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19 July 2021

ASX Market Announcements
ASX Limited
Exchange Centre
20 Bridge Street
Sydney NSW 2000

BY ELECTRONIC LODGEMENT

Investor Letter from VGI Partners Limited

VGI Partners Asian Investments Limited (ASX:VG8) is pleased to make available the enclosed Investor Letter prepared by VGI Partners Limited. The letter provides details on the performance of VG8 for the twelve months ended 30 June 2021 and commentary on current positioning.

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VGI PARTNERS

Investor Letter

19 July 2021

"No matter how solid your business model may seem, if you look 10 or 20 years ahead, you may find it's a house built on sand. Or worse, a house made of sand. All business is just that fragile. Society is like a river – it never stops flowing, even for a moment. The business climate continuously changes. Businesses that are currently successful will inevitably fail. You must always prepare for the worst, based on this assumption."

HIROSHI MIKITANI, Rakuten founder

Dear Fellow Investors,

For the twelve months ended 30 June 2021 (FY21), **VGI Partners Asian Investments Limited (ASX:VG8)** generated a net portfolio return of **+15.0%** after all fees. VG8's post-tax Net Tangible Assets (NTA) per share stood at $2.80 on 30 June 2021.[1] We are pleased that the FY21 return was at the top end of our target range of 10%-15% p.a. particularly given this return was generated with an average net equity exposure of 71% during the year.

The past twelve months has been a favourable period for equity market investors with most Asian indices, from the Nikkei to the KOSPI, pushing new multi-decade highs. As we discussed in our last letter the driver of this performance has been the massive amount of fiscal and monetary support that governments have provided in response to the COVID-19 pandemic.

These support programs have had their intended effect, bringing businesses and individuals through a very difficult period with rolling lockdowns in many economies. However, it is becoming increasingly clear that some of these programs are now resulting in unintended consequences with emerging inflationary pressures and pockets of speculation, from cryptocurrencies to SPACs and "meme" stocks.

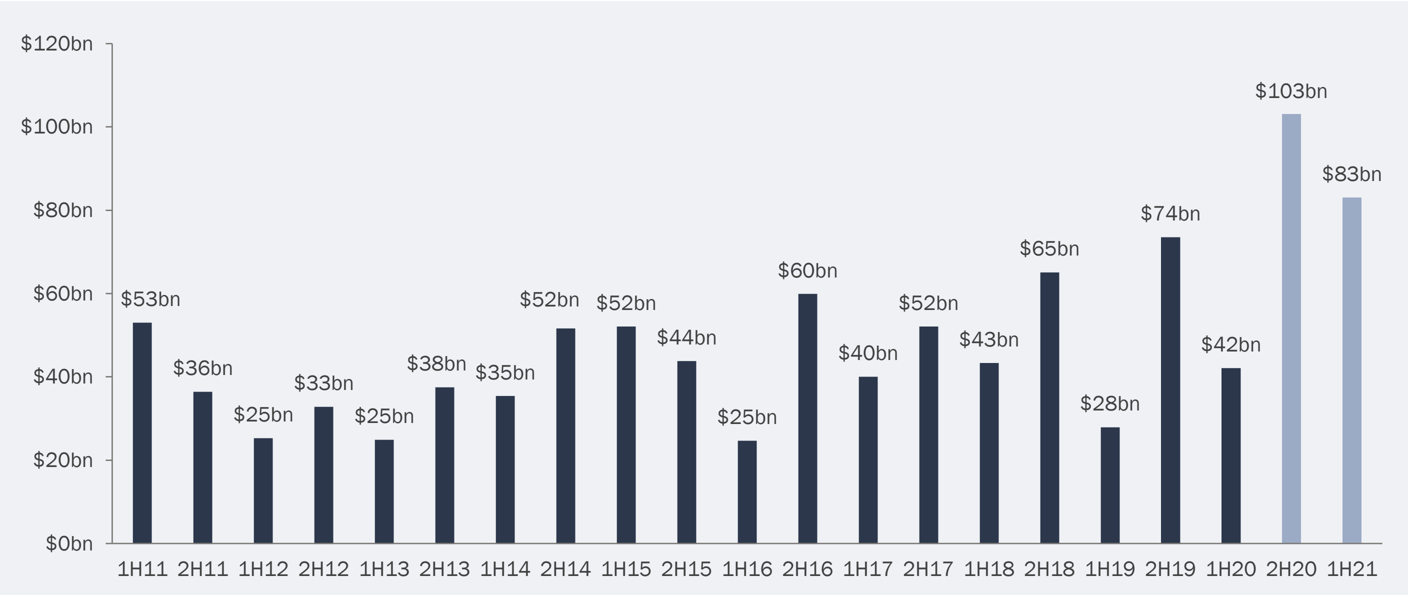
This is no more evident than in the IPO market, where globally $350bn has been raised in the past six months alone. The prior IPO raising record for an entire calendar year was $420bn in 2007, which looks as though it will be comfortably eclipsed by the end of 2021.

Much of this has been driven by raisings through Special Purpose Acquisition Companies (SPACs) or "blank cheque companies" that raise capital from investors to acquire an unknown target. The US SPAC market raised $95bn in the first quarter of 2021 alone, easily passing the record $80bn raised in the entire of 2020! As shown in the chart overleaf, this exuberance is also evident in Asia, where companies have raised $186bn through IPOs in the last fiscal year, the most over a 12-month period since 2010.

We are also seeing new cryptocurrencies being launched daily to meet insatiable investor demand for the latest digital coins in the hope they are the next token to explode in value. These signs of speculation have been increasingly accompanied by heightened volatility, particularly at a sector level where "rotations" from one investment trend to the next are driving large and rapid fluctuations in sector and stock performance.

[1] Post-tax NTA is calculated after tax on realised gains/losses, deferred tax assets and deferred tax liabilities, but before allowing for deferred tax liabilities/deferred tax assets on unrealised gains/losses.

Asia IPO Issuance (US$ bn)



Source: Bloomberg.

During the last twelve months in particular, we have seen a violent rotation between growth and value. In managing the portfolio, we do not concern ourselves with labelling investments as "growth" or "value" – we are focused on bottom-up stock picking and owning high-quality businesses with a moat and secular growth. This means owning businesses that can sustain long periods of elevated returns on capital while continuing to reinvest more capital in the business. Therefore we focus on selectively picking a handful of businesses that we think are exceptional and can be purchased with a margin of safety. Many of our investments can be labelled as both "growth" and "value" and these rotations provide us with an opportunity to grow or build positions at attractive valuations.

> We are focused on bottom-up stock picking and owning high-quality businesses with a moat and secular growth.

Occasionally we do build positions in companies that have more limited ability to reinvest capital at high rates. We label these types of investments as special situations. These often arise from a temporary mispricing due to one-off events, as in the case of Crown, or due to poor management, which creates a turnaround opportunity, as in the case of Yakult. When investing in these special situations we still exclusively focus on businesses that have a wide moat (exclusive casino licenses in the case of Crown and Star Entertainment or a global brand and distribution in the case of Yakult). We will continue to focus on finding the next high-quality long-term compounder because we believe this is the type of opportunity that will lead to the best long-term outcome.

With heightened concern around inflation combined with changes in supportive monetary policy, we think this heightened volatility is here to stay. This should continue to provide us with a fertile hunting ground for new long-term investments. Regarding inflation, we are seeing emerging signs of inflationary pressures across the board in Asia, from freight rates to raw materials.

As our long-term investors know, we are not macro traders and do not believe we can accurately forecast inflation. Instead, we focus on identifying high-quality businesses with the ability to generate attractive returns on capital and grow earnings over the long term. However, any investor, regardless of how fundamentally focused, needs to have some situational awareness of the range of potential outcomes and how this may impact their portfolio.

With this in mind, we want to discuss how we think about building a portfolio that will, over the long term, be insulated from periods of sustained inflation. We believe there are two attributes of a high-quality business that will allow it to perform well through an inflationary environment – pricing power and/or an ad valorem pricing model.

Given our intense focus on quality, we tend to gravitate to businesses that have a product where the customer is relatively insensitive to price and thus can raise prices with minimal or no impact to demand for the product. This will allow the business to continue to grow revenue and earnings ahead of inflation. An example of this in the portfolio is Richemont, which owns the Cartier jewellery business. Cartier is a luxury brand which we believe could comfortably increase prices 10% to 15% over the next two years without impacting the volume of necklaces and rings it would sell. This provides you, as a fractional business owner, with inflation protection. Looking through the portfolio today we are confident that our businesses will be able to raise prices, at least in line with inflation, and would see minimal impact to demand.

Under an ad valorem pricing model, businesses charge based on the dollar value of transactions which take place within the ecosystem that they operate. These businesses do not require incremental capital to grow revenues and in fact grow through the capital committed by their customer base. In inflationary environments the dollar value of transactions is likely to grow at least as fast as the rate of inflation (assuming you have a business benefiting from underlying secular growth) and as a result your revenue, which is a percentage fee of all transactions, will grow ahead of inflation. A good example of this in the portfolio are e-commerce businesses like Alibaba and Rakuten. These businesses take a clip of the value of transactions over their platforms. If inflation increases, the value of goods purchased over the platforms will increase and revenues will grow. Both Alibaba and Rakuten have a relatively fixed cost base, so over time we believe their earnings are likely to grow at a faster rate than inflation, thereby providing inflation protection to the long-term investor. Incumbent casinos like Crown Resorts and Star Entertainment are also good examples of this.

All businesses are not created equally when it comes to their ability to deal with inflation. Some are price takers and will see inflation erode their earnings base. However, we believe we have constructed a portfolio of businesses which have either ad valorem pricing models or pricing power, which gives them protection, over the long term, from sustained inflation.

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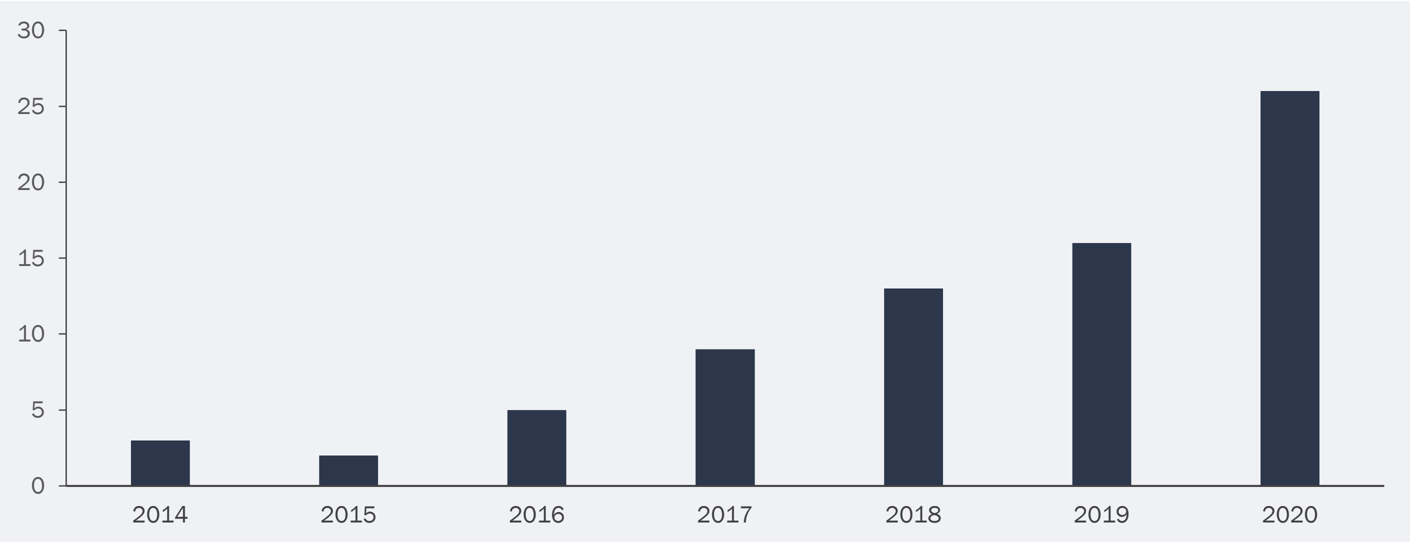
We view Japan as a particularly attractive market to be investing in. We are seeing significant corporate change take place in Japan and we believe this will result in attractive investment opportunities. Structural changes from corporate governance improvements to digital transformation are accelerating, encouraged by a government that recognises the need for reform.

Recent developments at Toshiba are a perfect example. Independent findings not only confirmed management wrongdoing but identified government members colluding against the interests of foreign shareholders. A number of directors are now calling for change at the company and we believe the Japanese government will be eager not be perceived as acting against its own corporate governance reform agenda going forward. In previous times the Toshiba incident would likely have been swept under the rug but the exposure of the full sordid details is, in itself, a prime example of changes actually taking place in Japan.

Japan has seen a steady rise in activist shareholder proposals in recent years and this has clearly stepped up further of late. We believe this is only the start of a wave of more aggressive change coming to Japanese corporates, who we expect will be forced to embrace more shareholder-friendly policies.

Number of Proposals From Activist Funds in Japan

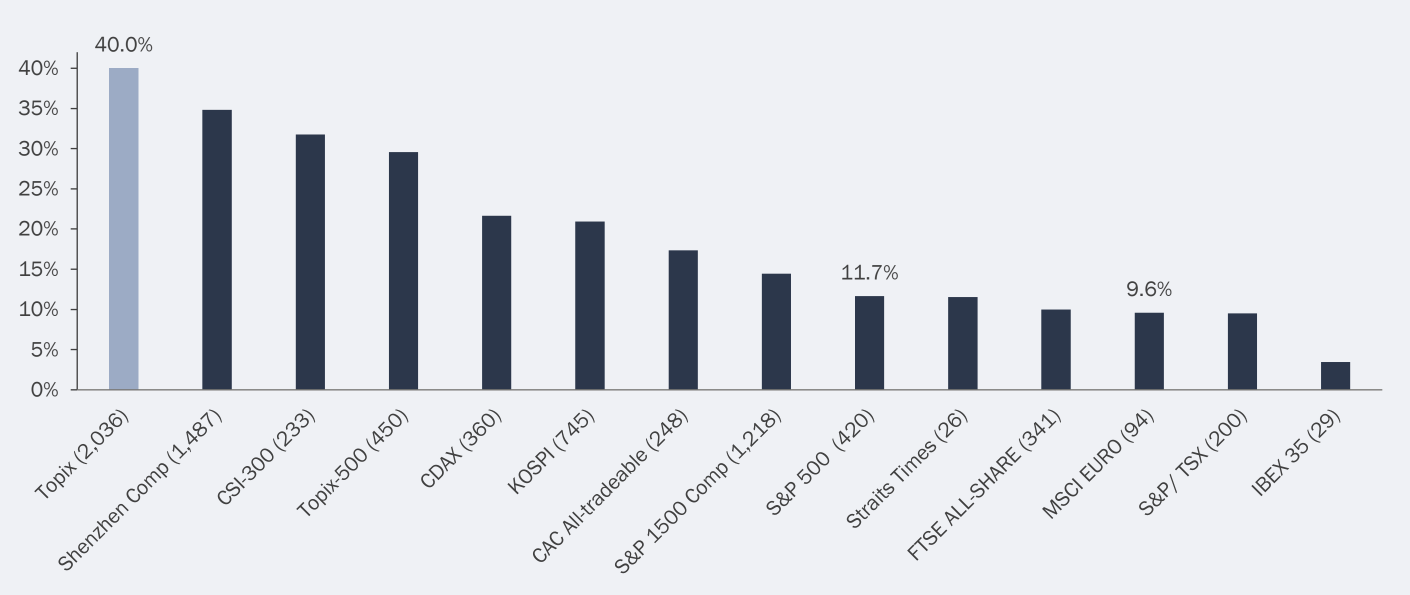


Source: CLSA, IR Japan.

At a broader level, Japan Exchange Group, the operator of the Tokyo Stock Exchange and Osaka Securities Exchange and a core VG8 investment, is increasingly focused on corporate governance and will require companies to meet certain governance criteria in order to join the new Prime Board. The GPIF (Japan's Government Pension Investment Fund) has also become a larger supporter of improving corporate governance within Japan after shifting its asset allocation from fixed income to equities, as the GPIF increasingly needs to generate higher returns to fund its future pension liabilities. Political interests are therefore aligned with the mission of shareholder reform.

Balance sheets of Japanese corporates remain far too bloated, with 40% of non-financial companies on the TOPIX having a net cash position of >20% of their market cap, compared to 12% on the S&P500 and 10% on the MSCI European index (see the chart overleaf). We expect capital allocation to remain a focal point, particularly given the amount of attention and dry powder being allocated to Japan by private equity, activists and large investment firms. We are already seeing this play out in several businesses in our portfolio through higher dividend payout ratios and reductions of cross shareholdings. When our businesses are slow to embrace corporate governance, we will also occasionally look to create our own catalyst, for example by undertaking friendly activism. We have been actively engaged with the management team of Yakult, one of our large holdings, to help influence strategy, push for capital allocation improvements and increase diversity on the Board. We discuss this in more detail later in the letter.

Percentage of Companies with Net Cash Over 20% of Equity – Japan vs Other Markets



Source: CLSA, Bloomberg.

Note: We exclude non-financial companies from the analysis above.

Beyond Japan, we are also finding opportunities in other regions, such as China. In late 2020, we saw an increase in regulatory scrutiny of large Chinese technology companies from the government. We proceeded to sell our small holdings in Tencent and Alibaba at that point, as we felt both stocks were not pricing the increased regulatory risk. We have since seen Alibaba navigate a regulatory investigation and, after a notable correction in the share price, we recently re-initiated a position in Alibaba.

At its core Alibaba is a very high-quality business, with a dominant e-commerce franchise in China and several other businesses at early stages of growth. This includes the dominant cloud computing player in China. We think the valuation is currently discounting a permanent impairment in the company's earnings power and we believe the current price offers a compelling opportunity to buy a leading e-commerce franchise in the largest market globally with a significant margin of safety. We also see additional upside optionality from a number of emerging investments.

We also believe the regulatory risk has now reduced after the Chinese government fined Alibaba over $3 billion for anti-competitive behaviour. In our previous letter we noted that the regulatory environment in China for firms like Alibaba was deteriorating rapidly; while the regulatory environment remains undoubtedly less favourable than in the past, we believe this is now more than priced in. We can assume a material reduction in the value of Alibaba's stake in ANT Group (its financial holding company), zero value for Alibaba's cloud computing business and little value for its other non-core assets, and still achieve upside to the current price. At VGI, we think it is important to have the ability to quickly change our minds when the facts change and, as Warren Buffett's business partner Charlie Munger says, invert the thinking. This is how we approached our thinking regarding Alibaba. Nonetheless we still are very cognizant of regulatory risk in China. As such, we will be prudent should we find more opportunities in China tech given the unfavourable regulatory environment and the VIE (Variable Interest Entity) ownership structure.

Performance for the Year to 30 June 2021

As aforementioned, for the twelve months ended 30 June 2021 (FY21), the Fund generated a net portfolio return of **+15.0%** after all fees.

The following table shows the returns of the Fund after all applicable fees and charges.

Year to 30 June	Portfolio Return (Net)	Net Equity Exposure
2020 (7.5 months)	(0.6%)	28%
2021 (12 months)	15.0%	71%
Total Return Since Inception	**14.4%**	**54%**
Compound Annual Return	**8.6%**	

Source: Citco Fund Administration.
Performance is shown after all applicable management and performance fees charged.

We do not benchmark the VG8 performance to any specific Asian index due to the lack of available benchmarks that appropriately reflect our strategy. For example, our portfolio includes a number of European-listed holdings (such as Richemont and Pernod Ricard), which are primarily driven by Asia but are not captured by Asian indices. Nonetheless, below we show the performance of some of the more relevant Asian benchmarks.

It is important to highlight here that we have generated our return with an average net equity exposure of 71% over the last 12 months, meaning this return has been generated while being significantly less invested than the indices, which are always 100% invested.

Index	FY21 Return
MSCI Japan Total Return (AUD)	14.7%
MSCI China Total Return (AUD)	17.1%
MSCI Asia Pacific Total Return (AUD)	23.5%
VG8 Portfolio Return (Net)	**15.0%**

Source: Citco Fund Administration and Bloomberg.
Performance is shown after all applicable management and performance fees charged.

Performance Attribution for the Year to 30 June 2021

The largest stock contributors to the performance of our Long Portfolio for the twelve months to 30 June 2021 were **Richemont, Crown Resorts, Nintendo, Kikkoman and Hong Kong Exchanges & Clearing (HKEX)**. Below we provide some commentary on these positions.

RICHEMONT

Cie Financière Richemont (SWX: CFR)

Richemont was the largest contributor to performance for the twelve months to 30 June 2021, generating a total return of **+87%** over the course of the year. We built most of our Richemont holding during the COVID sell-off as we expected Cartier jewellery sales to rebound steadily as stores reopened.

As the resilience of the business became increasingly clear and economies quickly rebounded from lockdowns, the share price rose sharply as the business shifted more of its sales online and previous tourism spending was repatriated to domestic markets. We still believe there is substantial hidden value in Richemont, particularly in their online luxury business YNAP (which includes the industry leading brands Net-a-Porter and Mr. Porter). As investments into this division come to an end, we expect profitability to normalise and the market to start attributing some value for it into their valuation of Richemont.

CROWN RESORTS

Crown Resorts (ASX:CWN)

Crown was the second largest contributor to performance for the twelve months to 30 June 2021, with the share price increasing **+38%** since we built the majority of our holding in October 2020. We built our Crown position late last year following the regulatory scrutiny with the NSW Inquiry into Crown's suitability as a casino operator. Since then, the company has attracted interest from a number of parties and has been the subject of a merger proposal from competitor Star Entertainment (that we view as particularly attractive).

In recent months we have trimmed some of our Crown investment but continue to hold a position as we think Crown remains attractively priced.

Nintendo

Nintendo (TYO:7974)

Nintendo was another large contributor to performance for the twelve months to 30 June 2021, generating a total return of **+39%** during the period. Nintendo continued to benefit from the COVID-19 pandemic, which drove an increase in demand for videogaming. Nintendo experienced a record year for earnings, but we think Nintendo is still at the early stages of shifting more to a digital strategy, adopting more recurring revenue streams like subscriptions and expanding outside of gaming to grow exposure of its brand (theme parks, movies, merchandise).

We discussed our Nintendo investment thesis in detail in the Portfolio Update of our prior letter.

Kikkoman (TYO:2801)

Kikkoman was another large contributor to performance for the twelve months to 30 June 2021 with the share price increasing by **+28%** between the start of FY21 and our final sale price. Kikkoman was a beneficiary of stay-at-home consumption in its United States soy sauce business (where it derives the bulk of its earnings) as the decline in the B2B restaurant channel was more than offset by growth in B2C at-home consumption.

Kikkoman was also able to closely manage its cost structure to alleviate margin pressure from operating deleverage. During the second half of 2020, we exited our Kikkoman position as the growth required to justify the valuation materially exceeded our estimates.

Hong Kong Exchanges & Clearing (HKG:0388)

HKEX was a large contributor to performance with the share price increasing by **+49%** between the start of FY21 and when we sold down our position earlier this year. HKEX has benefited from an increase in exchange volumes as a result of US financial exchanges becoming increasingly hostile towards Chinese companies. A number of Chinese ADRs have undertaken secondary listings on HKEX, which has, in turn, structurally expanded HKEX's overall market turnover.

At the same time, HKEX experienced an explosion in Southbound volumes (Mainland China flows into Hong Kong) due to Chinese mutual funds growing their allocation to Hong Kong. We have exited our position in HKEX due to it reaching a stretched valuation level and reallocated the capital into other ideas, but we continue to watch the business closely for a more attractive entry price.

Portfolio Update and Current Positioning

As we highlighted in our prior letter, we were conservatively positioned coming out of the COVID sell-off and were slow to deploy capital given the highly uncertain environment. However, as at the time of writing this letter, we are now around 90% invested as we have identified several attractive opportunities over the past 12 months.

We will maintain a flexible approach and avoid managing the portfolio to a specific net exposure. Not being fully invested provides a very valuable cash asset and allows us to move quickly as opportunities arise. As discussed later in the letter, we have also started to slowly increase our short exposure after coming across some attractive opportunities.

We continue to concentrate VG8's capital in our best ideas. Today, our Top 5 Long Investments represent 41% of total portfolio value and top 10 account for 67% of total portfolio value.

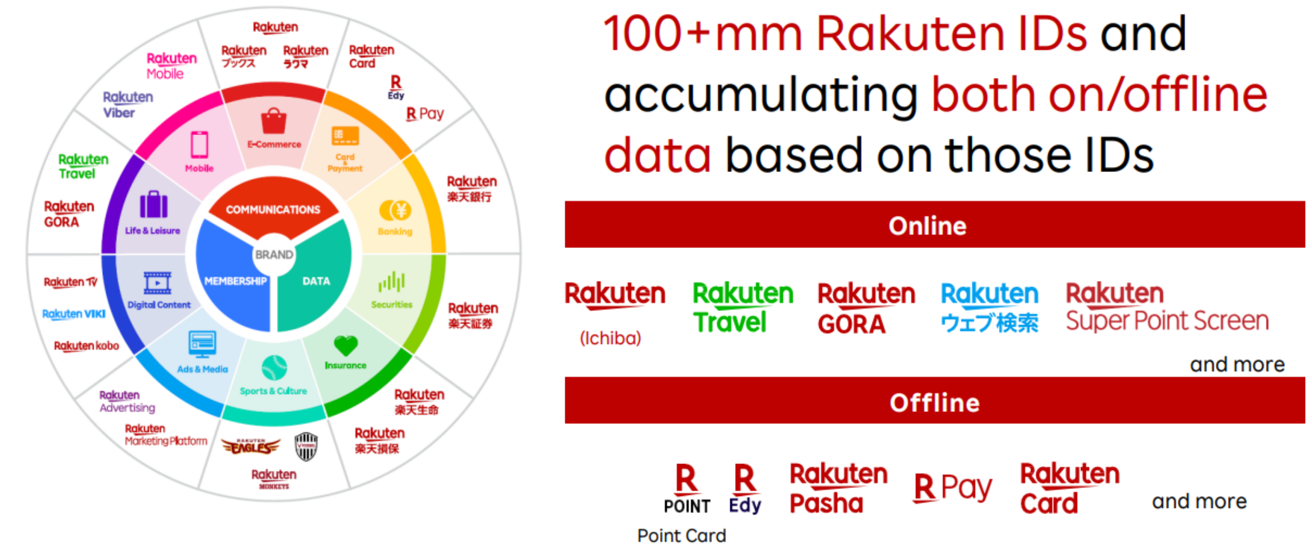
Below we discuss two of our current positions, **Rakuten** and **Yakult.**

Rakuten (TYO:4755)

Rakuten is one of the largest positions in our portfolio.

Rakuten was founded in 1997 by Japanese tech entrepreneur Hiroshi Mikitani. The company started as an e-commerce platform in Japan but has gradually evolved into a diverse business that spans both first-party and third-party e-commerce, online grocery, online travel websites, fintech (credit cards, banking, digital payments, online brokerage) and more recently, mobile phone plans.

Rakuten Ecosystem



Source: Rakuten Investor Presentation.

The company has three pillars: e-commerce, fintech and telecommunications.

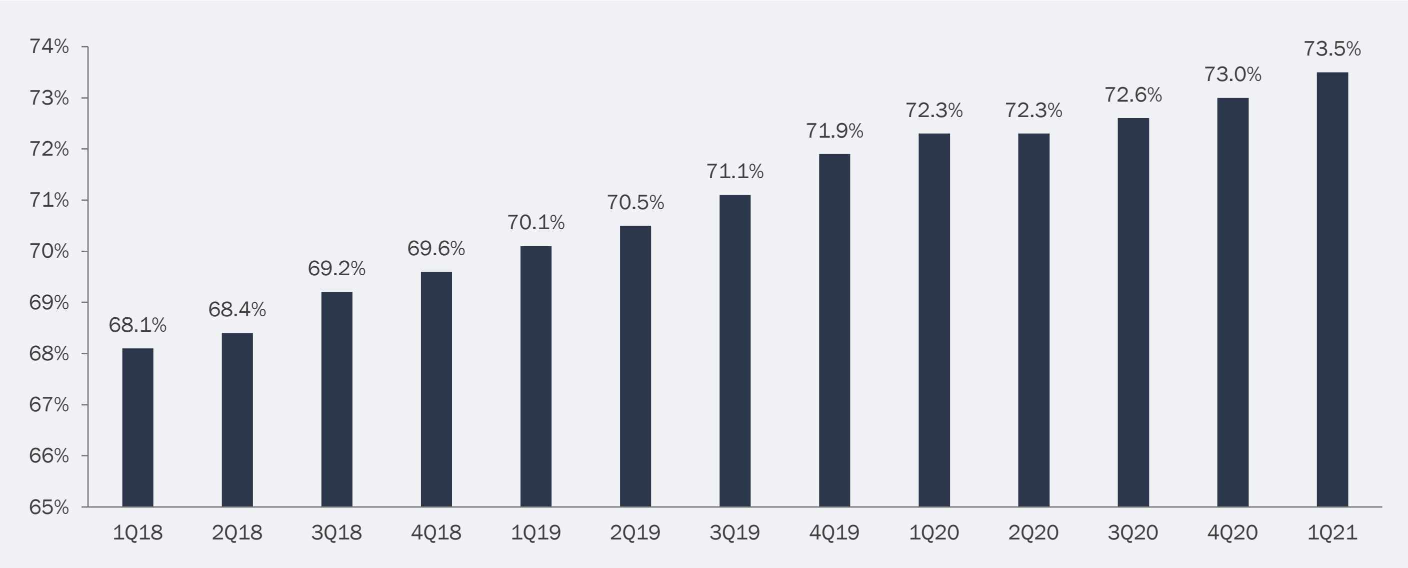
In e-commerce, Rakuten is a leader in Japan and has almost 55,000 merchants selling a broad range of items on the platform. Similar to many other online marketplaces, Rakuten generates both merchant fees from transactions as well as advertising revenues from businesses that want to take advantage of the platform's significant traffic. Rakuten has been continuously investing in logistics to improve its e-commerce offering, for example through same-day delivery. Recently the company announced a partnership with Japan Post to outsource fulfilment centre operations and last-mile delivery, which we view as a highly strategic and attractive partnership (Japan Post has in turn taken an 8% strategic stake in Rakuten).

In e-commerce, Rakuten mainly competes with Amazon Japan, followed by a distant third player in Yahoo! Japan. While Amazon is a formidable competitor, we believe there is significant room for both players to grow given e-commerce penetration in Japan remains low relative to most other developed economies (Japan is at 8% compared to 12% in the US and 20% in China), despite significantly higher density which is conducive to e-commerce. The e-commerce business has also been turbo-charged as a result of COVID and we continue to see a long growth runway for this business.

The second pillar is fintech. Rakuten is a proven disruptor in Japanese financial services and in less than 15 years, it has grown into the largest online bank in Japan (with >10m accounts), one of the largest credit card issuers (with >22m credit card holders) and the second largest online stock brokerage (with almost 6m accounts). Rakuten is taking market share from incumbent, legacy financial services players in Japan, who are ill-equipped to compete against digital-savvy players like Rakuten. We see a long runway for growth for Rakuten's fintech arm, particularly given Japan is still a cash-heavy society that is slowly starting to embrace digital payments.

What is powerful about Rakuten is that all the different services offered, from e-commerce to fintech, are linked by a single loyalty points ecosystem. The more services Rakuten customers use, the more loyalty benefits are accrued. Unsurprisingly, the number of Rakuten users that engage with multiple Rakuten services continues to steadily increase and has reached 74% compared to 68% three years ago. We believe Rakuten is creating a powerful network and lock-in mechanism for Japanese consumers.

Rakuten Cross-Use Ratio

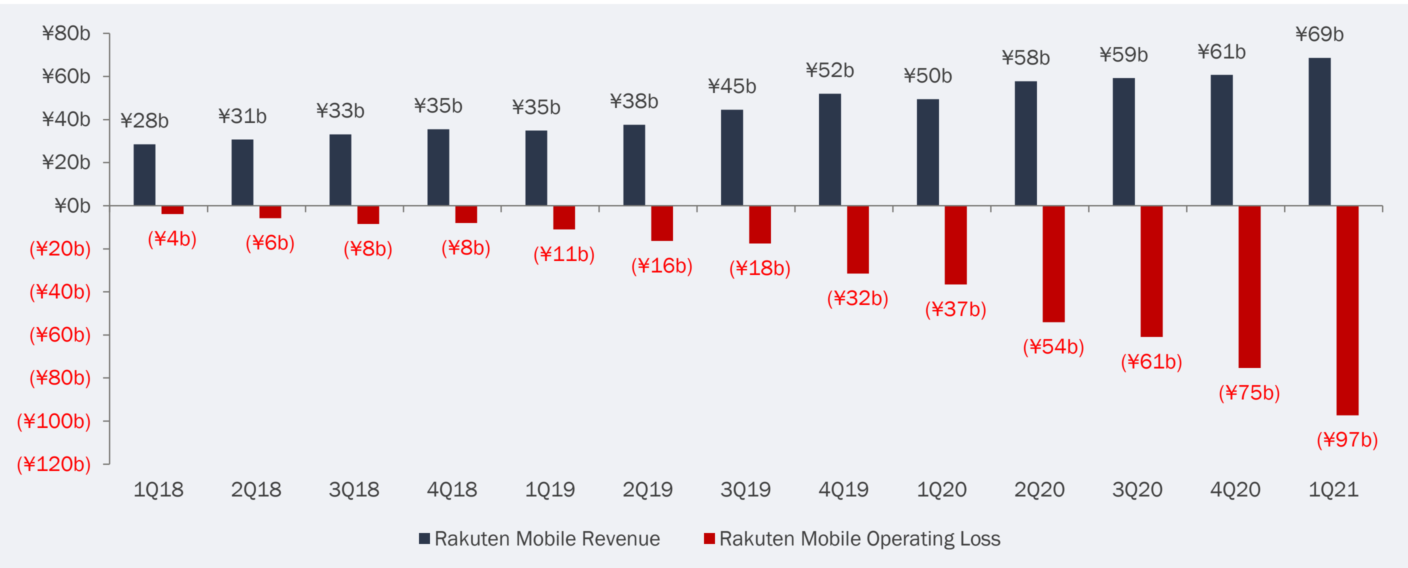


Cross-Use Ratio: Number of Rakuten members who have utilised two or more Rakuten services during the prior twelve months. Applicable services limited to those which can earn Rakuten Points. Source: Rakuten Company Documents.

The third pillar revolves around Rakuten's expansion into the Japanese telecommunications sector. In 2017 Rakuten announced plans to build a telecommunications infrastructure network to offer customers Rakuten mobile phone plans. By leveraging Rakuten's points ecosystem, the objective is to take market share from incumbent telco operators who have been operating in a cosy oligopoly (the three Japanese incumbents have been under government scrutiny for egregiously high pricing versus global standards) while also improving the proposition of the Rakuten ecosystem (and therefore raising the barriers to entry for competitors).

This initiative has required significant upfront investment which has camouflaged the earnings power and cashflow of the core Rakuten business. Over time the amount of capex required to build Rakuten's 4G and 5G mobile network has steadily increased and the total spend will come to at least US$10bn by the next few years. This has been funded by a combination of its internal profitable e-commerce and fintech operations and external funding.

Rakuten Mobile Revenue vs Operating Loss – The Market is Concerned by Widening Losses



Source: Rakuten Investor Presentation.

Investors and sell-side analysts have thus become particularly concerned that Rakuten is "diworsefying"[2] by entering the competitive and capital-intensive telco industry and investing large amounts of capital in doing so. Interestingly, Rakuten has approached the telco market in a disruptive manner – unlike a traditional operator purchasing expensive equipment from vendors such as Nokia, Ericsson or Huawei, they have pioneered a new way to build a telecom infrastructure (more technically through Open Radio Access Networks and cloud technology). Rakuten is the first to deploy this technology at scale and, if successful, it will provide Rakuten a structural cost advantage against incumbent operators with legacy infrastructure, while also creating the opportunity to monetise this technology by licensing to other telco vendors internationally. The company is currently engaged in a number of negotiations on this front to leverage its technology and its patent portfolio (which comprises >2,000 patents).

We are yet to see whether Rakuten's telecommunications technology will be superior at scale, but Rakuten has rapidly growing, and highly profitable, e-commerce and fintech operations to help subsidise the investment, so we think they are very well positioned to succeed in this field. The upside profit potential for this business is significant, but even more importantly the data that Rakuten will have access to through the mobile network will be invaluable. We do not believe the current share price captures any of this, and in fact the market is capitalising in perpetuity the large losses currently being generated by the mobile investments. This reminds us of Amazon in 2014, when the market was concerned by investments in logistics and cloud computing and capitalising these losses on the income statement.

We think it is a highly attractive situation. We believe the market is under-estimating the underlying earnings power of the business and the long-term strategy of its founder CEO, which is to build a thriving ecosystem eventually delivered through a "Super-App".

We think Rakuten is a multi-year winner given its dominant positions in e-commerce, fintech and potentially telecommunications. Rakuten is also exploring a number of new initiatives, such as online grocery delivery and even gaming (Tencent recently took a 4% stake in Rakuten), which creates real optionality. Meanwhile we believe its core business will continue to become increasingly entrenched in the everyday lives of Japanese consumers.

Finally, the business is run by a fanatical entrepreneur, Hiroshi Mikitani, who founded the business in 1997 and remains heavily involved in its operations. Our recent one-on-one meeting with Mikitani reinforced our view that he is a strategic thinker and extremely focused on growing value long-term. He is also highly incentivised – Mikitani owns 34% of the company and recently reinvested ~US$100m back into the business as part of a capital raising alongside investors such as Japan Post and Tencent. We love to see founders eat their own cooking and we are similarly excited about the long-term prospects of the business.

Rakuten's founder, Mikitani, owns 34% of the company and recently reinvested ~US$100m back into the business alongside investors such as Japan Post and Tencent.

Yakult Honsha (TYO:2267)

As we discussed in our January 2021 letter, Yakult has been a disappointing investment over the last two years. As such we have decided to engage more actively with the company to facilitate change.

At the core, we believe Yakult has a strong brand in its niche area of probiotics that should be benefiting from higher demand for health and wellness products. However, we feel management is failing to take advantage of the opportunity to reinvigorate the brand and in fact, may find it difficult to maintain relevance if it fails to act.

We are seeking a number of changes, including an acceleration in Yakult's digital marketing implementation, an introduction of premium brands into the key China market, an injection of more diversity into its board of directors and an increase in shareholder returns (through a higher dividend payout ratio and share buybacks).

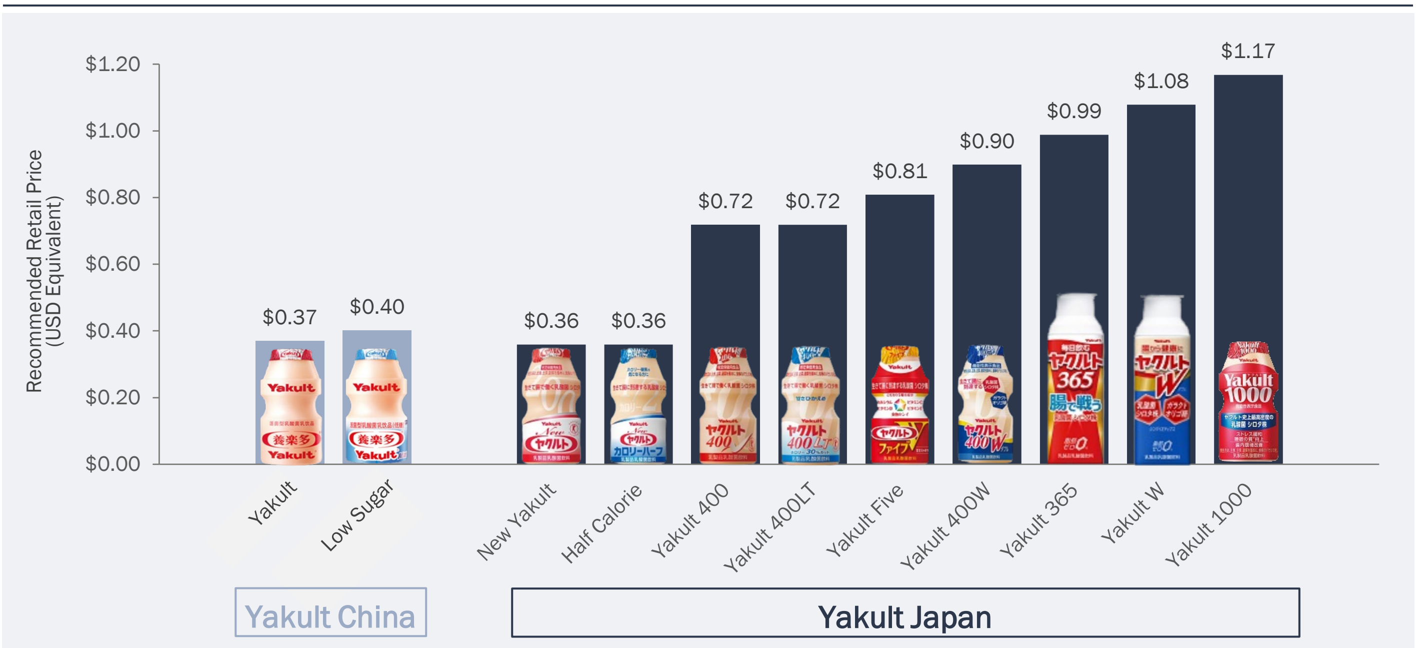
[2] A term coined by legendary investor Peter Lynch, author of One Up on Wall Street; diworsefication refers to expansion into new businesses that dilute a company's returns on capital and therefore lead to a deterioration of the overall quality of a business.

We prefer to engage with management teams behind the scenes rather than publicly, but when we see an unwillingness to embrace change and engage with supportive shareholders, we will act. Therefore, we recently voted against all of Yakult's proposed board members at its recent Annual General Meeting and have been in dialogue with management.

Recent coverage from the Wall Street Journal highlighted that VGI Partners was not the only Yakult shareholder to vote against resolutions put forward at Yakult's AGM. Calvert Research (a US investment management firm with over $33bn under management) also voted against all board resolutions and CalPERS (the California Public Employees' Retirement System, the largest public pension fund in the US) voted against the reappointment of the incumbents on the board. In addition, insider ownership by the Yakult management team and Board of Directors is minimal, which highlights the poor alignment between management and shareholders. As we mentioned in the introduction of this letter, we believe there is a wave of change coming to Japanese corporate governance in Japan and we think Yakult can be a prime example of change.

We think Yakult's biggest opportunity is international premiumisation. Yakult has historically undertaken minimal product innovation, which has been reflective of management's stale approach to marketing. In recent years the company has begun to premiumise the domestic Japanese market via the introduction of new products at higher price points. This includes the Yakult 400, which offers a higher concentration of probiotics, and Yakult 1000, formulated to relieve stress and improve sleep. Sales of these products have been a key contributor to the significant improvement in Yakult's operating margins in Japan, which have increased from ~8% to ~12% in two years. We believe Yakult needs to implement premiumisation more aggressively throughout other regions, particularly in China which is Yakult's second largest market after Japan. As can be seen in the chart below, Yakult's premiumisation in China has been negligible to date. This is an example of the initiatives we are trying to encourage the company embrace and we believe there is significant low-hanging fruit that Yakult can take advantage of.

Yakult's Probiotic Beverage Product Range



Source: VGI Partners analysis.

Short Selling

Our short portfolio detracted -0.1% from our returns in FY21.

The last twelve months has been a difficult period for short-selling. The combination of the liquidity that has been funnelled into financial markets and volatility in reported earnings, due to the pandemic, has led to heightened volatility, particularly amongst companies with highly geared balance sheets and challenged business models – which in normal times is what our short portfolio is comprised of.

Given the difficult environment for short-selling, we have been slow and selective in adding short exposure for VG8. We think this concern has proved to be warranted as through FY21 we saw several instances of short squeezes, with GameStop, AMC and Hertz being just a few of the most notable examples and we have also seen this extend to Asian markets. Many short sellers who decided to persevere through FY21 experienced significant losses, despite the apparent risks.

More recently, we have started adding more single-stock shorts in VG8. Currently our short exposure is 6%. We are still focused primarily on shorting businesses that are structurally flawed but we have started to adopt more of a thematic approach in order to reduce some of the single-stock risk. The process is not all that different – it just means that when we previously would have shorted a single stock given a thesis, we now look for other candidates likely to experience the same pressures and express our thesis across multiple shorts.

We think continuing to short sell is important to how we manage our portfolio. When we founded VGI in 2008 we decided to have an active short portfolio as we believed it would provide us with a partial hedge to our long portfolio, while also generating positive absolute returns. We have demonstrated our short selling capabilities over time (primarily in our global strategy), including generating positive returns in our global short portfolio in the 5 years leading up to the COVID outbreak, despite the market increasing +77% over this period. We think a short portfolio is a very valuable risk management tool and is particularly useful in the current market environment.

We believe a short portfolio is additive to our analytical abilities and in turn enhances our long-term investing capabilities and returns.

Over the past 13 years we have built up a significant amount of institutional knowledge in our short selling activities. We have built proprietary, industry-leading, screening capabilities, we have built a database of “bad actors”, we have an experienced team of short sellers and we have well established processes which help us to identify and avoid poor risk/reward situations.

This year we have added more risk management tools, including enhancing our social media tracking and chat forum scraping, as we see these as essential in navigating the current environment. We have also seen value in our existing rules, such as avoiding highly shorted situations and battleground stocks. We think having these risk management rules and procedures in place are critical to successful short selling and we continue to build off our process that has evolved and been refined over thirteen years.

Additionally, while in the past we have publicly discussed some of our single stock shorts we are unlikely to do this in the future due to the targeted short squeezes we have witnessed this year. Again, this is part of the evolution of our risk management processes. We will however try to provide broad commentary on secular short thematics, where appropriate.

Currency

VG8 is denominated in Australian Dollars (AUD). We actively manage our currency exposure as our analysis of the economic outlook for Australia evolves relative to Asia and other geographies.

The success of our purposeful and active management of the currency is evident in the returns achieved by the VGI Partners Master Fund; currency movements have enhanced the Master Fund's total return by +23% since inception in 2009.

Whilst previously being unhedged to the US Dollar and Japanese Yen, we moved to a fully hedged position in mid-CY20. With the recent move in interest rates globally, as well as the high correlation of risk assets, we no longer believe the AUD is clearly mispriced and therefore remain fully hedged today. In the future we may move back to an unhedged or partially hedged position - and take an active view on the currency - when we believe there is a clear mispricing based on our fundamental analysis.

CEO Appointment

In early April we were pleased to have Jonathan Howie join us as our new CEO. Jonathan joins us from BlackRock, where he spent 9 years in Australia and Hong Kong. Most recently, Jonathan led BlackRock's index equity business in Asia. Prior to his time in Hong Kong, Jonathan was responsible for managing BlackRock's iShares ETF franchise in Australasia.

Over the past 12 years we have continually improved our processes, both on the investment and operations sides of the business. Jonathan's focus as CEO will be to continue to improve VGI's operating platform, and to assist us in further developing our ability to serve clients. VGI has always taken a measured approach to growth, preferring to focus on managing money for our clients and investors, rather than get distracted by the alure of constantly growing assets under management. However, as our business has developed, it has become clear that we can do more to serve our valued clients more effectively.

In the relatively short period since joining, Jonathan has already begun the process of improving the information we send to clients. He's also had the opportunity to meet a number of investors and their advisors, despite the shifting sands of COVID restrictions. We know he is looking forward to meeting many more of you as conditions allow in the months and years ahead.

Finally, and importantly, Jonathan's presence will allow us to continue to evolve our operations, risk management and investor relationships capabilities while ensuring the investment team are able to dedicate the vast majority of our time to managing the portfolios. We're excited to have him as part of the team.

In Closing

As long-term investors know, we take alignment of interest between ourselves and our investors seriously. We have the vast proportion of our net worth invested in our Funds and VGI Partners itself and continue to add to our investments. As a result, investors should be confident that our investment team's energy and effort is focused on a singular outcome – to maximise returns over the long term while preserving our collective capital in what is a highly challenging investment environment.

At VGI Partners we are entirely focused on managing our portfolio. Our unwavering commitment is to preserve and grow your capital over the long term, regardless of the market environment, by owning high-quality assets which have been purchased with a margin of safety. We cannot eliminate short-term volatility from our returns, however we are more confident than ever that our process and investment philosophy positions our portfolio to produce attractive returns over the long-term and through the cycle.

We remain optimistic about our existing portfolio and will continue to take advantage of opportunities that present themselves. We are very grateful that we have long-term oriented investors who entrust us with their capital.

Once again, we thank you for your investment with VGI Partners.

Yours faithfully,

VGI Partners

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