EGP Concentrated Value Fund

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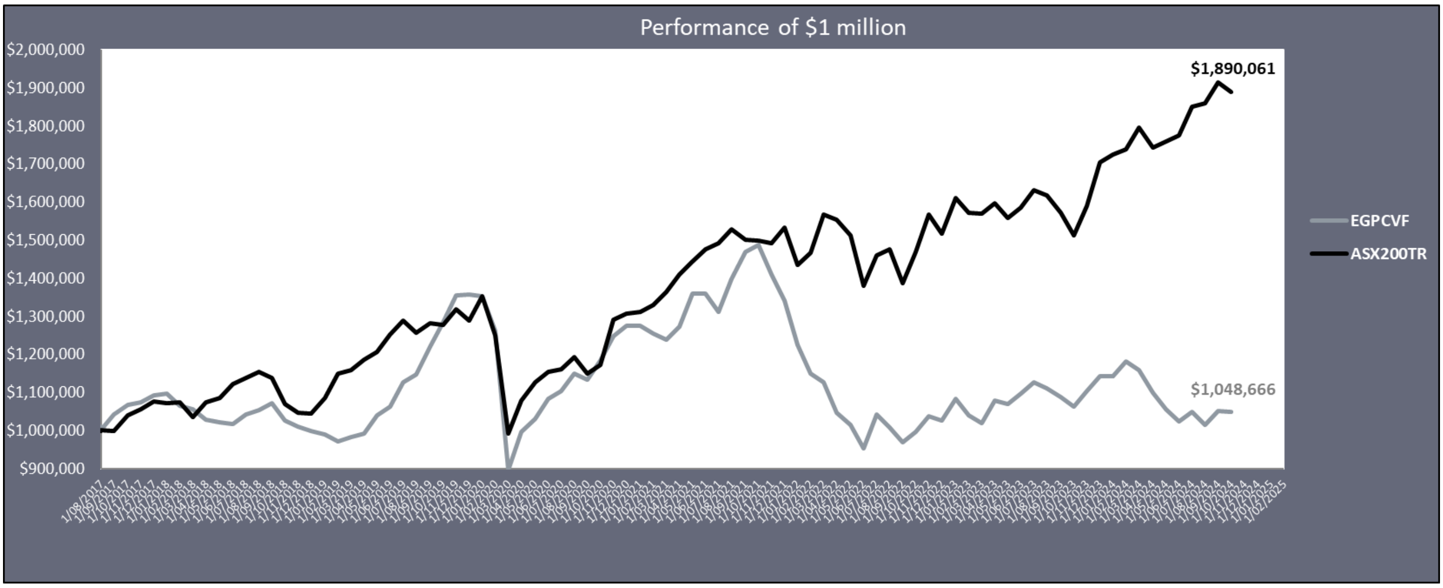
EGP Concentrated Value Fund – 31 October 2024

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%	(0.3%)									2.37%
Benchmark FY25	4.2%	0.5%	3.0%	(1.3%)									6.38%

*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 0.3% in October. Our benchmark fell 1.3%. The recent trend of modest small capitalisation outperformance continued in October.

The financials sector hit a new all-time high during the month, which is mystifying when you consider the widely held view that there is a cost-of-living issue in Australia. Combine that with housing prices which look to be rolling over in several major cities and the earnings environment for the major banks must surely be challenged for the next few years. The pricing in the financial sector certainly does not reflect an imminent earnings "rough patch".

Portfolio Update: -

The renewed market appetite for small and microcaps again positively impacted some portfolio holdings. Unfortunately, a major reversal in the share price of SmartPay (SMP) cost the fund ~2.3% in October. We will discuss SMP in more detail below. The performance of the portfolio feels like "one step forward and one step back" recently, but it surely feels like there is a renewed optimism for smaller businesses, if we can just avoid the land mines we have managed to step on in the past few months, we will finally be able to deliver the outperformance you deserve for remaining loyal unitholders.

The segment of this fund selected from the pool of quantitatively generated ideas has grown to 6.6% of the portfolio at the end of October. The absolute performance of four quantitatively generated Australian exposures was +12.13% in October, the eight US exposures were +12.44% in USD terms. A substantial (~5.1%) fall in the AU$ accentuated the results and saw the quantitative exposure deliver 16.11%, contributing +0.92% to the reported fund performance in October. Algorithmically generated holdings are listed in a table toward the rear of this report.

Major Movers: -

I have always argued capital allocation is the most frequent shortcoming of CEO's and Boards. It pleases me no end to outline and applaud Shriro Holdings (SHM) decision this month to conduct an off-market buyback. They have toiled for years to find suitable acquisitions without success. Given the powerful cash-generation of the business, where they had sufficient franking credits, they have paid fully franked dividends in the interim.

The recent re-design of the business into a truly "capital light" distribution business has released a mountain of working capital, and the board have announced they will conduct an equal access off-market buyback. The shares have traded at around 72.5c since the most recent dividend, meaning at the 81c offer, departing shareholders will receive a handsome premium over the recently prevailing price. The board has committed to buying back at least 19.2% of the outstanding equity and as much as 25.6% if they activate the second tranche. If nothing else changes and a company extinguishes 25% of its equity, the per share earnings rise by one third. Such is the power of a buyback. If the company is successful in generating some growth, then that would be additive to the 33% EPS growth the buyback itself would trigger.

The cleverness of the mechanism in a thinly traded stock means their own buying will not needlessly increase the price the company pays to lower its share count.

Should the share price continue to languish at ~10x EPS and the company continues to pay half its earnings as dividends and use the other half to buy back shares, after 5 years, it will have extinguished a further ~25% of its outstanding equity (adding another ~33% to EPS). That would mean over a 5-year stretch, between extinguishing 25% in the first year and a further 5% in each subsequent year, the EPS would have grown by ~75% even if the dollar-earnings remained flat. The mathematics of a low P/E ratio and aggressive buybacks are too poorly understood by most senior managers. I think SHM are about to give the Australian equity market a lesson in this iron-law.

Locality Planning Energy (LPE) released a quarterly showing the continued stabilisation of their business, in what is customarily the seasonally weakest quarter. They have guided $3-3.5m NPAT, which at the mid-point has the business at ~8.5x earnings at current prices. I met new CEO Scott Taylor in October and he clearly has many ideas on how the business can be better run, such that knowing which lever to pull first will be his hardest challenge.

As with Scott, I will point my readers to the recent takeover of TPC consolidated (TPC), which if the full earnout is activated was done at 18x EV/EBITDA (~$180m) and if the entire earnout were not earned was still 13x EV/EBITDA (~$130m). TPC is approximately twice as profitable as LPE and TPC's FY24 profitability I think is a suitable target for FY2027 or FY2028.

The TPC price clearly has a takeover premium embedded, but taking the mid-point ($155m) and halving (because LPE currently earns around half the profits) generates a $77.5m mid-price if LPE were to become a takeover target. If we assume such a transaction were to occur at a "juicy" 45% premium, then the undisturbed fair-trading price for LPE is ~$53m, which is close enough to twice the current valuation. As I pointed out to the CEO and Chairman this month, when you can buy your own equity at ~50c on the dollar, alternative applications of capital need to be something close to exquisite to leapfrog that activity in your capital allocation decision making.

PPK had a significant share price surge in October, closing around +30% on last month's pricing. It was primarily driven by the "look-through" valuation as the value of their significant stake in LIS Energy (LIS) almost doubled based on achieving a market leading 500Wh/kg performance from the batteries they are now producing on their production line and shipping to customers for testing.

Both LIS and PPK remain laughably underpriced on any reasonable assessment of the technologies they own and are developing. LIS has an enterprise valuation of barely $100m after doubling this month, you will not find a battery business with a remotely comparable product at anywhere near this low valuation anywhere globally.

After the recent in-specie distribution of some of the LIS shares PPK hold, the equity valuation of PPK's stake in LIS at market prices is still marginally higher than PPK's own market capitalisation. You effectively get everything else PPK owns for free… There are other very real and valuable businesses inside the PPK Group. The PPK stake in the Clark Ballistics business is also potentially near PPK's current market capitalisation in my estimation. The Power Plus business is also misunderstood by the market. A quick look at the incredible projects they are doing and you will quickly understand the incredible potential of that business. Then PPK has the BNNS/BNNT quinella to develop, each which will surely have billion dollar potential if markets can be found before others catch PPK in the low price at which they can produce these nanomaterials. Even after the price rise, one cannot help but look at our positions in LIS and PPK and think there must still be a mountain of gains to come once the market wakes up and smells the roses.

Smartpay (SMP) fell sharply in October as the Australian Federal Government outlined a policy to ban surcharging on EFTPOS cards from 2026. This is unequivocally bad news for SMP as presently a little over half of the revenue generated out of their Australian terminal fleet originates from these charges.

The current business model for the Australian acquiring terminal rollout substantially revolves around SMP providing the terminal and all associated costs and their customer agreeing to allow SMP to collect the fee revenue the terminal generates. The primary harm to SMP will be the requirement to now have a more complex array of offerings dependant on the blend of EFTPOS/Credit Card in their card mix.

For any of their customers with a high proportion of credit card payments, SMP will likely accept some lost EFTPOS revenues and retain the "free" terminal offering. But there will be a tipping point of EFTPOS usage that will necessitate a different offering or offerings. Complexity is the enemy of successful sales, so this will surely harm growth rates.

Realistically, if surcharges are banned it is almost a certainty that SMP (and other terminal providers) will simply increase the cost of the monthly rentals aspect of their offering to recover as much of the lost surcharging as they can without causing their customers to churn. The outworking of this reality is that merchants will generally adjust their price lists to reflect this and what the customer is no longer paying in a surcharge, they will pay instead via cost of their goods/services.

As with almost every poorly thought-out bureaucratic solution ever developed the significant good the creator imagines arising for the intended beneficiaries will fail to materialise. The inanity of this policy is highlighted by the considerable cost of cash-handling to the very businesses that benefit most from SMP's offerings. It varies substantially based on a variety of factors, but cash-handling is generally thought to cost most retail businesses 2-4% of cash turnover. Costs arise from slower transaction times as change is counted to moving the cash to and from the bank, increased incidence of employee theft, cash handling errors to counting and reconciliation. The only practical reason small retailers do not go cashless is for their love of a cash revenue stream that some small business owners are inclined not to fully declare!

I should be clear that I am a proponent of retaining the ability to pay for goods and services in cash. I detest the surveillance state we have allowed to develop around us, which accelerated with the gross Government mishandling of the COVID situation. But whilst I believe it should probably be illegal to go "cashless", it would also be reasonable in my view if businesses charged for the additional cost cash-handling imposes on them. Given the option between a (for example) 2% charge for paying cash and a ~1% charge for tapping a card, even a renowned cheapskate like myself may let the surveillance state have their win.

Governments that claim to seek efficiencies would do well to consider such things as a surcharge that is barely above 1% that enables such efficiencies is likely a significant benefit to society. SMP and their competitors if they are clever will encourage their clientele to offer a discount for card payment that exceeds the cost of the service. If the face value of a good is discounted by 1.5% for paying by card (as it is more efficient for the business), but the cost of using the card is for example 1.35%. You have created a win/win/win situation. The customer gets a lower final price than they would do had they paid in cash. The business gets to reap the efficiency benefits of faster, more secure payment and the payment provider wins from the additional inducement to use their terminal.

Finally, I cannot seem to get through a month without discussing Cettire (CTT). Cettire had what has become their "normal" trading range, moving up more than 40% early in the month before falling more than 40% towards the end of the month. We were trimming our position early in the month. The luxury market has been horrible (~-4% like-for-like sales for the majors) and my expectation was that if CTT managed to stay profitable, it would mean negative year on year growth and if they managed to grow meaningfully year on year, it would mean significant losses which would place an unwanted strain on the balance sheet.

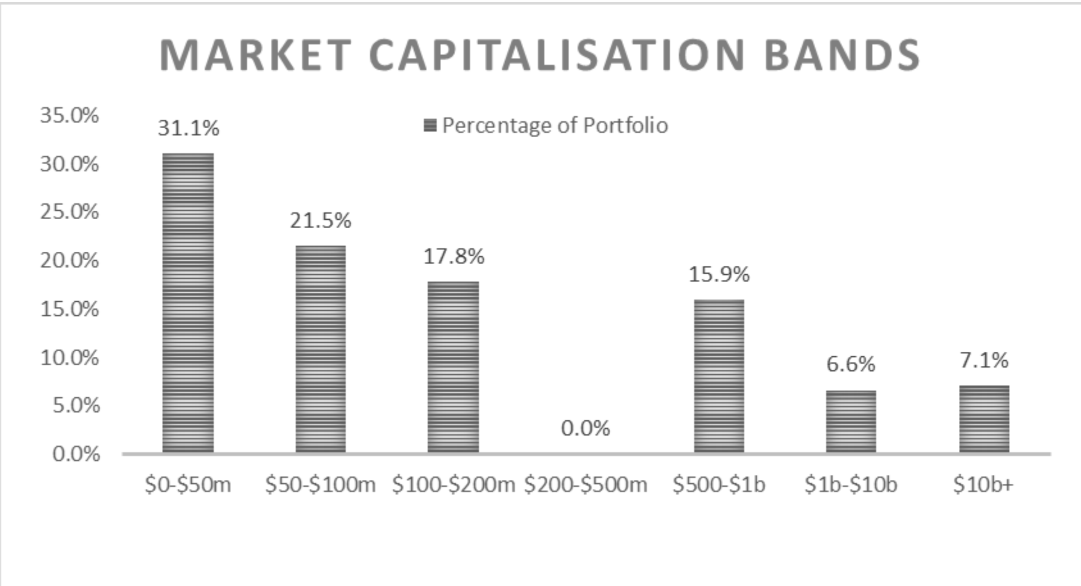
Imagine my surprise when they grew by around 5x system AND generated an EBITDA profit. Market participants saw the situation differently than I did and we managed to buy back all our sales from earlier in the month at a ~35% lower price.

Key Portfolio Information: -

Our top 10 holdings on 31 October 2024 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	12.5%	11.5%
2	Stealth Group (SGI.ASX)	8.9%	8.3%
3	SDI Limited (SDI.ASX)	7.2%	6.7%
4	Quantitative Holdings*	7.1%	6.6%
5	Shriro Holdings (SHM.ASX)	7.0%	6.6%
6	Dicker Data (DDR.ASX)	6.6%	6.2%
7	Matrix Composites (MCE.ASX)	6.4%	6.0%
8	Locality Planning (LPE.ASX)	5.0%	4.6%
9	Smartpay (SMP.ASX)	4.8%	4.5%
10	PPK Holdings/WG/PPKME (PPK.ASX)	4.6%	4.3%

Our largest 5 holdings comprise 42.7% of our invested capital, our top 10 holdings are 70.1% and our top 15 represent 87.7%. Cash and cash equivalents are 6.8% of the portfolio. The median market capitalisation is $73.7m. Weighted average market capitalisation is $3.8b.



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	Stock	Holding	Result
360	Australia	(0.9%)	CEG	USA	33.0%	APP	USA	40.6%
PME	Australia	18.3%	META	USA	10.1%	AVGO	USA	6.0%
PNI	Australia	3.2%	SN	USA	13.2%	ISRG	USA	(0.3%)
CDA	Australia	4.1%	THC	USA	0.2%	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 Annualised S/D – Benchmark	17.3% 14.5%
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	54.0% 64.4%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	4.9% 89.0%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	(1.3%) 24.9%
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	(11.0%) 8.0%
Fund Size	$26m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	(4.0%) 8.2%
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.7818 $0.0027	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.7830 $0.7806

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:

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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: