Motley Fool Hong Kong Interview Series: Vincent Lam (VL Asset Management)

Hayes Chan, CFA | March 20, 2019 |

I have a chance to interview a reputable Hong Kong asset manager Vincent Lam earlier. Vincent, the co-founder of VL Asset Management Ltd., is specialized in business opportunities in the Greater China region.

Vincent has over 20 years of expertise in financial analysis, investment research and active fund management in HK/China equities. In the mid-1990's, he began his career first as a financial journalist with the Hong Kong Economic Times and Next Magazine respectively writing analytical reports on companies listed on the Hong Kong Stock Exchange. In March 1999, Vincent joined Quam (Hong Kong) as an Equity Research Analyst. He was subsequently hand-picked by Tony Measor, a veteran value investor and fund manager with over 50 years' experience in Asia, as his right-hand-man, and was eventually promoted to Director of Quam's Research and Asset Management divisions.

Before establishing the current company in 2009, Vincent served as Managing Director of Ramius Capital Asia Limited. Since the first HK/China fund under Mr. Lam's management in July 2002, all his funds have been amongst the top performers.

Q.1 Hi Vincent, thanks for taking time off for this interview. You have successfully picked some outstanding investments (Luk Fook SEHK:590, Sino Biopharm SEHK:1177, China Resource Gas SEHK:1193, Techtronic SEHK:669) in the past ahead of the market. Can you share your idea generation and investment process that help you spot such extraordinary businesses?

A: Looking back at my experience in the past decade, the most successful stock picks were market leaders in the emerging industry with outstanding management teams. The following three criteria are equally important for multi-baggers long-term investment.

1. **Market leader**
2. **Emerging industry**
3. **Good management**

Taking Sino Biopharm (SEHK: 1177) as an example, healthcare was definitely an emerging industry 10 years ago and is still true nowadays in China. Healthcare demand grows robustly with rising incomes. It doesn't mean you will gain by investing the whole sector because most companies in this industry are competing in the Red Ocean like the generic drugs. What had caught my first attention soon of Sino Biopharm after the IPO was Patrick Ho (a famous ophthalmologist though now involved a corruption investigation in the US) sitting on broad as a non-executive director. Then, I found Sino Biopharm's co-branding a patent with GSK. My thought was that this company had invested a lot in R&D to increase its pricing power that could set apart from most of its competitors. Sino Biopharm later sold its Eye Drops business to Bausch & Lomb - it was a further endorsement of its R&D capability and products quality. Sino Bio has strong cash flow and never raises funds after the IPO.

Sadly to say, though we bought it at the early stage we sold once and bought again throughout its strong rising trend. Sino Bio remains a king in the industry!

Q2. How much do you use "Top-Down" vs. "Bottom-Up" in your research?

A: "Top-down" approach comes first and more critical. "Bottom-up" approach will be added as a backup strategy. If your view on the industry is wrong, the chance of your bottom-up stock picking will lead to a failure. There are hardly big fish in a struggling industry.

Let's take one of our past successful picks Techtronic (SEHK: 669) as an example.
Top Down: There were strong macro tailwinds in past 10 to 20 years like China entered WTO, cheap wages in China and the world was in deflation with cheap commodities supply. That the US housing market rebounded following the Fed's Quantitative Easing after the Global Financial Crisis was another macro tail wind.

Bottom up: Visionary management team migrated the company from a traditional OEM manufacturer to a brand owner. The management invested a lot in product development. The founder has a strong sales & marketing experience that successfully led this transformation.

In conclusion, if you couldn't identify the industry with a huge addressable market that is far from saturation, your hard work at the bottom-up approach will be a waste of time.

Q3. When was the last time your investment process failed? What lessons have you learnt?

A: The most fatal investment failure in the past 10 years was department store operators like Maoye (SEHK: 848) & Springland (SEHK: 1700). The main reason was that we underestimated the disruptive force of e-commerce to traditional retailers. This was a sector-wide problem. Even insiders were being cut by trying to catch the falling knife. The change was too quick and sudden that the growth rate of the entire sector fell from 20%-30% to 0% in just 2 years. From the company's P&L point of view, it didn't hurt much. However, their prior premium valuation was no longer true. The department store operators dropped drastically from a high PE stock to a low PE one.

What we have learnt from this lesson is that we would be more careful to analyse the power of technology change, which affects the current business environment and the entire industry ecosystem.

Q4. How should value investors avoid value traps?

A: When the industry is in the down cycle, don't be too subjective to do bottom fishing, in particular, when a disruptive change happens. The down cycle may last for 5 to 10 years so don't buy based only on the fact that current valuation is cheap.

Q5. How do you evaluate a company's balance sheet? Do you look for particular coverage or debt ratio?

A: Cash Flow Statement is more important to our analysis. We will evaluate if the Debt to Equity ratio is too high in the balance sheet.

Q6. What do you think of the next driver of growth in China economy?

A: Basically, innovation and consumption upgrade are two main drivers. Innovation comes from the internet or information technology. Consumption upgrade opportunity comes from "made in China 2025".

Q7. What do you think the issue to establish the Communist Party Committee in China's private companies?

A: I can't tell the impact at this moment and am not sure if that will affect the innovation of business. In my opinion, social media will be more likely to be affected than other businesses. We hold both Alibaba (NYSE: BABA) and Tencent (SEHK: 700) in our fund portfolio. I think the political risk is not that high because the internet giants know very well the government's requirement and bottom line.

Q8. What do you think about "made in China 2025"?

A: I am positive about that. Lots of consumers electronic companies are transforming from traditional OEM manufacturers to brand owners like Gree (SZSE: 000651) and Midea (SZSE: 000333). They have enough capability to do product innovation. Midea had high profile acquisitions on Germany's Kuka and Japan's Toshiba recently walking on its path to internationalization. The acquisition can boom its R&D capability. In fact, they have lots of patents but are just stuck at sales & marketing. Kuka's acquisition can further upgrade Midea's automation. They are traditionally cost leaders but will soon become brand owners to increase their pricing power.

Apart from computers and smartphones, the IOT products in the consumer electronics industry could be the future for China's companies. The biggest bottleneck perhaps is the R&D of semi-conductors.

Q9. Are there any industries you tend to prefer? Or avoid?

A; Apart from the industries mentioned about, another sector I am positive is biotechnology. This is a brand-new industry that China and other developed countries are on the same starting line. I think China companies have advantages over her competitors because:

1. Lower wages;
2. Lower-income patients in China are more willing to try new drugs;
3. The regulations in China are looser than western countries that the R&D environment in China is more accommodative.
4. The overall lab test and the clinical trial cost is much less than developed countries

Industry to avoid: The globe will have disinflation pressure because of the lower growth of population and ageing population, so I would like to avoid the traditional industry.

Q10. What do you think about "Belt and Road Initiative"?

A: I think it is more on a political mission and would be positive to China's long-term development. I think the risk is way too high that I won't invest in this area. At this moment, I don't think the Return on Invested Capital (ROIC) would be favourable to "Belt and Road" investors.

Q11. What do you think about the China corporate debt level?

A: I tend to be positive in this area. I believe the current central government grabs back the power from local governments that can help to control the entire debt problem in the country.

Q12. How do you approach diversification?

A: I usually cap at 5% on a single stock. The sector-wide allocation will be capped at 30%. We weight more on IT & Healthcare sectors currently.

Q13. Do you meet with management you invest in?

A: Not exactly. If public information is enough to make the investment decision, we may not visit the management team. If the exposure is too substantial, say 3% above on single stock, we would like to meet the management team before buying the shares.

Q14. When we experience a broad market sell-off (say 30% or more), what are you looking to buy first? Do you buy more of your core holdings? Or do you look to purchase stocks that have been on your watch list, but the valuation never made sense? Or do you first to the companies offering the largest margin of safety?

A: I prefer purchasing stocks in my watch list with premium valuation becoming more reasonable now. That's a once in lifetime opportunity.

Q15. What are the top 3 investment or business books you would recommend?

A: I would recommend

1. Investment book – "The Intelligent Investor".

2. Business book – "Good to Great", this book is inspirational to me - how to find a great management team.

3. Magazine – The Economist

Q16. What's your No.1 tip to HK retail investors?

A: I think there are more than 1 tips

1. Hard working

2. Critical thinking – An independent and objective thinking to distinguish what is relevant and irrelevant information is critical to investing. I think that's why many knowledgeable people failed in investing.

3. Execution ability

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