Pangolin Aviation Recovery Fund January 2023 NAV

As at 31st January 2023, the NAV of Class A shares of the Pangolin Aviation Recovery Fund was US$96.44 net of all fees and expenses, up by 17.40% compared to US$82.15 in December 2022.

The fund is 94% invested, with the split being approximately as follows:

Figure 1: Portfolio by sector exposure

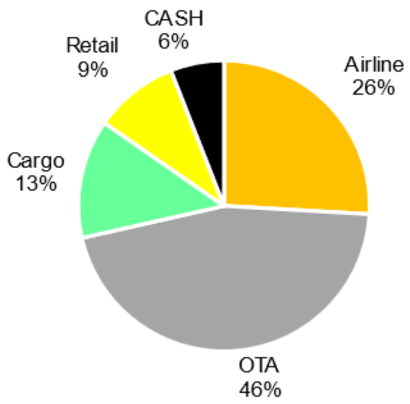
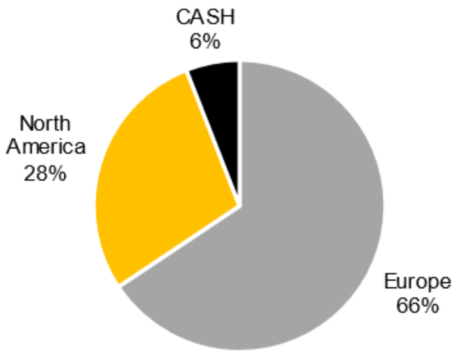


Figure 2: Portfolio by geographical exposure



Overview

The few aviation companies that have released their 4Q 2022 results were mostly fantastic with profits and cash flows surpassing pre-pandemic levels. None of our investments have released their 4Q 2022 results. We should have commentaries on them in the next month's newsletter. The mood is suddenly optimistic as news of China reopening and strong forward bookings offer a sense of relief for those expecting a terrible winter.

There were two activities in January; we increased our stake in Norwegian Air Shuttle and we sold our stake in GOL Aereas Linhas. GOL's pace of recovery is not what we hoped for, and the domestic political disturbances in Brazil are unsettling. We will mobilise the proceeds to other investments with better risk-reward.

The significant winners were Norwegian Air Shuttle and JET2 Airways, while the significant underperformers were Dufry and Sabre.

On the road again

We hit the road across the United Kingdom (UK), Germany, the Netherlands, and the United Arab Emirates (UAE) to visit companies and market the fund to new prospects. It was a very productive and knowledge-enriching tour of duty; I met five companies and a company that specialises in distressed airline restructuring.

There seems to be a common view among the management we met. They all said to the following effect: (1) consumer demand is solid and **NOT** consistent with an industry on the cusp of a recession; (2) consumers fret and hesitate but end up buying at the final hour and pay a premium; and (3) major problems are abating, and no new ones are emerging.

However, I noticed that all the management is on their toes because they fear things can change fast. They are happy and scared simultaneously. I have never met so many ambivalent people in a stretch before.

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Below are the excerpts of our company visits.

1. Robert-Stuart Ltd. The company is a Tier-5 original equipment manufacturer (OEM) based in Harlow, UK. They provide protective coating/s and material testing on various components used in aircraft and helicopters. Their customers include Tier-1 OEMs such as Airbus, Boeing, Rolls-Royce, Safran, and many others.

This meeting singlehandedly solved many of my unanswered questions on the supply chain issues besetting the industry. The root cause stems from the very basic material such as bolts, fasteners, tires, gaskets, and paints. These are low-value items, but you can’t fire up an engine with one bolt short or take off and land an aircraft with one tire less.

The conundrum was years in the making. Tier-1 OEMs have been pressing down margins and conferring intermittent contracts to their smaller service providers for a long time, forcing them to pull themselves up by their own bootstraps. The pandemic has ceased the peripheral companies for good. The remaining survivors focus on high-margin and fast cash cycle products just to scrape by. Hence, the vibrancy and flexibility of the aircraft OEM industry have fundamentally deteriorated.

The solution, in my view, is industry consolidation. The big OEMs need to buy out their suppliers and service providers to upgrade and upscale their operations. There is no quick fix to this. We sold our stake in Embraer in November 2022, and I believe our decision is vindicated.

2. Deutsche Post – DHL. We went to their headquarters in Bonn, Germany. DHL is our core holding and I have long wanted to meet with them.

I was happy to hear that business was overall healthy. Sea freight and business-to-business shipments have regressed, but other divisions remain robust. The logistics sector is fast normalising to what it was before the pandemic. This means cost efficiency and system robustness are what appeal to customers and enable some degree of pricing power. In this regard, DHL is galaxies ahead and gaining market share from its competitors.

The kickback, however, is institutional investors need to conform to their in-house economist’s view of a looming recession. A recession has historically negatively impacted global trade and shipment volumes which explains DHL’s lukewarm share price performance. Meanwhile, DHL continues to break record profits, fortifies its balance sheet, pays handsome ~5% dividend yields, and trades at only ~11x FY2023 earnings multiple. Thank you very much doom gloom economists.

3. Fraport. Right after the meeting with DHL, we jumped onto a train headed towards Frankfurt International Airport (FRA) to meet with Fraport. This was a company we used to own back in 2021.

We had a brief chat with the CFO. This was followed by a comprehensive tour of Terminals 1 and 2, the under-construction Terminal 3, the runaways, and the support facilities. For an ex-airliner, it brings back wonderful memories to see the intricacies of an airport. I think FRA is a well-designed airport and Terminal 3 expansion will boost operational efficiency and reduce overall costs.

FRA is the only major European airport embarking on an expansion whilst other airports have deferred or cancelled their plans. I believe this is the reason Fraport has been derated as investors are not warm to its capital-heavy phase, especially at a time of great macroeconomic challenges and rising interest rates. It is a chicken and egg argument. I love both chicken and eggs, so I won’t argue.

4. Trivago. The next visit brings me to Dusseldorf, Germany. I met Trivago for the first time for a pleasant journey of discovery. Trivago is a service provider for the best-price searches. Its algorithm scans the cyberspace, and within seconds shows you which website gives you the best price for accommodation. It saves you the hassle of opening multiple websites to compare prices. Trivago makes money for each click it brings a customer to the third-party website, and when the customer makes a purchase.

Trivago helped me save money on this trip. I normally book on Booking.com (a core holding of the fund) because I'm enamoured by its simplicity and product breadth. I am also a Level 3 Genius member, which should theoretically provide me with the best value accommodations in the market; or so I thought. It turned out that I saved almost 30% for my hotel stay in Amsterdam by booking directly on British Airways website (you read it right, there is no error) versus Booking.com's offer. My fidelity to Booking.com has taken a dent and I don't feel like a genius at all, quite the contrary!

For those of you who love to save money as much as I do, make use of Trivago. I highly endorse it. The app is user-friendly, efficient, and best of all it costs you nothing but can potentially save you a lot.

5. Air Arabia. We flew on Emirates Airline for our return leg to Singapore and transited in Dubai. The layover was long. So, I arranged a meeting with Air Arabia, the Middle Eastern's pioneer and biggest low-cost carrier based in nearby Sharjah.

Things are going great in the Middle East. The rapid reopening post-pandemic, supportive policies for tourism, and high energy prices support a flourishing domestic economy. Air Arabia is a beneficiary of this as its traffic has surpassed 2019's levels. Furthermore, there has been a surge of visitors from Russia and Central Asian countries, buoying record yields and profit margins.

I was impressed with the management's unwavering business strategy, its eagle eye on cost control, and its expansion plans. It has all the virtues worthy of a Pangolin stock: industry leadership, disciplined management, strong balance sheet, sturdy cash flow, and cheap valuation. The problem is our custodian doesn't service the UAE, and so we need to dwell on this administrative obstacle.

Outlook

We have reached the second phase of recovery in the aviation industry. Good companies are resolutely profitable and flexing all their muscles. They are known and discernible. This improved earnings visibility will help to lower investment risk.

The markets too seem to be more "value aware" lately. It was not happenstance that companies that delivered strong 4Q 2022 results have seen their share price surge and swiftly re-establish historical correlations. We are encouraged by this, as value investing is what Pangolin is all about.

I look forward to this year.

Mohshin Aziz
2 February 2023

Year	Details	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2023	***NAV***	96.44												**17.40%**
	MoM %∆	*17.40%*												
2022	***NAV***	110.60	108.72	106.42	103.80	97.14	76.62	79.66	79.91	65.91	75.13	82.18	82.15	**-22.54%**
	MoM %∆	*4.28%*	*-1.70%*	*-2.11%*	*-2.46%*	*-6.42%*	*-21.12%*	*3.97%*	*0.31%*	*-17.51%*	*13.99%*	*9.38%*	*-0.04%*	
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 %∆	-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)