FSSA Investment Managers

Summary

# China: what has changed... and what remains the same?

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Most people in North America and Europe hold a negative view of China, according to a recent survey.[1] This is hardly surprising given the portrayals in Western media – a Google Images search for "China" and "The Economist" returns front-cover headlines, such as: *The brutal reality of dealing with China, Trade without trust,* and *America v China; it's worse than you think.*

While opinions about China often swing to extremes, FSSA portfolio managers Winston Ke and Helen Chen believe there are reasons for investors to be optimistic. They believe China offers many attractive long-term opportunities – there is a large investment universe and despite the slowing economy, around 1,500 companies have doubled profits in the last five years. Meanwhile, China's large middle class is still growing and the country continues to advance in innovation, with more engineers graduating each year. Globally, consumers and companies remain deeply exposed to China, which is still the top exporter and second-largest importer in the world.[2]

FSSA's investment philosophy is focused on finding companies which can grow earnings sustainably and then holding them for the long term. As part of the team's emphasis on quality, FSSA seeks capable and prudent leaders at the helm of portfolio companies. Speaking at the FSSA Forum 2023, Winston and Helen highlighted a few companies held in FSSA's China portfolios, and the entrepreneurial qualities of the people leading them.

## The entrepreneurial spirit is alive and well

One such company is Shenzhen Mindray[3], China's largest medical equipment maker. Its key products include patient monitors, in-vitro diagnosis tools and medical imaging. FSSA first bought shares in the company over a decade ago, with research notes dating back to 2007.

Mindray's chairman and founder, Li Xiting, is a first-generation Chinese entrepreneur. Born into a poor rural village, his studies were cut short by the Cultural Revolution. Nonetheless, he went on to become a distinguished scholar and technical leader among scientists, and worked at China's first ever medical device company, Shenzhen Anke.

In 1991 while visiting high school classmates who were doctors, Li discovered that they were unable to afford basic medical equipment as foreign firms had monopolised the industry. He decided to start a company with a few colleagues from Anke and develop China's own products and brands. That company was Mindray. It has built an impressive track record over the years – Li's ambition is to make Mindray a world leader in medical devices. The FSSA team believe it has good potential, with 2022 revenue reaching USD 4.5bn, including USD 2bn in overseas sales.

Anta Sports[4] is another Chinese success story with the original founder still at the helm. In the mid-1980s, at age 16, Ding Shizhong started buying and reselling shoes from his father's factory. By 1991, he had founded his own brand, Anta.

1 Pew Research Center study, July 2023. https://www.pewresearch.org/global/2023/07/27/chinas-approach-to-foreign-policy-gets-largely-negative-reviews-in-24-country-survey/
2 World Trade Organization's Global Trade Outlook and Statistics, April 2023. https://www.wto.org/english/res_e/booksp_e/trade_outlook23_e.pdf
3 Largest holding in the Health Care sector in the FSSA Greater China Growth Fund (OEIC), as at 31 August 2023
4 The only sportswear company owned in the FSSA Greater China Growth Fund (OEIC), as at 31 August 2023

Ding realised that having a strong brand could enable premium selling prices for Anta's products and in 1999 he secured Kong Linghui, a table-tennis superstar and Olympic gold medallist, as brand ambassador. Anta has become the only major Chinese sportswear company to successfully grow multiple brands in different categories, such as FILA for high-end fashion sportswear and Anta for the mass market.

While still a family-run and majority-owned company, Ding has brought in outsiders to move Anta to the next level. The FSSA team believes this combination of long-term owners and well-aligned managers, including high-profile hires from Nike, Reebok and Lululemon, has been key to Anta's success.

## Management succession in a maturing market

As China becomes a mature market, Chinese companies are appointing more professional managers to take over from the original generation of founders. In general, Winston and Helen note that the management ranks are becoming more sophisticated and worldly, often possessing overseas education and experience at multinational firms.

The point was illustrated with Centre Testing[5], the biggest private testing, inspection and certification (TIC) company in China. In the two decades since it was founded, the company has successfully diversified its business and now has customers in the environmental, food & agriculture, oil & gas, marine, consumer goods and pharmaceuticals industries.

The founder's family remains well aligned with around 18% ownership, but the management team has been professionalised. Operations are now led by Shentu Xianzhong, who joined in 2018 from multinational firm SGS. By reining in headcount expansion and capital expenditures while increasing utilisation at existing facilities, profitability has improved while sales continue to grow.

The FSSA team believes that future growth will remain attractive given the potential for industry consolidation and market share gains from inefficient state-owned enterprises (SOEs). Centre Testing should also benefit from increasing regulations around quality standards and environmental protection.

Finally, the speakers highlighted China Resources Beer (CRB)[6], the largest beer company in China with around 30% market share. Although an SOE, China Resources businesses have typically been well run, with returns comparable to private enterprises. The company's strategy focuses on quality growth and profitability in a consolidating industry.

China's beer market is different from global markets, as volumes have been in decline since 2014. Despite this hurdle, FSSA bought CRB in 2017 as it was expected to benefit from the premiumisation trend, given its competitive operations. This has largely played out – CRB's share of premium sales has grown to just under 20% of turnover, with help from a 2019 merger with Heineken China.

CRB's chairman and CEO, Hou Xiaohai, has been at the company since 2001. He is a hands-on leader with a clear strategy. Helen and Winston noted his passion and commitment to the company, which stands out among SOE leaders.

## In closing

China remains an attractive place to do business, with a comprehensive supply chain and a large pool of talent. The financial market is deep and diversified with ample opportunities for bottom-up stock-pickers. In the pursuit of quality, the FSSA team looks for capable business leaders who can build up franchises and take them to the next level amid the ever-changing economy.

5 The only testing, inspection and certification (TIC) company owned in the FSSA All China Fund (OEIC), as at 31 August 2023
6 The only beer company owned in the FSSA All China Fund (OEIC), as at 31 August 2023

**Important Information**



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