

Value Investing in India: A Mirage?

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Value investing – the very word has brought in a renewed sense of excitement among the investor community of today. For one, it gives an individual or manager an association with one of the most successful investors in history, and secondly it just sounds cool. Sophisticated investors and fund managers, have given it varying definitions, which goes all the way from margin of safety, book value discount and buying companies at a cheap multiple to earnings.

To me, a definition of value is an alternate way of defining an edge. Every trade or investment made, needs to have a definite quantifiable edge which in turn, makes its way in the form of an allocation into one's portfolio. Here is where, the Indian market has been a minefield of opportunities for an observant investor.

Why minefield – for the simple reason of corporate governance and promoter history of maximizing returns for himself or the shareholder, which has been one of the biggest dilemma for the investor – and will continue to plague the market for as far as the future holds

However, within the same minefield (which I classify as an opportunity), we have seen multiple instances of companies which have had a phenomenal record of compounding wealth (at more than 25% over a 25 year period)– right from the likes of HDFC (which had no assets on its balance sheet when it came to the IPO market in the early 90s and was thought of a fly by night operator), to the likes of Lupin -a pharma major – (which had a poor track record of capital allocation, when the promoters forayed into real estate (in the mid-90s) and the move back-fired). Little would anyone believe me, when I say that one of the bellwethers of the Indian stock market history – Infosys – did not have its IPO fully subscribed in the early 90s and one of the lead managers had to fill the gap, by taking the risk on their books (and the rest is history).

When one looks back (it's always with the benefit of hindsight), there were multiple opportunities that the Indian market presented an investor, in the form of having a winning edge : from acquiring a stake in the largest liquor company in India (with 50% market share) in the late 90s, when the total size of the market was Rs 200 cr (USD 30 million), to as recently as five years ago, when companies whose market cap was sub Rs 500 cr (sub USD 100 million) were available at three times earnings, having recorded a year on year growth of 25% over the last 5 years. (and each of these opportunities multiplied wealth by 20x over a five-year period).

Well as they say, its with benefit of history we define our analysis – so let's talk about the present.

India, with its sheer size of the economy and its growth rate (which being an optimist, I will define as a country that will continue to grow at 8% over the next 10 years, as I do not see

any impending crisis sitting today) will continue to offer wonderful opportunities to an investor, who does not typecast himself – there are two types of investors that the Indian market will never appeal to, one who defines his investable universe through the market capitalization of companies, and one who says that he will never invest in select sectors because of reasons he justifies (once you form an opinion, you can train your mind to justify it), irrespective of the valuations they are offered at.

Currently, India is in the midst of a bull run which has come through as a result of varying macro-economic reasons, and I continue to believe that the bull market is here to stay for the next few years. Investing in the middle of a bull- market is never easy, as the odds of finding a successful risk reward bet are not stand-out.

However, there are varying themes worth exploring, some of which include – sectors where capex is beginning to come through because of increased demand (ala infrastructure) to micro themes like improvement in corporate governance which is seen through improving the capital structure and monetizing dead assets which have been carried at book value. Exploring themes is only the first step, as an investor needs to make an investment at the right price (where the odds of him getting it right, are a multi-fold winner to the odds of him not realizing a thesis).

However, the beauty of equity markets remain that they are an auction market – which means the very philosophy because of which they functioned 30 years back (cycles of fear and greed), will continue. Michael Jordan – the legendary basketball player, who I have been a biggest fan of and continue to, mentioned that his greatest victories were off the court during his practice sessions, where he would train his mind. The match was just an extension, of his practice off court.

We are in an era of easy money which may last for the next few years – I am not sure about the time period – but one thing I am confident of, is when easy money presents itself, the probability of misallocation of capital is high. The cycle we are in will be no different and I expect the darlings of today to be some of the most hated companies in the next cycle. Being an ardent fan of history, means, I am confident of investors actions of throwing out the darlings of their portfolio and labeling them as ‘dogs’ at some stage and one’s role as a value investor, is to evaluate the odds then. Its about training one’s mind constantly that one can aspire to stay away from the crowd during times of euphoria.

India, will continue to remain in a very unique state where the ‘corruption’ and ‘crime’ and negative headlines will continue to surface, along with the bout of volatility induced by politics. There are certain things that are constant, and it’s important that an investor acknowledges them. However within all the mess, and uncertainties, the country will continue on its growth and progress. What this means is an investor is faced with a market where in he can expect a potential of 25% IRR over a 10 year period, in a portfolio run well in a concentrated way, but the same investor must anticipate multiple periods of 30% drawdowns as par for the course.