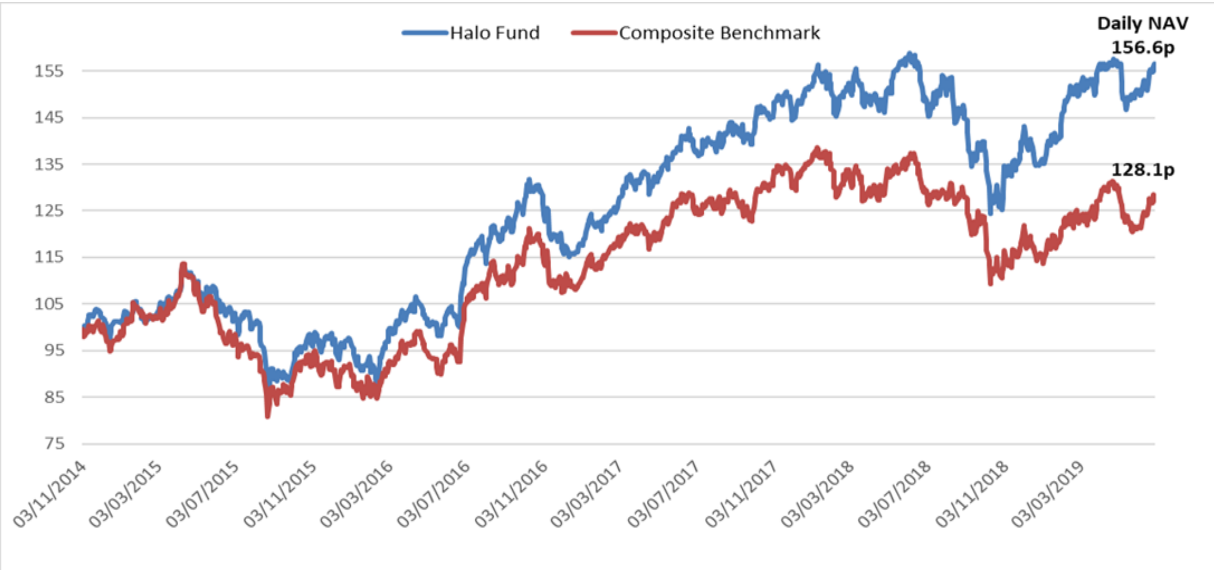
VT HALO Global Asian Consumer Fund

June 2019 Quarterly Letter

The second quarter of 2019 started with a benign April, as markets priced in the likelihood of the US/China trade deal being consummated. This was followed by a sell off in May, as Trump announced further tariffs on goods which are currently subject to 10% going to 25%. In addition, he threatened new tariffs of 25% on all other US imports from China, amounting to just over $300bn. This was unexpected, and as June progressed markets have rebounded as perhaps these actions are not as destabilising as feared, helped by the Federal Reserve becoming more dovish with regards to the path of US interest rates. A likely rate cut in July bodes well for the twin deficit countries of India, Indonesia and the Philippines, allowing them to cut interest rates, therefore helping their consumer confidence and ability to finance infrastructure investment, whilst removing the fear of further depreciation of their currencies and the knock on effect of importing inflation.

As I write, Trump has now announced that talks are back on and there will be no tariffs placed on the $300bn of products that are currently exempt. This has resulted in the Fund's unit price reaching a new high in the first week of July.



Performance data shown is of the B £ Net Acc. share class. Custom Benchmark, 30% MSCI AC Asia ex Jap Consumer Staples, 30% MSCI AC Asia ex Jap Consumer Discretionary, 10% MSCI Communication Services and 30% MSCI AC Asia ex Japan Index. From 01/12/18 Custom Benchmark reduced Consumer Discretionary to 30% and added 10% Communication Services, due to reclassification by MSCI. Past performance is not a guarantee of future returns. Data from Valu-Trac Administration Services and Reuters. This is for illustrative purposes only and in accordance with our Prospectus Halo does not benchmark against any index in accordance with our Information Memorandum and Prospectus.

This truce may last a few weeks or months, one does not really know given his unpredictability and so we don't allow these short term macro events to alter our focus on bottom up stock selection, which is based on long term structural factors within the industries in which we invest. So although this disrupts markets in the short term we do try to take advantage of individual stocks when they become oversold by adding to holdings and trimming them as the shares recover. While we maintain our focus on our investment philosophy this minor trading around existing positions has proved rewarding for the year to date.

The 12 months forward estimated earnings per share growth for the Fund has risen from 13.7% at the beginning of the year to over 20% now. Part of this is due to a few stocks which have easy comparatives as 2018 was a low base for them, but importantly it is principally driven by their good prospects over the next 12 months, with little impact from the trade war. Although this is based on sell-side consensus estimates from Bloomberg, we do expect there will be the inevitable cuts to some profit forecasts as typically the sell side are often too bullish. But when we stress test the numbers we do not expect any meaningful downgrades for the rest of the year. Indeed, we have just had Li Ning, the Chinese sportswear company, upgrade its guidance for the first half of 2019 from 30% profit growth to over 90% growth and the shares have duly responded by rising 20% since the announcement on 24th June.

As mentioned, we like to focus on bottom up industry fundamentals and one industry that remains fairly immune to macro conditions and whose operations are driven by industry specifics are the cinema operators. We currently have two in the portfolio, namely Major Cineplex based in Thailand and Inox in India.

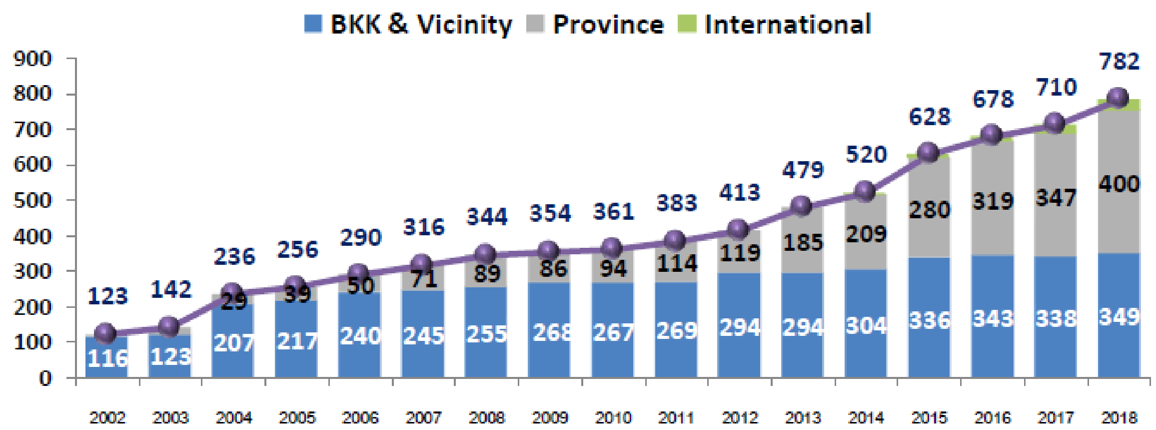
Major Cineplex

Major Cineplex is one of the stocks that had a weak 2018 due to a poor movie line up, both from Hollywood and the lack of local Thai movies, which are key for the population outside Bangkok. 2019 growth looks strong with a number of high grossing Hollywood movies and many more Thai movies being released.

The Thai market is a duopoly, with Major Cineplex dominating the Thai market with 71% market share while the no. 2 player has 29%.

Major Cineplex is expanding its screen count in a consistent manner, with the majority of new screens being opened outside Bangkok, as Bangkok is close to saturation. Outside Bangkok they do this principally in conjunction with hypermarket operators and also with owners of new indoor shopping malls. When these operators open new hypermarkets they typically approach Major to see if they are interested in adding a 1-3 screen multiplex within the same complex. Property landlords like to have them as they are a key footfall driver. At the end of 2018 they had 782 screens in operation and looking to add 50-60 screens per annum. They believe Thailand will ultimately have 2,000 screens, equating to 1,400 for them based on their 70% market share. The capital expenditure is actually quite small as they only have to pay for the fixtures and fittings and the landlord takes a share of the ticket sales in lieu of rent for the building. Rental rates can vary from as high as 20% in prime central Bangkok to as low as 8% in the rural areas. In addition, they have started to operate cinemas in both Cambodia and Laos, with 24 screens in Cambodia and 13 in Laos, all based in newly constructed shopping malls. Both these markets have potential for further expansion and we would expect the company at some point to enter Myanmar, when the middle class there is sufficient to warrant a multiplex in a relatively high end shopping mall.

Expansion has accelerated since 2011, driven by Upcountry areas



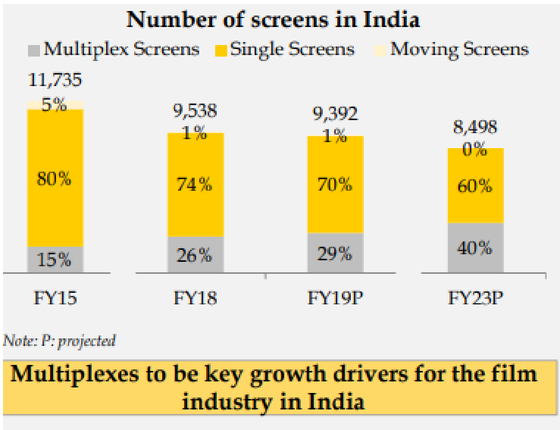
As well as the screen expansion, they aim to drive revenue growth by firstly increasing the average ticket price each year and secondly by encouraging increased spending on food and beverage (known as concession) by the cinema goers. Over the years the concession revenues have consistently grown faster than ticket sales. They target the share from concession revenues as a percentage of ticket sales to grow by at least 1% pa. This would be hugely beneficial to profits given the profit margin is 69% for concession as compared to 14% margins for admission revenue. The increase in sales should be feasible, as concession sales "Upcountry" are on average 40% of the ticket price, whilst only 28% in Bangkok. So as they expand the screen count outside Bangkok this should drive up the percentage of revenue from concession sales. Then the third leg to revenue and profit growth is the advertising business. This is not being disrupted by the internet like advertising on TV. Advertisers have a captive audience with easier to define demographics that appeals to advertisers targeting the younger middle and high income classes.

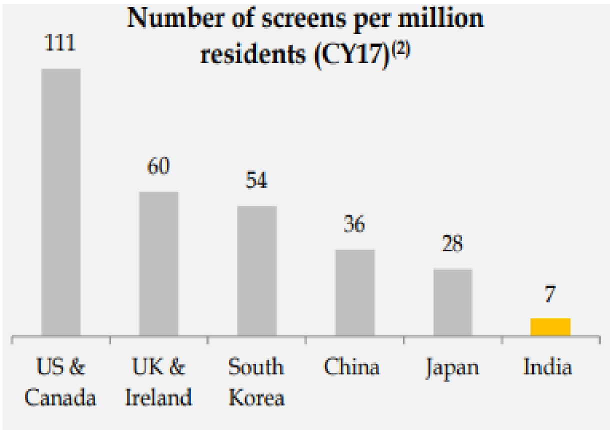
When we model these factors, we can assume an average annual screen additions of 6-7%. Broadly, the number of tickets sold rise in line with the screen count (although from year to year it will vary based on the number of blockbusters shown). One also expects the average ticket price to rise by 2-3% pa, so delivering 8-10% top line revenue growth from ticket sales. In addition, with faster growth coming from concession sales and at a much higher margin, should add another 1% to the top line with another 4-5% to profit growth. Advertising revenue should also grow in line with ticket sales. So the long term thesis is for the company to produce earnings per share growth of 12-14%. They also pay out over 80% of their profits as a dividend and this should then provide us with a 4% yield and so we are targeting an annualised total return of mid-teens over the long term.

This year is going to be an exceptionally robust year as we have seen very strong visitation due to the success of the Avengers movies, as well as some local high grossing Thai movies. It is now estimated that the profit growth in 2019 could be as high as 50%. This is on the back of 15% revenue growth and strong operating leverage within this business. One has to remember though that from year to year the bottom line is volatile due to the nature of the movie business and lack of consistent blockbusters. We understand this and will take the opportunity to add to the holdings when the market becomes overly pessimistic on the outlook, based on falling cinema ticket sales and trim our holding in the shares as euphoria sets in, when there are a number of blockbusters in the same year. We did add to Major in January of this year when pessimism reigned and reduced our holding in June after the shares had risen almost 30%, due to Avengers End Game breaking box office records. The shares currently trade on 20x 2019 earnings for profit growth after stripping out exceptional gains of 51%. However, this is then likely to slow to lower double digit growth in the following years.

Inox

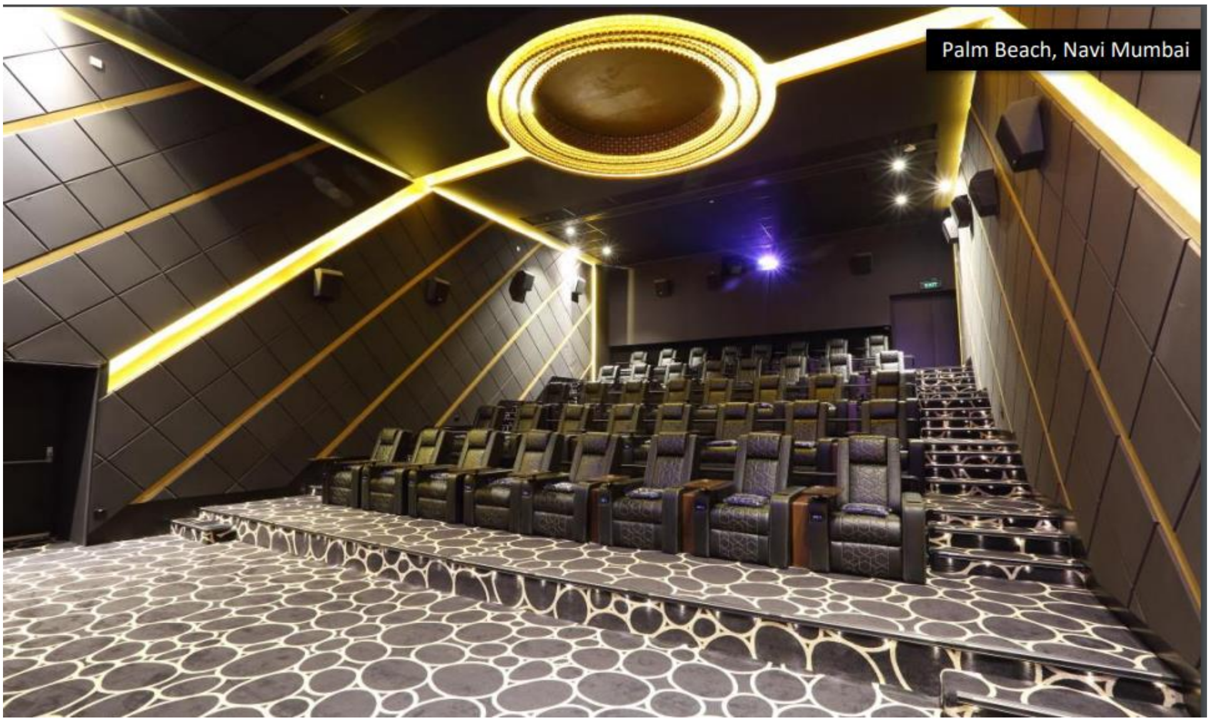
India has 4 multiplex operators, with Inox being the number 2 player with 27% market share, based on the most recent data available from March 2018. The number one player, PVR has 33% share. Although Inox's market share will continue to rise as they aggressively roll out new screens at a faster pace than most of their peers. As you can see below there is huge potential to increase the number of screens in India as incomes rise and also as multiplexes take share away from single screen operators. The pace of expansion is partly driven by the availability of new shopping malls across India who require a multiplex anchor tenant. As well as the number of screens driving revenue growth and of course the quality of movies being released, the other factor is affordability. Ticket prices typically increase by 3-5% and if wages for the middle class are growing faster than this, the addressable market of middle class consumers who can afford to go to a multiplex each year is also expanding.





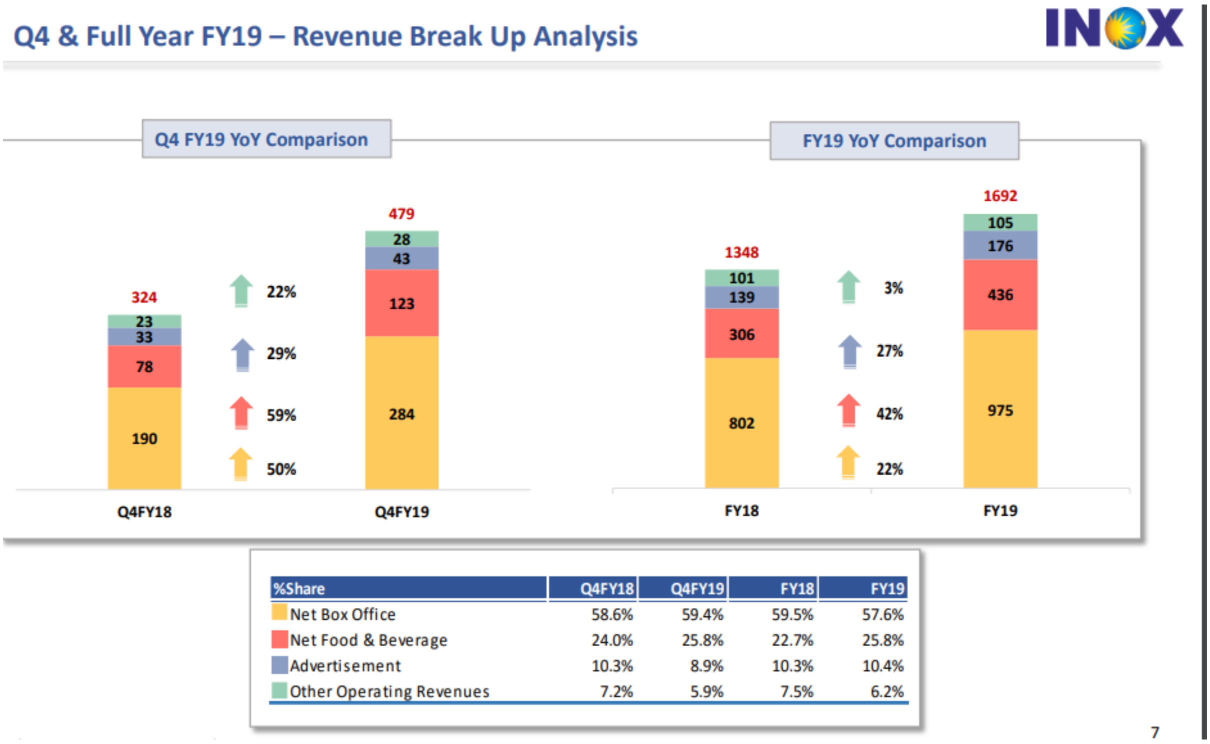
Inox had 574 screens as of March 2019 having added 84 screens in the previous 12 months and with the aim of adding an ambitious 70-80 screens pa over the next few years, something the market remains sceptical of, given the delays in building new cinemas due to Indian bureaucracy and licenses for opening new shopping malls. Nevertheless, even if they achieve 60 screens pa, the screen expansion will be 10% pa. Assuming that the occupancy of the new multiplexes reaches similar levels to their existing properties this will drive revenue growth of 10% from organic expansion. We can then add to this rising ticket prices as well as increased footfall due to the addressable market expanding each year, leading to revenue growth from ticket sales of somewhere in the high teens.

Below are a couple of new screens recently opened by Inox. I wish we had cinemas like this in Winchester and it is not just about selling a ticket but an experience, with segmentation of the screens and seats as in an aircraft. Ensuring customers who want to experience the luxury and can afford it, can do so. The next time I am in Asia I shall of course aim to try one out in the name or research.



But it is not just ticket sales that are driving the revenue and profits. Like Major Cineplex, the business derives a significant part of its profitability from additional sales of food, beverage and advertising. In both cases these are growing faster than ticket sales as they are under represented relative to the market leader who derives 42% of the average ticket price from F&B compared to 38% at Inox. Eating a meal in a cinema is more of a cultural norm in India and so it is not just fizzy drinks and pop corn, but hot food as well, with chefs onsite to prepare fresh meals. Another factor contributing to faster profit growth is advertising spend. As Inox rolls out further screens it is able to offer a better reach and cross section of consumers to advertisers, so enhancing the attractiveness of advertisers to allocate more spending in cinemas.

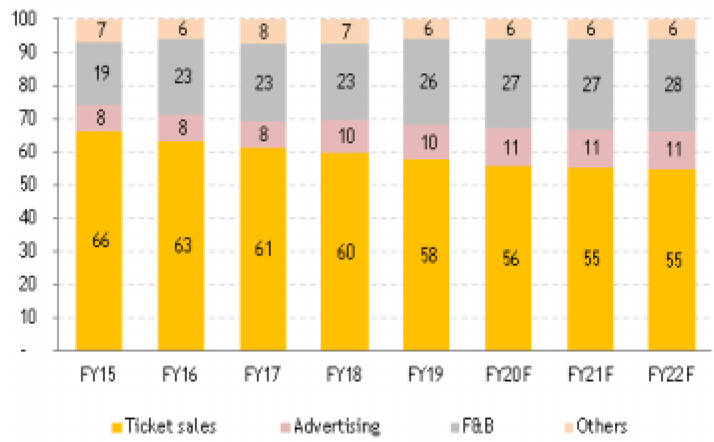
As you can see below the revenue from advertising is running ahead of ticket sales for the year to March 2019.



%Share	Q4FY18	Q4FY19	FY18	FY19
Net Box Office	58.6%	59.4%	59.5%	57.6%
Net Food & Beverage	24.0%	25.8%	22.7%	25.8%
Advertisement	10.3%	8.9%	10.3%	10.4%
Other Operating Revenues	7.2%	5.9%	7.5%	6.2%

As shown below this trend has not been a one year phenomenon and we expect this to enhance profitability for a few more years, given the significantly larger margins from these two business divisions. PVR the no. 1 player currently generates 52% of revenues from ticket sales compared to Inox at 58% and Inox should over the next few years approach a similar ratio to PVR.

Contribution from box office continues to decline



Source: INOL, Maybank Kim Eng

The opportunity for the expansion of multiplex cinemas as the industry moves away from the basic single screen towards a more luxurious experience remains a story for at least the next 10 years. Inox is playing catch up to PVR based on performance metrics for ancillary income from non ticket sales and if they can do this, we should see the share price appreciate at least in line with the earnings growth. In addition, there is room for multiple expansion with the March 2020 PE at 22x for Inox as it trades at a 30% discount to PVR, which currently trades at 32x. This discount is excessive given they are growing earnings at a similar rate of 20% per annum.

Conclusion

Above are just a couple of examples of some of our investments that are 100% domestically driven and not reliant on global growth, with industry fundamentals being the primary factor for the outlook for company profits. It is one of the reasons why we do not let short term macro implications drive our stock picking decisions and our outlook has to remain longer than one year and ideally over 5 years. Although the correlation of our Fund to MSCI AC Asia Ex Japan remains close to 0.9 on a daily basis, this should diverge when longer periods are involved. The 12 month forward earnings growth for the Fund remains above 20% compared to 10% for MSCI Asia ex Japan index. We shall see if this comes down post the earnings season which starts in a week or two's time. The forward PE multiple of the Fund today of 14.6x remains below its long run average since launch of 15.5x and so to us remains good value.