

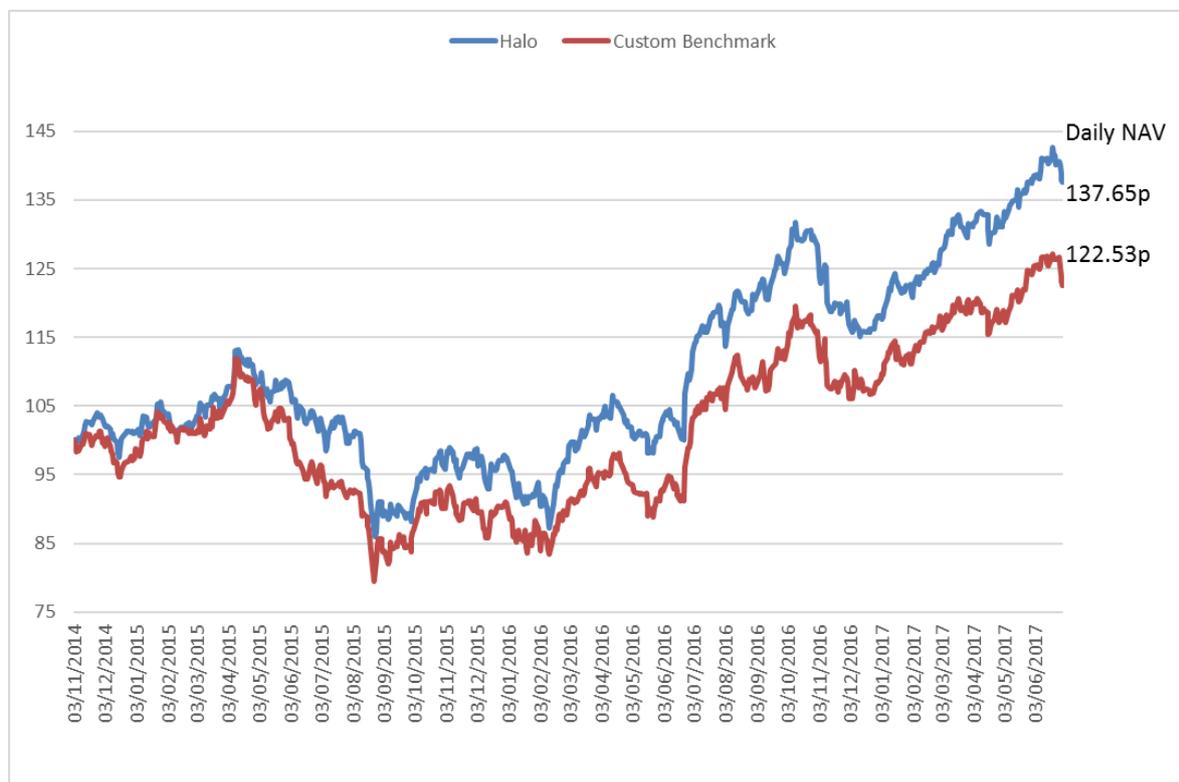
VT HALO Global Asian Consumer Fund

2nd Quarter 2017

The second quarter has been characterised by a softening US Dollar which is viewed positively for emerging markets and this applies to Asia as well. With strong PMI numbers from the region and robust growth, any concerns investors had at the beginning of the year have largely been dampened down and as a result we have seen inflows into Asian markets. The NAV of the fund is up from 131.1p to 137.7p, even as Sterling has been “relatively strong” due to hope of a softer Brexit with Sterling strengthening by 3.8% against the US Dollar over the three month period.

Performance data shown is of the B £ Net Acc. share class. Custom Benchmark, 30% MSCI AC Asia ex Jap Consumer Staples, 40% MSCI AC Asia ex Jap Consumer Discretionary and 30% MSCI AC Asia ex Japan Index. Past performance is not a guarantee of future returns. Data from Valu-Trac Administration Services and Reuters, 30th June 2017.

For illustration purposes only. Halo does not benchmark against any index in accordance with our Information Memorandum and Prospectus.



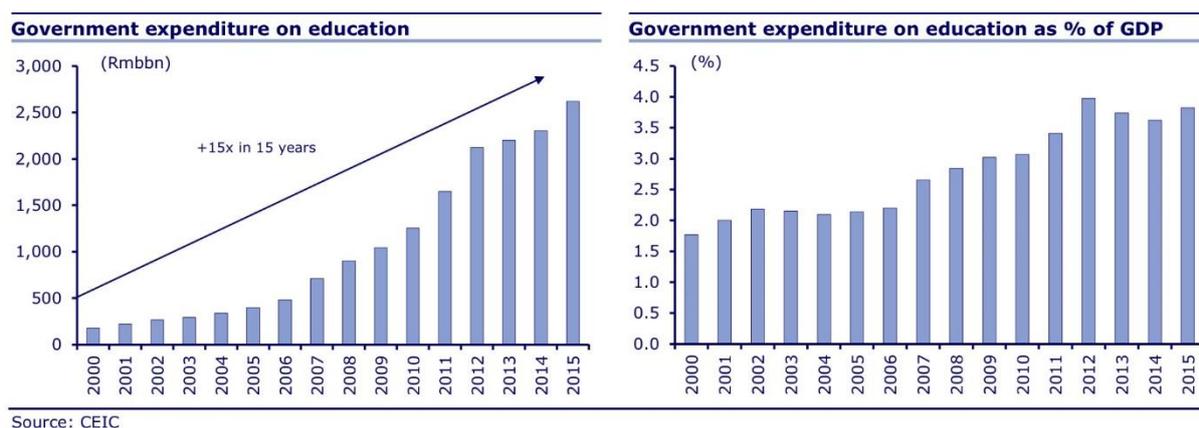
Against the custom benchmark which we stress is for illustrative purposes only it has been another quarter of relative out-performance which is pleasing. But our key objective is to produce 8-12% per annum without relying on any multiple expansion and we continue to deliver against this metric.

Again, for this Quarterly Letter I wish to say very little on the macro, but spend more time delving into another theme within the fund, the education sector, which we have touched on in the past, but this time is solely focused on China.

Chinese Education

Confucianism is deeply ingrained in Chinese culture and places a very high value on schooling. There is a strong urge to excel and grades still seem to be the key goal for parents and their children. Top marks in exams are seen as the route to wealth, power and social status, benefitting the person, his family and quite often future generations. This importance of academic qualifications to Chinese families implies a demand for educational services that is likely to be relatively inelastic. The most important exam for the Chinese is the GaoKao exam which is the key exam to get admitted to undergraduate studies. Quite simply it is the test that decides their destiny. Parents will invest the maximum they can afford to ensure the best results possible for their child. There is also an obsession with brand-name universities, including the prestigious Oxford, Cambridge, Stanford, Yale and Harvard. You can imagine the lengths to which the parents will push their children to gain the necessary grades. Competition for school places is intense.

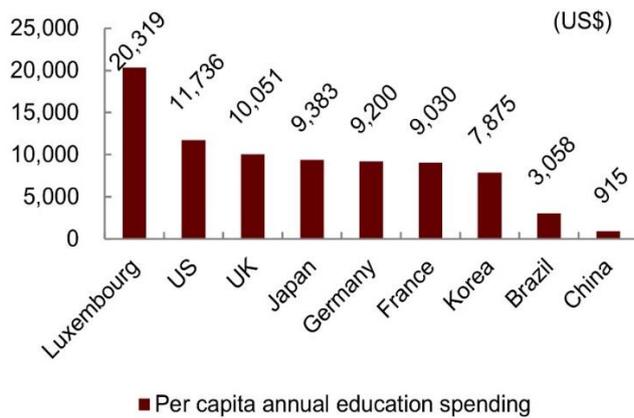
Government support for the education sector has been robust with sector investment having risen 15 fold over the last 15 yrs to over Rmb2500bn per year in 2015 . As a percentage of GDP this has risen from 1.8% to 3.8% over the same period.



More recently the government has encouraged the development of private school education and welcomed private investment, which help alleviates pressure on the government education budget. In 2010 priority was given to private preschools and the number of preschools in China grew by 40% between 2010-2014, with the number of regular higher-education schools up +7%. Despite this spending, the supply-demand balance has been quite stable. There are strict regulations around the private education industry especially with regards to foreign investment and the curriculum, which offer local established players a competitive advantage.

China is still in the early stage of wealth creation and accumulation, but as we see incomes rise we expect much of the demand for education to be increasingly filled by the private sector. However, as shown in the chart below, per capita annual education spending is rising but still well below that in developed markets. The Chinese still only spend 2% of household expenditure which remains amongst the lowest in the region.

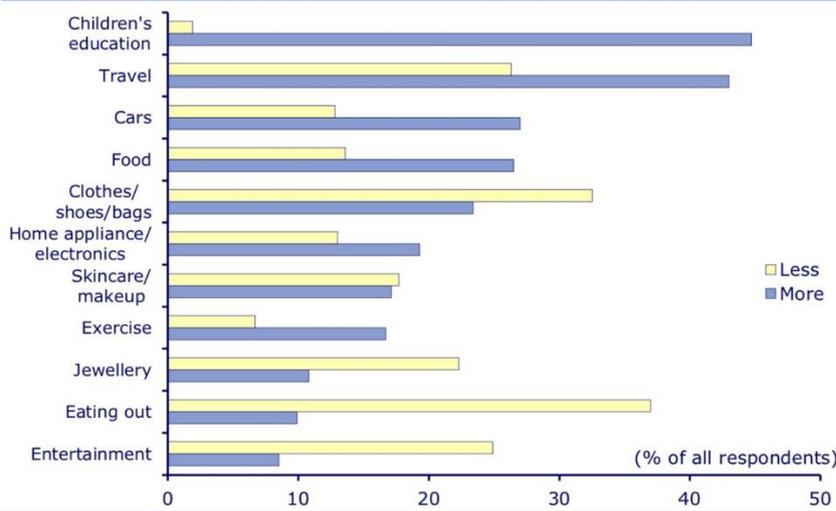
Per capita annual education spending is rising but still well below that in developed markets



Source: OECD.org, CICC Research

Given the importance the Chinese ascribe to education it is not surprising to find education spending remains very sticky as in this recent survey. Of all the discretionary spending items, children’s education tops the list of wishes to spend more as their income rises, and last to be cut. When Chinese parents are surveyed 45% say they would increase spending on children’s education when family income grows, ahead of all other categories such as travel, cars or skincare. Should family income fall, only 2% say they would cut spending on education as highlighted in the figure below.

If your family income grows/declines, what are the top areas you expect to spend more/less on:

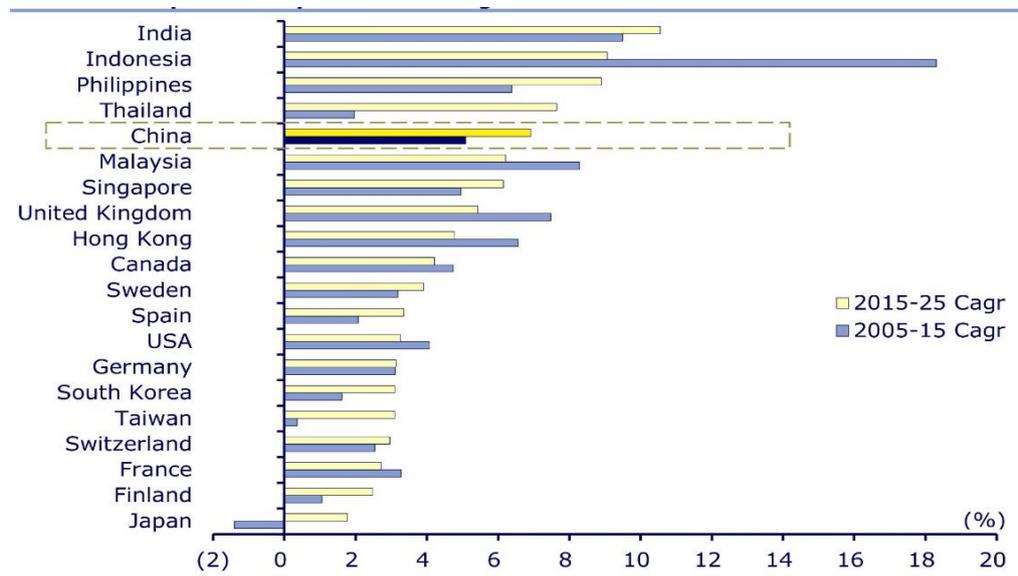


Source: CRR

The Chinese one-child policy, which was introduced back in the 70’s, did successfully control the population growth, but has led to an ageing population. In January 2016 the government relaxed this policy allowing couples to have two children resulting in almost 18.5m new babies being born in 2016 (up 12% year on year). Recent surveys report that around 50% of young families aged between 20-34

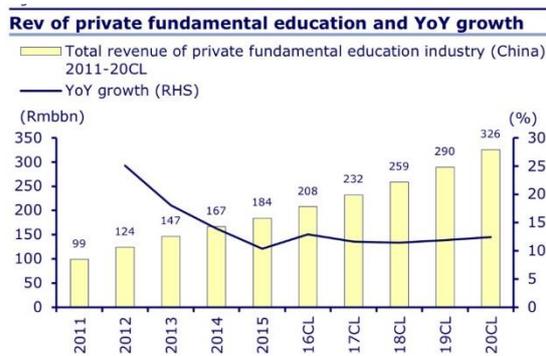
are planning to have a second child within the next two years. Correspondingly we expect the education expenditure growth to accelerate as illustrated below.

Education expenditure per household will accelerate.

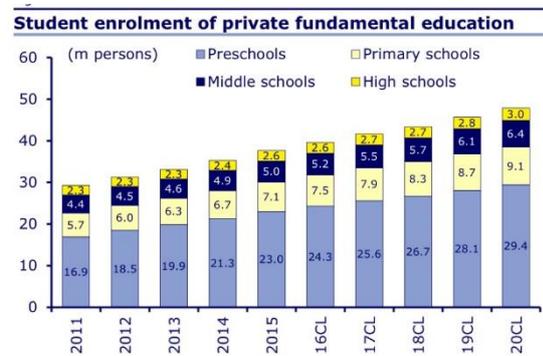


Source: Euromonitor

We should also expect both the revenue of private fundamental education and the student enrolment to rise steadily over the next few years.



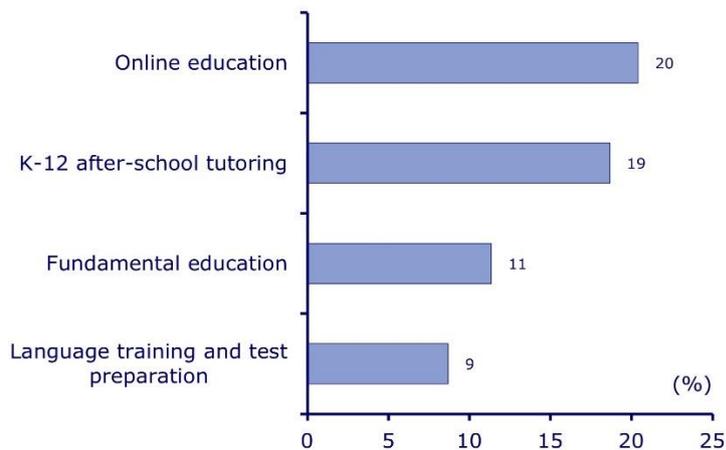
Note: For China. Source: CLSA, Frost & Sullivan



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As mentioned earlier, the Gaokao is the most important exam for children, and so today the newly emerging wealthy parents are keen to help broaden their child's education outside the school classroom. This is done through extra lectures, lessons at private academic institutes, internet and correspondence lectures. Typically, these classes are smaller than a class at school but can also cater for one-to-one tuition. After school tutoring can even stretch to classes in how to greet the elderly, interview training, lessons in etiquette, computer coding or Kung Fu. All with the aim of helping the student to become a more interesting and rounded university or job candidate. The chart below illustrates the growth by segment, with the after-school tutoring market expected to grow by 19% pa between 2015 and 2018, from a \$70bn market in 2014.

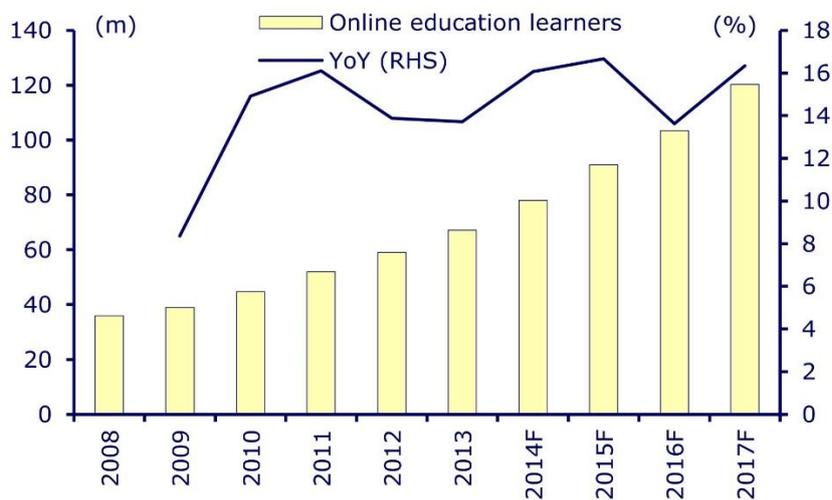
Growth by segment, 2015-18CL Cagr



Source: CLSA, iResearch

Another area of rapid growth has been the online after-school education industry. This segment’s revenue grew close to 200% between 2008 to 2014 when it generated US\$10bn, which industry specialists forecast will rise to US\$17bn+ for 2017. The number of online learners which stood at 78m in 2014 is expected to top 120m this year. Online learning should grow in line with broadband penetration, which stands at c50% in China, vs 75% in HK and 85% in Japan. There is still plenty of room to grow.

Number of online education learners



Source: iResearch

How are we investing in the region to gain from this thematic?

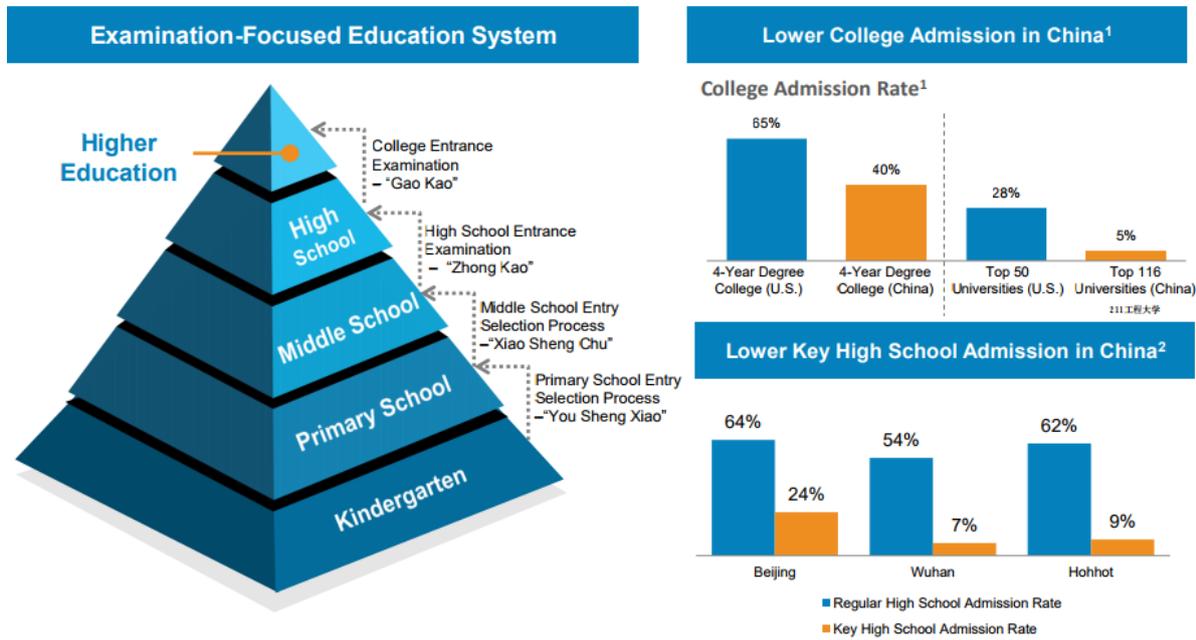
At present it is fair to say that China is the only market that currently offers investable opportunities where we can identify companies that fit our criteria of being leaders in their sector, having strong brands, pricing power and the private education market growing faster than the nominal GDP growth of the country. We see there are multiple earnings drivers over the next few years supported by enrolment growth, new schools, and tuition price hikes. The barriers to entry remain high given the government's strict standards on the curriculum and teaching standards giving the early movers an advantage. So for those of you who have read our fact sheets and previous quarterly letters you will be aware we own a number of stocks in this space. Firstly, China Maple Leaf, an operator of Chinese and international curriculum schools, with the vast majority based in China. Secondly, we also own an after-school K-12 company, New Oriental Education and lastly Tarena, a professional education company, with a focus on IT training.

China Maple Leaf

Their focus and unique selling point is the teaching of a bilingual syllabus in their high schools, so that graduates come out with a British Columbia School Diploma as well as a Chinese High School Certificate. They teach the international curriculum in English which then allows a smooth transition for students to English speaking universities around the world, with a claim that over 50% of their students go on to study at the Top 100 universities.

As you can see below it is extremely competitive to obtain a place in the top universities in China, in comparison with the US. Only 5% of applicants are admitted to the top 118 Chinese universities, against 28% to the top 50 in the US and so a lot of parents if they can afford it will opt for a private school education, with a view of going to an international university instead. In order to do this they will start their children in the private education system from an early age to ensure they will progress through to high school. Gaining entry into good private schools is based on exams and strict selection criteria as also illustrated below, and so if you start early you have a better chance of entering the system and graduating with the required grades.

Underpinned by Intensely Competitive Education System



¹ Source: National Association for College Admission Counseling, 2013; collegeadmissions100.com, 2013; learning.sohu.com, 2015; Ministry of Education of the People's Republic of China, 2015
² Source: lixue86.com, 2015; 51edu.com, 2015; chuzhong.eol.cn, 2015; edu-hb.com, 2015; ml.sohu.com, 2015; hhkszx.cn, 2015

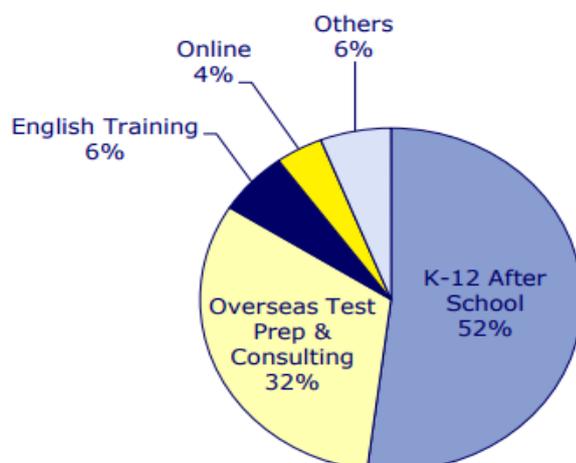
They currently have a school network of 60 schools from Pre School to High School in 15 cities with further expansions planned over the next few years as the brand becomes more well known and demand for private schooling remains strong. With plans to increase capacity from 38,000 students today to 55,000 in the 2018/19 school year, both through expanding existing schools and entering 4 new cities. This implies close to 50% capacity expansion over the coming two years with the company remaining confident that the capacity utilisation of its schools will remain broadly flat at 64% as the new schools take time to ramp up and existing schools operate at 90% or above utilisation rates.

In addition, as the brand strengthens throughout China they are also increasing the fees across all schools, with the average fee increase of about 5% pa over the whole group. We are thus expecting revenue growth to continue to remain above 20% for a few more years and although profit growth may lag revenue growth over the next 18 months as the new schools open, we expect it to catch up and overtake revenue growth as the new schools reach maturity in 3-5 years. We consider the valuation of 16x August 2018 as a very fair multiple for the company. If it delivers on its targets then we would expect a PE multiple expansion on top of the profit growth over the next 3 years and it remains a top 10 holding for us.

New Oriental Education (stock symbol EDU), after-school tutoring

EDU's business is the after-school market and test preparation for overseas study. Their revenue breakdown is shown in the pie chart below and the K-12 business, being the largest part, is currently growing its revenue at 49% in local currency. The overseas test prep is seeing student enrolment in low single digits but delivering revenue growth in the 10-15% range, on the back of strong pricing due to revamped courses.

Revenue contribution in 2QFY17



Source: company, CLSA

Demand for after school courses appears to have reached an inflection point with EDU and their main rival TAL Education seeing an acceleration in demand, which is likely to continue for a few more years. As a result, for EDU are doubling the rate of expansion of new learning centres from 30-40 to 70-80 per annum, over 2017 and 2018. As shown earlier, as consumers reach a certain level of income, education becomes the number 1 priority of increasing discretionary spending. After school learning is an extremely fragmented industry with a lot of very small companies in the industry and we expect EDU to continue to take share given their strong brand, as they expand into new and existing cities.

The sell side are expecting revenue growth of 20% for this company over the next 3 years but we believe this is likely to prove too conservative. With volume growth just for its K-12 and online businesses likely to be 30% and pricing of 5-8% pa, they can achieve this target with just these two verticals. With overseas test prep also growing at a minimum of low double digits it is fair to assume revenue growth will be closer to 30% pa. With increasing margins as economies of scale kick in and better utilisation of existing classrooms, then a bullish scenario is profit growth of something closer to 40% in 2018 and 2019. In this case, with improved cash flow, returns on capital and perhaps a more consistent dividend policy and it being on 25x PE for May 18 based on our estimates, we do not think it is expensive with this current outlook.

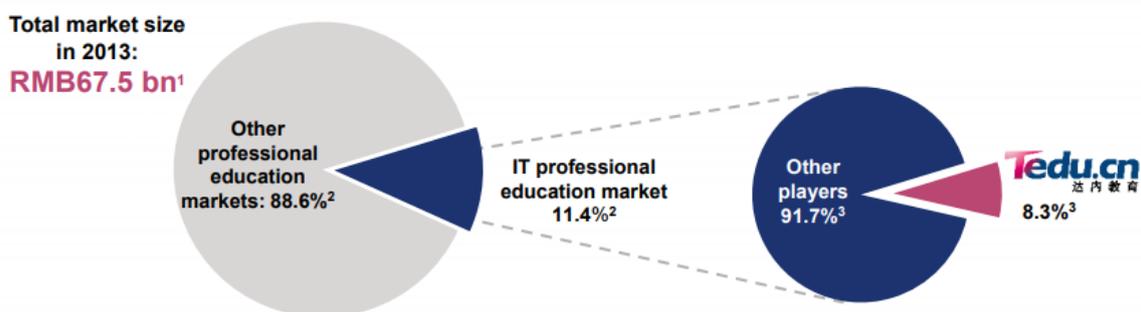
Tarena – Professional Education provider

Once you have spent money on schooling, there are those who leave college and university who then have to train to be appealing to a prospective employer and this is where our third holding comes into play. We own Tarena, a professional training provider specialising in IT, computer graphics and now online marketing courses.

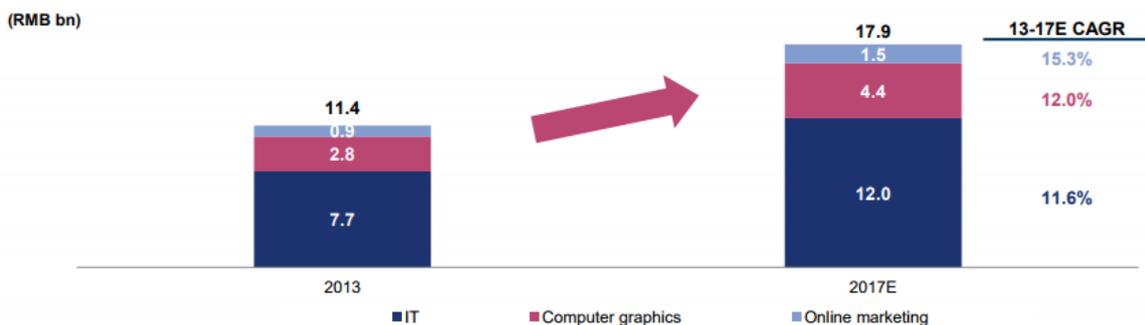
The job market is competitive and in order to stand out from the crowd it helps if you are able to offer a qualification, say in Java programming and Tarena's selling point is that 95% of their students will have a job within 6 months of finishing a course with them. The market has been growing at about

12% pa over the last 5 years and it would be fair to say this growth rate should continue for a few more years. Tarena as you can see below only has 8% market share in the IT professional education market and so has a lot of room to expand as it also is taking share from small operators. It has recently announced it is accelerating its roll out of new centres into Tier 3 and Tier 4 cities, as demand appears to be strengthening and there is now a critical mass of students who are after courses in this area. It is an inherently scalable business as the teachers/professors sit in Beijing and all teaching is done by video link into the class room in whichever city it might be, helped by teaching assistants physically in the actual classroom. This ensures all students experience the same quality of teaching wherever they happen to live.

Significant growth opportunities



Large and growing addressable market¹



1. Source: IDC
 2. Source: IDC, Professional education service market segment by revenues in 2013
 3. Source: IDC, IT professional education market share by revenues in 2013

Given the demand they are currently witnessing, the CFO, whom we met recently is expecting to see revenue growth in the 20-25% pa for the next 3 years, driven mostly by increasing student numbers. They also increase prices for their courses in line with the earnings power of the students who qualify and move into employment. Currently these graduates are seeing starting salaries rise by 5% a year and so we should expect similar annual price increases from Tarena for its courses.

In addition, they have in the last year started to roll out K-12 courses for IT programming and robotics as they believe there is parent demand for children to start learning the basics whilst still at school. It is also interesting to note that Zhejiang Province, the home of Alibaba, is starting a trial to include computer programming in the school curriculum. If this takes off nationally, then in the future we can expect K-12 after school courses to see rapid demand for this area as well and Tarena will be well positioned to take advantage of this new avenue of demand.

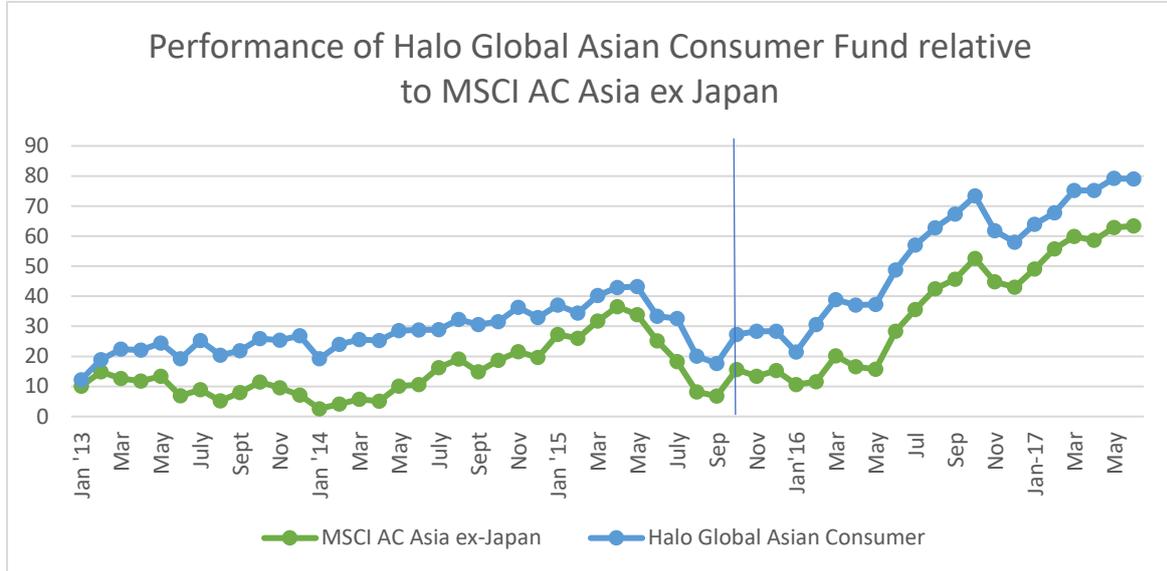
With revenue growth as guided by the company expected to grow by over 20% in the next few years and with margins expected to be flat to slightly up as utilisation rates will not change much due to an acceleration in the roll out of new classrooms, we should expect on average close to mid 20s EPS growth. The shares trade on 17x forward earnings, which is not expensive, with the market having concerns this is a more cyclical business than standard educational establishments and will be impacted if there is a downturn in the economy. We remain comfortable with this growth and don't believe the multiple is expensive, as we believe demand for IT professionals will remain robust given the growth in the new economy.

Conclusion

We believe education in Asia will remain a top priority for all middle-class parents and is an area where the underlying growth accelerates as the GDP per capita approaches \$10,000. We see the companies we own covering a number of areas, both schooling and after school services and expect demand to remain strong as GDP for China moves from \$9,000 towards \$20,000 over the next 10-15 years. Given how competitive the world has become, we expect education to be at the forefront of consumers' minds as we all want to do the best for our children. As a result, we are looking for other companies in emerging Asia that will benefit from similar trends as their economies develop, with a particular eye on India. However it may be a few more years before there are a number of quoted companies in Asia outside China which might be potential investments for us.

Appendix

Performance of the Fund including the paper portfolio.



Performance shown to the left of the blue bar is of the model portfolio gross of fees and trading costs, to the right is the performance of the VT Halo Global Asian Consumer Fund £B Accumulation units inclusive of all costs. Past performance is not a guide to the future performance.

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