FSSA Investment Managers

May 2022

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Monthly Manager Views

FSSA Regional India Strategy

FOMO[1]

That would perhaps be an accurate description of what drove some of my portfolio decisions as a young fund manager, roughly 15 years ago during the global financial crisis (GFC) meltdown. Of course, the phrase hadn't been invented yet back then; but the fundamental drivers of market cycles and human psychology have not changed. In the mid-2000s, when the Indian stock market was melting up (alongside global markets), it was the infrastructure and the real estate companies that were the darlings of the market. Despite the portfolio having done very well for our clients during that period, there was significant disappointment that we had 'missed' several real estate and infrastructure stocks that had turned into multi-baggers[2]. It was all about land banks and order books and it seemed certain that these business would become multi-billion-dollar enterprises over the next five to ten years! Then, when the markets began to wobble, these stocks fell quite substantially from their peaks. Sensing an opportunity to make amends in the portfolio, I rushed in and bought what turned out to be some of the biggest mistakes I've made in my career, watching them fall into an abyss when the GFC actually hit. Painful lessons like these keep us humble and make better investors out of those of us who manage to survive a few cycles.

Talking about cycles, without pretending to be a macro expert (regular readers will know that we are anything but!), it looks like we are probably at a similar stage in India with respect to some of the recent 'new age' initial public offerings (IPOs). We had written about this phenomenon last year – the gist is that a lot of businesses with questionable business models but fancy spreadsheet models listed themselves at ludicrous valuations; and we watched from the sidelines (save for our tiny investment in Nykaa, India's leading online beauty retailer, which we have since exited as valuations became more outrageous post-listing). For a time, our conservative stance made us question our convictions, as companies we thought were very expensive to begin with went on to double on the day of listing as a matter of daily occurrence. But now, we are once again seeing a wobble among these present-day market darlings (though "wobble" might be putting it mildly!)

For example, companies such as PayTM (-72% vs. its peak), Policybazaar (-60% vs. peak), Cartrade (-64% vs. peak), Zomato (-60% vs. peak) and even Nykaa (still up 30% vs. its IPO price but down 44% from its peak) have all fallen substantially this year. We are sure that a few of India's leading online businesses will emerge out of the rubble, but for now, we are yet to find any compelling investments. In a similar vein, we have been assessing several manufacturing businesses which have been recent beneficiaries of the systemic inefficiencies created by the pandemic or by geopolitical tensions. Growth rates for these businesses have accelerated in recent years alongside higher profitability and the market rewarded them with higher valuations too. With our risk-reward hats on, we stayed away, resisting the accompanying FOMO; that is until recently, when we followed one of India's most respected bankers who became chairperson of a seemingly well-run and fairly valued active pharmaceutical ingredient (API) manufacturer. The cycle then turned, as it always does, and the company's shortfalls were exposed. Regardless of the fact that the business is being repaired and should limp back to health in the medium term, this was a small mistake that we could have avoided in hindsight.

Fresh from our trip to Mumbai and Delhi, it does seem that growth expectations are being reset, cost inflation is being built into margins and some sort of sobriety is returning to how these erstwhile high-flying companies are valued. We remain on guard, keen not to repeat old mistakes.

[1] Fear of missing out

[2] An investment that appreciates to multiple times its initial value

* Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 31 May 2022 or otherwise noted.

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