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BARRON'S INTERVIEW

Contrarian Stock Picker Offers 2 Buys, 3 Shorts

APS Asset Management's Wong Kok Hoi on why he's bearish on JD.com but bullish on this cybersecurity stock.

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By [ISABELLA ZHONG](#)
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When the market is pointing left, Wong Kok Hoi looks right. Embracing a contrarian investment philosophy has helped the founder and chief investment officer of APS Asset Management to rack up a sterling performance. APS's flagship Asia Pacific Long Short Fund has outperformed the MSCI Asia Pacific Index by an average 17.5% since 2008 on a risk adjusted basis. The strong performance has helped APS to grow its assets under management from just \$15 million at inception in 1995 to \$2.8 billion last year.

Wong also doesn't shy away from making bold calls, having recently published a short seller's report slamming Chinese online retailing giant **JD.com** (JD). The Malaysian native, who earned his investing chops at Singapore's GIC, sat down with *Barron's Asia* at APS' head office overlooking Tanjong Pagar container terminal to talk about JD.com, two other stocks he's shorting and a company that's high growth and looks undervalued.



Wong Kok Hoi - Founder and chief investment officer of APS Asset Management

Barron's Asia: Tell us more about your investment approach.

Wong Kok Hoi: To do well, your starting point is to not do what others do. If you're a consensus investor then you're guaranteed a mediocre performance by definition. Also, Asian markets are still very inefficient, especially in China, so it's essential to adopt an investigative approach and not just listen to whatever Wall Street or sell side analysts say. So for us, we want to generate our own ideas and do our own primary research, which involves not taking things at face value – we take annual reports or what the CEO or management says with a grain of salt – and talking to industry insiders, competitors, suppliers and so on. We're also contrarian. If many people like a stock, we'll show little or no interest because the positives are already priced

in and we may then look at it as a possible short candidate.

Q: It sounds like you invest a lot of time and effort in research. How do you pinpoint companies to investigate?

A: One way is to look for long term trends. It could be business, social or political trends. For example, we decided to short **Wynn Macau** ([1128.HK](#)) after Xi Jinping appointed Wang Qishan as China's anti-corruption tsar. At the time, everyone was very skeptical that one man could take on the whole system because corruption was endemic to China and casino stocks continued to run higher. But we looked into Wang's background and discovered he's not your typical political leader. For one, he has no children and is going to fear no one, which could be why Xi appointed him to fix corruption. We lost money on the trade for a few months because Wynn continued to run higher, but we added to the position and then the stock collapsed 80%. We also sometimes develop investment ideas based on new and interesting things that we hear from contacts or the companies themselves.

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Q: Are you still short Wynn Macau?

A: We're still short on Wynn Macau and are going to add to the position because I don't think the rally this year is justified. The new casinos and hotels that are opening will almost double capacity, or put it another way, the casinos have doubled investments by building new properties. But gross gaming revenues (GGR) are still declining. The increased supply will also intensify competition and spur operators to ramp up promotions and discounts. That means the return on invested capital will be very bad, so the optimism that investors have about Macau casino stocks is completely misplaced. Perhaps the mass market is doing better, as Macau gaming executives often highlight, but what about your VIP market? The mass market gambler won't be able to change the fortunes of Macau casinos because they're not going to bring millions of renminbi to gamble away and the key driver of fortunes is still Xi's anti-corruption drive, which will only intensify. Wynn Macau, which is opening a new casino in August, has rallied the most among casino stocks. What we've noticed is shares of operators that have built casinos in the Cotai area tend surge ahead of the opening on expectation of a revenue boost from the new property. But then GGR doesn't actually improve and shares fall.

Q: Cybersecurity is another trend that stands out for you. How are you investing in it?

A: Edward Snowden's defection to China prompted us to build a long position in cybersecurity. We realized that espionage - whether it's military or commercial spying - was being conducted on a very wide scale and most countries and companies are underinvested. Remember how the NSA was eavesdropping on German chancellor Angela Merkel's phone calls? Sony's ([6758.JP](#)) IT system was also hacked into and all their customers' data got stolen. Not long after the Edward Snowden case surfaced, China formed a national security council where Xi himself is the chair. It shows how serious the issue is. We did a lot of research on listed cybersecurity companies and bought two stocks. We still own one of them: Venustech ([002439.CN](#)), which is the largest long position in our Asia-Pacific portfolio. We think the company will grow at 40% a year for the next five to 10 years, which is a rate they've delivered over the last three years. There's a pressing need for companies and governments to protect IT systems against hackers so cybersecurity capex will increase significantly over the next five to 10 years.

APS Asia Pacific Long /Short Fund

Top Holdings % of Fund as of 30-Jun-2016

1 Venustech Group	8.0%
2 Shenzhen International	6.3%
3 Shanghai Wangsu	6.0%
4 Kangde Xin Composite	5.4%
5 Chaowei Power	4.9%

Q: You have a well-publicized short position on JD.com. What prompted you to make the trade?

A: The biggest red flag we saw was the gross merchandise volume (GMV) metric that many investors use to value JD. It's meaningless! For one, GMV is calculated according to orders received so it could be inflated. Around 20% of orders that JD

receives end up being canceled. More importantly, GMV also doesn't say anything about the profitability of transactions. To have confidence about whether a company will make money, you need to look closely at its business model. The number one product that JD sells is smartphones, which account for around 22% of revenues. In China, there are hundreds of thousands of retailers that compete aggressively to sell smartphones, so even if JD doubles or triples sales, we don't think it'll make money off the product. Electronics retailer Gome ([493.HK](#)) has told us it doesn't make any money selling iPhones but rather the products are there to attract shoppers.

Another 50% or so of JD's revenues come from household appliances or other personal electronics. For most standardized electronics, you also can't make money because of competition and there are price comparison websites in China that help shoppers to find the best deal. While JD offers the convenience of next day home delivery, don't forget rivals like Gome can deliver three times a day, while Alibaba ([BABA](#)) has also improved its delivery system, so just relying on that isn't going to get it far. For any retailer, it's crucial to have products that could be sold at a decent profit margin.

Q: So JD.com isn't going to become profitable anytime soon?

A: We think JD is unlikely to make money or a meaningful GAAP profit in the next few years - or possibly even longer - and investors will eventually lose patience. JD said at the time of its IPO that it would turn profitable this year. There's no way it could make money this year. In fact, it lost CNY9 billion last year. JD has said it could make money anytime it wants to but is sacrificing margins to build market share. Do you believe that? It has raised \$2 billion in external funding this year and two weeks ago announced it'll raise another \$500 million. What this suggests to me is JD is still burning a lot of cash and isn't in a position to make money anytime soon. Alibaba, except its affiliate Ant Financial, hasn't raised a single dollar since its IPO.

Another thing: JD is a pure retailer, not a technology company. Let's compare JD and **Amazon** ([AMZN](#)). Amazon has invested heavily in technology - it has \$22 billion of net fixed assets, more than \$8 billion of accumulated depreciation and spent \$12.5 billion on technology and content last year alone. It has built a thriving cloud computing business that's helped it to become profitable. In contrast, it looks like JD has barely invested - net tangible fixed assets amount to only \$1 billion and accumulated depreciation around \$310 million. In other words, JD hasn't invested in capabilities to make money in the future: the cash it has burnt has essentially gone towards subsidies to consumers.

Q: *What's another stock you're shorting?*

A: **Harvey Norman** ([HVN.AU](#)). It's an Australian electronics and furniture retailer. Its business model is well, very weird. Their franchisees can buy franchises for just a dollar, which suggests they're not franchisees at all but are actually owned by Harvey Norman. Many of the franchisees lose money every year, which Harvey Norman helps to cover through loans, or so-called technical support. But because Harvey Norman isn't the legal owner of these franchise stores, it doesn't need to consolidate them into its financial accounts. That means its income statements are pretty useless because they don't reflect the unprofitable subsidiaries.

If you look at Harvey Norman's balance sheet, it has only about AUD7 million in cash but quite a bit of bank overdrafts, so I suspect it has been loss-making all these years. Rival Dick Smith recently went bust, which shows the industry is very competitive and margins are very thin. However, these bank overdrafts aren't going to continue forever. Also, we're concerned about inflated property values on the balance sheet. Harvey Norman owns a number of storefronts and based on what we know, many of these outlets are in rural areas and probably not worth much, but it has been booking quite a lot of valuation gains. Of course, having big numbers on the balance sheet is helpful for getting loans from the bank.

Q: *You own a Chinese tech stock that sounds like it belongs in the portfolio of a Barron's reader. Tell us more about it.*

A: **Wangsu Science & Technology** ([300017.CN](#)) is a stock that has strong growth underpinned by structural strengths and appears undervalued. The content delivery network operator is essentially the **Akamai** ([AKAM](#)) of China. It has been growing at a pace of about 70% a year and we expect it to grow at a 40% to 50% annual pace for at least another three to five years as China's internet gets bigger and more sophisticated. Wangsu trades at around 30 times forward earnings, which makes it a steal for the kind of growth it's delivering.

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