

Greencape Wholesale Broadcap Fund

Quarterly report - June 2016

| Performance # | Quarter % | 1 year % | 3 years % p.a. | 5 years % p.a. | 7 years % p.a. | Inception % p.a. |
|--------------------------------|-----------|----------|----------------|----------------|----------------|------------------|
| Fund return | 2.42 | 5.89 | 9.49 | 9.19 | 11.17 | 8.65 |
| Growth return | -0.19 | 0.50 | 1.54 | 2.56 | 4.61 | 2.46 |
| Distribution return | 2.61 | 5.38 | 7.94 | 6.63 | 6.56 | 6.19 |
| S&P/ASX 300 Accumulation Index | 3.98 | 0.87 | 7.68 | 7.20 | 8.68 | 4.84 |
| Active return [^] | -1.56 | 5.01 | 1.81 | 1.99 | 2.49 | 3.81 |

Past performance is not a reliable indicator of future performance.

Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures.

[^] Numbers may not add due to rounding

Investment objective

The Fund aims to outperform its benchmark over rolling three-year periods.

Responsible entity

Fidante Partners Limited

Investment manager

Greencape Capital Pty Ltd

Investment strategy

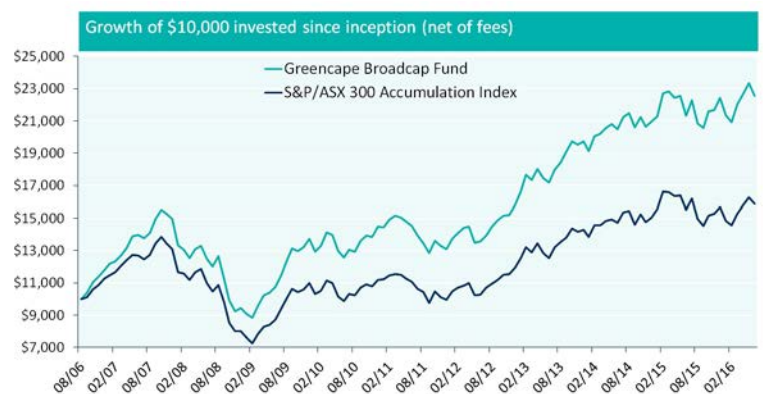
Greencape is an active, 'bottom-up' stock picker. Whilst Greencape does not target any specific investment style and will invest in stocks displaying 'value' and 'growth' characteristics, its focus on a company's qualitative attributes will generally lead to 'growth' oriented portfolios. This is an outcome of its bottom-up process. As such, Greencape's investment style may be classified as 'growth at a reasonable price'.

Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

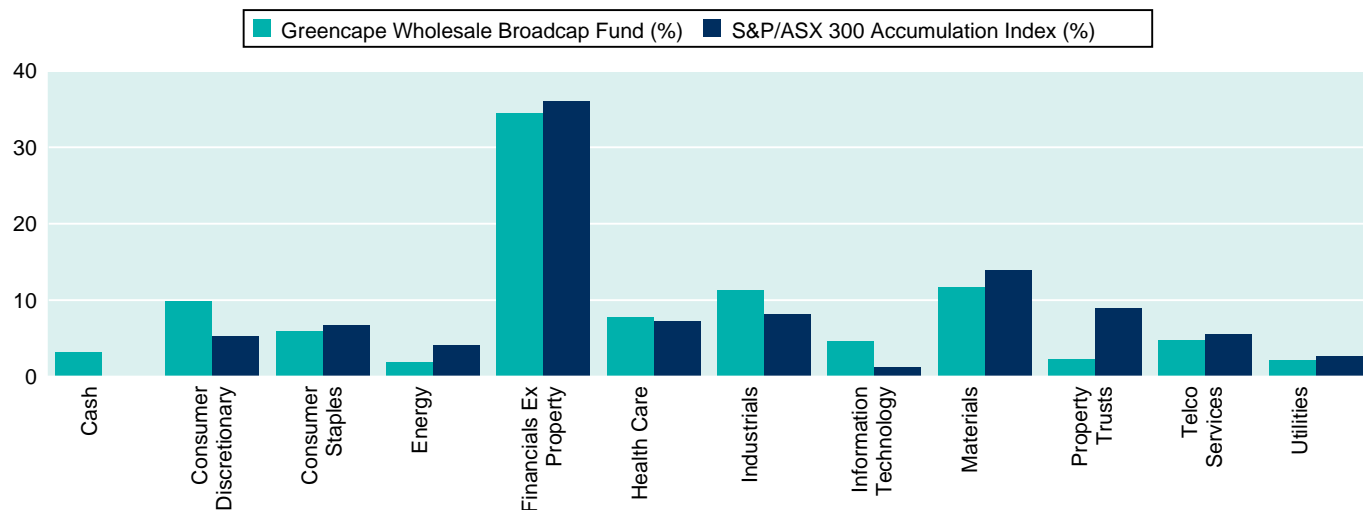


| Asset allocation | As at 30 June 2016 (%) | Range (%) |
|------------------|------------------------|-----------|
| Security | 96.85 | 85-100 |
| Cash | 3.15 | 0-15 |

| Fund facts | |
|----------------|-------------------|
| Inception date | 11 September 2006 |
| APIR code | HOW0034AU |

| Fees | |
|-----------------|--|
| Entry fee | Nil |
| 2014-2015 ICR | 1.09% |
| Management fee | 0.95% p.a. |
| Performance fee | 15% of the Fund's daily return (after fees and expenses and after adding back any distributions paid) above the Fund's Performance Benchmark (the daily return of S&P/ASX 300 Accumulation Index). |
| Buy/sell spread | +0.20% / -0.20% |

Sector exposure as at 30 June 2016



Fund performance summary

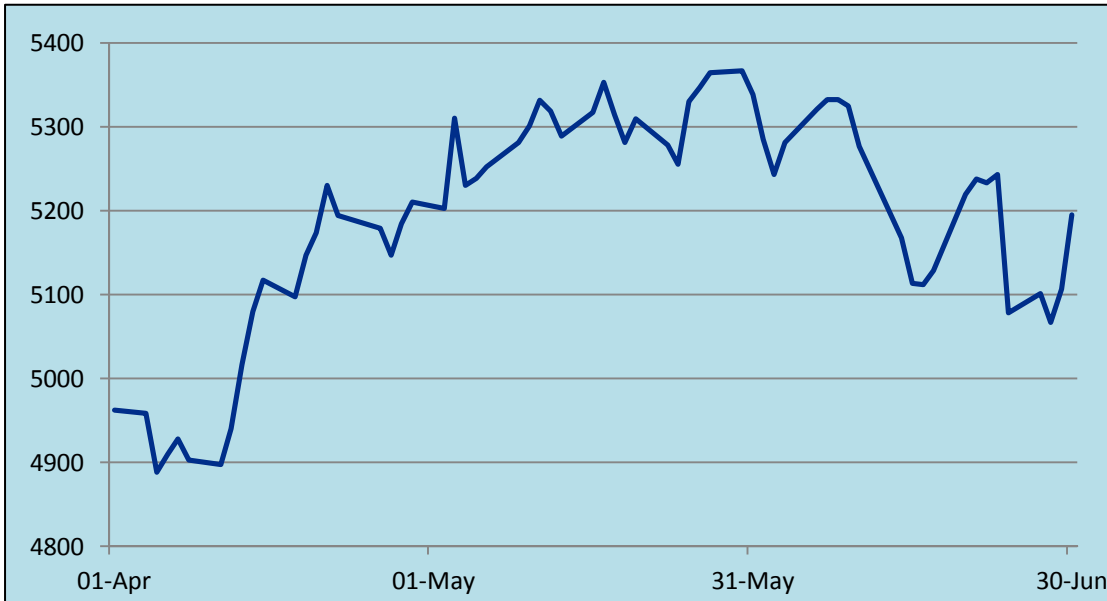
The S&P/ASX 300 Accumulation Index returned +3.98% for the quarter. The fund underperformed the market and delivered a +2.42% return over the quarter.



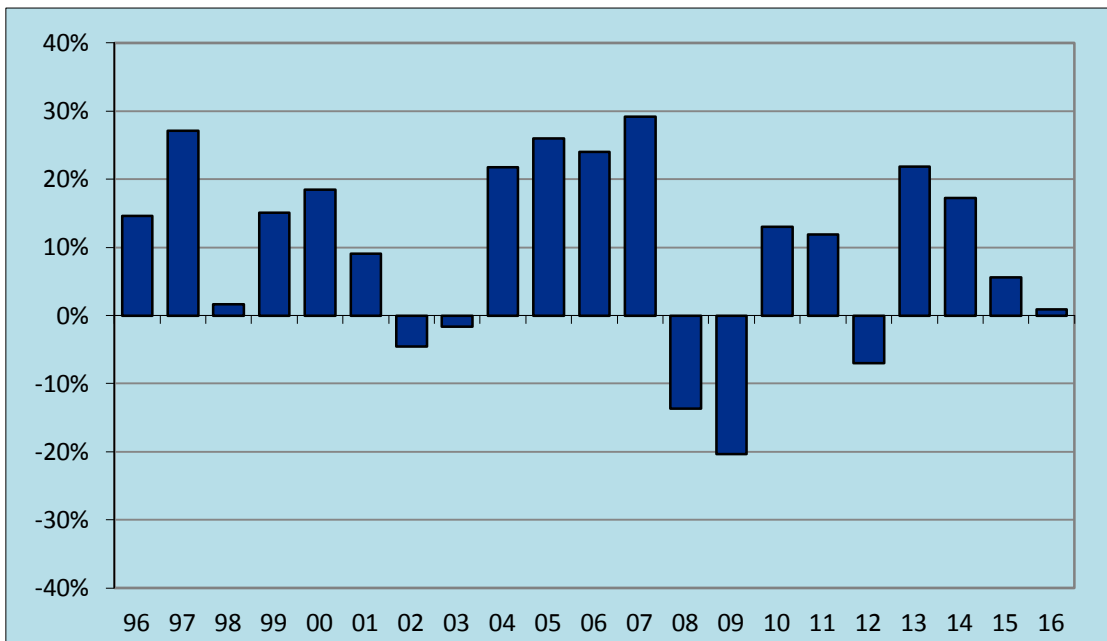
Market overview

A commodity price fuelled rally saw the local index start strongly during the period, as the Materials index rose 14% in April alone. Central Bank actions continued to influence markets, as expectations around another US Federal Reserve (Fed) interest rate hike were pushed out. A surprising referendum result in the UK late in the quarter caught global markets off guard, which resulted in a marked increase in volatility to round out the financial year. The Accumulation index still managed to post a small gain for the year, albeit the lowest in four years.

S&P/ASX 300 Accumulation Index



S&P/ASX 300 Accumulation Index Financial Year Returns Since 1996

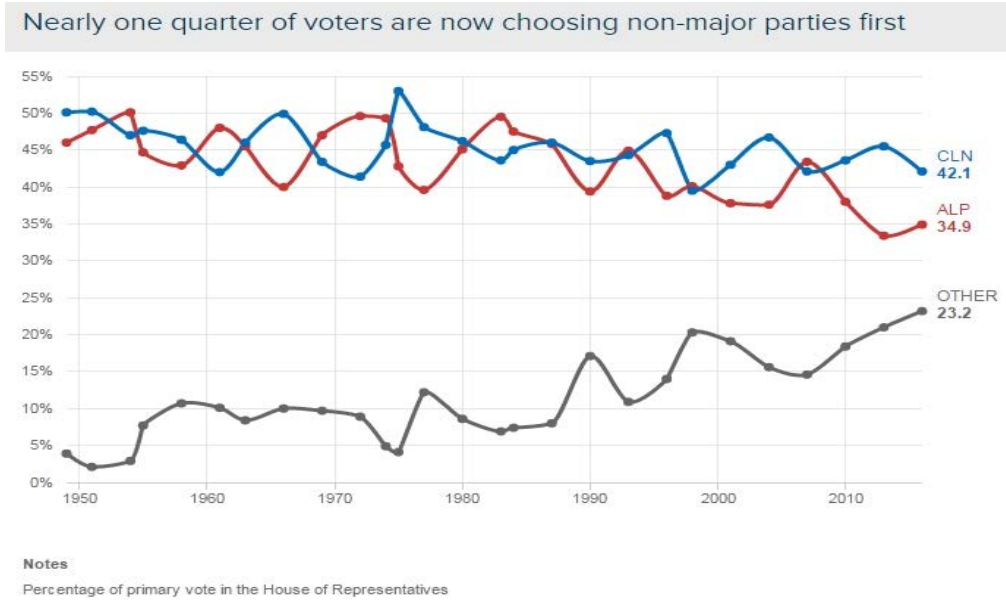


The divergence in performance between the mega-cap stocks and the smaller capitalised stocks was stark over the financial year.



The RBA surprised the market in May by cutting the overnight cash rate to a new record low of 1.75%. After the Brexit result, the market is now attributing an approximate 60% chance of another 25 basis point rate cut at the August meeting. A Federal election was held post-quarter end, the result of which was still undecided at the time of writing, as neither party could obtain a majority in the House of Representatives to form government.

As we see below, the share of non-traditional parties reached a record high as voters continue to desert the major parties.

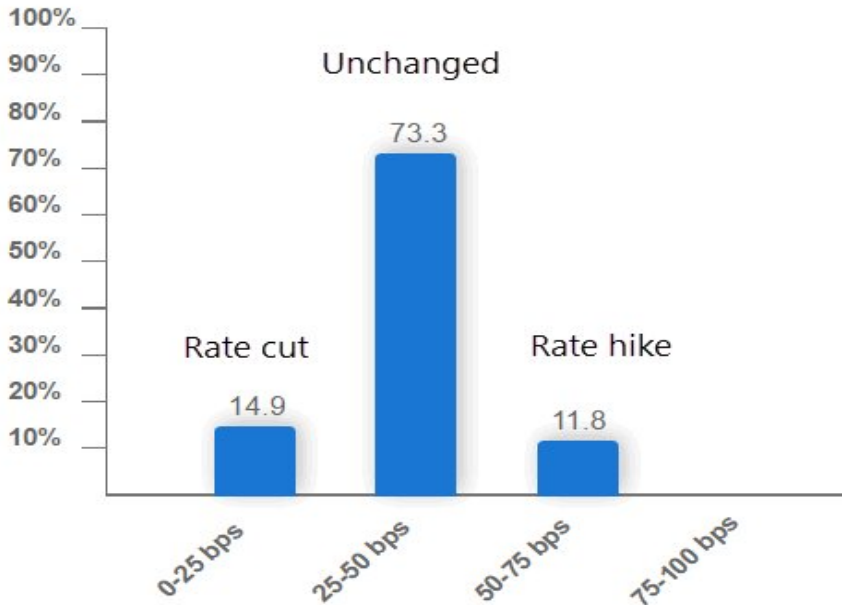


Source: ABC

The Federal Budget was also unveiled in May, which included the introduction of a \$1.6m cap on individual superannuation balances and a \$500k cap on life-time non-concessional contributions.

“Political gridlock that leads to a sustained widening of the deficit would put downward pressure on the (AAA) rating, particularly if the economic environment deteriorates.”
Mervyn Tang,
Director of Asia-Pacific Sovereigns
at Fitch, 04/07/2016

In the US, a much weaker than expected non-farm payrolls report (+38k jobs compared to market expectations of +160k) kept the Fed from hiking rates further in June. Despite the Fed's best efforts in communicating a hawkish tone and insisting the July meetings was still 'in-play' for another rate hike, the market has completely dismissed this view post the Brexit result. As shown below, the futures market is now pricing in a higher probability of a rate cut than a rate hike this year.



Source: CME

After the incredible rise and fall of the Shanghai stock exchange last year, Chinese investors turned their attention to commodity futures in April. The trading frenzy saw the prices of a range of commodity futures from soy beans to steel rebar soar, with the latter rising 65% from its December low.

Market turnover at the height of the frenzy in April was over USD\$260bn on the futures exchanges, which dwarfs the S&P500 average daily trading value of \$35bn. On a single day, there was enough cotton traded to make a pair of jeans for every person on the planet, and enough soybeans traded for over 50 billion servings of tofu. Similar to the Shanghai Composite index activity last year, this activity was driven predominantly by retail investors, with over 40% of the trading volume occurring during the night session.



Source: CLSA

“Trump has written a lot of books about business—but they all seem to end at Chapter 11.” Hillary Clinton, Presumptive nominee of the Democratic Party for President of the United States, 22/06/2016

The surge in activity came with exceptionally short holding periods, as investors sought to profit from heightened intraday volatility.



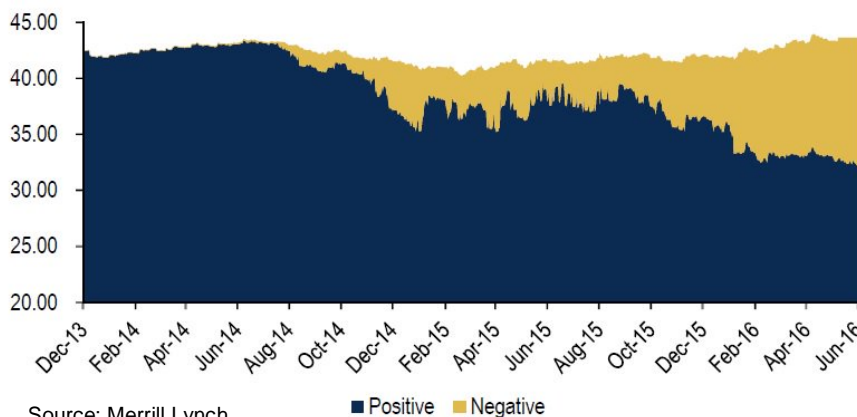
Source: Bloomberg

The rally in commodity futures translated into significant outperformance for the Materials sector during the quarter, as the sector found itself at the unfamiliar position at the top of the performance table for the quarter.

| | June 2016 Quarter | Year ended June 2016 |
|---------------------------------|-------------------|----------------------|
| ASX300 Accumulation Index | 4.0% | 0.9% |
| Best performing sectors | | |
| Materials | 11.5% | -2.8% |
| Healthcare | 10.2% | 21.1% |
| Property Trusts | 9.2% | 24.6% |
| Worst performing sectors | | |
| Consumer Staples | -3.9% | 1.4% |
| Financials ex Property Trusts | 0.4% | -8.6% |
| Information Technology | 1.5% | 3.8% |

Property trusts continued to outperform as investors sought alternative sources of yield to bonds, whose spreads continue to tighten. Following the Brexit referendum, the Australian 10 year government bond yield traded at a new record low of less than 2%. The yield is of course still positive however, unlike an increasing number of global bonds as evidenced below.

The world is even poorer....in yield terms...after Brexit (Global fixed-income debt, \$tr.)



“You have far too much credit, money sloshing about, money looking for higher returns... Even in commodities where you could have argued there is some reason for prices to rise, that gets quickly swamped by a nascent bull market and becomes an uncontrollable bubble.” Fraser Howie, Author, 10/05/2016

Consumer Staples was the only sector to retreat during the period. Price deflation continued to impact the major supermarket chains, as Woolworths posted negative comparable third quarter sales growth. On the conference call following the sales update, management called out two issues in particular, customer service improvement on weekends (especially Sundays) along with stock availability problems due to problems with the inventory management system, particularly in fresh food. We took a tour of a local Woolworths on a Sunday evening to see how these initiatives were tracking first hand.

We noted the following:

No baskets



No Bananas



No berries



“There's nothing more frustrating than a customer coming to the store and the product is not there. So, I think it's had a material impact on our customers and that's the thing we need to focus on most.” Brad Banducci, CEO of Woolworths, 02/05/2016

Along with a number of empty fruit shelves



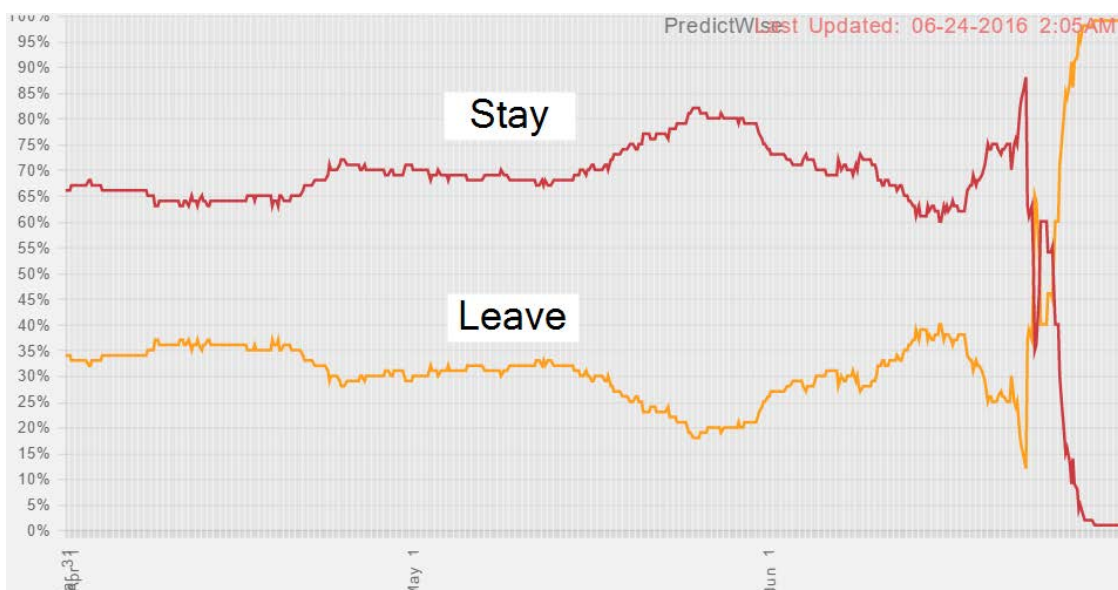
We will continue to monitor this situation, both as investors and consumers!

Brexit

Given the challenges the European Union (EU) has faced over recent years, there has been a growing discontent within the UK of its place within the bloc. In an effort to appease certain factions within the Conservative party, British PM David Cameron in 2013 promised to renegotiate the UK's relationship with Europe along with the intention to put the UK's membership in the EU to a vote. On June 23, a referendum was held whereby the United Kingdom was given the simple choice on whether to remain or leave the EU. Since the date of the vote was confirmed in February, betting markets had prescribed an approximate probability of 30% of the Leave vote succeeding. Opinion polls in the lead up saw the result as much closer, however it was assumed that the undecided voters would opt to remain with the status quo, much like the Scottish referendum on whether to leave the UK in 2014.

The betting markets were wrong.

Probability of Stay vs Leave

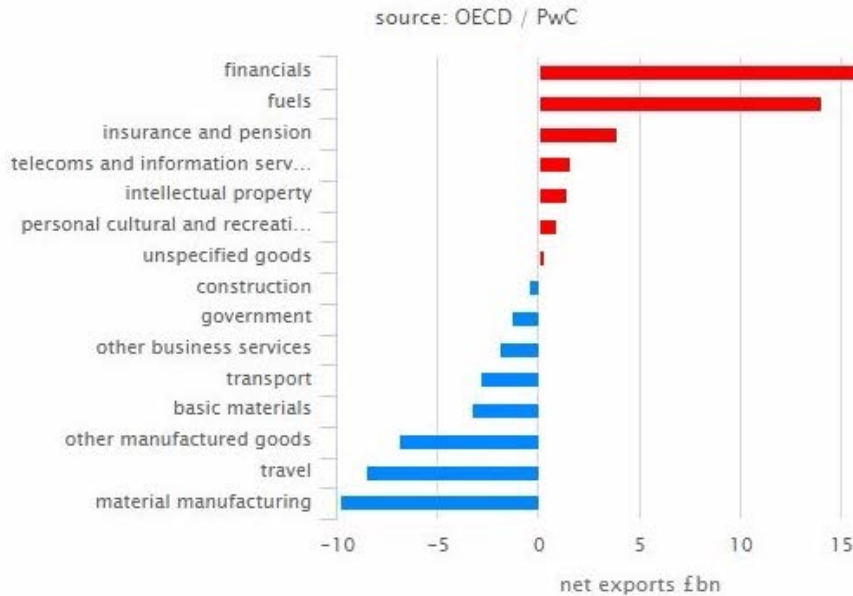


Source: PredictWise

The financial markets were also caught off guard, with the FTSE 100 up over 1% the day before the vote as the probability of a Leave outcome was given as low as 10%. The Australian market opened up nearly 1% on the 24th of June, however once the voting results started filtering through and the Leave outcome became increasingly likely, the ASX200 fell 5% from its intraday highs. Australian listed financial services companies with UK exposure were sold off harshly, as the Pound Sterling lost more than 10%. Globally, financial services companies with exposure to the UK were sold off harshly. Many of these companies have set up offices in the UK as their EU hub, which may have to change in the future.

"China hopes to see a prosperous Europe and a united EU, and hopes Britain, as an important member of the EU, can play an even more positive and constructive role in promoting the deepening development of China-EU ties."
 Chinese Foreign Ministry, 23/10/2015

UK's trade relationship with the EU



Source: OECD/PwC

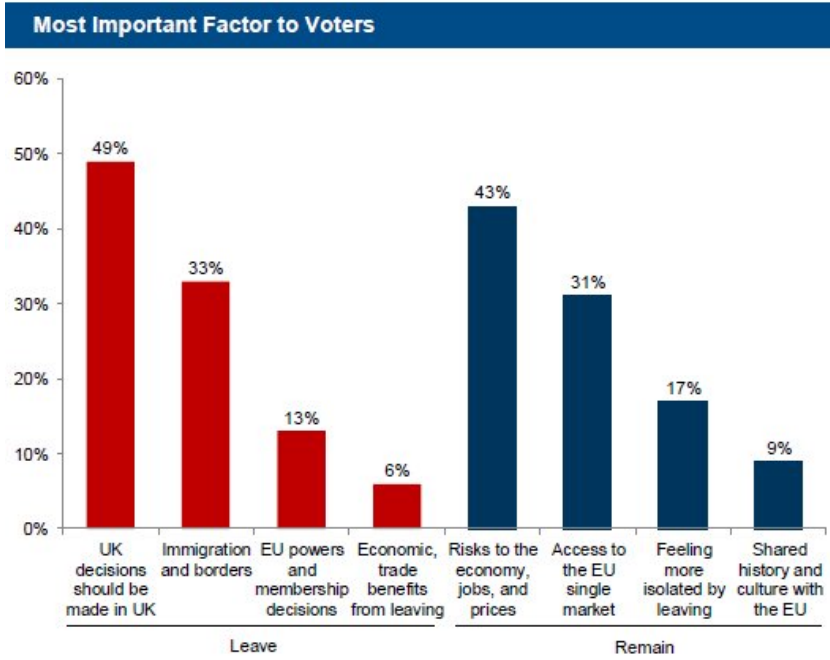
In the aftermath of the vote, the UK had its credit rating downgraded from AAA to AA. Below is a selection of economist predictions of the impact of the Brexit on UK GDP.

| | Effect on GDP Level (%) |
|------------------|-----------------------------|
| PwC | -3.1 to -5.5 (over 5 years) |
| Citi | -4 (over 3 years) |
| Credit Suisse | -1 to -2 (over 2 years) |
| Deutsche Bank | -3 (over 3 years) |
| HSBC | -1 to -1.5 (over 1 year) |
| JP Morgan | -1 (over 1 year) |
| Morgan Stanley | -1.5 to -2.5 (over 2 years) |
| Nomura | -4 (over 1 Year) |
| Société Générale | -4 to -8 (over 5 years) |

Source: Bank of England

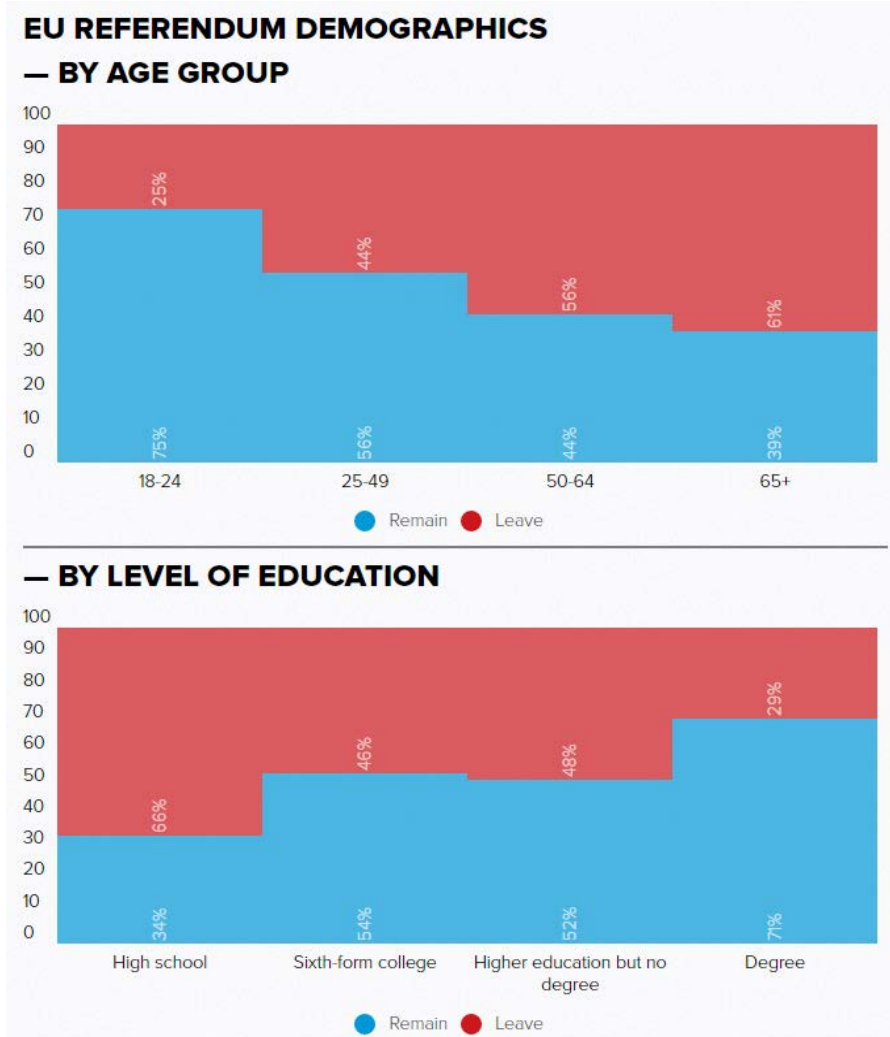
This data however was irrelevant to the Leave campaign, which told voters that they needed to stop listening to experts and bureaucrats. The campaign's main policies were to limit EU regulation and decision making in the UK, to 'take back' the £350m a week the UK sends to the EU, and to tighten border control. The latter policy it claimed was increasingly vital given EU membership was going to be granted to a number of new countries in the periphery of Europe, whose citizens could then enter the UK unabated. The Leave campaign also launched a large scale social media effort, in addition to a targeted door-knocking campaign which was aided through sophisticated data analytics of the voter base.

The Leave campaign clearly struck a chord, as voter polls showed their main arguments influenced voter behaviour.



Source: Goldman Sachs/Ashcroft Polls

The breakdown of the vote also showed older and less educated citizens were more inclined to vote to Leave.

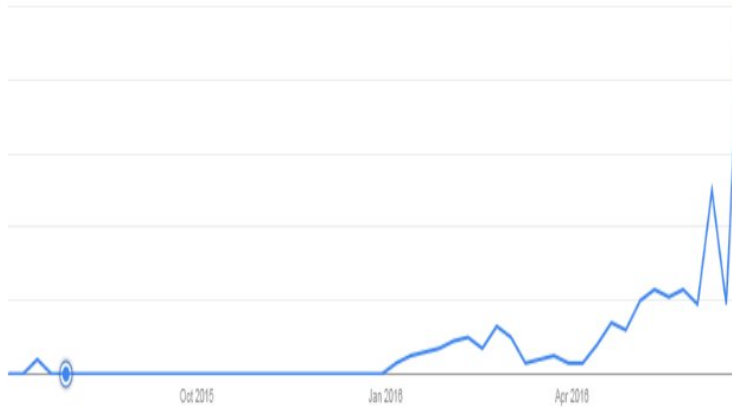


Source: Politico

“Married or divorced, but nothing something in between... We are not on Facebook, with ‘It’s complicated’ as a status.”
 Xavier Better,
 Prime Minister of Luxembourg,
 29/06/2016

In the following days, it became clear the U.K. population were not entirely clear on what they were voting for, as evidenced by this worrying Google search trend.

“What is the EU?” in Google search term

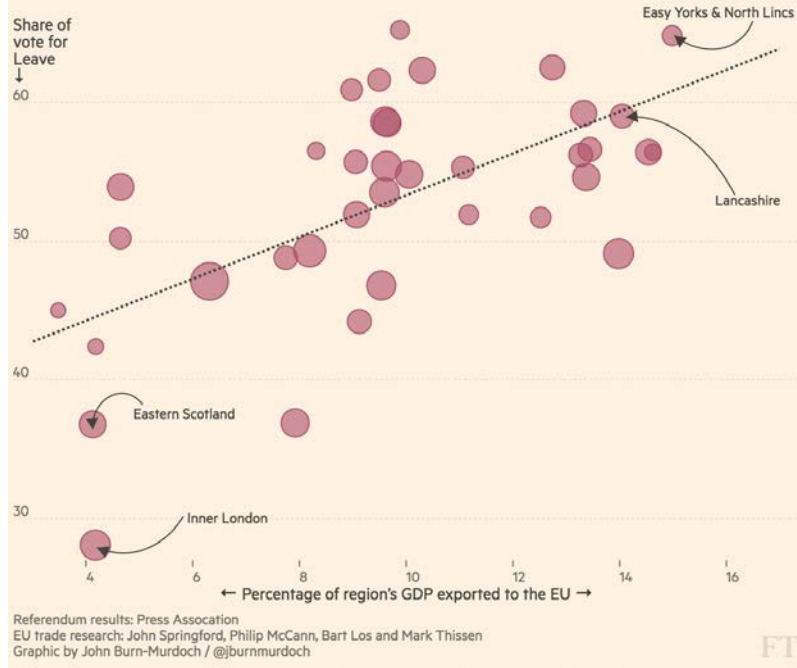


Source: Google and Deutsche Bank

Many voters, particularly in the more working class areas of the UK, are perhaps more economically dependent on the EU than they were aware of when casting their vote. Sunderland for example, which voted 61% to Leave, has a Nissan plant which employs nearly 7,000 people and exports 55% of its production to the EU.

Leave vote was strongest in regions most economically dependent on EU

The regions with the highest share of votes for Leave also tend to be the most economically intertwined with the EU. A higher percentage of East Yorkshire & Northern Lincolnshire's economic output is sold to other EU countries than is the case for any other UK region, yet 65 per cent of its electorate voted to Leave



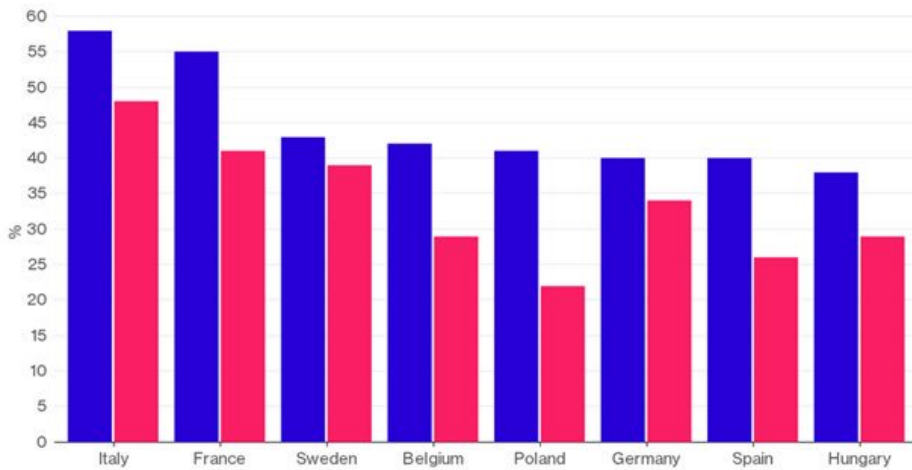
Source: FT

The position of Northern Ireland and Scotland in the UK has also been brought into the debate, as the majority in both countries voted to Remain. In Scotland, one of the main arguments in the vote to remain in the UK in the 2014 referendum was the benefits of EU membership. Some Scottish politicians have gone so far as seeking a way that they could somehow block the UK from leaving the EU, although that remains unlikely. Meanwhile, anti-EU parties within other countries such as France and the Netherlands have also called for their countries to hold referendums on their membership. Further countries voting to leave the EU would no doubt be problematic.

Brexit Contagion

Who else wants to leave the EU?

■ Want a referendum ■ Would vote to leave the EU



Ipsos Mori
Poll of 6017 adults, March-April 2016

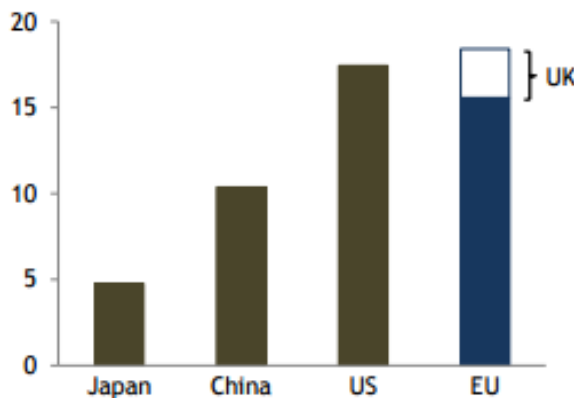
Bloomberg

Source: Bloomberg

"The will of the British people is an instruction that must be delivered." David Cameron, Prime Minister of the U.K, 24/06/2016

The focus has since shifted to the mechanics of how the UK, the second biggest net contributor to the bloc, can actually leave union. In order to leave, the UK must invoke article 50 of the Lisbon Treaty, after which time they have two years to finalise their exit. Within that two years however, the UK needs to organise individual trade and immigration deals with each of the 27 countries. It is unlikely these deals will be struck at terms favourable to the UK, given the EU will want to discourage further nations from leaving. German Chancellor Angela Merkel has taken a firm stance, saying the UK cannot 'cherry-pick' certain aspects of the EU which they want to access. She noted that Norway, which is not a member of the EU but has access to the market, only has access because it accepts open migration. Clearly this arrangement is in disagreement with Leave party policies. Furthermore, the UK will be in a distinct position of disadvantage given they must negotiate these agreements within the two year window.

Nominal GDP in 2014, \$trillion



Source: IMF

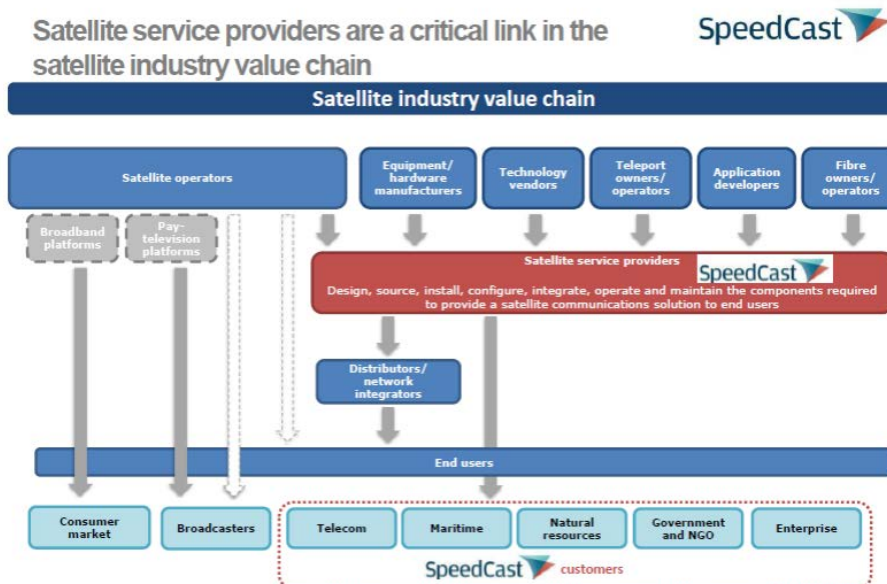
No matter the outcome of the negotiations, the EU (which as a single entity is the largest trading bloc in the world) will look somewhat different after the outcome has been resolved. The Australian market will continue to focus on this issue, given our close trading relationship with the UK and exposure to the EU at large.

Speedcast

Speedcast International Ltd (SDA) is a global provider of managed network services to government and commercial customers that require satellite communications. SDA doesn't own or operate satellites, it instead leases satellite capacity from satellite operators which it combines with other network inputs (including teleports, fibre capacity, equipment and applications) to provide bespoke managed networks for its customers based on their individual requirements. Over 90% of SDA's revenues are generated from providing these services with lower margin equipment sales contributing the remainder. Despite initial contract terms of usually less than 3 years, SDA's revenues are generally recurring in nature given the high renewal rates they experience as a result of their strong customer service and network quality. Approximately 50% of SDA's revenues are generated from government and enterprise (e.g. telecom, mining, media, aviation) customers, 30% from maritime (shipping) customers and 20% from customers in the oil and gas industry.

SDA listed on the ASX in August 2014 at \$1.96 with a market capitalisation of \$240m. Greencape first met the company in May 2015 and despite beating their prospectus forecasts and making two accretive acquisitions, the stock had actually de-rated from a 17x forward PE multiple at IPO to approximately 15-16x which provided an attractive entry into the stock in our view. We built confidence in the company and management team over the following 12 months through numerous meetings with the company and industry participants and currently hold approximately 10% of the total shares outstanding across the Greencape funds. In our view, SDA has the potential to be a high quality long-term compounding investment. Key highlights of the investment case include:

- Highly passionate, nimble and focussed long-term CEO who owns 6% of the company and is a very backable 'owner-operator'.
- Quality business model – predominantly recurring revenue (high renewal rates), diversified customer base (>2k customers, largest <4% of revenue), operating leverage from scale as they grow and acquire, sustainably high returns (>20% ROE), strong free cash flow generation (capital-light business model) which can be deployed into accretive acquisitions.
- Long organic growth runway – winning contracts and taking market share across industries growing faster than GDP (driven by remote data connectivity demand growth) from a low market share (<10%) today.
- Supplemented by accretive acquisitions – highly fragmented industry, good history of successfully integrating multiple acquisitions with both cost and revenue synergies (announced six acquisitions in 2015). Acquisitions will provide global scale which is a competitive advantage through better buying power with satellite operators.
- Attractive valuation – lower than market multiple for a business that we expect to sustainably grow earnings double-digit per annum over the medium-term.
- An appropriate level of leverage (ND/EBITDA <2.5x) given the business model, albeit the balance sheet lacks latency.



Offshore Trips

This quarter we travelled to the US on four separate occasions, in addition to trips to South America, China, South Korea, Malaysia and New Zealand.

US Observations

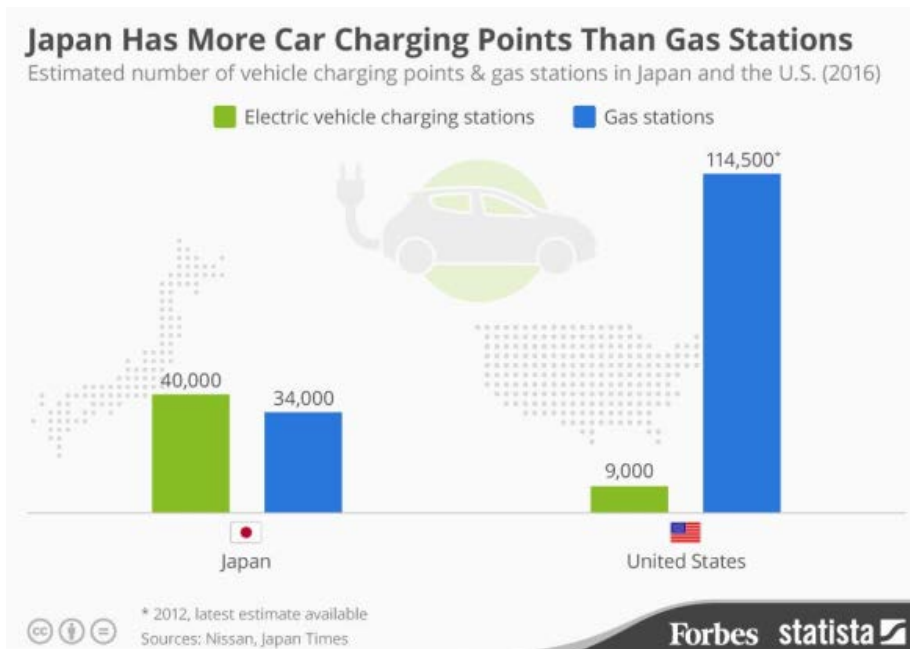
- The momentum of growth feels to have slowed somewhat, although some growth still remains. The uncertainty surrounding the November Presidential election was quoted a number of times as the key driver, however confusion surrounding Fed monetary policy was also mentioned frequently.
- The US consumer continues to shift spend away from apparel towards entertainment and when spending on the former, appears to be trading down. Industry fragmentation, particularly due to the proliferation of online offering has impacted traditional retailers.
- Millennials are delaying forming households, rather than abandoning the concept altogether, suggesting that there is a looming step change in the housing cycle still to come.
- The viability of Blockchain is not in question; however any hard solutions and timelines are still to be determined.
- Online travel companies have noted lower utilisation rates and yield during peak periods due to the impact of AirBnB and the 'sharing economy' at large.



Source: Statista

- Across most meetings, the use of data has been forward as an area of focus. 'Data scientists' are commonly being hired to take customer analysis further. There was no mention of this on previous trips.

- Battery/Electric Vehicle adoption is accelerating, with a very long way to go (especially when compared to Japan).



Source: Statista

South America

In June we visited Brazil and Argentina with a fast-moving consumer good (FMCG) focus, relevant for Brambles and Amcor (who recently announced a USD\$435m acquisition in the region). In addition, Brazil is home to meaningful operations for Nufarm, Seek and Carsales.com, whilst Argentina is a key New World Wine and Lithium producer (as used in electric car and home storage batteries).

- Both Brazil and Argentina are considered 'mature' emerging markets where a growing middle class and developing modern retail channel is an observed trend.
- Both economies have suffered several years of populist governments taking a route down the slippery slope towards the extreme case of Venezuela. Interestingly, recent political manoeuvres and subsequent elections have resulted in relatively pro-business political blocs taking over government. Importantly, such political change in the past would have only occurred via a military coup; encouragingly this time, democracy to a degree has appeared to work.
- FMCG volumes have been incredibly resilient. Typical key product volumes have continued to experience volume growth of 2-5% p.a. Furthermore, the large global brands are growing slightly faster than this.
- Unlike China where consumers readily trade up, South Americans are typically more value conscious but will select a global brand leader over a local brand at a similar price point.
- The quality of management in Brazil and Argentina is high. Most management we met had US or European MBAs, experience in multinational corporations and high standards when it came to preferring proven tier 1 suppliers.
- The feeling on the ground is that the worst is behind them, and that economic growth, political stability and various other key economic indicators will improve, albeit slowly.

“Car design will change more in the next 15 years than it has in the past 100; electrification will kick-start the biggest change in automotive design in history.” Ian Callum, Jaguar Head of Design, 13/04/2016

Outlook

Political uncertainty in UK (Brexit), Europe (response to Brexit), the US Presidential and Australia's inconclusive election are front and centre for global markets at the present time. Simmering in the background remains China's debt fuelled economy among numerous other emerging market growing pains elsewhere across the globe.

We are monitoring developments to observe whether this uncertainty translates into companies delaying investment and hiring, and whether consumers are changing their behaviour. The US still remains the key focal point of global markets, and we reiterate our view that the 'elephant in the room' remains the perception of a risk of a slowdown in the world's largest economy.

At the present time, there is a large degree of uncertainty across global markets, with sentiment regularly switching from risk-on to risk-off. Such volatility (and often increased liquidity) creates opportunity. As we have recently been highlighting, our conviction tends to favour stocks with a combination of management skill and balance sheet optionality, two key ingredients in these times of low interest rates, slow income growth and choppy market sentiment.

"The day to day market isn't a fundamental analyst; it's a barometer of investor sentiment. You just can't take it too seriously."
Benjamin Graham,
Investor and Author, 1932



More information

To find out more about investing with Greencape, please contact:

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