see money differently

Nedgroup Investments Entrepreneur Fund

Quarter Two, 2022

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Performance to 30 June 2022	3 months	6 months
Nedgroup Investments Entrepreneur Fund A	-6,5%	9,5%
ASISA Category Average	-9,5%	8,5%
Small Cap Index	-5,5%	19,5%
Mid Cap Index	-12,7%	3,9%

Source: Morningstar

Market overview

It was a harsh first half of the year for equity investors around the world.

Since our first quarter update, the global macro-economic growth outlook has deteriorated quite substantially. The war in Ukraine looks set to be protracted and Chinese economic activity remains stagnant due to strict Covid policies and on-off lockdowns. This has hampered supply chains and added to global inflationary pressure. In light of persistently higher inflation, monetary tightening around the world (with a few exceptions) has been faster than previously forecast.

The conflict in Ukraine has exacerbated rising inflation, creating more disruption especially through the energy and agriculture supply chains. While we hope that Russia and Ukraine will reach a peace agreement, this seems unlikely in the short term and so we need to adjust realistically for an extended period of sustained inflation and the likely economic impact.

The Federal Reserve in the US, after erroneously claiming that inflationary pressures would be "transitory" earlier in the year are grappling to contain it rising by +8.6% in May from a year earlier - the highest inflation reading in four decades. As a consequence, the Fed has aggressively raised their fed funds rate by +75 basis points in June (the largest hike since 1994) and indicated another likely +75 basis point hike at the end of July. Investor sentiment swiftly turned negative once it became clear the Fed would move more decisively on raising interest rates from ultra-low levels, with serious worries that these actions will induce a recession by the end of the year.

In South Africa, after recently emerging from one of the longest Covid lockdowns in the world, corporates and consumers are facing several headwinds, most notably continuous load-shedding as well as record fuel and food prices, and rising interest rates.

Against this backdrop world equities fell -16% over Q2, bringing the worst half-year returns since the GFC in 2008. SA equities fell sharply too, declining -11% in rand terms (-23% in US$). Resources and Financials ended the quarter down -21% and -15% respectively. Industrials held up better; down only 3% thanks to the last-minute strong performance from Naspers and Prosus in the final week of the quarter. The rand lost -11% against the US dollar over the quarter. There were few places to hide, with cash (+1.2%) the only domestic asset class to provide a positive total return in Q2 2022.

Portfolio commentary

Only a handful of stocks delivered a positive return in Q2, but the fund's allocation to a good number of these made a positive contribution. Naspers and Prosus FINALLY stood out with their +42% and +32% price appreciation after announcing a significant and open-ended share buyback. Mediclinic (+30%) announced good operational results and is the subject of takeover interest. British American Tobacco continued its steady recovery from very oversold levels, rising +13.5%.

Most mining stocks had a very poor Q2 2022 following commodity prices lower as investors fretted about the falling demand from slower economic growth induced by rising interest rates and the dogmatic zero Covid policies being followed in China. Our position in Afrimat on which we recently took substantial profits declined in sympathy with a falling iron ore price which is now a huge driver of the firm's profits.

Regular readers of our commentaries will know that Prosus and Naspers, the largest index constituent in the SA market (and essentially the same company) have been frustrating us for some time - their unnecessarily complex corporate structuring and exceedingly large investments in lossmaking ventures across the world (many in industries of dubious long term profitability such as fast food delivery) resulted in an ever-increasing discount to the underlying asset value (peaking at over 60% earlier in the year). In addition, the fashionable part of the investment world has rapidly moved on from backing "profitless tech" where management teams are doling out relatively free cash (low interest rates and high equity values with supportive shareholders) to build "scale" with the hope of eventually earning profits once the business achieves full scale. At the end of the quarter, Prosus/Naspers management announced an open-ended share buy-back, funded by the matching of open-ended sale of Tencent shares.

Although Tencent's share price has fallen significantly (it has halved since early 2021), it still represents more than 80% of Prosus' net asset value (and 125% of Prosus' market price). Selling Tencent then to fund Prosus share buybacks makes mathematical sense. The announcement alone caused a significant positive market reaction. It has, unfortunately but predictably put a dampener on the Tencent price, which has lagged the recent recovery in Chinese technology shares. Prosus management also disappointingly affirmed their determination to continue to invest capital in the rump of their assets - from food and grocery delivery in Brazil to selling secondhand cars in the US and offering Buy-Now, Pay-Later financial products in India – all increasingly loss making currently). Their investment track record in this respect is patchy at best and consequently why, despite the unlimited buyback program, we feel a discount to NAV is likely to persist. We have reduced the position into the short term very strong it has recorded.

Top contributors	Average weight (%)	Performance contribution (%)	Top detractors	Average weight (%)	Performance contribution (%)
Naspers	2,0%	0,9%	Afrimat	4,0%	-0,7%
Prosus	2,3%	0,8%	Italtile	4,0%	-0,7%
Mediclinic	2,7%	0,7%	Transaction Capital	2,3%	-0,6%
Thungela	1,6%	0,4%	Ninety One	3,0%	-0,6%
British American Tobacco	3,6%	0,4%	Impala Platinum	2,6%	-0,5%
		3,2%			**-3,1%**

Source: ABAX Investments

Currently positioning and outlook

During the quarter the fund reduced positions in Santam (ex a special and ordinary dividend) and Telkom (poor results) and sold out of Coronation (in preference for Ninety One), MMI (small position unbundled from RMI Holdings (Outsurance), Life Healthcare (in favour of Mediclinic subsequently the target of possible corporate action).

We have reduced our position in Reinet which despite the cavernous discount to NAV at which it trades we have lost all confidence in the management team constructively addressing this issue. It is quite remarkable that the matter is once again not raised at all in their 2022 integrated report.

We added to longstanding but smaller positions in Oceana Fishing, Italtile and Adcock Ingram as well as Kaap Agri (price artificially suppressed by overhang selling from the Zeder unbundling) and opened a position in very attractively priced motor vehicle dealership Motus to complement our existing position in CMH which is a similar business.

Hudaco Industries is now the fund's largest single position at about 5.1%. The business imports and distributes a wide range of quality, branded industrial consumable products from over 800 international suppliers to over

30,000 customers in Southern Africa. Further value is added by offering technical support for these products. The market in which the company operates can broadly be split into 3: consumer-facing, mining, and manufacturing. It carries over 230,000 product lines, most of which have very long lead times if ordered from the international supplier. Hudaco plays a crucial role for suppliers and customers. For customers, crucial parts are readily available without the need to carry excess stock, with technical advice as an additional service. For international distributors, there is a strong, local operator who is familiar with local legislation and boasts an extensive distribution footprint. While to investors, Hudaco might appear a small company on the account of its market capitalization (±R5bn), it enjoys market leading positions in the areas in which it operates.

The recent well publicized global supply chain disruptions, which have affected products from new cars to hot sauce, have brought to light the importance of having reliable, consistent supply. As a result, most companies are prioritizing security of supply, and they are placing orders with large, reputable suppliers. Hudaco, as a leading supplier of industrial consumables that keep the economic machine turning, has been a beneficiary of this shift, resulting in significant market share gains. The company has utilised the long-standing relationships it has with international suppliers and its strong balance sheet to ensure adequate stock availability, while also continuing to explore new opportunities. In the past 5 years, the company has increased investment in alternative energy, broadband and warehouse automation – areas that should continue to see meaningful growth. Excellent cost control is another one of Hudaco's features, which is important to be able to continue growing despite the weak domestic macro-economic environment.

While the features discussed above are impressive, it would not mean much if this could not be translated into meaningful financial performance, which is ultimately what drives shareholder returns. We are happy that in Hudaco's case, financial performance has been exceptional. The company has grown headline EPS and dividends at a CAGR of 8.4% and 10.1% over the 3 years to end 2021 and which includes the Covid impacted period. They have delivered average return on net operating assets above 20% over the same period. After reporting record first half earnings in FY21, they pleasingly grew HEPS and dividends by 25% in the first half of FY22 off that high base, despite the well-publicised supply chain issues. We are encouraged by the company's outlook statement, which points to a continuation of the momentum into the second half of the 2022 financial year. On our estimates the company trades on a 12-month forward PE of 8x and a dividend yield of 5.5%. To our minds this is very attractive given the quality and growth prospects of the company as well as the protective moat around the business model which management continue to shrewdly reinforce.

Responsible Investing

ESG thinking is embedded in our business and investment process. We carefully assess the ESG attributes of each company before deciding whether to add it to our portfolios and monitor our existing holdings for changes in their ESG profiles. We believe that high-quality companies with solid fundamentals and good valuations can offer compelling long-term investment opportunities, and that incorporating ESG research into the decision-making process improves both investment and societal outcomes.

Our investment professionals regularly meet with the management and non-executive directors of companies to discuss a range of issues relating to strategy, financial performance, governance, environmental and social topics. The main objectives of engagement are to enhance long-term shareholder value, meet our fiduciary responsibilities to our clients and benefit broader society.

Notable engagements during the second quarter of 2022 include.

- Oceana: Multiple engagements with management covering numerous issues including the recent whistleblower incident/accounting shortcomings, external auditor reappointment, remuneration, board independence/rotation and environmental impact of operations (more specifically, the effective communication of the company's actions in this regard).
- JSE: Participated in the JSE's Sustainability and Climate Change Disclosure Guidance launch.
- World Biodiversity Forum: Abax was a speaker at the World Biodiversity Forum hosted in Davos; addressing the influence of ESG issues on investment decisions.

Conclusion

After a volatile and eventful 1st half of 2022 global investors are more risk averse and circumspect of how they allocate funds. Risks associated with the FED's rate policy, geopolitics, inflation, and global growth remain top of mind and are likely to extend the volatility we have experienced in asset prices.

The South African equity market continues to offer compelling absolute and relative value when compared to elsewhere in the world. Whilst the government is moving ahead (albeit at a glacial pace) with structural reforms, the return of rolling power cuts is harming corporate and consumer confidence.

The Fund is appropriately diversified, containing businesses with attractive growth profiles and reasonable valuations. In addition, we continue to prefer companies with pricing power that are well placed to deal with cost inflation.

Despite the volatile market condition of the last quarter and negative returns we are more positive than we have been in a long time about the Fund's prospects from these levels.

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
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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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