



My journey: 0 to 1,000 crores

You too can do it !!

Raamdeo Agrawal

FLAME Investment Lab, 12 July 2017

1980-90 ... CA student to stock market buff



What was I doing?

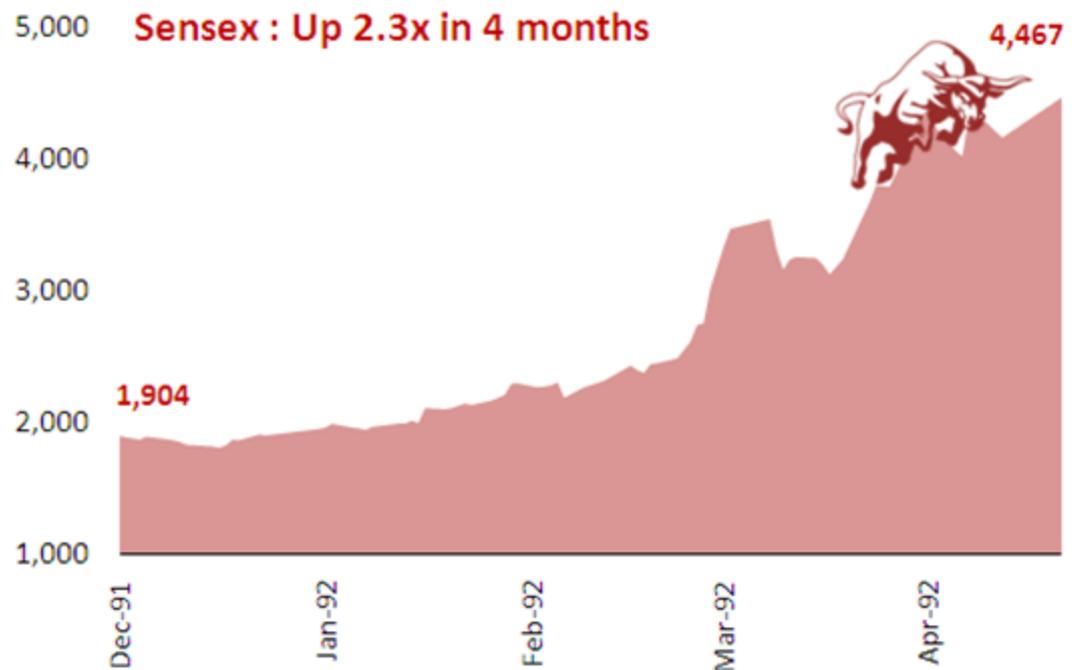


Only mantra !

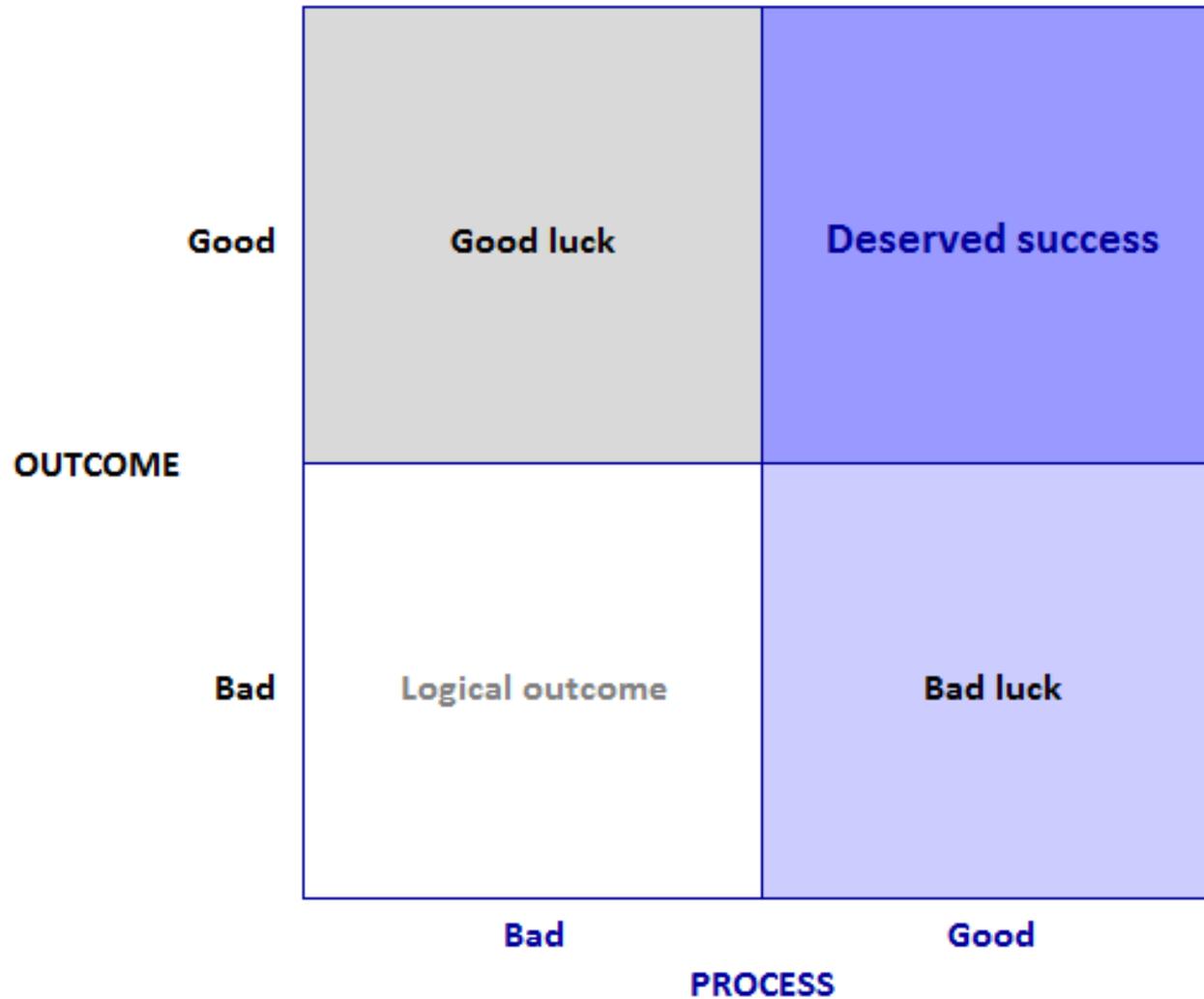
$$\text{Price} = \text{EPS} \times \text{P/E}$$

Me back then

- High passion ...
- ... but ignorance of ignorance !
- Low skill, high luck
e.g. bull run of 1992



Role of luck in equity investing

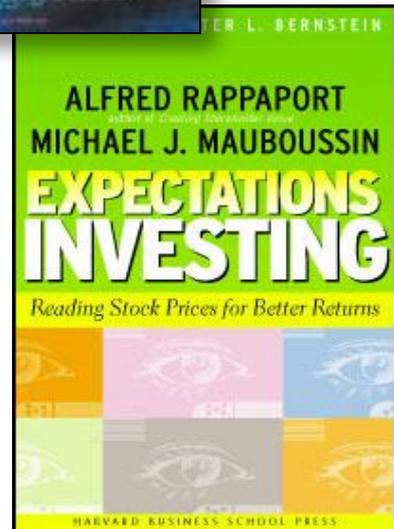
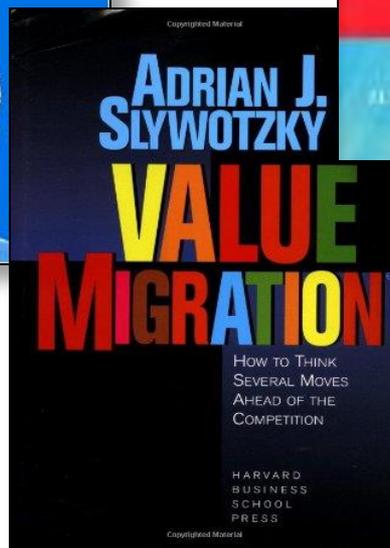
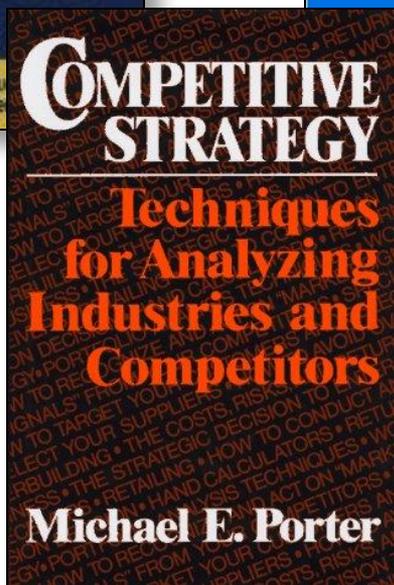
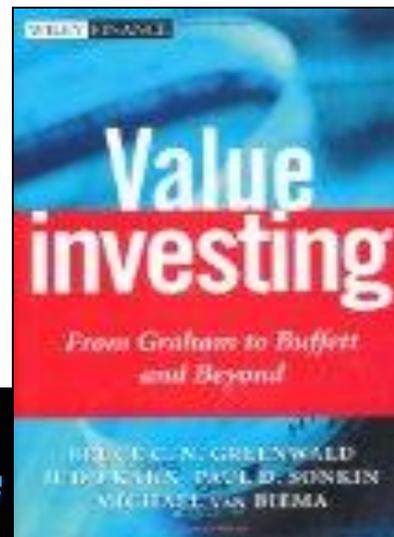
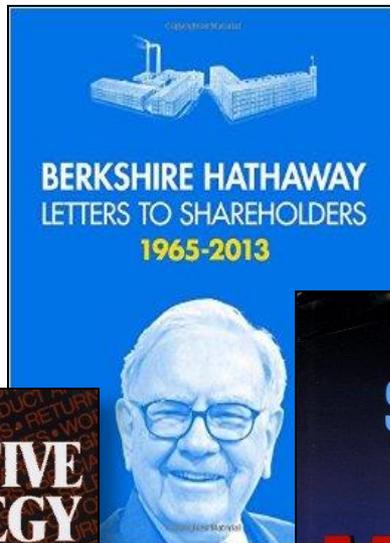
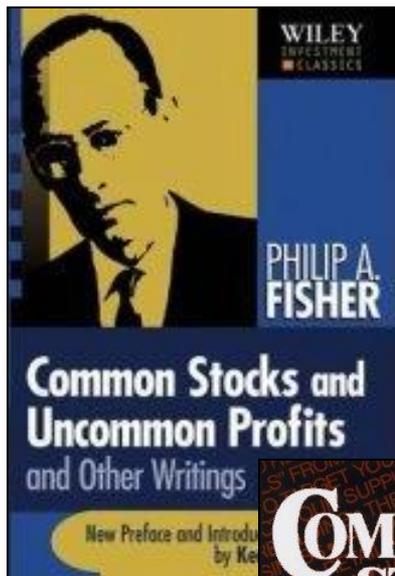


1994 ... Found my guru



Search for investment philosophy begins

Back then & even now ... Knowledge First !!



Rich learnings from 21 Wealth Creation Studies

Inquire

A Study on Wealth Creation

Draft Copy

Rank	FASTEST	CAGR % of adjusted may (Pt to Pt)	Rank based on size	BIGEST	Amount of Wealth Created 1991-96
1	Dr. Bhabha's Labs	88.0	1	Wind Lever	8102.2
2	Vysa Bank	85.3	2	SBI	7219.4
3	TICL	85.7	3	Fair	7074.0
4	United Phosphorus	85.0	4	TICL	6736.2
5	Indefinite Health	85.7	5	State Auto	4822.0
6	Hindustan Soda	79.8	6	Hindustan	4559.3
7	Indefinite Health	78.8	7	Indefinite Health	3344.4
8	M.P.F.C.	76.8	8	State Chemicals	3112.4
9	Tanjavur House	75.6	9	Parsons Ltd	2752.2
10	Excel Packaging	75.4	10	Catalist	2334.5

Conclusions

- Wealth Creating companies have a substantially high ROE and ROCE
- A high correlation is seen between ROE and PE for the Wealth Creation group - Inquire 100.
- Mid cap stocks have a propensity to create wealth faster as compared to the heavyweight blue chips.
- Companies located in their core business have 5% of the group.
- Creation of capital is as fast as or faster than their Wealth Creation.

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Inquire

A Study on Wealth Creation 1995 - 2000

The Biggest ...

Rank	Company	Wealth Created (Rs. in Cr)	Company	Share in %	Share in % CAGR (%)
1	Wipro	12470.1	200.8		
2	Infosys Technologies	8628.0	160.9		
3	Hindustan Lever	4050.0	4.4		
4	Jain Wellman	3650.0	47.8		
5	Hindustan Consumer Products	2400.0	100.4		
6	Hindustan Industries	2062.2	2.9		
7	Hindustan Textiles	1622.8	2.8		
8	Indefinite Technologies	1739.0	88.4		
9	ITC	1148.8	2.8		
10	Hindustan Fertilizer Corpn.	1080.1	18.7		

The Fastest ...

Rank	Company	Wealth Created (Rs. in Cr)	Share in %	Share in % CAGR (%)
1	SBI	184.7	20.7	
2	Infosys Technologies	196.1	20.9	
3	Infosys Technologies	125.4	18.8	
4	Hindustan Consumer Products	183.2	10.4	
5	Indefinite Technologies	148.2	80.8	
6	ITC	128.8	71.3	
7	Indefinite Technologies	127.7	40.7	
8	Indefinite Health	121.1	16.1	
9	Hindustan Textiles	104.4	10.3	
10	Jain Wellman	118.8	47.8	

big

Accelerated growth in New Economy companies combined with faster appreciation of businesses by stock markets have led to disproportionate returns in a short period.

In explicit terms, investment based on price of the share rather than price of the company.

50% of the wealth created by midsize-hedge has been due to P/E re-rating.

High growth business, which is run by an outstanding management and purchased with a one year pre-bid outside of "L" has a good chance of being a big winner.

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12TH ANNUAL WEALTH CREATION STUDY

BY SAMRIDDHI AGRAWAL

2002 - 2007

THE BIGGEST

Rank	Company	Wealth Created (Rs. in Cr)	Company	Share in %	Share in % CAGR (%)
1	Indefinite Health	1,300	87	12.26	12.26
2	ONGC	1,400	100	12.6	12.6
3	Shree Anil	5,300	230	27	47
4	Hindustan Soda	500	10	11	36
5	ICICI Bank	500	10	11	36
6	DAI	500	10	11	36
7	DAI	500	10	11	36
8	State Bank of India	400	10	11	36
9	Indefinite Health	400	10	11	36
10	Indefinite Health	400	10	11	36

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HIGHLIGHTS

- Barriers are found when markets are blind to large business opportunity, positive changes or sustained growth. Investors are disappointed when one grows average.
- India's best dollar dollar journey set its credibility. Budget corporate profits, and boom in savings & investment.
- At current valuations, margin of safety in the market is low. However, very high liquidity can lift the market to rich levels of valuation for long term.

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Great Good Guesseme

13TH ANNUAL WEALTH CREATION STUDY (2003 - 2008)

HIGHLIGHTS

- Understanding of Great, Good and Guesseme companies is critical to investment success.
- Clout from Buy-Back programs (operational based or reasonable prices, or interest free loan) may be a sign to look for some time.
- Guesseme companies are best avoided.
- Market is likely to see a sector shift - dominance of commodities will probably give way to users of commodities.
- Corporate profit boom of last few years is unlikely to continue. However, we have probably seen the market bottom of Guesse levels of 2000.

TOP 10 WEALTH CREATORS (2003 - 2008)

Rank	Company	Wealth Created (Rs. in Cr)	Company	Share in %	Share in % CAGR (%)
1	Indefinite Health	2,277	100	25.7	
2	ONGC	1,400	100	12.6	
3	Shree Anil	1,400	100	12.6	
4	ONGC	1,400	100	12.6	
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16TH ANNUAL WEALTH CREATION STUDY (2005-2010)

UU Investing

Creating wealth from the unknown and unknowable

HIGHLIGHTS

- UU investing is not meant for the "average person". It is for those who are willing to take on high risk and have a long-term horizon.
- Low liquidity ratio remains the most reliable indicator of future wealth creation.
- ESG - Low carbon footprint, through 2020 - will have a major role in creating opportunities in Indian financial markets.

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14TH ANNUAL WEALTH CREATION STUDY (2004-2009)

Winner Categories

Category Winners

HIGHLIGHTS

- India's 100 Best Blue Chip Stocks of GDP will be tracked by continued focus on discretionary, savings and investment.
- Winner Categories and Company Winners will enjoy exponential growth in profits.
- Category winners benefit of reasonable valuation create significant wealth over the long term.

TOP 10 WEALTH CREATORS (2004 - 2009)

Rank	Company	Wealth Created (Rs. in Cr)	Company	Share in %	Share in % CAGR (%)
1	Indefinite Health	1,300	87	12.26	12.26
2	Shree Anil	891	107	12.6	12.6
3	DAI	880	87	10.4	10.4
4	ONGC	578	64	8.4	8.4
5	ONGC	471	54	5.8	5.8
6	ONGC	450	52	5.6	5.6
7	ONGC	438	50	5.4	5.4
8	ONGC	420	48	5.2	5.2
9	ONGC	410	47	5.1	5.1
10	ONGC	400	46	5.0	5.0

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16TH ANNUAL WEALTH CREATION STUDY (2006-2011)

Blue Chip Investing

Creating wealth from dividends

HIGHLIGHTS

- Blue chip companies of dividend and offer an overall, if not more, than growth potential than lower quality companies, but with less risk.
- In investing, there is no profitable substitute for quality. Understanding quality of the company doesn't stop at profits and profitability, it goes beyond to dividend yield and frequency.
- Most Blue Chip enjoy premium valuation. In investing, when to buy and when to sell is more important than P/E. But when overall market value, relative dividend yield and average growth potential.
- In India, we had 20 years, Blue Chips have significantly outperformed the market.

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4					

30-year Manthan, 1 Mantra ... QGLP

Superior stock selection

Based on time-tested investment philosophy/process e.g. QGLP

Quality of business x Quality of management

- Stable business, preferably consumer facing
- Huge business opportunity
- Sustainable competitive advantage
- Competent management team
- Healthy financials & ratios

Growth in earnings

- Volume growth
- Price growth
- Mix change
- Operating leverage
- Financial leverage



Price

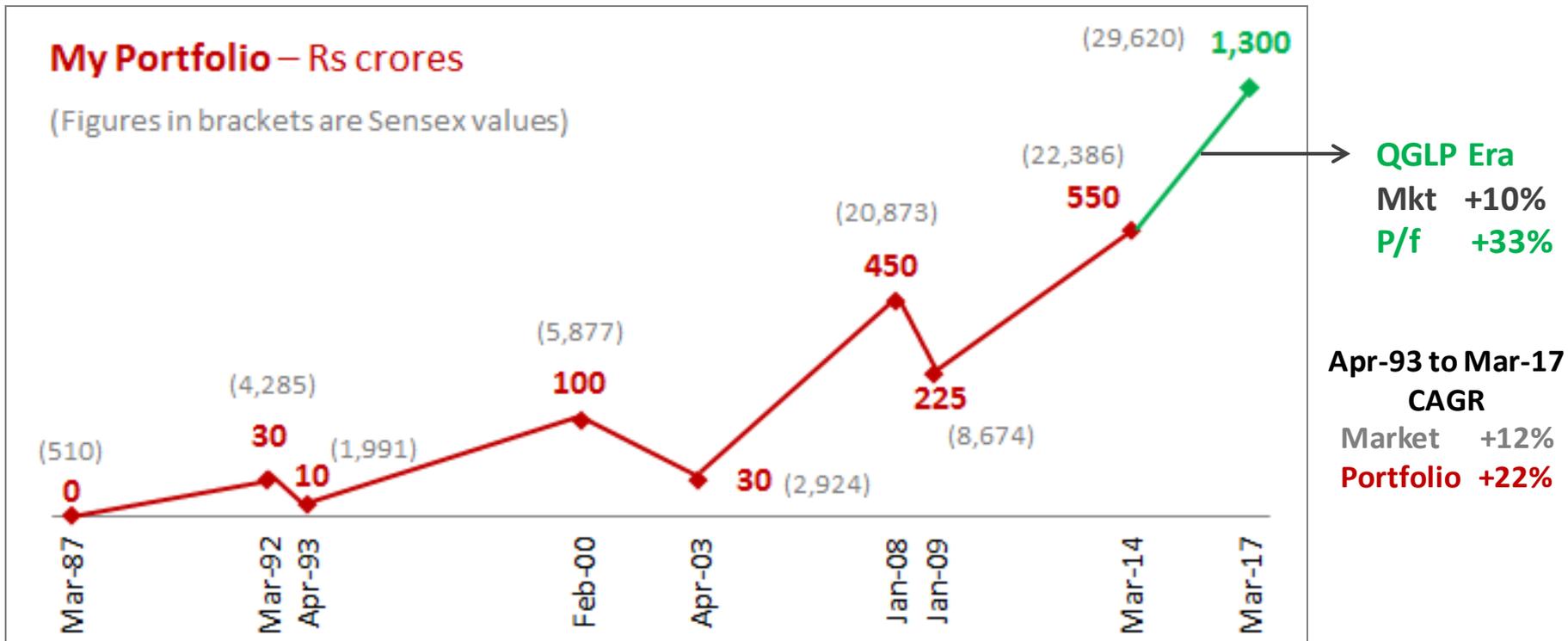
- Reasonable valuation, relative to growth prospects
- High margin of safety
- Prefer stocks with PEG of around 1x

Longevity – of both Q & G

- Long-term relevance of business
- Extending competitive advantage period
- Initiatives to sustain growth for 10-15 years

Bottomline: 0 to 1,000 crores

Charting out the journey



Power of Compounding

1,000x is actually 26% compounded over 30 years

Years \ Rate	5	10	15	20	25	30
8	1.5	2.2	3.2	4.7	6.8	10.1
10	1.6	2.6	4.2	6.7	10.8	17.4
15	2.0	4.0	8	16	33	66
17	2.2	4.8	11	23	51	111
20	2.5	6.2	15	38	95	237
25	3.1	9.3	28	87	265	808
26	3.2	10.1	32	102	323	1,026
30	3.7	14	51	190	706	2,620
50	7.6	58	438	3,325	25,251	191,751

You too can do it !

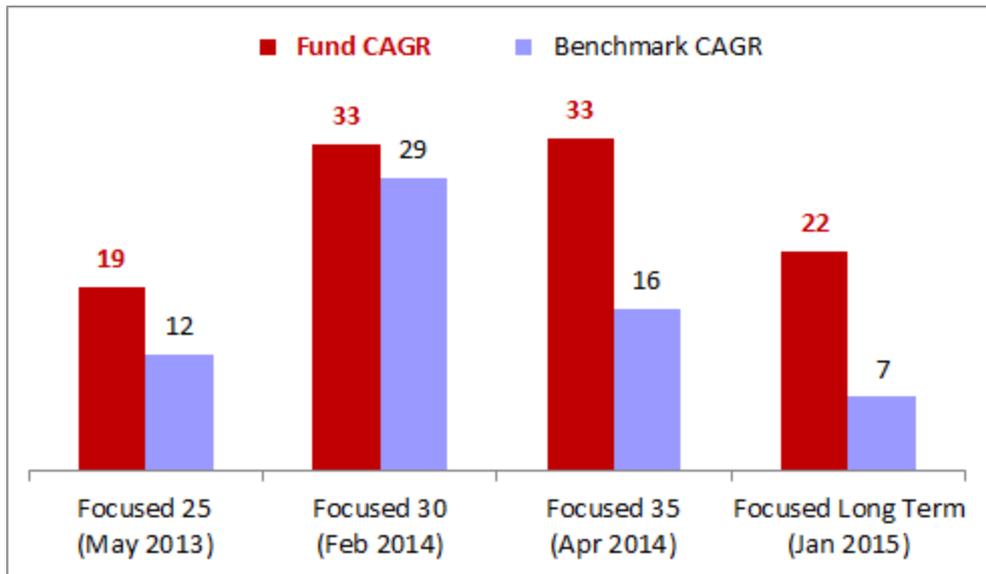
- **Think big, think positive**
- **Understand power of compounding**
- **Don't bother about the market**
(any case, markets don't move in a straight line)
- **Pre-requisites – *Philosophy, Inquisitive Mind***
- **Practice – *Vision, Courage, Patience***
- **Monitor portfolio performance**
- **Continuously improve**

MOAMC's Rs 25,000 crore journey

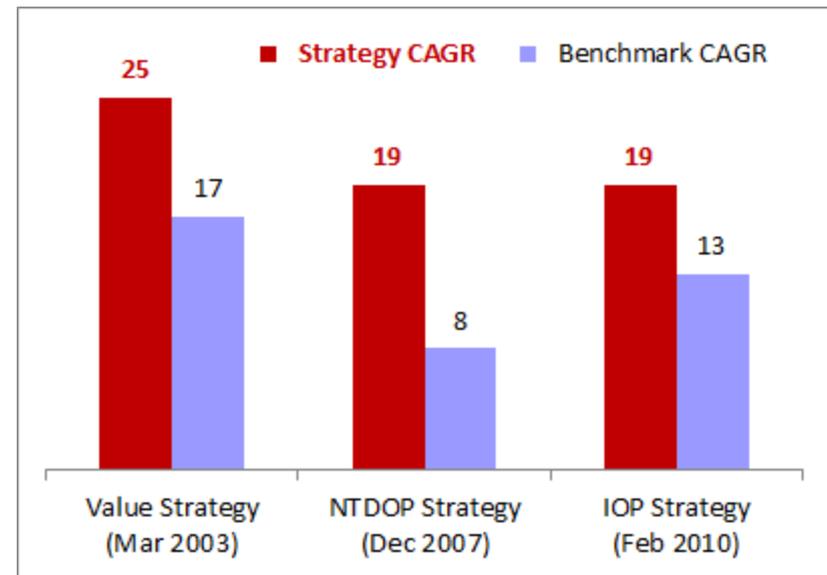


- **P#1 Philosophy** – “Buy Right, Sit Tight”
- **P#2 Process** – QGLP
- **P#3 Performance** – Healthy alpha across products

Returns since inception: Mutual Funds



Returns since inception: PMS



Note: Date of inception given in brackets

Data as on 9 June 2017

F**OCUSED INVESTING**

Power of allocation in Wealth Creation

20 Wealth Creation Studies on What to buy

First one on How much to buy

Allocation matters !

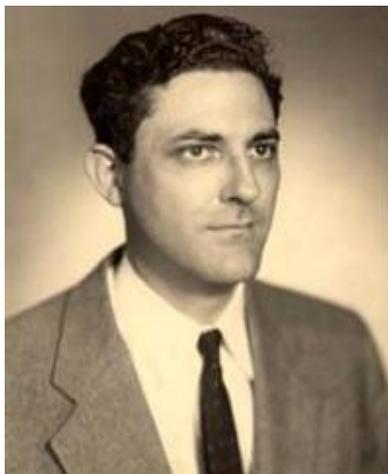
For same selection, allocation can significantly influence portfolio performance

	Stock Return	Allocation		
		Portfolio A	Portfolio B	Portfolio C
Stock 1	50%	10%	20%	5%
Stock 2	40%	10%	15%	5%
Stock 3	30%	10%	15%	5%
Stock 4	20%	10%	10%	5%
Stock 5	10%	10%	10%	10%
Stock 6	0%	10%	10%	10%
Stock 7	-10%	10%	5%	10%
Stock 8	-20%	10%	5%	15%
Stock 9	-30%	10%	5%	15%
Stock 10	-40%	10%	5%	20%
Portfolio Total		100%	100%	100%
Portfolio Return		5.0%	18.5%	-8.5%

Selection v/s Allocation

- **Allocation is under-researched vis-à-vis Selection**
- **Kelly Formula the only mathematical framework**

John Larry Kelly Jr



- **Scientist at Bell Labs in the 1950s**
- **Developed a formula to maximize the bankroll in gambling**

The Kelly Formula

$$f = (bp - q) \div b$$

f : fraction of bankroll to be wagered

b : net odds or win-loss ratio

p : probability of win

q : probability of loss

The Kelly Formula – Example

Say, you start with a bankroll of Rs 1,000.

If someone offers you a win of Rs 2 for every Rs 1 bet on a coin toss -

$$\begin{aligned}f &= (2 \times 0.5 - 0.5) \div 2 \\ &= 0.5 \div 2 \\ &= 25\%\end{aligned}$$

You should bet 25% of 1,000 i.e. Rs 250 in the first bet

Subsequent bet size dependent on outcome of previous bet

Gambling v/s Equity

Kelly's not mathematically relevant for equity investing due to significant differences v/s gambling

- **Payoff is not given**
- **Probability is not known**
- **Nature of bets – sequential v/s simultaneous**
- **Time – instant v/s individual-dependent**
- **Luck v/s Skill & process**

Kelly's Formula – adapted for equities

$$f = (Up - Dq) \div U$$

$$\text{Bet size} = \frac{(\text{Upside} \times \text{Probability of win}) - (\text{Downside} \times \text{Probability of loss})}{\text{Upside}}$$

INSIGHTS -

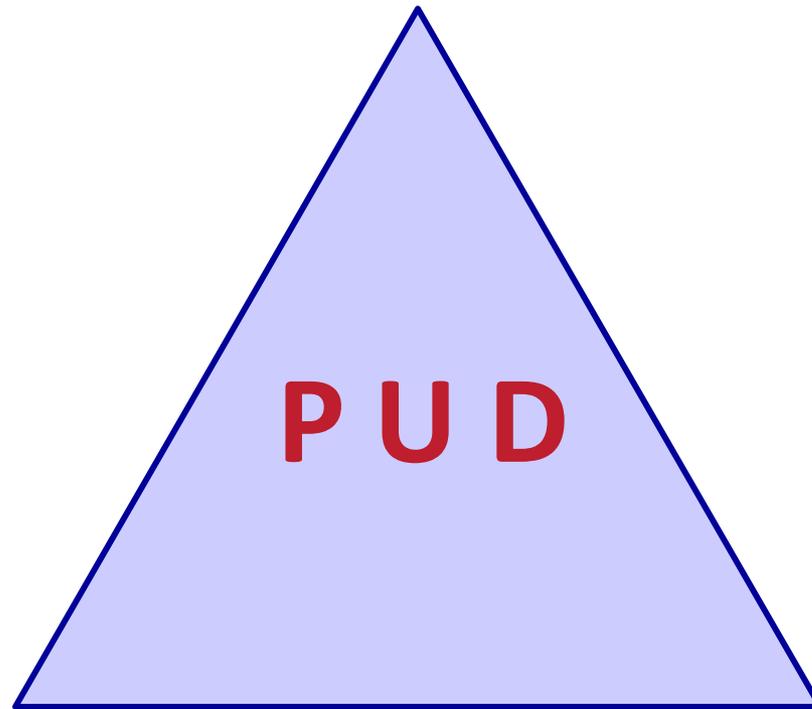
#1 : Look for asymmetric payoff

#2 : Create edge i.e. high probability of win

#3 : When both (1) and (2) coincide, bet big

PUD – A sound approach for equity analysis

P - Probability of win



U - Upside

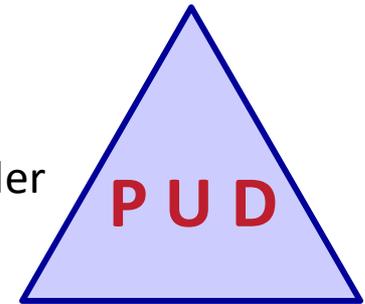
D - Downside

PUD Case #1 – Hero Honda in 1995

U – High, D – Low

- India a huge 2-wheeler market
- 100cc motorcycle a superior value proposition over scooter
- Combination of global technology leader and local marketing leader
- Market cap of only Rs 450 crores
- P/E reasonable at 23x, given RoE of 28% and payout of 25%

P - Probability of win



U - Upside

D - Downside

P – High

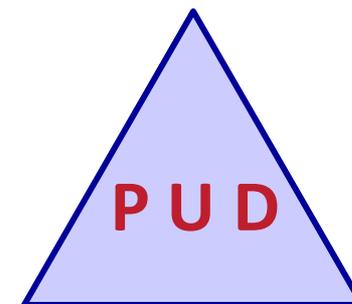
- Terrific business with terrific management at reasonable valuation

PUD Case #1 – Hero Honda in 1995

How PUD played out in next 5 years

Rs cr	1995	2000	CAGR
Sales	475	2,246	36%
PAT	19	187	57%
Mkt Cap	450	3,874	54%
P/E	23	21	
Price	23	194	53%

P - Probability of win



U - Upside

D - Downside

PUD Case #2 – Bharti Airtel in 2003

U – High

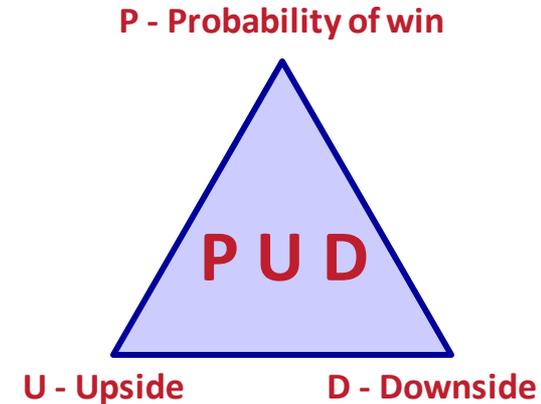
- Massive value migration from wired to wireless telephony
- Bharti was clear market leader
- Sales of only Rs 3,000 crores; long runway ahead

D – Low

- Market cap of only Rs 5,200 crores

P – High

- Company had already started clocking cash profit

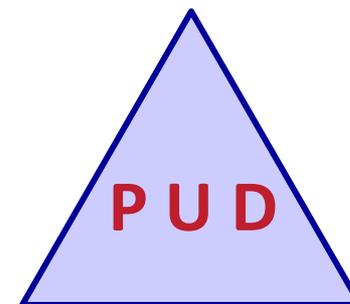


PUD Case #2 – Bharti Airtel in 2003

How PUD played out in next 5 years

Rs cr	2003	2008	CAGR
Sales	3,050	27,012	55%
PAT	-200	6,350	L to P
Mkt Cap	5,245	156,786	97%
P/E	–	25	
Price	14	413	96%

P - Probability of win



U - Upside

D - Downside

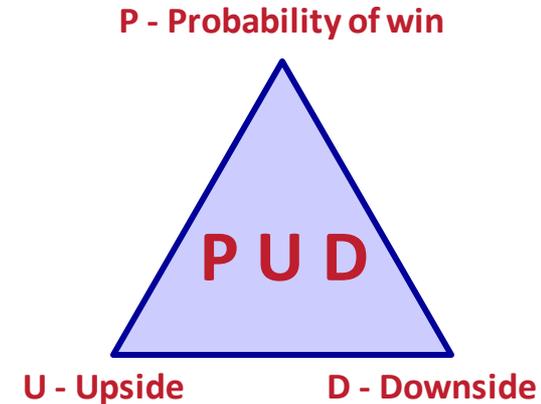
PUD Case #3 – Ajanta Pharma

U – High, D – Low

- Operating in profitable niches in India and abroad
- Very large opportunity
- Disciplined management
- Growing rapidly
- P/E attractive at 15x

P – High

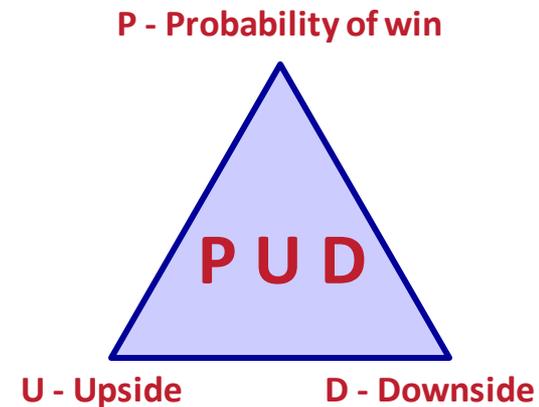
- Value migration in pharma
- Nascent company



PUD Case #3 – Ajanta Pharma

How PUD played out

Rs cr	2014	2016	CAGR
Sales	1,208	1,728	20%
PAT	234	406	32%
Mkt Cap	3,521	12,413	88%
P/E	15	31	43%
Price	401	1,411	88%



Kelly's insight #2: Create edge

Edge – Superior knowledge over the market

INFORMATION EDGE

- Information from dealers, suppliers, competitors, ex employees
- Quality & frequency of management interaction

ANALYSIS EDGE

Multiple analytical frameworks e.g.

- Porter's 5 forces
- India's NTD opportunity
- Role of industry tailwind
- Value migration
- Quality of management
- Terms of trade
- Power of compounding

Kelly's insight #3: Bet big

When payoff is asymmetric and you have edge, bet big

PAYOFF	High	Speculative Bet	Bet Big
	Low	No Bet	Bet Low
		No	Yes
		EDGE	

Why Focused Investing

- Investing is a unitary approach, not a committee approach
 - It is not possible for one individual to have edge in too many businesses
- Markets are efficient. So asymmetric payoff opportunities don't come easy
- Coincidence of asymmetric payoff and investor edge happens seldom

Focused Investing is a sound strategy to capitalize on this

Focused Investing – the golden mean

Focused Investing



No. of stocks: **15-20**
Volatility **Medium**
Return **Exceptional**

Diversified Investing



No. of stocks **50+**
Volatility **Low**
Return **Acceptable**

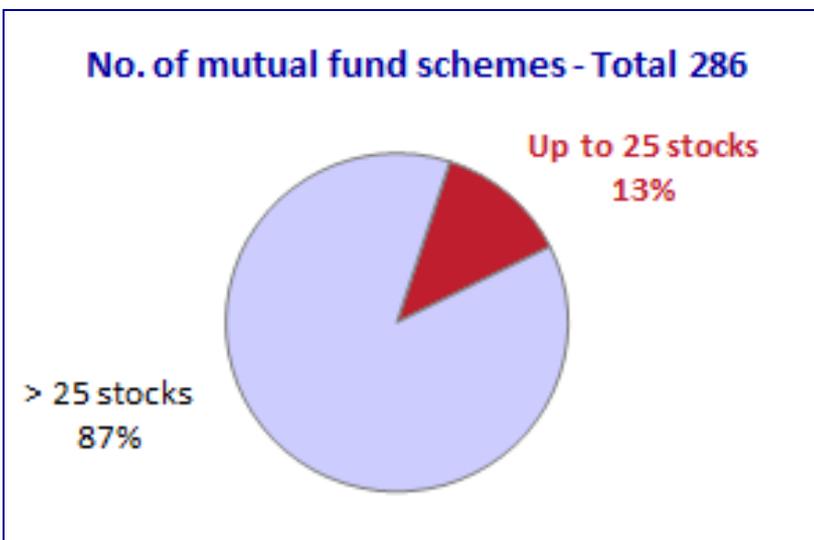
Concentrated Investing



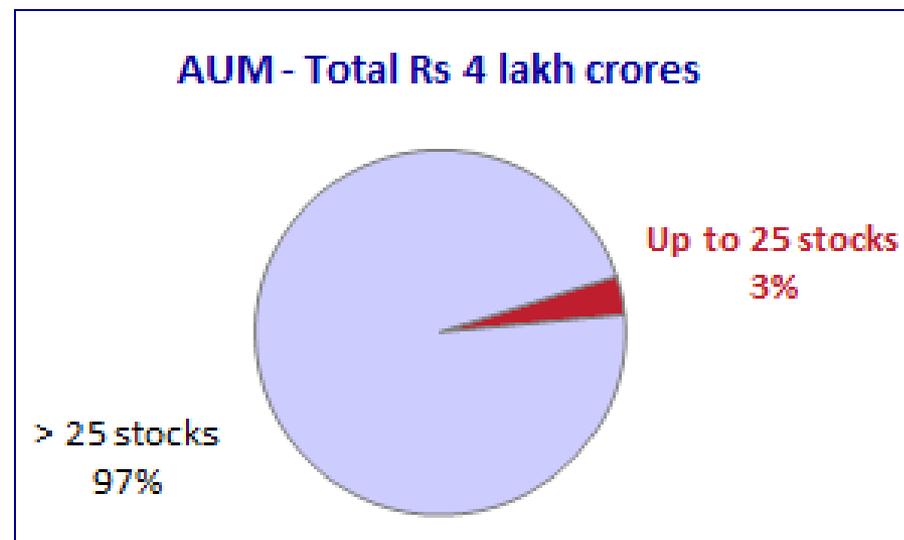
No. of stocks **10 or fewer**
Volatility **High**
Return **Exceptional**

Focused Investing – Indian scenario

36 Focused Portfolios ...



... managing Rs 14,000 crores



Source: Based on data from ICRA Online, excluding ETFs and sector funds

4 keys to successful Focused Investing

1. Clear portfolio goal
2. Superior stock selection
3. Rational allocation
4. Active monitoring

Clear portfolio goal

- A clear goal acts as a guidepost for both, stock selection and allocation
- Portfolio goal can be absolute or relative to benchmark

“We have to work extremely hard to find just a very few attractive investment situations. Such a situation by definition is one where my expectation of performance is at least 10 percentage points per annum superior to the Dow.”

– Warren Buffett, in 1966 letter to partners

“Double every 3 years!” – *Raamdeo Agrawal*

Superior stock selection

Based on time-tested investment philosophy/process e.g. QGLP

Quality of business x Quality of management

- Stable business, preferably consumer facing
- Huge business opportunity
- Sustainable competitive advantage
- Competent management team
- Healthy financials & ratios

Growth in earnings

- Volume growth
- Price growth
- Mix change
- Operating leverage
- Financial leverage



Price

- Reasonable valuation, relative to growth prospects
- High margin of safety
- Prefer stocks with PEG of around 1x

Longevity – of both Q & G

- Long-term relevance of business
- Extending competitive advantage period
- Initiatives to sustain growth for 10-15 years

Rational allocation

Suggested based on CAP (Confidence-Adjusted Payoff) –

- Rank selected stocks in descending order of expected 3 or 5-year upside
- To this upside, apply a Confidence factor range from 0 to 100%.
- For each stock, arrive at Confidence-Adjusted Payoff (CAP)
i.e. $\text{Upside} \times \text{Confidence factor}$.
- Rank the stocks in descending order of CAP
- Align the final allocation

CAP – Sample portfolio exercise

Stocks in descending order of 3-year upside & Confidence Factor

Company	3-year Upside	Confidence Factor	Rationale where Confidence factor is low
IndusInd Bank	31%	90%	
Interglobe Aviation	27%	70%	Multivariate industry
Ratnakar Bank	26%	70%	Short listed history; RoE yet to cross 15%
Bajaj Finance	26%	100%	
BPCL	25%	90%	
HDFC Bank	25%	100%	
Maruti Suzuki	23%	100%	
SBI	23%	80%	NPA situation still uncertain
HPCL	23%	90%	
Manpasand Beverages	22%	70%	Franchise yet to be fully established
Jubilant Lifesciences	22%	90%	
Eicher Motors	22%	100%	
Max Financial Services	21%	100%	
HDFC	21%	100%	
Britannia	20%	100%	
Ajanta Pharma	20%	100%	

CAP – Sample portfolio exercise

Final allocation – aligned with CAP

Company	3-year Upside	Confidence Factor	CAP	Allocation
IndusInd Bank	31%	90%	28%	9%
Bajaj Finance	26%	100%	26%	9%
HDFC Bank	25%	100%	25%	9%
Maruti Suzuki	23%	100%	23%	9%
BPCL	25%	90%	23%	9%
Eicher Motors	22%	100%	22%	6%
Max Financial Services	21%	100%	21%	6%
HDFC	21%	100%	21%	6%
HPCL	23%	90%	20%	6%
Britannia	20%	100%	20%	6%
Ajanta Pharma	20%	100%	20%	6%
Jubilant Lifesciences	22%	90%	20%	6%
Interglobe Aviation	27%	70%	19%	4%
Ratnakar Bank	26%	70%	18%	3%
SBI	23%	80%	18%	3%
Manpasand Beverages	22%	70%	16%	3%
Portfolio Total				100%

Common mistakes of allocation

- **Under-allocation**
 - risk aversion

- **Over-allocation**
 - overconfidence bias and confirmation bias

- **Over-staying with winners**
 - ownership bias

- **Over-staying with losers**
 - procrastination because of loss aversion

Active monitoring

Very important, as odds on stocks change frequently due to change in underlying fundamentals, or stock price, or both

“Monitoring helps you achieve excellence.”



In Conclusion

-
- ❑ **Stock allocation is a powerful tool for portfolio performance, but is under-researched vis-à-vis stock selection**
-
- ❑ **Kelly's formula offers 3 insights for equity investing: (1) Look for asymmetric payoff (2) Create edge (3) Bet big**
-
- ❑ **Opportunities for big bets come seldom; Focused Investing is a sound strategy to capitalize on them**
-
- ❑ **Keys to successful Focused Investing are: (1) Clear portfolio goal (2) Superior stock selection (3) Rational allocation (4) Active monitoring**
-
- ❑ **Disciplined practice should lead to exceptional returns rather than acceptable returns**
-

Wish you a successful 1,000-crore journey

with

 **FOCUSED INVESTING !**

**Wish you a successful
1,000-crore journey !**