ROZENDAL
PARTNERS

Rozendal Partners Investor Letter 30 June 2019

Dear friends and fellow investors,

Rozendal's performance vs. benchmark

Period	**Fund***	**Benchmark****
Since inception ***	7.4%	1.8%
Six months to 30 June 2019	5.4%	12.2%

*Rozendal Worldwide Flexible Prescient Qualified Investor Hedge Fund. Returns shown for the B unit class, which is the earliest unit class in existence. Return numbers for other unit classes may differ slightly. Returns shown assume income is reinvested gross of tax.

**FTSE/JSE All Share Total Return Index

***1 February 2018

A. Introduction

The first six months of 2019 was rather uneventful for the Rozendal Worldwide Flexible Prescient Qualified Investor Hedge fund ('the fund'). Returns were modestly positive but lagged the return of the benchmark. The SA market indices across all sectors increased strongly – with the notable exception of the Small Cap index, which continued to struggle. Our material exposure to this end of the market accounts for a large part of this underperformance.

What can perhaps be considered 'eventful' in the life of the fund is that we completed the investment cycle in two of the investments that the fund has owned. This means we are happy to share our thoughts on these two investments in greater detail later in this letter – we trust readers will find it helpful in gaining better insight into our investment thinking.

And what can be considered very 'eventful' in the life of Rozendal Partners, is that the Rozendal Global Fund received all necessary regulatory approvals in Guernsey (where the fund will be domiciled) shortly before the publication of this letter. More on this later.

B. Investment Returns

The fund's return since inception continues to be strong in relative terms, but modest in absolute terms. The past six months were weak in relative terms and modest in absolute terms. After a broad sell-off in markets during the latter part of 2018, markets recovered strongly in the first half of 2019. This pulled up most of the mega-capitalisation shares in the fund's benchmark in its wake but left behind the South African small cap stocks which feature prominently in the fund. Hence the relative underperformance over the past six months.

Before expanding on the drivers of returns in the past six months, we encourage readers to keep the following in mind. Six months is a very short time relative to our investment horizons. It is likely that the stocks that feature as top and bottom contributors to returns in any six-month period are the more volatile stocks in the portfolio. Stocks that take the slow and steady path upward will often not feature prominently in any six-month period. But it is often these 'slow and steady' stocks that contribute the most to overall fund returns in the long run. We will endeavour to highlight such investments over time, but in any given period it may well just be 'business as usual' for such stocks, with no specific events to pick out as drivers of the stock price in the short term. Please bear this in mind when reading our comments about top and bottom contributors to returns over any six-month period.

With the above caveat out of the way: platinum stocks again featured as a strong contributor to returns in the first half of 2019. We wrote about the change in market perception related to this sector in our previous letter. Six months later, it does now look like Impala's announcement that it is curtailing production during September 2018 was indeed the bell at the bottom for the industry.

Encouragingly, two stalwarts of the South African industrial landscape also contributed positively to returns during the past six months. Altron appears to be one of those rare examples of a quick and successful turnaround, brought about by a change in shareholders at the top, and a change in management at the bottom. The company has engaged in all the usual turnaround strategies of cost cutting, selling non-core assets and focusing on strengthening the balance sheet. In addition, though, Altron has managed to score some meaningful new business contract wins, which has gone a long way to restoring both profitability and investor confidence in the fundamentals of the business.

MTN is perhaps a more typical example of a longer-term recovery of a business operating in a cyclically challenged market that had also been hamstrung by some poor past business practices. MTN's share price has been on a roller coaster ride, suffering ups and downs depending on which way Nigerian regulatory pronouncements have tended to go in the short term. We are more focused on the long-term economics of the business – which we continue to like, and which we believe will prevail in time.

And in the context of our opening comments, Goldrush deserves a mention. We cover the investment in more detail below, but it delivered very satisfactory returns on a meaningful allocation of capital in a low risk way. Exactly what we are looking for.

On the negative side, Canadian uranium miner Cameco, South African construction company Stefanutti Stocks, and investment holding company Hosken Consolidated Investments were notable contributors to negative returns.

Stefanutti Stocks is by all accounts a class act in the South African construction industry. But even the quality operators have not been spared the brutal bloodbath that has been South African construction in recent years. Late or disputed payments by clients in Africa had been a problem, but failure to pay by Eskom for work on Kusile recently pushed the company to the brink. This has resulted in a sudden and severe sell-off in the stock. The South African construction industry has all the hallmarks of an industry offering long term opportunity to patient investors with nerves of steel. But picking the likely survivors is proving easier said than done.

HCI is a large holding in the fund. A mixture of continuing tough conditions in the local hospitality and gaming industry, ever widening holding company discounts, and moderately high gearing levels in underlying group companies have contributed to a steady erosion in the share price ever since we bought HCI in the fund. This has happened despite some notable efforts by management to unlock value in the group. It remains to be seen when our patience will be rewarded – but patient we will remain.

C. Investment Cycles Completed

1. Goldrush

Diligent readers of our fund Minimum Disclosure Documents will have noticed that Goldrush featured as a top ten holding in the fund from the very first MDD we published in February 2018 until the end of April 2019. Throughout this time, it was a meaningful holding in the fund – typically not far below 10%. 10% is about as large a position as we are willing to take in the fund, so clearly Goldrush must have been a very attractive opportunity. And indeed, it was. But first some background.

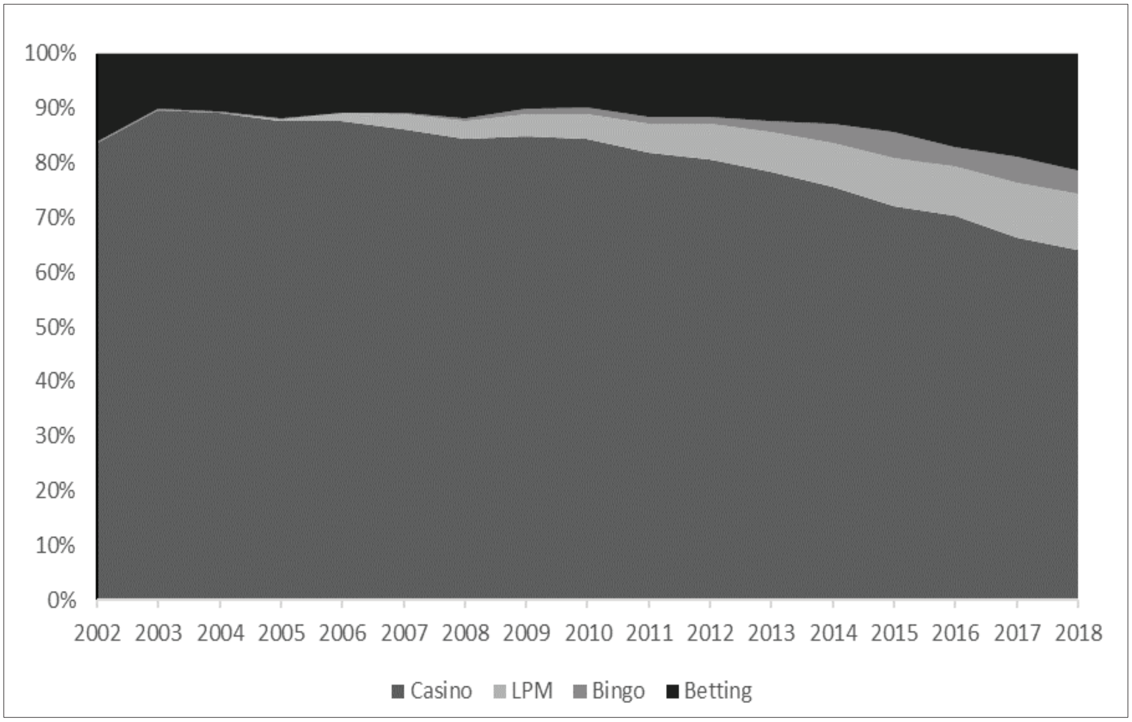
The very reason we decided to establish a Qualified Investor Hedge Fund when we founded Rozendal Partners was to be able to allocate capital to attractive opportunities as they came along, regardless of what the form of those opportunities are. Goldrush was just such an opportunity.

Goldrush is a private company, majority owned by the listed investment holding company RECM and Calibre Limited ('RAC' – refer to their website www.racltd.co.za for more information). We have had a long relationship with RAC, and the people involved with RAC – mainly because two of our founding partners were employed by them in the past. During a casual discussion over coffee with one of the RAC principals, it came to light that one of the minority shareholders in Goldrush wanted to sell their stake. RAC dearly wanted to buy this stake but had too much capital tied up in other opportunities to pursue this. We had investable cash on hand in the fund and could move quickly. Hence, we agreed with RAC to buy this stake in Goldrush, but simultaneously entered into a put and call agreement with RAC that would give us an attractive minimum return but allow RAC to buy the stake from us when they had capital available.

The put and call arrangement limited the equity risk to our Goldrush investment (hence the willingness to make it a large position in the fund) but did expose us to RAC credit risk in case we wanted to exercise our put against RAC. So, we had to gain comfort in respect of both RAC's creditworthiness and Goldrush as an equity investment. RAC ringfenced a pool of its assets for us as security to limit our credit risk in the transaction. This left the Goldrush equity investment case for us to gain comfort over.

Goldrush is a leading South African alternative gaming company. This means its core business is offering non-casino gambling, mainly in the form of electronic bingo terminals ('EBT's') and limited pay-out machines ('LPM's'). The alternative gaming industry came into its own well after the traditional casino industry, purely because the regulatory licensing regime for this industry was established only after that of the traditional casino industry. The greater convenience of the locations of EBT and LPM sites have made them popular, and as these have rolled out over the past decade, these formats – along with betting shops and online betting - have steadily taken market share from traditional casinos in South Africa.

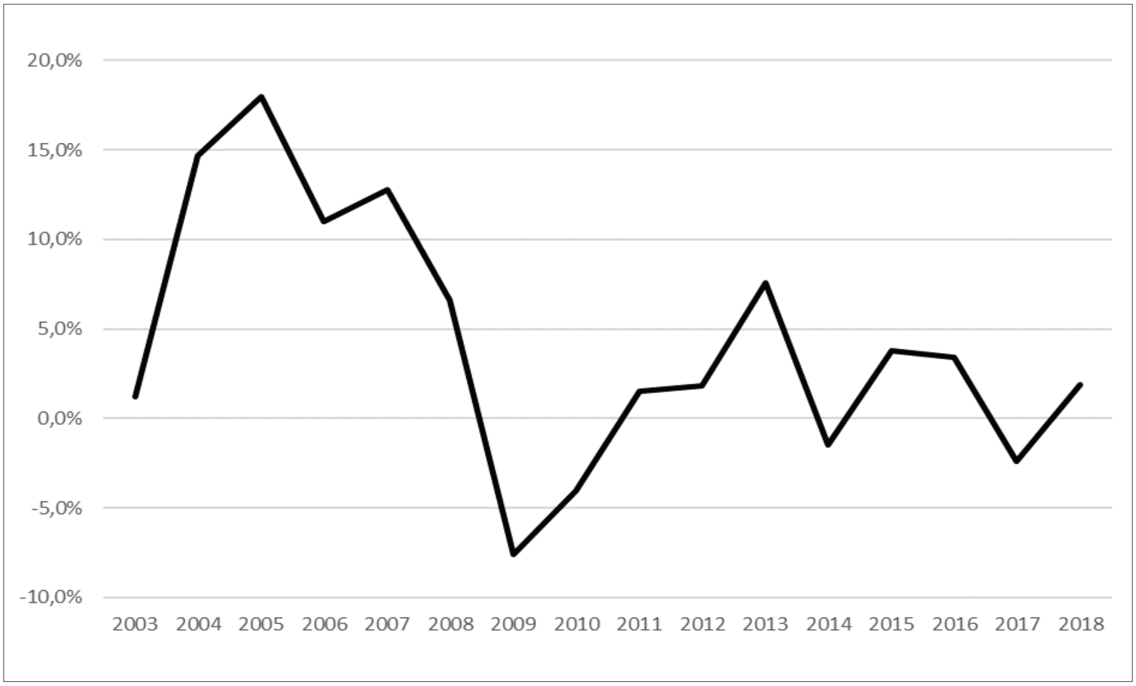
Chart 1: Share of gross gaming revenue in South Africa



Source: NGB

This gain in market share has allowed the alternative gaming operators to show solid growth in an otherwise very challenging gaming market – reflective of the weak South African economy in recent years.

Chart 2: Growth in inflation adjusted gross gaming revenue in South Africa



Source: NGB, Rozendal Partners

At the time that we acquired shares in Goldrush (early in 2018), the company held 32 EBT licences, of which only 24 had been rolled out, and the company held 4,200 LPM licenses, of which about 1,700 had been rolled out. This presented a clear growth path for the company. Importantly, this would be value-accretive growth, given the high returns on investment and short payback periods earned on the roll-out of these licences.

The very restrictive licensing environment related to gaming in South Africa is a double-edged sword. While it does restrict competition, and hence lowers the risk of high returns being eroded due to new entrants, it also places a business at the mercy of regulators. Actions such as increased gaming taxes or uneconomic investment requirements as a condition of license extensions or renewals are all very real risks in the industry. These cannot be ignored when valuing companies in the industry.

Our assessment of fair value for Goldrush at the time of our purchase translated to a multiple of EBITDAR (Earnings Before Interest Taxes Depreciation Amortisation and Rentals) of about 9 times. While a seemingly high multiple for an unlisted business, this was in line with the acquisition of the Niveus alternative gaming assets by Tsogo Sun, and attractive given the clear growth path for Goldrush in the next three years. The price we were paying for the Goldrush shares was ostensibly equivalent to about 7 times EBITDAR - which was an appealing price to us were we to become long term owners of Goldrush equity and not exercise the put RAC had given us.

About a year after our initial purchase, RAC approached us with a proposal to extend the term of our put and call agreement, as they needed more time to release the requisite capital from their other investments if they were to be in a position to exercise the call option or to buy the fund's Goldrush shares should we decided to exercise the put option. We agreed to this, as the revised terms offered us an equally attractive return profile to the original deal terms.

Throughout this time, we were expecting RAC to exercise their call option on the fund's Goldrush shares. It came as a surprise then when we were notified (well in advance of the expiry of the call option), that RAC no longer expected to exercise the call option. This made the decision between becoming long term shareholders of Goldrush, or exercising our put option to sell to RAC, much more salient. We carefully re-evaluated the Goldrush numbers and our valuation of the company.

In this process, we discovered that we had made a material error in our initial valuation. Our valuation was based on a multiple of EBITDAR. To get to equity value from the enterprise value calculated by multiplying EBITDAR by a given multiple, one must subtract the capitalised value of operating rentals. Failing to do so means one is ignoring the rental cash flows in the valuation of the business. In our initial assessment, we took cognisance of the fair value assigned to Goldrush by RAC in their audited financial statements. We were also given access to a valuation performed by a corporate finance firm with a view to facilitating the sale of the stake in Goldrush. In both cases, EBITDAR multiples were either the primary basis of, or at least a very material input to, the valuation. Both RAC and the corporate financiers adjusted for the balance sheet structure, including net debt, of Goldrush in their valuation. We assumed this included capitalised leases – as it should. But as they say, assumption is the mother of all mishaps – or something to that effect.

Upon properly accounting for leases in our valuation, it appeared that the price at which we could sell the fund's interest in Goldrush in terms of the put option was in fact not far from our estimate of fair value. This made the decision to exercise the put option much easier. In addition, with Goldrush accounting for a large part of RAC's own net asset value, it was (and still is) effectively possible to buy the same asset at a meaningful discount via RAC itself, as RAC is trading at a substantial discount to its net asset value. Thus, we decided to bid Goldrush farewell.

The fund earned a compounded annual return of about 16% from its investment in Goldrush. We consider this very satisfactory on a risk-adjusted basis, at a time when the fund's benchmark delivered essentially zero return.

Lessons learned (or knowledge reinforced) from our Goldrush investment? There were two primary ones:

- Having cash available and being able to move quickly when others need cash invariably results in good opportunities coming one's way. But by the same token, the opportunity cost of passing on moderately attractive opportunities for the sake of holding cash in anticipation of phenomenal opportunities coming one's way cannot be ignored.

- Be careful with assumptions, even if they appear reasonable. Check the facts and the numbers. This becomes impractical *in extremis* but should always be borne in mind.

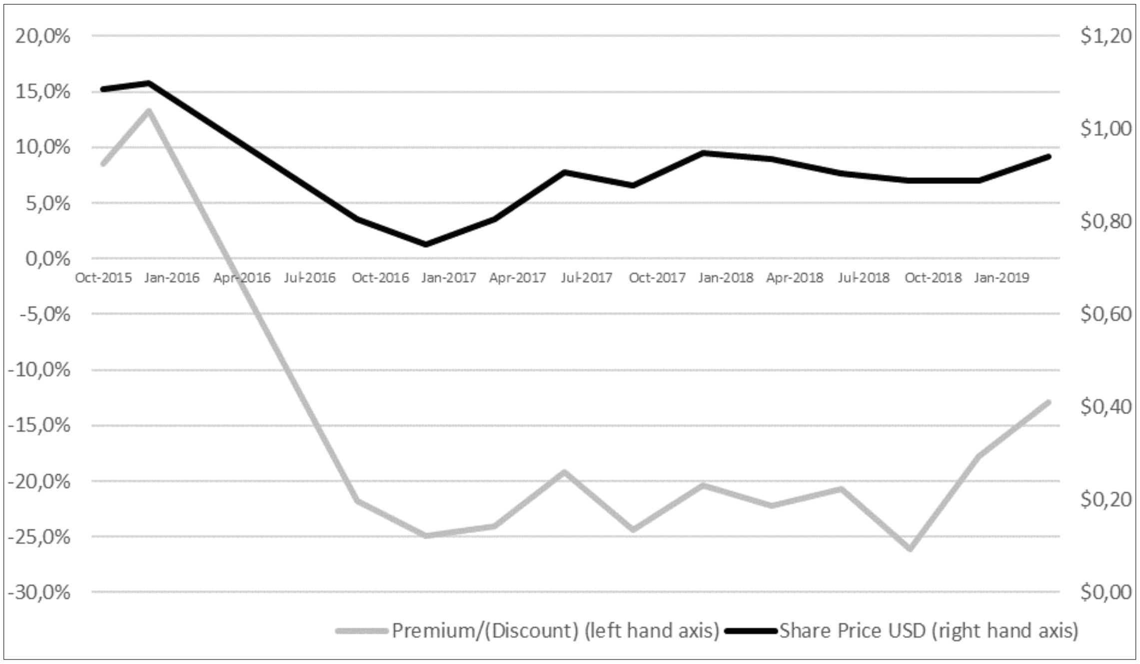
2. Astoria

Astoria is a closed end investment holding company listed in Mauritius with a secondary listing on the JSE. The company was formed at the behest of Anchor Group, a South African financial services firm. The company managed to raise $100 million late in 2015, mainly from South African investors, and Anchor was appointed as investment advisor to Astoria. For their services, Anchor was paid 1% of Astoria's net assets on an annual basis.

The timing of the capital raise was opportune: it was a time of grave political uncertainty and concern in South Africa, with the currency weakening precipitously during 2015. South African investor appetite for quick and easy offshore investments was strong, and Astoria offered exactly this. Astoria's objective was to achieve strong long-term capital appreciation by investing in global equities, private equity and other niche funds. Initial investor enthusiasm was so exuberant that Astoria traded at a premium to its net asset value shortly after listing – highly unusual for closed end investment companies.

Predictably enough, in time the premium to net asset value became a discount. By late 2016, the discount had grown as large as 25%.

Chart 3: Astoria premium/(discount) to net asset value



Source: Astoria, Rozendal Partners

Because the underlying assets of Astoria consisted mainly of large, liquid, globally listed shares, this discount started to attract the attention of activist investors. Liquid assets present the prospect of an effortless value unlock in a closed end fund trading at a discount to net asset value. Enter RECM & Calibre – yes, the very same RAC we were dealing with in our Goldrush investment.

RAC had started building a position in Astoria when the discount reached the 20% plus levels and had managed to acquire about 30% of the company in the ensuing two years. Their aim was twofold: firstly, to unlock the discount, and secondly to acquire the closed end Astoria structure for their own corporate purposes. RAC was not afraid of showing their hand: they made an offer to acquire full control of Astoria, albeit in a form that was not particularly attractive, consisting of a mix of RAC shares (at an implied price well above the market price of RAC shares) and cash.

The only complication with unlocking the value in Astoria was that there was a break-fee of 5% of net assets payable to Anchor Group if they were to lose their appointment as investment manager. However, with the discount as wide as it was and the underlying assets as readily realisable as they were, this was viewed as a price potentially worth paying.

As was to be expected, Anchor and Astoria's management was none too excited about RAC's plans. They proceeded to engage in legal delay tactics to either thwart RAC's plans or to negotiate a better deal for themselves should RAC manage to gain control of Astoria. These delays are what resulted in RAC's capital being tied up in Astoria for longer than they had envisaged, giving rise to the Goldrush opportunity for us.

It was during this stalemate between RAC and Astoria that we concluded that it was an opportune time to invest in Astoria shares. While it was plain to see that there was shareholder activism underway that could result in a value unlock in Astoria, the share price discount to net asset value persisted. Clearly the market had taken a dim view of the likelihood of RAC succeeding in its efforts. Our interactions with Anchor Group management led us to a different conclusion: it appeared to us that Anchor Group was more amenable to a reasonable outcome for all shareholders than the market had priced in. This made us more excited about the opportunity.

The key question on which the appeal of the opportunity hinged was what one expected the illiquid part of Astoria's portfolio (about 20% of the total assets) to fetch in a sell-down process. If one assumed that it can be sold at the balance sheet carrying value, the discount was indeed as wide as reported. If it could only be sold for 50% of carrying value, the discount was in fact only in the mid-teens percentage range, and not the mid-twenties. We were leaning more towards the latter than the former view. Which made the next question more relevant, namely: if a value unlock happens, how quickly does this happen?

Our research and reading of events had caused us to believe that the value unlock would in fact happen, and probably in a reasonable (less than one year) timeframe. This made even a mid-teens percentage discount attractive. What added to the appeal was that it was possible to hedge out a substantial amount of the risk of investing in Astoria. With a large percentage of its assets in large global listed equities, that on balance appeared expensive to us, holding Astoria outright for an extended period was unappealing. The listed portion of Astoria's portfolio followed global stock index movements very closely though. A short position in the MSCI World matching the exposure to global large cap stocks in Astoria was a good hedge for this risk, and we implemented this in conjunction with buying Astoria during October of 2018.

Within two months of making our initial investment, Astoria announced that the company would sell the liquid assets in its portfolio and return this capital to shareholders. It was also announced that Anchor and Astoria had agreed to a lesser break fee than the originally stipulated 5%. It was only after these announcements had been made and the amount of the capital return finalised that the share price started reacting meaningfully to this value unlock. While it was gratifying to see our investment thesis play out so quickly, it unfortunately also meant that we could only allocate a limited amount of capital to the opportunity – Astoria was always rather illiquid.

We held the Astoria shares until the capital return to shareholders had been paid out. The shares continued to trade at a discount to the company's published net asset value but given our view on the likely realisable value of the remaining very illiquid assets, as well as the quantum of overhead costs relative to the remaining asset base, the discount no longer offered the same appeal as before.

The fund earned an internal rate of return of 7.2% on the investment in Astoria. This is modest (and was less than what the fund's benchmark returned over the same period), but given the very low risk, hedged nature of the return, we consider it satisfactory.

Our key takeaways from the Astoria investment? The following are foremost in our minds:

- When an asset has fallen out of favour with the market, even obvious opportunities are sometimes ignored. There were some very clear and tangible signs that value was going to be unlocked from Astoria for months before the market started taking it seriously.

- There are a host of investment holding companies trading at substantial discounts to underlying asset value in South Africa. In most cases a discount is warranted due to head office costs and tax leakage in such structures. In fact, if one takes the view that the underlying pool of assets in a holding company will earn market-related returns, but head office costs reduce these returns, then at holding company level return on equity will always be less than cost of equity. This results in a classic value trap, that diminishes in value the longer one holds the asset or the faster it grows. One must assess whether management adds value in excess of their head office costs, and their ability to minimise tax leakage, very carefully in estimating an appropriate holding company discount.

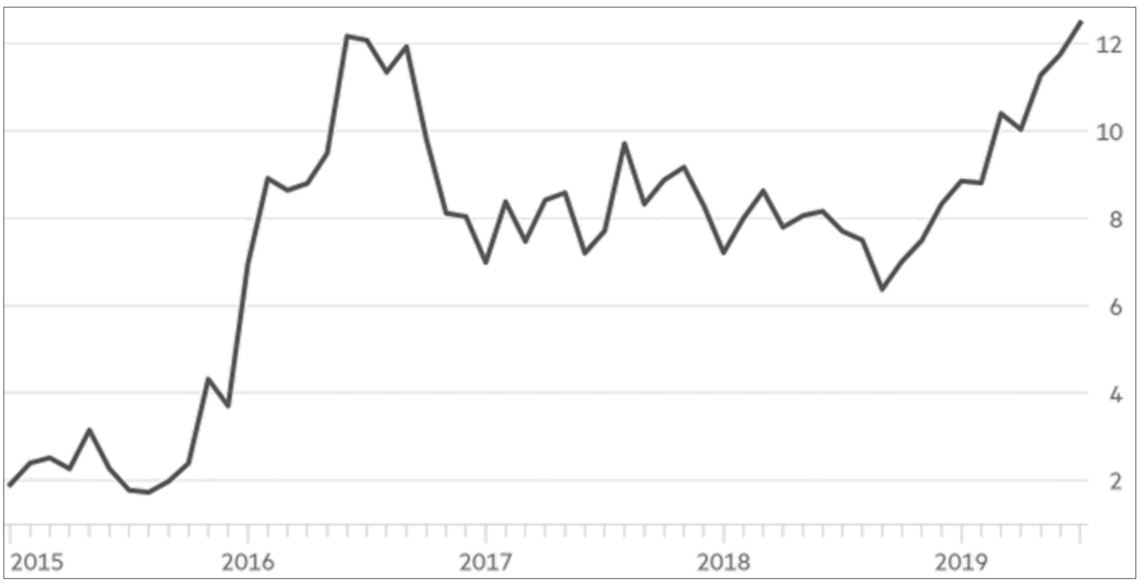
- Regulatory processes seemingly designed to protect shareholders' interests can often be very effectively used by shrewd management teams to frustrate exactly those interests. Astoria initially used Mauritian regulations and processes to exactly this effect.

D. Investment Observations

1. Negative interest rates

We are not in the business of macro-economic prognostication. But vast swathes of global government bond markets trading at negative yields is something even the most ardent bottom up investor cannot have failed to notice.

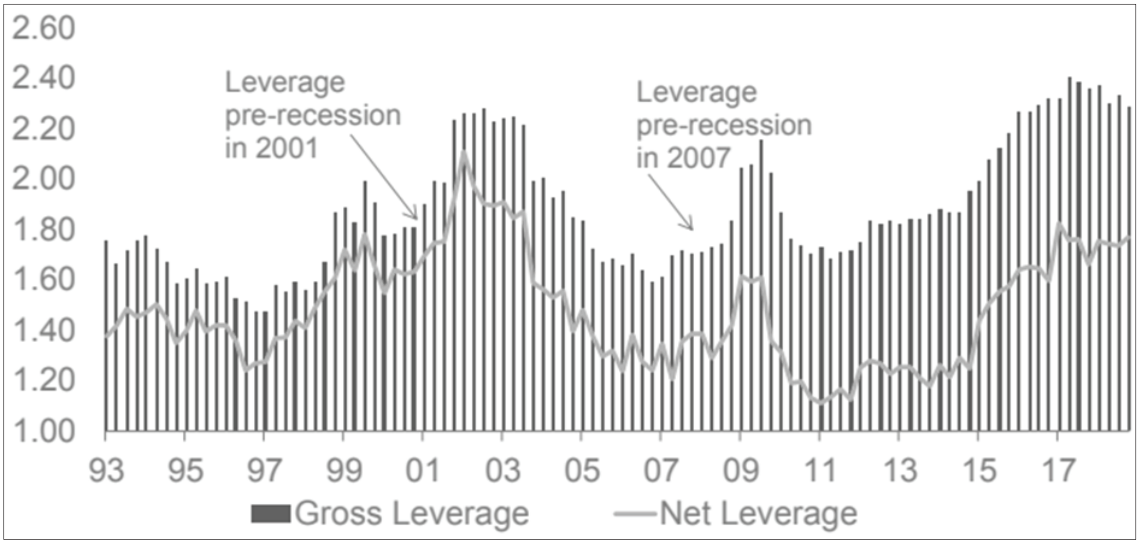
Chart 4: Bloomberg Barclays Global Aggregate Negative Yielding Debt index, market value (USD trillion)



Source: Barclays, Financial Times

One expects such low interest rates to drive up asset prices and increase the propensity to take on debt. That indeed seems to have happened over the past decade in most markets: asset prices are by and large expensive globally, and corporates have taken on increasing amounts of debt.

Chart 5: Global Investment Grade corporate leverage levels (multiples of EBITDA)



Source: Morgan Stanley Research, Bloomberg, FTSE Fixed Income LLC

Notice how corporate leverage in past cycles peaked during recessionary times, as EBITDA contracted during the recession. We are currently at previous peak gearing levels after a period of economic expansion, not during a recession. This probably does not bode well for corporate financial health should a recession arise.

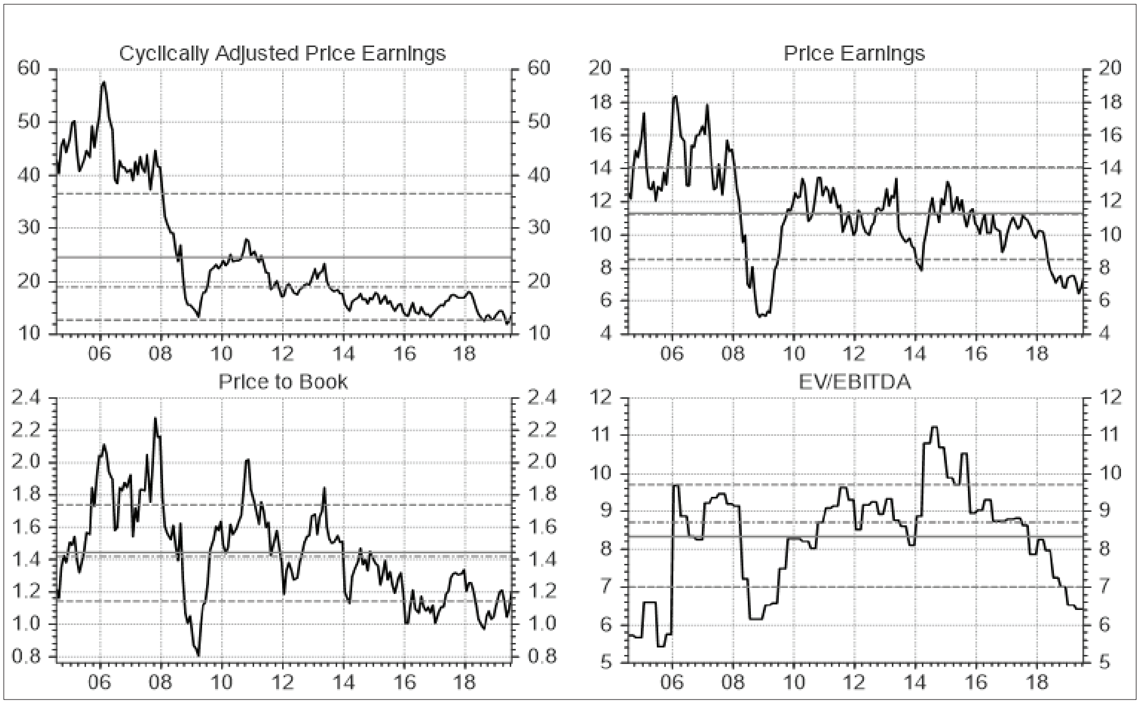
But interestingly, researchers at the University of Münster[1] recently found that in general, interest rate reductions do not affect risk-taking by individuals (not necessarily corporates). However, as soon as interest rates fall below zero, risk-taking increases significantly. Perhaps extended exposure to negative interest rates in retail bank accounts will finally push us through the looking glass into Wonderland as far as risk taking and asset prices in global markets are concerned.

2. Turkey

In the recent history of emerging markets enduring political chaos, Turkey features prominently. Along with countries like South Africa, Brazil, Argentina, Russia, Hungary, Romania, Zambia, Nigeria, et cetera, et cetera. But Turkey's fall from grace has been sharp and spectacular. Inflation has spiked, the currency has crashed, and the stock market has sold off. Exactly the type of environment where long term opportunity is born.

[1] Baars, Maren and Cordes, Henning and Mohrschladt, Hannes, How Negative Interest Rates Affect the Risk-Taking of Individual Investors: Experimental Evidence (July 2, 2019). Finance Research Letters, Forthcoming. Available at SSRN: https://ssrn.com/abstract=3174583 or http://dx.doi.org/10.2139/ssrn.3174583

Chart 6: Turkey stock market valuation multiples



Source: Refinitiv Datastream

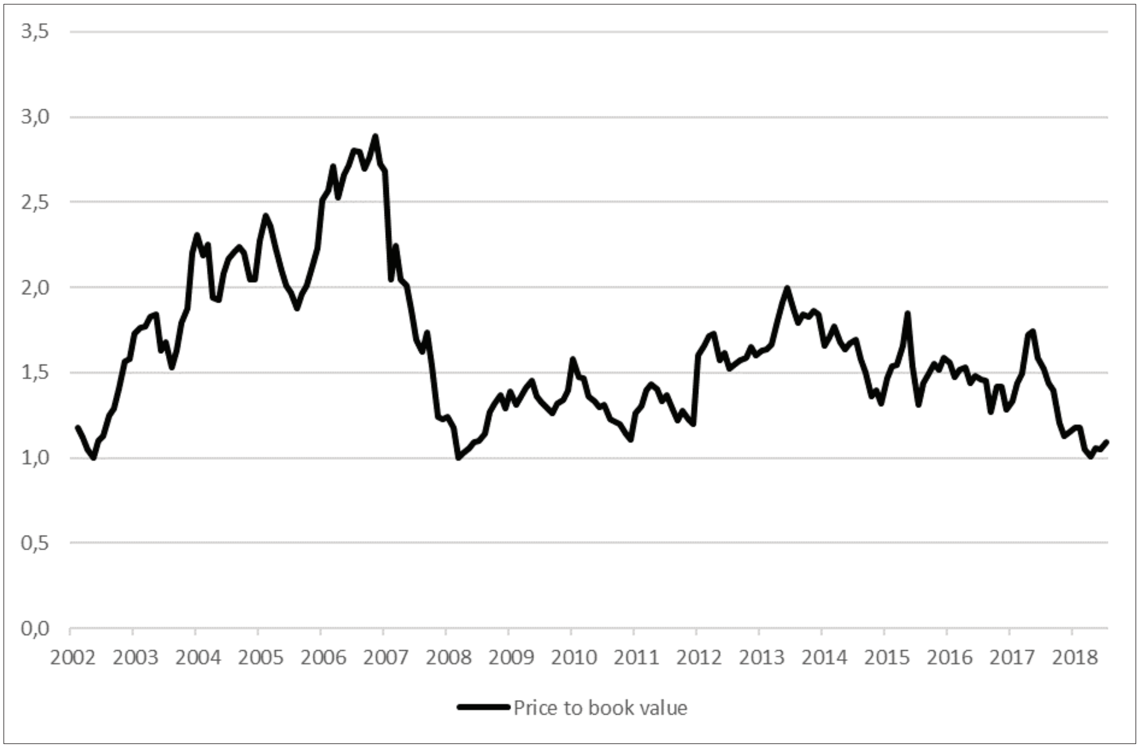
We paid a visit to several Turkish companies recently and are excited about the prospect of investing in some of them. We will share more on this when the time is right.

3. Small cap de-listings in South Africa

While it is not a flood yet, there have been a definite increase in the number of small South African listed companies de-listing. Examples over the past year include Clover, Howden, Verimark, Torre, Trans Hex and most recently Ingenuity and Pioneer Foods. This often involves insiders increasing their investment in the company going private and is a tell-tale sign of the market ascribing irrationally low prices to companies. While the short-term premium achieved in such a sale is often enticing to investors, the buy-out price offered is often well below long term fair value.

This pattern of de-listings fits the picture of cheap assets in the small cap sector of the South African market. Actual events are corroborating the charts – such as the price to book chart below.

Chart 7: FTSE/JSE Small Cap Index (excluding Real Estate) price to book value[2]



Source: Refinitiv Datastream, Rozendal Partners

Previous occasions when the JSE Small Cap index was trading at price to book multiples like today's level were generally very good buying opportunities. The chart below shows five year compounded annual total returns from investing in the JSE Small Cap index over time. Shaded areas indicate periods where the index was trading at price to book levels at or below 1.2. The graph stops in mid-2014 because that is the last date from which it is possible to calculate five year compounded total returns. But notice the extensive period of grey shading at the end of the chart – we have been in cheap territory in South African small caps for some time now.

[2] We exclude Real Estate because of the distortive effect that the substantial increase in the representation of the Real Estate sector in the FTSE/JSE Small Cap index has had over the period shown. Because most Real Estate companies carry their assets at fair value, price to book ratios are not comparable to that of industrial and financial companies.

Chart 8: JSE Small Cap Index five year compounded annual total returns

Source: Refinitiv Datastream

The correlation between low valuation and high future returns is clear. We are cautiously optimistic that this correlation will again prove to hold over the next five years.

E. Rozendal Partners update

As alluded to in the introduction to this letter, the Rozendal Global Fund recently received all required regulatory approvals from the Guernsey financial regulators. There remain some South African regulatory and administrative matters to be concluded before the Global Fund can be properly launched, but these should be resolved soon.

For the rest there has been little to report on within Rozendal Partners. We continue to hunt for attractive opportunities wherever we can find them, motivated by the same passion for achieving superior investment returns that set us off on our Rozendal Partners journey in the first place.

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As always, do feel free to get in touch with us. We welcome thoughts and discussions about all matters Rozendal – be they investment related or otherwise.

Yours sincerely,

Wilhelm	Paul	Jan

29 July 2019