

## Wage Growth in China

### Rising income growth

Recent demands for wage hikes at Honda and Foxconn are unlikely to be a short-term phenomenon, as wages are likely to rise more rapidly in China. Millions of other factory workers in China are looking to receive increased pay, especially as labour shortages, particularly in the urban coastal areas, continue to rise. Growth in salaries is likely to persist in the long-term, especially as demographics reflect that the working-age population shows an inflection point from 2010–2015, limiting long-term labour supply.

**Labour supply is expected to decrease after strong growth of Baby Boomers since 80's.**



Source: UN, CICC Research 2010

### Macro themes create opportunities for Value Partners through in-depth research

#### Higher income leads to higher spending

High-salary growth for Chinese workers will directly benefit the average Chinese citizen, thus increasing their expenditure. Sectors to benefit include:

- Consumer staples, such as food and beverage are clear beneficiaries, as demands for better quality food and more diversity is increasing.
- Demand for low-value consumer discretionary goods, such as electronics & mobile phones and other affordable luxuries will rise as individuals seek to improve their quality of life.

While the macro trend is clear, taking advantage of this trend may not be as easy, especially as valuation is a key factor. Consumption stocks are currently trading at above historical averages.

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Continued on page 2

**P/E & P/B Ratio of consumption stocks reflect higher than average pricing**

	PE (X)				PB (X)			
	Current	Historical (since listing)			Current	Historical (since listing)		
		Avg.	High	Low		Avg.	High	Low
F&B	21.8	17.1	54.9	8.3	2.9	1.8	4.1	0.8
Food retailers	22.1	20.7	31.5	9.1	3.9	2.6	4.5	1.5
Non-food retail	19.5	20.4	46.9	10.0	3.5	3.4	7.4	1.8
Paper tissue	20.3	14.4	30.2	6.6	5.0	2.6	5.5	0.9
Sports wear, woman shoes	20.0	15.7	35.0	8.0	4.2	2.8	9.9	0.3
Healthcare	21.5	18.4	37.1	10.0	3.4	1.9	3.8	1.0
Auto	12.9	10.2	24.5	5.0	1.9	1.4	2.6	0.4
Telecoms	12.1	16.3	56.0	8.0	1.7	2.7	12.5	1.1

Source: Bloomberg, BofA Merrill Lynch Global Research June 2010

At Value Partners, we consistently apply our in-depth investment research knowledge to determine a company’s fair valuations. Furthermore, we are continuously researching consumer brand names that are likely to benefit from the increasing spending from Chinese consumers. In particular, we prefer companies that have strong distribution capabilities and strong brands that consumers demand, since such competitive advantages can translate into strong earnings growth as consumption ramps up.

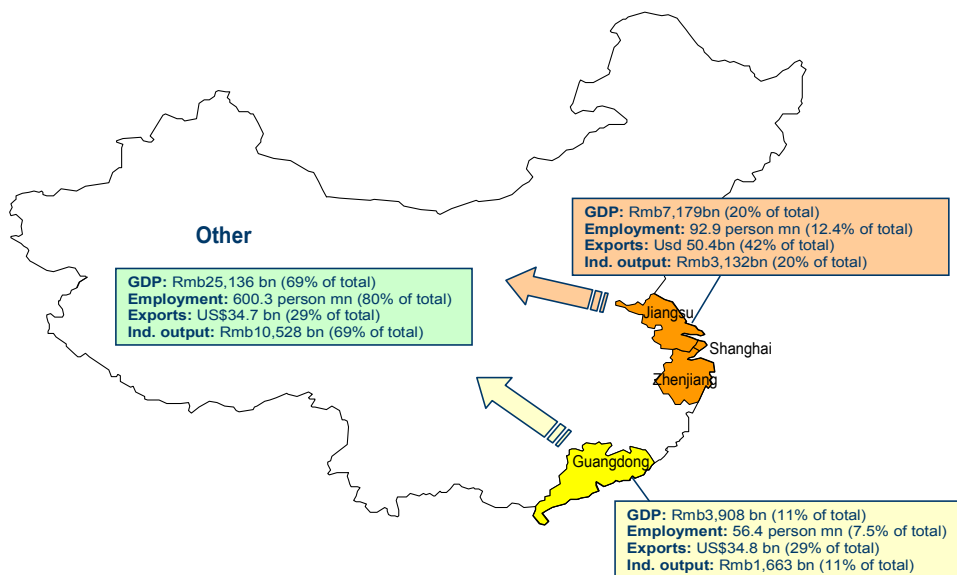
**Manufacturing costs to rise, squeezing margins**

Manufacturers relying on significant cheap labour resources are expected to see their margins squeezed as the cost of employment rises rapidly. Manufacturers producing commodity items, such as electronic components or toys where manufacturers have limited control of market prices, are unable to unload their increasing costs to the consumer. Therefore, we are likely to see costs increase as a portion of their production.

While the manufacturing sector has been under stress, this is not an area to be ignored, especially as valuations become more attractive. At Value Partners, we are looking to identify firms that are pragmatic in facing the latest cost pressures and are willing to rapidly adjust to mitigate these increased costs, such as by relocating their manufacturing base to inner China, where labour is more plentiful or products are produced that have a competitive edge where market share and growth is expected to remain strong.

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Value Partners applies a disciplined value investing approach that focuses on conducting our own in-depth investment research for stocks in the Asia-Pacific Region. While stock selection is the main driver of our strong investment performance, we also take into account how macro-economic events impact on the market. Through this document, we provide you with insights we have found and commentary on recent market developments.



Source: CEIC, Credit Suisse Estimates 2009