Chapter 1:
Malaysian Companies are Not the Same

1.1 Long-term Value Investing (or Buy-and-Hold Strategy) Does Not Work in Malaysia Stock Market

According to Koon, since the publication of his Rm 50 million donation to the Penang State Government to build student hostels to help the students of Universiti Sains Malaysia (USM), especially those from poor families, whilst some people wrote to ask him for financial help, a lot of people wanted to know how he managed to make so much money from the stock market to make the donation, to give out scholarship to underprivileged students, and to help poor students. In other words, they wanted to know his secret formula.

Well, his investing journey actually began in 1983 after he had his heart bypass surgery in London. Whilst recuperating in Harley Street Hospital, he read from the newspaper that the Hong Kong stock market crashed because the then British Prime Minister, Margret Thatcher, failed to secure the extension of British rule of Hong Kong. The British had a 99 years lease of Hong Kong and a part of Kowloon. The lease was about to expire, and China would soon take back Hong Kong.

Koon recalled many Hong Kong investors were afraid of the arrival of the Government of China. So they sold their holdings as quickly as possible, which resulted in the stock market crashed. Everything was on cheap sale. The Hang Seng Index (HSI) went below 1000, and HSBC was selling below HK$10 per share. At that time, he was not so good at picking stocks. He did not even know how to invest for long term, or short term, or timing the market. He just bought stocks that went down the most in terms of percentage using his business sense. You can say that he started this business blindly. As soon as China agreed to offer 50 years extension of capitalist system, the Hong Kong stock market rebounded, and he sold all the shares he bought initially with more than 200% profit. With all the proceeds, he bought HSBC, and other better-known shares. After about two years, he made so much money that he could afford 46% of Kaiser Stocks and Shares Limited, a stock broking company in Hong Kong, which gave him margin finance, and helped him made more profit.

After the short experience in Hong Kong, he decided to retire as the Managing Director of Mudajaya, and relinquished his roles in other organisations to focus on his investments. He always asks himself “Why should I work so hard when it is so easy to make money from the stock market? Moreover, all my profit is tax free, and I don’t have any management problem. I do not need to deal with people, which I find most difficult.”

After his retirement, he had more free time to read, and learn about investing. He began learning the investment philosophies of Warren Buffet, Peter Lynch, Benjamin Graham, and others. But, most of the books preach long-term value investing. They encourage investors to buy good, and profitable companies on the cheap, and hold them for long term. No doubt the results of those gurus are astounding, and their investing philosophies are solid. But Koon failed to emulate their results even though he had adhered to their advice, and followed their methods closely for several years.

When Koon analysed the root cause of his average return, he found out that the problem lies not with the approaches of those gurus, but with the characteristics of Malaysian companies/stocks. Whilst the buy-and-hold strategy works in US stock markets, it failed Koon (and may also fail us) in Malaysia, as most of the public listed companies in Malaysia do not meet the investing criteria of these gurus. The main reason is that Malaysian companies are not the same.

1.2 Why Are Malaysian Companies Not the Same

I know some of you, especially those long-term value investors who have invested in US markets for several years, may not agree with Koon's study. But if you think the same winning formula use by those Gurus can be used in Malaysia stock market, think again. Well, let me explain to you why the buy-and-hold strategy may also fail you in Malaysia.

1.2.1 Most of the companies do not have durable competitive advantage

Unlike US companies, most of the companies in Malaysia do not have a durable competitive advantage, which Warren Buffett calls economic moat. Whilst some Malaysian companies have the ability to earn lucrative profit, and show increasing earnings for a short period of time, very few if any have the ability to earn exceptional profits for a long period of time. The main reason is that the rivalry from new entrants, and existing competitors will eat into their market shares gradually, which results in their profit margins, and earnings shrink.

If you have no idea of what a sustainable competitive advantage is, the best way to begin with is by asking yourself if a company has the following traits:

- Strong network and strong relationship with clients
- Strong market position and large market share
- High degree of pricing power
- High barrier to entry
- Strong brand identity
- High switching cost
- Favourable regulatory protection
- Patent protection
- Cost advantage through process or efficiency improvement
- High bargain power with suppliers

Unlike Starbucks, Pepsico, and 3M, most Malaysian companies do not have the strong global brand identity. Without that kind of brand identity, customers are not willing pay more for their products. Hence, they lack the pricing power, and are unable to increase their profit margins, and earnings continuously. Even if they managed to attract a lot of customers at the beginning, and charge a high premium when they first launch a new product onto the market, the longevity of the benefit will be challenged when more and more cheaper, but similar type of products introduced by their competitors.

Unlike the products offered by Google, Boeing, and Intel, most of the products offered by Malaysian companies do not have strong patent protection. Due to their lack of creativity and innovation, competitors can produce the same kinds of products to compete with them, head-to-head, without spending a dime on research and development, or having much trouble of replicating the same type of products, and need not to even worry about any legal actions will be taken against them for exploiting the technologies.

Unlike Autodesk, Microsoft, and TransDigm, most of the public companies in Malaysia do not have the ability to retain their customers through the benefit of high switching costs. The costs may not necessary be measured by the amount of capital spent on the products, it can also be measured by the time, effort, risk, and training need to be spent, and borne by customers to adapt to a new system, or product. If the service providers, or product manufacturers are unable to protect the sustainability of their businesses through the switching expenses, the latter can change providers, or manufacturers any time they want.

Now, do you see the main difference between Malaysian companies, and the US companies referred to by those famous investment gurus?

Without having a durable competitive advantage (to protect it from invaders), a company's earnings and earnings growth are not sustainable, no matter how beautiful its story is. When competition begins to get stiffer, its earnings will be dwindling. If we buy a stock based on its current value, and hold the stock for long-term, the value of our money may be decimated eventually.

Thus, when we invest in a company with no economic moat for long term, even if we manage to buy the stock at a huge discount, our investment may still wind up with a loss.

Even if we have found a stock with a competitive advantage, we should never buy and hold it for long-term. In his book called Trade like a Stock Market Wizard, Mark Minervini said "*There is no such thing as a safe stock. No stock can be held forever. Many so called investment-grade companies today will face new challenges, deteriorating business conditions, or regulatory changes that can materially affect their future earnings potential*."

1.2.2 The performance of most Malaysian companies is cyclical in nature

Based on Koon's observation, no matter how good the business of a Malaysian company is, its performance will not go up in a straight line forever. There will be some ups and downs along the way. At some point the company will have a difficult time, be it during economic

crisis, industry downturn, or when the company management makes some bad decisions and investments.

During its industry downturn, especially right after the peak of its cycle, the supply of its products will outpace the demands of its products, as all of the industry players take loan to expand their capacities at an exceedingly fast rate. The supply glut issue will result in the companies' performance begin to go downhill. Some highly leveraged companies with a few quarters of abysmal performance would go into liquidation if their balance sheets are not strong enough to weather the downturn.

As an investor, Koon does not like to buy a stock when its company is in financial trouble, no matter how cheap its share price is, because its share price will go down continuously, and the pain of holding the loser is excruciating. Even if the company has the ability to survive the disaster, it may take a very long time to get the business back to its past glory, and some investors may not even have a chance to see light at the end of the tunnel.

As an investor, we are unable access to insider information, and, needless to say, we have no idea if or when the company's performance will turn the corner. The best thing we can do is to get out after the top of the cycle is formed before the shit hits the fan, and get back in near the bottom of the cycle when it starts to deliver result again before its share price takes off. If we practice long-term value investing by holding on to the stock without monitoring its business performance continuously, a lot of money-making opportunities would be slipping through our fingers.

Also, do not buy a stock because it is cheap, especially when its share price is on a downtrend. According to Francisco García Paramés, "*many of these cheap stocks are to be found in challenging sectors or subject to major competitiveness challenges, and in the long term can remain eternal duds. Time is not on our side with such stocks, since the returns on capital are low and the potential upside is slow to materialise and uncertain. The balance sheet isn't everything.*" The best way is to avoid this type of stocks, and buy them only when the situation begins to improve, and their earnings growth gains traction.

1.2.3 Political influence also plays an important role in the performance of some Malaysian companies

Unlike US companies, some Malaysian companies have strong ties with political parties. The unprecedented change of regime in Malaysia on 09 May 2018, and the plunge of some stocks' prices on 14 May 2018 have demonstrated that politics do have a strong influence on the performance of some businesses, and earning potential, and share price movement of some public companies in Malaysia. Those companies

that have strong political ties with Barisan Nasional government were pummelled mercilessly when the market opened on 14 May 2018, as investors ditched the stocks for some other stocks due to their gloomy earnings prospect. The share prices of these stocks took a nosedive when the opening bell rang, and continued to be sold down over the next few of days. If anyone owned any of the stocks until early May 2018 and refused to sell them, he or she could only witness their share prices plunge continuously.

In addition, the decisions of politicians or lawmakers may have an indirect impact on the performance of a stock. For instance, any change of plans such as subsidies, tax benefits, and resources allocated by the government may affect certain groups of companies. If you hold any stocks in the industry, where the tax benefits given by the government has been reduced, you too should reduce your position in the stock, as its net profit, and share price will drop subsequently.

Further, the decision of the government (or Bank Negara Malaysia) to change interest rate may also affect the profitability of a company. In general, high interest rate will affect a business negatively. Unless the growth rate of its earnings is higher than the cost of borrowing, a company is less willing to take loan to expand its business when the interest rate is on the rise, as the amount of interest needs to be paid is higher. This will deter companies from taking more loans, and will result in a lower growth rate. In addition, a highly leveraged company might also face the risk of liquidation if they are unable to service the loan. As an investor, we have no obligation to hold a stock for long-term. The best way to avoid the problem is to dispose the respective stock as fast as possible when monetary policy is revised.

1.2.4 Some of the companies are run by crooks

Even if you believe that a stock is very cheap, you should not buy and hold it for long term. You need to pay attention to its profit growth prospect, the actions of its management, and the main shareholders, its share price movement, the company’s development, and its business performance continuously. When the situation has turned sour, you should run for cover.

Based on Koon’s observation, many of the public companies in Malaysia are owned by the family members, relatives or close friends of their founders, co-founders or the top management teams. They are, essentially, the controlling shareholders of the companies. They grow their wealth either through share price appreciation and dividend payments, or by profiting from share price difference by buying their stocks at low prices and selling them at high prices.

Whilst some companies, such as Lii Hen, V.S. Industry, Supermax, Gamuda, Padini, Top Glove, Kuala Lumpur Kepong, Public Bank and etc., are happy to share their profits with shareholders when their trees

bear fruits, not all public companies are so generous. In fact, some of the companies are run by crooks. They are lack of integrity, and are not trustworthy. They get paid (in forms of salary, bonus, and allowances) before the shareholders. They make money at the expense of their shareholders by trading their own stocks with insider information.

In addition, they, together with their cronies, trade against minority shareholders. Just like a casino, they are essentially the house. Compared to US public companies, in general, Malaysian companies have a lower transparency in terms of corporate information, and financial disclosure. When the businesses begin to make increasing profits, the management will hide some of the profits. When the companies receive some lucrative contracts, they will hide the progress. At the same time, they will use tools such as private placement, and employee share option scheme (ESOS) to help their cronies, and relatives accumulate more shares at lower prices. Once they have bought enough, their cronies will then push the share prices up, they will create bullish sentiment with the use of some splendid news, or polished financial report announcements, and subsequently sell their shares to minority shareholders at inflated prices.

When the business stops growing, they will begin to distribute their shares to uninformed shareholders. When the business begins to deteriorate, they will give misleading information to shareholders, and sell their stake aggressively. If the value of the company is higher than their market capitalisation, when the market turns bad, they will take the companies private through selective capital reduction, or takeover offers when the share prices are at depressed levels. That is how they make themselves wealthier. At the same time, it leaves the buy-and-hold long-term value investors on the losing side of the game.

Also, instead of benefitting their shareholders, some of the owners list their companies with the intention of making quick bucks. Whilst some CEO of initial public offering (IPO) companies may argue that the reason of doing so is to raise capital to expand their business, it may not always be the case. Based on the study outcome of Jay Ritter, a professor of the University of Florida, the overall stock performance of IPO companies is 3% lower than the return of similar companies after five years. Francisco García Paramés explained that "*there is a simple reason for this: there are clear asymmetries in the information available to the seller and what we know as purchasers. The seller has been involved with the company for years and abruptly decides to sell at a time and price of their choosing. The transaction is so one-sided that there can only be one winner*."

Further, when the companies are small and growing, they preserve the cash (retained earnings) for expansion. When the companies do well, they milk the cash cow at the expense of the minority shareholders. That is why many of them refuse to pay dividends even though the

companies make money every year. Investors get no chance to enjoy their share of the pie when businesses bear fruits.

When you invest your hard-earned money in this type of companies, you really need to keep your eyes open, always. Do not buy an undervalued stock, and hold it blindly for long term, just because some famous investment gurus advise people to do so.

1.2.5 The future of most Malaysian stocks is fraught with many uncertainties

If you understand the nature of most Malaysian stocks, you will not be holding them for too long. The chance is that investors tend to lose money for holding the stocks for long term, as the future of these companies are full with uncertainties. Also, compared to mature markets, the stocks market of Malaysia is more volatile in nature.

The share price of a stock is more stable, and could grow steadily for decades if the company has an ability grow its revenue and profits continuously, and pay growing dividends. The traits can be found easily in those established US companies such as Coca-Cola, General Dynamics, VF Corporation, Walmart and AT&T, which have economic moat, the ability to grow their earnings continuously, and can afford to pay increasing dividends. But, this is not the case in Malaysia. Unlike those U.S. companies, most Malaysian companies do not have stable earnings, let alone having a progressive dividend policy.

The main reason of this problem is that most of the companies behind Malaysian stocks are young firms. These young companies, which are still in their infancy stage, cannot afford to distribute their profits as dividends to investors, as the retained earnings need to be reinvested into the business for upgrade and expansion purposes. Unfortunately, no immediate return can be expected when the money is reinvested to venture into upstream or downstream business, to acquire other companies, and for other expansion purposes.

Bear in mind that expansion does not guarantee profitability. Bigger factory does not equate to higher revenue. Higher revenue does not necessary translate to higher profits. Sometimes, the price paid for acquiring a new system or another company is so high that it could increase the level of risk. Also, expansion can lead to counterproductive effect, as it requires large amount of capital and result in higher operating cost, and it makes the situation worse when the demand of their products begins to decline. Moreover, a bigger team may not be as efficient as a small team. A more sophisticated machine may not necessarily produce less errors. Higher capital expenditure may not necessarily generate higher cash flow. At some point the company will face a bottleneck. And it takes a very long time to achieve a stable footing. In other words, there are a lot of uncertainties during the growth phase.

Of course, during this stage, managements may paint a bright future about their companies, make an irrational prediction of their company size, take loan to expand their office, and capacity aggressively, but they are unable to give you a guarantee of their future earnings, and dividend payments. Even if there is a positive sign of growth, good things will not last forever, earnings will not grow forever, companies will not do well forever, and their stocks will not outperform the market forever.

If we want to invest in this type of companies, the only way we can make more money is by monitoring the companies' progress closely and having a good understanding of human emotions, as the share price movement of this type of stocks is mainly driven by the earning prospect of the companies, and the emotions of investors – greed and fear.

When people are optimistic about the future of a stock, they will buy it aggressively. Share price can shoot through the root during the early stage of an event development such as the invention of an innovative product, signing of a lucrative contract, discovery of a new drug or finding of a giant oil deposit, as enormous amount of money are poured into the respective stock instantaneously. Also, when the company performs well, the share price of a stock will be on an uptrend. The market can be filled with a lot of investment crazes that offer tremendous upside gain due to hype. But the excitement wanes when everyone who intended to pile into the stock has done so, and smart money managers have begun to pile out. If you do not take your money off table when its share price is near the peak of an uptrend, someone else will. When a company fails to deliver expected results, reports decreasing earnings, or shows a series of abysmal performance, its value will then begin to evaporate, and risk-averse investors will trim their positions, or dispose their stake aggressively, then you would be witnessing your holding falls in value like a stone if you refuse to sell the stock.

1.3 How to make money in Malaysia Stock Market then?

Warren Buffett said that "T*he key to successful investing is to determine if a company has durable competitive advantage. Companies with durable competitive advantage consistently deliver outstanding results for investors*." But, most of the companies in Malaysia do not have the sustainable competitive advantage.

Benjamin Graham advocated to purchasing "*Securities at prices less than their intrinsic value as determined by careful analysis with particular emphasis on the purchase of securities at less than their liquidating value*." But, based on Koon study, this type of companies cannot provide us a satisfactory return in Malaysia. For example, there are many property stocks selling at prices far

below their net tangible assets (NTA), or liquidating values in Malaysia currently. If we buy them today, our return would be very low, as there are too many empty houses in every city of Malaysia, and there is no guarantee that we will see light at the end of the tunnel.

Geraldine Weiss stressed that "*each stock must be studies and evaluated according to its own unique profile of dividend yield, one that has been established over several investment cycles*." But, many of the stocks listed on Bursa Malaysia are inconsistent in paying their dividends, if not unable to pay dividends. If you insist on investing based on the dividend yield profile of a company, many good opportunities would be slipping through your fingers.

Now, the question is if most of the public companies in Malaysia do not meet the selection criteria of these investment gurus, does it mean that we should stash our cash under the mattress? Of course NO! That's the worst approach in money management.

If the long-term investing approach preach by those gurus are not applicable in Malaysia stock market, what should we do then?

Well, after many years of hard work, Koon eventually managed to pull all the resources he has gathered, including the basic accounting principles, wisdom of some investment gurus, chart patterns, and his prior experience in business world, to develop a method that enables him to make money from Malaysian stock market. The method emphasises on searching for stocks with high earnings growth potential, which have delivered two quarters of increased earnings. Then he will buy them when they are still cheap, and their share prices are about to rise, or have gained momentum. Doing so does not only improve the chance of making money, but it also shortens the time needed for the market to recognise the values of the stocks.

Chapter Summary

- Buy-and-hold and long-term value investing method may not provide you a satisfactory return for investing in Malaysia stock market.
- The reason why the buy-and-hold strategy may fail you is that Malaysian companies are not the same with those in the U.S.
- Why Malaysian companies are not the same
  - ✓ Most of them do not have durable competitive advantage
  - ✓ Their performance is cyclical in nature
  - ✓ Political influence also plays an important role in their performance
  - ✓ Some of the companies are run by crooks
  - ✓ The future of these companies is fraught with many uncertainties
- The best way to make money in Malaysia stock market is by searching for stocks with high earnings growth potential, which have delivered two quarters of increased earnings, and buying them when their share prices are about to rise, or have gained momentum, and sell them when they fail to meet your investment criteria.