

June 3, 2016

Dear clients and colleagues,

Recently we spent two weeks in Australia attending an investment conference and visiting companies in Sydney and Melbourne. The Macquarie Australia Conference is the largest conference of its kind in Australia. Over 100 companies and 800 investors participated this year – a record high. The overall sentiment of conference attendees was cautiously optimistic, despite the mining slowdown. Actually, many foreign investors found the economy more resilient than expected thanks to a low oil price, low interest rates and an increase in inbound tourism and immigration. There are clearly differences across the various regions of Australia. Simply put, the boom in Sydney and Melbourne has offset the gloom in Perth, Darwin and Brisbane. We saw many Asian tourists, on-going infrastructure projects, and rising condominiums.

This week's Q1 GDP data are consistent with our personal experience. Australia's economy grew 3.1% year over year, exceeding estimates of 2.8%. Expansion was driven by a 4.4% jump in exports and a 0.7% increase in household spending. This year, the price of iron ore rebounded thanks to higher demand from China. In April the unemployment rate dropped to a two-and-a-half-year low of 5.7%. Although the Q1 GDP picture seems rosy, we believe that it will not be easy for Australia to diversify from a commodity-based economy.

Australia accounts for 2.3% of the MSCI World Small Cap Index and 5.9% of MSCI EAFE Small Cap Index. We are still very conscious of the growth challenges facing Australia and therefore invest in a few niche leaders. These companies are all in large and growing industries with a strong competitive edge, focused growth strategy, experienced management and solid balance sheet.

We met a total of 24 companies during this trip, of which 3 are holdings in our portfolios: Greencross, Burson and Perpetual. Visits to Greencross and Burson stores further enhanced our confidence in these companies.

This week we would like to profile Greencross, a position that was initiated in our portfolios last year. Its stock price reached a 52-week high today. Year to date +17.8% versus +0.4% for the ASX 200.

Greencross Limited (GXL AU – A\$ 7.89)

www.greencrosslimited.com.au

Business Overview

Founded in 1994, Greencross is the number one pet care specialist in Australia, providing both retail and veterinary services. It has over 220 retail stores operating under the brand names Petbarn and City Farmers in Australia and Animates in New Zealand. In addition to selling pet food and accessories through its store network and online platform, Greencross offers a wide range of pet services including grooming, dog washing, obedience training and pet adoption. It owns and operates Australia's largest network of veterinary practices with over 150 clinics which include general practices, speciality and emergency centres, pathology labs and pet crematoria.

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Target Market

The pet care market size in Australia and New Zealand is about A\$9 billion, growing at approximately 3% per year and supported by demographics and social trends such as the humanization of pets and premiumisation. It is the second largest pet care market in the world behind the USA.

Australia has one of the highest rates of pet ownership in the world. About 63% of Australian households own a pet. It is estimated that there are more than 25 million pets in Australia, including 4.2 million dogs and 3.3 million cats.

ESG

Greencross recognizes that corporate responsibility is an essential factor to the long-term success of its business. For example, its carbon footprint is kept to a minimum through programs such as “Greening Greencross”. It respects human rights and aims to create a work environment that is positive and safe for all employees while ensuring an optimal level of customer service. It supports local communities through charitable contributions and by sourcing local products and employing local people.

The management team is very experienced and together owns about 3% of the company. Two out of five board directors are independent.

Market Data

Market Cap A\$901M, Net debt/EBITDA 2.5x, Dividend Yield 2.3%, P/E (2017/6) 17.5x, Ev/Sales 1.3x, Ev/EBITDA 9.8x, Gross Margin 55.5%, EBITDA Margin 12.7%, Profit Margin 5.0%, ROE 9.3%.

Competition

It is a very fragmented market. Greencross is the number one player with about 8% market share. Its retail business is larger than the next four largest competitors combined. It’s the same for its veterinary business; it is larger than the next four largest competitors combined.

Competitive Advantages

- Excellent reputation.
- Extensive network with 1.8 million active customers.
- Unique co-location model: retail plus veterinary services.

Growth Strategy

- Distribution: More store openings. Since the merger of its retail and veterinary businesses in 2014, the co-location model has proven to be very successful at attracting more traffic.
- Consolidation: It continues to pursue accretive acquisitions.
- Private label products: Target 25% of total sales from 18% today.

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Risks

- Acquisition integration.
- Forex: A weak A\$ may add pricing pressure to imports.

In its latest business update as at Week 43, Greencross reported a 14.5% growth in sales and a strong like-for-like growth of 5.1%. It expects to add 35 stores in fiscal year 2016 and will speed up co-location store openings in fiscal year 2017. We are confident that the strong business momentum will continue to reward long-term shareholders.

Have a great weekend.

The Global Alpha team

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