**EGP Concentrated Value Fund**

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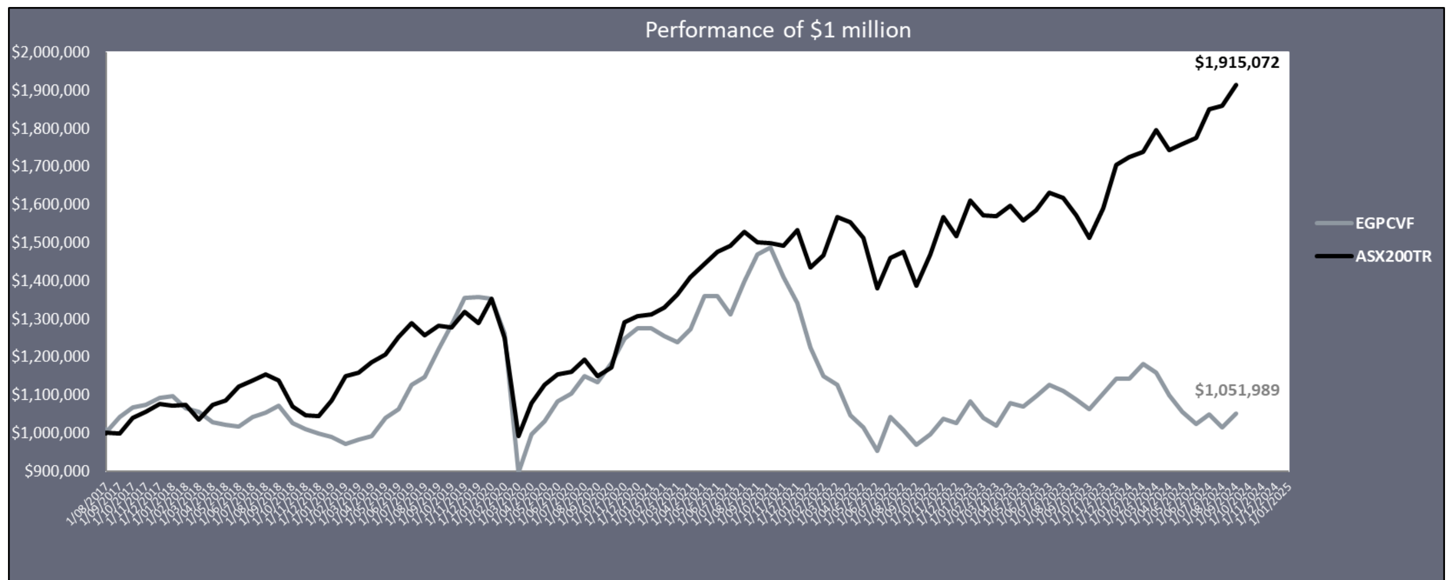
# EGP Concentrated Value Fund – 30 September 2024

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%) | 3.8% | | | | | | | | | | 2.69% |
| *Benchmark FY25* | 4.2% | 0.5% | 3.0% | | | | | | | | | | 7.79% |

*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 3.8% in September. Our benchmark rose 3.0%. Investor appetite finally turned to small capitalisation companies in September, with the small and microcap indices finally outperforming the ASX200.

Most of the positive benchmark performance came from commodities as the Chinese Government finally begins to wrestle with their imploding economy, announcing further rate cuts and massive stimulus. This news flowed through into commodity prices in September with BHP up almost 20% and RIO up almost 25% from mid-month lows.

**Portfolio Update: -**

The recent signs of "green shoots" in the market appetite for small and microcaps finally made their way to some of our portfolio holdings in September. Cettire (CTT) once again provided more than its share of excitement, at one stage after the release of the annual report, the price was +127% for the month. I will talk about the drivers of this a little more in the next section. Stealth Group (SGI) also jumped in September touching 37c per share after trading at 20c for almost all of August. The sharp rise of these two positions was a reminder how swiftly microcap share prices move when market participants (finally) come for them. More portfolio positions are I feel are due for a similar re-rating, if one or two per month get the CTT/SGI treatment, we will hopefully string together a long overdue run of good unit price performance.

The segment of this fund selected from the pool of quantitatively generated ideas has grown to 5.2% at the end of September. The absolute performance of four quantitatively generated Australian exposures was +6.6% in September, the eight US exposures were +17.8% in USD terms. Unfortunately, as with last month, AUD strength hurt the US exposures, but the unhedged result for our total quantitative exposure was still solid at +12.0% for September, contributing +0.57% to the reported fund performance in September. All ideas selected from the algorithmically generated pool are listed in a table toward the rear of this report.

**The Interesting Bits: -**

CTT share price, as mentioned above more than doubled mid-month. The cause of this is an excellent reminder of the dangers of short selling. Toward the end of June, CTT released an update that indicated the more difficult luxury market experienced in the March quarter had become worse in the June quarter.

Since that report, an additional 6% of the company was sold short. The percentage shorted rose from ~5.3% at the end of June to about ~11.3% before the annual report was released. The average price CTT traded at through that 3-month stretch was ~$1.35 to profit from short-selling at an average price of $1.35, those selling the stock short would have been hoping to buy the shares back meaningfully lower than this.

The "surprise" in the report was evidently that the auditors signed off on the company view of revenues. On that day, 23 million CTT shares (~6% of outstanding shares coincidentally enough) traded, they opened at $1.60 and closed at $2.38 the average price was ~$2 per share. If we assumed the only buyers were the short sellers who had spent the previous 3 months accumulating their position, then they dusted more the 30% of their capital, or around $15m. We won't know for a few days how much of the 23m traded was short sellers closing (n.b. early reports indicate only 2.2% of the short positions were closed, leaving enough open short positions to continue to make CTT a VERY risky short bet), but it was a good reminder that successfully short selling is a notoriously difficult thing to do. I will not criticise short sellers for trying here, to those who do not understand the business well, I can understand their scepticism.

One thing the auditor "caving in" reminded me of is what a "bought and paid for" service auditing is. If I were the lead auditor and was convinced the revenues should be presented differently, I would resign on principle if my firm overrode me just to keep the audit fees flowing. What does surprise me is the market reaction to the event. It changes the investment thesis not one iota in my view. You still have a business that ships >1 million orders annually and will have platform sales exceeding $1b either this year, or next. Whether the whole of the order or just their fee-take on it represents the correct revenue to report will not change the underlying growth rate and profitability of the business. Their own business model and luxury market conditions are the driver there.

Perhaps watching another portfolio holding in Dicker Data (DDR) restate their revenues I was more circumspect than others. I fully expected CTT to do exactly what DDR did, use the auditors preferred revenue figures to present "statutory" revenue and then just keep presenting management's preferred revenue figures as "Non-IFRS".

SGI re-rated sharply in September. There was an investor presentation, but that mostly seemed to outline information that had mostly already been provided with the annual results. The nexus of the rerating was likely driven by the announcement of a dividend and an increased belief in the achievability of the forward outlook. The inaugural dividend was well received by investors and potential investors. I have many times tried to explain to microcap CEO's why as much as they would like to keep their capital, paying a dividend often makes more sense. To prospective investors, a stated dividend payout ratio shows that there will be a "competitive tension" in the field of capital allocation. If a company has committed to half of its earnings being a dividend, it means that the other half is likely to be invested in the best "low-hanging fruit" opportunities with the best prospective investment returns.

The outworking of this competitive tension is usually a higher share price as investors generally like the cash payment and the knowledge that the additional capital discipline required to pay a dividend means the capital retained will likely find its highest and best use. The higher share price likewise gives management flexibility. In the case of SGI, any scrip component to any M&A they might like to undertake has now become meaningfully cheaper.

SGI earned 0.9cps in the June half, and the recent acquisition only had about a month to contribute. This likely means that the floor for FY2025 EPS is 2c. That does not make SGI especially cheap at a mid-teen P/E multiple. For a satisfactory return to be earned from current valuation, their strong history of execution must continue. Taken at face value, the FY2028 revenue aspiration of $300m at a target EBITDA margin of 8% would represent an exceptional next 4 years. The ~$24m EBITDA if achieved would represent a quadrupling of EBITDA at an annual CAGR exceeding 40%.

SGI has a current enterprise valuation (EV) of ~$48m and if it makes $24m EBITDA in FY28 would be unlikely to have an EV/EBITDA below 8x (if the aspiration were achieved in time, I would be surprised if a double-digit EV/EBITDA were not awarded SGI), which implies at least a valuation quadrupling if they succeed. The question investors must ask is how much equity dilution would be required to deliver this outcome.

Before the recent Force acquisition, and the initiation of a DRP with the dividend, the company had not issued a new share since listing, so it is clear management understand the value of their equity. To be fair, they were hamstrung by a pitifully low valuation for most of that time. Now they have a more sensible valuation, I would not be surprised to see them use their scrip as a currency more frequently.

In any case, if enterprise valuation quadrupled and shares on issue doubled, assuming debt ratios held constant, that would see an almost 20% p.a. return to equity. Given the high management ownership and the judicious use of equity capital to date, I would back Mike Arnold and his team to get to his $24m EBITDA target with as little as a 50% increase in equity on issue. If this is the case, even if it takes until FY29 for his ambition to be achieved, that would generate a >27% equity CAGR. As I wrote last time the newsletter discussed SGI, the dangers of using traditional P/E ratios are exacerbated with businesses that have the potential to completely re-base their earnings.

I spent much of this month thinking about how the share market is frequently slow to recognise meaningful changes in business conditions. The momentum factors underpinning some of the quantitative selections seek to exploit this market blind spot. As far as I can see, Locality Planning Energy (LPE) must be among the best opportunities in the market on this thematic. The share price has risen nicely since the current directors have controlled the business, but the valuation is laughably low when one objectively considers the business as it stands now.

The business earned $340k profit in the December half and $1.66m in the June half. There is a modest seasonality to this business, but the primary underlying driver of that uplift is the replacement of the previous CEO and Chairman who if were being charitable were incompetent, and if we were to be less charitable, would likely open ourselves up to litigation.

Even allowing for the traditionally stronger profit profile in the June half, as an absolute floor, LPE must be on a >$3m NPAT run rate. The EV using current share price and June 30th balance sheet is ~$24m. This figure ignores the ~$6.2m owed by the Bundaberg Biohub, which if received would reduce the EV to below $18m.

An annuity business such as this would be highly unlikely to change hands for less than 12x earnings, which puts a hard floor of $36m to the valuation, which leaves an EV upside of between 50-100% depending on your view of the likelihood of the Bundaberg Biohub principal being received. If I were not intending to repay the principal, I would likely already be defaulting on the interest. The borrower is not in default, paying >$76k per month to keep the loan current.

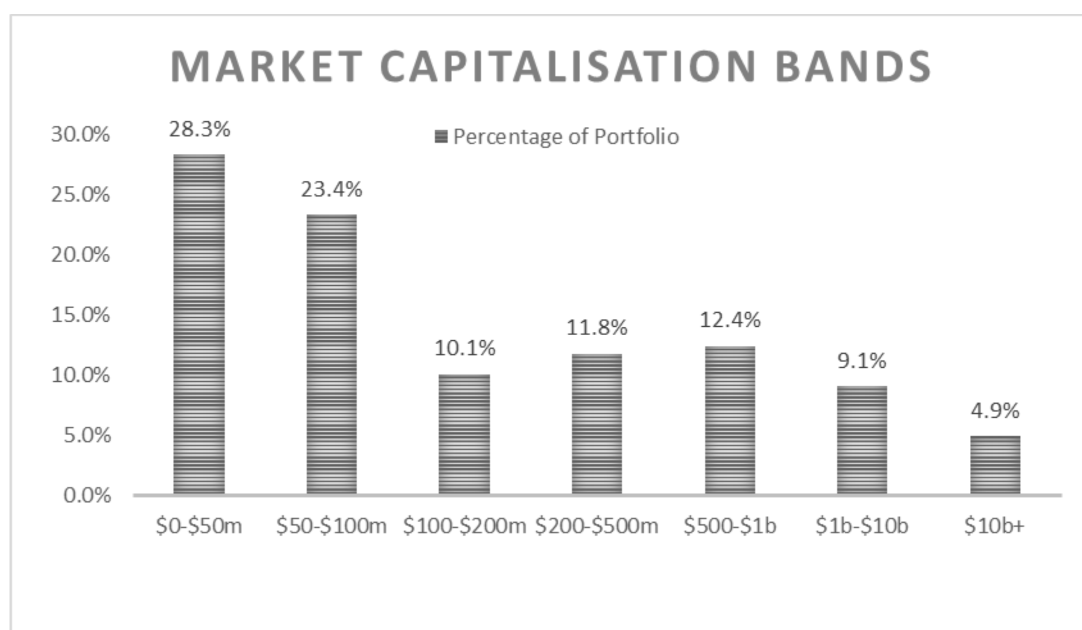
The 50-100% upside is predicated on nothing other than running the business as is. With a new CEO with deep embedded network experience in place, and a newly strong balance sheet/P&L, it is not hard to imagine profitable growth in the business will now begin and LPE will become what I always thought it would be. As I said when last I wrote about LPE, there is no sensible estimate of intrinsic value for this business that does not at least “begin with a 2” or 20c+. If the valuation continues to hold at these depressed levels, we will once again begin to add to our position.

## Key Portfolio Information: -

Our top 10 holdings on 30 September 2024 were:

| Rank | Holding | Percentage Equity Weighting | Percentage Portfolio Weighting |
|---|---|---|---|
| 1 | United Overseas Australia (UOS.ASX) | 12.4% | 11.6% |
| 2 | Stealth Group (SGI.ASX) | 8.8% | 8.4% |
| 3 | Smartpay (SMP.ASX) | 7.3% | 6.9% |
| 4 | Dicker Data (DDR.ASX) | 6.9% | 6.6% |
| 5 | Matrix Composites (MCE.ASX) | 6.9% | 6.5% |
| 6 | SDI Limited (SDI.ASX) | 6.6% | 6.2% |
| 7 | Shriro Holdings (SHM.ASX) | 6.1% | 5.7% |
| 8 | Quantitative Holdings* | 5.5% | 5.2% |
| 9 | Cettire Ltd (CTT.ASX) | 4.4% | 4.2% |
| 10 | Bathurst Resources (BRL.ASX) | 4.0% | 3.8% |

Our largest 5 holdings comprise 42.3% of our invested capital, our top 10 holdings are 68.8% and our top 15 represent 86.2%. Cash and cash equivalents are 5.5% of the portfolio. The median market capitalisation is $107.2m. Weighted average market capitalisation is $6.4b.




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 | Australia | (0.9%) | CEG | USA | 33.0% |
| PME | Australia | 18.3% | META | USA | 10.1% |
| PNI | Australia | 3.2% | SN | USA | 13.2% |
| CDA | Australia | 4.1% | THC | USA | 0.2% |
| APP | USA | 40.6% | ISRG | USA | (0.3%) |
| AVGO | USA | 6.0% | VST | USA | 39.5% |

| Fund Features | | Portfolio Analytics | |
|---|---|---|---|
| Min. initial investment | $50,000 | Sharpe Ratio[1] | -0.15 |
| Additional investments | $500k Maximum | Sortino Ratio[1] | 0.03 |
| Applications/redemptions | Monthly | Annualised Standard Dev. – EGP<br>Annualised S/D – Benchmark | 17.4%<br>14.6% |
| 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 | 54.7%<br>65.1% |
| Auditor | Ernst & Young | Cumulative return[2] – EGP<br>Cumulative return[2] – Benchmark | 5.2%<br>91.5% |
| Custodian/PB | NAB Asset Services | 1-year return[2] – EGP<br>1-year return – Benchmark | (3.3%)<br>21.8% |
| Responsible Entity | Fundhost Limited | 3-year annualised return[2] – EGP<br>3-year annualised – Benchmark | (10.6%)<br>8.5% |
| Fund Size | $27m | 5-year annualised return[2] – EGP<br>5-year annualised – Benchmark | (2.9%)<br>8.4% |
| Mid-Price for EGPCVF Units<br>Accumulated Franking per Unit | $0.7843<br>$0.0026 | Buy Price for EGPCVF Units<br>Sell Price for EGPCVF Units | $0.7855<br>$0.7831 |

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.

**DISCLAIMER:**

*EGP Capital Pty Ltd (ABN 32 145 120 681) (AFSL #499193) (EGP Capital) is the issuer of this report. The EGP Concentrated Value Fund (ARSN 619879631) (Fund) discussed in this report is offered via a Product Disclosure Statement (PDS) which contains all the details of the offer. The Fund and PDS is issued by Fundhost Limited (AFSL 233045) as responsible entity for the Fund. Before making any decision to make or hold any investment in a Fund you should consider the PDS in full. The PDS is available here and the Target Market Determination (TMD) for the Fund is available here. The content has been prepared without considering your personal objectives, financial situations or needs. You should consider seeking your own independent financial advice before making any financial or investment decisions. The information provided is believed to be accurate at the time of writing. None of EGP Capital, Fundhost or their related entities nor their respective officers and agents accepts responsibility for any inaccuracy in, or any actions taken in reliance upon, that information. Investment returns are not guaranteed. Past performance is not an indicator of future performance.*

*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: