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25th April 2023

Dear Investor

Bateleur Long Only Fund ("The fund") – 2023 first quarter report back to investors

The fund returned 3.3% for the first quarter of 2023. As additional comparisons, the JSE capped shareholder weighted total return index (Capped SWIX) gained 2.4% inclusive of dividends re-invested, SA government bonds (ALBI) delivered 3.4% and cash (STeFI) produced a return of 1.7%.

In the period under review, the fund benefitted from good stock selection in the industrials sector with Hudaco, Bidvest and Bidcorp adding a combined 2.0% in relative performance while underweight exposure to the PGM (platinum group metals) sector contributed 0.9%. Detractors were Richemont, gold miners (no direct exposure) and diversified miners (African Rainbow Minerals and Glencore).

Table 1 below illustrates the fund's largest relative contributors and detractors over the period.

Table 1 – Top relative contributors and detractors Q1 2023

Contributors (relative)	Under/Overweight	YTD 2023	Detractors (relative)	Under/Overweight	YTD 2023
Hudaco	OW	0.7%	Richemont	UW	-0.7%
Bidvest	OW	0.7%	Gold Fields	UW	-0.7%
Bidcorp	OW	0.6%	African Rainbow Minerals	OW	-0.5%
Amplats	UW	0.5%	Anglogold	UW	-0.5%
Spar	OW	0.4%	Glencore	OW	-0.4%

Source: Bateleur Capital

South Africa continues to be a challenging environment to do business, characterised by poor service delivery, crumbling infrastructure and ongoing parastatal challenges. This has culminated in an extended period of low GDP growth, low business & consumer confidence and an increasing cost of equity. As a consequence, equity markets trade at deep valuation discounts that offer attractive opportunities for stock selection.

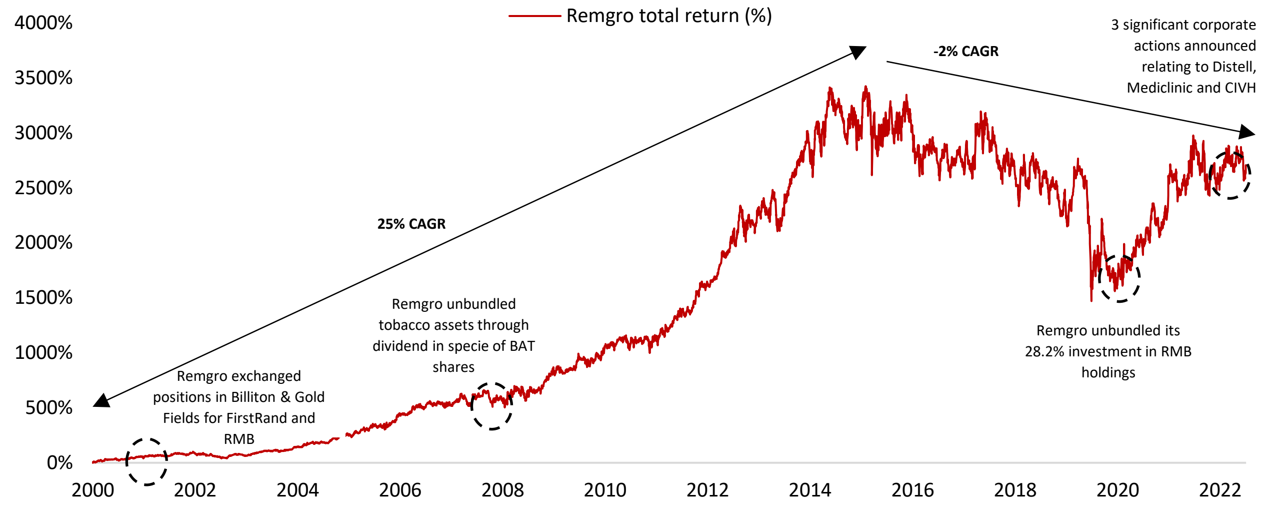
One such opportunity is Remgro, an investment holding company that has been held in the fund since 2018. The share price performance of Remgro has been disappointing since our initial investment, delivering a compound annual return of negative 0.7% relative to the Capped SWIX of 7.3%.

Below we provide background to Remgro, our view as to the reasons for this underperformance as well as a path to improving shareholder returns, independent of a weak local economy.

Remgro

Early investors in Remgro enjoyed spectacular returns, with Remgro delivering a compound annual return of 25% per annum between 2000 and 2016 (Chart 1). Returns were a combination of steady growth in net asset value (NAV), consistent cash dividends, share buybacks and the unbundling of assets.

Chart 1 – Remgro total return (%)



Source: Bateleur Capital, Bloomberg

In contrast, recent share price performance has been disappointing, delivering a negative total return over the past 7 years. NAV has declined from its 2016 peak (Chart 2), largely due to the deterioration in Mediclinic's share price[1] and a dilutive rights offer in 2017. In addition, Remgro's discount to NAV widened to a current record level of 42%, more than double the long-term average (Chart 3).

There are several reasons, in our view, that have led to the widening discount; 1) questionable capital allocation, 2) an unfocused investment strategy and 3) corporate structure concerns.

Chart 2 – Remgro NAV* per share (R)

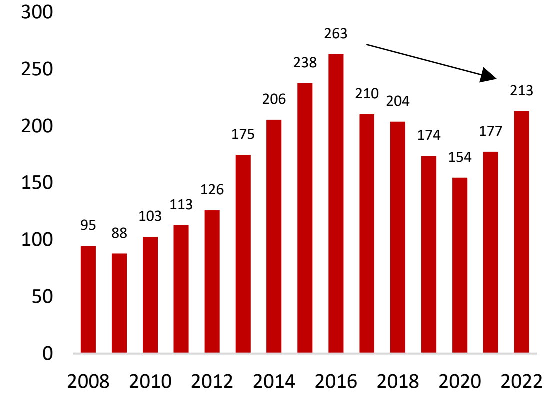
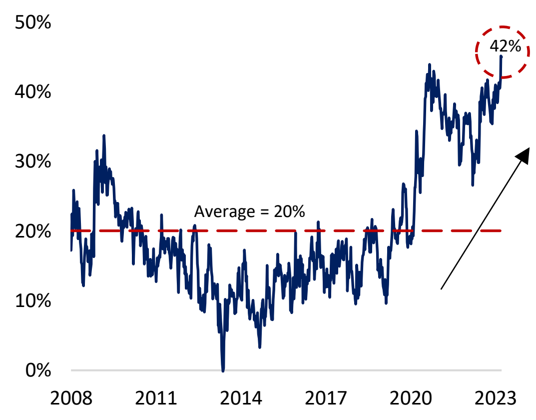


Chart 3 – Remgro discount to NAV (%)



Source: Bateleur Capital, SBG Securities *Adjusted for unbundling of BTI & RMB Holdings

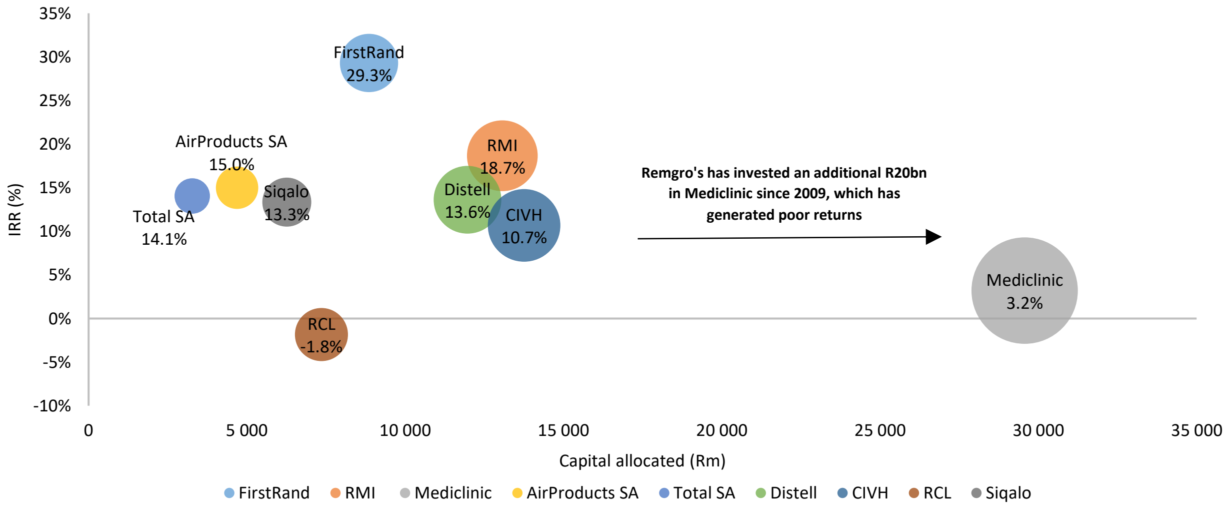
[1] Remgro's attributable value of Mediclinic reduced from R69.7bn in 2016 to R17.9bn in 2019

Capital allocation

Management's most important function in a holding company is capital allocation. Over the long term, the majority of Remgro's decisions in this regard have been sound, generating respectable returns and creating value for shareholders. However, these have more recently been overshadowed by the large allocation of capital to Mediclinic which has undoubtedly been a key driver of recent underperformance given its size in the portfolio[2] and low returns (Chart 4).

Remgro has invested significant capital supporting Mediclinic's strategy to geographically diversify the business which has resulted in acquisitions in Switzerland (Hirshlanden), the Middle East (Al Noor) and the United Kingdom (Spire Healthcare). Mediclinic overpaid for all three acquisitions and in addition, encountered operational difficulties due to a change in their respective regulatory environments which have impacted returns.

Chart 4 – Remgro investments and IRR* to the end of 2022



Source: Bateleur Capital, SBG Securities, * Internal Rate of Return

Furthermore, material debt was introduced into the Remgro structure to support Mediclinic's internationalisation, with net debt totalling R12.7bn at the end of June 2016 and required a dilutive rights offer (25% discount to NAV) to improve the balance sheet position.

Unfocused investment strategy

Remgro's investment portfolio has lost focus and lacks a clear identity. There are multiple smaller investments which are of insufficient size to materially impact group results. These include minority shareholdings in industrial companies (Air Products, Wispeco and Total Energies), diversified investment vehicles (KTH, Prescient China Equity Fund and Invenfin), media investments (eMedia) and social impact investments (Blue Bulls, Stellenbosch Football Club and Stellenbosch Academy).

As a recent example, Remgro has committed to invest $75m since 2021 (>R1.1bn) in Asia Partners LP (Asia Partners conducts private equity investments in technology companies focused on the Southeast Asia region). This investment is not aligned with Remgro's existing portfolio and further brings into question the group's investment strategy.

[2] Mediclinic approximately 30% of group NAV

These investments absorb capital and are at odds with Remgro's investment strategy disclosed in their 2022 annual report which states a preference for "Significant influence and board representation.….with a primary sector focus on Healthcare, Consumer Products, Financial Services and Infrastructure".

Corporate structure

Most listed companies have a single class of shares, with each share carrying identical economic and voting rights. In the case of Remgro, it is controlled by the Rembrandt Trust (Rupert family) which holds 100% of the B ordinary shares, each of which has ten times the voting rights in Remgro compared to Remgro A ordinary shares. This structure concentrates decision-making powers, diminishes board oversight and potentially shields management from scrutiny.

Furthermore, on review of the remuneration report, executive directors have limited incentive to reduce the current elevated discount to NAV as remuneration is heavily weighted towards growing net asset value with no KPI's aligned to reducing the discount.

Remgro's corporate structure limits the ability of minority shareholders to influence strategic direction and has failed to appropriately incentivise management to reduce the discount to NAV.

Remgro today

Catalysed by the widening discount and recent underperformance, management is targeting a strategic shift, transitioning from investing in primarily listed assets (in 2019 75% of NAV was listed equities) to holding stakes in a portfolio of unlisted assets with, in their view, scarcity value.

Recent corporate action bringing focus back to the portfolio

Firstly, Remgro is partnering with MSC Shipping to acquire the balance of Mediclinic and delist it from the JSE and LSE. Remgro will invest a further GBP201m (R4.4bn) to hold a 50% interest in the unlisted Mediclinic group.

Secondly, Remgro has agreed to merge its stake in Distell with Heineken South Africa to create a multi-category pan-African liquor group (Newco) with market-leading positions in cider, ready-to-drink beverages (RTD) and beer. Remgro will hold a significant interest in Newco while Heineken will be the controlling shareholder and manage the combined entity.

Thirdly, Remgro announced that Vodacom will acquire an initial 30% stake in a newly created company called Maziv, comprising Remgro's CIVH assets (Dark Fibre Africa and Vumatel) and Vodacom's existing fibre assets. This transaction should drive efficiencies of scale, accelerate the rollout of fibre and improve end offerings to the market.

In addition, RCL Foods (80% held by Remgro) is undergoing a managed separation and restructure of its FMCG (fast moving consumer goods), poultry, sugar and logistics businesses. Recently the company announced the sale of Vector Logistics and ultimately RCL Foods should transition to a focused FMCG company generating more predictable earnings and higher returns. The opportunity exists to merge RCL Foods' assets with Remgro's Siqalo spreads business which owns brands such as Rama, Stork and Flora, creating an FMCG business of scale.

Once completed, Remgro's core portfolio will consist of stakes in four unlisted assets (Mediclinic, Newco, Maziv and Siqalo) as well as two listed assets, RCL Foods and OUTsurance group. These 6 assets will account for c.70% of group NAV.

Addressing the balance sheet

Management has made good progress in addressing balance sheet concerns, with net cash up to R6.1bn, its strongest position since 2010. Following corporate actions in RMB Holdings (RMB) and RMI Holdings (RMI), Remgro holds portfolio investments in Discovery, Momentum Metropolitan and FirstRand valued at c.R14bn. These are liquid assets that can quickly be converted into cash.

Adding liquid portfolio investments to cash balances, Remgro is expected to have over R20bn in cash and portfolio investments by June 2023 (Chart 5) - a sizeable war chest relative to the group's current market capitalisation of R77bn.

In addition, Remgro's non-core assets, although immaterial individually, have a combined valuation of c.R22bn (Chart 6) that could provide additional liquidity if disposed of.

Chart 5 – Remgro net cash/portfolio investments

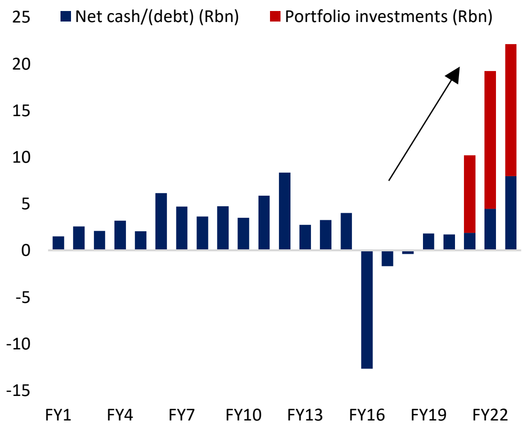
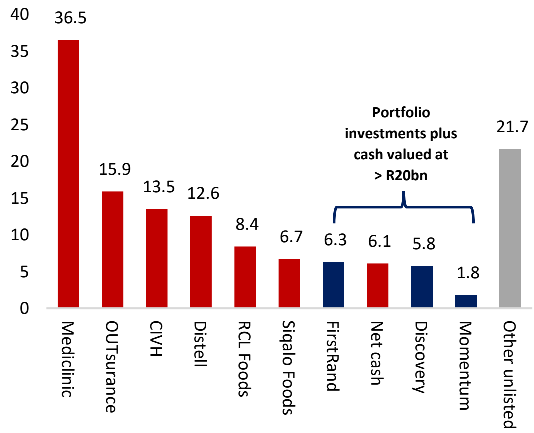


Chart 6 - Remgro core investments (Rbn)



Source: Bateleur Capital, Company reports

Value unlock opportunity

Despite management's efforts, Remgro continues to trade near a record discount to NAV, signalling scepticism among investors regarding the company's ability to create shareholder value. Core concerns relate to Remgro's recent capital allocation missteps, where we believe a strategic review has the potential to generate substantial value for investors.

It is our view that Remgro should provide the market with an updated strategic plan and a detailed roadmap to restructure into four key focussed verticals – Healthcare (Mediclinic), FMCG (Distell/Heineken & RCL/Siqalo), Financial Services (OUTsurance) and Telecommunications (Maziv & Seacom).

The portfolio investments are liquid, listed assets over which Remgro have little control. To date, there has been limited action taken by management to deal with these. Remgro should commit to realising portfolio investments as well as curtailing new investments outside the four key verticals.

At the same time, Remgro will be able to announce a share buyback program, targeting to utilise net cash and proceeds from portfolio investments to acquire its own shares at a substantial discount to NAV.

We estimate that the above will result in an immediate reduction in the holding company discount from the current 42% to at least 30%, unlocking c.R16bn in value. Assuming all portfolio investments are realised at current market prices and the proceeds, including cash available on the balance sheet, are utilised to buy back shares at a 30% discount to NAV, a further R9bn in value will be unlocked.

These initial steps could cumulatively create R25bn in shareholder value, increase NAV by 9% per share and potentially result in a 31% share price gain for Remgro shareholders.

Importantly, investors would have access to a portfolio of unique businesses with strong competitive positions. The portfolio will have a focused strategy, that will be viewed favourably by the market, and become the only entry point for these assets on the JSE. A further narrowing of the discount is likely as Remgro's strategic shift resonates with investors.

In the medium-term Remgro can sell an additional R10bn in non-core investments (for example Total Energies, Wispeco, Air Products and the Asia Partners LP fund). The proceeds could be utilised to buy back additional shares in a similar way as discussed above to create shareholder value.

We continue to engage management to express our views regarding Remgro's current strategy and capital structure.

Conclusion

The fund has been active over the quarter, adding to existing positions in South 32, African Rainbow Minerals, Implats, Sasol and Standard Bank while reducing exposure in Anglo American, Sibanye Stillwater, Bidvest and Bidcorp. Positions in Absa and MTN were sold while a new position in AB-Inbev was initiated.

Valuations of South African equities remain very attractive on an absolute and relative basis. 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 are encouraged by the wide opportunity set available.

Kind regards

Charl Gous | Warren Riley | Bheki Mthethwa

Co-Fund managers