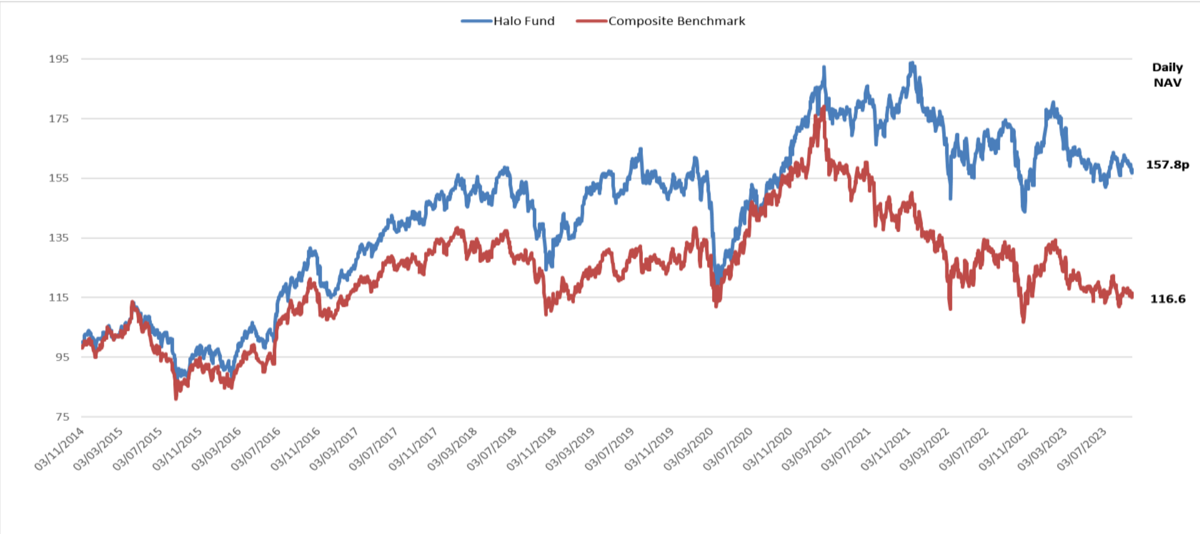
# VT HALO Global Asian Consumer Fund

## September 2023 Quarterly Letter

In Q3 the Sterling B Acc share class rose 1.8%, compared to our composite benchmark, which was up 1.1%. The increase in value was principally driven by sterling falling more than other Asian currencies over the period rather than seeing positive market moves. Indeed, we have seen a further derating of the Fund as the earnings growth continues to be positive, but the shares prices remain moribund. The direction of Asian markets has been driven by the rise in US bond yields which has had a negative effect, as the hoped-for rate cuts this year and early next year in several countries is receding, thus perhaps reducing the growth prospects of the economies and more importantly in the short-term raising the cost of capital for equities, leading to further multiple contractions. This is despite China and the US seeing a marginal improvement in political relations, with several visits of high-ranking political officials meeting and talking down the differences between the two countries. ASEAN is a clear beneficiary of these current tensions as companies seek to re-shore and diversify their supply chains to "friendly nations" and away from China. During September we took the opportunity to visit both Thailand and Vietnam to meet several companies and take the temperature of the mood and outlook for both economies.




***Past performance is not a guarantee of future returns.***

*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. Data from Valu-Trac Administration Services and Bloomberg. 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.

Vietnam's stock market showed a positive return in Q3, up 3.0% in local currency, as the government cut interest rates in Q2, and this has had a beneficial impact on investors' confidence with retail investors continuing to buy the market all the way through the quarter until mid-September. The subsequent rise in US bond yields in the latter half of September and strengthening US Dollar meant the Vietnamese Central Bank (SBV) had to withdraw liquidity from the market to stop the Vietnamese Dong depreciating any further, having fallen 3%. This knocked the confidence of local retail investors and with the market at its peak being at 1245 points fell 7.8% to 1154 by the end of September. This is still up 14.6% year to date, but this is coming off a very weak performance in 2022. The key question is does this market fall reflect the fundamentals of what is happening in the Vietnamese economy?

The equity market fell last year due to concerns over the freezing of the property market as investigations into corruption of some developers was announced. This also flowed through to the bond market where many of the larger developers accessed finance to fund their projects. The corporate bond market seized up and the property developers had to halt building their developments as they could not access the funding. Together with rising interest rates the cost of mortgages also rose from a typical 8% to above 12%. Retail investors who owned most of the bonds were then not able to sell them in the secondary market as there were no buyers and so sold equities across all sectors to ensure they had liquidity. Vietnam's GDP growth was hit by declining construction, falling exports as demand slowed in Europe and the US and lower consumer confidence at home as people lost their jobs. This resulted in GDP growth of only 3.7% in the first half of this year and the Government has been proactive in ensuring this is the low point. It has cut interest rates from 6% to 4.5% and capped deposit rates bank can offer, which is key, as lending rates are more driven by deposit rates than the central bank interest rate. Deposit rates today are closer to 6% having been as high as 10-11% at the end of last year. They have also changed some policies related to bond issuance to make it easier for corporates to issue bonds as well as ease the licensing rules to start new property developments. These actions started to boost investor confidence and hence why the market has performed well this year. Q3 GDP has just been published and growth has accelerated further to 5.3% and this number should also continue to improve in Q4 and is likely to have at least a 6 or possibly a 7 handle by the year end. This trend should continue into next year with growth being faster than 2023 and we are expecting it to be over 6% for 2024. So, although global growth may slow next year, Vietnam is likely to see an acceleration.

Talking to companies in the banking sector and whose primary focus are retail customers, they were all indicating Vietnam is through the worst of the property slowdown and there are signs of life today, albeit the recovery is at a very early stage, and it is going to take another 6-12 months before the property market returns closer to normality. The banks themselves have still not brought their mortgage rates down as fast as deposits have fallen. They will take up to 12 months to reprice the mortgages, which implies mortgages will start to be offered at rates below 10% in early 2024. In the meantime, their net interest margins are going to benefit. With banking profits this year being under pressure due to low loan growth and rising NPLs, next year we are likely to witness faster loan growth, falling NPLs, as the banks have said they have already peaked, and rising net interest margins. This bodes well for their share prices in 2024 as earnings growth will reaccelerate and we would expect our banks, Techcom Bank and VIB, to continue to perform well.

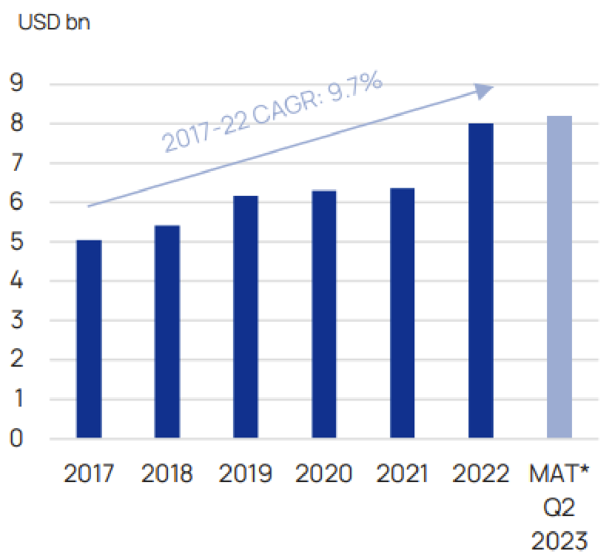
We also met with Vingroup the largest conglomerate in Vietnam and had the opportunity to visit the Vinfast factory and test drive the Vinfast V8 SUV. The founder and owner Mr. Pham Nhat Vuong of Vingroup, which also part owns Vincom Retail, another holding in the Fund has embarked on an ambitious plan to build an EV car company more or less from scratch.

They have a number of experts from Western car companies helping with the manufacturing, marketing and distribution. They have just floated on Nasdaq via a SPAC and have arranged financing to ensure they can reach cash flow break even with the manufacturing site twice the scale of the original Tesla factory. It is an impressive set up and they have models across several price points and firmly aimed at the mass market rather than the premium space. They aim to break even by 2025, and although we can't really comment on the likelihood of this and of its success, it will be interesting to see how they progress. The relevance for Vincom is purely whether Vingroup will sell down their stake in Vincom Retail to help finance Vinfast. From the presentation and conversation with management it appears this is not on the cards. They will rather raise equity on Nasdaq if they require further financing over and above what has been agreed so far with the Chairman and Vingroup.

We also had a chance to catch up with another holding in Vietnam, FPT Digital Retail (FRT), which has been the best performing share we own in Vietnam this year. The shares rose 48.3% to 30th September and have reached new highs as of today. This may seem counterintuitive given their largest exposure by revenue is selling mobile phones and laptops across 800 retail outlets nationwide. Over the last year this has been a painful experience, as demand has been weak for both as the replacement cycle is curtailed as everyone bought new equipment during Covid lockdowns and there has been little demand in 2023. Their main competitor Mobile World Group have decided to destock aggressively by cutting prices and trying to take market share. This has resulted in the whole industry bleeding red ink and a lot of the unorganised trade losing share and ceasing to exist. FRT sales are down close to 20% for the first six months and they will make a loss in this business for the year but it is likely that it will recover next year, although not back to its former glory.

So why are the shares hitting new highs and why do we own it? The key is its second business, a pharmaceutical chain known as Long Chau. It originally bought Long Chau, a pharmacy business consisting of 4 outlets in Ho Chi Minh, in 2017 and it had a reputation of a quality service by well-informed pharmacists, with greater shop sizes and SKUs compared to other traditional pharmacies. The underlying pharmaceutical market has been growing close to 10% per annum and faster than the GDP and something that is likely to continue over the medium to long term as consumers become wealthier and the population starts to age. This makes the underlying market attractive as an investment and why FRT has added this to its original business of selling electronics, which is now relatively mature business.

**Figure 1: Vietnam pharmaceutical sales**



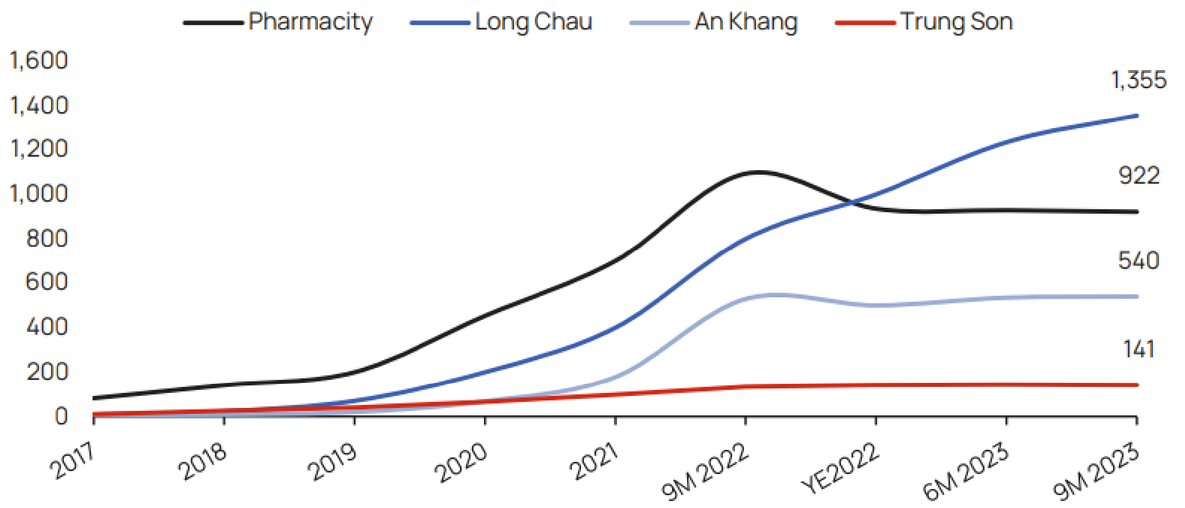

Source: IQVIA, Vietcap

MAT – Moving annual total

The company started to slowly expand its footprint and it was not until 2020 that it achieved 100 stores and then by the end of 2022 it had 1,000 stores. We started buying the shares in early 2022 when the store count was close to 500 stores and we could see this new business make a greater contribution to the revenue line and the market would start to recognise the value of this new business in the next year or so, as it further rolled out the stores. At our meeting last week, they mentioned the number of stores is now above 1,300 and expect to reach 3,000 stores by the end of 2026. Revenue from the pharmacy business in the first half of 2023 represented 46% of the group revenue and is likely to surpass 50% by the year end. The key point is as they expand, the economies of scale start to kick in, both in bargaining power as a large purchaser of pharmaceuticals, improving their ability to cut out several layers of wholesale distributors, allowing them to buy direct from the manufacturers or importers, and sharpening logistics as their network of pharmacies becomes more widespread. They currently offer their drug products at around a 5% discount to other pharmacies and can offer a far larger number of SKUs. Even if they do not have the SKU available in their store, they can now offer to deliver it from another store nearby or from their distribution centre, which no other chain is able to do.

There are competitors, namely Pharmacity, which looks more like a small Boots or Watsons, with less emphasis on the pharmacy and more emphasis on selling cosmetics, health and beauty products, something the Vietnamese consumer has yet to embrace. Pharmacity have retrenched with the number of stores down from 1,100 to 900 (see below) and they remain loss making. Another potential competitor is a drugstore chain owned by Mobile World, their key competitor in the electronic space, but again they have had to halt expansion as they could not make a profit on the pharmacy chain with 500 stores. Their sales per store only manages about 50% of what Long Chau currently achieve. Indeed, there is still plenty of room to grow with an estimated 80,000 pharmacies in Vietnam. So their ambition to have 3,000 by 2026 does not seem outrageous.

**Figure 11: Modern chain expansion**




Source: Vietcap compilation

The potential value of this business is now starting to be recognised in the share price. We think between now and 2025 when the store count will be 2,500, revenues will double, and the net margin will rise from its current 1% to 3%. This would see profits rise by 500% from today's level. Their profits in 2025 would equate to $40m and their market cap today is $520m, so you are paying 13x 2025 for a business that will still be growing its pharmacy business at 20%, assuming its 800 electronic shops are worthless. Clearly, they are not, as before the pharmacy business started to contribute any meaningful revenue the market cap of the company was circa $300m. Today given the electronics and phone retailing is still in a price war we might attribute $150m, as we think this price war will end as consumer confidence returns, and the replacement cycle kicks off in 2024. This would put the pharmacy business on 9x 2025, still undervaluing the business, if as we think, it should be trading on at least 15x forward earnings by the end of 2024.

We also visited Thailand where optimism is perhaps patchy when speaking to various companies. Those more exposed to tourist areas were optimistic but companies whose consumers are based upcountry (rural) or in the industrial zones of Thailand were currently experiencing a more testing environment. GDP growth this year has been downgraded from 4% to perhaps the low 3s, due to tourism visitation, particularly by the Chinese not being as strong as had been expected. Interestingly we are seeing upgrades to next year's numbers, though this is not due to the expected rebound of Chinese visitors. This is primarily due to the new government whose flagship policy is a plan to distribute THB 10,000 to every adult person. This equates to $270 per person and is certainly a meaningful sum when you consider Thai GDP per capita is estimated to be around $6,900. So, we are likely to see a sugar rush in consumption in H1 2024 as this will be distributed through a digital wallet. The government hopes this will stimulate growth but our concern is it will be great initially but there is likely to be a hangover afterwards. We are perhaps seeing the concern already being reflected in the currency, depreciating more than other Asian currencies as this is going to be funded from borrowing, which will lead to higher inflation and hence pressure on interest rates, rising public debt which may crowd out further investment.

There are several companies we met that we believe can generate high single digit growth but currently they are not trading at particularly cheap valuations. So, it is more of taking a wait and see approach with regards to us adding more exposure to the country. We did though have an interesting meeting with Mega Life Sciences, a company we already own, who primarily manufactures generics, nutraceuticals and supplements for the Thai, Myanmar, Vietnam and Cambodian markets, as well as having small operations in some African markets.

The company has always been conservative in how it runs its business and its profit guidance, given the countries it operates in. They have maintained their 6-year guidance of doubling their profits from 2019 to 2025 and after a stellar 2021 and 2022 they had increased profits by 83.6% since 2019 levels. But 2023 has been a year of consolidation as the demand for vitamins is down some 20% as covid subsides, but the core pharmaceutical business continues to grow at a high single digit rate. Profits this year are likely to be flat on last year and Thai investors, whose investment timeframe is a few months at best, have sold the stock as growth has fallen from 20% in 2022 to zero this year. The PE multiple of the company has gone from an historic 20x to just under 15x 12 months forward earnings. In the meeting they reiterated they target to double profits over the 6-year period and perhaps if 2024 comes in at the top of their guidance of high single digit growth from their branded business, being the most profitable division, they will achieve this one year early in 2024, delivering low double-digit growth in earnings. That though is the short term.

What has got us more excited is the potential beyond the next 12 months. They currently have over 170 products in the pipeline and so will launch over 30 a year over the next 5 years. In the past the number of products launched would be less than 10 a year. This acceleration in product launches, especially in the pharmaceutical business, will see faster topline revenue growth over the coming years. They are also entering Indonesia, a new market for them where they expect to break even in 2025 and would like to achieve $100m of sales in the long run. It is a $10bn market today, requires them to capture 1% market share, something they think is very achievable. Today their branded sales are $220m, illustrating the opportunity they see over the next 10 years. According to their guidance they plan to double profits again between 2025 and 2030, which would equate to 14% profit growth per annum. They also maintain a dividend payout ratio of 60% of profits, this equates to just over 3% dividend yield, providing us with a mid-teens total return. Given their track record in delivering the results in the last few years, we have taken the opportunity to add to our holding during the recent sell off. We expect that as growth returns, we should see a rerating back towards 20x earnings on stronger annualised growth, providing considerable upside over the next year and beyond.

**Conclusion**

Having visited Thailand and Vietnam, it is apparent that both governments are focused on stimulating their economies to spur faster economic growth in 2024 than we have seen in 2023. So even with a slowing global economy these countries are likely to buck the trend. I have also highlighted two companies whose growth is driven by independent domestic factors with external events having little impact on their operations. This is one of the key attributes to most of the stocks we hold, in that the bottom-up earnings growth is driven by domestic issues and not what may be happening in the US and Europe. Earnings growth for our companies this year continues to be in the high teens and we are expecting teens growth again next year. With the PE of the fund having fallen from 15.3x to 13.6x year to date, we believe the bottom-up outlook is still positive and consumption continues to grow in all the countries we invest in.

Andrew Williamson-Jones 16/10/23