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Interview with Vincent Lam, Chief Investment Officer of VL Asset Management Company

Eurekahedge

VL Asset Management, founded in January 2009, is a Hong Kong-based investment firm licensed by the Securities and Futures Commission (SFC) of Hong Kong. In its team of eight, four are investment professionals with complementary skills across fund management, equity research, equity trading, journalism and company audit.

The firm manages one flagship fund at present – VL Champion Fund, a long/short equity growth portfolio with a 'value investing with catalysts' approach [redacted]. Independent research is conducted to identify under-researched and under-valued equities with potential catalysts to unlock hidden value. The team's success has been largely due to early identification of undervalued or under-researched companies with clean balance sheets and sustainable business models.

Mr. Vincent Lam, founder and CIO of the firm, has over 15 years of experience in financial analysis, investment research and active fund management in Hong Kong and China. Before founding the current company, Vincent was Managing Director of Ramius Capital Asia and CIO of Quam Asset Management. He was also once a financial journalist in Hong Kong and visited listed companies and wrote analytical reports.

1. ***Could you tell us about the regional diversification of your fund's portfolio? Do you invest only across mainland China or in other countries as well?***

   Our whole investment team is home-grown and our knowledge edge in the Hong Kong and China market enables us to identify and validate the best opportunities in the region. The VL Champion Fund focuses on companies that are blessed by the growth of China. These companies can be listed anywhere as long as China is their revenue source. We may also invest in companies which benefit from and will continue to ride on a global trend that we can also feel in the Greater China region. [redacted]

2. [redacted] ***What were some of the factors that drove your past performance?***

   [redacted] We were early birds in many cyclical consumer names which turned out to be stars throughout the year due to the influx of tourists from the People's Republic of China (PRC) visiting Hong Kong. Our picks in the pharmaceutical sector in the first half of the year also generated good profits for our long books.

   In anticipation of a rising inflationary environment for 2011, we shorted selected consumer staples, which to us had been a crowded trade with both high valuations and the potential of rising margin pressure. Their earnings results did not meet market expectations but investors in those stocks were unexpectedly tolerant and the sector turned out to be among the best-performing safe havens of that year. We did have a few great investment calls including some Hong Kong-based telecoms operators which were up approximately 26% to 81% year-on-year, but the gains were not big enough to cover the losing positions.

3. ***How flexible is your fund in terms of its sectoral diversification? Is there any cap or restrictions in place with regard to your exposure in each sector?***

   We are flexible to diversify into and switch between different sectors so long as we find that company valuations are attractive and their business models are promising. There is no cap on sectors but normally our long exposure to a single sector will not exceed 35% and short exposure will be contained within -15%. We may long and short the same sector at the same time because even if a sector is in market favour, there are winners who can maintain their competitiveness while there are losers who suffer from contracting margins.

4. ***Your fund profile mentions that you employ various strategies (Value, Catalyst etc), what is the usual split across the different strategies? Can you give us some examples of winning investments?***

The split varies from time to time depending on available opportunities that we can identify when they arise, but for the past half year, Deep Value accounted for about 40% of our strategy while Turnaround, Merger Arbitrage and Relative Value each represented about 20%. For example, we participated in the takeover deal in Schramm (00955.HK) at a time when the market was extremely volatile, and returns from these positions helped improve our fund's performance a lot throughout the August to October 2011 period.

5. ***What sort of fundamental/technical analysis do you perform on the underlying stocks prior to making an investment?***

Our primary investment focus is on fundamental research, although there is a minor allocation (typically 10 to 20% of the fund's net asset value) to tactical trading based on technical analysis.

On fundamental research, our first step is to study the five-year track record of a company together with an industry analysis, followed by site visits to assess its business, corporate governance, deal rationale and regulatory considerations. After conducting a check on its suppliers/customers/competitors and trading liquidity, we will build our internal financial model which covers its earnings forecast, cash flow and gearing, etc. We will also compile DCF/SOTP valuation reports.

For technical analysis, our trader has more than 15 years of trading experience in Hong Kong and overseas listed equities, options and index futures based on his expertise in interpreting trigger events and news flow. A tactical trade decision is made if his initial interpretation can coincide with a number of technical indicators.

6. ***As a value stock picker, you are keen to conduct your independent research on listed companies. How does your in-house research add to what is already available? Does your research team offer any special advantages?***

Only by conducting independent research can we derive a fair and reliable valuation model. Our investment team, consisting of the CIO, Portfolio Manager (PM), Analyst and Trader, has complementary skills across fund management, equity research, equity trading, company audit, journalism and business management. The team's past exposure to different professions enables us to view a company from different dimensions and hence our analysis will be more thorough and in-depth. The PM and I have been following the listed companies in the Greater China region for over 10 years. Having been a financial journalist, I am particularly familiar with the management styles and corporate cultures of many companies. Our analyst was an auditor before and can read a company's business comprehensively from a CPA's perspective. It is these aspects that give us an edge.

7. ***You emphasise that 'people' are the crux of a business. This applies not only to your own house but also your stock selection philosophy. Could you explain further?***

Integrity is the cornerstone of our business as demonstrated by our persistence in pursuing absolute truth through independent research and our culture of maintaining a high degree of transparency to our investors. When we invest in listed companies, we are putting a bet on the people that run those companies. Some companies have wonderful figures but if their management quality cannot meet our due diligence requirement, we skip it to avoid any potential risk.

With regard to my business partners, Adrian Wong as the COO and Victor Tsang as the PM of the firm, they are both very experienced and talented. Adrian used to be a solicitor in England and Hong Kong specialising in listings and M&A deals and has been a member of the Listing Committee of the local bourse for years. Victor has co-managed two absolute return portfolios with me between 2005 and 2007 and held investment positions at Ping An China Asset Management (HK) and later CICC HK before joining the firm. The three of us are keen executors of value investing and have known one another for 10 years. Our mutual trust certainly helps to make business operations more efficient. We are committed to our business – to generate long-term wealth for both our investors and ourselves – and currently about 10% of the fund's assets are from our partners, directors and staff; we eat our own cooking.

8. ***Could you shed some light on how you manage risks for your fund's investments during different market conditions? Has your risk management been more stringent over recent times, owing to the high volatility across equity markets?***

We control our exposure carefully and stick to our gun – when there is panic selling, keep calm and hold our positions if their company fundamentals remain intact. On the contrary, when the street gets too crowded it is time to be more alert instead. Preserving investors' wealth is our number one rule while our ultimate goal is to generate long-term wealth appreciation for them. We seldom use leverage and every single long position that we hold must have a minimum market capitalisation of US$100 million. In times of higher market volatility, we tend to reduce our net exposure and trade more index futures for hedging purposes.

9. ***How do you think the increasing number of new products in Asian markets, such as index volatility futures on the Hang Seng and Nikkei, will benefit your investment strategy?***

The reality is that these new instruments are still too new to attract a critical mass of market depth meaningful for institutional investors. We are monitoring the progress of these instruments and once they have gained decent market liquidity, we may find them useful for our investment strategy.

10.

11. ***What are the different classes of investors (high net worth clients, institutions, funds of hedge funds, etc.) that your investor-base currently comprises? Out of all these classes, which one is your fund best suited for in terms of its risk / return profile?***

Currently, about 10% of the fund's total assets under management is partners' money. Another 27% comes from family offices mainly in Hong Kong and Switzerland. Institutions and high net worth individuals make up the remaining 63%. We do not have any funds of hedge funds investors at present but dialogues with them have been ongoing. We trust our fund is most suitable for investors who are value-conscious and risk-averse and are really looking for long-term sustainable wealth enhancement. Market volatility is something nobody can control but ground research and investing in a disciplined manner are what our team can perform and master well.

12. ***Some investors are sceptical about China's growth story. What is your view as a veteran manager in the region?***

China has just lowered its 2012 growth target to 7.5%. Some may find it disappointing but we regard it as a very decent figure especially when compared to the anaemic growth in the West. In fact, a less aggressive growth target may help improve the fundamentals of the Chinese economy as the government's heavy capital investment over the past few years may have led to rising inflation. Having said that, China's inflation should have peaked and if it can be contained within 4%, overall domestic consumption should continue to enjoy high, though slowing, growth amid the community's rising income and spending propensity.

In the medium term, we foresee challenges ahead for the PRC economy. By mid-2010s, the PRC is expected to see its working population starting to shrink as a result of the one-child policy (which has been implemented for more than 30 years). This will pose a big challenge to the medium term growth prospects of the Chinese and therefore Hong Kong's economies. We see both risks and opportunities in this upcoming structural socio-economic transformation.

With an ageing population and an increasing affluent higher and middle income classes, we strongly believe that there are ample business opportunities in the wealth management, family succession planning, retirement and medical servicing sectors and regard it as an opportunity instead of a risk factor for the asset management industry.

There are good times, and bad times, too. I have gone through the 1997 to 1998 Asian Financial Crises as an individual investor with losses to my personal wealth. I started managing investors' money in the middle of the burst of the TMT (technology, media and telecom) bubble and created meaningful profits for our investors. We turned the SARS epidemics into a bottom fishing opportunity for our investors. 2003 was one of the best years in my career as a professional money manager.

The current business environment is nothing compared to the 1997 to 1998 Asian crises and the 2003 SARS periods. We see last year's panic selling as a good opportunity to bargain hunt. While business environments may remain tough, this may not necessarily be the case for stock markets as we invest in specific stocks, rather than trading the markets.

13. ***In light of the market uncertainties ahead, what investment strategies are likely to be effective this year?***

We see quite a lot of deep value investment opportunities in Greater China, a region in which we have been researching and investing for more than 15 years. This view has thus far been supported by the increasing number of privatisation deals, together with marked rises in company share buybacks and major shareholders' top-up in their own company's shares since 4Q 2011. These have historically signalled that the market has hit a solid bottom.

In 2011, the Hang Seng Index was down by about 20% but the overall market dropped much more than the big-cap dominated index – over 64% of stocks listed on the local bourse was down more than the benchmark, and approximately a quarter of all listed stocks lost more than 50% during the year. The above illustrates, we believe, that underdogs abound and this is the right market for our Deep Value, and Event Driven investment strategies. In addition, Hong Kong is a market featured by active corporate activities, where M&As, asset injection, restructurings of businesses and privatisations could all favour our Catalyst-Driven approach.

Contact Details
Vincent Lam
VL Asset Management Company
+852 28518177
contactus@vlasset.com
www.vlasset.com