Amala

Emerging Asia Fund

Quarterly Commentary **2 nd Quarter 2021**

Dear Investors,

Our fund ended this quarter up 12.6 % net of fees and expenses. For the first half of 2021 the fund is up 17.1%. Stocks and indices had a mixed performance in our core markets. MSCI Asean was down 1% for the quarter and is down similarly for the first half. MSCI India index was up 8.2% for the quarter and 13% year to date.

In this quarter our net performance would have been better but for the decline of some Asian currencies against the US dollar. The Indian Rupee was down 1.4%, Thai Baht lost 2.5% while Indonesian Rupiah and the Malaysian Ringgit were largely flat during this period.

During the quarter we took some gains in our holding in Thailand. We also used the sharp rally in small cap stocks in India and completely exited one position.

Portfolio Check

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. There is an ongoing large second wave of Covid in South Asia in particular Indonesia while in India the infections are down substantially having peaked in May 21.

At the end of this quarter stock prices of about 90% of our portfolio holdings (93% in preceding quarter) are at par or higher than their January 20 levels. This list now consists of 20 companies (20) with underlying businesses such as consumer staples, home improvement retailers, IT services, specialty chemicals, media & entertainment. Presently about 10% of our portfolio consists of companies whose share prices are still 4-15% lower than their level in January 20.

Being Invested at Lifetime High

In this letter we highlight one business which we have owned and tracked in our personal and professional capacity over its entire listed history of 25 years.

We wrote about Marico Limited in our 4Q 2015 investor letter.

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

We recently bought an Indian mid-sized fast moving consumer goods company with presence in beauty and wellness categories. It's 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. Capital deployment has been productive for both internal growth and acquisitions.

Their objective has been to buy into small differentiated brands in existing and emerging consumer categories which could be expanded geographically.

We like the company for its market position, its capital allocation history, and the overall growth prospects of its product portfolio. We have bought this stock after a lot of trepidation on its valuation. We are paying up for quality with the hope that this company delivers on its three years earnings outlook. The biggest risk for this stock in the near term is a possible valuation contraction. Slower earnings growth versus expectations could be one such cause.

We first invested in the company in November '15 and doubled our commitment in November '16 when the stock markets in India sold off on the day of announcement of demonitisation. Marico is in its 25th year of being a listed company on the Indian exchanges and we thought this is a good company to highlight the power of long-term investing in a high-quality business run by ethical and highly competent owners and managers. We have evaluated its progress essentially on 3 significant parameters

- Diversification of the revenue base through organic growth and M&A
- Margin and profitability
- Capital Allocation and its productivity

Backstory

1996-2006

The core ethos of the company has been to offer uniquely Indian products where it had a competitive advantage in categories which typically had limited MNC FMCG company presence. The idea was to avoid being in cross hairs of MNC competition and build a business.

Marico listed in 1996 with revenues of Rs. 3.5 bn, profit after tax (PAT) of Rs. 0.2 bn and a market capitalization (Mcap) of Rs. 2.5bn. The company earned the bulk of its revenues from 2 major brands viz. "**Parachute**" (65% of revenues) and "**Saffola**" (20% of revenues). Its operating profit margin was in the 10-11% range. Profitability was solid with returns on capital employed (ROCE) of 34%. Investors were however skeptical on the company. The common push back then was high concentration of revenues from Parachute, the brands long term growth prospects and a risk to profitability since it was perceived to be a commodity type business.

In its first decade as a listed company, it did face some serious challenges on the raw material front and on the competitive front. Copra, a key input for coconut oil witnessed sharp price increases multiple times and the company was challenged to effect price increases to maintain its margins. The opinion on the street all through this period was that Parachute was not really a brand. However, the company proved itself over the decade in maintaining and improving its profit margins over time. The other major challenge was competition from Hindustan Unilever which had inherited a coconut oil brand through another acquisition. The company was indeed challenged but was successful in protecting its consumer franchise.

The company compounded its revenues and profits at 12% and 15% respectively. For FY 2006 Marico had revenues of Rs. 11 bn with a PAT of Rs.0.86 bn. It had successfully started building an international business which accounted for 11% of revenues. Margins were in the 11-12% range and profitability was at similar levels of ~ 30% in 1996. Skeptical Investors who had traded this stock at a 40-50% discount over MNC peers on the fear of competition and long-term sustainable business profitability had come around by 2005 the Mcap was 10x its IPO levels having compounded at

2006-2016

During this decade Marico continued with its core objective to diversify its revenue base and accelerate its growth. It chose a strategy to acquire brands both in India and in Asia to consolidate its position in certain categories while adding new categories or geographies to its revenue base.

In February 2006 Marico acquired **"Nihar"**, a competing coconut oil brand from Hindustan Unilever for Rs. 2.16 bn. We think this was the seminal moment for the company. The company was able to consolidate and establish a dominant position in the market. It added 8-10% share to its base of 45%. In 2010 it's acquired a hair grooming brand in Malaysia from Colgate Palmolive for US $ 3-4mn. In 2012 Marico undertook its biggest acquisition till date spending about Rs. 6.5 bn to buy out certain brands from Reckitt Benckiser. With the purchase of 3 key brands along with a few others the company made an entry into the fast growing but highly competitive deodorants category, hair styling and hair nourishment category. Further in 2013 the company spent an estimated US $ 60 mn to acquire a consumer products company in Vietnam which has a strong presence in male grooming products amongst other categories.

By FY 2016 Marico had revenues of Rs. 61 bn and a PAT of Rs.7.3 bn having compounded at 19% and 24% respectively. Interestingly its operating margin had improved substantially to 16% (10-11% in previous decade) and was the key driver of profit growth being ahead of revenue growth. Business profitability improved too with ROCE now in the ~ 35-38% range. The international business grew substantially faster than the Indian business and now accounted for 22% of consolidated revenues (11% in 2006). The contribution of revenues from Parachute now were down to ~35% (~48-50% in 2006). Investors further appreciated this transformation and the Mcap compounded at 30% during this decade moving up to Rs. 315 bn just around the time we started buying into this company.

2016-2021

The last 5 years have possibly been the most challenging in terms of external changes in the business environment. The overall consumer spending was already slowing down when the Indian government initiated a demonetization programme in Nov 2016. This was done with the objective to curb the cash economy and move towards a more tax-complaint one. This move had a significant impact on the traditional FMCG distributors for a few quarters. The government followed this by implementing a new Goods & Services Tax regime from 1 st July 2017. These two significant changes had a telling impact on the trade, consumer, and companies across the board. As money in circulation declined so did economic activity. We observed that volume growth across consumer companies started to decline as existing consumers cut a bit of their consumption and down traded while companies were challenged to add new consumers to their franchise. This was also a period of benign inflation as crude oil prices declined from the highs of 2014 and have stayed low till the beginning of 2021.

As consumers and markets were settling down with a noticeable pick up in business activity and volumes by 4Q FY 20 the Covid 19 global pandemic hit the companies. FY 21 began with a near total lock down for nearly 50 days in 1Q FY 21. Business picked up quite smartly since re-opening. The company ended FY 21 with growth in revenues and profits. For this 5-year period its revenues and profits compounded at 6% and 10% respectively, the lowest growth rate achieved in the last 25 years of being listed. Operating margins further moved up to 20% (16% in FY 2016) and aided profits to grow ahead of revenue. Business profitability too improved with ROCE now in the ~48-50% range. The international business grew at 6% and now accounts for 23% of consolidated revenues. Parachute brand sales now account for less than 30% of consolidated revenues. Investors further appreciated the continued transformation and the Mcap moved up to Rs. 600 bn having compounded at 15% during this period.

The company now trades at its lifetime high. Question that we debate internally is why we own it at this juncture and what do we expect.

We like the company for:

- how its positioned in its core business
- how it is developing its foods and international business
- its attempt to build a new growth engine

Marico has a strong core business (50% of consolidated revenues) comprising its Parachute and Value-added hair oils franchise in India. Parachute is a strong and well entrenched brand in the coconut oil space with a 50% plus market share. It has a very strong sourcing advantage which positions it well to convert loose oil users and grow the business. The company is also the leader in value added hair oils. Barring the last couple years this category has been growing steadily at 10-15% over the last 10 years. The company also plans to launch new products to address the absolute entry level consumers. Overall, we expect the company to grow in line with the category. We expect this portion of its business to compound at 9-10% in value terms.

Saffola oil and foods business (20% of consolidated revenues) has been doing well over the last few years. This edible oil business was particularly aided by the Covid 19 pandemic as lock downs and work from home meant a sharp increase in cooking at home. The company has been attempting over the years to grow the foods franchise on the back of a very powerful yet under-levered brand Saffola. Savory oats launched under the brand a few years ago have done very well for the company and have created a category. On that success, Marico has recently entered other foods categories viz. honey, noodles, protein nuggets building on the strong health equity of the Saffola brand. We like the initiatives being taken by the company to drive innovation and growth in this franchise. Overall, we expect the oils and foods side of the business to grow 25% over the next 3-5 years.

International businesses across Asia and Africa account for 23% of consolidated revenues. Its business in Bangladesh accounts for nearly 50% of this base. Here the company is a leader in the coconut oil business. Marico is replicating the India playbook in Bangladesh with non-coconut oil business having grown rapidly in the last 5-7 years; it already accounts for half the business. We expect this operation to leverage off the innovation being under-taken in India and other Asian operations. Vietnam is another operation where the company has a strong market position in male grooming category and is building on this strength to drive growth. Overall, we expect the international operations to grow 10-12% in constant currency terms.

A few but significant changes are taking place in the consumer products landscape. Online retail platforms such as Amazon India, Flipkart amongst others continue to gain traction amongst Indian consumers. The Covid 19 pandemic has induced a sharp increase in the adoption of online commerce and has possibly upfronted the anticipated transition by 7-10 years. Along with this we note the emergence and adoption of digital as a medium of marketing communication and the availability of high quality reliable outsourced manufacturing & distribution. Essentially these macro market developments imply a massive reduction in the handicap of smaller and start up branded consumer product companies. Such companies are now able to launch differentiated products across a whole range of categories (existing and emerging) with focused yet limited communication budgets to create brands and reach consumers directly(D2C). The outsourced production and go to market permits companies to choose their battle grounds and rapidly scale with success. The D2C brands are attempting to enter existing large and niche categories with differentiated products. The idea is to position itself early in this emerging change to be able to build a decent size when the market (the consumer) evolves.

In this backdrop Marico is attempting to build a new growth engine entering new categories to expand its total addressable market through a combination of In- house and acquired brands. The company has experimented with this emerging trend having acquired “**Beardo”**, a male grooming brand a few years ago. The brand has tracked well on its internal expectations and the company has now acquired 100% ownership in this company. In addition, it has launched its own D2C brands “**Pure Sense”** and “**Coco Soul”** and very recently acquired a majority ownership in a beauty care brand “**Just Herbs”**.

We read this strategy as both defence of its core franchise and an offensive posture as it works to expand its addressable market with a slew of new products. The emergence of new brands trying to woo consumers in the whole beauty and wellness space including hair care products implies a risk. Marico through these initiatives will work to keep its franchise intact. At the same time the company will logically enter large core personal care categories such as skin and hair care. As an example, a differentiated Indian Herb based shampoo/ skin cream helps them set the ground differently vs. launching a shampoo with limited product differentiation and equity. It remains to be seen if they can scale these brands over time to about 5-7% of base revenues. If the company manages to achieve that then these brands could contribute about 15% of incremental growth. This could also lift their longer-term growth expectations.

Overall, we expect the company to compound revenues at 13-15% and profits a little ahead. However, we expect profit growth to accelerate in the medium-term time frame as other engines of the group viz. foods and D2C brands gain size and contribute meaningfully to overall revenues.

Over 25 years of listing Marico stock from IPO is 275x having achieved a 25% CAGR over that period. Investors first treated it as a branded commodity play and the stock was priced at a 40-50% discount to peer group. Over time as the company has grown, diversified it revenue and profit base, improved its margins and profitability. At this juncture the company trades at 40x its expected FY 23 earnings. We remain believers in the management capability and the execution of Marico. The current high multiple keeps our optimism in check.

Outlook

Investors in Asia are currently more circumspect vs a bullish position in the first 2 months of the recent quarter. From a global perspective the big debate has been a potential rise in inflation and its impact on interest rates. The new wave of Covid infections have been particularly severe in India. The focus is now back on protocols like 2020. There are state-wide and localized lock downs to contain the spread of the virus. These measures are impacting businesses in the near term. Clearly this will have cost implications and push back the expected broad based economic recovery. The vaccination program is progressing but would take 6-9 months in most of Asia for the population to attain heard immunity.

In this slightly hazy backdrop, we believe Asian emerging markets could do well over the next 5-7 years. Our optimism is premised on faster economic growth (vs the developed world) resulting in higher revenue and profit growth in the larger Asian economies.

Our portfolio consists of 22 companies primarily in India and ASEAN countries, most of which have demonstrated solid and resilient operations in the backdrop of a very tough operating environment. The ongoing earnings season points to an improved outlook for 2021 despite the ongoing wave of Covid.

We will continue to navigate these markets with our committed investment process in search of solid high-quality growth businesses.

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

Ayaz Motiwala
Portfolio Manager

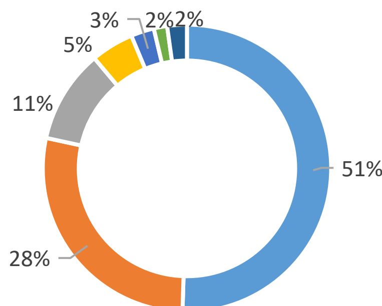
Amala
Emerging Asia Fund

Fund Performance

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2021	**NAV**	103.97	109.18	106.92	108.13	115.83	120.40							17.1%
	% Chg.	1.1%	5.0%	-2.1%	1.1%	7.1%	3.9%							
2020	**NAV**	100.20	90.15	66.47	72.27	73.49	76.61	79.76	85.32	85.63	85.14	91.72	102.79	5.1%
	% Chg.	2.4%	-10.0%	-26.3%	8.7%	1.7%	4.2%	4.1%	7.0%	0.4%	-0.6%	7.7%	12.1%	
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%	

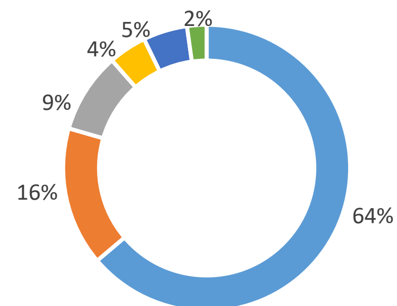
Cumulative return since 07 July 15 20.4%

Country Exposure



India · Indonesia · China · Philippines · Malaysia · Thailand · Cash

Sector Exposure



Consumer · Financials · Materials · Technology · Communication · Cash

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