ARISAIG ASIA DIARY

January 2010

ARISAIG PARTNERS
INVESTMENT MANAGERS

Performance

The NAV of the Asia Fund declined by 3.6% in January in what were choppy markets. A combination of mounting inflationary pressures in China, US Dollar strength and fears of trade spats unsettled markets.

We anticipate more of the same over the coming months, with the prospect of a full scale trade war being the most worrisome. Not that we would blame Mr Obama for adopting a more heavy-handed tack, his early overtures having failed to register in Beijing. China's increasing shrillness suggests disquiet beneath the surface. Perhaps the mandarins looking into SOE bank balance sheets don't like what they see.

Background noise aside, our holdings are reporting strong underlying growth - and this is all that really counts. Colgate India, for example, announced third quarter YOY revenues up 17% and net profits up 36%. Its market share in toothpaste has edged up to over 52% as it continues to take share from Unilever.

With only 7% of Indians brushing their teeth twice per day, the upside for Colgate remains huge. Of course competition could intensify, but with Colgate enjoying EBITDA margins of 24%, even after advertising spend of 15% of revenues, it would be a brave company to take it on. We suspect that P&G will focus its fire power on skin care and cosmetics where Unilever is also weak.

Meanwhile, Marico and Godrej have announced nine month YOY profits up 29% and 48% respectively.

Fund Restructuring

As we indicated in our December Diary, we will be asking shareholders to vote in April on the following proposals:

1. The amalgamation of our four specialist sub-funds - Greater China, India, ASEAN, and Korea - into Arisaig Asia Fund. With only 25 holdings we see no reason to retain the present structure. Almost all of those investors who were positioned at the sub-fund level have now, at our suggestion, migrated to the Asia Fund.

2. A reduction in the management fee to 1.5% per annum on the first USD1.5 billion and 1% thereafter. This compares to the existing 1.75% flat fee.

3. Lengthening our performance fee arrangements such that: (a) we have to beat our hurdle of 12.5% per annum over three years (instead of one year as currently); and (b) any fee earned (10% of the surplus) is locked up for a further three years in shares of the Fund (instead of two years as currently).

FUND DETAILS: as at 31 January 2010

	AAF*	ASEAN	AIF	AGCF	AKF
NAV (US$):	25.60	32.06	42.08	33.08	55.56
SIZE (US$M):	1,209.9	192.5	472.8	548.4	89.0
UNITS ISSUED (M):	47.3	6.0	11.2	16.6	1.6
LAUNCHED:	31.12.96	1.4.98	11.6.99	1.6.00	6.10.00
AAF% HOLDING:		14.6	36.7	41.4	7.2

* AAF is a holding fund investing in our specialist sub-regional funds.

4. Renaming the Asia Fund the "Arisaig Asia Consumer Fund". This step underlines our commitment to honour and respect this single focus which we believe, both based on our back testing and intuition, will deliver our investors "Alpha" over the long term.

Staff news

The reduction in management fee comes at our initiative. We recognise that tracking 60 or so dominant consumer companies, plus keeping a close eye on emerging dominant consumer companies, is less exacting than running a portfolio of 130 micro caps.

Indeed, we have taken the difficult decision in recent weeks to reduce our headcount from 39 to 35. Of the 35, four work on our Africa Fund and two our Latam pilot fund, which we plan to open to third party investors later this year. This leaves us with nine analysts in Asia spread between our offices in Singapore, Hong Kong and Mumbai.

Six employees have also become shareholders in Arisaig Partners with effect from January 2010. A further six are now participating in our three year profit share scheme, which leads into equity ownership. We anticipate that three years from now at least 15% of the company will be owned by employees.

Digging deeper

Our single-minded focus allows us to delve deeper. For example, we are finalising a 200 page report into the brewing industry in Asia, which may lead to the addition of one more holding. We have undertaken a similar exercise in Africa, where we own four breweries. Copies are available upon request.

We are also putting the finishing touches to reports on the confectionery sector in Asia (unearthing important China/India comparisons culminating in a "ROOT assault"); Coke bottlers the world over; and the drugstore sector in Latam (based on an analysis of the success of Walgreens in the US).

PERFORMANCE TO 31 January 2010 (%)

Performance	10 year	5 year	3 year	2 year	1 year	6 months	1 month	YTD	Since Launch	Annualised Return
Arisaig Asia Fund (%) *	+154.5	+52.9	-0.2	-15.3	+67.9	+14.4	-3.6	-3.6	+281.7	+10.8
Arisaig ASEAN Fund (%)	+100.0	+16.2	-28.1	-27.1	+45.7	+6.8	+2.3	+2.3	+220.6	+10.3
Arisaig India Fund (%)	+81.5	+56.9	-13.7	-35.9	+65.5	+15.0	+0.5	+0.5	+320.8	+14.4
Arisaig Greater China Fund (%)	N/A	+72.4	+31.7	+8.4	+87.5	+16.6	-8.1	-8.1	+230.8	+13.2
Arisaig Korea Fund (%)	N/A	+86.5	+10.9	-1.6	+61.3	+22.9	-6.9	-6.9	+455.6	+20.2

* Reflects the performance of the Arisaig Asian Small Companies Fund from 31.12.96 to 21.1.00 and thereafter the performance of AAF.

Vinay spent ten days in January introducing the CEO of one of the world's largest independent brand management companies (who happens to be a personal acquaintance) to our Indian holdings. He gathered insights into their product pipeline and marketing plans in this process. His meetings underlined just how important brand building will prove to be for the indigenous companies in India if they are to meet the MNC challenge.

Meanwhile Thiam Soon led an expedition to Dongguan, Shanghai and a wholesalers' market in Hangzhou to investigate how the distribution strategies of the indigenous Chinese F&B companies differ from those of the MNCs. This trip revealed one reason amongst many why local companies, all Taiwanese controlled, have been so much more successful.

It seems that chained retailers ask for incremental volume rebates - the higher the volume sold, the greater the rebate - and then exploit this system by over-ordering and "dumping" products onto the wholesale market, pocketing the spread generated by the rebate. Companies operating in China therefore require strong sales teams on the ground to smooth the process. Tingyi, for example, has 17,000 salesmen across the country.

This perhaps also explains why some companies, despite spending aggressively on advertising and promotion, have been unable to sustain strong early momentum (the Korean-owned ones most obviously). Of course this also means that the successful Taiwanese-owned businesses are fast becoming the joint venture partners of choice. We see Hsu Fu Chi being an obvious candidate given its strong market position in candies.

Two sides of Asia - Vietnam versus Korea

Whilst James ventured to Seoul, where the temperature was minus 18 degrees centigrade, Lindsay led a squad of four of our analysts to Vietnam, which he found considerably warmer and altogether more exhilarating.

Vietnam is often described as a mini-China. Our visits to Ho Chi Minh and Hanoi reinforced this impression: a population larger than Germany's (half under 25 years of age), bustling with energy and dynamism. This is still a frontier market - supermarket spend is still only USD 11 per capita per annum, one tenth of that in Thailand. We have a number of businesses in the food retail and fast food sectors within our peripheral vision, but most are still too small to back.

We met the lady CEO of our holding Vinamilk, the market leader in Vietnam's dairy sector. This is a company that seems to have got the plot. Sales have doubled and profits quadrupled over the past three years; yet working capital intensity has steadily declined. Despite generating ROCE of 49%, the stock still trades on only 10x 2010 earnings and yields 5.8%. With revenues of USD 700 million, Vinamilk more than satisfies our criteria of a dominant consumer company with miles of upside.

Korea, on the other hand, remains a country of paradoxes: still on steroids, and yet hurtling in the wrong direction; one of the most wired on the planet, yet backward in terms of social infrastructure. Once its electronics, auto and shipbuilding industries have gone offshore what will remain beyond pickling cabbage and cutting hair? Decades of misallocated resources and ingrained social introversion cast a long shadow.

That said Korea has, over the years, proven to be one of the best stock-pickers' markets and in LG H&H we have a cracker. Its CEO, the charismatic Mr. Cha, a former head of P&G in Asia, is just the man to take advantage of the inefficiencies in the FMCG and F&B sectors which arise, like in Japan, on account of the mostly invisible, yet deep-seated, barriers to entry that have marginalised MNC competitors.

His latest acquisition, the discount cosmetics chain Face Shop, is an easy add-on to his mid- and high-end cosmetics business with multiple synergies for the taking. For his next trick he is eyeing an own-brand beverage business to augment his Coke distribution network. We hope to be riding on his back for years to come.

It is hard for foreigners to comprehend the importance of cosmetics in North Asia. The average Korean woman applies four face creams per day (in Japan this number is over six!). With its rock solid door-to-door sales network (we interviewed a number of sales ladies) and a stranglehold on both department stores and street level outlets, Amore Pacific, our other holding in Korea, continues to go from strength to strength.

Amore is one of the few Korean companies that stands a chance of building a sustainable business in China. China revenues surpassed USD100 million in 2009 and we expect China profits to match those of Korea by 2015.

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ASSET ALLOCATION (%)

	AAF	ASEAN	AIF	AGCF	AKF
Hong Kong	4.9			11.8	
China	34.2			82.4	
Korea	7.1				98.9
India	30.4		82.9		
Sri Lanka	4.5		12.1		
Pakistan	1.4		4.0		
Singapore	1.6	11.3			
Malaysia	2.2	15.2			
Thailand	0.6	4.0			
Philippines	2.0	13.8			
Indonesia	4.9	33.4			
Vietnam	1.6	11.2			
Cash	4.6	11.1	1.0	5.8	1.1
Total	100.0	100.0	100.0	100.0	100.0

SECTOR ALLOCATION (%)

	AAF	ASEAN	AIF	AGCF	AKF
Food & Beverage	44.6	32.3	43.5	53.6	24.2
Consumer Products	26.4	33.4	44.0		74.7
Retail	4.6	19.2		4.3	
Services	4.2		11.4		
Supermarkets	15.0			36.3	
Other	0.6	4.0	0.1		
No. of Core Holdings	25	5	9	8	3
Top Ten Holdings (%)	58.7	88.9	99.0	94.2	98.9
Top Twenty Holdings(%)	84.5	88.9	99.0	94.2	98.9
Ave Mkt Cap (US $m)	2642	3052	1966	3091	2985
VALUATION (Dec'10/Mar'11)					
PER Weighted (x)	20.0	16.5	21.3	20.5	16.3
PER Harmonic (x)	18.1	14.8	20.4	18.7	12.9
Yield (%)	2.5	2.9	2.3	2.7	1.3
P/BV (x)	7.5	7.5	12.0	3.9	3.9
ROCE (%)	50.5	48.8	84.0	25.2	22.7
EPS Growth (%)	16.6	20.0	15.0	16.3	21.0