InvestorInsights: Ayaz Motiwala

Ayaz Motiwala is the founder of Amala Emerging Asia Fund which is focused on investing in quality businesses primarily in India, Indonesia, Thailand and Hong Kong. He has been investing professionally for 20 years of which the last nine years have been out of Hong Kong.

Prior to the current role, Ayaz worked at Samena Capital, a special situations fund based in Hong Kong. He has worked for four years independently managing the India and South Asia investment portfolio of Highbridge Asia Opportunities Fund in Hong Kong. He has also worked in other funds/ security houses viz. New Vernon Capital LLC, Birla Sunlife Asset Management, Motilal Oswal Securities and Ask Raymond James. Ayaz is an MBA in finance from Institute for Technology and Management, Mumbai and Bachelor of Commerce from Mumbai University.

Safal Niveshak (SN): Could you tell us a little about your background, how you got interested in investing, how have you evolved as an investor and what's your broad investment philosophy? Has your investment policy changed much through the years as your capital has grown?

Ayaz Motiwala (AM): My father started off as a small retail investor who had some lucky share allotments in the CCI era. So at home we always had some rudimentary discussions on companies and a very basic interest was developed. I took up the family effort to make IPO applications and tried to get lucky with those lottery allotments.

Then in college I found some similar like-minded friends who were interested in making money in the stock market. For us there was no process. It was a lot of tips and hearsay from over confident old punters of the market. Our readings were financial publications like Capital Market, Dalal Street Journal and Financial Wizard apart from the compendium of data at the BSE library. There was some very basic logic of observing multinational companies creating wealth for shareholders.

From there, it's been a long ongoing journey of discovery on what can work for me in the long term. I was lucky to land up a formal equity research job in one of the finest investment training grounds that you could find in Bombay then.

I started out looking at consumer product companies. This was partly due to my interest in seemingly easier to understand businesses. From there onwards it has a been a journey of self-discovery through lots of trials and errors. I made investments in a whole host of companies.

This journey has so far had three dramatic drops in the Indian stock markets due to local issues and once linked to the International situation at the time of Lehman Brothers bankruptcy. Lots of names that I owned burnt up and lost money. There have been some painful learnings. Over time this aspect has formed the basis of my core investment philosophy. Essentially the oversimplified version is that India is a capital short country and entrepreneurs who can use capital efficiently in the medium to long term are and will be well rewarded in the stock market. This over time has formed into what we now call high quality long term investing.

SN: Thanks for sharing about your background, Ayaz. Well, when you say "high quality long term investing," what are some of the characteristics you look for in high-quality businesses?

AM: For me the most important reflection of quality is the returns the business makes on capital employed. This one statistic is the summation of multiple decisions taken by owners and managers in running the business through the year and over time. A sufficiently high spread (over the prevalent bank rate in that country) combined with longer term consistency is the hallmark of a true high quality business.

Each business could be achieving the above through multiple aspects in the operation of their business. These could be a due to a brand/s, distribution and logistical advantage, technology or IPR and other such reasons which let a business continue to make excess returns on capital.

Also need to look at Returns on Equity in conjunction with Return on Capital Employed to understand the drivers of profitability and the leverage taken by the business to achieve that profitability. Looking at both these ratios make it possible to cross compare businesses on a pre-tax pre-depreciation basis thus cutting out potential differences regarding depreciation policies and tax benefits that are company specific.

At the end of the day, the ultimate ideal quality business would be one which can grow needing limited capital. Assuming the retained earnings are paid out as dividends would add healthy to total returns made on owning this business. From there onwards we can have derivatives of the capital intensity of the business and its ability to finance it internally.

SN: Moving on from the business to people managing the same, how do you assess management quality, especially in case of small companies where availability of information is an issue?

AM: For us there are two dimensions to assess management quality. First most important aspect is integrity. This can be practically assessed based on their dealings with all stake holders including minority shareholders, debt providers including banks, employees, environment and the government.

The other aspect is the capability. Again here you can do a look back on capital investment decisions from regular capex and its productivity, track record on acquisitions, how they have handled adversity in the business such as facing competition or some changes in the business landscape. Looking at a ratio like incremental returns on capital along with the above mentioned ROCE and ROE should help form a good judgement on how the management is faring in terms of capital allocation and its productivity.

Both the above aspects taken in conjunction forms the basis of appraising the quality of the management.

SN: Sure. Now how do you think about valuations? How do you differentiate between 'paying up' for quality and 'overpaying'?

AM: Honestly it's a tough question. If you pay a certain profit multiple and over time the stock delivers you will call it paying up. Else it will turn to be a case of overpaying and not getting compensated enough.

I think the key would be the confidence one has in the understanding of the business in question. It has to deliver. Period. After that it comes down to a debate on what's a reasonable period to look out. Current tuning in the markets is 6-12 months. So if you have confidence that the underlying business will deliver on say earnings growth while maintaining similar profitability than you can look a bit ahead. What you are essentially doing is convincing yourself that you have paid a much lower multiple but over say 18 months.

Another type of related trade in a quality business would be to try and buy into what is termed as good businesses in temporary trouble. Here again you are paying up a high (infinite in case of loss making) multiple to recent earnings. Here the hope is that the business reverts to its long term past profitability and you get rewarded for assuming that risk. This is the territory of buying quality turnarounds.

The third type would be newer businesses in terms of their operating and stock market history. Here too one is paying up in the hope of the company delivering on expectations of growth and profitability.

Clearly there are different risks and pay offs in each of the above approaches. We should be aware of the same when putting money to work.

SN: Being a manager of other people's money, do you believe in the concept of holding cash when you don't find opportunities to invest? Or are you fully invested at all times?

AM: We are bottom up investors and always on the look for high quality businesses at appropriate prices. There is an absolute threshold of potential returns based on what the underlying business can achieve in terms of say revenues, profits and profitability. Based on this if it makes sense to own a particular business we would do that. At the same time the flip side of disciplined investing is that we could have high cash levels at various points of time.

SN: How do you determine when to exit from a position? Are there some specific rules for selling you have?

AM: I think the biggest watch out signal for us is deterioration in the profitability of the business. The key from then would be what is the kind of latitude you are willing to give to that business. Questions to be asked would be like – Is the deterioration a false dawn i.e. the business is in some sort of temporary distress or is this a break down and thus a trend going forward. Once you have assessed that aspect you can take a decision on continuing to own the business or exit.

If the business is unjustifiably expensive due to the exuberance in the stock market, we would sell.

The last type of selling would be a sort of relative approach wherein you feel that a particular business is more attractive than a name in your existing portfolio. Thus you swap that name with your current holding.

SN: When you look back at your investment mistakes, were there any common elements of themes? Please explain with the help of a real-life example.

AM: I think the most common element has been misjudgement on the sustainable profitability of the business. We have owned a house ware retailer and have lost a lot of money due to poor judgment on sustainable ROE of the business. As business conditions deteriorated the company had no pricing power and thus profits and profitability went for a toss. The result has been a sharp fall in share prices over the last 15-18 months.

SN: What tricks do you use to save yourself from behavioural biases? What are the most common behavioural mistakes you make?

AM: We are all human and thus we have our biases. The biggest bias is to expect a company to show me consistent profitability over 5-7 years. If I don't see a certain type of operating numbers I am not willing to spend time, synthesize and look deeper. For me personally I am not a big fan of conglomerate type investing. Also I dislike sum of part valuation methodology to justify owning such names. In addition, I also am biased against holding discount trades.

SN: How can an investor improve the quality of his/her decision making?

AM: I think we all have to develop a mindset to say no and recognize the practical limitations of not being able to reach everywhere and uncover all businesses. This is just plain very difficult. Once we have that framework and a sort of no regret mindset, life is far easier. You are then putting in a certain self-imposed restriction on areas you would like to work on and improve understanding. This to my mind should help in improving decision making and result in better investment results over time.

SN: How do you avoid the noise and the overload of information that is available these days?

AM: I think all of us investors should work towards a sort of framework or a process which one is comfortable with. This would be an ongoing process of building on a base and evolving. By its definition this means that as an investor I am recognizing my limitations in terms of businesses I can own and understand. Once we can have that sort of mindset cutting out noise or searching for things that would fit in your framework would be far easier to do. In a way this relates very well to the earlier question on ability to improve decision making. Once we have a mindset to say no and yes based on our framework we are able to cut out lots of noise and improve decision making.

SN: How do you think about risk? How do you employ that in your investing?

AM: Risk in its purest single dimension is the prospect of losing money on an investment. As a long term quality investor we are hoping that we are able to manage risk within expectations. Our hope is that the underlying business will help in tough business conditions.

The other dimension of risk is not being compensated for the type of risk being assumed. This is a sort of relative risk to other asset classes and within equity itself. Here too our hope is to get compensated enough by owning growing quality businesses which compound over time.

SN: If you had just two-minutes to advise someone wanting to get into investing, what would your advice be? What are the pitfalls he/she must be aware of?

AM: I would say be clear of your objective. What are you trying to achieve by investing? Are you in it to make some quick money over short period or do you want to make a life time commitment to investing with a hope of making very large sums of money over time.
We must always realize that you are fighting against yourself and this is not an area to prove your strength and muscle.

SN: Great advice indeed! Anyways, which books/resources do you recommend to a budding investor for learning investing and multidisciplinary thinking?

AM: I would say read lots of annual reports from a diverse range of businesses. This sort of primary reading combined with cross referencing data from even the internet should help build an improved appreciation for a particular business. This done consistently and over time can help develop a basic level multidisciplinary thinker.

SN: Which investor/investment thinker(s) so you hold in high esteem?

AM: For me the most impact has been from reading Phil Fisher. The entire business based investment approach is the strong influence from his writings. I would recommend "Common Stocks and Uncommon Profits" a must read for all investors. Also the two of John Train relating to money masters has had an early and very impactful influence on my thinking. In the more recent times, investment articles by Michael Mauboussin too have contributed to my learning.

SN: Hypothetical question: Let's say that you knew you were going to lose all your memory the next morning. Briefly, what would you write in a letter to yourself, so that you could begin relearning everything starting the next day?

AM: Walk across to a bank and understand prevalent interest rates. Then observe and read up on businesses which have been around sufficiently long. Why and how well have they survived in relation to those bank rates that you had found out. Over time form a judgement on which businesses you think will survive the test of time and continue to make economic sense. Assume that there is no stock market and daily price quotation. So once you own some of these businesses there is no exit at least in the near 1-3 years. Make your bid to purchase a part interest in a business keeping the above in mind.

SN: What other things do you do apart from investing?

AM: I like to travel and see different parts of the world. I personally think travel makes you worldly wise and aware. It's also a good way to spend quality time with the family. There are lots of quality hiking trails in Hong Kong. I try to hike regularly. Also try to play squash as a way to keep fit.

SN: Thank you Ayaz for the insights you have shared with Safal Niveshak's readers!

AM: Thanks for the interview, Vishal! I really enjoyed it.