EGP Concentrated Value Fund

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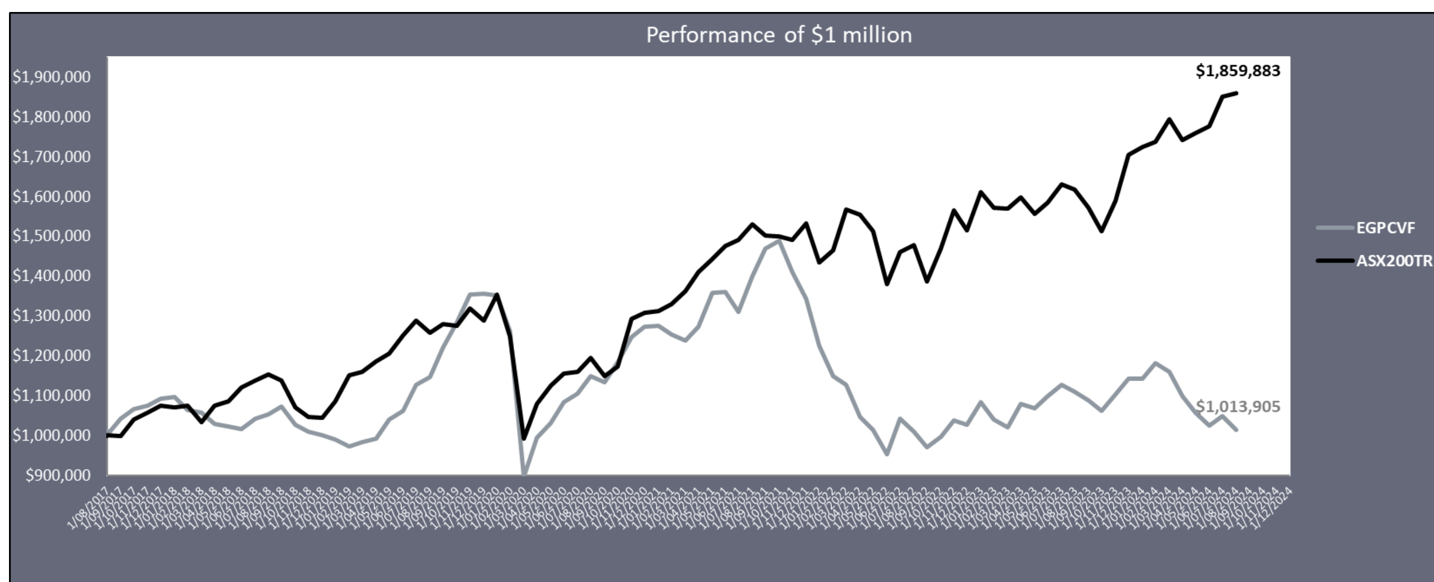
EGP Concentrated Value Fund – 31 August 2024

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%	(3.4%)											(1.02%)
Benchmark FY25	4.2%	0.5%											4.68%

*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 3.4% in August. Our benchmark rose 0.5%. We wrote down our unlisted investment in White Graphene in August. The commercialisation process has been much slower than forecast at the last capital raising (the previous carrying price), until there is some real evidence of commercial traction, prudence requires a more realistic valuation. The carrying value for Scout Security Limited (SCT) has also been held at a modest discount to the recent capital raising pricing, given the ongoing listing suspension. On the positive side, most of the unit price fall reported in August has been recovered in the first few days of September as investors came around to our way of thinking on a few of our holdings.

Portfolio Update: -

Aside from the White Graphen/SCT write downs, the portfolio was otherwise modestly positive through the month, though with many ups and downs, some of which are discussed below in the portfolio section. The Small Ordinaries again underperformed the ASX200 by about 2.5% for the month!

The proportion of the portfolio dedicated to positions I have selected from the pool of ideas generated quantitatively has grown to 4.9% at the end of August. The absolute performance of quantitatively generated Australian exposures was 5.71% in August, the US exposures were up 7.91%. Unfortunately, the AUD strengthened by more than 3.5% in August meaning the (unhedged) result for our total exposure to these positions was only +4.56% for August, adding almost 0.3% to the reported fund performance. All algorithmic positions are listed in a table below.

What Makes a Market: -

One of the things I taught my children is that to be successful in debate you should ideally understand and be able to argue your opponent's position better than they do. There have been many iterations of this assertion through the ages, but most seem to derive from the quote attributed to Plato "True dialogue requires us to see our opposite at his best.".

This mental exercise also informs how I try to think about investing. The sum of the views of all investors is what makes a market, so it is prudent to contemplate what might be going through the mind of the investor who sees your holding and thinks "why would you own that?".

If someone were to hold the diametrically opposed view on a holding of ours, I try to understand how they would come to that position. For some of our holdings, the argument is relatively simple. I hear the case for our largest holding, United Overseas Australia (UOS) regularly. It can be distilled to two elements, "what will ever cause the business to trade closer to the true value of its assets?" and "as long as the founders treat the share price with such contempt, it is un-investable".

When I discovered UOS during the GFC, they had just reported a $10.8m profit for the June half of 2008 and had annualised operating earnings (i.e. excluding property revaluation gains) of around >3cps and attributable NTA of about $225m (~27cps). In the panic of the GFC, the share price had been beaten down from around 30 cents per share (i.e. trading just above NTA) to just above 10cps. My average purchase price for UOS in 2008 was ~12.5cps (below half of the hard asset value) and a mid-single digit multiple of the operating earnings.

Fast forward through the 16 years I/we have owned UOS and the original shares purchased for ~12.5c in late 2008 have paid out 34.6c in dividends and are now selling for 55cps. This amounts to a pre-tax IRR (internal rate of return) of around 20% annually for the 16 years. Higher if you elected to take the DRP.

After the June 2024 half, attributable equity has grown to $1715m (up >7-fold in 16 years) and the operating earnings (i.e. excluding revaluation gains) over the 6 months to June were ~$34m (up >4-fold in 16 years despite development revenues being at the lowest point in the company's listed history). This is a much bigger, more profitable and stable business than it was 16 years ago on any metric you care to measure and yet I can still buy it for half NTA, around where I could as a microcap in the middle of the greatest financial panic of our lifetimes. So the answer to the first question "what will ever cause the business to trade closer to the true value of its assets?" is "The operational performance of the business over the past 16 years has been good enough to earn a 20% IRR with the price to NTA and earnings multiples staying at around GFC levels" any closure of the share price and the book valuation can simply be viewed as a valuation kicker to a business that is already operationally spectacular.

As to the answer to the second statement I hear when discussing UOS with other investors "as long as the founders treat the share price with such contempt, it is un-investable", I understand the sentiment, but returns over any reasonable holding period speak for themselves. It is incredible to think what this business could have been if the founders had a better understanding of capital markets and had used the frequent price-value dislocations of UOS to further enhance the outstanding operating performance of the business, by extinguishing shares on issue when valuations were low.

The "coiled spring" of future earnings continues to tighten for UOS. Unbilled sales at UOADB have grown from RM123.9m two years ago to RM368.7m at 30 June 2024, with few major project launches. The 9.8-acre Bamboo Hills megadevelopment launches this quarter and will cause an immediate acceleration in sales. The project is slated to complete in 2029, but revenues and profits will be progressively recognised over the next 5-years. Lost in the re-building of unbilled sales volume is the fact that "other income" from rentals, parking, hospitality etc is up 77% over the past two years. When development income joins that party, readers of this newsletter will not be able to claim not to have been fore warned.

Another of our larger holdings which has an "easy to make bear case" is Bathurst Resources (BRL). In fact, the ASX itself may have made the case in early August (.PDF) by questioning whether calling the cash balance that is locked in the 65% BRL owned BT Mining JV "consolidated cash" is reasonable given they cannot at their discretion access the money, both JV partners must agree.

The timing of value realisation is the core argument against owning BRL. In much the same way as the UOS example above, you cannot realistically criticise the operational performance. The business has grown the share of cash it owns (even if the timing of its access is arguable) from NZ$76m 2 years ago to NZ$140.7m at last report, despite investments into its own operations, plus some expenditures to grow reserves by acquiring/developing other assets. With the recent further falls in the BRL share price, plus the cash generated since the last date of cash reporting, it is highly likely the business now has a negative enterprise value (EV), i.e. that BRL's share of cash is now worth more than the market capitalisation of the business. You are effectively being gifted a business that grew its cash balance by ~NZ$70m in the past 2 years.

BRL has had their share of challenges, not the least of which is a recent collapse in the rail tunnel that is their primary logistics pathway (they will ship by road at slightly reduced volumes until the tunnel is repaired), but the value of a business is supposed to be the discounted value of all future cash that could be taken from the business for the remainder of its life. The current negative EV for BRL is clearly and egregiously incorrect unless management somehow take this prodigiously profitable business and turn it loss-making, or coking coal prices collapse. Given the demonstrated steady operational hand of BRL management and the grossly undersupplied metallurgical coal market, this seems highly unlikely.

The UOS/BRL cases are mostly what you might call "impatience arbitrage", something that I did very successfully in the early years of the fund, but which has cost us dearly in the past few years. Market participants are usually focused on the next 3/6/12 months and if you could keep your eyes a little further out, you used to be able to do very well. Impatience arbitrage has been a horrible trade for the past five or six years.

Another portfolio example of market participants looking at cyclical trough earnings and forgetting about the position in the cycle comes from NTAW Holdings (NTD). The past couple of years have been very poor for the business as they have been caught by a combination of negative factors including freight costs, higher oil prices and disadvantageous currency movements to name a few. Combine this with the decision to add significant borrowings to the business to make acquisitions and the earnings have been poor for the past two years. The market is supposed to be forward-looking and the underlying earnings of ~3cps in the June half will be augmented by a full year's contribution of the Dunlop distribution deal. The forecast FY2025 EBITDA range of $47-50m implies NPAT in the $9-11m range, which is a lowly P/E ratio of ~5x. Even if we incorporate the significant net-debt into the calculation, it is still an undemanding P/EV of ~10x.

The explanation for a weak share price response to the earnings derives from the company itself making the "sellers" case, mentioning upcoming capital calls to fund the Dunlop working capital, NZ warehouse expansion, CAPEX and to replace capital used to fund "the Brooklyn retread factory and the Wingfield retail store". That the company has so clearly drawn attention to these capital needs will cause the share price to anchor at a low valuation until the funding pathway is clearly resolved. The board hold more than 30% of shares on issue, so we at least know they will endeavour to find the capital in the least dilutive way. The company obviously "over-earned" in FY2021 with NPATA of ~$21m, but it's clearly "under-earning" at ~$6m of run-rate FY2024 NPATA. The question investors need to satisfy themselves of is what are the reasonable "mid-cycle" earnings? My central thesis is that over the next decade, if the company were not to make any further acquisitions, it should be capable of earning ~$120m post-tax. Anything remotely like this would make the current market capitalisation of around $50m an incredible mispricing.

I noted Matrix Composites (MCE) was one of the portfolio companies reports I was most looking forward to in last months newsletter. Market participants in this case have managed to "look through" the 6 months just completed. In isolation, the period was spectacular, ~$58m revenue, ~$10.4m EBITDA and $7.2m NPAT. If they could be annualised, those are staggering numbers that would leave the ~$55m EV business with an EV/EBITDA of 2.6x and P/EV of 3.8x.

Unfortunately, work in hand has shrunk from $84m to $33m over the same 6-month period, leaving followers of the business (understandably) sceptical about the repeatability of the half. Management flag ~$300m of quotes submitted and ~$200m of upcoming quotations. If their historical win-rates hold, FY2025 results would likely beat FY2024, which would make the current valuation very attractive. I like to remind myself that MCE operate in the same facility that averaged >$155m per year revenue through FY2011-2014, and as guided by management can support a revenue base exceeding $200m annually. The half just completed annualising ($116m revenues) is a live possibility if they happen to

win much of the work they have currently bid. At this tiny valuation, very little needs to go right for us to do very well from here.

The Dicker Data (DDR) report was poorly received. It marked a return to revenue growth (+>8% QoQ), but management have not been able to mitigate costs in the inflationary environment. The operating leverage DDR shareholders have become accustomed to was missing in the report. Staffing costs were quite well controlled, but with meaningfully higher interest rates and temporarily bloated working capital, finance costs did most of the damage +86% year on year. The return to growth makes it clear the much anticipated "PC refresh" cycle has begun, which will put a tailwind behind revenues for the next year or more. DDR remains an exquisitely well managed business in a segment with massive structural tailwinds. One need not look too far forward to imagine a business with considerably higher earnings than are currently being generated, despite DDR remaining among the more fully valued positions in our portfolio, it would only require a modicum of perceived traction for the share price to trade meaningfully higher than it has recently.

Finally, mention must be made of what is consistently the most "exciting" position in the portfolio, Cettire (CTT). CTT's results were pre-guided, so the market reaction to the result was always going to be driven by the first 8 weeks trading and outlook. CTT's investor presentation indicated sales were running ~20% above the same period last year, despite reining in marketing spend. This flies in the face of most of the major luxury brands that are either flagging year on year declines, or low single-digit growth. Even the dominant "grey market" player in China, Dewu only grew sales by 11% in the June half as compared to the 78% reported by CTT.

CTT stock sold off hard post the result, closing the month at $1.05 per share before rallying nearly 60% in the first couple of trading days in September as rumours swirled that CEO Dean Mintz was buying stock. These rumours proved correct as he announced he had spent $15.8m acquiring the maximum he is entitled to under "creep provisions" without making a formal takeover bid (3%). Some of the idiot commentariat that had pilloried Mintz for his stock sales worked hard to find a negative spin to put on his decision to buy. I am more inclined to take the view of investment great Peter Lynch on the decision - **"insiders might sell their shares for any number of reasons, but they buy them for only one: they think the price will rise."**. No one is likely to torch ~$16m to temporarily "prove haters wrong", if the company is the basket-case many pundits seem to think, no one would know this better than Mr Mintz and he is unlikely to throw away such a meaningful sum of money in vain.

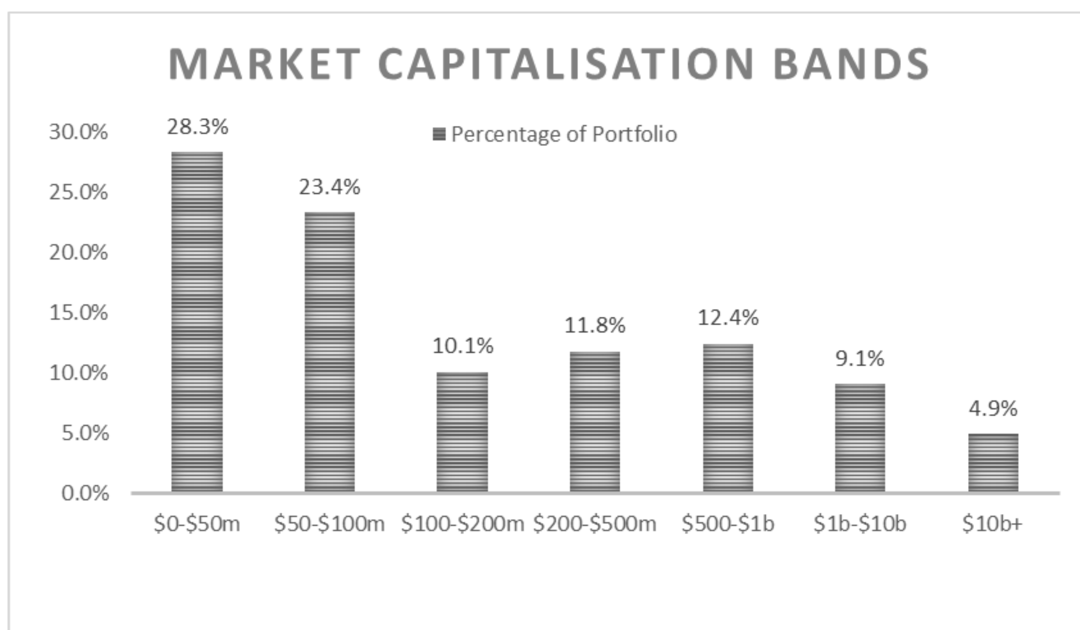
In the meantime, the company continues to grow at multiples of luxury goods system growth and remains a market share "minnow" with years of prospective above system growth ahead if they can continue to delight their customers. More than 1 million orders were placed in FY2024, if there was not a value proposition, a business of that scale could not have been built in a few short years.

Key Portfolio Information: -

Our top 10 holdings on 31 August 2024 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	12.4%	11.5%
2	Smartpay (SMP.ASX)	9.0%	8.3%
3	Stealth Group (SGI.ASX)	8.1%	7.5%
4	Dicker Data (DDR.ASX)	6.8%	6.3%
5	Shriro Holdings (SHM.ASX)	6.7%	6.2%
6	SDI Limited (SDI.ASX)	6.3%	5.9%
7	Matrix Composites (MCE.ASX)	6.0%	5.5%
8	Quantitative Positions*	4.9%	4.6%
9	Blackwall Ltd (BWF.ASX)	4.3%	4.0%
10	PPK Group (PPK.ASX) inc. White Graphene pre-IPO holding & PPKME	4.1%	3.8%

Our largest 5 holdings comprise 43.0% of our invested capital, our top 10 holdings are 68.6% and our top 15 represent 88.3%. Cash and cash equivalents are 7.1% of the portfolio. The median market capitalisation is $99.1m. Weighted average market capitalisation is $5.6b.



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

*Quantitative Holdings:

Stock	Country	Result	Stock	Holding	Result
360		12.9%	CTAS		6.0%
PME		4.1%	NTRA		14.7%
PNI		6.2%	HWM		0.1%
TLX		(1.1%)	THC		10.3%
APP		18.5%	ISRG		11.1%
AVGO		3.4%	KLAC		0.0%

Fund Features		Portfolio Analytics	
Min. initial investment	$50,000	Sharpe Ratio[1]	-0.15
Additional investments	$500k Maximum	Sortino Ratio[1]	-0.02
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D – Benchmark	17.4% 14.6%
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	54.1% 64.7%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	1.4% 86.0%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	(8.7%) 9.5%
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	(10.2%) 6.2%
Fund Size	$27m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	(2.4%) 6.7%
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.7559 $0.0002	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.7570 $0.7547

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: