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NEDGROUP INVESTMENTS ENTREPRENEUR FUND

Quarter Four, 2023

Nedgroup Investments Entrepreneur Fund

The MSCI All World Index appreciated 22% in 2023 (33% in SA Rand), reversing the 18% decline of 2022. The contributors to this strong growth were heavily skewed though; Developed Markets trumped Emerging Markets (for the 5th year in 6) with the S&P500 delivering 26%, the Nasdaq 43% and the Eurostoxx600 20.5%. At the other end of the scale, the Shanghai Composite declined -4%.

In SA, the JSE Capped Shareholder Weighted Index appreciated a more modest 7.9% in Rand. Driven by a very strong run in the final quarter, the JSE Mid and Small Cap Indices returned a stronger 9.7% and 11.2% respectively.

The Rand depreciated 7.8% against the US Dollar, the fourth year in a row of 5-8% declines.

The outlook for 2024 remains equally mixed. While global inflation metrics have now dropped in most markets to acceptable levels, growth expectations remain poor (and have been downgraded recently). Most outperforming markets of 2023 achieved this on account of P/E multiples re-rating, as opposed to underlying earnings growth – this could prove challenging from this point if growth does not materialise.

Central banks are generally expected to start their rate cutting cycles in 2024, although later and somewhat less than earlier expectations. We expect their messaging to be dissected word by word; will their cuts be to stimulate a sluggish economy, or because of inflation being under control? South Africa (and about 70 other countries around the world) will hold political elections this year, so one should also expect much rhetoric and potentially voter friendly economic policies. In addition, the heightened global geopolitical tensions, Ukrainian war, Middle Eastern conflict, and China/Taiwan rhetoric will keep investors skittish.

Portfolio Commentary

In Q4 2023, the JSE Mid and Small Cap Indices posted strong recoveries of +10.0% and +8.6% respectively. The fund which had had a good year until the end of September was performing strongly against peers and index benchmarks until hit by 2 primary setbacks in December which severely dampened absolute and relative performance – explained below.

Within equities, all sectors had a positive quarter, led by SA Financials (+12.3%). SA Industrials and SA Resources appreciated by +5.9% and +3.0% respectively. After depreciating earlier in the year, the Rand appreciated by +3% against the US Dollar in Q4.

We were encouraged to see the market starting to give Transaction Capital the benefit of the doubt that the firms debt in their SA taxi business is not likely to sink the entire firm and that it's two other businesses will continue to grow and thrive. This is starting to be reflected in the share price recovery, but which we think still has a long journey ahead as the firm trades into a stronger position in the year ahead.

Last quarter we wrote in some detail about the fund's exposure to the private education sector and it is pleasing to see the positive contribution made in this quarter from the exposure to Advtech and Curro.

Undoubtedly the biggest disappointment (again…) remains our long standing position in British American Tobacco. In spite of their science driven approach to developing reduced harm and alternative smoking products, and their strong cash generation, the market seems to take a very pessimistic view of BAT as a harmful tobacco company with no future and a value trap. Our lengthy patience with what we had hoped would be a unique asset in this portfolio has been costly - for the last 5 years! We have had the view that there will be a future for their reduced/no harm products post the eventual demise of combustible tobacco and on a 6X PE and almost 10% dividend yield, expect our now very long-term confidence to eventually be rewarded.

The last cruel blow to end of the quarter came on Christmas eve as the Chinese gaming regulator made a public announcement of several new possible regulations designed to curb predatory billing practises (as an example) but which was poorly handled and resulted in an immediate rout of all stocks in the sector, including Tencent, which naturally dragged down Naspers and Prosus. Although the authorities were very were quick to provide qualifying commentary to calm the market and even took the unprecedented step of dismissing the individual who made the announcement, it hit a market that has become increasingly nervous and sensitive to regulatory interventions in China and consequently the damage has proved to be impossible to repair in the short-term - reflected in the share prices which have not recovered fully to their already weak bases prior to the event.

Q4 Top contributors	Average weight	Performance contribution	Q4 Top detractors	Average weight	Performance contribution
Transaction Capital	1.4%	0.9%	BAT	3.9%	-0.3%
KAL Group	5.0%	0.9%	Impala Platinum	0.2%	-0.2%
Advtech	4.6%	0.9%	Oceana	4.9%	-0.1%
Curro	4.6%	0.7%	Sun International	6.3%	-0.1%
PSG Financial Serv.	3.2%	0.3%	Balwin Prop	1.4%	-0.1%
Total		**+4.0%**	Total		**-0.8%**

Current positioning and outlook

Domestic SA Equity

2023 was relentlessly challenging for SA given unprecedented levels of load shedding, Transnet’s freight volume and operational deterioration, foreign policy missteps (Lady R debacle, Russia Ukraine non-alignment versus Palestinian open support), SA’s grey listing by FATF, the continuation of the Phala Phala scandal, and ongoing reports of widespread corruption (most recently within NSFAS) - all of this sapped the prospects for an economic recovery. Investor sentiment towards SA hit a peak in May 2023 given the issues above, and exacerbated by fears of a grid collapse as well as concerns that SA could be sanctioned by the US following the US Ambassador to SA’s arms sale accusations. At least, there has been some progress in key areas (eg government-business relations) in the latter half of this year, though this uplift has been offset by worrying retreats in areas such as crime, local government, and the ineffective pursuit for state capture accountability.

The overhanging concerns have manifested themselves in a sub-par growth outlook and a deteriorating fiscal position evidenced by the Medium-Term Budget Policy Statement. However, there is some cause for tempered optimism given the realisation by government that private participation in key enterprises is a necessity. While the gradual liberalisation of key SOEs like Transnet and Eskom may remain ideologically distasteful to the ANC, it has become the only solution to ensure a functioning state. Despite the incredibly difficult operating environment, SA Corporates manage to drive earnings growth well ahead of GDP and there is a significant amount of caution already priced into SA equity prices with the MSCI SA fwd PE at <10X, a 25% discount to its 10yr average and at a 17% discount to Emerging Markets.

Looking to 2024, we anticipate that SA will face a tough first half given election uncertainty with still high interest rates curtailing consumption and challenges at Transnet negatively impacting SA exports. The trajectory for domestic businesses should improve in the second half of the year as the impact of rate cuts and lower inflation feed through, together with less load shedding given more private sector investment in renewables and which is already making a material contribution to lightening Eskom's proportional contribution to electricity generation. In addition, a recovery in China will aid emerging markets, including South Africa. The steady improvement in SA's growth constraints should also facilitate scope for a rerating of our stock market.

In the middle of 2023, we initiated a position in Zeda, which is primarily a vehicle leasing and rental company, spun out of Barloworld in Dec 2022. Through both share price appreciation and share purchases, the company is now one of our top 10 largest holdings. Despite only listing at the end of 2022 through the unbundling by Barloworld, the company has been operating for over 60 years and operates through well-known brands such as Avis (short-term car hire), Avis Fleet (longer term leasing), Budget (car hire) and Avis Car sales - the motor retail arm that helps manage the company's fleeting/de-fleeting cycle. Their estimated market shares in car rental and full maintenance leasing are estimated at 38% and 22%, respectively. The management team is experienced, having navigated different cycles; the brands are extremely strong and well-known worldwide; and the operations are well-diversified, with the bread-and-butter retail rental business complemented by the B-2-B leasing business and car sales.

Despite a very strong earnings base due to super profits from used car sales in the 2022 financial year, the company managed to grow earnings 17% to R3.81 per share for 2023. This implies a historic PE of 3x using the closing share price on the 31st of December 2023. This for a company that generates a ROIC of 18.7% (against 12.8% WACC), ROE of 36.7% and has an improving balance sheet, having repaid their most expensive tranche of debt ahead of schedule. The repayment of this debt allows the company to start paying dividends in FY24, and the indicative yield based on the current share price is at least 6%.

An obvious question would, of course, be whether, given the extremely low PE, this might be a value trap, or where profits may have peaked due to very favourable trading conditions in the post Covid recovery period of 2022 and 2023 reflected in profit margins. We do not think this is the case because while the car sales segment recently enjoyed super profits, the bigger business segments of car rental and leasing, should continue to grow profits. We think the car rental operations will benefit from a continued recovery in tourism and sustained high daily rates due to more rational behaviour by the industry; and the fleeting business should benefit from ongoing outsourcing of fleet ownership (eg Transnet), plus the expansion of lease ownership via new products into the retail market which is an industry still in it's infancy in SA. We believe the investment case is extremely compelling, and that our patience will be rewarded as the company continues to build a track record as an independent listing, and a new shareholder base is established.

Responsible Investment

In line with trends in recent years, 2023 has seen the breaking of multiple climate-related records. The first 10 months of 2023 were 1.4°C warmer than pre-industrial levels and the GST synthesis report shows that we aren't on track to meet the Paris Agreement goals. There is, however, a consensus among most global leaders (noted at the recent COP28 conference) that climate action has been insufficient to date, and that more coordinated efforts are required to halve emissions by 2030 and keep global warming to 1.5°C above pre-industrial levels.

The cost of inaction is high, with some regions significantly more vulnerable to climate events than others. As a result, company (and country) resilience will remain an area of ongoing focus given the increased damage from extreme weather events. According to Munich Re, the world's largest reinsurer, natural disasters caused an estimated US$95bn in insurance losses in 2023 which is well above the 10-yr average.

Given the trend of rising global emissions, there has been increased investor scrutiny of companies' decarbonisation targets and whether these are achievable given the viability, required capital and technological advancements needed. In addition to the ongoing focus on Climate Change, ESG's Social pillar has become a growing area of emphasis for investors.

At Abax, 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 actively engage with companies and other stakeholders to address ESG issues. Notable ESG engagements during the fourth quarter of 2023 include:

- Reunert: Engagement with Board members around the proposed changes to the Conditional Share Plan.
- Oceana: Engagement with management, specifically focusing on island exclusions and the plight of the African Penguin.

Conclusion

The last few years have been extraordinarily complex. The pandemic lockdowns pushed the world into a historic bust, then re-openings plus unprecedented macro stimulus (principally in the US) resulted in a sharp rebound across the board. Monetary policy then switched from super easy to the fastest tightening in history, and what went up came back down during 2022.

2023 was no less complex, with outcomes notably different to expectations set out at the start of the calendar year. The year was characterised by US outperformance. The US stock market recorded its strongest annual performance in two years following a blistering rally in recent months, as investors bet major central banks have finished raising interest rates and will cut them rapidly in 2024.

We are experiencing the highest level of geopolitical risk in half a century which will impact business and economic outcomes – the rise in populism, the war in the Ukraine, Hammas / Israeli volatility, and US / China rivalry. The pivotal US / China relationship will continue to be tense, with both vying to shape global norms and structures in alignment with their respective visions and interests – further complicated by a US election in 2024.

We will experience a wave of elections in 2024 - countries representing over half the world's population will hold elections, including the US and South Africa. There is a surge in media fears that a second Donald Trump presidency could usher in a "Trump dictatorship". In South Africa, national elections (expected in May) will remain a source of debate and uncertainty with polls pointing towards ANC support falling below 50% for the first time since 1994.

Given the above-mentioned considerations our investment outlook remains cautious, but we have a high degree of confidence in the stocks we have picked and their extremely attractive valuations relative to our expectations of their ability to grow profits and dividends despite the negative domestic macro environment discussed above. These convictions are clear from an examination of the larger positions in the fund, and on a historic weighted PE of 8.5X, a dividend yield >5% and a Price to Book ratio of 1.25X the fund represents enormous value.

Thank you for your ongoing trust in us and best wishes for 2024.

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)..

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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.

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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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