



Q&A from Matthews Asia

March 2021

Matthews Asia Innovative Growth Fund

What is the objective of the Matthews Asia Innovative Growth Fund?

The Matthews Asia Innovative Growth Fund seeks long-term capital appreciation by investing in innovative quality companies that can benefit from structural growth trends and large addressable markets across Asia. We aim to invest in companies that are capable of showing sustainable growth based on their fundamental characteristics.

How do you define an innovative company?

When it comes to defining innovation, we take a broad view. Innovation can drive economic moat creation across all industries. We now find five broad types of innovation driving long-term growth for business in Asia: business strategy innovation, business model innovation; product and services innovation; marketing innovation; and organizational design innovation. We aim to find companies in the early stages of their growth, and hold them until their growth slows.

Why do you think innovative companies in Asia are attractive investments?

We believe the next generation of leading innovation-driven businesses will come from Asia because the region has the key ingredients for innovation-led economic growth: large addressable markets; substantial entrepreneurial talent; and sustainable sources of capital.

Our portfolio managers believe Asia is still in the early stages of its current innovation-driven growth era. Innovation is going to be one of the key drivers of creating and retaining a competitive moat because of rising personal wealth in the region and the size of the consumer market in Asia. Historically, the main growth drivers for Asia's economy came from labor and capital-heavy industries such as commodities, materials such as steel companies, chemicals and everyday consumer products, like toothpaste, shampoo, among other things. However, as income in the region reached US\$8,000 to US\$10,000 levels, there's been a shift in the economy. Today, we see opportunities in more sophisticated industries, with many having long, multi-year and even multi-decade growth trajectories.

Where are you finding attractive innovative opportunities?

We find different types of innovative companies reflecting the different stages of development of the various economies within Asia. For example, in South Korea, Hong Kong and Singapore, we see innovation driven by aging populations, in areas such as biopharma and factory automation. In China, biotechnology and various kinds of internet services are significant economic contributors. In countries like India, we find innovation among companies providing both basic banking and private banking services.

Is this a new Fund?

The Matthews Asia Innovators Strategy has been available to investors in the U.S. since 1999. The UCITS Matthews Asia Innovative Growth Fund will follow the same bottom-up, fundamental investment approach and is managed by the same Lead Manager, Michael Oh—one of the longest-



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tenured members of the Matthews Asia investment team. Michael has been with the firm since 2000, and has been Lead Manager of the Asia Innovators Strategy since 2006. He brings a deep level of experience investing in innovative companies, whether it is a product, service or process in a new or established market.

Michael leverages the research and insights of colleagues across the broader investment team on behalf of the portfolio. He makes use of several of Matthews Asia's Knowledge Platforms, which are groups of research analysts and portfolio managers that come together to generate and discuss new investment ideas and perform industry and company analysis. These Knowledge Platforms provide more resources to not only discuss and share ideas, but also to conduct research and due diligence on companies relevant to the Matthews Asia Innovative Growth portfolio.

What experience does Matthews Asia have investing in Asia's innovative companies?

Matthews Asia has been investing in companies in the region for three decades and we understand what it takes for companies to be successful. We have a deep and diverse team of investment professionals with significant expertise of investing in the region. With a collaborative, team-based approach, our investment professionals share their insights and perspectives on the innovative companies in the region.

Since the start of this Strategy, our investments have been made across the market-cap spectrum, including many smaller "game changing" and innovative companies. We made more than 2,500 company visits in 2019 and this approach is well-suited to identifying the most attractive innovative companies in the region. Amid the pandemic, we continue to conduct extensive meetings with companies in our investment universe via video, audio and for our research teams based in Asia, also in person when it has been possible. In 2020 we conducted over 3,600 meetings, including 3,400 virtual meetings.

Why invest in the Matthews Asia Innovative Growth Fund?

Our Matthews Asia Innovators Strategy has been a highly successful approach for investing in growth companies in Asia since 1999. It is an approach that we believe will continue to be successful for identifying attractive long-term growth companies going forward.

We have long believed what many investors have come to appreciate in recent years—innovation can be a driver of productivity and competitive advantage for businesses. This investor appreciation for innovation has been channeled primarily towards companies in the U.S. during the recent market cycle (companies such as Facebook, Amazon, Apple, Netflix, Alphabet and Tesla). In our opinion, the next generation of innovation-driven business leaders will come from Asia. Many investors are now familiar with Alibaba and Tencent, but there is an

entire ecosystem and new generation of innovative growth companies in Asia. This Fund aims to provide exposure to that next generation through an investment process that includes innovation as one key criteria when we evaluate companies in our bottom-up stock selection process.

The Fund provides exposure to a number of structural themes that global investors are looking to access, such as health care, demographics, fintech, internet services, online entertainment, and educational services.

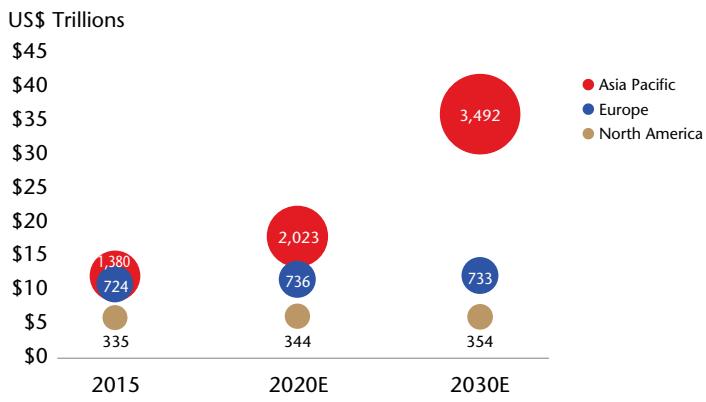
Why is innovation an important criterion to identify growth companies?

We believe innovation will have a major impact on economic growth in Asia. One reason for this is the rise of Asia's middle class. The region's middle class is estimated to be about 2 billion today—far more than North America and Europe combined. China has the largest middle class in the world and by 2022, urban household income is expected to have doubled from 2012 levels. This vast consumer market is now willing—and able—to pay a premium for innovative, high-quality products.

The Fund uses innovation as a criterion to identify high-quality growth companies in Asia that have a large addressable market and poised to benefit from structural growth trends, such as the rise of the region's middle class. We believe innovation can drive rapid revenue growth, improved competitive positioning and create an economic moat for Asian companies. In recent years, we have witnessed many innovative companies rewarded for the products and service ideas that are meeting the new demands of a region of rising wealth. We believe the opportunities being created by improving quality of life should incentivize even further innovation.

Asian entrepreneurs have contributed to the region's economies transition from a low value-added model to a higher value-added economy. This has been achieved through innovation and an ability to more easily cater to local populations—designing and developing products and services that appeal to local markets. Over the past 10 years,

Figure 1. Spending by Global Middle Class (2011 PPP)



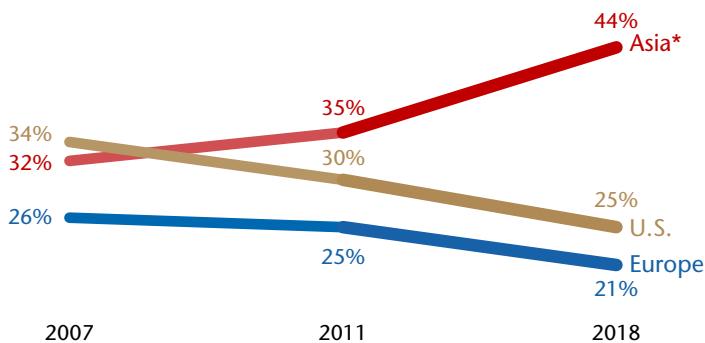
PPP = Purchasing Power Parity

Note: Bubble Size = middle class population (millions); 2020 and 2030 data points are projections. There is no guarantee any estimates or projections will be realized.

Source: Homi Kharas, 2017, The Unprecedented Expansion of the Global Middle Class: An Update

Figure 2. Investment in Innovation Rising

Share of global R&D spending



*Asia includes East, Southeast and South Asia. 2018 data points are projections
There is no guarantee any estimates or projections will be realized.
Sources: Global R&D Funding Forecast Dec. 2018, Dec. 2012; Businesswire 2009
Patent Application from World Intellectual Property Organization (WIPO) Database, Dec. 2020.

we have seen local companies become more sophisticated, and often they have a better understanding of localization and distribution than some multinational companies.

Meanwhile investments in innovation is increasing. Many policymakers in Asia have made innovation a national, strategic priority. The global share of research and development (R&D) spending by Asian companies surpassed that of U.S. companies in 2011, and the gap continued to widen in 2019. Asian companies also are increasing spending on R&D. This effort has given rise to numerous research hubs equipped with good infrastructure and skilled workers. In this way, Asian companies are increasingly laying firm foundations for future innovation.

What is your investment process?

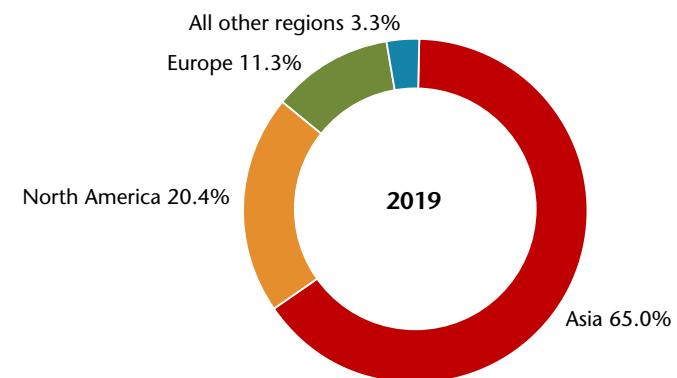
The portfolio is constructed via a bottom-up, fundamental, stock picking approach. The process starts with big ideas: the team looks for secular growth themes that provide a clear tailwind. Different stages of growth across various Asian economies present unique opportunities, from artificial intelligence and health care to education and basic banking services. The team seeks to identify beneficiaries of structural changes with large addressable markets, often led by consumer demand.

Idea generation is propelled by research trips to Asia focusing on pre-IPO, newly listed and private companies. The team also seeks ideas by regularly reviewing incumbents' business models to find opportunities for disruption.

When looking at a company, the team focuses on four key pillars:

1. Secular Growth Assessment—Examining whether a company has a clear secular growth tailwind and is the dominant player in emerging industries can help assess a company's future growth trajectory. The team avoids companies in declining industries and looks for the beneficiaries of structural changes such as evolving consumer behavior and disposable income growth. Another key factor is whether the company has a large addressable market with a scalable business model.

Patent application by region



2. Innovation Assessment—Looking at a company's innovativeness includes a qualitative assessment of five key areas of innovation: business strategy innovation; business model innovation; product and services innovation; marketing innovation; organizational design innovation. A quantitative assessment includes look at R&D spending in terms of revenue; R&D to product (RDP) conversion ratio; the number of patents filed; and higher than average growth.

3. Quality Assessment—Evaluating a company's sustainable growth prospects and identifying economic moats includes looking for prudent capital allocation, a quality management team, strong corporate governance standards and a solid balance sheet.

4. Appropriate Valuations Assessment—Focusing on the potential for market-cap growth potential is often a starting point for assessing valuations. The team also considers a multiple-based analysis relative to history and peers, as well as ROIC, ROE, free cash flow yield.

If the four pillars are in place for a given company, a position may be established.

How is the portfolio constructed?

We seek to construct a concentrated portfolio of companies at the forefront of innovation in the Asia ex Japan region. The portfolio typically holds between 30 and 50 high-conviction stocks, diversified across sectors, countries and market capitalization. The Fund is unconstrained and benchmark-agnostic; exposures are a by-product of bottom-up stock selection.

Position sizes are guided by analysis of long-term risk/reward, valuation and the team's conviction in corporate fundamentals. New positions tend to be modest, in the range of 0.5% to 1% of the portfolio. As the company meets the milestones established by the team, conviction grows and the position size can be increased. Although there is no stated maximum position size, a single position does not typically exceed 6% of the total portfolio.

How are ESG factors integrated into your investment process?

ESG factors are an important input into the investment process, with a primary focus on understanding and mitigating material risks facing our portfolio companies. Our overall company analysis includes a strong focus on certain factors which some investors consider to be "ESG" factors, but which Matthews Asia considers "core" to understanding the sustainability of revenues, cash flows, and profits—regardless of what label may be ascribed to this analysis. These factors include the commitment and ability of a firm to sustainably address labor matters, policy and regulatory requirements, customer interests, dividend policies, and minority shareholder rights.

From a research perspective, a critical component of our meetings with company management is our in-depth analysis of the company's corporate governance structure, philosophy, and commitment. We probe management's thinking on business models, capital allocation, budgeting and utilization as well as future growth initiatives, competition, and other issues. We seek to develop a view on the integrity of management, their alignment with minority shareholders, and their ability to effectively manage the company through market and economic cycles.

How do you decide when to buy or sell?

Although we seek to develop the conviction to invest in companies for the long-term, many factors may result in selling a company. Positions can be trimmed or exited for three reasons:

1. Declining fundamentals—this includes corporate governance issues, industry dynamics or changes in regulatory risks, and management changes

2. Identification of a better alternative

3. Extreme valuations—in this case, the position may be more likely trimmed than exited completely

We invest with a long time horizon. At the same time, our clear sell discipline and the fast-moving nature of innovative industries may result in occasional periods of temporarily higher portfolio turnover, particularly during inflection points for the market.

What sectors offer innovative companies?

The Fund aims to identify innovative companies across all sectors and industries without sector or industry limitations, which we believe allows our experienced lead manager to uncover opportunities ahead of other investors and capitalize on key economic developments in the Asian region.

We look for companies that can create sustainable value through innovation in their products, services, processes, business models, management, use of technology, or approach to creating, expanding or servicing their markets. This focus leads to an emphasis on technology, internet, health care, and other service oriented industries such as discretionary, staples, and financials.

We typically avoid mature companies in certain industries that we believe currently lack innovation such as utilities or industrials. However, our view could change if and when we detect innovation among players in these industries.

What is the country exposure of the Fund?

The Fund seeks innovative companies in Asia ex Japan. Different stages of growth across various Asian economies present unique opportunities, from artificial intelligence and health care to education and basic banking services. The team seeks to identify beneficiaries of structural changes with large addressable markets, often led by consumer demand.

The explosive growth of China's emerging middle class, for example, brought sweeping economic changes to the global economy and transformed China's equity market. The quality and variety of companies accessible to investors improved with many innovative companies disrupting the status quo. As a result we find many exciting opportunities in China. We also find innovative business models in South Korea and are keeping a close watch on India as an economy with the potential to become one of Asia's next innovative hubs.

Asia also has many emerging countries whose middle class has not yet entirely emerged. The ASEAN (Association of Southeast Asian Nations) region, which includes Indonesia, Malaysia, the Philippines, Thailand, Myanmar, Vietnam, is a compelling area of focus for future growth. With an overall population of about 625 million, this region holds exciting potential despite still being relatively poor with an overall middle class that is still developing.

Can you provide specific examples of innovation in Asia?

China is a good example of how innovation is generating opportunities in Asia. China has fully embraced the digital age, with retailers going straight to e-commerce, skipping over brick-and-mortar in many cases. China's merchants have already embraced digital currency and internet companies are penetrating deeper into the everyday lives of Chinese consumers in almost every aspect. Internet companies have touched upon just about every major life purchase—from cars to homes to insurance products. Mobile internet penetration in China is among the highest in the world, and China is often leading the innovation by creating new markets and services in the mobile internet space. China is also fully embracing financial technology and a broad range of online services as well. Along with Indonesia, it has among the highest levels of mobile banking penetration.

In India, we find innovation in basic banking services with the introduction of digital bank initiatives. Some Indian banks have leapfrogged by adopting the latest in technology, be it digital banking products and services or artificial intelligence to transform front and back office operations.

In South Korea, we find innovation in the production of DRAM (dynamic random access memory) and NAND (nonvolatile memory) and South Korean companies are benefiting from growing worldwide demand for products that employ semiconductors. By some estimates, there were be more than six network connected devices per person globally in 2020, fueling growth for flash memory products in Asia and worldwide.

Meanwhile we increasingly see innovative companies that address ESG issues. The global market for electric vehicle batteries is expected to grow tenfold in the next 20 years, and Asian countries, in particular China and South Korea, are poised to be major players, both as producers and consumers. We also expect that as disposable incomes rise, Asian consumers will turn towards brands that are environmentally responsible and socially ethical.

Health care is also an area where innovative companies are making great strides on the social front for improving quality of life for a broader range of patients across the developing world. The diversity of the health care sector goes well beyond biotech, including device companies, service providers such as hospitals and contract research organizations and pharmaceuticals. Health care is a natural sector where ESG and innovation tend to intersect, generating compelling growth opportunities for long-term investors.

What are the principal risks inherent to the Fund, and how are they mitigated?

Our first objective is to avoid permanent loss of capital in the companies in which we invest. We believe that by investing in high-quality companies with strong and sustainable competitive advantages, along with capable and committed management teams, we lower the overall investment risk for the Fund. Given the types of companies in which we invest, however, along with our benchmark agnostic approach, volatility may be higher at times than it is in other, more traditional Asian equity funds.

In addition, when we see opportunities, we attempt to invest in early-stage publicly listed companies. Higher risks may be involved at the initial investment stage. We try to avoid the excessive risks associated with early-stage investing by identifying companies with proven business models that have been tested in other markets. We also tend to keep position sizes small for early stage companies. By focusing on the possible risk of permanent capital loss and emphasizing long-term development over short-term volatility, we believe we increase the odds of delivering solid, long-term performance for our shareholders.

Share Class

Share Class	ISIN	Bloomberg ID	SEDOL	Minimum Investment	Management Fee
I ACC (USD)	LU2298459939	MAIGIUA LX	BLR7817	US\$100,000	0.75%
I ACC (GBP)	LU2298460192	MAIGIAG LX	BLR7828	£50,000	0.75%

Portfolio Management



Michael J. Oh, CFA
Lead Manager

Contact Matthews Asia

To learn more about Matthews Asia or how the Matthews Asia Funds can complement your globally diversified portfolio, please call +1 (415) 954-4510 or visit global.matthewsasia.com.

Important Information

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