# Amala

## Emerging Asia Fund

**Quarterly Commentary** **3rd Quarter 2019**

### 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**

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,**

Our fund ended this quarter down 6.5% net of fees and expenses. Stock markets across the region were down during this period. The Indian mid/small cap indices were down 9-10% while Indonesia, Malaysia, the Philippines & Thailand were down 3%, 13%, 5.5% and 5.4% respectively. In addition, Asian currencies depreciated against the US dollar with the Indian Rupee down nearly 3%, while The Philippine Piso and Malaysian Ringgit lost about a percent each. Indonesian Rupiah and Thai Baht were range bound with a small appreciation.

During the quarter, the fund had very limited trading activity. We sold a small residual holding in a non-banking finance company in India. With this exit we now have 25 stocks in our portfolio.

**Corporate Tax Reform in India**

The Indian stock market offers a higher % of high-quality businesses in relation to our other Asian markets. You would have noted our large allocation towards owning such businesses in India. In September the Indian finance minister announced a big tax reform. Corporates would now be paying tax of about 25% (base rate of 22% plus surcharges vs a 30% rate earlier) if they opt for no further incentives or exemptions implemented from the current fiscal year i.e. 2019-20.

This move will thus result in 10-15% higher post tax profits for companies depending on their earlier effective tax rates. We look forward to corporate action on the use of these some what wind fall type gains. The easiest decision would be to dividend out the extra profits. However, if there is no material change in dividend payout policy, managers would now have resources to make additional investments in the existing business or pursue acquisition targets. Some corporates may choose share buybacks to return cash to shareholders despite the 20% tax on buy back.

Most of our portfolio companies in India have an effective rate of ¬ 35% range and will thus benefit. The ideal scenario would be reinvestment of a bulk of these tax savings in the business which yield high return on the capital deployed.

**Reflecting on an existing investment**

Our investment philosophy is to own high-quality businesses with a history of solid & consistent profitability run by honest and competent people. We hope to pay reasonable prices to own such businesses. In this letter we are sharing our thought about one such investment in India where we have paid up for quality and hope the company continues to deliver on its growth promise.

In our 2Q 2016 investor letter we wrote about our ownership in a retail led real estate company in India.

*"This company has built on a legacy textile mill land what is now regarded as one of the few leading malls in India in the city of Mumbai. Building on that success, in 2007 the company issued fresh equity to set up five new similar sized city center retail led mix use real estate projects. The company has since completed the first phase of all these projects with some delays and cost overruns. All four new malls are well occupied, as the company has been able to leverage on its existing tenant mix at the highly successful central Mumbai mall. New projects of a similar character would need a lead time of five years and would cost at-least 50-75% more than what the company has spent. This should limit future supply and put a rational floor on rentals.*

*Investment opinion on this company has been weighted down in the last 24 months by the very aggressive Private Equity funded built out of online commerce in India. Investors seem to believe that the mall-based retail business model is broken, and most retail commerce would shift online. For us, at current enterprise value, we are probably paying only for the existing retail assets. The upside possibility would arise from ongoing rental revision cycle which will drive a meaningful lift in earnings. In addition, we expect the company to generate cash surplus from the second phase of these projects largely through residential development. Developing REIT regulations should also open the possibility of fund raising for value creating M&A's and de-levering the balance sheet. Medium term risk to our investment would be the acceptance of the revised rentals and the ability of the company to sell the bulk of its planned residential projects."*

We have now owned this company for about 4 years. During this period the company has done a host of value creating activities in operating the business. It has invested Rs. 13.5 bn from its cumulative cash generation to buy out largely PE investors in a series of transactions including the 4 city centric mall projects taking it ownership to 100% in Mumbai (24%), Pune (59%), Bengaluru (28%) and 50% in Chennai (31%) amongst others. The acquisitions were done at very attractive valuations considering the PE investors time pressed desire to exit.

In August 2017 it got a Canadian pension fund to invest Rs. 16 bn for a 49% stake in only the Bengaluru project valuing the joint venture at post money enterprise value of Rs. 38 bn with about Rs. 5.8 bn of debt. This implies an 8x return on the initial equity invested by the list co during 2007-08. During 2017-19, this JV company has acquired 2 large sized land parcels (Bengaluru & Pune) at Rs. 11 bn and is building similar retail mall led projects.

In addition, the list co has made 3 additional investments. It has acquired 2 semi completed mall projects from creditors in rapidly growing second tier cities. It has also jointly acquired a land parcel in the city of Ahmedabad to set up a version of its Mumbai luxury mall. With these growth plans in motion, over the next 4 years the total operational retail asset base could 2x (currently at 6 Mn sq. ft) and office asset base could 4x (current base 1.3 Mn sq. ft). The company has indicated that it still has enough room to add a few more assets in key metro cities at appropriate valuations.

The company has achieved 9-10% revenue growth and about 18% profit growth on a compounded basis over the last 4 years. Growth is credible considering ongoing challenge to core mall business from online commerce and the recent consumption slow-down in India. Our average acquisition cost is Rs. 360 and the stock has traded in the range of Rs. 275-775 in the last 4 years. Currently at Rs. 725, it trades at 22x March 19 trailing earnings. We believe the company has good visibility to grow its revenues & profits from its current operating assets in the 12-15% range driven by underlying consumption growth and the rental renewal schedule. In addition, the 5 ongoing new mall and office projects add further growth visibility to its recurring revenue businesses. The REIT regulations in India are now firmly in place and provide an avenue for future capital raising to fund growth opportunities.

Key risks we continue to monitor will be the ongoing evolution of E-commerce in India and the response of large mall asset owners such as our investee company. We note that already there is an increased skew towards food & beverage outlets. In addition, cost and timely completion of ongoing projects will be another key monitorable.

**Travel**

This was a busy quarter in terms of travel. In July we travelled to the US and met a few promising prospects who have expressed their desire to invest in the fund.

Towards the end of August, we attended a 2-day conference conducted by the Stock Exchange of Thailand. We met up with most of the existing companies we track and a few additional ones. Thailand while being challenged on the macro front continues to present us with interesting bottom up investment opportunities. We are constructive on Thailand and at appropriate valuations we hope to increase our allocation to this country.

Lastly, we visited companies in India during the middle of September. The key take away is a sharp slow-down in growth and continued liquidity challenge particularly for intermediaries across services. The growth challenge is being experienced across the board by businesses ranging from auto and auto parts, business services, consumer & retail, industrial and real estate.

**Outlook**

The third quarter has clearly been a very tough one with a decline in stock markets across Asia wiping out most gains made during the first half of the year. The recent announcements create a hopeful atmosphere of a possible resolution in the US-China trade issues. While some of these macro factors are positive, we note that there is increasingly more evidence of a slowing global economy.

In this backdrop we have a portfolio of 25 solid and unique businesses primarily in India and Asean countries. We feel most of our companies are performing reasonably well and will deliver on our internal expectations of business growth and profitability albeit at a slightly slower pace. Tepid growth over the last few years and the recent sharp slow-down is resulting in a further narrowing of breadth in the Indian stock markets. We note that investors are paying a premium on valuations for a small set of companies which are delivering respectable growth in a challenging environment.

We will continue to navigate these markets with our committed investment process in search for solid investment ideas while remaining patient on the outcomes.

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

**Ayaz Motiwala**
Portfolio Manager

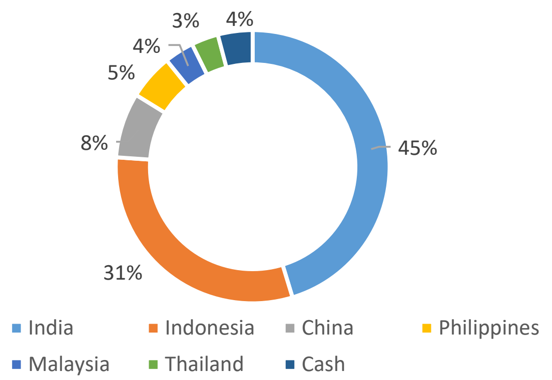
# Amala
Emerging Asia Fund

## Fund Performance

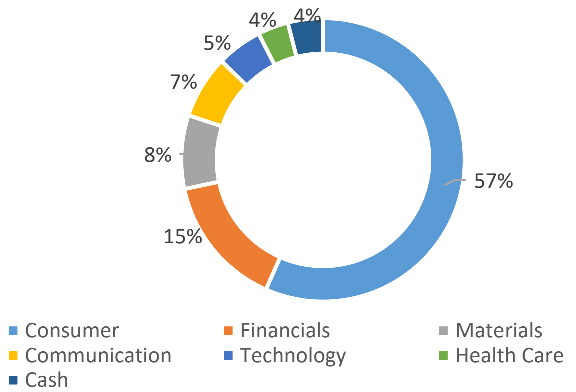
| | | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Year |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2019 | NAV | 99.59 | 98.95 | 103.90 | 102.36 | 103.45 | 105.16 | 102.51 | 97.93 | 98.34 | | | | -1.8% |
| | % Chg. | -0.6% | -0.6% | 5.0% | -1.5% | 1.1% | 1.7% | -2.5% | -4.5% | 0.4% | | | | |
| 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** -1.7%

## Country Exposure




## Sector Exposure

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