DETRACTORS

SWIRE PACIFIC 'B'

Description Family-backed Holding Company	**Total return on position FY19 (local)**[2] -12.5%
% of portfolio[1] 3.7%	**Total return on position FY19 (GBP)** -7.7%
Discount -46.8%	**Contribution (GBP)**[3] -0.34%
% of investee company 2.1%	**ROI since date of initial purchase**[4] 4.3%

Swire Pacific was your Company's fifth-largest detractor, reducing NAV by -34bps, as unrest in Hong Kong had an impact on two major components of Swire Pacific: Swire Properties (73% of NAV) and Cathay Pacific (11%).

The performance of Swire Pacific 'B' shares can be split into two distinct periods. Pre- and post- the Hong Kong demonstrations, with the first recognised protest held on 9 June. Up until this point of the financial year, Swire Pacific performed well, with the 'B' share price up by +10% on an increasing NAV (+13%), with a widening of the discount from 43% to 44%. Swire Properties was benefiting from its asset rotation policy, funding the next phase of developments, plus the de-centralisation story in Hong Kong was a boon for their Island East portfolio. Cathay Pacific, two years into their transformation programme, posted improving 2018 results, with the belief that they would continue to benefit from the roll-off of fuel hedges and improving operations.

However, since the demonstrations started, the performance of Swire Pacific and its underlying holdings has more than wiped out[1] the gains from the opening eight months of the financial year. The 'B' shares' discount has widened to 47% on a falling NAV, down 11% over the financial year, a swing of -24% since the start of the demonstrations.

Cathay Pacific has been in the headlines with staff involved in demonstrations while its three most senior management, Chairman, CEO and COO, have been replaced. Air China has a 30% stake in Cathay Pacific and the Civil Aviation Administration of China were critical of Cathay's commitment to safety and security, which were probably factors in the changes. This appears to have appeased the Civil Aviation Administration of China. While appeasing the Chinese authorities reduces some pressure in the short term, companies are having to tread a fine line between being seen to side with China or the protestors. While Cathay Pacific has suffered from the specific issues mentioned above, the unrest has also led to a dramatic fall in visitor numbers to Hong Kong. Cathay Pacific reported passengers flying into Hong Kong fell by -38% in August, as overall tourist numbers fell to nearly half of the level that they were expected to be, while cargo volumes have also declined on the back of slowing global trade. Although the current situation is painful for Cathay Pacific, we believe that when the current issues are resolved, visitor numbers will bounce back quickly, with Cathay Pacific being a beneficiary of this as it is the flag carrier for Hong Kong.

Source / Swire Properties Ltd.
Photo credit / One Taikoo Place

SWIRE PACIFIC / SWIRE PROPERTIES

Swire Properties is 82% owned by Swire Pacific and is your Company's largest underlying exposure. Swire Properties owns a prime, mixed-use portfolio in Hong Kong, Tier 1 cities in China and Miami. It trades on a discount of c.49% to estimated NAV.

3.7%
% of portfolio

Swire Properties has been at the epicentre of the recent demonstrations, with its large Pacific Place mixed-use scheme located beside Admiralty, where the protests originally took place. Indeed, demonstrations led the centre to lose some trading time to closures. As mentioned earlier, tourist numbers are down significantly, reducing spend in their retail assets, but also impacting hotel occupancy, with Swire managing and leasing several hotels in Hong Kong. The extent of these problems will be revealed in results for the third quarter. Despite this, performance of their office portfolio continues, with CLSA renewing their lease at Pacific Place at levels rumoured to be above where we value the property. Other lease discussions for offices continue as normal as they benefit from the move away from Central to cheaper business districts, such as Island East, where Swire Properties has significant exposure.

The 'B' shares, which your Company owns, still ascribe an efficient-market-hypothesis-busting negative valuation to the ex-Swire Properties businesses. While this situation has now persisted for well over a year, it seems unlikely that the Swire family will let this persist indefinitely, with almost half of their economic holding in Swire Pacific being through the 'B' shares.

1 For definitions, see Glossary on pages 89 to 92.
2 Weighted returns adjusted for buys and sells over the year.
3 Figure is an estimate by the managers and sum of contributions will not equal quoted total return over the financial year.
4 Figure quoted in GBP terms. Refer to Glossary on pages 89 to 92 for further details.

DETRACTORS

JARDINE STRATEGIC

Description
Family-backed Holding Company

% of portfolio[1]
4.1%

Discount
-39.7%

% of investee company
0.2%

Total return on position FY19 (local)[2]
-13.8%

Total return on position FY19 (GBP)
-9.5%

Contribution (GBP)[3]
-0.54%

ROI since date of initial purchase[4]
-3.6%

Jardine Strategic was our fourth worst performer, reducing NAV by -54bps over the year as the share price fell by -18%. The share price decline outstripped the -11% decline in NAV, and we saw the discount widen to 40%. Jardine is facing a multitude of headwinds, similar to Swire Pacific, but not all down to the demonstrations in Hong Kong. With 23% of NAV in Hongkong Land, it was an obvious detractor from performance (reducing NAV by c.8% since the protests started), as falling tourist numbers impacted retail sales along with a slowdown in Central Hong Kong rental growth as Chinese demand waned (this was likely occurring before the current demonstrations). We have also seen weakness from Jardine Cycle & Carriage (23% of NAV), Astra (82% of Cycle & Carriage's NAV) and Mandarin Oriental (5% of NAV). Similarly to Swire Pacific, performance was satisfactory until the demonstrations in Hong Kong started but deteriorated after, partly due to Hong Kong but also as a result of global growth concerns.

Jardine Cycle & Carriage and Astra are suffering from a South East Asian slowdown as commodity prices impact numerous divisions directly (mining and heavy equipment) but also second derivatives of these economies such as auto sales. While Astra has improved market share, auto sales in Indonesia have been weak, while increased competition has impacted margins.

Mandarin Oriental is an interesting case. Performance has been terrible, with the share price down by -24% this calendar year. With nearly 50% of earnings and NAV coming from the Excelsior hotel in Hong Kong, we see earnings pressure as the Excelsior closed in March, although this was flagged well in advance to the market. However, on a NAV basis, we see reason to be optimistic given the potential for outsized gains when the development of the Excelsior site into a commercial property is completed. Valuing a potential development at a 7% capitalisation rate means that this property alone would be worth more than the current market capitalisation of Mandarin Oriental, giving some sense of how cheap it is at present.

Short-term numbers coming through are suggesting that Hong Kong tourist numbers are down by as much as 50% and hotel occupancy down from a normalised 80% to c.50%. We are likely to see pain in reporting numbers of Hong Kong-focused stocks (Hongkong Land and Dairy Farm), while margin pressure on Jardine Cycle & Carriage's auto exposure is unlikely to ease in the short term until new models are released. However, the Jardine Group is now rich with cash, with Jardine Strategic sitting on USD1.5bn and Jardine Matheson USD1.3bn after the sale of Jardine Lloyd Thomson earlier this year. This gives them the firepower to take advantage of any weakness in their underlying holdings. With Jardine Strategic trading at the wider end of its discount range (40%) and their holdings in the main trading at discounts to their long-term multiples, we believe that much bad news has been priced in and will watch carefully to see where the company decides to deploy its cash reserves.

TOKYO BROADCASTING SYSTEM

Description
Asset-backed Company

% of portfolio[1]
3.2%

Discount
-48.6%

% of investee company
1.4%

Total return on position FY19 (local)[2]
-21.9%

Total return on position FY19 (GBP)
-14.3%

Contribution (GBP)[3]
-0.72%

ROI since date of initial purchase[4]
-3.2%

Tokyo Broadcasting Systems ('TBS') was our third largest detractor this year, reducing returns by 72bps. TBS' share price fell by -26% which, coupled with NAV growth of +2%, resulted in a substantial widening of the discount from 30% to 49%. Key holdings Tokyo Electron (25% of NAV) and Recruit Holdings (19%) had mixed fortunes, returning +36% and -13% respectively.

TBS announced its full-year results in mid-May. Management gave a weak outlook for the 2020 profitability due to reorganisation costs and the beginning of 4K broadcasting, announced a dividend payout ratio of only 23% (well below the company's stated 30% policy), and gave no further strategy for reducing cross-shareholdings. Investors had previously been hopeful for the prospects of a strategic change in policy, following a Citibank research note in February which explicitly mentioned the possibility of a large-scale sale of securities and greater shareholder returns through buybacks and dividends. The market reaction was distinctly negative, with the stock falling by -15% on the day of the announcement.

Further disappointment came when TBS declined to take part in either Tokyo Electron's buyback or a block offering of Recruit shares. We were disappointed by this as both represented opportunities to reduce the extraordinarily large allocation in TBS' NAV.

Against this, there are some grounds for optimism: in March, TBS sold down around 8% of one of its largest holdings, Tokyo Electron, introduced stock-based compensation for directors and saw a 3% reduction in key allegiant shareholder stakes.

Despite a difficult year, we believe that the investment case for TBS remains strong. It has excess cash, listed securities and prime Tokyo real estate which cover its market capitalisation almost two times over. TBS is, in effect, an asset manager with a small broadcasting business. Whilst thus far TBS has been ambiguous in its intentions for these assets, we believe that if it were to announce a clearly defined strategic policy to reduce its over-capitalised balance sheet, the market would reward the company with a much higher share price. We remain in regular dialogue with TBS's board of directors in order to produce a satisfactory outcome for all stakeholders. We added to our position on share price weakness during the year.

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