

Boots on the Ground: Looking Beyond China

December 31, 2019



The global economy has been plagued by ongoing US-China trade war uncertainty. The overhang of policy uncertainty has weighed on emerging markets and broad-based pessimism has overshadowed the pockets of resilience. Our investment team visited companies across emerging Asia to better understand the shifting supply chain dynamics arising out of the US-China confrontation and the fresh opportunities thereof.

An Incrementally Shifting Supply Chain

China's manufacturing base dominates the global supply chain and replacing it is out of question in the foreseeable future. However, even with the evolving eventuality of a trade deal, companies across Asia realized the latent systemic risk of China-reliance, and are looking to diversify out through incremental supply chain shifts. Southeast Asia ("ASEAN") is one of the biggest potential beneficiaries of this shift.

The growing interest in Vietnam is driven by its relatively young population of 100 million people and low employment costs. This has manifested in notable foreign investments in Vietnam relative to China (Exhibit I) in recent years. Vietnam's largest company by revenue is Samsung, a Korean electronics company, to the tune of \$65B USD in 2018.

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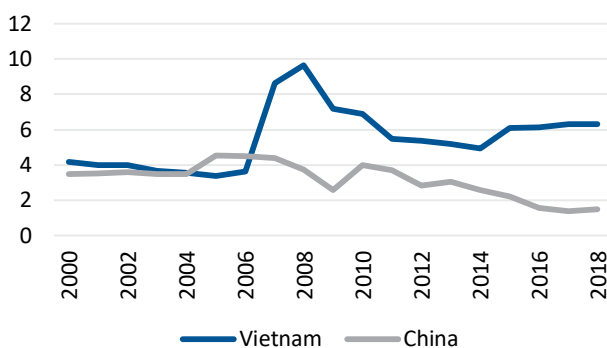
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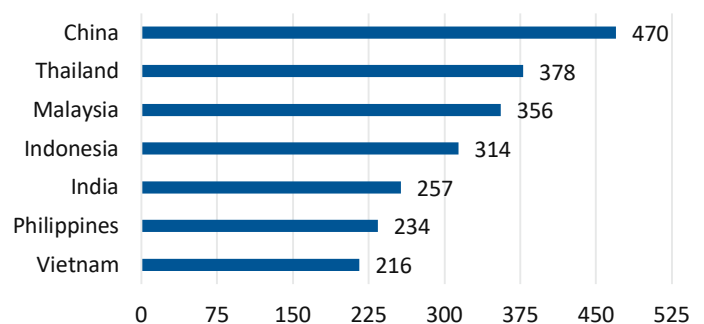
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Exhibit 1: FDI Net Inflows (% of GDP)



Source: Bloomberg, as of 12/31/18

Manufacturing Worker's Monthly Wage



Source: Japan External Trade Organization. Data is base salary as of 10/17, and converted to USD using average exchange rate for the month.

Two industrial estate companies with a long history of operating in Thailand are likewise increasingly optimistic about their operations in Vietnam. These industrial estate companies specialize in setting up 'plug & play' infrastructure for their manufacturing clients, covering logistics like land acquisition, utilities and even running services for employees like canteens. The Vietnamese government is supportive of such developers as it helps attract a more robust network of supply chain firms.

A shifting supply chain can bring new and often better-paying jobs. It can foster investment in infrastructure like roads, and potentially increase productivity over time. Those better-paying jobs fuel domestic demand as consumption patterns change with increasing income per capita.

Domestic Demand

Take, for example, the beverage market in Thailand. In Thailand where energy drinks are popular amongst blue-collar workers, Osotspa, a Thai fast-moving consumer goods (“FMCG”) company has been innovating across multiple product lines to expand its addressable market. This company has been dominant in this market for over 50 years with at least a 50% market share, and over the past five years, has undergone significant strategic and operational transformations. Redbull is a competitor in the energy drink space with a comparatively low market share. Marketing their products as “health drinks” instead of the more traditional nutraceutical has broadened product availability from solely pharmacies to local hyper marts. Given their significantly larger distribution when compared to any existing nutraceutical company, their health drinks are far more widely available. For comparison, a leading nutraceutical company in Thailand has overall sales that are dwarfed by sales of a single health drink of this FMCG company. The new management has experience in running FMCG businesses across the region, and they are now aggressively expanding its presence in Vietnam, Cambodia and Myanmar.

Paint is another segment with increasing demand growth across emerging markets over time. Traditionally, retailers held a staggering array of paint colors at any given time. With the advent of tinting machines and increasing availability to rent or own these appliances, distributors can now hold up to 80% fewer paint colors than has been standard over the past 10 years. This has freed



Source: Fiera Capital Inc, December 2019

working capital in the supply chain and enhanced the distribution network for paints. By taking advantage of these structural developments, TOA Paint, a Thai paint distributor, has increased its market share from approximately 20% to 50% in the same period. Competing against multinational corporations, they have gained market share by taking advantage of the growing distribution for paints, expanding their product category (into more premium paints) and better targeting their marketing budgets. Now, the company is expanding across ASEAN, with factories coming online shortly in Indonesia, Cambodia, and Vietnam.

As Emerging Asia’s (ex-China) economic landscape participates and benefits from this evolving value chain, regional companies that are nimble and guided by capable management teams are incrementally shifting their production capacities as well as product distribution to these new frontiers. Our investment team has a deep understanding of these Emerging Asian markets, their underlying cultural aspects, political and social challenges, and the opportunities. Having a team on the ground to continually access the changing economic dynamics is a key ingredient to success in emerging markets, in our view.

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