

Please note that the commentary is for the retail class of the fund.

In what was a very weak past few months for emerging markets (MSCI EM index -8.0% for the 2nd quarter), the Coronation Global Emerging Markets Fund returned -9.5%. The largest negative detractors over the period were the Brazilian education stocks, Kroton and Estácio, which together detracted 2.4%. Porsche (-0.56%) was the only other stock that detracted by more than 50bps. The main positive contributors were YES Bank (+0.50% contribution), Airbus (+0.37%) and Naspers (+0.36%). Over the past 5 years, the fund is behind the market (2.6% p.a.), partly due to the recent tough period and partly due to a very good year in 2013 (16.1% alpha) dropping out of the 5-year base. The fund has also just reached its 10-year track record (launched on 14 July 2008) and since inception it has outperformed the MSCI EM index by 1.9% p.a. after all fees.

The Brazilian education stocks, after being significant positive contributors in both 2016 and 2017, have been large detractors in 2018 so far. We wrote extensively about Kroton in the March 2018 commentary but given continued poor performance of the Brazilian education stocks and their impact on the fund's returns, we believe it worthwhile to briefly touch on them again. Even after appreciating by 20% so far in July, Kroton is still down 39% (in BRL) year to date and down 23% over the past 1-year period. In contrast, Estácio - while having declined by 20% this year - has appreciated by 70% over the past 1-year period. Estácio's performance this year has been broadly in line with the average Brazilian consumer stock - in other words its poor performance is largely due to macro factors (rising US rates, Brazilian politics/economic concerns driven in part by the truckers' strike and upcoming elections in October). Kroton's performance, besides being impacted by macro factors, has also been impacted by company specific factors, as one would expect to be the case given the differential in performance between Kroton and Estácio. During the quarter, Kroton reported their Q1 results, and while these results were in line with expectations they reduced their earnings guidance for the year (in contrast, Estácio's results and outlook were ahead of expectations). Kroton also announced the acquisition of an education publishing/K12 school business (Somos Educação) at what appears to be a high price. These two events as well as general economic concerns (and resultant education industry concerns) resulted in the share coming under more pressure. Kroton is already far more efficient than Estácio (c. 30% EBIT margins vs. c. 15% EBIT margins for Estácio) and as such don't have this lever to pull.

As is typically the case when a large fund holding is going through a tough period and is impacting the fund's performance, we spent a significant amount of time on Kroton over the past several months with the aim of assessing whether the investment case still holds or not. Besides spending half a day in Sao Paulo meeting with several individuals from Kroton's management team earlier this year, in the past few months we have had separate calls with Kroton's CEO (twice), CFO, Head of Campus and Head of K12, to assess the Somos transaction as well as discuss both the shorter and longer-term challenges and opportunities for Kroton. In addition, over recent months we have spoken with competitors (Estácio and others), former industry executives as well as 3 local Brazilian funds (2 are shareholders and 1 is negative on Kroton as we believe there is value in hearing and understanding views on differing sides). Our conclusion from all this work is that while Kroton are facing a tough year or two ahead, the long-term prospects remain very attractive: an underpenetrated market in a fragmented industry with the biggest players (Kroton is #1 and Estácio #2) having the opportunity to take market share in what is a scale business, and a new growth driver in the form of entry into the K12 schools market where the market size is more than double that of the tertiary education market. On the Somos acquisition, while the price does look high at face value, there are synergies that can be extracted to bring the acquisition multiple down. Somos's most recent results (post the announcement of the acquisition) showed a 40% increase in profits, which brings the acquisition multiple down further. Additionally, the asset brings diversification to Kroton as well as good cash generation with lower student defaults than in the tertiary sector. Somos provides a platform for a quick leap into Kroton's planned K12 expansion as it takes Kroton from having 2 schools to having 44 schools, which in turn makes it the largest operator in the K12 private market. Kroton now trades on less than 10x 2018 earnings with a 4% dividend yield (Estácio's valuation is not dissimilar) which we believe is very attractive given its favourable long-term prospects. Today 5.4% of the fund in total is invested in the Brazilian education companies, with 3.5% in Kroton and 1.9% in Estácio.

We were asked recently by a client whether, because we focus so much on the long-term in assessing businesses and making investment decisions (5 years+), we miss short-term data points. It is a valid question. The above discussion (12 Kroton-related calls with both management and outsiders in a 3-4-month period) hopefully answers the question to some extent. We do indeed focus on the long term (and in an ever increasingly short-term focused world, we firmly believe that truly taking a long-term view is a key competitive advantage) but we do also spend a large amount of time on assessing every new (and short-term by definition) development - whether that is an earnings release, an acquisition or some other event including macroeconomic events - and what they mean for both the short-term and long-term earnings streams of the business. A sharp decline in short-term earnings (next 1-2 years) does have an impact on the long-term value of any business, although in many cases the impact is far less than the extent of the share price decline. As such, while we are primarily concerned about the long-term (5 years+) earnings stream, the next 1-2 years' earnings, even though they are short-term, are important for us to understand. We model all businesses out 5-6 years and it is this earnings stream that determines our fair values. Within this 5-6 year period we will naturally model the next 1-2 years earnings. To summarise, even though our focus is firmly on the long-term (5 years+), we certainly don't ignore the next 1-2 years' earnings. In addition, with cyclical assets we always build in a down year into our 5-6 year modelling period as even though we may not know when such a down year will manifest, we know that it inevitably will.

Magnit (#1 Russian supermarket retailer by profits) has been the other main detractor from performance over the past several months, although it was a positive contributor over the quarter. During the quarter the company announced the potential acquisition of a pharmaceutical distributor, owned by a related party. The proposed acquisition was a big concern for us as a) we feel that management's time is better spent on addressing current issues in the core food retail business, which is underperforming; b) we question whether it is necessary to own a distributor in order to start rolling out a pharmacy fund (which was the rationale given by Magnit management at the time of the announcement); and most importantly c) we had corporate governance concerns on the transaction (the distributor for sale is owned by a related party, who had only recently bought a 10% stake in Magnit). As a result, we had calls with a few other large shareholders and drafted and sent a co-signed letter to the board expressing our collective concern about the transaction. We also held calls with the (independent) Chairman and Vice Chairman of Magnit as well as another independent director. We were encouraged by their constructive response to our concerns and how they intend to approach this and other issues. At the subsequent board meeting a few weeks ago, the CEO of Magnit (Khachatur Pombukhchan) tended his resignation and Olga Naumova was appointed in his place. Naumova recently joined Magnit as an Executive Director from X5 Retail, where she was head of X5's convenience business (Pyaterochka, which makes up c. 80% of X5's group revenue) and is largely credited with turning around this business (and hence the X5 Retail Group) over the past 5 years. With a new board, a new management team (besides the CEO, the new highly regarded CFO is also from X5 and

one of the new director's [ex-Lidl UK CEO] is also involved in an executive role) and a still fragmented Russian food retail market, we believe that Magnit is very attractively valued at current levels and it remains a top 10 holding.

There were 3 new buys during the quarter: Phillip Morris International (4.7% of fund and the largest new position), Anheuser Busch InBev (2.1% of fund) and YUM China (1.0% of fund). Having previously sold out, we also added 1% positions in each of Alibaba and Alibaba after reassessing Alibaba's fair value following a few related meetings and results announcements with additional disclosure. In terms of sells, we sold out of 5 positions (all of which comprised less than 1% of the fund as at end-March): YUM Brands, Puregold (both as they reached fair value), Hering (close to fair value but with increasing risks in Brazil), Reckitt (better global consumer staples opportunities) and Steinhoff (which was down to a 7bps position at the time of sale and where our view was that the probability of there being no equity value increased as various assets continued to be written down). In terms of other sells (reducing positions), we reduced the JD.com position (still 3.4% of fund, but wanting more of a balance between JD.com and Alibaba), the Heineken and Unilever positions (still 3.3% and 2.0% of fund respectively, but buying other even more attractive consumer staples like Phillip Morris), and Airbus (still very attractive and a 3.2% position, but getting somewhat closer to fair value). In terms of other buys, we added to the Ping An Insurance, Fems, TSMC and Cognizant positions after share price declines in all of these with no change to what we think the businesses are worth.

For the 9.5-year period since inception of the fund in July 2008 and until January of this year, we had on average 1% exposure to the tobacco companies. The reason for this was two-fold: a) concern over the very long-term prospects for these businesses (declining volumes, increasing regulation and even more health awareness and b) valuation (they had benefited from the general upward re-rating of all consumer staples). Over the more recent past there have been 2 key changes. Firstly, the development of successful reduced risk products (vaping and 'heat not burn' [HNB] devices) has meant that for the first time in decades far safer alternative products are available and as a result total tobacco/nicotine consumption has started to increase instead of decline. And secondly valuation: sharp declines (c. 25% this year) in the share prices of both British American Tobacco (BAT) and Phillip Morris International (PMI) have brought their valuations down: BAT to c. 13x Dec 2018 earnings and a 5.1% dividend yield and PMI to c. 16x Dec 2018 earnings with a 5.3% dividend yield. As such, we believe that for the first time in several years these stocks are now very attractive and BAT and PMI (both of which have high emerging market exposure: 43% and 55% respectively) are 5.3% and 4.7% positions in the fund.

The tobacco companies still have many of the qualities that have always made them very good businesses - most importantly pricing power, stable earnings, very high return on capital and high free cash flow conversion. In addition, they now have attractive long-term growth prospects in our view, due to having reduced risk products in their portfolio that provide an attractive healthier alternative to traditional cigarettes. In summary, the 2 main categories of reduced risk products (vaping and HNB) do not involve burning, and it is largely the burning (combustion) and subsequent release of chemicals of traditional cigarettes that create the health issues. By avoiding combustion, the risk reduced products eliminate the biggest issue with traditional cigarettes, which in turn is what makes them appealing. Both BAT and PMI have vaping and HNB products, with BAT being the global leader in vaping and PMI the global leader in HNB, with their IQOS (I Quit Ordinary Smoking) product. In our view, there is room for both products as they have different appeals, and being global leaders respectively, there is a high probability of BAT and PMI taking disproportionate incremental market share and hence increasing their overall global market share. PMI's next generation products (NGP) already contribute 13% of the group revenue and PMI have an aspiration to grow that to c. 40% of revenue by 2025 through a c. 4-5x increase in NGP total revenue from \$ 4 billion to c. \$ 18 billion. To put this \$ 18 billion into context, PMI's total group revenue was \$ 29.7 billion in 2017.

In terms of other new buys within the fund, Anheuser Busch InBev (AB InBev) has gone from being a market darling ('great management team') to being very much disliked ('only cost-cutters'), and the share price has followed this sentiment. Perhaps the truth is somewhere between these two extremes, but in our view global beer remains a very attractive industry (oligopolies in many markets, strong brands, premiumisation opportunities, stable earnings, high return on capital and amongst the best free cash flow generation of any business), and within this industry there are 2 gorillas AB InBev and Heineken, both of which have attractive long-term prospects. We continue to rate the AB InBev management team highly, and believe that what they may not know about branding/segmentation, etc. (which is very little according to the bear view) can be learnt from the SABMiller (SAB) assets that they acquired or be brought in. AB InBev have a globally diversified business, with a strong presence in Africa (both South Africa and the rest of Africa), Brazil, Colombia, Mexico, China and the US. Almost 60% of profits come from (lower consuming and hence faster growing) emerging markets. AB InBev trades on c. 19x 2018 free cash flow (with SAB revenue and cost synergies still coming, Brazil profits being below normal, Africa and China amongst other regions growing at a rapid rate, etc.) and with a 4% dividend yield, which we believe is attractive for an asset of this quality. YUM China is the Chinese business that was spun out of YUM Brands (global owner of KFC, Pizza Hut and Taco Bell). The company has c. 8,000 outlets in China (McDonalds as a reference point have 2,600 outlets and Burger King have 800) and continues to roll out 500-600 new restaurants a year. The vast majority (80%) of these outlets are KFC, with the balance largely being Pizza Hut. The royalty percentage paid by YUM China to its parent is far lower than industry norms, which in turn means higher margins and a higher return on capital can be achieved. The fundamentals of a big brand fast food restaurant chain are generally attractive (convenient and affordable, defensive earnings stream and very good free cash flow generation). In addition, with still low penetration, YUM China can continue to roll out stores in China for many years to come in our view. The fast food groups have been successful at addressing the needs of a more health conscious consumer (a clear long-term risk) with expanded menus, and home delivery has also become an important driver (16% of KFC's and 23% of Pizza Hut's sales in China are now deliveries). The company has a strong balance sheet (net cash c. 10% of market cap) and will continue to generate a lot of free cash flow in the years ahead - a large part of which could be applied to share buybacks. There is also opportunity for margins to expand in our view. All-in, we believe that YUM China is a high-quality business, that can grow earnings by c. 15% p.a. over the next 5 years and at around 22x free cash flow one year out is attractive at current levels.

Members of the team continue to travel extensively to enhance our understanding of the businesses we own in the fund, their competitors and the countries in which they operate, as well to find potential new ideas. In the quarter there were trips to Russia, South Korea, Taiwan and Singapore. In the coming months different members of the team will visit China on a few trips with a focus on the Chinese internet companies which remains the industry where the fund has its main exposure to China. The weighted average upside to fair value of the fund at the end of June was an attractive c. 53%.

Portfolio managers
Gavin Joubert and Suhail Suleman
as at 30 June 2018