

# VALUE INVESTING IN...

**Thian Chew**

**Polar Ventures**

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# Thian Chew

## Professional Experience

- Managing Partner at **Polar Ventures** (Hong Kong): Private equity firm focusing on small-medium sized enterprises in Asia
  - Chairman, ASX listed biotech company
  - CFO, consumer technology company
  - US\$150mm buyout, Chinese hospital group
- Executive Director at **Goldman Sachs** (Hong Kong, New York): Proprietary investments in growth capital, distressed and special situations
- Consultant Project Manager at **Morgan Stanley** (New York): Strategic Services Group
- Director at **KPMG Consulting** (Singapore, Sydney): Managing large-scale operational restructuring, post-merger integration and business performance improvement programs
- Senior Manager at **KPMG** (Taipei, Melbourne): Business process re-engineering, performing financial and information technology audit and assurance

## Education

- MBA from the Wharton School (Palmer Scholar)
- MA from the Lauder Institute, University of Pennsylvania
- Bachelor of Information Systems from Monash University
- Chartered Accountant

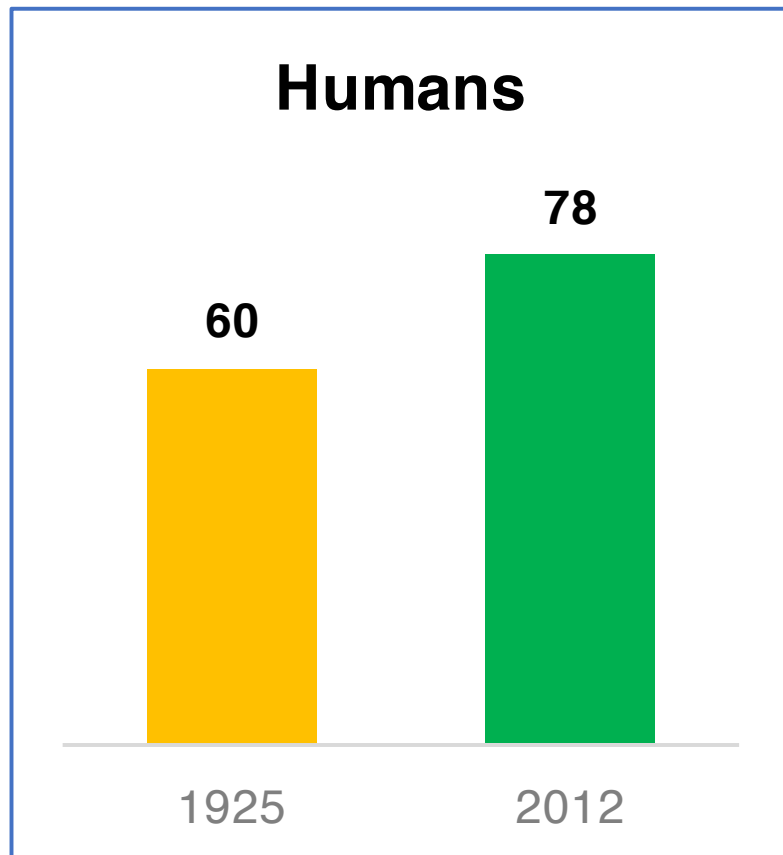
## Teaching

- Adjunct Associate Professor at HKUST MBA Program
  - Private Equity Investing
  - Business Transformation
  - Global Business Analysis
- Career Transition

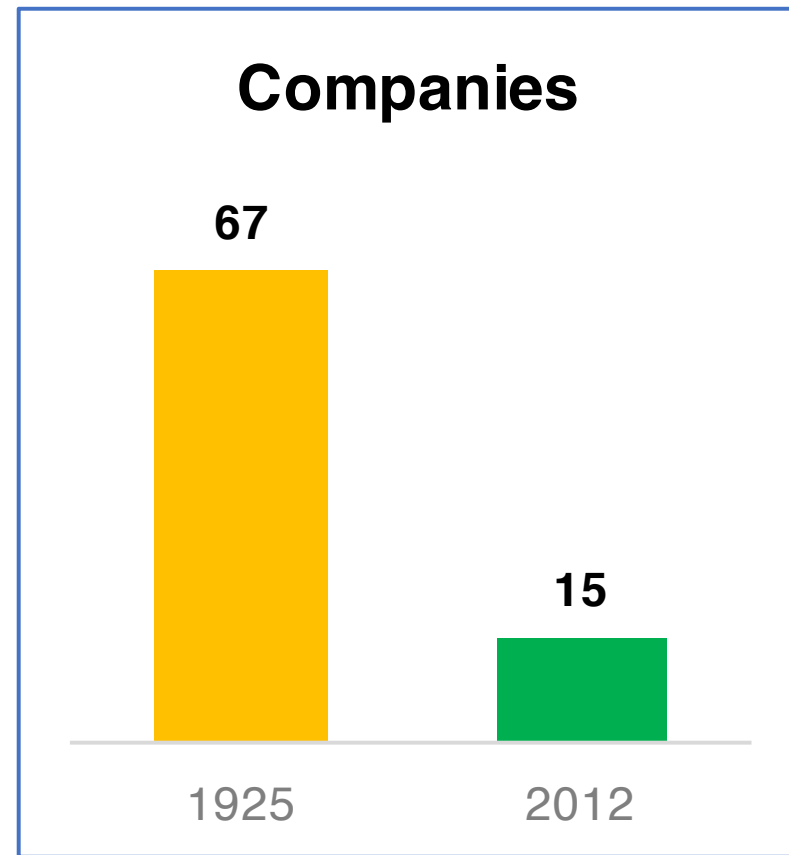
**FINDING VALUE  
IN A  
DIFFERENT WORLD**



# Lifespans have flipped



Men and Women US



S&P 500 Companies

## Implications for value investing?

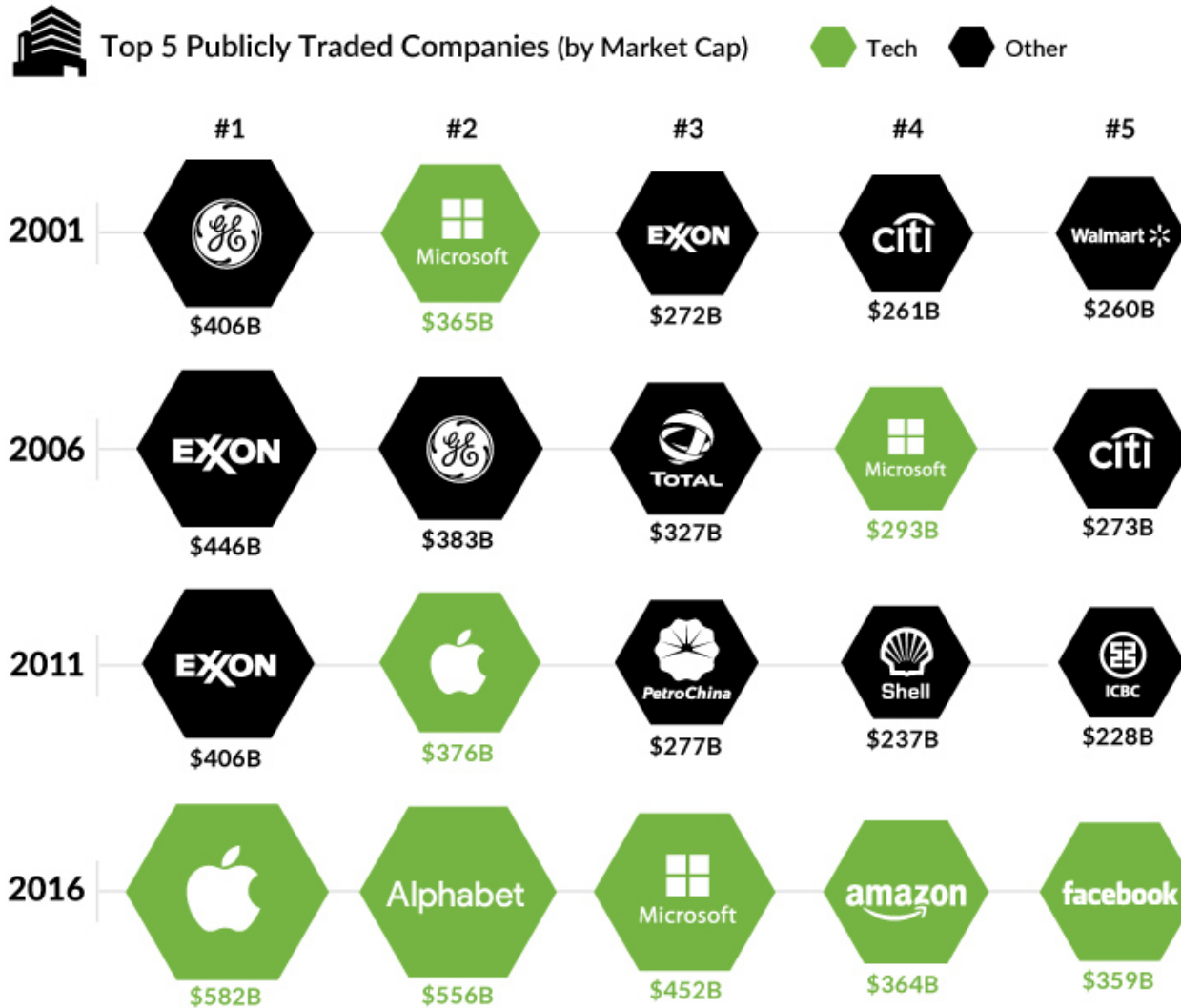
Source:

\* Lifespan of S&P 500 Companies, Richard N. Foster (Yale)

\* Men and Women US Lifespan National Center for Health Statistics, National Vital Statistics Reports. Web:[www.cdc.gov/nchs](http://www.cdc.gov/nchs).

# The world economy has changed

## The Largest Companies by Market Cap



Source: [visualcapitalist.com](http://visualcapitalist.com)

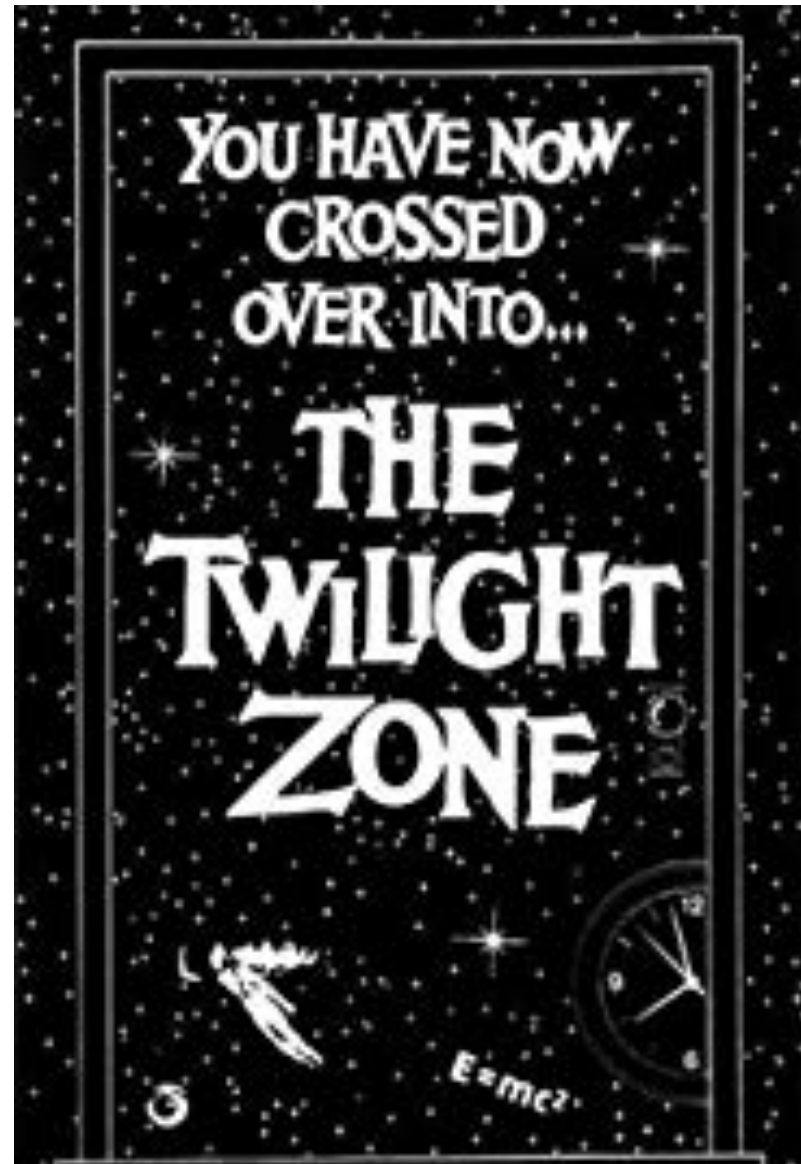
# So where can we find value?

- It's getting harder, even amongst the best of us... eg. Gotham Capital
  - 1985-2006: 40% annualized return
  - 2014-18 5 year cumulative return 10.87% (2.1% p.a.)
- Why
  - More people who know the rules
  - More tools
  - More money in the space
- So where else can we look?
  - Be better than a lot of really smart people
  - Look where fewer people play



## THE “TWILIGHT ZONE”

“An unusual situation or mental state between reality and fantasy”



# Traditional Markets



Public

**Low return  
Low risk**

- Eg, bonds

**High return  
High risk**

Private

**Low(er) return  
Low(er) risk**

- Eg, bank loans

**High(er?) return  
High(er) risk**

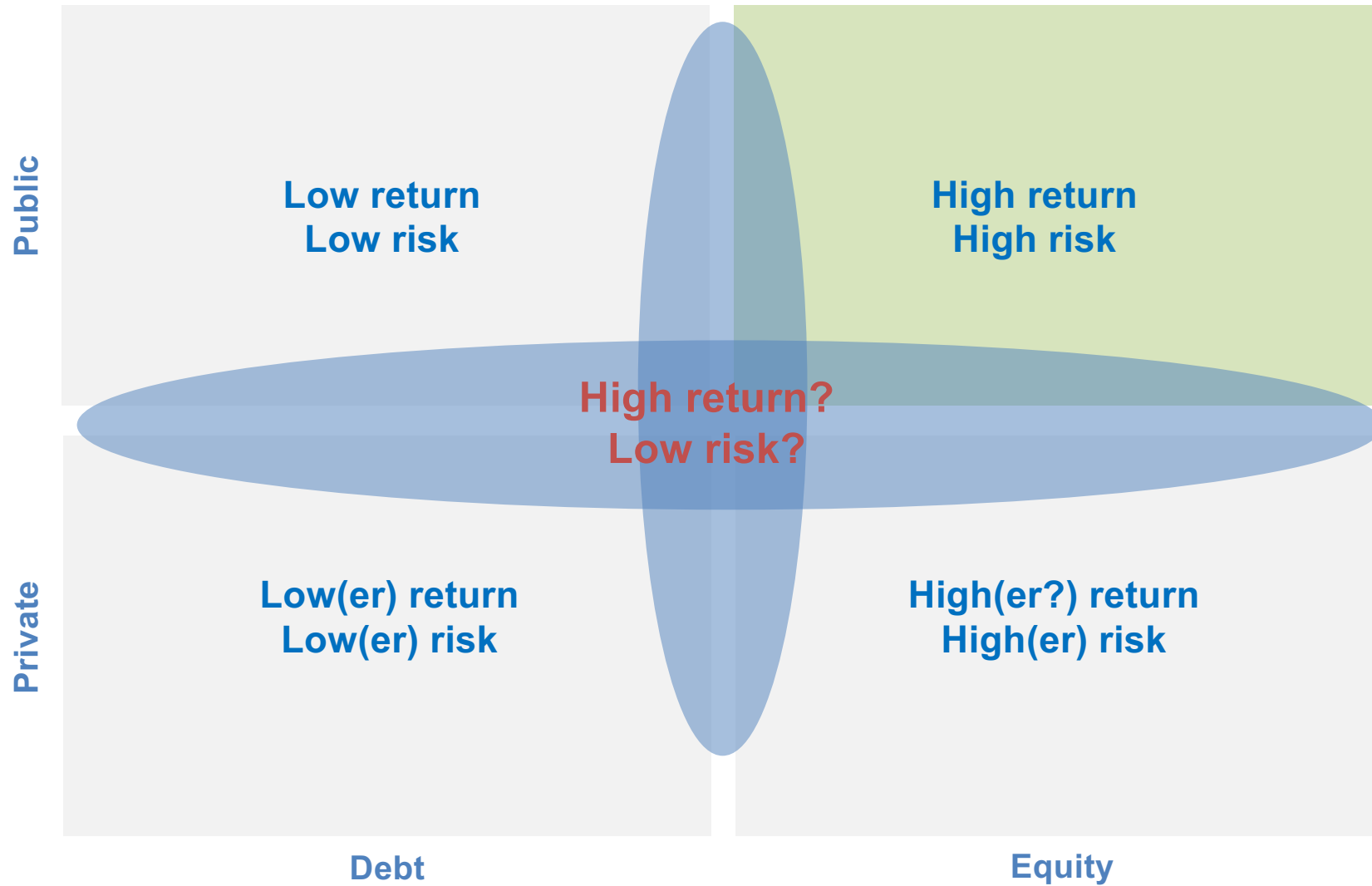
- Eg, We

Debt

Equity



# Finding value in odd places...



# How could this occur?

- Knowledge
  - Different worlds (debt / equity, private / public) - mispriced
- Illiquidity
  - Supply demand capital: Fewer players
  - Bid ask spread (which gets worse when you need liquidity)
- Ability to Negotiate -> pure buy/sell cannot reflect willingness to pay more/take less - a lot on the table (eg, really wants to sell, there's a clearing price)
- More dimensions to change the outcome
  - More terms / levers
    - Downside protection (credit)
    - Create asymmetric upside downside (negotiating terms – not just buy and sell)
    - eg, Debt: security, maturity, redemption, etc, Equity: voting rights, preference, board
  - Able to change the outcome (operational involvement)
- Fear and greed

However, there are pitfalls...



# Don't believe everything you read...

A spate of fraud accusations crushed public valuations of Chinese companies listed in the US and have destroyed market confidence in investing into the "China story"

## Sino-Forest

- "The foundation of TRE's fraud is its convoluted structure whereby... most of its revenues through "authorized intermediaries" ("AI")... ensures that TRE leaves its auditors far less of a paper trail."

## Duoyuan Global Water, Inc.

- "We estimate DGW's actual revenue is no greater than US\$800,000 annually, versus the US\$154.4 million it claims. Our estimate is based on DGW's PRC audit report."

## RINO

- "Chinese regulatory filings show that RINO's consolidated 2009 revenue was only \$11 million, or 94.2% lower than it reported in the US."

## China Media Express Holdings

- "We estimate that CCME's actual 2009 revenue was no more than \$17 million (versus \$95.9 million it reported)."
- We estimate that over half of CCME's network buses do not actually play CCME content. Rather, drivers play DVD movies that are often provided by passengers."



"LCD 1.0"

## Focus Media Holdings Limited

- **Nov 21, 2011:** Muddy Waters accused Focus Media of overstating the size of its LCD Network
- **Jan 6th, 2012:** FMCN announced that Ipsos Marketing Company completed a full count of FMCN's LCD display network, and FMCN currently has 185,174 displays
- **Feb 9, 2012:** LCD = "Light Cardboard Display" (FMCN labeled these "LCD 1.0 picture frame devices")... Muddy Waters claims over 30,500 of those "verified" displays are cardboard posters
- **...October 2019:** Listed in SZSE RMB 78B market cap

# Don't believe everything you hear...

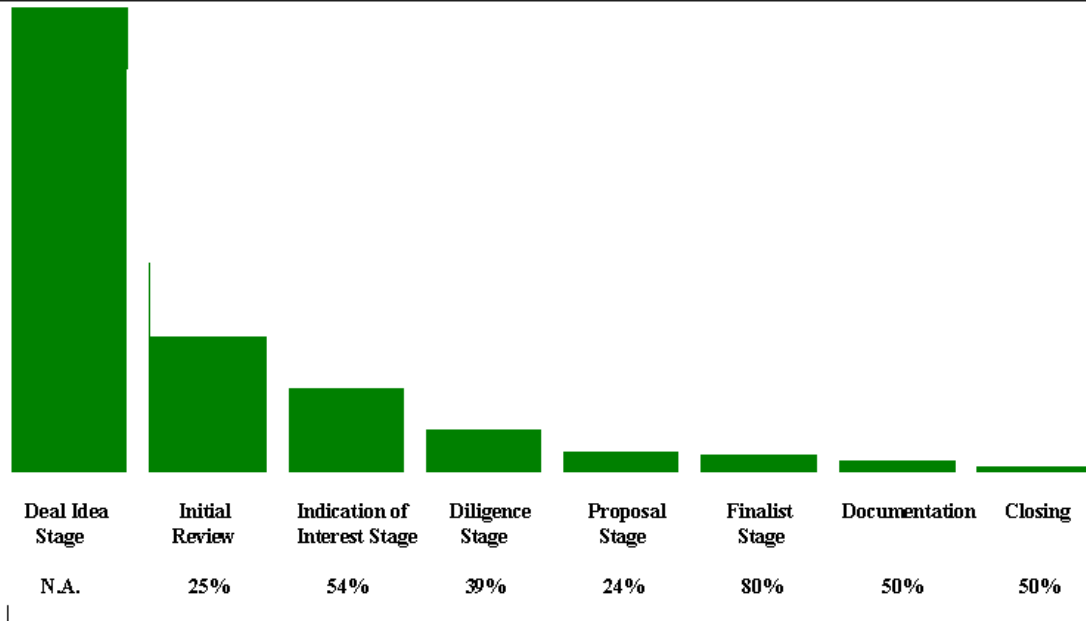
- Who is telling you and WIIFM? [Asymmetric information]
- Quiz: Who is the Buyer vs Seller vs Broker?



# And don't expect it to happen straight away...

It can take a long time to get a deal done (and with a low hit rate)...

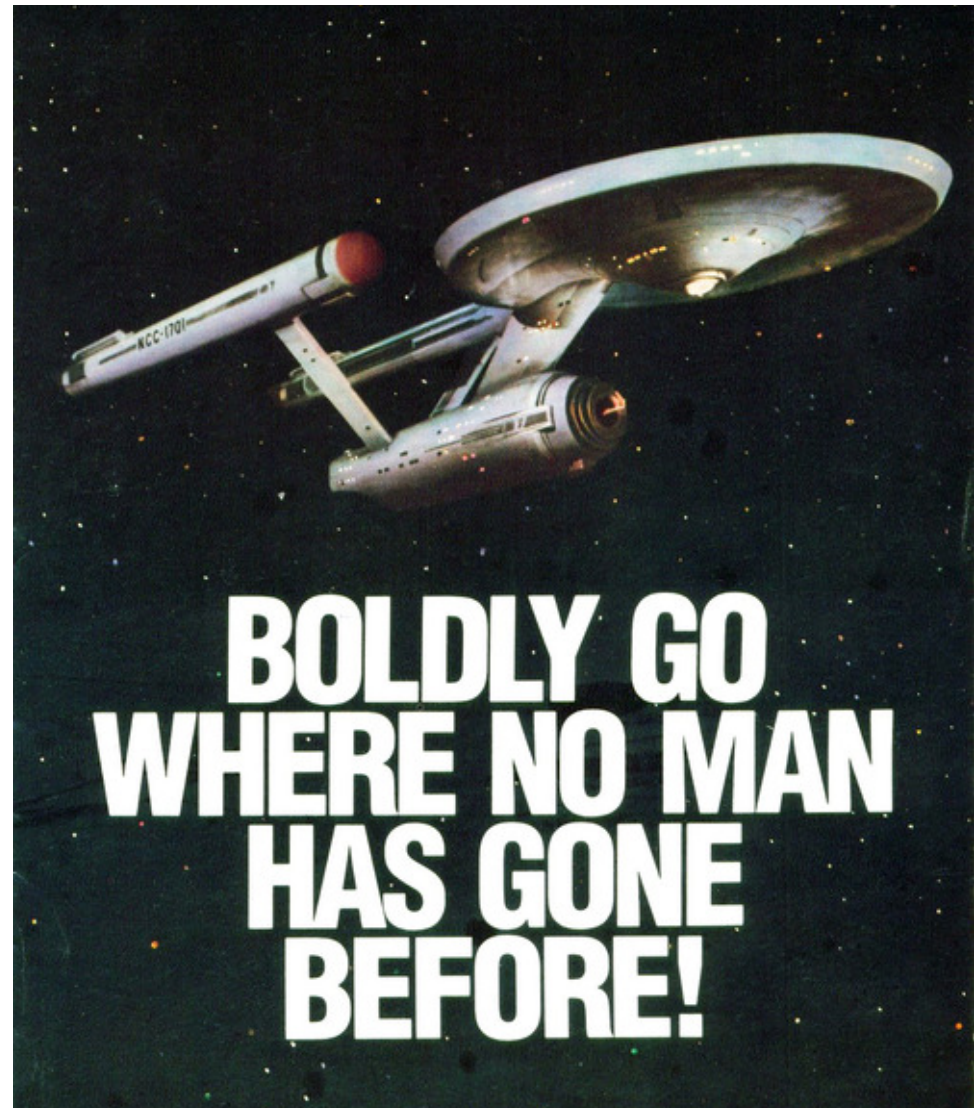
## Transaction Pipeline



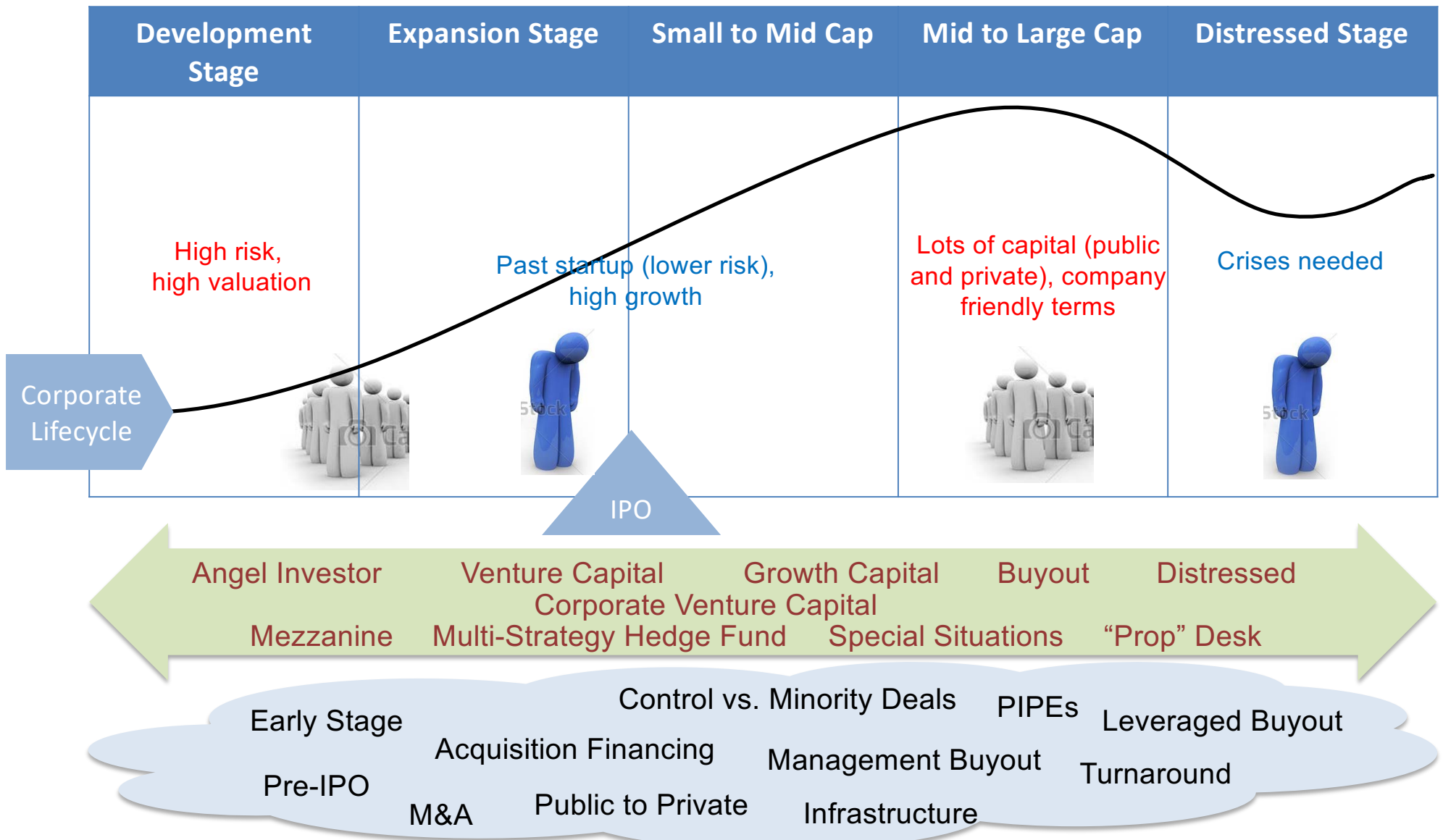
Conversion Rate At This Stage



**WHERE TO HUNT?**



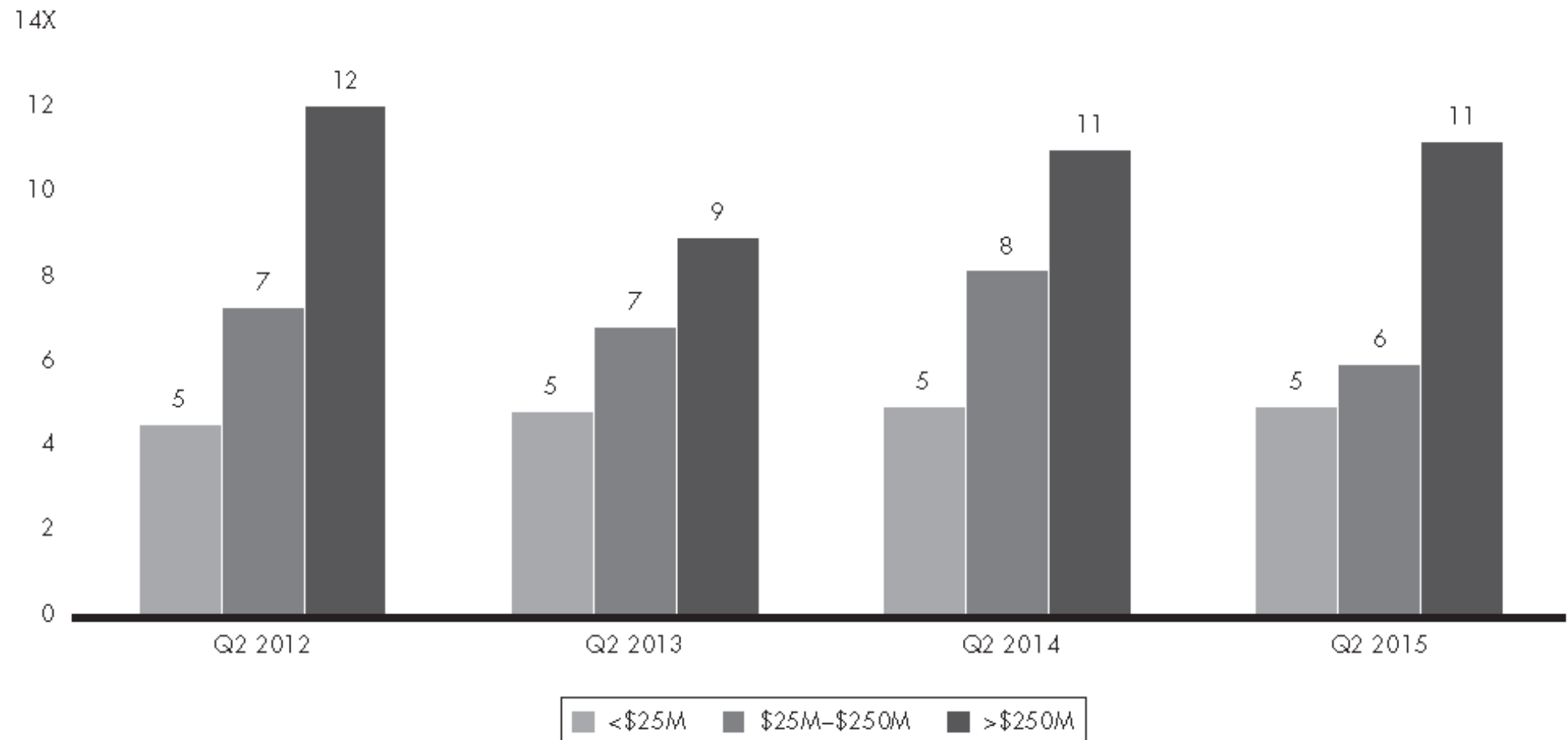
# Where to look... Stages of company





# Smaller deals: Larger funds are creating premiums on larger deals (ie, buying at a higher price)

Median EV/EBITDA LBO multiples (by enterprise value, global data)



Source: Pitchbook

# Where in the world...

## North America: Homogenous

### Canada



Population	34,834,841
Median Age	41.7 years
GDP per Capita	52,037 USD (2013)
Languages	English, French

### US



Population	318,892,103
Median Age	37.6 years
GDP per Capita	53,001 USD (2013)
Languages	English



# Asia: Diverse

## Japan



Population	127 million
Median Age	46.1 years
GDP per Capita	38,468 USD (2013)
Languages	Japanese

## South Korea



Population	51.2 million
Median Age	40.2 years
GDP per Capita	23,890 USD (2013)
Languages	Korean

## Hong Kong



Population	7 million
Median Age	43.2 years
GDP per Capita	37,955 USD (2013)
Languages	Cantonese

## Philippines



Population	108 million
Median Age	23.5 years
GDP per Capita	2,790 USD (2013)
Languages	Filipino, English, plus 8 major dialects

## Indonesia



Population	254 million
Median Age	29.2 years
GDP per Capita	3,510 USD (2013)
Languages	Bahasa Indonesia

## Vietnam



Population	93 million
Median Age	29.2 years
GDP per Capita	1,901 USD (2013)
Languages	Vietnamese, English

## Thailand



Population	68 million
Median Age	36.2 years
GDP per Capita	5,676 USD (2013)
Languages	Thai, Burmese

## Australia



Population	23 million
Median Age	38.3 years
GDP per Capita	64,578 USD (2013)
Languages	English

## China



Population	1,363 million
Median Age	36.7 years
GDP per Capita	6,959 USD (2013)
Languages	Mandarin, Cantonese, Hakka, Wu, Min, Xiang, and Gan

## Pakistan



Population	186 million
Median Age	22.6 years
GDP per Capita	1,275 USD (2013)
Languages	Punjabi, Sindhi, Saraiki, Urdu, Hindko, Brahui

## India



Population	1,242 million
Median Age	27 years
GDP per Capita	1,509 USD (2013)
Languages	Hindi, Bengali, Telugu, Tamil, Gujarati etc..

## Myanmar

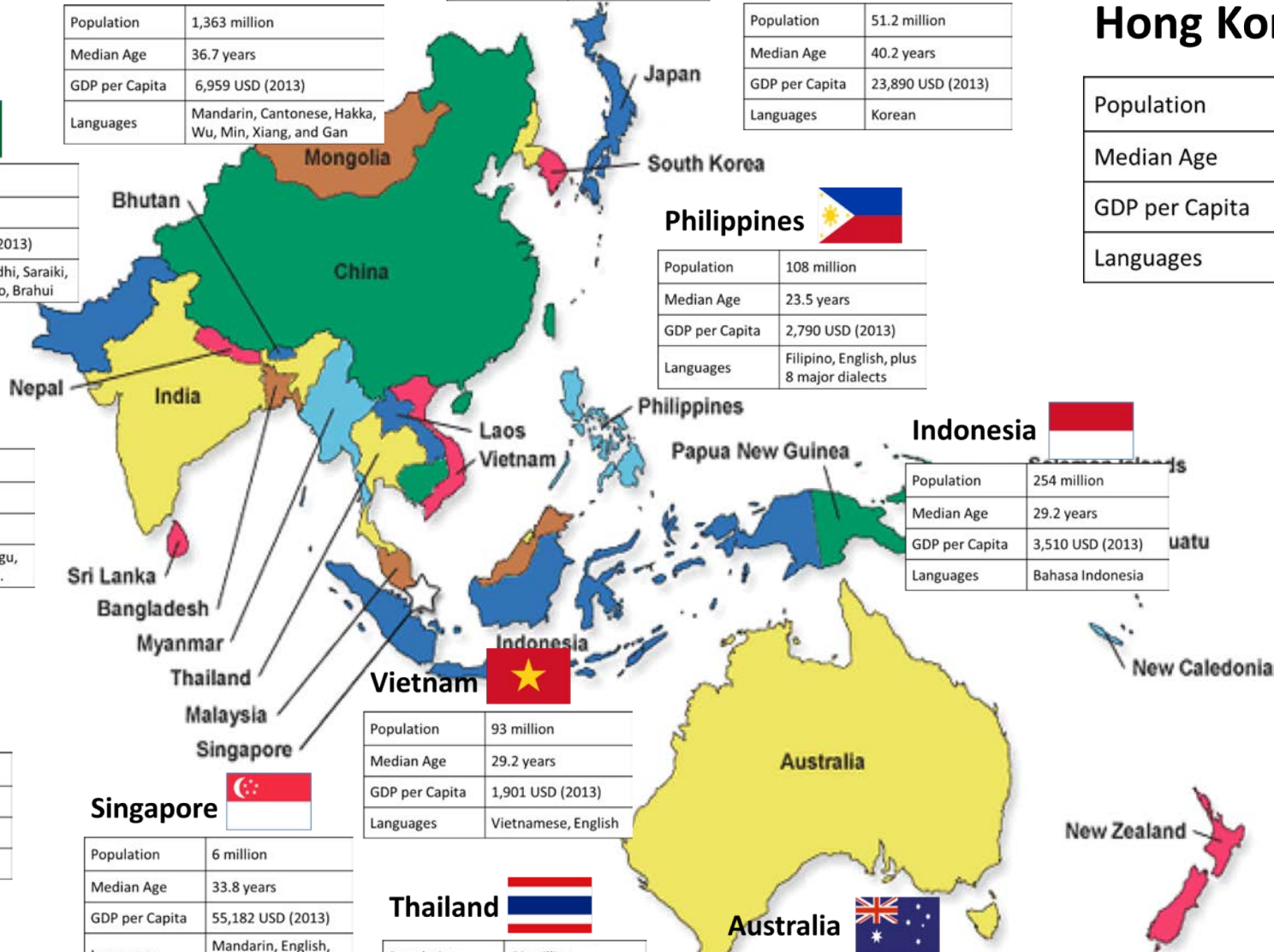


Population	56 million
Median Age	27.9 years
GDP per Capita	1,113 USD (2013)
Languages	Burmese

## Singapore



Population	6 million
Median Age	33.8 years
GDP per Capita	55,182 USD (2013)
Languages	Mandarin, English, Malay, Cantonese etc.



# Contrasting private deals in the U.S. vs. Asia

## United States

- More established, efficient and sophisticated market and players
  - Pricing more efficient (difficult to get credit terms AND equity upside)
- Homogenous market
  - More predictable enforcement of rights
  - Common language and culture
  - Deeper pool of experienced / transportable talent
- Focus on merits of information provided: analysis of information given
- Relationship is important, but so are deal economics
- Valuation more of a science
- More established rules of engagement

## Asia

- Younger industry, been through fewer cycles
  - Unrealistic expectations
  - Less appreciation of risk adjusted return -> opportunity to structure
  - Corporate Governance: a new mindset
- Fragmented market with several countries, languages and legal jurisdictions
  - High variability in ability to enforce legal and contractual rights (different jurisdictions)
  - Contract is the place to start future negotiations...
  - More opportunity for value-add -> But harder to find strong management teams suited for each market
- Greater skepticism on information provided and greater need to “kick the tires”
- Relationship is paramount (often more important than deal economics)
- Valuation more of an art
- Alignment of interests critical (carrot and stick)



**SO LET'S LOOK AT A  
TWILIGHT ZONE  
INVESTMENT...**

# Exercise: Distressed Investing

- Suppose you are looking to buy a marshmallow manufacturer that has filed for bankruptcy
- EBITDA is \$100mm and comparables are trading at 4.0x EBITDA; capex = depreciation; working capital needs are immaterial, interest is accrued but not paid
- Company capital structure

	Principal Amount	Trading Price	Coupon
Debt (Bonds)	\$500mm	0.50	10%
Equity (Market Cap)	\$50mm	n/a	n/a

- Questions
  - How would you go about determining whether to invest or not?
  - Would you invest in the company?
  - If so, what part of the capital structure and why?

# Upside downside... what will the future look like?

- Let's see we hold for 2 years when company emerges from bankruptcy... what will it look like? (Hint: Actually same value investing principles!)

COMPANY	Base Case	Upside Case	Down Case
EBITDA	\$100mm	\$150mm	\$60mm
Multiple	4.0x	6.0x	3.0x
Value of Company	400	900	180

DEBT	Base Case	Upside Case	Down Case
Purchase Price	50%	50%	50%
Debt Value at Purchase	\$250mm	\$250mm	\$250mm
Debt Claim	$500 + 2 \times 50 = \$600\text{mm}$	\$600mm	\$600mm
Debt Recovery	\$400mm	\$600mm	\$180mm
<b>ROI (Debt) over 2 years)</b>	<b>60%</b>	<b>140%</b>	<b>-28%</b>

EQUITY	Base Case	Upside Case	Down Case
Equity Purchase Price	\$50mm	\$50mm	\$50mm
Equity Value Remaining	0	\$300mm	0
<b>ROI (Equity)</b>	<b>-100%</b>	<b>500%</b>	<b>-100%</b>

Other dimensions: Probability of outcomes, risk appetite / fund mandate

# Framing the analysis

## What is the company worth?

- Industry and Market Analysis
- Company Analysis
- Financials and Projections (Base, Upside and Downside Scenarios)
- Investment Risks / Diligence
- Valuation (Base, Upside and Downside Scenarios)
  - Multiples: EV / EBITDA
  - Yields: Free Cash Flow
  - Other Sources of Value: Saleable Assets, Net Operating Losses (NOLs)
  - Sum-of-the-Parts (SOTP)
  - Net Present Value (DCF)
  - Recovery Analysis (Liquidation)

## Should you invest?

- **Entry Price / Valuation: Each Part of the Capital Structure**
- **Seniority**
  - **Capital**
  - **Structural**
- Returns Analysis (Base, Upside and Downside Scenarios)
  - IRR including coupons (total return concept)
  - Recovery Analysis
  - Relative value (cross capital structure, long-short)
- Investment Thesis: Highlights and Risks
- Other considerations
  - Liquidity / Exit
  - Catalysts / events to watch for
  - Margin of safety

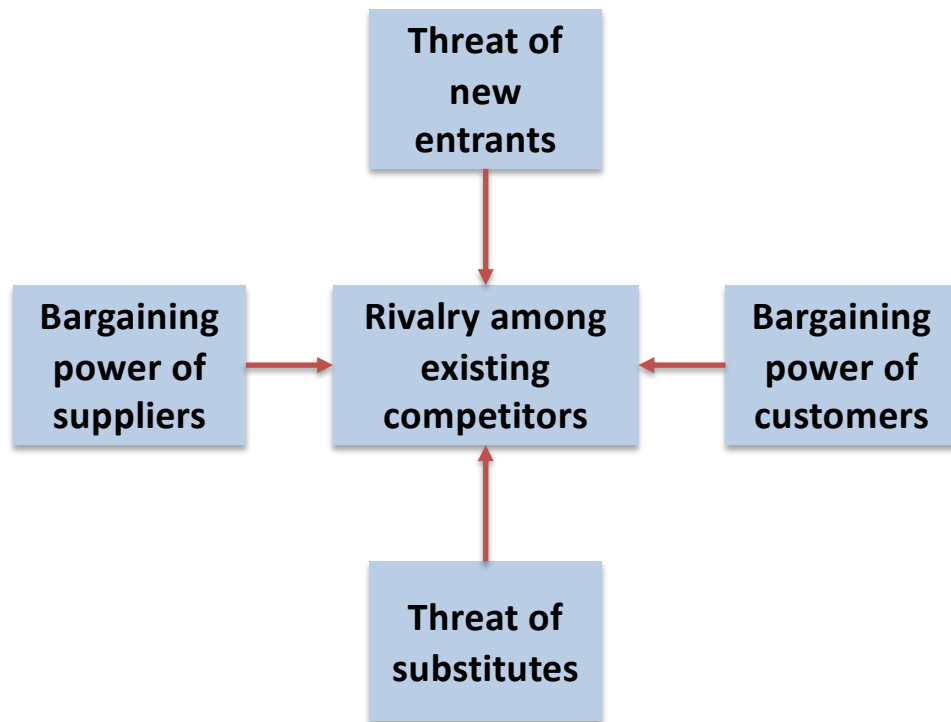




**SO IF YOU FIND YOURSELF  
IN THE TWILIGHT ZONE...**

# Step 1. Is it a “Good” Company?

Porter’s Five Forces can be a useful framework to think about a company



## Questions

- Does the strategy make sense?
- Is the company well positioned?
- Growth prospects / defensive characteristics of business?
- Competitive advantage / barriers to entry?
- Form and intensity of present and future competition?
- What are major risks to the business?
- Are margins sustainable?
- Is it a good management team (can I trust them in tough times, can they adapt, will they stay cohesive as a team)?

## Step 2. Can I get a good price or good terms?

- How flexible is the company on pricing and/or terms?
- What does management really want, what do we really want... can both of us get what we want?
- What alternatives do the company have and at what price?
  - Auction vs. proprietary deal?
  - Other financing options
- Can I get better downside protections?

## Step 3. Can I make the firm more valuable?

- Scale
- Synergies
- Operational improvements
- Optimize capital structure
- Strategic value-add
- Corporate governance and transparency
- Go public / sell to a strategic buyer



**QUESTIONS?**