# SOMERSET CAPITAL MANAGEMENT LLP

31 July 2021

## *MI Somerset Emerging Markets Dividend Growth Fund OEIC*

*Investment Adviser's Monthly Report*

**Mark Williams**
*Partner & Co-Manager*

**Kumar Pandit**
*Partner & Co-Manager*

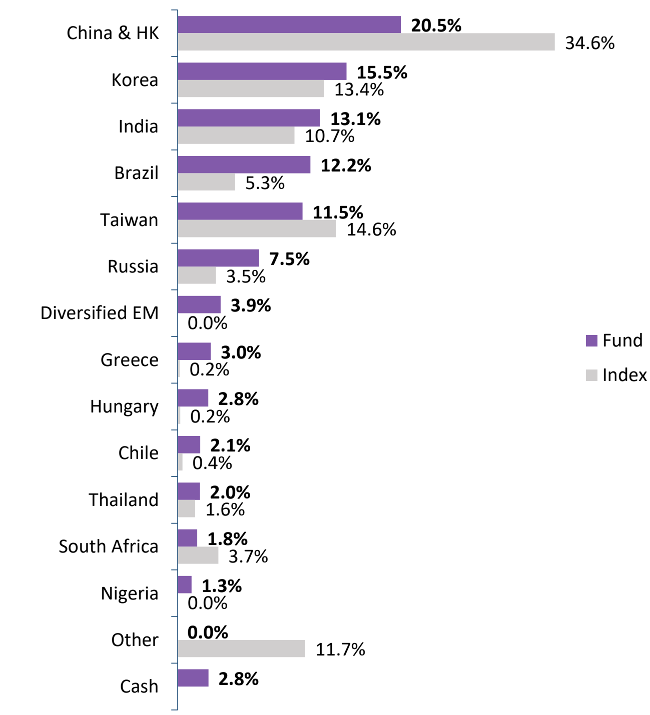
### Fund Objectives

The Dividend Growth Fund invests in companies which demonstrate prospects for long term cash flow and dividend growth. We aim for a portfolio of stocks whose dividend is above that of the comparable universe. Co-managers Mark Williams and Kumar Pandit structure a concentrated portfolio of 30-50 quality conviction ideas. All companies must adhere to Somerset's independent criteria around environmental, social and governance risk and we actively engage with companies on material issues. Mark and Kumar are supported by Somerset's team of fund managers and analysts based in London and Singapore.

| Assets Under Management | |
|---|---|
| Somerset Capital Management LLP | $7,175 m |
| Dividend Growth Strategy | $523 m |
| Dividend Growth Fund OEIC | £172 m |

| Portfolio Data | Portfolio |
|---|---|
| P/E (Historical)‡ | 79.2x |
| Dividend Yield (%) | 1.5% |
| Wgt Ave Mkt Cap ($m) | 105,889 |
| No. of Stocks | 35 |
| Price (Accumulation) | 191.85 |
| Price (Income) | 146.12 |

### Country Breakdown

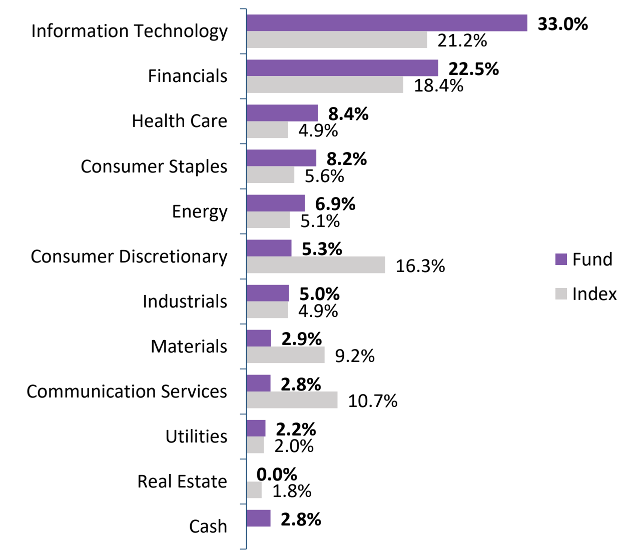



| Acc GBP Performance Net (%)* | Fund | Index⁺ | +/- |
|---|---|---|---|
| 1 Month | -5.64% | -7.33% | **+1.69%** |
| 3 Months | -1.40% | -4.80% | **+3.40%** |
| YTD | 4.16% | -1.47% | **+5.63%** |
| Since Inception* | 91.85% | 80.25% | **+11.60%** |
| 2020 | 0.01% | 14.65% | **-14.64%** |
| 2019 | 17.23% | 13.86% | **+3.37%** |
| 2018 | -15.46% | -9.27% | **-6.19%** |
| 2017 | 21.78% | 25.40% | **-3.62%** |
| 2016 | 26.83% | 32.63% | **-5.80%** |
| 2015 | -6.39% | -9.99% | **+3.60%** |
| 2014 | 8.41% | 3.90% | **+4.51%** |
| 2013 | -3.19% | -4.41% | **+1.22%** |
| 2012 | 15.82% | 13.03% | **+2.79%** |
| 2011 | -5.98% | -17.82% | **+11.84%** |
| 2010 | 12.45% | 11.83% | **+0.62%** |

| Top 10 Holdings | Country | NAV % |
|---|---|---|
| Samsung Electronics Co. | Korea | 5.9% |
| eMemory Technology Inc | Taiwan | 5.1% |
| Taiwan Semiconductor Manufacturing Company | Taiwan | 4.7% |
| Novatek PJSC-GDR | Russia | 4.5% |
| Locaweb Servicos de Internet SA | Brazil | 4.1% |
| Housing Development Finance Corp | India | 4.0% |
| Kweichow Moutai Co Ltd | China | 3.9% |
| HCL Technologies LTD | India | 3.8% |
| WuXi AppTec Co Ltd (HK-C) | China | 3.5% |
| SK Hynix Inc | Korea | 3.4% |

| Market Cap Breakdown | Fund |
|---|---|
| < $5bn | 20.4% |
| $5-$20bn | 24.6% |
| $20-$50bn | 13.6% |
| > $50bn | 41.4% |

### Sector Breakdown




‡ The Fund's price to earnings ratio (12 month trailing) is elevated this month due to a number of outliers in the portfolio. Locaweb has P/E ratio of 806.8x, due to weaker reported earnings through 2020. We believe the future prospects for these stocks now look significantly brighter and we expect their P/E multiples to normalise as earnings revert. The Fund P/E excluding this outlier is 43.4x.

* Source: Maitland Institutional Services Limited & MSCI. The Fund inception date is 30th March 2010 ⁺ The Index is the MSCI Emerging Markets Index with Net Dividends Reinvested.

July was a month of consolidation for emerging market equities. The Dividend Growth Fund fell by 5.64% in GBP terms though performed well compared to the MSCI Emerging Markets Index which fell 7.33%

China dominated global financial events, as official reports emerged on July 23rd about Beijing's plan to force companies offering after-school tutoring to become non-profit organisations. This followed on from an announcement in early June that ride-hailing company Didi was under investigation for cyber-security issues, just two days after it listed in New York. We have seen a concerted escalation in regulation coming from China this year, with breadth across areas including property (in an attempt to discourage speculation), pharmaceuticals (price limits and directing sensible research), data, finance, employment protection, internet names, potentially commodity pricing and now education. While the direction of regulation is merely a continuation of existing policies (often reflecting concerns that are being raised globally), there were two factors that we believe elevate the risks to Chinese equity investments. The first is the broad policy to promote 'common prosperity' from economic activity. The all-encompassing nature of such a policy is far greater than we have seen to date and heightens ongoing concerns that any profitable entity may fall under Beijing's scrutiny, as we have just seen with the education companies. Combined with the disregard recently paid to minority shareholders of both Didi and the education companies, this raises the concern that we are left with greater risks in China.

While this does not derail our thesis for Chinese equities, it magnifies the need to focus on areas that will benefit from government policy rather than those which may suffer from them. Fortunately this is already the position in the Dividend Growth Fund. We have not held any of the mega cap internet names apart from Tencent, nor the education names that have been recently hit. One of the main assessments made when we recently invested in Wuxi Apptech was the potential impact of an increasingly regulatory environment, and although the company did sell off in the midst of the panic it recovered swiftly.

Overall we see recent events as providing opportunities in China, but within a limited pool. We bought two new companies in the month as equities sold off: Hong Kong Exchange and Beijing Kingsoft, and we added to our existing holding in CSPC. This took our overall China exposure to almost 19% at the end of the month. While this marks a significant shift from 11% at the start of the year, we are still underweight the index where Chinese equities account for over a third of the total.

For the two companies that we bought in China, both clearly reflect the key attributes that we look for in companies: a long growth runway; deep and durable moats to protect this; sustainable longer term growth; and dividends which we forecast will grow over time. Hong Kong Exchange and Clearing has a monopoly in Hong Kong and we believe that its position as a financial gateway to China for international capital is most likely an advantage in the current regime. As both China and the United States place greater pressures on internationally listed Chinese companies, the preference for Hong Kong listings (compared to other international alternatives) will probably rise. The company pays a reasonable dividend which has doubled over the past decade, and its strong future pipeline of IPO's and secondary listings give us confidence that this will continue. Beijing Kingsoft Enterprises is a software company providing, amongst other things, a successful Chinese alternative to the Microsoft Office suite. The Chinese government is actively promoting the company to provide a domestic alternative to such products, which has resulted in 94% market share in central government procurement. This advantage continues to be bolstered by the companies high R&D spending (more than 30% of sales), and the networking effect of a large user base is a key advantage against any competitive threat. With an unlevered balance sheet and strong free cashflow all future growth should lead to further growth in dividends which have recently doubled. The company sold off in the recent China rout and we bought it almost a third below its recent highs. Our belief is that as the company accounts for a relatively low proportion of its customers overall investment, and as it effectively substitutes for an imported alternative, it is unlikely to be caught up in a broadening of Chinese regulation. The recent turmoil provided a good opportunity for the investment, we purchased the stock 35% below its January peak (in USD terms).

Elsewhere we continue to see emerging market data supporting a recovery, often better than expected, and one which continues to benefit our positioning. Most recently Russia raised its interest rate by 1%, the biggest move in six years, as it counteracts rising prices in an economy recovering faster than expected. These positive forces are being offset in some degree by the increase in Covid-19 cases in some parts of the world. China's recent infection rates are leading to ongoing lockdowns, which continue to disrupt supply chains across South East Asia. Overall, however, it seems that either by vaccination, aided by the weather, or through high infection rates in some countries, the forward looking environment continues to improve. A recent Indian government survey estimated that two-thirds of the population have Covid-19 antibodies, which raises the potential that the worst of the pandemic might be over despite having vaccinated only a quarter with a single dose and just 6.5% of the population fully.

This was where we made the other purchase for the portfolio, adding a position in IndiaMart Intermesh, the country's largest B2B online marketplace, founded in 1996. Its experience gives the company 20 years of consumer data, and it estimates that for a competitor to gather a similar number of sellers (6.5 million sellers and 70 million products) on a single platform would take at least 3 years, giving significant protection to their current model. Penetration of SME's in India is only 19%, which gives high potential increase in users, and as leader with 60% of online classifieds IndiaMart is best placed to capture that growth. Subscribers are only 2% of current total users and converting those to fee-paying customers provides further potential. The combination of low penetration and an already significant base (120 million buyers use the platform) give us confidence that the growth will continue, bolstered by increasing use of software services due to the inherent complexities of Indian regulatory regimes (such as tax) that these companies need to navigate. The company already pays dividends and is a beneficiary of operating leverage, itself leading to strong margin growth in recent years, and ultimately free cashflow to further grow dividends. A recent fall of more than 30% seemed to mark an attractive entry point for the company.

While we have referred to recent Chinese events, they were a positive for the Fund in terms of relative performance. We remain underweight China and while July amplified the risks there, we continue to look for opportunities that arise around the region and we do not think regulatory risks remove China from such opportunities. Our overall outlook remains the same, that global economies continue to recover and our investments are well paced to benefit from that recovery. Any purchases during the month were funded by reducing some of the larger positions (often due to strong performance) as we continue to diversify risk.

***Mark Williams and Kumar Pandit***

| Fees |
|---|
| 0.90% AMC |

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| Share Class Information | | |
|---|---|---|
| | **Accumulation** | **Income** |
| GBP Sedol | B4Q0711 | B4QKMK5 |
| GBP ISIN | GB00B4Q07115 | GB00B4QKMK51 |
| EUR Sedol | B3R0FQ4 | B56S7H8 |
| EUR ISIN | GB00B3R0FQ48 | GB00B56S7H80 |
| USD Sedol | B4PV5H7 | B4P9CN6 |
| USD ISIN | GB00B4PV5H71 | GB00B4P9CN62 |

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