Follow this mantra, never ever invest in any IPO: Mohnish Pabrai

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In an exclusive interview with ***Tanvir Gill of ET Now, Mohnish Pabrai****, Managing Director,* ***Pabrai Investment Funds****, says that direct stock investing should be treated as an anomaly or as an exception to the rule. Do not try to come up with stock investment ideas every week or every month because that is just not going to work.*

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Edited excerpts:

We get a lot of queries from retail investors and viewers asking why do they need to be patient if from a year to date perspective, the index has given a return of 24%, stocks like Future Retail have gone up 300%. We have had D-Mart which has had a stellar listing. A lot of these businesses are performing very handsomely within a short duration of time. How does that really hold ground for investing with a long-term where patience is the key virtue? Tell us how patience still pays in this market?

Let us take D-Mart for an example. If an investor has a very good idea of the cash flows that D-Mart will generate over say the next 10 or 15 years, you can discount that back to today and you can figure out whether it is a value buy or not. These are not easy questions to answer for most businesses. And most investors do not even go through that exercise of trying to project out future cash flows and discounting back and that is one of the reasons why you want to be unreasonable and want very low valuations because you get downside protection.

For example, if I look at something like Rain Industries, I did not have to do 10-year projections on Rain because I knew that in 2018 or 2019, in one year. I will get back what I put out today. And anything that happens after that is going to be just gravy on top. Do not get envious because your stupid neighbour is tripling his money every three months and he is rubbing it in your face. Do not worry about that. Focus on long-term compounding. Focus on the 15% a year and those sorts of things. Do not try to do 15% a month.

Generally speaking you are going to hurt yourself more than you help yourself and quite frankly I would say that in this environment, this overheated environment we are in India, probably better to give the money to professionals like I had mentioned Motilal and so on and let them deal with it.

Once you come up with something compelling where you know what the future cash flows are, you can always get some of the money back and make that investment. I would say that treat direct stock investing as an anomaly or as an exception to the rule. Do not try to come up with stock investment ideas every week or every month because that is just not going to work.

And mandatory disclosures? As an unbiased party, do you believe that Motilal Oswal Asset Management is doing a good job managing the mutual fund schemes that they run?

Yes. I have no stock position in Motilal and certainly I am not getting compensated in anyway. There are two things unusual about them – one is that they do not put out a lot of mutual fund products. They only have half a dozen products. Second, they are only in equities and so they are very focussed.

Third, they eat their own cooking and they eat their own cooking in two ways -- Raamdeo Agrawal himself is worth like Rs 1300 crore or something. Every penny of that is in one of his mutual funds that anyone else can invest in. The second is that the company takes its net profit and re-invests it back into their own funds. Out of thousands of mutual fund companies around the world, I do not know very many that do that. In fact I do not know any that focus on 100% re-investment. So, they have some unusual DNA. I have nothing to gain or lose whether you go with them or do not go with them but I think out of the many that I have looked at, they are one of the higher quality players.

Which are some of the schemes from the house that you really like?

I do not know exactly what the name is Focused 35 or Focused 50, but it is one that has Raamdeo himself as one-fourth of the fund. I think they have got about billion dollars or so in that.

Coming to the IPO market, there is so much activity happening there. Now, there are two camps that are approaching this market differently. One camp of course believes you go in for the high prices, names the consumer companies which are coming to the bourses at elevated valuations, buys them for the listing pop and take your gains on day one. The second camp is, of course, more focussed on the deep structural stories that are bringing about a change in the economy. For example, you have had a series of insurance papers come into the market from the general insurance side, life insurance side and also reinsurance. As business is picking up you have to keep your faith for the long haul. What would be the best way to approach the IPO market?

Yes, so there is a very simple rule of investing I follow, which is never ever invest in any IPOs and it has not hurt me over the decades following that rule and there is a number of reasons why that should be the mantra of most investors.

So first off all an IPO is a company selling shares into the market. The company controls the timing, the company controls the story, the company has lot of control over many factors and they are optimise to maximise the proceeds that the company is going to get. If the IPO market is hot for consumer non-durables, you are going to see a lot of consumer non-durables come out of that time and so one of the big advantages we have with equity investing in the markets is that these are auction driven entities and auction driven entities basically tend to give us a pricing that goes to extremes.

At times, it gets very euphoric and at times it gets very pessimistic and as an investor you can take advantage when things get pessimistic and usually be a seller when things get euphoric. For example, I mentioned the real estate firms at one-fourth of liquidation value. If I went to those promoters last year and I said to them listen I want to buy 25% of your company or 10% of your company or 1% of your company, would you sell it to me at a 20% premium to your current stock price they would just laughed me out of their office and say get lost. They would not be willing to sell it to me at five times the price that the stock was trading at because they know what is its worth and they know it is undervalued.

The beauty of the stock market is it allows me to buy those stakes without having those conversations with those promoters and that is the only reason why I was able to buy those stakes. It is the same thing between industries. In 2015, the company would not be willing to issue equity at those prices, they would never have issued equity at those prices but they did not need to. You could just buy it from unsuspecting investors in the market. The simple rule to follow is do not buy what is being sold, especially what is being sold by promoters. Just completely side step the IPO market.

The second is insurance. Clearly. India has a number of areas insurance, banking, asset management and so on that will grow a lot. They will grow at multiples of GDP growth and GDP growth itself will go through a lot but the investing game is not so much about these macro themes, it is getting down a specific business.

You have to identify businesses where the management is not only honest but they are also highly competent and they are going to go for growth. Also, you have to go for businesses where they are strong tailwinds and which are producing and gushing cash, producing lot of cash and when you get that combination at a reasonable price, that is when you step in. The rest of the time you do nothing.

The most important thing after getting fluency on compounding is to have patience. We will not find investments every day or every month or every year. I mean if you talk to me right now. I can hardly find anything to buy in India. There are 5000 companies traded in India I can hardly find anything to buy and that is not a tragedy it is perfectly fine. There will come times in the future when we will have plenty of opportunities and the important thing is when those time show up, you should have the will and the resources to act on it.