Why MRF, Nestle, and other 'pricey' stocks are happy being exceptions

Some companies stand out for not making their highly priced shares more "affordable". Well, they have little reason to do so

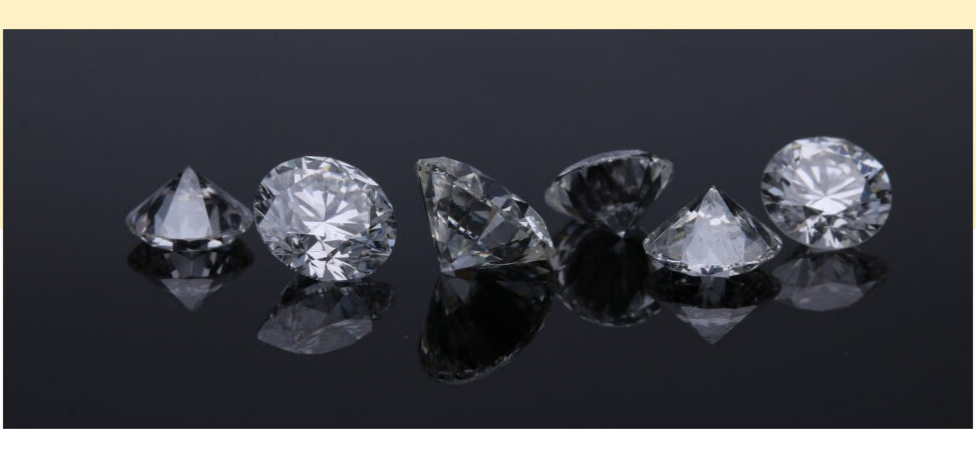
Anand Kalyanaraman, Seetharaman G, 26 Jun 2023

Listed companies generally want to have more retail shareholders, which means doing stock splits and issuing bonus shares to make the shares cheaper

But none of the 17 stocks whose shares are trading above Rs 10,000 apiece have done either in years

This hasn't necessarily meant a decline in retail shareholding. In fact, it has gone up in some cases despite a rise in the share price

Contrary to popular perception, these stocks' trading volumes, on a relative basis, are not different from their peers whose shares are prices much lower



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HIDE SUMMARY

Investing legend Warren Buffett is sitting at a table. The leadership from many listed Indian companies have gathered around him. A burning question is at hand: "Should companies crave more retail shareholders?"

Buffett, the CEO of conglomerate Berkshire Hathaway, says, "Nay". He wants only loyal, long-term investors who share his company's vision. (Berkshire Hathaway has never split its shares, each of which costs $510,000.) Most of the others at the table disagree. They want their shares to be affordable, without the lofty price tags. They decide to split stocks or dish out bonuses that can attract investors.

But some Indian companies do concur with Buffet.

Like MRF. It is making headlines because each of its shares now costs more than Rs 1 lakh ($1,220). It leads the pack of 17 companies whose shares are priced above Rs 10,000 ($122). And I'm talking big names like Nestle and Page Industries (the India licensee for the underwear brand Jockey).

As the hypothetical conversation heats up and numbers swirl like wildfire, you and I, dear reader, step back into the real world.

Investors are buzzing with excitement over the astronomical price of MRF shares. It's here that our storytellers, Seetharaman and Anand, are intrigued.

Then unfolds a captivating account of what happens when the cost of a single share becomes exorbitant. The narrative comes with research, analysis, figures (and, of course, charts), and myth-busting revelations.

Today's story unravels the assumptions tied to costly shares. Remember the notion we began with? The belief that rising share prices repel retail investors? Well, think again! One company has seen a three-fold surge in such users in just five years.

But if the likes of Eicher Motors, Dixon Technologies, and others have split their shares recently, why not the rest? Well, they have enough reasons not to if the data in today's story is not anything to go by.

At the same time, the case of MRF begs another question: Could sky-high valuations drag down stock prices?

So, in such a price-value conundrum, what's an investor to do?

In the past decade, MRF Ltd's share price has grown 7X. But what stole the spotlight earlier this month was the fact that the tyremaker's shares soared past the Rs 1 lakh (US$1,220) mark. From newspapers with page-one headlines to the general public with breathless tweets, everyone went wild.

Even though it may not mean much on its own, the price of a single share breaching that threshold hammered home a fundamental truth about the stock market. That big, juicy numbers get investors pumped, even if they have little to do with a company's revenue, profit, or market value.

"Retail investors are not interested in valuation; they are only interested in price," said Sumit Duseja, co-founder and chief executive of Truemind Capital, an investment advisory.

MRF shares now cost more than twice as much as those of electronic-component maker Honeywell Automation India Ltd, the country's second "priciest" stock. Including MRF and Honeywell, there are 17 companies whose shares are trading above Rs 10,000 (US$122), according to capital-markets-data provider Prime Database. And there are other well-regarded names here, including FMCG giant Nestle India Ltd, manufacturing major 3M India Ltd, and Page Industries Ltd, which is the India licensee for undergarment brand Jockey.

Price no bar

Most of the stocks trading above Rs 10,000 have outperformed benchmark indices in the past decade

	Closing price (on 21 Jun '23, in Rs)	Returns (in %) 1-year	5-year	10-year
MRF	100,422	47	34	676
Honeywell Automation India	42,650	28	130	1,643
Page Industries	38,260	-2	45	843
3M India	27,250	36	37	691
Shree Cement	25,661	38	68	453
Nestle India	22,892	35	132	355
Abbott India	22,679	25	211	1,480
Bosch	19,202	41	7	115
Procter & Gamble Hygiene & Healthcare	13,934	4	40	372
Lakshmi Machine Works	12,932	52	65	605
Tasty Bite Eatables	12,910	53	72	7,663
Kama Holdings	12,367	24	183	3,968
Polson	12,208	29	-7	494
The Yamuna Syndicate	12,100	3	450	N.A
Kaycee Industries	11,953	242	42	346
ZF Commercial Vehicle Control Systems India	11,895	64	66	612
Bombay Oxygen Investments	11,152	-8	27	110
S&P BSE Sensex		22	78	238
S&P BSE 500		24	74	266

Rs 1 = US$ 0.012

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These stocks are exceptions to the norm that listed companies are not all right with their shares costing thousands of rupees. Most of them want retail investors to be able to afford their shares. This is a key reason why they do a stock split or bonus issue.

For instance, truckmaker Eicher Motors Ltd was trading at close to Rs 22,000 (US$270) in August 2020, when it opted for a 10-for-1 split. And shares of contract manufacturer of electronics Dixon Technologies (India) Ltd were priced over Rs 20,000 ($244) until they were split 5-for-1 in March 2021.

Within budget

Leading non-bank lender Bajaj Finance Ltd and its parent, Bajaj Finserv Ltd, also issued bonus shares and split stock in 2016 and 2022, respectively, to make their shares affordable for small investors

On the other hand, none of the aforementioned 17 companies has had a stock split or bonus issue since at least 2002, shows data from Prime Database.

"Any promoter who is business-focussed wouldn't worry about the per-unit price of the stock," said a senior executive with a mid-tier mutual-fund house. An analyst with a family office pointed out such companies are more often than not market leaders with strong balance sheets and don't really need to raise funds from outside. There are some exceptions, though.

All this begs the question: is it even necessary for a company to want more retail shareholders?

If you ask the world's most followed investor, the answer would be no. Warren Buffet has stuck to his position on not splitting his investment firm Berkshire Hathaway Inc's class A shares, which currently trade at US$510,000. Splitting the stock to make it cheaper would mean "a shareholder base that would not have the level of sophistication and the synchronisation of objectives with us that we have now," he'd once said. (But even Buffet conceded after a point, to demands for a lower price point, offering Berkshire Hathaway's class B shares that are much more affordable, at under US$340 now.)

> "It does help to an extent if you are an institutional shareholder and there is liquidity when you want to sell. But other than that, there's no benefit from increased retail participation"
>
> - NITIN BHASIN, HEAD OF INSTITUTIONAL EQUITIES, AMBIT CAPITAL

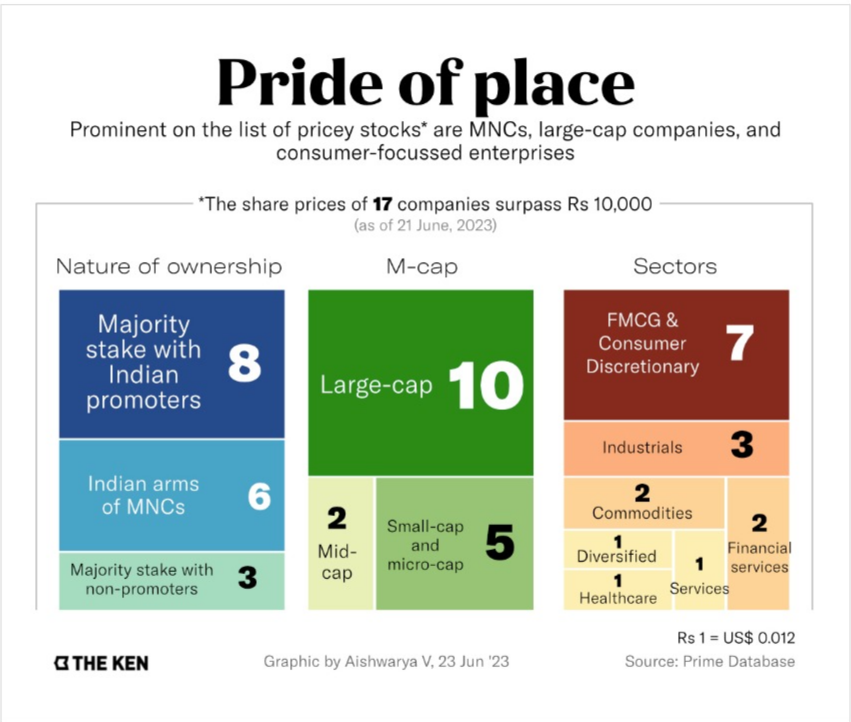
Most Indian listed companies of all sizes don't agree with Buffet's original philosophy on this—even though a stock split or bonus issue could increase trading-related speculation, according to the senior executive quoted earlier. They and a few others quoted in the story declined to be named as they are not authorised to speak to the media.

"In a bull market, everything flies," said Duseja. "But in a bear market, it becomes a pain to control speculators." Still, the former seems to outweigh the latter for a large number of companies. There have been over 60 stock splits in 2023 alone.

There's a group of companies that seems to have resisted the urge to widen its shareholder base, though. Six out of the 17 firms with the priciest stocks are Indian arms of large multinational corporations [MNCs], including 3M and pharma company Abbott India Ltd.

Fractional shares

Unlike in the US, fractional shares—a portion of a share less than one share unit—are not allowed in India. But the Company Law Committee in March 2022 recommended that the Companies Act, 2013 be amended to enable issue of fractional shares. If this happens, the "pricey" stocks could become more affordable to retail investors



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The consensus is that these MNCs have little incentive to attract more investors.

"The parent entities of MNCs listed in India want investors to be aligned with the global stock, not the subsidiary," said the senior executive with a mid-tier mutual-fund house quoted earlier. They added that delisting is an expensive and extensive affair, which is why they continue to be listed.

Mandated to go public

A former fund manager said many MNC stocks were forced to list in India decades back in the 1970s. Some, like American food-and-beverage major Coca-Cola and technology corporation IBM, exited India then, while others agreed and got listed. "They have just let these shares be since then," they added.

For deep-pocketed institutional and high-net worth investors, the high price tag of a pricey stock should not really matter. For instance, private-equity firm Nalanda Capital has a 4-7% stake in MRF and Page Industries, and SBI Mutual Fund owns 5-10% in the same companies. And seasoned investor Nemish Shah and his family have a 10% stake in Lakshmi Machine Works.

Surprisingly, though, data does not support a key assumption related to expensive stocks. It may seem logical to expect a decline in the shareholding of retail investors—who hold shares valued below Rs 2 lakh (US$2,441)—as the prices of these companies' shares increase. After all, as a stock's price keeps shooting up, buying even one such stock could increase the concentration risk for a retail investor and break the bank, so to speak, if the stock comes crashing down. But that assumption does not necessarily hold true.

Defying convention

A surge in the share price doesn't always mean a sharp fall in retail shareholding for pricey stocks

	5-year returns (in %)	Change in retail shareholding (in % points; As of Mar '18 → As of Mar '23)
MRF	34	-5.6
Honeywell Automation India	130	-0.1
Page Industries	45	1.4
3M India	37	-0.5
Shree Cement	68	-0.8
Nestle India	132	0.2
Abbott India	211	0.3
Bosch	7	-0.5
P&G Hygiene & Healthcare	40	-1.2
Lakshmi Machine Works	65	-0.5
Tasty Bite Eatables	72	-3
Kama Holdings	183	0.3
Polson	-7	0.8
The Yamuna Syndicate	450	0.1
Kaycee Industries	42	-6.5
ZF Commercial	66	-2.4
Bombay Oxygen Investments	27	-5.2

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Granted, as the value of MRF shares increased by one-third in the past five years, its retail investors' shareholding fell to 12.7% from 18.3%. But Honeywell more than doubled in value in this period, and the retail shareholding remained largely unchanged. The shareholding in Abbott has risen marginally despite a 3X surge in its share price. What's even more surprising is that the number of Abbott's retail shareholders has increased to 68,000 from 21,000 in the said period.

So, in effect, even as a company's shares become more "unaffordable", institutional investors do not necessarily edge out their small individual counterparts. Put differently, a high price per share may not always be the deterrent it's made out to be.

Odd names

Unlike the other Rs 10,000+ stocks that are mostly large-caps, the likes of Kaycee Industries Ltd, Polson Ltd, and The Yamuna Syndicate Ltd are micro- or small-cap stocks. The smallest stock on this elite list, Kaycee, has a market value of just Rs 41 crore (US$5 million). Micro- and small-cap stocks are generally riskier than large-cap ones

Sure, a pricey stock need not be a costly one. For example, a stock priced at Rs 1,000 (US$12) could well be costlier than a stock priced at Rs 10,000 ($122). Whether a stock is costly or not would depend on the stock's valuations, based on metrics like price-to-earnings [PE]. But data shows that the priciest stocks in India are often costlier than their peers.

Consider MRF. It's trading at 55X its profit in the past 12 months, compared to 24X Apollo Tyres Ltd, and a median of 34X for eight tyre companies, according to market-data provider Screener.in. The analyst with a family office quoted earlier attributed this difference in valuation multiples to the management quality at MRF and the company's growth prospects.

Indeed, much of the nearly 50% rise in the MRF stock price over the past year seems to be driven by an upward revision of the valuation multiple. For many years until early 2022, the trailing PE of MRF hovered at 25–30X. The high valuation multiple now leaves little room for error in the company's performance, which could then drag down both the multiple and stock price from its Rs 1 lakh+ perch.

Many of the other highly priced stocks also trade at a tidy valuation premium to their peers.

Pricey and costly too

Many high-priced stocks are trading at a valuation premium to their peers

Stocks	PE* (times)	Peer	PE* (times)	Peer set median PE
MRF	55	Apollo Tyres	24	34
Page Industries	75	K.P.R. Mill	28	27
Shree Cement	70	Ultratech Cement	47	37
Nestle India	86	Britannia Industries	60	72
P&G Hygiene & Healthcare	79	Colgate Palmolive	42	54
Abbott India	51	Glaxosmithkline Pharma	40	36
Bosch	40	Samvardhana Motherson	37	24
ZF Commercial	71	Uno Minda	51	24
Tasty Bite Eatables	109	Bikaji Foods	80	29

*Price-to-trailing 12 month earnings

Note: Higher the PE ratio, costlier the stock

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About 40% of these on the list of the priciest stocks belong to the consumer industry. Many of these companies, such as Nestle and Page Industries (Jockey), are household names that cater to millions of Indians.

Their trading volumes in the stock market, though, are a different story.

The daily average traded volume of MRF was less than 9,000 shares in the past three months. This is miniscule compared to the 2.5 million shares of Apollo Tyres that were traded daily on average during this period. Similarly, about 37,000 shares of Shree Cement traded daily on average, while Ultratech's volume was 9X higher.

But here's the thing: trading volumes should not be seen in isolation.

Volume game

Trading volumes of pricey stocks are lower than peers' but are not very different relative to total number of shares

Trading volumes*

Stocks			Peers
MRF	8,977	2,508,996	Apollo Tyres
Page Industries	33,385	279,875	K.P.R. Mill
Shree Cement	36,915	317,126	Ultratech Cement
Nestle India	79,747	202,350	Britannia Industries
Bosch	26,044	12,623,327	Samvardhana Motherson
Abbott India	12,473	63,349	Glaxosmithkline Pharma

Trading volumes as % of total number of shares

Stocks			Peers
MRF	0.29	0.40	Apollo Tyres
Page Industries	0.30	0.08	K.P.R. Mill
Shree Cement	0.10	0.11	Ultratech Cement
Nestle India	0.08	0.08	Britannia Industries
Bosch	0.09	0.19	Samvardhana Motherson
Abbott India	0.06	0.04	Glaxosmithkline Pharma

* Daily average traded volume on NSE+BSE (No.of Shares) over the past 3 months

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While the number of traded pricey stocks may be low, their proportion in relation to the overall share count is comparable to that of their peers. So, about 0.3% of MRF's shares were traded on a daily basis, not far from the 0.4% of Apollo Tyres' shares. In some cases, this metric was higher for pricey shares compared with their peers, including for Page Industries and Abbott. In terms of the daily value of shares traded, too, the pricey stocks are not too far off from their peers.

So, pricey stocks seem to defy some common perceptions—that retail-investor interest and also trading volumes would be low thanks to their seeming "unaffordability".

Investors, though, would do well to navigate the distance between price and value with finesse.

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