Pangolin Aviation Recovery Fund June 2022 NAV

As at 30th June 2022, the NAV of Class A shares of the Pangolin Aviation Recovery Fund was US$76.62 net of all fees and expenses, down 21.12% from US$97.14 in May 2022.

The fund is 95% invested, with the split being approximately as follows:

Figure 1: Portfolio by sector exposure

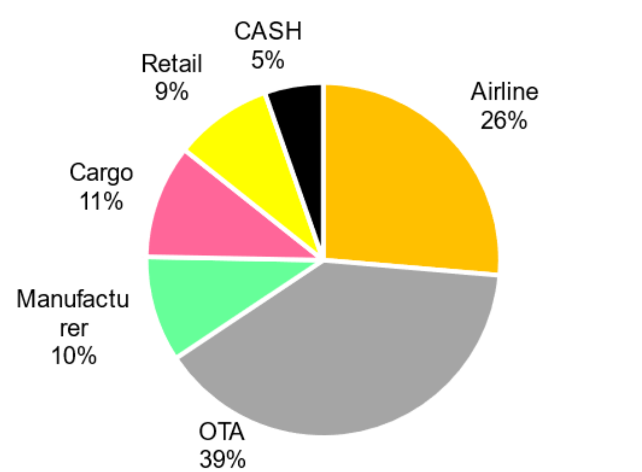
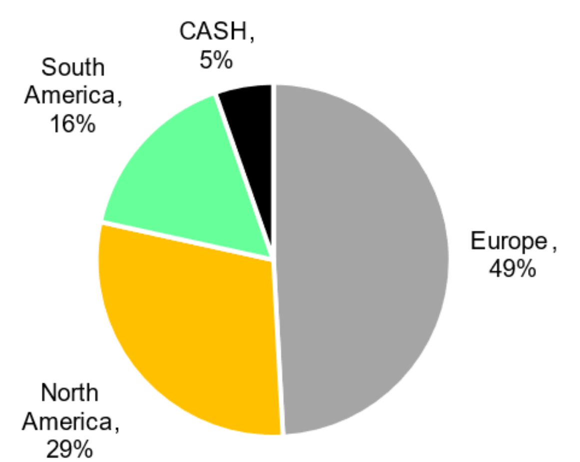


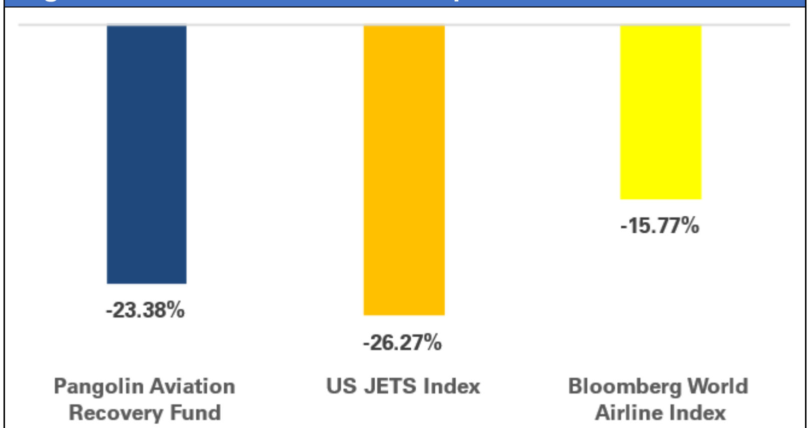
Figure 2: Portfolio by geographical exposure



Overview

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

Figure 3: Performance since inception



Source: Bloomberg

Market nervousness soared, believing that a recession is both inevitable and imminent. Every day we hear depressing economic jargon such as inflation, stagflation, weak consumer sentiment, and inverted yields. They all prophesied that economic hardship is looming.

The speed and degree of the market sentiment change are perplexing. Earlier in the month, market forecasters state the risk of a recession is 50/50. That number increased to 70% the following week and now they are debating whether it will be a soft landing or a hard landing?

We remain invested

We filter these market noises and put all our energy into studying fundamentals. We spoke to many companies; they all said consumers can absorb inflation better than what the market gives credits for. Airline ticket prices are higher than pre-pandemic levels, and flights are fuller than ever. Travel tours and hotels are enjoying brisk traffic and with very few cancellations. Air freight volumes have declined due to the Russia-Ukraine war and the lockdowns in China (should be temporary), but air freight rates continue to be elevated. Even aircraft manufacturers are announcing sizeable new aircraft orders[1] by airlines and lessors. These developments are consistent for an industry that is on a recovery trajectory.

Our research work infers that the risk-reward favours being fully invested as many stocks are exhibiting attractive value with a high probability to deliver higher expected returns. Therefore, we have mobilised our cash and bought two new names, sold one, and topped up existing investments.

Last month’s highlight is as follows:

Deutsche Post – DHL (DPDHL): DPDHL is a global logistics provider headquartered in Germany. It provides services in express delivery, freight, supply chain management, and e-commerce. Its share price has been under pressure recently due to concerns about deteriorating consumer sentiment and fears of a global recession. We understand this, but the move looks overdone in our view, with the group having a high degree of exposure to business-to-business and express parcels segments that tend to be demand inelastic. Furthermore, we don’t think the market has priced in management’s cost-cutting potential via streamlining information technology across its global operations and driving towards a unified business culture.

DPDHL trades at only 8.7x PE for FY22 based on consensus. This is a steep discount relative to its 10-year mean of 13x. The balance sheet is strong, it churns EUR 3 to 3.5 billion of free cash flow per year enabling it to pay handsome dividends (>5% yields) and perform share buybacks.

Embraer: Embraer is the world’s leading regional jet manufacturer based in Brazil. It is a name we have invested before in 2021. The share price has been under immense pressure this year due to an overly simplified thematic that small aircraft have the highest unit cost per seat in the current environment of high fuel prices. This statement is technically correct, but it makes no distinction of the fact that Embraer aircraft serves niche routes that other conventional aircraft can’t possibly service. Its aircraft portfolio is getting more popular and is getting traction from new potential customers across Asia and the Middle East.

Embraer is one of the companies that capitalised on the pandemic slow down to a great effect. It has streamlined its factories with a more modularised production line, consolidated operations and permanently closed inefficient facilities, and revamped the management team to include global industry champions. Efficiency has been greatly enhanced, and production costs slashed. 2022 is the ‘get back to normal’ year, with deliveries estimated to be 85-90% of the pre-pandemic level. By 2023, it should surpass that. Embraer trades at 12x PE for FY23 based on consensus. This is cheap relative to its 10-year mean of 18x.

Travel Sky: We sold our stake in Travel Sky. We still believe it is a great company and the long-term outlook is bright. However, it needs China to open its borders for it to reach its full potential. We were hoping that China would lift its travel curbs soon, to be in sync with the rest of the world. Unfortunately, President Xi Jinping threw cold water on this hope as China remains firmly committed to the Covid-zero policy. There is no point in investing in a company based on the hope that the government will change its ways, therefore we found it prudent to exit with the view to reinvest when the uncontrollable factor is out of the way and the fundamentals return to normalcy.

[1] China state airline to buy almost 300 Airbus jets; https://www.cnbc.com/2022/07/01/china-southern-to-buy-96-airbus-a320neo-jets-biggest-order-since-covid-.html

Outlook

Our portfolio is trading at a one-year forward PE of 10.1x, the lowest level since inception. Some of the companies' share prices are lower than where they were at the height of the pandemic back in March 2020. This is not consistent with the tangible recovery we are seeing.

The markets are being overly negative and ignoring the many positive signals in the aviation industry. Demand is exceptionally strong; it is supply issues that are restraining the industry.

I have faith that the industry captains will resolve the issues besetting the industry. One notable example is Federal Express (FedEx), which faced severe staff shortages in late 2021. The CEO has confirmed in its 4QFY22 (31st May year-end) earnings call[2] that it is fully staffed and able to cope with peak traffic. FedEx is a good example because it faced the situation much earlier than other sectors. Airlines, travel tours, and airports only fully opened in late February 2022 and are only 4-5 months into playing catch-up. It took FedEx about 8-9 months to solve its staff shortage issues.

In the next upcoming newsletter, many of our investments will have released their second-quarter results. The results will uncover the real situation at hand, and the market will be able to apply a fair-headed valuation.

Mohshin Aziz
4 July 2022

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							**-27.76%**
	MoM %Δ	*4.28%*	*-1.70%*	*-2.11%*	*-2.46%*	*-6.42%*	*-21.12%*							
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 4: Pangolin Aviation Recovery Fund NAV (USD/share)

---

[2] https://investors.fedex.com/news-and-events/investor-news/investor-news-details/2022/FedEx-Corp.-Reports-Fourth-Quarter-and-Full-Year-Results/