THE MONITOR

FLAME INVESTMENT LAB

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Chairman's Note

Parag Shah

The Investment Lab will teach students more than investing in the stock market. It will be a tool with which students will learn the value of investing in people and maintaining strong networks and most importantly investing in themselves.

The main issue for me was to provide a platform for students to develop logical ability – to be able to connect dots between seemingly disparate data. It was also necessary to have a dynamic curriculum with respect to the latest trends, so that students acquire skill sets attuned to the changing industry.

I envision a day when FIL will be recognized as a global brand, when students from other colleges and even from outside India will recognize FIL as an opportunity for personal growth and development. In a few years time, I wouldn't be surprised if a student is offered direct placement because of active involvement in FIL.

It was Nemish Shah who came up with the idea to start an investment lab and currently FLAME is the only institute in India to offer something like this. Discussions are on considering making FIL a part of the academic calendar.

President's Note

Indira J Parikh

Opportunity and success are two sides of the same coin - they go hand in hand. FIL is one such opportunity. Embedded with unique dimensions, it is structured to constantly keep you intellectually alive and challenged. Should students utilize this opportunity, it shall become a potent asset for them.

My vision for FIL is pitched at its peak. Time will turn this vision into reality. FIL as a program has the potential and rigor of being a School in itself. It wouldn't be surprising for the Flame School Of Investment to soon offer one/ two year courses to enthusiasts of the field. The Lab is a symbol of strength. With every experience one can build a steady upward momentum of learning.

Investment is an infinite term. It's about exploring the underlying philosophies and thereby expanding one's horizons. It dictates the fundamentals of multiplying one's wealth but not just monetarily. The scope is eternal. One becomes adaptive to the changing environment by learning from the mistakes made.

Over and above handling one's tangible assets, FIL shall facilitate the honing of his/her intangible assets – spontaneity, wit, diplomacy and social relationships. Remember: investing is a way of thinking - an attitude.

Lehman Recapitulated

Ronak Nangalia
Bharti Rohra
Compiled from: The New York Times

With more than a year of economic downturn, the fear caused by the collapse of financial institutions is still fresh in the minds of many people. Lehman Brothers Holding Inc was one such collapse. An investment bank dealing with equity and fixed-income sales, investments, research, management, private banking and private equity quickly grew into a primary dealer in the United States Treasury securities market.

The origin of the credit crisis dates back to another notable boom and bust: the tech bubble of the late 1990's. When the stock market began a steep decline in 2000 and the nation slipped into recession the next year, the Federal Reserve sharply lowered interest rates to limit the economic damage. Mortgage payments became cheaper as interest rates were lowered, leading to rising demand for homes which in turn escalated prices. The interest rate drop resulted in millions of homeowners re-financing their existing mortgages. As the industry grew, the quality of mortgages also deteriorated. Default and delinquency rates began to rise in 2006, but the pace of lending did not slow. Banks had devised complex financial instruments to slice up and resell the mortgage backed securities to hedge against any risks.

The first to collapse were the hedge funds (an investment fund open to a limited range of investors that is permitted by regulators to undertake a wider range of investment and trading than an ordinary investment fund) owned by Bear Sterns in June 2007 that had invested in the subprime market. At the same time, the rising number of foreclosures (the collateral siezed when a loan is defaulted) helped speed the fall of housing prices resulting in a rise in the number of prime mortgages. Decrease in housing prices led to a decrease in return from mortgage backed securities.

Source: toonpool.com

In August 2007 Lehman closed its subprime lender, BNC Mortgage, and took a $25 million after-tax charge and a $27 million reduction in goodwill. In 2008, Lehman faced losses due to continuing subprime mortgage crisis. Lehman had large positions in subprime and other lower-rated mortgage tranches (breaking up the mortgage assets into different categories) when securitizing the underlying mortgages.Securitization is a process of pooling different mortgaged assets and converting them into a security whose value in turn depends on the mortgaged assets.

In the second quarter of 2008, Lehman had reported losses of $2.8 billion and was forced to sell off $6 billion in assets. With no buyers or Treasury bailout and with stocks on a downward slump Lehman Brothers Holdings Inc. had no other choice but to declare bankruptcy. The investors had lost faith in Lehman due to untrue disclosure of its losses. At the Lehman Brothers Holdings Inc. headquarters on September 15, they announced Chapter 11 bankruptcy. The bank declared debt of $613 billion out of $639 billion worth of assets! On September 18, 2008 the Treasury announced a $700 billion proposal to buy toxic assets from banks to restore confidence in the financial system.

Lehman's demise set off tremors throughout the financial system. The uncertainty surrounding its transactions with banks and hedge funds intensified a crisis of confidence that contributed to credit markets freezing. This forced governments to try and calm panicked markets.

Now, almost a year after Lehman's bankruptcy, banks like JPMorgan Chase, Goldman Sachs and American Express have paid back a total of $68 billion. One of the lessons to be learnt from Lehman's case is that strict regulations controlling the risk a financial institution takes need to be put in place. It is a question of securing millions of tax payer's hard-earned money.

Another lesson learned is that leverage is a double-edged sword - it multiplies returns on the upside but has a very different impact on the downside.

Fundamental Analysis: Steel Sector

Bharti Rohra
Compiled from: worldsteel.org
economywatch.com

Barriers to Entry	High capital intensive technology required, therefore lower threat of new entrant
Threat	Aluminum and Plastic are common substitutes resulting in high threat of substitutes.
Bargaining Power (Buyer)	Fragmented and buyers with diverse uses will have a low bargaining power. However, large automobile companies, oil & gas and shipping companies do influence the pricing.
Bargaining Power (Supplier)	The bargaining power is low w.r.t. integrated BF/BOF (since they have their own mines of key raw-material) and high w.r.t. non-integrated BF/BOF.
Competition	High presence of large players in unorganized sector

Porter's analysis is a framework displaying what affects company service and profit

Steel consumption is dependent on GDP per capita, growth in automobile sector and construction sector. In 2005, developed countries like USA had per capita steel consumption of 450 kg with GDP per capita of $40,000 (PPP basis) while China had per capita steel consumption of 250 kg with GDP per capita of $7,000 (PPP basis). India on the other hand had per capita steel consumption of 10 kg with GDP per capita of $1,000 (PPP basis).This shows steel consumption's dependence on GDP and potential of developing countries to achieve steel consumption like that of developed countries. (Per capita consumption of steel denotes how many kg of steel is consumed by the population. GDP per capita is the GDP divided by population). India's per capita steel consumption continues to be low at 46 kg as against the global average of 198 kg. This further strengthens the belief that the potential ahead for India to raise its steel consumption is high. Growth in India's GDP is 8.1%, 9.6%, 8.7% and 6.7% for the fiscal years 2005-06 to 2008-09 respectively. The expected GDP for fiscal year 2009-10 is 7 %.

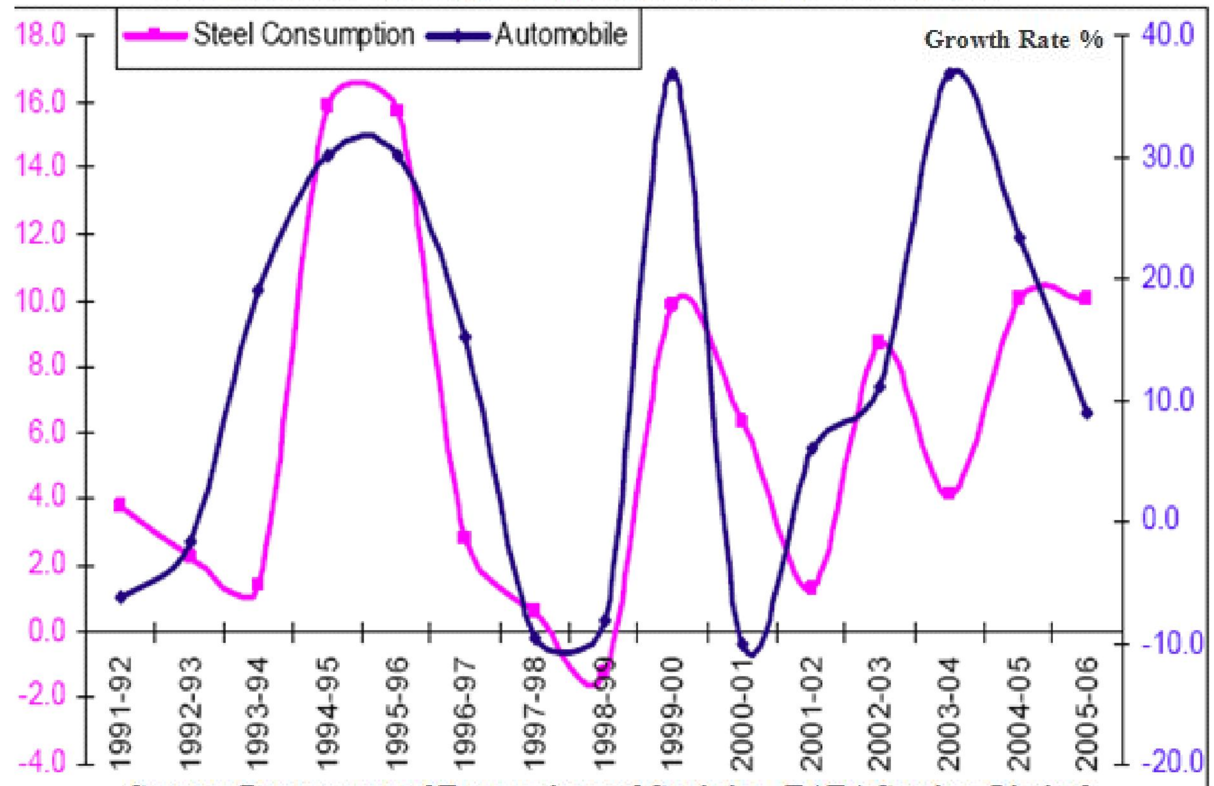
Indian Steel Industry

The Indian steel industry can be divided into two distinct producer groups: Integrated Steel Producers (ISP) with over 1 MT of capacity and smaller stand-alone steel plants that include producers and processors of steel. The ISP's include SAIL, Tata Steel, JSW Steel and Ispat Industries. They account for most of the mild steel production in the country and produce most of the flat steel products including Hot Rolled, Cold Rolled and Galvanized steel. The smaller stand-alone steel plants account for a majority of long products being produced in the country. The potential demand for steel in India is vast with the per capita steel consumption. Long steel (coils and sheets used in ship building, automobile manufacture, electronic equipment like fridges and in construction) prices have been reduced due to slow-down in construction activity and there has been an increase in flat steel (bars, rods and wires used in housing, heavy engineering and railway tracks) prices by Rs 500-Rs 1000 a ton (August 09 prices). Steel prices are currently hovering around Rs 30,000 a ton.

With new budget measures like allocation to Housing, Railways etc and a decrease in excise duty for petrol driven trucks/lorries from 20% to 18%, steel consumption is bound to increase. Add to this the proposal of IIFCL to refinance 60% of commercial bank loans for PPP projects in critical sectors and a plan expenditure increase of 34% over the previous year, the future outlook of the domestic industry looks bright

In 2007, the top three steel producing countries were China (489.0 mmt), Japan (120.2 mmt), and the US (97.2 mmt). In 2008, the top three steel producing countries remained China (500.5 mmt), Japan (118.7 mmt), and the United States (91.4 mmt). India ranks fifth in world steel production after Russia in 2008 with a manifold scope for improvement.

Growth in steel consumption w.r.t growth in automobile sector



Source: Department of Economics and Statistics, TATA Services Limited

Production	Till August 2009	2008	2007	2006	2005
Worldwide	758,207	1,307,339	1,351,289	1,217,462	1,138,319
USA (%)	6.5	9.5	9.8	10.8	11.2
India (%)	4.8	4.2	3.9	4	4
China (%)	38	38	36	35	31

Source: World Steel Industry (in thousand metric tons)

Global Steel Industry

World crude steel production reached 1,329.7 million metric tons (mmt) for the year of 2008. This is a decrease of 1.2% compared to 2007.

The World Steel Association is forecasting that apparent steel use will contract worldwide by 8.6% to 1,104 million metric tons (mmt) in 2009. It also claimed that China will be the critical factor driving the world steel demand in the near future primarily owing to China accounting for more than 35% of the steel produced in the world today.

World finished steel use

Equity Analysis 101

Vikas Menon

"There are many ways to go about equity research. My methodology is just one of them." As I sat down with Hemendra Singh, an ex-equity analyst who has to his credit a large private equity placement deal and a full time faculty at FLAME, to request a couple of articles from him, a talk on equity research was the last thing on my mind. This was my first interaction with him, and it was going to be an interesting one.

In his methodology, there is only one word - Research. One starts from scratch, which in this case is the sector wise analysis by using the PEST model. One chooses a sector by its attractiveness (Retail, Telecom, Financial Services, insurance etc) and then identifies the growth and opportunities within these sectors. One then proceeds to identify the leading companies within these sectors who not only have the capability to fill the gaps in the market, but also provide value. Once these companies are demarcated, do a cross comparison. Research, evaluate and analyze the data, work out the discounted cash flows and forecast the future. "Don't follow the market, predict it. That is what an equity analyst does."

The life of a successful analyst revolves around four cornerstones - honing one's analysis, developing a nature of inquisitiveness, raising the competency levels and accessing and sharing vital information. To conduct constructive research, the entire economic activity can be divided among various sectors with a team leader elected for each sector. Sectoral presentations can be made weekly by using the CMIE package or by tracking any secondary data published or even by meeting key people from the industry. "Everyone wants to eat the ice cream, but no one wants to go through the trouble of making it."

He left me with some questions he felt equity analysts should know the answer to:

1. Does there exist any correlation between ROCE and P/E multiple?
2. Why does HUL, Colgate have a higher P/E in the FMCG sector?
3. Why is technical analysis relevant in 8,500-17,000 index swing in _____ months?
4. Is the real estate sector over-priced?

Brain Teasers

a) X dropped out of college in 1928 and worked as second assistant to Benjamin Graham at the Columbia Business School. X, at the age of 94 was quoted as saying "I'm at the stage in life where I get a lot of pleasure out of finding a cheap stock." At 103, he is still the chairman of the firm he founded in 1978. Identify X.

b) She was built in 1980 at a cost of $100 million for a Saudi billionaire. She featured as the *The Flying Saucer* in the movie *Never Say Never Again* and was bought by X. X's activities as an investor became prominent when he bought a substantial tranche of Citicorp shares in the 1990's. He is also ranked by Forbes as the 22nd richest person in the world. What are we talking about, and who is X.

c)He was awarded the Padma Bhushan in 2008 and famously stated to his BOD, "My salary should be $1 per year with no bonus until we return to profitability."

(a) Irving Kahn
(b)The Kingdom 5KR yacht and Prince Al-Waleed bin Talal
(c) Vikram Pandit, CEO of Citigroup

Tata Steel & The Credit Crisis

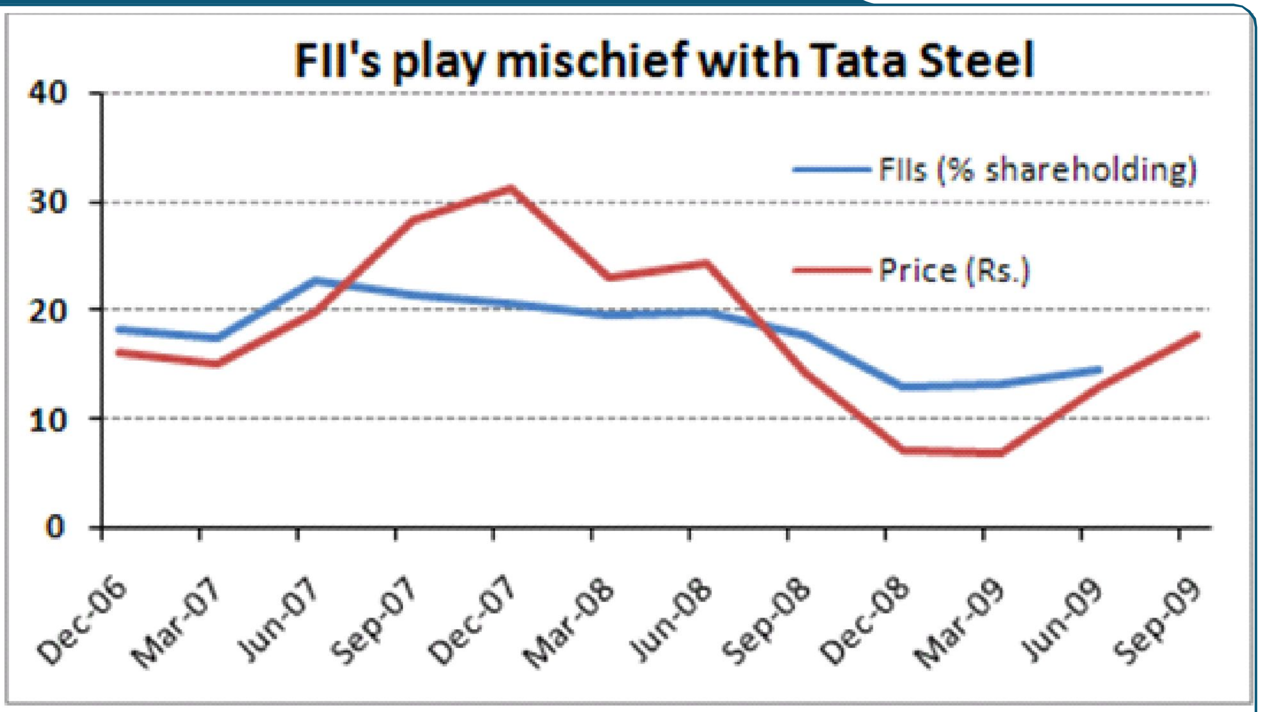
equitymaster.com

"The prices of stocks constantly fluctuate as buyers and sellers haggle towards a mutually agreeable price to buy or sell at any point of time. But can it be that the fundamental worth of each of those companies is actually changing every minute? Is the fundamental worth the only thing that determines the changes in the prices of stocks?"

What better case study than India's premier steel company - Tata Steel to answer these questions.Its price over the last one year or so has been nothing short of a rollercoaster ride, with some very extreme fluctuations in either direction. It touched just about Rs 1,000 in October 2007. Astonishingly, within a span of just one year, by December 2008 it had fallen to a low of Rs 149. A company that was being valued at Rs 603 billion in the market was suddenly being valued at only Rs 108 billion within the matter of a year, a fall of over 80%.

Corus was performing badly and the future didn't look bright for steel companies. The economic outlook was uncertain and most major economies were forecasted to perform badly for the next year or so. It was the same company, with the same management, and the same business, but was now being valued at dramatically low levels.

The fall in price that ostensibly seemed due to a grim outlook, actually had many more layers to it. One of them was the heavy selling activity from FIIs (foreign institutional investors) in a very short period of time. These institutions presumably had to meet many commitments back home. Redemption pressure from their own investors and an extreme liquidity crunch in their home countries could be two such reasons why they had no option but to sell, even if that meant receiving very bad valuations for their stock.



Note: The price of Tata Steel has been divided by 30for the sake of appropriate graphical presentation with the theme of the article.Data Source: CMIE Prowess

And so began the distressed selling where FIIs reduced their shareholding in the company from 20.55% at the end December 2007 to a low of 12.98% at December end 2008, causing company's share price to get beaten down to some very irrationally low levels.

What is also interesting to note is how the momentum of buying and selling by FIIs caused a momentum in the share price that lasted much after the buying and selling by these entities stopped. For example, when FIIs were aggressively buying between March 2007 and June 2007, the rise in the share's price lasted much after the buying stopped. The story is somewhat similar on the downside. An explanation for that could be that when the price of a stock is seen rising or falling in a big way for an extended period of time, speculation becomes rife in the stock, with speculators trying to cash in on the momentum.

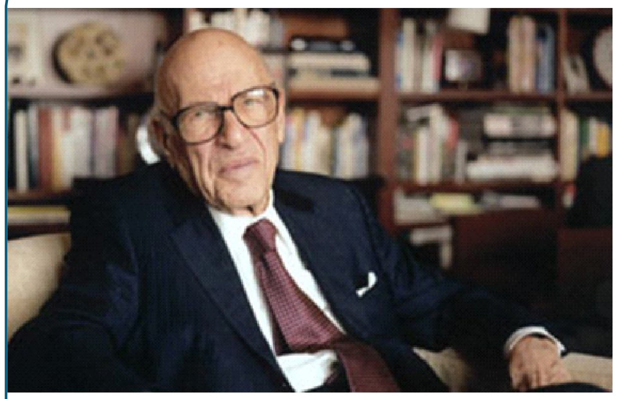
However, after a certain point, the speculator's themselves start affecting the stock's price in what can be called a self-fulfilling prophecy, until the time that such a price (either too high or too low compared to fundamentals) is no longer sustainable.

This had nothing to do with Tata Steel's business and it didn't stop it from affecting its share price.

The moral of the story is that the price quotes of a stock you see everyday does not always reflect the fundamental worth of the company. An intelligent investor should take advantage of these differences from fundamentals by either buying or selling the stock when the price gets way out of sync with its fundamentals.

On Display: Walter Schloss

Compiled From:
Forbes
smartmoney.com



Walter Schloss is considered one of the investment greats, a value investor in the same league as Warren Buffet. For a brief while in the 1950s, Schloss and Buffet even shared the same office. He says of himself, “I’m not very bright.” He didn’t go to college and started out as a Wall Street runner in the 1930s. Today he sits in his Manhattan apartment minding his own capital and enjoying the simple pleasures of life.

In a 1984 speech at Columbia Business School, Warren Buffett called Walter Schloss a “superinvestor” with a singular knack for finding undervalued stocks. “He knows how to identify securities that sell at considerably less than their value to a private owner: And that’s all he does. He owns many more stocks that I do and is far less interested in the underlying nature of the business.”

The root of Buffett’s admiration may seem clear enough: You could point to the fact that Schloss, like Kahn, started his career working for Ben Graham or you could note that during its 47-year lifetime, Walter J. Schloss Associates generated in excess of 20% gross annualized returns and netted to its partners more than 15% per year, while the S&P 500 gained slightly more than 10%. An investor with $100,000 in the S&P 500 from January 1, 1956, to December 31, 2002, would have made $9.3 million. That same $100,000 invested in the Schloss partnership would have generated over $78 million.

But really, the avuncular 92-year-old with the big smile came to appreciate the merits of a well-chosen stock much earlier; it was a dividend stock that helped ease the strains of the Great Depression. All it took was 100 shares in AT&T to improve his family’s experience of the 1930s. AT&T’s annual dividend of $9 a share went a long way at a time when rents in the neighborhood were $32 a month.

Schloss always had an affinity for numbers, though he didn’t dedicate himself to Wall Street immediately. He enlisted in the army right after Pearl Harbor and was tasked with decoding messages (Schloss received a belated letter of thanks from the Russian government in the 1990s.) It wasn’t until he returned to New York in 1946 that he took a job as a stock analyst. He and his son, Edwin folded up the fund in 2002. Schloss now manages his own multimillion-dollar portfolio.

“I’m not very good at judging people. So I found that it was much better to look at figures rather than people. I didn’t go to many meetings unless they were relatively nearby. I like the idea of company-paid dividends, because I think it makes management a little more aware of stockholders.”

He prefers to buy assets rather than earnings. “Most people say, ‘What is it going to earn next year?’ I focus on assets. If you don’t have a lot of debt, it’s worth something.”

So Schloss, who has about half his portfolio in stocks, is still keeping an eye out for companies like International Paper, which he bought because it was trading at a fraction of recent highs, paid a dividend and had little debt. “Debt bothers me,” he says. “The companies in trouble are usually the ones that owe a lot of money.”

Schloss doesn’t profess to understand a company’s operations intimately and almost never talks to management. “You’ve got to get a feel of a company – their history, background, ownership, what it’s done, the business they’re in, dividend payments, where earnings are headed. You’ve just got to get a general feel of a company.” Although he feels, “you never know all about a stock until you own it.”

Dilbert

Scott Adams

The Team

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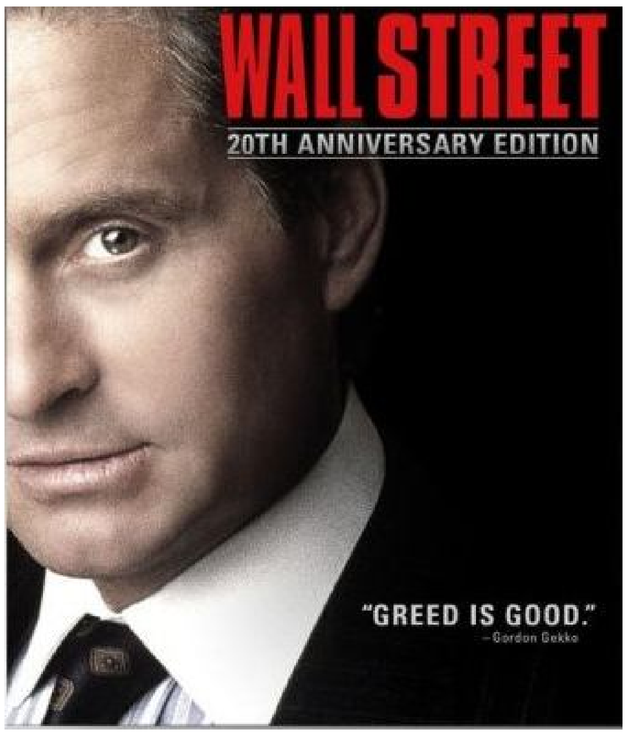
Masque

Abijit Vivek

Apart from being remarkably pretty for stock brokers for a hard on for greenery, Charlie Sheen (Bud Fox) and Michael Douglas (Gordon Gekko) do little to ham out a remarkably shallow and predictable script. If spoiler alerts weren’t bad enough we have clues strewn throughout the early filmscape. Case in point Sheen’s campy “Doing any better would be a sin.”

Oliver Stone does a remarkably B-grade job of slotting brokers and investors as money hungry heartless sharks that recognise good cuisine as well-tossed penny salads with their names watermarked. Douglas weakly ascribes to the adage of love being a rumour that “prevents people from jumping out windows.” A resurrection show of the downtrodden Gekkoo awaits in the Shia LaBeouf led sequel *Wall Street 2: Money Never Sleeps.*



Source: Google

Charlie’s father (real-life daddy Martin Sheen) joins in the dramarama to further enforce stereotype with his own footer quote: “Create instead of living off the buying and selling of others.” Investment labbers, especially, should not take such idealistic advice to heart.

Wall Street may have won an Oscar favour for Douglas but his reprisal of similar villainy in *Basic Instinct (1992)* and *A Perfect Murder (1998)* disfavour him in the eyes of an impartial observer cynic enough to spot him as easily guilty with his slicked back hair and smug grins and archaic view on profit as the end all be all. It may have worked in 1987 but two decades hence it’s time for a Michael Learns To Act keeping in mind the imminent next instalment. For thorough sell-yourself tutorials *Glengarry Glen Ross* comes highly recommended.