MINORITY SHAREHOLDERS WATCH GROUP
BADAN PENGAWAS PEMEGANG SAHAM MINORITI BERHAD
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❖ Unearthing hidden gems: The small-cap advantage for retail investors

Small-cap stocks have often taken a backseat in the eyes of investors, who tend to view them as riskier investments when compared to their larger-cap counterparts. This perception has led some fundamentally-oriented retail investors to avoid small-caps altogether. However, for those willing to invest the time and effort required, exploring small-cap stocks can be rewarding, offering the potential for higher returns.

One compelling reason to consider small-caps stocks is the increased likelihood of discovering a "hidden gem" due to their limited research coverage and lack of institutional investor following.

Institutional constraints: A winning edge for retail investors

Institutional investors, who manage significant capital, typically face limitations when it comes to investing in small-cap stocks, including internal mandates that confine their allocations to companies above a certain market cap threshold and stocks meeting specific liquidity criteria (based on their average daily trading value).

Institutional investors managing portfolios in the billions may also find it not worthwhile to invest in small-cap stocks due to the minimal impact it may have on their overall performance. For instance, if they accumulate a 3% stake worth RM3 million in an RM100 million market cap company, a doubling of the stock price would register as a mere blip within the context of an RM3 billion-sized portfolio.

Conversely, retail investors, who typically manage smaller sums of money, benefit from the opportunity to invest in smaller-cap stocks that have the potential to significantly generate high returns for their portfolios. The lower trading liquidity would also be of lesser concern for retail investors. Warren Buffett's statement in a 1999 interview with *Business Week* underscores this advantage. He emphasized how managing a smaller pool of money makes it considerably easier to achieve high returns, even going as far as stating that he could "guarantee" a 50% annual return if he was managing just US$1 million.

Capitalizing on market inefficiencies

The small-cap segment has limited sell-side research coverage compared to large-cap stocks. Brokerage houses rely heavily on institutional investors as substantial clients, resulting in sell-side analysts at these firms prioritizing research coverage for larger-cap stocks, which are deemed more "marketable" or "investable."

The limited coverage in the small-cap segment provides astute retail investors with another distinctive advantage. The efficient market hypothesis, which asserts that stock prices reflect all relevant information and thus always trade at fair values, appears to exert greater influence in the domain of large-cap stocks, because of their extensive research coverage and heightened media attention. In contrast, due to the scarcity of widespread information, small-cap stocks may not fully reflect their latest corporate developments or prospects.

Stock prices of under-researched smaller-cap companies often exhibit a slower response to positive developments, and in some cases, these developments go entirely unnoticed by the investment community. Small-cap stocks may possess similar positive fundamental qualities to their large-cap counterparts, but they could fetch significantly lower valuation.

All these factors create a unique opportunity to fully capitalize on the potential for substantial returns by investing early in lesser-known small-cap companies that begin to show promising prospects, such as strong earnings growth. If a small-cap company falls into the growth stock category, retail investors can benefit from two sources of share price appreciation: earnings growth and a higher valuation (as institutional investors start to take notice once the company reaches a certain size and receives more research coverage).

Case in point: Vitrox Corporation Berhad

A compelling case in point would be Vitrox, an automated machine vision inspection solution provider. If one had discovered and invested in Vitrox a decade ago, their investment would have grown more than 35-fold by today.

Back in September 2013, Vitrox had a market capitalization of about RM180 million and attractive fundamental attributes, such as a single-digit price-to-earnings (P/E) ratio, a high return on equity, and a net cash position. What made it even more appealing were its growth prospects, which largely remained under the radar of most investors.

A decade ago, attendance at the company's self-organized quarterly investor briefings was minimal, consisting of just a handful of individuals, including high-net-worth retail investors. Institutional interest was limited, and only one broker actively covered the stock.

However, as Vitrox's earnings continued to grow strongly, more brokerage firms began to cover the stock and institutional investors entered the scene (resulting in investor briefings now drawing large turnouts). The growth of Vitrox's stock price began to outpace its earnings as it underwent a valuation surge (also known as a re-rating).

For perspective, Vitrox's earnings from 2013 to 2022 increased eightfold, and the stock currently boasts a market capitalization of over RM6.5 billion with a high P/E valuation of about 40 times. If one had invested in the stock halfway through the period from 2013 to 2023, in mid-2018, they would have still enjoyed around a 2.5-fold increase in the stock price. However, this pales in comparison to the more than 35-fold jump in value that early investors experienced by discovering the stock earlier and holding it through.

So, while investing in large-cap stocks of familiar household names may be comforting, it might be worth searching for promising small-cap companies to uncover investment opportunities that have the potential to yield substantial returns. After all, hidden gems are often found where others have yet to look.

Ooi Beng Hooi
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MSWG AGM/EGM Weekly Watch 6 -10 November 2023

For this week, the following are the AGMs/EGMs of companies in the Minority Shareholders Watch Group's (MSWG) watch list.

The summary of points of interest is highlighted here, while the details of the questions to the companies can be obtained via MSWG's website at www.mswg.org.my.

Date & Time	Company	Quick-take
07.11.23 (Tue) 10.00 am	Eurospan Holdings Berhad (AGM)	The Group recorded revenue of RM37.6 million in FY2023, being the lowest in the last 10 financial years. The Group's net loss widened to RM6.1 million in FY2023 from RM4.6 million in the previous year, mainly due to the fear of impending global economic downturn led to reduced demand for the Group's products during the year. Notably after the financial year end, the Group sold two pieces of land together with factory buildings for RM8.15 million. It also proposed to dispose of Dynaspan Furniture Sdn Bhd, a wholly owned subsidiary and another 2 parcels of freehold land together with the buildings for RM54.6 million.
07.11.23 (Tue) 10.00 am	Ecobuilt Holdings Berhad (AGM)	In the FYE 31 May 2023, the Group recorded a marginal decline in revenue of RM2.9 million (or equivalent to 1.7% y-o-y) to RM164.1 million, attributed to lower revenue recognition arising from contract completion or nearing completion. Although three new projects worth RM219.3 million cushioned the revenue impact, soaring construction costs, especially sand and cement, and staff costs resulted in a substantially higher gross loss of RM12.5 million during the year (FY2022: - RM983,000).

		Meanwhile, it posted a widened pre-tax loss of RM34.06 million, exacerbated by bad debt written off of RM9.15 million following the de-consolidation of subsidiary Gabungan Eko Construkt Sdn Bhd. Despite challenges, the Group, whose financial position is fortified by a recent private placement, expresses cautious optimism, boasting seven ongoing contracts and a robust tender book of RM650.4 million.
08.11.23 (Wed) 10.00 am	Gadang Holdings Bhd (AGM)	The Group recorded a revenue of RM496.1 million and a loss before tax of RM27.9 million for FYE2023 (FYE2022: Revenue and profit before tax of RM652.0 million and RM70.1 million). These were mainly due to the following: a) Lower contribution from construction projects. b) A one-off impairment loss on goodwill. c) Impairment of concession assets, investment in joint venture, receivables, and contract assets. d) Provision for potential liability arising from liquidated ascertained damages.
10.11.23 (Fri) 10.00 am	SC Estate Builder Berhad (EGM)	The Company seeks shareholders' approval for the following resolutions: a) Proposed Rights Issue of 2,148,181,818 new ordinary shares in SCBUILD/0109 at an issue price of RM0.005 per rights share on the basis of 2 rights shares for every 1 SCBUILD/0109 share. b) Proposed LTIP of up to 30% of the total number of issued shares. c) Proposed awarding of Share Option Plan (SOP) Option d) Proposed awarding of Share Grant Plan (SGP) Award and/or SOP.

One of the points of interest to be raised:	
Company	**Points/Issues to Be Raised**
Eurospan Holdings Berhad (AGM)	The Group's gross profit for FY2023 and FY2022 are 12% and 13% respectively. (Page 38 of Annual Report 2023) a) The gross profit is relatively low as compared to other furniture players in the market. Please elaborate on the Group's challenges in increasing the gross profit margin. b) What are the strategies to improve gross profit margin?
Ecobuilt Holdings Berhad (AGM)	1. The Group's trade and other receivables credit impaired that were past due more than 180 days have increased significantly from RM5.4 million in FYE2022 to RM37.0 million in FYE2023 (page 89 of AR2023). a) What challenges did the Group encounter in collecting trade receivables overdue by more than 180 days, considering the substantial increase in outstanding amounts? b) Who are the customers and who make up this category (past due 180 days) of the Group's receivables on FYE2023? What are their profiles and how does the Company plan to manage these outstanding debts? c) Currently, how much of the overdue amount has been collected? 2. The allowance for expected credit loss on other receivables increased substantially from NIL in FYE2022 to RM2.9 million in FYE2023 (page 88 of AR2023). a) What comprises the other receivables amounting to RM2.9 million? What was the reason for the substantial increase in provision? b) How much of these provisions has been recovered to-date? c) What percentage of these provisions are expected to be non-recoverable? d) Are provisions expected to increase going forward?
Gadang Holdings Bhd (AGM)	1. The Utility Division recorded a significant decrease in its pre-tax result in FYE2023 with a loss of RM10.3 million (FYE2022: Pre-tax profit of RM6.7 million) which is mainly due to the impairment of concession asset of RM9.4 million for the 9MW mini-hydro power plant in Lintau, Indonesia, in compliance with accounting standard MFRS136 (Page 10 and Page 26 of AR2023). (a) What specific factors triggered the impairment of RM9.4 million? Are these factors expected to cause another impairment in the next financial year?

	(b) What is the current and expected performance of the Division's business in Indonesia in FYE2024? 2. There is a net Impairment loss on trade receivables amounting to RM2.0 million in FYE2023 (FYE2022: RM0.2 million) (Page 188 of AR2023). (a) What caused the higher impairment loss on the trade receivables in FYE2023? Which trade receivables are involved in the impairment exercise? (b) What are the measures taken to recover the amount? How much of the amount has been recovered? (c) What is the expected amount to be recovered in FYE2024?

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DISCLOSURE OF INTERESTS

- *With regard to the companies mentioned, MSWG holds a minimum number of shares in all* the companies covered in this newsletter.