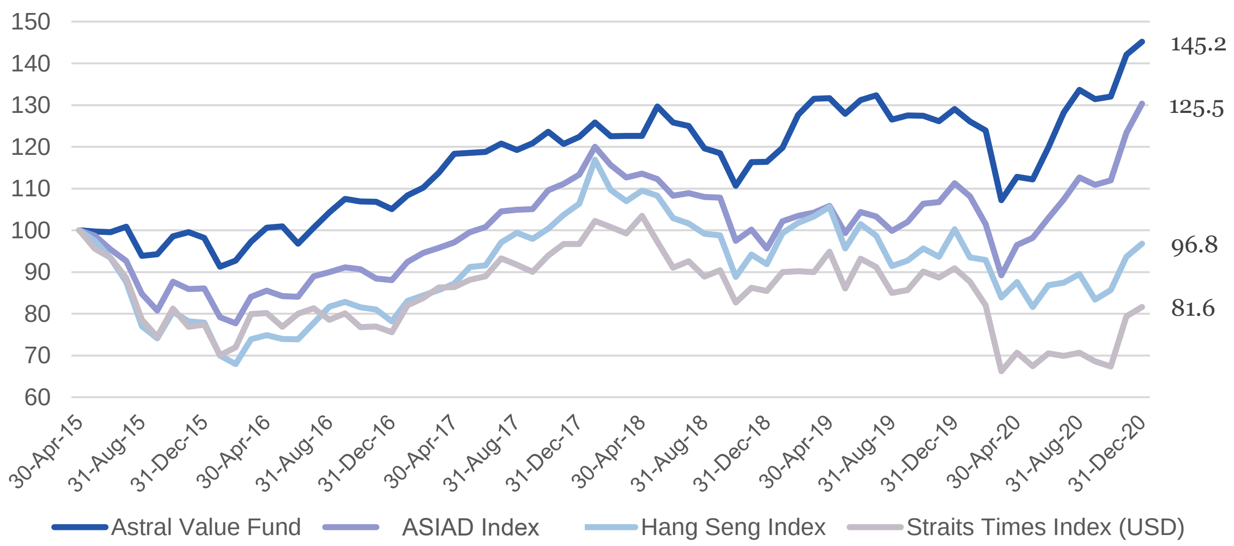
ASTRAL VALUE FUND

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%
2020	12.5%	10.1%	-3.4%	-10.2%
Returns since Inception	45.2%	25.5%	-3.2%	-18.4%
Outperformance		19.7%	48.4%	63.6%
Annualised Returns	6.8%	4.1 %	-0.6%	-3.5%

*Returns are net of 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

2020 NEWSLETTER

Dear Partners,

We are pleased to report that our NAV grew from 129.1 to 145.2 in 2020 for a full year gain of 12.5%. Our December NAV is an all-time high.

Since inception, we have returned more than 45% for our investors. In the same period, the reference indices for our main markets in Singapore and Hong Kong, the Straits Times Index and Hang Seng Index, both recorded negative performances, -18.4% and -3.2% respectively.

While our return in 2020 was positive, it is important to note the inherent volatility of equity markets. From January to March, we had consecutive negative months that resulted in a drawdown of close to 17%. While we were able to claw back the losses and finish higher year on year subsequently, investors only made money if they did not capitulate and redeem in March. In fact, passive investors in the Straits Times Index and Hang Seng Index had an even wilder ride. They were down -29% and -17% year to date respectively at end of March and were still in the red at year end. If temporal losses are not something you can stomach, then investing in equities is probably not for you.

Another reason for our outperformance this year was our reading of the prevailing macro situation in late March and the re-positioning of our portfolio for eventual recovery. You can reread our previous assessment here: https://bit.ly/2IxvFcw. COVID-19 has upended many businesses. Many assumptions and forecasts about businesses have had to be revisited and this is unlikely to be captured by historical data. If there ever was a time when you wondered whether active management would add value, we hope this is the year when your confidence in us proved well-placed.

As a brief recap, we target an annualized 8% return for our investors over time and to do so, we set 3 annual goals. At the start of each year, we aim to achieve a higher NAV than our previous year, preferably by at least 8%. Our secondary goal is to beat the market whether it is up or down. Lastly, we hope to invest in a way whereby we can dampen the downside volatility or reduce drawdowns for our investors. Across myriad funds, it is tough to explain our value proposition, but this year is a perfect example of why we prioritize our goals in the above order. In our opinion, focusing our priorities on the above order best helps us to achieve the balance of capital preservation, with as high a return as possible, and sparing our investors the agony of sleepless nights.

Our strategy to achieve our goals is via a diversified portfolio of stocks, classified into various undervalued categories, with a macro-overlay. Broadly the categories can be divided into six different situations of deep value, fast growers, franchise, turnarounds, income, and special situations. While the market tends to vacillate between growth, income, and value, sometimes to extremes, we always have something in our portfolio to offer to the market. This gives us the ability to harvest and reinvest our proceeds in overly beaten down categories. Some situations like turnarounds or special situations are opportunistic and require catalysts which are independent of market and allow us to generate returns consistently. Taken together, we believe we have put together an all-weather absolute return fund for our partners.

For this year we have achieved most of what we have set out to do. Our total return of 45% since inception works out to be about 8% simple return every year. Yet, linear return is not what our fund is about. We are cognizant that our current annualized compounded return of 6.8% is still slightly below the minimum of 8% we have set out to achieve. We remain optimistic that our current portfolio positioning and low valuation put us in good stead to attain our long-term goal.

Portfolio Valuation

At year end our valuation continues to be on the lower side since inception even though our NAV has rose significantly. While book values are low, it is important to note that the pandemic has destroyed permanently the value of some historical assets. With valuations marked to market at year end, asset values will be written down in the annual revaluation exercise. Nevertheless, we are assured that the stocks in our portfolio are worth much more than what the book suggests. Hence, we are quietly confident of our portfolio's future performance.

We continue to trade up our portfolio for companies with strong moats and huge cash flow position. While many are not as exciting as growth or tech companies, these companies churn out good cash flows even in face of an event like COVID-19 and we expect them to hold up well and even grow. Some of our companies' share prices have recovered a fraction of their intrinsic value and we believe there is more to come.

Date	P/B	EV/EBITDA
31 Dec 20	0.68x	6.6x
31 Dec 19	0.88x	5.9x
31 Dec 18	0.56x	4.3x
31 Dec 17	1.12x	6.6x
31 Dec 16	1.08x	6.6x
31 Dec 15	0.88x	7.3x

Our View of the World Now

What initially seemed like a harmless virus at the start of the year in Wuhan has morphed into a global pandemic with far reaching consequences for businesses and investors. Once the virus had had proven its virality and fatality, fear abounded everywhere. The acute shortage of medical supplies and the paucity of information about the virus made it worse. What had seemed inconceivable at the start of pandemic such as the challenge of obtaining sufficient medical supplies and enforcing the mandatory wearing of masks is now prevalent in many countries. Against all odds, a vaccine was produced and rolled out within 2020, even though it usually takes about 10 years to create a vaccine. It will not be the first time though that we have underestimated the ingenuity and adaptability of humanity.

Much has been written about the virus. As investors though, our focus is to predict the investment implications for the future. Rather than focus on ubiquitous themes such as increased digitalization, the rise of work from home trends and growing health awareness, we are making less mainstream, but no less salient, observations.

Industry consolidation

Business is inherently competitive and is always about the survival of the fittest. Once there is the possibility of earning supernormal profits, new competition will enter to try to snatch a piece of the pie. However, such competition takes a backseat whenever a seismic event like COVID-19 occurs. One of the less talked about implication of COVID-19 is that incumbents with the largest market share benefit the most the longer this pandemic drags on. As an example, logistics is the mainstay of the work from home phenomena. Instead of choosing the cheapest service provider, business users will gravitate to the tried and tested large logistics providers to ensure certainty of delivery. This creates a vicious cycle where smaller providers will have to deal with fewer orders from their best clients as well as increased bad debts from their less credit worthy clients. This example can be applied to many other sectors such as manufacturing and retailing where market concentration is relatively high. Inevitably, industries will consolidate further, and existing market leaders will gain from their bigger market share.

Postponement of the inevitable shift of manufacturing outside China

The much talked about manufacturing shift from China to Vietnam is being postponed even with the threat of trade war. This is due to the entire ecosystem is being hampered by logistics. A manufacturer can get land in Vietnam and build their factories, but installation of machinery will be delayed as installers cannot fly in. Even with installed equipment, experienced operators cannot fly in to teach the locals how to use the equipment. Hence products made in China will have a brief period of respite from falling demand. This explains the rising exports coming out of China since the 2nd half of 2020 and the trend should continue into the new year. While the vaccines are being rolled out now, it will still take about a year at least for most of the world's population to be inoculated.

Make no mistake though, all the management we talked to believe that this migration of low-cost manufacturing to other parts of South East Asia is here to stay. However, the timeline will be pushed back until world travel and logistics is normalized.

COVID-19 is making Asia an attractive investment

The speed and decisiveness that Asian countries were able to keep the pandemic in check stands in stark contrast to half-hearted measures implemented by many countries in the West. This is not a question about democracy. New Zealand and China are countries with different political systems, yet both managed to contain the virus in a very short period. The effectiveness of response is more about trust in the government and leadership in crisis. As a result of this initial control of the pandemic and concrete steps to stamp out new waves, Asian economies have rebounded well.

China resumed economic growth from the 3rd quarter of 2020 and is the only major economy expected to resume its path of economic growth in 2021. "Dual circulation", a term coined by China to focus on expanding local output and drawing in foreign investment and maintaining trade will help China to maintain her growth momentum. Consumption only accounted for slightly more than a third of China's GDP in 2019. In contrast consumption accounted for 66% of US GDP in the same period. With the pandemic, the consumption by the rising middle class in China is now squarely kept within China. Retail sales growth in China grew year on year for 4 successive months from August to November. The longer the world fails to deal with the crisis, the more time China will have to gravitate to a consumption economy.

Meanwhile the recent Regional Comprehensive Economic Partnership (RCEP) will serve to accelerate the burgeoning trade within intra-Asia. RCEP involves 30% of the world's population in Asia Pacific and is the world's largest free trade agreement (FTA). This is the first FTA between China, Japan, and South Korea and will go a long way to reducing tariffs in the region. Trade flows will increase between members of the RCEP and GDPs will likely rise.

By contrast, countries in the West continue to be devastated by COVID-19, with new recurring waves of infection putting a heavy toll on their economies and healthcare systems. It seems inevitable that fiscal spending will rise during and after the pandemic. Many Western economies already shoulder deep fiscal deficits and there will be much pain ahead for them. Faced with the above prospects, it is our belief that asset allocators will gravitate to the Asian region.

Musings

Death of value investing?

One of the questions investors have had to grapple with over the last decade was the strong performance of the growth tech stocks versus the lacklustre performance of value stocks. Since the initial recovery from the global financial crisis in 2009, investors have clearly preferred growth stocks. In a world of low interest rates, growth has taken a new meaning. The value of any asset is the sum of its future cash flows. Mathematically, in a typical discounted cash flow, future cash flows are discounted by the interest rate and low interest rates tend to bump up the value of the asset. A growing company would increase the annual cash flows to the firm and the combination of lower interest and higher growth serves as steroids for growth assets.

$$\mathrm{DCF} = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \cdots + \frac{CF_n}{(1+r)^n}$$

DCF = discounted cash flow
CF_i = cash flows period i
r = interest rate
n = time in years before future cash flow occurs

Even though low rates are expected to be with us for some time, we had been wary though about going all in on following the trend of investing in growth. Growth is one of the hardest things to judge in investing and on the occasion that it suddenly disappoints, the resulting fall in share price could be permanent.

People continue to have this misconception that value investors do not invest in growth stocks. As Buffett famously once said, "Value and growth are joined at the hip." Investing to us continues to be assessing the whole business, including the growth aspect, and buying in with a suitable margin of safety. As growth is harder to achieve, we ascribe a lower expected value for growth companies as a form of margin of safety. Thus, many growth stocks became priced out of our realm of possible targets.

Growth investing as a value investor

The year is 2020 and not 2000, more than enough time to study and understand new economy companies. For traditional value investors to continue to claim that tech and internet business models are new businesses with uncertain revenue models might not be accurate. Traditional value investing focuses on asset prices that are backed by hard assets as a margin of safety. However new technology and growth stocks tend to be both asset and capital light. The focus then shifts to assessing the strength and scalability of these new growth stocks which is more qualitative than quantitative.

Having observed these new economy stocks for some time, we do see a certain pattern as to how some of best players grow their businesses. First build traffic, then hit scale before it turns into a virtuous cycle (or "the flywheel" which is jargon that management use to impress investors) and then finally, monetise. The key is to build up a critical mass of sticky and paying customers. There are certain inflection points such as when traffic starts accelerating or sales start to gain traction. Another is when the business turns profitable. We view such milestones as an opportunity to enter – stock market participants are usually trained to extrapolate linearly whereas growth in such new economy stocks is exponential due to the inherent operating leverage in their business models.

One of the stocks we invested in during 2020 was HKTVmall (1137HK), which is the largest online shopping website in Hong Kong. We had been following the stock for the last few years and saw how the management built up the business together with heavy investment in fulfilment. CEO Ricky Wong is a highly successful serial entrepreneur in Hong Kong. He founded two highly successful businesses in City Telecom and Hong Kong Broadband since 2000. Each time, he was up against formidable competitors but was able to carve out significant market share for his companies and more importantly, he exited both businesses with huge returns for both him and his shareholders.

HKTVmall was the first domestic pure e-commerce player to achieve some scale in Hong Kong. As with all e-commerce first movers, there were plenty of brickbats, especially among Hong Kong investors. They argued that e-commerce would never take off in a small dense place such as Hong Kong where all the conveniences were within walking distance. From our experience in Singapore, we knew better as e-commerce had already taken off a few years back. COVID-19 was a boon to HKTVmall as the company sales doubled year on year. Thus, when the company announced that it had broken even for the first time in the 1st half of the year, we invested in the company and were promptly rewarded with the share price rising more than 100% within a few months. We were confident in our investment because we had already seen how the model works and were able to forecast more accurately how things would pan out.

Have a diversified toolkit

There is a season for everything. A word of caution, the markets' predilection with growth may fade as interest rates rise even though this seems faraway now. We remain watchful as industrial commodity prices for copper, iron ore and rubber ended 2020 on multi-year highs. Even oil clawed back most of its losses in 2020. Should inflation rear its ugly head and "tapering" restarts, growth stocks could be shunted. Long-time investors would do well to remember that after the dot.com crash in 2000, the entire tech sector languished for several years. Microsoft's stock price, for instance, languished for the entire decade. This was even though the company continued to churn out solid earnings and growth during the same period. They were continually shunned by investors until Satya Nadella came onboard.

For us, whether growth or value is in vogue, we have proven over the years that there are enough tools in the arsenal to help us achieve our targeted investment returns. As Deng Xiaoping once said, "It does not matter whether it is a black or white cat; as long as it can catch a mouse, it is a good cat."

Portfolio Snippets

In the following section, we shall discuss our thinking behind certain investments to showcase our investment process. Note that this is not investment advice. We hold the following positions at present:

QAF (QAF SP)

Last year, we talked about our holding in QAF. Turns out it was a great holding to shelter from COVID-19 as demand for convenience food rose. As the largest supplier of packaged bread in supermarkets, QAF was a strong beneficiary during the lockdowns. Being the largest supplier offers economies of scale which its closest competitor cannot replicate. Here is a little titbit on its operations. Have you ever wondered why sometimes Gardenia bread is well stocked on weekend evenings in Singapore supermarkets versus its other competitors? The reason is that the volume sold is sufficient for the management to restock the shelves of key outlets in the afternoon whereas its competitors' sales volumes are only sufficient to stock the bread once in the morning. This is yet another example of why market leadership and scale are so important.

The key part of our investment thesis is that the proposed sale of the primary production arm would unlock value and the market will subsequently re-rate the remaining company. Although this has not materialised, we are continuing to hold our position in the stock. The likelihood and attractiveness of a sale of its primary production business has diminished slightly due to recent conflicts between the Chinese and Australian government.

Nevertheless, with or without the sale, we remain optimistic about the company's three main businesses. The bakery business continues to be strong and the company retains their leading position in markets they are in. Their distribution arm, Ben Foods, is a beneficiary of work from home trends as they distribute food products mainly via supermarkets. Even for the primary production business, the outlook is positive. There continues to be a severe shortage of hogs in China due to the recent African Swine Flu. This has diverted stocks all around the world to China, reducing low-cost exports to Australia. Hence prices of hogs have held up in Australia, allowing the division to reap good profits.

Special Situation

Many people think that the best investment returns must come from buying an under the radar company with a killer product or service. While that may have some credence, we always prefer low-hanging fruits. Sometimes the best investment idea could simply be a large cap trading down due to a non-business specific reason.

China Unicom (762 HK)

Background

China Unicom is one of the 3 main telecom operators in China with majority of its business based in China. It is also the world's 4th largest mobile service operator. In 2017, the company was one of the pilot projects of mixed-ownership reform of SOEs in China which saw investments by strategic investors related to Internet giants Alibaba and Tencent. Since the reform though, the company has seen some negative changes in the industry such as the abolishment of data roaming charges and the huge capex outlay required to build up their own 5G network. Furthermore, the company began a process in late 2019 to weed out less profitable subscribers. This has led to significant drop in ARPUs and service revenue and a subsequent share price plunge in 2019. COVID-19 further exacerbated the woes of Unicom's businesses in 2020 as roaming revenue plunged early in the year when traveling was restricted. However, since the 3rd quarter this year, ARPUs and revenues have started to stabilise. The release of the 3rd quarter results caused a short run-up in the share price in early October before the company was sold down in November and December after the announcement of the US executive order on 12th November, which banned US companies from investing in Chinese companies with links to the government.

Investment thesis

We view the recent selling down of the company as mainly due to the actions US-based active and passive investors, and largely unrelated to the fundamentals of the company. Almost all the company's revenue is generated in Mainland China. After the recent sell-down, the entire Chinese telco sector is trading at a historical low. In addition, the market is ignoring the key improvements in China Unicom's business conditions.

Firstly, there is more rational competition among the 3 telcos which is evidenced by the stabilising ARPUs in all three of them. In addition, cooperation between China Telecom and China Unicom to build out their 5G networks is starting to reap benefits for both. Sharing 5G networks has reduced duplication and, more importantly, reduced the rollout costs for the two smaller telcos. In addition, China Unicom is benefiting from increased digitalisation and the build out of data centres as they are partners with many data centre operators. China Unicom, as an SOE, is more trusted by government linked entities. They can act as a go-between for data centre operators and the government linked entities to ensure data security on the cloud. Meanwhile, cash has been building up at the company and we believe that at some point, if the dividend payout is increased, the company will be re-rated.

We started accumulating the position in December 2020 and we estimate that at the HKD4.45 level that we entered, the valuation of the company would be around 1x EV/EBITDA. This means that the entire company can be theoretically bought out by 1x the cash flow of the company. This of course ignores the Capital Expenditure (Capex) for 5G deployment which we estimate to be about slightly more than half the EBITDA generated every year for next 3 years. Taking the 5G Capex and the normal operating Capex into account, the EV/FCF is about 3x, which is cheap for a telecom company in an oligopolistic environment. As a comparison, Singtel trades at 10x EV/EBITDA. Note that our estimation of EBITDA does not include the potential cash flow increase from the roll-out of 5G where data revenue is expected to increase exponentially in future. Even if we assume that US-linked institutions can never buy Chinese telcos again, we believe that this valuation is too cheap to ignore for investors in the rest of the world.

Acknowledgement and Well Wishes

In closing, we would like to thank you, our partners, for your unwavering support. When the market hit the nadir earlier this year, no one put in a redemption notice. We hope that our subsequent performance this year has gone a small way towards repaying your faith in us. The discounted B class is still open for subscription and we highly encourage you and your friends to capitalise on the improving investment climate in Asia.

It has been a tough year for much of the world, with some of us losing loved ones. For us at Astral, investment returns, while important, is simply a means to an end. We sincerely wish everyone good health and a blessed year ahead.

Lee Kian Soon & Sean Mah

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, 2% in Year 2, 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