August 2011

Equity investing at Coronation

- *Long-term, valuation-driven investors*

We are valuation-driven investors. We try to understand the value of a business as though we were business buyers. To us, it is about understanding the franchise value; what a business is going to earn over time.

At Coronation, we value businesses with a long-term outlook (typically five years). This means that we are not interested in what a business is earning today, tomorrow or even over the next 12 months. If you only look out 12 months, you risk reacting behind the curve. Short-term newsflow is nearly always irrelevant if you are interested in an asset's long-term normalised value. However, short-term behaviour in response to the story of the day often creates opportunities for investors who are prepared to take a longer term view.

- *One investment philosophy*

We believe in a single investment philosophy and one investment team. To us it is far better to deliver consistent results to all our clients (by managing all our funds with a common Coronation 'DNA') than it is to create confusion amongst clients and diseconomies of scale where you have lots of team members implementing different philosophies or approaches.

- *No 'star managers', yet consistent performance across products*

Allied to the above, we don't believe in the 'star manager' approach. We don't believe that is in the interest of our clients. For example, the Coronation Top 20 Fund has had six different fund managers since launch, yet it has achieved a very consistent long-term track record. We believe that a good process implemented by a competent team following a consistent philosophy is more likely to meet clients' expectations.

- *Own research*

We conduct all our research in house. We have a large research team and focus not only on the company, but its global competitors. We talk to its suppliers, customers and regulators so as to better understand the business, the fundamentals of the industry and the fundamentals of the company. We also have no sector specialists. Our analysts cover a number of different sectors as we believe this makes for better investors over time. It also allows our analysts to compare the profitability of e.g. retailers versus banks versus resources.

- *Equally disciplined about selling as about buying*

We are very disciplined about share price movement; not just about buying, but also about selling. At Coronation, we focus on the discipline of selling because we know that it is better to find the next best opportunity when there is no upside left in a current holding.

Our approach in practice

Example 1: Richemont – a typical value case

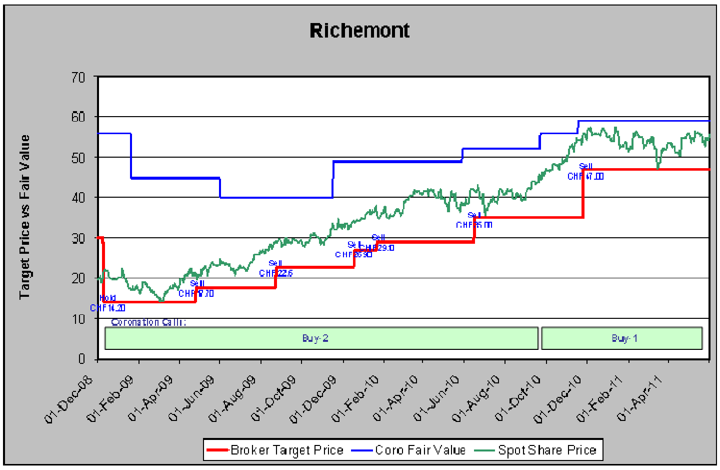
In the example below, we look at a typical value investor case where the share was trading well below its historic norm and earnings were low. In the midst of the global financial crisis in December 2008, Richemont separated from its tobacco holdings, British American Tobacco, and immediately its share price (green line in Figure 1) started trading down as a result of the prevailing uncertainty around the future of the luxury goods industry.

We took a very different view at the time. Instead of focusing on the short term, we looked at the valuation of the different brands within the Richemont business and tried to understand what these businesses were able to earn over the many years of their existence. As a result, we ended up with a very different number to what the market believed Richemont was worth.

The blue line in Figure 1 represents our fair value of the share, while the red line represents that of a leading stock broker. Note that the stock broker's valuation never moves very far from the actual share price. This kind of differentiation between our valuation and that of the market, as well as the fact that we were looking at the long term rather than the next 12 months, gave us the confidence to build a significant position.

It is clear from Figure 1 that the sell-side analyst tended to focus on the 6-monthly earnings. As things started to improve, the analyst slowly ratcheted his/her fair value until ultimately it came close to our fair value - but always reacting behind the curve. Given that the analyst always had the share on a 'sell', an investor following his/her advice would never have bought the stock! Due to our longer-term outlook, we always had it on a 'buy' and subsequently the share price improved almost 200% in Swiss francs (slightly less in rands).

Figure 1



Source: Coronation Fund Managers

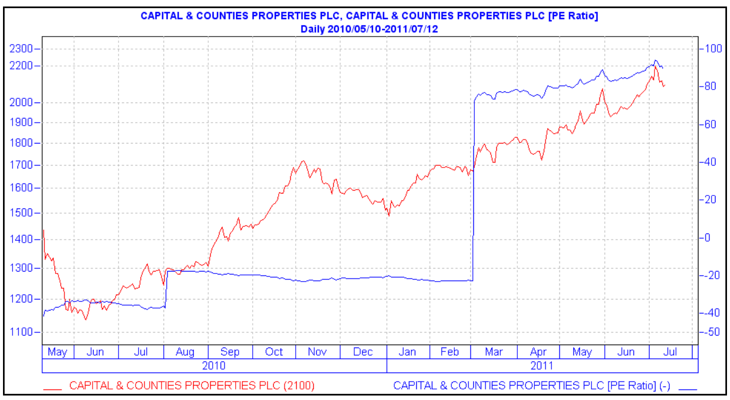
Richemont has been an absolutely phenomenal performer and we have now sold out of our holding. Today, instead of everyone focusing on what is an extremely difficult period, they are focusing on the fact that Richemont has had strong results from China and, as a result, has swung to the other level of short-termism which is being over optimistic. This is however the reality of the market: a difference in focus between the shorter-term sell-side stock brokers and the long-term manager.

Example 2: Capital&Counties – understanding the future value of the business

The following stock example would typically not excite a value investor. This listed property developer has very little earnings, very little current free cash flow and is situated in the UK - the epicentre of the property bubble. The share has traded close to its net asset value (NAV), doesn't pay a large dividend, and has a fairly new management team. Furthermore, all of the developments under consideration would only come on board over the next four years.

However, since Capital&Counties (Capco) has unbundled from the former Liberty International in 2010 the share price has climbed from R11/12 (red line in Figure 2) to about R21 at the time of writing. This represents an 80% return over the past year despite its poor PE multiple (blue line in Figure 2). The share was a fantastic performer for us and we probably remain its biggest shareholder.

Figure 2



Source: I-Net Bridge

Again, it comes down to understanding the company; about looking over the longer term and understanding the future value of this business. Capco is made up of three parts. First, through Great Capital Partnership (its joint venture with Great Portland Estates) they own some 30 office blocks which are concentrated in the West End of London and generate a steady stream of earnings. Second is the part of Capco's business that excites people most and which has been the main driver of performance - Capco is the biggest landlord in Covent Garden and is busy turning the area into a high rental, high density retail area with flagship stores such as Apple and Burberry. Until recently the stores in Covent Garden were of the type that sold trinkets to tourists and as a result did not pay very high rental. The difference between a tenant that sells pies at £2.50 compared to a tenant that sells iPads at £600 a piece enables Capco to charge significantly higher rentals, which is the uplift that we are looking at. In other words, we are not interested in the current NAV of this part of their business, but what the NAV will be in three to four years' time once the development has been completed.

The third part comprises their Earls Court & Olympia exhibition venues in central London. Whilst Earls Court continues to be a leading exhibition and events venue in London, planning is underway to develop this site into an enormous mixed-use residential/commercial/retail area. This mixture of residential units will cater for the poor, middle and upper class and forms part of the Mayor's draft Replacement London Plan. Earls Court has partnered with Transport For London (TFL), which owns some of the land and are very keen to monetise it. Even though this project, worth billions of pounds, will take some time to complete it is what we call an 'out-the-money' option in the centre of London. This is a key point given that the dynamics of property in London are very different to those in the rest of the UK. Demand for property in London is predominantly driven by foreigners; year-to-date Chinese buyers have been responsible for 35% of all property transactions in London.