Hong Kong Stock Exchange

Case of CSI Properties Ltd. (HK: 0497)

Originally published in the Dollar Vigilante of 9 December 2013:

I have devoted the last 8 years analyzing companies in the junior resource sector. I still make horrendous mistakes. I forget to appreciate and account for crucial information that I realize later—when I have lost money—was glaring at me. This does not only happen when there is a lack of information or when I am misled. Sometimes I miss crucial information because I either pigeonhole myself in a restrictive thinking-pattern or emotionally align myself in ways that hinder me from seeing the obvious. And it is very easy to fall for the hype in the market and pay attention to only one aspect, in a linear thinking pattern. Moreover, staying rational can be very hard when the trend of the market is such that time-consuming rational analysis might become your undoing.

Despite the above, I have been following the Hong Kong stock market for a while. Why Hong Kong? Not only HK is one of the freest markets in the world, given that it exists under the umbrella of China, and hence less vulnerable to pressures from Western countries, it is an extremely important part of any wealth diversification strategy.

Here is something that you might find useful:

There are some companies that are incorporated in mainland China, but trade on both Chinese stock exchanges (called A-shares) and Hong Kong stock exchange (called H-shares). Ideally these shares should trade at parity. Interestingly, sometimes they trade at a huge discrepancy.

Here is a document regarding Hang Seng China AH Premium Index that is updated by the Hong Kong stock exchange every month. As you can see in the document, A-shares on average used to traded at a premium of as much as 60% a mere five years back. With time the premium on index basis has declined to virtually zero, as it should have.

But within the index huge discrepancies still exist. For example, China Molybdenum Luoyang Co Ltd. (code: 603993 in Shanghai & 3993 in HK) trade at a whopping 165% premium in Shanghai. Unfortunately, you cannot play the arbitrage game here: buying in HK and selling in China is not allowed. But with Renminbi increasingly trading internationally, such arbitrage cannot continue to exist. Would I buy a company based on such arbitrage that I cannot immediately exploit?

Unless I could exploit such discrepancies in real-time, it is never advisable to invest without a proper valuation. But if your valuation supports an investment and if that company also trades at a premium in China, you have a nice icing on the cake.

Jiangxi Copper Co Ltd (HK code: 0358; HK$14.74) trades at a premium of 28% in Shanghai. With P/E of ~11 and dividend yield of ~4%, it might not be the most exciting investment, but P/cashflow is ~7 and almost 40% of market capitalization is supported by net cash (~US$3 billion). This gives

me satisfaction that they are capable of investing in new projects or to do accretive transactions. Alas, disclosures of Jiangxi, a public-sector company, are rather limited. For those seeking a country and currency diversification, but are not expecting a major speculative upside, Jiangxi might be a place to hold some money.

There is another idiosyncrasy of the Hong Kong market that is very interesting. Property index (of secondary private residential property) has been rising in HK for the last 10 years. This link of the index is updated every week. Hang Seng Properties Index, which is the index of property companies that trade on Hong Kong stock exchange, has maintained basic trend of property index—undershooting and overshooting from time to time—given the differing temperaments and costs of capital of the two different sets of investors. But his has happened with a curious result.

A closer look at the two indices will show you that since the beginning of 2004, Hang Seng Properties Index has gone up about 100% while property index itself has gone up about 200%. Looking at the more recent past, while property index has gone up ~60% since early 2010, Hang Seng Properties Index has mostly stagnated.

The result is that a lot of property companies trading in the HK stock exchange are trading at a heavy discount to their net asset values (NAVs).

My favorite is CSI Properties Ltd (code in Hong Kong stock exchange: 0497; HK$0.26). Its NPV (net value of the company after marking project values to-the-market and adjusting for cash/debt) was HK$1.11 on 31st March 2013. Based on this, there is an upside of >300%. P/E is less than 3 and dividend yield is 4%. Insiders own >46% of the company. The low share price of CSI has built-in expectation of a huge crash in properties in Hong Kong. As the property index shows there was a significant fall in property prices between the middle of 1997 until the middle of 2003. Once bitten twice shy; and people of Hong Kong likely still retain in their memories—quite rightly—that properties don't always go up. But even if one expects a 50% fall in properties, as the most pessimist property brokers anticipate, there is still a 100% upside in owning CSI Properties.

It is important to remember that despite obvious value, pessimism about property market in HK will likely keep CSI Properties subdued for a while. It is also a relatively illiquid stock. So, for an investor, it is extremely important to be patient, give limit-order and wait for the stock to come to him.

Sincerely,

Jayant Bhandari