

REACHING OUT TO THE HIGH GROWTH ASIAN CONSUMER MARKETS

The statistics are compelling – Asia is home to approximately 4 billion people, and emerging Asian juggernauts such as China, India and even Indonesia, are the most densely populated nations in the world, with a rapidly emerging and increasingly affluent middle class consumer base.

All these translate to fast-growing consumer markets in Asia. The Asian consumer landscape has grown tremendously in recent years – and multinational companies such as McDonald's, Starbucks, Carrefour, Nike, have been quick to establish their presence throughout the region.

It's not only the MNCs that are jumping on the Asian bandwagon. Asian companies have been sprouting up across the region – Asian brands such as Samsung, LG, Kia, and even Chinese sportswear company Li Ning are becoming increasingly popular across the region.

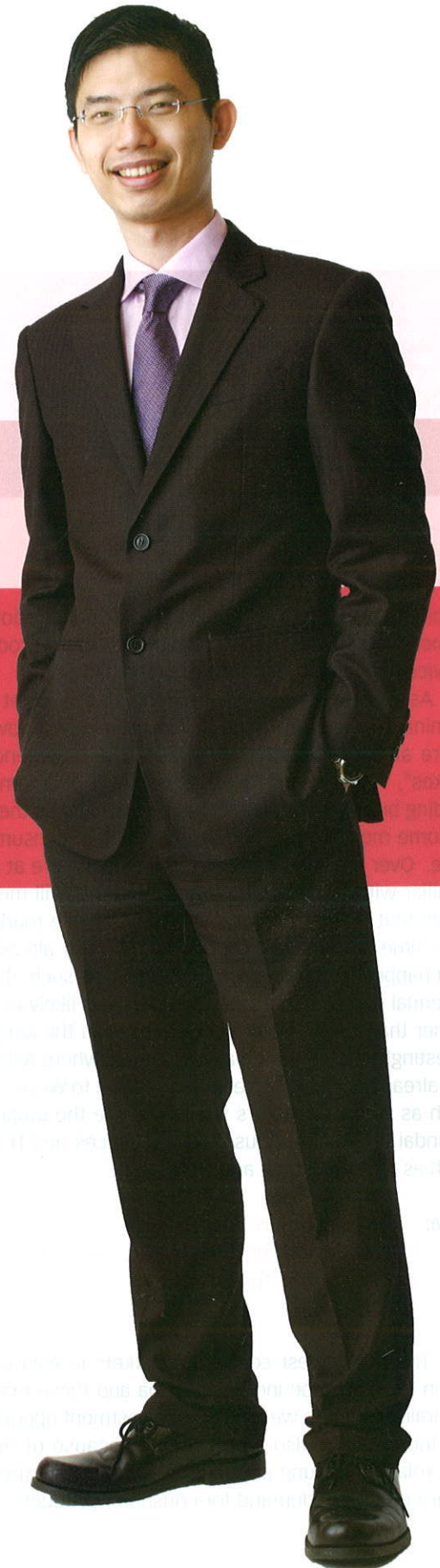
Paul Ho, fund manager, United Asia Consumer Fund, tells us more about why the Asian consumer space holds promising investment opportunities for corporations and investors alike, and why he favours the Chinese auto-makers and the food and beverage companies.

FUNDSUPERMART (FSM): What is the outlook for the Asian consumer landscape in the short-to-medium term?

PAUL HO (PH): Despite the recent sell down in the sector, we remain positive on the Asian consumer landscape in the short to medium term. From our recent interviews with many consumer companies, we get the sense that many companies will enjoy a growth of more than 20% p.a. in the next two years. In fact, we believe there are many companies that could potentially grow at substantially higher rates than that in the next few years. We believe this bodes well for the performance of the sector in the short-to-medium term.

FSM: What are the main drivers behind the rise of the Asian consumer?

PH: One of the lessons we learnt from the recent financial crisis is that Asian countries had been too reliant on exports in the past few decades. Going forward, we believe that the slow recovery in the West and the deleveraging of the consumers in these countries will make it very difficult for




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exporters in general. Rising Asian currencies, a reflection of a weakening USD and Euro, will also present headwinds for exporters going forward. As a result, to stimulate economic growth, some Asian governments have been implementing policies to encourage domestic demand as an alternative to the traditional exports growth model. With huge populations in Asia, relatively low consumer spending as a percentage of GDP and higher incomes over time, consumer companies in Asia look set to deliver robust growth. Asian governments have also clearly signalled that they are committed to supporting the consumer sectors with various favourable policies, such as the Rural Appliance programme and the auto subsidies programmes in China.

FSM: How different are the Asian consumers from their counterparts in the Western developed nations? How will this difference in consumer behavior impact the long-term growth trend in Asia and the West?

PH: We believe that basically the Asian consumers are likely to follow the consumption pattern in the West as their





>> income increases. This means greater penetration of consumer products over time, demand for more products and services and the importance of brand names.

Asian brands are still nascent at this point and the dominant brands in China still have relatively low market share at the moment. We foresee the emergence of the "Nikes", "Cokes" and "Nestles" of Asia over time as the leading brands consolidate the markets and as their brands become more entrenched in the minds of consumers over time. Over time, we think Asians will feel more at ease and familiar with home grown brands and this will mean eventually that Western brands are likely to lose market share over time to domestic brands and we are already seeing that happen in certain sectors in China. As such, the growth potential of Asian consumer companies is likely to be much higher than their Western counterparts in the long run. Interestingly enough, there are also areas where Asian brands are already gaining market share relative to Western brands, such as the auto sectors where we see the emergence of Hyundai and Kia, in household appliances and IT products such as Acer, Samsung and LG.

FSM: Within Asia, consumer patterns differ among the developed and developing nations. Are you actively seeking out investment opportunities mainly among the developing Asian countries only?

PH: The two largest consumer markets in Asia outside of Japan happen to be India and China and these markets will naturally be where we look to for investment opportunities.

Indonesia is also worth noting because of their huge and relatively young population, which forms the basis of future growth in demand for consumer products.

Developing countries also offer interesting investment opportunities. In the case of Korea, which is relatively more developed, there are international brand names like LG, Samsung, Hyundai or Kia. Interestingly enough, international brands such as Esprit and L'Occitane, which sells to international markets, are also listed in HK.

FSM: Could you give us some key examples of the Asian consumer plays which you like, and the reasons why you like them?

PH: We like Chinese auto and auto-related stocks because of the relatively low auto penetration rates currently. Chinese auto penetration rates are reported to be somewhere between 30 to 40 cars per thousand people. This is a far cry from the 400 to 600 cars per thousand that a developed country typically registers. Based on these statistics, if car ownership trends in China were to catch up with that of the developed world as China progresses, China probably have to increase their car volumes by 10 to 15 fold. Currently, the auto penetration rate of India is probably half of China's which means the market has a potential to grow about 20 fold from here. We have not even included the growth of potentially huge markets like Vietnam. From this perspective, the growth potential of auto stocks appears to hold great growth potential.

Another sector that we like is the food and beverage sector. This is a rather broad industry which includes the dairy sector, the wine sector and the other staple food sector such as pork and instant noodles. These sectors are both resilient in terms of their earnings especially in a downturn, and are likely to see rather high growth



rates in the near future. This is driven by the increased penetration of their products and the improvement in their distribution channels especially in the second- and third-tier cities in China where income levels are rising much faster than the national average.

FSM: Broadly speaking, which category of Asian consumer companies would you consciously avoid investing in, and why?

PH: In every segment of the consumer sector, there are both good companies to invest in and bad companies to avoid. We would generally avoid companies with low barriers to entry and where the markets are fragmented. This is where competition gets intense, margins and profitability levels remain low structurally. This is the case in certain sub segments in the Chinese auto sector such as the low-end Chinese domestic car producers.

At the moment, we are also having difficulties justifying buying some of the consumer staples names mainly because of their high valuations. Even though the companies are very well run, we believe that a lot of them are priced for perfection and there is little downside protection if things do not work out.

FSM: What are the implications of rising Asian consumerism on the key Asian currencies? Do you expect the Chinese yuan to be revalued significantly in the short-to-medium term?

PH: There are no obvious linkages between Asian consumerism and Asian currencies at this point. In fact, from the investors' point of view, the consumer sector is probably a

good place to hide if you want to avoid export plays which are subject to fluctuations in the currencies that are hard to predict over the short and medium term. Most of the brands have local sales and in most cases their costs are also in local currencies. In some cases, where the products are not produced domestically, they will need to import these from abroad. This would involve selling Asian currencies and buying foreign currencies. However, demand for foreign currencies generated from this segment is unlikely to be significant enough to cause huge movements in exchange rates.

As for the revaluation of the yuan, we believe that this will eventually happen and when it does, it will appreciate gradually, the appreciation largely driven by differences in the productivity levels of labour and in the economic growth rates between China and the other countries in the long run.

FSM: What factors/events would derail the Asian consumer story in the short-to-medium term?

PH: We don't think that the Asian consumer story will be "derailed" per se. However, because of the recent monetary tightening that we see throughout Asia, following very aggressive monetary easing last year, the Asian economies might see an easing in growth rates as well. This means that consumption spending might slow when compared to last year. The growth fundamentals and drivers remain intact but we should probably be prepared for lower growth rates than what we saw last year, which was really exceptional. In some cases where subsidies are withdrawn, we would also expect a short-term negative contribution to the growth rates. **FSM**