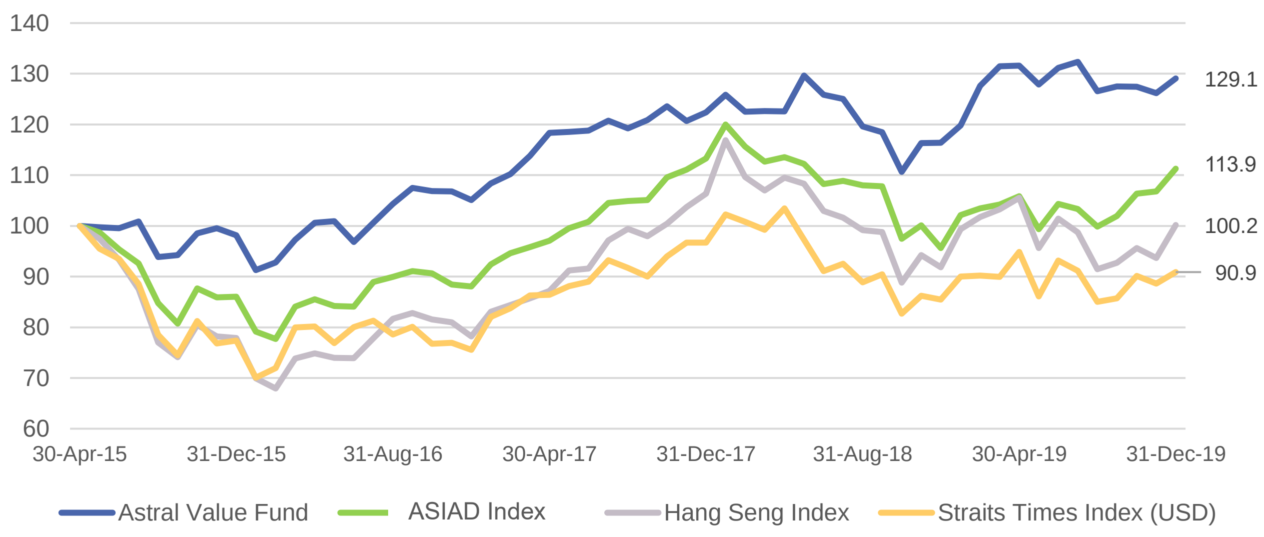
# ASTRAL VALUE FUND

## PERFORMANCE COMPARISON

| | Astral Value Fund* | ASIAD Index** | Hang Seng Index | Straits Times Index (USD***) |
|---|---|---|---|---|
| **May-Dec 2015** | -1.8% | -7.5% | -22.1% | -22.6% |
| **2016** | 7.0% | 0.1% | 0.4% | -2.3% |
| **2017** | 16.5% | 23.6% | 36.0% | 27.9% |
| **2018** | -4.9% | -14.1% | -13.6% | -11.6% |
| **2019** | 10.9% | 15.9% | 9.1% | 6.3% |
| **Returns since Inception** | 29.1% | 13.9% | 0.2% | -9.1% |
| **Outperformance** | | 15.2% | 28.9% | 38.2% |
| **Annualised Returns** | 5.6% | 2.8% | 0.0% | -2.0% |

*Returns are net of all fees.
**ASIAD Index refers to the Bloomberg Asia Developed Markets Large & Mid Cap Index
***STI Index was rebased using month-end exchange rate.

## US$100 INVESTED INTO OUR FUND VS THE INDICES




Note: Our fund is only open to “accredited investors” as defined by the Monetary Authority of Singapore

## 2019 NEWSLETTER

Dear Partners and Friends,

Our NAV grew from 116.41 to 129.05 which translates to a gain of 10.9% during 2019. This is a new year-end high from our previous watermark NAV of 122.4 in 2017.

Our annualised return since inception as at end of the year is 5.6% net of all fees. Even after accounting for annual dividends of about 3% for our main markets Hong Kong and Singapore, we continue to outperform the benchmark Hang Seng and STI indices significantly by about 3% and 5% respectively. Furthermore, investors who have been with us since Day 1 would have noted that our fund usually has less drawdowns during periods of market duress.

There is no doubt in our minds that we remain on track to achieve our targeted annualised 8% return for our investors. Management from the companies that we own have recently shared with us their continued optimism about their businesses despite the murky macro outlook. Another reason for our confidence stems from the valuation of our portfolio which remains low relative to the market. In addition, market valuation for the mid to small cap segment in one of our main markets Hong Kong are near the historical lows of 2009 as noted by Bloomberg recently. https://www.bloomberg.com/news/articles/2019-11-27/short-sellers-raid-on-hong-kong-means-small-caps-go-extra-cheap

We still believe Asia will drive the growth of the global economy. Despite all the talk about Asia slowing down due to the trade war and rising protectionism, the annual growth of the Chinese and ASEAN economies are at least double that of Western economies. We are still finding plenty of attractive investment opportunities in the markets we are in. We own companies trading at deeply discounted prices relative to their intrinsic value. Many of these companies have strong competitive advantages over their competitors and we are confident that the tailwinds of strong Asian domestic consumption growth will propel many of these companies to greater heights.

Frequent readers of our newsletter would have noted that we have reduced the frequency of the newsletter from bi-annual to annual basis. This is due to our desire to spend more time analyzing businesses and doing due diligence. The other reason for the change is to encourage long-term thinking. Investors today like to make money and as early as possible, preferably in days. Our edge in investing comes from appraising businesses and their strategies and our observation over the years is that most business strategies take years to shape and translate into execution. Hence the simple step of taking the long view gives us the competitive advantage to outperform the market.

### Portfolio Valuation

Our year end portfolio valuation seems slightly more expensive than that in the previous year. This is due to mainly to two factors. The financial results as at the end of last year had not yet reflected the negative effects of the trade war and the slowing economy in the region.

The other reason is that we have capitalised on the market meltdown in the middle of the year to trade up to better quality businesses. Investment is more art than science. Buying the cheapest company with lots of cash in a declining industry is more dangerous than buying a good quality company at expensive valuation. Management of companies in declining industries tend to make bad decisions in capital allocation. Instead of returning cash to shareholders, they would rather throw caution to the wind by expanding to businesses outside of their core competency. For instance, we have lost track of how many listed companies in Singapore have expanded their business scope to include property development thinking that they have deep pockets. They fail to consider that besides capital, it is the access to cheap financing, affordable land in good locations and project execution capabilities that will determine their viability as property developers. Given a choice between a mediocre business and a franchise, we would gladly pay slightly more for the latter which can compound its returns because of its strong moat.

| Date | P/B | EV/EBITDA |
|---|---|---|
| 31 Dec 19 | 0.88x | 5.9x |
| 31 Dec 18 | 0.56x | 4.3x |
| 30 Jun 18 | 0.72x | 5.1x |
| 31 Dec 17 | 1.12x | 6.6x |
| 30 Jun 17 | 1.34x | 7.4x |
| 31 Dec 16 | 1.08x | 6.6x |
| 30 Jun 16 | 0.89x | 7.0x |
| 31 Dec 15 | 0.88x | 7.3x |
| 30 Jun 15 | 1.26x | 9.0x |

## What We Have Learnt

Last year, we discussed the importance of paying attention to the macro environment as the trade war dampened sentiment. One of our key strategic moves then was to invest more in businesses that catered to domestic consumption in the Greater China region. Given our familiarity with Hong Kong listed retailers, we were heavily invested in them. Our thesis was simple. Many Chinese companies' first stop overseas is to set up offices in Hong Kong because of its proximity and ease of setting up businesses. In addition, international MNCs keen to enter China for the first time usually made Hong Kong its headquarters due to the country's established rule of law. Tourist arrivals and spending had continuously rose for the last few years. We believed that Hong Kong was entering its golden age. What we had failed to consider was the simmering discontent among the local populace over the increasing cost of living and perceived loss of freedom as Beijing strengthened its hold over the country.

The key lesson for us in 2019 was to be more decisive when circumstances change. As the extradition protests started gaining momentum in June last year, we were closely monitoring the situation. Initially we were rather optimistic that the protests would simmer down like the 2014 Occupy Central protest movement and hence we only selectively lightened up on some of our names. Looking back, it was probably loss aversion which caused us to not lighten more. The Chinese saying "当断不断, 反受其乱" (which literally means if you are not decisive when the time calls for it, the ensuring chaos would affect you) aptly captures our situation.

The Hong Kong market continues to be where we focus our efforts on. Some of our partners have expressed concern that our portfolio is heavily weighted towards Hong Kong listed stocks. We must reiterate that many of these stocks have operations outside of Hong Kong. While some residents in Hong Kong face the difficult decision of whether to relocate out of the country, it is relatively easy for us to sell off stocks of companies which depend on Hong Kong for their key sources of revenue. We estimate that in June, about 35% of our portfolio depended on the Hong Kong domestic market for revenue. This proportion has since fallen to around 20% by year end and consisted mainly of defensive names such as companies selling household necessities or medical services.

## Our View of the World Now

Last year we talked about the ending of the venture capital boom. This year we saw many touted unicorns get into trouble. WeWork's failed IPO and subsequent management shakeup was case in point and closer to home, HonestBee's implosion undoubtedly signalled that the days of easy money are gone. We believe this trend will continue and unless a business model is able to show an eventual path to profits, days of VCs blindly throwing cash to gain traffic, users or even data have ended.

***A long-haul trade war***

In our opinion, the trade war will not be resolved regardless of the interim agreement reached between the US and China. Markets will continue to be concerned over the continued trade barbs thrown by the US, especially with the impending US election, where candidates from both US major parties are likely to use China as a punching bag for job losses in America.

While the outlook will remain murky, Asia continues to be the manufacturing hub of the world. It is likely that South Asia will benefit from the global supply chain restructuring. Even before the trade war started, some large MNCs had already shifted their manufacturing facilities outside of China. Samsung and Sony, for instance, have both ended mobile phone production in China and shifted to India, Thailand and Vietnam. While this shift will benefit South Asian manufacturers, it is not all doom and gloom for China. This is a great opportunity for the country to restructure its economy, to wean China off low value manufacturing while increasing high value output like robotics and AI. It is our belief that China today has both the human and financial capital to succeed in the shift to high value manufacturing and services.

Being the financial hub of ASEAN, Singapore benefits not just from the shift in manufacturing in South Asia. She will benefit indirectly from the continued social unrest in Hong Kong. Before the unrest escalated this year, many international firms chose Hong Kong as their Asia hub due to its proximity to China. However, with the ongoing uncertainty, many are instead choosing Singapore as its base. Capital has started flowing to the country as the rich in Asia decide to stash some of their wealth away in Singapore. Before the protest began, foreign currency deposits averaged S$7-8billion at the end of each month in 1H2019. In the short space of 5 months, foreign currency deposits have doubled to S$16.4billion by the end of November 2019. The previous highest-ever deposit at month end was S$11.3billion in February 2016. We expect this inflow of capital to continue.

***Cautiously Bullish***

In general, we are cautiously bullish about the current world situation. We believe that after one and a half years of trade war and negotiations; businesses have started to take things in their stride and navigate around the uncertainties. In China we see some green shoots in positive PMI numbers and some rollback of US tariffs will be positive for Chinese exporters. Closer to home, we believe some recent corporate moves by Temasek and some companies present some opportunities in some Singapore names.

We continue to be concerned with the sky-high valuations enjoyed by the US equity markets. Besides the Fed lowering rates, we believe that the discount rates have been distorted by prevalent negative interest rates in other parts of the world like Europe and Japan. Valuations might revert if there is a strong lever to raise interest rates rapidly. Inflation however continues to be benign or even non-existent which allows central bankers to continue to maintain negative low rates. As capital markets continue to be hungry for growth, conditions are supportive of capital flowing to Asia and we are confident of benefiting from the reigniting of interest in Asia markets.

## Investment Showcase

At Astral, we divide our investment targets into six categories of franchises, fast growers, turnarounds, deep value, high income and special situations. One of the sources of inspiration to divide our investment into various categories comes from the book “One up on Wall Street” by Peter Lynch which we highly recommend. The following describes our thought process in initiating the position on a special situation and should not be considered as investment advice.

***Background***

QAF is an SGX listed company with three main businesses. The company manufactures and distributes the ubiquitous Gardenia brand bakery in Singapore, Malaysia and Philippines and is the market leader in all three regions. Another business arm distributes a large range of proprietary and international food products in Singapore and across Southeast Asia region. Lastly, QAF operates an animal production business under its Rivalea unit in Australia mainly for the rearing, slaughtering and processing of pigs.

The company currently trades at 49x PE based on depressed 2018 earnings. 2018 was a disaster for the company as Riverlea suffered huge losses due to low pig prices and high feed prices whereas an accident at one of their distribution warehouses caused the unit to suffer a rare loss. The bakery too had some operational hiccups due to ageing facilities. In an effort to increase the distribution of bakery in underpenetrated Philippines, the company spent substantial sums on capex to increase the production capacities to serve more areas, increasing the short-term depreciation expense of the bakery segment.

The pressure on the 3 units have been easing since the start of 2019. We have built up a position in the company since November 2019 when they announced the appointment of an investment advisor to help with the sale of its primary production unit. It is not the first time the company has attempted to sell its unit. A similar attempt to either do a trade sale or IPO was initiated in 2017 but failed.

***Investment Thesis***

We believe that the proposed disposal will be successful this time round. This is due to an acute shortage of pigs in China due to the outbreak of the African swine flu. Pork prices have risen from less than RMB10 per kg at the start of this year to over RMB30 per kg. Currently pigs in Australia are not allowed to be imported to China. With the trade war and other Southeast Asia regions farms potentially having contracted swine flu, it would make perfect strategic sense for an acquirer with Chinese connections to buy over Rivalea and establish exports to China. Afterall, if beef and lamb from Australia are both allowed to be exported to China, then pork shouldn’t be an odd one out. It is our belief too that after the failed sale of the unit less than two years ago, it would be unlikely that the management would sanction another strategic review unless they think that the likelihood of finding a buyer is high.

QAF trades at a current valuation enterprise value of S$560m. A conservative valuation of the primary production business Rivalea for a sale would be book value which is S$200m at the last audited accounts. We estimate that the remaining business of bakery and distribution generates free cash flow of 40-50m a year which is about 11-14x. We think the remaining businesses have dominant positions and should trade upwards of 15-16x. Adding the book value of Riverlea to our appraised value of the bakery and distribution business, we believe significant upside is possible if a sale goes through.

In our opinion, there is limited downside in our position due to the company’s improving earnings and generous dividends. Even if the sale does not go through, the recovery of earnings of the company should support the share price. Before the first proposed sale of the company in 2017, the company had traded above S$0.90 since

2015. Should the earnings normalise back to 2015 and 2016 levels, we expect the share price to recover to that levels. In addition to the current undervaluation, the company has given out 5 cents of dividend annually since 2011. At current price of S$0.80, it equates to a generous dividend yield of 6.25%.

## Acknowledgement

As we enter our fifth year in operation, we continue to be grateful for the continued support of our partners who have stuck with us through this period. We hope to repay that faith through higher returns. In the last few years, indexing and the listing of large companies in Hong Kong have diverted liquidity away from small to mid-cap companies. Singapore's inability to attract growth capital have led to a rather moribund equity market which have shifted investors' attention away from small caps. The drying up of liquidity in both markets has resulted in negative returns from small to mid-cap companies. The flip side is that we are now holding companies of high quality at a steep discount. We implore our investors to take heart, in that if we were able to achieve positive performance when markets are choppy and going downwards, as a long fund, we would do fine when the tide eventually rises.

## Fund Information

| | | |
|---|---|---|
| Fund Name | Astral Value Fund | |
| Bloomberg Ticker | ASTRALV KY Equity | |
| ISIN | KYG059281090 | |
| Base Currency | USD | |
| Fund Manager | Astral Asset Management | |
| Jurisdiction | Cayman Islands | |
| Share Class | A | B* |
| Subscription Charge | 1.0% | Waived |
| Management Fee | 1.5% p.a. | 1.2% p.a. |
| Performance Fee | 15% | 12% |
| Early Redemption Charge | 3% in Year 1 | 3% in Year 1,<br>2% in Year 2,<br>1% in Year 3 |
| Redemption Charge | 1% | |
| High Watermark | Yes | |
| Fund Administrator | Apex Fund Services Singapore Pte Ltd | |
| Fund Custodian | DBS Bank Ltd. | |
| Fund Auditor | Deloitte | |

*Limited Capacity