Fair Value in the vanguard of value investing in India

Backed by Value Partners founder V-Nee Yeh, Fair Value is notching up returns through a deep understanding of complex Indian markets and corporates

Rakshit Sethi's investment career started 10 years ago when, after a stint at a local securities firm and a business school at Gurgaon City in India, he went to set up his own advisory firm, Fair Value Research.

Benjamin Graham's value investing, a concept he came to know on his first day at business school, was an inspiration behind the bold move. The investment philosophy had such a deep impact on Sethi that he resolved to build a career around this new-found passion.

At Fair Value Research, he put his value-investing ideas to work, generating exceptional returns for clients that included family offices and wealthy individuals.

But Sethi had bigger aspirations. In 2011, he established Fair Value Capital Management and launched the long-biased equity-focused India Insight Value Fund in 2012. The fund was seeded by lauded value investor V-Nee Yeh, who is the co-founder of Value Partners, one of Asia's largest asset managers. Says Sethi: "I am grateful to V-Nee for having the confidence in me."

Since then, Sethi has beaten India's S&P BSE Sensex index, posting stellar monthly returns so far this year and surviving a difficult 2013. Between January and September this year, the India Insight fund was up an impressive 98.3%. By contrast, the Indian benchmark index, Sensex, gained 33.7%.


Rakshit Sethi

Deep understanding of the fundamentals that are key to investing

Sethi's strategy is to invest only in stocks he understands. He takes a bottom-up approach to stock selection and is sector-agnostic. He likes strong brands, reliable business models, and healthy balance sheets. He tends to stay away from businesses with high leverage and those that are susceptible to a rapid change in market environment, whether that is a cutting-edge technology or an internet-based company with potentially disruptive business models.

Sethi seeks absolute, long-term capital appreciation from largely ignored opportunities in the Indian equity space. True to the value-investing mantra, he buys stocks that trade for less than their intrinsic value, or at discounts that give the investment enough "margin of safety" and attractive upside potential. His stock-selection is research-driven and value-centric.

"There are a lot of nuances in a market like India. There are issues about corporate governance. We have, over the past many years developed models internally to navigate through these nuances. These (models) suggest prospective 'price/value mismatch' opportunities, which are then analysed. In that aspect, due diligence is thorough," explains Sethi.

"We approach every investment in terms of partnering with the underlying business. So even though we're investing in the public space, our research and due diligence is like a private equity fund," he adds.

Sethi's extensive experience and knowledge of markets within the "Indian context" adds a significant edge to his investment skill set.

"A deep understanding of how Indian businesses work — given that a vast majority of all listed companies are family-controlled, how they think and function on the ground, and the complexities peculiar to India — have helped us develop rigorous proprietary models and investment tools internally to effectively identify and monitor prospective opportunities on an on-going basis," he notes.

An example of that would be Somany Ceramics, one of India's largest ceramic tiles company. Sethi had been doing extensive research on the company for some time. He started accumulating the stock in March 2012, at a time when Somany was the second-largest player in the industry, cornering an 11% share of the domestic market. The brand was well known in India, but institutions that often stick to investing in blue chips were ignoring the little-known gem. Somany generated an absolute return of over 600% for the fund.

"We were the first foreign investor to identify this opportunity. There was no institutional coverage on the company when we discovered it. Not only were we able to identify the opportunity before others, we were able to conduct extensive research and due diligence internally because of our on-the-ground capabilities," Sethi explains.

Hidden gems provide true alpha

Fair Value Capital benefits from its in-depth, ears-to-the ground market access. Being based in India allows it to conduct first-hand research on opportunities and is an invaluable advantage in a market like India, says Sethi.

"India has over 3,000 actively traded stocks, but relevant institutional coverage is available for less than 10% of them," he adds. "So there are a host of under-covered or under-analysed opportunities which include many high-quality robust Indian businesses. Not only are most global investors denied the opportunity to partner with their growth, more importantly these companies are, therefore, highly prone to mispricing. That is where we fit in."

The strategy is clearly paying off. Over the fund's nearly three years, it has captured 13 "multi-baggers" or investments that multiplied in value. In Fair Value's experience, the gains were between 180% and 600%.

A case in point is Ashiana Housing, a high-quality, mid-sized fully integrated developer with a strong balance sheet and transparent operations — both of which are a rarity in India's real estate industry. Ashiana specialises in housing in India's second-tier cities. Over the last couple of years, the stock generated in excess of 350% for the fund.

The same goes for Garware-Wall Ropes, a mid-sized company but a world-leader in technical textile and synthetic cords. It was largely hidden from global investors with no institutional coverage when Fair Value discovered it. Fair Value started accumulating the stock when it was trading at less than five times trailing price-to-earnings ratio, with a dividend yield in excess of 5%. The stock has so far returned over 300% for the fund.

Sethi typically will hold about 20 to 25 stocks at a given time, with 10 of those accounting for over half of the portfolio. He goes into all positions with a long bias, but will lighten up or double down on a holding depending on the stock's swings. Last year, the fund held up well despite a difficult year in India with the Indian rupee crashing to record lows against the US dollar and an equity market that turned bipolar (split between a small group of shares that rallied, while the rest generally went nowhere).

Sethi put his trust in the strategy and was confident about picking up discounts during those stressful months.

"So even when there was extreme panic last year, we articulated our conviction in our investment discipline both by adding to some of our existing investments and also by initiating new investments at a time when most other foreign investors were selling out," notes Sethi. The months that followed registered strong gains.

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Pioneering value investing in India

But it wasn't always smooth sailing for Sethi, who today leads a team of five people helping Fair Value make intelligent investments. Around the time he started his advisory firm, India was not classified as an asset class as it is today. International hedge funds were absent in the market and there were few avenues to exercise one's value-investing conviction in the country.

"The only way you could be a value investor in India was either if you had enough of your own capital to set up a fund, which I didn't, or to start with friends and family by advising them. By default, I took the latter option. That's how we grew, from a very small-scale operation," he says.

Now 33, Sethi recalls how it was also tough convincing prospective investors back then to entrust their money to him given the limited experience he had. "Investors in India will usually entrust their money to men with white hair. The more white hair the more easy it was supposed to be. I had none at that time, but I have some now," jokes Sethi.

A graduate of economics from Delhi University, Sethi has come a long way from his investment advising days. The former national level tennis player leveraged his exposure to the India's unique financial markets to grow the business. "The capital available to me was limited. And in our business, we need capital as a raw material to demonstrate how effective we are. I believe if you focus on trying to prove a point, trying to demonstrate performance, you reach the point that the work starts speaking for itself and capital starts flowing in. We never had to market. If you give us money and we've delivered returns, we hope you'd talk about us, about your experience. That has led to our being here from there," adds Sethi.

CV: Rakshit Sethi

- Founder and managing director of Fair Value Research and fund manager at Fair Value Capital Management.
- Established Fair Value Capital Management in 2011.
- Prior to founding Fair Value Research in 2005, worked with Deloitte Touche Tohmatsu in their corporate finance practice and with Kotak Securities – at the time a joint-venture between Goldman Sachs and the Kotak Mahindra Group of India.
- Holds an MBA in Finance from MDI Gurgaon, India and the Copenhagen Business School, Denmark (2003) and graduated in Economics (Hons) from the Hindu College, Delhi University (2001).

Focus on consumption and investment growth themes

The change in India's political and economic landscape is keeping Sethi optimistic about the country's prospects. Prime minister Narendra Modi's leadership has set high hopes of economic revival following India's worst slowdown in years.

Two broad themes the market will be focusing on are India's consumption and investment growth, he says.

"The demographics in India today are something you've never seen before. There's never been such a large population with such a young age profile. And it will continue to get younger over the next five years. That will translate into a huge growth in consumption," Sethi predicts.

"Investment, on the other hand, had come to a standstill, and is now restarting. That's a lot of infrastructure investment that can drive a lot of industries over the next three-to-five years. You will see a large number of companies benefiting out of that," he adds.

Sethi is taking a long-term view on the financial markets, which he expects will remain robust amid hopes of reforms that could fundamentally shape India's industries and markets going forward. Investors are feeling very positive about India, and confidence in the financial markets can only grow further as soon as investors see more signs of growth-supportive policies from Modi.

"We believe that we are in a structural uptrend," says Sethi confidently. "Over the past few years the Indian economy, the entire capital cycle, had come to a grinding halt, but that has surely restarted, and very soon you will see that translate into higher earnings growth for companies and, in turn, into GDP growth. We are very optimistic about the prospects over the next three-to-five years."

Over the coming year, Sethi has no plans to launch a new fund. He aims to consolidate the current strategy ahead of expected fundamental changes in the country's markets and economy.

"We will be surprised if the election of 2014 does not define a pivotal moment for Indian politics, economy and the markets. The market here is opening up. The opportunities are increasing by the day. We are very bullish about where the economy's going. Though the markets have come a long way from the 2013 lows, this one feels different," concludes Sethi.