Asia Pacific UCITS Fund Commentary 4Q21

Longleaf Partners Funds

For Professional Investors Only

Portfolio Returns at 31/12/21 – Net of Fees

	4Q21	1 Year	3 Year	5 Year	Since Inception 2/12/2014
APAC UCITS (Class I USD)	-5.48%	-14.70%	3.92%	3.99%	3.90%
MSCI AC Asia Pacific Index	-1.84%	-1.46%	12.08%	9.90%	7.11%
Relative Returns	-3.64%	-13.24%	-8.16%	-5.91%	-3.21%

Selected Indices*	4Q21	1 Year	3 Year	5 Year
Hang Seng Index (HKD)	-4.69%	-11.94%	-0.36%	4.50%
TOPIX Index (JPY)	-1.74%	12.75%	12.67%	8.00%
TOPIX Index (USD)	-4.93%	1.07%	11.10%	8.27%
MSCI Emerging Market (USD)	-1.31%	-2.54%	10.94%	9.88%

*Source: Bloomberg; Periods longer than one year are annualized

The Fund returned -5.48% in the fourth quarter and -14.7% for the year, trailing the MSCI AC Asia Pacific Index for the quarter and the year. As discussed in prior letters, the disappointing performance for the year stems primarily from our high exposure to Hong Kong (HK) and overseas listed China shares. The fourth quarter was weak as Covid lockdowns re-accelerated with the Delta variant's proliferation, and macro weakness slowed the Chinese economy. China's real GDP growth decelerated from 7.9% in Q2 to 4.9% in Q3, and policy-induced debt defaults in the Chinese real estate developer market hurt demand for residential property and overall consumer sentiment.

The Fund's overweight allocation to Hong Kong and China-listed businesses drove the overwhelming majority of the relative and absolute declines in the quarter and the year. Extreme investor anxiety from several rounds of regulations in the Chinese technology, education, real estate, and Macau gaming sectors, combined with the overall economic slowdown in China caused extreme volatility during the quarter, allowing us to add to some of our investments at highly attractive valuations.

Performance Review

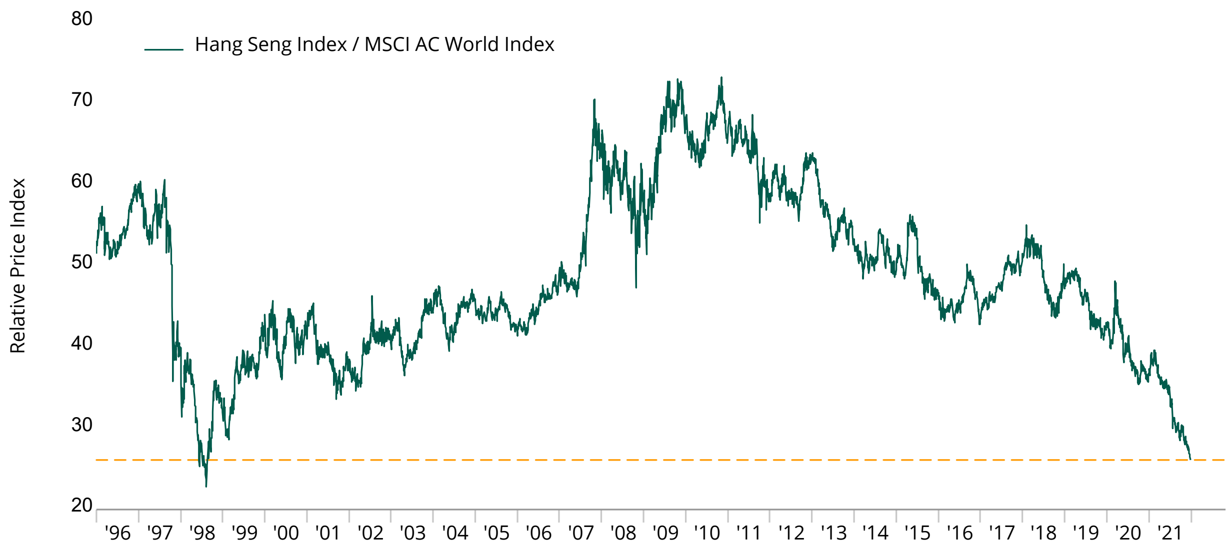
After a strong relative and absolute first half of the year, the portfolio gave up its initial gains in the second half, as China and Hong Kong were unduly punished in the face of macro pressures and regulatory uncertainty. The second half of the year developed very poorly for our "Covid re-opening" and "China regulatory crackdown is overblown" themed portfolio resulting in a negative 23% absolute return, while the index declined by 6.2% in the second half. The last six months of the year were marred by a second wave of the more transmissible Delta strain of Covid, which resulted in severe lockdowns across Asia. We also experienced continued regulatory assault on Big Tech in China, uncertainties in Macau gaming regulations, defaults by Chinese real estate developers on their US dollar bonds, and generally heightened skittishness among international investors for anything related to China.

The MSCI Zhong Hua (ZH) Index, a composite index comprising the MSCI China and Hong Kong indices, was down over 19% in 2021 and 5.7% in the fourth quarter. Overseas listed China ADRs were hit hard, with the MSCI Overseas China index down 38% in 2021 and 11.2% in December alone, exacerbated by year-end tax-loss selling. The ZH Index underperformed the MSCI EAFE, World, and S&P 500 by a stunning 30%, 41%, and 48%, respectively, in 2021, reflecting deep pessimism of investors towards China and the extremely strong performance of developed markets. The Hang Seng Index (HSI), where most of our Asian investments are listed, underperformed the MSCI World Index by about 34% last year and traded at the cheapest level relative to MSCI World since the Asian Financial Crisis in 1998. Trading at less than 10x forward earnings, and with a 3.2% dividend yield, the HSI offers investors an attractive combination of real yield and earnings growth in a low yield world.

Our investments made through the Hong Kong Stock Exchange and Stock Connect are even more compelling, with companies such as Gree Electric trading at less than 10x free cash flow (FCF) and offering a 7% dividend yield, or CK Hutchison trading at less than 6x earnings, and an almost 5% dividend yield. The overwhelming majority of our HK listed and Stock Connect companies including, Alibaba, Baidu, CK Asset, CK Hutchison, Gree Electric, L'Occitane, New World Development, Tencent, and WH Group, repurchased record amounts of shares last year, reflecting their compelling valuations.

Hang Seng Relative to MSCI AC World Index

The Hang Seng Index trades at cheapest level relative to world peers since 1998
1/1/1996 to 12/31/2021 (Local)



Source: FactSet

The S&P 500 Index generated 26% annual returns over the past three years, about 16 percentage points better than its 20-year average. In contrast, the ZH index underperformed its three and ten-year average annual returns by over 26 percentage points in 2021. The ZH index's 30.5% underperformance in 2021 vs. the EAFE index compares to an annualized underperformance of 0.6% over the past ten years. US Big Tech – Microsoft, Alphabet, and Apple – were the three largest contributors to the S&P 500 index's 2021 gains. On the other hand, Asian Big Tech – Alibaba, Tencent, and SoftBank – were three of the four largest detractors to the MSCI AC Asia Pacific's 2021 negative returns, driven primarily by increased tech regulation in China.

2021 has been an extraordinarily volatile year for capital markets in Greater China. US-China tensions, China property concerns, regulatory changes across the Chinese education and technology sectors, and Macau gaming license renewal uncertainty, on top of harsh Covid-induced border lockdowns, have contributed to extreme market volatility. The commentary from the 3Q letter detailing our interpretation of and response to these events remains relevant. We believe the worst is behind us regarding the uncertainty and fears from regulation in the tech sector, Macau gaming, and overseas-listed variable interest entities (VIEs).

The VIE structure has allowed Chinese companies to skirt a formal prohibition on foreign investment in internet services, but it has not been clear if policymakers would continue to tolerate these contractual arrangements. Concerns over the legality of VIE structures were put to rest when the China Securities Regulatory Commission (CSRC) officially extended oversight of offshore listing to Chinese firms with VIE structures in late December. This clarification removes an existential tail risk of the prospect that VIE structures would be deemed illegal, wiping out the value of foreign investors' holdings in such structures. According to the CSRC, "If complying with domestic laws and regulations, companies with VIE structure are eligible to list overseas after filing with the CSRC."[i]

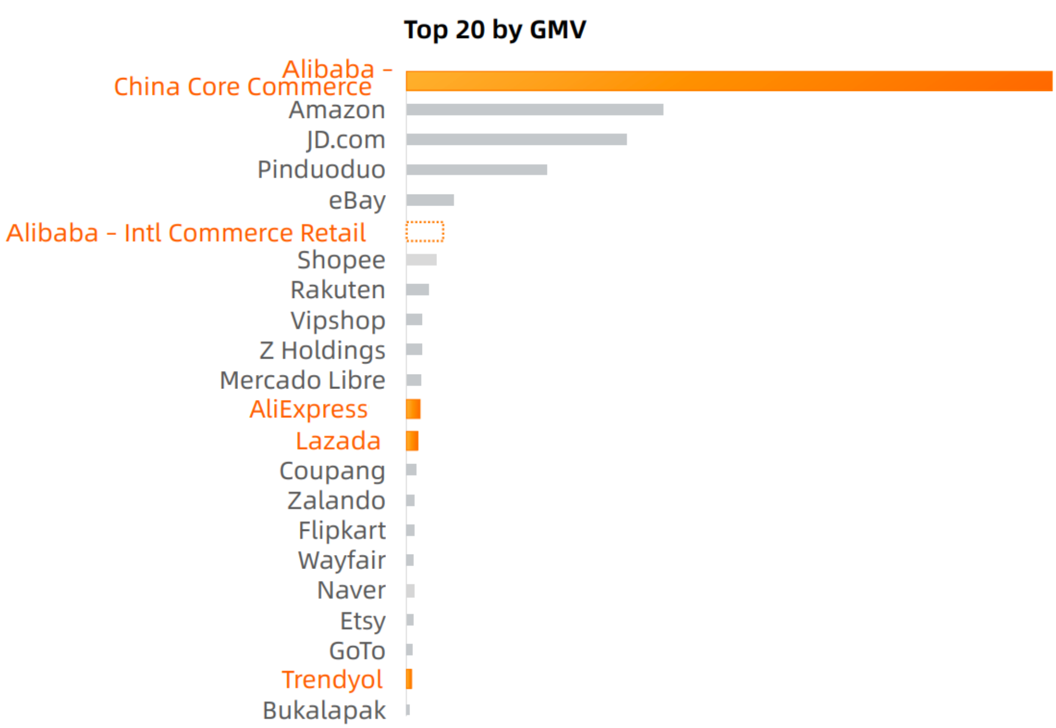
We also reduced our Chinese ADR de-listing risk by converting our holdings into HK-listed common stock where we could. JOYY, which doesn't have a HK listing, is not at high risk of being forced to de-list from the US, as it is a company headquartered in Singapore with almost all its business outside of China. After selling its Chinese live streaming business to Baidu last year (awaiting regulatory approval), JOYY poses no significant data security risk to China.

The Cyberspace Administration of China (CAC) has made itself the arbiter of new and expansive official concerns over data security in recent months. The CAC released final rules for cybersecurity review in January 2022, which is positive for HK listings. These rules give the CAC veto power over offshore listings with a broad definition of national security risk factors. While the CSRC's rules apply to all "overseas" listings, the CAC's rules only apply to firms listing "in foreign countries." The CAC rules exclude Hong Kong from automatic cybersecurity review, as Hong Kong is not considered a foreign country under China's "one country two systems" governance arrangement. This makes listing in Hong Kong even more attractive relative to the US, apart from impending US imposed de-listing of Chinese ADRs, which may occur as early as 2023.

China's policy backdrop − the key driver of underperformance last year − is starting to turn favorable. The annual Central Economic Work Conference (CEWC) was held in December to set economic priorities for 2022. The top priority for 2022 is stabilizing the economy, and officials should "be careful of introducing contractionary policies." While the CEWC still mentioned "preventing the barbaric growth of capital" and "setting traffic lights," massive regulatory tightening doesn't make sense in the face of demand contraction, supply shocks, and weakening expectations. We believe the likelihood of any further meaningful ramp-up in regulation on the real estate and tech sectors is low.[ii]

Government policy has shifted from structural reform to maintaining stability and economic growth. At the end of December, the Peoples Bank of China (PBOC) cut its benchmark lending rate for the first time in almost two years providing support to an economy showing strains from a property slump and sporadic coronavirus outbreaks and lockdowns. An earlier decision by the PBOC to lower banks' reserve requirement ratio came into effect in late December, freeing up 1.2 trillion yuan ($188 billion) worth of long-term funds. In January, China announced plans to relax its "Three Red Lines" policy by excluding debt accrued from acquiring distressed assets when calculating property developers' debt ratios. This will enable an orderly absorption of stranded projects, enable industry consolidation, and provide much-needed relief to the real estate sector.

Market concentration is a bigger problem in China than in the United States. The top three Chinese e-commerce players control 84% of the online market vs. 51% in the US, and Alibaba alone has a 56% share of the Chinese e-commerce market. In food delivery, the top three Chinese players have 98% share vs. 83% in the US, and Meituan alone has a 67% share. In China, Didi has a 90% share of the ride-hailing market, almost equivalent to Uber and Lyft's combined market share in the US. The sheer scale of Chinese operators' e-commerce dominance – particularly Alibaba – can be seen below. Alibaba alone represents about 18% of retail gross merchandise value (GMV) in China. Anti-trust regulators globally are breaking down walled gardens, forced exclusivity requirements imposed by platforms, and price discrimination (the practice of showing different prices for the same product or service according to the analysis of users' data). Considering the tech industry's very high market concentration and the digital economy's sizeable 38.6% share of China's GDP, the urgency of China's anti-trust activity is understandable.



Source: Alibaba, Global eCommerce Platform Ranking (Sep 2021) by GMV

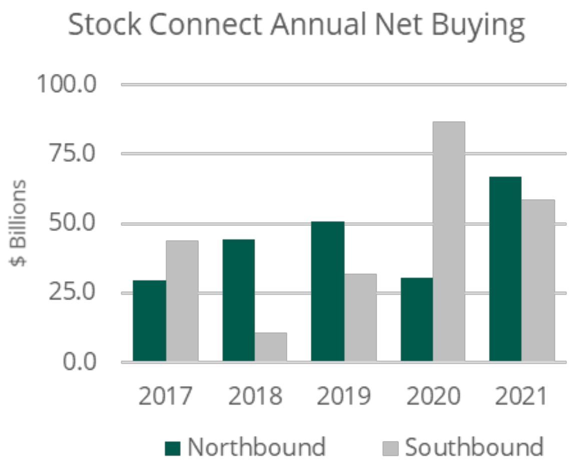
We think the worst of 'Big Tech' regulatory tightening is behind us. Anti-trust efforts will continue, but the biggest cases – Alibaba, Meituan, and Tencent – have been completed. The rules for cybersecurity review and listing overseas have also been released. The Chinese government's goal is not to diminish or nationalize 'Big Tech'; instead, it is to prevent the misuse of market power.

Fears over drastic regulation of gaming in Macau, including potential revocation of gambling licenses, subsided when the Macau government published its final report on the public consultation on the Macau license re-tendering on December 23. Although the report was merely a summary of public opinions gathered during the consultation period and not a final position by the government, it was positive in several respects. The majority of opinions supported at least six gaming concessions and disagreed with any distribution of profits requiring prior government approvals. While the industry remains depressed in the face of Covid-related lockdowns, Macau is poised to rebound quickly as pent-up demand is likely to fuel a rapid return when borders ultimately re-open.

Our HK, Macau, and other Chinese investments were affected to varying degrees by a resurgence of Covid-related lockdowns in the second half, as the Chinese government increased efforts to contain the Delta variant. Omicron's higher transmissibility will make it more difficult for China to maintain its "zero-Covid" strategy, exacting a greater toll on the economy, which is reflected in share prices. As Macau and HK conform to Beijing's zero-Covid strategy, their borders with each other should open faster, allowing more freedom of movement between HK, Macau, and Mainland China. This will benefit our investments in HK and Macau, particularly our investment in Melco and MGM China. The impact of further variants of Covid should decline over time as vaccination rates and immunity climb, while serious disease and death rates decline. The vaccination rate in China is approaching 90%, while Macau is at 70%, and HK is over 60%. Recently we have seen death and infection rates decoupling. Even though virus cases continue to surge, death rates are falling, and hospitalization rates are highest among the unvaccinated. With its zero-Covid strategy, even China will have to live with Covid being endemic (especially when mortality rates are very low), just like the common cold or flu, and balance lives with livelihoods.

Is Greater China Investable?

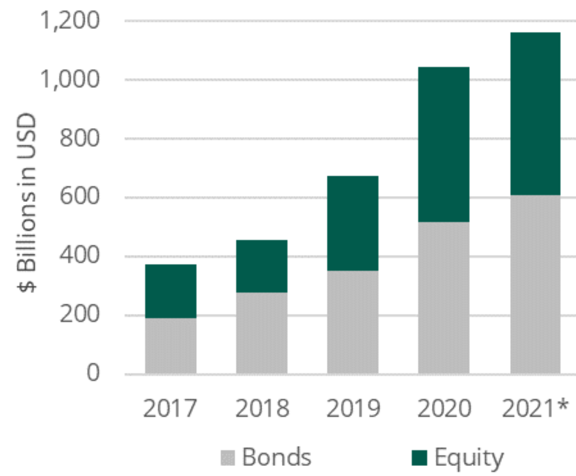
Chinese equities are attracting both local and foreign investors



Source: Bloomberg

Global Exposure to Chinese Securities

Value of renminbi-denominated stocks and bond held by foreign investors exceeds US$1 trillion



Source: PBoC

* As of 9/30/21 (most recent Data); Exchange rate = $0.15

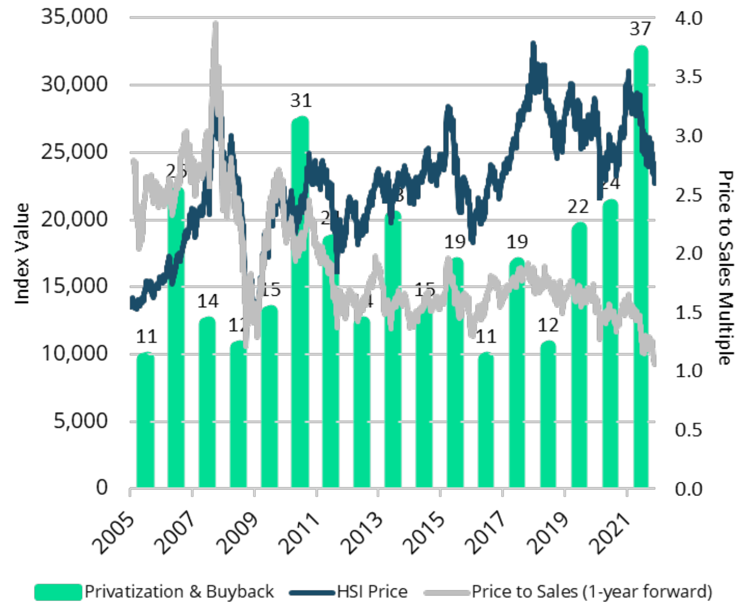
After a disappointing 2021 in the Chinese capital markets, many investors question whether China is investable. Yet, foreign money continues to flow into mainland China. In fact, foreign investment into the Chinese capital markets hit a record high in 2021, as did foreign direct investment into Chinese industry. The KraneShares CSI China Internet Fund ETF (KWEB), which tracks the CSI Overseas China Internet Index, was down 49% in 2021. Yet, a record $7 billion flowed into the KWEB ETF last year, 11x more than the previous year's $646 million inflow.

This is a testament to China's attractiveness to global investors and their long-term confidence in the Chinese economy. It is also a reflection of the search for yield and returns, as prospective returns in the US look meager, with the S&P 500 trading at 23x earnings and US 10 year Treasury yielding 1.6% -- or 62x FCF. With the Hang Seng China Index offering double-digit earning yields, and Chinese government bonds offering positive real yields, foreign capital continues to flow into the Chinese capital markets. China has shown no signs of limiting foreign investment in Chinese equities listed in Hong Kong and the Mainland. While foreign investors have been dumping offshore stocks, they are buying A-shares, and Chinese RMB bonds, with Stock Connect inflows rising to record levels. Mainland investors were net buyers of Hong Kong shares in the fourth quarter, taking advantage of the substantial disconnect between price and value.

While relative and absolute valuations make the region broadly attractive, as long-term, bottom-up fundamental investors, "cheap" is never enough for us. One of the most compelling qualitative cases for the "investability" of China and Hong Kong today is the high level of insider purchase activity across the region and especially within our portfolio companies.

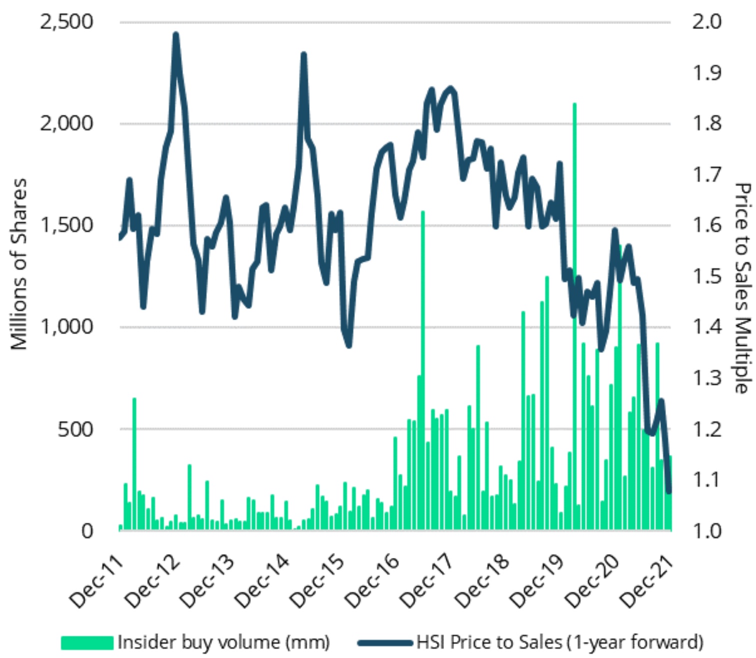
It is well known that insider buying is a strong indicator of a stock's attractiveness. Purchases made by US executives outperformed the S&P 500 over the ensuing 12 months by an average of five percentage points between 2015 and 2020, according to a TipRanks analysis. We firmly believe that insiders possess superior information to minority investors. Their trading activity conveys essential signals to the market, especially in areas like China, with less transparency and higher volatility. At a time of elevated uncertainty and investor panic, it's always reassuring to see what insiders — who have better access to information and policymakers than outside shareholders — are doing with their money. Insiders in Hong Kong are taking advantage of the dislocation in prices by buying significant amounts of their own companies. The number of applications to the Hong Kong Securities and Futures Commission for privatization and buybacks has increased significantly as market valuations became more attractive. In the last two months of the year, there was

Applications for Privatization and Buyback



Source: Hong Kong Securities and Futures Commission; Bloomberg

Insider Buying vs. Hang Seng Price/Sales



Source: 2iQ Research; Bloomberg

over 3x more insider buying than selling volume on the Hong Kong stock exchange, surpassing the levels seen in February 2020, when Covid fears rocked markets across the globe. The high level of insider buying, the spike in net buying of HK listed Chinese company shares by Mainland investors in the fourth quarter, and the vast underperformance of HK relative to other markets, give us significant confidence in prospective returns from our HK/Chinese investments.

Active insider buying in HK contrasts sharply with record levels of insider selling in the US, reflecting the high valuations of the US capital markets. While large insider sales have been well-publicized at market darlings like Tesla, Meta Platforms (Facebook), Google, and Microsoft, the trend is across the board. According to InsiderScore, insiders at US-listed companies sold $165 billion of stock in 2021, 2.4x the average since 2008. In 2021, US insiders sold 23x more than they bought. In Hong Kong, we saw record levels of insider buying in the last two years alone.

Outlook

The Fund is fully invested with a substantial list of on-deck opportunities. Despite recent underperformance, the high level of insider buying by locals, unprecedented levels of share repurchases and shareholder distributions, the vast underperformance of Hong Kong relative to other markets, and the strong fundamentals of our high-quality businesses and aligned management partners give us significant confidence in the prospects of our Asian investments. Your portfolio managers have also added personal capital to the strategy in the last two quarters. We are confident that this year's detractors are poised to be strong drivers of absolute and relative outperformance from today's depressed levels.

S&P 500 P/E minus Hang Seng Index P/E

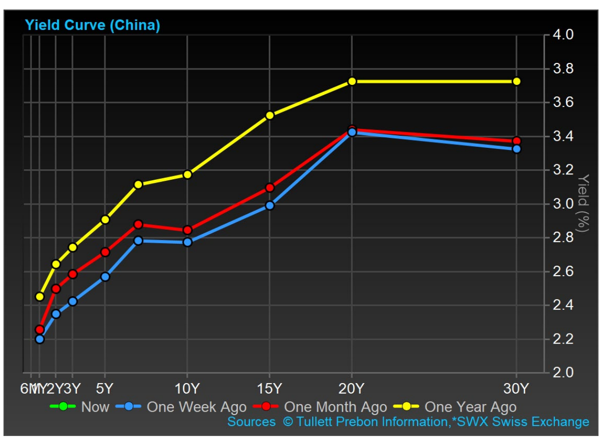
Difference in P/E Ratio Next Twelve Months (1/1/2003 to 12/31/2021) in Local Currency

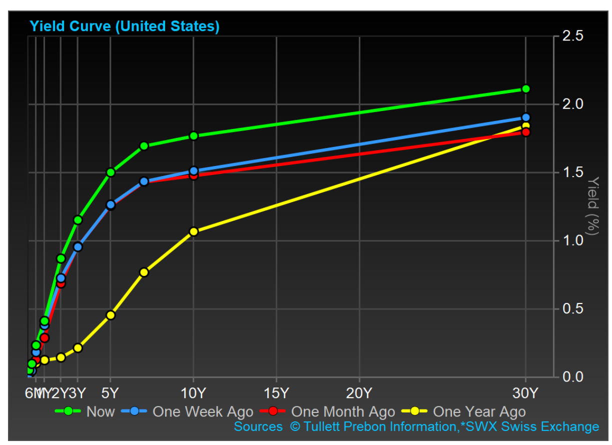
Source: FactSet

We believe the market trend of paying ever-higher multiples for revenue growth at the expense of profitability and reasonable multiples has led to a once-every-few-decades divergence in our portfolio vs. the index. This is most obvious in US markets, with valuations at elevated levels on nearly any metric. We believe that the US-dollar-led, Federal Reserve-enabled, growth stock-leveraged, meme stock fueled, speculative binge has peaked. Monetary policy is now changing course, with the US Federal Reserve tapering bond purchases, and signaling multiple rate hikes in 2022. Tech stocks are no longer outperforming, and the SPAC craze has fizzled.

China is heading in the opposite direction. After severe regulatory tightening in several industries in 2021, a zero-Covid strategy with numerous city-wide lockdowns, and a lack of fiscal or monetary stimulus, policymakers have begun easing and providing support to sectors that have been hit hard, particularly in the real estate sector. Policy easing measures, such as increasing bank credit to China's battered property sector, will positively affect consumption, confidence, and equity markets. The regulatory crackdown has subsided, and clarity has been provided for overseas investors fearful of VIEs, data security, and ADR de-listing risk.

Just as interest rates increasing from record lows in the US is a headwind for long-duration US equities and fixed income, Chinese interest rates' decreasing is a tailwind for the Chinese capital markets.





We are confident that our concentrated portfolio comprising strong businesses, run by owner-operators, currently trading at a highly attractive price-to-value ratio will deliver significant outperformance in the years ahead.

New Investment

We initiated an investment in Redbubble during the third quarter. Redbubble operates a print-on-demand marketplace under the Redbubble.com and TeePublic.com brands that connects independent artists with customers. While headquartered in Australia, the company sells more than 90% of its merchandise internationally, with North America accounting for about 70% of the gross transaction value (GTV). The company operates through a broad network of fulfillers who produce and distribute the final product to consumers. Redbubble has 728,000 artists with over 1 billion items on the marketplace, selling to about 9.5 million unique customers, which is growing fast. The business has a massive runway for growth. Redbubble's selling artist community grew 7.6x from FY2015 to FY2021, while its customer base grew 6.6x. Artists can upload their artworks on the platform, and customers can search and purchase various products that have the artwork printed on them. The beauty of Redbubble's business model is that the company holds no inventory. When a customer orders the product (Redbubble receives cash upon sale), the order is automatically sent to the closest fulfiller who manufactures the product and directly ships it to the customer, while paying artists about two weeks later and fulfillers about four weeks later. This negative working capital provides funding to fuel growth on top of its A$99 million net cash position. Redbubble's unit economics are attractive: For example, out of every $100 in GTV, $15 is paid to the artists, $44 is paid to fulfillers, and Redbubble keeps the remaining $29 after payment of processing fees and taxes. If you view Redbubble's business as a take rate business like a 3P retailer, Redbubble's effective take rate is 29%, which is very high and indicates the platform's value to artists.

Its business model is underpinned by a marketplace flywheel (network effect) whereby the more artists you have, the more artwork and unique content you have, which attracts more customers. If you have more customers, you will build better fulfillment networks and attract more artists onto the platform. The network effect continuously strengthens its moat against the competition. With increasing volume, Redbubble will have stronger bargaining power with the fulfillers. As you get bigger, you provide more value to customers and accrue more resources to improve the product. Once you have a strong network effect, entering or replicating the marketplace business becomes increasingly difficult.

Redbubble's stock price has been very volatile. This high volatility indicates that many market participants struggle with valuing the business in the post-Covid era. However, each time we talk to the new CEO Michael Ilczynski and hear him discuss his medium to long-term strategy, we are more convinced about the prospects of the business. The market's biggest concern seems to be the near-term EBITDA margin expectation, which is in the mid-single-digit range due to increased investments (mostly headcount in product and engineering and data analytics). The market is also worried that Redbubble – a pandemic winner – will be a re-opening loser. While short-term comparables vs. last year's Covid fueled year may be challenging, we are confident that Redbubble will continue to grow rapidly in the mid to long term.

Portfolio Review

We added to our China and Macau exposure buying highly discounted securities as panic, fear, and opportunity increased. While we continue to hold Prosus, we added Tencent directly to the portfolio in the third quarter, and further expanded our exposure to existing China tech names Alibaba, JOYY, and Tongcheng Travel throughout the year. We also added to Gree Electric and China Lesso, which were affected by weak home sales, a fragile real estate industry, macro concerns, and higher commodity input prices. We trimmed our Japan and India investments as they appreciated and reallocated the proceeds to fund our increased China investments.

4Q21		
	Contribution to Portfolio Return (%)	Total Return (%)
Top Five		
L'Occitane	+1.07	+22
CK Asset	+0.43	+9
Jollibee	+0.37	+5
Prosus	+0.13	+5
New World Development	+0.11	+2
Bottom Five		
Tongcheng	-1.31	-24
H&H International	-0.80	-34
Redbubble	-0.75	-25
JOYY	-0.70	-16
Alibaba	-0.66	-16

2021		
	Contribution to Portfolio Return (%)	Total Return (%)
Top Five		
L'Occitane	+2.19	+65
Hitachi	+1.04	+40
CK Asset	+0.77	+28
Trip.com	+0.69	+30
Richemont	+0.65	+25
Bottom Five		
MGM China	-2.94	-66
Alibaba	-2.51	-48
Melco International	-2.30	-38
JOYY	-2.08	-47
H&H International	-2.04	-55

L'Occitane International, the natural and organic-based beauty products company, was the top contributor for the quarter and the year. L'Occitane had a strong first-half performance in the six months ending in September, with revenues up 12.9% and like-for-like sales up 18.6%. Its first-half operating profit margin increased by a strong 6.1 percentage points to 11.3%, benefiting from operating leverage and efficiency gains, including from the Chapter 11 exercise in the US. Management indicated that Q4 sales were strong, with November Double 11 sales in China very strong. The company enjoyed 45% growth on Tmall during Double 11, and even higher growth on JD.com. Management upgraded its operating profit margin expectations for the year from 14%+ to 15%, and increased growth expectations from low-teens to low-to-mid-teens for the fiscal year ending March 2022. On the M&A front, the company acquired 83% of premium US body care maker Sol de Janeiro, known for its Bum Bum cream, the number one skincare SKU in Sephora North America, for an attractive $450 million enterprise value. Sol de Janeiro is a fast-growing brand that generates 21% EBITDA margins and grew revenues about 70% last year. With 83% of Sol de Janeiro's sales in North America, L'Occitane believes it can achieve significant synergies by plugging Sol de Janeiro into its global network to accelerate the growth of the business. Sol de Janeiro also gives L'Occitane access to a younger and dynamic customer base, namely Millennials and Gen Z, complementing L'Occitane's mostly older client base. We are optimistic about the elevation of HK-based Andre Hoffmann to CEO last September. We have followed Andre, who has been responsible for much of L'Occitane's success in Asia since its IPO in 2010, and have great respect for his business and capital allocation skills. We believe that his first significant capital allocation decision as CEO – the acquisition of Sol de Janeiro – is an intelligent shareholder-accretive use of capital.

Hitachi Limited, a Japanese conglomerate, was a top contributor for the year. This year, Hitachi has demonstrated a steady recovery, with profits surpassing pre-Covid levels. Its IT segment continued to deliver record-high earnings at a 10% operating profit margin. Hitachi Astemo, the auto part business, fell slightly behind expectations due to the global semiconductor shortage, and its recent discovery of inappropriate conduct (falsification of quality tests) put further pressure on this division. Hitachi remains confident about its prospects and has kept its 10% corporate operating margin target for the next financial year. In terms of M&A activity, the acquisition of GlobalLogic, a digital engineering company, will further expand Hitachi's Lumada IT business. The addition of Thales’ Ground Transportation Systems will strengthen Hitachi Rail's capability in signaling and train control systems. While Hitachi Metals' sale is delayed, Hitachi expects the divestiture to occur in the next fiscal year.

CK Asset (CKA), the Hong Kong and China real estate and global infrastructure company, was a top contributor for the quarter and year. In March, CKA offered to buy stakes in infrastructure assets from the founder's foundation via shares and structured a tender offer of shares to offset the dilution. After receiving feedback from various shareholders, CKA enlarged the tender offer size, which resulted in a net reduction in share count, and the transaction was completed in June. The net effect was that CKA bought infrastructure assets for HK$17 billion cash at about 8.3x EBITDA, which we viewed as fair, and repurchased a net HK$2.4 billion shares at HK$51 per share. The market was pleasantly surprised by CKA and the Li family buying more shares after closing the infrastructure acquisition. Since CKA is severely undervalued, this wasn't too surprising. In its most recent circular, an independent appraisal assessed CKA's NAV at over HK$130 per share, highlighting CKA's real estate portfolio value and the deep discount at which CKA currently trades. During the year, the company also initiated asset disposals to crystallize value. Other than selling Shanghai City Link in September to Hysan for RMB 3.5 billion, CKA reached an agreement in December to sell its entire aircraft leasing business above our appraisal, for HK$33 billion.

Trip.com, the largest online travel agency (OTA) in China, was a top contributor for the year. We initiated the position in 2019 when Trip.com's business was under pressure due to social unrest in Hong Kong, noise around forced de-listing of Chinese ADRs, and an overhang from Baidu selling its stake. We added to our investment in 2020 when Covid-related travel restrictions further impacted its international travel business (over 35% of the company's pre-Covid revenue). Despite revenue being down 49% YoY in 2020, the company still generated positive non-GAAP operating profit due to its asset-light business model and execution capability. The company is the dominant OTA player with a strong moat and brand value. It operates an 80% gross margin business, has a highly variable cost structure with minimal capital intensity, and enjoys a negative working capital cycle. During Covid, Trip.com further solidified its dominance and emerged even stronger. The expectation around travel recovery with the fast rollout of vaccinations and the ease of cross-border travel restrictions led to a sharp recovery in its stock price, and we exited our position in the first quarter as it reached our value.

Richemont, the Swiss luxury goods company, was a contributor for the year. Under the leadership of CEO and owner-operator Johann Rupert, Richemont has deftly navigated a volatile market over the last several years in the face of the Chinese crackdown on corruption and corporate giving, followed by political unrest in Hong Kong – one of the largest luxury watch markets – and most recently Covid. Against these challenges, management has always responded with a long-term value creative mindset, resulting in a stronger, more profitable, more dominant business. Richemont has been a relative Covid winner in the luxury goods space, as the most iconic brands that are less reliant on current advertising or trends remained top of mind throughout the lockdown environment and continued to gain share. Richemont's Cartier and Van Cleef & Arpels are two of the strongest brands in the market. Additionally, the benefits of value-accretive work behind the scenes have become highly visible this year in the reported results, with profitability at the jewelry maisons expanding to all-time highs, driving a step-up in free cash flow. Amid the macro pressures of the last several years, Richemont bought in the listed minority of Yoox Net-a-Porter (YNAP) in 2019, consolidating its losses, which optically made the group valuation look less attractive, but actually brought control of its increasingly important online distribution channels in-house. Given the power of the core Richemont brands and the structural drivers of branded jewelry and luxury goods more broadly, we continue to see strong growth prospects translating into mid-double digit EPS growth on a sustainable basis. We exited our position in the second quarter as it reached our value.

Health and Happiness (H&H), the HK-listed consumer goods company selling baby nutrition products, adult nutrition and supplements, and pet nutrition, was a detractor for the year. With

China's birth rate declining faster than expected in 2021, the drag from the baby nutrition business (BNC) offset the majority of incremental sales from adult nutrition business (ANC) and pet nutrition business (PNC). Furthermore, rising raw material costs and more intense competition in the infant formula business squeezed profits and the high base last year caused probiotics to decline in revenue. In the adult nutrition space, while H&H managed to turn around the ANZ operations, it has been temporarily impacted by channel shifts in China's cross-border e-commerce platforms towards emerging social media platforms like TikTok and the platforms holding less inventory. However, we believe that overall supplement demand remains healthy in China. Swisse's established adult nutrition brand awareness and good product portfolio should help it deliver double-digit topline growth in adult nutrition. For PNC, after setting up active sales in China last year, Solid Gold now enjoys growth from both the US and mainland China markets. The acquisition of Zesty Paws, completed in October, will further strengthen the pet portfolio and provide additional growth drivers.

JOYY, a global video-based social media platform, was a top detractor for the year. JOYY started the year with solid growth despite the high base in 2020. However, revenue momentum weakened in the second half as the relaxation of Covid restrictions reduced people's time at home and global macro uncertainty negatively impacted paying users' activities. Bigo Live users, on the other hand, consistently posted sequential growth throughout the year. More importantly, the company achieved positive non-GAAP net margins in Q3, helped by Likee's, a global short video creation and sharing platform, strategy adjustment from marketing investment to content development. This will make JOYY's future growth more sustainable. In February, the China YY Live business sale to Baidu was substantially completed; however, the transaction is still waiting for regulatory approval. While waiting and taking advantage of the share price opportunity, JOYY has already completed the prior US$300 million buyback program and announced a combined US$1.2 billion buyback program, which is equivalent to around 30% of the current market cap or over 40% of the free float. While we don't see any reason the YY Live deal should be blocked, if the deal doesn't go through, the current share price still presents sizable upside when we value YY Live at a discount to its transaction value.

Alibaba, the largest online retail platform in China, was a top detractor for the year. Alibaba reported weak quarterly results and downgraded its sales outlook for the current fiscal year to 20-23% growth, down from the original guidance of 29-32% growth. Macro headwinds, weak consumer sentiment, regulatory scrutiny and competitive forces are having a larger than expected impact on industry retail sales and Alibaba's market share. Notably, retail sales in China slowed to a meager 5% growth in the September quarter. Slowing consumption combined with stiff competition from new entrants in livestreaming e-commerce has resulted in a transitory deceleration in Alibaba's core e-commerce growth trajectory. The company is accelerating strategic investments in new initiatives, including Community Group Buying

(Taocaicai), Taobao Deals, Local Consumer Services, and International e-commerce. These are future growth drivers, but are depressing the company's earnings today. On the positive side, Alibaba's Cloud business continues to post strong growth (33% YoY), maintaining its market leadership. Alibaba's stock is currently trading at around 7x FCF, which is extremely attractive for a business that we expect will continue to compound at a low teens growth rate. In addition to investing in new growth areas and out-executing peers leveraging Alibaba's eco-system, we are glad to see the company taking multiple shareholder-friendly actions, including:

1. Share Repurchase: Alibaba increased its share buyback authorization from $10 billion to $15 billion and bought back over $5 billion in shares in the September quarter alone.

2. Organizational Changes: Key business units are being given more autonomy under a new leadership structure. This will lead to faster decision-making and could pave the way for external funding options (including spinoffs) for some of its key subsidiaries in coming quarters.

3. Better Disclosure: The company announced plans to increase transparency at the recent investor day by providing more relevant segment disclosures. Alibaba comprises multiple businesses at very different stages of maturity. Currently, the earnings of the core China e-commerce business are suppressed by investments in new initiatives, which are mostly expensed rather than capitalized on its balance sheet.

Melco International and MGM China, the Macau casino and resort operators, were top detractors for the year. Macau does not have a domestic market and heavily relies on cross-border tourism (primarily with mainland China), so the recovery is dependent on the border re-opening progress, which continues to get pushed back due to China's zero-Covid policy. In addition to the de-rating due to Covid, in September 2021, the Macau government announced its plans to kick off a 45-day public consultation period for amendments to the gaming law in preparation for the license renewal process for Macau casino operators. Licenses expire in June 2022, so this announcement was not a surprise. Yet, the sector took a beating as investors feared that Macau casinos were next on Beijing's hit list after crackdowns on the tech, for-profit education, and real estate sectors. The intensified scrutiny on VIP junket business culminating in the arrest of the founder of the largest junket operator, Suncity, further soured investor sentiment.

In our view, the license renewal process is moving forward as expected, and there is nothing we have seen in the results of public consultation document or government pronouncements that would warrant a material impact on the value. As for the VIP crackdown, this has been an ongoing theme since 2013 when Xi Jinping became the President of the People’s Republic of

China (PRC). Junket VIP represents a single digit % of Macau EBITDA and will not have a material impact on the earnings power of the industry. Our investments in Macau gaming operators are underwritten by growth prospects of mass-market demand. Mass-led recovery has been delayed due to severe border restrictions between China, HK, and Macau, and we are confident that when restrictions are eased, we will see earnings and stock price recovery. Our view is that "common prosperity" has already occurred in Macau. The six concessionaires provide 40% of their revenue in taxes to the government. The Macau gaming industry contributes 70-80% of the government's tax revenue, over 55% of GDP, and is the largest employer in Macau. Most Macanese are in a much better economic position due to the gaming industry. Post the sell down, we have seen insiders at two other local operators buying shares and Melco Resorts repurchase shares in the 2nd half, echoing our view that Macau shares are deeply undervalued and will be the major beneficiary of the re-opening.

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Endnotes:

[i] (http://www.csrc.gov.cn/csrc_en/c102030/c1662398/content.shtml)

[ii] (http://www.news.cn/politics/leaders/2021-12/10/c_1128152219.htm)