INTERVIEW

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Shri Maheshwari is a Commerce graduate from St Xavier's College Kolkata and is also a Cost Accountant. As a full time equity investor, he brings with him 22 years of experience in stock market investing. He has had a history of identifying several multibaggers over the past decade prominent ones being Pantaloon Retail, TV18, Trent, Page Industries, Titan industries, Hawkins Cooker, Gruh Finance and Repco Home Finance. In 2006, he found the online portal www.theequitydesk.com a platform where investors discussed investing ideas and thoughts. "The Thoughtful Investor" written by CMA Basant Maheshwari isn't just about creating wealth but also about retaining it. The book takes the reader across the various aspects of investing which would help in identifying the winning stocks and avoid the losing ones. He is also a regular commentator on various media channels like CNBC TV18; ET Now; NDTV Profit; Bloomberg India TV, CNBC Awaaz and Zee Business. The March 2013 issue of Readers Digest featured him as part of their lead story titled 'Secret of Self Made Millionaires'.

Q1. Earlier, selling price was determined by adding profit margin to cost. Nowadays selling price for a product is given by the market and cost control/efficiency determines margin.

In context of shares also, the share price is determined by broad market and the investor needs to use his skills to find out whether intrinsic value is less than that and then take his investment decision.

A. Do you agree with this?

Ans: Markets pay and penalize investors for surprises. Stock price discovery has moved beyond annual reports and balance sheets. It's more of understanding crowd psychology and evaluating how much of a good or bad news is in the price. The determination of news being in the price is far more important than understanding the news in isolation.

B. Would you say that determining intrinsic value involves cost study?

Ans: Stock price discovery is about profits. And if your costs are lower the profits will be higher. Cost analysis plays an important role in sectors which are commoditized or cyclical in nature. Some sectors where a low cost producer gets an unbeatable advantage are metals, cement, shipping and to a large extent banking because companies can't charge more for their product or service. The low cost producer wins big and loses less when these businesses go through cyclical ups and downs.

C. Can we apply principles of costing such as fixed & variable costs and break even analysis for equity research?

Ans: Operating Leverage is one of the biggest triggers of exponential profit flow. And companies that have a high contribution margin (low variable cost structure) enjoy bigger operating leverage. Companies that have a low variable cost structure are the last to close down when the sector is passing through pain. This happens mostly in cyclicals like cement, oil & gas or metals. When the external environment is gloomy the lowest cost producer with the lowest breakeven point is often the last man standing.

Q2. Which ratios do you rely on for decision making?

Ans: The RoE with the Du Pont analysis is the Gayatri mantra of stock market investing. It helps us understand how efficiently a company is using its capital. We also look at the Gross profit ratio, EBIDTA margin and the dividend payout ratio. We also look at the P/E ratio because stock analysis isn't just a beauty contest. One has to know the price that we pay for each unit of earnings.

Q3. Of these there must be some which are common across all industries? Can you elaborate on these and how important are these?

Ans: The Price to Earning or the P/E ratio is the most powerful of them all. Generally, P/E ratio is a function of how fast a company is growing its earnings. The P/E ratio is also dependent upon whether the company is a sector leader, dividend paying, generating free cash flow, large in size, if the shares are traded quite frequently and if it's a part of the Nifty or Sensex. Generally, a low P/E represents value but if it's a cyclical the low P/E indicates an earnings top off. No fixed rules here.

If there is one ratio that can be used across industries

We all pay for how much cash a business will earn over its lifetime. Investing is not a one size fits all but the level of free cash flow that a company generates is pretty much a ratio that one can use to track most industries and sectors.

Q4. How do you extract lead indicators from macro numbers?

Ans: A high inflation suggests that the RBI will raise rates so companies in banking and financial services will not do well. Capital expenditure will be postponed and anything that is sold on EMI like (housing, auto and consumer electronics) will slow down. High inflation also attacks disposal income and hence discretionary expenditure like restaurants and movie halls take a hit. Similarly, when Govt. spends on rural areas tractors, farm equipments and pesticides do well.

Q5. FDI & FII-what is good and bad about each?

Ans: FDI is solid long term money. FII is unstable, volatile and hot money. FDI means that foreigners have both ownership and control of the Indian asset like Dell setting up an office in India. They don't buy and sell frequently. FII means that the foreigners have only ownership and no control. They have bought the shares with a speculative bent of mind. Whenever there is a global risk off these FII sell shares adding to violent movements both in the stock and foreign exchange markets.

Q6. How much influence do FII have in the markets today? Is it Waning?

Ans: The impact and influence of FIIs is immense. Their impact is twofold. When they sell stocks the market obviously falls but secondly the outflow of foreign exchange has a negative impact on the Dollar rupee parity which in return affects the stock market again. It's like a negative loop function. Of late, the importance of FIIs have come down because the domestic pool of our own retail investors has been growing quite rapidly.

Q7. How to determine intrinsic value of a share?

Ans: The intrinsic value of shares is the Net Present Value (NPV) of all its future cash flows discounted at an appropriate rate till eternity. Companies that grows fast have a higher intrinsic value than a company that grows slowly. The discounting rate is a function of interest rates. When interest rates go up the market generally declines and vice versa. Companies that are expected to make more profits in the future (growth stocks) are more sensitive to interest rate movements.

Q8. How much would management quality contribute to this?

Ans: A good management guarantees longevity and execution. Longer the life span of a company higher the Net Present Value (NPV). Similarly, a company that can execute and grow well will have a higher intrinsic value.

Q9. What is the overall investment philosophy?

Ans: Very few people come to the stock market to get rich. Most come here to make pocket money. Our overall investment philosophy is to make such investments that change our balance sheet and not just our profit and loss account. We strive to achieve financial freedom through stock market investing.

Q10. What is the stock universe that you select from—for instance, do you focus on dividend-paying stocks, small-cap stocks, mid-cap stocks?

Ans: We don't like companies that pay too much dividend. We invest in listed stocks because we have surplus cash. Companies that give back dividends agree and accept that they have very little avenue for deploying their surplus cash. We like companies that grow revenue and earnings over time while using their capital quite efficiently. Small caps generally grow fast because they work on a lower base. However, the market cap should be viewed as a function of total market size in which the company operates.

Q11. What are the criteria for initial consideration of a stock? Are screens used to flag potential stocks? Are top-down factors—first focusing on the economy or industry and then looking for the stock—a consideration, or is a bottom-up approach used, focusing exclusively on individual companies?

Ans: Top down tells you about the tailwind and the market gives a higher P/E to companies that have a good tailwind. Anything that can identified for investment by a computer (screener) isn't worth investing. Stock picking is an art. It's more like painting than like physics. We like smaller capitalized companies, growing in a sector that is expanding with a large scale of opportunity, generating high RoE, run by a honest and ambitious management.