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PODCAST TRANSCRIPT

TALKING RESEARCH – ON THE ROAD IN ASIA

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Katie Boyce:
Hello and welcome to Talking Research. I'm Katie Boyce, an investment writer at Walter Scott. This podcast gives you an opportunity to hear directly from members of the Research team on what they've been up to, where they've been, and the topics at the forefront of their debates.

Today, that topic is Asia, as members of the team have been out on the road to Hong Kong, mainland China, Indonesia, Malaysia and Singapore. I'm delighted to be joined by three of those travellers. In the studio, we've got investment manager and member of the investment executive, Fraser Fox, who has been at the firm for 20 years and has travelled to Asia extensively.

Also here is investment analyst Michael Scott, who joined the firm in 2016, having first been a member of the Dealing team before he moved across to our Research team. And last, but by no means least, joining us virtually from out on the road, this time in North Carolina, is Head of Research and investment manager Alan Lander. Fraser, Michael, Alan, welcome.

So as already mentioned, you've all recently returned from various parts of Asia. It's always an interesting part of the world to visit, but it seems never more so than today. Alan, you could maybe start off by talking about Hong Kong and China?

Alan Lander:
Sure, I spent the first week in Hong Kong and the second week in China. And thinking about that Hong Kong trip first, the last time the firm was in Hong Kong was in May 2019. And that's an interesting date, because that's really the last time that Hong Kong was normal – if I can say that 'normal' in inverted commas – because in June 2019, the pro-democracy protests really kicked off. And in the second half of 2019 that really brought the city to a standstill. And then obviously moving into 2020, Covid hit and Hong Kong was the subject of strict Chinese Covid protocols for much of the next two years. So fast forwarding to today, it's really the first time in the best part of four years that Hong Kong has been much more akin to normal. So we wanted to get out on the ground there and start to build our own picture of how the city is evolving in that context.

And then for a second week, I popped over the border. It only takes 20 minutes these days to get from Hong Kong to Shenzhen on the high-speed train. I went across to China and was joined by Michael and, for the second week, we did a number of company visits across the Pearl River Delta. We started in Shenzhen, moved up to Dongguan, and then finally to Guangzhou. So in total close to 40 meetings with different companies.

Katie:
And Fraser, turning to you, what took you to South-East Asia?

Fraser Fox:
I've visited South-East Asia a lot over the years, and between work trips and personal travel, I've spent time in nine of the ten ASEAN countries. I always find there's a buzz about the region that's really quite infectious. You've got bright, hardworking, entrepreneurial people and companies embracing technology and innovation. I'm pleased to say I'm young enough – just – not to have been working in the industry during the Asian crisis in the late 90s. But that crisis was a huge wake-up call for the institutions in many of these countries, and their economic fundamentals have been put into a much more robust shape as a result.

Meanwhile, at a time when most developed countries – and actually many large emerging markets – face serious demographic challenges, a lot of South-East Asian countries are still enjoying tailwinds from having young and growing populations. Add in expanding middle classes and the increasing formalisation of economies, and you have a really healthy backdrop for growth companies operating in the region.

Now, Katie, I'd probably have told you all of that if we were having this conversation five years ago after my last research trip out there. But what makes this such an interesting time to be revisiting South-East Asia is the reorganisation of global supply chains that's currently taking place and the opportunities that that's opening up. And that was a topic that just came up time and again.

I kicked off this trip with four days of meetings in Indonesia with Michael. I was then let loose on my own for three days in Malaysia and then finished up with three days in Singapore. And I think it's fair to say my enthusiasm for the region is undiminished.

Katie:
Talking about Asia, I guess the obvious place to start is China. It's arguably at the top of the list of concerns for investors around the world of late. Alan, Michael, what are your takes having actually been there on the ground?

Alan:
My take is that it's certainly not all doom and gloom. I think it's fair to say that China's definitely had a muted recovery from Covid. Their issues in the property market are very well documented, and that's then got knock-on effects elsewhere in the industrial economy. Consumers haven't spent as much post-Covid. There hasn't been that revenge spending trend that we've seen in the West.

But, that said, China is definitely still growing. The Chinese government has a target this year for GDP growth of 5%, and it looks like it's going to get there or thereabouts. And I think that's largely because, for all the troubles in some sectors of the economy, in other areas China's firing on all cylinders. In the renewable space you've got electric vehicles, which are absolutely booming, and the battery infrastructure associated with that huge investment. There's still huge investment in the semiconductor industry too. So, there are certain parts of the Chinese economy which are doing really well.

Katie:
That sounds pretty positive but the message we often hear from foreign companies sounds quite different?

Alan:
I think it's fair to say that, as a foreign company in China today, it's a tough place to do business. And that's really a change from a decade ago when, as a Western company in China, it was

very hard not to make money. Success was easy to come by: foreign brands were in demand from consumers; foreign products were much higher quality than what was available locally; technology from foreign businesses was more advanced.

But fast forward to today and the environment's really quite different for a foreign business. China is a tough place to do business, and domestic competition is much higher quality. Local brands have risen in prominence to challenge some of those Western brands.

With respect to technology, China now leads the world in some technologies. And you've also got risks around regulation. Clearly it's a tough place to do business, but that's not to say there's not still huge opportunity for foreign businesses in China. You just have to be aligned with that direction of national policy. You have to have a differentiated offering, a differentiated product or service to bring to the market.

Katie:
Where are you seeing that differentiation?

Alan:
A great example of this, we think, is in the luxury goods businesses and the position they continue to have in China. Today, as the population grows richer, the heritage associated with a brand like Louis Vuitton, the prestige associated with having a Hermès handbag and buying a Ferrari, that just can't be replicated locally.

Katie:
And, Michael, what about you?

Michael Scott:
I think healthcare was one sector that really stood out for me, and Covid was certainly a step change in China. Since the pandemic, we've seen a real increase in investment in the country. We've seen campaigns like volume-based procurement and the anti-corruption crackdown.

Katie:
Did you have any healthcare meetings of particular note?

Michael:
A visit that Alan and I had was to the elderly care home of Ping An, a Chinese financial services and insurance company. The elderly care home was on the 77th floor of their office, and it was really quite amazing to see what felt like a five-star hotel all laid out for the beneficiaries of Ping An's life insurance policies.

Alan talked about the increasing technology advancements that are being made in China, and I think the easiest way to understand that when you visit the nation is how you have to interact with super apps like WeChat and Alipay. Whether that's paying for your bill at a restaurant or ordering a DiDi to get around the cities, it really makes you realise how advanced China is in some areas of technology.

EVs are an area that I found particularly interesting, and we visited the company BYD. The electric vehicle manufacturer is soon to overtake Tesla in terms of electric vehicle unit sales. The company was forced to vertically integrate from the very beginning, because there wasn't a supply chain set up when they looked to move into electric vehicles. That has led the business today to have innovation advantages and also cost advantages, which the company is hoping to leverage as they grow within China, but also as they penetrate international markets.

Katie:
We read and hear so much about "China Plus One". Already this year, there have been a number of Walter Scott research trips exploring the theme, whether that be the semiconductor industry trips to the US, China and Taiwan, or Alan's own trip to India earlier this year. All of which we've covered on previous podcast episodes if anyone would like to hear more. But China Plus One really has been the defining topic that binds these two trips. It would be great to get your sense of that theme when you were there. Is it all hype or did you actually witness it in reality?

Fraser:
Why don't I chip in first here, Katie. From my perspective, China Plus One is having a very real and significantly positive impact on South-East Asia. All of this predates Covid, and it predates the current geopolitical tensions that we're witnessing between China and the US. You can really trace the start of this back to the trade war that began during Donald Trump's presidency. I think there's also an ESG angle here. Some South-East Asian countries have been more willing than China to open up their supply chains to scrutiny by Western customers, and they're really now reaping the rewards from that.

But, partly, it's just basic economics. Labour costs are now much cheaper across most of South-East Asia than in China. Probably fair to say, most of the conversations were about these countries complementing existing Chinese capacity rather than wholesale replacing it. But the region is clearly taking share of incremental new investment. Policymakers are being smart about seizing the opportunities, positioning their countries as open for business with lots of tax holidays and special economic zones and so on, and companies are jumping all over that.

Now, the first major beneficiary was, of course, Vietnam; a country that we visited and that we've discussed with you several times in the past. Alan here is actually very much our resident Vietnam expert. But I think we heard several suggestions on this trip that the Vietnam story might be starting to run out of steam a little. The supply of labour is beginning to dry up and wages have risen, and supporting infrastructure may be struggling to keep up. So we're beginning to see that China Plus One theme broadening out.

Katie:
So which countries in particular are benefiting now?

Fraser:
That's good news for the likes of Indonesia, for Thailand, for the Philippines. And I heard it a lot in meetings in Malaysia, whether that was with the electronics manufacturer, the port operator, a manufacturing and logistics property landlord, or indeed a bank that's financing some of these investments. I think this really is significant. Of course, each individual country has its own strengths and weaknesses, and there's clearly an acknowledgement that China still has an edge in some important areas.

Katie:
Does that equate with what you heard in China, Michael?

Michael:
Absolutely. The messages that we were hearing were very similar to what Fraser has reflected there. In most of the meetings, a key discussion point was the diversification of manufacturing. And often South-East Asia was the obvious choice for companies, partly due to geographical proximity, but also the large and skilled workforce in the region.

I think the capacity constraints that still exist in some of these countries, or even the region itself, are important to talk about. China has a complex, multi-layered supply chain that will be extremely hard to replicate. It's also important to talk about the willingness of China to allow China Plus One to happen. The country is very keen to bring sensitive industries like healthcare and semiconductor onshore. And part of that is allowing less valuable industries to move to South-East Asia, for example. I think what was interesting, is the view that much of the diversification across South-East Asia will largely go to countries that have heritage or competitive advantages in certain sectors.

Katie:
Can you give me some specific examples?

Michael:
Thailand has a traditional auto supply chain and Vietnam has great pedigree in consumer electronics manufacturing. And Indonesia has a wealth of natural resources in electric vehicle batteries. So that will largely be how we see China Plus One play out, in my view.

Fraser:
But, of course, no country can do everything itself. And I think another factor working in South-East Asia's favour is regional integration. Living in post-Brexit Britain and closely following the ongoing spat between the US and China, it's interesting travelling in a part of the world where trade barriers are coming down. Despite some major differences in language and culture, and a huge wealth gap between mega-rich Singapore at one extreme and low-income countries like Cambodia at the other, it feels like there's a real desire to increase regional cooperation.

Katie:
In what way?

Fraser:
Some of this is formal. The ASEAN community, for example, was meeting in Jakarta a couple of weeks before we visited. But we also heard lots of small anecdotes about neighbouring countries working together. Whether it's an Indonesian telecoms company building a data centre to serve Singapore from an Indonesian island a few miles away, or the large numbers of Malaysians crossing the border every day to work in Singapore's hotels and restaurants. Just lots of examples of these sort of win-win arrangements.

Katie:
Michael, you and Fraser spent a week in Indonesia. As a first-time visitor to the country, it would be great to get your impressions.

Michael:
This was a great introduction to Indonesia. The economy is successfully growing in the mid-single-digit range, and the country has been very successful at taming inflation where other countries have succumbed in recent years. What I think is really interesting to talk about in Indonesia is the demographic tailwind that the country is going to benefit from. So around half of the population today are millennials, and that population is expected to reach around 300 million people by 2030.

Much of the success in the country has been accredited to President Jokowi. One of the key policies he enacted that receives a lot of media coverage is the onshoring of certain value chains in precious metals. The most important is the prohibition on the export of nickel ore, which is forcing the value chain to move domestically but also stimulating foreign direct investment.

Katie:
And Fraser, you know the country very well, having visited many times over the years. How has it changed?

Fraser:
I first visited Indonesia back in 2008, and I've been back several times since. In terms of obvious changes over that time, I'd really have to call out Jakarta traffic, which had become the stuff of Walter Scott research trip infamy. It almost got to the point where we'd be taking bets on how many meetings we'd actually manage to make on time. Fast forward to today, and things are still by no means perfect, but I was struck this time by the progress that's been made.

To Michael's earlier point, President Jokowi again is the one getting the credit for this. Infrastructure development has been a central pillar of his time in office. There are new toll roads (we met the company that built many of those), new railway lines, and everyone's talking about a new

Chinese-made bullet train that's just come on line. One of the things I love about travelling in emerging markets is that when it's done well, the benefits of infrastructure investment are just so plain to see, both in terms of boosting economic activity but also improving people's lives.

Katie:
And, of course, you didn't just visit emerging market countries on these trips. There's Hong Kong and Singapore. So let's turn to those more developed economies in the region. Hong Kong has had a terrible press in recent times, but how did you find it when you were there? Was it all doom and gloom?

Alan:
A lot has been written about the demise of Hong Kong. But when I was out there on the ground, that certainly wasn't the feeling that I got. There's actually a real sense of optimism in Hong Kong right now, and perhaps that's not unsurprising when you consider – as I was talking about earlier – that this is business as usual in Hong Kong for the first time in four years.

Katie:
You say "business as usual" but is it the same Hong Kong that it was?

Alan:
There's no doubt that Hong Kong is becoming a more Chinese city. And the national security law introduced in 2020 is the most obvious example of that. For some people who've lived in Hong Kong historically, that is an issue. And many individuals have left the country in recent years. From a corporate perspective, I think that some Western companies have left Hong Kong too. However, for those individuals and companies who remain, that greater integration with China is actually seen as a positive.

Katie:
What are your thoughts on that?

Alan:
Whilst Hong Kong is becoming a more Chinese city, it's not just becoming any other Chinese city. It still remains that financial gateway into and out of China; where China meets the world from a financial perspective and from a business perspective.

Historically, that financial gateway was very much about Western money flowing into China, foreign banks and corporates setting up in Hong Kong to gain access to that Chinese market. But that role is being turned on its head now. Hong Kong is increasingly China's gateway to the world. Chinese corporates are now to be found there as they look to expand their presence in Asia, in Africa, across South-East Asia. When we were on the mainland, we met many such companies in China who had international ambitions to expand and compete across the global South.

So, from an economic perspective, Hong Kong is certainly not firing on all cylinders right now. But, in my view, that's not structural in nature. It has little to do with the national security law and everything to do with the muted Covid recovery in China. There's still a significant link between Hong Kong and China. And all the while that China's not booming, Hong Kong is not going to be booming either.

Katie:
And we often hear about Singapore, in particular, being a major beneficiary of some of Hong Kong's perceived issues. What's your perspective, Fraser, having been there?

Fraser:
I've always felt Singapore is one of the world's best managed economies. It's also a very attractive place to do business. There's a well-educated population, great connectivity, low taxes, which everyone loves. And it's an economy that grows by continually reinventing itself, with the focus today in areas like biotech, fintech and artificial intelligence. And, for all of those reasons and more, Singapore, I think, has been a beneficiary of some of Hong Kong's and China's recent issues.

Katie:
Are there any particular industries where that's the case?

Fraser:
We've seen life sciences and other knowledge-based and professional services companies moving some regional operations into the city. Singapore's port has been picking up transshipment volumes that once went through Hong Kong. And, of course, we've all read about the Asian wealth flowing in and family offices opening up in Singapore.

However, I don't want to overplay this. When it comes to trade and investment flows between China and the rest of the world, I totally agree with Alan. Hong Kong isn't going anywhere, and the influx of expats that Singapore has seen isn't without its challenges. All the foreigners I met with are complaining about residential rents and international school fees going through the roof. And apparently there's a similar dynamic in Dubai now as well, where Russian money has been pushing rents up. So, interestingly, we are now starting to see some people going full circle and heading back to Hong Kong.

Katie:
And, in terms of the companies that you met with, was there a highlight in Singapore?

Fraser:
As you know, Katie, I've become a bit of a property geek in recent years, so I really enjoyed the meeting with CapitaLand Ascendas REIT, a real estate investment trust. Its portfolio is skewed towards the likes of science parks, data centres, and distribution centres – really tapping into some of Singapore's strengths in these sorts of new economy areas. The team there were incredibly generous with their

time and after our meeting took me on a tour of some of the key assets.

Katie:
Tell us more about that?

Fraser:
I got a great opportunity to snoop around some brand-new high spec green buildings, which gave an interesting glimpse into the future of hybrid working. We also visited some of the oldest business parks, which are in prime locations but, fair to say, I think, are beginning to look their age and are probably ripe for redevelopment. And, as these buildings are gradually replaced with bigger and better buildings, that should support growth in floor space and, ultimately, cash flows over a period of probably decades to come.

Katie:
And Alan, I should have asked you the same question about Hong Kong. Was there a meeting highlight for you?

Alan:
For me, it was the combination of Hong Kong and Shenzhen, which represented a great opportunity to really check in with the health of the Asian life insurance industry post-Covid. I met with AIA and Prudential in Hong Kong, and then – as Michael referenced earlier – we also met with Ping An Insurance in China, too. I think AIA and Prudential, both Hong Kong listed businesses, are really great examples of companies that we expect to continue to thrive in that region despite its evolution.

Covid has certainly been a tough period for the likes of AIA and Prudential. Life insurance is something that tends to be sold face to face, so lockdowns and social distancing have made sales more difficult and it's been a big headwind from a new business perspective. But momentum has definitely now shifted back towards growth as Covid restrictions have been lifted. For AIA and Prudential in particular, the flow of mainland visitors from China back into Hong Kong represents a big boost for businesses as those visitors buy insurance contracts in Hong Kong again.

And then we got a great insight as well into Ping An's strategy to offer services to its clients beyond just insurance. That tour of the retirement living home in Shenzhen that Michael referenced earlier: I think after an hour of being introduced to that facility, I would have been quite happy retiring with Michael on the bay in Shenzhen. But, in all seriousness, it was a great way to understand the strategy for Ping An and see how it's looking to differentiate itself from peers.

And it is first-hand insights like that show room visit that we had with Ping An, that help us to get a deeper insight into businesses beyond simply meeting with management. That's one of the key reasons why we undertake these research trips.

Katie:
We obviously really appreciate you coming back here to share your valuable insights with us. Presumably, you had some downtime at the weekends while you were away?

Michael:
It's a great privilege to visit these countries on research trips; Indonesia is a great example of that. On one of the weekends, while we were in Jakarta, Fraser and I travelled to the Indonesian Highlands and visited an active volcano.

Fraser:
Spending my middle weekend in a rustic little wooden hut by a river deep in the Malaysian jungle was a pretty cool experience and really a welcome change during a fortnight of airport queues, traffic jams and pollution.

Alan:
Whenever I'm travelling, I like to try and get out and do a little bit of running to see the places where I'm travelling and also to combat the jetlag. And, in Hong Kong, there's a great running trail on the side of the Peak called the Bowen Road Fitness Trail. From there you get a great view over the city and over the bay. So I spent a couple of early mornings just jogging along the trail there, which was really nice.

Katie:
Sounds good! On that uplifting note, Alan, Fraser and Michael, thank you very much for your time today. There's clearly a lot to get excited about in Asia at the moment, perhaps more than ever. But, at the same time, something like China Plus One sounds much more complicated than those three simple words would suggest. So definitely time well spent out on the road trying to make sense of that.

To our listeners, thank you very much as ever for your time. We've covered a lot so, if you would like any more information on anything that has been discussed, please don't hesitate to get in touch.

As we approach the end of 2023, the final podcast episode of the year will be with Walter Scott's Managing Director, Jane Henderson, and her fellow directors Charlie Macquaker and Roy Leckie, reflecting on the year gone by and, more importantly, looking ahead to 2024. Until then, thank you very much for listening. Goodbye.

IMPORTANT INFORMATION

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