CERNO CAPITAL

TM Cerno Pacific

UCITS Regional Equity Portfolio

Q4 2020

Investment Objectives

The Cerno Pacific portfolio is a geographically specific fund, which invests primarily across the Pacific area but also the wider emerging markets. The fund's objective is to produce capital growth over the long term through a focus on companies that are judged to be innovators or are beneficiaries of innovation through their products, services or business models. The optimal route to access the full benefit of innovation is likely to be, directly or indirectly, in the form of equity, which will be the predominant asset class in the portfolio. The manager takes an active approach to currency exposures and may hedge where deemed appropriate.

Fund Data

NAV/Share	£21.47
Fund Size (£mn)	£61.5mn
Currency Share Class	GBP (Base)
ACD	Thesis Unit Trust Mgt
Custodian	Northern Trust
Legal Structure	OEIC (UCITS)
Inception Date - Fund	Jan 2017
Inception Date - Strategy	Oct 2009
Saving Structures	SIPPs & ISAs
Share Type	Acc & Inc

Q4 20 Investment Report

Fund Activity

Performance commentary and position changes during the quarter

Center Testing International – Testing Times

China's leading testing, inspection and certification service provider

GMO Payment Gateway – Online Payment Enabler

Leading Japanese facilitator of online payments

Fund Managers

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Michael Flitton - Co Manager
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Fund Activity

The fund delivered +22.2% in Q4 in GBP terms. Full year performance was +66.7% against +19.7% for the Asian Index. The Technology and Healthcare sectors were particularly strong in the quarter as was consumption and export data from China.

The top three contributors in Q4 were Bilibili (+114%), Kingdee (+48%) and Hangzhou Tigermed (+55%) collectively adding +6.5% to portfolio performance. Bilibili, a Chinese online video entertainment platform, in particular saw strong price momentum since November, after surprising the market with a 74% year-on-year increase in revenues in Q3 and resumed its high active and paying user growth (+42% & +110% YoY, respectively), reversing the stagnation that worried investors over the summer months. The company, currently US-listed, has also announced plans to raise US$2bn via a Hong Kong listing.

On the other side of the spectrum, Alibaba was the main negative contributor (-133bps) to the portfolio. The stock declined 20%, buffeted by headwinds from the failed IPO of Ant Financial in November and the subsequent scrutiny into large internet platform companies by Chinese regulators in December. While we do not think this affects the fundamental growth of its core e-commerce and emerging cloud business, negative sentiment will likely remain an overhang as regulators tighten loopholes around monopolistic behaviours and M&A activity over the course of 2021. This move reminds us of the regulatory investigations that faced the Chinese online gaming and online education sectors a few years back and the toll it took on share prices over a 6-8 months period. Both sectors have recovered to pre-investigation levels after ratifications were completed and signed off by the regulators.

Currencies were broadly neutral in Q4 (-25bps). We continue to hedge KRW and TWD exposure against a long position in JPY. We added to the KRW position in December. Sterling was a broad headwind, rising 5% over the quarter.

Activity in the portfolio was primarily confined to adjustments to existing position weights. We introduced one new name into the portfolio: Centre Testing International, the largest Chinese testing, inspection & certification service provider. We will profile the company, alongside GMO Payment Gateway, a leading Japanese online payment provider, overleaf.

The fund will continue to look for innovative businesses across the Asia Pacific region in 2021. In the first quarter of this year, we plan to offer a Dublin domiciled variant of the fund, to be named Cerno Pacific (Dublin), with major currency classes offered. This fund will mirror the existing fund - the same holdings with the same weights – with the same co-managers and team and a flat priced share class, available in both income or accumulation. If this is of interest to you or investors you represent, please email Tom Milnes and Joseph Joyce via dublinfunds@cernocapital.com.

We thank you for your continued support.

- Fay Ren

Centre Testing International - Testing Times

Centre Testing International (CTI) is the largest privately-owned testing, inspection & certification (TIC) service provider in China. TIC is an essential service that permeates almost every industry, throughout the manufacturing and distribution process.

The Chinese private TIC market is very much the newcomer compared to its peers in Europe, where the large players have been established for over a century (some close to two). The industry only opened up to local private players in 1989, initially in the import/export sector, as China entered the global stage in trade. Gradually, the private sector has been allowed to participate in other industries biddings as part of incumbent State Owned Enterprise (SOE) deregulation with the aim to encourage benign competition. Private players tend to spend more on R&D and focus on operational efficiency versus SOEs. This trend is set to continue, as >50% of the Chinese TIC market to this date is still dominated by SOEs, particularly in sensitive industries. The latest major reform came in 2017 in Measurement & Calibration, where SOEs are no longer allowed to charge fees for this service. The auto sector, currently >70% SOEs, is also in the process of deregulation.

CTI's business spans across four major segments: Life Sciences (food, medical & environment), Trade (3Cs), Consumer (autos & diversified consumer products) and Industrial (real estate & engineering projects). It is one of the few local testers to reach scale in a market competing directly with SOEs, foreign players as well as local independents. It is the only player with nationwide footprint, thanks to its cycle of investments in building out its laboratory network (>140 labs as at end-FY20). While it is less advantaged versus foreign peers without a comprehensive global network that allows them to serve large multinational clients, it has built a solid presence in the domestic market where it derives 95% of revenues and have little exposure to the highly cyclical Energy & Materials industries.

Operating in the TIC market requires a diversified set of technical skills across a range of fields including chemistry, biology, physics, mathematical modelling, mechanics, and electromagnetics, amongst others. This requires trained expertise to execute and analyse the findings. CTI consistently invests in R&D to design more efficient and rigorous detection and analytical methodologies to meet unique testing demands, which tends not to be homogenous even within segments.

It also requires the company to maintain keen up to date knowledge and adaptation flexibility to local and global regulations across different industries. CTI's market position enables it to proactively engage in standard setting, working alongside regulators, which gives the company an advantage in gauging regulatory direction, one of the key risks for TIC businesses. This is a service that facilitates product to market, where customers value quality and credibility. The consequence of breaching regulations can be detrimental to a business both financially and reputationally.

The TIC market is characterised by lower capital investment relative to other business service sectors and better revenue visibility, as many contracts tend to be long-term and recurring in nature. This means that, despite a highly fragmented market, where the top 3 global players (SGS, Intertek, Bureau Veritas) hold <25% market share combined, it is still possible to deliver very decent margins. Concentration tends to occur in niche specific disciplines, with a long tail of small, highly sector-focused companies (e.g. only c.20 authorised auto testers in China).

The Chinese TIC market is anticipated to reach over US$60bn by 2027, according to Grand View Research, expanding at a CAGR of 7.8% between 2020-27. CTI is expected to grow at more than double this rate, having delivered +24% per annum revenue growth over the last 5 years. Higher standards of living and increased public awareness regarding product quality/safety and environmental impact are prompting more stringent regulatory standards. Companies are reacting by trying to reduce the operational cost burden by using specialised third party service providers instead of in-house, which still remains a large proportion of the market.

Despite some short-term disruption to business due to Covid-19 in 2020, over the longer term, the company is in a prime position to benefit from several structural growth drivers, including indigenous innovation, shorter product cycles, increased product complexity, regulation and outsourcing, on top of SOE deregulation.

- Fay Ren

GMO Payment Gateway - Online Payment Enabler

It is often observed that the Covid-19 pandemic has acted as an accelerator to established mega trends. The migration of commerce from offline to online is a prime example. Naturally, consumer facing companies benefitting from this shift attract the most attention. At Cerno however, we have often found the most interesting opportunities residing in the cogs behind the clockface. The B2B businesses facilitating the operations of others.

Underneath the online world is the financial plumbing that makes it all work. Like the Liberators (land levellers), and other specialist Roman soldiers, who engineered the Empire's vast road network, financial plumbing enables the proper functioning of more conspicuous entities.

GMO Payment Gateway is a facilitator of online payments. They are positioned in the middle of a multitude of markets, from ecommerce, to public taxes, and digital goods and services. Ecommerce is the largest revenue driver. They are in the business of plugging merchants into the online payment network of banks, card issuers, and other financial institutions in a safe, and secure way.

GMO PG is the largest independent payment processing company in Japan. The group holds a 12% market share and sits behind the big integrated retail players, Amazon, Yahoo and Rakuten, when measured on gross transaction value. But while the big retailers are internally focused, GMO aims to enable the next wave of Japanese businesses. Their customers are mostly smaller, higher growth companies. GMO PG's competitive advantage is derived from this strategic approach, as well its superior network. Despite Amazon Pay and Rakuten Pay entering the market since 2014, GMO PG's market share has expanded by 5pps as increasing scale has added value to their service. They have by far the larger number of member stores, wider range of customers, more advanced technology, and security. The company spends some 10% of revenue on R&D and capex to maintain this advantage. As with other successful payment network firms, GMO PG takes a small slice of transaction value (0.3%) by providing value to another member, in this case simplification and reliability of online acquisition for merchant acquirors.

Growth has been significant with revenues compounding at around 30% per annum since 2012. However, there remains a long runway driven by an expanding addressable market and rising use cases. Ecommerce in Japan is forecast to grow at 10% per annum, supported by existing low penetration (9% compared to 17% and 27% in the UK and China respectively in 2019). The opportunities to bring previously offline payments into the online domain has also been accelerated by the pandemic. GS estimates the addressable market could double between 2020 and 2025. Regulatory tailwinds have also emerged as Japan's government has identified the low digital transaction rate as a risk. The government is targeting cashless purchases to rise to 40% in 2025 from 18% in 2018, ultimately moving to 80% over the long term.

Despite these opportunities there are a number of risks, not least disruptive new entrants, a rich valuation and a relatively low free float. As a result, GMO Payment Gateway is one of the lower weights in the Pacific portfolio. Given the concentrated nature of the strategy this is still a meaningful position, which contributed 0.5% to performance in 2020.

- Michael Flitton

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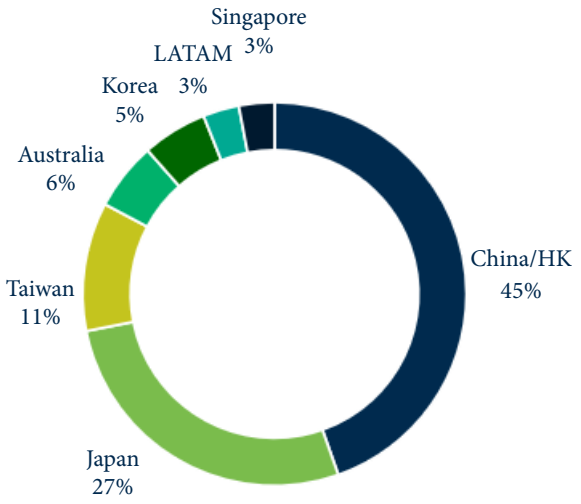
Top 10 Holdings

Samsung Electronics	5.2%
Tencent	5.1%
Wuxi Apptec	4.6%
TSMC	4.4%
Alibaba	4.2%
Hangzhou Tigermed	4.1%
Kingdee	4.1%
Shenzhen Mindray	3.8%
Tokyo Electron	3.8%
Nidec	3.5%

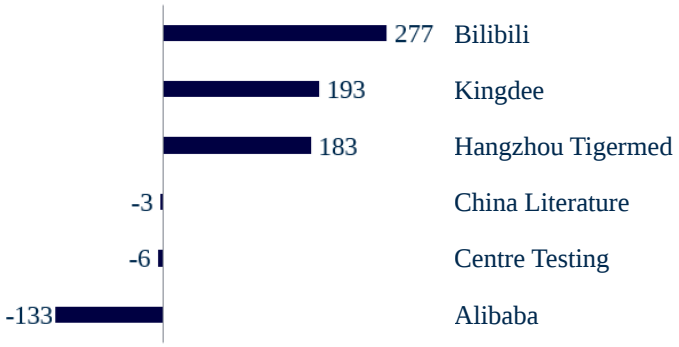
Geographic Allocation (Ex Cash)



Allocation by Sector

Information Technology	34%
Health Care	21%
Industrials	15%
Communication Services	14%
Customer Discretionary	12%
Cash	5%

Top/Bottom Quarterly Contributors (bps)

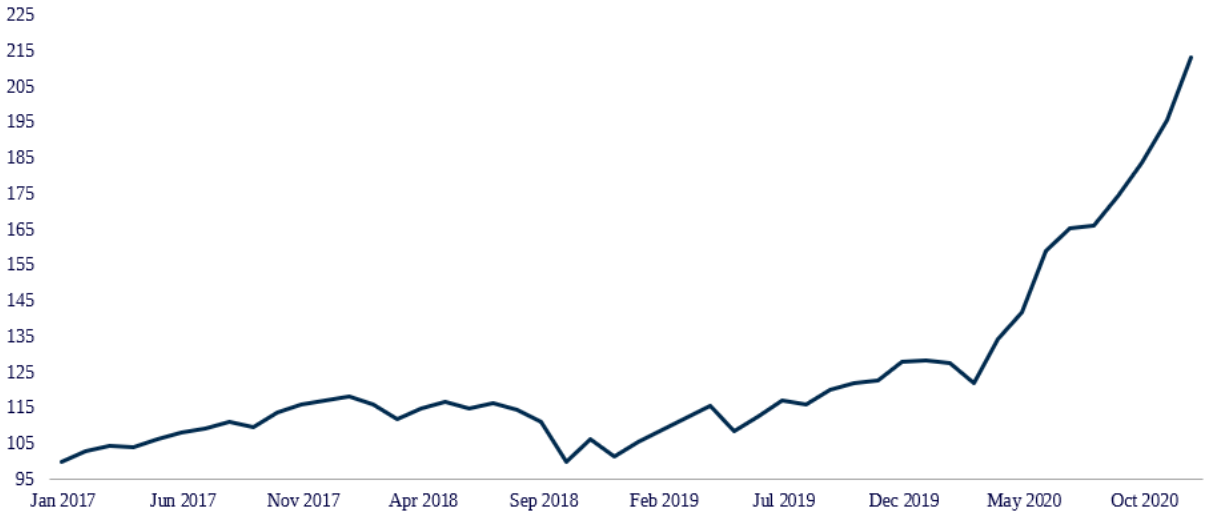


Track Record

Year Ended	Dec 2020	Dec 2019	Dec 2018	Since Inception*
Net Performance (Class B)	+66.7%	+25.9%	-13.3%	+114.7%

**Inception as a UCITS: 27 January 2017*

Source: Cerno Capital



Performance is based on a Net Asset Value (NAV) price basis with income reinvested, net of fees. Past performance is not a guide to future performance.

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Key Fund Information

Ongoing Charges (incl. Managment Fee)	Class A Management Fee 1.00% Allocated manager's Fees 0.07% Other Fees (Inc running costs) 0.21% OCF 1.28% Class B Management Fee 0.75% Allocated manager's Fees 0.07% Other Fees (Inc running costs) 0.21% OCF 1.03%
Initial Charge	5%-waived as standard
Key Fund Documents	https://cernocapital.com/cerno-pacific
Counterparties	Authorised Corporate Director: Thesis Unit Trust Management Limited (Authorised and regulated by FCA) Exchange Building St John's Street, Chichester, West Sussex Custodian: The Northern Trust Company Auditor: Pricewaterhouse Coopers LLP
Contact	Tom Milnes 0207 036 4126 tom@cernocapital.com

Fund Codes

	ISIN:	SEDOL:	Bloomberg:
A Acc	GB00BDCJ9Z32	BCDJ9Z3	TMCPEAA LN
B Acc	GB00BDCJB138	BDCJB13	TMCPEBA LN

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