NEDGROUP INVESTMENTS

UNIT TRUSTS | INTERNATIONAL | RETIREMENT FUNDS

see money differently

NEDGROUP INVESTMENTS
Private Wealth Equity Fund
Quarter Two, 2021

Nedgroup Investments Private Wealth Equity Fund

Performance to 30 June 2021 ('R)	Fund[1]	Benchmark[2]
3 months	3.3%	-3.5%
12 months	31.3%	18.3%

Market Overview

Measured in US dollars, in June the JSE All Share index gave back some of its recent outperformance relative to global indices, but remains a strong outperformer over the last 12 months (+52%).

During Q2 2021, the JSE All Share posted a flat total return of 0.0% while the ALBI gained 6.9%. Resources underperformed and posted a total return of -5.1%, while SA Industrials ended +5.5% for the quarter. SA Financials outperformed, with a total return of +7.5%. Large caps on the JSE returned -1.6% and Mid caps +5.9%. Small Caps stocks continued to meaningfully outperform in 2021, and posted a return of +8% for the quarter. Naspers and Prosus declined 15.1% and 14.5% respectively during the quarter.

The leading performers during the quarter were Distell (+43%), Dischem (+41%), TFG (+30%) and Investec (+26%), while the laggards included Montauk Renewables (-32%), Amplats (-23%), Anglogold (-18%) and Northam (-16%).

The SWIX40 returned 18.3% for the period. The strength of the USD/ZAR during the quarter surprised some market participants, as the terms of trade remains highly favourable given strong commodity prices. The USD/ZAR ended the quarter at R14.35 but strengthened all the way down to R13.43 at one point during the quarter. The SARB kept the repo rate steady at 3.5%.

In line with expectations, consumer and producer inflation accelerated again in May to 5.2% and 7.4% respectively. The All Bond Index gained 1.1% in June, bringing the returns over the quarter to 6.9%.

First quarter GDP was recorded at 1.1% (qoq, not annualised), supported by growth from the mining and finance sectors. With the Delta variant spreading rapidly in South Africa, the severity of the third wave prompted a move to Alert Level 4 restrictions for two weeks, to be reassessed in early July. While the global recovery is providing cyclical tailwinds, stricter lockdowns are an unfortunate setback.

The divergence in vaccination campaigns between the developed and the emerging economies has been made even more stark by the spread of the Delta variant across the world. Pledges from G7 members of vaccine supplies to those with need, including South Africa, will go some way to improving timelines and staying ahead of new variants and reinfection. The broadening of economic activity to the services sector is increasingly adding to global economic growth, even if the full reopening of economies remains elusive.

Global central banks have started to use language more alert to the potential for pricing pressures beyond base effects. The US Fed continues to support the premise that inflationary pressures will be transitory but refined their communication at the June meeting to reflect a slightly more hawkish stance. The median committee member now expects two interest rate hikes in 2023, bringing forward the tightening cycle. While the monetary policy setting will remain accommodative for some time to come, the level of support will likely abate. Talk of tapering or the withdrawal of liquidity will no doubt become one of the main drivers of potential volatility for markets that have become used to, if not dependent, on easy financial conditions.

[1] Net return for the Nedgroup Investments Private Wealth Equity Fund, A class. Source: Morningstar (monthly data series).
[2] Benchmark is the SWIX40.

Portfolio Commentary

"In the short-term, the market is a voting machine, but in the long-run it is a weighing machine"

- Ben Graham, The Intelligent Investor (1949).

The second quarter was relatively quiet for the fund, especially if we compare it to the same quarter of 2020. The value versus growth debate has quietened down quite a bit over the last few months, although the outperformance of value continues. To be clear, from an investment process and philosophy perspective, we don't particularly subscribe to looking at value and growth as factors, instead we estimate what we believe the intrinsic value of a business is, and we exercise patience until we can allocate capital at a sufficient margin of safety.

The quote above stands out as particularly relevant to us today, despite Ben Graham writing the book in the late 1940s. We believe the reason for this voting versus weighing comes down to a few factors that are at play; 1.) Psychology and behaviour of market participants, 2.) varying time horizons of market participants, and 3.) speculators trading on current news headlines.

To add some data to the above, we highlight the recent IPO filing of Robinhood Markets, who has constantly found itself in the media over the last few months. For 2020, Robinhood reported a 245% y/y increase in revenue to just under $1bn. Founded in 2013, Robinhood has over 12m customers and notes that more than 50% of its customers are <u>first-time</u> investors. Robinhood is aiming for an IPO valuation of $40bn.

Currently in the fund, we can point to a few positions where the market is voting in the short term, but where we believe the long term will bode well for risk-adjusted returns as the market eventually reverts to weighing again. It always does.

<u>Domestic</u>

***Naspers/Prosus** – further corporate action*

During the quarter, we had three announcements affecting the fund's largest position; Naspers. In April, Prosus announced the sale of a portion of its stake in Tencent. Then in May, Naspers/Prosus announced a voluntary share swap, which was then followed in June by full year results from Prosus/Naspers. We will discuss each of these below.

In April, Prosus announced the sale of c.192m Tencent shares, valued at ~USD14.6bn. The sale equates to 2% of Tencent's issued share capital and reduced Prosus's stake from ~30.9% to 28.9%. The Tencent shares were sold to institutional investors globally, at a price of HKD595/share, being a discount of 5.5%, based on Tencent's closing price at the time.

Prosus indicated that the proceeds will be used to increase its financial flexibility to invest in growth ventures, as well as for general corporate purposes. The ventures may include its core business lines and emerging sectors, as well as allow for complementary acquisitions. Prosus also committed not to sell any further Tencent shares for at least the next three years. This is in line with its long-term belief in the potential of the Tencent business.

At the time, we viewed the sale as accretive to shareholders given the large discount to NAV at both a Prosus and Naspers level. However, given the commitment to the lock up for the next three years, we questioned whether the size of the sale was big enough to make meaningful progress to unlocking value for shareholders.

In May, Prosus announced its intention to acquire up to 45.4% of Naspers N shares in issue in exchange for newly issued Prosus N shares. The voluntary offer will enable Naspers shareholders to exchange their holdings for Prosus shares at an exchange ratio of 2.27 Prosus N shares per Naspers N share. The transaction is subject to a minimum acceptance of 45.4% Naspers N shares and is expected to be concluded by the third quarter of 2021.

The proposed transaction represents the latest step in Prosus' and Naspers' journey to address the substantial discounts to underlying NAV which the businesses are currently trading at. In our view, the most immediate benefit comes from a trading and index weighting perspective: the transaction should help reduce the outsized Naspers weighting on the JSE while improving the liquidity and increasing the weighting of Prosus on the JSE and Euronext Amsterdam exchanges.

Acquiring lower-rated Naspers shares by issuing higher-rated Prosus shares (from a discount to NAV perspective) makes sense from a capital allocation perspective. However, the additional complexity introduced by the cross-holding structure threatens to offset some of the value unlock, in our view. We remain hopeful that management could move towards a more elegant solution over time. We nevertheless think that both Prosus and Naspers offer significant upside from current levels given the attractive fundamentals of its underlying assets.

In June, Prosus reported robust results for the year to March 2021, driven by accelerated growth and improving monetisation trends at most of the Group's investee companies. Core headline earnings per share rose 44% y/y to $2.91, driven by strong growth at Tencent and the Food Delivery and Etail segments. A dividend of €0.14 per share was declared (FY20: €0.11). Prosus disclosed its internal valuation for its ecommerce portfolio at $39bn for the first time. Along with the Group's listed investments in Tencent and Mail.ru, this implied an overall valuation for the Group of $268bn, or approximately R2 870 per share, at the end of March 2021. The current share price of ~R1 396 therefore represents a material discount to management's estimated intrinsic value.

During the quarter, the fund added marginally to its holdings in Naspers/Prosus given our view on the underlying Tencent valuation as well as the historically wide discount available at current levels. We don't believe the discount will close completely over the medium term but do view the downside protection from a discount perspective as asymmetrically skewed.

***Altron** – FY21 results and further value unlock going forward*

Regular readers of the fund's quarterly review would by now be familiar with our investment case for Altron. During the quarter, Altron reported a noisy set of numbers for the year to February 2021. Not only was the year impacted squarely by the pandemic, but it also coincided with the demerger and listing of Bytes Technology Group on both the LSE and JSE. We view the latest reported HEPS number of 31cps for FY21 as largely meaningless. Instead, we believe Altron finds itself at the base of a hockey stick shaped earnings rebound going forward.

HEPS should snapback meaningfully in the year ahead and into FY23 driven by: (i) Net finance charges declining by as much as 50%, (ii) non-recurring charges relating to payroll rationalisation efforts already undertaken, (iii) Covid restrictions easing compared to the hard lock down measures of 2020, (iv) ongoing head office costs which can be further reduced towards less than R100m per annum by FY24, (v) renegotiation and/or better execution of a few loss-making contracts within Karabina, and (vi) curtailing further capital into underperforming businesses in the rest of Africa.

Based on our valuation framework, we believe Altron remains undervalued by the market and we therefore added marginally to the position during the quarter. We believe management have further available levers to unlock shareholder value, while the balance sheet remains exceptionally strong.

International

The Fund's direct international exposure is predominantly to US-listed companies. We have provided brief commentary on highlights during the period.

During the quarter, no material changes were made to the offshore component of the fund.

Alibaba *- FY21 results*

In previous quarterly reviews, we have written extensively about the regulatory issues affecting the business. What follows below, is our assessment of the FY21 results which were reported in May.

Alibaba faced intense regulatory scrutiny during FY21; from Ant's sprawling business being reined in to being investigated for anti-monopoly practices which led to it being fined $2.8 billion. However, neither this nor Covid stopped the Company from reporting another record year.

During FY21, the Company's ecosystem reached $1.24 trillion in gross merchandise value (GMV), which included $1.14 trillion from its China marketplaces, while its international marketplaces and its food delivery platform reached $95 billion in GMV. Alibaba's mobile monthly active users (MAUs) reached 925 million, an increase of 79 million from the prior year. Annual active consumers (AACs) outside of China reached 240 million, with both its South East Asian platform Lazada and global platform AliExpress achieving more than 100 million AACs.

Revenue for the Group reached $72 billion in FY21, an increase of 41% or 32% excluding the consolidation of Sun Art. Adjusted net income increased 30% to $21.5 billion, or $7.86 per diluted share for the year. Alibaba generated $35.4 billion of operating cash flow and $26.4 billion of free cash flow during the year, ending with a net cash position of $49.5 billion or $18 per share.

On a segmental basis, Alibaba's Core Commerce segment continues to perform well. Marketplace-based commerce revenue grew 24% for the year, driven by 14% growth in GMV, while its take rate increased 33bps to 4.07%. Marketplace revenue is split between one-third commission and two-thirds advertising revenue. Marketplace revenue which consists primarily of its Tmall and Taobao platforms, continued to be the primary source of profit growth for Alibaba, generating 43% of Group revenue and 134% of Group adjusted EBITA.

Revenue for the rest of the Core Commerce segment increased by 71%, while the adjusted EBITA loss increased 18%. Losses started to decline through the year as some of its newer investment areas reached scale. However, losses accelerated in 4Q21 as Alibaba focused its investments on a new vertical, Taobao Deals. This is in response to the rise of Pinduoduo's (PDD) success in attracting new e-commerce buyers in lower tier Chinese cities. Alibaba has committed to invest all incremental profits during FY22 on Taobao Deals, as well as Taobao Grocery and its international business. Thus, investors can expect flat earnings for FY22. Another core commerce standout during the year was international retail which grew revenue by 42%, with growth accelerating to 77% in 4Q21. Its logistics platform, Cainiao, grew revenue by 68% during FY21, with 70% of revenue coming from outside the Alibaba Group. Cainiao reached breakeven from a cashflow from operations point of view.

Revenue from Alibaba Cloud increased 50% during FY21. Disappointingly, growth for cloud decelerated significantly to 37% in 4Q21 due to Alibaba losing an international client as a result of "non-product related" reasons. Alibaba Cloud reached adjusted EBITA profitability during a 2H21, after being an area of investment and reporting losses since the segment's founding little over a decade ago.

Based on our valuation framework, we believe the market is undervaluing the business. While we acknowledge the various risks associated with the company, we find the margin of safety at current levels to be wide enough given our assessment of the various scenarios that may play out going forward. We cannot take comfort from what other investor's do, but we draw attention to Charlie Munger's recent purchase of Alibaba via the Daily Journal Corp, leaving us in good company with fellow shareholders.

Alphabet *- Further runway*

Alphabet continues to benefit from Covid-19, even as the world and especially its largest market being the U.S., begins to re-open. The dynamic of businesses turning to online platforms to find new buyers, while consumers continue to shop online, has remained intact even as people are free to return to brick-and-mortar consumption.

Google, the largest advertising company in the world, benefits from this dynamic as its various platforms like Search and YouTube experience an acceleration in revenue growth from already record levels. This growth, combined with the cost controls Alphabet implemented during the depths of 2020, resulted in profit growth not seen for many years in its recent results. This is even more impressive when considering its current size, with the business earning ~$200 billion in revenue over the last twelve months.

Recently improved disclosure for its Cloud segment gave investors further insight into the business. Two key takeaways were just how much Google is prioritising Google Cloud as a growth platform, incurring large upfront losses as a result of continued investment into the platform, which is now the third largest cloud platform in the world, behind Microsoft Azure and Amazon Web Services (AWS). The other takeaway is the profitability of its core Google platform, which remains healthy after splitting out the losses from the Cloud and Other bets segments.

Alphabet will continue to be a beneficiary of the structural shift from offline to online consumption, which accelerated due to Covid-19. In the short-term, the business will also benefit from the recovery in services consumption and more specifically travel (Alphabet is the most used advertising platform by online travel sites), as the world re-opens. Its relatively new expense discipline should drive earnings over and above revenue growth, while its large portfolio of Other bets and its $120 billion net cash position presents significant optionality, in our view.

The fund currently holds a ~2% position in Alphabet.

Comcast *- More competition*

Comcast reported a solid set of 1Q21 results in April, as its Cable segment continues to perform well, while its Media segment has started to recover. The Cable segment added another 380k new client relationships, driven by 461k new high-speed internet subscribers. The much higher margin internet subscriber growth, more than offset the profits lost due to a 491k decline in cable video subscribers and resulted in the segment reporting another quarter of high-teen profit growth. Comcast announced the development of “Docsis 4.1”, which will allow the business to upgrade its current national cable network to transmit multiple-gigabit internet speed in future, up from its current 1.2Gbps speed capacity.

The Media businesses continued its recovery, as the decline in profits eased for NBCUniversal due to the losses incurred by the Theme Parks business narrowing with the opening of all four Theme Parks and increased attendance in Orlando. The recovery in the Theme Parks business, as well as the launch of Super Nintendo World at Universal Osaka and the opening of its fifth theme park in Beijing in August, will be a significant driver of NBCUniversal growth for years to come. NBCU’s streaming platform, Peacock, has gained traction, reaching 42 million signups in the U.S., with Comcast seeing compelling ways to distribute the platform internationally in the future. Sky Plc. also continued to recover as increased sport activity drives revenue growth, which partially offset the step up in soccer content costs.

A significant industry development during the quarter was the announcement that AT&T will spin out and merge its media segment, Time Warner, with Discovery Media. In our view, this corporate action impacts Comcast in two ways. Firstly, the spin out will reduce AT&T’s overburdensome debt load, freeing up capacity to invest into its fibre to the home (FTTH) network, which competes against Comcast’s cable internet business. Secondly, the newly merged entity will have increased scale in the streaming wars, with its combined content budget now ranking third, behind Walt Disney and NBCUniversal. While this transaction may raise industry competition, it will take many years and large amounts of capital to compete against Comcast’s leading high-speed internet network, on which it spent $30 billion in expanding and upgrading over the last decade.

We remain confident in Comcast’s ability to monetise its large library of media properties in the ever-changing media landscape. Growth in the medium-term will continued to be driven by strong broadband demand, a recovery in the theme parks and narrowing losses for Peacock. At current levels, we believe Comcast’s valuation remains relatively undemanding.

The fund currently holds a ~3% position in Comcast.

Top 5 contributors and detractors for Q2 2021: Overweight positions

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Adapt IT	4.4%	1.7%	**Northam**	1.4%	-0.2%
PSG Group	4.3%	0.7%	**Altron**	3.3%	-0.1%
Bidvest	3.2%	0.5%	**Citigroup**	2.6%	-0.1%
Facebook	2.5%	0.5%	**Cigna**	2.9%	-0.0%
Bytes Technology	2.0%	0.4%	**Prosus**	0.3%	-0.0%

Top 5 contributors and detractors for Q2 2021: Underweight positions

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Naspers	-17.1%	2.2%	**Capitec**	-2.7%	-0.6%
Anglo Platinum	-2.2%	0.5%	**Richemont**	-2.1%	-0.5%
Impala Platinum	-4.0%	0.5%	**MTN**	-1.4%	-0.3%
AngloGold Ashanti	-1.7%	0.3%	**ABSA**	-1.9%	-0.2%
Sibanye Gold	-3.2%	0.2%	**FirstRand**	-2.2%	-0.2%

Current positioning and outlook

The fund ended the quarter with approximately 27% of its available 30% direct exposure to international markets.

The fund's short-term performance (one year and less) has shown meaningful improvement over the last few months. However, the medium to long-term performance remains below our expectations.

For the first time in a while, we believe the capital tension in the portfolio is robust, with a well-diversified opportunity set. This is partly a function of size, with the fund currently at ~R1bn under management, allowing us to have some exposure to businesses outside the Top40 on the JSE. At the same time, some of the well-known, larger businesses also appear particularly attractive to us at current levels (NPN, SLM etc), which leaves the fund spoilt for choice to some extent.

We started this quarter's portfolio commentary by saying it has been a relatively quiet quarter, and we would like to end this commentary by reiterating the value of patience in the journey to meaningful investment results over time. We believe compounding is a powerful force, but it does require time to produce the results. In a world where soundbites dominate conversations, due to narrowing attention spans, we believe strongly that a long-term orientation which requires extreme patience at times, is a valuable behaviour to exercise.

We look forward to the balance of 2021 and thank you for your ongoing support.

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.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

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.

NEDGROUP INVESTMENTS CONTACT DETAILS
Tel: 0860 123 263 (RSA only)
Tel: +27 21 416 6011 (Outside RSA)
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.co.za

OUR OFFICES ARE LOCATED AT
Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001
WRITE TO US
PO Box 1510, Cape Town, 8000
DATE OF ISSUE
16 October 2019