PANGOLIN INVESTMENT MANAGEMENT

Pangolin Asia Fund February 2023 NAV

As at the 28th of February 2023, the NAV of the Class A shares of the Pangolin Asia Fund was US$585.67 net of all fees and expenses, up 2.40% from US$571.92 in January.

As of today, the fund is about 98% invested, with the split being approximately as follows:

Singapore	5%
Malaysia	28%
Indonesia	67%

We don't disclose our names but some details are always available to investors (and those wishing to become investors) on request.

Overview

To put things into some perspective, please see the tables below.

Return (in local currencies, except MSCI)									
Period	DOW	S&P 500	NASDAQ	JSE	KLSE	STI	MSCI Asia ex JP	MSCI-ASEAN	PAF
Feb-23	-4.19%	-2.61%	-1.11%	0.06%	-2.11%	-3.06%	-6.86%	-5.75%	2.40%
YTD 2023	-1.48%	3.40%	9.45%	-0.11%	-2.76%	0.35%	0.77%	-1.19%	7.81%

Return (in USD)									
Period	DOW	S&P 500	NASDAQ	JSE	KLSE	STI	MSCI Asia ex JP	MSCI-ASEAN	PAF
Feb-23	-4.19%	-2.61%	-1.11%	-1.71%	-6.90%	-5.54%	-6.86%	-5.75%	2.40%
YTD 2023	-1.48%	3.40%	9.45%	1.93%	-4.56%	-0.31%	0.77%	-1.19%	7.81%

% Change in Currency Vs USD			
Period	MYR	SGD	IDR
Feb-23	-4.89%	-2.56%	-1.77%
YTD 2023	-1.85%	-0.66%	2.04%

As mentioned in previous letters, for most investors, Asia is synonymous with China and/or India. Last year, some investors decided they no longer wanted to invest in China, but then changed their minds early this year, sucking away money from our region. This meant we've been able to increase some of our positions at attractive prices, some of which are higher than they were in January. Without falling currencies, the fund would have been up 4% last month. But we've come to accept weak Ringgit & Rupiah as a constant. We're running uphill.

The distorted truth about dividend policy vs capital allocation – Chiew Sia

We often hear investors asking companies whether they have a dividend policy in place. Pre-listing, IPO companies state in their prospectus a minimum dividend payout to attract investors. A dividend policy may provide certainty / security of a steady income stream to shareholders. However, it is not a guarantee, because when companies make losses, or during global crises such as the 2008 Financial Crisis or Covid-19 pandemic, many companies tend to halt dividend payouts to preserve cash. A dividend policy can be executed in different ways. The typical ones are setting a percentage of net profit, or pay a fixed amount every year, or dividend in specie. Worse still, some companies borrow from the banks to pay dividends.

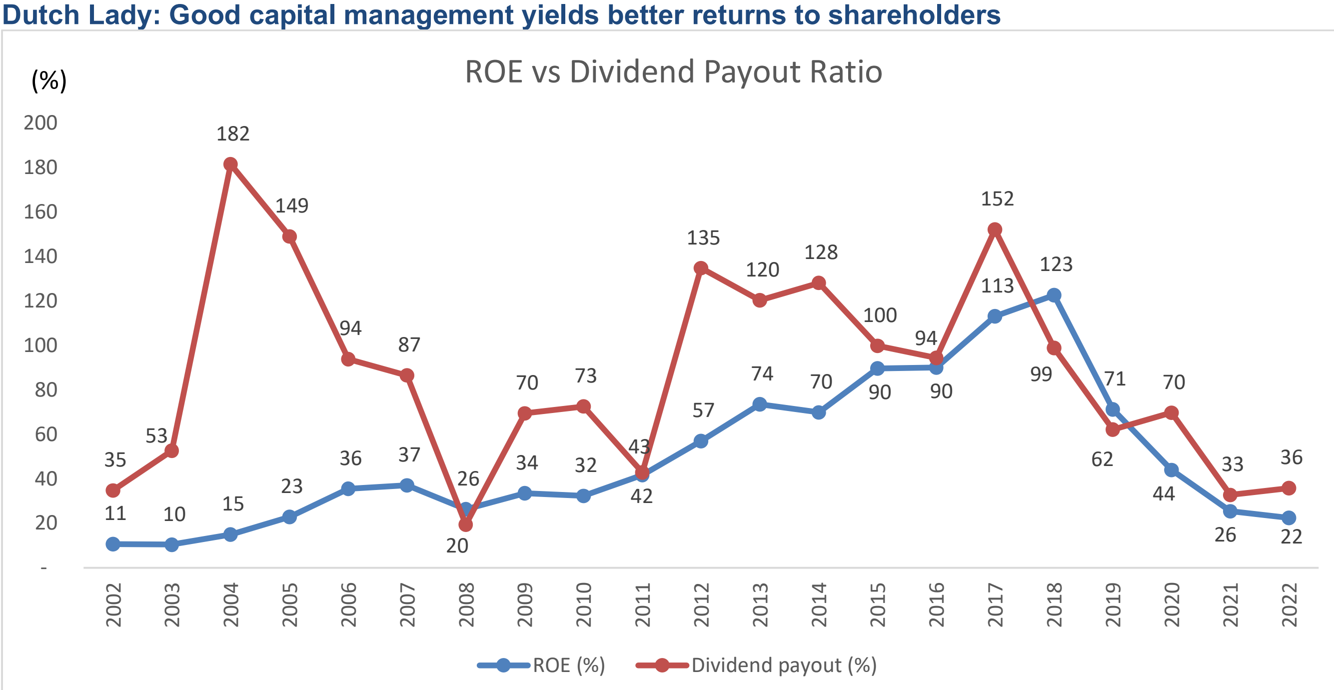
The focus should be on capital allocation instead of dividend policy. At Pangolin, we always advocate our companies to pay any excess cash back to shareholders after they've set aside whatever amount they need for working capital, capital expenditure and a rainy-day fund. The mindset of keeping the cash for growth and paying excess cash to shareholders is rare. Many companies, especially family-owned ones, prefer to keep the excess cash in the bank or for opportunistic investments.

The companies that emphasise efficient capital allocation are usually multinational companies such as Nestle, Dutch Lady, Heineken, Carlsberg, etc. Let's take a look at a couple of examples below.

Dutch Lady Milk Industries

The capital allocation strategy of Dutch Lady Milk Industries focuses on returning excess cash to shareholders when there are no major capital expenditure plans in sight and when positive profit growth is present. This is evidenced by their practice of paying out 100% of profits plus excess capital in the form of interims and special interims, which negates the need to wait for shareholders' approval at the AGM. However, when there are significant capital expenditure plans or opportunities for growth, Dutch Lady preserves its cash and refrains from returning excess capital to shareholders. This approach has enabled the company to consistently achieve ROEs in excess of 20% over the past 20 years.

Dutch Lady: Good capital management yields better returns to shareholders



Source: Dutch Lady's Annual Reports

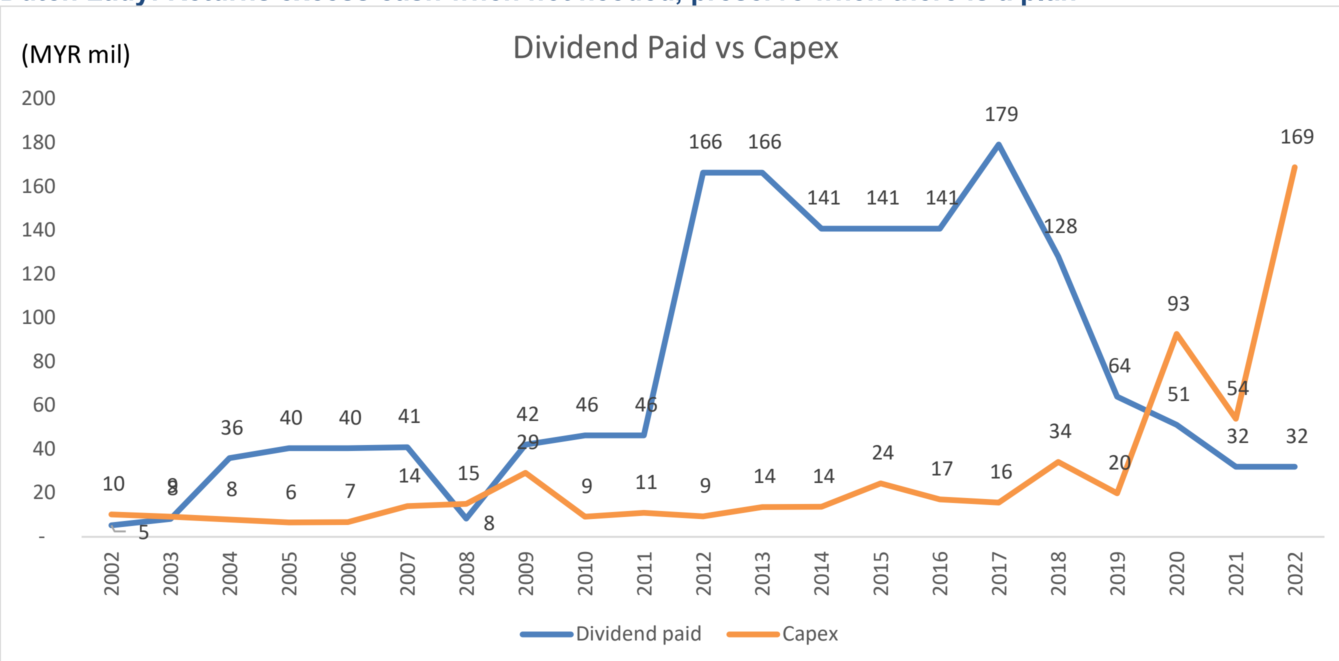
During the Global Financial Crisis in 2008, Dutch Lady cut its dividend payout to as low as 20% of profit despite resilient sales and profitability, thanks to lower raw material prices. The company took the opportunity to upgrade production facilities in 2008 & 2009. Normal dividend payout quickly resumed for 2009-2011 in the range of RM42-46m. Sales recovered and profit almost doubled in 2011, thanks to effective marketing activities and the above-mentioned facilities upgrade.

Its net cash pile swelled substantially to RM193m while net cash/equity was at 74.5%. The next year in 2012, they lifted dividend payout to 135% of net profit and this trend continued until 2018. The huge payout was reduced by half in 2019 when net cash balance had declined to RM16.9m with a low net cash/equity of 16% in 2018. That was also because of higher allocation for capex that year.

In 2019, the dividend payout was only RM64m or at 62% of profit, still not too bad. The year 2020 onwards saw big capital spending as Dutch Lady embarked on new expansion plan which involves a total of RM540m over 2021-2025. The capex will be easily funded by its strong Operating Cash Flow of RM100m-150m p.a. Shareholders are expected to tolerate a short-term low dividend payout in favour of long-term growth.

Assuming an investor had purchased shares of Dutch Lady in 2002 at a price of RM4.00 per share, the compounded annual growth rate (CAGR) return over a 20-year period, including dividends, would be 14% p.a.

Dutch Lady: Returns excess cash when not needed, preserve when there is a plan



Source: Dutch Lady's Annual Reports

Hup Seng Industries

Hup Seng Industries is the no.1 cream cracker brand in Malaysia with a market capitalisation of USD 133m. The company is run by the second generation of the Kerk family (owners since 1957). This shift in emphasis, from passive to active capital allocation, led to positive results for Hup Seng Industries.

We owned Hup Seng a decade ago. When we met the company in 2009/2010, it was trading at a forward PE 7x, had net cash/market cap 30%, zero debt, an ROE of 18%, and its dividend yield was 8%. Although old, the factory was still running efficiently, without the need for any major upgrade. At an AGM, we spoke to the newly appointed Independent Chairman, the late Mr Woon Chin Chan, who was an accountant by background. It was a fantastic conversation. Mr Woon completely understood that the best thing to do with cash was to return it to its owners (the shareholders) as quickly and as often as possible. He basically told the Kerks "it's all being returned unless you can really show a good reason for not doing so".

You can guess what happened. The share price rerated on the back of a much lighter balance sheet. By returning all excess cash, he removed any possibility of the management being sweet-talked into stupid acquisitions or diversification. And once investors perceive this risk to have been removed, the share price will rerate.

As Hup Seng's payout went up, so did the share price. With dividends, we made more than 4x our initial purchase price.

Hup Seng Industries: Share price

Source: www.ft.com

Conclusion

Many listed businesses in this part of the world are run by patriarchs. They think they are being generously benevolent if they increase the dividend. How can you be generous with other people's money?

There is a need to get away from thinking of dividends as a share of profits allocation. For a start, cash flow can often exceed profits. But that is the way it is taught and thought, although the MNCs and a few (sadly only a few) companies think otherwise.

This thinking needs turning on its head. Instead of deliberating how much to pay out, directors should think only about how much to retain. Retaining the minimum allows the management, without distraction, to focus solely on the core business.

We're looking at a small-cap company in Malaysia that "gets it". They invest only for growth and return all the cash they don't need. By single-mindedly focusing on the core business, without needless corporate exercises and non-core investments, the share price should take care of itself.

Outlook

If you want to know what's happening in the world, bin the FT and own shares in an Asian company that manufactures furniture for export to the US. As we do. Sales are collapsing, they tell us. They'll still be profitably generating cash and we're likely to hold on to the shares. While a US slowdown isn't great for anyone, in this part of the world, unless you're a direct exporter, the effects shouldn't be too bad. In the bad years (not Covid) Malaysian retailers tend to open fewer new stores than planned - i.e. they're still expanding.

I was reminded of the perils of shooting my mouth off shortly after publishing our Chinese New Year update in which I espoused the merits of Indonesia's Prodia, which we own. A couple of days later the stock was limit down (-20%) as it was removed from some minor index or other, forcing some funds to sell. And presumably to buy whatever was added to the index in Prodia's place. What a dumb way to allocate money – you can't call it investing. Anyhow, we'd been thinking of buying a bit more anyway and this gave us the opportunity to happily add more for less.

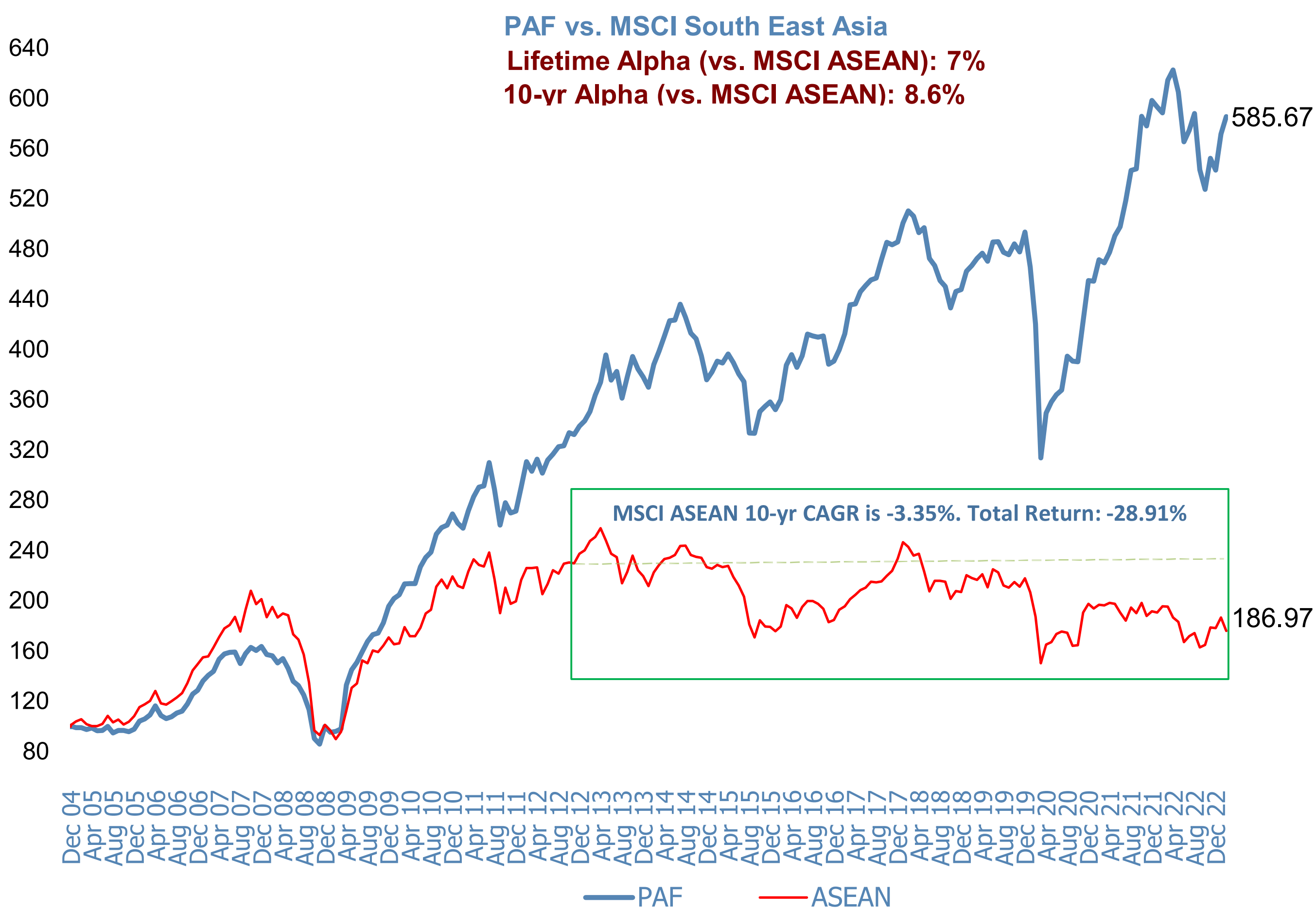
The Chinese New Year update letter can be found via: www.pangolinfund.com/newsletters/pangolin-asia-fund

In terms of valuations, weighted for the fund, I think we're not expensive.

Pangolin Asia Fund Fundamentals (28 Feb 2023)			
	2021A	2022F	2023F
P/E (x)	21.3	12.2	10.5
Profit Growth (%)	25	79	15
ROE (%)	18	20	20
ROIC (%)	31	28	43
Div Yield (%)	4.3	4.7	5.1

Chiew Sia & James
6th March 2023

Eighteen years track record and annualised return of 10.17%

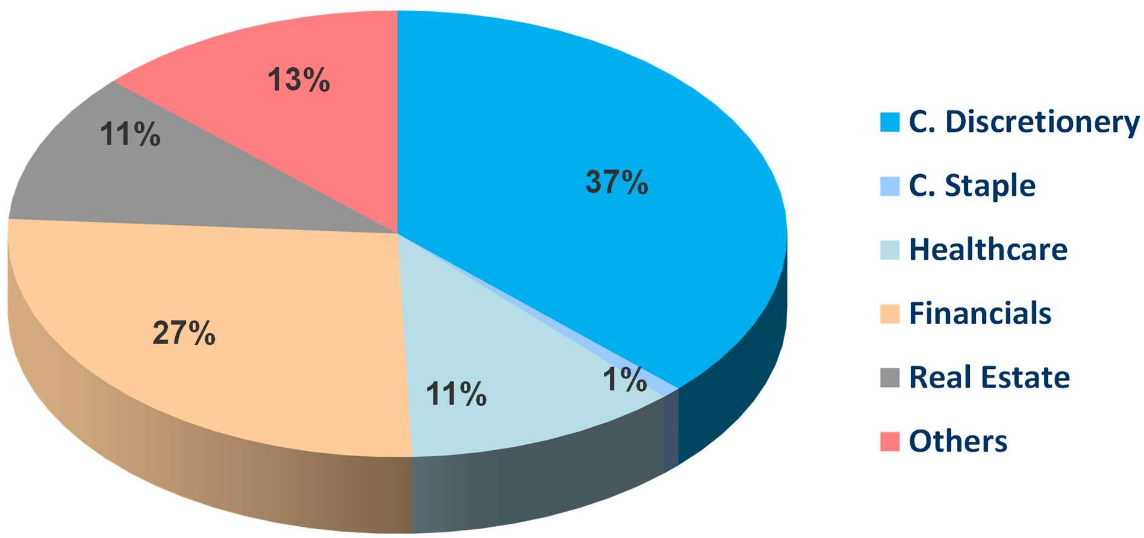


PANGOLIN INVESTMENT MANAGEMENT

Year	Details	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2023	*NAV*	571.92	585.67											7.81%
	% chg	5.28%	2.40%											
2022	*NAV*	593.29	588.82	614.73	622.83	605.35	565.54	574.94	588.17	543.35	527.78	552.46	543.22	-9.23%
	% chg	-0.86%	-0.75%	4.40%	1.32%	-2.81%	-6.58%	1.66%	2.30%	-7.62%	-2.87%	4.68%	-1.67%	
2021	*NAV*	454.64	471.89	469.26	477.70	491.07	497.99	518.78	542.88	544.24	585.87	578.32	598.45	31.44%
	% chg	-0.15%	3.79%	-0.56%	1.80%	2.80%	1.41%	4.17%	4.65%	0.25%	7.65%	-1.29%	3.48%	
2020	*NAV*	465.73	420.43	313.82	349.63	358.55	364.26	367.99	394.82	391.21	390.47	422.87	455.32	-7.80%
	% chg	-5.69%	-9.73%	-25.36%	11.41%	2.55%	1.59%	1.02%	7.29%	-0.91%	-0.19%	8.30%	7.67%	
2019	*NAV*	462.51	467.10	472.67	477.00	470.36	485.78	486.12	477.67	475.87	484.37	477.85	493.85	10.21%
	% chg	3.21%	0.99%	1.19%	0.92%	-1.39%	3.28%	0.07%	-1.74%	-0.38%	1.79%	-1.35%	3.35%	
2018	*NAV*	501.11	510.62	506.32	493.22	497.19	472.82	467.29	455.31	450.29	433.40	446.46	448.11	-7.76%
	% chg	3.15%	1.90%	-0.84%	-2.59%	0.80%	-4.90%	-1.17%	-2.56%	-1.10%	-3.75%	3.01%	0.37%	
2017	*NAV*	400.08	412.81	435.93	436.54	446.18	451.43	455.76	457.12	472.10	485.61	483.86	485.79	24.18%
	% chg	2.27%	3.18%	5.60%	0.14%	2.21%	1.18%	0.96%	0.30%	3.28%	2.86%	-0.36%	0.40%	
2016	*NAV*	352.31	360.43	387.79	396.17	386.04	395.41	412.53	411.2	410.02	411.25	388.48	391.19	9.16%
	% chg	-1.69%	2.30%	7.59%	2.16%	-2.56%	2.43%	4.33%	-0.32%	-0.29%	0.30%	-5.54%	0.70%	
2015	*NAV*	382.31	391.18	389.48	396.82	389.67	380.77	374.61	333.73	333.52	350.84	355.19	358.38	-4.76%
	% chg	1.60%	2.32%	-0.43%	1.88%	-1.80%	-2.28%	-1.62%	-10.91%	-0.06%	5.19%	1.24%	0.90%	
2014	*NAV*	370.08	388.25	398.79	410.89	423.38	423.84	436.37	425.85	413.36	408.97	395.23	376.28	-0.52%
	% chg	-2.16%	4.91%	2.71%	3.03%	3.04%	0.11%	2.96%	-2.41%	-2.93%	-1.06%	-3.36%	-4.79%	
2013	*NAV*	343.47	350.86	364.04	374.14	395.94	375.98	382.69	361.54	378.56	394.53	384.87	378.24	11.48%
	% chg	1.23%	2.15%	3.76%	2.77%	5.83%	-5.04%	1.78%	-5.53%	4.71%	4.22%	-2.45%	-1.72%	
2012	*NAV*	290.78	311.15	303.35	313.01	301.88	312.18	316.87	323.01	323.75	334.08	332.63	339.29	24.85%
	% chg	7.00%	7.01%	-2.51%	3.18%	-3.56%	3.41%	1.50%	1.94%	0.23%	3.19%	-0.43%	2.00%	
2011	*NAV*	261.86	258.03	271.83	283.00	290.51	291.75	310.23	289.05	260.46	278.31	269.95	271.75	0.85%
	% chg	-2.82%	-1.46%	5.35%	4.11%	2.65%	0.43%	6.33%	-6.83%	-9.89%	6.85%	-3.00%	0.67%	
2010	*NAV*	201.91	205.09	213.68	227.44	213.93	227.45	234.62	238.78	253.28	258.37	260.53	269.47	37.58%
	% chg	3.08%	1.57%	4.19%	6.44%	-5.94%	6.32%	3.15%	1.77%	6.07%	2.01%	0.84%	3.43%	
2009	*NAV*	95.67	96.38	98.12	133.22	145.25	151.32	159.71	167.99	173.21	174.49	182.60	195.87	95.34%
	% chg	-4.59%	0.74%	1.81%	35.77%	9.03%	4.18%	5.54%	5.18%	3.11%	0.74%	4.65%	7.27%	
2008	*NAV*	157.49	156.55	150.63	154.03	146.18	136.23	132.58	125.09	113.55	90.36	85.98	100.27	-38.81%
	% chg	-3.89%	-0.60%	-3.78%	2.26%	-5.10%	-6.81%	-2.68%	-5.65%	-9.23%	-20.42%	-4.85%	16.62%	
2007	*NAV*	136.43	140.75	144.17	153.68	157.90	159.36	159.56	150.23	158.13	163.17	160.72	163.86	27.19%
	% chg	5.90%	3.17%	2.43%	6.60%	2.75%	0.92%	0.13%	-5.85%	5.26%	3.19%	-1.50%	1.95%	
2006	*NAV*	104.53	106.09	109.42	116.62	108.82	106.34	107.96	110.76	112.41	117.94	125.81	128.83	31.74%
	% chg	6.89%	1.49%	3.14%	6.58%	-6.69%	-2.28%	1.52%	2.59%	1.49%	4.92%	6.67%	2.40%	
2005	*NAV*	99.24	99.37	97.77	98.86	96.77	97.05	100.14	94.90	96.99	97.05	96.14	97.79	-2.57%
	% chg	-1.13%	0.13%	-1.61%	1.11%	-2.11%	0.29%	3.18%	-5.23%	2.20%	0.06%	-0.94%	1.72%	
2004	*NAV*	-	-	-	-	-	-	-	-	-	-	-	100.37	
	% chg	-	-	-	-	-	-	-	-	-	-	-	0.37%	

Best monthly return	**35.77%**
Worst monthly return	**-25.36%**
Maximum drawdown	**-47.53%**
% of positive months	**64.84%**
Annualised return	**10.17%**

By Sector


13%
11%
37%
27%
11%
1%
C. Discretionery
C. Staple
Healthcare
Financials
Real Estate
Others