



Cederberg Greater China Equities 30 June 2018

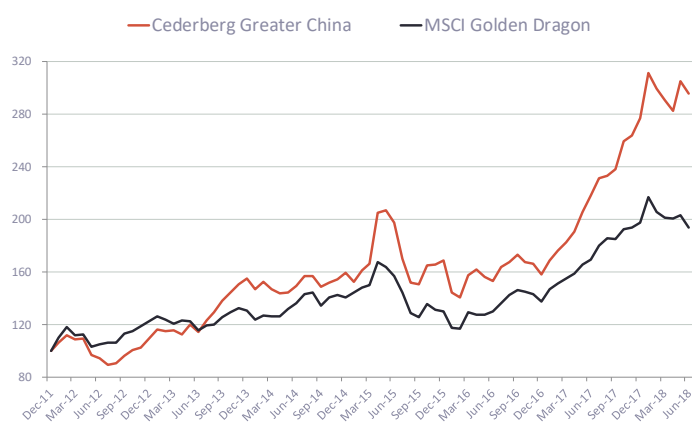
Cederberg Capital

- **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 region's best companies

Investment Principles

- **Moats** that are durable over our 4-year investment horizon
- **Management** that is excellent, honest and aligned with us
- **Margin of safety:** >100% upside to intrinsic value (at initiation)
- **High conviction portfolio** of long-term winners

Performance Chart¹

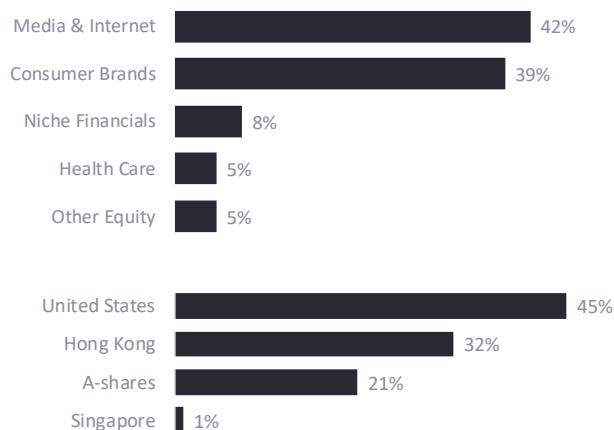


Past performance is not indicative of future results. Please see regulatory information on page 5. Source: Bloomberg, Charter Group, Cederberg. 30 June 2018

Performance Table¹

Net Returns in US\$	Fund	Index	Peer group	Percentile
<i>Annualised</i>				
Since Fund inception	18%	11%	10%	99
5 years	21%	11%	10%	99
3 years	14%	7%	1%	99
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
<i>Not annualised</i>				
Year-to-date	7%	-2%	-6%	98
3 months	2%	-4%	-8%	96
1 month	-3%	-4%	-7%	93

Portfolio Positioning²



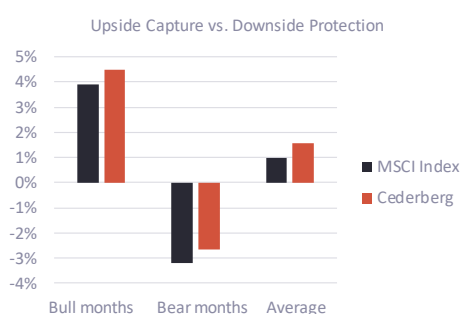
Major Holdings³

Alibaba	Ecommerce	Noah	Asset management
BJ Tong Ren Tang	TCM	Tencent	Social network
JD.com	Ecommerce	Wuliangye	Distillers
Kweichow Moutai	Distillers	Yihai	Condiments
Midea Group	Home appliances	YY	Online streaming

Median Portfolio Characteristics⁵

P/E (2019e)	19x	ROE	21%
EV/EBIT (2019e)	13x	ROIC	16%
EPS growth (2019e)	23%	Market cap	US\$27bn
Net cash to equity	45%	Number of holdings	18
Dividend yield	1%	Top 10 holdings	76%

Risk Metrics⁴



Fund Key Features⁶

Strategy	Long-only equity	Auditor	Deloitte
Domiciles	Cayman, Delaware	Custodian	Standard Chartered
Fund assets	US\$346mn	Administrator	Charter Group
Firm assets	US\$571mn	Cayman counsel	Maples & Calder
Peer group	Greater China Equity	US & UK counsel	Schulte Roth & Zabel
Benchmark	MSCI Golden Dragon	Phone	+44 207 871 7228
NAV	295.420	Email	info@cederbergcap.com

For information on the fund's different share classes, please see p5

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In this letter, we discuss the results of the fund's top 10 holdings in the most recent financial year (calendar year 2017, except Alibaba which has a March year-end). All 10 grew at a double-digit rate, with **median top- and bottom-line growth of 40% and 41%** respectively.

While we are obviously pleased with these results, two caveats are in order:

1. This growth is not sustainable: last year was an exceptionally strong year for many of our holdings; we expect growth to moderate over the next few years
2. Free cash flow drives long term returns: it remains to be seen at what level free cash flow will normalize for companies like JD, which is still in investment mode

Having said that, our **portfolio of world-class companies is priced at only 19x next year's earnings, which leaves us optimistic about the outlook for long-term returns.**

Alibaba – data juggernaut

Alibaba's revenue grew 58%, with its core commerce business growing 60%. Diluted Non-GAAP EPS grew 38%, as investments continue to hold back earnings growth. Our hypothesis - Alibaba will continue to monetize the world's most valuable collection of consumer data – appears to be playing out, as more retailers and brands paid the company more money to connect them with their perfect target customer.

In 2018, Alibaba's focus is 'New Retail': using data and technology to help brick-and-mortar retailers serve their customers better. As part of this push, it launched its own grocery retailer Hema, invested in brick-and-mortar retailers Sun Art and Suning, and beefed up its logistics through investments in Ele.me, Cainiao and ZTO. This has enabled the company to gather even more data, thus further widening its moat.

Despite its share price recently hitting an all-time high, our analysis suggests Alibaba's core commerce business is trading on 16x next year's normalized earnings. Meanwhile, the company's target addressable market could expand from RMB6trn to RMB36trn as it pushes into offline retail. The juggernaut is unlikely to stop any time soon.

Beijing Tong Ren Tang CM – good, can do better

It was business as usual at China's best known TCM (Traditional Chinese Medicine) brand. Sales grew 17% and net profits 16%. Virtually all growth came from volume, with its flagship product, *An Gong Niu Huang Wan* (used for the treatment of strokes) still relatively underpenetrated even in its core Hong Kong market. The company has been increasing its sales and marketing efforts to educate consumers on its products, which is becoming more important as it expands into new markets.



Tong Ren Tang was founded in 1669 and was made the sole medicine supplier to the Imperial Court during the Qing Dynasty in 1723. Today, it enjoys household familiarity in China. The brand is synonymous with best-in-class TCM: from the quality of its ingredients to its manufacturing craftsmanship, Tong Ren Tang maintains the highest standards. As a result, it has significant pricing power: its key product sells for four times the price of its nearest competitor's product. Despite being one of China's best-known consumer brands, it has seemingly flown under the radar of most investors as it was previously listed on the Hong Kong Stock Exchange's junior board. It recently made the transfer to the main board, which has led to increased investor attention and a richer multiple.

While results in recent years have been solid, we feel the company could do a lot better given the strength of its brand and its product portfolio. A share incentive program would certainly help to unlock some of this potential. Sadly, our primary research indicate that this is unlikely to be forthcoming anytime soon, though we continue to engage with management on this topic.

JD – delaying gratification

China's leading e-tailer had another strong year as it grew its revenue 39%. Due to greater economies of scale in procurement, warehousing and logistics, JD was profitable for the first time, though this remains a secondary objective for the time being. In fact, management's Bezos-like focus on improving customer loyalty by investing virtually all profits back into growing the business is impressive. We believe that this will ultimately result in a wider moat and in attractive shareholder returns, a view that has not been widely shared by the market of late.

JD has been increasing its product offerings, mainly in fast moving consumer goods, which should increase customer stickiness as purchase frequency in this category is far higher than in its consumer electronics mainstay. It has also made a push into apparel to attract more female shoppers, thus far with mixed results as Alibaba has been employing all sorts of tricks to thwart it, though ultimately we expect them to succeed as brands confirmed to us they would much rather deal with a duopoly than with a monopoly - who knew! Meanwhile, it is working closely with Walmart - which upped its stake in JD to 12% - to further improve its supply-chain capabilities. Our discussions with courier companies, retailers and brands suggest that JD's logistics subsidiary already offers industry-leading service levels; it was valued at US\$13.5bn in a recent funding round.

Kweichow Moutai – king of consumer upgrade

China's most famous premium consumer brand had another bumper year. Our channel checks indicated distributors ran out of stock frequently, even during the low season. In addition,



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Moutai has been struggling to keep prices down to its recommended retail price of RMB1,499 (c. US\$230) per bottle! End-user prices have consistently exceeded this by more than 10% due to the extremely high demand. This supply and demand imbalance helped Moutai grow sales 50% and net income 47%.

Moutai is a beneficiary of 'premiumisation', a multi-year trend where aspiring Chinese consumers trade up to buy better quality goods and services when they can afford to do so. The company still has a long runway for growth in both volumes and prices: low-teen volume growth appear reasonable given the demand tailwinds, and ex-factory prices remain far too low relative to the recommended retail price, leaving distributors with fat margins. We expect regular ex-factory price hikes to narrow the gap over the next few years.



Midea – no ordinary appliance maker

Revenue of the world's largest home appliance business recorded an impressive 31% organic growth in 2017. Including the acquisitions of Toshiba Home Appliances and the German robotics company Kuka, sales grew 51%. While net income was held back by these new investments (they are currently under-earning), it still grew a respectable 18%.

White goods manufacturing may appear to be an average business; however, we believe Midea has a durable moat because of its strong brand, distribution network and economies of scale. Moreover, it has an impressive 'wolf culture' - for the company's employees, it is very much a case of up or out. Well-structured share incentives further align management's interests with those of shareholders. These factors, combined with the company's various growth initiatives such as the Internet of Things, small appliances, automation and international expansion, leave us excited about Midea's future.



Noah – it's the destination not the journey

China's leading wealth and asset manager grew its top-line 12% and EBIT per diluted share by 18%. The company achieved several milestones as it distributed products worth US\$18bn, grew its assets under management to US\$23bn, and achieved an investment grade rating from S&P. It continued to attract and retain top talent – turnover amongst its leading relationship managers was less than 4%. It also continued to expand globally: in addition to its 237 onshore branches, it now has offices in Hong Kong, Taipei, Melbourne, Jersey, New York, Vancouver and Menlo Park.

Noah is increasingly focused on alternative investments, with 59% of its assets under management in private equity and venture capital. The major benefits of this strategy are 1) it increases recurring revenue as these tend to be multi-year investment products; 2) it is easier to differentiate itself from its peers, espe-

cially given its close cooperation with the venture capital firm Sequoia; and 3) there is less pressure on fees. At the same time, it is evolving from a product-driven company into a financial services platform, offering asset management, global investments, internet services, estate planning, tax and philanthropy advice to name but a few. Despite Noah's evolution, it remains a client-centric organisation – a relationship manager told us she met some of her clients up to 20 times per year!

We've been encouraged by Noah's ability to dodge most of the industry's pitfalls such as mis-selling, rampant conflicts of interest, and chasing growth at any cost. Whilst the nature of its business means an investment in Noah is unlikely to make for a smooth journey, we think the destination will ultimately be worth it.



Tencent – widening the moat

Another year of beating expectations for Tencent, with top and bottom line growth of 56% and 74% respectively. In fact, every one of its business segments grew strongly. Tencent continues to widen its moat, which is even more impressive when considering that it is arguably already one of the most entrenched companies in the world. By ramping up investments in everything from video content to e-payments, Tencent has created a sticky and pervasive ecosystem for its over 1bn users. While these investments – which tend to depress earnings – make it appear somewhat expensive on near-term multiples, we are confident that they will ultimately result in much stronger profitability, leading to much lower multiples in a few years from now.

What could spoil the party? The same risk other dominant internet companies in the world face: regulation. On this score, we think the likes of Tencent and Alibaba stand far less to lose vs. the major US tech behemoths, as the Chinese regulator appears to be relatively relaxed about monopolies – the Communist Party being a monopoly itself might have something to do with this...! In all seriousness though, there is compelling evidence to suggest that the government is far more supportive of monopolies than regulators in other parts of the world. Furthermore, because of the concentration of internet traffic within the Tencent and Alibaba ecosystems, they effectively facilitate the government's ability to monitor and control online traffic. Lastly, Chinese consumers appear to be more comfortable than Westerners when it comes to data protection, a hot topic for the likes of Facebook. We remain bullish on the long-term prospects of the dominant Chinese tech companies like Tencent and Alibaba.



Wuliangye – better incentives better outcomes

China's number two spirits band had a strong year, growing top and bottom lines 23% and 43% respectively, as it benefitted from the same premiumisation tailwind as Moutai. From numerous conversations with distributors, we believe that Wuliangye has further cemented its position as the number two *baijiu* (white



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spirit) brand over the past year, pulling well clear of the number three player.

While we've waxed lyrically about Moutai in the past, Wuliangye is equally praise-worthy: its origins go back 400 years and it enjoys 99% aided brand awareness. While Moutai's share of the premium *baijiu* market stands at c. 60%, Wuliangye's is around 25%. Importantly, it doesn't compete head-on with Moutai, as their flavours appeal to different segments, in the same way that bourbon and Scotch appeal to different types of whisky-drinkers.

The company completed its SOE (state-owned enterprise) reforms earlier this year by issuing shares to employees, distributors and domestic investors, totalling 2.2% of outstanding shares – a not insignificant US\$1bn's worth! The share scheme covers 10% of Wuliangye's workforce, and for many employees, the shares they received are worth more than their annual salary. The increased alignment of interest should provide a major boost to the company's long-term performance.

Yihai – spicy!

China's leading hot pot condiments company's top and bottom line growth accelerated to 51% and 41% respectively - far exceeding our expectations - on the back of a higher pace of Haidilao store openings and strong third-party sales. Execution was key to Yihai's 2017 performance, as management did an excellent job growing its distribution network by 30%, thus penetrating deeper into the hinterland. Our channel checks suggest Yihai's distributors are very satisfied, as they work with the best brand in the category and get offered better financial incentives than their peers.

Yihai's moat continues to widen, from the stronger distribution mentioned above and the increased strength of sisterco Haidilao's brand, the country's leading catering company akin to the 'Starbucks of China'. We are excited to see what the future holds for this little giant.

YY – streaming gold

China's number one live streaming platform had a blow-out year: revenue grew 41% as record users were attracted by better interaction between artists and fans, while earnings rose 57%, driven by operating leverage and the improved profitability of e-sports subsidiary Huya.

Huya successfully listed in New York on May 11th; its share price has since tripled. Backed by YY and Tencent – which owns a 32%-stake - the company is in an enviable position as e-sports broadcasting in China is rapidly growing and is essentially a two-player market (its peer Douyu is also backed by Tencent).

Excluding its 45% stake in Huya and US\$2bn in cash, YY is trading at 6x next year's earnings, which is remarkable considering its core business is growing at c. 20%. Investors who are after quality, value or growth: look no further!

Corporate update

The Class A fund share class is now closed to new subscriptions. Class B, C and the Delaware Limited Partnership—for US taxable investors—are currently open. For more information, please see the next page.

Conclusion

To our clients: thank you for your long term-orientation.
To the Cederberg team: thank you for your world-class work.

All best wishes,

David Krige

Additional commentary by investment team members 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 Source: Cederberg

⁴ Upside Capture is calculated by dividing the fund's average NAV return during months in which the index had a positive return by the average index return during those months. Downside Capture is calculated by dividing the fund's average NAV return during months in which the index had a negative return by the average index return during those months.

⁵ Median portfolio characteristics are quoted as of 4 July 2018. Source: Bloomberg, Cederberg.

⁶ As of 30 June 2018. 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	Class B	Class C	Delaware LP
Inception date	1 Jan 2012	1 Jul 2018	1 Jul 2018	1 Feb 2018
Status	Closed	Open	Open	Open
Min initial investment	US\$100k	US\$100k	US\$100k	US\$1mn
Subscription	Monthly	Monthly	Monthly	Monthly
Redemption notice	30 days	90 days	90 days	180 days
Redemption fee (payable to the Fund)	3% if redemption within first 6m	5% if redemption first 3yrs, thereafter zero	No redemption first 3yrs, thereafter zero	5% if redemption first 3yrs, thereafter zero
Management fee	1.50% p.a.	1.25% p.a.	0%	1.25% p.a.
Performance fee	20% of net alpha over MSCI Golden Dragon; payable after 3yrs if Fund generated >6% p.a. US\$	20% of net alpha over MSCI Golden Dragon; payable after 3yrs if fund generated >6% p.a. US\$	25% of returns over 6% p.a. US\$ hard hurdle; payable after 3yrs	20% of returns over 8% p.a. US\$ hard hurdle; payable annually
High water mark	Yes	Yes	Yes	Yes
Investor level gates (max redemption per investor)	N/A	25% per quarter	25% per quarter	N/A
ISIN	KYG2030A1004	KYG2030A1186	KYG2030A1269	N/A
Sedol	BMM1R81	BFZYW5	BD31D23	N/A