ICG

Economic and Investment Research

For institutional/professional/accredited investors only

Asia Economic and Investment Update

Powerful recovery underway

Key Points

- Asia has managed the Covid-19 pandemic well, keeping per capita deaths low and limiting economic damage relative to most of the rest of the world
- Building from a strong base, we think Asia's economic outperformance is set to continue as vaccination programs are rolled out and the global economy reopens
- Rapidly rising regional private consumption and services demand should feed through to strong company performance and provide earnings streams with reduced sensitivity to developed market business cycles
- We think companies in well-regulated developed Asia that are tapping – either directly or indirectly – into the spending power of emerging Asia's rapidly rising middle class provide the best risk/reward trade-off for private market investors
- With most major banks in Asia focusing primarily on financing large blue-chip companies and transactions, we think middle market companies will continue to turn to private markets for finance
- We believe that ICG, with 20 years of on-the-ground experience providing flexible private capital to Asia's middle market companies, is in a strong position to help meet this growing demand

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Introduction

Asia has managed the Covid-19 pandemic well. Deaths per capita, economic losses, and impairment to government finances have been much less pronounced than in the US, Europe and most the rest of the world. As vaccination programs are rolled out and the global economy re-opens, we believe Asia's economies are in a strong position to build on this strong foundation and continue to outperform.

We anticipate a robust period of growth for Asia's mid-market companies as new companies emerge and existing companies transform and expand to meet rapidly rising regional private consumption and services demand. With over 30 years' experience providing flexible capital solutions to private companies globally and 20 years of investing in Asia, we believe ICG is well placed to help finance this next phase of Asia's economic growth.

In this report we provide an update on how Asia is managing the pandemic, the economic outlook, where we see the greatest investment opportunities, and our investment strategy.

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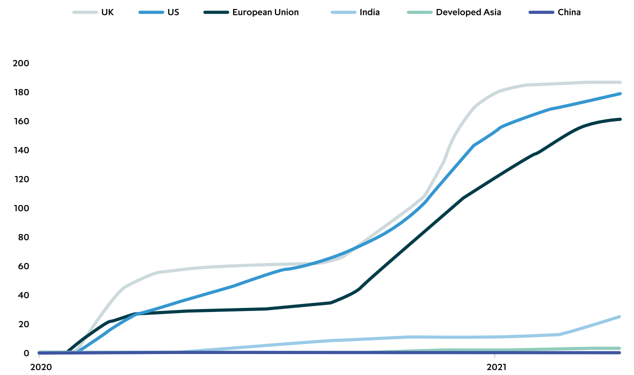
Asia has managed the Covid-19 pandemic well

Asia has managed the Covid-19 pandemic well relative to most of the rest of world, keeping deaths per capita low and managing to limit economic damage. The chart below shows the stark difference between death rates in Asia relative to the US, Europe and the UK. These numbers are measured on a per population basis so are not affected by the relative size of each country's population. For example, Australia at the time of writing has managed to keep total measured Covid-19 deaths to under 1000 people through the whole pandemic, or around 8 per 100,000 of its population. By contrast in the EU, US and UK measured deaths so far are approximately 730,000, 600,000 and 130,000 or 163, 181 and 191 per 100,000 population respectively.

Asia has managed to keep Covid-19 death rates low



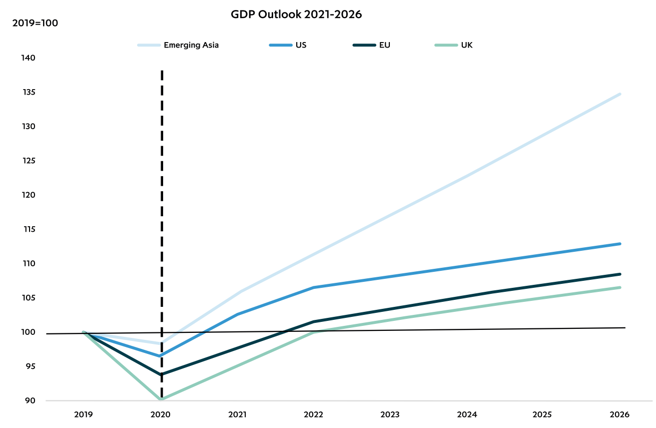
Source: Our World in Data, Johns Hopkins, June 2021

Part of the difference may be explained by demographic and health factors (younger populations with fewer underlying risk conditions), but policies have clearly played an important role. By quickly putting in place stringent controls on inward travel to limit new virus imports and implementing strictly enforced and effective domestic containment, test, track and trace programs, China and most of the more developed countries in Asia were able to contain the spread of the virus before it got out of control. While this caused economic activity to fall sharply initially, as new case growth has been contained, most countries have been able to allow large segments of their economies to resume normal activity.

China experienced a very sharp initial economic and health hit in early 2020. However, government statistics indicate by Q2 2020 GDP had already recovered to pre-pandemic levels. While not all economies in Asia have recovered as quickly, most reached or were close to reaching pre-pandemic levels by early 2021.

Although China has seen the strongest recovery, Taiwan, Korea, India and Australia have all seen relatively swift rebounds from early 2020 lows. The southeast Asian economies of the Philippines, Malaysia, Indonesia and Thailand have lagged behind due to varying combinations of less effective virus controls, slower vaccine rollouts and high tourism dependence. Hong Kong and Singapore fall somewhere in the middle as strong Covid-19 management and domestic support programs have been partially off-set by their economies' high sensitivity to global growth and trade flows. By contrast, the US economy is not expected to return to pre-pandemic levels until Q2 2021 (around 15 months after the virus hit its shores) and most of European economies and the UK are lagging behind by another two quarters or so.

Asia growth outperformance to continue

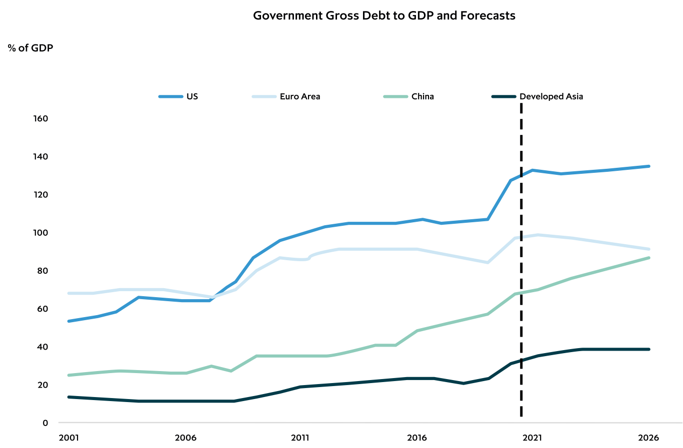


Source: IMF World Economic Outlook, April 2021

Less fiscal damage than the US and Europe

Despite the strict implementation of travel and domestic virus containment measures, most countries in Asia managed to stabilise their economies without hurting government fiscal and debt positions to the degree experienced in the US and Europe. This not only provides more fiscal and debt headroom as a buffer against future economic slowdowns and crises, but also indicates that the impact of the roll-off of Covid-19 emergency business and household support measures will likely be less disruptive than more government support-dependent sectors in the US and Europe.

Asia governments in better fiscal shape than the US and Europe



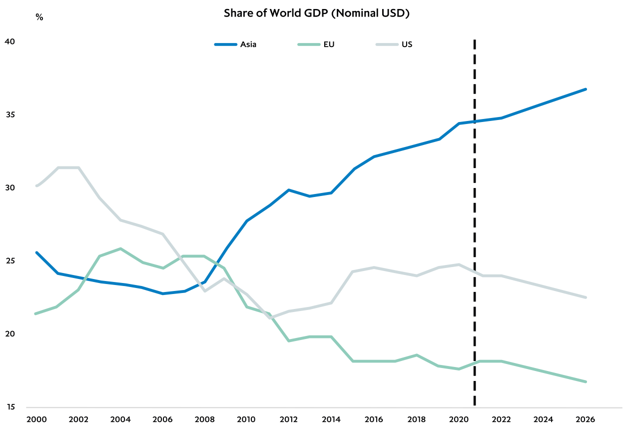
Source: IMF World Economic Outlook, April 2021

Asia's share of global GDP set to rise sharply

Looking forward, we expect Asia's economies to continue to outperform. As summarised in the GDP forecast chart on the previous page, on IMF forecasts by 2026 emerging Asia's real GDP is expected to be 35% larger than it is today. By comparison the US economy is expected to increase by 12% and Europe by around 8%. This translates in nominal US dollar terms to an increase of $13.1tr for emerging Asia versus a forecast $6.7tr increase for the US and $6.0tr for the European Union.

If these forecasts are correct, Asia's share of global GDP is set to rise at an accelerated pace over the next five years. Asia passed the US and Europe as a share of nominal global GDP during the global financial crisis of 2008/09 and has been rapidly increasing its share since then. On IMF forecasts both the US and Europe are expected to see their shares of global GDP decline over the next five years as Asia's share rises.

Asia's growing share of world economic activity



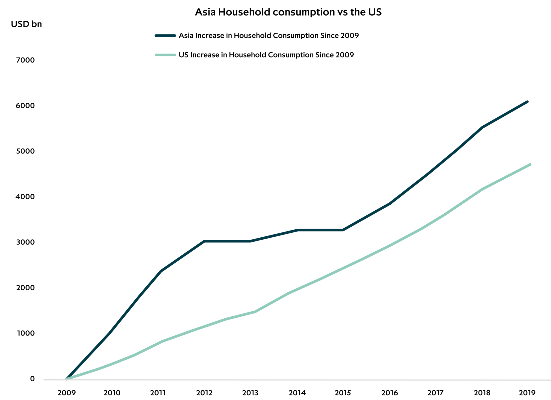
Source: IMF World Economic Outlook, April 2021

Diversifying income streams

Household consumption in Asia has surged as the number of households with disposable income (the "middle class") has grown. As the chart below shows, Asia's cumulative household consumption in nominal US dollar terms has increased by over US$6.1tr over the past ten years. Over the same period, the equivalent figure for the US was US$4.7tr and the rest of the world was $3.9tr.

This has practical implications for company earnings – not just in terms of growth rates, but in terms of their independence from US and Europe business cycles. Companies that are able to access this growing source of autonomous Asian demand should have a lower sensitivity to developed market business cycles, providing developed market investors with a source of diversifying earnings streams. Private companies tapping into this growth have the added benefit of not being buffeted by the typical emerging market listed company sensitivity to global risk market gyrations.

Asia consumption a rising source of autonomous demand

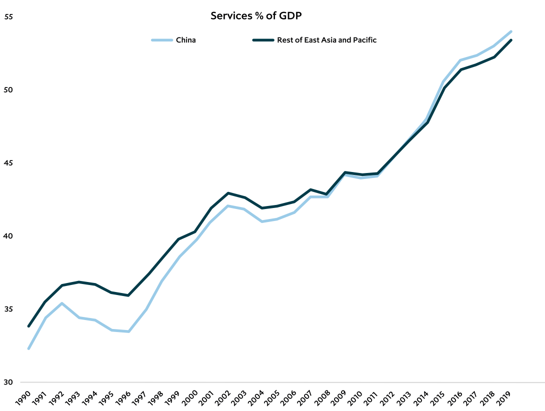


Source: World Bank, Cumulative increase in household consumption 2009-19

Where are the opportunities?

As per capita incomes have increased the nature of growth has continued to evolve, with higher value-added industry and services related businesses making up an increasing share of the economic pie. This is expected to drive continued strong demand for capital as new industries are created, companies evolve, expand and innovate.

As incomes rise, services sectors are expanding rapidly



Source: World Bank Databank, June 2021

In the fast-growing emerging markets of Asia, the growing affluent middle class is driving, in particular, increasing demand for healthcare, education, technology, healthy lifestyle products and services, and leisure activities. In China there are still huge potential efficiency gains (and capital needs) ahead as private companies gradually take an increasing share of the economy from the less efficient state-owned sector. In more developed economies such as Japan and Korea generational changes in company ownership and succession planning are playing an additional important role in driving demand for flexible financing.

How to invest?

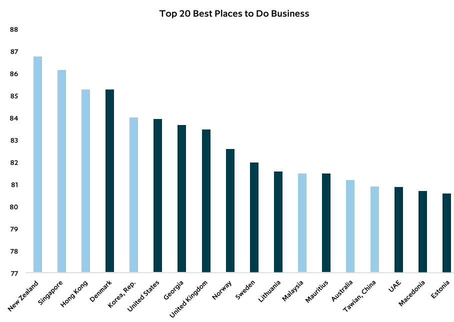
Developed Asia a gateway to emerging Asia growth

ICG has been actively investing in Asia private markets for 20 years, opening its first office in Hong Kong in 2001. With our roots in private credit and a medium to long term investment horizon, we naturally have a focus on downside protection. We have found that a strong legal and regulatory framework (including the ability to enforce agreements) is critical to protecting against downside risks and maximising returns.

In our view, mid-market companies in the more developed Asia Pacific economies such as Australia, New Zealand, Japan, Korea, Singapore, Hong Kong and Taiwan provide private credit and equity the best risk/reward balance.

Companies domiciled in these countries are covered by strong corporate regulatory and legal frameworks. Many of these companies are also directly or indirectly exposed to the high growth markets of China and the rest of emerging Asia. This gives investors access to the growth and dynamism of rapidly transforming developing Asia while limiting exposure to many of the risks associated with emerging market investing.

Developed Asia dominates "Ease of doing business" rankings



Source: World Bank "Ease of Doing Business" rankings 2020

Remarkably, developed Asia accounts for 4 of the top 5 places in the world to do business, according to the most recent "Ease of Doing Business" rankings by the World Bank. And Asia as a whole (developed and emerging) account for 7 of the top 20 places in the world to do business. These rankings include criteria such as ease of starting a business, investor protection, contract enforcement, insolvency resolution among many others. This has provided a rich pool of well-regulated companies to invest in.

In the table below we provide a few examples of some of the companies ICG has invested in that fit these criteria. Yudo, for example, manufactures hot runner systems that are critical for plastic injection moulding. Although domiciled in well-regulated and business-friendly Hong Kong, most of its sales (and a large proportion of its production) are in emerging Asia, particularly China. PSB Academy is another good example of a company benefiting from the rapid rise in the discretionary spending power of Asia's growing middle classes. PSB is one of Asia's leading higher learning education providers. With international campuses in Singapore, colleges in China, Indonesia and other countries around the region, as well as digital offerings, the company is well placed to tap into the strong and growing demand for higher education across the region. However, investors in the company benefit from it being domiciled in Singapore, a country with a legal system based on English law and ranked as one of the most well-regulated and business-friendly in the world.

We believe investing in this way gives investors access to the best of both worlds – exposure (directly and indirectly) to the high growth economies of emerging Asia while providing the protections of the strong legal and regulatory systems of more developed Asia.

Examples of Private Developed Asia Companies Exposed to EM Asia Growth

Company	Country of Domicile	Main business lines	**Sales exposure %**
Coreapuff	Korea	Cosmetic Supplies	**15-20% EM Asia, remainder primarily Korea**
PSB Academy	Singapore	Education	**~ 50% Emerging Asia, remainder mostly Singapore**
Yudo	Hong Kong	Industrial Goods (Hot Runner Systems)	**60~65% Emerging Asia, particularly China**

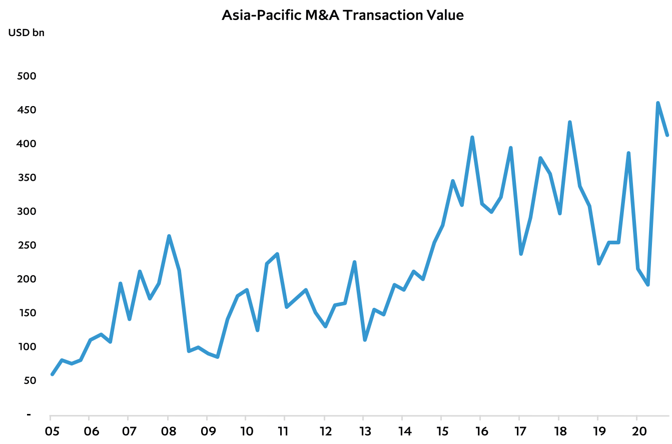
Source: ICG. Sample of private companies in which ICG funds are or have been invested

Strong deal flow ahead

The sharp slowdown in economic growth and extreme economic and market uncertainty in the early part of the pandemic caused deal flow to fall off sharply in the first half of 2020, with the value of M&A transactions falling to their lowest levels since 2014 in Q2 2020. However, in Q3 2020 as new Covid-19 cases globally started to come under control and economic activity rebounded, transactions surged to their highest levels on record.

Although there may be some moderation from the extreme highs of Q3 2020 as pent-up transactions from earlier in 2020 wane, we expect deal flow to remain strong. As Asia continues to grow and urbanise, wealth increases and services businesses develop to meet the demands of the region's rapidly increasing middle class, new business creation, expansion and transformation will accelerate. This will drive strong demand for capital. With most banks focusing on funding large blue-chip transactions, we think demand from Asia's middle market companies for flexible private capital will continue to grow at a rapid pace.

Deal activity on the rise



Source: Bloomberg, quarterly data to December 2020

Summary and outlook

Asia has managed the Covid-19 crisis well, managing to keep deaths low (relative to the US and Europe) while at the same time limiting economic damage. That is not to say parts of Asia have not suffered badly both in terms of human health and economic growth. However, by managing to control the virus quickly, most countries have kept per capita deaths low and have been in a position to re-open key segments of their economies faster than those in the west. This has generally meant shallower recessions and faster economic recoveries, with positive feed-through to company fundamentals.

Looking forward, we think Asia is in a strong position to continue this outperformance. In most countries, sound government finances, strong financial systems and rapidly growing middle classes should provide a positive environment for companies and investors. As new companies emerge and existing companies expand and transform to meet rapidly evolving consumer and business demand, we think deal flow and demand for capital will continue to rise rapidly in the coming years. With most major banks in Asia focusing primarily on financing large blue-chip companies and transactions, we think middle market companies will continue to turn to private markets for finance. We believe that ICG, with 20 years of on-the-ground experience providing flexible private capital to Asia's middle market companies, is in a strong position to help meet this growing demand.

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