the art of boring™

EP47 | Playing the plan: Mawer's emerging markets equity portfolio

Andrew Johnson	00:41	All right, welcome back to the podcast everyone! Today is another episode in our series that we call "Playing the Plan," where we talk to the portfolio managers that are actually building the portfolios here at Mawer. Today we have Peter Lampert, who is the lead manager on the Emerging Markets Equity Fund. Welcome back to the podcast, Peter.
Peter Lampert	00:58	Thanks, Andrew. Nice to be back.
Andrew Johnson	01:01	The Emerging Markets Fund is kind of the newest kid on the block here at Mawer, we launched it, I think, just a little over two and a half years ago.
Peter Lampert	01:07	That's right.
Andrew Johnson	01:08	So let's start there. I was curious to get your thoughts on what compelled you to think about and then eventually launch an emerging markets fund here at Mawer.
Peter Lampert	01:16	It's an area where we see a lot of exciting opportunities. We've been investing in emerging markets for over 30 years within our international equity strategy, but in emerging markets, as a dedicated fund, we think there's a lot of opportunity for us to add value for our clients. And one of the big reasons is that it's an inefficient universe. There're a lot of unturned stones, and we find getting out there, looking at companies—we could find a lot of great companies that meet our investment philosophy. The important thing is, we're sticking to our existing investment philosophy—doing what we've done around the world for many years—and just applying that to these markets. We say "we're taking our boring approach to these exciting markets."
Andrew Johnson	01:56	I think one of the things that our clients appreciate the most—or one of the things that they appreciate most about our approach—is [the] long-term nature of holding periods within our asset classes and portfolios we invest on [their] behalf.

		On average, I think we're somewhere in the five to 10-year range for a holding period across most of our asset classes. Is that something you expect (this in realization of the fact that you've only been about two and a half years investing in the actual fund) to be in line with the rest of our asset classes? Or maybe more or less in the future?
Peter Lampert	02:28	Our current turnover is tracking about 20% annually, implying that we have about a five-year holding period, so I think that's reasonable to expect going forward. There are [certainly] some fantastic companies in this portfolio I hope we can hold forever and never have to sell, but realistically, there will be some turnover. And five years on average is probably a reasonable expectation.
Andrew Johnson	02:48	Great. Many of the discussions that we have with our clients centre around, I guess, either a general curiosity or maybe even concerns around some of the headlines that they see out there, (and that we're frankly bombarded with on a daily basis), whereas much of the discussion that we have around here at the firm centres much more on the actual businesses that we're invested in or we're looking to invest in. So I think that's a good way to frame the rest of our discussion, maybe, is that macro and micro lens.
	03:18	I'll start with a big one for you: the U.S. and China are clearly maneuvering with each other—in particular around trade issues. Given these are the two largest economies, that's obviously going to play out in markets around the world. So, from an emerging markets standpoint, what are you seeing, and what kind of impacts are you seeing that are trickling down to the portfolio? Or maybe in the universe that you're looking at?
Peter Lampert	03:39	I think we've certainly seen an impact. I mean, this U.S.-China trade war has gone on for over a year, and during that time it's certainly impacted sentiment, I think. Consumer sentiment in China, and investment and exports in other countries like Germany and South Korea, the big exporters have taken a hit. So certainly there's been an impact. Like you said, we like to focus on the companies on a bottom-up basis—looking for great companies. And oftentimes these great companies that we find…they're still impacted but less impacted by some of these global themes.

		Because in China, specifically, we have nine holdings in this portfolio, and they're all domestically-focused companies. All or substantially most of their revenue comes from consumers within China. That's impacted if there's a slowdown in China prompted by the trade war; if consumer sentiment is hurt, that will still hurt these companies, but much less so than many of the exporters and companies that are really reliant on that U.S. trade and being impacted by the tariffs. So from a bottom-up point of view, I think we have a lot of great resilient companies that might see some impact, but we're still comfortable holding them for the long term.
Andrew Johnson	04:50	On that topic of exporting, I think I had noted recently from South Korea that we've seen some pretty weak data around exporting from that country itself—but that could be a sign of things to come in other areas in emerging markets. Is that something you're on the lookout for (first), but then second, is it trickling down through to the portfolio and some of the holdings that we have?
Peter Lampert	05:10	I think it highlights the value or the benefit of focusing on bottom-up companies as opposed to reacting to the headlines. If you saw the headlines about the China trade war, your first reaction might be to avoid investing in China or to sell your holdings in China, whereas it's actually companies in South Korea or even more so Germany that are being most impacted. Actually focusing on the companies and the fundamentals, I think, is very important. Not getting too wrapped up in the headlines—which is exactly what we do every day here at Mawer.
Andrew Johnson	05:39	Maybe give our listeners some examples of those holdings that you've seen remain resilient through some of this noise that we've seen.
Peter Lampert	05:47	Some great examples are [Kweichow] Moutai, the leading liquor brand in China—it's positioned as a very premium product and [is] often used as a gift or a status symbol. A bottle will be $200 or $300, so this is a premium luxury item that we think [is] a nice theme—that consumer spending in the luxury class can hold up better. People that are wealthy, have money, [and] continue to have money, are less impacted by the ebbs and flows of the economy. So that's an example where Moutai is continuing to do very well: increasing their selling prices, increasing their volumes, and seeing very, very strong demand.

Andrew Johnson	06:26	On that company in particular, [and] maybe that business model specifically—as you're monitoring a business like this into the future, what are some of the things that you're on the lookout for? It strikes me that maybe one area for a premium brand or a luxury brand would be some sort of barrier to entry to their business. What do we view as that barrier of entry to a company like this?
Peter Lampert	06:45	By far, the most important competitive advantage is their brand. If you ask any Chinese person in China, or overseas, they're not only familiar with this brand, but recognize it as [a] very high quality, highly desirable brand, and that's why they're able to charge such high prices and increase their prices. And that's the beauty of this business model. Once a brand attains that dominant position, it's very difficult for others. They have many competitors, many similar products, but it's very difficult for any of them to develop such a strong brand.
Andrew Johnson	07:17	So, resilience is important. Obviously having a competitive advantage is important. But inevitably, at some point, these things are going to deteriorate in certain businesses. Maybe you could walk us through an example of a company in China in particular where you've seen that deterioration over time.
Peter Lampert	07:32	Sure. One example is Hengan. This is a leading provider of consumer products, in particular sanitary pads. They have a great dominant position, good distribution—you'll find their products in every supermarket or corner store—but they've been falling behind in this transition to ecommerce, and they're just not as strong. Their competitors are catching up there, and their competitive advantage—which had been very strong distribution (they get their products in every city, town, corner store so they're very convenient to find)—is eroding with the shift online. And more and more commerce is happening online, especially in China, so that's allowing their competitors to catch up and close that distribution gap. That's one where the competitive advantage was really on the distribution, not so much on the brand, so it's more easily being eroded.
Andrew Johnson	08:23	When you see something like that, I would expect that that's a direct reflection on the management team and maybe our view on the management team. Is that an accurate representation?

Peter Lampert	08:31	I think that's fair to say—that they saw the shift happening and they made some steps but should have been more aggressive and perhaps were too slow to adapt to the changing distribution landscape.
Andrew Johnson	08:41	One other area of concern for a lot of our clients, many investors, and just market participants out there in the world, (related to China before we shift gears), [are] the protests that are happening in Hong Kong. Maybe just briefly: what's happening there, in terms of what are they protesting, and what are you seeing from an investment standpoint? Are there any immediate impacts that you've seen in the portfolio or in the universe? And maybe even longer term—what do you expect an outcome of these protests to be?
Peter Lampert	09:07	I think it's very significant what's happening in Hong Kong. The protests started with the protesting against the extradition bill but have expanded beyond that to some protesters demanding full democracy. And the Chinese government has a different view on that, and the protests have been very disruptive. So in the short term, we've already seen an impact. Businesses are feeling the impact. Two of our analysts in Singapore were planning to visit Hong Kong to meet with companies and they postponed those trips because of the disruptions to the flights and the transit in Hong Kong. So we certainly see that.
	09:44	AIA, one of our largest holdings in the portfolio, a leading provider of life insurance—a lot of the policies that they sell are based in Hong Kong, but from mainland Chinese visitors who buy these policies when they're in Hong Kong. With the protests and the disruptions, there just haven't been as many mainland visitors. So we expect their sales to decline. And that's the same case for many businesses in Hong Kong—a lot of reliance on those mainland Chinese visitors for their sales.
	10:12	That's the short-term impact. Longer term, there could be big impacts. I think Hong Kong's a fantastic city; I love visiting Hong Kong, I think there're a lot of great people in Hong Kong. But I think if the Chinese government has its way, a few decades from now, Hong Kong will just be another Chinese city, not a special city like it has been. And that has investment implications. It means that Shanghai is probably the major financial centre, not Hong Kong. It means that a lot of these businesses that were the bridge between China and the rest of the world through Hong Kong will be less important—if China's doing more direct commerce from mainland China.

So it shifts the investment landscape quite a bit if this does in fact play out over the next few decades.

Andrew Johnson	10:56	Right. And I guess there's no way to really fully predict that outcome, but obviously it's very serious; very, very significant impacts that could unfold, both from a portfolio standpoint, but just generally speaking from investing in emerging markets.
		I'll stay on China before we shift gears… what you were just talking about with the government's involvement in business there: as much as China has really kind of "opened up" over the last few decades, there are still very many outright state-owned enterprises, and we're noting more and more that the government wants state representatives at the companies that are maybe…not state-owned enterprises. How does that paint your view as an investor? Is it a hindrance or does it provide opportunity? How does it impact your viewpoint on investing in China?
Peter Lampert	11:48	It's both a hindrance and provides opportunity, so it's a very mixed impact. I think China, as an officially communist country, in many ways has moved well away from communism and is very much a market-based economy. But in some ways, they've retained elements of that communist system in which the state has a lot of control of the economy—whether it's through direct ownership in companies, or influence, even, on private businesses.
	12:13	The opportunity is that there're a lot of fantastic companies that have achieved very strong market shares, in some cases monopoly positions, and in some cases helped by the state—basically creating monopolies or thwarting competition. So you have many fantastic businesses—even much stronger businesses than we'd find in most other places in the world.
		But the flip side to that is yes, you have another boss. One of the things we look for in every company is an aligned management team. Managers who have the same interests as us as shareholders, which is to generate great wealth and create value for shareholders.
	12:50	We find that we encounter more trade-offs in China, where we have these fantastic businesses, but we know in some cases the management teams, especially if they're state-owned enterprises, may have different objectives [such as] to fulfill government requirements—not only looking out for maximizing shareholder profitability.

Andrew Johnson	13:06	So not only can the government give, but it can clearly take away at almost a moment's notice. Or maybe even over a short time period. Let's shift gears to another country in your world of emerging markets. I think for investors it's along the same lines as what we just covered, which is, I think India itself presents for investors great opportunity, but also some significant challenges to investing and finding profitable businesses. They're perhaps another sign of a slowing global economy; India is very much front and centre in emerging markets. As a portfolio manager, what do you see in terms of those opportunities and challenges in India?
Peter Lampert	13:45	India is a fascinating place, and there are a lot of great companies, a lot of entrepreneurs and business-minded people. We like looking for investment opportunities in India; companies that will meet our criteria of being wealth-creating companies run by excellent management teams and at more attractive valuations. Historically, if you look two, three years ago, there was a lot of excitement and enthusiasm around India, and valuations were quite high.
	14:07	That has shifted a bit. Sentiment has become more negative toward India as the economy has been slowing. They have a number of challenges, but that comes with improved valuations, so we may start to see more opportunities there. And that's a place we're actively looking. I'll be visiting India—I have a trip coming up in a couple months to meet with companies and look for more investment ideas there.
Andrew Johnson	14:27	And in particular to our portfolio, are there any names that come to mind that are great examples of both the opportunities but maybe the challenges as well that you're seeing in India?
Peter Lampert	14:36	Sure, HDFC Bank is just a fantastic, phenomenally well-run bank that's our largest holding in India. And despite some of the economic challenges in the country and the slowing economy—many of their competitors and other banks have been posting fairly weak results—but HDFC Bank, they've managed their risks very well and navigated some of these challenges very well and continue to perform very strongly. So that's a fantastic bank where we're happy to be long-term shareholders.
Andrew Johnson	15:04	Before you move on, when you compare that holding to the other industry participants in a similar business, what is the differentiating factor? Why are you seeing weak results in most others and clearly a winner so far in HDFC?

Peter Lampert	15:16	It's really the quality of the management team. And that's something we look for in every investment—an excellent management team. In this case, management's just done a very good job of hiring great people [and] putting systems in place to focus on running the bank well. Every loan that they make, they're making a decision: is this a good risk to take? Is the risk/reward favourable on this loan?
	15:38	As opposed to many of their competitors just kind of going with the market, handing out loans without putting much thought into it. They don't have good processes around it, either because they just don't have good processes and great people in place, or in some cases there're corruption issues, where the people giving the loans are getting favours in return. So there are lots of different reasons, but HDFC Bank's managed to just stick to their business of making good loans and doing it really well.
Andrew Johnson	16:04	And obviously, as investor[s], we can probably see a lot of that come through in numbers—you look at historical data, you look at annual reports, you look at the performance of holdings. But I think a huge part of our process is really getting out there and talking with management teams, whether that's directly in person or on the phone. With China and India in particular, those are distances that are quite far away from Calgary, Alberta, Canada. Have we recently been visiting those countries, and do we have any learnings there? And before you get too far, maybe provide our listeners with some background on why we think it's important to even go and speak with them in person.
Peter Lampert	16:37	Evaluating the management teams—that's a big part of our process. And like you said, we can look at their past actions, we can look at the results, and that shows up in financial numbers. But we also want to understand how they think, what is their strategy, how they make decisions, and if we think those are good; if they're making the right decisions to create value for shareholders over the long-term. So really asking why they do what they do, how they do things, and having a conversation or an in-person meeting is a great way to learn some of those things. HDFC Bank, as an example, is one we've talked to many times over the phone. I'll look to meet them on my upcoming trip to India; their CEO recently travelled through Singapore and met with our colleagues there. So, having that Singapore office helps us with some of that management access, too. That's why it's important.

	17:22	We've also recently had a couple trips to China. Both of our analysts based in Singapore, Josh and Wen, have each done trips to China [and] met with many companies, looking for investment opportunities, understanding what's going on there. Some of the quickly changing industries like internet and technology—trying to understand if there are new emerging investment opportunities there. Some of the state-owned enterprises—understanding some of the reforms as the government is trying make these companies more competitive and market-oriented and seeing if there's any real traction or merit to those claims. And just really digging into those and meeting with the companies.
Andrew Johnson	17:57	I think that's some really good reinforcing feedback for our decision [to] opening a small office in Singapore, is that not only can we travel to these regions less impactful to the individuals travelling there (rather than travelling from Calgary, we're travelling from Singapore). But also, as you mentioned, Singapore is very much a hub, so there [are] many CEOs and businesses coming through there and we're able to capture that as they're travelling through.
Peter Lampert	18:22	Yeah, I'm very happy with our Singapore office. And we've seen a lot of value coming out of it. Even though it's a small team, they're having a big contribution on our Funds and for our clients.
Andrew Johnson	18:30	Okay, so we've talked a lot about China, we've talked a lot about India, we've talked about some of the portfolio holdings there. Let's open it up to the rest of the emerging markets universe. What are some new names you've taken a look at and added to the portfolio over the last little while that speak to our philosophy, our process, and what makes these great businesses for clients?
Peter Lampert	18:51	Two of the recent holdings we've added are in Indonesia and Vietnam. One in Indonesia, it's Sarana Menara Nusantara, SMN for short.
Andrew Johnson	19:00	Yeah, thank you. That's what I'm going to call it for now.
Peter Lampert	19:02	They build and own cell towers, and they rent those out to the cell phone providers. We've seen this is a great business in other markets like the U.S., where having one provider of a cell tower and then renting that out to multiple tenants makes a lot of sense. It's just economically more efficient. And this is the leading company with the best track record doing that.

They have long-term leases with their customers, they're profitable, management is focused on earning a good IRR (return on investment) on each contract, and they have a good track record. In addition, management is reputable and trustworthy. It's backed by the Hartono family, who has a good reputation in Indonesia. So that's important to us as well.

Andrew Johnson	19:43	Two things that kind of strike me there are, again, you touched on it—alignment of interests. You've got an ownership group and maybe a management team that is well aligned with us as shareholders and our clients as shareholders. But you also spoke about, or at least talked around, some of the competitive advantages. How does a company like that get to a point where they are the premier provider of cell towers? Are they the first mover there, or did they come on later and kind of take this to the next level and beat out the competition? How did it unfold?
Peter Lampert	20:17	They had an early management team; they had people they had hired from American Tower, one of the leading tower companies in the world, based in the U.S. but operating around the world. So when they started this business, they hired a number of executives from American Tower who really knew the business well, put return discipline focus in place, and they've continued that. Even though the managers have changed over the years, they continue to do that. So whether they're building new towers, or acquir[ing] portfolios of towers from competitors or from the mobile phone operators themselves when they're looking to divest their towers to raise some money, and through a combination of acquisitions and organic growth, they've been able to attain a leadership position in the industry. Now they're very well positioned going forward. If any new opportunities come up, if there are divestments or acquisition opportunities, they're the best positioned for that. Their competitors have a lot of debt and high leverage. This company's management [has] been very prudent and conservative. They could afford to do any large acquisitions and further increase their lead as the number one tower company in Indonesia.
Andrew Johnson	21:18	Excellent. That was Indonesia. You also mentioned a holding in Vietnam?

Peter Lampert	21:22	Yes, we recently added Masan Consumer. This is a real under-the-radar stock, but we've come across it because they have the number one leading position in fish sauce, and that's a popular condiment that's used probably daily in most Vietnamese kitchens.
Andrew Johnson	21:39	It's popular in mine too.
Peter Lampert	21:41	[laughs] All right! Vietnamese and Halifax kitchens. And they have a dominant position, a well-known brand, and good distribution across Vietnam. And management's done a good job of continuing to introduce new products. So whether it's powdered coffees or energy drinks, they've been able to plug into that distribution network and grow the company over time. So we like the dominant position that they have, and also the entrepreneurial management team looking for ways to continue growing and creating value for shareholders.
Andrew Johnson	22:08	Okay, thanks Peter! Is there anything else that you wanted our listeners to hear about from you as the portfolio manager on the Emerging Markets Fund?
Peter Lampert	22:14	I think I would emphasize the same things that we always do, that there are a lot of headlines and a lot of noise out there right now. The big ones are the China trade war, the Hong Kong protests, maybe the India economy slowing. But for us, focusing on good companies on a bottom-up basis—wealth-creating companies with excellent management teams at attractive valuations—we think that makes a lot of sense to buy and hold these companies for the long-term. And we're seeing some good opportunities out there.
Andrew Johnson	22:40	Great. Well, I think that is an excellent place to wrap things up, so thank you, Peter, for your time. We appreciate you sitting with me and our listeners, and I think we've got an even better understanding of the emerging markets portfolio here at Mawer. We look forward to talking to you again.
Peter Lampert	22:53	Thanks, Andrew.