Greencape Broadcap Fund

Quarterly report - March 2022

Performance #	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	15 years % p.a.	Inception % p.a.
Fund return (net)	-1.91	10.67	13.10	11.41	11.86	8.66	10.02
Growth return	-2.24	6.24	8.45	5.26	5.48	2.49	3.95
Distribution return	0.34	4.43	4.65	6.15	6.38	6.17	6.07
S&P/ASX 300 Accumulation Index	2.08	15.21	10.83	9.38	10.10	5.88	7.03
Active return^	-3.99	-4.54	2.28	2.03	1.75	2.78	2.99

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'.

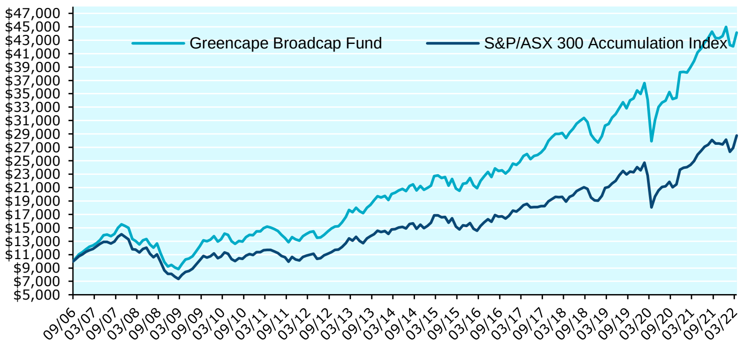
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

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



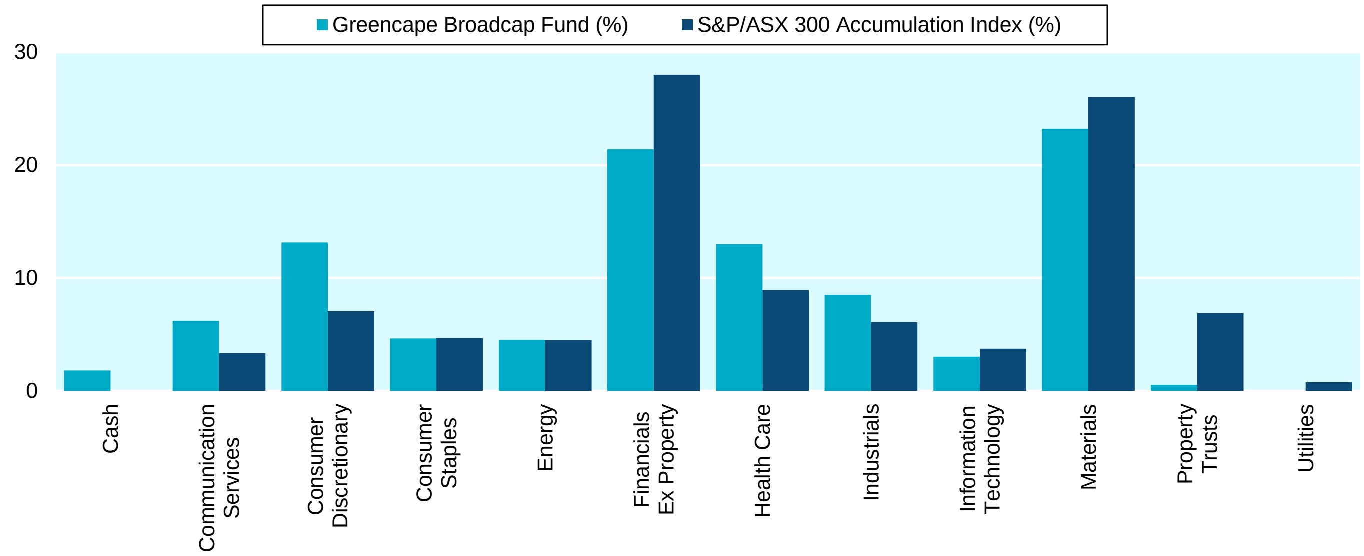
Asset allocation	Actual %	Range %
Security	98.19	85-100
Cash	1.81	0-15

Fund facts	
Inception date	11 September 2006
APIR code	HOW0034AU

Fees	
Entry fee	Nil
2020-2021 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%

Data Source: Fidante Partners Limited, 31 March 2022.

Sector exposure as at 31 March 2022



Data Source: Fidante Partners Limited, 31 March 2022.

Fund performance summary

The S&P/ASX 300 Accumulation Index returned +2.08% for the quarter. The fund underperformed the market and delivered a -1.91% return over the quarter.

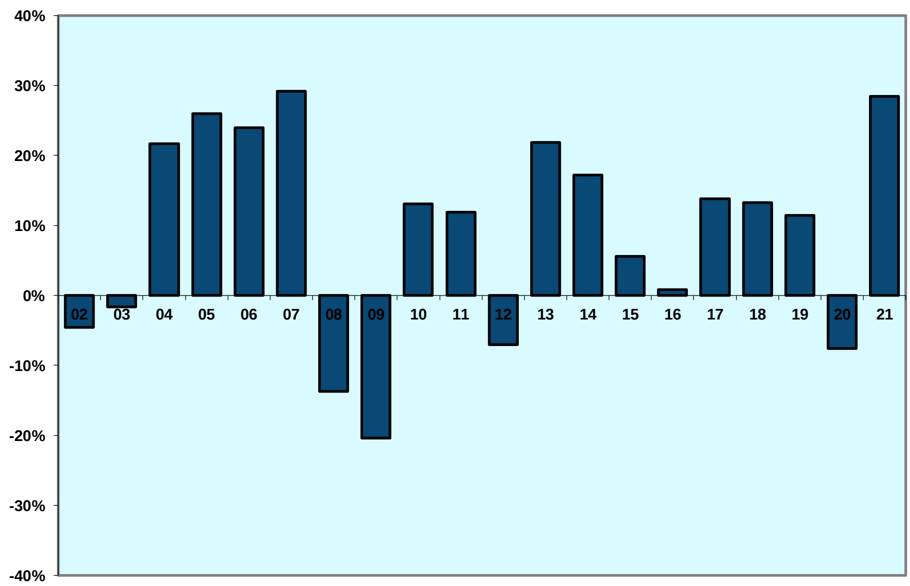
Market overview

The index posted its sixth consecutive quarterly gain despite Russia's invasion of Ukraine and the US Federal Reserve raising their cash rate for the first time since December 2018. Beneath the surface however it was strong gains in Energy, Resources and Utilities that offset losses in almost all other sectors.

S&P/ASX 300 Index

Source: IRESS

S&P/ASX 300 Accumulation Index Calendar Year Returns Since 2002

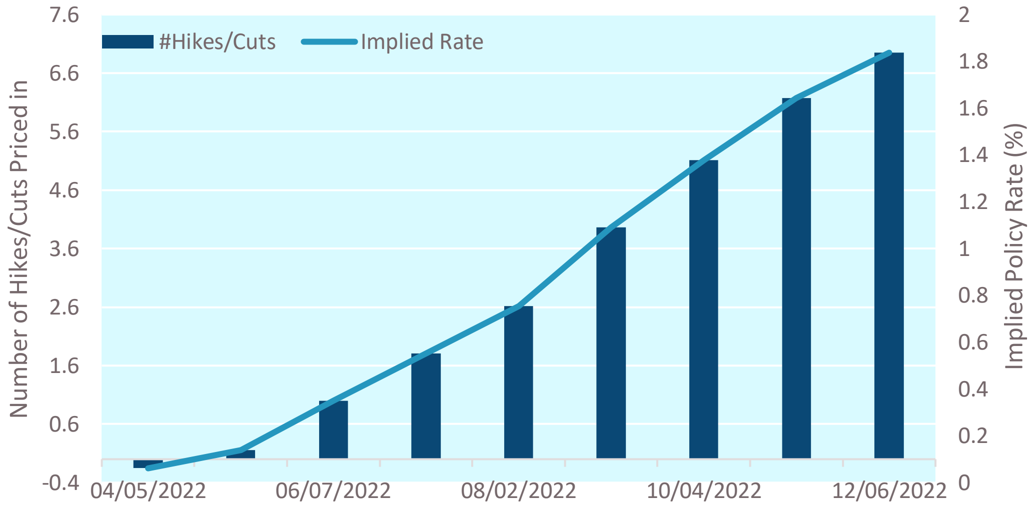


Source: IRESS

As expected, the Reserve Bank of Australia (RBA) kept its cash rate target unchanged at 0.10% throughout the quarter. Despite inflation picking up, RBA members have remained patient with raising rates. In saying this, the cash rate futures implied yield curve has priced in 7 rate hikes by December 2022 with the first hike being in June. With rates expected to rise this year, it'll be a change of pace with cheap money being harder to come by. The last rate rise was over a decade ago in November 2010.

"The Board is prepared to be patient as it monitors how the various factors affecting inflation in Australia evolve." – RBA March 2022 minutes

Implied Overnight Rate & Number of Hikes/Cuts



Source: Bloomberg

One of the observed consequences of Russia's war with Ukraine so far has been to further exacerbate already tight supply chains and add fuel to inflationary pressures being felt as the world emerges from the worst of COVID 19. This in turn adds to the potential for central banks to further tighten monetary policy to combat inflation, although potential downside economic risk from the conflict may act as an offsetting factor. Clearly geopolitical and macroeconomic uncertainty remains high.

Whilst we have no particular insight into how the Russia conflict will ultimately play out, on a very long time scale we thought the following chart was an interesting perspective on Russia's relative economic standing within the world.

"The implications are clear. Europe uses far more energy than it produces and makes up the difference through imports. Russia, on the other hand, uses far less than it produces, leaving the remainder to generate economic and strategic gains." – Howard Marks, Co-founder & Chairman of Oaktree Capital Management, 23/03/22

Energy was the best performing sector for the quarter on the back of higher oil prices that followed Russia's invasion. Woodside (WPL) and Whitehaven (WHC) were particularly strong, up 52% and 61% respectively for the quarter.

Information Technology was the worst performing sector for the quarter as bond yields pressured what are still historically high revenue multiples. Xero's 27% fall for the quarter was noteworthy, as was Computershare's + 25% gain (a direct beneficiary of rising interest rates) which was one of the few positive exceptions for the sector.

"If net interest margins are around the same in a few years' time, I would be disappointed, but I wouldn't be surprised". - Australian Bank Director

	QUARTER	YEAR
ASX300 Accumulation Index	2.1%	15.2%
Best Performing Sectors		
Energy	28.3%	25.3%
Materials	15.2%	28.5%
Financials Ex-REITs	4.4%	16.8%
Worst Performing Sectors		
Healthcare	-10.1%	0.4%
Consumer Discretionary	-10.4%	2.4%
Information Technology	-13.7%	-3.2%

Source: IRESS

Mineral Resources

In October 2021 we wrote about our investment approach to resource companies. Here we go into more detail on one of our long-held investments, Mineral Resources (MIN), with a focus on its undervalued lithium business.

MIN is a combination of iron ore mining, lithium mining/production and mining services businesses. It also looks set to add gas as a fourth pillar with exciting gas flow rate results (a record for the Perth Basin) announced on 28 March from their Lockyer Deep Test well. Because MIN is a conglomeration of different businesses, and its current iron ore operations are high cost and low grade, their lithium business is undervalued within the current share price relative to comparison "pure play" lithium companies.

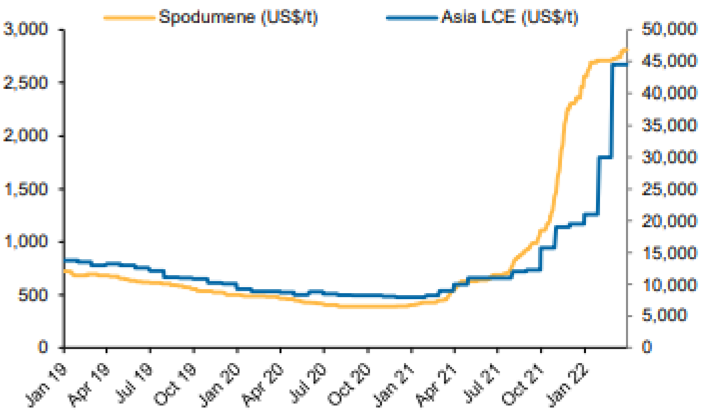
Taking a closer look at MIN's lithium business – MIN announced at their February result their goal of producing greater than 100,000 tonnes of lithium hydroxide within 5 years. This will come via their existing 3 assets in Western Australia:

- Mt Marion – a 50% equity interest in a currently producing spodumene mine. MIN have a Lithium hydroxide toll treatment agreement in place with their Joint Venture (JV) partner Gangfeng. We estimate this will result in ~ 40,000 tonnes p.a. of lithium hydroxide for MIN.
- Wodgina and the MARBL JV – a 50% interest in large spodumene mine (currently undergoing commissioning) and plans to invest in lithium hydroxide conversion capacity with their JV partner Albemarle. We estimate this will result in greater than 50,000 tonnes p.a. of lithium hydroxide for MIN.
- Kemerton hydroxide plant – MIN has a 40% equity interest, but purchases the spodumene feedstock from it's JV partner Albemarle on a commercial basis. First production is scheduled for May. MIN's share of lithium hydroxide will be 20,000 tonnes p.a.

Whilst MIN's 100,000 tonnes of lithium hydroxide target is set for 5 years time, MIN will have tonnes from Mt Marion and Kmerton this year and we expect a ramp up (initially of spodumene) from the MARBL JV to begin in late 2022.

The lithium market remains extremely attractive for producers. The charts below give a high-level overview of the strength of the market currently.

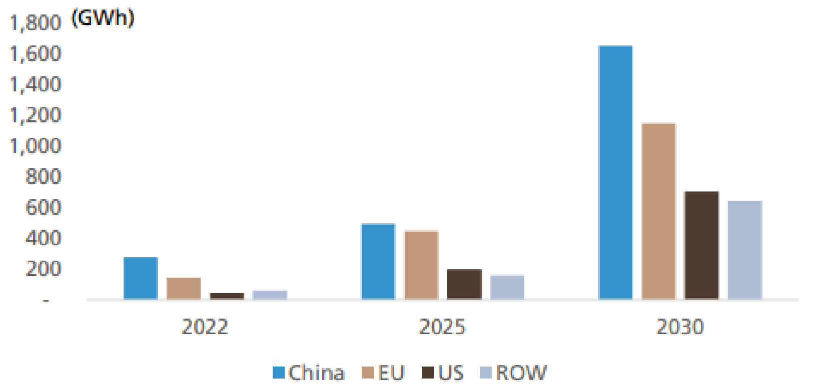
The first chart shows the spodumene price on the left, with the one of the Asian indexes for lithium carbonate on the right. With respect to these prices Allkem Ltd on the 1st of April guided to US$5,000 per tonne spodumene for the June quarter, and Platts currently quote the China spot lithium carbonate price at US$74,000. Both of these prices if shown would be literally off the chart below!



Source: Bloomberg, Macquarie Research, April 2022

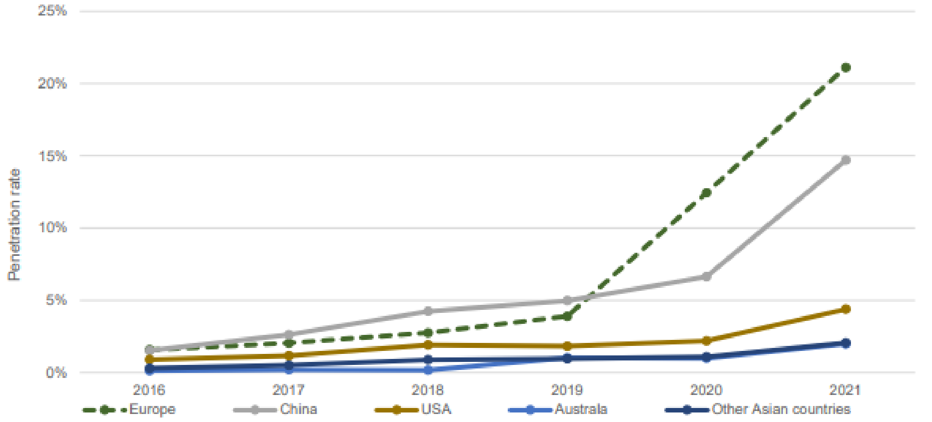
The next two charts show the extent that current global lithium (i.e. batteries for electric vehicles) demand has been driven by China, and more recently Europe. Both of these regions are still in the early stages of Electric Vehicle (EV) adoption, with the US further behind. With this in mind and the challenges of bringing on new mines/brines it appears hard for supply to catch up with demand in the near term, hence we expect elevated prices to continue for some time.

Figure 3: Battery demand by region



Source: UBSe

Figure 2: Major market EV penetration rates



Source: Statistica, Rho Motion, Focus2move, company reports

Earnings implications - We assume the spodumene price falls back to ~ US$1,000 in 5 years time. We think this is a reasonable assumption, whilst it's higher then where prices fell to a few years ago, we view a premium being required to incentivise new supply in what looks like more than a decade of strong demand growth to come. Given our assumptions of declining forecast prices (as supply eventually catches up) and MIN's growing lithium hydroxide production profile (as the MARBL JV ramps up), we forecast MIN's lithium earnings to be relatively stable at ~ A$1,300m p.a. between FY25 and FY30.

Valuation implications – Whilst we use DCF (Discounted Cash Flow) models as our principal valuation tool for resource companies, given lithium is an industrial mineral and MIN's assets are very long duration we also think it's worth thinking about an earnings multiple once MIN is a fully vertically integrated lithium hydroxide producer. This is currently how some of MIN's largest competitors/partners trade as shown in the table below.

		EV/EBITDA	
Name	**Mkt Cap US$m**	**FY1**	**FY2**
ALBEMARLE CORP	26,472	23.6	17.7
GANFENG LITHIUM CO LTD-A	27,188	16.4	13.2
LIVENT CORP	4,522	25.1	18.0
QUIMICA Y MINERA CHIL-SP ADR	24,200	8.9	8.5
TIANQI LITHIUM CORP-A	19,031	9.9	9.6

Source: Bloomberg

Given that MIN's assets are located in WA with relatively low sovereign risk, and they have long life assets that are low on the cost curve, we view a 10x Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) multiple on FY25 earnings as a reasonable valuation metric. In comparison Albemarle and Livent were trading on approximately 18x CY23 at the time of writing.

At 10x our expectations for FY25 EBITDA on lithium alone ($1,300m p.a.) the valuation to MIN shareholders would be $13bn, or ~ $70 per share. This compares to the share price at the time of writing of $60, and is before attributing any value for their mining services business (~ $500m EBITDA p.a.), current/future iron ore operations, and their recent gas discovery.

A key question remains of will anything happen to “unlock” the lithium business valuation within MIN’s share price. MIN have stated in the past their preference is to develop mining assets with the aim of locking in their own mining services business as the life of mine contractor, and then selling the mining asset (in part or full) to recycle the capital into their next project. Given the current opportune environment to be a seller of lithium assets and MIN’s need for capital to invest in two large iron ore projects (Ashburton and South West Creek) we expect MIN will crystallise some of their lithium assets in the near/medium term which should provide them both a healthy cash injection and a share price benefit from the valuation read-through on their remaining equity stake.

We continue to hold a positive view of MIN.

Outlook

With inflationary expectations shifting from temporary to somewhat more medium term, interest rate expectations have taken a step up, with many commentators stating the RBA is behind the curve. Throw in the Ukraine war, energy price spikes, China getting more active in the Pacific and a federal election, general uncertainty also has taken a step up.

We observe market leadership has narrowed further, with energy and resource stocks alone taking the market higher. This isn’t expected to be sustainable. We observe market sentiment as skittish and somewhat nervous.

Greencape consider our market milestone scores have increased in importance in our stock selection. Good news from our companies may not be rewarded as much as it once was but bad news will be punished. The tide of cheap money is no longer lifting all boats and macro news flow has overwhelmed many positive bottom-up stories.

Greencape is being very selective in buying into sold off stocks. In addition to backing in stocks with excellent shareholder stewards, we are finding more conviction in stocks with attractive market milestones and identifiable positive catalysts. Value has improved, indeed become attractive, in many high-quality longer duration names. Stock picking and active management is expected to be more important to deliver attractive returns.

“Panics do not destroy capital; they merely reveal the extent to which it has been previously destroyed by its betrayal in hopelessly unproductive works.” John Mill 1868

"Most of those in political office, quite understandably, are firmly against inflation and firmly in favor of policies producing it.” Warren Buffett 1977

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**

Greencape Capital won the Australian Equities - Large Cap category. The Zenith Fund Awards were issued 30 October 2020 by Zenith Investment Partners (ABN 27 130 132 672, AFSL 226872) and are determined using proprietary methodologies. The Fund Awards are solely statements of opinion and do not represent recommendations to purchase, hold or sell any securities or make any other investment decisions. To the extent that the Fund Awards constitutes advice, it is General Advice for Wholesale clients only without taking into consideration the objectives, financial situation or needs of any specific person. Investors should seek their own independent financial advice before making any investment decision and should consider the appropriateness of any advice. Investors should obtain a copy of and consider any relevant PDS or offer document before making any investment decisions. Past performance is not an indication of future performance. Fund Awards are current for 12 months from the date awarded and are subject to change at any time. Fund Awards for previous years are referenced for historical purposes only.

This material has been prepared by Greencape Capital Pty Ltd (ABN 27 130 132 672, AFSL 303903) Greencape, the investment manager of the Greencape High Conviction Fund. Fidante Partners Limited ABN 94 002 835 592 AFSL 234668 (Fidante) is a member of the Challenger Limited group of companies (Challenger Group) and is the responsible entity of the Fund. Other than information which is identified as sourced from Fidante in relation to the Fund, Fidante is not responsible for the information in this material, including any statements of opinion. It is general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. You should consider, with a financial adviser, whether the information is suitable to your circumstances. The Fund's Target Market Determination and Product Disclosure Statement (PDS) available at www.fidante.com should be considered before making a decision about whether to buy or hold units in the Fund. To the extent permitted by law, no liability is accepted for any loss or damage as a result of any reliance on this information. Past performance is not a reliable indicator of future performance. Greencape and Fidante have entered into arrangements in connection with the distribution and administration of financial products to which this material relates. In connection with those arrangements, Greencape and Fidante may receive remuneration or other benefits in respect of financial services provided by the parties. Fidante is not an authorised deposit-taking institution (ADI) for the purpose of the Banking Act 1959 (Cth), and its obligations do not represent deposits or liabilities of an ADI in the Challenger Group (Challenger ADI) and no Challenger ADI provides a guarantee or otherwise provides assurance in respect of the obligations of Fidante. Investments in the Fund are subject to investment risk, including possible delays in repayment and loss of income or principal invested. Accordingly, the performance, the repayment of capital or any particular rate of return on your investments are not guaranteed by any member of the Challenger Group.