Greencape Wholesale Broadcap Fund

Fund report and commentary – June quarter 2010

Performance	Quarter (%)	1 year (%)	2 years (%) p.a.	3 years (%) p.a.	Inception (%) p.a.
Greencape Wholesale Broadcap Fund	**–10.86**	**17.21**	**0.41**	**–3.39**	**6.26**
Growth return	–11.16	14.95	–2.40	–6.29	1.64
Distribution return	0.30	2.26	2.82	2.91	4.62
S&P/ASX 300 Accumulation Index	–11.20	13.05	–5.10	–8.05	0.07
Active return (net)	**0.34**	**4.16**	**5.51**	**4.66**	**6.19**

Returns are calculated after fees have been deducted, assuming reinvestment of distributions. No allowance is made for tax. Past performance is not a reliable indicator of future performance.

Investment objective

The Fund aims to provide capital growth over the medium to long term investment horizon through a diversified portfolio of large, mid and small capitalisation Australian shares and provide returns above the benchmark, the S&P/ASX 300 Accumulation Index, over rolling three-year periods.

Investment manager

Greencape Capital Pty Ltd

Investment strategy

Greencape is an active, bottom-up stock picker. Whilst not targeting a specific investment style and investing in stocks displaying 'value' and 'growth' characteristics, Greencape's focus is on a company's qualitative attributes, which will generally lead to 'growth' oriented portfolios. This is an outcome of Greencape's bottom up process. As such, Greencape's investment style may be classified as 'growth at a reasonable price' (GARP).

Distribution frequency

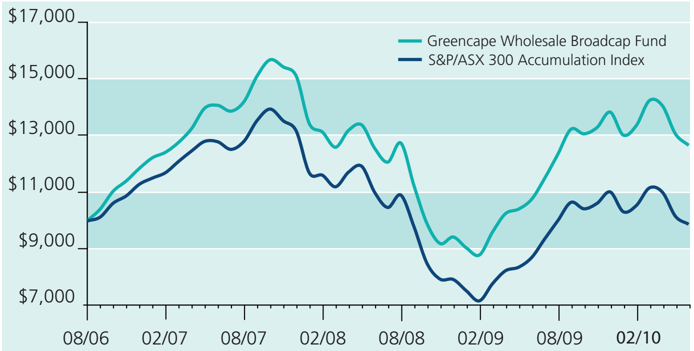
Quarterly

Suggested minimum investment timeframe

At least five years

Greencape Broadcap Fund

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

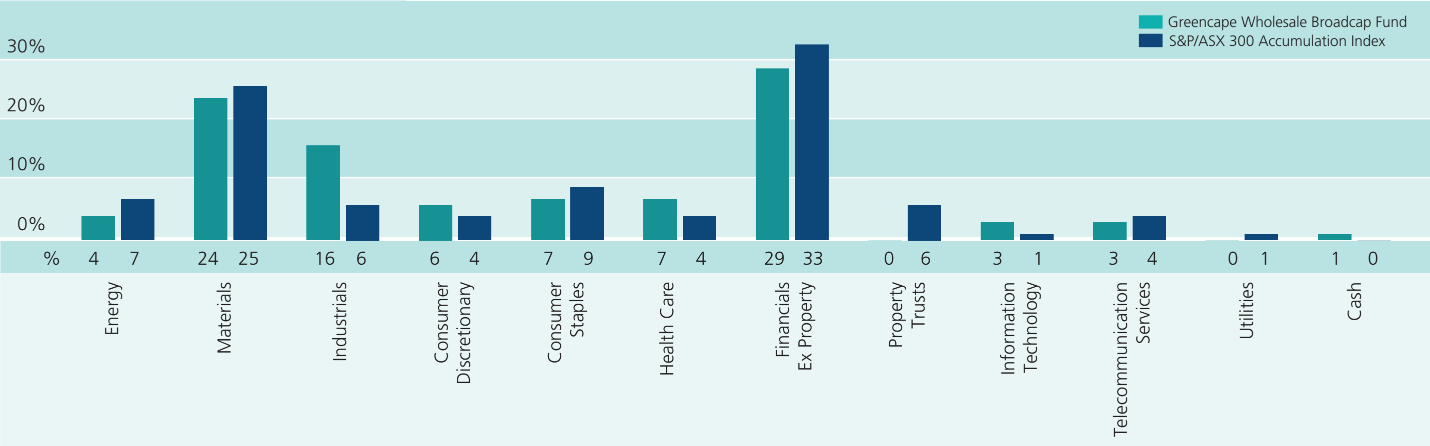


Asset allocation	Current (%)	Range (%)
Securities	97.36	85–100
Cash	2.64	0–15

Fund facts	Greencape Wholesale Broadcap Fund
Inception date	11/09/2006
APIR code	HOW0034AU

Fees	Greencape Wholesale Broadcap Fund
Entry fee	Nil
2008/09 ICR	1.49%
Management fee	0.95%p.a.
Performance fee	15% of the Fund's after management fee return above the Fund's benchmark.
Buy/sell spread	+0.30%/-0.30%

Sector exposures as at 30 June 2010

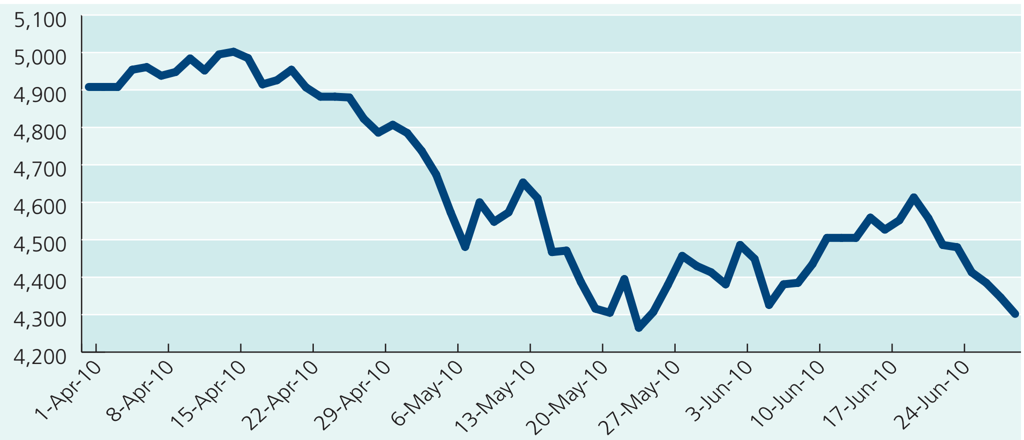


Market review

The S&P/ASX 300 Accumulation Index fell 11.2% for the quarter but gained 13.5% for the financial year to 30 June. The Greencape Wholesale Broadcap Fund outperformed the market and delivered a –10.86% return over the quarter.

The market climbed 3% from the start of the quarter to 15 April where it peaked briefly through 5,000 points (S&P/ASX 200 Index), before declining 15% to a trough in late May, which was revisited at quarter end after a modest rally in late May/early June. The fall in April was precipitated by ongoing concerns about Greece's sovereign debt which was followed by credit downgrades in May for Spain and Portugal. The Federal Government's announcement of a Resource Super Profits Tax (RSPT) in May and concerns of China's economic growth slowing weighed on the Materials sector, which was down 17% at its May trough from the beginning of the quarter before recovering to be down 11% for the quarter following Kevin Rudd's departure as Prime Minister. The Australian dollar was volatile, starting at 92 US cents, peaking at 93.5 cents in early April before falling to 81 cents in early June, and then closing out the financial year at 84 cents.

S&P/ASX 200 Index



The Telecommunications sector (88% of which is Telstra) reversed its performance as the worst performing sector in the March quarter to be the standout for the June quarter following their announcement of reaching a Heads of Agreement with NBN Co. Property Trusts and Consumer Staples both fell less than the market given their relative defensive qualities.

Industrials was the worst performing sector for the quarter with Brambles falling 26% after a subdued trading outlook and loss of a large US contract. Leighton Holdings also fell 26% with market concerns over their Middle East exposure and a slower new work win rate than anticipated. Downer fell 51% after taking a provision against its high profile passenger rail supply contract with the NSW Government, combined with concerns they may need to raise capital. Virgin Blue and Ausenco both fell 59% for the quarter following company profit warnings.

"Economists may come up with terrific theories, but these must be translated into workable law that does more than provide tax advisers with years of lucrative work… If the objective here is to ensure a bigger take from the large mining companies to reflect the fact they are using non-renewable resources, why not apply a 10% surcharge to the corporate tax rate…?"

Robert Deutsch, Professor, University of NSW 29/06/10

"We have no plans to die"

David Thodey, CEO Telstra 19/05/10

Financials underperformed led by Westpac which fell 25% after it reported lower margins versus expectations at its result in May along with market concerns about their high reliance on offshore funding costs which are rising. Macquarie Group also dragged down financials, falling 24% due to a declining outlook for market-linked earnings following their strategy day in June. Discretionary retail was also weak with a number of stocks falling between 16% and 30%, with Fairfax's decline of 27% having the biggest impact on the sector on no specific news flow.

	June Quarter	1 year
Market (S&P/ASX 200 AI)	–11.1%	13.1%
Best performing sectors:		
Telecommunications	7.3%	1.9%
Property Trusts	–1.3%	20.4%
Consumer Staples	–4.5%	15.9%
Worst performing sectors:		
Industrials	–19.1%	9.7%
Financials (excl. Property Trusts)	–15.2%	17.2%
Consumer Discretionary	–12.3%	14.6%

Company visits and observations

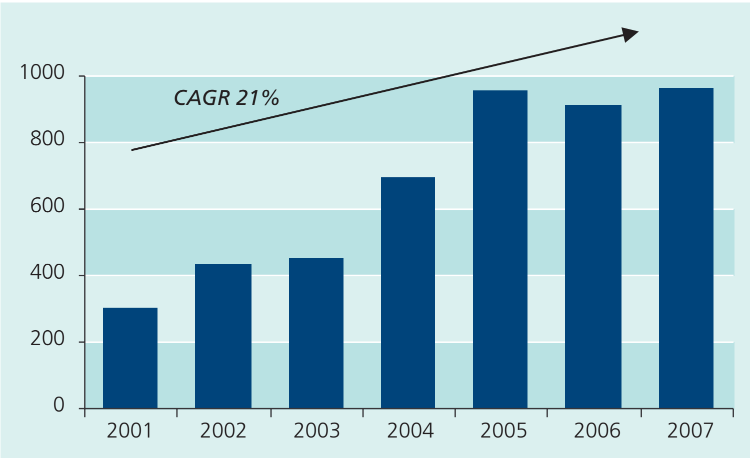
- Europe and USA trip – In June we visited numerous companies in Western and Eastern Europe and the USA. Below are some of our observations:
  - European consumers have become more nervous recently. The psychology of expected 'austerity programs' is amplifying inequalities between rich and poor, not just people, but countries.
  - Inventory levels are lower than usual going into the northern hemisphere summer; however another destocking phase is occurring in anticipation of weaker consumption. The 'delta' this time is lower, and hence the level of price discounting is significantly less than 2008, but it is a still a negative development.
  - The UK consumer was described as 'resilient'. Interestingly, the post GFC bonus caps (regulation and public pressure) is resulting in solid base salary inflation amongst city bankers and executives. This has been amplified by key staff poaching as bailed-out banks rebuild teams. The resultant under-current is best described as a 'personal optimism from those paid to articulate current economic uncertainty'!
  - UK house prices have rebounded solidly from GFC lows, with the high end robust, although liquidity remains low. Four bedroom houses on 600m^2 blocks, 1.25 hours by train to the West of London in a leafy area like Ascot still command £1.8m price tags!
  - European economic conditions are extremely varied. The weak Euro is stimulating the export economies of France, Belgium, Scandinavia and particularly Germany. In nearly every German meeting it was highlighted how strong export demand was supporting local consumer confidence. And on more than one occasion, it was mentioned that Germany is quietly enjoying the economic uncertainty and subsequent weak Euro.
  - Eastern European economies remain fragile from a fiscal perspective however they share the urbanisation, low cost base and underlying growth drivers of emerging markets in Asia and Latin America. The difference in economic growth rates and consumer demand between East and West Europe is increasing further.
  - It has never been more important to be fully aware of the exact geographic footprint a company has in Europe. For example Brambles' CHEP European business is predominantly UK and Spain whilst Campbell Brothers' European operation is almost 100% Eastern Europe.
  - Companies are risk adverse and those that recently recapitalised are comfortable maintaining 'lazy' balance sheets.

"Department stores have high highs and low lows ."

Mark McInnes,
former CEO David Jones 28/09/09

- Management teams who operate in consolidating industries remain patient, expecting vendors to lower prices. The much talked about M&A activity increase appears to have stalled somewhat.
- Private equity funds remain key stake holders in a large number of industries, e.g. the number two, three, four and five players in European packaging are all private equity controlled. Amcor's acquisition of Alcan makes it the clear number one player in packaging (approximately 40% market share), with the number two player circa 10%. Consolidation of this industry has been a long time coming.
- Fiscal austerity is driving regulatory risk with both positives and negatives. Healthcare industry participants in the UK and France see opportunity for the more efficient private sector to drive cost savings by taking over the provision of public sector healthcare services. In contrast, the legislated price reduction of 10% for blood plasma products in Germany, a freeze in hospital related spending in France, and the UK government's encouragement of its government owned Blood Fractionator (BPL) to aggressively sell excess product into export markets (such as the US), will negatively impact companies like CSL.
- Regulatory change and consumer demand for more information on quality controls and socially acceptable production processes is driving GDP growth in the Compliance, Certification and Testing industry. The fastest growing sectors within the industry are Environment, Energy and Food (see chart below).

EU alert notifications



Source: EU, Rapid Alert System for Food and Feed

- The social trend towards more home entertainment continues with BSkyB (UK pay TV) increasing its High Definition TV penetration from 20% to 26% (higher revenue per subscriber) despite the tough UK economy.

"Integrating acquisitions works well when it's done from a technical perspective, not when acquisitions are done purely from an investment perspective."

Greg Kilmister, CEO Campbell Brothers, 27/05/10

- UK commercial property:
  - Property price increases have been greater than rental income.
  - Banks are yet to relax funding criteria for property developments.
  - Large shopping malls have understated vacancy rates by as much as 10%. Otherwise vacant shop spaces are being used rent fee so that shoppers don't see the empty spaces.
  - East London is the growth corridor of London, driven by the Olympic village.
  - UK councils can rapidly improve their fiscal positions by selling off land.
- **Singapore trip** – In April we travelled to Singapore meeting with various companies in different industries, which gave us insight to other areas of Asia as well. Following are some of our observations:
  - The Middle East is dead with respect to property buying interest.

- Vietnam is especially attractive given its demographic growth drivers. However they have low foreign reserves, a current account deficit and have devalued their currency twice recently.
- Singapore commercial high-end rental price growth was 100% in 2008!
- Wireless data use is growing fast with 34% of total data traffic now being accessed via mobile devices. Singtel charge a $16 per month premium for mobile 3G data.

- In the compliance, certification and testing industry:
  - The food sector is growing strongly.
  - The environmental sector is another growth opportunity in the region with the next catalyst being a crack down on regulation enforcement.
  - US and EU importers now want certification at point of exit, not entry, hence more testing in Asia is required.
- Singapore casino industry (recently legalised):
  - The high roller business is low margin and winnings are taxed at 5% versus Macau at 39%, which is a significant advantage to lure high rollers.
  - Casinos attract high rollers via Junket operators by offering rebates of up to 1.5% of turnover.
  - Service to clients also plays a part, but golf courses, nice food and 'other entertainment' can all be sourced readily in any market.
  - The Singapore Government wants to license junket operators which involves probity checks. Given the 'questionable' character of some operators, this is proving difficult.
  - Las Vegas Sands (the second Singaporean casino) opened in April.
  - 40% of patrons are locals who have to pay a S$100 (A$80) entry fee versus foreigners who enter for free!
- Chinese tier one property prices are at high levels but 25% of properties are purchased with cash and for the rest the loan-to-value ratio limit is 70%. Buyers must also hold properties for at least five years to avoid cap gains tax.
- China's economy is stronger than government data makes out.
- Indonesian sovereign bonds will become investment grade soon.
- China's water table keeps falling.
- Commonwealth Bank is the biggest foreign bank in Indonesia, which has some pockets of high net wealth.
- ANZ's pan Asian strategy risks spreading itself too thin if integration isn't managed well. Commonwealth Bank has taken a deliberate single market focus approach, and appears to have targeted the best markets.
- Singapore is a key medical tourist market with 40% of patients being foreigners paying full prices. Why can't Australia do this?
- There is approximately 650mtpa of seaborne thermal coal produced globally, 200mt of which is produced by Indonesia's Bakri family alone. They are powerful people.
- 60% of exported food production is in Africa but despite cheap gas, minimal fertiliser is produced there.
- Rubber prices are likely to increase over the next few years before supply catches up: a negative for Ansell.
- Financial speculators' share of trade in soft commodities is circa four times the amount physically produced.

"Between 2003 and 2008, the amount of speculative money in commodities grew from $13 billion to $317 billion, an increase of 2,300%. By 2008, a barrel of oil was traded 27 times, on average, before it was actually delivered and consumed."

Matt Taibbi, Rolling Stone 13/07/09

- The Singapore Stock Exchange is not interested in trying to compete against the ASX's clearing and settlements business and considers it unlikely that Australian regulators would allow it, highlighting the barriers to entry created by individual country's regulators.
- The value premiums from Chinese stock market listings are considered misleading as in many cases only a very small percentage of a company is listed in China.
- Algorithmic share trading is growing rapidly and now makes up over 35% of trades in Singapore.
- **Australian Stock Exchange (ASX)** – For the quarter, the ASX fell 17% for the quarter and is down 21% for the year versus the S&P/ASX 200 Index which is up 9%, despite the majority of its earnings being market-linked. The main reason for the fall is the market's increasing attention on new competitors, such as Chi-X, that are likely to enter the share trading market soon. Chi-X have applied for an operating licence from ASIC and are expected to begin operating in early 2011. In addition, there is speculation that competition in time will also extend into clearing (the function performed by ASX that guarantees each order will be cash settled in T+3).

Despite these competitive threats, in the table below we show that only 21% of ASX's revenue streams will be subject to competition, and if competition extends to clearing it will be 29% of group revenue.

ASX revenue sources	% of revenue	Chance of competition	
ASX – Trading	9%	High	Government announcements to date support, impact from H1 2011
ASX – Clearing	8%	Medium	More difficult than 'Trading' to attack, requires sig capital + regulator approval
ASX – Settlement	14%	Low	
Derivatives (SFE)	24%	Low	
IPO listing fees	1%	Low	
Annual listing fees	9%	Low	
Capital raisings fees	11%	Low	
Other listing fees	1%	Low	
Information services	12%	High	Likely competition will emerge with 'Trading' competition
Technology infrastructure	5%	Low	
Austraclear services	5%	Low	
Other revenue	2%	Low	

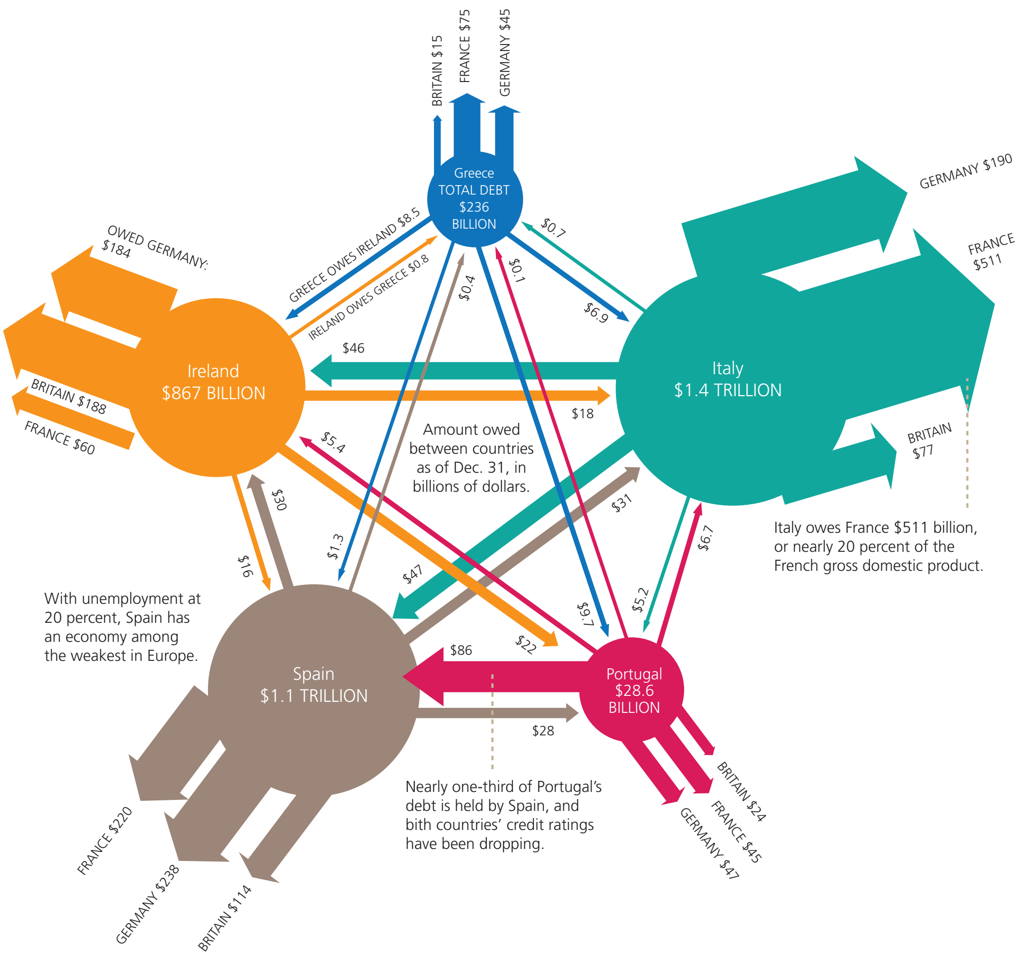
It's worth noting that ASX has already reduced its headline trading fee from 0.0028% to 0.0015% per trade and announced plans to further increase its trade execution speeds in order to match Chi-X's expected fees and execution speed.

- **Asahi beer** – Distributors in Australia identify four different sources of Asahi in Australia. Fosters brew Asahi in Australia, Woolworths buy it from the UK, some comes from a Thailand brewery and other retailers source it from Korean breweries. The production from Korea is normally destined for China, and tastes very different to the Fosters brewed product! This highlights the challenge to Australia's domestic premium beer market, which currently earns one of the highest manufacturing margins globally, but faces increasing competition from parallel imports.

Macro observations

European sovereign debt

Below is a well publicised diagram which illustrates the complex interdependencies of European sovereign debt which we consider worth showing here again for the record!



Source: NY Times 1 May 2010.

In May the European Union and IMF announced a €750bn bailout package for Greece which has, at least for now, subdued some of the markets concerns. However it's important to keep in mind that Greece's issues have not been solved by this package, only deferred. The real test will be their willingness and ability to reign in their budget deficits by raising taxes and cutting spending, both of which have proven difficult historically for democratically elected governments worldwide.

Australian banks reliance on foreign funding

Australian banks have historically funded their loan book through a combination of bank deposits, securitisation markets, wholesale term borrowing (majority offshore) and wholesale short-term borrowing (the majority of which is domestic). Since the Global Financial Crisis (GFC) began, the securitisation market has all but disappeared and hence greater reliance on the remaining funding sources has ensued.

In the post-GFC world, European and US banks have either significantly slowed or seen their lending growth turn negative as the private sector has deleveraged, and hence their wholesale borrowing requirements from offshore have reduced or ceased altogether. However during this period Australian banks continued lending at historically high levels and hence their offshore borrowing relative to foreign banks has grown significantly, per the following chart.

"In the short run, governments can borrow or print money to augment its resources. Like all debt it borrows from tomorrow to pay for today.… While governments can influence an economy, they cannot completely reverse inevitable adjustments dictated by market forces."

Satyajit Das, GFC Cures – Placebo Effects, 29/07/09

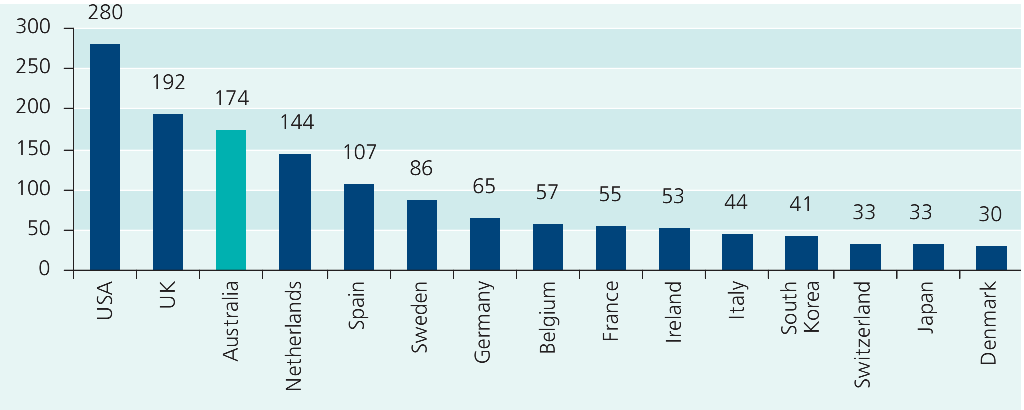
"Very few societies aged gracefully by recognising early that eternal prosperity was unattainable. Most societies decayed because the cost of maintaining their high level of prosperity increased (overspending)."

March Faber, 01/09/09

"The socialisation of private losses and fiscal laxity aimed at stimulating economies in a slump have led to a dangerous build-up of public budget deficits and debt. So the recent global financial crisis is not over; it has, instead, reached a new and more dangerous stage."

Nouriel Roubini, 19/05/10

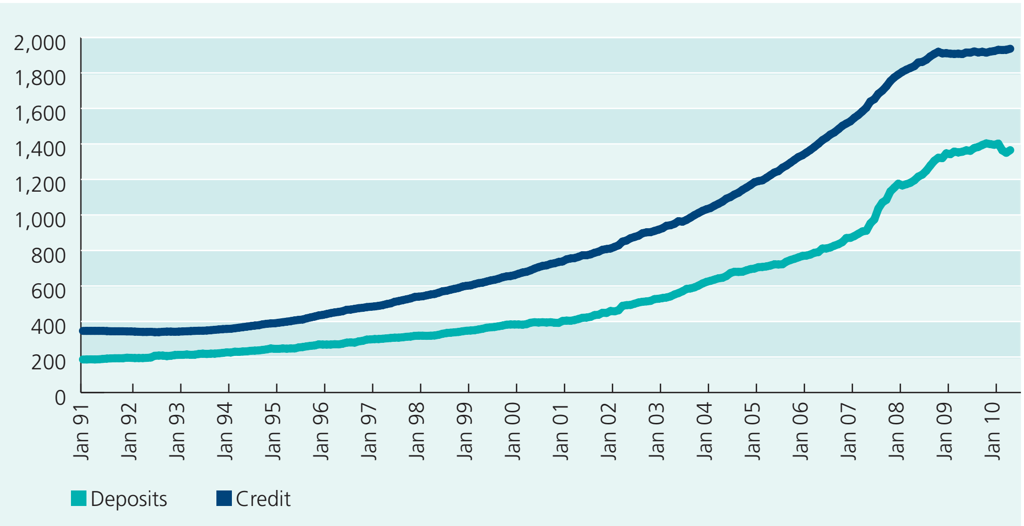
Global senior debt issuance by country (US$b) since 1 January 2009



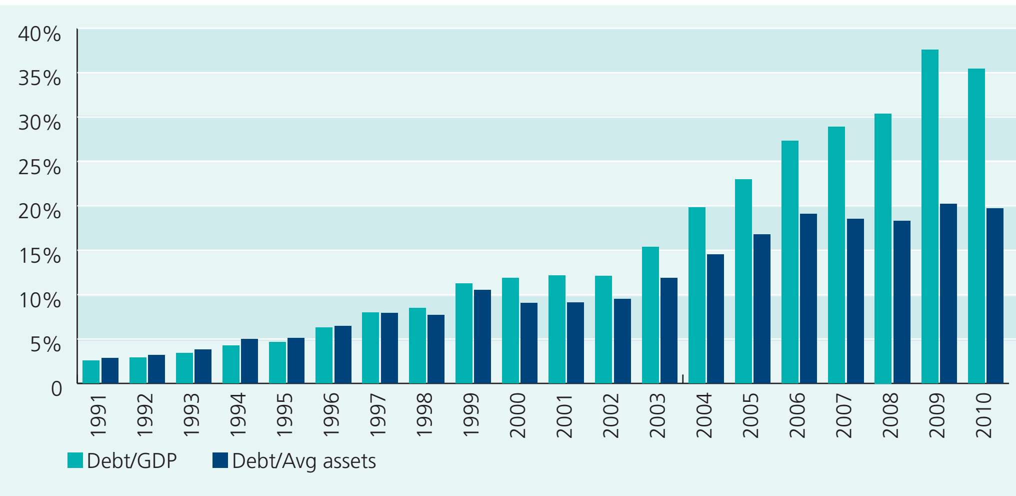
Source: Dealogic Bondware, UBS estimates. Note: Excludes Subordinated issuance

With credit growth greater than deposit growth this led to an acceleration of an established trend for the reliance on offshore wholesale markets in 2009, as shown in the charts below.

Australian banks deposits vs lending ($ billion)



Australian bank wholesale debt funding



"All four [Australian] major banks are in the world's top 15 term debt issuers since January 2009"

Jonathan Mott, UBS banks analyst
22/04/10

"… in healthy economies interest rates are kept at levels that produce a lending, borrowing, investment, and consumption balance."

Birdgewater, 13/11/09

"…banks can face significant refinancing pressures when sentiment turns adverse."

Bank for International Settlements
28/06/10

In our discussions with the Australian banks, management have highlighted their ongoing need to continue sourcing debt from offshore to meet their forecasts for lending growth. What is uncertain however is foreigners' willingness to continue lending to Australian banks on top of the $484 billion already lent, in an environment where developed countries borrowing requirements are growing and with risks of a sovereign credit crisis emerging. Whether the risk of a freeze in offshore credit markets eventuates or not, it appears at the very least that Australian banks average funding costs will continue to increase.

Outlook

We recognise that macro outcomes can be expected to have amplified impacts on the equity market. It is evident that developed economies have completed the post GFC restocking phase whilst the aggressive fiscal stimulus packages employed by most governments are beginning to roll off. What will be revealed is something closer to the underlying demand picture and underlying business confidence and consumer sentiment will play a bigger roll in economic activity going forward.

Asia, particularly China, has a material influence on sentiment in Australia, given much domestic economic activity stems from Asian demand. We observe that medium term Asian demand drivers remain intact and that the deleveraging of companies (including banks) combined with the recent market correction reduces downside risks to investors. However the bull case for equities appears dampened as the market's earnings expectations for 2011 and 2012 seem optimistic.

Greencape's best stock picking ideas share one or more of the following factors:

1. Management who have managed market expectations conservatively;
2. Management who have used the post GFC period to reduce gearing and/or set the business up for a capex holiday in coming years;
3. Business models with dependable cash flows and an ability to pay sustainable dividends; and/or
4. Outlooks that are not overly dependent on macro economic outcomes.

Our portfolio is somewhat balanced currently given macro uncertainty, with a clear bias to quality management teams and business franchises.

"The response to the initial crisis was to throw money, to lower interest rates and expand budget deficits. But with interest rates now low and deficits high, what happens if there's another crisis?"

Robert Samuelson, Washington Post Writers Group, 29/06/10

"While the crash only took place six months ago, I am convinced we have now passed the worst and with continued unity of effort we shall recover rapidly."

Herbert Hoover, 1 May 1930

"I see no penalty in being conservative."

Louis Gries, CEO James Hardie 27/05/10

"We don't have to be smarter than the rest. We have to be more disciplined than the rest."

Warren Buffett

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