SOMERSET CAPITAL MANAGEMENT LLP

31 August 2021

MI Somerset Emerging Markets Discovery Fund OEIC

Investment Adviser's Monthly Report

Mark Asquith
Partner & Co-Manager

Christopher White
Partner & Co-Manager

Fund Performance GBP (%) Net	Fund	Index⁺	+/-
1 Month	1.29%	3.42%	**-2.13%**
3 Months	-1.73%	4.45%	**-6.18%**
YTD	6.55%	14.93%	**-8.38%**
Since Inception*	8.52%	31.46%	**-22.94%**
2020	0.95%	10.79%	**-9.83%**
2019*	0.89%	3.25%	**-2.36%**

Fund Objectives

The Somerset EM Discovery Fund seeks to achieve capital appreciation by investing in a concentrated portfolio of <50 emerging market stocks with a market cap between $250m to $7.5bn. Co-managers Mark Asquith and Christopher White follow a bottom-up, research intensive process where long-term profitability and value are paramount. In addition, company risk profiles are assessed using Somerset's independent criteria around environmental, social and governance risk and we actively engage with companies on material issues. Mark and Christopher are supported by Somerset's team of fund managers and analysts based in London and Singapore.

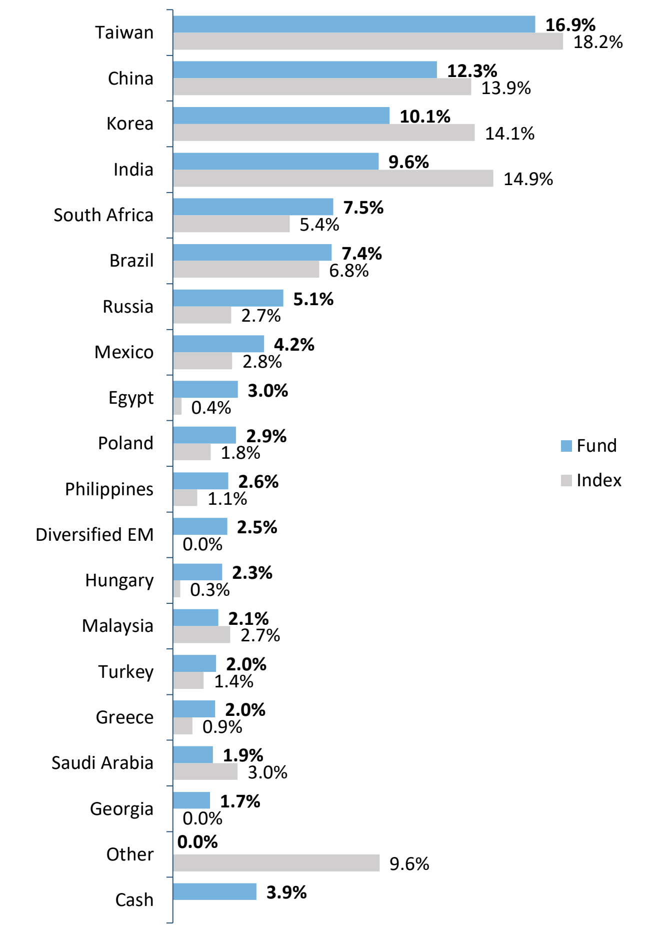
Top 10 Holdings	Country	NAV %
ASPEED Technology Inc	Taiwan	4.0%
Advantech Co Ltd	Taiwan	3.7%
LEENO Industrial Inc	Korea	3.6%
Shriram Transport Finance	India	3.1%
Commercial International Bank	Egypt	3.0%
HeadHunter Group PLC	Russia	3.0%
Dino Polska SA	Poland	2.9%
China Overseas Property Holdings	China	2.9%
Koh Young Technology Inc	Korea	2.8%
Nien Made Enterprise Co	Taiwan	2.8%

Assets Under Management	
Somerset Capital Management LLP	$7,161 m
Small Mid Cap EM All Country Strategy	$677 m
MI Somerset EM Discovery Fund	£11 m

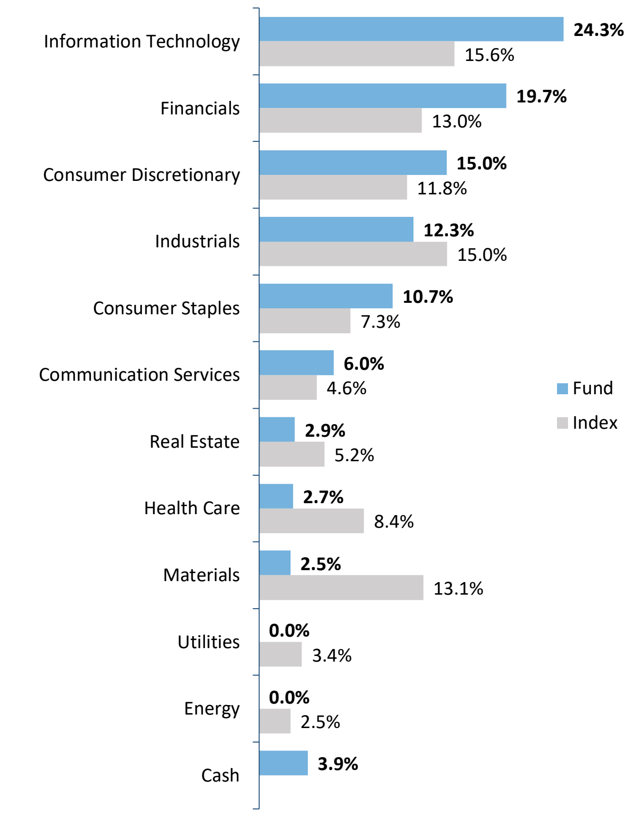
Market Cap Breakdown	Fund
< $1bn	9.7%
$1-$2.5bn	18.9%
$2.5-$7.5bn	44.5%
> $7.5bn	23.0%

Portfolio Data	
P/E (Historical)	37.4x
Dividend Yield (%)	1.40%
Wgt Ave Mkt Cap ($m)	4,890
No. of Stocks	45

Country Breakdown



Sector Breakdown



* Source: MSCI. Inception Date is 30th October 2019. ⁺ The index is the MSCI EM Small Mid Cap Index with Net Dividends Reinvested. Index data is sourced directly from MSCI.

The fund returned 1.29% in August compared to 3.42% from the MSCI Emerging Markets Small Mid Cap benchmark. Small Mid Cap stocks modestly underperformed large cap stocks over the month but have handsomely outperformed this year to date. Despite this, the valuation of SMID stocks remains at a discount to large caps in EM (e.g. 6.5% discount on Bloomberg consensus 2021 P/E, 18.5% discount on price/EBITDA) whereas historically they have traded at a premium.

The top contributors to the fund's return over the month were Converge ICT and HeadHunter, which are both relatively recent additions (within the last 12 months). Converge ICT is rolling out high-speed broadband to the underserved Filipino population: demand is strong, penetration low and competition comes from the sclerotic incumbent telcos, which have poor service quality and have been slow off the mark in rolling out fibre. Converge ICT is still majority-owned and run by the husband-and-wife team that founded the company, supported by a highly incentivised management team. Profits are increasing rapidly (EBITDA +96% in 1H21) as the company rolls out its network and management is confident in years of strong growth ahead.

HeadHunter is the dominant online recruitment platform in Russia. The company is used by practically every large corporation in Russia, in many cases to fulfil the vast majority of hiring needs. Historically, HeadHunter has significantly undercharged these large customers relative to the value it is providing. The company is now gradually starting to adjust its pricing architecture. This is driving strong earnings growth: EPS more than doubled in the first half of 2021, admittedly from a low base last year. The company's long-term growth prospects remain good: there is still plenty of scope to increase pricing for large corporate customers and the number of SMEs using HeadHunter's platform continues to rise as businesses switch from using much more expensive offline solutions (recruitment agencies, internal HR); which still account for around 70% of recruitment spending in Russia. Valuations for both Converge and HeadHunter remain reasonable (c. 40x 2021 PE) given their high profitability and the strength of their long term-growth trajectories.

The largest individual detractor from performance over the month was NCSoft. The stock declined 20% in reaction to weaker than expected performance of its latest mobile game title called Blade & Soul 2 ("B&S2"). B&S2 was the 3rd major mobile title remake based on its rich collection of legacy MMORPG IPs after Lineage M ("LM") in 2017 and Lineage 2M ("L2M") in 2019. Given LM and L2M's dominance in Korea over the last 4 years (both ranked #1 and #2 in app store sales), where each title generated $700-800m of annual revenues respectively, market expectations for B&S2 were understandably high.

However, B&S2 got off to a slow start (initially #11 on Google Play) and is now expected to generate around $250-300m annual revenues, or 50% lower than initially expected. While it may seem high, the shortfall equates to just ~8% of 2022e consensus sales and ~6-7% of profits relative to NCSoft's overall revenues. Based on a 20x earnings multiple, the implied incremental impact would have been ~$800-900m vs. the actual $3.5B loss in market value, which we believe looks excessive.

We believe the strong negative market reaction was caused by several factors:

- First, disappointment from high B&S2 expectations which is a common reaction for all online gaming stocks. That said, despite B&S2's initial slow start, it has since climbed rapidly to #4 on Google Play which is encouraging.
- Second, rising competition concerns as Kakao Game's Odin recently overtook LM/L2M as the #1 game in Korea. While Odin has only been in service for 2 months, this was deemed significant given how long LM/L2M dominated the market. That said, the sustainability of Odin's lifecycle revenue generation still remains an unknown given its limited track record. To compare, LM and L2M had cumulatively generated revenues of $3.4B and $1.1B, respectively, since launch. Lastly, with recent rise in user discontent on certain "pay-to-win" monetization schemes, the company miscommunicated to users prior to B&S2's launch that users would enjoy a softer monetization intensity vs. LM/L2M. This turned out to be only partly true which led to poor initial sentiment (although this was quickly rectified with 2 software updates). While there are also market concerns on the sustainability of the "pay-to-win" monetization model in general, this seems premature given Odin itself is based on the exact same monetization model.

We believe the first two factors are largely temporary as NCSoft still has a strong pipeline of new games including Lineage W (end-2021) and Aion 2 (2022). Although the last factor is potentially more concerning given user fatigue to high monetization intensity could translate to weaker monetization for future games; our base case was never for the new titles to generate as much as LM/L2M and that the global launch for new games going forward should be able to offset the lower monetization with a wider user base.

Although the hit-driven nature of the game business will not change, we remain constructive on NCSoft given its proven multi-decade track-record of strong, original in-house game IP and sustainable game lifecycle management capability. Despite B&S2's weaker than expected performance, the title will not only generate a meaningful amount of incremental revenues, the growing number of launches in its overall portfolio means the potential earnings impact of each successive launch should be much lower than before. Meanwhile, valuations look undemanding at ~17x P/E ('22e) which is in-line with historic average levels.

We initiated one new position in the course of the month with the purchase of Park Systems, a Korean company that is the global technology leader in industrial atomic force microscopes. Atomic force microscopes are used for nanoscale microscopy: historically used for cutting edge applications by university researchers and national laboratories, the miniaturisation trend in advanced semiconductors and integrated circuit packaging has broadened the scope of applications. The proliferation of nanotechnology based industrial applications over the next decade will drive high growth and allow atomic force microscopes to take market share from optical and electron microscopes within the $6-7bn process control market.

Park Systems' advantages lie in its ability to satisfy its customers three main requirements: 1) measurement accuracy and precision; 2) process reliability and repeatability; and 3) speed and cost efficiency. Its superior technology manifests in its key customer relationships with at least 8 of the top 15 global semiconductor companies including TSMC and Intel. Its technology advantage was further validated in 2015 when it was selected by the leader R&D hub for semiconductor scaling, Interuniversity Microelectronics Centre (IMEC) over the other main player Bruker to be its Joint Development Project Partner. This relationship will continue until at least 2023.

Since 2015, interest from semiconductor companies has increased rapidly resulting in strong revenue growth at a 29% CAGR over three- and five-year periods and we expect this to continue. Financial risk is low as the balance sheet is in a net cash position and return on capital exceeds 20% and will improve further. The stock appears optically expensive at 81x trailing earnings but the forward multiples fall rapidly to the low 20s by 2023(E) given the high growth rate and margin improvement.

We funded this by trimming our large exposure to TCS which is now more expensive after a 190% rally in its shares so far this year.

Mark Asquith and Christopher White

Founder Fees Share Class
0.75% AMC (Currently Waived)
No Performance Fee

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Share Class Information		
	Accumulation	**Income**
GBP ISIN	GB00BK5SP702	GB00BKPJ1T76
EUR ISIN	GB00BKYC2W77	

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