

6/18/2020: Fairfax India (FIH.U)

Business Description: Fairfax India Holdings Corporation, an investment holding company, engages in the investment activities in India. It invests in public and private equity securities and debt instruments in India and Indian businesses, or other businesses with customers, suppliers, or business primarily conducted in, or dependent on, India.

The Thesis: FIH.U trades at 2.5x earnings and half of book value. The company's assets are comprised of long-term equity investments (some private, most public). These assets have a stated book value of \$3.2B. Over the next three-to-five years, we believe these assets will trade at substantially higher share prices as they begin to reflect their true intrinsic value. In turn, FIH.U's NAV will rise along with its share price as investors realize the massive value disconnect.

Too Long; Didn't Read(TL;DR):

- FIH.U owns interests in a collection of Indian businesses (both private and public)
- The holding company trades at a severe discount to the sum of its parts
- Bangalore Airport is the largest investment in the company and is worth nearly half its book value
- You can buy the holding company for 2.5x earnings and half of book value
- The businesses inside FIH.U are great businesses with durable competitive advantages, economies of scale and (in some cases) fast growth

What's The Holding Company Worth? And What Will It Look Like With No Revenues?

The entire bull thesis revolves around FIH.U's massive disconnect between the value in their holdings vs. the value of their common stock. If we can prove that their holdings are, in fact, severely undervalued -- the stock should take care of itself over the long term.

Also, COVID-19 brings into consideration zero-revenues for one of FIH.U's most prized possessions: Bangalore Airport. We'll model that out as well, don't worry.

Here's a list of FIH.U's holdings:

	Date of Initial Investment	Ownership
NCML	August 2015	89.5%
IIFL Finance*	December 2015	26.5%
IIFL Wealth*	December 2015	13.9%
IIFL Securities*	December 2015	26.5%
Spaisa*	December 2015	26.6%
Fairchem Speciality	February 2016	48.8%
Sanmar Chemicals Group	April 2016	42.9%
National Stock Exchange	July 2016	1.0%
Saurashtra Freight	February 2017	51.0%
Bangalore International Airport	March 2017	54.0%
CSB Bank	October 2018	49.7%
Seven Islands Shipping	March 2019	48.5%

Let's go through each investment.

Bangalore International Airport (54% Ownership)

FIH.U reported 2019 revenues of \$211 for the airport, along with \$132M in free cash flow. Airports have high cash flow margins. After massive upfront cap-ex to build the airports, the assets turn into annuity streams.

Bangalore makes money through three sources:

- Aero
- Non-Aero
- Real Estate Monetization

The aero segment has grown revenue at a 19% 10YR CAGR. These revenues, of course, will take a severe hit during the COVID-19 shutdown. But if we look out three-to-five years, revenues and earnings should stabilize in this business.

The non-Aero segment comprises cargo hauling, ground handling, fuel sales, food and beverage, etc. This segment's grown at 17% CAGR for the last ten years.

Flow-Through FIH.U Figures:

- Revenues: $\$211\text{M} * (54\% \text{ Ownership}) = \114M
- Free Cash Flow $\$132\text{M} * (54\% \text{ Ownership}) = \71.3M

Sanmar Chemicals Group (43% Ownership)

FIH.U has a 43% ownership stake in Sanmar Chemicals Group. Sanmar is a great business and has over 50 years of operating history. Sanmar specializes in paste PVC, chloromethanes, ethylene dichloride and vinyl chloride monomer.

The company did \$719M in sales last year but lost \$9M in EBITDA. This is a cyclical business, however, as the company did over \$100M in EBITDA in 2018.

Flow-Through FIH.U Figures:

- Revenues: $\$719\text{M} * (43\%) = \309M
- EBITDA: $-\$9\text{M} * (43\%) = -\3.87M
- Asset Value: $\$2\text{B} * (43\%) = \860M

CSB Bank (49.7% Ownership)

CSB is one of the oldest private banks in India and FIH.U was able to purchase their stake for 1.1x book value. Not a bad deal. CSB operates 416 branches and 290 ATMs throughout India. Along with their branches, the company owns 37 residential and commercial properties.

The bank hit every performance benchmark last year. They grew loan advances 9% and increased deposits 3%. This resulted in 35% net interest income growth and a 71% credit to deposit ratio. Yields on loans also rose to 10% while net interest margin increased 80bps.

These improvements resulted in \$107M in revenue and \$8M in net income for 2019.

Flow-Through FIH.U Figures:

- Revenues: $\$107 * (49.7\%) = \$53.18M$
- Net Income: $\$8M * (49.7\%) = \$3.98M$

IIFL Wealth Management Limited (IIFLWAM): 13.9% Ownership

IIFL Wealth Management is India's leading wealth management player. They control over \$25B in assets and have over 900 employees across 29 global offices. IIFLWAM is the only publicly listed pure-play wealth management company.

The company is a beast. They've averaged 48% annual revenue growth and grown operating margins from 38% to 61%. At the end of 2019, IIFLWAM did \$15.7B in revenues and \$9.5B in operating income.

At 23x normalized earnings, you might think IIFLWAM is expensive. But think about the fact that its *still growing* earnings around 30%/year. You're paying less than 1x PEG for the company.

Flow-Through FIH.U Figures:

- Revenues: $\$15.7B * (13.9\%) = \$2.18B$
- Net Income: $\$3.745B * (13.9\%) = \$520M$

IIFL Finance Limited (IIFL): 26.5% Ownership

IIFL is a pure-play NBFC (non-bank financial company). Before its spin-off in 2019, IIFL was part of IIFL Holdings (three-business conglomerate). NBFC's play a crucial role in India, having been a source of debt financing for individuals and companies for over 50 years. IIFL is the 22nd largest NBFC in India.

NBFCs were humming along until the September 2018 scandal with Infrastructure Leasing & Financing Services Limited (IL&FS). Since then, loan approvals have dropped around 30% -- negatively impacting IIFL's ability to generate revenue.

2019 was a banner year for IIFL. They grew loan AUM by 11% (to \$5B) and increased microfinancing loans 70%. IIFL also sports a surplus on all maturities and has \$400M in undrawn lines of credit.

These improvements translated to a 15% increase in revenues (to \$363M) and \$103M after-tax profit. Despite one of its best years ever, the stock currently trades at near 5x normalized earnings.

Flow-Through FIH.U Figures:

- Revenues: $\$363M * (26.5\%) = \$96.2M$
- After-tax Profits: $\$103M * (26.5\%) = \$27.30M$

National Collateral Management Services: 89.5% Ownership

National Collateral (NCML) is an end-to-end grain procurement, testing storage and collateral management company. They sport over 1.6M metric tons of storage across 700 warehouses in 16 states.

The 1.6M metric tons are worth roughly \$700M, or 30% share of India's agriculture collateral management market. FIH.U made its original investment in 2015 for an estimated \$188M investment. Today, NCML's DCF valuation puts them around \$135M.

The company generated \$148M in revenues last year, down 29%. They also reported a net income loss of \$0.8M. Since they aren't public, it's hard to find annual financial data. We'll have to trust FIH.U's figures.

Flow-Through FIH.U Figures:

- Revenues: $\$148M * (89.5\%) = \$132.5M$
- After-tax Profits: $-\$0.8M * (89.5\%) = -\$716K$

Fairchem Specialty (FAIRCHEM): 48.8% Ownership

Fairchem Specialty operates in the oleochemicals business. In short, they turn plant and animal fat into edible/non-edible products. It's a niche business in a large industry.

They sport robust 30% gross margins and 12% operating margins. That said, there's a few concerns I have with this business. Venture to the cash flow statement and find accounts receivables / inventory. We're seeing a three-year trend of reduced cash received from receivables. In other words, they're collecting less in cash on the revenue they're booking on the income statement.

Moving down we also see massive fluctuations in inventory levels. This makes sense given their industry -- but it affects how you value the business' cash flows on an annual basis.

FAIRCHEM's grown like wild over the last ten years. Sales have averaged 22% per-year, earnings even higher at 47%/year. In 2019, FAIRCHEM did \$39M in revenue and \$4M in earnings.

The company trades at 10x normalized earnings and 7x EBITDA.

Flow-Through FIH.U Figures:

- Revenues: $\$39M * (48.8\%) = \$19.03M$
- After-tax Profits: $\$4M * (48.8\%) = \$1.95M$

Seven Island Shipping (48.5% Ownership)

Seven Island Shipping owns and operates tanker vessels along the Indian coast. It's the second largest private tanker shipping company in India. FIH.U spent \$84M over 2019 buying their stake in the business.

Last year, Seven Island did \$82M in sales, \$12M in net income and returned 11% on equity.

Flow-Through FIH.U Figures:

- Revenues: $\$82M * (48.5\%) = \$39.77M$

- After-tax Profits: $\$12\text{M} * (48.5\%) = \5.82M

IIFL Securities (IIFLSEC): 26.4% Ownership

IIFL Securities caps off FIH.U's investment in the various IIFL businesses. FIH.U owns nearly 27% of IIFLSEC. The company is a major player in India's financial services industry. They offer advisory and brokerage services to retail and institutional clients. IIFLSEC serves over 800K customers.

The company operates three segments:

1. Retail brokerage and financial products (70% of revenue)
2. Institutional Brokerage (21% of revenue)
3. Investment Banking (5% of revenue)

IIFLSEC generated \$113M in revenues and \$30M in Pre-tax profits in 2019. The stock's declined >30% since late February and trades around 5x earnings.

But here's the kicker. IIFLSEC has around \$76M in real estate that they rent out for commercial use. That's around 52% of their market cap in these real estate assets.

Flow-Through FIH.U Figures:

- Revenues: $\$113\text{M} * (26.4\%) = \29.83M
- After-tax Profits: $\$12\text{M} * (26.4\%) = \3.17M

Saurashtra Freight (51% Ownership)

Saurashtra main business is owning and operating container freight stations. This is a decent business. Ports need to maximize container traffic and not bottleneck containers waiting for shipment. The company can handle 180,000 twenty-foot equivalent shipping containers per year. It's also the leading CFS with 14% market share (highly fragmented industry).

The company generated \$5M in free cash flow off \$21M in revenues. They have zero debt and \$18M in cash on the balance sheet. Unfortunately, that's where the good news ends. FIH.U's noted that the company's experienced significant erosion in revenue growth and EBITDA. In fact, the company has a paltry 3% 3YR average ROE.

Flow-Through FIH.U Figures:

- Revenues: $\$21\text{M} * (51\%) = \10.71M
- After-tax Profits: $\$5\text{M} * (51\%) = \2.55M

5paisa Capital (5PAISA): 26.6% Ownership

5PAISA is an Indian-based online trading platform dedicated to servicing the needs of retail and high-frequency traders. The company offers myriad products including mutual funds, bonds, debentures, stocks and insurance products. 5PAISA spun-out of IIFL Holdings in 2017.

The company's growing like gangbusters. Commission revenue went from \$90K in 2015 to \$7.81M in 2019. It's still in the early-growth stage of life, so earnings and cash-flows look ugly. What matters here is top-line growth and user base growth. Last year 3.6M people downloaded 5PAISA's mobile trading app.

Flow-Through FIH.U Figures:

- Revenues: $\$8.11\text{M} * (26.6\%) = \2.16M
- After-tax Profits: $-\$3.24\text{M} * (26.6\%) = -\862K

The Big Picture: Collective Value of FIH.U's Businesses

Take a breath. That was a lot to digest. Let's compile these businesses to get an idea of FIH.U's underlying earnings power.

- Total Revenues: \$2.98B
- Total Earnings: \$630.6M

Of course we *have to* discount these earnings and revenues for COVID-19 effects. FIH.U's most prized asset is their airport, Bangalore International. What would the holding company's revenues, earnings and equity value look like if we assumed the business went to zero?

Strip out FIH.U's 54% ownership in Bangalore and you're left with the following:

- Revenues: \$2.86B
- Earnings: \$558M

A theoretical drop in the bucket given FIH.U's myriad businesses. But what investors might not see if they *don't* look at book value is the massive weighting of the airport to FIH.U's asset value.

Assigning a \$0 valuation on Bangalore International drops FIH.U's fair value from \$3.05B to \$1.62B. That's a 53% hit to book value.

That's *still* higher than the current market price of \$1.06B. The odds of Bangalore going to \$0 are slim, but we're protected if they do.

Of course there's operating expenses and investment that needs to go into the airport -- to the tune of \$1.2B over the next eight years. That investment will come from internally generated funds and debt.

FIH.U is stupid cheap. It's a Pabrai, "heads I win, tails I don't lose much" situation. For a \$1B market cap you get over \$3B worth of businesses, most of which have positive earnings, high growth and dominating market positions.

You're also investing with one of the best value investors of all time in Prem Watsa. Finally, FIH.U is one of the purest ways to play the global rise of India and the coming economic expansion.

