EMERGING MARKETS SPOTLIGHT

JOHCM Global Emerging Markets Opportunities Fund

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- Technology companies face an extremely supportive operating environment
- The portfolio has significant exposure to this trend
- We retain a preference for investments that also have a catalyst that can unlock the potential in the company and its share price

Technology companies (broadly defined) generally face an extremely supportive operating environment at present, with the offline to online move hugely accelerated by Covid-19, coinciding with the rise of artificial intelligence and machine learning, all of it requiring massive investment in new hardware.

The portfolio has significant exposure to companies that are benefiting from these trends, but we retain a preference for investments that also have a catalyst that can unlock the potential in the company and its share price. This includes some of the largest holdings in the Fund.

Twin discounts

One of our largest aggregate portfolio positions is in the related companies of Naspers (a South African holding company), its subsidiary Prosus (a Dutch media conglomerate focused on the internet in emerging markets), and Prosus' largest investment, Tencent (one of the Chinese internet giants).

One of the oddities about the listings of these three is that Naspers trades at a discount to the market value of its shares in Prosus, and Prosus trades at a discount to the market value of its stake in Tencent (let alone the value of Tencent and Prosus' other listed and unlisted investments). Naspers has a market capitalisation of US$85bn (all data as at 31 October 2020 unless otherwise indicated). Almost the whole of Naspers' balance sheet consists of its 72.5% stake in Prosus. Prosus has a market capitalisation of US$162.7bn, making that 72.5% stake worth US$117.9bn. Various explanations exist for the gap, mostly around the gap in liquidity, index membership and investor market access between South Africa and the Netherlands.

Sitting behind that valuation anomaly is another, more complicated and potentially larger. Prosus owns 28% of listed Russian internet company Mail.ru, 22% of German-listed food delivery company Delivery Hero and 6% of US-listed Chinese online travel retailer Ctrip, these three holdings being worth US$7.7bn. Crucially, it also owns 30.9% of Chinese social media and gaming behemoth Tencent, that stake having a market value of US$225.8bn. Further, the long tail of unlisted emerging market online companies in classifieds, food delivery, payments, travel, education, and social media has a value, which, while harder to assess, is conservatively estimated at over US$20bn.

At the December 2019 capital markets day, Prosus management indicated a desire to create at least US$100bn in shareholder value over the medium term. As a step towards achieving that, in October 2020 Prosus announced a US$5bn buyback, consisting of US$1.37bn of Prosus shares and US$3.63bn of Naspers shares. This sits alongside a commitment to increase Prosus' free float by reducing Naspers' stake to below 70%. The really big step, however, would be Prosus selling some of its stake in Tencent in order to do further buybacks. Although there are no immediate indications that this is about to happen, it should be noted that the last such sale (in March 2018) followed a very strong share price run in Tencent, as we have seen year-to-date.

Through the twin discounts in the group's market capitalisations, there exists very substantial potential for gains to shareholders from proactive steps to buyback shares. We have seen a concrete step towards this in October and expect further steps in current months.

Reform in the chaebol sector

Another one of the portfolio's largest positions is Samsung Electronics (SEC) in South Korea. SEC is a multi-faceted conglomerate operating across various consumer electronics and information technology products. Using its last four quarters results as a guide, the largest division by revenues is IT & Mobile, which produced US$9.7bn of operating profits on US$85.4bn of revenues with a margin of 11.4%. The next largest (but most profitable) division is semiconductor products, which produced US$15.4bn of operating profits on US$59.8bn of revenues with a margin of 25.8%. There are also smaller units producing display products and consumer electronics; these together produced US$4.0bn in operating profits.

This operational profit translated into US$21.3bn of free cash flow for the period. SEC has a market capitalisation of US$297.8bn, but, crucially, its balance sheet is extremely cash-heavy. At the end of September 2020, SEC had US$105.2bn of cash and only US$17.5bn of debt. The company has tended to always grow organically, and does not use its cash for acquisitions, making this essentially surplus cash able to be returned to shareholders.

Since 2015, SEC has had a far more positive approach to dividends and share buybacks, currently operating a shareholder return policy of paying out KRW 9.6trn (US$8.7bn) in dividends each year, and seeking to returning a minimum of half of free cash flow over the three-year period 2018-2020 through dividends or share buybacks. The company was due to announce an update to this policy in the fourth quarter of 2020.

However, Samsung group chairman KH Lee passed away on 25 October 2020, having been unwell since a heart attack in 2014. Mr. Lee had led the Samsung Group since 1987 following the death of his father, the Samsung founder BC Lee, and he had transformed Samsung into a world-leader in multiple sectors, with SEC at the heart of the group.

Mr. Lee's son JY Lee has been acting chairman of SEC since 2014 and had driven the change in shareholder return policy. JY Lee is set to inherit stakes of major Samsung group companies, including SEC, and we expect SEC to continue to improve the shareholder return policy. The Lee family's control over SEC may decline as it sells down stakes in related group companies to meet inheritance tax obligations, while the Moon government's pressure on chaebol holding structures continues to increase. This is likely to increase the role of minority shareholders in major decisions at SEC, which should drive an improving shareholder return policy at SEC.

As a result, the announcement of the new shareholder return policy has been moved to late January. This will be a key moment for SEC. The buyback programme has been on hold since mid-2018 as a capital expenditure bulge meant that the KRW 9.6trn dividend payment commitment met the free cash flow return commitment. However, the last four quarters have seen free cashflow run at an annualised level of around KRW 25.6trn (US$21.6bn). This suggests that either the commitment to pay dividends increases, or the buyback programme resumes.

In conclusion, we certainly find many opportunities in the broader technology space, but prefer to focus our larger positions on ones with strong operating momentum and an additional potential driver of returns from restructuring and the unlocking of value. We are particularly excited about potential newsflow for these holdings in the next few months.

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5 year discrete performance (%)

Discrete 12 month performance (%):

	31.10.20	31.10.19	31.10.18	31.10.17	31.10.16
A USD Class	-8.01	12.12	2.56	16.05	4.20
Benchmark	5.66	13.65	-1.15	23.11	1.87
Relative return	-12.94	-1.34	3.75	-5.73	2.29

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg, NAV of Share Class A in USD, net income reinvested, net of fees as at 31 October 2020. The A USD Class was launched on 30 June 2011. Benchmark: MSCI Emerging Markets NR (12pm adjusted). Performance of other share classes may vary and is available on request.