Greencape High Conviction Fund

Quarterly report - September 2022

Performance #	Quarter %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	15 years % p.a.	Inception % p.a.
Fund return	-0.52	-9.74	4.50	7.56	9.59	6.21	8.74
Growth return	-1.81	-20.25	-2.99	-0.72	1.57	-0.28	1.81
Distribution return	1.29	10.51	7.49	8.28	8.02	6.49	6.93
S&P/ASX 200 Accumulation Index	0.39	-7.69	2.67	6.76	8.41	4.30	6.03
Active return^	-0.91	-2.05	1.84	0.80	1.18	1.91	2.71

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'.

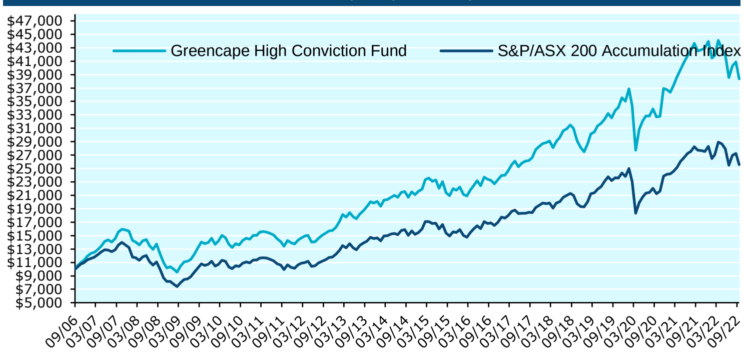
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

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



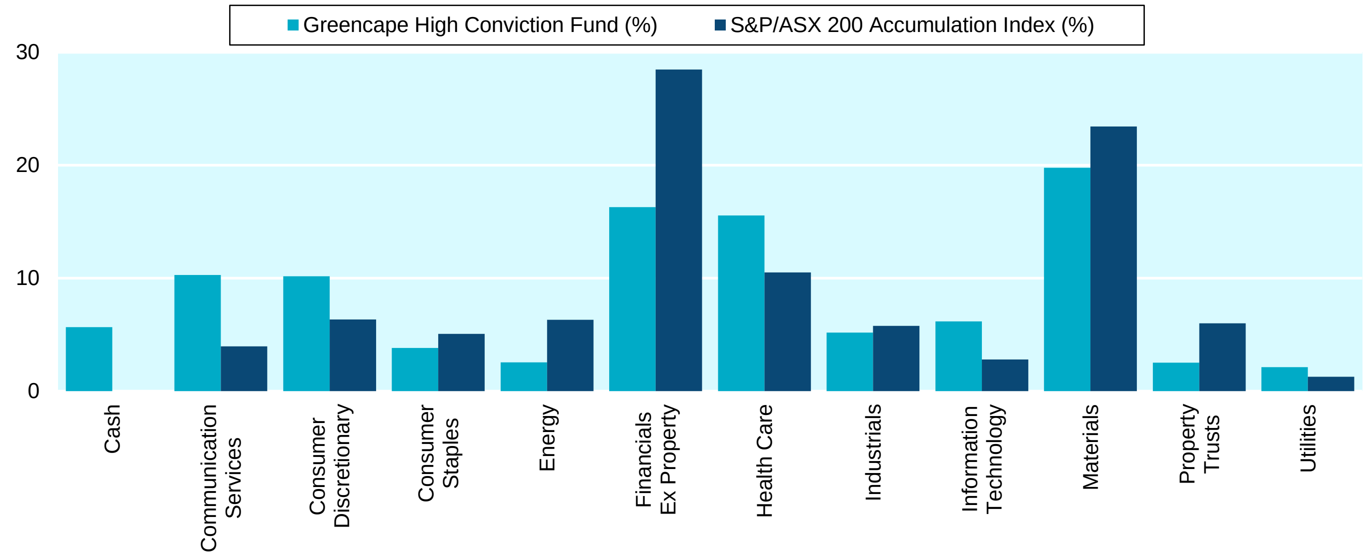
Asset allocation	Actual %	Range %
Security	94.34	85-100
Cash	5.66	0-15

Fund facts	
Inception date	11 September 2006
APIR code	HOW0035AU

Fees	
Entry fee	Nil
2020-2021 ICR	0.91%
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 2022.

Sector exposure as at 30 September 2022



Data Source: Fidante Partners Limited, 30 September 2022.

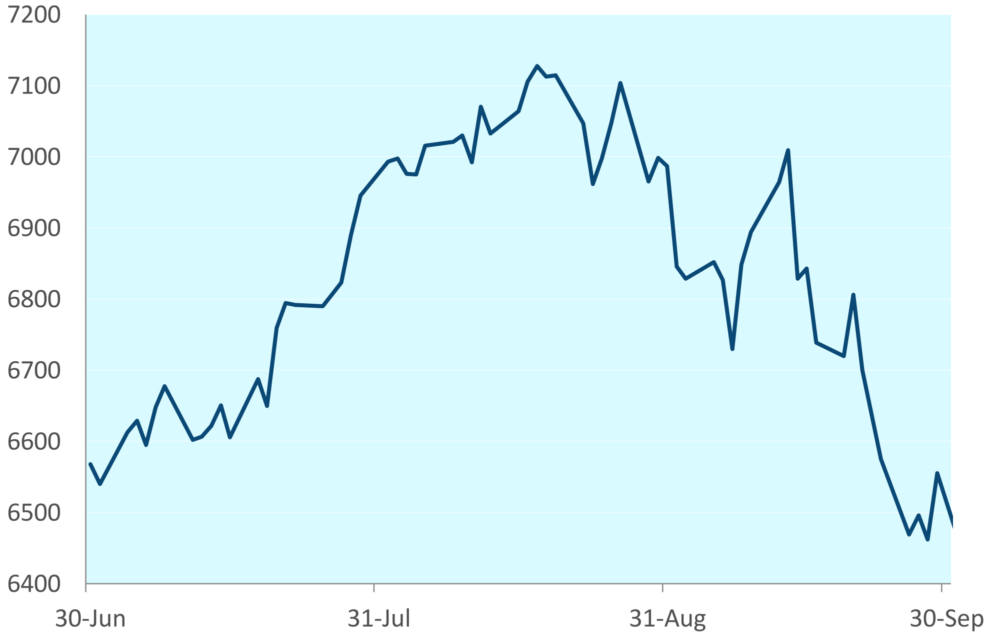
Fund performance summary

The S&P/ASX 200 Accumulation Index returned +0.39% for the quarter. The fund underperformed the market and delivered a -0.52% return over the quarter.

Market overview

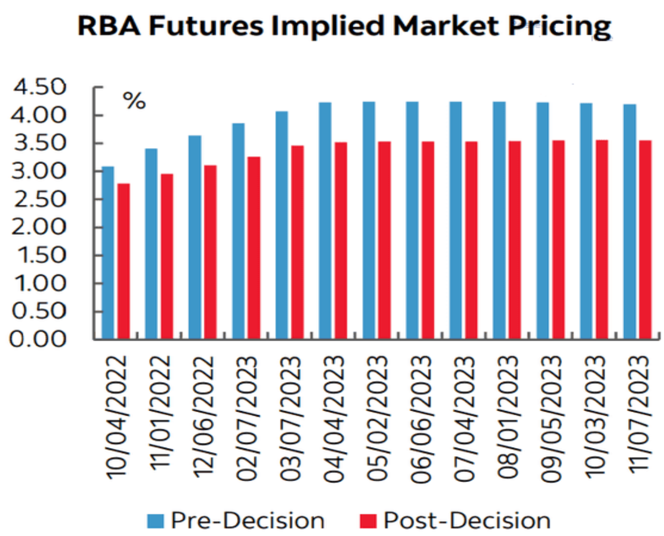
The market initially rallied from the June lows, however the recovery proved to be short lived as higher than expected inflation data saw central banks approach rate tightening with renewed vigour. Meanwhile, geopolitical tensions continued to simmer in the background as the prolonged Russia-Ukraine conflict threatened to escalate, having potential implications for critical energy supply going into the European winter.

S&P/ASX 200 Index



Source: IRESS

The RBA followed up its drought breaking rate hikes in Q2 with a threepeat of 50 point hikes during the quarter. This was followed by a 25 basis point hike post period end, below the median expectation of 50 basis points. This was seen as dovish by the market and trigged a strong rally. The futures market now implies another 4 interest rate hikes in the next 12 months, with the peak target rate settling at 3.5%, 50 basis points lower than it was prior to the October meeting.



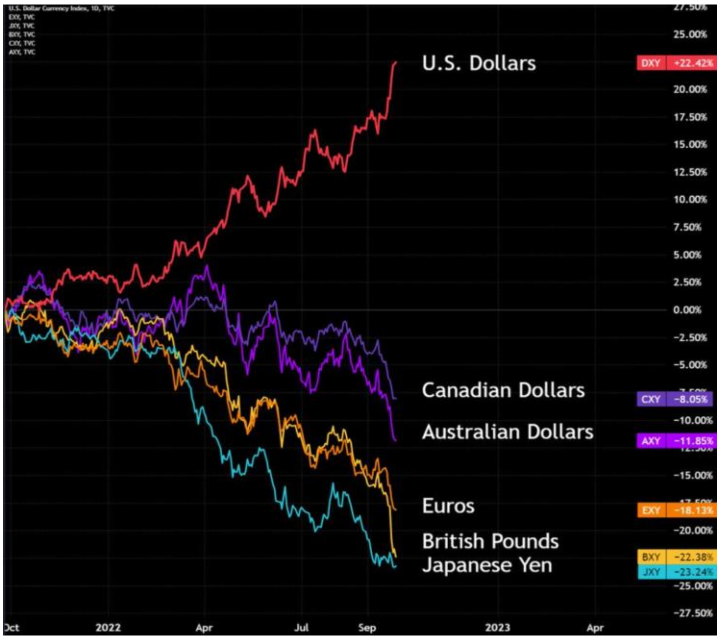
Source: The Daily Shot

"The Board's priority is to return inflation to the 2–3 per cent range over time. It is seeking to do this while keeping the economy on an even keel. The path to achieving this balance is a narrow one and it is clouded in uncertainty." Philip Lowe, RBA Governor, 04/10/2022

The heads of the developed world's largest central banks gathered in Jackson Hole, Wyoming in August. Stock market bulls who were hoping for a 'pivot' from central banks were left disappointed, with the sobering message being that bringing down inflation will be painful, with likely a 'sustained period of below-trend growth' to be expected. Furthermore, Fed Chair Jerome Powell tempered expectations of premature rate cuts, invoking former Chair Paul Volcker by saying the Fed would 'keep at it' until they are confident inflation is under control. Global markets retreated in the wake of the gathering and continued to fall throughout September.

The strength of the US dollar was notable during the period. As many Australian companies source inputs in USD, this dynamic only adds to local inflationary pressure.

"We are taking forceful and rapid steps to moderate demand so that it comes into better alignment with supply, and to keep inflation expectations anchored. We will keep at it until we are confident the job is done." Jerome Powell, Chairman of the Federal Reserve, 26/08/2022



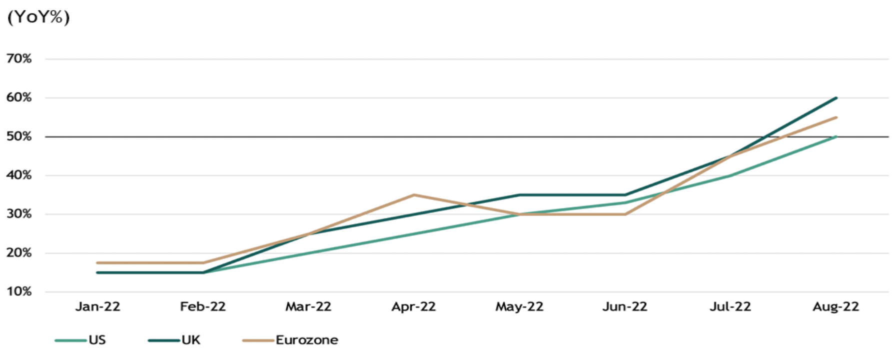
Source: TradingView

Meanwhile in the UK, the newly installed Prime Minister Liz Truss wasted little time after being sworn in by the Queen, embarking on hugely expansionary fiscal policy to help prop up the economy. The market was sceptical, selling off UK Government Bonds (GILTs) to a point where the Bank of England was forced to step in to control the market.

The confluence of headwinds has manifested into a bearish outlook for major global economies, with the odds of a recession consistently increasing over the past 12 months.

"The facts have changed and I've changed my mind about cash as an asset: I no longer think cash is trash." Ray Dalio, Founder of Bridgewater Associates, 03/10/2022

Figure 1: Median Consensus Estimate of Recession Probability in the Next 12 Months[iii]



Source: Blackstone

	QUARTER	YEAR
ASX200 Accumulation Index	0.4%	-7.7%
Best Performing Sectors		
Energy	5.9%	26.1%
Healthcare	3.3%	-8.9%
Information Technology	2.9%	-39.3%
Worst Performing Sectors		
Utilities	-12.5%	13.1%
Property Trusts	-6.7%	-21.5%
Industrials	-5.5%	-8.3%

Source: IRESS

The local market managed to generate a small gain for the quarter, however sector performance was far from consistent. Energy was the best performing, as energy security remained top of mind for governments globally. In September, a Heads of Agreement was announced between the Australian Government and east coast LNG exporters, whereby uncontracted gas volumes will first be offered to the domestic market before being offered to international customers. Elsewhere, in Europe the Nord Stream gas pipeline which carries gas from Russia to southern Europe was damaged, with the cause not being immediately clear.

Utilities was the worst performing sector, with APA Group being the main drag. In August the company announced the resignation of the CEO in conjunction with the decision not to pursue a US acquisition in the foreseeable future. Property Trusts also under performed. Given property prices have an inverse relationship with capitalisation rates, unless property owners can raise rents ahead of yield expansion there is expected to be a degradation in asset values. Property landlords with stronger degrees of pricing power are consequently seen as better placed to protect asset values in an inflationary environment.

Offshore Trips

This quarter we travelled to the US on three separate occasions, including to attend the James Hardie Investor Day in New York.

- Both anecdotal and company feedback suggests that consumer spending is still very strong. Despite experiencing inflation which has been far more acute relative to Australia, the American consumer seems currently unperturbed. A major bank we met with noted “if you squint” you can see some pressure in the lower end of the market, but this is yet to spread into the mid to higher level consumer. The consensus expectation is that some degree of slowdown will come in 2023.

- Office occupancy is not near approaching pre-COVID levels and landlords are now contemplating the structural hit to asset values. The impact is most visible in San Francisco, which from our observations was meaningfully quieter compared to visits prior to the pandemic.

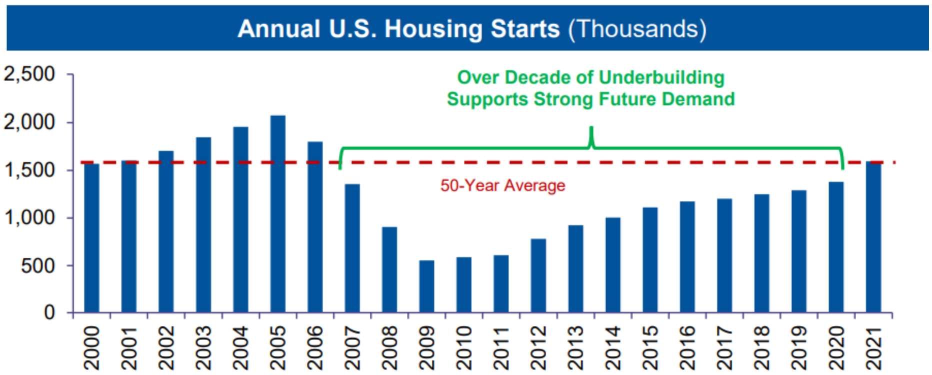
- Given ESG/activist investor presence on Energy company share registers, there is less demand for long cycle exploration and development capex.

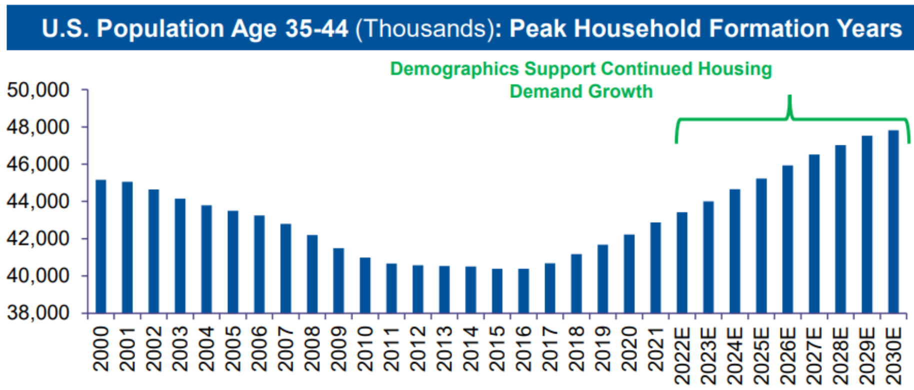
- The cost of funding has blown out. A Fortune 500 REIT we met with mentioned they recently issued 10 year debt at 4.7%, which was a 120 basis point spread over Treasuries. This represented a tripling of the base and a doubling of the spread.

- Repair and Remodel (R&R) activity is expected to remain strong driven by healthy home equity levels, a long backlog of projects and a high number of homes in prime remodel age. US R&R expenditure has grown at a 5% CAGR since 1996 and has exhibited much less volatility relative to new construction.

- Whilst US Housing Starts more than halved during the GFC, in the period since there has been a large underbuild as Starts have consistently been below the 50-year average. Considering this alongside supportive demographics of the US population coming into peak household formation years (35-44) suggests this downturn should not be as severe as the GFC.

"Simply put, the US needs more single and multifamily housing units, and until we get them, demand seems likely to remain higher than the supply." Joe Zidle, Chief Investment Strategist at Blackstone, 03/10/2022



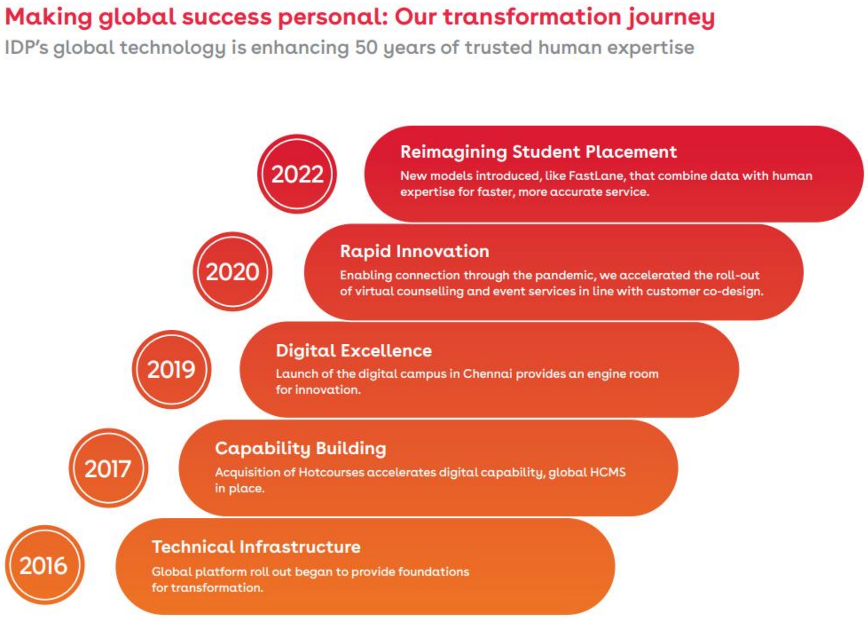


Source: Westlake

IDP Education

IDP is a leading global provider of education services. The vast majority of the company's earnings are generated in two pillars: English Language Testing and Student Placements.

We first invested in IDP at the IPO in 2015 when the company was spun out of Seek. Whilst the operating divisions have remained broadly similar over the past 7 years, under the stewardship of CEO Andrew Barkla the business has gone through a remarkable transformation from what was a largely analogue based operating model to a digital platform based business.

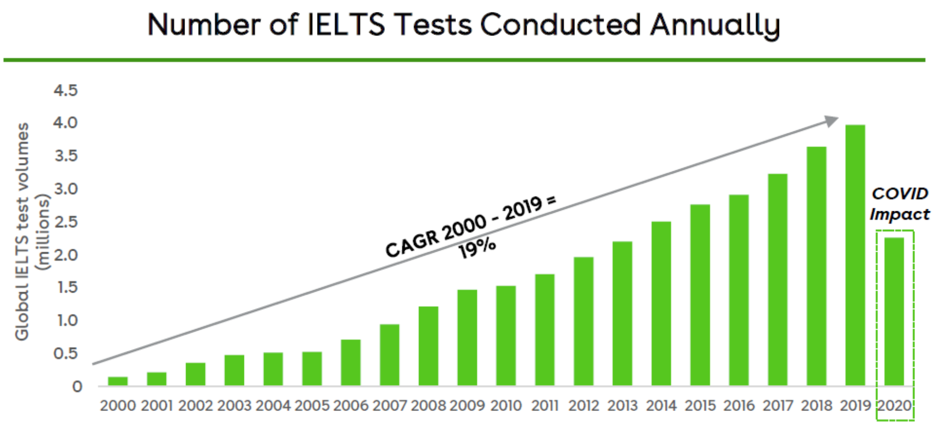


Source: Company Reports

IELTS

IDP is a co-owner and co-distributor of IELTS, the world's leading high stakes English Language test used for migration, study and work purposes. Demand for the test has been in long term structural growth given secular trends of global mobility and economic growth in emerging markets. Prior to the pandemic, IELTS volumes grew at a 19% CAGR over 20 years.

"Like student placement, IELTS is going through a significant transformation that is a continuation of the investments we've made through the last number of years. Those investments are really focused on creating a great consumer or customer experience relative to our competitors, leading the market in terms of the choices in the way people can take the test and where they can take that test and providing an improved support for those customers on their very important journey." Andrew Barkla, CEO of IDP, 25/08/2022



Source: Company Reports

Cambridge Assessment produces the test whilst IDP and The British Council (BC) both distribute and administer IELTS. Each party owns a third. For its part, IDP receives a fee for the tests it administers and pays a royalty (denoted in GBP) per test to Cambridge. Historically, IDP and BC have jointly distributed IELTS in all major markets with some exceptions. They do not compete in the UK or Australia as these are seen as 'home' markets for the organisations. China is also unique whereby BC run the operations, and they pay a fee to IDP for each test administered. Whilst BC is technically a competitor, the organisation is an arm of the British Government with a goal of promoting the English culture (and within that the English language) globally. In fact, it is not unusual to see them celebrate IDP's arrival into a market they already operate in, which is unusual behaviour for an operator who just lost their monopoly.

IDP has continued to innovate the IELTS product over time. In 2017 a Computer Delivered (CD) test was introduced to market and this year saw the launch of IELTS Online, a test version which give the taker more flexibility on where they take the test. The company also launched the IELTS app which enables customers to book, prepare and receive provisional results from their smart phone. The app is available in 55 countries and has already been downloaded over 160,000 times since its launch in May.

Student Placements

IDP is the world's largest student placement agency globally. The business places international students into institutions, for which is receives a fee paid by the education provider based on a percentage of tuition. In addition to this fee, Chinese students also pay an advisory fee to the company. The division reports in two segments: Australia and Multi-Destination (ex-Australia). Whilst IDP is the largest agent in the world, it's global market share is estimated to be only mid-single digit which speaks to the fragmented nature of the market.

Similar to IELTS, demand for Student Placements enjoys structural growth giving the burgeoning middle class in emerging markets which has led to growing demand for migration and education in destination markets. In recent years the company has also benefitted from Post Study Work Right (PSWR) reform introduced by various governments, namely the UK and Canada as these countries look to attract more skilled migrants. We see this trend as continuing, and we would expect the US and Australian governments to embark upon some form of PSWR reform in the future to remain competitive in the market for skilled migrants.

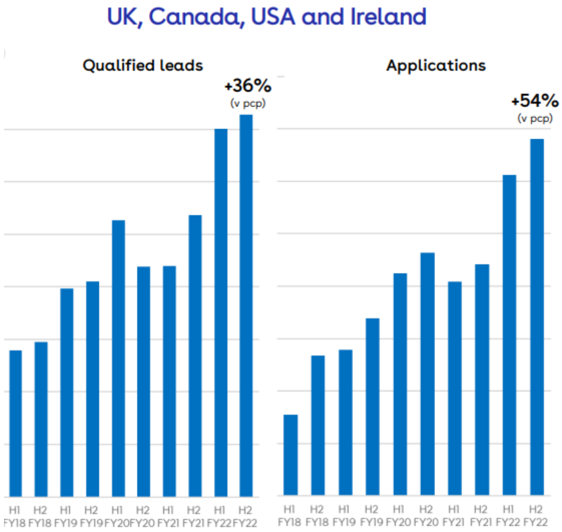
IDP has continued to invest to accelerate growth and strengthen its competitive advantage in the Placements market. The company has substantially increased its office footprint over time, particularly in India where the company now operates 67 placement offices in 60 cities. The Placements product has been continuously developed also, and last year 'IDP Live', a student-centred app was launched. Take up has been strong with over 1 million downloads and a 4.5 star rating on the App Store. One of the many innovations embedded within the product is Fast Lane, a feature which allows students to create an academic profile to match with relevant courses and receive an offer in as little as 30 minutes. This feature has been well received by students, with over 5,000 total offers in principle being made in FY22, well ahead of the internal target of 2,000.

Management have also undertaken various bolt on acquisitions since listing. In 2017 IDP acquired Hotcourses, one of the world's largest education search engines in the world. This not only gave them a comprehensive dataset for international courses, but also delivered significant tech capability to the company. More recently IDP acquired Intake Education, a company that provides placement services across various region in Africa and Asia. Nigeria has long been identified as a key growth market for the company, and this acquisition meaningfully accelerates share penetration in a market which has quickly become the third largest source of students to the UK.

In 2021 IDP acquired British Council's operations in India, the largest IELTS market globally. We viewed this as a transformational acquisition as it gave IDP a monopoly in what has become the most important source market in the world for Student Placement volumes. Whilst there were some cost synergies in the transaction, we are far more positive on the step change widening of the funnel for the Student Placements business in India. Although IDP is now the monopoly provider of tests in India, they have not taken over and above a standard price rise in the market. We see this as latent pricing power and a lever which remains at the company's disposal.

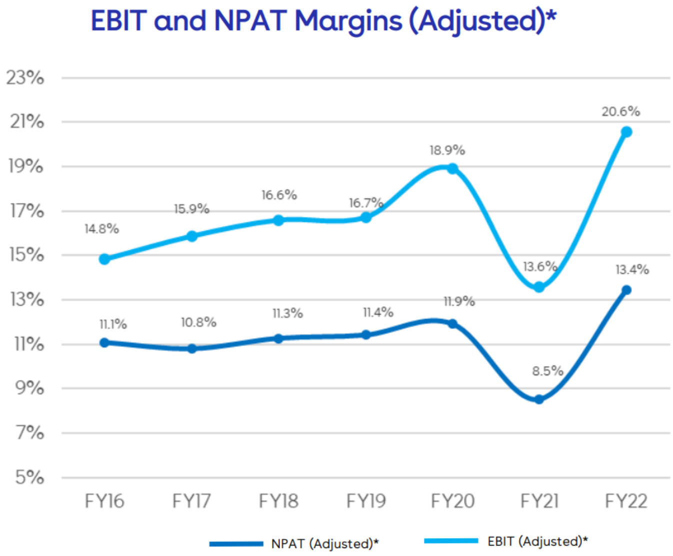
Through this holistic approach to Student Placements, whereby IDP is widening the funnel at the top and then through various product innovations is increasing lead conversion capability, we see the company as single-handedly transforming what is already a rapidly growing industry.

In the near term we see earnings certainty as high, especially relative to other 'growth' stocks in the market. We are particularly encouraged by supportive visa data in key IDP markets as well as strong growth reported in the company's internal pipeline.



Source: Company Reports

In terms of valuation, we acknowledge the stock is trading on a premium multiple, but we believe this is more than justified given the fundamentals. Even at what we view as an early stage of the company roadmap, the business is already generating an EBIT margin of over 20%. Whilst impressive, we see the potential for continued margin expansion given the capital light nature of incremental revenue. We also see the potential for further consolidation in IELTS distribution, which as well as being immediately accretive to earnings will also bring further cohorts of students into the Student Placement ecosystem for conversion. Despite the impressive progress to date, we still see the company as early in its monetisation journey.



Source: Company Reports

"From an industry leadership perspective, IDP really does hold a unique place in terms of its trusted brand and unique combination of digital and physical solutions for our clients and for our customers to engage in their ambition and their international education and/or migration strategies for the clients and the governments. Clearly, we have an ongoing program of innovation. That pace does not stop and will continue into the years ahead as we set out to remain the leader in the segments that we compete in." Andrew Barkla, CEO of IDP, 25/08/2022

Outlook

The market is clearly nervous. Despite weakness in the index to date, sentiment and investor positioning remains cautious with attention continuing to focus on interest rate trajectory and mounting evidence of a weakening consumer. Notable sources of interest rate nerves include central bank jawboning, stubborn inflation reads and questionable fiscal policy in the UK. The concerns around a weakening consumer are largely driven from evidence of very high inventories, shrinking savings rates, and several high profile profit warnings (FedEx, Nike, Walmart, Target etc).

Each of these categories of negative market drivers give rise to different stock winners and losers. The winners from the interest rate increase concerns are generally Computershare, insurers, miners and banks, and losers are long duration quality growth and defensive names. When the weakening consumer drives sentiment, winners are the recession-proof defensives, long-duration quality growth and Healthcare, whilst the losers are Banks, Cyclicals, and Consumer Discretionary names. Indeed, market leadership itself has become increasingly volatile!

The August reporting season was frustrating in that companies generally made backward looking comments stating that business remained solid and sell-side analysts generally remain optimistic with their earnings expectations, as they themselves await clearer earnings guidance from the companies they follow. Meanwhile the gyrating macro drivers once again took over from the bottom up.

The Greencape team took 3 overseas trips post reporting season, talking to numerous companies, industry bodies and regulators. The general take out was the consumer is hanging in there for now, and the impact of rate rises and cost of living spikes won't impact consumer in earnest until after the Christmas holiday season, after which time reflection and reality *may* change behaviour.

We are actively tracking expectations for peak interest rates along with the slope of the longer duration rate curves. We are observing the breadth of peak rate expectations is narrowing. We expect this will begin to result in the driver of market caution to increasingly be the weakening consumer, rather than interest rate rises. With this shift in market concern comes a market leadership transition, and our portfolios are positioned for this with a high active share in quality recession proof growth and defensive names. We have also selectively begun to build some of the more cyclical longer duration quality names, albeit we remain somewhat patient and a tad greedy in our approach.

"A Fed pivot, or the anticipation of one, can still lead to sharp rallies. Just keep in mind that the light at the end of the tunnel you might see if that happens is actually the freight train of the oncoming earnings recession that the Fed cannot stop." Michael Wilson, Chief US Strategist at Morgan Stanley, 02/10/2022

More information

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

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