VGI PARTNERS
Asian Investments

VGI Partners
Asian Investments Limited
ABN 58 635 219 484
39 Phillip Street
Sydney NSW 2000 Australia
T. +61 2 9237 8923
www.vgipartners.com/lics/vg8

21 January 2021

ASX Market Announcements
ASX Limited
Exchange Centre
20 Bridge Street
Sydney NSW 2000

BY ELECTRONIC LODGEMENT

Investor Letter from VGI Partners Limited

VGI Partners Asian Investments Limited (ASX:VG8) is pleased to make available the enclosed Investor Letter prepared by VGI Partners Limited. The letter provides details on the performance of VG8 for the twelve months ended 31 December 2020 and commentary on current positioning.

Authorised for release by:

Ian Cameron
Company Secretary

For investor queries, please contact:

Ingrid Groer, CFA
Head of Investor Relations
VGI Partners Asian Investments Limited
Phone: 1800 571 917 (inside Australia)
+61 2 9237 8923 (outside Australia)
Email: investor.relations@vgipartners.com

VGI PARTNERS

21st January 2021

Investor Letter

"He who is prudent and lies in wait for an enemy who is not, will be victorious."

- Sun Tzu (Chinese general and author of the Art of War)

Dear Fellow Investors,

For the twelve months ended 31 December 2020 (CY20), **VGI Partners Asian Investments Limited (ASX:VG8)** generated a net return of **+12.7%** after all fees. VG8's post-tax Net Tangible Assets (NTA) per share stood at **$2.74** at 31 December 2020.[1] As at writing, VG8's NTA was **$2.82**.

We are pleased that the CY20 return was within our target range of 10%-15% p.a. particularly given this return was generated with an **average cash weight of 52%** during the year. However, we are by no means satisfied by this outcome and will continue to focus on generating attractive risk-adjusted returns.

The last twelve months brought with it one of the most extraordinary investing environments witnessed in modern times. On one side is COVID-19 that has wreaked havoc globally, leading to unprecedented shutdowns of entire economies. On the other side are governments and central banks around the world who have together taken an incredibly accommodative posture through wage replacement schemes, rental and loan deferrals, historically low interest rates, and collectively supplying unprecedented liquidity through seemingly limitless central bank money-printing.

[1] Post-tax NTA is calculated after tax on realised gains/losses, deferred tax assets and deferred tax liabilities, but before allowing for deferred tax liabilities/deferred tax assets on unrealised gains/losses.

SYDNEY
VGI Partners Limited
ABN 33 129 188 450
39 Phillip Street
Sydney NSW 2000
Australia
T. +61 2 9237 8900
www.vgipartners.com

NEW YORK
VGI Partners, Inc.
600 Madison Avenue
Suite 2101, New York,
NY 10022, USA
T. +1 212 937 4700
www.vgipartners.com

TOKYO
VGI Partners Limited
Representative Office
Level 8 Tri-Seven Roppongi
7-7-7 Roppongi Minato-ku
Tokyo 106-0032, Japan
T. +81 3 6629 3515
www.vgipartners.jp

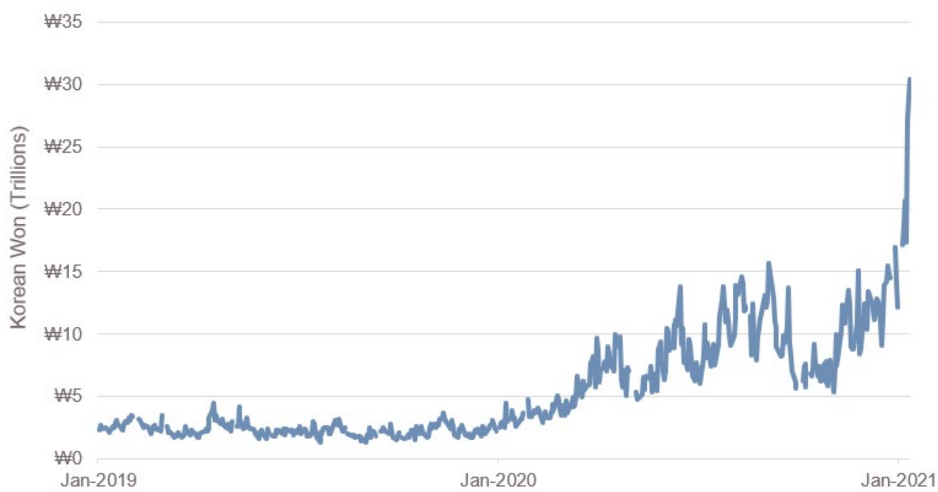
AFSL No. 321789
SEC Registered

This central bank positioning has driven indices around the world to above or close to their previous highs. For instance, Tokyo's Mothers Index, a benchmark consisting of 300+ smaller companies and start-ups, rose almost 40% in 2020, reaching its highest level since 2006. Against this backdrop, we are seeing clear pockets of frenzied speculation, including record retail investor participation and booming demand for IPOs. The biggest IPO in Asia last year, JD Health in Hong Kong, saw its retail tranche 422x oversubscribed, while ANT Group, whose IPO ultimately was cancelled, was purportedly oversubscribed by 390x in its Hong-Kong listing retail tranche and by 870x in its Shanghai listing retail tranche.

This is not a normal investing environment and the flood of liquidity from central banks coupled with zero interest rates is driving a level of behaviour across global markets, especially key Asian markets, which has all the hallmarks of a speculative bubble.

A prime example of this speculative mania can also be observed in Korea which has seen retail investor participation explode, with day traders accounting for almost 90% of trading volumes in some months of 2020 while total deposits at local brokerages in Korea have reached record highs. Not only is retail participation growing rapidly, but margin debt is also at record levels. Korean regulators have even issued statements to retail investors requesting they refrain from reckless speculation in the equity market, especially with borrowed money. We think this is illustrative of a wider phenomenon across global markets and has parallels to the Robinhood trading phenomenon in the United States (US). At the same time, there has been a short-selling ban in Korea for most of the year, which has accentuated the market rally by removing sceptical market participants.

Daily Trading Activity by Individual Investors in South Korea (Purchase Value)



Source: Korea Stock Exchange.

Compounding this situation is a highly divisive political environment as the conflict between the US and China shows no sign of easing. If anything, the trade war has only accelerated and we have seen both sides introduce additional restrictions, from export controls on sensitive military technologies to de-listings of Chinese companies in the US.

In addition to international pressure, Chinese companies have also been the subject of increasing domestic regulatory pressure. We have always had reservations about investing in China given most companies are structured as Variable Interest Entities (VIEs), meaning shareholders do not have direct legal ownership of a company and instead own shares through legal agreements that are at the discretion of Chinese courts. In late 2020, we saw these risks come to the forefront, beginning with the cancellation of the IPO of ANT Group (Alibaba's financial subsidiary). We believe this signalled a step change in the Chinese government's stance and as soon as we saw this, we decided to sell our small holdings in Tencent and Alibaba which, despite being great businesses, we felt were not being priced for the increased regulatory risk.

Subsequently, we have seen an acceleration in regulatory threats by the Chinese government in the form of increased scrutiny and supervision of market-dominant businesses such as Alibaba and Tencent, given both companies have become vital to everyday life in China. For instance, there are growing threats of fintech regulation, such as limiting the issuance of consumer loans or forcing companies such as ANT Group or WePay (owned by Tencent) to share consumer data with domestic banks, which would diminish Alibaba's and Tencent's competitive advantage in favour of domestic, state-owned enterprises. Another example was in December 2020 when China's central bank called out ANT Group alleging it had exploited regulatory loopholes.

The day before the ANT Group IPO was cancelled, China's official state media published the below cartoon which features a cloud in the shape of a horse together with a cryptic message *"Don't speak thoughtlessly, don't do as you please, people can't act on their free will"*. While there was no reference to Jack Ma, Alibaba's founder and one of China's wealthiest individuals, the message could not have been less subtle given Jack Ma's Chinese name is 馬雲 which is literally "horse cloud" and the message was posted the same day as a closed-door meeting that involved Jack Ma and Chinese government officials. We remain of the view that regulatory risk in China remains elevated and generally not priced by investors.

Source: Cartoon posted on Xinhua’s official WeChat account on 2 November 2020.

Compounding the fragile political environment, we have global debt sitting at record levels, an ambiguous vaccine rollout schedule, a virus that can rapidly mutate, signs of emerging inflation and an uncertain timeline around the opening of economies, with the associated employment stapled to it.

Amidst this ongoing uncertainty, we aim to be both prudent and patient with the allocation of our collective capital whilst moving aggressively as we see opportunities present themselves. At the time of writing, VG8’s net equity exposure is 82% which provides us with a valuable cash asset that is ready to be deployed as new opportunities arise.

The current environment of elevated valuations and heightened risk-taking also reinforces our view that a rigorous research process is more important than ever. Our sole focus at VGI Partners is to identify attractive long-term investment opportunities through unique insights that can only be acquired through high-quality fundamental research and a deep understanding of the companies we own and the industries in which they operate. Over the past six months we have refortified our core investment processes as a team and continue to relentlessly focus on testing our existing investment theses whilst tirelessly searching for new investment opportunities.

We continue to look for investments with Asian exposure across all markets. While most of our current holdings are in Japan, Australia, Hong Kong and Europe, we have also been focusing on some situations in Korea and recently initiated a small position in a Singapore-listed business. The investment in Singapore is particularly interesting as the business essentially operates a monopoly with an asset-light model, ~50% EBITDA margins and has exposure to growth in other South-East Asian economies. We believe we were able to buy this business at a very attractive valuation, which is a testament to the opportunities that are available in these markets.

Over the last twelve months we have also seen a meaningful acceleration in several structural trends that we have been witnessing over the past ten years – whether that be online marketplaces, electronic payments, gaming, the accelerated shift of the corporation into the cloud or the application of artificial intelligence.

As a result, we have continued to evolve the areas of focus for the investment team and have built some new positions, ensuring the portfolio is aligned to these long-term secular growth areas. We have always been highly focused on ensuring that the portfolio is exposed to structural growth and we believe this will be increasingly important in the coming years. We have accordingly redoubled our efforts to ensure the companies we own are beneficiaries of these accelerated secular changes that are taking place globally.

Even in Japan, where change has been historically slow to take place, we have seen new Prime Minister Yoshihide Suga push an agenda of digital transformation. Unlike promises of prior Japanese governments, we are seeing tangible evidence that this new digital shift is real. For instance, Suga has begun eliminating the use of hanko stamps, commonly used in Japan as a form of signature. This has led us to identify businesses that we believe are best positioned for the digitisation of corporate Japan and we have already started building positions in some businesses that will benefit from this trend.

"As people's behavioural patterns shift due to COVID-19, accelerating digital transformation is crucial… I will thoroughly review regulations hindering digital transformation and swiftly undertake relevant reforms, unleashing the potential of the private sector."
– Yoshihide Suga (Japanese Prime Minister)

This environment has conversely driven an acceleration in the creative destruction of business models. Short selling recently has been difficult as the market has been both far less discerning of questionable accounting and more willing to look through short-term business performance, even if it may be a strong indicator of long-term issues. However, the lessons of last year reiterate to us that our best performing shorts over the past ten years have been structurally challenged businesses susceptible to this creative destruction and this is where we are diligently focusing.

As aforementioned for the twelve months ended 31 December 2020 (CY20), VG8 generated a net return of **+12.7%** after all fees. This result consisted of a **+2.7%** return in the first half of CY20. As we previously reported, we were conservatively positioned going into the crisis and this allowed us to generate a modest positive return despite most indices in Asia being down significantly through this period.

As we put some of our cash to work and recalibrated the portfolio towards secular growth areas, we were able to return **+9.7%** in the second half of the year with strong contributions from these newer additions to the portfolio. Far more importantly though, we believe a number of new additions will be multi-year structural winners for VG8.

Whilst we strongly believe returns need to be viewed over longer time periods, we highlight the above as we are deeply encouraged by the changes we have made to the way we function as an investment team. Over the past six months, we believe that we have strengthened our investment process with a more collaborative approach which only increases our probability of long-term success.

One change to our decision-making process worth highlighting is being more disciplined around selling situations with capped upside. This is a tricky balancing act because you never want to sell high-quality businesses, but sometimes the valuation leaves very little room for error in terms of execution, or alternatively the growth required to justify the valuation exceeds levels that we view as reasonable. As such, during CY20 we took the opportunity to exit some positions that had generated strong profits but had reached stretched valuation levels and where the outlook for incremental returns on capital appeared weaker.

As long-term investors know, we take alignment of interest between ourselves and our investors seriously. We have the vast proportion of our net worth invested in our Funds and VGI Partners itself and continue to add to our investments. Board members, staff and their families have $42m invested in VG8, which accounts for 7% of VG8's shares on issue.[2] As a result, investors should be confident that our investment team's energy and effort is focused on a singular outcome – to maximise returns over the long term while preserving our collective capital in what is a highly challenging investment environment.

Performance Attribution for the Year to 31 December 2020

The largest stock contributors to the performance of our Long Portfolio for the twelve months to 31 December 2020 were **Nintendo**, **Nuix**, **Kikkoman**, **Hong Kong Exchanges & Clearing (HKEX)** and **Richemont**. Below we provide some commentary on these positions.

Nintendo (TYO:7974) was the largest contributor to performance for the twelve months to 31 December 2020 with the share price increasing by **+39%** since we first initiated a position in July 2020 and by **+31%** on our average purchase price. Nintendo was a beneficiary of the COVID-19 pandemic due to consumers allocating more of their time to gaming. This resulted in Nintendo's Switch console having its best year since being launched while also benefiting from the shift to digital downloads and strong sales of new and back-catalogue games. We discuss our Nintendo investment thesis in detail in the Portfolio Update section later in this letter.

Nuix (ASX:NXL) was the second largest contributor to performance for the twelve months to 31 December 2020. VG8 was a cornerstone investor in the company's IPO and received a meaningful allocation. Following the IPO in December 2020, the share price increased by **+55%**. Nuix is a developer of investigative analytics and intelligence software used for extracting knowledge from structured and unstructured data. Nuix is primarily used by law firms and law enforcement agencies undertaking investigations, although the business is expanding its use cases as the needs for governance, risk and compliance continue to grow.

[2] Based on post-tax NTA of $2.82 at time of writing. Includes look-through interest in shareholdings in VG8 owned by VGI Partners (given VGI Partners is over 77% owned by VGI Partners' Board, staff and their families). Board members include those from VGI Partners Limited, VGI Partners Global Investments Limited and VGI Partners Asian Investments Limited.

Kikkoman (TYO:2801) was the third largest contributor to performance for the twelve months to 31 December 2020 with the share price increasing by **+26%** between the start of the year and our final sale price. Kikkoman was a beneficiary of stay-at-home consumption of soy sauce in the US (where it derives the bulk of its earnings) as the decline in the B2B restaurant channel was more than offset by growth in B2C at-home consumption. Kikkoman was also able to closely manage its cost structure to alleviate margin pressure from operating deleverage. During the second half of 2020, we exited our Kikkoman position as the growth required to justify the valuation materially exceeded our estimates.

Hong Kong Exchanges & Clearing (HKG:0388) was the fourth largest contributor to performance for the twelve months to 31 December 2020 with the share price increasing by **+68%**. HKEX has been a beneficiary of the widening geopolitical fault line between the US and China as US financial exchanges have become increasingly hostile towards Chinese companies. The ensuing uncertainty has led to a flurry of Chinese ADRs (overwhelmingly weighted towards new economy companies with high daily trading volumes) to undertake secondary listings on HKEX which has in turn structurally expanded HKEX's overall market velocity. We expect HKEX to continue to benefit from its pre-eminent position as the facilitator of equity capital flow between China and the rest of the world.

Cie Financière Richemont (SWX:CFR) was the fifth largest contributor to performance for the twelve months to 31 December 2020 with the share price increasing by **+5%** during the year but by **+62%** from its March lows. Richemont's business was severely impacted by store closures and travel restrictions as a result of COVID-19, leading to the stock falling significantly in the first half of the year. As long-term shareholders we took advantage of this weakness to buy what we believe is a very high-quality business at bargain prices, looking through the temporary impacts of COVID-19 and focusing on the long-term fundamentals of the business. The stock rebounded strongly late in the year as Richemont's core jewellery business (Cartier and Van Cleef & Arpels) returned to growth in the September quarter despite ongoing store closures, a phenomenal performance in such a challenging environment.

VGI PARTNERS

Portfolio Update and Current Positioning

We continue to concentrate VG8's capital in our best ideas. Today, our Top 5 Long Investments represent 37% of total Portfolio value. VG8 currently has 82% net equity exposure.

Below we discuss two of our current core positions, **Nintendo** and **Crown Resorts,** in more detail, as well as **Yakult**, which is the portfolio's sixth largest position and was the largest long detractor for the twelve months to 31 December 2020.

Nintendo (TYO:7974)

Nintendo remains our largest portfolio position.

Nintendo has been making games for over 130 years. The company started as a manufacturer of hand-made playing cards in Japan with the push into video games really beginning in the 1970s. Nintendo has been a world-class player ever since.

Nintendo owns some of the best and most durable franchises in gaming (Mario, Pokémon, Donkey Kong, Zelda and Animal Crossing). This is important as content and distribution are critical – this holds true in gaming as much as it has in video, movies and music. When we look at the top 20 best-selling gaming franchises of all-time, Nintendo dominates the rankings and has more leading franchises than any other competitor.

Something that differentiates Nintendo is that its games typically appeal to both casual gamers and hardcore gamers. This has helped Nintendo's evergreen franchises withstand the test of time. Another differentiator has been Nintendo's vertically integrated business model, as the company both develops games and manufactures consoles. This allows Nintendo to control the full user experience across software and hardware. Nintendo's latest device family, the Switch, is unique as it combines a home console with a portable device. We believe the Switch could turn into a powerful gaming platform which creates substantial optionality for Nintendo.

Historically, Nintendo's revenues have been volatile due to the console cycle. With this boom-and-bust backdrop, there is still a perception amongst investors that Nintendo's earnings are cyclical. However, we believe the business is rapidly changing as Nintendo's revenue model is evolving to one that is more predictable and recurring through increased digital penetration and growing Games-as-a-Service which are monetised through subscriptions, downloadable content and add-ons.

For instance, Nintendo Switch Online subscriptions have almost doubled in less than 12 months to 26 million. The subscription allows users to play online with friends and access the back-catalogue of games. As games incorporate more online multi-player content, the proposition for gamers becomes more attractive. Importantly, online subscription revenue is recurring in nature, reducing the cyclicality of the business while also being accretive to Nintendo's margins. We believe there is still significant room for digital penetration given most other videogame publishers are generating around 90% of software sales through digital channels whereas Nintendo is still below 50%.

Nintendo is also adding social and online multi-player features to its games while embracing mobile gaming to grow engagement. In the past mobile has been a weak spot for Nintendo, but the company appears to be testing new ideas, such as a partnership with Tencent to develop mobile games. In addition, we are encouraged that management is pursuing intellectual property (IP) opportunities beyond gaming, including theme parks, movies, flagship stores and merchandise. The objective is to increase touchpoints with the consumer thus creating an IP-flywheel.

The primary catalyst behind the pivot to digital and mobile has been the new CEO, one of the youngest in Nintendo's history, who has been vocal about the digital transformation and IP initiatives. We think there is significant untapped potential for Nintendo. In fact, we see some broad parallels to Disney, except Nintendo is adopting a capital-light approach and using partners to fund these initiatives. We think these initiatives are very encouraging and will grow Nintendo's long-term brand equity.

More broadly, we find gaming to be an attractive industry as we believe interactive entertainment, and in particular gaming, will continue to gain share of media consumption. Gaming is already an important industry – it is now bigger than the music industry and box office combined. But we think there is still significant room for penetration to grow as gaming is becoming more social, interactive and therefore addictive. Not only are people spending more time and money on videogames, they are also spending more time watching other people play videogames (around 2 billion hours a month on Twitch, the leading videogame streaming platform). We think this is all very positive for Nintendo.

As industry leading triple-A gaming content is becoming scarce and mega-tech companies are all focused on gaming (e.g. Microsoft, Google, Amazon), we think Nintendo's content is becoming increasingly valuable. We believe this, together with the evolution of Nintendo's business model, are being under-appreciated by the market. We think the valuation looks very attractive and the current metrics give no credit for the transformation taking place. Nintendo also has several valuable equity investments that are not being valued in the current share price and a robust balance sheet (~20% of its market cap in net cash). Overall, we remain very positive about Nintendo's long-term potential.

Crown Resorts (ASX:CWN)

Crown is our third largest position.

Crown is Australia's largest gaming and entertainment group, operating casinos and hotel venues across Australia. Crown holds exclusive casino licences in Melbourne and Perth, in addition to a licence in London and potentially the right to operate a second Sydney casino imminently.

We have followed the Australian casino industry for a long time and were large shareholders in Echo Entertainment between 2012 and 2015 (now renamed Star Entertainment, the operator of Sydney's Star casino), an investment that delivered a strong return for us. More recently we became interested in Crown following the large share price decline which was initially caused by concerns around the COVID-19 lockdown and subsequently compounded when the company faced a government inquiry into its corporate governance practices.

We like Crown for a number of reasons. It is a regulated monopoly in Melbourne and Perth and potentially on the cusp of becoming a duopoly operator in Sydney. As a result, Crown's gaming business is a highly cash generative, economically resilient business which benefits from a loyal domestic customer base and long-dated casino concessions (the earliest expires in 30 years) which provide certainty around tenure and thus cashflows. Finally, we like the tangible asset-backing of the business given Crown owns the real estate at its venues.

We view our holding in Crown as a special situation investment. It is not the typical multi-year growth compounder that we seek, but nonetheless we believe the sell-off during 2020 presented a rare opportunity to build a position in a high-quality asset at a very attractive price. Understandably, the pandemic lockdown had a significant impact on the company's operations with the forced closure of its venues. However, the share price in our view began to extrapolate an unrealistic scenario and imply that the asset was permanently impaired. Taking a long-term view, we were comfortable Crown would eventually return to a normalised level of trading. We also did not have any concerns around the balance sheet and believed the company would be able to limit the cashflow burn rate after it moved quickly to right-size the cost base.

We had another chance to grow the position following the sell-off around the time Crown faced a NSW government inquiry into its corporate governance practices. There is no question that Crown has made errors in its dealings with junket operators and around aspects of compliance. The issues have been known since at least 2016 when Crown employees were arrested in China for enticing Chinese players to gamble in Australia. This was highlighted by the recent NSW government inquiry which led to a more comprehensive review to assess Crown's suitability as a casino operator in Sydney.

The inquiry has been a public process which has drawn a lot of media attention and has raised questions around Crown's Sydney licence, causing in turn a share price decline. While there is a small chance that Crown will lose its Sydney licence, our analysis showed that, at the price we scaled our position in October 2020, there was essentially no value being attributed to the Sydney casino. We like to find investments that have upside optionality and where we do not have to pay for this optionality, and we thought this was the case with Crown. In addition, we felt we had an attractive margin of safety at the time of purchase given our assumption that none of Crown's VIP business would come back due to travel restrictions and bans on junket operators.

We are of the view that the inquiry will lead to a significant improvement in corporate governance at Crown. This may lead to additional compliance-related costs to strengthen governance and monitoring controls, but we think these are manageable expenses particularly given Crown took the opportunity during COVID-19 to structurally improve its cost base. Better compliance and governance will make the business more sustainable longer-term.

A more negative scenario would be the termination of Crown's casino licence in Sydney. We feel this would set a dangerous precedent for private sector investment in NSW given Crown will have invested over $2bn in the Barangaroo project. But we are cognizant of this risk and as such we also have a position in Star Entertainment (the operator of the other Sydney casino), which would be a key beneficiary should Crown's Sydney licence be revoked.

Questions around Crown's suitability as a casino operator have also spread to Melbourne, with the Victorian government initiating an investigation. This is a risk we have been monitoring closely. In our analysis, we must price risk while also probability-weighting scenarios and we think the likelihood of Crown losing its Melbourne licence is very low. There are a few reasons for this: firstly, Crown is a key contributor to state government revenues; secondly, Crown is the largest private sector employer in Melbourne; and thirdly, we think the initial solution will be to introduce stricter oversight and compliance, with the potentially drastic step of revoking Crown's licence only taken as a last resort. Therefore, we think Crown is highly likely to retain its Melbourne licence, potentially with some additional costs to the business for compliance and stricter governance.

Today Crown continues to operate with guest restrictions, but we believe attendance will eventually normalise but that the company will come out of the crisis with an even more favourable cost structure after the cost savings initiatives that were implemented during 2020. Meanwhile, in the near term, Crown may actually benefit from limited international travel due to consumers redirecting more discretionary spend domestically. International VIPs may never come back but we are comfortable with this given it is a small contributor to earnings (mid-single digit contribution to EBITDA).

We also think Crown has the ability to eventually resume shareholder returns via higher dividends and possibly buy-backs. In the near term, excess free cashflow will be used to deleverage the balance sheet, which should happen quickly as Crown will be collecting approx. $700m from the sale of luxury apartments that have been built above the Sydney casino complex. Free cash generation should also expand meaningfully over the next few years as the company has finished the majority of its large capex projects, leaving ample room for share buy-backs on our math. Another incremental area of upside is a sale-and-leaseback of Crown's property assets which would provide further free cashflow flexibility. Crown previously explored this initiative in 2016 but now that private equity giant Blackstone is a large Crown shareholder, the sale-and-leaseback option could be back on the table given Blackstone have been involved in other similar casino situations in the US.

VGI PARTNERS

Besides the optionality, we view Crown as a strategic asset that would be highly attractive to a range of suitors. In 2019 Crown was approached by both Wynn and Melco (the former offered to buy the company outright while the latter attempted to acquire a 20% stake). This demonstrates the appeal of Crown's assets and we believe that any operator with casino operations in Asia, like a Las Vegas Sands for example, would find it attractive to combine their Macau or Singapore operations with Crown, creating a pan-Asian casino operation. Foreign buyers may face regulatory restrictions, but we think these are manageable and in fact may even appease regulators given Crown's poor governance under the current ownership. Alternatively, we could see Blackstone seek to increase their ownership beyond their existing 10% stake in the company. We are not banking on a transaction, but we think this provides some downside protection to our investment.

Yakult Honsha Co (TYO:2267)

Yakult manufactures and distributes probiotic consumer products. The brand is seen as "the category" when it comes to probiotic drinks. Since its first foray offshore into Taiwan in the 1960s, Yakult has established operations across 40 countries with the bulk of its earnings now derived internationally.

We like Yakult for a number of reasons. Firstly, Yakult has long commanded a significant premium to competitor products demonstrating its strong brand equity. It is one of the few consumer staple businesses in Japan where price hikes have been successfully executed with minimal adverse impact on volume. Secondly, its proprietary distribution network of approx. 80,000 Yakult Ladies around the world provides a cost-effective consumer touchpoint that is both sticky and conducive to up-selling. Thirdly, Yakult remains underpenetrated internationally with a long runway for growth in large markets such as China, South East Asia and the US.

Our investment in Yakult has thus far been disappointing as a result of headwinds encountered by its China business, which is an important growth driver. Recently, the ambient product category (which holds significant distribution advantages over chilled products, especially with respect to lower tier cities and e-commerce channels) has outpaced chilled products category growth in China. This has caused Yakult's products, which require refrigeration to sustain their probiotic properties, to lose wallet share to copycat ambient temperature products which have no probiotic properties but have been regarded as an alternative to Yakult by a portion of Chinese consumers. This has been exacerbated by aggressive discounting from local dairy competitors and by Yakult holding firm to its long-standing policy of not discounting its products.

While we have misjudged the issues in China, we do believe some of these concerns appear temporary. Additionally, market expectations have been reset therefore we do not need to assume that Yakult's China business returns to high growth rates to justify Yakult's current valuation. Meanwhile, Yakult has maintained healthy volume growth in other large markets such as Indonesia, Vietnam and the US; these markets could eventually overtake China as key growth drivers.

We remain Yakult shareholders as we think the business is attractively priced and could also be a prime candidate for shareholder activism given the clear, unexploited potential within what is a globally recognised brand and an extensive proprietary distribution network.

Currency

VG8 is denominated in Australian Dollars (AUD). We actively manage our currency exposure as our analysis of the economic outlook for Australia evolves relative to Asia and other geographies.

The success of our purposeful and active management of the currency is evident in the returns achieved by the VGI Partners Master Fund; currency movements have enhanced the Master Fund's total return by +23% since inception in 2009.

Whilst previously being unhedged to the US Dollar and Japanese Yen, we moved to a fully hedged position in mid-CY20. With the recent move in interest rates globally, as well as the high correlation of risk assets, we no longer believe the AUD is clearly mispriced and therefore we are fully hedged. In the future we may move back to an unhedged or partially hedged position - and take an active view on the currency - when we believe there is a clear mispricing based on our fundamental analysis.

VGI
PARTNERS

In Closing

At VGI Partners we are entirely focused on managing our Portfolio. Our unwavering commitment is to preserve and grow your capital over the long term, regardless of the market environment, by owning high-quality assets which have been purchased with a margin of safety. We cannot eliminate short-term volatility from our returns, however we are more confident than ever that our process and investment philosophy positions our Portfolio to produce attractive returns over the long term and through the cycle.

We remain optimistic about our existing Portfolio and will continue to take advantage of opportunities that present themselves. We are very grateful that we have long-term oriented investors who entrust us with their capital.

Once again, we thank you for your investment with VGI Partners.

Yours faithfully,

VGI Partners

VGI
PARTNERS

Disclaimer

VGI Partners Limited (ABN 33 129 188 450) (VGI Partners) is the holder of an Australian Financial Services Licence (No. 321789) and is SEC Registered. VGI Partners Asian Investments Management Pty Limited (ABN 84 635 179 538), a subsidiary and Authorised Representative (No. 1277600) of VGI Partners, is the manager of VGI Partners Asian Investments Limited (VG8) (ABN 58 635 219 484).

The information in this document (Information) has been prepared for general information purposes only and without taking into account any recipient's investment objectives, financial situation or particular circumstances (including financial and taxation position). The Information does not (and does not intend to) contain a recommendation or statement of opinion intended to be investment advice or to influence a decision to deal with any financial product nor does it constitute an offer, solicitation or commitment by VGI Partners.

It is the sole responsibility of the recipient to consider the risks connected with any investment strategy contained in the Information. Neither VGI Partners nor any of its directors, employees, officers or agents accepts any liability for any loss or damage arising directly or indirectly from the use of all or any part of the Information. VGI Partners does not represent or warrant that the Information in this document is accurate, complete or up to date and accepts no liability if it is not.

Past performance

The historical financial information and performance figures given in this document are given for illustrative purposes only and should not be relied upon as (and are not) an indication of VGI Partners views on the future performance of the Funds. You should note that past performance of the Funds cannot be relied upon as an indicator of (and provide no guidance as to) future performance.

Forward-looking statements

This document contains certain "forward-looking statements" that are based on management's beliefs, assumptions and expectations and on information currently available to management. Forward-looking statements can generally be identified by the use of forward-looking words such as, “expect”, “anticipate”, “likely”, “intend”, “should”, “could”, “may”, “predict”, “plan”, “propose”, “will”, “believe”, “forecast”, “estimate”, “target” “outlook”, “guidance” and other similar expressions. Indications of, and guidance or outlook on, future earnings or financial performance are also forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements. Any such statements, opinions and estimates in this document speak only as of the date of this document and are based on assumptions and contingencies and are subject to change without notice, as are statements about market and industry trends, projections, guidance and estimates. Forward-looking statements are provided as a general guide only. The forward-looking statements contained in this document are not indications, guarantees or predictions of future performance and involve known and unknown risks and uncertainties and other factors, many of which are beyond the control of VGI Partners, and may involve significant elements of subjective judgement and assumptions as to future events which may or may not be correct. There can be no assurance that actual outcomes will not differ materially from these forward-looking statements. No representation, warranty or assurance (express or implied) is given or made in relation to any forward-looking statement by any person (including VGI Partners or any of its directors, officers, employees, agents or advisers). In particular, no representation, warranty or assurance (express or implied) is given that the occurrence of the events expressed or implied in any forward-looking statements in this document will actually occur. Except as required by law or regulation, VGI Partners disclaims any obligation or undertaking to update forward-looking statements in this document to reflect any changes in expectations in relation to any forward-looking statement or change in events, circumstances or conditions on which any statement is based.