

The power of the ordinary

Why it is possible to earn a decent return in the stock market by paying attention to just the basics

June 2023

*“We don’t have to be smarter than the rest.
We have to be more disciplined than the rest”*
- Warren Buffett

Confessions at the outset

- I cannot predict how the stock market index is going to move tomorrow.
- I have little idea when the interest rates would peak out.
- I would blink if you asked me what would be the rupee-dollar movement over the next year.
- All major sharp moves of stock prices, upward or downward, happen without me predicting them.
- I do not have superior analytical skills compared to my contemporaries.
- Most importantly, I don't feel the lack of any of the above qualities.

Structure of the presentation

- **Staying away from these extreme positions definitely helps:**

- Extreme optimism about stocks that have recently outperformed
- Extreme pessimism about stocks that have not moved for some time

- Bias against a class of shares

- Hype for something new

- **Learnings from the masters**

STAYING AWAY FROM THESE EXTREME POSITIONS DEFINITELY HELPS

Extreme optimism about stocks that have recently outperformed

Extreme pessimism about stocks that have not moved for some time

Some very popular stocks during 1999-2000

Company	5-year average PE as on 31-03-2000	PE as on 31-03-2000	Subsequent stock price performance (CAGR %) for the next 5 years (Mar 2000-Mar 2005)
GTL Ltd	6.70	40.10	(47.3%)
Infosys Ltd	28.25	94.48	(1.4%)
Wipro Ltd	37.60	192.13	(19.5%)
Visualsoft Tech (*)	88.92	241.73	(57.8%)
Zee Ent	50.05	305.05	(33.3%)

(*) Visualsoft was listed only in Nov 1998. Data source: ACE Equity.

- 1 During a wild bull run, the popularity of a stock or sector rises to very high levels
- 2 At that time, investors should not lose sight of the underlying valuations
- 3 Extreme popularity means buying at very high prices
- 4 Buying at very high prices means poor subsequent returns

Note: "popularity" is measured in terms of the stock's valuation related to its past history of valuation, and/or its estimated sustainable growth rate in earnings. For our purposes, any valuation above 1 SD of historical average can be considered expensive

There were good buying opportunities available in the same period

Company	Mkt cap (Feb 2000) (INR cr.)	Mkt cap (Dec 2007) (INR cr.)	CAGR (%)
Nestle India Ltd	3,336	14,461	20.6%
ITC	19,952	78,856	19.2%
Asian Paints	1,504	10,576	28.3%
State Bank of India	13,000	124,793	33.5%
Hindalco	5,883	26,365	21.1%
Larsen & Toubro	9,568	121,331	38.3%

Sources: Bloomberg, ACE Equity and BSE.

- 1 In early 2000, only stocks in IT, Entertainment and Communications were favoured (as demonstrated in the earlier slide)
- 2 All other sectors were derided as “old economy” and were mostly shunned
- 3 But as evidenced above, most of these stocks proved to be excellent investments over the next several years, far outpacing the favoured sectors of the time

Hyped-up stocks during the 2007 boom

Company	5-year average PE as on 31-12-2007	PE as on 31-12-2007	Subsequent stock price performance (CAGR %) for the next 5 years (Dec 2007 - Dec 2012)
Unitech	10.19	60.40	(41.3%)
DLF (*)	20.31	32.70	(26.7%)
Jai Corp	21.56	356.82	(43.5%)
Larsen & Toubro	13.52	42.91	(4.9%)
Reliance Industries	9.89	25.01	(10.3%)

(*) DLF was listed only in July 2007. Data source: ACE Equity.

- 1 Almost the entire story of the Tech boom of 1999-2000 was repeated in 2007, only this time the names were different
- 2 When a stock like SBI starts getting recommended because of the value of its “real estate holdings” we can be sure that the real estate sector is highly overvalued
- 3 The same thing was repeated in 2017 for mid and small caps, and in 2018 for NBFCs and HFCs

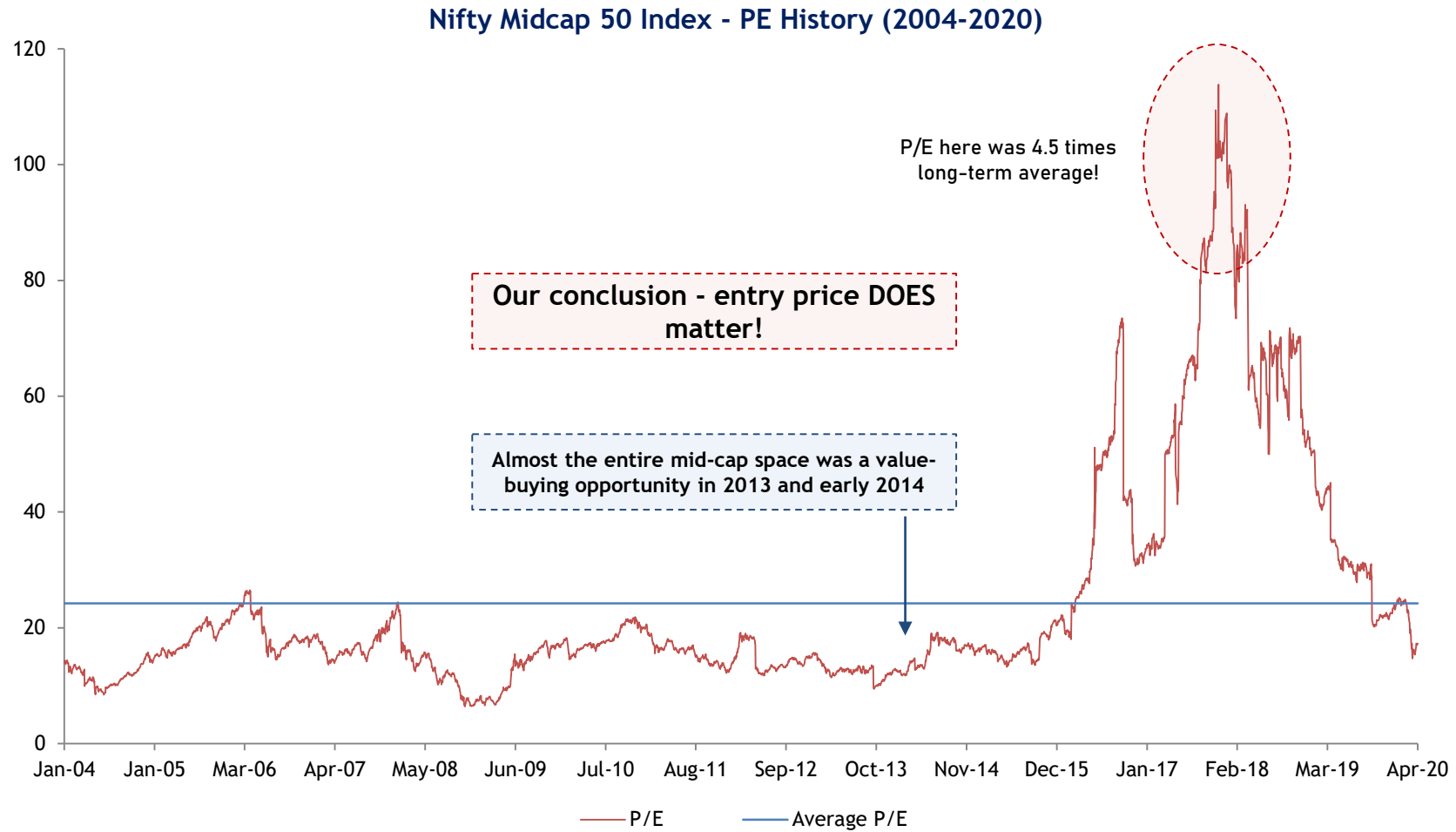
There were good opportunities in 2007 too

Company	Mkt cap (Dec 2007) (INR cr.)	Mkt cap (Jun 2017) (INR cr.)	CAGR (%)
GSK Consumer	3,094	22,500	23.2%
Procter & Gamble	2,544	26,119	27.8%
Hindustan Unilever	47,179	234,108	18.4%
Asian Paints	10,576	105,910	27.4%

Sources: Bloomberg, ACE Equity and BSE.

- 1 By 2007, stocks like HUL and P&G were almost totally shunned because they had not given any returns since 1999
- 2 From a high of more than 60 PE multiple in 1999, HUL had fallen to less than 25 PE
- 3 These were the value stocks at the time of the Infra/Real estate boom, and many of them did much better than the Infra/Real Estate stocks over the next many years

Same story, another chapter



Source: NSE

Not surprisingly, the heaviest inflows into the mid & small-cap Sectors happened between 2016-2017

STAYING AWAY FROM THESE EXTREME POSITIONS DEFINITELY HELPS

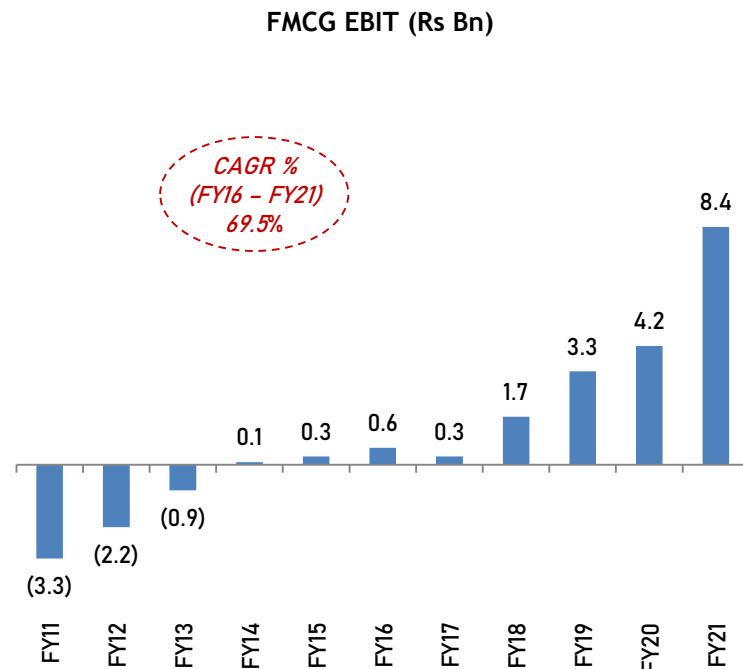
Bias against a class of shares

ITC

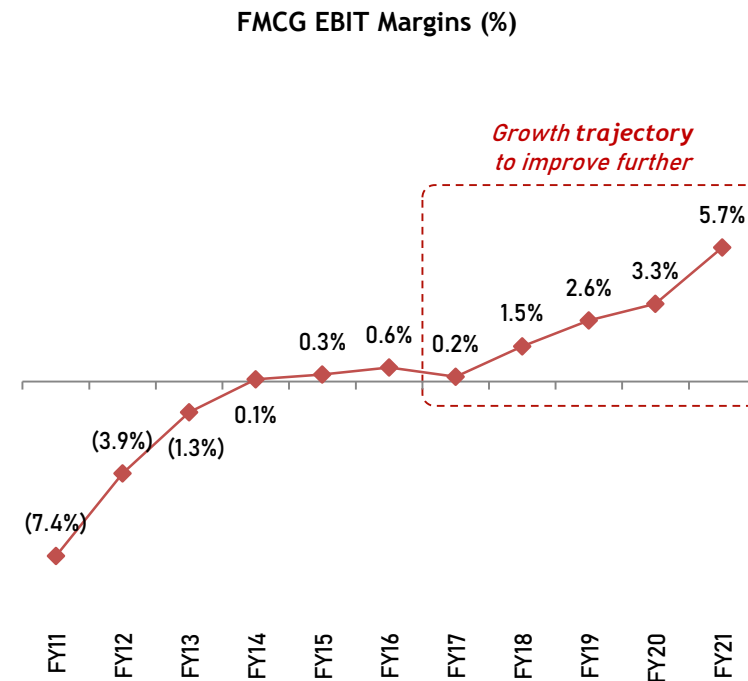
The investment case in 2021 (when it was very unpopular)

ITC FMCG segment business performance

FMCG segment margin profile and growth rates



We are excited about the profitability growth of ITC's FMCG business (although the base is now low). Its growing at 69.5% during the last five years (FY2016 - FY2021)

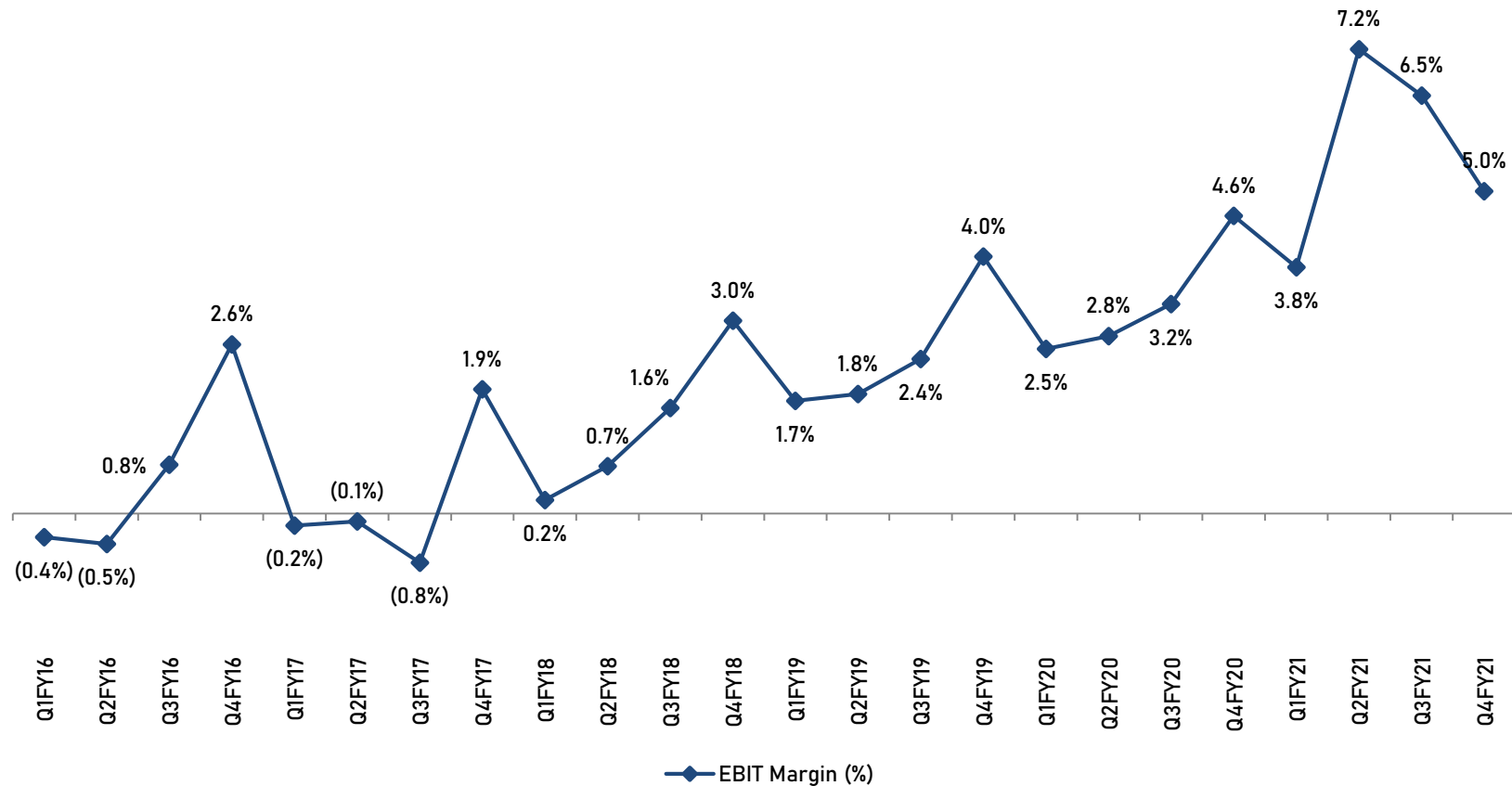


ITC's consumer products business has turned profitable. Segmental EBIT Margins have turned positive.

Source: Ace Equity

FMCG EBIT margins - quarterly trajectory

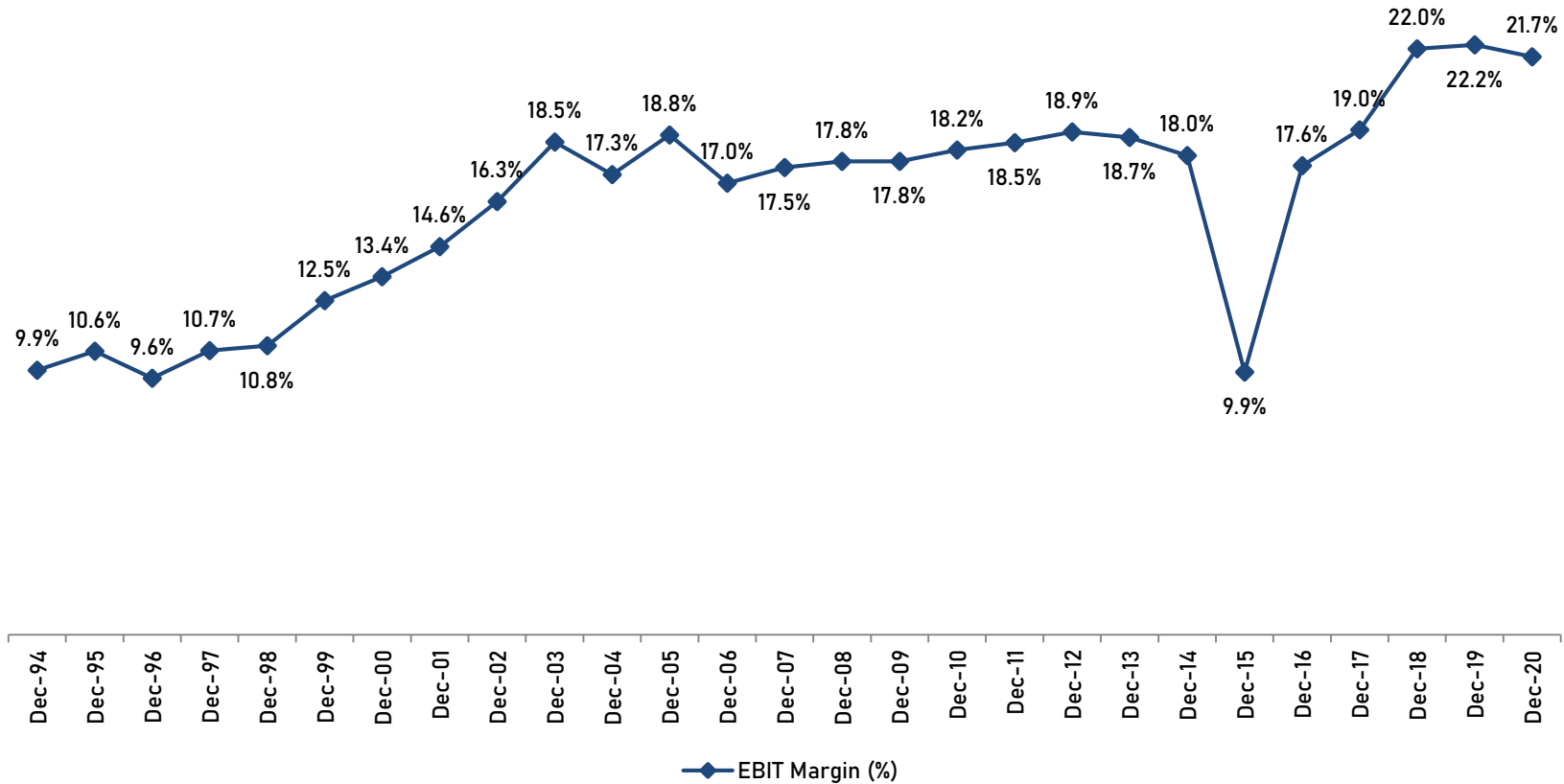
ITC FMCG EBIT margins likely to improve with strong revenue growth (69% CAGR since last 5 years)



Source: Ace Equity

Nestle - history of EBIT margins

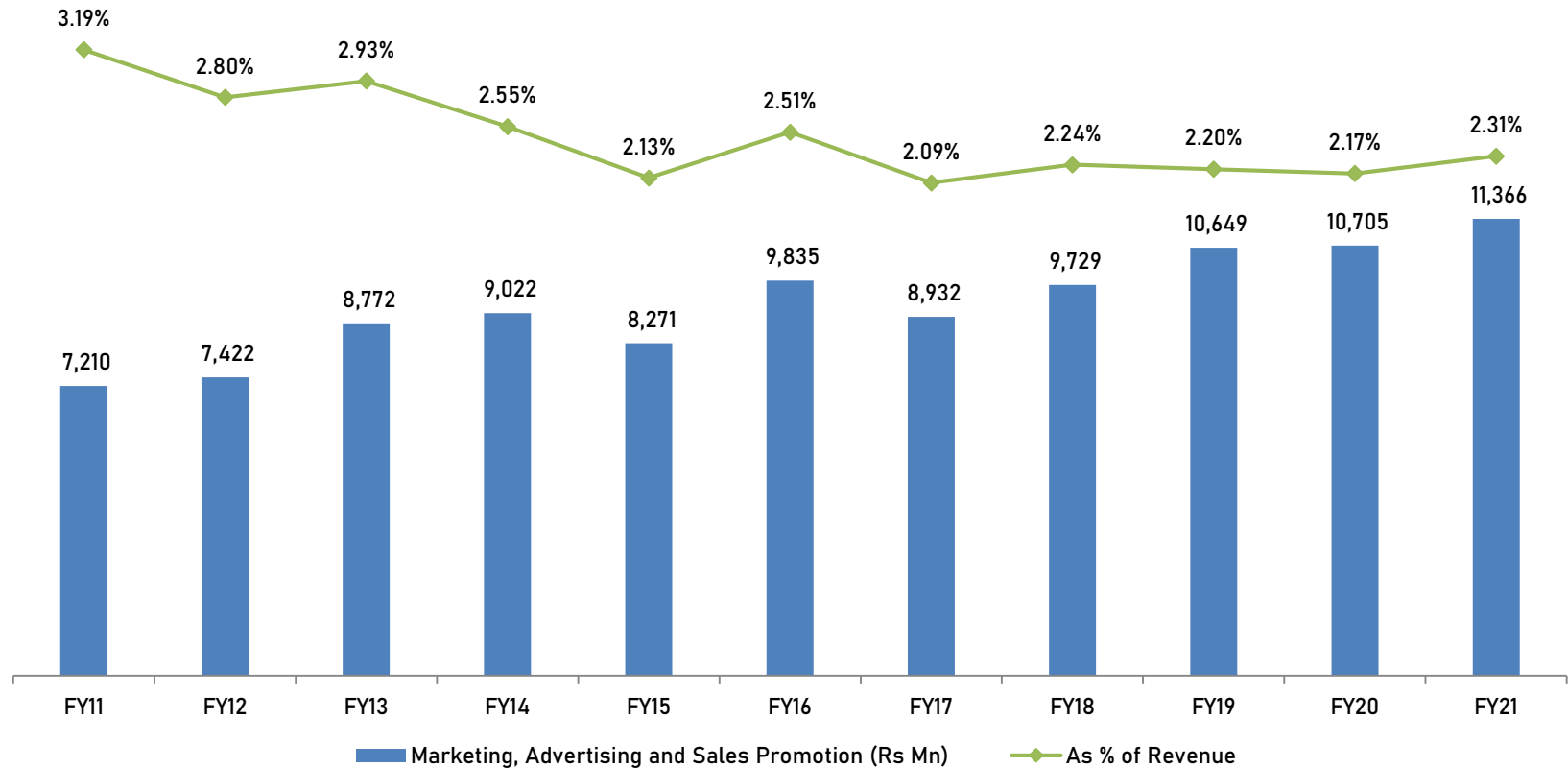
Maggi took more than 10 years - 1995 to 2005 to achieve a consistent margin profile



Source: Ace Equity

ITC - the impending benefits of operating leverage

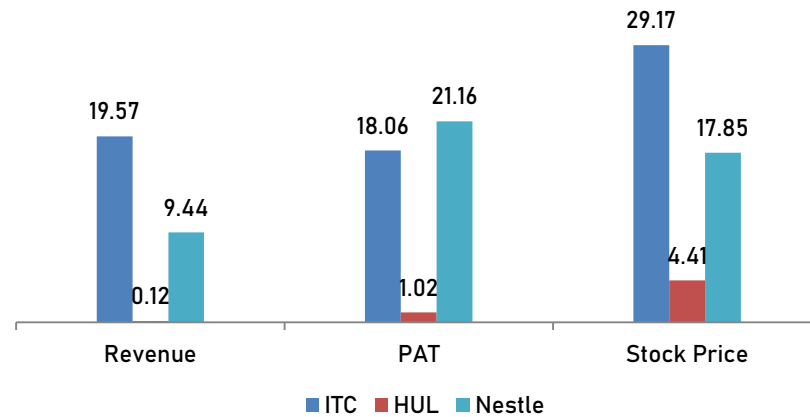
Marketing, Advertising and Sales Promotion is primarily in FMCG and Hotel segment



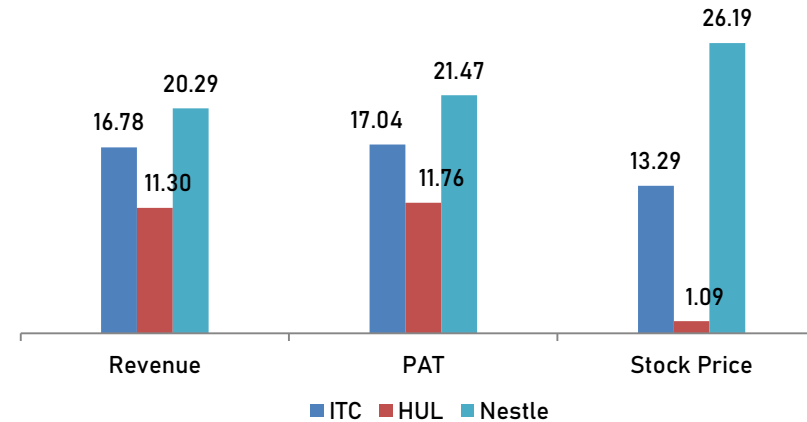
Source: Ace Equity

ITC vs HUL vs Nestle (5 years CAGR growth %)

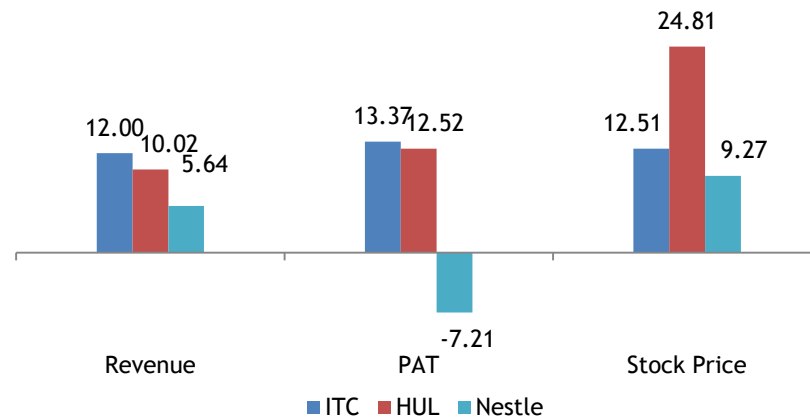
March 2001 - March 2006



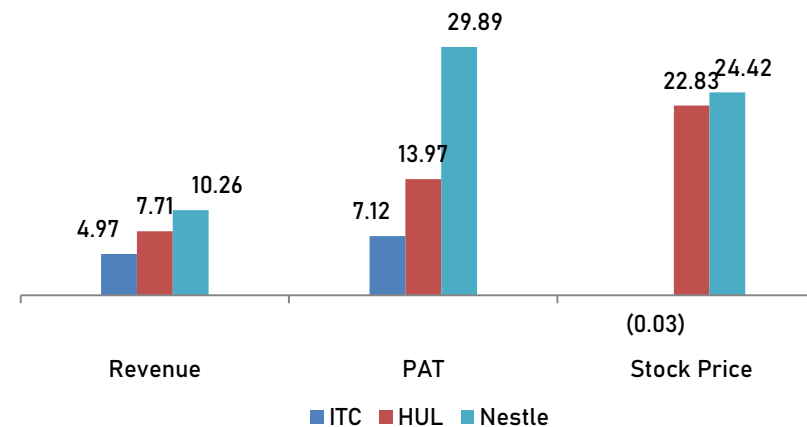
March 2006 - March 2011



March 2011 - March 2016



March 2016 - March 2021

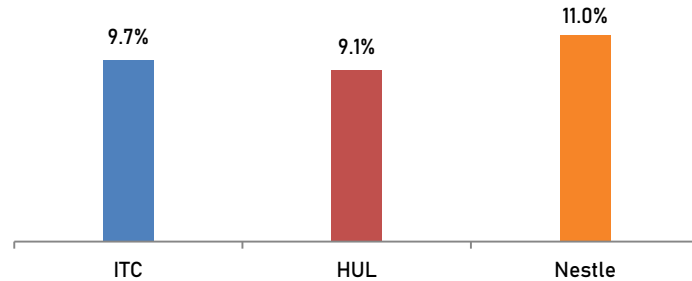


Source: Ace Equity

Despite being comparable to HUL and Nestle on almost all parameters...

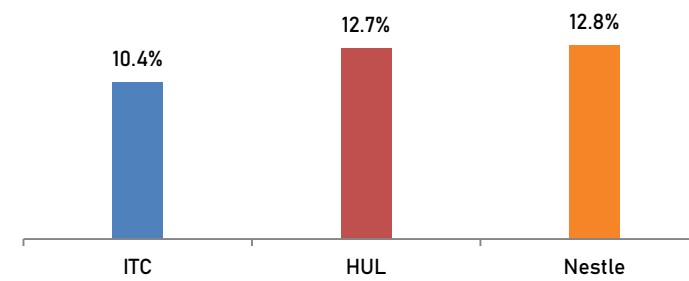
ITC compared with Hindustan Uniliver (HUL) and Nestle India (NESTLE) for period FY2007 - FY2021

Revenue Growth



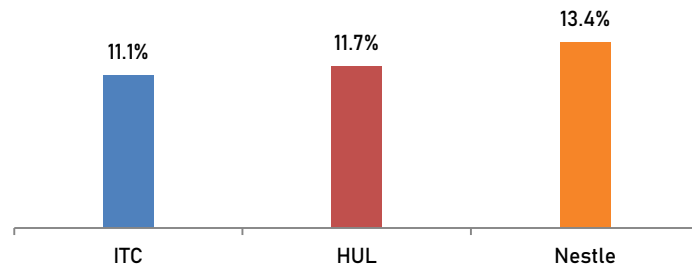
Revenue growth of ITC is higher than that of HUL and lower than that of Nestle

Operating Profit Growth



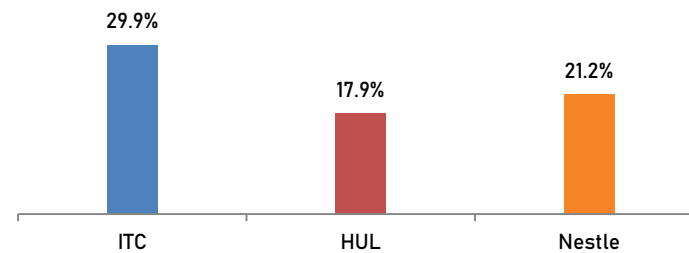
ITC operating profitability growth is lower than that of HUL and Nestle

Net Profit Growth



ITC net profit growth is comparable to HUL and lower than that of Nestle.

Operating Margin %



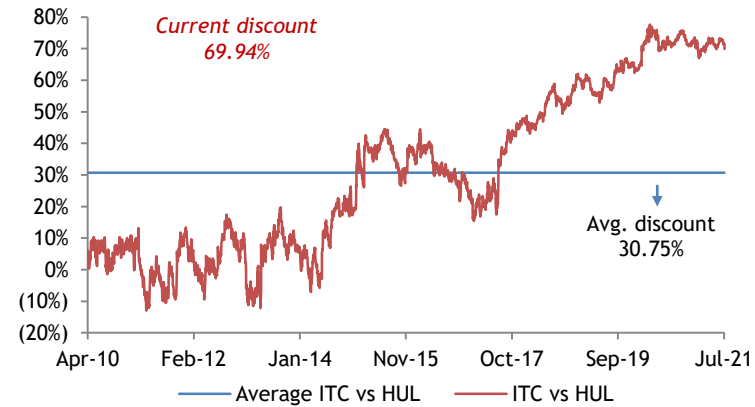
Operating Margin profile of ITC is significantly superior than that of HUL and Nestle

Source: Ace Equity

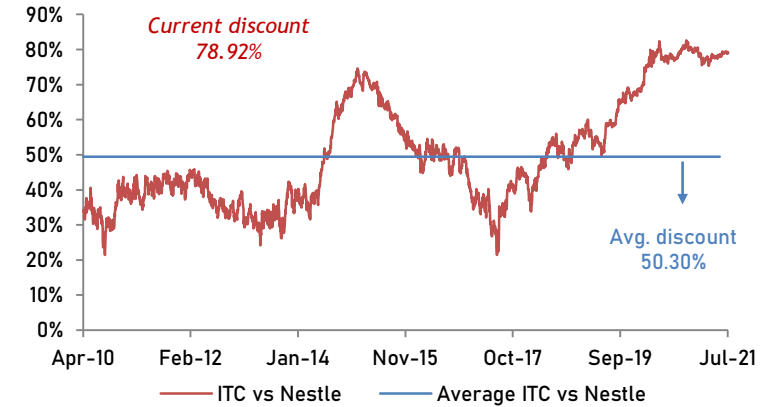
...ITC's valuation lags those of the other two significantly.

Discount of ITC valuation to HUL and Nestle despite comparable financial parameters is an investable opportunity

ITC 1 Year FWD PER Discount vs HUL



ITC 1 Year FWD PER Discount vs Nestle



ITC's stock is trading at significant discounts on PER and EV / EBIDTA basis to almost all of its peers.

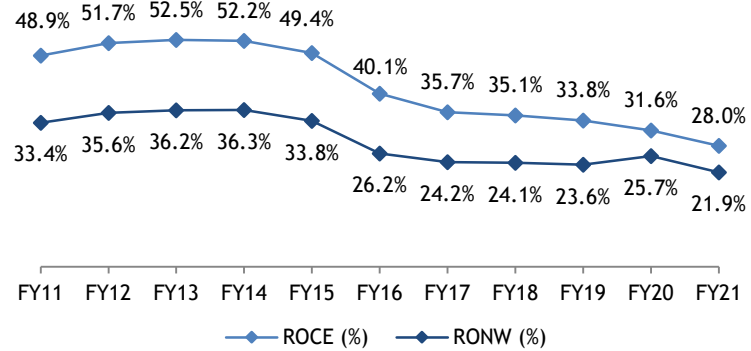
Company	PE Multiple (TTM)	EV/EBITDA (TTM)
ITC	18.77	12.43
Hindustan Unilever	67.65	45.17
Nestle India	80.92	49.85
Dabur India	61.59	44.44
Britannia Industries	44.45	29.86
Marico	58.76	40.91
Prataap Snacks	125.14	24.35
Jyothy Laboratories	32.01	18.94
P&H Hygiene & Healthcare	61.83	42.21

Data sources: Company's website and ACE Equity. Prices updated till July 23rd, 2021.

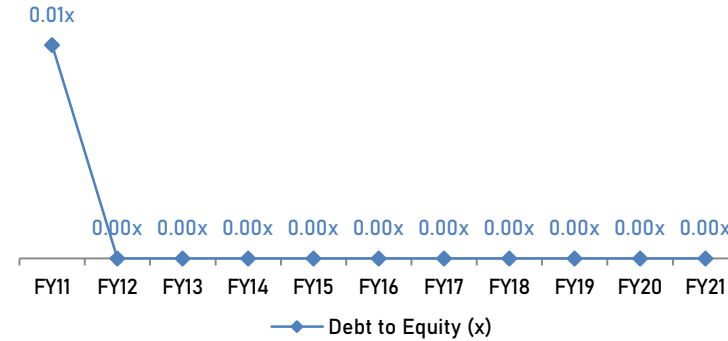
ITC - Financial highlights

Healthy Return Ratios with Zero Debt and strong Free Cash Flows

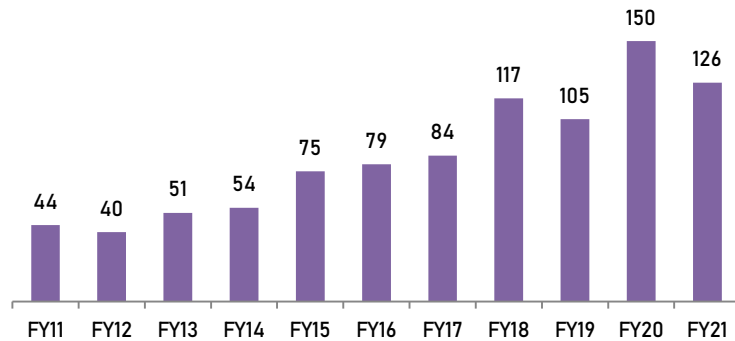
ROCE (%) vs. RONW (%)



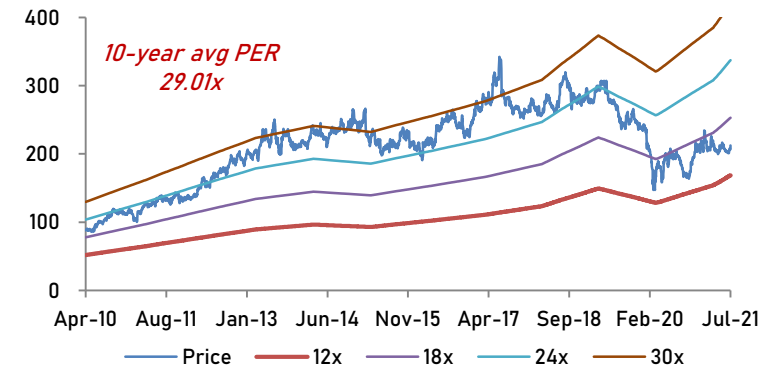
Debt to Equity (x)



Free Cash Flow (Rs Bn)



ITC: Current PER - 15.11x



Source: ACE Equity, Company Website, PER band updated till July 23rd, 2021

ITC - Comparison with leading consumer companies

S. No.	Company	PAT (Rs Cr)	M Cap (Rs Cr)	CFO (Rs Cr)
1	Asian Paints Ltd.	2,723	2,95,793	2632
2	Nestle India Ltd.	1,970	1,74,936	2234
3	Dabur India Ltd.	1,448	1,04,330	1614
4	Godrej Consumer Products Ltd.	1,496	1,00,225	1588
5	Britannia Industries Ltd.	1,393	82,854	1485
6	Pidilite Industries Ltd.	1,119	1,17,211	1280
7	Marico Ltd.	1,043	68,954	1218
8	Havells India Ltd.	735	71,633	827
9	Berger Paints	699	82,973	793
10	P&G Hygiene & Health Care	433	41,546	474
11	Whirlpool Of India Ltd.	476	27,813	380
	Sum of the Above	13,535	11,68,267	14,525
	ITC	13,390	2,61,440	12,527

CFO: Cash Flow from Operations

Source: Ace Equity, Industry, MCap updated till July 23rd, 2021

ESG ratings of some prominent companies

Company	MSCI ESG Rating
ITC Ltd	AA
Hindustan Unilever Ltd	A
Nestle India Ltd	AA
Britannia Industries Ltd	BB
Reliance Industries Ltd	BB
Asian Paints Ltd	AA
Maruti Suzuki Ltd	BB
Pidilite Ltd	BB
Bosch Ltd	BBB
Ultratech Cement Ltd	B
Tesla Inc	A
Apple Inc	A

Sustainalytics ESG Rating	Score
Medium Risk	26.7
Medium Risk	25.9
High Risk	30.8
High Risk	31.7
High Risk	35.0
High Risk	30.6
Medium Risk	25.9
High Risk	35.0
Medium Risk	22.6
High Risk	34.1
High Risk	31.1
Medium Risk	23.6

Sustainalytics - ESG Classification
 Score of 0 - 10 - Negligible Risk
 Score of 10 - 20 - Low Risk
 Score of 20 - 30 - Medium Risk
 Score of 30 - 40 - High Risk
 Score of 40 + - Severe Risk

MSCI - ESG Classification
 AAA - Highest; CCC - Lowest

Data Sources:
 1. www.msci.com/esg-rating
 2. www.sustainalytics.com/esg-rating

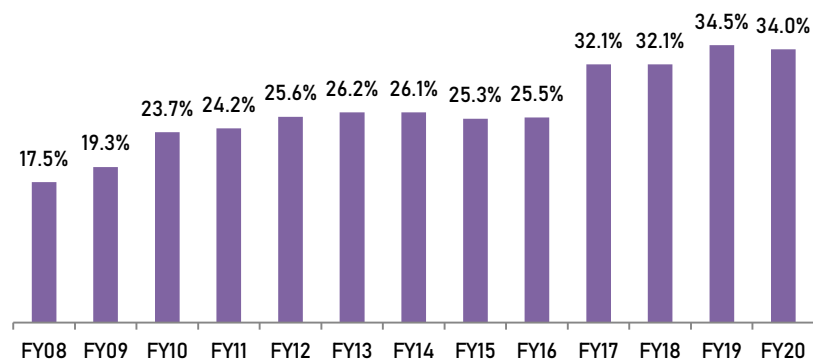
SBI

The investment case in 2020 (when it was very unpopular)

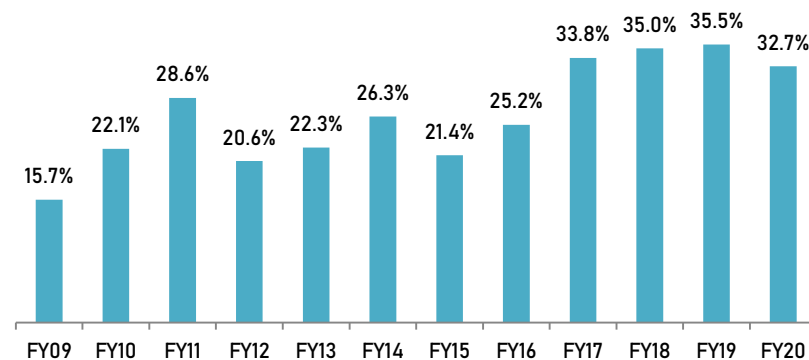
SBI market share in different categories

Leader in Home Loans, Auto Loans, Mobile Banking Value Share and second in Credit Card Value Share

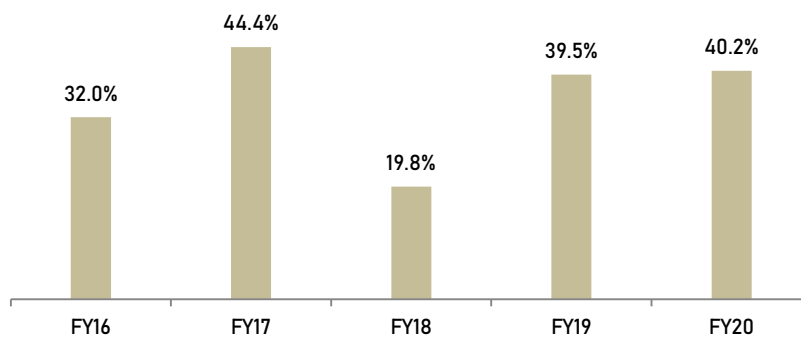
Home Loans Market Share (%)



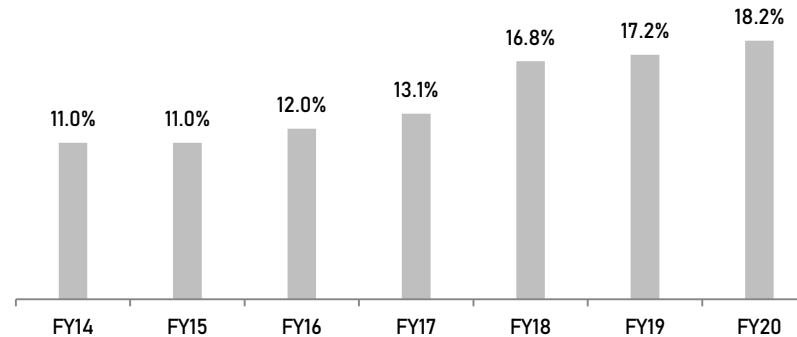
Auto Loans Market Share (%)



Mobile Banking (Value) Market Share (%)



Credit Card (Value) Market Share (%)

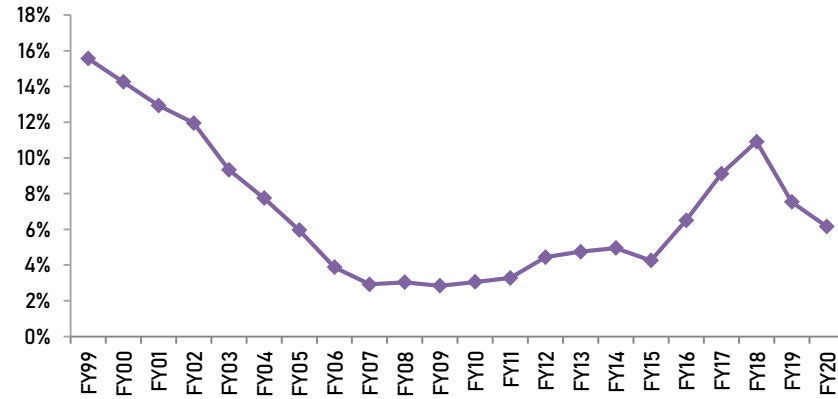


Source: ACE Equity, Company Website

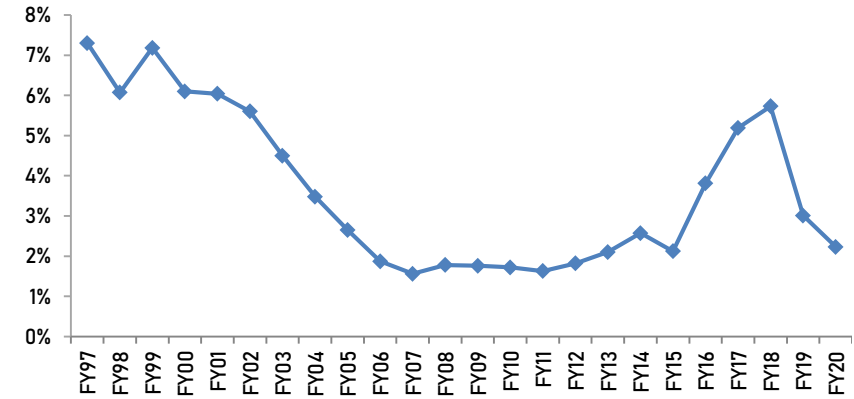
SBI - Other financial metrics

GNPA and NPA have started to decline. NIM are stable. CASA ratio remains buoyant despite emergence of private banks

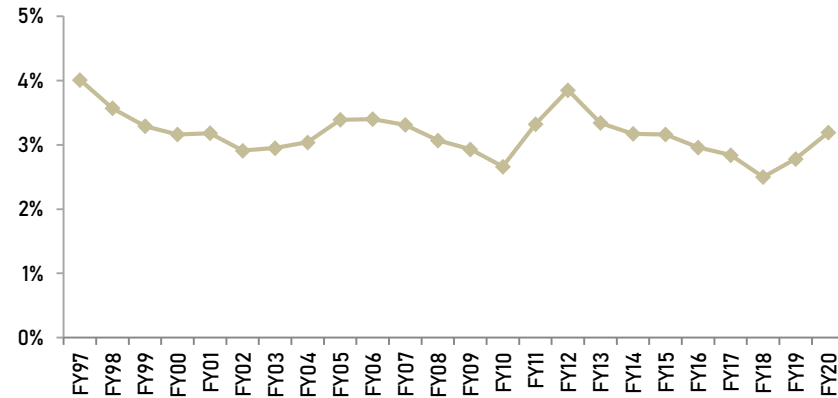
GNPA (%)



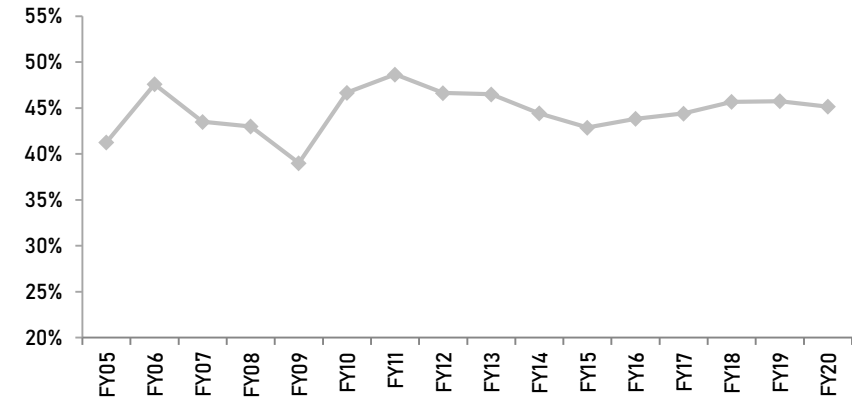
NNPA (%)



NIM (%)



CASA Ratio (%)



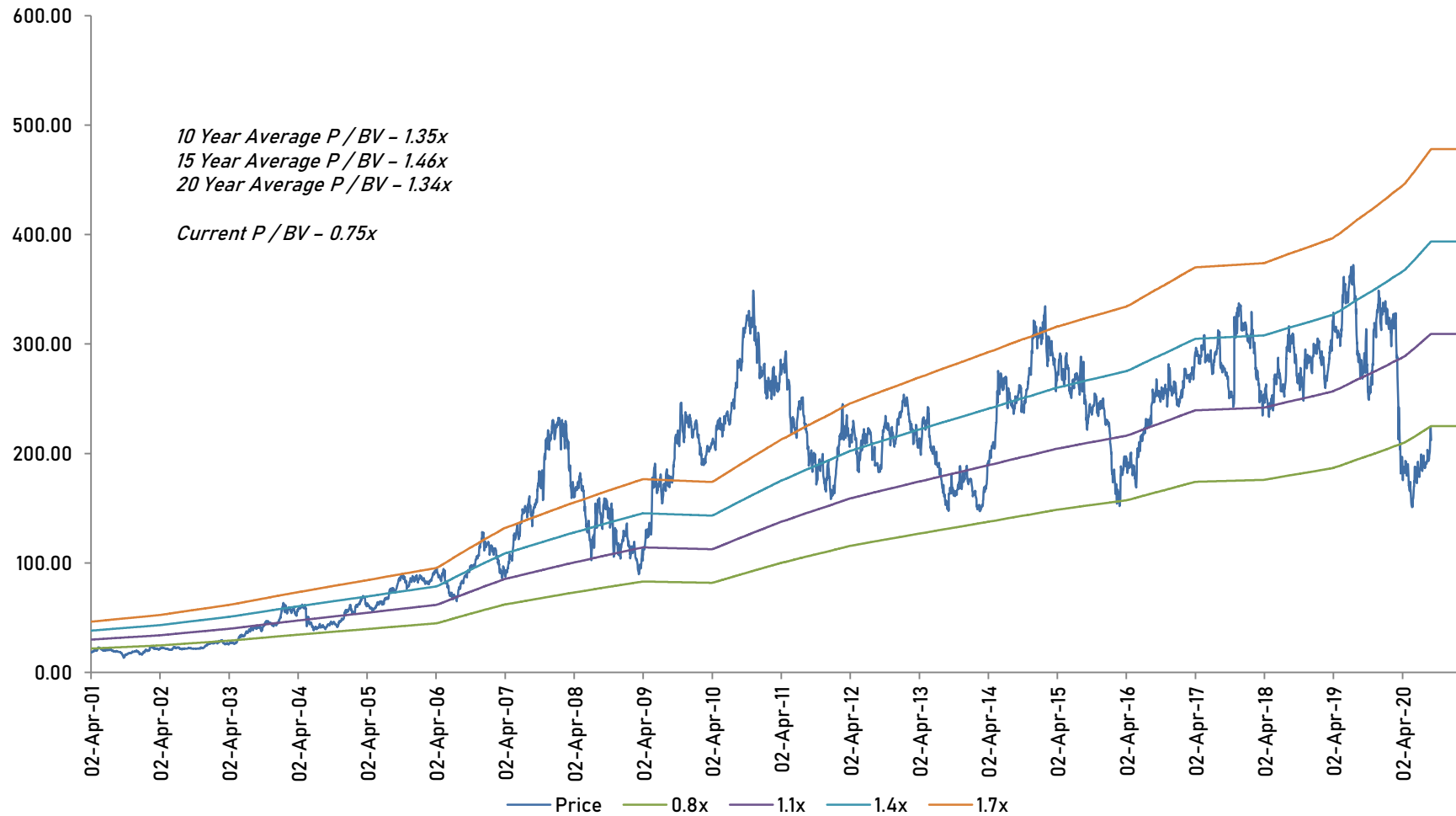
Source: ACE Equity, Company Website

SBI SOTP valuation

With key financial metrics getting better, valuation ratios can improve further

SBI Valuation	Method	Rs per Share	Comments
SBI Standalone	P / BV (x)	379.6	Based on Bloomberg Estimate for FY22E BV (Rs 281.2) and 10-year average P / BV (1.35x)
SBI MF	AUM	29.6	Taken as 7% of the AUM (Rs 3,210 bn) managed by SBI MF as on June 30, 2020
SBI Life Insurance	Stake Value	38.5	SBI holds 57.6 % stake in SBI Life. SBI Life valued at Market Cap of Rs 796 bn and holding discount taken at 25%
SBI Cards	Stake Value	44.6	SBI holds 69.5% stake in SBI Cards. SBI Cards valued at Market Cap of Rs 763 bn and holding discount taken at 25%
SBI General Insurance	PER Value	3.5	FY2020 PAT @ Rs 4.12 bn. Assuming growth of 10% for FY21 and FY22. SBI holds 70% stake and holding discount taken at 25%
TOTAL		495.8	

SBI - 1 year forward price to book value



Data Source: Ace Equity, P/BV band updated till September 25, 2020

INFOSYS

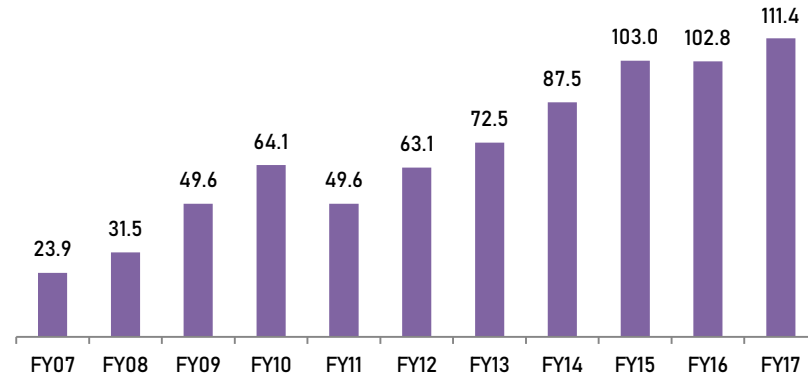
The investment case in 2017 (when it was very unpopular)

Some of the reasons why INFOSYS was ignored in 2017

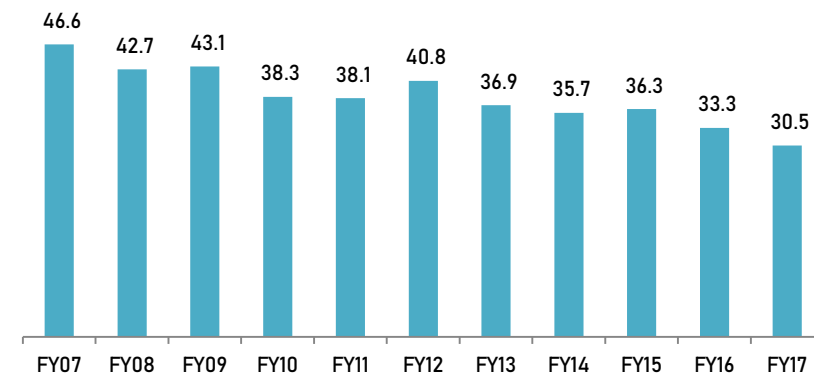
- Slowdown in revenues
- Fear that the US would not give H1B visas for Indian IT engineers
- Accusations about Panaya acquisition
- Comments about a Board Member being politically connected
- Accusations that Infosys was not paying out sufficient dividends
- Low institutional holdings

INFOSYS - Financial highlights

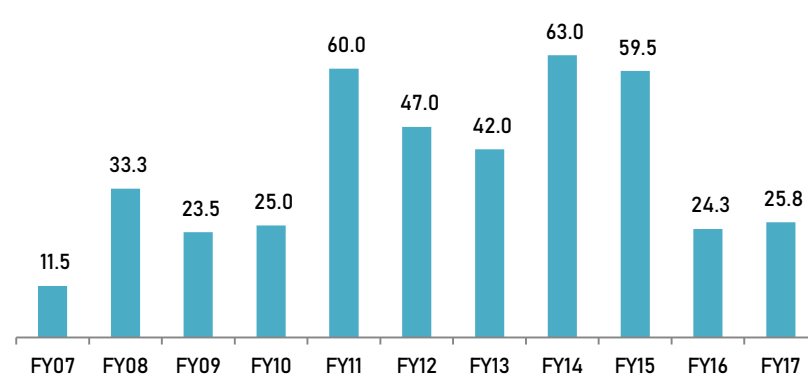
Free Cash flow (INR Bn)



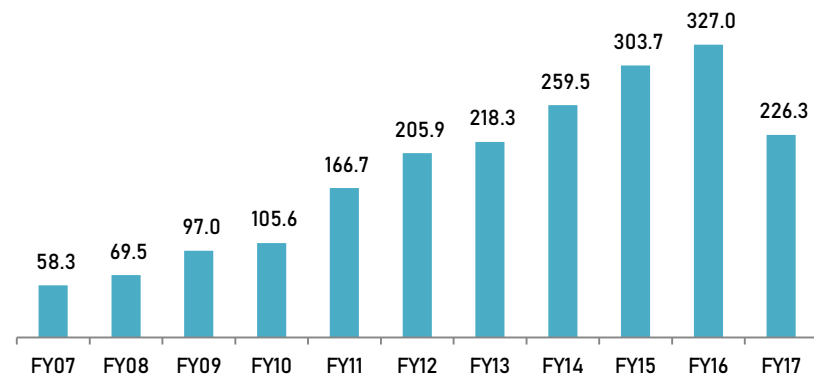
ROCE (%)



DPS (INR)

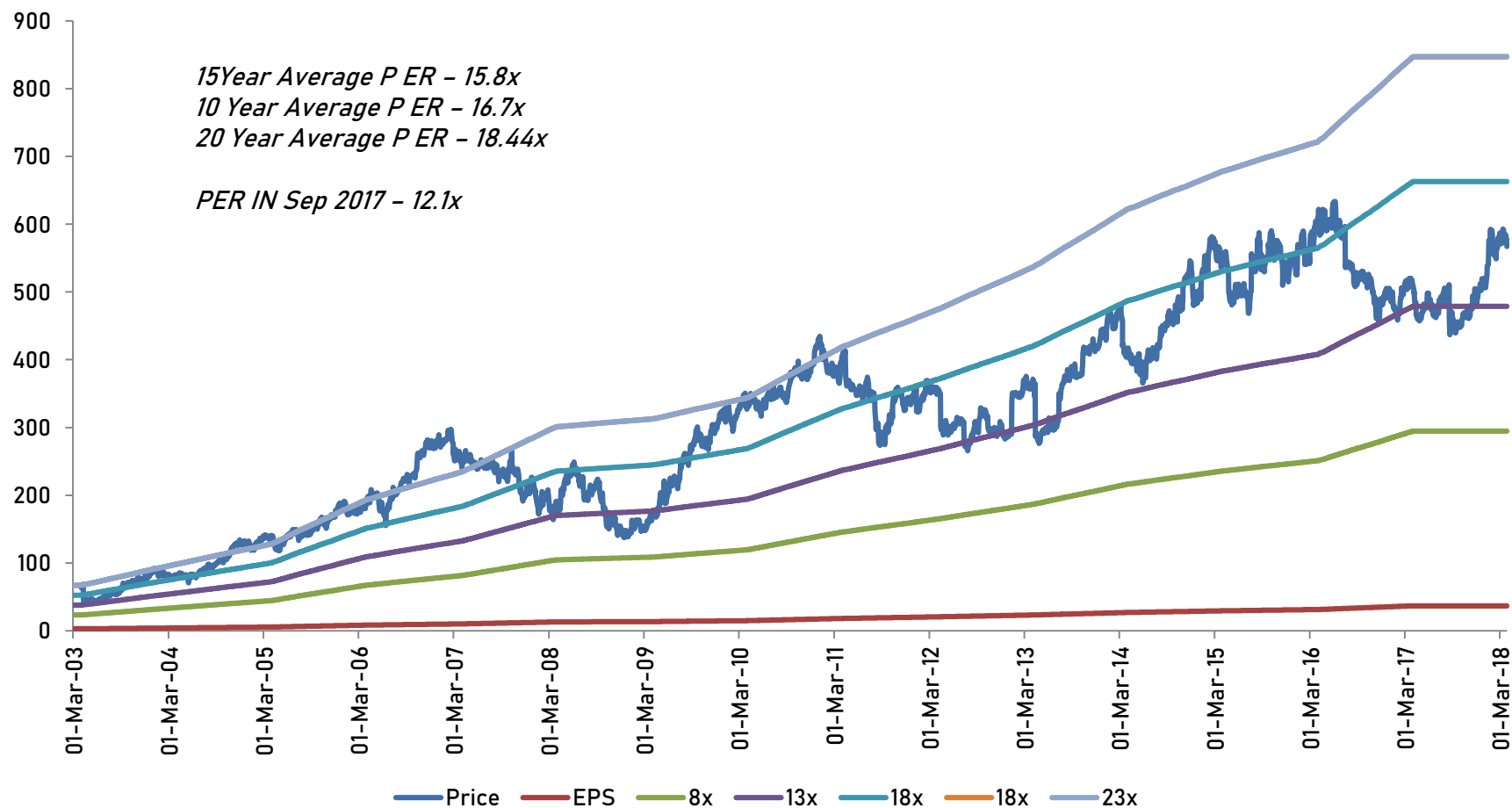


Cash in Balance Sheet (INR Bn)



Source: ACE Equity, Company Website

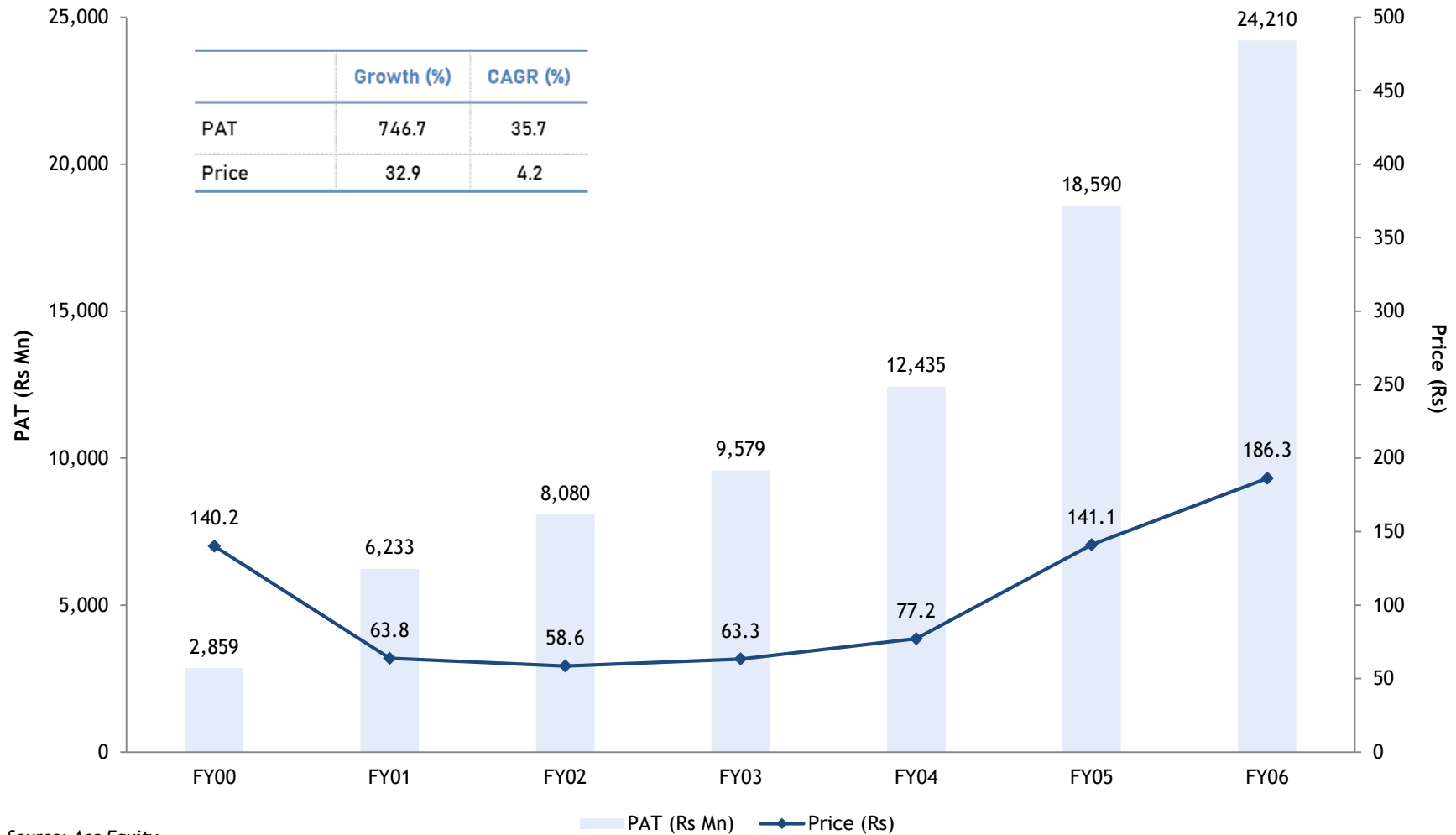
INFOSYS - 1 year forward PER band



Data Source: Ace Equity, PER band updated till March 31, 2018

Why the entry price is crucial (1/2)

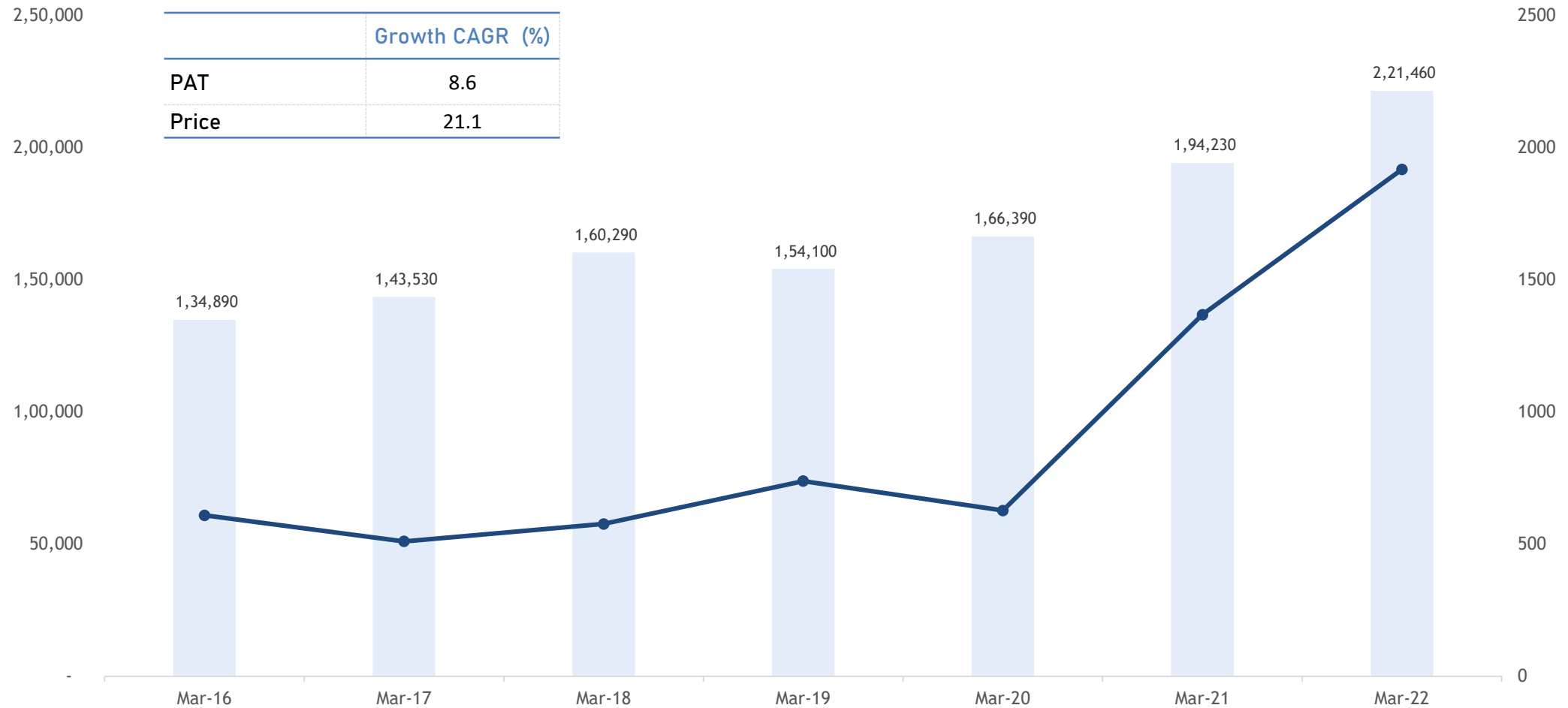
Example 1 - Infosys - A Wrong Entry Price Doesn't Compensate for High Profit Growth (2000 - 2006)



Source: Ace Equity

Why the Entry Price is Crucial (2/2)

Infosys 2016 - 2022



Source: Ace Equity

Net profit (millions) Share price

STAYING AWAY FROM THESE EXTREME POSITIONS DEFINITELY HELPS

Hype for something new

The hype around something new and exciting - Cryptocurrency

■ Bitcoin price chart



Cryptocurrency exchanges are on a decline

Ukraine, US shut down 9 cryptocurrency exchanges.

Bitfront, a U.S. crypto exchange backed by Japanese social media firm Line Corp, said it has suspended new sign-ups and credit card payments and will cease operations in a few months despite efforts to overcome challenges in the rapidly evolving industry

Visitors to 24xbtc.com, 100btc.pro, pridechange.com, 101crypta.com, uxbtc.com, trust-exchange.org, bitcoin24.exchange, paybtc.pro, and owl.gold now get a message stating that the domains have been seized by law enforcement.

The hype around something new and exciting - IPOs

Price Chart

Valuation

Company 1



Timeline	Price (INR)	PER (x)
Nov-21	407	2,907
Mar-22	282	4,029
Mar-23	124	258
Jun-23	150	146

Company 2



Timeline	Price (INR)	PER (x)
Nov-21	1,783	-46
Mar-22	571	-20
Mar-23	637	-39
Jun-23	877	797

LEARNINGS FROM THE MASTERS

Learnings from the Masters - 1

So, why does one refuse to acknowledge something that is staring at us in the face?

- The fear of underperformance?
- The fear of ridicule?
- The urge to always do something “extraordinary”?
- Illusions of superiority?
- The overreaching effect of noise?

Learnings from the Masters - 2

From stock picking to managing a portfolio

- A portfolio is not just a collection of “best ideas”
- Just as everything else in life, a portfolio needs balance
 - Between aggressive growth and stability in the portfolio
 - Between mature businesses and companies in the younger stage of their lifecycle
 - Cyclical businesses and more secular growth companies

The importance of being ourselves

- Knowing the time horizon we are operating in, and not deviating from it
- A portfolio is an extension of our own temperament, and there’s no need to be ashamed about it.
- Being aware of the extent of interest displayed by the others in the stocks that we are interested in.

Learning from the Masters - 3

- Let's not begin with a target return in mind
- Stocks of excellent companies can frustrate us for long
- Stocks that go up sharply do not necessarily represent good quality companies
- Constantly trying to “beat everyone else” is a recipe for disaster
- A fund manager does not “generate returns”. A fund manager’s job is to reduce risk in the portfolio, to the extent possible.
- Clearly demarcating what is known, and not known, to us
- Not being bothered too much about how much money someone else has made
- Focussing on things that are within our control (very few things, really)

A Few Quotes that have Inspired Me

- “Respect the difficulty of working with a mass of information. Few of us can use it successfully. In-depth information does not lead to in-depth profits” - David Dreman
- “Positive surprises result in major appreciation in out-of-favor stocks, while having minimal impact on favorites. Negative surprises result in major drops in the prices of favorites, while having virtually no impact on out-of-favor stocks” - David Dreman
- “You will be much more in control, if you realise how much you are not in control” - Benjamin Graham

Thank You