NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS PRIVATE WEALTH EQUITY FUND

Fourth Quarter, 2019

For the period ended 31 December 2019

Market overview

The JSE (SWIX40) posted a fourth quarter return of +4.7%. During the quarter, the top performing sectors were Platinum Mining (+47.0%), Pharmaceuticals & Biotech (+30.9%) and Gold Mining (+26.1%). On the downside, the decliners were led by Fixed Line Telecoms (-49.9%), Beverages (-15.0%) and Household Goods (-14.3%).

Fund performance – Q4 2019

The fund returned +0.3% for the quarter, underperforming its SWIX40 benchmark by 4.4% over this period.

Stocks held which contributed to Q4 performance included Remgro (+0.47%), Aspen (+0.34%) and Alibaba (+0.31%), as well as an underweight position in Naspers (+1.00%). Not holding Woolworths (+0.20%) and FirstRand (+0.17%) also added to relative performance.

Stocks held which detracted from Q4 performance included Adcorp (-1.20%), Adapt IT (-0.85%) and Altron (-0.56%). Not holding Impala Platinum (-0.74%), Sibanye Gold (-0.62%) and Anglo Platinum (-0.49%) also detracted from relative performance.

The Fund continues to hold a modest allocation to higher quality, small and midcap shares, where valuations have retraced to bear market levels, last seen in 2008/2009.

Portfolio changes

International equities

The Fund now holds ten international equity positions as detailed in prior quarterly updates. Together with USD cash, international equities now represent ~15% of the fund.

Cigna Corporation (CI)

During the quarter, the fund added incrementally to its position in Cigna. We continue to believe Cigna presents an attractive value opportunity, in a relatively expensive US market.

Cigna is a diversified health insurance and services company. The company recently acquired Express Scripts, a Pharmacy Benefit Manager (PBM), which represents a meaningful acquisition for the Company. Cigna’s Integrated Medical segment provides large corporates who self-insure, access to its participating network and administration services. The segment also sells health insurance to Commercial (smaller corporates) and Government (Medicare Advantage) clients. The Health Services segment provides PBM and mail order pharmacy services. PBM’s aggregate drug prescriptions, which enables them to negotiate reduced medication costs with manufacturers and pharmacies. Cigna also provides, to a lesser extent, insurance services internationally as well as short and long-term insurance.

Cigna's latest results showed strong revenue and earnings growth, which translated into strong free cash flow generation, allowing the group to de-gear its balance sheet. Despite the solid operating performance, the market continues to take a negative view on the company due to political rhetoric on healthcare that dominates the headlines going into the 2020 November elections in the US.

Fedex Corporation (FDX)

FedEx, founded in 1971, is the world's largest express delivery company and the second largest ground shipping company in the US. The company's FedEx Express segment provides delivery services for packages and freight (>70kg per item) to more than 220 countries and counties, covering 99% of the world's GDP. The FedEx Ground segment, which uses and independent contractor model, does deliveries in the US and Canada, utilising a drop-off and pick-up network of more than 50,000 locations. The third segment, FedEx Freight, does deliveries of less than-a-truck-load in size in the US, Canada and Mexico.

During the quarter, Fedex released its Q2 2020 results. Revenue remained broadly stable at $17bn, while operating margins contracted sharply to 3.2% from 6.6% in the prior period. Management are incurring capex now, in order to generate shareholder value in future periods. These initiatives include year-round seven-day FedEx Ground delivery, enhanced large package capabilities and the insourcing of FedEx SmartPost packages. In addition, operating results were further impacted by weaker global economic conditions, the loss of a large customer and a more competitive pricing environment. As a bellwether of global trade, Fedex has been caught in the middle of the trade war between China and the US. The fund retains a relatively small position to Fedex which we will consider adding to at the right price.

Domestic equities

Domestic equities – Position sizes reduced

During the period we reduced positions held in **RMH**, **Mr Price, Mediclinic, Sasol** and **Quilter.** Generally, the fund will reduce or exit positions completely for three reasons; 1.) position reaching fair value, 2.) more attractive, lower risk use of capital, and 3.) where the facts have changed (eg: a thesis not playing out, an error being made etc). The majority of the sales during the quarter were driven by positions reaching fair value.

Sasol has been at the forefront of discussions across most asset managers over the last few months. Negative headlines, a depressed share price and widely different views on estimates of fair value set the scene for many hours of debate, including within our own investment team.

After a lengthy delay and plenty of shareholder frustration, Sasol eventually released its FY19 results, along with its independent board review. Given the trading statement which was released a few months prior, the focus of the results was less on the past 12 months financial performance, and more on unpacking what exactly went wrong at the Lake Charles Chemical Project (LCCP), as well as an update on what shareholders could expect going forward.

The review identified that the conduct of the former LCCP project management team was incompetent and non-transparent, but no intention to defraud was found. Pleasingly, the review also found that no restatements of financial performance was required. The causal factors behind the outcomes included inadequate reporting controls, a culture of deference and insufficient experience in executing mega-projects.

The fund continued to hold a limited position size in Sasol over the last few months. Despite all the negative headlines, the share price had already discounted the majority of the negative outcomes. The balance sheet risk was the biggest area of concern, however, Sasol management had a few levers to pull to relieve some of the pressure including: 1.) passing the dividend, 2.) sale of non-core assets, 3.) continue the hedging program, and 4.) restructure some of the debt covenants.

In mid-December, Sasol announced the successful replacement of the acetylene reactor catalyst at the LCCP Ethane Cracker. Importantly, this meant that the capacity utilisation has increased to normal levels and that the quality of the Ethylene has met the required specification. As a result, in our view, the market quickly priced out some of the looming short-term risks. In addition, due to some positive developments on the US- China trade war front, the oil price also traded above our estimate of normalised long-term levels, which further assisted the Sasol share price. As a result, we marginally reduced our position size as Sasol moved closer to fair value levels.

The fund has been an owner of **Quilter** since it’s unbundling out of Old Mutual, and at various points since then, the position size was increased at attractive levels. Quilter is well-positioned in the UK wealth market as an integrated wealth management business. Via its at-scale adviser force and IT platform, the group benefits from a large and growing wealth market, where regulatory changes have profoundly changed the industry dynamics in favour of larger players. Quilter is a relatively capital light business, that we expect will continue to scale up over time as more assets move on to platforms and as the adviser force continues to grow.

During the quarter, some of the negative sentiment regarding Brexit abated, which saw Quilter’s share price move closer to our estimate of fair value and as a result we trimmed our position size.

Domestic equities – Position sizes increased

The quarter saw a continuation of volatility which we used to our advantage to add to existing holdings at attractive valuations. The fund added to positions in **Standard Bank** and **AB Inbev**.

The SA banks continue to occupy a modest allocation of the fund’s capital. The most recent results season for the banks showed stable top line growth, and well contained opex growth. However, bad debts charges are beginning to normalise to higher levels as the effects of the dire macro conditions begin to filter through. Most management teams are not too optimistic on the outlook for SA and warn that 2020 might become another “lost” year. Despite all the negativity, we believe select valuations in the banking sector are attractive. This view is largely premised on healthy dividend yields, well capitalised balance sheets and stable ROE's.

Standard Bank currently trades at c.1.5x price to book and a healthy 7% dividend yield. A key differentiator for SBK amongst its peers is its higher exposure to Africa, where it earns a healthy 22% RoE. Given the de-rating during the quarter, the fund used the weakness to incrementally add to its position.

We continue to view **AB Inbev** as a high quality, globally diversified, defensive business, led by able and aligned management. Much of the negative sentiment over the last few reporting periods for the business, was focused on the geared balance sheet. Management have however already pulled a few available levers to address the elevated financial risk by: 1.) disposing of its Australian unit, 2.) separately listing Budweiser APAC, 3.) reducing the dividend, and 4.) restructured the debt to extend the maturity.

Going forward, we expect a continuation of the strong organic cash generation to further deleverage the balance sheet as the premiumisation and portfolio expansion strategies are executed. Given the sharp de-rating during the quarter, the fund incrementally added to its position.

<u>Company specific commentary – FSR/ RMH/ REM</u>

The fund has been a long-standing owner of RMH, as a discounted entry point to FirstRand. During the period, RMH announced a restructure of its portfolio, following an internal review.

RMH plans to distribute its 34.1% stake in FirstRand, valued at c.R130bn and, thereafter, monetise the Property Assets in an orderly manner over time. The FirstRand Distribution will be net of the settlement of the FirstRand debt and associated costs, and an appropriate capitalisation of RMH post the FirstRand distribution. RMH will remain listed on the JSE until that process is complete. A detailed announcement relating to the restructuring, including the relevant approvals required and the related timetable, is expected to be made during Q1 2020.

Post the announcement, the market re-priced the discount to NAV on RMH, and the fund used the opportunity to exit a portion of its holding. The fund retains exposure to RMH & FSR via its stake in Remgro, who will also be distributing, in full or in part, its exposure to the two assets. We continue to view Remgro as a stable, diversified holding company which, based on our assessment, is expected to produce attractive returns from current levels, over a range of outcomes. Based on the attractive symmetry of returns from the current discounted valuation, Remgro occupies a meaningful proportion of the fund's capital.

Closing

In an uncertain world, with many looming risks, the fund remains well diversified across several businesses whose operations span different sectors and different geographies. 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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