Umthombo Wealth Equity Report for Quarter ended 31 December 2024

UMTHOMBO
WEALTH

Economic food for thought

The dawn of a new year presents an exciting opportunity for asset managers. It is a time to reflect on the past year, with the clarity that hindsight offers, and to forecast the trends and themes we expect to see in the months ahead. At this crossroads of past and future, strategy and insights are born.

Last year, we frequently commented on the momentous political events of 2024, as nearly half of the world's population headed to the polls, including in the US and South Africa. Politically, a trend of "U-turns" emerged, with many countries opting for opposition parties, swinging sharply to the left or right of the incumbent. Notable examples include the re-election of Republican leader Donald Trump in the US and the end of the Conservative Party's 14-year reign in the UK in favour of the Labour Party. The political drama continues, with the long-standing Canadian Prime Minister resigning at the time of writing.

South Africa was arguably one of the biggest wild cards in the global elections of 2024. The outcome of South Africa's national elections in May, followed by the formation of a Government of National Unity (GNU), proved to be a significant boom for both the JSE and the rand. From the beginning of April 2024, the local equity market (JSE All Share Index) ended the year up by approximately 13%, with South African-sensitive sectors significantly outperforming the broader index. These sectors included clothing retailers, general retailers, insurance companies, banks, real estate, and food producers.

Monetary policy was a recurring theme in the lexicon of investment professionals worldwide, taking markets on a wild ride. Initially, markets anticipated smooth and swift interest rate cuts, given the expected easing of inflationary pressures. However, capital market professionals soon realised their optimism was premature. The long-awaited rate cuts only materialised in the third quarter of 2024, with the US Federal Reserve (Fed) beginning to cut rates in September. The initial cut was by half a percent, followed by a 25-basis-point reduction in November, and another cut in December. However, the Fed's comments did little to boost the "holiday spirits." While the Fed's statement showed minimal changes, it introduced a new qualifier regarding the "extent and timing" of future rate cuts, suggesting a slower pace in 2025 than previously anticipated.

When assessing bond yields, it appears the market is not pricing in US rate cuts for the foreseeable future. We share this sentiment and believe interest rates will remain "stickier for longer." This view is rooted in the expectation that US inflation will face ongoing pressure, driven in part by policies from the new Trump administration. Specifically, the introduction of tariffs could contribute to inflationary pressures by raising import costs. Additionally, Trump's pro-growth stance, which may include lowering tax rates, could further exacerbate the already overwhelming $36.22 trillion federal debt. The combination of tariffs, growing debt, and persistent deficit challenges—further compounded by the legacy of COVID-era debt accumulation—suggests a limited ability for the US to address its fiscal imbalance effectively.

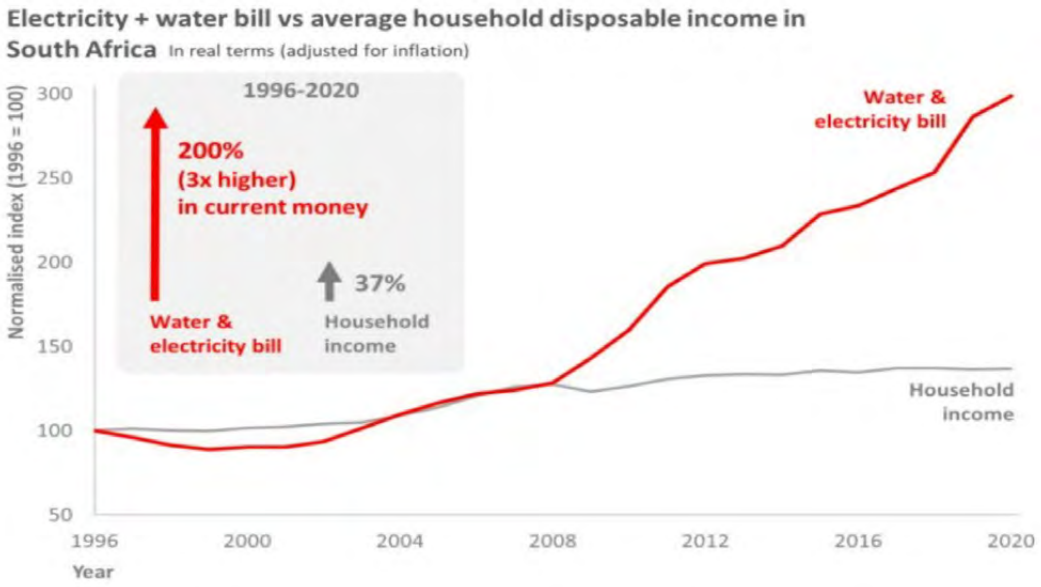
The addition of trillions in debt during the pandemic, along with an additional $2.5 trillion in 2024, has created a substantial refinancing burden. This raises concerns among investors about whether the bond market will be able to absorb such a high level of debt. In particular, questions are emerging about the market's willingness to take on more US Treasury bonds unless incentivised by higher real yields.

Americans may not be accustomed to a conservative and cautious central bank, but here in sunny South Africa, it's almost as inevitable as death and taxes. The South African Reserve Bank (SARB) followed the Fed's lead and cut interest rates by 25 basis points in September, bringing the prime lending rate down to 11.5%—finally ending a four-year cutting hiatus. In November, the SARB reduced the repo rate by another 25 basis points to 7.75%, bringing borrowing costs to their lowest level since April 2023.

We recognise the vital role of the SARB as the economy's goalkeeper, tasked with protecting the value of the rand and ensuring price stability. However, we believe the bank has adopted an overly conservative approach, appearing excessively focused on administered inflation—an area largely outside its control. This focus, coupled with its often-hawkish stance, risks turning the SARB from a goalkeeper into a barrier, inadvertently hindering economic growth instead of striking a balance between stability and expansion.

Currently, the real interest rate—the difference between the nominal interest rate and the inflation rate—are relatively high, indicating that borrowing costs remain elevated after accounting for inflation. If inflation remains stable at its current level, there is ample scope for the central bank to reduce nominal interest rates without risking a surge in inflation. Lowering rates under these conditions could stimulate economic activity by making borrowing more affordable for businesses and consumers, thereby supporting growth while maintaining price stability.

A significant driver of inflation in South Africa can be traced to the decades-long decline in critical infrastructure. Deteriorating power generation, unreliable water supply, and inadequate transport networks have not only raised the cost of doing business but also disrupted productivity across key sectors. This systemic failure has created supply-side constraints, driving up the cost of goods and services while undermining economic efficiency. The resulting inflationary pressures are structural rather than cyclical, highlighting the urgent need for infrastructure revitalisation to address this persistent and severe source of inflation.



Source: Poweroptimal.com

There is some light at the end of the tunnel. The markets have acknowledged that South Africans are literally seeing the light, with over 250 consecutive days free of load shedding. Moreover, some positive strides have been made: the country achieved its first primary budget surplus in 15 years, the Department of Home Affairs is beginning to get its affairs in order, and our logistics sector, which is critical to the functioning of our economy, has shown notable improvements.

This progress follows corrective initiatives we've undertaken in partnership with business, labour, and Transnet.

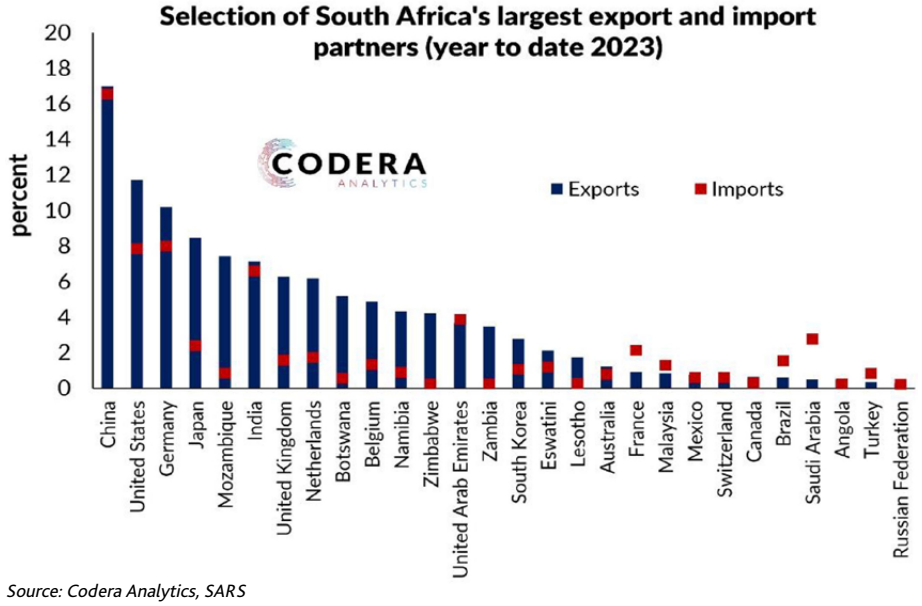
Our ports have reduced long delays in handling imports and exports, and rail freight is flowing more efficiently.

Despite these newfound glimmers of hope, we know that South Africa is by no means out of the woods. External analysis indicate that Transnet is costing the economy R1 billion a day, and South Africa's water infrastructure remains under-serviced, threatening the country's water security in much the same way load shedding has threatened our electricity delivery.

Another prominent investment theme that emerged last year was "geopolitics." Geopolitics undeniably cast a long shadow over markets in 2024. From the lingering conflicts in Eastern

Europe and the Middle East, which continued to disrupt supply chains and fuel inflationary pressures, to the escalating tensions between major global powers. The interconnectedness of political events and economic performance became starkly evident. These geopolitical flashpoints created an atmosphere of uncertainty, prompting investors to seek safe-haven assets and contributing to market volatility.

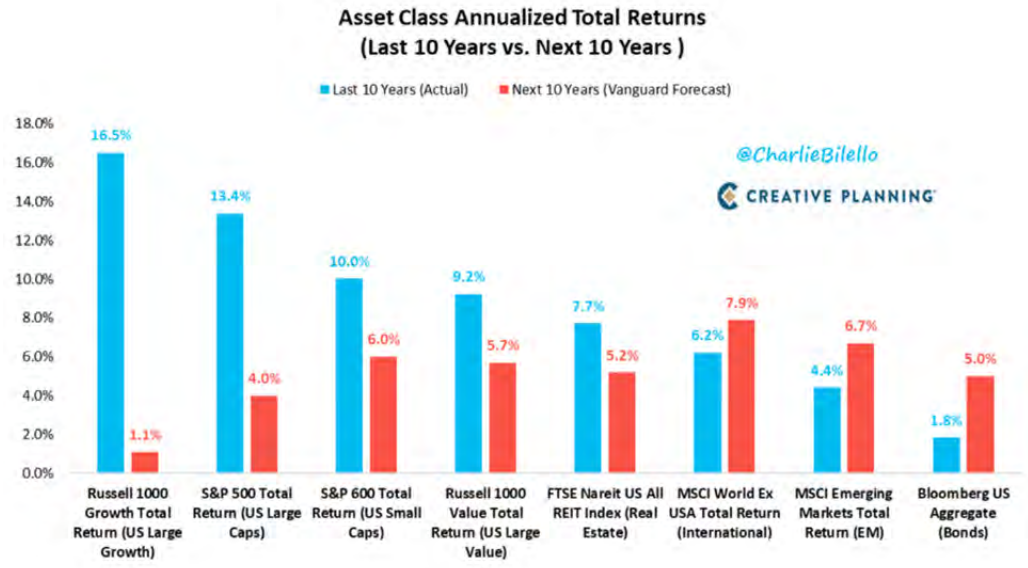
The echoes of Cold War-like sentiments can be seen in Donald Trump's policies, which included imposing sweeping tariffs on economic rival China and proposing tariffs as high as 25% on fellow North American neighbours, Canada and Mexico. While his pro-business stance and lower taxes excited US markets, his approach might not be as beneficial for a globalised world reliant on exports to the US. South Africa, as one of the largest beneficiaries of AGOA (the US-Africa trade program), could face challenges. Since its inception in 2000, AGOA has generated $55.9 billion in trade for South Africa, making the US its second-largest trade partner—well ahead of countries like Russia and Iran, with which South Africa has political ties that may not be viewed favourably by the US.



Source: Codera Analytics, SARS

The US markets delivered another stellar performance in 2024, with the S&P 500 returning 25%, compared to the MSCI World Index's 19% USD returns. It's impossible to discuss the US markets without acknowledging the remarkable performance of the past decade.

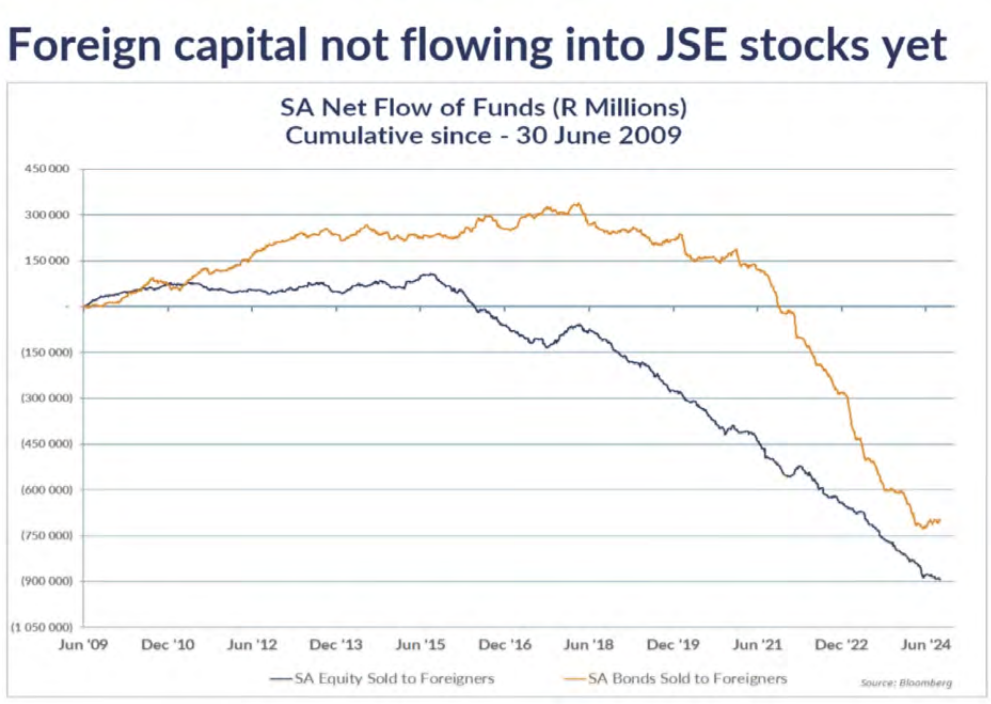
However, we are uncertain about the sustainability of this trend. Starting valuations play a crucial role, and with future returns seeming more muted, we believe replicating the previous decade's success may prove challenging.



Source: Vanguard, Charlie Bilello

South Africa's market presents an intriguing contrast to the US. While the past decade has been challenging, with slow growth and downward revisions to earnings estimates, 2024 shows signs of change. Projections are now being maintained and even raised, indicating a potential turning point for the local economy and stock market. With consensus expecting earnings growth of 27% in 2025 and 12% in 2026, there's room for optimism, although these estimates may be adjusted as the year progresses.

The JSE remains undervalued, and starting valuations are crucial in understanding future performance. Given the cyclical nature of markets, South Africa has the potential to deliver strong relative performance in the coming decade, particularly if economic growth takes hold. The fact that JSE stocks are still under-owned and foreign capital has yet to return means there's untapped potential. If South Africa can demonstrate sustainable economic progress, it could ignite a recovery in share prices, and with foreign investors potentially re-entering the market, the JSE could experience a notable boost.



Source: Vanguard, Charlie Bilello

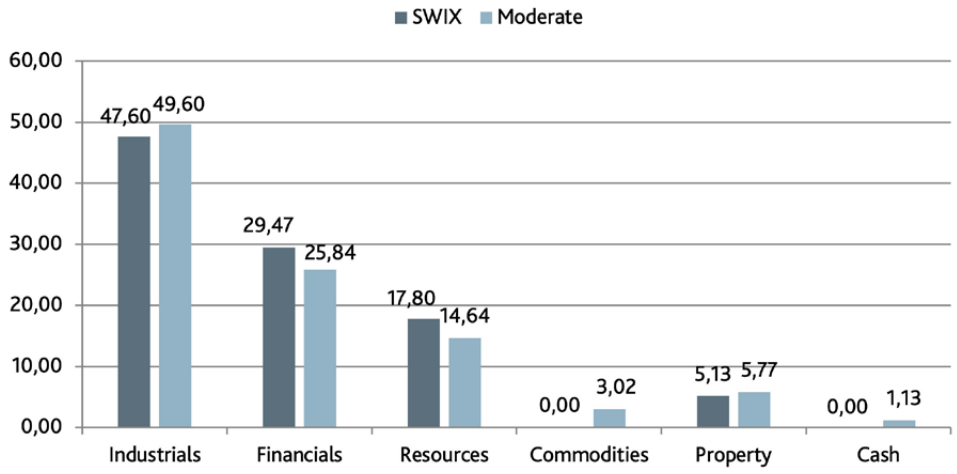
We view many of the "SA inc" companies as cheap in absolute terms, cheap relative to comparable companies elsewhere in the world, and very cheap relative to their history. Our preferred options have attractive relative valuations, with sustainable dividends and a high margin of safety. Luckily for us, liquidity has improved, risk premiums have reduced, and self-help value investment cases are in abundance. Our base is getting higher, and SA is being priced for some growth and hope.

"SUCCESS CONSISTS OF GOING FROM FAILURE TO FAILURE WITHOUT LOSS OF ENTHUSIASM."

Winston Churchill

Portfolio insights

Sector and sub sector positioning



*Source: Maitland SA, *Umthombo Wealth internal classification*

Industrials

Our Moderate equity offering is currently overweight in the industrial sector, which has benefitted our performance over the last six months. The fund has no exposure to pharmaceuticals, chemicals, or paper, and only selective exposure to telecoms. We have increased exposure to hotel and gaming, food retail, and food producers, while we have reduced exposure to clothing retail.

We remain optimistic about various opportunities within industrials, but with an emphasis on stock selection.

Financials

We currently hold an underweight position in financials, with a preference for banks over insurers. We remain constructive on Absa and Nedbank and have been increasing our exposure to FirstRand. We remain cautious about Capitec and have no exposure at current price levels.

Our exposure to Investec and Sanlam has been reduced, while we have increased our exposure to Ninety-One. We remain concerned about Discovery and do not view Old Mutual as attractive for the time being. OUTsurance and Santam are being continuously monitored for potential investment, but we are not satisfied with the current margin of safety.

Resources

We continue to be cautious about resource counters, and our level of conviction has not changed. While PGM companies have sold off aggressively, we remain watchful as our indicators have not yet signalled a pivot in the cycle. Currently, we continue to prefer ETF exposure over direct share exposure. Gold stocks' performance has traded more in line with our expectations, although we recognise major geopolitical uncertainties, and fiscal indiscipline continues to be tailwinds for gold. Our contrarian view on coal has not changed, and we view certain diversified miners as relatively attractive.

Property

Our exposure to listed property remains overweight; however, we have taken profits across the board. We remain cautiously optimistic about medium-term return potential but focus on stock specific, rather than the broad sector. Our preferred counters remain MAS Real Estate and Dipula Income Fund.

Selected stock insight

Mustek

Mustek's share price has made a substantial recovery over the last six months. Based on the material changes in the share register over this period, it became apparent that potential corporate action was a possibility. On the 15th of November 2024, confirmation was received via SENS that JSE-listed Novus (ticker NVS) shareholding in Mustek has surpassed 35%, and a mandatory offer was made to shareholders.

The mandatory offer options (cash consideration of R13, a cash amount of R7 plus one Novus share, or two Novus shares for each Mustek share) were not attractive, and it was clear that Novus had no intention to buy all the outstanding shares or to delist the company. Novus has subsequently clarified their intentions, and we are in favour of them.

Umthombo Wealth is a substantial shareholder in Mustek, as we assess it to be extremely undervalued and well-positioned to benefit from a stronger South African economy and continued real growth demand for ICT hardware and services. At Umthombo Wealth, we welcome Novus as shareholders and believe they, combined with the Mustek management team, have the ability to extract material value for stakeholders. We thus plan to remain invested for the journey that lies ahead.

Tiger Brands

Tiger Brands delivered excellent FY24 results that confirmed our turnaround investment case is well on track. Result presentations over the last decade and a half have mostly been sombre affairs, however the renewed energy, confidence, and vision of CEO Tjaart Kruger at the last set of results has very encouraging.

The company continues to push its strategic initiatives, which should see it continue to unlock value for shareholders, especially given its strong cash generation and balance sheet. Tiger Brands has a material amount of non-core assets it can sell (between five and seven billion rand), which can be utilised for much-needed capital expenditure in both maintenance and expansion to claw back efficiencies it has lost over the years. We also anticipate Tiger Brands' operating profit margins to expand, which can then lead to material growth in free cash flow and increased dividends for shareholders.

Despite Tiger Brands' share price performing very well over the last year, we believe there remains ample opportunity to grow earnings and shareholder returns over the medium term. Turnaround strategies in weak economic environments seldom work, but we have been encouraged by the progress that has been made thus far, and we believe even better prospects lie ahead for shareholders.

Capital Appreciation

Capital Appreciation released disappointing 1H24 results and has grown earnings by only 5% CAGR over the last three years. This three-year performance was certainly below expectations, but we believe a much better outcome can be expected over the medium term.

The Payment business has seen steady growth in its terminal estate with a 3-year CAGR of 14.3% to 1H25. This has not translated to EBITDA growth (2.3% CAGR over the period) due to a shift to rentals. Nevertheless, the larger estate provides a greater base from which to earn annuity revenue (more than 50% of its revenue) and a larger estate that, at some point, will be replaced with new technology, prompting a surge in sales and rentals.

Another driver for the payments business is the phasing out of 2G and 3G networks. This will be a material shift given that circa 50% of the estate still runs on these networks, and will require replacement by 2027 if government deadlines materialise. The weak South African economy has led to banks keeping payment terminals for longer (purposely extending the replacement cycle), which is not sustainable. With possibly better economic prospects for 2025 and 2026, we believe demand will increase significantly, which bodes well for Capital Appreciation.

Capital Appreciation's Software division has been decimated by industry-wide delays in IT project spending. This revenue congestion came at a time when Capital Appreciation invested heavily in talent, which has caused a collapse in profitability. The war for talent within IT is important, thus building up capacity in anticipation of project pipeline growth seemed like a prudent strategy. However, with the benefit of hindsight, it has been a disaster. The recovery will not be easy, but we do anticipate an improvement going forward, and if large-scale projects do come back into the market, Capital Appreciation seems to be well-positioned to benefit.

Our investment case for Capital Appreciation has long term duration. We have built a substantial position and are confident our patience will be rewarded over time. Profitability can be lumpy, but the business generates strong cash flows and boasts a strong balance sheet, which can sustain any cyclical downturn.

Ninety-One

Ninety-One's share price performance since listing has been very disappointing. It initially almost doubled, but since December 2021 it has lost more than 40% of its value, despite relatively strong developed and emerging capital markets over that period. Capital flows over this period have favoured developed over emerging markets, and passive over active investing, as most of the global equity returns could be attributed to the so-called "Magnificent 7" within the US market.

We do not find US equity valuations attractive, and risks are starting to build as the US equity market now resembles more than 70% of global equity market capitalisation. This is the highest level in history, and we question the sustainability of it. It is a fruitless exercise to forecast when a pivot will happen, but we believe the probability of assets flowing away from developed into emerging markets, and from passive to active strategies, continues to increase as these valuation multiples remain to defy gravity.

Ninety-One's recent AUM update for 2Q25 was a disappointment and has led to share price weakness. Investor patience is starting to dwindle, and negative sentiment is affecting the valuation of the share. Despite the apparent weakness in net flows, we remain confident in the outlook and believe there is scope for an improvement in flows over the medium term.

Ninety-One possesses an excellent platform, brand, management, and investment teams with an outstanding long-term performance track record. We believe this foundation will enable Ninety-One to benefit immensely from any pivot in the abovementioned factors, and if Ninety-One can deliver any form of earnings growth over the next three to five years, we believe the share is materially undervalued and offers a compelling opportunity. Patience will be required here, but investors are likely to be well rewarded in the future.

Equity fund range performance

Umthombo Wealth Equity funds breakdown

Umthombo Wealth has four equity offerings that accommodate a range of client risk/return solutions. Our offerings include low tracking error benchmark cognisant funds and non-benchmark cognisant high tracking error funds.

Fund name	Conservative Fund	Moderate Fund	Best House View Fund	Unconstrained Fund
Type of fund	Benchmark cognisant	Benchmark cognisant	Non-benchmark cognisant	
	High IR	With constraints	High conviction	No constraints
Number of shares	50 to 75	30 to 60	20 to 30	10 to 25
Tracking error	< 3%	3% to 5%	> 5%	> 5%

1. Moderate Fund

Our Moderate offering represents our constrained best house view active positioning relative to any specific benchmark. The share count ranges between 30 and 60, targeting a tracking error of less than 5% over a rolling three-year period. The Moderate offering is ideal for clients seeking an actively managed solution with certain constraints. It provides a balanced approach that aims to capture opportunities while managing risk.

Fund Information

Portfolio Managers:	Alexander Duys, CFA, CAIA, Matthew Zunckel, CFA, Nomtha Ngumbela
Benchmark:	CAPPED SWIX Total Return
Inception date:	1st January 2016
Investment vehicle:	Segregated only
Fund size:	R6.44bn (invested within the Moderate offering)

Umthombo Wealth Equity composite performance. (net of fees)

Performance	Moderate Equity Composite		
	Composite	Benchmark*	Alpha
Inception Date		1st Nov 2016	
1 Month	1.06%	-0.29%	1.35%
3 Months	-0.05%	-2.13%	2.08%
6 Months	11.73%	7.27%	4.46%
1 Year	16.73%	13.53%	3.20%
2 Years	12.99%	10.65%	2.34%
3 Years	10.62%	8.25%	2.37%
4 Years	13.55%	11.32%	2.23%
5 Years	10.44%	8.58%	1.86%
6 Years	10.43%	8.27%	2.16%
7 Years	7.62%	5.30%	2.32%
8 Years	8.51%	6.67%	1.84%
Number of years	8.08		
Since Inception	95.84%	71.00%	24.84%
Since Inception (Ann)	8.67%	6.86%	1.81%
Downside Risk	2.16%	2.44%	
Volatility	3.88%	4.23%	
Sortino Ratio	0.77	-0.06	
Sharpe Ratio	0.43	-0.03	
Tracking error (inception)	2.86%		
Information ratio	0.63		

**Benchmark: Capped SWIX Total Return (TR) from 1st November 2016 until 30th of November 2019. 1st December 2019 until current is SWIX Total Return (TR).*

"SUCCESS COMES WHEN PEOPLE ACT TOGETHER; FAILURE TENDS TO HAPPEN ALONE."

Deepak Chopra

2. Conservative Fund

Our Conservative offering represents our most cautious active positioning relative to any specific benchmark. The share count ranges between 50 and 75, targeting a tracking error of less than 3% over a rolling three-year period. The aim is to achieve a high information ratio. Our Conservative offering is ideal for clients seeking a core-satellite approach.

Fund Information

Portfolio Managers:	Alexander Duys, CFA, CAIA, Matthew Zunckel, CFA, Nomtha Ngumbela
Benchmark:	CAPPED SWIX Total Return
Inception date:	1st January 2016
Investment vehicle:	Segregated only
Fund size:	R637m (invested within the Conservative offering)

Performance	Conservative Equity Composite		
	Composite	Benchmark*	Alpha
Inception Date		1st April 2020	
1 Month	0.03%	-0.31%	0.34%
3 Months	-1.92%	-2.14%	0.23%
6 Months	8.27%	7.27%	1.00%
1 Year	13.12%	13.41%	-0.29%
2 Years	10.92%	10.60%	0.32%
3 Years	8.70%	8.17%	0.53%
4 Years	12.02%	11.26%	0.76%
Number of years	4.75		
Since Inception	103.84%	104.91%	-1.07%
Since Inception (Ann)	16.18%	16.30%	-0.13%
Downside Risk	1.57%	1.66%	
Volatility	3.94%	4.08%	
Sortino Ratio	5.84	5.59	
Sharpe Ratio	2.33	2.28	
Tracking error (inception)	1.84%		

**Benchmark: SWIX Total Return (TR) from 1st April 2020 until 31st of July 2022. 1st August 2022 until current is Capped SWIX Total Return (TR).*

"TREAT FAILURE AS A LESSON ON HOW NOT TO APPROACH ACHIEVING A GOAL, AND THEN USE THAT LEARNING TO IMPROVE YOUR CHANCES OF SUCCESS WHEN YOU TRY AGAIN. FAILURE IS ONLY THE END IF YOU DECIDE TO STOP."

Richard Branson

3. Best House View Fund (BHVF)

Our Best House View Fund (BHVF) offering represents our most convicted active positioning relative to any specific benchmark. The share count ranges between 20 and 30, with all positions being overweight compared to the benchmark, without any positions at neutral or underweight. The offering does not have a specific tracking error target but is expected to exceed 5% without a cap. Our BHVF offering showcases our capability to add value when minimal limitations are in place. It provides an opportunity for clients who seek a high conviction approach with the potential for significant outperformance.

Fund Information

Portfolio Manager:	Alexander Duys, CFA, CAIA
Benchmark:	CAPPED SWIX Total Return
Inception date:	1st January 2016
Investment vehicle:	Segregated only
Fund size:	R226m (invested within the BHVF offering)

Performance	Best House View Equity Composite		
	Composite	Capped SWIX TR	Alpha
Inception Date		1st October 2021	
1 Month	0.34%	-0.31%	0.65%
3 Months	-0.27%	-2.14%	1.87%
6 Months	13.31%	7.27%	6.04%
1 Year	17.47%	13.41%	4.06%
2 Years	14.38%	10.60%	3.78%
3 Years	13.24%	8.50%	4.74%
Number of years	3.25		
Since Inception	52.90%	38.82%	14.08%
Since Inception (Ann)	13.96%	10.62%	3.34%
Downside Risk	1.41%	1.90%	
Volatility	3.30%	3.90%	
Sortino Ratio	4.94	1.91	
Sharpe Ratio	2.11	0.93	
Tracking error (inception)	4.62%		
Information ratio	0.72		

"ACHIEVEMENT IS TALENT PLUS PREPARATION."

Malcolm Gladwell

4. Unconstrained Fund

Our Unconstrained offering represents our most strongly held conviction on an absolute basis. The Unconstrained fund incorporates our best and highest conviction ideas. The share count ranges between 10 and 25, providing greater flexibility in portfolio construction compared to the Best House View Fund (BHVF). The offering does not have a specific tracking error target but is expected to have a tracking error higher than 5%, without a cap. Our Unconstrained offering exemplifies our ability to add substantial value when no limitations are in place.

Fund Information

Portfolio Managers: Matthew Zunckel, CFA
Benchmark: CAPPED SWIX Total Return
Inception date: 1st January 2019
Investment vehicle: Segregated only

Umthombo Wealth Equity Model performance

	Model Equity Portfolios							
Performance	Best House View	Benchmark	Moderate	Benchmark	Conservative	Benchmark	Unconstrained	Benchmark
Inception Date	1st Jan 2016		1st Jan 2016		1st Jan 2016		1st Jan 2019	
1 Month	0.40%	-0.31%	1.11%	-0.31%	0.07%	-0.31%	0.49%	-0.31%
3 Months	-0.11%	-2.14%	0.16%	-2.14%	-1.69%	-2.14%	-0.05%	-2.14%
6 Months	13.81%	7.27%	12.13%	7.27%	8.71%	7.27%	14.31%	7.27%
YTD	18.61%	13.41%	17.33%	13.41%	14.21%	13.41%	21.13%	13.41%
1 Year	18.61%	13.41%	17.33%	13.41%	14.21%	13.41%	21.13%	13.41%
2 Years (Ann)	15.69%	10.60%	13.84%	10.60%	12.12%	10.60%	18.47%	10.60%
3 Years (Ann)	14.68%	8.50%	11.89%	8.50%	10.33%	8.50%	15.15%	8.50%
4 Years (Ann)	16.63%	12.87%	16.09%	12.87%	14.39%	12.87%	18.73%	12.87%
5 Years (Ann)	15.67%	10.30%	13.07%	10.30%	11.52%	10.30%	15.85%	10.30%
6 Years (Ann)	15.55%	9.70%	12.77%	9.70%	11.15%	9.70%	16.52%	9.70%
7 Years (Ann)	11.67%	6.49%	9.74%	6.49%	8.16%	6.49%		
8 Years (Ann)	12.99%	8.37%	10.80%	8.05%	9.61%	8.05%		
Number of years	9.00	9.00	9.00	9.00	9.00	9.00	6.00	
Since Inception	176.78%	98.06%	141.48%	93.48%	123.09%	93.48%	150.33%	74.26%
Since Inception (Ann)	11.98%	7.89%	10.29%	7.61%	9.33%	7.61%	16.52%	9.70%
Downside Risk	1.74%	2.36%	2.08%	2.36%	2.14%	2.36%	1.83%	2.67%
Volatility	3.53%	4.21%	3.88%	4.21%	3.96%	4.21%	3.58%	4.65%
Sortino Ratio	2.86	0.38	1.58	0.26	1.08	0.26	5.21	1.01
Sharpe Ratio	1.41	0.21	0.85	0.14	0.59	0.14	2.66	0.58
Tracking error (inception)	5.17%		2.87%		1.81%		6.74%	
Information ratio	0.79		0.93		0.95		1.01	

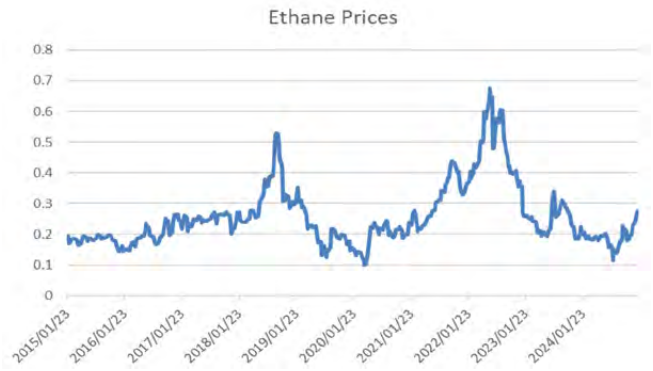
Company and sector insights

Sasol faced another challenging year in 2024, with the share dropping 55%. The company finds itself in a perfect storm. Issues include low oil prices, feedstock challenges in South Africa, coal mining productivity issues, and various environmental concerns. Many of these issues will require an enormous amount of capital to address, and the clock is ticking for management, with issues like the carbon tax set to become more significant for Sasol from 2026. A recent flare-up in Mozambique's political situation post-elections is also poorly timed for Sasol, as they have a critical gas plant operating in the country.

However, a 55% drop in the share price is not to be ignored. Over five years, the share price is down a staggering 74%. The market is assigning minimal value to the Group's substantial asset base. Sasol trades at a market cap of R46bn. The asset base, were it to be rebuilt, would cost multiples of this number. A better way to think about potential value in Sasol is to be more forward-looking and assess the potential for the asset base to generate positive free cash flows. Unfortunately, this is where things look particularly bleak.

The South African business is set to face increasing pressure as capital expenditure (capex) and cost requirements become increasingly onerous, with management needing to resolve the feedstock issue, presumably at higher cost, as well as comply with increasingly stringent environmental regulations. This leaves the US and European businesses to fund debt repayments.

Net debt remains significant at Sasol, standing at R74bn, which exceeds the Group's market cap. The US business, particularly the base chemicals business, has reasonable prospects going forward and is substantial enough in the Group mix to make a difference. Unfortunately, securing more free cash flow from these operations is relatively outside of management's control. The business model is fairly commoditised and requires lower input costs or higher selling prices to achieve better margins. Therefore, management will need the global chemical cycle to turn in their favour.



Source: Bloomberg

Another option, and one we have investigated more closely, is that management could completely sell the US operation to pay down debt. Management sold 50% of the base chemicals business to LyondellBasell in December 2020 for $2bn. We believe they could achieve a higher selling price than this for the balance of the business, but even if they could achieve a $3bn selling price, they would not be able to pay off all their debt (Net debt $4bn). This would mean they would still need to fund some debt, yet they would have lost their potentially biggest cash generator. We think it more likely that management will pin their hopes on a chemicals supercycle.

Overall, we see value in the share under certain circumstances, but those circumstances are relatively outside of management's control, and thus the investment case remains a low-conviction one. Sasol has been an exclusion and underweight position across our funds, and we have gained significant alpha from this call; however, there is a case to be made to now reduce the underweight position to lock in some of the alpha generated.

It has been a tumultuous past year for Pick n Pay, with many investors unwilling to believe a turnaround can be achieved. The odds remain against Sean Summers and his team, but after the recent successful Boxer IPO, Pick n Pay is now ungeared with ample cash reserves and can thus finally embark on this journey to recapture some of its former glory.

The recapitalisation of the balance sheet came at a cost, as Pick n Pay previously benefited from having 100% of Boxer's earnings to offset Pick n Pay division losses. The contribution of Boxer has now been reduced to 68%, which will make the underperformance of Pick n Pay more evident. Boxer, in our view, is an excellent business and represents an extraordinary long-term investment thesis for investors. So, even though Pick n Pay were unwilling sellers, it was necessary to incorporate a sustainable and viable turnaround plan.

Pick n Pay's core supermarket business turnaround will be based on rebuilding efficiency, and less on regaining lost market share. We believe at least one-third of the group's corporate store base is underperforming and either needs to be closed or converted to Boxer/franchise. Closing stores can be problematic and costly due to onerous, lengthy leases, the of execution of this will thus not be easy or as quick as required. However, a turnaround of this magnitude necessitates tough decisions, like closing stores even at a substantial short-term cost.

The conversion of underperforming Pick n Pay stores to Boxer makes intuitive sense, but this can only be done at locations where it is commercially viable and represents a better opportunity compared to Boxer's existing store expansion plans. We thus expect some conversion from Pick n Pay to Boxer to happen over the short to medium term, but it will not be able to rectify the problem at hand. Another solution for Pick n Pay is to convert underperforming corporate stores to franchise; however, investors bearish on the stock will quickly point to the dismal operational performance franchise has delivered in the recent past. We agree a turnaround is required here, but it will not be easy. Franchisees may not have the tolerance or resources to wait for a turnaround, and their decreasing loyalty or exit could diminish purchasing power with suppliers.

A big headwind in enforcing a turnaround for Pick n Pay corporate stores is the low gross margins, especially compared to peers. Factors that have affected gross margin include the range rationalisation of the disastrous Ekuseni strategy, a decline in private label participation, and lower contribution from fresh and ready meals. Pick n Pay has already started to address these problems, so we do anticipate a recovery here, but the full benefit will be realised in the long term. In order to improve competitiveness, Pick n Pay will have to invest back into price, which could hamper gross margin recovery.

The Pick n Pay investment case has high execution risk, thus, unsurprisingly, the investment community is split on the potential outcomes. With the recapitalisation of the balance sheet, we believe that Pick n Pay can finally start to spend the necessary capital to rectify the underlying problems. It is likely that they will have to take a few steps backwards, so that they can leap forward at some stage in the future. The recovery will not happen in a straight line; unexpected headwinds are almost a certainty, but we believe that Sean Summers and his team have already made monumental steps in the right direction. We believe there is substantial value in the core Pick n Pay business (corporate and franchise), and combined with the excellent prospects of Boxer, the sum of the parts is quite compelling.

In our view, at current levels, Pick n Pay fails to discount the underlying value of Boxer, as well as the potential for recovery in the core business. We are thus cautiously optimistic about the prospects and have built positions in both Pick n Pay and Boxer.

We will continue to monitor the progress at Pick n Pay and will assess any updates with an open mind and will not hesitate to increase our exposure when progress is made and likewise exit if our investment case is impaired.

Nampak
quality distinction

Nampak, the leading manufacturer of beverage cans in South Africa, embarked on a remarkable turnaround story in 2024, led by renowned turnaround specialist Phil Roux.

Mr. Roux, having previously worked his magic at Pioneer Foods, has acted with urgency and precision since taking the helm at Nampak in April 2023. At the time of his appointment, the share price was R217. Less than two years later, it is now at R400, a gain of 84%, as many of his interventions are beginning to have a positive impact.

When he took the helm, the Group was in severe financial distress, with a significant foreign currency debt position and deteriorating operational performances across the Group. Previous management had deployed significant capital into the Nigerian market, even while the South African operations were not performing as expected. Mr. Roux's first order of business was a substantial disposal programme, selling off non-core assets in Africa. Proceeds were then used to pay down debt. At the same time, the core operations in South Africa started to show improvement, with margins increasing in the South African Bevcan operations, and the notoriously poor-performing DivFood operation finally being turned around.

Source: Nampak FY 2024 Results Presentation

However, it remains early days for Nampak's turnaround story. The Group still has net debt of R4.4bn, which exceeds the market cap of R3.3bn. There is much still to do. Key will be closing out the disposal of the Nigerian Bevcan operations. This is expected imminently. R1.8bn worth of disposals are currently pending. This, combined with greater free cash flow from the core operations, could de-gear the balance sheet quite rapidly. This is crucial given that finance costs for FY 2024 were R1bn. This also sets up the Group to possibly restore, at least partially, the dividend from FY 2026.

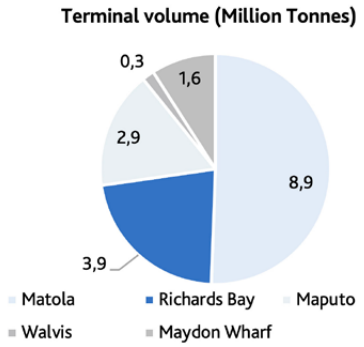
We think the Group can generate approximately R450m in headline earnings, although the results are messy due to all the corporate action and African operations operating in different currency regimes, thus it takes some work to get to a clean earnings number. R450m of earnings places the Group on a PE of 7x, which we view as quite attractive, as we would back Mr. Roux to continue extracting efficiencies from the Group. This sets the Group up for a good few years of earnings growth without needing the economy to shoot the lights out, and at an attractive valuation.

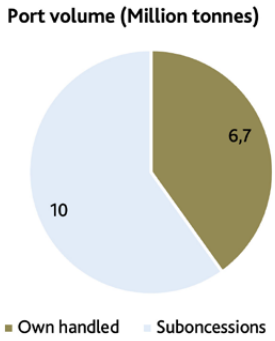
Risk remains high due to the excessive debt levels, but there is a clear and achievable plan to address this. We do not hold Nampak in our portfolios but consider it a potential idea to pit against some of our other SA Inc opportunities. We find the combination of de-gearing, operational efficiencies, and exposure to upside in South African macroeconomics all makes for a very interesting investment case. Trust in management is always critical to our investment cases, and Nampak ticks this box in this regard too.

Grindrod Group is a dynamic South African freight company specialising in end-to-end solutions for cargo moving through the corridors of Africa via road, rail, and sea. The company is a key investor in the Maputo Port Development Company with a 24.7% equity stake.

The Port of Maputo handles chrome, ferrochrome, and other commodities. Grindrod manages and operates several sub-concessions, including the Matola Coal Terminal and the Grindrod Mozambique Limited dry bulk facility. The Matola Terminal is a dry bulk facility operating 24 hours a day, 7 days a week, 365 days a year, handling coal and magnetite with an annual capacity of 8.9 million tonnes.

The Matola Cargo Terminal also houses grain and aluminium terminals. The coal terminal is now fully controlled by Grindrod, with a loading capacity of 750,000 to 850,000 tonnes per month. The group also provides logistics services to the ports and terminals via road and rail corridors for its customers.





Source: Grindrod Group Interim Results, Umthombo Wealth

Recent Performance

The group reported a slowdown in operational performance, largely attributed to a decline in commodity prices, lower volumes, unfavourable weather, and more recently, the ongoing unrest in Mozambique, the impact of which is yet to be felt in the last quarter of 2024.

With margins dropping across ports, terminals, and logistics; EBITDA margins inevitably fell from 39% to 33% in the interim period. One should also consider that the business experienced additional headwinds alongside the lower volumes which included a negative mineral mix as well as new low-margin inter-border business.

Despite a generally bleak trend, the Group's core HEPS remained steady at 73 cents per share. The muted performance slightly impacted the balance sheet, prompting management to return to a 3.5x cover. However, the softer performance is not a death sentence for Grindrod shareholders. Management has communicated its plan to redeploy 13 locomotives from Sierra Leone. It is estimated these locomotives will have a R30 million impact on Grindrod's after-tax profit on a quarterly basis or R120 million equivalent annual fresh new profit from the deployment alone. This highlights the abundance of levers management could pull to enhance shareholder value, in addition to the sale of non-profitable equity capital base in the form of marine and private equity assets valued at R850 million.

The successful disposal of these non-core assets will further enhance the group's return on common equity and improve the readability of the complex financial reporting. The group's balance sheet remains strong with net gearing at 16%. However, following two corporate actions, net gearing excluding 2H performance should increase from R1.6 billion to R2.1 billion or 21%, while the successful sale of remaining non-core assets will reduce group net debt by R850 million to R1.2 billion.

Political Headwinds and Regional Economic Importance of Mozambique Port and Terminals

There is no doubt that the post-election outcome in Mozambique presents a fresh headwind for Grindrod, on top of the ongoing soft global demand suppressing commodity prices. The contested October election has had fatal consequences as the unrest continues across cities in Mozambique. From a port perspective, there has inevitably been delays in shipments from Maputo to the rest of the world.

The significance of the trade route cannot be underestimated, as the Port of Maputo represents Southern Africa's shortest route to global market. Regional markets such as South Africa has seen a continuous increase cargo volumes handled through Maputo since 2020, with more than 95% of transit goods in 2023 originating from South Africa. The Port of Maputo benefits from its 24-hour service, allowing shipments to be loaded at any time of the day. According to sources, preliminary estimates indicate that delays at the port of entry in the Lebombo border post are costing South African producers R5 million a day, a figure which could skyrocket depending on the scale and extent of the unrest.

The Mozambique port of entry has significant regional economic importance, providing regional producers with an efficient route to global markets from a distance and cost perspective. The Matola Terminal provides the shortest road to global markets, making Matola the terminal of choice in the region (SADC). The Maputo Bulk Sugar Terminal has handled 12.5 million tonnes of sugar from Eswatini, South Africa, Zimbabwe, Mozambique, Zambia, and Malawi since the start of concessions from 1994 to 2022. This highlights the importance of the Mozambique port of entry to economic development in southern Africa.

As such, if prolonged, the ongoing unrest will impair Grindrod's ability to provide timely port and terminal services to customers, leading to lower volumes and revenues.

Recent Corporate Action

It was a busy year for Grindrod management from a corporate action perspective, following the recent disposal of KZN land loans and the acquisition of the remaining stake in the Matola Coal Terminal.

In line with Grindrod's vision of continuous improvement, the group increased its exposure in high-growth avenues following the acquisition of the remaining 35% stake in a privately-owned company, Terminal de Carvão da Matola Limitada (TCM), for $77 million. This is a very good value-for-money acquisition given GND's superior P/E multiple (8x) compared to the acquisition multiple (4x). This means it is earnings accretive with an above mid-teen ROE (16%). This is consistent with management's hurdle rate of 16% on new investments.

The lower acquisition multiple also demonstrates management's ability to unlock value for existing shareholders on a risk-adjusted basis. The acquisition will increase Grindrod's attributed share of volumes from 4.2 million tonnes to 6.5 million tonnes. This acquisition demonstrated management's ability to enhance value for shareholders whenever the situation presents itself.

On the other hand, Grindrod successfully found a buyer for its KZN land for R500 million, taking a haircut of R250 million on the initial valuation. This cash will now be invested in high-return investments, unlike the land, which did not generate any money for the group. Disposal of the land will also boost GND's return on equity as the investment did not generate any cash flow for the group.

Conclusion

Despite decreasing volumes and depressed margins, we believe Grindrod is a well-managed and well operated business. We believe the Mozambique equity risk premium was priced into Grindrod's valuation well before the elections outcome, given the political risk inherent in investing in the northern territory of the country.

In our analysis of the asset quality of the business, as well as management's ability to retain EBITDA margins in excess of 35% an EV/EBITDA of below 5x does not seem justified. Moreover, when assessing the EV/EBITDA multiples demanded by emerging market which are in the mid-teens, we contend that the discount being place on Grindrod may be overdone.

Additionally, Grindrod's core equity base generates mid-teen ROEs through the cycles. This isn't sufficient to justify a 15% discount to NAV. We believe Grindrod could also make use of a share repurchase programme as a means of appraising its shares.

While Grindrod is not without risk, the current valuation and share price does reflect this at current levels. We therefore see re-rating opportunity for the counter. Additionally, management maintains a conservative approach to new projects, while targeting a 16% return on invested equity capital.

Umthombo views this as a reasonable and achievable target given the opportunities ahead. We remain confident that Grindrod is well-positioned to take advantage of the SADC's growing economy and the need for the SA government to fix Transnet infrastructure, which should provide Grindrod with the opportunity to showcase its expertise in rail infrastructure and rolling stock investments

ESG - Insight into Overservicing in Private Hospitals

Understanding Overservicing in Private Healthcare

In day-to-day life, overservicing can include examples such as your financial adviser recommending excessive or unnecessary financial products (e.g., insurance policies or investment plans) when simpler alternatives would suffice. Another example could be your car mechanic charging for repairs or parts replacements you probably don't need, like changing brakes or filters that are still fine—something we all suspect happens but is rarely call out.

This practice is simply a natural consequence of how privatised systems operate, where economic incentives often take priority. In healthcare, overservicing is an unfortunate side effect of privatisation, driven by financial motives that encourage unnecessary or excessive treatments, tests, and prescriptions. It's far more common—and often more insidious—than it appears on the surface, straining resources and increasing costs for patients.

Beneficiaries of Overservicing

Two main beneficiaries of overservicing are healthcare practitioners (doctors, surgeons, specialists, etc.) and hospital groups. The relationship between these two groups is indirect, as healthcare practitioners in South Africa are typically not employed directly by private hospitals. Instead, practitioners operate independently, renting facilities such as operating theatres from the hospital.

Hospitals provide the necessary infrastructure and support, while practitioners earn fees for their services—often set by medical aids or negotiated directly with patients. Regardless, both groups are remunerated once when a service is rendered: practitioners for the procedures they perform and hospitals for keeping patients admitted. Based on our discussions with management, this indirect arrangement effectively prevents hospital management from overseeing or intervening in the services provided by healthcare practitioners.

Key Performance Indicators and Overservicing

As part of the investment community, we evaluate private healthcare providers such as Life Healthcare and Netcare in South Africa by analysing various financial and operational metrics. Among these, two key hospital-specific performance indicators (KPIs) are Paid Patient Days (PPD) and occupancy rates.

PPD measures the total number of days patients are billed for hospital stays, offering insight into hospital throughput and revenue generation. Occupancy rate, meanwhile, reflects the percentage of available hospital beds that are occupied, highlighting how efficiently a hospital utilises its capacity. Both KPIs are crucial for assessing the operational performance and financial sustainability of hospital groups.

Overservicing can artificially inflate these KPIs, as higher figures are generally viewed favourably. However, there are natural limits: average occupancy rates should ideally stay below 70%, as overly occupied hospitals can increase the risk of infections. On the other hand, occupancy rates below 60% may render hospitals unprofitable, underscoring the delicate balance required for optimal performance.

Impact on Medical Aids

Other than patients, another key stakeholder affected by this practice is medical aids. During a research call with a surgeon (who, for professional security, has asked to remain anonymous), we learned that overservicing can cost medical aids between R18,000 and R25,000 per day, compared to R4,000 to R5,000 per day when doctors unnecessarily allocate patients to the ICU (Intensive Care Unit) when they would be better suited to a less intensive ward.

According to the surgeon, a significant portion of ICU patients may not actually need to be there. In their opinion, up to a third of ICU patients at any given time could be more appropriately placed in lower-intensity wards. With ICUs often operating at 95% capacity, this practice also poses a risk to patients, as they are more likely to contract infectious diseases compared to other wards. Moreover, this overservicing can prevent patients who genuinely need ICU care from receiving it.

Signs of Overservicing

If you go straight home after a stay in the ICU, you might have been a victim of overservicing. But how can you identify it? This is admittedly a grey area, as treatments often rely on doctors' judgement, and there's usually no malicious intent. However, signs of overservicing might include situations where doctors are quick to consistently default to major procedures.

For instance, cardiologists who frequently administer stents or surgeons who perform tracheotomies (a surgical procedure where a hole is made in the neck to assist with breathing) within a week of treatment, without exploring less invasive options first. South Africa's world-leading rate of non-emergency C-sections, which are often unnecessary or not in the mother's best interest, also highlights the issue.

While these are extreme examples, overservicing can also take subtler forms—like ordering unnecessary tests. Take ultrasounds, for example—they're often casually used to locate blood vessels. It may seem harmless, but such practices can quickly add up, with an ultrasound potentially costing you R2,000.

Conclusion

Firstly, it's important to clarify that Umthombo's views are not anti-private healthcare or healthcare practitioners. We believe, however, that critiquing certain practices, such as overservicing, is vital for improving the system. Overservicing is an inevitable byproduct of privatised medicine, just as its opposite is true in the public sector.

While we don't believe the practice can be fully eradicated, as members of the asset management community, we see an opportunity to engage with management within publicly listed medical aids and hospital groups.

By doing so, we hope to spark change in their policies, encourage collaboration between stakeholders, and, above all, raise awareness about this issue. Ultimately, our goal is to protect both patients and investors, ensuring a more transparent, ethical healthcare environment.

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