Greencape Broadcap Fund

Quarterly report - September 2018

Performance #	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Inception % p.a.
Fund return	0.73	14.75	14.46	10.06	10.63	9.78
Growth return	0.23	6.00	6.68	1.93	4.00	3.22
Distribution return	0.50	8.75	7.77	8.13	6.63	6.56
S&P/ASX 300 Accumulation Index	1.50	14.03	12.18	8.20	7.66	6.26
Active return^	-0.77	0.72	2.27	1.87	2.98	3.52

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'.

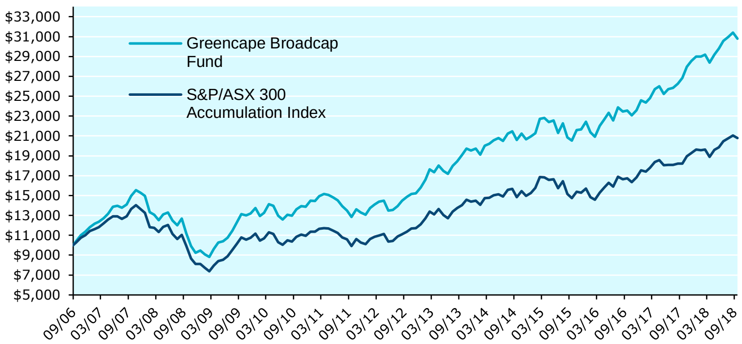
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

Growth of $10,000 invested since inception (net of fees)

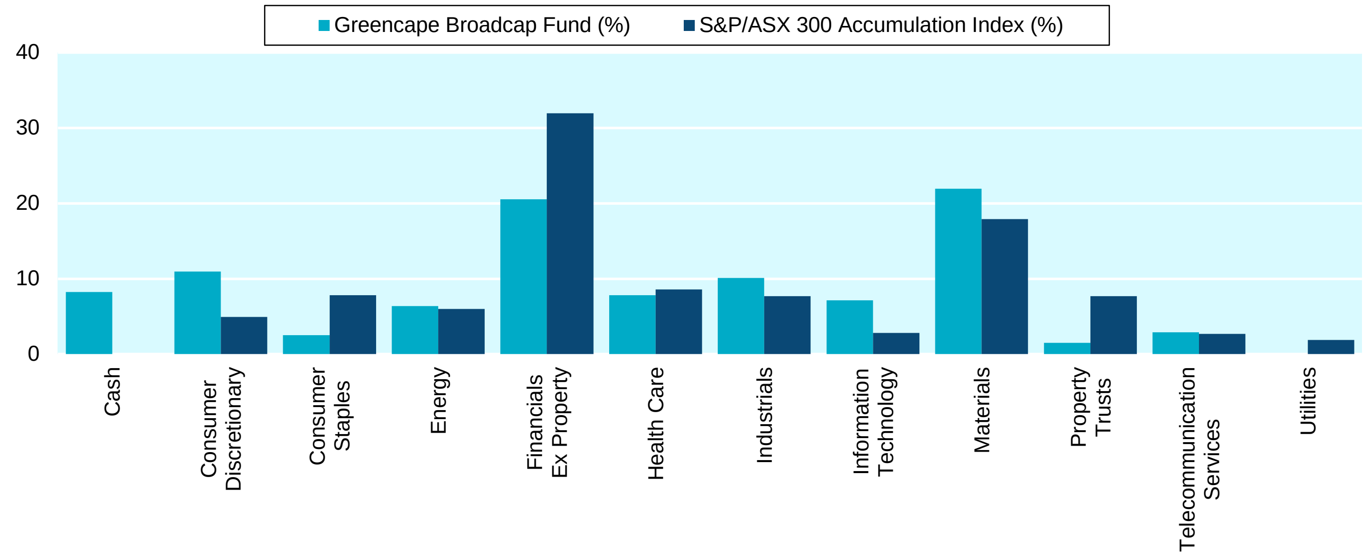


Asset allocation	Actual %	Range %
Security	91.76	85-100
Cash	8.24	0-15

Fund facts	
Inception date	11 September 2006
APIR code	HOW0034AU

Fees	
Entry fee	Nil
2016-2017 ICR	0.95%
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 September 2018



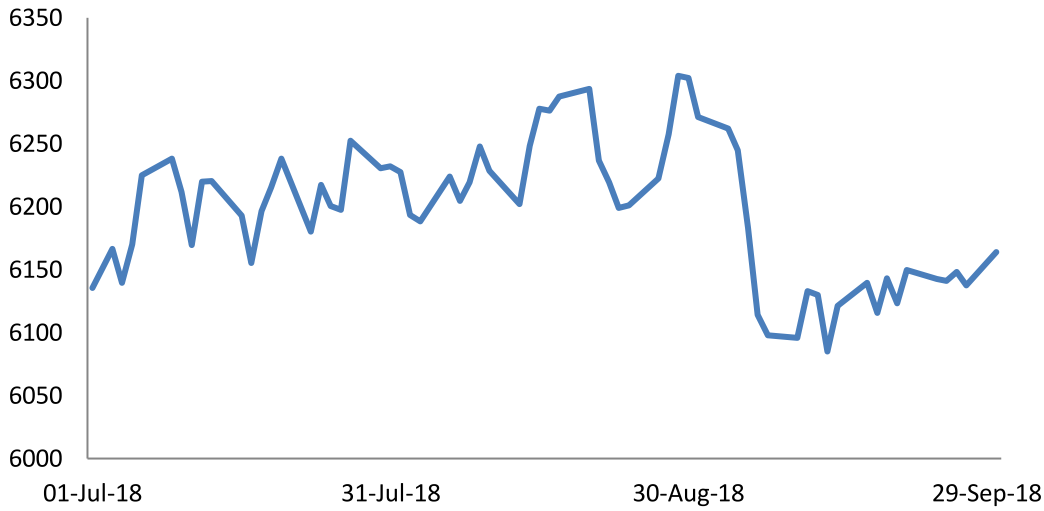
Fund performance summary

The S&P/ASX 300 Accumulation Index returned +1.50% for the quarter. The fund underperformed the market and delivered a +0.73% return over the quarter.

Market overview

Despite the weak end to the quarter, the market managed to eke out a small gain for the period to consolidate the strong performance in the June quarter. News flow during the period was abundant, as locally we saw another change in Prime Ministers during the busy August reporting season, whilst elsewhere the Global Trade war escalated amongst our key trading partners.

S&P/ASX 300 Index

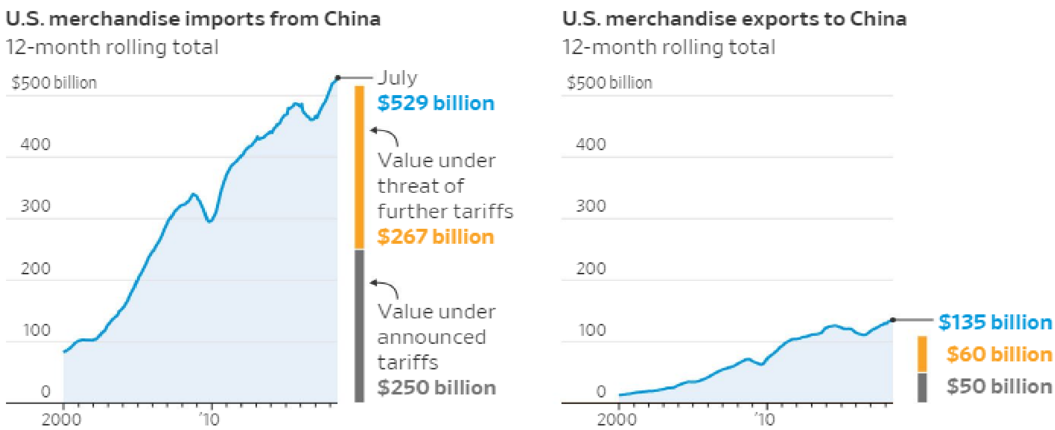


The closing level of 6164 for the ASX300 represents the highest quarter close since 2007.

As expected, the RBA kept the cash rate target at a record low level of 1.50% at all three meetings during the quarter - the rate at which it's been since August 2016. According to the futures market, the first hike is not expected to occur until October 2019, three months later than was expected at the end of the June quarter. The dysfunction within the Federal Government boiled over in August, as two spills of the leaderships were held which eventually saw Scott Morrison installed as Prime Minister. Interestingly the impact of the events on the equities market was benign, likely because such events are sadly not uncommon for local investors. Local data however was strong during the period, with third quarter Gross Domestic Product (GDP) of +0.9% beating expectations of +0.7%, and the unemployment rate falling to a 5½ year low of 5.4%.

"The banking royal commission now offers a real opportunity for significant reform across the industry." Josh Frydenberg, Treasurer of Australia, 14/09/2018

US President Donald Trump made good on his promise to further increase tariffs on goods imported from China, as the US implemented tariffs on a further USD$200bn of goods in September. China then retaliated, announcing tariffs on USD$60bn on US goods. As we can see below, the trade war threatens to impact all goods traded between the two countries

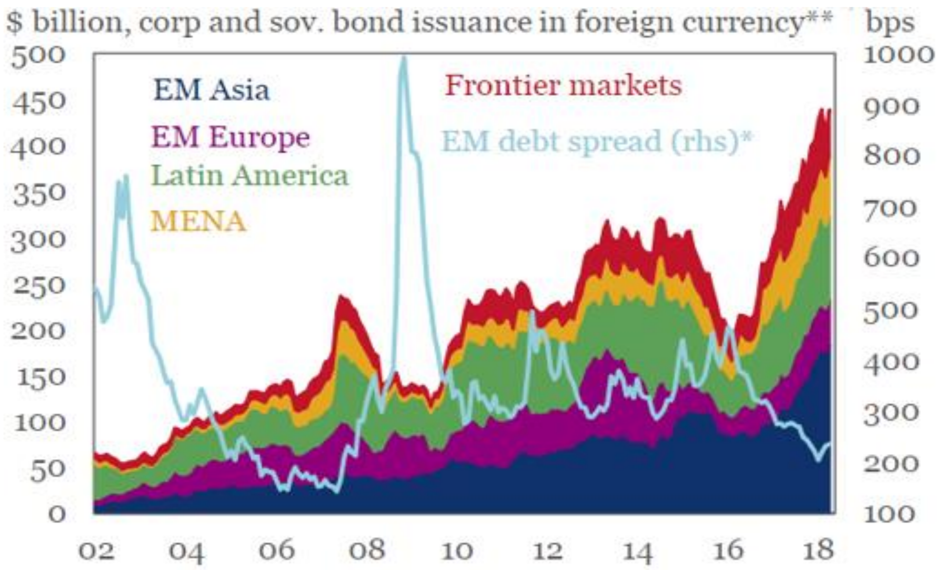


Sources: Census Bureau (exports and imports); White House (tariffs)

Despite the trade war, US economic data continues to go from strength to strength. Second quarter GDP was strong at +4.2% (above expectations of +4.1%), which was a substantial increase from first quarter growth of +2.2%. US consumer confidence and small business confidence numbers also recorded post crisis highs, whilst the unemployment rate recorded an 18-year low. Much to the President's chagrin, this strong growth prompted the Federal Reserve to raise rates 25 basis points for the third time this year, with the futures market also pricing in a 70% chance of a fourth hike by year end.

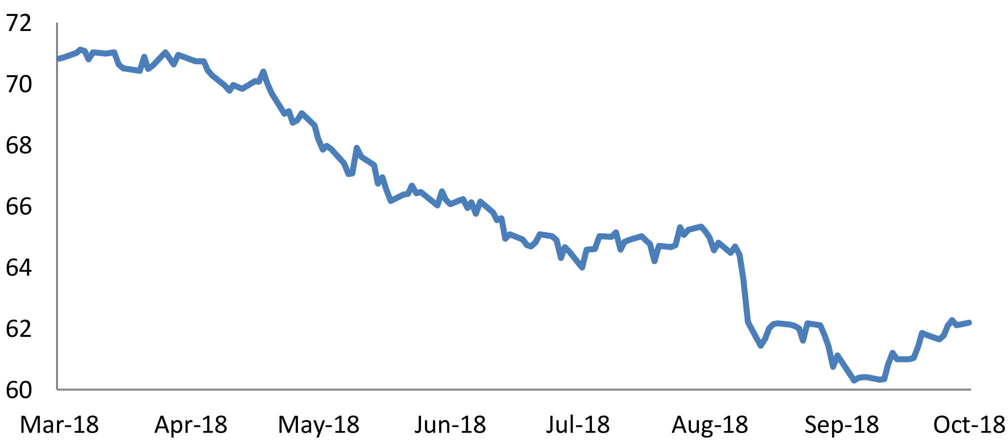
A troubling situation which we briefly touched on in prior quarterly reports, regarding emerging market economies taking advantage of low debt spreads and gorging on USD denominated debt (chart below) came to the fore during the period. As the USD strengthens, it becomes harder for emerging markets to fund their USD denominated commitments with a rapidly devaluing local currency. After a spike in inflation and a drop in the Peso, Argentina was given a USD $57bn loan in September by the IMF to ease concerns that the country will not meet its debt obligations in 2019.

"The world has told us that we are living beyond our means." Mauricia Macri, President of Argentina, 03/09/2018



*Source: IIF, Bloomberg, Thomson One; * ICE BofAML US Emerging Markets External Debt Sovereign & Corporate Plus Index (DXEM Index); **12-month moving sum*

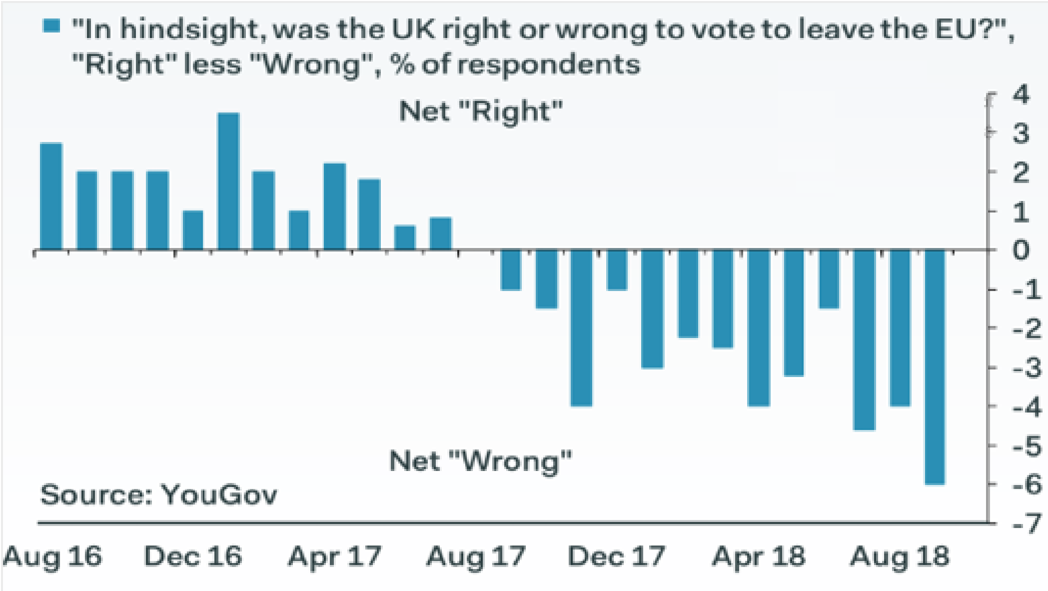
JP Morgan Emerging Markets Currency Index



Source: Bloomberg

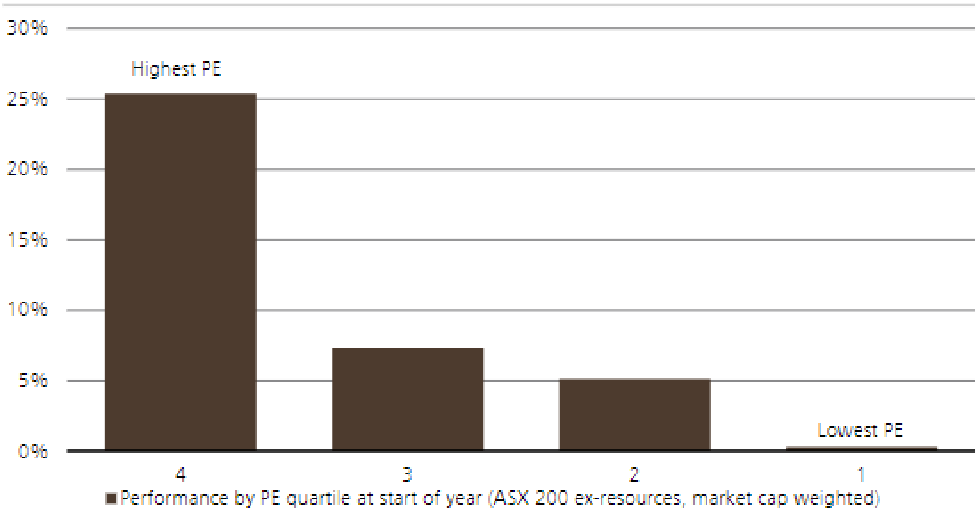
In the UK, Brexit negotiations have largely stalled with the issue of a physical border between the Republic of Ireland and Northern Ireland having become a major sticking point. The target date for agreeing on terms in the withdrawal agreement is October 18 at the European Council meeting, however this looks unlikely given the current state of play.

Below we see a visual representation of Brexit regret.



The major theme arising from the August reporting season, was the persistence of the 'rich getting richer' thematic, i.e. optically expensive growth names becoming even more expensive. As per UBS analysis below, the top quartile of Price-to-Earnings (P/E) multiple stocks have materially outperformed lower multiple stocks this year.

Figure 1: The high PE names have outperformed the low PE names by 25% ytd



Source: FactSet, UBS

"I have always said that these negotiations would be tough - and they were always bound to be toughest in the final straight." Teresa May, Prime Minister of Great Britain, 21/09/2018

	Sept 2018 Quarter	Year end June 2019
ASX300 Accumulation Index	1.5%	14.0%
Best Performing Sectors		
Telecom	24.8%	1.9%
Information Technology	10.2%	45.5%
Industrials	4.6%	39.7%
Worst Performing Sectors		
Utilities	-3.9%	1.3%
Materials	-1.2%	20.1%
Consumer Staples	-1.0%	23.8%

Telco stocks found themselves in the unfamiliar position of being the best performing sector during the quarter, aided by the announcement of the TPG and Vodafone merger. Vocus and Telstra also performed strongly, as investors began to take a less pessimistic view of prospects for the sector at large. Utilities struggled as bond yields surged on the back of expedited expectations of central bank interest rate increases.

"Together we will become a more effective industry challenger that strives to create competitively-priced consumer products with the high levels of customer service that differentiates us in the market." Iñaki Berroeta, CEO of Vodafone Hutchuson Australia, 30/08/2018

Fisher & Paykel Healthcare

New Zealand company Fisher & Paykel Healthcare (FPH) is a global leader in the development of medical devices for use in respiratory care applications in hospitals and the treatment of obstructive sleep apnoea (OSA) in the home. FPH has a long history of growth, innovation and product development since introducing its first heated humidifier for invasive ventilation applications to the market in the 1970's. FPH has since expanded into OSA, non-invasive ventilation, nasal high flow therapy for respiratory care and surgical humidification with product development stemming from a consistent focus on its core expertise of heating and humidifying air. Today, approximately 60% of FPH's revenue is derived from respiratory care applications and approximately 40% from OSA applications.

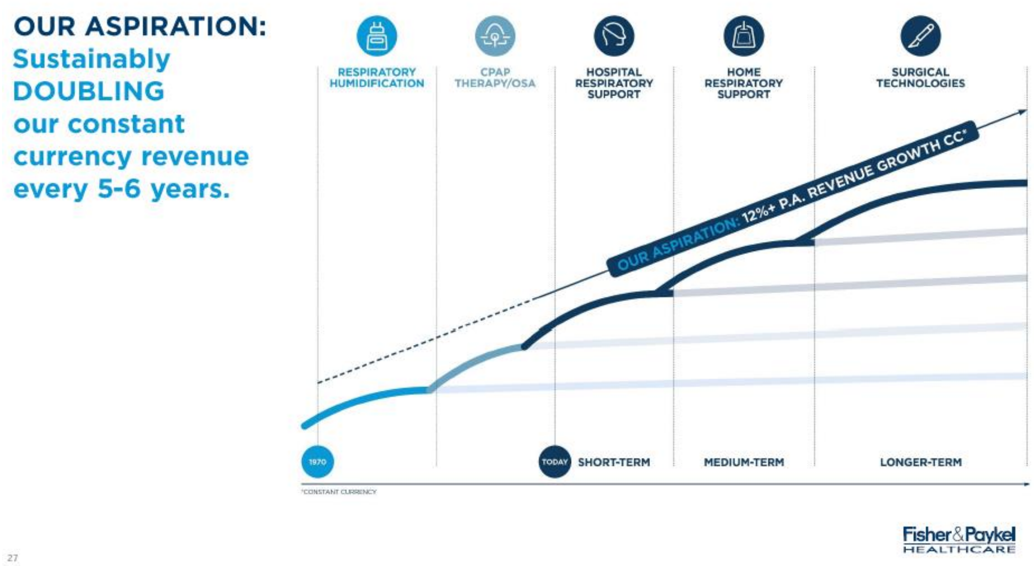
Despite being a A$7.5bn market cap company listed on both the Australian and New Zealand stock exchanges, FPH has to some extent flown under the radar of Australian investors over the years. This is partly due to not being included in the ASX100 index (despite the index including companies with market capitalisations of less than one-third of FPH's market capitalisation) and being only a small 0.13% of the ASX200 index (vs. companies of a similar market capitalisation being approximately 0.5% of the index).

We are attracted to FPH for the following reasons:

- Long growth runway driven by large underpenetrated markets and continuous product development which should underwrite a doubling of revenue every 5-6 years over the long-term (see diagram below which outlines the growth horizons in front of FPH);
- It is estimated that 10 million patients are treated using FPH products each year vs. a market opportunity of over 60 million patients that continues to grow strongly;
- In particular their 'category killer' Optiflow nasal high flow therapy product for respiratory applications in hospitals (which accounts for more than 20% of revenue) is still less than 10% penetrated despite growing consistently over 20% p.a. in recent years;
- Solid history of gross margin expansion largely driven by a gradual shift in manufacturing from NZ to Mexico where the cost of manufacturing is 70-75% the cost of manufacturing in NZ – Mexico accounts for approximately one-third of current output and we expect this to grow to greater than one-half of output over the medium-term;
- Solid history of operating cost leverage through scale and sales force productivity which we expect to resume over the medium-term. This has been impacted somewhat over the last 2 years due to a large increase in legal expenses to defend themselves against patent litigation from their largest OSA competitor ResMed – we are confident in FPH's ultimate legal and commercial position here relative to ResMed's claims and expect a non-negative resolution for FPH in the coming years;

- Conservative balance sheet with a target to operate within a -5% to +5% gearing range; and
- Exceptional culture of innovation and putting customer care at the forefront of its philosophy which is driven by long-serving employees who act as owners, led by CEO Lewis Gradon who has been an employee of FPH for over 35 years.

The attributes outlined above do not come cheaply and the biggest hurdle we face with an investment in FPH is valuation, with the stock trading on a 40x FY19 P/E multiple based on FY19 earnings guidance at the current share price of A$13. We first added the stock to the portfolios in late 2016 at prices below A$9 when the stock was trading on a low 30's P/E multiple. Our confidence to hold the stock in the portfolios today despite the re-rate over the past two years is driven by our expectation that FPH's earnings growth will accelerate from FY20-onwards after three years of sub-trend growth and should outperform consensus expectations. This is driven by our view on an uptick in sales growth (especially driven by new OSA masks to be released from 2019) combined with a return to solid margin growth from the ramp up of new Mexico manufacturing capacity and a resolution to the patent litigation dispute with ResMed (or at worst a reduction in annual spend defending their position).



Source: FPH

Offshore Trips

During the period we travelled to the US 3 times, Hong Kong, Europe and the UK.

US Snippets

- Feedback on the overall economy was overwhelmingly positive. Advertising pricing is up, like for like retail sales are solid and general company sentiment was buoyant. The feedback was by far the most positive we have heard in a number of years.
- All telco's are going through a version of their own transformation programs. The US evidence shows that with a strong management team, it is in fact possible to take out absolute costs out of a telco business.
- Oilfield service companies are seeing equipment order and tenders from large deep water offshore rig owners as they prepare for an offshore drilling recovery.
- All companies are wary of Amazon.

"Blowout numbers on New Jobs and, separately, Services. Market up!" Donald Trump, President of the United States, 02/10/2018

Outlook

Greencape is observing volatility and uncertainty increasing in equity markets with trade war rhetoric, Brexit negotiations and domestic political upheaval all cause for concern for investors. This coincides with more evidence that inflation is accelerating, having spread beyond raw materials and energy and having found its way (finally) into wages. This trend was particularly prevalent in the US, which we observed as consistent feedback during our multiple trips during the period. We have also observed an uptick in Mergers and Acquisition activity, as acquirers look to capitalise on interest rates which may not be lower for longer after all.

We are closely monitoring a number of important elections which are scheduled to take place both locally and globally in the coming months. The US mid-term elections will provide a clearer picture of how the current administration is faring with voters (and Trump's likelihood of securing a second term).

Greencape consider shareholder stewardship has rarely been more valuable, and our core positions share this trait as a common thread. With volatility increasing, including in names on the more 'quality' end of the spectrum, the ability to top and tail positions is crucially important. Whilst we are not immediately alarmed, the tenure of the current bull market makes it more likely we are closer to the end than the beginning. We are therefore considering liquidity of paramount importance.

We have slightly reduced our bank underweight, using proceeds from profits taken in more expensive 'growth' names that have reached full valuations. Our cash weights remain elevated, and this acts to reduce the market beta of our portfolio somewhat. The value in the market that we are identifying at present time tends to be increasingly more relative value rather than absolute, and this in and of itself is instructive to us.

"Investors have had plenty of time to get used to monetary stimulus and reliance on the Fed to inject liquidity to support economic activity." Howard Marks, Chairman of Oaktree Capital, 26/09/2018

More information

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

Fidante Partners Investor Services team on: **13 51 53**

Visit the Greencape website: **www.greencapecapital.com.au**

Email Greencape at: **bdm@greencapecapital.com.au**

Financial advisers

For more information, please contact:

Fidante Partners Adviser Services

Phone: **+61 1800 195 853**

Email: **bdm@fidante.com.au**

The Professional Planner/Zenith Fund Awards are determined using proprietary methodologies. Fund Awards and ratings are solely statements of opinion and do not represent recommendations to purchase, hold, or sell any securities or make any other investment decisions. Ratings are subject to change.

Unless otherwise specified, any information contained in this publication is current as at the date of this report and is provided by Fidante Partners Limited ABN 94 002 835 592 AFSL 234 668 (Fidante Partners) the issuer of the Greencape Broadcap Fund ARSN 121 326 341 (Fund). Greencape Capital Pty Ltd ABN 98 120 328 529 AFSL 303 903 (Greencape) is the investment manager of the Fund. It should be regarded as general information only rather than advice. It has been prepared without taking account of any person's objectives, financial situation or needs. Because of that, each person should, before acting on any such information, consider its appropriateness, having regard to their objectives, financial situation and needs. Each person should obtain the relevant Product Disclosure Statement (PDS) relating to the Fund and consider that PDS before making any decision about the Fund. A copy of the PDS can be obtained from your financial adviser, our Investor Services team on 13 51 53, or on our website www.fidante.com.au. If you acquire or hold the product, we and/or a Fidante Partners related company will receive fees and other benefits which are generally disclosed in the PDS or other disclosure document for the product. Neither Fidante Partners nor a Fidante Partners related company and our respective employees receive any specific remuneration for any advice provided to you. However, financial advisers (including some Fidante Partners related companies) may receive fees or commissions if they provide advice to you or arrange for you to invest in the Fund. Greencape, some or all Fidante Partners related companies and directors of those companies may benefit from fees, commissions and other benefits received by another group company.