Bateleur BCI Equity Fund

2024 final report back

bateleur capital

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Dear Investor

Bateleur SA Equity Fund ("The fund") – 2024 final report back

The fund returned 8.8% (net of fees) for the year ending December 2024, behind its benchmark (JSE Capped Shareholder Weighted All Share Index with dividends reinvested) of 13.4%.[i] We consider this a disappointing result, which is discussed under the 2024 review.

Despite a weaker relative performance in 2024, the medium-term track record has been assisted by good returns over the past five years, with the fund delivering an annualised 12.1% return over the period (Chart 1).

Since its inception, Bateleur's SA Long Only Equity strategy has returned 11.8% CAGR (net of fees), ahead of its benchmark*, which returned 10.3% CAGR (gross of fees) over the same period (Chart 2).

Chart 1: Medium-term track record (5yr CAGR)

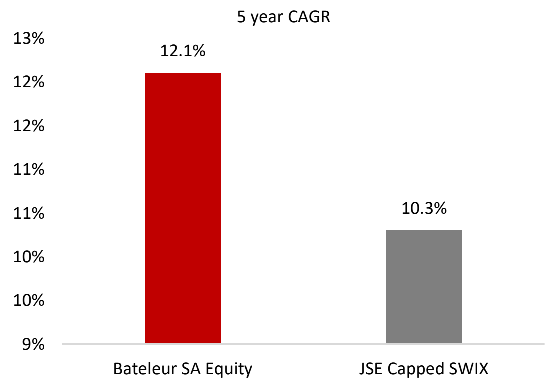
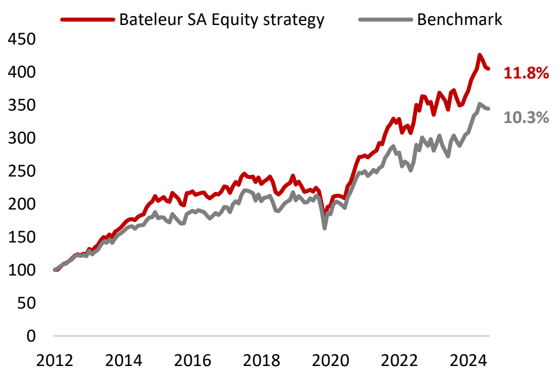


Chart 2: Bateleur SA Long Only Equity strategy^



Source: Bateleur; Bloomberg; ^longest running SA Long Only equity strategy; *SWIX to July 2021 and Capped SWIX from August 2021 onwards.

2024 review

A summary of top relative contributors and detractors is shown below.

Table 1: Top relative contributors and detractors 2024

Top relative contributors	%	Top relative detractors	%
Hudaco	1.1%	Capitec	-1.7%
Premier	1.0%	Anglo American	-1.0%
AVI	0.8%	Glencore	-1.0%
Italtile	0.8%	Sasol	-0.8%
Naspers/Prosus	0.6%	African Rainbow Minerals	-0.8%

Source: Bateleur Capital; Bloomberg, 31 December 2024

Fund performance benefitted from sound stock picking in domestic facing names such as AVI, Hudaco, Italtile, Mr Price, Premier, Reunert and Truworths. However, this was offset by underperformance in three main areas – Financials, Resources and stock-specific opportunities.

Financials

The financial sector performed well during 2024, with the JSE Financials Index delivering a total return of 22.4%. Within the banking sector, the fund held large absolute positions in FirstRand and Standard Bank which underperformed peers during the period after delivering strong outperformance during 2023 (Table 2).

Table 2: JSE Banks 2023/2024 total return

Security	Total return 2023 (%)	Total return 2024 (%)	Cumulative return (%)
Capitec	12.0%	58.0%	77.0%
Nedbank	10.3%	40.8%	55.2%
Absa	-9.0%	26.7%	15.3%
Standard Bank	33.9%	14.6%	53.0%
FirstRand	25.8%	9.7%	38.0%

Source: Bateleur Capital; Bloomberg, Total returns to 31 December 2024

The fund did not own Capitec, Absa and Nedbank (acquired Q3 2024) which detracted a combined 3.0% from relative performance, opting for increased exposure in domestic retail, industrial and stock-specific opportunities.

Capitec was the single largest detractor and can be considered a missed opportunity given its qualitative characteristics. Despite trading at a large premium to domestic banks, Capitec was the best performer in the sector - delivering a 58.0% total return on the back of continued strong financial results. Capitec's current valuation is demanding (as it was at the start of 2024 on an absolute and relative basis), trading at 24 times forward earnings, with little room for operational disappointments. Given its stretched valuation and heightened earnings growth expectations, the fund holds no exposure to Capitec.

FirstRand is the fund's preferred exposure in the banking sector given its qualitative characteristics and attractive valuation. The bank is expected to maintain its industry-leading return on equity (ROE) while delivering compound earnings growth in the low teens over the next three years. Short-term share price performance has been hampered by the UK's Financial Conduct Authority review of commission arrangements in the motor finance industry. FirstRand (R414bn market capitalisation) set aside R3bn in provisions to cover potential penalties relating to the investigation that is currently tied up in legal proceedings. Albeit large in absolute terms, the possible fine is expected to have a limited impact on the long-term valuation of the business. Despite these near-term headwinds, we see good value at the current share price, trading at 9.3 times forward earnings.

The fund held no exposure to Absa given ongoing management and asset quality concerns but initiated a position in Nedbank based on its leverage to improving domestic credit growth combined with an undemanding valuation.

Resources

In hindsight, the fund had too much exposure to diversified miners (Glencore, BHP Group and African Rainbow Minerals) which detracted a combined 1.9% from relative performance. In addition, the fund held no exposure to Anglo American which benefitted from an unsuccessful takeover bid from BHP Group, outperforming diversified mining peers.

Several considerations drove the decision to forgo exposure to Anglo American. The company's balance sheet was stretched, free cash flow generation was inferior relative to peers, and the company has had a questionable history of capital allocation. Moreover, desired commodity exposure could be accessed more effectively through positions in BHP Group and Glencore, both of which offered more attractive valuations and stronger balance sheets.

African Rainbow Minerals (ARM) has been discussed in prior reportbacks. The company has a c.11.8% stake in listed Harmony Gold valued at R13bn, net cash on the balance sheet of R11bn and owns substantial iron ore, manganese, platinum and coal operations. ARM today has a market capitalisation of R34bn, suggesting these operational assets are valued at R10bn. On currently depressed commodity prices, these assets are expected to generate R4bn in headline earnings, implying a 2.5 times price/earnings ratio, significantly undervaluing the business and its future cash generation. We continue to view ARM as a value unlock opportunity.

The fund has largely maintained exposure to the diversified miners, reducing its stake in BHP Group while maintaining existing positions in Glencore and African Rainbow Minerals.

Stock-specific opportunities

The fund holds several stock-specific opportunities (AECI, Remgro, Bidcorp & AB-Inbev) which underperformed during the period, detracting a combined 1.3% from relative performance.

AECI, a key holding in the fund, is undergoing a restructuring process to unlock shareholder value. Progress on asset sales has been slow and material once-off charges associated with reorganising the business are impacting short-term profitability. AECI continues to offer material shareholder upside based on the expectation of management successfully executing the turnaround strategy, the disposal of loss-making business units and corporate action optionality as the global explosives industry is set to consolidate. Exposure to AECI has been maintained, with robust discussions continuing with both management and the Chairman of the board.

Remgro continues to trade at a wide discount to net asset value, currently estimated to be 45%. The company's share price declined 4.5% over the year and materially underperformed the JSE Capped SWIX Index. We continue to engage with management on the operational turnaround of the investee companies and capital allocation priorities of the business, which presents shareholders with an attractive investment opportunity should management successfully execute the turnaround plan. The fund maintained exposure to Remgro.

Bidcorp's share price was flat during the year, despite delivering a sound operational and financial performance, growing revenue and earnings by 15.1% and 15.5% respectively for the financial year ended June 2024. Bidcorp is considered a high-quality business with strong cash generation, limited debt, high returns on shareholder capital and a history of sound capital allocation. At 16 times estimated forward earnings accompanied by a healthy growth outlook, it remains a core holding in the fund and we would look to add into any further weakness.

AB-Inbev's (ABI) share price declined over 20% during the year, driven by both sector weakness and company-specific concerns given foreign exchange depreciation in both Brazil and Mexico. While the share price has been weak, the investment case remains intact. With profitability and margins improving, free cash flow should continue to strengthen driving improved shareholder returns. At 13.6 times estimated forward earnings, ABI trades at a steep discount to history.

<u>2025 outlook</u>

US exceptionalism

US exceptionalism, at least in terms of economic and earnings performance, looks broadly set to continue in 2025 (Charts 3 and 4). This is supported by several factors including expansionary fiscal policy, artificial intelligence (AI) investment and leadership as well as the pro-growth stance of the incoming administration.

Chart 3: US cumulative GDP growth vs G7

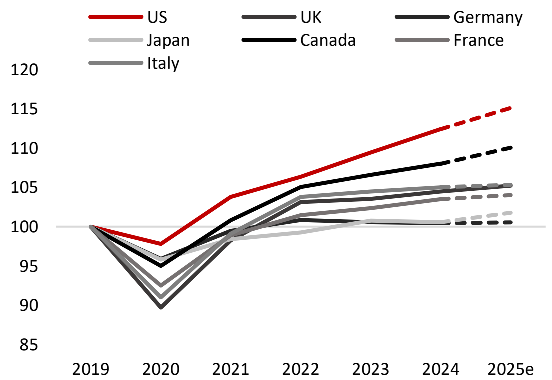
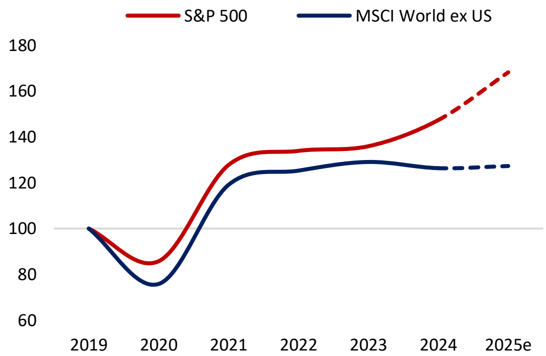


Chart 4: US EPS growth vs ROW



Source: Bateleur Capital; Bloomberg

Fiscal policy in the United States stands out globally for its continued expansionary stance, creating significant economic momentum. Beyond the $5 trillion deployed in Covid-era rescue packages, three major legislative initiatives have committed an additional $2.2 trillion in strategic investments. This includes the Infrastructure Investment and Jobs Act ($1.2 trillion), the Inflation Reduction Act ($750 billion), and the CHIPS Act ($280 billion) as shown in chart 5.

While the rescue packages focused on economic stabilisation, newer initiatives target long-term structural growth through strategic investments in infrastructure, clean energy, and advanced manufacturing. In addition, these packages have included matching requirements from the private sector, which have had a multiplier effect on GDP growth via investment and job creation. As an example, the CHIPS Act provided $52.7 billion specifically for semiconductor manufacturing subsidies, with an additional $24 billion in tax credits for chip production. This has already catalysed private sector investment, with companies like Intel, TSMC, and Samsung announcing major U.S. manufacturing facilities.

This sustained fiscal expansion is unprecedented, distinguishing the U.S. from the more conservative fiscal stances adopted by many other advanced economies (Chart 6).

Chart 5: US fiscal packages ($tn)

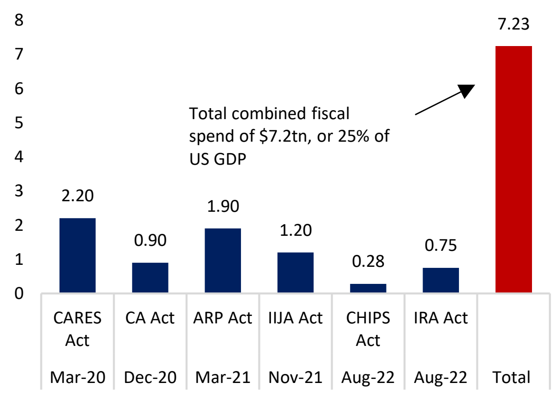
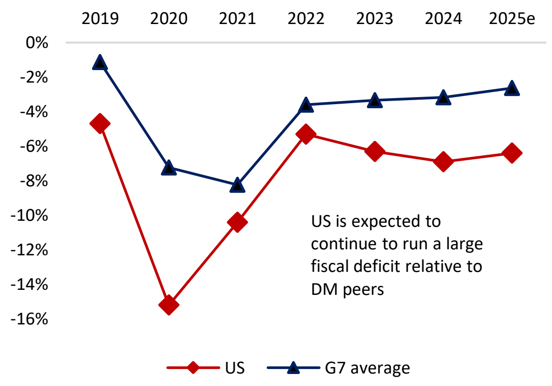


Chart 6: US deficit as % of GDP vs G7



Source: Bateleur Capital; Bloomberg, US Congressional Budget Office

In addition, the US has emerged dominant in global technology and AI, creating a self-reinforcing cycle of investment, innovation and productivity. Since 2014, U.S. private capital investments in AI have reached $430 billion, with the country's share of global AI investment climbing to 70% in 2024 (Chart 7).

This dominance is further amplified by the significant capital expenditure from major U.S. technology companies, which invested $240 billion in 2024 alone (Chart 8). The momentum shows no signs of slowing, with AI investment projected to grow to $282 billion this year, reinforcing America's first-mover advantage and positioning the country to capture a large share of AI-driven productivity gains and economic growth.

Chart 7: Private capital invested into AI

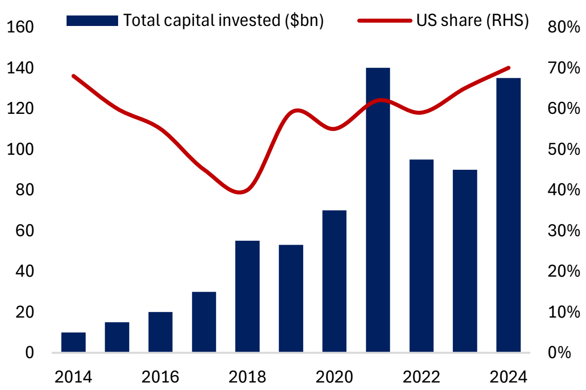
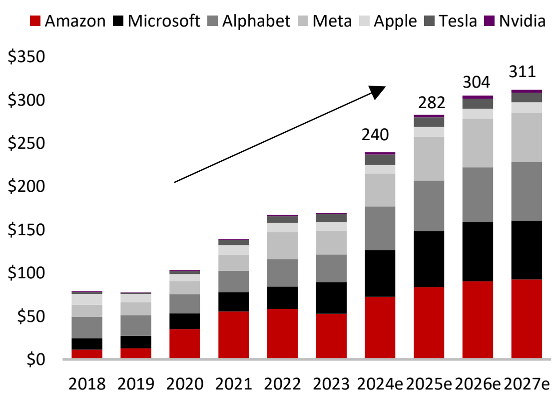


Chart 8: MAG7 capex ($bn)



Source: Bateleur Capital; Bloomberg, JP Morgan

Finally, 2025 will see the return of President Trump. A broadly pro-growth policy agenda centred on deregulation and tax reduction should improve business and consumer confidence, resulting in improved economic activity, and counterbalancing the effects of stricter immigration and trade measures.

Taken together, the outlook for growth in real GDP and corporate earnings remains relatively healthy.

While the fundamental backdrop appears robust heading into 2025, some caution is warranted.

US markets have enjoyed significant outperformance and valuations are elevated relative to history, reflecting investors' optimistic outlook for continued economic expansion and earnings growth (Charts 9 and 10).

Chart 9: S&P 500 vs MSCI AC ex-US

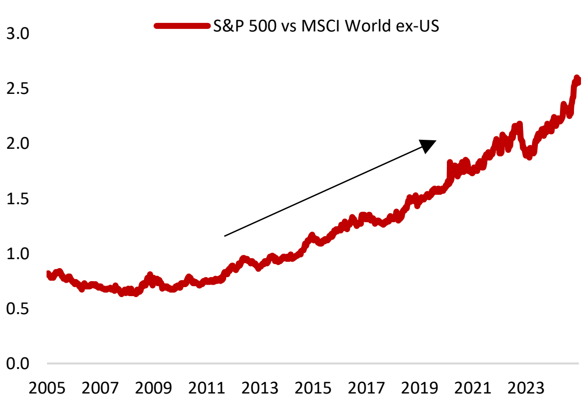
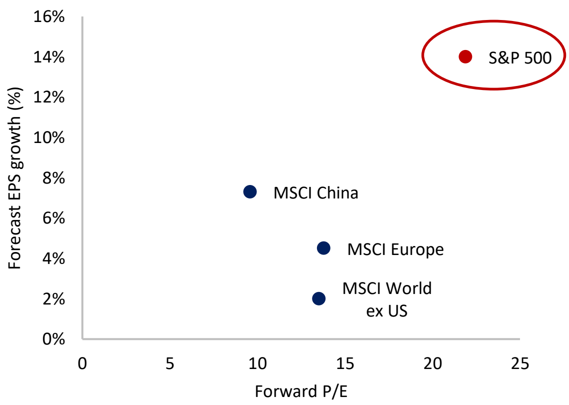


Chart 10: EPS growth vs Forward P/E



Source: Bloomberg, Bateleur Capital

Big deficit spending comes with a cost. Total US federal debt has ballooned to $35tn (123% of GDP as of September 2024) and the Congressional Budget Office projections show that the treasury will need to issue at least $23tn of new debt to fund growing deficits over the next 10 years.

As rates rise, the interest cost to service these debts has rapidly increased, to almost unaffordable levels, with annualised net interest payments as a percentage of government revenues doubling to over 19% (in 2024), a level last seen during the 1990's (Chart 11). The bond market has begun to respond to these deteriorating metrics, with investors demanding higher yields to compensate for growing fiscal risks (Chart 12).

Chart 11: US interest costs to service debt

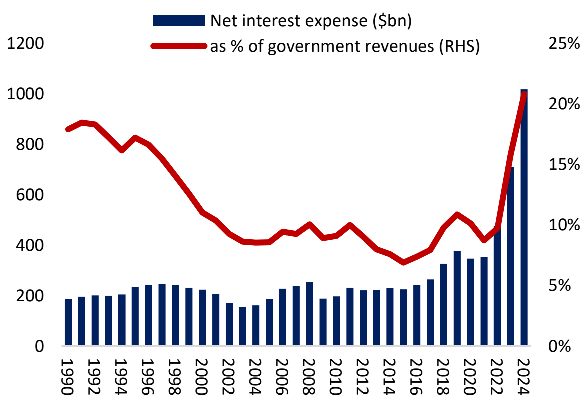


Chart 12: US 30 year yields are rising

Source: Bloomberg, Bateleur Capital, US CBO

High starting valuations and a precarious fiscal situation are just some of the risks facing US markets, leaving little margin of safety should growth disappoint to the downside.

China

China's economy continues to face significant challenges. While exports remain strong, particularly in high-value sectors like automotive and renewables where Chinese firms have gained market share, the country faces ongoing pressure from a deflating property bubble and tepid consumer confidence (Charts 13 and 14).

Chart 13: China automotive exports

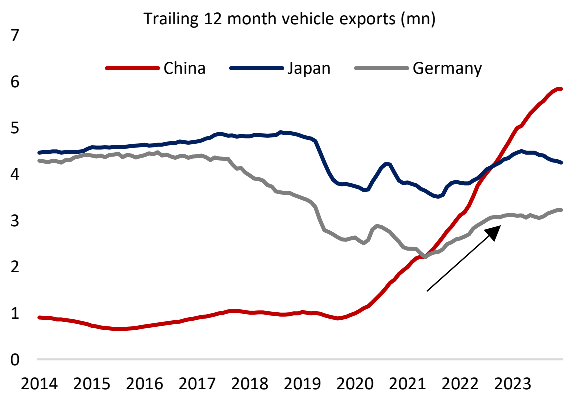
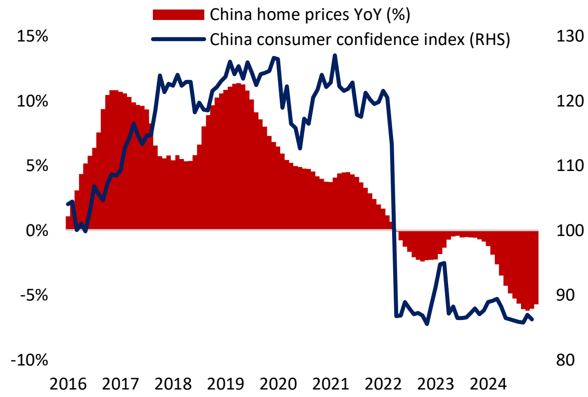


Chart 14: Consumer sentiment & property prices



Source: Bloomberg, Bateleur Capital

The divergence between healthy external demand (exports) and subdued domestic demand (consumption) has increased pressure on the government to introduce additional stimulus measures, especially as the export sector faces the prospects of renewed tariffs from the incoming Trump administration.

During the final quarter of 2024, policymakers began shifting their approach by introducing stimulus measures worth approximately 10% of GDP. While substantial, these measures were notably smaller than those implemented during the Global Financial Crisis (GFC). Current economic indicators suggest that even more intervention may be necessary: bond yields are near record lows, CPI data shows persistent deflationary pressures and consumer spending remains weak. These factors all point to the need for additional monetary easing.

Table 3: China stimulus today vs. GFC

	Percent of GDP (%)	
Stimulus Measure	**GFC**	**Present**
Investment programs	11.5%	
Tax cuts	0.4%	
SOE bailouts	1.4%	
Accomodative monetary policy	13.9%	0.8%
Stock market support		0.7%
Local Government investment projects		0.2%
Local Government debt swap plan		7.9%
Total	**27.2%**	**9.6%**

Source: Blackstone, Bateleur Capital

Faced with a soft economy and deflationary pressures, the Politburo (at the December 2024 meeting) loosened the policy approach of China's central bank and called for "extraordinary" measures to support economic activity. Should this easing materialise, it could provide a meaningful tailwind for global markets and offset the expected pressures from US tariffs. This could particularly benefit Chinese stocks, which are currently trading at low historical valuations and face muted market expectations, unlike their US counterparts.

South Africa

We start the year with better GDP growth expectations compared to last year, but still well below the required run rate to offset the structural impediments facing South Africa.

Several economists forecast domestic GDP growth of close to 2% in 2025 and 2026 (Chart 15). This improvement is driven by increased consumer spending, lower interest rates, business confidence at a five-year high (Chart 16), announced fixed investment spending at multi-year highs, and further economic reform post the Government of National Unity (GNU) formation.

Chart 15: Accelerating GDP growth

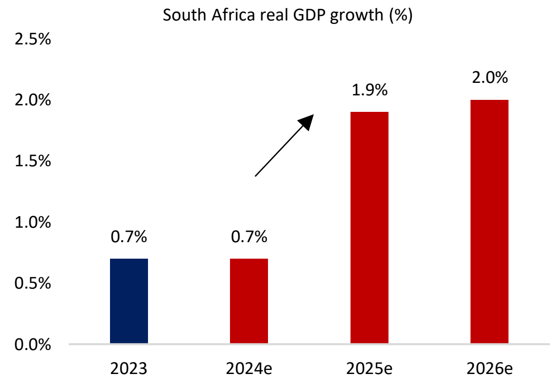


Chart 16: Improving business confidence

Source: Bateleur Capital; Bloomberg

A combination of attractively priced domestic assets (equities and government bonds) and the likelihood of accelerating GDP growth is a positive set-up for South African risk assets in the medium term. However, it is too soon to envisage a scenario where the economy grows, at a sustained and high rate, beyond the next couple of years.

Economic data thus far show limited tangible evidence of accelerating economic growth. During the third quarter of 2024, South Africa's real GDP only managed a 0.3% increase year-on-year (including a questionable, large contraction in the agricultural sector) and declined from the level recorded in the second quarter. With the GNU active for only a few months it is still too early to evaluate the effectiveness of the new government.

However, we have recently witnessed an acceleration in automotive sales (especially passenger vehicles) and positive sales updates from clothing retailers in the final quarter of 2024 assisted by two-pot withdrawals (Charts 17 and 18). We have recently interacted with over twenty local management teams across various industries. The key takeaway is that they are more positive on the outlook for their businesses, but have yet to see a noticeable uptick in trading activity.

Chart 17: Auto sales improving

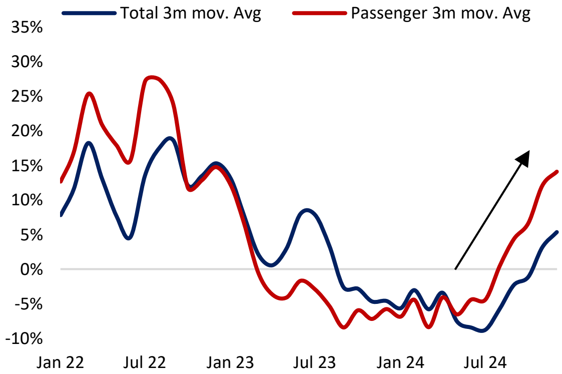
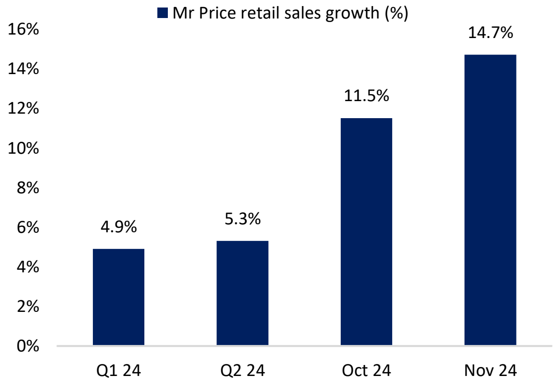


Chart 18: Mr Price sales trend



Source: Bateleur Capital; Bloomberg, Company reports

Aside from a better functioning South African government, Eskom and Transnet, a reduction in interest rates also presents a significant opportunity to accelerate economic growth. Little doubt exists over the depressing effect that high interest rates continue to exert on fixed investment and the consumer with exceptionally high debt servicing cost being a hindrance to economic growth.

The South African Reserve Bank (SARB) continues to hold real repo rates at the highest level in 20 years, reflecting a hawkish inflation focus. Two declines of 0.25% each since September are inadequate to assist the country's quest for higher economic growth and employment, while consensus forecasts only 0.5% of rate cuts in 2025 (Charts 19 and 20).

With inflation firmly under control (3.0% reading in December 2024), there remains ample room to reduce interest rates in excess of market expectations. However, although lagging global interest rate cuts to date, the South African rate cycle is unlikely to decouple meaningfully from developed market peers in the short-term.

Chart 19: SA real rates are elevated

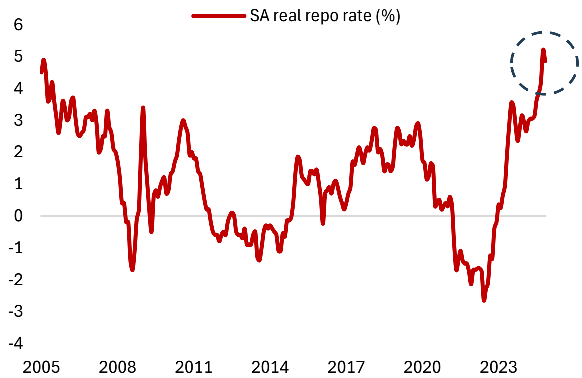
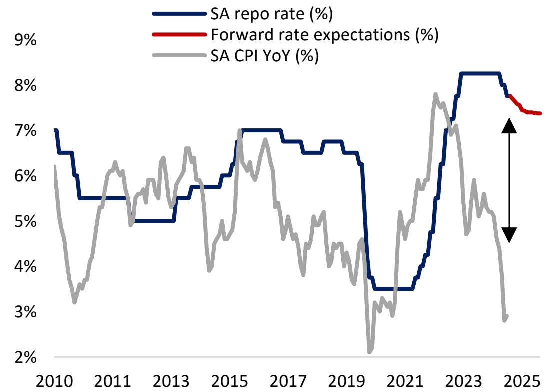


Chart 20: SA repo rate expectations



Source: Bateleur Capital; Bloomberg

Conclusion

Several global and local themes will impact the domestic market in 2025, with the most consequential being the role newly elected President Trump will play in the global political landscape and the US's stance towards China – an important trading partner for South Africa. President Trump's brinkmanship is expected to be accompanied by increased capital market volatility.

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

The fund remains positioned for an improving South African economic environment, domestic exposure has been increased while commodity exposure marginally reduced. New positions were added in Motus and Life Healthcare while the existing position in BHP Group was reduced.

Kind regards

Charl Gous | Warren Riley | Bheki Mthethwa

Co-Fund managers

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[i] [i] 1 Year: Fund 19.5% |Benchmark 25.4%
3 Year : Fund 15.0% |Benchmark 12.4%
5 Year : Fund 13.7% | Benchmark 11.9%
Since inception (21 April 2015): Fund 7.2% | Benchmark 6.3%
Highest rolling 1 year return 54.4%, Lowest rolling 1 year return -25.5%.

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