Amala

Emerging Asia Fund

Quarterly Commentary **4th Quarter 2018**

FUND INFORMATION

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.

LAUNCH DATE
7th July 2015

FUND SET-UP
Cayman Islands Regulated Fund

INVESTMENT MANAGER
Amala Capital Management Ltd,
Cayman Island

INVESTMENT SUB-MANAGER
Nivalis Partners Limited, Hong Kong

ADMINISTRATOR
DBS Bank, Hong Kong

CUSTODIAN
DBS Bank, Hong Kong

SUBSCRIPTIONS / REDEMPTIONS
Monthly :
Minimum initial investment USD 100,000
Subsequent investment USD 50,000
Notice :
Subscription: 5 days
Redemption: 30 days

MANAGEMENT FEE
1.50%

PERFORMANCE FEE
10% with a high watermark

FUND ELIGIBILITY
Professional Investors

Dear Investors,

In the fourth quarter of 2018 our fund gained nearly 3% providing some respite in a what was a very tough year. Most of the Asian currencies too recouped some of their earlier declines. At the year end, the Indian Rupee ended down 8.5%, Indonesian Rupiah down 6.3%, Philippine Piso down 5%. Our fund ended the year down 16.2% of which we estimate 6.5% is attributable to the decline in local currencies versus the US dollar. We note that equity holdings were down only 6%.

The fund took gains in a position each in India and the Philippines while we completely exited a position in Indonesia. We would like to thank our existing investors who have shown faith in us and added to their holdings during the year. In a tough year like 2018 our fund ended this period with a small net addition to our capital base.

Reflecting on an existing investment

We like to invest in high-quality businesses with a history of solid & consistent profitability run by honest and competent people. Ideally, we would like to pay a reasonable price such that we can protect our capital while expecting the underlying business to deliver growth and capital productivity. As mentioned in our past letters valuations to purchase such companies have been elevated. In our desire to own quality businesses and pay sensible prices we also try and own some businesses which have historically been recognized as quality and are currently facing a challenging environment. This could be from a host of factors such as increased competition, surge in raw materials cost, a slowdown in growth etc.

In this letter we are sharing our thoughts in relation to one such investment. In our 2Q 2016 investor letter we wrote about our Indonesian investment in a discretionary home improvement retailer.

This company has a network of more than 100 stores across the nation. It has strong brand equity and a leading market position. Over the last five years it has grown revenues and profits at 24% and 27% respectively while maintaining profitability in 22-25% range. The entire growth post a small fund-raising IPO in 2007, has been internally funded.

The company has developed a solid merchandising and sourcing team. It has also created a very efficient nation-wide logistics and distribution capability. Its business scale gives it a big procurement cost advantage over competition. The company has developed proprietary retail productivity measurement tools, which has helped maintain and improve operating margins over the years.

We have owned this company now for nearly nine months. The opportunity has come to own this name at reasonable valuations in our view as investors have sold off as growth slowed over the last 18 months. In addition, the company faced increased competition from new market entrants for the first time. The volatile and depreciating Indonesian Rupiah affected its business model and the slowing growth resulted in an inventory build-up. Based on its past operating history and actions being taken by the management, we feel the company is well positioned to cope with its current business challenges. Our investment in this high-quality business is premised on the hope that the company is getting back on its growth path and competition starts waning. For us the still high level of inventory in the system is a risk and an important factor to monitor going forward.

Our investee company has made good progress over the last 2.5 years since we wrote about it. Same store sales growth (SSG) which was flat lining during 2015-16 has smartly recovered to 9% and 13.5% respectively in 2017 & 18. It added 15 & 32 new stores during the last 2 years. This has resulted in a 20% plus revenue growth against the back drop of only 4% growth in 2015 & 16. It has been able to maintain gross margins at around 46% through the period of last few years despite the built of competition and the depreciation of the Indonesian Rupiah. This has been achieved with continued improvement in staff productivity at stores and large-scale procurement using its balance sheet. As a result, inventory levels continue to remain high at 195 days in each of the last 3 years vs 145-150 days in 2012-14. Despite this business profitability in terms of Return on Capital and ROE through the last 5 years has been consistent in the 23-25% range.

As we observe evidently the growth is back in the business. The company has demonstrated its solid competitive position in the face of aggressive competition and extraneous pressure with the depreciation of its home currency. It has also set up a new mini sized store format to tap the medium to long term growth opportunity beyond the top 10 cities. The core merchandise in this format is the fastest moving range from its large format stores. The stock now trades at 19x expected operating profit (implying earnings yield of 5%) and 23x net earnings for 2019. The stock has done well for us and we continue to own this name. We maintain our investment rationale that this is a high-quality business which has a large and long-term growth opportunity. Additionally, we will monitor the progress of the company in its new express store format both in terms of unit economics and the ramp up in stores.

Auditor change

During this quarter the board of directors of the fund decided to change our fund auditors after a period of 3 years. We appreciate our association with PWC having audited our fund and helped us improve our internal accounting processes. Baker Tilly Cayman Islands will be auditing our fund accounts from 2018 onwards.

Outlook

The new year seems to have started on an optimistic note across both developed and emerging markets. While the US-China trade related issues continue to simmer in the background, investors seem to be turning more constructive taking positive cues from soft crude oil prices and expected slower increase in US interest rates. Price correction through 2018 has made stocks relatively attractive with favorable risk reward and has expanded the investment universe. At the same time, we are weary in a market like India with tighter liquidity conditions and the unravelling of corporate governance issues in certain companies.

Most of the businesses we own continue to deliver good business performance and solid profitability. However, we note through our years of investing that market prices rarely trade close to intrinsic values of firms. Infact, the core existential reason of investing is this search for gaps between price and value. We believe that in the long-term prices do indeed converge towards the underlying value. Our search for solid investment ideas continues while we remain patient and committed to our investment process.

We thank each of you for entrusting us with the management of your money. We would like to encourage all our investors to take advantage of the current market correction by adding to their existing holdings in the fund.

Ayaz Motiwala
Portfolio Manager

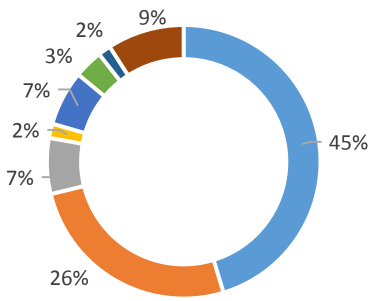
Amala
Emerging Asia Fund

Fund Performance

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2018	**NAV**	121.86	119.89	118.82	118.62	117.07	109.92	110.31	106.08	97.30	93.07	99.11	100.18	-16.2%
	% Chg.	2.0%	-1.6%	-0.9%	-0.2%	-1.3%	-6.1%	0.4%	-3.8%	-8.3%	-4.3%	6.5%	1.1%	
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 0.2%

Country Exposure



Sector Exposure