



15<sup>th</sup> October 2021

## How should one invest in the Indian Equity Markets?

### What really makes a GREAT business?

An Excerpt from Warren Buffett's Shareholder letters:

"An economic franchise arises from a product or a service that: (1) is needed or desired; (2) is thought by its customers to have no close substitute and (3) is not subject to price regulation. The existence of all three conditions will be demonstrated by a company's ability to regularly price its product or service aggressively and thereby to earn high rates of return on capital. Moreover, franchises can tolerate mismanagement. Inept managers may diminish a franchise's profitability but they cannot inflict mortal damage.

In contrast, "a business" earns exceptional profits only if it is the low-cost operator or if supply of its product or service is tight. Tightness in supply usually does not last long. With superior management, a company may maintain its status as a low-cost operator for a much longer time but even then, unceasingly faces the possibility of competitive attack. And a business, unlike a franchise, can be killed by a poor management."

Now, let's look at Berkshire Hathaway's core investment portfolio. Note: These are companies where Berkshire owns minority positions and does not wield management control. Also, these form 90% of its investing portfolio.

Sr.	Stock Name	% of portfolio	# of Shares	Reported Price	Value	Industry
1	AAPL - Apple Inc.	29.74	24,51,55,566	\$293.65	71,98,99,33,000	Hardware, software, platform
2	BAC - Bank of America	13.46	92,50,08,600	\$35.22	32,57,88,03,000	Retail Bank
3	KO - Coca Cola Co.	9.15	40,00,00,000	\$55.35	22,14,00,00,000	F&BCG
4	AXP - American Exp.	7.8	15,16,10,700	\$124.49	18,87,40,16,000	Fintech & payment processing
5	WFC - Wells Fargo	7.18	32,32,12,918	\$53.80	17,38,88,55,000	Retail Bank
6	KHC - Kraft Heinz Co.	4.32	32,56,34,818	\$32.13	10,46,26,47,000	F&BCG
7	JPM - JPMorgan Chase	3.43	5,95,14,932	\$139.40	8,29,63,82,000	Retail Bank
8	USB - U.S. Bancorp	3.24	13,24,59,618	\$59.29	7,85,35,32,000	Retail Bank
9	Liberty Group	2.70	NA*	NA*	6,50,93,40,000	Broadband, Telecom, Cable
10	MCO - Moody's Corp.	2.42	2,46,69,778	\$237.41	5,85,68,52,000	Retail finance research
11	BK - Bank of New York	1.66	7,97,65,057	\$50.33	4,01,45,75,000	Retail Bank
12	DaVita HealthCare	1.2	3,85,65,570	\$75.03	2,89,35,75,000	Healthcare services
13	VRSN - Verisign Inc.	1.03	1,29,52,745	\$192.68	2,49,57,35,000	Internet annuity business
14	V - Visa Inc.	0.82	1,05,62,460	\$187.90	1,98,46,86,000	Fintech & payment processing
15	MA - Mastercard Inc.	0.61	49,34,756	\$298.59	1,47,34,69,000	Fintech & payment processing
16	PNC - PNC Financial	0.57	86,71,054	\$159.63	1,38,41,60,000	Retail Bank
17	MTB - M&T Bank Corp	0.38	53,82,040	\$169.75	91,36,02,000	Retail Bank
18	SYF - Synchrony Fin.	0.31	2,08,03,000	\$36.01	74,91,16,000	Fintech & payment processing
19	STNE - Stone Co Ltd.	0.23	1,41,66,748	\$39.89	56,51,12,000	Fintech & payment processing
20	MDLZ - Mondelez Intl	0.01	5,78,000	\$55.08	3,18,36,000	F&BCG

These 20 scrips form 90% of Berkshire Hathaway portfolio. If we carefully analyze the portfolio, we can clearly see that majority of companies like these DO NOT exist in India. If we go to search for an Indian equivalent of these entities in, we will be surely left empty handed. At most, the companies closest to some of the above portfolio companies are 2 Indian consumer banks namely HDFC Bank & Kotak Mahindra Bank. Indian MNCs like HUL, Nestle & P&G are just Indian subsidiaries of Unilever (A Dutch company), Nestle (A Swiss MNC) and P&G (An American company) respectively. There is no company like Apple in the world. Moreover, companies like American Express, Visa, MasterCard and Synchrony just do not exist in India. These are in the true sense GLOBAL franchises. Brands like Coca Cola or Kraft Heinz are not just made in India. On the other hand, we have listed entities like Varun Beverages, which is a bottling agency for Pepsi/co. Again, the rating agency- CRISIL is owned by S&P. The closest that can come to Liberty group- can be Reliance Industries, which owns TV18, Jio Infocom, & Hathaway cables. But again, till the subsidiaries are not demerged or separated from the petroleum refining business, it cannot be compared.

### So, should Indians not invest at all?

That's not true. While looking at the Indian market, one can notice a few obvious things. India does have a few good quality franchise MNC companies. But they do trade at ridiculously high valuations aided by the fact that most outstanding shares are held by long term institutional investors leaving almost no float for retail investors thus driving them to astronomical valuations. Another way to look at the listed space in India is the family owned businesses. The



TATA group as such is a franchise but none of its businesses are real powerful economic behemoths as described by Buffett.

In order to invest in the Indian market, one must look at commodity companies. Most Indian companies are in the true sense commodity companies. Right from companies like Nalkamal, Wimplast and Prima plastics which can be classified as injection moulding players, to sugar companies having violent swings in their upcycle and downcycle, a lot of money can be made simply by catching such companies at their cheap valuation when in down cycle and selling them at the top of their cycle. The trick is to get out before its best earnings. Peak prices come before peak earnings.

MOST BUSINESSES ARE CYCLICAL inherently. The markets and stocks are far more cyclical than we think. Even the economy is cyclical. There are 3 levels of cyclical

- Deep Cyclical (commodities)
- Moderate Cyclical (cars, financial services)
- Low Cyclical (FMCG & economic franchises)

As and when India becomes a Real Free market, we do have a chance to make many economic franchises over time. But as of now, cyclical commodities or MNC subsidiaries or at the most low-cost producers (Pharma, IT, commodity chemicals) rule the listed space in India.

### **What should you really focus on in the Indian Market?**

Investing is a game of financial analysis, business cycles and above all temperament. Some general non-financial tips absolutely necessary for surviving in the Indian markets are as follows. More can be added with time as my knowledge increases with time.

- Invest ONLY with a comfortable margin of safety. Quality at any price is one of the biggest LIES ever peddled by the media. It is OK to miss out on doubtful opportunities rather than suffer permanent loss of capital due to rerating of PE ratios or slowing of expected growth. In short, pay a significant attention to the VALUATION of the company and where it stands in its business cycle.
- A good business does not equal to a good stock. Markets work on expected growth. The most accurate “ratio” to evaluate valuations is the PEG ratio. The growth is what determines at what PE multiple you get your stock. As the growth slows down, we often get what is called as “re-rating” of the PE ratio. Use the Trailing PE to have a margin of safety for valuation cushion.
- Majority of market news is not only useless but also harmful for financial health
- NOBODY in the world knows what the market will do in the short run- Not even Buffett & he does not claim that either.
- Most IPOs will burn you. Simply because people with more information than you want to sell.
- Most of what is taught in schools and business classes about investing is THEORETICAL NONSENSE.
- Today we have an enormous volume of news/ information as compared to 15 years ago. But this just translates to an enormous amount of NOISE.
- Charlie Munger once said, “Show me a man’s incentives and I will tell you how he/she will act”. There is absolutely NO ACCOUNTABILITY in the financial pundit area. They say anything and everything that has been proven to be wrong for the past many years. Trust no one who is on any financial TV news channel more than twice a week.
- Read a lot. Know a lot more than required for your research.

### **Making money in Indian Stock markets is tougher than in American Markets**

Remember, making money in Indian markets is tougher than American markets simply because, over the past 12 years (2008-2012), the index of NIFTY 50 has given a negative return in terms of Dollar return.

At the time of writing this article, 1USD= 75.10 INR.

Exactly 12 years ago, 1USD= 41.41 INR.

So even if you had just purchased US dollars in 2008, you would have still made close to 6% annually.

Consider you had invested in an index ETF, using the same dates, Nifty was 4040 (USD 97.56) in 2008 and 9857 (USD 131.25) as of today. This gives a CAGR of 2.5% for 12 years and that too in an era when India had annual inflation of about 7-8%. (And note that we do not have any Long-Term Capital Gains Tax as of Aug 2017). HOWEVER, in the same period some 20-30 stocks (ignoring the operated penny stocks) have gone up 10x-50x in India. And such returns are unheard of in developed markets. CHOOSE WISELY in Indian markets and that’s the only way to beat global inflation and currency depreciation.



#### Legal Information and Disclosures

This memo has been compiled in good faith by Breit Consulting Services ("Breit"). However, no representation is made as to the completeness or accuracy of the information it contains. In particular, you should be aware that this information may be incomplete, may contain errors or may have become out of date. Breit makes no commitment, and disclaims any duty, to update any of those reports. Breit reserves the right to add, modify or delete any information on this website at any time. Certain information contained herein is based on or derived from information provided by independent third-party sources which Breit believes are reliable; however, it cannot guarantee the accuracy of such information. Further, Breit makes no representation, and it should not be assumed, that it solicits investment in any stocks/ bonds or financial instruments connected with sectors/ companies mentioned on the website or its contents. Breit does not claim to be registered with SEC, SEBI or any regulatory body connected to capital markets. This website is being made available for educational purposes only and should not be used for any other purpose. Reproduction or distribution of any materials obtained on this website or linking to this website without written permission is prohibited. Any enquiries pertaining to this memorandum should be emailed to [breitconsultingservices@gmail.com](mailto:breitconsultingservices@gmail.com).

BREIT CONSULTING SERVICES