Interview with Sandy Mehta, CFA –Founder, CEO of Evaluate Research Ltd.

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Evaluate Research Ltd. focuses on high quality, detailed and consistent research coverage of undervalued and undiscovered small/midcap equities on a truly global basis. With offices in Singapore, India and the USA, Evaluate is often the sole research provider of a given stock, thus providing great value-added to the listed company and its management, all investors who are able to freely access all reports on multiple platforms, the stock price and liquidity, etc. Further details and all published reports at: www.evaluateresearch.com

Sandy Mehta, CFA, has over 30 years of investment experience, and has previously founded investment advisor Value Investment Principals [HK/India], and hedge fund Acumen Capital Management in Boston. He has also been a Portfolio Manager for two 5-Star funds, a $15 billion "flagship" Global Equity Fund, and $2 billion small cap fund, at Putnam Investments and Wellington Management Co both in Boston. He has also been the Head of a global research team, and incubated a $300 million small cap fund, at Putnam. He was the first analyst ever hired by legendary value manager John Rogers at Ariel Capital in Chicago, and also worked with Arnie Schneider and John Neff at Wellington. A Wharton MBA and a CFA, Sandy has been quoted extensively in the financial press globally.

Interview With Sandy Mehta, CFA

Q: Give us some details on your firm and research focus?

A: Evaluate Research provides institutional quality research on small/midcap equities on a global basis. Our firm is 4 years old, and we have an experienced and dedicated team of both research analysts as well as marketing professionals. We provide a valuable service of high quality, consistent, detailed and objective research coverage for companies that are not followed by the traditional sell-side, in fact, in the majority of cases we are the only research provider for these companies. In that sense, it is a valuable service that really helps connect investors with these stocks, which are almost by definition highly undervalued and often times rapidly growing and in the early stages of their life cycle. Research is all we do; we are not compromised by investment banking or brokerage activities.

As someone who has had significant experience on the buy-side and as a Portfolio Manager, I can tell you as a practical matter it is increasingly difficult for any PM to buy a midcap stock in their portfolio and take on higher risk for say a 30bps or 60bps position, if they need to do all the research work by themselves from scratch. It is too easy in today’s world to just buy AAPL/GOOG/AMZN/etc. and call it a day, and more and more smallcaps are being left behind and ignored due to poor quality or nonexistent research coverage. Effectively, independent research coverage is a necessary criterion to just “get on the map and get in the door” of most buy-side funds. With so much information flow and investment choices for all investors, without research coverage most investors simply will not invest in a stock, regardless of how compelling or cheap it is, especially if it’s a smallcap.

Q: What makes your research unique? Is there really a need for research outside of the traditional sell-side brokers?

A: The need for independent [non-investment banking focused bulge bracket brokerage firms] company research is greater than ever before as brokerage firms and traditional sell-side research firms continue to shrink around the world. There are secular headwinds for the buy-side, such as fee compression, indexation/ETF, MiFID2, delivering returns above an index, etc. Combined with declining trading costs and research unbundling, there is ongoing pressure on brokerage firms, and we see a huge number of layoffs among the sell-side analyst community. In fact, according to Bloomberg, firms like BlackRock, Morgan Stanley, Nomura, Goldman have started cutting a significant percentage of their global workforce after the 2018 market turmoil. You are also seeing younger, inexperienced analysts and the large firms “outsourcing” report writing to outside firms, all at the expense of quality to save costs. I have to admit, all of our research team has at least some grey hair, and we don’t outsource any of our work!

The MiFID2 regulations implemented in the UK in January 2018, whereby institutional investors now have to pay from out-of-their-own-pocket for research, has dramatically shrunk sell-side broker’s revenues, budgets, and analysts employed. In fact, Fund Managers are now communicating to the smallcap stocks they own, “please ensure you have research coverage, or else we may not be able to own your shares.”

Q: Do companies really benefit from your services and research coverage?

A: There are significant benefits of having regular research coverage for public companies. Research coverage can lead to higher liquidity, more access to capital [equity and debt] markets, a more fair stock price, more access to all sorts of investors [individuals, domestic and foreign institutions], increased visibility of the company and management, etc. For the nominal fee we charge covered companies, we believe the time that the CEO/CFO/IR saves in explaining the background and investment merits to potential investors is by itself a huge value addition. Management need not constantly “reinvent the wheel” when talking with potential investors. Our Initial Reports are at least 30 pages, and we do Update Notes upon all earnings releases and other significant events. Plus, our research is freely available to all investors, big or small, on Bloomberg, Thomson Reuters, S&P Capital IQ, FactSet, etc. in addition to our own website and company websites [if they chose to post it there].

Q: From an overall business standpoint, what are your biggest challenges and your biggest advantages?

A: Everyone knows that there are “no free lunches”, especially on Wall Street! All bond research globally is paid for by the underlying company, and we are seeing this trend being increasingly accepted in equity research as well. While we have DCF-derived price targets for all our covered stocks, most investors look to research for the overall thesis, critical variables, company background, etc. – and not so much for a recommendation. So it’s the experience of the analyst conducting the research, the quality of the report, and the consistency/regularity of coverage which eventually matters to investors. Without any banking or brokerage related fees, we believe our work is much more objective, and also at a much lower effective cost for the company, than that by the large investment banks or our other competitors.

Q: Are any of these midcap stocks you cover clear industry leaders?
A: Yes, several of our stocks are industry leaders in some secular growth areas. Some examples include:

PuraPharm [1498_HK] is one of only five companies, and the only non-mainland China company, that is licensed by the China Food and Drug Administration to manufacture and sell CCMG [Concentrated Chinese medicine granules] products in China. PuraPharm enjoys the market leader position in the Hong Kong CCMG market with over 70% market share, and a broad array of more than 670 products. We recently met with the senior management of the company in Hong Kong and our discussion suggests that the company has a long runway for future growth. Following 26% revenue growth in FY2018, we expect PuraPharm to grow revenues at a robust 16% CAGR over the next 5 years, while EPS is expected to grow at a 92% CAGR over the next 5 years. The stock is trading at just 08.x price/book, and 8x P/E on our estimates!

Industry leader **Rajesh Exports [RJEX_IN]**, US$3.0 billion in market cap, is India's largest exporter of gold jewellery with a 40% market share. It is also, via its wholly owned Valcambi subsidiary in Switzerland, the world's largest refiner of gold. The company has grown rapidly over the past decade and expects to maintain strong growth momentum going forward; over the last five years, the company has recorded 33% EPS CAGR and 60% revenue CAGR. The company stands at the cross-section of 3 key secular trends in India: jewellery demand, retail, and strong consumer demographics. The stock trades at just an 11x P/E.

USA industry leader **Fresh Del Monte [FDP_US],** at US$1.4 billion market cap, is one of the world's leading vertically integrated producers, marketers and distributors of fresh fruits, fresh cut fruits, prepared fruits, beverages and snacks. While only a single-digit revenue grower, the company generates strong FCF, with a 7% trailing actual FCF yield, and is undervalued at just 11x P/E.

Q: Presumably valuation levels are pretty cheap for many undiscovered names?

Leoch International [842_HK] is one of the leading manufacturers and exporters of lead-acid batteries in China. The company has a strong international presence with about 50% of its revenue from countries outside China. With strong R&D capabilities, Leoch is one of the few companies that possess the third generation pure lead battery and the fourth generation start-stop battery technologies. A huge beneficiary of the global 5G rollout, Leoch is the market leader in the telecom reserve power segment with 30% market share, and management targets to increase this to at least 40% over the next 1-2 years. Trading at just 4x P/E, 0.3x tangible price/book, we see 130% upside for this stock as it simply recaptures its prior highs.

Sintex Plastics [SPTL_IN] in India is probably the cheapest stock in the world's most expensive stock market! With a 21% FCF yield, and the stock down significantly from a major corporate spinoff a couple years ago, it is just way too cheap for a 45 year old brand franchise. The Sintex water storage tanksfound on residential rooftops areubiquitous in India, and is a superbrand with more than 50% market share in premium category. Global investment giant KKR invested US$186 million in Sintex's debt, and with a seat on the board, suggests they have confidence in the company's growth prospects, management and overall corporate governance.

IRC Ltd [1029_HK] is the only supplier of premium 65% grade iron ore operating on the Russian/China border. The company has 4 mining projects with a total resources life of 30+ years. The company reported a strong 40% growth in revenues for the most recent half-yearly results, and with minimal further CAPX requirements, the stock trades at a 17% FCF yield based on our estimates. Despite the stock being up a whopping 270% YTD, it remains both undiscovered and underfollowed, and we expect a robust 26% growth in revenues this year.

Sun Hung Kai & Co Limited [86_HK] is a niche investment and finance firm with a focus on China and HK. The company has 50 years of operating history, and operates in multiple growth areas such as mortgages and consumer finance. The stock is extremely undervalued trading at just 0.50x tangible P/B and at 5.4x P/E on our FY2019 earnings estimate. In fact, the company has just completed a buyback of 6.7% of its shares outstanding, and this is in addition to a 6.5% dividend yield.

Q: You mentioned that several companies are in their "early life-cycle stage", what would be some examples?

Indonesia & Singapore headquartered **Agritrade Resources [1131_HK],** a US$1 billion market cap, is in a sweet spot in its life cycle, with surging growth as its core coal operations achieve critical mass among favorable Asian market conditions. Agritrade has grown its revenues at 26% CAGR over the last five years, while net income has had a rapid 53% CAGR. Management is striving to maintain historical growth rates in the mining business at more than 20% going forward. With 35+ years of proven coal reserves life, strong relationships and demand in China [24% of sales] and India [22% of sales], Agritrade has a long runway of growth, and the stock is undervalued with a 7.0% FCF yield.

NASDAQ-listed Aptorum Group [APM_US] is a US$ 500 million cap Hong Kong based early stage biotech company focusing on developing drugs in a number of therapeutic areas including infectious diseases, gastroenterology and oncology. Aptorum's projects are currently in the pre-clinical stage of development and during our recent meeting with the company's senior management at their HK headquarters, they indicated that they expect to be able to submit applications of at least one of its lead projects for Investigational New Drug [IND] to the USA FDA and other regulatory agencies by 2020 or 2021. Aptorum has obtained 12 exclusive licenses of technologies across the areas of neurology, oncology, etc. Aptorum's lead projects are significantly different from existing treatments and offer novel solutions for various medical conditions.

Ozner Water International [2014_HK] is the leading supplier of water and air purifiers in China, a secular growth area. The Chinese water purification market has grown at solid double-digit rates over the last few years, and Ozner's vast distribution network of 7,202 distributors in 3,882 counties throughout China has grown at a 20% CAGR over the past 3 years. According to a report by Frost & Sullivan, the penetration of water purifiers in China increased from 13.4% in 2013 to 21.7% in 2017, but still much lower level than developed countries' penetration of more than 70%. Ozner is the largest manufacturer of water purifiers in China in the commercial sector with 8% market share which is higher than the combined market share of the 2nd to 5th ranked companies. We expect 20% revenue and 30% earnings CAGR over the next 3 years, and 110% stock price upside. The company has been buying back stock, and trades at just 0.9x P/B, 8x P/E, and 4x EV/EBITDA.

Q: Thanks for your time and insights.

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