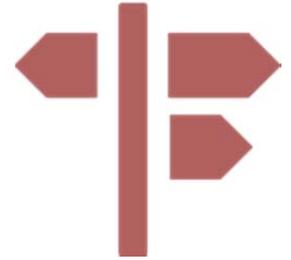


Street view

Travel notes from our **emerging markets** research team



Several members from the emerging markets equity team were away from their desks for some time in July. Unfortunately for them, it wasn't summer break. They were on a research trip to China and had journeyed across Shenzhen, Hangzhou and Suzhou.

Geoffrey Wong, head of emerging markets and Asian equities pens his observations.

These research trips are important to our investment process. It's one thing to study the financials of companies and do desktop research. But, there's no substitute for on-site research. You get another perspective during these trips.

Visiting the factories, walking around the shop space, talking to the management, their customers and vendors allow the team and me to test if the assumptions in our valuation models are likely to be achieved.

This time, our meetings included various manufacturers – drone, home appliances, industrial machinery departmental stores, internet companies and after-school education centres.



Geoffrey Wong (second from right) and the emerging markets team visiting a drone manufacturer

We started in Shenzhen – home to the world's largest consumer drone company. During the trip, we visited many of these companies and had the chance to view the latest drones. Some are small as a can of coke and can be controlled through hand actions. The consumer ones are used mainly for taking photographs and videos. As you know, you need a stable hand to take good photographs. Some of these companies have come up with a complex image stabilization technology so that the photographs and videos taken are not shaky.

The technology these companies presented to us is world class and gives a new meaning to "Made in China". With many of the high-end tech products from China these days, "Made in China" also means developed and designed in China by local talents.

While we are not able to invest in these drone companies (still privately held), these visits showed us how far China has risen on the innovation rung. Significant resources are required to innovate and we see many Chinese firms – both listed and privately-owned ones ploughing large proportions of their profits into research and development (R&D). China's huge domestic market means large cash flow are available to sustain R&D activities.

If the commitment to innovation continues, we will see more companies from China rising to be global industry leaders in the near future.



Sky-high technology: China is a global leader in drones

With their treasure chest, Chinese firms have also been acquiring overseas companies with strong technology footprint to scale up the innovation ladder quickly. We have seen Midea, a leading Chinese home appliance company purchase Kuka, a German robotics leader recently. The deal gives Midea a chance to improve its technology and manufacture appliances for the higher-end consumer segments. We have also observed how many cash-rich OEM (original equipment manufacturers) for foreign brands are branching out successfully to build their own local brands, with products catered for local tastes.

Adaptation to local tastes and premiumization are two strong trends we see with local consumer companies.

As we move across these three cities, we visited a good number of consumer goods companies. Again, we saw how innovative local companies were in catering to domestic needs and are more nimble in adapting than foreign competitors. An air conditioner manufacturer we visited had developed units that also double-up as air purifiers. This is especially useful as air pollution can be a major problem in parts of China.

At another Chinese home appliance manufacturer, they showed us a smart cooker that can download recipes from the internet and automatically cooks the dish.



IoT (Internet of things) cooker: Downloads recipes from the internet and automatically cooks the dish.

We popped into a few home electronics stores to understand how popular these products were. Many of these premium local appliances are on the shelves and are well-distributed across tier one and two cities. As incomes continue to rise, consumers in these cities are willing to pay more and are trading up for better quality products. We see this demand not just with white goods but also across the automobile, and food and beverage industries. Premiumization is a theme that we have been investing into for a while now and several companies in our portfolios are key beneficiaries of this trend.

It's well-known that China has the highest mobile penetration rate and local companies have been tapping into this large subscriber base. Across malls and restaurants, we saw how mobile payments are replacing cash and higher-cost credit cards. This provides companies involved in mobile payments with a huge amount of data on transaction types, customer preferences and buying habits. Companies can monetize this data through cross-selling other products and services and also generate advertising revenue. Tencent is a good example of such a company.

How else are Chinese consumers spending their salaries?

I think parents in Asia will get this right. Yes, on their kids' education. Our macro research shows that spending on education continues to grow at a healthy pace. While on-the-ground, we witnessed how supply of quality education providers is still playing catchup. At an after-school education center, we were told of the long waiting lists for a range of tuition classes

and this is not uncommon in many other centers across the country.

Overall, China's transition from a fixed asset investment led economy to a consumption and services oriented economy is very evident on the ground. By constantly visiting and monitoring our companies first hand, we gain confidence that we are investing well in these trends.



Lessons at an after-school education centre



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