



Our Thoughts Ken Applegate in China

One of the benefits of managing the International Growth Fund is that we have the flexibility to invest anywhere outside of New Zealand and Australia. The world is our oyster. While there are great companies in the United States and Europe creating shareholder wealth, some of the most compelling investment opportunities are in Asia.

Critical to our investment success is a deep understanding of the companies in which we invest. This means that Scott Brown and I travel the globe and typically meet with more than 300 companies every year. I have just returned from a two week trip to Asia which confirmed our bullish view on China as an investment destination.

Trip Summary

I visited four companies in two provinces in China; meeting with two of our current companies (Wasion Meters and Zhuzhou CSR Times Electric) and two potential investments, one of which we have subsequently added to the portfolio. I also met with 33 different companies during two investment conferences in Singapore and attended presentations by economists and politicians including Laura Tyson (US President Obama's economic advisor) and Jim Rogers (a legendary investor).

In addition to these meetings, I hired an interpreter to speak to dozens of 'local' Chinese at department stores in four cities in China. You can't beat actually seeing and hearing first hand what the mood and sentiment is like amongst consumers and business owners.



- Hunan Province**
 - Changsha
 - Zhuzhou
- Fujian Province**
 - Xiamen
 - Quanzhou

Key Themes we are tapping into

We have consistently talked about the shift of economic power from the West to the East. One of the key investment themes we have identified within the International Growth Fund is the urbanisation in China driven by the emerging middle class. Less than 50% of people in China live in cities, but as you can see in the graph below, more and more people are moving to cities every day. Most developed countries have an urbanisation rate above 80%, in New Zealand it is 86%. To put the scale of this into perspective over the next 20 years more than 300 million people in China will move to cities – that's equal to the entire population of the US. Think about the infrastructure required and the increased wealth and consumption that will develop with this trend.



One of the prime beneficiaries of this is the upgrade of the railway network in China. The Chinese use rail more than five times as much as other countries. The development of China's rail infrastructure has dramatically lagged demand growth making it the busiest rail system in the world in terms of traffic. Given the Chinese economic growth engine and the trend toward urbanisation, the need to upgrade the railway

Key Themes we are tapping into (cont.)

system in the country is critical. I met with Midas Holdings and Zhuzhou CSR Times Electric on this trip. The CEO of Midas Holdings commented that the NZ\$200million in orders announced over the past month, which has increased their order backlog to nearly 2 years, is “just the tip of the iceberg”. The Chinese government has committed to this as a key initiative over the next decade. Nearly half of the Rmb4trillion (NZ\$900billion) stimulus package announced last November is being allocated to upgrading the transportation network. We expect many years of strong growth ahead.

China is a big place and conditions are not the same countrywide. Where you live has a big bearing on your future prospects. If you live in the coastal areas, life is tough. You have been impacted by the export and manufacturing slowdown. Companies are going out of business, unemployment is rising, the shops are empty and everything is on sale. You hear stories of the millions of people leaving the coast and going back inland – it is easy to see why. It is the exact opposite if you live in the central or the northern parts of the country. These areas are benefiting from the stimulus package, all the infrastructure investments and the liquidity banks are pumping into these regions. Life is great if you live here as there are plenty of jobs, increasing wealth and people feel optimistic about the future.

Introducing a new company – China Zaino

During the trip I was able to visit one of the companies I have been researching for a number of months. After meeting with the CEO Perry Chen, a tour of their facilities and retail outlets we made the decision to invest in the company.

China Zaino is China’s leading backpack and luggage company with more than 3,000 stores throughout China. Their retail brand is called Dapai and is focused on the mid range market. Given their scale in the baggage industry they have become the low cost producer and developed the Dapai brand through advertising, promotion and sponsorship endorsements. This has enabled them to maintain market leadership. Growth in the future will come from opening additional stores, further penetration of the luggage market and new product lines.

This is a great company but we think could make for an even better investment. The stock is currently trading below the cash on the balance sheet so you are essentially getting the business for free. How can this be? The company listed on the Singapore exchange in April 2008 and the stock has since been savaged by the bear market as small cap and consumer stocks fell out of favour. In addition, given the company doesn’t fit into a broader industry sector, bankers and analysts haven’t supported the stock. More recently the Swine flu has impacted travel related stocks.

Some of you may have visited Beijing or Shanghai but that is not where we see the best investment opportunities. Companies we speak to increasingly talk about how hard it is to make a profit in the larger cities given how competitive and expensive it is to conduct business there. The opportunity for growth in the future is in the smaller tier 2 and tier 3 cities. By small I mean with a population of 1 to 5 million people. These cities also happen to be located inland or to the north where all the stimulus monies are flowing. The Chinese are flocking to these cities to get jobs. The companies we own in the International Growth Fund focus on the emerging opportunity in tier 2 and tier 3 cities. Because they are smaller companies these small city opportunities have a positive impact on their earnings. I visited Changsha and Zhuzhou, both ‘small’ cities in the Hunan province, and they are buzzing with excitement. When I went to two of the local Home Inn hotels in Changsha they were fully booked and commented how strong business is. The other great advantage of investing in smaller companies is that we get direct access to the Chief Executives. This helps us really understand the businesses in which we invest. The photo at the top of this article shows the welcome by the CEO of Wasion Meters when we arrived at their facility in Changsha, Hunan Province – outstanding!



China Zaino is China’s leading backpack and luggage company



Ken in discussion with the CEO Perry Chen

Introducing a new company – China Zaino (cont.)

I have completed thorough due diligence on the company including the day I spent with them at their facility in Quanzhou, Fujian Province. The last stock we owned that was trading below cash was O2Micro. Now the stock is up 150% from its low. China Zaino is waiting to be discovered!

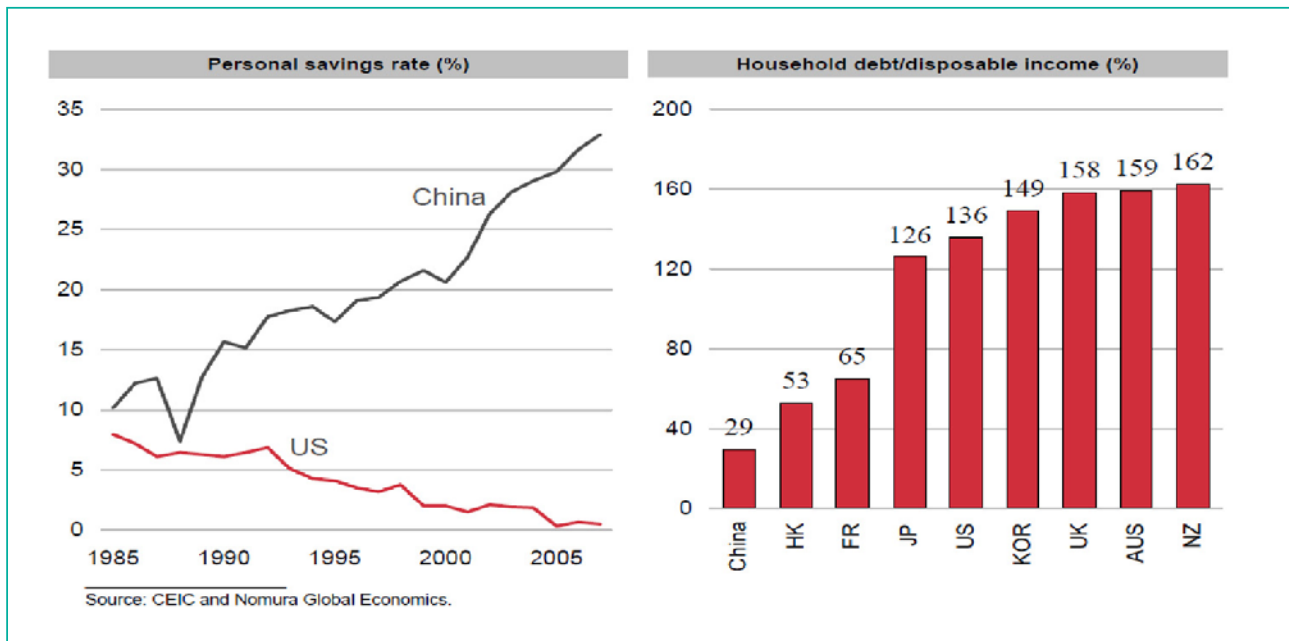


Construction of a new manufacturing facility that will double capacity and be ready in early 2010

The Outlook

China recently reported Q209 GDP growth of 7.9% and we believe this is poised to accelerate to a long term average of more than 9% per year. More importantly the quality of growth continues to improve as China will not be relying on its export sector. The growth batons in the future will be infrastructure spending, domestic demand and

increasing consumption. As you can see from the chart below the US and China are coming from two very different places. The Chinese consumer is starting from a strong base; incomes have been growing for a decade and they have a high savings rate with low levels of debt and leverage.



We have already started to see the fruits of our exposure to China in the International Fund with the fund up 26%* since the start of 2009. China is leading the global economy out of recession and the International Growth Fund is well positioned to benefit from this growth.

*Performance to 24th July 2009

If you would like to discuss the International Growth Fund in more detail or to add it to your investment portfolio, please call us on 0508 FISHER (0508 347 437).

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