Bateleur BCI SA Equity Fund

Third quarter 2023 commentary

bateleur capital

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Dear Investor

Bateleur Equity Fund ("the fund") – 2023 third quarter report back to investors

The fund returned 4.3% year to date – ahead of the JSE Capped Shareholder Weighted Index (Capped Swix)) return of -0.3% for the same period.

During the reporting period, the fund benefitted from good stock selection in the industrials sector with AECI, Bidvest, Bidcorp and Hudaco adding a combined 3.7% in relative performance. African Rainbow Minerals was the fund's largest detractor, partially offset by limited direct exposure to platinum group metal miners.

A summary of the top contributors and detractors is illustrated in Table 1 below.

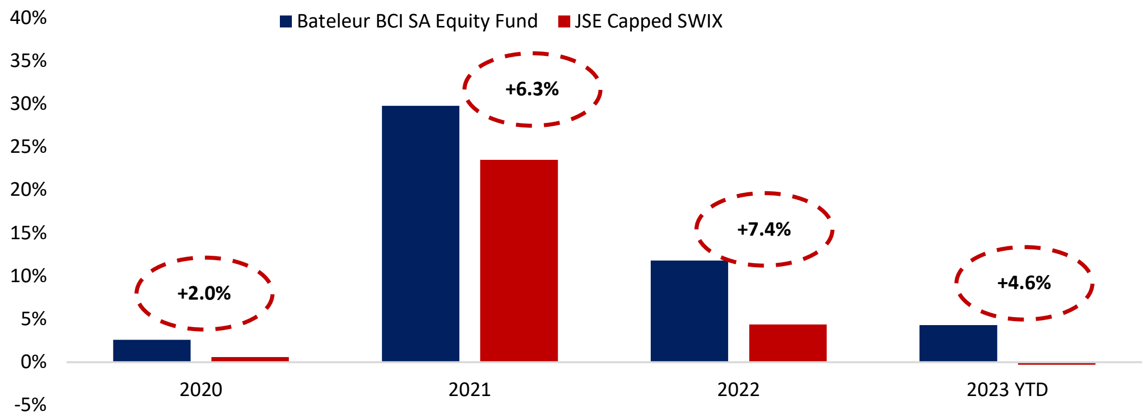
Table 1: Top relative individual contributors and detractors year to date

Contributors (relative)	Under/Overweight	YTD 2023	Detractors (relative)	Under/Overweight	YTD 2023
AECI	OW	1.4%	African Rainbow Minerals	OW	-1.7%
Bidvest	OW	0.9%	Sanlam	UW	-0.6%
Bidcorp	OW	0.8%	Italtile	OW	-0.4%
Amplats	UW	0.7%	Gold Fields	UW	-0.3%
Hudaco	OW	0.6%	Aspen	UW	-0.3%

Source: Bateleur

In a testing investment environment, the fund delivered on its objective of producing consistent returns ahead of the benchmark (Chart 1). In addition, the fund has produced an absolute cumulative return of 55.3% since January 2020, ahead of the JSE Capped Shareholder Weighted Index (Capped Swix)) return of 33.0% over the same period.

Chart 1 – Bateleur BCI SA Equity Fund, **Inception: 23 April 2015***



Source: Bateleur.
***Highest and Lowest rolling annual figures of the Fund and Benchmark (since inception): High54.4% 54.2% | Low: -25.5% 24.5%**

Return Period	Fund	Benchmark
5year:	5.8%	4.2%
3year:	8.5%	6.4%
1year:	16.0%	11.9%
Inception:	5.8%	4.2%

Local investment markets continue to be impacted by ongoing macro headwinds (negative per capita GDP growth, high unemployment and elevated interest rates) and a litany of own goals by government. Against this backdrop, stock selection is an increasingly important driver of returns, with attention to company-specific fundamentals and position sizing of paramount importance.

Below we highlight three stock-specific opportunities that have contributed positively to year to date performance, and which we expect to deliver continued credible returns.

1. <u>AECI – Market capitalisation R11.6bn</u>

Under the leadership of newly appointed CEO, Holger Riemensperger, AECI is reviewing its growth strategy and aims to address previous capital allocation missteps to focus the group on its core competencies, explosives and mining chemicals.

The opportunity to improve AECI's operational performance is significant. AECI has historically suffered from poor capital allocation discipline and over time has become an unfocused business. Several past acquisitions had limited strategic rationale, failed to deliver on their financial targets and have destroyed shareholder value.

AECI's mining solutions division (comprising AEL and Senmin) provides blasting services and produces chemicals (collectors and flocculants) to beneficiate mineral ores. AEL is well entrenched with its client base, offering business critical services that support efficient, sustainable and safe mining practices. When delivered consistently, this creates a competitive advantage and strong business franchise.

AEL is the third largest explosives company in the world, with a c.6% global market share, and the leader in Africa where its market share is estimated at 40%[1]. The explosives business has been successful in diversifying and internationalising into Africa, Indonesia, Australia and South America. Currently, 69% of mining solutions' revenue is earned in hard currency, indicating AECI's ability to transfer its technology and capabilities into new markets with scale (Chart 2).

The group's mining solutions business, the core of its operations, has a long history of consistent profitability and operating income growth, delivering an 8.4% CAGR over the last 23 years (Chart 3).

Chart 2 – AECI Mining USD revenue (%)

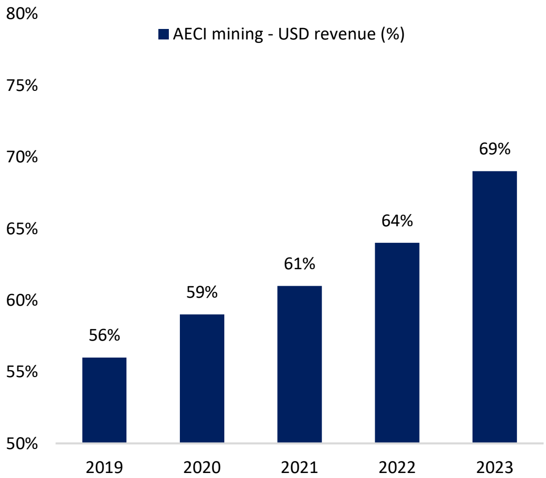
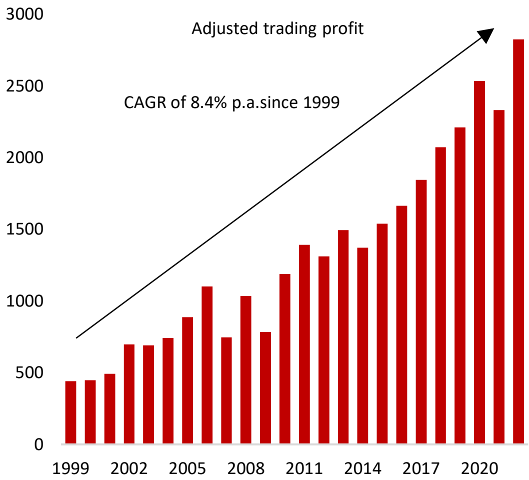


Chart 3 – AECI Mining O/Profit (R m)



Source: Bateleur, company reports

[1] Data provided by AECI Investor Relations – 11 October 2023

At 7 times our assessment of normalised earnings, we view AECI as significantly undervalued. We look forward to AECI's strategic review (to be presented at a capital markets day in November), where we expect management to announce plans to dispose or close down underperforming businesses and provide clear medium term targets to enhance operational profitability.

2. Bidvest – Market capitalisation R95.8bn

Bidvest recently reported record full year results, growing headline earnings by 17.7%. The group has delivered compound annual growth in earnings of 8.0% per year since 2016, led by the successful internationalisation of their key services division, which now accounts for c.40% of group trading profit (Charts 4 and 5).

Chart 4 – Bidvest HEPS (R)

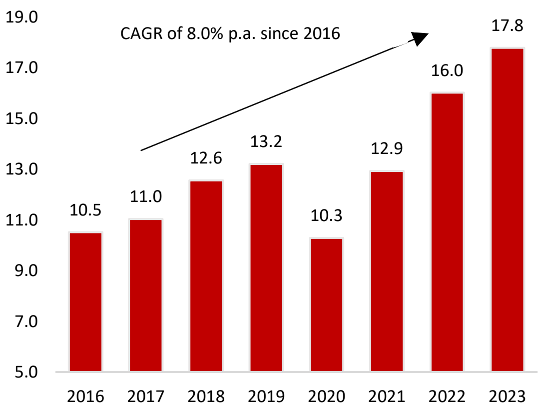
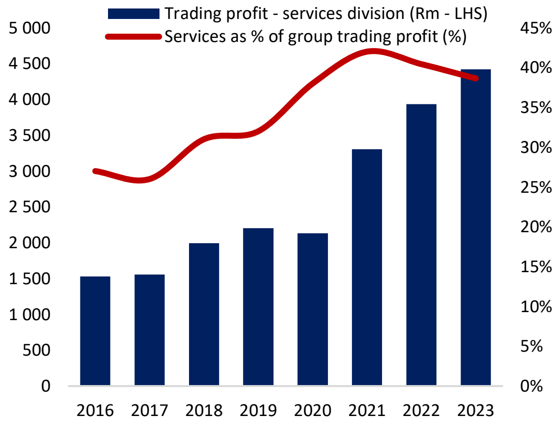


Chart 5 – Bidvest services contribution (%)



Source: Bateleur, company reports

Post the unbundling of Bidcorp in 2016, management embarked on an international growth strategy, with an ambition of building a global hygiene and facilities management service business. This included the acquisitions of Noonan, PHS, BIC and more recently CPS providing Bidvest entry into the UK, Ireland, Spain and Australia.

Today, over 20% of group trading profit[2] is generated from international services and is expected to increase further as management executes its acquisition pipeline.

Services is an attractive business model where the majority of income is derived from long term annuity-type contracts which are generally asset-light and highly cash generative. These appealing qualities can be seen in the valuations of global service companies such as Rentokil, which trades on a forward price earnings multiple of 25.8 times.

As services increase its overall contribution to group earnings, we expect Bidvest's valuation to re-rate towards its global peers, failing that we would not be surprised if Bidvest management followed a similar playbook to Bidcorp and separately listed its global services business once it reaches scale.

Locally, despite the weak economic backdrop, management is focusing the business on pockets of the economy that continue to show growth (such as mining, agriculture, renewable energy and travel & tourism) and are well-positioned to benefit from private sector opportunities offered by the gradual demise of state-owned enterprises.

[2] Bidvest 2023 annual financial statements

Despite delivering strong returns YTD (+31.5%), Bidvest remains attractively valued at an estimated June 2024 P/E multiple of 13 times.

3. Bidcorp – Market capitalisation R143bn

Bidcorp is a global food services business, generating 95% of its revenue outside South Africa, operating across 35 countries on five different continents.

After the tumultuous "COVID" impacted years, 2023 delivered a record result for the company as economies reopened and trading patterns normalised, with headline earnings per share 49% above 2019 levels (Chart 6).

Food services is a structurally attractive industry, with growth benefitting from a secular shift in food consumption away from home (led by demographic trends and increased disposable income). For example, in the US, food consumed away from home has recently surpassed food consumed at home, a trend which has accelerated post-pandemic (Chart 7)[3].

In nearly all the geographies where Bidcorp operates, spending on food away from home is substantially lower than in the US, suggesting strong growth potential over the medium term.

Chart 6 – Bidcorp HEPS (R)

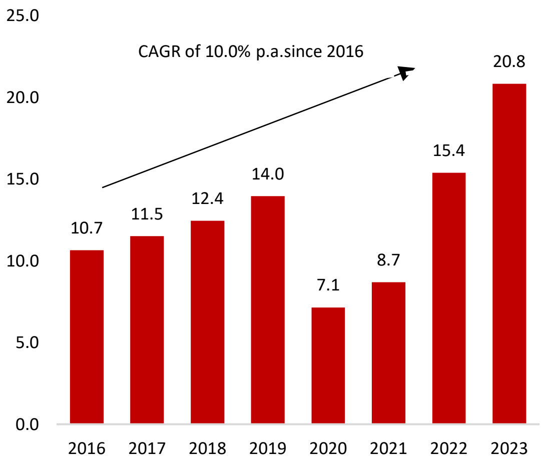
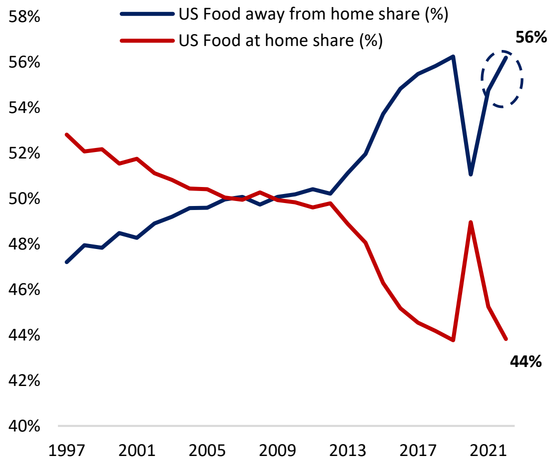


Chart 7 – "Food away from home" share (%)



Source: Bateleur, company reports

Bidcorp has market-leading positions in Australia and the UK (c.20% market share) and is strategically positioned in several regions and countries[4] where food services remain fragmented and Bidcorp's market shares are negligible. There is an opportunity to consolidate these markets, gain critical mass and extract purchasing power efficiencies.

This opportunity can best be seen when comparing the profitability of Bidcorp's mature market (Australia with an 8.0% trading margin) to Bidcorp's emerging markets (5.1% trading margin).

Bidcorp has a strong medium term growth outlook, supported by continued secular growth in food consumption away from home, market share gains, industry consolidation and operating leverage from additional scale. At an estimated 17.8 times forward earnings, we continue to find Bidcorp an attractive investment opportunity.

[3] United States department of Agriculture
[4] Latin America 2.5%; Netherlands 10%; Belgium 6%; Spain 1%; Poland 7%; China/Hong Kong 1.5%

<u>Conclusion</u>

Continued strong employment data from the US and stubborn inflation led markets to price in 'higher for longer' interest rates – in this environment global equities appear fully valued relative to risk free rates.

The widely expected economic recovery in China has underwhelmed. South African capital markets carry large exposure to China through resource companies, Naspers/Prosus via Tencent and luxury goods.

To date, Chinese officials have announced moderate monetary and fiscal support measures, however a more drastic approach is likely required to regain consumer confidence and support economic activity to achieve GDP growth targets.

While South Africa has its own set of challenges, valuations of South African equities remain attractive on an absolute and relative basis and present good investment opportunities.

The fund has been active over the quarter, adding to existing positions in African Rainbow Minerals, AB-Inbev, Remgro and Mondi whilst reducing exposure in Implats, Growthpoint and Adcock Ingram. New positions in Anglogold, Gold Fields and MTN were initiated, albeit not material.

The fund is invested in quality companies, trading at low valuation metrics with solid earnings growth prospects that are expected to produce pleasing returns. We remain encouraged by the wide opportunity set available.

Kind regards

Charl Gous | Warren Riley | Bheki Mthethwa

Co-Fund managers

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