UP

October 2018

Kagiso Asset Management Quarterly

www.kagisoam.com

Bright prospects for unbundled Quilter

Rahgib Davids - Investment Analyst

Quilter is a leading UK financial advice and wealth manager with a robust, integrated business model. Recently unbundled from Old Mutual, the dual-listed business has grown rapidly and taken market share in recent years, establishing itself as a top player in the highly attractive and fast-growing UK wealth market.

We discuss the boom in the UK retail wealth market and why Quilter's model is uniquely positioned to benefit from this supportive context.

Bright prospects for unbundled Quilter

Supportive market backdrop

Until recently, UK retirees had little choice when they retired but to accept the regular pension offered by their employer's fund or to invest in an annuity offered by a life insurer. However, the introduction of pension reform in 2015 has meant a complete overhaul of this system. For the first time, UK retirees are faced with choices and investment decisions to make upon retirement as it is no longer compulsory to annuatise their premium pot.

With a variety of new product options available, individuals are now responsible for using their pension savings to fund their retirement in a tax efficient manner, while ensuring that they do not outlive their capital. This can be a daunting task for the average retiree and many are turning to financial advisers to help with the complex task of product selection and tax structuring.

Like South Africa, the UK is one of the few countries in the world where pension auto-enrolment (mandatory salary contributions to an employee pension fund) is a common practice, meaning that most employees retire with some pension savings to invest. In addition, the UK's ageing population demographics mean a disproportionately high growth in individuals entering retirement, creating strong demand for financial advice and ongoing growth in the post-retirement savings market (chart below).

These structural growth dynamics, coupled with increasing tax-free investment allowances, should continue setting a supportive backdrop for UK wealth managers. Quilter has taken early steps to position itself to benefit from this ahead of its competitors.

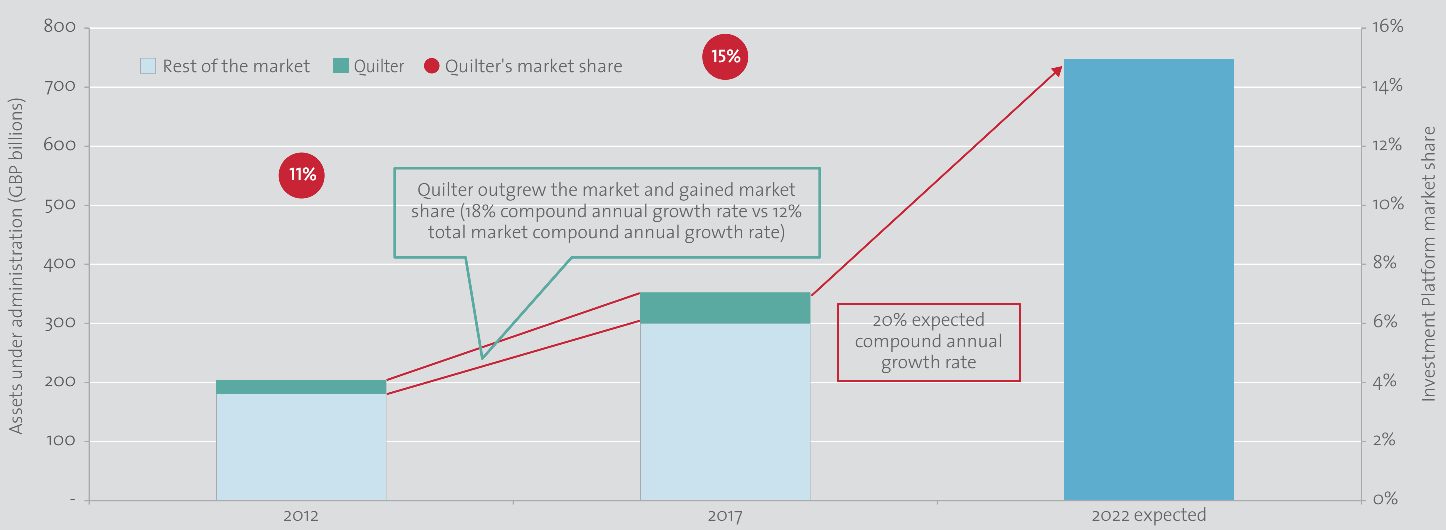
A story of transformation

Quilter was previously Old Mutual Wealth - the UK arm of Old Mutual Plc. - following Old Mutual's 2006 acquisition of European life insurer, Skandia. This acquisition included a UK business with a unique, open architecture investment platform, popular with advisers in the UK.

From 2012, Quilter recognised the compelling growth opportunity in the UK wealth market created by the incoming pension reform changes and embarked on a transformational restructure to focus the business on the opportunities for growth. Quilter disinvested from its European life insurance operations and made the Skandia Investment Platform the foundation of the transformed business.

An investment platform is a core tool in any adviser's business, enabling access to a wide suite of products and automating much of the paperwork, tax management and administration aspects of a client's assets. A platform enables the adviser to structure client investments in various legal 'wrappers'

Investment platform market growth offers significant opportunity



Source: Fundscape, company reports

according to individual needs - such as in Individual Savings Accounts (the UK tax-free account), unit trusts or self-invested personal pensions (similar to our voluntary retirement annuity vehicles).

The Quilter platform has won multiple awards for its design and offering and the excellent support service that accompanies it. Advisers receive rapid support and assistance with instructions and queries, enabling fast solutions for their clients. Quilter has successfully grown market share over the last five years and is now the second-largest investment platform in the UK (measured by assets under management).

Building distribution

In addition to pension reform, the regulatory environment for investment advice has undergone a large-scale overhaul, resulting in the 2013 implementation of the Retail Distribution Review (RDR) - a regulation designed to protect clients and ensure value for money.

The reform has moved advisers from a commission-based remuneration model to a fee-based model - making it more difficult for advisers to maintain their previous earnings level. This is accompanied by significantly increased regulatory scrutiny into the quality of advice given - creating onerous compliance, reporting and record keeping requirements for advisers and substantially increasing their operating costs. These costs have placed economic pressure on smaller independent advisory firms, creating opportunities for consolidation in the market. Quilter made a series of acquisitions of independent adviser networks, giving it the second-largest adviser force in the UK (chart below).

Adding to its offering

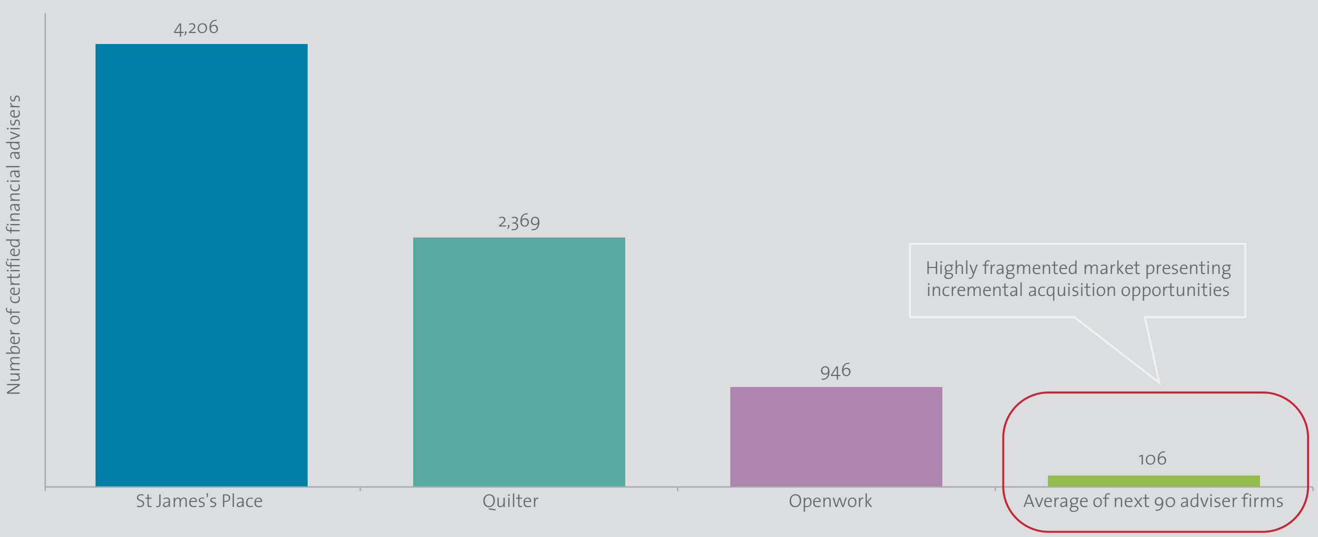
Quilter has also invested to expand and improve its service capabilities - including acquiring a high-net-worth discretionary private wealth business (Quilter Cheviot), adding new investment solution products. It has also invested heavily in the development of a new and improved investment platform system (set to go live in early 2019).

By its listing in June, Quilter had become a full service, vertically integrated business providing capabilities across the entire client wealth management journey - financial advice, investment platform asset administration and asset management.

Robust business model

Quilter boasts one of the few full service, open-architecture, vertically integrated wealth management business models of scale in the UK. It offers solutions to meet the full spectrum of

Increasingly consolidated UK advisory market



Source: Kagiso Aseet management research

Bright prospects for unbundled Quilter

a client's savings and investment needs - such as savings, retirement, offshore investing and discretionary wealth services (graphic below). The open-architecture model allows both Quilter-owned and independent advisers to access and use the Quilter platform and services.

Quilter receives three revenue streams: a percentage of any advice fee charged by its advisers, a platform fee if the adviser uses the Quilter platform to make an investment on the client's behalf, and an investment management fee should the client choose to invest in a Quilter investment product.

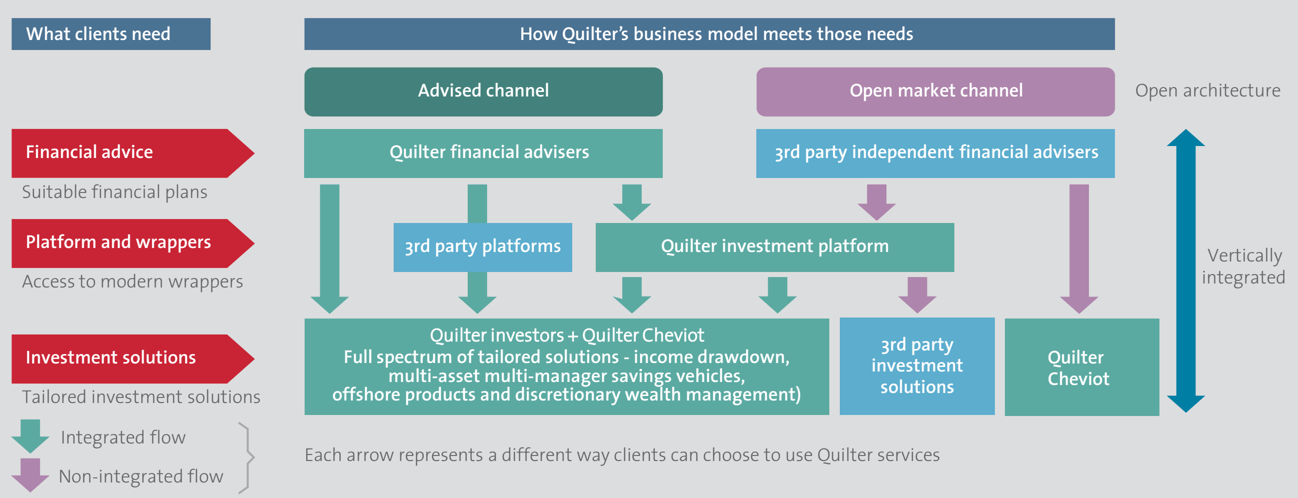
This remuneration model is favoured by advisers and the regulator for its flexibility and transparency. Quilter prides itself on the flexibility and choice provided to clients, who only pay for services they choose and have freedom to use third-party services if they want to. Pricing for services is clear and clients have full control over what they are paying for. For example, as shown in the graphic below, a client is able to use the Quilter investment platform and still invest in a third-party investment solution. With the industry regulator focused on enforcing better client value, Quilter compares favourably to competitors who often restrict clients to their own offerings, and get away with charging excessive bundled service charges.

The Quilter business has the ability to generate new client funds from multiple sources. The assets gathered are long term in nature (such as retirement products) with investment objectives focused on client outcomes rather than only investment performance. Supported by an adviser force, this allows the business to better retain assets in periods of market weakness when clients may be irrationally tempted to make large withdrawals. This makes for a sustainable asset base off which to grow and provides a predictable source of recurring cash revenues.

Outlook

As heightened levels of capital expenditure and the period of transformation comes to an end, Quilter has emerged as a well-positioned young business with exciting growth potential. The supportive savings industry backdrop and robust business model sets Quilter up well to deliver strong earnings growth. This makes for a compelling investment case, which we expect will deliver long-term value for our clients. UP

Quilter's business model



Source: company reports, Kagiso Asset Management research

Siemens: building a digital factory

Jihad Jhaveri - Head of Process

Siemens is a global industrial company founded in 1847 by inventor Werner von Siemens. Following early successes in telegraph, lighting and X-ray equipment, and automotive and train components, Siemens grew quickly into a sprawling conglomerate business.

In recent years, the company has sold businesses and simplified its structure. It is now reorganising its portfolio to unlock greater shareholder value obscured by its previously complex structure and scale.

Siemens: building a digital factory

A new structure

The company's eight previous divisions will be reorganised into three operating companies (Gas and Power, Smart Infrastructure and Digital Industries) and three, separately-listed companies, majority-owned and consolidated by Siemens (Siemens Healthineers, Siemens Gamesa and the still under plan Siemens Alstom).

In our view, Siemens Healthineers and Siemens Digital Industries are particularly high quality businesses with unique competitive advantages that offer investors exposure to favourable markets.

Siemens Healthineers

Siemens Healthineers is the second-largest medical equipment supplier globally. Profits are largely derived from the fast-growing medical imaging (radiology) market, where it has the dominant market share (31%) in a highly concentrated industry. Laboratory diagnostics make up the remaining profits.

Scans are the fastest growing medical procedure globally due to their significance in oncological and neurological treatments. The high quality soft tissue imaging contrast provided by CT and MRI scans are vital in detecting and monitoring clots and tumors. There is a particular shift towards MRI technology (where Siemens is especially dominant) for its superior imaging capabilities and safety advantages as it emits no radiation (table below).

The radiology equipment market is dominated by three large competitors (Healthineers, Philips and General Electric). This creates meaningful barriers to entry for new competitors as the existing players have a large base of installed equipment, long-term customer relationships and the scale to outspend smaller competitors on hardware and software development.

Healthineers has the largest existing installed base in hospitals (roughly 600 000 worldwide, double that of closest competitor Philips). This is the result of strategic decisions taken in the late 1990s and early 2000s to focus on growth through increased research and development spend, large acquisitions and cross-selling complementary software solutions. The market share has proven enduring over equipment replacement cycles, with equipment becoming embedded in hospitals' operations and integrated across their software systems.

As a result, 55% of Healthineers' income is from recurring revenue from equipment servicing, sale of chemical reagents and other consumables and services (including traditional after-sales services and healthcare facility workflow software).

Growth in demand for radiology is expected to continue, supported by global trends such as ageing populations, increasing lifestyle disease prevalence and increasing healthcare spend in developing markets. Healthineers' strongly entrenched

Siemens medical imaging technology

Modality	Ultrasound	X-ray	Computer Tomography (CT)	Magnetic Resonance Imaging (MRI)	Molecular Imaging (MI)
Description	Uses high frequency sound waves to view inside the body. Images captured in real time to show organ movement and blood flow.	An X-ray tube generates a flow of particles directed at the patient anatomy, producing a 2D bone and soft tissue contrast.	CT products use an X-ray detector mounted on a large disk rotating around the patient table, taking multiple cross sectional image "cuts".	Based on the interaction of water molecules in the body and radio frequencies. Produces superb soft tissue contrasts.	Measures the behaviour of energy emitting tracer material injected into the body. Application overlap with CT scans, but also subtle molecular imaging and predisease diagnostics.
Ionizing radiation	None	Some	Higher than X-ray	None	None
Siemens Healthineers revenue split	7%	15%	28%	37%	13%
Market position	5	1	1	1	2
Price range (euro)	15k - 300k	50k - 500k	150k - 2m	400k - 8m	250k - 2m

Source: https://www.health.harvard.edu/cancer/radiation-risk-from-medical-imaging, company reports, Redburn Research position creates a sustainable formula for superior returns and cash flow.

The business has also successfully participated in strong Chinese market growth over the last decade, with a large proportion of its equipment manufactured in China.

Siemens Digital Industries

Digital Industries offers a portfolio of integrated hardware, software and technology-based services to support manufacturing companies worldwide in automating and digitising their processes.

Siemens has been a global leader in automation technology since the 1950s when it used advances in transistor technology to develop and launch the Simatic (Siemens Automatic) system in 1958. The system connected sensors on factory machinery to a controller, measuring temperature, iterations and speed - allowing the controller to track the machine's activities and initiate successive steps. The system became the industry leader for industrial automation.

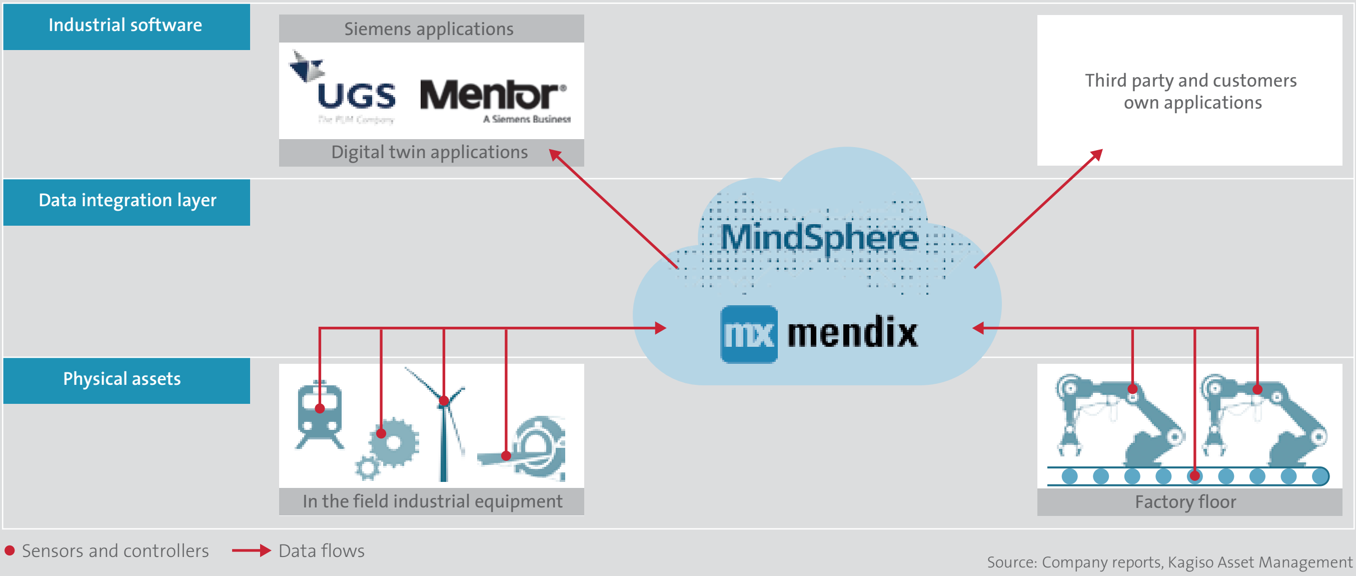
Rapid advances in computer processing power and data storage efficiency have revolutionised the field of industrial automation in recent years. Industrial digitalisation and the use of big data and the internet of things (the interconnection of everyday devices via the internet, enabling continuous data exchange) is now central to the field - integrating hardware with diverse industrial software and applications.

Siemens is still well placed in hardware, particularly in human-machine interfaces (high performance computers and software for managing machinery) and programmable logic controllers (integral to motion control systems in robotics). However, it is in industrial software (which is far less commoditised and offers superior returns) where Siemens, through organic development and material past acquisitions, has its strongest prospects.

Siemens Digital Industries' cloud-based internet of things operating system, MindSphere, connects to sensors on the "factory floor" during manufacturing as well as in "the field" during actual product operations (graphic below). MindSphere manages the sensors and receives, standardizes and stores the data generated so that it can be analysed and used by higher-level industrial software to identify weak points, improve performance, optimise processes and proactively schedule maintenance based on real-time analytics.

The MindSphere software is open architecture (sensor and machinery agnostic) and is becoming a widely accepted industrial operating system that enables efficient higher-level

Siemens Digital Industries



Source: Company reports, Kagiso Asset Management

Siemens: building a digital factory

industrial software development. This year, Siemens purchased the popular "low code" application development company, Mendix, for $700 million. Low code development makes it easier for less experienced developers to efficiently build applications. This acquisition will be integrated into MindSphere to allow Siemens customers (and third-party developers) to more easily develop and market customised industrial software to suit their businesses and clients.

Siemens has also made two large acquisitions of leading specialist industrial software providers. Although expensive based on historic profitability, both acquisitions have integrated well into the existing software businesses and have shown good growth.

In 2007, Siemens bought the leading product lifecycle management (PLM) software business, UGS, for $3.5 billion. This acquisition, combined with Siemens' own extensive data from its diverse manufacturing plants and product fleets, has put Siemens in a competitive position to offer simulation applications. Using data received through the MindSphere system, Siemens PLM software enables users to create a complete computer-based simulation, or 'digital twin', of their products at each of the following stages:

- Idealisation - product idea generation and design.
- Realisation - the manufacturing process.
- Utilisation - in-the-field usage, based on experienced conditions. This data is fed back to the idealisation stage.

Simulations can be used to design anything from an optimised manufacturing process to the complex wiring running through a Boeing - testing how components interact or how an element will respond to heat, pressure or any other stressor. This increases flexibility and quality of the entire production cycle and reduces time to market, while optimising product performance.

In 2017, Siemens purchased Mentor Graphics (for $4.5 billion), a leading electronic computer-aided-design software company specialising in electronics. The acquisition has enhanced Siemens' PLM software offering by allowing customers to better model the increasingly complex electronics within products (eg automotive simulations can robustly model the interactions between intricate wirings, circuit boards and on-board computers).

Recent financial performance from the Digital Industries division has been excellent (and better than the small group of comparable niche competitors), with high organic revenue growth and increasing margins. It has achieved particularly strong demand from the Chinese market where, although robotics has been strongly embraced, industrial software penetration remains low.

The rest of Siemens

The rest of Siemens comprises diverse industrial manufacturing businesses, all exposed to the global investment cycle. Business activities include: wind power, rail mobility and electrical power management. We expect good cost performance going forward as a result of the simplified structure.

Siemens has a structurally-challenged Power and Gas business that sells and services large-scale turbines for electricity production from coal and gas. Price deflation in the cost of wind and solar energy production and battery storage has led to a precipitous decline in demand for new large-scale turbine equipment. Massive production overcapacity at Siemens and competitors (in particular General Electric) has meant painful restructuring actions. The competition for the remaining profit pool has meant discounting of traditionally highly-lucrative after-sales services. While the outlook for this business is poor, its exposure is now relatively low.

Options to narrow the conglomerate discount

Siemens Digital Industries is strategically well placed to continue its strong growth as its software solutions enable industrial customers to operate more efficiently. Healthineers' entrenched position in imaging means continued strong after-sales revenue. Together, these two premium-rated businesses make up the bulk of our Siemens valuation.

The current corporate restructuring will provide greater options to narrow the large implied conglomerate discount on the remaining business, including further initial public listings and even outright unbundlings of individual businesses. For these reasons, we hold Siemens on behalf of our clients in our funds with global equity exposure and are excited about its long-term prospects. UP

Datatec is unlocking value by restructuring

Aslam Dalvi - Portfolio Manager

"Datatec was founded in 1986 as a South African networking equipment distributor. It listed on the JSE Securities Exchange in 1994 and, a few years later, began its expansion into international markets through a combination of organic investment and acquisitions."

Datatec is unlocking value by restructuring

Today the company is a global information and communication technology (ICT) solutions and services group operating in more than 50 countries across six continents. The group comprises three separate operating companies: global technology distributor Westcon International, global ICT services business Logicalis and Analysys Mason, a niche global consultancy.

Current restructuring activities at Datatec, brought about by the sale of its Westcon Americas business and a poorly executed back-office streamlining exercise, provide an attractive opportunity to buy its market-leading Logicalis business at a substantial discount to competitors.

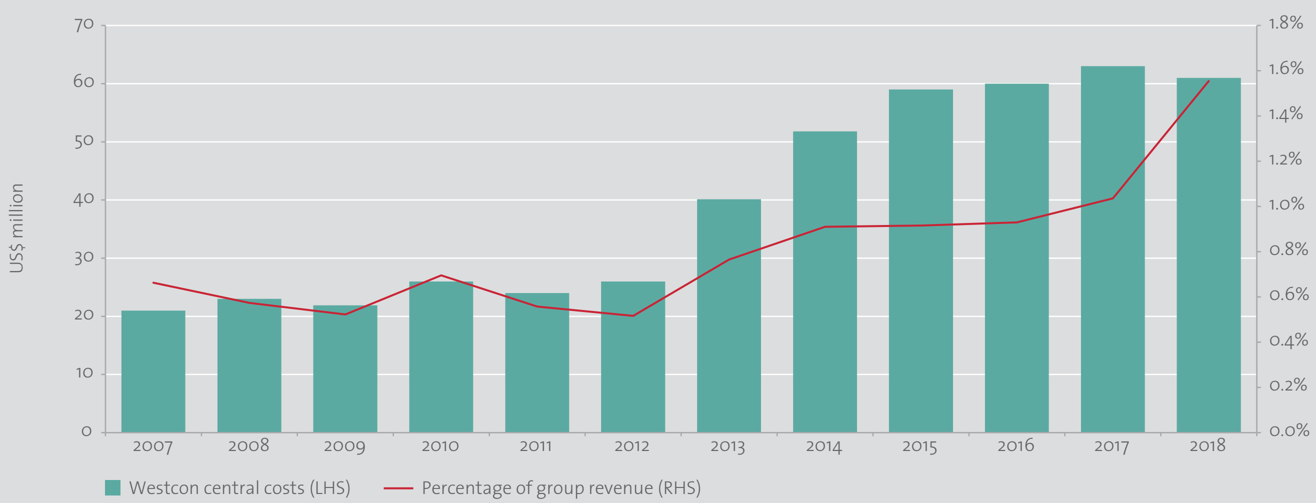
An attractive deal for Westcon

Westcon International distributes cyber security and network infrastructure. It follows a typical distribution business model with low margins, large working capital investment and relatively low returns on capital invested. Distribution forms a critical component of the business-to-business IT supply chain, supporting global companies in executing large-scale IT projects. Westcon, with over 180 global warehouses, staging facilities and training centres, stands out above competitors for its comprehensive end-to-end global logistics solutions.

Although historically a profitable business, Westcon's early acquisitive growth model resulted in a significant duplication of costs over time. In 2012, the group began to convert its existing enterprise resource planning system to a new SAP-based platform in an effort to streamline back-office functionality across global operations and reduce head office costs. The project was poorly executed and resulted in a material increase in costs and deterioration in quality of service to clients. Consequent market share losses were exacerbated from 2015, when a decision to outsource certain back-office functions further negatively impacted client and vendor relationships. After being relatively stable in the decade prior to 2012, overall head office costs doubled between 2012 and 2017 (see chart) resulting in Westcon delivering a poor performance over the last five years.

Late in 2017, as Westcon was nearing the end of the SAP implementation project, US-based hardware distributor Synnex offered to purchase half of Westcon (the US and Latin American operations) as well as a 10% stake in the remaining business, in a deal worth over $600 million. This was a very favourable deal for shareholders as it allowed Datatec to realise a premium valuation for part of Westcon while retaining the option of further significant value unlock as management addresses the remaining underperforming businesses.

The evolution of central costs at Westcon



Source: company reports

The sale agreement with Synnex required that Westcon continue to provide back-office support for the 12 months following the deal's conclusion, leaving the remaining Westcon business with an outsized cost base and temporary losses. The 12-month service agreement expired at the end of August 2018 and these costs will now be reduced. As part of its 2018 earnings release, Westcon's management team also announced their intention to bring the outsourced functions back in-house. With the SAP implementation complete and the failed outsourcing arrangement cancelled, we expect a swift return to profitability for the remaining Westcon businesses.

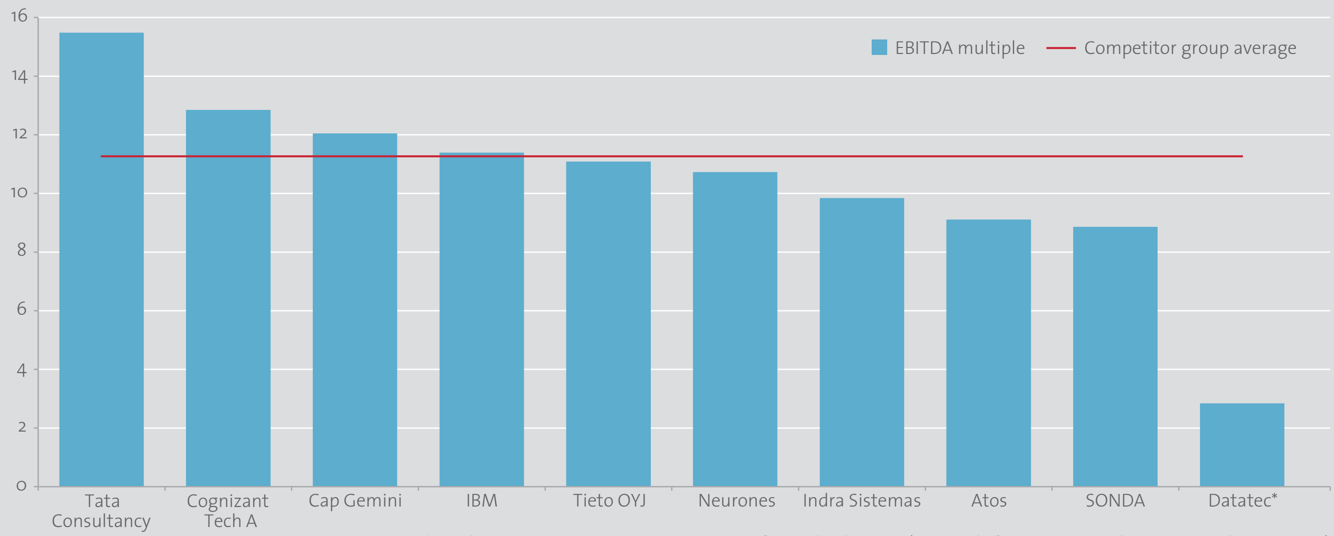
Logicalis - an attractive asset

Logicalis is a leading global IT solutions and managed services provider. Although the business offers some hardware distribution, it is primarily a services business providing end-to-end project management and other ICT-related professional solutions to customers. Its key services competitors are global leaders such as Accenture, Dimension Data, Cap Gemini and British Telecom.

The business was quick to identify the rapid shift in IT needs towards "flexible" IT services, such as collaborative communication, virtualisation, remote working, datacentre management and "on-demand" services. Recognising the opportunity, Logicalis re-focused its strategy in 2012 to build capability in specific niche areas designed to meet these needs. Today, the company has leading positions in most of its key geographies.

The business is exposed to attractive growth industries. Its recent investments have increasingly focused on building further capability in high growth areas such as cloud services, security and the internet of things market (the interconnection of everyday electronic devices via the internet, enabling data exchange and remote operation). As an example of this, Logicalis recently completed a smart cities project - the largest public lighting project in Latin America. The business was selected to manage the automation of 12 000 street lighting points in the city of Belo Horizonte in Brazil, extending to 30 500 within a year. The solution it developed is a first for the region and makes it possible to adjust light intensity, turn the lights on and off remotely, and draw on a series of indicators to maintain greater control over power consumption. The network infrastructure put in place also allows for new sensors to be added for services such as connected traffic lights and environmental management systems.

Earnings multiples for Logicalis competitor group



*Based on Kagiso Asset Management estimate of normalised EBITDA (earnings before interest, tax, depreciation and amortisation)

Source: Bloomberg, Kagiso Asset Management estimates

Datatec is unlocking value by restructuring

Logicalis wins several partner awards each year, marking the company as a clear leader in its field. It was recently certified as a Cisco Global Gold Partner, a highly coveted achievement that allows them to plan, build and manage complex Cisco networking solutions across the globe. There are only five other companies globally that are certified at this level.

The company is also unique in that, relative to global competitors, it has a large and dominant position in Latin America with an estimated market share in excess of 30%. While current economic issues and currency swings are of some concern, Latin America remains one of the fastest growing regions for ICT services. Per capita, ICT services are well behind peers and developed markets, highlighting the longer-term growth opportunity in the region.

Longer-term growth and returns for the business have been robust. Relative to Westcon and comparable industry competitors, Logicalis clearly stands out as a business delivering attractive returns.

The value opportunity

The recent corporate action and internal restructuring at Westcon has put pressure on Datatec's earnings and the group reported a loss last year. However, a closer understanding of the business and recent issues reveals a large and clear value opportunity for the patient and observant investor.

Datatec currently has a market capitalisation of R5.5 billion, which is a substantial discount to our fair value for the Logicalis business alone. At the current share price, investors are therefore buying the Logicalis business at a significant discount to its competitor group (chart previous page) and are paying nothing for the Westcon business, which we expect will return to profitability in the next 18 months.

In time, we expect the Westcon turnaround to reveal a substantially more valuable company than implied by the current share price and significant value to ultimately be unlocked via the sale of one or both of its remaining businesses. CEO and founder Jens Montanana has a material shareholding, ensuring management is closely aligned with shareholders from a value unlock perspective.

In the near term, while the turnaround takes shape, Datatec will undertake a highly accretive R1 billion share buy-back programme, equal to around 20% of the company's current market capitalisation, which was approved at the end of July. Having paid a very large special dividend in early 2018, the buy-back will be funded by cash holdings that remain after the Westcon sale. UP

Diamonds are still forever

Mandi Dungwa - Portfolio Manager

"The market for diamonds is one of the few natural resource markets driven, almost entirely, by sentiment - a sentiment largely established only 70 years ago.

Today, shifting consumer tastes and trends, falling marriage rates in developed countries and the emergence of laboratory-grown genuine diamonds are all changing the dynamics of the market. We consider the history, recent trends and possible outlook for the market."

Diamonds are still forever

How the diamond got its shine

More than 70% of brides in the United States wear a diamond ring. This was not the case as recently as 1938, when De Beers' management wrote to N.W. Ayer, a US advertising agency, to suggest the use of marketing to boost diamonds sales. At the time, the jewels were seen as a luxury item for royalty and the elite. Their general popularity had been on a downtrend as a result of the Great Depression.

Inspired by the success of the Uncle Sam war propaganda campaign, De Beers set an ambitious target to convince every man pledging marriage to acquire a diamond engagement ring for his bride. In 1947, the slogan "A diamond is forever" was coined. It was named the slogan of the century.

Shifting demand dynamics

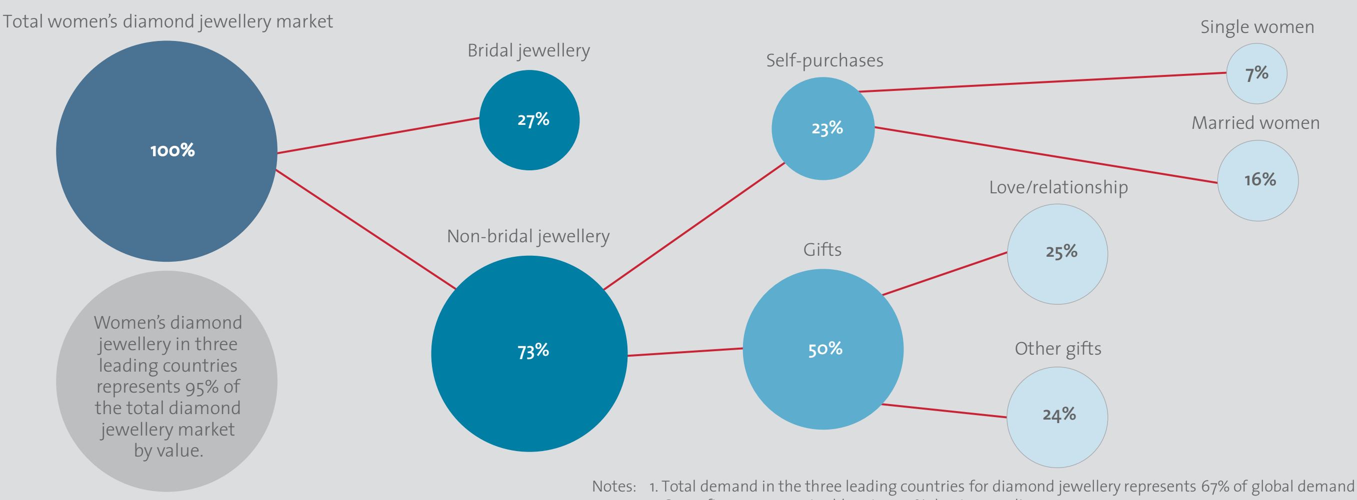
In contrast to precious metals, which have multiple sources of demand besides use in jewellery, the diamond industry derives 99% of its value from jewellery demand. The remaining 1% is from industrial applications including cutting, drilling, grinding and engraving.

The De Beers engagement campaign transformed the diamond market, but today the bridal category is only a moderate portion (27%) of the total diamond jewellery market. Falling global marriage rates mean that, for developed markets at least, future demand growth is likely to come from the non-bridal jewellery market (graphic below). Western marriage rates have fallen, with US rates falling by 30% from 1990 to 2016. Millennials (born between 1981 and 2000) are marrying later than their parents: the average age of a first marriage for women in the US rose from 20 in 1960 to 27 in 2015.

While the non-bridal diamond jewellery market is not reliant on marriage rates for growth, it does compete with the rest of the luxury goods market for a share of consumers' sought-after discretionary spend. Like the bridal market in the 1940s, growth in this market will depend on how much diamond producers are willing to spend on marketing diamond jewellery. Major luxury retailers invest an average of 10% of revenue on marketing programmes. By contrast, marketing budgets for diamond producers decreased from 5% of revenue during the early 2000s, to less than 1% of total revenue in 2017.

The industry aims to reverse this trend - a need reinforced by evidence of changing modern preferences, away from traditional luxury goods in favour of experiential luxury. In 2017, high-end food and wine, and premium cruises, were the fastest growing luxury categories, outpacing the traditional luxury market including diamond jewellery. In 2015, the world's major diamond producers formed the Diamond Producers Association (DPA) to foster and grow consumer demand. The DPA has

The women's diamond jewellery market



Notes: 1. Total demand in the three leading countries for diamond jewellery represents 67% of global demand
2. Some figures may not add up to 100% due to rounding
3. Data from the three leading consumer countries: US, China and Japan 2014-2016

Source: De Beers-commissioned diamond acquisition studies in US, China and Japan 2014-2016 launched the "Real is Rare" advertising campaign, aimed at inspiring millennials to appreciate the value and rarity of natural diamonds.

Despite this shift in Western consumer behaviour, significant emerging market demand growth has meant the $82 billion diamond jewellery industry has grown steadily at a compound rate of 3% per annum. Unusually for a natural resource, diamond demand is still dominated by the US market, which accounts for 48% of global demand (graphic below). China makes up only 16% of diamond demand, but is the fastest-growing diamond jewellery market with a 12% 10-year compound growth rate since 2006. Nearly half of brides in China now wear diamond jewellery - up from almost 0% in 1990 - showcasing the incredible growth in the market, with room for strong additional growth in the bridal and non-bridal categories.

Emerging market growth (including India, currently at 6% of global diamond demand) should offset the impact of stagnant US demand levels.

Rarity and supply

Diamonds were formed over three billion years ago, under conditions of intense heat and pressure, as the earth took shape. They were formed at depths of 125 to 400 kilometres below the earth's surface, and, as far as is known, the conditions for their creation have not reoccurred since this early formation of the planet, giving natural diamonds their rarity.

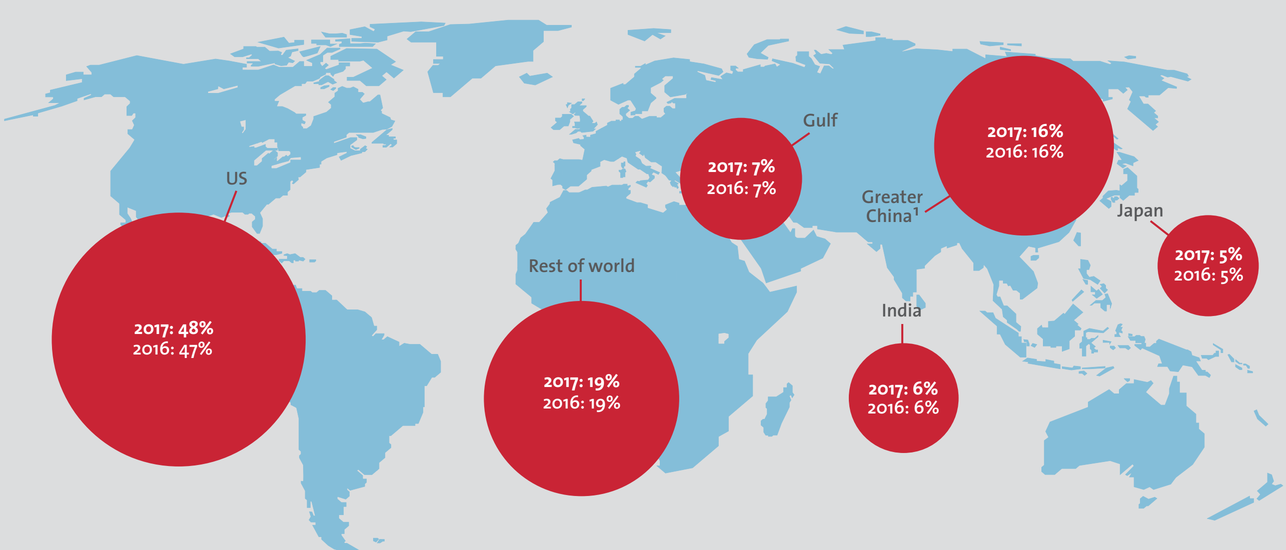
Until the 18th century, India was thought to be the only source for diamonds. When the Indian supply was depleted, the search for alternative sources began. In 1866, the Eureka diamond was discovered in South Africa on the banks of the Orange River, leading to the Kimberley Diamond Rush. Today, the largest diamond-producing countries are Botswana, Russia, Canada, Australia and South Africa (left pie chart over page).

As diamonds are neither consumed nor worn-out, there is a large potential recycling market. Currently an estimated 10% of global supply is derived from recycled diamonds.

Laboratory-grown diamonds

One threat to diamonds' rarity value is the entry of laboratory-grown diamonds. These are chemically identical to those formed through geological processes (made of pure, crystallised carbon) but formed in a laboratory using extreme temperature and pressure. They are impossible to differentiate from mined diamonds and often have superior properties. Currently, laboratory-grown diamonds make up a relatively insignificant portion of the market. However, supply is growing rapidly, and could become a material threat to diamond miners if consumers see little reason to differentiate between the two.

Global polished diamond demand share by geography



[1] Greater China includes Mainland China, Hong Kong and Macau
Source: De Beers-commissioned studies and retailers' publicly available information

Diamonds are still forever

As with mined diamonds, laboratory-grown producers have priced their product at a premium ($4000 to $6000 a carat). Producers are now required to certify their diamonds as 'lab-grown' - a requirement which they have used to their advantage to market the benefits of their offering: more environmentally friendly and ethically superior as there is no question over the origins or political consequences of their trade.

Despite the Kimberley Process Certification, introduced to track the origin of mined diamonds to curtail the sale of 'blood diamonds' from conflict regions, corruption in the system means that the certification is not fully trusted. Laboratory-grown diamonds remove ethical or environmental concern, which their producers have argued should come at a premium, maintaining the luxury status of their product.

Earlier this year, De Beers - still the largest mined diamond producer in the world (see right pie below) - announced that it would begin selling lab-grown diamonds through a newly-created subsidiary called Lightbox. This development is likely a strategic move intended to protect the existing mined diamond business rather than grow the lab-grown market.

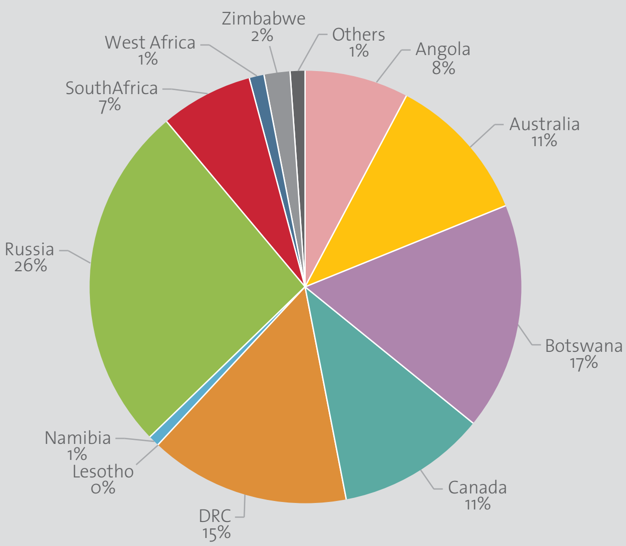
Lightbox has priced its diamonds to significantly undercut other lab-grown diamond producers, at well below $1000 per carat. This is below the level of profitability for competitors and is an important psychological level for consumers. It puts lab-grown diamonds in the same price category as diamond simulants and takes them out of the high-end luxury range, reinforcing the idea that only mined diamonds are rare and worth paying up for. This is a bold move from De Beers. However, given its strength in marketing, it could push many lab-grown producers out of business and undermine the potential threat they pose to the mined diamonds industry.

Outlook

Diamonds have been the quintessential symbols of romance and commitment in the developed world for most of the 20th century. As consumer preferences (and inclination towards marriage) change, the ongoing profitability of producing these jewels will once again depend on successful marketing campaigns to re-establish sentiment and reinforce the perception that diamonds are a superior choice over other luxury goods or commemorative items.

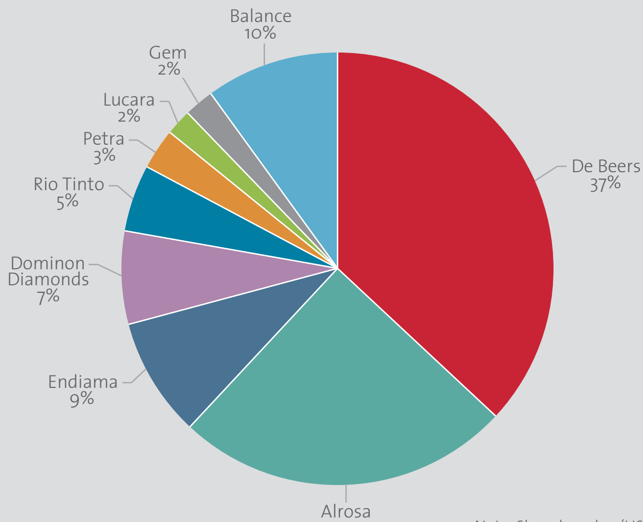
Strong growth in the Chinese and Indian markets is likely to continue to offset low growth in developed markets as marriage rates decline. With a renewed focus on marketing to the non-bridal category around the world, we expect sustained growth in the diamond market. UP

2016 production by country - volume



Source: De Beers

2016 rough diamond market share by company



Note: Share by value (US$)
Source: De Beers

Kagiso Asset Management Funds

Performance to 30 September 2018	1 year	3 years[1]	5 years[1]	10 years[1]	Since launch[1]	Launch	TER[2]	TC[3]
Unit trust funds[4]								
Equity Alpha Fund	-0.1%	7.8%	5.5%	11.1%	16.4%	Apr-04	1.93%	0.47%
SA Equity General funds mean	1.0%	3.8%	5.5%	9.7%	13.1%			
Outperformance	-1.1%	4.0%	0.0%	1.4%	3.2%			
Balanced Fund	2.2%	8.7%	6.6%	-	8.9%	May-11	1.53%	0.51%
SA Multi Asset High Equity funds mean	3.2%	5.3%	6.7%		8.9%			
Outperformance	-1.0%	3.4%	-0.1%		0.0%			
Protector Fund	3.7%	7.9%	6.7%	7.2%	9.8%	Dec-02	1.59%	0.37%
CPI + 5%[5]	9.4%	10.2%	10.2%	10.2%	10.6%			
Outperformance	-5.7%	-2.3%	-3.5%	-3.0%	-0.8%			
Stable Fund	6.7%	8.8%	7.5%	-	8.2%	May-11	1.53%	0.51%
Return on large deposits*	7.1%	6.5%	6.1%		5.8%			
Outperformance	-0.4%	2.3%	1.4%		2.4%			
Institutional funds[5]								
Managed Equity Fund (SWIX)	-1.5%	6.2%	4.3%	10.9%	10.9%	Sep-06		
FTSE/JSE SWIX All Share Index	0.8%	5.6%	8.0%	12.5%	11.8%			
Outperformance	-2.3%	0.6%	-3.7%	-1.6%	-0.9%			
Managed Equity Fund (Capped SWIX)	-1.9%	-	-	-	4.0%	Jan-17		
FTSE/JSE Capped SWIX Index	0.4%				4.4%			
Outperformance	-2.3%				-0.4%			
Domestic Balanced Fund	1.5%	8.1%	5.2%	9.6%	8.1%	May-07		
Peer median[6]	3.0%	6.6%	7.3%	11.3%	9.4%			
Outperformance	-1.5%	1.5%	-2.1%	-1.7%	-1.3%			
Global Balanced Fund	4.0%	9.9%	7.8%	-	9.3%	Jul-13		
Peer median[7]	5.4%	7.4%	8.7%		9.9%			
Outperformance	-1.4%	2.5%	-0.9%		-0.6%			
Bond Fund	9.0%	8.8%	-	-	8.1%	Aug-15		
BESA All Bond Index	7.1%	7.7%			9.4%			
Outperformance	1.8%	1.1%			-1.3%			
Money Market Fund	8.4%	8.5%	7.7%	7.4%	7.8%	Jan-04		
Alexander Forbes STeFI Composite Index	7.3%	7.3%	6.8%	6.8%	7.4%			
Outperformance	1.2%	1.2%	0.9%	0.6%	0.5%			
Sharia unit trust funds[4]								
Islamic Equity Fund	7.0%	12.1%	7.3%	-	11.7%	Jul-09	1.47%	0.26%
SA Equity General funds mean	1.0%	3.8%	5.5%		11.2%			
Outperformance	6.0%	8.3%	1.8%		0.5%			
Islamic Balanced Fund	5.6%	9.1%	6.5%	-	7.3%	May-11	1.49%	0.17%
SA Multi Asset High Equity funds mean	3.2%	5.3%	6.8%		8.9%			
Outperformance	2.4%	3.8%	-0.3%		-1.6%			

Highest and lowest monthly fund performance	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest
Equity Alpha Fund	6.6%	-6.0%	8.2%	-6.0%	8.2%	-6.0%	10.9%	-9.0%	11.9%	-9.0%
Balanced Fund	4.8%	-3.0%	5.5%	-3.5%	5.5%	-4.2%	-	-	6.2%	-4.2%
Protector Fund	2.5%	-2.3%	3.4%	-3.0%	3.4%	-4.2%	7.8%	-5.3%	9.5%	-5.3%
Stable Fund	2.4%	-0.9%	3.8%	-2.8%	3.8%	-3.5%	-	-	4.0%	-3.5%
Islamic Equity Fund	5.3%	-2.4%	7.3%	-4.0%	7.3%	-4.6%	-	-	8.1%	-4.9%
Islamic Balanced Fund	4.0%	-2.0%	4.6%	-3.0%	4.6%	-3.0%	-	-	8.2%	-5.4%

[1] Annualised (ie the average annual return over the given time period); [2] TER (total expense ratio) = % of average NAV of portfolio incurred as charges, levies and fees in the management of the portfolio for the rolling three-year period to 30 September 2018; [3] Transaction costs (TC) are unavoidable costs incurred in administering the financial products offered by Kagiso Collective Investments and impact financial product returns. It should not be considered in isolation as returns may be impacted by many other factors over time including market returns, the type of financial product, the investment decisions of the investment manager and the TER. This is also calculated on the rolling three-year period to 30 September 2018; [4] Source: Morningstar; net of all costs incurred within the fund and measured using NAV prices with income distributions reinvested; [5] CPI for September is an estimate; [6] Source: Kagiso Asset Management; gross of management fees; [7] Domestic Balanced Fund benchmark returns are an estimate for September; [8] Median return of Alexander Forbes SA Manager Watch: BIV Survey; [9] Global Balanced Fund benchmark returns are an estimate for September; [10] Median return of Alexander Forbes Global Large Manager Watch. * Total return of CPI+2% pa from 1 January 2018 (previously: Return on deposits of R5 million plus 2% (on an after-tax basis at an assumed 25% tax rate)). # CPI + 4% from 1 May 2018 (previously: Risk adjusted returns of an appropriate SA large cap index). Disclaimer follows overleaf.

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