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Hong Kong

John Qiu

Contrarian, fundamental, long term, aligned equity investing

John Qiu founded Orlog Capital in January 2022 with the name based on the Anglo-Norse belief in a recursive, fluid and probabilistic fate. It has significance both in the investment approach of the fund, as well as the way the business is operated.

Qiu's educational background in biochemistry and molecular biology (as part of a double degree including finance) has influenced his use of the scientific method in stock analysis – start with a few key core hypotheses and constantly challenge them using collected data. Evolutionary biology is another major influence and he considers the ideas behind evolutionary theory to be a base framework for understanding the world. Despite his background (or because of it), Qiu does not invest in early-stage biotech, explaining it as: "My background can provide understanding, but does not give me any edge in predicting a drug's success rate. I would rather look at firms where their competitive edge can be clearly defined".

Qiu views the stock market as a zero-sum game, like poker: "Somebody else has to be making a mistake for me to win at the game. My contrarian, fundamental and long-term approach gives me more optionality to exploit market biases".

Former employers and fund model

Qiu spent 15 years at two very different asset managers before launching his own firm. In 2007, fresh out of university, he joined the recently launched Orbis/Allan Gray Australia. Later, after relocating to Hong Kong in 2013, he joined Overlook Investments as one of a five-member investment team. Both dates were momentous in timing, the first coinciding with the beginning of the global financial crisis, and the later with the beginning of significant western capital flows into domestic and offshore Chinese equities. These events left a deep impression on Qiu's approach to investing.

Orlog's investment philosophy and business model takes elements from both investment managers. Allan Gray taught him the deep-value, contrarian investment approach, which worked extremely well in the aftermath of the global financial crisis, while Overlook provided insights into long-term, high quality, compound growth investing. Qiu describes his own approach as contrarian, fundamental, long term and high conviction: "I am more deep value and contrarian than Overlook but generally speaking, require more growth as a driver of returns compared to Allan Gray Australia". Equally, Qiu owns some companies he could not envisage either of his former employers owning, such as China's on-demand platform, Dada Nexus, whose share price has been very volatile. Qiu has actively traded around the volatility, top slicing the position in January 2023 and now buying back shares, illustrating his adherence to a clearly defined valuation range, no matter how bright he thinks their long-term prospects are.

Qiu deliberately hires from outside the investment industry, which is something also commonly practiced at Orbis/Allan Gray. Qiu looks for people with 3-5 years of work experience and often from non-finance related academic backgrounds such as maths, science and accounting. They are required to complete the CFA to get up to speed on finance. Past hires have included a lawyer, tech startup employee and biotech private equity analyst. The remuneration structure is similar to Overlook where the bonus, based on individual investment contributions, is the key feature.

Portfolio structure

Qiu has the mentality of a private markets buyer and limits his portfolio to 15-25 names; the top five of which could make up 50% or more of the book. He only invests once he has a deep understanding of the company and industry, focusing most of his attention on the supply side and competition dynamics. This often leads him to avoid certain companies or situations: "We are not confident about predicting competitive dynamics in EVs and could not build enough confidence understanding how content competition and the transition from linear to streaming model would affect future profits at Netflix, Disney and Paramount: we simply wouldn't know what to do if their share price fell another -20-30% lower". This is important because if the price falls and the core thesis hasn't changed, Qiu will generally buy more shares in the company (assuming relative returns versus other opportunities has also improved).

Investments could be held indefinitely if the thesis remains intact and there is no superior alternative to recycle capital into. The 15-25 portfolio stocks must constantly compete to retain their place in the portfolio.

Qiu does not generally own companies below $1 billion market capitalisation unless the risk/return ratio is exceptional.

Ambitious return targets

Qiu is seeking much higher returns than most asset managers. "We set a minimum hurdle of 25% CAGR over three years for investment candidates, which works out at around 20% CAGR assuming a 70% hit rate and disappointing underperformance on the theses that do not play out." With high quality companies available at distressed prices today, Qiu sees significantly higher returns potential for the current portfolio but expects the realisation of this to be very lumpy.

China

It is rare to find high quality compounding companies at cheap prices but Qiu sees no shortage of these opportunities in Chinese equities today. The ongoing geopolitical tensions and the disappointing pace of economic recovery post ending Covid-lockdowns in late 2022 has depressed sentiment and created excessive fear on investing in China. "I couldn't call myself a contrarian value investor if I wasn't attracted to Chinese equities at these prices today," says Qiu.

Stock selection is on a bottom-up basis, which for his Chinese holdings today, happens to be mostly internet and consumer goods/services companies. This includes his Macau casino positions, first acquired in 2022: "I thought the risks of license renewal was grossly mispriced and that gaming revenues would rebound quickly once Covid restrictions were lifted".

Some contrarians were tempted by Chinese property, but Qiu has avoided these investments: "Although there are similarities here to what Allan Gray Australia did investing in distressed Australian REITs in 2008, I felt that many of the Chinese developers had been aggressive in their accounting. It was clear early in the crisis they weren't going to get book value for most of their assets and nobody could be certain what the real level of liabilities was. Additionally, the industry had been far too aggressive bidding on land. It wasn't clear to what extent this would unravel. This made assessing the risks and outcomes very uncertain, even using a basket purchase approach".

Technology companies

Qiu often finds investor understanding of technology companies to be lacking or myopic. The long-term impact of competition is usually neglected next to optimistic assessments on demand. As for accounting, on the one hand valuations commonly use non-GAAP metrics which reverses out non-cash expenses such as share based compensation (which he believes is aggressive) but on the other hand, investors don't really know how to evaluate and treat expansionary expenses (equivalent to expansionary capex for a traditional company). Qiu thinks sell-side research often makes things worse with their overzealous focus on short-term forecasts and flawed use of valuation methods such as P/S and DCF. He believes market assessment of risk and valuation for technology companies frequently differs significantly from their true prospects, in both directions.

He gave the example of when the market fell out of love with Amazon during the early 2000s: "They didn't understand Amazon's accounting, they didn't understand retailing and they didn't understand the long-term strategy of using negative working capital to fund the disruption of offline retailers". It was the same in China with JD.com and there was a period of time where some investors thought the company was an unsustainable fraud and almost everyone preferred Alibaba. Today, the valuation gap between the two has compressed significantly and both companies have been oversold in Qiu's opinion. The widely reported Chinese crackdown on technology companies was a major contributor but Qiu believes it misrepresented the actual situation: "Previously there was a lot of anti-competitive behavior among the Chinese tech majors. They used their market clout to create walled gardens and suppress fair competition. It was an unhealthy, unsustainable environment. For the most part, the regulatory responses were pragmatic and stopped this behavior".

Qiu believes it's not a winner takes all situation and multiple e-commerce companies can prosper as 75% of Chinese consumer spending is still offline and there remains large scope for these platforms to improve efficiency and generate attractive returns. He thinks competition today is vigorous but rational and companies have started moving away from burning cash to drive activity and instead, are focusing on improving profitability. Also, they've become more shareholder friendly, making positive progress in capital returns and operational restructurings. Among the Chinese e-commerce companies Qiu holds JD.com and Dada Nexus among his top five positions: "JD is an excellent operator, always keenly focused on operational efficiency and the consumer experience. They outcompeted peers in consumer electronics/home appliances and we think they'll continue to grow share and profits in other verticals. Dada is a subsidiary of JD and is basically the entirety of its offline to online marketplace business and express delivery e-commerce. It is closely integrated within the JD ecosystem which gives it exclusive access to vast amounts of traffic. We think both companies are trading at a fraction of their long-term intrinsic value".

Non-China investments

Other top five positions include non-China equities: Spirit Aerosystems and KION. "We like both of these companies for their low valuation and dominant positions in their respective verticals," says Qiu.

Spirit Aerosystems (SPR) is the world's largest commercial aerostructures manufacturer and exclusive supplier of key parts to both Boeing and Airbus, including all 737 Max fuselages (which contributed most of their historical profits).
The stock has been depressed since 2020 when the 737 Max was grounded and Covid started. Qiu says: "The commercial airplane market is a duopoly and SPR enjoys a monopoly position within the ecosystem. Despite facing the perfect storm, we think it is only a matter of time before production and profitability mean reverts. On top of that, SPR has grown significant value in their defense and after-sales businesses". Qiu thinks the return upside is large using a wide range of bull and bear scenarios.

KION is the world's second biggest forklift manufacturer and warehouse automation provider. Qiu started buying the stock in the second half of 2022 after the company issued an unexpected third quarter 2022 profit warning which highlighted a trifecta of issues: sharply rising cost inflation, supply chain shortages on forklift parts and a downturn in warehouse automation spending. Qiu thinks investors are overly concerned about transitory issues and the quality of the business is high: "They've changed their contracts to build in inflation protection and resolved their forklift parts shortage. The way they did it showed strong pricing power and a rational competitive environment. As for the economic cycle, while forklifts are cyclical, the warehouse automation business is more of a structural growth story, especially given high wage inflation. The customer base is extremely sticky for both businesses and KION earns high margins providing after-sales services to its growing installed base".

Investor base

The ideal investors are patient capital who can withstand volatility because Qiu defines risk as the risk of absolute loss. "For our strategy to work it requires holding power and conviction in our model. The capital base must match," says Qiu. The fund has no marketing team with all client dialogue directly handled by the investment team.

The current capital within the fund is all friends and family with most of it coming from Qiu's family office and personal savings. "We are looking to open the fund to external capital but there's no rush. Focusing on performance is the priority," says Qiu. Orlog Capital has recently started a database for investor interest on their website and has tentative plans to open the fund either late 2023 or early 2024.

Orlog Capital is a Cayman fund and licensed with the Hong Kong SFC. Investors should review Orlog's detailed quarterly letters, on the firm's website, for more colour on the firm's philosophy, process and the aforementioned stocks.