Pangolin Asia Fund March 2018 NAV

As at the 29th of March 2018 the NAV of the Class A shares of the Pangolin Asia Fund was US$506.32 net of all fees and expenses, down 0.84% from US$510.62 in February.

Please see the table at the end of this letter for further detail.

As of today, the fund is about 91% invested, with the split being approximately as follows:

Singapore	12%
Malaysia	37%
Indonesia	32%
Thailand	19%

We don't disclose our names but some details are always available to investors on request.

Overview

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

Return (in local currencies, except MSCI Asia Ex-Japan)									
Period	DOW	S&P 500	JSE	KLSE	STI	SET	MSCI ex JP	MSCI-ASEAN	PAF
Mar 2018	-3.70%	-2.69%	-6.19%	0.01%	-2.56%	-3.45%	-1.81%	-2.82%	-0.84%
YTD 2018	-2.49%	-1.22%	-2.62%	3.31%	0.74%	0.75%	0.27%	1.10%	4.23%

Return (in USD)									
Period	DOW	S&P 500	JSE	KLSE	STI	SET	MSCI ex JP	MSCI-ASEAN	PAF
Mar 2018	-3.70%	-2.69%	-6.29%	1.24%	-1.54%	-2.73%	-1.81%	-2.82%	-0.84%
YTD 2018	-2.49%	-1.22%	-4.11%	8.05%	2.65%	5.00%	0.27%	1.10%	4.23%

% Change in Currency Vs USD				
Month	MYR	SGD	IDR	THB
Mar 2018	1.24%	1.04%	-0.11%	0.75%
YTD 2018	4.58%	1.90%	-1.53%	4.21%

How Companies Destroy Shareholder Value

There are many companies in Asia that combine operational excellence with value-destroying practices. Unfortunately, these companies are in the majority. The root of all balance sheet evil is the misallocation of cash. Below is an incomplete list of bad practice.

1. Cash Retention

At Pangolin we don't like companies with debt. The next biggest problem is excess cash burning holes in directors' pockets. Returns on the core business may well be in excess of 20% but the company's ROE is dragged down by low cash returns.

Furthermore, cash becomes a distraction as management try to find ways to enhance the returns; and there are many horrible ways companies can do this – from stock market investing to poor acquisitions. And bear in mind, cash attracts ***advisers***.

Cash on the balance sheet should be no more than working capital requirement + a rainy-day fund.

2. Being Asset Heavy

Many Asian businessmen treat a large shareholding in a business as 100% ownership, stuffing the board with pliant directors to ensure that what they want to happen, happens. In particular, many of the older generation of entrepreneurs have a penchant for accumulating assets, as if this gives their companies strength.

Often the Board, the firm's employed-professionals and the founder's business school educated kids disagree with this strategy, but Confucian values ensure that no-one criticises the boss.

So, we end up with land acquisitions, share portfolios, investment in non-core businesses, ownership of logistics when outsourcing is cheaper etc. All of which detract from the company's ROE.

3. Non-core Business

What to do with excess cash when the core business has no need for further investment (in fact it's throwing off cash)? Buy into something totally unrelated of course.

A fairly cursory examination of Asian businesses will give you plenty of examples of widget manufacturers venturing into:

Coal mining, plantations, property development, COFFEE (in capitals because COFFEE is a favourite non-core diversion), restaurants etc.

And it can be geographic; "Malaysia is a small market but there are a billion Chinese…." This usually ends in disaster.

4. Not Cutting Losses

The circuit board maker who 5 years ago opened a noodle factory in China (remember there's a billion of them and they all eat noodles) who has steadily seen his losses increase. It won't make a profit next year either. But so many business owners hang on in some kind of hope, or don't want to lose face.

And when we meet the Finance Director, he will shrug his shoulders and say "what to do lah? It's the boss's pet project."

Not cutting losses means the company allows consistent underperformance to persist over a prolonged period. In its defence, they may argue that it is a business that needs time to mature. They choose to do nothing, hoping it can turn around in the near future. The better option would be to cut their losses and exit the business, thereby extracting the capital to invest elsewhere or return to shareholders.

Having high cash holdings also prevents managers from quickly scaling down unprofitable business lines as cash earns interest income to serve as a buffer to operating losses. It may also choose to stay in bad business because of poor corporate governance, in that those who run the firm view shareholders as just another stakeholder group way down the list of priorities. And view cost of capital as an abstraction rather than an opportunity cost.

Or there are institutional factors to preserve the status quo because there are benefits derived by others. For example, a company decides to invest in a social enterprise in which any financial return doesn't really tie in with the social return. It continues to operate such loss-making business because of social objectives.

5. Share Buybacks

History shows us that pretty much the worst people to buy back shares are the directors of the company. And the best companies don't buy back their shares; they return excess cash to shareholders and allow them to choose what to do with the cash.

In most Asian companies the founder owns a substantial number of shares. How do we know if he has not pledged these as collateral for some side deal and therefore the buyback is not designed to stop his margin being called?

The excuse often given is to stabilise the share price. But as shareholders, we are backing the management to make profits from their core business, knowing that the market will, in the long-run, appropriately value a well-run profitable company.

The moment a company buys back shares the management become fund managers. They waste time looking at the share price and become rabbits in the headlights when the price falls. If the core business has a ROIC of 30%, doing anything other than focusing on that is a misuse of time.

Furthermore, if there is a market crash then we, as value investors, should not be having to compete with management for shares.

Even worse, we occasionally see cash rich businesses investing in other companies' shares or unit trusts, for which there is clearly no excuse.

6. Too Much Time Looking for M&As

Cash rich companies are often on the lookout for M&As. The longer they go without making an acquisition, the more the pressure increases to make one; and the greater the likelihood there is to make a bad one.

Even if they're not looking, ***advisers*** will find them.

We commonly see, in AGM resolutions, a request for permission to be granted to issue 10% new shares at the discretion of the directors. The excuse is often given that the company might need the cash for a purchase of a rival firm. We always vote against this. If a company has to call a rights issue for an acquisition then you can imagine how much more DD they will have had to do compared to a situation in which they either dip into cash reserves or quickly issue another 10% of share capital.

Perversely, we often see the resolution requesting carte blanche for the directors to issue new shares just above the request for permission to buy back shares.

7. Employee Stock Option Scheme

Abuse of ESOS has died down since they have had to be expensed. Except in Malaysia that is, where companies are allowed to issue new shares up to 15% of capital to their employees. A major shareholder (perhaps with 60% stake), will also be in line for ESOS, as if already owning 60% is not motivation enough.

15% is so ridiculously dilutive to minorities it ought to be criminalised. Furthermore, ESOS are frequently also issued to "independent" directors, thus ensuring they won't cause a stink or resign over some issue.

I can live with 3% if it is genuinely for employees, although why they can't be rewarded in cash I don't know. Anything else is too dilutive and is clearly about self-enrichment at the expense of outside shareholders.

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8. Warrants

Warrants are often issued to minorities to keep them sweet. But this reflects a complete lack of financial planning by the management. On conversion, the company issues new shares (dilutive) for cash. But unlike in a rights issue, the company has no control (outside of a 5-year window) as to when it will receive the money, or, even if it will.

If the share price falls below the conversion price, no-one will convert.

A company should raise cash and if and when it is required, not in dribs and drabs over 5 years (maybe).

9. Bonus Issues and Stock Splits

These are clearly the biggest waste of time. They also cost money, which is why ***advisers*** recommend them. Unfortunately, they remain popular with retail investors, who presumably also believe in alchemy.

10. Dividends

The board of directors alone can decide when to pay an interim dividend, whereas a final dividend requires shareholders' approval at the AGM. Paying regular quarterly interim dividends ONLY is far superior from a cash flow planning perspective.

On January 1st the Finance Director sees he has $100m in the bank. He knows the company can pay out $50m. A board resolution on January 2nd can approve that payment for January 3rd. But for a shareholder-approved final dividend, he has to wait for the audited results to be out, the annual report to be printed and the AGM to be convened. This takes months. Meanwhile, cash the company has no use for is piling up in the bank, which we all know is a dangerous distraction.

Unsurprisingly, the companies that have followed our recommendations have seen a re-rating of their valuations. Examples are Padini and Hup Seng in Malaysia, who have chosen to mirror the best practices of balance sheet-efficient multinationals. In a way, they don't just set the bar; they raised the bar. In Hup Seng's case, payment of a final dividend has been discontinued since FY2014 in favour of 3 regular interim dividends with payout ratio in the vicinity of 100%. Padini started paying interim dividends only since FY2010.

Among the larger caps in the fund, Public Bank only pays interim dividends. In 2014 the bank called a rights issue which was easily subscribed. The lesson being that companies that pay out regularly face no problem raising cash from shareholders when they genuinely require it.

In much of our geographical area, particularly in Indonesia, dividends are paid out once a year. For a December year end we might receive our divi only in July. May being about the earliest in Indonesia.

Padini's Dividend History

FYE Jun	Decl Date	Ex Date	Pay Date	DPS (MYR)	Total DPS	Type	
2009	28-May-2009	08-Jul-2009	05-Aug-2009	0.0120		Interim	
2009	26-Nov-2009	24-Feb-2010	15-Mar-2010	0.0150	0.0270	Final	AGM date 22-Dec-2009
2010	27-May-2010	28-Jun-2010	19-Jul-2010	0.0150		Interim	
2010	30-Jun-2010	26-Aug-2010	17-Sep-2010	0.0150	0.0300	Interim	AGM date 22-Dec-2010
2011	13-Jan-2011	31-Jan-2011	17-Feb-2011	0.0200		Interim	
2011	30-May-2011	21-Jun-2011	18-Jul-2011	0.0200	0.0400	Interim	AGM date 23-Dec-2011
2012	29-Nov-2011	13-Dec-2011	29-Dec-2011	0.0200		Interim	
2012	28-Feb-2012	13-Mar-2012	29-Mar-2012	0.0200		Interim	
2012	30-May-2012	13-Jun-2012	15-Jun-2012	0.0200	0.0600	Interim	AGM date 18-Dec-2012
2013	29-Aug-2012	12-Sep-2012	28-Sep-2012	0.0200		Interim	
2013	28-Nov-2012	12-Dec-2012	31-Dec-2012	0.0200		Interim	
2013	26-Feb-2013	11-Mar-2013	27-Mar-2013	0.0200		Interim	
2013	30-May-2013	13-Jun-2013	28-Jun-2013	0.0200	0.0800	Interim	AGM date 19-Dec-2013
2014	28-Aug-2013	10-Sep-2013	27-Sep-2013	0.0250		Interim	
2014	25-Nov-2013	11-Dec-2013	27-Dec-2013	0.0250		Interim	
2014	25-Nov-2013	11-Dec-2013	27-Dec-2013	0.0150		Interim Special	
2014	26-Feb-2014	13-Mar-2014	28-Mar-2014	0.0250		Interim	
2014	28-May-2014	11-Jun-2014	27-Jun-2014	0.0250	0.1150	Interim	AGM date 12-Dec-2014
2015	27-Aug-2014	10-Sep-2014	29-Sep-2014	0.0250		Interim	
2015	26-Nov-2014	10-Dec-2014	29-Dec-2014	0.0250		Interim	
2015	16-Feb-2015	04-Mar-2015	20-Mar-2015	0.0250		Interim	
2015	19-May-2015	03-Jun-2015	22-Jun-2015	0.0250	0.1000	Interim	AGM date 18-Nov-2015
2016	18-Aug-2015	02-Sep-2015	21-Sep-2015	0.0250		Interim	
2016	26-Nov-2015	10-Dec-2015	31-Dec-2015	0.0250		Interim	
2016	23-Feb-2016	09-Mar-2016	28-Mar-2016	0.0250		Interim	
2016	18-May-2016	01-Jun-2016	29-Jun-2016	0.0250		Interim	
2016	18-May-2016	01-Jun-2016	29-Jun-2016	0.0150	0.1150	Interim Special	AGM date 26-Oct-2016
2017	25-Aug-2016	09-Sep-2016	29-Sep-2016	0.0250		Interim	
2017	25-Nov-2016	13-Dec-2016	30-Dec-2016	0.0250		Interim	
2017	20-Feb-2017	08-Mar-2017	27-Mar-2017	0.0250		Interim	
2017	30-May-2017	13-Jun-2017	30-Jun-2017	0.0250		Interim	
2017	30-May-2017	13-Jun-2017	30-Jun-2017	0.0150	0.1150	Interim Special	AGM date 16-Nov-2017
2018	25-Aug-2017	13-Sep-2017	29-Sep-2017	0.0250		Interim	
2018	29-Nov-2017	13-Dec-2017	29-Dec-2017	0.0250		Interim	
2018	26-Feb-2018	13-Mar-2018	29-Mar-2018	0.0250		Interim	
2018						Interim	
2018					0.0750	Interim Special	

11. Not following best Corporate governance guidelines: changing of auditors, ancient and unqualified directors

a) Auditors

If your company makes teaspoons and you're the best in the business at it, why not also follow the best CG practices too? It costs nothing and reduces shareholder criticism at your AGM (particularly if you're unlucky enough to have Pangolin as a shareholder).

As a best practices, external auditors should be changed every 5 years (the audit firm not just the partner). I know it's disruptive but surely management should welcome a new set of eyes scrutinising their books. It is not uncommon to find companies that have been using the same external auditor for the past 30 years, or since the company's inception.

b) Directors

Choosing suitable independent directors should be a must. In many cases companies fail in this.

A couple of companies that we know had issued ESOS to independent directors as part of the "appreciation for their past contribution". In both cases, the independence of these directors becomes questionable; can they can still exercise their professional duties on behalf of the minority shareholders? Or are they tied to the major shareholder?

Directors should be qualified to carry out their duties and to oversee, build and grow a business. We see cases where the directors have no relevant experience to the business, but are there because of family relationships. Independent directors are there to protect the minorities, as we like to remind them.

It is not uncommon to find a company with the minimum 3 non-execs who have all been on the board well in excess of 10 years, and who are also up for re-election on account of them being over 70 years old. Why are they still continuing? If you look closely you will often find that these 3 geriatrics comprise the 3 members of the Nominating Committee which (yes, you've guessed it) is the committee that recommends their reappointment.

c) The AGM

For a good AGM experience, the board should prepare a presentation detailing the past year's performance and prospects for the current year, before opening up the floor for Q&A. This is for the benefit of all shareholders who may be new, don't have access to management, or only meet up with the board of directors once a year. Most of the AGMs we attend have no presentation at all.

These companies would expect all shareholders to read the 100-200 pages annual report before the AGM and go straight to the Q&A.

The AGM should be held in a venue that is big enough to seat all shareholders and in a conveniently accessible location (and with enough parking space). One of our former holdings (Wing Tai Malaysia) held its AGM at a hotel next to KL International Airport. This is because the key directors flew in just for a two-hour AGM meeting and then rushed off to catch their flights out of the country.

There have been incidents whereby directors and managers are absent from board meetings. At one smaller company's meeting we attended it turned out that the founder, major shareholder and chairman of the board never attends his AGM.

12. Focusing on the Share Price

A management that focuses solely on its business and runs an efficient balance sheet will, assuming that the business generates a high ROIC and is growing, see its share price appreciate in line with the business. However, all too often we meet managers who have one eye on the share price and implement many of the malpractices outlined above.

As mentioned in (6) above, companies often request the right to issue new shares equivalent to 10% of the outstanding. Once upon a time, when I was an ***adviser*** I would persuade companies to issue new shares to fund managers, to "institutionalise" the share register. As if having institutions as shareholders is better than having individuals. It isn't. It's worse.

The excuse often given for such an issue is "to increase the liquidity of the company's shares". So, in many cases a company that has no need for cash raises a load of cash in order to have more shares in issue. Complete nonsense but commonplace.

In Conclusion

This list is not exhaustive. As fund managers we find it frustrating that the operators of so many operationally well-run businesses destroy shareholder value as listed above. And we haven't even got into fraud, excess salaries, related party transactions, the wife and kids all being employed in executive positions etc.

Things are gradually improving. Really, unless you are a crook, it is probably easier to follow best practice than not. But inertia, "the way we've always done it", and ***advisers*** are probably the biggest impediment to change.

We've had some success with some of the companies we have owned. Sometimes it is hard to convince an Asian businessman that he can manage his cash in the same way as Nestle Malaysia or Unilever Indonesia. They are seen as being remote, white-man companies. That we can now show them Padini or Hup Seng as exemplars is more than useful; these are companies they can relate to.

The AGM season is starting now. Wish us luck.

Vinchel Budihardjo and James Hay.
9th April 2018

We don't like to discuss stocks publicly but I am always happy to talk to existing investors and those interested in investing. The Pangolin Asia Fund is most suitable for investors who are happiest when markets are falling.

Year	Details	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2018	*NAV*	501.11	510.62	506.32										4.23%
	% chg	3.15%	1.90%	-0.84%										
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	**-20.42%**
Maximum drawdown	**-47.53%**
% of positive months	**67.50%**
Annualised return	**12.94%**

By Sector