Idea Brunch with Amit Mantri of 2Point2 Capital

A guide to investing in Indian markets and exposing frauds

EDWIN DORSEY
21 AUG 2022

8

Share

Welcome to Sunday's Idea Brunch, your interview series with underfollowed investors and emerging managers. We are very excited to interview Amit Mantri!

Amit is currently a fund manager at 2Point2 Capital, a concentrated India equities investment firm he co-founded in March 2016. Before launching 2Point2 Capital, Amit was a Vice President at Hornbill Capital and a Vice President at Zephyr Peacock India. Since its inception in 2016, 2Point2 has a cumulative return of 145%, or 16.2% annualized, compared to a cumulative return of 100% for the NIFTY 500 Index. Amit earned widespread admiration in India for publicly exposing accounting irregularities at various companies.

(Last time we interviewed Tim Staermose of Global Value Hunter and our next interview comes out Sunday, September 4.)

Amit, thanks for doing Sunday's Idea Brunch! Can you please tell readers a little more about your background, why you decided to launch 2Point2 Capital, and your passion for investing in high-quality companies in India?

I am a computer science engineer from the Indian Institute of Technology (IIT) Kharagpur and went to business school at the Indian Institute of Management Bangalore. Even as a student I had fallen in love with the world of finance and investing. I had become a Buffett/Munger devotee and ended up reading everything I could on value investing.

I started my professional career in the investing world by working with a few private equity and hedge funds that invested in Indian businesses. That was when I grew the most as an investor — I made several mistakes as a young analyst and learned from them. I became aware of how weak the corporate governance standards were in Indian companies and how little you could trust reported audited numbers and management commentary.

In 2016, I co-founded 2Point2 Capital, a public market focused fund, with my engineering college hostel-mate Savi Jain. Our view was that if we followed a value investing approach coupled with a deep, on-ground research-oriented process that seeks to minimize blunders we would be able to deliver reasonable alpha to our investors over the long term. We now manage an AUM of ~$80 million under a single portfolio strategy that is concentrated, market-cap agnostic and sector agnostic. We invest in businesses that have a long track record of creating economic value and available at a reasonable price. We have used our forensic and on-ground research capabilities to highlight many frauds that have later rocked the Indian capital markets. These capabilities have helped us avoid major blunders and, in a few cases, find interesting ideas to invest in.

In December 2016, you wrote an incredible report on accounting irregularities at Manpasand Beverages. Two and a half years later the management was arrested for fraud and the stock ultimately filed for bankruptcy. Can you tell us a little

more about your experience publicly exposing problems at Manpasand Beverages and the state of corporate governance in India?

The entire Manpasand Beverages episode was an interesting experience for us. We had started looking at the company from an investment point of view – the company was reporting great numbers, giving strong guidance, and had a reputed investor base. But even basic channel checks clearly showed that the numbers reported by the company didn't match with the on-ground reality. Red flags kept piling up as we dug deeper. We tried to highlight all the major red flags in our report. However, our report was largely ignored and the stock kept hitting new highs. An investment bank that had led the capital raising exercise for Manpasand wrote a weak rebuttal that chose to question our experience/pedigree rather than the merits of our report.

Our expectation was that our report would force investors to take a closer and independent look at the business rather than blindly relying on management assertions and company reported financials. Little of that happened. There was a raging bull market in India at that time (particularly in small and midcap stocks). Before 2018, corporate governance issues were not considered a material risk worth worrying about by most investors.

In 2018, the Manpasand stock collapsed after the auditor refused to sign off on the financials. Most investors now realized that this was not a real business. A year later, the management was arrested for invoice fraud. Manpasand's fall coincided with the small and midcap crash in 2018-19 when a large number of companies went bust after governance issues emerged. Several other companies we had written about saw value erosion of 80%+ in this period and have not recovered.

The 2018-19 small and midcap crash has resulted in a higher focus on corporate governance standards by investors in India. However, fraud continues to be endemic in corporate India. It is still far too easy for companies to cook books, spin a growth narrative and attract unsuspecting investors.

What are the necessary skills to be a successful investor in India? What should investors focus on? And what are some of the common traits you find in your successful investments?

The investing skills required to succeed in India would not be very different from other large markets. While strong analytical capabilities are necessary, a sound temperament and patience are probably the most critical requirements.

Most of the companies in the Indian market are majority owned and controlled by promoters. The number of companies that have diverse shareholding and are run by independent Boards is low compared to the US markets. So unlike in the US markets where Boards/managements need to act in the best interest of shareholders or risk being replaced by activist campaigns, in India there is little room for shareholder activism. Indian promoters often take actions that are detrimental to minority shareholders, and minority shareholders have little recourse in such situations.

This dynamic makes it important for long-term investors to focus on not just the quality of the business and the price of the stock but also on the ethics and integrity of the majority owners. Many good businesses have turned out to be terrible stock investments because the majority owners have used their controlling power to enrich themselves and not share the value created with minority shareholders. Successful investors need to focus on corporate governance far more in India than in other developed markets.

One of the common traits in our successful investments has been that a good business is being dumped by investors because of an external crisis that impacts all industry players. Typically, in such a scenario the business sees a P&L impact for a few quarters but eventually recovers and continues on its normal trajectory once the crisis recedes. However, investors are unwilling to see beyond the next few quarters and often assume that the business will never recover. Our view is that most good businesses emerge stronger from a crisis by gaining market share over weaker players. Since the selling in such periods can be indiscriminate (everyone heading for the door at the same time), the low price provides an excellent risk-reward.

How do you evaluate management teams? What are some of the common red flags? And are there any management teams with high integrity that you admire?

Our evaluation of management teams is largely based on studying their long-term performance track record. We believe that if a business does well in good and bad environments, it may be a reflection of a good management team.

We avoid management teams if we see multiple red flags highlighted below:

> - Empire builders – acquisitive, capital hungry
> - Business actions driven by what is being rewarded by capital markets in the short term
> - Misaligned incentive structures
> - Excessive concentration of power

> - Aggressive guidance

We are admirers of the management teams at **D-Mart/Avenue Supermarts** (led by Neville Noronha) and **Bajaj Finance** (led by Rajeev Jain). Both these businesses operate in highly competitive industries but have created a differentiated and profitable niche for themselves. They have been highly consistent and focused on playing to their strengths while many of their peers have gone bust trying to blindly copy them without the right foundation in place.

What are some interesting ideas on your radar now?

We have a large exposure to private lending businesses in India. Credit penetration is still fairly low in India and largely dominated by inefficient public sector enterprises. There is a large opportunity in categories of small business loans, affordable housing and personal loans. Good management teams with strong underwriting skills should be able to build sizable lending businesses in many of these categories that are not being addressed by the current banking system.

(Editor's note: 2Point2 Capital discusses more individual companies in its great recent investor letters available here and here.)

Amit, what are some of the first things you do when researching a potential investment? What does that first hour of research look like for you? Do you do anything that few others do?

When studying a completely new business, we start by looking at the history and the evolution of the business. This would include studying past financial performance, annual reports, and reading results from conference call transcripts. If we still find the business interesting, we would do a lot of deeper work in trying to understand the moat and the key drivers of the business.

Our focus on on-ground research and forensic financial analysis would probably be the only major differentiator compared to other investors.

Amit, thank you for the great interview! What is the best way for readers to follow or connect with you?

Thank you as well for the opportunity. Readers can follow me on Twitter @amitmantri or email me at amit@2point2capital.com

If you enjoyed this Sunday's Idea Brunch interview, please forward it to a few friends and encourage them to subscribe! *And if you have feedback or want to suggest a great investor we should interview, please hit reply or message us on Twitter @IdeaBrunchEmail.*

This newsletter is not investment advice and is for informational purposes only. *You can reach the publisher by email at edwin@585research.com or on Twitter @StockJabber. This article is for premium subscribers of Sunday's Idea Brunch newsletter. If this article was forwarded to you, please consider becoming a premium subscriber to receive interviews like this one every Sunday. Learn more here.*