NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS ENTREPRENEUR FUND

Quarter Three, 2023

Market commentary

The first nine months of 2023 saw material divergence in performance between regions, currencies and asset classes. Against a backdrop of much uncertainty over central bank interest rate decisions, sticky inflation, growing geopolitical tensions and extreme weather events, investors valiantly attempted to pre-empt central bank moves. The consensus view at the beginning of the year was that inflation would rapidly decline, mostly on account of base effects, that central banks would start cutting interest rates in H2 and that Chinese growth would bounce back after their gruelling zero-Covid policy. This was not to be. South Africa got caught in the cross-fire, also scoring predictable own goals (ongoing loadshedding, global non-alignment, Lady R, Phala-Phala, Grey Listing, Transnet implosion etc.).

The Rand devalued 11% against the USD during the first 9 months, materially impacting our already poor economic prognosis. The FTSE JSE Capped Shareholder Weighted Index declined 3.8% in Q3, erasing earlier gains to now be -0.3% for the year to date. To demonstrate the divergence, the S&P500 index also declined 3.2% in Q3, but is still up 23.8% for the year (as measured in ZAR). The SA performance is particularly disappointing, considering that about 2/3 of the profits of SA listed equities come from outside SA (almost all the mining houses, Naspers, Richemont, British America Tobacco and Anheuser Busch are almost 100% offshore earners, with a range of other companies also earning significantly outside our borders).

On a year to date basis, although the overall market is flat, Financials are up +6.8% and Industrials are +10.1%, with the overall market dragged down by the fall we have seen in the Resource sector -14.4%. In contrast the relatively Resource stock light Mid and Small Cap Indices have returned -0.3% and +2.4% respectively.

Looking ahead, we should not confuse the narrow market rally with the health of the global economy. Core inflation measures in developed markets are resurfacing and remain stubbornly high, with US rate cuts now only expected in 2024 (much later than what was expected at the beginning of the year). Higher borrowing costs will continue to test economic resilience and geopolitics, which are surging again today with the outbreak of conflict in the Middle East, and will add to unpredictable economic outcomes. Investors should be prepared for further market volatility.

Portfolio Commentary

The fund had a very satisfactory quarter in Q3, rising by 2.4% and out-performing all benchmark indices and the peer group.

Sun International	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Sun International	5.4%	1.5%	Italtile	4.4%	-0.8%
Advtech	5.3%	0.8%	Prosus/Naspers	8.9%	-0.5%
Curro	3.0%	0.5%	Kaap Agri	4.7%	-0.4%
AECI	1.3%	0.3%	KAP Ind	3.6%	-0.4%
AVI	3.5%	0.3%	Transaction Cap	1.3%	-0.3%
Total		3.4%	Total		-2.4%

We wrote last quarter about the negative impact we have suffered as a result of our exposure to Transaction Capital. The company remains delicately balanced as a very sceptical market seems to doubt the assurances management have given regarding the ring fencing of SA Taxi debt and their commitment not to inject further capital into that business. They also announced a management change with the CEO stepping down – normally a bad sign. We met with the company again in September and considering the small position in the fund to (to which we added) we have retained the holding. We think the outcomes for shareholders will be binary – either bankruptcy or we will recover a multiple of our investment. The reality is that business conditions remain difficult for the customers of SA Taxi, interest rates are not expected to start falling until at least mid-2024. As a result we are only likely to see the likelihood of this firm's survival in 6 – 9 months – still some time away.

The portfolio currently has 9% in private education stocks. While ADvTECH has been a core holding for a several years and a steady performer, we introduced Curro as a second holding in the sector in the second quarter of 2023.

We find the sector attractive for several reasons. Firstly, most schools in the public education system are failing, presenting a large market opportunity, providing the issue of affordability can be overcome. Secondly, companies in this space have learned the painful lessons of expanding too fast and committing too much capital too quickly, and the importance of focussing on cost control and efficiency. Thirdly, the brands are increasingly well-known and respected in the market, and the product offering has been refined to cater for the current macro-economic environment. Last, but not least, the companies' earnings prospects are attractive, we estimate a 3-year earnings CAGRs of 15% and 28% for ADvTECH and Curro, respectively. However, despite displaying these attractive attributes, both companies trade on low double-digit forward PE ratios. They also offer growth prospects that are independent of the SA macro limitations and a long possible trajectory as the State Education system in most parts of the country continues to crumble and collapse.

It would be natural to ask why we added Curro after avoiding it for many years, and whether we should have both companies in the portfolio. To answer the first question, the simple answer for many years is that it was just too expensive – but with the share price falling from over R40 in 2016 to below R10 earlier this year it entered interesting valuation territory. In addition we have been encouraged by Curro's revised strategy which is now focused on growing into their existing capacity of a very well-invested asset base. We expect this strategy to support earnings growth and improve return metrics. To answer the second question, the two companies have slightly different characteristics. Curro is more focused on SA K12 education, while ADvTECH is more diversified, with sizable operations in SA & Africa K12, varsity and resourcing. Additionally, ADvTECH is more mature, as shown by the slightly slower expected earnings growth, but better cashflow and return metrics. As such, the two companies offer slightly different characteristics to the portfolio, but are both exposed to attractive, powerful growth trends.

We used the bounce in AECI to sell out of this small holding completely. It is a complex, capital intensive business that we do not consider a long term holding.

Current positioning and outlook

We have little to add to what we said in last quarter's commentary and that is simply to remind investors of the tremendous value in the stocks we hold and that can be found in the broader mid and small cap space in South Africa. We often feel that we are swimming against the tide as every investor we engage with (private and institutional) seems determined on extracting every Rand they possibly can from the SA market and this is very apparent from only a cursory analysis of JSE trading statistics and cashflows within the industry. However we are confident our patience will be rewarded, and so far despite the problems recent returns have been more than satisfactory, with a 3 year compound rate of return delivered of >15%.

We are by no means observing our very obvious domestic problems through rose tinted glasses – but we are also able to find and invest in businesses weathering these storms well and finding innovative ways to thrive – there are many examples in the fund and the case of the private education sector discussed above is only one.

Responsible Investment

We focus on doing the right thing for our clients, community and the environment and we expect the same from the companies in which we invest. We seek to invest in companies that are well positioned to provide sustainable returns into the future and that consider their impact on all stakeholders. Abax actively engages with companies and other stakeholders to address ESG issues. Notable ESG engagements during the third quarter of 2023 and that are applicable to the fund include:

- Woolworths: Engaged with food and sustainability experts discussing how Woolworths Food business is supporting a healthy and sustainable world.
- Multichoice: Engagement with several board members on various governance matters, with an emphasis on remuneration practices.
- Naspers / Prosus: Engagement regarding remuneration practices which we regard as excessive and not adequately aligned to shareholders.
- Pepkor: Engaged with the company regarding the impact of the Cape Town taxi strike, how they ensured continuity of operations as well as the treatment of staff.
- Mr Price: Participated in an independent stakeholder engagement survey.
- Pick n Pay: Engaged with the company regarding the impact of the Cape Town taxi strike, how they ensured continuity of operations as well as the treatment of staff.
- EWT Biodiversity Framework: Abax was co-opted to participate in development and monitoring of biodiversity performance ratings of SA companies.

Conclusion

We continue to expect a volatile and possible weak period in the second half of the year, as hawkishly high interest rates and stubbornly high inflation in the US pressurise monetary authorities. The start of the US election cycle will be fraught with antagonistic comments and grandstanding to win support and comes at a time when geopolitical tension in many parts of the world is already high and sensitive.

The South African equity market continues to be very attractively priced, but with a looming election in 2024, a gloomy consumer and business confidence mood, limited progress on the anti-corruption agenda and ongoing loadshedding we see little reason for any kind of re-rating. Consequently our focus remains on identifying the most attractively valued local stocks where dividend yield is a large part of expected total return, but who also have some angle around the ability to grow despite the headwinds. We were most encouraged by a series of meetings at a recent investment conference to find the mood surprisingly resilient – with the realities of commercial survival in the face of load shedding costs now well in hand for most firms.

Despite our overall caution we look to the final quarter with some optimism. The fund trades on a PE of 8.4X and offers a dividend yield of 5.6%.

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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