Asia Small Companies Unit Class
TAMIM Fund

At 31 January 2020

January 2020 Comments

Sentiment turned sharply negative in January following news of the outbreak of a new coronavirus (2019-nCoV) first identified in Wuhan, Hubei Province, China. Our benchmark index fell by 3.8% in US dollar terms which converted to a small gain in Australian dollar terms of +0.8% due to a sustained decline in the local currency by 4.8%. The Australian dollar dipped below US 67 cents to end the month at lows not seen for eleven years.

All of our investment markets fell during the month in US dollar terms, Singapore -2.4%, Japan -3.1% and perhaps surprisingly China was (only) -3.3%. The biggest impact was felt in Korea -10.9%, Hong Kong -5.7% and Taiwan -4.8%. Markets are likely to remain volatile in coming weeks as investors react to news surrounding the coronavirus. Evidence from past events of this type, especially Severe Acute Respiratory Syndrome (SARS) in 2003 is that the market impact is relatively short-lived. Unlike 2003, the response from the Chinese authorities has been open and proactive, resulting in the rapid identification of the 2019-nCoV genome sequence which will see the development of vaccines for testing in a matter of weeks. Back in 2003, during this phase of SARS the Chinese authorities were in complete denial of the situation. The better communicated and proactive response this time around may have exaggerated some of the stock market volatility, however, we take the view that this isn't a reason to exit companies in the region. Investor selling into this type of volatile environment typically "forget" to re-enter the markets as fear generates too many confusing signals. In terms of long-term investment outcomes, it is always better to be a net buyer in this type of situation.

The Stock Exchange of Hong Kong has taken the first steps towards allowing companies to hold weighted voting rights with a consultation paper published in late January. Weighted voting rights were introduced in 2018 with ownership limited to individuals. If this expansion of weighted voting rights is enacted then Hong Kong will find itself being downgraded in the regional assessments of corporate governance having taken another move away from "one share, one vote".

The "phase one" trade agreement between the United States and China was signed in mid-January, this removes one of the key risk factors that has hindered Asian markets in the past eighteen months. With the deal signed we should have seen the end of pre-emptive tariff increases imposed on China by President Trump until at least the other side of the US Presidential elections. The agreement is more of a "truce" than a long-term solution for the United States trade deficits with China.

In normal circumstances we would have seen a strong response in China to the election results in Taiwan in which the Democratic Progressive Party (DPP) won a second term in a landslide result securing 57.1% of the votes. This was an incredible comeback for President Tsai Ing-wen who recovered from very low approval ratings and major losses in the 2018 mid-term elections. There were two key factors in the DPP success, first, partly due to trade tensions between China and the United States, Taiwan has been the beneficiary. Taiwan's fourth quarter GDP growth of 3.8% was the fastest since mid-2018 helped by a strong electronics sector as factory production switched from China to Taiwan. Second, the protests in Hong Kong has increased pro-independence sentiment which is a key DPP theme while the opposition KMT adopt a much more pro-Beijing stance.

We undertook a number of transactions in January with the aim of reducing our overall number of holdings and exposure to Korea. Three companies (GS Home Shopping, Grand Korea Leisure and COM2US) were sold in Korea to take our country exposure down to 6.5%. We also sold three companies following reviews of the value, momentum and quality scores. Two of the sales were in Japan, automotive parts maker Toyoda Gosei and hardware retail chain Komeri. The final sale was the Taiwanese footwear manufacturer Yue Yuen Industrial which is listed in Hong Kong. All three companies were unable to maintain our requirement for momentum, having sustained earnings downgrades in recent months. The portfolio now holds 60 companies which is the lower end of our 60-80 target range.

We were pleased to see one of the "quiet achievers" Sawai Pharmaceutical emerge as our biggest holding through sustained performance, rising by 34% since early October, to now exceed 3% of the portfolio. Another of our pharmaceutical companies, Sinopharm Group, took the decision in January to issue shares in an after hours placement as permitted under the rules of the Stock Exchange of Hong Kong using a General Mandate, causing a dilution of our shareholding by 4.8%. This action by Sinopharm Group will prompt us to conduct a review of their governance and treatment of minority shareholders.

We will continue to invest in Asian small to mid-sized companies with strong value, momentum and quality attributes together with accounting, strategy and governance standards that meet our requirements. Long-term returns will be generated by the ability of our companies to deliver growing profits and dividends.

Stock Review

SUGI HOLDINGS CO. LTD. (Sugi) is a Japan-based holding company mainly engaged in the management of retail pharmacy stores. Sugi is engaged in the sale of medicines, health foods, cosmetics, daily necessities and prescription preparations. Sugi also operates visiting nursing stations that closely cooperate with regional medical institutions and social welfare operators, through the provision of visiting nursing services and in-home nursing care support services. In November 2019 Sugi operated a total of 1,271 stores (including nursing stations) and employed 6,237 full-time in addition to 10,456 part-time staff.

Accounting, Strategy and Governance Comments

Accounting

1 - Full compliance Japanese GAAP accounting standards which are largely equivalent to IFRS. The accounts are overseen by three outside auditors in accord with standard practice in Japan.

2 - Sugi pays a full corporate tax rate in excess of 30%.

3 - Sugi publishes earnings on a quarterly basis, updating full year earnings per share and dividend per share forecasts with each set of results. Sugi also publishes monthly sales figures, therefore providing better transparency than is typical in Japan.

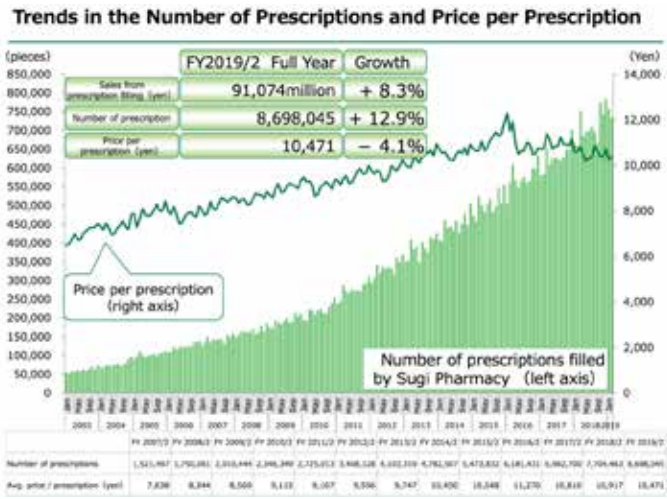
Strategy

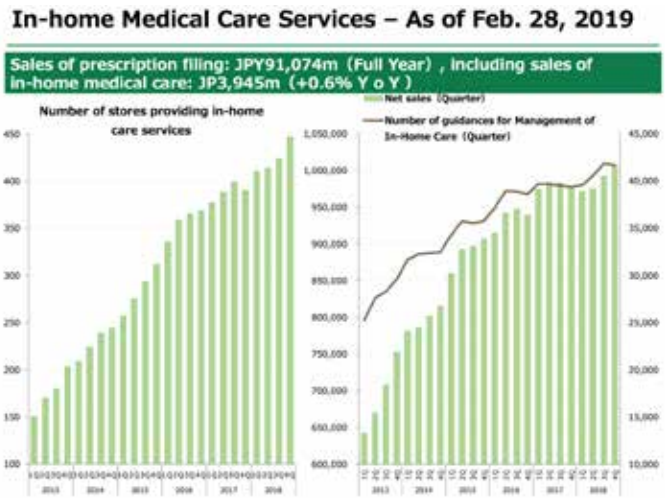
1 - Sugi has an excellent history of growth and has sensible plans going forward that doesn't rely on increased prescription values. The average prescription value for Sugi peaked at ¥ 11,270 in 2016 and had fallen to ¥ 10,660 in the quarterly reporting for Q3 2019.

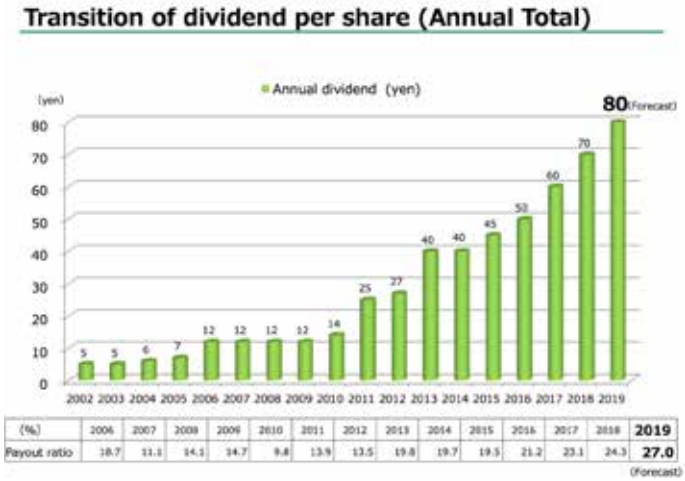
2 - Sugi has a strategy directed to growing the number of stores, the Q3 accounts indicated a total of 1,271 stores which is expected to rise to 1,290 by March 2020 an 8.4% increase from the March 2019 total of 1,190. Growth rates of new stores varies by region with the more mature regions of Chubu and Kansai growing at a 5% rate while the Kanto and Hokuriku regions are growing at a double digit pace. Growth is directed towards the Sugi branded stores, the company had an earlier alliance (2005) and then merger (2013) with Japan Co. Ltd which brought in stores branded "Japan". The "Japan" brand looks likely to be phased out over time. Sugi has a target for 110 new stores in 2020 and 120 new stores in 2021. In addition to building new stores Sugi is increasing the number of stores providing their "home care" visiting service which has a positive impact on revenue per client.

3 - Sugi is gradually increasing the sales area of their stores, in 2014 the average sales area was 578 m2 which is expected to achieve an average of 603 m2 by the end of 2020. Sugi has a total of 16,693 full and part-time employees with 62.6% employed on a part-time basis. The ratio of part-time employees has increased from 57.7% in 2014, which gives Sugi more flexibility in the management of the business. Sugi's annual investment in new stores amounts to ¥14,500 million and the spend on existing stores is ¥3,000 million which combines for a total equivalent to USD 160 million. Sugi's investment rate is running at twice the rate of depreciation and is funded from internal resources.

4 -Sugi has achieved very good diversification of sales with prescriptions accounting for 21.7% of the total, there is a good spread across other categories including healthcare products (20%), health foods (19%) and beauty products (21%). The gross profit margin for prescriptions exceeds all other categories at 38.5% versus the overall average of 31.2%. Sugi has managed to improve the overall gross margin from 29.8% in the past year.







Governance

1 - Sugi has three independent directors on the Board comprising seven directors. The Sugiura family control 32.5% of the share capital and they have three family members sitting on the Board. Continuing involvement of the Sugiura family is a positive for the business.

2 - In June 2019 the Board announced a possible business integration with Cocokara Fine Co. Ltd. In August 2019 the discussions were terminated without an agreement being reached. The Board took the view that prospects for their business were better without the prospect of an eventual merger of a business that is 50% the size of Sugi. We prefer Sugi looking to grow their business in the existing manner without taking on a relatively large and complex merger.

3 - Sugi is fully compliant with the governance regulations in Japan.

4 - The dividend payout ratio has increased during the past decade, hitting a low point of 9.8% in 2010 to the current level of 27%. There is scope for further increases in the dividend payout ratio.

Value, Momentum and Quality Comments

1 - Sugi has a long history of delivering revenue and profits growth by expanding the number of stores. The company has developed from filling 500,000 prescriptions per annum in 2003 to 8.7 million by 2019. Sugi operates in a sector that attracts high valuations, the forward P/E of 18.3x is reasonable versus the sector average in excess of 20x.

2 - Return on capital employed in excess of 11% helps to underpin strength in the score for quality. The company has a strong balance sheet with no debt and generates positive free cash flow each year. The company can comfortably fund the new stores expansion programme from operating income.

3 - There are just six analysts covering the stock and they have upgraded their 2021 earnings forecasts by 9% in the past year. The company has delivered positive earnings surprise in each of the past three years, in 2019 the actual earnings exceeded expectations by 9.8%.

All charts sourced from Sugi Holdings Full Year Results 2019.

Asia Small Companies Unit Class
TAMIM Fund

At 31 January 2020

Fund Overview

The TAMIM Fund Asia Small Companies unit class seeks to achieve a high real rate of return over the long-term within defined risk parameters acceptable to the Investment Manager through a diversified portfolio of Asian small and mid-cap shares.

Key Facts

Investment Structure:	Unlisted unit trust
Minimum investment:	A$100,000
Applications:	Processed monthly
Redemptions:	Monthly, with 30 days notice
Unit pricing frequency:	Monthly
Distribution frequency:	Annually
Management fee:	1.00% p.a.
Expense recovery fee:	Up to 0.35%
Performance fee:	20% of performance in excess of hurdle
Hurdle:	MSCI AC Asia Small & Mid Cap Index
Buy/Sell Spread:	+0.30%/-0.30%
Exit fee:	Nil
Single security limit:	+/- 5% relative to Benchmark
Country/Sector limit:	+/- 10% relative to Benchmark
Target number of holdings:	60-80
Portfolio turnover:	< 30-40% p.a.
Investable universe:	MSCI AC Asia Small & Mid Cap (US$ 500m - 10bn)
Cash level (typical):	0-100% (0-5%)

Returns

	1m	3m	6m	9m	1y	Since inception p.a.
TAMIM Asia Small Comp.	0.30%	4.10%	8.97%	9.11%	15.31%	2.93%
MSCI AC Asia SMID	1.03%	1.93%	7.28%	5.92%	13.19%	3.52%

Note: Returns are quoted net of fees and assume distributions are reinvested. Past performance is no guarantee of future performance. MSCI AC Asia SMID refers to the MSCI AC Asia Small & Mid Cap Index in AUD. Inception 1 October 2018.

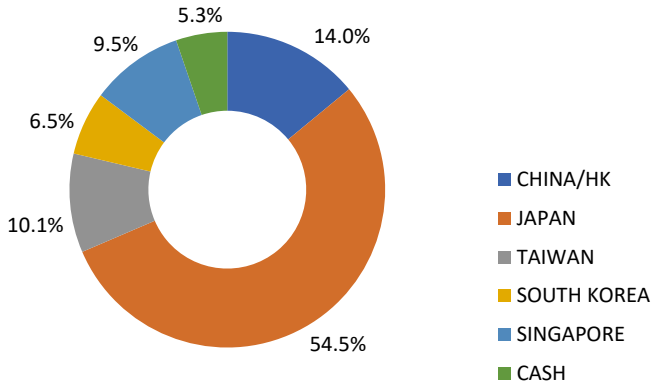
NAV

	Buy Price	Mid Price	Redemption Price
AU$	$8.3388	$8.314	$8.2890

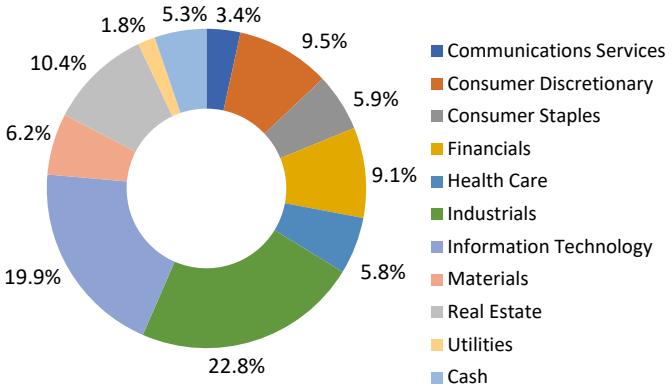
Portfolio Profile

Equity	94.7%
Cash	5.3%

Regional Allocation



Sector Allocation



Selection of 5 Holdings

Stock	Code	Exchange
Sojitz Corp.	2768	Tokyo
Simplo Technologies Co.	6121	Taiwan
Kerry Logistics Network	0636	Hong Kong
Venture Corp.	VENM	Singapore
China Lesso Group	2128	Hong Kong