LIGHTHOUSE ADVISORS
Keeping Your Capital Safe

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Client Newsletter for the period ended 31 March 2022

Welcome to the Lighthouse Advisors newsletter for March 2022.

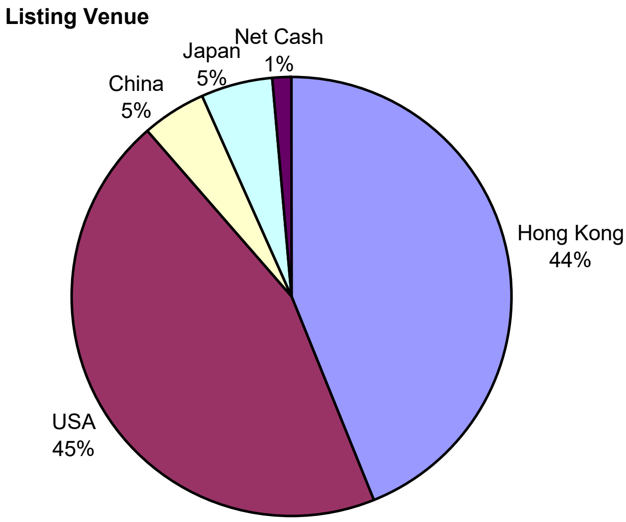
1. **Summary**
2. **Market Commentary**
3. **Portfolio Review**
4. **Rights without Votes**

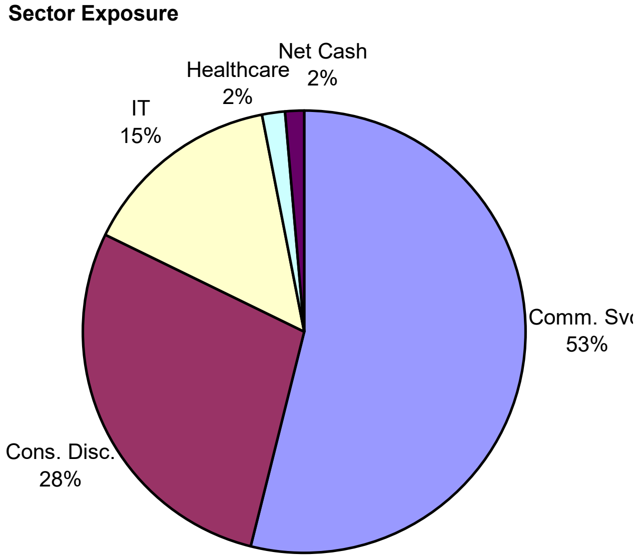
1. Summary

The NAV for March 2022 was USD 70.58 (SGD: 95.63). Year-to-date return was -14.8% (SGD: -14.4%).

Market Index	1Q22
Hang Seng Tech	-19.6%
NASDAQ	-9.1%
Fund	**-14.8%**

19 securities made up 98% of the Fund's holdings, with the balance in cash and cash equivalents. The following charts show the approximate exposure by place of listing and GICS sector (percentages may not add up or match exactly due to rounding).





A detailed chart of holdings is in Annex I. NAV values (USD and SGD) are tabled in Annex II.

Updated 23 June 2022

2. Market Commentary

Inflation from high energy prices and supply chain disruptions have combined with higher interest rates to spook investors. The sell-offs have been steepest in speculative securities, but blue chip stocks have also been sold down.

Cryptocurrencies have come under pressure after the collapse of "stablecoin" **Terra** (now renamed Terra Classic, **USTC**) and its sister token **Luna** (now Luna Classic, **LUNC**)[1]. The fallout has spread to other crypto-linked assets, such as non-fungible tokens (NFTs).

The abuse of cryptocurrency novices was perhaps best exemplified by Sky Mavis' game *Axie Infinity*, which promised that players could "play to earn" but was fundamentally dependent on new players paying as much as US$1,000 to join i.e. it was simply a Ponzi scheme masquerading as a game, as earnings of existing players came from cash paid by new players[2,3].

Chinese technology stocks have mostly been stable since the government resumed approving video games in April, while US stocks have been sold down as investors worry about inflation.

The next newsletter will be written for the period ending 30 June 2022.

Benjamin Koh
Chief Investment Officer
Lighthouse Advisors
23 June 2022

[1] *The Fall of Terra: A Timeline of the Meteoric Rise and Crash of UST and LUNA*, **Coindesk**, 1 Jun 2022

[2] *Axie Infinity's financial mess started long before its $600 million hack*, **The Verge**, 8 Apr 2022

[3] *Axie Infinity – a developing world's Messiah or the biggest Ponzi Scheme in crypto?* **Medium.com**, 10 Aug 2021

3. Portfolio Review

Divestments

There were no divestments.

New Investments

There were no new investments.

Other Developments

Alibaba reported that FY22 Q4 revenue increased 9%. Adjusted EBITDA was lower by 22% due to lower margins in China commerce. In revenue terms, China Commerce grew 8%, International Commerce grew 7%, Local Consumer Services grew 29%, Cainiao logistics grew 16%, Cloud grew 12% and Digital Media was flat.

Alphabet announced that in 2022 Q1, revenues were up 23%, while operating income rose 22%. The company also launched a US$70bn share repurchase plan.

Baidu reported that 2022 Q1 revenues rose 1%, while operating income fell 7%. Ad revenues remained weak, but non-ad revenues grew 35%. AI Cloud rose 45% and is now about 70% of non-ad revenues.

Booking announced that for 2022 Q1, revenue rose 136%. Adjusted EBITDA was US$310m versus a loss of US$195m. Demand continues to recover as post-Covid travel resumes.

Expedia reported that for 2022 Q1, revenue rose 81%. Adjusted EBITDA was US$173m versus a loss of US$58m. Demand is recovering as major economies exit Covid restrictions.

Hong Kong Technology Venture reported that 2021 revenues rose 8.8%. Net profits fell 92% due to promotional expenses for a gift voucher program, as well as the lack of government subsidies compared to the previous year. User metrics remain strong with daily orders rising by 14% and unique customers increasing by 16%. The company now carries over 800,000 products from 5,500 merchants, versus 500,000 products from 4,200 merchants in 2020.

Kingsoft reported that 2022 Q1 revenues increased 19% while operating profits fell 2%. Games revenue rose 24%, while office software revenue rose 13%. However the revenue gains were offset by higher costs in research and development (rising 24%) and selling and distribution (up 32%). The company expects better results for the rest of the year due to new game launches.

Kweichow Moutai reported that 2022 Q1 revenues rose 18%, while net profits rose 24%. Direct-to-consumer sales are now 34% of revenue.

Meituan reported that 2022 Q1 revenues rose 25%. Adjusted EBITDA improved by 23% but remained lossmaking. Food Delivery revenue arose 17% and operating profits rose 41%. In-Store, Hotel and Travel revenue rose 16% and operating profit rose 26%. These were offset by New Initiatives, where revenues rose 47% but losses also increased by 12%.

Microsoft reported that for the March 31 quarter, revenue rose 18% and operating income increased 19%. Productivity and Business Processes revenues rose 17%. Intelligent Cloud revenues rose 26%, and More Personal Computing revenues rose 11%.

Mobvista reported that 2H21 revenues rose 80% while adjusted EBITDA was US$21m versus a loss of US$10m.

NetEase reported that 2022 Q1 revenue was up 14.8% while operating profits rose 29%.

Nexon reported that 2022 Q1 revenues were up 3% while operating income was down 11%. Its launch of *Dungeon & Fighter Mobile* on March 24 was very successful and the company expects Q2 operating income to increase sharply, in the range of 47-77%.

Sea reported that 2022 Q1 revenues rose 64% versus the previous period. However EBITDA was a net loss of US$510m versus positive EBITDA of U$89m. This was attributed to increased research and development expenses, continued investments in Brazil and Indonesia, and declines in the Digital Entertainment segment due to the game *Free Fire* being banned in India.

Tencent reported that 2022 Q1 revenues fell 6% while adjusted profits fell 23%. Costs for servers, bandwidth and content rose 8%, compressing margins.

Tongcheng Travel reported that 2022 Q1 revenue rose 6.5%, while adjusted EBITDA increased 4.4%. Paying users increased by 21.4%.

Unity Software reported that 2022 Q1 revenues rose 36%. Adjusted loss was US$23m, flat versus the previous period. However the main concern was accuracy problems with its Pinpointer ad engine, which resulted in poor results and decreased ad spending. Pinpointer is expected to be fixed during 2022. The estimated impact is about US$110m, or 7% of 2022 forecast revenues.

4. Buy Now Pray Later

Buy Now Pay Later (BNPL) has become increasingly popular in recent years. Companies like **Klarna**, **Afterpay**, **Affirm** and **Zip** are some of the better-known players.

Proponents call BNPL a financial innovation, splitting a purchase into a small number of equal interest-free installments. This improves affordability, which in turn encourages the consumer to buy more: BNPL increases the basket size by over 50%[4] . For merchant and consumer alike, it looks like a win-win. Is the BNPL provider a winner too?

Installment payments are not new. Homes have been bought on mortgage for centuries, and since the last century cars have been bought on credit. But houses and cars are good

[4] *Buy Now Pay Later: Will Regulation Burst the Bubble?* **Endava.com**, 1 Feb 2022

collateral – they can be seized and resold by the lender to raise cash to pay off the loan.

Financing consumer goods is a different game. Furniture retailers and department stores have offered installment plans (hire-purchase) for big-ticket items like sofas, beds, televisions and washing machines for decades. But it is a problematic business model: demand is traditionally highest in the weakest economies, but weak economies generate high default rates. Defaults are a problem – most of the goods have very little value when seized and resold. The high cost of repossessing goods means it is seldom worthwhile to do so. In other words, a default often results in a total loss on the remaining balance, unlike houses or cars, where a substantial sum can be raised from auctioning off the seized asset. As a result, installment plans typically charge high rates of interest to compensate for defaults.

BNPL companies mostly do not charge interest to the consumer. So how do they make money? They buy the receivables from the merchant at a *discount*, and aim to collect the full balance from the consumer. So a merchant who sold $400 of goods to a consumer would deliver the goods, but sell the $400 receivable to the BNPL company at a discount, perhaps at $380. The BNPL company in turn bills the consumer in equal installments e.g. 4 equal payments of $100. Essentially, the BNPL company is a short-term lender.

Buying and selling receivables is also not new. It is known as **factoring**. The difference is that typically, it is business-to-business receivables that are bought and sold. Finance companies purchase receivables outright at a discount and eventually collect the full value from the paying party. BNPL providers buy consumer-to-business receivables and similarly take over the collection of the full sum.

However, when a finance company buys receivables, it performs <u>credit analysis</u> to assess the odds of a default. If it is unsure, the discount is large, or it declines to purchase. In contrast, BNPL providers start with no **specific** data on the consumers who owe the money. While they may impose penalties for late payments and blacklist repeat offenders, these are *reactive* measures that cannot prevent the original loan from going bad.

Combining the low effective interest rates charged, the high cost of repossession, and the low resale value of seized goods, it becomes clear that BNPL companies cannot afford to have any meaningful defaults on their portfolio. Yet, because BNPL financing is not reported to credit bureaus, it is possible for imprudent consumers to use several BNPL services at the same time, with each BNPL operator none the wiser until it is too late. Essentially, the business model of BNPL companies is **Buy** (receivables) **Now**, then **Pray Later** that defaults are low.

As it happens, the global economy is now weakening. How are BNPL companies faring? In a word: poorly.

Klarna booked revenues of SEK 4bn and net losses of SEK 7bn in 2021. In 2022 Q1 revenue were up 19% to SEK 856m, but losses increased nearly *4 times* to SEK 2.5bn.

Affirm reported revenues of US$985m and losses of US$521m for the 9 months ended 31 Mar 2022.

Afterpay was bought by Block (then named **Square**) in February for US$39bn. In April, Block reported that Afterpay's pre-tax losses increased from US$76m to US$502m. One analyst estimated that Afterpay's bad debt ratio was actually *13%*, not the claimed 1.2%.

Zip reported that for the 6 months ended 31 Dec 2021, revenues were up 89%, but bad debt rose 403%.

While the sage is not over yet, it seems BNPL companies need a better business model than just assuming end-users are good credits. In fact, it seems wiser to assume the converse. For now, BNPL shareholders can only… pray.

End

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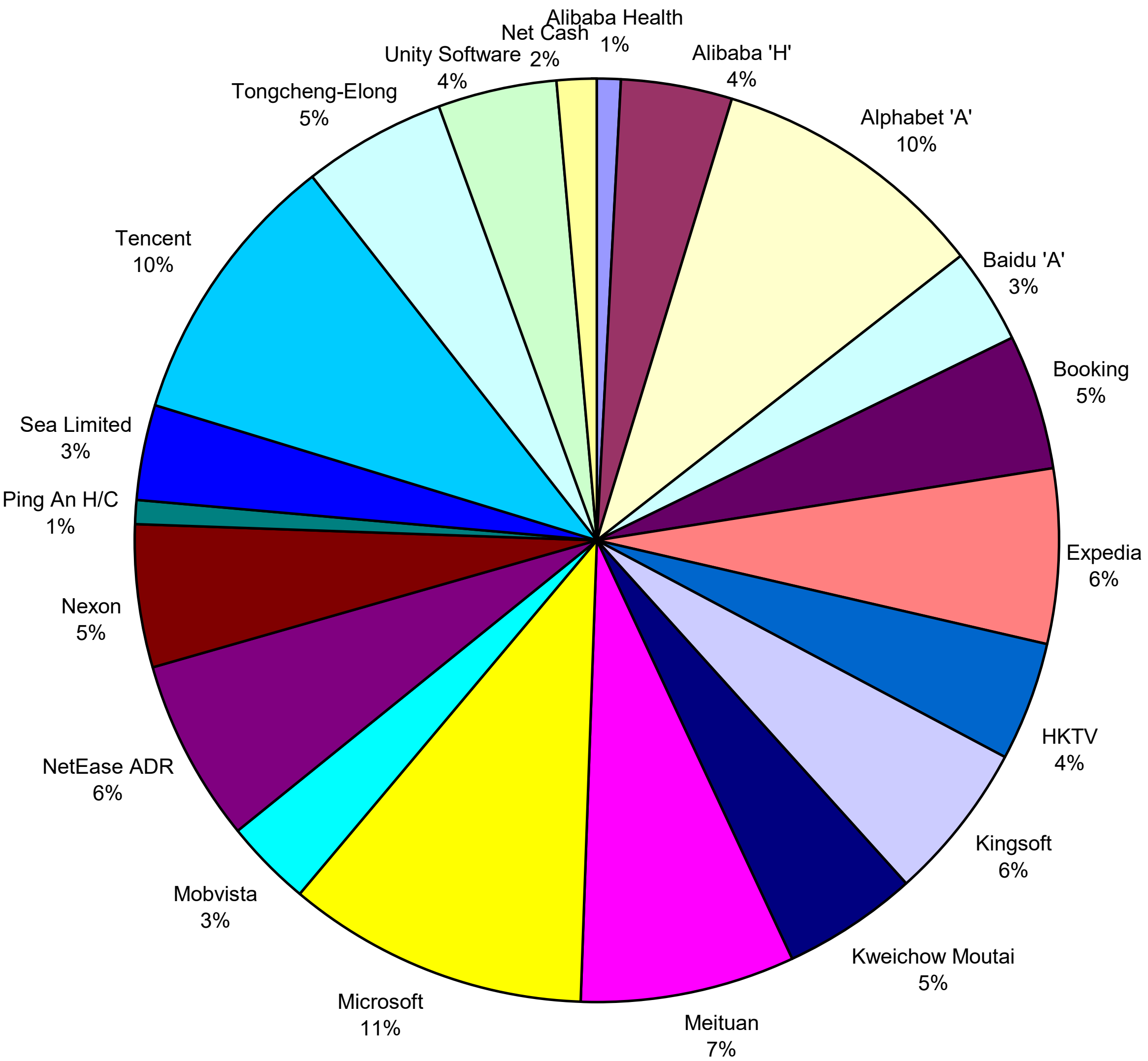
Annex I

Portfolio as of 31 March 2022



Updated 23 June 2022

Annex II

NAV in USD (Official)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008										34.16	33.49	35.62	**4.3%**
2009	34.57	33.52	33.37	36.69	46.20	46.00	50.06	49.68	52.66	54.17	56.68	59.94	**68.3%**
2010	59.05	61.09	65.17	68.27	64.14	65.69	70.65	72.24	81.06	83.56	85.10	90.30	**50.6%**
2011	87.21	86.29	88.13	92.81	90.85	91.35	91.17	83.69	69.04	78.23	73.00	72.88	**-19.3%**
2012	77.40	82.90	82.52	83.32	76.36	77.25	77.27	77.91	80.57	79.44	82.70	84.92	**16.5%**
2013	91.43	97.36	99.96	100.24	99.14	95.09	98.50	100.00	100.86	102.24	102.63	102.93	**21.2%**
2014	99.15	101.78	99.80	101.84	105.45	106.57	109.05	108.58	103.60	103.91	101.87	99.94	**-2.9%**
2015	97.97	98.16	97.74	103.80	103.69	100.99	96.17	85.91	84.17	88.91	86.20	86.35	**-13.6%**
2016	81.56	83.81	88.82	92.18	91.50	91.52	94.48	94.86	94.87	93.34	91.92	90.20	**4.5%**
2017	93.18	97.08	101.10	101.39	105.74	107.11	109.67	108.57	109.35	112.57	108.28	109.41	**21.3%**
2018	113.04	109.56	109.03	105.39	109.62	104.37	101.26	93.71	94.25	85.19	86.83	86.66	**-20.8%**
2019	91.98	92.36	90.04	90.21	82.80	84.21	82.57	78.45	76.52	77.82	78.75	82.80	**-4.5%**
2020	78.58	75.37	67.15	71.23	70.50	77.22	82.23	88.36	84.97	86.77	90.34	93.20	**12.6%**
2021	99.54	99.36	94.98	99.37	96.76	96.86	86.54	87.88	85.09	90.51	85.32	82.81	**-11.1%**
2022	78.21	74.05	70.58										**-14.8%**

Note: The Net Asset Value of the Fund has been linked to the rebased NAV of the Reference Account, which had the same investment style. Until the launch of the Fund, the Reference Account served as the model portfolio for all the separately-managed client accounts. Its trading records were distributed to clients as proof that the Manager's interests were fully aligned with those of the clients. The Reference Account was started at the end of 2008 and became inactive following the launch of the fund on 1 September 2013.

The following data is for the convenience of SGD-based investors and is for reference only.

NAV in SGD (for reference only)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2008										50.68	50.69	51.20	**2.4%**
2009	52.22	51.91	50.74	54.21	66.70	66.59	72.06	71.60	74.19	75.67	78.50	84.15	**64.4%**
2010	83.11	85.83	91.17	93.55	89.79	91.72	96.10	97.84	106.70	108.12	112.34	115.86	**37.7%**
2011	111.57	109.76	111.06	113.64	112.11	112.14	109.75	100.70	89.85	97.91	93.64	94.48	**-18.5%**
2012	97.39	103.46	103.79	103.05	98.44	97.76	96.12	97.20	98.89	96.95	100.95	103.74	**9.8%**
2013	113.19	120.44	124.03	123.50	125.34	120.54	125.55	127.49	126.57	126.83	128.86	127.81	**23.2%**
2014	124.51	128.55	125.58	127.84	132.26	132.85	135.95	135.58	132.14	133.61	132.91	132.34	**3.5%**
2015	132.68	133.74	134.11	137.66	139.74	136.08	131.71	121.30	119.78	124.68	121.53	122.26	**-7.6%**
2016	116.13	117.82	119.59	123.86	126.08	123.36	126.71	129.30	129.32	129.95	131.79	130.54	**6.8%**
2017	131.35	135.81	141.22	141.04	146.29	147.44	148.75	147.28	149.30	153.38	146.00	146.32	**12.1%**
2018	148.13	145.04	142.95	139.64	146.74	142.24	137.76	128.59	128.83	117.98	119.13	118.06	**-19.3%**
2019	123.77	124.86	123.01	122.81	113.88	113.93	113.02	108.85	105.83	105.92	107.71	111.33	**-5.7%**
2020	107.23	105.02	95.47	100.41	99.64	107.68	112.93	120.15	116.02	118.55	121.20	123.14	**10.5%**
2021	132.30	132.32	127.74	132.16	127.85	130.26	117.21	118.19	115.50	122.11	116.41	111.73	**-9.3%**
2022	105.70	100.32	95.63										**-14.4%**