31 July 2018

Dear Investor,

This is our first quarterly letter for the ASEAN Equity fund. With your trust and support, we set this fund up at the beginning of March to invest for the long-term in a relatively concentrated portfolio of quality businesses and assets in the high-potential ASEAN region.

As market watchers will have noted, ASEAN markets, after a spectacular 2017 (+30% for the MSCI ASEAN index) have not performed well this year (-9%) and in the last quarter (-11%). Currencies have also weakened, compounding the damage. We are quite pleased with these developments and current negative sentiment; we believe our timing in the launch of the fund has been good as we have been able to take advantage of volatility and unreflective selling. By design, we have been patient in deploying our capital into securities of companies trading at what we believe are unjustifiably low valuations relative to long-term earnings power or ascertainable asset values. This has not meant we have not lost some money on a mark-to-market basis in the last few months (though we have lost a lot less than the indices), but it does mean we think we have bought well relative to fundamental valuations and have confidence that, over the long-haul, we will generate meaningful positive returns. We have significant cash in reserve (around 22% of NAV at quarter's end) to take advantage of opportunities.

Table 1 - Largest Gains and Losses

Inception to End 30/06/2018 - (in millions of $)

Largest Gains		Largest Losses	
Erajaya Common	0.5	Srisawad Common	(0.5)
Yeah 1 Common	0.1	Metro Retail Common	(0.2)
		Jaya Real Property Common	(0.1)
		Link Net Common	(0.1)
		Kido Common	(0.1)

Source: Probus Middle East Ltd. & Bloomberg

Investible (by the fund, at least) ASEAN markets are home to around 3,000 listed companies. How can we possibly cover them all? The short answer is that we don't even try. We choose instead to play to what we see as our strengths (patience, belief in fundamentals, and experience in the region) and attempt to take advantage of mis-pricings occasionally caused by the psychological biases of others. In other words, we are searching for companies that are trading well below a conservatively assessed fair value for reasons other than fundamentals. To find such opportunities, unlike many managers, we are not solely guided by regular screens on traditional valuation metrics, but rather we start by looking for areas where mis-pricing is likely to exist and then focus our energies on investigating such areas for potential investment opportunities. Our current portfolio is a result of this process as can been seen in the below discussion of our top 5 holdings.

Our approach brought us to Indonesia, by far our largest allocation (~31% of NAV). In the context of ASEAN, Indonesia and its young 260MM strong and increasingly productive population are hard to ignore. Despite this, capital markets are relatively undeveloped, uncovered, and underinvested - the kind of market where a bit of fundamental research can pay off handsomely. When we first visited Indonesia in the context of this fund, we of course looked at many of the well-owned larger capitalisation stocks (like Telkom - see below), but we were most interested in less well-trafficked names (even our brokers were surprised by some of them). Due to lack of coverage and institutional sponsorship, it seemed that markets were not properly pricing, in our view, the long-term potential of some business models whose success had been proven (and observed by us) in international and regional markets. In other words, we found that we were able to pay a cheap-to-fair price for current sustainable earnings of quality consumer-facing businesses that we understand and pay very little for solid long-term growth prospects.

Our largest gains over the quarter came from our investment in one such firm - **Erajaya** is a 30-year-old 30% market share mobile phone retailer and distributor in Indonesia with huge runway for growth as it attempts to penetrate lesser cities in Indonesia and grow share to 60%. In Erajaya, we immediately saw parallels to Mobile World in Vietnam, a successful retail venture that we have owned for another portfolio, though Erajaya seems earlier in its development cycle in what is arguably a much larger long-term market opportunity on the strength of population alone. Since our purchase at around book value, the stock has more than doubled following first quarter results, a strategic investment by Chinese electronics maker Xiaomi, and market "discovery". Despite the run-up in price, the stock remains cheap in our view at less than 10x run/rate cash earnings. Brokers are now beginning to cover the stock.

Telkom (the owner of the largest cellular operator in Indonesia) is one of the largest companies in the market, so it was surprising to us that it made its way into the portfolio. The stock had sold off markedly before our purchase on the back of concerns over a temporary slow-down in cellular operations following regulatory change (SIM card registration) and increasing market-share-based competition on regional markets. We believe this sell-off was overdone and that the market was not assigning proper value to the high growth and improving margin business in fixed line/broadband. Telkom is fundamentally and historically cheap at a pre-tax yield of over 10% and close to zero net debt.

Vietnam, whose markets reached all-time highs this year and has since fallen spectacularly (the HCM index was off around 18% in 3 months to June in local currency), is another country of focus. We have been investing in this market for the best part of a decade and continue to see opportunities in businesses serving an increasingly wealthy and urban population.

We bought into $300MM media and advertising company **Yeah1** via a pre-IPO commitment well in advance of its late June IPO. Admittedly, we got the sizing a little bit wrong (despite expectation to the contrary, we were not scaled back and therefore a little bit over-allocated in a reportedly 2.5x over-subscribed offering) and the timing, given current market turmoil, was less than ideal. While the price moved up to the end of the month (a positive contribution to return in June), it has since declined significantly on low local volumes. This is a temporary setback in our view and the company and its broker are working to correct the issue.

In the end, it's the fundamentals that matter. Established in Vietnam as an online social media platform in 2006, Yeah1 has developed into an integrated advertising and media business targeting the young and increasingly digital population in Southeast Asia along two complementary business lines: (1) traditional media production, distribution and advertising; (2) digital media management and advertising, where it benefits from its large local and regional scale and licensing arrangements with both You-Tube (largest multi-channel network in Asia) and Google (for Adsense and AdExchange). The company does more than 70% after tax on capital employed, with its main growth driver (non-you-tube digital) earning significantly more as the marginal cost of additional revenues/customers is minimal. As a general rule, for this kind of growing franchise, we would look for a 6% on normalised free cash after tax (reflecting our view on longer-term rates) and aim to get the growth on the cheap. At the price we paid (a bit under 6% yield), we think we have bought for a fair price based on 2018 after tax operating profit adjust for some non-cash item - we expect Yeah1 should kick out well over VND300BN this year and management was ahead of this in its recent 1H results. We see significant upside should management execute to plan (more than doubling of operating profit by 2020 on the back of growth in the non-you-tube digital business in Vietnam and Southeast Asia) and a potential (we stress potential) multiple re-rating above our base case. To this point, we note that regional entertainment companies (including our old friend Workpoint in Thailand) trading in the range of 20-40x forward earnings and the most similar MCN - smaller Japanese firm UUUM - at an astounding 80x). Importantly, management and founders did not sell into the listing.

Followers of the Mekong Fund should not be surprised to see **Kido Group** common in the portfolio, a company we have owned and invested in successfully over the last five years. Kido Group is a family controlled national consumer distribution platform with arguably the best distribution network (200,000 POS) in the fragmented Vietnamese retail market. Via listed subsidiaries Kido Frozen, TAC, and VOC, the company dominates the ice cream and edible oil industries. The stock sold off with the emerging market rout and we were able to purchase our stake at below book value, which we think is well below a reasonable liquidation or break-up value for the business. We see significant upside from its ongoing exploitation of its unrivalled distribution and cold-chain logistics network.

Outside of Malaysia and Singapore, Thailand is arguably the most economically developed of the ASEAN countries (it has quite a head start for historical reasons) and is playing a key role in providing capital and expertise to the region via direct investment and M&A. We are attracted to well-run Thai businesses that are exposed to the broader region though the roll-out of business models that have been proven at home. A significant sell-down in consumer finance stocks in Thailand directed us to revisit the sector and in particular, **Srisawad Corp**, a company whose management we have known for more than a decade and in which we have successfully invested for another portfolio. Following our purchase, unfortunately, the stock sold off again (the position was our largest loss for the quarter) on the back of short-term stock specific concerns centred on the impact on profitability of the company's recent acquisition and consolidation of a Thai bank, which acquisition was made to ensure compliance as the Bank of Thailand moves to regulate consumer finance businesses. We think current issues will prove short-lived and management expects a return to prior levels of profitability within the year. We further expect that the company's decision to take some short-term pain to get ahead of the expected regulatory change (unlike some of its listed peers) should position it to take advantage of market consolidation opportunities. The company also has significant opportunity ahead of it as it uses its spare balance sheet capacity (30% equity/assets) to expand its proven business model into Cambodia, Laos, Myanmar, and Vietnam. The stock is now at half its 2017 highs and looks cheap at below 14 times temporarily depressed earnings.

We will continue to identify opportunities in presently unloved corners of the markets and are well-positioned to take advantage of such opportunities as they arise. We see political change (see recent events in Malaysia), busted IPOs, and holdings companies as particularly interesting search areas at the moment. We look forward to growing your capital over the long-term and thank you for your trust.

Table 2 - Growth in an Assumed $100 Investment

	Fund Class I2	MSCI ASEAN
Inception	$100	$100
March 2018	$99.49	$97.50
June 2018	$93.11	$86.87
Quarterly % Change	(6.4%)	(10.9%)
Total % Change	(6.9%)	(13.1%)

Source: Probus Middle East Ltd. & Bloomberg

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