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Stewart Investors
Sustainable Funds Group

Asia: Playing the Long Game

Risk factors

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Investment terms

View our list of investment terms to help you understand the terminology within this document.

Time-horizons matter. In a world beset by an ever-expanding list of developmental, environmental and economic challenges, a long-term mind-set is crucial if companies are to not only survive, but contribute and benefit from the necessary changes required over the coming decades. But with the average tenure of a CEO now close to five years[1], and the average holding period for a stock less than six months[2], time horizons are collapsing when they should be expanding. In 2020, lockdowns, loose monetary policy by central banks and stock market euphoria combined to create an environment plagued with short-term pressures. We believe being able to think and act for the long-term is one of the strongest, and rarest, assets a company can have today.

In the two hundred or so corporate meetings we conducted this year we focused more than ever on understanding where management teams were making long-term decisions that required sacrificing near-term profitability in order to improve value-creating opportunities in the years to come. These decisions tend to reflect time-horizon and sense of purpose, especially at a time of crisis. If time horizon is short and sense of purpose ambiguous then such tough, long-term decisions are near impossible to make and long-term success, and survival, is compromised.

It is for that reason that we believe, over the long term, stock prices closely match growth in underlying business value, and, over that time frame, it is the quality of the people that influence whether value is created or destroyed. Brand strength, technological lead or the attractiveness of a platform are essential but not sufficient ingredients of long-term success. For even unique assets that are not nurtured and invested in, will succumb to deterioration and see any associated excess profitability competed away.

In 2020, companies capable of looking through next quarter's expectations and next year's results, and continued making long-term decisions, have been able to compound their competitiveness relative to peers. We have seen many of our companies gain market share, launch new products and partake in opportunistic mergers and acquisitions (M&A).

The value of a long-term approach

We invest in a Hong-Kong listed manufacturer of power tools, and believe they provide an example of the benefits of being able to play the Long Game. We like the company's collection of brands, proven track record of innovation and leadership in an industry well-placed to deliver attractive long-term growth. The power tool market is relatively consolidated with their major competitor being a large US company. The company is majority owned by a family steward while their US competitor has no long-term owner, or discernible culture, and so serves at the pleasure of short-term shareholders. Watching how these companies have managed themselves through 2020 provides a great insight into the outcomes of time-horizon and, in our eyes, quality.

During the depths of the COVID-induced panic, in line with their historic behaviour and true to their goal of achieving global leadership, the company's management made some important long-term decisions (see quote below).

In contrast, their competitor announced an 'initiative' to cut USD1bn in costs[3]. We believe that any business with that kind of excess has either been materially mismanaged or is cutting into muscle rather than fat. While the long-term impact on their brand and innovation capabilities are unquantifiable there is little doubt that key assets are being under-invested in to save this year's bonus. Such behaviour tends to be the rule rather than the exception for companies with no mission, overriding purpose or long-term destination in mind.

We have since seen the company continue to gain market share - a trend that is likely to continue as they remain focused on building long-term assets while peers focus on preserving their bottom-line. Another tangible outcome of their divergent approach, and a major reason why we like the company, is their unassailable leadership in battery technology. A relentless focus on research and development (R&D), where they spend twice as much as a percentage of sales versus competitors, has steadily compounded to a point where they are now one of the largest manufacturers of batteries globally. Their leading battery-powered range has improved safety and environmental outcomes for consumers, as well as improving franchise strength by locking users onto their platform, helping to ensure repeat purchases. The strength of their battery ecosystem and the attractive positioning of the franchise for sustainable development are outcomes of numerous decisions to forgo short-term profitability in order to build something great, and enduring, in the long-term.

We believe the company's long-term mind-set, innovative culture and competent management will continue to deliver long-term success. These enduring factors will not be evidenced in ESG scores or fit conveniently into a model but continues to be key to our conversations and analysis.

Culture as a competitive advantage

In our March letter – COVID-19 and Investment returns in Asia - we highlighted that our Indian IT companies had frustratingly failed to protect capital during the market sell-off. Tech Mahindra, Tata Consultancy Services (TCS), Cyient and Infosys[5] all help corporates across the world to evolve and enhance their business models through the use of

> "We invested more in manufacturing capacity. We also invested aggressively in even more product development. We wanted to accelerate product development because we felt there were so many opportunities for us to capture market share and to increase the pace in which we are achieving global leadership in the tool market. And we also decided to invest heavily in rolling out more salespeople. We wanted - we felt strongly that if our customers, if our retail partners and our distributors were open for business during the virus, then we had to be in those stores, in those showrooms, helping our customers sell through their products and helping the end users select the right tools."

Company CEO, August 2020.[4]

technology. These companies saw large portions of their market capitalisations wiped away in short order as the market assumed pressure exerted by large-scale lockdowns would force corporates to curtail investments and consequently reduce the Indian IT companies' cash flows. We spoke with each of these companies throughout the depths of the sell-off. Like us, they had little idea of what lay ahead. All they could point to was the resilience and adaptability of their cultures as well as their determination to be reliable partners to customers.

We have watched these companies adapt and maintain their relevance to customers through many economic and technological cycles but it is only in the depths of a crisis where great cultures can truly be appreciated. Within a couple of weeks these companies had reengineered themselves from centralised structures housed in vast campuses to a form of extreme decentralisation, with hundreds of thousands of engineers not only working from home, but continuing to support customers' mission-critical activities. Such change would have been impossible without cultures that empower employees and are genuinely focused on delighting customers.

We could also point to TCS's industry-leading attrition levels as evidence of their quality: an outcome of loyal and empowered engineers. Such an employee base tends to be cheaper to maintain, more productive and capable of preserving long-term relationships with customers. We think it comes as no surprise that TCS can maintain industry-leading margins while also being voted one of the best places to work in both the US and India.[6]

Thanks to what they have learned this year, TCS has committed to a '25-by-25' strategy which aims for only 25% of its workforce to be in an office by 2025.[7] This model will likely prove both lucrative to margins and improve TCS's access to a greater pool of high-quality talent with more working mothers able to enter, and remain in, the workforce. We hope to see more women enter the higher echelons of these businesses: a topic we continue to engage them on.

Rather than the envisioned pain, COVID-19 served as a catalyst in increasing the appreciation and urgency for all businesses to have technology at their core. We believe this has the potential to start a multi-year technology investment cycle of which Tech Mahindra, TCS and Infosys should be leaders, and major beneficiaries. Despite strong recoveries in share prices, we believe these businesses continue to be attractively valued for their quality and growth opportunities.

Time is on the side of our financial companies

With lockdowns destroying economic activity and central bankers holding rates low, now is certainly not a boon time for banks. With that, many of our financial holdings were detractors to performance last year. However, as with previous crises, we are seeing high quality financial institutions prosper and position themselves favourably for the eventual recovery.

Our four largest financial holdings have a cumulative two hundred years' of experience under their belt.[8] Surviving this long in such a cyclical, heavily-leveraged, industry is no easy feat and entirely the result of the quality of people.

Each of them continually sits in the highest ranks for asset quality – a function of patience and discipline. But despite the quality of underwriting, these lenders continually choose to hold more capital and build provisions far earlier and more aggressively than their peers. Such conservatism supresses short-term profitability but promotes long-term survival. Decisions like these can only be made with a mind-set that is intent on playing the Long Game.

Their hard-earned reputations for strength at time of crisis does not go unnoticed by depositors who race to hand over hard-earned savings at the expense of lower quality peers who consequently face capital withdrawals and see borrowing costs rise. They now sit on strong, low cost capital bases, and have improved their already strong relative competitiveness at the bottom of the cycle: a behaviour we have seen time and time again. We believe each of them should be able to compound at an attractive rate from here as they benefit from industry consolidation as well as the growing penetration of financial products in their respective economies.

Looking forward

2020 has proven that forecasting, especially over the short-term, is of little use and time is best spent on factors we can control. Growing political and environmental risks, combined with accelerating technological and consumption trends, mean time-horizons matter more than ever. We continue to allocate our clients' capital to companies where we trust high-quality, aligned, long-term stewards to build enduring franchises capable of generating attractive amounts of cash-flow over the years, decades and generations to come.

Douglas Ledingham

January 2021

[1] Source: https://www.pwc.com/gx/en/news-room/press-releases/2019/ceo-turnover-record-high.html#:~:text=The%20study%2C%20which%20analyzed%20CEO,over%20the%20time%20period%20analyzed

[2] Source: https://www.reuters.com/article/us-health-coronavirus-short-termism-anal/buy-sell-repeat-no-room-for-hold-in-whipsawing-markets-idUSKBN24Z0XZ

[3] Source: Company data.

[4] Source: S&P Capital IQ. Q2 2020 Techtronic Industries earnings call script 13 August 2020.

[5] Source: Stewart Investors. All Indian IT companies held in the Asia Pacific Sustainability strategy as at 31 December 2020.

[6] Source: Company data and Top Employers Institute.

[7] Source: Company data.

[8] Source: Stewart Investors as at 31 December 2020. Company experience relates to existence of the company.

These figures refer to the past. Past performance is not a reliable indicator of future results.

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