Greencape Wholesale High Conviction Fund

Fund report and commentary – 31 March 2009

Overview: The Greencape Wholesale High Conviction Fund (Fund), posted a return of 0.72% (after fees)* compared with the S&P/ASX 200 Accumulation Index (benchmark), which returned -1.98%.

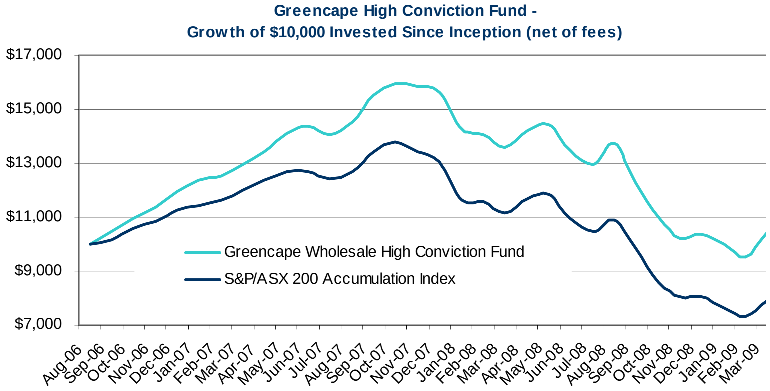
Performance

	Quarter (%)	1 year (%)	2 years (%) p.a.	3 years (%) p.a.	Inception (%)
Greencape Wholesale High Conviction Fund	**0.72**	**-23.23**	**-10.19**	**-**	**1.68**
Growth return	0.11	-28.01	-17.99	-	-5.59
Distribution return	0.61	4.79	7.80	-	7.27
S&P/ASX 200 Accumulation Index	-1.98	-29.52	-19.06	-	-8.43
Active return (net)	**2.70**	**6.29**	**8.87**	**-**	**10.11**

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 long term through a highly concentrated portfolio of Australian shares, and provide returns above the benchmark, the S&P/ASX 200 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

Asset allocation

	Current (%)	Range (%)
Securities	96	85 - 100
Cash	4	0 -15

Fund facts

	Greencape Wholesale High Conviction Fund
Inception date	11/09/2006
APIR code	HOW0035AU

Fees

	Greencape Wholesale High Conviction Fund
Entry fee	Nil
2007/08 ICR	0.90%
Management fee	0.90%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%

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FUND AWARDS 2008 AUSTRALIA WINNER STANDARD & POOR'S

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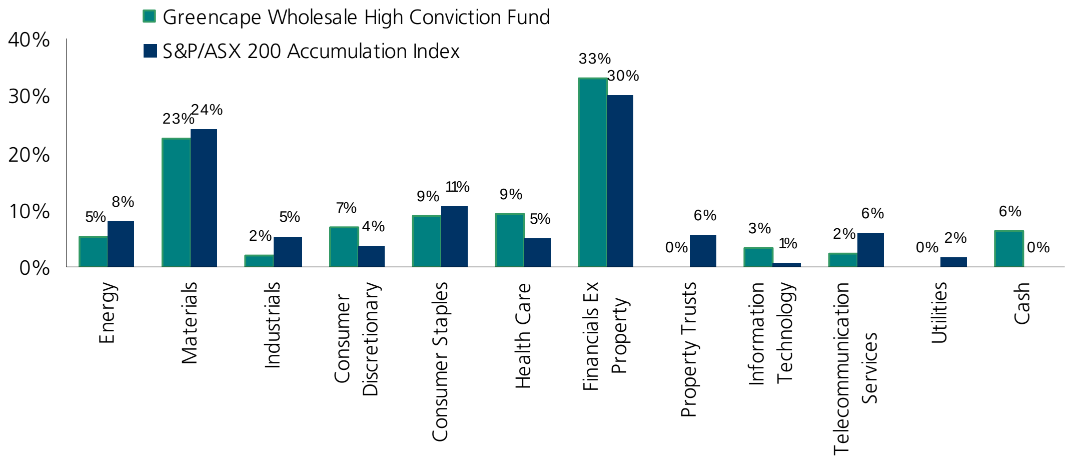
Sector exposures as at 28 February 2009



Market Review

In the March quarter the S&P ASX200 Accumulation Index returned -1.98%. This marked the sixth consecutive quarter of negative returns. There has never been seven consecutive negative quarters in Australia's history. The Greencape Wholesale High Conviction Fund outperformed the market by a positive 2.70% return over the quarter.

The market began the quarter cautiously with very weak economic data highlighting the rapid global economic slow down during the December quarter. An example of this was the loss of over 2million US jobs being announced between December and February and the US unemployment rate jumping from 6.8% to 8.1%. Early in the quarter the market was focussed on the corporate reporting season. Many analysts downgraded earnings expectations ahead of the results announcements which saw earnings generally delivered in line with the lowered expectations. A key feature of January and February was the urgency of companies with stretched balance sheets and pending debt refinancing, electing to raise capital via the equity market. The Australian market has raised $41.6bn since June 2008. Companies that raised capital represented in excess of 35% of the S&P/ASX300 index. This weighed on the market given the rapid increase in supply of equity. Below is a table highlighting the issuance status of the Top 20 stocks this financial year to date.

Company	Index weight	Equity Issued?
BHP Billiton Limited	13.50%	NO
Westpac Banking Corporation	6.40%	YES
Commonwealth Bank Of Australia	5.50%	YES
Telstra Corporation Limited.	5.20%	NO
National Australia Bank Limited	5.00%	YES
Woolworths Limited	4.60%	NO
ANZ	3.70%	???
QBE Insurance Group Limited	3.00%	YES
CSL Limited	2.90%	YES
Westfield Group	2.50%	YES
Wesfarmers Limited	2.40%	YES
Woodside Petroleum Limited	2.10%	???
Newcrest Mining Limited	1.80%	YES
Rio Tinto Limited	1.70%	???
Origin Energy Limited	1.60%	NO
AMP Limited	1.40%	YES
Foster's Group Limited	1.30%	NO
Suncorp-Metway Limited.	1.00%	YES!!!
Macquarie Group Limited	0.90%	???
TOTAL INDEX WEIGHT	67.50%	

The Australian market fell 4.8% in January and a further 4.6% in February. The market weakened further in early March before the first tentative signs were seen that the rate of US economic contraction was slowing. US housing starts increased to an annualised rate 583,000 in February from 450,000 in January, a rate which was last seen in the 1920's! US consumer sentiment ticked higher as did the US ISM Manufacturing Index which illustrates manufacturing activity levels. This data combined with reports that key US banks were operating profitably in January and February, plus further announcements of fiscal stimulus packages from numerous governments globally, has provided the market with a small injection of confidence. The Australian market then rallied 14% from its lows into the end of the quarter. During the quarter only three sectors delivered positive returns as shown in the table below:

	March Quarter	Year to March
Market (S&P/ASX 200 AI)	- 2.0%	- 29.5%
Best performing sectors:		
Materials	6.3%	- 33.0%
Energy	5.3%	- 8.9%
Financials (excl. Property Trusts)	1.0%	- 22.9%
Worst performing sectors:		
Property Trusts	- 24.4%	- 57.6%
Industrials	- 19.1%	- 47.5%
Telecommunications	- 11.2%	- 22.4%
Healthcare	-7.7%	- 9.4%
Consumer Discretionary	- 4.1%	- 43.8%

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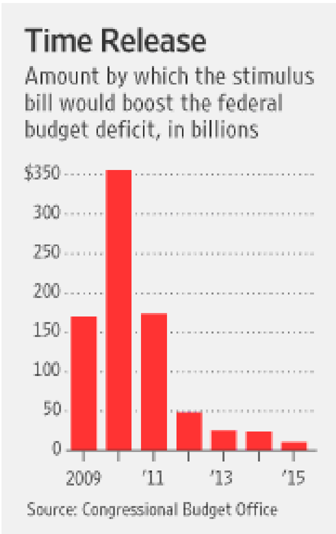
Company visits and observations

- With billions of dollars of fiscal stimuli being announced globally, debate has centred on the targeting of the spending programs. Much has been written about the trade off between achieving an immediate impact but is poorly targeted (e.g. cash handouts being largely saved), versus better targeted spend which takes time to achieve its impact (e.g. nation building projects that can improve productivity). It is interesting that compromise can result in the worst of both worlds. For example, in the US an estimated 30billion litres of drinking water is lost each day through leaking pipes and over a quarter of all US bridges are structurally deficient or functionally obsolete[1], yet less than a third of the US$825B fiscal stimulus package is targeted at infrastructure. Less will be spent on US roads and transit infrastructure than on US federal government buildings. Below is the scheduled timing of the expenditure with the two biggest years being 2010 and 2011.



- In early March with the market down a further 16% since the start of the calendar year, extremely negative economic news was everywhere and post Christmas job loss announcements filled up newspaper headlines. The degree of bearishness was extreme. It is interesting to compare the recent headlines with those of the past. Below are a selection from the 1970's, which are a reminder that in bear markets, it always seems the darkest just before the dawn.

[1] Source: American Society of Civil Engineers

- We have mentioned in past reports the observed de-leveraging that is taking place as companies repair balance sheets and households reign in spending and attempt to accelerate debt repayments. A feature of the downturn has been the speed at which the global economy has stalled. The chart below highlights the speed at which household de-leveraging is happening.

"In the long run we are optimistic and in the short run we are trying to get to the long run."
"We are dealing with the most fragile thing in the world and the hardest thing to predict, which is confidence." **Lloyd Blankfein, CEO Goldman Sachs, 13/03/09**

US Household Savings Rate

Source: Morgan Stanley Research

"Aldi may not be the biggest but they are now probably the most influential retailer in the country." **Geoff Erby GM Home Ingredients Goodman Fielder 25/2/2009**

"True discretionary spending has stopped." **Mark McInnes CEO David Jones 26/11/2008**

- During the quarter we had numerous meetings with senior management within the Australian banking sector. Banks consistently highlighted that their corporate lending book is overweight the commercial property, retail and manufacturing sectors, whilst generally underweight agriculture and healthcare. This highlights that companies who are debt dependent (or whose clients are debt dependent) operating in the property, retail and manufacturing sectors, face greater challenges obtaining debt at reasonable prices. This dynamic is only compounded by the retreat of many foreign banks which have historically been significant lenders to these sectors. This will result in further pressure on impacted companies' equity values and future growth prospects. One senior bank executive made the following observation ***"I remind you that equity holders sit beneath debt holders. The next phase of the down turn will highlight that when banks fully exert their power, as they will, it is in their interests to shift risk from debt holders to equity holders. This by necessity involves diluting equity holders*"**.

- Whilst the listed property trust sector has made recent attempts to improve balance sheets by reducing distributions and raising capital, analysis of the sector's cash flows suggest not enough is being done and risk to equity holders remains significant. It is worth noting that many property trusts capitalise substantial amounts of interest which inflates reported profits and interest coverage metrics. Only cash flow analysis reveals such financial engineering. **The analysis below highlights the sector's**

continued challenges, with cash outflows equal to 174% of cash inflows during the December 2008 half.

LPT cash conversion

LPTs	FY06 (A)	FY07 (A)	FY08 (A)	Dec HY08 (A)	FY09 (E)	FY10 (E)
Cash EBITDA growth	52	0	16	-274	-1	-7
Maintenance capex growth	524	107	49	16	10	0
Net interest expense growth	54	17	22	-47	4	-5
Tax paid growth	4	-16	90	36	-57	18
% change in Working Capital	193	-23	75	-112	225	26
Operating cashflow growth	10	15	6	-35	-17	6
Operating cashflow per share growth	-1	10	-2	-34	-23	-7
Dividends paid growth	-4	9	2	0	-10	-13
Cash payout ratio (%)	**141**	**131**	**126**	**174**	**132**	**108**

Note: Operating cashflow is defined as EBITDA less cash interest expense less cash tax expense less maintenance capex less net chg in working capital.
Source: Company data, Macquarie Research, March 2009

Source, Company data, Macquarie Research.

- From the perspective of a company's board and management, the value in being listed in a well regulated market with a well capitalised audience of potential investors has never been greater. A key function of listed equity markets is to facilitate the efficient allocation of capital. With debt markets constraining capital flows, equity markets have been necessary, and in some cases, urgent, providers of capital. Urgent provision of equity capital only highlights the value of being listed.

"Only two things are infinite, the universe and human stupidity, and I'm not sure about the former." **Albert Einstein**

- Banks are currently lending to large corporates, whose earnings are six times greater than their interest expense, at lending rates around 4% above cash rates. Compared this to first home buyers, whose income is closer to only two times their interest expense, yet are only being charged around 1.5% above cash rates. Also, covenant and security requirements for corporates are far more onerous compared to retail customers. Its hard to believe, given the experience of sub-prime lending in the US, that first home buyers in Australia can still borrow with loan-to-value ratios of 97%!

"My biggest concern is first home buyer grants are encouraging people without a track record of saving, to borrow large amounts of money at low variable interest rates. These very borrowers will bear the brunt of rising unemployment. The risk is it creates Australia's own subprime issue." **Ralph Norris CEO CBA 17/2/2009**

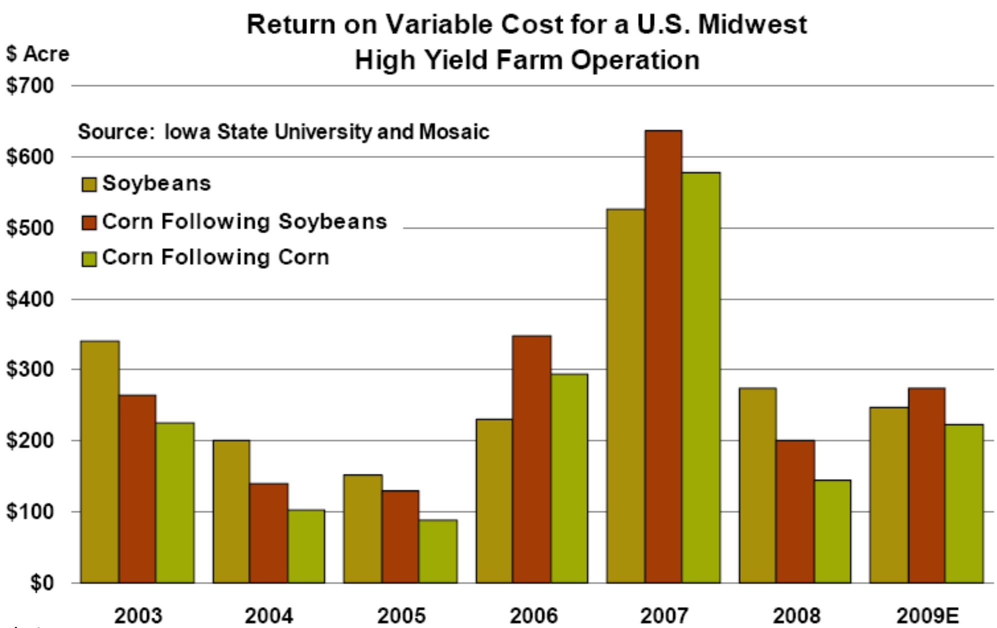
- It's apparent that the US economy is further through the economic slow down cycle than Australia. The US have been in recession for over a year whilst Australia is expected to have started its negative growth in the December quarter of 2008. US destocking cycles suggest inventory levels can generally only rise from current levels, whilst Australia is still in an inventory destocking phase. In coming quarters, US economic data points will begin to cycle weak data points from last year whilst in Australia this will not occur until the December quarter and not in a meaningful way until the March 2010 quarter. We expect this to have implications for the performance of US cyclicals versus Australian domestic cyclicals in the short term.

- The US and UK governments' response to the economic crisis has involved an increase in the money supply (termed "quantitative easing"). This is designed to increase the banking system's ability to lend and thus stimulate the economy via the multiplier effect. [The multiplier effect is economic jargon that reflects the fact that when a bank receives $1 as a deposit, it can lend out more than $1 which is used to stimulate demand in the economy] Many economists argue such actions have associated inflationary risks, where "too much money chases too few goods, which in turn pushes up prices". Economists who are in favour of temporarily increasing the money supply argue inflationary fears are over played and consider deflation is a more imminent risk. They also point out that when asset prices fall and loses are realised on balance sheets, this acts to reduce money supply. The point we take out of such intellectual debates is the differing time horizons taken. It is apparent, those less concerned about inflationary risk are taking a shorter term view than those who are.

"In the long run we all are dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again." **John Maynard Keynes**

"All scenarios that are explained to me are plausible." **Andy Penn, CEO AXA Asia Pacific 1/4/2009**

- During the quarter, Greencape had numerous meetings with Australian and international agriculture companies. Despite recent volatile economic activity, the agriculture sector's fundamentals remain stable with demand for crops, unlike hard commodities, remaining solid. The economic incentives for farmers to produce crops remain very attractive.



Source: Mosaic Inc

- Greencape has paid close attention to companies which have a hidden debt dependency. Companies who provide project related goods and services are dependent on projects obtaining finance. With lower global demand for hard commodities it is important to identify which current and future infrastructure projects are related to servicing the resources sector, which we consider are most at risk. The era of skills shortages, inflated capital expenditure pricing and inflated building materials pricing is likely to be at an end as existing projects are completed and new projects are delayed or cancelled.

- The consequences of nationalising sectors appears to be one of diminishing economic returns. As highlighted in past quarterlies, the vertical integration of the Aluminium industry by China has greatly reduced the sector's profitability (i.e. China has an incentive to keep Aluminium prices low as its objective is to use Aluminium to build infrastructure – the cheaper the better when considering the big picture). This has consequences for coal and iron ore industries given China's recent moves to increase equity in producers such as Oz Minerals, Fortescue Metals and Rio Tinto. It also has consequences for the western banking industry. The UK government for example is forcing its nationalised banks to lend, which is driving down margins in the sector. It has been pointed out to us that western countries whose banks have reported significant losses, have an incentive to nationalise their troubled banks. By way of example, consider in the US that the accumulated losses of troubled banks creates a significant reduction in expected corporate tax revenues. The size of losses to-date means that several banks will not be required to pay income tax for perhaps the next decade. If those banks were nationalised a government can protect its income by offsetting tax revenue losses with future bank profits. Such consideration is all the more valuable given the fiscal pressure many western governments are under.

Fund outlook

As per last quarter's commentary, "markets provide compelling value but also considerable earnings risk". The difference this time however is that value is equally compelling (we are at similar market levels as this time last quarter) yet we feel that the magnitude of earnings risk has reduced a little. This is because the quantum of downside risk to FY2009 profit expectations is considered to be much smaller than a quarter ago. That said, there remains risk to 2010 earnings, but again the quantum of expected revisions has reduced.

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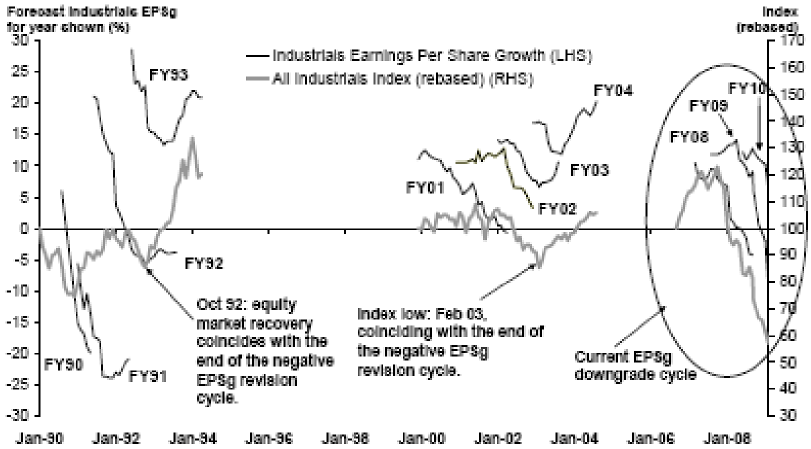
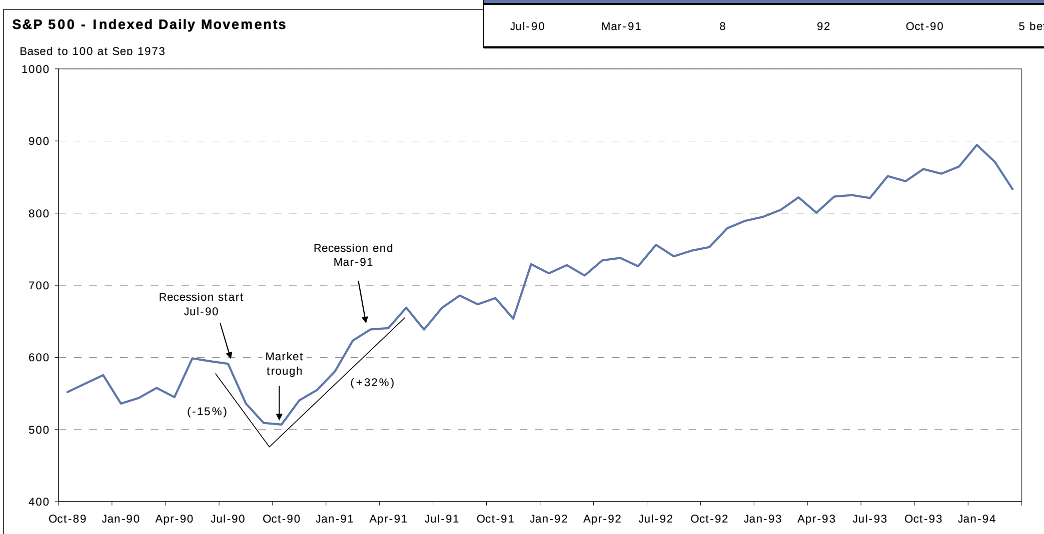


Source: Macquarie Research, March 2009

We are conscious of the lag in the Australian economic cycle relative to the US, yet the likelihood is that moves in the US equity market are reflected immediately in the Australian market. This is because US market moves directly impact the risk appetite of Australian investors which suggests any sustained rally in the US would result in the Australia market rallying despite greater near term earnings risks. What is expected is that the market will turn bullish before the economic data does. Consider the last few recessions:

1990-91

Economic peak	Economic trough	Contraction Peak to Trough (Months)	Expansion - Previous Economic Trough to Peak (Months)	S&P Trough	S&P Trough vs Economy (Months)
Jul-90	Mar-91	8	92	Oct-90	5 before



Source: Compustat, NBER, Goldman Sachs Research, GSJBW Research.

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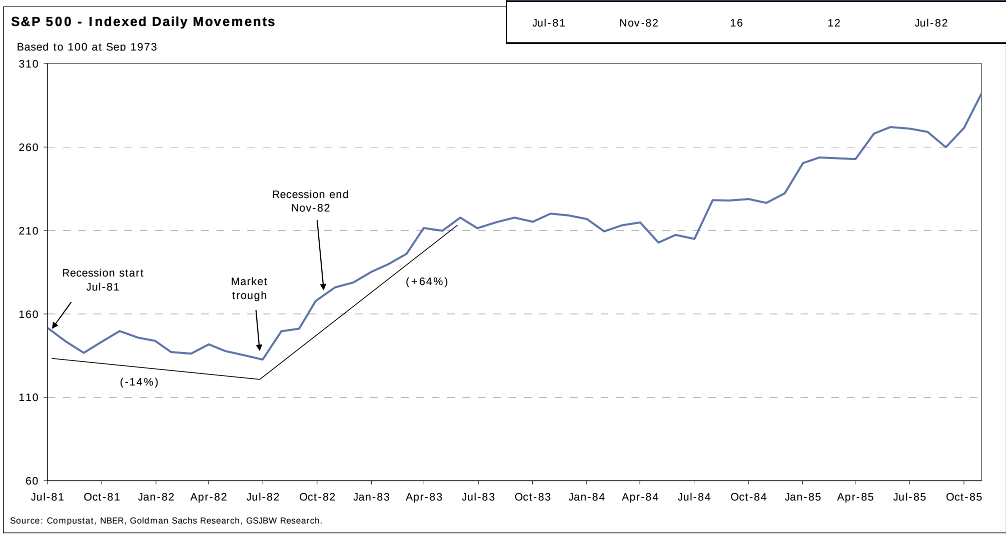
1981-82

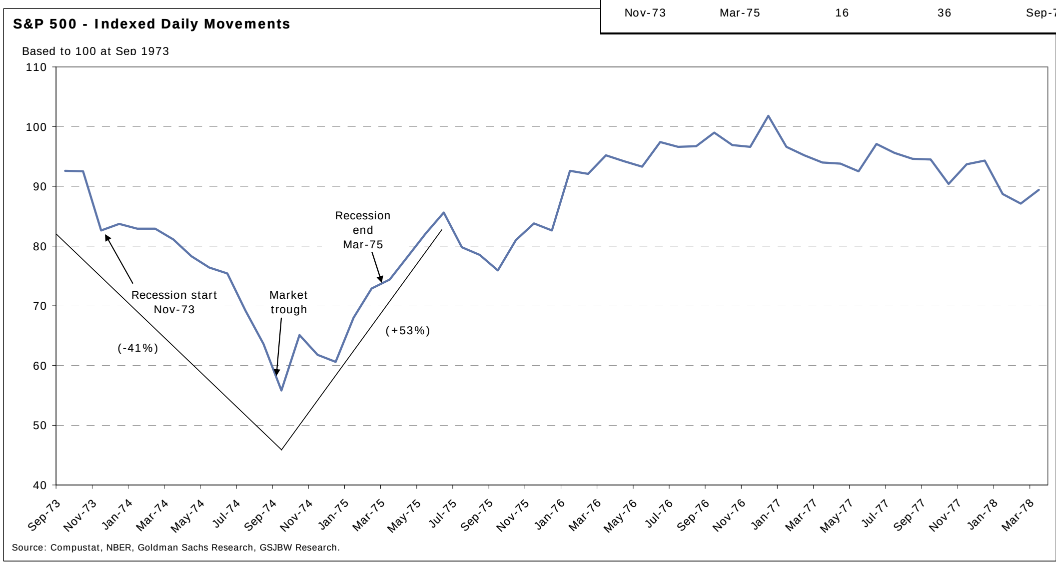
Economic peak	Economic trough	Contraction Peak to Trough (Months)	Expanison - Previous Economic Trough to Peak (Months)	S&P Trough	S&P Trough vs Economy (Months)
Jul-81	Nov-82	16	12	Jul-82	4 before



Source: Compustat, NBER, Goldman Sachs Research, GSJBW Research.

1974-75

Economic peak	Economic trough	Contraction Peak to Trough (Months)	Expanison - Previous Economic Trough to Peak (Months)	S&P Trough	S&P Trough vs Economy (Months)
Nov-73	Mar-75	16	36	Sep-74	6 before



Source: Compustat, NBER, Goldman Sachs Research, GSJBW Research.

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Through the quarter we have further reduced the portfolio's exposure to relatively expensive yet lower earnings risk names. This action was used to increase our exposure to high quality stocks where there is some increased short term earnings risk, but superior value. Such value will become increasingly obvious as the economic cycle begins to bottom and the market's time horizon lengthens.

"Separate and distinct things not to be confused, as every thoughtful investor knows, are real worth and market price." **'The Theory of Investment Value', Williams, John Burr. 1938 p. 3**