

## **Message from APS Chairman & CIO, Wong Kok Hoi**

### **Reflections on Performance and Investment Philosophy**

#### Asset Growth

Many have suggested to us that the root cause for our recent underperformance was our strong asset growth in recent years. While we have indeed seen many examples of capacity constraints impairing performance in this business, we would like to assure you that this is certainly not the case in APS. Given that the out-performers in this liquidity-driven bull market have primarily been large cap stocks, we believe our performance would have been much worse had we simply been investing in small cap stocks while completely ignoring large caps. Therefore, we have in effect been saved partially by our AUM growth – which may sound ludicrous, but is in reality actually not very far from the truth.

Instead, we believe that our underperformance has been more attributable to our preference for industrial stocks rather than index stocks or asset reflation plays. The market in the past 18 months or so has largely been a large cap, blue chip market. Fund managers did well by just buying and sitting on familiar names – the less one did in terms of research, the better one probably did.

Take the Singapore market as an example. One would have done very well by buying large cap property and bank stocks, which comprise a substantial proportion of the index and are also beneficiaries of so-called asset reflation. Insiders know that the government's recent measures to stimulate the property market was meant to help property developers get rid of completed but unsold units, which still stand at 3 years worth of (over)supply. Meanwhile, retail investors are more fascinated with REITs paying 4 to 5% dividend yields rather than companies that are earning 20% ROEs. This is a mystery to me.

Frankly, we have been struggling to find value in bank stocks as well. Most Asian banks, with the exception of the Korean ones, are not cheap by any measure. Furthermore, the fungible nature of their financials makes them almost 'un-analyzable', and therefore difficult to invest in with conviction. As a result, we have paid the price for missing out on these index stocks.

#### APS' Investment Focus

We have always had a strong preference for companies with robust business models and core competencies that were difficult for others to replicate. These 'structural alpha' companies tend to be found in industries that are characterized by high barriers to entry, and are run by competent and honest management – usually generating sustainable ROEs of more than 20%.

We also like value stocks that are selling for way below their intrinsic value – such as those trading at net cash, for example. We call these 'economic alpha' stocks. Economic alpha stocks can be out of favor for a long time, but we know time and again from experience that they cannot and will not stay cheap forever. You do not dump them from the portfolio just because they had not delivered returns for one, two or even three years.

Although we also invest in 'dynamic alpha' (or cyclical) stocks, we usually do not have as large an exposure to this alpha cluster because of inherent difficulties in timing the industry and the market.

#### **APS Asset Management Pte Ltd**

## Discipline in Investing

When the going gets tough for a fund manager, he naturally reflects and wonders whether he has lost his analytical skills. He begins to question his ability to understand how financial markets work.

We know that stock markets are often characterized by periods of euphoria and despair – where rationality loses its place among individuals and institutions alike. A professional fund manager worth his salt, however, should not lose his head and be overwhelmed by emotional extremes in the markets. Instead, he must endeavor to stay calm and composed in all market situations, relying on quality research, common sense, experience and sound judgement to make rational investment decisions.

As a fund manager who has lived through numerous market tribulations, such as the Japanese super bull market in the 1980s and super bear market in the 1990s, the Asian economic miracle and subsequent financial crisis of the 1990s, and the boom and bust of the TMT bubble, I am convinced that a necessary condition for successful investing is to have the discipline to stick with a proven and sensible investment approach.

An investor with a disciplined investment philosophy that strives always to perform diligent fundamental research whilst not being influenced by short-term fads holds the key to surviving in all kinds of difficult market conditions. On the contrary, investors who constantly chase the latest investment fads could do well in the short term, but would eventually get wiped out in subsequent bear markets.

Warren Buffet is a classic example of a successful investor who steadfastly adhered to his investment convictions by refusing to invest in technology stocks during the dot-com boom despite widespread criticism from other market participants. He was branded as a dinosaur investor due to his failure to ride the boom. However, as we all know, it was the views that his critics held that eventually became extinct when the bubble finally burst!

## Stock Examples

Here, we present 3 stocks in our portfolio that have not performed well over the past 12 months but which we continue to hold due to their attractive valuations and strong fundamentals. These showcase the type of investment approach APS has and will continue to adopt – finding value through rigorous and original research. In these cases, we believe that the market will eventually come to recognize the value inherent in these names, and the current mispricing – while hurting our results in the short term – will eventually contribute positively to performance in the longer term.

### *Meiloon Industrial (Taiwan) – Structural Alpha*

Meiloon is one of the largest makers of mid- to high-end speakers in the world. In 2004, the company suffered a 45% decline in net income, largely because of high raw material prices (steel and plastics) as operating margins fell 5.4%. In addition, its new business division (DLP projectors for home theatre use) did not take off as expected.

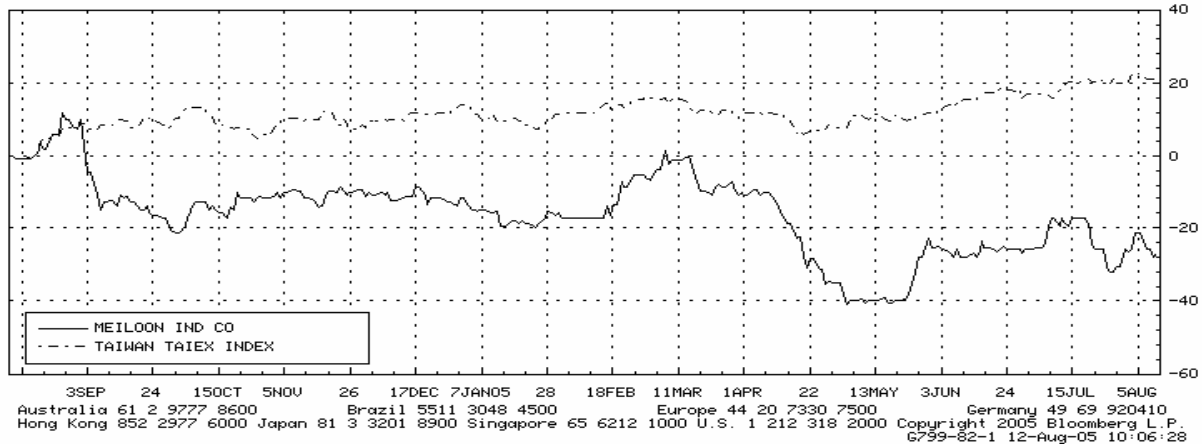
The situation is expected to turnaround dramatically this year. The Chairman personally assured us that the net margins will improve by 3% as he managed to increase the average selling prices for the company's products. We are now expecting a 50% YOY profit increase this year. In addition, after 2.5 years of investments, the projector business has also taken off in a big way and the company is now confident of growth rates of 30-40% in the next 2 years. Based on our estimates the stock is trading at less than 5x PER06 on normalized ROEs of 20-25%. The stock had underperformed by 48% in the last 12 months.

<HELP> for explanation.

P165Msg:MICHAEL WONG

| COMPARATIVE RETURNS     |        |          |       |           |            |           | Page 1/22 |
|-------------------------|--------|----------|-------|-----------|------------|-----------|-----------|
| Range 8/10/04 - 8/11/05 |        | Period   | Daily | 366 Day   | Period     |           |           |
| Securities              | Crcncy | Prc      | Appr  | Total Ret | Difference | Annual Eq |           |
| 1 2477 TT Equity        | TWD    | -32.68 % |       | -26.82 %  | -48.09 %   | -26.75 %  |           |
| 2 TWSE Index            | TWD    | 17.80 %  |       | 21.28 %   |            | 21.21 %   |           |
| 3                       |        |          |       |           |            |           |           |

\*  
(\* = No dividends or coupons)



## Hankuk Electric Glass (Korea) – Economic Alpha

Hankuk Electric Glass (HEG) is one of the only two Korean makers of glass tubes used in Cathode Ray Tube (CRT) televisions. The stock underperformed the KOSPI by 54% over the last 12 months on concerns that sharply declining TFT-LCD panel prices would lead to increased substitution away from CRT televisions. However, through numerous conference calls and company visits, we found that CRT demand was still brisk, especially from emerging markets. The company had also been operating at full capacity since 3Q05.

HEG is now trading near its net cash value (market cap of W322.5bn vs. net cash holdings of W299.7bn). Given that the company is still profitable and generating strong free cash flows (estimated at W25bn in FY05), we find current valuations extremely compelling.

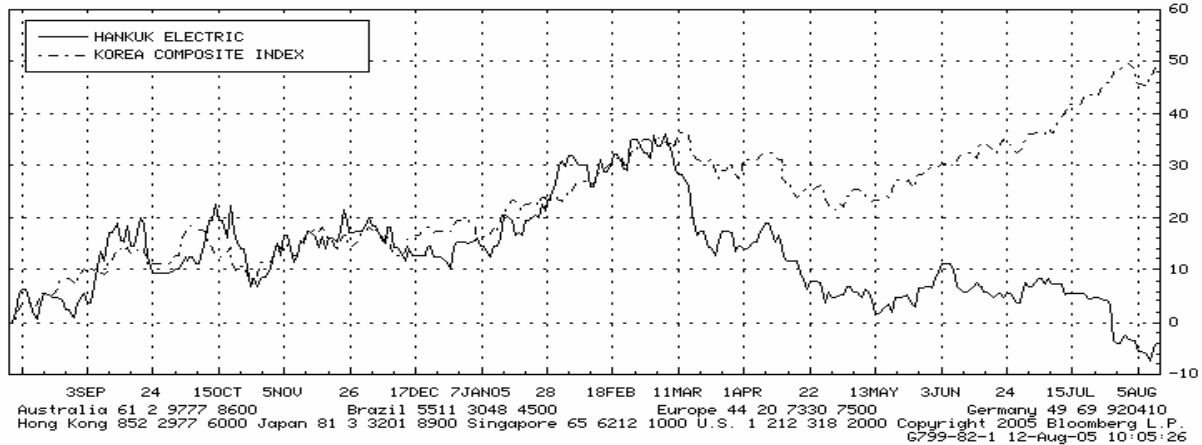
Furthermore, there is potential additional upside from its links with its parent Asahi Glass, which is one of the top 3 TFT-LCD glass makers in the world. Together with Corning and Nippon Electric Glass, these 3 together account for 90% global market share. Korea sites two leading TFT-LCD panel makers (Samsung and LG), but only one glass maker, a Samsung affiliate and JV with Corning, has operations in Korea. We think that HEG is therefore in a favorable position to begin participating in this highly lucrative (almost 40% operating margins due to formidable entry barriers) and fast growing segment, should Asahi Glass decide to build a glass plant in Korea to serve LG with HEG as a JV partner. In fact, Asahi is already in possession of a tract of land next to LG's TFT-LCD plant in Kumi City.

<HELP> for explanation.

P165Msg:WAI HOEY

| COMPARATIVE RETURNS     |       |          |           |            |           |  | Page 1/22 |
|-------------------------|-------|----------|-----------|------------|-----------|--|-----------|
| Range 8/10/04 - 8/11/05 |       | Period   | Daily     | 366 Day    | Period    |  |           |
| Securities              | Cnrcy | Prc Appr | Total Ret | Difference | Annual Eq |  |           |
| 1 009720 KS Equity      | KRW   | -7.84 %  | -3.97 %   | -54.11 %   | -3.96 %   |  |           |
| 2 KOSPI Index           | KRW   | 50.11 %  | 50.14 %   |            | 49.97 %   |  |           |
| 3                       |       |          |           |            |           |  |           |

(\* = No dividends or coupons)



### Hana Microelectronics (Thailand) – Dynamic Alpha

Hana Microelectronics is a PCBA and IC packaging and testing company that focuses on niche segments. IC packaging and testing comprises about 40% of Hana's revenue and we expect the company to benefit from an anticipated industry up-cycle as inventory levels are currently running low. Going forward, its involvement in RFID chips will also provide additional upside should adoption of RFID technology in inventory control take off in a significant way.

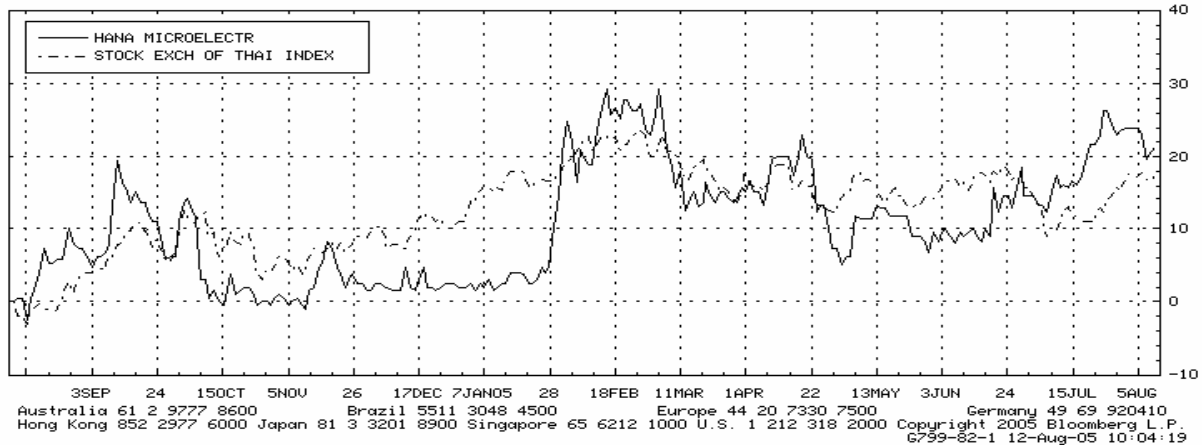
Its diversified revenue stream has meant that Hana has been able to maintain an average ROE of 18% over the cycle. In contrast, its peers have been struggling to stay profitable during industry troughs. Meanwhile, expansion into China will enable the company to continue extending its cost competitiveness. It currently trades at forward P/B of 1.8x and PER of 11x, with ROE of 18-22% and a dividend yield of 5%. Given that cash accounts for 35% of its balance sheet, current valuations are not demanding.

<HELP> for explanation.

P165Msg:WAI HOEY

| COMPARATIVE RETURNS |                |                   |         |        |           |            | Page 1/19 |
|---------------------|----------------|-------------------|---------|--------|-----------|------------|-----------|
| Range               |                | 8/10/04 - 8/11/05 |         | Period | Daily     | 366 Day    | Period    |
| Securities          |                | Crcncy            | Prc     | Appr   | Total Ret | Difference | Annual Eq |
| 1                   | HANA TB Equity | THB               | 15.18 % |        | 21.16 %   | 4.16 %     | 21.10 %   |
| 2                   | SET Index      | THB               | 12.36 % |        | 17.00 %   |            | 16.95 %   |
| 3                   |                |                   |         |        |           |            |           |

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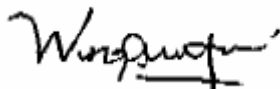


## Moving Forward – Discipline, Patience and More Hard Work

Given the current mix of alpha generators along the abovementioned lines in our portfolio, we are confident that the portfolio will turn around. As we have seen repeatedly, successful investing requires discipline, patience and hard work – and APS is certainly long on all these three attributes.

Be that as it may, we had, starting from last year, thoroughly reviewed each and every stock in the portfolio. This was in addition to our usual research efforts. Furthermore, to minimize the potential agony of underperformance in future, we have decided that we should demand even more compelling valuations whenever we buy any stock going forward. We also resolved to seek yet more contrarian ideas, while remaining cognizant that we should not be too early in terms of timing any potential turnarounds.

All said and done, I still believe that the last thing that we should do is to tinker with our investment approach simply because our results have fallen short of expectations. Regardless of how tough the going gets for us, my staff and I remain committed to doing as much hard work as is required to find the best values and regain lost ground. Never have financial markets anywhere and at anytime forsaken fundamentals for an extended period of time; we see no reason why there should be an exception this time.



Wong Kok Hoi  
Chief Investment Officer  
15 August 2005

## APS Asset Management Pte Ltd

3 Anson Road, #24-03 Springleaf Tower, Singapore 079909. Tel: (65) 6333 8600 Fax: (65) 6333 8900 E-mail: [info@aps.com.sg](mailto:info@aps.com.sg)  
[www.apsalphafund.com](http://www.apsalphafund.com)