

Greencape Wholesale High Conviction Fund

Fund report and commentary – 31 March 2010

| Performance | Quarter (%) | 1 year (%) | 2 years (%) p.a. | 3 years (%) p.a. | Inception (%) p.a. |
|--|-------------|------------|------------------|------------------|--------------------|
| Greencape Wholesale High Conviction Fund | 2.96 | 43.96 | 5.13 | 5.11 | 12.14 |
| Growth return | 2.43 | 39.54 | 0.22 | -2.10 | 5.39 |
| Distribution return | 0.53 | 4.42 | 4.91 | 7.20 | 6.75 |
| S&P/ASX 200 Accumulation Index | 1.36 | 41.71 | -0.06 | -2.44 | 3.55 |
| Active return (net) | 1.60 | 2.25 | 5.19 | 7.55 | 8.59 |

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

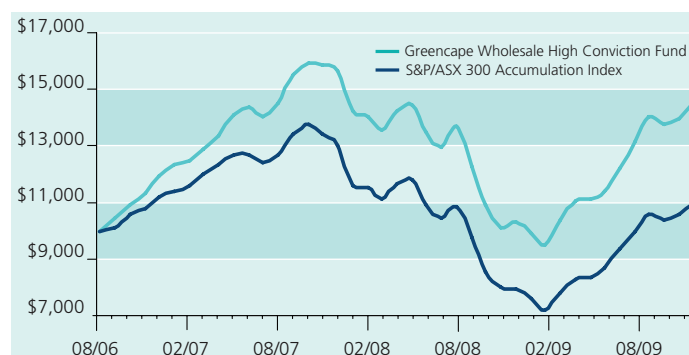
Quarterly

Suggested minimum investment timeframe

At least five years

Greencape High Conviction Fund

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

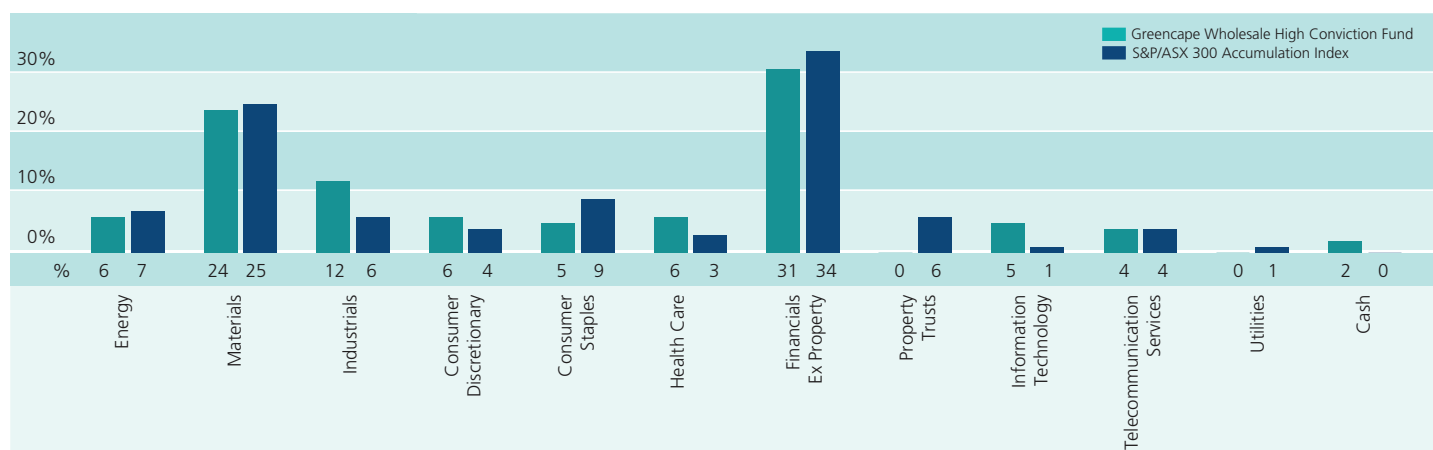


| Asset allocation | Current (%) | Range (%) |
|------------------|-------------|-----------|
| Securities | 96 | 85–100 |
| Cash | 4 | 0–15 |

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

| Fees | Greencape Wholesale High Conviction Fund |
|-----------------|---|
| Entry fee | Nil |
| 2008/09 ICR | 1.71% |
| 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% |

Sector exposures as at 28 February 2010

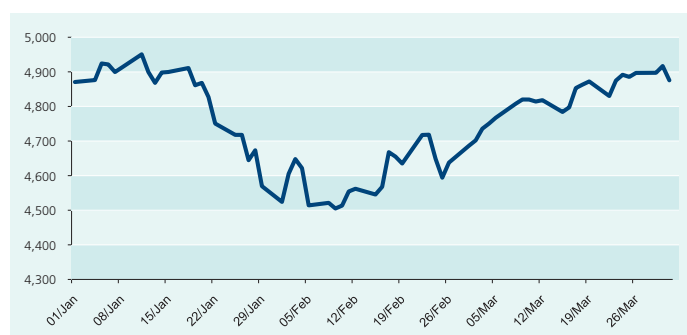


Market review

The S&P/ASX 200 Accumulation Index returned 0.6% for the quarter and 40.6% for the rolling 12 months. The Greencape Wholesale High Conviction Fund outperformed the market and delivered a 2.96% return over the quarter.

The market was steady in early January but then fell 8% from late in the month into early February as concerns were raised about Greece's government debt position, as well as the announcement of tighter credit conditions in China. The index then rose steadily throughout the second half of February and into March on better than expected reported company earnings and continued strong economic data.

S&P/ASX 200 Index



By sector the net movements for the quarter were relatively minor compared to recent history, with the healthcare sector performing the strongest. Healthcare's performance was driven by CSL's stronger than expected earnings result in February, which saw it up 12% for the quarter. Financials were led by the banks with ANZ and Westpac up 11% and 10% respectively. Utilities performance was driven by AGL, up 7%, which reported underlying earnings growth of 22% for the half.

Telstra (88% of the telecommunications sector) fell 13% (9% including the dividend) in the quarter after its half year result came in below market expectations and showed an accelerating trend in the decline of their fixed line revenues. Property trusts' modest fall was largely across the board with the sector falling less than market in January but then not participating in the market's recovery in March. Energy was slightly down for the quarter with Worley Parsons falling 12% after downgrading earnings guidance in January, offset by a bid by Shell to acquire Arrow Energy, which saw its shares up 21%.

| | March quarter | 1 year |
|------------------------------------|---------------|--------|
| Market (S&P/ASX 200 AI) | 1.36% | 41.71% |
| Best performing sectors: | | |
| Healthcare | 4.6% | 18.6% |
| Financials (excl. property trusts) | 3.3% | 53.7% |
| Utilities | 2.8% | 15.3% |
| Worst performing sectors: | | |
| Telecommunications | -9.0% | 1.2% |
| Property trusts | -1.5% | 40.6% |
| Energy | -0.2% | 23.5% |

Company visits and observations

- **China trip** – In March we again travelled to Korea, Hong Kong and mainland China, this time with a focus on the steel and construction industries to gain insight into underlying demand for Australian commodities, particularly iron ore and coking coal. We visited a number of steel producers, construction companies, banks, ship builders, auto manufacturers, the Australian consulate and consumer goods manufacturers. Some of our key observations were:
 - The Federal Government is well positioned to proactively manage economic outcomes – e.g. fiscal strength + ability to pull micro level levers quickly to restore balance (e.g. during the GFC a 30% interest rate discount was offered to property investors, which has now switched to a 15% premium!)
 - China is on its way to sustainable growth – the Government is using infrastructure development as a means to increase household wealth and stimulate household consumption. At the same time it is imposing restrictions on the pace at which heavy industry develops. Over time China's services based economy will be a more meaningful contributor to growth.
 - The Chinese steel industry remains structurally inefficient – the industry is very fragmented with a large number of subscale manufacturers who lack bargaining power in iron ore price negotiations relative to their scale peers. Whilst a slow grind, the Government appears to be taking measured action to close uneconomic capacity.
 - Large steel producers are able to pass on raw material price rises – particularly to auto and appliance manufacturers whose increasing scale is bringing manufacturing efficiencies.
 - Iron ore is likely to be priced beyond fundamental forces in the near term – stockpiling has occurred ahead of price negotiations as well as traders buying on the spot market in anticipation of higher future prices.
 - Quarterly benchmark pricing for iron ore is highly likely.
 - Chinese residential property market investment is likely to continue although the pace should slow in 2010 – prior to 1999 employers had an obligation to provide housing for employees which resulted in a lot of poor quality houses which are currently being replaced, along with new housing construction to cater for migration from rural areas to the cities. This thematic would appear to have a significant tail to it with little sign of a material fall in residential construction in the medium term.
 - Australia remains open for business – the Australian consulate highlighted that of the 140 Chinese applications made to the Foreign Investment Review Board (FIRB) in the past two years, none were denied outright and only five had preconditions requested.
- **TPG Telecom (TPM)** – In March shareholders of Pipe Networks approved the takeover bid by TPM. The acquisition gives TPM direct ownership of an underutilised backhaul network and international cable between Australia and Guam, which has now given TPM the ability to launch broadband plans with unlimited download capacity. TPM is currently the fourth largest internet service provider (ISP) but is growing organically at the fastest pace. It also offers consumers the cheapest plans by a considerable margin, yet has operating margins that are close to the highest in the industry, demonstrating its very low cost business model.

'... of the previous 28 of 30 centuries, China was the largest economy in the world, and the fact that it will be again by 2027 is merely a return to where it has been for most of the last 3,000 years.'

Richard Coppleson, GSJBW 13/01/09

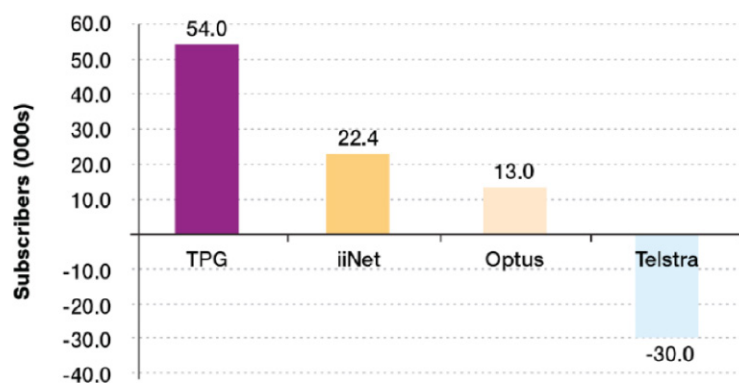
The table and chart below give an indication of TPM's industry position.

| | Fixed line Broadband Subscribers | ADSL 2+ Broadband plans | | |
|-----------|----------------------------------|-------------------------|--------------|------------------|
| | | Entry | Mid-range | Top plan |
| Telstra** | 4,300k | \$50 (2GB) | \$110 (50GB) | \$180 (200GB) |
| Optus | 1,016k | \$40 (4GB) | \$60 (21GB) | \$70 (90GB) |
| iiNet | 500k | \$30 (10GB) | \$50 (60GB) | \$130 (180GB) |
| TPG | 460k | \$30 (12GB) | \$50 (130GB) | \$75 (unlimited) |

*All plans above are with a home phone (excluding some Optus plans).

** Telstra charge for excess usage and charge a premium for unmetered ADSL speeds.

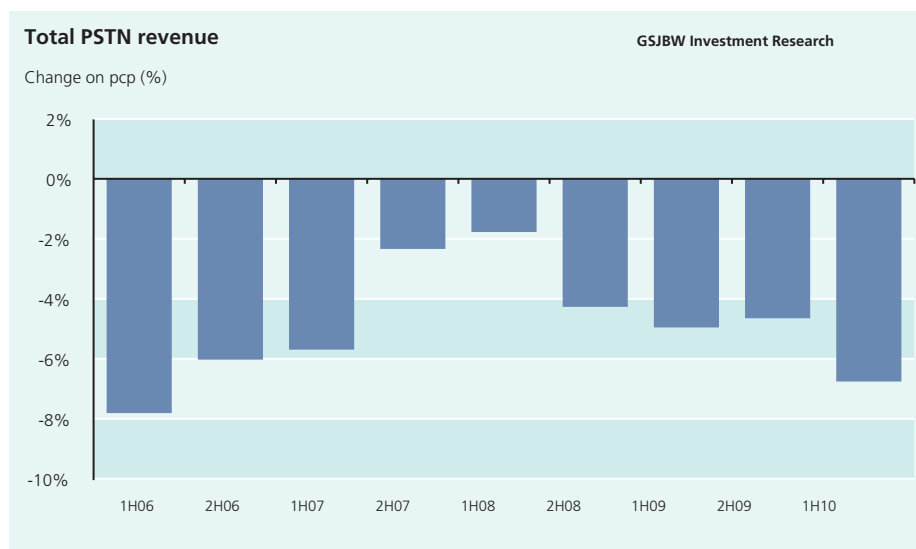
Fixed Broadband Subscriber Growth (in last 6 months reported*)



* TPG: Aug 09 to Jan 10 incl. Others: Jul 09 to Dec 09 incl.

Source: Published financial reports for Telstra, iiNet and Singtel TPG Telecom 1H-10 Results

- **Telstra** – In February Telstra reported earnings below market expectations, with revenue down 2.9% and EBITDA flat for the half. What was concerning from an investor's perspective was:
 - The re-acceleration of the decline in public switched telephone network (PSTN) revenues (fixed line voice, see chart following).
 - Loss of market share in both fixed line and wireless.
 - Internal IT system issues which delayed Telstra's response to competitor moves in mobile and broadband (we note that one of the key platforms of Sol Trujillo's turnaround plan over the last four years was implementing a new IT platform that would allow rapid and seamless deployment of new products).

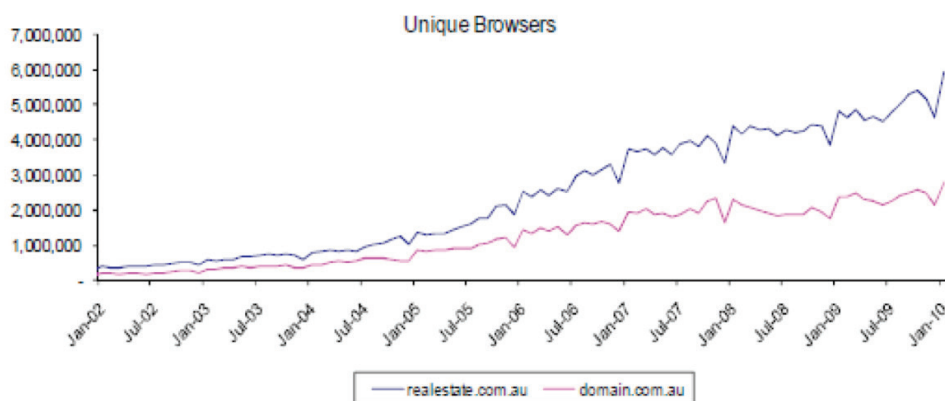


As shown by our comments regarding TPM, we feel that Telstra's price premium in the broadband market is unsustainable. Telstra are responding by offering package deals with broadband, home phone and Foxtel and signing consumers up on two year contracts. However competitors are also offering similar packages and we suspect prices will ultimately have to fall to come closer to competitor prices.

In mobile and wireless broadband it's a similar story, yet Telstra does have a strong coverage advantage and price differences are less transparent.

Given the accelerating PSTN decline, unsustainable price points in broadband/mobile and IT issues which will make it hard for Telstra to cut costs significantly in the near term, we find it hard to see how Telstra can meet the market's current earnings forecasts for flat to slightly increasing operating margins over the next two years. Although in the near term the market appears preoccupied with whether or not Telstra can negotiate a favourable deal with the government for the National Broadband Network.

- **REA Group** – REA run the realestate.com.au website as well as a similar website in Italy. In Australia REA have 95% of real estate agents (across residential and commercial property) as paying subscribers and in recent years have increased their dominance as the number one website.



Source: Nielsen Market Intelligent, REA Group

This market position is allowing REA to raise its prices for agents and is coinciding with a push to offer more 'value-added' products for agents (e.g. allowing local agent brand advertising when property seekers search by suburb).

'Think about pricing. What has every telco in the world done in the past? It's used confusion as its chief marketing tool. And that's fine... You could argue that that's how all of us keep calling prices up and get those revenues, high-margin businesses, keep them going for a lot longer than would have been the case. But at some level, whether they consciously articulate or not, customers know that's what the game has been. They know we're not being straight up.'

Theresa Gattung,
former CEO Telekom NZ, 20/03/06

Our discussion with suburban real estate agents showed that when vendors sell a property the typical cost passed on for internet advertising is \$400 versus print advertising which ranges from \$3,000 to \$10,000. Yet, anecdotally it's reported that c 50 – 70% of buyers will use realestate.com.au to find and research the property.

Morgan Stanley recently released a report¹ on mobile internet usage, in which they noted that internet usage take-up on mobile devices was occurring at a more rapid rate than fixed line internet was taken up in the 90's/early 2000's, and that the number of mobile devices is ten times as large as the number of fixed computers. We feel that the popularity of the iPhone will further entrench the likes of REA as people can access the website while out visiting properties, and hence the migration from print advertising to online will continue to play out. Products such as the Apple iPad may also help online players offer a product with a look and feel at least as good as property adverts in a glossy magazine or newspaper.

- **Toll Holdings (TOL)** – TOL reported its first half result in February which was below market expectations and the stock recorded its biggest one day fall (17.9%) since listing in 1993. Management attributed the following reasons for the poor result:
 - Weaker volumes, particularly in the retail sector which impacted their Australian business during the key pre-Christmas trading period. This resulted in fixed cost de-leverage and weaker margins.
 - Increased competition and an inability to push through price rises.
 - No net new business wins, together with minimal contribution from new businesses acquired versus previous periods.

TOL has historically traded at a P/E premium to the market, largely attributable to its strong acquisition track record. However TOL's expansion to date has been domestically focused, where TOL consolidated a number of mid-sized traditional line-haul and express transport businesses to emerge as the largest transport and logistics operator in Australia. Today 80% of TOL's earnings are generated from Australia but the current acquisition strategy focuses on Asia and in freight forwarding services. Observations on TOL's strategy and whether a market premium is still justifiable include:

- TOL's move into Asia is focused on building Asia-Australia trade lane capabilities given the shift of Australia's manufacturing base to Asia, although we note that the majority of freight forwarding decisions are made at the point of destination i.e. the importing company.
- Acquiring Asian businesses has also opened additional 'beach heads' for TOL i.e. Asia is now the world's manufacturing base and goods are exported globally. As an example TOL acquired BalTrans in 2008 (a Chinese based freight forwarder) which services the Asia-Pacific region, Europe and North America and in February acquired Summit Logistics, a freight forwarder with 30% of revenue derived from operations within the US.
- Freight forwarding businesses generally have lower margins versus traditional transport and logistics. The largest global freight forwarders EBIT margins range between ~2-5%, with scale and volume key to generating margins at the top-end of the range. As an example, in 2008, Panalpina (a top five global freight forwarder) generated \$CHF8.8b in revenue and an EBIT margin of 2.1%. Today TOL has ~\$A1.5 billion in freight forwarding revenue p.a. with a target to double this and TOL's EBIT margin at the half year result was 1.2%. Whilst also reflective of a point in the economic cycle, this raises the questions as to whether adequate returns are being earned relative to TOL's cost of capital.
- TOL's focus is on making earnings per share accretive acquisitions which is relatively easy to achieve when using cheap debt. TOL's return on equity (ROE) has fallen from ~high teens during TOL's Australia centric consolidation rollup to ~10% today. Investors should also remember that TOL wrote-off ~\$1.3b in shareholder value as part of its disposal of its interest in Virgin Blue which has the effect of raising the reported ROE.

'...[today] is truly a tipping point for role that the internet will play in the future'

John Chambers CEO Cisco, 08/03/10

'Organic growth is what leads to growth in the value of the company.... we are not reliant on acquisitions to fuel our growth. Organic growth is the hallmark of any quality business.'

Greg Kilmister, CEO Campbell Brothers, AGM 05/08/08

'One thing I've learnt with banks is that when you need debt from them you can't get it, and when you don't need any it's easy to get.'

Bevin Slattery CEO of Pipe Networks, 02/11/09

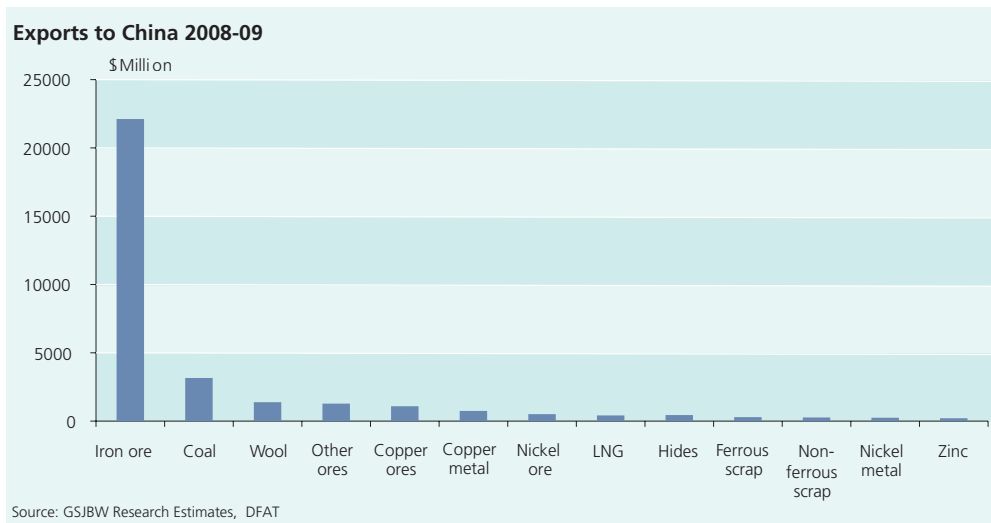
¹ *Mobile Internet Report, Morgan Stanley, 15/12/09*

The balance to the above points is that post the first half result, TOL now trades on a market multiple. With 80% of TOL's earnings generated from Australia and with emerging signs of a stronger macro outlook for the Australian economy, there is potential for TOL to experience a rebound in volumes and margins. Although we note that the market is anticipating this recovery.

Macro observations

China

Much has been written recently about whether China's economy has become overheated as a consequence of the Government's stimulus package in 2009 as well as high levels of property speculation. The concerns raised were the precursor to our most recent visit (see commentary above) where we focused on the implications to the steel industry given the importance of China to Australian exporters of iron ore and coal, as highlighted in the chart below.



Below we've summarised some of the risks that have been raised along with counter-arguments put forward by the 'China-bulls'.

| Risks | Counter arguments |
|--|---|
| – Credit conditions tightening in 2010 => risk of a sudden drop off in fixed asset investment | – Government target for RMB 7.5 trillion loan growth in 2010 still allows investment growth |
| – Chinese local governments have taken on considerable debt in 2009 to fund investments | – All debt has been funded from within China and therefore there is low risk that this causes a financial crisis |
| – Migration of rural workers to cities, which has driven infrastructure demand, is maturing | – China is only 60% urbanised and current and future infrastructure investment is going more towards regional 2nd and 3rd tier cities |
| – Early signs of inflation appearing, driven by wage pressure in coastal areas | – Temporary impact on food prices from snow storms and drought which should reverse |
| – Property speculation rampant with some prices in Beijing and Shanghai up c 70% in 12 months | – Limited to wealthy areas in major cities where owners typically purchase with large cash deposits |
| – Iron ore speculation by traders and corporates has left inventory levels high => risk of a lull in demand for Aus exports if destocking occurs | – Is a potential risk, but infrastructure investment to remain strong in 2010 and 2011 => demand for iron ore should remain robust |
| – China has misallocated capital by building vacant cities/shopping malls and bridges to nowhere | – Isolated examples in a huge economy but capital allocated at micro-level (local governments) and capital stock in China is still very low (chart below) |

'China has embraced capitalism to keep entrenched the socialist elites, whereas in the West we've embraced socialism to keep entrenched the capitalist elites.'

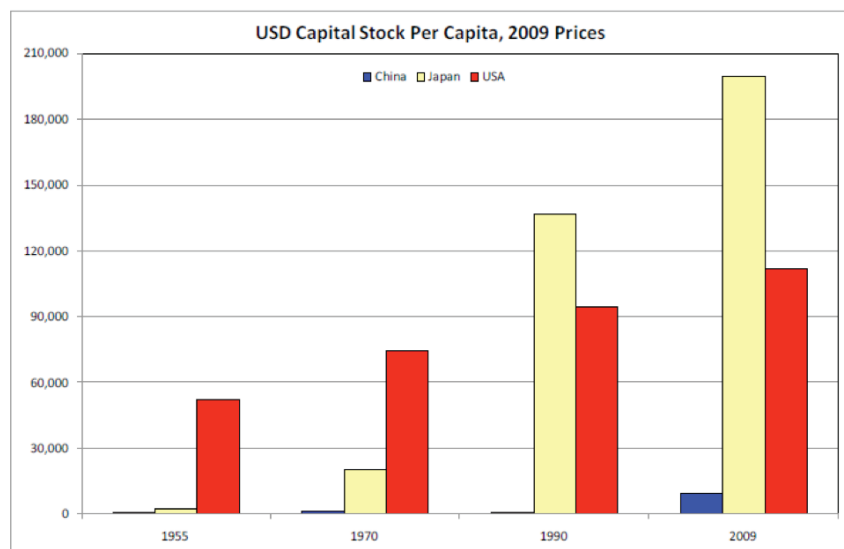
Jim Chanos, 02/02/10

'In the West we're always derisive about the ability of governments to get it right, given the ability for a small amount of people to make decisions about a complex economy, plus the leakages you get from inefficiency and corruption. Yet in China everyone seems confident that 9 guys in a room can get it right every time.'

Jim Chanos, 02/02/10

'... Chinese policymakers have mistakenly assumed a stable currency is essential for a stable economy, whereas it is really a source of instability in credit growth and investment rates.'

Birdgewater, 13/11/09



Source: DSGAsia 15/03/10.

Our view is that inflation is the key risk to watch in 2010, since higher interest rates may force greater credit tightening which would reduce infrastructure investment and hence lower demand for Australian commodities.

Australian house prices

Further to our write up in our September 2009 report, Demographia released their latest report on housing affordability² in which they compare a number of countries property markets with respect to affordability. Demographia classify any market with a median-price-to-income³ multiple of three times or more as 'unaffordable' and any market with a multiple of greater five as being 'severely unaffordable'. Their table below shows that of the 20 most unaffordable markets, Australia has 12 of them, including 10 that rank ahead of New York!

| Rank | Nation | Metropolitan market | Median multiple |
|------|----------------|---------------------|-----------------|
| 1 | Canada | Vancouver | 9.3 |
| 2 | Australia | Sydney | 9.1 |
| 3 | Australia | Sunshine Coast | 9.0 |
| 4 | Australia | Gold Coast | 8.6 |
| 5 | United States | Honolulu, HI | 8.2 |
| 6 | United Kingdom | Bournemouth | 8.1 |
| 7 | Australia | Melbourne | 8.0 |
| 8 | Canada | Victoria | 7.9 |
| 9 | Australia | Wollongong | 7.5 |
| 10 | Australia | Adelaide | 7.4 |
| 11 | Australia | Newcastle | 7.2 |
| 11 | United States | Santa Cruz | 7.2 |
| 13 | Australia | Darwin | 7.1 |
| 14 | Australia | Mandurah | 7.1 |
| 14 | United Kingdom | London (GLA) | 7.1 |
| 16 | Australia | Bundaberg | 7.0 |
| 16 | United States | New York | 7.0 |
| 16 | United States | San Fransisco, CA | 7.0 |
| 19 | Australia | Perth | 6.9 |
| 20 | Australia | Hobart | 6.8 |

² 6th Annual Demographia International Housing Affordability Survey: 2010, Ratings for Metropolitan Markets (Australia, Canada, Ireland, NZ, UK, USA).

³ Median house price divided by gross annual median household income.

'All of Australia's... markets, including smaller markets were 'severely unaffordable' (Median Multiple above 5.0) except Ballarat, which was 'seriously unaffordable' (Median Multiple between 4.1 and 5.0).'

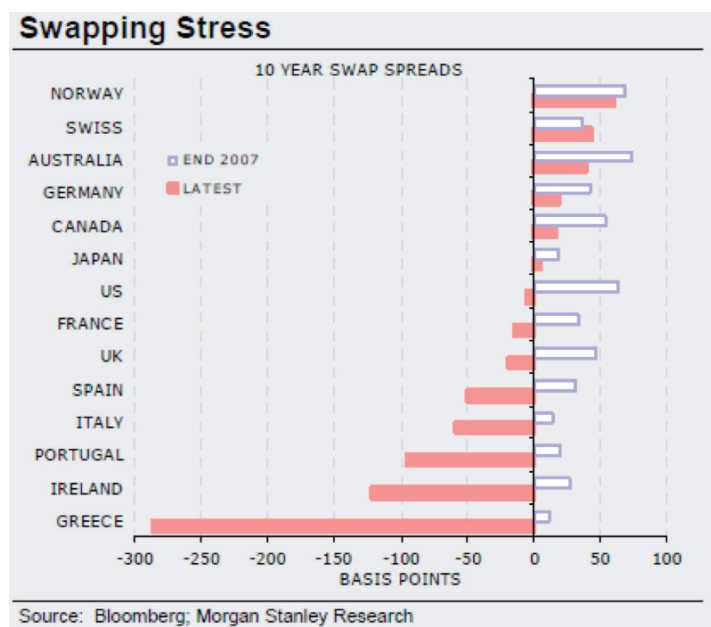
Demographia, International Housing Affordability Survey 2010

'For metropolitan areas to rate as 'affordable' and ensure that housing bubbles are not triggered, housing prices should not exceed three times gross annual household income. To allow this to occur, new starter housing of an acceptable quality to the purchasers with associate commercial and industrial development, must be allowed to be provided on the urban fringes at 2.5 times the gross annual household income of that urban market. The fringe is the only supply or inflation vent of an urban market.'

Demographia, International Housing Affordability Survey 2010

Sovereign debt costs > Swap rate

The chart below shows that the gap between the US 10 year Treasury note yield and the LIBOR swap has turned negative for the first time in history. This means that the US government borrowing cost is now greater than the headline inter-bank borrowing rate, due to market concerns of either credit risk or the quantity of future debt supply (or both). Morgan Stanley predicts this is a precursor for long-term interest rates to rise.



'Sweden's problems [in the early 90's] (and those of its neighbours Finland and Norway) were rooted in the normal culprits of financial liberalisation, leading to yawning current account deficits, excessive credit creation and real estate bubbles, eventually going into reverse.'

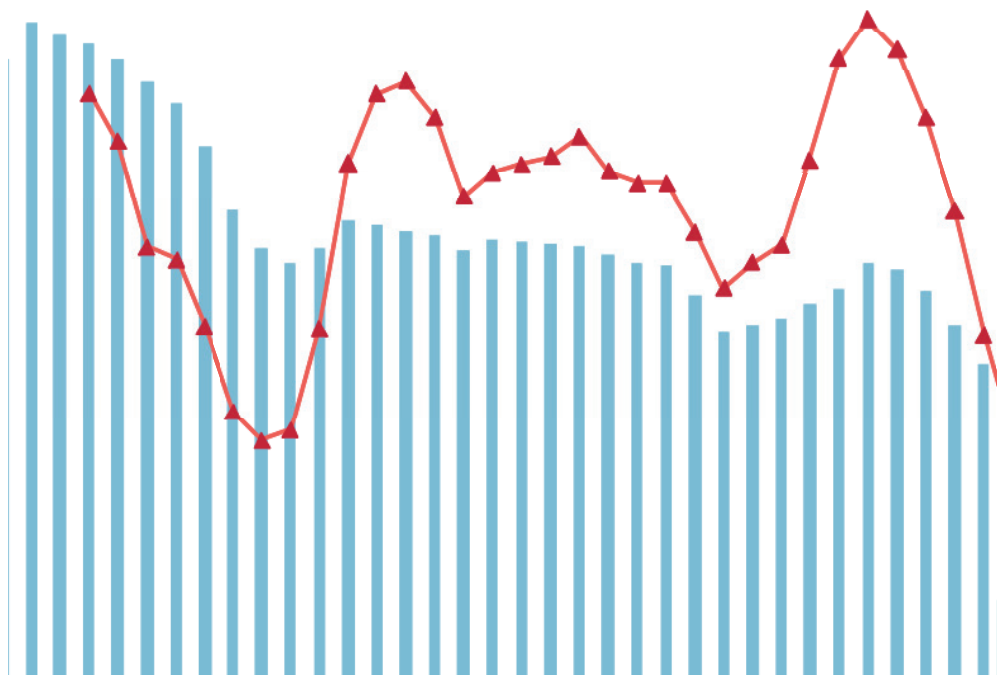
DSGAsia 22/09/08

'The United States bond market... the long term government bond market, that's the next bubble. Why? I mean would you lend money to the United States government for 30 years, at 4% or 5%, in US dollars??'

Jim Rogers, 12/10/09

US restocking cycle

US department store inventories are currently at multi-year lows which highlights that restocking has yet to impact supply chains. It also highlights the caution evident in consumer discretionary retailers.



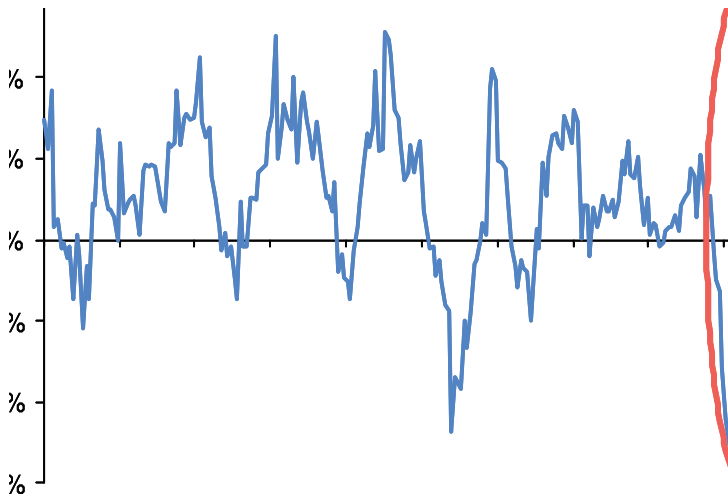
Source: Morgan Stanley Research

'There is no reason to believe that the rating agencies will do a better job on sovereign risk than they have done on corporate or structured finance risks... Their main role, again, appears to be to tell everyone that things are fine, until a real crisis emerges at which point they will pile-on credit downgrades at the least opportune moment, making a difficult situation even more difficult for the authorities to manage.'

David Einhorn 19/10/09

In addition, strong use of air freight into the US also highlights the low inventory levels in consumer discretionary supply chains in the US with air freight being used to order goods just-in-time rather than take a risk that goods may not sell by holding high stock levels.

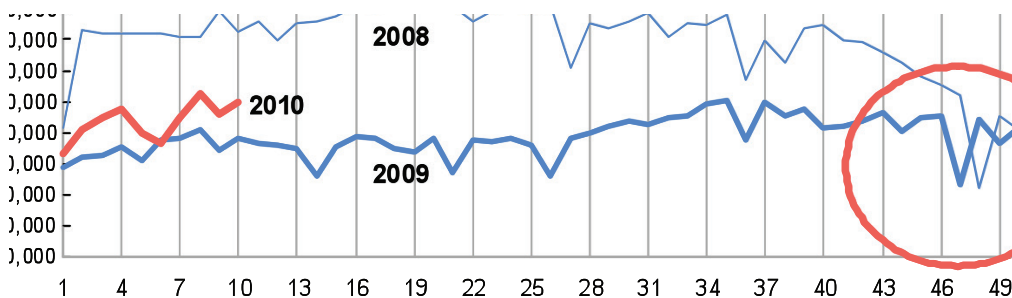
International Revenue Ton Miles



Source: ATA, Morgan Stanley Research

US rail data illustrates that activity levels are off the lows of 2009 but still significantly below the levels of 2008. This further demonstrates the structural shift in destocking post the GFC.

US Rail Activity for Commodities, Excluding Coal and Agriculture



Source: AAR Traffic Data, Morgan Stanley Research.

'A democracy will continue to exist up until the time that voters discover that they can vote themselves generous gifts from the public treasury. From that moment on, the majority always votes for the candidates who promise the most benefits from the public treasury, with the result that every democracy will finally collapse due to loose fiscal policy...'

Alexand Raser Tytler, 1770

'... all the Fed's purchases and all the government's men can't put the residential [US] real estate market together again.'

Caroline Baum, Bloomberg, 25/03/10

Outlook

In general, global economic data seen in the first quarter 2010 appears to have validated market moves to date. While the market looks reasonable value based on FY11 earnings expectations, meaningful top line growth is a precondition for these to be met. In particular, the significant cost out programs enacted over FY09 will mean margin expansion will be a key feature as revenue growth resumes. The by-product of this, of course, is that the cushion to earnings from cost extraction that existed 18 months ago no longer exists – i.e. operating leverage works both ways. While on balance we consider 'unmanageable' global economic shocks less likely going forward, this is still a real risk, and indeed a risk that we want to price into market forecasts.

If you take market earnings expectations for FY11 as a given, then on an un-risked basis the market looks reasonable value to 5,500 (S&P/ASX 200). But key risks include a sell off in global long bonds (but particularly US bonds) while domestically continued increasing short-term interest rates could work to stymie growth.

Looking further ahead meaningful market returns looking increasingly difficult as global economies start to digest the huge toxic debt balances which for the most part have simply been transferred from private to public hands.

'While most accept that those who forget the mistakes of history are doomed to relive them, few appreciate just how short people's memories really are. Since even those remembering such mistakes seem to repeat them, it is likely that history's mistakes will repeat indefinitely whether remembered or not.'

Peter Schiff 23/06/04

'Catalysts are only ever visible in hindsight; otherwise they'd be factored into asset prices..... on all our best shorts we've been early'

Jim Chanos, 02/02/10

'The stock market serves as a relocation center at which money is moved from the active to the patient.'

Warren Buffett, 1992



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