LIGHTHOUSE ADVISORS
Keeping Your Capital Safe

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Client Newsletter for the period ended 30 June 2023

Welcome to the Lighthouse Advisors newsletter for June 2023.

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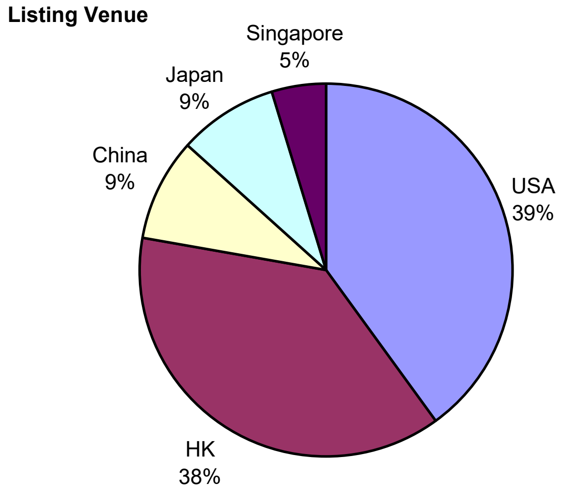
1. Summary

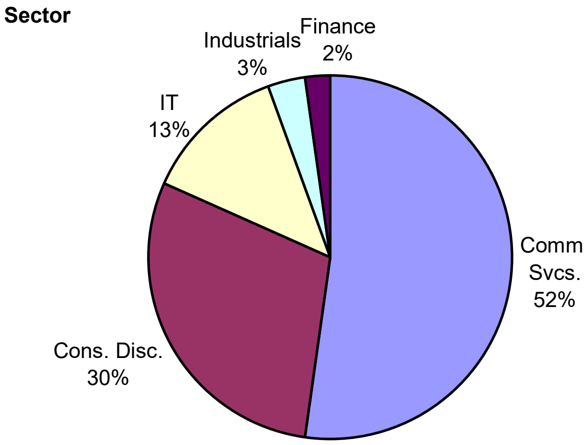
The NAV for June 2023 was USD 64.01 (SGD: 86.56). The year-to-date return was +11.4% (SGD: +12.5 %).

Market Index	1Q	2Q	YTD 2023
S&P 500	+7.0%	+8.3%	+15.9%
Hang Seng Index	+3.1%	-7.3%	-4.4%
Nikkei 225	+7.5%	+18.4%	+27.2%
FSSTI	+0.2%	-1.6%	-1.4%
Hang Seng Tech	+4.2%	-9.1%	-5.3%
NASDAQ	+16.8%	+12.8%	+31.7%
Fund	**+14.1%**	**-2.3%**	**+11.4%**

As the Fund now has significant holdings in non-technology stocks, some general market indices are again shown for reference.

19 securities made up 100% of the Fund's holdings, with immaterial balances in cash and cash equivalents. The following charts show the approximate exposure by place of listing and GICS sector (percentages may not add up or match exactly due to rounding).





NAV values (USD and SGD) are tabled in Annex I.

2. Market Commentary

The second quarter of 2023 was mixed. In the US, technology stocks continued to rally, led by the "Magnificent Seven" of **Meta**, **Apple**, **Amazon**, **Alphabet**, **Microsoft**, **Nvidia** and **Tesla**. However their Chinese counterparts languished under the fears of government regulation and US-China tensions.

Japan attracted attention after the Tokyo Stock Exchange announced that companies trading below book value would have to come up with plans to rectify the situation. Investors have bought in on the hope that Japanese companies will follow the herd with dividends and buybacks to raise their share prices[1].

In China, the property sector appears to have found a bottom, thanks to official comments acknowledging problems in the sector and expressing support. The catalyst was possibly liquidity problems at state-owned developers such as Greenland and Sino-Ocean. After all, if state-owned banks are not lending to state-owned developers, something has clearly gone wrong somewhere. Greenland has defaulted[2] on bond payments due 25 June, while Sino-Ocean recently won a grace period, but not a repayment extension, on bonds due 5 August[3].

A list of 30 key developers' bonds on Bondsupermart[4] shows bifurcated outcomes. The bonds trade in 2 broad groups: below 20% of par, and 50-98% of par. The first group has lost all credibility in the capital markets, while the second group retains support – for now, with discounts reflecting cautious optimism. Your manager remains wary of the sector.

The general focus of the investing public on cryptocurrency, artificial intelligence (AI) and meme stocks in the last few years has left many "normal" companies neglected. Your manager has found some good ideas and expects such stocks to increase in importance to the Fund this year.

Benjamin Koh
Chief Investment Officer
Lighthouse Advisors
7 August 2023

[1] *This Time is Different – Japan Value and Corporate Governance*, **Man GLG**, March 2023.

[2] *China state-backed developer Greenland defaults on $432 mln dollar bond*, **Reuters**, 19 July 2023.

[3] *Sino-Ocean bondholders agree to grace period but not repayment extension*, **Reuters**, 3 August 2023.

[4] *A List of 30 Key Chinese Developers' Latest Development*, **Bondsupermart**, 28 July 2023.

3. Portfolio Review

To protect the interest of clients, detailed discussion is confined to the client-only version of this newsletter. Client newsletters are embargoed for one year, after which they are made available online.

4. The Everything Stock

Amazon is one of the world's largest technology companies today. It started off with grand ambitions to be the "everything store": selling anything, to anyone, at the lowest prices possible.

As is now well-known, Amazon chose books as its first category, where it had important advantages versus brick-and-mortar retailers: an essentially unlimited selection, lower real estate costs, and avoidance of sales tax. Early success there saw Amazon expand into music and movies. These successes led investors and competitors to classify Amazon as an e-commerce company – a dangerous competitor if you were a retailer of some sort, but of limited interest otherwise.

The rise of Amazon Web Services (AWS) changed perceptions. Slowly, then inevitably, AWS emerged as the true profit engine at Amazon. AWS was developed to provide the essential software infrastructure for Amazon's own e-commerce business, but it became a business all by itself. In fact, from a purely financial perspective, one might say that AWS *is* the business of Amazon, and that everything else is peripheral. The numbers do not lie:

USD bn	2018	2019	2020	2021	2022
Revenue					
North America	141.4	170.8	236.3	279.8	315.9
International	65.9	74.7	104.4	127.8	118.0
AWS	25.7	35.0	45.4	62.2	80.1
Operating Income					
North America	7.3	7.0	8.7	7.3	-2.8
International	-2.1	-1.7	0.7	-0.9	-7.7
AWS	7.3	9.2	13.5	18.5	22.8

Without the original e-commerce business, AWS would probably not exist today. But now, AWS is clearly more valuable than the e-commerce business; in the last 5 years it brought in just 13% of cumulative revenues, but accounted for over 80% of cumulative operating income.

Amazon may yet create another enormously valuable business from its own operational requirements. Already, AWS underpins the video-streaming business of Prime Video (and that of competitor **Netflix**), as well as the Alexa functionality of the Amazon Echo (whose various versions collectively make Amazon the world's biggest loudspeaker company by sales).

Amazon's e-commerce business also spurred the creation of Amazon Logistics, to provide services that partners like **UPS**, **FedEx** and the US Postal Service could not, or would not, provide (for example, UPS and FedEx resisted delivering on weekends). At end-2020, Amazon Logistics was moving more parcels in the US than Fedex[5]. In 2021, it began shipping packages for outside businesses[6].

For those who were smart (or lucky) enough to buy shares many years ago, Amazon has been the "everything stock", delivering world-beating investment returns. But for anyone owning it today, there is the question of valuation.

Traditionally, the stock market accords a "conglomerate discount" to companies whose businesses cover unrelated industries, on the basis that (i) top management is likely to be distracted and lose out to a focused one-industry company; and (ii) investors can obtain similar multi-industry exposure by owning shares in competing best-of-breed companies focused on a single industry. Hence, the required discount.

But Amazon is clearly *not* a traditional conglomerate. Its business activities interlock: there is synergy between AWS and Amazon e-commerce, Prime Video and the Echo, while Amazon Logistics serves Amazon's e-commerce business as well as outside customers.

So instead of a conglomerate discount, Amazon might attract a "synergy premium". The question is what this premium might be.

Amazon's e-commerce is fundamentally a retail operation: buy goods at wholesale and resell them at a markup. Plenty of large, successful low-cost retailers can serve as proxies. Two come to mind: **Walmart** and **Costco**. Walmart is the world's largest retailer by sales, with a significant e-commerce arm:

[5] *Amazon pulls back from UPS as it builds out logistics empire*, **Supply Chain Dive**, 3 March 2023.

[6] *Amazon is now shipping cargo for outside customers in its latest move to compete with FedEx and UPS*, **CNBC**, 4 September 2021.

USD bn	FY19	FY20	FY21	FY22	FY23
Revenue					
US	331.7	341.0	370.0	393.2	420.6
International	120.8	120.1	121.4	101.0	101.0
Sam's Club	57.8	58.8	63.9	73.6	84.3
Operating Income					
US	17.4	17.4	19.1	21.6	20.6
International	4.9	3.4	3.7	3.8	3.0
Sam's Club	1.5	1.6	1.9	2.3	2.0
E-Commerce Sales					
US	not given	24.1	43.0	47.8	53.4
International	not given	11.8	16.6	18.5	20.3
Sam's Club	not given	3.8	5.3	6.9	8.4

Costco, on the other hand, has membership fees, akin to Amazon Prime: the "gateway drug" to inducing high levels of spending that fuel the retail flywheel, as high sales volumes lower wholesale costs, which allow lower retail prices, which in turn drive up sales in a virtuous cycle. Costco's numbers:

USD bn	FY18	FY19	FY20	FY21	FY22
Revenue					
US	102.3	111.8	122.1	141.4	165.3
Canada	20.7	21.4	22.4	27.3	31.7
Other	18.6	19.6	22.2	27.2	30.0
Operating Income					
US	2.8	3.1	3.8	4.5	5.3
Canada	0.9	0.9	0.8	1.1	1.3
Other	0.8	0.8	0.8	1.1	1.2

Amazon's retail business approaches Walmart in size, while it resembles Costco in its membership philosophy. Perhaps the retail business could be valued using Walmart and Costco as proxies.

Prime Video's obvious competitors (and proxies) are Netflix, Disney+, and Paramount. A key advantage of Prime Video is its price: *free* (technically, it is included with a Prime membership). Nonetheless, as a standalone business (whether within Amazon or spun off) it should be allocated some of the Prime membership fees.

	Subscribers (Q2 2022), mn	Share of US TV viewing
Netflix	221	8.0%
Prime Video	220	3.0%
Disney+	138	1.8%
HBO Max	81	1.0%
Hulu	45	Not material
Apple TV	20	Not material
Other		10.2%
Youtube		7.3%
Total Streaming		**34.8%**
Cable TV		34.4%
Broadcast (free-to-air) TV		21.6%
Other		9.2%

Despite its impressive subscriber numbers, Prime Video's share of TV viewing in the US is only 3.0%, which means most of its subscribers are not using it much, if at all, despite the unbeatable price. Prime Video is certainly not worthless, though it is clearly *not* worth 3/8 as much as Netflix. One proxy could be Pluto TV, owned by **Paramount Global**. Pluto now has 80m subscribers and is fully ad-supported i.e. "free".

Amazon Logistics has 2 obvious proxies: FedEx and UPS. Amazon Logistics is now closer in size to UPS than FedEx, but either company serves as a sensible benchmark.

AWS is by far the biggest component in a sum-of-the-parts valuation of Amazon. Fortunately, key competitor **Microsoft** is a good proxy, as its cloud segment is both growing rapidly and highly profitable. Microsoft's Intelligent Cloud business provides about 40% of its operating earnings.

Making the heroic assumption that these proxies are, on balance, fairly valued, investors then have some sort of reference for Amazon. After all, they are all large and highly successful enterprises, and they compete to some extent with Amazon. The actual valuation (and applying a suitable conglomerate discount or synergy premium) is left as an exercise to interested readers.

Is there another "everything stock"? **Tencent** could be a candidate.

Like Amazon, Tencent had humble origins. It launched the instant-messaging service **QQ** in 1999. A mobile version followed soon after. Fees were earned from value-added services like stickers, ringback tones, music, and games. Advertising and e-commerce became meaningful contributors.

The turning point came with **WeChat**. The app was released in 2011 and took just 433 days to hit 100m users. The Moments and Official Accounts features added in 2012 greatly boosted user engagement.

A "Cambrian explosion" took place in 2017 when WeChat Mini Programs were launched, giving developers a platform to access WeChat's 800 million users from day one. Within a year, 580,000 Mini Programs had been launched, with over 170 million daily active users. In a way, WeChat served as both the AWS *and* Apple App Store of China.

Tencent invested in many of these startups and gave them access to WeChat traffic. Many, perhaps most, of the startups failed. But some survived and became enormously valuable. The largest of these today include **Meituan** and **Pinduoduo**. Tencent recently distributed most of its 17% stake in Meituan as a special dividend. It retains a 15% stake in Pinduoduo.

Parallel to the rise of WeChat was Tencent's involvement in videogames. The strong cash flows of successful games allowed Tencent to use the money to acquire or develop more game properties, which in turn produced still more cash to invest in yet more games. Important acquisitions include **Supercell** (maker of *Clash of Clans*), **Riot Games** (developer of *League of Legends*) and **Epic Games** (developer of the *Fortnite* game and its *Unreal* engine).

Tencent discloses three core business segments: value-added services (mainly video games), online advertising (ads shown to WeChat users) and FinTech and Business Services (TenPay and Tencent Cloud). However, as with Amazon, these segments support each other, making each a more effective member of the team.

Tencent is the largest video game company in the world by revenues. The games are played online, which means a robust, high-performance, low-latency cloud infrastructure is needed. As a result, Tencent Cloud is particularly suited to hosting video games for other companies, much like how Amazon's AWS hosts both Prime Video and Netflix. At the end of 2022, Tencent Cloud had a 16% share in China's cloud computing market. In videogames, its share is likely to be far higher.

WeChat provides a very large user base (800m+ in China) which is very attractive, both to developers providing services via Mini Programs, and to advertisers trying to engage existing customers and reach new ones.

TenPay offers payment processing to Mini Programs hosted on WeChat. This is a big time- and cost-saver for Mini Programs developers. TenPay is integrated into WeChat as **WeChat Pay**, though it is TenPay that holds the payments license and does the underlying work.

WeChat Pay and **AliPay** (from **Alibaba**) form a mobile payments duopoly in China, similar to the duopoly of **Visa** and **Mastercard** outside China. Cash usage has all but vanished in China, replaced by QR code payments via AliPay and WeChat Pay. As early as 2017, even beggars in China were accepting donations by QR code[7]. TenPay's merchant fees are lower than those of Visa or Mastercard, but as a standalone company, its value could be comparable.

Revenue	Curr.	2018	2019	2020	2021	2022
Visa (Group)	USD bn	20.6	23.0	21.8	24.1	29.3
Mastercard (Group)	USD bn	15.0	16.9	15.3	18.9	22.2
Tencent (Fintech and Business Services)	RMB bn	73.1	101.4	128.1	172.2	177.1
	USD bn	10.2	14.2	17.9	24.1	24.8

Tencent's FinTech and Business Services segment includes Tencent Cloud, which is not disclosed separately. But it is widely reported that Tencent Cloud's market share in 2022 was 16%, versus Alibaba Cloud's 36%. Alibaba Cloud's revenues were reported to be RMB 77.2bn in 2022. Tencent Cloud revenues would then have been RMB 34.2bn in 2022. Crediting TenPay with the balance of the segment revenue, this would be RMB 142.9bn, or about USD 20bn. In revenue terms, TenPay is comparable to Mastercard.

Finally, there is WeChat **Channels**. This is Tencent's response to the short video format popularized by **Douyin** (known as **TikTok** outside China) and **Kuaishou**. Tencent originally provided short video through a standalone app, WeiShi, back in 2013. But WeiShi did not take off, and it was merged into Tencent Video. It lost user time to Douyin and Kuaishou, and in early 2020 Tencent decided to re-launch short video within WeChat itself, as Channels.

Integrating Channels into WeChat instead of providing a separate app proved pivotal: by June 2022, Channels had more monthly active users than Douyin or Kuaishou. However, as of December 2022, Channels still lags both Douyin and Kuaishou in time spent per user, so much work remains before it can claim the short-video crown. In any case, Kuaishou is listed, and serves as a crude proxy to what Channels could eventually be worth.

Clearly, Amazon and Tencent operate in different worlds. But they both excel in leveraging a core business to create competitive advantages for adjacent businesses.

Disclosure: At the time of writing, the Lighthouse Fund owned shares in Tencent. This article is for educational purposes only and is not to be construed as investment advice.

☙ End ❧

[7] *Beggars in China now accepting donations via mobile payments and QR codes*, **International Business Times**, 24 April 2017.

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Annex I

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%**
2021	99.54	99.36	94.98	99.37	96.76	96.86	86.54	87.88	85.09	90.51	85.32	82.81	**-11.1%**
2022	78.21	74.05	70.58	65.87	65.29	64.03	61.31	60.68	53.29	46.97	56.74	57.43	**-30.7%**
2023	63.58	58.90	65.54	62.61	59.65	64.01							**11.4%**

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%**
2021	132.30	132.32	127.74	132.16	127.85	130.26	117.21	118.19	115.50	122.11	116.41	111.73	**-9.3%**
2022	105.70	100.32	95.63	91.14	89.43	88.99	84.64	84.78	76.49	66.51	77.25	76.95	**-31.1%**
2023	83.53	79.42	87.22	83.58	80.63	86.56							**12.5%**

Updated 7 August 2023