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Summarized "Can you make big money in micro-cap stocks? Learn from Ashish Chugh" talk between @hiddengemsindia and @varinder_bansal

Ashish Chugh's journey:

Engineer by education but never had interest in software and started career with DSP Merrill Lynch.

He was working from 1993 to 2003, and in 2003, he decided to start full time investing.

First understand your capacity:

Would you be able to hold the stock when it falls 40%?

Understand yourself and know your temperament

When there is panic in market, these stocks become illiquid and even small selling damages the stock price.

One must have a contingency fund with themselves.

If you don't need money till 3 years from stocks then micro cap is fine.

He avoids leverage as if a situation like Mar 2020 comes you would be forced to sell your quality stocks to cover the margin.

Advises not to get into margin trading funding.

You would need some years to understand which style suits your temperament.

He himself realized that micro-cap world suits him after 8-10 years.

Essential Traits for a micro-cap investor:

1. Patience: In the downturns you would be able to sell, so you must hold it if the thesis is not changed
2. Focus on Company
3. Risk Appetize

4. Stomach for profits: Don't buy cheap and sell cheap. Think about the psychology how the market. How would market rate such a company?
5. Independent thinking
6. Valuation

Annual report is very important:

Many micro-cap companies don't do concalls so, annual reports are very important source of information here.

Focusing on numbers is important here.

Important parts of annual reports:

1. Chairman's speech/message
2. Director's report
3. Management Discussion
4. Reading between the lines

Here is an example on how to read:
This company was one of the only three players of cast water soluble films.

If you look at their financials you won't be able to buy them, as they might be loss making company.

Exports of our products have increased but there is an unlimited and untapped potential world wide. There are only 3 major players in cast water soluble films, and Arrow is one of them. All of us have unique methods of production of these films and have earned patent protection. Arrow UK has generated excellent inquiries and all this need special care. This year we segregated a new division specially to address to Arrow UK and other export markets. This should give a positive impetus to our export sales this year.

The manufacturing technology for Titanium castings has always been a niche and closely guarded technology. For the first time ever, it has been brought to India with a purpose to enable complete indigenous production of critical titanium parts which are required across a wide spectrum of applications in the aerospace and defence sectors. Since its commercialisation in the 1970s, this technology remains available in only 5 countries and less than 10 companies worldwide. These castings are vital in manufacture of components and spares for aircrafts, ships, submarines, Ultra-Lightweight Howitzer artillery guns, all of which are currently being developed in India, some for the first time ever. Over the last 70 years, the country has had to import all such components and spares making them extremely expensive and often subject to numerous restrictions by other countries. Now, with the advent of Titanium casting

The group is amongst the largest manufacturers of LPG Cylinders in Asia

How to filter? The filtration happens naturally over time. Just keep reading and reading.

Thought process:

1. Good business-Potential Growth-Good People-Attractive valuations
2. Your thought must be of risk management and potential upside.

3. Biggest profit comes from "Ugly duckling becoming a Swan.": A hated company evolving into the most loved.

4. Look for mispriced stocks: When the price is down people only look at risk and try to justify the price. Think about the probability and opportunity in the stock price

Mispricing can happen due to any reason:

1. Capital Allocation: Ex: Balaji Amines - They invested some money in building the hotel and market did not like it, which led to business being available at the price of its two years cash flow.

KCP: They have invested into other businesses but doing very well in cements. (by Varinder Bansal)

2. Negative short term signals: Headwinds, lower profits, High depreciation, etc.

Example- Atul Auto: Has done capex recently but demand is not there and even we know that next 2-3 quarters the numbers won't be good. This creates opportunity.

3. Perception of company: When companies don't talk to analyst then the market prices it down but balance sheet is fine.

Ex: Saregama: Two companies which are listed, debt free, ROC is fine but management's perception is not in favor of market (by Varinder Bansal)

Apl Apollo Tubes: It was listed as Bihar Tubes at 20-30 cr market cap and is at 11,000cr. Here he bought it cheap and sold cheap.

4. Unnoticed by markets

5. Survival in question: High debt

Be very careful here because if you are wrong you can go to zero

There are two types of companies here: Doing one time settlement (OTS) with banks and other are NCLT companies

OTS has more chances for making profit. Ex: CG Power, Jain Irrigation, Sical Logistics is currently talking with banks.

In cases of NCLT generally nothing is left for equity shareholders. These are good for short term gains.

6. Hunting for triggers: Don't hunt for triggers. Focus on business, its potential, and Valuations.

Triggers can come from anywhere: Investor entering, story getting told to market, research reports.

7. Special situations: Mergers/Demergers/Corporate actions. Ex: Arvind Mills
8. Actions of SEBI/Stock Exchange.

On Management Quality:

1. Past conduct
2. It is in most case perception driven and you can be wrong
3. Look how equity dilution is happening

4. Whether coming is doing expansion through internal cash or raising debt.
5. Gross block, Sales, and Profit going up together: Sometimes gross block goes up but sales and profit doesn't go up.
6. Skin in the game: High stake
7. Giving out dividends & Buybacks happening

On Risks:

1. Liquidity
2. Patience: may not deliver for years
3. Execution risk
4. Untested management
5. Disruption
6. Delisting/Suspension of trading

To conclude: Follow your style which fits your temperament and not what your neighbor follows.

Q&A:

Q: How many stocks do you know and how big is your stocks?

A: As a micro cap investors you don't have much options to manage your risks. So the only tool is diversification.

He keeps 1-2% in a stock and can't put 10% in a stock. Maximum can be 2-3%.

He has no problem in keeping 50 stocks as you don't have to track them daily.

Problem with high allocation is that if the stock did not move for years and when it suddenly moves up, you would sell.

Q: Do you keep stop loss?

A: Price is not very important for him. He focuses more on business and its problem.

Q: What is your exit strategy?

A: His allocations are so small so he does not have to worry.

Q: What is your edge?

A: As long as the mistakes won't blow up your portfolio there is no problem with mistakes.

Q: Why didn't you talk about ROC and similar ratios?

A: These are very important ratios but they are the outcome and not the process.

Ex: IEX look at their 2013 ROC which was around 12-14% and the stock was available at double digit. Today ROC is around 30% and stock is in triple digit.

Look at the companies where business is going to be more profitability. Buy them before them start delivering good Ratios.

Q: What are your thoughts of IPO?

A: It fine for listing gains but if you seen the past record, generally after 3 years you get the stock price below the IPO price. He believes that there is better value in secondary market than in IPO.

Q: Have you ever thought of changing your style when you don't earn money for long time?

A: There will be phases when the stocks won't perform. be flexible but not a monkey who keeps changes their style.

---THE END---

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