Asia Pacific Strategy Commentary 3Q21

Southeastern Asset Management

For Institutional Investors Only

Portfolio Returns at 9/30/21 – Net of Fees

	3Q21	YTD	1 Year	3 Year	5 Year	Since Inception 10/31/2014
APAC Strategy (USD)	-17.57%	-8.09%	10.37%	2.78%	5.62%	4.98%
MSCI AC Asia Pacific Index	-4.41%	0.38%	18.28%	8.49%	9.63%	7.39%
Relative Returns	-13.16%	-8.47%	-7.91%	-5.71%	-4.01%	-2.41%

Selected Indices*	3Q21	YTD	1 Year	3 Year	5 Year
Hang Seng Index	-13.94%	-7.61%	7.40%	-1.07%	4.37%
TOPIX Index (JPY)	5.22%	14.59%	27.40%	6.19%	11.41%
TOPIX Index (USD)	4.89%	6.17%	20.64%	6.84%	9.33%
MSCI Emerging Markets	-8.09%	-1.25%	18.20%	8.58%	9.23%

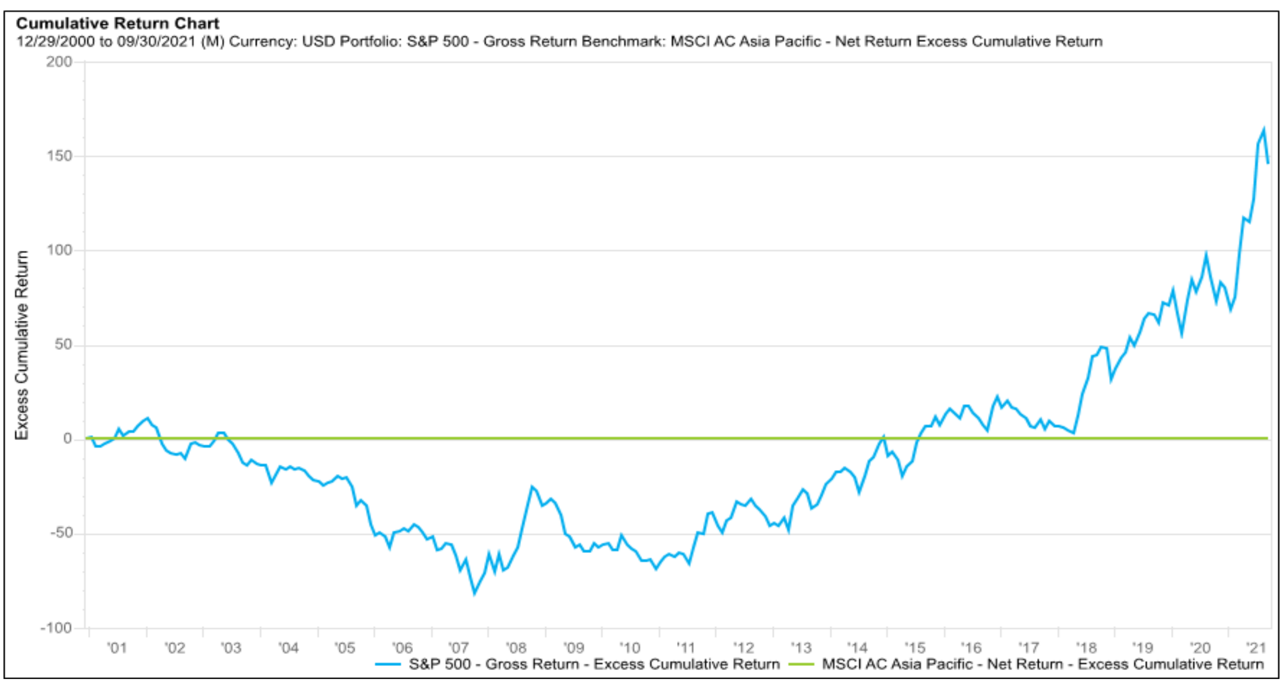
*Source: Bloomberg; Periods longer than one year are annualized.

The Portfolio returned -17.6% in the third quarter, trailing the MSCI AC Asia Pacific Index. Undoubtedly, it was a disappointing absolute and relative quarter, the second worst since the inception of the Strategy aside from the March 2020 quarter. It raises the natural question, "what on earth happened?" In a word, China. The Portfolio's Hong Kong (HK) and China-listed businesses drove the overwhelming majority of the relative and absolute decline in the quarter. Our underweight allocation to Japan relative to the benchmark also hurt performance as Japan posted positive performance in the quarter. The Portfolio's overweight to sectors in China associated with increased regulation negatively impacted the Portfolio's relative performance. Extreme investor anxiety from several rounds of regulation in the Chinese technology, education, real estate, and Macau gaming sectors also created extreme volatility during the quarter.

The last six months have been reminiscent of the Asian Financial Crisis in the late 1990s when we first established an office on the ground in Asia. We are no strangers to volatility in the region. As value investors, we recognize that macro-driven market swings can wipe out some businesses overnight while simultaneously creating compelling, historically discounted opportunities to invest in other companies over the long term. We have been very active, meeting with our investment network, reviewing the portfolio's top-down exposure to Asia, and evaluating each company we own on a bottom-up, case-by-case basis. With much of our net worth in the Strategy, we are also asking ourselves: what happened, what does this mean for our portfolio holdings, what have we done in response, and what are the prospects from here?

The MSCI China Index declined 18.2% during the quarter, and the Hang Seng Index declined 13.9%. Within the Hang Seng Index, the China Enterprises Index dropped 17.4%, the Tech Index fell 25.8%, and the Property Index dropped 12.6% during the quarter. In contrast, the China A-Share market declined by "only" 4.0% during the quarter. The significant difference in performance between onshore China and offshore China reflects the higher share of businesses listed overseas undergoing stringent regulatory action and extreme fear among foreign investors, who are unaccustomed to the furious pace of regulation in China. The MSCI China Index underperformed the S&P 500 Index by 18.7% during the quarter, the highest level of quarterly underperformance since the Global Financial Crisis in 2008.

Equity market returns in Asia have severely lagged those in the US and Europe both this past year and this quarter. The MSCI AC Asia Pacific Index is just above breakeven, at 0.4% YTD, underperforming the S&P 500's 15.9% and MSCI Europe's 16.2% YTD returns. Asia's underperformance relative to the US is at record levels due to unprecedented monetary and fiscal spending in the West as opposed to regulatory crackdowns, a resurgence of COVID lockdowns, and fiscal restraint in China.

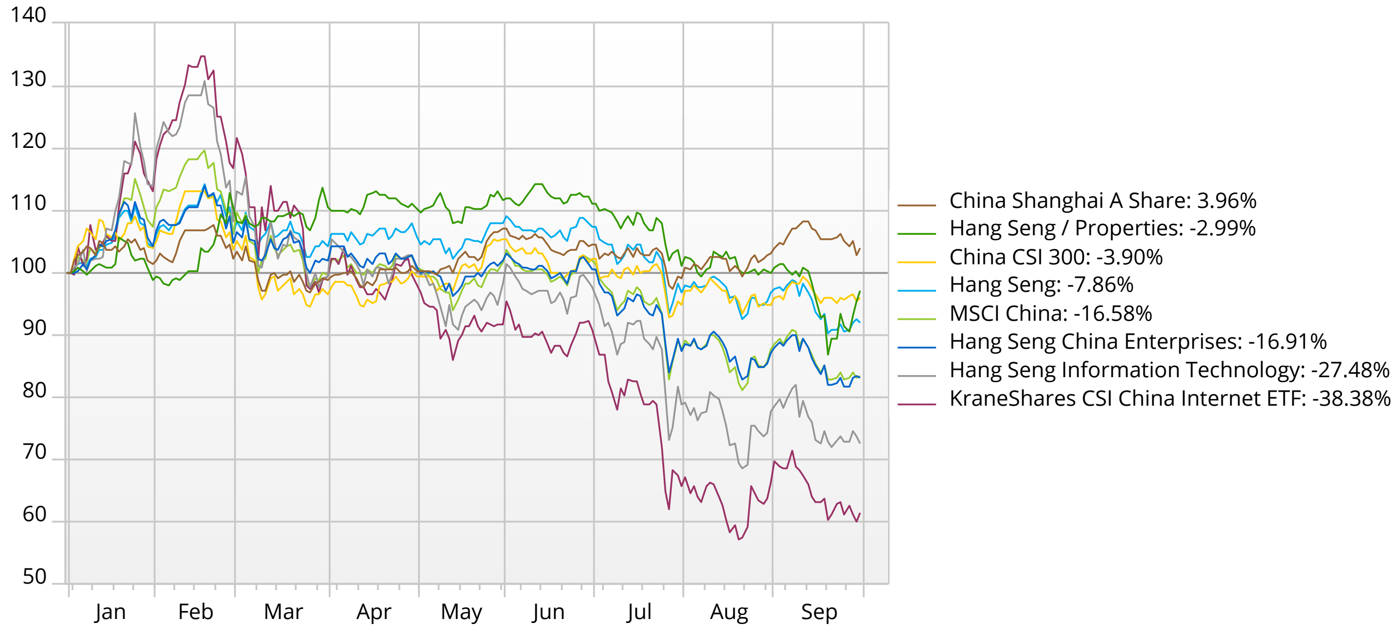


Source: FactSet

What happened?

China Equity Market Performance YTD

Total Return In USD (1/1/2021 to 9/30/2021)

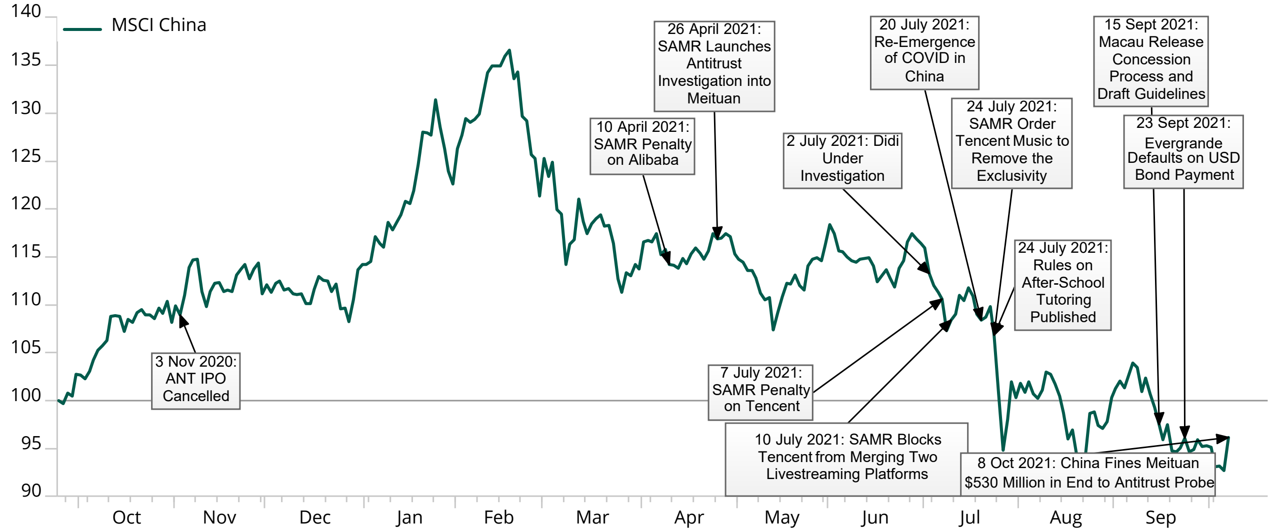


Source: FactSet

The last seven months have been extremely challenging for Chinese (and Hong Kong) markets. The Chinese government increased regulation across multiple sectors, resulting in a spike in market volatility and the largest decline in Chinese equity markets since the Global Financial Crisis. Investor fear and a "sell now, ask later" approach drove a steep drop in share prices, as various Chinese equity markets plummeted by 21-54% from record highs in February 2021, shown in the chart above.

China's tech crackdown started in November 2020 when the Ant IPO was suspended, stoking fears about increased regulation in the tech sector. Over the last seven months, the Chinese government has rolled out an unprecedented crackdown on the technology industry, outlined in the chart below.

China Major Market Events



Source: FactSet

Markets fell in April/May 2021 as anti-trust investigations and fines were meted out to some of China's largest tech companies. These sanctions came at an alarming pace, transforming the previously unregulated industry overnight and shaking investor confidence.

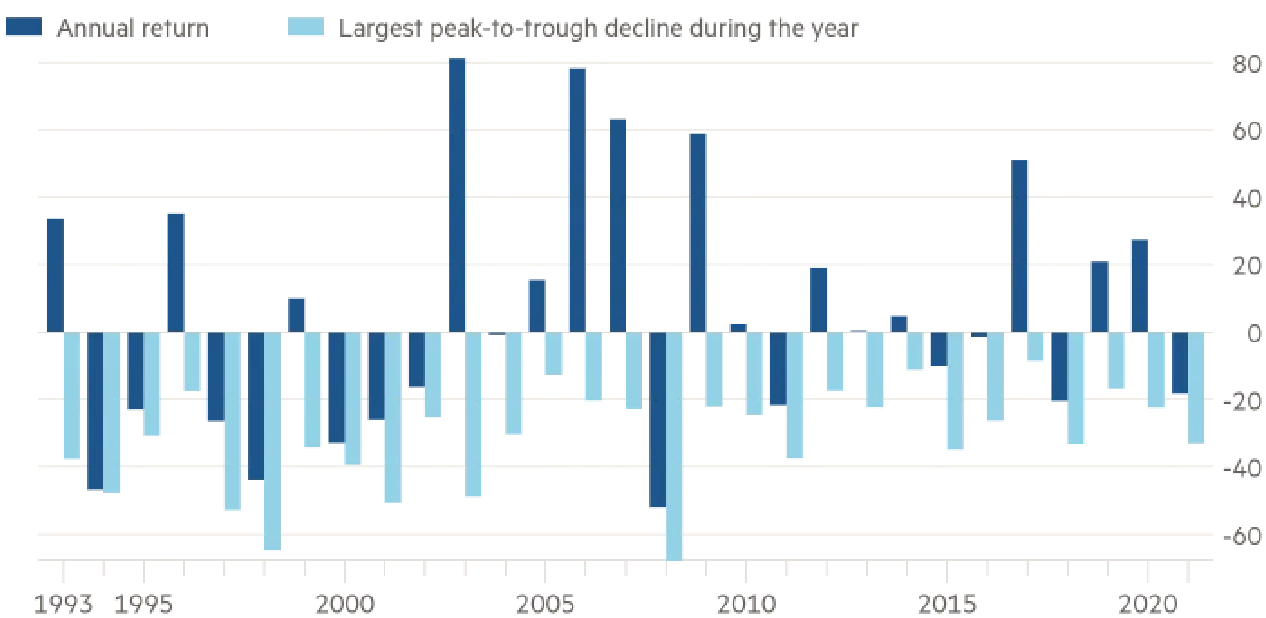
In our view, these initial rounds of regulation reflect the government right-sizing its anti-trust oversight to conform to global standards. Markets declined further in July 2021 as the regulatory crackdown widened to focus on data security with the investigation of Didi early in the month and again later that month when the focus shifted to the private education industry. We view the subsequent round as a crackdown on sectors that potentially threaten the government's social stability and national security agenda — we recognize that more companies and industries could be at risk over time.

The next two moves to rock markets were the release of guidelines for the Macau concession process (which had been planned for years and is unrelated to the tech crackdown) and then news that Chinese real estate developer Evergrande would likely default on its debt payment. More details on the Macau concession process are discussed below. Evergrande set off a fresh set of worries and fear reverberated across global markets as investors asked if Evergrande was "China's Lehman moment." To further compound volatility created by regulatory action, COVID re-emerged in China, leading to restrictions and lockdowns across numerous cities. As a result, August retail sales were weak, and sales of large ticket items such as property and automobiles also dropped.

In a recent Financial Times article titled "[The Bull Case for Investing in China]" chief global investment strategist at Charles Schwab Jeffrey Kleintop wrote, "Investors seemed to switch from calmly interpreting regulators' actions as only focused on a few big tech firms to alarm that no industry is isolated from a sudden rush of regulatory reforms. Fears spread, that changes aimed at reining in the excess leverage of property developers, such as Evergrande, could bring the risk of a financial and consumer meltdown. The truth is that the rapid and targeted regulatory changes shaking China's stock market are not uncommon and often are followed by sharp rebounds in share prices driven by broadly favourable policy actions. In fact, this year's peak-to-trough retreat of 33 percent in China's stock market is close to the 28 percent average annual drawdown over the past 20 years, measured by the MSCI China Index. It can be easy to forget that there is a bear market nearly every year in Chinese stocks (17 of the past 20 years), usually driven by some policy issue. Historically, investors have tended to be compensated for this heightened volatility with strong annualised total returns. From August 2001 to August 2021, the MSCI China Index produced an annualised total return of 12.3 percent, outperforming the 9.3 percent produced by the S&P 500."

There are bear markets in Chinese stocks most years - but strong returns compensate for volatility

Change in MSCI China index (%)



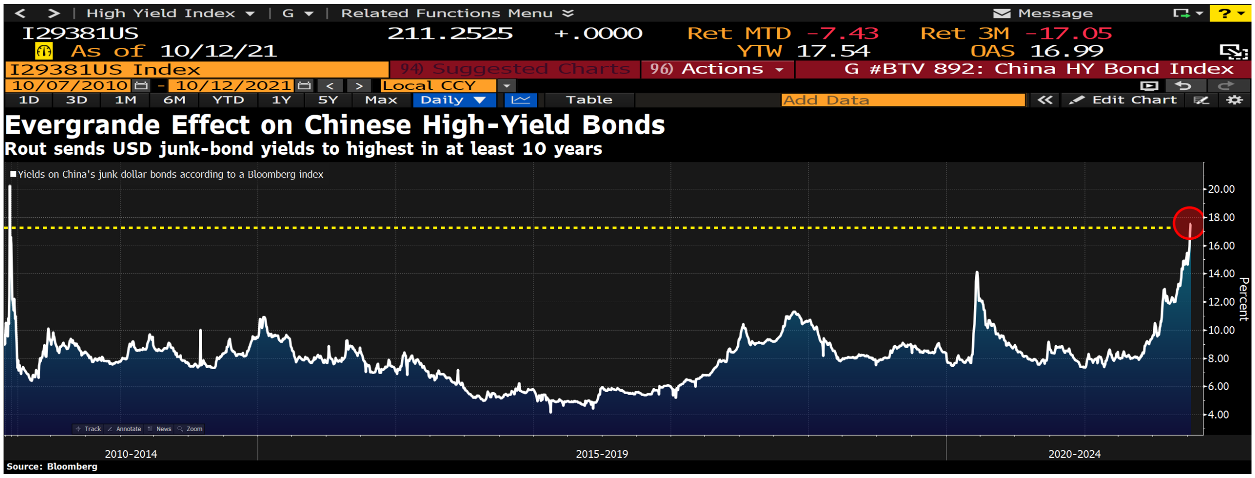
Sources: Charles Schwab, Factset

When the government abruptly blocked Ant Group's $37 billion IPO last November, it was seen as a kneecapping of Jack Ma. Ma had criticized the government for stifling innovation and had criticized financial regulators and banks for having a "pawnshop" mentality, relying on a "pledges and collateral" system. Several months later, however, it's clear that this was just the beginning of a program to regulate the Chinese tech industry.

We believe that the tech anti-trust activity in China is primarily a catch-up to global standards. The regulations are part of a worldwide trend of governments wresting power out of the arms of tech companies. China is also catching up to Europe's GDPR data privacy laws by implementing its data privacy regulations (Personal Information Protection Law). China's data privacy law also prevents tech companies from transferring Chinese citizens' data overseas without government approval. The US government's attempt to force TikTok to sell its US business in the name of national security last year probably accelerated China's efforts to protect its data as part of its own national security efforts.

In the US, tech regulation is also gaining momentum, as news about big tech's dominance and bad behavior continues to hit the headlines. Over the past two decades, tech giants have risen to become the most valuable companies in the world while operating with little formal, structured government oversight. Given the potential for big tech to abuse their technological and data superiority to quickly dominate different market segments and adopt anti-competitive practices, preserving market competition has become a top priority for authorities globally. In China, tech sector regulation was practically non-existent until this year, and the speed at which regulation was put in place caught the industry and participants off guard. Still, we believe that the government aims not to crush this industry, but to counteract its dominant, anti-competitive behavior. In China, unlike in the US and Europe, the speed at which policies can be implemented is much faster. It's this rapid roll-out of policies that is causing volatility in the capital markets. We think there will be plenty of room for participants to grow and thrive — even in a more demanding regulatory environment.

China Property



Source: Bloomberg

In line with China's multi-year effort to deleverage the real estate sector, the government imposed financial covenants on developers last year and severely restricted access to bank financing for developers who failed to meet the "3 Red Lines" leverage tests. The Chinese government has been aggressively tackling the leverage and speculation in the real estate market to prevent an unhealthy misallocation of capital towards the sector and avoid a "Lehman Moment." The scale of the real estate bubble was famously pointed out in 2009 by Hugh Hendry, Eclectica hedge fund manager, who posted a video of himself touring Chinese streets and abandoned skyscrapers on YouTube. The Chinese government has been tackling real estate speculation for years, but last year's imposition of the 3 Red Lines Policy marked a step up in its effort to control excess leverage in the sector. Severely restricting access to bank financing has led to an acceleration of bankruptcies in the property sector and led to HK-listed China Evergrande, one of the largest Chinese developers and borrowers, defaulting on its debt obligations. HK-listed Chinese developer Fantasia Holdings also missed paying interest coupons due on its US dollar bonds on October 4. Another Chinese developer, Sinic Holdings, warned that it would likely default on its $250mm bond maturing on October 18, 2021.

Evergrande's unsustainable capital structure was highlighted as far back as 2012 when Citron Research published research claiming that Evergrande was insolvent. Evergrande's financial issues have been well known in the Asian capital markets, which is why its cost of financing was higher than usual — as high as 13.75% for five-year debt issued in 2018. Even then, there were strange actions, such as the group's Founder and Chairman, Hui Ka Yan, buying $1 billion out of the $1.8 billion debt issuance when it was declaring significant dividends of $2.2 billion. In our view, Chinese real estate offshore bonds are more akin to equity than debt and deserve to trade at yields closer to their cost of equity. Typically, the offshore listed parent is in the Cayman Islands, and bonds issued by the offshore vehicle are structurally subordinated to onshore debt, which has a priority claim on onshore assets. Furthermore, funds can only be transferred offshore as dividends, which attracts a 10% dividend tax.

Fears of contagion spread to other Hong Kong-listed developers (and equity markets globally), including our portfolio companies New World Development (NWD) and CK Asset (CKA). Not only do we believe the two companies are unaffected by China Evergrande's dire situation, but we also believe that there will be opportunities for them to opportunistically acquire attractive assets in HK and China. Levered Chinese developers are seeking liquidity, and we expect them to sell assets at discounted prices. We also expect that there will be opportunities to take over or form joint ventures with developers who need funding to complete partially constructed projects. NWD and CKA's relative competitive advantage will increase as competition for landbank declines, and their financing cost remains low.

Source: Bloomberg

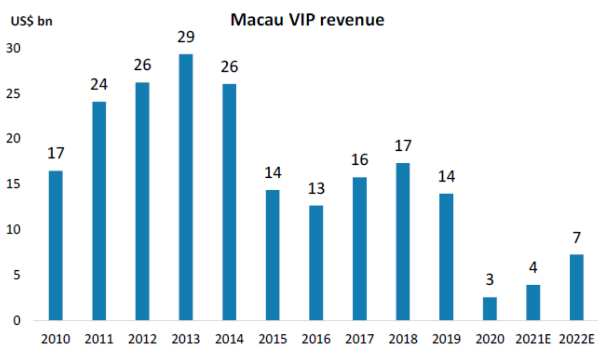
HK property developers also weakened in September 2021, in reaction to a Reuters news article on September 17 claiming that mainland officials met with HK developers to redirect resources to help solve the housing shortage in HK. Fears of a "Common Prosperity" agenda, leading to housing price controls and the confiscation of idle landbank caused the Hang Seng Property Index to plunge (as seen in the chart above). The city's largest developer, Sun Hung Kai Properties (SHKP), said that no such meeting had occurred and no such directives had been given. Raymond Kwok, SHKP's Managing Director, bought US$123 million of SHKP shares since the Reuters news article. In small group meetings, NWD Managing Director Adrian Cheng also confirmed that there was no central government directive, and the Reuters article was wrong – "there is a lot of rumors and fake news."

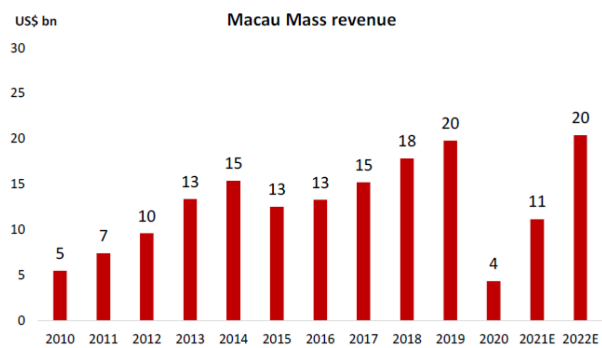
On October 6, HK Chief Executive Carrie Lam officially announced the Northern Metropolis development plan in her Policy Address to expand the housing supply in HK. The Northern Metropolis has a total area of 300 square kilometers in the northern territories near Shenzhen. It is expected to provide housing to accommodate a population of 2.5 million in the long term. This plan is favorable for NWD, as 90% of its 16 million attributable square feet of agricultural land bank is in the Northern Metropolis area. We can expect the conversion of farmland into residential land – previously a long process – to accelerate. CKA, with 10 million square feet of attributable farmland, should also benefit from the government's efforts to increase land supply for mass housing in the New Territories. NWD has taken advantage of the weakness in its share price by acquiring HK$963 million worth of shares in July and August, among the largest repurchases across the HK developers. At the same time, Henry Cheng, Chairman of NWD, has been actively buying shares, and Victor Li, Chairman and Managing Director of CKA, has spent over HK$1.1 billion since June buying CKA shares.

<u>Macau</u>

On September 14, 2021, the Macau Special Administrative Region (SAR) announced that the government would overhaul the casino industry's primary regulation, known as the "Legal Framework for the Operations of Casino Games of Fortune." The Macau government kicked off a 45-day consultation period for amendments to the gaming law in preparation for the much-expected re-licensing process for Macau casino operators. All six concessionaires' licenses are set to expire in June 2022. The sudden issuance of the public consultation process led investors to shoot first and ask questions later. The market panicked amid fears that casinos were next on Beijing's hit list after crackdowns on the tech, for-profit education, and real estate sectors. The very concept of gambling is hardly in keeping with the idea of "common prosperity." Investors worried that gaming concessionaires might lose their licenses. Share prices dropped significantly in mid-September, with Sands China's share price falling 33% and Wynn Macau falling 29% the next day. This sharp decline on top of the de-rating that has occurred as renewed COVID outbreaks in China and draconian quarantine measures continued to inhibit visitation to Macau.

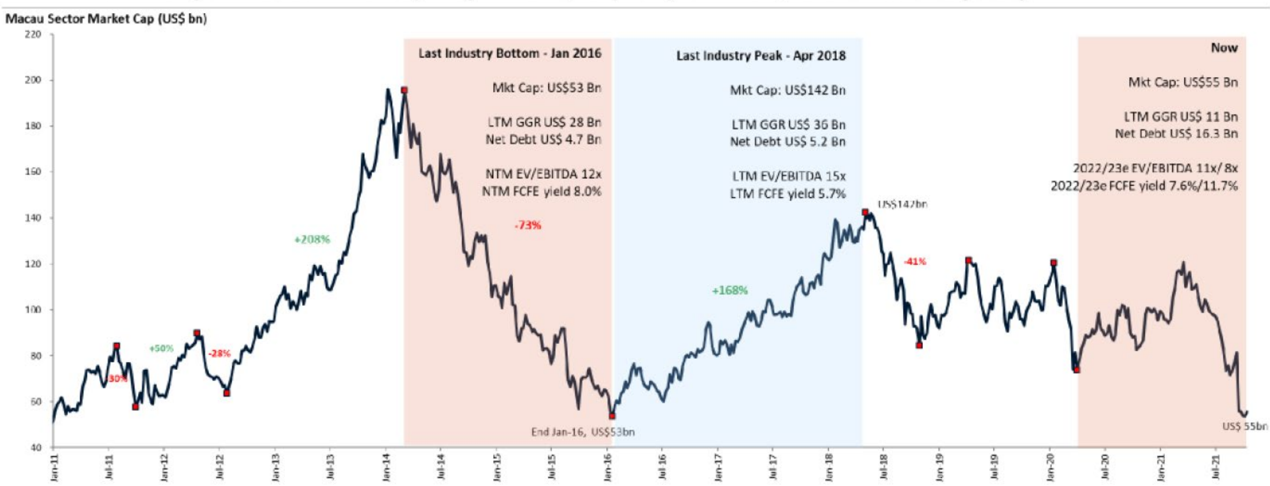
Investors are worried that Macau gaming will be the next industry targeted by extremely restrictive measures applied to sectors deemed "spiritual opium" such as video gaming by children or against the policy of "common prosperity," such as after-school tutoring. On the contrary, Macau was first in line to suffer from Xi Jinping's anti-corruption reform campaign after Xi was elected President in 2013. His anti-corruption campaign resulted in the VIP junket business, which accounted for the bulk of Macau's gross gaming revenue to shrink dramatically from 2014 to 2016. The regulatory assault on junket business continues, and the view is that the VIP business will continue to shrink. During this prior period of "regulatory crackdown," Macau's market cap had shrunk 73% from peak to trough.





Source: Morgan Stanley

Macau Market Cap has been driven by Regulations, Capacity Addition, and China's Liquidity

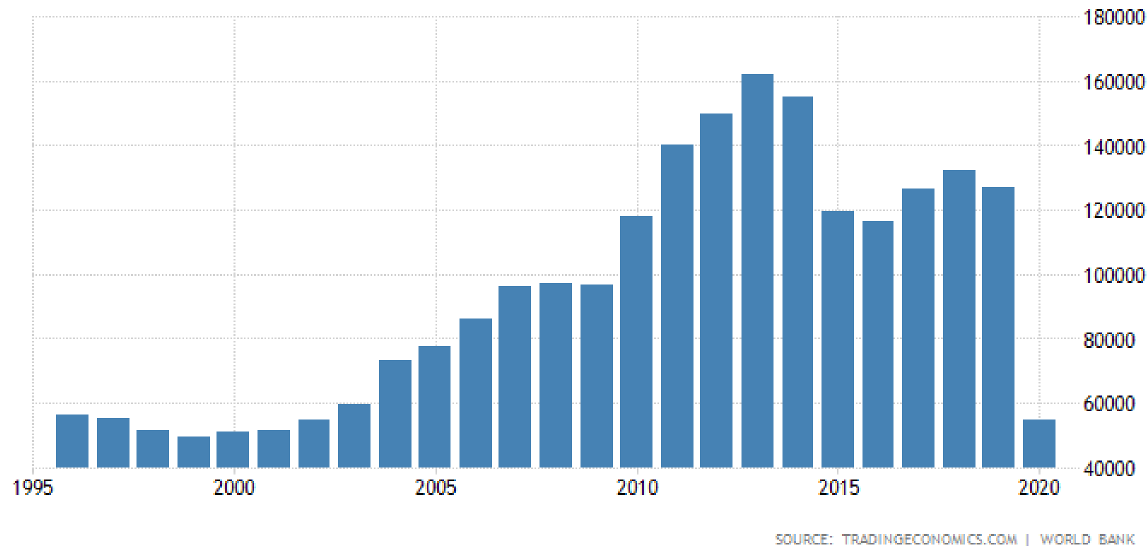


	Last Bottom – Jan 2016	Last Peak – Apr 2018	Now
Stock drivers	(1) China's anti-corruption campaign (2) Limited liquidity (e.g. declining Adj. TSF)	(1) Capacity addition/ Ramping (MGM, MLCO) (2) GGR growth > consensus/ normal seasonality	(1) Reopening (2) Concession extension (3) Gaming Law Revision (4) China's Common Prosperity

Source: Company data, Refinitiv as of Oct 11, 2021, Morgan Stanley Research

<u>"Common Prosperity" has already occurred in Macau</u> – VIP junket business has been severely regulated, and mass-market revenue will be the primary growth driver for Macau. Macau is the model of common prosperity; the six concessionaires provide 40% of their revenue (not profits) in taxes to the government. Most Macanese are in a much better economic position due to the gaming industry. Today, Macau enjoys one of the highest GDP per capita globally and by far the highest in China. According to the Gaming Inspection and Coordination Bureau (DICJ), the GDP of Macau in 2019 was more than 7x compared to before the liberalization of the gaming sector in 2001. During COVID, all six operators strongly demonstrated their commitment to "Common Prosperity" by maintaining full employment of locals — including full pay and bonuses — despite the industry getting crushed.

Macau GDP per Capita (US$)



Source: https://tradingeconomics.com/macau/gdp-per-capita-ppp

Our two largest detractors in the quarter, Melco International (-36% Q3) and MGM China (-59% Q3), were not spared from the carnage. We are confident that our two concessionaires will not lose their licenses next year. The Macau gaming industry contributes 70-80% of the government's tax revenue, over 55% of GDP, and is the largest employer in Macau. If you include ancillary businesses such as hotels, food & beverage, and retail, the industry's contribution to GDP is even higher. The gaming sector is an essential pillar of the economy of the Macao SAR, and it accounts for over 17% of the total employed population in Macau, underscoring the sector's importance. The Macau government cannot afford to lose tax revenues from gaming, and any dramatic change would devastate the local economy, serving none of Beijing's interests.

The consultation paper indicated tighter supervision and regulation to come with new licenses, creating uncertainty and a sell-off across the sector. The consultation covers nine main topics, with three primary areas causing market concern, aside from the primary risk of operators losing their gaming licenses:

1. Increasing statutory requirements for oversight, requiring greater Macanese shareholder representation in the concessionaire, leading to concerns about stricter control on capital management. Investors fear being diluted at low prices to accommodate local ownership requirements. From a legal perspective, these regulations apply strictly towards the gaming concession company and not the publicly listed holding companies. MGM Grand Paradise (Macau) and Melco Resorts (Macau) are the concession companies that are subsidiaries of publicly listed MGM China Holdings Limited and Melco Resorts & Entertainment Limited. Both Lawrence Ho (Melco) and his sister Pansy Ho (MGM China) are Macau Permanent Residents and are Managing Directors of their respective gaming concession companies. They each hold 10% voting rights (no economic rights) at the concession company levels. It won't be an issue for Lawrence and Pansy to increase their voting rights to meet any increased local ownership regulations. Moreover, if the government requires minimum local ownership at the listed entity, both Melco and MGM China already fulfill any potentially higher local ownership requirement at the listed company level. Pansy Ho holds a 22.5% stake in MGM China, and Lawrence Ho controls 58% of Melco International, which owns 56% of Melco Resorts & Entertainment. In Melco's case, Macau gaming regulators already require Melco International to have majority control over Melco Resorts and Lawrence Ho to have a majority equity interest in Melco International.

2. Approval for distributions of profits to shareholders – dividends, whether in cash or shares, will need to be approved by the Macau government. We believe that this ensures that operators remain in solid financial condition, withstand crises such as COVID, and prevent operators from distributing excessive profits. Some foreign operators have distributed more than 100% of net income in past years and currently have significant negative shareholder equity. We don't think the goal is to limit shareholder distributions necessarily, but rather to make sure that proper investment is made in Macau's gaming industry and that it has enough capital to continue investing in Macau. Macau needs concessionaires to keep investing in gaming and non-gaming, so it is unlikely that the government will ban dividends. Melco has a strong track record of capital allocation, including opportunistic buybacks when trading at an extreme discount.

3. The introduction of a government representative creates fear around the increasing supervision and control of daily operations. This will not unduly burden operations, however, as the casino operators are already closely working with the DICJ, and the operators have been complying with the high regulatory standards. While this may seem negative at first, when looking at other precedents in Macau, government delegates do not sit on the board of the listed companies, nor do they have any voting power. Macau gaming operations are already highly regulated. The DICJ has an office on every casino floor and signs off daily on the total winnings, as the government is entitled to 40% of the gross gaming revenue.

We remain confident in our holdings in Melco International and MGM China. Our Macau investee companies are local operators led by Lawrence and Pansy Ho with solid ties to Macau and Mainland China. The Ho family has been running casino operations in Macau since their father, Stanley Ho, won the 40-year monopoly casino license in 1962. Lawrence is a member of the National Committee of the Chinese People's Political Consultative Conference and Vice Chairman of the All-China Federation of Industry and Commerce. Pansy is a Standing Committee Member of the Beijing Municipal Committee of the Chinese People's Political Consultative Conference, an Executive President of China Chamber of Tourism, and a Vice President of China Women's Chamber of Commerce under the All-China Federation of Industry and Commerce.

A few data points in the last few weeks and months give us further confidence that Macau gaming operators will have their concessions extended and that the share prices are attractive. It gives us comfort that the state-owned enterprise (SOE) Bank of China arranged a $1.5 billion revolving credit facility for Wynn in mid-September 2021, with the longest tranche having a maturity of September 2025, beyond the current concession expiry date of June 2022. While these revolving facilities do include a "loss of concession put option," we believe that it's meaningful that a government policy bank would lend to a Macau gaming operator. We have just seen the Chinese government restrict bank lending to sectors (i.e., real estate development) in which they don't approve.

Melco's largest creditor is the Chinese government bank ICBC, and in June 2021, ICBC arranged the refinancing of their $880 million loan to Melco International and upsized it to $1 billion. In addition, subsidiary Melco Resorts refinanced and upsized its bank facility from $1.25 billion to $1.92 billion last year, with the bulk of the loans coming from Chinese banks — all partially state-owned. On September 23, 2021, Sands China issued almost $2 billion of 5, 7, and 10-year bonds, with the longest maturity bonds yielding only 3.26%.

The strength of the credit markets stands in sharp contrast to the weakness in the equity capital markets. Melco Resort's stock price collapsed 57% since early March 2021, driving 30-day volatility up 81% to 70%. Yet, Melco's 2027 bond yield only went up 75 basis points to 5.4%.

Melco Resorts' Equity, Equity volatility, and Debt trends

Source: Bloomberg

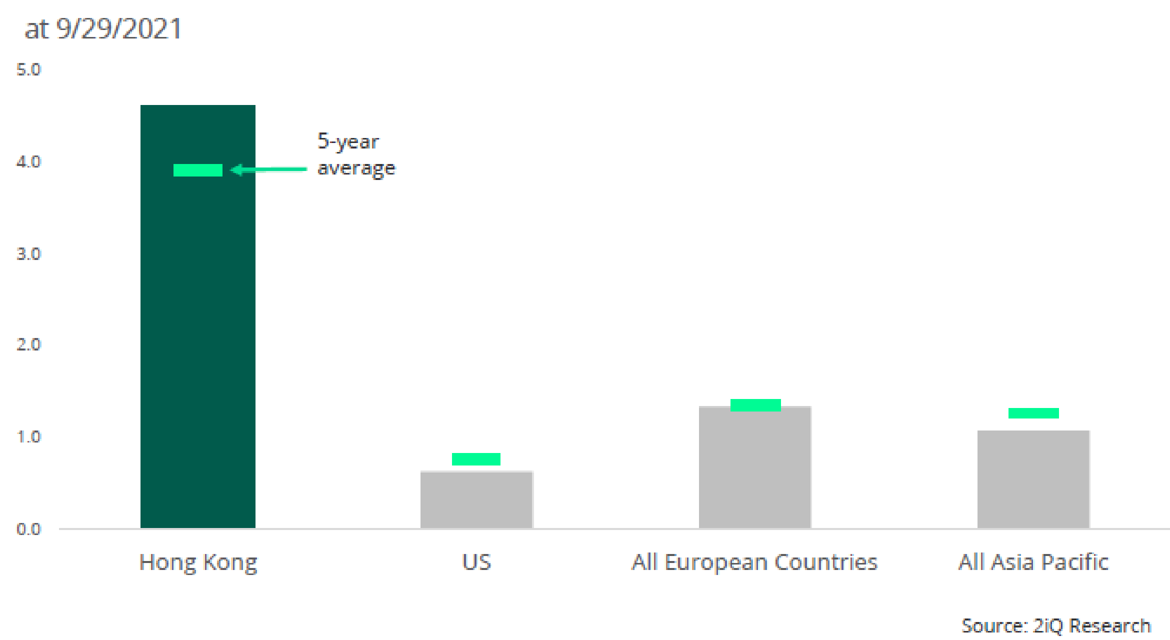
With $3.5 billion of Macau casino debt successfully issued in the debt capital markets in the last few weeks, with a strong Chinese government investor base, who are overwhelmingly institutional, and in our opinion, as close to the Chinese government as the Macau regulators are, we are confident that Macau gaming operators will still be in business years from now.

We always view insider purchases and share buybacks as crucial indicators of a well-informed management team's outlook on a business. In the past few weeks, the CEOs of two local operators have personally bought shares. Francis Lui, CEO of Galaxy Entertainment (and a member of the 13th National Committee of the Chinese People's Political Consultative Conference), bought shares in family holding company K. Wah, which has a 3.74% stake in Galaxy, which is worth about 65% of K. Wah's market capitalization. At SJM, Co-Chair Angela Leong, a fifth-term Macau politician who serves as a member of the Macau Legislative Council, also bought shares at the end of September 2021. Connected insiders have started to buy shares in their own Macau gaming companies, further confirming our confidence that Macau gaming operators are undervalued and will rebound. We have also added to our Macau exposure in recent weeks.

Buybacks and Insider Purchases

Hong Kong Insider Buy/Sell Ratio

The insider buys to insider sells ratio of Hong Kong is over 7 times higher than the US, and is close to March 2020 highs (5.6)



At a time of elevated uncertainty and investor panic, it's always reassuring to see what insiders — who have better access to information and policymakers than outside shareholders — are doing with their money. As famed investor Peter Lynch once said, "insiders might sell their shares for any number of reasons, but they buy them for only one: they think the price will rise." In Hong Kong, we have seen a noticeable spike in insider buying this year as prices have collapsed. There is almost five times more buying than selling by insiders in the HK markets, which is approaching levels seen during the market panic in March 2020. The HK market represents many sectors hit by regulation – Chinese tech, Chinese property (and banking), and Macau. This triple whammy has hit Hong Kong hard. 36% of the Hang Seng Index is financials, which are suffering from contagion effects from Evergrande, 8% property which is suffering from Evergrande contagion and "Common Prosperity" regulation fears, and 23% are tech companies that are under regulatory scrutiny. Macau casino players only represent 1% of the index.

On top of higher levels of insider buying in sectors that we own, we have seen a significant rise in share repurchases by companies run by owner-operators, as share prices have dropped. These companies and their management teams know the situation better than anyone else, and it is thus encouraging and comforting to see the ramped-up pace in share buyback at these prices. We see record levels of share repurchases by our investee companies in China. This gives us confidence that insiders with skin in the game are allocating significant capital to share repurchase to take advantage of the volatility. There is commentary that all Chinese companies are turning into SOEs, with the needs of the country taking precedence over the needs of investors. However, if shareholders' interests are taking a back seat, why do we see massive levels of share repurchase activity in the tech sector and among our investees? These share repurchases are being executed to benefit shareholders by repurchasing shares at massive discounts to management's view of intrinsic value. Capital allocation is the most critical difference between an SOE and a private company led by owner-operators. We don't see any indication our investees are reallocating capital towards non-productive uses. We believe all of our investee companies are allocating capital to increase long-term value.

Within the China tech sector, almost all our investees -- Tencent, Prosus, Alibaba, Baidu, and JOYY -- are putting their net cash balance sheet to work and executing record levels of buybacks at value accretive prices.

While some Chinese developers are struggling with liquidity issues, our investees have ramped up buybacks. CK Asset, New World Development, and Gree Electric, all in real estate exposed sectors, are buying back record amounts of shares and stand to benefit from industry disruption. For example, within the last year and a half, Gree Electric has repurchased almost 9% of the company while paying out an 8.4% dividend yield at current prices. Gree is the largest share repurchaser in China.

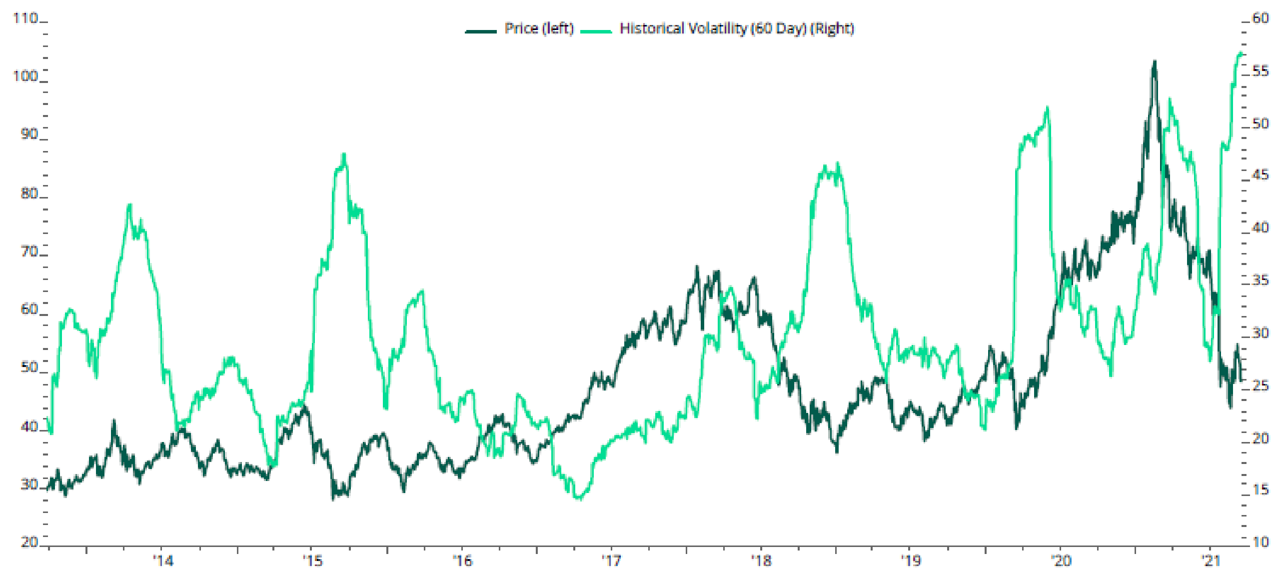
HK listed Chinese pork producer WH Group repurchased 13% of the company in August 2021, and CK Hutchison's buybacks are running at 10x the previous year's levels.

While companies in Macau are understandably not buying back shares given the cash burn due to border closures currently, we have seen well-connected local insiders at K. Wah (Galaxy Entertainment's family holding company) and SJM buy more shares after the market meltdown in mid-September 2021, which sends us a strong message that the businesses are significantly undervalued.

Finally, we have also increased our co-investment this quarter, adding further personal capital as the price/value ratio of the portfolio fell into the low 60s%. Like many of the owner/operators running our portfolio companies, we believe that it makes sense to buy when volatility is high, as the subsequent periods tend to be profitable, as the historical chart of China internet ETF prices and volatility below illustrates.

Krane Shares CSI China Internet ETF (KWEB): Stock Price vs. Historical Volatility

60 Day Historical Volatility at 9/17/2021



Source: Bloomberg

Portfolio Review

During the quarter, we added to our China and Macau exposure to buy highly discounted securities as panic, fear, and opportunity increased. We expanded exposure to China tech names Alibaba, JOYY, Tongcheng-Elong, and Tencent. We also added further to Gree Electric and China Lesso, which were affected by weak home sales, a fragile real estate industry, macro concerns, and higher commodity input prices. We trimmed our Japan and India investments as they appreciated and reallocated the proceeds to fund our increased China investments. We initiated a starter position in one new investment listed and headquartered in Australia (currently undisclosed).

	3Q21			YTD 2021	
	Contribution to Portfolio Return (%)	Total Return (%)		Contribution to Portfolio Return (%)	Total Return (%)
Top Five			Top Five		
HDFC	+0.48	+12	Hitachi	+1.68	+54
Hitachi	+0.20	+5	L'Occitane	+1.24	+36
Undisclosed	+0.10	+8	TCEL	+0.94	+25
TCEL	+0.04	-3	Trip.com	+0.77	+30
Tencent	+0.02	+1	Richemont	+0.68	+26
Bottom Five			Bottom Five		
MGM China	-2.29	-59	MGM China	-2.76	-64
Melco International	-2.18	-36	Melco International	-2.50	-40
Alibaba	-2.09	-35	Alibaba	-2.17	-37
Baidu	-1.65	-25	Gree	-2.01	-33
China Lesso	-1.56	-34	JOYY	-1.46	-37

Past performance does not guarantee future results. Holdings are subject to change

Housing Development Finance Corp (HDFC), the premier financial services conglomerate in India, was a contributor for the quarter. Despite a devastating second wave of COVID in India, which impacted most of the fiscal first quarter, HDFC's performance was resilient, with the individual loan book growing at 14% YoY. Despite the much-advertised pricing pressure from banks in the mortgage market, HDFC's interest spread remained stable at 2.29% as its funding cost had declined in line with loan yields. Most importantly, asset quality remains stable with non-performing loan ratios at 2.2%, much better than street expectations despite regional lockdowns impacting collection efficiency and no RBI-mandated moratorium on debt payments. The real estate and finance sectors have gone through a tough four years and seem to be at an inflection point, with strong players getting stronger and housing sales picking up at a record pace. July 2021 was the third highest mortgage loan disbursement month in HDFC's three-decade history.

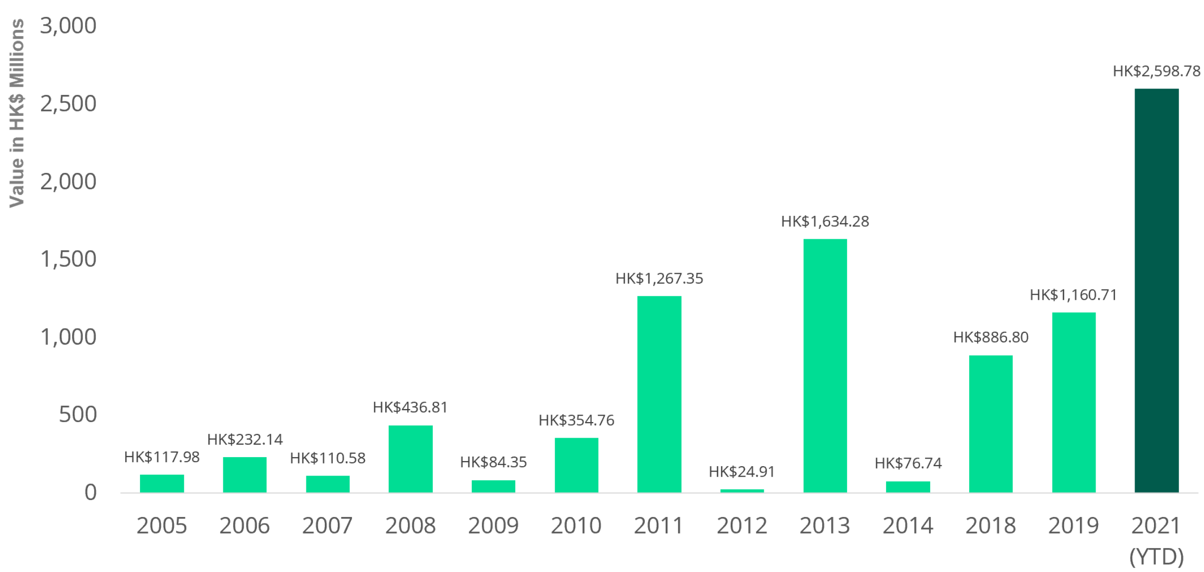
Tongcheng Elong (TCEL), one of the top three online travel agencies in China, was a contributor for the quarter. TCEL reported strong second-quarter results and has continued to gain market share driven by its strategy focused on lower-tier cities and best-in-class execution. Despite COVID outbreaks and travel restrictions in certain regions, TCEL reported 35% growth in revenue and 21% growth in EBITDA compared to pre-COVID levels. During the quarter, TCEL announced a contract renewal with Tencent on favorable terms. Tencent will continue to provide traffic support with preferential WeChat access, advertising, and promotion support with WeChat moments, etc., in exchange for reasonable fees subject to an annual cap. The contract is for three years with an option to renew for another three years. The spread of the Delta variant in China led to travel disruption in July and August 2021, but TCEL saw recovery in September 2021. Although sporadic COVID outbreaks will likely lead to volatility, the last 18 months have proven that fundamental travel demand is not impaired and comes roaring back when travel restrictions are eased. Despite its strong performance, we continue to like TCEL as the cheapest and fastest-growing major OTA we follow.

Hitachi Limited, a Japanese conglomerate, was a contributor for the quarter. Hitachi reported first-quarter results that were in line with expectations for the fiscal year ending March 2022, and profits have recovered above the pre-COVID levels. The IT segment continued to deliver record-high earnings with a 10% operating profit margin. Hitachi Astemo, the auto parts business, was slightly behind plans due to the global semiconductor shortage in the quarter. Hitachi's power grid business was also relatively weak due to the COVID impact in India and Indonesia, but the company remains confident and kept to its 10% operating margin target for the next financial year. In July 2021, the company completed its acquisition of GlobalLogic, a digital engineering company. We expect Hitachi to leverage GlobalLogic's expertise in digital transformation and further expand Hitachi's Lumada business.

Tencent, a world-leading internet and technology company, was a new initiation and contributor for the quarter. We have been investing in Tencent via Prosus, but added additional direct exposure this quarter as the sell-off made Tencent shares attractive with a sufficient margin of safety. In August 2021, a state media article calling mobile gaming "spiritual opium" added downward pressure on Tencent in addition to broader Chinese internet weakness. While the Chinese government has been concerned about game addiction by teenagers, Tencent has been implementing control measures stricter than industry requirements and using innovative tools such as facial recognition to restrict under-aged players. Spending by players aged 16 or under on Tencent's gaming accounts for a low single-digit percentage of its China game grossing receipts. Any further restrictions will have a limited impact on earnings. Furthermore, Tencent's gaming business is not just a China business; its international gaming revenue grew over 30% YoY and contributed 25% of segment revenue in the second quarter. Tencent's gaming business has been repositioned from a primarily China-centric business to a global business, which more than tripled its addressable market. Another headline in the quarter was that Tencent earmarked RMB 50bn investment to support "common prosperity." Just like the RMB 50bn pledged by Tencent in April 2021 for sustainable social value, these initiatives will not be funded from cash today, but over time from Tencent's investment gains and have no impact on its non-IFRS profits. The combined 100bn RMB would represent about a low single-digit percentage of our appraisal for Tencent. It is encouraging that Tencent has been repurchasing shares almost every day after its second-quarter results announcement in August 2021. The cumulative purchase so far this year is already the most they have ever repurchased.

Tencent: History of Share Repurchase

In HK Dollars as of 10/8/2021



Source: www.webb-site.com

Alibaba, the largest online retail platform in China, was the top detractor in the quarter. Alibaba reported weaker than expected first-quarter results, and the outlook for the current quarter is weak. Sporadic COVID outbreaks, property market fluctuations, and power shortages leading to manufacturing disruption have negatively impacted domestic consumption. China's retail sales growth decelerated from 12% YoY growth in June to 8.5% in July to just 2.5% in August, 2021. Alibaba's China marketplace-based commerce revenue growth is expected to slow down to high single digits growth in the current quarter vs. 14% YoY in the first quarter. A slowdown in Alibaba's cloud business growth has been another cause for investor concern. Q1 growth of 29% YoY was below market expectations, but if we exclude the negative impact of a single customer (which had to terminate its Ali Cloud relationship in international markets due to geopolitical pressure), the growth has remained in the 40-50% range contrary to the market's bearish view. Comps are tough until the September quarter due to elevated investments in multiple areas in the current fiscal year. Still, we are encouraged to see the initial results from these investments, including the 200% QoQ growth of Community marketplace's GMV, Taobao Deals AAC reaching 190mm, 90% YoY growth of Lazada orders, and stabilization in Ele.me's market share.

Alibaba has a proven track record of incubating new businesses, which develop into multibillion-dollar franchises (for example, Alibaba Cloud and Cainiao), and we are confident that current investments will achieve attractive IRRs over time. In addition, the much-publicized regulatory headwinds continued to fuel negative sentiment. In August, China passed the Personal Info Protection Law (PIPL), China's version of Europe's General Data Protection Regulation (GDPR). We believe its impact on Alibaba is relatively small compared to the audience targeting platforms. Alibaba is a private marketplace platform where consumers come with an intent to purchase. Alibaba does contextual marketing and does not engage in buying and selling data/traffic. While these new regulations could lower ROI on marketing dollars for merchants, the relative impact on e-commerce platforms like Alibaba will be lower than social networking, short video, and live streaming platforms.

At today's depressed stock price, the underlying core China marketplace business, which we expect will compound at a low to mid-teens rate in coming years, is only trading at a mid-single-digit FCF multiple. It is noteworthy that Alibaba increased its buyback authorization from $10bn to $15bn, indicating the management's optimistic view of its growth prospects. As of the end of July 2021, the company had repurchased $3.7 billion of shares since the March 2021 fiscal year-end. Current repurchase volumes represent a massive leap in share repurchase vs. last year's $118 million, reflecting management's view of the compelling returns on capital achieved through share buyback at current prices.

Baidu, the dominant AI company in China, was a detractor in the quarter. Along with other Chinese internet companies, concerns of potential further regulation in the sector have affected Baidu's share price. While Baidu remains the dominant company for Chinese search engines, search advertising represents less than 20% of the overall China online advertising market, and Baidu is not thought to engage in monopolistic behaviors. In addition, the Chinese government supports areas such as artificial intelligence and autonomous driving that Baidu has been investing in for many years. As such, we feel confident about Baidu's positioning in the current regulatory landscape. In June 2021, Baidu launched the 5th generation Apollo robotaxi, and the cost per mile dropped on average by 60% for each launch of the past five generations. It is expected that by 2025, Apollo robotaxi will reach cost parity with ride-hailing with human drivers. The total addressable market for robotaxis is projected to be US$224 billion in 2025. None of this potential is reflected in Baidu Core's single-digit EBITDA multiple. Baidu's management strongly believes the company is undervalued and has ramped up the buyback pace. Since

2020, Baidu has repurchased nearly $2.5 billion of stock, compared to slightly above $700 million in 2019.

China Lesso, the largest plastic pipe manufacturer in China, was a detractor for the quarter. The liquidity crisis at Evergrande spread concerns to industry suppliers. However, the direct impact to China Lesso is limited because the company has a diversified customer base, with its top five customers representing less than 5% of its revenue. Evergrande only accounts for 1-2% of its revenue. China Lesso's cash flow is safe, with over 60% of its sales conducted via its 2,500+ independent and exclusive first-tier distributors, whose credit terms have been prudently managed. The market is concerned about the PVC cost hike putting pressure on industry margins. Still, China Lesso has demonstrated its pricing power over the past decade by operating on a cost-plus model and maintaining a stable to increasing gross profit margin. China Lesso has delivered gross margin expansion despite the cost challenges in the first half of the year by increasing its plastic pipe pricing +14% year over year while growing volume by 9%. The company remains confident in its full-year margin and double digits revenue growth.

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 September 30, 2021. 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			
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.

<u>Institutional Asia Pacific Equity Composite</u> - 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. ("Southeastern") claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Southeastern has been independently verified for the periods January 1, 2001 through December 31, 2020.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Institutional Asia Pacific Equity Composite has been examined for the periods November 1, 2014 through December 31, 2020. The verification and performance examination reports are available upon request.

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 complete list of composite descriptions is 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. Policies for valuing portfolios, calculating performance, and preparing compliant presentations 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.