Pangolin's Hay forages in Asian markets for gems; shuns eco-damaging companies

| BY LOH CHEN-YI |

Briton James Hay, who has been trading in Asian financial markets since 1986 as a broker, relocated to Kuala Lumpur in 1993 to be close to the action in what was then Southeast Asia's biggest bull market.

The term "emerging markets" was still a relatively new phrase in the investment lexicon and Southeast Asia, especially Malaysia, was in the thick of it then, attracting investors from all over the world. But a credit bubble was also rapidly building up across Southeast Asia, and when it finally burst in 1997, Hay lost his job with the now defunct Caspian Securities a year later.

Instead of leaving the region that he had come to know and love, Hay stayed on in Malaysia to invest his own money, while indulging in his other passion of adventuring and trekking around Asia. He was doing well enough on the investment front to start attracting requests from friends to also manage money on their behalf. The amounts started to snowball and in December 2004, Hay incorporated a boutique fund management business, which he named Pangolin Investment Management (PIM).

PIM manages the value-driven Pangolin Asia Fund, which has now grown to some US$40 million ($49.5 million) in size. It's a small fund within the hedge fund universe, but a star performer nonetheless, according to rankings by Reuters/Lipper TASS. For the one-year period until end-February 2013, Pangolin Asia Fund was the sixth-best performer with a return of 18.12% among hedge funds registered for sale in Singapore. It's a performance that Hay is especially proud of, given that he does not short-sell, but only buys and holds stocks that he considers to be highly undervalued.

"People say I should have started a long-short hedge fund, because I'll be able to raise US$200 million," says Hay. "But I didn't really want to do a long-short fund because I'm not a hedge fund guy and I didn't know enough about shorting. From my experience, I know I'm good at buying stocks cheaply and in most cases, if you do your homework well enough, you can ascertain if a stock is selling below what it's worth and if you buy it below what it's worth, you can make money on it."

SAMUEL ISAAC CHUA/THE EDGE SINGAPORE

Whether or not there are elections, Malaysia is always the cheapest market — it's been the cheapest market in the region since 1998 — Hay

Inspiration from pangolins

An avid naturalist, Hay takes inspiration from the eponymous animal after which his business is named. "I spend a lot of time in the rainforest and I wanted to draw some awareness to a protected species and the rainforest at the same time," he explains. "It was originally going to be called the Tapir Fund because I wanted an animal that snuffed around the forest floor looking under leaves for its food, so we could say we snuffed around for our investments, looking under the leaves like a tapir does. But at the last minute, after I checked, I realised that the tapir actually eats leaves and fruits, so I had to change it to another animal and therefore, it became the pangolin." And that is an apt description of how Hay and his team of analysts — all based in Singapore — scour the markets of Southeast Asia for companies to invest in.

The brunt of this foraging work falls on the shoulders of Hay and PIM director, Vinchel Budihardjo, an Indonesian national who coordinates the work of two other analysts, to research companies for Pangolin Asia Fund. Budihardjo has been with the firm since February 2005, two months after Hay set up the business at end-2004, with just US$1.5 million under management. Today, the fund is still of a modest size owing to Hay's penchant for keeping things manageable as well as his focus on companies that not only fit in with his investment thesis but also his personal convictions.

"We just try to buy good sustainable businesses that are not cyclical, so we avoid commodities because they tend to be cyclical," says Hay. "And, we avoid companies that destroy the habitat of the pangolin, so we avoid timber and palm oil because they are drivers of deforestation." Hay says the fund's investment philosophy is made clear in its marketing materials.

Despite what some may describe as the restrictive nature of this approach, those who have invested with Hay have been richly rewarded. The fund has made an annualised return of 16.43% in just over eight years, suffering negative drawdowns only in 2005 and 2008. Hay does, however, encourage his investors to be with him for the long haul, stressing that Pangolin is a value-oriented fund, where a patient approach delivers results.

Searching for gems

"Between two companies which are very much the same, why could one perhaps be much cheaper than the other?" asks Hay. "Normally, it boils down to liquidity, so we end up researching companies that other people don't work on and that's why I have three analysts — our job is research and occasionally, we buy a company." Pangolin's focus is on highly undervalued companies with growth potential. These companies are, more often than not, thinly traded and therefore, rank as "illiquid stocks" at most brokerages and buy-side firms which restrict investment in them.

"We look at lots of these companies and every now and then, we find one which we think is very cheap and therefore, are willing to buy it," notes Hay. As such, Pangolin's analysts spend a great deal of time researching small-cap companies across Southeast Asia to uncover well-managed "gems" with upside potential. They then relay their findings to Hay for discussion and evaluation before he makes the final call on the companies. This meticulous process is evident in the fact that there are only 18 stocks in the current portfolio and half of its assets are invested in no more than five to six names.

Given the concentrated nature of the portfolio, Hay is naturally cautious about giving away specific information about the stocks it holds. Suffice to say that most are small-cap counters less familiar to the average investor, especially if they are trading on a foreign bourse. Hay does let on, however, that **Public Bank** is the largest-cap stock in Pangolin's fund, and Malaysian companies are the largest country allocation with 40% of the fund's assets. There are good reasons for this, says Hay. "Whether or not there are elections, Malaysia is always the cheapest market — it's been the cheapest market in the region since 1998," he observes. "There are nearly a thousand listed companies in Malaysia and when you start looking at the small to medium-size listed caps there, you'll find many good businesses — it's the least understood market and it's also the least covered one, that's why we spend a lot of time there."

Buying cheap businesses

The rest of the portfolio holds 17 other Indonesian, Malaysian, Singaporean and Thai companies. "What we believe in doing is to be very thorough in our research," explains Hay. "We're not trying to spread our risks: I'm not a great believer in diversification; we're just trying to find very cheap businesses — not stocks, businesses. There's a key difference — we're trying to buy businesses cheaply, which also happen to be listed."

Hay says a minimum holding period of three years is required, in order to realise the companies' hitherto undiscovered potential. Combine that with the sometimes illiquid trading of these counters — especially in the amounts that the fund may wish to acquire or dispose — and that is why redemptions can be done only quarterly, and after a minimum notice of 60 days has been issued. Subscribing to the fund can, however, be done monthly, although it is only for persons or corporations that meet the definition of "accredited investors" as set down by the Monetary Authority of Singapore. They must invest at least US$200,000 and pay a management fee of 1.5% as well as a performance fee of 15% of any increase in the fund's net asset value above the high watermark.

Things have gone well for Hay and the Pangolin fund. After a solid 2012 with returns amounting to 24.85%, it has notched up more gains in early 2013, with a rise of 3.41% until end-February. But that's not to say that it will always be plain sailing ahead. "At the moment, markets have run up quite firmly and it is much harder to invest — so we have to work a lot harder to find things to buy at the right price. We can find good companies that will continue to grow in Asia over the next five or 10 years, but it is harder to buy them ultra-cheaply now," cautions Hay. E