

Griffin Value Fund
2020H1 Letter to Investment Partners
August 6, 2020

During the first half of 2020 the fund's net asset value decreased by -11.71% after fees. Since inception in October 2011, the annualised gross return was 9.37% and the estimated annualised gross return on our equity investments was 16.44%¹. Please refer to your statements for individual performances based on the timing of your investment.

The fund was 79.56% invested at the end of June.

Performance June 2020

NAV: 12786.10

2011*	2012	2013	2014	2015	2016**	2017	2018	2019	2020 YTD
1.60%	6.13%	9.04%	9.30%	15.32%	13.39%	12.66%	-3.13%	21.09%	-11.71%

* Gross Performance since inception Oct 2011 through Dec 2015 (A Shares)

** Net performance as of 2016 (B Initial Shares)

Portfolio Composition

Number of investments: 20

Invested (long): 79.56%

As mentioned in the 2019 Q4 letter to our partners, we have moved to updating you semi-annually. We made this change as we believe this better aligns with our long-term strategy. We will focus our energy on two letters per year, using our familiar format, i.e. explaining our thought process on the companies in which we invest. Coincidentally, this change to semi-annual reporting happened in one of the most interesting and volatile periods in the existence of our fund. With the first wave of COVID-19 behind us, we are given the opportunity to write with some retrospective analysis.

When we decided to start Griffin a little less than ten years ago, the Great Financial Crisis of 2008 was still fresh on everyone's mind. Back then, we had already spent a considerable time studying successful investors and internalised the notion that volatility does not equal risk, but we had little first-hand stock picking experience. We were keenly aware that the human psyche can mess with our ability to think clearly for making sound investment decisions during times of distress. From day one, we built a rigid process focussed on risk management and downside protection, allowing for mistakes and unexpected events. Aside from a general market sell-off in 2015, which had a relatively minor impact on our companies, we would not encounter a serious crisis until March 2020. Enter Coronavirus.

As if to mark the turn of the decade, the world was first introduced to COVID-19 in December of last year. At first the Western world largely ignored it for two months and subsequently faced the

¹ Estimate calculated by dividing the annualised return of A-shares by the average of invested capital as a % of AUM, at the end of each month. The difference between the fund's overall returns and the total returns on equity investments is explained by keeping large cash positions over the years. The fund gradually invested the cash since inception and did not compromise on the investment criteria for the sole purpose of being fully invested at all times.

consequences of hugely underestimating this new reality. In retrospect, it is fascinating to see how even with the outbreaks in Italy, most people were still prepared to brush off this news about an unknown virus without a cure. The mortality rate seemed acceptably low and the West continued to go about their normal business. Our initial reaction was generally no different from consensus. After all, had we not seen this movie before with SARS in 2002 and MERS in 2012?

As the pandemic unfolded over Europe and with some delay across North America, opinion changed. Stock markets started sliding in February and our instinct to invest when others are fearful, kicked in. We began adding to the portfolio in early March, which was - in hindsight - a little early, as share prices kept falling into the second half of March. Only then did it become clear that lifechanging measures with devastating results for the economy would be required to contain the spread of the novel coronavirus.

We always limit our time spent on macro analysis as we believe it does not add value to our investment process. However, witnessing these extreme market conditions, we couldn't help ourselves to have some internal debates about the long-term impacts of the current monetary and fiscal policies. We argued over the sustainability of debt levels, the risk of inflation or deflation and the probability of high vs low interest rates. Too many factors influence economic activity (not to mention second and third order effects), making it hard or almost impossible to predict. We therefore invest in a broad set of exceptional businesses, led by exceptional management, in a conservative and risk averse way. Whatever the world economy throws at us, our portfolio companies and the portfolio as a whole should survive in times of crisis and thrive in the long run.

We have never feared volatility. On the contrary, we welcomed a bear market to increase our investments in quality companies. However, this time around it became increasingly clear towards the end of March that the prospects of many business models would be altered (in most cases negatively, in some cases quite the opposite). As we re-assessed our current and prospective investments in light of this new reality, we started deploying more of our capital. We were fortunate to have only minor exposure to the hardest hit sectors (e.g. airlines and travel, hospitality, brick-and-mortar retail). On the flip side, the portfolio had no meaningful exposure to businesses that materially benefited from the impact of COVID-19 (e.g. e-commerce, remote working technology, pharma).

This crisis serves as a good test for our investment strategy and our capital allocation. Share prices of our companies were very volatile, as was to be expected from the small and medium-sized companies we typically invest in. We first focussed on re-assessing the balance sheet strength and then updating the intrinsic values of our holdings. It is precisely for unexpected and adverse events like these that we've always required strong balance sheets. The overwhelming majority of our portfolio companies are all well-capitalised (in many cases over-capitalised), which gave us confidence the portfolio can weather this storm. Once we were comfortable with the balance strength, we turned our attention to the impact on intrinsic values. In the darkest hours of the crisis, it was hard to pinpoint with high probability what the cash flows for the next few years would look like. However, as data started to trickle in, we gained further confidence in a relatively minor hit.

HI Portfolio Update:

We started the year with 67.59% exposure to the equity markets. As the crisis unfolded, we initially added to our existing positions. During the month of March, our invested capital had increased to 77.42%, with the addition of three new names to the portfolio; Softbrain Co Ltd (Japan), Nice I&T, Inc. (South Korea) and PSG Group Ltd (South Africa). By the end of April, we added another name in South Korea, NeoPharm Co Ltd, to reach an equity allocation of 83.94%. The only meaningful change to the portfolio in May & June was to trim our investment in Sporton International Inc., the Taiwan-based international company specialising in wireless communication device testing (i.e. your mobile phone), when the risk-reward decreased after a strong rally of the share price. Sporton was added to the portfolio in October 2018 at a cost of NTD114. By June 2020, we reduced the position by half at

NTD230. While we still hold a 5.71% position in the company, the fund realised a cumulative profit of 102% on the shares sold. We ended the first half of 2020 with an equity exposure of 79.56%.

Costain Group Plc (1.69%): Fortunately, we do not often have to report on investment mistakes. Our investment strategy reduces the number and the impact of loss-making investments and this has worked well over the past 10 years. Although we have not yet exited our investment in Costain, it is already clear that we should not have invested. We assessed Costain as a leading player in the UK infrastructure industry with a multi-year pipeline of projects, trading at a large discount to our estimate of fair value. Although there were some structural headwinds in the sector, we were attracted by a strong and seemingly well-capitalised company in the a-cyclical industry of large infrastructure projects (transport, motorways, public transport, etc.). During the sell-off in March 2020, the company announced plans to raise almost the entire market cap in additional capital without offering a convincing explanation as to why this destruction of shareholder value could take place. This was a bolt from the blue, as the company had a net-cash balance sheet (i.e. more cash than debt) and even promoted their strong balance sheet to investors. The company argued that the working capital requirements for the business had structurally increased. As this was a known issue for quite some time, we had modelled a substantial working capital increase but certainly not to the extent now required. In addition, they mentioned attractive growth opportunities as another reason, without much consideration for the large cost of dilution. In May 2020, Costain raised £100m whilst diluting existing shareholders by 60%. Several factors played into our mistake. Firstly, despite our focus on management quality and shareholder value, we compromised on the alignment of interests between board & management with its shareholders. Secondly, we need to attach greater importance to the availability of capital for the entire industry. While an abundance of capital usually makes for poor hunting grounds, the opposite can be dangerous as well. We need to be better aware of the willingness of banks and bond holders to provide debt and to what extent, even if the balance sheet seems strong. Thirdly, significantly increased working capital requirements are a red flag for (too much) uncertainty. Based on our analysis, including detailed conversations with the CFO, we had concluded that the increased working capital requirements could easily be self-funded. We were wrong. However unpleasant this loss may be, it is an inevitable part of investing. Costain was a 4% position at cost and represents 1.69% of the fund at the end of H1.

Thinking Electronic Industrial Co., Ltd. (TE) (6.75%): On the brighter side, we were able to significantly increase our investment in Thinking Electronic. We had visited the company in Taiwan in 2018 in order to finalise our thesis. We then started accumulating shares, but the price ran away before we could establish a meaningful position. Now, with the pandemic, it was once again available at a bargain price. TE is a global leader for thermistors and varistors. Their components are used in power supplies and most electrical devices, to help regulate temperature, voltage and current. A large global market share of 40% has allowed the company to develop significant cost advantages. Most products are tailor-made and represent a low cost - yet critical - item for their customers. Big customers like BMW, Tesla, Samsung, Sony and Panasonic typically sign 10-year contracts with trusted suppliers, whom they believe can meet their requirements in terms of R&D, timing, quality, cost and supply. Furthermore, we think very highly of management, who specialise in less competitive niche applications with a relentless focus on efficiency improvements. These attractive characteristics resulted in a strong historical financial performance with revenue growth of 5% p.a., annual EPS growth of 12%, 5-yr operating margins of 21% and ROE over the past five years of 18%. Although there is a short-term impact on TE's financial performance from COVID-19 (revenue declined by 8% in the first half of 2020), we think the longer-term outlook remains positive. The sharp decline in share price allowed us to accumulate our position mid-March at a trailing P/E of 8x (6x net of cash). We believe our downside is protected and the probability of generating an attractive return is high. For further information, you can read our recently published investment thesis on Joel Greenblatt's [Value Investors Club](#).

NeoPharm Co., Ltd (2.94%): We have been monitoring the South-Korean market for many years. The corona pandemic offered us an opportunity to invest in two companies, one of which we describe here. NeoPharm is a Korean cosmetics company specialising in over-the-counter and prescription moisturizers for adults and infants. The company has strong brands and a leading market share of 20-40% in its core products. NeoPharm has an excellent growth record with a 27% sales CAGR (compound annual growth rate) in the past five years and 19% over the past ten years. Management's guidance for this year, prior to the COVID-19 outbreak, was for 20% growth in revenue and operating profit. While there will be some temporary disruption in sales in the first half of 2020, we believe most of the company's products are non-discretionary and the temporary impact is more than discounted in the valuation. The stock, which has fallen nearly -35% this year, offers exceptional value at only 12x trailing P/E, 7x trailing EV/EBIT, with 33% of the market cap in net cash and an average ROE of 20% over the last five years.

At the end of H1 2020, the three largest positions of the fund were as follows:

Boustead Projects Ltd & Boustead Singapore Ltd (BP 4.79% and BS 3.15%): Key to our investment thesis is the value of a portfolio of industrial real estate in Singapore and management's intention to monetise these assets, most probably through a REIT structure. Boustead has already received regulatory approval and we expect the company to reach critical size for a launch by next year. BP's share price declined 20% since the start of the year. At the current share price, we are protected by the strong balance sheet (more cash than debt) and a large discount of 60% on the third-party appraised value of the underlying properties.

Volusion Group Plc (7.09%): Volusion is a leading supplier of ventilation products with a portfolio of long-established brands in the UK, Continental Europe and Australasia. The company achieves high profit margins as their customers prioritize available, easy-to-install, reliable and familiar products, over the decisions related to pricing. We see a long runway for growth. Volusion benefits from scale advantages and can organise the distribution of many different parts, often low in value, at an efficient cost. Ventilation in Europe is typically a fragmented market, offering the opportunity for value enhancing acquisitions. Stricter building regulations have resulted in a shift towards air-tight buildings and increased demand for Volusion's products. The company's trading update for the year to July 2020 confirms our analysis of the resilience of the business. Volusion continued to generate strong cashflow, even while revenue declined -19% for the February to July period. When the share price declined sharply as a result of COVID-19, we increased our investment to a high conviction position of 7%.

Shinoken Group Co Ltd (6.75%): Shinoken is a Japanese real-estate developer offering services to both owners & occupiers; it sources the land, applies for planning permission, then builds and sells the apartments and condominiums. It also operates a business that offers a whole range of property management services. These services include the actual management of the properties, finding tenants, collecting rent, provide rent guarantee, insurance, electricity and gas etc. This creates a recurring revenue stream growing at more than 20% p.a. with a high profit margin and high returns on capital. Results released so far in 2020, indicate no negative impact of COVID-19 on this earnings stream. We believe these growing management services are very attractive and are worth more than the entire value of Shinoken. Looking at this company differently, we are not paying for the construction business or the property development business. During the first six months of 2020, the sales and operating profit declined for these businesses, whilst the share price declined 40% since the start of the year. We believe Shinoken is a resilient business with negligible net-debt, and a recurring revenue stream that continues to grow during the crisis. The impact on this year's profit from a slowdown in property sales is most likely temporary and the business risk has been further diversified by the recent launch of a private REIT. This will add another channel to its properties sales.

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We are grateful for your trust and welcome any remarks or questions you might have with regards to the fund or the strategy.

Best,
Griffin Value Fund

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