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Client Newsletter for the period ended 31 Dec 2020

Welcome to the Lighthouse Advisors newsletter for December 2020. The format has been revised following client feedback.

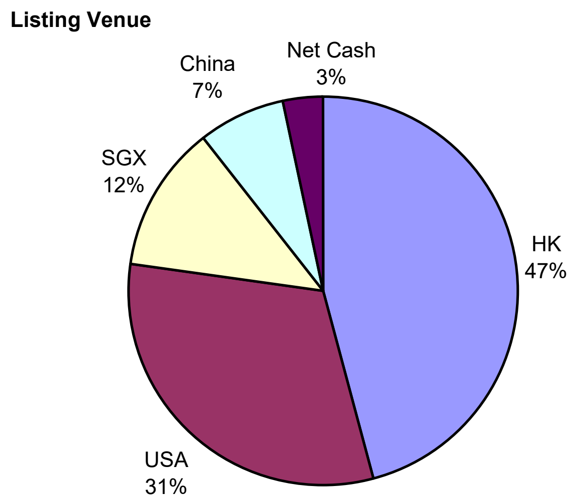
1. **Summary**
2. **Market Commentary**
3. **Portfolio Review**
4. **Cross-Selling**

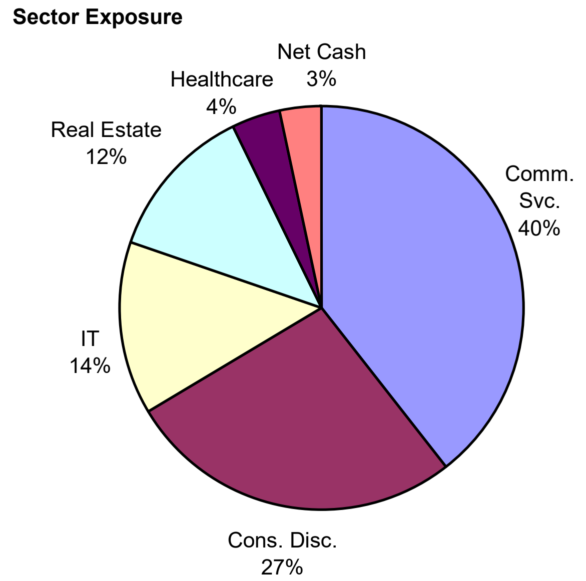
1. Summary

The NAV for December 2020 was USD 93.20 (SGD: 123.14). The full-year return was 12.6% (SGD: 10.5%).

Market (Index)	1Q20	2Q20	3Q20	4Q20	Full Year
Singapore (STI)	-23.0%	4.4%	-4.8%	16.3%	-11.0%
Hong Kong (HSI)	-16.3%	3.5%	-4.0%	16.1%	-3.4%
Shanghai (SSE)	-9.8%	8.5%	7.8%	7.9%	13.9%
USA (NASDAQ)	-14.2%	30.6%	11.0%	15.4%	43.6%
Fund	**-18.9%**	**15.0%**	**10.1%**	**9.7%**	**12.6%**

22 securities made up 97% of the Fund's holdings, with the balance in cash and cash equivalents. The following charts show the approximate exposure by place of listing and sector (numbers may not add up or match exactly due to rounding).





A detailed chart of holdings is in Annex I, while NAV values in both USD and SGD are tabled in Annex II.

Updated 8 February 2021

2. Market Commentary

2020 was a most unusual year. The pandemic inflicted massive economic damage, but stock markets soon anticipated a recovery and surged from the second quarter onwards. Optimists were proven right as vaccines were announced in the fourth quarter.

Apart from China, the world economy is muted as many countries are struggling to cope with new outbreaks. Vaccines are now being made available, so these outbreaks should taper off in both size and frequency. In the meantime, stock markets have looked ahead and priced in a strong rebound.

Technology stocks continue to be mispriced in both directions, as investors underestimate the continued strength of established winners and overestimate the prospects of new challengers.

Interest rates remain persistently low, which should continue to give equities a tailwind.

The next newsletter will be written for the period ending 31 March 2021.

Benjamin Koh
Chief Investment Officer
Lighthouse Advisors
8 February 2021

3. Portfolio Review

After a poor first quarter, the Fund rose for 3 straight quarters and ended 2020 with gains.

<u>Divestments</u>

Delfi was sold due to the delayed recovery in Indonesia. After dividends, loss on sale was about 6%.

Oversea-Chinese Banking Corporation was sold due to the continued low interest rate environment. After dividends, gain on sale was about 3%.

Ping An Insurance was sold due to the continued low interest rate environment. Loss on sale was about 4%.

United Overseas Bank was sold due to the continued low interest rate environment. Including dividends, there was an immaterial gain on sale.

<u>New Investments</u>

Alibaba Health Information Technology is the healthcare arm of Alibaba. It operates Tmall Pharmacy, the largest healthcare e-commerce platform in China. Growth will come from prescription drugs, which are 80% of the drug market but could not be sold online until December 2019.

Other businesses include hospital IT services such as telemedicine, medical insurance processing, and data analytics. The company is the largest such player, with 6,500 medical institutions signed up. It also has its own online doctor network, with 24,000 medical professionals. The Covid-19 pandemic boosted online purchases of drugs versus at the hospital or pharmacy, and non-urgent consultations moved online as hospital visits were reduced to minimize transmission risk.

The shares were acquired at about 16 times estimated FY21 sales.

Hong Kong Television Network is the largest e-commerce company in Hong Kong. The business benefited from the pandemic as Hong Kong residents went online to order everything from groceries to cosmetics. The company turned profitable in 1H20, and profits are expected to rise dramatically as sales increase.

The shares were bought at about 4 times estimated 2020 sales.

Ping An Healthcare is the online healthcare arm of Ping An Insurance. It provides telemedicine services via its own in-house staff, an external doctor network, and artificial intelligence (AI)-based systems. The AI healthcare system has received the highest level of certification from the World Organization of Family Doctors. The company's online healthcare platform is the leader in China, connecting 3,000 hospitals and 94,000 pharmacies with its 300m+ users.

Currently its healthcare e-commerce business accounts for over 50% of revenue and should grow rapidly as more prescription drugs are sold online. Telemedicine is expected to grow even faster, and given the higher gross margins, group profitability should improve accordingly.

The shares were bought at about 17 times estimated 2020 sales.

Unity Software is the developer of the Unity engine used to create games. The Unity engine is used in over half of the top 1,000 mobile games. Revenues come from license sales, revenue sharing from in-app purchases, and revenue sharing of in-game ads. The company has also entered other industries such as automotives and architecture. These revenues are growing even faster than gaming.

The shares were purchased at about 30 times estimated 2020 sales.

Other Developments

Nil.

4. Cross-Selling

Cross-selling refers to the practice of selling additional goods and services to customers in order to increase profits. Compared with acquiring a new customer, it is comparatively trivial to sell more to existing customers.

Retailers have long used promotions as a sales tactic: mark down an item to an attractive price to draw in customers, then profit off other purchases in the basket. The promotional item is usually some sort of product with wide appeal: in earlier days it might have been toothpaste or frozen chicken, in more recent times a flatscreen television. The tactic is described as a "loss leader" – losing money on specific goods and services, but drawing in a customer and making enough on the basket to earn a healthy profit overall.

But what happens when an entire line of business is discounted? For a new business, this raises visibility and gains mindshare, with the hope that customers will be loyal after prices normalize. But if new competitors enter the fray, a price war ensues, and discounts may be prolonged. The player with the deepest pockets, or who can "refill" them from other businesses, should eventually emerge the winner and profit thereafter.

Besides owning unrelated businesses that can supply cash flow (diversification), cross-selling is a key monetization channel. In some cases, cross-selling is actually *more* profitable than the supposed core business! Clearly, it is a competitive advantage against other players who are unable or unwilling to utilize such strategies. Some case studies follow.

Transport

ComfortDelgro is the world's second largest land transport operator. It operates taxis, buses and subway systems in Singapore, Australia, China and the UK. With a ~70% market share in Singapore, its taxis were very profitable. Then the ride-hailing operators arrived.

Initially, media attention was focused on **Uber** and **Grab**. They competed with heavy subsidies for both drivers and passengers. Eventually, Uber gave up and exited Southeast Asia, in exchange for a 27.5% stake in Grab.

Why did Grab beat Uber? Uber's core business is *transport*: it moves passengers and (via UberEats) food packages. It aims to make a profit from this basic service. Grab, in contrast, is a super-app: besides moving people and food, it sells movie tickets, tickets to attractions, dining vouchers, shopping vouchers, air tickets, hotel rooms and even spa services. Transport is merely a *customer acquisition* operation; it only needs to break even here, while the real money comes from merchant commissions. Now that Grab (together with **Singtel**) has been approved for a digital bank license, its user monetization will increase: it can issue credit cards, finance drivers' cars, and lend to passengers.

Uber retains a stake in Grab, so it hasn't actually lost, it has simply become a junior partner. The real loser is ComfortDelgro. The Uber-Grab price war brought in droves of new customers. Post-war fares have mostly been cheaper than taxi fares, so customers stayed. Grab does not need to make money from rides, so it can – and does – price lower, on average, than ComfortDelgro, which sets fares at levels that allow its hirers to pay its taxi rentals. The Uber-Grab price war escalated in 2016, and concluded with Uber's exit in 2018. The table below shows the impact on ComfortDelgro:

Year	Taxi Revenue SGD mn	Op. Profit SGD mn	Year-End Fleet (Singapore)
2014	1,283.7	150.9	16,933
2015	1,326.8	163.9	16,997
2016	1,340.8	167.5	16,821
2017	1,208.7	135.1	13,244
2018	726.5	129.4	12,360
2019	668.6	104.2	10,700

Before the price war in 2016, the taxi business was stable. By the time Uber and Grab called a truce, taxi revenues had halved, and the fleet was one-third smaller. As ComfortDelgro's elderly technophobic taxi drivers retire, fleet size and profits are likely to decline further.

ComfortDelgro shareholders who expect a recovery in the taxi business are betting against the billions that investors have given Grab. ComfortDelgro has, to date, shown no interest in taking the fight to Grab by developing a super-app to cross-sell to drivers and passengers. Instead, its latest initiative is to pilot a ride-hailing service of its own, which suggests the management has completely missed the plot.

<u>E-commerce</u>

Loss leader campaigns abound in e-commerce: many operators use aggressive discounts to acquire new customers, then hope the buying experience convinces them to stay. In the US, **Amazon** leads, while in China the giants are **Alibaba**, **JD** and **Pinduoduo**. In Southeast Asia, the throne is still vacant, but **Lazada**, **Tokopedia** and **Shopee** are seen as the main contenders. All three have raised money from marquee investors, as shown below.

Platform	Investor	Notes
Lazada	Alibaba	100% owner
Tokopedia	Sequoia Capital Alibaba Softbank Google	
Shopee	Tencent	Shopee's parent company **Sea** is listed on NYSE.

Like Grab, **Sea** will leverage finance to monetize its user base. Sea has been awarded a digital bank license in Singapore, and it recently acquired **PT Bank Kesejahteraan Ekonomi** in Indonesia. Credit cards, merchant financing and consumer loans are obvious next moves. Importantly, Sea also has a gaming division with a highly successful game, *Free Fire*. The cash from *Free Fire* offsets losses at Shopee, so even before the move into finance, Sea could already endure e-commerce losses better than Lazada or Tokopedia.

Lazada announced a tie-up with small business lender **Finaxar** in 2018 to offer financing to its merchants, but there have been no recent updates. It is likely that Alibaba is preoccupied with restructuring **Ant Financial** after the latter's failed IPO. With a distracted leadership, Lazada may find it tough going.

Tokopedia tied up with peer-to-peer lender **Modalku** in 2019 to provide financing for offline kiosk operators. Also, in January this year it was reportedly in merger discussions with Gojek, Indonesia's dominant ride-hailing super-app. Gojek owns 22% of **PT Bank Jago**, so it already has a financial partner to help monetize its user base. A merged Gojek-Tokopedia could be a strong player.

So it seems Shopee will win in Indonesia, with Gojek+Tokopedia (if it happens) and Lazada fighting for second place.

Food Delivery

Meituan is China's largest food-delivery platform. Together with **Ele.me** (饿了吗), it dominates the industry. Meituan's food delivery has been operationally profitable since 2Q 2019, but from all accounts, Ele.me remains unprofitable.

The difference is that for Meituan, food delivery is their key business, but Ele.me is (like Lazada) a wholly-owned unit of Alibaba. Alibaba's other businesses are so large that Ele.me is relatively less important. The table below makes it clear.

	3 months ended Sep 2020	
Company	**Group Rev. RMB bn**	**Food Delivery Rev. RMB bn**
Alibaba	155.1	Not disclosed
Meituan	35.4	20.7

As of Q1 2020, Ele.me's market share was about 31% versus Meituan at 67%, so its food delivery revenue is correspondingly smaller. This means it is no more than 7% of Alibaba's revenue, making it a non-core business, whereas at Meituan, food delivery is 58% of revenue, clearly a core business.

As a result, while Meituan deploys its best talents to optimize its food delivery business and monetize its user base, Alibaba's best talents are working at its core businesses like Taobao, Tmall, Alibaba Cloud and so on. Ele.me (and Lazada) are always going to play second fiddle.

The difference is visible in Meituan's super-app, which allows users to book plane tickets, hotel rooms and myriad other services. *Food delivery is a Trojan horse:* travel-related commissions account for most of Meituan's profits. In fact, just 3 short years after entering the travel industry, Meituan became the largest travel agent in China, surpassing the previous leader Ctrip in March 2018. Ele.me does not come close to having such an ecosystem, and therefore does not generate the cashflows needed to reinvest in the food delivery platform. It is a virtuous cycle for Meituan, but a vicious one for Ele.me.

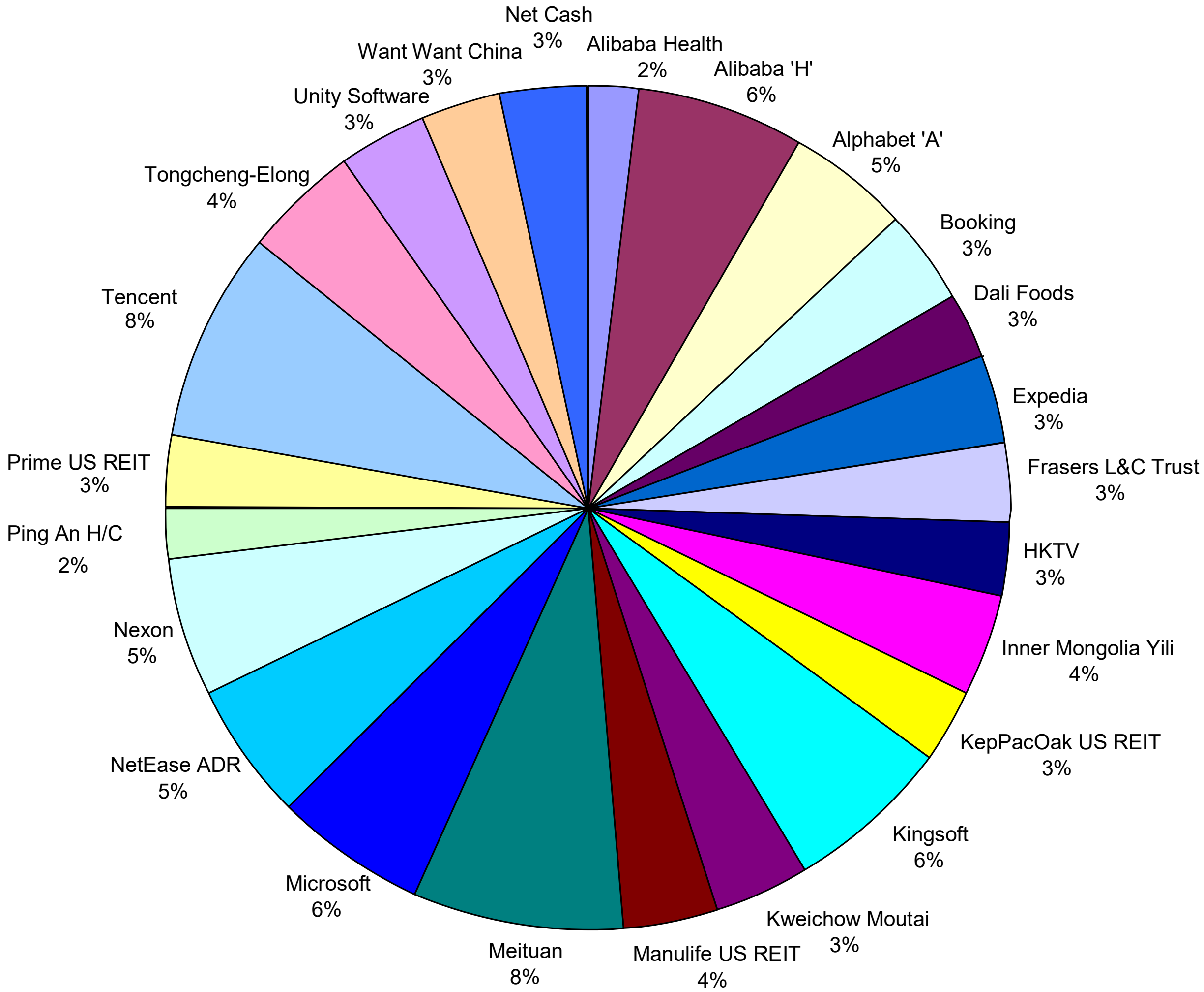
Conclusion

When a company faces a price war in its core business, it must cross-sell to monetize its user base. Failure to do so will doom the core business itself.

End

Annex I

Portfolio 31 Dec 2020



Updated 8 February 2021

Annex II

NAV in USD (Official)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008										34.16	33.49	35.62	**+4.3%**
2009	34.57	33.52	33.37	36.69	46.20	46.00	50.06	49.68	52.66	54.17	56.68	59.94	**+68.3%**
2010	59.05	61.09	65.17	68.27	64.14	65.69	70.65	72.24	81.06	83.56	85.10	90.30	**+50.6%**
2011	87.21	86.29	88.13	92.81	90.85	91.35	91.17	83.69	69.04	78.23	73.00	72.88	**-19.3%**
2012	77.40	82.90	82.52	83.32	76.36	77.25	77.27	77.91	80.57	79.44	82.70	84.92	**+16.5%**
2013	91.43	97.36	99.96	100.24	99.14	95.09	98.50	100.00	100.86	102.24	102.63	102.93	**+21.2%**
2014	99.15	101.78	99.80	101.84	105.45	106.57	109.05	108.58	103.60	103.91	101.87	99.94	**-2.9%**
2015	97.97	98.16	97.74	103.80	103.69	100.99	96.17	85.91	84.17	88.91	86.20	86.35	**-13.6%**
2016	81.56	83.81	88.82	92.18	91.50	91.52	94.48	94.86	94.87	93.34	91.92	90.20	**+4.5%**
2017	93.18	97.08	101.10	101.39	105.74	107.11	109.67	108.57	109.35	112.57	108.28	109.41	**+21.3%**
2018	113.04	109.56	109.03	105.39	109.62	104.37	101.26	93.71	94.25	85.19	86.83	86.66	**-20.8%**
2019	91.98	92.36	90.04	90.21	82.80	84.21	82.57	78.45	76.52	77.82	78.75	82.80	**-4.5%**
2020	78.58	75.37	67.15	71.23	70.50	77.22	82.23	88.36	84.97	86.77	90.34	93.20	**+12.6%**

Note: The Net Asset Value of the Fund has been linked to the rebased NAV of the Reference Account, which had the same investment style. Until the launch of the Fund, the Reference Account served as the model portfolio for all the separately-managed client accounts. Its trading records were distributed to clients as proof that the Manager's interests were fully aligned with those of the clients. The Reference Account was started at the end of 2008 and became inactive following the launch of the fund on 1 September 2013.

The following data is for the convenience of SGD-based investors and is for reference only.

NAV in SGD (for reference only)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008										50.68	50.69	51.20	**2.4%**
2009	52.22	51.91	50.74	54.21	66.70	66.59	72.06	71.60	74.19	75.67	78.50	84.15	**64.4%**
2010	83.11	85.83	91.17	93.55	89.79	91.72	96.10	97.84	106.70	108.12	112.34	115.86	**37.7%**
2011	111.57	109.76	111.06	113.64	112.11	112.14	109.75	100.70	89.85	97.91	93.64	94.48	**-18.5%**
2012	97.39	103.46	103.79	103.05	98.44	97.76	96.12	97.20	98.89	96.95	100.95	103.74	**9.8%**
2013	113.19	120.44	124.03	123.50	125.34	120.54	125.55	127.49	126.57	126.83	128.86	127.81	**23.2%**
2014	124.51	128.55	125.58	127.84	132.26	132.85	135.95	135.58	132.14	133.61	132.91	132.34	**3.5%**
2015	132.68	133.74	134.11	137.66	139.74	136.08	131.71	121.30	119.78	124.68	121.53	122.26	**-7.6%**
2016	116.13	117.82	119.59	123.86	126.08	123.36	126.71	129.30	129.32	129.95	131.79	130.54	**6.8%**
2017	131.35	135.81	141.22	141.04	146.29	147.44	148.75	147.28	149.30	153.38	146.00	146.32	**12.1%**
2018	148.13	145.04	142.95	139.64	146.74	142.24	137.76	128.59	128.83	117.98	119.13	118.06	**-19.3%**
2019	123.77	124.86	123.01	122.81	113.88	113.93	113.02	108.85	105.83	105.92	107.71	111.33	**-5.7%**
2020	107.23	105.02	95.47	100.41	99.64	107.68	112.93	120.15	116.02	118.55	121.20	123.14	**10.5%**