COVER STORY

WILL THE BULL RUN CONTINUE?

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STOCKS to buy for the market's next phase

As the economy recovers, the property, hospitality and manufacturing sectors are expected to do better, say the speakers at *The Edge Singapore*'s 2017 Mid-Year Investment Forum. Here's where they think investors should be putting their money.

| BY ZAVIER ONG |

The local stock market may be headed for a correction in the third quarter of this year, but that should not deter investors from putting their money into stocks right now. Some segments of the market look set to head higher on the back of improving macroeconomic fundamentals, with some of this recovery yet to be priced in.

Property stocks, for instance, will likely be supported by growing demand. And select hospitality plays have been underappreciated. The manufacturing sector, meanwhile, is likely to continue its recent rally as tech equipment and component makers continue to enjoy strong order flows.

These views and more were presented to nearly 400 readers at *The Edge Singapore*'s 2017 Mid-Year Investment Forum, held at the Suntec Singapore Convention & Exhibition Centre on July 22. Our previous forums had focused on macro-oriented issues such as central bank policy outlooks and global capital flows, as well as asset classes such as property, currencies and commodities. On this occasion, however, the forum had a distinctly micro flavour. After a strong market rally in the first half of this year, attendees were looking for investment ideas. And the speakers delivered, with views on where the market is headed and stock picks with good value.

Underappreciated hospitality plays

After a strong 1H in which the benchmark Straits Times Index gained 13.1%, driven by liquidity-flushed global markets and an accommodative US Federal Reserve, the local market is due for what Terence Wong calls "a healthy correction".

"I don't think it will be a 15%-to-20% correction because I believe the market is backed by strong fundamentals. But valuations have run ahead of fundamentals and you can see that price-to-earnings ratios have slowly crept up," says Wong, who is CEO of boutique fund manager Azure Capital. The firm bills itself as a "special situations fund" that sources investment opportunities with potential catalysts within the next six to 12 months, and relies on fundamental analysis and meetings with a variety of stakeholders — management, analysts and even other fund managers — to drive its investing strategy.

As analysts look forward to 2018 and revise their price targets to include next year's earnings, however, Wong sees price-to-earnings multiples going down to more palatable levels. "I think this is going to be a short but healthy correction. And at the end of the year, the STI will be higher than where it is today," says Wong, who used to be head of research at DMG & Partners Research. DMG was acquired by **RHB Bank** and is now known as RHB Research Institute Singapore.

One of Wong's picks is **Amara Holdings**, a hotel operator that he thinks is trading at a sharp discount to its revalued net asset value of $1.40 a share. He believes Amara's management is progressive and likely to extract value by divesting some existing properties. "I think the only thing that will not be up for sale is the flagship Amara Singapore in Tanjong Pagar. Anything else is fair game, and I believe there should be interest in the Amara Sanctuary Resort Sentosa. That should be a catalyst for the counter," he says.

Wong is optimistic that the outlook for the local hospitality sector will improve. "I believe demand will pick up. Currently, we have 63,000 rooms, up from 45,000 six years ago. Visitor arrivals flatlined between 15 million and 16 million a year from 2013 to 2016. But looking ahead, our visitor arrivals will increase because of the opening of the new Terminal 4," he says. "The number of rooms has also started to taper off. It was growing at 5% annually between 2011 and 2017, but this will taper to 2.3% from 2018. But revenue per available room (RevPAR) will pick up by 5% next year."

Also on Wong's list is **Banyan Tree Holdings**,

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Speakers sharing their views on where the market is headed and stock picks with good value at the investment forum

a counter which he says has been underappreciated by investors. He notes that Banyan Tree is turning to an asset-light model and earning management fees in the process. As part of a partnership agreement, French hotel group **Accor** has taken up a mandatory convertible debenture that will give it a 5% stake in Banyan Tree. The deal gives Banyan Tree access to Accor's global reservations and sales network, as well as its loyalty programme. "Both companies are already working together to secure new sites and explore possibilities for using the Banyan Tree brand on those sites," he adds.

China Vanke Co, the largest property company in China, has also taken a 5% stake in Banyan Tree. Both companies will form a joint venture, Banyan Tree China, to consolidate the ownership of Banyan Tree-branded hotels and assets in China. Wong says the JV will lead to valuation gains for Banyan Tree and greatly reduce its gearing ratio. Vanke is also keen to use the Banyan Tree brand for luxury senior-assisted living condominiums in China.

Havard Chi, director and head of research at Quarz Capital Asia, is positive on several companies in the hospitality space too. A unit of Switzerland-based activist investor Quarz Capital Management, Quarz Capital Asia set up shop in Singapore in June 2015 to engage with undervalued local companies. Chi thinks **Far East Hospitality Trust** offers good value just now, having fallen 40% from its listing price. FEHT has a portfolio of quality assets, comprising eight hotels and four serviced apartments in prime areas such as Orchard, Clarke Quay and Bugis. He expects income from Oasia Hotel Downtown, a property close to the Tanjong Pagar MRT station, to stabilise by 2H2018. Additional income is expected from the Outpost Hotel Sentosa and the Village Hotel Sentosa developments. FEHT owns a 30% stake in both projects, which are expected to be completed by end-2018.

However, Chi cautions that things could get worse for FEHT before they get better. "We think distributions per unit will fall another 10%, while RevPAR will fall another 8%. That should give us a dividend yield of 5.8% this year. But a lot of people do not realise there is a fixed rent component built into the structure, which provides a DPU floor of 2.8 cents. That equates to a 4.1% yield at the counter's current stock price. This provides a degree of income stability."

He sees a bad 2H and possibly a bad 1Q2018. "But after that, there will not be much supply left in the market." Revenue could also be boosted by key events next year, such as the Singapore Airshow, the World Cities Summit and the *Singapore Biennale*. He expects FEHT's dividend yield to rise to 6.7% by end-2019.

Potential property recovery

Outside of the hospitality space, Chi thinks **Tuan Sing Holdings** is a good bet. Tuan Sing, which counts billionaire hotelier Koh Wee Meng of **Fragrance Group** among its biggest shareholders, currently trades at a rock-bottom price-to-book ratio of 0.4 times. Chi notes that Tuan Sing has an enviable portfolio of 999-year and freehold properties — a rarity among local developers. And the completion of Robinson Tower in 2H2018 should provide a boost to Tuan Sing's rental income.

"We think the catalyst is that its projects will soon be completed and go onto the market at a time when supply is coming down. We think commitments will come in very quickly. Investors will start getting excited when they see anchor tenants coming in," says Chi. He estimates that the completion of Robinson Tower will bring in $17 million in recurring income every year, which should provide "plenty of room for Tuan Sing to pay increased dividends".

Moreover, he adds, Tuan Sing's management is open to the idea of divesting its assets into a REIT. He estimates that between $500 million and $1 billion of capital could be released through such a deal. The capital released could then be used to pay a special dividend and to further grow Tuan Sing's real estate portfolio. Tuan Sing could also sell its non-core assets, property inventories at Cluny Park and new developments to unlock capital of $350 million to $400 million, says Chi.

"We see potential upside of 40% by 2019. We are long-term investors; we think things take time to work out and we are happy to wait two years for things to materialise. Of course, timing is uncertain, but we like to take bets that do not cause us to lose too much money. In the worst-case [scenario], there is no catalyst. But since we are buying the stock at rock-bottom prices, we will just exit the investment without making or losing any money," he adds.

Quarz has a history of engaging with companies to unlock value. Last September, it 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. On Jan 13, the fund issued an open letter to the board of medical property developer **International Healthway Corp** stating its support for the ousting of the then board and outlining a plan to stem the erosion of shareholder value by selling non-core assets. And on May 31, it issued an open letter to the board of steel manufacturer **HG Metal Manufacturing** urging the company to take "immediate steps to address the severe undervaluation" of its shares.

Chi also thinks the property sector could see a rebound in the quarters ahead, having lingered in the doldrums over the last few years as a result of oversupply and various government cooling measures. "A lot of capital is now trapped on the sidelines because of the Additional Buyer's Stamp Duty. But there is a demand for second homes, so we think transactions will be well supported. That means when property developers bid for land, they should be able to sell them quite easily," he says.

Other property counters that Chi likes are **First Real Estate Investment Trust** and **Ho Bee Land**. "Every acquisition that First REIT makes will be accretive and will give investors a higher dividend yield," he says. Meanwhile, he notes that Ho Bee Land's share price only reflects its Metropolis property and some Sentosa assets. "You get everything else for free. People talk a lot about Ho Bee's UK properties. But if you're getting them for free, if it goes well, good for you. If it doesn't, you have the Metropolis. Something may happen with Metropolis. A young generation is taking over at Ho Bee; they have new [ideas] and they might look to do something," he adds.

Be nimble on manufacturing stocks

In the manufacturing space, Wong of Azure Capital thinks investors need to exercise some caution and be nimble entering and exiting their positions. Many counters have seen a doubling or tripling of their stock prices this year, he points out. "We have seen the momentum sweep up companies such as **Jadason Enterprises** and **Avi-Tech Electronics**. These companies have enviable cash reserves, but have been largely ignored over the last two years. Despite the lack of attention from the market, they have continued to generate strong cash flows over the years," he says. "And because a lot of the machines have been fully depreciated, every item they churn out [is] like churning out cash."

Wong believes the sector is poised for another round of consolidation, led by bigger companies going for mass and scale. Private equity firms, too, are on the lookout for acquisition targets within the sector. He notes that **KKR & Co** recently said it is eyeing "mid-cap manufacturing industrial companies that are family-owned and have a market capitalisation of a few hundred million dollars to $1.5 billion... This underscores the fact that there is still value in the market. Many of these tech manufacturers are still cheap by international standards, even though they have already run up considerably".

Despite its recent appreciation, Wong likes Avi-Tech. "It hasn't run up as strongly as the likes of **UMS Holdings**, **AEM Holdings** and Jadason. Avi-Tech's share price movement is a lot tamer. But it's something to look at. It's promising because it is a burn-in solutions provider that serves the fast-growing automotive sector."

Wong says Avi-Tech is likely to see growth of between 10% and 15% annually. The company also possesses a strong balance sheet and there is a possibility it will go for some form of merger and acquisition. Avi-Tech's net cash position is about 30% of its market cap. "This cash can be deployed to line shareholders' pockets, with the possibility of a special dividend with a targeted yield of 6%," he adds.

Competitive strengths

Investors should not ignore large, blue-chip names altogether, though. Ken Teng, an entrepreneur and a financial speaker at Value Investing College, says it can sometimes be difficult to find value. "You can do however much analysis and you will realise that all this information is already reflected in the stock price." So, Teng adopts a simpler strategy of investing in companies without obvious competitors, or that have a strong competitive position relative to their peers.

He likes local bourse operator **Singapore Exchange**, which has "no foreseeable competitors for the next 10 years". He also likes **Facebook**, whose products are highly ubiquitous. "Just observe what passengers on the trains are using: Facebook and WhatsApp. It's highly unlikely that another company will emerge as a competitor."

Teng says investors should stay invested, even though stocks appear expensive in the current market environment. "With most investors, cost averaging every month is a lot more powerful than your portfolio having a home run. It's very difficult to have home runs, hence the need to look for consistency. Consistency will pay you far better than home runs." ■

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