Greencape CAPITAL

Greencape High Conviction Fund

Quarterly report - September 2020

Performance #	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Inception % p.a.
Fund return	-0.35	-2.74	7.05	9.29	8.65	8.80
Growth return	-0.86	-3.85	0.53	2.94	2.15	2.44
Distribution return	0.51	1.11	6.52	6.35	6.50	6.35
S&P/ASX 200 Accumulation Index	-0.44	-10.21	4.79	7.31	6.93	5.50
Active return^	0.09	7.47	2.26	1.98	1.73	3.29

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'.

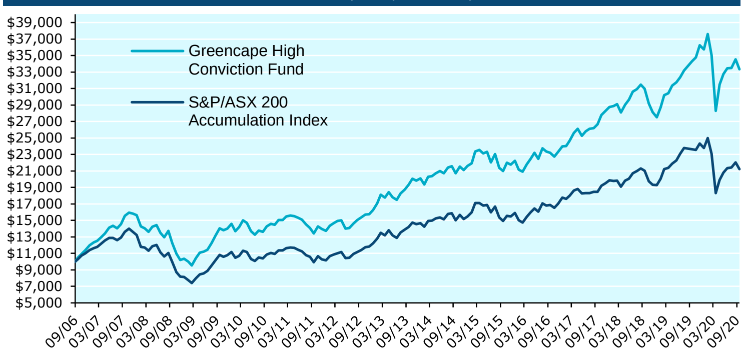
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

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



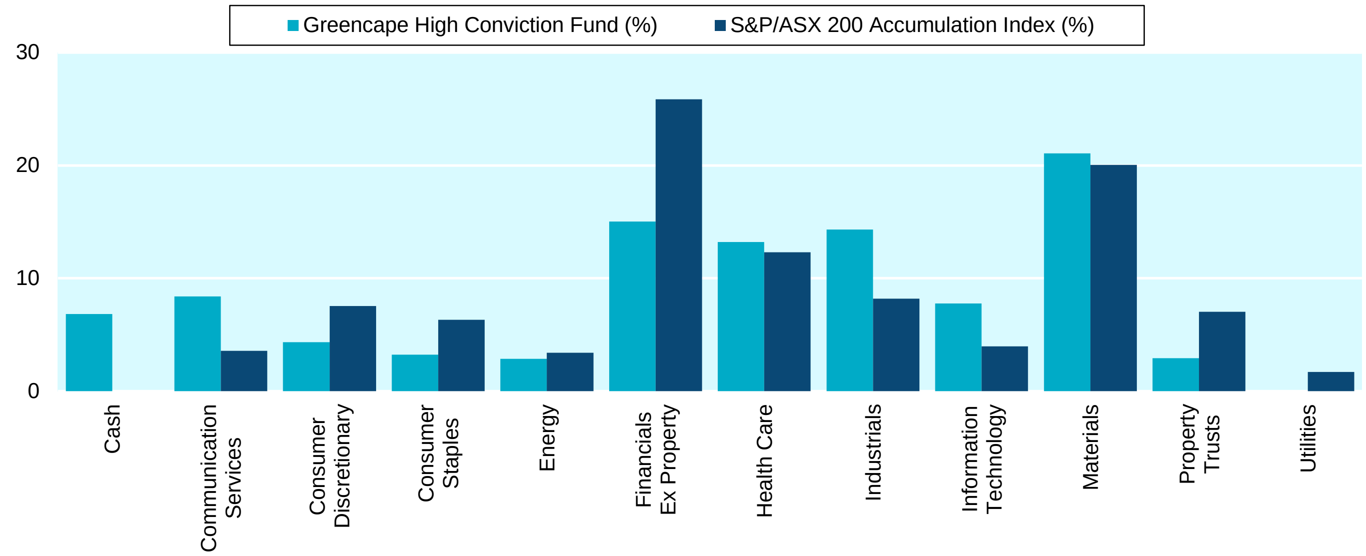
Asset allocation	Actual %	Range %
Security	93.17	85-100
Cash	6.83	0-15

Fund facts	
Inception date	11 September 2006
APIR code	HOW0035AU

Fees	
Entry fee	Nil
2017-2018 ICR	1.59%
Management fee	0.90% 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 200 Accumulation Index).
Buy/sell spread	+0.20% / -0.20%

Data Source: Fidante Partners Limited, 30 September 2020.

Sector exposure as at 30 September 2020



Data Source: Fidante Partners Limited, 30 September 2020.

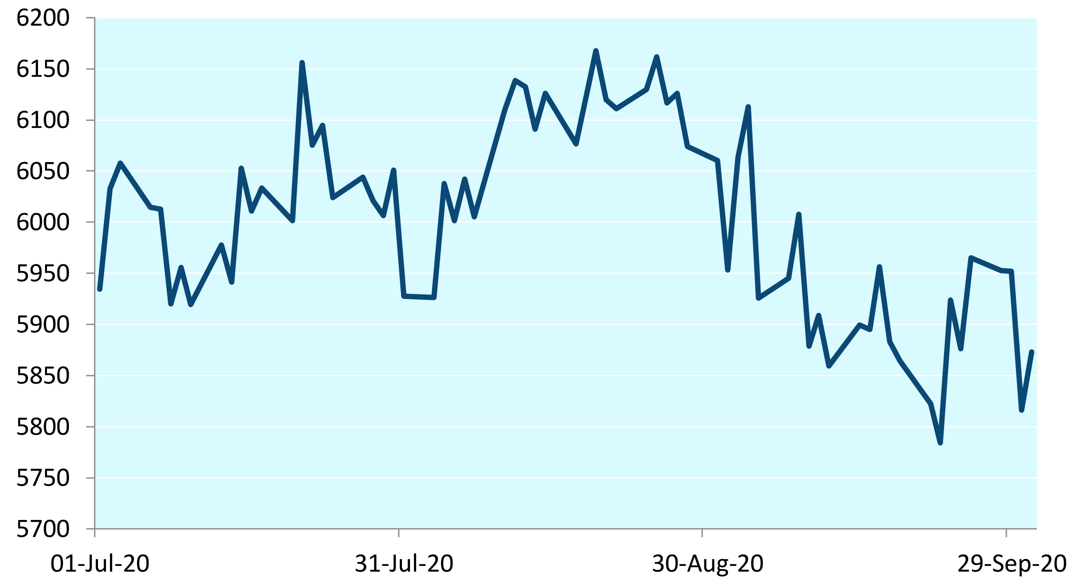
Fund performance summary

The S&P/ASX 200 Accumulation Index returned -0.44% for the quarter. The fund outperformed the market and delivered a -0.35% return over the quarter.

Market overview

In contrast to the large moves experienced in the previous two periods, the market finished relatively flat for the September quarter. Uncertainty continued to reign supreme with market sentiment changing almost daily, supported by the prospects of either an economic recovery or fresh rounds of government stimulus. August also brought with it the bi-annual reporting season which added to the degree of difficulty for local investors attempting to navigate the market.

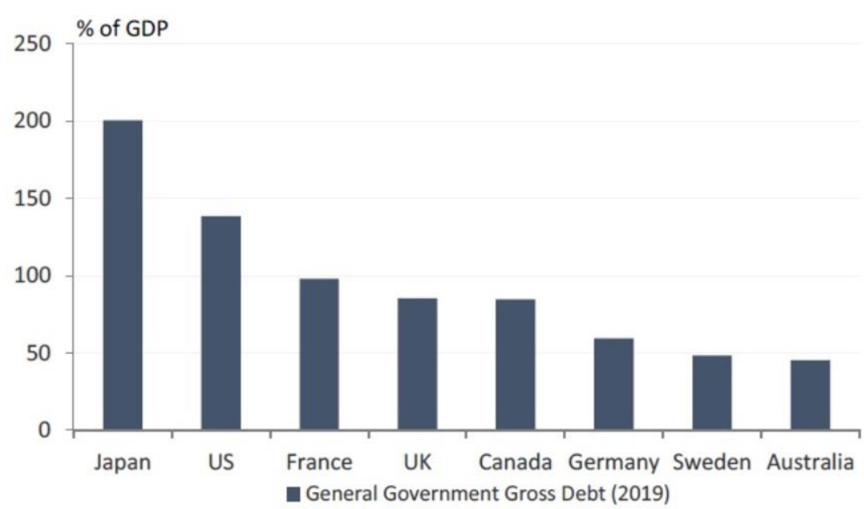
S&P/ASX 200 Index



Source: IRESS

The Reserve Bank of Australia (RBA) sat on the sidelines during the quarter, leaving the benchmark interest rate at 0.25%, however commentary out of the bank continued to be dovish. The 3-year government bond yield (which the RBA was targeting at 0.25%) was allowed to trade lower, finishing September at 0.18%. RBA Governor Philip Lowe also called on the federal government to take advantage of record low borrowing costs to implement further fiscal stimulus, a sign that perhaps the RBA was running out of mechanisms to implement further stimulus themselves.

Potential fiscal stimulus could be funded from debt given Australia has ample headroom relative to other developed economies.



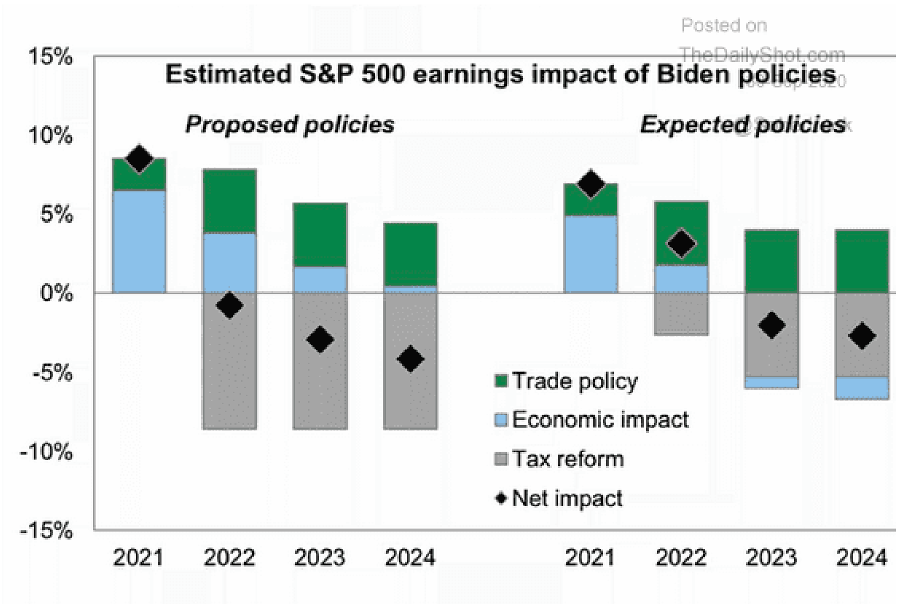
Source: Morgan Stanley

"It might be nice being able to tell your community you've got zero or one case, but what are you going to tell them when they don't have a job?" Gladys Berejiklian, Premier of NSW, 21/09/2020

Elsewhere, the US market continued to outperform the rest of the developed world despite still recording a high number of COVID-19 cases (and deaths). As we wrote about in June, this rally has largely been driven by the mega cap technology names with the rest of index constituents being relatively flat.

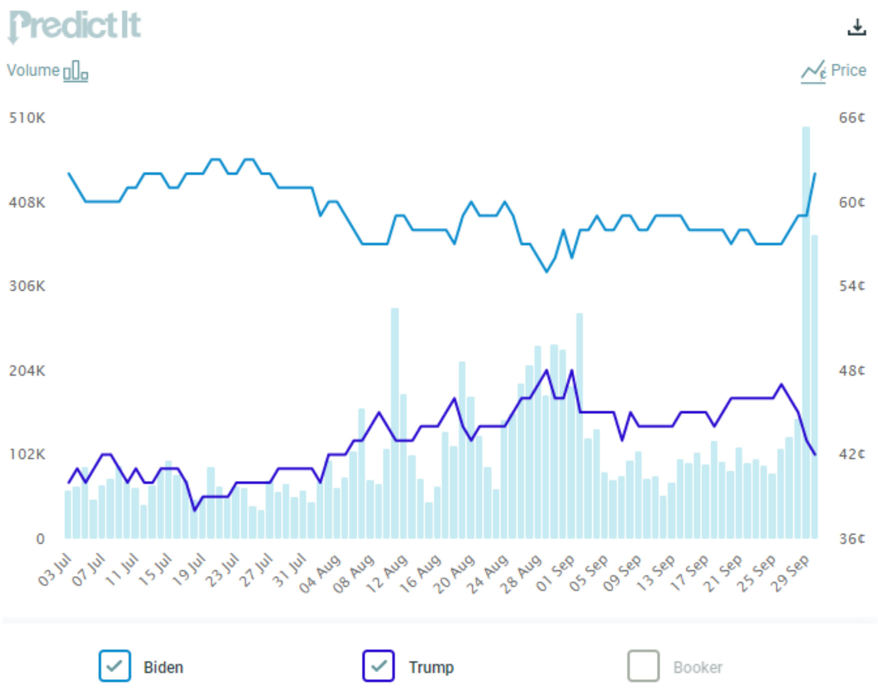
Source: BAML

The upcoming Presidential election also influenced market sentiment, with the first debate in late September indicating it will be a uniquely contested vote. The outcome of the election will have ramifications for the markets, with a Biden victory likely to impact S&P500 earnings given the scope of tax reform pledged. The market may have already priced in this outcome, with Biden estimated to have a 63% likelihood of taking over the oval office. Pre-election polls have proven to be fallible however, as the Brexit and 2016 US Election demonstrated.



Source: Goldman Sachs

"The Dow Jones Industrial just closed above 29,000! You are so lucky to have me as your President. With Joe Hiden' (sic) it would crash." Donald Trump, President of the United States of America, 02/09/2020



Source: PredictIt

After an astonishing $23bn was raised in the June quarter in Australia, the recapitalisation cycle, aka 'Deal Mania', slowed but still saw over $9bn in equity raised during the September quarter. August brought with it reporting season, which like a lot of things in 2020 was truly 'unprecedented'. Investors were forced to fly blind ahead of results to a certain extent, as a large number of companies chose to withdraw earnings guidance after the onset of the pandemic. Given the wide range of expectations, stock price return dispersion in post result trading was the highest in 8 years. On average, return dispersion was quite positive, which indicates how bearish investor sentiment was going into August.

Figure 1: Reactions to results were very positive, with the median stock outperforming 0.7% after reporting

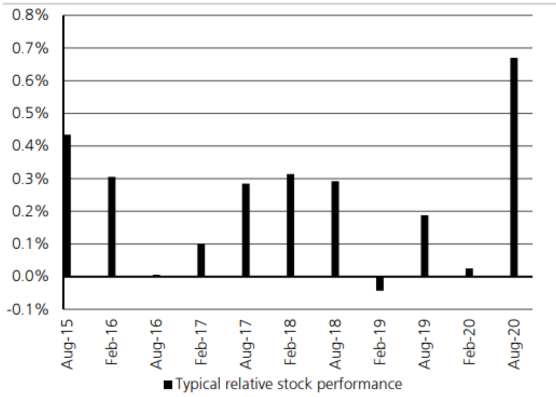
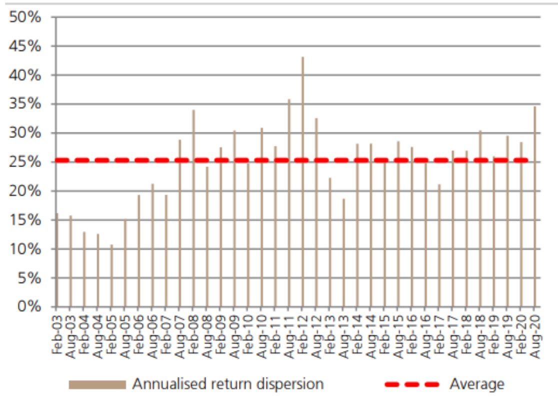


Figure 2: Return dispersion rose sharply for the ASX 100 to the highest level since Feb-2012



Source: UBS

	QUARTER	YEAR
ASX200 Accumulation Index	-0.4%	-10.2%
Best Performing Sectors		
Information Technology	12.6%	28.6%
Consumer Discretionary	8.7%	3.3%
Prop Trusts	7.0%	-16.7%
Worst Performing Sectors		
Energy	-14.1%	-39.0%
Utilities	-8.1%	-10.5%
Fin Ex-Prop Trust	-6.2%	-28.5%

Source: IRESS

Similar to the offshore experience, the local Technology sector topped the tables for performance during the period with the Buy Now Pay Later (BNPL) sector leading the way. Strong stock price performance from first movers in the sector has led to a plethora of BNPL initial public offerings (IPO's) and strategic pivoting of traditional consumer finance companies to BNPL offerings. Traditionally as more capital enters an industry, returns are lowered as incumbent margins are competed away. This eventuality seems likely to us given the number of recent entrants into the space.

Consumer discretionary stocks benefited from a narrower set of options for Australians to spend their cash, which according to economist estimates households had more of compared to last year given the quantum of government stimulus and superannuation withdrawals. As Australians couldn't spend on items such as international travel (usually a circa $55bn spend), consumers instead chose to funnel cash into areas such as home improvement, electronics and online gambling. Companies such as Wesfarmers (Bunnings/Officeworks), JB Hi-Fi and Breville were amongst the beneficiaries.

"Globally, suppliers, like us, are having a pretty good time, particularly around working and learning from home. So you can imagine at times, that will be well telegraphed. You couldn't get a monitor, you couldn't get a keyboard. Obviously, suppliers have ramped up production. I'm pleasantly surprised with the inventory we have on hand that we can drive the sales numbers we are." Richard Murray, CEO of JBH, 16/08/2020

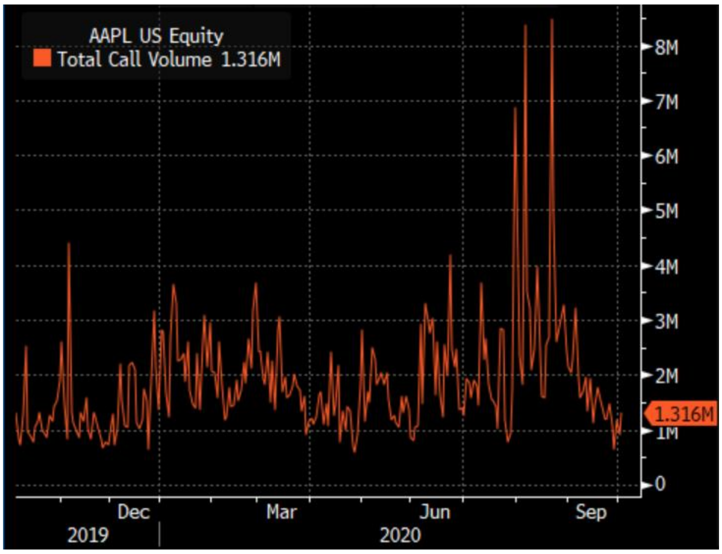
Options and Volatility

There was no shortness of excitement due to the volatility of markets over the last quarter. A key contributor to the uptick in volatility was the frenzy of option trading, particularly call options. Purchasing a call option gives the investor the right to buy shares at a specific price at a certain future date. Since the buyer of these call options is purchasing the derivative, not the stock itself, the strong buy skew of call options doesn't increase the underlying price of the stock directly. However, for every buyer of a call option, there must be a seller. In order to hedge the risk of the underlying share price rising (delta), the options dealer must buy the underlying stock in the market. In theory this works, but in volatile markets with a large buy skew push from investors, the underlying share price can increase rapidly, and the seller of the call options needs to continually re-hedge their short call position by buying the underlying stock due to them being short 'gamma'. This 'gamma squeeze' pushed large tech stocks like Apple up more than 10% (US$170 bn) overnight in late July (approx. 1.9x CSL's market cap).

Options trading volumes (and volatility by virtue) reached a dizzying high in early September. Softbank, the Japanese conglomerate was rumored to be 'Nasdaq whale' – the market participant behind the large call option volume for tech stocks (namely the FAANGS). It was reported that Softbank bought up to US$4bn of single stock call options, and this on top with retail investors buying FAANGS stocks was thought to have been a key driver of the recent tech rally.

We can see from search activity that interest in the phrase 'call option' has surged in the past few months.

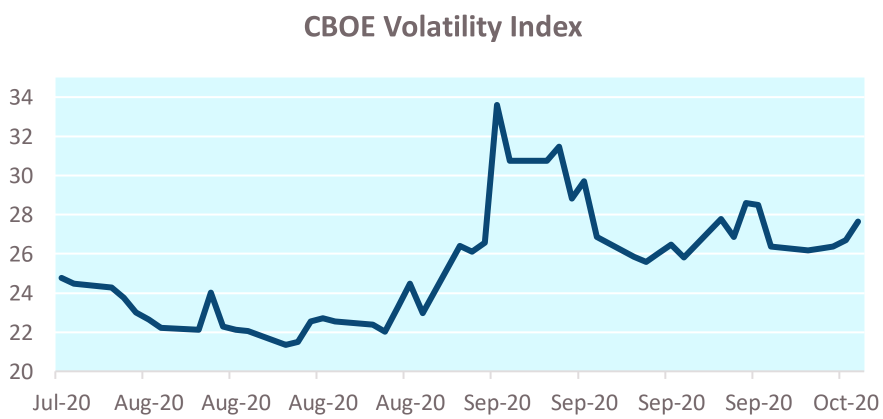
Source: Google Trends (US)



Source: Bloomberg

Historically when volatility, as measured by the VIX (Chicago Board Options Exchange's Volatility Index), rises the market tends to fall. Earlier in the quarter however the market and the VIX rose in unison, an uncharacteristic move potentially attributable to the 'Nasdaq whale' and retail speculation. Options volumes have now broadly returned to normal, however the VIX has remained slightly elevated relative to the pre-peak level. This implies that the current VIX levels are reflecting an expectation of heightened volatility across the market. With increasing uncertainty regarding the US elections and other factors like the potential for COVID-19 vaccines, we continue to remain vigilant for any possible distortions which may arise from spurious market activity.

"It's almost unprecedented to see volatility rise with prices. Not only are people buying a lot of Apple calls but also they're paying more for them. Rarely does that work." Jason Goepfert, President, Sundial Capital Research, 14/09/2020



Source: IRESS

Travel

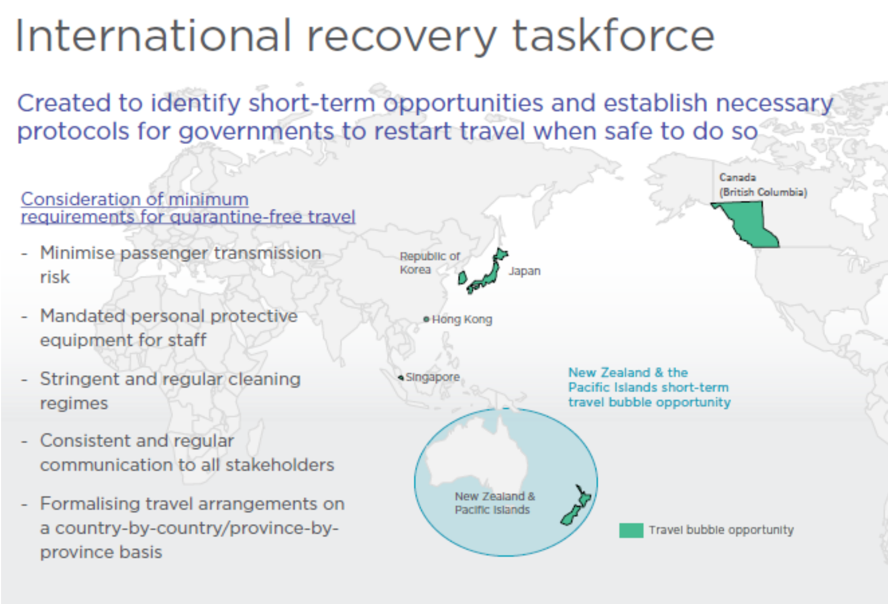
Travel has arguably been the sector most decimated at the hands of the pandemic. Whilst other businesses were able to ‘pivot’ and reorganise supply chains to find new ways of operating, without the movement of people the travel sector was forced to come to a complete standstill. Given the elongated cash conversion cycle, where customer cash is collected usually months in advance of travel (which enables the business to fund operations), revenue evaporating saw operating models unravel. For businesses with negative working capital cycles such as travel agents, this caused a large unwind in cash reserves as revenue fell to zero and refunds were requested, whilst payables remained due. Airlines fared little better, having to also (somewhat begrudgingly) provide cash for refunds whilst still having to make payments on items such as aircraft leases. Airports, whilst not suffering the working capital dynamics to the same extent, were caught with levels of leverage that were uncomfortably high in a period of minimal passenger movement. The resultant recapitalisation cycle in the travel names came with a flurry, with the sector now in a position to sustain itself, at least for the time being.

“Aviation is used to sudden shocks. Qantas has dealt with several just in the past decade and come through them stronger.” Alan Joyce, CEO of Qantas, 25/06/2020

Over the course of history, the demise of travel has been predicted on numerous occasions and each time the sector has come back stronger than ever. We believe this time should prove no different as the fundamental factors which made travel a structural growth sector prior to the pandemic still remain. These include a burgeoning emerging market middle class, continuing shift of preference for experiences over materials goods (helped by social media/FOMO factor) and the ongoing improvement in the efficiency of aircraft making travel easier and cheaper than ever before. However, given the nature of the virus, the timing of any recovery is uncertain and as balance sheets aren’t fortressed sufficiently to last a downturn of more than 12-24 months, we are approaching the sector carefully.

We agree with the consensus expectation that the recovery will be led by domestic travel. As at the time of writing, us Melbournians have finally managed to control the spread of the virus. Assuming (and hoping) this remains the case, the prospect of domestic borders (excluding WA) opening before Christmas is a distinct possibility. There is a great deal of pent up demand in the system to absorb Domestic capacity, particularly in the VFR (visiting friends and relatives) and leisure market. This is evidenced by participation in recent sales campaigns by the airlines, which included a Jetstar sale which sold 150,000 fares in 3 days (220 per minute) and the Qantas ‘flight to nowhere’ which sold out in 10 minutes. Intrastate routes such as Perth to Broome and Brisbane to Cairns are also operating at above pre-COVID capacity, which indicates the propensity for people to travel locally when they have no other option.

The international picture is decidedly more opaque. Whilst there may be significant pent up demand from Australians who love to travel abroad, unlocking this demand will likely prove difficult in the near term. A vaccine will no doubt help get things moving along, however in reality to open our borders up to another country where the virus has spread, there needs to be a critical mass of vaccination on both sides of the border. This will not happen immediately due to the logistical challenge of administering the vaccine, plus there is growing apprehension from people to get vaccinated. Encouragingly, the prospect of a Trans-Tasman bubble with New Zealand (and potentially other countries in the Pacific) remains strong, with both governments seemingly keen to establish a bubble as soon as safely possible.



Source: SYD

We have been pragmatic in our approach to the sector. Whilst having confidence in the recovery over a long period of time, we have used our bottom-up, fundamental stock picking framework to manage our exposure to the sector in the short term. We took part in a number of the capital raisings in the sector over the past 6 months given the significant value on offer at the issue prices.

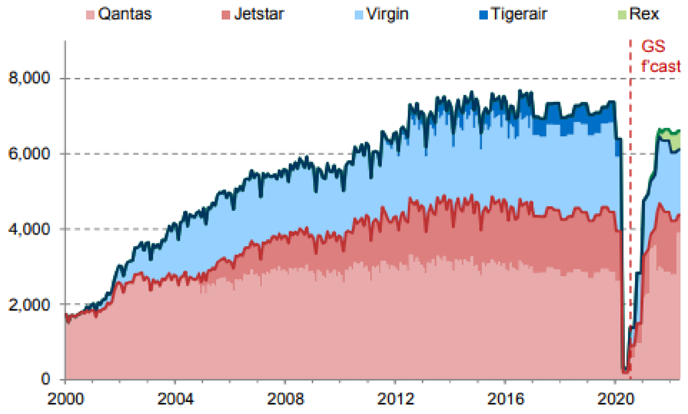
SYD: Sydney Airport has been a core Greencape holding for many years. As a monopoly airport servicing the largest population centre in Australia, SYD is the nation's gateway airport. We acknowledge that SYD's recovery will be longer dated given the majority of earnings are derived from international passengers. It is important however to look at the stock through a long term lens given SYD is a long duration asset. There are still 80 years left to run on the lease, which is much longer than a typical toll road concession. We believe that the equity value of the company has been oversold on an event which analysts predict will have a 4-5 year impact on passenger numbers. From a bottom-up perspective, the strength of SYD management is under appreciated by the market. We particularly admire the incredible cost discipline in the company which saw costs reduced on an absolute basis in 2019, an admirable feat for any growing company. We also see attractive optionality in development of the airport, particularly on the Qantas Jet Base site which is 30 hectares of prime land at the north of the airport (closest to the city) which will be handed back to SYD from Qantas in the near future. There is also the potential for relaxation of the SYD's strict slot movement cap which will unlock capacity at high demand peak times at the airport. Whilst Western Sydney Airport is a potential threat as it comes online in 2026, given the site is over 50km from the city we see SYD remaining as the primary gateway for passengers accessing Sydney, particularly for high value corporate and international passengers.

"The behaviour we are seeing at the moment from certain states is inconsistent with what it means to be Australian. This is the moment we should all band together. We should have each other's back.

But unfortunately self-interest has swallowed national interest." Geoff Culbert, CEO of Sydney Airport, 18/09/2020

QAN: Whilst not a traditional Greencape stock, we believe there is significant value in Qantas as the domestic market opens up. Qantas has to date traded in line with its international airline peers, but an important distinction to make is that Qantas makes the majority of its earnings from its Domestic and Loyalty divisions. As mentioned earlier, there is significant pent up demand in the system for passengers wanting to travel, and once domestic borders open there should be a sufficient depth of demand ready to absorb new capacity that is introduced. We also expect pricing of added capacity to be buoyant as witnessed in New Zealand, with Air NZ stats showing RASK (Revenue per Available Seat Kilometre) growth of 8% on the resumption of Domestic travel in May. Whilst it may be wishful thinking to hope that the aggregate Australian Domestic profit pool from FY19 will be restored in the short term, we think it has the potential to grow quickly from the current low base. A recapitalised Virgin Australia under Private Equity ownership is expected to be rational, not aggressively seeking to retain or grow its market share. Qantas is therefore well positioned to take share, particularly in the lucrative Corporate travel market. Whilst the Virgin restructure should help them compete from a unit cost perspective (particularly due to operating a streamlined fleet of Boeing 737s), Qantas has spent no time wasting the crisis, accelerating its own restructure to remain competitive. Importantly for investors, a Domestic border reopening will be hugely beneficial from an operating cash perspective and should allay balance sheet concerns.

Exhibit 13: QAN to regain c.70% market share
Australian domestic aviation market shares



Source: Company data, Goldman Sachs Global Investment Research

Source: Goldman Sachs

AIA: Auckland International Airport is a relatively recent addition to the Greencape portfolios. We have long admired the company but struggled with the valuation at which the stock has historically traded, especially in comparison to SYD. With the stock selling off through March and the company raising equity in early April, we were able to add the stock to the portfolios at attractive prices. AIA is the gateway into New Zealand with approximately 75% of all international visitors arriving through its terminals. It is also the largest domestic airport in NZ by a factor of 3x the 2nd largest. In 'normal' times, 45% of the >20 million passengers passing through the airport are domestic passengers and with the recent lift in domestic utilisation back to 60-70% of pre-COVID levels, the company is back operating at approximately EBITDA (earnings before interest, tax, depreciation and amortisation) breakeven. From here we expect AIA to show great leverage to a probable near-term Trans-Tasman (and potentially Pacific Island) bubble with approximately two thirds of pre-COVID international passengers originating from New Zealand, Australia and the Pacific Islands. In addition to the airport terminals, AIA has a substantial investment property portfolio (currently valued at NZD$2 billion, approximately 15% of AIA's enterprise value) with a long runway of growth through continued development of owned land adjacent to the airport. AIA also owns 25% of Queenstown Airport, NZ's 4th largest airport. Post the equity raise, AIA has a conservative level of debt and ample liquidity to ride out the subdued operating environment, and we expect this balance sheet headroom to prove to be a valuable asset as operating conditions normalise over the coming years.

"As much as we would hate to admit it, I think we miss each other… We like you visiting us, it's very important to us… We'll be looking to what decision you make as to what qualifies as a hotspot but I do think this opens up some opportunities," Jacinda Ardern, Prime Minister of NZ, 30/09/2020

Outlook

The market managed to consolidate the gains achieved in the June quarter, aided by record central bank liquidity and fiscal support. High frequency economic data generally exceeded market expectations whilst reporting season was not as bad as feared. Outlook commentary from companies was generally vague, with those companies daring to give guidance providing a wider than usual range. We are hearing a similar message from companies we speak to. The heightened uncertainty not only reflects broadened expectations of the market returns (up or down), but also uncertainty over the drivers of these returns.

Many commentators theorise that the tech/growth stocks will begin to make way for ‘value stocks’ due to record outperformance (i.e. mean reversion). An important observation Greencape makes is that for the many commentators predicting this rotation there are a multitude of definitions of what constitutes ‘value’. For instance, are the value stocks that are theoretically due to normalise merely those stocks that have underperformed? Or are they stocks which may not grow much but generate attractive free cashflow yields relative to the market? Or are they COVID-19 impacted names which will improve as a vaccine is developed and/or pandemic/travel restrictions are lifted? Market pundits are seemingly able to choose their own adventure.

Greencape has reflected the wider range of market outcomes by more actively utilising the tails of our portfolio than we traditionally have in the past. We continue to apply our process and patiently continue our search for bottom up conviction to reflect in the portfolio.

“We don’t predict the future. We prepare for all eventualities.” Shayne Elliot, CEO of ANZ, 04/09/2020

“There will be some circumstances where people are better off selling out early and taking some equity out of their homes or keeping some equity before it disappears.” Ross McEwan, CEO of NAB, 13/08/2020

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**

The Professional Planner/Zenith Fund Awards are determined using proprietary methodologies. Fund Awards and ratings are solely statements of opinion and do not represent recommendations to purchase, hold, or sell any securities or make any other investment decisions. Ratings are subject to change.

Unless otherwise specified, any information contained in this publication is current as at the date of this report and is provided by Greencape Capital Pty Ltd ABN 98 120 328 529 AFSL 303 903 (Greencape), the investment manager of the Greencape High Conviction Fund ARSN 121 326 225 (**Fund**). Fidante Partners Limited ABN 94 002 835 592 AFSL 234 668 (**Fidante Partners**) is the responsible entity and issuer of interests in the Fund. The information in this publication should be regarded as general information and not financial product advice, and has been prepared without taking into account of any person's objectives, financial situation or needs. Because of that, each person should, before acting on any such information, consider its appropriateness, having regard to their objectives, financial situation and needs. Each person should obtain and consider the Product Disclosure Statement (PDS) and any additional information booklet (AIB) for the Fund before deciding whether to acquire or continue to hold an interest in the Fund. A copy of the PDS and AIB can be obtained from your financial adviser, our Investor Services team on 13 51 53, or on our website www.fidante.com.au. Please also refer to the Financial Services Guide on the Fidante Partners website. Past performance is not a reliable indicator of future performance. Neither your investment nor any particular rate of return is guaranteed. The information contained in this document is not intended to be relied upon as a forecast and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy, nor is it investment advice. If you acquire or hold the product, we, Fidante Partners or a related company will receive fees and other benefits which are generally disclosed in the PDS or other disclosure document for the Fund. Neither Fidante Partners nor a Fidante Partners related company and its respective employees receive any specific remuneration for any advice provided to you. However, financial advisers (including some Fidante Partners related companies) may receive fees or commissions if they provide advice to you or arrange for you to invest in the Fund. Greencape, some or all Fidante Partners related companies and directors of those companies may benefit from fees, commissions and other benefits received by another group company.