# Asia Pacific Strategy Commentary

# 1Q22

Southeastern Asset Management

For Institutional Investors Only

## Portfolio Returns at 3/31/22 – Net of Fees

| | 1Q22 | 1 Year | 3 Year | 5 Year | Since Inception 10/31/2014 |
|---|---|---|---|---|---|
| APAC Strategy (USD) | -8.05% | -26.41% | -3.06% | 0.41% | 2.72% |
| MSCI AC Asia Pacific Index | -5.98% | -9.48% | 6.48% | 6.62% | 5.73% |
| Relative Returns | -2.07% | -16.94% | -9.54% | -6.21% | -3.01% |

| Selected Indices* | 1Q22 | 1 Year | 3 Year | 5 Year |
|---|---|---|---|---|
| Hang Seng Index (HKD) | -5.66% | -20.53% | -6.13% | 1.31% |
| TOPIX Index (JPY) | -1.29% | 1.80% | 9.43% | 7.58% |
| TOPIX Index (USD) | -6.47% | -7.37% | 6.09% | 5.71% |
| MSCI Emerging Market (USD) | -6.98% | -11.37% | 4.94% | 5.98% |

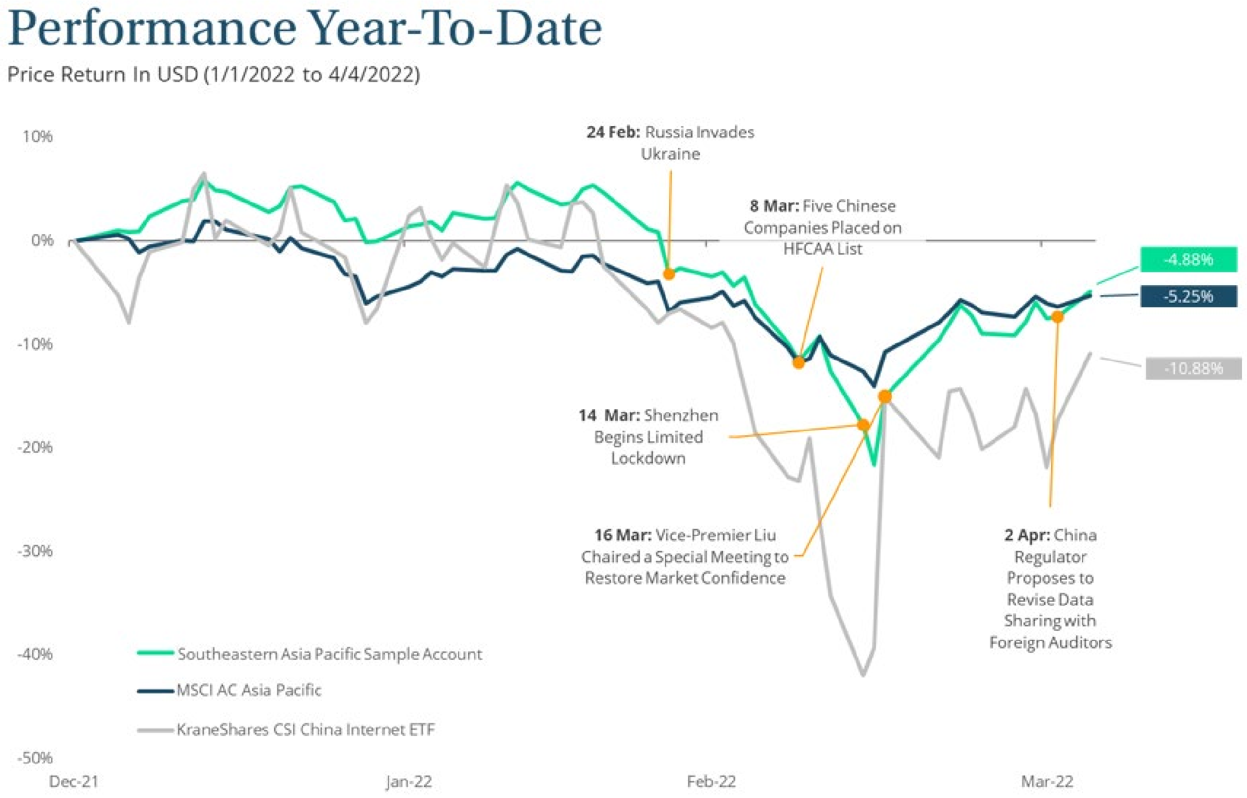
*Source: Bloomberg; Periods longer than one year are annualized

The Strategy returned -8.05% in the first quarter, trailing the MSCI AC Asia Pacific Index, primarily due to the portfolio's overweight position in Hong Kong/China, which has experienced extraordinary volatility during the quarter—even by Asian standards.

The quarterly returns don't truly reflect the extreme intra-quarter and daily volatility we experienced. Volatility in Chinese tech stocks, as represented by the KraneShares CSI China Internet Fund ETF (KWEB), was severe—it was down over 42% at its lowest point, yet finished the quarter down 22%. Four unrelated events combined to compound the extreme volatility in March:

1) The Russia-Ukraine War
2) Covid resurgence in China
3) Chinese ADR delisting fears
4) Rising inflation fears and ensuing tighter monetary conditions in the US

Importantly, only one (Covid disruption) out of these four events has a direct, though transitory, impact on the underlying fundamentals of our companies. The remaining three events are all about short-term sentiment.



Performance Year-To-Date

Price Return In USD (1/1/2022 to 4/4/2022)

**24 Feb:** Russia Invades Ukraine

**8 Mar:** Five Chinese Companies Placed on HFCAA List

**14 Mar:** Shenzhen Begins Limited Lockdown

**16 Mar:** Vice-Premier Liu Chaired a Special Meeting to Restore Market Confidence

**2 Apr:** China Regulator Proposes to Revise Data Sharing with Foreign Auditors

Source: FactSet

China declared its friendship with Russia as having "no limits" with no "forbidden areas of cooperation" just days before Russia invaded Ukraine on February 24th. The market assumed the worst case—that China would be dragged into the conflict by supporting Russia and suffer from the same drastic economic sanctions that have left the Russian economy on the verge of collapse, with about half of its foreign exchange reserves frozen. Economic growth and the social stability that comes with it are of paramount importance to the Chinese Communist Party. Western sanctions on China would have major consequences (on both sides), so we believe that China will not actively support the invasion and will do the minimum necessary to prevent the US from imposing secondary sanctions on China. China has too much to lose from western sanctions. China needs to keep its manufacturing engine running and continue exporting to the West to ensure employment in an already weak macro environment. It also depends on Western inputs to produce goods such as iPhones. About half of China's exports go to the US and the EU, and its largest import is semiconductors, an industry dominated by Taiwanese and US technology. Furthermore, the bulk of its $3.2 trillion of foreign exchange reserves is in the US and EU, which are at risk of being frozen. On the other hand, imposing sanctions on China would further dent an already fragile global supply chain and fuel inflation, becoming a political hot button in the US.

On top of Russia-Ukraine sanction fears, China is currently suffering from its worst episode of Covid since Wuhan, with about 373 million people in 45 cities, making up 40% of its economy under complete or partial lockdown, based on estimate from Nomura economists. Major cities have been locked down, including Shanghai and Shenzhen. Shanghai, a city with 25 million residents, is locked down to perform extensive Covid testing. It is the epicenter of China's worst virus outbreak so far. Retail sales and travel have plunged, and already weak property sales have weakened further. Covid is rampant in Hong Kong, with death rates per capita among the highest in the world because a large percentage of Hong Kong's elderly are unvaccinated. China faces the same problem, with about 20% of its elderly above 60 years not fully vaccinated – around 50 million people. In Zhuhai, for example, as of March 8th, only 60% of those over 70 years old have been vaccinated. China's under-resourced hospital system cannot deal with an uncontrolled outbreak of Covid variants, given their low vaccination levels and lack of mRNA vaccines (currently under clinical trials).

Further compounding the volatility in March, an initial batch of 11 Chinese companies were placed on the "Provisional list of issuers identified under the Holding Foreign Companies Accountable Act (HFCAA)," which starts the clock on a three-year timeline leading to the delisting of the ADRs from US stock exchanges. Despite many ADRs already being dual-listed in Hong Kong, investors in Chinese ADRs panicked. News of potential ADR delisting fueled share price volatility despite having no effect on companies' business fundamentals.

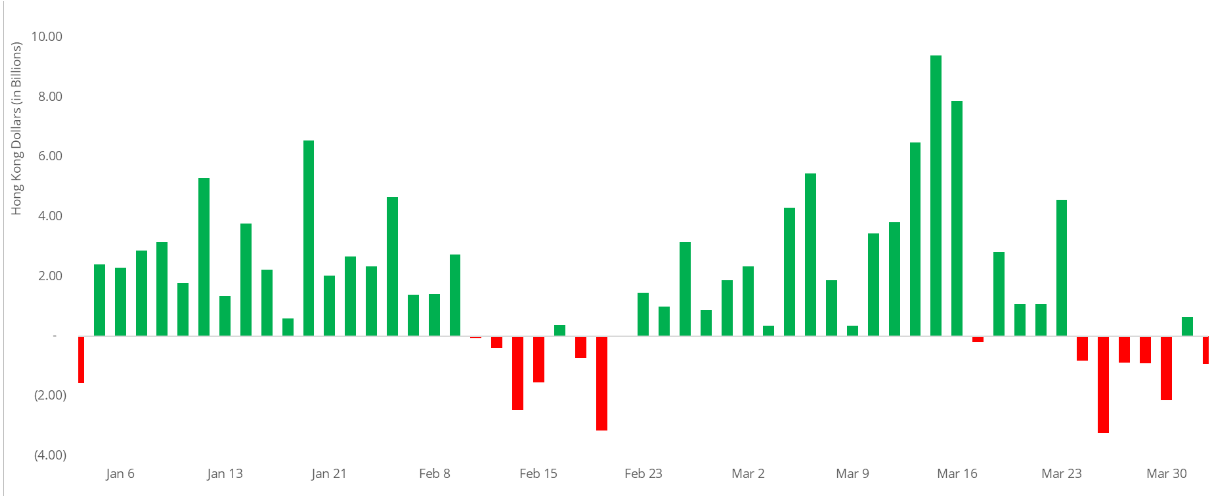
In advance of delisting, investors can simply convert their ADRs into Hong Kong listed shares. This is what we have done with our holdings in Alibaba and Baidu. Chinese ADRs could also list in Hong Kong without issuing equity at value-dilutive prices. In fact, more than a decade ago, that's what Melco Resorts did. The company completed a dual primary listing by way of introduction in Hong Kong. We hold two ADRs — Melco Resorts (MLCO) and JOYY (YY) — which don't have secondary listings. That said, they could potentially change auditors to solve the issue. The overwhelming majority of our exposure to Melco is through our holding Melco International, listed in HK, not Melco Resorts. Currently, the Public Company Accounting Oversight Board (PCAOB) cannot review audit papers of auditors in Mainland China and Hong Kong. However, in the case of JOYY and Melco, most of their assets are outside of Hong Kong and Mainland China. JOYY's China business was sold to Baidu and is currently awaiting approval from the competition authorities. JOYY is a Singapore company with most operations outside China. Melco is a Cayman company with no operations in Mainland China. One quick solution could be to change auditors from Hong Kong or mainland China to Singapore. One company that we do not hold, but that serves as a good example of corrective action, is BeiGene. The company recently switched auditors to Ernst & Young USA from Ernst & Young China for its US Securities and

Exchange Commission (SEC) audit reports to avoid a de-listing in the US. We have not converted the small amount of CK Hutchison exposure we hold via ADRs, as they are unsponsored Level 1 ADRs. CK Hutchison does not have an annual reporting obligation with the SEC and is not covered under the HFCAA.

In April, in a significant concession to US regulators, Chinese regulators proposed to revise the rule regulating how Chinese companies listed overseas should handle confidential and sensitive information. Chinese authorities are preparing to give US regulators full access to audit working papers of the majority of the 200+ Chinese ADRs. This potentially paves the way for US-China audit cooperation and reduces Chinese ADR de-listing risk.

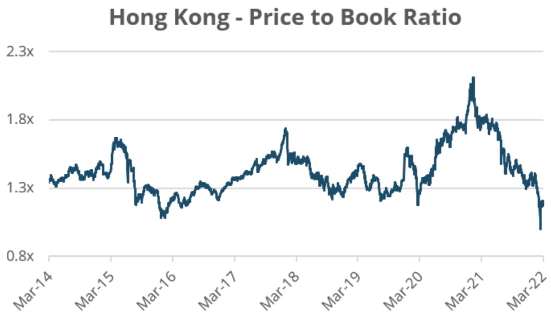
Shifting a company's primary listing to Hong Kong will be beneficial in attracting new investors. It will enable them to be listed on the Hong Kong Stock Connect program, allowing mainland Chinese investors to invest in Hong Kong-listed stocks. Chinese ADRs/overseas-listed stocks are suffering from capitulation primarily from foreign investors. However, the earnings and fundamentals of the Chinese ADRs and dual listed companies we own are not imploding. On the contrary, they are still growing, despite macro weakness. We firmly believe that if the earnings remain resilient, stock prices will invariably follow in time. While it takes years to build strong franchises with resilient earnings streams, market sentiment can change on a dime. Chinese investors are taking advantage of the noise, buying these strong franchises on the Hong Kong Stock Exchange at bargain prices as shown in the charts below. So are we!

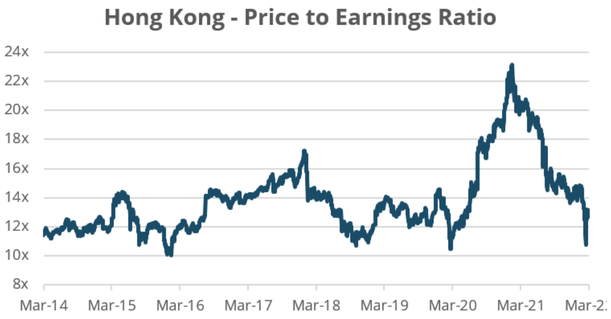
## Southbound Turnover on the HK Stock Exchange

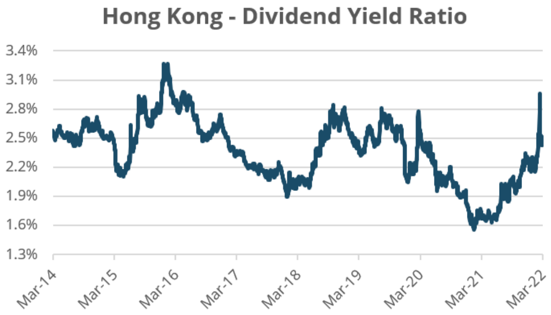


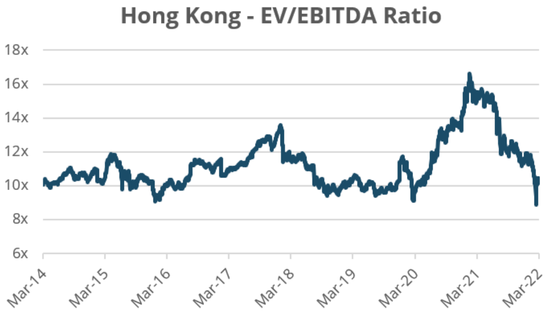
Source: Bloomberg

Notably, both the multiples and earnings are currently depressed due to China's zero Covid policy and consumption slowdown.


Hong Kong - Price to Book Ratio


Hong Kong - Price to Earnings Ratio


Hong Kong - Dividend Yield Ratio


Hong Kong - EV/EBITDA Ratio

On March 16th, Vice-Premier Liu He chaired a special Financial Stability and Development Committee (FSDC) meeting to restore market confidence. The meeting readout addressed market worries, driving a dramatic recovery in the Chinese capital markets. Market commentators likened Liu He's declaration to China's "Draghi moment" when the European Central Banker (ECB) Mario Draghi declared in 2011 that the ECB is "ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

## Key Points:

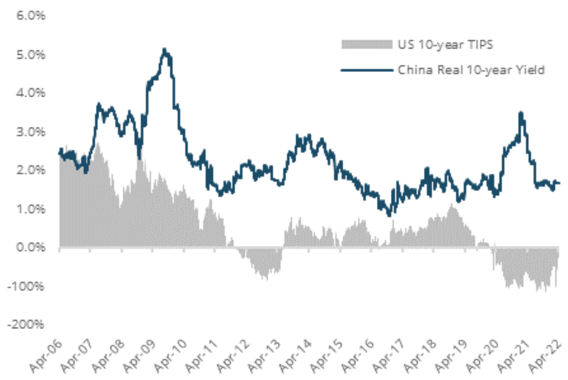
1. Carry out more easing policies to support the economy in Q1 and pledged to "actively introduce market-friendly policies "to maintain stable operation of the capital market."
2. He called for "effective risk prevention and mitigation solutions" to deal with the struggling property sector.
3. Signaled a quick end to Beijing's 'anti-monopoly' policies, tasking "relevant agencies with completing rectification work on large platform companies as soon as possible."
4. Suggested that both sides are making decent progress and deliberating concrete resolutions on the auditing dispute between the China Securities Regulatory Commission (CSRC) and the Public Company Accounting Oversight Board (PCAOB).

Most importantly, the meeting stated that for all policies that could have a major impact on the capital market, financial regulators must be consulted in advance to maintain stability and coherence of policy expectations. The FSDC will coordinate this process and hold those accountable for failing to consult the regulators ahead of policy announcements, indicating disciplinary actions (using the powerful anti-corruption watchdog).

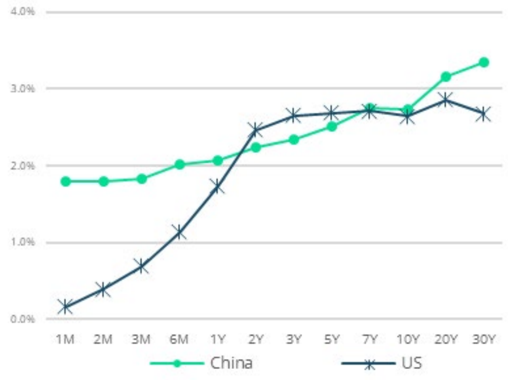
On April 6th, Premier Li Keqiang chaired a State Council executive meeting to further stress "maneuvering monetary policy tools to bolster real economy." The State Council "decided to use monetary policy tools as appropriate to more effectively support growth of the real economy." Just a few days later, on April 11th, Premier Li emphasized in another meeting that authorities shall "add a sense of urgency" in implementing existing policies to deal with the mounting downward pressures. Given the macro headwinds China is facing and the targets set for GDP growth, we believe more aggressive financial support will be launched to stimulate economic activity. China's supportive policy is in stark contrast to the US, tapering asset purchases, raising the federal funds rate, and shrinking its balance sheet. In China, we have already seen new bank lending rise above expectations in March, confirming that the government followed through on its statements around loosening monetary policy.

We live in an unprecedented world for our generation. We have a full-scale war in Europe, a cold war between China and the US, high inflation for the first time in decades, high energy prices, and a reversal of decades of globalization and trade integration. The financial system has also been used as a weapon against rogue states to an extent not imagined by most players. Investors now have to worry more about the safety of foreign currencies and securities – even for government bonds previously thought of as risk-free. As inflation and interest rates increase, eroding the value of longer duration free cash flows, it has become even more critical to seek higher-yielding and faster-growing free cash flow (FCF) generating assets with pricing power. Despite interest rates spiking upwards in the US, real yields on US treasuries remain negative. While this may be the cost of "safety," this is no longer the case for foreign governments like Russia, which had the vast majority of its US and European government bond holdings frozen. This loss of "safety" premium negatively affects governments that fund their current account deficits with foreign borrowings.

**10 YR TIPS vs. 10 Year China Govt Real Yield**



**Nominal Yield Curve: US & China**



Source: Bloomberg

With the Hang Seng China Index offering double-digit earning yields that are growing faster than inflation and Chinese government bonds offering positive real yields, the opportunity set is compelling in Greater China. In Hong Kong, insiders have been voting with their feet. In Q4 2021, insiders bought 9x more than insiders sold on the Hong Kong stock exchange (revised up from the 3x last reported by 2iQ). In March, during the extreme market volatility, the insider buy-sell ratio was around 6x, according to 2iQ.

In the China tech space, buyback activity has quickly accelerated. Alibaba led the pack with its $25 billion buyback program, which was upsized from $15 billion and from $10 billion the year before. In the first nine months (April-Dec) of the fiscal year, the company repurchased $7.7 billion, and in the March quarter has repurchased $1.5 billion so far – a $10 billion annual run rate. Given the ridiculously low valuation levels of Alibaba, this makes a lot of sense.

*"We believe that the market has not placed sufficient value on Alibaba's business in terms of how it's being driven by this multi-engine strategy. The full value of each of these businesses is not being reflected in where we're at today. And this is a big part of the reason why we're pursuing a share buyback strategy." Alibaba CEO Daniel Zhang, February 24th, 2022*

Recently, we've heard market commentary that the Chinese tech sector is controlled and owned by the government. We don't subscribe to this blanket opinion. The capital allocation decision to repurchase shares on this scale and the significant cost-cutting and employee lay-offs among our investees in the China tech sector do not reflect a government's typical actions, but rather the efforts of owner-managers focused on increasing shareholder value.

Alibaba is not alone in re-allocating significant cash flow towards share repurchase to take advantage of the opportunity created by volatility. Many Chinese companies have recently announced buybacks, to name a few: Tencent, Xiaomi, Vipshop, Weibo, JD.com, JD Health, Ping An, Ping An Healthcare, and YUM China.  The record scale of buybacks among the worst-hit overseas-listed Chinese companies has been encouraging, demonstrating focus on creating shareholder value and reflecting confidence in their companies' prospects.

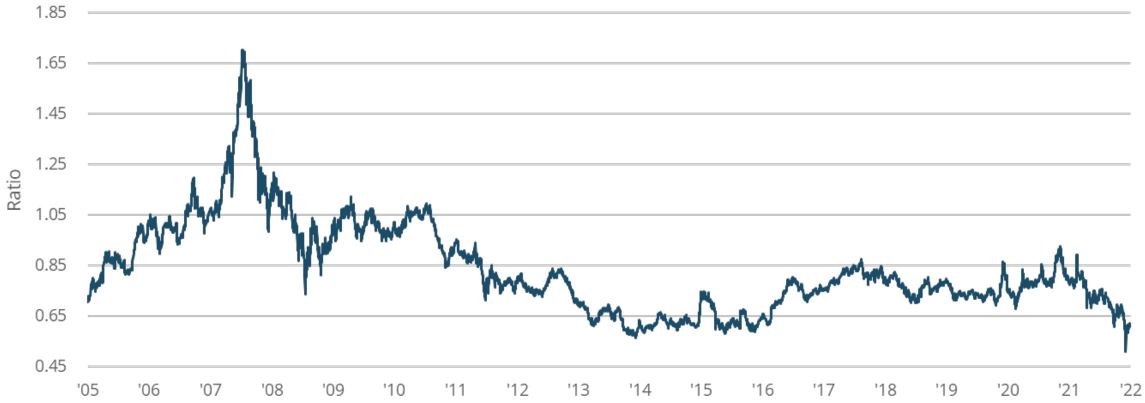
We have also seen significant share repurchases across our portfolio.  Besides Alibaba, Tencent's buyback is also noteworthy.  Before entering the earnings blackout period in January, Tencent was repurchasing about HK$200mm per day, doubling last year's pace.  In March, Tencent returned to the market and ramped up the buyback pace to HK$300mm per day post blackout. Year-to-date, Tencent is the largest share repurchaser on the Hong Kong stock exchange; with a $16 billion special dividend of JD.com shares, which we received in the quarter, and a regular cash dividend, our shareholder return has been about 4.1%.  JOYY is another one that warrants honorable mention.  In the most recent quarter, the company allocated over $200mm towards buybacks, more than what was repurchased in 2020.  While the absolute amount is not the largest, it is significant considering the $3 billion market capitalization of JOYY.  It is encouraging that JOYY has about $1 billion remaining in its repurchase authorization that it intends to deploy fully this year.  Seria, the Japanese 100 yen operator, which we re-initiated as an investment during the quarter, repurchased shares for the first time since listing in 2003, reflecting the compelling valuation of the company and the positive evolution of CEO Kawaii-san's thinking on capital allocation.  Baidu, CK Hutchison, Man Wah, and Prosus have also repurchased shares in the quarter.  Furthermore, management at CK Asset, Man Wah, New World Development, and Prosus bought shares in the last few months.

## Outlook

We have added more personal capital to the strategy in March, as we believe valuations are the most attractive since the GFC. Will China trade at a perpetual discount moving forward? We don't think so, but even if it does – there is an immense opportunity to be in the right companies as they close that massive discount to a more reasonable discount versus global peers.

MSCI China Index Forward P/E Divided By MSCI AC World Index Forward P/E

12-April-2005 to 8-April-2022



## Portfolio Changes

As you would expect during periods of high volatility, we made a lot more changes than usual to take advantage of opportunities. We initiated four new investments – two in Japan (Oisix and Seria) and two in China (Man Wah and a dual-listed ADR that we'll discuss next quarter). Among the new buys, Seria and Man Wah are repeat investments. We also increased our investment in Alibaba, Tencent and Tongcheng Travel, as prices declined even further in the quarter, as China tech bore the brunt of the volatility. We exited Dairy Farm and Health and Happiness and reduced six other investments to fund the new investments.

## New Investments

During the quarter, we invested in Japanese online fresh food retailer Oisix ra daichi (Oisix). Maybe akin to an online version of Whole Foods, Oisix is an online retailer specializing in subscription sales and delivery of organic meal kits, fresh food products, and ingredients. The company has three domestic brands—Oisix, Daichi wo Mamoru Kai (Daichi), Radish Boya, and a US brand Purple Carrot that all offer home delivery services. Meal kits that can be prepared in 20 minutes account for 40% of revenues, with other quality fresh food groceries accounting for the rest. Customers typically sign up for a box of meal kits or fresh foods to be delivered on average 2-3x per month, with an average monthly spend of 12k yen for its largest product line Oisix and an average monthly spend of 23k yen for its upscale Daichi brand.

In contrast to the typical e-commerce (EC) website, where one-off purchases account for most sales, most Oisix customers are subscribers to a weekly/bi-weekly home delivery service. Each week, customers can add or delete items as necessary from a recommended list of products found in their shopping carts. Because the orders received from customers are passed along to producers, the company can usually avoid holding inventory at its distribution centers, keeping spoilage costs significantly below other online supermarkets and brick-and-mortar retailers.

Perishable fresh food is the unconquered territory where nearly all online players are loss-making. Unlike traditional EC, fresh food EC has much higher logistics requirements in shorter delivery time and end-to-end temperature-controlled logistics to ensure product quality. The harsh unit economics results in low margins. Unlike most online food/grocery delivery players, Oisix is profitable, generates positive cash flow, and enjoys high returns on invested capital. Oisix generates 50% gross margins, 20% EBITDA margins pre-CAC & pre-corporate expenses, and 7% consolidated EBITDA margins. In the last ten years to March 2021, Oisix has generated 2.9x more after-tax operating cash flow than the company has spent on Capex and acquisitions. Oisix targets 10% corporate EBITDA margins in the medium term primarily through operating leverage. We view this target as achievable, if not conservative. The largest global comparable, HelloFresh achieved 13.5% adjusted EBITDA margins in 2020 during COVID. While 2020 was a bumper Covid year, HelloFresh projects 10-15% long-term EBITDA margins, with their more mature regions generating higher than 20% EBITDA margins. This is in-line with another listed competitor Marley Spoons' stated long-term operating EBITDA margin potential of 15+%.

The stock pulled back meaningfully because of the concerns around Oisix being a Covid reopening loser, the entrance of German competitor HelloFresh in Japan, and short-term operational issues due to opening a new distribution center. With very low online food/grocery penetration in Japan, Covid boosted the market's awareness of online food/grocery/meal kit delivery and allowed the company to accelerate market growth cheaply. Combined with competitor HelloFresh's entrance in Japan, market awareness should continue to grow. Oisix, which has built an extensive direct from farm supply chain network and strong brand equity, will be the primary beneficiary of market growth. In January, a relocation issue at Oisix’s Ebina distribution center led to delays in deliveries, which attracted media attention and caused investor concerns. Oisix quickly fixed the logistics issue, and the churn rate did not increase meaningfully, indicating that customers remained loyal. The new distribution center will expand shipping capacity, improve operating efficiency, and consolidate multiple facilities. We took advantage of the volatility and initiated an investment in the company.

Through our investments in numerous fragmented industries in Japan, we realized that the consumer typically pays high prices because the wholesale distribution system takes a sizeable portion of the value chain. However, if the retailer is large enough, they have the power to disintermediate the wholesale distribution system and go direct to source, retaining more margin. Oisix captures most of the value chain by going directly to the farmer. In Japan, the farmer typically only receives 30% of the final retail price, and 70% goes to the multiple distribution layers between farmer and consumer. As a result, Oisix has a 50% gross margin, significantly higher than a typical supermarket operator's 30% gross margin.

Man Wah, the leading recliner sofa manufacturer in China, is a company that we have successfully owned previously that we re-initiated in the quarter. The market’s short-term concern about the Chinese real estate segment was evident in the stock price pullback, whereas we believe Man Wah can continue to grow and expand product penetration. Man Wah is the world's No.1 recliner sofa company. We have witnessed over the years that Man Wah has transformed from an ODM exporter into a mainly domestic branded sofa manufacturer. In China, its Cheers brand recliner had 59% market share in 2020, up from less than 20% ten years ago. For every two recliners sold in China, at least one is from Man Wah. Despite its dominant share in recliners, Man Wah still has a long runway for growth because of the low penetration of recliners and the fragmentation of the upholstered furniture market in China. We are encouraged to see that Man Wah's growth rate increased as it gained scale, and its competitive moats in the brand and channel strength widened over its peers, compounding the business and generating over 20% ROE. We have a 60% owner-operator — Wong Man Li — at the helm, who has a track record of buying back shares and increasing his stake in the company when the shares are cheap, as he has done this quarter. We were able to buy this business for about 12x earnings during the first quarter, similar to the price we paid before. However, the company's business and its competitive moat have improved significantly since we last owned Man Wah.

Seria, the second-largest 100 yen store operator in Japan, is another company that we re-initiated in the quarter. The 100 yen industry in Japan is facing tough post-Covid comps and cost pressures from inflation and a weaker yen. Furthermore, there are concerns that the industry could become more competitive, with the #3 player Can Do being taken over by Aeon, one of the largest retail groups in Japan. As a result, Seria's share price derated from these market concerns. Aside from owner-operator Kawaii, Seria's most significant competitive advantage lies in its proprietary data analysis system, which provides insights on popular products and enables efficient operations. 100-yen shops are specialized retail, and neither Can Do, nor Aeon can run this format well.  While Aeon could provide some good store locations to Can Do, we do not think the competitive landscape will be altered materially.  Seria's industry-leading operating margins, ample net cash, and positive FCF enables the company to bear near-term cost pressure and emerge stronger as the industry grows and consolidates.  Adding to our comfort is the management team led by CEO Eiji Kawai, whose family owns around 30%, and the recent initiation of a share buyback program for the first time to take advantage of this opportunity.  We paid below 12x maintenance FCF, an even more attractive price than when we first owned Seria.

| 1Q22 | | |
|---|---|---|
| | Contribution to Portfolio Return (%) | Total Return (%) |
| **Top Five** | | |
| CK Hutchison | +0.57 | +14 |
| Undisclosed | +0.41 | +39 |
| Oisix ra Daichi | +0.39 | +30 |
| CK Asset | +0.23 | +7 |
| New World Development | +0.16 | +5 |
| **Bottom Five** | | |
| Redbubble | -1.61 | -51 |
| Melco International | -1.37 | -24 |
| L'Occitane | -1.31 | -20 |
| Gree Electric Appliances | -0.84 | -13 |
| Prosus | -0.68 | -35 |

CK Hutchison (CKH), a conglomerate of telecommunications, health & beauty, infrastructure, and global ports, was a top contributor for the quarter. It reported a solid full-year 2021 result with overall revenue up 10% YoY and EBITDA up 15% YoY. The port division had the strongest recovery, with profits already above the pre-Covid levels, and the positive momentum is holding up in 2022. The retail business benefited from a low base in 2020, with stores in Western Europe outperforming those in China. The resurgence of Omicron in China will put further pressure on the recovery of store performance in the region. The telecom division had profits decline by mid-single digits in local currencies, mainly driven by Italy, where competition continued to intensify, and the wholesale revenue from Iliad Italia declined after Iliad built its network. What is encouraging is that the UK regulator has indicated its intention to de-emphasize the number of players in the market, which may open up consolidation opportunities that will benefit 3 UK. In March, CKH finally obtained conditional approval for its UK tower sale to Cellnex, the biggest and last tranche of six tower asset disposal deals first announced in 2020. Upon completion, the UK telecom tower disposal will bring in 3.7 billion euros, representing around 15% of the current market cap of CKH. Management has indicated that a portion of the proceeds will be used for share buyback, which is an excellent, value accretive use of proceeds at the current 7x earnings, 5% dividend yield of CKH.

CK Asset (CKA), the Hong Kong and China real estate and global infrastructure company, was a top contributor for the quarter. CKA announced full-year results with a final dividend above investor expectations. The total dividend for 2021 recovered to above pre-Covid level in 2019. Both development property and investment property businesses were largely on track with expectations. Losses from UK pub operations greatly narrowed last year compared to 2020. Barring a further lockdown in the UK, this division should start to contribute profits in 2022. In March, CKA sold a London office tower - 5 Broadgate - to the Korean National Pension Service for £1.2 billion or less than a 4% cap rate. This is above our appraisal and the total return from this building over a less than four-year holding period is 45% ROI. Together with the aircraft leasing business disposal announced in December last year, asset sale proceeds would provide enough cash for the company to launch more aggressive shareholder return activities or engage in other value accretive transactions. CKA also confirmed that parties had expressed an interest in London electricity distributor UK Power Networks Holdings Limited during the quarter. CKA's 20% equity interest in the rumored enterprise value offer of £15 billion is equivalent to about 10% of CKA's market capitalization.

Redbubble, the leading print-on-demand marketplace operator, was a detractor for the quarter. The company posted weak first-half results, which led to a strong sell-down of the stock. Its revenue was broadly in-line with expectations, but its EBITDA was significantly below, driven by lower gross margin, higher paid acquisition costs, and higher operating costs. Redbubble's gross profit margin deteriorated by 270bps on a YoY basis to 36% in the second quarter due to cost inflation and unfavorable product mix. Gross profit after paid acquisition margin in the quarter also fell to 20% as paid acquisition costs as a percentage of marketplace revenue recorded an all-time high. This was the result of the company increasing customer acquisition spending and promotional activities amidst intensified competition. Management downgraded the topline guidance from slightly above fiscal year June 2021 underlying marketplace revenue to slightly below the fiscal year 2021 underlying marketplace revenue, further disappointing the market. However, management reiterated its medium-term target of $1.25 billion in marketplace revenue and a 13-18% EBITDA margin. The market is skeptical of Redbubble's execution capability to deliver the results, but based on our conversations with the management team and our network, we think the management team is solid, and continued new hires will add more expertise to the fast-growing business in a large, underpenetrated TAM.

Interestingly, one of our Macau holdings, MGM China was a contributor, while Melco International was a top detractor. Both the companies did well operationally among their peer group, reporting strong fourth-quarter results beating our expectations. MGM China continues to gain market share in the all-important premium mass segment. Melco was the best Macau casino operator in terms of sequential EBITDA improvements in 4Q21, thanks to its solid mass operations and tight cost controls. Both the companies have strong liquidity and can sustain cash burn for over two years under an unlikely zero revenue scenario. However, these quarterly results are not relevant when the demand is subdued due to Covid-related travel restrictions in the Greater China region. Melco CEO Lawrence Ho shared a cautious outlook on the near-term reopening prospects given ongoing Covid resurgence in China and its zero-Covid policy.

While the underlying fundamentals are exactly the same for both of our Macau holdings, the key reason for the divergence in their stock price performance is negative sentiment related to ADR delisting risk for Melco Resorts. We own Hong Kong-listed Melco International whose subsidiary Melco Resorts (MLCO) is listed in the US. MLCO has a Hong Kong auditor, and the US Public Company Accounting Standards Board (PCAOB) cannot conduct inspections in Hong Kong. As of today, we do not see any near-term delisting risk, and the issue needs to be resolved before the 2024 annual report filings. Even in the case of delisting, there are realistic solutions, such as listing the stock on the Hong Kong stock exchange or merging with Melco International. Many scenarios are value-neutral to value accretive, so we see the current valuation as unwarranted.

While the timing of travel resumption remains unclear, we remain confident that the long-term demand for Macau and gaming is solid. Macau will be the biggest beneficiary of Chinese outbound tourism. It will benefit further from China's government development of the Greater Bay Area. Both MGM China and Melco should enjoy stronger growth than peers with their leading position in the premium mass segment.

L'Occitane International, the natural and organic-based beauty products company, was a detractor in the quarter after being the top contributor in the fourth quarter and 2021. L'Occitane was affected by the severe outbreak of Covid in Hong Kong in February, resulting in the strictest social distancing measures to date. This was followed by the worst outbreak of Covid and overall consumption slowdown in Mainland China in March. Hong Kong and Mainland China are L'Occitane’s largest markets, accounting for about 26% of the company's sales and an even larger share of profits. Furthermore, Russia accounts for about 3% of group revenues. Being a Hong Kong-listed company, L'Occitane was caught in the violent downdraft of the Hong Kong capital markets. However, we remain confident in L'Occitane's long-term prospects. Growth should accelerate when Covid lockdowns ease in Hong Kong and Mainland China.

Gree Electric Appliances, the dominant air conditioner manufacturer in China, was a top detractor for the quarter. Rising raw material prices (copper) and relatively weak consumer demand are challenges facing the air conditioner industry in China. Since March, the Covid resurgence and lockdown across several cities has added near-term pressure on the industry. The good news is that the industry's competitive landscape is stable, and the leading players are all increasing prices to pass on the cost pressure. In addition, Gree has consolidated Dun'An, one of its upstream component suppliers, which should create additional savings and synergies along the supply chain. With over US$10 billion in net cash, industry-leading operating margins, and positive FCF, Gree should be able to navigate through the current industry headwinds. In January, Gree also announced its shareholder return plan for the next three years, including twice a year dividend distributions and a 50% dividend payout ratio floor. The stock is trading at a 7% yield, and we think there is further room for the company to announce another share buyback program this year after buying 8.7% of the company from the past three programs.

Prosus, a global consumer internet group, was a top detractor for the quarter. Tencent, which accounts for 85% of Prosus's NAV, has faced pressures from weak macro and regulatory headwinds. High base effects and proactive initiatives to reduce minors' game play temporarily slowed down Tencent's domestic game growth, despite its international game business growing strongly. The regulatory crackdown on the after-school tutoring sector and reduced ads inventory impacted Tencent's ads businesses. In contrast, Tencent made solid progress with new initiatives, increasing viewership, user time spent in video accounts, and strong user growth in SaaS. We believe in Tencent's long-term sustainable growth with intrinsic capabilities and strong dominance across business lines despite short-term headwinds. Meanwhile, geopolitical risk and rising interest rates have impacted Prosus's global e-commerce portfolio NAV. Prosus has exposure to Russia through Avito, the leading classifieds business in Russia. Avito accounts for a low single-digit percentage of NAV, but a more meaningful 20% of group FCF. Additionally, higher interest rates and tighter liquidity conditions negatively impacted valuations of long-duration, high-growth, loss-making businesses such as food delivery company Delivery Hero. The company remains confident that its balance sheet can support incremental investments at much better valuations today while maintaining an investment grade rating. The NAV discount has widened to record highs despite a sizable $10 billion buyback in the last 12 months and the share exchange offer in August 2021. We believe this NAV discount is unwarranted and are confident that our management team is working on initiatives to narrow this discount. Our management partners Bob van Dijk (CEO) and Basil Sgourdos (CFO), personally bought a significant amount of shares in the market, highlighting their confidence in the business.

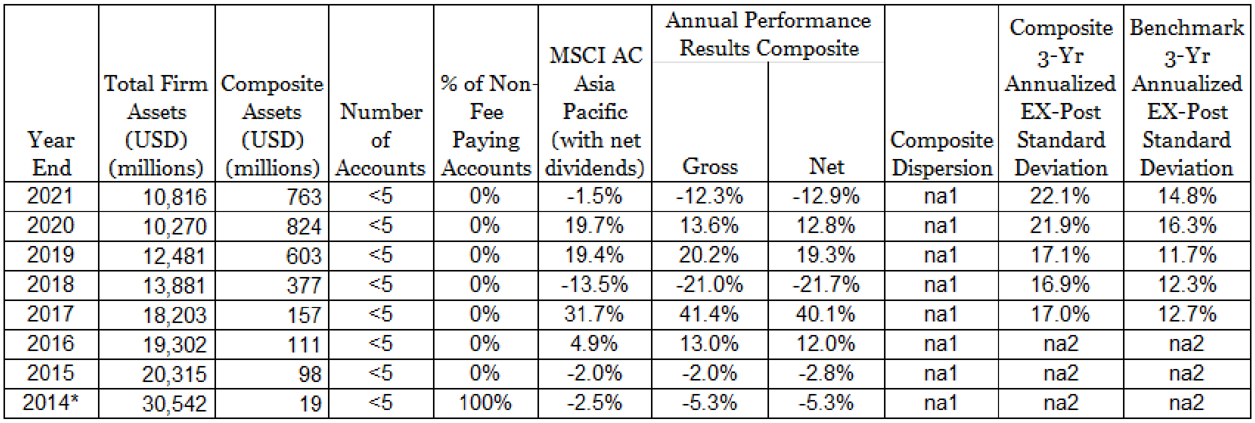
*See the following pages for important disclosures.*

This document is for informational purposes only. Further information about Southeastern Asset Management can be found in our ADV Part 2, available at www.southeasternasset.com. Statements regarding securities are not recommendations to buy or sell the securities discussed. The statements and opinions expressed are those of the author and are as of the date of this report. Holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients. Current and future holdings are subject to risk and past performance does not guarantee future results. Portfolio information is based on a sample account at March 31, 2022. Portfolio makeup and performance will vary on many factors, including client guidelines and market conditions.

P/V ("price-to-value") is a calculation that compares the prices of the stocks in a portfolio to Southeastern's appraisal of their intrinsic values. The ratio represents a single data point about a strategy and should not be construed as something more. P/V does not guarantee future results, and we caution investors not to give this calculation undue weight.

"Margin of Safety" is a reference to the difference between a stock's market price and Southeastern's calculated appraisal value. It is not a guarantee of investment performance or returns.

Asia Pacific Equity Composite Annual Disclosure Presentation



| Year End | Total Firm Assets (USD) (millions) | Composite Assets (USD) (millions) | Number of Accounts | % of Non-Fee Paying Accounts | MSCI AC Asia Pacific (with net dividends) | Annual Performance Results Composite | | Composite Dispersion | Composite 3-Yr Annualized EX-Post Standard Deviation | Benchmark 3-Yr Annualized EX-Post Standard Deviation |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Gross | Net | | | |
| 2021 | 10,816 | 763 | <5 | 0% | -1.5% | -12.3% | -12.9% | na1 | 22.1% | 14.8% |
| 2020 | 10,270 | 824 | <5 | 0% | 19.7% | 13.6% | 12.8% | na1 | 21.9% | 16.3% |
| 2019 | 12,481 | 603 | <5 | 0% | 19.4% | 20.2% | 19.3% | na1 | 17.1% | 11.7% |
| 2018 | 13,881 | 377 | <5 | 0% | -13.5% | -21.0% | -21.7% | na1 | 16.9% | 12.3% |
| 2017 | 18,203 | 157 | <5 | 0% | 31.7% | 41.4% | 40.1% | na1 | 17.0% | 12.7% |
| 2016 | 19,302 | 111 | <5 | 0% | 4.9% | 13.0% | 12.0% | na1 | na2 | na2 |
| 2015 | 20,315 | 98 | <5 | 0% | -2.0% | -2.0% | -2.8% | na1 | na2 | na2 |
| 2014* | 30,542 | 19 | <5 | 100% | -2.5% | -5.3% | -5.3% | na1 | na2 | na2 |

*Composite and benchmark performance are for the period 11/01/14 through 12/31/14

na1 - Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

na2 - Information is not statistically meaningful due to an insufficient period of time.

Institutional Asia Pacific Equity Composite - Portfolios included in this composite invest in securities in Asia Pacific markets. These markets include developed and emerging markets in Asia or the Pacific region, including Japan, Australia and New Zealand which the manager deems eligible.  These portfolios normally contain 15-25 holdings.  Country, industry weightings and market cap size are a by-product of bottom-up investment decisions.  Cash is a by-product of a lack of investment opportunities that meet Southeastern's criteria. The benchmark used for comparison is the MSCI All-Country Asia Pacific Index with net dividends.

Southeastern Asset Management, Inc. claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Southeastern Asset Management, Inc. has been independently verified for the periods January 1, 2001 through December 31, 2021. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The Institutional Asia Pacific Equity Composite has had a performance examination for the periods November 1, 2014 through December 31, 2021. The verification and performance examination reports are available upon request.

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Southeastern is an independent investment management firm that is not affiliated with any parent organization. Southeastern invests primarily in equities.

Results are based on fully discretionary portfolios under management that are managed without regard to tax considerations. Past performance is not indicative of future results.

A list of composite descriptions, a list of limited distribution pooled fund descriptions, and a list of broad distribution pooled funds are available upon request.

The U.S. dollar is the currency used to express performance. Returns are presented gross and net of management and performance fees and include the reinvestment of income. Dividends are recorded either gross or net of foreign withholding taxes based on the treatment of these taxes by the accounts' custodian. Net of fee performance is calculated using actual management and performance fees. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the portfolios in the composite the entire year. Composite dispersion and 3 year annualized ex-post standard deviation are reported using gross returns. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

The investment management fee schedule for accounts with a market value less than $100 million is 1.15% on the first $50 million and 1.00% on the next $50 million. The fee schedule for accounts with a market value exceeding $100 million is 0.90% on all assets. Actual investment advisory fees incurred by clients may vary.

The Institutional Asia Pacific Equity Composite was created on November 1, 2014.  The inception date for this composite is October 31, 2014