

OVERVIEW: ONWARD WITH H.E.R.O.

“*This is precisely the time when artists [our insertion: value investors and structural growth winners] go to work. There is no time for despair, no place for self-pity, no need for silence, no room for fear. We listen, we write, we do language [our insertion: value investing]. That is how civilizations [our insertion: markets] heal. I know the world is bruised and bleeding, and though it is important not to ignore its pain, it is also critical to refuse to succumb to its malevolence. Like failure, chaos contains information that can lead to knowledge — even wisdom.*”

We paraphrased the above opening quote from Toni Morrison, recipient of the 1993 Nobel Prize and Professor Emeritus at Princeton University, who made a poignant commentary about why the task of the “artist” is a grounding and elevating force in turbulent times from her stunning essay in the 150th Anniversary Special Issue of The Nation. When “artist” is replaced by “value investors and structural growth winners”, we believe her inspiring words would be applicable for value investors seeking to navigate the turbulent and uncertain markets ravaged by COVID-19.

The pandemic coronavirus has resulted in negative demand shocks and supply chain disruptions in the economy, a situation that is likely to persist in the months ahead till year end or longer. The road ahead will be bumpy and punctuated by episodes of bankruptcies, defaults, bailouts, and credit & solvency events.

Year-to-Date 2020, the MSCI All World Index and S&P 500 had plunged 30.2% and 28.7% respectively. The Median US Stock Index is down over 50% from its highs. The market correction has opened up investment opportunities for us, which we are well positioned to capitalize upon, due to the purposeful prudent capital preservation strategy that we have taken, which has enabled us to outperform and be more resilient relative to the market and, more importantly, to currently have substantial firepower in cash to allocate in stages to invest in great world-class companies at far less than their intrinsic value and future compounding potential.

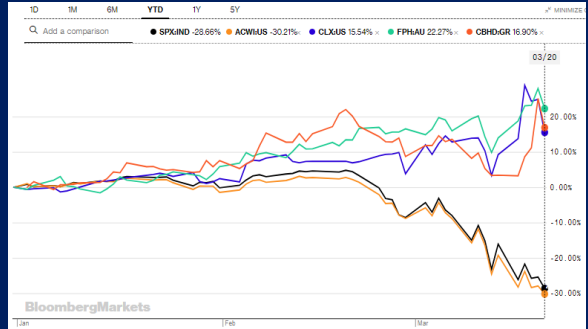
Our investment plan and action in continuing to protect and to grow your wealth in your financial planning journey will be pursued with our enhanced investment strategy to focus on investing in “structural growth winners”. These are exceptional innovators and market leaders in their respective fields with unique, scalable, recurring-revenue and high-profitability business models run by high-integrity, honorable and far-sighted entrepreneurs with a higher purpose in solving high-value problems for their customers and society whom we call H.E.R.O. - Honorable. Exponential. Resilient. Organization.

A number of these H.E.R.O Innovators have generated actual positive absolute returns in the current portfolio of selected UDMS (Unicorn Discretionary Management Services) clients during this COVID period (see side bar column to the right) – and we believe the upward trajectory of the returns is very likely to be sustainable.

The overarching reason is because these innovators are amongst an exclusive group of resilient companies who continue to deliver healthy quality earnings growth, and they have either upgraded or maintained their earnings guidance in their corporate announcement updates on the COVID impact to their business.

This is especially important as it takes away the critical uncertainty factor hampering a proper price discovery mechanism (PDM) which is observed in orderly bid-ask spread and impacts stock liquidity and valuation in volatile market conditions.

Structural Growth Innovators Have Upgraded or Maintained Their Earnings Guidance – And Generated Positive Absolute Returns in 2020



YTD 2020: S&P 500 -28.7%, MSCI All World Index -30.2%
 Clorox (CLX:US) +15.5%
 Fisher & Paykel Healthcare (FPH:AU) +22.3%
 Coloplast (CBHD:GR) +16.9%

Fisher & Paykel Healthcare (FPH) is the global leader in respiratory humidification medical devices used in respiratory care, acute care, surgery, in neonatal units and operating rooms, and in the treatment of obstructive sleep apnoea (OSA). Whether it's the delicate lungs of a premature newborn baby or the tender lungs of an ageing grandparent, the company has crafted humidification technologies to support their specific respiratory needs. A large proportion (86%) of revenue are generated from recurring items, consumables and accessories.

Prior to the COVID outbreak, the highly profitable FPH (operating profit margin 33%, ROE 42.8%, ROA 31.3%) had posted strong earnings growth and even upgraded its revenue and earnings guidance as announced on 14 Oct 2019. FPH had reported twice on 21 Feb 2020 and 17 Mar 2020 an upgrade to its revenue and earnings guidance, due to strong demand for its respiratory humidifiers and consumables which are directly involved in treating patients with COVID.

Fisher & Paykel HEALTHCARE
IMPROVING PATIENT CARE AND OUTCOME

1.3%
Dividend Yield

202%
Capital Growth
Since Jan 2018 Vs S&P

-\$US\$10+ billion and growing market opportunity
 New applications consumables now make up 50% of its Hospital consumables revenue, up from 50% in FY201 and 54% in FY2017.

HOSPITAL

- Intensive Care
- Neonatal Intensive Care
- Neurological Intensive Care
- Large Intensive Care
- Operating Rooms
- ICU

HOMECARE

- Obstructive Sleep Apnoea

86%
Revenue from recurring consumables

NEW APPLICATIONS
In neonatal units and operating rooms, and in the treatment of obstructive sleep apnoea (OSA)

Global leader in respiratory humidification medical devices used in respiratory care, acute care, surgery, in neonatal units and operating rooms, and in the treatment of obstructive sleep apnoea (OSA).

This Sword of Damocles in uncertainty that hangs over the stock price can easily whipsaw opportunistic traders, resulting in the “bargain hunter’s folly” from being caught bleeding in “catching a falling knife” as the eyes are blinded by the untethered view that the “stock has fallen so much and hence is cheap in valuation and should bounce back in price”. What we will NOT do is to try to predict, to time or to chase after some relief bounce in the market that is most likely not sustainable. The surest way is to ascertain there is an orderly PDM in the selected individual stocks as a result of the core earnings still intact or growing.

Furthermore, while most of everyone else cough out profit warnings, pull sales & earnings guidance, or suspend/ cancel dividends & share buybacks amidst COVID uncertainty, as these innovators continue to report quality growth, their healthy status will shine even more, thereby enabling them to command resiliency and a scarcity premium in valuation re-rating.

Looking back to SARS and saying it was fine after three months is really the wrong lens to look at COVID. Notwithstanding the known arguments that China has gone from 4% of global GDP in 2003 to over 17% today and is more integrated with global supply chain, and that China’s COVID situation is supposedly more stable now with declining new cases, the unknown risks remain that the COVID is far more stealthier in escaping detection with no displayed symptoms and that “recovered” patients can re-infect others. It also appears that COVID can withstand hotter weather conditions that withered SARS and hence last beyond the summer.

Unlike SARS, the March 2010 Iceland’s volcano eruption, Japan’s earthquake and tsunami in March 2011, and the flood in Thailand in August 2011 etc, the supply chain disruption is mitigated by companies carrying 15 to 30 days’ worth of inventory; COVID is different and by mid-to end March, a major tsunami-like supply chain disruption news across many companies in a broad swath of industries could hit the markets, resulting in another leg down in market correction.

The obvious risks: (1) COVID cases have yet to peak in US, Europe and worldwide, (2) Healthcare systems are straining, (3) The real economic fallouts from lockdowns, travel restrictions, shut-down of non-essential businesses, disruptions to daily life, and supply chain disruptions rippling across over 80% of industries have yet to be felt the most and reflected in lagging numbers, (4) Corporate earnings are yet to be downgraded and slashed, (5) the Sword of Damocles in the above knock-on effects to banks, markets and deleveraging of trades and corporates have yet to fall.

The not-obvious risks: The possibility that the COVID strain in Europe and US may have mutated precisely due to containment measures and have thus become more virulent, deadlier and more persistent than the virus that originated from Wuhan, China. This has yet to be impounded into expectations and asset prices. This is possibly the main reason why COVID’s infection and death rates are worst in Europe (and likely US) than in China. This HIV-like COVID, which is 1,000 times stronger than SARS in binding to the human cells, can stay on in the cell after a “cured” patient recovers, meaning that it could evolve and mutate further. Just as the superficial flippant market experts who kept dismissing the COVID as “nothing more than a bad flu” and declaring that there is “certainly no recession risks”, so too are those who say, hey, look at how China has recovered, and extrapolate to the current outbreak situation outside of China. There could be a second wave of infection in Hong Kong and China from imported as well as community-spread infections, based on patterns seen in other pandemics in history.

This time round, applying the historical lens of the 2007/09 GFC (Global Financial Crisis) to determine the trajectory of bottoming and recovery may not be as relevant, as the market’s “Patient Zero” is a global health emergency crisis and not credit or financial-induced with bad pathological agents like Lehman Brothers. Hence, the typical western-style strong steroidal medication in the form of QE (Quantitative Easing) and TARP (Troubled Asset Relief Program) to

suppress and treat market inflammations may not work effectively this time round. Central banks increasingly appear limited and tired in their “do whatever it takes” firepower and markets are less exuberant on steep rate cuts to zero and the massive trillions of QE and fiscal stimulus news to soften the blow from COVID.

And a vaccine prevention and treatment cure looks to be quite some time away despite a whole gamut of drug and biotech firms rushing clinical trials and claiming they are close to success. Early coronavirus drug trials yield mixed results, with the current treatment using HIV antiretroviral drug combination not improving the condition of severe COVID patients. The history of previous viral outbreaks like Ebola and Zika show little success in producing viable treatments. Some potential drugs were developed only after the epidemics already waned through containment measures. The anti-malaria chloroquine drug, which is inexpensive and already widely used in the world, could be the possible wild positive card, but the side-effects have been so severe that the Chinese health authorities have cautioned its use after some initial encouraging results. No one knows whether the coronavirus will disappear ultimately, or will it persist like flu and become prevalent intermittently, or will it be like hepatitis B that resides in people without sufficient immunity and spreads to others in that way.

USD + Yield Spikes Vs Safe Havens Gold, Bonds, REITs

The concurrent roaming of the twin Godzilla monsters in the strong USD and the upward spike in Treasuries yield (despite Fed emergency rate cut to near zero) and the FRA/OIS spread (a closely followed indicator of interbank U.S. Dollar funding availability) has resulted in devastating deleveraging and sell-down across the traditional safe havens in gold, bonds and REITs.

Until these twin Godzilla monsters are “defeated”, the safe havens in bonds and REITs are less likely to experience stability and recover, though gold may still be a relatively outperforming asset class.

Recent U.S. Dollar gains reflect the greenback's role and status as an international currency as demand for the world's reserve currency jumped in anticipation of a prolonged coronavirus pandemic, and institutions and companies around the world rush to draw down credit lines and seek U.S. dollars for funding and liquidity needs, creating an intense U.S. Dollar shortage. The majority (over 60%) of forex reserves are still held in U.S. denominated assets and U.S. Dollar denominates most global commodity trade, most cross-border lending to emerging markets, and an outsized share of global trade volumes. We are in an unprecedented perverse situation where the more central banks ease, the more U.S. Dollars are being stacked. In essence, U.S. Dollar appreciation reflects the unique role the currency plays in the global economy and financial system, rather than a view among investors that the U.S. economy is better placed to weather the coronavirus shock.

The U.S. Dollar is a global funding currency for US\$12 trillion in USD-denominated global debt and its margin call has come in, posing intense downward pressure especially on emerging market currencies and markets that include Southeast Asian nations (Indonesia, Philippines, Thailand, Malaysia), as well as corporates with USD loans. It's a potential replay of the 1997/98 Asian Financial Crisis. King Dollar is unlikely to weaken substantially against almost any cross (perhaps Swiss franc CHF excepted) until global markets stabilize.

The U.S. national debt is likely to grow to US\$30 trillion in two or three years as spending explodes in response to the COVID crisis, which means about US\$3-4 trillion in net issuance per year, and that upcoming supply tsunami is likely sending bond prices lower, potentially dealing a deathly blow to the popular risk-parity/balanced "60/40" portfolio model. PBOC (People's Bank of China) is the only major central bank in the world without a U.S. Dollar swap line with U.S. and the world runs the risk of China tapping its Treasury portfolio to sell them, and yields would spike up further.

Amid the market turmoil, a reminder to investors: Buying the correction doesn't mean timing the bottom. The story of October 16, 2008, Warren Buffett op-ed in the New York Times titled "Buy American. I am" - and stocks proceeded to drop another 30% after that date. Yet, Buffett wasn't wrong. The people who managed to miss out on all the gains were the ones who sold when headlines made them queasy. The importance of playing the long game is an apt reminder to investors.

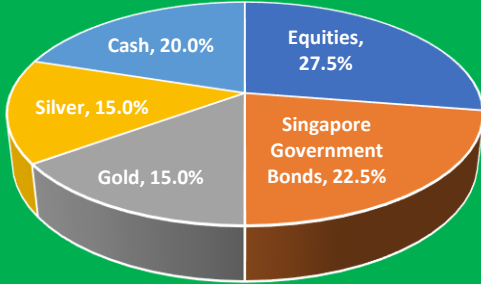
ASSET ALLOCATION

We will be making four main changes to the overall asset allocation in this investment call (see side bar column to the right):

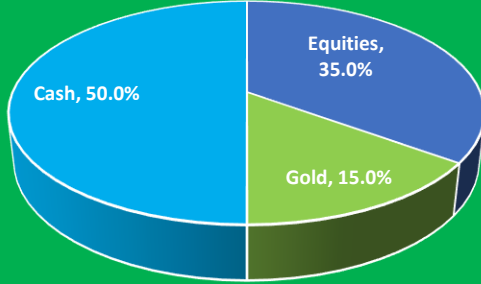
- (1) Increasing significantly our cash allocation from 20% to 50%.
- (2) Increasing slightly our equities allocation from 27.5% to 35%, and to progressively increase our allocation over time as market throws up investment opportunities for us to purchase great companies at far less than their intrinsic value. We will elaborate our plan in allocating the cash in stages if the market were to continue to fall as the COVID crisis deepens and prolongs.
- (3) Selling out Silver and Singapore Government Bond.
- (4) Switching existing equities in Rolls Royce, Beijing Airport, Tencent, and Hang Seng H-Shares ETF into a more diversified portfolio of 14 stocks.

For the capital preservation assets in Gold, Silver and Singapore Government Bonds, we would maintain our position in Gold, and sell out Silver and Bond. The COVID crisis has impacted the industrial demand (over 60% of its consumption) and outlook for silver, for instance, in electrical & electronics and in the production of solar cells that produce electricity. China has taken the axe to alternative energy funding, slashing subsidies for solar and wind. Budget for new solar power plants will be cut in half this year and China plans on completely ending handouts for offshore wind farms. EVs (electric vehicles) could be next on the chopping board.

CURRENT ASSET ALLOCATION

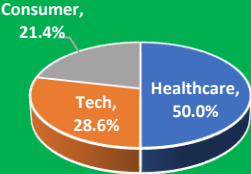


NEW ASSET ALLOCATION

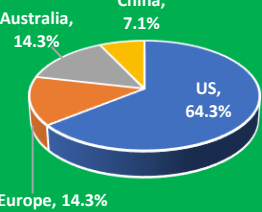


EQUITIES ALLOCATION

BY SECTOR



BY GEOGRAPHY



Note: The equities allocation by geography is based upon the country of listing or domicile, which is not fully reflective of the global nature in revenue generation of these businesses.

EQUITIES SELECTION

The equities portfolio’s long-term investment objective seeks to capture long-term investment returns created by disruptive forces and innovation by focusing on high-quality, liquid, large-cap listed global equities.

The portfolio companies are exceptional innovators and market leaders in their respective fields with unique, scalable, recurring-revenue and high-profitability business models run by high-integrity, honorable and far-sighted entrepreneurs with a higher purpose in solving high-value problems for their customers and society whom we call H.E.R.O. - Honorable. Exponential. Resilient. Organization. Not only do the H.E.R.O. innovators generate high profitability at the inflection point of their exponential growth trajectory, more importantly, they are governed by a greater purpose in their pursuit to contribute to the welfare of people and guided by an inner compass in choosing and focusing on what they are willing to struggle for and what pains they are willing to endure, in continuing to do their quiet inner innovation work, persevering day in and day out.

These H.E.R.O. are making our world

- (1) Healthier & Stronger: Fisher & Paykel Healthcare (FPH:AU), CSL (CSL:AU), Coloplast (COLOB:DC), Novo Nordisk (NVO:US), Zoetis (ZTS:US), Masimo (MASI:US), West Pharmaceutical Services (WST:US), Sartorius Stedim (DIM:FP)
- (2) Cleaner & Safer: Clorox (CLX:US), Qualys (QLYS:US)
- (3) More Intelligent Community: Microsoft (MSFT:US), Adobe (ADBE:US), TSMC (TSM:US), Wolters Kluwer (WKL:NA)
- (4) More Delightful: Hershey (HSY:US), Costco (COST:US)

Prior to the COVID outbreak, these structural growth H.E.R.O. innovators have generated healthy growth and continue to maintain or even increase their quality earnings growth guidance. A number of them are experiencing strong COVID-related demand for their innovative products, services and solutions. These innovators include Fisher & Paykel Healthcare with its respiratory humidifiers and consumables which are directly involved in treating patients with COVID; Clorox, the U.S. #1 leader in cleaning agent and home care products, with nearly 80% of its global portfolio from #1 and #2 share brands and its products are in 9 out of 10 U.S. homes, is experiencing an uplift in demand for its portfolio of household products (e.g. Disinfecting Wipes,

Multi-Surface Cleaner + Bleach) which are in the US EPA (Environmental Protection Agency) list to protect against the spread of COVID.

What we will NOT invest in are companies who appear statistically “cheap” (cheap-gets-cheaper value traps) but are fundamentally wounded by the twin shocks in demand and supply from COVID, as well as opportunistic companies whose demand for their products have increased due to COVID, but whose demand would decline after COVID has passed, resulting in unsustainable earnings and an inventory oversupply problem. These include the toilet paper manufacturers; masks & rubber glove makers; infrared thermometer, thermal scanners and related companies; e-gaming companies, etc.

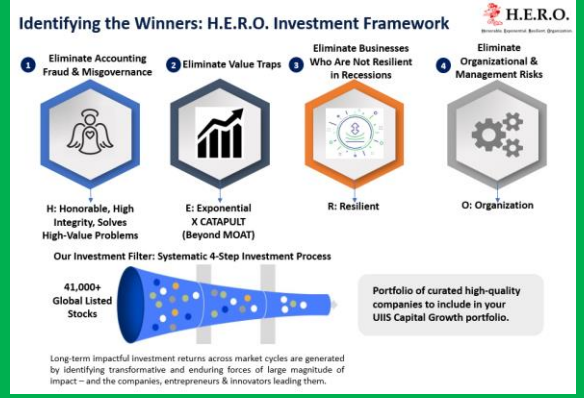
Another group of H.E.R.O. Innovators are those who are maintaining their revenue and earnings guidance with healthy growth or are slightly impacted temporarily by COVID for a small part of their business due to supply chain disruptions, but the majority of their core business remains intact in their growth trajectory.

For instance, Microsoft reported in Feb 2020 that its personal-computing division (contributing 38% of revenue and 30% of operating profit) would not meet its recent guidance because the supply chain in China “is returning to normal operations at a slower pace than anticipated.” At the same time, its Azure cloud platform business continues to grow strongly and its enterprise messaging platform, Teams, passed Slack as the No. 1 workplace messaging app. It had 13 million daily users halfway through 2019. Six months later, that number grew to over 20 million, thanks to buy-in from many of America’s largest companies. Microsoft is a recurring revenue machine for enterprise and consumers with its productivity suite of services. It is also at the heart of the Big Data and Artificial intelligence evolution, with Azure and Power Platform, as well as a growing Dynamics 365 business in enterprise CRM. These businesses will power the future of AI and automation and has a certain amount of recession resilience. Over 70% of Microsoft’s revenue and profitability are recurring and sticky.

The details of the companies in the portfolio are in the last segment of this report.

Identifying the Winners: H.E.R.O. Investment Framework

The investment philosophy and framework H.E.R.O., which stands for “Honorable. Exponential. Resilient. Organization.”, is operationalized into a unique, systematic 4-step investment process to identify the winners, to distinguish between the true innovators and the swarming imitators, between the devoted missionaries forging a greater purpose and the mercenaries.



INVESTMENT OBJECTIVE & FOCUS

To achieve long-term capital growth in stocks of stable, simple-to-understand, non-cyclical quality businesses who are resilient in economic downturns.



Avoid Cyclical: Zero exposure to cyclical (concentrated in economically-sensitive and rate-sensitive sectors such as financials, property & construction, energy & materials, industrials & capital equipment) that may not be resilient in economic downturns or to increases in interest rates.



Avoid Disrupted Cheap-Gets-Cheaper Yield- and Value Traps: Avoid legacy old profitable businesses and once-stable industries that are being increasingly disrupted (e.g. Kraft, Tesco).



Avoid Accounting Fraud: Application of proprietary forward-looking fact-based accounting fraud detection system that was pioneered and taught at the Singapore Management University, ranked top five in the world accounting rankings, and presented to the top management team of Singapore’s top financial regulator to mitigate downside risks.



Invest in Structural Growth Winners & Innovators: Long-term impactful investment returns across market cycles are generated by identifying transformative and enduring forces of large magnitude of impact – and the companies, entrepreneurs & innovators leading them. Guided by the H.E.R.O. investment framework; H.E.R.O., which stands for “Honorable. Exponential. Resilient. Organization.”, is operationalized into a systematic 4-step investment process to identify & invest in structural growth winners.

CASH ALLOCATION

Our plan is to allocate the cash, which is increased from 20% to 50% of the portfolio after this investment call, in stages into equities if the market were to continue to fall as the COVID crisis deepens and prolongs. As markets and investors panic upon headline-grabbing news events and overreact, we will increase the equities allocation in thoughtful, measured notches, and not in a rushed, ad-hoc reactive manner. We are expecting these potential frightful events in the near horizon which could present and trigger potential buying opportunities:

- Boeing’s bankruptcy and its US\$60-billion bailout, a negative shock event which would reverberate throughout the value chain in the aviation, aerospace and travel industry.
- Massive wave of bankruptcy and default in the industries most hit by COVID, including tourism & travel (US\$1 trillion), hospitality/ hotels, entertainment, retail, restaurant, services sector, energy companies and property developers.
- Extreme stress and funding crisis in the various credit and debt markets from Treasuries to Money Market Funds, Commercial Paper, Municipal Debts, Leveraged Loans, High-Yield Debt, Mortgage Bond, Structured Products (e.g. Korea’s autocallables), etc. REITs are unable to meet their dividend distribution and there are significant cuts.
- Regional US bank(s) or/and big European bank(s) or financial institution drowns under an ocean of large-scale loan defaults and goes bankrupt or is bailed out, triggering a loss in confidence and bank run.
- A LTCM or multiple LTCMs (big leveraged hedge funds) with “low-volatility” strategies blowing up, resulting in deleveraging and fire sale liquidation of its portfolio which would create tremendous downward pressure on share prices. According to Bloomberg, those strategies accounted for roughly US\$1.5 trillion in assets under management (AUM) before leverage, US\$500 billion of which were in risk parity funds and US\$350 billion in vol-targeting funds.
- Replay of the 1997/98 Asian Financial Crisis in the emerging market currencies and markets, triggered by the continued strength of the USD and the dollar shortage.
- Cancellation of the Tokyo Olympics 2020 and the resulting unpredictable big movement in yen that would impact the global FX market

The events described above is a taste of how things can worsen from current level whereby shocks can get amplified to a full-blown financial crisis when funding liquidity and market liquidity evaporate.

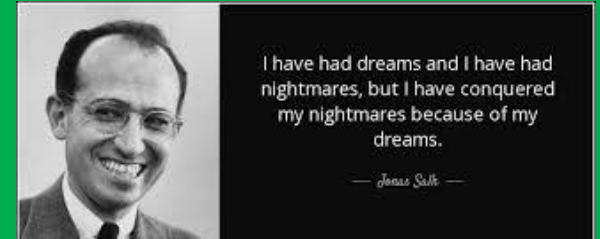
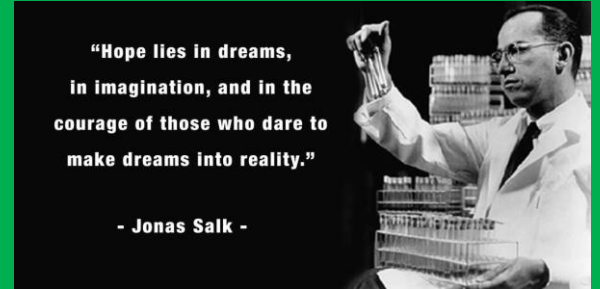
We wish to encourage our Unicorn clients and friends, who may have your own DIY investment portfolios in stocks, ETFs, and unit trusts, to consider consolidating the various investments under the care and vigilance of the Unicorn family where we have the resilience to thrive together in an ever-changing world and to participate in the H.E.R.O.’s Journey, in the long-term growth of exceptional innovators and entrepreneurs solving real-world problems, creating value for the underserved, and becoming part of the lives and improving the well-being of other people.

Growth isn’t always linear: COVID may have set the world one step back; take two steps forward with Unicorn. Move forward as we move the world onward. Reach out to your loved ones, your support systems, and your exceptionally dedicated, competent and caring Unicorn Consultants and Unicorn Investment Committee. Know that we’re here for you.

Yours,
Unicorn InvesCo
23 March 2020

MESSAGE OF HOPE FROM JONAS SALK, THE HERO WHO DISCOVERED & DEVELOPED THE FIRST SUCCESSFUL POLIO VACCINE

SALK POLIO VACCINE PROVES SUCCESS; MILLIONS WILL BE IMMUNIZED SOON; CITY SCHOOLS BEGIN SHOTS APRIL 25



Polio is a highly infectious disease caused by the poliovirus which is usually spread from person to person through infected faecal matter entering the mouth, or by food or water containing human faeces and less commonly from infected saliva. Those who are infected may spread the disease for up to six weeks even if no symptoms are present. Until 1955, when the Salk vaccine was introduced, polio was considered one of the most frightening public health problems in the world. According to a 2009 PBS documentary, “Apart from the atomic bomb, America’s greatest fear was polio.” As a result, scientists were in a frantic race to find a way to prevent or cure the disease. Salk devoted himself to this work for the next seven years from 1948. When news of the vaccine’s success was made public on April 12, 1955, Salk was hailed as a “miracle worker” and the day almost became a national holiday. The Americas were declared polio-free in 1994.

Identifying the Winners: H.E.R.O. Investment Framework

1 Eliminate Accounting Fraud & Misgovernance



H: Honorable, High Integrity, Solves High-Value Problems

2 Eliminate Value Traps



E: Exponential X CATAPULT (Beyond MOAT)

3 Eliminate Businesses Who Are Not Resilient in Recessions



R: Resilient

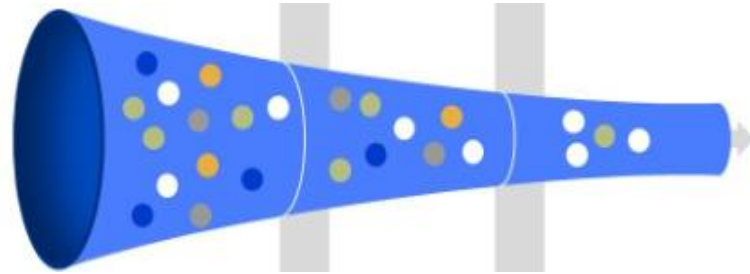
4 Eliminate Organizational & Management Risks



O: Organization

Our Investment Filter: Systematic 4-Step Investment Process

41,000+ Global Listed Stocks



Portfolio of curated high-quality companies to include in your UIIS Capital Growth portfolio.

Long-term impactful investment returns across market cycles are generated by identifying transformative and enduring forces of large magnitude of impact – and the companies, entrepreneurs & innovators leading them.

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R: Resilient

4 Eliminate Organizational & Management Risks



O: Organization

H.E.R.O. Innovators have **High-integrity** and are **Honorable** in the way they conduct both their business and life. We conduct due diligence research on the management's:

- Treatment of minority shareholders in corporate governance matters, shareholder structure, business group structure
- Purpose Quotient (PQ), focus and sense of urgency to build something with a Purpose and commit to an idea larger than themselves to serve others
- Discipline and prudent stewardship in handling growth, capital allocation, power and wealth
- Hunger level, whether they are hungry with a sense of purpose to innovate and create new categories of growth, or have become contented, conservative or complacent

H.E.R.O Innovators are companies focused on and expected to benefit from **Exponential** non-linear structural growth in disruptive forces and innovation with large total addressable market.

- (1) Identify & eliminate cheapgets-cheaper value traps & companies vulnerable to disruption, failing to adapt and are likely to underperform
- (2) Distinguish between true innovators & imitators, identify the structural winners

H.E.R.O Innovators have financial and business model **Resiliency** in solving High Value Problems for their target customers and society:

- Financial resiliency:
 - (1) Healthy ROE, ROA & operating cashflow
 - (2) Strong balance sheet with low gearing or net-cash
 - (3) Pricing power with healthy working capital dynamics
- Business model resiliency:
 - (1) Resilient recurring revenue streams
 - (2) Proprietary or unique offerings or solutions
 - (3) Capabilities in design knowhow and manufacture of mission-critical and innovative products in multiple applications
 - (4) Attractive position in the value chain/ecosystem without being dependent on a few specific suppliers or customers
 - (5) Not constrained by sticky super-variable cost overheads in scaling up e.g. "SG&A as % Sales" declining even as sales increase?

Many Asian businesses fail the acid test: Remove the founder and the business is not worth much. H.E.R.O. Innovators understand deeply that the **Organization** needs to be larger than any single leader in order for the firm to last the distance and find enduring and perennial success that grow stronger with each passing day. Patient sacrifice and stable capital for longer-term profound investments in business and people are made, with relentless pursuit of excellence in perfecting its offering, institutionalizing its craftsmanship and codifying the knowledge to pass from one generation to another:

- Corporate culture of decentralization, trust and cooperation to foster innovative experimentations, including investing in a system to cascade decision rights and disseminate relevant and timely knowledge throughout the organization
- Treatment of human capital in the organization e.g. Growth in salary/employee vs Growth in EBIT/employee

SUSTAINABILITY & ESG (Environment, Social, Governance) PRINCIPLES POWERING OUR INVESTMENT FRAMEWORK

We place special emphasis on the positive criteria of sustainability and ESG (Environment, Social, Governance) principles, selecting companies that generate sales in products and services that contribute to the achievement of the UN Sustainable Development Goals (SDGs), especially ferreting out innovators and market leaders who are solving high-value problems for their target customers and society.

1 Eliminate Accounting Fraud & Misgovernance



H: Honorable, High Integrity, Solves High-Value Problems



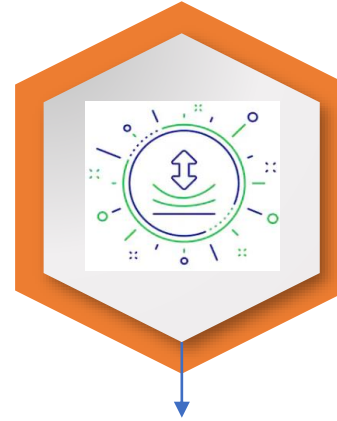
2 Eliminate Value Traps



E: Exponential X CATAPULT (Beyond MOAT)



3 Eliminate Businesses Who Are Not Resilient in Recessions



R: Resilient



4 Eliminate Organizational & Management Risks



O: Organization



The United Nation Sustainable Development Goals (SDGs) are a collection of 17 global goals designed to be a "blueprint to achieve a better and more sustainable future for all".

Goal 9: Industry, Innovation, and Infrastructure - "Build resilient infrastructure, promote inclusive and sustainable industrialization, and foster innovation."

Goal 16: Peace, justice and strong institutions - "Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels."

Goal 3: Good health and well-being for people - "Ensure healthy lives and promote well-being for all at all ages."

Goal 9: Industry, Innovation, and Infrastructure - "Build resilient infrastructure, promote inclusive and sustainable industrialization, and foster innovation."

Goal 11: Sustainable cities and communities - "Make cities and human settlements inclusive, safe, resilient, and sustainable."

Goal 12: Responsible consumption and production - "Ensure sustainable consumption and production patterns."

Goal 5: Gender equality - "Achieve gender equality and empower all women and girls."

Goal 8: Decent work and economic growth - "Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all."

Goal 10: Reducing inequalities - "Reduce income inequality within and among countries."

Goal 17: Partnerships for the goals - "Strengthen the means of implementation and revitalize the global partnership for sustainable development."

Step 1 of H.E.R.O.: Honorable & High-Integrity Owner Operators

Value Investing Needs to be Adapted to Mitigate the Risks of Accounting Irregularities and Misgovernance

Publication: The Business Times, p27
Date: 18 August 2015
Headline: Scouring Accounting Footnotes to Prevent Tunnelling



Companies that are red-flagged can be grouped in a separate category of the Singapore Exchange website to inform and educate the public about the potential risks. PHOTO: REUTERS

Scouring accounting footnotes to prevent tunnelling

Framework needed to tackle insiders' stealing of corporate wealth. BY KEE KOON BOON

IMAGINE that the S-clip Singapore-listed China stock fraud with its "locking cash phenomenon" and its primary stock scandal never happened - because there was no way to prevent them.

While accounting information and disclosures may be abused to deceive, instead of being used to inform, there is a countermeasure if one only looks for it. For fraud perpetrators actually, if, inadvertently, leave behind a trace of their accounting irregularities in the footnotes of annual reports.

In their paper "Tunnelling Through Intercorporate Loans, The China Expert" published in the *Journal of Financial Economics*, professors Charles Lee, Jiang Guohua and Yee Hong said that concerning shareholders use intercorporate loans for related party loans, typically reported as Other Receivables (ORs), to siphon billions from listed companies.

"This 'forane' form of corporate abuse is still tunnelling, or insider stealing of corporate wealth.

While financial reporting standards require that such related party transactions (RPTs) are a normal feature of business, cases of their abuse in equities abound.

In the United States, a landmark case involved undisclosed related party loans from Adelphia Communications to members of the controlling Siga family.

In Australia, related party loans helped the Bulletin building and subprime bank of the Asia Bond empire. During the 1997/98 Asian financial crisis, many firms that experienced the worst price declines had made inter-

related party loans.

Specifically, firms with unusually high related party loans - measured by Other receivables to total assets - or Other receivables to total equity - are more likely to experience worse future operating performance, quoted asset acquisition, asset suspension, and regulatory investigations.

The average daily Other receivables increased a per cent (median a per cent).

Thus, if a company's Other receivables jump abruptly from, say an average of 1.5 per cent in a year, it would be a red flag. An Other receivables 30 per cent would put the company in the high-risk red group of insider stealing of corporate wealth.

FORMER DARLING

Consider one such S-clip example. Sports shoe maker China Hongkong Sports (CHS) is a former stock market darling with a track record of high net cash in the balance sheet, high profit margins (15 per cent), and high return on equity (over 13 per cent).

Market value at its peak in October 2007 crossed S\$1 billion. On Feb 25 2011, CHS shares were suspended with the shocking announcement that auditor Ernst & Young had uncovered irregularities in the cash and bank balances, accounts receivable, accounts payable and other receivables during the course of its audit of the China incorporated subsidiary 2010 accounts.

Could this accounting fraud have been detected?

In one of the footnote disclosures of CHS in 2008, there was a sharp increase in "Prepayments, Deposits and Other Receivables" of 87 million yuan (S\$192 million) over the year.

The Other receivables jumped to 26.3 per cent in 2008 from 7 per cent in 2007.

Most of the increase in Other receivables related party loans was controlled by associated firms in the "business" or "distribution".

In other words, there was no indication of any potential impairment or cash payment risks imposed on these newly identified companies.

Importantly, the increase in Other receivables in 2008 corresponds roughly to the rise in revenue of 84.3 million yuan in 2008. Other players in the industry were also performing well - worse off, markedly so, 2010 with a plunge in cash and cash equivalents of 2.8 billion yuan until the start of 2011. In other words, the accounting irregularities left behind roughly matched the changes in related party loans and such related party loans - disguised also as "business", "prepayments", "deposits", "receivables", "inventory", "subsidies", "dividends", etc. - can be changed to "cash equivalents", which then form part of the consolidated balance sheet with the listed company, thus ensuring the net funds back to the listed company. "Cash equivalents" together with the fact that the balance sheet is healthy.

In essence, we need a forward-looking system sensitive enough to detect accounting fraud before it happens and causes harm.

RED FLAG

Companies that are thus red-flagged can be grouped in a separate category on the Singapore Exchange website to inform and educate the public about the potential risks.

This will help the investing public make better informed decisions, as well as spur these companies to curb or amend the fraudulent transactions.

An excellent fact-based fraud detection system as proposed here would be a welcome addition to the Singapore Exchange website to enhance the status of the Singapore capital markets, thus attracting and retaining foreign investors and sustainable wealth for shareholders.

The writer is an accounting professor at the Singapore Management University and a former director of the Singapore Institute of Management. He is also an officer at A&P (Asia) Holdings Ltd.

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https://www.smu.edu.sg/sites/default/files/smu/news_room/smu_in_the_news/2015/august/aug19/BT_20150819_1.pdf

A World's First Fact-Based Forward-Looking Fraud Detection System for Singapore



Presentation for:

23 September 2015

Presentation by: KEE KOON BOON

Chief Investment Officer

H.E.R.O. is unique in eliminating the downside risks from accounting tunneling fraud and misgovernance through unusual related-party transactions, consolidation accounting craftiness (opportunistic shifting of expenses and debt into unconsolidated entities), and hidden balance sheet liabilities at the wider pyramidal business group level etc., which escape detection by western-based forensic tools through a proprietary forward-looking fact-based accounting fraud detection system developed by KB.

For instance, prevalent across Asian companies, previously Big-4 audited "cash" in the balance sheet are often misclassified "cash equivalents" disguised from improper short-term related party loans employed by the insiders to expropriate or tunnel out cash from the company after initially propping up financial numbers artificially to create false positive signals to lure in funds.

KB had taught accounting at the Singapore Management University (SMU) as a faculty member and also pioneered the 15-week course on Detecting Accounting Fraud in Asia as an official module at the SMU. KB remains grateful to be invited by Singapore's top financial regulator to present to their top management team about implementing a world's first fact-based forward-looking fraud detection framework to bring about benefits for the capital markets in Singapore and for the public and investment community.



ELIMINATE FEAR FACTOR OF PREVALENT ASIAN-STYLE ACCOUNTING FRAUD & MISGOVERNANCE RISKS

KB Kee has developed a proprietary forward-looking fact-based accounting fraud detection system and was invited to present to Singapore's top financial regulator.



Beyond Economic Moat: Catapult Analysis of Business Model Quality

The Exponential Edge of 4Cs

CATAPULT Systematic Observations & Leading-Indicator Questions to Ask in Portfolio Companies



Curiosity Edge

- User-centric customized recommendations, engagement depth in time invested, etc
- Examples: Amazon Prime, Netflix, Spotify, Hershey, Costco, Clorox

Does the company create or generate curiosity and discovery amongst the users and customers for its products and services? Is there a riveting effect that leads to engagement?



Compellingness-Craftsmanship Edge

Does the company create and deliver products, services or solutions with compellingness and craftsmanship?

- Process IP, intangible know-how/system and mastery to bring about comfort, convenience, "customized" pain-killing mission-critical solutions to customers
- Compellingness (external) combined with Craftsmanship (internal)
 - ✓ Craftsmanship: Think Steve Jobs shared the story of how he was inspired by his dad who taught the young Jobs that it was important to craft the back of cabinets and fences properly, even though they were hidden. "He loved doing things right. He even cared about the look of the parts you couldn't see."
- Examples: Fisher & Paykel Healthcare, Novo Nordisk, Coloplast, CSL, Zoetis, Sartorius Stedim



Catapult to Exponential Value Creation!

CATAPULT



Community Edge

Does the company build a community/platform where customers/users/members can connect and interact repeatedly with one another to forge longer-term relationship and emotional connections Vs mere transactions-based exchange?

- User-generated content (UGC) in reviews; ratings to foster trust, credibility, collaboration and celebration in the many-to-many interaction; feedback loop to improve; brand advocates/ raving fans/ whale curve; is there social capital capacity to expand into complementary products and services to serve the community
- Watch out for unusual capitalization of customer acquisition costs, goodwill
- Examples: Apple iOS, Costco, Microsoft, Adobe, TSMC, Zoetis



Circumspection Edge

Does the company deliver/ enable circumspection and acumen/ insights/ Intelligence for the customers with usable framework of knowledge, tools and analytics to bring useful insights to help them think better, make better decisions?

- Examples: Microsoft, Adobe, Coloplast, TSMC, Wolters Kluwer, Masimo, Qualys

Note and Source, Disclaimer and Important Notice

Note and Source

- the gain/loss on your portfolio may be different due to the timing of purchase of this security

¹ – Bloomberg, XE.com

² – Client FAME account

All figures and numbers cited in the report on the markets and companies are from regulated public sources that include Bloomberg, Reuters, SCMP, Wall Street Journal, Financial Times, New York Times, Nikkei, the Australian, Australia Financial Review, Barron's, Exchange Announcements, and Annual Reports & Financial Statements.

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