# Investing in businesses with deep moats

ArunaGiri N

Of all the things with which Value Investors fall in love, the most seductive one is 'Business Moat'. Few things can be as fascinating as finding the next business with solid moat. In simple terms, moat is all about 'durable competitive advantage' of a business. Durable competitive edge acts as a protective barrier for a business to stall any threat from competition (The way a 'moat' around the castle protects it from enemy).

High moat means superior economics of business with high pricing power, solid return ratios and wide operating margin supported by growing free cash flow. As a result, the business seldom needs debt for its growth and hence sports a clean balance sheet with substantial cash reserves.

## MOAT SOURCES

Strong brand, first mover with long operating history, diversified customer base, wide distribution network, IP based business, high switching cost, annuity/ sticky business, low cost manufacturing or economics of scale are some of the well known sources of moat.

In contrast, businesses which operate in segments with concentrated buyers (OE business), high risk of technological obsolescence, capital intensive sectors (sucks constant capital to grow), commodities, cyclicals, etc, possess low or negligible moat. Airlines, infrastructure, power, regulated industries, capital goods, etc, come to mind as examples of businesses with low moat.

Business with deep moat exhibits in general high degree of predictability in its revenue and cash flow streams. The reason being the criticality of predictability of cash flows for ascertaining intrinsic worth of the business on which the whole edifice of 'Value' stands. To the uninitiated, the intrinsic value is nothing but the present value of future cash flows discounted at appropriate discount rate.

So far so good. But will it have any practical use if such solid businesses aren't going to be available cheap (discount to their intrinsic worth). It appears so, if one goes by the sky rocketing valuations of some of the consumer franchisees in the market, i.e., Unilever, Nestle, Marico, Godrej Consumer, Glaxo, Titan etc. Do not get disheartened as market is not so efficient that it prices businesses to perfection especially in the broader market. In the small- and mid-cap space, there are innumerable businesses with solid moats available at significant discount to their intrinsic worth. Hidden gems are many for those who are prepared to dive deeper.

## INTERESTING SPACE

Though there are many segments in the broader market that possess economic moat, there is one interesting space where the opportunities are multitude especially given the nature of large domestic market for industry products, i.e., 'Industry retail'. Unlike consumer companies (highly visible and hence high valuations), Industry retail is about well established brands in the narrow, not-so-visible intermediary market.

Brands with long presence and niche characteristics in this space command pricing power and customer loyalty.

Businesses with such brands, especially those with long operating history in their domain possess superior economics of business with high return ratios, strong pricing power, durable competitive advantage aided by high free cash flow generation, basically very high moat.

There are many names that come to the mind. But some prominent ones are Grindwell, Finolex Cables, Amara Raja Batteries, V-Guard, ESAB welding, Astral Poly, Hindware, WimPlast, Plastiblend, Indag Rubber, Greenply, Havells and so on. Some of these are already rerated by the market, while most remain undervalued thanks to the inefficient market.

Such businesses are not only limited to this Industry retail space.

Check for the company which grabbed the deal from the RBI recently for the core banking solution. So much for efficient market hypothesis.

*(The author is CEO & MD TrustLine Holdings Pvt Ltd. The views are personal)*