



Matthews Asia

Matthews Asia Perspective

Q&A: Matthews Asia Small Companies Fund

For growth-oriented investors, what do Asia's small companies bring to the table?

Asia's smaller companies offer attractive growth potential, as well as the opportunity to gain highly differentiated portfolio exposures. For many global investors, Asia small companies are unlikely to overlap with existing investments. An allocation to Asia small caps can therefore help improve the risk/reward profile of an overall portfolio, while providing access to nimble, entrepreneurial businesses in fast-growing economies.

Is small-cap investing the same worldwide?

Some benefits of investing in small companies tend to be universal. For example, small companies everywhere have the potential to help investors capture the size factor, which is the historical performance advantage that small company stocks have had over larger company stocks over longer periods, such as five to 10 years. Another potential benefit is that stocks of smaller companies may be inefficiently priced, creating a marketplace where active management can add value. And finally, smaller companies tend to offer access to businesses whose earnings and market share are growing faster than that of larger companies.

What makes investing in small companies in Asia different than other regions?

Small companies in Asia may enjoy some distinct advantages over other regions. First, many Asian economies are growing faster than the U.S., Europe and Latin America, according to the International Monetary Fund's (IMF) World Economic Outlook. Accordingly, the structural growth potential of Asia tends to be much higher than other regions. The IMF projects that GDP across Asia could grow by as much as 5.9% in 2021, compared with 1.7% GDP growth for the U.S., 1.4% for Europe and 2.3% for Latin America. Second, the absence of older technologies in parts of Asia has encouraged leapfrogging, where new technologies and distribution channels can come to the fore more quickly. And third, the middle class in Asia is expanding more rapidly than in any other part of the world. We believe this combination of qualities makes Asia small companies an appealing asset class for growth-oriented investors.

How do you define small companies?

We typically invest in companies that have a market capitalization between US\$100 million to US\$5 billion at the time of purchase. We tend to focus on companies at the lower end of the spectrum. The portfolio's average market capitalization has historically ranged from approximately US\$1 billion to US\$1.3 billion. We typically sell out of a position when a company moves above US\$7 billion to US\$9 billion in market cap. This keeps our style purely oriented toward small caps.

Risk Considerations

The value of an investment in the Fund can go down as well as up and possible loss of principal is a risk of investing. Investments in international and emerging market securities may involve risks such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation. The Fund invests in holdings denominated in foreign currencies, and is exposed to the risk that the value of the foreign currency will increase or decrease. The Fund invests primarily in equity securities, which may result in increased volatility. The Fund invests in smaller companies, which are more volatile and less liquid than larger companies. These and other risks associated with investing in the Fund can be found in the Prospectus.

How big is Asia's universe of small-capitalization companies?

If you include small-cap and micro-cap companies, the universe is huge. The investment process for the Matthews Asia Small Companies Strategy begins with the universe of companies located in Asia ex Japan, which consists of all countries and markets in Asia excluding Japan, but including all other developed, emerging, and frontier countries and markets in the Asian region. This universe is narrowed down to over 11,000 companies by applying a minimum \$100 million market cap and maximum \$5 billion market cap. The universe is deep and diverse, with small companies now operating across all key sectors within the region's economy.

What are structural drivers of growth for small companies in Asia?

Rising domestic demand will be an increasingly important driver of regional economic growth as wealth and the size of the middle classes grow. The Brookings Institute estimates that more than 50% of middle-class consumption and spending globally will come from Asia by the year 2030. As economies shift from being export dependent to more consumption driven, they will be less influenced by the broader macro environment and issues affecting developed markets. We believe small companies in Asia are well-positioned to take advantage of these important trends, and are small and nimble enough to react quickly to the region's changing patterns of consumption.

What is the role of entrepreneurs in Asia?

Asia is synonymous with an entrepreneurial spirit and small companies have always been central to Asian economies. As the number of small companies continues to grow and their access to capital increases, they are driving both innovation and employment. Many small companies in Asia are also helping economies transition from industrials to services. Small companies can more easily cater to local populations, designing and developing products and services that appeal to local markets. Large Western multinationals, in contrast, often have a harder time gaining traction in Asian markets because they tend to have an insufficient understanding of local market nuances. As the products and services from small companies become brands in their own right, this leads to more sustainable returns on equity and returns to shareholders, making small companies an attractive investment proposition.

Are Asia's capital markets conducive to funding small companies?

Asia's capital markets continue to gain increased breadth and depth. We see small companies gaining access to capital markets as a result of several trends, including:

- ✿ A desire by owners to expand their business and create wealth
- ✿ Further deregulation in some markets
- ✿ Improved access to credit and capital
- ✿ Next-generation family management teams that have more entrepreneurial spirit
- ✿ A need for greater transparency

Local regional entities are trying to create lending channels for various countries in the region. If the availability of capital becomes challenging due to global monetary tightening, it may constrain the pace at which Asia's economies can grow. On balance, however, we see local sources of funding for small companies expanding.

What is your investment process?

At Matthews Asia, we employ a fundamental, bottom-up investment process. We seek to identify companies with sustainable long-term growth prospects, strong business models, quality management teams and reasonable valuations. In particular, we believe this bottom-up process is particularly suited for this asset class. We screen for companies with the following general criteria in mind: attractive revenue growth rates, capital efficiency, superior profitability and healthy valuations relative to industry peers or historical valuations. We spend a considerable amount of time on the ground visiting management teams in Asia to help us make qualitative and quantitative assessments of a company's operations and integrity. It is important to evaluate whether companies have both the aspiration as well as the financial ability to implement their growth strategies.

What attributes do you look for in a company?

We seek companies with high-quality business models and management teams. It is important that companies hold a sustainable competitive advantage in the marketplace that may enable them to grow and compete effectively over the long run. We prefer companies that focus on domestic or regional markets as opposed to those dependent on exports to developed markets. We also tend to favor companies with strong balance sheets and a track record of prudent capital deployment and operational spending. We seek motivated owners, and find that many of the region's small companies are typically majority family-owned businesses that possess notable entrepreneurial spirit.

How do you construct the portfolio?

Our portfolio is benchmark-agnostic and is fairly concentrated, holding around 60 to 80 names. It is constructed via bottom-up, fundamental stock selection. Our position sizes are determined by several factors such as liquidity, valuations and our conviction in corporate fundamentals. If a company grows and exceeds the upper end of the Strategy's market-cap range, we are not required to sell our holdings. We will look at the relative attractiveness of holdings in the portfolio and sell if we deem there are more compelling investment opportunities.

What risks should investors keep in mind when investing in Asia small companies?

Investing in Asia brings a number of risks. These include political, social and economic risks together with the potential for higher volatility and adverse movements in foreign exchange. In addition, some small companies may have limited product lines, markets or financial resources. Smaller companies may also be more dependent on one or a few key persons and may lack depth of management. Other issues can include poor stock liquidity due to larger portions being held by a small number of investors (including founders and management) than is typical of larger companies. Additional potential issues facing investors in the asset class include difficulty in obtaining information about smaller companies and the way in which changing market, economic, regulatory and other factors may impact businesses.

How do you manage these risks?

At Matthews Asia we take the risks associated with investing in Asia and small companies seriously. Our in-depth due diligence process is an important form of risk control. We manage the risks of investing in small companies through our knowledge of the markets and the intensive research conducted on the companies in which we invest. We conduct onsite visits as well as conference calls with management and in-person in our offices. We also carefully consider the size of each position, as well as monitor our overall sector and country exposure in the portfolio to ensure we maintain diversification.

What role does good governance play in helping companies to grow quickly?

Small companies often have management teams closely aligned with shareholder interests. This is because management teams typically have significant share holdings, creating an incentive for the company to succeed. In many cases, small companies are managed by entrepreneurs whose ambitions for their company lie beyond any short-term price movement in their stock. Their primary desire is to see the company grow. In addition, small companies often operate in industries that are in the early stages of development. Since they could become future regional or global brand leaders, they represent an attractive investment opportunity. Finally, small companies also may benefit from mergers and acquisitions activity as sectors and industries consolidate—an increasingly important trend as Asia's economy continues to grow and competition increases. Small companies also are of particular interest to large multinational companies looking to penetrate the Asian market by acquiring existing companies with strong management.

What differentiates the Matthews Asia Small Companies Fund from its peers?

Each of our portfolio team members has lived in Asia and seen first-hand the importance of the small-cap universe. We also spend considerable time on the road, researching companies and speaking to management teams. While the strategy has the ability to invest in small caps and micro-cap stocks, we generally sell those that become mid-cap or large-cap stocks, helping us to maintain a clear style discipline toward small-cap investing. Importantly, we build portfolios that look very different from our benchmark and generate high active share, offering investors true diversification and attractive long-term growth potential.

PORTFOLIO MANAGEMENT TEAM



Tiffany Hsiao, CFA
Lead Manager

Tiffany Hsiao is a Portfolio Manager at Matthews Asia. She manages the firm's China Small Companies and Asia Small Companies Strategies and co-manages the Asia Innovators Strategies. Prior to joining the firm in 2014, she was a Vice President at Goldman Sachs Investment Partners in Hong Kong and Tokyo from 2007 to 2013, responsible for Asia Pacific investments with an emphasis on equities in China. Previously, she spent six years at Franklin Templeton Investments, where she managed the firm's global communications fund. Tiffany earned her Master of Science and Information Technology from Carnegie Mellon University and received a B.A. in Economics from the University of California, Berkeley. She is fluent in Mandarin and Taiwanese, and conversational in Cantonese.



Beini Zhou, CFA
Co-Manager

Beini Zhou is a Portfolio Manager at Matthews Asia and manages the firm's Emerging Markets Equity and Asia Value Strategies, and co-manages the Asia Small Companies Strategy. Prior to joining Matthews Asia in 2013, he was a Research Analyst with Artisan Partners on the Global Value Team, responsible for covering pan-Asia stocks across all industries. Before joining Artisan in 2005, Beini spent three years as a senior product analyst at Oracle Corp. He received an M.S. in Computer Science from the University of California, Berkeley and a B.A. in Applied Mathematics from Harvard College. He is fluent in Mandarin.

Important Information

For Institutional/Professional Investors Only

The Fund is a sub-fund of Matthews Asia Funds SICAV, an umbrella fund, with segregated liability between sub-funds, established as an open-ended investment company with variable capital and incorporated with limited liability under the laws of Luxembourg.

Investment involves risk. Past performance is no guarantee of future results. The value of an investment in the Fund can go down as well as up. This document is not a Prospectus/Offering Document and does not constitute an offer to the public. No public offering or advertising of investment services or securities is intended to have taken effect through the provision of these materials. This is not intended for distribution or use in any jurisdiction in which such distribution, publication, issue or use is not lawful. Investors should not invest in a Fund solely based on the information in this document. An investment in Matthews Asia Funds may be subject to risks, such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation. The current prospectus, Key Investor Information Document or other offering documents ("Offering Documents") contain this and other information and can be obtained by visiting global.matthewsasia.com. Please read the Offering Documents carefully before investing as they explain the risks associated with investing in international and emerging markets. It is the responsibility of any persons wishing to subscribe for shares to inform themselves of and to observe all applicable laws and regulations of any relevant jurisdictions. Prospective investors should inform themselves as to the legal requirements and tax consequences within the countries of their citizenship, residence, domicile and place of business with respect to the acquisition, holding or disposal of shares, and any foreign exchange restrictions that may be relevant thereto.

An investment in the Matthews Asia Funds is not available in all jurisdictions. The Fund's shares may not be sold to citizens or residents of the United States or in any other state, country or jurisdiction where it would be unlawful to offer, solicit an offer for, or sell the shares. No securities commission or regulatory authority has in any way passed upon the merits of an investment in the Fund or the accuracy or adequacy of this information or the material contained herein or otherwise.

Matthews Asia is the brand for Matthews International Capital Management, LLC and its direct and indirect subsidiaries.

Matthews International Capital Management is the Investment Manager to the Matthews Asia Funds, and is a U.S.-based investment adviser registered with the U.S. Securities and Exchange Commission who has not represented and will not represent that it is otherwise registered with any other regulator or regulatory body.

The information contained herein has been derived from sources believed to be reliable and accurate at the time of compilation, but no representation or warranty (express or implied) is made as to the accuracy or completeness of any of this information. Matthews Asia and its affiliates do not accept any liability for losses either direct or consequential caused by the use of this information. The views and information discussed herein are as of the date of publication, are subject to change and may not reflect current views. The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles.

In Singapore, this document is available to, and intended for Institutional Investors under Section 304 of the Securities and Futures Act. It should not be circulated or distributed to the retail public in Singapore. Issued in Singapore by Matthews Global Investors (Singapore) Pte. Ltd. (Co. Reg. No. 201807631D).

In the UK, this document is only made available to professional clients and eligible counterparties as defined by the Financial Conduct Authority ("FCA"). Under no circumstances should this document be forwarded to anyone in the UK who is not a professional client or eligible counterparty as defined by the FCA. Issued in the UK by Matthews Global Investors (UK) Limited ("Matthews Asia (UK)"), which is authorised and regulated by the FCA, FRN 667893.