Interview with Sandy Mehta, CFA – CEO of Value Investment Principals Ltd.

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Value Investment Principals Ltd. is a Hong Kong based investment advisory firm focusing on unique "deep value" stocks globally. Their clients include many savvy investors such as Royce, Ruane Cunnif, First Eagle, Barrow Hanley, Ariel, etc.

Previously, earlier in Sandy's career, he had the good fortune of working with several prominent investors such as John Neff, Arnie Schneider and John Rogers as an analyst and colleague. More details can be found at the bottom of this article. Sandy was kind enough to sit down with us for an interview.

Q: Give us some details on your firm and investment approach?

Sandy Mehta: Value Investment Principals [VIP] specializes in finding unique "deep value" stocks on a global basis. Our clients include some of the most prominent value investors in the world, and in fact many of them are often profiled regularly in your newsletter. Our valuation metrics are typically quite extraordinary, and this is our edge. For example, we have had a dozen stocks where net cash on the balance sheet is greater than the market cap, so investors are getting a quality underlying operating business essentially for "free". We have done really well with these net cash [and Net-net] type ideas. Over the past 6 years, all of our stocks have had average dividend yields in the 5%- 8% range. Single digit P/E's, price/books well below 1.0, EV/EBITDA below 4 or even below 0, are the sort of extreme deep value metrics we seek.

But it's not just about "throw away" valuation metrics. Two-thirds of our investments are "growth" companies, or at a minimum in growth sectors, and one-third are clear industry leaders. So this unique combination of deep value, growth, industry leadership and dividend yield is an intuitively appealing mix for most investors. Our investments are diversified by geography and market-cap; so we are typically 1/3 USA/Canada, 1/3 Europe/Japan, and 1/3 Asia/EM. And by market cap: 1/3 large-cap, 1/3 mid-cap, 1/3 small-cap. We like quality businesses, clean balance sheets, and strong FCF. We shy away from excessive debt, and only a handful of our investments have been "leveraged" companies.

Q: What else makes your style unique within the value investing arena?

Sandy Mehta: We are very risk-reward focused, and therefore, price sensitive. We like to catch stocks at multi-year lows in terms of stock price. The sell-side will always come to you with recommendation upgrades after stocks have already moved up 50%. For example, among the more well-known large-caps, we invested in Toyota below 2,800, Microsoft at 25.00, H&R Block at 16.11, Suncor below 30.00, Total at 35.00, Corning 12.63, Sony 1,890, InterActive IACI at 20.30, etc. Looking back over the past six years, many of our entry points were close to multi-year lows. Extreme deep value, emergence of catalysts, receiving rich dividends while we wait - this enables us to pull the trigger. A low entry point increases risk-reward and sets up multi-bagger opportunities. And have been able to consistently find one new deep value idea each and every month on average, despite global market highs.

Q: How has performance been?

Sandy Mehta: Performance has been strong. In addition to solid relative-to-benchmark performance, approximately half our stocks have been up 25% or more absolute, and one-third up 75% or more. Currently one of our stocks, Samsung C&T [000830_KS] is the subject of shareholder activism and a takeover bid - fully 20% of all of our stocks have been the focus of activist shareholders which really helps to unlock value. Given the deep value metrics and extreme undervaluation of all of our ideas, we would not be surprised to see more of these companies being the targets of activists, as well as outright buyouts, several of which we have also had. [Please do see our full disclaimer on our website]

Q: What are some of your best "new money" opportunities today in the USA?

Sandy Mehta: Kulicke & Soffa [KLIC; $900 million cap] is the clear industry leader in the semiconductor ball bonding business with about 70% market share and 50 years of operating history. It used to be domiciled in the USA, but they switched to a Singapore domicile a few years ago, and the stock continues to have a sole listed on the NASDAQ. This company will be a beneficiary of the "Internet of Things" phenomenon and the wider use of semiconductor IC's. The stock jumped up 50% last year after we got involved, but has since retraced and looks very compelling today at about 60% net cash, 12% FCF yield, 5x P/E ex-cash, 1.1 tangible price/book. The company continues to accumulate cash at a rapid rate. The stock has been the subject of an activist shareholder which has directly led to a large 10% share buyback. In a consolidating industry globally, this may eventually be acquired.

Suncor [SU_CN and SU_US, $40 billion cap] is Canada's largest energy company and is a leader with 60 years plus oil reserve live, one of the longest in the world. We believe oil prices today are trading well below "normal" levels of around $80, and Suncor's production is tied to Brent, not WTI. Including buybacks and dividends, Suncor's return of capital to shareholders is about 6%, and the stock is trading at 1.2 price/book.

Q: Asia must be ripe with deep value companies also growing rapidly?

Sandy Mehta: Bajaj Holdings in India [BJHI_IN; US$2.6 billion market cap] continues to look very undervalued, despite the overall Indian market having done well. Nobody really follows this company, so it remains an undiscovered gem. By owning BJHI, investors are getting exposure to two extremely high growth and underpenetrated Indian consumer businesses: motorcycles and insurance. BJHI is among the industry leaders in both businesses. We have already doubled our money in this stock, but even today net cash [no debt] + all investment securities = 250% of mkt. cap, 0.4 price/book, 7x P/E, and 20% ROE's. Even applying a 30% holdco discount [which is debatable given zero capital gains and dividend tax], there is 70% further upside.

Mainland China-listed Gree Electric [000651_CH; US$21 billion market cap] is the world's largest producer of air conditioners, and has about 30% market share in the domestic China market. This is one of the highest quality financials on the Mainland, trading at just 7x P/E, 7% dividend yield, 12% FCF yield, 20% net cash on the BS, and 35% ROE's. This is a great example of growth + deep value + leadership + dividends. The stock's investability should increase significantly with the upcoming HK-Shenzhen Connect. The company is growing revenues at 15%, and EPS at about 25%. Net income margins have expanded from 6.3% in 2011 to 10.5% today. By way of comparison, Indian competitors such as Blue Star and Voltas are trading at about 3 times higher price/earnings multiples, with inferior growth and financial metrics.

Q: What looks undervalued in Europe?

Sandy Mehta: Dream Global REIT [DRG-U_CN; US$ 900 million market cap; name changed recently from Dundee International REIT] often slips through the cracks, as it is a German commercial property REIT with a sole listing in Canada. Germany remains perhaps the only developed economy in the entire world which has not had a property boom and/or bust in the past couple decades. Underlying economic fundamentals are robust with an unemployment rate in Germany at a 25 year low of 4.5% while the vacancy rates across the "Big 7" office markets at record lows at the end of Q1 at 7.5% with strong demand for high quality commercial space. Dream remains very undervalued with a solid 8% dividend yield [paid monthly and fully covered by FCF], 0.97x P/B vs. past 2-year average of 1.2x and high of 1.4x, and 11x P/AFFO. USA property stocks have done really well, trade at nearly 80% higher valuation levels than Dream, and Europe is at least two years further down the road in terms of monetary tightening.

Finally, Fondul Proprietatea [FP_RO; Romania and also London listed; US$3.0 billion market cap] is one of the most undervalued closed-end funds globally, trading at a 25% discount to its marked-to-market NAV. The recent London listing of its shares we believe is a significant catalyst. There's a 5.5% dividend yield [12% dividend CAGR last 4-year average] fully backed by underlying dividend income, and the underlying investments are undervalued at 1x P/B, 11x P/E and 4.3x EV/EBITDA. The Fund is actually managed by Templeton, and they have repurchased 17% of the share in the last two years.

Thank you.

Value Investment Principals [VIP] is a leading investment advisory firm focused on unique "deep value" stocks diversified across geography/market cap/sector. We were founded 6 years ago, and our clients include many of the top value managers globally such as First Eagle, Royce, International Value Advisors, Ruane Cunniff, Barrow Hanley, Oldfield, Advisory Research, Columbia Wanger, Ariel, Artisan, etc. We look for extreme valuations, such as ten stocks we have recommended where net cash on the balance sheet is greater than the market cap, and one gets the underlying business for "free". In addition to undervaluation, 2/3rd of our ideas are in growth industries, and 1/3rd are clear industry leaders. With an average dividend yield consistently in the 5%-8% range for all our ideas over the past six years - the mix of value, growth, yield plus leadership is an intuitively appealing combination for most investors. Performance has also been strong, with over one-in-every-four of our stocks appreciating >50%.

Our CEO and CIO, Sandy Mehta, CFA, has 25 years of investment experience, and has previously been a PM for a $15 billion "flagship" global fund, been PM of two [international and domestic] 5-Star rated funds, and also founded a $200 million international hedge fund. He was the first analyst ever hired by legendary value manager John Rogers at Ariel, and also worked with Arnie Schneider and John Neff at Wellingon Management.