CORONATION
TRUST IS EARNED™

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

The Coronation Global Emerging Markets Fund had a good quarter, returning +1.5% compared to the MSCI Emerging Markets Index's return of -2.1% and in doing so outperformed the market by 3.6%. Year to date, the fund has now generated a return of +23.3%, leaving it 14.7% ahead of the market's return of +8.6%. We would note that this is an extremely short time period and, in our view, performance is better assessed over very long time periods. In this regard, since inception 11 and a half years ago, the fund has outperformed the market by 2.0% p.a. after all fees.

During the quarter to end June 2019 the 5 largest positive contributors to relative outperformance were Wuliangye Yibin (+20% return, +0.7% contribution), Adidas (+25% return, +0.6% contribution), Sberbank (+21% return, +0.5% contribution), X5 Retail (+38% return, +0.4% contribution) and the Housing Development Finance Corporation (+9% return, 0.37% contribution). There were only 2 negative detractors of note (greater than 0.5%): Yes Bank (-1% contribution) and British American Tobacco (-0.6% contribution). We sold totally out of the Yes Bank position during the quarter due to a combination of factors. Top of these were our concerns over additional bad debts after March year-end results were published. This worsened their capital situation and accelerated the need for a capital raise, which would be very dilutive to existing shareholders after the share price decline. The last straw was the forced appointment of a director to the Board by the Reserve Bank of India, which we interpreted in a negative light. In stark contrast to this, we continue to hold the view that British American Tobacco, on less than 10x earnings and a 7% dividend yield, is very attractive and at the time of writing it was a 3.4% position in the fund, making it a top 10 holding.

In addition to Yes Bank, we mostly sold out of Indiabulls Housing Finance (Indiabulls) due to concerns over the sustainability of their wholesale funding model going forward (the position was fully exited post quarter end). The small MultiChoice position inherited from the spinout from Naspers was also sold, along with the small remaining exposure to international payments business VISA. We added to the Alibaba and AIA positions on share price declines and reduced the Brazilian education exposure (Kroton and Estacio). Although we continue to like both Kroton and Estacio (1.8% positions each at end June, so 3.6% total Brazil education exposure) and both trade at reasonable levels of 10-12x earnings, the elevated competitive intensity in the industry, their increasing student loan books and an ongoing weak economic environment all led us to conclude that smaller positions were more appropriate from a risk perspective. Both shares have also done well this year, with Kroton having appreciated by 40% year to date in USD at the time of writing and Estacio by 35%. We also reduced the Cognizant position on concerns that excessive cost cutting are diminishing the long-term prospects of the business, with the bulk of this going into Tata Consultancy Services (TCS, 0.8% of fund).

In terms of country exposure, the largest upward change was an increase in China to 32% at end June, largely as a result of increasing the 51job position and the additional Alibaba buying. In contrast, exposure to India reduced to 9.1% at end June due to the sales of Yes Bank and Indiabulls mentioned above. The Brazilian exposure reduced to 8.4% due to the trimming of the Brazilian education stocks.

We added to the opening small position in 51job to reach 0.9% at quarter end. 51job is China's leading online recruitment operator in the white-collar space. This provides 2/3rdsof their revenue, with the balance coming from Human Resource Services; clients outsourcing (BPO) HR functions like payroll management to them. The company was founded 21 years ago and management owns 25% of the business. In the 15 years since the company listed on Nasdaq, profits have grown by 21% p.a. Today there is still a large opportunity in both areas of their business in our view: 51job has 500 000 corporate users of their online recruitment services and 10 000 corporate users of their BPO services. This is out of a market size of 85m registered businesses (and growing) in China. In addition to this, the company is very free cash flow generative (having converted 128% of accounting net profit into free cash flow over the past 10 years) and has a rock-solid balance sheet with net cash of over $1b (or 25% of its market capitalisation). 51job today trades on c. 20 forward earnings (15x ex the net cash position), which is attractive for a company of this quality and with this market opportunity, in our view.

One new purchase worth noting was that of Hero MotoCorp (Hero, 0.5% position). The company is lower down the quality spectrum than an Alibaba or TCS, but has a number of qualities that we like, and after a 35% decline (in Rupees) since its peak price in mid 2017, it trades on c. 15x forward earnings, with a 4% dividend yield and a strong balance sheet (net cash position). Hero is the largest manufacturer of two-wheeler (motorbike) vehicles in India, a market which has historically grown at a high rate and is still underpenetrated, but which is going through a tough period currently after industry volumes were hit by the tightening of requirements to purchase third-party insurance along with the bike purchase. Hero is the clear market leader in the entry-level market (75cc to 110cc, where they have c. 50% market share) and in the 'executive' market (110cc to 125cc, where they have close to 70% market share). Overall, of the 20m motorbikes sold in India annually, 7.5m are sold by Hero. Besides being dominant in the entry level market, Hero has recently put more effort into making inroads into the scooter and premium markets, and the export market also holds large potential. It is unclear yet as to the level of success they will have in these areas, and we will continue to evaluate this over time, but the entry-level and executive markets alone will provide many years of growth in the years ahead in our view. There were a few other new buys in the quarter, but none of these exceeded 0.2% of fund.

Members of the Global Emerging Markets 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 as to find potential new ideas. In the second quarter, there were trips to India, Thailand, Hong Kong and Singapore. The coming months will see trips to China and Russia. The fund's weighted-average upside to fair value at the end of June was c. 35%, which we feel is compelling. We would also consider the overall quality of the stocks held in the fund currently to be above average when compared with other points in the fund's history.

Portfolio managers
Gavin Joubert and Suhail Suleman
as at 30 June 2019