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Value investor backs Samsung's youthful appeal over Apple

Jonathan Shapiro

In the clash of the mobile handset titans, former Platinum fund manager Jacob Mitchell is backing Korean giant Samsung over Apple.

Samsung Electronics is the largest position in Mitchell's Antipodes Global Fund, accounting for just under 4 per cent of the fund's holdings on the basis the company is both undervalued and well positioned to dominate its main lines of business.

Apple meanwhile will struggle to win over younger customers amid competition from cheaper and improving Chinese handset makers and keep its Asian suppliers on good terms.

"Apple is increasingly dependent on its richer older consumer base, because they suffer the most inertia," Mitchell tells *The Australian Financial Review*.

"To preserve their business longer term, they have to recruit younger consumers who are more price-sensitive and open to new devices."

Samsung and others "are feeding off the android ecosystem" which may leave them better placed.

"Younger people see it as a more open, affordable platform. You are competing against these lower-end handsets that are becoming higher-end in their capabilities," he says.

To understand Samsung, it helps to understand Korea, Mitchell says. This has been a strange and challenging country for foreign investors. While Korea has produced world-beating companies such as Samsung and Hyundai Motors, concerns about corporate governance has persisted.

Jacob Mitchell believes Samsung is undervalued. PHOTO: BRENDON THORNE

In September 2014, when Hyundai Motors revealed it would buy land worth $US10 billion ($13.4 billion) in central Seoul, many global investors gave up on investing in Korean companies. More recently, however, Korea's economic exposure to China and the competition it has faced from this emerging powerhouse has unnerved investors.

But Mitchell says though the risks are real, valuations at GFC levels for Korean auto, technology and financial companies that remain competitive means it's once again a compelling place to invest.

Social forces are working behind the scenes to enact change in Korea which will ultimately be good to shareholders, he says. The patriarchs of the Korean "chaebol" conglomerates are on their way out while there is huge political pressure to ensure the inherent wealth created by these businesses is equitably distributed.

In addition to Samsung, Mitchell likes the "cheap defensives", like Chinese search engine Baidu and Microsoft which has been reinvigorated by the push into cloud computing services.

He is prepared to bet against many companies and industries that he feels have benefited from the boom in high-yield bond issuance that has fed cheap credit into the corporate world.

This extends from 80s' style "conglomerates" that have relied on financial engineering for earnings growth, to biotech and technology companies whose valuations have soared in a search for returns.

"It's a low-growth environment, so the mentality has been to invest in 'certain growth' or 'hypergrowth'," he says.

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"We think both of those factors have become expensive in the market. What matters more than anything is pricing power and it will be industry structures," he says.

Mitchell left Kerr Nielson's Platinum Asset Management in late 2014 to run his own fund and is off to a strong start since it began investing in July of 2015, despite choppy conditions. The fund is up 3.7 per cent, beating its benchmark – the MSCI World Index – by 8.2 per cent a year.

The art of value investing is splitting into two categories: traditional value investors who seek to buy businesses that are cheaply priced on the market, relative to the value of their assets; and pragmatic value investors who are more attuned to disruptive structural forces that can make a cheap business an obsolete one, he says.

"Pragmatic value puts more weight on structural change and recognises cyclical change happens in a structural framework. Some businesses don't come back from a classical downturn because they are being impacted by long-term changes."

He also points out that fund managers are facing threats themselves as computers become better "at replicating value strategies".

More large funds are turning to "smart beta" strategies that use repeatable systems to outperform indices, putting added pressure on funds to demonstrate their worth.

"We are competing against smart beta and we think we can win because smart alpha is better than smart beta," he says.