CEDERBERG CAPITAL

Cederberg Greater China Equities 30 June 2019

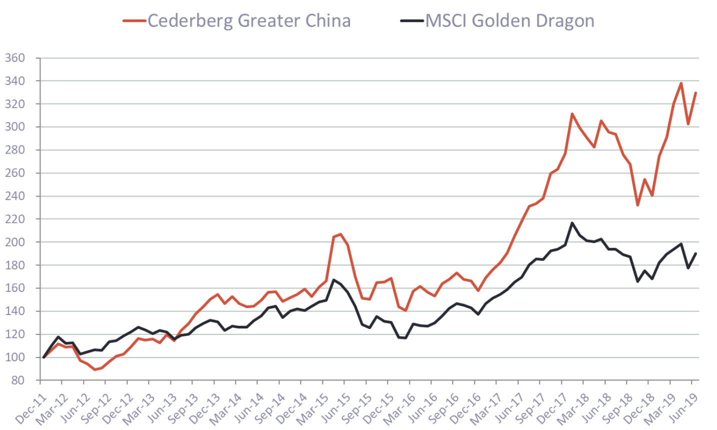
An introduction to Cederberg

- Greater China specialists founded in 2011, majority staff-owned
- Mission: Run client money like we run our own
- Unique perspective from team in London & Shanghai
- Research-driven process focused on the region's best companies
- In every investment, we look for a durable Moat, excellent Management, and a large Margin of Safety
- We manage a high conviction portfolio of long-term winners, with low portfolio turnover

Why Cederberg might not be right for you

- Our products are considered very risky; given our long-term focus and comfort with being different, **we are not for most investors**
- Chinese equities are highly volatile: declines of 70% are not uncommon
- Cederberg's returns have been more volatile than those of the index
- We manage a concentrated portfolio that typically differs substantially from those of our peers and from the market
- **Our past returns are unlikely to be repeated in the long run**
- Our strategy is only suitable for clients who invest for at least 10 years

Performance chart[1]

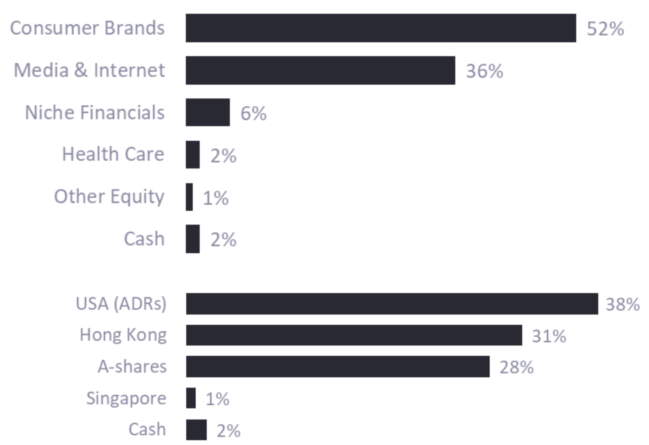


For Class A shares. All figures in US$ net of fees. MSCI Golden Dragon Index includes net dividends. Past performance is not indicative of future results - please see regulatory information on p5. Source: Bloomberg, Charter Group. 30 June 2019

Performance table[1]

Net Returns in US$	Class A	Index	Peer group	Percentile
Annualised				
Since inception (1/1/2012)	17%	9%	7%	100
5 years	17%	7%	6%	98
3 years	29%	14%	8%	99
2018	-13%	-15%	-23%	90
2017	75%	44%	36%	99
2016	-7%	5%	-5%	44
2015	6%	-7%	-5%	89
2014	3%	8%	3%	38
2013	42%	7%	10%	99
2012	9%	22%	18%	5
Not annualised				
Year to date	37%	13%	18%	97
3 months	3%	-2%	-2%	96
1 month	9%	7%	6%	91

Portfolio positioning[2]



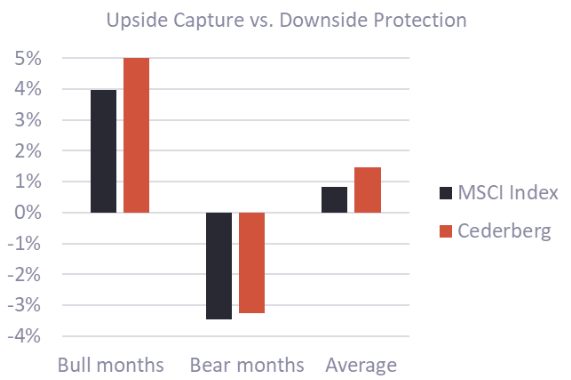
Major holdings[2]

Alibaba	Ecommerce	**Naspers**	Media
Haidilao	Restaurants	**Noah**	Asset management
JD.com	Ecommerce	**Tencent**	Social network
Jiangsu Yanghe	Distillers	**Wuliangye**	Distillers
Kweichow Moutai	Distillers	**Yihai**	Condiments

Median portfolio characteristics[4]

P/E (2020e)	20x	**ROE**	22%
EV/EBIT (2020e)	16x	**ROIC**	13%
EPS growth (2020e)	20%	**Market cap**	US$28bn
Net cash to equity	56%	**Number of holdings**	17
Dividend yield	1%	**Top 10 holdings**	80%

Risk[3]



Key features[5]

Strategy	Long-only equity	**Auditor**	PwC
Domiciles	Cayman, Delaware	**Custodian**	Standard Chartered
Fund assets	US$673mn	**Administrator**	Charter Group
Firm assets	US$1.4bn	**Cayman counsel**	Maples & Calder
Peer group	Greater China Equity	**US & UK counsel**	Schulte Roth & Zabel
Benchmark	MSCI Golden Dragon	**NAV - Class A**	329.75
Expenses	14 bps (2018)	**NAV - Class B**	111.68
Turnover	14% (2018)	**NAV - Class C**	98.04
Email	ir@cederbergcap.com	**Phone**	+44 203 745 1701

Results roundup

In this letter, we discuss the top 10 holdings' results in the most recent financial year (calendar year 2018, except Alibaba, which has a March year-end). All ten's intrinsic value grew at a double-digit rate, with median top- and bottom-line growth of +32% and +25% respectively. We are pleased with these results, especially given that 2017 was a high base to grow from and given the relatively sluggish Chinese economy in 2018. This year's results should be broadly similar, though growth might slow a tad.

It is important to note that these growth rates are not sustainable: some of our companies are already huge, and trees do not grow to the sky. However, it is likely that our holdings will continue to outgrow the 'average company' – be it in a Chinese or a global context - for two reasons. Firstly, China consumption is a multi-year growth story. Secondly, our companies are well-placed to participate in this growth, given their wide moats and excellent management teams that continue to reinvest wisely.

With growth likely to slow, it is **highly likely that future returns will be lower than what the fund has experienced historically**. Nonetheless, with the portfolio priced at a reasonable 16x next year's pre-tax earnings, long term returns could still be decent.

What we can guarantee though, are periods of extreme volatility and poor returns given the nature of the asset class and our concentrated portfolio. We would urge investors not to pay much attention to our track record, but instead to focus on our investment process and the execution of that process.

Alibaba

Ecommerce giant Alibaba's organic revenue grew +39%, with its two most significant divisions Core Commerce and Cloud growing +43% and +84% respectively. While its China retail marketplace business was hugely profitable, the company continued to invest heavily across all its segments, which weighed on overall profitability: diluted non-GAAP EPS grew a mere +17%.

Alibaba's mission is to make it easy to do business anywhere. Last year, the company did just that by helping merchants penetrate lower-tier cities and adding over 70mn consumers from less developed regions to its platform, which increased annual active consumers on the company's China retail marketplaces to 654mn. Furthermore, it continues to capture synergies between its different entities. For example, couriers for Ele.me - Alibaba's local services platform, similar to Grubhub and Just Eat – are now also making deliveries for the group's fresh groceries chain Hema. Ele.me also shares data with the group's financial services associate Ant Financial, which has allowed Ant to offer working capital loans to restaurants and other offline stores.

Despite making progress on many fronts, Alibaba's share price performance has been muted for two reasons. Firstly, as the largest US-listed Chinese company, its shares are often traded as a trade war proxy, even though its business is driven by domestic consumption. Secondly, the market appears to be concerned about slowing growth given that Alibaba has deferred the monetisation of Taobao's recommendation feeds to support merchants in a soft economic environment. We view this as a case of 'short term pain for long term gain'; more merchants will become more reliant on the platform, leaving it better placed to fend off competition from the likes of PinDuoDuo in the long run. Given the width of Alibaba's moat, the quality of its management team and the length of its growth runway, we find its valuation of 16x next year's pre-tax earnings highly attractive.

Haidilao

Following its IPO in 2018, Cederberg invested in China's most famous hotpot restaurant chain earlier this year. Having fine-tuned its operational processes and incentive mechanisms, Haidilao embarked on an aggressive expansion plan two years ago. Last year, its top- and bottom-line grew +60%, as it increased its restaurants from 273 to 466 and as same-store sales grew +6.2%.

Founder Zhang Yong was a welder before he opened his first restaurant aged 19. Early on, he realised that it is easier to differentiate a hot pot restaurant by providing better service than by offering better food. Today, the typical Haidilao restaurant employs 120-150 staff, who would move heaven and earth to delight their customers - several books and a Harvard Business School case study have been written about the company's service excellence. Like its sister company Yihai, Haidilao's incentive mechanisms allow it to bring out the best in its highly-trained employees. A good example is its 'apprenticeship model', where restaurant managers are encouraged to train apprentice managers, and in turn receive a net profit share of their apprentices' restaurants when they open, in addition to a profit share of their own store. All KPIs at Haidilao are fully quantifiable and systematically evaluated. Not only does this reduce internal politics, it also makes the appraisal process fully transparent.

While Haidilao appears expensive based on near-term multiples, we believe it is undervalued given its long growth runway and future cash flow generation. Management's long term target of 3,000 restaurants appears realistic, considering that KFC runs over 5,000 restaurants in China and continues to add new ones. With its highly standardized operational processes, a culture of ownership and best-in-class incentives, Haidilao should continue to take share in the highly fragmented restaurant industry.

JD.com

Internet retailer JD's sales slowed from previous years' lofty levels, though it still grew a healthy +28%. Its net margin was -0.5% as the company continues to pass on scale benefits to consumers. With its ecommerce business facing slower growth, the company is investing heavily in its logistics segment and signing up third-party customers to use its supply chain services.

The market took a less rosy view of JD in 2018: its share price fell 60% from its peak to trough, though it has bounced back somewhat recently. We believe this was due to a combination of Alibaba becoming more competitive in supply chain, increased competition in rural China, some of its key product categories coming under pressure and concerns over CEO Richard Liu's personal life. While these concerns aren't entirely unjustified, JD remains China's number two ecommerce player with robust operations and decent growth prospects. With its valuation near a historic low – it is trading at 0.2x Gross Merchandise Value vs 0.5x when we invested in 2016 – we remain owners of the name.

Jiangsu Yanghe

New holding Jiangsu Yanghe – our third investment in a *baijiu* distiller – enjoyed a solid 2018: sales and earnings grew +21% and +22% respectively. Revenue outside of the company's home province of Jiangsu is growing strongly; it is forecasted to be more than half of total sales this year. Like Moutai and Wuliangye, premiumisation provides a nice tailwind for the company: last year, virtually all of its growth came from a change in average selling prices. This rise was achieved through a combination of price hikes and product mix shift, with the premium Dream Series selling exceptionally well.

We view Yanghe as a structural winner in a great category (white spirits), similar to its *baijiu* peers Moutai and Wuliangye. While its brand is not yet dominant, management is investing in marketing and distribution to build Yanghe into a top nationwide brand. All industry experts we have spoken with endorse Yanghe as having the best-in-class management team and strongest sales & marketing capabilities.

Even though the company is well-known and admired by many – and thus seldom offers a large margin of safety – the trade war-induced market volatility allowed us to buy this excellent company late last year. Its shares have rallied +30% since then, yet they are still trading on only 12x next year's pre-tax earnings, or 18x on an after-tax basis.

Kweichow Moutai

China's top white spirits brand had another terrific year in 2018, with its top- and bottom-line growing +26% and +30% respectively. A third of revenue growth came from volumes and the rest from the long-awaited hike in prices, which had been held at unsustainably low levels for the prior five years. Even after the increase, Moutai's ex-factory price of RMB969 per bottle is less than half its typical retail price of RMB2,400, which is set by market forces. We view this RMB1,400+ gap as a margin that is there for the company's taking over the next several years.

After recently hitting RMB1,000, Moutai's shares are trading at 24x next year's after-tax earnings. Where is the margin of safety, you ask? We agree that Moutai is no longer a bargain. However, its valuation is supported by the high likelihood of double digit earnings growth over the next several years. Volumes should continue to grow at a mid to high single digit level rate each year – based on pent-up demand and increases in production capacity – while prices could be increased by at least as much without impacting consumers.

What could go wrong? Moutai's flagship product enjoys a virtual monopoly, isn't particularly economically sensitive and is highly unlikely to be regulated (Chinese people have been drinking *baijiu* for 4,000+ years). The risk of disruption appears to be minute, and whether young people end up drinking it or not doesn't affect our thesis. Instead, risks appear to be in the areas of food safety and governance. Food safety risks are mitigated by the fact that the company has one production facility and uses water from a single source. Regarding governance, as an SOE (state-owned enterprise), Moutai's interests could diverge from those of its minority shareholders. However, given management's solid track record, an attractive dividend policy and the fact that the company is the second largest taxpayer in Guizhou province, we view this risk to be acceptable.

NetEase

Internet company NetEase enjoyed revenue growth of +24%, as a temporary slowdown in its core online games business was more than offset by rapid growth in its ecommerce division. However, EPS fell -42% due to the impact of regulatory headwinds in online games, higher promotional expenses in ecommerce and rising content costs in music.

We view these issues as transient; the regulatory environment for online games has already improved substantially in recent months. Moreover, the company has recently disposed of poorly performing assets and has rationalised its investments in ecommerce and in music streaming, which bodes well for future margin expansion. Fundamentally, we remain bullish the long term outlook for high quality game developers and distributors such as NetEase and Tencent as 5G, cloud and handset improvements will lead to better user experience, and as augmented and virtual reality (AR and VR) go mainstream. Game content also represents valuable intellectual property that can be monetised in other formats such as video, live events and merchandise.

We have been NetEase shareholders since the fund's inception and have experienced several ups-and-downs over the years. What has been consistent though, is the rationality of its highly-aligned founder William Ding and the excellence of its core gaming franchise. Despite the ups-and-downs, the shares we bought in Jan 2012 have subsequently gained +550%. We think the future could also be quite profitable for investors who are willing to take a long term view.

Noah

Despite a tough fundraising environment and A-share market turmoil, China's leading independent wealth and asset manager increased its top-line +16% and earnings per diluted share +19%. Revenue quality improved as the proportion of recurring revenue grew from 49% to 54%. Despite the harsh operating conditions, the company has been investing in a counter-cyclical fashion by growing its relationship manager team from 1,335 to 1,583. It has also been rapidly expanding its family office services, its short-term collateralized lending to clients and its international business.

Wealth and asset management does not have a wide moat: new entrants emerge daily, and poor decisions can inflict serious harm on an incumbent's reputation. However, it can be an excellent business IF it is done well, given its high customer stickiness and low capital intensity. We believe Noah's management team has built a great company based on a culture of putting clients first. The nature of their business means it is prone to bouts of volatility (in fact, it is experiencing a product issue right now). However, over time, we believe it will become bigger and better. Trading at less than 8x next year's pre-tax earnings, it seems our view is not widely shared.

Tencent

Internet giant Tencent grew its top-line +32%, though margin compression reduced EPS growth to a mere +3%, its weakest in 14 years. Unforeseen government regulations hurt its core online games business, as new game approvals were suspended and as it was unable to monetise some of its existing blockbusters; gaming revenue grew +6%. The margin compression was due to a lower contribution from gaming and the company's continued substantial investments into cloud , video and financial services.

From a fundamental perspective, we do not believe Tencent's competitive positioning has worsened at all. Its core competitive advantage remains its social networking ecosystem, the all-encompassing super-app WeChat, where Chinese internet users spend a good chunk of their online and offline lives. Users remain as sticky as ever and the company continues to hold back ads on WeChat to protect the user experience. With arguably the most powerful social networking ecosystem in the world and growth coming from games, ads, financial services, cloud, video, music and ecommerce, we are confident Tencent will be a significantly more profitable business five years from now.

Wuliangye

Wuliangye outgrew its more illustrious rival, Moutai, in 2018, with sales and EPS growth of +33% and +36% respectively. The bulk of revenue growth came from ASP, with a direct price hike of its flagship Crystal Wuliangye product and a mix shift towards high-end products.

As the number two *baijiu* brand, Wuliangye started to take advantage of Moutai's supply-side constraints since the second half of last year, a trend which has continued into 2019. The SOE reforms of 2017 have also rejuvenated management. They have taken steps to flatten distribution by beginning the process to double its sales & marketing team and encouraging distributors to sell directly to end-users. They are also proactively increasing the supply of high quality liquor distilled out of the base liquor to produce more premium products in the future. Trading at 23x next year's after-tax earnings, Wuliangye is no longer a bargain, but it remains undervalued given the quality of its brand and its double-digit long term growth potential.

Yihai

Yihai, the Haidilao group's condiments business, epitomises the importance of a company getting the best out of its people via optimising incentives. After implementing the 'partnership program' at the beginning of 2018, whereby employees share in the net profits they personally create for the firm and all employees are incentivised to innovate new products and in exchange receive a share of the net profits those products generate, Yihai's sales growth accelerated to +63% last year while net income doubled. CEO Shi Yonghong described his task as "…aligning employees' interests with those of the business. We believe everyone has the potential to do a fantastic job and my role is to set the incentives right".

Yihai's share price enjoyed another stellar year, partly helped by sister company Haidilao's IPO increasing the group's profile. While near-term valuations appear high, we believe some margin of safety remains given our forecast of earnings compounding north of +30% over the next several years, supported by new products, further points-of-sale penetration in lower tier cities, and the attractive growth prospects of Haidilao itself.

Corporate update

After eight years, the time has come to say goodbye to 26 Throgmorton Street. In 2011, we were a 'one man band' starting with $12mn in AUM in an office shared with our friends at Clearance Capital, outstanding investors in European real estate. Over time, we moved to two rather unglamorous offices in the same building – one was subsequently turned into a bicycle shed! As our team has grown – and given the depressed London office market – we decided to invest in something a bit nicer at 91 Jermyn Street, where we hope to be based for the next ten years plus. Joe has done a stellar job of settling us in. Drop in for a cup of coffee, cha or rooibos anytime.

Conclusion

To our clients: thank you for keeping your eyes on the horizon.
To the Cederberg team: thank you for your terrific work.

David Krige

Additional commentary by investment team members Adeline Chong, Daniel Ng and Da Wei Zhang.

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Regulatory information and risk warning

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Disclosure

[1] Past performance is not indicative of future performance. Investors whose reference currency differs from the US dollar may be subject to exchange rate movements that alter the value of their investments. MSCI Golden Dragon Total Return Index includes net dividends reinvested. Peer group is Bloomberg universe of equity funds with Greater China geographical focus. Source: Charter Group Admin, Bloomberg, Cederberg.

[2] Category definitions as per Cederberg. Source: Bloomberg, Cederberg

[3] Upside Capture show the fund's average return vs. the index's average return for those months in which the index had a positive return. Downside Capture shows the fund's average return vs. the index's average return for those months in which the index had a negative return. Source: Bloomberg, Cederberg

[4] Median portfolio characteristics are quoted as of 04 July 2019. Source: Bloomberg, Cederberg.

[5] Data as of 30 June 2019. Expenses include all fund level expenses excluding investment management fees divided by the fund's average AUM in 2018. Portfolio turnover is for 2019 and is calculated as the lower of all buy and sell transactions divided by fund's average AUM. Source: Cederberg.

Investors should note investment involves risk. The price of units may go down as well as up and past performance is not indicative of future results. Investors should read the Fund's Offering Memorandum for further details and risk factors, in particular those associated with investment in emerging markets. Information in this report has been obtained from sources believed to be reliable but Cederberg Capital does not guarantee the accuracy or completeness of the information provided by third parties.

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	Class A (closed for new subscriptions)	Class B	Class C	Delaware LP - Class B	Delaware LP - Class C
Inception date	1 Jan 2012	1 Jul 2018	1 Jul 2018	1 Aug 2018	1 Aug 2018
Status	Closed	Open	Open	Open	Open
Min initial investment	US$100k	US$100k	US$100k	US$1mn	US$1mn
Subscription	Monthly	Monthly	Monthly	Monthly	Monthly
Redemption notice	30 days	90 days	90 days	180 days	180 days
Redemption fee (payable to the Fund)	3% if redemption within first 6m	5% if redemption first 3yrs, thereafter zero	N/A—3yr hard lockup	5% if redemption first 3yrs, thereafter zero	N/A—3yr hard lockup
Management fee	1.50% p.a.	1.25% p.a.	0%	1.25% p.a.	0%
Performance fee	20% of net alpha over MSCI Golden Dragon if Fund generated >6% p.a. US$ returns; payable for the first time in Jan 2015 and annually thereafter	20% of net alpha over MSCI Golden Dragon if Fund generated >6% p.a. US$ returns; payable for the first time in Jan 2022 and annually thereafter	25% of returns over 6% p.a. US$ hard hurdle; payable for the first time in Jan 2022 and annually thereafter	20% of returns over 8% p.a. US$ hard hurdle; payable annually	25% of returns over 6% p.a. US$ hard hurdle; payable annually
High water mark	Yes	Yes	Yes	Yes	Yes
Investor level gates (max redemption per investor)	N/A	25% per quarter	25% per quarter	N/A	N/A
ISIN	KYG2030A1004	KYG2030A1186	KYG2030A1269	N/A	N/A
Sedol	BMM1R81	BFYZYW5	BD31D23	N/A	N/A