

the counterintuitive opportunity in China's State-Owned Enterprise (SOE) sector

Value Investing Seminar Trani

6 July 2023



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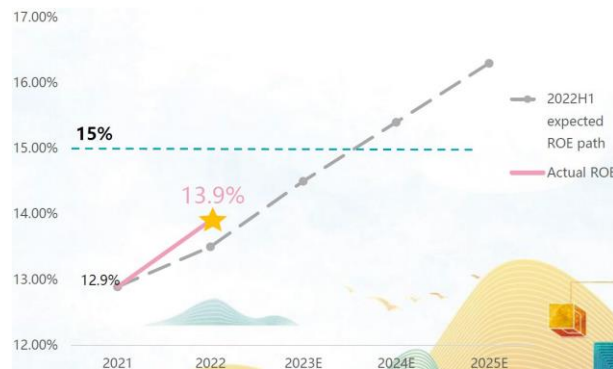
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Today

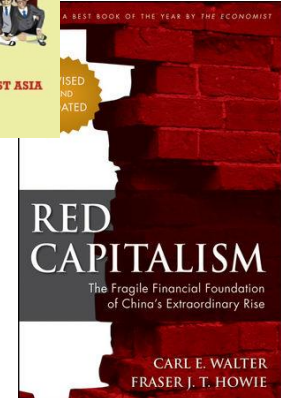
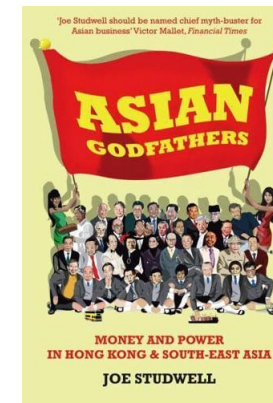
SLAM Value Investor in Asia



SOE Reform: ROE, SOP, IR



Book Recommendation



SLAM - About Us

- ▶ We are a c. \$900mn AUM pan-Asian boutique investment firm headquartered in Singapore with affiliate offices in Jakarta, Taipei and London. We serve institutions, family offices, high net worths and a large sovereign wealth fund.
- ▶ We have >800 meetings with Asian corporates per year, creating information networks and two-way relationships for active ownership.
- ▶ We seek to succeed against the inherent challenges of investing across Asia through a set of highly differentiated and capacity-constrained strategies, each with a solid long-term risk-adjusted performance outlook.
- ▶ We are an extended team of 20+ professionals and follow a philosophy of constructive engagement and deep management contact, responsible investing, and we are grounded in a value orientation fit for the 21st century.



Florian Weidinger
CEO

- ▶ MBA (Stanford Graduate School of Business) MS in Environment and Resources (Stanford Univ.)
- ▶ 20+ years experience in financial services; incl. prior Vice President at Lehman Brothers Principal Investing Division
- ▶ founder of Hansabay/SLAM predecessor



James Morton
Chairman

- ▶ MBA (Stanford Graduate School of Business) MS in Third World Economics (Stanford Univ.)
- ▶ 45+ years experience in financial services, Multiple award holder, e.g. Golden Award for Equity Emerging Markets;
- ▶ co-Founder of CIM/SLAM predecessor



Lim Thiam Kon, CFA
Partner

- ▶ CFA and BA (Nanyang Technology University)
- ▶ 20+ years experience in fund management, including with ING Investment Management and Pheim Asset Management; experienced company director
- ▶ partner Hansabay/SLAM predecessor

What we can do for you

SLAM is licensed and regulated by the Monetary Authority of Singapore and holder of a Capital Market Services (CMS) License under the Securities and Futures Act.

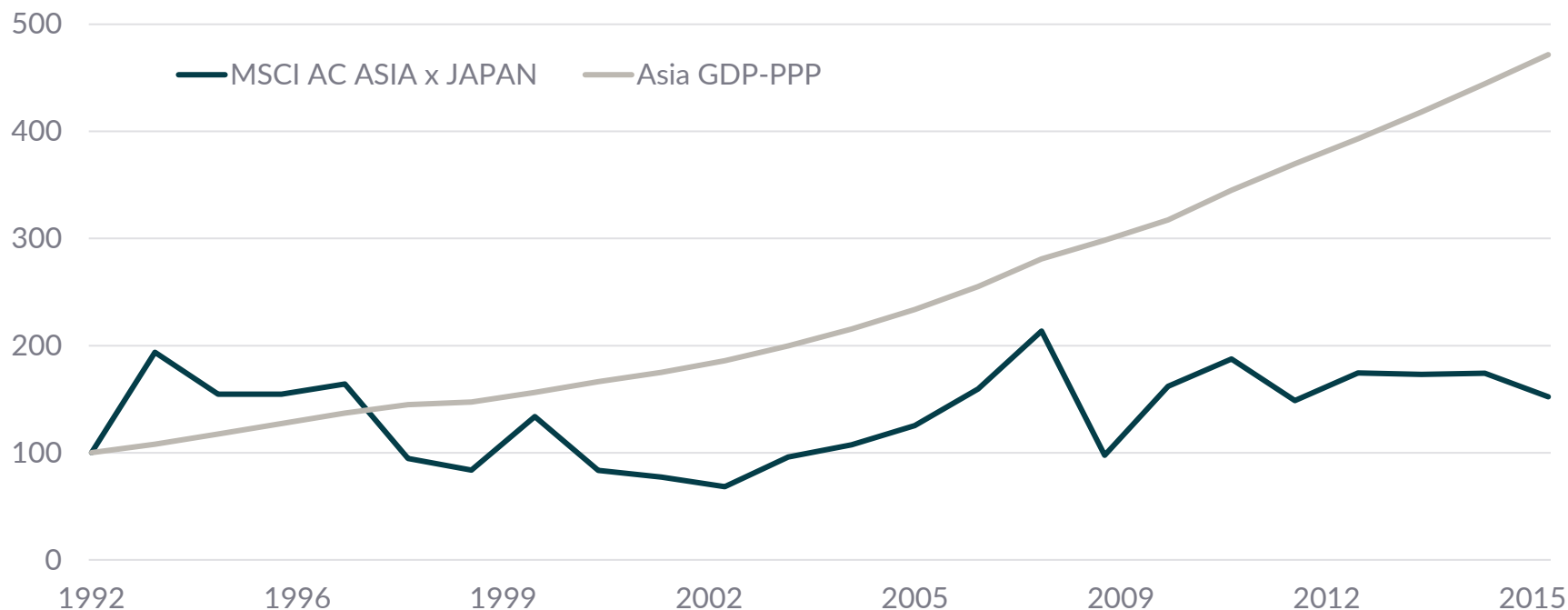
SLAM is a signatory to the UN Principles for Responsible Investment (PRI).

- ▶ Fund Management: three specialist & niche strategies
 - Asian dividend yields (UCIT, BVI, sub-managed accounts)
 - Southeast Asia special opportunities (SIF & sub-managed accounts)
 - Taiwan long/short market neutral (UCIT)
- ▶ Wealth Management: solutions and opportunities
 - tailored managed account mandates leveraging the Fund Management teams
 - access to private investment opportunities

The Difficulties in Asian Investing

- ▶ Asian equities are the only major equity market that has historically underperformed long-term economic growth – due to poor capital allocation, sometimes fraud, and often a disregard for the share price or minority investor
- ▶ strong case for active management, (temporary) alignment, detection of change

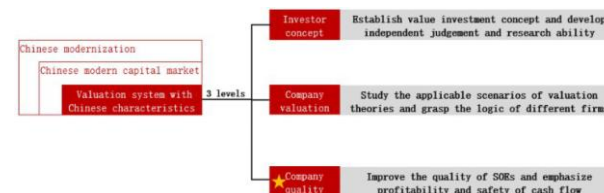
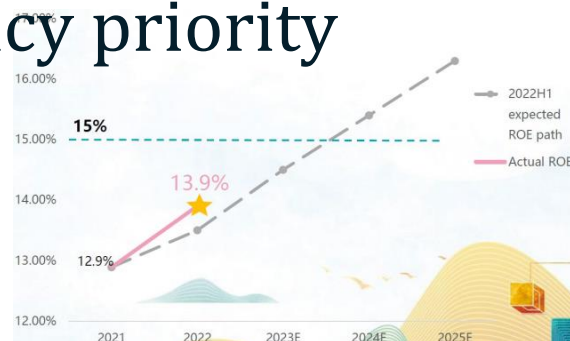
Asia Real Output vs Real Equity Returns, cumulative, Jan 1992=100: 4.5x vs flattish



Source: Bloomberg



With 14FYP, SOE Reform has accelerated 2020-2022 to become a major policy priority



SOP: Incentives

- ▶ it used to be frowned upon to have a share-option scheme
- ▶ today many SOEs are adopting incentive-based pay plans
- ▶ legal and official pathway for managers to get rich

ROE: Targets

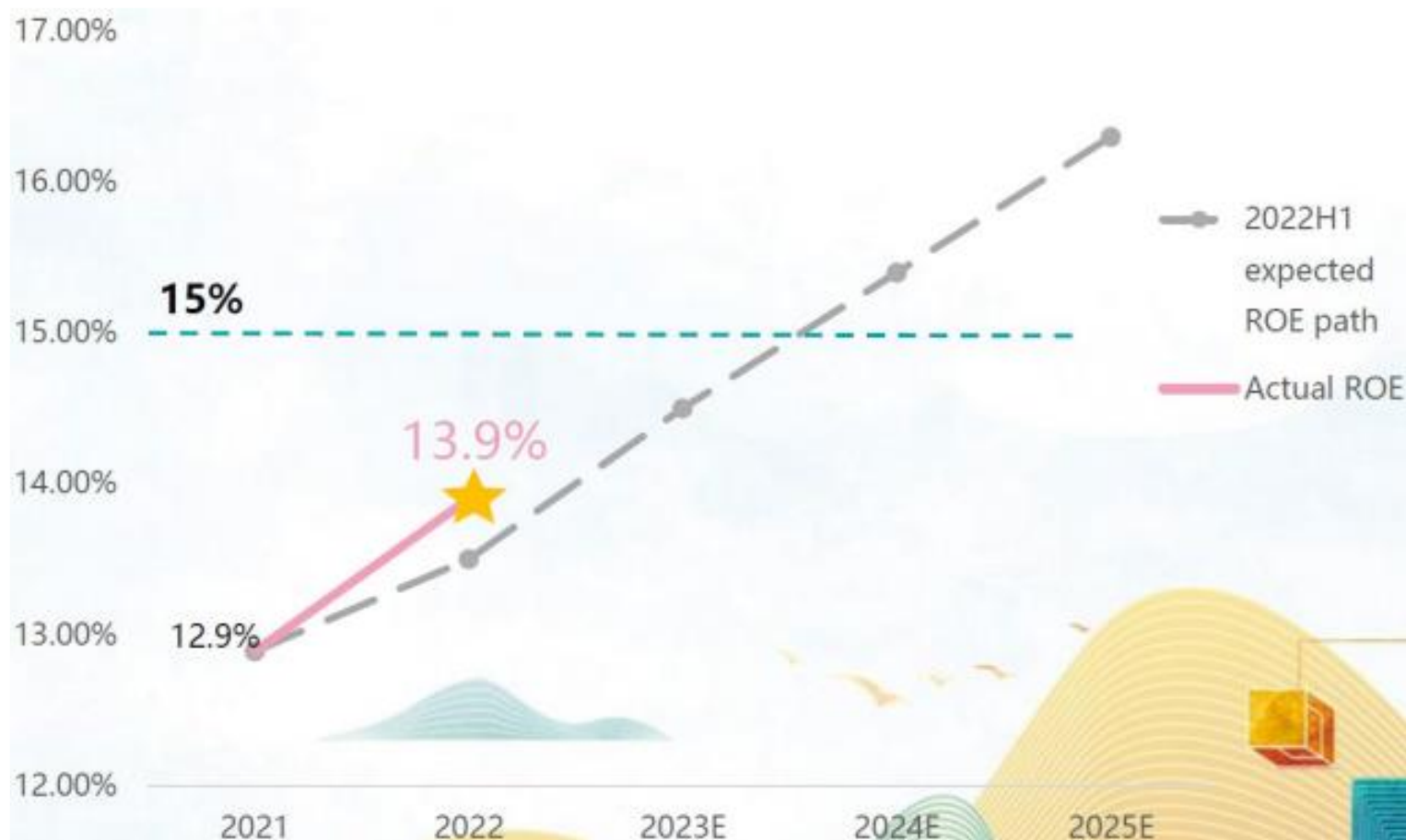
- ▶ at the turn of the year, return on equity was included in the annual list of KPIs for the state-owned enterprises for the first time; several share option plans vest contingent upon an ROE level being reached

Changes in performance appraisal		
	2022	2023
Indicator	Net profit	ROE
	Operating profit margin	Operating cash ratio
	Total profit	Total profit
	Asset-liability ratio	Asset-liability ratio
	R&D investment	R&D investment
Requirement	Total labour productivity	Total labour productivity
	Growth rate of total profit and net profit higher than the growth rate of GDP	Growth rate of total profit higher than the growth rate of GDP
	Control the asset-liability ratio	Stabilise the asset-liability ratio
	Increase operating profit margin, R&D investment and total labour productivity	Increase ROE, operating cash ratio, R&D investment and total labour productivity

P/E: Valuation & IR

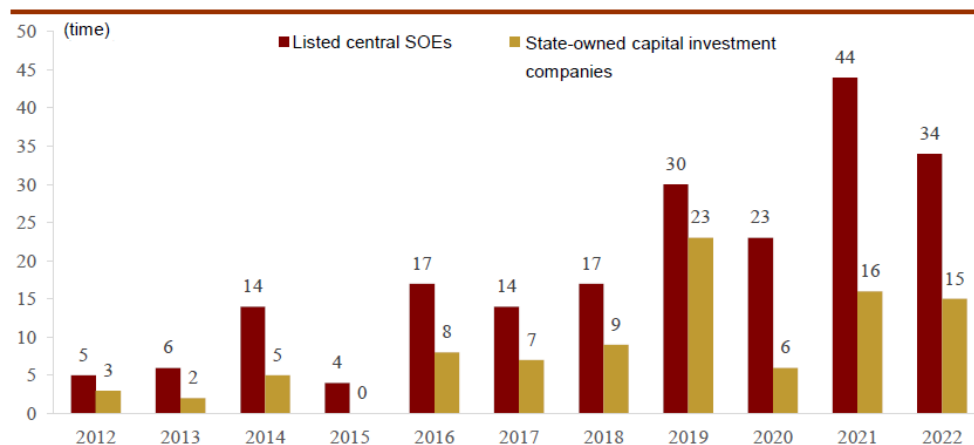
- ▶ a valuation system with Chinese characteristics was proposed by Yi Huiman (CSRC Chair at the Financial Street Forum in 2022)
- ▶ official acknowledgement that the valuation of listed SOEs is often low, so investor communication and ESG concepts need to be strengthened to improve their valuation

Focus on Targets: RoE Plans (are reformed SOEs the best listcos in Asia today?)

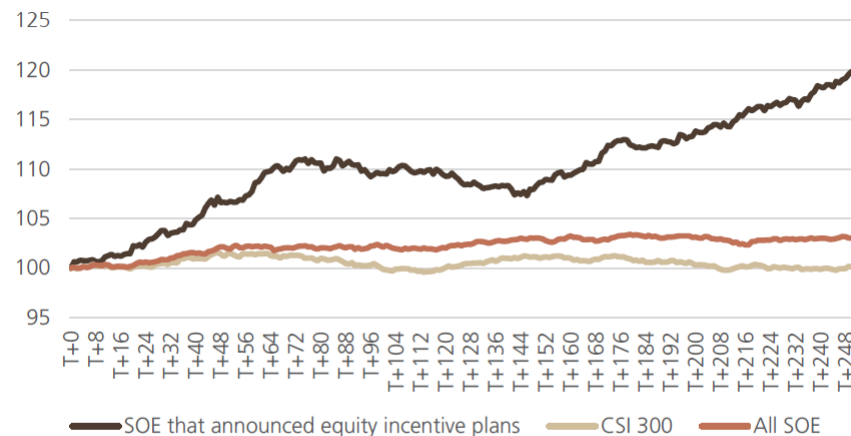


Focus on Incentives: Share Option Plans (show me the incentives, and I show you the outcome)

SOE share option plans announced

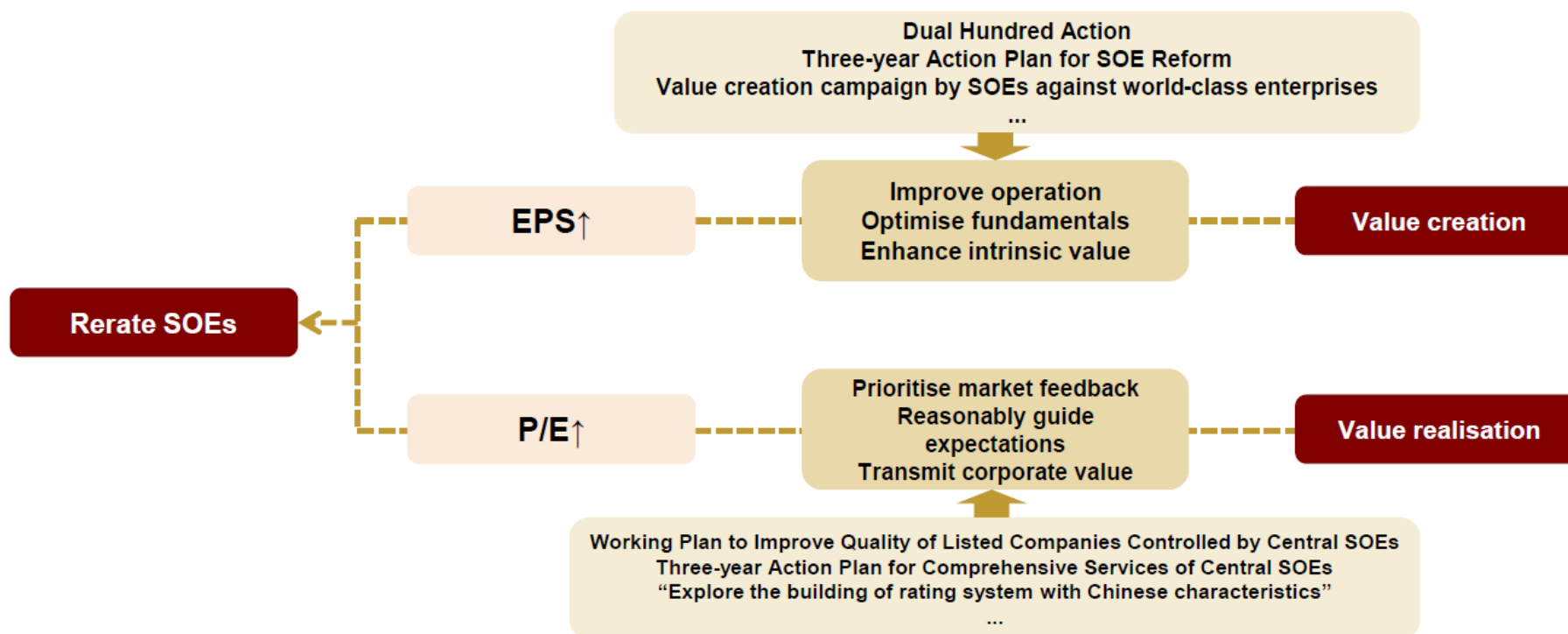


SOE performance post-adoption of share option plans



Source: Wind, FactSet, UBS Note: Return for SOE announced equity incentive plans is equally weighted. Only A share SOEs are included. T+0 indicates the announcement date of equity incentive plan. Data since 2015. The numbers represent number of trading days.

Focus on IR & Capital Markets








General rule: avoid all non-profit maximizing firms...



And be discerning re which SOEs: Central SOEs and Select Provinces & Municipalities

Issuance time	Document name	Issuance time	Document name
April 2021	Implementation Plan of Beijing Municipality for Three-year Action Plan for SOE Reform (2020-2022)	June 2021	Three-year Action Plan of Hainan Province for SOE Reform (2020-2022)
March 2021	Implementation Plan of Hunan Province for Three-year Action Plan for SOE Reform (2020-2022)	June 2021	Implementation Plan of Autonomous Region for Three-year Action Plan for SOE Reform (2020-2022) (Ningxia)
March 2021	Implementation Plan of Jiangsu Province for Three-year Action Plan for SOE Reform (2020-2022)	March 2021	Three-year Action Plan of Yunnan Province for Deepening SOE Reform (2018-2020)
November 2020	Implementation Plan of Zhejiang Province for Three-year Action Plan for SOE Reform (2020-2022)	November 2020	Three-year Action Plan of State-owned Enterprises under Chongqing Municipality to Develop Digital Economy (2020-2022)
November 2020	Implementation Plan of Guangxi Autonomous Region for Three-year Action Plan for SOE Reform (2020-2022)	January 2021	Implementation Plan of Shanghai Municipality for Three-year Action Plan for SOE Reform (2020-2022)
June 2021	Three-year Action Plan of Jilin Province for Reform and Development of State-owned Enterprises under Jurisdiction	January 2021	Implementation Plan of Shandong Province for Three-year Action Plan for SOE Reform
February 2021	Implementation Plan of Heilongjiang Province for Three-year Action Plan for SOE Reform (2020-2022)	January 2021	Implementation Plan of Liaoning Province for Three-year Action Plan for SOE Reform (2020-2022)
January 2021	Implementation Plan of Shanxi Province for Three-year Action Plan for SOE Reform (2020-2022)	January 2021	Implementation Plan of Henan Province for Three-year Action Plan for SOE Reform (2020-2022)
March 2021	Three-year Action Plan of Our Province for State-owned Capital and Enterprise Reform (Shaanxi)	January 2021	Implementation Plan of Inner Mongolia Autonomous Region for Three-year Action Plan for SOE Reform
December 2020	Implementation Plan of Anhui Province for Three-year Action Plan for SOE Reform (2020-2022)	March 2021	Implementation Plan of Hubei Province for Three-year Action Plan for SOE Reform (2020-2022)
September 2020	Implementation Plan of Jiangxi Province for Three-year Action Plan for Reform and Innovation of State-owned Capital and Enterprises (2020-2022) (Jiangxi)	May 2021	Implementation Plan of Hebei Province for Three-year Action Plan for SOE Reform (2020-2022)
October 2020	Implementation Plan of Gansu Province for Three-year Action Plan for SOE Reform (2020-2022)	March 2021	Implementation Plan of Sichuan Province for Three-year Action Plan for SOE Reform (2020-2022)

Some SOE Improver Ideas

Portfolio	Description	SOE angle	Investment Thesis & Valuation
	Sinotrans (598 HK) – SOE in domestic and international freight forwarding; JV with Deutsche Post for "DHL China"; beneficiary of ecommerce; German governance JV earnings are nearly half of net profit	<ul style="list-style-type: none"> warehouse assets could be CREITed (active engagement with mgmt on this) active ESOP with >200 management staff and RoE targets 	<ul style="list-style-type: none"> H-shares at P/E <5x and 9% yield; significant discount to A-shares increased disclosure to drive rerating
	China Suntien Green Energy (956 HK) – renewable energy producer and midstream natural gas infrastructure	<ul style="list-style-type: none"> Hebei based SOE evaluating ESOP 	<ul style="list-style-type: none"> H-shares at P/E <4x and 7% yield; significant discount to A-shares catalyst: payout of receivables on balance sheet & GDR issue
	China State Construction International (3311 HK) – construction firm, pioneer in modular construction technology	<ul style="list-style-type: none"> authentic RoE targeting dated ESOP, evaluating new avenues of pay 	<ul style="list-style-type: none"> shares at P/E <5x and 5% yield
	China Communication Services (552 HK) – communication and technology business services company	<ul style="list-style-type: none"> active ESOP SASAC isn't immediately in charge of firm 	<ul style="list-style-type: none"> shares at P/E <5x and 9% yield; increased disclosure to drive rerating; significant discount to A-shares
	Yuexiu Property (123 HK) – leading SOE property developer from Guangzhou	<ul style="list-style-type: none"> Active and early ESOP SOE property developer with very strong market position in Guangdong province and integrated transport projects; 	<ul style="list-style-type: none"> shares at P/E est. <7x, 0.7x PB, 5% div yld one of the key winners in a very challenged sector; still funding at <4% and still expanding even in this environment

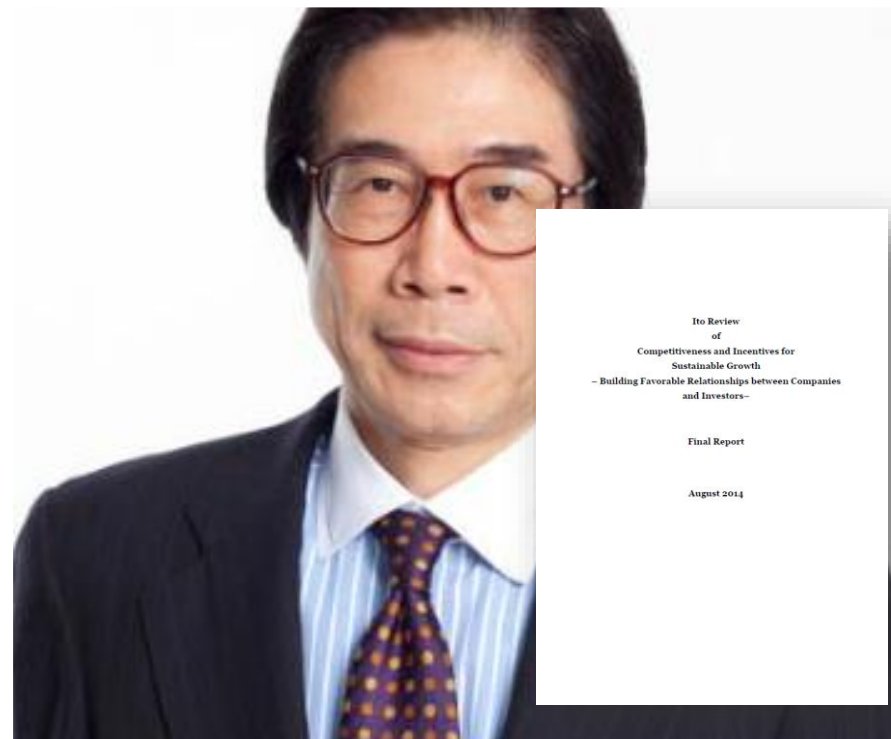
Closing



SOE Reform is a multi-year capital market event for China



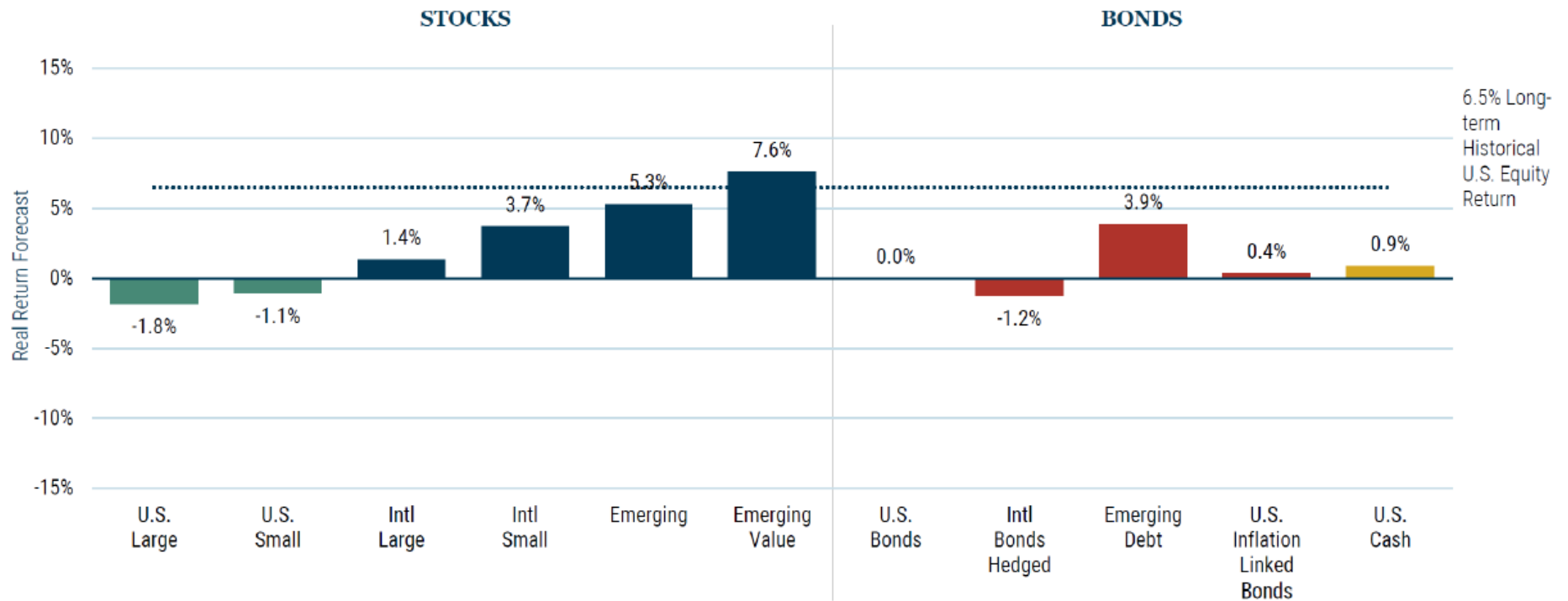
SOEs are turning from fairly priced value destroyers trading at low single digit P/E ratios to dramatically undervalued neutral-to-value-creating capital allocators



China's SOE reform echoes the Ito Review in Japan 2014 and its focus on RoE: "shift to capital efficiency focused management, optimization of the investment chain, and promotion of a two-way dialogue between companies and investors."

Asian/EM Value Equities are historically cheap ...

GMO 7-year real per annum return forecast by asset class



... growth differentials suggest a 13 year break-out?

EM vs. DM GDP growth and relative stock market performance



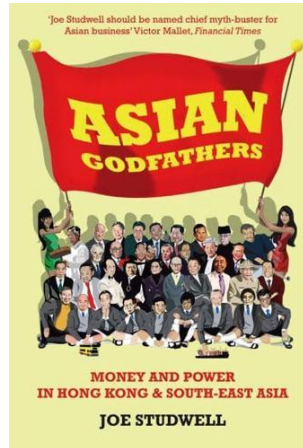
Source: CLSA, Oxford Economics forecasts, MSCI

Real Interest Rates are Positive in EM vs. Negative in DM



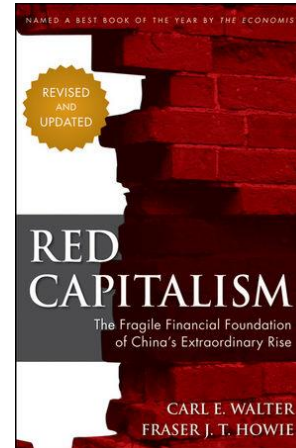
Source: CLSA, BIS, Refinitiv

Book Recommendations



Joe Studwell
Asian Godfathers

My forever recommendation for investing in Asia. Everyone should read this book because it goes to the core of the controlling vs. minority shareholder problem through vivid stories. Noble House in real life.



C.E. Walter & F.J.T. Howie
Red Capitalism

Do you remember the recapitalization of Chinese banks in 2004? Did you know that China didn't have a proper bond market in 2010? An excellent account of the history of the financial and capital market system in China. Reading books (or older reports) are a great reminder that what may seem obvious in the present appears much less plausible ex-post.

SANTA LUCIA ASSET MANAGEMENT



Thank you very much.

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