

EMERGING MARKET EXPERTISE: UNDERSTANDING LOCAL NUANCES

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The decline of emerging market equities from peaks earlier this year may mean lower share prices, but the premise for investing in emerging markets remains.

In many cases, trade and “Twitter wars” have little effect on the drivers which make a number of emerging market companies attractive investments.

Emerging markets offer investment opportunities which are different to those in developed markets. Most sectors are further behind the development curve than those in developed markets and industry leaders sometimes have only single digit market share. As a result, the growth outlook for these companies is much longer in duration than that of their equivalents in developed markets.

Coronation has a 25-year track record in South Africa and 10 years in global emerging markets. The investment process focuses on businesses with sustainable, long-term advantages. The current largest single country exposures are in China, India, Russia and Brazil. The selection of underlying holdings varies from country to country, with choices based mostly on an understanding of local market specifics, the long-term prospects for each company, regulatory risks, management quality and - most importantly - valuation, since a great business purchased at an expensive price can turn out to be a very poor investment.

The biggest exposure in Coronation's Emerging Market Fund is to China, with the largest part of that in internet and e-commerce companies, where we believe growth potential is large and of a very long duration. The fund holds stakes in China's two largest online retailers Alibaba, owner of Tmall, which has a 57% market share, and JD.com with a 25% share. These could be likened to eBay and Amazon, respectively. Unlike eBay and Amazon, they have very little competition from dominant high street retailers such as Walmart, Target and



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Costco as China did not see the emergence of national retail chains after its economy modernised from the 1980s onward. In China, most physical retail consists of department stores and subscale regional chains that lack the buying power to compete with national e-commerce retailers. Smart phones are now prevalent and people quickly adopted a preference for online shopping due to the range of goods on offer, their very competitive prices and the short delivery times. E-commerce sales in China have already overtaken those of the US (US\$378billion vs \$394billion) despite the market penetration of e-commerce being only 17% of total retail sales.

Another of Coronation's Chinese investments is Noah Holdings, the country's largest dedicated wealth and asset manager, which has almost 200 000 clients serviced by 1 286 relationship managers and invests in fixed income, private equity and fund of funds.

Noah's main attraction is its positioning to capitalise on the 20% per year historic growth of China's high net worth individuals, together with the fact that wealth and asset management industries are in their infancy in China. Noah has only a 2.4% market share in wealth management and 0.3% of the asset management sector, suggesting significant revenue growth potential. While penetration in its existing

markets has enormous potential, so does the development of other products in the sector.

India is another example of financial services exposure. The country is one of the most attractive emerging markets because of its large, young and rapidly urbanising population, many of whom are trying to enter the housing market. It has a high GDP growth rate and is not overly reliant on any particular sector. It also has among the lowest consumption penetration in emerging markets across many products and services.

Financial services penetration is particularly low, while over 70% of the industry sits in the hands of state banks, which are inefficient and often poorly run with political objectives in mind rather than shareholder return. With only 30% market share, the opportunity for private banks to gain further share is significant.

At the moment, mortgage penetration is only 9% of GDP, which is low relative to peer countries like China (22%). Rising house prices have not reduced affordability as incomes have risen and the government offers mortgage interest deductibility for first time buyers of entry level housing. The proportion of banked population is rising - debit cards almost tripled in the past five years and the number of people with a bank account has almost doubled. In addition, India's household debt is among the lowest in the world, opening opportunities for lending products.

Coronation's fund has invested in three financial services companies in India's financial services sector. It has a stake in Yes Bank, the fourth largest private bank in India, with significant scope to grow - particularly in retail banking. Yes Bank is also on an attractive valuation with earnings growing at 20% per year but trading on a 15x earnings multiple. Another sector holding is the Housing Development Finance Cor-

poration, which has a 41-year track record of exceptional performance and is run by an experienced management team whose interests are aligned with shareholders. Its main business is in housing finance but it also has exposure to private sector banking, life assurance, asset management and general insurance, among other financial services. The third investment is in Indiabulls Housing Finance, which specialises in home mortgages for the self employed.

One of Coronation's more unique investment ideas is OdontoPrev, a dental insurer in Brazil. The company is a beneficiary of the country's high emphasis on dental care. Brazil has the world's highest (per capita) consumption of toothpaste and practicing dentists. Only 23 million people have standalone dental plans, with a further 80 million Brazilians either paying out of pocket for dental care or relying on general medical aid.

OdontoPrev's business model is extremely scalable with the number of employees remaining flat since 2012 but with revenues up 50%. It is three times the size of its closest competitor, only focuses on dental insurance and has a highly effective IT platform which allows for effective risk management and fraud prevention resulting in the industry's lowest ratio of payouts relative to premium income.

Coronation's experience in emerging markets, understanding of their nuances and long-term time horizon, means it is able to identify and take advantage of opportunities in very different markets. Members of the team travel extensively to enhance their understanding of the businesses owned, their competitors and the countries in which they operate, as well as unearth potential new ideas.

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