with the bottom end of our expected IRR over 5-years is >20%. Usually, we target a >20% CAGR at the mid-point of our range. The scale of the expected portfolio return would ordinarily see us scale SGI to our largest position. Because of the small size of the business (we already own >7% of the outstanding equity) and its illiquidity, we will not do that, but I do think it is highly probable that SGI becomes the largest holding in the fund sometime within the next 2 years if the future resembles any of the scenarios contemplated above.

Key Portfolio Information: -

Our top 10 holdings on 31 March 2024 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	11.2%	10.7%
2	Smartpay (SMP.ASX)	9.7%	9.2%
3	Cettire (CTT.ASX)	7.8%	7.4%
4	Tellus (unlisted)	7.3%	7.0%
5	Dicker Data (DDR.ASX)	6.3%	6.0%
6	Shriro Holdings (SHM.ASX)	6.0%	5.8%
7	Stealth Group (SGI.ASX)	5.5%	5.2%
8	SDI Limited (SDI.ASX)	4.8%	4.6%
9	Matrix Composites (MCE.ASX)	4.8%	4.6%
10	PPK Group (PPK.ASX) inc. White Graphene pre-IPO holding & PPKME	4.4%	4.2%

Our largest 5 holdings comprise 42.3% of our invested capital, our top 10 holdings are 67.8% and our top 15 represent 85.3%. Cash and cash equivalents are 4.6% of the portfolio. The median market capitalisation is $145.3m. Weighted average market capitalisation is $535m.



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	$50,000	Sharpe Ratio[1]	-0.15
Additional investments	$500k Maximum	Sortino Ratio[1]	0.19
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	17.7% 15.0%
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	56.3% 63.8%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	15.9% 79.6%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	13.7% 14.5%
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	(2.2%) 9.6%
Fund Size	$38m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	3.4% 9.2%
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.8922 $0.0058	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.8936 $0.8909

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.

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This report contains some forward-looking statements which reflect the expectations of EGP about the prospects of companies held within the portfolios of the funds. While EGP considers its expectations to be based on reasonable grounds, there is no guarantee that those expectations will be met. Actual performance of the portfolio companies will be impacted by a variety of factors, including circumstances that cannot be foreseen, and could differ significantly from the expectations of EGP. These statements should therefore not be relied upon as an accurate representation or prediction as to any future matters. Where portfolio companies do not perform in line with EGP's expectations, the funds could be adversely impacted.

Appendix 1: -

Combined funds cumulative return since inception: