FSSA Investment Managers

Fund Manager Q&A

FSSA ASEAN All Cap strategy

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Rizi joined FSSA Investment Managers in 2016 as a senior investment analyst with a focus on the Southeast Asian markets. Rizi is now portfolio manager of the FSSA ASEAN All Cap strategy (formerly the FSSA Singapore & Malaysia Growth strategy).

The FSSA Singapore & Malaysia Growth strategy was renamed the FSSA ASEAN* All Cap strategy in December 2021 to reflect a change in the portfolio's mandate. The strategy is now able to invest in the broader Southeast Asia universe, including companies listed in Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam.

Why the change to a broader ASEAN mandate and when did the portfolio transition take place?

Interestingly, the strategy has a long history and has evolved several times over the years. It was launched in 1969 as the Singapore Growth Fund under Chartered Unit Trust Management, a subsidiary of the Chartered Bank. In 2002, after several acquisitions and name changes, the strategy became part of First State Investments (now First Sentier Investors) and managed by the FSSA team.

When the strategy first launched, Singapore and Malaysia were part of a single stock market. Singapore developed rapidly and Malaysia became one of the largest of the emerging markets in the early 1990s so having a portfolio focused on both countries served a purpose – these economies were large and relevant.

However, since then the Singapore market has shrunk and Malaysia has slowly de-industrialised. The recent mandate change to include the ASEAN countries provides access to a much broader opportunity set, supported by stronger demographics and faster growth – the ASEAN population is 15 times that of Singapore and Malaysia, while GDP is four times bigger. The universe of quality companies is much bigger too.

We follow the same bottom-up approach for all our strategies, and conduct detailed analysis and fundamental company research on all potential new holdings. As part of the transition we added a number of new companies and divested others that were relatively less attractive. The portfolio fully transitioned to an ASEAN portfolio in December 2021 and turnover should be much lower from here.

What do you find attractive about the ASEAN markets?

Although we are bottom-up investors, a few broad themes support our stock selection. First is the demographics of the region. The working population is still growing and, similar to India where there have been powerful

* ASEAN is officially known as the Association of Southeast Asian Nations

demographics at work for years, the hope is that this will attract more companies into the region. This would create new jobs, lift income levels and lead to increased consumption power. A growing population and rising incomes should translate into a large market for everyday goods and services like food and beverages, supermarkets and banking.

Second is the rise in digitisation, which we believe is going to be one of the region's biggest tailwinds for the next 5-10 years. While this should be relevant for the broader ASEAN region, Indonesia, Vietnam and the Philippines, being the largest and the youngest in terms of population, are the most attractive places for digitisation to take hold. As bottom-up investors, we still need to find quality companies that are investible, but we believe that the market statistics are supportive. While the number of "new economy" companies in Korea, the US and China has grown significantly over the last 10 years and account for a large part of those markets, in ASEAN that figure is perhaps less than 10%.

In the last two years, we have seen an acceleration in new listings, as companies mature to be part of the public markets. Grab, the regional ride-hailing and food delivery platform, and Bukalapak.com, Indonesia's largest B2B e-commerce marketplace are recent examples.

Sea Ltd, Southeast Asia's largest gaming and e-commerce platform, was one of the earliest ones to list in late 2017. While it is headquartered in Singapore and listed in the US, it is really an ASEAN business with Indonesia being its largest market. We have done our research and followed the company's evolution but have not invested in Sea Ltd so far. We could not make sense of the high valuation investors were willing to pay while ignoring the risks around the company's single-game exposure and its ability to manage its e-commerce entry into many new countries at the same time. As these risks come to the fore, valuations may come down to levels that offer a more attractive risk-reward (although, who knows if that will be the case). We are happy to wait as part of our process.

Another beneficiary of digitisation and where we are shareholders is iFast Corp, a leading online wealth management platform headquartered in Singapore. It offers a large selection of investment products at a lower fee than banks and with the convenience of being online. It was founded by Lim Chung Chun in 2000 — he still leads the company and remains its largest shareholder. Assets under administration have grown to USD 14bn and should continue to grow as more customers, which includes individuals as well as financial advisors, move online over time. We like the management team, franchise and long-term growth opportunity but have reduced our holdings due to high valuations.

Third, despite the number of quality companies with leading franchises, ASEAN is largely an ignored market with limited broker coverage on the region. Foreign ownership of public equity has been declining and is the lowest it has been in a decade as investors have tended to favour North Asian markets. This is exciting to us from an investment point of view, as there are many high-quality companies with reasonably good growth potential hiding in small market capitalisations in these markets.

Can you provide examples of such opportunities?

Compared to China, where there are numerous entrepreneurs and multiple capital providers replicating one good idea, ASEAN is at the other end of the spectrum. There is not enough capital and the market is locked between a few players, so competition is more benign.

We own Heineken Malaysia and Carlsberg Brewery Malaysia in the portfolio. This is a cozy duopoly market, with the two breweries taking about 80% share. Both are owned by good-quality global breweries, compete rationally and generate very high returns on capital. Similarly, Multi Bintang, the Heineken subsidiary in Indonesia, has 60% share of the beer market in Indonesia with revenue of only circa USD 175m in 2021. These kinds of market structures are harder to find elsewhere.

Credit Bureau Asia in Singapore and CTOS Digital in Malaysia are two more examples. In many markets, credit bureaus (which carry out credit checks on companies and individuals) are either government-owned or they are global players like Equifax and Experian. Domestic credit bureaus are relatively unique. Both Credit Bureau Asia and CTOS Digital are monopolistic businesses (as companies prefer to conduct their credit checks with the largest and most established credit bureau) and generate very high returns on capital.

We also own Unicharm Indonesia, which is 60%-owned by Unicharm Japan — a company that we have known and owned in our regional Asia Pacific strategies for many years. Unicharm Indonesia is the market leader in three categories — baby diapers, feminine hygiene and adult incontinence — with over 40% share. It generates just USD 600m revenue in a country with a population size of around 270 million, while revenue per capita of USD 2.2 is much lower than the USD 21 in Japan and USD 8-10 in neighbouring Thailand. Based on these comparisons, we believe there is plenty of room for Unicharm Indonesia to grow.

Unicharm's evolution in most markets starts primarily with the baby diapers business. The product mix starts

to improve with growth of the more profitable feminine hygiene business and then finally, in an ageing society the adult incontinence business leads — and this part is the most profitable. We believe Unicharm Indonesia will follow a similar trajectory over the next 5-10 years, leading to revenue growth as well as better profitability and return on capital from here. Valuations are also attractive at only 12 times earnings because investors are less focused on Indonesia as an investment destination. We see this as a great opportunity — and believe that the business could be multiple times its size today.

What are some of the portfolio's largest holdings and why do you own them?

Three of the largest holdings in the ASEAN strategy are DBS Group, Jardine Cycle & Carriage (JCNC) and Bank Central Asia (BCA). We owned DBS and JCNC previously, while BCA has become a much bigger position since the change in mandate.

DBS is one of best banks in ASEAN, in our view, and a recent meeting with the company reaffirmed our positive stance. Piyush Gupta, CEO since 2009, has done a fantastic job in turning the bank around. Under Piyush's leadership, DBS has improved significantly in terms of wealth management, loan market share and its digital offering. Earnings per share has grown at 10% per annum in the last five years with an average return on equity of 11% — despite the challenging environment of very low to zero interest rates for banks. Return on equity rose to 12% in 2021 and should increase further as interest rates rise.

JCNC is 75%-owned by the Jardine Matheson Group and operates as a holding company for the group's investments in Southeast Asia. Astra International, Indonesia's dominant auto franchise in partnership with Toyota and Honda, accounts for more than 80% of JCNC's earnings and value. The strength of Astra's franchise is borne out by its market share — it has gained share in both cars and motorcycles during the last decade when demand was weak and competition increased. We are optimistic about Astra's earnings growth as auto volumes recover from Covid-19 lows. Car penetration in Indonesia is still low (around 85 per 1,000 people) and has room to grow. We also like JCNC's investments in good quality companies in Vietnam. One such example is THACO, a leading Vietnamese auto franchise. Vietnam, with only 25 cars per 1,000 people remains even more underpenetrated than Indonesia and THACO should benefit from increasing wealth in the country. All of this and other businesses are available for slightly less than JCNC's book value. We find the risk-reward attractive.

BCA is another high-quality bank, this time in Indonesia. It has the lowest-cost deposit franchise in Indonesia and continues to invest in technology and customer services to stay ahead of existing and upcoming competition. The culture is conservative when it comes to lending and the bank is committed to growing earnings sustainably and predictably. BCA remains very profitable and we believe it has the ability to compound book value at high rates without taking too much risk. Low credit penetration and household debt in Indonesia should provide a good backdrop for the bank to continue to grow for a number of years.

What do you think about the quality of companies in ASEAN? How have they evolved?

There are around 4,000 listed companies across the six key ASEAN countries (Singapore, Malaysia, Indonesia, Vietnam, Philippines and Thailand), of which maybe 1,100 or so have a market cap above USD 250m, which is just enough liquidity for us to invest. However, in terms of our quality criteria, the universe is reduced to just 150 to 200 companies that we think are investible.

I first started researching ASEAN companies in 2014 (at a previous firm). In my experience, many of them were poor quality with weak alignment and board structures. However, at FSSA, we are benchmark agnostic investors — there is no company that we have to own in our portfolios. We are happy to say "no" when a company does not meet our quality threshold. For example, we steer clear of companies owned by certain families in Indonesia or other families in the Philippines with poor governance track records and considerable related-party transactions.

However, there are companies where we see positive generational changes and management professionalisation — one example being Universal Robina Corp (URC) in the Philippines.

URC's governance track record was poor until Lance Gokongwei, current chairman and the founder's son, took over the business in the 2000s and improved the corporate governance standards of the group. More recently, he brought in Irwin Lee as the first outsider CEO of URC. Irwin is a Filipino national who spent three decades with Procter & Gamble in various roles. He brings multi-national company (MNC) processes and rigour to a homegrown franchise, which will be much needed for URC to perform better and become a bigger business. We tend to think that this combination of long-term family ownership and professional management is a positive sign of improvements to come.

How do you look at environmental, social and governance (ESG) matters in the ASEAN markets?

We look at ESG matters in the same way that we do for every strategy in the FSSA universe. There is no change in our investment process or philosophy in terms of assessing the management's track record and looking for quality businesses to invest in. There is no compromise on that. And our stance on ESG is not relative. We do not make allowances for less developed markets – there are certain families and businesses and that we simply would not invest in.

Ultimately, we want to invest in companies that can grow their business sustainably. We are often asked about our investment in Jardine Cycle & Carriage which is the only company we own with some exposure to contract-mining coal as well as palm oil. We have engaged with the management and discussed how they can move away from the coal business under United Tractors (a subsidiary company). The management has committed not to invest further into coal-related business and aims to diversify into other areas, including renewables and infrastructure assets. We are comfortable with our position, although it is still something to monitor.

The issue with coal is that it is still a large part of the Indonesian economy with an estimated contribution of 5-6% to GDP.[1] The transition away from coal will take time, considering the impact on social and development goals. But we believe it will be inevitable. There are now draft regulations in place and the pace of change should pick up from here. In fact, all of the ASEAN countries are pushing towards renewable energy sources. It may be slower than in other places, but we think the direction of travel is positive.

Similarly, many businesses that we engage with are aware of their broader ESG responsibilities. Heineken Malaysia and Carlsberg Brewery Malaysia are part of global businesses, which are often more straightforward – they aim to maintain the same global standards (such as water consumption in their brewing process) in their ASEAN subsidiaries. But family-owned businesses in ASEAN are moving forward in these areas too. For example, URC has set goals on nutrition (in terms of reduction of sugar, sodium, saturated fats, etc) and packaging (75% is now recyclable), as well as more ethical and sustainable sourcing practices.

At one point, ASEAN was touted as the new "Asian Tigers". What happened to that growth?

It started with the rapid industrialisation of Singapore in 1970s as one of the original "Asian Tigers". In the '80s and '90s, Malaysia, Thailand and others tried to emulate the export-led growth model. But they were on thin ice in terms of foreign debt, poor balance sheets and very poor governance, which led to the Asian Financial Crisis (AFC). Investors were badly burned, especially on currency, and many simply stopped investing in ASEAN altogether.

This coincided with China becoming a member of the World Trade Organization (WTO) in 2001 and its rise towards being "the world's factory". Southeast Asian countries were simply unable to compete against this behemoth. One often cited example is the shift of electronics exporters from Malaysia to China.

Today, investors tend not to think about secular or structural themes in ASEAN anymore – and for good reason. Deep structural domestic reforms and improvement in human capital have been slow. Capital investment has ticked up over the last decade, especially in Indonesia, but remains below what is required for the current state of development. Political stability in certain countries is yet another issue to worry about.

On the positive side, unlike many other emerging markets, ASEAN economies have competent bureaucrats and conservative central banks, while financial systems are largely stable and underleveraged. These are all outcomes of the pain suffered through the AFC. Meanwhile, there is talk of another "commodity supercycle" taking hold, although these things tend to be cyclical and we wouldn't bank on it. A period of high commodity prices can be beneficial to net commodity exporters like Indonesia and Malaysia. But over the next 10-20 years, for growth to be sustainable it has to come from improvements in productivity, efficiency gains and the creation of jobs. We believe digitisation will be a powerful tailwind in this regard – just like it has been in other countries. The shift in global supply chains to a "China + 1" policy should help ASEAN too.

Irrespective of the above, our goal remains to find and invest in quality companies that can grow sustainably and are attractively valued. The overall quality of companies continues to improve, in our view, and the investible universe has grown larger than before. While there are still a lot of land mines to avoid, we believe the ASEAN region offers good potential growth opportunities for long-term-minded investors.

[1] Source: Extractive Industries Transparency Initiative (EITI)

Source: Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 31 March 2022 or otherwise noted.

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