Greencape Broadcap Fund

Quarterly report - March 2023

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	5.15	-1.51	15.91	8.88	9.62	8.65	9.28
Growth return	4.46	-11.84	8.62	2.03	2.56	2.34	2.92
Distribution return	0.70	10.34	7.28	6.85	7.06	6.30	6.36
S&P/ASX 300 Accumulation Index	3.33	-0.57	16.60	8.63	8.13	6.37	6.56
Active return^	1.82	-0.94	-0.69	0.24	1.49	2.28	2.73

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'.

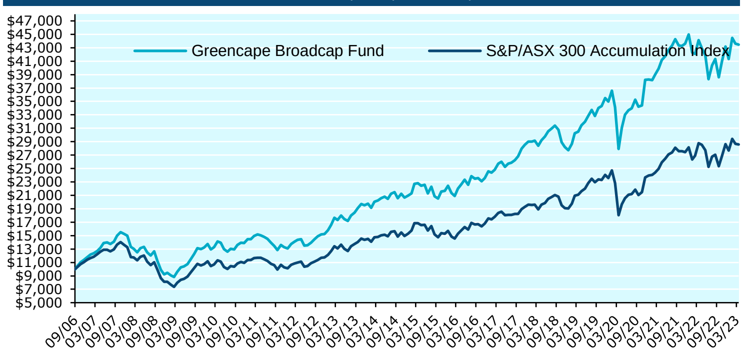
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

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



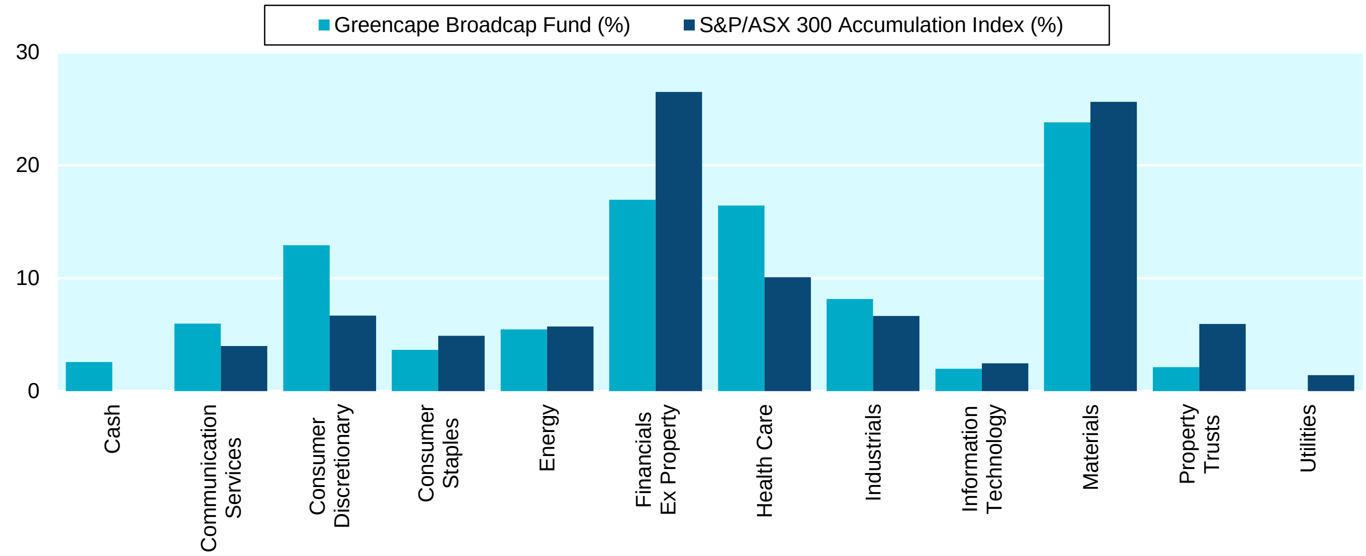
Asset allocation	Actual %	Range %
Security	97.43	85-100
Cash	2.57	0-15

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 2023.

Sector exposure as at 31 March 2023



Data Source: Fidante Partners Limited, 31 March 2023.

Fund performance summary

The S&P/ASX 300 Accumulation Index returned +3.33% for the quarter. The fund outperformed the market and delivered a +5.15% return over the quarter.

Market overview

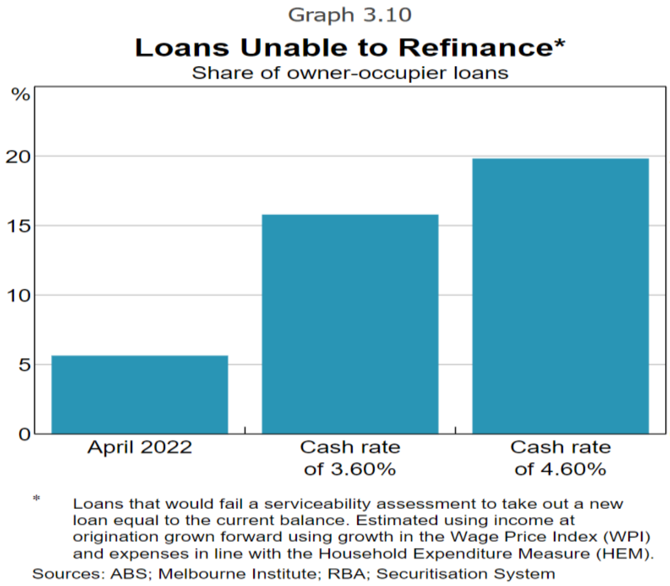
After a weak finish to 2022, equities came back to life with a vengeance to start the new calendar year with China reopening and moderating inflation expectations providing cause for optimism. Investor confidence was later jolted in March, with regional banking turmoil in the US causing markets to sell off before central banking authorities stepped in to prevent wider contagion. Meanwhile, the world became captivated by the emergence of Generative AI, the use cases of which continue to be expanded on a daily basis.

S&P/ASX 300 Index

Source: IRESS

The RBA raised rates at both meetings held during the period, taking the tally of consecutive rate rises to 10. In the commentary following the March decision there was a noticeable change in tone from the RBA which suggested futures hikes were less certain and would largely be dependent on four key data points: employment data, business surveys, retail sales and inflation. Whilst the first three data points were a mixed read, the February monthly CPI release at the end of March came in below expectations with the indicator rising 6.8% year on year relative to market expectations of a 7.2% rise. After period end, the RBA paused for the first time since April 2022. The futures market now implies rates will be on hold for the rest of the calendar year.

With the fixed interest rate reset cliff looming, the RBA estimates that 16% of owner-occupier housing loans in Australia are unable to meet serviceability assessments for a new loan at current interest rates.

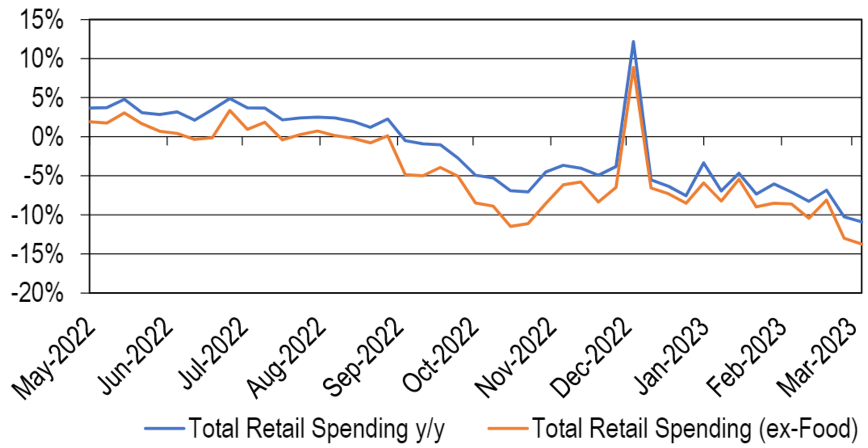


Source: RBA

Similar to the RBA, the Federal Reserve (Fed) also raised rated 25 basis points at both meetings held during the period. Whilst the March decision was well flagged to the market, the change of tone in the accompanying commentary also marked a noticeable shift, with Chair Powell and the Committee now seeing the risks to the outlook as more balanced than previously. The market and the Fed continue to be in dispute on the path of on the Fed Funds rate which we delve into more detail later in the report. The inflation data continues to be incrementally more supportive of a pause in the hiking cycle, with the Personal Consumption Expenditures (PCE) Index for February coming in below estimates.

High Frequency data from the US is also becoming more negative, with Citi credit card data weaker in March.

Figure 5. Total spending vs LY (weekly)



Source: Citi

Locally, February saw the bi-annual reporting season with companies reporting weaker results on average with earnings misses outnumbering beats. Higher operating costs and trends towards more cautious demand trends were common themes throughout the period, with forward earnings being revised lower on average.

Figure 1: ASX Forward EPS vs Lead Index

Source: Credit Suisse

	QUARTER	YEAR
ASX300 Accumulation Index	3.3%	-0.6%
Best Performing Sectors		
Consumer Discretion	10.8%	2.9%
Telecom Services	9.5%	2.9%
Info Tech	7.5%	2.6%
Worst Performing Sectors		
Financials ex Property Trusts	-2.7%	-5.7%
Energy	-1.0%	13.8%
Property Trusts	0.3%	-14.0%

Source: IRESS

The Consumer Discretionary sector found itself in the unfamiliar position at the top of the performance table during the quarter. Fund holding Aristocrat Leisure performed strongly, although the rally early in the period was seemingly more a function of the share price bouncing off oversold levels in December given the absence of news flow. Elsewhere in the sector, Flight Centre Travel Group outperformed after announcing the acquisition of Scott Dunn, a UK-based luxury travel brand.

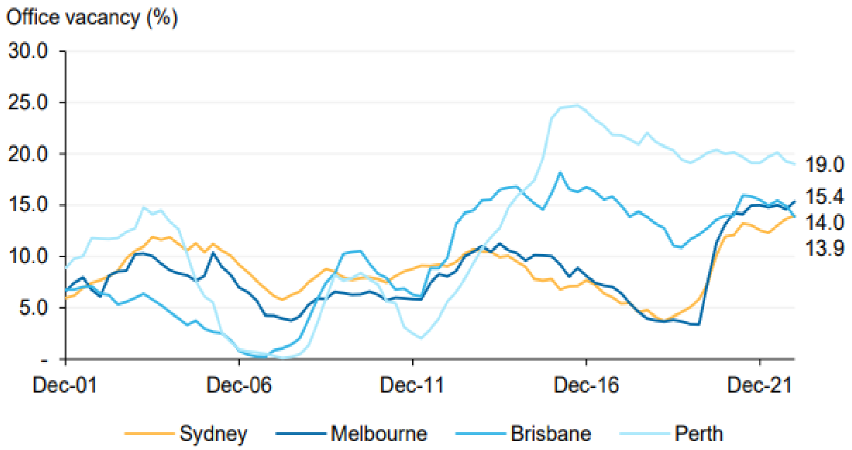
Telecommunications performed strongly on the back of Telstra, with the company reporting a strong first half result in February with the highlight being the Mobile division which grew revenue and EBITDA by 9% and 13% respectively. Additionally, there were media reports in February that the company has appointed investment banks to advise on the sale of a stake in Infraco, Telstra's specialist Infrastructure unit.

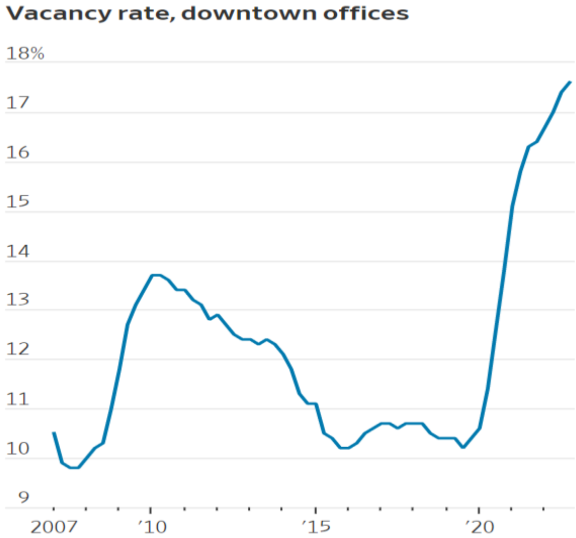
"Growth in the Australian economy has slowed, with growth over the next couple of years expected to be below trend. There is further evidence that the combination of higher interest rates, cost-of-living pressures and a decline in housing prices is leading to a substantial slowing in household spending. While some households have substantial savings buffers, others are experiencing a painful squeeze on their finances." Philip Low, Governor of the RBA, 04/04/2023

Financials lagged the market during the period. Investors took a dim view towards the CBA result, with disclosure from the company indicating that Net Interest Margins have potentially peaked. Looking further abroad and in addition to the Silicon Valley Bank drama, UBS was forced by the Swiss government to acquire its rival Credit Suisse. Although the headline price paid was only USD $4.5bn, the Swiss government provided USD$9bn to backstop losses as well as a further USD$200bn of liquidity to help facilitate the deal.

REITs underperformed during the period, with a persistent theme clouding the office sector being the structural impact from Working from Home. Whilst there are some structural differences between countries, the US provides a sobering lead indicator with vacancy rates continuing to rise, with cities like San Francisco posting vacancy rates as high as 29%.

Fig 453 Vacancy begins to increase in Syd and Melb



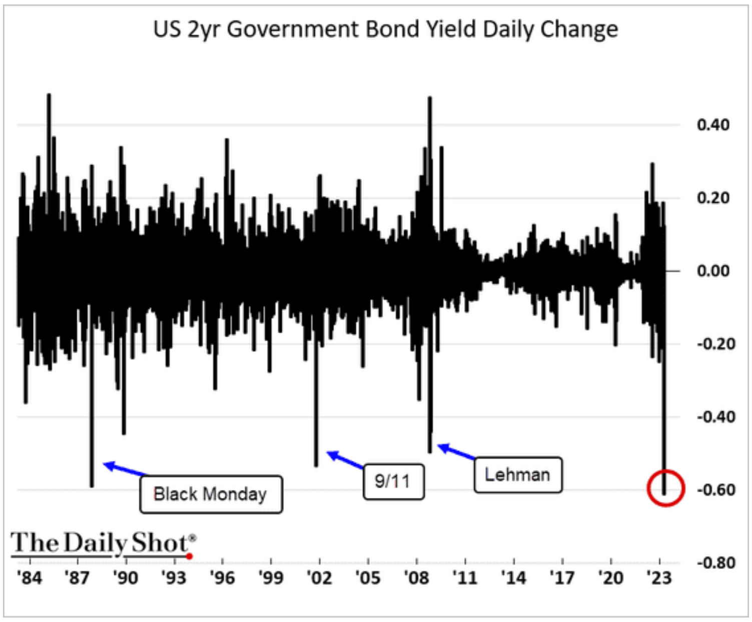


Source: Macquarie, WSJ

Silicon Valley Bank

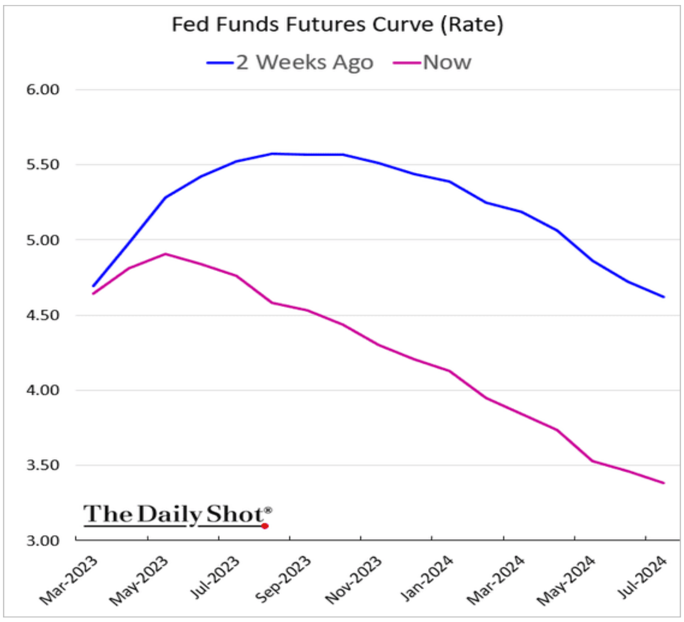
The Silicon Valley Bank (SVB) collapse was a timely reminder of the perils of asset-liability duration mismatches in deposit-taking institutions. Whilst we won't further ruminate on the drivers which lead SVB's to collapse in this report (as these have been discussed ad nauseum over the past month), some of the market reactions and implications from the events are worth highlighting.

The movement in the rates curve in the wake of the collapse was typical of previous cataclysmic financial events, with the front end of the curve seeing the largest repricing in recent history.



Source: The Daily Shot

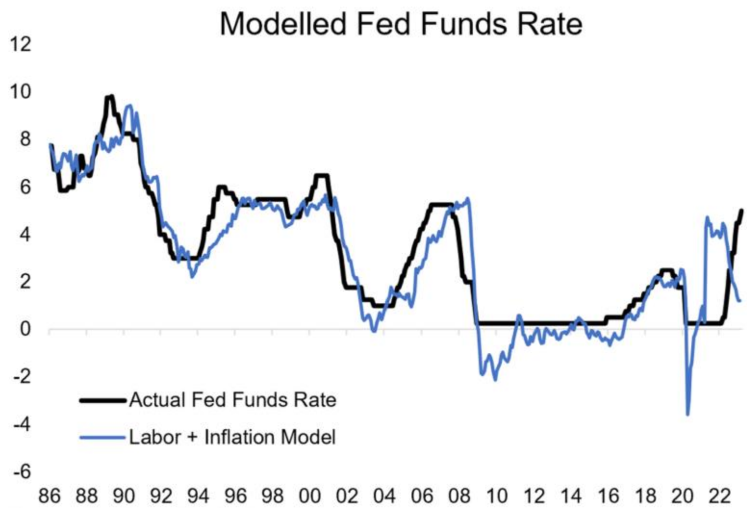
The shape of the curve across all durations has changed markedly, with the market now ascribing a 75% chance of a rate hike in May, followed by circa 60 basis points of rate *cuts* by the end of the year. At the time of writing, the futures implied rate and the Fed Dot plot average projection for December 2023 are 70 basis points apart.



Source: The Daily Shot

Just as the Fed was too slow to hike rates when inflation initially spiked during the pandemic (due to the initial thinking it was 'transitory), it now looks like The Fed may continue to hike rates into a rapidly slowing economy. Whilst the market is of the view the hiking cycle is at or near its completion, commentary from various Fed members indicates they are staunch in their stance that multiple hikes are still required to get inflation under control.

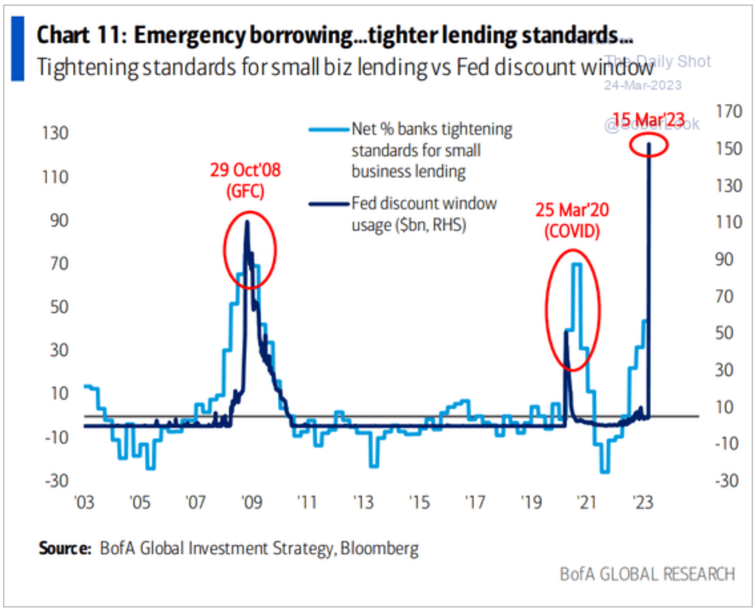
"In my view, continued appropriate macroprudential policy can contain financial stress in the current environment, while appropriate monetary policy can continue to put downward pressure on inflation." James Bullard, President of the St Louis Fed, 29/03/2023



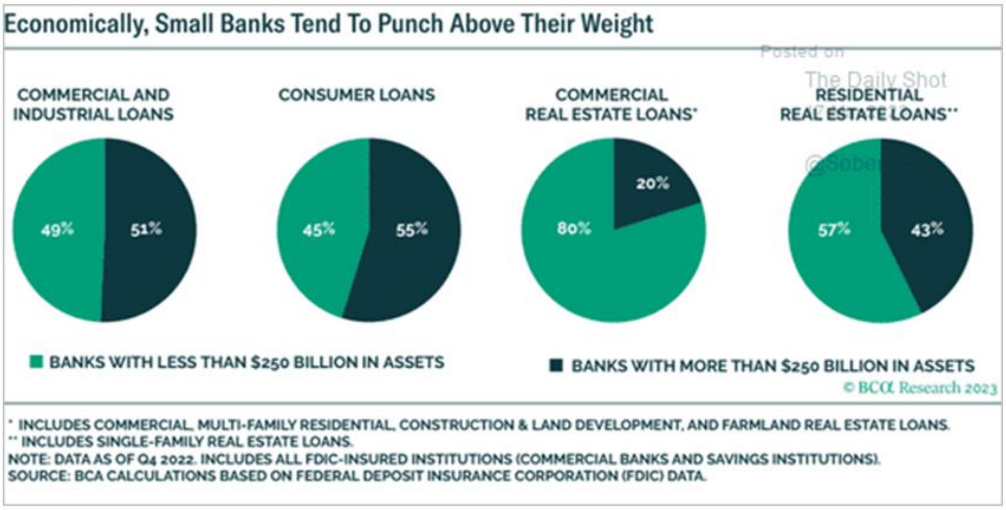
Source: Topdown Charts

Amongst the frenzy of the SVB turmoil, banking institutions in the US drew down on two Fed backstop facilties at unprecedented levels. Whilst the Fed Discount Window is a program which has always been available to US banks, the Bank Term Funding Program (BTFP) was only opened on March 12 after the Fed declared emergency conditions following Silicon Valley Bank's collapse. Unlike the Fed Discount Window which can only be extended for 90 days, loans from the BTFP can be extended up to a year. This suggests there is sufficient liquidity in the system (and a willing Fed) to contain systemic issues for the time being.

"While the current crisis has exposed some weaknesses in the system, it should not be considered, as I pointed out, anything like what we experienced in 2008." Jamie Dimon, Chairman and CEO of JP Morgan, 04/04/2023



Whilst in Australia we are accustomed to the dominance of the big four banks, the banking landscape in the US is somewhat different. Regional banks write more than half of all Residential Real Estate loans and 80% of Commercial Real Estate loans according to data from the Federal Data Insurance Corporation. Given the systemic importance of regional banks, a lesser appetite to provide credit to customers could have wider implications to the US economy.



Source: BCA Research

Flutter

Flutter is an international sports betting and gaming company which operates a number of brands worldwide including FanDuel in the US and Sportsbet in Australia. We first bought Flutter in September 2021 and steadily increased our position through 2022 as the share price declined. While the share price has performed strongly over the last nine months, it's worth noting in the chart below that it's still yet to recover it's 2021 highs, at which time it's US business (FanDuel) was being ascribed a similar revenue multiple to DraftKings of ~14x. Since then, DraftKings' revenue multiple has fallen to 3x today (having troughed at less than 2x) as interest rates rose and market multiples ascribed for loss-making long duration growth companies contracted. At the same time Flutter faced headwinds in its home UK & Ireland division, self-imposing tighter bettor protections ahead of the UK government's long awaited Safer Gaming Whitepaper, as well as in their International division (e.g. Russia sanctions). On consensus numbers we think the market is currently pricing in FanDuel at 5x 2023 revenue.

"We're also part of a global community of over 1,000 such experts in Flutter. Being able to tap that network has been invaluable in helping us build the capabilities we needed faster than we otherwise could have done. And while the scale of that resource has absolutely been critical to our success, the most important part of our approach is that the teams are highly integrated with the rest of the business. We're integrated with the commercial, marketing, product, technology teams." Conor Farren, SVP of Sports Product & Pricing at FanDuel, 09/11/2022

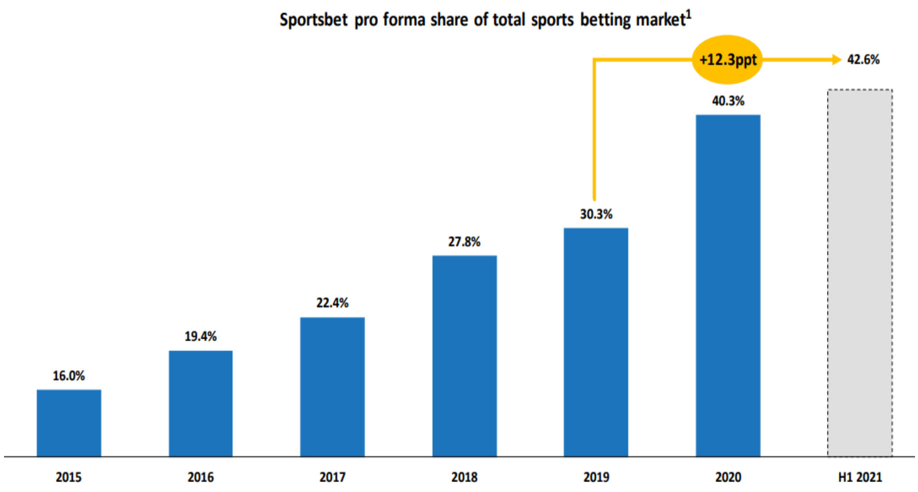
Source: Capital IQ

Our key attraction to Flutter is their dominant market position and growth outlook in their US business, FanDuel. Before delving into FanDuel it's worth touching on the rest of the group, which also adds context to why FanDuel has been so successful to date, and why we think it will continue to be in the years ahead.

Consensus expectations for CY23 are for Flutter, excluding the US, to generate £1.5bn of EBITDA, which is expected to grow at 7% p.a. over the next 3 years. Within this, the International division (which includes several different countries, Italy and India being the largest) is expected to grow at over 10% p.a., whilst the more mature markets of UK & Ireland and Australia are expected to grow at a mid-single digit rate.

One thing that's been apparent to us having visited SportsBet (Flutter's Australian business) and FanDuel many times is how many people they move around the group internationally to cross-pollinate knowledge. Similarly, their shared tech platforms and product development across the group gives them a large advantage versus domestically focused competitors. Many companies in other industries talk up such benefits but it's something we've witnessed as a stark advantage in online wagering with Flutter. Examples of this have been SportsBet's steadily growing market share in Australia at the expense of Tabcorp, and the performance of FanDuel in the USA versus DraftKings, a business that started with very similar advantages to FanDuel, but who FanDuel have steadily outperformed as more US states have legalised sports betting since a US Supreme Court ruling in 2018 overturned an effective national ban.

The charts below show SportsBet's market share gains in Australia.

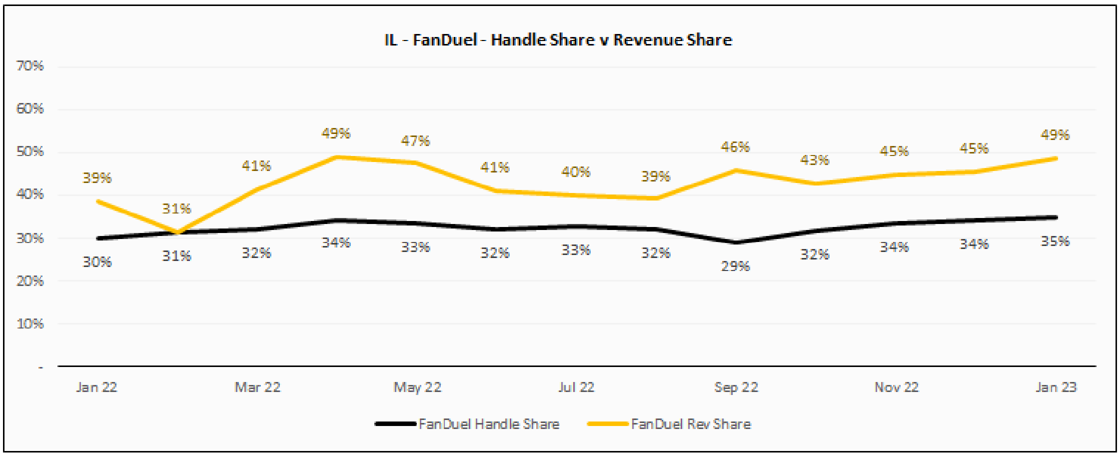


Source: Company Reports

One of the specific key drivers of SportsBet's success was the creation of the multi-bet product which FanDuel then leveraged in the US (aka 'Parlays'). The advantage with multi-bets is they produce a significantly higher margin relative to traditional fixed odds bets without the drawback of disengaging customers that would occur when wagering operators extract a higher margin out of each bet. An example of this is that the odds of winning 3 separate 5-to-1 mutually exclusive bets should be the same as winning one multi-bet on the same 3 outcomes, which is 125-to-1. In Flutter's case they may price this multi-bet at 135-to-1 with the customer being none the wiser on the discrepancy between the 135 and 125-to-1 theoretical price. This equates to a higher margin for the wagering operator.

SportsBet was the first to market with multi-bets in Australia. With their proprietary technology stack, they've been able to further iterate and improve their offering compared to some of their competitors that still rely on third party software to run and price their multi-bets. This has led SportsBet's brand becoming synonymous with multi-bets and hence they have a significantly higher proportion of their bets being multi-bets vs competitors. SportsBet last disclosed that 55% of their customers were using their Same Game multi-bet product. This gives SportsBet a distinct margin advantage vs its competitors, and their strategy to date has been to reinvest some of this additional margin back into 'generosities' (e.g. bonus bets and special offers) which has attracted more customers to the brand.

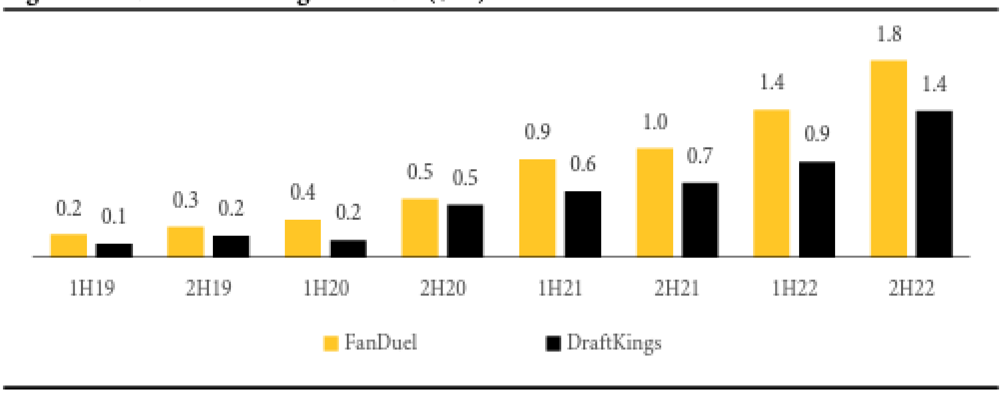
The development of the multi-bet product in Australia has been leveraged into FanDuel in the US and a very similar market share dynamic is playing out there. The chart below is for Pennsylvania but is typical of most US states that FanDuel operates in. It highlights that FanDuel is consistently converting it's 34–35% online sports betting handle (turnover) market share into an over 45% revenue share given their margin advantage. We expect this to continue.



Source: Taylor Collison

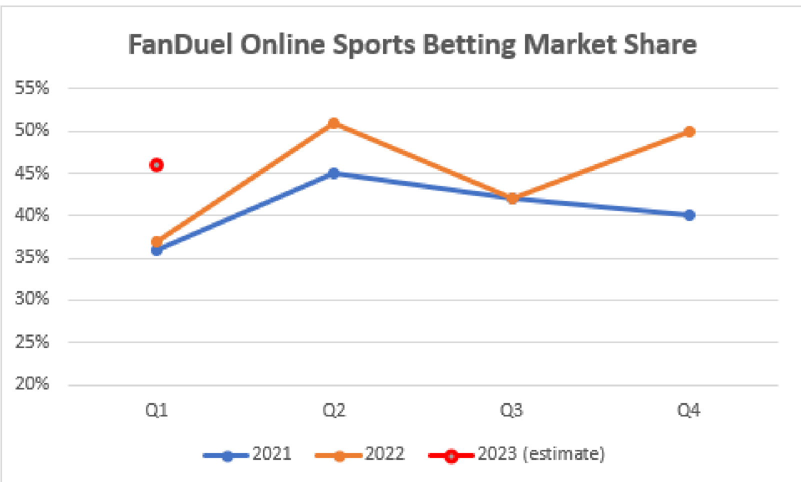
The result has been that FanDuel's scale advantage over its nearest competitor (DraftKings) in Sports betting has widened over time as shown in the chart below.

Fig 4: FanDuel vs DraftKings revenues ($bn)



Source: Redburn, company

The chart below shows FanDuel's growing market share off an already high starting base.



Source: Flutter, Eilers & Krejcik data for Greencape's 2023 estimate

"We have a lot of runway for growth in this business. First, we have states representing a sizable chunk of the U.S. population that have yet to come online. By June of this year, we've reached about 35% of the U.S. population for sports betting and about 11.5% for iGaming. We now see a path to those numbers reaching 80% for sports betting and 25% for iGaming by the end of this decade." Christian Genetski, President of FanDuel, 09/11/2022

Given sports wagering is a low margin business (due to gaming taxes, licencing fees etc.), scale matters. FanDuel's growing market share as shown in the chart above has given management the ability to forecast an EBITDA profit for the first time in 2023, compared to DraftKings which is still expected to generate large losses.

As FanDuel transitions from years of losses to profitability this year and then margin expansion thereafter, the impact on Flutter's group earnings should be significant. Market consensus expectations are for Flutter's earnings per share to grow at an average of 33% p.a. between 2024 and 2026. Free cash flow will also materially step-up, allowing Flutter to rapidly deleverage from its current peak level of 4x Net Debt to EBITDA and/or to further deploy capital into acquisitions.

The table below highlights the changing earnings mix within Flutter over the next few years, highlighting FanDuel's transition from being significantly loss-making in 2022 to almost a third of group earnings in 2025.

% of Group EBITDA

	CY22	CY23	CY24	CY25
UK & Ireland	63%	43%	35%	30%
Australia (SportsBet)	37%	23%	20%	17%
International	34%	33%	29%	26%
US (FanDuel)	-24%	7%	21%	31%

Source: Visible Alpha, Greencape estimates

Beyond 2025, FanDuel's earnings growth prospects partly hinge on the timing of large US states legalising sports betting and iGaming. Texas and California for instance both look unlikely to legalise before 2025, but if/when they do legalise, then the opportunity for Flutter is significant given the combined population of these two states is more than 2.5x that of Australia, which is currently a sizable market for the group.

Whilst Flutter's share price has nearly doubled off it's 2022 low, we still view the long duration earnings growth ahead of them as a significant opportunity that is still not yet being fully factored in by the market. Against this we are continually monitoring and assessing the potential for a greater regulatory burden on gambling and what impact this could have on the group.

"This year, on NFL performance, we spent 27% less year-on-year in existing states that had a comp to acquire 23% more customers. This is an immediate and accretive efficiency advantage that, again, falls to operators of scale primarily." Mike Raffensperger, Chief Commercial Officer of FanDuel, 09/11/2022

Outlook

Last quarter we mused that either the market had gotten ahead of itself, or the bearish indicators would turn more positive. The March quarter provided numerous observations including reporting season and outlook statements, post-Christmas high frequency data releases (e.g. retail spending, credit card data) and several Greencape research travel trips both domestic and international. Our observations identified that the bearish indicators have become more bearish on balance. Teasing this out, this is more so the case in Australia and NZ, and less so the case in US and even Europe, however these big markets are patchy (e.g. Texas is holding up better than Illinois).

Greencape cannot stress enough the value of bottom up observation in these uncertain times. Indeed, another wave of information gathering travel is underway over the next few months. Our conviction has increased in recession proof earnings and cash flows, with names like CSL increasing in portfolio weight. Our 'buying the dips' strategy has slightly shifted towards the more structural growth stories over cyclical names (e.g. IDP Education over homebuilders). We have also attempted to maintain cash weights, with funding from buckets such as Financials where we see numerous headwinds emerging.

Our cautious and somewhat defensive stance (especially for domestic facing businesses) has not reduced our portfolio's active share, which reflects our growing conviction in selected stocks driven by our bottom-up observations.

"Global conditions have become more complex and more confronting, even in the course of the last few months. Higher interest rates have exposed vulnerabilities in parts of the international banking system and that has added to the already significant challenges of persistent inflation, slowing global growth and the war impacts of the war in Ukraine as well." Jim Chalmers, Treasurer of Australia, 11/04/2023

More information

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