REPRINTED FROM JANUARY 28, 2019

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Looking for Stocks with Low Valuations and Possible Catalysts in Asia

JAMES MORTON is Chief Investment Officer and a Portfolio Manager at Santa Lucia Asset Management Ltd. He has extensive expertise in recovering and small-cap companies, as well as emerging markets. Mr. Morton's career in the investment industry began in 1985, and he was a subadviser to Mackenzie Cundill between 1996 and 2018. He is an accomplished author, editor and investment columnist. Mr. Morton holds a degree in law from Trinity Hall, Cambridge University, and an M.A. in third-world economics as well as an MBA from Stanford University.

SECTOR — GENERAL INVESTING

TWST: Could you tell me a little bit about the firm?

Mr. Morton: We do equities in Asia, ex-Japan. We're a value investor, which is a bit unusual for our part of the world. We look for stocks trading at a discount to net asset value mark to market, and we also have a high yield equity strategy, for shares that are trading at yields significantly above benchmark.

TWST: Did you want to talk a little bit about the current investment climate that you're seeing?

Mr. Morton: I think it's interesting to comment on the dynamics in the political environment in the Asian part of the world compared to the U.S., North America and Europe. This will be quite a lively year — 2019 — since about 80% of the people in Asia who actually get to vote will be voting in the first half of the year. The most important of course being India, but Indonesia too. Also, Thailand looks like they're finally going to have an election. And this has the potential to make a difference.

I'd like to start off with Indonesia because that's probably the easiest. The incumbent known as Jokowi is looking very likely to get elected for a second term, and because the elections to the parliament are happening at the same time as the presidential ones, which is not always the case, he is also likely to emerge with a very strong position, able to more or less push through any program he wants.

Now, this is important for a couple of reasons. Firstly, in the last few months, a bit of momentum has gone out of the government. It has been thinking more about how to win a second term than what they're doing today, and that's affected, in particularly, the construction sector, with new awards down and programs running a bit late and payments to contractors behind schedule. But in a second term, we know presidents behave differently. They're thinking more of their legacy. The first couple of years, in particular, they should have an ability to carry out that program without considering the negative consequences on the voting public, so doing things that are right for the country.

Jokowi has shown himself to be a good president. So we expect Indonesia to be one of the best economies in the region, once the elections are out of the way. Elections tend to depress activity, but we expect construction in particular to pick up because infrastructure has been one of his great achievements. I'm sure he will want to push that forward across all aspects of infrastructure, not just roads, light rail and so forth, but ports and airports — as all have a hugely positive multiplier.

In addition, he can take further steps to improve tax collection in the country, which is still at a very, very low level relative to where it should be. And we expect him to continue a program of reform and cleaning up the political environment once the election is out of the way. So we're very encouraged.

Indonesia had a tough year in 2018, partly because of the weak currency and a slowing economy pre the election. I think it is a country where you could see economic forecasts ratcheted up rather than down as the year progresses. The central bank in Indonesia had to raise their base rate 175 basis points last year to protect the currency. There may be one more rate increase in the pipeline, but more likely, by the middle of this year, we will see rate reductions. And as we know, those are beneficial to several sectors, such as property, and we should see that reflected in the stock market. So we like Indonesia as a country, and we think that the market will be one that surprises to the upside compared to analyst forecasts about the year ahead.

We've talked about Indonesia in the past and still like most of the same stocks. **Persero** (IDX:PTPP) is one of the big four SOE contractors in the country. They have particular expertise in airports and

ports, which are going to get, I think, a lot more emphasis, and they've been winning big contracts. If you look at the price/earnings and market to book, this company is pretty close to its all-time lows since listing, although it has bounced off the bottom since October and unfortunately was up 5% or 6% this morning, which is a good way for them to start the new year, but not so great if you haven't got it in your portfolio.

There will be reform of the sector with two new holding companies created, which I think will facilitate new contract awards, and the government is keen for these companies to be profitable, so they can reinvest and expand infrastructure — as I said, being a key priority for the administration. I think we will see even more of this in the second term, which should lead to a return closer to the multiples we saw when Jokowi was elected the first time, which were three times the current multiple.

In the same context of an improving economy, financial stocks, which are a big part of the Indonesian market — we like **CIMB Niaga** (IDX:BNGA). Again, unfortunately, the stock was up a lot the first day of the year, but it's deeply oversold, has strong management, good credit control with low nonperforming loans and a reasonable net interest margin and a leading position in online banking. And when you put all these things together, it's strange that this company is trading at such a deep discount to the sector.

Highlights

James Morton discusses Santa Lucia Asset Management Ltd. Mr. Morton is a value investor in equities in Asia, ex-Japan. He notes that this will be a lively year in Asia as there will be quite a few elections taking place in the first half of the year. Mr. Morton suggests investors look for domestic-focused businesses in Asia that are ideally related to consumption. He also recommends looking for undervalued stocks with a possible catalyst.

Companies discussed: Pembangunan Perumahan (Persero) Tbk PT (IDX:PTPP); Bank CIMB Niaga Tbk PT (IDX:BNGA); West China Cement Limited (HKG:2233); Anhui Conch Cement (ADR) (OTCMKTS:AHCHY); Hopefluent Group Holdings Ltd. (HKG:0733); Technovator International Ltd. (HKG:1206); China Nuclear Energy Technology Corp. Ltd. (HKG:0611); China Suntien Green Energy Corp. (HKG:0956); China Lilang Ltd. (HKG:1234); Xtep International Holdings Limited (HKG:1368); Bosideng International Holdings Limited (HKG:3998); Accordia Golf Trust (SGX:ADQU); Orix Corporation (TYO:8591); Filinvest Land (PSE:FLI); E Ink Holdings (TWO:8069); Pricer AB (STO:PRIC-B); Xiaomi Corp. (OTCMKTS:XIACF); Coolpad Group Ltd. (OTCMKTS:CHWTF); Qingdao Hisense Electric Co. Ltd. (SHA:600060) and China Resources Cement Holdings Limited (HKG:1313).

I think it's a legacy issue because **Niaga** had problems in the past, so that is another where we would look to take advantage of a stock that's come off a long way from its high. In fact, until today, it was trading at 60% of where it was a year ago, and at the same time, the earnings and the net asset value per share of the company were growing 10% and probably higher growth in 2019. So these are two interesting ways to get involved in Indonesia, which we feel very positive about.

Moving onto India, almost all people believe that Modi will emerge again from this contest with a majority, but perhaps not as great as he has now, which may cause him to have to rethink a little bit his coalition structure. He's a great campaigner. I wouldn't count him out even though his party lost a couple of key state elections toward the end of 2018.

So continuity is the theme here. Continuity in Indonesia, with a stronger position. Continuity in India, perhaps a weaker position. And we just saw Bangladesh also voted to return Hasina again with a landslide. Continuity is usually better for markets, and the reverse is not so good. Look what happened in Malaysia when we got a surprise there last year.

Thailand, well, that will be another story with the country coming out of military rule, but there again, the probable person to emerge as prime minister will be a general who is currently effectively running the country today. So whatever happens to the Senate and the constitutional bodies, I don't think we're going to see any significant changes in policy post the election.

When you add all this up, what is interesting to me is that you've likely got stability politically in large parts of Asia. And that seems to contrast favorably in my view with the political situation in the U.S. where obviously President Trump faces a very different set of dynamics with the new Congress, and in Europe, where European elections in May look likely to change the composition of the European Parliament, and all the top positions in Brussels and the ECB will be changing in the second half of next year. And there are also a lot of things going on politically in almost every country in Europe that could be considered uncomfortable. So it suggests to me that the deep discounts of valuation multiples you see in most of Asia, China and Hong Kong, in particular, maybe they don't deserve to be so lowly rated compared to markets in Europe or North America where the context might be more uncertain and more difficult in this coming 12 months.

"So continuity is the theme here. Continuity in Indonesia, with a stronger position. Continuity in India, perhaps a weaker position. And we just saw Bangladesh also voted to return Hasina again with a landslide. Continuity is usually better for markets and the reverse is not so good. Look what happened in Malaysia when we got a surprise there last year."

TWST: Did you want to talk about some other locations and companies?

Mr. Morton: Yes. We must come back to China, of course, although they aren't voting and not likely to be voting any time soon. But China remains the core country around which everyone else is

really a satellite. And so we have to feel confident that country can continue to pull its weight.

Obviously, we expect lower growth. The general economic statistics released at the beginning of this year tell us that the country is going to be growing at a lower pace, but it's still going to be growing. And there are a lot of very, very interesting companies that are being overlooked by the market, which offer great investment opportunities.

1-Year Daily Chart of West China Cement Limited

Chart provided by www.BigCharts.com

which was relatively becalmed last year with projects being delayed, particularly in the first half of 2018 due to the audit of all PPP inventory — and money not being made as available at the local government level as in years in the past.

But this year, we expect to see more. We think there will be modest growth in most cement markets, low single digit, but when you are at a high utilization level, every extra percent is very profitable, and we think pricing will be flat to slightly up year over year, plus coal should be slightly down. Therefore, although this is a somewhat cyclical industry, we see companies like **West China** capable of earnings growth of 10% against this very low p/e. Also, the company is trading at roughly half the replacement cost of its capacity.

In addition, I think in China, for 2019, successful investors need to find stocks that have catalysts. And the catalyst here is that **Anhui Conch** (OTCMKTS:AHCHY), the second-largest cement producer in China, did try and take control of **WCC** three years ago. The price at which they were going to bid though — which was unable to go forward because of regulatory intervention — was HK$1.69 per share. That compares to the closing price for 2018 of HK$1.06 at a time when the company is making twice as much money or more depending on which part of the income statement you're looking at. So we think there's a potential M&A catalyst here over the next 12 months, which could be an added benefit over and above an upside earnings surprise against market forecasts.

"But this year, we expect to see more. We think there will be modest growth in most cement markets, low single digit, but when you are at a high utilization level, every extra percent is very profitable, and we think pricing will be flat to slightly up year over year, plus coal should be slightly down."

I'd like to start with **West China Cement** (HKG:2233). We like this industry because it's been a story over the last couple of years of consolidation of market share within a circumscribed geographic area where cement plants compete. Consolidation has been driven by government policy to get companies to reduce pollution. That has been a big focus for the cement industry, and partly because of that, the government has not been pushing the industry so hard on pricing because they want them to invest in clean technology and upgrade their operations, and of course, that investment process caused smaller, less efficient, highly polluting plants to fall by the wayside. That led to significant market share concentration, with the result that margins in the industry have risen and the gross profit per ton is now in some places at the highest levels we've seen in recent history.

And **West China Cement** — that company is the market leader in Shanxi Province. It's really only got two competitors in its core market geography. And this company has seen a huge rebound in profit to the extent that it looks to be trading at its year-end price for 2018, at roughly three times historic earnings. In our view, we should still see some growth this year mainly through aggregate acquisitions they've made to improve vertical integration. And the industry as a whole should be a beneficiary of the need of China to stimulate domestically in order to offset negative headwinds affecting exports.

We think people need to look carefully at their choice of individual stocks in China to make sure they are aligned with policy. And the cement industry, I think, will benefit from a pickup in infrastructure,

1-Year Daily Chart of Hopefluent Group Holdings Ltd.

Chart provided by www.BigCharts.com

And staying in the theme of domestic Chinese companies, I would look at a company called **Hopefluent** (HKG:0733), which is a realtor, the largest in Guangdong. Many people would say Guangdong is the most important province in China. This is a company that has fallen a bit off of investors' radar screen last year because it was engaged with a transformational acquisition of the realtor operations of **Poly**, which is the fifth-largest real estate company in China measured by space sold. That deal has occupied management for most of the year. It has been completed, but there's a couple of conditions relative to the issuance of equity at, I should say, a very high premium to the current share price

— actually about 100% if the proposed price does not change. That still awaits regulatory approval. So management has not been able to engage with the market at a time when real estate in China is out of favor.

"Policy has not really turned, but minor helpful changes would be consistent with what you might expect given the need the government has to stimulate the domestic economy. And therefore, they cannot allow property, which is still a very important part of the economy, to go too soft."

However, I think it's very important to note that the negative policy environment around Chinese property, which has prevailed really since Q3 2016, so for two and a half years now, has started to at least move into a neutral stance, and there are even one or two signs of local policy relaxation. Policy has not really turned, but minor helpful changes would be consistent with what you might expect given the need the government has to stimulate the domestic economy. And therefore, they cannot allow property, which is still a very important part of the economy, to go too soft.

Hopefluent is now trading pretty close to its all-time low valuation multiples. This is a company, when it reports in March, that is likely to show it's trading on a p/e of about four times. And it's net cash, so no financial risk. But it's now the third-largest or will be the third-largest real estate company in China as well as the leader in Guangdong once this deal can be booked in its financial statements. We will only see a full year of these earnings in 2019 and, on top of that, should see an improvement in the property market for realtors relative to forecast, which is calling for negative growth. So we like **Hopefluent** because it's been marked down 50% from its share price high last year, and yet, earnings should be up in double digits with the impact from this acquisition, meaning the company is capable of delivering 20% earnings growth in 2019. So a real valuation anomaly.

TWST: Are there any other companies or regions you want to talk about?

Mr. Morton: I think we can stay with China. If you want a really unusual situation, look at **Technovator** (HKG:1206). This company came out of Tsinghua University in Beijing and is what they describe themselves as: a green construction company. Again, I would say you want to pick domestic companies, and this one is 100% domestic. They have a number of different areas of activity: transportation, smart cities, smart buildings.

Their business model is interesting because a lot of contracts are designed as a sort of profit share arrangement. By which I mean, it says to a local housing authority, "Look, let us come in and install our programs, our controls, our systems and our kit, and we will make the buildings you're managing much more energy efficient. We will reduce significantly the total amount of energy you need, and what we'd like is a percentage of that saving." So it's a little unusual in that respect.

And in the same way, they have developed state-of-the-art technology for particularly MRT, which is a growth area, and they have been able to retool part of the Beijing subway, for example, with a superior set of signaling and timing devices. So this is an unusual company on many levels. It was a subsidiary effectively of a state-owned entity. It hasn't really been run as a proper public company, and the share price has come off over 85% since 2015. It's trading at a deep discount to where shares were placed and also at about a third of the price of management stock options.

1-Year Daily Chart of Technovator International Ltd.

Chart provided by www.BigCharts.com

With this depressed share price, you've got a company that effectively is on an EV/EBITDA of around 1.5 times. Again, this company has no debt. It's trading on a p/e below three and is about as cheap a stock as you can find anywhere but not because it's not growing; it is growing. Earnings should be growing probably midteens. The business has its own proprietary technology; the business has a sustainable growth model.

So it's interesting to note a couple of new developments. The first is the company got a new Chairman last year. It's probably too soon to expect dramatic change, but the previous Chairman was much more of an academic than a business leader and ran the company accordingly.

What makes **Technovator** really interesting at this particular moment is that, on the 31st of December, the university effectively sold its controlling stake to **China Nuclear Engineering Corporation** (HKG:0611). This is a company trading at a 17 times earnings multiple. So a completely different animal, obviously, specializing in nuclear but needing new growth areas and needing to improve its image, and **Technovator** is a green construction company. I think you'll see dramatic changes when this deal gets finalized, which may take a few months.

Obviously, one might expect **China Nuclear** to want to buy the rest of the shares in **Technovator**. They could certainly afford to pay a massive premium to the current depressed market price. So I come back to the point I made earlier, which is you want to buy domestic shares in China because that way you're largely insulated from whatever happens externally. You want your company positioned in a policy-friendly environment, which this company certainly is, and lastly, look for some possible catalyst, and this transaction is clearly a transformational deal.

There are ways that **China Nuclear** could go that would be less supportive to minority shareholders, and we need to recognize that's a risk, but the upside-downside ratio looks very compelling. And when you look around China, the areas that I think should attract investor attention are things like renewable energy. We have a holding in that space, **China Suntien** (HKG:0956), that looks attractively priced.

Domestic brands that are focused on Chinese consumers, companies like **China Lilang** (HKG:1234), are interesting. **Xtep** (HKG:1368) is a sportswear brand, which has been enjoying a revival. **Bosideng** (HKG:3998) is another company, a market leader in down jackets with a potential catalyst from the Winter Olympics coming up in a couple of years. So this is where I think investors need to look. They need to be very careful investing in trackers or indices because these sorts of stock aren't to be found there, and these are ones that are likely to outperform.

"So this is where I think investors need to look. They need to be very careful investing in trackers or indices because these sorts of stock aren't to be found there, and these are ones that are likely to outperform."

1-Year Daily Chart of Accordia Golf Trust

Chart provided by www.BigCharts.com

TWST: Are there any other companies or locations you want to talk about?

Mr. Morton: I think we should venture further around Asia because there are lots of other interesting things going on. And again, you want cheap stocks that are special situations. One which has had a very difficult couple of years is **Accordia Golf** (SGX:ADQU), listed in Singapore. This is the largest owner of golf courses in Japan.

Now, this company had just a terrible period where everything that could possibly go wrong has gone wrong. The weather, as we know, is becoming more volatile, but in Japan, starting in September 2017, you had a horrendous period with more than normal typhoon activity followed by a very severe winter, with a lot of snow affecting a number of golf courses. Because there was a lot of snow, there was flooding and then a very wet period going into the spring. After that, they were affected by earthquakes. After that, you got the hottest August I think on record, and when it's that hot, people don't like to go out and play golf — and then a bunch more typhoons.

This company is unlikely ever to experience such a bad weather sequence again. And it's obviously had a severe impact on the number of playing rounds. **Accordia** managed to more or less hold price per round, but it's caused the dividend to drop by about 40%, and the share price, too, has come off from SG$0.80 to about SG$0.50, which is a major move. Now, this is a stock that is owned for its yield. And of course, the distributable dividend per unit — DPU — had to take a hit of 40% over the last 18 months.

It's almost inconceivable that this company could have such a bad weather scenario looking forward in 2019. If we just assume that normal weather conditions return, and that's not an unreasonable assumption, they're going to have a significant uplift in distributable dividend per unit this coming 12 months, and there's really no reason why the stock shouldn't retrace most of its decline, maybe not all the way up to SG$0.80, but SG$0.70 would put it on a yield of around 7.5%, which is very attractive. In addition, if you look at the valuation of the courses, they are a lot higher than the current share price — in fact, over SG$0.80 a share.

And again, as I say, you want to find stocks with a catalyst. The catalyst here is that the owner of a management company, a Korean venture capitalist, MBK, a firm with a good reputation, recently started to buy more courses. They've bought a bunch of courses from **Orix** (TYO:8591), the Japanese financial conglomerate, the fourth-largest owner in Japan. If you look at the sorts of yields golf courses have been selling at in Japan, **Accordia**, on its normal operating cash flow generation, would be valued closer to SG$0.80 than SG$0.50.

The logical thing, if MBK wants to buy courses, is to buy **Accordia Golf**, but of course, they may choose not to. There are no guarantees in M&A. If they do not, we expect management will use its new banking arrangements to buy more courses that would be DPU-enhancing and may sell a few underperformers as well. So I think **Accordia** fits the bill for what investors need to be looking for in 2019, which is domestic-focused businesses related ideally to consumption that have a degree of undervaluation and some kind of possible catalyst.

TWST: And any other companies that you want to highlight?

Mr. Morton: Let's stay with this theme and move to the Philippines. I've got one for you there. **Filinvest Land** (PSE:FLI) is not one of the top-tier developers, but it is one of the bigger tier-2 developers in that country. Their primary residential development business is not exciting, targeted at the low end that often appeals to overseas foreign workers. Overseas remittances into the Philippines have been strong but were lower growth in 2018 — although the currency helped with the weaker peso. But the domestic environment for residential real estate in the Philippines deteriorated in 2018 also because of rising interest rates, so that side of the business, which is their legacy business, has been underperforming.

However, the reason why we like this company and think it fits the narrative we are looking for is that they have a very substantial pipeline of investment property, which they have been building out starting about five years ago. It was a relatively small part of the business back then, but when the 2018 year-end numbers come out, I expect to see rental income at about 50% of the operating profit versus below 20%, and that percentage should continue to increase in 2019 all the way through 2021 as its announced pipeline completes and is rented.

1-Year Daily Chart of Filinvest Land

Chart provided by www.BigCharts.com

We don't expect this company to be liquidated — unfortunately — but there are two possible catalysts. Firstly, the market must, at some point, and I think it will come in 2019, recognize the improvement in the quality of earnings with now over 50% from recurring revenue from their own investment portfolio. That profit stream has a very different level of attractiveness than low-end residential real estate. This company has transformed itself.

And the other interesting potential catalyst relates to a number of programs going on at Clark Airport where **Filinvest** is actively involved. We aren't sure exactly what its role will be, but it's building some offices there. There are a number of other things where it might get involved depending upon bids that are ongoing to redevelop this area, which could become the second most important logistics hub in the entire country. So there is potential blue-sky upside, which is not factored into any of these valuations, and **Filinvest** is already at a massive discount to the lowest estimate of its net asset value.

I'd like to end in Taiwan. The company that's attracted our interest there is **E Ink Holdings** (TWO:8069). It's a little different from everything else we've talked about. It doesn't exactly fit our normal value model, but it does have fascinating catalysts and, in particular, an extraordinarily dominant market share in its core business providing materials for two product categories.

"What is interesting is electronic shelf labels. Online having done a lot of damage to offline, traditional retail, physical stores are trying to fight back by making the shopping experience better and also offer more dynamic pricing. The best way to do that is with electronic shelf labels, which can provide a lot of information and also can be updated dynamically across locations."

It's mostly office. **Filinvest** has been attracting the offshore gaming industry. The retail side has also grown, but office is the most valuable part of its portfolio. They also have a subsidiary involved in industrial parks, including one close to an airport, and are expanding that activity. Therefore, in a small way, **Filinvest** could also be a beneficiary of trade disruption because some Chinese companies have said they are going to expand manufacturing activities in the Philippines. That would make a lot of sense, and **Filinvest Land** should be a small beneficiary of this.

But what's really fascinating about this company is that the stock's gone nowhere for years. I mean, it's gone up and down, but it is now back at where it was in 2010 when earnings were less than half of 2018. There has not been any rights issue, so the result of this is that valuation levels are significantly depressed compared to where they were in the past. And this is for a company where the earnings quality has dramatically improved. Normally, you would expect to see a rerating upward of multiples, but in **Filinvest Land's** case, exactly the reverse has happened.

This is a company that is now trading at a p/e of a little bit over six times historically, maybe closer to five for projected 2019 earnings, and less than half of book, but the book is very, very understated. We've done some analysis and several brokers have also looked at the current market value, and the range of valuation, net asset mark to market per share for this company is quite wide, but none are less than 3 pesos, and the stock's at 1.40 pesos now. We think the fair value is closer to 5 pesos. We've seen one broker who's up at 7 pesos.

The first is e-readers. This is not a particularly dynamic business. Kindles have not been very successful but seem to have a steady following. And the other is electronic shelf labels. **E Ink** has over 90% market share globally in this business, mostly produced in Taiwan. So again, immune we think from trade disruption.

The e-reader business is pretty steady. What is interesting is electronic shelf labels. Online having done a lot of damage to offline, traditional retail, physical stores are trying to fight back by making the shopping experience better and also offering more dynamic pricing. The best way to do that is with electronic shelf labels, which can provide a lot of information and also can be updated dynamically across locations from a central location or at the local level based on store and customer specifics. You need **E Ink's** material for this technology to work. There is only one other competitor at the moment, and it is more expensive.

This is a very high growth area, but to balance it, you've got a core legacy business generating sustainable positive cash flow, and the company is sitting on a lot of cash, which we like to see, so capable of supporting a very high growth area. They've won some big accounts in the U.S., some of which they are unable to talk about. They've been working with **Pricer** (STO:PRIC-B), the largest electronic shelf label company in the world, and they've been winning accounts in China. And really, they are the only game in town for this. So if you believe in the need for traditional retail to

reinvent itself, this technology can transform the shopping experience and can also operate in stores where there are no people, which may or may not be a material business in the future.

But there's more icing on this particular cake because the company recently got itself approved for a new generation of e-readers likely to be launched by **Xiaomi** (OTCMKTS:XIACF), one of the key Chinese mobile phone companies next year. In addition, it would appear that their materials are ideally suited for dual-screen phones and foldable electronic devices. They've already got approved by **Coolpad** (OTCMKTS:CHWTF), who's a tier-2 Chinese player, and **Hisense** (SHA:600060), which is better known as an appliance company.

You can see all sorts of interesting things opening up for this company, and why it works for them is that they have this very strong financial position. Net cash is about a third of their market cap, so they don't need to raise any money to take advantage of these growth opportunities. In fact, the biggest problem they have over the next two years is ramping up production capacity fast enough to meet demand, and there aren't many companies you can say that about at the moment.

"Net cash is about a third of their market cap, so they don't need to raise any money to take advantage of these growth opportunities. In fact, the biggest problem they have over the next two years is ramping up production capacity fast enough to meet demand, and there aren't many companies you can say that about at the moment."

In spite of having growth prospects, this company is trading on a multiple we believe to be less than 12 times forward earnings and has very strong cash flow and net cash. **E Ink** should deliver a nice yield, probably over 6%. As for the earnings growth, well, you can more or less pick your own number because there are so many variables, but we feel confident it will be a lot higher than the price/earnings multiple. And again, this is a company that, in spite of all the uncertainties of global markets, of trade and of politics, because it is positioned to take advantage of the positive side of disruption in domestic marketplaces, should be a big winner over the next two years.

TWST: And changing direction, as we talk in early January, what do you think the Trump Administration and investors in the United States have learned about some of the trade policies that the administration has been pushing forward — in regard to Asia and based on what the market here in the United States is going through? And what are the lessons for 2019?

Mr. Morton: I think it's an unwise person who would want to make predictions about what President Trump will do. He has consistently advocated the narrative that the U.S. has been a loser from growth in global trade and the rise of China, and I think this is a fundamental mistake because the average U.S. consumer has been the single biggest beneficiary of the rise in global trade. So it's hard to know where he wants to end up. He has appointed to his team two people who are extreme trade hawks, very antagonistic toward China, and his administration has indicated concerns about national security issues relating to China. China is no angel, but horse and stable door and bolted come to mind here.

I think the President is going to find himself dealing with more problems domestically than in the first two years of his period in office, so China may become less of a priority simply because he will have to allocate more of his time to dealing with domestic issues. And I hope for everybody's sake that a trade deal can be delivered. We have seen a dialing down of the rhetoric since the dinner in Argentina. We saw Mr. Navarro go on Fox News and say he thought a deal could be done, which certainly was a 180-degree turnaround from his position before the dinner, and I'm sure he didn't enjoy giving that interview.

I don't think one should be too optimistic. There are real problems, and China, while delivering fantastic benefits to U.S. consumers, there's no doubt they've also been behaving quite badly in acquiring technology in ways that are unacceptable. But we are at a point now where a deal could be done.

In terms of intellectual property, I think the Chinese have reached a point in their economic development where they see both pluses and minuses and are already moving down the path of protection. There are clearly opportunities for China to buy more products from the U.S. The difficulty will come in the details. It's an incredibly complicated topic, and I don't see how a sensible deal could emerge in the 90-day extension.

But with goodwill on both sides, I mean the deal is there to be done and hopefully one that will find favor with the President and his team because I think, in a trade war, history shows there are no winners. Everyone loses; it's just a question of who loses more, and that's not healthy for the world or for the U.S. or China. So let us hope in 2019 we see a deal that makes sense to the President politically and for everybody else economically.

TWST: And as investors wait for that deal, should they be reminded that there are many opportunities in Asia that they might want to look at?

Mr. Morton: Yes. My starting position and the way we positioned our portfolios is there will be no deal. If there is, Asian markets should react very strongly, very quickly and very positively because the narrative in Asia has moved from where it was at the beginning of 2018, which is, "Oh, this isn't really a big deal. It's not going to mean anything," to "This is the biggest deal there is." And it's going to be damaging to everyone, including the U.S. economy, and not just because of the tariffs and the fact that prices of all these Chinese goods will have to go up, and therefore, demand is likely to go down. That could create a global slowdown as the loopback in consumer demand dries up.

But also, because of the disruption to supply chains, which have been built up over 20 years, they are not easy to dismantle. There will be a lot of cost moving your production from Guangdong to Pattaya in Thailand or Surabaya in Indonesia or Bangladesh, and it's not just the dollars and cents of relocation and putting in place new infrastructure. It's the fact that one of the problems, for example, of Bangladesh is that it's very difficult to get product shipped out on time. Myanmar has cheap labor but high cost logistics. So the world's

supply chains will be adversely affected if these tariffs stay in place for any length of time and more and more companies decide they have no choice but to move.

That cost will end up in two places. Obviously, the companies themselves will end up absorbing some, but the consumers will absorb part of it as well. And so I think until this is clear, it's hard to make a case for earnings growth for companies engaged in global trade. And this is obviously going to be negative for multinationals located in the U.S. and listed on the U.S. markets as well because, on top of that, you've got the strong dollar. So earnings translation year on year is going to be lower in 2019 because, depending on which country you're getting your earnings from, you could say the U.S. dollar is more or less 10% up across the piece.

In Asia, the reverse is true, and Asian companies are also benefiting from lower commodity prices since mid-2018. Though, the strong dollar takes away some of the benefit of commodity price declines. But net net, raw material prices are dropping across almost every category of metal and oil-based product. This is good for margins.

So you ask, where is the opportunity? First, in domestic businesses with low valuations and preferably an identifiable catalyst. Second, when this dust settles and a deal is done, there will be a moment when investors see enough certainty to come back in, and they can do the analysis with more confidence and will spot that margins could be higher going forward than they have been in the period 2017 to 2018 when there was a lot of price pressure on the cost side of the equation for manufacturers from raw materials through to components such as semiconductors of all types. So right now, with too much uncertainty, you don't want to own any of these, but this could change very rapidly in the year ahead.

TWST: Is there anything we didn't talk about you care to mention?

Mr. Morton: I would like to just mention two other important trends. And one of them we did touch on when talking about **West China Cement**. Market share consolidation is a sign of a more mature economy, and economies are maturing in Asia, although many have a long way to go. But if you take China, you can see over the last two years, partly through regulatory intervention, partly through government target setting and partly through market forces, there has been a significant concentration of market share in traditional industries. This doesn't apply in services, but it certainly applies across most manufacturing, heavy industry, utilities and so forth.

This has meant there's less competition. And with the government giving priority to things like the environment, there has been less concern about companies making money to pay for these less tangible goods. So profitability has improved in places where it has been poor in the past, even in sectors like coal and steel. We've chosen cement, but it runs through aluminum and other heavy industries as well.

And we're seeing it in the property market. There's a dramatic divergence with strong financial performance and growth amongst the top, say, 50 names in China, while tens of thousands of small companies are unable to meet payroll and are going out of business in the same space, providing those with liquidity the chance to make good deals through joint ventures. Five years ago, everyone bought land from the government. Today, the big, solvent players may be buying half or more cheaply from distressed competitors, so better margin development even in a more difficult environment.

The second point I would make, which is also important and relevant to investors, and I think positive, is that as the growth is slowing, management are placing more emphasis on cash flow and margin. This is not just lip service. It's managers really changing their focus and their objectives, where their emphasis is not just to grow the top line, because that's becoming more difficult apart from anything else, but the bottom line. That is a very healthy development, and of course, if the environment is growing at a slower rate, you don't need to invest so much in plant and equipment, you don't need so much working capital. You end up with higher free cash flow generation, and then, this is available for shareholders.

Now, what management will do with the extra cash is still a question mark, but we are starting to see a little more of share buybacks, small at the moment, and some higher dividends. But down the road a year or two, I think you will see a strong pattern of growth in cash returned to shareholders. In the first instance, maybe it's used to pay down debt. If I take the cement industry again as an example, you see at **China Resources Cement** (HKG:1313) and **West China Cement**, these companies, they are paying off their debt rapidly. **West China** has been tendering for its outstanding bond. **China Resources Cement** will probably be net cash sometime in 2019.

Then, the next step is what about giving more to shareholders because there isn't the need to reinvest in the business; there's no obvious M&A to be done. So you get to the final option, which is give it back to the shareholders. And I think this will be a tremendous positive for share prices. As we know, buybacks in the U.S. have been arguably the single most important factor driving up the market over the last five or six years. This trend hasn't really begun in Asia yet, but I see green shoots, and I think this will become very, very important over the next five years.

TWST: Thank you. (ES)

JAMES MORTON
Chief Investment Officer & Portfolio Manager
Santa Lucia Asset Management Ltd.
OCBC Centre
65 Chulia St.
#43-05/06
Singapore 049513
Singapore
+65-6513-4100
+65-6513-4113 — FAX
www.slam.com.sg

© 2019 The Wall Street Transcript, 622 3rd Avenue, New York, NY 10017
Tel: (212) 952-7400 • www.twst.com