NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS PRIVATE WEALTH EQUITY FUND

Quarter Two, 2019

For the period ended 30 June 2019

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Market overview

The JSE (SWIX40) posted a second quarter return of +3.09%. During the quarter, the top performing sectors were Fixed Line Telcos (+29.7%), Gold Mining (+29.6%) and Mobile Telcos (+17.6%). On the downside, the decliners were led by Household Goods (-30.8%), Chemicals (-21.3%) and Tobacco (-15.7%).

Fund performance

The fund returned 3.91% for the quarter, outperforming its SWIX40 benchmark by 0.82% over this period. The Fund ranked **10th out of 160** peers in the SA General Equity category. While our focus is on the long term, these results are nevertheless pleasing.

Stocks held which contributed to Q2 performance included **Altron** (+1.2%), **EOH** (+0.61%) and **Adcorp** (0.39%) as well as underweight positions in Sasol (+0.40%) and British American Tobacco (-0.28%). Stocks held which detracted from Q2 performance included Glencore (-0.44%) and Reinet (-0.36%) as well as underweight positions in Absa (-0.32%) and not holding AngloGold Ashanti (-0.28%).

The fund has held **Altron** since shortly after the introduction of Value Capital Partners as shareholder of reference and primary change agent behind the successful restructuring of the Group. The investment in Altron highlights the fund's ability to be opportunistic and to participate in special situations on the JSE as they arise. At this juncture, however, we are mindful that the market has substantially closed out the glaring valuation gap compared to the deep value that was evident in 2017.

Portfolio changes

International equities

As long-standing unitholders in the fund will be aware, the composition of the fund includes ~5% in international equities listed predominantly in the US.

During the period the fund exited its position in consumer goods group, **Unilever**. Unilever's diverse portfolio of ~400 brands are used by consumers across income brackets and economic cycles in 190 countries. These defensive characteristics and Unilever's relatively high dividend pay-out ratio has resulted in the market bidding up the stock. Unilever's appeal is further underpinned by prevailing global economic uncertainty and the current low interest rate environment. That said, Unilever is currently trading at record levels and at more than 20x forward earnings; this fails to provide sufficient margin of safety given the fast-changing nature of today's consumer goods industry, in our view.

The fund invested in two new international equity positions, namely diversified health insurance and services company, **Cigna**, and **United Technologies Corporation** (**UTX**).

About Cigna: Cigna recently closed the acquisition of Express Scripts, a Pharmacy Benefit Manager (PBM). Cigna's Integrated Medical segment provides large corporates who self-insure access to its participating network and administrative services. The segment also sells health insurance to Commercial (smaller corporates) and Government (Medicare Advantage) clients. The Health Services segment provides PBM and mail pharmacy services. PBMs pool drug prescriptions to negotiate prices with manufacturers and pharmacies in an effort to reduce medication costs. Cigna also provides, to a lesser extent, insurance services internationally, as well as short- and long-term insurance.

Investment thesis: Both Cigna and Express Scripts have industry leading cash generation. The two companies will generate more cash combined, improve its service offering, add to its scale, and diversify the Company. However, headline US risks from the Democrats gaining more power to change health policies has seen the market turn negative on the Commercial Insurance industry. It's difficult to argue against the fact that medical costs in the US are anything but exorbitant.

However, we believe that health insurers and PBMs add a lot more value in decreasing medical expenses, relative to the economic profits these companies earn. As an example, Express Scripts lowered drug costs by $45 billion for its clients, resulting in only a 0.4% price inflation for its commercial clients. The risks already alluded to still saw Cigna de-rate to levels well below what the two traded at separately before the acquisition announcement, discounting the upside post-acquisition. This creates an attractive entry point for patient investors to benefit from Cigna's long-term defensive growth, in our view.

About UTX: United Technologies Corporation is an industrial holding company which owns a number of high-quality businesses. The Company consists of four distinct businesses: (i) Otis – the world's largest elevator and escalator company with over two million units serviced globally. (ii) Carrier – a global provider of commercial and residential heating, ventilation and air-conditioning services as well as fire and security products and services. (iii) Pratt & Whitney – a leading supplier of aircraft engines and aftermarket services for commercial, military and business aircrafts. (iv) Collins Aerospace – a leading supplier of a range of interior products, advanced technological equipment and avionics located on aircraft for the aerospace and defence industry. Each business is a leader in their respective industries, benefitting from noteworthy barriers to entry and would all feature on the S&P 500 on a standalone basis.

Investment thesis: The announced separation of the business into three independent companies is expected to unlock shareholder value as the Company is currently trading at a conglomerate discount to its sum-of-the-parts value. Upon separation (or as soon as company specific information is released) the market will likely reflect the quality and growth prospects of each underlying business. This is expected to act as a catalyst for share price appreciation. The separation is expected to occur before the second half of 2020.

UTX's portfolio of businesses stand to benefit from long-term trends such as: (i) population growth; (ii) urbanisation; and (iii) a growing middle class. This will result in new aircraft being built and new buildings being used that require elevators, air conditioners and fire and security services. Multi-year backlogs of $115.5 billion and long-term service contracts on its large installed base of products provide recurring cash flows, high visibility and moderate cyclicality.

Domestic equities – Position sizes reduced

During the period we reduced position sizes in **Bidvest** and **Bidcorp**. Bidcorp, for example, is unquestionably one of the better businesses listed on the JSE. However, a 5% position in this name was no longer appropriate given a multiple in excess of 20x forward earnings.

Also on the selling list during the quarter were **Standard Bank** and **Mr Price**, both of which the fund exited completely. Although the rationale for this investment action on Standard Bank was prompted by valuation, we note that the domestic banking industry is becoming increasingly competitive as evidenced by the number of recently launched entrants. We understand that a further 16 new banking licenses are currently being evaluated.

In prior fact sheets, we have set out our approach to managing concentration risk in the fund, notably by capping the overall exposure of the fund to **Naspers**; this continues to be the case. At quarter end, the fund's position in Naspers was reduced below 12%, compared to the +30% Naspers weight in the SWIX40.

Domestic equities – New to the fund and company specific commentary

Netcare: The fund added Netcare for the first time having never owned this name since the inception of the fund 15 years ago.

About Netcare: Netcare offers private hospital and trauma services through 56 owned hospitals (10 520 beds) across South Africa. These services include emergency medical services, cancer care, dialysis stations and mental health via Akeso Clinics. The Primary Care Division operates medical and dental provider services through MediCross, as well as a managed care organisation that focuses on uninsured lives through Prime Cure.

1H19 results overview: Group revenue increased 5.6% y/y, assisted by the acquisition of Akeso Clinics at the end of March 2018. Normalised EBITDA increased 1.3% y/y and the margin declined 90bps to 20.0%. Comparable adjusted HEPS from continuing operations increased 2.4% to 84.3c. This excludes all non-cash and non-recurring items as well as interest income on the contractual economic interest in BMI Healthcare's debt. The interim dividend was increased 6.8% to 47.0cps and R452m in share buybacks were concluded in the period, cancelling 1.3% of shares in issue.

Hospital and Emergency Services: The inclusion of Akeso Clinics boosted revenue growth to 5.1% y/y. Acute hospital patient days declined 1.0% while revenue per acute patient day increased 4.2% y/y. Acute hospital admissions were negatively affected by ongoing funder case management and the introduction of new hospital networks. Growth in demand for mental health services remains strong; Akeso Clinics saw a 20% increase in patient days over the period. Normalised EBITDA increased 2.0%, and the margin contracted 70bps to 20.8%.

Primary Care: Revenue growth of 18.8% for the period was driven by expanding the occupational health offering as well as the rollout of the national day clinic network. Occupational health is a lower margin business and the day clinics are yet to mature. As a result, EBITDA only increased 2.0% and the margin declined by 220bps to 13.3%.

Outlook: The inclusion of Akeso Clinics for a full year will assist FY19 revenue growth and the current negative underlying acute patient day growth is expected to deteriorate further. Guidance from Netcare suggests that margins for Hospitals and Emergency Services are expected to decline between 50 and 80 bps for the full year. No additional acute beds will be added in FY19, and Netcare will continue to convert beds to higher demand areas. In FY20 128 hospital beds (cancer care, cardiac care) will be added and the new 427-bed Netcare Alberton is expected to be complete in FY21.

Technical weakness – a buying opportunity: Netcare was excluded from the Top40 during the period. In tandem with the accentuated selling pressure of this event and based on our assessment of value, the Fund now holds an opening position in Netcare and will look to build this up further, market conditions permitting.

Closing

The fund remains committed to our over-arching investment philosophy: "Long-term investing, well-considered" and we would like to thank our unitholders for sharing the same long-term disposition.

DISCLAIMER

WHO WE ARE

Nedgroup Collective Investments (RF) Proprietary Limited, is the company that is authorised in terms of the Collective Investment Schemes Control Act to administer the Nedgroup Investments unit trust funds. It is a member of the Association of Savings & Investment South Africa (ASISA).

OUR TRUSTEE

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Funds are valued daily at 15:00. Instructions must reach us before 14:00 (12:00 for Nedgroup Money Market Fund) to ensure same day value. Prices are published daily on our website and in selected major newspapers.

FEES

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DISCLAIMER

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