Twitter Thread by Ram Bhupatiraju

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@RamBhupatiraju

Insights from Philip Fisher. One of the best docs I came across for individual investors.

Phenomenal effort by @SiddharthVoraPL @PLIndiaOnline ■■

cc: @dmuthuk @Gautam__Baid @saxena_puru

https://t.co/K19gWk9TFO

ACUMEN
POWER OF INSIGHTS

Series 1.0 PHILIP FISHER
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"If the job has been correctly done when a common stock is purchased, the time to sell is - almost never"
- *Philip Fisher*

EDITOR'S NOTE

Welcome to the first edition of ***ACUMEN – Power of Insights***

Every single world-class investor comes with their own set of special qualities. These investors are not just academics, but they have a long term-track record of outperformance that backs their investment philosophies.

In the words of Warren Buffett, *"Valuing a business is part art and part science."* Through these newsletters, we will take you through both the art and science that successful investors employ to pick stocks for long-term wealth generation.

Developing the right perspective, mental models and decision-making framework is the key to successful investing. A successful investor needs to commit his time and efforts to research and uncover information that others do not know.

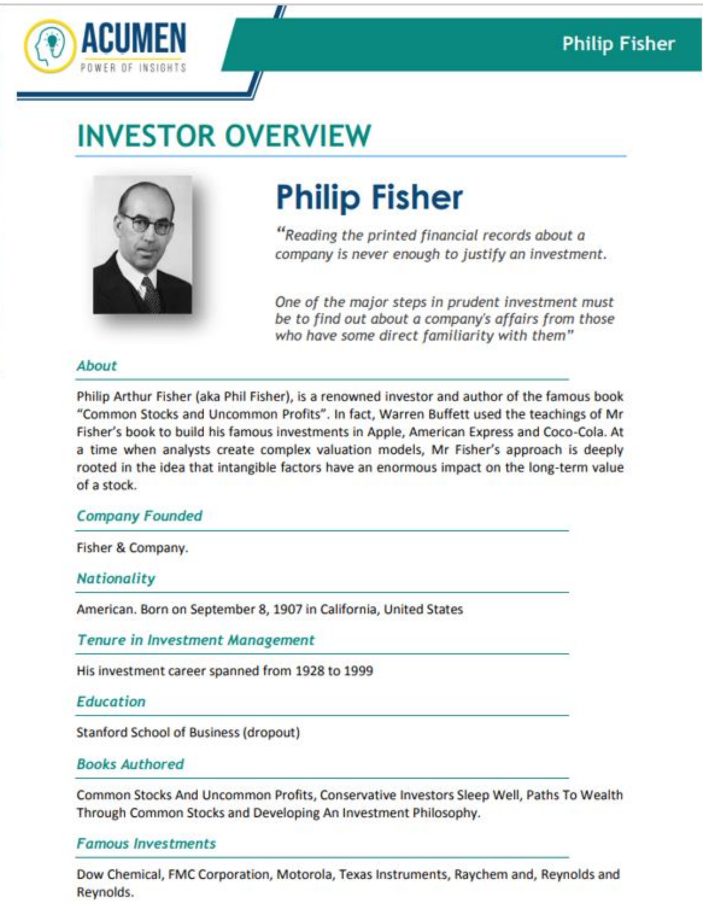
How can you develop such an approach? Simple, you apply the teachings of investing mentor Philip Fisher. Fisher consolidated years of investing experience into a well-defined framework. The Scuttlebutt technique is the key investing ideology established by him.

We hope the insights of Phil Fisher will help you pick stocks that make money and avoid those that won't.

In the forthcoming series of this report, we will apply Phil Fisher's 15-point checklist in the Indian context and highlight companies that met or failed to meet Fisher's checkpoints.

Regards,

Siddharth Vora
CA-CFA-MSc
Investment Research & Products Strategy



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Philip Fisher

INVESTOR OVERVIEW

Philip Fisher

"Reading the printed financial records about a company is never enough to justify an investment.

One of the major steps in prudent investment must be to find out about a company's affairs from those who have some direct familiarity with them"

About

Philip Arthur Fisher (aka Phil Fisher), is a renowned investor and author of the famous book "Common Stocks and Uncommon Profits". In fact, Warren Buffett used the teachings of Mr Fisher's book to build his famous investments in Apple, American Express and Coco-Cola. At a time when analysts create complex valuation models, Mr Fisher's approach is deeply rooted in the idea that intangible factors have an enormous impact on the long-term value of a stock.

Company Founded

Fisher & Company.

Nationality

American. Born on September 8, 1907 in California, United States

Tenure in Investment Management

His investment career spanned from 1928 to 1999

Education

Stanford School of Business (dropout)

Books Authored

Common Stocks And Uncommon Profits, Conservative Investors Sleep Well, Paths To Wealth Through Common Stocks and Developing An Investment Philosophy.

Famous Investments

Dow Chemical, FMC Corporation, Motorola, Texas Instruments, Raychem and, Reynolds and Reynolds.

Philip Fisher's 15 points, simplified. ■■

Highlights of Fisher's 15-point Checklist

1) **Expanding Market** – Companies should have products and/or services that have an expanding market.
2) Management must have determination to **Develop New Products** – No product can remain successful and yet remain the same.
3) **Efficient research and development** – Look at how much the company has gained in revenue per rupee spent on research
4) **Above-average sales organization** – This is the most basic activity of an organization and should be seen that it is handled better than its competitors
5) Pick companies with **Handsome Profit Margin** – Look at how much each rupee in sales produces in operating profits. The higher it is, the greater is the cushion in bad times.
6) **Keeping that Profit Margin** – A company not only needs to generate good profit margins today, but it also needs to do everything to maintain them in the future. Thus, it is important to check how efficiently a company has been in cutting costs.
7) **Great labour relations** – Most investors underestimate the importance of strong employee relations. It is important for the companies to have great relations with their employees as they are the roots of the organization
8) **Awesome executive relations** – If the relations with blue collars are important, a firm's relationship with its executive personnel is vital. These are the people that can make or break any venture
9) **Depth in Management** – You want to invest in a business that has depth in its management. A one man show can be successful for a while, but organizations where people grow can stay successful forever
10) **Great Cost Analysis** – Without this, a firm cannot know where to allocate its resources most effectively. It's difficult to decide if a company is truly outstanding in this perspective but it's easy to identify if they are deficient

11) **Great Industry specifics** – The key strengths of a business differs from one industry to the other. For a retailer, it might be how they handle their inventory. For an airline, it might be how efficient they are at pricing every available seat. Find that strength.
12) **Long range on profits** – Few businesses create great profits today at the expense of profits tomorrow. But, for long-term investors this is undesirable. A company aiming for profits in the long-run creates a sustainable business plan.
13) **Low risk for dilution** – Seek out companies having strong cash positions and/or great borrowing opportunities that would avoid the need to dilute shareholder's equity.
14) **Communicates risks too** – Avoid firms where the management brags about good news as soon as they get a chance to, but don't reveal bad ones until absolutely necessary
15) **Unquestionable integrity** – The management is much closer to the assets of the company than the investors are, and the number of ways that they can benefit at the expense of the shareholders legally is infinite. Therefore, this is the only one of the 15-points that is absolute. Which means, if it's not fulfilled, you should not invest.

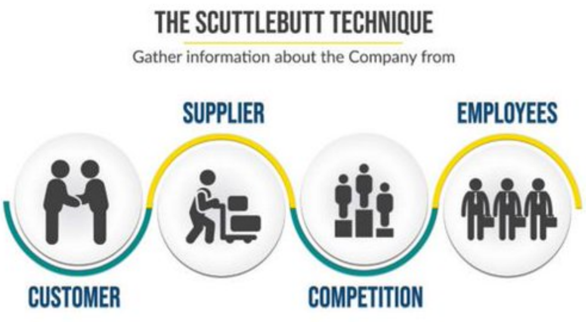
His Investment strategy and Search strategy. ■■

Full scale scuttlebutt is not possible for individual investors (lack of time, resources, contacts), but with efficient search & communication online (tuning out the noise), there are still some ways to do good research.

INVESTMENT STRATEGY

"There are two approaches to accumulating wealth in the stock market. One is to time the market, buying stocks when they are cheap, and selling when they are expensive. The other is to find outstanding companies and hold them."

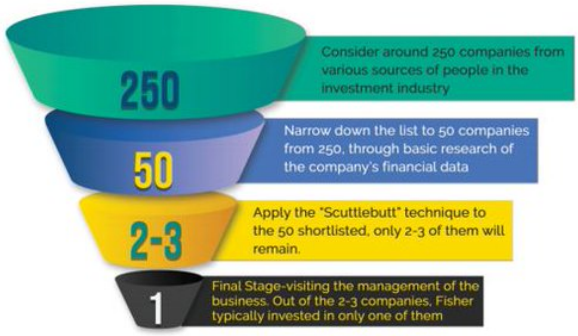
Fisher preferred the latter. He sought companies run by high-quality management, which were leaders in a growing industry, and those with a long history of above-average profit margins or low cost structures *vis-a-vis* the industry. Additionally, he specialized in identifying innovative companies driven by research and development. His growth investing style stems from the "15-point Checklist" also known as the "Scuttlebutt" approach.



FISHING IN THE RIGHT POND

Evaluating a stock idea takes a considerable amount of work. It is virtually impossible to apply all of Fisher's 15 points for every publicly traded company. You would spend too much time researching cases that you could have dropped much earlier. Therefore, you need a process that can quickly separate the winners from the losers. In investing terms, we refer to this as "screening". To make big money on investments, it's unnecessary to get an answer to every investment possibility—it is more important to get the right answer for the select few.

FISHER'S PROCESS



Good sequence of steps to filter from a wider universe of companies to the few promising ones that meet the criteria. ■■

How to arrive at 1 Stock out of 250 Stocks?

Once you have identified 250 companies from various sources, both physical and digital, you can follow the below process.

Step 1

Highlight companies that can achieve sustainable sales growth and profits greater than the overall market and thereby delivering much higher returns

Step 2

Favour them opportunistically, either when

- the market temporarily undervalues the company due to unexpected bad news, or
- when the overall markets are depressed

Step 3

Investigate further, in order to identify potential companies that are either in or entering into an area with opportunities for unusual sales growth, but in which other newcomers or competitors would struggle.

Step 4

Examine the financial statements of potential companies for a thorough understanding of the nature of the business, primarily:

- Capital structure and Financial position
- Profit Margins
- Breakdown of Total Sales by Product lines
- Extent of Research Activity
- Earning statement figures that throw light on depreciation and abnormal or non-recurring costs in prior years' operations
- Major owners of the stock
- Degree of ownership by management

Step 5

Use "Scuttlebutt" approach – i.e. answer Fisher's Checklist (based on three broad categories; ***Management's Qualities, Characteristics of the Business and Functional Items***) after talking to competitors, analysts, and other stakeholders or people who have a decent understanding of the company.

Step 6

Invest in companies fulfilling most of the above 15 points.

Excellent Checklist for Business, Management and Financial characteristics. ■■

Fisher's Comprehensive Checklist based on 3 Broad Categories

Business Characteristics

1	What are the trends in the profit to sales ratios for the company?	Increasing □ Decreasing □
2	Does the firm operate so efficiently that high margins are protected by that efficiency?	Yes □ No □
3	Is the firm's competitive advantage easy to identify?	Yes □ No □
4	Does the firm have the ability to enter new markets and compete against established players in those markets?	Yes □ No □
5	When the company enters a new market, does it use ingenuity or novelty to gain traction?	Yes □ No □
6	Does the company display excellence in areas such as technology that will help it guard against competition?	Yes □ No □

Management Qualities:

1	Does the company have a leader with a determined entrepreneurial personality combining the drive, the original ideas, and the skills necessary to build the fortunes?	Yes □ No □
2	Has management shown an ability to work as a team?	Yes □ No □
3	Does the company usually find its CEO from inside the firm? (Outside hires should be watched carefully)	Yes □ No □
4	Does the company change the way it does things in order to improve processes?	Yes □ No □
5	When changes are made, does the management turn a blind eye to the risks of those changes?	Yes □ No □
6	Do employees feel invested in the company and its success?	Yes □ No □
7	Do employees believe they are treated well?	Yes □ No □
8	Do employees feel motivated by benefits and work environment?	Yes □ No □
9	Do employees feel comfortable expressing concerns with managers?	Yes □ No □

Functional Items:

1	Is the company a low cost producer?	Yes □ No □
2	Does the company have a customer relationship that allows it to react quickly to changes in tastes and preferences?	Yes □ No □
3	Does the company have an effective marketing program that keeps a close eye on costs and effectiveness?	Yes □ No □
4	Does the firm have a strong research capability that allows it to produce new products/better products or for non-manufacturing firms to provide services more effectively or efficiently?	Yes □ No □
5	Does the company focus on high margin lines of business?	Yes □ No □
6	Does the company deploy its capital wisely and deliberately?	Yes □ No □
7	Does the company have a system that warns management of potential threats to profits with sufficient lead time to adjust to those threats?	Yes □ No □

When to sell ■■
✔■Wrong Facts
✔■Changing Facts
✔■Better Opportunities

STOCK MONITORING & WHEN TO SELL?

Philip Fisher was a strong advocate of long-term investing, advising investors to hold onto their stocks until he's not encountered with either of the followings:

1. Wrong Facts

Fisher advises selling "mistakes" quickly, once they are recognized. There are times after a security is purchased when the investor realizes that the facts do not support the idea behind the original purchase. It's probably the case where the investor has made an error in his/her assessment of the company. If the purchase thesis was initially built on a shaky foundation, then the shares should be sold.

2. Changing Facts

One should sell the stock if a company has deteriorated in some way and no longer meets Fisher's 15 points for purchasing a stock. Fisher specifically points out that if the company's growth slows to a rate similar to that of the economy, the stock should probably be sold. He suggested that investors use a **three-year rule** for judging results. One should have the courage to hold the stock and see it underperform the market for a period of three years, keeping other things constant. However, if the stock continues to underperform beyond that period, then he recommends the investor to sell the stock.

3. Scarcity of Cash

One should sell the stock of a company if there is a shortage of cash and at the same time the investor finds a better company which promises higher long-term results after factoring in capital gains. If a unique opportunity presents itself, it would be imprudent to let such a good opportunity go. Thus an investor should be selling some of his or her existing holdings to take advantage of the new opportunity. But, caution is advised here because it is crucial that we are well-informed about the new opportunity

Three Don'ts and Key Takeaways. ■■

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FISHER'S TOP 3 DON'TS

Fisher identified three don'ts when approaching a stock investment. He explained this elaborately in his book, "Common Stocks and Uncommon Profits." These cautions provide investors with timeless advice on how to avoid common pitfalls that lead to underperformance.

1. Don't overstress diversification

"I don't want a lot of good investments; I want a few outstanding ones"

One should not over-diversify his portfolio, unless confident about the nature and actual business activities of the company. Sufficient diversification would cover an investment in 10 or 12 larger companies in a variety of industries with different characteristics, and an holding of over 20 companies is probably too much as per Fisher's philosophy. Wall Street tells you not to "put all your eggs in one basket." However, Fisher states that over-diversification can lead to lower returns and it would be hard to keep a track of all the investments.

Investors who are oversold on diversification put far too little money into companies they thoroughly understand, and far too much in others about which they know nothing at all. But the more companies you have, the less you know about each of them, thus increasing the risk of the unknown.

2. Don't quibble over eighths and quarters

One should not quibble over small differences if the market price is attractive for a fundamentally sound company. Attempting to shave points off the price often results in a trade not going through, and the investor misses a long-term investment in an outstanding firm.

3. Don't follow the crowd

One really has to be contrarian at heart to follow Fisher's footsteps. Contrarian in this regard means to avoid following fads and styles of the stock market, but instead, search for stocks in the areas the crowd has left behind. Fisher particularly liked to purchase stocks during macroeconomic gloom, or when a particular sector was disfavored by the investment community. Many times depressed sectors resulted in unduly discounted companies.

KEY TAKEAWAYS

The investing principles of Phil Fisher dates back more than half a century, but most of his teachings are still relevant today. Even though today, high frequency trading systems execute a thousand trades a second, investing still requires in-depth qualitative research, in order to find businesses with the potential to generate long-term wealth.

Some of us may be born with a greater or lesser degree of each of the required traits than others. However, Fisher believes all of us can "grow" our capabilities in each of these areas if we discipline ourselves and make the effort.

While good fortune will always play some part in managing common stock portfolios, luck tends to even out. Sustained success requires skill and consistent application of sound principles. Within the framework of Fisher's guidelines, we believe that the future will largely belong to those who, through self-discipline, make the effort to achieve it.

15 Indian Companies cited for each of the 15 Pts.■■

(Note that the Value prop, Competitive & Management factors change over the years).

THE 15-POINT CHECKLIST IN THE INDIAN CONTEXT

FROM THE NEXT ISSUE OF ACUMEN, WE WILL DELVE IN DETAIL ON THE BELOW 15 POINTS IN FISHER'S CHECKLIST

For each point on the checklist, we have provided a relevant example in the Indian market

1. **Expanding Market** – **Page Industries**
2. **Product Development/Product Innovation** – **Saregama India**
3. **Efficient Research and Development activities** – **Cipla**
4. **Above Average Sales organization** – **Britannia Industries**
5. **Handsome Profit Margin** – **Colgate-Palmolive (India)**
6. **Initiatives to Improve Margins** – **Eicher Motors**
7. **Relations with Employees** – **Godrej Consumer Products**
8. **Relations with Executives** – **HDFC**
9. **Depth in Management** – **Hindustan Unilever Ltd (HUL)**
10. **Cost Analysis and Accounting controls** – **Jubilant Foodworks**
11. **Industry Specific factors** – **HDFC Bank**
12. **Long Range on Profits** – **Reliance Jio**
13. **Financial Strength (Avoid Equity Financing)** – **Tata Consultancy Services (TCS)**
14. **Good Investor Relations/Disclosures** – **Kwality** *(as a negative example)*
15. **Unquestionable integrity** – **Vakrangee***(as a negative example)*