Management report

Dear fellow shareholder,

It always amazes us the difference a few months can make in financial markets and the outlook for them. In our YE (2017) investor letter, we communicated how global (and EM) macro and markets had not looked this uniformly positive in a very long time, with the consensus outlook for 2018 for more of the same. Fast-forward to today and global politics is in flux, inclusive of a US led escalating trade war, all with widespread macro implications. In our world, the emerging world, cracks are beginning to appear (many of which are specific and self-inflicted) reflected principally in negative moves YTD in both the fixed income and currency markets. Also situations are escalating and subsiding apace with markets flipping from stable and positive to volatile and back again in extremely short windows – more on this below. Global volatility aside, Q2 2018 was another positive quarter for VEF with continued uplift in our NAV per share and we were also excited to announce our first foray into Mexico via new portfolio addition, Konfio, SME digital lender.

Q2 2018 was a quarter where we increased the valuation of three of our portfolio holdings; TransferGo, iyzico and JUMO. While Tinkoff has been both, the most substantial mark-to-market positive, and exited investment to date, we have now seen increases in the NAV of almost half our portfolio holdings, primarily driven by new higher valued investment rounds. However, in Q2 2018, with iyzico, it is the first time we have increased the valuation of a portfolio company outside of a funding round, on a mark to model basis. iyzico is a benchmark investment for VEF and has broadly doubled its customers, payments volumes and top line revenue YoY for the past 3 years. The company has become THE standout payments play in Turkey and just announced its intention to broaden its scope to East European markets. We increased the valuation of our stake in iyzico this quarter by 95% to USD 17.6 mln, based on its underlying performance and global comps in the space. It is now the 4th biggest holding in our portfolio. We see a much bigger and brighter future for this delivering scale fintech opportunity.

VEF ended Q2 2018 with another quarterly record NAV per share of SEK 2.98, up 21% from YE17 and 46% YoY. In 2018 our NAV went above USD 200 mln, while the discount to our market cap averaged 24% over the 1H period. For a company and team, which focuses and prides itself on shareholder value over the medium to long term, we have more than enjoyed the early journey valuation driver that has been Tinkoff Bank. However, we believe that the future drivers of value sit amongst the 11 other (and growing) private holdings that we have added to the portfolio since the summer of 2015.

Back to macro – Unlike the benign investment environment of 2017, top down themes of politics and geopolitics have dominated the investment landscape, with immediate impact on traded public markets and potential medium-term effects on the global economy, all offering potential opportunities and threats for VEF's mandate and portfolio. In our Q1 investor letter we focused on Russia as an outlier within our portfolio countries, as further sanctions made it the exception risk case to a broader more stable geographic portfolio mix. Through Q2 the volatility spread across emerging markets. Given its importance to VEF's portfolio, we focus on Brazil in this letter, but could easily have written on Pakistan, Mexico or Turkey. Given the recent escalation of the crisis in Turkey, it will not doubt have a section in our next quarter letter. As a caveat to our valuation uplift in iyzico in Q2, we are very closely watching market and currency developments in Turkey through this window and will of course factor any key developments in, when the dust settles, for our Q3 iyzico valuation.

Brazil – In January 2018, Brazil was a country where economists, strategists and companies alike spoke about a macro recovery led by a reform oriented (although soon to be changed) government, with inflation and interest rates falling to single digits for the first time in a long time and GDP recovery to 3%+ pa around the corner. On the political front, there was a general view that a presidential candidate from the centre would appear well before the elections in October and sweep to victory and continue the reform and growth agenda as would be logical at this stage for Brazil and all its vested parties. But in the world of emerging (and many developed) markets life is seldom this simple and partly why we love them so much. So, what has changed since…

1. We had a nationwide truck strike of epic proportions over the rising price of fuel, forcing a social and budgetary give away at the wrong time. And a boost for populism and populist parties who clearly backed the event.
2. Politics is becoming a concern, as with the elections approaching we have four candidates coming to the fore with the leading two from the far right and far left and both populists by nature. This is besides Lula, jailed former president who is still running 30% in the polls despite not being able to run! As always, the wrong leader, with the wrong policies is clearly not what Brazil needs at this point in its recovery cycle, especial to get budgetary reforms like pension reform through.

The Bovespa and Brazilian currency reflected these trends through Q218, but has since stabilised and even recovered, as is the speed of volatility across our markets in this window. It is important to note that on a micro level, we have seen little impact on our portfolio companies as a result.

Elsewhere and more generally, it has been a year of elections which is always noisy in the emerging world, especially in the period leading up to the event, can affect currencies, fund flows and general consumer confidence. Pakistan, Mexico and Turkey have just passed, while earlier in the year we had Russia. It should be clear that while we don't invest in public markets, we remain acutely aware of the top down trends and how they can influence our private holdings as well as how we manage our capital and positions through volatile windows. It is key to remind all that we are structural thematic investors. Our firm belief is that fintech is a structurally winning theme to invest in, through the cycle. In line with other new economy spaces, it is the way of the (banking) future. Respect the macro, but we invest in winning micro stories and then look to navigate what can be volatile macro and politics to opportunistically provide support where necessary for our portfolio names and invest in great names in volatile windows.

Konfio, VEF's latest investment, is a great example of the above. While the public markets may be deeply debating the effect of a change in the presidential guard in Mexico to the left and overly focusing on short term macro and currency concerns, we were very happy to announce our USD 15 mln investment into Mexican online small business lending platform, Konfio. Konfio is a digital-first unsecured lending platform, with a mission to fuel the growth of, and empower small businesses in emerging markets, by offering access to credit. Mexico represents a scale market with approximately 7 mln SMEs, of which in excess of 90% fall into the smaller end category. Being underserved by the large banks, the key focus and opportunity for Konfio is in the higher credit and lower risk tier segment of the small-end SME market, representing an USD 45 bln opportunity. We often find that our latest investment becomes your natural favorite, but we love the SME scale opportunity in Mexico, the team driving the business and their very focused business model and traction to date. The SME space in general is one we are spending a lot of time on across markets.

Key to the long-term value creation process is an on-going drive to improve corporate governance at VEF and investor communication and third-party broker research is a crucial part of this. In a post MiFID world, coverage for small and mid-cap stocks, like ourselves, has increasingly fallen as less resources are allocated to the space. Given this backdrop, we were very happy to see the fresh coverage of VEF by Nau Securities in June. Nau is a highly regarded research first, Latam focused house and it was our growing portfolio of quality Latam fintech assets that saw us hit their radar screen and thanks to their research and marketing efforts, their investor's radars also. We were in the US and UK marketing with them seeing a range of top tier investment managers. It is an example of the continuous work we are doing with brokers which eventually pays dividends in terms of coverage and all the good things that can come with it. In Q2 we also held a successful Fintech conference call with Citibank and asked the CEO of Tinkoff Bank, Oliver Hughes and the CEO of Creditas, Sergio Furio to join us in what was a great show case of the success in the VEF portfolio across markets, business lines as well as later and earlier stage investment themes.

I would like to close off my comments by thanking my supportive board and team at VEF for all their on-going efforts. To fellow shareholders, we appreciate your on-going support. Delivering shareholder value through a focused approached 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.

August 2018,
David Nangle