Pangolin Aviation Recovery Fund October 2022 NAV

As at 31st October 2022, the NAV of Class A shares of the Pangolin Aviation Recovery Fund was US$75.13 net of all fees and expenses, up by 13.99% from US$65.91 in September 2022.

The fund is 97% invested, with the split being approximately as follows:

Figure 1: Portfolio by sector exposure

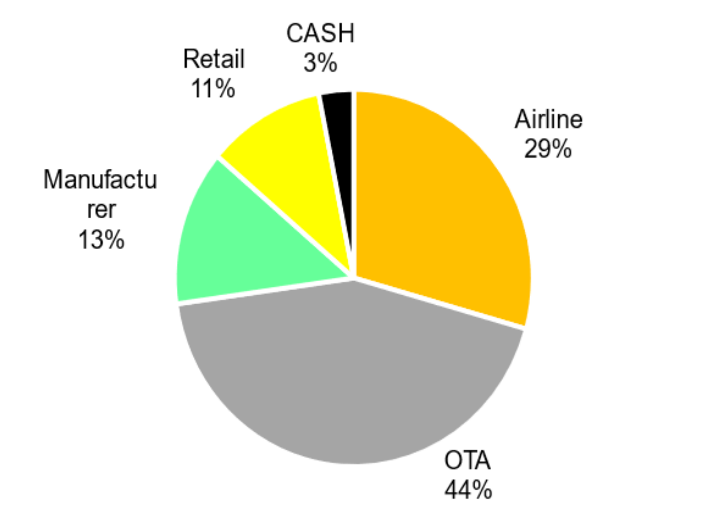
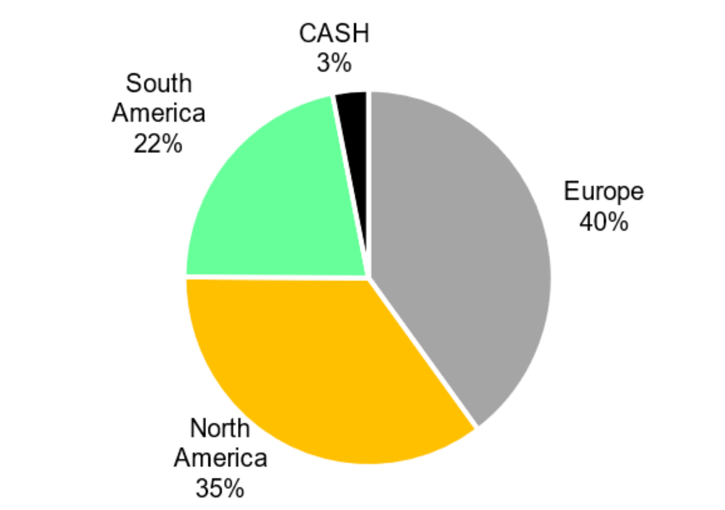


Figure 2: Portfolio by geographical exposure



The fund had a nice bounce in October. There was no change in our fund composition; the movement was entirely market driven. This year has been marked by constant bullish and bearish market pulls. Sometimes both happened in the same month. Strange times.

The significant winners were Embraer and JET2 Airways, while the significant underperformers were On-the-beach and Dufry AG.

Third quarter results observation

The third quarter results season is underway, and the aviation sector has been a bright star. Many companies have reported positive surprises with solid numbers and an equally resilient outlook, shrugging off concerns about an economic slowdown. The words 'record' and 'best ever' reverberated many times in aviation companies' earnings calls.

The three observations from the third quarter 2022 are as follows:

First, companies that did not downsize, and those that purchased assets during the pandemic benefited the most. Examples are Booking.com and Norwegian Air Shuttle which delivered exceptional record-breaking performances. More importantly, it won't be a one-quarter wonder because both companies have structurally lowered their cost base, expanded their clientele catchment, and have a more direct interface with their end-users.

Second, companies that continued to invest in their businesses but downsized and sold assets during the pandemic, have delivered respectable improvement but are still one yard short of a home run. Such examples are Dufry, GOL, and Sabre. Dufry's profit margin surged in 3Q22 but it is still 250 basis points lower than pre-pandemic levels. GOL attained record yields and load factor, but it is still loss-making due to high fuel costs and high operating costs brought about by a lack of scalability. Sabre is making good incremental revenue and cost reduction, but it needs at least two more quarters to boost scalability and achieve a turnaround. They are getting there, just at a slower pace.

Third, companies that downsized sold their assets, and cut Capex during the pandemic have been left behind. Many of the big national carriers and airports in Europe are in this category. Sometimes it becomes a double whammy because underinvested airports like Heathrow, Schipol, and Frankfurt resorted to passenger caps due to their inability to manage the peak traffic, thus aggravating incumbent airline operations such as British Airways, Air France-KLM, and Lufthansa.

20th National Congress of the Chinese Communist Party

The recent congress saw President Xi receiving an unprecedented third term and the new seven-member Politburo Standing Committee filled up with his close allies. We can expect more of the same in terms of aviation policies for the next five years which include: (1) insular foreign policy; (2) a push for self-sustainability; and (3) strict travel.

We don't have any investments in China due to its strict travel restrictions, quarantine-on-arrival requirement, and its Covid-zero policy. However, China is the second-largest aviation market and exerts a systemic impact on global aviation. In 2018, there were 150 million outbound Chinese tourists[1] (10.7% of the global total) and they spent USD 277 billion[2] (15.1% of the global total) overseas. Domestic tourism is big as well, with an estimated revenue of USD 127 billion in 2018[3].

Without an open China, it is almost impossible for the aviation industry to achieve full recovery to pre-pandemic levels. International airlines, hotels, holiday tours, duty-free outlets, and aircraft manufacturers miss Chinese tourists immensely. We hope that China will ease its travel restrictions just like the Asia Pacific countries did. Until then, we will avoid Chinese aviation stocks and any companies that rely substantially on the Chinese market.

Outlook

We are encouraged by the forward-looking statements of company management that oddly sound as if they came off the same script. They pointed out that the performance in September 2022, and early October 2022 were much stronger than in July 2022. July is an important month because it is the seasonal peak month for the Northern Hemisphere aviation market. This means that the busy peak summer traffic is being carried over to what was historically a shoulder period. I like this comment by Delta's CEO Ed Bastion, "Demand has not come close to being quenched by a hectic summer travel season".

Furthermore, many companies state there are no noticeable changes in consumer behaviour despite the macroeconomic headwinds. Some go as far as to raise their 4Q22 and full-year 2023 earnings guidance in a poised manner. The aviation recovery story is real.

Our portfolio currently trades at 2023 PE of 11x, and 2024 PE of 9x based on the latest consensus. There is a good chance that this number becomes cheaper if earnings continue to surprise on the upside.

Mohshin Aziz
4 November 2022

[1] http://www.asean-china-center.org
[2] World Tourism Organisation
[3] http://www.asean-china-center.org

Year	Details	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2022	***NAV***	110.60	108.72	106.42	103.80	97.14	76.62	79.66	79.91	65.91	75.13			**-29.16%**
	MoM %Δ	*4.28%*	*-1.70%*	*-2.11%*	*-2.46%*	*-6.42%*	*-21.12%*	*3.97%*	*0.31%*	*-17.51%*	*13.99%*			
2021	***NAV***	93.38	112.20	116.33	116.30	119.97	113.86	109.74	108.43	115.97	109.28	93.87	106.06	**6.06%**
	MoM %Δ	-6.62%	20.15%	3.68%	-0.49%	3.16%	-5.09%	-3.62%	-1.19%	6.95%	-5.77%	-14.1%	12.98%	

Figure 3: Pangolin Aviation Recovery Fund NAV (USD/share)