

Singapore stocks

Hunt for growth stocks

Global market volatility in the face of looming sovereign debt crises in Europe and the US is spurring gold to new highs. But investors might be better off taking a longer-term view and accumulating a selection of solid growth stocks instead.

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Global financial markets have been buffeted over the past week by renewed concerns about looming sovereign debt crises in Europe and the US. Notably, the Aug 2 deadline for US lawmakers to raise the country's debt limit is fast approaching, amid fractious political posturing. If the US is unable to meet its obligations, extreme global financial turbulence could ensue, with borrowing costs spiking up and stock markets sinking, some market watchers warn.

Closer to home, the tailwind of a global recovery appears to be waning. In June, Singapore's non-oil domestic exports (NODX) grew by a much-lower-than-expected 1.1% y-o-y, versus consensus expectations of 4.6%. NODX rose 7.6% y-o-y in May. "The softness in the global economic cycle has clearly hit Singapore's high-beta economy," says Leif Eskesen, HSBC's chief economist for Asean and India. "While we had anticipated the direction, the underlying growth currents are weakening somewhat more than anticipated."

Eskesen still believes the slowdown will ultimately prove to be temporary as supply-chain disruptions related to Japan's natural disasters begin to dissipate and fuel prices fall. "But, the risks to this outlook have clearly tilted more to the downside with the extension and intensification of the European sovereign-debt saga, which ultimately could prolong and further soften the global soft patch."

Add the fact that global stock markets have rallied a long way from their 2008 lows, and it seems that investors face a very tough time in the months ahead. In a note dated July 17, Morgan Stanley strategist Gerard Minack says, "The developed world faces above-average macro risk while most asset classes offer below-average returns."

It is perhaps little wonder, then, that gold, arguably the ultimate safe-haven play, has shot to new highs recently, with the gold spot price hitting US\$1,610.10 an ounce on July 19. Yet, for investors with a longer-term horizon, a significant sell-off in equity markets could be an opportunity to pick up good growth stocks at bargain prices. Even if the sovereign-debt issues in Europe and the US take years to be resolved, a good selection of such counters could help boost the medium-term returns of investors' portfolios.

Defining growth stocks

Exactly what is a growth stock? Many investors associate the idea of "growth" with small, high-risk companies. To be sure, companies at the early stages of their lifecycle are more likely to grow faster than after they mature. Yet, many growth companies are large, and have dominant positions in their respective markets. Case in point: **Apple**, the company behind the iPhone and iPad, which have come to represent the coolest gadgets in the fast-growing smartphone and tablet markets. After years of growing at a breakneck pace, barely stalling during the recent financial crisis, Apple now has a market capitalisation of US\$358.7 billion, making it the second-largest company listed in the US, after **Exxon Mobil**.

The key to Apple's high growth was its stran-



BRYAN TAY/THE EDGE SINGAPORE

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Index, has returned 7.4% a year. Over the last one year to July 15, the fund has returned 9.45%, putting it third among Singapore equity funds. In first and second place, the DWS Singapore Small/Mid Cap A SGD fund and the DWS Singapore Equity fund are much smaller, however, with assets under management of just \$6.7 million and \$81.2 million, respectively. The United Growth Fund has AUM of \$151.2 million.

Now, as the concerns about broad economic growth swell, Teo sees opportunities emerging to pick up stocks with good long-term growth prospects. "We don't just look at this year's earnings growth. We want to ensure that this growth is also there for the following year, so it's not just a one-year wonder," he says. And, in a market sell-off, the likelihood of finding good growth stocks at attractive prices rises. "Usually, this would be a stock that exhibits faster earnings growth than its valuation multiples," Teo says. For instance, for a company growing at a compound annual rate of 15%, a reasonable price would be anything less than 15 times its earnings.

So, what are the hot growth sectors? And, which locally listed companies does Teo like now?

Offshore and marine

Among the stocks that Teo thinks qualify as growth plays is **STX OSV Holdings**. "This is one of the world's leading builders and designers of high-end offshore support vessels," he says. Offshore support vessels are used to transport people and goods to and from an oil rig or other offshore oil platform or structure. "Usually, the cycle for new order intake for such OSVs typically starts maybe about a year or so after the orders for the rigs have been given out to the rig builders," says Teo. Given that orders had begun to come in strongly for rig builders starting late last year, Teo sees this as an opportunity for the order momentum to pick up for STX OSV.

Teo is also keen on the offshore and marine sector in general. Higher oil prices have fuelled exploration and production activity, creating conditions for the whole industry to continue growing at a healthy pace. Meanwhile, a whole new market for rigs and other offshore-related products and services has opened up in Brazil, where the country's largest oil company, **Petrobras**, has been handing out orders. Petrobras recently indicated that the award of 21 ultra-

glehold on a market for products and services that were just starting to emerge. That enabled it to maintain a growth rate that had little correlation to broad economic activity. And, its current scale is just a reflection of the sheer size of those markets.

Yet, the technology space is not the only sector in which new markets for products and services are being spawned all the time. The rise of huge, populous countries such as China and India has been spurring massive demand over the past decade for more prosaic products such as shoes, packaged foods and housing. That is creating growth opportunities for companies that can position and entrench themselves in those new markets, as well as companies that have a lock on the supply of raw materials to make those products.

On the face of it, Singapore seems an unlikely hunting ground for such stocks. It is a small country that already has a relatively high per capita income, and has never produced a technology company in the vein of Apple. Yet, there are more than a handful of listed growth companies hiding in plain sight. Just ask Teo

Hiang Boon, who heads UOB Asset Management's Singapore and Asean teams and oversees the United Growth Fund.

Teo works with his team to identify big growth trends. "That will help form a top-down overlay to do the bottom-up analysis that will follow," he explains. The bottom-up selection involves picking companies that have the best chance of outperformance within the sector. "These are stocks with good corporate governance, quality management and a good business model," he adds.

Another important factor is having a strong financial position in terms of balance-sheet and cash-flow strength, so it can undertake future growth. He says, "That also ties in with gearing, which cannot be too stretched." Also, it must have a durable competitive edge that affords it significant pricing power.

The strategy seems to work. The United Growth Fund has returned an average of 8.9% a year over the last decade. Including the 5% sales charge, the fund has returned 8.2%. In that period, its benchmark, the Straits Times

Growth plays in the United Growth Fund

BLOOMBERG

COMPANY	PRICE AS AT JULY 21 (\$)	MARKET CAP (\$ BILL)	CHANGE YTD (%)	PER (TIMES)	DIVIDEND YIELD (%)
DBS Group Holdings	14.98	35.1	4.6	18.0	2.8
Oversea-Chinese Banking Corp	9.77	33.0	-1.1	15.3	3.1
Keppel Corp	10.82	19.3	5.1	11.4	3.8
United Overseas Bank	19.99	31.4	10.4	12.2	3.0
Noble Group	1.82	11.7	-16.1	14.4	1.7
Overseas Union Enterprise	2.90	2.8	-11.9	3.5	1.4
STX OSV Holdings	1.53	1.8	34.2	6.9	2.0
Sembcorp Industries	5.08	9.1	-0.8	11.4	3.0

deepwater rigs, which had been delayed, would be completed this year.

In the Singapore market, **Keppel Corp** and **Sembcorp Industries** have a presence in Brazil and are widely thought to be globally competitive makers of oil rigs and offshore vessels. Teo says Keppel is a good example of a stock with strong fundamentals. "[It] is a conglomerate, but with a substantial part of its earnings coming from the offshore and marine segment. They are one of the world's leading builders of jack-up rigs and semi-submersibles," he says. "With the elevated oil price and continued search for oil, we have seen improvement in the order intake for such rigs, jack-up rigs in particular, this year. They have a good order book, good order momentum and valuations are attractive."

Meanwhile, Sembcorp is the parent company of **Sembcorp Marine**, another world leader in rig-building. On top of this, Teo points out that Sembcorp has a very strong and dominant position in the local utilities space, especially on Jurong Island.

"With the continued investment in petrochemicals in Singapore, this stock will benefit and ride along this growth phase. They are also expanding outside Singapore and have made headway," Teo says. "We like Sembcorp because there is growth in the utilities business, and I think the valuation accorded by the market today to the utilities business is too low."

Sembcorp's 60.7% stake in SembMarine has a market value of about \$6.8 billion. However, Sembcorp's own market capitalisation is just \$9.1 billion. The utilities business makes up about 30% of the group's profits while offshore and marine makes up 66%.

Property, banks and commodities

Another sector that Teo likes is local prime office space. Among the United Growth Fund's top 10 holdings is **Overseas Union Enterprise**. Within the CBD, the company owns One Raffles Place, which consists of two prime Grade A office towers and a shopping centre just above the Raffles Place MRT station, as well as Towers One and Two of DBS Building. At the same time, it has just completed OUE Bayfront, a new 18-storey office tower. And it owns and manages the Mandarin Orchard and Marina Mandarin hotels here.

"We like this name because it is a proxy to the office cycle in Singapore. Some of the buildings that they are completing are able to sign on leases that are currently rising, so it's able to tap the rising rental market for prime office space in Singapore," says Teo. According to data from the URA, prime office rents improved 5.1% q-o-q in 1Q2011, rising above \$9 psf a month and closer to their peaks in 2008, when they were above \$14. This is despite a healthy amount of new supply in space, as prime office buildings continue to enjoy strong occupancy rates on the back of steady economic growth as well as a rising number of MNCs opting to base their Asian or international headquarters here.

"At the same time, OUE gives us exposure to the tourism and hospitality industry via its Mandarin Hotel on Orchard Road, which is enjoying good occupancy and improving rates," Teo adds. The country is expected to see between 12 million and 13 million visitors this year. In contrast, Australia received 5.9 million visitors during the year to Jan 31. Teo says OUE also trades at a significant discount to its revised net asset value, which he says is currently above \$4.

Another sector in which Teo sees growth is financial services, spurred by increased corporate and eco-

nomie activity. "Our Singapore banks have a growth element too. We are looking at good loans growth in Singapore and the region," says Teo.

All three local banks — **United Overseas Bank**, **Oversea-Chinese Banking Corp** and **DBS Group Holdings** — have expanded outside Singapore: DBS in India and China; UOB in Indonesia and Thailand; and OCBG in Malaysia and Indonesia. Given that these countries are mostly expected to see higher GDP growth rates than Singapore, the banks should be able to ride on that growth too.

"We should be looking for the net interest margins to gradually stabilise into the second half," Teo adds. "With provisions still expected to remain low in this part of the economic cycle, I think the banks do have some growth element." In fact, the United Growth Fund is currently heavily weighted in banks, with about 41.5% of the fund's allocation currently in financials. Another 33.1% is in industries, which would include stocks in the offshore and marine sector.

Yet, another growth industry in Teo's view is commodities. Here, he likes **Noble Group**, which derives about half of its earnings from the energy sector, in coal, gas and oil, and another 30% in agricultural commodities. Teo says Noble is a good play on overall macroeconomic growth, but has the ability to generate better-quality earnings because it operates in both hard commodities such as coal and soft commodities like sugar.

Outperforming, rain or shine

If it seems like Teo is leaning towards relatively heavyweight names, it is because he is. Of the 30 or so names within the United Growth Fund, Teo says only 20% are off-benchmark stocks. As he sees it, the fact that stocks are large does not mean they cannot grow fast. After all, these are companies that are likely to dominate their respective industries. Moreover, in uncertain periods, money tends to gravitate to large caps, he adds.

While some hot, small-cap stocks might well deliver massive outperformance from time to time, consistent, market-beating performance is more likely to come from a judicious selection of larger-capitalisation, growth-oriented stocks. Teo says. Indeed, the United Growth Fund has managed to outperform the STI over the last one-month, three-month, six-month, one-year and three-year periods.

"Generally, growth stocks would probably tend to perform better in periods when the sustainability of global economic growth is more assured because it does provide some kind of tailwind and, therefore, this drives down risk premiums, and the market would place emphasis on such growth," says Teo. "But it doesn't necessarily mean that growth stocks become shunned in periods when there is an economic slowdown, because in such periods the growth becomes scarce and therefore one may be prepared to buy these names because of their above-average EPS growth versus the rest of the market."

So, if one believes that the world will emerge from whatever crisis lies ahead, as it always has, this might be the time to begin tracking a handful of good growth stocks.

"We think it is more like a mid-cycle slowdown and we don't think it's a hard landing. The environment is of course tougher now, because in such an environment, where macro concerns are always in the headlines, these concerns give some headwinds to the overall market," he says. "But, at the end of the day, if we were to choose fundamentally strong stocks, the market will eventually reward these names." ■