

21 August 2024

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

RG8 Investor Letter

In combination with the FY24 Annual Report released earlier today, Regal Asian Investments Limited (ASX:RG8) is pleased to make available the enclosed Investor Letter. The letter provides details on the performance of RG8 for the period to 30 June 2024, recent market developments and some current portfolio positions.

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ABOUT RG8

RG8 provides investors with access to an actively managed, concentrated portfolio, comprised of long investments and short positions in securities with exposure to the Asian region. In June 2022, portfolio management responsibilities for RG8 transitioned from the VGI Partners investment team to specialist alternatives investment manager Regal Funds Management (Regal) under an investment advisory agreement with Regal Asian Investments Management Pty Ltd. In November 2022, the Company changed its name and ticker from VGI Partners Asian Investments Limited (ASX:VG8) to Regal Asian Investments Limited (ASX:RG8) to reflect those changes. Utilising a fundamental, bottom-up investment approach, the portfolio leverages Regal's extensive experience, network and specialist investment team.

Regal Asian Investments 2024 mid-year newsletter

August 2024

Dear fellow investors,

We are pleased to provide the following update. Thank you also for your continued support.

Regal Asian Investments Limited (ASX:RG8 or the Company) generated a positive net portfolio return of +13% after fees for the 6 months to 30 June 2024. For the 12 months to 30 June 2024, the portfolio returned +17%, after fees.

This strong performance was largely driven by our investments across Korea, Japan and Australia, while investments in China were a small drag on the portfolio.

Pleasingly, for the 24 months following the transition of RG8's portfolio management responsibilities to Regal Funds Management in June 2022, the total net portfolio return has been +27%, after all fees, and the total share price return (including gross dividends) has been +41%.

For the 24 months following the Regal transition, RG8 has outperformed the MSCI AC Asia Pacific Index



Source: Bloomberg. Total share price returns (which include dividends gross of franking) indexed to a starting value of 100.

While pleased with the continued performance of the portfolio, we remain mindful that RG8 shares are trading at a discount to the Company's net tangible assets (NTA), albeit at a smaller discount than prior to the Regal transition. This remains a key focus for both RG8's Board of Directors (the RG8 Board) and the Investment Manager, with a number of activities currently underway seeking to further close this gap.

One tool the RG8 Board has been utilising is capital management, as evidenced by the RG8 Board obtaining shareholder approval for a large-scale on-market share buy-back of up to 25% of RG8's shares on issue for the 12 months from 30 November 2023. In addition, an updated dividend policy is in place to provide investors with greater clarity on future expected dividend payments, with the RG8 Board targeting a dividend of at least 5 cents per share on a six-monthly basis. At the share price of \$2.20 as at 30 June 2024, this would imply a forward 12-month dividend yield of 4.5% (pre franking) or 6.5% (including franking).

MARKET OBSERVATIONS AND OUTLOOK

In recent weeks, Asian markets have experienced a period of heightened volatility, particularly within Japan. We provide some thoughts on this later in this letter, but our overall view is that certain stocks have been oversold in this correction and we have consequently increased our holdings in some of our highest conviction investments.

We continue to see the long-term outlook for Asian equities as positive given we see:

- attractive valuations across most major Asian markets;
- significant catalysts from new shareholder focused corporate initiatives, particularly in Japan and, to a lesser extent, Korea and China;
- earnings expectations improving across various markets;
- growing evidence that most major Asian markets remain under-owned versus various benchmarks; and
- underperformance of Asian markets versus US markets over the past few years.

We firmly believe our high conviction, bottom-up stock-picking approach across Asian equities will be rewarded over the coming period and the RG8 portfolio remains well positioned to capture this growing opportunity set.

A heightened focus on corporate reforms, particularly across Japanese corporates, is one area of current focus and is creating a large number of opportunities driven for value to be unlocked for shareholders from higher dividends, buy-backs and unwinding of cross shareholdings (alongside other positive changes such as measures to encourage more retail participation in the market). In addition, there has also been a dramatic increase in focus from Japanese management teams on generating higher profit margins and earnings for shareholders, with the Tokyo Stock Exchange naming and shaming those that do not outline plans for achieving a higher return on capital. Increasing shareholder activism adds further impetus for Japanese management to continue to improve shareholder returns. We believe we are still at the early stages of the Japanese corporate reform process and remain constructive on the long-term opportunities in Japan.

South Korea's stock market is also benefiting from the country's increased focus on corporate reform through the "Value Up" program. While the initial newsflow surrounding these efforts has waned since the National Assembly election in April 2024, the Value Up program has the potential to be significant, particularly within the backdrop of a Korean market that we believe screens as cheap, both from a relative and absolute sense. That said, our focus in Korea is on leading companies with decent management and strong competitive advantages and is not specifically reliant on the Value Up program.

While Japan and Korean markets have proved favourable, both the Chinese stock market and broader economic outlook for the Chinese economy continues to be challenging. In our view, the key issues for the region have yet to be meaningfully resolved, including:

- a weaker domestic Chinese economy, with insufficient stimulus measures in place;
- continued major issues in the property market - while recent initiatives to help clear excess property inventories are positive, the current plan is not large enough and only addresses some of the problems the property market is facing;
- high leverage, particularly at local governments and property developers;
- weak consumption, driven by various factors which are not easy to fix in the short term; and
- ongoing geopolitical issues.

While a lot of the key issues in China appear to have stabilised, or improved slightly, we are not yet seeing a strong recovery in China and uncertainty across the region remains.

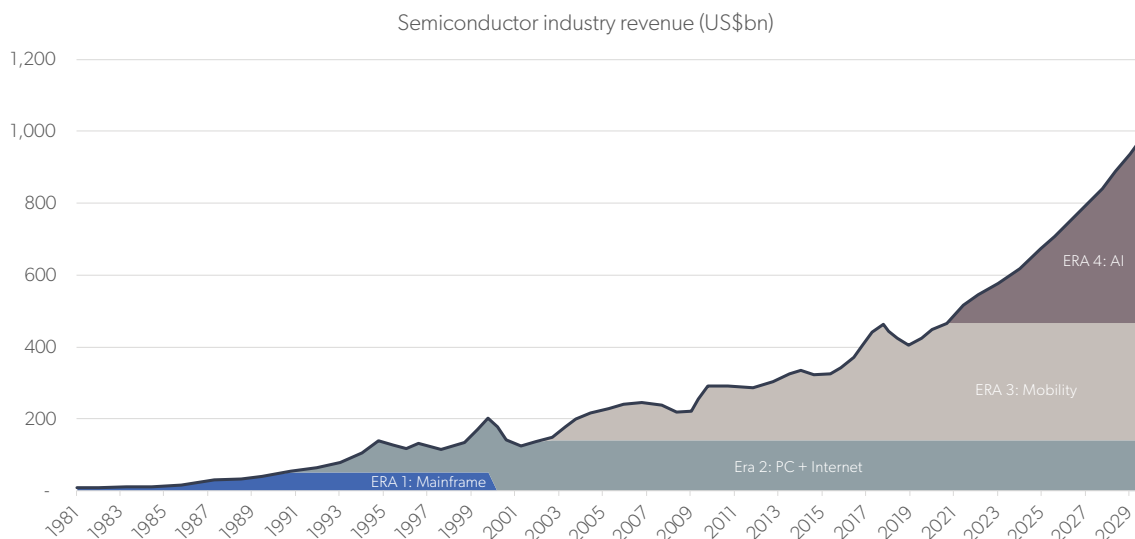
The RG8 portfolio retains some incremental exposure to China, primarily given the market and leading stocks are cheap, sentiment is poor, and many investors have moved away from investing in China. Our focus is on larger, higher quality companies which we consider to offer attractive valuations, competitive advantages and ideally a reasonable dividend yield.

Below we highlight a selection of our highest conviction Asian investments.

ASIAN SEMICONDUCTORS – AI GROWTH EXPOSURE AT HIGHLY APPEALING VALUATIONS

Artificial Intelligence (AI) has become a significant new growth driver for the most advanced or leading-edge semiconductor chips used to train and inference large language models.

AI-related demand is the next major growth driver for the semiconductor industry



Source: SEMI, Applied Materials.

Asia plays an important role in supplying AI chips with world leaders in semiconductor manufacturing as well as precision machinery and materials used in the production processes. Within Taiwan, South Korea and Japan there are a number of companies with the technological strengths to truly benefit from strong AI chip investment and this is where we focus our long semiconductor positions.

After a strong period of returns, semiconductor stocks have seen a retracement in recent months. We believe the fundamental earnings outlook remains strong for the leading-edge stocks in which we are invested. Key customers for AI chips, including global tech leaders Microsoft, Google, Amazon and Meta, have reiterated their commitment to further growing their AI investments at recent results announcements. It will take time for these tech giants to generate the desired returns on their investments, but these well capitalised and highly profitable incumbents are likely to continue to invest in building out AI capabilities for fear of being replaced by competitors offering superior AI-enhanced solutions. The suppliers of leading-edge chips in Asia, or the pick and shovel makers, should continue to benefit from that investment.

In our view, it is important to distinguish between leading-edge chips, where demand is extremely strong in AI servers, and demand for more traditional applications, where demand is seeing a moderate recovery, such as semiconductors for smartphones, PCs, general servers and autos. Furthermore, while China's semiconductor industry is receiving substantial government support, it is still at a substantial technological lag and faces restrictions in accessing leading-edge chip production equipment. We therefore believe Chinese companies should have less competitive impact on our long positions (that are focused on more advanced chips) and we hold short positions in several semiconductor companies that focus on older chip technologies (which face more muted demand and rising supply competition from the Chinese players).

Of course, the semiconductor sector will continue to move in cycles, even if the AI-driven leading-edge demand impulse is longer than others, and we will adjust positioning in the sector based on changing dynamics. We continue to channel check, assess the supply/demand balance in each area and closely watch for phases in the cycle. All investing must also be considered within the context of valuations; it is here where we feel Asia shines as a way to access AI-driven growth.

Examples of companies that we feel are undervalued versus their fundamental outlook for AI-driven growth include:

- SK Hynix: a leader in semiconductor memory used in advanced AI processes, which is on 5x price-to-earnings (using consensus FY25E forecasts);
- SK Square: on a 66% discount to its NAV, with its largest asset being a stake in semiconductor maker SK Hynix (referred to above); and
- Softbank Group: at a 57% discount to its NAV, with its largest asset being ARM Holdings, a world leader in semiconductor chip design.

The examples of Softbank Group and SK Square above are also particularly interesting in the context of rising pressure on holding companies in both Japan and Korea to unlock value.

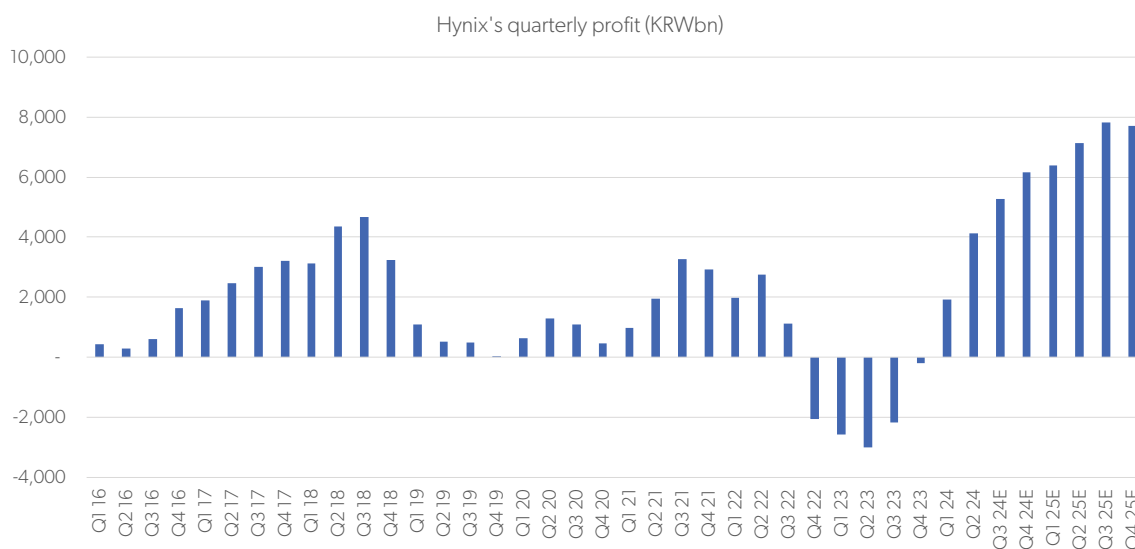
We provide further background on SK Hynix, SK Square and Softbank Group below.

SK HYNIX (000660 KS) – the leader in AI-related memory

South Korea's Hynix is the second largest memory maker globally and currently the clear leader in the most advanced AI-related High Bandwidth Memory (HBM). Hynix has a dominant market share in supplying HBM used by Nvidia in its AI accelerators.

Following an unusually large memory inventory correction in 2022 in the wake of COVID-19, Hynix has also recently benefited significantly from price increases in non-HBM memory. Rising demand has been met with tight supply due to strong capacity discipline from leading players. In addition, there is minimal new capacity being added for non-HBM memory, given key companies are prioritising supplying HBM to meet the booming AI-related demand and even converting non-HBM memory to HBM.

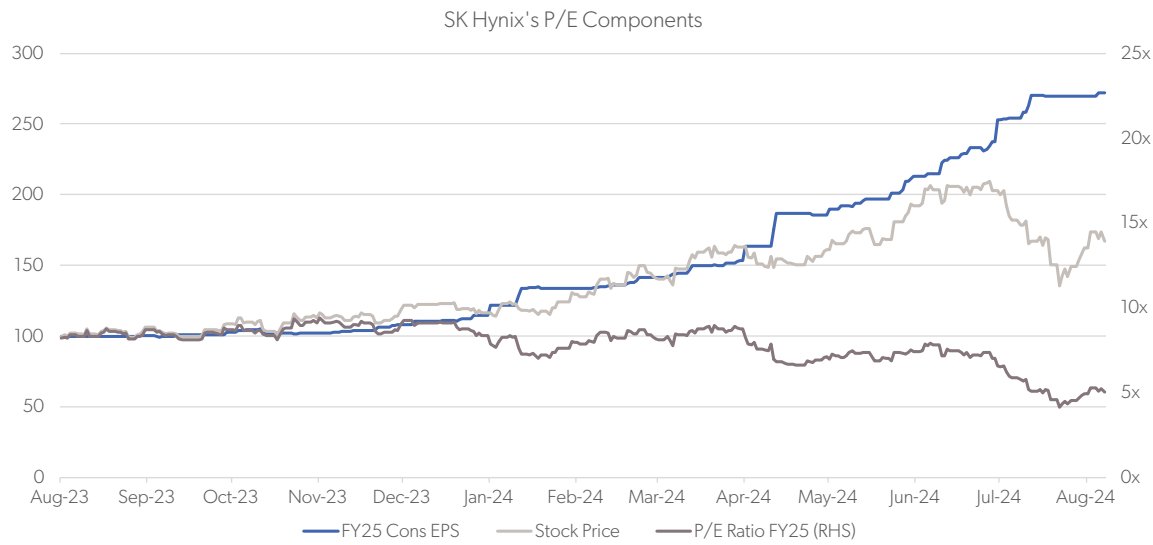
Hynix's profit has only just started recovering after a large downcycle, with AI-related demand a key driver



Source: Bloomberg.

Over the last year Hynix has seen its earnings per share forecasts increase by far more than its share price, which has resulted in its price-to-earnings ratio falling to 5x.

SK Hynix valuation has fallen as stock price risen less than earnings forecasts

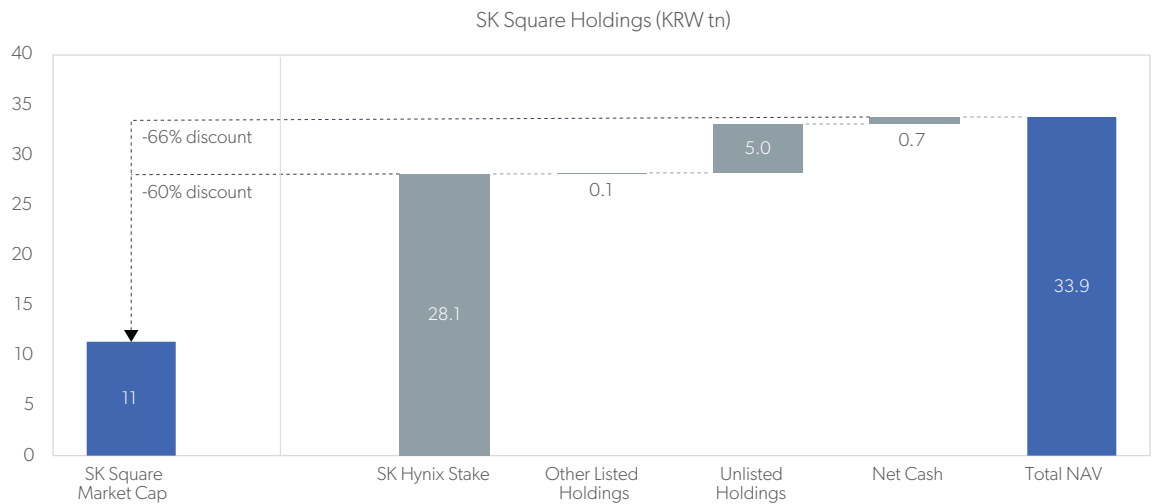


Source: Bloomberg. Values are shown for a one year period and have been rebased to 100 as at August 2023.

While increased competition in the AI-related HBM market from the other two major memory makers (Samsung and Micron) is highly likely, we think Hynix has further upside to its earnings expectations and valuation multiple.

SK SQUARE (402340 KS) – SK Hynix at a significant further discount

SK Square is an investment company that holds 20% of the outstanding shares of SK Hynix. This stake is worth ₩28.1tn, or 2.5x its own market capitalisation of ₩11.4tn. After considering additional listed and unlisted investments, SK Square trades at a 66% discount to its net asset value, thereby offering an additional attractive vehicle for investing in SK Hynix which is particularly leveraged to the rising pressure in Korea for companies to unlock value for investors.



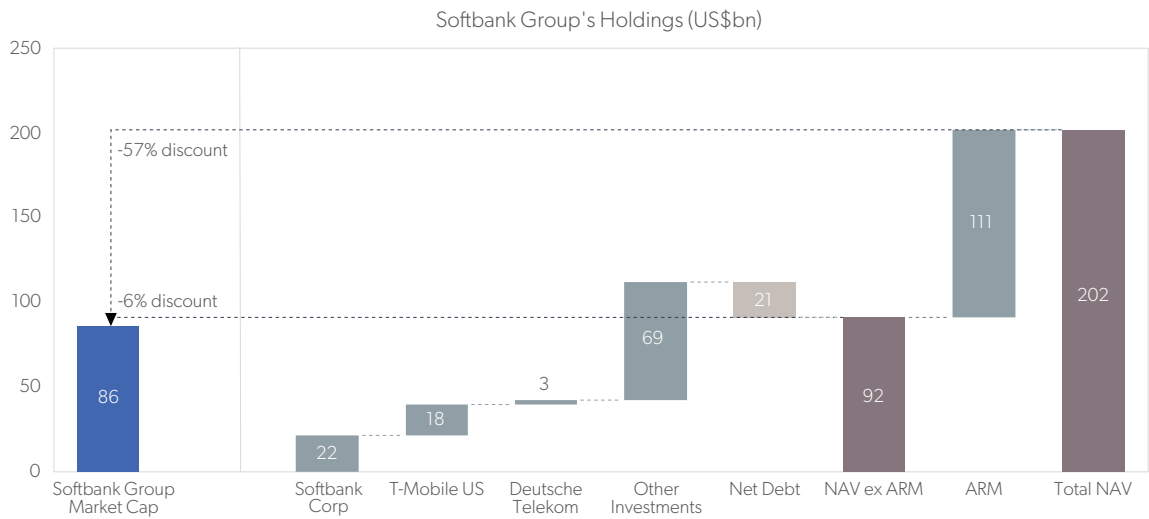
Source: Bloomberg, CLSA.



SOFTBANK GROUP (9984 JP) – investing in a global semiconductor leader for free

Softbank Group (Softbank) is a Japanese holding company with a market capitalisation of US\$86bn and trading at a 57% discount to its US\$202bn Total Net Asset Value (NAV). Another way to think about Softbank’s valuation is that it trades at a 6% discount to its NAV excluding the majority stake in semiconductor design leader ARM US. This means that Softbank investors receive a stake in ARM for free which is currently valued at US\$111bn and more than Softbank’s own US\$86bn market cap.

Softbank is trading at a significant discount to NAV

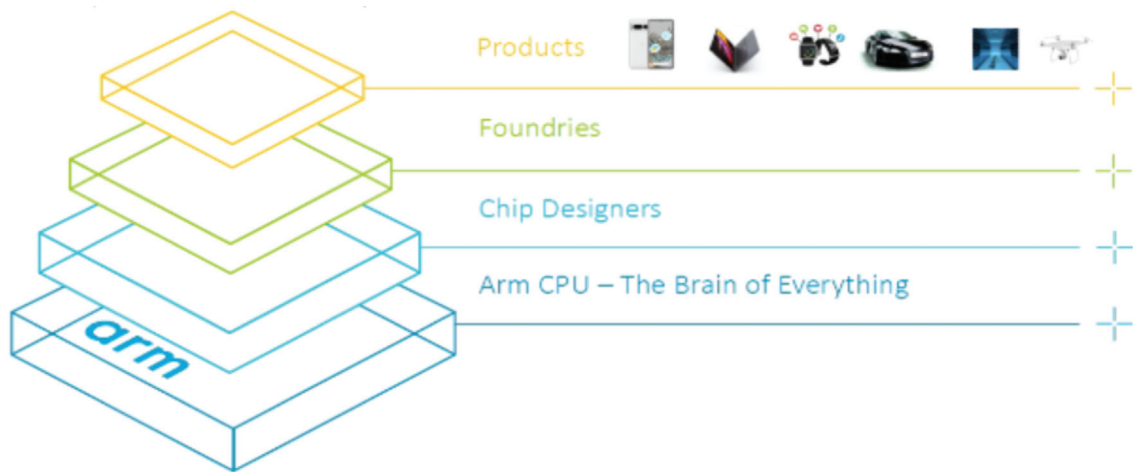


Source: Bloomberg, company data, shareholding valued adjusted for relevant asset backed finance.

ARM is the global leader in providing the foundation design for semiconductor chips, particularly Central Processing Units (CPUs), in exchange for licensing and royalty fees. ARM-based designs are used in 99% of all smartphones globally, along with uses in PCs, automobiles and the Internet of Things (IoT). They also have increasing importance in the server and AI markets.

ARM is renowned for designing the most energy efficient CPUs for customers such as Microsoft, Apple, Qualcomm, Samsung and Nvidia. ARM is particularly benefiting from a rise in AI-enabled smartphones, PCs and other devices with AI functionality, with increasing demand for more efficient computing power. For example, the initial batch of Microsoft “Copilot Plus AI enabled” laptops released in June this year all ran on ARM-based CPUs.

ARM’s designs and IP form the foundation of CPUs designs which chip designers then customise for use in their end products



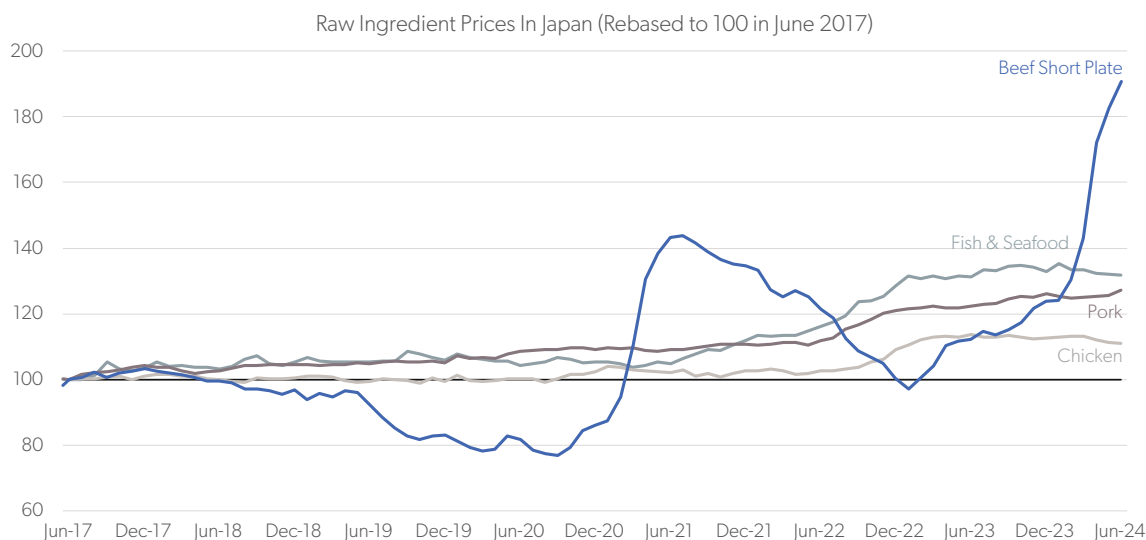
Source: ARM.

The transparency in Softbank Group's investment portfolio has increased dramatically over the past few years, with around 70% of its overall NAV now in listed assets. Over coming years, we expect this transparency to increase further, with around half of its remaining private assets in the later stages of preparing to IPO. We believe that Softbank Group may use some of the proceeds from these IPOs for shareholder returns, particularly given its history of aggressive share buy-backs in which it has returned more capital via this method than any other company in Japan. The likelihood of shareholder-friendly policies like this has also increased given one of the world's largest activist funds is now a shareholder of Softbank.

YOSHINOYA HOLDINGS (9861 JP) – a short facing rising input costs, wage pressure and demographic headwinds

While we believe there are many attractive long investments in Asia, we also continue to seek opportunities for shorting. One of these shorts is Yoshinoya Holdings, which operates a chain of Gyūdon beef-bowl restaurants in Japan. The company is facing significant margin headwinds given the cost of its largest ingredient, beef short plate, has nearly doubled over the past year. In our view, it will be difficult to pass this on given competing restaurant formats such as sushi (fish and seafood), yakitori (chicken) and tonkatsu (pork) are facing more muted input cost pressures.

All input costs have risen, however beef prices have risen significantly more than other major meat groups

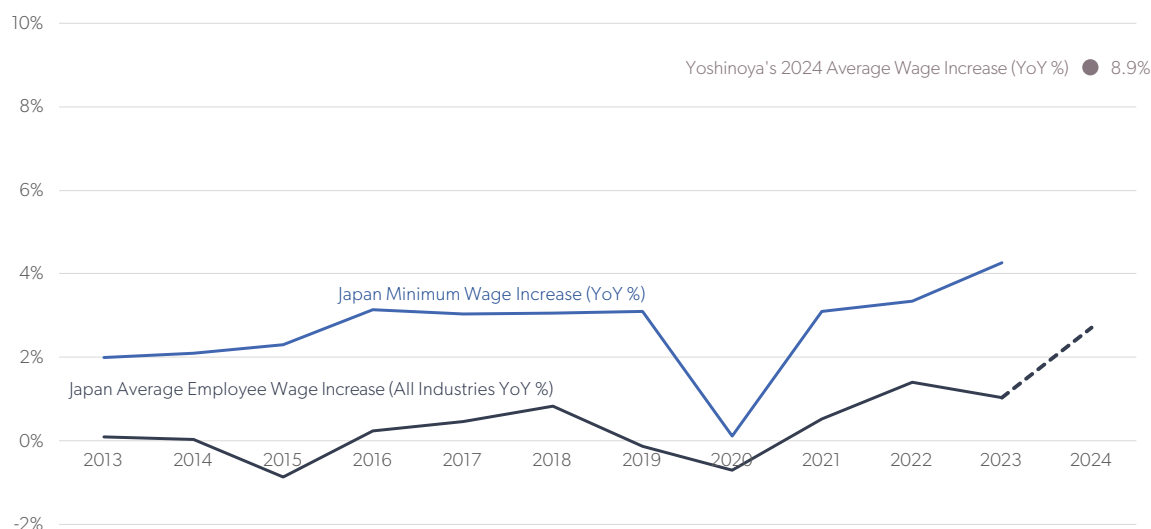


Source: Bloomberg.

We also think beef prices are likely to increase further and remain higher for years. A key reason is that Yoshinoya imports its beef from the US where industry studies forecast the supply shortfall will worsen due to calf numbers being at their lowest levels since 1948.

Additionally, Yoshinoya is facing margin pressure from rising labour costs. This occurred originally because a large portion of its staff were receiving minimum wages, which have been rising faster than the national average wage due to Government policies. However, the headwind has worsened because Japan's aging population is also leading to severe labour shortages and some companies having to offer substantial wages hikes just to secure staff. Earlier this year, Yoshinoya announced a +8.9% wage increase for full-time employees, well above national average, which will add additional earnings pressure.

Minimum wages rising faster than the national wage growth



Source: Company data and Ministry of Health, Labour & Welfare. Japan Average Employee Wage Increase is based on actual scheduled cash earnings increases for 2013-23. 2024 Japan Average Employee Wage Increase is a Regal estimate based on the most recent May 2024 YoY data.

Japan's aging society also means that Yoshinoya is fighting for market share in a shrinking overall market. As people age, their expenditure on eating falls, which is leading to a long-term structural decline in aggregate revenues for the restaurant industry.

Yoshinoya is currently trading on almost 50x PE which, in our view, appears far too high given the long-term growth headwinds, along with substantial margin risk

RECENT ASIAN EQUITY MARKET VOLATILITY AND OUTLOOK

As mentioned earlier, following the 30 June 2024 reporting period for this investor letter, Asian markets have experienced a period of heightened volatility, particularly within Japan.

A key driver of the recent volatility has been the Bank of Japan (BOJ) raising the cash rate on 31 July 2024, in notable contrast to the US Federal Reserve signaling rate cuts ahead. This change in relative interest rate trends caused the Japanese Yen to rally sharply versus the US Dollar and other key global currencies. "Carry traders", who could access borrowed money at attractive lending rates in Japan to invest overseas, saw the effective cost of that "cheap money" increase, not only due to the increase in interest rates but also the appreciation of the yen, and started to unwind positions by selling risk assets from US equities to crypto currencies.

Over the following few sessions, markets experienced the Yen rallying further, carry trades unwinding further, risk assets falling further, and volatility rising sharply. The inevitable second wave of selling from margin calls, systematic and trend-following funds ultimately culminated in the Nikkei Index falling by 12% on one day, its largest single day loss since the 1987 stock market crash. South Korea's KOSPI Index fell 8% in sympathy.

While a stronger Japanese Yen is a headwind for the earnings of export-orientated Japanese companies, we still see very appealing earnings growth, particularly relative to valuations, for the companies in which we are invested. Regal is of the opinion this correction was more of a liquidity event than a fundamental event and, while unpleasant in the short term, these periods of heightened short-term volatility often provide highly attractive opportunities for bottom-up stock picking investment approaches, particularly those with slightly longer investment horizons.

In aggregate we believe the outlook for Asian equities is positive, starting from a position of highly attractive valuations, heavy underperformance versus global equities and broad under-ownership. As we have outlined in this letter, we anticipate a variety of catalysts for value to be released and have invested in a number of stocks where we see a highly appealing return outlook.

Some of these catalysts may include shareholder-friendly initiatives, resilient earnings growth, policies to increase domestic equities investments and international fund flows towards a region that stands out for valuation appeal.

We also can identify a range of more esoteric short opportunities where we will seek to add further returns.

We believe our high conviction stock-picking in Asian equities will continue to be rewarded and the RG8 portfolio is well positioned to capture the opportunity set.

Furthermore, RG8 currently has an on-market share buy-back program for up to 25% of the shares on issue for the 12 months from 30 November 2023, while the dividend policy is to target a dividend of at least 5 cents per share on a six-monthly basis. Both initiatives are important mechanisms intended to address the current RG8 discount to NTA.

Once again, we thank you for your continued support and investment.

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