NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS ENTREPRENEUR FUND

Quarter Three, 2020

Nedgroup Investments Entrepreneur Fund

Performance to 30 September 2020	Nedgroup Investments Entrepreneur Fund[1]	ASISA category average	Small Cap Index	Mid Cap Index
3 months	-1.4%	3.7%	3.5%	1.3%
12 months	-12.9%	-12.6%	-17.6%	-15.0%

Market commentary

The All Share Index rose 0.7% in Q3 2020, continuing the recovery from the COVID-19 induced market crash trough recorded in late March 2020, and bringing the year-to-date return to -2.5% by the end of September. The "Covid crash" is now officially on record in the history books as the fastest to reach trough as well as the fastest to record the extent of recovery that it has – so far. We remain in extremely uncertain times and are not complacent in concluding that the worst is behind us.

For the quarter, the Resource sector (+6.0%) was again the strongest, this time driven by platinum shares (+21.6%), while Financials (-1.6%) and Industrials (-2.3%) were again the weakest, driven by the Property sector (-20%) which continues to be decimated.

Year to date this pattern remains the same with positive market returns coming from an extremely narrow portion of the market. Resources are +11.9%, Industrials have eked out +4.3% driven by very few names (Naspers by far the biggest) while Financials -32.8% have been severely negatively impacted and have shown little to no recovery yet from the impact of Covid-19.

The Rand traded in a relatively stable range for the quarter, closing at 16.60 to the US dollar. While this is 13% stronger than the R19.13 recorded in mid-April, it is still 19% weaker than the R14.00 it was on 1 January 2020.

Portfolio Commentary

The fund had a disappointing quarter declining by 1% in comparison to the positive 1.3% and 3.5% recorded by the JSE Mid and Small Cap Indices. The table below details the primary contributors and detractors from performance. Disappointingly, the success of our star stock pick Royal Bafokeng Platinum was undone by the weak performance of some of our defensive positions – notably Santam and Adcock Ingram - as well as long term winner and core position Naspers, which had a weak quarter.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Royal Bafokeng Platinum	5.34%	2.96%	Adcock Ingram	4.32%	-0.92%
Afrimat	4.69%	0.73%	Naspers	9.87%	-0.68%
AVI	3.26%	0.18%	Santam	6.36%	-0.62%
Advtech	0.82%	0.17%	Oceana	4.21%	-0.52%
Italtile	1.53%	0.16%	Alexander Forbes	2.87%	-0.51%
Master Drilling	0.69%	0.15%	Reunert	2.55%	-0.39%

Santam: This is a high-quality core position in the fund, is the largest and most efficient short-term insurance company in South Africa, and offers product across the full spectrum of short term cover either through brokers and financial advisers or direct (mostly motor vehicle) through their Mi-Way brand. In addition they have a stake

[1] Net return for the Nedgroup Investments Entrepreneur Fund, A class. Source: Morningstar (monthly data series).

in a company called Saham which is a large pan-African short term insurance business principally operating in Morocco, which is the only other African country with a short term insurance industry of material scale.

At the onset of the COVID-19 crisis, this position was extremely effective at protecting value in the portfolio as it barely moved, and we did lighten the position at that time. More recently as a result of anxiety and uncertainty around the firms potential exposure and liability to business interruption claims caused by the Covid-19 pandemic, the share has fallen dramatically by 22% and we have used this weakness to add to the position size again. It is currently the 3rd largest position in the fund.

The COVID-19 pandemic has affected Santam and its clients in a variety of different ways. The company has most of its risk exposed to Property and Motor Vehicles, both of which are experiencing unusually favourable trading conditions as a result of lower natural disaster events (think Knysna / Bettys Bay fires, extreme thunderstorm activity on the Highveld) and the lockdowns which have resulted in far lower driving activity and consequently lower accidents. Despite refunding some of the premiums to their vehicle insurance clients in the last few months, their vehicle underwriting business has recorded an exceptionally high level of profitability.

BUT – they are exposed to Business Interruption Insurance (BII) claims, and here is what has caused the market's anxiety. Businesses only have a claim where there is a specific clause stating that the Business Interruption is caused due to an outbreak of disease. This has become a highly contentious and emotive issue because many small businesses are having to close, and people are losing livelihoods. While Santam, as long-term operators in the industry, are anxious to settle valid claims and support their clients, there is a degree of uncertainty in the wording of many of their policies where the cover was always intended to be for a localised outbreak of disease, and not for a global and widespread event. In addition, there is the complication in areas where the disease was not present, but the business has been interrupted by the state imposed national lockdown, not a localised outbreak of disease.

A further complication comes as Santam pass on some of the risk on their balance sheets to global reinsurers who will be liable for their share if the claim is ruled in court to be valid. However, if Santam has in haste and good faith settled a claim to assist their client, but the court rules they should not have done so, the reinsurers will not be liable for their share and Santam will carry that full burden. The situation is tricky and Santam management have done an excellent job by striking a negotiated interim settlement, which assists their clients but keeps the reinsurers liable until we have a court ruling which resolves the matter, but unfortunately this takes time. We have spent some time examining the issue with management and are reasonably confident that even in a worst-case scenario regarding a court ruling, we have already experienced the worst of the financial impact. However, should the court rule in Santam's favour, we expect a very favourable outcome.

In the meantime, trading conditions remain very favourable for motor insurers and the firm's balance sheet is quickly approaching a level of surplus capital to warrant a special dividend.

Royal Bafokeng Platinum (RBP): This is a small platinum mining company that effectively operates two mines, both within sight of Sun City. One mine is fully operational, while the other has been under development for most of the last decade. We have been very patient investors in this firm for a long time and it seems our patience is finally beginning to pay off as the production growth profile of this firm is more attractive than any other in the sector.

While we have a healthy relationship with the management of the firm, they have a weakness for incurring unnecessary costs which we are encouraging them to curb and they do acknowledge this point which is constructive. In addition, the execution of the second mine (called Styldrift) has not been seamless but is now finally ramping up to full production.

As with all mines, RBP's revenue, and even more so profits, are geared to the underlying prices of the commodities they produce as well as the Rand / Dollar exchange rate. I am sure many readers will be aware of the recent movement in the exchange rate (as exporters, a weaker rand is what RBP want) as well as the platinum price (more or less flat at $900 over the last 3 years) and palladium price (very strong ±35%).

But it is the much lesser known Rhodium, a commodity also used in catalytic converters with unique abilities to filter NOx from exhaust fumes and found almost only in South African ore bodies. This commodity, which has historically exhibited high volatility has risen >400% in the last two years and will suddenly go from an immaterial number to >30% of RBP's profits. The sustainability of this high Rhodium price is clearly uncertain and there are strong arguments for why it should and shouldn't hold. We are on the side of those who think it can for a while to come, driven by rising demand caused by tightening exhaust emission limits, and limited incremental supply more than offsetting the weak global vehicle sales volumes side of the equation. Time will tell, but in the meantime, each week this business is generating very strong levels of cash and we expect this to be returned to shareholders.

Current positioning and outlook

It's difficult to compress the range of work, research and effort our team has applied over the last few months into a few bullet points in the extremely uncertain circumstances we have found ourselves in, but;

Our attention has been focused on:

- The extent to which the extreme monetary and fiscal interventions implemented around the world will succeed in driving an economic recovery internationally as well as here in South Africa.
- Which businesses have thrived or will emerge as survivors and which will be unable to recover or adapt to a world that will be permanently altered in certain respects.
- In the context of the above the stocks and sectors which best reflect and offer the most opportunity for recovery, while at the same time not wanting to be lured into something which may be trading at record low levels of valuation but are ultimately doomed to fail. In this category we retain our heavy Financials exposure, although these are all niche players and dominant players in short term insurance, investment management and the JSE. We continue to resist any temptation to invest in the property sector which we think has many tough years still ahead of it.
- The fundamentals supporting the variety of commodity prices that drive our domestic mining stocks remain largely very supportive, especially for PGM's and Copper and to a lesser extent Iron Ore and Gold. We consequently have large positions in RBP and Afrimat where >50% of profits now come from Iron Ore mining.
- We retain a heavy exposure to the Naspers / Prosus combination ±15% and there are rumours of further steps to be implemented to address every investor's frustration regarding the discount. It is still all about Tencent where we remain very positive and view current valuation as attractive.
- We have select exposure to domestic SA industrials and while we note the positive recent events regarding accountability for corruption, the economic recovery plan prepared between the State, Labour and BUSA and support their stated targets, we worry it will fail at the implementation stage as all prior plans have. On selection we have a strong quality bias on firms with strong balance sheets and likely to emerge as the survivors of the future – eg AVI and Adcock Ingram.

As at end Sept 2020 the fund traded on a weighted PE of 21X, Price to Book of 1.3X and Dividend Yield of 4.0%.

Responsible Investment Comments

ESG factors and ongoing research are integrated into our investment analysis to strengthen the decision-making process and ensure that investments generate long-term value in an ethical manner.

Notable engagements relevant to the Entrepreneur fund during the third quarter of 2020 include;

- Reinet: Engagement regarding the NAV discount and suggestions to unlock the trapped value.
- JSE: Engagement with the Chairman of the Board regarding remuneration and other business matters.

Conclusion

While sentiment remains extremely negative towards SA Inc and business and consumer confidence languish at record low levels, there is undoubtedly value in the space. We have already been bought out of 2 positions this year at significant premiums to prevailing prices pre-bid and have this week been approached by a possible third. This shows that astute long-term investors see value in the space. If the economic recovery plan currently attempting to launch can gather some momentum as well as the clean governance faction within the ANC we are in with a chance.

Time will tell.

Disclaimer

WHO WE ARE

Nedgroup Collective Investments (RF) Proprietary Limited is an authorised Collective Investment Scheme and the representative of Nedgroup Investments Funds PLC in terms of the Collective Investment Schemes Control Act. It is a member of the Association of Savings & Investment South Africa (ASISA)..

OUR TRUSTEE

The Standard Bank of South Africa Limited is the registered trustee.
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HOW ARE OUR FUNDS PRICED

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

A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

DISCLAIMER

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

Some funds may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks, which could include foreign exchange risks, market conditions and macro-economic and political conditions.

A fund of funds may only invest in other funds, and a feeder fund may only invest in another single fund, both will have funds that levy their own charges, which could result in a higher fee structure.

The Nedgroup Investments Money Market Fund offering aims to maintain a constant price of 100 cents per unit. A money market fund is not a bank deposit. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument held. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of a capital loss. Excessive withdrawals from the fund may place the fund under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. The yield is calculated using an annualised seven day rolling average as at the relevant dates provided for in the fund fact sheet. Nedgroup Investments has the right to close its funds to new investors in order to manage it more efficiently.

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