EGP Concentrated Value Fund

Address: Suite 2, Level 11, 37 Bligh Street
Sydney, NSW, 2000

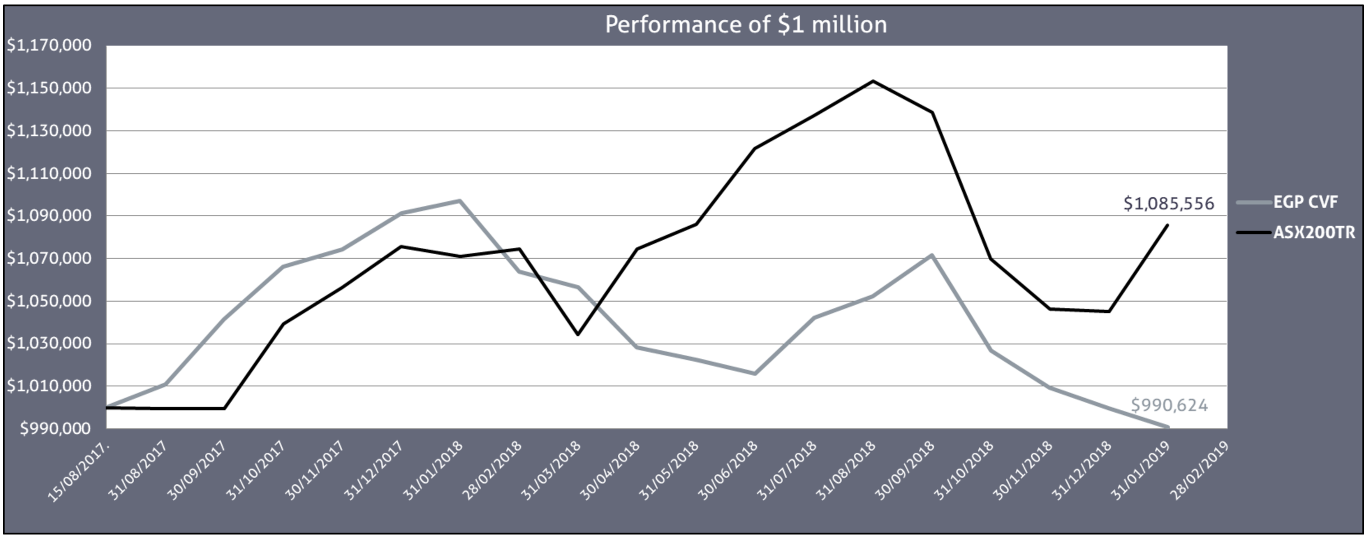
Mobile: 0418 278 298

EGP Concentrated Value Fund – 31 January 2019

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%)						(2.48%)
Benchmark FY19	1.4%	1.4%	(1.3%)	(6.1%)	(2.2%)	(0.1%)	3.9%						(3.23%)

*August 2017 is the period from August 15th-31st for both the fund and the benchmark in the above tables.



<u>**The Month That Was:-**</u>

The fund fell by (0.9%) in January. Our benchmark rose by 3.9%.

The subject of our monthly update last month caused most of the underperformance we endured this month. Locality Planning Energy (LPE) was responsible for reducing the assets of the fund by 1.1% in January. I will expand on this in one of the sections below. One of the "Undisclosed" holdings in the top 10 also caused us some quotational pain as the stock was sold off late in the month on very thin volumes causing a mark to market loss of about 0.6% of the fund. We will leave this investment undisclosed as we think it is an extraordinary opportunity at current prices and will continue to accumulate the stock if pricing remains at current levels.

The fund would have been up over 1% in January without these two stocks, but would still have meaningfully trailed our benchmark which was sharply higher. This is the price one can pay for concentrated investment at times. There were a number of positive announcements from the fund's other investments throughout the month, but not a sufficient reaction to the positive results to save us from the markets view of the value of LPE and the undisclosed holding.

On Saving and Building Wealth:-

I've had a couple of requests for more writing about the wealth creation and cost minimisation strategies I have periodically featured in the blog and newsletters. We won't go too detailed this month, but there are a few very simple things that should become habitually embedded in the household behaviour of anyone wishing to accumulate wealth.

Most of these ideas are laid out in broad-brush strokes in an old favourite book of mine called "The Richest Man in Babylon". The book can be found in a downloadable (.pdf) version without too much effort via an internet search, but I won't post a link as I can't be certain of the copyright issues in so doing. I commend the reading of the book to anyone looking to improve their financial situation, it's coming up on 100 years old, but the material is pretty timeless.

The first one is habitual saving "Start thy purse to fattening" is the relevant chapter from the book. The best method will vary here depending on personal circumstance; it may be a sweep of 10 or 20% of after tax salary (or more if you can afford it!) into a savings account after every payday, or perhaps to salary sacrifice into superannuation. Despite constant meddling by all political parties in Australia, superannuation will likely remain the best way to save to ensure a comfortable retirement.

Chapter two of the book is "Control thy expenditures", which is an area very few households couldn't find ways to improve. Apparently 40% or more of the average household bin is food waste, which evidently amounts to at least $8 billion annually. This fact staggered me; I'd be surprised if as much as 5% of my family bin is food waste. Some very basic planning could free up at least $1,000 or more for an average family annually. I point out to my children that in order to have $1,000 to spend, most people need to earn about $1,500 before taxes.

Habitually checking annual bills like insurances can save most households plenty as well. Ensuring the most cost effective telecommunications and utilities can also have a big impact. Constantly badger your bank to ensure you've got the best home loan deal too. Smoking and playing virtually any type of lottery are two behaviours that anyone who spends a few moments thinking about them will have little trouble stopping. Both activities are basically massive voluntary tax payments, surprising when most people don't think the taxes they pay are very efficiently spent. Most lotteries return less than 2/3 of the money taken as prizes. The average smoker in Australia apparently spends $9-11,000 annually on their habit, with most of that cost being taxes. If the Government raised the average taxpayers' contribution by $10,000 the taxpayer would be (correctly) outraged.

Outside of these simple things, thinking about whether the consumption you are undertaking is really adding sufficient marginal happiness for the detriment it is inflicting on your financial situation. I recommend a heuristic called "Satisficing", which will leave plenty of extra cash in your pocket when employed habitually. Instead of owning the best or most expensive product, you find the least expensive version of the product that satisfies your need. Make sure you're not using your consumption to please others, only you need be pleased with what you own and use.

Rational Choice Theory implies individuals always make prudent decisions based in logic. This may apply fairly broadly to groups, but for most individuals, if they were to think deeply about the intersection of their long-term financial goals more regularly, the deferral of gratification would be much easier to do.

Portfolio Activities:-

As I mentioned in "The Month That Was" section, LPE severely hurt our performance this month. The market reaction to the Appendix 4C and the subsequent correction to that document were deservedly harsh. Investors who are not intimate with the internal operations of a business rightly expect forecasts to be achieved and that the market announcements a company release to be accurate. LPE failed on both fronts this month. Firstly, the cash revenue was about 25% down on what I was expecting, and based on the correction to the share price, even more than that down on market expectations. Upon reviewing the [AER website](), it is clear that wholesale electricity prices in Queensland (the major driver of LPE's revenues) were meaningfully lower in the December 2018 quarter than the prior period. The majority of LPE's customers are still embedded networks and the embedded network relationship essentially involves LPE applying a margin to the wholesale price and the network costs. This ensures margins are maintained even when markets are volatile, but in a sharply lower pricing environment severely impacts revenues and therefore profits.

Unfortunately LPE's management didn't take the opportunity to quantify the level of wholesale pricing differences compared to the PCP, or any reduction in network charges they are also required to pass along. Without the ability to fully understand the drivers of the revenue shortfall, market participants (understandably) panicked. I have spoken at length with management about the poor quality of their communication and the need to ensure all the information that is not commercially sensitive that a market participant might need to fully understand the business should be included. They acknowledged their failings in this regard and said they intended to get a comprehensive clarifying 'mea culpa' announcement out ASAP. My advice was not to do it ASAP, but when the presentation was clearly and unambiguously complete, correct and contained all relevant information. They still haven't released it, so I gather they're still working on it.

The market reaction looks very much to me like a 'baby out with the bathwater' situation. The cashflow for December 2018 was 45.6% higher than December 2017 and FYTD19 vs FYTD18 cash flow is up 51.5% and they are cashflow positive. Absent the lower wholesale prices realised so far in FY19, these figures would likely be more like 70-75% higher year on year. This is a very fast growing business in the process of building out a highly cash generative and stable annuity cashflow stream. We have been adding to our position.

Through January and since, the share price of our second largest holding (KPT) has risen steadily. Now that the EIS has been submitted, market participants appear to be seeing the light at the end of the long approval tunnel. We wrote in April about the highly cash generative business KPT (.pdf) would have if they gain approval for the wharf. Since then the price for export woodfibre has increased by 11%, which should make the cash flows even more attractive should approval be granted.

We discussed the fund's investment in Site Group in the June Report (.pdf). We will be traveling to The Philippines for a few days this month to assess the progress of the land sale first mentioned by management in June 2018. If we can get comfortable about the likelihood of a deal completing, we may well add to the position as the upside is potentially a multiple of the current share price should a real estate transaction occur. Somehow despite the nightmare the business is being put through with the authorities crippling the Australian education business, they've managed to be cash flow positive in the first half as the international business rapidly expands.

The price of our largest holding (UOS) dropped sharply through January, this enabled us to add to the position at incredible prices of 60-61c that we thought were unlikely to be seen again given how powerfully the business is presently operating. The NTA per share should slightly exceed $1 per share when the results are released later this month. As I've described previously, NTA is extraordinarily conservatively stated, with a running yield exceeding 7% on the investment properties despite about 1/3 of the properties being very immature and not yet fully let. The "other income" lines of the business (rental/car-parking/hotels/associates etc) now cover all operating costs of the business and mean 100% of any property development profits fall straight to the bottom line. The December profit update indicated $88m of after tax earnings despite not revaluing any investment properties this year has the company trading at a very low valuation based on any metric such a business would normally be measured on. The two blockbuster developments at Sentul Point and United Point will complete in 2020 and the business will be gushing cash at that point.

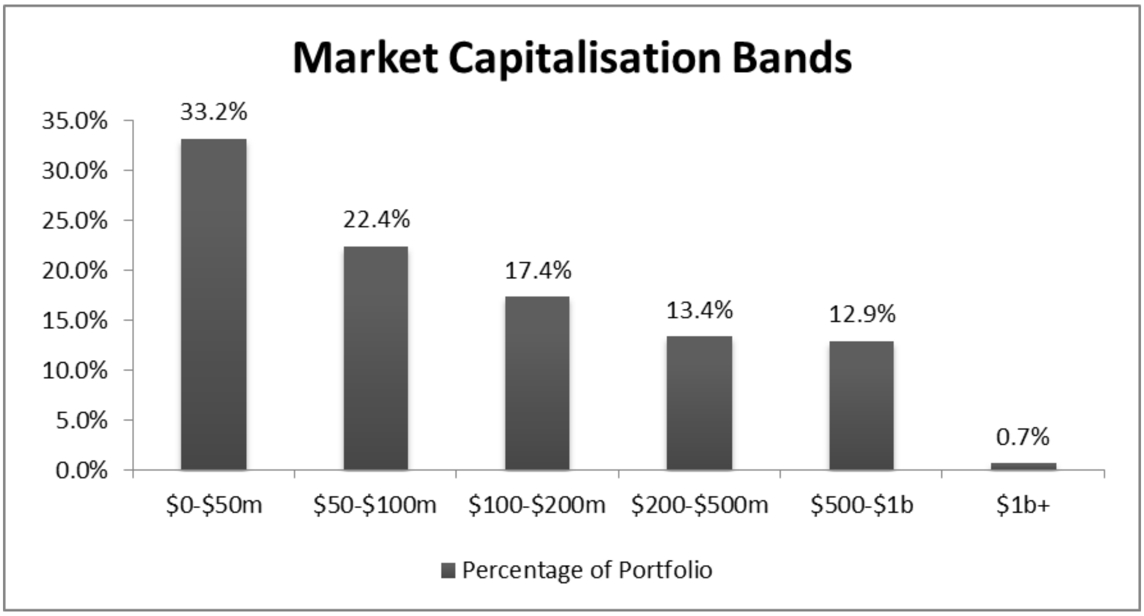
Key Portfolio Information:-

Our top 10 holdings at 31 January 2019 were:

Rank	Holding	Percentage Equity Weighting	Percentage Portfolio Weighting
1	United Overseas Australia (UOS.ASX)	12.9%	11.1%
2	Kangaroo Plantation (KPT.ASX)	9.2%	7.9%
3	Legend Corporation (LGD.ASX)	7.9%	6.8%
4	APN Regional Property (APR.NSX)	5.5%	4.7%
5	Undisclosed	4.6%	4.0%
6	SRG Global (SRG.ASX)	4.5%	3.9%
7	Blackwall Limited (BWF.ASX)	3.8%	3.3%
8	Locality Planning (LPE.ASX)	3.2%	2.8%
9	Undisclosed	3.1%	2.7%
10	Dicker Data (DDR.ASX)	2.8%	2.4%

Our largest 5 holdings now comprise 40.1% of our invested capital, our top 10 holdings are 57.6% and our top 15 represent 70.1%. Cash and cash equivalents are 14.1% of the portfolio.

The market capitalisation graph is set out below. This month, the median market capitalisation is $85.6m.



As always, investors with any questions, suggestions, comments or investment ideas should feel free to drop me a line – Tony@egpcapital.com.au

Fund Features		Portfolio Analytics	
Min. Initial investment Max. Initial investment	$50,000 $2,000,000	Sharpe Ratio[1]	0.52
Additional investments	$5,000 (Minimum) $200,000 (Maximum)	Sortino Ratio[1]	0.41
Applications/redemptions	Monthly	Annualised Standard Dev. – EGP Annualised S/D - Benchmark	7.03% 9.26%
Distribution	Annual 30th June	Largest Monthly Loss – EGP Largest Monthly Loss - Benchmark	-4.2% -6.1%
Management fee	0%	Largest Drawdown – EGP Largest Drawdown - Benchmark	-7.6% -9.4%
Performance fee (<$50m) Performance fee (>$50m)	20.5% (inc GST) 15.375% (inc GST)	% Of Positive Months – EGP % Of Positive Months - Benchmark	48.6% 54.3%
Auditor	Ernst & Young	Cumulative return[2] – EGP Cumulative return[2] – Benchmark	(0.9%) 8.6%
Custodian/PB	NAB Asset Services	1 year return[2] – EGP 1 year return – Benchmark	(9.7%) 1.4%
Responsible Entity	Fundhost Limited	3 year annualised return[2] – EGP 3 year annualised – Benchmark	N/A N/A
Fund Size	$55.4m	5 year annualised return[2] – EGP 5 year annualised – Benchmark	N/A N/A
Mid-Price for EGPCVF Units Accumulated Franking per Unit	$0.9528 $0.0040	Buy Price for EGPCVF Units Sell Price for EGPCVF Units	$0.9542 $0.9513

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.

The information in the below table is provided for shareholders in EGP Fund No. 1, and does not relate to the EGPCV Fund.

EGP Fund No. 1 Pty Ltd Equivalent Price	$1.9546
EGP Fund No. 1 Pty Ltd Franking Credits	$0.0111