EGP Concentrated Value Fund

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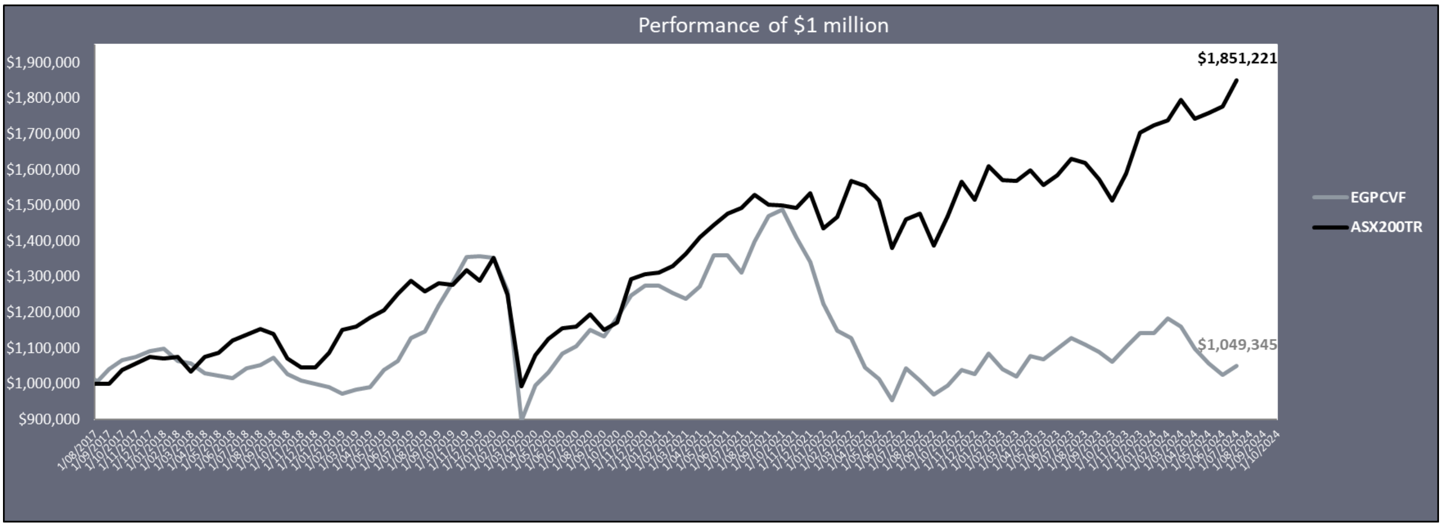
EGP Concentrated Value Fund – 31 July 2024

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%)	(5.2%)	(3.9%)	(3.0%)	(6.69%)
Benchmark FY24	2.9%	(0.7%)	(2.8%)	(3.8%)	5.0%	7.3%	1.2%	0.8%	3.3%	(2.9%)	0.9%	1.0%	12.10%
EGPCVF FY25	2.4%												2.44%
Benchmark FY25	4.2%												4.19%

*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 2.4% in July. Our benchmark rose 4.2%.

Portfolio Update: -

July was an interesting month for equities. On 10 July, there was a sudden divergence in the performance of US small-caps and large-caps. Over 5 trading days, the Russell 2000 index (the most followed small-caps index in the US) outperformed the NASDAQ by 11.6% and the S&P500 by 8.9%. This was apparently the largest 5-day divergence in history. As I draft this newsletter (29 July), the divergence in the 12 trading days since the 10 July close between the Russell 2000 and the NASDAQ stands at 18.14% (RUT +10.15% and NDX -7.99%).

Such an environment should naturally flow on to the Australian market one would expect given the global inter-connectedness of equity markets. At the time of drafting this newsletter, with three trading days to go, the Small Ordinaries was underperforming the ASX200 by 1.1% in July. The buyers strike at the small end of the Australian market seems to be ongoing…

The performance of individual stocks within our portfolio was also volatile in July, there is clearly extreme difficulty at the small-cap end of the market with sensible price discovery at present. PPK Holdings moved from 38 cents per share (cps) to 42cps (+10.5%) via an intra month high of 85cps (+124%). Cettire went from $1.17 to $1.325 (+13.2%) by way of $1.81 (+54.7%). As an aside, the results of global luxury goods purveyors announced in July gave enormous credence to the CTT's management's claims that the June quarter was simply a weak one for global luxury goods demand. As much as the "look Ma, I did a jernalism!" "journalists" and bloggers that have cast aspersions on the CTT business model might like to claim responsibility for the recent fall in the Cettire share price, it is clearly more a macroeconomic matter, with the AU$180b that has been wiped from the valuation of LVMH (Louis Vuitton-Moet Hennessy) since March roughly 200 times the loss in value that has occurred at Cettire. LVMH revenues were reported to grow at 2% when they reported their June half results this month, whilst Cettire's growth rate "slowed" to ~78%...

The quantitative component of the portfolio remains at a little over 3% and performed poorly in July, down 5.1% (hurting monthly fund performance by ~0.2%). The Australian quant positions were profitable, especially ZIP Co Ltd (ZIP) which was the best quantitative performer at +30.8% and the Australian quantitative element +9.2%, but among the US quant positions, several hurt, but especially Crowdstrike, whose mid-month software update caused a massive global computer outage and unsurprisingly the shares were down 39.4% leading the US quantitative element down ~13%.

Late in June, we exited our unlisted position in Tellus Holdings. Tellus is a geological repository operator that isolates complex wastes in a 300-million-year-old, geologically stable kaolin clay bed. I have been enormously bullish on the prospects of the business, but the delivery of commercial outcomes has been frustrating and much slower than managements original projections. Approximately breakeven EBITDA in FY23 was followed on with ~$25m of EBITDA in FY24 and expectations of $40-50m in FY25 indicating commercial traction has finally taken place. Unfortunately, with the recent poor performance of the fund, the position had become uncomfortably large and without any clear near-term liquidity event, when we were offered the opportunity to exit the holding at our carrying value, this seemed a prudent decision.

As exceptional as the upside is for Tellus, as I outlined in the investor calls that took place in July, similarly bullish upside can be demonstrated for most of our largest listed positions, and they have the advantage of being able to be liquidated with far fewer limitations if required.

Smartpay released an update in conjunction with their AGM presentation that indicated terminal deployments had re-accelerated from the slower growth reported in the second half of last year to a similar rate to this time last year. Under the weak prevailing economic conditions this speaks incredibly favourably of the SMP business model. SMP added 2700 acquiring terminals in FY23 and reported +700 in the first two months of FY25, implying a 56% increase in deployment rates year-on-year if the first two months were to be representative of the full year. Management also confirmed the NZ acquiring rollout will begin in the second half, if deployments match the bottom end of managements projections, the NZ acquiring business will be the same size as the current Australian acquiring business within about 3 years. This should see group revenues grow something in the order of 2.5x over the next 4 years. If as I expect, operating costs grow at roughly half that rate, the bottom-line result will be explosive profit growth.

Dental products manufacturer SDI Limited released a trading update early in the month that should have been paid more attention. After earnings were flat in FY23, SDI have announced FY24 saw NPAT +>40% in FY24. This is why we try hard to look through a weak period as an investor, very few businesses grow in a straight line. This significant profit uplift was achieved despite the business being mid-transition between two operating premises and in the face of a significant loss of the amalgam cash cow as that business slowly dies. The step-change in operating efficiency once the move is complete should ensure the next decade is even better than the past, implying the business should eventually trade at a higher multiple than it did a decade ago.

Over the past decade, SDI has grown revenues and earnings by about 70% without issuing a single share, whilst paying out about half of earnings as dividends. 10 years ago, their shares traded at an undemanding 13x earnings. Today their shares trade at around 10x earnings. 70% profit growth over 10 years paying out half of earnings represents >100% return in a decade if the multiple had remained the same.

By way of comparison, CBA has grown per share earnings over the past 10 years by about half of SDI's growth (34%). They have paid out a more generous dividend, about 80% of earnings, but their earnings multiple has grown from around 17x to about 22x. This is representative of the odd operating/pricing dynamic in the smallcap/largecap universes. Despite growing half as fast as SDI, CBA has seen a ~30% multiple expansion over the past decade. Despite growing EPS twice as fast as CBA, SDI has seen an approximately similar contraction in their earnings multiple.

The total shareholder return for CBA has been much better, but had multiples remained constant, SDI would have been a much better investment. It is axiomatic in investment markets that over a long enough timeline, a business that grows its earnings per share faster than another business will see its valuation reflect this fact (absent some major difference in working capital needs/payout ratios etc). Ordinarily, the reasonable market participant would expect a decade to be a long enough period, provided starting multiples were sensible (which they were in this case).

My expectation for SDI is that the next decade is likely to see an acceleration in EPS growth compared to the decade just passed. The market opportunity they are addressing is large, their ability to access the opportunity proven, and the operating constraints at their current facilities are very real. There is no such reason to believe the next decade for CBA will be better than the last decade has been, the environment looks highly likely to be much more challenging for banking over the next decade than the last has been, higher rates are already crimping economic activity and compression in NIM (net interest margin) is anticipated.

Finally, as August begins, there has been a continuation of the fall in global equities that began globally in mid-July, with the NASDAQ having entered "correction" territory, down >10% from recent highs. The Australian market is down a little over 5% from the all-time high set on 1 August. The Japanese Nikkei index has been hardest hit, reacting very poorly to a modest rise in interest rates. That index entered a bear market (down >20%) in only 15 trading days since its recent high. The speed at which equities markets can move is truly breathtaking. Warren Buffett claims not to "time the market", but news in July indicated Berkshire Hathaway liquidated >US$75b of stocks in the June quarter leaving them holding more T-Bills than the US Federal Reserve! That move is looking very prescient early in the next quarter and the resulting cash pile would be large enough to buy all but the top 25 companies in the S&P500 outright (ignoring the required takeover premium).

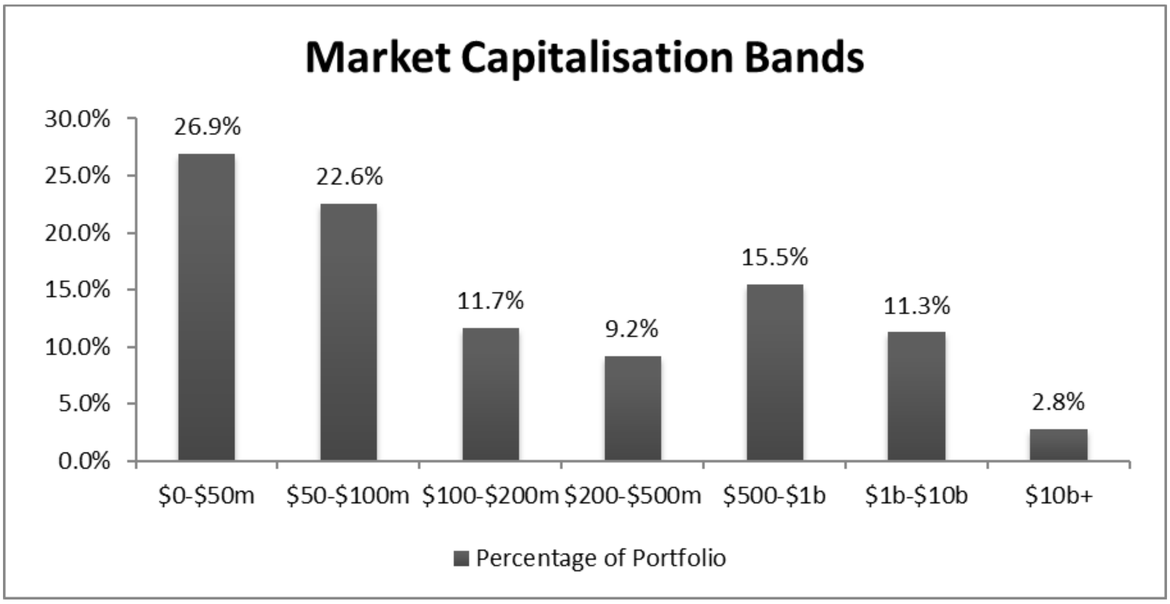
What should determine our August returns will be most of our holdings reporting their annual results. There are a number we expect will surprise market participants to the upside, with Matrix Composites (MCE), Dicker Data (DDR) and Stealth Group (SGI) among our largest holdings where recent trading feels like it is not anticipating the same results our modelling expects.

Key Portfolio Information: -

Our top 10 holdings on 31 July 2024 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	12.3%	11.8%
2	Smartpay (SMP.ASX)	9.2%	8.9%
3	Dicker Data (DDR.ASX)	7.7%	7.4%
4	Shriro Holdings (SHM.ASX)	7.6%	7.4%
5	Stealth Group (SGI.ASX)	6.3%	6.1%
6	Matrix Composites (MCE.ASX)	6.2%	6.0%
7	SDI Limited (SDI.ASX)	5.9%	5.7%
8	PPK Group (PPK.ASX) inc. White Graphene pre-IPO holding & PPKME	5.5%	5.4%
9	Blackwall Ltd (BWF.ASX)	4.6%	4.4%
10	Cettire (CTT.ASX)	3.8%	3.7%

Our largest 5 holdings comprise 43.0% of our invested capital, our top 10 holdings are 69.0% and our top 15 represent 84.7%. Cash and cash equivalents are 3.2% of the portfolio. The median market capitalisation is $107.2m. Weighted average market capitalisation is $3.3b.



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]	0.05
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D – Benchmark	17.5% 14.7%
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	54.8% 64.3%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	8.2% 83.3%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	(6.9%) 13.5%
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	(7.2%) 7.4%
Fund Size	$29m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	(1.4%) 7.5%
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.7823 $0.0000	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.7835 $0.7811

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.

Appendix 1: -

Combined funds cumulative return since inception: