NORTHSTAR

ASSET MANAGEMENT

Client Letter 20 July 2010

Quarter End: 30th June 2010

Dear Investor

The second quarter of 2010 saw world markets embark down a slippery slope after the positive performances of the first quarter. The domestic stockmarket was no different, as all three months of the quarter showed negative returns and the local market ended the period down 8.66% lower than it started it.

We had been circumspect of the optimism which the market had baked into share prices in the run up to the second quarter and this ensured that the losses experienced by our clients were less than half those delivered by the market.

Interestingly, in the three months since our March 2010 Market Report, in which we explained our reluctance to participate in the fashionable and crowded 'China trade', that country's stockmarket has lost 25% of its value.

Clients will note that we have little changed their portfolios as we see a possible continuation of the decline in company real earnings, which have fallen by a quarter in the past year. In our opinion, these factors are not yet fully priced into the valuations of many companies' share price. Our clients' portfolios remain defensively positioned and will remain so until we have a high degree of certainty that taking on risk will be well rewarded.

The shares of those companies most dependent on the economic cycle bore the brunt of the sell-off in the 2008 crash. They have also made most of the recovery. The share price of many of these cyclical companies is expensive both in absolute terms, when we assess their valuation through the lens of realistic prospects for future earnings; and in relative terms, when we compare their valuations with those of non-cyclical companies.

We find greatest value in non-cyclical, large international companies with low gearing and high free cash flows. Naturally, it is in these companies that we have the highest degree of certainty in their future earnings and the integrity of their dividends. Additionally, by our measure, the line of least resistance on the Rand would be biased towards a weakening of the currency. While the timing of these events is not something we seek to do, we have identified, and included in our clients' portfolios, companies which would meaningfully benefit, were this to occur.

While, at current levels, the overall stockmarket does not offer compelling value, we believe it to be interestingly poised; there is an increasing divergence of valuations which will result in meaningful price gains and declines. Less dependent on the tide of rising or falling markets to provide opportunities to profit, the current market is a stock-pickers one. Considering that this is where we have historically done our best work, we enthusiastically look forward to the unfurling of events.

It remains our great honour to be entrusted with the responsibility of managing our clients' capital and we know of no better way to show our gratitude than by providing superior service in protecting and growing our clients' wealth.

Yours sincerely

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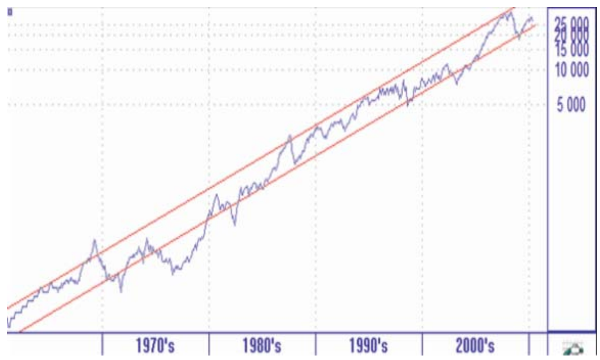
We know two indisputable facts. The first is that, over the long term, share market returns beat the returns generated by all other asset classes and secondly, that unlike bonds or money market deposits, share market returns are unpredictable and lumpy by nature.

JSE ALSI Index 1961 to 2010 - log chart



Source: Northstar Asset Management

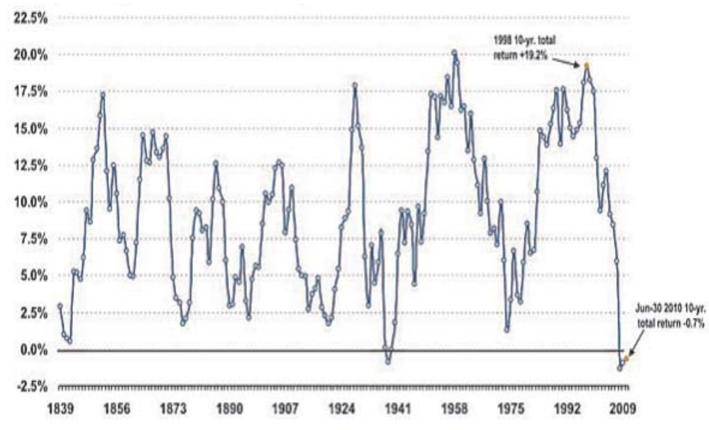
We accept the latter as the price we gladly pay to enjoy the former. Over the past 50 years the Johannesburg Securities Exchange (JSE) All Share Index (ALSI) has generated a compounded annualised nominal return of 16.8%pa.

As is evident from the chart above, this 16.8%pa average gain has come in fits and starts. Even the 1987 stockmarket crash, in which the Index plunged more than 40%, seems insignificant relative to the returns which long term investors have enjoyed.

Despite having returned a gain of 14.9%pa compounded over the past 5 years, the -4.4%pa loss produced by the JSE ALSI in the past 2 years has already tested the patience of less disciplined investors.

However, as reflected in the very long term (from 1830!) chart (below) showing the rolling 10 year compounded returns generated on the US Stock Market composite index, periods of very poor returns are followed by periods of above average returns; and vice versa. This is described by one of the most powerful forces in investing; mean regression.

US S&P Composite Index - Rolling 10 year Compounded Annual Total Return
(Including reinvested dividends - 1830 to June 2010)



Source: Franklin Templeton Research

In 1998, in a substantially overpriced market, investors in the US S&P 500 Index had enjoyed a significantly above average rolling return over the prior ten years of 19.2%pa compounded. By 2008 those same investors would have experienced the worst 10 year rolling return since 1839; -0.7%pa compounded.

This illustrates one of our central tenants of investing; more than anything, future returns are dictated by starting valuations. This explains why we at Northstar prefer to be contrarian investors. In avoiding shares that are fashionable, and fully priced, we find far greater comfort in investing in high quality companies which are temporarily out of favour and which can be bought at a reassuring discount to their intrinsic value.

Currently the market seems to be favouring the shares of companies which are geared to the economic cycle. These so-called 'cyclical' companies include base commodity miners and credit retailers. Both of which have all-but-no representation in our clients' portfolios. By our measure, their share price valuations currently reflect very optimistic future earnings expectations. Should these not materialise, these companies have the potential to meaningfully disappoint investors.

We thought that it may be informative to present our investment thesis for a recent acquisition and one of our clients' larger holdings.

Sasol is an unusual commodity company. The company is currently unloved by the market which is all the more reason why it loomed large on our research horizon and, subsequently, in our clients' portfolios. From being the darling of the market, its share price more than halved in 2008; at which time Northstar's clients held zero shares in Sasol.

Since the lows of the crash in November 2008, Sasol's share price has gained just 15% as compared with the 63% increase in the JSE resource sector. That Sasol's current valuation is not as rich as average resource companies listed on the JSE is only partly attributable to Sasol not being a 'China play' which is currently the investing vogue; all the more so, in its sector.

The bulk of Sasol's profits are derived from their South African oil-from-coal operations which supplies one-third of domestic fuel requirements. Almost all of its costs are Rand based and almost all of its revenues are determined in US Dollars based on global oil and related product prices. Ironically, the company's earnings are far more sensitive to the Rand / Dollar exchange rate than they are to fluctuations in the US Dollar oil price.

In comparison to other resource companies Sasol is far more vertically integrated, from mining, beautification and, more recently, retail distribution. This allows for greater control of its cost base. Unlike its peers which sell their oil at a discount to prevailing spot prices, Sasol is paid a premium. These factors ensure that Sasol enjoys a wider profit margin on every barrel sold than do its peers.

With the low-hanging fruit in global oil exploration having been picked, and growing resistance to ultra-deep water drilling following the recent BP disaster in the Gulf of Mexico, oil producers are under pressure to replenish reserves. At current rates of extraction, Sasol's proven reserves are 300% larger than those of the average global oil majors.

The company has not been without its challenges. The 'double whammy' of a strengthening Rand combined with a declining US Dollar oil price resulted in Rand oil prices falling by over half. Profit margins in core activities were further compressed from their historic 28% by significant hikes in areas such as wages and electricity which resulted in above-inflation input-cost increases.

Competition and corporate governance issues as well as significantly increased capital expenditure programs added to Sasol's burden. None of these headwinds is insurmountable and, once normalised, will result in an upward mean regression in margins and an improvement in the company's free cash flow.

While capital intensive expansion programs eat into short-term cash flows, they make Sasol one of the few large resource companies in SA which will be able to ramp up, and potentially double, production in the next decade.

Unlike other resource companies, Sasol is not experiencing abnormal 'super-profits' which may normalise downwards. Prevailing oil prices are not abnormally above production costs, and global marginal additional supply capacity is well managed.

We calculate that, on a normalised basis, Sasol's 2011 annual earnings per share should be double the R14 per share earned in the 2010 year of account. This places the company's share price on an earnings multiple of 10 times. We take further comfort that this equates to a discount to the multiples of both the JSE resources sector and the market as a whole.

Additionally, we have little doubt that the quality and transparency of Sasol's future earnings, and the integrity of its dividends, are at a premium to those of the other large resource companies listed on the JSE and we are pleased to have secured these for our clients at a discounted price valuation.