CORONATION INDUSTRIAL FUND

Quarterly Portfolio Manager Commentary

CORONATION
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Please note that the commentary is for the retail class of the fund.

The fund declined -0.4% for the third quarter of 2019 (Q3-19). Since inception, it has averaged an annualised return of 16.4% relative to its benchmark's return of 13.8%, while it has moderately underperformed its benchmark over the past five- and 10-year periods.

Despite the surprisingly positive GDP growth reported during the second quarter of 2019 (Q2-19) (+3.4% quarter-on-quarter), the domestic economic environment remained extremely challenging. The Purchasing Managers Index (PMI) declined to 41.6 in September – the second consecutive month of sharp declines and reaching the lowest levels seen since the global financial crisis in 2009. This data served to reinforce how dire the underlying economic situation really is. Investor and consumer sentiment continue to remain very weak and government urgently needs to deliver on much-needed structural reform in order to restore consumer and corporate confidence and kickstart the economy. During September, the South African Reserve Bank (SARB) held the policy rate unchanged at 6.5%, but the SARB's statement was more dovish than in July when it did actually cut rates. We believe that, given the weak domestic economy, contained inflation and favourable global rate expectations, the SARB has room to further cut rates in coming months. Against this challenging economic backdrop, the rand weakened against most developed market currencies and depreciated almost 7% against the US dollar during the quarter.

Performance attributions over the past three years have been boosted by our holdings in Cartrack, Netcare and Spar. Richemont – while consistently being one of the largest positions in the fund – contributed meaningfully to absolute fund performance over the past three years. However, its underweight position contributed to relative underperformance. Our holding in Mediclinic has also detracted from performance as the ill-fated Al Noor acquisition coupled with changes in the Swiss regulatory environment have weighed negatively on earnings and, consequently, the share price.

During the previous quarter, we highlighted the exceptional value we were seeing in many domestic stocks. It was therefore pleasing that in July, global food and beverage conglomerate PepsiCo announced a takeover bid for Pioneer Foods, at a more than 50% premium to the Pioneer share price at the time. Our combined holding in Pioneer and Zeder (whose largest asset is its stake in Pioneer) was one of the largest overweight positions in the fund, and the subsequent repricing of both stocks contributed meaningfully to performance during the quarter. We used the rerating in Pioneer to sell out of our position and redeploy the proceeds into other more attractive investment opportunities. The fund continues to retain exposure to Zeder as we feel the PepsiCo offer price for Pioneer is not yet fully reflected in the Zeder share price. We also believe some of the remaining assets – Zaad and Kaap Agri in particular – are attractive businesses and, with Zeder still trading at a circa 30% discount to its reported underlying intrinsic value, we continue to believe the stock is attractive.

In line with this theme of cheap domestic stocks becoming takeover targets by foreign multinationals, the Competition Tribunal finally approved the proposed buyout of Clover by Milco SA (a consortium led by Israel-based Central Bottling Company), thereby clearing the path for Clover to be delisted. As the Clover share price converged on the proposed Milco offer price, the fund sold out of its Clover position.

Trencor recently announced that it will be unbundling its Textainer stake to its shareholders in the coming months. Coronation has been actively pushing for this unbundling over the last few years and are extremely pleased that it is finally proceeding. The share price reacted positively - up 37% for the quarter – and this contributed meaningfully to quarterly performance.

Another material corporate action that took place during the quarter was the much-anticipated listing and part unbundling of Prosus from Naspers. Prosus is the corporate entity that will house Naspers' global internet portfolio, including its stake in Tencent and its interests in online classifieds, food delivery and online payments. Post the unbundling, Naspers has retained a stake of 74% in Prosus. We are encouraged by the recent steps Naspers management have taken in an attempt to narrow the discount at which the stock trades at relative to its underlying intrinsic value and believe the listing of Prosus is another positive development in this regard and a way to further unlock value for shareholders. A foreign listing of Prosus will assist Naspers in pursuing its ambitions to become a leading global consumer internet business by giving it access to a wider pool of investors and capital. Furthermore, going forward, the two-tier corporate structure provides Naspers with more financial flexibility and the ability to more efficiently manage the discount to its intrinsic value by using capital allocation tools like share buybacks. In this corporate action, the fund elected to take the full allotment of Prosus shares, given the value unlock opportunity we expected.

The largest addition to the fund during the quarter was the purchase of Remgro. Remgro is the Rupert family-controlled investment vehicle that owns stakes in a number of good listed businesses, including FirstRand, Rand Merchant Investment Holdings, Mediclinic, Distell and RCL Foods, together with a number of other high-quality industrial, media and telecoms businesses. Remgro management are very shareholder friendly and we like the fact that the balance sheet is conservatively positioned, with Remgro currently sitting in a net cash position; well poised to capitalise on attractive investment opportunities in this tough economic environment. Furthermore, the discount at which it trades at relative to underlying investment portfolio has recently widened to circa 25% - a 10-year high. We believe this to be attractive entry point for this portfolio of investments.

Other trading activity during the quarter was primarily limited to opportunistically adding to existing positions at attractive prices. Examples include Aspen, Spar and Pick 'n Pay. We also established a position in Altron.

Notwithstanding the challenging economic environment, given current valuation levels and portfolio positioning, we remain very excited about future return opportunities.

Portfolio managers
Adrian Zetler and Tumisho Motlanthe
as at 30 September 2019