CEDERBERG CAPITAL

Cederberg Greater China Equities 30 June 2020

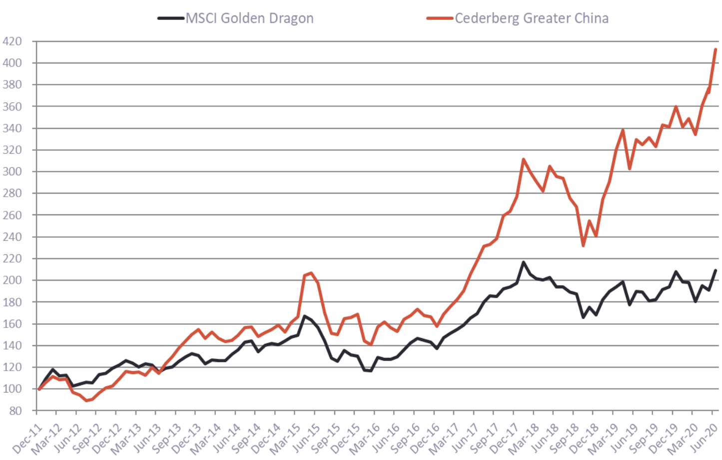
An introduction to Cederberg

- 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
- Durable **Moats**, excellent **Management**, and a large **Margin of Safety**
- We manage a high conviction portfolio of long-term winners
- **Current investors are able to add to their subscriptions; new investors will be accepted should capacity become available**

Why Cederberg is not suitable for everyone

- Our products are considered very risky; given our long-term focus and comfort with being different, **we are not suitable for most investors**
- **Chinese equities are highly volatile: declines >50% are not unusual**
- Our returns have been more volatile than those of the index
- We run a concentrated portfolio that differs from the index and those of our peers
- **Our past returns are unlikely to be repeated in the long run**
- **We are only suitable for those with an investment horizon >10 years**

Performance chart[1]

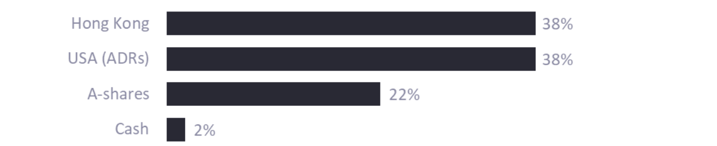


Class A shares. All figures in US$ net of fees. MSCI Golden Dragon Index includes net dividends. Past performance is not indicative of future results - please see regulatory information on p6. Source: Bloomberg, Charter Group. 30 June 2020.

Performance table[1]

Net Returns in US$	Class A	Index	Peer group	Percentile
Since inception (1/1/2012)	18%	9%	8%	100
5 years	16%	6%	3%	100
3 years	24%	7%	8%	98
2019	50%	24%	32%	86
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	15%	0%	8%	69
3 months	24%	16%	8%	88
1 month	11%	9%	11%	48

Portfolio positioning[2]



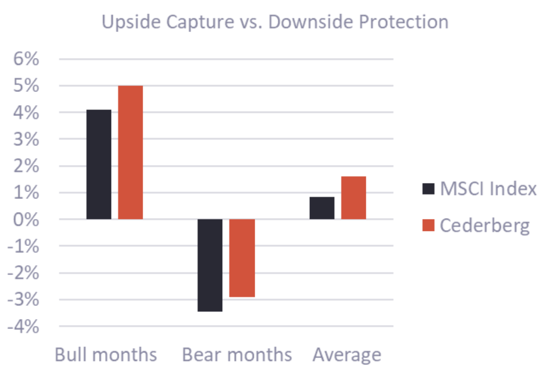
Major holdings[2]

Alibaba	Ecommerce	**LexinFintech**	Consumer finance
Haidilao	Restaurants	**NetEase**	Online gaming
Kweichow Moutai	Distillers	**Tencent**	Social network
China Meidong	Autodealers	**Wuliangye**	Distillers
GDS Holdings	Datacentres	**Yihai**	Condiments

Median portfolio characteristics[4]

P/E (2021e)	26x	**ROE**	24%
EV/EBIT (2021e)	22x	**ROIC**	16%
EPS growth (2021e)	23%	**Market cap**	US$12bn
Net cash to equity	43%	**Number of holdings**	17
Dividend yield	1%	**Top 10 holdings**	84%

Risk[3]



Key features[5]

Strategy	Long-only equity	**Auditor**	PwC
Domiciles	Cayman, Delaware	**Custodian**	Standard Chartered
Fund assets	US$1.2bn	**Administrator**	Charter Group
Firm assets	US$2.3bn	**Cayman counsel**	Maples & Calder
Peer group	Greater China Equity	**US & UK counsel**	Schulte Roth & Zabel
Benchmark	MSCI Golden Dragon	**NAV - Class A**	412.55
Expenses	14 bps (2018)	**NAV - Class B**	140.54
Turnover	15% (2019)	**NAV - Class C**	142.38
Email	ir@cederbergcap.com	**Phone**	+44 203 745 1701

Top 10 Holdings Results: The Strong Getting Stronger

"For whoever has will be given more, and they will have an abundance." Matthew 25:29

In this letter, we discuss the top 10 holdings' results in the most recent financial year (calendar year 2019, except Alibaba, which has a March year-end). **All ten companies' intrinsic value increased at a double-digit rate, with median top- and bottom-line growth of +37% and +34% respectively**. Though Covid-19 could shave over ten percentage points off growth this year, all our holdings are industry leaders with higher profitability and healthier balance sheets than their peers. As such, we expect the pandemic will lead to **the strong getting stronger**; this is already playing out for some of our holdings – more on this below.

To be sure, last year's rapid expansion is not sustainable in the long run: trees do not grow to the sky! However, it is likely that our holdings will continue to substantially outpace the 'average company' – be it in a Chinese or a global context - for two reasons. Firstly, **consumption in China has a very long growth runway**. Secondly, **our companies are well-placed to benefit from this growth given their wide moats and excellent management teams** that continue to reinvest wisely. We are optimistic that they will all be stronger and more cash-generative in five years.

Alibaba

Internet behemoth Alibaba's revenue surged +35%, with its Core Commerce and Cloud divisions expanding +35% and +62% respectively, while non-GAAP diluted EPS increased +38%. It facilitated sales greater than US$1trn of gross merchandise value ("GMV"), reaching the goal it set five years ago. We are optimistic that it will realise its next five-year target of serving at least 1bn customers and facilitating at least US$1.4trn GMV by 2024.

Covid-19 has proven to be a boon for Alibaba. While its ecommerce platforms experienced some supply chain and delivery disruptions in February and March, its performance during the June 18th online shopping festival points to a rapid recovery. Merchants, brands, and farmers are increasingly using the company's livestreaming functions to improve customer engagement and sales. Its market-leading cloud business will invest $28bn over the next three years to meet explosive demand. Hema has enjoyed greater demand for online groceries, while its communication tool DingDing has gone viral due to the work-from-home trend.

Alibaba continues to focus relentlessly on what's best for its customers, employees, and shareholders – in that order – over the long run. It remains a prime beneficiary of the structural growth in China's digital economy, yet its share price has lagged some of its nimbler peers in recent years. As a result, it currently offers exceptional value considering its dominant ecosystem and its long-term potential; it remains a core holding.

China Meidong Auto

After six years of navel-gazing – and missing out on a 20-bagger - we finally invested in Meidong Auto this year. Meidong is a premium auto dealership group servicing some of the most profitable brands in China, namely BMW, Porsche, Lexus, and Toyota. While conventional wisdom would view a dealership as a narrow moat business, Meidong's "Single City Single Store" strategy has helped it to avoid the fierce competition in major hubs, instead allowing it to enjoy a monopoly in its lower-tier cities, particularly in highly lucrative aftersales (services and repairs). Its MIT-educated CEO Ye Tao has implemented a data-driven approach, with a laser-like focus on operational efficiency. This has translated into higher asset turnover, lower inventory days, higher customer retention, and much higher ROE (>30%) than its peers.

Meidong's potential in this highly fragmented market is enormous. It owns c.60 out of 30,000 dealerships and represents less than 5% of the China sales of each of its current auto brands. Moreover, it is still early days for luxury autos in its markets: the category represents 5-7% of car sales in lower-tier Chinese cities vs. 25% - and growing - in Beijing and Shanghai. This all contributed to a stellar 2019: +47% growth in new car sales and +41% in aftersales. Mix improvement and greater efficiencies meant its adjusted earnings surged +78%. Despite recent industry headwinds, the company is on track for another solid year.

While Meidong's share price has already done very well, we are confident that its quality and growth runway more than justify its valuation. Its young average store age suggests that its existing network could increase sales by +20% p.a. over the next several years. On top of that, it plans to open c.10% new stores a year and engage in M&A opportunistically. The Ye brothers, who own 56% of the company, continue to run the business brilliantly. We are delighted to be their long-term partners.

GDS

New holding GDS is the number one carrier-neutral internet datacentre ("IDC") provider in China. Exponential growth in data usage – and hence demand for IDCs - should continue for the next decade and beyond as cloud computing, AI, video, and 5G take off. GDS has both the best assets and the best management team in the industry. Its moat is underpinned by the scarcity of its assets: its portfolio of Tier 1 city datacentres cannot be replicated due to a shortage of both land and power. This leads to extremely sticky customers, with retention rates north of 99%. Management is likewise best-in-class: since CEO William Huang founded the business in 2001, he has done a terrific job acquiring strategic sites, partnering with hypergrowth customers, and lowering funding costs (unlike our other investments, this is a capital-intensive business).

Last year, revenue soared +48% and adjusted non-GAAP EBITDA +74%. We expect growth of at least +20% p.a. over the next decade as GDS develops its existing sites and acquires new ones. While it trades on high near-term multiples, rapid expansion and rising margins imply ample upside for long-term investors.

Haidilao

Hotpot chain Haidilao's top- and bottom-line growth of +56% and +29% respectively were driven by the company's brisk expansion in 2019. It opened c.300 restaurants to take its total up to 768. Given the quality of its brand and its management team, we view its long-term target of 3,000 restaurants as highly achievable – despite being the biggest restaurant group in China, Haidilao's market share is a mere 1%!

Among our major holdings, Haidilao has been the most heavily impacted by Covid-19 as its restaurants were closed during the nationwide lockdown in February and March. As a result, earnings will shrink this year, though revenue is likely to rise. However, we view this as no more than a bump in the road for the company, which is likely to be a long-term beneficiary of accelerated industry consolidation due to the pandemic. Given its peers' misfortunes, the company will have access to great people and prime locations to facilitate its future expansion. Moreover, as consumers become pickier about food hygiene, they are likely to gravitate towards the most reputable brands such as Haidilao.

It was also gratifying to see the company supporting its staff and local communities during the crisis. Apart from donating money and food supplies to affected areas, it kept all of its store staff on full pay and offered counselling to those affected by the pandemic. Haidilao is a rare example of consumers, employees, shareholders, and communities being better off due to its existence.

Kweichow Moutai

Following three blowout years, white spirit ("*baijiu*") distiller Moutai's 2019 growth normalised to levels we would consider sustainable for the medium-term, with revenue and profit increasing +15% and +17% respectively. It is now more valuable than Coca-Cola and three times bigger than Diageo. Its share price has gone up 13x since we first bought it over seven years ago. Is it over-cooked, you might ask?

Moutai remains a brand with few – if any – comparisons globally. As China's best homegrown luxury brand, its runway remains long. To ensure scarcity, volumes should continue to grow at a modest mid-single digit rate. However, prices should increase much more rapidly. With the company's distributors currently enjoying super-normal profits of RMB1,500 (c.$200) per bottle, there is certainly scope for Moutai to raise ex-factory prices substantially over the next few years. Cutting out distributors by selling directly to end-customers could be even more lucrative, which is exactly what the new leadership has been doing. If this turns out to be even a modest success, Moutai could still offer meaningful upside for long-term investors.

Lexin Fintech

New holding Lexin (pronounced Luh-sheen) is an online consumer finance platform catering to young, educated adults across China. While graduates with the right degrees from the right universities often have bright career prospects, a lack of credit scores means that they can struggle to find attractive financing options. Founder Jay Xiao left Tencent in 2013 to focus exclusively on servicing the needs of this "near-prime" segment. What has most impressed us about the company is its culture: risk management seems to be central to everything it does, a trait that we have observed at best-in-class lending businesses operating in other parts of the world. When it comes to customer acquisition, rather than purely relying on the internet giants, it has also developed its own channels such as its e-commerce platform Fenqile, its virtual credit card Lehua Card, and a highly productive offline salesforce. Despite the company's youth, it has already been featured in Harvard's fintech syllabus.

Last year, revenue and non-GAAP net income increased +39% and +16% respectively. Given that it enjoys better regulatory support, scale-driven efficiencies, as well as ample funding from its lending partners, the company will continue to take share from its weaker competitors struggling with delinquencies. Lexin is well-placed to serve the consumption needs of its Generation Y and Z customers, yet it is trading at only 5x next year's earnings.

While competition, regulation and execution present risks, we believe the company has the potential to become much stronger and more valuable in the years ahead.

NetEase

Online games juggernaut NetEase enjoyed +16% revenue and +46% non-GAAP diluted EPS growth last year. Its flagship multi-player game Fantasy Westward Journey is close to 20 years old, yet fans' interests were reignited by the launch of its 3D version. NetEase continues to have a healthy pipeline, incubating new games internally as well as partnering with intellectual property owners such as Warner Brothers on a Harry Potter game. Its online education subsidiary Youdao increased its revenue +78%; Covid-19 has accelerated demand for its services even further.

Twenty years since its IPO, founder William Ding recently wrote an inspirational shareholder letter that provides a blueprint for the next two decades. Despite NetEase being a 130-bagger - it has compounded at 27% p.a. - with a $60bn market cap, William does not intend to spend more time on the golf course: "To date, we have yet to achieve success and are still growing". This obsessive culture, combined with healthy industry tailwinds and a reasonable valuation, suggest the company could continue to compound at attractive rates for years to come.

Tencent

After a bumpy 2018, internet giant Tencent's growth accelerated in 2019, with sales increasing +21%. The gaming business, which took a big hit in 2018 due to regulatory changes, regained double digit expansion. Digital advertising slowed to +18% due to a tepid economy and competition from its aggressive rival Bytedance, however this should pick up in the future. Although WeChat's number of users is approaching its peak, the social network is still severely under-monetised: only recently have certain users been seeing up to four adverts per day, with most seeing much less - something Facebook users can only envy! Tencent's razor-sharp focus on preserving the user experience continues to impress us.

From its nadir in 2018, Tencent now trades at 36x next year's expected earnings, though on a normalized basis it is much cheaper given that ongoing investments in cloud and fintech are temporarily depressing margins. Given its excellent quality and its ability to generate growth of +20% p.a. over the next several years, Tencent remains a core holding.

Wuliangye

Baijiu distiller Wuliangye's turnaround continues to be driven by one thing: incentives! Owning shares that are now worth close to $600mn, management have transformed the company's distribution, fine-tuned its production process, and upgraded its product portfolio. Rather than competing head-on with Moutai, they have cemented Wuliangye as the number one *nongxiang* (strong aromatic) brand in consumers' minds.

Last year, the company continued to take advantage of Moutai's production slowdown, outpacing its more illustrious rival in the process: revenue and earnings increased +25% and +30% respectively. Despite the impact of Covid-19 on consumer and business sentiment – and therefore on demand for its products – its sales will likely increase at a mid-teens level this year and beyond. Trading at 21x next year's pre-tax earnings, its valuation is on par with Diageo's, despite Wuliangye growing five times faster.

Yihai

Condiments brand Yihai continued to surprise to the upside, with sales and earnings up +60% and +39% respectively. Its best-in-class incentives system, aligning the interests of employees and management with those of shareholders, has been key. Expanding and solidifying its distribution footprint have driven first party sales, while sister company Haidilao's store expansion has driven related party sales. Both of these drivers have ample room for expansion. On top of that, the company has made a big push into ready-to-eat foods, starting with a hugely popular self-heating hotpot product. We expect more innovation in this segment as the company continues to cater to generation Z consumers' preference for tasty, convenient food.

Yihai's near-term valuation multiples have risen steadily. While we have reduced the name substantially, we are still unable to identify a visible ceiling to its growth: we expect earnings to compound at over +30% p.a. for the next several years. With the company's entrepreneurial culture driving its innovation and its excellent KPI framework encouraging employees to go the extra mile, we believe there is a decent chance that Yihai will continue to provide shareholders with more positive surprises.

Summary

We remain excited by the long-term outlook for our portfolio of domestic consumption champions. While Covid-19 has presented a hiccup for some of our holdings, we are confident that it will ultimately result in the **strong getting stronger**. With respect to future returns, given that our holdings won't be able to sustain their historic growth rates, **it is likely that the fund's long-term performance will be lower than what it has experienced historically**. Nonetheless, given the portfolio's reasonable valuations, returns could still be decent for patient investors. No doubt there will be periods of extreme volatility and poor performance. As always, we would encourage our clients to focus on the fundamentals of our holdings to assess whether we are staying consistent to our long-term investment process.

Business update

We will be hosting our semi-annual update to clients on July 22nd 3-4pm UK time. Charter Group will be sending out call details to investors in the next few days, but if you don't hear from them and would like to attend, please email ir@cederbergcap.com.

Our annual investor day will most likely be a virtual affair. Please mark your calendar for October 14th 2-5pm UK time - clients and friends are all welcome! Details to follow.

Warm regards,

Dawid Krige

Additional commentary by Cederberg analysts Adeline Chong, Da Wei Zhang and Luke Chen.

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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 2 July 2020. Source: Bloomberg, Cederberg.

[5] Data as of 30 June 2020. Expenses include all fund level expenses excluding investment management fees divided by the fund's average AUM in 2019. Portfolio turnover 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.

Cederberg Capital Limited

2nd Floor, 91 Jermyn Street, London, SW1Y 6JB

Room 2455, Cloud 9 International Plaza, No. 1018 Changning Road, Shanghai, China 200042

上海市长宁区长宁路1018号龙之梦大厦2455室

	Class A	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	Hard closed	Soft closed	Soft closed	Soft closed	Soft closed
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