BAOBAB
INVESTMENT MANAGEMENT
AFRICAN ROOTS | GLOBAL PERSPECTIVE

Annual Partners Report

Our primary benchmark for success is our ability to deliver on our long-term return objectives for our client partners. We are very happy with the way our established accounts performed in 2019 and are pleased with the results and progress over the past 4 years. Some new accounts, including our unit trust, are still being established and may not have participated in some of the recent gains, but over time our best investment ideas will appear in all portfolios. What is important is that we apply the same thinking and approach to each portfolio and in the long-term all of our portfolios will offer a very similar return profile in line with our stated investment objective.

The purpose of our annual report is to align our thinking and expectations as much as possible with our client partners. The right partners should not choose Baobab based on past performance, but because they view us as a sensible, long-term custodian of their hard-earned capital. We will go through tough periods, but hopefully these reports will provide context and understanding, and portray an approach that is prudent, sensible and consistent. At the end of the day, it is our investment approach and process that drives the decisions that will deliver the returns of the future and distinguishes Baobab from other managers.

Managed Share Portfolio Performance Summary to 31 December 2019

Annualised Returns (Rand)	Baobab Domestic Portfolio	JSE All Share Index	CPI+5%
Since Inception (1 January 2016)	**8,99%**	3,01%	9.97%
1 Year	**10,91%**	8,24%	9.02%
3 Year	**5,61%**	4,06%	9.40%

Annualised Returns (USD)	Baobab Global Portfolio	MSCI World Index	6% USD
Since Inception (1 January 2016)	**8,22%**	9,12%	6.00%
1 Year	**10,59%**	25,19%	6.00%
3 Year	**7,77%**	10,43%	6.00%

Managing risk

As a boutique manager we are pleased that we have been able to produce both portfolios that are truly differentiated and returns that are in line with our stated investment objective of above average returns at below average levels of risk. Put another way, we want to compound the wealth of our client partners, but we want to do so safely. That means we think about the potential downside risk (how could we lose money) in every single investment that we make. Because risk is so difficult to measure and only becomes clear when it is too late, I do not think that the average global investor has any idea what sort of risk they are currently taking on. As Howard Marks commented recently:

"Profits are not rising, stock prices are. It's what we call a liquidity-driven rally. It doesn't mean the market is going to go down tomorrow, but it does mean that the odds are not, in my opinion, in the investor's favour."

As most of this liquidity is being invested via passive solutions, US mega-cap shares are attracting the bulk of the flows, making them particularly risky in my view. As an example, Apple saw its revenue and operating profit decline in 2019, yet the share price nearly doubled as investors scrambled for exposure to US equities. Approaching a market capitalization of $1.4 trillion, it has become a larger part of most passive indices and attracts more of each incremental dollar of global equity investment, regardless of its price, valuation or operating performance. Most of these very large companies that are the natural home for excess liquidity are very good companies, but in my view, the risk of owning them along with just about every equity investor in the world, is under appreciated.

At the opposite end of the spectrum, domestic shares in South Africa have suffered a multi-year liquidity drain as investors continue to exit the market. The result is some very compelling valuations on very low earnings levels, but with a very challenging economic environment. We do not buy markets, but sound companies within markets that we think are attractively priced. As a result, we do not need to be bullish on the prospects for the domestic economy to be excited about the prospective returns for some of the local companies we own. An economy that is one day "less bad" should be good enough to generate very good returns given the extremely negative sentiment and depressed valuations.

Portfolio and company commentary

Top Ten Equity Holdings

Baobab Global Portfolio	Baobab Domestic Portfolio	Baobab SCI Flexible Fund
Brookfield Asset Management	Hosken Consolidated Investments	Hosken Consolidated Investments
Barrick Gold	Old Mutual	Old Mutual
Telecom Italia	Combined Motor Holdings	Combined Motor Holdings
L Brands	Grindrod Shipping Holdings	Grindrod Shipping Holdings
Affiliated Managers Group	Trellidor Holdings	Trellidor Holdings
Liberty Broadband	Liberty Broadband	Liberty Broadband
Fairfax India Holdings	Fairfax India Holdings	Fairfax India Holdings
Teekay Offshore	Teekay Offshore	Master Drilling Group
Lindblad Expeditions	Exor Ord	Cameco Corp
Fiat Chrysler Automobiles	Anglogold	RECM & Calibre Ltd Pref Shares

Domestic portfolios

Having been very patient in waiting for the poor domestic fundamentals to translate into opportunity, we became much more active in building positions during 2019. Small and mid-capitalisation industrial shares have become particularly cheap and much of our buying has been in this area that most investors can't, or won't, invest in. One of the positive attributes of this sector is the ability to invest alongside owner-managers that are significant co-shareholders in the business, something one doesn't always find in larger companies run by executive managers seeking short-term growth. During the year we initiated positions in Hosken Consolidated Investments (HCI), Trellidor and Combined Motor Holdings, three sound companies with strong, aligned management teams, all trading at very attractive valuations.

Our 2019 returns for established domestic portfolios were dominated by Impala Platinum and Anglogold. Anglogold gained 74% during the year and Impala went up more than 3 times. Having been uninvestable for most just a year ago, Impala Platinum is now a firm favourite amongst momentum investors on the back of very strong appreciation in the underlying metals basket, particularly palladium. We sold our last Impala shares at the end of 2019 and reinvested the proceeds elsewhere, notably into

HCI where we retain some exposure to the platinum market but are in essence getting this exposure for free (see further commentary below). Unfortunately some new accounts, including our unit trust, did not have exposure to Impala given timing and share price movements.

As investors scramble to gain exposure to platinum shares we have found a few sectors that look a little like platinum a few years ago. These are cyclical industries that have been through a multi-year bear market, but where some form of scarcity factor may well lead to improved pricing in the future. Shipping is a terrible industry that has been through a very tough cycle. Within a year of a separate listing, the price of Grindrod Shipping offered a very attractive entry point at a third of its net asset value which is made up of a reasonably modern fleet of ships. The tough market and new regulatory issues around sulphur emissions from marine fuel should curtail future supply of ships, resulting in improved pricing for incumbents with modern fleets at some stage in the future.

Domestic portfolios retain a reasonable offshore element that allows us the flexibility not to be forced buyers of expensive rand hedge shares.

The major disappointment of 2019 has been our investment in Tongaat. We will know more about new management's plans soon, but it has been a very frustrating investment from which we have learned valuable lessons.

Hosken Consolidated Investments (HCI)

HCI is now our largest position which reflects our conviction in the investment thesis. HCI is an empowered investment company under John Copelyn's stewardship that has a long history of sound capital allocation and strong shareholder returns. With a market capitalisation of just over R7 billion, their listed investments in Tsogo Sun Gaming and Tsogo Sun Hotels alone account for more than their market value. These assets may face operational challenges in the current environment, but they are valuable assets that would be difficult, if not impossible, to replicate. While the very large discount to NAV provides a strong underpin, we think there is also significant hidden optionality within the HCI portfolio that may be realised in the next few years, most notably their stakes in Impact Oil and Gas and Platinum Group Metals. HCI owns 30% of Platinum Group Metals which is a part owner of a significant, palladium rich reserve in the Waterberg. Impala Platinum is a partner in the project which has enormous potential value given the very strong palladium market. With the HCI share price as depressed as it is, we gain exposure to assets like these for free, providing a very favourable and asymmetrical investment set up.

Late in 2019 Impala completed the purchase of Canada's North American Palladium for C$758 million. The table below provides a very interesting comparison between this and the Waterberg asset that we are part owners of via HCI.

Comparison to recent Implats Acquisition

	North American Palladium	**Platinum Group Metals**
	Lac des Iles	**Waterberg**
Resources (M&I)	72.98M tonnes	242M tonnes
Mine Life	9 Years	45 Years
Total All-in Cost (USD)	$834/Pd ounce	$767/4E ounce
Annual Production	294,000 ounces/3E	420,000 ounces/4E
Market Capitalisation (USD)	$758M	$90M
Market Cap/Reserve Ounce (USD)	$216.57	$9.23

Source: Platinum Group Metals Investor Presentation

Trellidor

Trellidor is a brand known to most South Africans and we wrote about it in a detailed note that can be accessed on our website. (https://www.baobabim.com/wp-content/uploads/2020/01/The-Friday-Filter-Safety-First-15.11.2019.pdf). Trellidor Holdings is a good example of the current opportunity set in small cap industrial shares. With a market capitalisation of under R400 million, it is uninvestable for most South African institutions, but is a solid business with a very strong brand, a proven track record of over 40 years, and a disciplined management team. Trading at 9 times fairly depressed earnings it is not as cheap as some other small cap shares, but the quality of the business and management team are supportive of the investment case. The company has not wasted the economic recession and has focused on improving manufacturing efficiencies that position the Group well for any potential upturn in the domestic economy. We rate management highly, led by CEO Terence Dennison and Chairman Mark Oliver, both of whom are significant shareholders alongside us. We are comforted by the fact that they are focused on margins, cash flows and return on invested capital. While they are always on the lookout for synergistic acquisitions, they have been more disciplined than many other South African management teams and have chosen to focus on internal organic opportunities and efficiencies. Their capital allocation has been sound and they are taking advantage of the undervalued share price to repurchase shares in the open market. Despite the challenges of the domestic economy, the valuation and quality of the business and management make Trellidor a sound long-term opportunity for patient investors.

Combined Motor Holdings (CMH)

CMH is an owner-managed automotive retail business with a strong track record in a tough industry. It has produced high returns on equity for many years and has grown earnings and dividends by 14% and 22% annualized respectively over the past 7 years. While vehicle sales are clearly not booming in South Africa, 35% of profits are generated by other services such as car hire, financial services and parts and servicing. Trading at 7 times earnings and a dividend yield of over 8%, we think we are being well rewarded for the risk posed by a weak local economy. The investment case is further supported by the very strong management team who own more than 40% of the business. To quote from the CEO, Jebb McIntosh, in the 2019 Annual Report:

"The group is in a sound financial position. Its financial statements record a solid and stable asset base, backed by strong cash flow generation. Costs have been reduced to a minimum, and the management team is experienced, hardworking and enthusiastic. The missing ingredient is a boost to the revenue line."

CMH is a good example of a well-run business that has coped well in an extremely tough environment but are well placed should there be any improvement in trading conditions in the years ahead. In the meantime, the company is producing good cash flows and paying us a very healthy dividend.

Global portfolios

Our global portfolios didn't keep up with global indices in 2019, but they produced solid returns at significantly lower levels of risk. During the year Liberty Broadband appreciated by 73% and Brookfield Asset Management by over 50%. Exor, Lindblad Expeditions, Telecom Italia and Barrick Gold also appreciated markedly during the year. These gains were countered by declines in L Brands, Atlas Mara, Rolls Royce and our portfolio hedges against expensive US equities. Three of our positions, Oaktree Capital, 21st Century Fox and Teekay Offshore were subject to corporate takeovers during 2019. We retain exposure to Oaktree Capital via Brookfield Asset Management who were the acquiring party. Fiat Chrysler and Peugeot announced a 50/50 merger to create the world's fourth largest automobile maker in a combination that should create significant synergies and position the combined entity well for a challenging environment for the sector. We view the news as positive for both Fiat Chrysler

Automobiles and holding company Exor and expect the strong management team involved to extract value for shareholders in the years ahead.

Our biggest global mistake of 2019 was perhaps one of omission. We researched a number of opportunities during the year, only to see the share prices surge higher before we had built the conviction to buy. Most of our purchasing was in existing names where we used price weakness to add to Fairfax India, L Brands and Atlas Mara. While L Brands' Victoria's Secret Brand has been struggling, its other main asset, Bath and Body Works, continues to trade very well and we think is a very valuable asset.

We hold the management of Fairfax Financial in high regard and they are a core part of our investment thesis in both Fairfax India and Atlas Mara. Fairfax Africa are a significant owner of Atlas Mara, a sub-Saharan financial services group. While Africa is not high on the list of global investors at the moment, we share the Fairfax view that financial services across the continent is a long-term growth opportunity. With some sound assets, solid management and a deeply discounted price, we think a small position is warranted in this largely unknown entity. We also initiated new positions in Affiliated Managers Group and Cameco.

Affiliated Managers Group (AMG)

AMG is a very good case study of our investment process in action, from idea generation through to execution. In 2014 I watched an online presentation by a portfolio manager from Yacktman Asset Management who presented a very compelling investment thesis on Samsung Electronics that was very cheap at the time. The presentation led me to doing further research and eventually buying Samsung, an investment that ended up being extremely profitable. It also led me to following Yacktman Asset Management a little more closely and starting to read their investment commentaries. In this process I discovered that they were part owned by a company called Affiliated Managers Group that identifies and partners with a number of boutique investment firms around the world that are involved in actively managed investment strategies. The boutique managers maintain operational and investment autonomy, but AMG provides them with a global distribution platform as well as support with product development, marketing and compliance. After further research it became clear that AMG was a good, cash generative business with very good management operating in an industry that I understood very well. (Note – understandability is one of the most important boxes to tick in our investment process.) Unfortunately these qualities were well reflected in the share price and we passed and moved on.

Fast forward five years to 2019 and the future of active management is being questioned, with the bulk of flows going into passive solutions. While I am firmly in the camp that thinks low cost passive management has a place, I think there is space for both and the more pervasive passive becomes, the greater the opportunity for the active managers that are left standing. Despite the challenging environment AMG has grown its assets under management, free cash flow and earnings over the past 5 years, but the share price has declined from over $200 to our purchase price of just above $75. At these levels the company trades on a very modest multiple of earnings and free cash flow, supported by a very strong management team. Management are sound capital allocators who are able to use the strong cash flows of the business to either seek new partnerships or repurchase shares at a discount. They have repurchased 12% of outstanding shares since 2017.

While most of the investment industry is writing off active management, we are happy to invest in an outstanding collection of active asset management businesses, overseen by a focused management team, at a very attractive price. We have waited over 5 years for the opportunity and hope that over the next 5 years our patience will be rewarded.

Cameco Corp

Cameco is a cyclical business that we think has a favourable set up. It is another example of a good company operating in a bad industry that is potentially somewhere near an inflection point where supply shortages come into play. Cameco is the bellwether in a uranium industry that has been in a vicious bear market for many years. Uranium is the fuel used in nuclear power plants to generate electricity. Nuclear Energy is the only carbon-free source of electricity that can be ramped up to massive scale very quickly and provide power reliably around the clock, regardless of weather conditions. While the use of nuclear energy is an emotive issue for obvious reasons, it does seem to me that given the challenges we face, it will be a part of the solution to provide cleaner energy going forward, especially as new reactor technology provides better and safer solutions. This view is supported by the number of new reactors being built, especially in China and India. The end result is a future where demand is likely to be greater than supply, yet the price of uranium is less than the cost of production. Going forward I expect this to translate into higher uranium prices that will benefit a world class producer such as Cameco. Even at current depressed uranium prices, Cameco is cash flow positive, partly thanks to a very disciplined management team who recently shut down production at one of their largest mines. Trading below book value and with a solid balance sheet, we think it offers a very attractive long-term opportunity at current levels.

Outlook and strategy

While I do not have particularly strong views as to what is in store for us in 2020, we will continue to operate in the same prudent manner as we do every year. We will look through the noise for mispriced securities that offer significant upside if our thesis is right, but where downside is limited if we are wrong. It is an election year in the USA and Trump will do everything in his power to keep the economy and stock market strong. He may well succeed, but valuations of US large cap equities are very stretched and leave little room for disappointment. We will not be blindly following the herd into large cap US equities, but looking for hidden gems that fall outside of the major indices. While I expect another challenging year for the domestic economy, some valuations are too compelling to ignore and we will continue to selectively take advantage of this.

In an environment where technology shares are the firm crowd favourite, I will end with a quote from renowned investor, Sir John Templeton.

"Technology may – or may not – be changing the world but it has not changed human nature."

Whatever happens in 2020 and beyond, I remain confident that human nature will lead to incidents of excessive greed and fear, creating opportunity for those who have the temperament to take advantage of investor sentiment. It is for this reason that I think the long-term outlook for value-conscious investing is as bright as ever.

Thank you for entrusting your hard-earned capital to Baobab. I will continue to spend each day seeking the right opportunities to build robust portfolios that will endure whatever conditions may lie ahead.

Kind regards

Sandy Le Roux

Note: The performance figures quoted are for a fully discretionary managed client and are net of fees. For domestic portfolios, asset swap is used for the offshore holdings. Because we construct each portfolio individually based on the opportunities available in the market, there will be some variation in returns across our accounts, particularly for newer accounts and those where we have inherited positions. While this can make communication about our portfolio difficult in the short-term, we believe that building portfolios in a bespoke and considered manner is in the best interests of our clients and a key differentiator of our offering.

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