Bateleur BCI SA Equity Fund

First half 2024 commentary

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Dear Investor

Bateleur Equity Fund ("the fund") – First half report back to unitholders

The fund returned 4.0% year to date (YTD) compared to the JSE Capped Shareholder Weighted Index (Capped SWIX) return of 5.7% for the same period.[i]

African Rainbow Minerals, Bidvest and Truworths contributed a combined 1.8% in relative performance. However, companies not owned detracted 3.2% versus the benchmark, namely Anglo American (failed corporate action attempt), Capitec and gold miners (AngloGold and Harmony Gold).

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

Table 1: Top individual contributors and detractors year to date

Contributors (relative)	Under/Overweight	YTD 2024	Detractors (relative)	Under/Overweight	YTD 2024
African Rainbow Minerals	OW	1.0%	Anglo American	UW	-1.2%
Bidvest	OW	0.5%	Capitec	UW	-0.9%
MTN	UW	0.5%	AngloGold	UW	-0.6%
Anglo Platinum	UW	0.4%	Harmony Gold	UW	-0.5%
Truworths	OW	0.3%	Remgro	OW	-0.5%

Source: Bateleur

JSE listed equities (+4.1%) staged a strong rebound in June off a depressed base - following the market friendly election outcome and formation of a Government of National Unity (GNU). Relative performance improved during the second quarter, with the fund outperforming its benchmark by 2.1%. Returns were aided by solid gains in domestic facing holdings such as FirstRand, Standard Bank, Shoprite, Bidvest and AVI.

Valuations remain attractive, expectations are low and there are signs of improved momentum in state owned entities (Eskom/Transnet) which should boost confidence and provide a cyclical lift to economic growth in the short-term.

Moving forward, the critical task at hand will be the swift implementation of existing reforms and pro-growth policies. Should the new administration successfully execute, we anticipate a favourable outlook for South African risk assets.

Below we discuss the outlook in more detail as well as the fund's current positioning.

The short-term outlook for domestic equities and government bonds has improved following: 1) the market friendly election outcome, 2) a tentative recovery in key state-owned enterprises (SOE's), and 3) expectations for interest rate cuts to commence from September.

With domestic fund manager weightings in SA equities at historically low levels (chart 1), and valuations cheap relative to history (chart 2) – this provides a favourable backdrop for an equity market re-rating.

Chart 1: Allocation to domestic equities

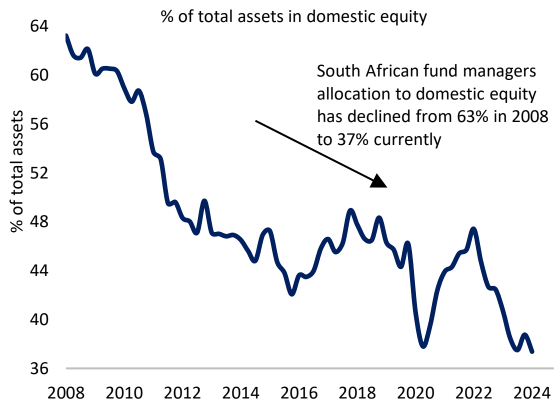
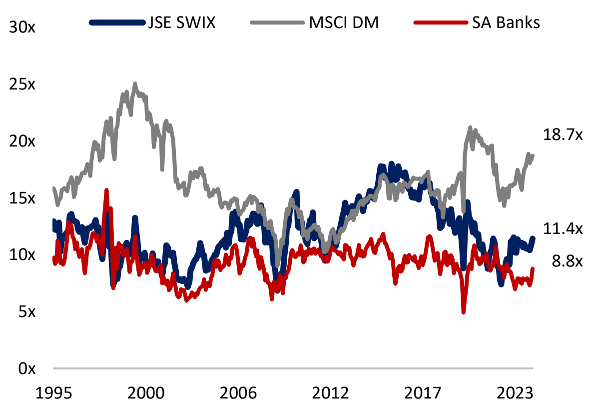


Chart 2: JSE is cheap vs. history and peers



Source: Bateleur, Bloomberg, SBG securities

During 2023, SA endured 335 days of loadshedding detracting 1.5% from GDP according to the SA Reserve Bank (SARB)*. At the time of writing there has been no loadshedding in SA for 121 consecutive days due to improved energy availability and fewer unplanned outages (chart 3). If these grid improvements are sustainable, there will be a sharp improvement in SA GDP growth in 2024/2025 merely from a non-repeat of 2023's loadshedding.

Changes implemented at Transnet under new leadership – that encompass a more constructive dialogue with business - are being reflected in improved commodity railage and better handling at the ports (chart 4). Increased exports of hard and soft commodities are clearly positive for SA's mining and agricultural industries. National Treasury estimates that an improvement in the functioning of the rail and ports off the current depressed base could add at least 0.3% to SA's annual GDP growth.

Chart 3: Eskom EAF and unplanned outages

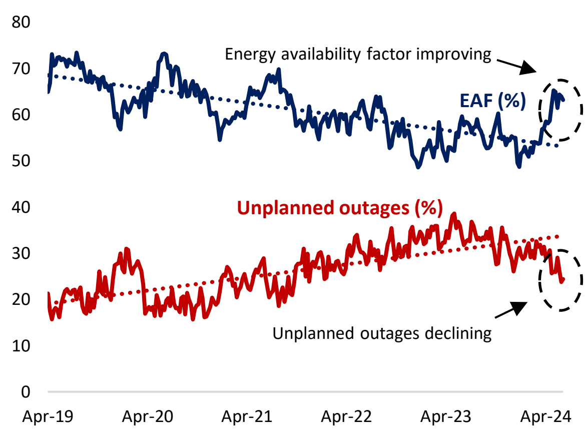
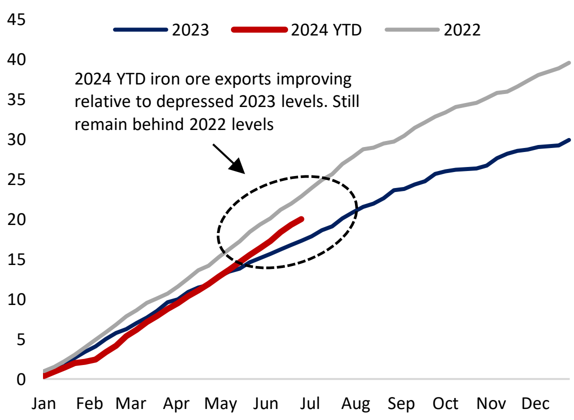


Chart 4: Cumulative SA iron ore exports (Mt)



Source: Bateleur, Bloomberg, RMB MS *SARB statement of the monetary policy committee – July 2024

The recent stability of the rand combined with declining inflation expectations provide a favourable environment for cutting interest rates. Bloomberg consensus is for the SA Reserve Bank to follow the US's lead and cut by 25bp at its next meeting in September. A cumulative 125bp in rate cuts is forecast by the end of 2025, taking the repo rate from the current 8.25% to 7.0%.

Lower interest rates reduce debt servicing costs, increase household consumption, and stimulate credit extension. Since 2009, private credit extension in SA has increased by only 5% a year, well below the 14% average growth preceding this period (chart 5).

The combination of these factors could result in SA GDP growth reaching 2.5% to 3.0% in 2025, well ahead of the 0.7% average since 2015 (chart 6), providing much needed impetus to corporate earnings growth.

Chart 5: SA private credit extension

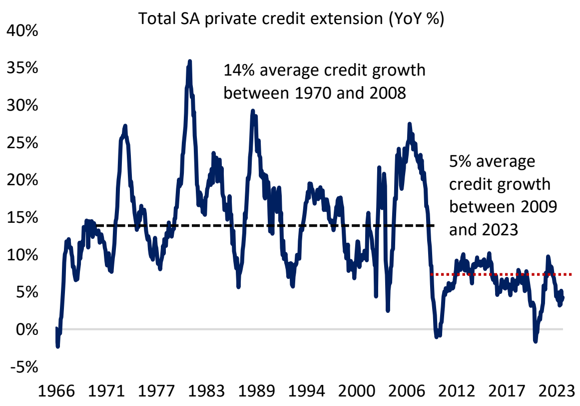
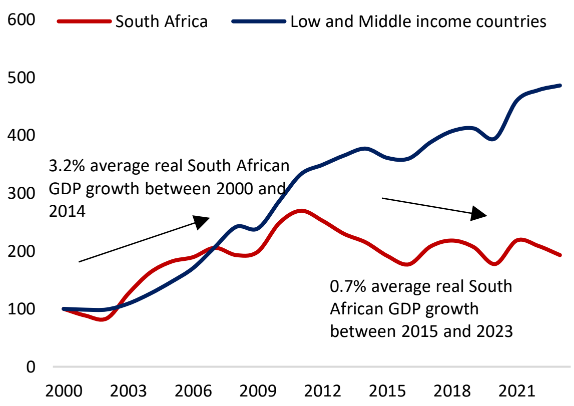


Chart 6: SA GDP per capita



Source: Bateleur, Bloomberg, SBG securities, IMF

Over the medium to long-term more concrete steps will be required for SA to achieve sustainable GDP growth of 3.0%. In a recent publication, The Bureau of Economic Research (BER) presented its glide path to 3.5% GDP growth by 2029 (chart 7). The report identified economic reform, private sector fixed investment, and improved sentiment that lifts consumer spending, as the required drivers.

At Bateleur, we have created our own growth flywheel for SA (chart 8). Once again, the start point is structural reform – which includes functioning government departments with effective leadership; a sustainable improvement in energy, ports and rail; improved dialogue between government and business; a reduction in bureaucratic red tape; a reduction in, and accountability for corruption; and sensible foreign policy.

Should these reforms materialise, we are certain it will lead to an improvement in business and consumer confidence - "the cheapest form of stimulus".

Increased confidence will, in turn, lead to increased investment (both public and private), which for a country like SA is the easiest way to bolster employment levels. Newly elected Public Works and Infrastructure Minister Dean Macpherson recently communicated "My number one priority is to invest in infrastructure and turn SA into a massive construction site under the theme LetsBuildSA."

Increased employment and wage growth would lead to a further increase in credit extension (both consumer and corporate) which has a multiplier effect on GDP growth – and so the flywheel continues.

Chart 7: BER glide path to 3.5% GDP growth

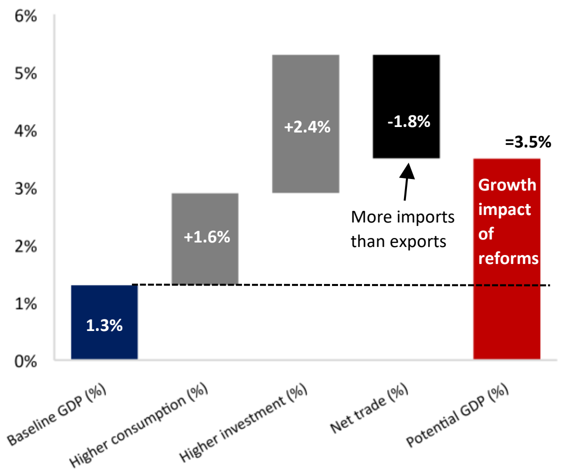
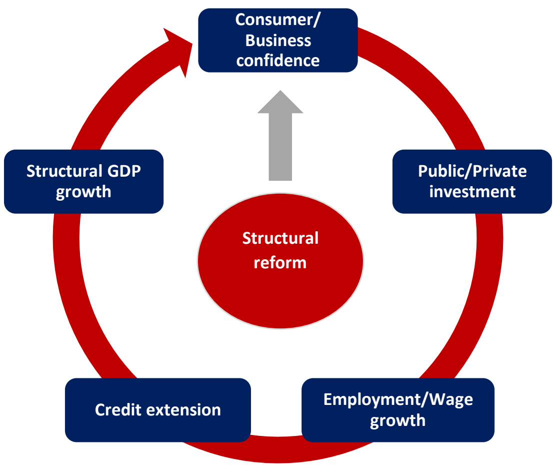


Chart 8: Bateleur flywheel to structural growth



Source: Bateleur, Bloomberg, BER – redefining South Africa's economic trajectory – June 2024

This is merely a hypothetical path to structural growth. Given past disappointments, which are numerous, SA remains a "show me" story. However, it does indicate the potential for outsized returns from SA public markets – should structural reform policies be successfully implemented.

Current positioning

The portfolio is tilted towards a favourable domestic outcome while maintaining appropriate exposure to offshore earners given the uncertainty around the execution and implementation of structural reforms.

The fund cautiously added SA Inc. exposure over the quarter, retaining a bias for quality companies which are expected to grow earnings despite the prevailing economic climate.

New positions initiated were in the hospital groups (Netcare and Life Healthcare), gaming (Sun International) and food producers (Premier), while an existing position in AVI was added to. To fund these acquisitions, the fund exited Mondi and reduced exposure to British American Tobacco.

Table 2 below illustrates the fund's movement between domestic facing and rand hedge equities over the quarter, albeit assisted by market movements. 52% of the fund is currently allocated to domestic facing holdings, up from 47% at the beginning of the second quarter, while rand hedge exposure reduced from 52% to 47%.

Table 2: Fund positioning – end of Q1 2024 vs current

Date	Rand Hedge	SA Inc.	Cash
Q1 2024	52%	47%	1%
Current*	47%	52%	1%

Source: Bateleur *Current as of 12th July 2024

Fund positioning can be broken down into the following categories:

Rand Hedge Industrial (29% of fund value)
Naspers/Prosus is making good progress in addressing the discount to net asset value (NAV), achieving core e-commerce (assets excluding Tencent) profitability and positive free cash flow ahead of schedule, as well as creating significant shareholder value via the open-ended share buyback program.

Tencent remains the group's primary asset and the outlook is encouraging – management has cut unprofitable business lines, is rapidly growing higher-margin revenue streams and guides toward a long runway for increased monetisation and margin expansion. Short-term earnings will be enhanced by a sizeable share buyback program ($13bn) and are expected to compound at teens over the medium-term. Tencent remains attractively valued at an estimated 16.3 times forward P/E ratio and remains a meaningful position in the fund via Naspers/Prosus that offers a discounted entry point.

The balance of the fund's rand hedge exposure has been selected based on a combination of near-term solid earnings growth prospects and attractive starting valuations[1]. These include Ab-Inbev (16.7 x P/E, 2.1% dividend yield), Bidcorp (16.0 x P/E, 3% dividend yield) and British American Tobacco (6.7 x P/E, 10% dividend yield).

Rand Hedge Resources (18% of fund value)
The fund retains a preference for diversified miners with exposure to future facing metals, where the outlook for prices remains constructive based on continued capital underinvestment by major producers driving increasing supply deficits and decarbonisation/electrification trends which are structural in nature and should support higher demand over the medium-term.

BHP Group's recent bid for Anglo American, to secure additional tier-one copper assets, serves to highlight the attractive outlook for future facing metals as well as the difficulty and time constraints in building new greenfield projects.

The fund maintained positions in Glencore, BHP Group and African Rainbow Minerals trading at attractive high single digit free cash flow yields. The fund is currently not directly invested in gold mining equities and carries a large underweight position in platinum group metal miners. The fundamental characteristics combined with current valuations do not offer a sufficient margin of safety to warrant exposure to precious metal miners at this point.

Domestic Financials (17% of fund value)
The fund increased its exposure to FirstRand and Standard Bank during the period but remains collectively underweight the financial sector, given the wide and attractive opportunity set available on the JSE.

The banking sector is leveraged to an improving domestic growth outlook and should benefit from increased lending activity and a reduction in bad debts in a more favourable growth and interest rate

[1] 12 month forward price to earnings ratio and DY

environment. Preference remains for higher quality banks (FirstRand and Standard Bank) which have demonstrated prudent lending practices, are well capitalised and have a history of shareholder value creation.

Quality Domestic Large Cap (17% of fund value)
The fund is invested in domestic industrials with a history of consistent earnings and dividend growth, strong market positions and which are run by management teams with a track record of sensible capital allocation decisions. We consider these to be high-quality businesses that warrant a premium rating relative to peers.

These companies are expected to continue to grow earnings in the current environment and are well positioned should the SA economy improve. Holdings include AVI, Bidvest, Mr Price, Shoprite and Truworths.

Quality Domestic Mid-Cap (10% of fund value)
The fund holds a meaningful stake in a selection of quality domestic mid-cap companies. Despite a tough economic backdrop, several of these businesses are reporting record financial results, continue to trade at attractive valuation multiples and are well positioned to benefit from improved domestic economic activity.

These businesses offer exposure to diversified areas of the SA economy such as discretionary retail, electrification, branded healthcare products, home improvement, hotels & leisure (gambling) and manufacturing not specifically captured in large-cap SA facing companies.

Table 3 below highlights key mid-cap holdings of the fund. These businesses are under owned by local funds, lowly valued and offer optionality in respect of corporate action.

Table 3: Domestic mid-capitalisation holdings

Company	FY22 HEPS (ZAR)	FY23 HEPS (ZAR)	FY24E HEPS (ZAR)	NTM HEPS^ (ZAR)	NTM P/E	Outlook
Hudaco	19.5	20.7	21.2	**21.8**	**7.9x**	Benefit from pick up in industrial activity & consumer spending
Mpact	4.6	5.1	5.2	**5.3**	**5.6x**	Capital projects to deliver & geared to improved consumer/agri sectors
Italtile	1.5	1.3	1.3	**1.3**	**9.0x**	Will benefit from lower rates and pick up in disrectionary spend
Adcock Ingram	5.0	5.6	6.0	**6.5**	**9.3x**	Geared to stronger rand - large portion of COGS USD linked
Premier	4.5	5.5	7.4	**8.3**	**8.9x**	Growth from capital projects & market share gains in bread category
Sun International	4.3	4.7	5.2	**5.5**	**6.7x**	Continued growth from online gaming & geared to consumer spending
Reunert	5.2	5.7	6.8	**7.5**	**9.8x**	Continued growth from strong defense and electrical engineering divisions

Source: Bateleur ^12 month rolled forward P/E

Value unlock opportunities (8% of fund value)
The fund maintained positions in AECI and Remgro where there is considerable upside optionality.

AECI is on a restructuring path and targets doubling the profitability of its core business (mining and chemicals) by 2026. The group recently announced the signing of a sale agreement for its Animal Health business, albeit small, a positive signal that the restructuring process is on track. We await further progress on larger non-core assets sales such as Much Asphalt and Schirm which should serve as a positive catalyst for the group that remains undervalued.

Remgro has been discussed comprehensively in previous report backs, encouragingly, there are tentative signs of improvement. These include 1) the placement and exit of its Momentum Metropolitan stake valued at R2.7bn; 2) the simplification of RCL Foods via the unbundling and separate listing of Rainbow Chicken and 3) the appointment of Carel Vosloo as head of investments and alternative director to current CEO, Jannie Durand. We anticipate that Vosloo's appointment will bring a fresh perspective to Remgro's portfolio management and capital allocation strategies. With Remgro trading at a large (c.45%) discount to intrinsic NAV, there remains scope for substantial value creation.

<u>Conclusion</u>

Positive signs are emerging for the South African economy that supports an increased allocation to domestic facing companies. The fund is in the fortunate position to access a wide and attractive opportunity set supported by our deep knowledge of domestic equities.

We remain confident of delivering on the fund’s objectives going forward.

Kind regards

Charl Gous | Warren Riley | Bheki Mthethwa

Co-Fund managers

[i] 1 Year: Fund 10.3% |Benchmark 10%
3 Year : Fund 12.4% |Benchmark 10.1%
5 Year : Fund 10.0% | Benchmark 8.7%
Since inception: Fund 6.3% | Benchmark 5.4%
Highest rolling 1 year return 54.4%, Lowest rolling 1 year return -24.5%.

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