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

Performance

The Fund returned 9.8% in ZAR in the first quarter of 2023 (Q1-23), outperforming the benchmark MSCI Global Emerging Markets (Net) Return Index by 1.2%. Over six months, the Fund has returned 19.8%, almost 8% ahead of the benchmark, and over one year the Fund has outperformed by 8.9%. After a very tough 15-month period from March 2021 to June 2022, we are very pleased that performance has improved so markedly. That being said, we are cognisant that the three-year and five-year relative performance figures remain negative, and we still have some way to go to fully recover the negative impact of the period of underperformance. Since inception in December 2007, the Fund has returned 7.5% p.a.

The biggest contributor to relative performance (alpha) was MercadoLibre (MELI), the Latin American ecommerce and fintech operator. MELI returned 58% and provided 1.5% alpha. MELI's share price performance has largely been driven by excellent operational execution that resulted in 2022 being by some distance the best year in the company's history. In 2022, their fintech arm processed more than $100bn in payments, the company booked $10bn in revenues and exceeded $1bn in operating income. Another huge milestone was exceeding 1 billion items shipped. Their base of Gross Merchandise Value (GMV) is up 2.5x from the 2019 year and fintech revenues are up almost five times over the same period. The investment in logistics means they have almost doubled the proportion of GMV delivered within 48 hours, from 44% to 80% since 2019. We remain very excited by the prospects for MELI, and it is still a top five holding despite some trimming as a result of the strong absolute share price move.

The next largest contributor was SEA Ltd, a predominantly Southeast Asian ecommerce and gaming business. SEA was up 69% and contributed 0.8% of alpha. The bulk of historical cash was generated by their hit game Free Fire, and they used this money to invest in their Shopee ecommerce operation. SEA was a glory stock during the pandemic, when its share price increased eightfold from the bottom of the market in March 2020. The flood of cheap capital allowed SEA to raise $3.5bn of equity at $318 a share close to the peak of the market, as well as $2.5bn in convertible bonds. Needless to say, the embedded call option in these bonds is now worthless with the share having traded below $50 fairly recently. We first bought SEA into the Fund in the first quarter of last year, as it was too expensive for us before that, and added to the position size as it declined. The market view of SEA had gone from a buying frenzy to one more circumspect as Free Fire has bled users and the ecommerce business incurred huge losses. Our research suggested that Shopee would see a material reduction in losses and SEA would exit markets where they had little hope of becoming profitable due to strong incumbents or a lack of competitive advantage. This thesis largely played out during 2022, with SEA exiting the Polish market and materially reducing losses in their other big loss-making market – Brazil. For 2022 as a whole, despite flat GMV, their ecommerce revenue increased 42% in constant currency terms, and they generated positive EBITDA of $196m even though they lost $124m in Brazil (down from a $352m loss in Brazil in 2021). Management is confident that Brazil will be profitable by the end of 2024 and with all their Asian markets now profitable they are on track to deliver from an operational point of view.

Naspers/Prosus was the third largest contributor to alpha at 0.7%, however this was fully offset by not owning Tencent directly, which cost a similar amount.

The largest detractor in the period was JD.com (-19% return, -1.3% alpha), which continues to come under pressure due to slowing revenue growth and competition from Pinduoduo. After years of 20%+ growth rates, JD's retail arm delivered only 7% revenue growth in 2022, partly due to Covid restrictions that will not affect it going forward. The retail arm is now sustainably profitable with an EBIT margin of close to 4% despite continued investment. The company also generates loads of cash and is now sitting on ~$26bn of cash, about a third of their market capitalisation. They have started paying regular dividends ($1bn this year), paid a $2bn special dividend last year and have almost completed a $3bn buyback programme. We believe JD.com is exceptionally cheap – after stripping out cash and the value of listed subsidiaries, the core retail business is trading at an astonishingly low 4x earnings multiple. The company believes they can double EBIT margins in the retail business in the fullness of time (our research supports this view due to specific identifiable drivers) and this, coupled with narrowing losses in their other less mature businesses like JD Health, means profitability is expected to increase strongly for the business as a whole.

Other material detractors were Delivery Hero (-26%, -1.1% alpha), 3R Petroleum (-13% return, -0.5% alpha) and Brazilian cash & carry operator Sendas (-10% return, -0.4% alpha). While many other tech names have rebounded sharply from the sell-off last year, Delivery Hero has failed to hold onto initial gains and remains unloved by investors. It didn't help that the company issued €1bn of convertible debt in the period to assist with liquidity. The share price weakness is not unique to Delivery Hero with other food delivery platforms also coming under pressure. This reflects the perceived weaker investment case for food delivery as the world has reopened post Covid, since order frequencies have declined from the levels reached during the pandemic (although they remain well above pre-pandemic levels). We believe there are real network effects for food delivery and most major food delivery markets will end up being dominated by two to three players. There is also evidence that once customers come on board, their order frequency increases significantly over time.

Fund positioning

There were a number of new buys in the quarter including FILA Holdings and KB Financial Group (both Korean). We have owned the latter before (a few years ago) but sold it due to lack of progress on capital allocation. There has been substantial pressure exerted on the Korean banks to improve capital allocation and we believe it is likely to bear fruit since even the government seems motivated to improve shareholder friendliness of Korean companies. KB trades on 4x earnings and at less than half its book value, making share buybacks highly accretive. It also pays a very attractive 7.5% dividend yield. FILA Holdings is the global rights owner of the FILA brand. It operates a retail and wholesale business in Korea, a predominantly wholesale business in North America and sells in the rest of the world under a licensing arrangement, including a JV in China with Anta Sports. In addition to the FILA business, the company owns just over half of Acushnet, the US-based golf equipment maker that owns the Titleist and FootJoy brands. FILA trades at 7.5x forward earnings and is on a 4.5% dividend yield. Elsewhere in Asia we bought Bank Mandiri in Indonesia and made the Fund's first investment in Saudi Arabia, with the buying of a 0.6% position in Saudi National Bank, the country's largest bank by assets. The last new buy was Becle, the owner of the tequila brand José Cuervo.

There were two sales in the Fund, with Reliance Industries and PagSeguro being sold completely.

Outlook

At the time of writing, the Fund has a weighted average upside of close to 70%, well above the historical average of 45%. The weighted average five-year IRR is also an attractive 18% p.a. We believe these metrics best capture the potential for outperformance by the Fund in the periods ahead.

Portfolio managers
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as at 31 March 2023