



**Platinum Asia  
Investments Limited<sup>®</sup>  
Quarterly Investment  
Manager's Report**

30 June 2016



**Platinum<sup>®</sup>**  
ASIA INVESTMENTS LIMITED

ABN 13 606 647 358

## Performance

(compound pa, to 30 June 2016)

	QUARTER	SINCE INCEPTION
Platinum Asia Investments Ltd	4%	-5%
MSCI AC* Asia ex Japan Index	4%	0%

\* Morgan Stanley Capital International All Country

Source: Platinum and MSCI. Refer to note 1.

The MSCI AC Asia Ex Japan Index rose 1% (in local currency) for the quarter. Depreciation of the Australian dollar amplified the gains for Australian investors, and the Index was up 4% in AUD terms.

Most Asian markets were more or less flat for most of the quarter. The United Kingdom's decision to exit the European Union following a referendum was widely unexpected, and it rocked global markets. Its impact on Asia was less severe, though not unfelt. The Chinese A-share market was down 2% while the Hong Kong H-share market was flat. The Malaysian market was down 4% and the Korean market was down 1% while the Thai and Indonesian markets were up 3% and 4% respectively. The Indian and Philippine markets saw better performance, both up more than 7%. Platinum Asia Investments Limited (ASX: PAI) maintained a minimal exposure to Indonesia and Malaysia and a relatively big exposure to India. PAI's performance was in line with the market over the quarter.

With respect to PAI's portfolio, the consumer-related companies with strong market positions were the better performers this quarter. Samsung Electronics was up 9%, Tencent (China's Facebook) up 11%, Uni-President (Taiwanese food and beverage conglomerate) up 12%, and Kweichow Moutai and Jiangsu Yanghe (Chinese liquor makers) were up around 18% and 8% respectively. Elsewhere, Ayala Land (largest property developer in the Philippines) was up 10% and Yes Bank (a leading Indian private bank) was up 28%.

The detractors of performance were mostly US-listed Chinese companies. JD.com fell due to a slowdown in sales while Baidu fell as a result of the recent government crackdown on healthcare advertising on its online search platform.

## Net Asset Value

The following PAI net asset value per share (NAV) figures are respectively before and after provision for tax on both realised and unrealised income and gains.

	PRE-TAX NAV	POST-TAX NAV
31 March 2016	\$0.8986	\$0.8986
30 April 2016	\$0.9021	\$0.9021
31 May 2016	\$0.9476	\$0.9476
30 June 2016	\$0.9338	\$0.9338

Source: Platinum.

## Disposition of Portfolio Assets

REGION	JUN 2016	MAR 2016
China (Listed Ex PRC)	24%	29%
China (Listed PRC)	7%	7%
Hong Kong	3%	5%
Taiwan	4%	4%
India	21%	17%
Korea	10%	9%
Thailand	7%	7%
Philippines	5%	4%
Singapore	3%	3%
Vietnam	2%	2%
Cash	14%	13%

Source: Platinum. Refer to note 2.

## Changes to the Portfolio

PAI's net invested position reached 86%, leaving some room to further upgrade holdings should opportunities emerge. During the quarter, we took advantage of stock price weakness and added to companies with strong market positions and growth. Companies that are able to grow earnings look particularly compelling.

Signs of buoyancy in the Chinese markets early in the quarter lessened the relative attractiveness of some of our holdings there. We took the opportunity to reduce some of our China positions – the financials and Weichai Power.

We initiated a position in **Hang Lung Properties**, a major shopping mall developer in China with prime retail land ownership in central city locations across a number of populous Chinese cities. Valuation has more than factored in the temporary impact of both the crackdown on graft-related luxury consumption and weakness in some cities' local economies. With the bulk of Hang Lung's rental income coming from the economically vibrant cities of Hong Kong and Shanghai, this stock is attractively priced with a cash flow yield of 9% and a dividend yield of 6%. Exceptionally disciplined with its cash flow and almost debt free, the company is well positioned to take advantage of opportunities to acquire more prime retail real estate in China.

In India we added **IDFC Limited** and its recently spun-off subsidiary **IDFC Bank**, which was awarded a private banking licence in India in 2014. The Indian banking sector is still hindered by the stale public sector banks, which present an opportunity for the more agile private banks to take market share and grow profitably. If history is any guide, IDFC has the prospect of becoming a great long-term growth story. Trading at below net asset value, though already generating a profit, valuation is attractive given the favourable growth trajectory ahead.

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We also added **Coal India** to PAI's portfolio, a national coal mining company that is highly profitable but out-of-favour with the market. For the first time in many years, this company has managed to grow production under the stewardship of the new Minister for Power, Coal, New and Renewable Energy. Realised coal prices, which have historically traded at a discount to global prices, are catching up. Improvements in rail infrastructure, better financial health for the country's power distribution companies, and continued efforts to improve productivity per employee should be beneficial to the company's growth. Coal India has 20% of its market capitalisation in cash, a return on equity of 35-40%, and a dividend yield of greater than 7%, which seems to be good value for a utility company with a dominant position and likely to benefit from the economic growth of the country for years to come.

We have added a 4% hedge against the Korean won and maintained a 19% hedge against the Chinese yuan as further depreciation of these currencies against the US dollar is likely to result from accommodative interest rate policies.

## Commentary

The recent quarter was a relatively uneventful one until the British referendum took place. Markets around the world were inevitably shaken as investors shied away from risk-taking in the face of widespread uncertainty. However, the panic appeared to have subsided rather quickly as the prospect of further monetary loosening lends support to stock valuations. The Brexit outcome is not expected to have a major impact on Asia's economic growth, nor is it expected to have a significant direct impact on PAI's portfolio as most of our holdings are domestically or regionally focused. While political storms appear to be gathering elsewhere in the globe, countries in the Asia-Pacific region, such as India, China, Indonesia and the Philippines, continue to make progress in lifting the living standards of the people through sensible government reforms and policies.

### India

Indeed, in a world where growth is scarce, India looks like a shining star. Signs of recovery are evident with encouraging economic indicators. Electricity generation, oil consumption, and commercial vehicle sales continue to point decidedly in the positive direction. Better agricultural prices have led farmers to invest in tractors and motor vehicles again after a few years of dull sales. It appears that sensible interest rate policies, responsible central government budgeting and economic reforms will indeed lend sustainability to India's growth in the years ahead. Our holdings in India, including private banks, India's largest power utility, a leading road construction and toll-way operation company as well as other smaller holdings, are expected to benefit from these encouraging trends.

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However, sooner than expected, the Governor of the Reserve Bank of India (RBI) announced his return to academia at the end of his current three-year mandate which ends in September. Over the last three years, India has managed to lower its inflation, stabilise its currency, increase economic growth, reform the RBI and implement a robust clean-up of the banking system. Without a doubt, the outgoing RBI Governor has done an exceptional job. But with the bitter medicine already swallowed, the government appears to want to lean on a further interest rate cut, if conditions permit, and potentially a weaker Indian currency.

### China

#### Property Market

Moving onto China, where the property market is confounding both in its vast scale (US\$1.3 trillion each year in new property sales) and in the differing fortunes across the country's many cities. China has built around 85 million residential apartments since liberalisation of the property sector began about 17 years ago, but this is just over 30% of the nation's urban population. **Two-thirds of urban residents are still living in accommodation built in the pre-reform era.** Those flats were built by the government and allocated to individuals; they tend to be of poor quality and sometimes lack basic modern amenities, giving residents little incentive for home improvement.

Not only is the demand to upgrade undoubtedly high, as wages continue to move upwards (average annual income per person has reached around US\$5,000), ongoing migrant inflow from rural areas and the less prosperous cities adds further to housing demands in the major cities.

The proportion of people living in cities is only around 56% (comparable to Japan in the early 1970s and Korea in late 1970s). Authorities aim to increase this to 60% by the end of 2020 through various policy incentives, which would mean a rise of over 15 million in urban population, representing an incremental demand for more than 20 million apartments!

Immediately after the global financial crisis (GFC), property development did become something of a frenzy. However, measures were taken to bring it back to balance and, more recently, inducements have re-invigorated demand. These relate to easier down-payment terms of 30% on first homes and 40-50% for the second.

After a 1.25% interest rate cut since the beginning of 2015 and a slight relaxation in policy, reports are once again pointing to recovery in the residential property market. The number of months taken to clear inventory has more than halved, construction activity is picking up and land sales, in select cities, are seeing new record prices.

The story is more complex and nuanced, however, and one senses growing divergence. Cities that continue to enjoy the economic boom appear to be doing very well. Jobs are plentiful with the expansion of the service sectors; people are

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flooding in in search of better opportunities; wages are rising steadily. Demand for property is healthy and, in some cases, too healthy. The converse is true for cities clouded by shrinking old-economy industries where job opportunities are becoming scarce and wage and population growth is stagnant. The property market in these cities, while generally stable, is by no means thriving. These are the regions in China that are experiencing a significant oversupply.

In the 11 top performing cities,<sup>1</sup> **the number of months taken to clear unsold apartments has on average come down markedly from the peak of 23 months to 7 months**, property prices have risen strongly (25-30%) from a year ago, and policy tightening is starting to be brought back to cool speculative demand.

The next tier comprises some 42 cities with reasonably strong local economies. People continue to move to these cities for jobs and better amenities. **The number of months for unsold apartments to clear improved from 29 months to 14 months on average**, and prices rose a moderate 7-8% from a year ago. In many ways, **this group of cities, which make up one-third of China's vast property market by volume and value, represent the real China.** To give a sense of the size and whereabouts of some of these mid-tier cities:

- **Shijiazhuang** (population: 11 million, area: 16,000 km<sup>2</sup>) is a city situated 276 km southwest of Beijing (or 1 hour by high speed rail). It is a transportation hub at the intersection point of three major railway lines. This is the food bowl of northern China, producing much of the agricultural produce such as wheat, walnuts and pears. In recent years, the economy has been transitioning with a focus on the development and production of pharmaceutical drugs.
- **Chongqing** (population: 30 million, area: 82,000 km<sup>2</sup>) is a megacity with countless skyscrapers and winding overpasses criss-crossing its mountainous terrain. Situated 1,700 km west of Shanghai, it was one of China's earliest industrial clusters, with a focus on heavy industries such as car-making. In recent years, it has branched into electronics manufacturing and has become the world's largest laptop manufacturing base. In 2015, it produced 61 million (or one in every three) laptops for companies such as Toshiba, Acer and HP.
- **Wenzhou** (population: 9 million, area: 12,000 km<sup>2</sup>) is a coastal city situated 500 km south of Shanghai. It is one of the most economically vibrant and affluent cities in China. Despite its small geographical footprint, Wenzhou is a world leading manufacturer of many small commodities ranging from cigarette lighters, zippers, buttons and shoes to electric equipment, valves and locks.

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The neighbouring city of Yiwu is home to the world's largest wholesale market for small goods. Yiwu is also "the city where Christmas is made", producing more than 60% of all of the world's festive decorations each year!

- **Kunming** (population: 7 million, area: 21,000 km<sup>2</sup>) is situated in southern Yunnan province, which borders Myanmar, Vietnam and Laos. The high annual rainfall and other geographic characteristics of the region mean that it is a natural exporter of hydroelectricity to the rest of the nation. Its mild climate is also ideal for agriculture, especially flower growing. Today, Kunming is the largest flower exporter in China and accounts for more than half of the country's flower production. It is also the tourist gateway to national parks and historical townships like Dali and Lijiang.

Outside these two groups are the less prosperous cities which are seeing stable property prices, though unsold inventory is still running at 20-25 months or so. In the coming six months, it is likely that we will see a pick-up in construction activity in the healthier half of China's vast property sector.

#### Excess Capacity Closure

In early May, the official mouthpiece of the Chinese Communist Party, People's Daily, published an article by an anonymous 'Authoritative Insider', who was widely believed to be from China's senior leadership. The article stated that China is facing slowed growth and stressed the importance of cutting capacity and reducing debt in many old-world industries. The impediment to closing excess capacity has always been the fear for rising unemployment, but this article marks a confident change in attitude from the authorities and their determination to implement capacity closure policies across a number of industries (e.g. cement, coal and steel) while setting aside RMB100 billion to assist laid-off workers. This is likely to lead to a bottoming of prices for those oversupplied commodities.

#### E-Commerce

In China, our focus has been on consumer-facing sectors with long-term growth prospects. E-commerce in the country is leading the world in both scale (sales are in excess of US\$600 billion) and innovation with platforms that provide a great selection of products at cheaper prices with same-day delivery services and trusted internet payment systems.

Distinct from shoppers in the developed world who have for decades enjoyed physical shopping malls catering to all classes of society, the lack of quality shopping venues and experience in the smaller cities means that many Chinese consumers are initiated into the world of shopping through e-commerce. **For many, e-commerce is shopping!** As customers discover new products on these online platforms, it becomes imperative for merchants and producers to advertise online to build brands and influence purchasing decisions. As shoppers' eyeball time continues to move from offline to online, advertising dollars will shift too.

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<sup>1</sup> Beijing, Shanghai, Shenzhen, Guangzhou, Hangzhou, Nanjing, Suzhou, Hefei, Xiamen, Wuhan, and Tianjin.

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There is no let-up on expansion of categories and geographies. Grocery, which requires more specialised logistics, is growing in popularity. Leading players continue to invest in logistic centres and warehouses in rural areas, bringing products to rural residents who still account for half of the nation.

PAI is well placed to participate in the rise of e-commerce through our investments in **Alibaba Group** and **JD.com**. Alibaba operates the two dominant marketplace platforms (Tmall and Taobao) which together account for 76% of all e-commerce gross merchandise volume (GMV) in China. The company's current valuation is attractive, with its shares trading at 20x forward P/E.

Alibaba's dominance in e-commerce in China has enabled it to build a powerful online payments and financial services company, Ant Financial Services Group. Its major business is Alipay, the payment system that processes around US\$2 trillion in transaction value per annum and is more popular than credit cards in China both online and offline. As it collects vast amounts of financial, commercial and personal data off its enormous user base, the fintech giant is also gaining an advantage over traditional financial institutions in the evaluation and pricing of risk, and that will have a profound impact on the insurance and banking industry.

Alibaba also has a strong cloud business. With Internet connection getting faster and the cost of storage getting lower, many companies are moving their systems to the cloud to save cost. Alibaba has a dominant position in this burgeoning industry that has more than doubled in size since 2013.

JD.com is the largest online retailer in China with a strong position in consumer electronics. As the company continues to increase its volume in first-party business, JD.com is expected to be able to extract better pricing terms from suppliers, allowing it to become more competitive against its offline peers. JD.com's control over its self-operated logistic network provides a unique advantage in its ability to lower delivery cost and standardise service quality. At the same time, the company is expanding its category of products outside of consumer electronics through a third party marketplace model. Recent investor fears over China's macro slowdown gave rise to an opportunity to invest in this durable franchise at a compelling valuation.

### Samsung Electronics

Samsung Electronics is one of PAI's longest-held stocks and currently the largest holding in PAI's portfolio. It is a technological leader and continues to strengthen its lead by investing in new technology and capacity, ensuring its long-term profitability. The company is at an interesting juncture as its two emerging but world-leading technologies (organic light emitting diode (OLED) and 3D NAND) are now set to be adopted by mainstream consumer electronics companies. Despite the obvious strengths in its core businesses and its focus on the long-term, Samsung

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Electronics is attractively valued at 10x 2016 earnings and offers a dividend yield of nearly 2%.

OLED is a superior display technology that will be the 'next big thing' for smartphones. It offers higher resolution, bendability as well as lighter and thinner design. Apple is rumoured to be incorporating flexible OLED display in its new generation of iPhones, allowing for interesting form-factors. Come 2017, the new iPhone may have quite a different look. If the rumour turns out to be true, Apple, Samsung's most formidable smartphone competitor, will likely be sourcing almost 100% of its OLED supplies from Samsung!

3D NAND is a data storage technology that is more reliable and cost effective than conventional flash memory (e.g. USB drives). Samsung is on its way to becoming an industry leader in this space as superior attributes (light weight, low power consumption) and lower costs propel its products to rapidly displace traditional hard drives.

### Outlook

Markets have been volatile, as economic restructuring, especially in a low growth world, has proven to be a rocky path.

A stabilising property market and, indeed, improving activity in the construction sector should provide some stability to China's economy in the months ahead. Capacity closure is a much needed step that the authorities appear resolute to undertake. The Indian story is panning out largely as envisaged and the likelihood of further interest rate cuts has increased, though current levels of enthusiasm may temper in the near term.

The fact that **interest rates in most parts of Asia are still well above zero** (as opposed to those in much of the developed world) **portends superior growth and investment returns**. Companies in the region with sustainable competitive positions will likely prove to be worthwhile investments over the long run. Our view is that the direction taken by policymakers in the region is generally positive. As many companies in the Asian market are trading on attractive valuations, and a cheap starting valuation is a good indicator of future returns, we will continue to deploy capital when suitable opportunities arise.

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## Notes

1. The investment returns are calculated using PAI's pre-tax net asset value (as released to the ASX) and represent the combined income and capital return of the investments for the specified period. Please note that the results are not calculated from PAI's share price.

The investment returns shown are historical and no warranty can be given for future performance. You should be aware that historical performance is not a reliable indicator of future performance. Due to the volatility in the underlying assets of PAI and other risk factors associated with investing, investment returns can be negative (particularly in the short-term).

The portfolio inception date for PAI is 16 September 2015.

It should be noted that Platinum does not invest by reference to the weightings of the MSCI All Country Asia ex Japan Net Index (A\$) (the "Index") or any other indices or benchmarks. Underlying assets are chosen through Platinum's individual stock selection process and, as a result, holdings will vary considerably to the make-up of the Index. Index information is provided as a reference only.

2. Invested position represents the exposure of physical holdings and long stock derivatives.

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