

Amala

Emerging Asia Fund

Information Sheet

4th Quarter 2017

<p>FUND INFORMATION</p> <hr/> <p>FUND OBJECTIVE To achieve long-term capital growth by investing in equity and equity-related securities of emerging companies in Asia whose businesses are geared towards domestic demand.</p> <p>LAUNCH DATE 7th July 2015</p> <p>FUND SET-UP Cayman Islands Regulated Fund</p> <p>INVESTMENT MANAGER Amala Capital Management Ltd, Cayman Island</p> <p>INVESTMENT SUB-MANAGER Nivalis Partners Limited, Hong Kong</p> <p>ADMINISTRATOR DBS Bank, Hong Kong</p> <p>CUSTODIAN DBS Bank, Hong Kong</p> <p>SUBSCRIPTIONS / REDEMPTIONS Monthly : Minimum initial investment USD 100,000 Subsequent investment USD 50,000 Notice : Subscription: 5 days Redemption: 30 days</p> <p>MANAGEMENT FEE 1.50%</p> <p>PERFORMANCE FEE 10% with a high watermark</p> <p>FUND ELIGIBILITY Professional Investors</p>	<p>Quarterly Commentary</p> <p>Dear Investors,</p> <p>Happy New Year. The fund had a good fourth quarter 2017 with a gain of 8.4%. December was particularly good with gains of 4.6% while October and November with gains of 2.6% and 1% respectively neatly rounded off the quarter. The fund made a total net return of 19.7% for the calendar year 2017. While this is a very decent return we could have done better.</p> <p>Our Indian investments have done particularly well and gained further during this quarter. Overall our holdings in India and Malaysia have gained slightly upwards of 50% during the year. In Philippines, of the two businesses we own one gained 31% (80% in our two plus years of ownership) while the other is up marginally but we owned it only for a few quarters. The clear disappointment so far has been our investments in Indonesia and Hong Kong. While single stocks are making money aggregated together the contribution from these two countries to overall performance is currently negligible. These businesses are tracking well fundamentally and we remain invested in these names.</p> <p>We bought our first stock in Singapore and will write about its business in a subsequent investor letter. We also made our first complete exit from an Indian auto part stock which made us very good gains but had gotten way ahead of solid fundamental justification.</p> <p>Reflections on our portfolio performance</p> <p>Our fund has now completed 2.5 years of operations and we thought it is time to reflect on our core investment process. We like to own high quality businesses run by people of high integrity and capability at reasonable prices.</p> <p>The fund started investing in July 2015 with the external backdrop of continuing low interest rates globally, elevated asset and equity prices. India which is one of focus countries had delivered very robust stock market returns (35-60% across indices) on the back of a very decisive election mandate in 2014. As bottom up investors we started investing rather slowly seeking down side protection faced with elevated valuations. Our efforts over time have resulted in a portfolio with India (53%) and Indonesia (25%) accounting for bulk of the investments. The first 18 months to December 2016 were a struggle for Asian markets which were down 12-14%. We managed to remain around par value through a combination of positive performance in individual securities and a high level of cash.</p>
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In the year 2017 considering our performance particularly in India one could argue that we should have had a higher allocation to that country. Our geographic allocation is purely an outcome of bottom up selection of attractive individual securities. In addition, our judgement has been weighed by higher absolute and relative valuations in India and the economic impact of demonetization. Thus, on balance we are quite satisfied with the performance of our Indian holdings. Our challenge has been the lack of performance in our holdings in Indonesia and Hong Kong.

Our portfolio companies typically feature in three distinct buckets. One is companies with a long-demonstrated quality track record at near full valuations where investment return expectations are premised on continued business growth and profitability. Here we use our long-term capital and business understanding to compound capital at reasonable rates. Another bucket is quality businesses which have a shorter operating history, are possibly smaller in size and are thus under researched and less aggressively valued. Such businesses need both an ability to assume relative illiquidity and time to deliver financial returns. With our capital we are well placed to take advantage of such opportunities. The last bucket is quality businesses that are currently challenged or are going through some business transition. This to our mind is the most difficult investment bucket but if done well can be very rewarding.

In this note we reflect on two holdings from the businesses that are going through some business transition as the key investment rationale, how the thesis has played out thus far and the reasons to continue owning them.

In our 3 Q 2015 investor letter we wrote about a houseware and home improvement retailer that we owned in Hong Kong. It's a dominant player with an estimated 65% market share and a large store network. The company has over the last 20 years consolidated the market, gaining share from mom & pop stores and having bought out a few competing store networks. The houseware retail business has been resilient to economic shocks having grown even during the global financial crisis in 2008-09. The company has grown revenues in 10-12% range over a fairly long period while achieving ROIC exceeding 30%.

In 2010-11 the company, with a view to drive growth, extended its highly successful retail model to Singapore and parts of Malaysia and mainland China. It faced significant challenges in each of these markets. Overall it meant that growth and profitability expectations were not being achieved. Management is aware of the matter, understands the challenges and is working to solve the problems. We have bought into this company for its solid operations in Hong Kong with a decent level of growth and high profitability. Our expectation is that the company would be able to turnaround its Singapore operations over the next 12-18 months. In the meantime, we earn about 6-7% dividend yield and the company has 40% of its enterprise value in cash on the balance sheet. Key risks in this name are a potentially weaker economic environment in Hong Kong and an expensive failed effort to turnaround its Singapore operations.

In its journey towards improved growth and profitability the company over the last 2.5 years has reported the following. Same store growth in its core Hong Kong market is now 3-4% vs 6-8% earlier. Rents have remained elevated and continued to rise marginally proving to be stickier versus our expectation considering the backdrop of a weak retail environment. The company improved its gross margins by 0.7% to 48.8%. But its operating margin declined by 5% to hit a low of 3.6% in FY 16 and has since recovered to 4.6%. Continuing rent and employee cost increases contributed to this sharp decline. The company has shut down its retail operations in Malaysia and Mainland China. It is now focusing only on Singapore as its next core market. Here too it has shut down 14 unviable shops bringing down current operating base to 51.

Why do we still own this name? We continue to believe this is a high-quality business with barriers to entry which in turn results in good capital productivity. However, growth here is slow and the market seems to be well penetrated. Its attempt to allocate capital to fund operations in newer geographies has not produced expected results. We like the fact that the management recognized this quickly and took corrective action by shutting operations in those countries. In the recent half-year results Singapore operations did report a 10% revenue growth. Cash generation through this period has been solid resulting in cash on balance sheet being nearly 40% of its current enterprise value. The company has maintained dividend effectively raising the payout in the face of declining earnings. Our investment payoff will materialize when growth and margins move up. Until such time we remain owners of this name.

In 4Q 2015 we wrote about owning a leading *ceramic tiles company in Indonesia which has a strong presence in the low to mid end of the market. Over the last five years to 2014 the company grew its revenues at nearly 20%. Profits grew faster and its achieved business profitability in terms of returns on capital of 20% plus during this period. On the back of continuing growth, the company and a few other players expanded manufacturing capacity. However, growth slowed down quite sharply in 2015 and most players resorted to aggressive product discounting. As a result, the industry and company's profitability has dropped substantially. We have known this company for a long time and are appreciative of its business management ability. Currently there are early signs of industry growth coming back while competition seems to have gotten more rational. For us this stock fits into the good business in temporary trouble category. Lower than anticipated growth and profit recovery are the major risks to the turnaround prospects of this stock*

When we bought the stock in 3/4Q 2015 it had declined 65% from its peak on the expectation of a sharp decline in profits and profitability. At end of 2015 Gross margin declined by almost one third to 22.3%. Operating and net margin too declined to 7.9% and 5.4% respectively. Net income declined by 73%. The company has gradually improved its operations gaining back 1% on gross margin and reporting 30% and 38% net income growth in 2016 and 2017 respectively. It has been free cash flow positive in each of the last three years after spending an average Rp. 75 bn of capex annually.

We continue to own this name which seems to be tracking well on our fundamental expectations. In the early stages of the turnaround the stock moved up nearly 50-70% from our purchase levels but lost almost all of it. We and probably all market participants have hoped for higher revenue growth and much faster recovery in margins against what the company has reported thus far. We are not losing much on this position currently however we have so far lost out on time. Again, here too it will faster growth which will help the company get back on track with improved profitability. Till such time we keep the faith in this holding.

Conclusion

While it is often mentioned that turnarounds don't turnaround or take a while to turnaround we continue to synthesize selective investment cases where we believe things can be repaired and growth & profitability can come back. However, despite our best efforts to cover most of the relevant angles and giving time frames of up to 4 quarters for improvement, things do not always play out as anticipated. Clearly these are the challenges of investing in quality businesses undergoing a transition.

India Office

We are very happy to share that we set up a small two-member research office in Mumbai, India. We hope this on the ground presence will help us improve our understanding of businesses and contribute actionable ideas to our portfolio.

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Portfolio Outlook

At current valuations of stock markets across Asia we are satisfied with the portfolio of businesses we own with always room to improve the quality. Considering our Asian universe of quality stocks, we expect Indian businesses to account for 40-60% allocation.

As mentioned we completely exited one of our holding in India and taken part profits in 2 other Indian holdings. We will continue having a low portfolio turnover as we are appropriately invested. However, if stock prices move significantly ahead of fundamentals we are always prepared to take some gains.

We remain patient and committed to our investment process while continuing to search for solid investment ideas.

We would like to thank each of you for entrusting us with the management of your money.

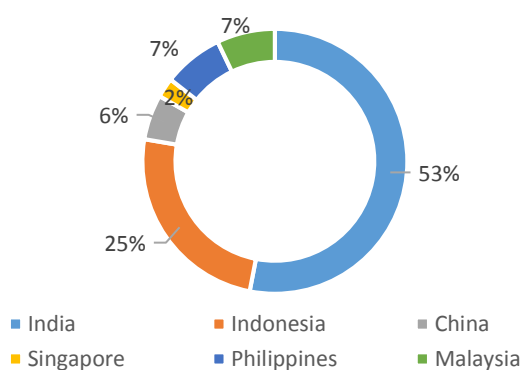
Ayaz Motiwala

Portfolio Manager

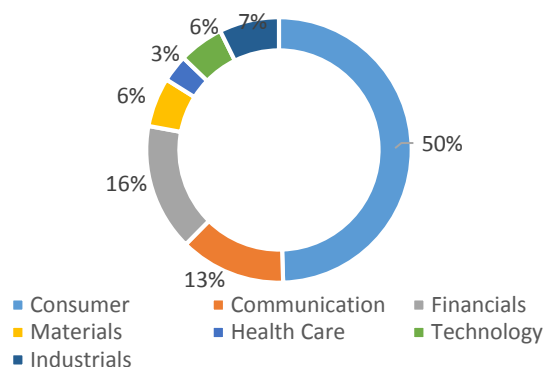
Fund Performance

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017	NAV	100.40	102.88	106.95	110.92	110.61	113.58	114.44	110.69	110.27	113.15	114.31	119.52	19.7%
	% Chg.	0.5%	2.5%	4.0%	3.7%	-0.3%	2.7%	0.8%	-3.3%	-0.4%	2.6%	1.0%	4.6%	
2016	NAV	96.25	93.76	97.63	100.83	99.22	102.13	104.00	105.89	104.99	106.72	100.29	99.86	1.2%
	% Chg.	-2.4%	-2.6%	4.1%	3.3%	-1.6%	2.9%	1.8%	1.8%	-0.8%	1.6%	-6.0%	-0.4%	
2015	NAV						100.00	99.71	98.11	97.58	98.49	97.74	98.63	-1.4%
	% Chg.						-0.3%	-1.6%	-0.5%	0.9%	-0.8%	0.9%		
													Cumulative return since 07 July 15	19.5%

Country Exposure



Sector Exposure



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