



Investor Conference Call
Dealing with a Rapidly Changing Investment Environment
March 2011

Historically Asia has traded at a 'discount' to developed markets for good reasons

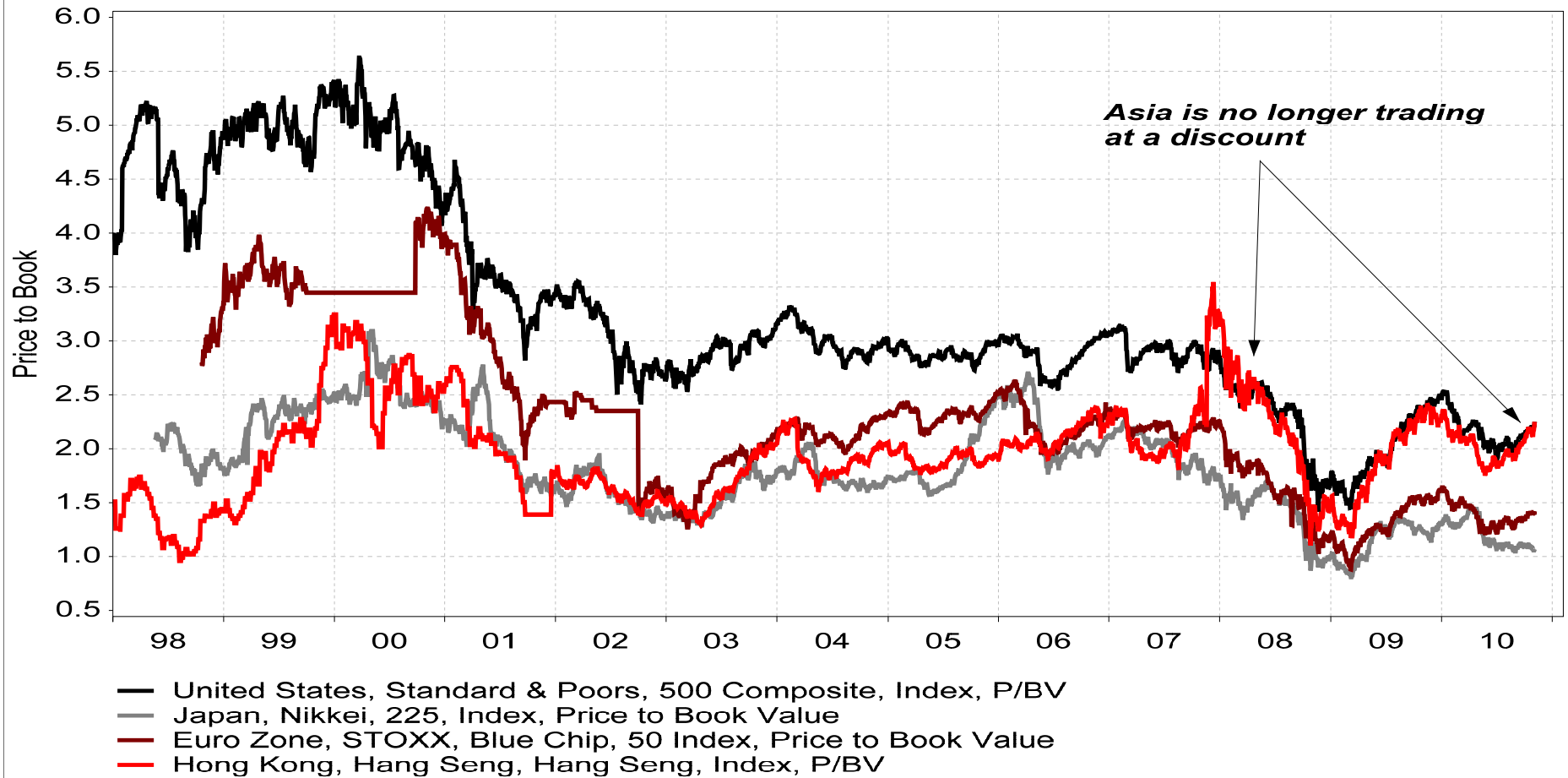
- The first and greatest challenge of investing in Asia is that a large number of companies have not been listed that long. As such, the track record of companies, CEOs and CFOs is unproven and a lot of questions are unanswered: what is a company's capacity to weather an economic cycle? A financial cycle? etc...
- The second challenge is that the degree of 'institutionalization' of companies is not what it is in the West. For example, how many Asian companies are today running management training programs so that the cream rises to the top? Are procedures in place to routinely sack the bad managers? Are CEOs controlled by independent boards or are firms run like little empires in which no-one dares contradict the top management?
- The third important challenge when investing in Asia is that the 'distress factor' in Asia is typically not 'financial leverage' but instead 'operational leverage'. Indeed in the Western world companies in 'trouble' have typically mismanaged their balance sheets and, for a financial analyst, this is easy enough to identify and work through. Meanwhile, in Asia, a company in trouble has usually mismanaged its operations... and this is much harder to identify, especially if a company has a limited track record.
- The fourth, and most important challenge when investing in Asia is that policy risk and country risk frequently tend to be the greatest drivers of returns.



Looking at these challenges, we believe that two strategies make structural sense in Asia. Investors should either follow 1) a 'deep-value' strategy, aiming to identify assets that already discount all sorts of potential negative corporate or policy surprises; or they should embrace 2) a well diversified strategy which aims to identify the countries that are most likely to outperform, and within those countries, overweight growth stocks.

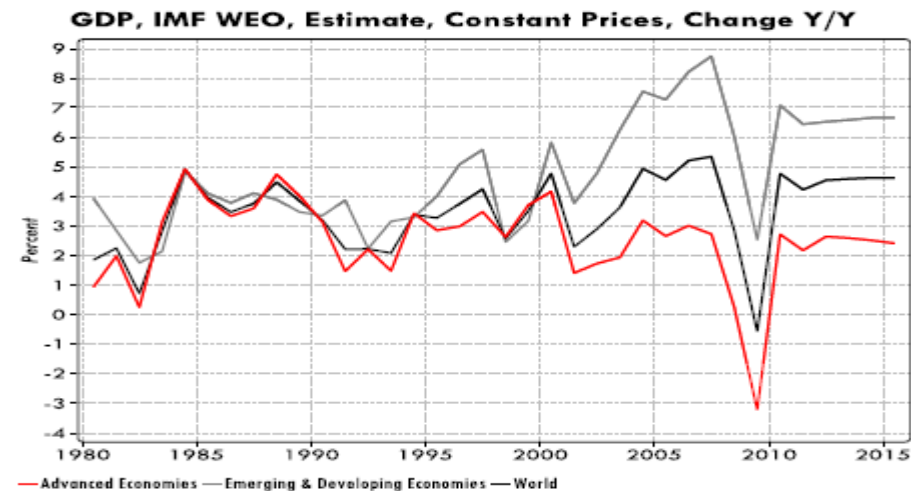
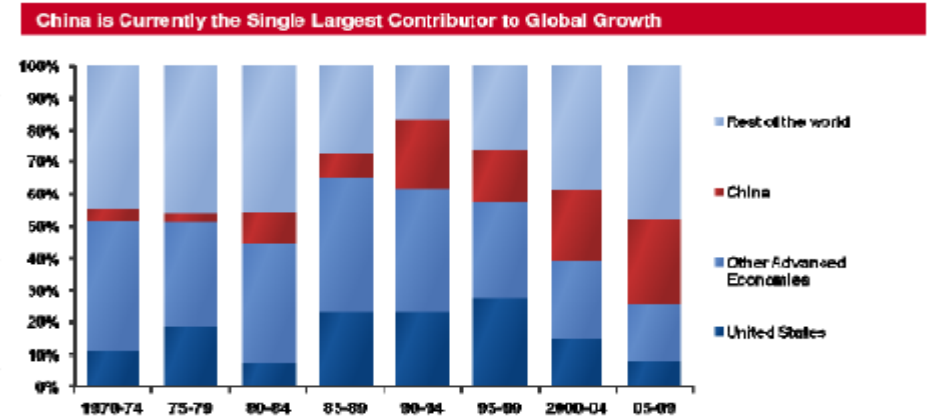
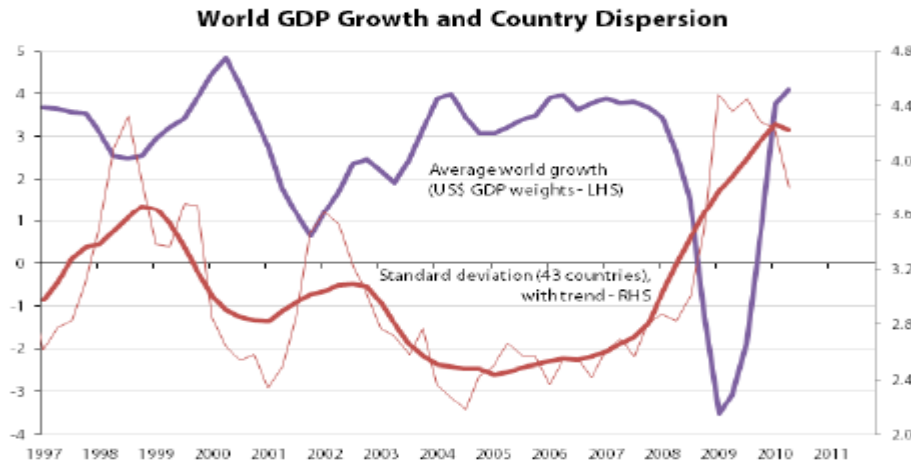
At the Beginning of the Decade, Asian Equities Were Trading at Distressed Valuations. This is No Longer the Case.

Price to Book of US, Europe, Japan and Hong Kong



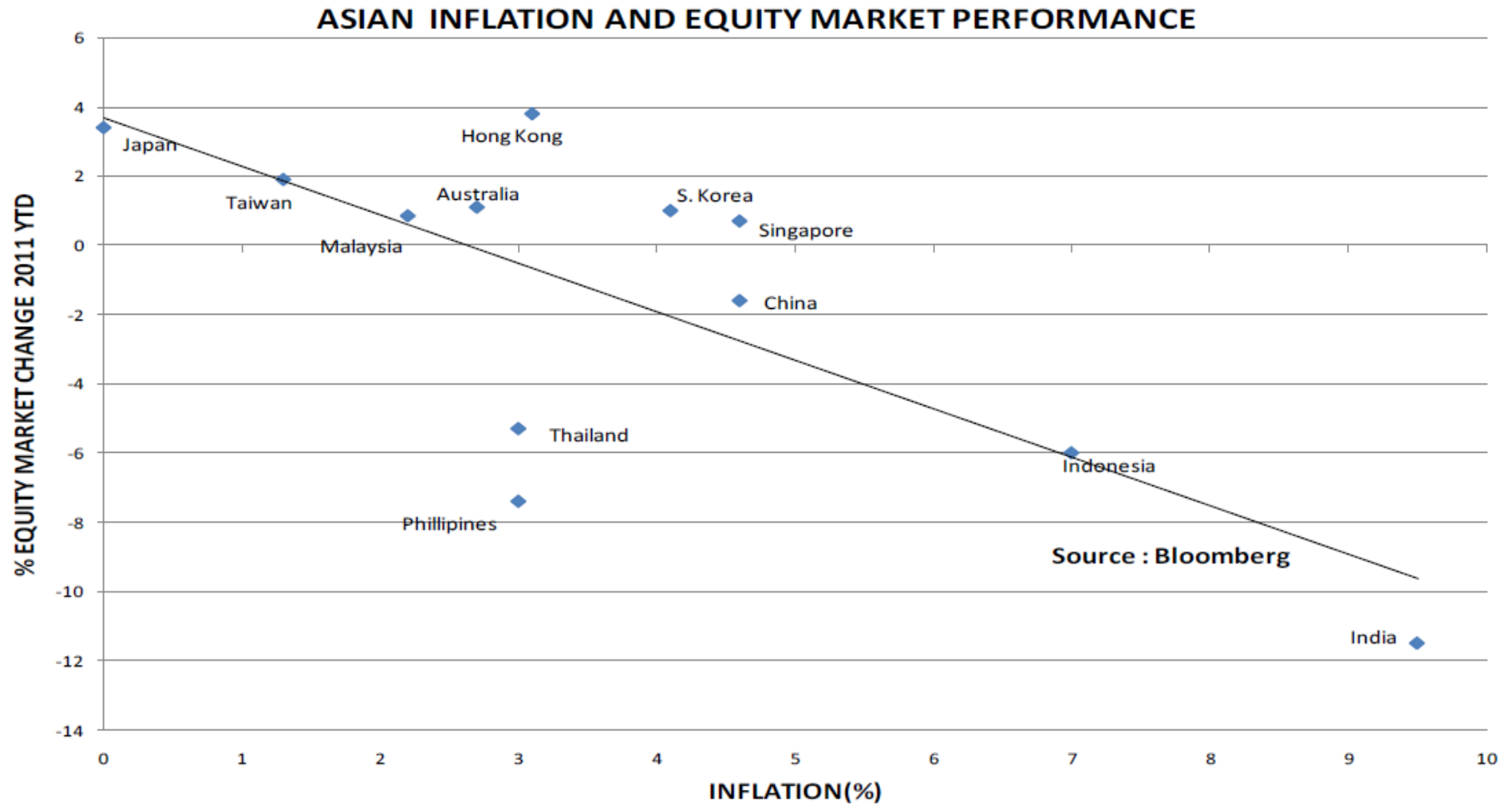
GaveKal Research

Asia's 'premium' linked to the extraordinary nature of the current cycle

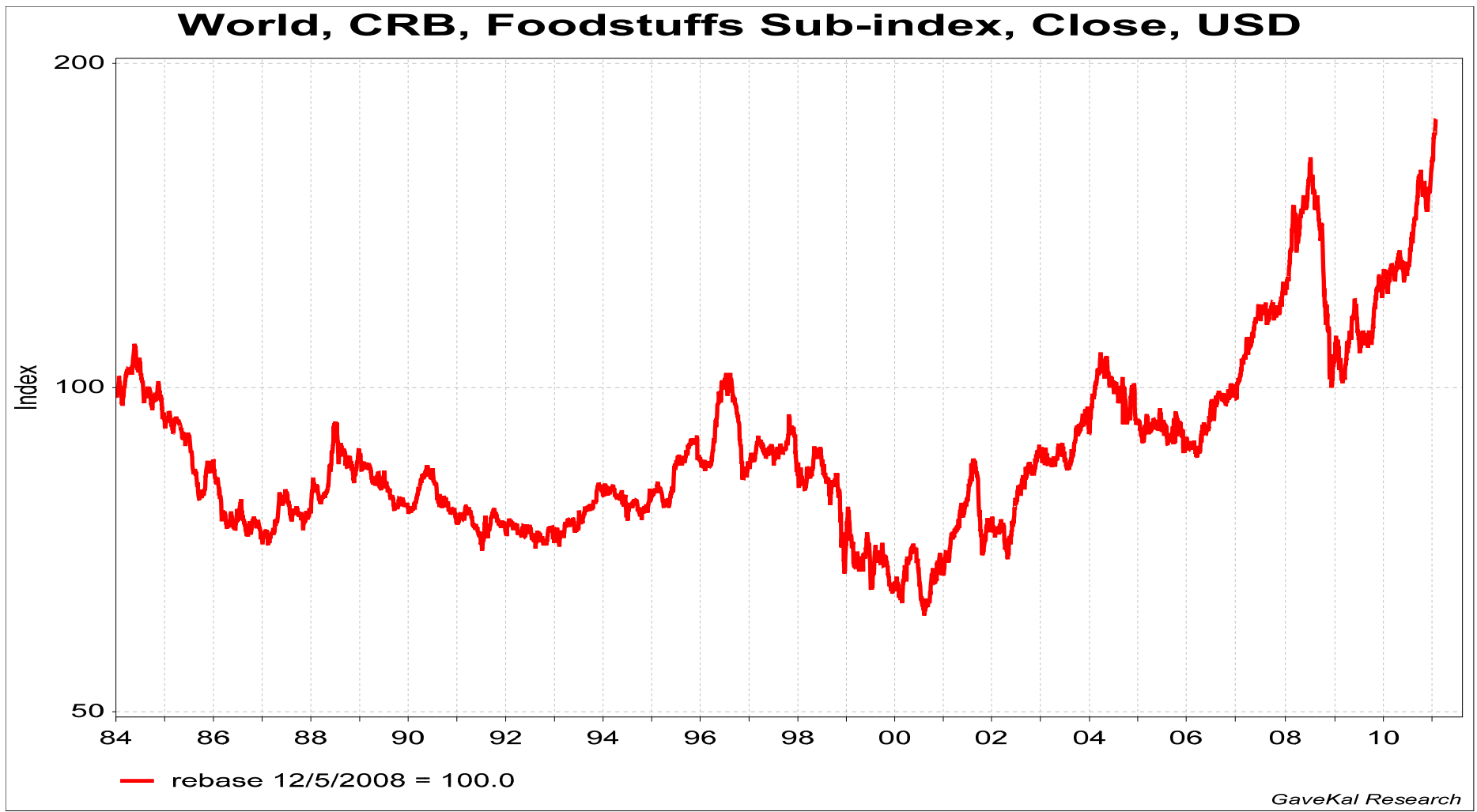


- The global economy is back to growth... but not like before; last time around, +4% global growth triggered feelings of global prosperity because dispersion was low. Today, the dispersion of growth around the world is at a record high.
- The current divergences result from the excesses of the previous decade, when growth rates were too much aligned by the effects of currency manipulations and world financial flows.
- **How will financial markets and policymakers react to this new environment of growth dispersion?**

But this is now changing: growth no longer the main driver of performance

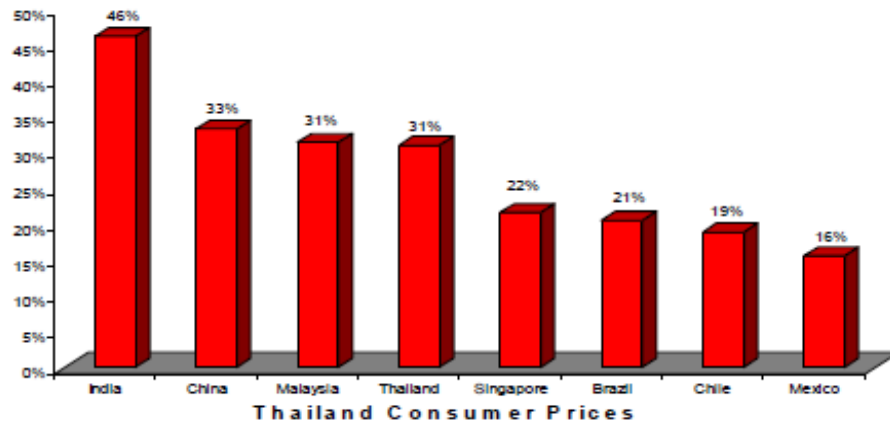


Undeniably, the spike in food prices is very problematic

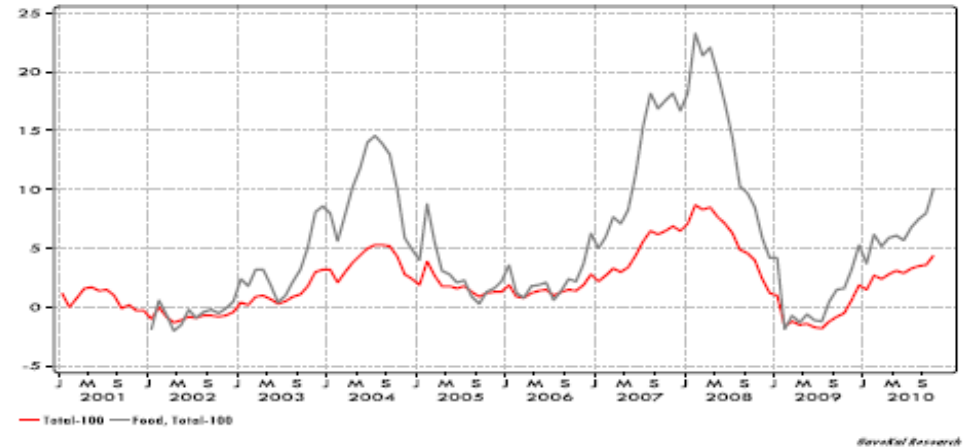


Higher food prices call for a policy response

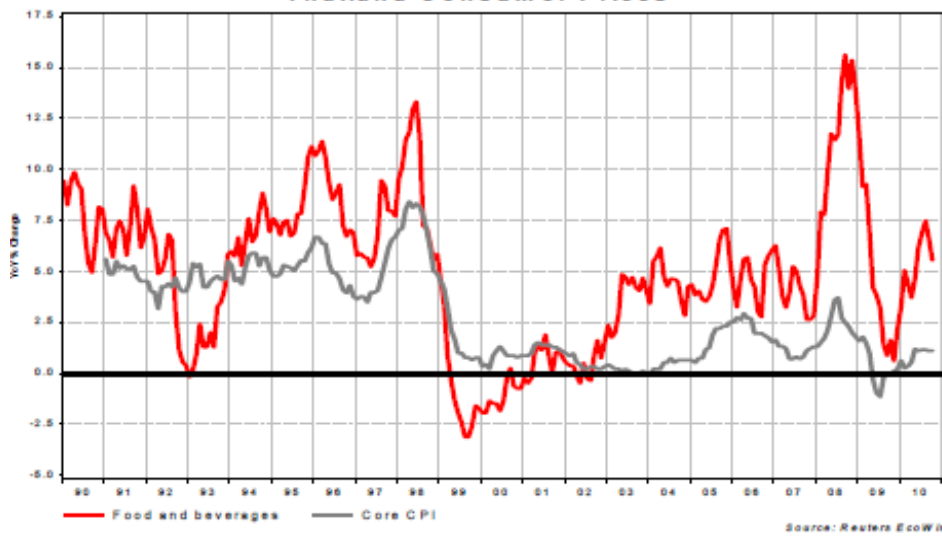
Weight of Food in Inflation Across Major Emerging Markets



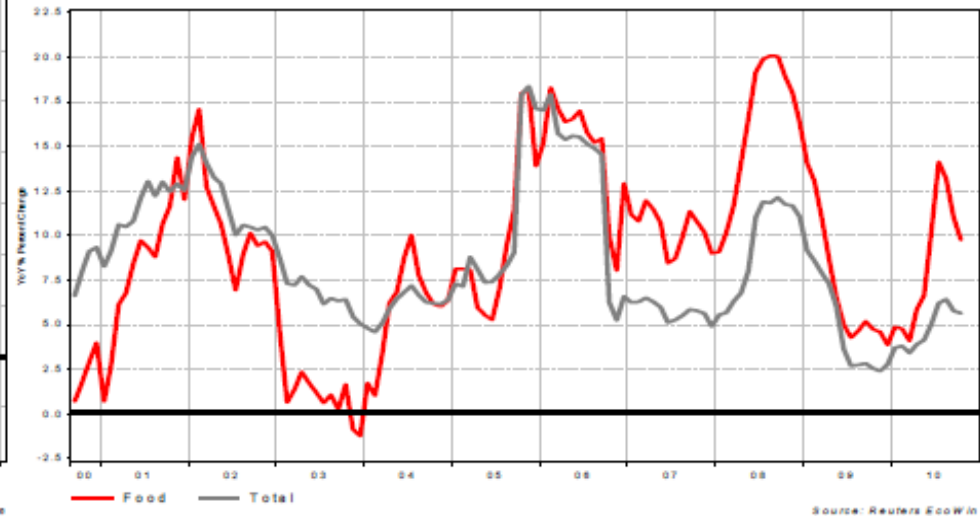
China, Consumer Price



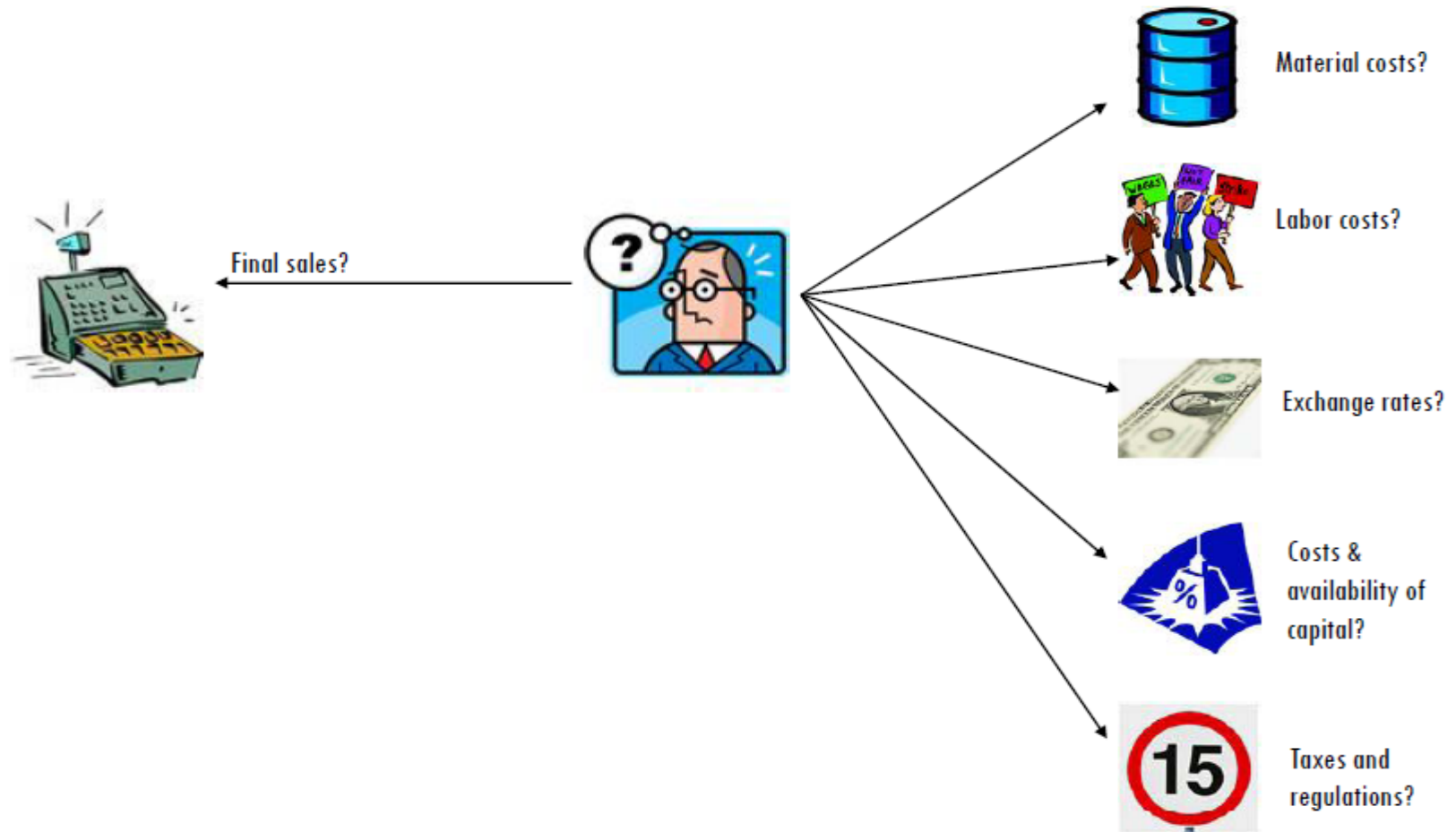
Thailand Consumer Prices



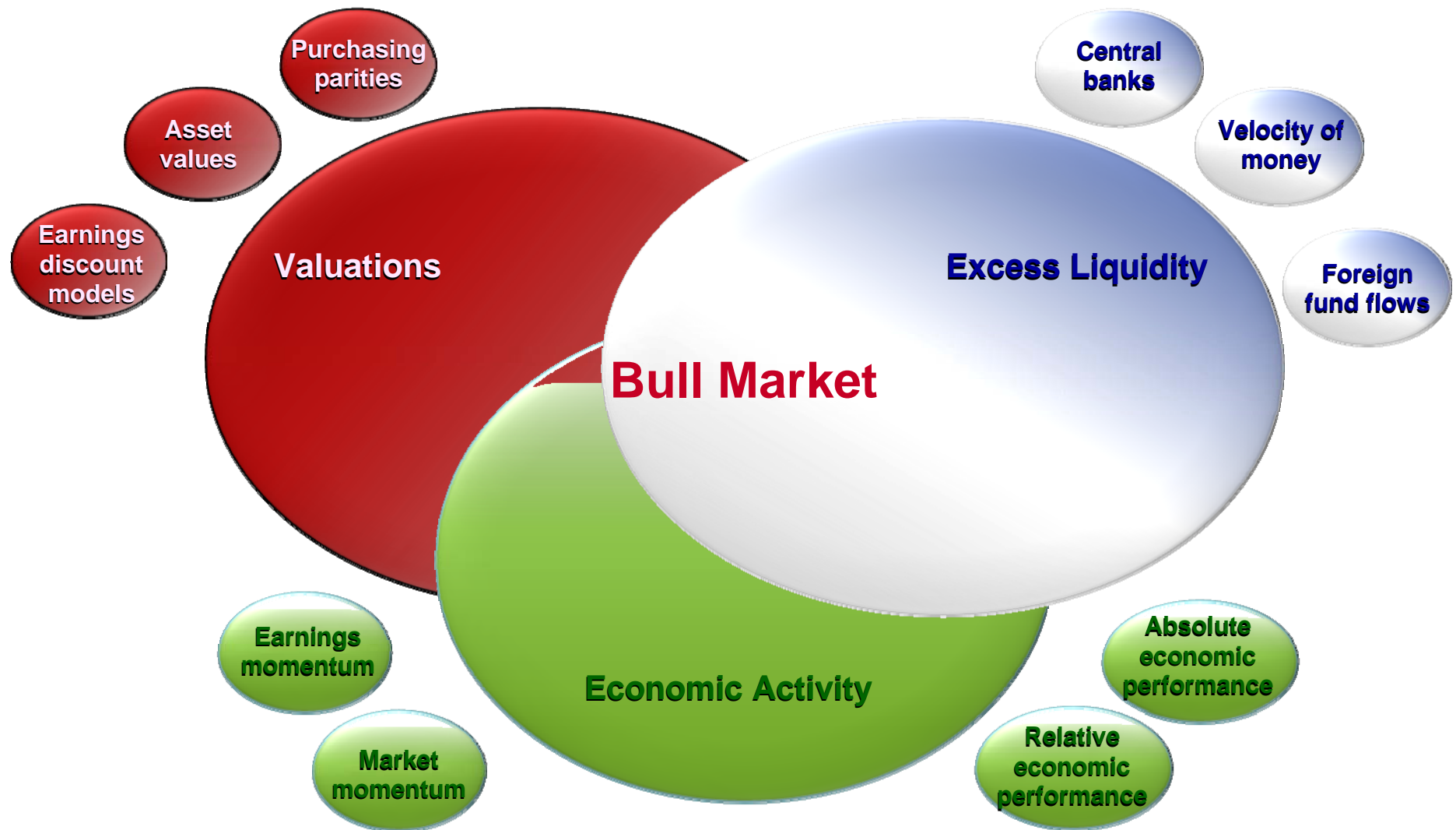
Indonesia Consumer Prices



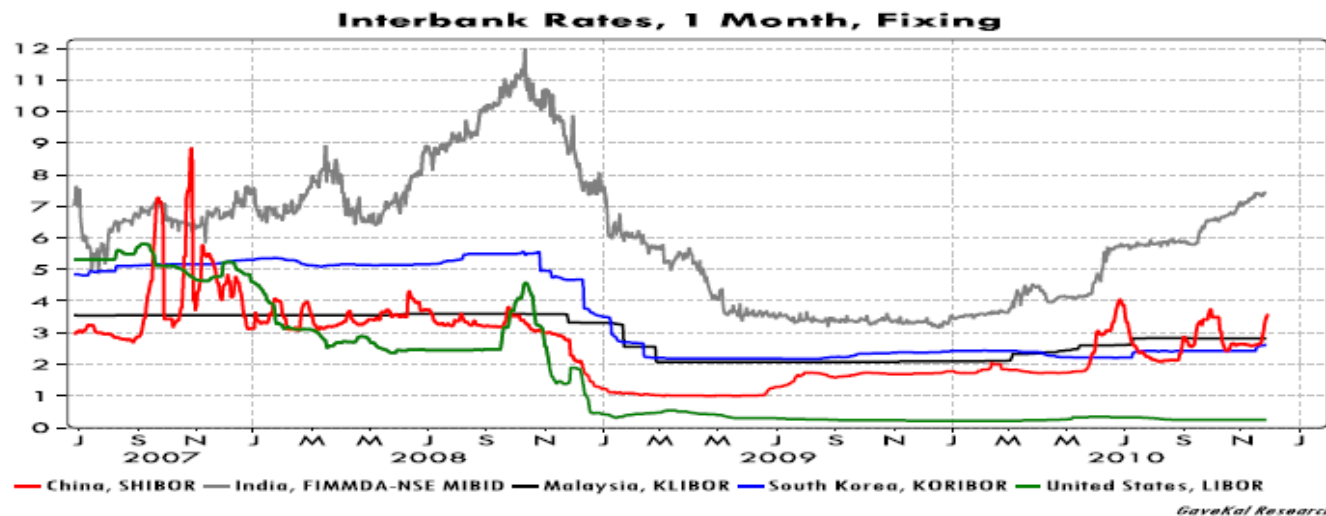
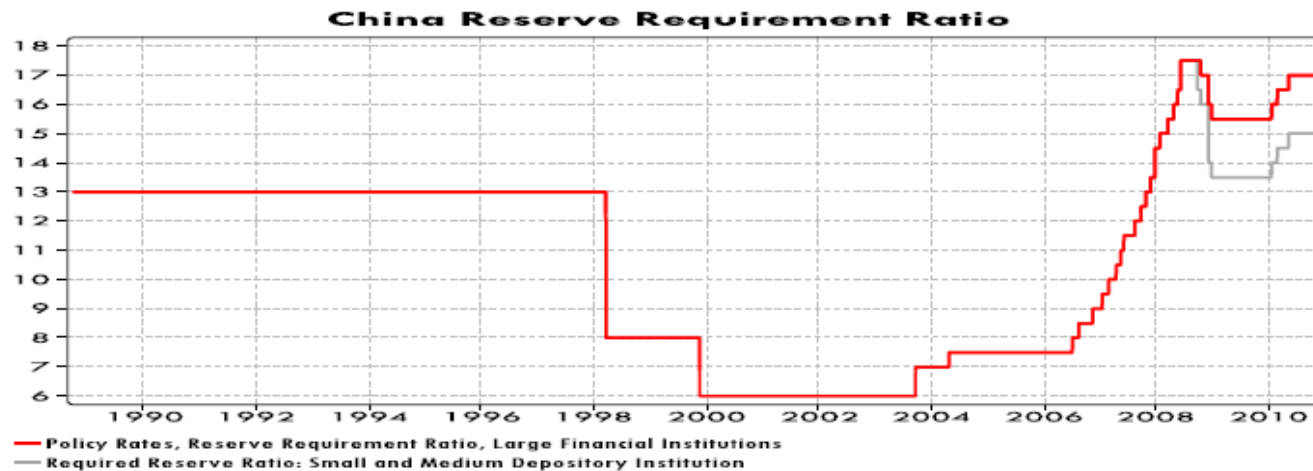
A reality confirmed by bottom up contacts



Equity Bull Markets Rest on 3 Pillars: Valuations, Excess Liquidity and Growth



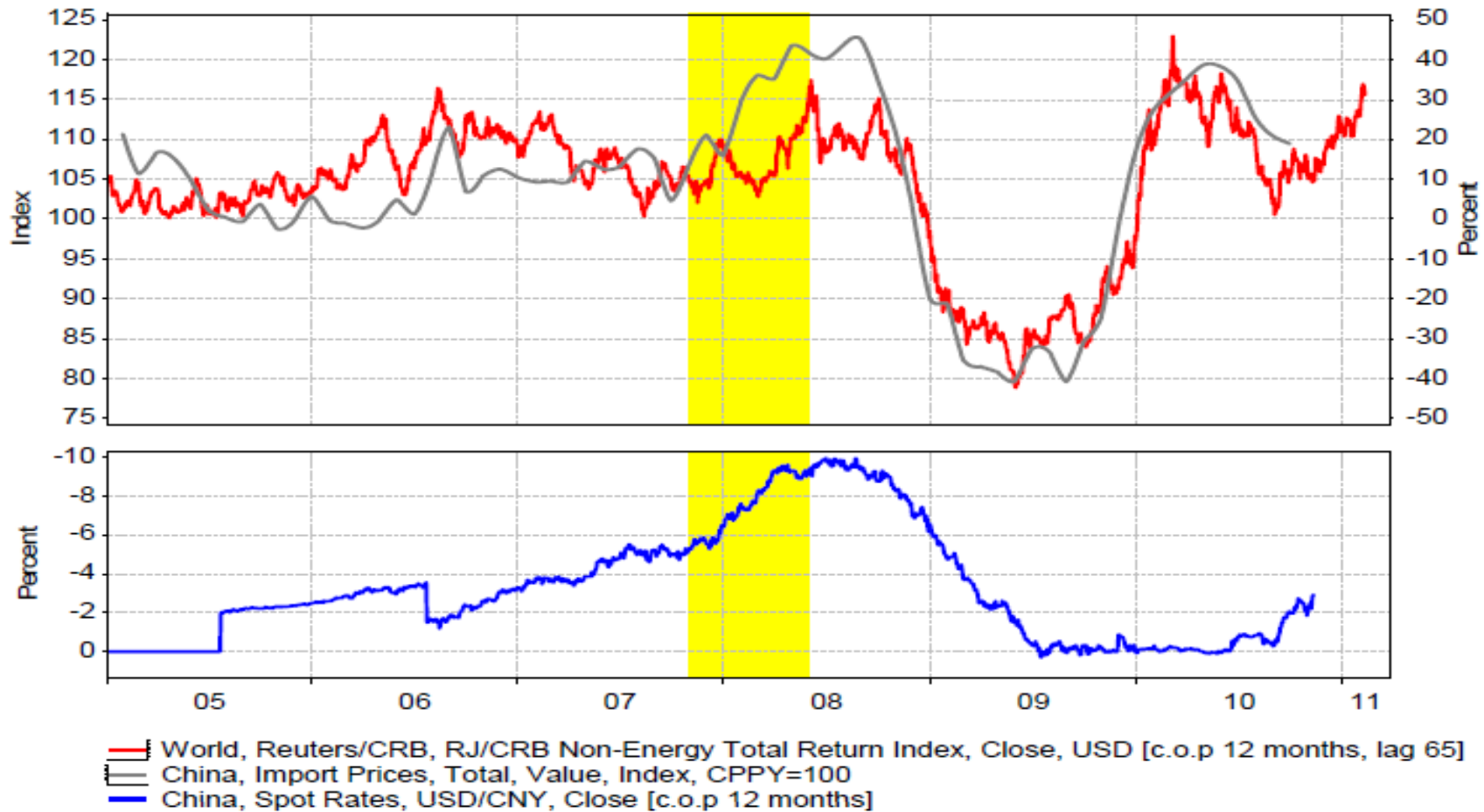
Will this response be continually tighter monetary policy?



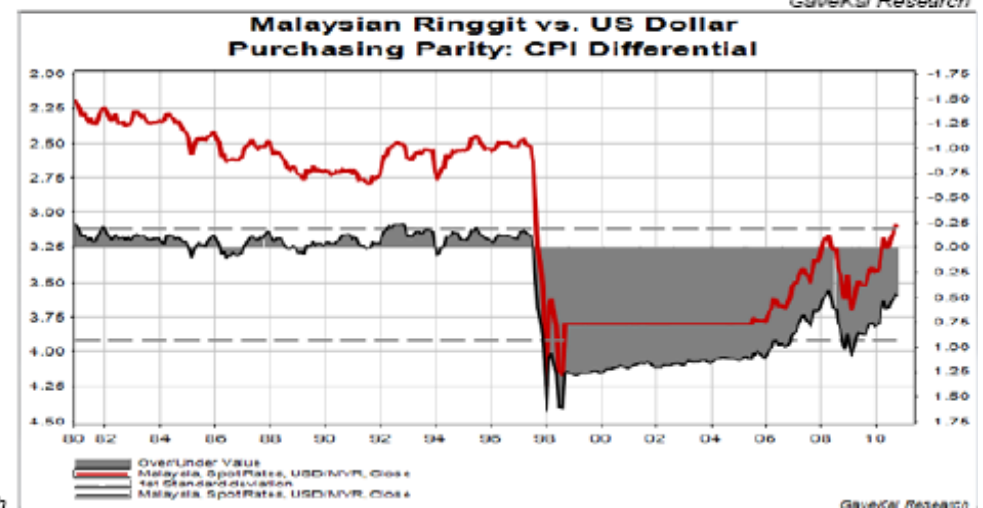
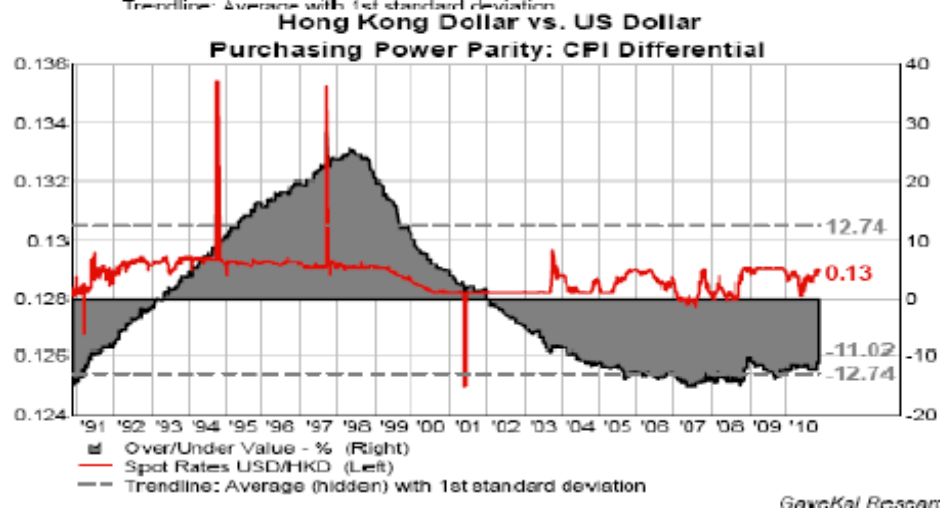
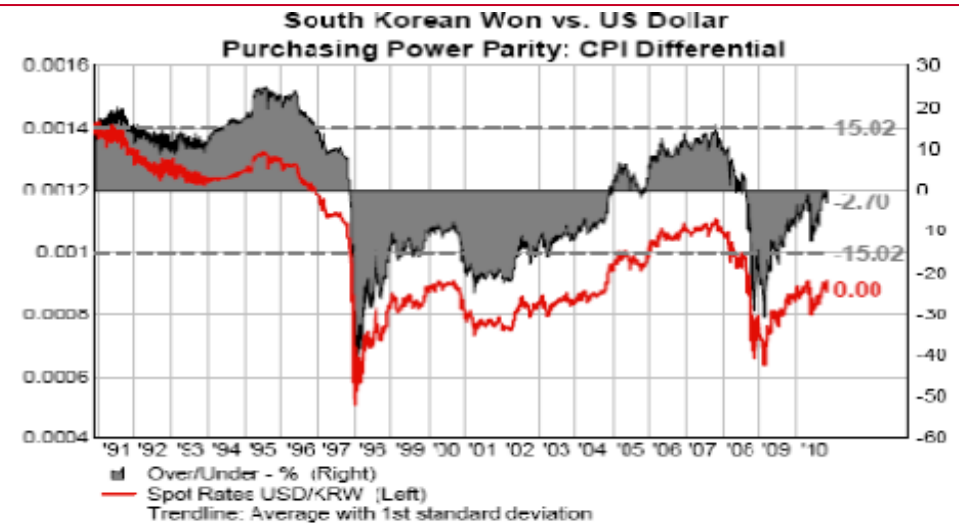
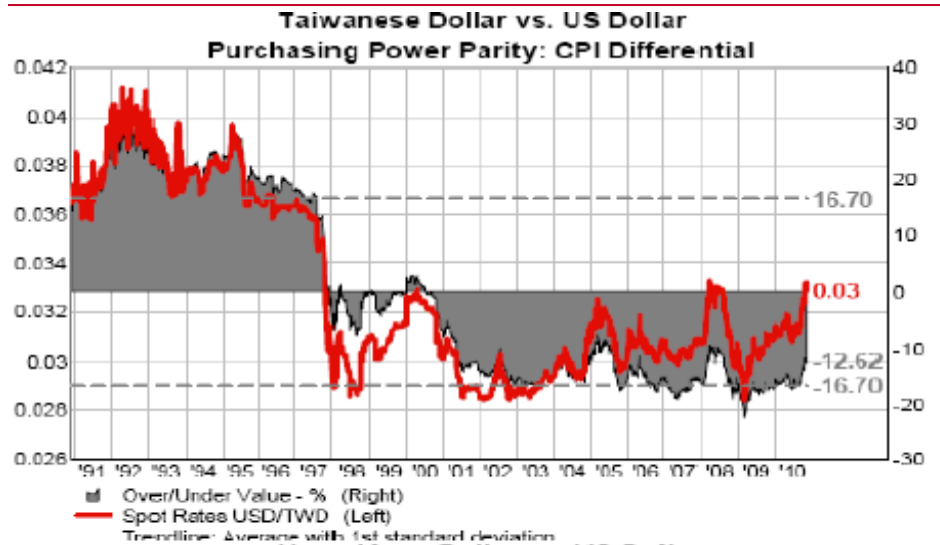
- With three increases in the past two months (just before Chinese New Year too, like the Fed raising rates before Christmas!), the PBoC is showing its desire to curtail the growing inflationary expectations.
- The cost of capital in China will continue to rise and its availability shrink.
- Historically, this has been a hurdle for domestic asset prices.

Or will it be a faster pace of appreciation in local exchange rates?

China Import Price and CRB Non-Energy Index



Most Asian currencies have room to be revalued

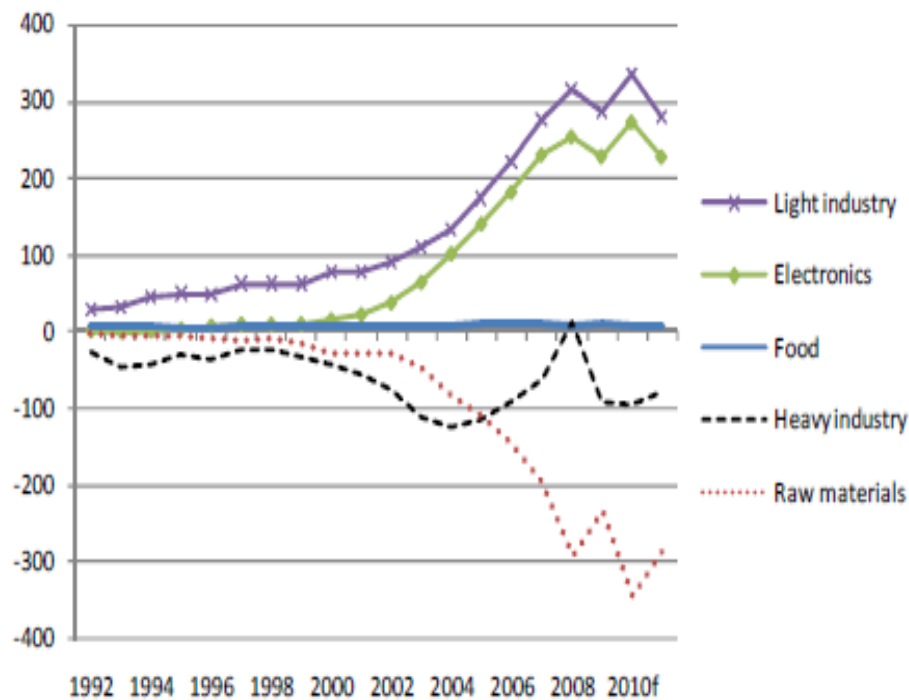


Source: MW GaveKal / GaveKal Research
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It has to be noted that food price inflation is not necessarily a bad thing

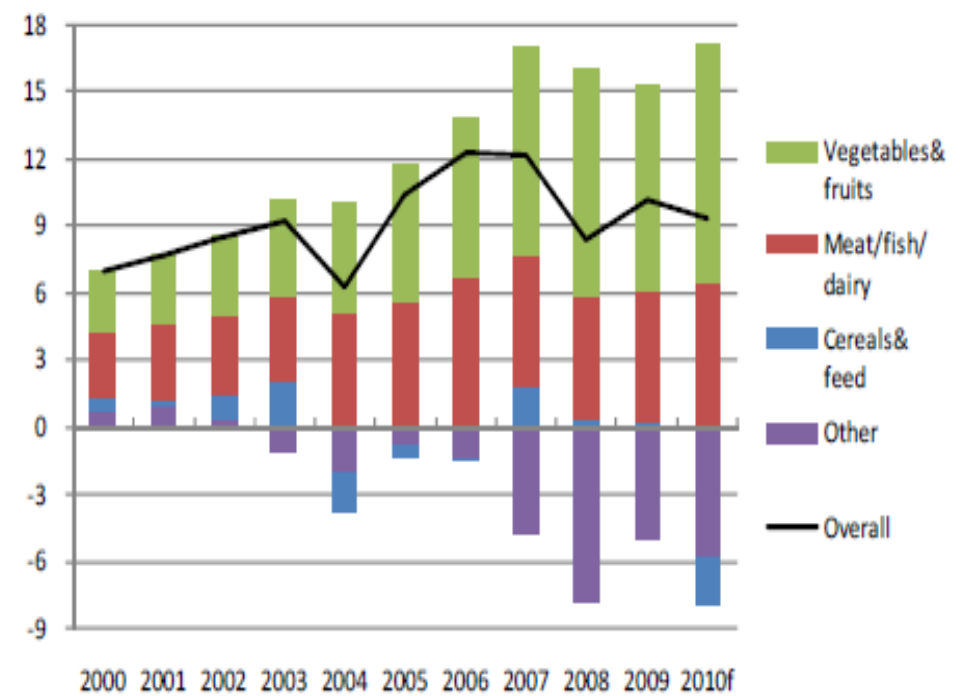
China Composition of Trade Balance

US\$ bn



China Composition of Food Trade Balance

US\$ bn



With such shifts, picking the 'right' business models matters tremendously

Figure 1: Breakdown of market share by revenue in 2008:

Company	Market share, %
Nike	15.2
Adidas	13.6
Li Ning	9.5
Anta	6.9
Kappa	4.2
Xtep	3.9
361	3.9
Erke	3.9
Peak	2.7
Puma	2.4
Converse	1.6
Mizuno	1.0
Others:	31.2

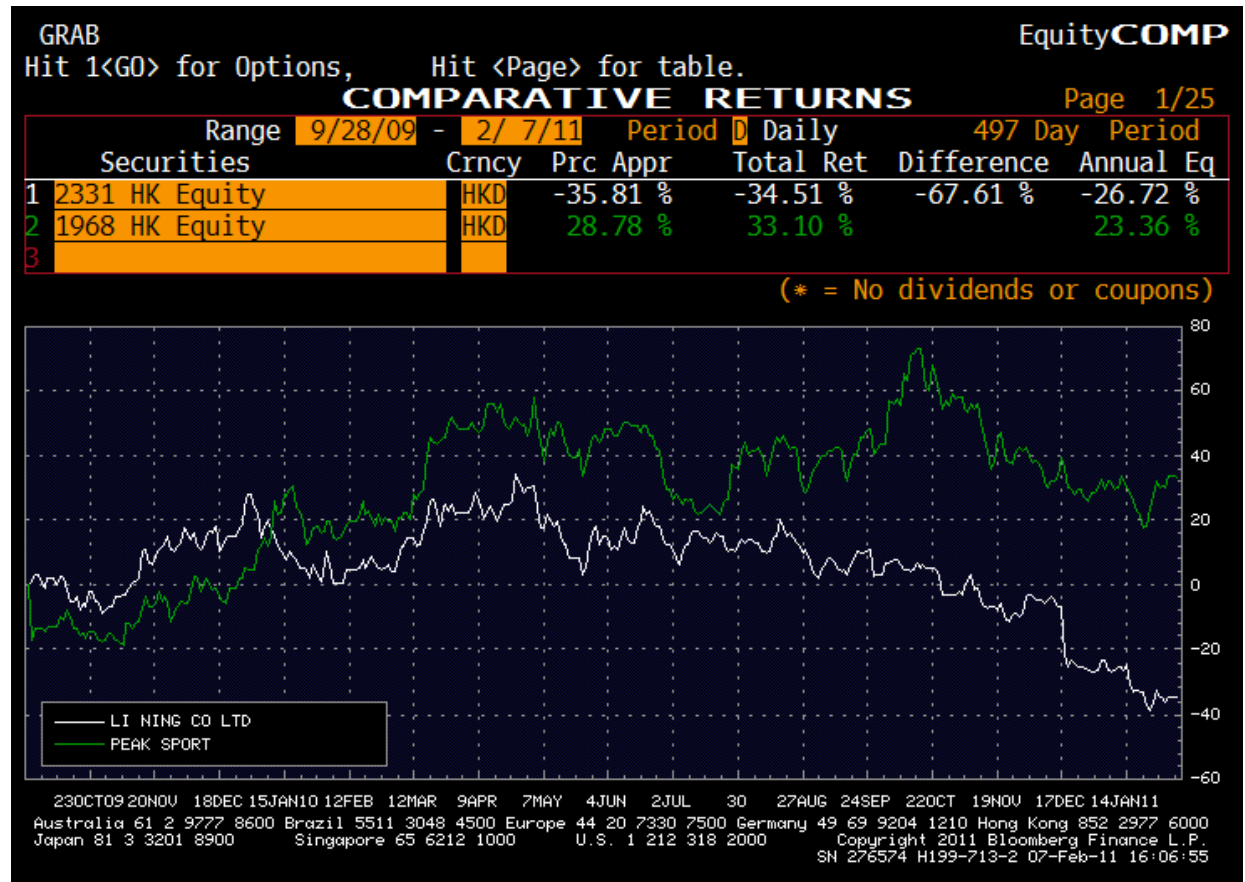
Source: Zou Marketing Ltd

Figure 4: Key financial data for sports shoe firms, 2008

	Turnover US\$ m	Gross profit US\$ m	Gross profit margin %
Li Ning	980	472	48.1
Anta	678	271	40.0
Xtep	420	156	37.1
361	505	175	34.6
Peak	299	98	32.5
Nike*	19,000	8,600	44.9

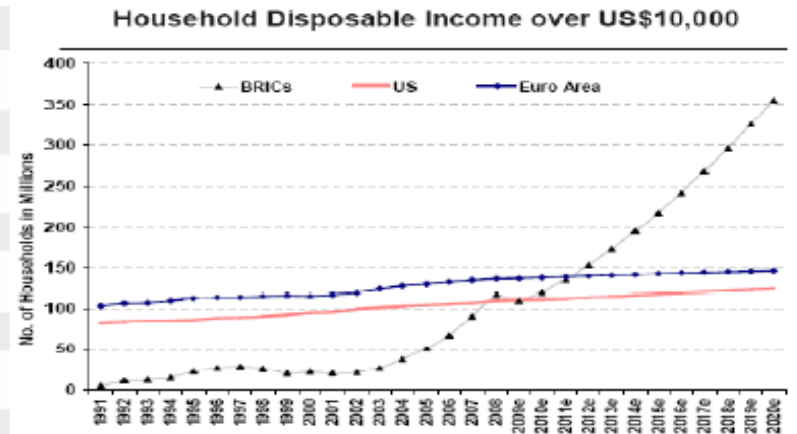
*Nike does not disaggregate its China data; its figures are global for fiscal 09, ending May 31.

Source: Companies, exchange rate as of Jan 10, 2010.

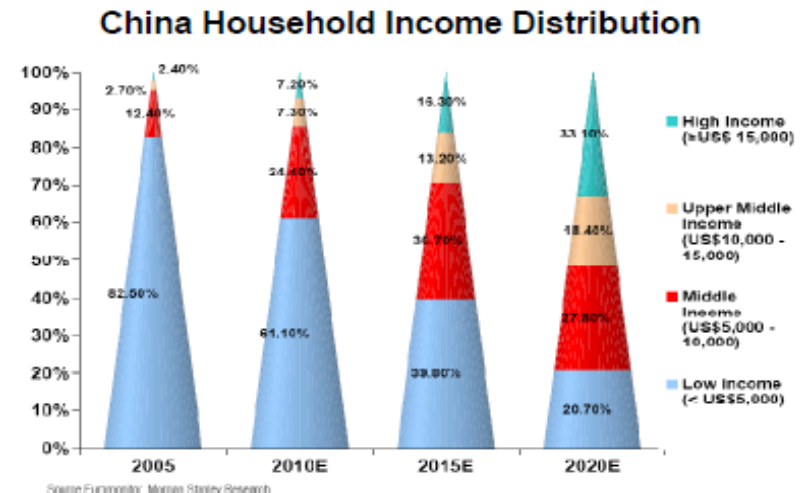


The change in consumption pattern is too enormous to conceptualize

- 700,000** Engineers graduate annually from schools in China *Source: The Beijing Axis*
- 53,000** RMB is the average cost of a license plate in Shanghai
- 40,000** Cabs drive around Shanghai daily
- 30,000** Chinese MBA students were expected to graduate in 2008. The number in 1998 was 0
- 649.7** Million mobile phones were in circulation in China in 2008
- 500** Coal-fired power plants to be built in China by the next decade
- 160** Cities in China with populations that exceed 1 million. There are 9 in the US and just 2 in the UK
- 97** New airports to be built in the next 12 years, bringing the total number to 244 by 2020
- 80** Percent of the world's zippers are produced in the factories of Qiaotou city in Zhejiang Province
- 80** Percent of the world's toys are made in China, in more than 10,000 toy factories
- 70** Percent of the world's pirated goods come from China
- 50** Percent of the world's pork is eaten in China
- 34** Children are born every minute in China
- 30** Percent of Chinese adults live with their parents
- 30** Nuclear power plants currently being built in China
- 6.3** Million passenger cars are registered in China. The number in 2004 was 2.4 million
- 5.7** Million students graduated from Chinese universities in 2007. The number in 1977 was 270,000
- 5** Million Chinese are estimated to visit ski resorts this year. Ten years ago, only 500 people in China could ski
- 1.8** Is the average number of credit cards owned by a person in Shanghai

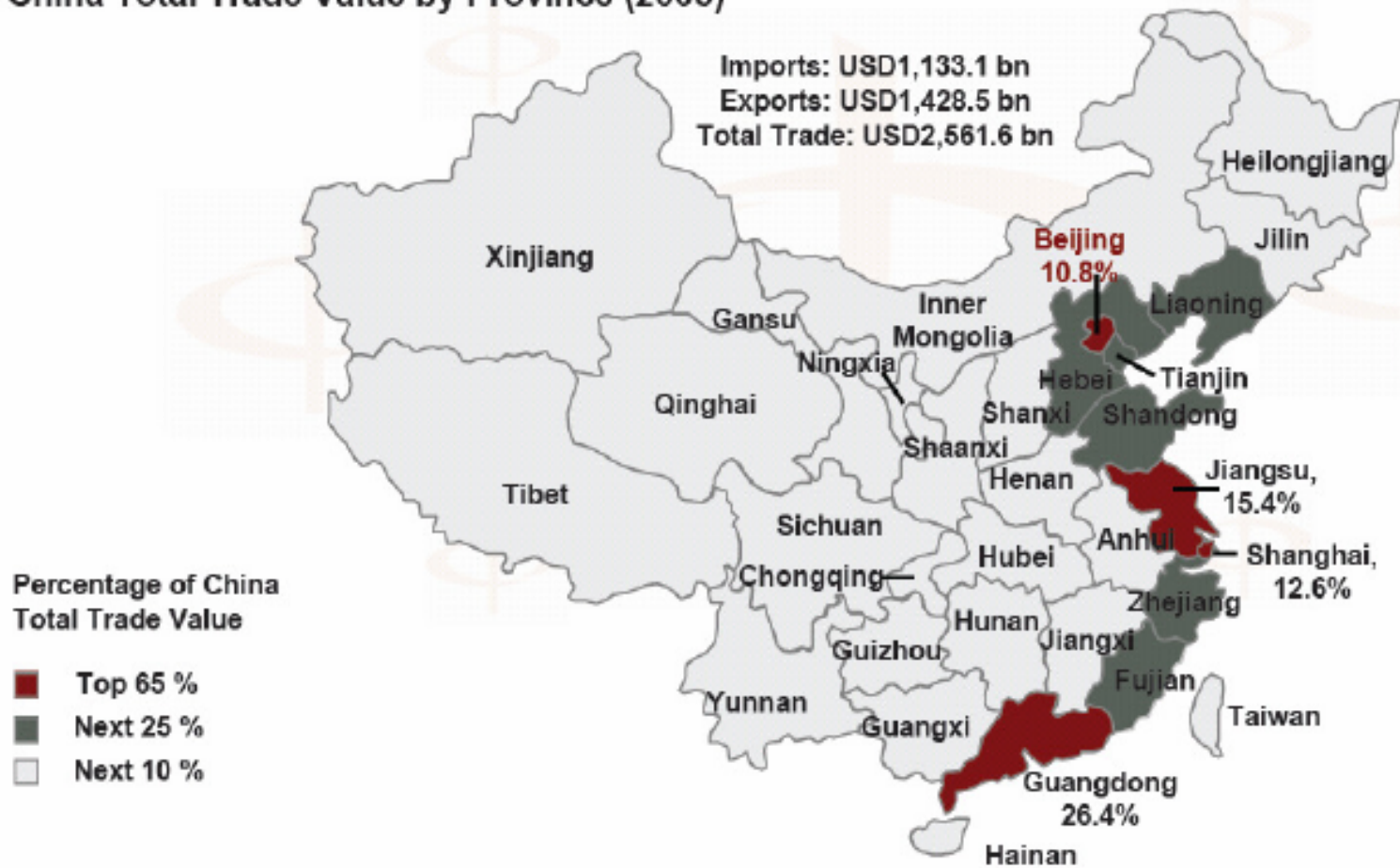


Source: Euromonitor, Morgan Stanley Research. *Forward projections are Euromonitor Estimates



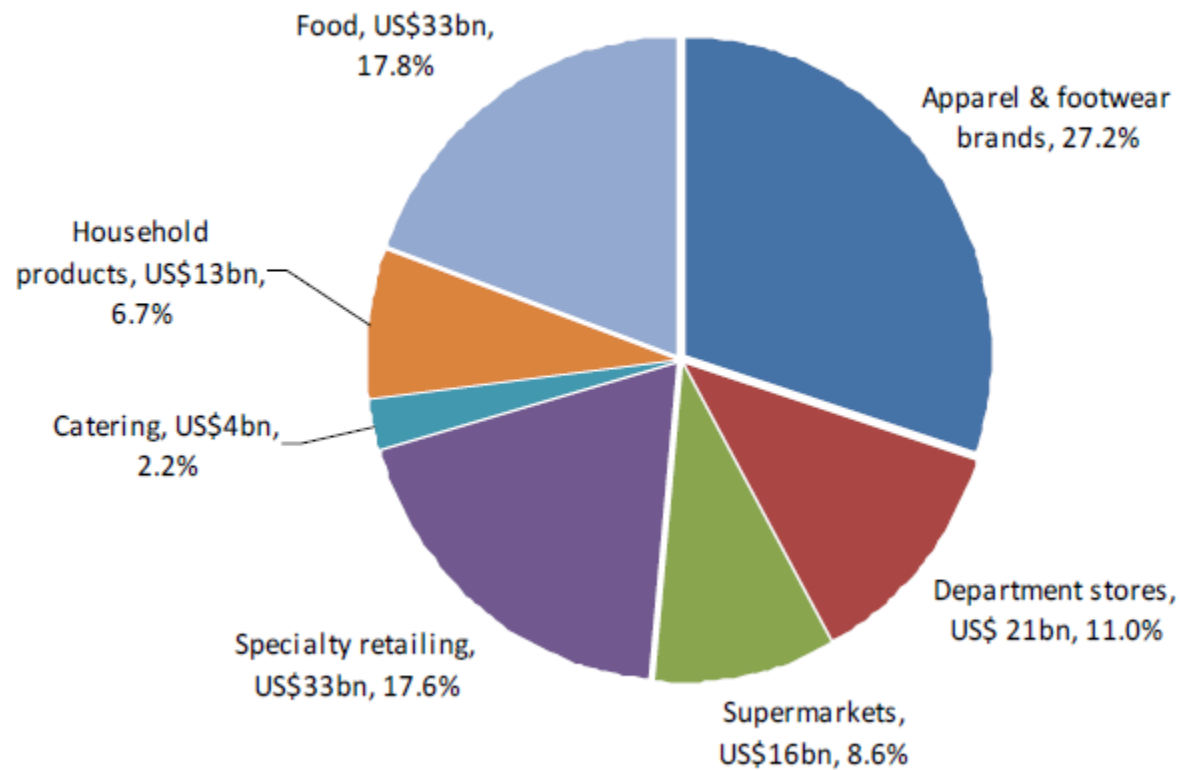
We should also not forget that Asia is undergoing an important transformation

China Total Trade Value by Province (2008)



Could Chinese consumer stocks be the next great bubble?

China Consumer Stocks Listed in Hong Kong



Key Take-Aways

- With strong domestic growth and valuations that are not overly stretched, a major bear market across Asian equity markets seems unlikely. At the same time, with liquidity conditions tightening because of a) domestic inflation and consequent central bank tightening and b) less foreign investor inflows as growth can now be found across the OECD, a roaring bull market is also unlikely.
- With very different policy responses, we are likely to see very strong dispersion between markets. So far, it seems that inflation is this year's driver of equity market returns. This should continue until inflation makes a meaningful turn. With that in mind, the Australian floods and revolutions in the Middle-East have not been helpful for some markets (China, India, Thailand, Indonesia...).
- Along with greater country dispersion, we should also expect greater stock dispersion as companies adjust to a very different policy environment and macro environment. With that in mind we would avoid:
 - Indices (all too often too overweight on financials and real estate – dangerous when yield curve flatten)
 - Business models overly reliant on 'labor-cost arbitrage'
 - Business models reliant on excess government spending (infrastructure, casinos, etc...)With strong domestic growth and valuations that are not overly stretched, a major bear market across Asian equity markets seems unlikely. At the same time, with liquidity conditions tightening because of a) domestic inflation and consequent central bank tightening and b) less foreign investor inflows as growth can now be found across the OECD, a roaring bull market is also unlikely
- On the flipside, we need to favour:
 - Business models which can leverage off the infrastructure put in place (airlines, logistics companies, auto manufacturers...)
 - Business models that cater to the low end consumer (low-end retail, food distribution...)
 - Business which benefit from an appreciation in local currencies (local utilities, telcos...)
 - Countries with little or no inflation problems (Japan, Korea, Taiwan...)



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