GLOBAL VALUE ADVISORS
A Division of Moody Aldrich Partners

Emerging Markets

Third Quarter 2019

COMMENTARY

Global Value Advisors is an investment boutique specializing in long-only international and global equities. We are value investors, who buy businesses that are undervalued due to temporary, non-structural reasons. We believe in combining the discipline of quantitative investing with qualitative judgement informed by fundamental research. Our research shows that companies that generate positive free cash flows and return capital to shareholders outperform the market.

Q3 2019 Total Returns (Net of Fees)	
GVA Emerging Markets	**-5.57%**
MSCI Emerging Markets	-4.25%
Value Added	**-1.32%**
MSCI Emerging Markets Value	-6.48%
MSCI Emerging Markets Growth	-2.04%

Regional Indices	
MSCI China	-4.73%
MSCI South Korea	-4.51%
MSCI Taiwan	5.19%
MSCI India	-5.15%
MSCI Emerging Markets Small Cap	-4.25%

The GVA Emerging Market Equity strategy returned -5.57% (net) in the third quarter of 2019 versus -4.25% for its benchmark, the MSCI Emerging Markets Index. Since inception on May 13th 2019, the fund is down -1.19% (net) versus -1.54% for its benchmark.

The -1.32% relative performance of the fund during the quarter was driven by a combination of weak stock selection and negative allocation effects. The escalating tariff war with China led to the underperformance of Emerging Asia. The weakest countries in the portfolio were Indonesia, South Korea, and Taiwan. All three countries saw poor stock selection. This more than offset strength in Brazil. The weakest sectors were Energy, Materials, and Consumer Staples.

Our portfolio positioning has not changed substantially over the past few months apart from a reallocation from Brazil into China. Our most notable country bets include a 9% overweight to Russia (13% vs 4%), a 9% underweight to China (23% vs. 32%) and a 9% underweight to India (0% vs. 9%). Our stand-out sector bets include a 10% overweight to Energy (18% vs 8%) and a 13% overweight Materials (20% vs 7%).

During the third quarter starting in September, the market experienced a sudden shift from momentum stocks to value plays. GVA's fund outperformed in September, but was unable to offset the underperformance in July and August. Thus far in 2019, the MSCI Emerging Markets Value Index returned +1.8% while the MSCI Emerging Markets Growth Index returned +10.0%. Over the last 20 years, our models have typically slightly outperformed during growth led markets (except when the growth/value spread is egregious as it has been this year) and significantly outperformed when value dominates. The inception to date performance is in line with what we would expect from GVA's approach and demonstrates the unique return profile of our value strategy.

The following table provides a selection of metrics that summarize the identity of our portfolio especially when compared to its benchmark:

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	GVA Emerging Markets	MSCI Emerging Markets Index
Wtd. Average Market Cap	$4.1 Bln	$49.8 Bln
Dividend Yield (LTM)	8.0%	2.9%
Price/Earnings (FY1)	7.5x	12.8x
Price/Book	0.9x	1.6x
Free Cash Flow Yield	15.0%	4.7%
Shareholder Yield**	12.3%	2.4%
Net Debt to Equity (ex-financials)	-1.8%	27.1%
Return on Equity	15.1%	15.9%

*** Shareholder Yield = dividends + Net Buybacks + Change in Debt. Shareholder Yield and FCF Yield are weighted averages. Source: FactSet as of September 30, 2019*

As you can see, our portfolio reflects deep value metrics without sacrificing profitability and balance sheet strength. Our approach leads us to companies with strong and sustainable cash flow generation, a proven record of returning cash to shareholders while generating above average Returns on Equity and carrying almost no debt. These companies tend to do well in a variety of market environments and, when combined with extremely cheap valuations, should lead to strong outperformance when value stocks are in favor.

Top 3 Performers in Q3 2019

Qualicorp (QUAL3-BR)
Qualicorp is a leading provider of health insurance and healthcare services in Brazil. In August, the leading hospital operator in Brazil announced it is taking a 10% stake in Qualicorp, which both validated the business and improved corporate governance. Q2 2019 EPS was also ahead of expectations. Free Cash Flow (FCF) Yield is 8%, Shareholder Yield is 3%, and PE FY1 is 16x.

West China Cement (2233-HK)
West China Cement is the largest cement producer in the Shaanxi province, where 80% of its production capacity is located. New floor space under development in the Shaanxi province has been coming in ahead of expectations (1H 2019 up 21% year-over-year), which led to strong demand for cement and price increases. Management expects strong construction trends to support cement demand in the 2H 2019 and 2020. Note that cement markets in China are often volatile. FCF Yield is 26%, Dividend Yield is 4%, and PE FY1 is 4x.

Garanti Bank (GARAN-TR)
Turkey was the best performing country in the MSCI Emerging Markets Index in Q3 (up 30% in USD terms). At the end of July, Garanti Bank posted Q2 2019 earnings that were flat year-over-year, but were well ahead of expectations. Revenues grew 12% year-over-year in the 1H 2019, driven by both net interest income and fees. The capital position is strong, with a Tier 1 ratio now at 16%. ROE is healthy at 16%. Note that non-performing loans are rising, but still manageable at 6%. Guidance for 2019 was reiterated. FCF Yield is 18%, Shareholder Yield is 17%, and PE FY1 is 6x.

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Bottom 3 Performers in Q3 19

PT Indo Tambangraya Megah Tbk (ITMG-ID)
PT Indo Tambangraya Megah is an Indonesian coal miner. Weak Q2 2019 results were reported in August and the outlook for coal is negative. A combination of slower global growth and higher production trends has pressured coal prices. International coal prices fell 20% in the third quarter and are down 40% YTD. ITMG is scrambling to cut costs, as the company is now loss making at current coal prices. Note that ITMG has 40% of the market cap in net cash. FCF Yield is 29%, Shareholder Yield is 26%, and PE FY1 is 7x.

Enauta Participacoes (ENAT3-BR)
Enauta Participacoes engages in energy exploration in Brazil. Brent oil prices fell 10% in the quarter and Enauta reported mixed Q2 2019 results in August. Group EBITDA was ahead of expectations, but the core Manati asset saw production fall 40% year-over-year due to weak demand and a one-off maintenance stop. 2019 guidance for Manati now looks optimistic. Note that net cash is $1.2 bln (Rand) or 40% of the market cap. FCF Yield is 14%, Shareholder Yield is 19% and PE FY1 is 11x.

Dongyue Group Limited (189-HK)
Dongyue is the largest fluorochemical manufacturer in China. Chemical companies tend to be highly sensitive to changes in GDP growth rates and Dongyue reported weak 1H 2019 results in August. Revenues fell 18% year-over-year and gross margins contracted. As a result, EPS fell 30% year-over-year. Note that Dongyue has HK$1.5 bln in net cash on the balance sheet, or 20% of the market cap. FCF Yield is 29%, Shareholder Yield is 12% and PE FY1 is 4x

Please feel free to contact us with any questions or comments. Thank you for your interest in Global Value Advisors. We look forward to updating you again next quarter.

Sincerely,

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For comparison purposes, the GVA Emerging Markets strategy performance is measured against the MSCI Emerging Markets Index.

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