EGP Concentrated Value Fund

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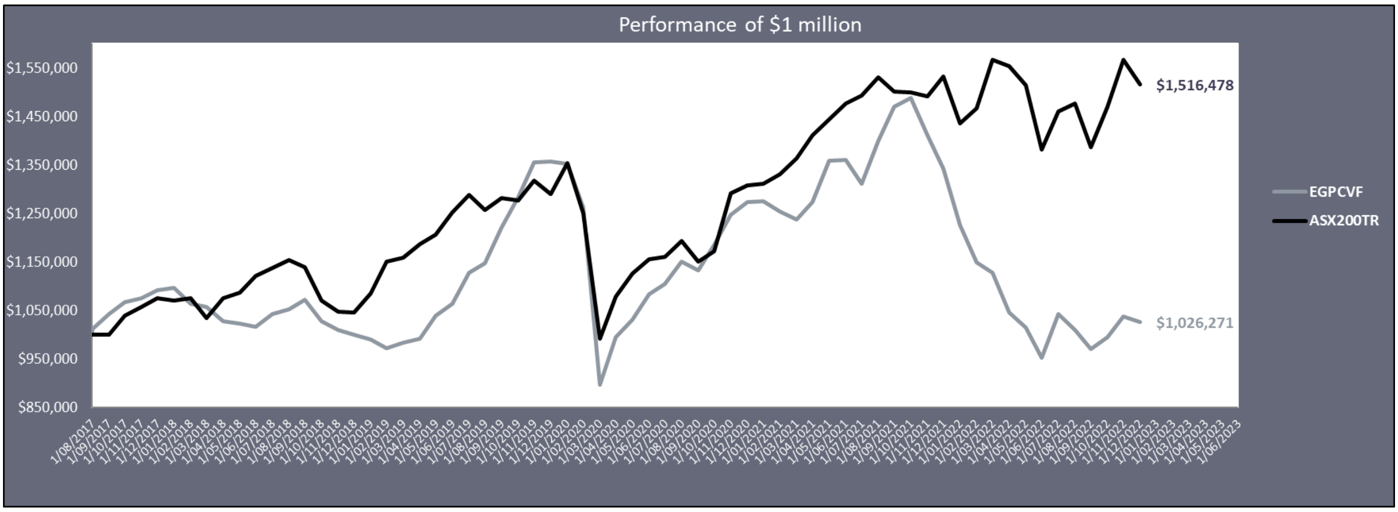
EGP Concentrated Value Fund – 31 December 2022

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%)							7.71%
Benchmark FY23	5.8%	1.2%	(6.2%)	6.0%	6.6%	(3.2%)							9.82%

*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 (1.1%) in December. Our benchmark fell (3.2%). In years gone by, I have often written about how I am happy to outperform a falling benchmark with more modest falls fall in our own valuation, you take outperformance wherever it presents itself. More than 100% of the outperformance we generated for the fund in the first 5 or 6 years came by outperforming a falling market and almost keeping pace in a rising market.

Given how poorly the fund has performed in the past few years, it is harder than ever to enjoy outperformance accompanied by a negative return. Nonetheless, the behaviour of our portfolio in the past few months has started to feel more like it did in our boom years, modest outperformance in negative months and some underperformance when the market jumps hard.

Calendar 2022 was a very different year for the Australian market than any I can remember in more than 20 years of investing. The unusual divergence of the market can be best demonstrated like this:

- Total return for the ASX20 = +3.63%
- Total return for the ASX100 = +0.63%
- Total return for the ASX200 = (-1.08%)
- Total return for the Small Ordinaries = (-18.38%)
- Median return for all ASX companies = (-30.91%)

On average, the further you got away from the bluest of the blue chips in the Australian share market, the worse your results were. Unfortunately, with a median market capitalisation of about $140m throughout 2022, our fund could not have been much further from the largest stocks in our market.

This does give me cause for optimism however, as reversion to the mean is one of the axioms of investing. Many smallcap/microcap/nanocap stocks have continued to see their businesses perform well but have still suffered enormous valuation reductions. This is an attractive environment in which to deploy capital and we continue to flex the portfolio positioning to where we see the greatest value. Between these activities and the already attractive valuation characteristics of the existing portfolio, we hope to see a return to form in 2023 in terms of our performance relative to the ASX200 we use to benchmark our efforts.

Quarterly Meeting: -

We will hold our quarterly investor question and answer session on Monday 23 January at 12:30pm. I have scheduled the meeting using Microsoft Teams this time as I think Microsoft is probably the least evil of all the mega-technology companies. If you wish to participate in the meeting, diarise the below meeting link for 12:30pm on January 23rd:

Click here to join the meeting

If those wishing to attend the meeting are unable to set up a reminder in your own calendar, you are welcome to email me (tony@egpcapital.com.au) requesting an invite and I will forward one to you by email. The meeting as always will be a free-form Q&A session, where anything can be asked and I do my best to answer, but among the topics discussed will be the future of the fund.

In the June newsletter, I acknowledged that the performance of the fund over the past few years, with the past year especially falling well short of my expectations, and I expect, those of most people who have joined the fund. There were several pathways forward discussed.

The first was a re-opening of the fund to new investment. The fund has been shuttered for some time, investors can redeem their investment, but no new investors can join, and existing investors cannot add to their holding. The target I gave was that when one quarter of the annualised underperformance (which peaked in May 2022) had been recovered, I would begin the process of reactivating our Product Disclosure Statement. We have recovered only 13.5% of the underperformance since then, as such we have not contemplated reopening the fund. Several more months of strong outperformance would be required for that to happen.

The other options were to appoint another manager to the fund to assist myself with the investment decisions, or to wind up the fund and return the capital to investors. Given the faith investors have shown me in persisting through our poor performance of late, the latter would be considered only reluctantly. We will discuss the former in the investor teleconference on January 23rd to get a feel for investors sentiments.

Based on the discussions with investors in the quarterly teleconference, we may run an informal vote in either of the January of February investor emails to further gauge investor preference.

Portfolio Update: -

Firstly, I need to publish a correction to last month's newsletter. I mentioned Smartpay (SMP) had a 1.1% churn rate. This is a monthly churn rate, meaning that they lose something closer to 13 or 14% of their customers annually. This figure is very low by industry standards, but still means they need to replace about 135 terminals each month based on the current fleet size before achieving growth.

Given their net additions (after replacing churn) in the September quarter was 1,600 terminals, this implies the sales team added ~668 terminals per month before accounting for churn. This in turn implies that just 20.2% of the deployments (135/668) are required just to cover churn. The point I made in the November newsletter was that if the company chose to stop growing and just ran the business for maximum near-term profit, a large portion of the sales team and the marketing costs associated with pursuing this growth could be eliminated. About 80% if the number of sales staff and quantum of advertising if they perfectly correlate with sales outcomes. Therefore, despite this correction, the point remains valid that the already very profitable SMP could massively increase their profitability if they slowed down their growth ambitions.

That would (of course) be a massive mistake, the inexpensive (apparent) ease with which SMP are capturing market share means if anything, they should probably be more aggressive with their marketing strategy. Prudently, SMP management are treading a sensible line between optimising growth and maintaining profitability, they have indicated that the ~23-25% EBITDA margin currently being achieved is being used as a floor in the growth ambitions, with the company willing to expense additional profits beyond that level pursuing growth.

Matrix Composites (MCE) which was detailed in the May 2022 newsletter won a $44m SURF (Subsea Umbilicals, Risers and Flowlines) contract which more than doubled the company's secured order book to $77m and should underwrite a return to strong profitability after years of struggling just to stay afloat. When I re-read the May newsletter, I was reminded that in business, smaller companies have very little control over the timing of such announcements, but the win was a reminder of just what an enormous opportunity MCE sits astride when a single contract can double your order book and when your sales pipeline holds many other opportunities of similar scale.

National Tyre and Wheel (NTD) announced what the market had already started to guess, trading conditions have been terrible in the December half and the period will mark the bottom of the down cycle that began about 18 months ago, triggered by the massive increase in logistics costs and the weak AU$ caused by global Covid policies. Aside from the failed ERP implementation which sounds like an ongoing problem, every other headwind the company has faced recently has now reversed and will be a tailwind in 2023. The market is theoretically forward looking, but the behaviour of the NTD share price demonstrates that market participants need to see a turnaround commence before they will start to price a business like it really is turning around. The 5-fold increase in NTD's share price over the 9 months to January 2021 reminds us how quickly investor sentiment can turn when conditions turn. Whilst we are not expecting anything quite so dramatic, there was this uncharacteristic forward-looking statement:

"NTD is targeting gross margin improvements and cost reductions to deliver a 2H23 result close to the 2H22 Operating NPATA ($7.6m), with the full year impact of these measures returning net profit margins to FY22 levels in FY24"

FY22 was a long way from NTD's best year for net profit margin, but on the ~$600m revenue base now embedded in the business, implies a >$12m NPAT for FY24, which if achieved implies an FY24 price to earnings (P/E) multiple based on the current valuation below 6x. If the 2H23 result guided above (i.e. "close to $7.6m NPATA) can be annualised in FY24, the forward P/E is more like 4.8x, which is incredibly low for a business which has the sort of scale NTD possess.

I failed to anticipate the severity of the reversal in conditions post the boom year of FY21 and did not trim our NTD holding nearly as aggressively as I should have. In trying not to make what is effectively the same mistake twice, I will ensure I increase our NTD position as a proportion of the portfolio with appropriate aggression whilst the valuation is as attractive as it presently is, and market participants are only seeing the current poor conditions.

Otherwise, there was not a lot of notable announcements from our portfolio companies in December, January is likely to be quiet on the announcement front also, with bated breath we will await February when the December accounts are published, we think several of our companies are likely to surprise the market with how well their businesses are travelling despite the weakening conditions being reported in the media.

The ZFC update: -

Following a December meeting with JANA we can advise that many areas of the meaningful reorganisation previously flagged have now been finalised. We are advised that JANA's current planned timeline for review and prioritisation of new products is expected to occur during the first quarter of 2022 and a further meeting is planned for February.

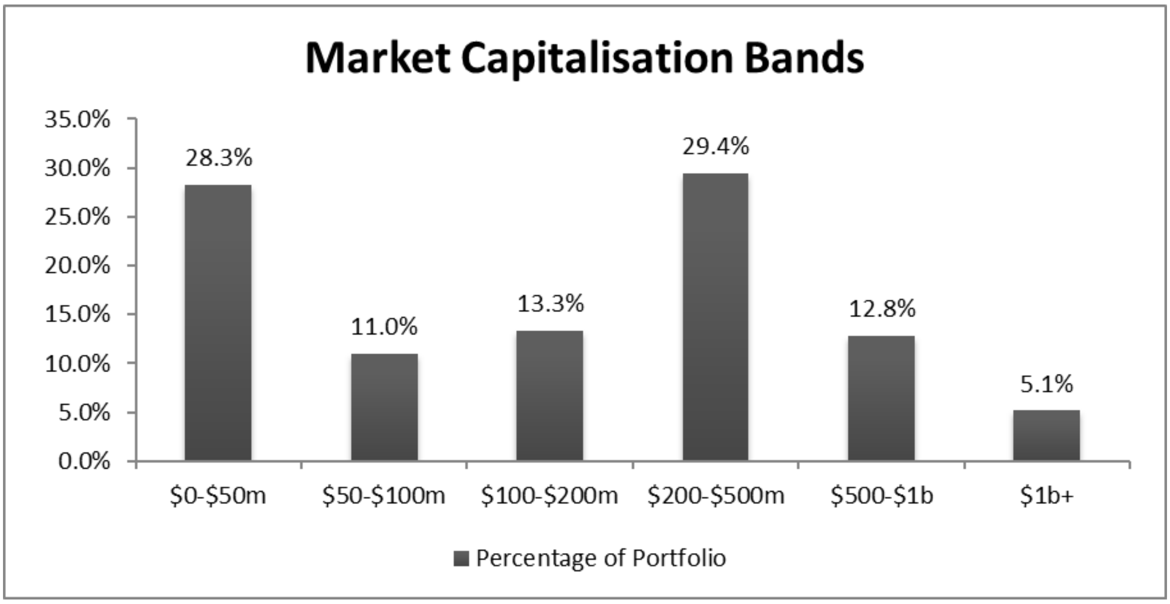
We continue to work with JANA and further updates will be made when able. Prospective managers and qualified investors as always, are invited to contact Brad (brad.hughes@thezfc.com.au) or myself.

Key Portfolio Information: -

Our top 10 holdings on 31 December 2022 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	12.8%	11.8%
2	Smartpay (SMP.ASX)	11.0%	10.2%
3	Shriro Holdings (SHM.ASX)	6.9%	6.4%
4	Tellus (unlisted)	6.2%	5.7%
5	Cettire (CTT.ASX)	5.6%	5.1%
6	Dicker Data (DDR.ASX)	5.1%	4.7%
7	SRG Global (SRG.ASX)	5.0%	4.6%
8	PPK Group (PPK.ASX) inc. White Graphene pre-IPO holding & PPKME	5.0%	4.6%
9	Blackwall Limited (BWF.ASX)	4.7%	4.3%
10	Matrix Composite (MCE.ASX)	4.6%	4.3%

Our largest 5 holdings comprise 42.5% of our invested capital, our top 10 holdings are 66.9% and our top 15 represent 83.5%. Cash and cash equivalents are 8% of the portfolio. The median market capitalisation is $141.2m. Weighted average market capitalisation is $320m.



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	Fund Closed	Sharpe Ratio[1]	-0.17
Additional investments	Fund Closed	Sortino Ratio[1]	0.05
Applications/redemptions	Redemptions only, monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	18.9% 15.7%
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	56.9% 64.6%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	2.6% 51.7%
Custodian/PB	NAB Asset Services	1-year return[2] – EGP 1-year return – Benchmark	(23.6%) (1.1%)
Responsible Entity	Fundhost Limited	3-year annualised return[2] – EGP 3-year annualised – Benchmark	(10.1%) 2.6%
Fund Size	$47m	5-year annualised return[2] – EGP 5-year annualised – Benchmark	(1.7%) 6.1%
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.8103 $0.0031	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.8115 $0.8091

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.

Past performance is not an indicator of future performance.

Appendix 1: -

Combined funds cumulative return since inception: