PANGOLIN INVESTMENT MANAGEMENT

Pangolin Aviation Recovery Fund October 2021 NAV

Year	Details	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2021	*NAV*	93.38	112.20	116.87	116.30	119.97	113.86	109.74	108.43	115.97	109.28			9.28%
	% chg	-6.62%	20.15%	4.16%	-0.49%	3.16%	-5.09%	-3.62%	-1.19%	6.95%	-5.77%			

As at 31st October 2021, the NAV of Class A shares of the Pangolin Aviation Recovery Fund was USD109.28 net of all fees and expenses. This represents a 5.77% decrease over September 2021 and a 9.28% increase since its launch on 4th January 2021.

As of today, the fund is fully invested, with the split being approximately as follows:

Figure 1: Portfolio by sector exposure

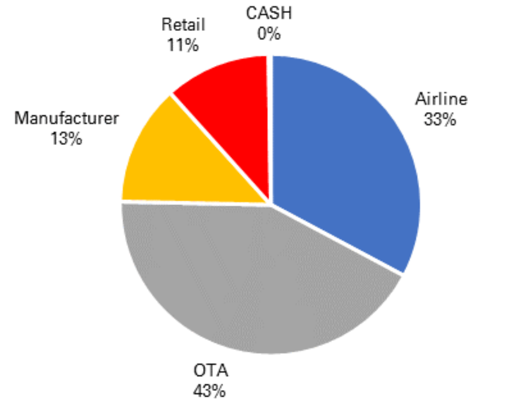
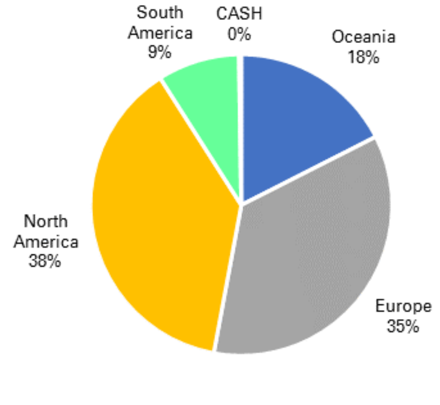


Figure 2: Portfolio by geographical exposure



Overview

To put things into some perspective, please see the table below

Return (in USD terms)			
Period	**US JETS Index**	**Bloomberg World Airline Index**	**PARF**
Oct-21	(5.97%)	(2.12%)	(5.77%)
YTD 2021	(0.71%)	2.62%	9.28%

Fundamentals, where art thou?

October turned out to be another wacky period for aviation stocks. Earlier in the month, it was on rocket fuel heading to the stars, buoyed by the easing of travel restrictions and the reopening of borders in the US and many Asia Pacific countries. Then, Delta-Plus struck, fuel price surged and flare-ups of Covid cases across China brought the entire aviation stock prices back to ground zero as sentiment deteriorated and money flowed out to other sectors.

The key drivers to stock price are money flow, sentiment, and fundamentals. Right now, sentiment and money flow are doing all the driving while fundamentals are hibernating in a remote cave somewhere. We are a stickler for fundamentals, and we see no other way in our approach to investing. Whilst money flow and sentiment can change overnight, fundamentals are deep-rooted and tangible.

We believe the aviation industry fundamentals are improving steadily. The global trend is clearly toward opening, but there are a handful of places facing rising Covid-19 numbers and the authorities are cracking down again as a stop-gap measure. Travel companies and hotels have reported strong demand recovery and forward bookings surged to levels higher than before the pandemic. Many people have already booked their holidays for the summer and Christmas of 2022! Two of our investments are beneficiaries of this long-forward booking trend; Norwegian Air Shuttle and Dufry both reported positive free cash flows in their recent September quarter.

7 billion vaccines have been administered globally[1], and by my crude estimation, this equates to 57% of the global population that can receive the Covid-19 vaccines (13 years and older). This number increases by 30 million each coming day and assuming this trend continues, ±70% would be fully vaccinated by the end of 2021. In my mind, this achievement is far greater than putting a man on the moon.

We don't know when fundamentals will awaken from its slumber and take command as the equity valuation yardstick. But I am confident that our portfolio will be worth a whole lot more when it does. We are fully invested and happy with the current holdings, and therefore the portfolio will continue to be inactive.

Gol Linhas Aéreas Inteligentes (GOL)

This month I share with you our investment thesis on GOL, the largest carrier in Brazil with diversified operations covering both budget and full-service segments. It also has a sizeable logistics business.

My first encounter with GOL was back in 2004, in New York's Grand Astoria Hotel. Raymond James was hosting a Growth Airlines Conference, and I was there to usher my then CEO Tony Fernandes of AirAsia. Tony was scheduled for a panel discussion with JetBlue and GOL. We were held in a holding room before our slot, but Tony was missing and not answering his calls. I would be his replacement if he didn't show up! There I was next to the living legend David Needleman (JetBlue's CEO) and Richard Lark, the highly intimidating CFO of GOL. Next to Richard was this young good-looking guy with a physique of an Olympic athlete looking at the floor, avoiding all eye contacts. He was obviously uncomfortable and out of his skin like I was.

I cracked a conversation with him as a means of therapy that I would step in for Tony and all of New York would label me as a doofus. He was friendly and funny, knew a lot about cars and his football too. While all the reporters in the room surrounded Needleman and Lark and hit them with torrents of questions, we were in our own corner, chatting away, cracking jokes, oblivious to the surroundings.

Thankfully, Tony showed up at the last minute. He told me to disappear to a dark corner and not talk to people.

I sat and blended in with the crowd for the panel discussion. On the stage were Raymond James' moderator, David Needleman, Richard Lark, and that young, good-looking guy who was introduced as Constantino de Oliveira Jr, the founder of GOL.

I have not met Constantino since then and I doubt he remembers me. The impromptu chat we had left an impression that he is a nice and genuine gentleman. The corporate relationship between AirAsia and GOL blossomed thereafter. Both companies shared ideas and GOL's Investor Relations team helped me to become a better investor relations officer. There were study tours between companies, and we fed off each other in areas of human resource development, corporate culture, and branding.

The backstory is meant to delude you into a feeling of nostalgia and perk up your mood because here comes the not-so-good news.

[1] Bloomberg Covid-19 tracker

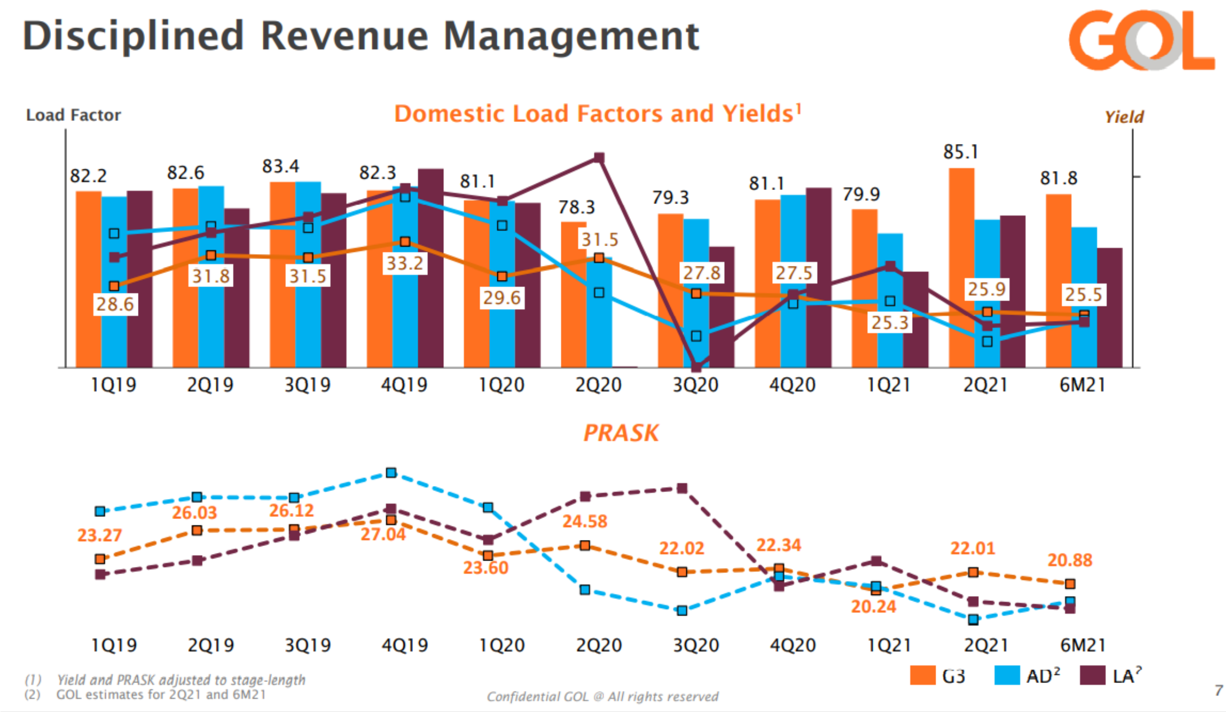
GOL has underperformed and is the biggest drag on our portfolio performance. Its share price is down 42% year-to-date (to Oct 2021), refer to Figure 3.

Figure 3: GOL share price (US ADR, price in USD)

Source: Bloomberg

We bought GOL because we were impressed with its capacity and cost management, and the strategic actions taken by the management team. It has consistently delivered load factors exceeding 80% in 2021, which is the highest of any listed airline globally. Operating costs were slashed, and cash burn rate was reduced to a minimum. The Brazilian Real has been depreciating, but GOL's treasury was able to manage it by dollarizing their revenue stream and matching it with their USD liabilities.

The slide below is from GOL's 2Q21 presentation which underpins our high conviction. Prior to the pandemic, GOL's load factor was hovering around 82% with Yields[2] of around US25¢ per kilometer. It fell to 78% but recovered to above 80% level in just two quarters after the pandemic; the fastest recovery of any airline I can think of. Currently, the yield is still 15% lower, but the outlook is improving as vaccination campaign is progressing well (75% of the population have received their first dose and 57% fully vaccinated). It is just a matter of time more borders will open, and business travel will resume.



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[2] Yields or PRSAK is a fancy airline word for how much a passenger pays for each kilometre flown

We think GOL's competitors have lost the plot. They are deploying too much capacity and still launching flights where there is little demand. Furthermore, the Azul-Latam merger rumors are a distraction. GOL, on the other hand, is a suave operator who will deploy capacity with clinical precision and manage costs effectively all the time. It is an old hand with 20 years of ups and downs. And the management knows too well that any recovery is incremental, and the company can adapt and pounce when an opportunity presents itself.

The reason why GOL's share price underperformed is due to negative country sentiment. President Bolsonaro is highly unpopular. Worse, he threatened to nationalise the oil industry which raised alarm bells and shocked investors. Whenever a premier murmurs the word 'nationalise', investors instantly view him as the unholy cross of Hitler and Thatcher. Even for the most hardened capitalist, this is an eternal sin. As you would have guessed, investors sold off Brazil furiously, and every capital class tanked (equity, bond, or even cash).

As strange as it seems, Brazil has a knack of going through this cycle of electing a person who is highly popular at first, followed by a rapid decline in approval ratings thereafter and eventually a messy exit ─ kinda like Jose Mourinho in his third season. In the past decade alone, it happened thrice (also like Jose Mourinho), with President Lula in early 2011 and President Dilma Rousseff in mid-2016.

However, we note from Brazilian history that political headwinds will pass, and the stock market always recovers, assuming the fundamentals back the story. If we get new inflows into the fund, I won't hesitate to top-up GOL in a heartbeat.

The human touch

We made our first marketing trip to Switzerland, with one day each at Geneva, Zurich, and Luzern. After the Swiss trip, we had a couple of meetings in London. It was so nice not to see a Bloomberg screen and to be able to go out and meet with real people again. The meetings went well, my guests were engaged and threw me with many fantastic questions. Had it been on a Zoom call, it would have all been over in 20 minutes. But in person, all my meetings easily exceeded an hour.

At the end of each meeting, when we said our goodbyes, I had to resist myself from giving everyone a bear hug and a kiss to the cheeks like how I would do to my brothers and sisters. To those who say business trip is dead and Zoom call is the future, you probably have a great dislike for people. To me, there is just no comparison, especially in the world of fund management where we are dealing with people's hard-earned savings. That human touch goes a long way.

I hope to do more marketing in the future, and I especially hope to meet with all our investors. Until then, a virtual hug and kiss will do.

Mohshin Aziz
3rd November 2021

P/S: the format change in this month's newsletter was James' doing. He thinks both the Asia Fund and Aviation Fund should look identical, to preserve the Pangolin look and feel.

I suspect this trend will continue. The next time we meet, my hair will be much longer and all over the place. But on the bright side, I'll be much slimmer too.