Equity investment opportunities remain but expect few fireworks in tough environment- Kagiso Asset Management Chief Investment Officer Gavin Wood

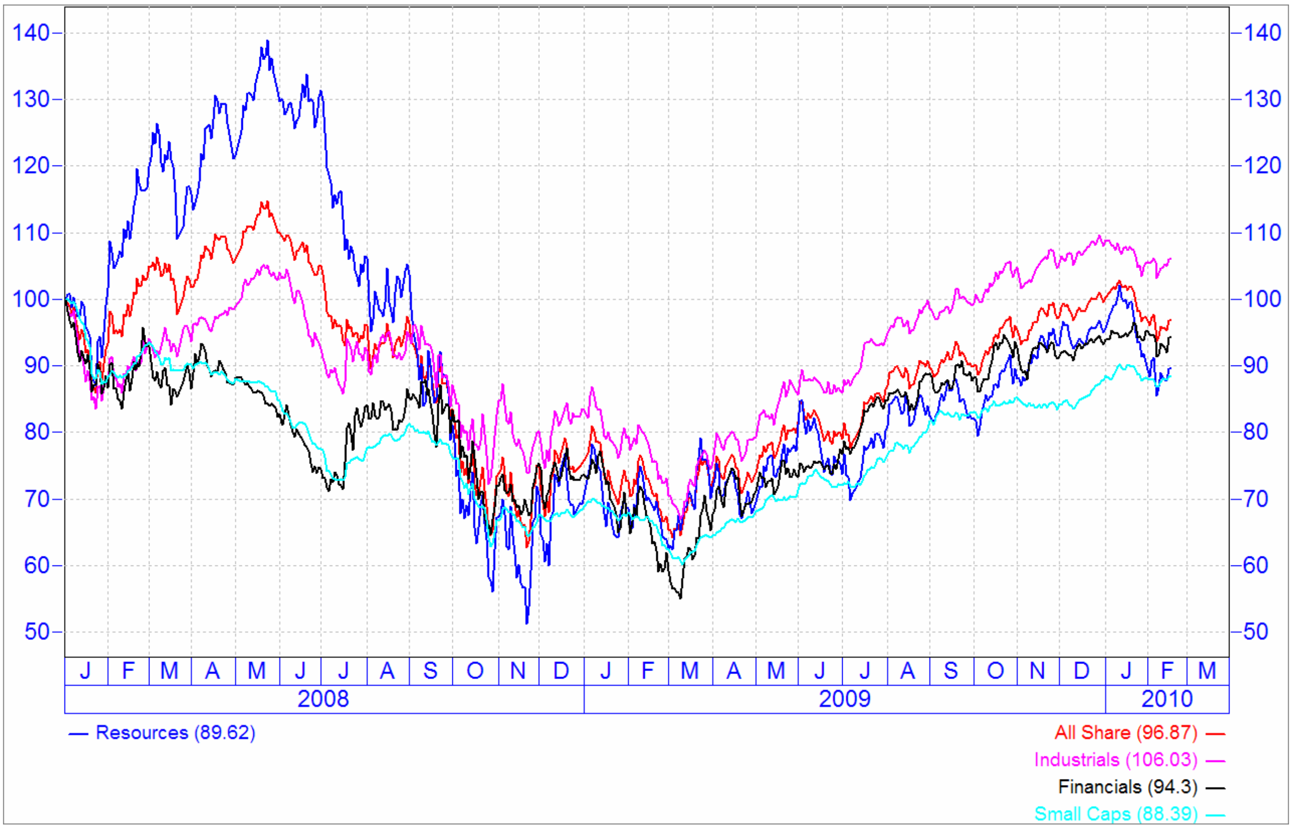
The last two years (2008 to current 2010) have been an exceptionally volatile time for global equity markets as well as for the local equity market.

The period can be divided into the following stages:

- a commodity supercycle fuelled by China and concurrent banking crisis in the West
- the spread of the banking crisis globally
- the meltdown in global financial markets, post the collapse of Lehman Brothers
- a massive rebound rally from oversold levels, following the unprecedented global government intervention in the form of fiscal and monetary stimulus

Currently, equity markets are in what can be described as the start of the "reality bites" period, absorbing the cost of the unparalleled global fiscal and monetary stimulus. Looking ahead, global markets are likely to experience a choppy performance against a background of a tough economic environment for at least a couple of years.

Sectoral volatility & a dissection of the last 2 years in the equity market



Source: INET

The current global economic environment remains very uncertain. The global economy, while no longer on its deathbed, is in hospital on aggressive life support. The period of stable, uninterrupted growth before the global crisis was long and borrowing excesses were unprecedented. Unwinding high borrowing levels in the world will not be positive for the global economy. In addition, the impact of the unprecedented fiscal and monetary stimulus is difficult to assess in terms of what it has meant for current asset prices and current economic activity. There is also huge concern about global unemployment levels with, for example, US total employment currently back down to early 1980's levels, painting a subdued economic picture for the next few years.

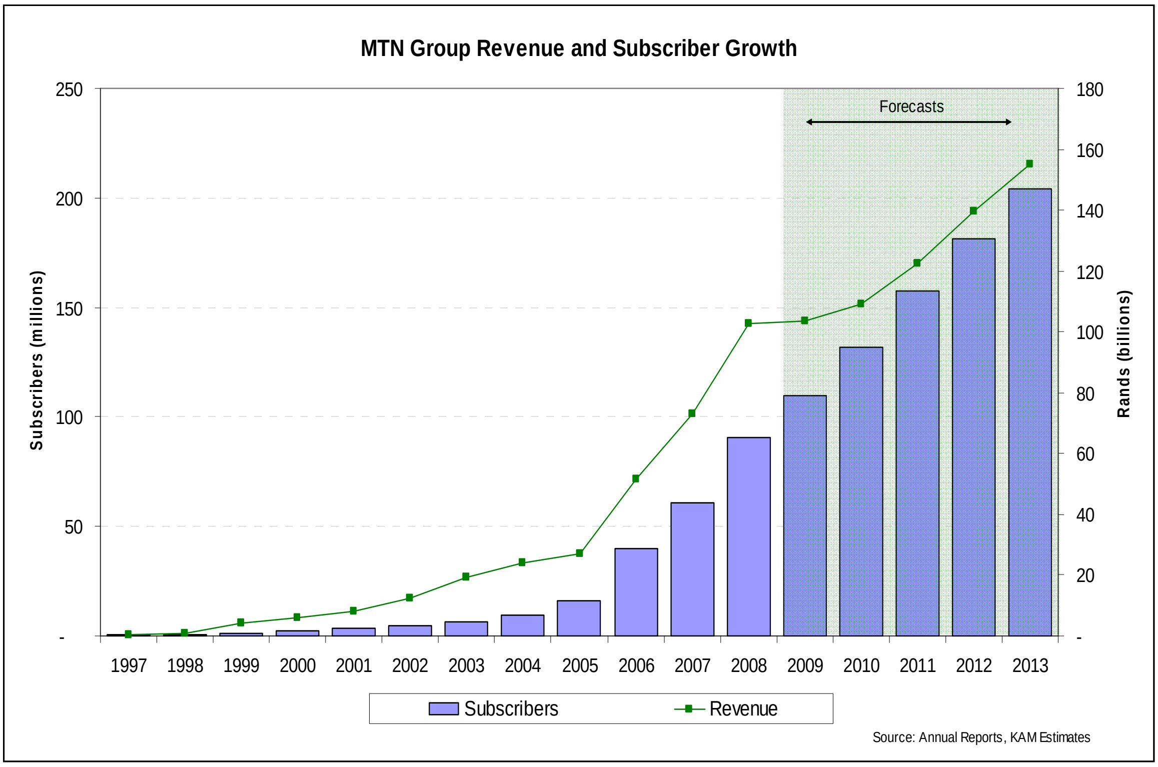
Looking at South African equity markets, despite extreme volatility in global equity markets, the local market performed strongly over the last year with the All Share index performing well in dollar terms (although it did less in rand terms). Over the last two years, the more conservative, defensive shares, such as SABMiller, Mediclinic, and Standard Bank were reasonably solid while some of the leveraged, "riskier" shares such as Old Mutual, Supergroup, Anglo American and Sappi showed huge volatility and underperformed the market.

Overall, the South African equity market valuation level continues to be reasonable "steamy" with earnings levels still high. Of the sectors, resources are relatively unattractive while financials better.

Strong growth in underlying market &/or market share

Strong revenue growth & possibly further margin expansion

Naspers
MTN
Cipla
Medpro
Discovery
Illovo
Tongaat



Source: Annual Reports, KAM Estimates

In this tough economic environment, the following types of companies offer opportunities, providing the investor is able to buy them at a reasonable level relative to the intrinsic value of their future cashflows:

- Companies that can produce at lower average cost than their competitors and whose higher margins can better withstand tough times. Examples of these types of businesses: lower cost oil producer Sasol, local sugar producers Illovo Sugar and Tongaat and low cost producers BHP Billiton and Mondi.
- Companies with strong brands and a dominant market positions which can pass on rising input costs, can reduce costs to maintain margins and will be less negatively impacted by competition. Examples are: Naspers, Kagiso Media, South African banks including Standard Bank, MTN. In addition, SABMiller, which is the dominant player in many of the countries it operates in.
- Companies with strong balance sheets that can withstand abnormal losses or downturns and that can take advantage of competitors in distress. Examples here include ArcelorMittal SA, the JSE, BHP Billiton, BCX, Sanlam, South African banks and South African construction companies. In particular, companies with very high debt should be avoided.
- Companies that, even in these tough times, are strongly growing their underlying market and/or are growing their market share. Examples include Naspers, which

is growing strongly in China, MTN, which is growing its subscriber base strongly in Africa and the Middle East and Illovo Sugar and Tongaat (both groups are growing strongly and are investing heavily in their African operations to grow).

- Companies with cashflows that are not dependent on cyclical demand, such as hospital groups Mediclinic and Netcare and pharmaceutical groups Adcock and Cipla Medpro as well as food retailer Shoprite and food producer Tiger Brands.
- Companies that have already spent their capital expenditure, are in "cash spewing mode" and are likely to pay strong dividends. Examples here include AECI, Mondi, Mediclinic, Netcare and Aspen.

In summary, the local equity market is no longer cheap, historic company earnings are still high and the rand is strong. Riskier assets have bounced back strongly and higher economic levels are unlikely to return soon. Opportunities still lie in "quality shares" however, going forward, there are likely to be few fireworks against the backdrop of the current tough trading environment.

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