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# Baring China Equity Capability

September 2016

**William Fong – Investment Director, Asian Equities**

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# Baring's Hong Kong China Team & Investment Process

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## Growth at a Reasonable Price

Provides the level of certainty needed for a three to five year earnings forecast

Focus on companies with growth of 10-20% CAGR




Seek unrecognised growth over a three to five year horizon, only paying a justified short term premium over the market

***Quality GARP companies can deliver superior returns with lower volatility***

# Investment process – Summary



## Sourcing ideas

**High conviction ideas generated from Barings' diverse pool of global investors**

Company and country visits

Quantitative screening for quality GARP

Thematic/top down analysis



## Researching companies

Focused and in-depth

Finding unrecognised growth on a three to five year horizon

Companies scored 1 to 5

Best Ideas List owned by a panel of three senior investors



## Constructing portfolios

**Key characteristics**

Quality

Growth

Upside

High conviction/active share

**Risk analysis**

Tracking error

Liquidity

Volatility



## Monitoring portfolios

Portfolio Manager

Quant Team

Head of Equities

Investment Risk

# Identifying unrecognized growth

## Fundamental, bottom-up research using a consistent stock scoring methodology




| Quality | Growth | Upside |
|---|---|---|
| **Helps to drive sustainable, steady results** | **Provides a long term platform for outperformance** | **Measured using a disciplined, discounted earnings approach** |
| **Franchise (1-5)**<br>- Competitive advantage<br>- Efficiency<br>- Stability | **Last three years (1-5)**<br>net earnings growth | **Discounted earnings over five years (1-5)** |
| **Management (1-5)**<br>- Competence<br>- Commitment<br>- Alignment with shareholder interest | **12 month (1-5)**<br>net earnings growth | **Next 12 month P/E (1-5)**<br>- Compared to history<br>- Compared to sector<br>- Compared to peer |
| **Balance sheet (1-5)** | **Next five years (1-5)**<br>net earnings growth | **P/B relative to ROE and cost of capital (1-5)** |
| **QUALITY (1-5)** | **GROWTH (1-5)** | **UPSIDE (1-5)** |

# Portfolio Management Structure

## Your Dedicated Hong Kong China Team



**Laura Luo**
Head of HK China Equities
21 : 3



**William Fong**
Director, Head of Research
16 : 12



**Derick Leung**
Investment Manager
10 : 8



**Nicola Lai**
Investment Manager
10 : 5



**Ben Wei**
Investment Analyst
10 : 1



**Titus Wu**
Investment Analyst:
9 : 1



**Baiding Rong**
Investment Analyst:
7 : <1



**Alan Lee**
Investment Analyst:
4 : <1



**Joining soon (3)**

***Integrated team approach***
***1 leader, 1 team***

Source: Barings, September 2016. Years of experience: Investment experience; Time at Barings

## Sunny Optical

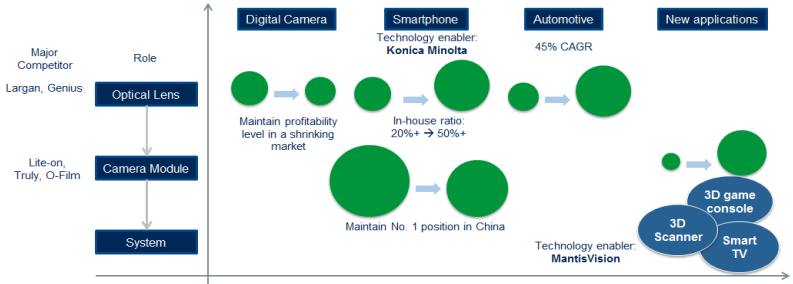
### Price Performance




### Investment case

- Sunny Optical is a vertically-integrated optical component supplier, supplying camera modules as well as lenses in handset and vehicles.
- Product mix: vehicle lens (7%/ 18% of sales/GP) & handset lens (10%/ 24% of sales/GP) > camera module (76%/ 42% of sales/GP).
- The company is going to see a meaningful and positive shift in its product mix, given our higher-than-consensus forecast in its vehicle and handset lens growth, that will see the company deliver strong and sustainable long-term growth rates.
- The market leader in the web portal business with 70% traffic market share
- Provider of mobile messenger service, LINE, for global mobile application

### Sunny at a glance




Source: (Upper left) Factset, June 2016; (Lower left) Company data, Nomura Research, September 2015; (Right) Barings, June 2016

## Sunny Optical - Where we are ahead of consensus

| Breaking down our vehicle lens growth assumptions | 2015 | 2020 | | |
|---|---|---|---|---|
| | China smartphone | ADAS-only car | Auto-drive car | Car total |
| **End product volume (m)** | **500** | **100** | **100** | |
| Adoption rate | 100% | 50% | 5% | |
| Number of cameras | 2 | 2.5 | 8 | |
| Camera volume (m) | 1000 | 125 | 40 | 165 |
| **Camera Lens Market** | | | | |
| ASP (USD) | 0.8 | 4.5 | 8.5 | |
| Market Size (m USD) | 800 | 563 | 340 | 903 |
| **Sunny's Lens business** | | | | |
| Market share | 20% | | | 30% |
| Volume (m) | 196.8 | | | 46 |
| Revenue (m USD) | 157.44 | | | 395 |
| Revenue (m RMB) | 976 | | | 2,566 |

Source: Barings, June 2016

# Stock example 1

## Sunny Optical

### Company Scorecard

| Company name | Sunny Optical | |
|---|---|---|
| **Quality** | Franchise | 2.0 |
| | Management | 2.0 |
| | Balance sheet | 1.0 |
| | **Overall** | **1.7** |
| **Growth** | Last three years | 1.0 |
| | Next 12 months | 1.0 |
| | CAGR next five years | 1.0 |
| | **Overall** | **1.0** |
| **Upside** | Market measure | 5.0 |
| | Static measure | 5.0 |
| | Discounted earnings | 1.0 |
| | **Overall** | **3.7** |
| **Stock score** | | **2.1** |

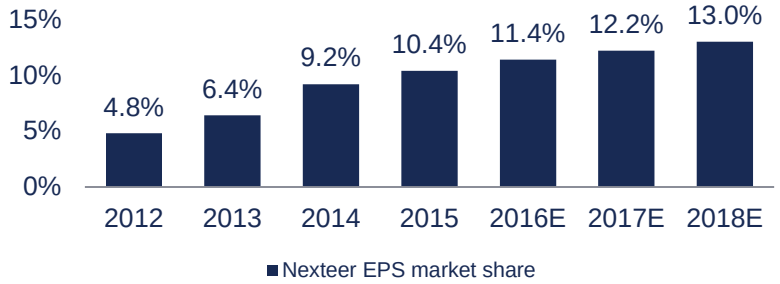
- **Franchise:** Sunny Optical's handset and vehicle lens business raises entry barriers and the quality of the franchise significantly. ROEs have improved from mid-teens to 23% in 2016. We are forecasting for this to further improve to 27% by 2020. Net cash balance sheet with increasing free cash flow from 2015 onwards.
- **Growth:** We are forecasting a 32% 5 year CAGR growth rate.
- **Valuation:** Using our discounted earnings method, we see attractive upside at an undemanding terminal PE multiple of 13x.

Source: Barings, June 2016. Please refer to Important Information. Stock sample is for illustrative purpose and for reference only and must not be used, or relied upon, for the purposes of any investment decisions.

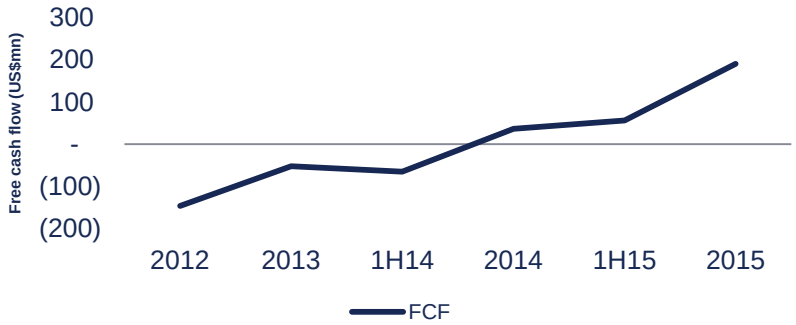
# Stock example 2

## Nexteer Automotive

### Gaining market share in the EPS market




### Free cash flow enhances franchise quality




### Investment case

- Nexteer is a well-established technology-led autoparts supplier with a niche focus on EPS (electronic power steering), with over 100 years of experience. In 2010 a China SOE, PCM, became the largest shareholder, giving the company a unique profile as a very well-managed US company that has an opportunity to tap into the China market and its growth potential.
- Nexteer has increased their global market share in EPS from 4.8% in 2012 to 10.4% in 2015. We expect them to continue to gain share over the next 3-5 years given their strong positioning in emerging markets.
- Strong ROE generation since listing at high 20% places Nexteer as one of the best ROE profiles among global auto component suppliers with free cash flow generation.
- An under-valued company with quality management and strong core technology that positions the company ahead of other auto component suppliers in the next autonomous driving era.

Source: (Left upper) Company data, Macquarie, March 2016; (Left lower) Company data, Nomura, April 2016; (Right) Barings, September 2016

# Stock example 2

## Nexteer Automotive

### Company Scorecard

| Company name | Nexteer Automotive | |
|---|---|---|
| **Quality** | Franchise | 2.0 |
| | Management | 1.0 |
| | Balance sheet | 3.0 |
| | **Overall** | **1.5** |
| **Growth** | Last three years | 1.0 |
| | Next 12 months | 1.0 |
| | CAGR next five years | 2.6 |
| | **Overall** | **1.5** |
| **Upside** | Market measure | 1.0 |
| | Static measure | 1.0 |
| | Discounted earnings | 1.0 |
| | **Overall** | **1.0** |
| **Stock score** | | **1.5** |

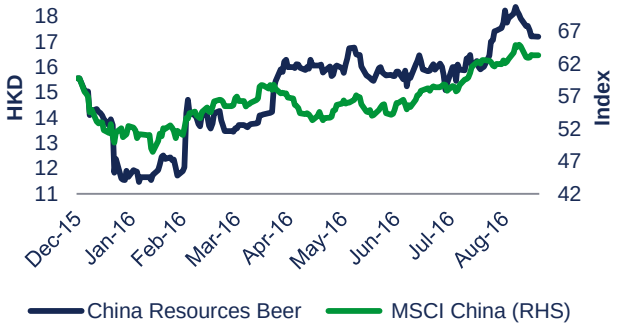



- Strong historic growth driven by strong orders from EPS from rising penetration, and diversification from General Motors to other customers, as well as from US to other countries like China. Margins have increased steadily thanks to positive product mix from higher margin EPS product.
- Nexteer has consistently spent 6% of sales in R&D with a roadmap that extends beyond steering, and into ADAS related technologies involving steering for future growth.
- Very reasonable valuations, strong quality, steady growth, with ADAS-related M&A as an option

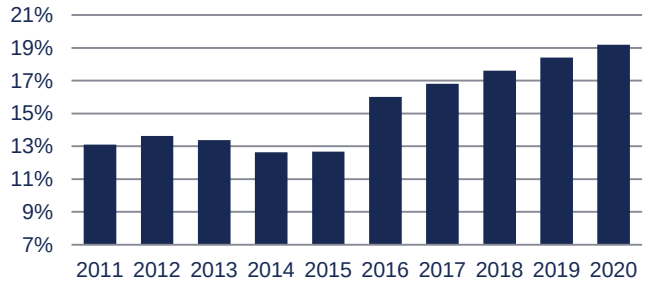
Source: Barings, August 2016
Please refer to Important Information. Stock sample is for illustrative purpose and for reference only and must not be used, or relied upon, for the purposes of any investment decisions

## China Resources Beer

### Price Performance




### CRB EBIT margin on uptrend




### Investment case

- China Resources Beer (CRB) is the leading brewer in China with approximately 25% market share in 1H16.
- CRB is proactively improving its product mix to ride on the consumption upgrade trend in China and we see huge potentials there given the big gap of the profitability between CRB and its closest peer ABI in China.
- CRB is to complete the purchase of 49% stake of its beer assets held by SAB Miller at approximately 1x P/B ratio, which is value creative to its equity share holders.
- With a strong balance, CRB is seeking for more M&As to further consolidate the beer market in China.
- Based on its decent track record in the pas decade, CRB is expected to continually gain market share in the beer market in China.

Source: (Upper left) Factset, September 2016; (Lower left) Company data, Barings September 2016; (Right) Barings, September 2016

# Stock example 3

## China Resources Beer

### Company Scorecard

| Company name | Sunny Optical | |
|---|---|---|
| **Quality** | Franchise | 1.0 |
| | Management | 1.0 |
| | Balance sheet | 1.0 |
| | **Overall** | **1.0** |
| **Growth** | Last three years | 4.0 |
| | Next 12 months | 1.0 |
| | CAGR next five years | 1.0 |
| | **Overall** | **3.0** |
| **Upside** | Market measure | 5.0 |
| | Static measure | 5.0 |
| | Discounted earnings | 2.0 |
| | **Overall** | **4.0** |
| **Stock score** | | **2.7** |

華潤啤酒(控股)有限公司
China Resources Beer (Holdings) Company Limited

- CRB holds the largest market share in China with strong presence in North-East, East as well and Southwest markets.
- Management has a strong focus on profit margin, operating efficiency, and market-share gain.
- Despite the stagnant volume growth of beer consumption in China, CRB is delivery strong earnings growth by successful product mix upgrade, which makes it stand out among local peers.
- CRB has a decent track record of M&A and will continue to grow on both internal and external drivers.
- Strong balance sheet and the support of China Resources Group to fuel more M&As.

Source: Barings, June 2016
Please refer to Important Information. Stock sample is for illustrative purpose and for reference only and must not be used, or relied upon, for the purposes of any investment decisions

# Portfolio construction and performance

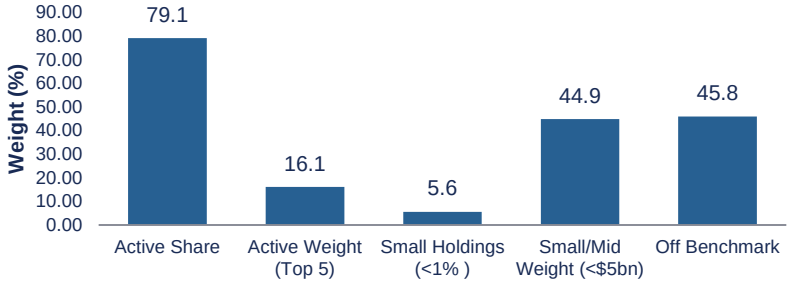
## Baring China Select Fund

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## Baring China Select Fund scorecard

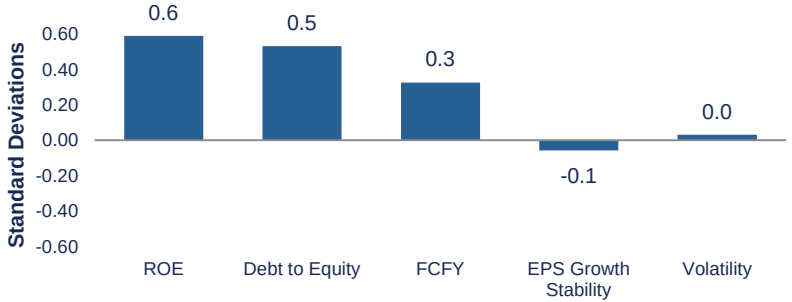
### Conviction



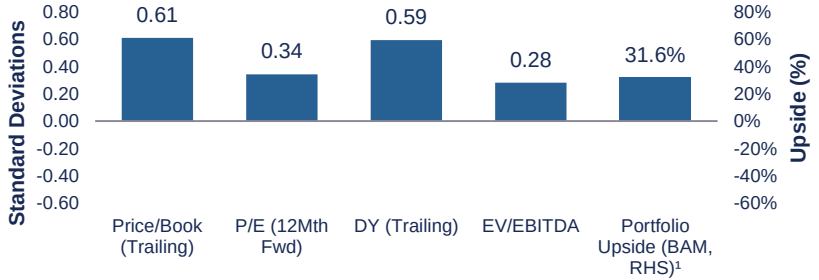

### Growth




### Quality




### Upside & Valuation




***Systematic quantitative tools in building portfolios in line with objectives***

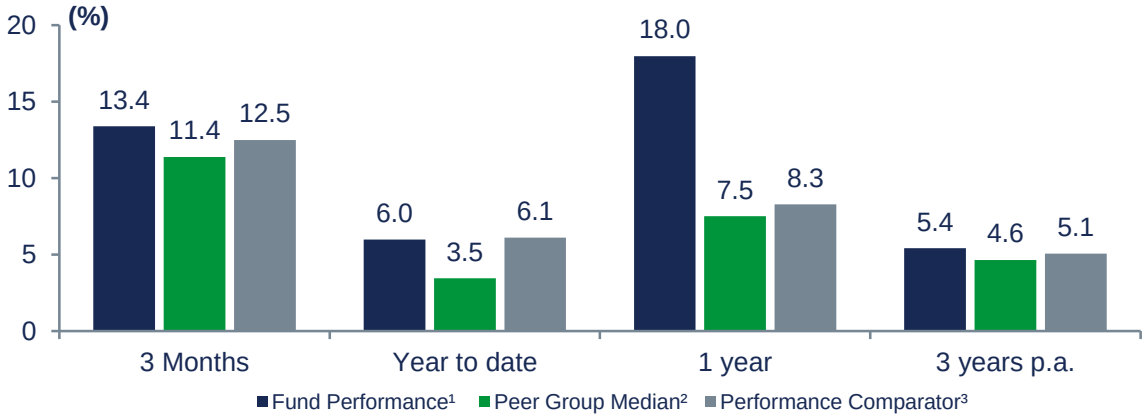
Source: Barings, 31 July 2016
1 EPS Growth (5 Year BAM) and Upside are computed for the portfolio only

## Baring China Select Fund – Top Ten Holdings

| Name | % of Fund | Sector |
|---|---|---|
| Tencent | 6.4 | Information Technology |
| Ping An Insurance, Class H | 3.9 | Financials |
| Brilliance China Automotive Holdings Limited | 3.9 | Consumer Discretionary |
| AAC Technologies | 3.7 | Information Technology |
| Sunny Optical | 3.6 | Information Technology |
| Alibaba Group | 3.5 | Information Technology |
| Baring China A-Share Fund | 3.4 | Mutual Funds |
| Nexteer Automotive | 3.1 | Consumer Discretionary |
| China State Construction International | 3.0 | Industrials |
| China Resources Beer | 2.8 | Consumer Staples |
| **Total** | **37.5** | |

Source: Barings, as at 31 July 2016. Holdings are subject to change.

## Performance as at 31 August 2016




| Quartile[4] | 1st | 1st | 1st | 2nd |
|---|---|---|---|---|

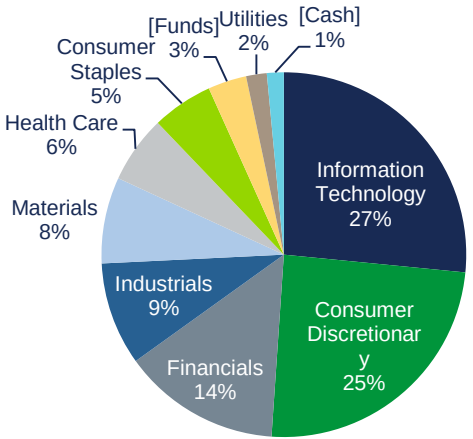
***Past performance is not a guide to future performance***

[1] Fund performance are NAV to NAV, net of fees, gross income, US$, Class A USD Inc. [2] Peer Group Median / Quartile Ranking is based on Morningstar China Equity Universe.
[3] Benchmark Index - MSCI China Total Return. Reference to the index is for comparative purposes only.
Source: © 2016 Morningstar, Inc.
For risks associated with investment securities in emerging and less developed markets, please refer to the Offering Document for details. Transactions in derivatives, warrants and forward contracts and other fund derivatives instruments may be used for the purpose of meeting the investment objective of the Fund. The Net Asset Value of the Fund may have a high volatility due to these instruments and techniques being included in its scheme property and may involve a greater degree of risk.

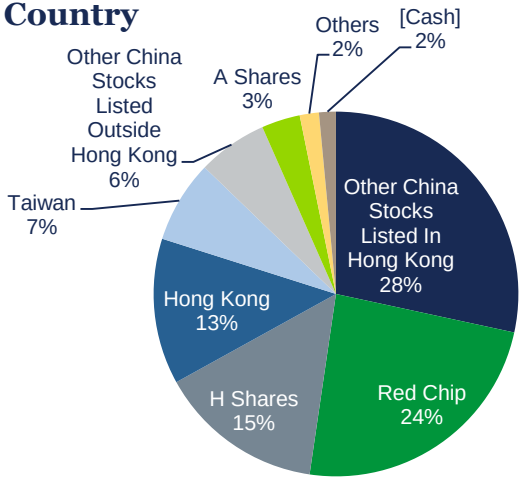
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## Sector and country breakdown

### Sector




### Country




***Country and sector breakdown are a by product of bottom-up stock selection***

Source: Barings, 31 July 2016

# Baring China Select Fund Style characteristics

## Consistent with GARP approach

| Metrics | China Select Fund | MSCI China |
|---|---|---|
| Return on equity (ROE) | 19.7% | 19.4% |
| Debt/equity ratio | 58.7% | 96.6% |
| Five year BAM EPS growth* | 19.1% | -- |
| Dividend yield | 1.4% | 2.5% |
| P/E FY1 | 14.6x | 12.1x |
| Active share | 79.1% | -- |
| Market cap (US$Bn) | 31.2 | 88.1 |
| Number of holdings (ex cash) | 45 | 137 |

Source: Barings and Style Research (Index source), 31 July 2016. Holdings are subject to change * EPS Growth (5 Year BAM) is computed for the portfolio only

# Market outlook and strategy

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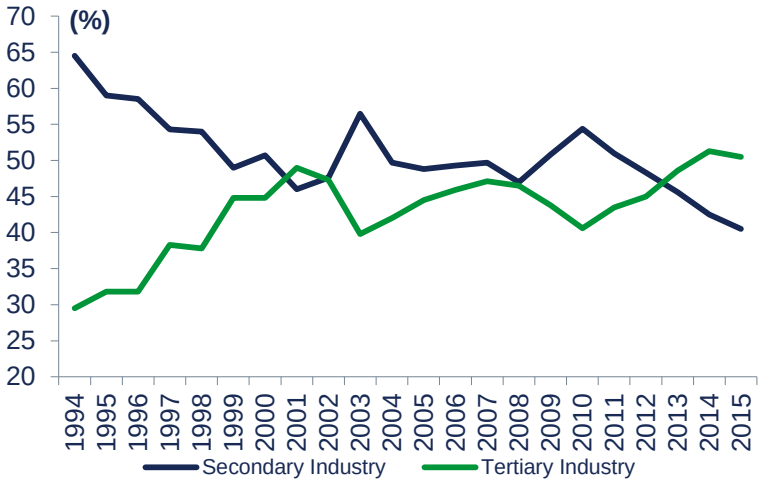
# China market outlook

- China's overall economic growth will likely remain weak in 2016, however, we've seen signs of the economy stabilizing at lower level during first half of 2016.
- With commodity prices rebounding, upstream earnings will see improvement, but downstream may not benefit if they cannot pass-on the increasing raw material costs.
- We expect Chinese government to do further policy easing (both monetary and fiscal) and reforms. The recent emphasis on supply side management and reform should help cleaning up over-capacity and good for longer term economic development, despite short-term pressure on employment and credit risks.
- Longer term, a stabilization of both economic growth and currency trend will provide support to corporate earnings and the equity market. On-going structural reforms may provide further upside. Household wealth reallocation to non-bank deposit and non-property sectors should continue to support equity market development.
- We continue to look for opportunity to add well managed companies with good growth prospects, as valuations are getting more attractive after recent corrections.

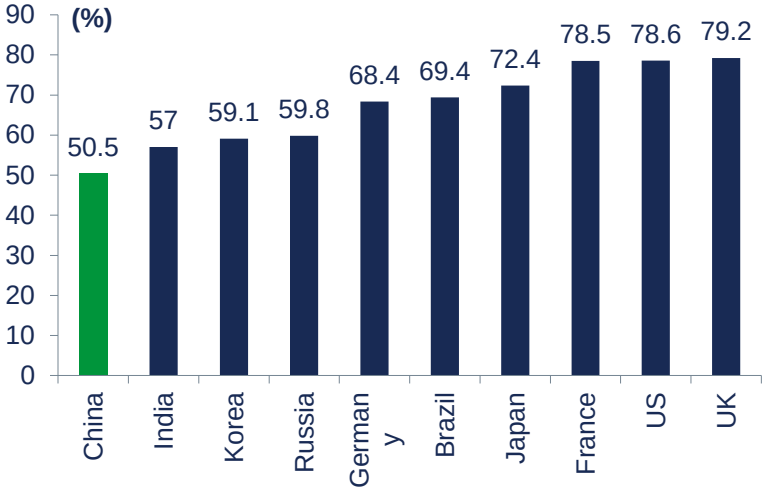
Source: Barings, September 2016

# Rebalancing of the economy: service industry taking the lead

**China GDP growth contribution – secondary and tertiary industries**



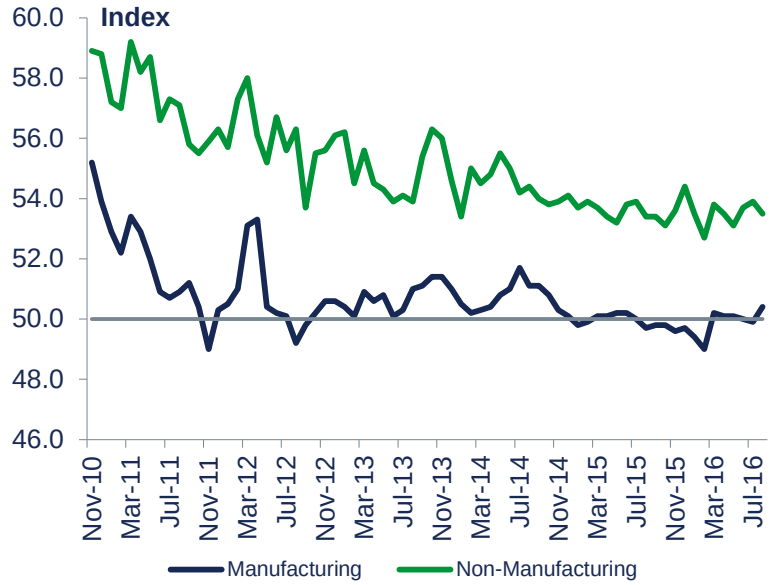

**Share of service industry in GDP (2015)**



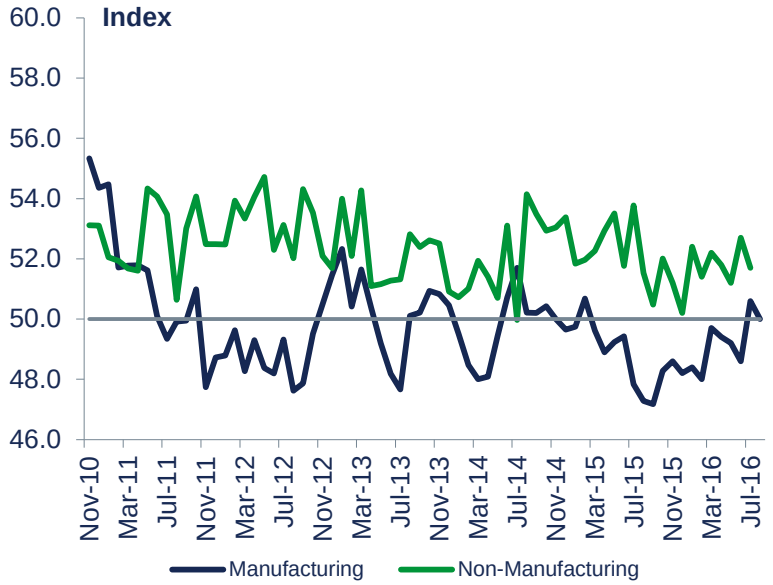

Source: NBS, BNP Paribas, April 2016.

# Rebalancing of the economy: service industry taking the lead (2)

**PMI - Official (NBS)**



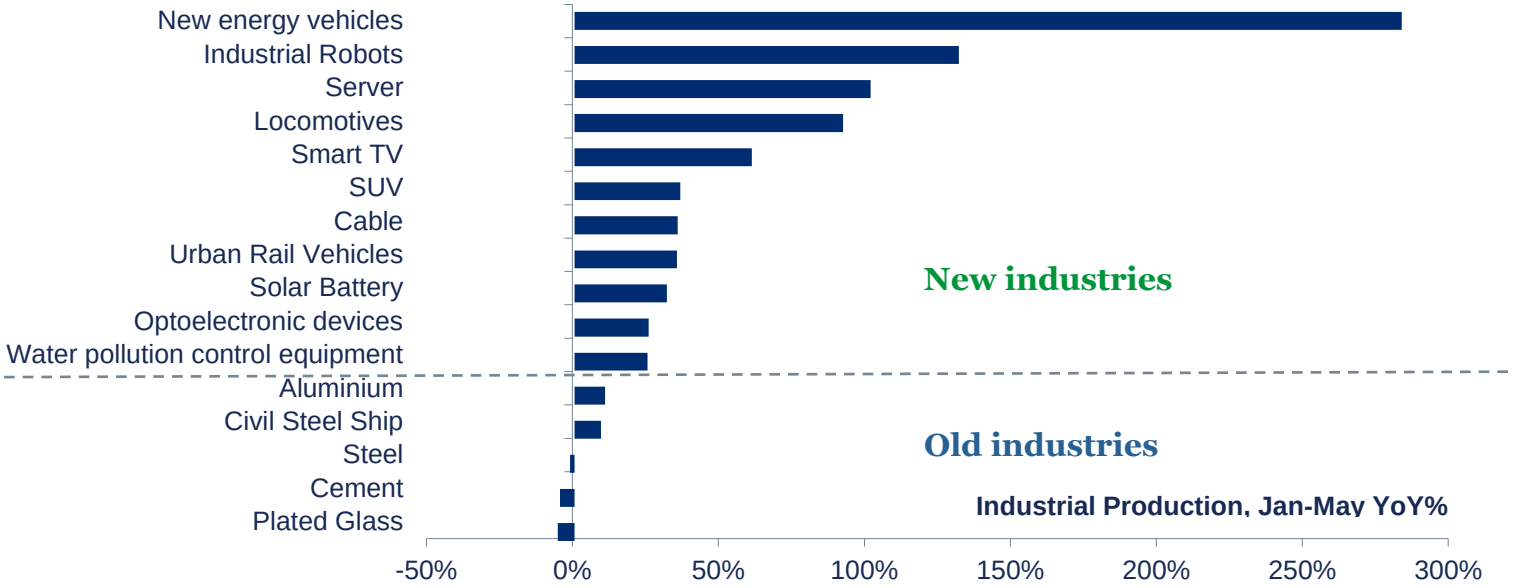

**PMI - Caixin (ex-HSBC)**




Source: Citi, Bloomberg, Barings, September 2016

# New economy – the new growth driver

**Output growth: old industries versus new industries**



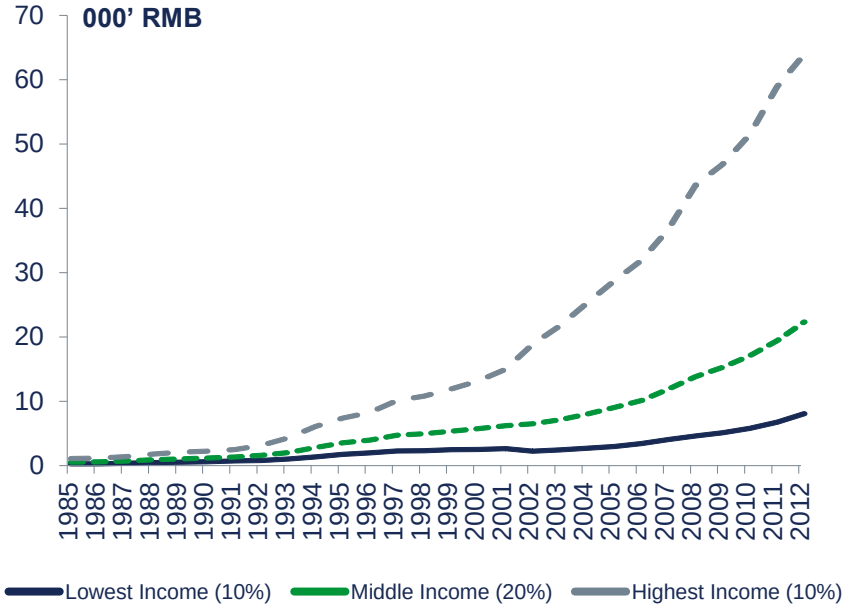

*According to NDRC, new industries are representing around 15% total industrial revenues in 2014.*

Source: CEIC, NBS and Citi Research, September 2015

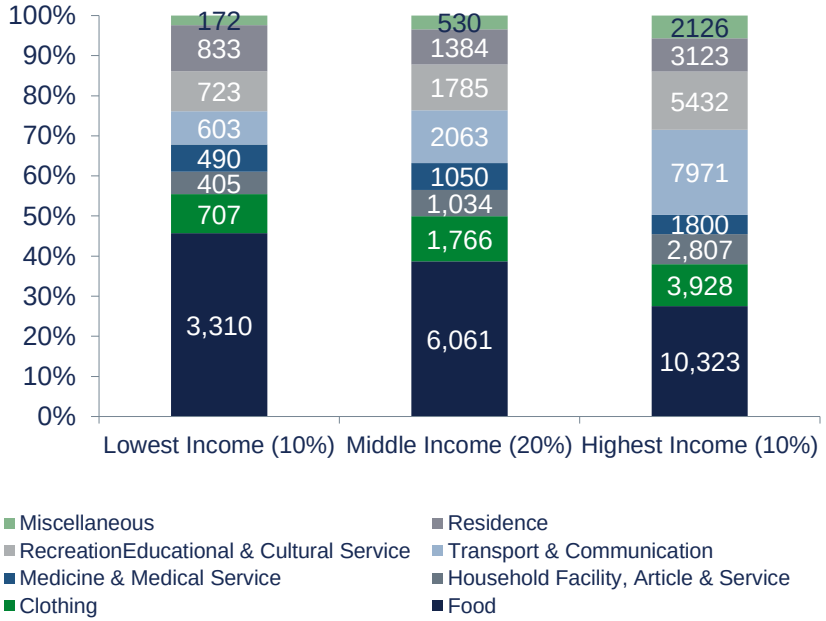
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# Income inequality and consumer spending potential

**Urban household income by 10% lowest, middle income 20% and 10% highest**



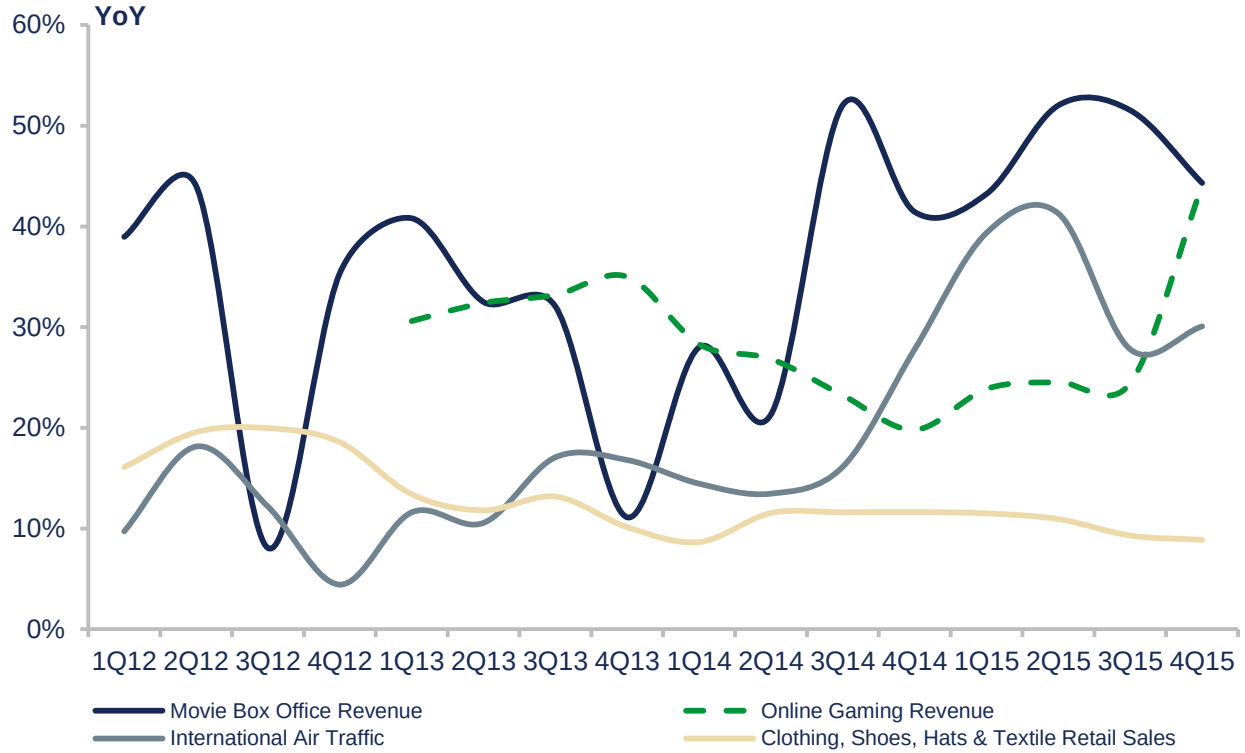

**Urban household consumption: 2012**




Source: CEIC and Citi Research, July 2016

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## Growth in new consumption segments will outpace that of…



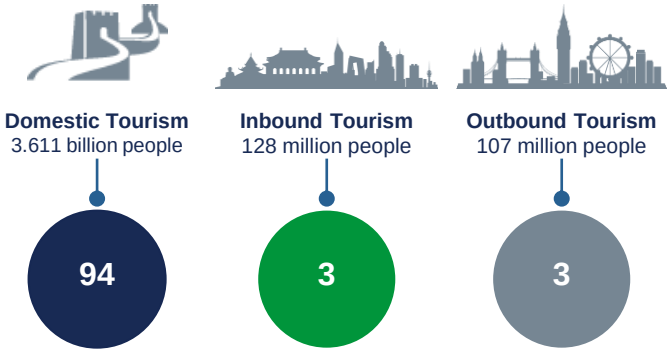

Source: NBS, SARFT, Civil Aviation Administration of China, iResearch, Goldman Sachs Global Investment Research, May 2016

***…traditional consumer items (basics)***

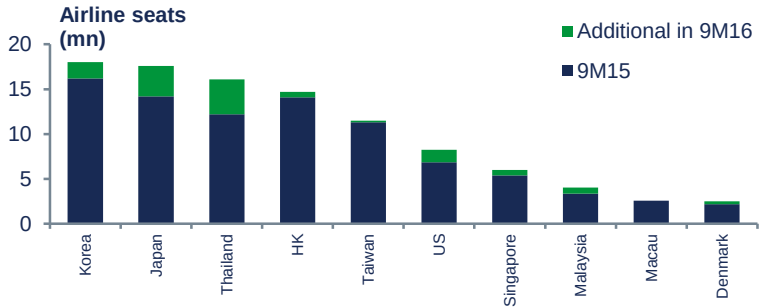
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## Travel and leisure

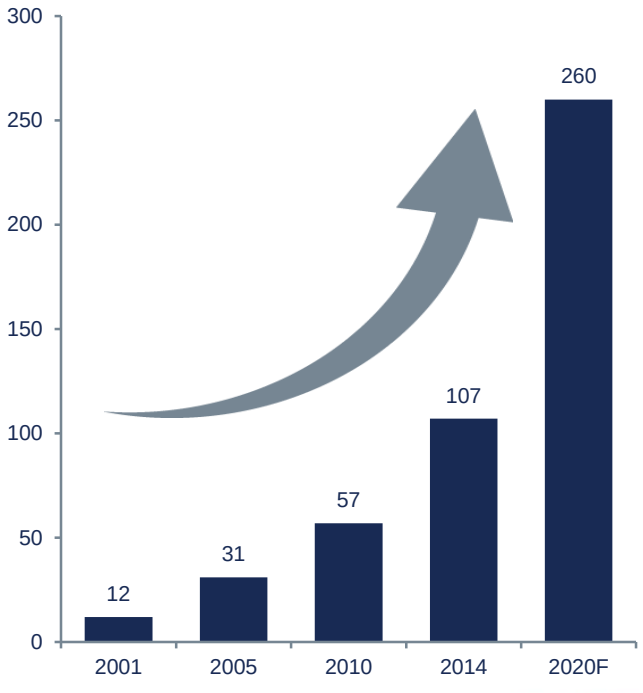
### China Tourism Industry




### Top 10 China outbound markets




### Evolution of Chinese outbound tourism (million people)




Source: (China Tourism Industry, Evolution of Chinese outbound tourism) Richemont/Marketing Services, HSBC, December 2015; (Top 10 China outbound markets) OAG Aviation Worldwide, Macquarie Research, April 2016

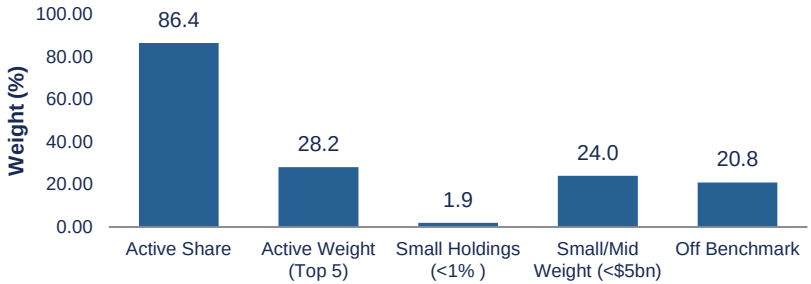
# Appendix:
# Portfolio construction and performance
## Baring China A-Share Fund plc

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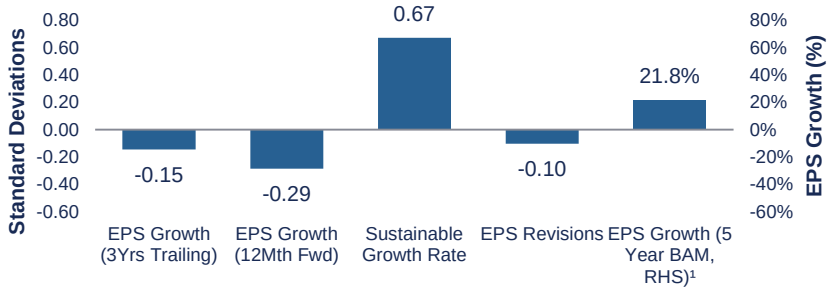
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## Baring China A-Share Fund plc scorecard

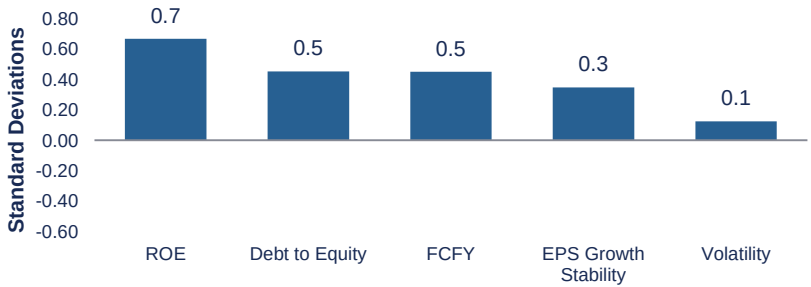
### Conviction



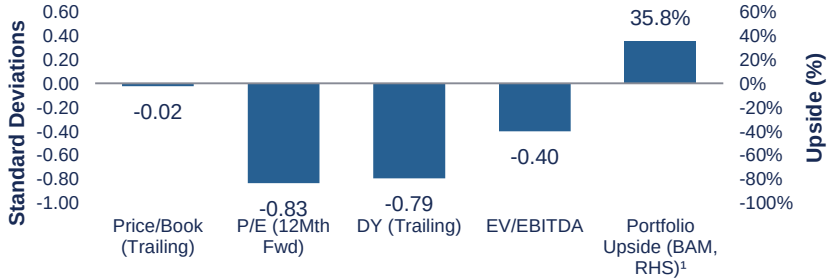

### Growth




### Quality




### Upside & Valuation




***Systematic quantitative tools in building portfolios in line with objectives***

Source: Barings, 31 July 2016

¹ EPS Growth (5 Year BAM) and Upside are computed for the portfolio only

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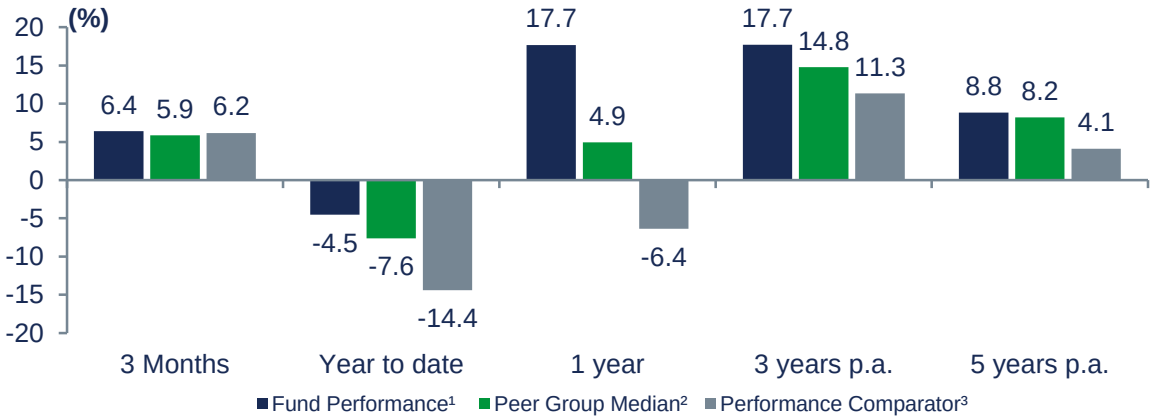
## Baring China A-Share Fund plc – Top Ten Holdings

| Name | % of Fund | Sector |
|---|---|---|
| Ping An Insurance | 5.9 | Financials |
| Jiangsu Yanghe Brewery | 5.7 | Consumer Staples |
| Gree Electric Appliances | 5.3 | Consumer Discretionary |
| Zhejiang Huace Film & TV | 4.8 | Consumer Discretionary |
| Fujian Sunner Development | 4.3 | Consumer Staples |
| Ningbo Joyson Electronic | 4.3 | Consumer Discretionary |
| Wanda Cinema Line | 4.2 | Consumer Discretionary |
| Jiangsu Hengrui Medicine | 3.9 | Health Care |
| Guangdong Haid Group | 3.7 | Consumer Staples |
| Anhui Conch Cement Company | 3.6 | Materials |
| **Total** | **45.7** | |

Source: Barings, as at 31 July 2016. Holdings are subject to change.

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## Performance as at 31 August 2016




| Quartile[4] | 2nd | 2nd | 1st | 2nd | 2nd |
|---|---|---|---|---|---|

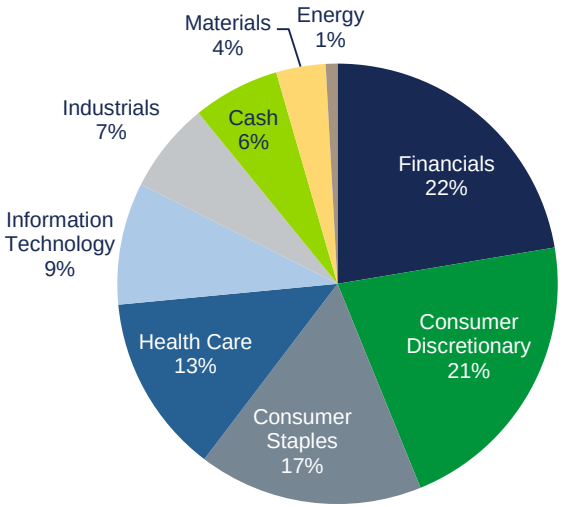
***Past performance is not a guide to future performance***

[1] Fund performance are NAV to NAV, net of fees, gross income, US$. Source: © 2016 Morningstar, Inc. (See Important Information)
[2] Peer Group Median / Quartile Ranking is based on Morningstar China A-Share Equity Universe. Source: © 2016 Morningstar, Inc. (See Important Information)
[3] Benchmark Index - MSCI China A Total, Gross Return. Reference to the index is for comparative purposes only.
For risks associated with investment securities in emerging and less developed markets, please refer to the Offering Document for details. Transactions in derivatives, warrants and forward contracts and other fund derivatives instruments may be used for the purpose of meeting the investment objective of the Fund. The Net Asset Value of the Fund may have a high volatility due to these instruments and techniques being included in its scheme property and may involve a greater degree of risk.
Note: Baring China A-Share Fund plc is currently not authorized or registered for public sale in Hong Kong & Singapore.

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## Sector breakdown

### Sector




***Sector breakdown is a by product of bottom-up stock selection***

Source: Barings, 31 July 2016

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# Baring China A-Share Fund plc Style characteristics

## Consistent with GARP approach

| Metrics | China A-Share Fund | MSCI China A |
|---|---|---|
| Return on equity (ROE) | 16.9% | 12.9% |
| Debt/equity ratio | 99.0% | 131.3% |
| Five year BAM EPS growth* | 21.8% | -- |
| Dividend yield | 2.0% | 1.7% |
| P/E FY1 | 14.8x | 16.5x |
| Active share | 86.4% | -- |
| Market cap (US$Bn) | 18.9 | 15.8 |
| Number of holdings (ex cash) | 29 | 813 |

Source: Barings and Style Research (Index source), 31 July 2016. Holdings are subject to change * EPS Growth (5 Year BAM) is computed for the portfolio only

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