




Matthews Asia™

## Matthews Asia Value Fund

### Period ended March 31, 2018

For the quarter ending March 31, 2018, the Matthews Asia Value Fund returned 0.86% (Investor Class), while its benchmark, the MSCI All Country Asia ex Japan Index, returned 0.70%.

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#### Market Environment

The Asia ex-Japan market ended the quarter slightly higher but this masked a roller-coaster ride that seemed to catch many investors by surprise. How long does it take for a market to drop 5%? Only one day, as we witnessed in the quarter. The same question would likely have puzzled many investors in late January. It is often hard to pinpoint the triggers that lead to a market correction. The threat of a China-U.S. trade war? Investor angst over rising interest rates? Or simply a long-in-the-tooth bull market in the U.S.? We don't know for sure, but we believe it could have been a confluence of all these factors.

#### Performance contributors and detractors

The Fund slightly outperformed its benchmark during the quarter. The top contributor was Yamada Consulting in Japan, a management consulting company primarily servicing domestic small- to medium-sized enterprises. Yamada generally receives little sell-side coverage, but during the quarter, Daiwa Securities, one of the biggest local brokerage houses in Japan, initiated a “buy” coverage on the company. This led to a big jump in its share price over the following few weeks. We took advantage of this and trimmed close to half of our position.

The single biggest detractor in the quarter was Clear Media, traded in Hong Kong. Clear Media, an outdoor media company, sells bus shelter advertising and is the biggest player in China with over 70% market share in top-tier cities. In early January, Clear Media announced that two of its employees had misappropriated approximately 77 million renminbi. The majority of the misappropriation, according to management, happened back in 2010. Upon discovery, Clear Media launched an independent investigation in addition to a police investigation, which are still ongoing. The company announced its full year earnings at the end of March and trading of its shares has been suspended since this earnings announcement, pending the final outcome of the investigation.

This has been an unfortunate incident. Though the outcome of the independent investigation is still unknown, here's how we view the situation: unless the misappropriation amount turns out to be a lot more than the disclosed 77 million renminbi or there are other misdeeds, we believe the impact from this incident should be well contained. If anything, strengthened internal measures in response to this incident will be good news for shareholders. On the fundamental side, the company disclosed financial numbers for the second half of 2017 that look decent with good cash flows as well as close to double-digit growth in both top line and operating profit. We believe the bad news has been more than discounted in the current depressed share price, which is trading at 3x EBITDA or less than 6x EBIT. We added to the position in the quarter as the share price kept sliding.

#### Notable portfolio changes

We exited two positions in the quarter—Orion Holdings in South Korea and Naigai Trans Line in Japan. We exited Naigai, a shipping freight forwarder, after more than doubling our money since we initiated the position in late 2016. We sold the shares as their price came close to our estimated

#### Average Annual Total Returns - Investor Class (3/31/2018)

1-year 24.76%  
3-year n.a.  
5-year n.a.  
10-year n.a.  
Inception (11/30/15) 17.43%

#### Gross Expense Ratio <sup>1</sup>

11.48%

After fee waiver and expense reimbursement: 1.50% <sup>2</sup>

<sup>†</sup> Actual return, not annualized.

<sup>1</sup> Matthews Asia Funds' 12b-1 Plan (the “Plan”) is inactive. Although the Plan currently is not active, it is reviewed by the Board annually in case the Board decides to re-activate the Plan. The Plan would not be re-activated without prior notice to shareholders and any amounts payable under the Plan would be subject to applicable operating expense limitations. If the Plan were reactivated, the fee would be up to 0.25% for each of the Investor Class and Institutional Class, respectively.

<sup>2</sup> Mathews has contractually agreed (i) to waive fees and reimburse expenses to the extent needed to limit Total Annual Fund Operating Expenses (excluding Rule 12b-1 fees, taxes, interest, brokerage commissions, short sale dividend expenses, expenses

intrinsic value.

Orion Holdings, on the other hand, was a mistake. The South Korean confectionary business announced a restructuring into a holding company and an operating company last year. We initiated a position in the holding company last summer soon after it became listed in the market. Its valuation seemed compelling at the time. We were aware of a future share swap for the controlling family between their stake in the holding company and their stake in the operating company. The swap ratio was to be determined at a specified date. To obtain a favorable swap ratio for themselves, the family had incentives to see a lower share price in the holding company. This was something we overlooked. In this particular case, ironically, the cheaper the share price of the holding company became, the more dilution there was going to be and the more expensive the shares actually became for minority shareholders like us. We've learned our lesson. The only silver lining was that it was a relatively small position.

We initiated four positions in the quarter, two in South Korea and two in China/Hong Kong. We'll highlight two here. We initiated a position in Samsung Fire and Marine (Samsung F&M). Samsung F&M is the biggest property and casualty insurance company in South Korea and is a Samsung affiliate. It has a dominant market share in the online auto insurance market, a fast-growing segment of the market. It owns a small stake in Samsung Electronics and that stake is worth around 40% of the insurance company's current market cap. The share price of Samsung Electronics, which incidentally is a current holding of ours, has done well in recent years, yet Samsung F&M's share price largely has been trading sideways over the same period. This implies that its core growing insurance business has become increasingly undervalued. Its balance sheet is well capitalized and appears to be the best among all major industry players. In addition, it announced in the quarter that it is raising its dividend by over 60%, a positive surprise to the market. We initiated the position in its preferred shares, which are trading at a substantial discount to its common shares, at around 60% of their book value with a more than 5% dividend yield.

We initiated a position in China Mobile in the quarter. China Mobile is the biggest mobile telecom service provider in the country with about 60% market share by mobile subscriber count. It is a state-owned enterprise. Concerns over regulatory-driven tariff cuts and uncertainty over a potential increase in 5G-related capex spending have driven down the price of its shares to about 2.5x EBITDA and less than 10x free cash flow (FCF) ex cash in terms of valuation. We're not holding our breath over industry's long-term growth prospect, but we believe it will continue to grow relatively steadily at a mid to high single digit compound annual growth rate (CAGR) over the medium to long term while producing a lot of FCF along the way. Management is committed to increasing the company's dividend payout ratio over time. This might not be the most exciting company around, but we're happy to have picked up its shares at what we consider to be a compelling price.

## Outlook

The Korea peninsula crisis seems to have dissipated for now as U.S. President Trump agreed to meet with North Korean leader Kim Jong Un later this year. The two biggest concerns for many people seem to be the threat of a trade war between the U.S. and China and rising interest rates. On both fronts, we believe our portfolio is well-positioned. On the former, most of our holdings are either domestic in nature or have little exposure to trade between the U.S. and China. On the latter, all of the companies in our portfolio have strong balance sheets and thus we do not expect a direct negative impact if U.S. interest rates rise faster than expected later this year. If anything, with cash in the portfolio at a double-digit level at quarter end, we have enough cash holdings to take advantage of any market dislocation due to either of the two concerns.

As of 03/31/2018, the securities mentioned comprised the Matthews Asia Value Fund in the following percentages: YAMADA Consulting Group Co., Ltd. 3.8%; Clear Media, Ltd. 5.0%; Samsung Fire & Marine Insurance Co., Ltd., Pfd. 1.4%; Samsung Electronics Co., Ltd, Pfd. 1.8%;

incurred in connection with any merger or reorganization or extraordinary expenses such as litigation) of the Institutional Class to 1.25% first by waiving class specific expenses (i.e., shareholder service fees specific to a class) of the Institutional Class and then, to the extent necessary, by waiving non-class specific expenses of the Institutional Class, and (ii) if any Fund-wide expenses (i.e., expenses that apply to both the Institutional Class and the Investor Class) are waived for the Institutional Class to maintain the 1.25% expense limitation, to waive an equal amount (in annual percentage terms) of those same expenses for the Investor Class. The Total Annual Fund Operating Expenses After Fee Waiver and Expense Reimbursement for the Investor Class may vary from year to year and will in some years exceed 1.25%. If the operating expenses fall below the expense limitation in a year within three years after Matthews has made a waiver or reimbursement, the Fund may reimburse Matthews up to an amount that does not cause the expenses for that year to exceed the lesser of (i) the expense limitation applicable at the time of that fee waiver and/or expense reimbursement or (ii) the expense limitation in effect at the time of recoupment. This agreement will remain in place until April 30, 2018 and may be terminated at any time by the Board of Trustees on behalf of the Fund on 60 days' written notice to Matthews. Matthews may decline to renew this agreement by written notice to the Trust at least 30 days before its annual expiration date.

***All performance quoted is past performance and is no guarantee of future results. Investment return***

China Mobile, Ltd. 1.5%. The Fund held no positions in Daiwa Securities Group Inc.; Orion Holdings Corp.; Naigai Trans Line, Ltd. Current and future portfolio holdings are subject to risk.

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*and principal value will fluctuate with changing market conditions so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the return figures quoted. Returns would have been lower if certain of the Fund's fees and expenses had not been waived. Please see the Fund's most recent month-end performance.*

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