Greencape Broadcap Fund

Quarterly report - March 2024

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	5.40	15.36	7.96	10.47	9.51	11.65	9.62
Growth return	5.01	9.17	0.75	4.20	2.33	5.04	3.27
Distribution return	0.38	6.19	7.21	6.27	7.19	6.61	6.36
S&P/ASX 300 Accumulation Index	5.43	14.40	9.46	9.16	8.27	9.89	6.99
Active return^	-0.03	0.96	-1.50	1.32	1.24	1.75	2.63

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'.

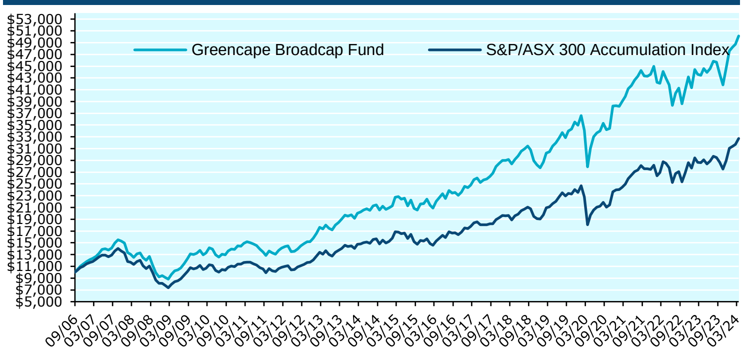
Distribution frequency

Quarterly

Suggested minimum investment timeframe

At least five years

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



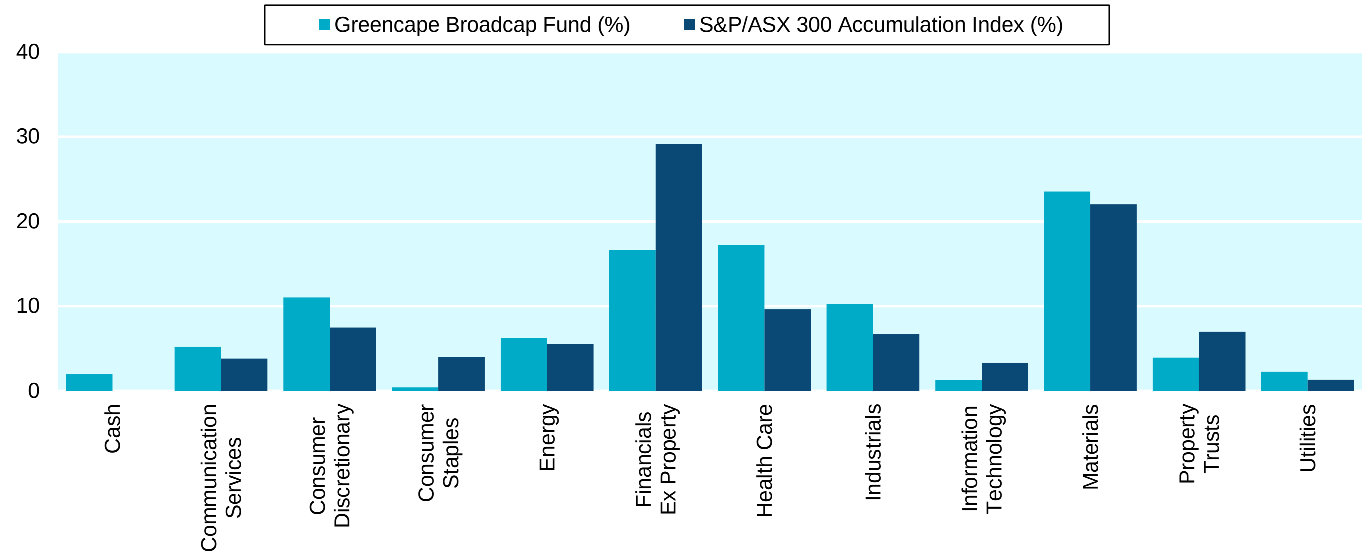
Asset allocation	Actual %	Range %
Security	98.04	85-100
Cash	1.96	0-15

Fund facts	
Inception date	11 September 2006
APIR code	HOW0034AU

Fees	
Entry fee	Nil
2022-2023 ICR	0.95%
Management fee	0.95% p.a.
Performance fee	15% of the Fund's daily return (after fees and expenses and after adding back any distributions paid) above the Fund's Performance Benchmark (the daily return of S&P/ASX 300 Accumulation Index).
Buy/sell spread	+0.20% / -0.20%

Data Source: Fidante Partners Limited, 31 March 2024.

Sector exposure as at 31 March 2024



Data Source: Fidante Partners Limited, 31 March 2024.

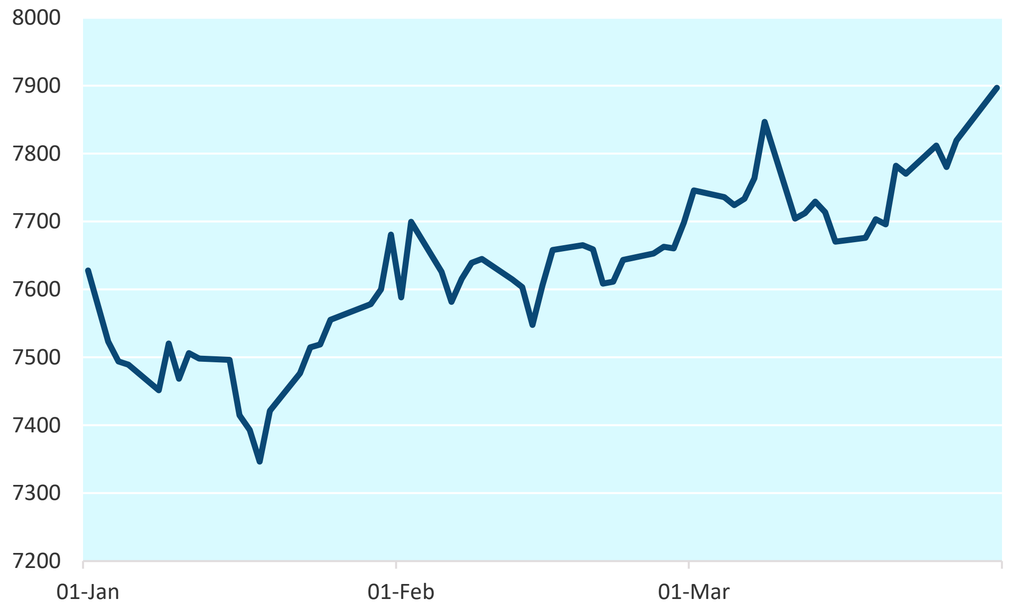
Fund performance summary

The S&P/ASX 300 Accumulation Index returned +5.43% for the quarter. The fund underperformed the market and delivered a +5.40% return over the quarter.

Market overview

The local market carried the momentum of 2023 into the new calendar year, with investors becoming increasingly comfortable with the economic outlook as interest rate cuts finally begin to come into view. Australia's attention was split between Taylor Swift and Reporting Season, with both events exceeding expectations.

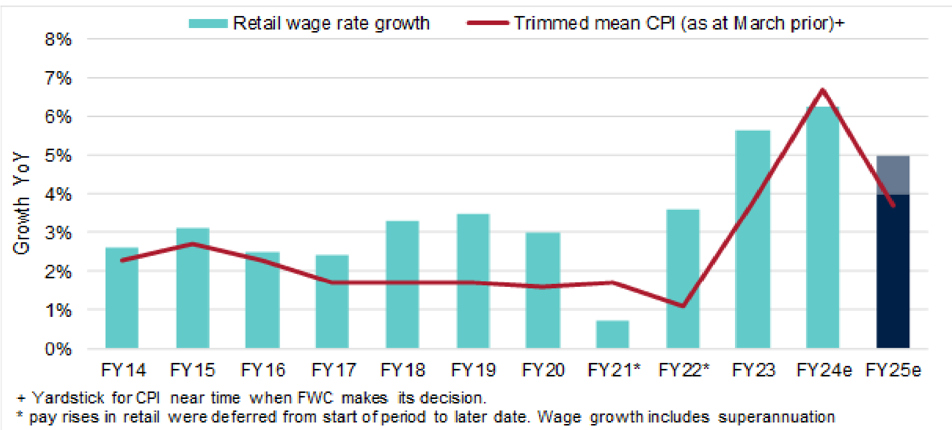
S&P/ASX 300 Index



Source: IRESS

After raising rates in November, the RBA opted to leave interest rates unchanged at both meetings held during the period. In the minutes released following the March decision, the RBA called out easing momentum in inflation, mainly driven by moderating goods prices. The futures market currently implies there will be up to 2 rate cuts by the end of the year, with the first cut not fully priced until the November meeting.

A consideration for the outlook is the looming Fair Work Commission (FWC) minimum wage decision, which typically drives wage rate increases across the wider economy. As per the chart below, the FWC typically look to increase the wage rate above inflation so there is *real* wage growth. Given inflation is forecast to be around 3.5% at the time of the decision, the minimum wage rate should therefore be somewhere in the vicinity of 4%. Adding in superannuation, this means that all else being equal that wage costs should rise between 4% and 5% in FY25. Businesses will therefore need to generate strong revenue growth (or reduce other costs) to maintain profitability.

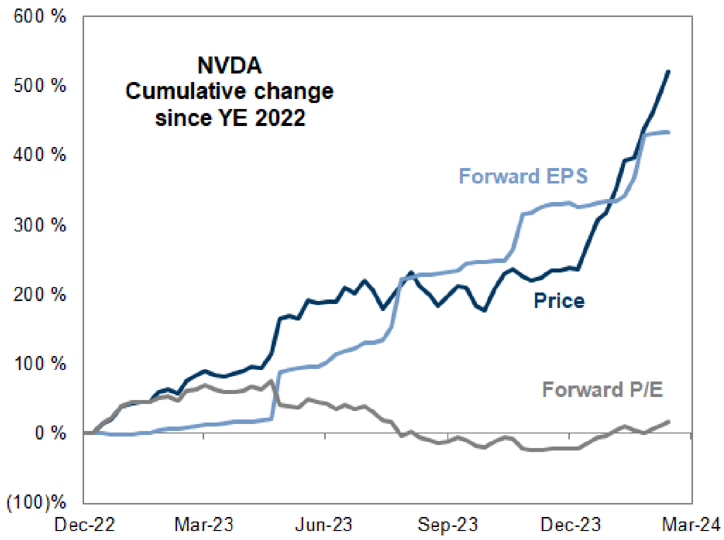


Source: MST Marquee

"I'm pretty glass full. Inflation seems to be coming under control and central banks seem to be getting to a point where they can now reduce rates later this year and deliver that elusive soft landing that really none of us were forecasting." Shemara Wikramanayake, Macquarie Group CEO, 11/03/2024

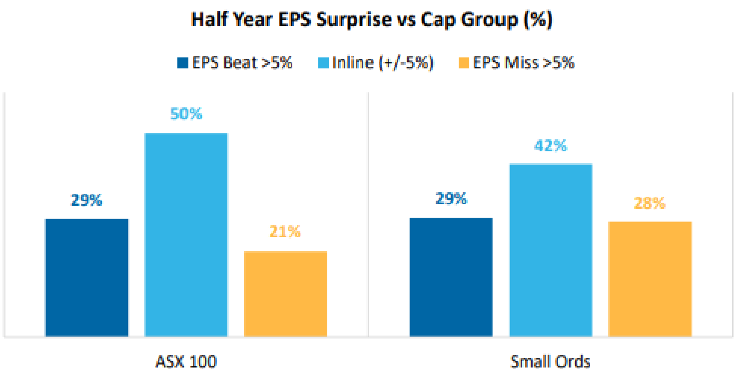
Elsewhere, data out of the US continued to be supportive of a soft (or no) landing as the closely watched Personal Consumption Expenditures (PCE) deflator reading for February came in marginally below expectations. Whilst rate cuts sometime later in the year are almost assured, the timing continues to be pushed out. The market is now fully pricing in a rate cut by September, out from an expectation of a May cut at the beginning of the year.

The hype cycle around AI showed no signs of slowing during the quarter, with Nvidia's quarterly result being the most anticipated set of earnings in some time. The company managed to surpass the high bar set by the market, delivering another beat and upgrade. Whilst the share price rally in the stock may suggest the company is trading on an eye-watering multiple, the rally has been driven by earnings upgrades, with the earnings multiple remaining relatively flat.



Source: Goldman Sachs

In Australia, February brought with it the bi-annual reporting season. Results were better than expected, with more earnings beats than misses and large caps delivering better results versus consensus relative to small caps.



Source: Macquarie

Tech stocks performed well during the period, as the AI thematic buoyed sentiment in the space globally. Also adding to sector performance was Altium, a developer of Printed Circuit Boards who announced it had entered an agreement to be acquired by a Japanese firm at a 31% premium to its previous all-time high.

Property Trusts also fared well, largely driven by a positive result from Goodman Group. At the company's February update, the company highlighted strong progress in their data centre development strategy, having now secured over 2GW of power, with another 2GW in advanced stages of procurement. Data centres under construction now represent approximately 37% of the company's Development WIP.

"But, ultimately, we do think that financial conditions are weighing on economic activity, and we think you see that in—a great place to see it is in the labour market, where you've seen demand cooling off a little bit from the extremely high levels." Jerome Powell, Chairman of the Federal Reserve, 20/03/2024

	QUARTER	YEAR
ASX300 Accumulation Index	5.4%	14.4%
Best Performing Sectors		
Information Technology	23.6%	48.3%
Property Trusts	16.2%	35.4%
Consumer Discretionary	13.4%	24.7%
Worst Performing Sectors		
Consumer Staples	2.1%	-3.9%
Telecom Services	1.1%	7.7%
Materials	-6.3%	0.5%

Source: IRESS

Materials fell during the period on the back of lower commodity prices. The most notable move was Iron Ore, which retreated 40% in the quarter. Lithium, which fell as much as 84% from peak to trough, staged a small comeback closing the quarter up 7%. M&A activity was also a feature in the sector, with CSR agreeing to a takeover by Saint-Gobain for a 33% premium to its closing share price ahead of the announcement.

Elsewhere in commodities, supply issues in West Africa have caused a huge spike in the Cocoa price. It's expected that this will be reflected in product prices in the second half of the calendar year.

Source: The Daily Shot

Offshore Trips

During the period we travelled to the US twice in addition to a trip to China.

US observations:

- We met with a number of large companies with broad exposures across consumer demographics. A consistent theme was a 'sequentially improving' sales environment. There was a marked improvement in sentiment compared to our previous visits in late 2023.
- The online sports betting market in the US is increasingly looking like it will evolve into a duopoly between FanDuel and DraftKings. Despite challenger brands launching in various states with aggressive incentives, the observation has been that customers will generally default back to the operators with the best product. This is similar to what has occurred in Australia.
- We attended Nvidia's GTC conference in San Jose, California. Interest in the space is high, with the 18,000 seat arena full for CEO Jensen Huang's keynote address.
- Short term demand for compute product remains incredibly firm, with wait times of over 6 months being spoken about by customers down the value chain. Longer term, it is clear we are still in the early innings of Generative AI, with companies in sectors such as Healthcare and Telecom speaking to how they are only just now exploring the potential use cases within their respective fields.
- Nvidia can be expected to take an even larger percentage share of incremental spend, with the company highlighting progress on creating a full AI software ecosystem for customers, rather than just simply selling the GPU.

"We're currently training our next-gen model Llama 3, and we're building massive compute infrastructure to support our future roadmap, including 350k H100s by the end of this year -- and overall almost 600k H100s equivalents of compute if you include other GPUs." Mark Zuckerberg, CEO and Founder of Meta, 19/01/2024

China observations:

- First quarter GDP growth is expected to be muted. Whilst there is scope for the government to undertake both fiscal and monetary stimulus, visibility on the size and shape of any intervention is extremely limited.
- Sentiment in the property sector remains weak, with transaction volumes continuing to languish with inventories remaining above historical averages. Despite softer prices, affordability is still cited as a key issue.
- The economy continues to experience a mix shift from old-world property and infrastructure to new-world consumption and innovation. This is potentially positive for base metals such as Copper, which is a key input into Electric Vehicles and appliance manufacturing.
- The drivers behind short term movements in the lithium benchmark indices appear financial/speculator driven and not representative of fundamentals. This dynamic suggests that momentum is the key driver in the short term, with the potential for a sharp rally to occur if traders gain confidence that the price has reached a bottom.

"Iron ore is our biggest export to them and the price of that obviously impacts the income of the resource sector and that's important for the national income of the country. China is facing significant headwinds, they have set themselves a growth target next year of 5 per cent – the question is whether or not they can meet that target. It is a concern. It's something we're watching very closely." Michele Bullock, Governor of the RBA, 19/03/2024

ALS Limited (Stock code ALQ)

ALQ is a company we've been following prior to the inception of Greencape Capital, when it was formerly a business division within the Campbell Brothers Group. The business operates in the Testing, Inspection and Certification (TIC) industry alongside large international competitors such as SGS, Bureau Veritas and Eurofins. Although in comparison to its competitors, ALQ's business is much more focused on Laboratory testing and has a much larger weighting towards commodities which is currently ~ 60% of group earnings. The remaining 40% of earnings comes from the Life Sciences division, which management is currently focused on bolstering with bolt-on acquisitions to reduce the earnings volatility of the group that is inherent from the commodities division.

Our investment decision – The ALQ share price has been rangebound over the past three years (first chart below) despite delivering an average of 10% EPS growth p.a. over the last 2 years. The predominant reasons for this in our view was due to the declining sample volumes from Junior miners/explorers during this time as well as the performance of ALQ's acquisition of Nuvisan, both of which are discussed in more detail below. During this time ALQ's 1 year forward P/E derated from 25x to 19x at the time of writing, which we view as attractive for a global leading business that generates a Return on Equity (ROE) in excess of 20%, and where a large proportion of earnings are at what we believe to be cyclical lows.

ALQ share price

Source: Iress

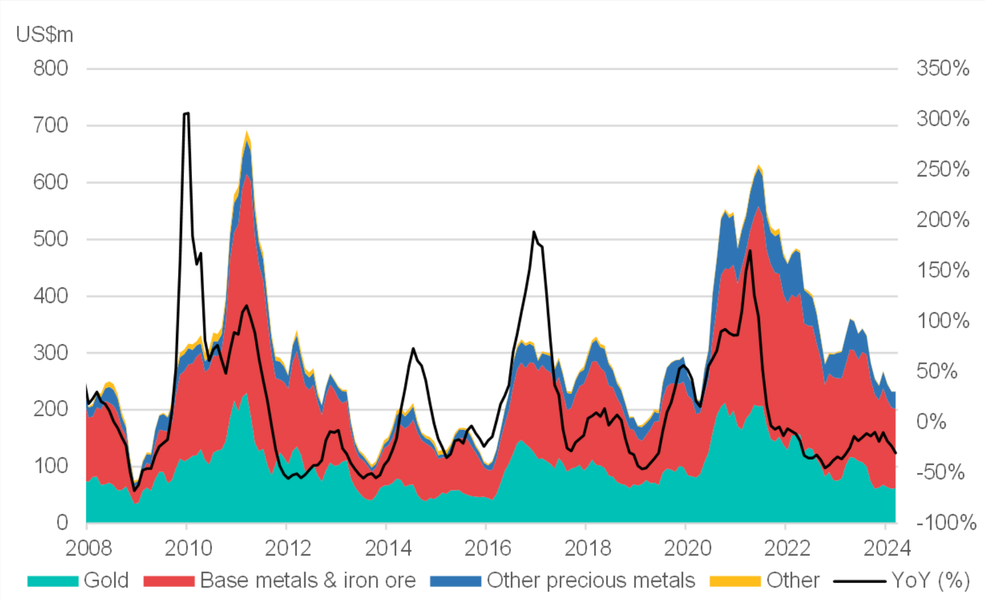
During the quarter we increased our position in the company at an average price of ~$12 per share. Our decision was premised on management's continued demonstration of their ability to outperform the commodities cycle, combined with the potential for a cyclical recovery on the back of rising Gold and Copper prices. In the Life Sciences division we felt the market's focus on Nuvisan's weak performance was obscuring the value of both the call and put options management had for the remaining 51% of the business that they did not own (more detail below), as well as the strong performance of the Life Sciences division outside of Nuvisan. In short, the market was looking backwards and putting the group on a low P/E at cyclically depressed earnings.

Commodities division – The largest business within the Commodities division is Geochemistry, which is a global network of laboratories that tests for minerals in drilling core samples received from miners and mining explorers. Our channel checks suggest that ALQ's sample turnaround time, accuracy and pricing is on par with competitors, however one of ALQ's core competitive advantages is the global software platform it's labs sit on, which allows clients to see globally consistent results across their operations through one interface. This system also supports ALQ running of a 'hub & spoke' model which allows them to direct samples to their labs that are best suited to perform each test (e.g. group similar tests to one site where scale efficiencies are gained through automation), hence delivering them a margin advantage. This system contrasts with ALQ's competitors where the equivalent Geochemistry business in each country/region reports to that country/region's head, rather than as part of a global Geochemistry business. The evidence of ALQ's success here is a global exploration market share that has now increased to greater than 50% and an EBIT margin of ~30% vs competitors' margins in the mid-teens.

Of the exploration market, Junior miners can make up anywhere between 20-40% of the drilling sample volumes (Majors the balance), with Juniors currently towards the low end of that range. Their effect on revenue is typically greater than this percentage given higher average prices paid vs Majors. By commodity, Gold is currently around 40% of exploration spend, and Copper (the bulk of the red section in the below chart) around 25%. With Juniors' obtaining their funding for exploration drilling primarily from equity capital raisings, the chart below gives an overview of the decline in Juniors' funding since the 2021 peak. Whilst the current equity raisings shown in the chart below looks in line with the 2016-2020 average, we note there's been significant cost inflation since that time, and hence a dollar raised today gives less drilling metres than it did 5 years ago.

"The growth agenda is strongly supported by megatrends, such as the clean energy technology transition, increased outsourcing from our clients, increased regulations and enforcement from authorities and increased demand for sustainability-linked services." Malcolm Deane, CEO of ALQ, 13/11/2023

Global Junior Equity Raisings (rolling 6 months)



Source: Bloomberg

Looking forward however, the recent move up in Gold and Copper prices (see charts below) is a promising lead indicator for future Junior equity raisings. Whilst forecasting the Gold price is beyond us, we are very positive on the outlook for Copper over the next several years. Copper demand is being boosted from the ‘green energy revolution’ and subsequent electrical grid investments required globally to support it, as well as from new Data Centre power requirements to support the Artificial Intelligence arms race. Some analysts are forecasting Data Centres alone could add as much as 0.5-1.0% points to global Copper demand, vs average annual demand growth of ~2.5% over the last 40 years. In addition to the improved demand outlook, there has recently been several production downgrades by copper mines, highlighting the inherent difficulties in copper mining and bringing on new supply.

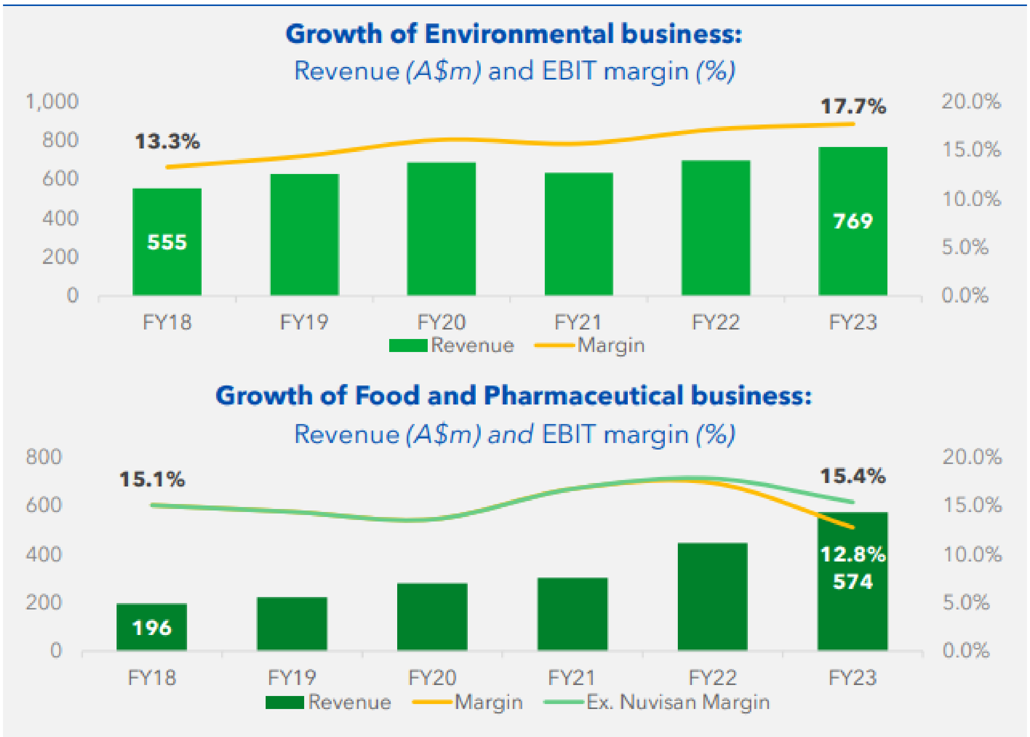
Gold Price per ounce (USD)

Source: Iress

Copper Price per pound (USD)

Source: Iress

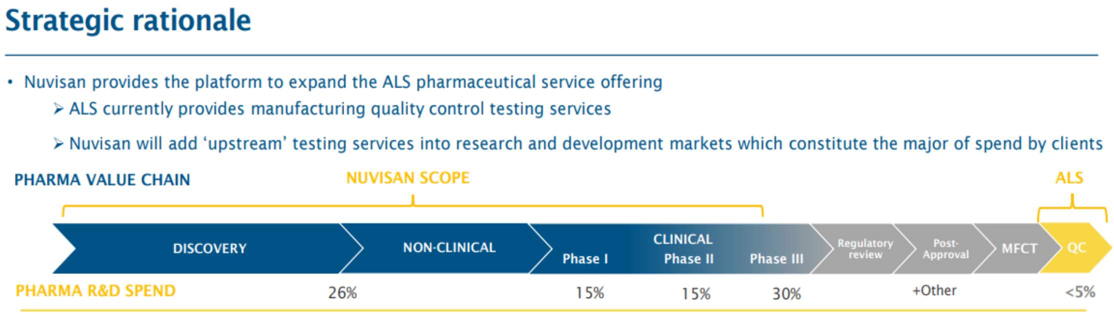
Life Sciences division – Within this division the Environmental business is the largest, followed by Food and then Pharmaceutical, all of which offer a broad range of laboratory testing to clients. The competitive advantage here is lower compared to the Geochemistry business in our view, although management have said they are applying Geochemistry learnings to the Environmental business now that it has reached global scale. The chart below gives an overview of the historic steady growth and margin improvement in this division, noting that bolt-on acquisitions have boosted the Food and Pharmaceutical revenue during this time.



Source: Company reports

Each of the businesses in this division are supported by global megatrends such as increasing regulation and new contaminants being found. An example of the latter is PFAS, which are a group of over 10,000 synthetic chemicals that have historically been used on a wide range of applications including fire retardant and consumer products. PFAS are also referred to a 'forever chemicals' and have infiltrated water ways, and food supply chains globally. Hence, there's growing regulation to test for them which is helping to boost the growth outlook for the Life Sciences division.

Nuvisan acquisition – In July 2021 ALQ announced the acquisition of 49% of Nuvisan for €145m, with a call option on the remaining 51% at a 13x trailing EBITDA multiple. The deal structure also gave ALQ downside protection with a put option to sell back their 49% stake. The strategic rationale at the time of the acquisition was to move ALQ further upstream in the Pharmaceutical business as outlined in the following excerpt from their acquisition presentation.



Source: Company reports

Since the time of acquisition, Nuvisan's earnings have been in decline and have dragged on ALQ's group earnings. For context, Nuvisan was only 4% of group earnings when acquired, which has since declined to zero. Whilst ownership of Nuvisan to date has been disappointing, the structure of the deal allowed ALQ to take ownership of the remaining 51% of Nuvisan for nil consideration. And under full ownership ALQ now has the ability to implement the €25m cost out program it recently announced along with other improvements it was unable to do as a minority shareholder. In any event, we think this announcement removes the Nuvisan uncertainty overhanging the share price and expect it to no longer be a source of earnings or sentiment drag on the stock.

Overall, ALQ is an example of a high quality company and management team that we've been able to purchase opportunistically given some temporary factors which we expect in are the process of reversing.

"Nuvisan is positioned to benefit from any expected or potential market recovery, complementing ALS's organic growth outlook. With full control and refocused business development efforts in key markets, we have a defined pathway to grow the business and improve profitability." Malcolm Deane, CEO of ALQ, 25/03/2024

Outlook

The market managed to digest cautious and, in some cases, vague outlook commentary from reporting season reasonably well. Sentiment has predominantly been driven by expectations of rate cuts following pockets of weakening economic data and inflation over the Christmas period. More recently however, the commentary from central banks has been more balanced with respect to rate cuts. Indeed, the mantra from central banks globally is that they are 'data driven'. To that point, with recent data showing inflation has stabilised to just above the top end of target ranges, the market has adopted some concern that rate cuts this calendar year are no longer a foregone conclusion.

At Greencape, we are conscious of macro turning points. We deal with these turning points through positions in the tails of our portfolios, whilst our core positions are driven by bottom up conviction. Macro sentiment swings often create attractive opportunities to top and tail these positions, which we are finding today.

"We're making progress in our fight against inflation, but it does remain high. What we need is greater confidence that inflation will return to the target band in a reasonable timeframe and will stay there. The war isn't yet one, so we continue to be vigilant." Michele Bullock, RBA Governor, 19/03/2024

More information

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

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