Bargains in Thailand

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First, I would like to thank Dr. Faber for giving me the opportunity to tell you about our Thai Focused Equity Fund and our approach to investing in Thailand. My case is broken into four parts: (1) a discussion of our track record and investment philosophy; (2) an update on the Thai economy (from a fund manager's point of view); (3) the results of a recent study of the correlation between EPS growth, P/E, and stock prices; and finally (4) some specific examples of the kind of companies that we find interesting.

INDEXING VERSUS ACTIVE MANAGEMENT

Quest Management is the only Bangkok-based foreign fund manager with an exclusive focus on Thai stocks. Unlike many portfolio managers, we take concentrated positions. We typically have 50–60% of our portfolio in only six to eight stocks. In total, we usually have no more than 20 stocks in our portfolio. We believe that we can reduce the risk of taking these concentrated positions by working closely with the management teams of the companies in our portfolio. We have been managing a large portfolio of Thai stocks since April 1990, and started the Thai Focused Equity Fund by rolling in a number of our managed accounts in 1997. The fund's minimum investment is US$100,000 and it offers monthly liquidity.

We think that performance is the reason that people want to invest in funds, so we would like to give you a number of measures of how we have performed over the last ten years. In dollar terms, we are up a cumulative 273% over the last ten years as of the end of December 2002. That's a pretty good track record, but it's a truly amazing track record when you take into account what we have had to work with in Thailand. To give you a better idea, we looked at the dollar return of every listed Thai stock (see Table 2). (There were 177 stocks trading then that are still trading today.)

Of all these listed stocks, the best-performing stock was the largest mobile phone services provider in Thailand, Advanced Info Service (ADVANC), which was up 93% in dollar terms. The SET Index as a whole was down 76% over the same period. Only 11 stocks in Thailand had positive returns, and 95 of the 177 stocks did worse than the SET Index.

If you compare someone who invested with us back in December 1992 against someone who invested in the SET Index, the person who

Table 2 **US Dollar Performance over Last Ten Years as of December 27, 2002**[1]

QUEST ($)	**273%**	GYT	–35%	SPI	–58%	DVS	–68%
ADVANC	93%	SNJ	–37%	CHOTI	–59%	HTC	–68%
SPP	84%	WACOAL	–36%	BJC	–60%	TTI	–69%
STANLY	61%	GFPT	–38%	BIGC	–60%	BBL	–69%
DCC	52%	ROH	–40%	RCL	–61%	TR	–69%
CFRESH	29%	SSC	–42%	LH	–61%	SMG	–69%
SCC	28%	UPOIC	–43%	TTL	–62%	TOPP	–69%
TPCORP	16%	RAM	–43%	TVO	–62%	KK	–70%
PG	15%	LTX	–44%	LEE	–62%	SFP	–71%
SCCC	10%	KKC	–46%	TASCO	–62%	PAF	–71%
AJ	10%	TWFP	–47%	BKI	–63%	ICC	–71%
STA	8%	FE	–49%	SUC	–63%	PA	–72%
METCO	–4%	TPC	–50%	AYUD	–63%	APRINT	–73%
UPF	–7%	PHA	–53%	CENTEL	–63%	KDH	–74%
RGR	–11%	CPF	–53%	THAI	–64%	TFI	–74%
OHTL	–14%	SEED	–53%	BANPU	–64%	TMD	–74%
TF	–17%	RHC	–54%	KCE	–65%	SMPC	–74%
PR	–20%	TCB	–54%	AST	–67%	DTC	–75%
TNL	–22%	AHC	–55%	MATI	–67%	TIC	–76%
PPPC	–23%	CSR	–56%	SHANG	–67%	NBANK	–76%
SHIN	–35%	TAF	–58%	UF	–68%	**SET Index ($)**	**–76%**

98 stocks performed worse than the SET Index.
1. Returns do not include dividends.

invested with us has accumulated over 16 times more wealth than the SET Index investor. It is clear that in a market like ours, which is volatile and has experienced prolonged bear market periods, active management can add a lot of value over index investing. It also goes to show that index investing — which has taken the US by storm in recent years — isn't all that it's cracked up to be. If anything, index investing is only a profitable bet in bull markets.

Our investment returns have been generated on a consistent basis, not as a result of any one good trade. For example, since we started the fund in October 1997, we are up 89% and the index is down 37%. For year 2002, we were up 27%, while the index was up 20%.

People often talk about the correlation between emerging markets and the US market, but if you look back over the last two years, the Nasdaq has experienced a 46% drop, the Thai market has increased 32%, and our Thai Focused Equity Fund is actually up 43%.

Okay, but you could say that it was easy to outperform the SET because the SET has been such a terrible basket case. Point well taken, but, again, we believe that investors invest in funds for performance. Let's look at Quest Management's performance benchmarked against a number of developed market indices (see Figure 11).

As you can see, we are not only doing better than the Morgan Stanley Asia ex Japan Free Index and the S&P 500 Index, we have also caught and substantially passed the Nasdaq.

The Thai market is very volatile, so we are looking for investors with a two-year time horizon. To show you why we think a two-year time horizon is important, we looked at our 12-year track record on a monthly basis over all the two-year periods. If you step through our performance month by month, there are 121 two-year samples (see Figure 12).

To make a long story short, Figure 12 shows that the probability of having a positive return in this two-year buy and hold scenario is 75% and the average positive return is 33%. The probability of realising a negative return is much smaller, at 25% of all the samples, and the average negative return is only 10%. Based on the test results, it is clear that we offer our investors an asymmetric risk profile.

So, the question is: "How do we do this?" We have consistently generated great returns, even in poor market environments, but to make sense of the numbers, it's necessary to understand our strategy and how it enables us to replicate our success in the future. What we do is simple. We drill into a select few companies, and we attempt to get as close to having our hands on the controls of those companies as we can.

We find companies by performing extensive research, and we look for companies that are trading at the lower end of their relative P/E ratio range and that are expected to generate strong and consistent earnings growth. Then we go out and meet the management and conduct initial brainstorming sessions of three or four hours in length in which we make a lot of suggestions. If management says, "Don't try to tell

Figure 11 **Quest versus Major Indices, 1990–2002**

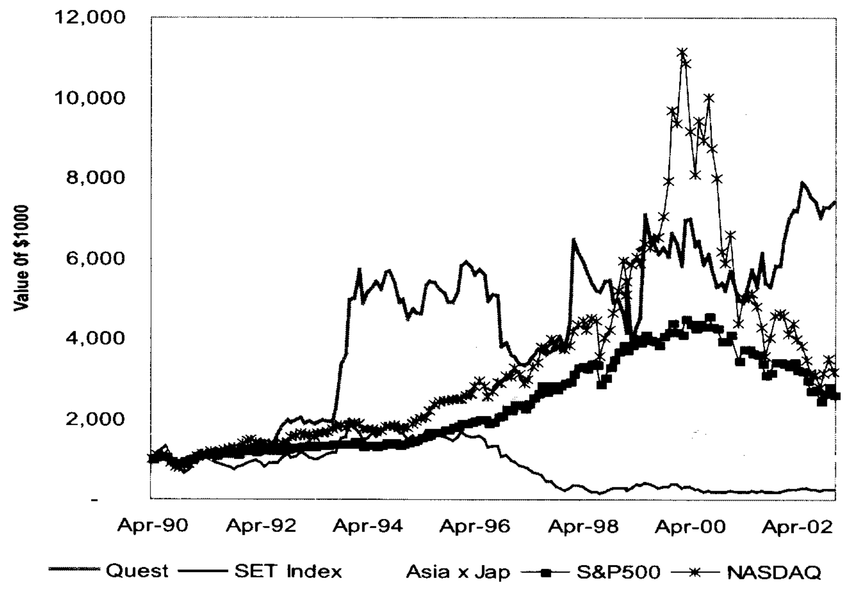
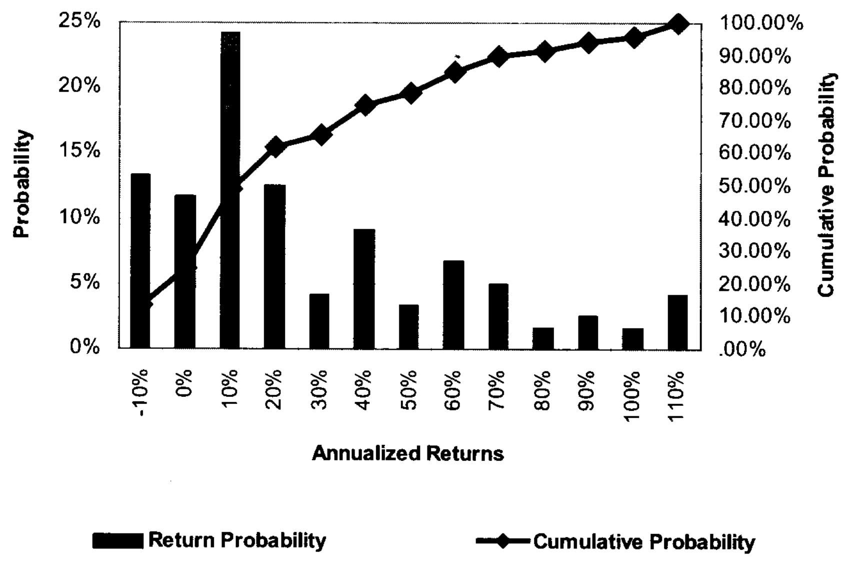


Figure 12 **Quest Management — Distribution of Two-year US Dollar Return**



me how to run my business," they self-select themselves out of the list of companies that we might invest in. If, however, they are receptive to our suggestions, we will usually take a small position in the company and slowly increase our exposure as we get to know more about the company.

Each year, we visit 100 to 200 companies. (There are only 348 listed companies, so we see some companies many times in a year.) Over the years, we have built up a good rapport with 40 or 50 companies, so we know who the bad guys (the TPIs of the world) are, and we know which are the really good companies. At any given time, we seek to manage an investment portfolio comprised of only the best companies trading at the lowest valuations.

WHAT'S GOING ON IN THE THAI ECONOMY?

The SET Index is essentially suffering from poor worldwide sentiment, nothing else. The domestic economy is looking good, and will perform even better as the US and Japanese economies start to grow again.

Thailand has steadily improved its external payments position, supported by the recent rebound in exports and high foreign exchange reserves. S&P, Moody's, and Fitch IBCA have continually upgraded their ratings outlook from stable to investment grade. Moreover, Thailand announced that it will repay its US$4.8 billion in outstanding IMF loans during the first half of 2003, about two years before the loans are due.

Although investors are bearish right now, we continue to maintain a very substantial long exposure to the market, for the following reasons:

1. Thai interest rates (both on deposits and on loans) remain at historically low levels, while domestic inflation is running at an annual rate of less than 1%. As such, Thai depositors are effectively earning a zero real rate of return on their deposits, which we believe will encourage them to seek new alternatives for investment capital.

2. The macroeconomic picture in Thailand continues to brighten. Thai GDP growth accelerated from 3.9% in 1Q02, to 5.1% in 2Q02, to 5.8% in 3Q02, and NESDB revised up 2002 GDP to 4.9% from 4–4.5%. The government figures indicate that the Thai economy is seeing an across-the-board recovery, and consumer confidence remains robust with improving access to financing providing support for consumer spending. The government made further moves to stimulate domestic consumption by approving a tax-cut package to exempt the first THB80,000 of income from tax. Furthermore, the government continues to boost the property sector by eliminating the capital gains tax on home sales, and by extending an incentive package that reduces the business tax and ownership transfer fees.

3. With the government stimulating domestic consumption, there are many consumer-related companies showing profits and/or profit growth for the first time in years. In corporate fundamental terms, Thai-listed companies have shown solid improvement in their operations. For the first nine months of 2002, 280 out of 356 listed companies produced better earnings, and the average earnings growth was 10% y-o-y. This earnings growth came as a result of increasing sales, improving gross margins, and lower interest rates. The market expects to see another 25 basis points cut in the interest rate in 1Q03, which will boost stock market sentiment and domestic consumption, and improve corporate operating income.

4. Also, for the first time in years, these companies now have access to both the debt and equity markets, resulting in a large number of expected IPOs over the next 12 months. In 2002, there were 21 IPOs with market capitalisation of US$937 million. Ten out of 21 stocks made gains above their IPO prices in the range of 2–99%. The president of the Stock Exchange of Thailand expects Thai market capitalisation to reach US$65 billion in 2003. Sixty companies are expected to list, and 25 have already filed with the SEC for approval

5. Government statistics continue to point to a gradual US economic recovery. Exports showed strong growth of 8% and 10% y-o-y in November and December, respectively. A majority of Thai exports are ultimately destined for the US markets, and we expect Thai export-oriented companies to report improved operational results over the next several quarters. Export companies that we follow are currently trading at only five to six times earnings.

6. Most importantly, stocks are cheap right now. The index has dropped 12.2% from its peak in mid-June. The weighted average P/E on 2003 earnings for our portfolio is now only 5.1x.

GROWTH TO P/E

When I arrived in Thailand over 12 years ago, Thai investors and brokers told us not to waste our time trying to do financial models on Thai companies. We were told that it was a market dominated by speculators and day-trading housewives who all got great insider information from their corporate executive husbands.

Since financial valuation was the only thing we understood, we tried to see if there was a correlation between earnings and the ensuing stock price. In fact, while there were wide swings around fair value (anywhere from 50% to 300% of fair value), about every four years prices crossed the fair value line. Therefore, if we could find companies trading at below fair value, we were fairly certain that, in time, pricing would become overvalued and we could sell out at a profit.

While investing in cheap stocks the first few years, we noticed another interesting fact. If we could find companies that were growing more than five times their forward P/E (for instance, a company with steady 20% growth and a forward P/E of 4x), we found that that stock had a good chance of doubling fairly quickly.

Recently, we spent some effort looking at the historical earnings per share and prices for all Thai stocks, and found that this relationship actually works very well. In fact, over the time frame we tested (1995 to the present), this style of stock selection produced 77 trades with an average return of 104%, an average holding period of two years, and an average annualised return of 39%.

Using the same valuation measures on our current portfolio, we calculate an investment-weighted 2003 growth to P/E ratio of about 7. Our investment-weighted P/E ratio is only 5.1x on 2003 earnings. Based on these calculations, we are looking forward to another big run in the Thai stock market in the near future.

STOCK PICKS

Going forward, we are excited by the business prospects of the following three stocks.

Thoresen Thai Agencies

While we continue to maintain a significant shareholding interest in Regional Container Lines PCL (RCL), Southeast Asia's largest feeder operator of containerised cargo, we have become equally bullish in recent months on Thoresen Thai Agencies PCL (TTA), Thailand's largest integrated shipping group. Unlike RCL, which operates purely in the container trans-shipment segment of the market, TTA is diversified, operating bulk/general cargo liner services between Southeast Asia and the Middle East and a diversified mix of shipping-related service businesses.

On the shipping side of the business, TTA has focused on its fleet upgrade program in recent years, and now owns a diversified fleet of 26 general cargo vessels and bulk carriers. The company's markets have high barriers to entry, due to TTA's long-established presence and customer relationships. The company's Thai flag and corporate income tax-free status lead to lower-than-industry-average operating costs and high returns on equity.

Future growth prospects are bright. TTA has recently embarked on a fleet expansion program to extend its liner operations to new ports. Given the weak market for secondhand vessels, the company is expected to earn *immediate* 30–50% returns on equity for new acquisitions. Moreover, only minimal incremental investment in overhead is required to support the expanded fleet and extension of services.

We have a strong conviction that a major turn in the shipping cycle is near. Despite a less than stellar rebound in the US economy, continued weakness in Japan, and concerns over the continuing war on terrorism, the industry has faced a stable to improving freight rate environment in recent months. Furthermore, few new vessels, especially in TTA's segments of the market, are entering the global fleet, and scrap rates are high given the +20-year average age of the global fleet. Freight rates must rise at least 80% *and* stay at that level on a sustained basis before it becomes economic to build new ships of TTA's size.

The service operations, on the other hand, generate value-added returns and are the group's fastest-growing operations. In fact, the collection of businesses, which include agency, stevedoring, ship brokering, port management, telecommunications, marine safety, offshore diving, and offshore supply-related services, have reported a 24% CAGR in earnings since FY1994/95. The services operations also provide important operational synergies to the shipping operations, while financial results are relatively independent from shipping cycles. And, unlike shipping, the services operations require minimal capital expenditures to fund ongoing operations and growth initiatives.

The service operations face no shortage of opportunities. The company only recently made its first foray into port management operations, when it entered into a joint venture with the Emirate of Sharjah, one of the seven emirate states forming the UAE, to manage the operations of Port Khalid, the main port for Sharjah.

Other service companies in the group are opening a new ship brokerage in Indonesia and entering joint ventures to own and operate offshore supply vessels and remotely operated vehicles for offshore work. We expect that two of the service companies, Mermaid Maritime Ltd. and Horizon Mobile Communications Ltd., will either seek an industry sale or IPO within the next one to two years, which we believe will help to realise the hidden value of these assets.

TTA represents a compelling investment opportunity. The company generated US$19 million of recurring operating cash flow in each of the last two years, even at the bottom of the shipping cycle. Management targets US$24 million of EBITDA, a 26% increase, for the current fiscal year. TTA has net debt of US$45.9 million. Market capitalisation is roughly equivalent to debt, so the company has a US$90 million enterprise value. On that basis, TTA is trading at an EV/EBITDA multiple of less than 3.8x, a meaningful discount to its global peers.

Better still, we believe there is a significant opportunity to create shareholder wealth as debt is retired from the balance sheet. The company generates more than enough cash flow from operations, as well as from the scrapping of old vessels and availability of attractive financing terms, to fund its fleet upgrade and service company growth initiatives. This excess cash flow, taken together with its modest leverage (D/EBITDA = 2.5x) and strong interest coverage ratios (EBITDA/Interest Expense = 7.2x), will enable TTA to be largely debt-free within two to three years. Even if EBITDA didn't grow and there were no multiple expansion, there should still be more than a 100% appreciation in the shares as the company deleverages the balance sheet.

TTA top management personnel own over 40% of the company's shares, a key attribute in terms of aligning management's interests with that of other shareholders. Management is equally committed to best practices in disclosure and corporate governance. The company recently resumed dividend payments after a multi-year hiatus, and has recently split the shares in an effort to broaden the shareholder base and to enhance liquidity. We remain in constant contact with management and have one seat on the company's board of directors.

Banpu

We believe that Banpu PCL (BANPU) is still one of the cheapest large market capitalisation, liquid stocks in Thailand. The shares are currently trading at THB 34.75, up from THB 25 at the end of 2001, and THB 17 at the end of 2000. Market capitalisation is approximately US$173 million, while trading volume averages over 1.2 million shares per day. Notwithstanding BANPU's steady appreciation, the company continues to trade at a significant 57.3% discount to our conservative THB 81.4 net asset value estimate. On an attributable earnings basis, BANPU trades on a P/E of only 4.4x.

While it's not uncommon to find a listed Thai company trading below NAV, most such companies are illiquid and/or have small market capitalisations, and few investors believe the intrinsic value of the assets within these companies will ever be realised. BANPU, on the other hand, is a SET50 stock — the 38th-largest stock in Thailand. The company has returned THB 9.1 (54%) per share in dividends over the last two-and-a-half years in addition to a capital gain of 104%.

Why is BANPU misunderstood? It is a diversified energy company with product segments that span multiple markets, so it is hard to find comparables. A significant part of its value is in minority investments in power companies, so these earnings are typically ignored. Likewise, given the significant changes that BANPU has been making to its operating and financial structure over the past few years, few investors fully grasp the long-term cash-generating capabilities of the group.

BANPU has made great strides to rationalise the balance sheet, resulting in the monetisation of non-core assets and reinvestment in high-growth areas. In recent years, for instance, the company:

(i) sold its remaining 10.8% stake in Cogeneration PCL (COCO) to Belgium's Tractebel, S.A., raising US$50 million in cash;

(ii) exited engineering services, which were costing the company almost US$10 million in annual pre-tax losses;

(iii) sold its port services unit for US$11.5 million to COSCO;

(iv) converted loans to The Aromatics (Thailand) PCL (ATC) into equity, which, if sold at current market levels, will raise cash of roughly US$35 million; and

(v) spun off the majority interest in its specialty mineral operations into a joint venture vehicle, realising approximately US$11.4 million.

Altogether, BANPU is expected to raise nearly US$108 million, of which 68% has already been realised, and enhance future pre-tax profits by US$10 million per annum from its recent restructuring initiatives. Selling these units also makes the company easier to analyse, which allows more brokers to follow the company.

The restructuring efforts have resulted in BANPU cutting its focus to two core activities: power generation and coal mining.

Power Generation

The company's power generation operations are conducted through several associate entities. BANPU has a 14.99% stake in Ratchaburi Electricity Generating Holding PCL (RATC). Incorporated in 2000, RATC is Thailand's largest independent power producer (IPP) with 3,645MW of generating capacity. The Electricity Generating Authority of Thailand (EGAT) has awarded RATC a 25-year take-or-pay power purchase agreement, which guarantees a 19% fixed rate of return on equity.

BANPU also owns significant interests in two other IPP projects: Tri-Energy Co. Ltd. (TECO), a 700MW gas-fired plant, and BLCP Power Ltd. (BLCP), developer of a 1,400MW coal-fired power plant. Both projects have long-term power purchase agreements with EGAT. BANPU owns a 37.5% stake in TECO, and is partnered with ChevronTexaco and Edison Mission Energy. TECO commenced commercial operation in June 2000, and is expected to contribute at least THB 1.0 per share of dividend income per annum to BANPU over the life of the project. The BLCP project is expected to complete its project financing package in 2003 and commence commercial operations in 2007. The project is a joint venture with China Light & Power. BANPU also owns 30% of Amata Power (Bien Hoa) Ltd., developer of a 126MW power project in Vietnam.

On an attributable basis, BANPU currently owns 848MW of operational electric generating capacity. By 2007, the figure should jump to 1,521MW. At the current share price, BANPU's stake in RATC is worth US$92.1 million — THB 15.3 per BANPU share. TECO is directly comparable to RATC, since both companies are IPPs operating under long-term, take-or-pay power purchase agreements with EGAT. Applying RATC's current 8.95x EV/EBITDA multiple to TECO values BANPU's stake at US$71 million, or THB 11.8 per share. Taken together, these two projects alone have a fair — and mostly *liquid* — value of THB 27.1 per share. (Remember, the share price is only THB 34.75.)

Coal

BANPU dominates the coal business in Thailand, with over a 50% share of the market, and is one of the largest producers and distributors of coal in all of Asia. The company produces coal from deposits at three sites in Thailand, with total production capacity of 3.8 million tons per annum. Domestic reserves total 13.7 million tons; a four- to five-year useful life at current production levels. Its main domestic customers are the cement industry, large steam users, small power producers (SPPs), and EGAT. BANPU's margins benefit from corporate income tax-free status, low distribution costs, and fixed long-term supply contracts. We figure that BANPU's domestic coal assets are worth US$41.4 million, or THB 6.9 per share.

In addition, BANPU owns a 10% equity interest in Thailand's second-largest coal producer, Lanna Lignite PCL (LANN). LANN's shares are publicly traded on the SET, and BANPU's stake is currently valued at US$3.1 million.

BANPU also owns controlling stakes in three coal-mining units in Indonesia: Jorong, Indocoal, and Mampunpandan (a pre-development stage company).

Jorong commenced commercial operations in early 1999, with an initial annual output of 350,000. Since that time, BANPU has successfully ramped output to a rate of 3 million tons per annum (nameplate production capacity). The mine has 43.9 million tons of remaining coal reserves. Coal supply contracts have been signed with parties in Hong Kong, India, Indonesia, Spain, Taiwan, and Thailand. At current production levels, BANPU should generate approximately US$5 of operating cash flow per ton of coal shipped to customers, or US$15 million per year. BANPU developed this mine for only US$20 million! Based on discounted cash flow analysis, the Jorong operation has a US$67.3 million fair market value.

On March 1, 2002, BANPU purchased a 95% stake in Indocoal from the Indonesian Bank Restructuring Agency for US$54 million. Given the timing of the share conversion, BANPU was only able to consolidate one month (March) of financial results for Indocoal during last year's first quarter. Since that time, however, Indocoal's sales revenue has represented over 50% of BANPU's reported consolidated revenues. In our view, the Indocoal assets are worth US$312 million, or THB 51.7 per share. (Remember, the share price is only THB 34.75.)

On the back of this transaction, BANPU's overall reserves jumped 220%, to nearly 250 million tons of marketable coal reserves. The purchase of Indocoal strengthens BANPU's position in the regional market, and it enables the company to offer customers a wider range of coal grades with different qualities (heating value, sulphur content, etc.).

Despite the steady progress being made both on the corporate development and restructuring fronts, BANPU remains poorly understood by the investment and analyst communities. In fact, few analysts are even aware that BANPU is one of Thailand's largest power generation companies and one of Asia's largest coal producers. We believe that much of this confusion will gradually fade away as management continues to successfully execute its strategic plans. We believe that Indocoal will act as a major catalyst for the stock and lead to a dramatic jump in operating cash flow and earnings in coming years.

Furthermore, just this week, the company released its first ever externally audited reserve data for its mines in Indonesia and Thailand. The new reserve figures show a 43% jump in exploitable reserves, and an even greater 106% increase in reserves from the company's highest-grade, producing mine sites.

Quest continues to actively work with BANPU management to unlock the company's realisable potential by providing ongoing financial, strategic, and investor relations support. BANPU is one of the fund's largest investment positions. Our adjusted NAV estimate is summarised in Table 3.

Internet Thailand

Internet Thailand Ltd. (INET) officially began operation as Thailand's first commercial Internet service provider on March 1, 1995. INET's licence is perpetual, but other ISPs were granted ten-year licences, which will start to expire from 2004.

INET is now the largest ISP in the country, focusing on the corporate and government connectivity markets, and has consistently provided higher international bandwidth than other Thai ISPs. Currently, INET has the largest international and domestic bandwidth available, with a full-duplex 45 Mbps fibre link to the west coast of the US and around Asia. By offering fast and reliable connectivity and high-quality service, the company has become the benchmark for other providers in the country.

INET is the only profitable ISP in Thailand. Revenue has grown consistently every quarter since inception at an average of more than 35%. Annual profit has grown most of the time, but the growth is cyclical. Profit stays flat when INET increases its international bandwidth, which usually occurs every one-and-a-half to two years.

Since inception, the company has consistently been profitable, while the

Table 3

	Fair Market Value (US$mn)	Fair Market Value per Share (THB)[1]
Indocoal	312.0	51.7
RATC	92.1	15.3
TECO	71.0	11.8
Jorong	67.3	11.2
ATC[2]	42.0	7.0
Domestic Coal	41.4	6.9
Engineering Services[3]	23.4	3.9
Land[4]	14.9	2.5
Loans to Associates/Non-Listed Investments	7.5	1.2
Specialty Minerals	7.4	1.2
Other Power Assets[5]	6.0	1.0
LANN	3.1	0.5
Total Asset Value	688.1	114.0
Less: Net Debt	(196.7)	(32.6)
Net Asset Value		81.4
Current Stock Price		34.75
Premium/(Discount) to NAV		–57.3%

1. Per share figures include the assumption that 40% of recently expired in-the-money warrants are converted into common shares.
2. Estimate includes market values for residual loans and 20% equity stake in the company.
3. Appraisal values for machinery and equipment left over from termination of loss-making engineering services operations.
4. Appraised value of 600 rai of freehold land at Mah Tah Phut Industrial Estate.
5. BLCP and Amata Power projects valued at book value (original cost).

other 17 ISPs have faced losses as a result of their focus on the retail segment of the market, which has been subject to intense price competition. In fact, many of its competitors have opted to exit the industry. Other ISPs have sought to reduce losses through mergers. The completed mergers have created larger competitors who continue to lose money. While its competitors concentrate on correcting past mistakes and rationalising operations, INET is focused on diversifying its operations, on top of a solid business foundation, into more profitable areas.

The company charges premium rates for its high-quality engineering and high international bandwidth. Instead of engaging in price wars to win large numbers of new subscribers, the company derives its competitive edge by providing value-added, high-quality services. Corporate customers account for approximately 75% of revenue, and INET has an impressive client list of corporations, government agencies and state enterprises, academic institutions, non-profit organisations, and the thousands of individual subscribers. (We use INET for our mission-critical Internet requirements.) The best indicator of an ISP's size and market share is the number of networks it manages. At present, INET manages about 40% of Thailand's routable IP addresses, as recorded by the Internet Routing Registry at Merit Network Inc.

Future prospects and business opportunities are bright. INET has moved into value-added electronic payment and settlement services, data centre and co-location services, and office building Internet utility services to further insulate and differentiate itself from the highly competitive dial-up ISPs. INET's data centre business has been very successful despite the fact that others lost money in the business. INET has an advantage over its competitors in developing systems and applications, since it is the only ISP in Thailand that has its own R&D department serving the needs of its customers.

Recently, the company signed a four-year agreement with Krung Thai Card PCL to develop business-outsourcing applications for electronic bill presentment and payment, credit card payment through GPRS mobile data services, and e-payment gateway services.

Together with Krung Thai Card PCL and Allied Retail Trading (ART), a government-backed nationwide order aggregator, INET is using its national dial-up network as a channel for orders from retail stores all over the country to be sent to ART for consolidation and placement with manufacturers in bulk.

The outlook for business outsourcing services in Thailand is also growing, especially Internet data centre offerings. Factors that are bolstering outsourcing demand are the privatisation of state enterprises and the need for businesses to improve operational efficiency, competitiveness, and security systems. To add value to its services, INET has teamed up with reputable software and technology firms such as Oracle, HP, and IBM.

INET is a growth company. Over the last four years, the company has generated an average earnings growth of 37% and management believes that the company can continue to grow the business at similar rates over the foreseeable future. The company has continued to provide more value-added services to maintain its growth and to diversify its revenue base. It plans to increase non-access (service) business to 45% of revenues over the next five years, from 5% in 2001. Meanwhile, the access business should continue to grow at 20–25% per annum. Currently, Thailand has about 4.8 million Internet users out of a population of 63 million, so there is still plenty of room to grow.

Both access and non-access business are generating attractive net profit margins of 18–20% and we believe the company will continue to maintain margins at these levels. However, the THB 500 million proceeds from the IPO is in fixed deposits at a very low rate, so the blended ROE will be lower this year. INET is working hard to find investment opportunities for the IPO proceeds. If not, we will advocate a liquidating dividend.

In addition, the company is in the process of applying for exemption from 25% corporate income tax on some of its new projects, which will add another couple of percentage points of margin to the bottom line.

Despite the high growth, INET is trading at a very low P/E. At the current THB 4.3 trading price, INET is net cash to the tune of THB 2.1 per share (nearly half the current market capitalisation). It has an enterprise value of US$13.2 million and management targets US$4.4 million of EBITDA in 2003. On this basis, INET is trading at an EV/EBITDA multiple of only 3x. In terms of PER, excluding cash, INET is trading at 5.6x 2003 projected earnings. We are currently one of the largest shareholders of Internet Thailand and plan to increase our stake.

If you would like more information on our fund, visit our website at www.questthai.com, e-mail us at barnet@mozart.inet.co.th, or call us in Bangkok at 662-652-2750, fax 662-652-2740.

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