Amala

Emerging Asia Fund

Quarterly Commentary **3 rd 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 12% net of fees and expenses. Most Asian markets in the region gained during this period adding on the gains made in the prior quarter. For instance, the MSCI Asean small cap index was up 1% and the MSCI India small cap was up about 13%. Asian currencies had a mixed performance during the quarter against the US dollar. The Indonesian Rupiah lost nearly 4% and the Thai Baht declined 2.3%. On the other hand, the Philippine Peso continued its gains, up nearly 3%; the Malaysian Ringgit was up about 3% and the Indian Rupee up 2.7% during the quarter.

In terms of our investment activity, we trimmed our holding in a specialty chemical company in India after a sharp run up during the quarter. This stock is up nearly 500% since our purchase in October 2015. We also reduced our holding in a mall operator in India as its business recovery continues to be marred by localized lock downs in a couple of its key markets. We participated in an IPO (after a long time) of a technology company. In addition, we bought a building materials company that manufactures sanitary ware, tiles and bathroom fittings. We will share our thoughts about this company in a subsequent investor letter.

A Quarter of recovery

Companies in Asia had reported extremely poor operating results for the quarter ended June which included 45-60 days of total closure of businesses. Markets looked ahead treating that quarter as an aberration and focused on the potential recovery in the next quarter and beyond.

The recent quarterly results at the end of September confirms some positives (on a sequential basis) which markets were expecting within continuing overall decline in sales and profits (on a year over year basis) at the broader level. Most businesses we own have demonstrated solid resilience in their business model. Manufacturing companies have their operations running at 80-90% of pre-covid19 levels, supply chain issues have been ironed out and business activity has normalized. The cost control initiatives are still in place although discretionary spending on brand building & advertising is now being stepped up. Corporates hope to retain 20-30% of their cost cuts on a permanent basis.

Portfolio Companies

We continue to reflect on our interactions with our portfolio companies to understand the impact of the pandemic on their business and how they have coped with this crisis. At the end of this quarter, 70% (47% in preceding quarter) of our portfolio consists of companies whose share prices are at par or higher than January 20 levels. This list now consists of 17 companies (9) with underlying businesses such as consumer staples, home improvement retailers, IT services, specialty chemicals, media & entertainment.

Currently 30% of our portfolio consists of companies whose share prices are still 2-20% lower than levels in January 20. In this letter we highlight a couple names whose businesses have been relatively more affected and have yet to fully recover from the pandemic. We however continue to own these businesses; we explain our rationale for owning them at this juncture and their outlook.

In India we own a leading retail-led real estate company. This company has built, on a legacy textile mill land, its first mall, now regarded as one of most successful in India. Post that success, it raised fresh external equity in 2007 and created four large-sized retail-led mix-use projects in city centers.

We've owned this company for 5 years now. During this period, the company has created shareholder value using its cumulative cash generation to buy out PE investors in the 4 city-centric mall projects, amongst other initiatives. It embarked on its next phase of growth in mid-2017, when the company entered a joint venture with a leading Canadian pension fund, selling a 49% stake (INR 16 bn) in its Bengaluru project. The JV had a post-money enterprise value of INR 38 bn with about INR 5.8 bn of debt. This transaction implied a solid 8x return on the initial equity invested by the listed co (that we own) in 2007-08. Interestingly, this JV has taken the form of a platform (like its parent) and in the last couple years has acquired 2 large-sized land parcels and an incomplete mall project which was in receivership, to build similar retail mall-led projects. The listed co has made 2 additional investments: it acquired another semi-completed mall project in a Government auction in the rapidly growing second tier city of Lucknow; and it jointly acquired a land parcel in Ahmedabad to set up a version of its Mumbai luxury mall.

The Covid-19 pandemic has had a severe impact on mall-based retail business. All the company's 7 operating malls were shut April through June. After that, the company was permitted to open gradually across different states. In the last 6 months, it has taken significant measures to survive the crisis, protect its tenant/consumer franchise and be well positioned when normalcy returns. The company has cut its rentals by 50% for the full FY 21 along with eased terms of payment. However, it has negotiated a higher percent revenue share from the 2H FY 21, to catch up on lost revenue due to the rental discounts. In FY 22, rental agreements revert to the original terms with the company still maintaining a higher percent of revenue share for the 1H FY 22. We think this is a very pragmatic arrangement done by the company with its tenants, foregoing short term profits but ensuring business continuity and an option to make up (with higher revenue share) when the consumers and their spending return to its malls. The company has also raised INR 11 bn of fresh equity to fund working capital, interest & principal repayment, apart from being well capitalized, to seize potential acquisitions opportunities. The new mall in Lucknow is operational since the end of July. This is part of the company's plans to expand retail asset base 2x (currently at 6 mn sq. ft) and office asset base 4x (current base 1.3 mn sq. ft). Construction activity at its other ongoing project sites is back to normal and the company has indicated that, barring minor delays, all 4 upcoming malls are on track.

Investors seem to believe that the mall-based retail business model is broken, and business economics will never return to pre-Covid levels. The shift of retail commerce online has certainly been accelerated by the pandemic. We continue to believe the company has good visibility to grow revenues & profits driven by consumption growth and the rental renewal schedule. For us, at current enterprise value, we are probably paying only for the existing retail assets. We think the 4 new malls coming on stream and new office projects will add further to its recurring revenue base; these are currently not priced into the estimates. The REIT regulations in India are now operational and provide another 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, from international experience being replicated in India, that there is already an increased skew towards food & beverage outlets.

We own a multi finance company in Indonesia. Its core business is to finance largely pre-owned 4 wheelers deployed primarily for commercial use. It is amongst the largest multi finance companies with over 380 branches and sub branches across Indonesia. Over the recent 6 years (including 9M FY 20) the company has grown its loan book at 12% CAGR while the industry grew at 5%. Revenues have compounded at 17% while profits at 23% CAGR. The growth has been well calibrated with solid underwriting keeping NPL's in the ~1% range and effective credit costs of 2- 2.5%/year. ROA's range of 8-10% and leverage factor of only 2x (scarred from the Asian financial crisis) the company has achieved 20% plus ROE. The company has the best ROA and ROE amongst its peers highlighting its solid underwriting skills.

The Covid 19 pandemic has taken a toll on this business particularly in 2Q CY 20. The company has responded to the challenge on all key aspects of its business. The company took a decision to completely stop disbursing new loans in 2Q during the peak of the pandemic assessing that the economic impact of closures would constrain borrower repayment capacity and result in higher delinquency. Thus from an average of Rp. 4 tr/quarter of new business booking in FY 19 the company for 9M FY 20 has cumulatively booked Rp. 5.4 tr(Rp. 4 tr in 1Q, Rp. 53 bn in 2Q and Rp. 1.3 tr in 3Q of CY 20) down 52% yoy. The total managed receivables are however down only 17.6% YoY to Rp. 14.8 tr.

On its current book the company has restructured Rp. 5.23 tr(35%) of Loans at the end of September. Nearly 60% of this constitutes a combination of grace period on principal repayment and loan tenor extension. It has given a single instalment waiver to only 3.7% of its outstanding receivables. NPL now stands at 2.67% a substantial improvement from 3.73% at the end of the June quarter. Despite this LLR has increased to 6.51% (5.89% QoQ) and NPL coverage now stands at 2.4x. The revenues for the 9-month period are down 8%. There has been a sharp focus on cost control with its opex down 9% during the same period. The improvement in the quality of its business continues with Non-Dealer business accounting 84% of new bookings and 71% of the assets. Additionally, the company has raised funds by issuing new bonds and thus having the capital and balance sheet ready for growth when business conditions normalize.

The majority shareholder has cancelled the plans to sell its stake in the company. We view this move positively and expect a sharper focus on the business. An additional point to note is that the company has settled its long pending litigation with a past shareholder group through an out of court settlement towards the end of CY 19.

We continue to own this business with good fundamentals at an attractive 1x book as market participants continue to view multi finance lenders as risky in the backdrop of the pandemic. We believe the company is past the peak of the crisis and is well positioned for the market growth. Our optimism on this company is premised on the long-term financing growth opportunity in Indonesia, its relatively small market share of 3.4% and the execution track record of the core management team. With its conservative leverage position and existing profitability, we feel the company should grow its business at 18- 20% without needing to raise additional shareholder equity.

Other matters

Towards the end of this quarter, I - along with my family - got an opportunity to fly back to Hong Kong. We took 3 Covid-19 tests and completed the mandatory 14-day hotel quarantine. It feels nice to be back in the office. As mentioned in our earlier letters, our Hong Kong-based colleagues at Nivalis Partners have ensured that the fund's affairs have remained managed as normal at all time.

Outlook

At the time of writing, the US presidential election, including subsequent process, is over. The country has a new president-elect waiting in the wings to take charge on January 20, 2021. Investors across the world are hopeful for constructive US trade & international affairs policies going forward. We think Asian emerging markets could do well over the next 5-7 years and eventually correct the sharp underperformance recorded versus the developed markets, particularly the US. Our optimism is premised on higher earnings-per-share growth, driven by a continued recovery in the larger Asian economies in the context of benign inflation and interest rates.

Our portfolio consists of 22 companies primarily in India and ASEAN countries, most of which have demonstrated solid and resilient operations in the two recent toughest quarters for businesses. The earnings outlook has improved a lot post the recent results, as businesses start operating in a normalized environment. We remain sanguine on the medium to long term prospects. However, we retain our caution on the near-term outlook, with the prospects of a second wave of Covid-19 hitting some of the Asian countries where we invest, with its associated impact on businesses. Even as Asia seems to weathered this health emergency better than other, richer regions, the wide availability of a cheap and effective vaccine will be needed for a return to normal conditions.

We will continue to navigate these markets with our committed investment process in search of solid investment ideas. Our fund is up 30% from the lows in March 2020 but we still have a way to go before we get back to the January levels. 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

Amala

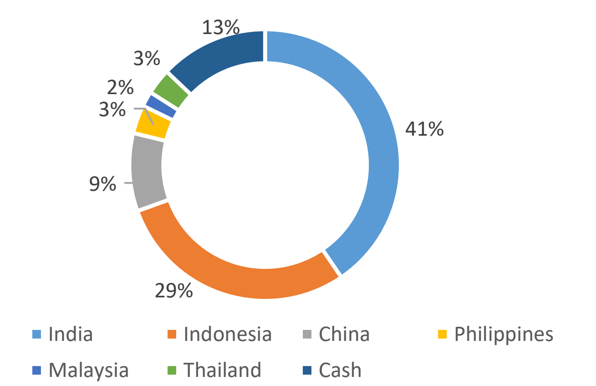
Emerging Asia Fund

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	79.76	85.32	85.63				**-12.5%**
	% Chg.	**2.4%**	**-10.0%**	**-26.3%**	**8.7%**	**1.7%**	**4.2%**	**4.1%**	**7.0%**	**0.4%**				
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 **-14.4%**

Country Exposure



Sector Exposure