

# DIE UNTERSCHÄTZTEN QUALITÄTSUNTERNEHMEN AUS DEN SCHWELLENLÄNDERN

*Marc Erpelding, Fund Manager*

11/05/2023

# BLI - Banque de Luxembourg Investments

*An investment philosophy common to all equity strategies*



## Marc Erpelding, Lead Fund Manager

- Degree in Civil Engineering (Swiss Federal Institute of Technology in Zurich)
- MSc in International Management (King's College, London)
- Joined BLI/Banque de Luxembourg in 09/2002
- CIIA (Certified International Investment Analyst)
- In charge of Emerging Markets Equity strategies since 10/2007



## Raphaël Fürst, Analyst

- BSc in Economics, Solvay School of Economics and Management, Brussels
- MSc in Business Economics, Financial Markets and Services, Solvay School of Economics and Management, Brussels
- Joined BLI/Banque de Luxembourg in 2021
- Analyst Asian Equities (including Japan)

## Guy Wagner, CIO, Manager

### European equities

- Ivan Bouillot, Manager*
  - All caps
  - Family-owned companies
- Tom Michels, Manager*
  - Small & Mid-caps
- Amélie Morel, Analyst*
  - All caps

### US equities

- Luc Bauler, Manager*
  - Large caps
- Henrik Blohm, Manager*
  - Small & Mid-caps
- Julien Jonas, Analyst*
  - All caps

### Japanese and emerging equities

- Marc Erpelding, Manager*
  - Asia excl. Japan
  - LatAm & EEMOA
- Raphaël Fürst, Analyst*
  - Asia incl. Japan
- Steve Glod, Manager*
  - Japan, all caps

### Global equities

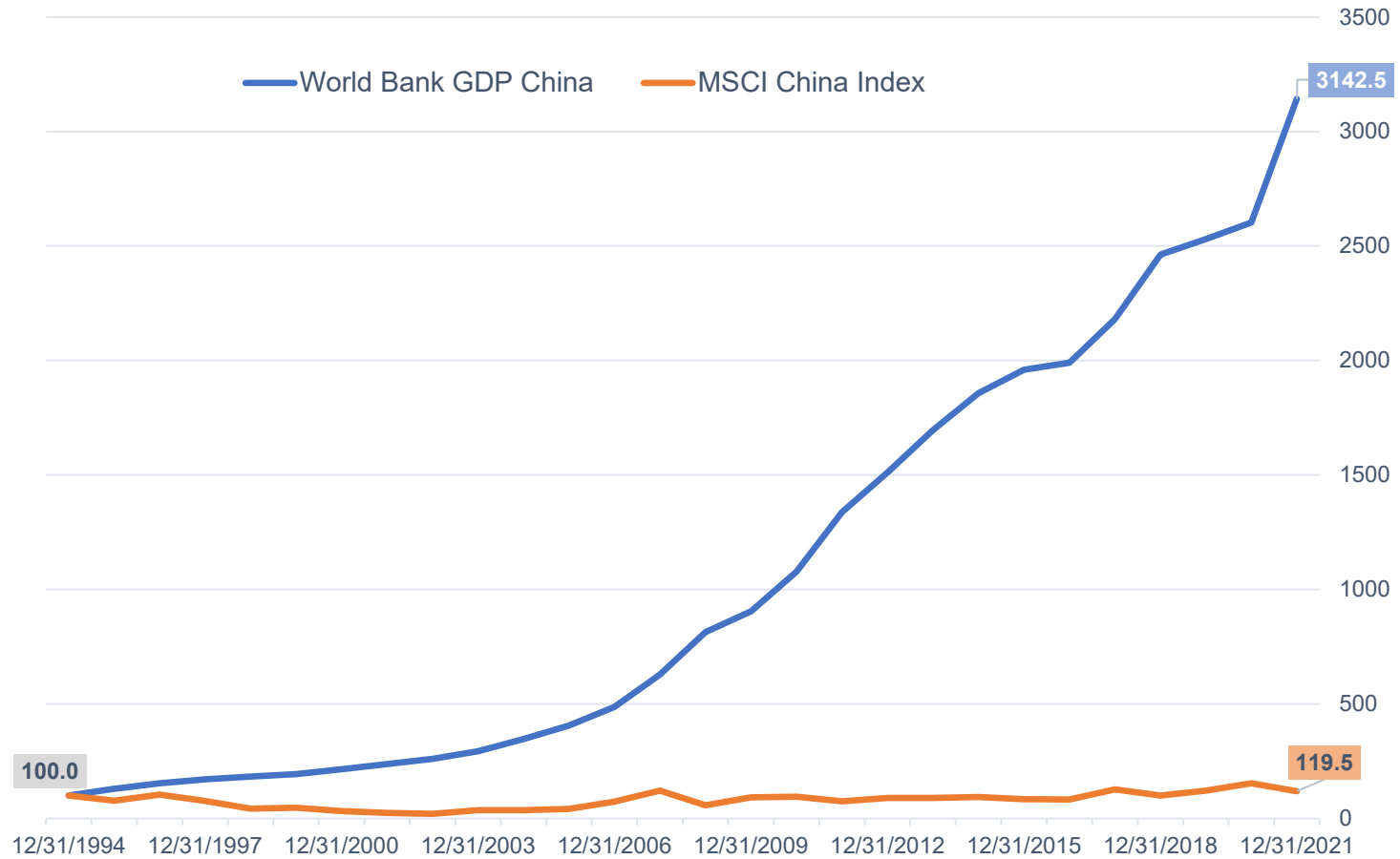
- Maxime Hoss, Manager*
  - All caps
- Jérémie Fastnacht, Manager*
  - Dividends
- Annick Drui, Manager*
  - SRI

### SRI Strategy & Stewardship

- Thierry Feltgen*
- Alice Tharaud*
- Misch Koob*

# Emerging Markets

*GDP growth does not equal stock market performance*

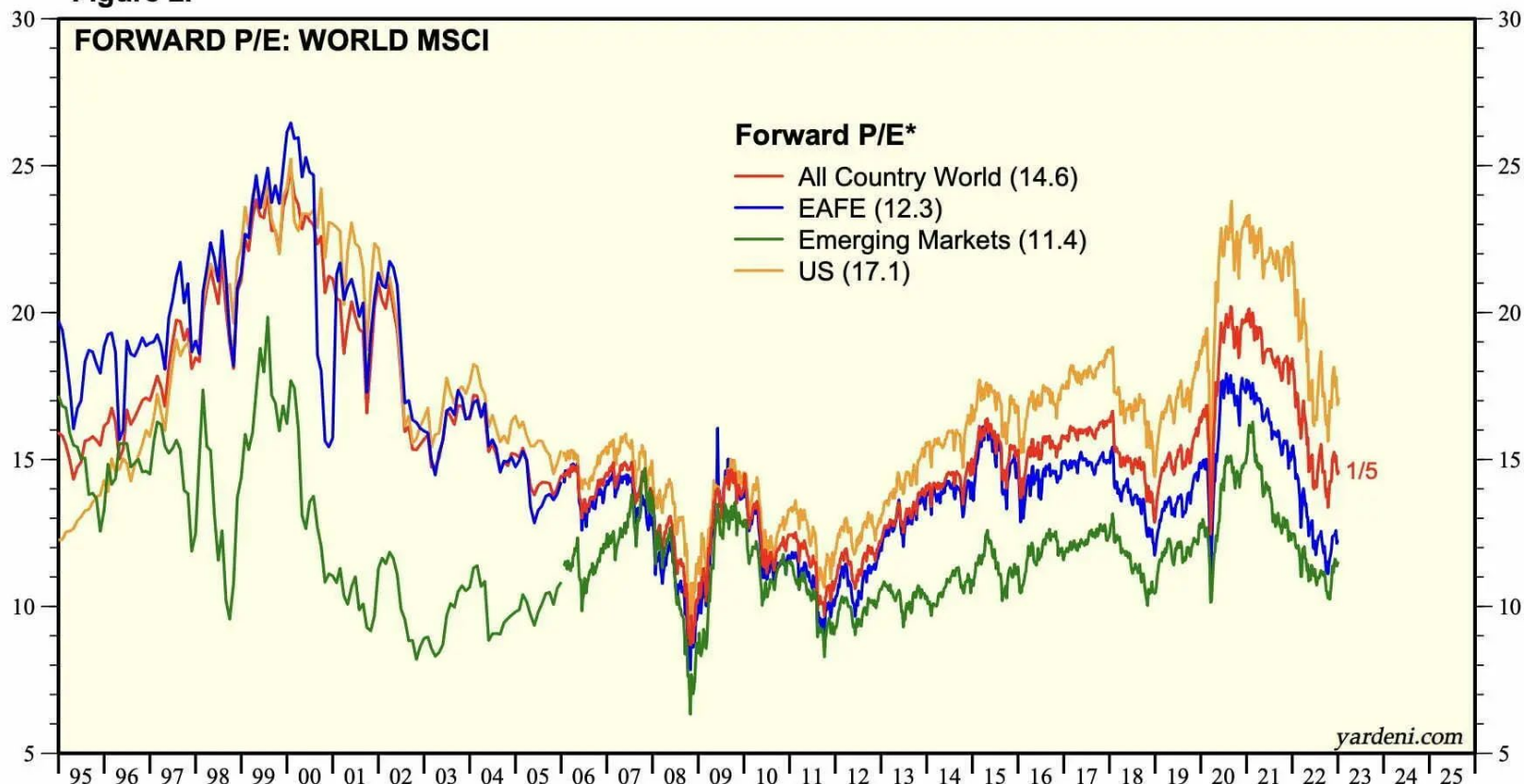


Source: Bloomberg, MSCI, World Bank

# Emerging Markets

*Emerging markets are undervalued...*

**Figure 2.**



\* Price divided by 12-month forward consensus expected operating earnings per share. Monthly through December 2005, weekly thereafter.  
Source: I/B/E/S data by Refinitiv.

# Emerging Markets

*Emerging markets are undervalued... so what?*



Source: Bloomberg, MSCI



# BUSINESS - LIKE INVESTING

# Investment Approach

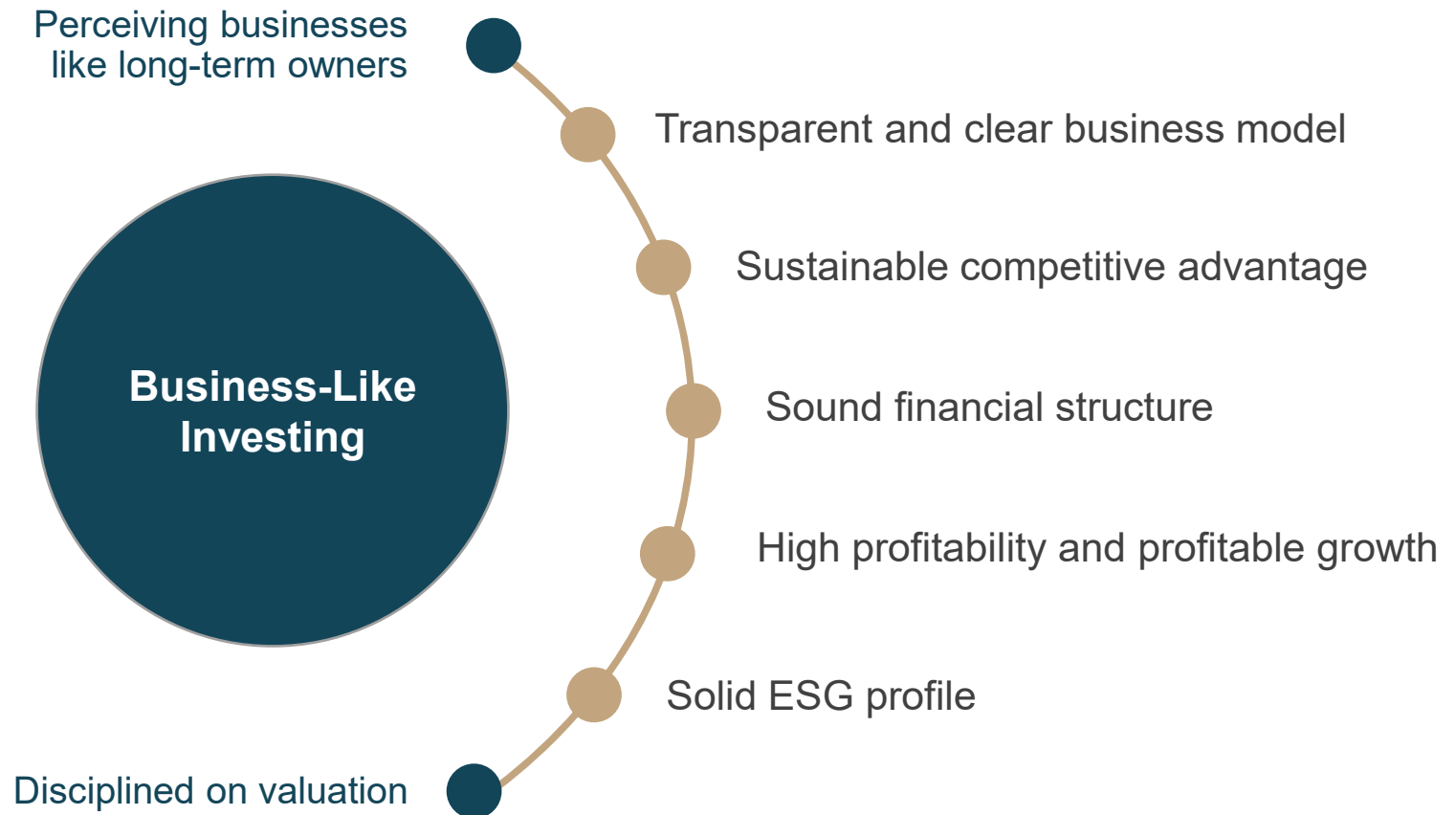
## *Philosophy*

*“ If you don’t feel comfortable owning something for 10 years, then don’t own it for 10 minutes.”*

*(Warren Buffett, CEO Berkshire Hathaway)*

# Investment Approach






## *Philosophy*





# Investment Process

## Business Model Differentiation

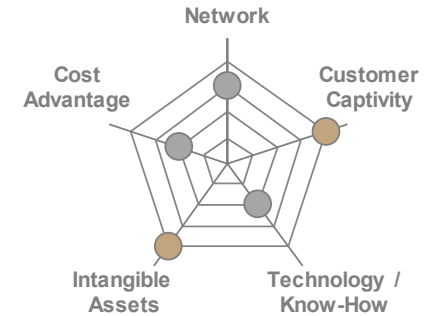
Intangible Assets	Customer Captivity	Network	Cost Advantage	Technology & Know-How
<p>Brand Perception of Quality</p>	<p>Switching Costs Aftermarket Sales Ongoing Service</p>	<p>Network Effect Distribution Network</p>	<p>Lower Costs Economies of scale</p>	<p>Proprietary Technology Innovation Patents</p>
 <p>MOUTAI</p> <p>雪花露 Sulwhasoo</p> <p>The history of 花</p>	 <p>D&amp;L</p> <p>Alibaba</p> <p>TCS TATA CONSULTANCY SERVICES</p>	 <p>7-ELEVEN</p> <p>Coca-Cola FEMSA</p> <p>CLICKS</p>	 <p>कॉनकॉर CONCOR</p> <p>Fuyao Glass</p> <p>ambev</p>	 <p>tsmc</p> <p>ASPEED TECHNOLOGY Inc.</p> <p>LEENO</p>

⇒ No long-term success without competitive advantage

# Case Study

**Kweichow Moutai** is the leading Chinese producer of premium baijiu, a traditional and strong alcoholic liquor distilled from fermented sorghum.

*It has a very strong brand image and is considered to be China's luxury liquor.*



## INVESTMENT CASE

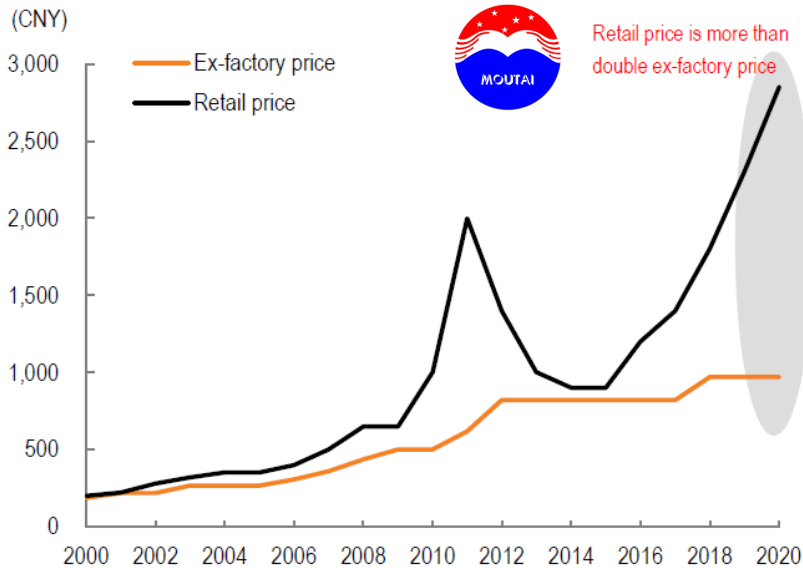
- Founded in 1951
- Can only be produced in Maotai town next to the Chishui river in Guizhou province
- Leading premium baijiu producer in China with very strong brand image. The liquor is often served at official banquets and offered as a gift
- The production process involves 9 distillations, 7 filtrations and 8 fermentation periods, all of which are done by hand. Even the basic Maotai takes at least 5 years to produce
- Highly profitable with gross margins close to 90%
- Strong pricing power due to premiumisation trend and scarcity



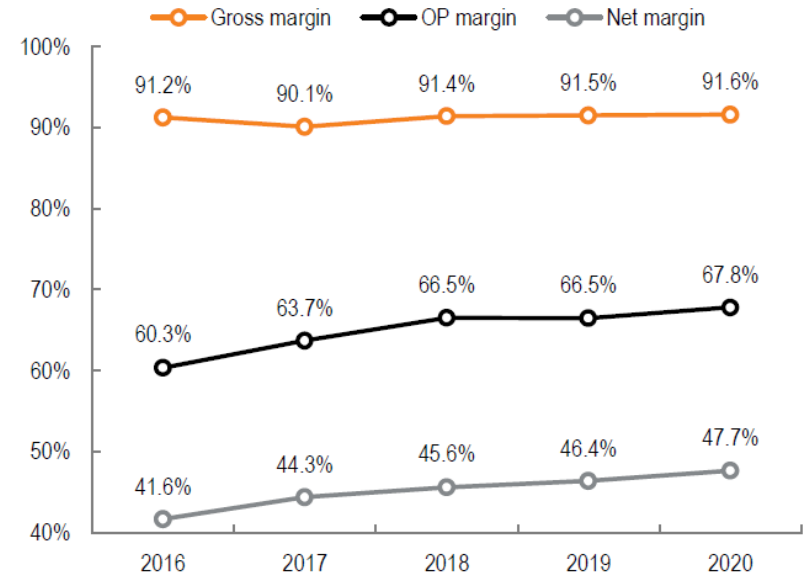
# Investment Process

## Competitive Advantage: Intangible Assets & Brand

**Figure 32. Ex-factory and retail price of Feitian Moutai (53%, 500ml)**



**Figure 57. Kweichow Moutai: Gross margin, OP margin, and net margin**

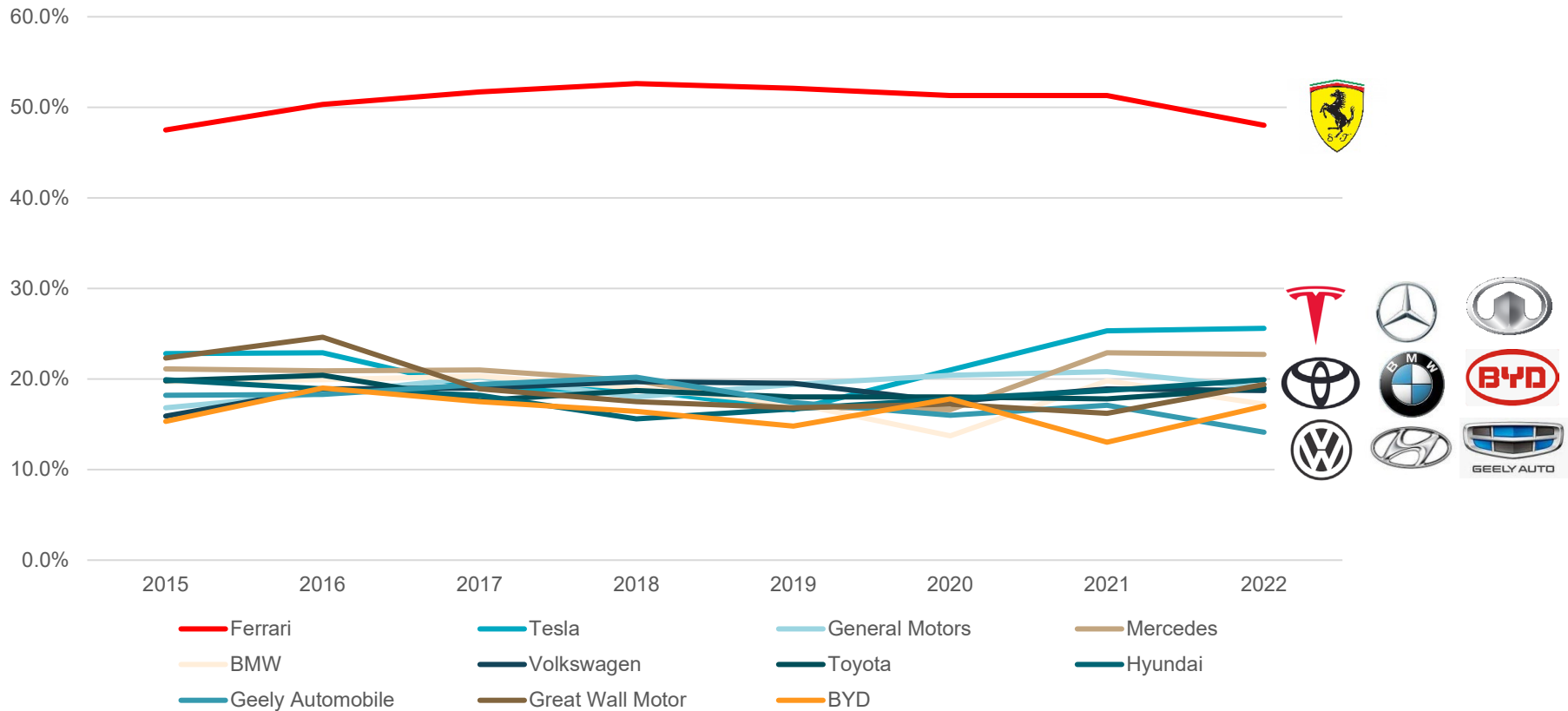


Source: Press Reports, Wind, Mirae Asset Securities Research

# Investment Process

## Competitive Advantage: Brand & Pricing Power

Gross Margin of various car producers

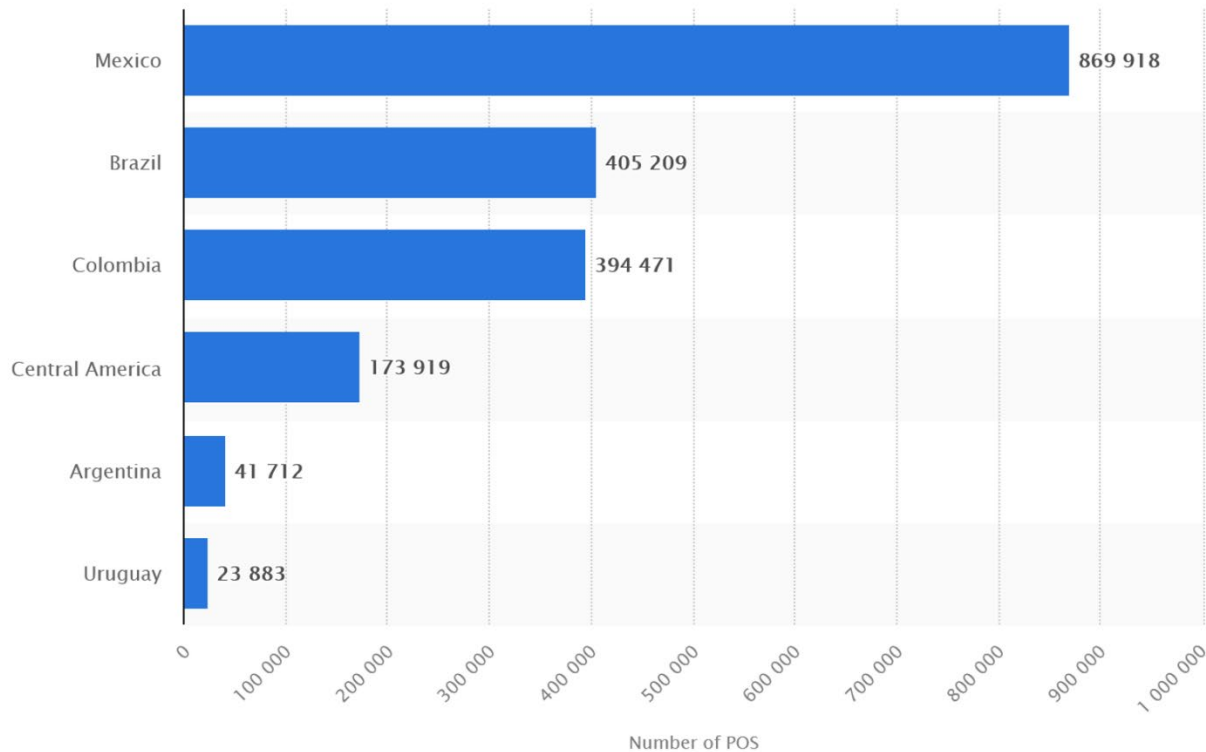


Source: Bloomberg

# Investment Process

## Competitive Advantage: Distribution Network

Number of POS (point of sale) for Coca-Cola FEMSA, by region



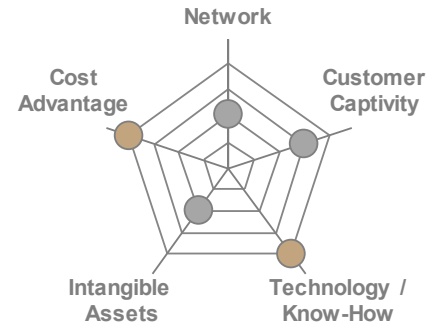
- Present in 10 countries
- > 260 million consumers
- > 3.4 billion unit cases
- > 2 million POS
- > 65 bottling plants
- > 340 distribution centers

Source: Statista 2021 (estimates for 2019)

# Case Study

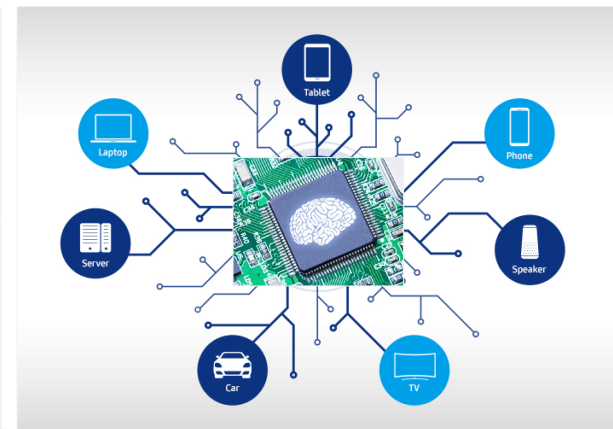
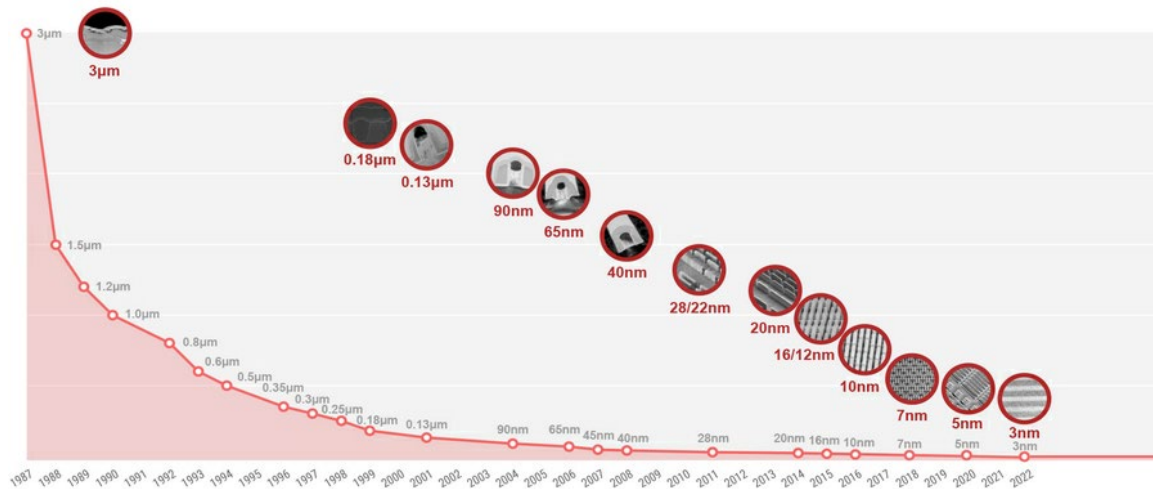
Founded in 1987 and headquartered in Taiwan, **Taiwan Semiconductor Manufacturing Company** (TSMC) is the world's largest dedicated independent semiconductor foundry.

*As a leading edge foundry, TSMC is a key beneficiary of the digital revolution.*



## INVESTMENT CASE

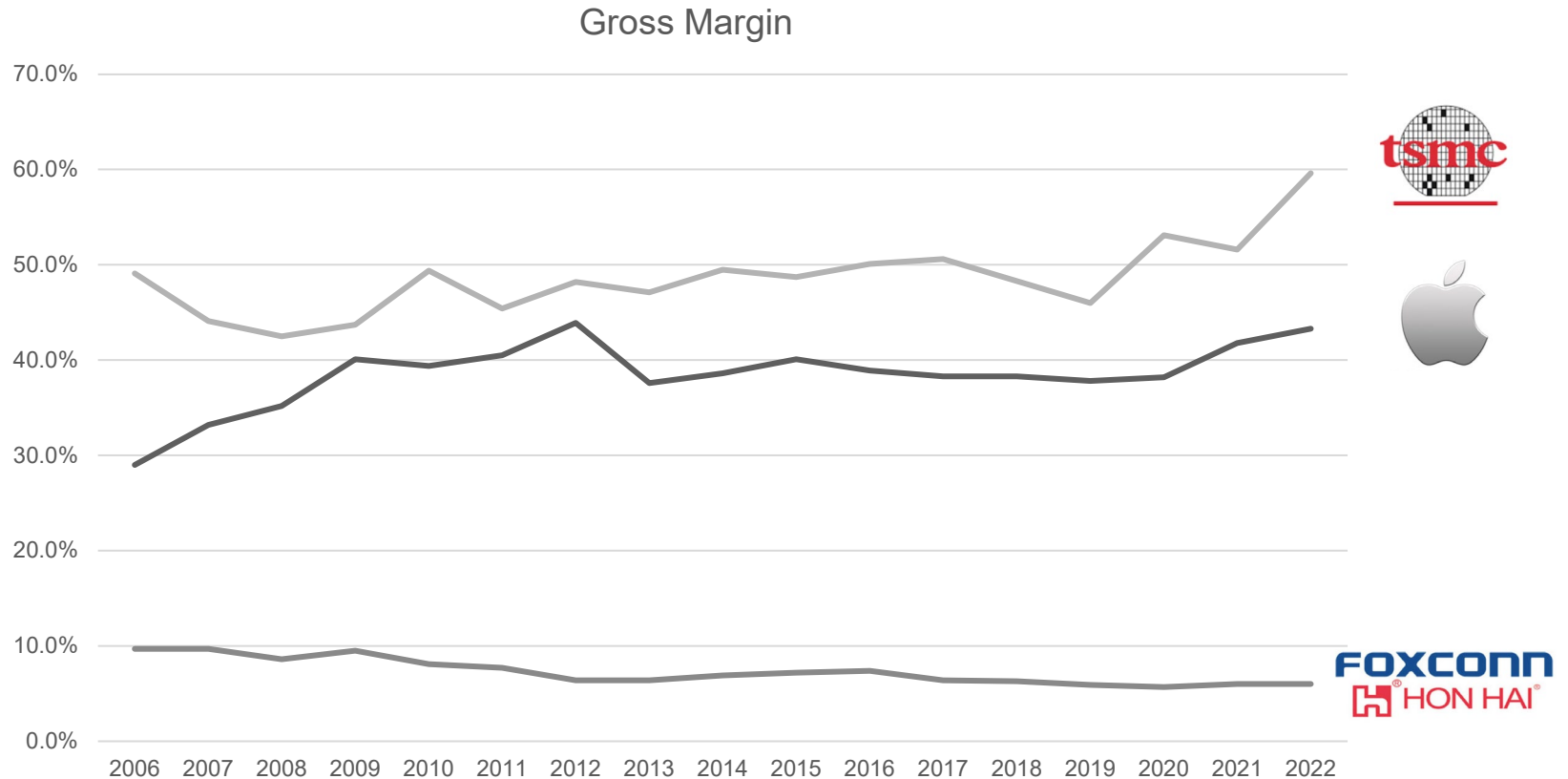
- Independence: TSMC does not have and does not design its own chips.
- Important economies of scale due to high fixed costs and large volumes.
- Key beneficiary of global technological advances (autonomous driving, AI, robotics, ...).
- Diversified product portfolio (250 distinct technologies and over 10.000 products).
- Strong customer captivity (design library, joint development in high-end chips)



Source: Company, Banque de Luxembourg Investments

# Investment Process

*Competitive Advantage: Technological Know-How*



Source: Bloomberg, Banque de Luxembourg Investments

# Investment Process

## *“Food for Thought” on Competitive Advantage*

- Prefer **local dominance** over **global presence** !?
- **Change** (disruption) is the biggest threat to an existing competitive advantage !?
- **Strong growth** lowers barriers to entry !?
- **Brand** is only a competitive advantage if the company can capitalize on it !?
- **Capital intensity** is not a competitive advantage !?
- **Customer captivity** is the strongest competitive advantage !?
- **Distribution network** is the weakest competitive advantage !?



# Investment Process

## *“Food for Thought” on Sectors*

- **Banks:** macro-driven (interest rates, GDP growth, inflation), opaque
- **Telecommunication:** low customer loyalty, price competition, capital intensive
- **Transport** (e.g. airlines): low customer loyalty, price competition, high percentage of variable costs, low economies of scale
- **Natural Resources:** macro-driven (global growth), geopolitical (e.g. OPEC cartel, war, conflicts), capital intensive, cyclical

*“ We may engage in activities that **give preference to the objectives of the Brazilian federal government** rather than to our own economic and business objectives.”*

(Petrobras/SEC, 2010)

Specific for Emerging Markets:

- **Industrials** in Emerging Markets: rarely leading technologies, volume-driven, many assemblers
- **Pharmaceuticals** in Emerging Markets: many generics companies, high-risk business models



# PORTFOLIO REVIEW

# Portfolio Review

## *General Characteristics of Emerging Markets Strategies*

- **High quality** companies from Asia ex-Japan, Latin America, Africa and the Middle East.
- Purely **bottom-up**. No macroeconomic analysis.
- **Portfolio = sum of individual companies** and **far removed from the index** (MSCI Emerging Markets).
- **Strong sector biases**. Very little exposure to natural resources, financials, telecoms and utilities.
- Strong focus on **domestic consumption**. High exposure to consumer staples.
- Companies are **often local leaders** in their home country or in the region (+/- 75% of portfolio).
- The portfolio will have a **strong mid- and small-cap bias**.
- Low turnover (< 20%).
- Performance target: **outperform MSCI Emerging Markets** (100% equities) over full cycle.

# Portfolio Review

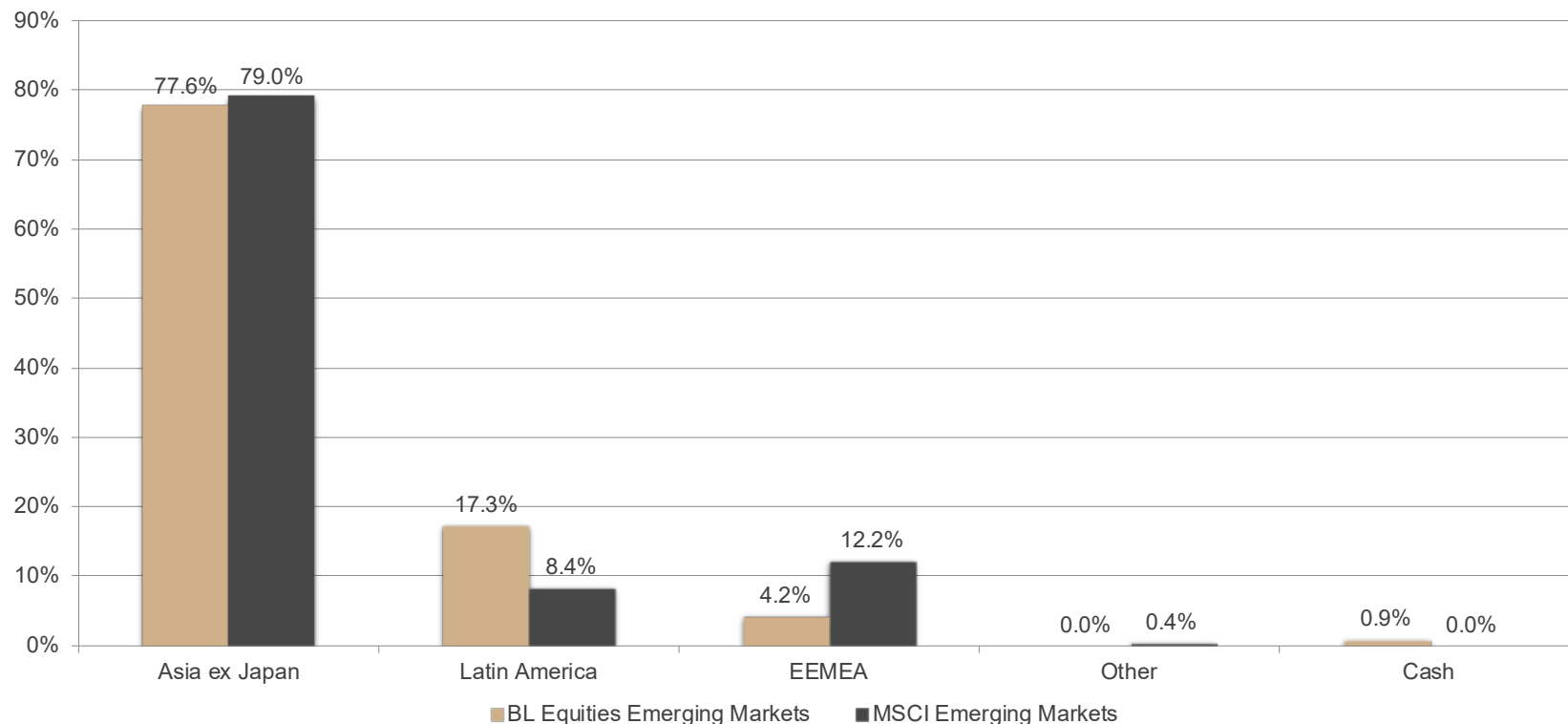
## General Characteristics of Emerging Markets Strategies



	BL Emerging Markets	BL Equities Emerging Markets
Inception Date	10/2007	10/2021
AUM	+/- EUR 400 millions	+/- USD 100 millions
Hedged Share Classes	No	No
Geographic Focus	Asia ex Japan/LatAm/EEMEA	Asia ex Japan/LatAm/EEMEA
Equity Allocation	60-100%	100%
Cash/Bonds Allocation	0-40%	< 5%
SFDR	Art. 8	Art. 8
Sustainable Investments Art. 8	min. 5%	min. 30%
Label ISR	No	Yes
Company MSCI ESG Ratings	AAA-CCC, NR	AAA-BB
Fund Overall ESG Rating (Equities)	A	AA
ESG Impact Factors	No	Yes
Number of Holdings (Equities)	+/- 65	+/- 45
Weight Top 10 Holdings	+/- 25%	+/- 40%

# Portfolio Review

## BL Equities Emerging Markets – Regional Allocation (as of 31/03/2023)



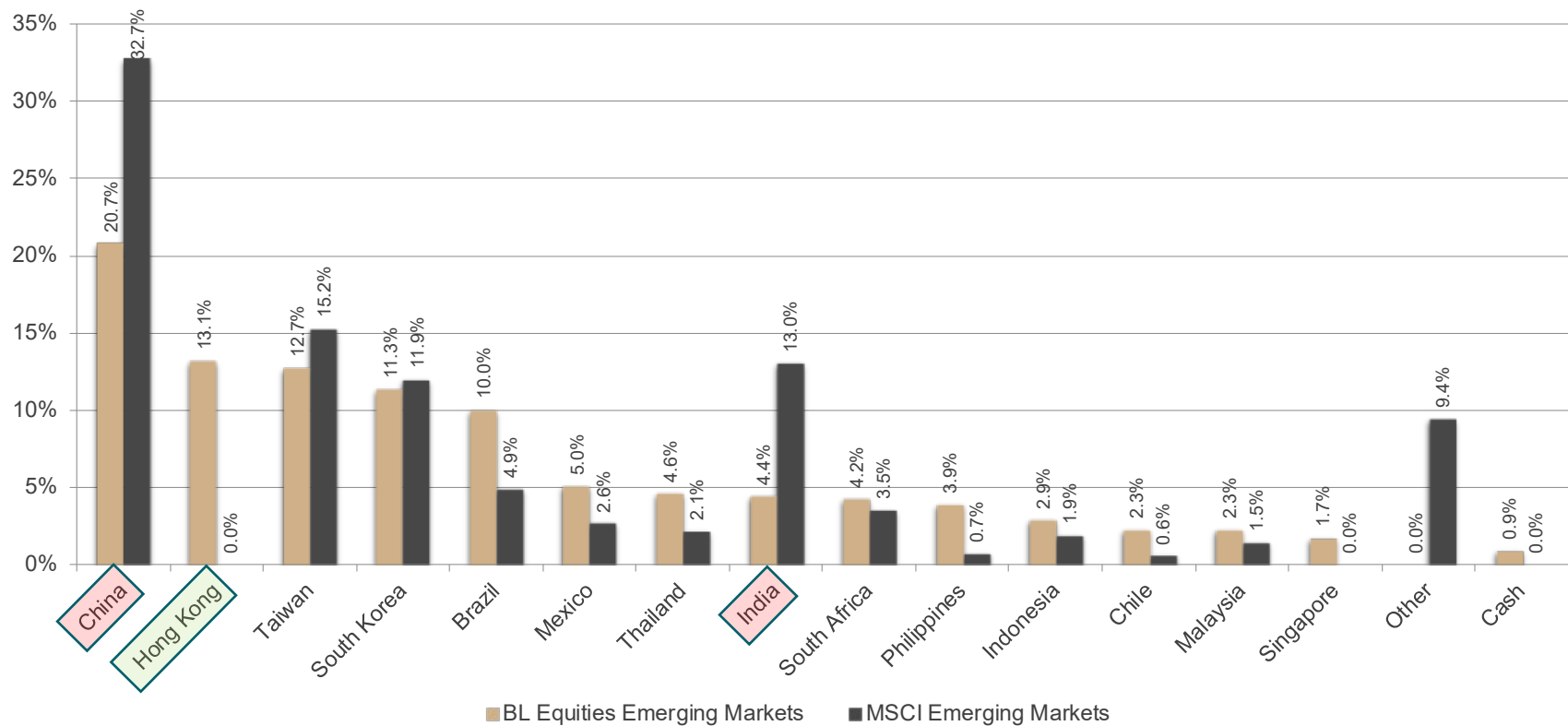
Data in USD as of 31/3/2023

Data source: MSCI / BLI

Data is given as information only and is as a given date and may evolve over time. Reference to a market index is made for comparison purposes only; the market index is not mentioned in the investment policy of the sub-fund.

# Portfolio Review

## BL Equities Emerging Markets – Country Allocation (as of 31/03/2023)



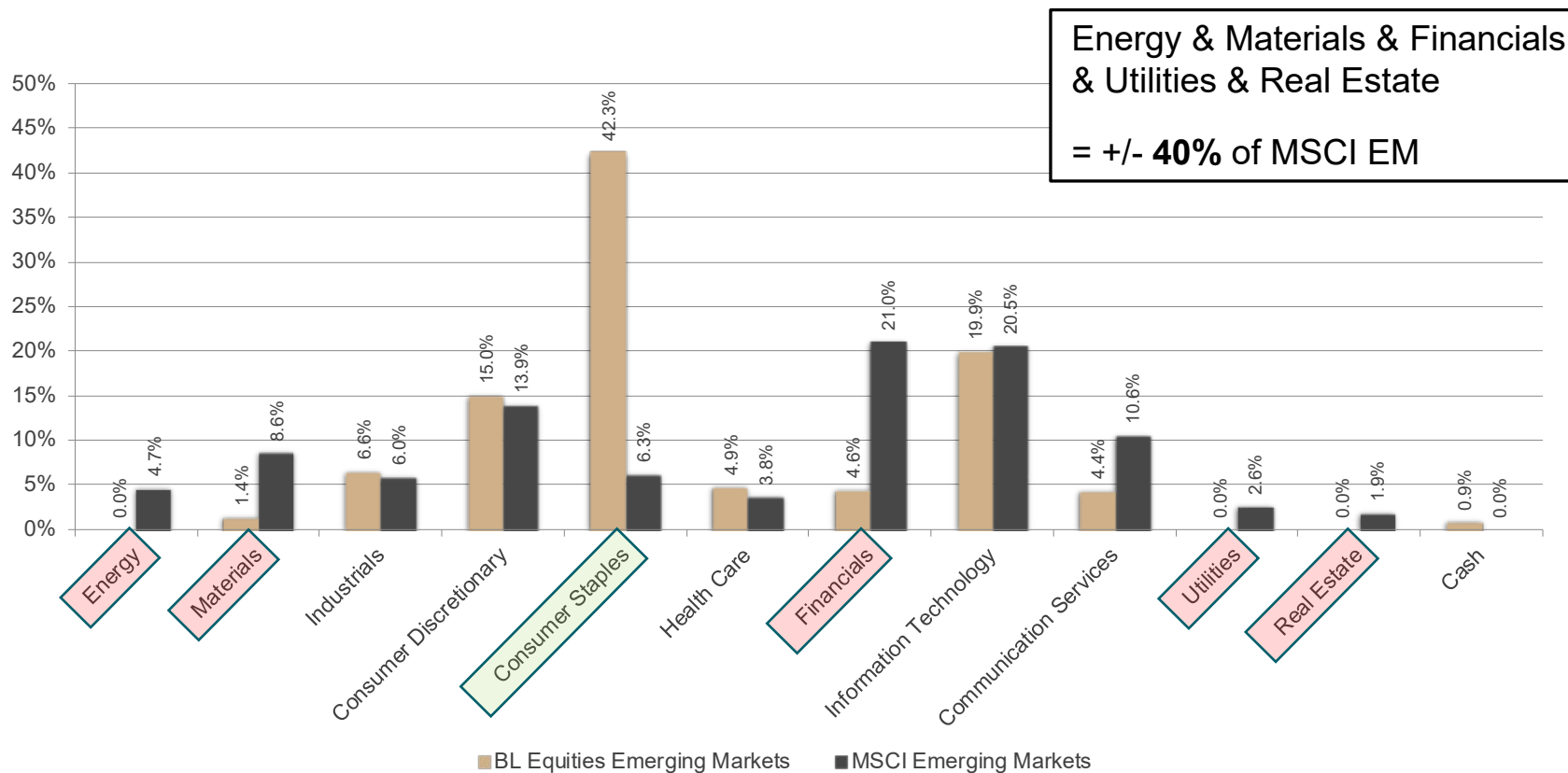
Data in USD as of 31/3/2023

Data source: MSCI / BLI

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# Portfolio Review

## BL Equities Emerging Markets – Sector Allocation (as of 31/03/2023)



Data in USD as of 31/3/2023

Data source: MSCI / BLI

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# Portfolio Review

*Consumer Staples – Are these businesses correlated ?*



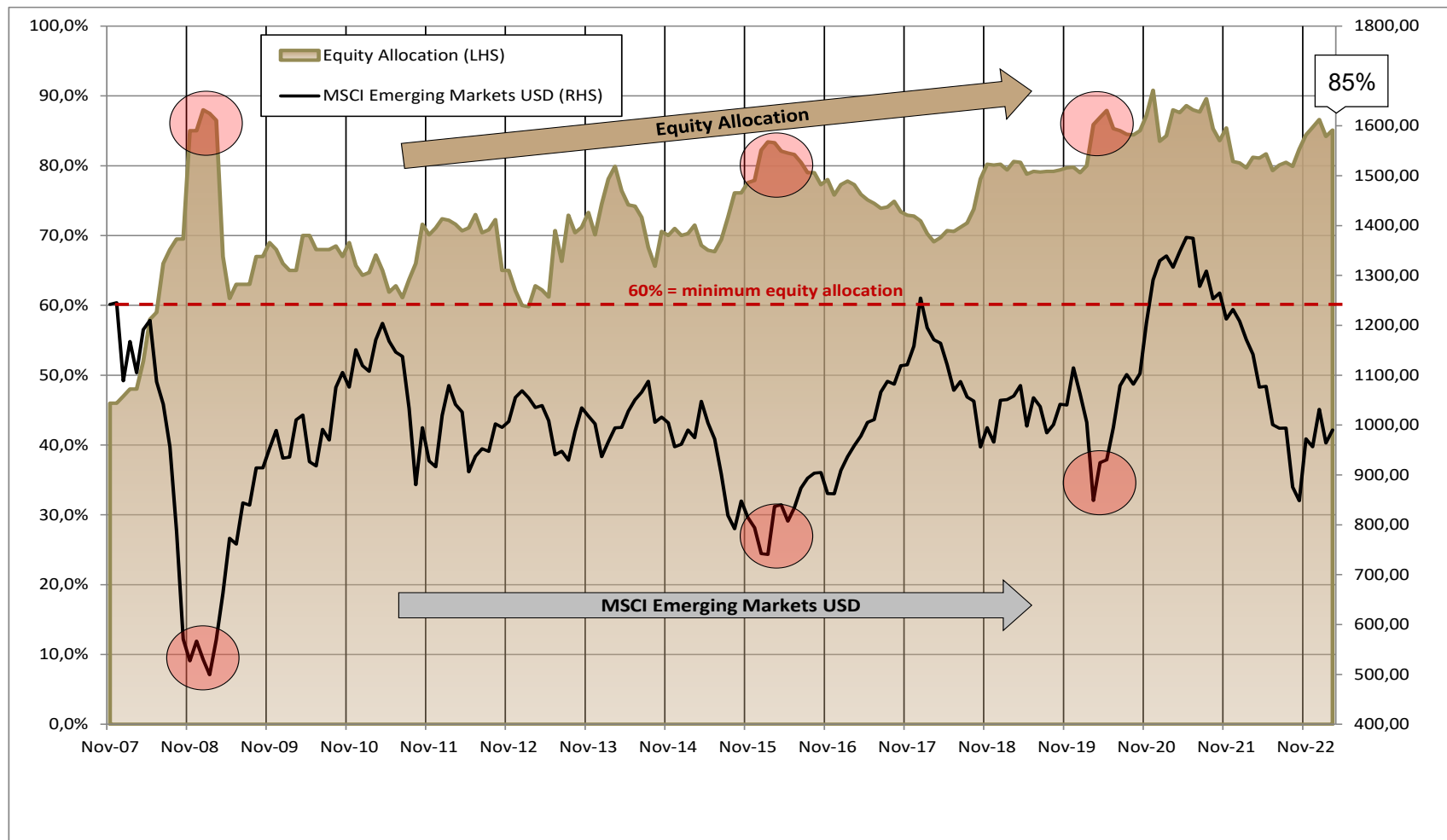
Products: beer, household products, cosmetics, convenience stores, pharmacies, dairy products, cookies ...

Countries: Mexico, Brazil, Chile, South Africa, China, South Korea, Thailand, Singapore, Vietnam, Taiwan, Philippines...



# Portfolio Review

## BL Emerging Markets - Historic Equity Allocation



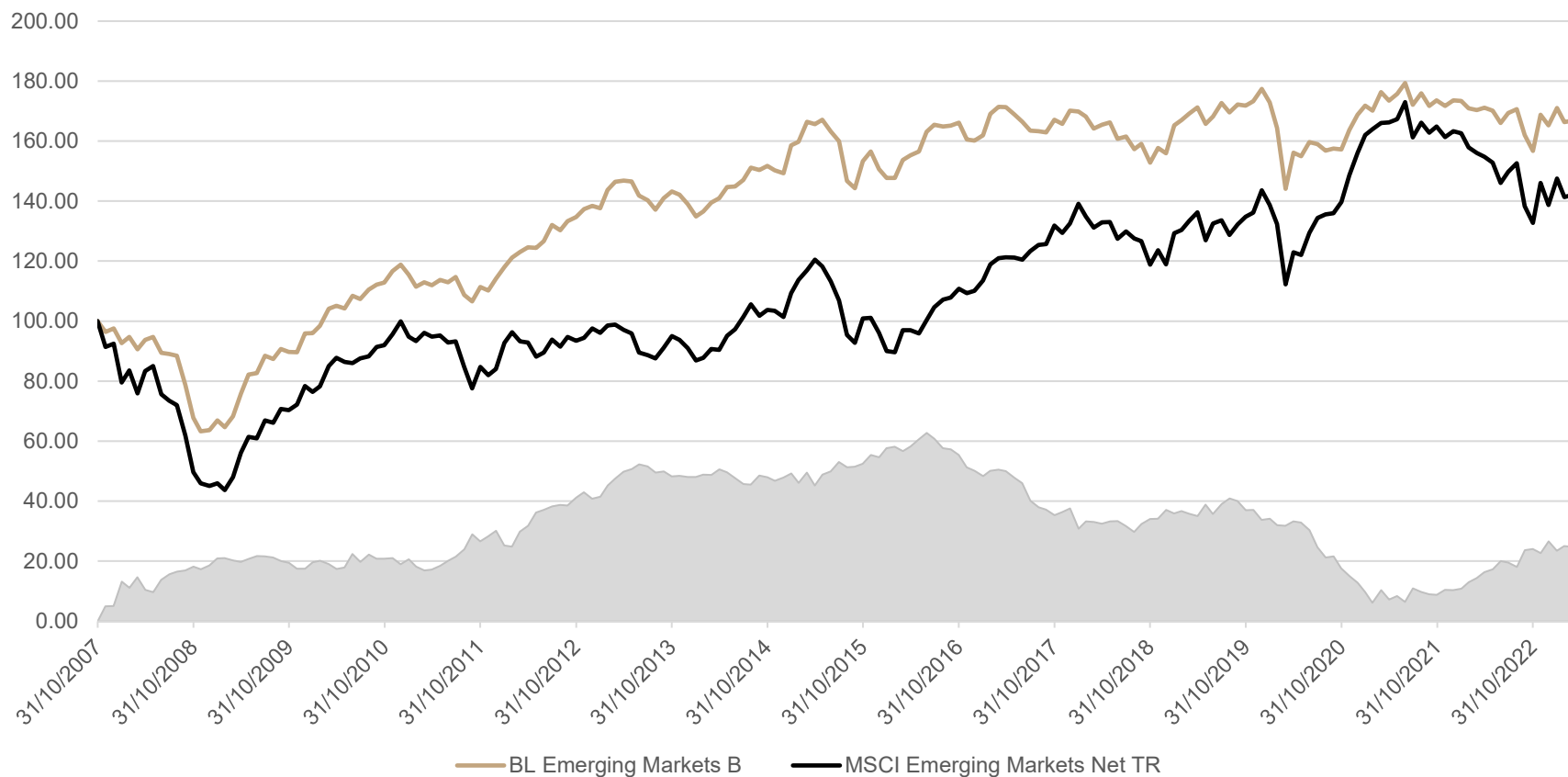
Data source: Bloomberg / MSCI / BLI as of 31/03/2023

Data is given as information only and is as a given date and may evolve over time. Reference to a market index is made for comparison purposes only; the market index is not mentioned in the investment policy of the sub-fund.

# Portfolio Review

## BL Emerging Markets - Performance since launch (retail share class B)

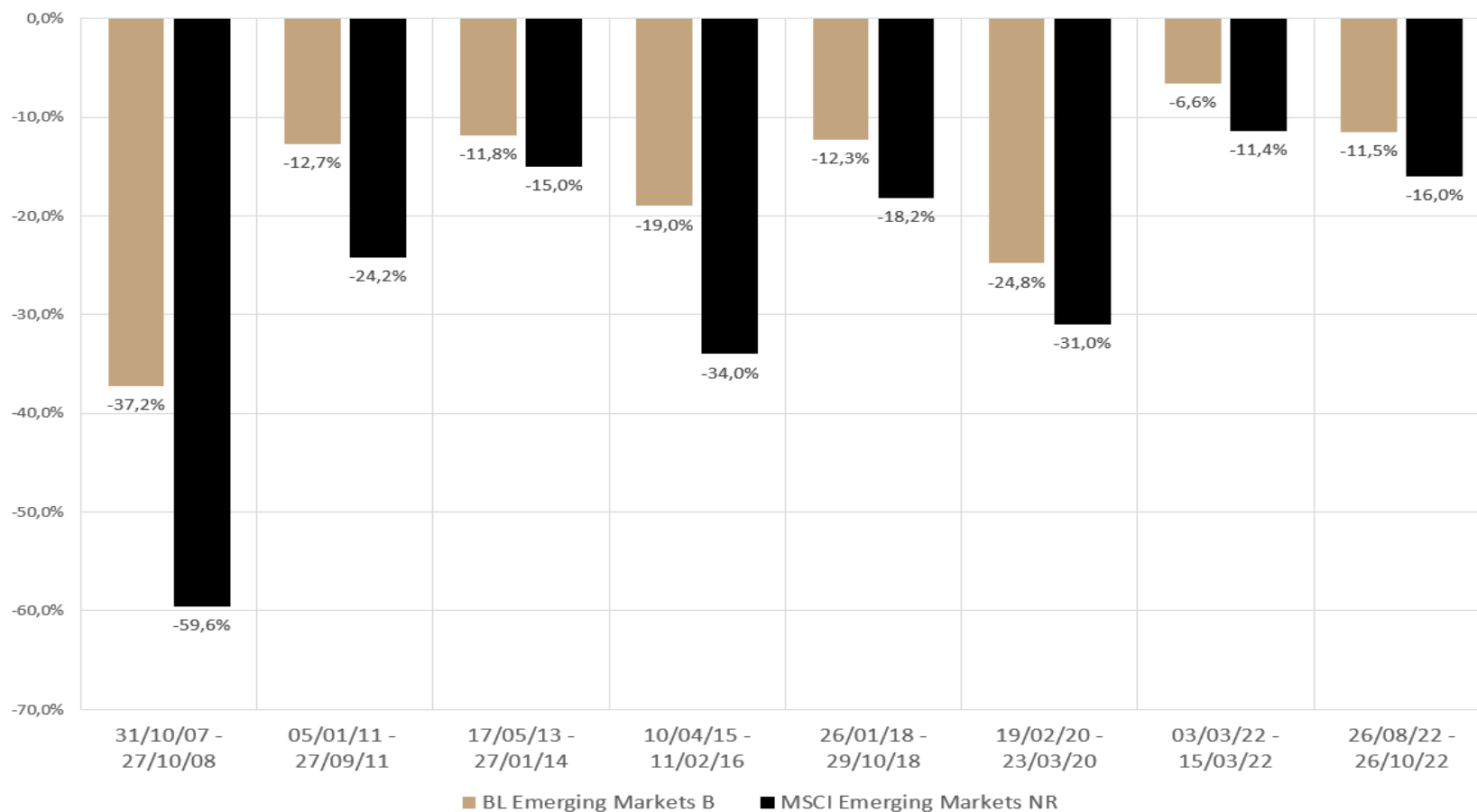
*Note: Performance net of fees. Past performance does not guarantee or predict future performance. Reference to a market index is made for comparison purposes only; the market index is not mentioned in the investment policy of the sub-fund*



# Portfolio Review

## BL Emerging Markets - Major Drawdown Periods (as of 31/03/2023)

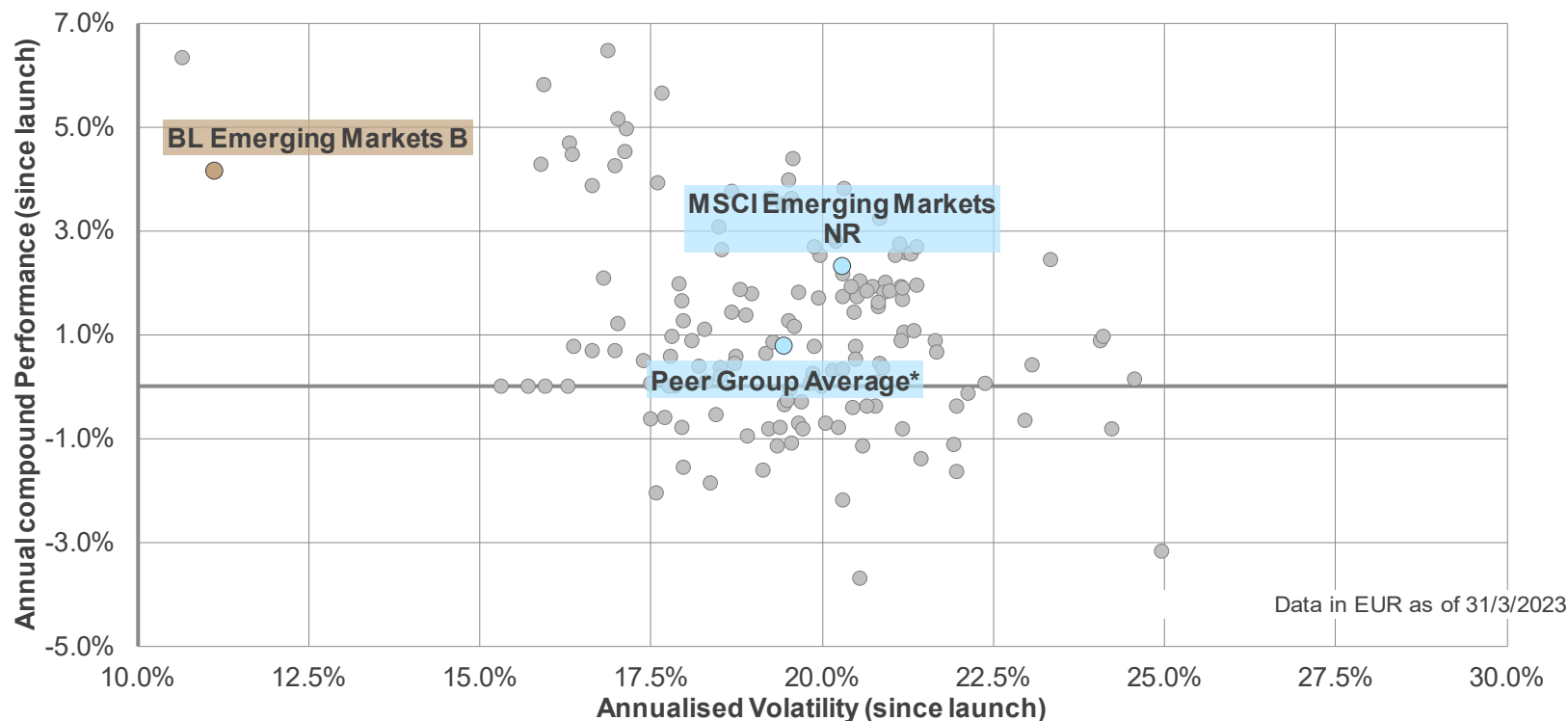
*Note: Performance net of fees. Past performance does not guarantee or predict future performance. Reference to a market index is made for comparison purposes only; the market index is not mentioned in the investment policy of the sub-fund*



# Portfolio Review

## BL Emerging Markets - Risk / Return Profile vs Peergroup (31/10/2007 - 31/03/2022)

*Note: Performance net of fees. Past performance does not guarantee or predict future performance. Reference to a market index is made for comparison purposes only; the market index is not mentioned in the investment policy of the sub-fund*



\*Peer Group Average: The average of the fund's chosen Lipper peer group (Lipper Global Equity Emerging Markets Global ), minus the funds not registered for sale in the following countries: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Luxembourg, Netherlands, Norway, Singapore, Spain, Sweden, Switzerland, UK.  
Data source: Lipper / BLI.

# Q&A

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# APPENDIX

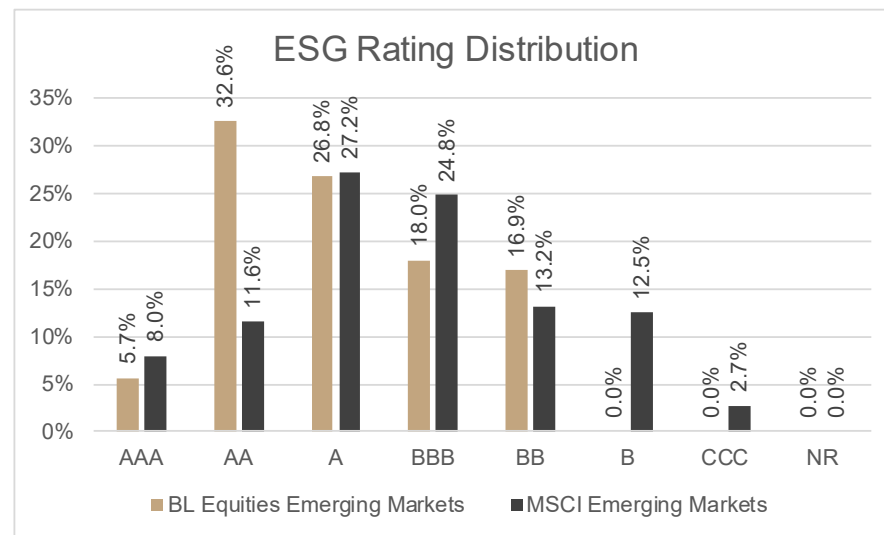


# BL Equities Emerging Markets

## ESG Report

	BL Equities Emerging Markets	MSCI Emerging Markets
<b>ESG Quality Score</b>	<b>6.98</b>	<b>5.42</b>
<b>Environmental</b>		
Carbon Emissions Intensity	73.41 (100%)	320.30 (100%)
Environmental Controversy Score	6.98 (100%)	9.30 (100%)
<b>Social</b>		
Social Controversy Score	8.00 (100%)	6.80 (100%)
<b>Governance</b>		
Governance Controversy Score	8.50 (100%)	7.55 (100%)
<b>Global Norms</b>		
UN Global Compact Signatories	57.0% 100.0%	35.9% 99.2%
UN Global Compact Compliant	100.0% 100.0%	80.7% 99.9%
UN Global Compact Watchlist	0.0% 100.0%	18.6% 99.9%
UN Global Compact Fail	0.0% 100.0%	0.7% 99.9%

Scores / 10  
(%): Data Coverage

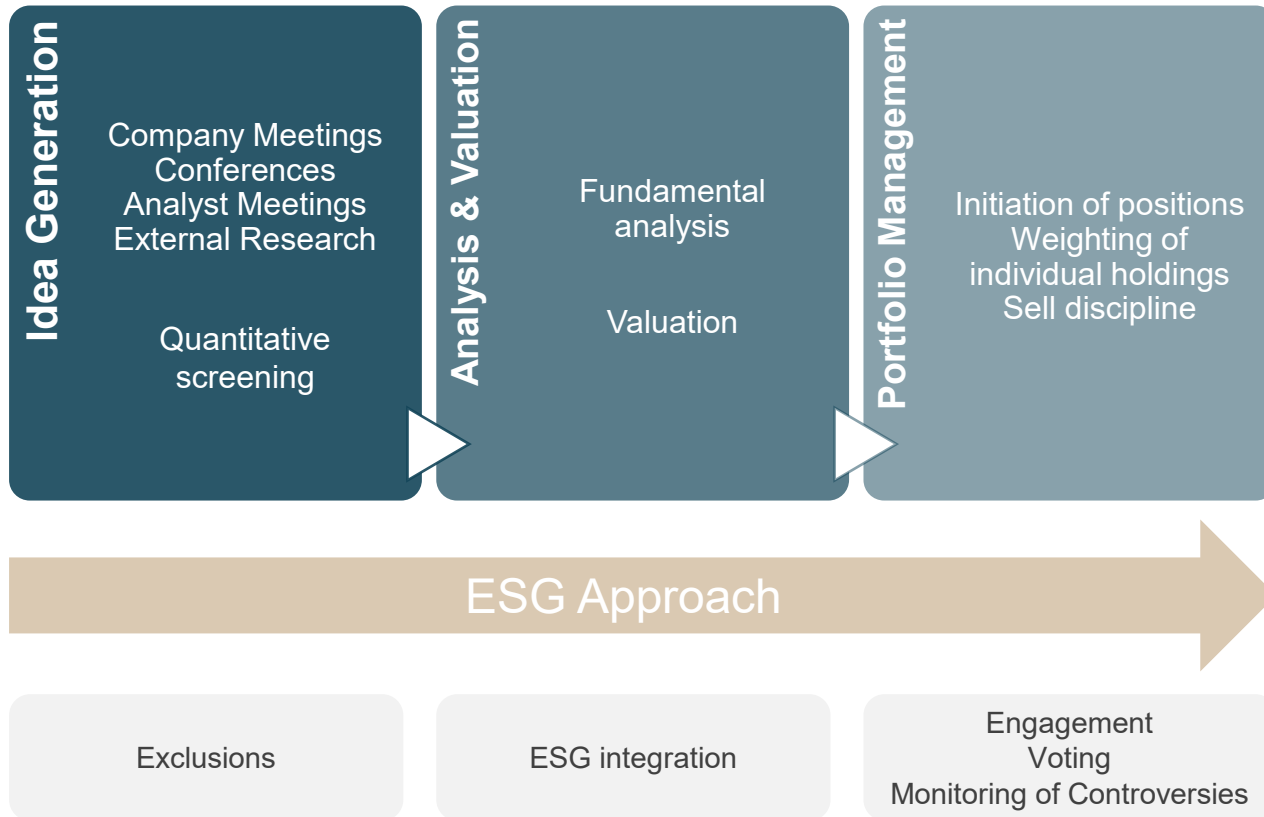


Data as of 31/3/2023

Source: BLI / MSCI

# Investment Process

*Bottom-up investment process*

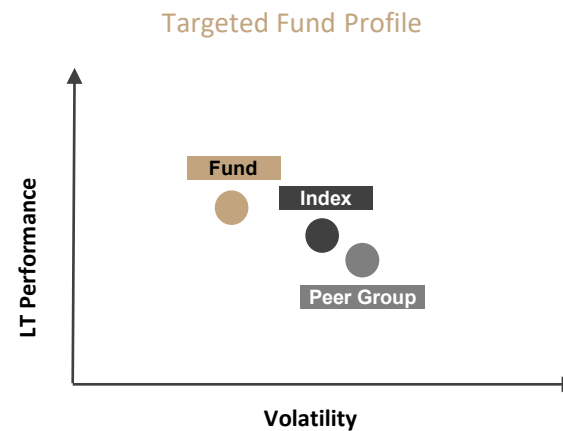


# Investment Approach

## Risk Consciousness at the Heart of the Process

→ Aiming to minimize risks and maximize returns through a stringent investment process

- Selective stock picking
- Staying within our circle of competence
- Diversification, but without benchmarking
- Buying only with a margin of safety



*“We (investors) obsess with outcomes over which we have no direct control. However, we can and do control the process by which we invest.”*

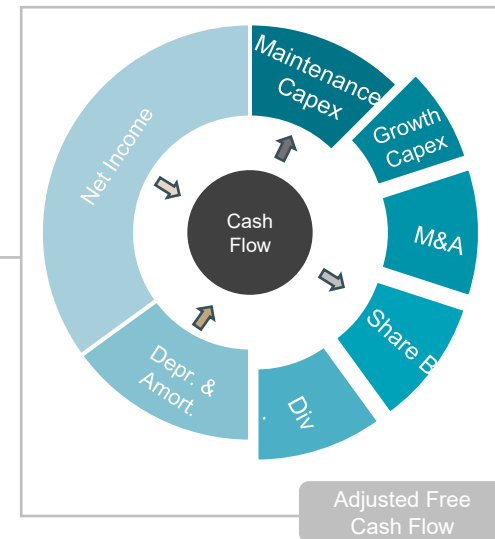
James Montier, Investment Strategist at GMO

# Investment Process

## Valuation Model

⇒ No profitable growth without competitive advantage

- Quantitative evidence of an economic moat
  - Economic profit levels (ROCE, ROE)
  - Operating Margins
- Analyse additional company fundamentals
  - Balance sheet strength
  - Capital Intensity
- Assess the company's FCF-generation capacity



# Investment Process

## Valuation Model\*

- Get an indication about the value of the company without future growth
  - Calculation of the Earnings Power Value **EPV** (the value of the company based on its current business using adjusted FCF)
- Future growth only creates value if the company benefits from a sustainable competitive advantage
  - Calculation of the growth-related value multiplier **GM** and the fair value of the company **FV**

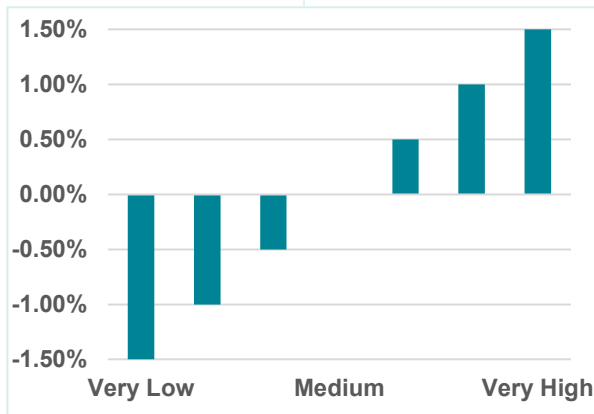
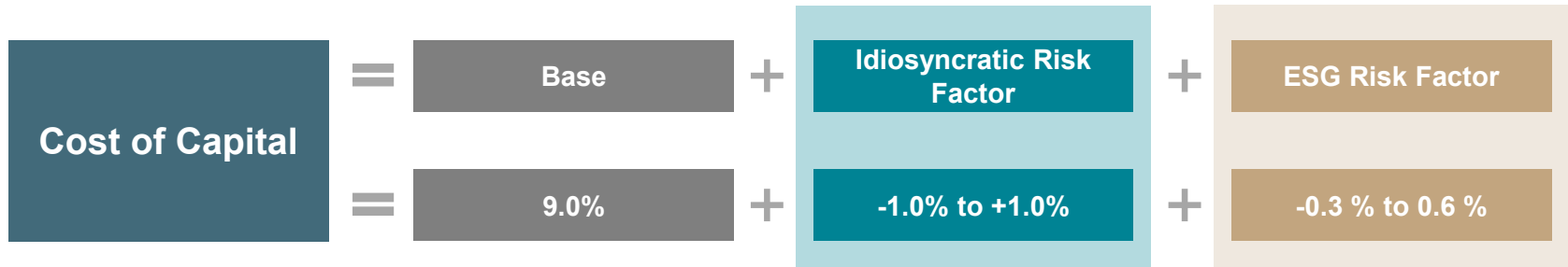


⇒ Provide a reference point to avoid overpaying for quality companies

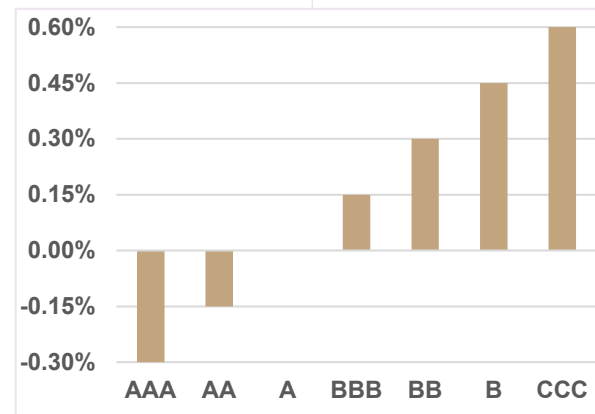
\*Bruce Greenwald et al. (2001). "Value Investing: From Graham to Buffett and beyond", Wiley Finance

# Investment Process

## Valuation Model



Risk Category



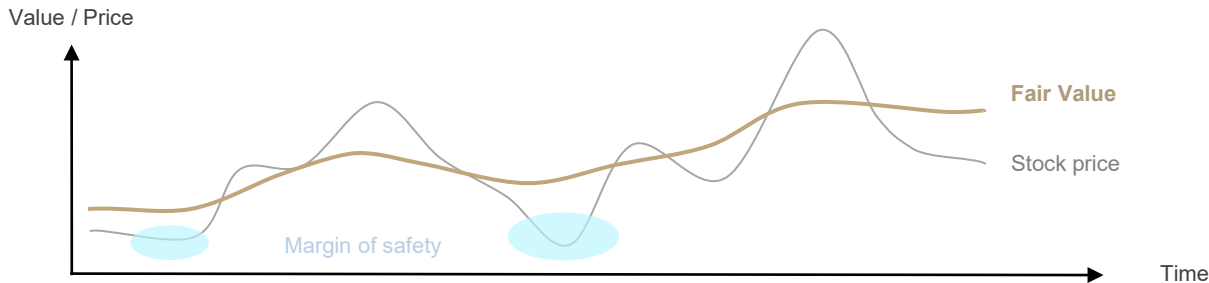
MSCI ESG Rating

⇒ Integration of several risk factors into the cost of capital that is used in the valuation model

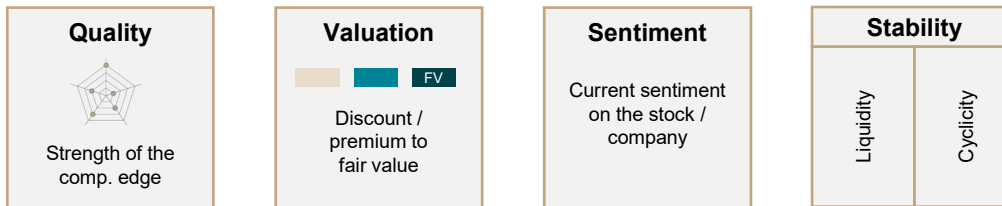
# Investment Process

## Portfolio Construction

→ Investments are initiated with a discount (margin of safety) to the fair-value



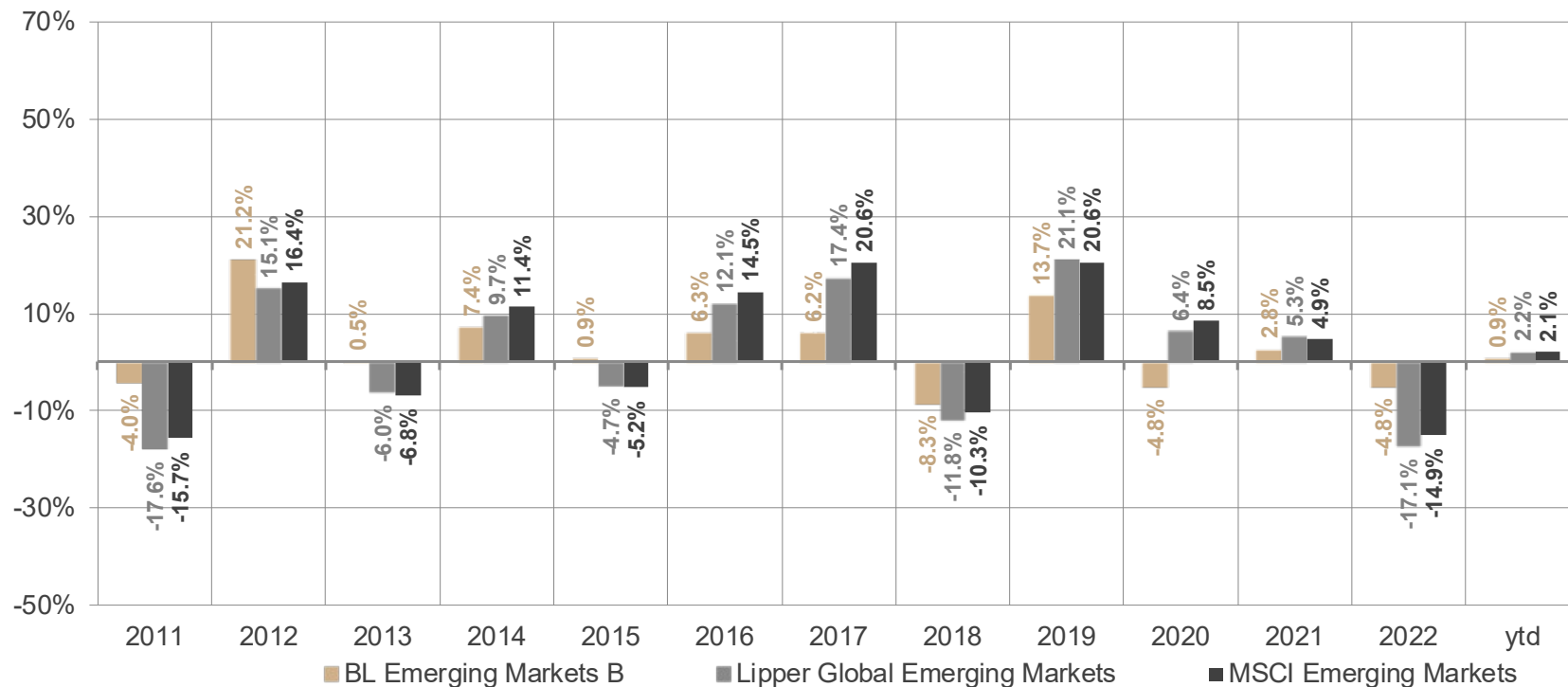
→ Investment weightings depend on the following factors:



→ Stocks are sold when the investment thesis fundamentally weakens, the growth profile deteriorates, valuation becomes excessive or better investment opportunities arise

# BL Emerging Markets

## Yearly Performance vs Index



Data in EUR as of 31/3/2023

Data source: Lipper / MSCI / BLI

Performance net of fees. Past performance does not guarantee or predict future performance. Reference to a market index is made for comparison purposes only; the market index is not mentioned in the investment policy of the sub-fund.



# Investment Process

## Competitive Advantage: Brand & Premiumization (Beer in China)



BUDWEISER BREWING COMPANY APAC  
百威亚太控股有限公司

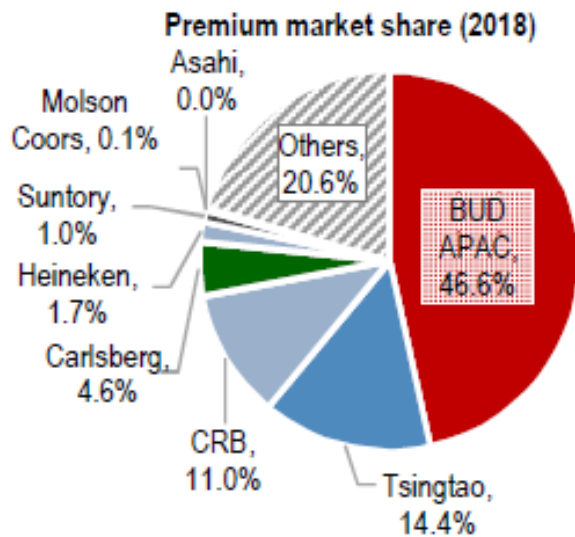


Figure 34: In China, premium & super premium segments have 5-9x profitability of the core & value segments

### Segment comparisons

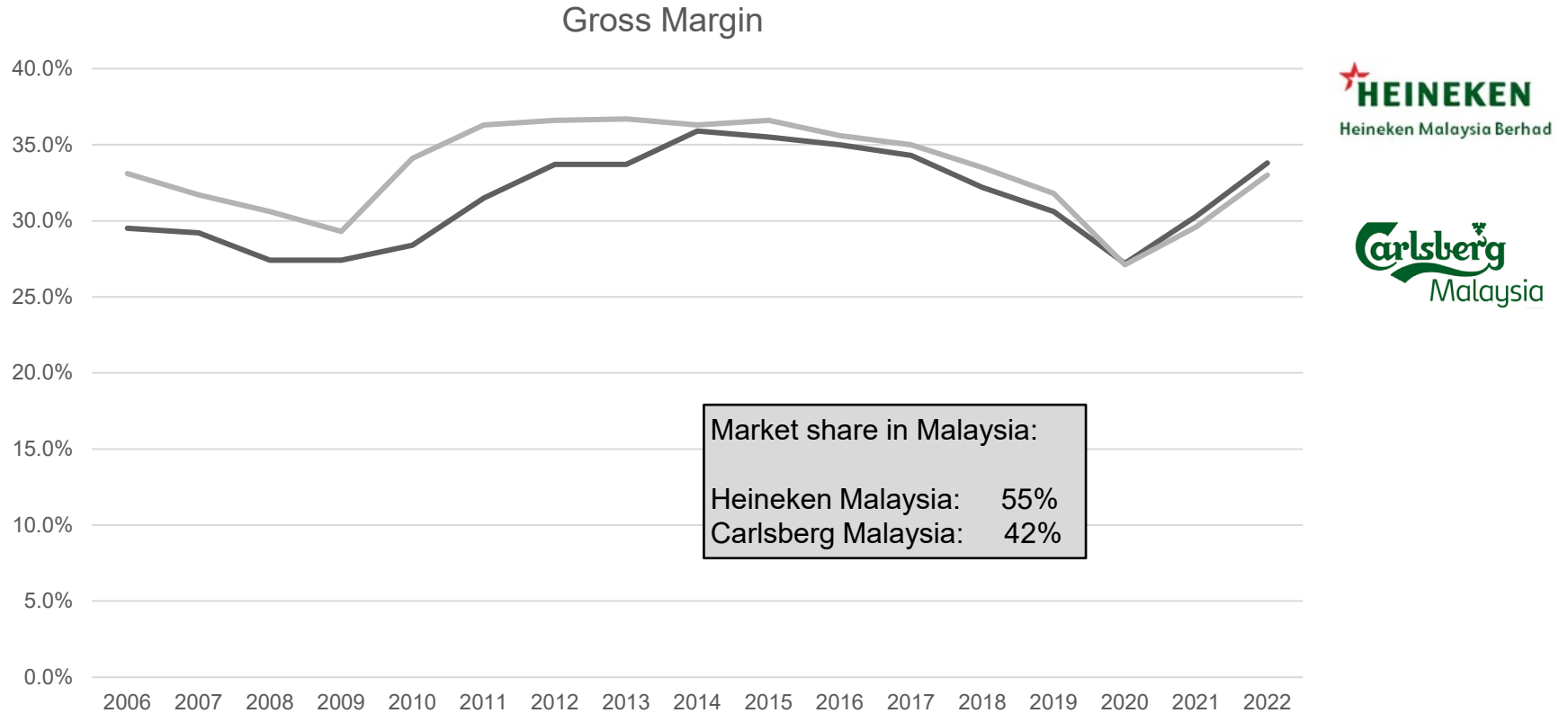
Indexed at 100% for core & value segment

	Price to consumer	Net revenue	Gross profit
Super premium	5.0x	7.0x	9.0x
Premium	2.5x	3.0x	5.0x
Core +	1.5x	1.5x	1.6x
Core & Value	100%	100%	100%

Source: GlobalData, Euromonitor, AB InBev (2015)

# Investment Process

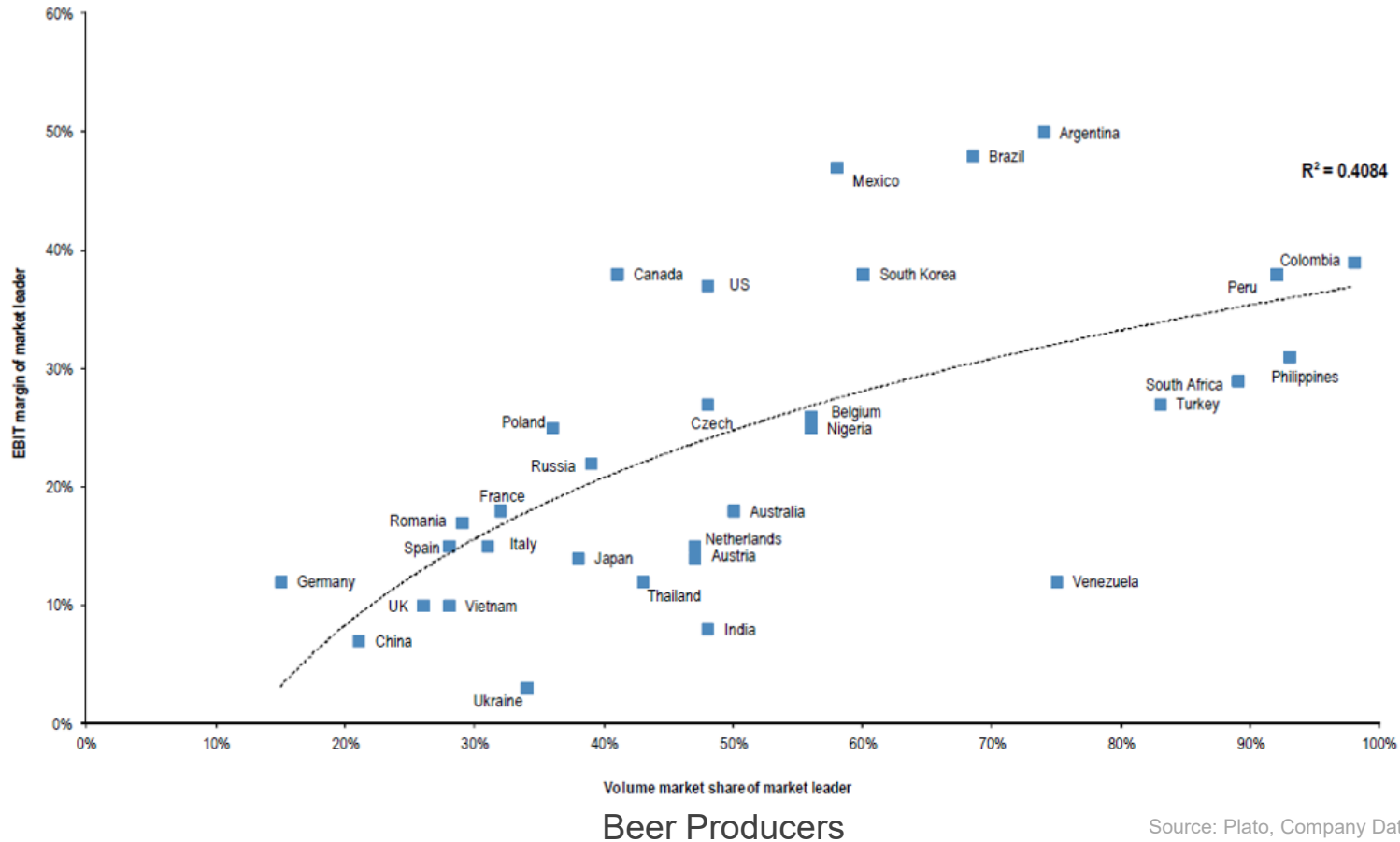
## Beer in Malaysia: Local Dominance & Economies of Scale



Source: Bloomberg, Banque de Luxembourg Investments

# Investment Process

*Competitive Advantage: Local Dominance & Economies of Scale*



Source: Plato, Company Data, JP Morgan, 2013



# ESG INTEGRATION & SUSTAINABILITY

# Investment Process

## A multi-pillar ESG approach

### Pre Investment

#### Exclusions

- **Exclusion** of companies
  - Production of unconventional weapons
  - Present in Global Coal Exit List
  - Present in different international sanction lists
  - Non compliant with UN Global Compact \*
  - Involved in highly severe controversies (red) \*
  - ...

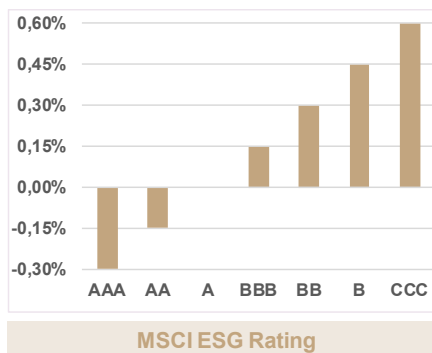
#### Controversies screening

- Ongoing monitoring to identify ESG events that may affect a company's business model and reputation

### Intra Investment

#### ESG Integration

- Integration of ESG factors in the valuation model
  - Adjustment of Cost of Equity (downwards or upwards) depending on the ESG rating \*



### Post Investment

#### Engagement & Voting

- **Active engagement**, incl. on defined impact factors
- BLI votes at the **annual meetings** of invested companies.

#### Controversies follow-up

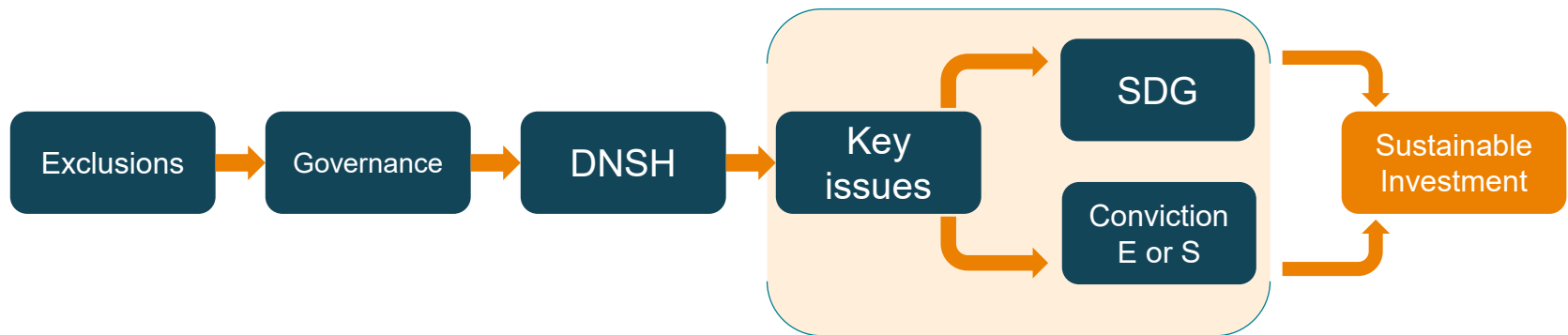
- Assess the progress realised

# Investment Process

## *Sustainable Investments*

EU's Sustainable Finance Disclosure Regulation (SFDR) classification:

- **Article 6:** funds that do not integrate any kind of sustainability into their process
- **Article 8:** funds that promote environmental (E) or social (S) characteristics
- **Article 9:** the fund's objective is targeting sustainable investments (100%)



# OUTLOOK

# Emerging Markets Funds

*Buy&Sell in 2022/2023*

## Buy

Brazil (CD): **Pet Center Comercio**  
China (CD): **JD.com**  
Hong Kong (FIN): **HK Exchange & Clearing**  
Hong Kong (IND): **Techtronic Industries (BL EM)**  
Taiwan (IT): **MediaTek**  
South Korea (IT): **Leeno Industrial (BL EM)**  
China (CD): **Fuyao Glass**

## Sell

India (CS): **Godrej Consumer**  
Philippines (CS): **Emperador**  
China (CS): **Hengan**  
Brazil (CS): **M Dias Branco**  
Malaysia (CS): **7-Eleven Malaysia**  
Mexico (CS): **Femsa**  
China (CommServ): **Tencent**

➔ mainly sold **consumer staples** (CS) and started to build positions in companies from more **cyclical** sectors like consumer discretionary (CD), financials (FIN), industrials (IND), information technology (IT).



# Investment Themes for 2023

## Emerging Markets

- Chinese government refraining from further **regulation** → key beneficiaries will be large Chinese companies mainly from the tech, e-commerce, gaming and education sectors (holdings like Alibaba, NetEase, JD.com).
- Chinese government abandoning **zero-Covid policy** → key beneficiaries will be companies exposed to Chinese tourism like duty-free channel, on-premise consumption, tourism sector (holdings like Travelsky, Cafe de Coral, Amorepacific, LG H&H, Budweiser APAC, Kweichow Moutai).
- **Inventory correction** in semiconductors coming to end by end of 1H2023 → key beneficiaries will be companies in the semiconductor supply chain (holdings like TSMC, Samsung Electronics, MediaTek, ASM Pacific, Aspeed, Leeno Industrial).
- **Commodity prices** (energy, packaging, soft commodities) peaking → key beneficiaries will be companies that were able to raise consumer prices due to strong pricing power (portfolio holdings in consumer staples or industrials mainly).
- Adani Group / Hindenburg Research → could have a negative impact on **Indian stocks** and bonds. Our EM funds are strongly underweight in Indian equities due to valuation.