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MONEY MANAGER INTERVIEW

Deep Value Investing on a Global Basis

SANDY MEHTA, VALUE INVESTMENT PRINCIPALS LTD.

SANDY MEHTA, CFA is the Principal and CIO of Value Investment Principals Ltd. He has more than 25 years of experience in the investment management industry. In addition to his duties at Value Investment Principals, Mr. Mehta founded Acumen Capital Management in 2004, and he incubated a long/short Pan-Asia hedge fund with $20 million in initial assets at launch. He successfully grew the firm to more than $200 million in both hedge fund and long-only assets. Acumen's client mix has included seed investors Weston Capital and Atlas Capital Group, LLC; European and U.S. pension clients; institutional investors; fund of funds; and five separate accounts, the largest being a $50 million mandate from a Swiss publicly listed company. Prior to launching Acumen, Mr. Mehta was a Portfolio Manager of $3 billion in global and international core portfolios at Wellington Management Company, LLP, in Boston. At Putnam Investments, Mr. Mehta was a Portfolio Manager of two five-star-rated funds, the Putnam Global Equity Fund — a flagship product with $15 billion in mutual fund, 50 separate institutional client accounts — and the $2 billion Putnam Capital Opportunities Fund. He also incubated a global small-cap fund, raising $300 million in initial assets. Mr. Mehta was previously Head of the global financial research team at Putnam, supervising eight analysts who covered global financial equities. He has an MBA from the Wharton School.

SECTOR — GENERAL INVESTING

(AES500) TWST: If you would start, just for new readers or to refresh existing readers' memory, start with a little bit of a history, value investment principles and an overview of your business today.

Mr. Mehta: We are a Hong Kong-based investment advisory firm, and we seek deep value or extraordinarily undervalued stocks on a global basis. We're quite diversified in our approach in terms of stocks from North America, Europe, Japan and Asia. We're pretty diversified by market cap as well as geography.

We find ideas everywhere, basically, and the performance has been very strong. We've had a bunch of recommendations where companies' cash on the balance sheet is greater than or equal to the market cap, so you get the underlying business essentially for free. Our average dividend yield for our stocks has ranged from 6% to 8%. And the beautiful thing is that two-thirds of our companies are growth companies, or at a minimum they're in growth industries, and one-third are clear industry leaders. These are quality companies that, for some reason or other, the stock prices are down, and that creates great risk/reward opportunities for us.

TWST: Is there anything you'd add in terms of your overall investment philosophy and strategy?

Mr. Mehta: Our time horizon is generally one year to two years or longer, so we're really looking for multibaggers. More than 25% of our recommendations have gone up over 50%. We're not buying a stock for next week's earnings report, but really for meaningful gain — 30%, 50% or higher gains going forward.

TWST: Do you start with a macro view on themes or sectors or countries, or are you strictly looking at stocks from a bottom-up perspective?

Mr. Mehta: We tend to look at it from a bottom-up perspective. All of our stocks have to have multiple deep-value criteria, multiple metrics, whether it's price to book, EV to EBITDA, dividend yield, price to earnings, things like that. Each and every stock has to have multiple parameters on which the stock is very, very cheap. We start from that point, and then we look at the fundamentals, and again, we're looking for quality balance sheets, good returns on capital and good businesses. These are not stocks that are cheap because they have bad balance sheets or they have some legal risk or things like that. Generally, they're down and out temporarily, and that creates an opportunity.

TWST: That said, are you finding that there are a greater amount of opportunities in particular countries or regions?

Mr. Mehta: We tend to be pretty diversified, so I would say, right now, we are seeing opportunities everywhere. I think maybe a little bit more in Asia than in some other markets, and the performance has been very strong this year. If you look at our performance through the end of August, a quarter of our stocks are up 30% year to date; even the overall global equity markets are up single digits at around 9%. The stock recommendations that we found last year have been outperforming indices by approximately 23%, and our recommendations and new ideas from this year are outperforming by 7.7%.

So even though markets have gone up, we continue to find good opportunities. Sometimes, in some regions, for example Europe, it's a little bit more difficult to find stocks right now. But we really do try to have a balanced portfolio. Please see our website, vipglobalresearch.com, for full disclaimers on performance and risk factors.

TWST: Would you give us a few examples of recent stock picks, and tell us a bit about why they appealed to you and fit your criteria?

Mr. Mehta: Let's start with the U.S. One of our favorite ideas is **Och-Ziff** (OZM), which is the hedge fund organization. This is one of the leaders in the business, with $35 billion in assets. What you see with **Och-Ziff** is you have a 12% trailing dividend yield, and if you look at the consensus forecast as well as our forecast for this year as well as next year, you're looking at around a 12% forward dividend yield. The stock is trading at 7 p/e, so these are extraordinarily attractive valuations.

There are very few stocks in the entire world that can sustain a 12% dividend, and the company is doing really well. They had very strong performance in their hedge funds last year as well as year to date this year, so based on that they're seeing record inflows. In fact, the month of May was their strongest inflow month in their history. So their assets are at a peak. The company is really firing on all cylinders, yet you have a company that's trading at only seven times earnings. The stock is much closer to its trough, so we see substantial upside in this name.

Another name that I would highlight is **Suncor** (SU). **Suncor** is Canada's largest market cap energy stock. This is a $50 billion market cap company. They're one of the leaders in the entire world in reserve life for oil; they have 60 years of oil reserves, and they have 80 years of gas reserves. What you see is there is a paradox — that oil prices are near their three-year high, but a stock like **Suncor** is closer to its three-year low.

It's interesting, we've been recommending the stock since last year, but Warren Buffett just took a stake. He bought $5 billion of the stock; that was announced a few weeks back, and that has given a lift to the stock price. But you have a company, again a clear industry leader, trading at a 10 p/e. If you look at the dividend yield plus buybacks, they're returning 5% of their current stock price to investors every year. The price to book is 1.3 times. The EV to EBITDA is 4.4. We are quite bullish on oil prices longer term, and we think this is a good play. And again, the stock is near its three-year low, and when you have investors such as Warren Buffett coming in, I think that is just an endorsement of the idea.

TWST: How about in Europe? You said it's a little more challenging in that region.

Mr. Mehta: We have several ideas in Europe; **RSA Insurance** (RSA.L), for example, which is based in London. This is an insurance company in the property and casualty space. They have very strong franchises in some niche markets, such as Scandinavia, Canada and emerging markets. This is a company with a strong balance sheet. It has a 5.3% dividend yield, and that's only with a 50% payout, so we think there's room for the dividend to increase. The valuations are attractive at 1.3 times price to book, a single-digit p/e at around nine times earnings. And what we're seeing is that property and casualty rates have been rising over the past year or so, so that's a major catalyst for the stock. This is a stock that's still a little bit out of favor, and we see quite a bit of upside in this name on strong industry fundamentals.

One other idea in Europe would be **Groupe Bruxelles Lambert** (EBR:GBLB). This is actually a holding company, and they've had a great track record over the past several decades. You're getting the stock at very attractive levels. You have a 4.4% dividend yield. It's trading at 0.88 times tangible price to book. You can think of this company as a closed-end mutual fund, and it's trading at 37% discount to its net asset value. This is a great way for investors, in one single stock, to get broad-based exposure to a lot of good companies in Europe, and you're doing it at a 37% discount to its NAV.

One of their large holdings is another one of our recommendations, **Total** (FP.PA), which is the leading French oil company and the third largest oil company in Europe. They just reported a very strong outlook today, and you have **Total** trading at 8 p/e with a 5.5% dividend yield. It's one of the more attractively valued energy stocks in the world. So again, if you look at **Groupe Bruxelles Lambert**, in one stock you have an outstanding management team and you get broad-based exposure to a lot of quality companies in Europe.

TWST: And last but not least, Asia?

Mr. Mehta: We have a lot of good ideas in Asia. One of

Highlights

Sandy Mehta discusses his deep value investment philosophy. Mr. Mehta looks for stocks that are extraordinarily undervalued and are diversified by market cap and geography. Mr. Mehta uses a bottom-up perspective as opposed to a macro view, and believes that in 2014 investors should see good opportunities with individual stocks in developed markets, namely the U.S. and Europe. He shares his top picks as well as his exit strategy.

Companies include: Och-Ziff Capital Management Group LLC (OZM); Suncor Energy (SU); RSA Insurance Group plc (RSA.L); Groupe Bruxelles Lambert SA (EBR:GBLB); Total SA (FP.PA); Qin-gling Motors Co. Ltd. (1122.HK); ISUZU MOTORS LIMITED (TYO:7202); Guoco Group Limited (0053.HK); Circle K Sun-kus Co., Ltd. (TYO:3337) and Macquarie International Infra-structure Fund Limited (M41.SI).

our favorites is **Qingling Motors** (1122.HK). This is a company that has throw-away, deep valuation metrics. They have no debt, and the net cash on the balance sheet is 88% of the current stock price. It's trading at 0.6 times price to book, a 7.3% dividend. They make trucks, and they have a joint venture with **Isuzu** (TYO:7202), which is one of the world's largest trucks manufacturers out of Japan. **Isuzu** owns 20% of the stock, and they've had three board seats going back the past 10 years.

We just spoke with management last week, and you have two major catalysts happening here with this company. One is that you're beginning to see a cyclical recovery in China, and the second is that, with their joint venture with **Isuzu**, they are importing a lot of components from their partner in Japan and with the depreciating yen, their margins are getting a big jump. Every 10% depreciation of the yen increases their margins by three percentage points, so we expect their earnings to be up quite strongly in the second half, the present period. We're looking for an 83% growth in earnings, and we're ahead of consensus expectations.

So again, you have a company where the stock is near its lows, almost 90% of the market cap is explained by cash, you get the underlying business essentially for "free," and you have two major catalysts that are unfolding right now. There are only a few analysts that cover the stock, so we think it's still an undiscovered gem of an idea.

TWST: You mentioned earlier that on average you hold stocks for one to two years. Please tell us about the components of your exit strategy, and if you could, illustrate that with recent examples.

Mr. Mehta: We will exit a stock if it reaches our price target or if we see a change in fundamentals. Last year we had two companies that were taken over, which contributed to strong performance last year. **Guoco Group** (0053.HK) in Hong Kong and then **Circle K** (TYO:3337) in Japan were our recommendations that received takeover offers. A third company, **Macquarie Infrastructure Fund** (M41.SI) in Singapore, is a holding company that is selling off all of its assets and returning all the capital to shareholders. So those are types of situations where we close out of positions.

We also try to maintain a stop loss, too, so if a stock is not working and our recommendation is wrong, we don't want to have too great of a loss. But the good thing is, our average dividend yield today for all of our ideas is 5.9%, so while we are waiting for stocks and catalysts to unfold, we're being paid almost 6% to wait, which is nice in a world where interest rates are very low. When we recommend a company, when we purchase a position, we're very mindful of catalysts; we identify clear catalysts, both short term and long term, so that the value is unlocked.

TWST: What do you use to benchmark your performance?

Mr. Mehta: We look at stocks versus the local markets; so for example, in the U.S. it would be versus the S&P 500. The performance that I mentioned to you earlier, where this year on average we are outperforming by 763 basis points, that's that average outperformance versus benchmark.

TWST: What do you think distinguishes Value Investment Principals from other money managers with a global strategy?

Mr. Mehta: I think that our discipline in terms of valuation metrics is very unique. In my 25 years in the industry, I've not seen people as focused on deep value as we are today. Whether the markets are high or low, we don't alter that discipline. Sometimes it's more difficult to find these types of ideas, but we keep looking. We have a backlog of ideas, and I think if you can buy things at a discount to its value or if you can get underlying businesses for free, and they're quality companies and they're growing such as some of the examples I shared today, I think that the risk/reward tends to be quite favorable.

TWST: What is your overall outlook on the market as we head into the last few months of the year and toward 2014?

Mr. Mehta: I think that you will see good opportunities with individual stocks in some developed markets, which is the U.S. and Europe. I think markets are pretty fairly valued if you look at the U.S. market, the Japanese market. So I don't think the market will do a lot; I think it has already done well over the past year and a half.

Some markets that have lagged, for example Asia, Chinese stocks, Singapore stocks, things like that, you will see opportunities. I think there are opportunities in out-of-favor stocks because those have lagged. But overall the markets will be okay. You'll probably get single-digit returns, and it really comes down to stock selection to outperform. We're a little bit cautious on emerging markets because of the strength in the U.S. dollar and money coming back to the U.S., so we would be cautious on some emerging markets. But I think overal, you need to really be a stock picker to do well, to add alpha.

TWST: Thank you. (MN)

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