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NEDGROUP INVESTMENTS
Private Wealth Equity Fund

Quarter Four, 2022

Nedgroup Investments Private Wealth Equity Fund

Performance to 31 December 2022	Fund[1]	Benchmark[2]
3 months	7.6%	13.4%
12 months	-2.7%	6.5%

Market Overview

Financial markets ended a challenging year on a mixed note, as investors held both the easing of China's restrictive zero-COVID policies, and optimism that a moderation in the global interest rate hiking cycle is underway, against weakening economic activity data and the anticipation of slower global growth in 2023. This prompted lower bond yields and a US dollar that depreciated by c.7,7% over the quarter. Volatility aside, risk assets staged a credible rally over the fourth quarter with developed market equities banking double digit returns.

For markets in general, the year was defined by the impact of inflation, geopolitics and a steep global interest rate hiking cycle which led to the uncommon breakdown in negative correlation between equities and bonds and saw both asset classes deliver meaningful negative returns for the year. Outside of the US dollar (+7,9%), energy sector and specific commodities, there were few places to hide. Interest rate sensitive growth stocks, in particular technology counters, declined meaningfully from their relatively high valuations at the start of the year, especially relative to value stocks. Local Chinese markets rallied once more in December as Covid restrictions were lifted, with the Hang Seng gaining 6,4% over the month and 15,7% over the fourth quarter. This provided some ballast to emerging markets, which have been under duress from weak economic growth in China, higher interest rates and a very strong US dollar.

Faced with intense loadshedding, floods, multiple strikes and transport challenges, the South African economy has shown remarkable resilience over the last year as activity normalised after each shock. Third quarter GDP printed at 1,6%, exceeding market expectations with the help of robust results from the agriculture and finance sectors. Of course, the normalisation of activity after the pandemic is set to run its course and incoming activity data shows the foundations for economic growth remain at risk from continued loadshedding, which escalated to stage 6 again in December. Credit ratings agencies S&P (positive outlook) and Fitch (stable outlook) reaffirmed the country's current credit ratings, but Moody's opted not to use the scheduled date.

The South African Reserve Bank (SARB) increased interest rates by 75bps in November, the third consecutive hike of this magnitude. Three members voted in favour of a 75bps hike and two were in favour of a 50bps hike, signalling that a smaller hike may be considered at the next meeting. Local bond markets and the currency suffered in the wake of the Phala Phala report in early December, but were buoyed by global bond trends, moderating price gauges and continuity in leadership following the ANC national conference.

For the quarter, the Capped SWIX 40 delivered 13.4%, while the ALSI 40 returned 15.2%. It is worth highlighting that Richemont and Anglo American now constitute ~30% of the ALSI 40.

Most sectors had positive performance during the quarter. Technology (+24%) and Consumer Discretionary (+23%), were the best performers for the quarter, while Energy (-7%) and Healthcare (+2%) underperformed. Overall, the Top 40 returned 17.1%. Small Caps returned 4.4%, while the Mid Cap index returned 8.0% for the quarter.

The standout performers on the JSE during the quarter were Investec (+54%), Harmony (+38%) and Richemont (+30%), while the laggards included Montauk (-38%), Telkom (-35%) and Spar (-19%).

The USD/ZAR ended the quarter 6% stronger as global markets ended the year with somewhat of a relief rally.

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[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 quarter the fund exited two offshore holdings, Stryker and Meta. We have written about these two names in the past explaining our investment thoughts. Stryker was exited on valuation grounds and the proceeds was used to top up some of our SA positions to balance the overall portfolio with respect to currency risk. Meta was exited in a phased manner due to repeated slippage of our key performance indicators which we use to track our investment case. Ultimately, we view the investment case as having changed significantly as more and more capex will be required for the business to maintain its position, as well as the large amount of capital being deployed into the Metaverse which has a wide range of outcomes at this point.

Locally, the fund added to its position in Sasol on weakness, given our assessment of the valuation range of outcomes from current levels and our constructive view on the oil price over the medium term. The Sasol top-up purchases were funded from trimming our Northam position where the RBPlats deal remains an uncertainty and overhang.

The fund also initiated a position in Remgro after not owning the business for a few years. Remgro offers investors diversified exposure to several good quality businesses and have more recently taken some positive steps to try an alleviate the wide discount to NAV at which the business trades. We believe the strong balance sheet and ample firepower via its held for sale investments, could be used to meaningfully return capital to shareholders at an attractive price over the short to medium term. We also own some of the portfolio holdings directly, including Outsurance and Firstrand.

For the quarter under review, the fund underperformed its benchmark by 5,8%. The benchmark returns were driven largely by Resources (+16%) and Industrials (+15%), while Financials underperformed despite posting double digit returns (+13%). Naspers and Prosus staged a welcomed recovery during the quarter, returning 25% and 24% respectively. The fund remains overweight Prosus and Underweight Naspers. For further detail on the relative performance, refer to the attribution table on page 5 and 6.

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

Prosus *– Capital Markets Day*

Prosus held its Capital Markets Day (CMD) on the 6th December and presented on classifieds, payments & fintech, edtech, food delivery, sustainability, capital allocation and its path to profitability. To improve value creation, the management team indicated that it will: (i) accelerate ecommerce profitability, (ii) continue with its open-ended share repurchase programme, (iii) benefit from a strong recovery from Tencent, and (iv) explore ways to further simplify the group’s structure.

Ecommerce profitability will be enabled through: (i) scale dynamics, with the Group exiting those markets/areas where it cannot achieve sufficient scale, (ii) growth ahead of peers in fast growing markets, and (iii) cost optimisation and efficiencies in all segments, in all markets. We are encouraged by the level of financial disclosure and detail shared to the market.

The path towards controlled asset profitability is clear, detailed and well-articulated. The Group is committed to reaching profitability by 1H25. Losses are guided to reduce rapidly as the Group benefits from scale, prioritises best initiatives, and through significant cost optimisation and cost reductions. Targeted trading margins are set as follows: Classifieds +35%, Food delivery +25%, Payments & fintech +10%, Edtech +15%. We view these as achievable, with potential surprise to the upside. We note that management was unable to provide guidance on when the core would reach free cash flow breakeven – albeit that it will be later than 1H25.

The share repurchase enables the reduction in shares, which in turn results in higher NAV per share given the lower share count. Tencent is viewed as a prized asset given its unique position in the Chinese internet market. Prosus sees Tencent as core and is a committed long-term holder. No details were released on how the group might further simplify its structure. This also remain subject to regulatory and tax implications.

On capital allocation, the focus is on investing in the things the Group knows well and on shifting capital to the buyback based on market conditions and the level of the discount. The portfolio is reviewed periodically which enables the Group to continually re-evaluate and reshape – thus resulting in a “cycle of value creation”.

At current levels, we view Prosus as undervalued and Naspers as fairly valued. We own both Prosus and Naspers and are overweight Prosus and underweight Naspers relative to the capped SWIX40 benchmark. The fund currently has a position size of ~10% in the combined entity.

Spar *– Lots of moving parts*

Spar released FY22 results during the period, which were characterised by margin pressure in SA and Ireland, narrowing losses in Poland – although below expectations – and higher debt levels. The R1bn increase in debt reflects an increase in bank overdrafts to fund additional inventory and the impact of a weaker rand given the group’s predominantly (98%) foreign currency denominated debt.

Spar continues to face several challenges over the short to medium-term, most significantly; 1) turning around its Polish business, 2) regaining market share and remaining competitive in a highly contested SA grocery market, and 3) implementing a group-wide SAP implementation with limited disruption to its operations.

Management is now guiding for SPAR Poland to breakeven at operating level in FY24. This requires an increase in revenue through higher retailer loyalty – currently more than 60% in the north of Poland and 40% in the south with 90 stores in each region – and an increase in the store network. Driving retailer loyalty involves improving engagement with retailers, competitive pricing and broadening the product range.

Management aims to add at least 40 new stores per annum over the next few years through the onboarding of independent retailers under the SPAR brand. While management remains confident that there is a large addressable market of independent retailers, they admit that the uptake of the SPAR brand has been slower than what was anticipated on entry into Poland a few years ago.

The core SA grocery business has underperformed relative to peers over the last two years. Part of this has been driven, in our view, by a loss of focus at a time when competitors were sharpening theirs. Recent changes in the management structure of the SA business and a renewed focus on better retail execution aim to address this underperformance. The increase in promotional activity, acceleration in store upgrades and the launch of SPAR2U (on-demand offering available in 87 stores as at year end) during the period add support to this endeavour.

The SAP implementation commenced in October 2022 and will continue over the next 18 months; one distribution centre and one region at a time to minimise the potential business disruption (of this notoriously disruptive process). While the current SAP implementation relates only to the distribution business, the group is considering a systems modernisation of the independently owned SPAR retail stores.

This system upgrade, while not yet finalised, is likely to take place in the next 2-3 years, over a period of 12-24 months, to enable the group to leverage the full benefits (eg. better stock availability and more efficient replenishment) of a fully integrated end-to-end system.

The actions being taken by management to address the group's various challenges are sound. The outcome, however, is far from certain. We expect the turnaround of SPAR Poland and the recovery of the SA grocery business to be gradual. While the currency mismatch between debt and earnings remains a risk – a risk that materialised in the current period – we view absolute debt levels and the serviceability thereof as manageable for a cash generative and defensive business such as Spar.

To add further complexity, Spar faced several corporate governance failure allegations in the media in quarter four, which further pressured the share price. Management have detailed some of their responses, and at the time of this writing, we are in the process of re-visiting the merits of the investment proposition.

At current levels, we believe Spar is under-valued. As at the end of the quarter, the fund held a ~2% position in Spar.

Altron– *New CEO*

Altron released a reasonable set of results for the six months, which showed revenue growth across all divisional clusters. Management however, highlighted margin pressure, from both demand and supply factors, which impacts margins and profitability for the businesses.

This set of results was broadly neutral for our investment case, coupled with a deterioration in our outlook for Netstar, given the margin pressure that management expect will continue in the near future.

The appointment of an industry veteran to the CEO position, Werner Kapp, provides stability and likely continuity to the existing strategy. The backdrop however is extremely challenging, but the new CEO appears ready to step in and roll up his sleeves to get the job done for shareholders.

The setback with the disposal timeline of Altron Document Solutions (ADS) is not ideal, but management appear confident that the sale will still take place within twelve months. This is one of the key performance indicators which form part of our investment case, which should it not occur, will be a setback for our balance sheet and capital return outlook for the business. Our understanding is that the outstanding conditions precedent relate largely to regulatory approvals, which are expected to be received early next year.

We have reduced our margin assumptions mainly for Netstar, which is offset by slight improvements in our revenue assumptions for the other business units, on the back of this period's performance. The balance sheet remains strong and should be further strengthened by the pending sale of ADS.

Management also highlighted an imminent announcement regarding the sale of the banking solutions business within the Managed Services cluster. We will pay close attention to the multiple received for this unit, given Altron's current depressed implied valuation (excluding the ADS proceeds). Going forward, assuming the balance sheet de-gears and is strengthened in line with our expectations, we would expect a balance of capital returns with bolt-on M&A to be the pathway to further value creation.

At current levels, we believe Altron is undervalued. The fund currently owns a ~3% position in Altron.

Detailed fund attribution: Q4 2022

Top 5 contributors and detractors for Q4 2022: <u>Overweight</u> positions

Top contributors	Average relative weight	Performance contribution	Top detractors	Average relative weight	Performance contribution
Prosus	3.3%	0.4%	**Brookfield**	3.3%	-0.7%
Northam	1.1%	0.2%	**Spar**	2.0%	-0.7%
Bidcorp	1.2%	0.1%	**Alphabet**	2.4%	-0.7%
Glencore	0.5%	0.1%	**Meta**	0.9%	-0.5%
Discovery	1.0%	0.1%	**Sanlam**	1.4%	-0.3%

Top 5 contributors and detractors for Q4 2022: <u>Underweight</u> positions

Top contributors	Average relative weight	Performance contribution	Top detractors	Average relative weight	Performance contribution
Clicks	-1.6%	0.3%	**Naspers**	-5.5%	-0.6%
TFG	-0.8%	0.3%	**Impala**	-3.5%	-0.4%
Shoprite	-2.5%	0.2%	**Anglogold**	-1.8%	-0.3%
Mr Price	-1.0%	0.2%	**Investec**	-0.8%	-0.2%
Firstrand	-3.7%	0.2%	**Capitec**	-3.6%	-0.2%

Current positioning and outlook

The Fund ended the quarter with ~24% direct exposure to international markets. The top 10 positions in the fund account for ~43% of the capital, with a total of 33 holdings.

2022 was a tough year for global financial markets as evidenced by the MSCI World Index falling 18% for the year. With many market moving events taking place during the year, together with a backdrop of sharp increases in interest rates after record lows for several years, there were only a few places to hide. The JSE was somewhat shielded and stands out from a performance perspective especially against US indices (S&P -18%, Nasdaq -33%).

We have no crystal ball for 2023 in terms of market moving events, but believe the broad themes of interest rates, inflation and geopolitics will continue to dominate. We continue to focus on downside risk and balance sheet strength and remain cognisant of the long-term fundamentals of the businesses we own, despite the macro-environment.

The performance of the fund remains behind our expectations, and we continue to strive to improve performance over all meaningful periods.

Thank you for your ongoing support and we look forward to a fresh 2023.

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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