OPINION

This world-class company has modest debt, thoughtful management, a juicy dividend - and a stock price too cheap to ignore

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CONTRIBUTED TO THE GLOBE AND MAIL

PUBLISHED OCTOBER 26, 2021

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Sir John Templeton once said that to get the best bargains, you must buy what others are selling. As a deep value investor who worked with Peter Cundill for almost 15 years, I take this to heart. I look for 40 cent dollar bills.

Which brings us to China. Without a doubt there are many risks around investing in China. What a value investor tries to do is find companies tarnished but not completely at risk in such situations. One such company is CK Hutchison Holdings Ltd., whose founder, Li Ka-shing, was once called the Warren Buffett of Asia and is widely known as one of Asia's richest men.

Mr. Li is truly a rags to riches story. In the early 1950s he founded a plastics manufacturing company that ultimately grew to become one of Asia's largest conglomerates. In 2015, he split his empire into a real estate company and an operating company. CK Hutchison is the operating company.

Today, CK Hutchison's business has five "legs." The largest of these is its telecom/mobile business, a leading operator in Europe, Hong Kong and Indonesia serving more than 100 million customers. This is followed by its 75 per cent ownership of A.S. Watson Group, a health and beauty retailer with more than 16,000 stores in 23 countries. The third-largest business, Hutchison Ports, is one of the top operators of container ship terminals in the world, having about 52 ports in 26 countries. Its fourth-largest division is CK Infrastructure, which is its ownership, both directly and indirectly, of assets that include businesses such as water and sewage, gas distribution and, here in Canada, Park 'N Fly. Finally, the finance and investment division holds various investments including a 15.7-per-cent ownership in Cenovus Energy Inc.

In other words, CK Hutchison owns a lot of stuff that would be hard to replicate.

Hong Kong-listed Hutchison also trades over the counter in the U.S. as an American depositary receipt under the symbol CKHUY. At the current price around US$6.75, its market capitalization is about $30-billion (Canadian). The ADR price is down significantly from US$15 where it first traded in 2015. I believe this is primarily due to CK Hutchison being punished for being listed on the Hong Kong Stock Exchange, yet I estimate only a quarter of the value of its businesses are directly related to China. But is it cheap? For a value investor, that is the key question. And if you have downside protection, the rest of the outcomes are pretty good.

CK Hutchison sells at about 40 per cent of its book value, with a single digit price-to-earnings ratio. Net of expenses, I expect the ADR to pay a dividend of 36 US cents, for a yield of 5.3 per cent. (Since this dividend is not paid from a Canadian corporation, it does not qualify for the preferential Canadian dividend tax treatment and is subject to tax at your marginal tax rate similar to interest income). Going a step further, the sum of the parts, in other words, the total estimated value for the company if each division was sold separately is, I believe, much higher than the book value. In a nutshell, our margin of safety is large and I think we are definitely buying a dollar bill for less than 40 cents.

The second question I ask: Is this a “brick house” or a “straw hut”? As in the story of The Three Little Pigs, a wolf always comes to the door at some point. Given CK Hutchison’s strong balance sheet with its net debt on a consolidated basis less than 25 per cent of equity, free cash flow generation and the leading market position of its businesses, we are definitely in a brick house.

Finally, it’s important to understand the interests of the board and management. Are their interests aligned with the company’s, or diverging? They are definitely aligned. CK Hutchison today is operated by Mr. Li’s son, Victor, and the family – through various trusts – continue to be by far the largest owner, controlling about 30 per cent of the shares. Board and management compensation is modest, recent capital allocation looks thoughtful and the company is repurchasing shares.

Granted, CK Hutchison doesn’t have the sexiness of, say, GameStop Corp. On the other hand, as a value investor I’d rather get my excitement fix outside of my investment portfolio. CK Hutchison is a world-class company with distinctive businesses, modest debt and thoughtful management, all at a large discount to its value. Boring, perhaps, but it can make money. Needless to say, and by way of disclosure, McElvaine Value Fund has approximately 8 per cent of its net asset value invested in CK Hutchison at a price not much different from where CK Hutchison is currently trading.

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