Bateleur Flexible Prescient Fund

Third quarter 2024 commentary

bateleur capital

Bateleur Flexible Prescient Fund – 2024 third quarter report back to unitholders

The fund appreciated 9.1% net of fees over the nine-month period to end September 2024[i]. As comparatives, the JSE All Share Index rose 15.9%, a basket of SA government bonds (ALBI) gained 16.7%, while cash (STeFI) returned 6.1%.

Attribution by strategy and the top contributors and detractors YTD are displayed in Table 1. JSE listed equities added 7.3% to returns, foreign listed equities 0.6%, and government bonds 1.8%.

Table 1: YTD to end September 2024 - Fund attribution by strategy and top contributors and detractors

Strategy	Return (%)	Top contributors	%	Top detractors	%
JSE listed equities	7.3%	Naspers/Prosus	1.8%	Aker BP	-0.5%
Foreign listed equities	0.6%	TSMC	1.0%	Heineken	-0.4%
SA Government bonds	1.7%	Standard Bank	1.0%	Novo Nordisk	-0.4%
US 2YR T.Bills (sold)	0.1%	FirstRand	0.8%	Merck	-0.3%
Cash & money market	0.5%	Bidvest	0.7%	Glencore	-0.3%
Costs	-1.1%	Amazon	0.6%	Vinci	-0.2%
Total	9.1%				

Source: Bateleur, 30 September 2024

The top-down asset allocation decisions made in the fund over the course of the third quarter were sound. These include increasing the weighting of JSE listed equities post the favourable SA election outcome and further rotating out of SA cash into SA government bonds. In terms of underlying strategies, the performance of the fund's foreign listed equity portfolio was somewhat muted.

This is best illustrated by grossing up the fund's YTD performance by asset class and comparing it to the relevant indices (Table 2).

Table 2: YTD performance per fund asset class grossed up

Strategy	Ave exposure (%)	Grossed Fund return (%)	Index return (%)	Index
JSE listed equities	41.6%	17.5%	15.9%	JSE All Share
Foreign listed equities (USD)	33.7%	8.2%	18.9%	MSCI World
SA Government bonds	9.8%	17.2%	16.7%	ALBI

Source: Bateleur, 30 September 2024

The grossed-up performance of the fund's JSE listed equity portfolio was comfortably ahead of the JSE All Share Index, while the performance of the government bond portfolio was slightly ahead of the ALBI Index.

However, the grossed-up foreign listed equity portfolio was behind the MSCI World Index, largely explaining the fund's relatively subdued YTD performance.

A component of the foreign underperformance can be clarified by the fund not owning certain mega cap stocks that performed well – including Nvidia (+190% YTD* in USD with a 5.1% weighting in the MSCI World Index) and Apple (+23% YTD* in USD with a 4.9% weighting in the MSCI World Index). The bar is high for these companies in terms of future growth expectations, as is the risk of capital loss from the current elevated ratings.

*Pricing on 23 October 2024

Additionally, a select number of foreign stocks that the fund does own – underperformed in the short-term and require further commentary.

Aker BP ('Aker') declined 16.9% in Norwegian krona and 21.5% in rand over the third quarter due to a declining oil price and waning investor sentiment on energy shares outside of the US.

Operationally, the company continues to perform well with oil production from its existing fields in line with guidance while also investing in new offshore oil projects that will come into production from 2027.

These new developments are expected to more than counter the well communicated decline from the company's flagship oil field 'Johan Sverdrup' - starting from 2025.

On a group wide basis, Aker is targeting oil output of 525 000 barrels per day by 2028, 19% higher than the current output of 440,000. This target includes announced capital projects that are already in development but excludes any upside potential from exploration activities or the extension of the operating life of existing oil fields.

Aker is a highly profitable company with an all-in portfolio production cost (including capex) of USD35 to USD40 per barrel, significantly below the current oil price of USD74 per barrel.

Using the average YTD realised oil price, Aker trades on a projected December 2024 P/E multiple of 7.0 times and offers a compelling dividend yield of 11% (before Norwegian dividend withholding taxes).

The company's stated policy is to grow the dividend by at least 5% per year, which implies that investors are getting paid a substantial yield to wait for a potential share re-rating. Aker has a strong balance sheet with a leverage ratio of 0.2 times. This supports the incremental dividend policy as long as the oil price does not significantly deteriorate. We continue to view Aker as materially undervalued.

Heineken declined 11.1% in euros and 12.6% in rand over the third quarter. In its half-year results to end June, the company reported beer volume growth of 2%, which was below market expectations of 3%. Management cited poor weather over the European summer as well as ongoing weakness in the key emerging market of Vietnam as contributing factors.

Despite subdued volume growth, satisfactory revenue growth of 6% was achieved aided by price increases and strong performances from the company's higher margin premium beer brands.

Operating profit grew by a healthier 12%, assisted by lower input costs on key commodities (aluminum, barley and oil) as well as efficiency gains. Looking at the big picture, the results were solid if unspectacular and certainly did not warrant the negative share price response.

Heineken is an innovative beer company with strong premium brands that resonate well with aspirant consumers. It has constantly reinvested in its brands while steadily delivering earnings growth over a lengthy period – displaying compounding attributes.

The share is attractively valued on a projected P/E multiple to December 2024 of 15.8 times based on the company's most recent guidance. This is at a discount to both its long-term average (18.5 times) and its brewing peer group (18.0 times).

Novo Nordisk ('Novo') is the largest manufacturer of GLP-1 drugs globally which have proven to be especially effective in treating Type 2 diabetes and obesity (Ozempic for diabetes, Wegovy for obesity).

The market opportunity for treating obesity on a global scale is enormous (refer to our first quarter 2024 report back for further insight) and the two largest players, Novo and Eli Lilly, are both ramping up production as fast as possible to meet insatiable demand.

Further demand is expected to materialise from recently completed clinical trials which confirm that GLP-1 drugs also reduce the risk of co-morbidities, including cardiovascular failure (i.e. heart-attack or stroke) and chronic kidney disease.

The company has guided strong sales growth for the 2024 financial year (+22% to +28%) and to date has reliably delivered on guidance. However, with high growth expectations and a premium valuation (current one year forward P/E multiple of 30 times) the market is understandably fixated on the quarterly sales from its blockbuster Ozempic and Wegovy drugs.

In its recent second quarter results, GLP-1 revenues fell short of consensus expectations, partly due to the timing of rebates (which are an inherently unpredictable feature of the US pharmaceutical industry) as well as ongoing production shortages in the US. This led to Novo's share price declining by 21.5% in Danish kroner and 22.8% in rand over the review period.

Despite the disappointing quarter, we remain confident in Novo's ability to: 1) successfully scale production over the medium-term to meet demand, 2) bring new, higher efficacy diabetes and obesity drugs to market (we await the imminent trial results of CagriSema due before the end of 2024), and 3) continue to deliver strong and sustainable earnings growth and free cash flow.

Novo's share price volatility is likely to remain elevated – especially around quarterly financial results and trial data readouts from competitors. Nevertheless, the long-term investment thesis is intact, and the share remains a fund holding.

Outlook and current fund positioning:

Current fund positioning as well as implemented asset allocation changes between the first quarter and third quarter of 2024 are shown in Table 3 overleaf.

The fund continued to increase its weighting assigned to JSE listed equities with a quality focus. This strategy currently comprises 48% of fund NAV – compared to 38% at the end of the first quarter and 44% at the end of the second quarter. SA domestic equities remain attractively valued and under owned despite the recent re-rating. They are especially compelling should SA be able to return to annual GDP growth above 2%.

Foreign listed equities have declined to 27% of fund value due to rand strength, select foreign disposals and domestic equity outperformance. The foreign portfolio comprises an appropriate mix of growth and defensive companies – with no single investment accounting for more than 3% of fund value.

Domestic government bond exposure totalled 16% of fund value at the end of September, up from 10% at the end of June. The weighting was raised in early August and was largely funded from domestic cash. The fund's bond holdings have an average maturity of 9 years.

SA government bonds are viewed as attractive relative to cash – considering the high real yield on offer and the recent commencement of the rate cutting cycle in SA.

Table 3: Fund allocation changes between Q1 and end Q3

	Q1 2024 allocation (%)	Q2 2024 allocation (%)	Current allocation (%)	Change	Commentary
Domestic Equities	38%	44%	48%	↑	Increased exposure post positive election outcome - quality focus
Foreign Equities	37%	35%	27%	↓	Reduced due to Rand strength, outperformance of domestic equities and select disposals
Total Equities	**75%**	**79%**	**75%**	↓	
Domestic cash	12%	5%	5%	→	Rotated out of cash into domestic government bonds & equities
Foreign cash	2%	2%	4%	↑	Increased due to foreign equity profit taking
Domestic government bonds	7%	10%	16%	↑	Increased exposure - SA bonds attractive relative to cash
Offshore government bonds	4%	4%	0%	↓	Exited short term US government bonds on sharp fall in yields
Total Cash & Fixed Income	**25%**	**21%**	**25%**	↑	

We remain confident in delivering on the fund's investment objectives.

Sincerely,

Kevin Williams
31 October 2024

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[i] A1 Class Performance:
1 Year: Fund 14.0% |Benchmark 9.2%
10 Year : Fund 10.2% | Benchmark 9.0%
Highest rolling 1 year return 39.0%, Lowest rolling 1 year return -7.2%.

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