FSSA Investment Managers



Fund Manager Q&A

Meeting companies amid China's post-Covid rebound

April 2023



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Martin joined the team in 2002 and he is the portfolio manager of a number of strategies, including the FSSA Greater China Growth and Asian Equity Plus strategies.



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Winston joined the team in 2015 and he is the portfolio manager of the FSSA All China and China A-share strategies.



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Helen joined the team in 2012 and she is the portfolio manager of the FSSA China All Cap strategy.

Following on the FSSA China Growth strategy's 30th anniversary, we sat down with our China portfolio managers Martin Lau, Winston Ke and Helen Chen to respond to recent questions from investors. In this Q&A, they discuss market valuations, inflation, geopolitics and recent company visits.

After the sharp rebound in China equities following the lifting of Covid Zero restrictions, do you think the market still looks attractive?

Many of our clients think the China market rebounded too quickly, but we think equity valuations are still reasonable. The

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rebound has only been a few months, and we don't invest for such short time horizons. We are still positive about China over the long term, which for us means three to five years and beyond. With company earnings likely to recover, we think the market's confidence will continue to improve.

China equity valuations still look reasonable following the recent rebound



Source: Factset, FSSA Investment Managers, as of 27 March 2023.

To put things in context, last year investor sentiment was extremely low — there was a feeling that China was not investable, and valuations were near historical troughs with the Hang Seng index falling to 1997 levels. The market's main concerns were the Covid Zero policy, the weakness in the property market and new regulations hurting the prospects for certain sectors.

Most of these headwinds have cleared up. Covid Zero is unlikely to return, after most of the population has been infected or vaccinated. The pessimism around the property market has also improved. And in general, regulations have turned more pro-growth, if you look at areas like property, internet and education.

We had been adding to our high-conviction holdings throughout the tough times. After the Covid Zero policy ended suddenly, the fast recovery in economic activity made us more positive than before. We saw a lot of pent-up demand being released, for example in travel and consumption during the Chinese New Year holiday.

The team recently took some trips into mainland China to visit companies. Can you share some key impressions and takeaways?

We are bottom-up investors and focus on understanding the companies we invest in, especially the people who run those companies and the culture they have built. Although we continued to meet companies virtually during the pandemic, face-to-face meetings can allow us to better assess quality and spot the subtleties. This is important in markets like China where information flow is often restricted, and transparency is one of the key traits we look for in companies.

Since travel restrictions were lifted in the mainland, we have taken multiple trips there. For example, in February we visited a few cities in Guangdong Province, and they were bustling with activity. Restaurants were packed, hotel occupancy was high, and we experienced multiple traffic jams. In contrast to our recent trips to the UK, we rarely heard about anyone working from home. The high-speed train back to Hong Kong was almost full. The recent data confirms this — activity in restaurants, hotel revenues and domestic air travel have all recovered to above 80% of pre-Covid levels by March.

On the other hand, the companies we met sounded conservative or cautious about the outlook for their businesses — the management believe that things have troughed but it will take time for any meaningful recovery to materialise, as income growth has been affected by the pandemic restrictions in recent years. This view was common in consumer companies across electronics, property-related products, specialty lighting and bedding products.

We also met a few healthcare companies during the trip, which sounded optimistic about demand after Covid. These included portfolio holdings such as DaShenLin, a leading regional pharmacy operator, and Guangzhou Kingmed, a leading provider of independent clinical lab (ICL) services. DaShenLin is accelerating its store expansion, and the company expects margins to increase this year thanks to demand rebounding for high-value products. Kingmed has strengthened the non-Covid areas of its business, with increased market share and revenue contribution from top-tier hospitals.

Did you find any compelling investment opportunities during your recent China trips?

To give an example of what we look for in the companies we invest in, we added Centre Testing following our recent visit to Shenzhen. It is the biggest private testing, inspection and certification (TIC) company in China, and we have followed it for nearly a decade. Globally, in our view this is an attractive industry with decent returns and steady mid-teens growth through economic cycles.

In the two decades since it was founded, the company has successfully diversified into different segments and now covers environment, food & agriculture, oil & gas, marine, consumer goods and pharmaceuticals customers. It now has more than 30 business lines, 150 labs and 260 service points in over 70 cities. Meanwhile its revenue and profit grew by 60x and 40x respectively over the last 15 years.

The founder's family is well aligned with around 18% ownership, while the management team has been professionalised. The CEO Shentu Xianzhong joined from global industry leader SGS in 2018. Since then, Centre Testing reined in its headcount expansion and capital expenditures while increasing utilisation at existing facilities. This caused operating leverage to kick in as sales continued to grow. As a result, the company began to show positive (and growing) free cash flow in 2018 after it was negative during 2014-17.



Photo from the FSSA team's visit to Shenzhen in February, at Mindray's office.

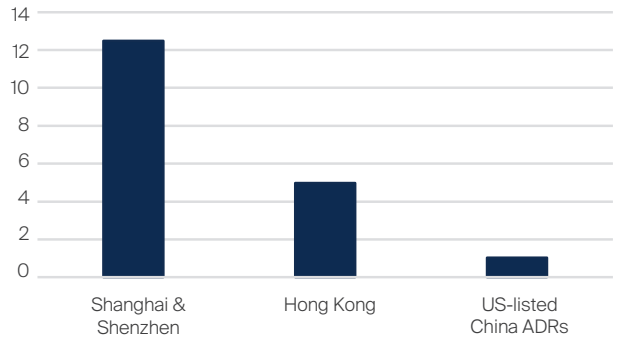
We think future growth will remain attractive given the potential for industry consolidation, gaining market share from inefficient state-owned enterprises (SOEs) and deepening business with key accounts such as Wal-Mart. There is also further scope to increase utilisation of existing facilities, after it has gone up from 25% to 35%. With China's increasingly stringent regulations around quality standards and protecting the environment, we expect the TIC industry to achieve above-GDP growth.

Another company we have been adding to is Shenzhen Mindray, the leading medical device manufacturer in China. The investment case for this company is described in detail in our latest Global Emerging Market client letter. An additional point worth mentioning is that we have been engaging with the company on increasing its board diversity and disclosing more details about its carbon emissions. The company responded positively to our suggestions, and will share more in its upcoming ESG report, scheduled for late April. We believe its efforts in improving sustainability will help it to become a world-class company with attractive long-term growth.

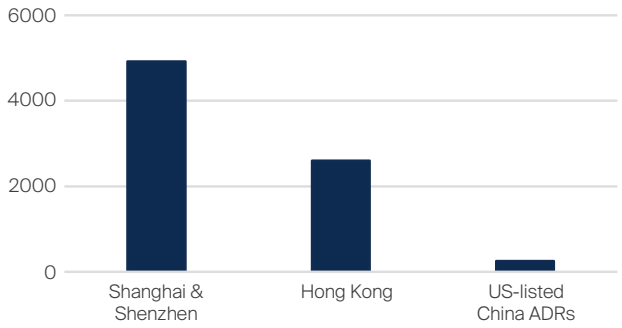
What is the team's outlook on the A-share market?

The A-share market continues to trade at a valuation premium to H-shares and ADRs, perhaps due to lower sentiment among foreign investors. However, we think the appeal of the A-share market is not on valuations, but the market depth and range of choices.

Total market capitalisation (USD trn)



Number of stocks



Source: World Federation of Exchanges, US-China Economic and Security Review Commission, data as of January 2023.

In certain industries, such as industrials, home appliances, medical equipment and drug companies, investors can only access the best Chinese companies via A shares. For example, in our portfolios we own home appliance companies like Midea, medical device makers like Mindray, and pharmacies like Yifeng, Dashenlin and Laobaixing. Our China portfolios are mainly driven by domestic demand opportunities, as we invest heavily in areas like pharmacies, home appliances, home decoration, express delivery, and hotels. The key is that we want to benefit from the recovery taking place this year.

China's economy experienced a difficult two years, but the leading companies improved their competitive positions over that time — similar to what we saw with restaurants in Hong Kong, the survivors became stronger after some market consolidation. For example, Mindray increased its penetration among hospitals due to a shortage of medical equipment and supply chain issues for their foreign competitors. Shenzhen Inovance also gained market share during the early stages of Covid as foreign competitors were unable to come to China. Other companies including Impro Precision and Haitian International have also gained share from foreign competitors. We think much of these market share gains could be sustained.

We do need to be careful about valuations, as the A-share market is largely driven by short-term traders and momentum. While this is good for small companies looking to raise funding, as seen in the high number of initial public offerings (IPOs), in certain areas we think valuations are still too high, like electric vehicles for example.

Another positive is that the China A-share market is still in the process of being included into global indexes like MSCI. Meanwhile the Chinese government is still keen to attract global investors. As the market becomes more developed and well-researched, we believe our active management approach, 30-year history in China and company relationships built up over this time will allow us to uncover more hidden gems.

Are you concerned about inflation heating up in China after the reopening?

First of all, we need to differentiate between good inflation and bad inflation. When the economy is stagnant and there is no inflation, like Japan over the past few decades, that's a negative for investors. Another bad scenario is if there is inflation without corresponding economic growth — in other words, stagflation. But if China sees more inflation due to reopening and a strong recovery, we would argue that it's a good thing.

Some inflation could also be good on the company level. Historically for China, people like to look at the consumer price index (CPI) compared with the producer price index (PPI). In most of the last two years, CPI growth was below PPI, so we saw margin pressure for manufacturers because they were unable to pass on all the rising costs in raw materials to consumers. If CPI increases and PPI falls, which is what has been happening recently, then it's probably better news for company margins.

China's PPI grew faster than CPI for most of the last two years



Source: Bloomberg, FSSA Investment Managers, as of March 2023.

We also do not think inflation will be as severe as what we have seen in the West. Due to the weak economy in recent years, China's unemployment rate was quite high. The feedback on the ground is that it is not difficult to hire workers back, while the turnover of workers is lower than in previous years. As people are glad to be employed, we think the pressure to raise wages won't be as strong as in the West. In addition, it seems the upward pressure on energy prices is easing, so we doubt the economic impact will be as severe as for the West last year. We are more concerned about unemployment and the impact on longer term growth.

How do you think about geopolitical risks when investing in China?

Generally speaking, geopolitics will not go away. It's a structural issue that investors do need to think about. That said, it's also a two-way street, and China is also trying to curb certain products from the US. Import substitution is a major theme for us. We mentioned earlier, companies like Inovance and Mindray are gaining share from foreign players.

We also think about geopolitics from the perspective of entry barriers. Being able to manage a global supply chain is a challenge but also an opportunity. Japan went through a similar process in the 1980s when there were more protectionist policies from the US to counter Japanese exports. This forced Japanese companies to set up production facilities globally, and now we have a few like SMC, Daikin and Toyota who are leaders in global operations.

Chinese companies are not known for being able to expand globally. For instance Minth and Fuyao Glass have tried with mixed results. Recently Contemporary Amperex Technology (CATL) is expanding globally, BYD acquired some factory plants from General Motors, and Shenzhou has been able to scale up its manufacturing in places like Vietnam and Indonesia. For those companies who can succeed at expanding their footprint globally, such as TSMC, we think it's positive — it leads to an economic moat which is hard to replicate.

With recession risk increasing in the US, is the team concerned about export-oriented companies?

If we take a step back, companies which are world class at what they do tend to become exporters. Examples include Huawei, Samsung, TSMC and Toyota. In Asia we have quite a number of globally competitive companies. Mindray earns over 40% of its revenue from exports, and not many Chinese companies with leading technologies can achieve that. There are certainly risks, like geopolitics for Huawei or the US property market for Techtronic. For China we focus on manufacturing upgrades and how it can help certain companies gain business domestically.

Hong Kong may be more exposed to exports given its economy, but there are some Hong Kong-listed companies which became local miracles due to their dominance in global markets, like Techtronic and ASM Pacific. As bottom-up investors, we focus on companies which can gain market share and succeed through business cycles. There are always macro risks but we believe good management teams can overcome those issues.

Source: Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at March 2023 or otherwise noted.

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