

iCap eyes undervalued stocks with its cash hoard

Capital Dynamics' fund waiting for the right time to strike – when the market has corrected



CAPITAL Dynamics Group's listed closed-end fund iCapital Bhd (iCap) is flush with cash and it wants to use the war chest to invest in cheaper and undervalued stocks when the market corrects.

The fund manager's founder and managing director Tan Teng Boo says: "We have been holding a lot of cash for the listed fund, with 55-60% of its assets in cash. We are waiting for the right opportunity, when the market is cheaper and more attractive, then we are able to make use of the cash."

He hopes there is a correction in the market so that he can make use of the cash to pick up undervalued stocks. "By doing so, hopefully in the future, the NAV [net asset value] will rise at a faster pace again."

The veteran fund manager is not satisfied with the listed fund's current performance. The fund's units are largely traded at a discount to their net asset value (NAV). And over the years, the discount gap has widened.

Tan reckons the NAV growth of iCap in the past 15 months "has been quite flat", as the fund is holding a lot of cash. Cash level surged to RM240 mil as of May 31, 2014, from RM209 mil a year ago. This is to build up iCap's war chest for potential opportunity in the future.

For him, the opportunities for investment are likely to be lying in a bear market.

"There are a lot of listed companies in Malaysia, but in terms of companies that are undervalued, we are finding it very difficult to find them. It is the valuation. Comparing the intrinsic value of these companies to the share price, the latter is higher than the former," he says.

He adds: "Sun Tzu [a Chinese general and military strategist in 6th century BC] said, in peace, prepare for war. So in time of bull market, prepare for bear market and vice-versa."

"Unfortunately, we are in times of bull market, and the bull has been there for six years. It is getting old."

The fund's huge cash hoard has also drawn criticism from some quarters.

"Holding cash is actually very difficult. A lot of people question why you are holding so much cash and accuse us of not doing the proper thing. So, [if I want] to make sure I do not have the pressure, it will be easier for me to invest in everything."

"But easier does not mean it is the correct thing to do. It is irresponsible because as a fund manager and value investor, [and] if we do not follow the value investing discipline, that would be



by Lim Gian Yai

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Padini Holdings Bhd is one of the companies iCap is invested in. It has a 2.88% stake, making it one of the 30 largest shareholders in the apparel and shoe retailer



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totally irresponsible."

iCap is mandated with finding undiscovered gems but it has no intention of going into private equity that has even more potential due to the disclosure issue.

"There are several types of value investing. For one, it is simply looking at the database, filtering it and selecting stocks. Our type is closer to private equity where we look at their business, management quality, buyers, competitors and then do a long-term valuation."

"It needs a lot of due diligence. But in our case it is a bit easier because our investees are listed companies. It is easier for us to obtain information from listed companies as compared to

unlisted firms," he says.

The NAV of Tan's listed iCap has expanded at a 14.01% compound annual growth rate (CAGR) as at August, since its inception in 2005. It has outperformed the 8.38% compound return recorded by the benchmark FTSE Bursa Malaysia KLCI over the same period.

iCap invests primarily in a managed portfolio of securities, which includes shares, stocks, warrants and bonds issued by companies listed on Bursa Malaysia.

The closed-end fund is often compared with Warren Buffett's Berkshire Hathaway Inc, with the former outperforming the latter in the last 10 years if one were to ignore the variable that

Berkshire has a larger base and largely exposed to the US market.

As for Berkshire, book value of its Class A share grew at a CAGR of 10.81% to US\$134,973 (RM442,711) last year, from US\$59,377 eight years ago. However, the scale of Berkshire is far more enormous than that of iCap. Its market capitalisation crossed the US\$300 bil mark in May. On top of that, its Class A shares are currently traded at US\$206,900.

In contrast, Tan's iCap closed at RM2.43 on Oct 1, giving a market cap of RM340 mil.

Commenting on this, the fund manager says it is not a matter of size.

"It is not about smaller or bigger. The important thing is we know what we are doing. Whatever we do must be logical and show results. And in our case, we definitely produce the results," referring to the iCap and the other two open-end funds – iCapital Global Fund and iCapital International Value Fund, under his management.

Having said that, the founder of the fund management and investment advisory firm sees himself as far from reaching Buffett's achievement.

"Warren Buffett's company is huge with US\$300-400 bil of market capitalisation and 300,000 workers. We are not even one tiny part of it," he quips.

Rising awareness of value investing

Value investing is perceived as a low-risk, high-return type of investing strategy focusing on undervalued stocks. The investment objective is long-term capital appreciation while reducing the margin of error.

It has been 40 years since Tan started being involved in the Malaysian and Singapore stock markets. Over the years, he believes the crowd of followers for value investing has gotten bigger.

"When we first started to publish a newsletter in 1989, value investing was still not completely understood by investors. The situation has seen much improvement 16 years later when we listed the fund (iCap) in 2005. The IPO [initial public offering] was oversubscribed and those investors who invested in 2005 must have heard of and understand the philosophy as well."

Fast forward to now, Tan believes he and his team have spread the word and contributed to the increasing number of value investors in Malaysia.

Like any other capital market in the world, speculative activities in Malaysia, which oppose the doctrine of value investing, are always thriving.

On Aug 20, trading volume on Bursa Malaysia hit a peak of 7.67 billion shares after recording 5.11 billion shares a day earlier because of the speculative element.

"Even in developed markets like London and New York, we always have people who do not believe in value investing. That is why we have all the bubbles. It is impossible to have a situation where all investors are value investors."

"Secondly, value investing is not exciting. You buy a good company, and keep it for years. This requires a lot of patience and discipline, and it is not as exciting as penny stocks that you buy today and the price doubles one month later."

Capital Dynamics will hold its two-day annual event, 2014 Investor Day, at the Kuala Lumpur Convention Centre on Oct 11 and 12 to further educate Malaysian investors on value investing.

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