

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Investing in Long/Short Global Equities



HIMANSHU H. SHAH is the Founder, President, and Chief Investment Officer of Shah Capital Management Inc., and Managing Partner of Shah Capital Fund LP. Prior to founding the investment company, Mr. Shah was Vice President and Senior Portfolio Manager at UBS Securities. With 16 years' experience in the investment management business and having grown up in a business family in India, he brings a wealth of knowledge, experience and a unique perspective to the firm. He is active in support of various cultural and philanthropic organizations in the community. Mr. Shah received a Bachelor of Commerce in Accounting from Gujarat University and an MBA from the University of Akron.

TWST: Please begin with an overview of Shah Capital Management and its investment philosophy.

Mr. Shah: Shah Capital Management is a Registered Investment Adviser. We manage over \$182 million, and are fundamental investors with a global focus. We offer two investment strategies — a long/short equity fund and long-only separately managed accounts. We are not taking new investors into our separately managed accounts today. We have a team of six professionals, with two in research and three in client services, compliance and marketing. I am the Founder, President and Chief Investment Officer of the firm.

TWST: Tell us about the global strategy aspect of your investments.

Mr. Shah: I've been in this business for 16 years now, and I have invested overseas since 1993. When we say global, we are mainly talking about Western Europe, Asia — Japan, South Korea, Greater China region, and India, and lastly Brazil, Canada, Mexico and the US.

TWST: Does your investment process begin with a top-down approach to global economies?

Mr. Shah: We do have a top-down component to our research. However, we primarily use a bottom-up, fundamentals-driven process to identify the most attractive risk-adjusted securities. We overlay macroeconomic trends like economic growth, current account surplus/deficits, budget surplus/deficits, and most importantly, the government support for business growth. We are looking for the countries that are more capitalistic and business friendly.

TWST: What about the composition of your portfolio? How much is in North American stocks and how much is in overseas stocks?

Mr. Shah: In 2002-2003, we were overweight US. In 2004, we were overweight Europe. In 2005, we were overweight Japan. In 2006, we were overweight mainly non-Japanese Asian companies and Western European companies. As we look at it today, we are underweight US and Europe and overweight Asia.

TWST: What is the performance record of your portfolio?

Mr. Shah: We launched the long/short fund in July of last year, and are ahead of both the S&P 500 and the Tremont Long/Short Index over the last nine months with less volatility, especially in

terms of standard deviation and beta. For our long-only equity composite of separately managed accounts, we have attained 18.7% annualized compounded over the last five and a half years ending March 31, 2007. In the same time frame, the S&P 500 Index was up 7.7% inclusive of reinvested dividends.

TWST: What stocks have attracted your attention? What are the reasons why you wanted to buy them?

Mr. Shah: Perhaps the best way to answer that is to look at a few of our top holdings. That should also give you some idea about the way we look at things at Shah Capital Management. We own a company called **Chiquita Brands** (CQB, \$14.00). They are the largest banana company in the world. They've got almost 25% market share worldwide in bananas. They are also one of the largest packet salad companies in the US, with around 48% market share. This company has done very well, moving from a commodity business, which is bananas, to high-margin packaged fruits and salads.

The company's revenue run rate is around \$4.5 billion, and the market cap is around \$600 million. **Chiquita** got hit with the Eu-

ropean Union banana tariffs last year, and that's why the stock came down almost 50% from where it was 18 months or so ago. The EU tariffs are not fair, and lots of countries in South and Central America have taken the EU to court for that. The tariffs cost them more than \$100 million last year net, which is almost \$2.5 per share before tax.

The other thing is the E. coli outbreak in August of last year. Even though **Chiquita's** products were not affected at all (it was their competitors' products), the whole industry suffered because people stopped eating spinach for a long time. Those are some of the things that hurt the company's bottom-line performance in 2006. We think the tariffs in the EU are going to eventually go away or get reduced substantially, because they are unfair, and I don't think the WTO will stand for that.

We think the balance sheet of **Chiquita** is strong. They have debt on the balance sheet because they bought Fresh Express back in 2005, and I thought that was a good acquisition on their part. Overall, the earnings power of this company is a lot higher than what you see in the EPS numbers today.

Another company that we own in the portfolio is from Canada called **Abitibi-Consolidated** (ABY, \$2.80). They are the

largest newsprint maker in North America. Naturally, the company has suffered quite dramatically over the last five years or so with high natural gas prices. You have the Canadian dollar going from \$1.55 to \$1.10 last year, and since most of their paper mills are in Canada, they got hit on the cost side quite a bit. The Internet has replaced a lot of the newspaper readership, especially in the US, so it's a triple whammy.

This stock traded a lot higher than where it is today. It has a market cap of around \$1.2 billion. We like **Abitibi** because of their hydro and power assets in Quebec and Ontario. We think the Canadian dollar peaked last year, and that is going to help the company. Also, their merger with **Bowater** (BOW) is going to yield tremendous savings to the bottom line by next year.

Last but not least, a lot of paper mills have closed down in North America both because of poor demand over the last five years and profitability issues. This industry has really restructured, so if there is any incremental demand either from North America and/or from overseas, the bottom-line impact could be significant. On a NAV basis, it is a very undervalued name.

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1-Year Daily Chart of Chiquita Brands



Chart provided by www.BigCharts.com

TWST: The merger has been announced with Bowater?

Mr. Shah: They announced a merger. Naturally, they are going to have to get the antitrust approval, which they should get, because neither of these companies has made any money in four or five years. So I

would be very surprised if the authorities do not approve the merger between **Abitibi** and **Bowater**. If everything goes well, I think a merger could be consummated by the end of the third quarter of this year.

The third company that we own is from Brazil. It is **Tele Norte Leste** (TNE \$14.00), called **Telemar**. They are the largest fixed-line operator, one of the largest broadband players, and one of the top four wireless operators in Brazil. They have almost 14 million wireless subscribers growing at a decent clip. This company is a cash flow powerhouse. The stock trades at only 3.3 times EBITDA. Just to compare, **AT&T** (T) trades at 7 times EBITDA. So the valuations are very reasonable.

The company has been de-leveraging for many years now. They would have a high investment-grade rating if they were not domiciled in Brazil, based on the balance sheet. On the regulatory front, I think the second term of Lula, the President of Brazil, could be more conciliatory toward the telecom operators in Brazil than what they have been in the past, especially in the last eight years or so.

Lastly, I think the convergence is taking place. **AT&T** has done very well because of its triple play, and I think **Telemar** is also planning to do the same thing in Brazil. As I said, it's a cash cow, so you wonder why the stock has not participated in this rally. One of the biggest reasons is because of their convoluted voting structure.

The balance sheet is solid. The book value is close to \$10 per share. The company has been growing the top line in the double digits for many years. The market capitalization is only \$300 million. Again, not that many people know about this company. It has very little following on Wall Street. The company is domiciled in Singapore, but its main operations are in China. We own other companies that are related to the growth story of China, but this is the company that I really like.

The Chinese operation CEO was named as one of the best executives in China in 2006. Technologically, **CYD** was the first company in the PRC to get the Euro IV standard for their heavy-duty truck engines, and they were also the first company to get the Euro III standard. So technologically, this company is also ahead of its competition.

We think the company is going to make more than \$1 per share profit in 2007 so it is trading at around 8 p/e on this year's earnings. It is trading at .3 times revenues, and around 6 times EBITDA.

TWST: How many holdings do you generally have in your portfolio? Does the number fluctuate?

Mr. Shah: I believe you can get proper diversification with 30 to 40 positions as long as you are well diversified among different industries. With separately managed accounts, we haven't had more than 40 positions. In our fund, the range can be between 30 and 70.

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Actually, they announced an arrangement a year or so ago that would have a structure giving equal voting rights to everyone, including the ADR holders in the US. The stock was trading at \$19 at that time, but the terms the company proposed were not very friendly to the ADR shareholders, so it was defeated late last year. That's one of the reasons why the stock has come down quite a bit. But operationally, the company is doing well. On a valuation basis, it is very cheap, and we like what's happening in Brazil on a macro level.

TWST: What about companies that are benefiting from the impact of China and India in the Asian market?

Mr. Shah: That brings us to another company that we own in the portfolio, called **China Yuchai International** (CYD, \$8.00). It trades on the New York Stock Exchange. **CYD** is the strongest brand of diesel engines in China. They had around \$200 million in revenues back in 2000. Last year, their revenue was close to \$900 million, and this year, they could surpass the \$1 billion mark. They also have one of the best distribution networks in China.

TWST: This is a very research-driven process. How do you find the ideas for your portfolio?

Mr. Shah: If you are really passionate about what you do and love what you do, you can find a lot of information on a lot of companies. Sixteen years of experience also helps in creating the knowledge base!

TWST: Would you comment on the portfolio relative to the average turnover?

Mr. Shah: In our fund, around 70% of the portfolio holdings are held for the intermediate to long term. The rest of the portfolio has high turnover.

TWST: What is the sell process?

Mr. Shah: We take profits when profits should be taken.

TWST: How do you attempt to control investment risk at the portfolio and the individual security level?

Mr. Shah: First of all, we have zero derivatives in our portfolio. I truly believe that you manage risk over the intermediate to

long term through diligent fundamental analysis. We think you can reduce two-thirds of the risk in the due diligence process. Regarding market risk and/or event-driven risk, I have found that you can address that risk through derivatives, but when you factor both the opportunity cost and the actual cost (of owning derivatives), it washes out. So that is how we look at it.

The other thing is discipline. When you have a disciplined investment management process, it also mitigates the risk of greed and fear. Back in the summer of 2002 when the market sold off and there was an awful lot of “sky is falling” fear, I was buying aggressively. So the way we manage money is strictly fundamentals- and valuation-driven.

TWST: How do you think that your investment approach is differentiated from that at other firms? What are you bringing to the table that others might not?

Mr. Shah: There are a number of things that differentiate Shah Capital compared to other firms. First of all, we are truly fundamental investors. Because of our strategy of multi-cap global, we don’t have capacity issues, nor the issue with regard to the future of compressed returns. We also take contrarian bets, like **Abitibi**, but a lot of bets that we have made in the past have yielded good results.

To give you an example, I significantly overweighted HMO stocks in the early part of the decade when a lot of people on the Street were bearish on the industry. We did exceedingly well. We also did well in the utilities and technology stocks that we had in 2003 and the oil infrastructure-related (exploration and mining) stocks back in early 2004, when the crowd was not too crazy. Numbers don’t lie, so I can tell you that we can do this and we can do that, but ultimately, it comes down to the actual returns that you produce for your investors.

TWST: Who are your typical clients? Are they mostly individuals or do you have institutional as well?

Mr. Shah: We have both high net worth and institutional clients. Our client retention rate is actually very good. Our strategy also fits very well with what’s going on in the institutional marketplace today. There was a recent study that said only 1% of US public pension plan assets are in the alternative space. If you look at the endowment space, it is lot higher. So we think there will be more investing into hedge strategies going forward. We also think we are well positioned with plan sponsors that want to expand their exposure to global equities.

TWST: What possible challenges do you see ahead for your investment process?

Mr. Shah: Because of our multi-cap global strategy, we have no capacity issue or issues of compressed returns.

TWST: Since you think 2007 is going to be a challenging year, what advice would you give to people about having a global strategy portfolio?

Mr. Shah: The problems in subprime and the Alt-A mortgage market in the US are well publicized. However, a lot of people are not focusing on the significant weakening in non-defense capital goods orders. I think it is negative for the US growth outlook — at least for the rest of 2007. We think growth in the US is going to be below average, around 2% or less in 2007. So we are not that positive on the US stock market, although there are always going to be pockets of opportunities. There is an old cliché that the market creates opportunities every day — if you know where to look.

When I say challenging year, I mean that the last four years have been amazing years for investors. You also have this private equity premium that has been built into the market to a great extent. If the corporate profit, which had been very strong until last quarter, slows down, you could definitely have weak stock prices.

I think it’s company by company. There are some companies that are not going to be affected that much with the slowdown that’s happening in the US. However, I would definitely shy away from consumer discretionary stocks in the US.

We do like Asia for the intermediate to long term. Naturally, all equity markets are going to be negatively affected in the short term if markets fall quite a bit in the US, however I don’t think it’s going to be sustained because the demographics in Asia are strong, the valuations are not outlandish, the productivity growth story is just unfolding, and the long-term economic growth profile is stronger than in the US and Europe.

TWST: Thank you.

Note: Opinions and recommendations are as of 4/4/07.

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