

EGP Concentrated Value Fund



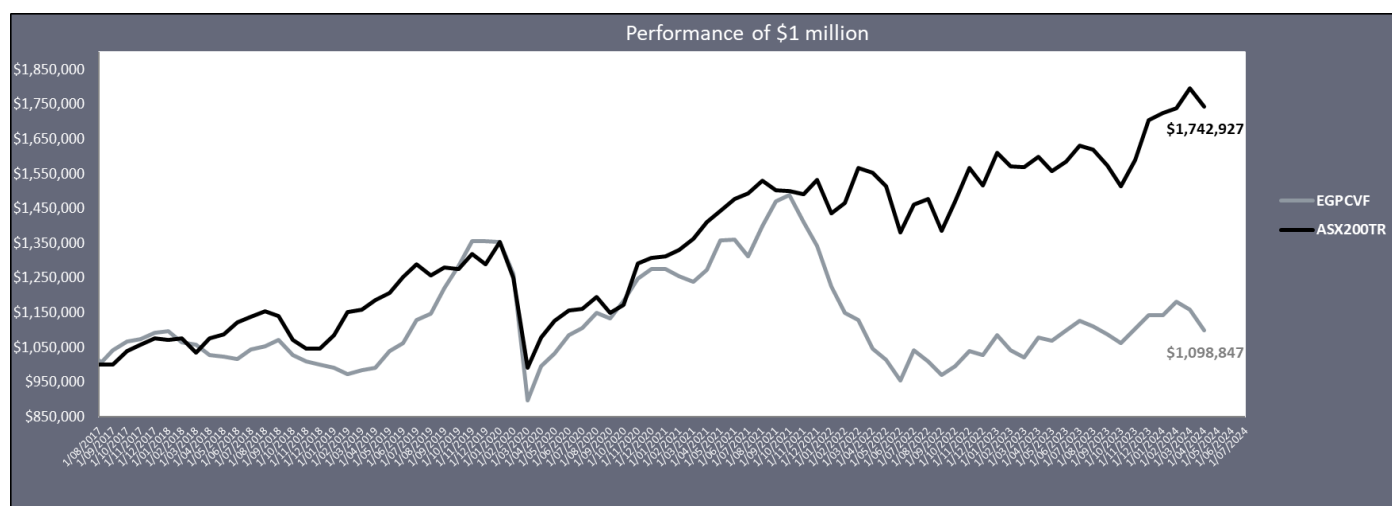
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EGP Concentrated Value Fund – 30 April 2024

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%)			0.10%
Benchmark FY24	2.9%	(0.7%)	(2.8%)	(3.8%)	5.0%	7.3%	1.2%	0.8%	3.3%	(2.9%)			9.97%

*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 (5.2%) in April. Our benchmark fell (2.9%).

Portfolio Update: -

Three larger holdings caused most of the portfolio pain in April. The most painful was Stealth Group (SGI), whose business I profiled in last month's newsletter. In the last week of the month someone began exiting the stock recklessly, causing the price to fall more than 20% by the end of the month. We were aggressive buyers of the tail end of this selling, which was completed on the second day of May. CEO Mike Arnold as I mentioned last month is an excellent communicator and will presumably reprise the Q3/9-month update he gave last May this month. If results are anywhere near my expectations, I expect swift reversal of the price fall.

The recent storm of negative press for Cettire (CTT) turned into a deluge in early April. Despite the wall-to-wall coverage, there remain no substantive issues to our eye. The [trading update](#) (.PDF) released in April showed an acceleration in revenue growth from the 80% for January reported with the December results to 88% for the 3rd quarter as the company did exactly as CEO Dean Mintz said they would on the last investor call and increased investment into advertising. This investment modestly crimped margins for the quarter, but with the demonstrated lifetime value of additional customers now well proven, there is unlikely to be a better investment avenue for CTT (save perhaps repurchasing its own shares). We resumed modest buying of CTT when it fell below \$3 per share (compared to recent highs of almost \$5), but the ~\$250m our CEO has sold weighs on conviction, preventing more aggressive purchasing. My Wife is making a purchase from Cettire this month for a friends' birthday, I look forward to reporting on the buying experience next month.

SmartPay (SMP) also fell about 10% on the month like SGI, on no business-related market announcements. SMP will deliver their FY2024 results this month and if they can provide some reassurance about the rate of net deployments which slowed last half on a cooling economy, the value should rise. If they can provide any concrete guidance about the commencement of the NZ acquiring rollout, then a complete reversal in sentiment should be expected.

The most interesting development was probably the takeover bid launched for Locality Planning Energy (LPE). LPE has been a dreadful investment as I have written several times, but with the managers responsible for the massive value destruction of the past few years removed, the new board appears well on the path to allowing LPE to be the cashflow machine I always thought it could be.

The takeover bid grossly undervalues the business in our assessment. The suitor points out the large premium the bid offers to pre-bid trading prices, but those prices assumed the continuing management ineptitude that the past few years have demonstrated. With those managers removed, the company is a very different beast. I estimate that LPE once properly optimised for profitability and cashflows can earn at least \$2m annually. Furthermore, as the recent takeover of their competitor TPC showed, run properly, there is a demand for such businesses. I estimate LPE should be worth between a quarter and a third of the EV TPC sold for. I resumed buying LPE for the fund in April.

Bathurst Resources (BRL) announced quarterly results and the current enterprise value of ~\$36m is a fraction of the \$87m increase in cash the business generated in FY23. Such things do not happen in rational markets.

Owning a Company in Our Benchmark!: -

I frequently remind unitholders that we selected the ASX200 as our benchmark because it is the highest quality benchmark in Australia. If you want exposure to Australian shares and do not want to take the risk of selecting individual fund managers, an ETF (Exchange Traded Fund) aping the ASX200 is likely your best alternative.

When I made the decision to use the ASX200 as a benchmark, periods of the quantum of index divergence between it and the smaller indices were generally modest, and in hindsight, although the unprecedented divergence of the past few years seemed improbable, selecting the Small Ordinaries or Emerging Companies indices would likely have given unitholders a more accurate view of the environment in which we were investing for the fund.

Nonetheless, despite a small and microcap focus at EGP, our mandate allows us to buy value wherever we see it, and through March, I added an approximately 2% position in Whitehaven Coal (WHC) at an average price just below \$7 per share.

Before delving into our second (albeit small) coal investment, allow me to make the obligatory comments on climate change to assuage any unitholders who might be uncomfortable with such an investment. Firstly, it is almost inconceivable that the usage in any given year of fossil fuels that took many thousands of years to develop could have zero effect on the earth. It is likewise true that since the early 1980's, the rate of warming has significantly undershot almost all published models and the many catastrophic predictions that have failed to materialise have seriously discredited the urgency of climate change in the estimation of most regular citizens.

In my view, what is needed is less catastrophe rhetoric and instead messaging the climate as it is currently operating on earth has been ideal for humanity to thrive. Acknowledging that, we should adopt policies that minimise human impact whilst simultaneously fostering optimal economic improvement particularly for the poorest and most vulnerable of earth's citizenry. To achieve this outcome requires an unemotional assessment of the optimal engineering pathway under currently known technologies that will optimise these two goals, with the capacity for "path correction" when newer and superior solutions arise.

The likelihood that our current usage of fossil fuels represents the "highest and best use" for humanity is vanishingly small. A goal of retention of as much of the available hydrocarbon capacity of earth for use in flying over driving seems like a no-brainer to me. There are likely even higher and better uses for hydrocarbons than even flying that we have yet to develop. Despite the noble goal of "leave it in the ground" believers (of which I would consider myself one, on the proviso it does not cause undue suffering to the global poor and vulnerable), there are always second and third order consequences that must be considered.

There is, for example, a growing body of evidence to suggest the lifetime carbon emissions for EV's might materially exceed ICE (internal combustion engine) vehicles when properly measured. The enormous Li-Ion batteries required to propel the current EV fleet have a massive carbon intensity usually overlooked. The required energy-intensive trucks, crushers, and mills to extract each battery's nickel, cobalt, lithium, and copper produce a mountain of carbon emissions. A proper assessment of lifetime carbon intensity would see most EV owners choke on their decaf oat milk latte with a drizzle. Kidding, I know plenty of EV drivers, but they must jettison any environmental smugness associated with the decision. If it stacks up economically and the driving experience is good, buy an EV. If environmental considerations are driving your decision, do more work.

As an aside, the foregoing paragraph is part of the reason we considered the Li-S Energy battery so potentially transformational, requiring less lithium and more easily obtained sulphur, it is a far more environmentally friendly energy storage solution. If carbon reduction were truly the goal of governments, they would not be able to accelerate the development of such transformational technologies quickly enough...

The most under-discussed elements of transitioning to a low-carbon economy are "Energy return on Energy invested" (EROI) and [capacity factor](#). EROI is a ratio that measures the amount of usable energy delivered from an energy source versus the amount of energy used to create that energy resource. An EROI score of at least 7 is required for an energy source to be viable on an energy return basis. As much as [25 to 60 percent](#) of the energy generated in renewable system is consumed internally, compared with ~3 percent for a modern gas plant.

Wind and particularly solar-photovoltaic both have long, complicated supply chains that consume mountains of energy to create. An under-reported contributor of the massive Chinese energy demand increase in recent decades (that has precipitated their massive installation of coal-fired power plants – see below) is their domination of global production of solar panels, mostly exported to western countries attempting to "lower global emissions". Breaking a bond of silicon dioxide requires a temperature exceeding that of steelmaking, very few who are passionate about solar as a "pro-environment" option seem to understand the importance of this to emissions reduction attempts.

EROI is only a score of the energy required to produce an energy source and does not consider the commercial return of the power source. To be clear, in grids underpenetrated with renewables, they can sometimes stack up well on a traditional investment return calculation if EROI is ignored and until the capacity factor tipping point is reached (discussed further below), investment returns for renewables can be quite good. There are conflicting EROI scores available through research, but the below are some widely accepted estimates of EROI for common generation:

- Nuclear – 75

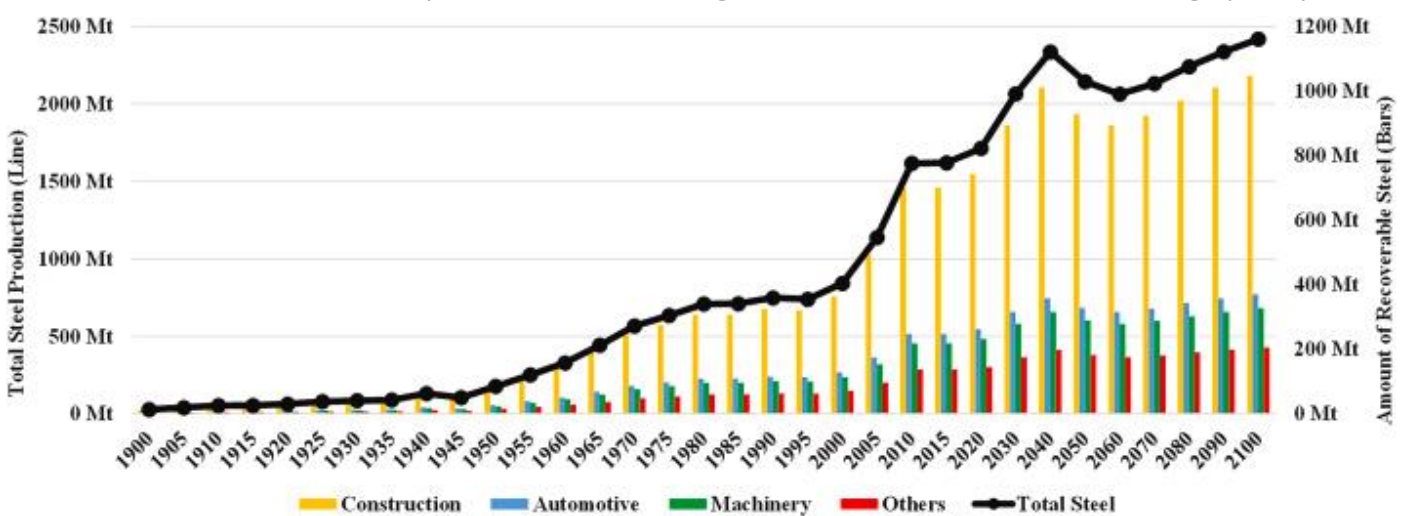
- Hydro – 35
- Coal – 30
- Gas – 28
- Solar thermal – 9
- Wind turbines – 4
- Biomass – 4
- Solar PV – 2

To be clear, these are the scores for the installed base for these asset types, and there have been improvements in more recent generations of the solar and wind especially. Some technological improvement is likely in any new generation method, for example when oil sands first began commercial extraction in the 1970's, the EROI was around one, but current oil sands extraction has an EROI between 4-8, with outliers in the teens, with the technology improving still.

With climate change addressed, onto the WHC investment itself. The Whitehaven acquisition looks like the type of heist that would make a young [Frank Abagnale Jr](#) proud. A sometime correspondent of mine, a retired mining analyst has said to me for years, whenever there is M&A activity from BHP, you must try to be on the other side of the deal. Despite a generally excellent operational track record, BHP have an abysmal record in M&A, overpaying for assets at the tops of cycles and jettisoning excellent assets at the bottoms of cycles. The sale of the Blackwater and Daunia mines to Whitehaven if measured on a long enough timeline may yet be worse than the horrific decision to spend >\$30b acquiring shale assets at the last major peak of the oil cycle. Not long after, BHP wrote off around [1/3 of that investment](#) (~\$10b), but there has been a subsequent recovery in oil prices from ~US\$30 to almost US\$90 since the shale write-down, meaning some of the write-down has likely been recovered. Tragically (for BHP shareholders), the sale is likely driven not by economic factors, but by the BHP boards desire to quiet the madding crowd on ESG.

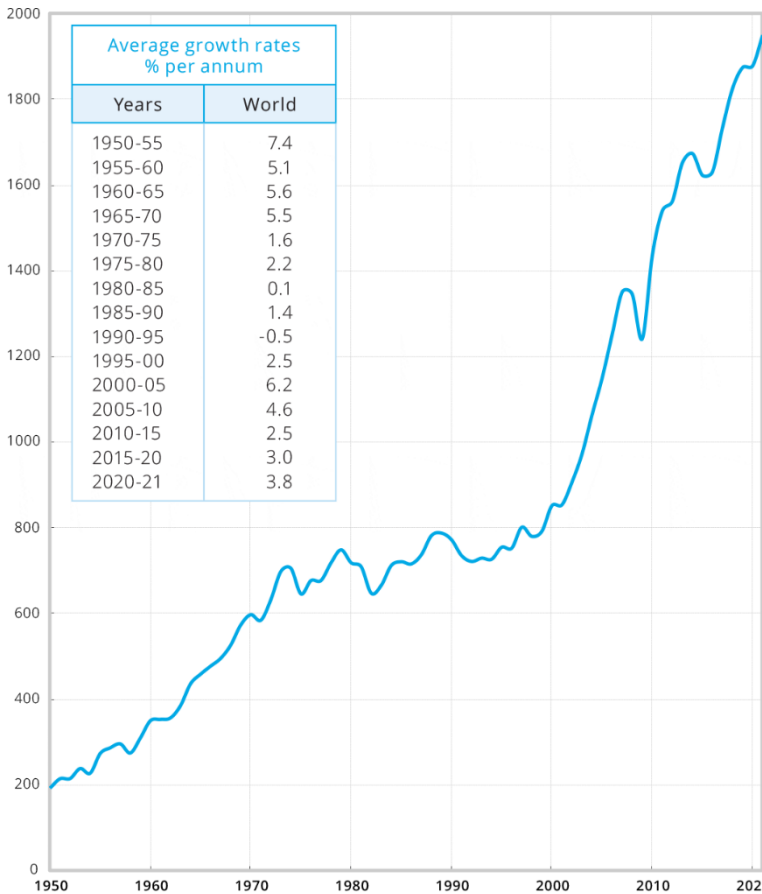
For the AU\$4.8b sale of Blackwater and Daunia to be worse for BHP shareholders than the shale debacle, the assets would need to have been sold for perhaps 40 or 50c on the dollar of their worth and on a long enough timeline, that feels likely to be the case.

To discuss why I like coal as a thematic, we will first look at the “macro” factors that make coal attractive. The argument can be summed up in one sentence – **coal consumption consistently exceeds forecasts, and a lack of greenfield supply means the market is chronically undersupplied** – but such broadbrush statements work better if we can show the scale of such mismatch. When I wrote about our other coal exposure (Bathurst Resources – BRL.AX) I outlined why I feel that metallurgical coal exposure over the long-term is a better/safer bet than thermal/energy coal. In short, there are a variety of viable alternatives to using coal for power generation, which could interrupt the current supply mismatch (particularly once the EROI and storage/capacity factor shortcomings of renewables improve) but there is yet to be a viable, economic alternative to using met coal for steelmaking. Without a viable alternative, it is a financial mistake you do not want to bet against the economic realities the below graphs represent.



I would hazard that the forecast of steel production being similar in 2100 as in 2040 is almost certain to be a massive underestimate. A very few forward thinkers would have anticipated the ~50-fold increase in global steel production

the 20th century observed. But likewise, very few would have anticipated a near quadrupling in global populations accompanied by falling malnutrition through the same period. There has been some progress in the development of electric arc furnace (EAF) steelmaking, and there is even one [Swedish steelmaker \(SSAB\) who has committed to converting their production to the new method](#). Based on their own figures in that piece, there will be a EUR4.5b investment (what's the bet this blows out significantly?) to generate a EUR429.7m expected uplift in EBITDA (what's the bet the realised earnings improvement falls well short of this?). Assuming normal steelmaking depreciation schedules, a ~5% implied pre-tax return on capital for such a risky move makes one wonder if BHP's M&A analysts may have been employed for help in the SSAB EAF investment decision...



The practical reality is that even if EAF proves viable, there is an installed base of ~2000Mt per annum of global steel production capacity, that as a weighted average useful remaining life exceeding 30 years.

There were two mistakes most analysts made when incorrectly predicting the death of thermal coal. The first was that China would behave like the West by ignoring the enormous advantages reliable baseload supply provides for an electricity grid. Despite the rhetoric, in a preponderance of situations, for the past 20 years, when placing a proper economic value on grid-stability, coal and/or gas generation has been the safest investment for ensuring the required [capacity factor](#) existed to handle a larger renewables generation.

A cursory understanding of capacity factor explains why power costs have risen at multiples of the ordinary inflation rate in countries which have leaned heavily into renewables. This is not my “gut-feel”, electricity prices in China have risen from ~CNY0.40 per kwh in 2000 to ~CNY0.55 in 2024 (37.5% increase) in the 21st century Chinese inflation has totalled 70.7%, this means Chinese electricity prices have become 19.4% cheaper in real terms. Electricity prices in Australia have risen from ~10.4c/kwh in 2000 to ~30.9c/kwh in 2024 (197.2% increase) in the 21st century Australian inflation has totalled 99.9%, this means Australian electricity prices have become 48.7% more expensive in real terms.

Nuclear is the gold standard for capacity factor, the example used in the link is [Palo Verde in Arizona](#), which typically runs at a capacity factor exceeding 90%. Next are coal-fired plants, which for most of their lives will run close to 90% but fade fast after they go past their useful life. Australia’s elderly coal plants demonstrate this dropping from [88% in 2008 to 67% in 2020](#) (.pdf) now they are well past their expected lifetimes and being “limped along” because decision-makers have not made the required investments in replacement baseload.

Gas-fired plants usually run up around 60%+, but that is underselling because of how they are typically operated. Because they have the huge advantage in “renewables heavy” grids of being able to come online quickly, gas plants are often used at “peaking supply” running hard when wholesale electricity prices are high, and switched off when excess renewables send wholesale prices negative.

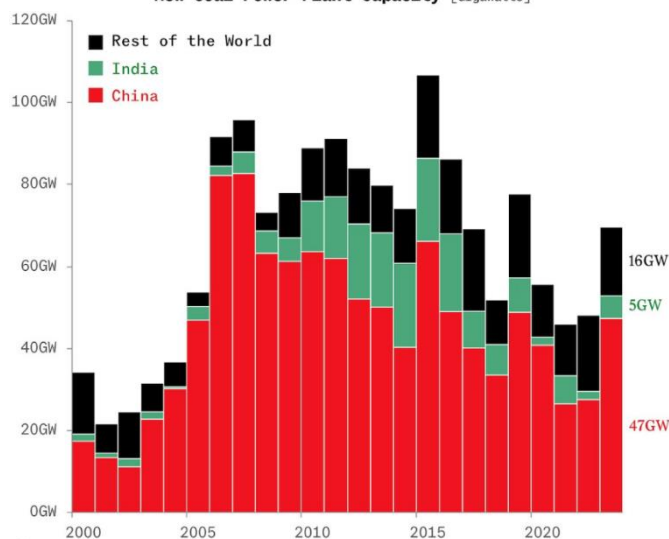
Wind power runs in most installations with a capacity factor of almost 40% but is highly variable given the inherent unreliability of wind. Solar power typically runs around 20-25%, depending on the latitude of the installation, but has a more predictable supply than wind. The table overleaf offers a flavour of US capacity factors over multiple years:

Year	Non-fossil fuels								Coal	Natural Gas			
	Nuclear	Conv. Hydro	Wind	Solar PV	Solar CSP	Landfill Gas and MSW	Other Biomass including Wood	Geothermal		CC	CT	ST	ICE
2013	89.9%	38.9%	32.4%	NA	NA	68.9%	56.7%	73.6%	59.8%	48.2%	4.9%	10.6%	6.1%
2014	91.7%	37.3%	34.0%	25.9%	19.8%	68.9%	58.9%	74.0%	61.1%	48.3%	5.2%	10.4%	8.5%
2015	92.3%	35.8%	32.2%	25.8%	22.1%	68.7%	55.3%	74.3%	54.7%	55.9%	6.9%	11.5%	8.9%
2016	92.3%	38.2%	34.5%	25.1%	22.2%	69.7%	55.6%	73.9%	53.3%	55.5%	8.3%	12.4%	9.6%
2017	92.2%	43.1%	34.6%	25.7%	21.8%	68.0%	57.8%	74.0%	53.7%	51.3%	6.7%	10.5%	9.9%
2018	92.6%	42.8%	37.4%	26.1%	23.6%	73.3%	49.3%	77.3%	54.0%	57.6%	11.8%	13.7%	NA

As the graphic below demonstrates, for the past 20 years, China has built almost three-quarters of the new coal-fired electricity generation globally in the past 20 years. Given they are the largest producer of solar panels, this tells me that Chinese electrical engineers likely had more input into the format of the electrical grid than they have been given in Western countries which have allowed their grids to become dangerously unstable in many instances.

BURNING AMBITION China Is Still Building New Coal Plants

New Coal Power Plant Capacity [Gigawatts]



CHART

Source: Global Energy Monitor

The outworking of this fact is that there is a 2.3 terawatt global installed coal generation capacity that has a useful life of more than 30 years and is forecast to remain at [~2.3 terawatts until 2050](#). If one looks back at predictions about coal usage over the past few decades, one could be forgiven for expecting the installed coal capacity to exceed that expectation.

The foregoing outlays a few of the reasons why both thermal and met-coal demand has been grossly underestimated in recent decades.

Anyone with a cursory eye on the news would understand why the supply response that would usually accompany such an event has not materialised. Coal of all types is a pariah in the eyes of an increasingly powerful environmental lobby.

The “inconvenient truth” is that the low EROI of renewables mathematically requires an increase in the consumption of

fossil fuel until the reliability and installed capacity of renewables allows fossil fuel “escape velocity” to be achieved. As much as an exit from fossil fuel use is required, to co-opt a quote I once heard, but cannot remember the correct attribution for, “In the battle between ideology and physics, physics is undefeated”.

The nearly 4 pages above outline the factors that created the coal market we currently see, that allows the WHC opportunity to exist. But all that really matters for investors is what is the return we can expect from making an investment.

At our purchase price and using the forward price curve as our “base case” when one annualises the production levels of the business after the acquisition completed in April, the free cashflow to equity is almost 40%. We know the spot price for all commodities swing wildly, but we are currently in “shoulder season” for coal, when prices are weak, and given the structural supply/demand mismatch described above, spot prices as a base feels fair.

For our “bull” case, we use prices about 25% above spot and the FCF to equity yield at purchase exceeds 60%. For a “bear” case, a price 25% below spot is used and still generates close to 20% FCF to equity.

Commodity prices can swing capriciously, but the market dynamics are very much in our favour with demand steadily rising and the brakes on new supply from every direction. WHC management have stated an intention to use the FCF

from the newly acquired assets to retire the debt used to fund the deal, whilst the cash from the original mines will be used to fund dividends.

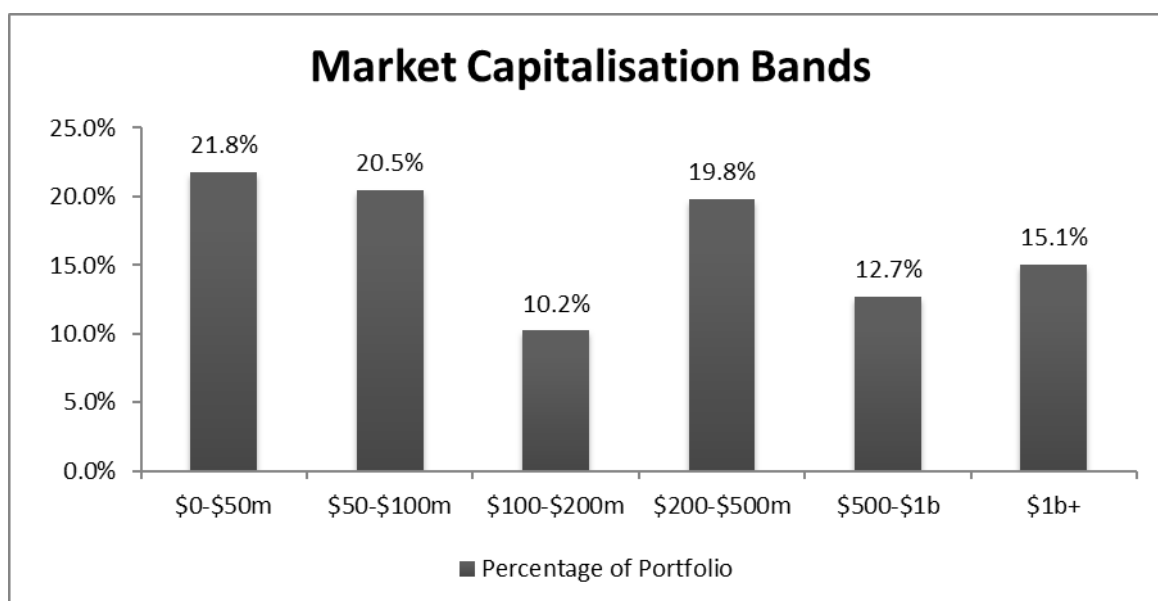
My expectation is that with this deal effectively “vendor financed”, is that as each tranche of debt falls due, the net debt of WHC overall is likely to fall. That is how bad the BHP transaction is, they are effectively paying WHC to take it from them. One of the acquired mines began operation in 1967 and has resources that will last at current rates of production for more than 50 years. Truly world class assets, with a management that intends to improve operations, but with an investment case that requires no operational improvements for a great investment outcome. Furthermore, in FY2025, this one smallish miner will pay somewhere in the ballpark of \$2.5b of royalties and income taxes to various Australian governments.

Key Portfolio Information: -

Our top 10 holdings on 30 April 2024 were:

Rank	Holding	Percentage Weighting	Equity	Percentage Weighting	Portfolio
1	United Overseas Australia (UOS.ASX)	12.7%		12.1%	
2	Smartpay (SMP.ASX)	9.4%		9.0%	
3	Tellus (unlisted)	7.9%		7.5%	
4	Shriro Holdings (SHM.ASX)	6.9%		6.6%	
5	Dicker Data (DDR.ASX)	6.7%		6.4%	
6	Cettire (CTT.ASX)	6.1%		5.8%	
7	Matrix Composites (MCE.ASX)	5.3%		5.0%	
8	SDI Limited (SDI.ASX)	5.2%		5.0%	
9	Stealth Group (SGI.ASX)	4.6%		4.4%	
10	PPK Group (PPK.ASX) inc. White Graphene pre-IPO holding & PPKME	4.5%		4.3%	

Our largest 5 holdings comprise 43.6% of our invested capital, our top 10 holdings are 69.4% and our top 15 represent 85.2%. Cash and cash equivalents are 4.6% of the portfolio. The median market capitalisation is \$143.6m. Weighted average market capitalisation is \$535.2m.



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	-0.16
Additional investments	\$500k Maximum	Sortino Ratio ¹	0.12
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP	17.7%
		Annualised S/D - Benchmark	15.0%
Distribution	Annual 30 th June	Largest Monthly Loss – EGP	-28.9%
		Largest Monthly Loss - Benchmark	-20.7%
Management fee	0%	Largest Drawdown – EGP	-33.9%
		Largest Drawdown - Benchmark	-26.7%
Performance fee (<\$50m)	20.5% (inc GST)	% Of Positive Months – EGP	55.6%
Performance fee (>\$50m)	15.375% (inc GST)	% Of Positive Months - Benchmark	63.0%
Auditor	Ernst & Young	Cumulative return ² – EGP	9.9%
		Cumulative return ² – Benchmark	74.3%
Custodian/PB	NAB Asset Services	1-year return ² – EGP	1.9%
		1-year return – Benchmark	9.1%
Responsible Entity	Fundhost Limited	3-year annualised return ² – EGP	(4.8%)
		3-year annualised – Benchmark	7.3%
Fund Size	\$35m	5-year annualised return ² – EGP	2.1%
		5-year annualised – Benchmark	8.0%
Mid-Price for EGPCVF Units	\$0.8458	Buy Price for EGPCVF Units	\$0.8458
Accumulated Franking per Unit	\$0.0062	Sell Price for EGPCVF Units	\$0.8446

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:

