REPRINTED FROM SEPTEMBER 12, 2016

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Managing a Go-Anywhere, All-Cap Asia Pacific Strategy

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SECTOR — GENERAL INVESTING

TWST: Would you begin with an introduction to Southeastern Asset Management? Tell us a little bit about the firm's history, the kinds of clients you serve and a bit about your role there.

Mr. Siazon: Southeastern is a U.S.-based firm, headquartered in Memphis. We were founded in 1975 and have about $20 billion in assets under management — half of which are in mutual-fund or UCITS formats in our Longleaf Partners Funds and the other half in separately managed accounts. The bulk of our client base is institutional in nature. We have close to 70 employees and are owned by our 18 principals. I'm one of the principals and am based in Singapore. My job is to lead up the research effort in Asia.

TWST: Tell us about the Asia Pacific strategy and the investment philosophy that guides that strategy.

Mr. Siazon: We started the Asia Pacific strategy at the end of 2014. It was opportunistic, just like with anything else we do in our firm. We saw that the opportunities in Asia were quite compelling, and we decided to start a dedicated strategy. In terms of the strategy, it follows the approach Southeastern has used for over four decades across our portfolios globally. We build concentrated portfolios of around 20 names. We're value-focused and follow a business/people/price discipline. We are looking for strong businesses that we can buy at deeply discounted prices, that are run by managers who act like owners.

TWST: Given that strategy, are there certain sectors or market caps that you are gravitating toward at this point?

Mr. Siazon: Our Asia Pacific strategy is an all-cap strategy, and we can invest anywhere in the region where we feel there is value. We think that's a very interesting proposition because, as you know, Asia has been quite volatile in the past few years, and the opportunity set tends to move around quite a bit. So having a go-anywhere, all-cap strategy gives us the flexibility to go after the best opportunities, regardless of market-cap size and location.

TWST: What are some of the regional trends in Asia that you think are currently creating investment opportunities?

Mr. Siazon: There are a number of trends we are trying to take advantage of. Let's start off with cheapness. If you look at how public equities in Asia are priced relative to the U.S. or other developed markets, it is clearly cheaper. For example, in Singapore, Hong Kong and Japan, almost half of the companies listed there are trading below book. So from that perspective, Asia is very interesting relative to other regions.

There's also the corruption crackdown in China that has affected a number of companies that are focused on high-end luxury spending. Whether it's gaming in Macau, watches or other luxury goods, all those companies have been severely affected by the corruption crackdown, as have hotels and anything related to high-end consumption. We increased our exposure over the past two years to sectors that were affected, and today, our primary exposure is via Macau gaming companies. We think the market has overreacted, since long-term, we see a consumer-driven economy coming out of the massive wealth creation that has taken place in Asia.

Another interesting trend happening in Asia is a generational change in management. A lot of the companies that were formed after World War II were founded by owners who today are 70 or older. There's been, in the last few years, a change in management, mainly passing businesses from father to son. The founders operated the companies as

old-style Asian conglomerates, but much of the successor generation has been educated in the Western world with a shareholder-value perspective. So the generational shift in management often brings meaningful changes in capital allocation.

In the U.S., where you have activist shareholders, conglomerates have been taken apart to maximize value. By contrast, in Asia, where you have companies that are essentially controlled by families, outside shareholders can't force change. So one of the biggest agents of change is when the son or daughter takes over a family company and begins to focus on capital allocation to create value through reorganizations and discounted share repurchases. We've benefited from that in a number of scenarios in Asia, such as **Cheung Kong**, where the son Victor Li took over from the father Li Ka-shing two years ago. Since then, a significant restructuring has taken place, led by Victor, who is 50 years old, Western-educated and frustrated by the massive discount to the sum of the parts at which **Cheung Kong** has traded.

Another trend we've seen is a focus on capital efficiency in Japan brought about by changes in governance and Abenomics. It's interesting because, in the past two years, Japan has appreciated quite a bit in response to some of the reforms that have taken place. But as you know, in the last eight months, the prices in Japan have actually unwound quite a bit. And so we're finding opportunities in Japan where the prices are quite attractive, but at the same time, capital allocation and corporate governance have improved significantly.

Within Japan, we see an interesting trend for small- to mid-cap domestic consolidations. These companies tend to be undercovered by the sellside community. They have a higher level of ownership by managements who have skin in the game. Smaller companies also have domestic growth opportunities, whereas if we look at large caps, a lot of their growth is overseas because they often already dominate the domestic market, and when large-cap Japanese companies expand overseas, they tend to overpay for assets.

The small- and mid-cap companies in Japan have the opportunity to increase market share and be the dominant player in a fragmented industry with smaller competitors. That's a theme we've taken advantage of in a number of investments, whether it's **AIN** (TYO:9627) in the pharmacy space, **Coca-Cola East Japan** (TYO:2580) in the bottling space, **IIDA Group Holdings** (TYO:3291) in the single detached homebuilder space or **JIN** (TYO:3046) in the optical space. I would characterize all of those industries as no or low growth and fragmented, where the dominant player can grow through market share gains.

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In the last year and a half, another trend we've taken advantage of is the weakness in natural resources. We have owned **Mineral Resources** (ASX:MIN) and **Seven Group** (ASX:SVW), which are Australian service providers to the iron ore industry. As global demand for iron ore slowed, Australian producers, who are the low-cost providers to China, increased production to help make up for prices that fell from over $100 per ton to the $40s. Because **Mineral Resource**s and **Seven Group** make money from production of iron ore in Australia, increased supply benefits them.

Mineral Resources is paid per ton for crushing iron ore on behalf of miners like **Rio Tinto** (NYSE:RIO) and **BHP** (NYSE:BHP). Similarly, **Seven Group Holdings**, which has the monopoly **Caterpillar** (NYSE:CAT) dealerships in Western Australia, sells more equipment, parts and service with higher mining activity. In essence, we owned exposure to companies that benefit from iron ore production growth rather than commodity price.

Finally, although we see a long-term opportunity for smaller caps, over the last 12 months, we've seen the selling off of liquid, large-cap, consumer-oriented Asian names as the volatility in China has created a massive risk reversal. Until now, these types of companies tended to be quite expensive, and for us, as a value investor, never cheap enough to be able to invest in. But recently, we have been able to buy these faster-compounding businesses with Chinese exposure at significant

Highlights

Ken Ichikawa Siazon discusses Southeastern Asset Management, Inc., and the Asia Pacific strategy. Mr. Siazon is value-focused and follows a business/people/price discipline. He looks to build a concentrated portfolio with strong businesses. He also wants the businesses to be run by managers who act like owners and to be available at a deep discount. Despite the volatility in Asia, the strategy has the flexibility to invest in the best opportunities regardless of market cap or location. According to Mr. Siazon, some of the trends creating opportunities include the cheapness of equities, the corruption crackdown in China, generational changes in management, the focus on capital efficiency in Japan and the weakness in natural resources.

Companies discussed: AIN Holdings (TYO:9627); Coca-Cola East Japan Co. Ltd. (TYO:2580); IIDA Group Holdings. (TYO:3291); JIN Co., Ltd. (TYO:3046); Mineral Resources Limited (ASX:MIN); Seven Group Holdings Ltd. (ASX:SVW); Rio Tinto plc (NYSE:RIO); BHP Billiton Limited (NYSE:BHP); Caterpillar (NYSE:CAT); Baidu (NASDAQ:BIDU); WH Group Ltd. (HKG:0288); Global Logistic Properties Ltd. (SGX:MC0); Hutchison Whampoa Limited (HKG:0013); CK Hutchison Holdings Ltd. (HKG:0001); Cheung Kong Property Holdings Ltd. (HKG:1113); Vipshop Holdings Ltd. (NYSE:VIPS) and Alibaba Group Holding Ltd. (NYSE:BABA).

discounts to what we think they're really worth — whether it's the internet search provider **Baidu** (NASDAQ:BIDU), the pork producer **WH Group** (HKG:0288) or **Global Logistics Properties** (SGX:MC0), which does logistics primarily for the consumer space in China.

TWST: What would you say are the risks specific to investing in the Asia Pacific, and how do you manage those risks?

Mr. Siazon: The level of risk varies a lot between the various countries. Some stock exchanges like Hong Kong are developed market exchanges, where I would argue that the minority shareholders are protected better than in the United States. For example, in Hong Kong, minority protection for shareholders is very strong, which is why you don't have a lot of take-private deals there.

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On the other hand, a lot of companies in Asia are run by owner CEOs who have a lot of control. To the extent that your objectives as an outside shareholder aren't in line with theirs, issues can arise. In general, we're always trying to make sure we're aligned with management at the right levels of the company or the conglomerate. You will rarely see us, for example, as a shareholder downstairs in the listed subsidiary of a conglomerate; you'll most likely see us at the same level as the controlling family or CEO. Being aligned with management is very important in Asia, especially in jurisdictions where you have weak corporate governance regimes.

We allocate capital to what we think is the best risk-adjusted return on investment, which today means that a lot of our investments are in companies listed in developed market locations with better governance, whether it's in Japan, Hong Kong, Singapore or the U.S. with Chinese ADRs. In terms of EM Asia, we have limited exposure. We have one out of our 20-plus names in Malaysia. However, it may not always be that way. As opportunities develop and become compelling in certain regions, I could see us putting more money into other countries.

TWST: Is there anything we didn't discuss that you'd like to add?

Mr. Siazon: I talked a little bit about **Cheung Kong** and will give you a little bit more color because it's a good example of a few opportunities we're seeing. Right now, Hong Kong stocks are among the cheapest in the world, and real estate in Hong Kong in particular is very cheap in the public markets compared to the physical private transaction market. In Hong Kong, real estate transacts at essentially a 3% cap rate, which is basically the same cap rate that land or buildings transact in the U.S. in the gateway cities. But the discount that public real estate companies and conglomerates in Hong Kong trade at when compared to the physical value of the real estate is the greatest, I think, anywhere in the world.

At a company like **Cheung Kong**, which was founded by Li Ka-shing, who is in his late 80s and is known as the Warren Buffett of Asia, the discount to NAV was something like 40% to 50%. And so when Li Ka-shing handed the business over to his son, Victor, a couple of years ago, Victor unlocked value by collapsing **Cheung Kong** and 50%-owned **Hutchison Whampoa** (HKG:0013) into **CK Hutchison Holding Company** (HKG:0001), and spinning out the real estate into **Cheung Kong Property Holdings** (HKG:1113). Victor also started to repurchase shares for the first time in the Li family's history. In the last two years, the disclosure and the engagement with shareholders have improved rapidly. **Cheung Kong** encompasses a number of trends that we talked about — the generational transition resulting in drastic positive changes in capital allocation, Hong Kong being one of the cheapest markets in the world and real estate companies in Hong Kong trading well-below book value.

Another thing I wanted to mention is our set up and our team in Asia. We've had investment staff in Asia since 1998 to support our international research. I personally joined the firm 10 years ago to lead the effort in Asia. We have three analysts in Singapore with broad Asian perspectives as they come from the Philippines, China and India. We also have a Japanese research associate in Tokyo and a trader in Singapore.

1-Year Daily Chart of CK Hutchison Holdings Ltd.

Chart provided by www.BigCharts.com

I mention our local staff because unlike the U.S., where there's a lot of company disclosure and sellside research coverage, in Asia, it's very different. Disclosure and investor relations are limited. It takes a lot more effort to cover these companies, and the cumulative base of knowledge and contacts Southeastern has built over the 18 years we've been in Asia, along with our various backgrounds, are invaluable. Also, a number of the U.S. and European companies that the Southeastern team covers out of those offices tend to do a lot of business in Asia, further adding to our research depth.

As a final point, I wanted to bring up the fear around China's economy slowing down to what is probably low-single-digit growth. The old economy faces lower growth, but the other half of the economy, the consumption part, is increasing at double-digit rates, and within that, you have businesses that are growing significantly faster than the average. For example, the internet company **Vipshop** (NYSE:VIPS), which is like an online version of

T.J. Maxx, is growing at almost 50% a year. **Alibaba** (NYSE:BABA) is also growing around that rate. **Baidu** is growing at around 20% a year. These are perfect examples of the kind of the opportunity set that we can take advantage of when there's widespread fear around a certain country, but there are companies that are compounding at double-digit rates that are led by managers who are big owners, and the fear has made them available at significant discounts to what we think they really are worth.

TWST: Thank you. (MES)

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