CERNO CAPITAL

TM CERNO *Pacific*

UCITS Regional Equity Portfolio (Class B)

Q2-2023

Fund Data

NAV/Share (Class B Acc)	£13.98
Fund Size (£mn)	64
Currency Share Class	GBP (Base)
Investment Management Charge	0.75%
Ongoing Charges Figure	0.99%
Dealing Frequency	Daily
Legal Structure	OEIC (UCITS)
Co-Managers	Michael Flitton & Fay Ren
Inception Date Fund	2017
Inception Date Strategy	2009
Share Type	Acc & Inc

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.

Q2 Investment Report

Fund Activity

Fay Ren provides performance commentary and details position changes during the quarter.

Japanese Corporate Reform

Michael Flitton details the corporate reform momentum in Japan.

New Indian positions

Oscar Mackareth outlines the rationale behind two new Indian positions - Affle India & Tanla Platforms.

Fund Activity

Fay Ren

The fund delivered a negative -6.1% return for the quarter against -1.6% for the comparator index. This brings the year-to-date performance to -2.4% versus +1.0% for the index.

In local currencies, performance on a stock level was net flat, with a negative China offset by gains in Japan and semiconductor names. However, currency direction had been unhelpful, given a usually strong Sterling against Asian currencies. In particular, the -10.6% slide of the Japanese Yen and -8.0% of the Chinese Renminbi against Sterling in Q2 accounted for the majority of negative attributions (-4.8%).

Initial enthusiasm in China's re-opening narrative quickly dissipated over disappointing economic data. The lack of consumption appetite outside of the service industry, and the lack of risk appetite from the private sector demonstrates lingering apprehensions on the trajectory of the economy. China faces the triple pressure points of high youth unemployment, stagnant wage growth, and poor local government finances. A negative -7.5% surprise in May exports numbers from a softening global economy dampened any hope that global demands can at least partially offset a slow domestic economy.

Anticipation of a large-scale stimulus package did not materialise, as the government hesitates on reigniting the property sector and accelerating the currency slide. The government's conservative piecemeal approach to economic stimulus so far had not been too effective, fuelling expectations of further policy manoeuvres in the second half.

Japan returned to the limelight in Asia. The TOPIX Index rose to 30 year highs as inflation finally appears to take hold after three decades of deflation. Long touted corporate governance changes also appear to be gaining greater momentum, spurring hopes of valuation uplift and improved shareholder returns on the back of relative low valuations.

The portfolio has 33% exposure to Japan. While our names may not be the biggest beneficiaries of governance change (these companies are already ahead of their peers in terms of shareholder returns), their advantage in niche, high value, high precision manufacturing industries entrench them in a critical role in the global supply chain. Michael Flitton writes in more detail on this topic in a separate piece overleaf.

On a stock level, semiconductor names were the top contributing to performance this quarter, including Tokyo Electron (+51bps) and Samsung Electronics (+47bps), and other names including TSMC and Disco. The semiconductor industry was boosted by the buzz created around Generative-AI, where NVIDIA's impressive GPU sales opens up new growth opportunities for the upstream equipment makers and foundries in related fields. The potential for productivity gains from Gen-AI feels much more within reach as businesses race to adopt this novel technology.

Detractors included Sea Ltd. (-149bps), Glodon (-119bps), and Wuxi Apptec (-83bps).

After re-establishing priorities last year to focus on profitability, Sea declared consolidated net profits and positive free cash flow in all three of its divisions for the first time in Q4. This is a step change from its prior strategy focusing on growth. Inevitably, a slower topline compared to its past records of churning out triple digit growth prompted investors to question whether it'll become a permanently low growth business. We feel that the company management demonstrated discipline in the face of changing macroeconomic environment, the pivot to sustainable growth last year had been a sensible move.

The company has the capacity to ramp up spending to reinvest for growth. The announcement of a 5% pay rise can be interpreted as an early signal of their readiness.

Glodon and Wuxi Apptec both reverted from their recent highs on renewed worried over China's growth prospects. Glodon is exposed to the construction industry, and Wuxi Apptec is exposed to the biotech funding cycle. Glodon's proposition of improved cost efficiency through digitalisation and supplying one-stop shop solutions remains attractive. In an under-penetrated and fragmented industry, the increasingly cost-conscious clients are seeking to consolidate vendors post-Covid. For Wuxi Apptec, while China may remain challenged in 2H23, we are seeing positive signals emerge in the global biotech funding trend. Wuxi has a robust global client base which should benefit from this rebound, with growth opportunities from new modalities through continued investments in both overseas capacity and leading technologies.

In Q2 we introduced two Indian names to the portfolio, both at 1% initially. These are fast growing businesses in the communications and digital marketing space, respectively: Tanla Platforms and Affle India. Oscar Mackereth profiles the two companies in the pages overleaf.

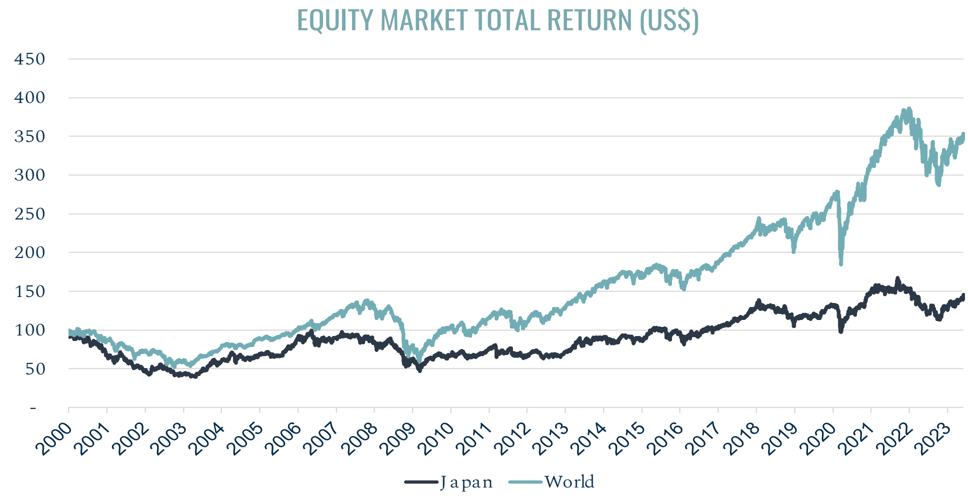
Finally, I attach in a separate journal, a 'Postcard from China' from my three weeks of travels around the country in May for the first time since Covid began, documenting some of the anecdotal observations during my time spent there.

- Fay Ren

Japanese Corporate Reform

Michael Flitton

Despite a rich history of innovation, entrepreneurial culture, and supportive government policies, Japanese stocks have underperformed global equities over the past twenty years.

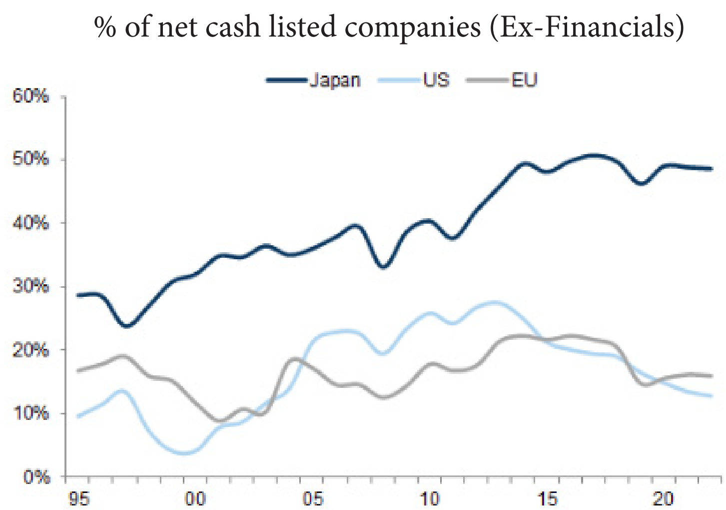


Source: Bloomberg

A contributing factor has been the conflicting priorities of global investors and Japanese companies. Leadership teams in Japan have tended to prioritise operational excellence. No bad thing. The result has been world leading business franchises.

However, corporate governance has been demoted as a result. Offence in one area has been offset by defence in another. Cross-holdings and bloated balance sheets have risen like buttresses around the Japanese corporate castle.

According to Goldman Sachs, almost 50% of listed companies (ex-Financials) are net cash. This compares to 10-15% in US/EU. Some cash is good, but all things in moderation. A lot can be bad for your health. Half of those Japanese companies have cash over 20% of equity.



Source: GS

This cash weighs heavily on return on capital and the valuation of Japanese businesses. Half of listed companies (ex-financials) trade below book value or theoretical liquidation value. This compares to just 20% in Europe and less than 5% in the US.

Herein lies the opportunity. With appropriate motivation companies can return cash, slim down, and close the valuation gap. The authorities in Japan have long tried a softly-softly approach to reform. However, in January, The Tokyo Stock Exchange (TSE) went full bore, proposing naming and shaming companies persistently trading below book. In Japan, shame is a highly powerful motivation. Since then, 13 companies have announced buybacks over 10% of outstanding shares (CLSA).

This renewed reform agenda has helped catalyse outperformance of Japanese equities, the NIKKEI index is up 21% in 2023.

We have looked to prosecute this theme in Cerno multi asset portfolio via a specialist manager, Zennor which is focused on corporate reform.

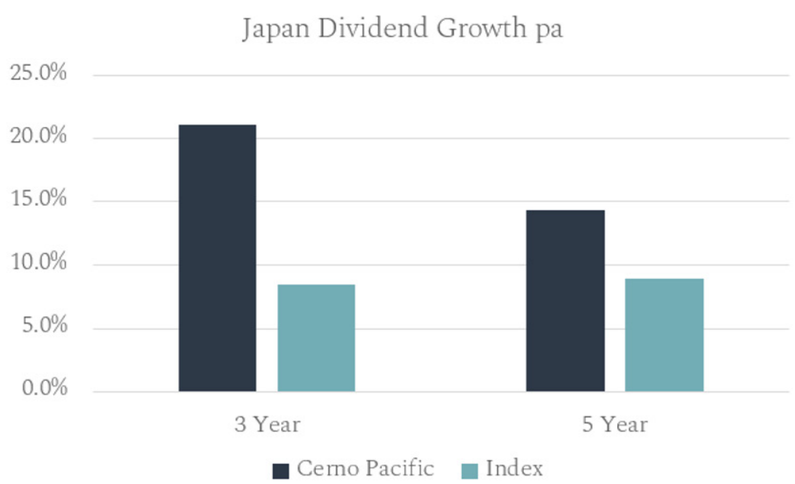
In Pacific, our focus on quality and management alignment means we do not own the types of companies being targeted by the TSE. Nevertheless, all corporates can see the way the wind is blowing. We would not be surprised to see reform proposals burgeon across the listed sphere.

Our search for resilience in the companies we own leads to significant potential for increased cash returns; the average net debt to equity ratio for our Japanese holdings is -32% (one third net cash).

Cross holdings reform is also gathering pace. This is not a governance feature we like to see in the companies we own, despite the strategic logic from a company perspective. It is particularly encouraging, therefore, to see action taken when the strategic logic wanes.

Denso, an enabler of the green transition in autos, has tended to use strategic shareholdings to foster research collaboration or support better relationships with clients. In June Denso announced that it had sold all US$116mn of its holdings in Suzuki Motor as well as 70% of its stock in Honda Motor (Nikkei). The new filing shows Denso holds stakes in 20 or so listed companies, half as much as 2019. The company has been duly rewarded by investors. Its stock is up 44% year to date against 28% for the auto supplier sub index.

Japan is the largest country weight in the Cerno Pacific portfolio at 33%. The companies invested already exhibit superior governance than the market at large. We would expect to continue to benefit from this characteristic as patient shareholders over the long term.



Source: Bloomberg

The Japanese holdings in Pacific are set out below

Company	Description
Hamamatsu	Photonic instrument maker for industrials & medical uses
Nabtesco	Specialist provider of large reduction gears for robotics
Sysmex	Global leader in haematology analysers
Denso	Global leader in auto parts gearing into EV supply chain
Murata Manufacturing	Passive electronic components leader
Tokyo Electron	Semiconductor & FLD equipment supplier
Harmonic Drive	Producer of speed reduction gears for robotics
GMO Payment Gateway	Online payment enabling software
Disco	Key provider of SPE equipment
Nihon M&A	M&A boutique focused on succession of Japanese SMEs

- Michael Flitton

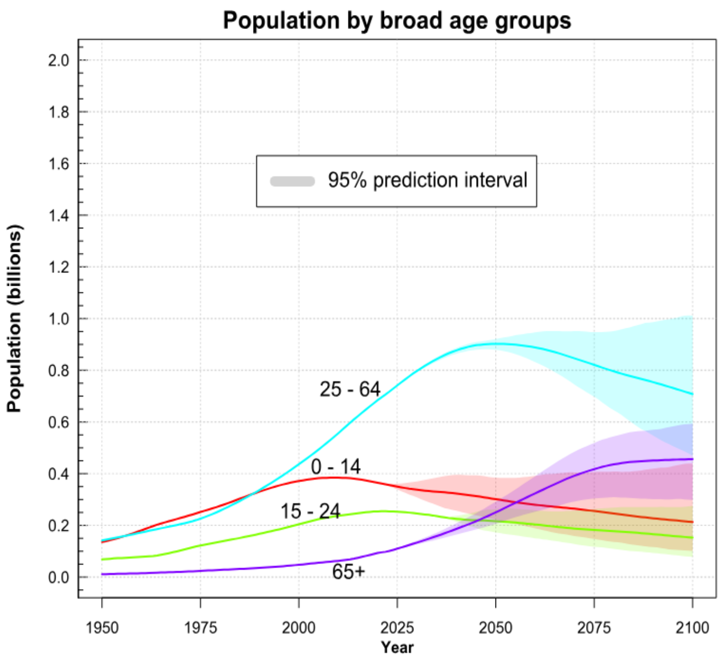
New Indian positions

Oscar Mackareth

India, a founding member of Morgan Stanley's 2013 'Fragile Five' [1], has experienced a transformative decade. Driven by programmes of corporate governance reform, improving political and currency stability, rising private expenditure, lower debt, and favourable demographics, India presents one of the most compelling global growth stories.

According to UN estimates[2] , in April of 2023, India overtook China as the world's most populous country. This represents the first time since the 1950s, when the UN first began taking global population records, that China has not sat atop the global podium. Since 1950, the Indian population has grown by over a billion, with forecasts suggesting a 1.7 billion peak by 2064. Simultaneously, total fertility rate decline has moved towards replacement levels, thus reducing the dependency ratio [3] . The country will have a largely youthful population over the next two decades, laying the foundation for a sustained 'demographic dividend' [4] .

Figure 1: UN Forecasts of Indian Demography [5]



India's ability to leverage this advantage will depend on continued investment into the technological literacy of the country's incumbent and new workers, who will likely increasingly rely on digital connectivity to interact with global commerce.

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[1] A group of countries that relied heavily on foreign investment for growth due to domestic instability, originally made up of Brazil, India, South Africa and Turkey, https://www.businessinsider.com/morgan-stanley-fragile-5-emerging-markets-2013-9?r=US&IR=T
[2] undesa_pd_2023_policy-brief-153.pdf
[3] The rate of the population of young (0-14 years) and old (60+ years), to the population in working ages (15-59 years).
[4] Demographic dividend refers to the economic growth that occurs when a country's working-age population is larger than the population that is dependent on it.
[5] 20/06/2023, UN Department of Economics and Social Affairs, Population Division, https://population.un.org/wpp/Graphs/DemographicProfiles/Line/356

By most measures, India is making significant progression towards becoming digitally advanced. Driven by public governmental programs such as the 'Digital India Initiative'[6], in 2022, non-active Indian internet users were a minority for the first time. Smartphones are the primary means of internet access driven by steady declines in the cost of hardware.

Last year, 52% of total users engaged in e-commerce, 45% in digital payments and 88% engaged in OTT services [7,8] . Thus, in absolute terms, India lags only China in most vectors of digital adoption.

We invested in two listed Indian businesses in the second quarter: Affle and Tanla.
Both are deeply integrated in India's digital evolution. They provide high value utility functions to their end markets via innovative processes and proprietary technologies.

affle

Affle (**AFFLE.NS/AFFLE.BO**) is a leading programmatic digital advertising business. It is differentiated by the vernacular diversity of its offering enabled by AI capabilities.
Affle operates through a consumer platform which seeks to acquire and re-engage customers for enterprise clients. The group specialises in under-served, high-growth markets: non-metropolis and rural emerging-market communities. Its primary markets include India, Affle (AFFLE.NS/AFFLE.BO) is a leading programmatic digital advertising business. It is differentiated by the vernacular diversity of its offering enabled by AI capabilities.

Affle operates through a consumer platform which seeks to acquire and re-engage customers for enterprise clients. The group specialises in under-served, high-growth markets: non-metropolis and rural emerging-market communities. Its primary markets include India, Southeast Asia, Africa, and Latin America. Secondary markets include developed markets such as North America, Europe, Japan, Korea, and Australia.

Alphabet and Meta have historically controlled the lion's share of global digital marketing revenue. However, recently their dominance has regressed with the emergence of nascent advertising technologies and a shift away from traditional online communities, such as Facebook. Thus, their market share has declined from near 60% in 2016 to an estimated ~45% in 2023 [9].
Affle considers the residual 55% to be its total addressable market (TAM). Due to the markets' fragmented nature, it is difficult to present reliable share data. Affle estimates that market share falls in the low single digit percentiles. However, because of low penetration, this places Affle within the top three competitors in their target markets.

The communities targeted by Affle have historically been underserved due to the low levels of their internet penetration and commercial interactions size. The technical barriers of advertising in areas with intense vernacular diversity are also significant. Affle has mitigated these issues through its proprietary Machine Learning (ML) and Artificial Intelligence (AI) driven algorithms, which utilises its unique data inventory to automatically present consumers with multi-media advertisements which are specific in both content and linguistic preference. This level of localisation is difficult for multinationals, like Google, to replicate.

[6] https://digitalindia.gov.in/
[7] 'Over The Top' media services – digitally native platforms, offering traditional telecom services (voice, messaging, video calls) in an online only format (e.g. WhatsApp).
[8] IAMAI & Kantar, 2023: 'Internet in India 2022', https://www.iamai.in/knowledge-centre
[9] https://www.bloomberg.com/news/articles/2023-01-10/meta-meta-and-google-googl-advertising-dominance-slips#xj4y7vzkg

The programmatic nature of this service allows it to minimise costs and maximise campaign efficacy. Therefore, as a demonstration of faith in its proprietary systems, Affle utilises a 'cost-per-converted user' structure whereby fees paid by the enterprise customer is proportional to the success of the contracted campaign. This allows Affle to guarantee a pre-determined ROI to its customers, whilst evidencing the efficacy of their systems via a strong earnings profile.

Finally, Affle has evidenced the efficacy of its technology in diverse geographical markets through its successful international expansion program. Affle attributes the adaptability of its systems to its target consumers not having been digitally native for long enough to develop unique browsing behaviours. Thus, the operations of the business appear to be capable of scaling with both local and global digital penetration trends.

tanla

Tanla Platforms (**TANLA.NS**) is a cloud computing business, offering businesses communication platform services (CPaaS). Tanla facilitates communication and engagement services via automated messages services in a medium agnostic format.

Its primary market is India, where it maintains a 20% share of mid-market enterprise revenue and a 50% share in large enterprises, resulting in a 45% revenue market share of the Indian SMS TAM. The Indian CPAAS market has an estimated TAM of INR 53.3 billion (US$650mn)[10] and is predicted to grow at a CAGR of 24.8% until 2028.

The growth of the CPaaS market is driven by increased online transactions and interactions. Tanla accesses this market via an 'application-to-person' messaging and platform business. Aided by a disciplined acquisition programme, Tanla has developed the technical capabilities to offer end-to-end CPaaS solutions via an asset light business model, now delivering over 169 billion automated messages per year and processing over 800 billion interactions annually[11]. Tanla's competitive edge in this market is denoted by the technical barriers to entry it has established through a first mover advantage.

Moreover, Tanla also maintains a smaller, but higher growth platform segment. This can be largely split into the Trubloq stack and the Wisely Platform.

Trubloq is a blockchain-enabled commercial communication stack, designed to provide a secure platform for commercial communications.

Trubloq uses blockchain technology to create an immutable ledger of promoters and the message headers and templates they use. These are used to verify the authenticity of messages sent, record delivery to the intended customers and prevent SMS based fraud. Today, roughly 65% of India's A2P SMS traffic is processed through the Trubloq system, resulting in a net reduction of 60% of customer complaints of SMS based fraud[12]. This likely makes Trubloq the largest case study of commercial blockchain utilisation in existence today.

Finally, Tanla's latest endeavour, the Wisely platform, is a digital marketplace for enterprises and suppliers. It provides a global edge-to-edge network, delivering private, secure and trusted customer communication capabilities. It's two main components are the Wisely Network and Wisely Marketplace.

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[10] https://www.mordorintelligence.com/industry-reports/india-communication-platform-as-a-service-market
[11] https://www.tanla.com/media/images/Annual/Annual-Report-26-2022_revised.pdf
[12] https://trai.gov.in/sites/default/files/PR_No.75of2022.pdf

The Wisely Network is a managed end-to-end encrypted network, encrypted via proprietary cryptographic algorithms which provide critical data security services within global A2P communication services.

The Wisely Marketplace is a digital marketplace where enterprises can both host their own communication services and connect with new enterprise customers. This allows enterprises to obtain essential CPaaS services in a consolidated location, saving time and money and allowing inter-provider collaboration in key projects.

Wisely provides coverage in over 190 countries, allowing customer global reach and scalability. Moreover, it has provided Tanla with a means of exporting the technical capabilities developed in its native market to an international audience. Trubloq has deployed as the security foundation for Wisely, ensuring that all commercial communications are secure and encrypted, as well as tracking the delivery of messages to their intended recipients.

These organisations have developed unique technical capabilities via a focus on innovation, which allow them to operate within markets which have higher barriers to entry, lower competition, and higher growth dynamics. Both have outgrown India's digital expansion trend due to their investing in sustainable competitive advantages and capture of defensible market share. Moreover, these companies offer strong balance sheets, free cash flow profiles and management teams, which has allowed them to capitalise on lucrative inorganic growth opportunities both locally and internationally.

- Oscar Mackareth

CERNO CAPITAL

TM CERNO *Pacific*

FUND FACTS

Geographic Exposure

- Japan - 33%
- China/Hong Kong- 29%
- Taiwan- 12%
- Australia - 8%
- Singapore - 5%
- Korea - 6%
- LATAM - 4%
- India - 3%

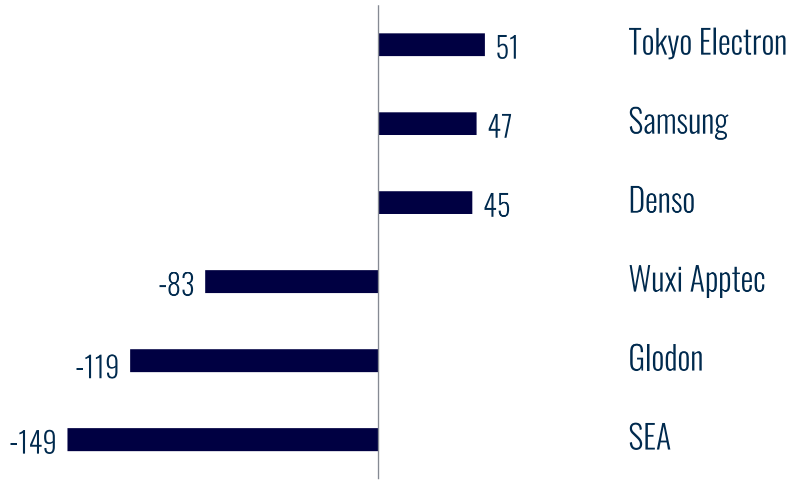
Top 10 Holdings

TSMC	6.0%
Samsung Electronics	5.9%
Hamamatsu	5.0%
CSL	5.0%
Trip.com	4.8%
Nabtesco	4.3%
Midea	4.0%
Tokyo Electron	3.9%
Denso	3.9%
Advantech	3.8%

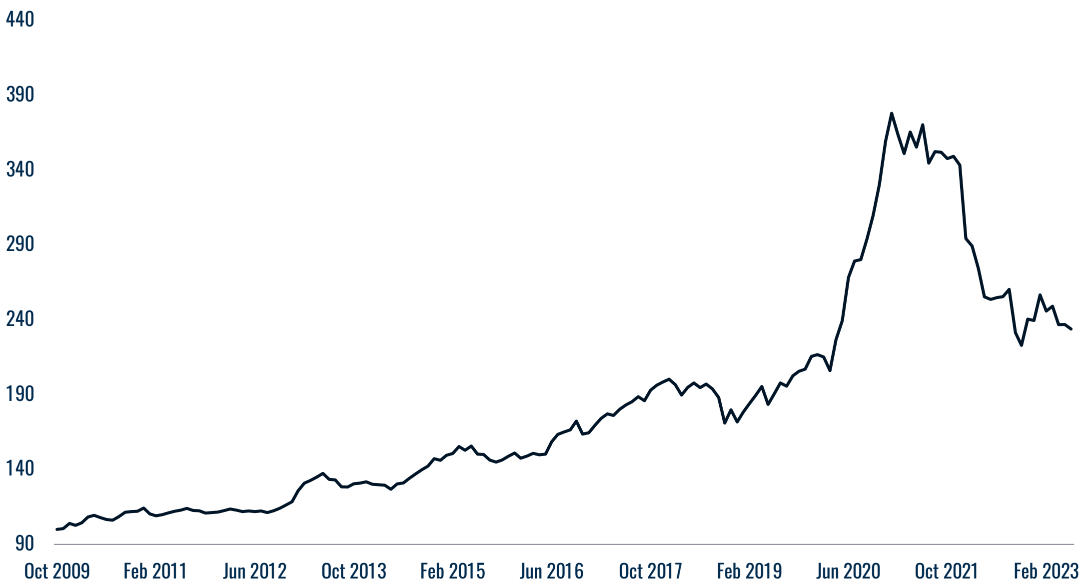
Allocation by Sector

Information Technology	36%
Industrials	28%
Health Care	19%
Consumer Discretionary	11%
Communication Services	3%
Materials	1%
Cash	2%

Top/Bottom Quarterly Contributors (bps)



Performance Since Inception



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

Performance

Year Ended	June 2023	June 2022	June 2021	June 2020	June 2019
Net Performance	-8.3%	-31.2%	+37.9%	+41.1%	-1.9%

***Inception as a UCITS: 27 January 2017**

Fund Codes

	ISIN:	SEDOL:	Bloomberg:
A Acc	GB00BDCJ9Z32	BDCJ9Z3	TMCPEAA LN
B Acc	GB00BDCJB138	BDCJB13	TMCPEBA LN

Key Fund Information

NAV/Share Class (Acc)	£13.98
Fund Size (£mn)	64
Currency	GBP (Base)
Authorised Corporate Director	Thesis Unit Trust Management (Authorised and regulated by FCA) Exchange Building St John's Street, Chichester, West Sussex PO9 1UP
Fund Custodian	The Northern Trust Company
Auditor	Pricewaterhouse Coopers LLP
Fund Legal Structure	UK OEIC (UCITS)
Inception Date - Fund	January 2017
Fund Saving Structures	SIPPs, ISAs & JISAs
Key Fund Documents	cernocapital.com/cerno-pacific
Ongoing Charges - Class A (incl. Management Fee)	Management Fee 1.00% Other Fees (incl. running costs) 0.24% OCF 1.24%
Ongoing Charges - Class B (incl. Management Fee)	Management Fee 0.75% Other Fees (incl. running costs) 0.24% OCF 0.99%
Transaction Costs	Explicit Costs 0.06% Implicit Costs 0.10%*
Initial Charge	5% - waived as standard
Contact	Tom Milnes 020 7036 4126 tom@cernocapital.com

*We have only started calculating this data from 1st July 2021, and as such this is an estimate based on the available data so far