NEDGROUP INVESTMENTS ENTREPRENEUR FUND

NEDGROUP INVESTMENTS

see money differently

Quarter One, 2018

For the period ended 31 March 2018

NEDGROUP INVESTMENTS ENTREPRENEUR FUND

PERFORMANCE

Performance to 31 March 2018	Nedgroup Investments Entrepreneur Fund[1]	ASISA category average	Small Cap Index	Mid Cap Index
3 months	2.1%	-1.8%	-1.3%	-3.6%

Entrepreneur has returned +2.0% for the first quarter of 2018 in comparison with the primary benchmark returns of the JSE Small Cap Index -1.3% and the JSE Mid Cap Index -3.6%. Out of interest, the broader JSE All Share Index declined by -6.0%.

After the volatile end to 2017 which contained the knife-edge conclusion of the ANC elective conference and the implosion of Steinhoff with the commensurate impact on the JSE and investor portfolios, we had hoped for a return to more reasonable levels of market volatility in 2018. This was not to be. The first quarter of 2018 has continued to be volatile and following the Steinhoff debacle, investor nervousness remains at very high levels. This has been fuelled by a witch hunt to examine and expose any other companies that display any “Steinhoff-like” characteristics, the most dramatic of which has been the publicity surrounding the Resilient Group of companies (Resilient, Green Bay, NEPI Rockcastle and Fortress) and their inter-linked shareholdings. All of their share prices have collapsed and are trading at fractions of their values as of only three months ago. Several other once high-flying businesses have also seen substantial declines in their value and these include Aspen, Ascendis and EOH.

In addition, with little new financial information yet available from Steinhoff in order to address its balance sheet problems, the company has started to dispose of its equity interests in the already public companies – at the inevitable liquidity discount. This started with PSG. PSG was additionally troubled by the short-seller report on Capitec (PSG’s largest contributor to the firms’ asset value), which although in our opinion fraught with inaccurate statements and conclusions, in the environment of a very nervous South African market caused substantial volatility in both companies share prices. Next up was the part disposal of Steinhoff’s stake in KAP, which we had also anticipated and which is one of the largest positions in Entrepreneur. We used the opportunity to add to our positions across the firm at an attractive price.

As if the above were not enough, the deaths of so far about 190 South Africans caused by listeriosis from consuming contaminated food products has sent shock waves through the food producers companies and their shares. This was most acutely felt by Tiger Brands whose Enterprise meat processing facilities have been declared as the primary source by the health authorities. A thorough scientific investigation remains underway at the time of writing to establish full culpability for this tragedy.

It is pleasing to be able to report that the fund has managed to largely avoid the above shocks and has recorded a pleasing start to 2018.

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

PORTFOLIO COMMENTARY

The fund's top five performing positions added +3.5% to our return for the quarter while the bottom five detracted -2.9%.

Winners	Ave. weight	Total Return	Performance contribution	Losers	Ave. weight	Total Return	Performance Contribution
JSE	4.6%	24.5%	1.1%	Naspers	6.6%	-16.2%	-1.1%
Santam	4.3%	24.4%	1.0%	RMI	3.9%	-12.9%	-0.5%
Massmart	2.8%	18.0%	0.6%	BAT Plc	2.9%	-15.0%	-0.5%
Truworths	3.2%	16.8%	0.5%	Sappi	3.0%	-13.0%	-0.4%
City Lodge	2.8%	16.2%	0.4%	Reinet	2.6%	-16.1%	-0.4%
			3.5%				**-2.9%**

Primary contributors to the funds outperformance in the first quarter were firstly its avoidance of many of the problems, but in addition several of our larger stock positions performed very well. These include the JSE, Santam, and retailers; Truworths and Massmart.

The JSE was the largest positive contributor to the fund's performance in the quarter. The company recently reported a better-than-expected 2017 financial result. We were particularly pleased with the earnings performance in the second half of the financial period as well as the strong cash generation. We anticipate these positive trends to continue in 2018 - equity value traded is up sharply year-to-date which bodes well for revenue delivery and significant work has been done to reduce their cost base. This, coupled with the businesses strong cash generative ability bodes well for earnings and dividend growth in the year ahead.

Our position in Truworths was also a positive contributor to performance in the first quarter. We built a position in the latter half of 2017 at which point we felt that an attractive asymmetric profile had emerged. In our opinion, Truworths is ripe for improvement – their domestic challenges should fade during the next 12 months, aided by improving consumer health and the recent favourable court ruling on the affordability regulations. We regard Truworths as a responsible credit provider, but their ability to extend credit had been curtailed in 2015 when new affordability assessment regulations were enforced. In March 2017, the Cape Town High Court set aside aspects of the regulations to the benefit of the credit retailers (70% of Truworths South African sales are generated via credit). In addition to improving sales activity, earnings growth should be further enhanced by de-gearing, share buybacks, as well as a better bad debt outcome.

The bad-debt charge has more than doubled over the last several years, and the R1.2bn expense incurred in their 2017 financial period represented 31% of group profit-before-tax, indicating the significance of this expense item. Given the expectation that consumer health will slowly improve, we anticipate that the unwind of the bad-debt charge will provide a boost to profitability. This expectation is supported by the improving health of their debtors' book as seen in the December 2017 interim result as well as data from TransUnion, a credit bureau.

Pleasingly, the Truworths share price has appreciated approximately +40% since we acquired our shareholding. The fund retains its exposure to the company as the dividend yield (+4.8%) and relative price-earnings rating remains attractive (Truworths trades at a 20% discount to SA listed apparel peers). In addition, Truworths is most geared to a better South Africa, unlike several peers (Foschini, Woolworths) who have substantially increased their offshore presence.

As always, we did not get everything right and the disappointing performance from our reduced rand-hedge exposure through Naspers and British American Tobacco / Reinet detracted from the fund's performance.

In our December report we commented extensively on the Naspers position in the fund. The Q1 2018 update on this position is disappointingly that further damage has been done to the firm's valuation through mismanagement. Naspers sold a very small portion (6%) of their position in Tencent for cash. Tragically, management communicated a message of using all the proceeds (US$10 billion) to reinvest in their existing other businesses which continue to consume cash. This is quite illogical in the context of the alternative to buy back shares considering the discount trapped in the firm's market valuation. Unsurprisingly this decision was punished by the market with the discount widening further as the deep scepticism with which the market views management commercial judgement widened further.

MARKET OUTLOOK

The election of Cyril Ramaphosa as head of the ANC and his subsequent appointment as state president following the resignation of Jacob Zuma is the most positive political development in the country for more than a decade. Mr Ramaphosa's immediate changes especially to key economic positions of political power and within some state-owned enterprises are additionally very encouraging. Despite these, our analysis shows that it will require skill, continuity, conviction and many years of investment before the severe economic damage done during the Zuma years can be recovered. As a consequence, despite the low base, we do not anticipate a very fast acceleration in economic growth in the short term. This is exacerbated while policy uncertainty remains in many sectors of the economy (Mining Charter, Land Expropriation without compensation, BEE Charter requirements) and considering the diverse opinions on these matters between stakeholders, are unlikely to be resolved in the short term.

As a consequence, we are sceptical of the sustainability of the strong rally we have seen in the last quarter in select sectors and have reduced our exposure to some of the top performers there. In addition, the further strength of the rand has caused some high-quality businesses with non-South African generated profits to underperform where to our mind, valuations are beginning to look more attractive. While this opportunity set is quite limited for the Nedgroup Investments Entrepreneur Fund we have managed to find some. In addition, we continue to unearth several other neglected domestic - oriented businesses where the valuations are more appealing on a relative basis.

As at the end of March 2018 the fund's weighted PE, dividend yield and Price to Book ratios were 13.5, 2.9% and 2.1X respectively.

WHO WE ARE
Nedgroup Collective Investments (RF) Proprietary Limited, is the company that is authorised in terms of the Collective Investment Schemes Control Act to administer the Nedgroup Investments unit trust funds. 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.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

PERFORMANCE
Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Certain unit trust funds may be subject to currency fluctuations due to its international exposure. 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.

PRICING
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
Certain Nedgroup Investments unit trust funds apply a performance fee. For the Nedgroup Investments Flexible Income Fund and Nedgroup Investments Stable Fund, it is calculated daily as a percentage (the sharing rate) of total positive performance, with the high watermark principle applying.

For the Nedgroup Investments Bravata World Wide Flexible Fund it is calculated monthly as a percentage (the sharing rate) of outperformance relative to the fund's benchmark, with the high watermark principle applying. All performance fees are capped per fund over a rolling 12-month period. A schedule of fees and charges and maximum commissions is available on request from Nedgroup Investments.

DISCLAIMER
Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Nedgroup Investments has the right to close unit trust funds to new investors in order to manage it more efficiently. For further additional information on the fund, including but not limited to, brochures, application forms and the annual report please contact Nedgroup Investments.

NEDGROUP INVESTMENTS CONTACT DETAILS
Tel: 0860 123 263 (RSA only)
Tel: +27 21 416 6011 (Outside RSA)
Fax: 0861 119 733 (RSA only)
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.co.za

OUR OFFICES ARE LOCATED AT
Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001

WRITE TO US
PO Box 1510, Cape Town, 8000

NEDGROUP INVESTMENTS