January 2024

Dear Investor

2023 ANNUAL LETTER

This is our seventh annual letter. We appreciate your decision to entrust your savings to Capensis Capital. Managing your money is a privilege.

Investment results

	Capensis Capital (consolidated)	Benchmark (US inflation + 6%)	Average cash holding
2017 (9 months)	+11.0%	+5.6%	64%
2018	-13.5%	+7.9%	40%
2019	+22.3%	+8.3%	24%
2020	+23.5%	+7.4%	23%
2021	+15.2%	+13.0%	13%
2022	-22.8%	+12.5%	8%
2023	+27.0%	+9.4%	7%
Total	**+63.6%**	**+84.2%**	
Total annualised	**+7.6% p.a.**	**+9.5% p.a.**	

Source: Interactive Brokers, CapitalIQ, Capensis Capital

Please review the investment statement accompanying this letter. Your individual return might differ from the returns above, depending on your starting date and some minor differences in your portfolio compared to the consolidated account.

Welcoming the winds of fortune

"And if this is the long haul, How'd we get here so soon?" Taylor Swift, Coney Island

In the Cape we have experienced one of the windiest summers in recorded history. While this has spelled misfortune for beachgoers, the winds of fortune have been favourable for the share prices of several of the companies held in your portfolio. This was on top of already good returns earned before the arrival of the South African summer and has resulted in strong 12-month returns.

These returns bring us joy, partly because we are also investors in the same portfolio ourselves but especially because we are delivering for our partners. At Capensis Capital, we don't see 'our clients' as a generic term; we see faces. Some we know very well (and spent the windy holidays with on the beach) and some we know less well, but these are the faces that drive us to leave no stone unturned in our hunt for good investment opportunities.

However, we would like to caution as we often do, that your portfolio will not always generate the short-term returns you have experienced over the past 12 months. In fact, it is possible that there will again be times when your portfolio will generate negative returns over shorter periods. Share prices can be dragged down significantly by broad panic. Measured over long periods we hope to deliver at least our benchmark returns, but all journeys have good and bad weather along the way. Being aware of this is especially important on investment journeys as the weather can swing violently, which could tempt you to make short-term decisions based on current conditions.

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Director: PJ Bosman, HP Vermaak, P Ntshiba

We don't spend too much time watching the weather vane

A different question would be whether strong returns are likely to be followed by weaker or negative short-term returns. Should we be expecting a change in weather? We certainly do not have the answer to this. We will always ask you to focus entirely on the long-term returns, which will largely be driven by the profits of the companies you own. They will also partially be driven by the extent to which the companies we own re-rate from undervalued to more fairly valued. We remain excited about the prospects of many of the companies you own and believe that there are many different opportunity sets in the portfolio. We have highlighted some of these below.

1. The strong economics of a few companies in the semiconductor industry

Global processing capacity is very likely to grow rapidly for a long time and there are several companies that have strong competitive advantages within this industry. This makes it unlikely for new entrants to enter their specific area of expertise. Companies operating in the semiconductor industry currently make up 24% of your portfolio. These companies have generated good returns for our clients and especially so over the last 15 months. For example, Lam Research Inc has more than doubled since mid-October 2022. There was a dramatic industry-wide sell-off early in the first half of 2022, which we used to increase your exposure. Although such high returns are unlikely to continue, we believe that profit growth will continue to drive share prices higher over time.

2. Listed property

This is an opportunity we have written about before. Share prices have started to move up for some of the companies we own – especially so in the case of Unibail-Rodamco-Westfield. However, this price remains way below what we believe the company to be worth. This is also the case for the other property companies we own, as they continue to trade far below their net asset values. Importantly, property companies will be challenged by the rising cost of debt. We only own companies where we have conviction in their ability to absorb a higher interest bill. Property companies currently comprise 10% of your portfolio.

3. Companies that have built a strong platform in growth markets

We expect the revenue of the companies we own in this category to grow both from market growth and market share growth. In our view, these companies are well positioned to take market share because they are offering a superior product or service without charging more than competitors. Our holdings include Microsoft, Mastercard and Interactive Brokers. Their share prices are generally deemed expensive, but companies that can generate consistently high returns on capital should be more expensive. We rate the management teams at these businesses very highly, but also remind ourselves not to fall in love with companies. We continue to scrutinise their actions and those of their competitors. These companies collectively make up 11% of your portfolio.

4. Investment companies

These are companies that own several different businesses, partially or entirely. Here we believe that we are partnering with good allocators of capital. Although we look through to the underlying companies to build comfort with the basket, we also place value on the fact that we are partnering with individuals who have track records of making good investment decisions. In all cases these individuals have meaningful holdings in their own companies. In this category we include Exor (holders of Ferrari, Stellantis, Philips and CNH Industrial, who make New Holland tractors), Berkshire Hathaway and Markel Group. These companies collectively make up 29% of your portfolio.

It is important to note that these opportunity sets are not all mutually exclusive. For example, we believe that the management at Howden Joinery (a kitchen manufacturer in the UK) are also very good capital allocators. Then there are various idiosyncratic opportunities like EOG Resources (a US listed oil and gas company, which provides some protection against rising oil prices) and AIA Group, a Hong Kong-based insurer that offers some exposure to the rapidly growing insurance and investment markets in Asia.

The long haul

We incrementally invested the portfolios through 2017 and 2018. Although we are pleased with the portfolio returns over the last five years, we also know that the investment horizon of these portfolios – the duration of our partnership with our clients – is much longer. There will be more good and bad weather along the way, but we trust that our relentless search for opportunities that match our investment criteria will generate the returns our clients need, also over the long haul.

Investment review

The largest contributors to performance were your semiconductor businesses, Exor and Howden Joinery. The main detractors AIA Group, BAT and First Republic Bank.

During the year, we sold your holdings in Adobe, Burford Capital, CTT Correios de Portugal, First Republic Bank and Wix.com. We used these proceeds to add property companies (Derwent London, New River Reit and Unibail-Rodamco-Westfield) and EOG Resources to your portfolio. Additionally, we selectively added to some of the longer-standing investments as the market provided opportunities to do so.

We are pleased that our conviction in the semiconductor businesses showed a significant rebound from the weakness of 2022. A year ago, we noted that we thought these businesses showed particular potential. 2023 was the year in which the terms “generative artificial intelligence” and “ChatGPT” became part of the common lexicon. While we never had confidence in making specific predictions about technological advancements, we explained that the general trend of the world is toward increasing digitisation. This means more data generation, more transfer and storage thereof and ultimately more processing to convert data into information. The companies you are invested in will benefit from many different future scenarios, irrespective of which company designs the next revolutionary chip.

Additionally, we are growing in our conviction around the property companies we have invested in. Property is a very long cycle business and this has been a painful cycle. We think there is evidence of the cycle bottoming out and we expect the future to deliver attractive returns as rents stabilise and grow, as capital values return to growth and ultimately as discounts to property values reduce. Any one of these would lead to acceptable returns. However, if they all occur during the same period, you’ll see some very exciting returns from these companies. We won’t attempt to predict how this might play out, but we feel that your portfolio is very well positioned.

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The business of Capensis Capital

It has been four and a half years since Capensis Capital partnered with Granate Asset Management. Granate continues to build an impressive track record in the South African investment market and the brand is slowing gaining recognition. A number of our Capensis investors have also invested in the Granate funds.

However, questions are often asked about the difference between Granate and Capensis. We remain one team, following one investment philosophy and process. The only difference is that in the Capensis accounts, our ideas are limited to opportunities outside of South Africa.

We are considering renaming Capensis Capital to reflect that fact that Capensis is part of Granate Asset Management and clear up any confusion. Therefore, we would appreciate any opinions you might have this regard: Do you have any comments or ideas that you would like us to consider around this potential rebranding of Capensis?

Conclusion

It continues to be a pleasure and a privilege to manage your capital. As always, we invite you to contact us if there is anything you would like to discuss. We find that there are valuable learnings for both clients and us in portfolio discussions, especially when clients take opposing views.

Your long-term partners

Alex, Catherine, Henno, Paul, Philasande, Simone and everyone at Granate Asset Management

Disclaimer

This document is intended for the clients of Capensis Capital (Pty) Ltd. All data provided by Capensis Capital, unless otherwise stated, is current as at 31 December 2023.

Capensis Capital (Pty) Ltd is an Authorised Financial Services Provider, regulated by the South African Financial Services Board. Registered office: 2nd floor, Josephine Mill, 13 Boundary Road, Newlands, 7700, South Africa

More information about Capensis can be found at http://www.capensiscapital.com.

The value of your investments and the income from them may go down as well as up. It is possible that you may receive less than you invested. Past performance is not indicative of future performance.