Greencape Broadcap Fund

Quarterly report - December 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 (gross)	9.15	16.19	8.54	12.75	10.53	12.81	10.93
S&P/ASX 300 Accumulation Index	8.36	12.13	9.01	10.28	7.91	9.37	6.77
Active return^	0.79	4.06	-0.47	2.47	2.61	3.44	4.17

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'.

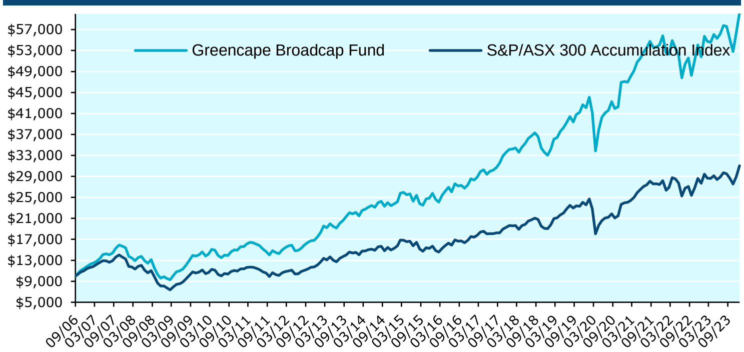
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

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



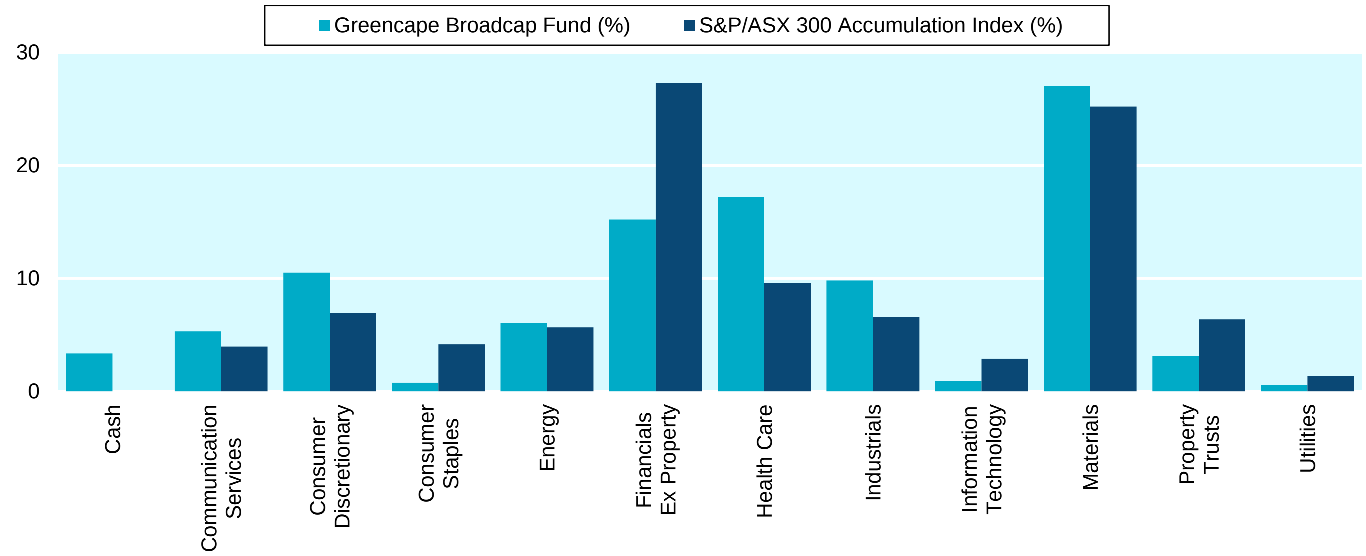
Asset allocation	Actual %	Range %
Security	96.65	85-100
Cash	3.35	0-15

Fund facts	
Inception date	11 September 2006
APIR code	HOW0034AU

Fees	
Entry fee	Nil
2022-2023 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%

Data Source: Fidante Partners Limited, 31 December 2023.

Sector exposure as at 31 December 2023



Data Source: Fidante Partners Limited, 31 December 2023.

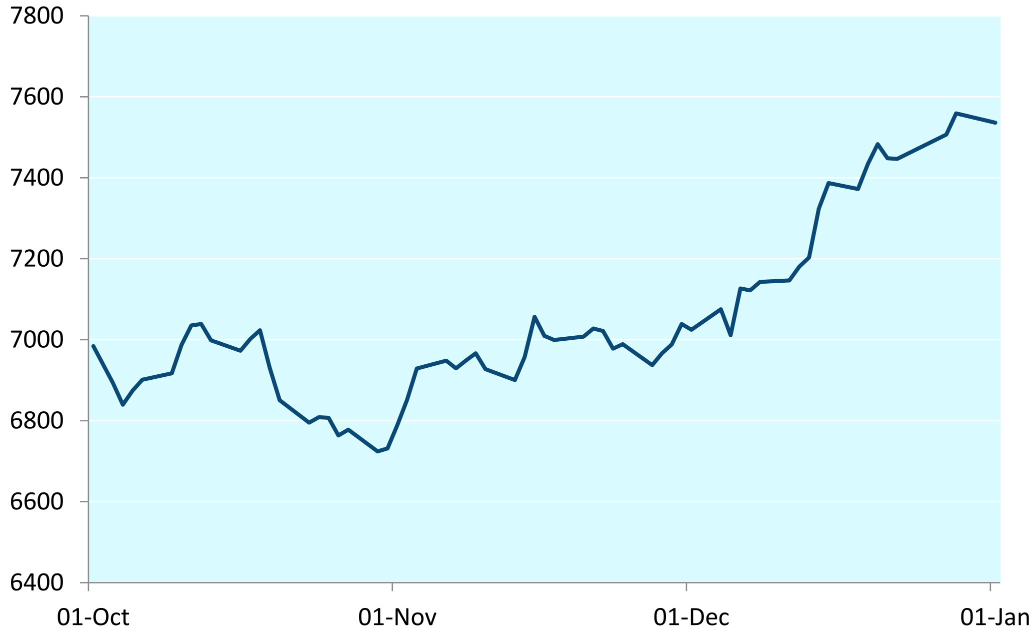
Fund performance summary

The S&P/ASX 300 Accumulation Index returned +8.36% for the quarter. The fund outperformed the market and delivered a +9.15% return over the quarter.

Market overview

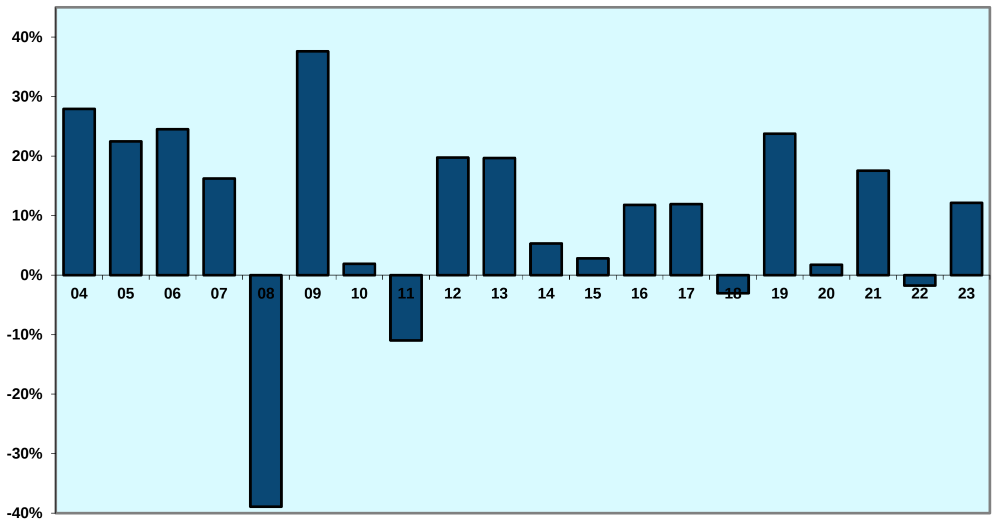
Despite a soft start in October, equity markets rallied strongly into year-end with December recording the biggest monthly gain since November 2020, at which time the index surged on the back of COVID vaccine efficacy data. The catalyst on this occasion was softer than anticipated inflation data which saw the Fed 'pivot' their strategy and bring forward expectations for interest rate cuts.

S&P/ASX 300 Index



Source: IRESS

S&P/ASX 300 Accumulation Index Calendar Year Returns Since 2004

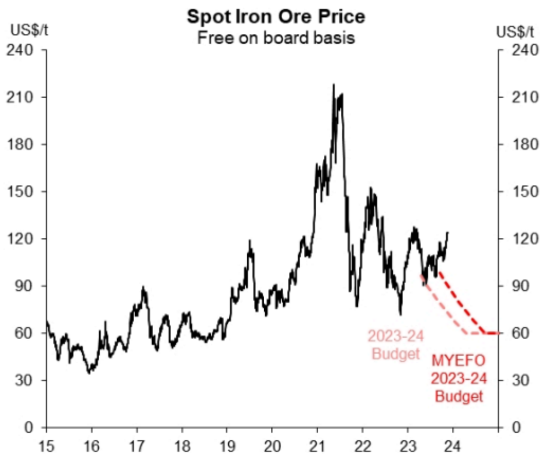


Source: IRESS

The RBA raised interest rates 25 basis points during the period. In the minutes released following the change, the board stated that inflation had been more persistent than previously anticipated, and that it would take until late 2025 for inflation to decline to the top end of the RBA's 2-3% target range. The next board meeting is in February, with the market not expecting any move unless there is a significant upside surprise in the Q4 CPI data which is due to be released at the end of January. The futures market currently expects two rate cuts next year, the first of which is fully priced in by the August meeting.

The government also released the Mid-Year Economic and Fiscal Outlook (MYEFO) in December. Tax revenues are forecasted to be higher than expected on the back of higher commodity prices, leading to a reduction in the FY24 deficit to $1.1bn, compared to $13.9bn forecast in the May budget.

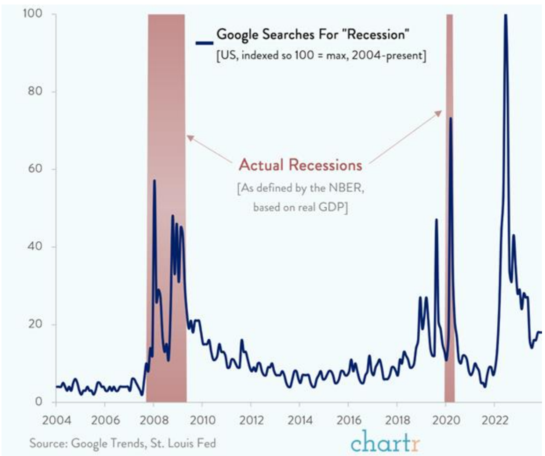
The government continues to forecast Iron Ore prices declining from current levels, which suggests there is still some upside to budget projections in the near term.



Source: Macquarie

In the US, the Fed 'pivot' predicted by the market came to fruition in December. Despite only two weeks earlier saying it would be premature to speculate when rates might ease, Fed Chair Jerome Powell told a post FOMC meeting press conference that rate cuts were beginning to 'come into view' and it was 'clearly a topic of discussion' amongst Fed members. In response to a question in the Q&A session, the Chair also did not push back when asked if he was comfortable with the market forecasting a rate cut as soon as March. Despite already declining 80 basis points from the high in November, the yield on 10-year treasuries declined a further 14 basis points following the press conference. The market now assumes the Fed will cut 5 times in 2024, with the first cut fully priced in by May.

Despite predictions of a US recession and record related Google searches, a recession never eventuated (at least not yet).



"Members noted that the shifting composition of employment growth towards more part-time jobs and a decline in average hours worked over preceding months were consistent with hours worked being a key margin of adjustment to slower growth in demand." RBA December 2023 Meeting Minutes

"It would be premature to conclude with confidence that we have achieved a sufficiently restrictive stance, or to speculate on when policy might ease. We are prepared to tighten policy further if it becomes appropriate to do so." Jerome Powell, Chairman of the Federal Reserve, 01/12/2023

"Naturally, it begins to be the next question, which is when it will become appropriate to begin dialing back the amount of policy restraint that's in place." Jerome Powell, Chairman of the Federal Reserve, 13/12/2023

	QUARTER	YEAR
ASX300 Accumulation Index	8.4%	12.1%
Best Performing Sectors		
Property Trusts	16.5%	16.9%
Healthcare	13.3%	4.0%
Materials	13.2%	15.1%
Worst Performing Sectors		
Energy	-9.0%	4.7%
Utilities	-2.1%	3.2%
Consumer Staples	0.1%	1.3%

Source: IRESS

Property Trusts performed strongly during the quarter as declining treasury yields increased the relative attractiveness of REIT dividend yields. HMC Capital rallied on the back of the announcement of Chemist Warehouse reverse listing via Sigma Healthcare, where HMC is the largest shareholder. Materials also fared well, driven by firmer commodity prices, in particular iron ore which rallied 19% during the period.

"It's Field of Dreams stuff – build it, and they will come." Damian Gance, Chief Commercial Officer of Chemist Warehouse, 11/12/2023

Energy was the worst performing sector as oil prices fell during the quarter. In December, the two largest companies in the sector, Woodside and Santos, confirmed press reports that they were in discussions regarding a potential merger. Utilities also lagged the market as the takeover of Origin Energy fell over, with the vote on the deal failing to garner sufficient shareholder support.

Offshore Trips

This quarter we travelled to Hong Kong twice, India, the US and Europe.

Asia

- REA's Indian business has strong, stable local management in place and a clear strategy to be the number one player in Tier 1 and Tier 2 cities. The Indian economic backdrop should also be supportive of growth as the country continues to develop at pace. That said, we should expect operating losses to continue albeit at reduced levels as it progresses towards a breakeven point.

- Goodman Group are well progressed with a number of high value data centre sites in Hong Kong and have good upside in Japan. Further powered sites are likely as the model progresses towards a higher end value state that should generate attractive development margins and uplifts on rent.

- Seek have successfully implemented their unification plans in Asia and can now leverage the single platform for features such as variable pricing which they deploy already in Australia.

- The demand for Nvidia GPU chips from Generative AI and datacentre requirements remains very strong, outstripping available supply. On the supply side, various parts of the supply chain are scaling up to deliver a material uplift, which we believe will drive further revenue growth going forward.

"Countries like Japan are realising that you need to own your own data, build your own AI factories and produce your own AI intelligence." Jensen Huang, CEO of Nvidia, 04/12/2023

Europe

- Consumer confidence in the EU remains challenged. The CEO of a multinational Consumer Electronics retailer labelled it a 'mental depression'. Whilst consumers still have money, they are not willing to spend. A manifestation of this is the savings rate in France which has reached as high as 19%.

- Consumer Electronics is broadly flat in value terms with prices up and volumes down. Audio Visual remains weak, with the recent Rugby World Cup failing to stimulate demand. The Computer category continues to suffer from the aftereffects of a pull forward in demand, with an upgrade cycle not expected to kick in until 2025/26. Conversely, the small appliance category is in growth with management teams calling out coffee as a category which continues to trade well.

- French companies we spoke to were generally more positive than others, with a key driver being the nation's lesser reliance on imported gas and higher reliance on nuclear energy.

Breville Group

Breville Group (BRG) is a global designer, developer and distributor of small domestic appliances. Under the stewardship of Jim Clayton who commenced as CEO in 2015, the company has evolved from a niche appliance brand to a global innovation leader.

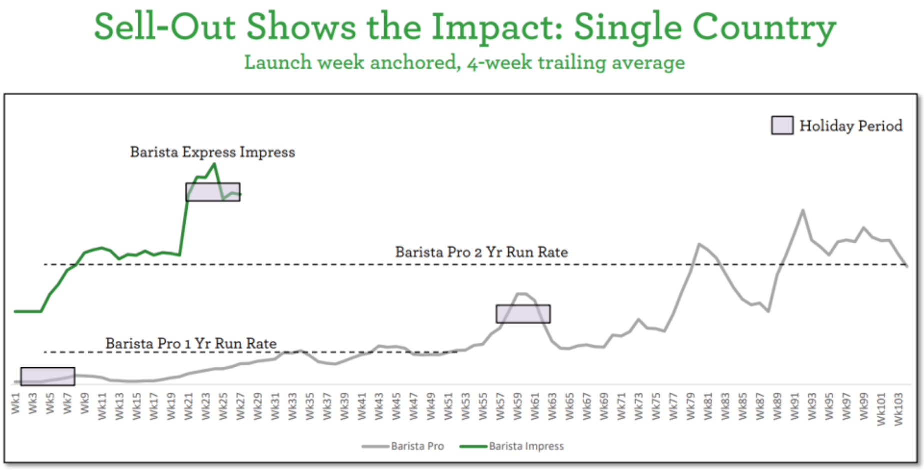
Our first exposure to the company was indirect, via our shareholding in Premier Investments which in turn is a 25% shareholder in BRG. Whilst we had admired the solid progress the company had made in penetrating offshore markets, it was not until Jim Clayton unveiled the 'Acceleration Program' roadmap in 2016 that we considered the company for a standalone investment. At that announcement, Jim acknowledged that whilst Breville had grown satisfactorily to date, if the company was to take the next step in transitioning to being a global, innovation-driven product company, then the company had to radically transform its operating model. This involved but was not limited to; improving the go-to-market strategy, expanding into new geographies and distribution channels, increasing investment into R&D and marketing, as well as shortening product development cycles to accelerate new product releases.

The degree of difficulty of this transformation was significant, with management having to carefully balance investment whilst still delivering earnings growth for shareholders. Management had once described it to us as 'fixing the plane whilst flying it'.

By any measure, the company has executed well on the program.

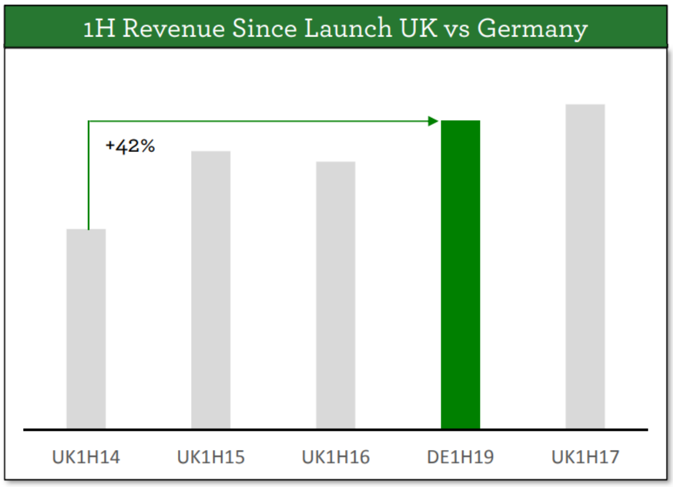
The key pillar to the transformation was the construction of a global unified go-to-market platform. By utilising a more centralised model, the speed at which new products can be rolled out globally has dramatically increased, with products able to be launched in various markets simultaneously rather than in the staggered approach under the old model. This also serves to generate better scale on marketing spend which can be coordinated globally. As per the graphic below, the recent launch of the Barista Express Impress took 7 weeks to achieve a sales run rate that took the Barista Pro 2 years to reach.

"Underpinning this oven solution is our standards-based connectivity platform. This is the real asset. This cloud-driven platform is agnostic to the endpoint device. It could have been anything. Building a platform takes longer, but it means you can build it once and use it across multiple devices. Jim Clayton, CEO of BRG, 15/02/2022



Source: Company reports

The platform has also facilitated accelerated entry at a country level. An example of this is Germany, which generated 42% higher revenue for the first six months compared to when the company entered into the UK. To put it another way, it took the UK 3.5 years under the old model to achieve the same revenue that Germany generated in its first half year of operation.



Source: Company reports

If we take a look at how the program has impacted the economics of the company since it was introduced, we can see that although Marketing/R&D/Tech spend has increased at a 20% compound annual growth rate from $79m in FY18 to $194m in FY23, the company has still been able to grow EBIT at 15% per annum. We believe that management could easily cut costs in any given year to achieve a supernormal earnings growth outcome, however the company is taking a longer-term view and is instead electing to reinvest operating leverage in order to strengthen its competitive advantage and prolong the runway ahead of it.

Acceleration Program Scorecard

Acceleration Program Scorecard	FY18	FY19	FY20	FY21	FY22	FY23	FY18-FY23 CAGR
BRG Revenue (AUDm)	**646.8**	**760.0**	**952.2**	**1,187.7**	**1,418.4**	**1,478.6**	**18.0%**
Revenue Yr/Yr Growth	*6.8%*	*17.5%*	*25.3%*	*24.7%*	*19.4%*	*4.2%*	
Global Segment Revenue	**522.2**	**612.0**	**764.4**	**984.2**	**1,178.5**	**1,279.2**	**19.6%**
Global Segment CC Growth	13.4%	12.0%	20.1%	37.0%	18.0%	4.1%	
Global Segment GM%	38.2%	38.2%	35.7%	36.9%	36.4%	36.8%	
Distribution Gross Profit	30.0	37.7	48.0	50.8	57.2	46.4	
BRG EBIT	**86.9**	**97.3**	**109.9***	**136.4**	**156.4**	**172.0**	**14.6%**
EBIT Yr/Yr Growth	*10.0%*	*12.0%*	*12.9%*	*24.1%*	*14.7%*	*10.0%*	
Marketing/R&D/Technology Spend	79.4	94.5	113.1	160.0	195.6	193.5	**19.5%**
Marketing/R&D/Tech as % Revenue	*12.3%*	*12.4%*	*11.9%*	*13.5%*	*13.8%*	*13.1%*	
ROE	21.5%	22.7%	17.9%	19.7%	18.9%	15.9%	
AUD:USD (yearly average)	0.775	0.716	0.671	0.747	0.726	0.671	**-2.8%**
Yr/Yr Change	*2.8%*	*-7.7%*	*-6.3%*	*11.3%*	*-2.8%*	*-7.6%*	

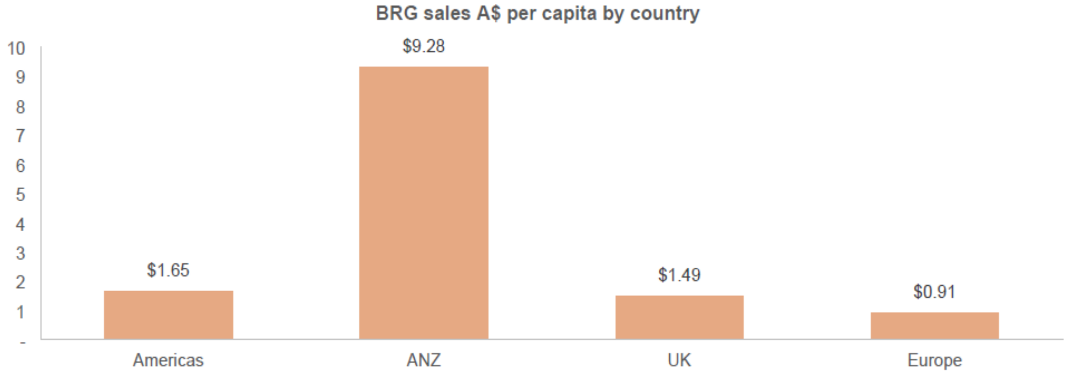
* Normalised EBIT as reported in FY21

Source: Company reports

Another perhaps more esoteric element of the transformation is the evolution from BRG simply selling kitchen hardware to providing a more holistic ‘solution’ to the customer. An example of this is Breville+, which includes guided recipes and live and on demand classes which are tailored to the cooking appliance purchased. Over time, we see the scope for multiple Breville appliances to be connected via a single app which will help coordinate timing of the various meal preparation components. This has the added benefit of the solution becoming more valuable the more Breville products a customer owns, building an ecosystem which in theory could see Breville becoming the ‘Apple of the kitchen’.

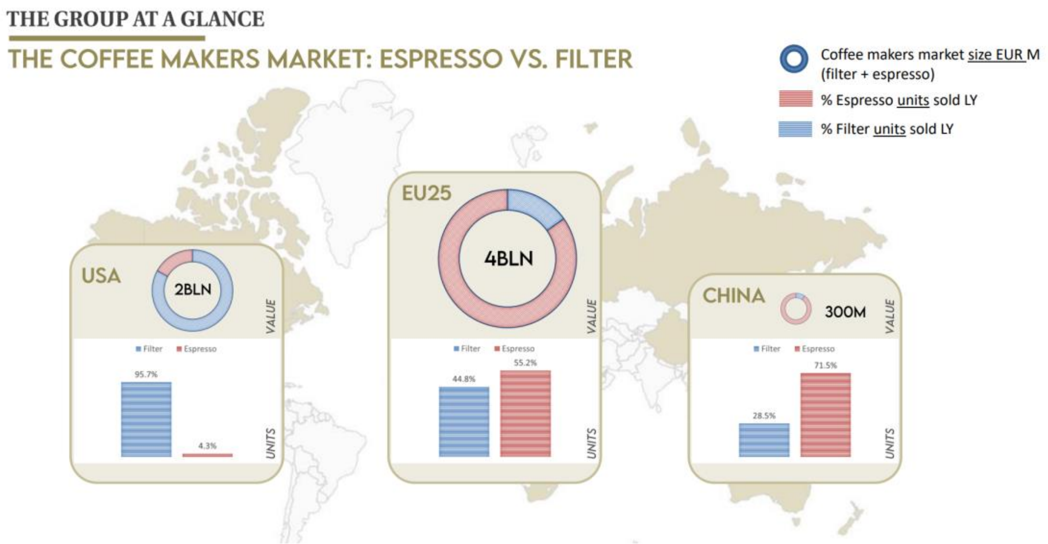
The other example of a solution the company has brought to market is Beanz. A key frustration of customers after they purchase a coffee machine is that the quality of the coffee isn’t up to their desired standard. To help customers get the most out of their machines, Breville has launched a solution which provides access to training, espresso tools and a roasted coffee bean marketplace (Beanz). We believe the Beanz marketplace component has the potential to be a meaningful earnings contributor over time. The company has successfully onboarded a curated selection of the best roasters Australia, the US and the UK and the subscriber can choose which coffee they want and how frequently it is delivered. If the customer is unsure, they can leave it up to Breville to send them a rotating selection of coffee beans tailored to the flavour profile selected by the customer. Putting some numbers around the opportunity, we estimate there are currently approximately 50,000 subscribers to Beanz worldwide. If we simply assume that Breville take rate is $5 per bag and each customer orders 1 bag per week, Breville could be earning over $12m in Gross Profit (at a very high drop through rate to EBIT). The main caveat to this analysis is that Breville runs persistent promotions where they give up this Gross Profit stream for a year as a value-added benefit to a coffee machine purchase. If these customers choose to renew their subscription after the promotional period has ended, Breville then starts to recognise the profit. As Beanz is a marketplace whereby the product is drop shipped from the roaster and never handled by Breville, the earnings stream should be valued at a higher multiple relative to the base hardware business.

Whilst the company has executed well to date, the investment case today depends on the length of the remaining growth runway ahead. If we assume that Australia is a fully penetrated market in terms of sales per capita, then both the Americas and Europe have the potential to grow by a factor of 6 before they reach the equivalent penetration levels in Australia. That suggests there is plenty of white space to grow in existing markets before considering other markets such as Korea and China which represent further upside should the company be able to execute.



Source: Barrenjoy

From a product perspective, we assume that coffee machines represent approximately half of Breville's revenue. Delonghi recently released some category data that helped demonstrate the runway left in the espresso coffee market. In the US, a market which is already ~50% of Breville's revenue, the penetration of espresso coffee machines is only a mere 4%, with the vast majority of machines sold being filter. Anyone who has been the US recently can attest to the country still being relatively early in its coffee maturity journey!

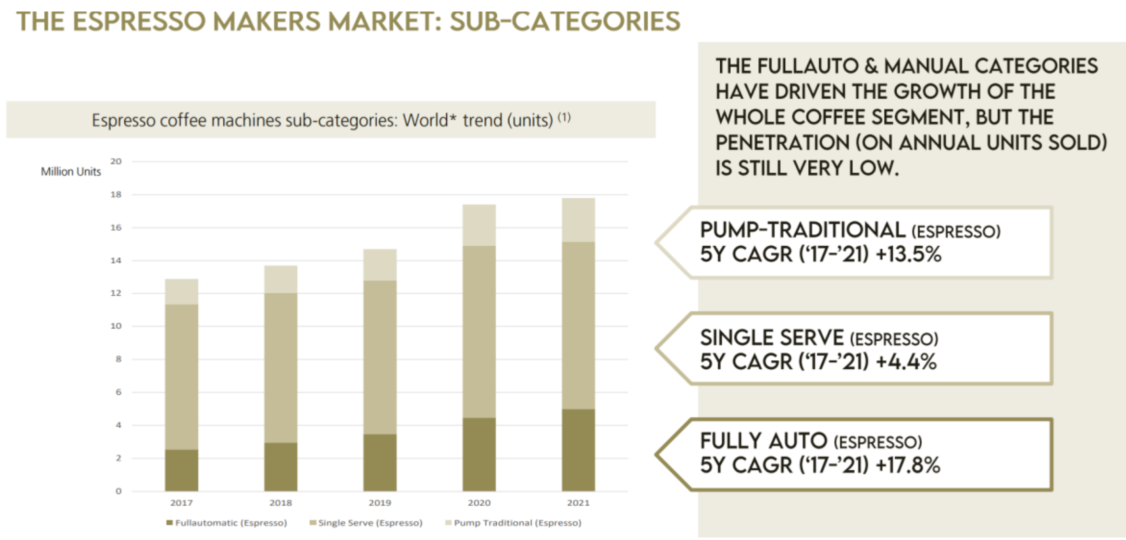


Source: Delonghi

If we drill down into the espresso category itself, we can see that 'pump' or semi-auto machines, (Breville's main coffee category) only represent a mid-teens percentage of espresso sales, with the vast majority of machines sold in the category being capsule machines. We see the install base of capsule machines as a fertile addressable market for semi-auto coffee machines, as these consumers will likely look to trade up into a better machine over time.

"Plenty of customers seem to be redirecting coffee spend from the 3.75 GBP latte that you get on the high street to having their own machines at home, and bean-to-cup coffee machines again had a good Black Friday period." Alex Baldock, CEO of Curry's (UK Electrical Retailer), 14/12/2023

"Kitchen continues to see strength in high-end electrics, particularly in coffee and espresso." Laura Alber CEO of Williams Sonoma, 16/11/2023



Source: Delonghi

In terms of valuation, whilst BRG trades at a multiple premium to the market, we believe this is justified by the earnings outlook which we forecast as double-digit compound growth for well over a decade. Should the company execute successfully on its growth plans, we see significant upside to the share price today.

Outlook

Following on from the strong 'Santa rally', equity markets are now pricing in a soft landing and several rate cuts over the next 12 months in the US and by extension Australia. With the February results season looming, bottom-up stock fundamentals should once again drive share prices. We expect news flow will test the market's willingness to look through what will likely be a weak seat of results reflecting low consumer confidence and heightened cost pressures.

As we have highlighted previously, we observe Australian inflation as stickier than in the US, as such we see a lower probability of Australian rate cuts relative to current consensus expectations. If cut expectations were to be further pushed out, we expect softness in consumer sentiment and general economic activity through the first half of the year. Stock selection will remain critical as ever, as competent management and structural growth themes will become even more important as the macro environment remains challenged.

"What we're seeing now I think we can describe as a soft landing, and my hope is that it will continue." Janet Yellen, US Treasury Secretary, 05/01/2024

"The enemy of the markets is uncertainty. It breads anxiety and fear and results in a risk off and cautious approach more focussed on capital preservation than growth. As the outer bands of the possible narrow and the inputs (rates, geopolitics, recession) become more certain, then investors can return to what they do best…stock picking." Bobby Molavi, Partner at Goldman Sachs, 08/01/2024

More information

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

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