CORONATION GLOBAL EMERGING MARKETS FUND

Quarterly Portfolio Manager Commentary

CORONATION

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

The Coronation Global Emerging Markets Fund returned +12.6% during the fourth quarter of 2019, which was 0.8% ahead of the +11.8% return of the benchmark MSCI Global Emerging Markets Total Return Index. For the 2019 year as a whole the fund returned 38.2%, which was 19.8% ahead of market's return of 18.4%. This performance made it the fund's best relative year since inception almost 12 years ago (the previous best relative year was 2013 when the fund outperformed the market by 16.4%) and its third best year from an absolute return point of view, behind 2009's + 87.1% and 2017's + 38.3%. The fund has now outperformed the market over 1, 3 and 10 years, and most importantly is ahead of the market over long (and hence meaningful in our view) time periods with outperformance of 1.0% p.a. over 10 years and 2.3% p.a. since inception.

There were several stocks in 2019 that contributed more than 1% each to this outperformance and only one that detracted by 1% or more. In terms of positive contributors, Wuliangye Yibin led the way (appreciating by 161% and contributing 3.6% to performance) followed by New Oriental Education (+121%, +2.5% contribution), JD.com (+67%, +1.3% contribution), Yduqs/Estacio (+95%, +1.2% contribution), Yandex (+59%, +1.2% contribution), Adidas (+58%, +1.1% contribution) and Li Ning (+194%, +1.0% contribution). The good performance in 2019 was partly a reversal of a poor 2018 - three of the five worst performers in 2018 (JD.com, British American Tobacco and Cogna/Kroton) were all top 15 positive contributors in 2019, but was also aided by a number of long-held positions coming through - including Yduqs/Estacio and Adidas referred to above. In addition, the likes of Airbus (+54%) and Sberbank (+59%) also contributed meaningfully. Lastly, a number of more recent (calendar 2018) buys also played a large role including Wuliangye, New Oriental and Li Ning. Of the 7 largest positive contributors in 2019 we have totally sold out of one (Li Ning) as it reached our fair value, and we have materially reduced the position size of a few of them including New Oriental (2.5% position in Sep 2019 to a 1.3% position Dec 2019) and Adidas (1.4% position Sep 2019 to a 1.0% position Dec 2019). In terms of negative detractors, it was only Taiwan Semiconductor (TSMC) that detracted by more than 1% (-1.1% impact). The fund did own TSMC, but the position size was smaller than that in the index and TSMC was a strong performer in 2019 (+62%).

There were four new small buys in the fund during the quarter (all 1% or smaller positions) and five sells to zero. In terms of new buys, we initiated positions in Tencent Music Entertainment (TME, 1% position), LG Household & Healthcare (0.8% position), Midea and CP ALL (both 0.5% positions). In terms of sells, the fund fully sold out of Li Ning and China Resources Beer (+194% and +59% respectively during 2019 with both reaching and exceeding our estimates of their fair values), as well as selling the remaining small position in BB Seguridade after it reached fair value, selling Porsche (concerns over the long-term future of the traditional automobile industry) and lastly selling Cognizant, largely due to switching into the higher quality competitor Tata Consultancy Services, which was already a fund holding. In terms of geographic exposure over the quarter, the only meaningful change was the reduction in the fund's developed markets exposure (companies with at least 40% of revenue, profits or value coming from emerging markets) which went from 21.3% to 18.4% due to the sale of the Porsche position as well as the reduction in the Adidas position. This 21.8% current exposure is largely in line with the average developed market exposure of 17.8% in the fund since inception just under 12 years ago and well below the fund's cap of 25% developed market company exposure. China remains the largest country exposure in the fund (32.2% but effectively 35.1% if the look-through Tencent exposure in Naspers/Prosus is included), followed by India (10.1%) and Russia (9.3%).

TME (1.0% new position) is 58% owned by Tencent and has two main businesses: a) it is the leader in online music in China (c.75% market share) and b) has a large online social entertainment business, which focuses on music-related live streaming and online karaoke. The online music streaming business is the better of the 2 businesses in our view and is essentially the Spotify of China (Spotify actually owns an 8.6% stake in TME). TME have c.650 million online music users in China (as a reference point, Spotify globally have a total of around 250 million users) but both the proportion of users who pay anything and the average revenue per user of those who do are low, and should increase over time and drive the top-line. Today the business makes a small loss at the operating level but, with continued revenue growth and resultant leverage of the cost base, in our view this business will be very profitable in years ahead. Content costs are cheaper in China than elsewhere globally (partly due to a fragmented music industry) and this should result in higher operating margins than the likes of Spotify, for example, are likely to achieve. Today the online music business contributes c.30% of TME's revenue (and no profit) by our estimates, but over time we forecast that it will contribute c.45% of TME's revenue and c.35% of its profits. The online social entertainment business (70% of TME's revenue today and 100% of profit) is a very profitable business (EBIT margins of c.25%) but operates in a far more competitive area of the market where the barriers to entry are lower. We still expect this business to do well going forward, but the jewel in the crown and the main driver going forward will be the online music business in our view. TME went public just over a year ago at $13 a share and we didn't participate in the IPO at the time. The fund has only ever participated in one IPO (JD.com) in its 11.5-year history as almost always IPOs are priced very favourably for the seller. After completing our due diligence on TME and gaining conviction, with the share price doing little since the IPO, we built the fund's position one year later in December 2019 at an average price below $12. At time of purchase, TME was trading on around 25x forward earnings (c.20x forward Price/Free Cash Flow as the business converts c.125% of earnings into free cash flow), which we believe is an attractive entry point for this asset.

LG Household & Healthcare (LG H&H, 0.8% position) is a South Korean branded consumer company with c.75% of profits coming from cosmetics (largely premium) and the other 25% from household personal care goods (similar to Unilever) and beverages (including the Coca-Cola rights in South Korea). The cosmetic business is the key driver and is what interests us most. The worldwide cosmetics industry has grown in excess of global GDP over the past decade (LG H&H in turn have grown at 2-3x the industry), is economically resilient and is a prime beneficiary of the wealth effect and rising disposable incomes. This is particularly the case with the Chinese consumer and in this regard LG H&H is very well placed and today over half its sales come from the Chinese consumer (c.15% in China itself and the balance from Chinese shopping largely at duty free stores in South Korea). LG H&H has been investing heavily in its main brand 'Whoo' for the past decade and this brand in particular has been successful with the Chinese consumer. This is both a continued opportunity and a threat going forward. Over the past decade LG H&H has grown revenue at 13% p.a. and EPS at 18% p.a. and today the business generates a ROE of c.20%. The fund purchased LG H&H on c.22x forward earnings which we believe is attractive for this high-quality asset.

The two smaller purchases were 0.5% positions in each of Midea and CP ALL. Midea is a leading Chinese household appliances manufacturer, with 34% market share in washing machines in China, 24% market share in air conditioners and 15% in fridges. The company is vertically integrated (R&D, manufacturing, sales, warehousing & delivery) and is increasingly expanding into and developing logistics and robotics capabilities, as we increasingly move towards a smart technology world. While China (58% of sales) is its biggest market by far, it also generates revenue by selling in 200 other countries. Over the past 5 years, 110% of earnings have been converted into free cash flow and the business generates ROEs of c.25%. In our view, the share is attractively valued today, trading on c.14x forward earnings with a 3% dividend yield.

CP ALL is the 3rd largest 7-11 (convenience store) operator in the world (behind Japan and the US) with 11,500 convenience stores in Thailand (c. 80% of group profits) as well as over 100 cash and carry stores (Makro, 20% of group profits). The business continues to roll-out c.700 new 7-11 stores a year in Thailand as well as increase the contribution from higher margin categories such as coffee, ready to eat meals and banking services within its stores. As a result, in our view the business can continue to grow at a low double-digit rate in the years ahead. In addition to its core Thailand business, it has nascent cash & carry operations in Cambodia, Myanmar, India and China and is in discussions for the 7-11 master license in Cambodia and Laos. Once a market darling, the share has been flat for the past 2 years and recent concerns about a potential bid for Tesco's business in Thailand brought it into buying range.

At the end of December, the weighted average upside to fair value for the fund was around 30%. This is lower than the approximately 50% historical average, however this is not abnormal after a period of strong absolute performance and we believe the absolute upside is still quite compelling. This is especially so when one considers that the quality of the companies owned in the fund is above average when compared to history.

Portfolio managers
Gavin Joubert and Suhail Suleman
as at 31 December 2019