Management report

Dear fellow shareholder,

Nearly halfway through 2019 and 4 years into our journey, we feel as confident as we ever have about the future of Vostok Emerging Finance. Having seen and experienced so much across the world of emerging markets fintech, battle scarred from building and living with a portfolio of leading fintech names and recently experiencing our first exit, the path to continued value creation is very clear to us. We have little doubt that we are playing into a very strong, structural value creation theme and have developed a real investment edge for our focus space. As important, through 1Q19, we have returned to a very strong capital position, almost at a level when we first raised capital in 2015. However, we have more options than ever to deploy it in a value-accretive manner, which is the truly exciting part of our life today.

1Q19 performance review and highlights

In 1Q19, total USD NAV of VEF grew 0.8% QoQ to USD 203.07 mln. NAV per share grew 5.5% QoQ to SEK 2.93.

The major drivers of NAV for an investment company like VEF will naturally be the larger names in the portfolio. Historically, Tinkoff was that key driver. Through 2018, iyzico started to step up and drive our NAV, while we look to growing portfolio favourites, Creditas and Konfio, to join it as we move through 2019. On the other side, Guiabolso continued to weigh on our NAV trajectory as we rebased the valuation further during the quarter.

As mentioned in our annual report letter, in the early part of 2019, we completed the sale of our Tinkoff position, which was our first portfolio exit and a clear milestone for the Company. Over the course of our exit of the position we took USD 108 mln (average exit price USD 17) off the table, plus an additional USD 9 mln in dividends. An IRR of 65% and 6x cash on cash returns.

While we invest in individual companies, there is clearly a portfolio effect to our investment process. Short-term quarterly marks will always be watched by the markets, but we would point to the long-term investment journey (both behind and ahead of us). At VEF, we have more than doubled our NAV since inception and are positive on this growth trend continuing as we look ahead.

Backing our winners harder – iyzico and Nibo

From a capital allocation perspective, we continue to see three distinct avenues for our capital: 1) new company investments, 2) investing more money into current portfolio companies and 3) VEF share buybacks (returning capital to shareholders). While we remain active on all three fronts (with IRR on capital deployed an ever-present benchmark and roadmap), of late we have been especially active in putting more capital to work in current portfolio companies. Quite simply, if something in our portfolio is working well, we look to back it harder and deploy more capital. The investment risk is naturally lower, as we have lived with the company for some time, while returns also have to stack up to make the additional investment worthwhile. Two names which have met that mark of late are iyzico and Nibo.

iyzico, Turkey's standout payments company, has already driven its B2B business to the number one spot in Turkey following their partnership with Amazon, and with the core business coming close to breakeven, management decided to raise a small internal round to fund expansion into a consumer- focused offering, something akin to a PayPal for Turkey. It was one of our easier investment decisions to write a USD 1.75 mln cheque as part of an internal USD 4 mln funding round in 4Q18.

Nibo is a company that has really delivered beyond our expectations, and today boasts one of the largest SME client sets in the Brazilian market. More importantly, given its accounting SaaS product offering, it has all key accounting, tax and cashflow data on this growing set of loyal customers, something which is akin to gold dust in the data-light, opaque world of small businesses across the emerging world. This data opens up many avenues of value creation for the business going forward, above and beyond its underlying SaaS revenue model, which itself is growing at a healthy clip. Through 1Q19, we injected another USD 2 mln in Nibo as part of a broader USD 4 mln internal round.

Brazil revisited

As our exposure to Brazil continues to grow as a portion of NAV, we felt the need to share latest feedback from our recent tour there.

At a country level, we found that there is as much hope for an economic recovery as there is concern that the new Bolsonaro government may blow their big opportunity, as the early shine wears off and the difficult task of actually getting things done begins. That said, the country feels better on a micro and anecdotal level post-elections as the country continues to crawl out of recession. For VEF, while macro cycles will come and go, we remain as positive as ever on the fintech opportunity that Brazil offers. With every fresh look at Brazil fintech and comparison with global emerging market peers, we become more convinced that we are deploying much of our sector-dedicated capital into the right geography. Besides the positives of a scale market, Brazilians are embracing all areas of new economy, a function of how young and online the market is. The banking system profit pool in total and the revenue opportunity on a per-unit basis (into this scale market) is unparalleled globally. We see plenty of other "higher risk/lower return" markets globally for fintech. We still need to back the right horses, but we are convinced we are in the race with the biggest prize money. We are looking to put more capital to work in Brazil, and to hold many other markets and investment opportunities to the investment bar it has created for us.

However, the ecosystem is heating up and getting busier. On the private funding side, Softbank plans to drop a USD 5 bln funding bomb from on high, which could ripple down through the ecosystem, with effect on deal demand and pricing – but not yet. While the banks are still not exactly the main threat today, the large listed payments players like Stone, PagSeguro and MercadoLibre are busy rolling out broader and deeper financial ecosystems for small businesses and consumers – all of which offers a threat and potential benefit (M&A and partnerships) for our companies.

Investor relations and our companies working for us

We started to up our game regarding investor relations and general investor education in 2018. Effectively, having spent (and still spending) the majority of our time on portfolio build-out, position management and exits – which is where the fundamental value of our company is created – we felt it was time to reach out to the investment community more, now that we have more than ever to speak to investors about – a real portfolio, NAV on the up, standout portfolio names, and size value accretive exits to name but a few. Furthermore, our larger portfolio holdings, like Creditas, Konfio and iyzico have been open to meet investors while they are on tour in-country and have also taken part in a number of Fintech/new economy panels at conferences hosted by global investment banks, which has had an impact. Nothing speaks louder for us than our companies meeting and impressing institutional investors first-hand. All these efforts do seem to be having an effect, as our share price has seen some support through 2019.

Concluding remarks

As we approach the midpoint of 2019, we feel as well-placed as we ever have and are both confident and excited for the near-term (2019) and longer-term outlook. Also, our confidence that our actions and NAV growth will be reflected in our share price is growing as we continue to actively engage the market to drive that evolution sooner as opposed to later. We re-iterate that delivering shareholder value through a focused approach to increasing our NAV per share and reducing traded discount to market value remain our core focus. We take a long-term view on our company, investments and indeed life, which is necessary when investing in the space that we do. Hence we are ready to act and react in any environment with these supporting mindsets.

May 2019,
David Nangle