Amala
Emerging Asia Fund

Quarterly Commentary **2 nd Quarter 2020**

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 up 15.3% net of fees and expenses. Stock markets across the region gained back a portion of the lost ground in the preceding quarter. Asian currencies appreciated against the US dollar with the Indonesia Rupiah leading the rally having gained 14%, Thai Baht up 5.7%, The Philippine Peso up 2%, Malaysian Ringgit up 0.7%. The Indian Rupee which was down 3-4% during the quarter ended flat.

The quarter witnessed a very sharp share price recovery across sectors in most of our markets which was a pleasant surprise. Currently it looks like market participants are willing to treat the economic damage to companies in the whole of FY 21 as one off and look ahead. Investors have discerned though as stocks of staples, pharmaceuticals, technology and services companies have done relatively better over industrials, financials and infrastructure stocks in an otherwise broad-based recovery.

We reduced our holding in an Indian IT services company in the middle of the quarter, a defensive move, to take some gains. The narrative for outsourced IT services was a sharp cut in spending budgets at client end. However, in the last couple months its getting clearer that the need for businesses to outsource even more with the advent of more competition and hastened disruption to traditional business model by the Covid crisis. We also reduced our holding in a media company in the Philippines.

A Quarter of Survival, Restarts and New Beginnings

In 1Q CY 20 results declared by a couple of companies were only partially impacted by Covid 19 with businesses affected by lockdowns for 15-20 days. As we write this letter companies are reporting the second quarter the quarter highly impacted by the pandemic. Investors continue to focus on levels of recovery from the lows of April/May into June and beyond. In an Asian context Thailand and Malaysia seem to have done better in relative terms of containing the pandemic and faster resumption of economic activity.

Our conversations with both portfolio and other companies have been along the following lines relating to the business of each company. We have asked companies about the restart of their business in terms of four major areas – manufacturing operations, supply chain situation, cost control programmes initiated and emergence of alternate ways to do business.

We have spoken to companies with a view to understand their current operating levels, improvement during the last three months from the absolute lock down levels and also compared to the pre-covid period. The consumer staple, pharmaceutical companies clearly have demonstrated high resilience and good agility to deliver a very sharp recovery in their manufacturing operations which currently are running around 85-95% of pre-Covid levels for most companies. In contrast we note that a host of consumer discretionary, industrial, commodity and services companies continue to operate at very low levels.

Supply lines for raw materials were meaningfully affected in April upto the middle of May. Here again depending on the nature of demand i.e. consumption vs industrial demand supply chain operations have now largely been fully restored by the quarter end.

All companies have taken this pandemic as an opportunity to initiate a comprehensive cost review exercise. The key objective is to lower the fixed cost of the business and attempt to variablise operating expenses. The focus is on costs relating to salaries, rents, advertising, promotion and travel. The forced work from home phenomena has resulted in companies optimizing their workforce. There is a move to operate at lower fixed pay with an increased component of variable pay in the total compensation.

Another major finding from our conversations with companies perhaps the most significant of this pandemic has been rapid adoption of the digital way of doing business. Social distancing and contactless deliveries have driven a dramatic growth in online retail in the last quarter eclipsing growth rates achieved in the last 5-7 years. Digital marketing and advertising are now at the center of consumer companies go to market strategies. Adoption of digital payment is now mainstream and the whole eco system has got a massive boost and has taken off.

Portfolio Companies

Based on our interactions with companies in the backdrop of Covid, we focus at the two ends of our portfolio in this letter. These businesses cumulatively account for 73% of our portfolio. About 47% of the portfolio companies share prices are at or upto 10% higher than January 20 levels. This list consists of nine companies five of which are consumer staple businesses, a houseware retailer, an IT services company, a specialty chemicals player and a media company. We highlight a few names in this letter in terms of their state of business and outlook and the key reasons why we continue to own them.

Home and houseware retailer in Hong Kong

Houseware retail in the Hong Kong context, is a small bill size highly frequent purchase category. This business has demonstrated resilience to economic shocks and grown even during the global financial crisis in CY 08-09. Our portfolio company is a dominant player with a 300 plus store network and an estimated 65% market share. We like this company for the strength of its brand, profitability metrics and growth of its Hong Kong operations combined growth optionality in the region.

In the last 3 years the company has worked hard to weather the dual cost pressures of rising rents and employee costs. It has also focused its efforts on improving its business in Singapore while closing operations in other Asian geographies.

The company recently reported its FY 20 results. Total revenues grew 8.3% with Hong Kong revenues growing 8.1% (SSG of 4.6%) and Singapore grew 8.9% (SSG 9.8%). Gross margins have improved to 46.6% a gain of 0.6%. It has been able to cut opex by 1.3% for the full year. It added 13 new stores taking total global store count to 378. Profits are up 27% for the year. This company trades at 10x trailing earnings. It has announced its highest per share dividend implying a 10% yield at cost for our investment. We think our investment will further pay off when growth outlook improves and margins move up as the rental growth cycle reverses in Hong Kong.

Key risks in this name would be weak economic environment in Hong Kong which could affect the floor value of its core business and a stall in the continuing improvement in its Singapore operations.

Mid-sized consumer staples company in India

It is a growing dominant leader in its core hair care business in India. Over the last fifteen years this company has used its cash flow to enter adjacent hair care markets in India, parts of Asia and Africa. We like the company for its market position, its capital allocation history and the overall growth prospects of its product portfolio.

The company recently results for 1Q FY 21 a period which included about 45 days of complete lock down of business. Despite this challenging environment the company has been able to report a small growth in revenues for the quarter. The company has also gained market share in 90% of its portfolio and is well positioned to gain coming out of this covid crisis. In addition, it has launched products in a few new categories relating to health and hygiene. A tight control on operating costs has resulted in flat operating and after-tax profits.

We think this company will emerge stronger from the Covid crisis. It already has a good new product development engine which it has fast tracked. We are further enthused by a stronger desire to focus effort on launching new products in strong growth tailwind categories versus earlier attempts at trying to create new niche categories.

Indian industrial conglomerate promoted IT Services company

This company started life as an internal IT services division of the largest engineering, electrical and construction conglomerate. Over time it built capabilities in other verticals which has resulted in growth, reduced client concentration and risks to its business model.

Traditional IT services business is undergoing a transformation driven by the rapid improvement in machine learning, automation and coding tools. In addition, we note that technology spending budgets are being directed towards digital transformation. Its current revenue profile is quite similar to a traditional Indian IT majors while it attempts to position itself for IT Services 2.0. The company has been winning new business being relatively nimbler than its larger peers.

The current top five client concentration is high, and this risk had come to bear about a year ago when one its top client decides to scale down its engagement. Thus, new client wins particularly in new and emerging service areas will be an important monitorable for us on this investment. Valuation too is now 18x forward earnings much richer than 10x when we first bought this stock about 3.5 years ago.

Specialty Chemicals company in India

We own a specialty chemical company whose core business philosophy is based on developing products with clean and green chemistry. They have launched products only on achieving a unique chemical process which gives them long-term cost advantage and potential to be a leading global player. The company is a leading manufacturer of Isobutyl Benzene (IBB) globally having scaled this business rapidly in the last 10 years. It also has an estimated 65% global market share in Acrylamido Methylpropane Sulfonic Acid (ATBS) its other core product. Over the last 10 years, the company has compounded revenues at 18% while its operating and net profit have compounded at 25%. It has demonstrated impressive capital allocation ability by achieving an ROE of 26% through this period when its asset base has expanded 11x.The company has lined up a few new projects to execute over the next 3-4 years. These would be additional drivers of growth over its current operating business. While a couple of its projects are delayed by 1-3 quarter due to the ongoing pandemic the company is confident of achieving its threshold profitability parameters.

We believe this company could grow earnings at 15-18% annually while maintaining high profitability based on the strength of its current business and future investment plans. We also think some Indian specialty chemical manufacturers have the prospect to grow globally as international customers look for another source of credible supply beyond China. A large and growing home market will be an added competitive advantage to these Indian companies.

Since this is a global business, key business risk we continue to watch is competition being able to offer better and cheaper products. The other important monitorable would be the timeline on execution of its new investment projects. Over the next 6-9 months the challenges ahead of the company are to complete its planned expansion in ATBS and improve utilization its butylphenol facilities.

Other matters

We have completed our fund audit for 2019 and completed the requisite filings with Cayman Islands Monetary Authority.

Currently I continue to work out of Mumbai due to the continuing restrictions on international air travel into and out of India. Our colleagues at Nivalis Partners have been a great support helping us function on a normal basis.

Outlook

We have a portfolio of 23 unique companies primarily in India and Asean countries which have solid and resilient businesses. The outlook on earnings for the current year at this juncture is hazy in the light of the ongoing pandemic and the continued uncertainty of business operations. We strongly believe these companies are well positioned to quickly recover from the virus-related economic impact and gain share in their respective markets.

We will continue to navigate these markets with our committed investment process in search for solid investment ideas. These are unprecedented times and as usual where there is risk there are opportunities – we will try our very best to make good use of the opportunities ahead to get our fund back on track.

Ayaz Motiwala
Portfolio Manager

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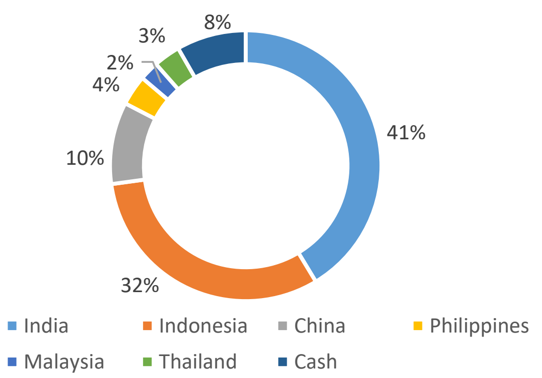
Fund Performance

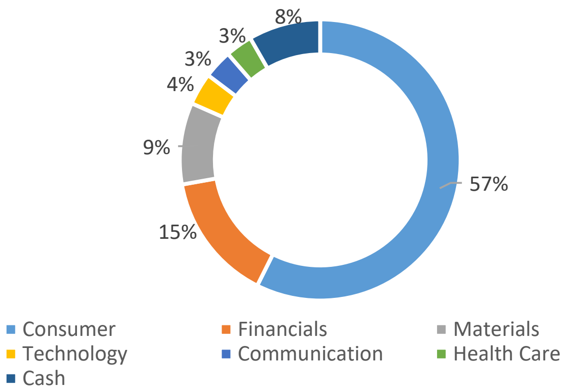
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2020	**NAV**	100.20	90.15	66.47	72.27	73.49	76.61							**-21.7%**
	% Chg.	2.4%	-10.0%	-26.3%	8.7%	1.7%	4.2%							
2019	**NAV**	99.59	98.95	103.90	102.36	103.45	105.16	102.51	97.93	98.34	98.56	95.07	97.83	**-2.3%**
	% Chg.	-0.6%	-0.6%	5.0%	-1.5%	1.1%	1.7%	-2.5%	-4.5%	0.4%	0.22%	-3.54%	2.90%	
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 -23.4%

Country Exposure



Sector Exposure



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