

CORONATION GLOBAL EMERGING MARKETS FLEXIBLE [ZAR] FUND

Quarterly Portfolio Manager Commentary

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

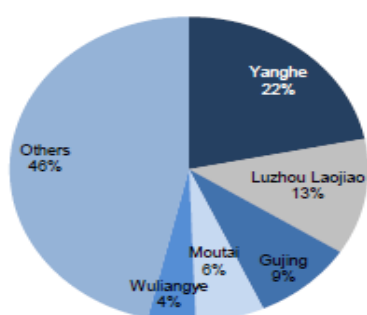
The fund had a very good quarter, returning 21.6% compared to the MSCI Emerging Markets Index return of 11% (both in rands) and in doing so outperformed the market by 10.6%. This made it the fund's best quarter of outperformance since inception over 11 years ago. Its previous best quarter was the one to end September 2008 (9.4% outperformance) in the midst of the 2008 GFC.

During the quarter to end March 2019 there were a number of stocks that contributed positively, with all of the 15 largest positive stock contributors appreciating by more than c. 20% in USD. At the top of the list was Wuliangye Yibin (+92%, 1.8% contribution), New Oriental Education (+62%, 1.2% contribution) and Yes Bank (+53%, 0.9% contribution) followed by British American Tobacco (+29%, 0.8% contribution), Ctrip (+60%, 0.7% contribution), JD.com (+36%, 0.7% contribution) and Philip Morris (+34%, 0.6% contribution). A number of these stocks were poor performers in 2018 (specifically in the last few months of the year) and so the fund's strong performance to date in 2019 is partly a reversal of a poor 2018. JD.com, Yes Bank, British American Tobacco, Philip Morris and Ctrip would all fall into this category. In addition, a few of the new buys in late 2018 were strong performers, most notably Wuliangye Yibin and New Oriental Education. Lastly, a number of long-held positions contributed positively, including Airbus (+38%, 0.6% contribution), Ping An Insurance (+28%, 0.4% contribution) and 58.com (+16%, 0.2% contribution). At the same time there were few large negative contributors with only one detractor of more than 0.5% (Alibaba's -0.6% detractor). Since inception over 11 years ago the fund has outperformed the market by 1.7% p.a.

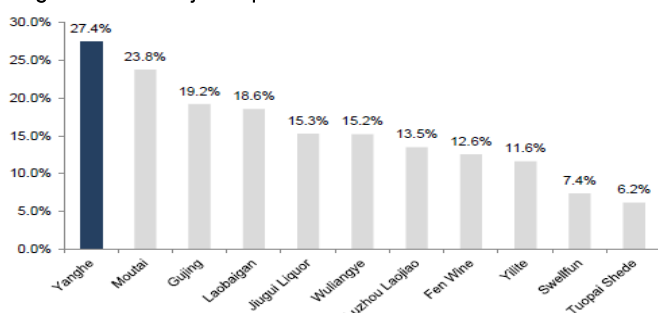
There were 5 new buys during the quarter. The 2 largest new buys were that of Jiangsu Yanghe Brewery (1.6% position) and LVMH (1.7% position). The 3 other buys were small: a 0.9% position in NetEase (#2 online gaming company in China after Tencent), a 0.5% position in BM&F Bovespa (Brazil's dominant vertically integrated multi-asset [equity, bonds, derivatives] exchange) and a 0.4% position in Eastern Tobacco (Egypt's monopoly cigarette manufacturer). In total, the 5 new buys represent 5.1% of the fund. During the quarter, we sold China's #1 search engine, Baidu (a 1.5% position at the start of the year) due to increasing concerns about the core search business as well as the uncertain future return from the numerous other areas where the group is investing significant capital. In terms of other portfolio activity, we reduced the positions in New Oriental Education, Ctrip, Noah, Li-Ning and Adidas (all on strong share price performance and resultant less upside to our estimate of fair value) as well as Indiabulls (largely due to a reduction in our fair value and a less attractive risk/return profile). From a buying point of view, most of the activity was in the 5 aforementioned new buys but we also added to the existing positions in HDFC Bank and Pão de Açúcar.

Jiangsu Yanghe Brewery is the largest *premium* brand baijiu (the dominant white spirit in China) company, in contrast to the main *ultra-premium* (very high end) baijiu companies Kweichow Moutai (not owned in the fund) and Wuliangye Yibin (a 3.3% position in the fund). We bought a position in Wuliangye Yibin late last year and subsequently continued to do additional work on the industry, including a week's trip to China solely focused on the Baijiu industry which led us to Jiangsu Yanghe.

Market share of premium baijiu



Sales growth rates of baijiu companies 2007-2017

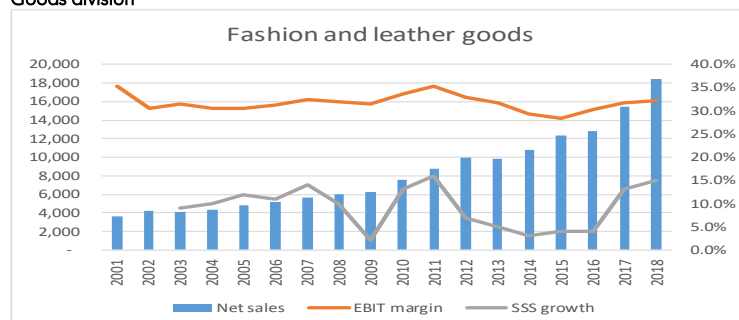


Source: Euromonitor, Deutsche Bank

Over the past decade, Jiangsu Yanghe have grown sales by 27% p.a., making them the fastest growing baijiu company over this period. Both net profit and free cash flow have grown by 35% p.a. over the past 10 years and today the company generates over \$1b of free cash flow. The company is a beneficiary of the premiumisation of baijiu (their main premium brand 'Dream Blue' series has gone from being 2% of sales a decade ago to contributing over 20% of sales today) and we expect this to continue, together with further expansion to regions outside of their home base, Jiangsu (which today still contributes 53% of sales). A unique feature of Jiangsu Yanghe that also attracts us is the fact that management own c. 21% of the company. Just like Kweichow Moutai and Wuliangye Yibin, the financial metrics of Jiangsu Yanghe are impressive with operating margins of c. 45%, return on capital of c. 20% and high free cash flow conversion (over 100% of net profit in the past 3 years has been converted into free cash flow). The share trades on c. 18.5x forward earnings with a 3% dividend yield, which we believe is attractive given its long-term prospects.

The other new buy of note was a 1.7% position in LVMH, which we have covered for several years and have owned in the Strategy in the past. LVMH (Louis Vuitton Moët Hennessy) is the largest global luxury goods company and the owner of the Louis Vuitton brand (c. 50% of group profits) and many other global brands including Moët & Chandon, Hennessy, Christian Dior, Fendi, Bulgari and Tag Heuer. Over 40% of sales come from emerging markets and the Chinese consumer alone (purchasing at home as well as while travelling) is responsible for well over 50% of incremental growth.

Historic sales, same-store sales growth and EBIT margin of LVMH Fashion & Leather Goods division



Source: Coronation, LVMH annual reports

LVMH has an enviable track record (over the past 20 years EPS has compounded at c. 12% p.a.) and today is well placed to be a key beneficiary of the growing emerging market middle and upper class and the wealth effect. The barriers to entry possessed by the true global luxury brands (Hermès, Louis Vuitton and Gucci) are amongst the highest in any industry in our view: in the case of Louis Vuitton, a 150-year history and investment in the brand for a start. The resilience (of both the topline and profitability) of the Louis Vuitton brand in particular in tough economic periods is also unparalleled: in 2009 (post the GFC) sales of the Fashion & Leather division (with Louis Vuitton making up the lion's share of this division) of LVMH grew by 2% and EBIT grew by 3%. In 2002 (post September 11th) the Fashion & Leather goods division experienced 16% sales growth (and this after double-digit sales growth in 2001 as well) and 5% EBIT growth. The fund bought LVMH on c. 20x forward earnings and a 2% dividend yield, which we think is attractive for what we would consider to be one of the best businesses in the world.

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 first quarter, there were 2 trips to China and 2 to India. The coming months will see a further trip to China as well as one to Brazil. The fund's weighted average upside to fair value at the end of March was c. 40%, which we feel is compelling. We would also consider the overall quality of the stocks held in fund currently to be above average when compared with other points in the fund's 11-year history.

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