BARRON'S INTERVIEW

Chartwell's Ronald Chan Finds Good Value in Asia

The Chartwell CIO channels Winston Churchill & Warren Buffett in value investing. 3 stocks he likes now.

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Offices in Hong Kong's financial district tend to be modern, if monotonous. Not Ronald Chan's. Walking into the office of Chartwell Capital's chief investment officer feels like going back in time to an old City of London establishment. Some lobbies might display a smattering of meaningless awards, but hanging by Chartwell's entrance are Chan's share certificates in Berkshire Hathaway, The Coca Cola Co. and Tiffany's – an indication of what's really important to him, which is investing for the long term.

Despite its name, Chartwell isn't a firm of technical analysts. The firm takes its name from Winston Churchill's country estate, and to many a symbol of endurance and perseverance. *Barron's Asia* sat down with Chan in an office filled with books, investment memorabilia and stacks of research produced by his small army of investment analysts.

Barron's Asia: *You are a dedicated value investor in a region where value investing is less prevalent. How did you come to embrace it?*

RONALD CHAN: As a young boy with no background in investing, I listened to the radio, watched CNBC, went on Yahoo! Finance, and I began trading stocks, options. I tried different strategies and I lost money. My late father, being very kind, said: "Alright, son, I'll replenish that lost capital, but think of something where you can sleep at night, and be rational with it."

I came across Peter Lynch's books - One Up on Wall Street, Beating the Street, and Learn to Earn. It seemed like a philosophy I could apply, and I was totally enlightened. I was studying in America, so I began to look into American stocks. That was the late '90s, and everyone was buying Yahoo! (ticker: YHOO), eBay (EBAY) and Amazon (AMZN), but I was looking into Nike (NKE), Procter & Gamble (PG) and MacDonald's (MCD), because I consumed them.

I also bought books on Amazon, and through Amazon's recommendations, I got into Warren Buffett, Benjamin Graham, and Phil Fisher. After reading more about Warren Buffett, I was a converted value investor.

Q: *You wrote two books - Behind the Berkshire Hathaway Curtain and The Value Investors. What did you learn from Berkshire?*

A: One of Buffett's executives told me, "The measure of success is not how much you have in your bank account, but how many people attend your funeral." So my goal is to make sure people do attend my funeral.

The most intriguing thing about value investing is all these investors come from different walks of life, and yet they share the same mind-set. I have flashback memories of what they said, and their quotes have become my personal words of wisdom. I remember Thomas Kahn saying, "Investing is about growing capital, not finding companies that grow. You can still grow your capital with a no-growth company, as long as the valuation is justified."

Q: *How have you adapted value investing to better fit Asia?*

A: You really have to be long-term greedy. The problem in Asia is that everything is too fast-paced, because the Asian economy is so much driven by foreign capital. We must understand that capital flows are a much bigger concern when you practice value investing here.

Secondly, a lot of Asian businesses are family-controlled, so you really have to read behind the numbers and understand the direction of these families in order to understand whether or not these can be considered value stocks. You know there are loads of companies trading at deep discounts, but if the management is not willing to unlock that value - it's a value trap.

So you really have to act like a friendly shareholder sometimes to test their willingness to unlock value. We have to share with them what shareholder value is, and financial metrics like cost of capital, return on equity and debt to equity.

Q: *Do you focus less on large-cap stocks as they may be more affected by fund flows?*

A: Not necessarily. Howard Marks said there's no such thing as a good asset, only good buys, and as long as you find a good price it's better than just finding good businesses. So everything is down to price. And you still have to keep track of large caps to understand the economy and business trends.

Small- and mid-caps would be classified as long-term investments, because you can have easier access to management, and you can understand the business better. Imagine having two folders of research: One for large caps based on price, where you know that management is good and it's safe. If it's good, you get in, and when it's fairly-priced you get out. The other folder is for the small and mid-caps, where you really understand the business and its growth, and then you can stay with it for a longer period.

Q: *North Asia seems quite cheap now. Any examples for that first folder?*

A: In Japan, if you take away the cash holdings, the price/earnings ratios would be much lower than what's reported.

We like auto-part makers in Japan. Through the weakening yen, the stimulation of the economy by the government, they might be a silent winner in the growth of the automobile business. In South Korea, I'd rather buy the auto makers, like Hyundai (005380.KS), and Kia (000270.KS), because unlike Japanese automakers they have no problem with branding in China, and everyone knows that China is going to be a major market for these automakers. So while the Korean automakers themselves will benefit in China, the Japanese auto-part makers will benefit in China. Both groups will also benefit from Southeast Asia.

In China, the endorsement of the banking sector is ultimately an endorsement of the country. Now, with their dividend yields of 5% to 6%, banks are pretty attractive if you have the courage to hold them for the next decade.

Also, the western media always links Chinese property with ghost towns. That's a part of the truth, but not the entire truth. Selectively, I think the Chinese property sector is worth a look.

Q: *Any specific examples?*

A: Central China Real Estate (832.HK) in Henan province. Management says it has no intention of investing outside its home turf, and it has a good brand in this province of 95 million people. The company is focused on the mid- to high-end market. The rich and famous like to stick together, so if you have a high-end complex, they want to live next to each other. We did a site visit and we met with extremely focused management. Singapore's CapitaLand (C31.SG) is a big shareholder, so that's also an endorsement. Now the stock is trading at four times earnings, 0.5 times book value, and pays a 5% dividend yield.

Q: *What other value holdings do you like?*

A: Oriental Watch (398.HK) is a classic Benjamin Graham example where its assets are trading much higher than its market cap. Its market cap is about HKD900 million. Its retail properties are worth HKD650 million. The watch inventory, which is 70% Rolex, has a value of HKD1.8 billion. Add cash, minus debt, I think it's worth HKD2.4 billion. I can sleep at night because I know that it has good inventory and the retail locations that are worth a fortune. This is a classic asset-driven, asset-backed idea which no one looks at!

The craziest thing is they have been writing down the valuation of the Rolexes because inventory has to be written down by accounting standards. Their reported inventory value is HKD1.8 billion, but I'm not surprised if the actual market value is 10% - 20% higher. Also, management says it has plans to offload some of the retail properties. If they do that, it means they're realizing their retail property at full value. If I were big enough, I would love to take the company over.

We also like a company called Dynam (6889.HK), which is a pachinko operator. The funny thing is that Hong Kong analysts do not cover this company because it is Japanese, and Japanese analysts don't cover it because it is listed in Hong Kong. So you have this very unique opportunity with an obscure security.

When we bought the stock, it was trading at five times earnings. The enterprise value is 2.5 or 3 times EBITDA (earnings before interest, taxes, depreciation and amortization). It pays a 6% dividend yield, has a return-on-equity of more than 10%, and it has no debt. No one was looking at it. We felt that even if the stock doesn't move, we'd still be happy to receive a 6% dividend.

Being a pachinko operator, the business is close to being a casino, and we do think there's a chance they'll actually receive a casino license. Indeed, it did rise 100% last year from about HKD15 to HKD30. We sold down some shares, but we still maintain a position. It seems like at HKD30, value investors were passing on the shares to momentum investors, but because nothing happened, the stock did not have enough momentum, so it dropped back to HKD20, and momentum traders are passing the shares back to value investors.

Q: *You have such a broad appetite for learning. What has inspired you?*

Winston Churchill's My Early Life – it's inspiring what the human brain can achieve. Although I'm not fighting in World War II, the investment world is a battlefield. Sometimes you need the endurance to keep going forward, and you need to have the knowledge to hang in there, because if you're too attached to the market you can get really frustrated after a while. The way I try to handle it is as if I'm fighting a very long war, but I need to stimulate myself with different perspectives in life.

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