Q2 2019 MANAGER COMMENTARY

"Headlines, in a way, are what mislead you because bad news is a headline, and gradual improvement is not."
Bill Gates, CEO of Microsoft

24 July 2019

Dear fellow MMIT shareholder,

Over the last quarter, emerging and frontier markets have remained at the centre of a macro tug-of-war. One moment the asset class is threatened by a prolonged trade dispute derailing already fragile global growth; the next there is an unexpected breakthrough ending tariffs or central banks have signalled further interest rate cuts. This cacophony of market speculation can become deafening. Given our long-term view, we are satisfied that the fundamentals point to emerging markets growing faster than their developed counterparts, while remaining significantly undervalued (*see Figure 1 below*) and competitive. In 2017, 1.3mln patents were filed in China, more than double the number in the US. 473 of these were related to AI (artificial intelligence), compared to 65 in the US and 2 in the UK [1].

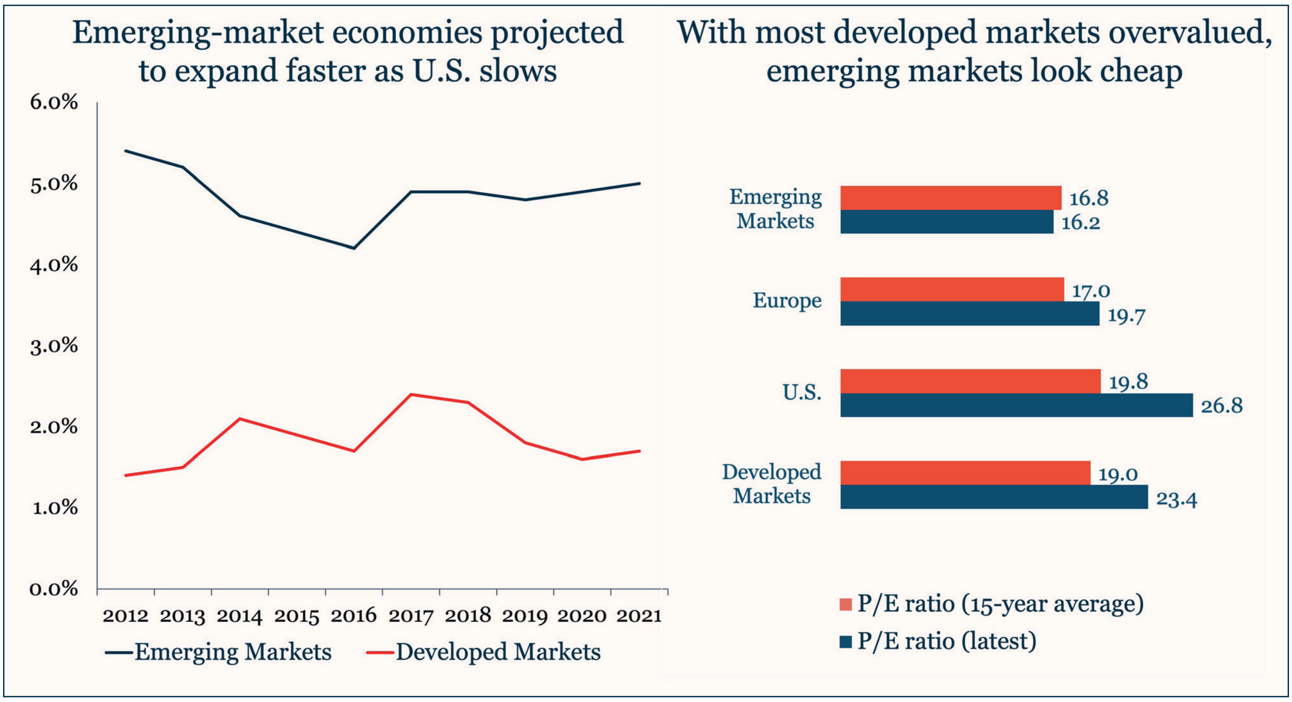

Figure 1, Source: Bloomberg, Note: Data from 2019 to 2021 based on forecasts
Note: Price/present-value average earnings of the past 10 years

We would rather use this commentary as an opportunity to draw attention to some of the characteristics and themes that frequently reoccur across our portfolio holdings, irrespective of the different geographies and sectors of the underlying companies. Whilst similarities in the business models are quickly apparent, we believe the more interesting commonality between holdings lies in the second pillar of our investment strategy, the opportunity to unlock further value through engaging with management and stakeholders.

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In the chart below (*Figure 2*), we have compiled a high-level analysis of the 149 engagement items we raised with portfolio companies between October 2018 and June 2019. These can be broadly categorised into seven buckets, namely: Governance (raised in 67 instances), Strategy (raised in 25 instances), Capital Allocation (raised in 19 instances), ESG Reporting (raised in 18 instances), Operational (raised in 8 instances), Social (raised in 7 instances) and Environmental (raised in 5 instances).

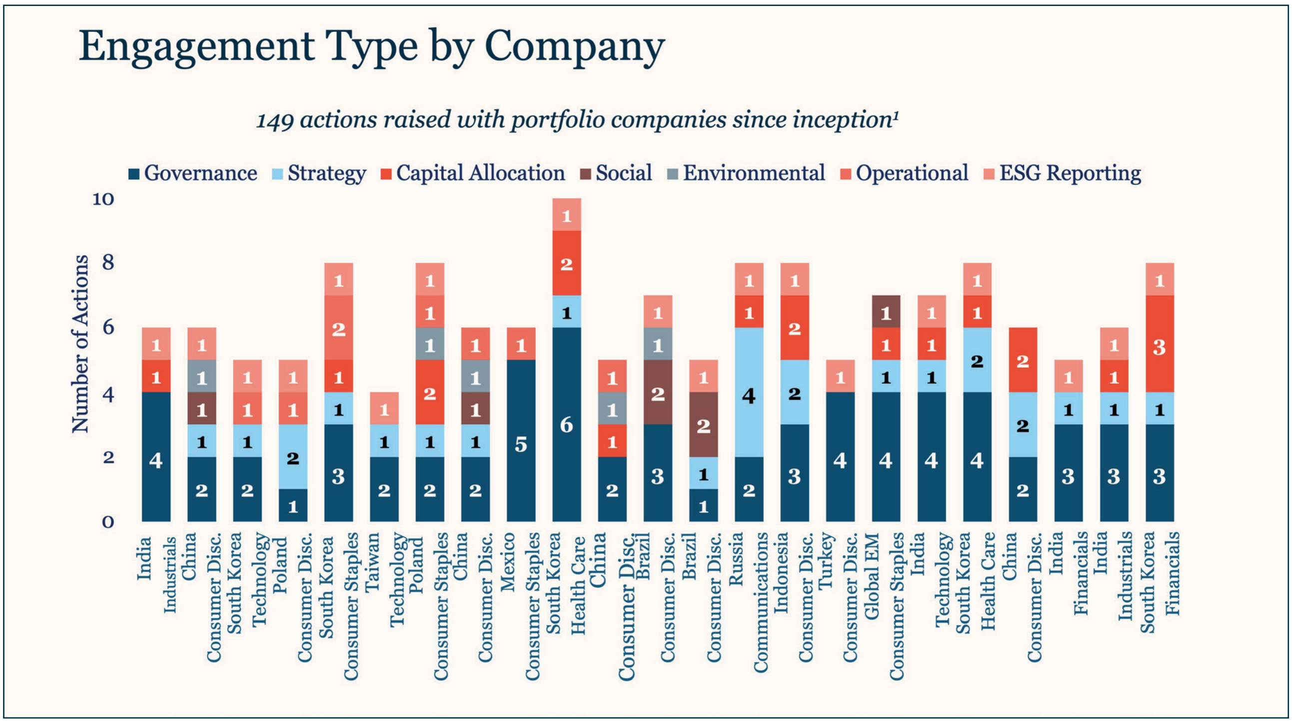

Figure 2, Source: Mobius Capital Partners LLP 2019, as of June 2019

When reviewing this graphic, Capital Allocation is a particularly interesting theme. Our initial investment screen seeks to remove companies with unsustainable capital structures. However, we then accentuate this factor further by actively seeking out companies with large amounts of undeployed cash, with a view to optimising the balance sheet. This is not purely an exercise in financial engineering: whilst higher returns to shareholders are always considered, sustainability is a priority. We avoid any strategy that comes at the expense of value accretive investment into the business.

While differences in corporate culture have an impact on our partnership approach, whether we are operating in Eastern Europe, Latin America or Asia, the overall aims of our management teams are predominantly the same – to drive a pathway of increasing returns on capital. We have found that stakeholders generally appreciate the link between incrementally higher returns and the value of their business. As a result, they are broadly open to our proposals. Equally, management teams that are immediately receptive to this discussion during our due diligence phase, significantly increase the appeal of the investment opportunity. Repeating the process across different holdings, sectors and geographies broadens our accrued knowledge and experience. This can be reapplied elsewhere to increase the likelihood of success, a positive externality of the process.

In MMIT's first nine months 'Governance' has been the most frequent topic addressed with portfolio companies. Aligning the interests of management or proposing changes to the overall composition of the Board is certainly not picking "the low hanging fruit" first, but it is almost always our starting point. This is a direct result of our belief that before any operational issues can be rectified, you must first have in place the appropriate mechanisms and processes by which the company is controlled.

"Governance has been the most frequent topic addressed with portfolio companies"

As a result, we have found a number of family run businesses in emerging and frontier markets (comprising approximately 20% of our current portfolio) that wish to be perceived as more than domestic players. They understand that strong corporate governance standards are a requisite for diversifying their shareholder base and are open to making the required changes. We often find that this internal reform is driven by the second or third generation. These individuals have returned from Western business schools with an in-depth understanding of the procedures and transparency expected of a publicly listed company. One of our current portfolio companies, Turkish denim manufacturer Mavi, has already successfully introduced a long-term incentive program for executives based on share price performance and operating profit, aligning the interests of the founding family with those of senior management and minority shareholders. Our prior experience enabled us to propose a suitable structure as well as suggest a local law firm to work with on the drafting and implementation.

Separately, other portfolio companies have announced upgrades to shareholder return policies, additional hires in IR departments, inaugural investor days and a number have increased transparency around reporting. Of the 149 engagement actions points raised between October and June, 27 have already been successful. There have been 14 unsuccessful actions points, the majority of which are attributable to two of the positions we exited (*see Investment Update below for more details*).

We recognise that some engagement topics will take time to execute and for the benefits to be borne out in the company's valuation. As result, we remain confident in our ability to identify resilient business models which are undervalued and mispriced (Pillar 1 of our investment approach) ensuring we are still able to generate returns while we attempt to unlock further value. We describe this as our principal of "being paid to wait" and have a strong conviction that the combination of the two approaches will generate outperformance over the long term.

Performance

The Net Asset Value (NAV) of MMIT decreased by 0.8% over Q2 2019, reaching a high of 101.25p on 23 April and closing at 97.84p on 30 June 2019. The MSCI Emerging Markets Index (GBP) and MSCI Frontier Markets Index (GBP) were up 3.1% and 4.5% (respectively) over the same period.

MMIT's share price increased to 100.2p in Q2 2019 (up 1.7%), trading at an average premium to NAV of 1.7% (compared to a premium of 2.2% in Q1 2019). This increased to 2.4% at close on 30 June 2019.

Key positive contributors to the performance over this period were Oriflame Cosmetics, eMemory Technology and Hugel. Cafe24, CCC and Goodbaby International were the largest negative contributors. Over the quarter, MMIT's exposure to equities decreased from 90.6% to 80.6%, with our cash position adding a natural drag (3.2% compared to the wider market).

This increased cash position is linked to three disposals in the last quarter. One of these, Brilliance China Automotive, was directly attributable to the lack of progress around our Pillar 2 (active engagement). Despite this, the share price still rose by ~25% during our holding period. Separately, we exited our position in Iochpe Maxion as we became more concerned with our original Pillar 1 assumptions, following a sharp slowdown in the global automobile market. Finally, in June we exited our position in Oriflame Cosmetics following the announced takeover tender offer by the founding family. The stock returned 33.3% over the last quarter.

We remain committed to our stated investment strategy and process. We recognize that our high active share (+99%) will result in short term disparities with the wider market, but will act as a source of alpha as the benefits of our engagement with each portfolio holding are borne out.

Investment Update

As of 30 June 2019, MMIT had invested 80.6% of capital raised at IPO, with 21 holdings across 10 countries. As previously stated, we always look to exercise caution and discipline in allocating capital.

MMIT's top ten holdings are shown below:

Top 10 Holdings (%):	Country	(%) of MMIT portfolio
Yum China Holdings Inc	China	6.1%
Hugel Inc	South Korea	5.9%
Mail.Ru Group	Russia	5.6%
eMemory Technology Inc	Taiwan	5.2%
Kroton Educacional	Brazil	5.0%
Eurocash S.A.	Poland	5.0%
Lojas Americanas S.A.	Brazil	5.0%
Grupo Lala S.A.B de C.V.	Mexico	4.8%
Apollo Tubes	India	4.8%
Persistent Systems	India	4.7%
Total		52.1%

During the last quarter, the investment team have undertaken 73 calls and meetings with new companies as part of our 360-due diligence, as we test and refine our investment thesis. We also had 27 calls and meetings as part of our ongoing engagement with key stakeholders in our portfolio holdings.

In-line with our previous quarterly report, below we have outlined how our two key investment pillars apply to a holding within our current portfolio, with Pillar 1 (fundamental stock-picking) summarised under 'Why We Invested', and Pillar 2 (active engagement) summarised under 'Key Engagement Topics'. Please note, however, that our full plans for engagement with each company are sensitive, and so cannot be disclosed in detail in this commentary.

Kroton Educacional

Kroton Educacional is the largest education provider in Brazil, with over 150 campuses and 1,410 distance learning centres. The company has over 1mln enrolled students (40/60 split between on campus and distance learning). The company is listed on the Novo Mercado of São Paulo's Stock Exchange, with a significant free float as no shareholder holds more than 10%.

Why we invested?

- **Entering new market:** In 2018, Kroton Educacional entered the K-12 (primary school) market which is highly fragmented and offers an attractive growth opportunity. We are particularly excited about Learning Systems division which is an asset-light, highly profitable and scalable B2B/B2B2C business

- **Valuation:** At the time of investment, the share price was heavily discounted compared to global peers and exciting growth opportunity driven by K-12 business and recovery of post-secondary education segment

Key Engagement Topics

The engagement plan focuses on capital allocation, governance and ESG reporting improvements.

Kroton: K-12 opportunity and addressable market:

	Textbooks	K-12 platform as a srvice	K-12 school management	Total
Total market size BLR bn	1.5	45	81	
2017 Kroton's revenue				**2.2**
Target Market Share	40%	11%	8%	*5.5x*
Potential revenue BLR bn	0.6	5	6.6	**12.2**

Figure 3, Source: Corporate presentation, May 2019

Country Focus – Brazil

The mood of the Brazilian business community has shifted significantly over the last six months. The bullish sentiment that rode in on the back of President Bolsonaro's inauguration has begun to drain away, with a more downbeat view taking hold. Investors and the wider electorate are waiting for clear signs that the newly-elected president is making progress implementing his promised economic reforms, particularly those linked to public pension schemes.

As an outsider looking in, we agree with the view that reforming the incumbent system is crucial for the economic development of the country. Currently, Brazil's spending on social security is among the highest in the world. This is unsustainable given the IMF estimates that government debt levels will reach almost 90 per cent of GDP this year.

The social security reform bill has now moved to the Lower House where the main text was passed by a wide margin. However, a second vote on the complete bill including any amendments has been delayed to August. The key issue is to what degree projected savings may be watered-down. The initial proposal estimated over BRL 1.2trn (c. 18% of nominal GDP) in savings over 10 years. If this figure significantly reduces (a first congressional committee report indicated it is likely), we would expect this to have a negative impact on the domestic equity market.

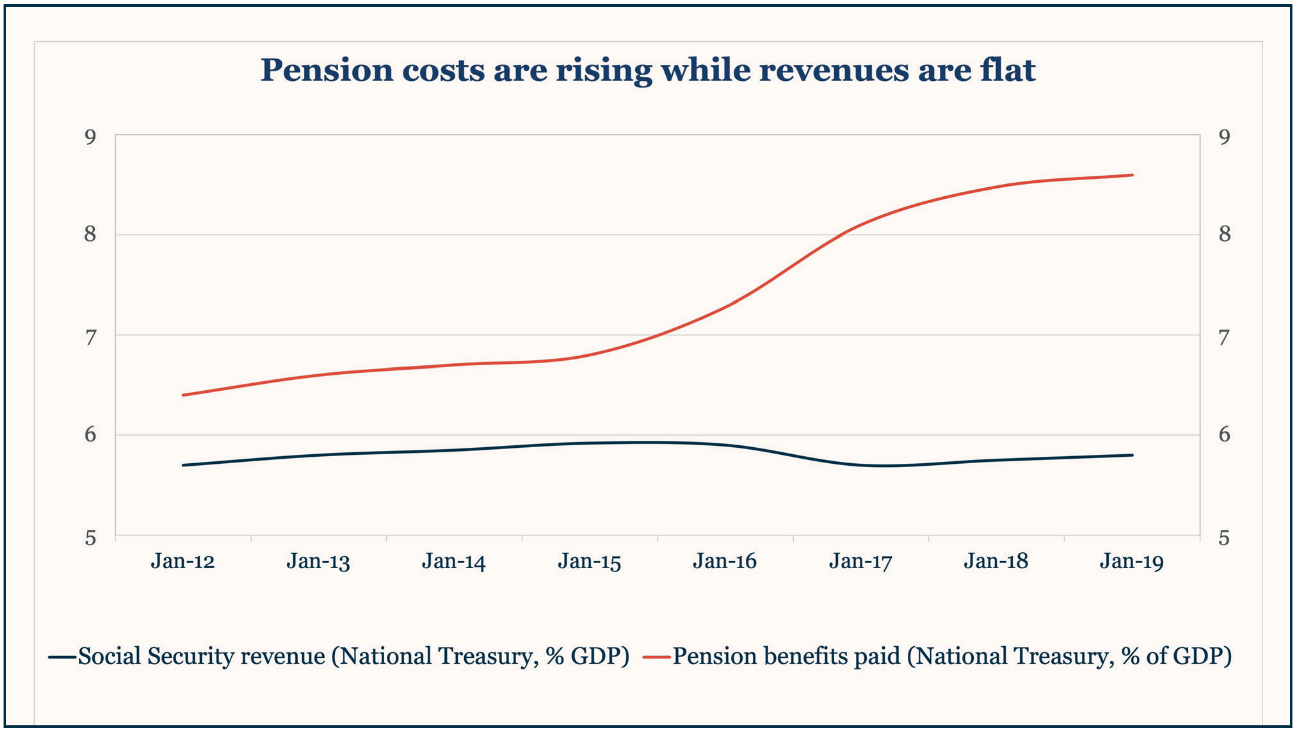

Figure 4, Source: GlobalSource, National Treasury

The Brazilian economy has gone through a difficult time over the last 4-5 years. However, if these reforms begin to gain traction there is an opportunity for further improvement. Currently, the economy remains depressed and the Q1 2019 GDP numbers of -0.2% q/q and +0.5% y/y [2] failed to show an acceleration of growth. However, we are seeing some positive signs: car sales for May 2019 were strong (21.6% YoY) [3], whilst supermarket sales (Abras) [4] grew 8.1% YoY in April (in real terms).

The significant increase in debt over the last 15 years severely limits the government's ability to increase spending to stimulate the economy. In addition, there remain a number of structural issues left behind by previous governments. This includes the high long-term unemployment (5 million workers have been looking for a job for more than a year; 3 million for more than 2 years) which has led to a loss in skills and productive capability. The capital-labour ratio in the economy has declined due to insufficient, mis-allocated, and poor-quality investment. The result of this lag in investment is that much of the nation's infrastructure and public services are in decay.

All of these problems take time to correct. However, we believe Bolsonaro's reform program, which is centred around free market policies, is the right way forward.

Almost 22 years after Brazil undertook one of the largest privatization efforts in history, the new Bolsonaro administration is aiming to repeat, and perhaps exceed, what has gone before. There are as many as a hundred state-owned businesses which could be liquidated or privatized as part of Bolsonaro's plans, some of which rank among the largest companies in the country. This would not only attract foreign investors, but also add much needed liquidity to the stock market.

If the Bolsonaro administration manages to successfully unblock and deliver on the privatization pipeline set out by the previous Temer administration, the government could raise nearly USD 90bn (c. 5% of Brazil's nominal GDP) over the next two years (including exiting state stakes in Petrobras, Eletrobras, BNDES, Banco do Brasil and Caixa Economica Federal).

> "We have been particularly encouraged by the quality of management compared to other markets"

While uncertainties remain about the size and timing of the programme, the overall direction appears positive. Our view is that the less state involvement in the economy, the better for the longer-term outlook of the country. While lasting fiscal sustainability depends more on the social security reform than on privatization, the proceeds will nevertheless help fund the government's transition and maintain discipline. Moreover, a well-structured privatization push would rekindle investments and improve the efficiency of the economy.

Last but not least, another important item on Bolsonaro's agenda is increasing the accessibility of the economy. Brazil is unusually closed when it comes to international trade (export plus imports as % of GDP is only 23.1% which is significantly below other emerging economies like India or China with 39% and 37.3% respectively) [5].

We remain cautiously optimistic on the Brazilian equity market, as valuations are still at a relatively attractive level with strong earnings recovery to come once the economy returns to growth. We have also been particularly encouraged by the quality of management compared to other markets. Through our engagement we have found a strong focus on return on invested capital (ROIC) and shareholder value creation are considerations that drive almost every business decision within an organisation. We have also noticed a strong desire to improve efficiencies which is usually driven by the adoption of new technologies.

To close, we wanted to highlight that on 18 September we will be hosting the inaugural Mobius Capital Partners Investor Day. Attendees will have the opportunity to meet with senior representatives from a number of our portfolio companies, who we believe best capture the exciting opportunities emerging from the developing world. They will present an introduction and outlook for their company, as well as reflect on key engagement areas and participate in an interactive Q&A session. The day will also give investors the opportunity to personally catch up with our entire investment team. If you are interested in attending, please email Harry Stein (harry@mobiuscapitalpartners.com) as places are limited.

Mark Mobius, Carlos Hardenberg and Greg Konieczny

Founding Partners
Mobius Capital Partners

Footnotes:

1. World Intellectual Property Organisation
2. Brazilian Institute of Geography and Statistics
3. The Associacao Nacional dos Fabricantes de Veiculos Automotores (ANFAVEA)
4. ABRAS – Brazil Association of Supermarkets
5. EIU, 2017

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