



Persistently low valuations over the years have led to a string of privatisations in the market, but this may change soon as professional investors, large corporations and boutique funds increasingly find value among local small- and mid-cap companies

# NEW DAWN FOR SMALL CAPS

Activist investors and boutique funds are snapping up stocks depressed by years of apathy. Is the drought over? Which counters are ready to run?

| STORIES BY ZAVIER ONG |

**A**fter 16 years of being a public listed company, traditional Chinese medicine firm Eu Yan Sang International was delisted last year. CEO Richard Eu says the privatisation move was necessary to implement some long-term plans. “The benefit in the short term is that we do not have to worry too much about having to do the financial reporting and face investors every quarter,” says Eu in an interview with *The Edge Singapore*. “This allows us to plan a bit more on the longer-term basis. We have some plans we want to execute which may not be beneficial in terms of short-term earnings.”

Eu was part of a consortium that made a general offer for shares in Eu Yan Sang last year. Other members of that consortium included an investment vehicle backed by private equity firm Tower Capital and UOB Venture Management, state investment fund Temasek Holdings, and other members of Eu’s family.

The consortium paid 60 cents a share in cash, a 24.7% premium to Eu Yan Sang’s volume-weighted average price per share for the six-month period prior to the offer announcement date. The offer price was also 58.8 times the company’s earnings per share of 1.02 cents for FY2015 ended June. After watching the value of their holdings decline for two years, shareholders were happy to take it.

Eu Yan Sang was not the only home-grown company to go private in the past year. As companies battled weakening valuations, controlling shareholders saw an opportunity to restructure away from the public eye. And private equity players as well as larger corporations snapped up companies on the cheap. Other iconic local names that left the Singapore Exchange (SGX) included budget carrier Tiger Airways, lifestyle products company OSIM International, property developer Sim Lian Group, transport operator SMRT Corp, and container shipping company Neptune Orient Lines.

In total, 27 privatisations wiped a collective

\$13.2 billion in market capitalisation off SGX. This figure excludes deals announced last year but not yet concluded. Among them are the proposed privatisation of REIT manager **ARA Asset Management** and Dutch beverage giant Jacob Douwe Egberts’ \$1.5 billion bid for instant coffee producer **Super Group**.

## Privatisations driven by low valuations

The spate of delistings attracted lots of attention from investors and traders, who worried that the stock market was being hollowed out. But will these companies be missed? After all, many were not actively traded, barely had a following, and announced few corporate actions. Mostly, they had been whittled down by apathy into small caps with hardly any investor interest.

“Most of these companies are just not going to the market to do anything. Many have not done any placements in a long time. There is also no interest and no liquidity in the market,” says Terence Wong, CEO of boutique fund

manager Azure Capital. “Regulations have also been a lot tougher over the past few years. Listing costs are high as well.”

Mainboard-listed companies are subject to annual listing fees of between \$35,000 and \$150,000. There are additional fees of up to \$200,000 for the issuance of additional shares. Companies on the Catalist board are charged annual listing fees of between \$15,000 and \$50,000, and \$8,000 for the issuance of additional shares. The need to report financial results on a quarterly basis can also be cumbersome and costly.

Havard Chi, head of research at investment manager Quarz Capital Asia, admits that some companies just do not need a public listing. Businesses with low-capital expenditure requirements, for instance, may be better off staying private. “Does your company really have to be listed? If [it] has a capex-heavy model, there may be a need to raise capital, particularly if management is thinking about embarking on a development project,” he says.





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However, Chi thinks privatisations usually boil down to weak valuations. "A lot of companies have cited being answerable to investors on a quarterly basis as the reason for delisting. In reality, they are not really beholden to investors, particularly if the investors have very low shareholding levels. At the end of the day, it's about dollars and cents. And they are just not getting the kind of value they want for their companies."

So, what ails the Singapore market? Have local brokers undersold the local market? Why do retail investors refuse to pay a premium for companies, then lament when another buyer sees value and makes an offer for the stock?

"It is essentially a confluence of factors built up over time," says Wong. For one, corporate governance and accountability issues have dented investor confidence. "During the 2008 global financial crisis, S-chips were falling like flies almost every week, up till 2013," he adds, referring to China-based companies listed in Singapore. "When the tide receded, a lot of investors were swept along with it. [Sportswear maker] China Hongxing Sports led the bloodbath, and the S-chips never really recovered after that."

Slower economic growth in 2011 dealt a further blow. "Our economy has been growing at a very pedestrian pace. That hit a lot of companies and caused their earnings to slide. At the same time, [countries] such as Indonesia, Thailand and the Philippines were starting to run from 2013 to 2014. Singapore was coming off while our neighbours were growing very rapidly, so there was naturally no real interest in the local market," Wong says.

The final nail in the market coffin was the penny stock crash of 2013. "Investor confidence had already been hit considerably and the whole Asiasons Capital (since renamed **Attilan Group**), **Blumont Group** and **LionGold Corp** saga just exacerbated it," he adds. Shares in these companies plunged spectacularly that year after months of steady gains.

### Changemakers making a difference

But companies with a decent business and earnings potential do not stay undervalued for long. As shareholders of Eu Yan Sang found out last year, someone else will eventually see their value too. Wong and Chi are among a breed of investors who see value in the local market and intends to realise some of it through activism.

"If the constituents of the stock market work together, if enough of us believe in the market and it better reflects the true value and

worth of companies, then you wouldn't see many companies having the impetus to privatise," says Wong.

His Azure Capital bills itself as a "special situations fund" that sources opportunities with potential catalysts within the next six to 12 months. The fund relies on fundamental analysis and meetings with a variety of stakeholders — management, analysts and even other fund managers — to drive its investing strategy. It prefers companies in the small- and mid-cap space. Wong says he is always on the lookout for undervalued companies that are ignored by the market. Sometimes, he brings these companies on roadshows to raise their public profile.

"I am an active manager in the companies that I have a stake in. I may not be an expert in the operational aspects, but what I do know is how to manage the investors," says Wong, who used to be head of research at DMG & Partners Research. The firm was acquired by **RHB Capital** and is now known as RHB Research Institute Singapore. "I know which funds are looking for what kind of companies, and I know what kind of analysts cover which companies and what they [are] interested in. That's the value I bring to the table."

Wong says a company's value can rise very quickly once it has investor attention. "There are so many companies out there that have been ignored and it's a real shame. Look at **Singapore Medical Group**. Just a few months ago, it was largely ignored. Now there are coverage and reports; the share price is up three times over a four-month period. There are a lot of such stories in the market; we just need people to recognise and invest in them."

Chi of Quarz Capital Asia says companies sometimes need to be prodded into taking action to boost shareholder value. A unit of Switzerland-based activist investor Quarz Capital Management, Quarz Capital Asia set up shop here in June 2015 to engage with undervalued local companies.

"One of the reasons we think Singapore is a good place for active engagement is that a lot of companies have very good and transparent financials. The financial reporting is solid, but the engagement with shareholders is a bit slow, especially in home-grown companies," he says. Part of the problem may be

that majority shareholders and founders have tended to run the companies as their own. "We think this will slowly change. But now, it's definitely lacking."

Last September, Quarz Capital issued a letter to the management and board of **Metro Holdings** urging the retailer and real-estate developer to return some of its significant cash holdings to shareholders.

Metro's cash holdings of \$393 million amount to more than half its market capitalisation then. That is high compared with other companies listed on SGX, Quarz noted in its letter. It also pointed out that Metro shares were then trading at about 40% below book value. Among other things, it also urged Metro to pay a one-off dividend of 21 cents a share to return cash to investors. It is "inconceivable that Metro's share price continues to languish... despite the company's strong recurring earnings profile and valuable assets," Quarz wrote.

Metro directors did not take well to Quarz's letter. In response, the board implied dissatisfaction that Quarz had raised those issues in a letter instead of at the company's annual general meetings or results briefings. It also said "many of the issues raised in the open letter had been raised and considered" on these platforms.

Chi says Quarz prefers to engage with companies behind the scenes rather than in the public sphere. "We try to engage with the management and present our views to them first. We tell them that these are the measures we think they should take. Unfortunately, with Metro, it was just a little difficult."

He believes companies have a responsibility to maximise returns for their shareholders. "When shareholders invest in a company, they want a good return on their capital. If companies already have a majority shareholding and are comfortable with where they are and have no intention to maximise shareholder returns, they should take the company private. For Metro, it's a little different: There is still a substantial free float and you have to create value for that 70%," says Chi.

### Sectors, stocks to watch

With professional investors, large corporations and boutique funds increasingly finding value among local small- and mid-cap compa-

nies, could the sector get a lift this year? What companies might be targets next?

Chi says he prefers companies in which the majority owner holds a substantial stake. "For companies to unlock value themselves, we prefer that the shareholding level is much higher. **Ho Bee Land** is an interesting example, where [the majority shareholder holds] about 70% to 80% of the total shares. Adding another 20% would not be difficult," he adds.

Ho Bee is trading at 4.8 times earnings and half its book value. The counter has declined 13.6% since it hit a 52-week high of \$2.36 last June. For the nine months ended September, the company posted a 79.7% increase in earnings to \$87.2 million, boosted by a 173% increase in revenue to \$256.9 million.

Chi says sectors with cyclically depressed earnings are also attractive plays. In particular, he thinks the construction and property sector is a "very interesting space" and singles out real estate developer **United Industrial Corporation (UIC)** as a stock worth watching.

UIC is 49.3% controlled by its chairman, Wee Cho Yaw, who is also the chairman of **United Overseas Bank**. Telegraph Developments, a private company owned by Filipino businessman John Gokongwei Jr, owns 37%. Gokongwei Jr also controls Filipino carrier **Cebu Air** and property giant **Robinsons Land Corp**.

"People are currently not very excited about commercial real estate because rents are coming down. But [that's] more of a cyclical than a structural thing. Also, construction is slowing down. The price-to-earnings (PE) ratios look bad but companies have a lot of value and cash on their books. As they hand over projects, they are also collecting a lot of money back," says Chi.

For the nine months ended September, UIC posted a 27% increase in earnings to \$235.6 million. Revenues rose 22% to \$699.8 million. The stock is now trading at 12.7 times earnings and at 60% of its book value. The counter has gained 1.1% this year.

In the semiconductor space, Chi says he has been looking at companies such as **UMS Holdings** and **Sunningdale Tech** for a while now. "We think the industrial sector has hollowed out; there has been some nice consolidation and what is left are the ones that have something in them. Sunningdale, for example, has a nice market share in terms of injection moulds and it is also making a lot of cash," he notes.

In the telecommunications sector, Chi thinks **M1** is currently undervalued. "The share price has fallen quite a lot and the PE ratio is quite low. Earnings will take a hit because M1, like the rest of the incumbents, will try to make sure that the fourth telco does not get any market share," he says.

"But M1 is still generating a lot of cash, and the fourth telco needs time to build up a whole network. It will only be operational in 2018 and will probably only ramp up by 2020. That's an awfully long way to go. At the end of the day, it doesn't really make sense for the fourth telco to underprice too much. The initial outlay is going to be huge and they would want to at least make a 5% to 10% return. We have churned out the models a lot of times, and it just doesn't seem that they can underprice that much."

The stock is trading at 11.5 times earnings and five times its book value. For the nine months ended September, M1 posted a 12.6% decline in earnings to \$117.9 million. Revenue declined 12% to \$747 million. Shares in the company are down 31.5% from the 52-week high of \$2.89 they hit last July. Analysts remain bearish. According to Bloomberg data, there are three "buy" and eight "hold" calls on the stock and 11 "sell" calls.

Like Chi, Wong favours companies with large cash holdings and in which the founders have significant control. But Wong also looks

### Companies that delisted in 2016

COUNTER	DATE OF DELISTING	LAST TRADED PRICE (\$)	MARKET CAP AT DELISTING (\$ MIL)	
1	Neptune Orient Lines	Sept 6	1.3	3,384.90
2	SMRT Corp	Oct 31	1.675	2,556.90
3	China Merchants Holdings (Pacific)	Aug 26	1.005	1,803.50
4	Biosensors International	Apr 20	0.83	1,411.40
5	Tiger Airways	May 11	0.46	1,150.40
6	Sim Lian Group	Nov 1	1.08	1,086.40
7	OSIM International	Aug 29	1.39	1,030.80
8	Xinren Aluminium	May 26	0.6	782.2
9	Interplex Holdings	June 8	0.82	460.1
10	HTL International	Sept 9	0.995	397.8
11	Pteris Global	Sept 7	0.85	327.6
12	Eu Yan Sang International	Oct 7	0.6	269.5
13	China Milk Products	June 13	0.24	177.3
14	Lantrovision (S)	June 17	3.24	174.6
15	China Dairy Group	June 13	0.194	85.3
16	Zagro Asia	Apr 13	0.3	77.6
17	Select Group	Sept 6	0.515	73.3
18	Otto Marine	Oct 7	0.315	67
19	Eastern Holdings	Mar 8	0.43	64.5
20	Sinotel Technologies	Mar 15	0.128	54.1
21	China Yongsheng	July 1	0.031	51.6
22	XYEC Holdings	June 2	0.3	31.8
23	Texchem-Pack Holdings	Apr 14	0.09	12.5
24	Pacific Healthcare	Aug 30	0.007	4
25	MFS Technology	May 18	0.006	3.9
26	Chinasing Investment Holdings	Dec 5	0.014	1.7
27	AAT Corp*	Jan 13	0	-
				15,540.70

\*Secondary listing Data as at Nov 21, 2016

CONTINUES NEXT PAGE



# COVER STORY

## Cyclical sectors may see renewed interest

**FROM PREVIOUS PAGE**

for companies that have not done placements for a long time.

He thinks the offshore and marine space currently presents some buying opportunity. "I think oil prices have steadied but I don't think it will see US\$100 soon. At the US\$50-to-US\$65 level, [the price] is not too high to impede our growth, and low enough to drive certain businesses. And because we came out from a very low base, some of these players that have survived will see better days in 2017 compared with 2016."

Wong says the property space may be interesting as well. "Some of these property companies are already trading at a steep 40% discount to their net tangible assets. A lot of things can happen now. There is this privatisation angle, which may actually be a good thing. If enough people think the companies are going to be privatised, it may lead to a rerating, which I like.

"If the market plays up the privatisation angle and the property market gets bad enough, we will likely see a reversal of some of the proper-

ty market cooling measures, which is positive. At its current form, there is already value. So some of the companies do look interesting."

Wong sees value in the manufacturing space too. "The US recovery seems pretty strong, so some of the manufacturing companies might see an increase in demand for their products. Companies that can really benefit include those whose revenues are denominated in US dollar, and whose costs are in renminbi or the ringgit," he says. Many of the local manufacturing companies have tightened up a lot, he adds. An improvement in orders would therefore lead to better margins.

He is optimistic that 2017 will be a better year for the markets. "If the stars are aligned, and we work things out, there are enough champions out there who will be able to recognise how much value there is in the market. If the right catalyst sets in, I will not be surprised if Singapore surprises," he says. "And if investors recognise the undervalued companies sufficiently early before they are taken private, it's likely that they will be well rewarded." ■



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### How to find an undervalued stock

Screening for cheap companies does not always turn up bargains. Oftentimes, companies are undervalued for a good reason: a lack of earnings momentum; indebtedness and poor management, for example. And, given a general lack of trading liquidity, value buys can easily turn into value traps. Nevertheless, investors who can stomach risk can occasionally turn a profit.

To find potentially undervalued plays, *The Edge Singapore* screened the Singapore stock market for companies with market capitalisations of less than \$500 million and that are trading at less than half their book values. The 19 companies (see 'Companies that delisted in 2016' on previous page) have also posted earnings growth of more than 10% in the past 12 months and generated positive free cash flow over the same period. They may not all be good buys. But some companies are

investing in future technologies and may stand to reap the rewards in time to come. Others are winning more orders and could receive a boost as earnings continue to improve.

Consider one-time tech darling **Creative Technology**. The company first rose to global prominence in the 1980s with the introduction of the massively popular SoundBlaster soundcards. But it failed to respond to the rise of inexpensive alternatives and soon lost its market dominance. Subsequent ventures into CD-ROM drives, 3D graphics cards and MP3 players all fell victim to industry shifts and a series of self-inflicted missteps. The company is now banking on virtual reality as its next driver of growth, with the introduction of a VR headset called the BlasterX and VR software BlasterZone. On Jan 4, Creative also showcased its Creative Outlier Sports

Sweatproof Wireless In-Ear Headphones at the annual consumer electronics show CES in Las Vegas.

In FY2016, the company posted earnings of US\$2.6 million (\$3.7 million). This was a reversal from a loss of US\$33.4 million a year ago. Revenue fell 15% to US\$84.6 million, but earnings were buoyed by a US\$33.5 million one-off gain from litigation settlement as well as lower levels of impairment and lower currency translation losses. The counter is trading at 8.7 times earnings.

A somewhat steadier name is **Midas Holdings**. The company supplies parts to train makers in China and recently announced some new contracts. On Jan 3, Midas announced that its joint-venture company, CRR Nanjing Puzhen Rail Transport Co, had secured two metro train car supply contracts worth a total of RMB1.8 billion (\$375.4 million). Delivery is slated between January 2018

and August 2019. Midas has a 32.5% stake in NPRT.

Last November, Midas announced that NPRT had secured new metro train car supply contracts worth a total of RMB2.59 billion for delivery between August 2017 and June 2018. A month later, it announced that its subsidiary, Jilin Midas Aluminium Industries Co, had been awarded five supply contracts worth RMB232.1 million. The contracts are for projects in China, the Middle East and Europe.

Midas trades at just 43% of its book value but has a rather hefty price-earnings ratio of 18.3 times. It does, however, have a dividend yield of 1.1%. That yield is supported by steady free cash flow generation. For the first nine months of last year, Midas reported earnings growth of 40.9% to RMB51.2 million, on the back of higher contributions from NPRT.

In the real estate space, **OUE** is a standout. The company develops residential properties, runs hotels and resorts, and has stakes in commercial and retail properties. It is also the parent of two real estate investment trusts in the market — **OUE Hospitality Trust** and **OUE Commercial REIT**.

In October 2016, Stephen Riady, executive chairman of the group, revealed that OUE was approached to purchase shares in **United Engineers**, but there were no discussions and no assurance of any definitive or binding agreement. On January 5, UE announced it had begun a formal process of assessing bids for the company.

For the nine months ended September, OUE posted an 86.6% increase in earnings to \$141.6 million. Revenue more than doubled to \$675.9 million. The counter trades at 40% of its book value.

### Buying opportunities in the small- and mid-cap space

These undervalued companies show signs of improving earnings and cash flows

COMPANY	WHAT IT DOES	MARKET CAP (\$ MIL)	SHARE PRICE (\$)	TOTAL RETURN 1-YEAR (%)	PER (TIMES)	P/BV (TIMES)	EPS QUARTER GROWTH (%)	EPS 1-YEAR GROWTH (%)	DIVIDEND YIELD (%)
Creative Technology	Designs and manufactures multimedia and computer peripherals	72.6	0.965	-15.7	8.3	0.5	52.4	55.0	-
Stamford Tyres	Distributor of tyres and wheels	62.4	0.265	-1.8	12.5	0.5	118.8	59.0	3.8
Hanwell Holdings	Markets and distributes consumer essentials	127.3	0.230	-11.5	29.4	0.5	49.6	108.6	-
Hotung Investments	Venture capital firm specialising in start-up and expansion stage investments	145.2	1.490	22.6	8.8	0.5	179.9	214.8	11.4
Frencken Group	Mechatronics and integrated manufacturing Services provider	99.6	0.245	26.4	7.8	0.5	14.8	14.9	3.1
Midas Holdings	Manufactures and sells aluminum alloy extrusion products	377.9	0.225	-23.2	18.3	0.4	20.9	28.1	1.1
Miyoshi	Designs and manufactures mould and precision pressed parts	21.3	0.047	8.5	20.4	0.4	34.4	128.6	8.5
Hengxin Tech	Manufactures telecommunications and radio frequency (RF) coaxial cables	122.2	0.315	3.9	4.9	0.4	30.2	31.5	2
Aztech Group	Designs and manufactures electronics and LED lighting products	19.9	0.410	-21.2	-	0.4	91.7	75.8	-
OUE	Real estate developer and operator	1,600.7	1.775	0.8	7.1	0.4	499.4	622.4	1.1
Seroja Investments	Provider of marine cargo and coal transportation services in Indonesia and China	24.2	0.062	21.6	-	0.4	-69.7	75.5	-
Sin Heng Heavy Machinery	Rents and trades lifting equipments	39.5	0.345	-42.5	-	0.4	445.1	52900.0	-
Hong Leong Asia	Manufactures and distributes diesel engines and other industrial products	258.0	0.690	-10.9	-	0.3	6.5	17.0	1.5
SP Corp	Engages in tyre distribution and commodities trading	17.5	0.500	-56.5	9.5	0.3	60.7	60.7	-
Thakral Corp	Involved in manufacturing, logistics and property development in India, China and south-east Asia	35.3	0.270	40.8	-	0.3	-	17.9	8
Sino Grandness	Manufactures and distributes juices, canned fruits and vegetables	185.2	0.275	-24.2	1.2	0.3	114.9	116.7	1.4
First Ship Lease Trust	Provider of lease financing solutions to the maritime industry	102.6	0.161	1.9	6.2	0.2	25.0	25.0	-
Beng Kuang Marine	Provider of corrosion prevention services to marine vessels	13.8	0.102	-15	84.5	0.2	84.6	70.9	-
Lafe Corp	Engages in property development and investment	72.6	0.315	-52.1	-	0.1	75.7	65.1	-

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BLOOMBERG