

Client Update

FSSA Global Emerging Markets Equities

September 2021

Overview

Since our last update, global markets have not been short of action and the manic behaviour characterising today's markets has taken investors on another rollercoaster ride. While not quite comparable to the market movements seen during the dark days of March 2020, the recent correction – especially in China-related companies – has been notable. Yet, from a market perspective, a sense of normality is finally starting to emerge after the more speculative phases over the past 12-18 months.

Companies related to the Work- or Consumed-From-Home environment are starting to discount a more realistic outlook and, equally, franchises with good long-term prospects that were experiencing temporary uncertainties caused by the pandemic have, for the most part, regained some of the lost ground as their underlying business fundamentals continue to improve.

Despegar in Argentina and Alsea in Mexico – two of the most pandemic-impacted holdings in our portfolio (focused on travel and restaurants respectively), are examples of the latter. We have been in regular touch with both management teams throughout the pandemic and, while demand may not recover to pre-pandemic levels for yet another year, strong operational leverage from cost-cutting efforts has resulted in a margin recovery that far outpaces their topline growth. Both companies expect to see continued margin expansion in the coming years, and we would not be surprised if their profitability levels end up exceeding previous peaks.

In the following note we will discuss the most significant changes to the portfolio during the period in review and some of our broad observations on emerging markets.

New investments

For each of our portfolio investments, we look for distinct competitive advantages, often in the form of price advantages or cost advantages.

While empirical evidence suggests that price advantages are easier to sustain than cost advantages in the long run, the latter can be just as protective for returns, especially if they come in the form of economies of scale or scalable processes.

One such company benefitting from these advantages is Syngene in India, the first of the new additions to the portfolio.

Syngene

Syngene is a leading Indian pharmaceutical company in the attractive global research and development (R&D) outsourcing industry, offering integrated R&D services to global pharma companies. We have known and monitored Syngene for a number of years and have been impressed by the operational capabilities and strategic focus of the senior management team. The company is currently headed by British-born Jonathan Hunt, and sits within the Biocon Group, which owns a 70% controlling stake. Biocon is headed and controlled by the respected and long-term minded Mrs Kiran Mazumdar Shaw, who set up the company in 1994.

R&D budgets at global pharma companies typically expand at an average rate of around 5% annually¹. An increasing proportion of these budgets are accruing to companies such as Syngene, which offer integrated contract R&D services. The benefits for customers are multifold – given that R&D service providers focus on specific parts of the R&D process, they can offer specialised expertise at a lower cost and thus help bring products to market faster. Additionally, the emergence of many new small and mid-sized biotech companies, which tend to be asset-light businesses, has led to a growing market for outsourced R&D services. The biotech companies gain access to expertise and can achieve scale much faster than they would otherwise, while also lowering their operational risks as costs are kept under control.

The R&D outsourcing value chain can be broadly classified under three verticals: discovery, development and manufacturing. Historically, Syngene has focused on discovery and development, and is now the largest Indian player in these segments. However, since 2016 Syngene has started to integrate manufacturing into its service offering to become a complete Contract Development and Manufacturing Organisation (CDMO). We believe this will be important for future growth as CDMOs are increasingly the preferred option from a customer perspective due to fewer handover points as well as greater savings and synergies.

Syngene's client list includes leading multinationals such as Bristol Myers Squibb, GlaxoSmithKline, Sanofi, Johnson & Johnson, Merck and Unilever. In addition, it operates dedicated R&D facilities for Bristol Myers Squibb, Baxter and Amgen, to name a few. Syngene's total client base has expanded by 10% CAGR² over the last five years (from 256 to more than 400), in line with revenue per client which has grown from INR 42m to INR 54m over the same period.

The company has two distinct advantages that has aided its rapid market share gains, the first being its cost structure. Salaries for Indian scientists are on average 40% lower than comparable Chinese scientists with similar qualifications, and up to 70% below their US and European peers. However, low cost is not Syngene's only advantage. Clients also care about the quality and credibility of research, and the productivity of a service provider's scientists. We believe that Syngene is among the leading players in the industry based on these measures – and the growing number of new customers and continued extension of contracts from the likes of Bristol Myers, Merck and Baxter are a testament to Syngene's quality.

Unsurprisingly, these advantages are reflected in its margins and profitability. Syngene commands some of the highest operating margins in the industry at 20%. While the move to a vertically-integrated manufacturing business is more asset intensive than the traditional discovery and development businesses, we believe higher margins

should compensate. Increased sales from customers who prefer the vertically-integrated offering should lead to improved operational leverage and higher profitability levels. The outcome of all these variables is that we expect Syngene's return on invested capital (ROIC) to double over the next five years. As the market is still vastly underpenetrated and growing at an estimated 10% per annum (p.a.), we believe these favourable tailwinds should translate into solid cash flow growth at an even greater rate for Syngene, which we expect to compound at attractive rates for many years to come.

Prosus

The second new addition to the portfolio is Prosus, a spin-off from Naspers, the South African company that famously bought a 32% stake in Tencent 20 years ago. Its USD 32m investment in Tencent is today worth USD 190bn and as such has grown in value at 54% CAGR! Prosus still owns a 29% stake in Tencent, which complements the investment we made in Tencent last year. We will discuss the investment rationale of Prosus in the following paragraphs, but first, we will briefly recap our investment thesis in Tencent as the investment case for Prosus is inevitably tied to it.

We initiated an investment in Tencent during the pandemic sell-off last year, after having stayed on the sidelines for some years.

Arguably we should have invested earlier as its omission has been one of the costlier investment mistakes we have made since the inception of the strategy.

Previously, we held the view that Tencent's value was too big for a gaming company and that the law of large numbers would eventually have an impact on its fundamentals and lead to a painful de-rating. However, while the gaming segment has slowed down, it remains exceptionally profitable. But more so, what we in hindsight were too late to appreciate was that Tencent was becoming more than just a gaming company. It was becoming the infrastructure of the digital economy in China.

Founded in 1998 by Pony Ma, who remains the CEO and a significant shareholder, Tencent's DNA is focused on experimentation and constantly trying out new things. Alongside the gaming business, which took off in the middle of the 2000s, Tencent's original PC-based chat program "QQ" made the transition to smartphones early on and the company used that experience in 2011 to develop Weixin (WeChat in English). Weixin/WeChat is widely considered the world's first "Super App" and is now an integrated part of daily life for more than 1.2bn users.

¹ Source: Evaluate Pharma

² Compound Annual Growth Rate

Compared to WhatsApp, which arguably has one of the world's largest user bases, but, up until now, has failed to materially monetise it, Tencent's master stroke was to take advantage of the tremendous network effects created by its messaging app and to develop other features on top of it for monetisation. Weixin not only facilitates messaging, but has also built a social media app (Moments), a payment app (WeChat Pay) and multiple other services (such as ride hailing, commerce, streaming etc), which, combined, make up an ecosystem with incredibly strong network effects, and thus, high barriers to entry that protect its profit pool.

The other key to Tencent's success is related to capital allocation. With the growing dominance of Weixin and its super app, Tencent also started to gain notable insights into user preferences. Tencent could spot new trends early and leverage this insight to fund the most promising operators. Early and subsequently very profitable investments in the likes of JD.com, Meituan, Pinduoduo and Kuaishou are testament to that. The benefits also worked two ways, as the investment by Tencent would often ensure a preferential position for these companies in its ecosystem, and thus, greatly enhance the chances of success. This frequently made Tencent the preferred investor by many start-ups and greatly contributed to the value accretion over the years.

Like any company that controls the rails, we believe Tencent is an incredibly profitable company. The combined operating margin has been ranging above 24% for the past decade, and we estimate that it has generated free cash flow in excess of USD 100bn during the same period. A substantial portion of this has been used to fund the various investments, which, we estimate have generated equally attractive returns over the same period.

Tencent's three main business units, Gaming, Social Media and Advertising, make up 32%, 22% and 17% of sales respectively and has each grown by 22%, 35% and 36% CAGR respectively for the past five years. We expect future growth to be dominated by the Advertising and Business Services (mini programs) divisions and, given its dominance in what we consider to be underpenetrated markets, we believe Tencent can achieve a sustainable high teens growth rate for the next five years.

It was for all these reasons that we were very excited when Tencent sold off last year during the early stages of the pandemic, and decided to initiate a position. This has subsequently been accompanied by an investment in Prosus earlier this year, which we will now discuss below.

Prosus is a consumer internet group and one of the largest technology investors in the world. While listed in South Africa and Holland, a significant majority of Prosus' assets are focused on emerging markets. In addition to its 29% ownership stake in Tencent (which at current market prices is valued at USD 190bn), Prosus also owns stakes in listed

companies such as the social network Mail.ru in Russia (28%), the multinational food delivery platform Delivery Hero (27%), and the online travel platform Ctrip (6%). The cumulative value of its listed portfolio excluding Tencent is USD 12bn. Furthermore, Prosus has built a range of market-leading businesses across three core segments in emerging markets, Food Delivery, Online Classifieds and Fintech, with its unlisted businesses currently estimated to be worth around USD 45bn.

While the pandemic has significantly boosted demand for its Food Delivery businesses (which includes stakes in Swiggy, the leading food delivery service in India, iFood in Latin America and Delivery Hero, which operates in 40 countries) it is the Online Classifieds and Fintech segments we are particularly excited about. Prosus' portfolio of Online Classifieds businesses is among the largest in the world, and includes OLX Group in Brazil and Avito in Russia. These businesses generate annual sales of USD 1.2bn and have grown at more than 20% CAGR for the past many years. Similar to Online Classifieds peers in developed markets (such as Zillow, REA Group, Seek, Recruit, Autotrader and Auto1 Group), Prosus' businesses enjoy strong durable moats from network effects and, owing to the asset-light nature of the business model, tend to generate significant free cash flow.

Among Prosus' Fintech businesses, PayU (99%-owned) is the prime asset and is heavily exposed to India not least because of its recent acquisition of BillDesk, India's largest Payment Processor. There is an immense opportunity in the unorganised market for fintech businesses that can act as a bridge (between banks and the unorganised market) and help facilitate commerce and credit in reaching a wider part of the population.

While no other investment is likely to be as successful for Prosus as Tencent turned out to be, Prosus has still done a very reasonable job over the years. Between 2008 and 2020, the management team at Prosus have compounded capital at a 20% IRR³ excluding Tencent and was behind several notable exits including FlipKart (India), Allegro (Poland), MakeMyTrip (India) to name a few. While secular tailwinds favouring many of these businesses have clearly been helpful in generating the strong returns, it does not take away the fact that the management team are experienced capital allocators with a track record few have been able to match.

Although there are plenty of reasons to be excited about the continued appreciation of the unlisted businesses, another factor that prompted our interest in Prosus was its significant discount to underlying net asset value (NAV). While the discount has improved marginally since we initiated our position, at the time of writing the market value of Prosus' Tencent stake roughly make up the entire market value of Prosus.

³ Internal rate of return

In other words, by buying Prosus today one really only pays for Tencent and in addition gets some of the best assets in emerging markets we can think of (PayU in India; leading Classifieds franchises in a combined 1bn population market) and a team with a proven ability to spot trends early and build large businesses for free – an offer we increasingly felt was too good not to take advantage of.

On the other hand, some might argue though that once a holding discount has emerged it is usually quite persistent. While we cannot dispute this conventional wisdom, we would argue that the typical reasons for holding discounts (such as suboptimal capital allocation or tax disadvantages) have little merit in Prosus' case. In fact, as we have highlighted above, its capital allocation has been superior over the years; and from a tax perspective, by operating as a holding company its capital gains are exempted from taxes should Prosus decide to divest any holdings.

One key question relates to regulations and the impact it might have on Tencent and indirectly on Prosus. While we cannot claim to have any specific insights on the regulatory direction from here, we note that Tencent has always enjoyed a good relationship with the regulators and has been proactive when it comes to implementation. In 2018 for instance, despite tighter rules to curb gaming addiction among young people, Tencent was relatively unaffected as it had already implemented its Healthy Gameplay system a year before. In addition, founder Pony Ma keeps a low profile, has a humble, down-to-earth reputation and a history of giving back to society. Still, given Tencent's sheer size, there is widespread belief that the government will levy some kind of fine on the company.

Yet in our recent conversations with the management we were left reassured that any regulatory actions should be manageable and that the company's growth and profitability over the longer term would be left unharmed.

Finally, one might debate if there is a need to own both Tencent and Prosus in the long run? At the moment we keep an open mind. Should the discount narrow substantially, or the value of Prosus' unlisted companies be more than adequately reflected in the share price of Prosus, it would be a reason for selling down or to move some of the proceeds into Tencent. But until then, we remain happy shareholders in what we consider to be two of the leading franchises in emerging markets.

Divestments

During the period in review we divested our holdings in Indocement in Indonesia and 51job in China. Indocement is a subsidiary of Heidelberg Cement and the second-largest cement manufacturer in Indonesia with 26% market share, while 51job is the leading job search platform in China.

Indocement

While cement can be an attractive sector, it requires a rational competitive environment with few players and favourable regulation. We were attracted to Indocement because of the oligopolistic industry structure, wherein the leader Semen Indonesia, along with Indocement and Holcim Indonesia, together controls over 80% of the market. This had historically resulted in attractive returns for the industry and Indocement in particular. For example, over the 2010-2015 period, Indocement's average return on capital employed (ROCE) was 43% and arguably among the highest of any cement company that we have come across. Starting in 2015, the industry began to increase capacity as utilisation rates reached 90%. New entrants, such as Anhui Conch from China, also set up new plants. Total industry capacity went from 75 million tons to 120 million tons over the 2015-2020 period and profitability started to drop notably. The regulator then stepped in and prevented the addition of any meaningful new capacity. Our expectation was that this would lead to significant improvements in returns and profitability.

Attracted by this outlook we initiated a position in Indocement, but our thesis did not turn out as we had expected. As the cement sector is capital intensive, has high fixed costs and provides a product that is close to a commodity, operators that struggle to gain scale are incentivised to compete on prices to gain market share as marginal costs tend to be low. Challenged by the slump in demand caused by the pandemic, prices have not been able to rise to the same extent as costs, thus delaying the turnaround in margins. While we are prepared to be patient investors, it is hard to see Indocement making attractive returns even in the medium term, given the new challenges facing the industry structure.

As such we decided to follow Warren Buffett's advice: "Should you find yourself in a chronically leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks."

51job

We believed 51job would remain the dominant job search franchise for many years to come. With the largest database of resumes and job postings in the country, plus the ability to capture half of all new joiners to the

workforce every year (which in turn helps to attract more enterprise customers), we felt that the company's network dominance was sound and would continue. We also had the opportunity to speak with the founder of the business, who remains actively involved as the CEO. We were drawn to his long-term vision to expand the company into Human Resource (HR) services, thus creating a bigger and more resilient business.

However, the situation began to change in 2020. Firstly, their closest competitor Zhaopin – which is controlled by the reputable Australian company Seek – was showing significant growth in user volumes and it seemed a matter of time before they overtook 51job. Secondly, the quality of the company's communication with minority investors began to deteriorate notably – starting with a reduction in disclosure on user metrics, which coincided with a takeover bid from a private equity firm that left 51job reluctant to speak with investors. Thirdly and lastly, we increasingly became aware of a new competitor called Boss Zhipin, which was starting to gain notable traction with a technologically more advanced platform compared to 51job's. While we do not consider Boss Zhipin as a credible threat yet, we remain wary of the implications of its rise.

Faced with a franchise that was under increasing pressure from both existing and new competitors and with no interest from management to communicate with investors, we decided to exit our position and use the proceeds to invest in higher conviction ideas with greater visibility.

Substantial additions to the portfolio

Over the past six months, we have taken advantage of the recent weakness in share prices to add to JD.com in China and Commercial International Bank (CIB) in Egypt. The former has been caught up in the sell-off prompted by the regulatory actions earlier in the year, but similar to Tencent, we believe the regulatory risk is manageable and used the correction to increase our position. As the company has become one of the top five positions in the strategy, we would like to elaborate further on JD.com and our investment thesis.

JD.com

JD.com is China's second-largest e-commerce company. Richard Liu, who remains the CEO and a significant shareholder, founded the company in 1998. JD operates both direct sales ("1p") and a marketplace platform ("3p"), and has built its own nationwide fulfilment infrastructure. The company is dominant in the electronics and white goods categories, and in recent years has built a significant presence in fast-moving consumer goods (FMCG), as well as other general merchandise categories.

In the world of retailing, mastering three specific variables has proven to be the driving force behind any winning formula: *Price*, *Convenience* and *Selection*. While the variables do not change over time, how consumers define

them does. For retailers to excel in the past their prices just had to be competitive; with a store that wasn't too far away from their customers; and perhaps slightly bigger than the rest of their peers to ensure a greater selection. How the world has changed!

Today, the most successful retailers need to have prices which are the lowest in the country (if not the world), with a same day delivery guarantee and a selection in the millions that 15 or 20 years ago was probably only possible to find in the world's largest metropolises.

Adjusting to the changing customer definitions has been one of the key problems facing legacy bricks and mortar retailers, which got stuck in the middle. Not only did they gradually lose out on convenience as they failed to embrace the new online channels, but even worse, as they lost market share and were burdened by legacy cost structures, their cost advantage from scale and efficiency was also eroded. Losing out on one proposition can be manageable if the two other variables continue to improve (US bulk retailer Costco with their "Scale Economy Shared" framework being a great example). However losing out on one or two simultaneously without the remaining factors improving can be disastrous. This goes a long way to explain the carnage seen in traditional retail over the last decade. Conversely, for the ones that get it right, the sky does not appear to be the limit any longer as Amazon and more recently Jeff Bezos have shown!

As China's most prominent retailer, Alibaba is often described as the "Amazon of China" – a description we have long been sceptical about. Unlike Amazon, which scores well on the three variables listed above, Alibaba can only claim to be the leader in selection – and even here we would argue that its lead is narrowing. The piece that is missing in Alibaba's business model is direct sales (or "1p") – and this is where JD excels.

From the outset, JD has had a relentless focus on price, convenience and selection. In the early days, JD's business proposition was focused on selling genuine consumer electronics at the lowest possible price. In a country rampant with fake goods, being able to guarantee its product quality was clearly an appealing strategy. And by operating online, JD was able to take out expensive layers from its cost structure making it more competitive against the dominant brick and mortar retailers despite its lower scale. However, equally important for its initial success was its direct sales model and focus on consumer electronics. Consumer electronics is a standardised category with high inventory turnover, making it ideal for a cost optimised business model such as online selling. As JD achieved increasing gains in procurement

scale, it passed these scale benefits on to consumers in the form of lower prices which again attracted more customers; and the foundation for its scale-based, competitive-advantage flywheel was created.

After JD became dominant in consumer electronics, it started taking on other large standardised categories such as white goods and FMCG using the same playbook. In every instance, however, when JD scaled a major category, the incumbent retaliated with price wars or anti-competitive behaviour. But there was only so much competitors could do. With its lower cost structure JD could operate at a gross margin as low as half of the category's incumbent, which meant that the rival had to choose between cutting margins to maintain market share or ceding market share to protect margins – each option ultimately benefitting JD's position.

Against marketplace rivals such as Alibaba, JD's direct sales model also proved to be superior. Although Alibaba could reduce merchant gross margins by spurring competition, the fragmented nature of its suppliers meant that there was little structural pressure on the cost of goods side of Alibaba's model, meaning prices could only go down so far. In every instance, JD's model enabled it to come out as a winner after the price wars subsided.

The second piece, *convenience*, came a few years later as JD's business model started to take off. Since China's logistics infrastructure was virtually non-existent at that time, 70% of customer complaints involved delivery services. To overcome this challenge, JD decided to bring logistical operations in-house, recognising that faster and more reliable delivery would be a critical differentiator in providing better customer service – something that other internet companies, including Alibaba, had resisted doing. To put its logistics capabilities in context, JD today operates a network of over 100 warehouses, including seven fulfilment centres and 28 distribution centres, and can deliver more than 90% of its total orders within 24 hours. The comparable number for Alibaba (relying on third-party providers) is 90% within 72 hours. Not only will it require deep pockets for any rival to close the gap, but the time and complexity involved makes it almost impossible, in our view.

Thirdly on *selection*, while JD's direct sales model dominates in standardised product categories (JD's net sales is greater than its five closest competitors combined), the marketplace model ("3p") is usually more advantageous in long-tail product categories like apparel. Although JD launched its marketplace business in 2010 (to combat Alibaba with a trusted version of their Taobao), it has not achieved quite the same success as the direct sales business. While the platform was lacking in functionality in the early years (both from a merchant and customer perspective), this is less of an issue today as

JD has significantly stepped up investments in this area. Likely a greater hindrance, however, has been Alibaba's exclusivity policy.

To fend off competition from JD and other platforms, Alibaba issued its top merchants with an ultimatum: either they use Alibaba's platform exclusively or their web traffic would be shut off. With Alibaba's dominance, especially in apparel, few merchants had much choice in the matter and so pulled their products from JD. However, Alibaba's exclusivity policy has been a key casualty in the Chinese government's recent crackdown on anti-competitive behaviour and they were forced to scrap it completely earlier this year. The impact can already be seen on JD's marketplace business, which has recorded strong sales growth since then. While it is doubtful that JD will overtake Alibaba's marketplace position anytime soon, its leading direct sales proposition combined with an increasingly credible marketplace offering should put it well on track to become the "Everything Store" of China – the third piece of the winning formula.

But what about regulation which has recently become a growing problem for the majority of the new digital companies in China? Unlike pure platform companies which have often engaged in questionable practices that ultimately ends up undermining many of their key stake holders, JD has a track record of focusing on the long term and creating value for the entire ecosystem of customers, suppliers, employees etc. While it doesn't mean that JD is faultless, we think the risks associated with its business practices are substantially lower compared to many others – and the regulatory actions this year would also seem to corroborate our view. After the regulator meted out a gentle slap on the wrist in May 2021 (with a USD 47,000 fine) citing "pricing irregularities" around the Singles Day sales, JD has not been called out by regulators for any other offences. In fact in our latest meeting with the management, they shared that they have received positive feedback from the regulators and do not expect any major impact on the business or new fines.

As such, coming out of this regulatory turmoil, we believe JD is likely to have a higher market share, face less competition and as a result should be on a trajectory to raise margins. While the latter point has often been a target for criticism, we think JD is in a much better position than the majority of its peers given its scale and substantially more efficient operations. In our view, JD should be able to raise margins in the coming years to a level where it will remain the cost leader (and thus able to continue attracting a growing number of price sensitive customers) but, at the same time, also make a healthy profit margin on a much larger pie which it would otherwise not been able to command had it chosen to maximise short term margins at an earlier stage.

In other words, by forgoing supernormal profit up until now to ensure that a sustainable competitive advantage had been built, JD has extended the life of its franchise and should be able to significantly accelerate its profitability in the coming years.

While we do not know when these attractive prospects will be reflected in the share price, we remain confident in the long-term trajectory of JD and added to our position during the sell-off earlier this year.

Commercial International Bank (CIB)

Commercial International Bank (CIB) is another company we added to during the period in review. CIB is the No. 1 private sector bank in Egypt and we have known and interacted with the management team for over a decade. With a market share of around 6% in loans and deposits, we believe there is still significant room for growth. To the credit of its risk-aware and counter-cyclically minded senior management team, CIB consistently generates high returns on assets (ROA) with a 10-year average of 2.7%. Book value per share (BVPS) has compounded at an impressive 20.5% CAGR over the past decade despite the country's many issues (e.g., the Arab Spring, devaluation of the Egyptian Pound and Covid). Adept at assessing credit risk, CIB only lends to top quality corporates (such as multinationals like Coca Cola) and is conservative with respect to coverage ratios (now at 200%). It has also benefited from the high yields offered by Egyptian government securities, where it has parked 45% of its assets. Its loan-to-deposit ratio is only 40% and will rise as and when the credit growth in the economy returns (Egypt is massively underpenetrated in terms of credit, with credit-to-GDP at only 37%).

Egypt's poor macroeconomic situation owing to the pandemic has led to a delay in credit growth while also keeping foreign equity investors away. Recently, the bank's chairman resigned on account of a long-running spat with the Central Bank governor. This led to a short-term sell-off in the share price. We spoke to the CEO recently and it was clear that there has been no collateral damage vis-à-vis the relationship between CIB and the Central Bank. So, we took advantage of the attractive valuations and added to our position.

We believe CIB should continue to compound away at a high rate, driven by attractive returns on its investment book and the high net interest margins (NIMs) of around

6% that it generates on its loan portfolio. Despite all the volatility that one has witnessed in Egypt over the past two decades, the company has rewarded investors with a 16% p.a. compounded total return in US dollar terms over that period, underscoring our belief that well-run franchises tend to perform well despite the external challenges.

Outlook

In spite of substantial progress on the vaccine roll-out in many parts of the world, the Covid-19 pandemic remains a challenge for the vast majority of emerging markets. While daily new cases in India, South Africa and most parts of Latin America have declined significantly from the peaks reached earlier in the year, many parts of Asia, including China, are yet again battling with rising case numbers.

Still, we are hopeful that the vaccination drives across the world will soon make a difference. As of September 2021, roughly 41% of the world's population has received at least one dose of a Covid-19 vaccine. 5.6 billion doses have been administered globally, and 31 million are now administered each day⁴. This pace of vaccination means that even the laggards are perhaps only 2-3 quarters behind the leaders.

From a company perspective, we believe there are also many reasons for optimism. The businesses that we own are market leaders in attractive categories with significant competitive advantages, which allow them to generate high returns on invested capital and strong free cash flows (FCF). Further, they have plenty of scope to grow in the coming 3-5 years, are led by some of the best management teams in emerging markets, and the majority have a net cash position and are thus ideally positioned to weather a crisis. Yet, most of our holdings continue to trade at a discount to longer-term averages, despite many of them seeing significant improvements in underlying business trends. When looking ahead we expect the aggregate earnings of our holdings to grow by more than 20% p.a. for the next two years, then settle at 14-15% p.a. in the medium term. By our estimates, the aggregate FCF yield for the non-financial companies in the portfolio stands at 3.7%. This is roughly in line with the longer-term averages, despite the current depressed profit levels in many cases. We believe this is attractive and should bode well for longer-term returns.

If there are any questions or feedback concerning the strategy, our approach or operations, we would welcome hearing from you.

Thank you for your support.

⁴ Retrieved from: '<https://ourworldindata.org/coronavirus>' [Online Resource] on 8th September 2021

Source: Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 31 August 2021 or otherwise noted.

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