

## Quest identifies value in Thai market

By Simon Osborne | 10 September 2010

Bangkok-based fund manager Doug Barnett talks about value in Thai stocks.

*Quest Management is a Bangkok-based foreign investment manager focused on Thai stocks. Its fund is the Thai Focused Equity Fund. It manages assets of \$150 million and has a 16.8% internal rate of return (IRR) since inception in 1997. It is run by Doug Barnett, who came to Thailand in 1990.*

### What is your performance this year?

This year we're up 42% after fees. We're stock-pickers and we like high-earnings growth and also stocks that are liquid, so that we can put a million dollars to work in a couple of weeks.

### Does that need for liquidity make investing in small-cap stocks more tricky?

Yes, we were looking at a stock the other day called Petburi Concrete Products. We tried to buy it for several days, the price went up 300%. But if you look at how much you could have bought at the cheap level, it was about \$30,000 worth. Great to be up 300%, I suppose, even if it is just on a million baht.

Our biggest position is plastics-maker Indorama Ventures, into which we've put about \$15 million. That stake is now worth about \$50 million, so it's a serious amount of money. It's a three-bagger in six months. When we bought it originally the stock wasn't well covered. It was an illiquid, tiny stock three years ago. To allocate just 1% of our portfolio to it took six months. It kind of traded 'by appointment'.

Indorama is a low-cost producer in a space where others with higher cost-bases are losing money, so they are buying assets from motivated sellers and turning them around. It has done a good job of growing its bottom line and just done a reverse takeover of its parent. That took its market cap from \$400 million to \$1.5 billion, making it a much more liquid stock.

Our total turnover of stocks is about twice per year, but the names are all pretty much the same. It depends on the market: if things look expensive, then we sell them.

### Is the market looking expensive now?

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No. There's been terrific earnings growth. Our portfolio is at around 9.5 times price/earnings and high 20s earnings per share (EPS) growth. We stayed short in 2009 for too long, and so underperformed the Stock Exchange of Thailand (SET) market.

**What sort of events could derail the bull-run: baht strength, political instability, correlation with overseas double dips?**

Yes, all of the above. However, the probability is that at the end of the year the index will be higher than it is today. There are many things that can still happen, though.

Our job is not to call the market, it is to find stocks with higher EPS growth. During 2002 to 2009 we had a military coup, bird flu, exchange controls, a tsunami worldwide financial disaster. Everything that pretty much could go wrong, did. But the top 10% of companies grew EPS by 300% to 400% and total returns were 600% to 700%. So the market recognized their good job on earnings but rerated their price/earnings ratio. The bottom 10% did much worse than the markets. So if I can just find the top 10% then I am going to make money as long as I can get investors to stick long enough for the earnings effect to overcome any volatility events.

**How do you pick your investments?**

We do a lot of homework, we screen for sufficient volume (\$1 million traded per day), and those with good EPS growth and ones that will continue to grow. Then we go and see all those companies and we get a certain number of stocks. It's not rocket science.

There are also bad companies out there, and you should avoid them. There are about 60 to 80 that we think are ethical and well-run by people who operate a good strategy. At any given time we will have a large proportion of assets in five of those stocks, and a smattering in 10 to 15. The rest are at the wrong part of the cycle.

**Are there any sectors in their entirety in Thailand where further growth does look constrained?**

I just bought some banks yesterday but that was a liquidity play. In terms of growth, though, my outlook isn't optimistic. They take equity risk for a fixed income return. How can that ever be a good idea? But the banks stay in business and the governments support them. The banking sector here is highly competitive and I'm not a big investor in either them or brokerages. The latter is going through another round of deregulation of fees, and the last time that happened overseas, players slashed fees and subsidized from their foreign operations to grab market share.

**How do you characterize the effect of Thai politics?**

I always say *'politics is a great reason to buy in Thailand'*. Historically, it has been the correct thing to do. There are no anarchist groups here. There are people arguing about who gets to run the show, but they are all capitalists. They've been squabbling since I got here, and probably will continue to do so for the next century.

**Who do you think will form the next Thai government?**

I don't know or care. If the market goes down, I'll buy more stock.