CI ASIAN TIGER FUND
QUARTERLY REPORT

Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

SEPTEMBER 2014

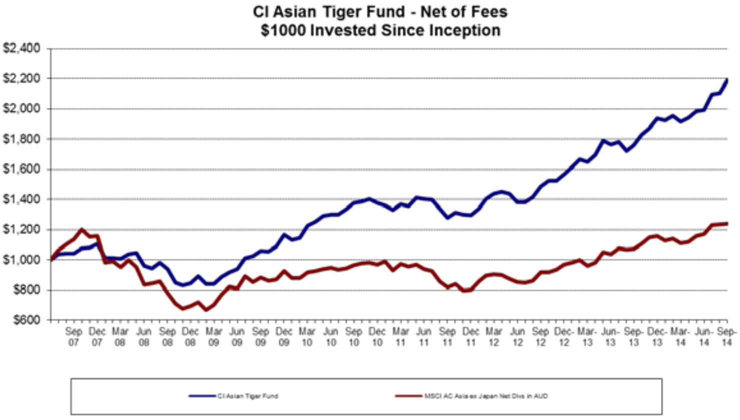
"The secret of health for both mind and body is not to mourn the past, not to worry about the future, not to anticipate trouble but to live in the moment wisely and earnestly" …. Buddha

"Sometimes your joy is the source of your smile, but sometimes your smile can be the source of your joy" …Tich Nhat Hanh.

"A coward is incapable of exhibiting love, it is the prerogative of the brave" … Gandhi.

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	10.76%	6.07%	4.69%
ROLLING 1 YEAR	26.44%	15.67%	10.77%
ROLLING 2 YEAR	23.59%	16.42%	7.17%
ROLLING 3 YEAR	21.44%	14.84%	6.60%
ROLLING 5 YEAR	18.45%	7.02%	11.43%
ROLLING 7 YEAR	13.27%	1.25%	12.02%
SINCE INCEPTION*	13.45%	3.03%	10.42%
SINCE INCEPTION^	149.70%	24.13%	125.57%

*Annualised
^Cumulative (2 July 2007)
**Before fees and expenses
MSCI AC Asia ex Japan Net Divs in AUD



Market and Portfolio Performance

If "euphoria" defined the more recent trend in world share markets, then a more appropriate term to describe the September quarter's performance would be "cautious". That acknowledged, the MSCI AC World Index still managed to close the quarter in positive territory (+0.79%) in local currency terms as did the MSCI Asia Ex Japan Index (+0.11%) in local currency terms.

Notwithstanding the above comments, the returns to A$ investors over the quarter were magnified by the dramatic decline in the local currency. Reflecting this, the MSCI World Index in A$ terms rose 5.37% while the MSCI AC Asia Ex-Japan Index in A$ terms increased 6.07%. While the A$ / US$ rate peaked at around 1.10 in July 2011, over the September quarter of 2014 it has fallen from a high of 0.95 to a low of 0.87 or by 8.4%. Some of the reasons for the fall may be summarised as:

- Continued commentary from RBA Governor Glen Stevens that the A$ is overvalued;
- The expectations of more subdued growth in China, which continues to negatively impact on the price of key Australian exports like iron ore and coal;
- A general belief that the US Federal Reserve will normalise monetary policy next year, which in turn will raise American interest rates; and
- A perception that economic data in Australia will continue to lose impetus;

We retain our long held cautious view about the A$ despite its recent correction.

As we have highlighted before, markets in Asia are not correlated. This is particularly well highlighted by the table below, which shows the widely divergent performances of individual markets over the September quarter.

SEPTEMBER 2014

MSCI Data With Net Dividends	Sept Quarter in A$ Terms	Sept Quarter in Local Currency Terms
MSCI World	+5.37%	+0.79%
MSCI Ac Asia Ex Japan	+6.07%	+0.11%
MSCI Australia	- 0.69%	-0.69%
MSCI China	+3.08%	+1.61%
MSCI Hong Kong	+5.08%	-2.40%
MSCI India	+10.39%	+5.09%
MSCI Indonesia	+11.55%	+6.29%
MSCI Malaysia	+4.44%	-1.08%
MSCI Philippines	+12.21%	+6.95%
MSCI Singapore	+6.58%	+1.03%
MSCI Korea	+0.02%	-3.29%
MSCI Taiwan	+4.02%	-1.75%
MSCI Thailand	+16.08%	+7.52%

While the numbers in the table are positive in A$ terms, they are less flattering in local currency terms. The best four markets over the quarter in order of performance (A$ and local currency terms) were Thailand, Philippines, Indonesia and India. The worst performing markets varied with rankings dependent on currency of measurement. That said, Korea, Taiwan and Malaysia were always in the mix and China/Hong Kong also deserve a mention.

Amazingly, the best performing market over the last three months has been Thailand. As many readers will know, a military coup occurred in May 2014 and General Prayuth Chan-O-Cha is now running the country. Perhaps the market is pleased that there is a working plan which calls for a general election in October 2015. This could prove challenging as fundamental divisions continue to exist in Thai society between “red” and “yellow” shirts. Perhaps more pertinent factors behind the resilience of the market include the prospect of economic revival in 2015, the start of some delayed infrastructure initiatives by the military and tax driven purchases of the local market by Thai institutions.

The economic resilience of the Philippines has been supported by sound macro-economic policy, Overseas Remittances and the development of growing industries like Business Process Outsourcing (BPO). Together with political stability under President Aquino, this has made the stock market perform well in recent years. Nevertheless, the country will have to promote institutional development through reform, invest heavily in infrastructure and create jobs (economic inclusion) to sustain economic momentum in future years.

Both the Indonesian and Indian markets put in stellar performances over the September quarter. Investors in India continued to celebrate the election of Mr Modi and his BJP Party. This is in anticipation that a well led, strong central government will be able to implement much needed reform. This in turn would help India deliver on the country’s much debated economic potential. While we share the enthusiasm for India, the story is long term and near term the market appears to have already discounted much of the positive news. In a similar vein, the election of Joko Widodo has also been a reason for celebration in Indonesia. While Mr Modi was “honing” his administrative skills as the Chief Minister of Gujarat, Mr Widodo was doing the same thing as Governor of Jakarta. Indeed, both individuals are ordinary people, who have risen on merit rather than influence and connections. Furthermore, both are hardworking, able and appear honest. Nevertheless, Joko Widodo’s political position to instigate reform currently appears weaker than Mr Modi’s. That stated, both have the strong backing of public opinion in their respective countries to initiate change. This gives us reason to be cautiously optimistic, despite all the risks and challenges. Indeed, the portfolio retains overweight positions in the Philippines, Indonesia and India, although we have recently taken profits in the two last named markets.

SEPTEMBER 2014

We were slightly surprised by the subdued performance of the Korean market during the period in question. The country is in a relatively strong economic position with a very modest fiscal deficit, strong current account surplus, reasonable reserves and a strong currency. Furthermore, the Government appears to be doing more to boost domestic demand (see later comments), while at the same time trying to encourage companies to invest more and lift dividends. Then again, perhaps investors remain cautious about an economy significantly dependent on exports to the West and, increasingly China, and a loss of competitiveness against "arch rival" Japan due to Won appreciation.

With the technology sector accounting for nearly 60% of the MSCI Taiwan Index, this sector remains crucial to economic activity in Taiwan. However, the sector is performing well at the moment supplying, as it does, various components to smart phones, as well as other electronic niche products. Perhaps investors have been unsettled by the fact that the Cross Strait Service Trade Agreement has not yet been officially ratified. Among other things, this would materially aid the country's domestic economy. More recently, the market has also been negatively influenced by political disturbances in Hong Kong.

So what's been happening in Hong Kong? After being returned to China in 1997, Hong Kong became a Special Administrative Region. This in effect created "one country two systems" with Hong Kong and its people having a high degree of autonomy in all areas except defence and foreign affairs. This special agreement will last until 2047. The civil disobedience reflects concern that China will renege on its promise to introduce universal suffrage in 2017 to elect a new Chief Executive. The main area of anxiety centres on individuals only being able to vote from a small list of candidates approved by Beijing.

Unfortunately it is hard to see China backing down on such a fundamental issue and people are fearful of a repetition of a Tiananmen Square type event. This is all occurring at a time when the economy is suffering from fewer mainland tourists, which is negatively impacting retail sales. Furthermore, the already soft property market would be even more vulnerable if American interest rates started to normalise. On the subject of property it is interesting to see that China has recently introduced measures to aid its housing market. These include a reduction in down payments to 30% (prior was 60%) for second home buyers (no other mortgages) and access to preferential rates of interest. The table below sourced from JP Morgan, gives readers a sense for how Asian equity markets are currently rated.

	Prospective PE/Ratio		**Prospective Yield**		**Earnings Growth**	
	2014	**2015**	**2014**	**2015**	**2014**	**2015**
Australia	15.1	14.1	4.7	5.0	5.3	7.4
China	9.8	8.8	3.3	3.6	9.6	11.6
Hong Kong	16.3	14.8	2.8	3.0	5.8	10.0
India	18.8	16.1	1.5	1.6	13.9	17.3
Indonesia	15.9	14.3	2.4	2.7	12.2	11.4
Korea	10.9	9.1	1.3	1.4	15.1	19.7
Malaysia	16.0	14.7	3.2	3.5	7.1	8.8
Philippines	21.2	18.6	2.1	2.3	5.6	14.2
Singapore	14.5	13.3	3.5	3.7	8.2	8.7
Taiwan	14.2	13.2	3.0	3.4	21.0	7.7
Thailand	14.6	12.8	3.0	3.3	12.8	14.0

Source: JP Morgan

SEPTEMBER 2014

The Portfolio

Both the MSCI AC Asia Ex-Japan index 6.07% and the Portfolio 10.76% rose over the September quarter. The Portfolio was aided by its over-weight position in the Thai, Philippino, Indonesian and Indian Markets which all performed well. In contrast, being under-represented in poorly performing markets like Korea, was a positive.

With the global political and economic environment so uncertain and visibility limited, the portfolio has a defensive tilt (low beta, low debt etc.) and remains well diversified by both geography and industry. Its current composition is as follows:-

Geographic	Portfolio	
Hong Kong / China	33%	(underweight)
India	15%	(overweight)
Korea	8%	(underweight)
Taiwan	8%	(underweight)
ASEAN	27%	(overweight)
Other	2%	(overweight)
Cash	7%	
Total	100%	

Industry	Portfolio	
Materials	8%	(overweight)
Industrials	26%	(overweight)
Consumer Discretionary	13%	(overweight)
Consumer Staples	10%	(overweight)
Healthcare	3%	(overweight)
Financials	26%	(underweight)
Information Technology	4%	(underweight)
Utilities	3%	(underweight)
Cash	7%	
Total	100%	

The portfolio only has indirect exposure to energy and no exposure at the moment to telecommunications.

Over the September quarter, a total of four new investments were added in the Philippines. These have given the Portfolio further exposure to financial services and additionally to the country's utility and infrastructure sectors. This was facilitated by a reduction in our exposure to Indonesia and Thailand. Following a strong performance, we also took profits in India, although we remain over-weight this market. Elsewhere, we sold out of a Thai investment and also Lotte Confectionery. Two new names were introduced in Korea and these operate in the Pharmaceutical and E-Commerce industries. We sold out of Navitas, which leaves us with just one small investment in Australia. During the quarter we accepted KKR's S$1.4billion bid (S$2.50 per share) for the portfolio's holding in Goodpack. The cash raised, together with other cash balances, was partially invested in a leading family owned Chinese fabric manufacturing company, which gives us indirect exposure to some of the world's leading sportswear manufacturers. Lastly, a new position was established in a Taiwanese company which owns a leading beauty chain in China. This gives us incremental exposure to rising affluence, growing consumption and urbanisation in China.

At the time of writing, the portfolio was invested in 52 Stocks. Turnover, which amounted to 18% on a rolling 12 month basis to June 2014, continues to be relatively modest.

International Visits – Philippines, Indonesia and South Korea, July 2014

Philippines

The **population** of the Philippines currently amounts to 105 million, making it the 12th largest in the world. The population continues to grow rapidly at 1.89% per year and remains very young. The wider metropolitan Manila area is estimated to contain a quarter of the entire population of the country. It is estimated that some 10.5 million Filipinos work overseas in a wide variety of jobs such as doctors, nurses, IT professionals, engineers, technicians, seafarers, domestic helpers and caregivers.

The Philippine archipelago consists of over 7,000 islands many of which are uninhabited. The islands are divided into three main island groups comprising Luzon (Manila), Visayas (Cebu) and Mindanao (Davao).

The Philippines is the most exposed large country in the world to tropical cyclones or **typhoons**. They can be so deadly that certain parts of the country like the east coast of Luzon are sparsely populated. On average, 8 or 9 make landfall in the Philippines each year, causing wide destruction and loss of life.

Unlike other countries in the region the Philippines have **no subsidies** on things like food, fuel and power. Indeed, the country's 'safety net' could only be termed modest, making for a strong work ethic throughout the country.

Historically the economy in the Philippines was based around agriculture and low end services. Today it is centred on **Overseas Remittances** and **Services (BPO**), while other industries like Tourism / Gaming are also becoming more important.

Foreign ownership in aggregate in any individual Philippino stock is limited to 40% with the balance of 60% having to be owned by locals.

The Philippines is likely to record **real GDP** growth of 6.6% in 2014 (versus 7.2% in 2013), while **inflation** is likely to be 3.9% in 2014 (versus 2.9% in 2013) according to JP Morgan. In 2013 the country's **current account** surplus as a percentage of GDP amounted to a healthy 4.4%, while its **fiscal deficit** was estimated at a comparatively modest 2%. The country's **external debt** as a percentage of GDP amounted to a respectable 21.8% last year. In short, the Philippines is in sound financial health.

The GDP per capita in metro Manila amounts to US$7,400, but the national average is just US$2,600.

The Philippines remains **under banked**, with just 20% of the population having a bank account. Near term prospects for the Filipino banking industry may be summarised as follows:

Deposit Growth	Single Digit
Loan Growth	High Teens
Net Interest Margins	Flat
Non Performing Loans	Benign
Capital Position	Comfortable

A leading bank commented that historically the credit multiplier in the Philippines has been 1.5x nominal GDP. While it had recently increased to 2x, the bank stated that only 1.5x was sustainable long term.

SEPTEMBER 2014

In the Philippines **stock market** "local institutions trade for price, whereas foreign institutions trade for liquidity". Also, given the modest size of the market it was commented that most overseas interest is buy and hold with hedge fund activity currently minimal due to lack of liquidity.
The Philippines stock market as at December 2013:

Market Indicator	2013	2013 vs 2012 % change
PSE Index year end close	5,889.83	↑ 1.33%
Total Value Traded (in billion Php)	2,546.18	↑ 43.71%
Average daily value traded (in billion Php)	10.52	↑ 44.90%
Foreign buying (in billion Php)	1,308.51	↑ 53.91%
Foreign selling (in billion Php)	1,292.93	↑ 74.68%
Net foreign buying / (selling) (in billion Php)	15.59	↓ -85.83%
Total foreign (in billion Php)	2,601.44	↑ 63.58%
Share of Foreign Trading to Total Trading	51.09%	↑ 13.82%
Capital Raised (in billion Php)	175.07	↓-20.09%
Initial Public Offerings (in billion Php)	60.98	↑ 154.18%
Additional Listing (in billion Php)	114.08	↓ -41.52%
Market Capitalisation, year end (in billion Php)	11,931.29	↑ 9.16%
Domestic Firms (in billion Php)	9,645.22	↑ 2.43%
Foreign Firms (in billion Php)	2,286.08	↑ 51.02%
No. of Listed Companies, Year End:	257	↑ 1.18%
Domestic	254	↑ 0.79%
Foreign	3	↑ 50.00%
No. of Listed Issues, Year End:	294	0.00%
Domestic	291	↓ -0.34%
Foreign	3	↑ 50.00%
Total Market: Dividend Yield	2.36	↑ 1.04%
Total Market: Price-Earnings Ratio	17.95	↓ -5.99%

From an ownership perspective, insiders and domestic institutions own 55%-65% of the Philippines market. In contrast, retail investors own 5%-10% and foreign institutional investors the balance of 25%-40%.

Interestingly, out of the top 1,000 companies in the Philippines, only around 100 are listed. As family companies move through first, second and third generation, ownership will become more diverse. This will likely create a steady stream of IPO's, which will enhance diversity of choice and liquidity in the market. The overall Free Float Market Capitalisation of the Philippines stock market remains tiny at US$64billion and this necessitates that investors take a long term view. Put into perspective, at the end of 2013 Boeing ranked number 107 in the Financial Times Global 500 rankings with a market capitalisation of just over US$65billion.

Luzon makes up 60% of the **cement market** in the Philippines. In turn, the market is dominated by Holcim Philippines and Lafarge Republic, with national market shares of 35% and 29% respectively. The country's archipelago nature and lack of infrastructure make logistics and transport both difficult and very expensive. This results in large barriers to entry for many industries including cement. With signs of a pickup in the **investment cycle,** the cement sector appears well placed. While a small company (market cap around US$1billion), Holcim Philippines is still the country's 14th largest taxpayer.

SEPTEMBER 2014

A leading **utility** company targets nominal rates of return of 13%-15% per annum in the Philippines. In contemplating investment in other emerging markets in the region with a similar stature like Indonesia and Vietnam, it expects nominal returns of between 17%-19%. The requirement for a higher rate of return reflects foreign exchange and political risk.

Demand for **housing** in the Philippines amounts to around 360,000 units per year, versus supply of just 200,000. As such, substantial latent demand for property exists in the country. This is being driven by rising incomes, affordability and a young growing population. That acknowledged, outside of high end properties, real estate prices have increased an average of 3%-5% per year for the last five years. This is because developers have focused on volume rather than price to drive profitability. Typical property prices in Manila are currently as follows:

Position	Size	Price Peso
High end	130,000 square metres	25million (US$568,000)
Mid End	95,000 square metres	15million (US$340,000)
Low End	65,000 square metres	7 million (US$159,000)

Ayala Land is still positive about retail development, due to the need for additional shopping malls in Manila (traffic congestion related issues) and in regional areas (connectivity issues given the archipelago nature of the country). Mall rental yields are low compared with other countries in the region and in absolute terms are still below Asian Financial Crisis levels.

India remains the biggest competitor to the Philippines in **BPO**. Nevertheless, with its large educated workforce, who speak “accent neutral English”, the Philippines is now the world leader in voice based BPO. Furthermore, it is moving up the value chain (non-voiced based BPO’s such as those performing procurement services / payroll entry / data process jobs requiring no voice interaction with customers) in order to sustain growth in future years. The BPO industry in the Philippines was worth US$15.5bn in 2013 and is projected to grow to US$18bn this year and US$25bn by 2016.

The Philippines remains a consumption based economy and its people like their food. Important ingredients for success in the highly competitive, Philippino **Quick Service Restaurant (QSR**) industry are:

1. Brand
2. Taste of product (and innovation)
3. Product quality
4. Value for money
5. Knowledge of targeted market
6. Economies of scale
7. Distribution and support systems
8. Service

Consumers usually opt for fast food because it’s both quick and cheap rather than for its taste. Successful QSR companies combine all three.

The QSR market in the Philippines is currently worth Peso 500billion per year and is growing at 12% per annum. Growth drivers are higher consumption expenditure, urban migration and demographics. The market remains “fragmented” with the organised trade having 27% of the market and the unorganised “Sari Sari” trade having 73%.

A common mistake QSR chains make in emerging markets is expanding too quickly. This typically results in infrastructure and personnel deficiencies, resulting in product quality and supply chain management issues. For example, there have been a number of food health scares in China.

There are material differences between the developed world and EMA's. The West suffers from widespread obesity, whereas malnutrition is still an issue in other parts of the world. As such, children in countries like the Philippines drink Coca-Cola. This occurs not because it is good for them, but because sugar in developing countries, which Coca-Cola contains in abundance, is a cheap form of energy, that particularly appeals to a young working demographic.

Both company owned and franchised models can work in the QSR industry. While franchised models have disadvantages, a sense of ownership, coupled with an ability to find good store locations and knowledge of local customers, frequently produces very positive results.

The Philippines has embraced new **technology** and as at January 2014 had:

105.7million people	49% urban and 51% rural
37.6 million internet users	36% penetration
34.0 million active Facebook users	32% Facebook penetration
106.9 million active mobile subscriptions	101% mobile penetration

From a social media perspective, 94% of internet users in the Philippines use Facebook compared with only 54% in the USA. Facebook chat is the most important app and Filipinos spend more than five hours a day across various social media channels. This makes the Philippines the most engaged populace in the entire Asia Pacific region.

While mobile penetration in the Philippines is 101%, smartphone penetration is still low at 15% (China 75%, Thailand 49%, Indonesia 23% and India 18%). That acknowledged, smartphone penetration is expected to grow rapidly in future years. The two major network operators for mobile internet in the Philippines are Smart Communications and Globe Telecoms, which combined control 83% of the market. Some 88% of the mobile internet population is below the age of 34, which is very important from a macroeconomic perspective. A telecommunications executive commented that "In the past, Filipinos used to go to the "Sari Sari" store to purchase bread, now they go there to load their "sim cards." Nearly seven out of ten Filipinos who are online still access the internet via internet cafés.

South Korea

During our week-long visit to Korea we were lucky to meet a senior official from the Government's Economic Policy Bureau, who shared with us some policy insights. From an **economic** standpoint Korea is doing relatively well.

Economic Overview:

GDP	3.7% in 2014 (good relative to USA / Europe / Japan)
CPI	1.8% (too low)
Unemployment	3%
Current Account Surplus	3.7% (but in 2013 it is going to be 5%-6%)

While the CPI is low, a risk of deflation exists should a "world shock" occur. The overall unemployment rate is good, but youth unemployment at 8% is a challenge. Furthermore, while the Government wants to have a current account surplus, it regards 5%-6% as too high

It was commented that Mr Choi (Deputy PM and Finance Minister) is introducing new policies to try and resolve some of these challenges. Indeed the Government is putting more focus on domestic demand. Its aim is to increase household income and to lower the current account surplus by increasing imports. To do this it is giving tax / financial incentives to corporates to hire people and increase wages. Minimum wages are currently the equivalent of around US$5 per hour, having recently been increased by 7%.

Labour income tax incentives – the Government has asked companies to increase wages and if this occurs, they will get tax incentives.

Dividend tax incentives – dividend payout ratios are currently very low in Korea. If companies increase dividends they will also get tax incentives.

Corporate income tax circulation tax system – Chaebol's have historically accumulated massive cash piles to use for their own purposes, such as the establishment of cross shareholdings. The Korean government wants this cash to be used more productively by increasing wages, paying higher dividends or being invested. If this surplus cash is invested in such ways, the companies in question will be granted tax incentives. Again, while the aforementioned reflects Mr Choi's policy, details are yet to be formulated. These factors are all potentially positive for the stock market.

In 2014, the Korean Government set out an Economic Innovation plan for period 2014-2017 to boost growth. Initiatives included the following:-

- Raise Labour Supply (women and youth)

- Boost Investment

- Boost Productivity – focus on Deregulation (Korea is even "complicated" for Korean people!) and the Service sector industry

- Introduce specific project based solutions to sort out issues corporates face associated with:
  - Regulation
  - Tax
  - Labour
  - Environmental

Furthermore it was noted that the Household debt/household income ratio (1.6x) is very high in Korea, due to high property prices, relative to household income and the need to take out large mortgages. The Government wants to try and improve this position. As previously stated this will be done by encouraging companies to increase wages and job opportunities and as an incentive it will grant tax incentives.

Turning to other industry/company observations and comments in Korea:

Retail sales growth in Korea has averaged around 5.7% over the last eight years. However, in 2013, it amounted to only 1.5%, but should recover to 3.8% in 2014, based on government initiatives to increase consumption. New trends evident in the Korean retail market are "trading down" and growing online shopping.

In 2013, South Korean retail sales amounted to KRW 265 trillion and comprised:

Department Stores	11.3%
Discount Stores (hypermarkets)	17.1%
Supermarkets	13.5%
Convenience Stores	4.4%
Online and Home Shopping	14.5%

Home Appliances	2.8%
Specialised Stores	36.0%
Overseas Online Shopping	0.4%
Total	100%

South Korean companies have developed a world leading position in Original Design Manufacturing (ODM) of **cosmetics**. In effect, this means the development, manufacturing and packaging of cosmetics to specifications given by a customer. In turn the product is branded, distributed and sold by the customer, such as a global cosmetics company or a retailer.

South Koreans only spend 3% of GDP on **culture and entertainment** compared with 6-7% in both the USA and Japan. This should ensure industries exposed to this area of the economy, such as ticketing and travel companies, have favourable growth prospects for many years to come.

The **digital music** market in South Korea is worth US$570 million and it is expected to grow to around US$602million in 2015. From a composition standpoint downloading accounts for 70% of the market and streaming 30%.

The largest **security services** provider in Korea is S1 with a market share of 60%. Its closest rivals are ADT with 25% and KT Telecom with 11%. Subscription growth is 7-8% per year, but average revenue per user peaked in 2011 and has subsequently declined 1-2% per year. While a high quality reoccurring business, future industry growth is likely to be modest by historical standards. As such, S1 has recently expanded into building maintenance (facility management / property management / brokerage). Demographic trends favour security service firms.

The global **medical care and pharma** market is worth US$5,800 bn which is 1.7x bigger than the Information Technology market. Korea has some interesting companies operating in this area, who we visited on our recent trip.

South Korean **movies** account for 49.1% of the country's **cinema** market with the balance ex-Hollywood. The industry has grown just under 7% over the last 10 years, despite Korea having the highest annual admissions per capita in the world. Over recent years the industry has consolidated and in 2013 three companies had a combined market share of over 90%. At least one South Korean company is now rapidly expanding elsewhere in Asia, where cinema admission per capita is amongst the lowest in the world.

The **convenience store** industry in Korea, with some 25,000 stores, accounts for around 4.5% of retail industry sales. Growth drivers for the future include more stores (60,000 Ma & Pa stores still exist in South Korea), more private label sales, increased high margin product sales and improving relationships with franchisees. The industry remains very concentrated with the top three players having a combined market share of over 90%. While future industry growth is unlikely to match the 17% achieved historically, it should still average 8%-9% (demographics) and margins are likely to improve.

Private equity continues to be reasonably active in Korea. MBK (Korean private equity fund) purchased a stake of 31% in Coway in 2013. Coway's key products are water purifiers (market share 45%), bidets (market share 38%) and air purifiers (market share 38%). The company's whole business is centred around a rental model which gives it high quality reoccurring revenue. Coway is currently expanding its business in China.

Indonesia

The trip also included Indonesia where we saw 9 companies in Jakarta. The industries covered were mainly consumer, banking/insurance and industrials. The general mood post the **election** result was positive. Joko Widodo's win was expected by the business world, but it proved closer than expected. Feedback on him has been very favourable. He's apparently hard working, competent, has no corruption history and is willing to implement reform. Furthermore, he seems more open to foreign investment, with the reality that Indonesia's economic situation will outweigh protectionist/political policies. Lastly, he's not from an elite political background, having been a business man before becoming Governor of Jakarta.

The country's population has high expectations that their lives will improve under Joko Widodo. The PDI-P Party and its partners control 37% of Indonesia's Parliamentary Seats, compared with Prabowo's Gerindra Coalition with 52% and the Demokrat Party with 11%. Nevertheless it is expected that elements of the Gerindra Coalition (the PAN and PPT parties) will shift their alliance to the PDI-P, giving it a small Parliamentary majority (around 53%). Given the nature of politics in Indonesia, it is very important for Joko Widodo to be a strong leader and his track record as Governor of Jakarta suggests he will be more decisive than Susilo Bambang Yudhoyono.

It should be remembered the **Indonesian Presidency** is a very powerful position. For example, as well as controlling the military, it can also issue regulations without parliamentary approval. Furthermore, Joko Widodo is likely to be well supported by his highly experienced Vice President, Jusuf Kalla and people like Basuki Purnama, who will shortly succeed him as Governor of Jakarta.

Indonesia's **macro-economic** position remains challenging and many of the reforms likely to be undertaken by Joko Wijodo's government will exacerbate the situation in the near term. Indeed, the benefit of any reforms undertaken will take several years to fully eventuate (like India).

Currently Indonesia is experiencing a slowdown in GDP growth (2014 E 4.9% source JP Morgan) and investment, elevated inflation (2014 E 5.75% source JP Morgan) and both a current account and a fiscal deficit. These factors have manifested themselves in both a weak currency and, until the last quarter, an under-performing stock market.

In an attempt to meet these challenges head-on, Joko Widodo has already formed a Transition Government and has substantially staffed his Cabinet (34 people) with technocratic people. While longer term Indonesia must do more to improve **governance**, its most pressing near term need is to undertake **reform** in key areas of the economy.

Amongst the most important of these is the removal of **energy subsidies**. According to CLSA, the Indonesian Government spends around 22% of its budget on these subsidies which account for 4% of GDP. Indeed, this amounts to around US$30bn per year (US$21bn is comprised of fuel), and complete elimination would remove the country's fiscal deficit.

Along with the above mentioned initiative, improving tax collections (12.3% GDP) would free up substantial amounts of capital that could be used for more productive purposes. Examples would include:

- Infrastructure development (1.9% of GDP in 2013 but with a government target of 3.7% in 2017). This should be aided by the Country's Land Bill becoming effective in 2015.
- Energy Diversification (more natural gas and coal).

- Improved Education (less than 4% of Indonesians have been to university and only 2% of the population speaks English) and healthcare services.

- Minimum wage reform.

Turning to specific industries, liquidity in the Indonesian **banking** sector remains very tight. This is the result of loan growth of 20-25% per year vs deposit growth of 15% per year in recent times. Bank of Central Asia (BCA) is considered one of the best managed banks in Indonesia. 75% of its deposits are sourced from current accounts and savings accounts. Furthermore, the bank has been prudent in capping its Loan to Deposit Ratio at 75%. The bank estimates its loan growth will be 10% at best this year. That acknowledged, BCA's Net Interest Margin is still a healthy 6.5% and while Non-Performing Loans may rise slightly they appear to be well controlled. The banks ROE remains an impressive 25%. Interestingly, but not surprisingly, rich Indonesians still prefer to have a good proportion of their capital held/managed outside of the country in countries like Singapore.

Total Indonesian **life insurance** premiums in 2012 amounted to around IDR100tr. The life insurance sector has been growing at 25% CAGR in the past 10 years and will still register 15-20% growth going forward. Growth drivers include the growing middle class, aging population and the fact that government is trying to educate people in terms of getting protection.

Indonesia's life insurance premium/capita is US$46 compared with the world average of US$370. At present most people are interested in protection rather than investment products (70:30 split). The primary means of selling life insurance in Indonesia is via agents (48%), banks (30%) and the balance is done through channels like telemarketing. There are 47 insurance companies operating in Indonesia and high levels of profitability continue to attract new market entrants. Prudential is the market leader in the Indonesia's life insurance market with a 25% market share.

The **Do it Yourself or DIY** market in Indonesia is under-penetrated, worth about US$2.2bn and growing at 8-9% a year. ACE has a market share of 18% (No 1) and is currently growing between 15-20% per year. ACE believes its competitive advantages are its brand, scale, diversity and supplier relationships. The company's target market is "middle to upper class" consumers with incomes of the equivalent of US$4,000 or more each year.

The Indonesian **pharmaceutical** market currently comprises:

OTC	41% v 20% in developed markets
Prescription	59% v 80% in developed markets

In turn prescription medicines are split:

Branded and licensed	86%
Unbranded	14%

Going forward growth in branded and licensed medicines is likely to be 10-15% per year, whereas unbranded medicines are likely to grow 20%.

The per capita spending on healthcare in Indonesia is US$132 compared with China's US$470 and Australia's US$3,780 and accounts for no more than 3% of Indonesia's GDP. The government is implementing a universal health care insurance scheme to cover the whole population by 2019.

Currently the total Indonesian pharma market is worth IDR53tr and blended average growth in future is likely to be between 15-20% per year. The largest player in the market is Kalbe Pharma with a market share of around 12%.

There are 10 **television** channels in Indonesia and importantly no more spectrum space available. People in Indonesia watch 5-6 hours of TV every day. TV advertisements in Indonesia are one of the cheapest in the region (US$4,000 vs India's US$9,000 and Philippines US$13,000, 30sec prime time rate) and advertising spend, which is sourced 80% from FMCG companies, is growing at 15% per annum. Most of the content is locally produced and inexpensive.

Indonesian **cement** demand continues to grow around 5-6% in volume terms and should be a major beneficiary of infrastructure development over future years. Highlighting this potential is the fact that the last major road, linking East Java and West Java, was built in the Dutch colonial era. Indocement, the country's second largest cement company behind Semen Gresik, believes it will grow in line with the market and that price increases will continue to be forthcoming. While we still like the oligopoly nature of the market, near term the reduction in fuel subsidies and an increase in electricity tariffs may impact margins. Lastly, uncertainty exists over the industry's planned expansion plans and the possible entry of new players beyond 2016.

United Tractors, the Komatsu dealership agent in Indonesia, is also a substantial **mining contractor** and producer of **coal** in its own right. Management stated that in regard to the company's own coal production, that its costs amounted to the equivalent of US$68-71 a tonne in 2013. This compared with a Newcastle coal price of just under US$70 a tonne at the time of our visit. It is worth mentioning that United Tractors had reduced its cost of coal production from US$75 a tonne in 2012 by lowering its stripping ratio. The company still aims to lift coal production by over 60% between 2014-16, assuming no further price weakness. Apparently the lowest cost coal miners in Indonesia have a cost of production around US$55 a tonne.

As developing economies like Indonesia grow and become more affluent people's **diets** change to incorporate more protein. Chicken is a favoured source of protein in Indonesia because it is inexpensive compared with other alternatives:-

Protein source	Price/kg (Rp)	Protein content	Protein Price/Gram (Rp)
Egg	16,700	12.5%	134
Chicken (Boiler) meat	36,300	18.5%	196
Fresh milk	24,895	3.5%	711
Beef	192,000	20.0%	960
Fish	190,000	17.5%	1,086

Prices as at May 2014

Indonesia's poultry consumption per capita (kg/year) is also modest compared with other countries in the region:-

Country	Chicken consumption per capita (kg/year)	Income per capita (US$1,000)
Brunei	47	38,800
Malaysia	38	10,600
Thailand	16	5,800
Philippines	9	2,500
Indonesia	8	3,700
Vietnam	6	1,500
Cambodia	2	800

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Market Outlook

Following years of unconventional monetary policy, the divergent trends between world growth and asset prices continues. As we have mentioned before, whether the Federal Reserve is tinkering or tapering, is open to debate and although widely expected, “tightening” has not yet occurred. While quantitative easing has been substantial, its economic impact to date has been modest and we feel that the American economy is not as strong as many perceive. Whether quantitative easing ends with success or failure, “weaning” the world off cheap credit, at a time of elevated debt and historically low interest rates, will be challenging and fraught with difficulties. It remains to be seen if central bankers are up to the task, given the high levels of geopolitical tension and economic uncertainty that currently exist around the world, as well as concerning issues like Ebola. As such, we feel some measure of caution is warranted from an investment standpoint and that sensible diversification by geography, industry and asset class (including cash and gold) is of paramount importance. With positive political developments occurring in many, but not all Asian markets, we remain favourably disposed to the region and continue to find sensible investment opportunities. Our search is aided by the continuance of sound economic growth, centred on generally orthodox monetary policies. Reasonable valuation levels, post a number of years of under-performance relative to developed markets, is another attribute. In summary, while we remain positive about Asia, we remain concerned about the impact that external shocks, emanating from elsewhere in the world could have on the region. While we acknowledge and applaud the Chinese leadership’s seemingly real commitment to reform, it remains the Asian economy most at risk from systemic shock. That stated, it is also now Asia’s cheapest stock market and arguably at least some of the risk has already been discounted in stock prices.

Portfolio Characteristics

	Portfolio	Benchmark	Variance
Number of Stocks	50	595	545
Beta	0.87	1.00	-0.13
P/E (X)	13.8	11.7	2.1
Yield (%)	2.5	2.8	-0.3
P/B (X)	2.4	1.6	0.8
Historical EPSg(%)	11.0	12.6	-1.6
Forecast EPSg(%)	11.9	8.2	3.8
Return on equity (%)	17.2	13.2	3.9
Dividend Cover (x)	2.9	3.1	-0.2
Net Debt/Equity (%)	-6	31	-37

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