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NEDGROUP INVESTMENTS ENTREPRENEUR FUND

Quarter One, 2023

Nedgroup Investments Entrepreneur Fund

Performance to 31 March 2023	Nedgroup Investments Entrepreneur Fund[1]	ASISA category average	Small Cap Index	Mid Cap Index
3 months	0.1%	0.4%	0.8%	-0.9%
12 months	-0.6%	-3.7%	4.2%	-5.9%

Market commentary

In the December 2022 commentary we bemoaned the tough year for equities, impacted by worse than expected inflation, China's harsh zero-Covid policy, extreme weather events and the Russian invasion of Ukraine, all of which conspired to create great angst, volatility, and poor returns. Locally, "Stage 6" entered the lexicon and our politics continued to be messy, yet SA outperformed global markets by not falling nearly as much.

Given this bleak backdrop, Q1 turned out much better than expected, although – as always – not necessarily in the order one expected it to be:

- Central banks continued to raise interest rates, the optimists seeing every hike as one step closer to the inevitable pause and then decline in rates – this might be too simplistic.
- The Ukraine war arguably got worse with no clear practical solution.
- We experienced a banking crisis significant enough for Credit Suisse to find itself one day away from bankruptcy before being taken over. But regulators and central banks stepped in very quickly to pacify markets and offer guarantees.
- The one big positive surprise was China's sudden abandonment of its zero-Covid policy. Against the odds, the mass infections that followed did not translate into equivalent mortality rates and very rapidly subsided – whether this was good fortune or scientific planning will remain a mystery.
- In SA, loadshedding got much worse, causing material economic disruption, and leading to significant business investment in alternative supply. It remains to be seen whether the newly appointed Energy Minister will solve this problem, however based on the State's track record we expect this is unlikely.
- As generally expected, SA got grey listed by the Financial Action Task Force (FATF) on concerns about our anti-money laundering and counterterrorism financing measures and could have negative consequences for the country's ability to attract foreign investment and conduct international financial transactions. To address these concerns, South Africa will need to take decisive action to strengthen its regulatory and enforcement frameworks and demonstrate a commitment to combating financial crime, where to date it has shown almost no success and limited commitment.
- The USD did not weaken as expected, but rather strengthened.
- Chat GPT dominated all discussions – Abax can vouch that this report was all written by a human.

Global markets reacted swiftly to the great China re-opening and the MSCI All World Country Index appreciated 7.3% in USD in Q1, bookended by the Nasdaq's 16.7% appreciation and the Hang Seng's modest 2.5%. The JSE All Share ended up 5.2% in ZAR (a mere 1% in USD as the Rand depreciated), reversing some of last year's outperformance. The Midcap Index was down 0.9% and the Small Cap Index was up 0.8%.

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

In March 2023, the IMF slashed South Africa's growth outlook, expecting South Africa's gross domestic product to increase by only +0.1% in 2023, significantly lower than its January forecast of +1.2%, citing the country's deteriorating electricity situation. It is also no surprise, that South Africa's Q1 consumer confidence index slumped to -23 points, the lowest reading on record since 1994. This too is indicative of extreme concerns among consumers about loadshedding, economic prospects and household finances.

Portfolio Commentary

Q1 2023 started off well ahead of expectations, however the return line was predictably not linear. January saw a significant relief rally after the surprising sudden stop to the harsh zero-Covid policy in China, especially as the sudden mass infection did not result in the feared high mortality rates. However, having gotten off to a strong start, the Small and Midcap indices were quite weak in March, resulting in returns for the quarter of 0.8% and -0.9%, respectively. Entrepreneur followed suit and ended the quarter up just 0.1% which, while not too exciting in absolute terms, was encouraging relative to the indices.

The top 2 contributors to our performance in the quarter released exceptional results, while the Naspers/Prosus complex benefitted from a recovery in the Tencent share price, which was in turn driven by the China reopening. Further positive contribution came from some of our long-held names, together with Premier, a new name in the fund. The successful listing of Premier (albeit at the second try), was a positive development for our market, which has recently seen more de-listings than listings.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Sun International	3.7%	1.4%	KAP	4.7%	-1.5%
Hudaco	5.7%	1.0%	Transaction Capital	2.0%	-1.5%
Reunert	4.3%	0.8%	Thungela	2.0%	-1.0%
Prosus	4.0%	0.7%	Impala Platinum	2.4%	-0.5%
Naspers	4.0%	0.6%	Pepkor	3.0%	-0.4%
Total		4.4%	Total		-5.0%

Sun International, which was introduced into the fund just over a year ago, continued its strong recovery. The company's FY22 results pointed to market share growth, increased profitability and strong cashflow generation, which resulted in a stronger balance sheet (gearing now below target) and a resumption of dividends. Despite the share price recovery, we are still positive on the company's prospects, and we believe the valuation still looks attractive.

Hudaco and Reunert are familiar names in the fund, and we are happy to see our patience being rewarded.

Unfortunately, KAP's share price began weakening at the start of the year, and their weak interim results failed to spark a recovery. While the results showed strong revenue growth, headline earnings were down, mainly due to high input cost inflation, loadshedding, constrained consumer wallets and a breakdown at their PET (plastics) plant. While the operating environment remains challenging, the company has initiated several initiatives that should aid performance, going forward.

Transaction Capital, despite being a relatively small position in the fund, was the second largest detractor in the quarter, after releasing a weaker than expected earnings guidance. More detail has since been provided and the company is now trading off its lows, but still well-below pre-announcement levels.

Current positioning and outlook

We reiterate the point we made in last quarter's commentary. It is impossible to grow an economy without more power and business and consumer confidence will not show any sign of recovering until this problem is addressed. With the government continuing to pursue uninspiring strategies to try and resolve issues, most companies have taken it upon themselves to create a stable operating environment. Companies are investing in alternative energy and stepping in to address government shortcomings in other areas as well.

Against this backdrop, the portfolio has a heavy tilt towards quality companies with operations that should weather the weak economic environment better than peers, if not benefit in some instances. The Small and Midcap sectors typically fall out of favour during weak economic cycles such as the one we find ourselves in. The share price and valuation weakness we are seeing now has spared no one, and we believe some good companies are trading at attractive valuations. This is demonstrated by the current PE of the fund being 7.7x and the dividend yield, 5.5%. While it might take some time for the value we are seeing to be unlocked, we would not be surprised to see alternative buyers approach companies in the fund, as has been the case for the past few years.

Responsible Investment

Responsible investment is crucial for creating sustainable, long-term value for investors and society as a whole. By considering environmental, social, and governance (ESG) factors in our investment decisions, we can help drive positive change and promote responsible business practices. Responsible investment also helps to mitigate risks, as companies that fail to manage ESG risks are more likely to experience financial and reputational damage. As such, responsible investment is an essential part of our effort to achieve financial objectives while also contributing to a better future for all.

Abax actively and consistently engages with companies and other stakeholders to address ESG issues. Notable engagements during the first quarter of 2023 include:

- Mr Price: Participated in an ESG engagement with management covering the company's alignment with UN SDGs as well as their ongoing effort to improve supply chain transparency and sustainability.
- Spar: Engagement with Chairman and Interim CEO regarding recent governance concerns, CEO resignation, ongoing litigation, and business risks (Poland, elevated debt, South African underperformance).

Conclusion

There are plenty of reasons for caution at this standpoint. Many of the risks that led to last year's extraordinary confluence of negative events remain unresolved. And now one can add a banking crisis (albeit being well managed so far).

Overall, the South African economy remains in a challenged position, with significant structural and institutional hurdles to sustained growth and development. While there are some signs of progress, much more needs to be done to address the root causes of the country's economic challenges and put it on a path toward a more prosperous future.

Having said this, we remain confident that the fund is well positioned to not only weather a weak (and sometimes chaotic) macro-economic environment, but also benefit from any improvement we might see. This opinion is principally based on the extreme low levels of valuation both on an absolute and relative historical and forecast basis in the fund.

Disclaimer

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