Greencape CAPITAL

Greencape Broadcap Fund

Quarterly report - June 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 (gross)	-12.92	-9.27	6.74	9.78	12.37	8.41	10.41
S&P/ASX 300 Accumulation Index	-12.22	-6.78	3.43	6.91	9.24	4.58	6.04
Active return^	-0.70	-2.50	3.31	2.87	3.13	3.83	4.37

Past performance is not a reliable indicator of future performance.

Performance figures are calculated before 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

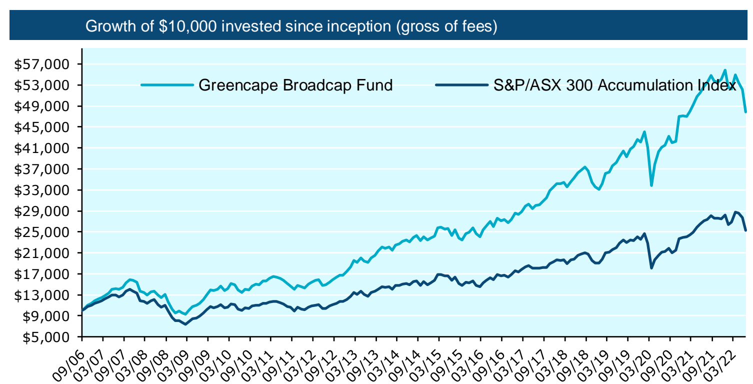
Greencape is an active, 'bottom-up' stock picker. Whilst Greencape does not target any specific investment style and will invest in stocks displaying 'value' and 'growth' characteristics, its focus on a company's qualitative attributes will generally lead to 'growth' oriented portfolios. This is an outcome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



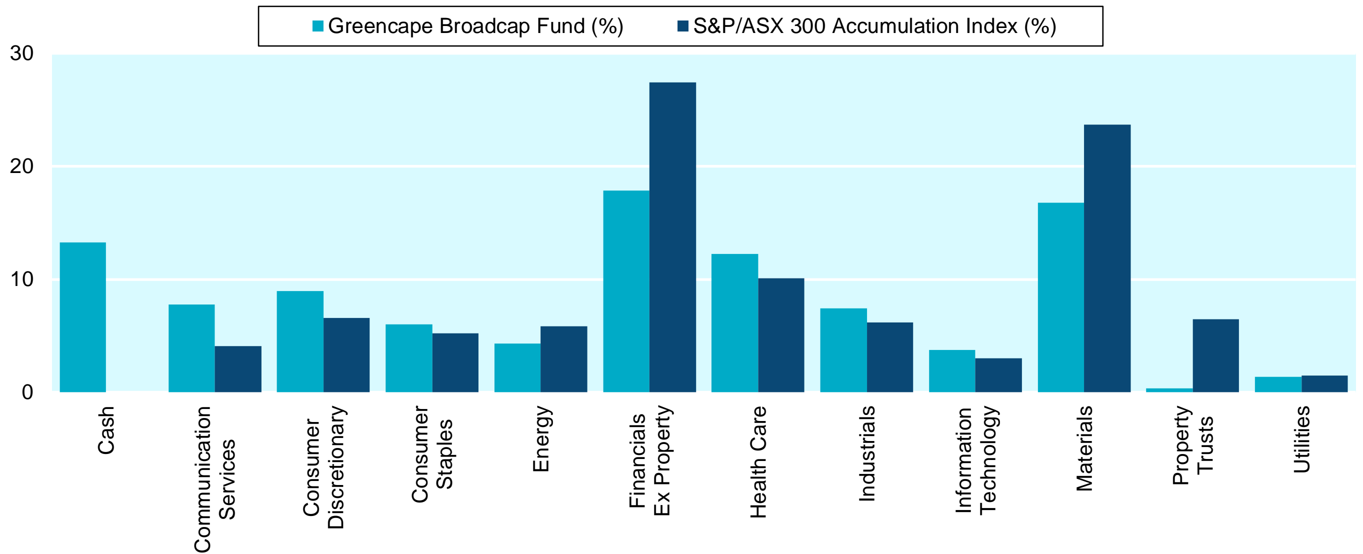
Asset allocation	Actual %	Range %
Security	86.77	85-100
Cash	13.23	0-15

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, 30 June 2022.

Sector exposure as at 30 June 2022



Data Source: Fidante Partners Limited, 30 June 2022.

Fund performance summary

The S&P/ASX 300 Accumulation Index returned -12.22% for the quarter. The fund underperformed the market and delivered a -12.92% return over the quarter.

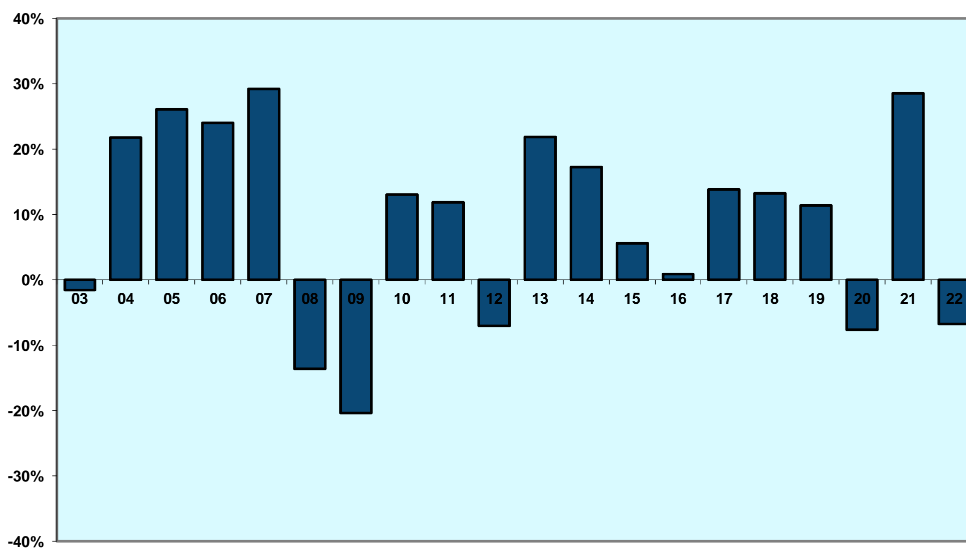
Market overview

After registering 8 consecutive quarters of growth the market sold off with a vengeance, posting its worst quarterly performance since the beginning of the pandemic. The sudden about-face from central banks around interest rates in light of rampaging inflation saw a widespread repricing of risk across asset classes. Locally we had a change of Federal government, with the Labor party (eventually) able to form a majority government following the May vote.

S&P/ASX 300 Index

Source: IRESS

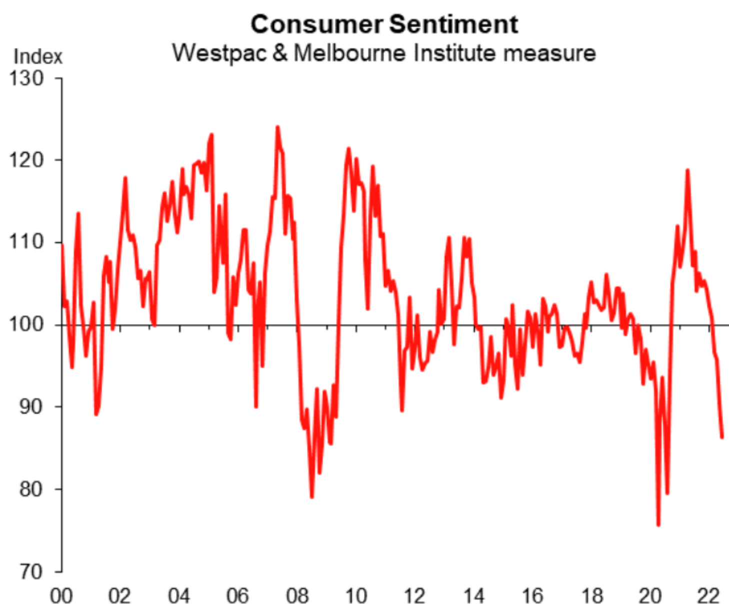
S&P/ASX 300 Accumulation Index Financial Year Returns Since 2002



Source: IRESS

Despite previously telling the market they would not raise interest rates until at least 2024, the RBA raised the overnight cash rate in May for the first time since 2010. That initial 25 basis point hike was followed up by another 50 basis point hike in June.

Inflation was the topic du jour worldwide during the period with increasingly higher prices on staples such as food and petrol pinching the consumer. The prospect of further interest rate rises and ongoing inflation has resulted in Aussie consumers feeling bearish on their situation, and this has manifested in meaningfully weaker Consumer Sentiment.



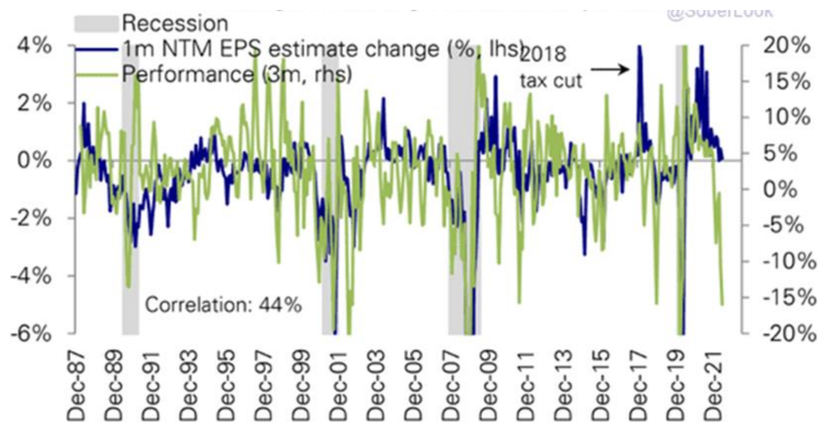
Source: Macquarie

In the US, the annual inflation rate reached 8.6% in May, the highest level since 1981. After initially raising the Target Rate 25 basis points in March, the Fed followed up with 50 and 75 point hikes in May and June respectively, taking the rate to 1.75%. Pricing of futures implies the market expects the rate to peak near 4% at the start of 2023, before being cut again later in the year.

Whilst the trading multiple of the S&P 500 index appears to have retreated back to the 20-year average, earnings estimates are little changed. Forward indicators for earnings (third chart) appear weak, which suggests the market could have further to fall.

"In its application, however, and with the benefit of hindsight, the yield target could have been ended earlier." – Philip Lowe, RBA Governor, 20/06/2022

"Household spending remains elevated, but the rapid rate of growth observed at the start of the year has stopped and instead a moderate softening is underway." Harry Ottley, Associate Economist at CBA, 17/06/2022



Source: The Daily Shot

Meanwhile in Europe, the ECB (European Central Bank) have also found themselves behind the inflation curve. Whilst the inflation reading in the Eurozone was similar, 8.1%, the ECB's main policy interest rate is -0.5%. The bank has publicly provided guidance for the rate to be at or above zero by July.

	QUARTER	YEAR
ASX300 Accumulation Index	-12.2%	-6.8%
Best Performing Sectors		
Utilities	1.7%	16.1%
Energy	1.2%	29.9%
Healthcare	-2.2%	-12.1%
Worst Performing Sectors		
Information Technology	-26.3%	-36.4%
Property Trusts	-17.5%	-23.0%
Materials	-16.6%	-3.4%

Source: IRESS

Tech stocks performed poorly over the period as higher interest rate expectations saw the market upwardly adjust the cost of capital, which had an outsized impact on longer duration growth names. Whilst the strategy of growth at all costs was rewarded a high (revenue) multiple over the course of the pandemic, higher risk-free rates have seen the market become more discerning on the viability of loss-making business models. In a similar vein, Property Trusts underperformed as higher risk-free rates signaled higher capitalisation rates (and therefore lower valuations).

Energy stocks performed relatively well over the quarter as persistently higher commodity prices saw the market continue to upgrade earnings expectations. Woodside Energy also completed the merger with BHP's oil and gas portfolio in June. The usually quiet Utilities sector was rich with news flows during the quarter as AGL's demerger plans were scuppered by Grok Ventures, the private investment firm of Atlassian co-founder Mike Cannon-Brooks. Elsewhere, the Australian Energy Market Operator (AEMO) seized control of the east coast energy market for the first time ever in June, suspending the spot price for wholesale electricity in order to minimise the risk of blackouts.

Offshore Trips

During the quarter we travelled to the US on three separate occasions, in addition to attending a weeklong US conference virtually. We also travelled to the UK.

US observations

- On the ground the economy felt better than tumbling share prices would suggest. Feedback from the cross section of companies we spoke to was consistent in that demand indicators were still strong, and cost inflation was able to be offset by price rises. Management teams were 'hearing but not seeing' a softening of the demand outlook, which suggests a slowdown could be self-fulfilling to a certain extent.
- Supply chain constraints across most industries have restrained supply such that demand hasn't or can't be fulfilled. There is a gradual loosening of supply chains, with shipping costs and container availability now moving in the right direction. On top of the recovery, there is a clear move to re-shoring of certain industries.
- Inflation is top of mind but for now it is not stopping consumers from spending. Jobs are still secure, consumer balance sheets are strong and people are tired of staying at home.
- On housing, relative to the previous cycle there has been far less exuberance in house building given supply constraints, and this has resulted in a large underbuild of homes relative to household formation. Furthermore, home builders have been much more rational during this cycle given they still wear the scars of 2008.

UK observations

- The pandemic is well and truly over. Not a mask in sight and no one speaks of COVID anymore.
- The inflation situation felt worse than the US. The consistent anecdote provided was that it used to cost £100 to fill up the car and now it's £150. Power bills are also starting to meaningfully step up, with the average bill expected to more than double.
- Over 5 years on and Brexit continues to hurt the UK economy, with the inability to attract foreign labour now considered to be a structural issue.
- "TWATs" (Tuesday, Wednesday and Thursdays) is the term du jour for office workers, with most city workers spending those three days in the city with Monday and Friday from home.

"An entire generation of entrepreneurs and tech investors built their entire perspectives on valuation during the second half of a 13-year amazing bull market run. The "unlearning" process could be painful, surprising, & unsettling to many. I anticipate denial." Bill Gurley, Partner at Benchmark (Venture Capital), 30/04/2022

"We need five years of unemployment above 5% to contain inflation. In other words, we need two years of 7.5% unemployment or five years of 6% unemployment or one year of 10% unemployment." Larry Summers, Former US Secretary of the Treasury, 21/06/2022

"The demand for our full-priced products once again allowed us to more than offset higher product and freight costs, while still delivering record margins and strong top line sales… but we have seen some short-term moderation in demand sales within our portfolio brands, but

CWY

Cleanaway Waste Management Ltd (CWY) is Australia's leading waste management company with a market capitalisation of approximately $5bn. The company operates a substantial network of vertically integrated assets across Australia including waste collection vehicles, transfer stations, landfill assets, recycling facilities and liquid treatment plants. For FY22 the company should generate approximately $2.8bn in revenue and $570m in Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA).

In February, new CEO Mark Schubert unveiled the company's refreshed strategy, 'Blueprint 2030', which can be viewed as a customer-led evolution of the 'Footprint 2025' strategy executed on by previous CEO Vik Bansal which was focused on generating better returns across the supply chain by shifting the portfolio towards higher valued infrastructure assets and from a strong focus on operational excellence. The core premise of the Blueprint 2030 strategy is to invest in and extend the current network of infrastructure assets to provide more sustainable/circular solutions with the aim of being recognised as the most innovative and sustainable waste company in Australia. They aim to achieve this by:

- Developing energy-from-waste projects that will generate low carbon power from waste that would otherwise end up in landfills
- Expanding their resource recovery solutions to turn more waste into recycled products, e.g. plastics reprocessing, organics recycling
- Optimising the current landfill footprint to extend its life through more sophisticated pricing, operational efficiencies and expanding licenses
- Creating a digital customer platform to provide tailored access to CWY's carbon and sustainability solutions

In our view the Blueprint 2030 strategy above, if executed upon well, has the opportunity to deliver substantial medium-to-long term growth at higher than current returns for CWY. Australia is a global laggard in recycling and energy-from-waste (especially compared to Europe) and we believe CWY is uniquely positioned to capture this opportunity given its strategic infrastructure footprint assembled over the last decade and with the improved industry structure in Australia following much industry consolidation over the past 5 years. In a more sustainable/circular world, we believe that more value in the supply chain will accrue over time to the 'resource owner' such as CWY. Our 'Business Evaluation' score which attempts to capture our assessment of business quality, growth optionality and industry trends has never been higher for CWY.

With CWY trading in the mid $2's through late June and early July, our 'Valuation' score on the stock has improved and it has become a larger position across the portfolios. The majority of the current issues impacting CWY's trading conditions are temporary or one-off in nature (flood damage to a landfill, fire at a medical waste facility, lagged fuel cost recoveries, constraints on labour availability, upfront overheads to support Blueprint 2030) and as such we think are being over-capitalised in the current share price. Insights from our recent trips to the US and UK indicate that international public and (and particularly) private markets are willing to ascribe a higher value to these waste management businesses than what the current CWY share price is implying. CWY is one of the few ASX-listed stocks which trades at a multiple discount to international peers (e.g. large US waste companies trade on 2-3x higher EV/EBITDA multiples) and at a lower multiple than recent comparable transactions in Australia and New Zealand (and of inferior businesses in our view), which adds to our conviction in buying CWY in the mid $2's.

nothing to the degree that we're hearing others reporting out there at all." Julie Whalen, CFO of Williams Sonoma, 25/05/2022

Outlook

We observe the longer term yield curve has flattened. The 5yr cost of money is cheaper than 3yr today, and indeed short-term cash rate peak expectations have come off their highs. This is happening as early evidence of consumer demand destruction is identified in certain sectors and geographies (reflected in low consumer sentiment) . We expect a number of earnings downgrades will be announced in coming weeks, and cautious outlook commentary from companies at the August result briefings.

Based on these observations, our portfolio has pivoted somewhat. Our relative conviction has increased in several defensive names, some we consider are candidates for earnings upgrades (g Telstra and Computershare). This defensive ballast in the portfolio has allowed us to add to some select sold off quality growth names where we have conviction in structural growth, backable management and now additional valuation appeal.

The payoff may be slightly longer dated but our conviction is telling us time is on our side. These portfolio moves have generally been funded by cyclicals, resources and banks, with some profit taking from a couple of defensive names which have largely done their job (eg Amcor). We have maintained our higher than usual cash weights as liquidity is still considered valuable given the volatility and heightened geopolitical risk. We expect active stock picking will be better rewarded in coming weeks and months.

More information

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

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