



# Bateleur BCI SA Equity Fund

first quarter 2024 commentary

**22 April 2024**

**Dear Investor**

**Bateleur Long Only Fund (“The fund”) – 2024 first quarter report back to investors**

The fund returned negative 5.7% for the first quarter of 2024. As additional comparisons, the JSE capped shareholder weighted total return index (Capped SWIX) declined 2.3% inclusive of dividends re-invested, the value of a basket of domestic bonds (All Bond Index) reduced by 1.8% and cash (STeFI) produced a return of 2.0%.

In the period under review, there were limited contributors while detractors were stock-specific holdings - namely African Rainbow Minerals (diversified miner), Remgro (holding company) and AECI (mining explosives). In addition, the fund is not invested in gold miners which detracted 1.2% of relative performance.

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

**Table 1 – Top relative contributors and detractors Q1 2024**

<b>Contributors (relative)</b>	<b>Under/Overweight</b>	<b>YTD 2024</b>	<b>Detractors (relative)</b>	<b>Under/Overweight</b>	<b>YTD 2024</b>
MTN	UW	0.4%	African Rainbow Minerals	OW	-1.0%
British American Tobacco	OW	0.3%	Remgro	OW	-0.7%
BHP Group	OW	0.2%	AECI	OW	-0.7%
Absa	UW	0.2%	Gold Fields	UW	-0.5%
Discovery	UW	0.2%	AngloGold	UW	-0.4%

Source: Bateleur Capital

South African equity markets had a tough start to the year, characterised by continued foreign and domestic investor outflows, deteriorating liquidity, weak investor confidence and an increasing cost of equity.

The economic outlook remains constrained, and although lower levels of loadshedding and a reduction in interest rates could bring relief in the short term, they are no panacea for the structural issues facing the economy.

Upcoming elections will be critical, carrying the potential to usher in much-needed political change and a return of investor confidence. However, an adverse outcome will do little to attract capital from domestic and international investors but rather encourage further disinvestment from South Africa.

Consequently, SA equities are trading at low absolute and relative valuations.

The fund’s return for the quarter was disappointing and below expectations, albeit measured over a short period. In this report we will focus on stock specific detractors that impacted performance and their respective investment propositions.

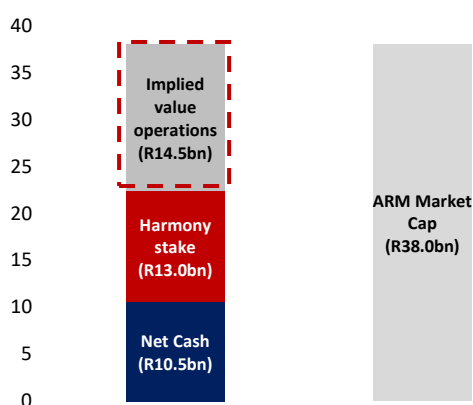
## African Rainbow Minerals (ARM)

ARM's share price declined 17.8% over the period and continues to trade at a large discount to our assessment of fair value.

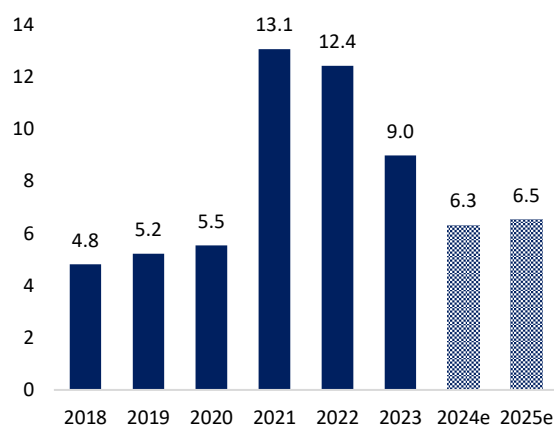
The business has net cash on the balance sheet (R10.5bn<sup>1</sup>) and holds a 12% equity stake in Harmony Gold, valued at R13bn<sup>2</sup> - together accounting for 60% of the current market capitalisation\*.

Therefore, the implied value of ARM's operational businesses is R14.5bn (R38.0bn – R23.5bn), which is made up of a diverse portfolio of mining assets with a long history of profitability and, despite current low commodity prices, are expected to generate positive earnings and cash flow (Charts 1 and 2).

**Chart 1 – ARM sum of the parts (Rbn)**



**Chart 2 – ARM headline earnings (Rbn)**



Source: Bateleur Capital, Company reports \* as of 2<sup>nd</sup> April 2024

ARM's key asset is its 50% shareholding in Assmang, a leading producer of iron and manganese ore in the Northern Cape. Assmang is highly profitable at spot commodity prices and is currently expected to generate the majority of ARM's earnings and free cash flow while PGM's and energy coal prices remain depressed.

The owner of the remaining 50% of Assmang, Assore, was taken private during 2020 at a valuation of R44 billion, providing a reasonable benchmark for the fair value of ARM's stake, that alone exceeds the implied valuation of all ARM's operating assets.

ARM's additional operating assets include PGM mines - Two Rivers (54% shareholding), Modikwa (42% shareholding) and the recently acquired Bokoni (85% shareholding), a 20% shareholding in Glencore's South African thermal coal operations as well as nickel and chrome interests.

Our internal valuation of ARM's operating assets is R50bn<sup>3</sup>, indicating a sizeable margin of safety when determining the sum of the parts. In addition, the company has a robust balance sheet that can weather commodity cycles and the ability to produce materially higher earnings in a more favourable pricing environment.

<sup>1</sup> Made up of net cash on ARM balance sheet of R7.9bn and R2.6bn attributable cash at Assmang.

<sup>2</sup> Harmony Gold is listed on the JSE. Market cap as on 2<sup>nd</sup> April was R108bn. ARM's 12% stake worth R13bn.

<sup>3</sup> Internal valuation based on NPV (Net present value) of operating assets over their life of mine.

At current commodity prices, ARM shares can be acquired at an estimated 5.6 times earnings and a forward dividend yield of 9.0%.

ARM remains a key holding in the fund.

### **Remgro**

In previous reports, we have written in-depth on Remgro's widening discount to net asset value (NAV) and the opportunity to unlock shareholder value.

Remgro's latest set of financial results were disappointing, largely related to the underperformance of Heineken Beverages SA<sup>4</sup>, delays in approving Vodacom's investment into Maziv<sup>5</sup> and market scepticism around management's valuation of Mediclinic.

- 1) Heineken Beverages SA had a tough start to its short existence – reporting an unexpected loss for the six months ending December 2023. Production issues forced the company to import beer at a loss to maintain market share. Remgro management indicated that production has since returned to normal and operational performance is steadily improving. Importantly, the rationale for the combined entity remains intact and short-term trading performance is not an accurate reflection of the long-term prospects of the business.

As operational performance and profitability improve, Heineken Beverages SA should support Remgro's earnings, cash flow and the internally calculated net asset value of the beverages unit, which we view as overly punitive.

- 2) The proposed transaction, whereby Vodacom will acquire an initial 30% stake in Maziv encountered regulatory delays. The Competition Commission blocked the transaction which has now been referred to the Competition Tribunal to be heard in May 2024.

Maziv requires additional capital to drive its fibre infrastructure expansion programme, which has been slowed as management awaits the impending Vodacom investment and associated capital injection. As a result, current debt levels are elevated which increased finance costs and reduced the company's contribution to Remgro's earnings.

Should the Competition Tribunal prohibit Vodacom's investment into Maziv, Remgro (and external shareholders of the underlying operating entities) will be required to recapitalise the business. In this regard, it is comforting that Remgro's balance sheet is in a net cash position with material liquid investments that can be monetised to reset Maziv's capital structure to support its growth strategy.

- 3) Mediclinic is Remgro's largest investment, with management facing increased scrutiny over its internal valuation. Management's valuation implies a historic P/E multiple of 24.2 times,

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<sup>4</sup> Heineken Beverages South Africa was formed on the 26<sup>th</sup> of April 2023, through the combination of Distell and Heineken South Africa. Remgro owns an effective 18.8% of Heineken Beverages SA.

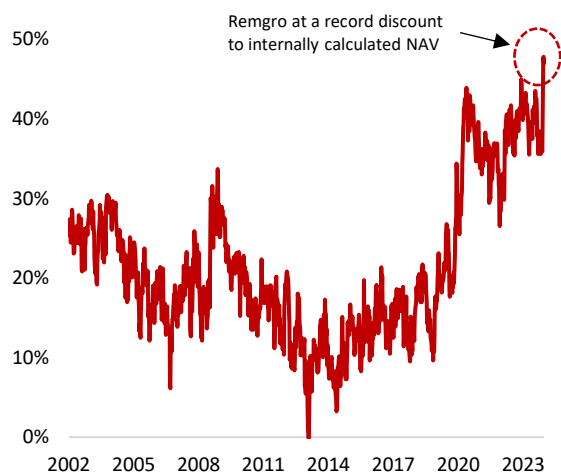
<sup>5</sup> Maziv is active in the telecommunications and information technology sectors. The key operating companies of the group are Dark Fibre Africa and Vumatel. The proposed merger of Vodacom and Maziv will see Vodacom invest c.R10.2bn (assets & cash) for a 30% stake in Maziv. Remgro owns an effective 57.0% in Maziv.

significantly higher than local peers such as Life Healthcare (12.1 times) and Netcare (11.8 times).

This comparison is overly simplistic, as only 34% of Mediclinic’s earnings are generated in South Africa with the balance from Switzerland (40%) and the Middle East (26%). These developed market regions benefit from lower costs of capital, thus attracting higher valuation multiples. Our internal valuation for Mediclinic is more prudent at a discount of approximately 30% to Remgro’s internal valuation.

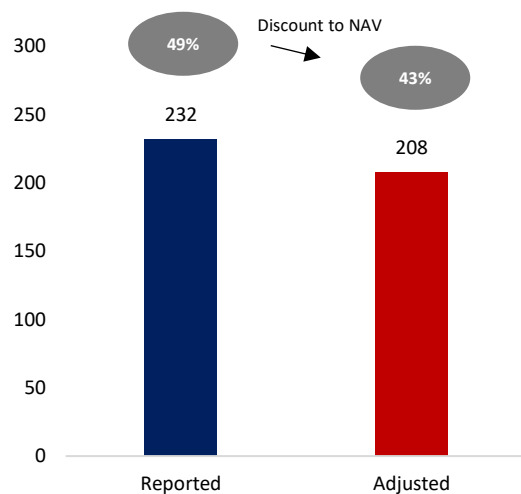
Following the recent decline in Remgro's share price, the company trades at an unprecedented 49% discount to reported NAV. Applying our internal valuation to Mediclinic, the current share price\* is at a 43% discount to adjusted NAV. (Charts 3 and 4).

**Chart 3 – Remgro discount to NAV (%)**



Source: Bateleur Capital, Company reports,\* as of 2<sup>nd</sup> April 2024

**Chart 4 – NAV (R per share) and discount to NAV**



Remgro experienced a challenging period that increased investor scepticism regarding the company’s ability to create shareholder value. There is considerable work to be done to improve the operational performance and cash generation at Remgro’s investee companies – specifically those discussed in this report.

The majority of issues that impacted Remgro in the period we view as short-term in nature and expect an improvement in the periods ahead. The large discount to NAV reflects the above concerns, but presents Remgro with an opportunity to redirect capital to the benefit of shareholders.

We have been disappointed with management’s execution in the short term and have been increasingly vocal in our engagements. We continue to advocate for a strategic review that includes an aggressive share buyback program and see good upside from the current share price.

The fund maintained exposure to Remgro.

**AECI**

AECI announced a strategic review<sup>6</sup> that aims to refocus the business on its core mining explosives and chemicals businesses while divesting underperforming non-core units.

<sup>6</sup> Strategic restructuring announced at 2023 Capital Markets day – November 2023

Management provided clear medium-term targets, aiming to double group EBITDA by 2026, improve margins, cash generation and profitability metrics.

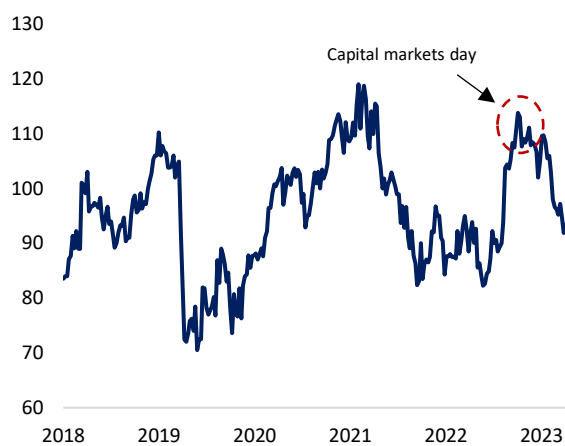
Over the next 18 months it is expected that AECI will begin to divest of its non-core businesses which includes the disposal of Much Asphalt and Schirm, both past acquisitions which have failed to deliver on their financial targets. Disposal proceeds will reduce group debt, but importantly will remove loss-making operations from the portfolio and improve shareholder returns.

Despite these positive developments, the valuation of AECI has continued to derate and now trades at 5.9 times our assessment of normalised earnings for the financial year ending December 2024.

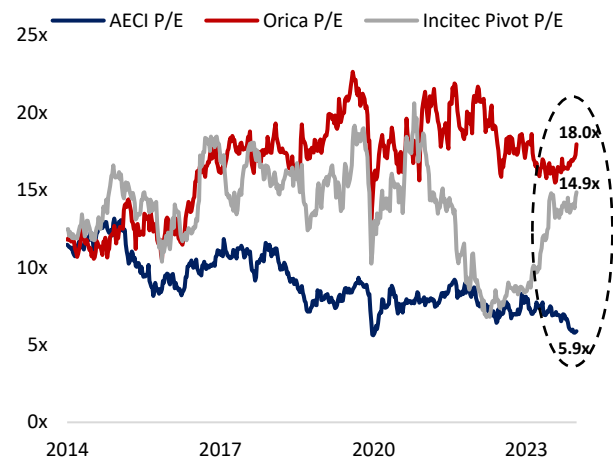
We view AECI as significantly undervalued and expect a valuation uplift closer to global peers as management’s strategic execution becomes evident (Charts 5 and 6).

AECI remains a key holding in the fund.

**Chart 5 – AECI share price (R)**



**Chart 6 – AECI peer group P/E multiples**



Source: Bateleur Capital, Company reports

**Conclusion**

While performance has been disappointing in the short term, we remain confident in the composition of the portfolio and its underlying holdings.

There have been limited changes to portfolio positioning over the period. The fund initiated a new position in BHP Group while adding to existing exposure in Mr Price, Shoprite, Standard Bank and Truworths.

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.

Kind regards

Charl Gous

Warren Riley

Bheki Mthethwa

Co-Fund managers

## Bateleur Capital (Pty) Ltd

Authorised financial services provider

FSP no 18123

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Block H, The Terraces

Steenberg Business Park

Westlake

7945

—

T +27 (0)21 681 5060

F +27 86 649 1794

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E [funds@bateleurcapital.com](mailto:funds@bateleurcapital.com)

W [bateleurcapital.com](http://bateleurcapital.com)

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Boutique Collective Investments (RF) (Pty) Limited, Catnia Building, Bella Rosa Village, Bella Rosa Street, Bellville, 7530

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