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Private Wealth Equity Fund
Quarter Two, 2022

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Performance to 30 June 2022	Fund[1]	Benchmark[2]
3 months	-4.4%	-10.6%
12 months	1.8%	5.0%

Market Overview

In the second quarter, markets continue to be dominated by inflation fears, central bank tightening of monetary policy, as well as supply chain disruptions around the globe. The US market has seen a large reset of both equity and bond markets (some estimates of ~USD15 tn), while SA appears somewhat more sheltered given our own local dynamics. The US 10-year yield breached 3% during the quarter, a level last seen in 2018.

Central banks remain in focus as inflationary pressures remain elevated across the world. In May, the US Federal Reserve hiked interest rates by 50bps, the largest hike since 2000, while the Bank of England increased interest rates by 25bps, its fourth consecutive hike. Other monetary policy makers were even more hawkish, with countries such as Poland, hiking interest rates by 75bps. Subsequently in June, the US Federal Reserve actioned its largest rate hike since 1994, increasing rates by 75bps. The ECB kept policy rates unchanged but used the June meeting to communicate a decidedly hawkish pivot, indicating that it would end its bond-buying programme in July and commence its policy rate hiking cycle the same month with 25bps, with the possibility of more aggressive actions should the inflation outlook deteriorate.

Locally, Headline inflation surprised to the upside at 6.5% y-o-y in May, a breach of the 6% upper target of the SA Reserve Bank and the highest figure since 2017. While food and fuel remain meaningful drivers, food prices were a key source of the upside surprise. Producer price inflation again exceeded market expectations with a 14.7% increase over the year.

For the quarter, the Capped SWIX 40 delivered -10.6%, while the ALSI returned -11.7%. The benchmark composition continues to shift, given market movements, with Naspers and Prosus now constituting a collective 15.8% of the Capped SWIX 40. We highlight the JSE index review to take place in September, which will likely see this combined weighting decline going forward, due to the proposed capping methodology. FirstRand and Anglo are the second and third largest holdings in the Capped SWIX 40, behind Naspers, at 6.8% and 5.4% respectively.

Energy (+59%) and Financials (+1%) were the two best performers for the quarter, while Healthcare (-20%) and Consumer Discretionary (-24%) underperformed. Large caps on the JSE returned -9%, while Small and Mid-caps outperformed their larger peers, returning -2% and -6% respectively.

The standout performers during the quarter were Naspers (+42%), Prosus (+32%) and Mediclinic (+30%), while the laggards included Goldfields (-33%), Sibanye (-32%) and MTN (-31%).

The USD/ZAR ended the quarter 11% weaker, as bouts of extreme loadshedding sparked renewed fears across the market. In addition, some commodity tailwinds have subsided somewhat.

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

Portfolio Commentary and Activity

During the first half of the quarter, the Fund marginally increased its holding in Prosus, as the discount to the underlying NAV reached record lows (~50%). Given how wide the discount was, and the fact that Tencent itself was reasonably attractively valued, our view was that the payoff profile was compelling. Notwithstanding our assessment of the payoff profile, the Fund continued to incorporate a stringent layer of risk management via overall position size limits.

At the end of the quarter, Prosus released its final FY22 results along with the announcement of an open-ended share buyback programme, which will be funded by further sales of its stake in Tencent. Management noted that the lockup agreement on the Tencent stake was terminated, and that Tencent was supportive of further sales. At the upcoming AGM, 50% buyback authority will be requested, which shows the intent on the share buyback. We also note some changes in the remuneration structure, which is now more aligned with shareholders, by focusing on further discount reduction. Post these announcements, the share price increased sharply, and at the time of writing, the discount has already narrowed to some extent. The fund currently holds ~11% of the capital across Naspers and Prosus.

In the previous commentary, we unpacked the RMI unbundling which was finalised during the quarter. On receipt of the unbundled stakes in Momentum Metropolitan and Discovery, the fund redeployed the capital back into RMI, which for a brief period post the unbundling was mispriced, in our view, as the market digested the new structure. We continue to believe that Outsurance is a business with a strong market position, and the management team are executing on several growth initiatives both locally and abroad.

The Fund also introduced a holding in Richemont during the period. Richemont is a business that we have covered for many years, but for a long time, could not justify the premium the market was willing to pay for the business. During the quarter, Richemont sold off and provided what we believe to be an attractive entry point to initiate a position. Futher detail on Richemont's recent results follows in the next section.

Aspen is a relatively small holding in the Fund, which was also increased incrementally during the quarter. Our assessment of the current valuation is that the market has been far too punitive on the business. We have conducted a scenario analysis to account for the potential areas of concern in the business (vaccine orders, API business turnaround, Russia exposure), and believe that the valuation discounts more than a worst-case scenario resulting in an attractive risk/reward opportunity.

For the quarter under review, the fund outperformed its benchmark by ~6%. The benchmark returns were driven by a reversal of previous strong performances from Resources and Financials, which underperformed for the quarter at -21% and -15% respectively. The Precious Metals & Mining sub-sector reported a -27% decline for the quarter, which the fund has limited exposure to. For further detail on the relative performance, refer to the attribution table on page 6.

We turn now to discuss portfolio holdings and related events of the quarter.

Spar *– All eyes on Poland*

Spar released its interim results during the quarter, which reflected a stabilisation in the SA core grocery businesses' market share losses, increasing cost pressures in Spar Ireland and Spar Switzerland and a narrowing of losses in Poland.

Following a year of market share losses, the SA core grocery business reported an encouraging recovery in sales – up 4.6% for the six months compared to the -0.4% reported for FY21.

The ongoing recovery in liquor sales (+41.6%), following a period of intermittent trading restrictions, provides support to grocery sales as TOPS acts as a footfall driver to the co-located SPAR supermarkets. Build it (+1.4%) posted a resilient performance against a high base and slowing home improvement activity. Growth in operating costs (+6.9%) was contained below sales growth for the region (+7.6%); that's despite the 40.0% and 55.3% increase in fuel and marketing costs respectively. Operating profit was 8.1% higher with the operating margin stable at 3.2%.

In Poland, operating losses narrowed to R166m from R222m in the prior comparable period. Retailer loyalty levels, at 31.0%, remain below the c.40% level required for the business to achieve breakeven. Management has implemented several initiatives to improve the performance of Spar Poland, chief amongst them is the signing of new supply contracts by retailers which will require a minimum level of loyalty.
The outcome of this process, which is expected to be finalised at the end of June 2022, will be a key driver of the prospects of this business unit.

Spar faces a few challenges in the short-term, particularly turning around its Polish business, remaining competitive in a highly contested SA grocery market and implementing a group-wide SAP implementation with limited disruption to its operations. A geared balance sheet, laden with euro-denominated debt, further adds to investor concerns. Management is, in our view, taking the necessary actions to manage all these issues and has a solid track record of delivering good results.

The fund remains invested in Spar, which we believe is attractively valued. The current position size is ~2%.

Mediclinic *– Board rejects unsolicited offer*

Mediclinic reported full year results during the quarter. In Southern Africa, SA revenue exceeded pre-pandemic revenue by 8%. Occupancies improved to average 64.3% and are approaching pre-pandemic levels (FY20: 67.9%). Average revenue per bed day (+3.2% y/y) was 11.7% higher than pre-pandemic levels, reflecting elevated acuity of treatments. Average length of stay reduced by 2.5%, reflecting the increase in non-Covid-19 Paid Patient Days ("PPDs"), which have a shorter average length of stay compared with Covid-19 inpatients. Adjusted EBITDA grew 55% y/y in constant currency but remained 3% below pre-pandemic levels. The EBITDA margin came in at 18.6%, up from 14.2% in the prior period. The effects of Covid-19-related costs and the change in case mix continued to weigh negatively on the margin when compared with the pre-pandemic period (FY20: 20.8%). The division reported a cash conversion ratio of 108% (FY21: 111%).

Swiss revenue exceeded pre-pandemic revenue by 4%. The occupancy rate came in at 62.6% which improved due to the 0.4% growth in average length of stay together with growth in inpatient activity. Outpatient and day case revenue contributed ~20% to total Swiss revenue. Adjusted EBITDA grew 9% y/y in constant currency. The EBITDA margin came in at 15.6% (FY21: 13.1%). However, the margin remained below pre-pandemic levels (FY20: 17.0%).

Overall, adjusted earnings per share grew 65% to ~23 pence. All three divisions' earnings in local currency were ahead of pre-pandemic levels with only translation differences resulting in the Group adjusted earnings being down 6% vs pre-pandemic levels. The balance sheet continues to de-gear, with net debt to EBITDA reducing from 5,1x to 3,9x. The dividend was reinstated at 3 pence/share, which represented 25% of the second half's adjusted earnings.

In May, the Mediclinic board rejected a cash offer by a Consortium for the entire share capital of the group, not already owned by Remgro (current holding 44.6%). The Consortium is comprised equally of Remgro and SAS (MSC Mediterranean Shipping Company SA). The offer price was set at 463 pence/share. This equates to a 23% premium to the 25 May 2022 closing price. The offer price included the final dividend of 3 pence/share declared by Mediclinic on 25 May 2022. Post quarter end, a revised offer was made at 503 pence/share, which the board has indicated it will approve should a firm offer be made in August.

The fund continues to hold a ~2% position in Mediclinic and will re-assess its position should a firm offer be made.

Richemont – *Attractive entry point*

The luxury goods sector has been one of the beneficiaries of Covid/lockdowns over the last two years, with demand surging across the globe. In May, Richemont reported its full year results which were characterised by record sales, a more than doubling in operating profit, a 55% increase in net cash and a special dividend of CHF1/share.

Group sales reached an all-time high during the period – and are 35% above pre-pandemic levels – reflecting double-digit growth across all Maisons, channels and regions. The group's three Jewellery Maisons, Buccellati, Cartier and Van Cleef & Arpels, together achieved 49% growth in sales. The Specialist Watchmakers division staged an exceptional recovery, reporting sales growth of 53% and margins last seen in FY16. The group's Online Distributors (YNAP and Watchfinder) and Other businesses (fashion & accessories) grew sales by 27% and 53% respectively, and both reported a reduction in operating losses.

On a regional basis, the Americas (+79%), Middle East and Africa (+54%) and Europe (+51%) were the largest contributors to growth. The gross profit margin gained 290bps as the benefits of a favourable regional and channel sales mix, higher manufacturing capacity utilisation and select price increases more than offset rising input costs. Growth in operating costs of 35% was well below sales growth. Driving the increase in costs was a sharp recovery in marketing costs back to pre-pandemic levels (10% of sales), investments into new stores and manufacturing capacity, as well as additional reward payments to employees given the group's strong performance. Cash generation remained strong, aided by a measured increase in working capital, driving the significant rise in the group's net cash position. The EUR5.2bn net cash represents c.9% of Richemont's current market capitalisation.

Following a year of extraordinary growth, we expect a meaningful slowdown in sales growth over the coming year and a normalisation to high-single digit growth – in line with historical trends – thereafter. Solid demand for branded jewellery, improving fundamentals in the Specialist Watchmakers division as well as narrowing losses in YNAP and the fashion & accessories business underpin the strong earnings growth we expect from Richemont over the medium term.

The fund currently owns a ~2% position in Richemont.

Northam Platinum – *Corporate action ongoing*

The fund has been a holder of Northam since 2020. During the quarter, the group reported a weak set of results for the interim period ended December 2021. At the mining level, production volumes were flat – not an ideal outcome for a company guiding for class-leading growth over the medium term. Revenues were supported by a 15% increase in the average ZAR-based PGM basket price, while an 18% increase in mining and concentrating costs limited the flow through to earnings.

The Zondereinde mine (deep-level, labour-intensive, conventional mine) reported a 6% y/y decrease in 4E metal production to 157 koz. Management attributed this decrease to a combination of safety incidents and Covid-related absenteeism, which has also been cited recently by peers with similar mines. The mine is largely at steady state, with modest incremental growth towards 350 koz per annum still to come.

The Booysendal mine (shallow, mechanised mine) reported a 5% y/y increase in 4E metal volumes to 179 koz, despite several incidences of regional community unrest. The unrest, as we understand, is related to general service delivery in the surrounding area as opposed to industrial action. Unit costs increased by 19% for the mine, due to lower-than-expected volumes along with rising labour and operating fleet costs.

It is worth noting that the Booysendal closing headcount increased by 18% y/y, as an expanding mine needs to employ additional workers prior to the planned volume uplift. Naturally, this leads to unit costs increasing before the benefits of growth are realised. The annual production target of 500 koz remains on-track and is expected to be achieved by 2025.

The balance sheet is healthy and within management's target of 1x net debt to EBITDA. The accelerated maturity of the Zambezi BEE transaction resulted in a total outflow of R6.6bn, including taxes. During the period, R4bn was paid for the 35% stake in RBPlats, with a further R4bn deferred to April 2022 and a further R1.6bn deferred to September 2022.

The longer-term impact of the RBPlats stake may work out favourably for Northam. We view Impala as needing to find a way to augment the RBPlats mining assets with those of its own Rustenburg mine, before the Rustenburg volumes start declining from approximately 2025 onwards. This, arguably, places Northam in a stronger negotiating position as its 35% stake can act as a roadblock to Impala's aspirations. We view a joint venture agreement as most likely. Another likely possibility would be an arrangement where Impala gains access to its most-desired RBPlats mine assets, while Northam takes the balance.

Notwithstanding the impact of potential further M&A surrounding RBPlats, we are mindful that Northam's earnings ultimately remain leveraged to the PGM basket price. Prior to recent geopolitical events, the PGM basket was at the mercy of the semiconductor chip shortage. We are of the view that the chip shortage gradually eases over the course of 2022, which should be positive for palladium and rhodium demand. Current geopolitical outcomes and resulting macroeconomic implications pose a risk to this view, to the upside and the downside, as both supply and demand could be significantly affected.

The fund retains a ~3% holding in Northam, which is the only direct PGM exposure in the portfolio.

Detailed fund attribution: Q2 2022

Top 5 contributors and detractors for Q2 2022: <u>Overweight</u> positions

Top contributors	Average relative weight	Performance contribution	Top detractors	Average relative weight	Performance contribution
Prosus	2.4%	1.1%	**Quilter**	1.8%	-0.3%
Cigna	3.3%	1.0%	**Sanlam**	1.7%	-0.2%
Mediclinic	2.8%	1.0%	**Northam**	1.7%	-0.2%
Alibaba	2.0%	0.5%	**Spar**	2.1%	-0.2%
RMI	1.6%	0.3%	**Meta**	1.8%	-0.2%

Top 5 contributors and detractors for Q2 2022: <u>Underweight</u> positions

Top contributors	Average relative weight	Performance contribution	Top detractors	Average relative weight	Performance contribution
Sibanye	-2.8%	0.7%	**Naspers**	-4.5%	-2.6%
Goldfields	-2.3%	0.6%	**Sasol**	-2.5%	-0.3%
MTN	-2.2%	0.5%	**Mondi**	-1.0%	-0.1%
Anglo American	-2.2%	0.5%	**Glencore**	-1.1%	-0.1%
Anglo Gold	-1.8%	0.4%	**Exxaro**	-1.2%	-0.1%

Current positioning and outlook

The Fund ended the quarter with approximately 26% direct exposure to international markets. The top 10 positions in the fund account for ~44% of the capital, with a total of 35 holdings.

Economic data releases continue to show negative trends across the globe. Given the base effects at play, and the fact that the data is very much backward looking, we are mindful of our overall objective of long-term compounding. We do not forecast economic data, but rather continue to position portfolios for a range of outcomes. Despite the negative headlines, we believe patient, long-term, valuation-based investors, are able to navigate the volatility and identify inflation-beating investment opportunities.

The relative performance over the quarter is encouraging, but we continue to strive to improve the longer-term performance which remains below our expectations.

We look forward to the balance of 2022 and thank you for your ongoing support.

Disclaimer

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