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NEDGROUP INVESTMENTS PRIVATE WEALTH EQUITY FUND

Third Quarter, 2019

For the period ended 30 September 2019

Market overview

The JSE (SWIX40) posted a third quarter return of -5.08%. During the quarter, the top performing sectors were Platinum Mining (+25.8%), Equity Investment Instruments (+20.7%) and Tobacco (+13.7%). On the downside, the decliners were led by Chemicals (-25.6%), Household Goods (-24.6%) and Coal Mining (-24.1%).

Fund performance

The fund returned -4.34% for the quarter, outperforming its SWIX40 benchmark by 0.74% over this period.

Stocks held which contributed to Q3 performance included **Reinet** (+0.88%), **AB InBev** (+0.64%) and **Woolworths** (+0.28%) as well as underweight positions in Shoprite (+0.29%), Anglo American (+0.29%) and Sasol (+0.21%). Stocks held which detracted from Q3 performance included EOH (-0.61%), Curro (-0.42%) and RMI (-0.28%) as well as underweight positions in Naspers/Prosus, British American Tobacco (-0.34%) and not holding AngloGold Ashanti (-0.21%).

The fund continues to hold a small position in EOH on the basis that a turnaround opportunity exists in this counter from current levels. Notwithstanding the fact that FY19 results are likely to make for grim reading, our focus is on FY2020 and beyond. EOH is a much-maligned asset on the JSE but this jaundiced view does not take into account the complete governance overhaul and enhancement of management practises instituted by the new CEO. We will remain patient at this juncture and evaluate the investment case KPIs, and any slippage thereto, based on a clearer picture which is likely to start emerging from FY2020.

Portfolio changes

International equities

The fund now holds nine international equity positions as detailed in prior quarterly updates. Together with USD cash, international equities now represent ~13% of the fund.

Brookfield Asset Management (BAM)

A low interest rate environment has made real assets one of the few places investors can look for yield. This has led to record levels of fundraising by BAM over the last twelve months ("LTM"), driving strong growth in cash available for distribution and/or reinvestment.

BAM raised over $30 billion of capital over the LTM across its different strategies, which contributed to a 22% increase in fee-related earnings (excluding performance fees earned on the share price of Brookfield Business Partners) to $954 million. BAM held the first close of its latest infrastructure fund at $14.5 billion in May, significantly larger than its predecessor fund. As the funds get larger, the cash that BAM generates and can

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therefore utilise for new investments or distribute to shareholders, grows. This has led to growth of BAM's free cash flow at a CAGR of 25% over four years to $2.5 billion.

BAM's portfolio of diversified real assets forms the backbone of local economies and should generate cash flows over the long term in a variety of economic environments. BAM enjoys a large runway opportunity resulting from: (i) a transfer of real assets from indebted governments to the private sector; (ii) $49 billion of dry powder to deploy; and (iii) institutions allocating a greater proportion of funds to real assets in search of attractive yields, resulting in larger funds. These funds are typically long-dated and therefore generate a predictable earnings stream.

The BAM investment case is further underpinned by its global presence in over 30 countries and close to a century of operational expertise. This allows the Company to successfully deploy capital into regions or markets where they see value. This has enabled BAM to compound its book value per share by 11.5% on an annualised basis over 20 years, which we expect to continue going forward.

Alibaba

Alibaba reported solid 1Q2020 results, despite decelerating economic growth in China. The group's core profit drivers remain strong, while losses in future growth businesses have begun to ease. The first quarter of FY20 marks the one-year anniversary of the partial consolidation of Alibaba's Consumer services platforms Ele.me and Koubei, which compete against Tencent's Meituan-Dianping in the food delivery space.

On a segmental basis, Alibaba's Core Commerce segment continues to perform well. Revenue for the segment increased by 44% y/y to $14.5 billion, while adjusted EBITA increased 25% y/y to $5.98 billion. Core online marketplaces grew revenue by 26% y/y to $9.3 billion and adjusted EBITA to $6.82 billion, an increase of 27% y/y. The two main drivers are advertising revenue from its Taobao and Tmall platforms, which grew by 27% y/y to $6.1 billion, and commission revenue from its Tmall platform, which increased 23% y/y to $2.5 billion. The two platforms increased monthly active users (MAUs) by 34 million during the quarter and 121 million over the last 12 months (+12% y/y) to 755 million users. Less developed areas and lower tier cities represented 70% of user growth.

Revenue for the rest of the Core Commerce segment increased by 94% y/y to $5.2 billion. Adjusted EBITA was a loss of $0.84 billion during the quarter, a 645bps improvement compared to Q1'19. Revenue growth and operating losses were driven by investments into Consumer Services (food delivery), its International retail platform (Lazada) and its Logistics platform (Cainiao). Alibaba has also been investing in a retail model that uses its online data to merge its online with an offline (brick & mortar) offering, with New Retail revenue increasing 134% y/y to $2.44 billion. One such format is its Hema stores: https://www.youtube.com/watch?v=UDIvWdwVZMg.

Alibaba is the largest online retailer in the world measured by GMV and well positioned to benefit from continuing secular trends in China. These trends include: (i) the consumption upgrade of China's +300 million middle class; (ii) healthy balance sheets of Chinese households and increasing availability of credit which fuels consumption and (iii) Alibaba's role in digitising the retail sector, which increases its total addressable market (TAM) to the entire retail economy in China.

Alibaba generates most of its income from selling advertisements and taking a commission from sales on its platforms. This model (3P model) has high cash margins, with limited incremental capex. This allows Alibaba to be highly scalable, without compromising margins. The Company's strong cash generation allows it to invest into expanding its ecosystem and make investments that will pay-off for many years to come.

Domestic equities – Position sizes reduced

During the period we exited positions held in **MultiChoice, Woolworths** and **Coronation.** These sales were actioned as a consequence of either fair value being attained, or better opportunities having been identified elsewhere for the fund to pursue. The fund continued to reduce its Bidcorp exposure, notwithstanding marginally better than expected results for the year to 30 June 2019. Insiders have also been sellers of Bidcorp in reasonable size more recently.

Domestic equities – New to the fund

The quarter saw some pronounced volatility in names which the fund did not own and had been waiting for better entry points on. As a result, the fund started new positions in **Discovery** and **Shoprite** and will look to add to these positions should the opportunity arise.

Shoprite's financial year ended June 2019 was one characterised by stock shortages as a result of strike action at its largest distribution centre, disruptions caused by the implementation of its new SAP ERP system and a dramatic slowdown in its non-SA operations. Within this context, Shoprite reported a 19.6% decline in diluted HEPS (down 34.2% when adjusting for the hyperinflation impact of Angola). Dividend cover of 2x (adjusted) HEPS was maintained with the DPS at 319c. The larger than expected decline in earnings, together with a R4.7bn increase in debt levels and the deterioration in the group's cashflow position has precipitated the decline in the Shoprite share price to levels last seen in 2011.

We view Shoprite as the best-in-class food retailer in South Africa underpinned by its dominant market position and significant scale advantage. The Group's unrivalled distribution network into the rest of Africa remains a key differentiator over the long term. With the disruptions related to the supply chain and new systems now resolved we expect a steady recovery in the performance of the SA operations over the medium term, while the non-SA operations are expected to remain loss-making in the short to medium term. We believe that the market erred in the extent of the sell-off in response to these circumstances and this provided our entry point.

Discovery recently reported its FY19 results, which showed a continuation of reasonable profit growth from the established businesses (excl. SA life), exceptional growth from the emerging businesses (+94%) as well as investment into new businesses. Core new business was strong across the group, increasing 13% y/y. The key disappointment was SA Life, which although showing a recovery in 2H19, continued to underperform the actuarial assumptions.

Discovery's share price declined materially YTD (after falling 14% in 2018). This decline was largely driven by fears around the implementation of NHI and then aggravated by sell-side reports regarding aggressive accounting and potentially high debt levels. In our view, DSY's complexity requires attention to finer detail rather than high-level sound bites.

Following the sharp sell-off, we were of the view that a margin of safety was wide enough to open a direct position. Position size remains a key consideration given the risks attached to the various parts of the Discovery investment case. As a result of also having exposure to Discovery via RMI, our direct position is modestly sized.

The Foschini Group was also on the buying list during the period under review. Proceeds from Woolworths were re-allocated to Foschini in response to a sharply firmer Woolworths share price over the quarter. The valuation opportunity in Foschini was confirmed shortly thereafter in the form of an AGM trading update. The update from Foschini showed the Group to be in remarkably good shape across its multi-branded portfolio.

Having entered the quarter underweight **Bidvest**, significant pressure on this counter provided an opportunity to materially increase our position.

With organic growth hard won in SA (marked by a notably softer 2H19), bolt-on M&A is the go-to lever for Bidvest. In addition, larger acquisitions in the UK and Ireland are being considered which could come to fruition during 2019. That said, it helps to have ample balance sheet capacity when needed and Bidvest finds itself in just such a financial position. With annuity-based income accounting for ~64% of the total income, the portfolio effect attraction which has been the hallmark of the group remains intact.

Bidvest expects to deliver earnings growth in the year ahead. The mix of earnings supporting the 2020E outlook is likely to be skewed towards acquired earnings and certain cyclical components of Bidvest's portfolio bouncing back. Adcock Ingram will be consolidated from 1 August 2019 and the Eqstra acquisition is expected to be completed by the end of 2019.

There are relatively few assets "built to last" in the context of the weak economic environment that currently prevails in South Africa – Bidvest is such an asset and we don't think this resilience is adequately reflected in its current rating.

Company specific commentary – Naspers/Prosus

During September, **Naspers** listed its international internet assets on the Euronext Amsterdam. **Prosus**, the newly formed entity, is 74% owned by Naspers and has a secondary inward listing on the JSE. The international assets include Tencent, Mail.Ru, Ctrip, Delivery Hero, Avito, OLX, PayU as well as other ventures. The rationale for the transaction was to: (i) address Naspers's outsized weighting on the JSE, (ii) address the large discount that Naspers previously traded at, and (iii) reach a global pool of investors via a developed market listed entry point. Since the separate listing, based on our assessment and after accounting for tax consequences, the see-through discount to the underlying assets has remained broadly unchanged.

During FY19, we witnessed management's increased focus on reducing the discount, which included, amongst others: (i) the successful listing and unbundling of MultiChoice Group in February 2019, which unlocked ~USD4bn in value, (ii) the sale of Flipkart to Walmart for gross proceeds of USD2.2bn, at an internal rate of return of 29%, and (iii) improved disclosure of the group. In addition, the separate listing of Prosus now gives management flexibility to further address the discount via accretive share buybacks.

Our investment thesis for the combined Naspers and Prosus group remains intact. The group provides investors access to regional leaders in businesses including social networks, classifieds, payments and online food delivery. Its ability to cross-pollinate best practice and expertise across its portfolio of investments underpins its expected healthy growth. Tencent currently equates to ~85% of Prosus's NAV, before taking into account any holding company discount. Tencent's key performance indicators are tracking in line with our expectations and our investment thesis remains intact.

In our view, management has allocated capital reasonably well, demonstrated by: (i) the strategic moves that took place during FY19, (ii) reducing the Tencent stake at a favourable price, (iii) the ability to identify winners, and (iv) the Group's very low investment impairment rate. This discipline is also shown in management's continued optimisation of its portfolio, including sensible mergers and acquisitions and disinvestments where needed. The listing and unbundling of assets such as OLX and PayU are key performance indicators we are looking for over the medium term. Importantly, both entities have strong balance sheets, with Prosus housing $6bn of net cash and Naspers holding no interest-bearing debt which adds potential optionality going forward.

The fund reduced its position to under 10% in the run-up to the unbundling based on valuation and prudent risk management. Based on the price action post unbundling, the fund has further reduced its aggregate exposure to Naspers/Prosus and upweighted other direct offshore positions with the proceeds.

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).

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