湍流 Turbulence

Q3 2021

FLAGSHIP
ASSET MANAGEMENT

Navigate Safely Forward

Constantia, Cape Town • info@flagshipsa.com

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Who we are

Flagship is a specialist global asset manager

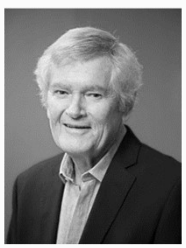
- Founded in 2001
- 100% owned by staff and directors
- Alpha-generating track record spanning nearly two decades
- One of the most awarded boutique asset managers in South Africa*

*10 Raging Bulls and 7 S&P / Micropal awards since 2004

Meet the Flagship Team

Management

Simon Hudson
LLB (CEO)
(54, 20 years)



Winston Floquet
CA (SA), MBA
(Chairman)

FAM Investment Team

Global Investment Team

Pieter Hundersmarck
MSc Finance
(41, 14 years)

Kyle Wales
CA (SA) CFA
(38, 13 years)

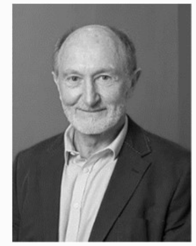
JJ Brink
CA (SA) CFA
(29, 3 years)

JD Hayward
BA Ing
(29, 1 year)

Domestic Specialist Funds

Paul Floquet
CA (SA) CFA
(48, 20 years)

Niall Brown
CA (SA)
(63, 38 years)



Bruce Anderson
CA (SA)
(65, 35 years)

Distribution & Client Service

Christo Terblanche
BCom (Hons)
(15 years)

Emma Hulton
(BBusSci Hons)
(15 years)

Candice Scholtz
(BBusSci)
(12 years)

Trading & Support

Gabi Hough
(BA History)
(12 years)

Naomi van der Colff
(20 years)

Ricky Lutchmia
(20 years)

Investment Team: (age, years of experience)

What sets us apart?

We are established, experienced specialists who run concentrated portfolios

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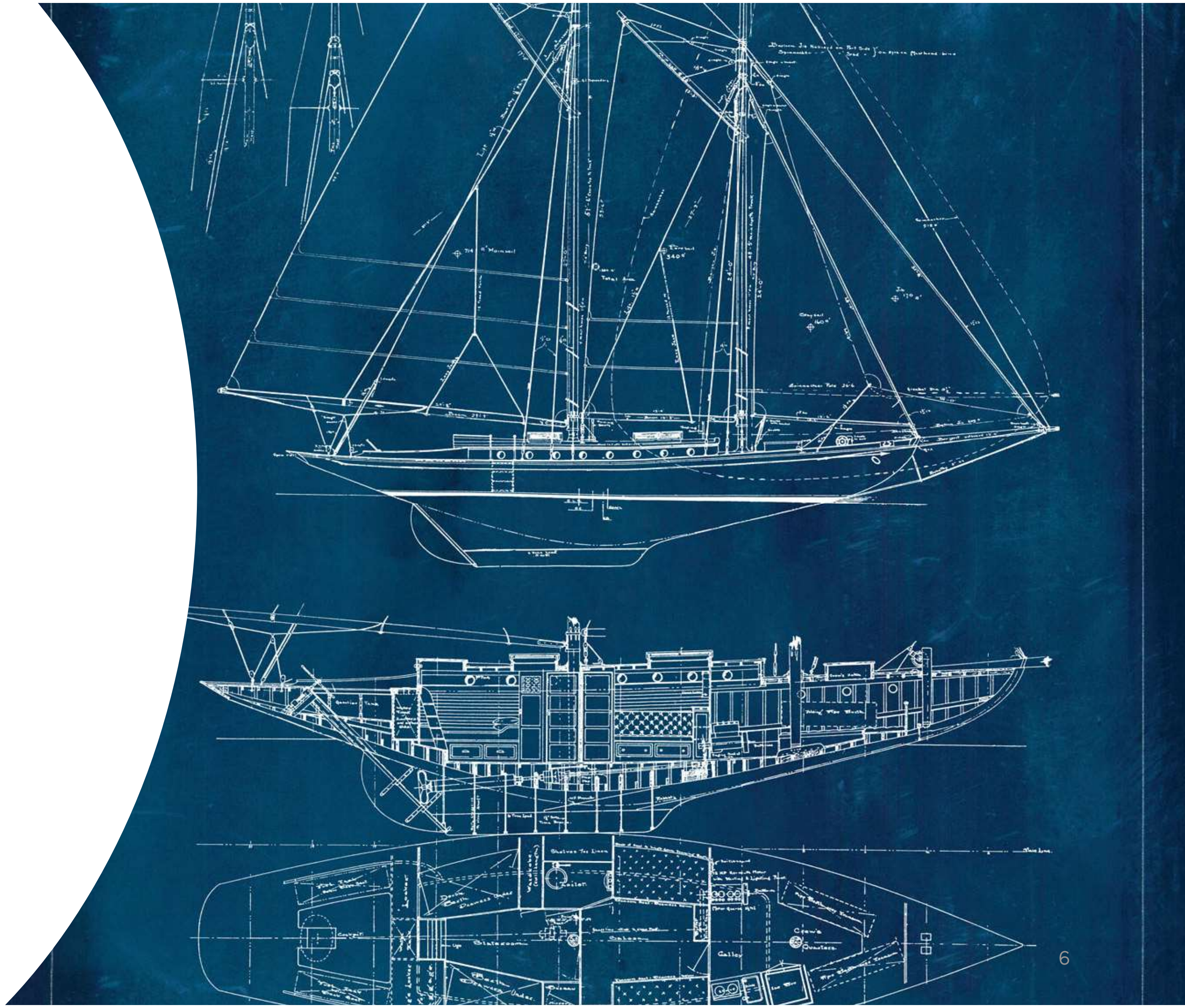
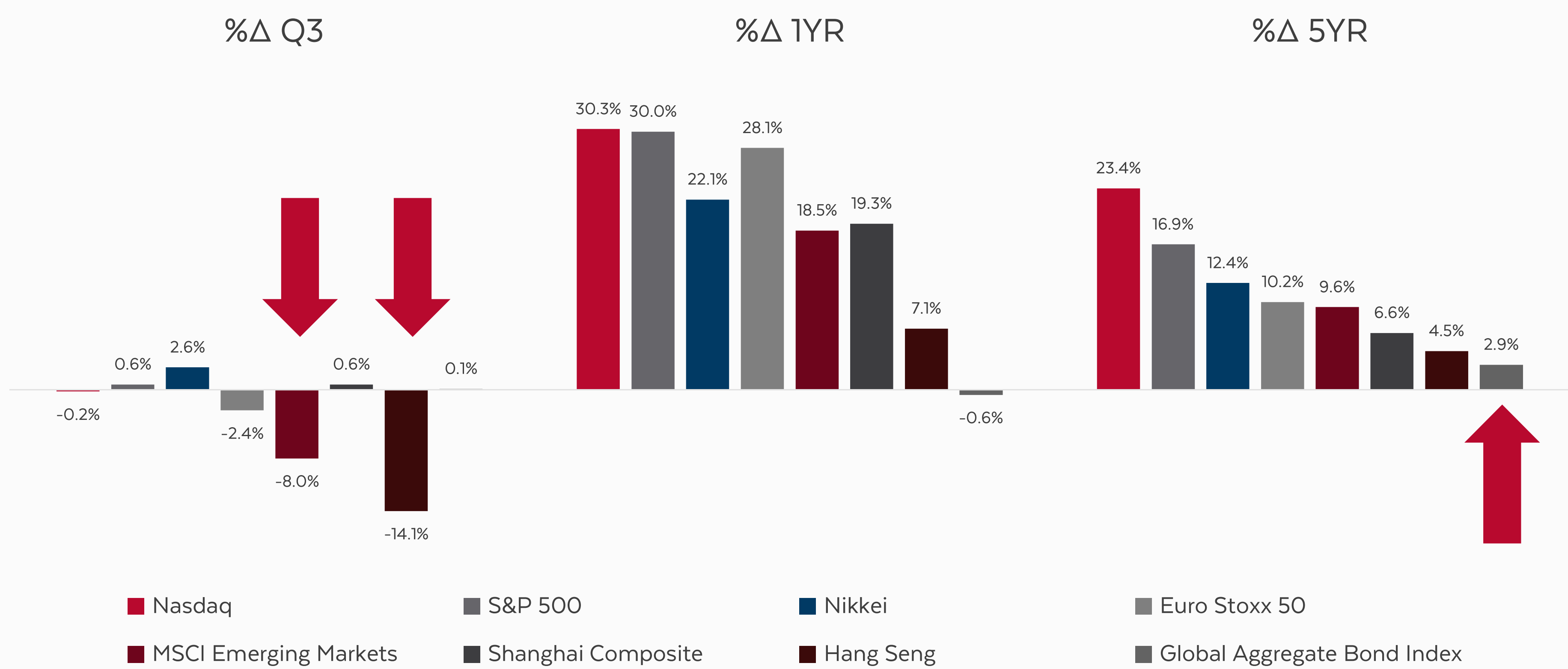


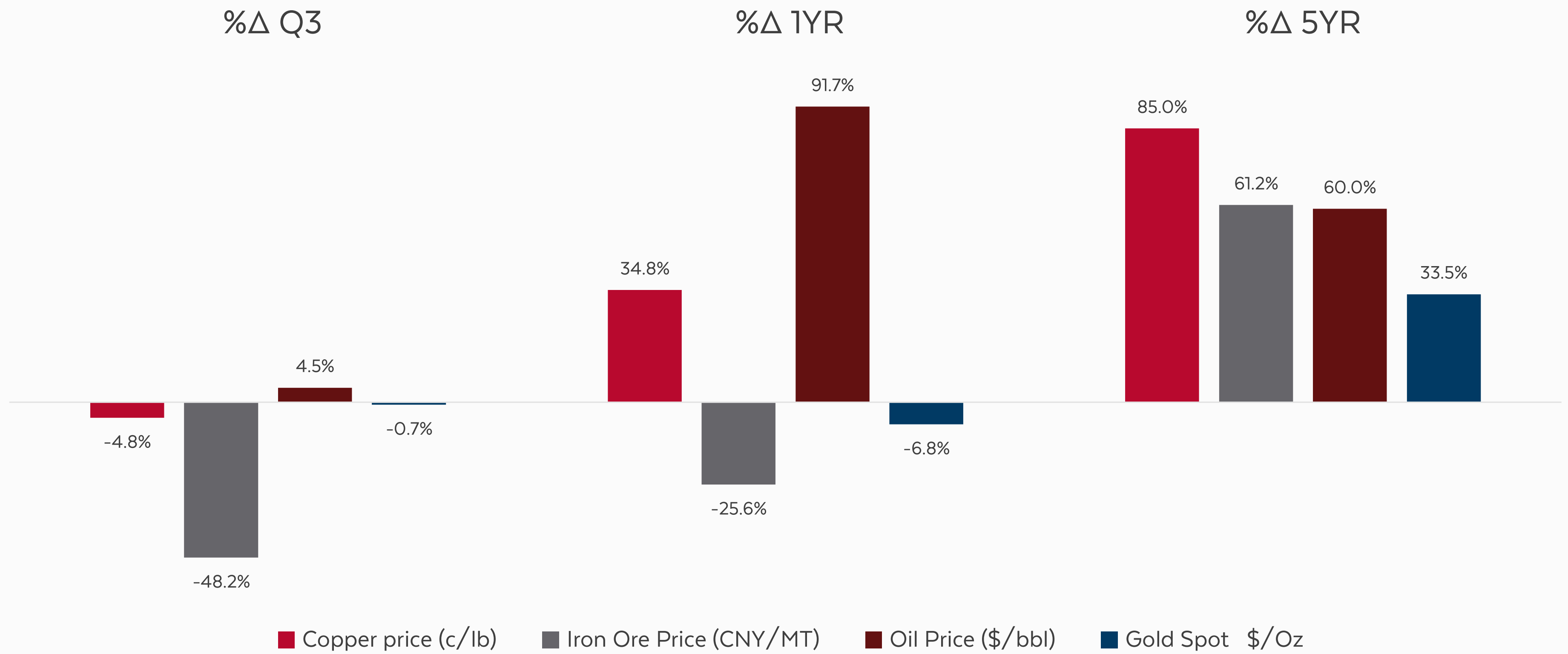
US listed Equities continue to dominate

US listed equities still clear winners over the long term, while emerging markets + bonds clear losers



Hard Commodities mixed for the quarter

All up considerably since 2016, but with large underlying volatility



Q3 2021: The Panda Awakens

Inflation and Chinese regulation were strong signals during the quarter

湍流

“Turbulence”

Signal

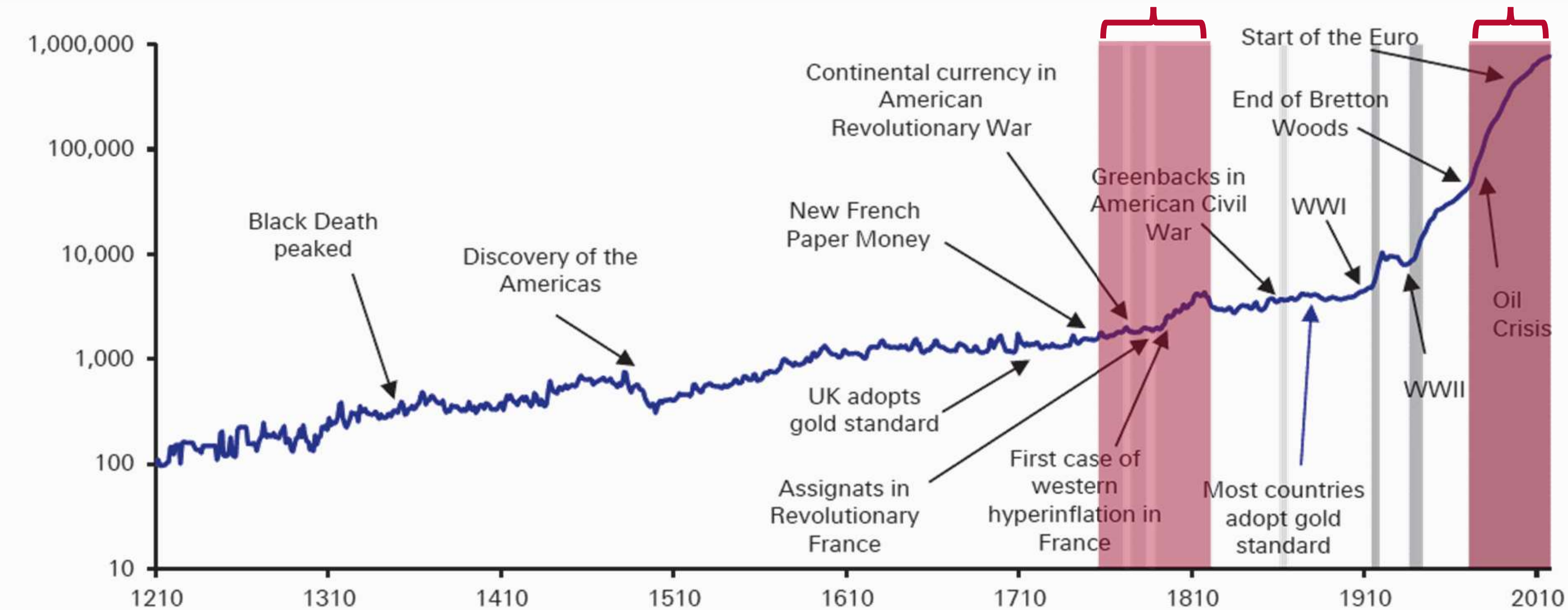
- Inflation (Fed comments on tapering)
- Chinese regulation

Noise

- US Government Shutdown (we’ve been here before)
- Crypto crackdown (China, SEC comments)
- Evergrande

Is inflation coming?

The short answer is yes, of course it is.

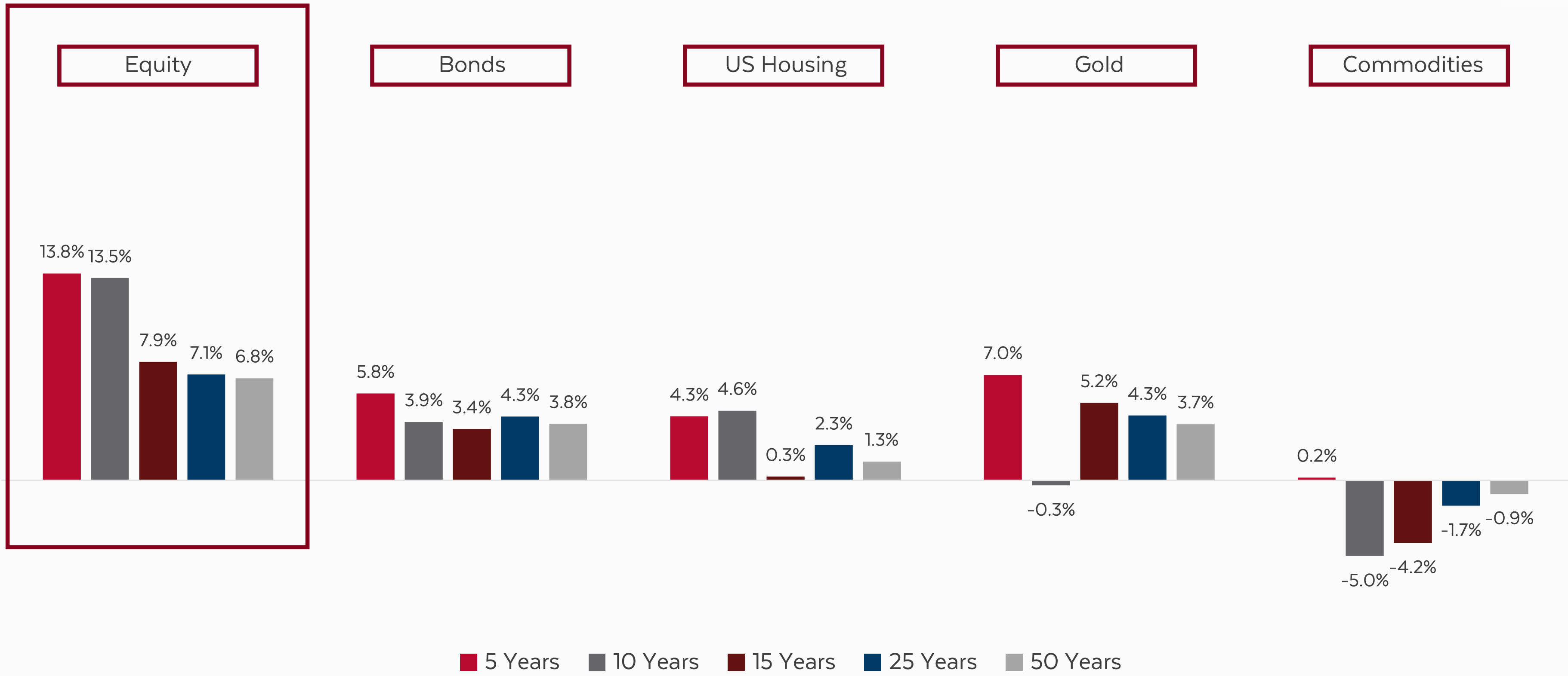


Views, orthodoxy and money systems change over time.
Because its supply is not fixed, fiat money generally leads to inflation.

Global median inflation n series (log scale). Inflation follows fiat. Source : GFD, Deutsche Bank . Note: This series compiles the median price level for around 100 countries over time. At first, only the UK has available data, but Sweden then joins in 1290 and others progressively follow

What's the best asset to hold during inflation?

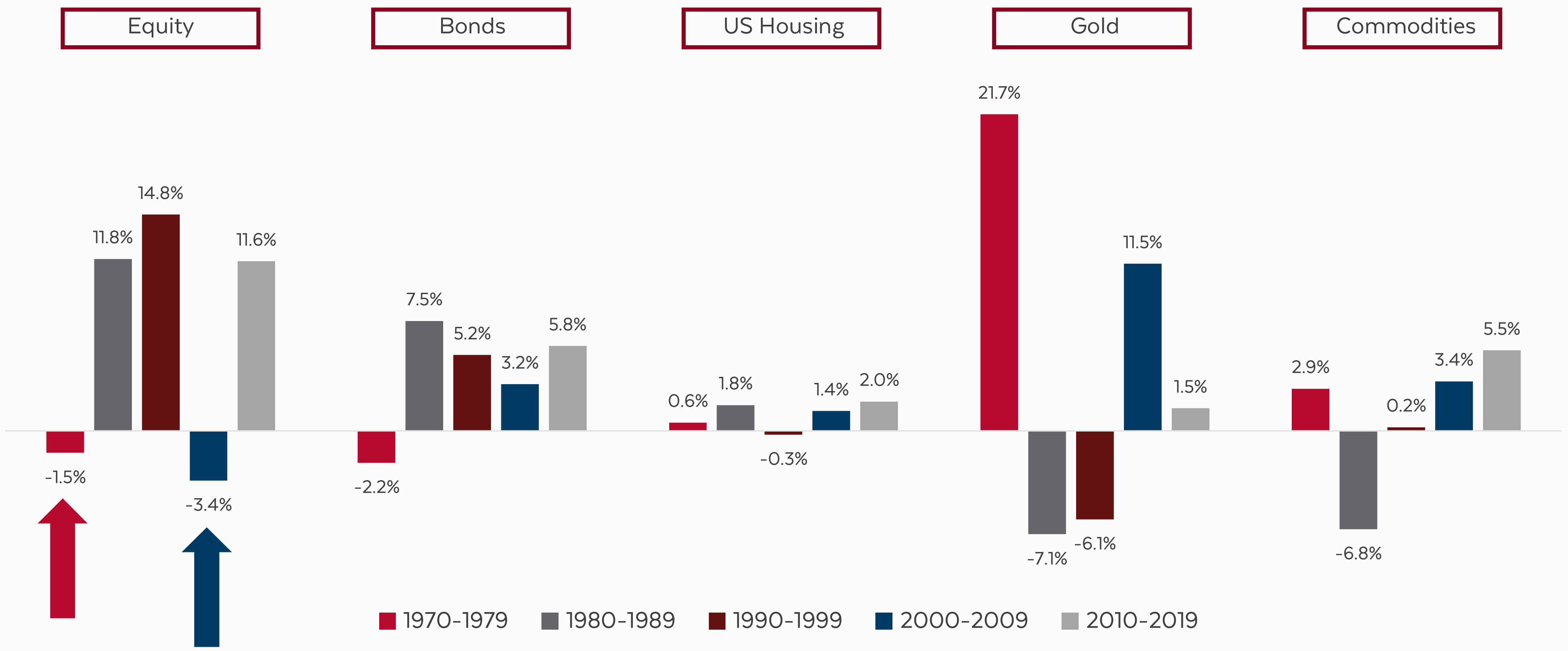
Real returns for equities (after inflation) dominate over all time periods



Source : Deutsche Bank

But what about rolling periods?

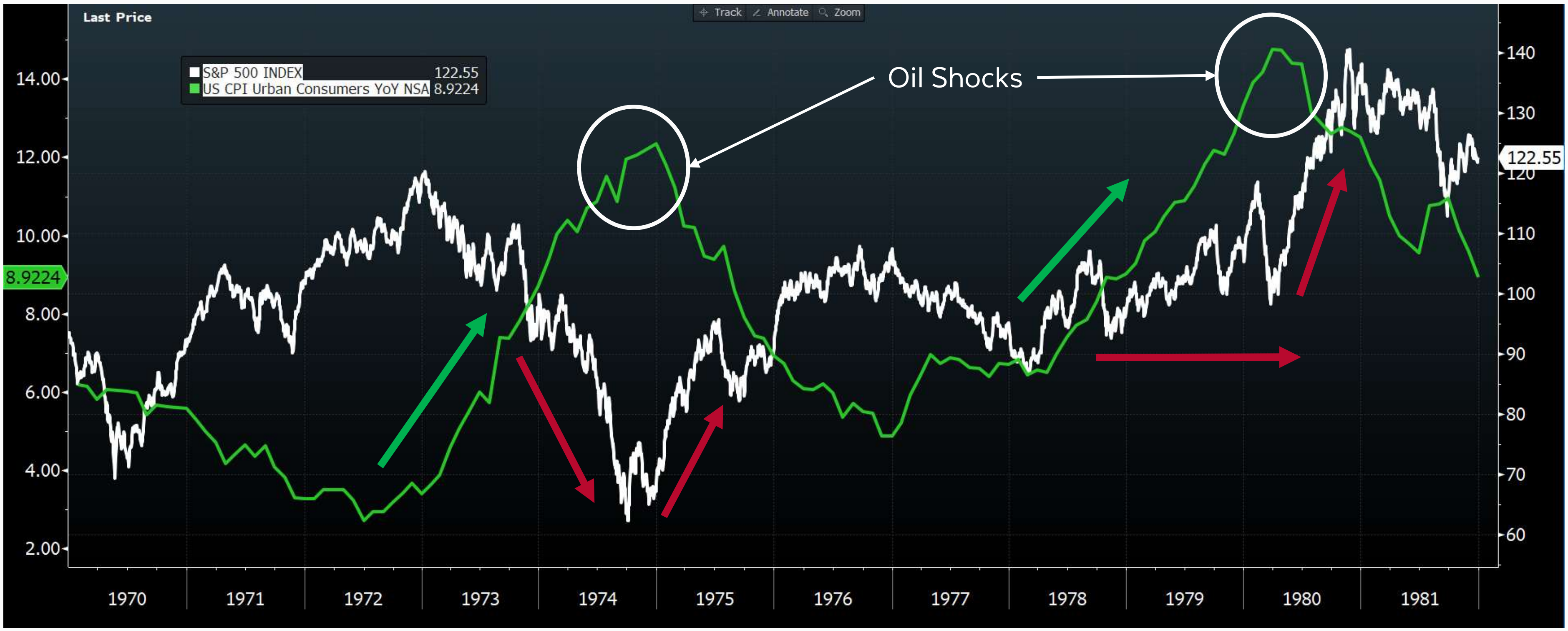
Real returns for equities dominate over all time periods EXCEPT for the 1970s and the 2000s.



Source : Deutsche Bank

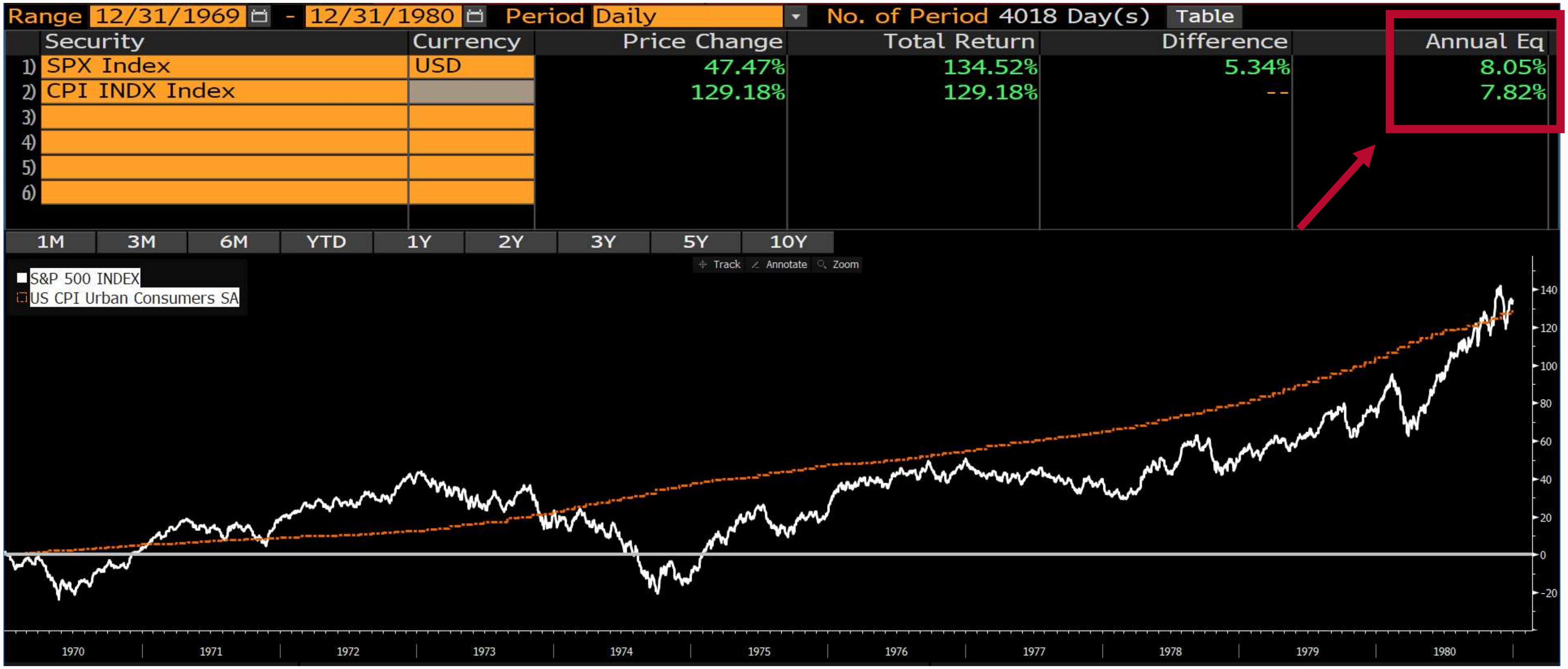
1970 - 1981 is instructive

Inflation is a powerful driver of short term equity returns



Equities are the best hedge against inflation

There are leads and lags, but ultimately equities hold their value in inflationary environments



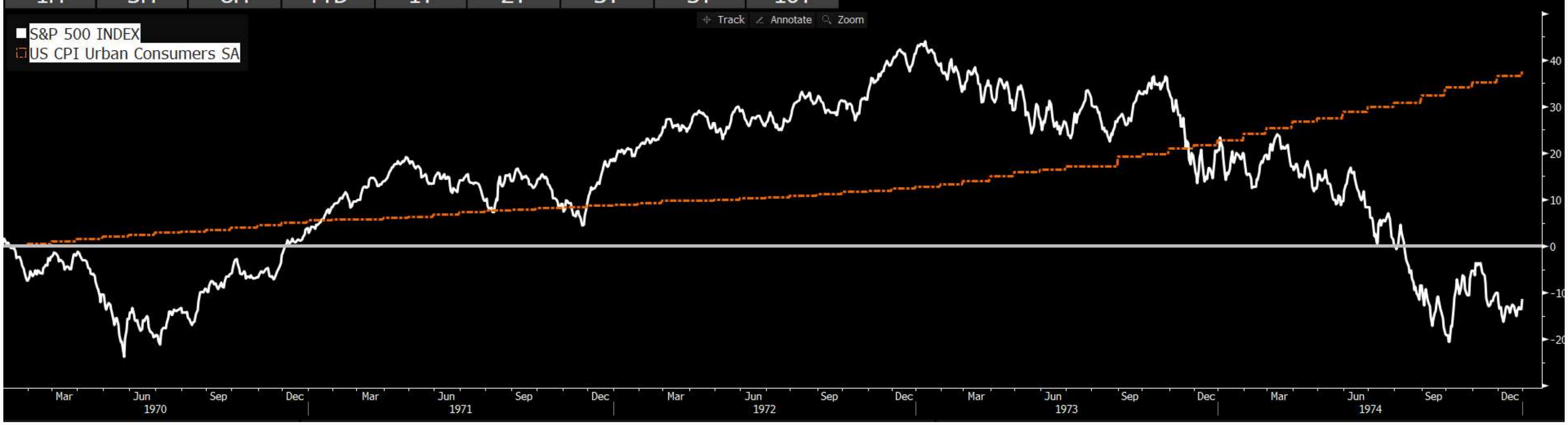
However, you must stay the course

Sharply rising inflation leads to sharp corrections which are only recovered as inflation is once again tamed.

Range 12/31/1969 - 12/31/1974 Period Daily No. of Period 1826 Day(s) Table

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	SPX Index	USD	-25.53%	-11.32%	-48.98%	-2.37%
2)	CPI INDX Index		37.67%	37.67%	--	6.60%
3)						
4)						
5)						
6)						

1M 3M 6M YTD 1Y 2Y 3Y 5Y 10Y



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Flagship Funds in Q3

A challenging quarter

- **Our Global Flexible and Global Equity Strategies returned -3.2% and -4.6% respectively**. The top contributors to our total return for the quarter were **Endava**, **TCS** and **Microsoft** and the largest detractors were **Alibaba**, **Zalando** and **Netease**.

- Year to date the flexible and equity strategies are up 1.4% and 3.6% respectively.

- In our **Global Fund of Funds**, the top contributors to our total return of +3.9% for the quarter were **Artisan Global Discovery** and **Sands Capital**, while the largest detractors were **Guinness Global Innovators** and **Lindsell Train.**

- Year to date the global fund of funds strategy is up 9.6%.

How have our investments fared?

Results confirm that our companies continue to perform strongly

zalando	Beat consensus. GMV +40% Revenue + 35%. Reiterated 2021 growth outlook	TINKOFF	Beat consensus. +30% loan growth, FY increased to 50%+ loan growth.
Microsoft	Beat consensus. Revenue +21%. EPS + 49%. Cash returned to shareholders reached $10.4bn	CAPRI HOLDINGS LIMITED	Beat consensus. Annualized revenues tracking higher than pre-pandemic, raised full year guidance.
APPLIED MATERIALS	Beat consensus. Revenue +41%. EPS +79%. Raised guidance for the year	PayPal	Beat consensus. Revenue +20%. PayPal now has 403 million users, up from 345 million 1 year earlier.
PagSeguro	Beat consensus. PagBank TPV + 342% yoy, 11.2 million users and a loan book of R$1.1 billion.	endava	Beat consensus. Revenue +30% yoy, profitability higher than expected. Guidance raised.

Activity in Q3 2021

3 out, 3 in

OUT	Why?
Taiwan Semiconductor	Valuation (26% return)
Adobe	Valuation (89% return)
Tencent	Rationalizing Chinese exposure (-15% return)

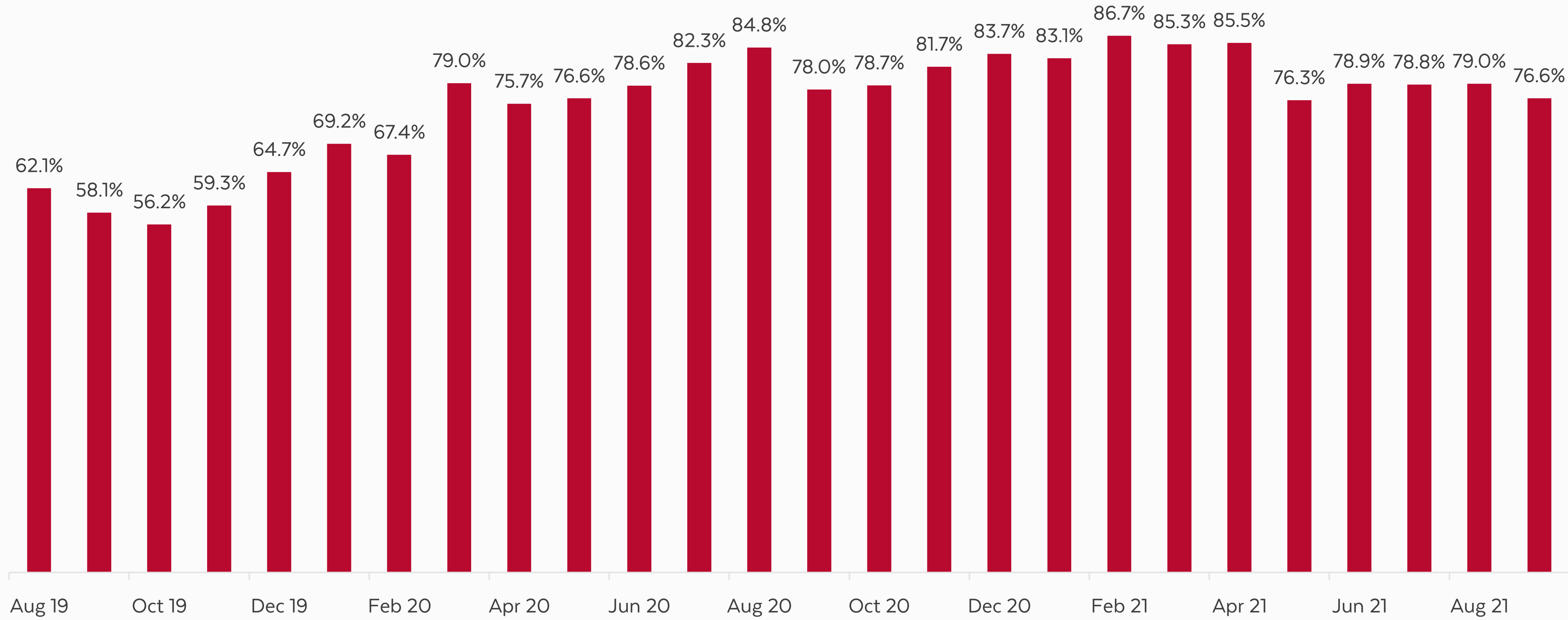
IN	Why?
Applied Materials	Leading equipment manufacturer to the Semiconductor Industry
Rakuten	Japanese E-commerce leader pivoting into telecommunications
Wilson Bayly Holmes	High quality construction company benefiting from cyclical upturn

Positioning in the Flexible Strategy

Stock selection is augmented or de-emphasized using risk mitigant tools

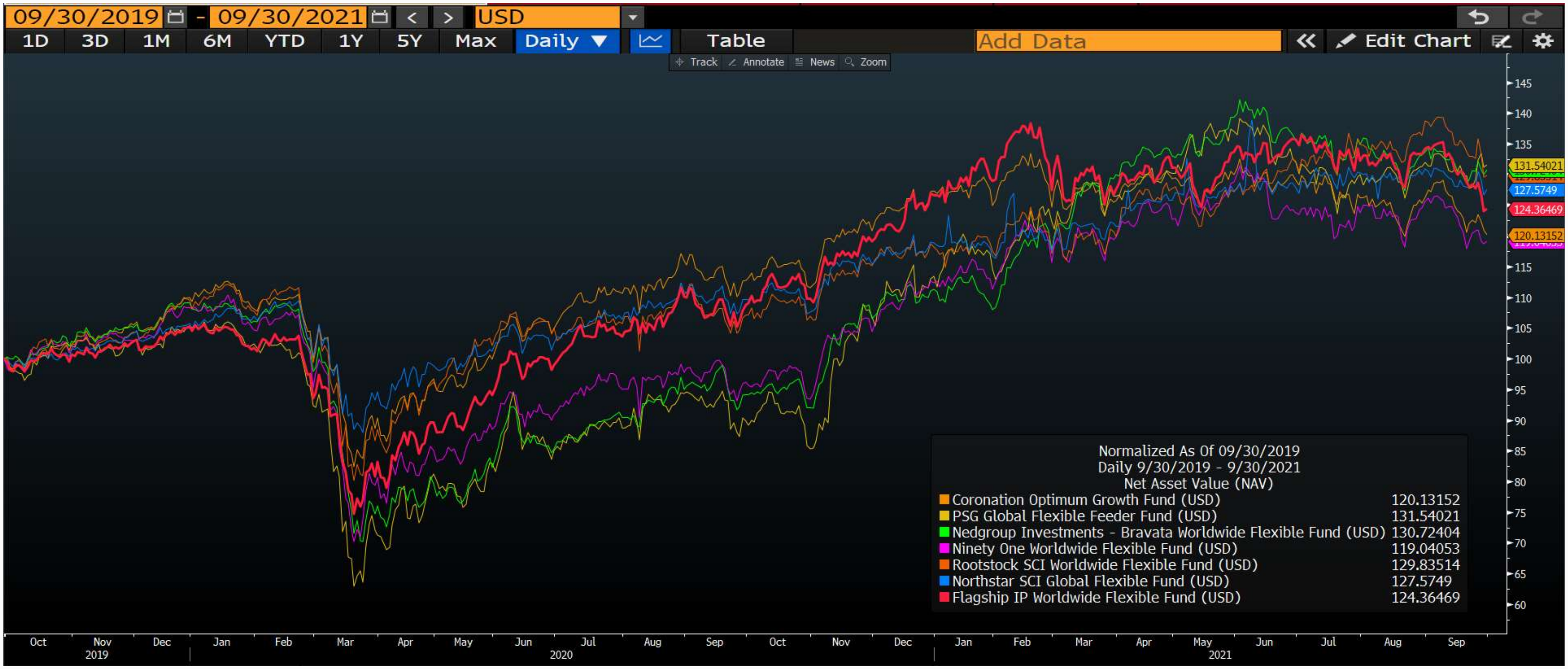
Equity Exposure in the Flexible Strategy

Equity exposure was lightened in May 2021 as we entered the 2H of 2021



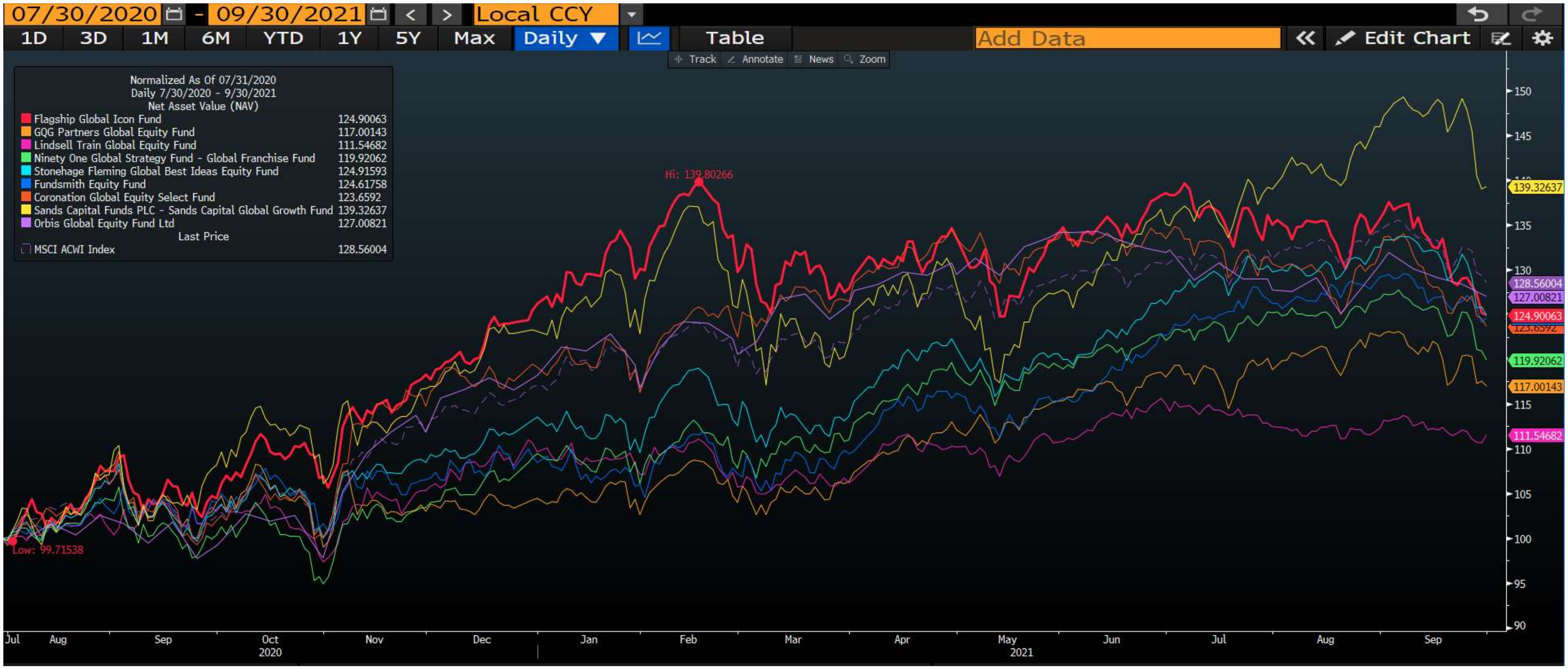
Flexible Strategy Performance vs Peers

Flagship IP Worldwide Flexible Fund, two years to September 30, 2021, normalized at 100



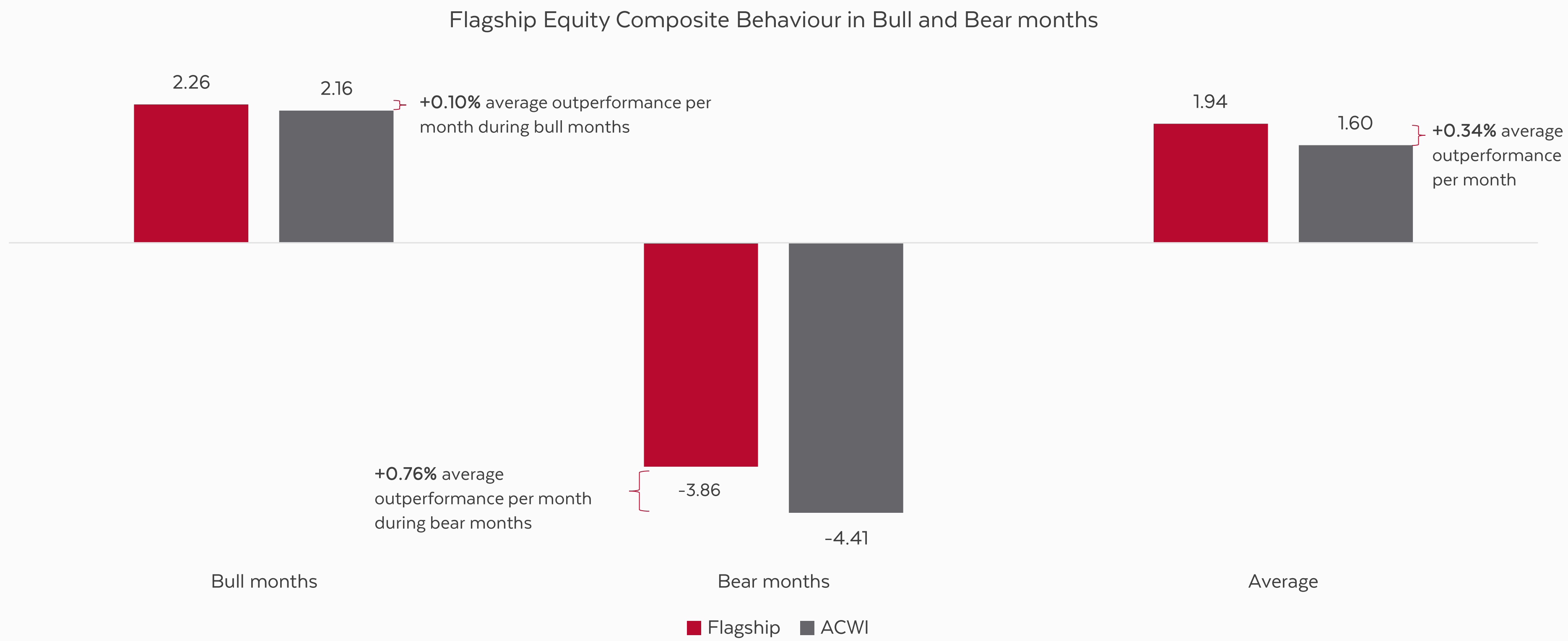
Equity Strategy Performance vs Peers

Flagship Global Icon Equity Fund since launch, normalized at 100



Monthly Equity Returns – Bull & Bear

Performance of the Flagship Equity Composite - June 2019 to September 2021



Note: The Equity Carve Out begins from the date that the Equities in the Flexible Fund transitioned to the selection determined by the current global team, on June 1, 2019. The carve out excludes trading costs, fees, and other fund expenses. From August 2020 the returns of the Icon Global Equity Fund Class "C" are used. The C class carries zero management fees, but incurs manco fees of 30bps annually.

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Setting the scene

China is an inescapable part of the global investing landscape and managers need to learn to price it correctly

1. There is no hiding from China.
2. We are and have always been selective in China.
3. Quality first.

We are fully aware of the **risks** in China, just as we are fully aware of the possible **returns** from China and other emerging markets..

Emerging markets are part of the universe

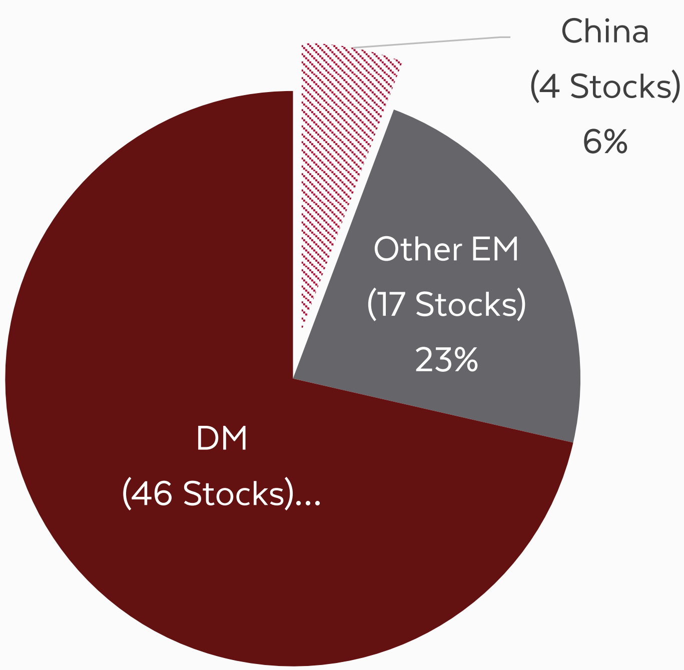
EM positions have contributed a net +**9.84%** to Flexible Strategy performance since May 2019.

- **TCS** (Russia) + 299.8% since May 2019
- **Pag Seguro** (Brazil) + 23.0% since May 2019
- **HDFC Bank** (India) + 49.2% since May 2019
- **Cartrack** (SA) + 94.1% since May 2019
- **Netease** (China) + 95.6% since May 2019

Note: May 2019 used as this is the date the current global team assumed responsibility for the Flagship Global Strategies

China exposure is concentrated in a few stocks

66 positions have been held by the Flexible Strategy since May 2019, only four are Chinese



- The Flexible Strategy has held a total of 66 positions since May 2019

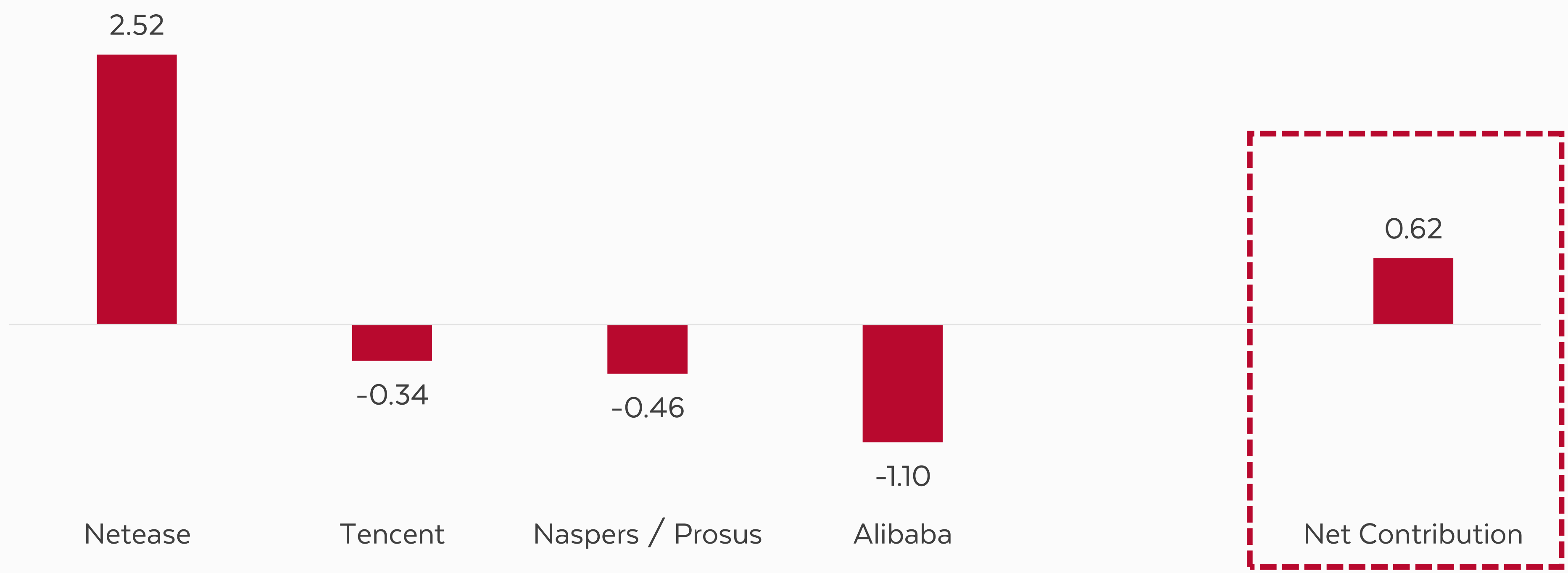
- Only 4 have been Chinese (6% of total positions held): Netease, Alibaba, Tencent and Naspers/Prosus

Note: May 2019 used as this is the date the current global team assumed responsibility for the Flagship Global Strategies

Emerging markets are part of the universe

66 positions have been held by the Flexible Strategy since May 2019, only four are Chinese

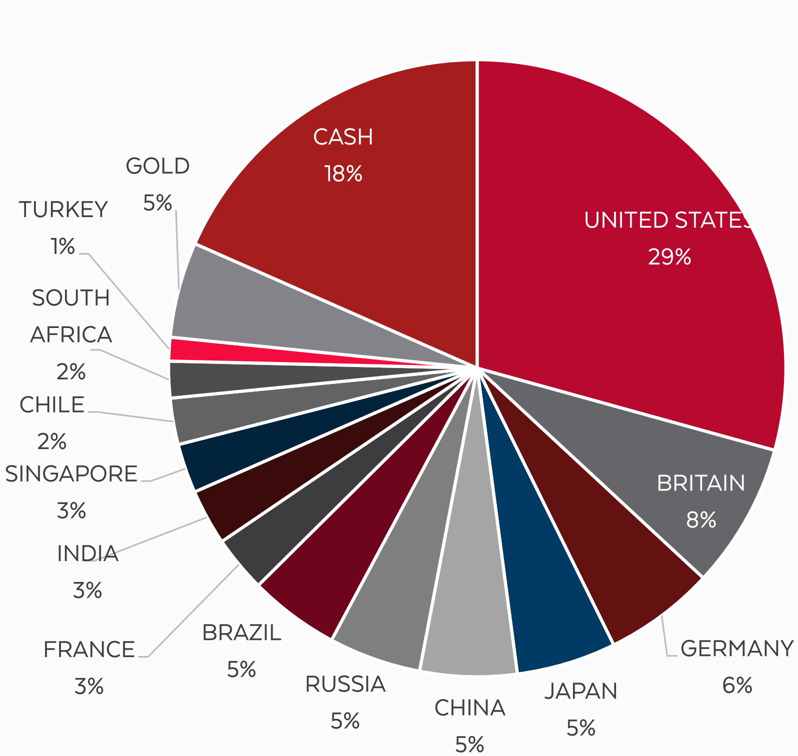
- Our <u>four</u> investments in China specifically have been net positive **+0.62%** to our longest running strategy.



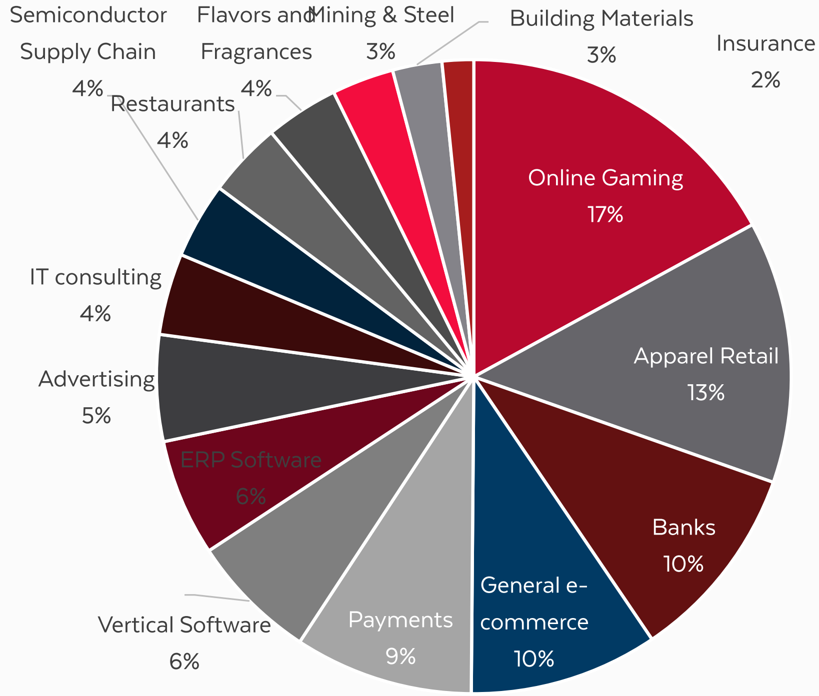
Flagship Geographical & Sectoral Exposure

As of September 30, 2021

By Geography



By Effective Sector



Chinese stocks vs diversification

Flagship Global Icon Fund since inception. Diversification is key to risk management.

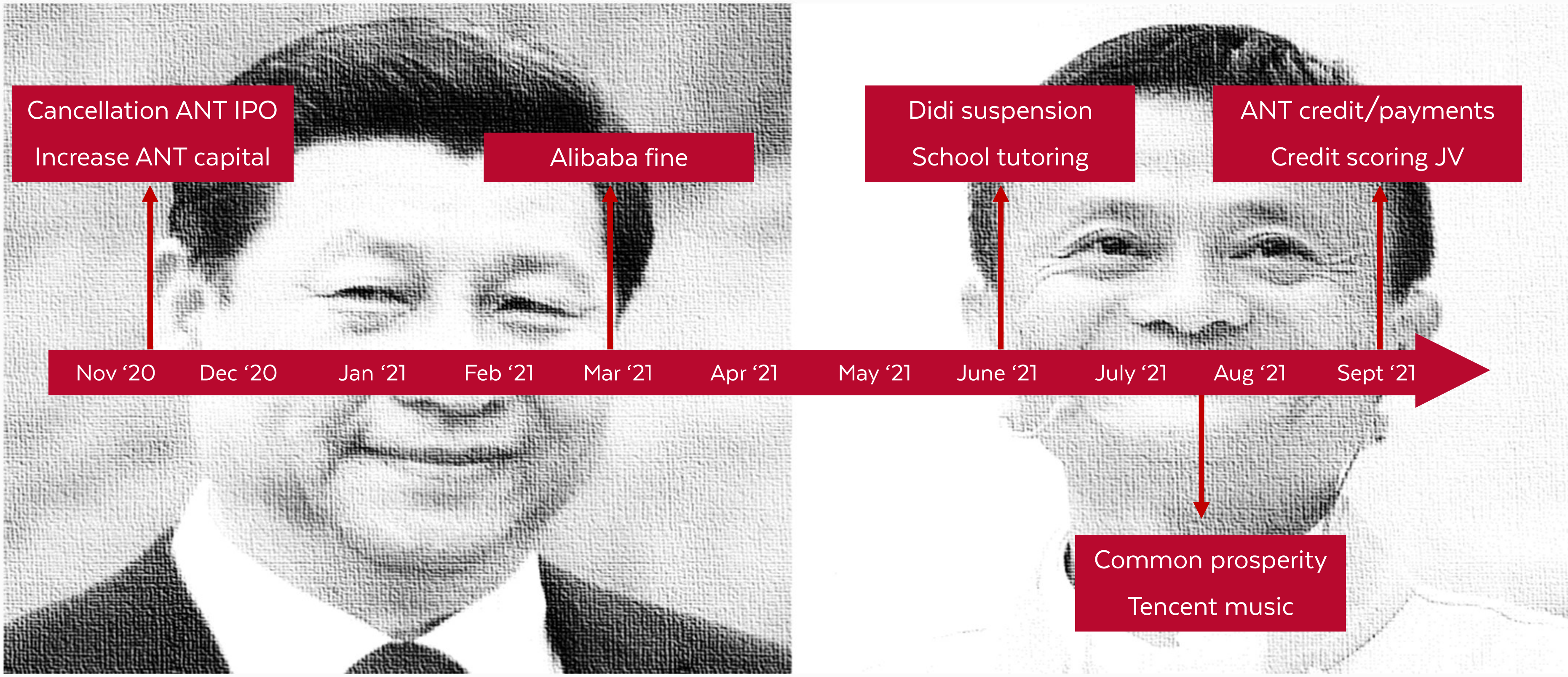
Range 07/31/2020 - 09/30/2021 Period Daily No. of Period 426 Day(s) Table

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	FLAGLIA GU Equity	USD	24.90%	24.90%	65.92%	20.99%
2)	BABA US Equity	USD	-41.02%	-41.02%	--	-36.39%
3)	NTES US Equity	USD	-6.85%	-5.83%	35.19%	-5.01%
4)	700 HK Equity	USD	-13.99%	-13.75%	27.27%	-11.91%
5)						
6)						

1M 3M 6M YTD 1Y 2Y 3Y 5Y 10Y

What has happened in China

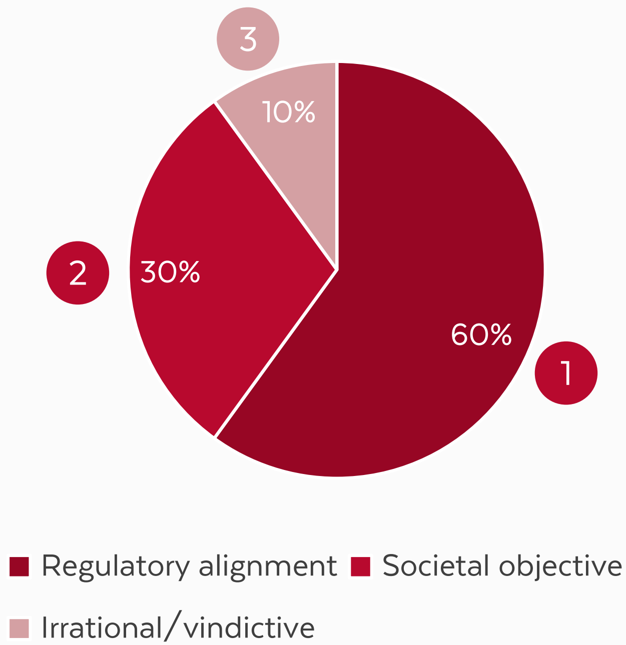
Where it all began



The goal of most regulations are laudable

The manner in which they were promulgated was not

Nature of Chinese newsflow



1

Align regulations with the West

- Increase of ANT capital requirements
- Fines
- Removal of Didi from app stores
- Labor regulations

2

Societal objective

- Ban profit on after school tutoring
- Common prosperity
- Computer gaming

3

Irrational/vindictive

- The disappearance of Jack Ma?
- The potential resignation of Didi founder?
- Macau?

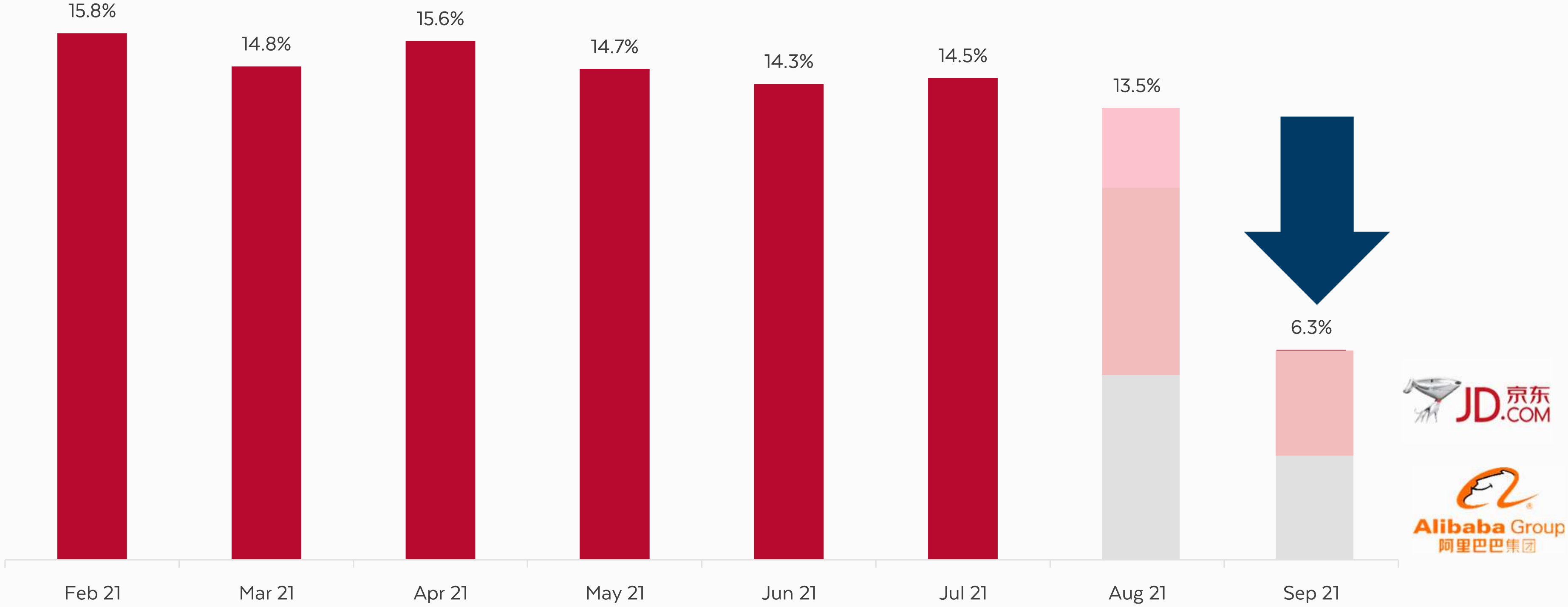
China-specific risk, for now, is higher

If risk increases and commensurate return is the same (or lower), then the position exposure must fall

- Circle of competence?
    - Imponderables
- Should we go to zero?
    - No. Attach low probability to tail risk scenario, remains a compelling base case scenario

Chinese stocks in the Equity Strategy

Despite the attractiveness they present, Chinese stocks will be held within proper risk parameters



Chinese stocks in the Flexible Strategy

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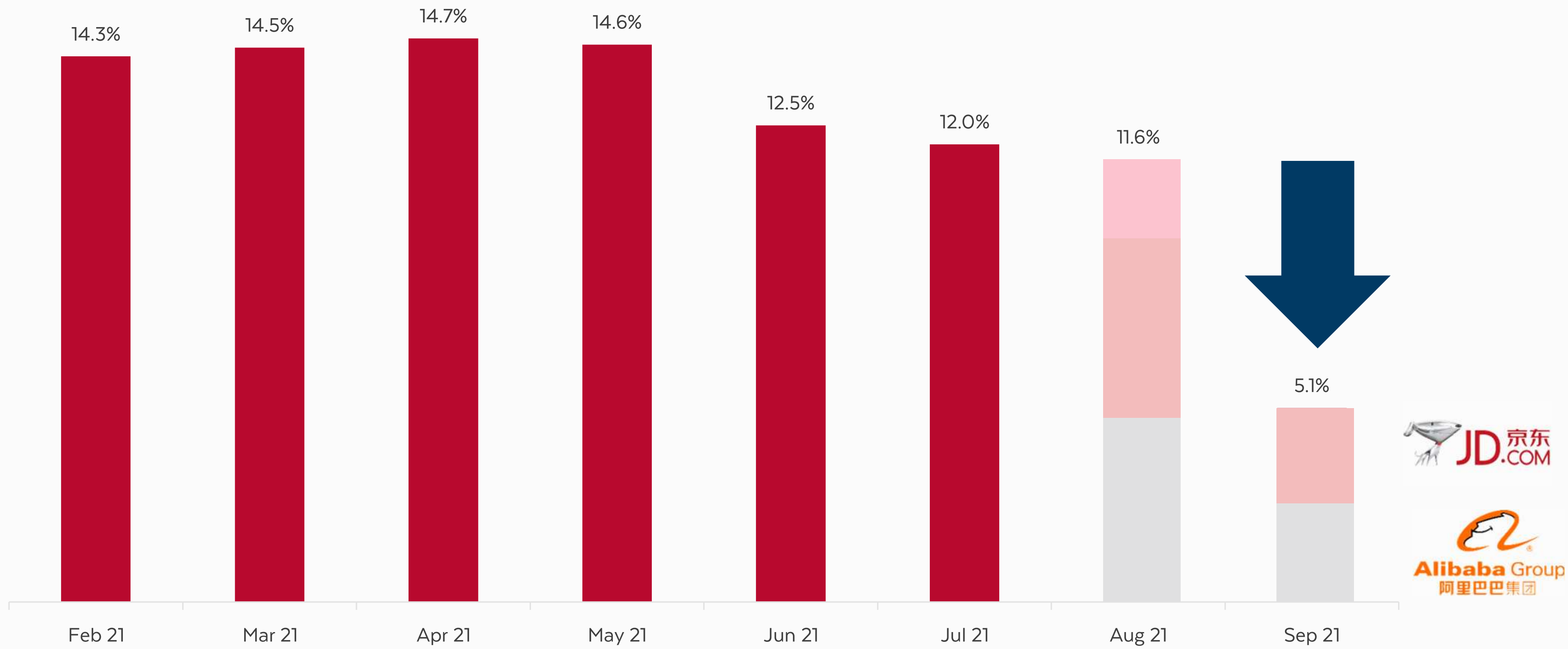

Why these two shares?

Placing Alibaba's valuation within context: Alibaba vs Amazon

	Alibaba Group 阿里巴巴集团	amazon.com
Pillar 1: Ecommerce	GMV = $1.3trn	GMV = $475 bn
Pillar 2: Payments	TPV = $18 trn	Visa: TPV = $10.8 trn
Pillar 3: Cloud	Revenues = $10 bn	Revenues = $56 bn

- Alibaba expected to grow its revenues at a similar rate to Amazon at circa 15% p.a.
- How cheap is Alibaba?
  - EV/commerce "adjusted EBITA": 11X, P/E = 13X
  - Alibaba's market cap = USD 500bn
    - vs Amazon + **Visa**: USD 2.2 trn

It is far too convenient and comfortable to believe that these things don't matter.
But valuation always matters.

The forced bankruptcy of Yukos oil

What is the real story from Yukos? Did Russia become uninvestable? No.

Concluding Thoughts

Some Yin, some Yang

- The new regulations are both sound and in most cases laudable.
- If the greater good can be achieved, sacrifices will be made. The implementation of policy will have winners and losers. And unintended consequences that equity holders may suffer from.
- Counter to the thrust of many of its most powerful economic trends of the past four decades: entrepreneurial activity, a thriving start-up culture, private-sector dynamism, and innovation
- Uncertainty in policy application can only reduce the multiple that is applied to Chinese businesses, and hence their upside.

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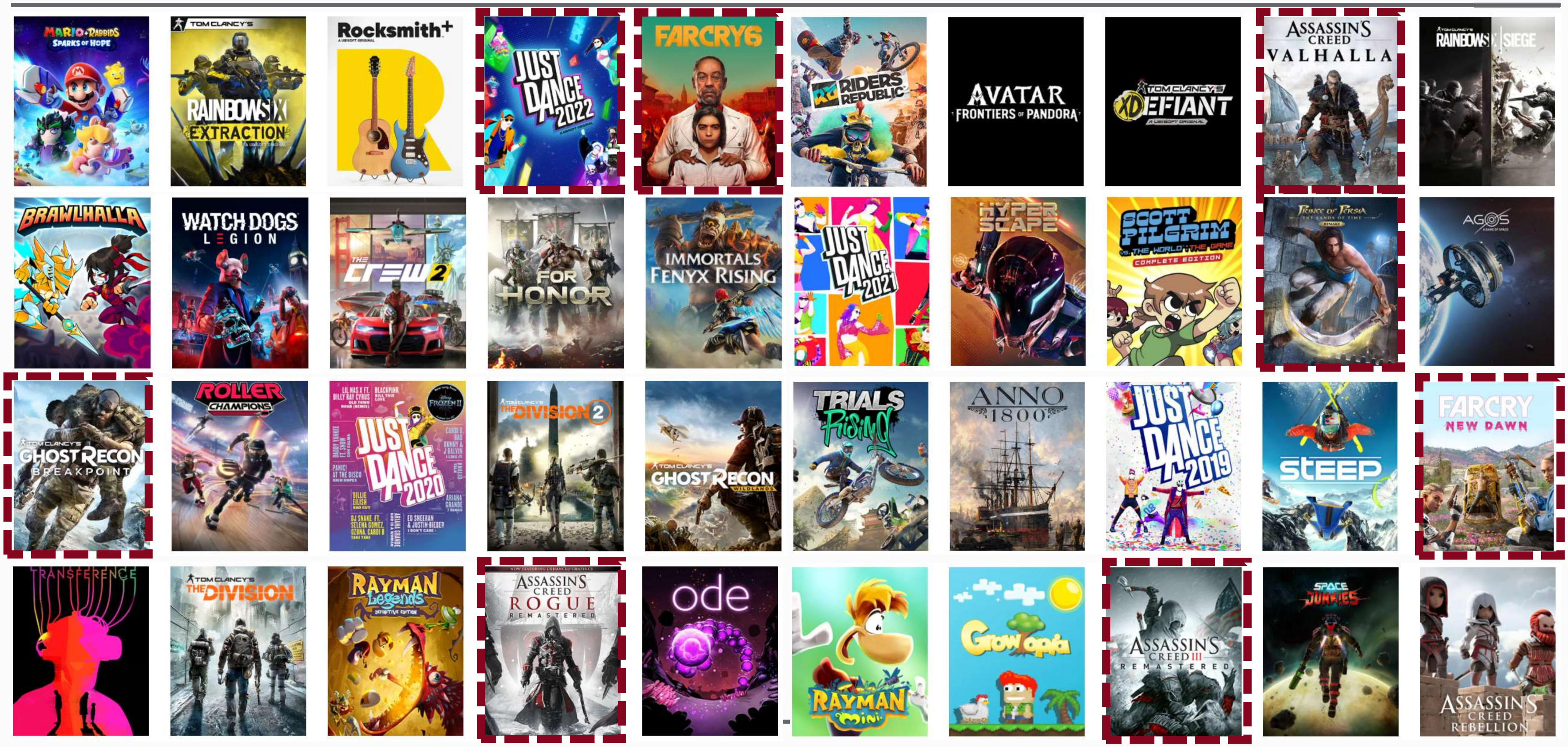
Ubisoft

The creator of *Prince of Persia, Assassins Creed, Rainbow Six, Ghost Recon* and many others

- Why is there a profit-making opportunity?
  - Games are delayed, strategic shift to 'live' games & mobile
  - Inefficiency and low margins
  - Cultural issues
- What's in the price?
- Go where the money isn't going. Small changes can make big waves

A ubiquitous publisher

Beyond their more popular franchises, Ubisoft has a host of niche titles



A founder-led business

Founder-led businesses have outperformed the broader market

- The founding five Guillemot brothers remain entrenched in the leadership of Ubisoft and retain an 18.5% equity stake in the company.





Ownership of their Intellectual Property

Ownership of IP is critical to ensure long term franchise value

KEY PLAYERS' TOP FRANCHISES: IP OWNERSHIP

UBISOFT	
Assassin's Creed	Yes
Far Cry	Yes
Rainbow Six	Yes
Watch Dogs	Yes
The Division	Yes
Ghost Recon	Yes
For Honor	Yes
The Crew	Yes

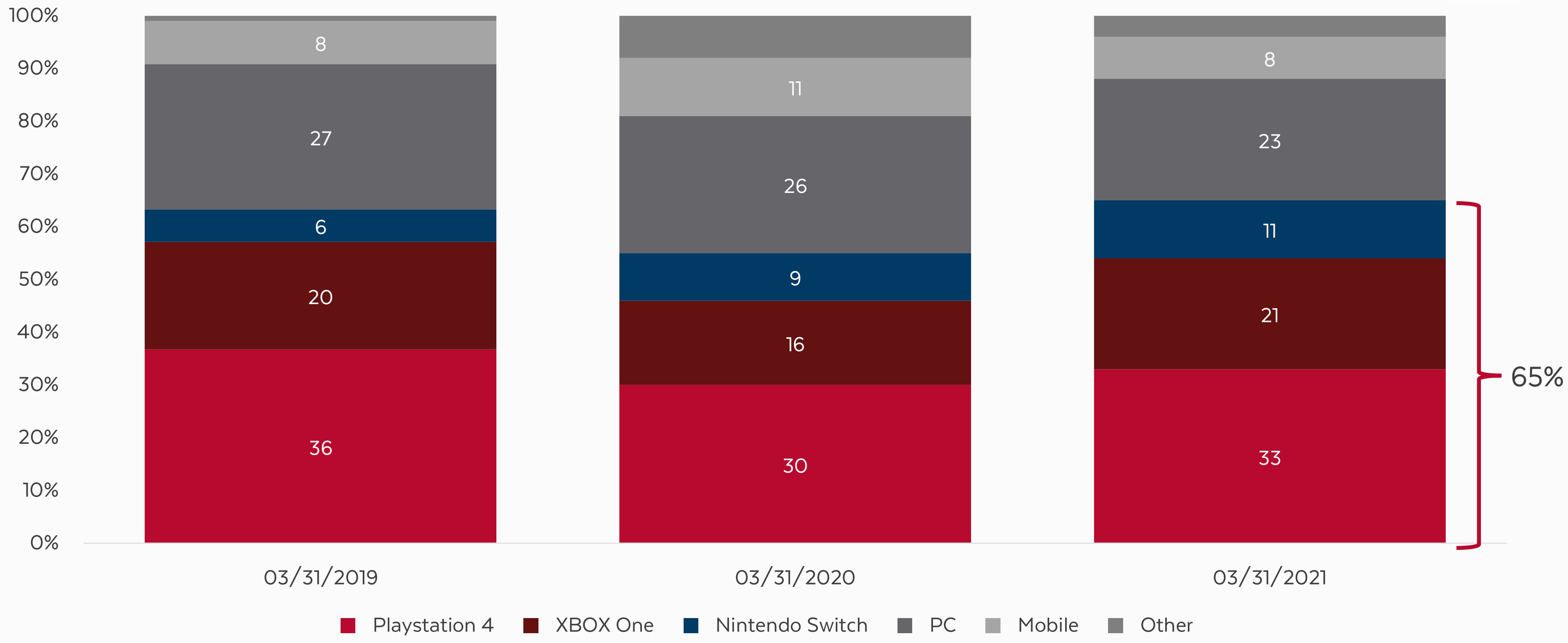
ACTIVISION BLIZZARD	
Call of Duty	Yes
World of Warcraft	Yes
Overwatch	Yes
Destiny	No
HearthStone	Yes

T2	
Grand Theft Auto	Share profits with dev.
Red Dead Redemption	Share profits with dev.
NBA2K	No
Borderlands	Developed externally
Mafia	Yes

EA	
FIFA	No
Battlefield	Yes
Star Wars Battlefront	No
Madden	No
NHL	No

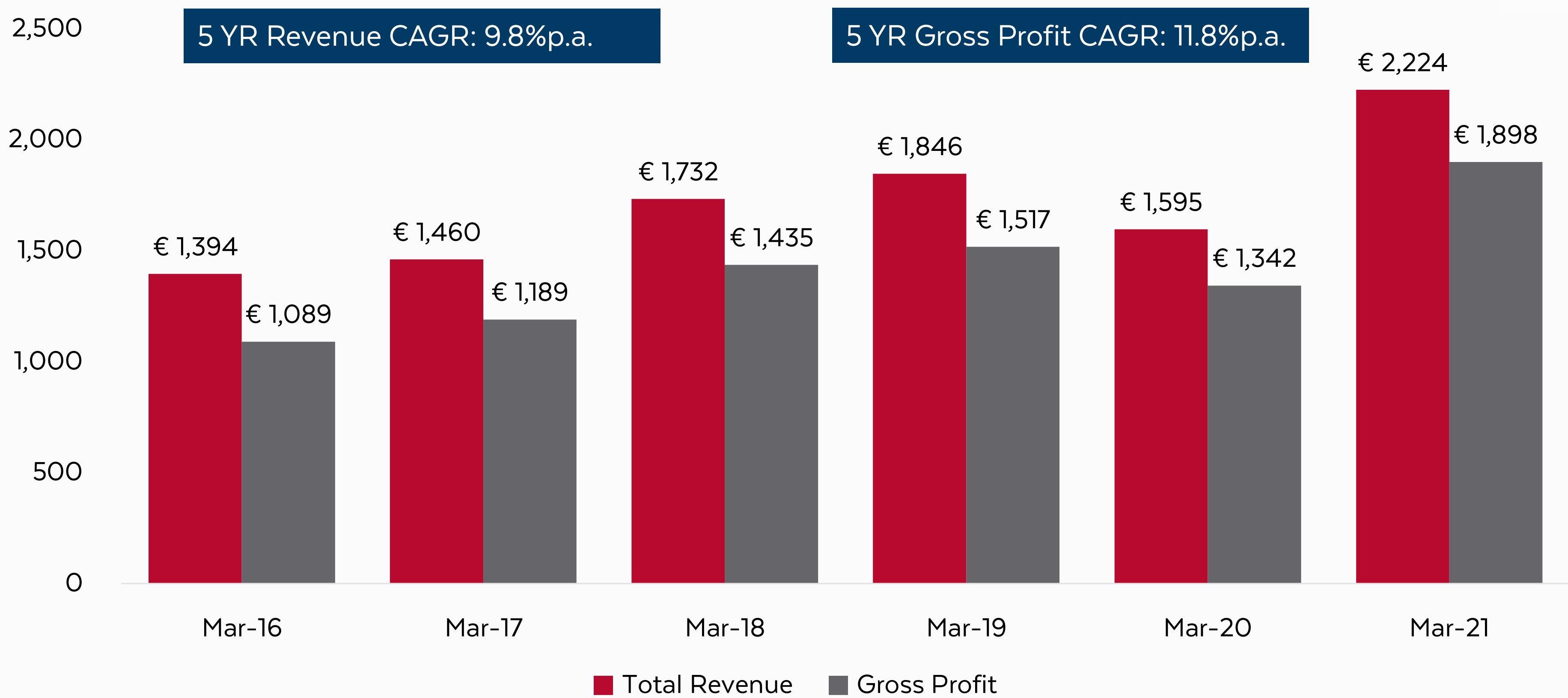
Diverse Distribution Channels

Consoles account for 2/3 of sales, although mobile lagging heavily at 8% of 2021 sales



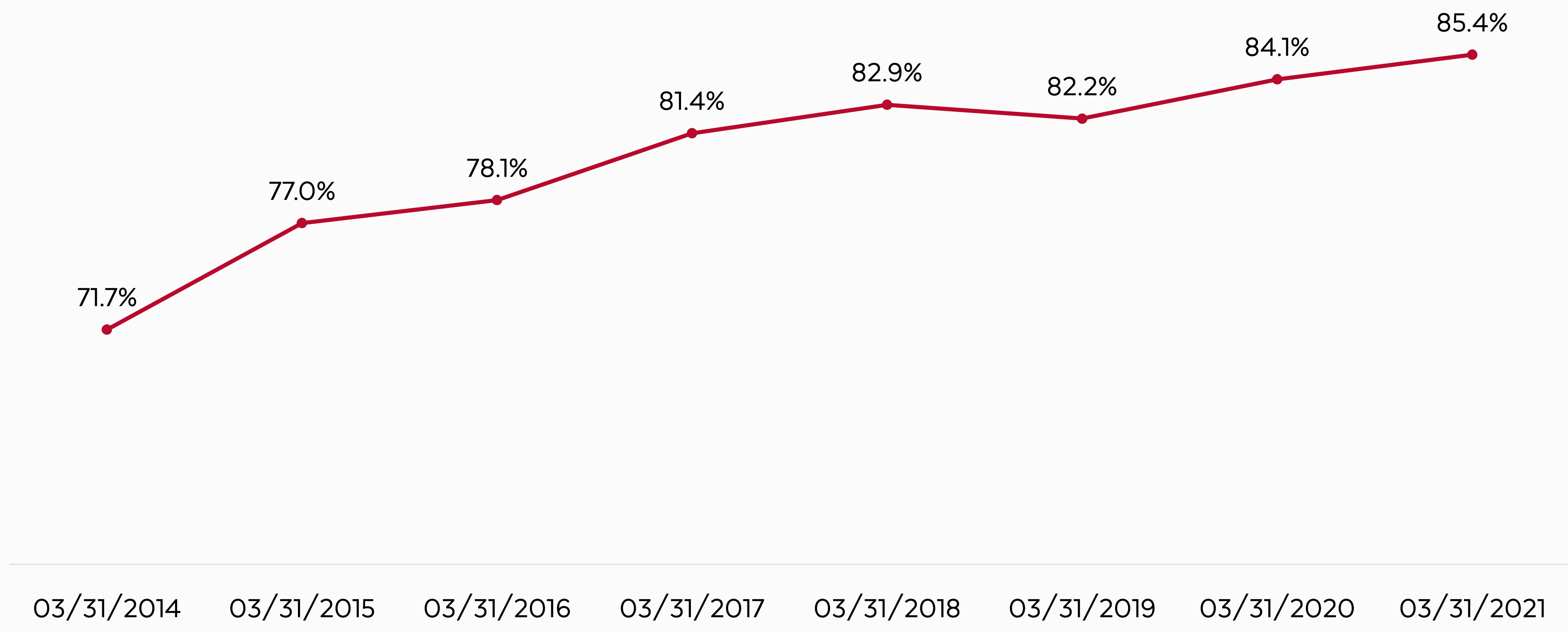
Growing revenue and gross profit

5 year revenue and gross profit CAGRs are attractive



Gross Profit Margin has been steadily rising

This is a good indicator of pricing power



The share price has fallen

UBI lost 1/3 of it's value over the past year, now trading at the same share price as late 2017 (four years ago)

The P/E has derated

from high 20s to low 20s

Why? Three major issues

Less annual releases, more live games, more recurring revenue, and more mobile games are driving changes

Game delays, embarking on strategic changes

*"We **overhauled** our portfolio, developing numerous multiplayer games in recent years which have dramatically increased player engagement in the Ubisoft world"*

Inefficiency

- Revenue per employee a fraction of its peers.
- Between 2016 and 2021, Ubisoft's revenue increased at a CAGR of **only 5.3%,** while its headcount increased at a CAGR of **14.0%.**

Cultural issues

- There have been alleged instances of sexual harassment at its various workplaces

Employee inefficiency

Labor costs have been allowed to balloon.

- The growth of headcount significantly restricts profitability, with Ubisoft generating losses in FY2020 (before recovering to profitability in FY2021).

Company	2020 Employee Headcount	2020 Revenue (US$ millions)	2020 Revenue per Employee (US$)
Take-Two Interactive	5,800	3,089	532,600
Activision Blizzard	9,500	8,086	851,200
Ubisoft	18,045	1,944	107,700
Zynga	2,245	1,975	879,700
Electronic Arts (EA)	9800	5,537	565,000

New Strategy is definitely positive

But there will be a bumpy road while they get it right

Example: Increasing user engagement leads to higher recurring revenue such as item sales

IN-GAME REVENUE

ASSASSIN'S CREED

FLAMING HORSE:

1,500 HELIX

=

14.99€

DIGITAL EXTRA CONTENT REQUIRES MUCH LOWER LEVELS OF R&D AND MARKETING

+ 10 points in incremental digital extra content monetization

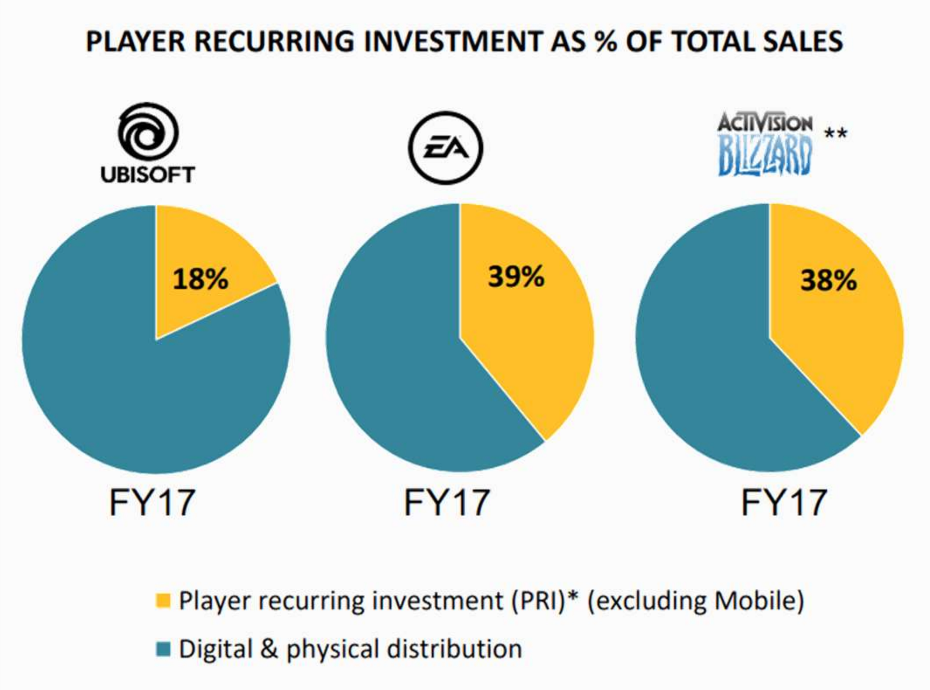
=

+ 3 points in Gross Margin (full EBIT impact)

+ additional EBIT margin uplift from operating leverage on low R&D and marketing costs

Ubisoft has a long way to go

Recurring revenue model has been adopted by peers far sooner, to greater effect



What is the downside?

The IP sets a floor to the valuation

- On the high side, Microsoft paid 6x sales for Bethesda, EA paid nearly 5x for Codemasters
- A price lower than 2.5x revenue would immediately cause a bidding war on Ubisoft
- Ubisoft currently trades on a price/sales multiple of 3X
- We believe its floor price is only 15% below current, upside is potentially significant

An Asymmetric Investment Case

- It's an good gaming company priced as a very poor gaming company.
- The actions they are taking on the gaming portfolio should lead to higher revenue and operating profit growth in the next few years
  - Small changes in its operations will lead to a higher multiple
  - Growth in sustainable digital sales will lead to a higher multiple
  - An end to the current cultural issues will lead to a higher multiple
- The downside protection is the value of the IP – which sets a floor

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The Way Forward

Investors should expect more of the same: diverse exposure to our best investment cases

Flagship DNA

- Hold an intelligently concentrated collection of businesses we know well

Regional exposures

- Create diversified portfolios that contain risks we understand and can manage

Asset allocation

- In our multi-asset funds, making use of the tools we have available in our flexible funds

info@flagshipsa.com

Your Future is Safe with those who Know.