Greencape Broadcap Fund

Quarterly report - December 2018

Performance #	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Inception % p.a.
Fund return	-9.91	-4.39	7.35	7.04	11.37	8.64
Growth return	-10.63	-12.30	0.26	-0.88	4.70	2.22
Distribution return	0.72	7.92	7.09	7.93	6.67	6.43
S&P/ASX 300 Accumulation Index	-8.41	-3.06	6.65	5.60	8.92	5.37
Active return^	-1.50	-1.32	0.70	1.44	2.45	3.27

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'.

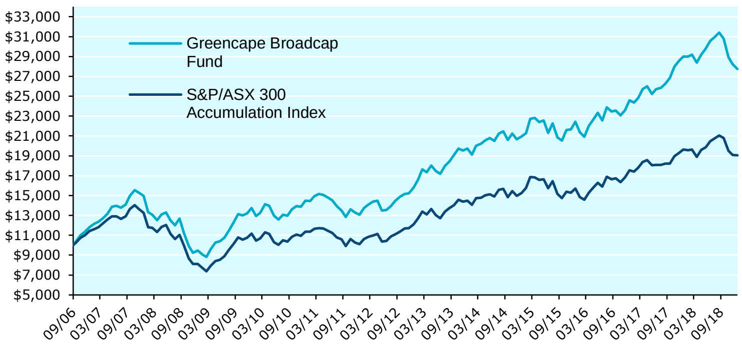
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

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

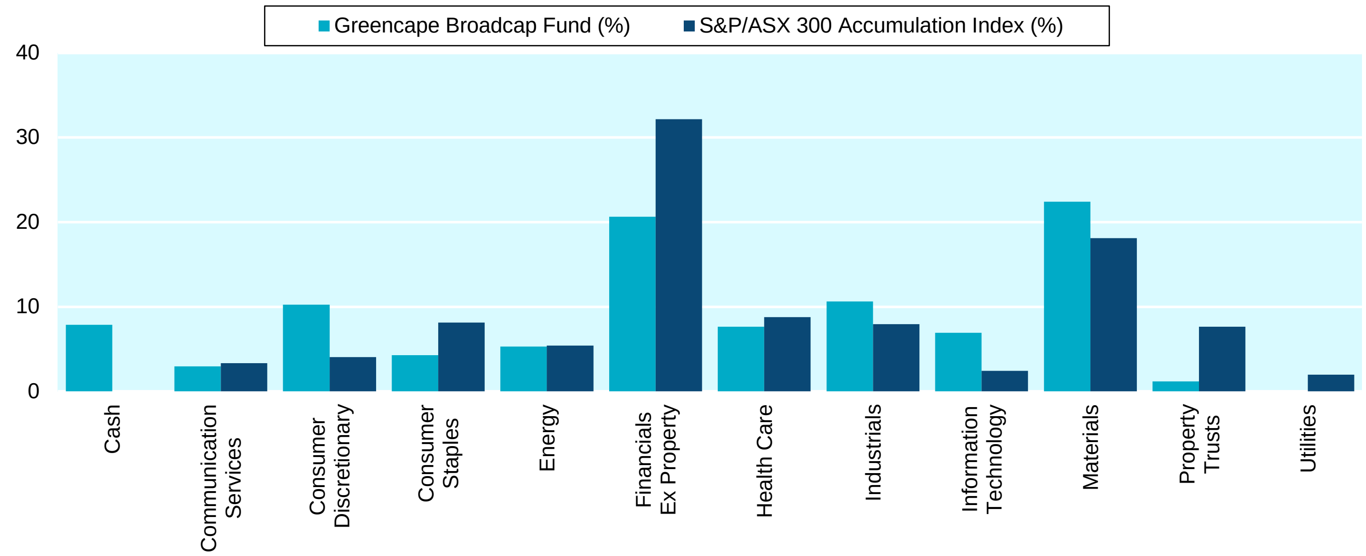


Asset allocation	Actual %	Range %
Security	92.12	85-100
Cash	7.88	0-15

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 31 December 2018



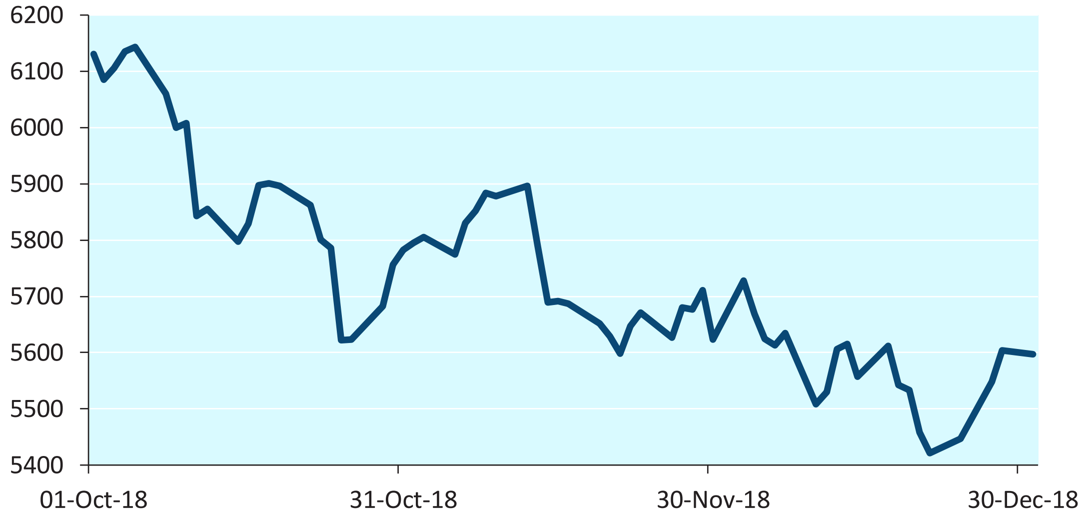
Fund performance summary

The S&P/ASX 300 Accumulation Index returned -8.41% for the quarter. The fund underperformed the market and delivered a -9.91% return over the quarter.

Market overview

Global markets ended 2018 on a sour note, as geopolitical tensions along with concerns over slowing global growth saw investor sentiment violently shift to a 'risk-off' mindset. Locally, the Australian index posted its worst quarterly return in over 7 years, with a declining housing market and unstable political environment compounding investor concern.

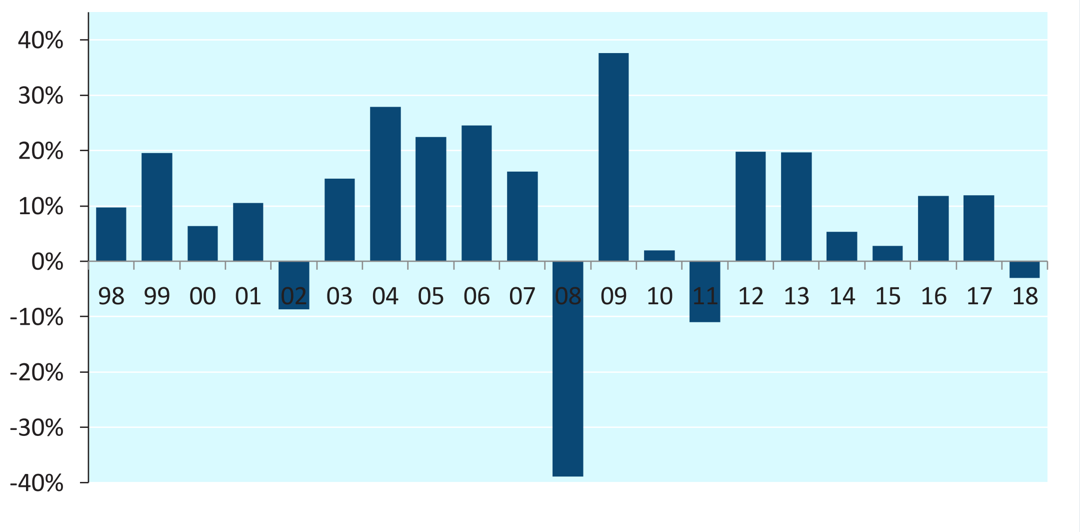
S&P/ASX 300 Index



Source: IRESS

The poor performance in the third quarter broke the market's consecutive streak of positive calendar year returns, with the index posting a negative return for the first time since 2011.

S&P/ASX 300 Accumulation Index Calendar Year Returns Since 1998



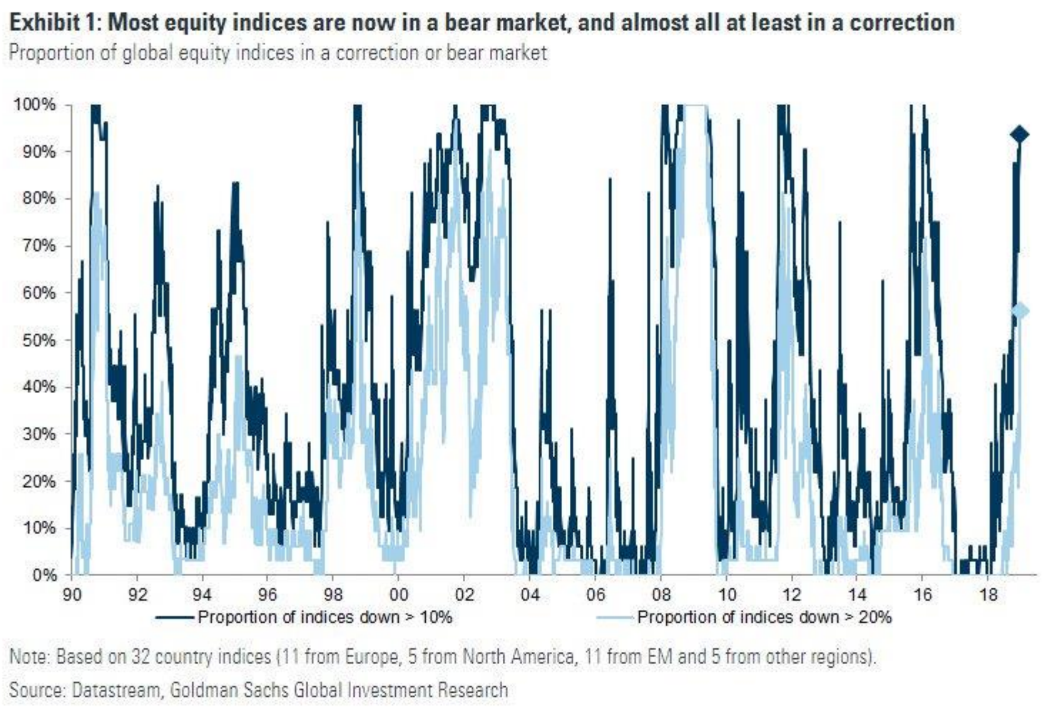
Source: IRESS

"Their actions were undeniably for themselves. For their position in the Party. Their power. Their personal ambition. Not for the Australian people who we represent. Not for what people voted for in the 2016 election." Julia Banks, Independent MP (former Coalition MP), 27/11/2018

As expected the Reserve Bank of Australia (RBA) kept the cash rate target at the record low level of 1.50% at all three meetings during the quarter, the rate at which it has been since August 2016. The futures market now indicates that a rate cut is more likely than a rate hike by the end of calendar year 2019. It was also reported in December that RBA Governor Phil Lowe met each of the big four banks to caution them against an 'overzealous tightening of credit'. Meanwhile, the political situation in Canberra remains fraught, with the Coalition losing the seat of Wentworth (vacated by Malcom Turnbull) and MP Julia Banks resigning from the Liberal Party to sit on the crossbench as an independent. Investors are now grappling with the implications of a Shorten led Government being sworn in by mid-2019, with the Coalition likely headed for obliteration at the Federal election. Local economic data was mixed during the period. The third quarter Gross Domestic Product (GDP) gain of 0.7% beat expectations by 0.2%, however Building Approval numbers (which are seen as a forward indicator) took a turn for the worse. October approvals were down 13.4% on the prior year, although this was above expectations of a 14% fall.

"I'm doing deals, and I'm not being accommodated by the Fed … They're making a mistake because I have a gut, and my gut tells me more sometimes than anybody else's brain can ever tell me." Donald Trump, President of the United States, 27/11/2018

A year ago the phrase 'synchronised global growth' was perhaps one of the most popular phrases in finance. Fast forward to present day and the majority of global indexes are now in correction territory.



Source: Goldman Sachs

Similar to the weakness experienced in January, markets sold off in October on initial concerns of an uptick in bond yields. However unlike in January there was no snapback recovery, as market attention soon moved to geopolitical concerns; specifically how the ongoing trade war between the world's two largest economies will impact global growth. There was a breakthrough in trade negotiations during the period however, with the implementation of additional tariffs by the US (and planned retaliatory tariffs by China) being postponed at the G-20 summit in Argentina. The tariff increases will now be implemented on March 2 unless the two countries can agree on a trade deal. Despite the rhetoric on trade, the US economy remains buoyant with consumer confidence remaining elevated (albeit slightly off recent highs). The US Federal Reserve (Fed) continued its campaign of rate hikes during the period, much to the chagrin of the President. It was reported that the President was considering firing Fed Chair Jerome Powell following the December rate increase; however this was later denied by Treasury Secretary Steve Mnuchin.

In the UK, Brexit negotiations remain in a state of flux with a vote in the House of Commons on the latest deal being delayed due to it likely facing a heavy defeat. UK Bookmakers now believe a second referendum on the issue is more likely than not, as this is seen as a more palatable option for Teresa May than revoking Article 50. In Continental Europe, the populist government in Italy finally reached a budget deal with the EU after the European Commission initially rejected its 2019 spending plans. The Italian government agreed to reduce its deficit target to 2.04% of GDP (from 2.4%), however the makeup of planned spending remains a concern to the EU; namely the introduction of a basic income, lowering of the retirement age and a proposed flat tax rate.

	QTR	YR
ASX300 Accumulation Index	-8.4%	-3.1%
Best Performing Sectors		
Property Trusts	-1.7%	3.3%
Utilities	-3.1%	-4.9%
Materials	-5.1%	0.8%
Worst Performing Sectors		
Energy	-21.6%	-8.4%
Telecom	-14.9%	-18.3%
Consumer Discretionary	-14.2%	-7.3%

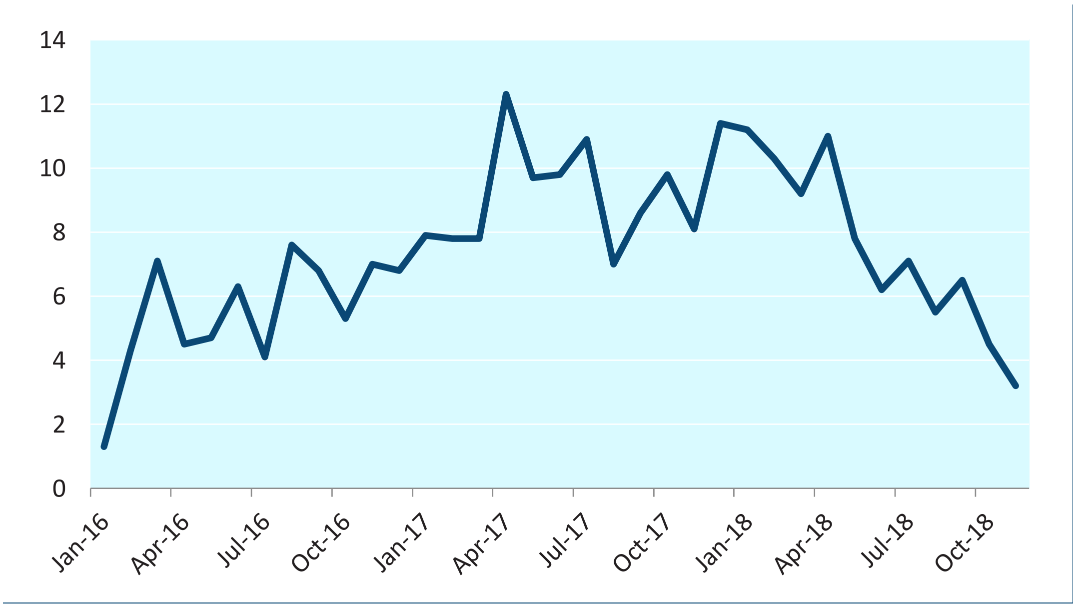
Source: IRESS

Investors sought the safety of defensive and bond-like equities during the period as Gold stocks, Utilities and Property Trusts outperformed. High growth stocks with little valuation support were sold indiscriminately, with investors suddenly unwilling to take a glass half full approach to valuation.

Concerns over global growth and supply hit oil prices hard during the quarter, with Crude ending the period more than a third lower and hitting listed Energy names. Discretionary names also underperformed, with the 'wealth affect' of falling dwelling prices hitting consumer confidence which fell to a 2.5 year low in November.

"No one is in the position to dictate to the Chinese people what should and should not be done." Xi Jinping, President of People's Republic of China, 18/12/2018

NAB Consumer Confidence



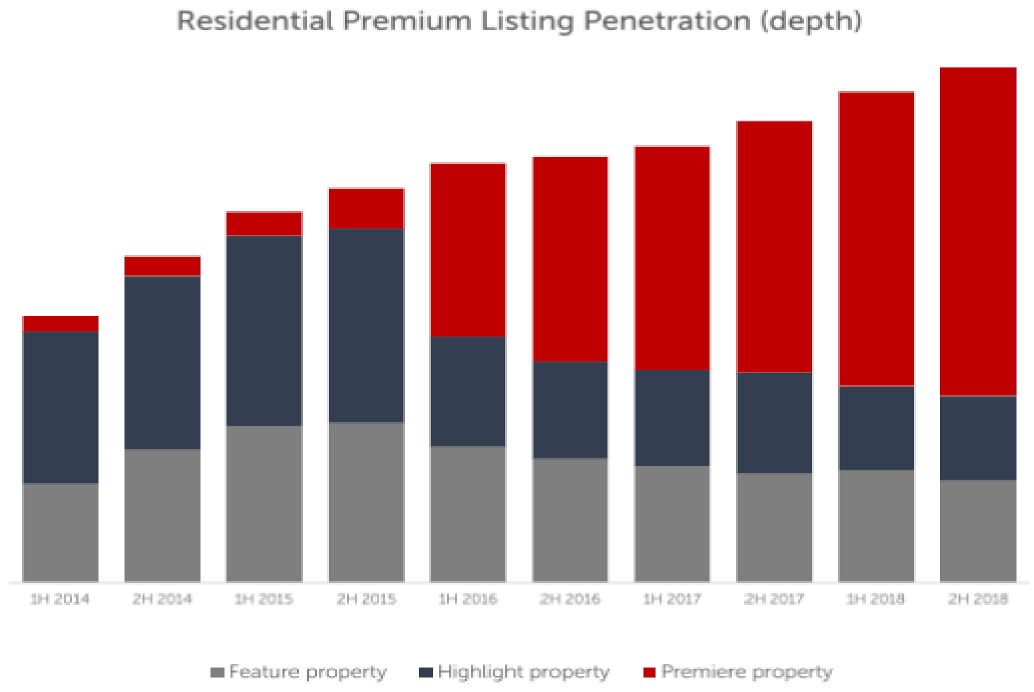
Source: Bloomberg

REA

Realestate.com.au (REA) is Australia's leading online property portal. It's where the majority of Australian's search for properties. In certain pockets such as Eastern suburbs Sydney and Melbourne, Domain.com.au (DHG) has a competitive presence. However once you move beyond this area, REA dominates across factors such as; inbound enquiry to agents, total visits, app launches and time on app.

REA's core business is Australian property listings and whilst recent investments have been made into its Asian property sites, lifestyle advertising, financial services, and other agent related value added services, we're going to concentrate on the core domestic listings business in order to highlight its resilience. Revenue in this area is a function of volume (i.e. the number of property listings) and the price that REA can charge for these listings.

The price REA charges customers comes from a mix of what's known as 'depth' listings. In the 2018 financial year, total revenue from 'depth' grew at 21%, and was over 75% of the group's total Australian revenue. Depth comes in three forms; feature, highlight and premiere listings, the latter being the most prominent and highest priced. Depth is priced depending on suburb, with higher value suburbs costing more. In recent years, the total proportion of 'depth' has continued to increase. We estimate penetration is around 30% of total listings however there's a large variance depending on suburb. Overall however, we think there's scope for penetration to increase further.



Source: Company reports

Annual price rises have also paid a part in increasing group revenue. Australia relative to the rest of the world has what's known as 'vendor paid advertising' or VPA. This means that you, as the vendor cover the cost of advertising, which is a fee above that of the agents' commission. This occurs across a reasonable proportion of the country and importantly, in all the more affluent suburbs which helps with 'depth' penetration.

Selling a house generally occurs infrequently therefore vendors often don't recall what they last paid for online advertising. Furthermore, selling is an emotional experience and one where an incremental buyer (especially in an auction scenario) can potentially drive a higher final price. Agents therefore emphasise the importance of reaching as many potential buyers as possible. The feedback from agents we speak with suggests that REA attracts anywhere between 50% and 90% of their inbound enquiry, therefore advertising on the site is essential. Furthermore, agents are often strong supporters of REA's Premiere listing package (its highest priced product), as it includes preferential placement on the site. Importantly from an agent's perspective, the Premiere products offers better agent branding (which helps them attract their next vendor) at no cost to them. Finally, the actual cost of advertising on REA relative to the value of the house being sold remains small in percentage terms, especially when considered against what REA provides in the form of audience reach and inbound enquiry. These factors, combined with the constant investment into product and innovation provides REA the ability to increase prices by around 10% per year. Our view is that price rises can continue.

The housing price declines across Sydney and Melbourne have been well documented, and volumes have pulled back (which has seen listing numbers reduce). Despite this, the combination of increased depth penetration and price rises has allowed REA to generate strong revenue growth. Should listing volumes improve, this will likely see REA's revenue growth accelerate. There's also an inbuilt mechanism that softens the revenue impact from a weaker property market (as defined by days on market extending). Often in this scenario, auction clearance rates are lower, and hence vendors will need to relist their property after the 45 day premiere listing period expires (if the property hasn't sold). Furthermore, we've confirmed with agents that rental numbers are increasing as vendors pull properties for sale as price expectations are not being met. REA also generates income from rental listings and in a similar way, there is depth attached to this.

Underpinning our view on the earnings certainty of REA is the ability of an experienced management team to actively control its costs. Whether it be allowing natural staff attrition to lower employee numbers, a more active reduction in contractors, or the delay of pipeline projects, there are a number of levers available in order to ensure 'positive jaws' across the year, whereby revenue growth exceeds cost growth.

Our view is that REA, despite noise around the Australian property market remains a resilient business, run by an experienced and proven management team which is especially important in the current environment.

Offshore Trips

This quarter we travelled to the US three times, New Zealand, China, Singapore and Malaysia.

US Observations

- The consumer remains in good spirits at the present point in time, with confidence still relatively strong and consumer balance sheets in good shape. No retailers we spoke to noted any real signs of stress, but there was some concern if the trade war escalated further.

- Retailers are super focused on winning over the Millennial consumer. Important initiatives include reaching Millennials where they browse digitally and an emphasis on ESG (Environmental, Social and Governance), whether it be sustainable sourcing or actively donating to charities.

- Retailers who failed to invest in digital capabilities ahead of the curve are finding it incredibly hard to catch up, as they grapple with bloated cost bases compared to digitally native upstarts who have already taken meaningful share.

- The President is more popular on the ground than we anticipated. Even Democrat voters we spoke to have appreciated the boost in disposable income from the tax cuts. Furthermore, the candidate nomination for the Democrats is crucial for the 2020 election, as its likely Trump will win again if the Democratic candidate is unable to unite the party's base.

"We continue to see strong economic growth in the U.S. economy with robust activity from consumers and business." Steve Mnuchin, Treasury Secretary of the United States, 23/12/2018

China Observations

- Trade tensions with the US are impacting commodity-intensive demand, as evidenced in lower power generation growth and copper demand. However unlike previous slowdown, there does not appear to be an inventory overhang which will cause pricing to cascade lower.

- Any potential stimulus to offset slowing growth is likely to be more targeted at certain subsectors in the economy, rather than a broad based scattergun approach.

- The focus on the environment and air pollution is still strong. For example, hotels now have large digital screens updating guests on the air quality readings outside.

- Electric Vehicle (EV) penetration will continue to increase, with the potential for the government to target a set percentage of EV production as a portion of total car production. However EV subsidies are set to reduce over the next 2 years which will impact supply chain profitability.

Outlook

Activity in the recent quarter justified that caution was indeed warranted, with political driven uncertainty (Trade wars, Brexit, Trump tweets and domestic politics) influencing investor sentiment despite economic data both globally and domestically remaining at or above market expectations. As the sentiment has over-ridden fundamentals, we therefore start the year with improved value on offer with sufficient pessimism now priced in for an increasing number of names.

We observe that the recent increased volatility in equity markets appears to be driven by the large weight of money in quantitative style strategies, which now make up a record percentage of market flows (believed to be upwards of 80%). As a result, bad news is punished severely (with large overreactions now typical) and vice versa. At Greencape we consider such moves do create stock picking opportunities, however we acknowledge blindly taking on such quant driven flows can be dangerous. In other words, it's too early to fire all one's bullets and a measured approach makes more sense to us. Just like on the way up when the market didn't distinguish between a stock on 30x vs 35x, these days the market isn't distinguishing a stock on 8x vs 6x, and therefore we see it critical to have a strong view on earnings certainty.

Our 'market milestone' scores come to the fore in this volatile market. A stock not only requires some relative value to perform, but an identifiable catalyst. With this in mind, our portfolio has become somewhat more defensive. Our larger positions have what we consider a combination of earnings certainty and value on their side, with quality still being of paramount importance. We have selectively deployed some of our cash during the during the recent market weakness, but still have a higher than normal levels of cash available for investment.

The key sentiment drivers identified above still remain important and indeed domestically, the political landscape will only increase in prominence as the election approaches. We remain cautious, yet look forward to reporting season where we believe earnings certainty will be a key factor in stock outperformance.

"Financial markets have been sending ... signals of concern about downside risks, about slowing global growth particularly related to China, about ongoing trade negotiations, about - let's call it - general policy uncertainty coming out of Washington." Jerome Powell, Chairman of the Federal Reserve, 04/01/2019

More information

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

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