October 31, 2018

Value Investor INSIGHT

The Leading Authority on Value Investing

Seeing Around Corners

His strategy and process have little changed since he left Westwood Holdings to start Ballast Asset Management in 2015, but Ragen Stienke has found one pleasant change to his day-to-day routine. "I can devote more time now just to managing the portfolio and picking stocks," he says. "You don't realize at a bigger firm how easy it is to get pulled away from that."

When he left Westwood, Stienke was managing $3.5 billion and the "SMidCap" mutual fund he ran over ten years beat its Russell 2500 benchmark by 180 basis points per year. Still seeking companies for which there are "undeservedly low expectations," he sees value today in such areas as laser systems, shoe retailing and data analytics. See page 2

Ragen Stienke
Ballast Asset Management

Skilled Translation

While U.S. equity investors have enjoyed a ten-year bull market, the ride has been rougher for Moneda Asset Management's Alejandro Olea. He launched the firm's Latin American equities strategy just before the crisis and for years has been navigating macroeconomic and political turmoil in the region. “Yes, we haven’t always had the wind at our back,” he says.

He has ably managed the storm, earning since 2008 a 2.5% net annualized return, 650 basis points better than the benchmark MSCI EM Latin America Investable Market Index. Though always wary, he and co-manager August Petrillo see plenty of upside today in such areas as cell towers, e-commerce, financial services and tortillas. See page 9

Alejandro Olea
Moneda Asset Management

The Road Less Travelled

Born in South Africa, raised in Australia and trained as an accountant, Jonathan Tanne crossed paths in 2009 with a billionaire global investor as a result of their shared interest in dirt-cheap Australian real estate trusts. That led to a job scouring the globe for public and private investment opportunities before Tanne launched London-based Tangible Investment Management in 2012.

Befitting that eclectic path is an eclectic portfolio – “Usually when people see my top positions they've never heard of them,” he says – which has so far earned a net annualized 22.0%, vs. 9.5% for the MSCI World index. Among areas of interest today: Russian banking, U.S. pharma and industrial-commodity bets in India and China. See page 14

Jonathan Tanne
Tangible Investment

Inside this Issue

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INVESTMENT HIGHLIGHTS

Investor Insight: Jonathan Tanne

Jonathan Tanne of London-based Tangible Investment Management describes where he looks for "non-obvious" ideas, how's he's responding to a 600% share-price increase in a current holding, how he tries to balance risk and reward based on company lifecycle, and why he's seeing unrecognized value in TCS Group, Rain Industries and Henan Jinma Energy.

You say you look as an investor for the "unpopular, underresearched and undervalued." Where do you look for that?

Jonathan Tanne: The world is very competitive, with smart people looking at a lot of different ideas. If I'm trying to be the smartest man in the room, it's best to go to the rooms without many people. Looking for things under the radar, generally I can find better pricing.

I've always thought flexibility was key, so I have a broad remit across securities, sectors and countries. But while I can go anywhere, I don't go everywhere. The financials have to be in English. I have to understand the accounting. I have to be able to go through my checklist and understand the fundamentals of the business, the industry, the competitive landscape, the regulatory environment and everything necessary about the company's business model and capital structure.

How do I find ideas? I do a lot of screening, but most of it is just observation, in life and in business. I'll go to conferences. I'll look at what select investors are doing. I don't wake up and say, "I have to buy a stock today," but I'm always looking, always reading, always researching. From time to time, interesting things surface.

If you favor the undiscovered, it involves a lot of digging. Earlier this month, for example, I went to Turkey to meet with several companies and their management teams. There's been a severe economic and currency crisis, so for good reason the market has sold off and it's not exactly a popular place to be looking to put money to work. Nothing may ever come of it, but you try to discover and learn and perhaps one day it leads to something to do.

The stock of Amarin [AMRN], one of your holdings, went from $3 to above $20 in short order a few weeks ago. Tell us the story behind that.

JT: I met the CEO at a conference in London a few years back. The company's primary asset is Vascepa, an FDA-approved omega-3 fatty acid treatment available only by prescription. It's basically a high-strength, purified and unoxidized fish oil – or Eicosapentaenoic Acid [EPA] – and after its launch in 2013 it was growing nicely as a treatment to lower triglyceride levels in patients with very high levels of fatty acids in their blood. While that was interesting, Amarin's goal was always to sell Vascepa to a much broader population of people at risk of cardiovascular disease – the single biggest cause of death in the U.S. – and the company was spending heavily on a trial study that might justify the broader use of the drug.

> **ON INVESTING CHECKLISTS:**
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> **I get excited when I find something new – my checklist just helps slow me down and keep me focused.**

As part of my research, I read through everything I could find on the science and comparable studies done in the past. I visited pharmacies to understand the EPA content in over-the-counter products. I spoke with cardiologists about treatment options and past omega-3-related studies. In the end, I concluded there was a reasonable probability the trial research would support far broader usage of the drug. On a probability-weighted basis, then, I thought the stock was undervalued on its existing business alone and that it had considerable upside potential.

Last month the company announced top-line trial results showing that Vascepa showed an approximately 25% relative risk reduction over a placebo. There's still more to be disclosed – including on the specific extent of the risk reduction and on secondary endpoints – which is embargoed until its release at the American Heart Association's annual meeting in Chicago on November 10th. I'll be there.

We take that to mean you still see upside in the shares?

JT: I took some profits, which is only prudent when something goes from an $800 million market cap to more than $5.5 billion in about a week. The company absolutely can't say anything about the further study results, but it has indicated it has no intention of raising capital prior to the AHA meeting, which I take as a bullish sign. Based on my interpretation of the trial design and how it compares to similar studies in the past, I also believe there's a good chance the trial results will show an actual reduction in the incidence of cardiovascular deaths among study subjects. If that's true at a high statistical significance, that should be amazing news for patients and shareholders, as Vascepa would likely become a blockbuster.

Explain a bit more about your investment checklist and why the discipline of working through it is important to you.

JT: The checklist covers around 70 different points, none of which would likely surprise you or strike you as unusual. It's all informed by my experience with what's important. Do I fully understand the operating leverage in the business? What does the Porter's "five-forces" analysis tell me about the competitive environment? What is the level of recurring revenues? Does the company have pricing power in an inflationary environment? Have management and the board been buying stock?

The goal of the checklist is to keep me from missing anything important and really just slow me down. I get excited when I find something new, so the list serves as kind of an inanimate sounding board to keep me focused and on track.

You've described balancing risk in your portfolio by owning companies at different stages in their lifecycles. Please explain.

JT: I categorize each company into five buckets based on where it is in its lifecycle: dividend-paying and growing profits; profitable but not paying dividends; cyclically challenged with recovery potential; emerging, not yet profitable; and emerging, not yet profitable and requiring capital. Risk increases as you move from the beginning to the end of that list, and thinking about what I own in this way helps me gauge if the portfolio has the appropriate mix of stability and opportunity going forward.

While the companies I own are often rather obscure, more than 50% fall into the first two lower-risk buckets. For those, time and the resulting compounding of results should be their friend.

Roughly 20% of the portfolio today is in more highly levered companies with cyclical challenges but real turnaround potential. They have adequate interest coverage and through their unique assets, cost leadership, operating leverage and strong management teams should see substantial upside in their stocks when the capital cycle turns.

The last 20% or so of the portfolio is in emerging companies that aren't yet profitable. These typically are real innovators with protected intellectual property and heavy R&D spending that I believe are well on the way to outsized profitability and free cash flow. Amarin would fall in this category, which I find I'm spending more time on today. It's about as far as I'll go when it comes to risk, however. Emerging companies that aren't yet profitable and are not close to being fully funded are more venture-capital-type investments that I'd rather leave to others.

To the extent you worry about the macroeconomic situation today, what worries you the most?

JT: My biggest worry is the "drawbridge-up" mentality you see in things like Brexit and the increasing interest in protectionism and tariffs by countries that seem to want to focus inward rather than outward. I'm in the camp that believes human progression is all about trade and I worry that the political trends you can see in many countries could eventually lead to tangible economic damage globally. That's a challenge to any global portfolio manager.

ON MACRO CONCERNS:

My big worry is the "drawbridge-up" mentality you see in things like increased protectionism and tariffs.

Of course it can also be an opportunity. Investors flee when there's political uncertainty, and any time that happens there's the potential for inefficiently priced stocks.

One example I own is Kin Yat Holdings [Hong Kong: 0638]. It manufactures in China a significant share of the vacuums sold by iRobot [IRBT], and the worry today is that iRobot may have to source elsewhere to avoid damaging tariffs. That's clearly a risk, but my research of iRobot's supply chain would indicate it's not that easy for it to just pick up and go. Even if it eventually does, Kin Yat on a normalized basis now looks incredibly cheap. Its land alone, particularly a site in Shenzen that I have visited, is worth probably 2-3x the current market cap.

One of your largest positions today is in Russian financial-services company TCS Group [London: TCS]. Explain your investment case for it.

JT: This is actually the world's largest fully online bank, serving more than seven million consumers across Russia with a broad range of investment accounts, credit and debit cards, payment services, mortgage services, car insurance, travel services and loyalty programs. Everything is done online, over the phone, or utilizing a network of more than 1,800 couriers that make 20,000 pickups and deliveries a day all over Russia.

The company was founded in 2006 by a serial entrepreneur named Oleg Tinkov, who saw an opportunity to "bring credit cards to Russia" in a much bigger way, modeling TCS after Capital One in the U.S. He put up $100 million of his own money and recruited to run it a brilliant Englishman, Oliver Hughes, the ex-CEO of Visa's Russian business. The management team, which owns about 6% of the company, has continued to expand the franchise, which we think still has tremendous growth potential as they build out both new and existing businesses and take market share from less entrepreneurial and technologically savvy competitors. From seven million customers today, TCS could have 20 million or more in the not-distant future.

How do you think about the inherent risk of investing in Russia?

JT: Russia went through a financial crisis from 2014 to 2016, with one response being the central bank set stringent capital requirements that ended up significantly cutting the number of banks in operation. TCS responded to the crisis well, tightening underwriting early, expanding into debit cards to lower overall repayment risk, and putting emphasis on attracting stable and relatively low-cost customer deposits. That's all paid off considerably in improved profitability and customer growth as the credit cycle has turned and is currently quite healthy.

With respect to things like international sanctions, while concerns there probably help explain why the company's stock is so cheap, we'd argue that as mostly a consumer bank TCS has little exposure to Russian companies that may be sanctioned. More broadly, I'd point out that Russia pumps 11 million barrels of oil per day, three-quarters of which are exported. The world needs this oil, so I think over time the country is unlikely to become more isolated. I prefer to look past the

INVESTMENT SNAPSHOT

TCS Group
(London Intl: TCS)

Business: World's largest fully online bank offering a broad range of services, including investment accounts, debit and credit cards, mortgage services and automobile insurance.

Share Information (10/30/18):

Price	**16.80**
52-Week Range	15.32 – 24.85
Dividend Yield	6.2%
Market Cap	$3.07 billion

Financials (2017):

Revenue	$899.3 million
Operating Profit Margin	38.9%
Net Profit Margin	29.6%

Valuation Metrics
(@10/30/18):

	TCS	S&P 500
P/E (TTM)	8.0	21.7
Forward P/E (Est.)	7.4	16.4

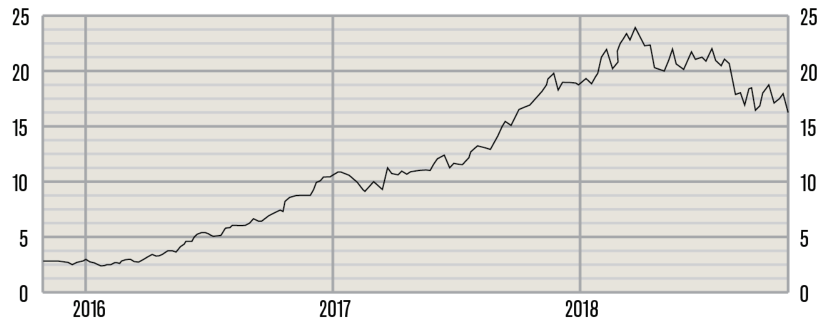
Largest Institutional Owners
(@6/30/18 or latest filing):

Company	% Owned
Norges Bank	6.0%
Schroders plc	4.4%
Fidelity Intl	3.9%
Ameriprise Financial	2.2%
Pictet Funds	2.2%

Short Interest (as of 10/15/18):

Shares Short/Float	n/a

TCS PRICE HISTORY



THE BOTTOM LINE
Geopolitical concerns are likely weighing on its stock, but Jonathan Tanne believes those concerns are less relevant given the financial-services firm's domestic consumer focus. Assuming an "almost-punitive" 20% discount rate and a terminal return on equity far below its current level, his discounted-cash-flow model pegs the stock's fair value at $26.

Sources: Company reports, other publicly available information

daily negative headlines and invest in businesses based on the track record of management and forward earnings potential.

On that front, how cheap do you consider the stock at a recent $16.80?

JT: On the 30 billion rubles in net profit I model the company can earn next year – one-third of which should come from non-credit-related businesses – the stock trades at around 8x forward earnings and below 4x tangible book value. That is not at all expensive for a bank growing profits at 15-20% per year and with a massive 60% return on equity. Even using an almost-punitive 20% discount rate and assuming a far lower terminal ROE, my discounted-cash-flow analysis still yields a fair value of at least $26 per share. Meanwhile, the company pays a 6% dividend. In fact, since my initial investment three years ago, I have received back nearly my entire investment cost just in dividends.

From Russia to India, describe your interest in Rain Industries [Bombay: RAIN].

JT: Rain is one of the world's leading producers of calcined petroleum coke (CPC) and coal tar pitch (CTP), two key feedstocks for making the carbon anodes used in producing aluminum. Its manufacturing plants are located in North America, Europe and Asia. In the larger business of the two, petroleum coke, four players – Rain, Oxbow, BP and ConocoPhillips – control 70% to 80% of the global market outside of China. Rain is very competitive from a cost standpoint and industry competition is generally fairly rational as it is not easy to get into this market.

Much of the appeal here for me is Jagan Mohan Reddy, who runs the company and has proven to be an excellent manager and capital allocator. Owning shares in Rain is somewhat like investing in a publicly traded private-equity fund (without the fees) that has a skilled entrepreneur allocating capital to global capacity expansion and M&A, all with an eye toward building long-term shareholder value.

Petroleum coke's high carbon content makes it a target of environmental regulation. How do you assess that risk in handicapping Rain's prospects?

JT: Regulation can clearly impact both operational results and the market perception of the stock. In 2017, for example, the business and the stock performed exceptionally well as the price of CPC rose because the Chinese government cracked down on polluting industries and took CPC production out of the market. Earlier this year, on the other hand, the stock was hit hard when India banned the import of petcoke to keep people from using it to burn as fuel. India's Supreme Court recently ruled that imports to be used as feedstock – which is what Rain provides – were excluded from the ban. While that particular overhang is gone, delayed orders as a result of the ban will most likely negatively impact the company's Q3 and Q4 results.

Rain has a good record with environmental regulation. It was early to invest heavily in waste-heat recovery systems, scrubbers and flue-gas-desulfurization technology. The biggest long-term threat to the business is the development of noncarbon anode technology. But in all my discussions with industry experts, they say this technology has been under development for decades and no one believes it is realistically feasible, at least in the medium term.

The shares have been on quite a ride over the past two years. At a recent price of 193 Indian rupees, how are you looking at upside from here?

JT: It's not surprising that the stock is both volatile and prone to mispricing, given that this is an obscure, family-owned, India-listed mid-cap with no decent coverage or peer comparables. When I first invested in 2013, the stock was trading at a forward P/E of around 1x.

The shares are up more than five times from our original purchase price, but due to the petcoke import ban in India and generally softening CPC prices, the stock is down nearly 60% from its highs earlier this year. If pricing in the industry normalizes, we estimate Rain can generate at least $500 million in EBITDA by 2020. Even if the EV/EBITDA multiple stayed at today's low 7x level, the stock at that point would roughly double from here.

INVESTMENT SNAPSHOT

Rain Industries
(Bombay: RAIN)

Business: Global producer of calcined petroleum coke and coal tar pitch, two primary feedstocks required to make the carbon anodes that are used in producing aluminum.

Share Information
(@10/30/18, Exchange Rate: $1 = 73.95 Indian rupees):

Price	**INR 192.80**
52-Week Range	INR 148.65 – INR 475.50
Dividend Yield	1.1%
Market Cap	INR 64.85 billion

Financials (TTM):

Revenue	INR 133.05 billion
Operating Profit Margin	16.4%
Net Profit Margin	8.3%

Valuation Metrics
(@10/30/18):

	RAIN	S&P 500
P/E (TTM)	5.9	21.7
Forward P/E (Est.)	5.4	16.4

Largest Institutional Owners
(@6/30/18 or latest filing):

Company	% Owned
Sujala Inv	11.2%
Meghamala Enterprises	5.2%
Pabrai Inv	4.8%
Nivee Holdings	2.4%
Arunachala Holdings	1.6%

Short Interest (as of 10/15/18):

Shares Short/Float	n/a

RAIN PRICE HISTORY

THE BOTTOM LINE
Shares of this "obscure, family-owned, India-listed mid-cap with no decent coverage or peer comparables" tend to be volatile, says Jonathan Tanne, and also prone to mispricing. He believes the latter is the case today and that with more normal price and demand levels the stock, with no valuation change, could roughly double over the next two years.

Sources: Company reports, other publicly available information

What do you think the market is missing today in China's Henan Jinma Energy [HK: 6885]?

JT: Jinma reminds me of Rain Industries in that both companies convert chemical inputs into chemical outputs and earn a price spread for doing so. Jinma makes coke, a derivative of metallurgical (coking) coal that along with iron ore are the key inputs for steel mills.

The number of coke producers in China decreased from 1,000 in 2013 to around 300 in 2017 as increasing government environmental regulation is forcing a consolidation of the industry that likely has much further to run. Scale is extremely important and has become even more so as the costs of regulatory compliance increase. That benefits companies like Jinma, which is already one of 50 or so producers with annual production capacity above two million tons, and which has aggressive plans to increase its capacity through acquisition.

One interesting aspect of the company is that its two largest customers, Maanshan Iron & Steel and Jiangxi PXSteel, are also its key shareholders, owning 27% and 10% respectively, of Jinma's shares. They are contractually committed to purchase at least 1.2 million tons of coke from Jinma each year at independent market-benchmark prices. That guarantees over half of Jinma's annual sales volume.

You obviously don't have a problem with cyclical businesses.

JT: It is a cyclical business and the way the stock is priced the market clearly believes that the company's coke earnings are near peak levels. There's also a lot of concern about tariffs on Chinese steel.

I don't want to minimize either of those concerns, but I do think the market is focusing on the noise rather than the fundamentals of the business. The consolidation in the Chinese coking industry has taken a lot of capacity out of the market and should continue to do so, which has the potential to smooth out some of the extremes in coke prices and spreads. With

INVESTMENT SNAPSHOT

Henan Jinma Energy
(Hong Kong: 6885)

Business: China-based producer and processor of coke, a derivative of metallurgical coal that along with iron ore are two of the primary inputs used in steel manufacturing.

Share Information
(@10/30/18, Exchange Rate: $1 = 7.85 HK$):

Price	**HK$4.25**
52-Week Range	HK$2.62 – HK$5.00
Dividend Yield	6.3%
Market Cap	HK$2.28 billion

Financials (TTM):

Revenue	HK$899.9 million
Operating Profit Margin	16.3%
Net Profit Margin	11.0%

Valuation Metrics
(@10/30/18):

	6885	S&P 500
P/E (TTM)	n/a	21.7
Forward P/E (Est.)	3.0	16.4

Largest Institutional Owners
(@6/30/18 or latest filing):

Company	% Owned
RAYS Capital Partners	14.3%
ICBC Intl	6.0%
Citigroup	5.1%
Fullgoal Fund Mgmt	3.8%
Carne Global	1.8%

Short Interest (as of 10/15/18):

Shares Short/Float	n/a

HENAN JINMA PRICE HISTORY

THE BOTTOM LINE

Concerns that its main business is close to a cyclical peak and that it is threatened by higher Chinese steel tariffs are overblown, says Jonathan Tanne, who sees upside for the company as its industry further consolidates. Paying 3x forward cash earnings for a growing business with a 40% ROE and 6%-plus dividend yield is "extremely rare," he says.

Sources: Company reports, other publicly available information

respect to tariffs, Jinma is less exposed because its large customers are domestic steel companies which tend to produce higher-end products made more to customer specification and not so much the basic flat-steel products that get exported.

With the shares at HK$4.25, how are you looking at valuation?

JT: It's extremely rare to find a business growing strongly that earns a 40% ROE and pays over a 6% dividend yield trading at only 3x forward cash earnings, which is the case here. The way I look at it, if annual production and the coke-price spread stay at current levels, the company will earn in net profit its entire market capitalization over the next three years. At that point the prospects going forward should be at least as good long-term as they are today, so even if there is no multiple expansion, the share price should be much higher from earnings accretion alone.

Describe a position or two you've sold in the recent past and why.

JT: I sell for the usual reasons: for better opportunities, to lower risk in an individual name, when the valuation is full, if there's a deterioration in the industry, or when I've made a mistake.

S&P Global [SPGI] has a number of financial rating and information businesses and as much as I like the management, the industry structure, the business model and the macro tailwinds behind the business, when the P/E started getting into the mid- to high-20s earlier this year it was time to move on. I'm still basically of the mind that good things happen to cheap stocks and, as wonderful as this business will probably be going forward, the stock was just too expensive.

Another recent example where I decided rather quickly to sell was in a company called Scorpio Tankers [STNG], a product tanker shipping company. The people behind it, Emanuele Lauro and Robert Bugbee, have a long history of investments in the sector and this was one of those cyclically challenged businesses with operating and financial leverage that I thought had a considerable amount of turnaround potential as low tanker shipping rates eventually improved. Soon after we bought in, they came to market with an equity raise at a dilutive valuation and disclosed various transactions with related parties that together made me quite concerned about the corporate governance. The basic thesis may very well play out when tanker rates rise, but I was just no longer comfortable owning the stock.

You have around 30% of your portfolio today in cash. What does that say about how you're looking at the current opportunity set?

JT: That level of cash, the highest I've had, is the result of some inflows and profit-taking rather than anything tactical. I also just launched a new fund replicating my portfolio for investors outside of a family office. As I'm constantly looking for new ideas and have a broad global opportunity set, I'm usually working cash down to a single-digit portion of the portfolio over time. That said, at the current stage of the market cycle I'm quite happy to have the level of cash I do. VII