COOPER INVESTORS ASIAN EQUITIES FUND

QUARTERLY COMMENTARY REPORT

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

For current performance information please refer to the Monthly Performance Report.

SEPTEMBER 2019

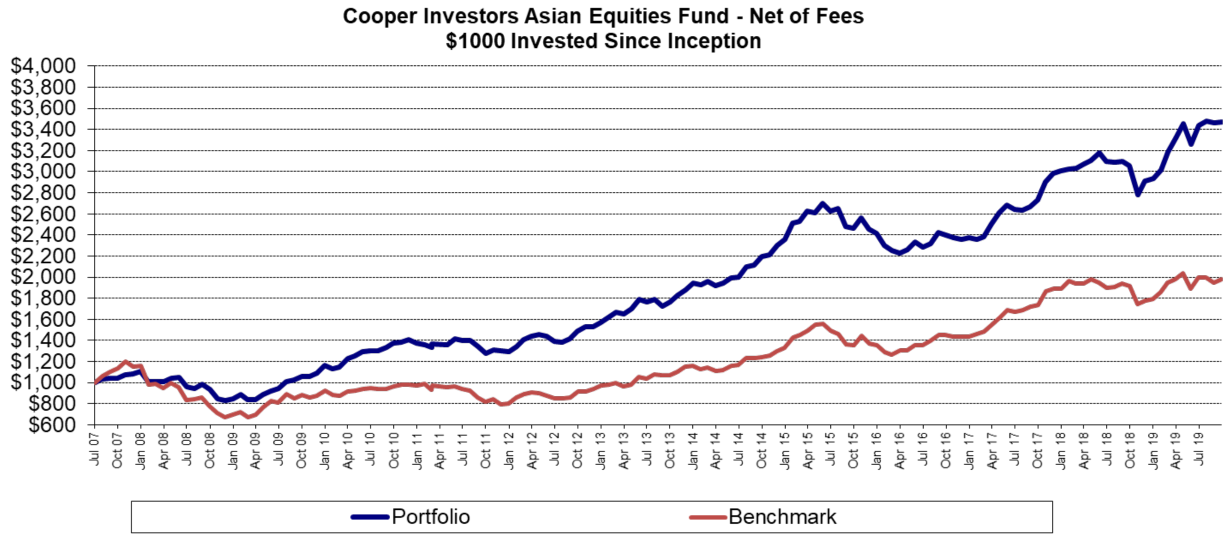
"I constantly ask myself what is the baggage of history and what are the lessons of history". Uday Kotak, Founder and CEO of Kotak Mahindra Bank

"It is not always you get to hit the iron when it is hot. I believe in hitting it so hard, that it gets hot". Lakshmi Mittal, CEO of ArcelorMittal

"Whenever you find yourself on the side of the majority, it is time to pause and reflect". Mark Twain

	**PORTFOLIO	#BENCHMARK	VALUE ADDED
ROLLING 3 MONTH	1.26%	-0.64%	1.90%
ROLLING 1 YEAR	14.54%	3.59%	10.95%
ROLLING 2 YEAR	13.81%	6.76%	7.05%
ROLLING 3 YEAR	14.34%	10.90%	3.44%
ROLLING 5 YEAR	10.89%	9.80%	1.09%
ROLLING 7 YEAR	14.38%	11.65%	2.73%
ROLLING 10 YEAR	14.61%	8.40%	6.21%
SINCE INCEPTION*	12.40%	5.74%	6.66%
SINCE INCEPTION^	318.67%	98.09%	220.58%

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



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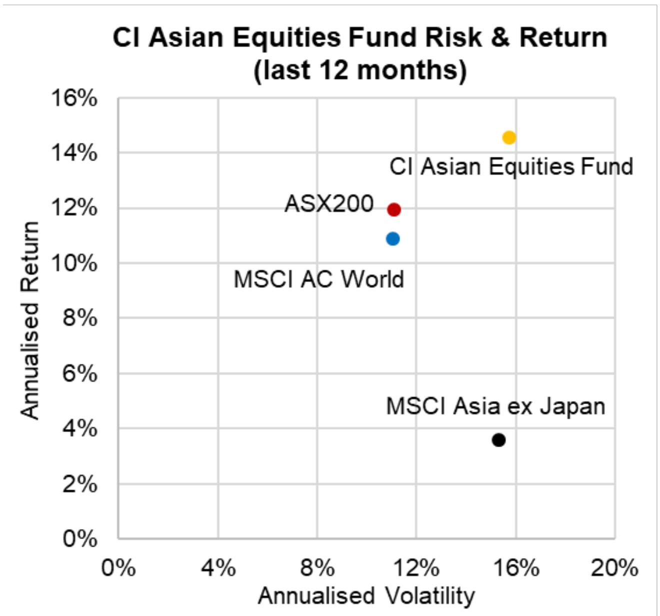
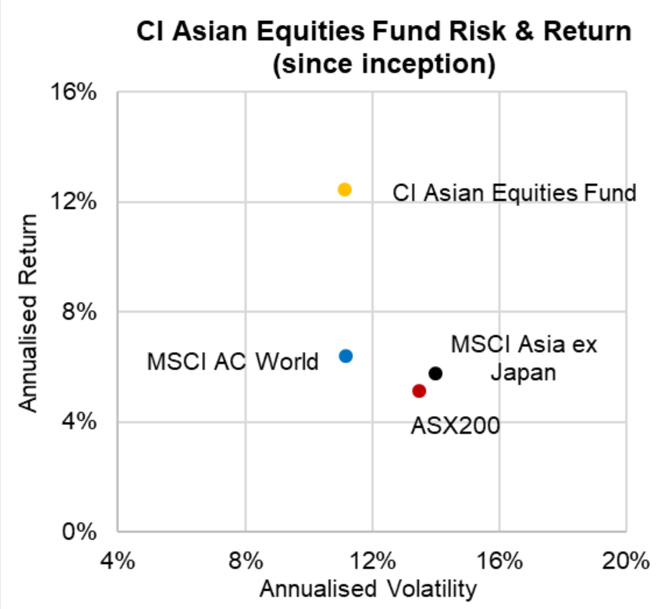
Market and Portfolio Performance

The portfolio gained 1.26% over the September quarter, compared to a decline of 0.64% for the MSCI Asia ex-Japan index. The 190bps outperformance was driven by stock selection.





Our China and Hong Kong portfolio holdings contributed 1.40% to outperformance during the quarter. On an absolute basis, our stocks were roughly flat whilst the benchmark declined by 2.7%.

A significant portion of the outperformance was generated by large domestic consumer companies (Anta, Li Ning and Sun Art). These companies have invested in product and distribution network upgrades over the past few years. They are now offering the best value for quality products in the marketplace. They are beating multinational companies on price competitiveness and pace of innovation, and winning over their smaller domestic peers on superior quality and distribution. Furthermore, these domestic champions are investing in technology progressively, building another key long term competitive advantage.

In dairy, for example, China Mengniu have invested in premium farms and niche international brands since 2015. It patiently built a high quality, premium product portfolio, and is now combining this with a deep, national distribution network covering 1.5 million points of sales. Mengniu has also rolled out a ‘smart network project’ to digitize these distribution channels. It is partnering with Alibaba’s best-in-class retail network software, Ling Shou Tong, to further improve inventory management, delivery, and POS software.

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We are observing the same trends in many other consumer-focused industries such as sportswear, cosmetics and snacks – once the large local companies are ‘switched on’, they become formidable competitors. The cultural and behavioural traits of management that we are looking for are –

- Humility to learn from international companies on product design and quality control
- Ability to quickly adapt to changes in consumer preferences in products and marketing channels
- Willingness to invest in, test, and use technology in all aspect of their businesses

Portfolio companies that belong to this cluster of ‘switched on domestic champions’ include China Mengniu, Anta, Li Ning, Sun Art, and the Huazhu Group. We expect the cluster to continue contributing meaningfully to the portfolio in the long term.

The prolonged anti-government protest in Hong Kong has disrupted tourist arrivals and retail sales. For example, during the month of August, tourist arrivals and retail were estimated to be down 40% and 23%, respectively. Unsurprisingly, the local Hong Kong stocks underperformed their Chinese peers meaningfully, with the Hang Seng -9% and Shanghai index -1% over the September quarter. Despite the portfolio holdings in Hong Kong being predominantly stalwarts and defensive in nature, our positions in Hong Kong (AIA, Hong Kong Stock Exchange and Vitasoy) still detracted from performance. We are monitoring the Hong Kong situation carefully, and will adjust the portfolio based on our observations of risk-adjusted returns.

In general, we are utilising market volatility to continuously upgrade our portfolio. As the risk-adjusted returns became attractive for businesses whose management teams we have admired for a long time from afar, we leapt at the opportunity to own them. Needless to say, our team is busier than ever.

Our India holdings contributed 0.34% to outperformance during the quarter. On an absolute basis, our stocks in India gained 1.7% whilst the Indian index declined by 1.3%.

The slowdown in the overall Indian economy exacerbated, with the June quarter only growing at 5%. In our view, this level of growth was unacceptable in the minds of Indian people, and the pressure to promote growth is immense for the Modi government. The government took the first big step in September by cutting the marginal corporate tax rate by 10 points. We believe this is a welcoming start, especially as Indian businesses were burdened with one of the highest effective corporate tax rates amongst major economies. Whilst we are not experts in politics, we do observe substantial latencies in better policy-making, with much room for reform in labour, land acquisition laws, GST and more accommodating interest rates.

Our existing holdings in banks will directly benefit from the corporate tax cut, as they have been full tax payers at the highest rates. The 10-point cut in taxes will hence translate into higher profit for the shareholders. We expect the well-capitalized private banks such as HDFC and Kotak Mahindra to invest these tax gains in accelerating branch expansion and technology deployment, creating further long term competitive advantage over their public banking peers.

The competitive environment for the private banks also remains favourable. Despite the announced consolidations, we do not observe real reforms or improvement in management quality in the public sector banks in India. The non-bank financial companies (“NBFCs”) also remain challenged, with stretched balance sheets and distracted management. In comparison, management teams in the best private banks are laser-focused in providing the best consumer experience and risk management. We expect private banks in India to drive portfolio outperformance in the years to come.

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Performance from the rest of geographies netted at small positive outperformance of 0.2%.

The Portfolio - Strategy, Structure, Process, Risk Review and Recent Changes

Strategy

- The Asian equities strategy targets enduring total returns growth, with annualized returns exceeding the MSCI Asia ex Japan index by 200-400bps over the long term
- The strategy tends to outperform in down-markets
- The strategy is to find a portfolio of stocks in Asia with the best risk-adjusted value latencies across six subsets of value.
- The strategy emphasizes long term thinking in research, investment horizon and partnership with management
- The strategy allocates capital based on bottom up stock selection and industry analysis

Structure

- Concentrated, long-only, long-term equities portfolio with 30-50 stocks
- Portfolio companies with risk adjusted value latencies across six subsets of value
- Long term investments in 'proprietary managers' who think and act like business owners
  - Passionate, humble and focused
  - Aligned incentives
  - Knowledgeable and 'learning machines'
  - Value-based capital allocation with conservative balance sheets

As of Sep 30th, 2019, the portfolio is positioned around five subsets of values as follows:

- **Stalwarts (43%)** - sturdy, strong and generally larger companies with world class privileged market and competitive positions. (HDFC Bank)
- **Growth (35%)** – growing companies with identifiable value propositions using traditional value metrics and run by focused, prudent and experienced management. (Tencent)
- **Cyclicals (4%)** - stocks showing upside leverage to the cycle with experienced and contrarian managers who can allocate capital prudently and with good balance sheets. (Huazhu)
- **Low Risk Turnarounds (6%)** - sound businesses with good management in place and good balance sheets. We especially like spin offs and government to private turnarounds. (Sun Art Retail)
- **Bond-Like Equities (2%)** - businesses with secure, low-volatile dividends that can be grown and recapture inflationary effects over time. (Link Real Estate Investment Trust)

The portfolio holds [9.5%] cash.

Portfolio attributes as at September 2019 are summarized below:

	Portfolio*
Number of stocks	39
Beta	0.93
P/E (x)	19.5

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Yield (%)	1.8
P/B (x)	3.3
Historical EPSg (%)	16.2
Forecast EPSg (%)	15.0
Return on Equity (%)	17.0
Dividend Cover (x)	2.79
Net Debt/Equity (%)	-15.9
Tracking Error vs MSCI Asia ex Japan	3.52

Source: UBS PAS

We believe the management types that produce the most attractive investment opportunities in Asia are 1) Founder-led, where the original founder aligns his/her interest with investors and remains committed to leading the business to bigger successes; or 2) owner operator, where the strong and unique culture permeates the organization, and 'thinking like an owner' becomes second nature to the management team. Over 50% of our portfolio companies are under the leadership of these two management types.

Portfolio by Management Type	
Founder Led	24%
Owner Operator	28%
Focussed Management	39%
CASH	9%

Process

- The Asian equities stock selection process follows Cooper Investors' VoF philosophy
- We aim to build out deep research, a high quality and extensive network, and proprietary data bases in our focused clusters
- A small, focused team travels to the Asia region, visiting high-quality management teams repeatedly. On average, we conduct 500+ company meetings and calls per year
- 150+ watchlist stocks provide a pool for new idea generation
- Active liaison with other CI funds and leverage CI's global networks. Leverage CI's well-resourced research platform and back office
- Risk controlled for balance of subsets of value and conviction
- Active positions and benchmark unaware

Portfolio Risk Metrics

The portfolio's volatility remains below that of our benchmark. The portfolio has outperformed ~80% of the time during down-market months. We believe this is an outworking of the CI VoF investment process.

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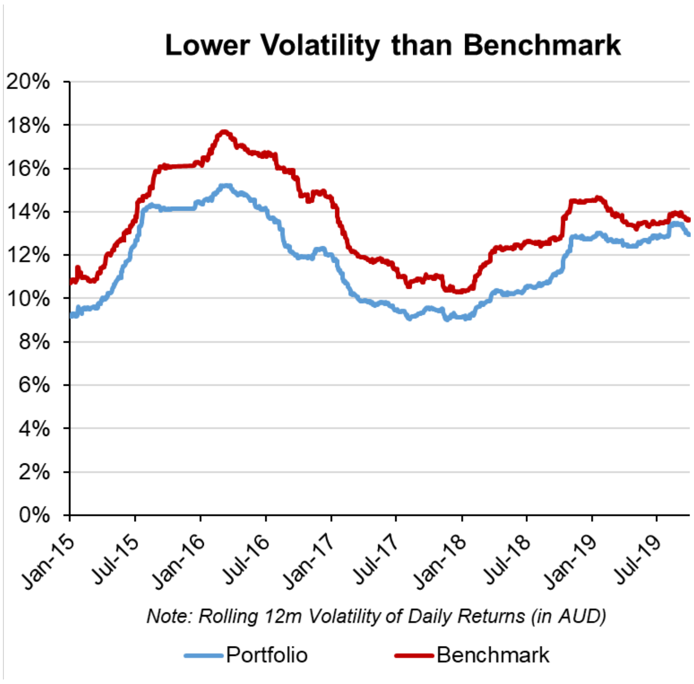

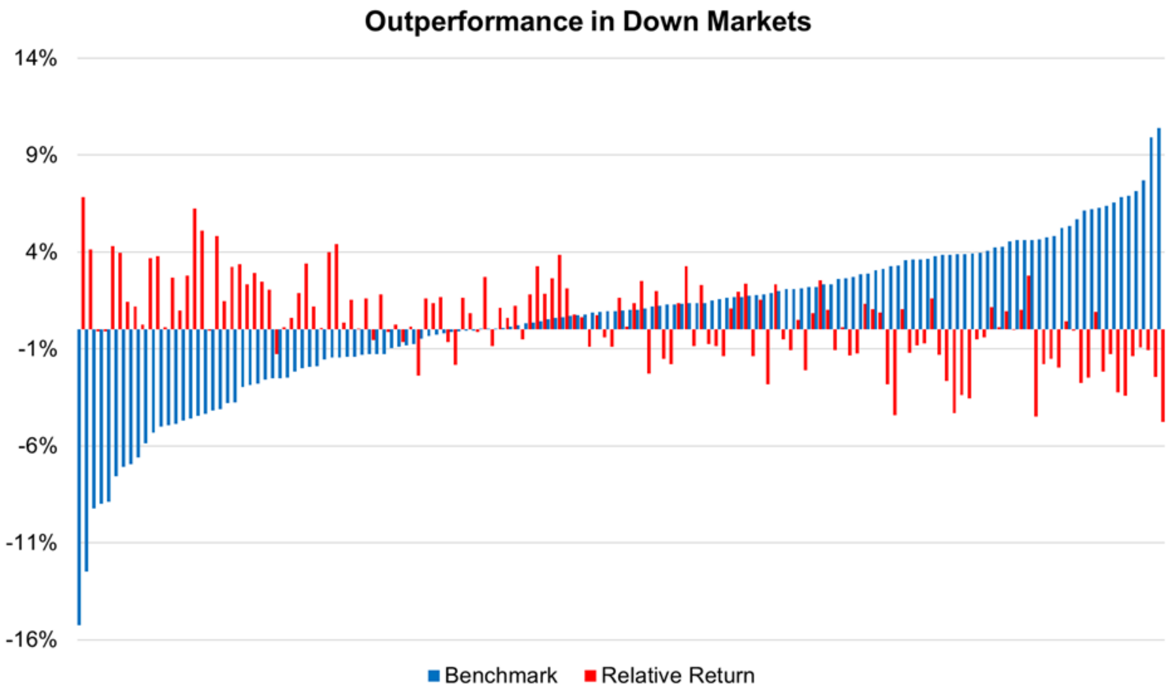

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From a sector and country perspective, the Asian Fund current exposure is as follows:

Portfolio by Industry Sectors	
Financials	26.0%
Consumer	25.2%
Communication Services	16.0%
Information Technology	13.1%
Real Estate	3.8%
Industrials	2.9%
Health Care	2.7%
Utilities	0.8%
CASH	9.5%

Portfolio by Country	
China and Hong Kong	50.5%
ASEAN	14.7%
India	12.0%
Korea and Taiwan	8.3%
Japan & Other	5.0%
CASH	9.5%

Recent Portfolio Changes

We initiated a position in the **Huazhu Group ("HTHT")** after meeting with management in Shanghai. HTHT was founded by Mr. Ji Qi, a serial entrepreneur who also co-founded Ctrip.com (the dominant online travel agent). It operates primarily an asset-light, franchise model. HTHT has been on our Watchlist for a number of years, as we have long admired its strong execution, capital discipline, and technology prowess. The hotel industry in China is currently experiencing a cyclical downturn. HTHT management, however, is deploying capital in a counter-cyclical fashion and speeding up the pace of expansion. In challenging times, independent hotel operators who are struggling with low occupancy rates are more likely to join HTHT for better operating efficiencies and access to its network of loyal members. HTHT is also foraying into the high end hotels, taking advantage of favourable rental terms offered by premier real estate landlords. We believe there is substantial value latency in accelerated franchised network expansion, further efficiency and margin enhancement, and potential successes in business and high-end travel.

We also initiated a position in **Kotak Mahindra Bank ("KMB")**. Led by its highly reputable founder, Mr. Uday Kotak, KMB built a premium franchise in retail banking in India, together with a suite of other financial services such as insurance and wealth management. KMB management developed a 'relentless focused' approach to attract new deposits with attractive rates and high quality service. As a result, it enjoys the highest current and savings account ratio ("CASA ratio") in the industry and hence the lowest funding costs. We are impressed by KMB's risk culture. The founder is known for being "paranoid about risk" and famously turned down Tata Steel on account of risk control. His sentiment reverberated in KMB, with 'return OF capital' emphasized over 'return ON capital'. We believe KMB could grow 15-20% sustainably, with additional latencies from its non-banking businesses.

We initiated a position in **A2 Milk ("A2M")** during the quarter. A2M is a New Zealand-based company selling fresh milk and baby formula in Australia, China and the US. We are optimistic about its business in China. Having grown largely based on word-of-mouth, A2M is now building an on-the-ground team and investing more in marketing and distribution. We believe these investments are strategic and necessary for A2M's sustainable long term growth. The room to grow is large – A2M is currently present in around 17,000 retail stores in China and we estimate it has the potential to reach

40,000 to 50,000. We met with A2M's management team in Melbourne as well as on their Investor Day in Shanghai. We like its entrepreneurial culture and fast execution capabilities. Compared to its international conglomerate competitors, A2M is nimble and adapts to ever-changing consumer tastes and the regulatory environment more quickly. There is also meaningful balance sheet latency with ~7% of A2M's market cap in net cash and its stake in Synlait.

We exited **Hong Kong Exchanges & Clearing, Jardine Strategic and CK Asset**. Hong Kong Stock Exchange was a recent buy for the portfolio. We continued to be optimistic on its increasingly important role connecting Chinese companies to international capital markets. The recent announcement of the US potentially restricting Chinese companies from listing on its exchanges further strengthened the relative importance of the Hong Kong markets. However, we have become concerned by Hong Kong Stock Exchange's unsolicited offer to take over the London Stock Exchange, a company almost equal in its size. We believe the chance of success for the proposal is low, and it could potentially distract key management from pursuing various long term strategic growth initiatives such as derivatives, commodities and data. As focused management behaviour is a key investment criterion, we decided to exit the position and await for more clarity on where and how the company will invest its capital and management resources. As for Jardines and CK Asset, operating trends have deteriorated meaningfully for their Hong Kong real estate holdings.

Stock News

China Mengniu sold its stake in domestically-based, mass-market infant formula company, Junlebao, and announced the acquisition of Bellamy's, a premium organic Australian baby formula brand. We applauded Mengniu's management for their resolve to continuously upgrade its product portfolio, and believe these upgrades will meaningfully enhance return on capital over time. In general, we have been impressed with Mengniu's management, led by a CEO with extensive multi-national company experiences (Danone, Johnson & Johnson and General Electric). Mengniu has already seen improved operating trends in its key product categories such as liquid milk and room temperature yoghurt, driven by its product innovations.

Trip and Meeting Notes

The September quarter saw the team busy with a lot of travelling. We visited Bangalore, Delhi and Bombay in India. We focused our efforts around our key research industries of banks, insurers, IT and consumer companies, and meaningfully upgraded our network. Around half of our company meetings are with founders and CEOs, with the other half with key C-level executives. We also met with various large local fund managers and thought leaders.

The industry with the best risk-adjusted return characteristics and long term strategic trends remains private banks in India. They are widening the lead over their public sector peers in dynamism, risk controls, and IT capabilities. We remain confident in our current holdings (HDFC Bank, City Union Bank and Kotak Mahindra Bank).

We had a solid meeting with the CFO of **Titan**. Initially started as the joint venture between the Tata Group and the state government of Tamil Nadu, Titan has grown to be a successful group with multiple consumer businesses including jewellery and eyeglasses. We were impressed with the culture of Titan ("competitive but not aggressive" and "we built our business on NOT cheating the consumers") and its thoughtfulness at expanding the business ("we only go to markets that are unpenetrated and unorganized, with no strong brands"). Titan management is expanding the business skilfully, and in a counter-cyclical fashion. As the rest of the industry is struggling with tight bank credit and dampened jewellery demand due to high gold prices, Titan is doubling the pace of store expansion. We think this kind of decision making and counter-cyclical risk taking bodes well for long term and sustainable market share gain.

We enjoyed a high quality meeting with the CFO of **Dr. Lal**, a national pathological chain in India with 200 clinical laboratories and ~2,500 collection centres. The pathology testing industry is currently very fragmented but moving towards a more consolidated structure. Independent, mom-and-pop testing centres dominate with 95% of market share. However, changes in regulation compliance and rising costs of medical equipment are raising capital expenditure requirements and customer acquisition costs. The well capitalized large national chains are therefore well positioned to consolidate the market. Dr. Lal is very strong in the northern regions of India, especially around Delhi. We believe there is strong latency in national expansion.

We also met with the CEO of **ICICI Lombard**, the most successful private general insurer in India. We found Bhargav knowledgeable, humble yet confident, and passionate about the business. This is a management team that puts risk management first and is willing and able to forgo business when they deem risk-adjusted returns to be too low. One recent example is that they decided to stop the crop insurance product when its ROE fell below the required threshold. Crop went from 17% of the business to 0% in the latest quarter. The long term industry trends are positive as the private insurers gain market share from the public insurers (still over half of the market), and new industry regulations are accelerating the penetration of insurance (e.g., increasing the mandatory duration of insurance policy on new vehicles).

Additionally, we had an insightful and engaging meeting with the CEO and CFO of **HDFC Bank** in our Melbourne office. We continue to like HDFC's approach to risk, growth and IT investments and its owner-operator culture. We are optimistic on the semi-urban and rural expansion over the medium to long term. HDFC strategically leverages the government's rural service centers to distribute its banking products. The CEO, Mr. Aditya Puri, recently travelled to hundreds of villages in India and came back with deeper insights in the rural landscape. We applaud his 'wearing thin shoe leather' approach, a practice we aspire to follow in investing.

Finally, we observed that despite news stories surrounding a consumer slowdown in India, management teams remain upbeat. They remain focused on their core competencies, without worrying too much about things outside their control. In some instances, they are taking this as an opportunity to further strengthen their competitive positions.

We also visited Shanghai, Beijing and Hangzhou in China. We attended **A2M'**s investor day in Shanghai. We were impressed by A2M's China CEO, Li Xiao, who presented extensively during the investor day. He was energetic, down to earth, entrepreneurial, and had a good sense of humour. He brings to the role very significant multi-national (Nike and Burger King China) and local (the Wanda Group) experiences. We believe he could lead A2M to accelerate its distribution expansion and intensify the marketing efforts effectively. We also got a glimpse of A2M's culture which is focused, no-excuse, not afraid to experiment, and with decision making based on evidence and research.

We attended **Alibaba's** investor day in Hangzhou. One of our favourite events of the year, the investor day did not disappoint and gave us a deeper understanding of the inter-connectivity of Alibaba's various businesses. We continue to be impressed with management's focus on achieving Alibaba's core mission - "to make it easier to do business anywhere in the digital era." Despite a soft macro backdrop, eCommerce in China continued its healthy growth of over 20%, and Alibaba is growing even faster than the market, fuelled by its highly valuable data-driven insights into consumer behaviour. We continue to observe multiple sources of value latency with Alibaba's core eCommerce business, including further monetisation of recommendation feeds, upgraded TMall product, and potential in the consumer-to-consumer transactions. We are also excited about value latencies outside of eCommerce such as cloud, local services, and fintech.

We met with the CFO of **Sun Art** in Shanghai, and visited a number of its new format stores. We were impressed by the substantial improvements that Sun Art is making to its flagship hypermart stores. The newly renovated stores are small (usually less than 5,000 square meters rather than over 20,000 historically). Product assortments are focused on food and high frequency daily items; we observed very few products from categories that compete directly with eCommerce such as electronics and apparel. Alibaba is Sun Art's second largest shareholder, and the two companies have made good progress at integrating on the technology side. Conveyor belts whizzed by overhead, sending bags of groceries out of the door for fast delivery. Checkout counters are run on cloud-based software, all accepting mobile payments. We look forward to further cooperation between Sun Art and Alibaba, including warehouse sharing between Sun Art and the rapidly growing TMall Supermarket. We also liked Sun Art's low-key, roll-up-the-sleeves, humble yet focused culture.

We had the rare opportunity of visiting the low-key founder and Chairman of **Jiangsu Hengrui Medicine**, the most successful pharmaceutical company in China. Mr. Sun Piaoyang led Hengrui's transformation from a state-owned-enterprise to a private business in the 1990s, and has been the biggest shareholder since 2003. He was frank on the long term regulatory challenges on the common generics industry, but also very optimistic on the future for the companies that have invested in research and development for innovative drugs. Hengrui has been investing aggressively in innovative drug development over the past 5 years, and started to see its efforts bearing fruit. Interestingly, he also believes that the best-in-class Chinese pharmaceutical companies will expand outside of China profitably in the future.

We met with management of **NetEase** in Beijing. NetEase are optimistic about the regulatory backdrop for game approvals, noting that the pace of approvals has been accelerating this year and that they are increasingly confident that the situation will normalise in 2020. We are also encouraged by NetEase's sale of Kaola, their cross-border ecommerce platform, to Alibaba, another sign of the increasing level of discipline.

We also met with the CFO of game livestreaming platform **Huya**. Overall, competition in the industry continues to stabilize into a duopoly between Huya and its key rival, Douyu. The aggressive poaching of each other's best performing broadcasters had largely stopped. Operating trends are overall positive for Huya as rapid revenue growth continued and margin expansion is on track as a result of better content cost control.

Team and Other

We welcomed Shashank Gupta to the team. Prior to CI, he was an analyst at KIS Capital, a Sydney-based investment fund. Shashank is passionate about investing. In his spare time, he co-teaches an online advanced valuation course at New York University.

We are also pleased to announce that Sagar Thakkar, who has been on the team since April 2019, will be spending most of his time in Mumbai in FY 2020. We are looking forward to deepening the CI network in India.

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