QUARTERLY COMMENTARY

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Manager Update: April 2024

John Qiu, Founder

Price volatility is an expected part of our contrarian strategy of seeking out investments negatively impacted by operational uncertainty, fear and disappointment. We invest when our assessment of company fundamentals indicates significant asymmetric upside vs current price. Mean reversion is a base case requirement; for the majority of our investments, we require structural growth drivers to take operations and profitability meaningfully higher over the next three to five years. Our portfolio is comprised of a concentrated number of stocks with a diverse range of non-systematic exposures which together form a positive skewed returns distribution. We believe buying value cheaply is the starting point for achieving strong long-term returns as well as our primary defense against loss. Our strategy focuses solely on the risk of absolute loss which is usually related to company fundamentals rather than fluctuations in share price. Assessing and weighting this risk exposure is how we shape our returns distribution, especially the left-side.

Continuing the discussion from last quarter, it is normal for a concentrated portfolio like ours to be materially impacted by individual company news. But even in today's volatile environment, it is rare for two of our top five positions to be hit with separate black swan events within a short period of time. As promised, we'll review these two stocks through the lens of our investment strategy.

Spirit Aerosystems - review

Spirit Aerosystems (SPR) was discussed in our 2022Q2 report and again in our 2023Q3 report. Our history of ownership of SPR began in 2020 after the combined impact of the B737 Max suspension and Covid induced global lockdowns froze its operations and severely hit its share price. The original thesis was SPR's operations and profitability would eventually mean revert once the B737 issues were resolved where we believed the certainty of this outcome was high given the duopolistic commercial airplane market, slow adjusting production (limiting Airbus' ability to capture lost Boeing orders) and SPR's crucial position within Boeing's (and to a lesser extent, Airbus) supply chain. Additionally, there was attractive long term structural growth from rising global commercial airplane demand (10year CAGR in the high single digits: 2-4% from expanding fleets and 4-6% from replacement) and SPR's growing After-Market and Defense businesses. The risk of absolute loss (to equity) from SPR running out of money and filing for Chapter 11 bankruptcy was very low due to regulatory disruptions and unwanted contract renegotiations (giving debtholders leverage over Boeing and Airbus). SPR seemed like the perfect high beta play on a Boeing recovery.

SPR's five-year price chart marked with major events and our investment actions is shown below.

During the 1st accumulation period, the Market had no clarity when the B737 would be recertified, and Covid-lockdowns were in full swing. We ended this period with a position average price in the low $20s. Our valuation range at that time was in ~low $40s to mid $70s. The B737 was cleared by the US FAA in October 2020 which saw SPR's share price take-off and the recovery in B737 production began in May 2021. During the 2nd accumulation period and until March 2022, we bought shares in the low $40s and trimmed in the high $40s to low $50s ending this period with a position average price in the mid $30s. For both the 2nd and 3rd accumulation periods, our valuation for SPR was roughly the same as the 2022Q2 report: low $50s to $90s. In the 3rd accumulation period, we took advantage of volatile prices caused by rising interest rates, supply chain pressures, and production delays to average down our price to around ~$30/share. However, the setbacks continued in 2023 as a parade of quality issues, industrial action, rising costs and mounting losses on widebody programs cumulated with the departure of SPR's CEO in September 2023. We reassessed the thesis post its mid-year price fall and concluded that with the additional costs and delays, SPR's value had declined to ~$30-65/share (this was before better renegotiated terms on Boeing contracts). By buying stock in the mid $20s and below, we ended the 4th accumulation period with an average price in the high $20s.

After the mid-air door plug blowout incident on Alaska Air on January 5, 2024, SPR's share price fell from the low $30s to as low as the mid $20s. We didn't think our thesis and valuation had materially changed and maintained our portfolio weighting. In early March, Boeing confirmed plans to buy SPR to reintegrate aerostructures manufacturing. This seems like a necessary step to assuage regulators and reset its image with its customers. Our best guess is the takeover terms will be announced before 2nd quarter results and completed by 3rd quarter. At worst, the deal will be done by the time Boeing CEO David Calhourn departs at the end of 2024. SPR's price at the time of the takeover announcement was $29 and we think the final offer price will probably need to be in the range of high $30s to mid $40s to pass shareholder approval.

Despite the SPR investment playing out differently to what we had originally anticipated (ironically, now being monetised as a Boeing Put), we stand to make a reasonable return. By adjusting to SPR's changing circumstances but understanding the downside protection inherent within its relationship with Boeing, we were confident having SPR as a regular top five position within the Fund and buying stock during periods of panic. The intrinsic value of the company never changed as much as its price oscillation between $15 and $50s during our four-year history with this company.

DADA - review

DADA was another company discussed in an earlier quarterly report: 2022Q1. Since that time, it has been a dismal performer, falling consecutively lower since its mid-$8 price in early 2022 to <$2 today.

Operationally, the disappointments have mostly been from its e-commerce business (JDDJ) and in occurring in 2023. We saw:

- Slower than anticipated User growth: estimated low to mid-teens CAGR (2021-2024) instead of 40%
- Slower GMV growth: estimated mid 20s % CAGR (2021-p2024) instead of the originally estimated 50%, primarily related to the lower User growth
- Disappointing Ad/Marketing monetization

The last point was the catalyst for over -50% collapse in DADA's share price to <$1.5/ADS in the days following January 8, 2024 when it announced an internal audit had identified ~RMB500m of suspicious Online Ad revenues and a similar amount (offsetting) in Operational Support Costs. Two months later, a 3rd party audit confirmed that between 4Q22 to 3Q23, JDDJ Ad/Marketing Rev was overstated by RMB568m and Operational Support Costs was overstated by RMB578m. The official explanation was ground level staff had initiated some transactions with the objective of meeting sales targets where client payments were later fully reimbursed back to the client. The total impact for this period was -8% decrease in JDDJ Rev (and -5% to Group Rev) and immaterial impact to profits (a slight RMB10m gain). The President stepped down following the conclusion of the audit, only few months after the departure of the previous Chairman and CFO in December 2023. The share price briefly recovered to $2.5 but lost ground and has weakened again to <$2 today.

The core of the DADA thesis is based on its monopoly monetisation of all <1hr delivery orders and offline-to-online (O2O) orders in the JD ecosystem (contractually all such orders belong to JDDJ). Essentially, the >7bn annual orders generated by JD's >600m Users are being split into time-sensitive 'convenience' and 'normal' purchases (similar to convenience store purchases vs regular supermarkets). Additionally, offline retailers are increasingly migrating their sales online (the O2O trend) to achieve the economies of scale necessary to compete on convenience and price against pure e-commerce players and each other. This is an established dynamic already seen in the restaurant industry via the online food delivery platforms. DADA is the monetisation of this structural trend within JD's traffic through both its JDDJ business and DADANow deliveries. The primary operational risks look low given:

- Secure traffic and no competition (within JD's ecosystem)
- Flexible unit costs: a) JDDJ shares a % fee with JD (completed orders on JD only), b) DADANow receives a cost-plus based fixed fee per delivery order from JD Logistics

The Per Unit profits for orders for both JDDJ and DADANow are positive and rising. So given stable fixed costs, DADA's path to profitability is driven entirely by scaling top line growth. Unfortunately, the poor macroeconomy in 2023 and reduced physical goods demand impacted growth: JDDJ's GMV only grew ~16% while JD's GMV grew ~1%. In this environment, businesses also spent less on advertising which was worse for JDDJ because its Ad/Marketing sales are primarily to offline retail Merchants rather than product Brands. It's still unclear at this stage if JDDJ can change its sales team structure and convince Brands to allocate marketing budgets to the O2O channel.

During 2023, JDDJ also decided to pull resources and slowly wind down its self-operated platforms and migrate fully to JD's App. We didn't anticipate this but understood the reasoning: reduce fixed costs and consolidate branding. So, despite JDDJ's JD sourced Users growing 53%, the stand-alone JDDJ Users fell -35% which offset most of the User gains in 2023.

In contrast to JDDJ's poor performance, DADANow performed above expectations driven by strong 3rd party orders.

Relevant financial and operating metrics are shown in the tables below:

DADA	2017	2018	2019	2020	2021	2022	2023
JDDJ	318	754	1,103	2,305	4,046	6,141	6,492
DADA Now	900	1,168	1,997	3,435	2,821	3,158	4,014
Total Rev	**1,218**	**1,922**	**3,100**	**5,740**	**6,866**	**9,299**	**10,506**
JDDJ growth		*137%*	*46%*	*109%*	*75%*	*52%*	*6%*
DADA Now growth		*30%*	*71%*	*72%*	*-18%*	*12%*	*27%*
Total Rev growth		*58%*	*61%*	*85%*	*20%*	*35%*	*13%*
Core OP	**-1,588**	**-1,995**	**-1,825**	**-1,659**	**-2,735**	**-2,239**	**-1,215**
% Core OPM	*-130.4%*	*-103.8%*	*-58.9%*	*-28.9%*	*-39.8%*	*-24.1%*	*-11.6%*
Normalised Non-GAAP OP		**-1,802**	**-1,626**	**-1,317**	**-2,389**	**-1,586**	**-544**
Non-GAAP OPM %		*-93.8%*	*-52.5%*	*-22.9%*	*-34.8%*	*-17.1%*	*-5.2%*

*Yellow highlight: accounting change (gross to net) reduced DADANow rev in 2021 and 2022. On a comparable basis, DADANow rev actually grew +83% and +43% and Group rev grew +78% and +49% in FY21 and FY22

	2017	2018	2019	2020	2021	2022	2023
Commissions			348	688	1,077	1,686	1,835
Ad/Marketing			112	524	1,199	2,146	1,975
Commissions/Ad & Marketing			460	1,212	2,275	3,831	3,810
Fulfillment and Other			643	1,094	1,770	2,379	2,679
JDDJ Total Rev (NEW)			**1,103**	**2,305**	**4,046**	**6,210**	**6,489**
Commission growth				*98%*	*57%*	*57%*	*9%*
Ad/Marketing growth				*367%*	*129%*	*79%*	*-8%*
Commission/Ad/Marketing growth				*163%*	*88%*	*68%*	*-1%*
Fulfillment and Other growth				*70%*	*62%*	*34%*	*13%*
Total Rev growth				*109%*	*75%*	*54%*	*4%*
JDDJ metrics							
GMV-JDDJ: Rolling 12months (RMBm)	**3,287**	**7,334**	**12,205**	**25,262**	**43,100**	**63,300**	**73,400**
Total GMV growth		*123.1%*	*66.4%*	*107.0%*	*70.6%*	*46.9%*	*16.0%*
JD sourced Users				12.4	24.9	34.6	53.1
JDDJ only Users (non-JD)				28.9	37.4	44.0	28.6
Active consumers: Rolling 12months (m)	**7.3**	**14.7**	**24.4**	**41.3**	**62.3**	**78.6**	**81.6**
JD sourced Users growth					*101.1%*	*38.8%*	*53.4%*
JDDJ only Users (non-JD) growth					*29.3%*	*17.8%*	*-35.1%*
Active consumers growth		*101.4%*	*66.0%*	*69.3%*	*50.8%*	*26.2%*	*3.8%*
Order Volume: period specific (m)	**50.4**	**102.2**	**119.7**	**165.1**	**228.6**	**281.3**	**293.6**
Order Volume growth		*102.7%*	*17.1%*	*38.0%*	*38.5%*	*23.0%*	*4.4%*
Commissions % GMV			2.8%	2.7%	2.5%	2.7%	2.5%
Ad/Marketing % GMV			0.9%	2.1%	2.8%	3.4%	2.7%
Commissions/Marketing % GMV			3.8%	4.8%	5.3%	6.1%	5.2%
Fulfillment/Other % GMV			5.3%	4.3%	4.1%	3.8%	3.6%
JDDJ Take Rate (Total Rev as % GMV)			**9.0%**	**9.1%**	**9.4%**	**9.8%**	**8.8%**
Total JDDJ Incentives % GMV	**-11.0%**	**-10.7%**	**-7.7%**	**-5.9%**	**-6.8%**	**-6.0%**	**-4.9%**

Where do we stand today? We think the core thesis is still intact. Although the original timeline for breakeven proved unrealistic, the structural traffic trend driving topline growth is still happening alongside declining incentives, reducing fixed costs and improving operating margins. This is the same familiar pattern and playbook we've seen in other online businesses including JD, Meituan and Amazon. In DADA's case, there is lower risk because external competition isn't a major factor and it has captive access to traffic which is cheap and in the early stages of growth by both penetration (current JDDJ's GMV, orders and Users are only ~2%, ~4% and ~10% of JD's) and retail demand. The negative traffic impact from reducing JDDJ stand-alone Users is short-term and will become immaterial by 2025. There is little clarity on when or how Ad/Marketing monetisation improves but the current 5% total take-rate (excluding delivery costs) is at the low end compared to regular e-commerce platforms and low relative to the restaurant O2O platforms (mid-teens). For DADANow, it benefits from both the rising penetration of JD traffic and continuing strong growth in 3rd party on-demand deliveries. As a crowd sourced platform, it fills a vital role optimising rider utilisation and serving as an alternative to Meituan and S.F.

The new management team are all senior JD executives (most with JD Logistics backgrounds). Perhaps some of the current disruptions is kitchen sinking expectations and cleaning out the closet. We won't know what major operational changes (if any) they decide on until they complete their review in May. At that time, we hope they speak frankly with investors and highlight JD integration, JDD Ad/Marketing team overhaul and further cost controls as top of their priority list.

At <$2.1/share DADA's EV is $0 (Market Cap=Net Cash). At the price of $1.84 (April 18), an investor is essentially getting RMB480m Net Cash and its two businesses for free. We expect FY24E free cashflow to be RMB0 to -200m and turn positive by 2025 so cash burn isn't a factor. On reduced expectations we think DADA will show non-GAAP profits in 2025 and GAAP profits by 2026. Longer term, we still believe DADA can realise GAAP operating profit margins in the high single digits to low double digits.

The major risk with the thesis remains DADA's reliance on JD. Ultimately, JD has full power over DADA's fortunes through decisions on traffic or monetisation. Here we take comfort that JD has many other listed subsidiaries and they have yet to treat any of them unfairly. To do so in DADA's case would be senseless given its small size and low significance to JD's own profitability. Also, it was only mid last year that JD announced their 35711 vision: to have 7 publicly listed companies with >RMB100bn Market Cap. And before this, in early 2022, JD chose to honour its agreement (made in 2021) to buy a further 6% of DADA and consolidate its financials paying US$546m to do so (at $20/ADS which was double DADA's share price at the time). Ironically, DADA's current Market Cap of US$480m is even less than what JD paid for that 6% stake.

We've been buying DADA throughout the past two years, and we accelerated this buying after the Market decided to offer us its businesses for free. The situation is not quite the same as SPR but there are similar themes at play: interest alignment with a strong parent, limited competition, structural growth, an existentialist reason for being. Also, we think this type of operational scaling has lower execution risk compared to an industrial turnaround. And with its large Net Cash position, DADA has higher likelihood of reaching our forecast profitability and target valuation. Despite what the Market is saying, we still believe DADA's ADSs are worth mid-teens to $30s.

The Fund

Our 2024 first quarter net performance was -6.6% which was heavily impacted by the slide in DADA's share price and continuing weakness in Chinese equities. KION was the best performer during this period as it recovered from the cost inflation and supply chain issues of 2022. While top-line growth near term could remain low due to the weak macroeconomy in Europe and a low part of the warehouse capex cycle, margins will continue to mean revert upwards as it runs off the last of its low margin/loss making contracts (new contracts now all have inflation protection clauses built in) thus driving strong bottom-line earnings growth. Structurally, we think supply chain automation is an upward cycling growth industry and remain optimistic KION's best days are still yet to come. We decided to sell CNOOC during the quarter after four years as a consistent top five holding (CNOOC was the last of our oil & gas positions bought during the oil market collapse in 2020). Despite a modest valuation and attractive dividend, we felt that with oil prices in the $80s, it was pushing on a string to expect further operational upside or enthusiasm from the Market. As was the case, we sold early but we have come to accept that we will usually be early buyers and earlier sellers, especially for cyclical industries where we only try to capture the rough, broad extremities of the cycle.

We have not been shy in the past about sounding the investment attractions of Chinese stocks. Those comments were at least a year too early as was obvious from our poor 2023 results. Before then, in 2022, the Market still held hopes of a China recovery once Covid-lockdowns were over and rewarded individual stocks based on their non-systematic risks as was the case for Macau casinos. But since 2023, alpha has been left stranded by the roadside and beta has been driver for the trainwreck which has been Chinese equities. Interestingly, many of the Macau casino stocks are now trading within their 2022 price range despite renewing their licenses and enjoying a strong recovery in operations – Mass Market gaming is above 2019 levels and average hotel room occupancy has hit the mid-80s%.

Looking forwards, we remain firmly convinced in the fantastic risk/returns of our Chinese stocks. Where in the past this view has been based purely on the pricing of individual companies, today we venture the opinion that the gravity of the market is now biased towards the upside based on an accretive series of government intervention steps and monetary conditions:

1. Increasing curbs on selling: since late 2023, regulators have taken progressive series of actions to dampen selling e.g. restricting large shareholder sales, suspending brokerages from securities lending to short-sellers, ban on net-equity reductions by institutional funds at market open and close, restrictions on quant fund trading activities, investigations and restrictions on derivatives and high-frequency trading

2. Government entities are buying: state entities have been buying ETFs since last year. In late January 2024 there were rumours of a RMB2trillion market rescue package on review. Recently, one State fund reported RMB300bn of ETF purchases during 1Q24

3. Cost of debt is low while liquidity is ample: currently the 10-year Chinese government bonds are being sold in the low 2.x% while major SOEs are borrowing at sub 3%

4. Large equity vs debt yield spread: major A-share indices are trading at high-single digit earnings yields (low-double digit forward P/Es) and paying mid-2 to mid-3% dividends. Hong Kong listed shares are even cheaper and the HSI is trading at a double-digit earning yield and paying mid-4% dividends

The sceptics will point out that the China housing crisis isn't yet over, and macro conditions and consumer confidence remain poor. That is correct but we are of the opinion that the Chinese government doesn't need to solve the economy before solving the markets. Asset prices are directly linked to the amount of liquidity and the cost of capital in the system. With inflation close to 0%, the monetary capacity and willingness to reignite asset prices is high. This is what is meant by the old Wall Street saying: 'don't fight the Fed'. Currently China is going two-steps further with both the Central Bank and government coordinating to push monetary levers, buy stocks and enact policies to support equity prices. The reason for urgent and continuing intervention is simple: a healthy equity market is needed to fund technology development and create economic wealth. These are the future arenas in which the US/China conflict is being fought.

In terms of new ideas, we've found good opportunities among the top-quality Chinese consumer brand companies. China only has a handful of these nationally recognized brands and in the past, they've always traded at large premiums (much like their counterparts in the U.S.). While total consumption volume has remained stagnant, we've found the premiumnisation trend intact for certain categories of consumer goods and brands which is driving their sales and margins higher. We've being buying these companies at historically low valuations with good earnings growth and expanding market share.

Early in the year we tried finding value among the listed property developers but sadly, couldn't get any comfort on their absolute risk of loss nor form any unique differences in opinion. Maybe the specialized distressed debt investors can take advantage of individual circumstances on certain assets, but for the average equity investor, the only 'out' seems to be a total government bailout which we don't think will happen. China is in a different development phase to the past and reinflating the demand to build idle assets for speculation doesn't seem logical. Lower house prices over the long-term should unlock significant savings, especially among youths. That's a better future.

Listed Chinese airports

In the deep-value investment category, we've found far better risk/reward opportunities among the listed airports. China only has two full-service international airports (three, if counting Hong Kong) which is Shanghai Pudong International Airport (PVG) and Beijing Capital Airport (PEK). Other regions have only limited international services (usually only to East Asia and Southeast Asia regions) due to a combination of limited demand (local economics related) and lower priority route approvals (country to country agreements, airspace access rights). As a result, most long-haul international flights demand within Mainland China are channeled through these two airports where in 2019 PVG was the busiest international airport in China with ~36m passengers and PEK was second with ~28m passengers. In terms of global total passenger rankings, in 2019 PEK placed 2nd (100m passengers) and PVG placed 8th (76m passengers). PEK is owned by Beijing Capital International Airport (BCIA) while PVG is part of Shanghai International Airport (SIA). Currently these stocks trade at:

- BCIA: HK$2.3/share, MCap RMB10bn (US$1.4bn), EV RMB19bn (US$2.6bn)

- SIA: RMB36.5/share, MCap RMB91bn (US$12.5bn), EV RMB100bn (US$13.8bn)

The combined value of BCIA and SIA is MCap ~US$14bn, EV ~US$16bn which is less than what superannuation funds paid for Sydney Airport (2019 rankings: 49th busiest airport, 44m passengers pa) in 2021: MCap US$15bn, EV US$20bn. BCIA's valuation is especially egregious, and we estimate it trades at merely 15-20% of replacement value (the new Daxing Airport with similar capacity but inferior location cost ~US$17bn).

The Market is bearish given international air travel has yet to fully recover in China and Duty-free store commissions (an important part of airport profits) were cut in the recent December 2023 contract to half: low 20% vs low 40%s previously. Additionally, in BCIA's case, the total passengers in the region are now being shared with the new Daxing Airport (estimated ~70m pa each in 2024) and it is uncertain when it will return to profitability.

We think BCIA is an attractive asymmetric returns opportunity because of large downside protection and likelihood for material profit recovery. The parent of BCIA, with 59% shareholding, is Capital Airports Holdings (CAH) which also owns Daxing Airport. CAH is a 100% owned subsidiary of Civil Aviation Administration of China (CAAC) which is the regulator overseeing all civil aviation

matters in China including airspace, international route agreements, management of airports and airport usage charges. As a result, BCIA has access to cheap, guaranteed financing with an interest cost in the mid-2.x%.

In our experience, the economics for essential, monopoly assets eventually work to generate a reasonable level of returns. From a big picture perspective, we think BCIA's long-term economics will at the minimum reflect the cost of debt applied to the total build cost of Daxing Airport (similar annual passenger capacity). Roughly this amounts to ~RMB3.6bn (US$17bn x 3%). BCIA's profitability can probably exceed this given its closer proximity to Beijing, more long-haul international routes and home airport to Air China. Profit recovery will come from a range of areas including recovery in air travel, structural growth in international travel, expanding Duty-free sales (note DF stores are now allowed in the city while the airport still collects the commission). Also, we think CAAC will continue raising various aeronautical charges – international passenger fees raised starting 2024 (last raised 2007) and aircraft movement fees is likely to follow (last raised in 2017). It is in the best interests of everyone that Beijing's two airports are both economically stable.

BCIA last traded at HK$2.3/share in mid-2004. Current market valuation implies P/B=70% and EV of 15-20% of replacement value. If earnings mean-revert to 2019 levels, BCIA trades on 4x P/E and if it reaches our minimum long-term return expectation of RMB3.6bn, this implies a current valuation of 2.7x P/E. Total passenger traffic can probably reach 2019 levels within 5 years (with a higher international passenger mix) which using the mid-range of BCIA's 2019 share price of ~HK$7.5/share implies 3.2x upside or a 27% 5year CAGR.

Final Thoughts

The Market narrative on Chinese equities is yet to catch up to the developments we're seeing on the ground. It will. The economics of situations always wins out eventually which is true for both bubbles and market panics.

Portfolio Overview

ORLOG CAPITAL

Top Five Major Holdings (in alphabetical order)	
DADA Nexus	E-Commerce
JD.com	E-Commerce
KION	Materials handling
Spirit Aerosystems	Aerostructure Manufacturer
Wynn Macau	Casino

Performance	
Annualised Net Returns in US$[1]	
Since Inception (Jan 3, 2022)	-4.6%
1 Year	-28.7%
Non Annualised Net Returns in US$[1]	
3 months	-6.6%
6 months	-8.9%

1. Net of 1.5% annual management fee and 20% performance fee (excess return above 5% hurdle rate and subject to HWM)

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