# 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?

ORIGINAL
CA PASS !
ORIGINAL

Annual Reports

**Only mantra !**

**Price =**

**EPS**

**x**

**P/E**

# Me back then

➢ **High passion …**

➢ **… but ignorance of ignorance !**

➢ **Low skill, high luck**
   *e.g. bull run of 1992*



Sensex : Up 2.3x in 4 months
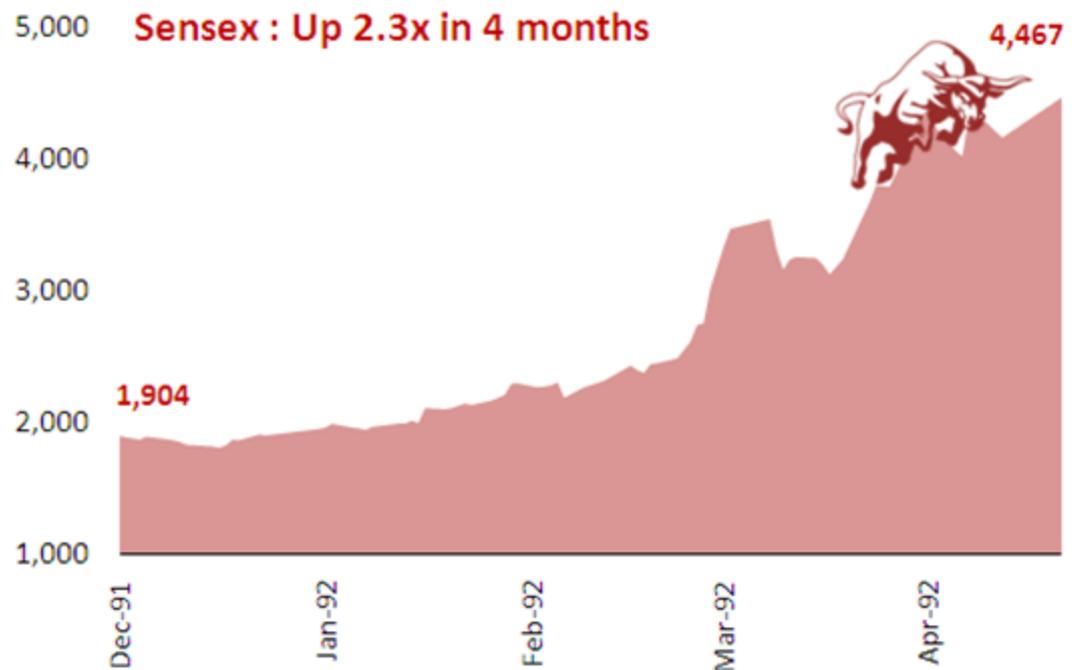
# Role of luck in equity investing
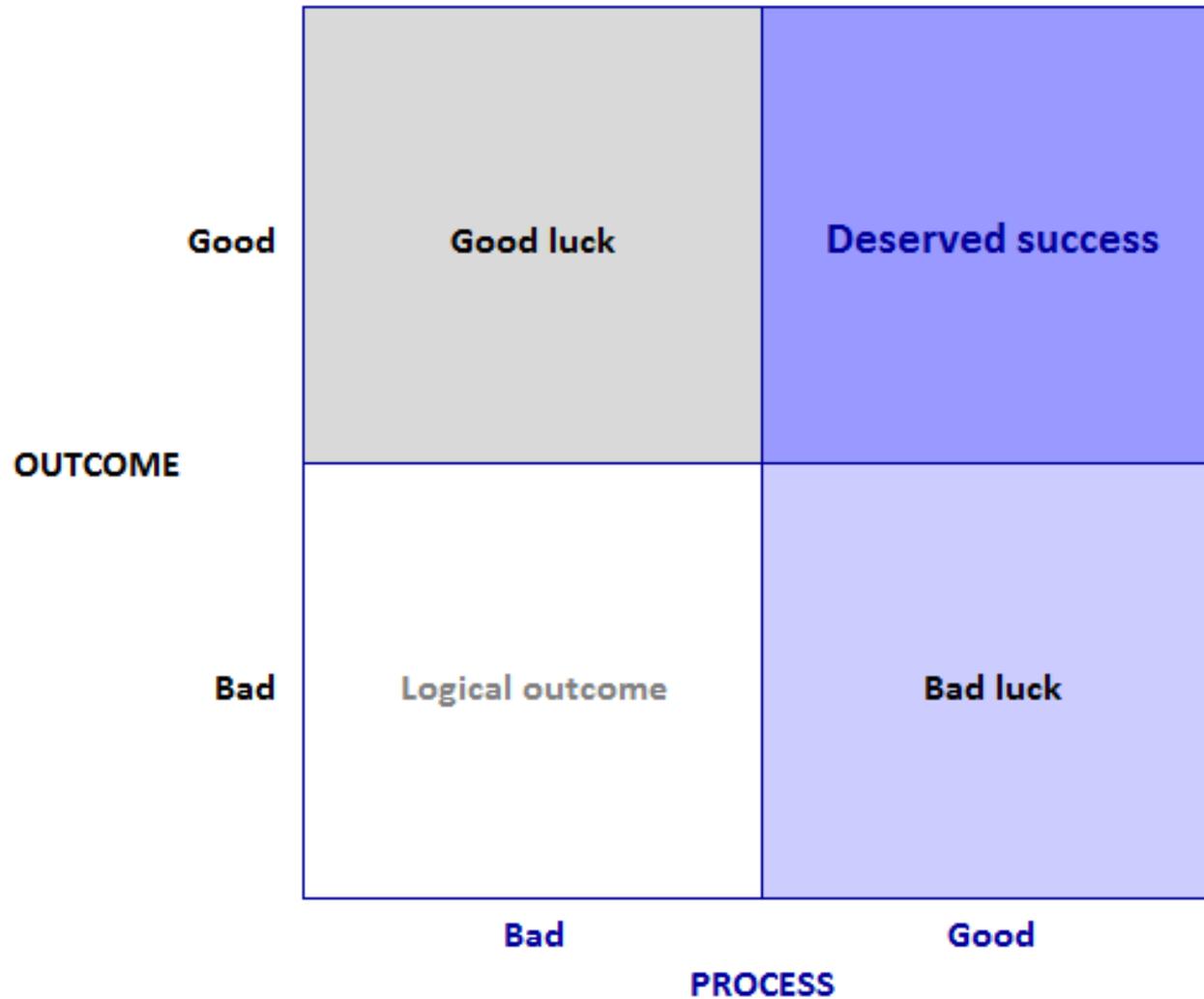
# 1994 … Found my guru

# Search for investment philosophy begins

# Back then & even now … Knowledge First !!
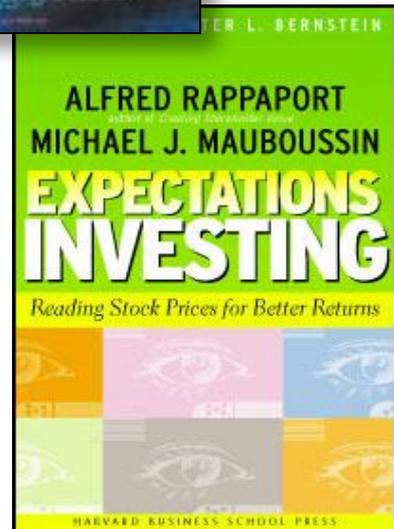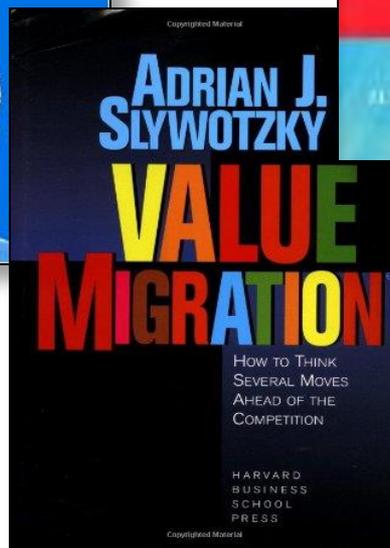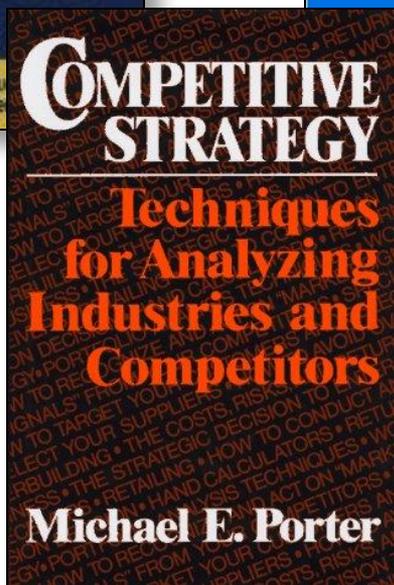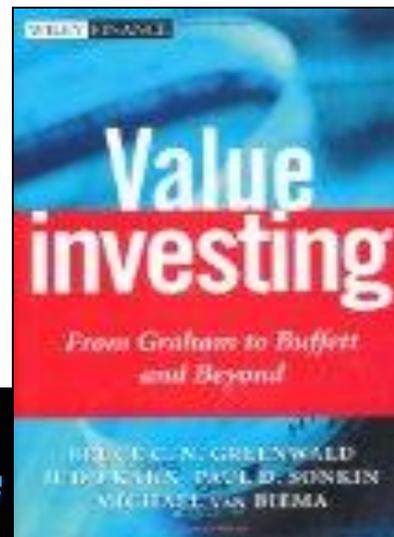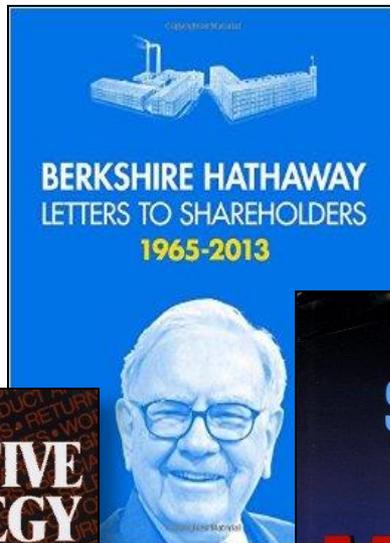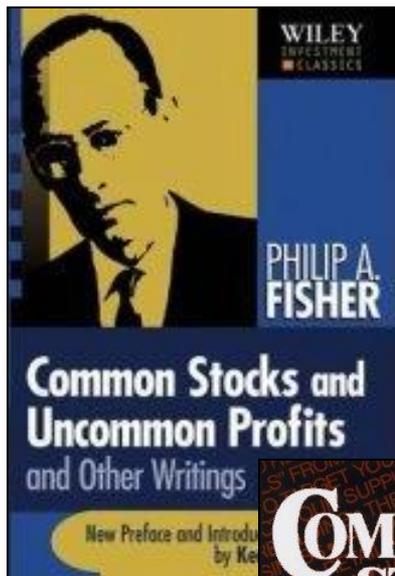
# Rich learnings from 21 Wealth Creation Studies

# 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



My Portfolio – Rs crores

(Figures in brackets are Sensex values)

| Date | Portfolio (Rs crores) | Sensex |
|------|----------------------|--------|
| Mar-87 | 0 | (510) |
| Mar-92 | 30 | (4,285) |
| Apr-93 | 10 | (1,991) |
| Feb-00 | 100 | (5,877) |
| Apr-03 | 30 | (2,924) |
| Jan-08 | 450 | (20,873) |
| Jan-09 | 225 | (8,674) |
| Mar-14 | 550 | (22,386) |
| Mar-17 | 1,300 | (29,620) |

QGLP Era
Mkt +10%
P/f +33%

Apr-93 to Mar-17 CAGR
Market +12%
Portfolio +22%

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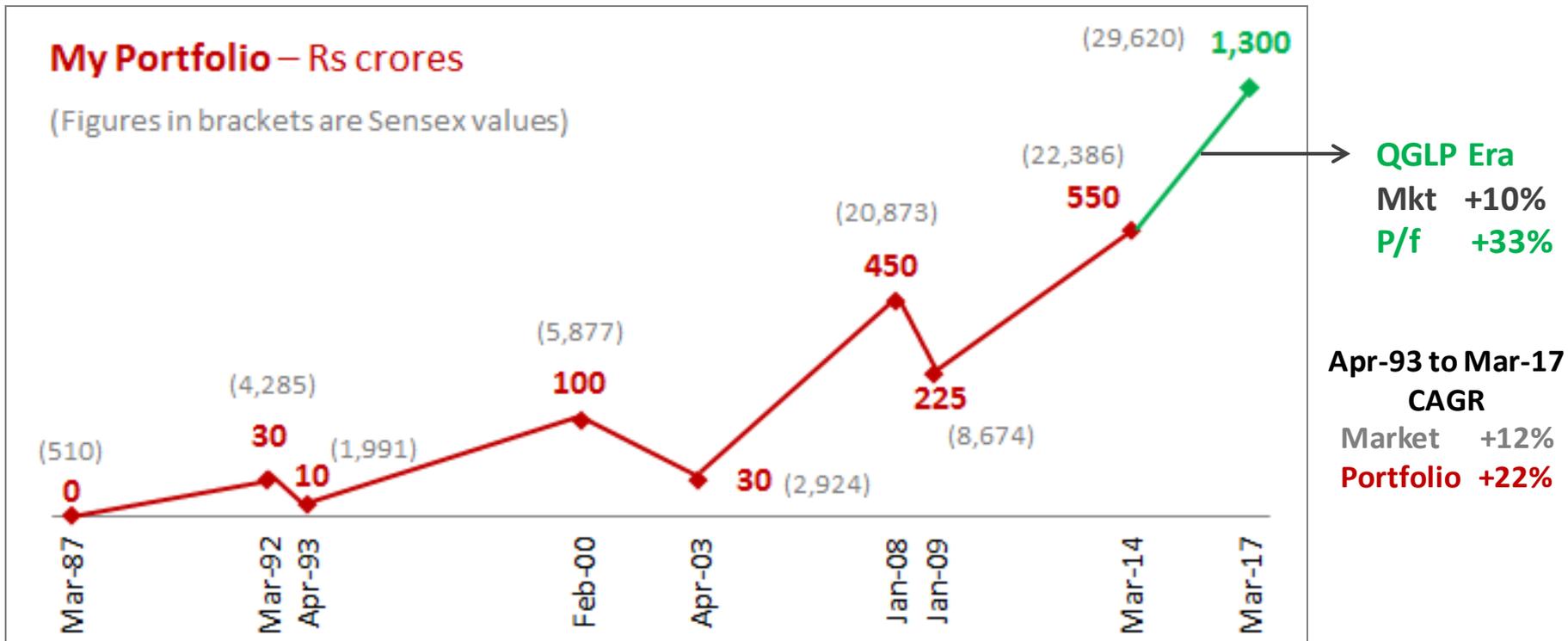
# Power of Compounding

## 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**
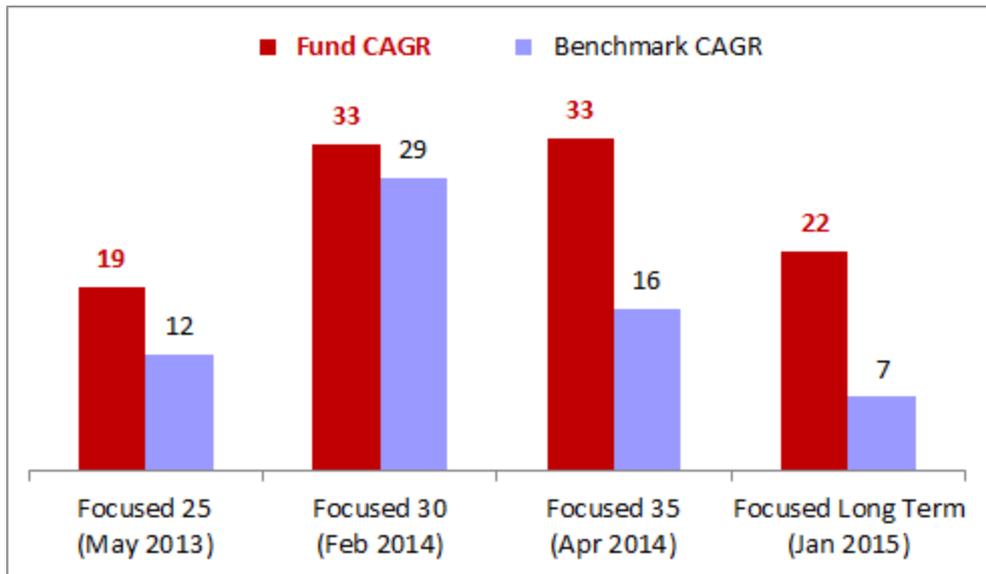


**Returns since inception: PMS**
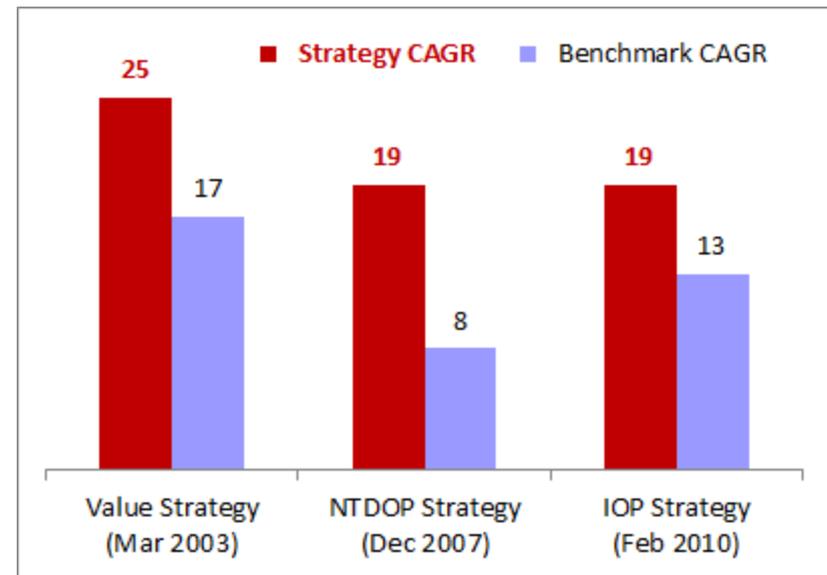


Note: Date of inception given in brackets

Data as on 9 June 2017

# Backdrop

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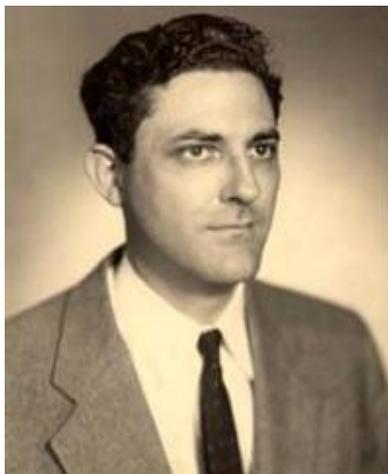
- ➢ **Scientist at Bell Labs in the 1950s**
- ➢ **Developed a formula to maximize the bankroll in gambling**

# 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 -

$$f = (2 \times 0.5 - 0.5) \div 2$$

$$= 0.5 \div 2$$

$$= 25\%$$

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

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

**Bet size** = $\dfrac{(\text{Upside x Probability of win}) - (\text{Downside x Probability of loss})}{\text{Upside}}$

**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

P U D
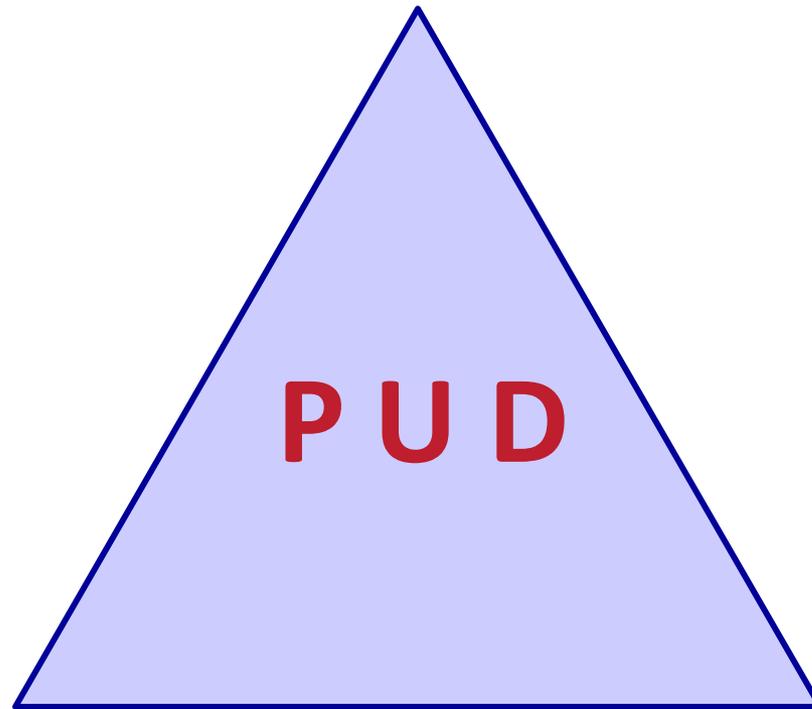
U - Upside     D - Downside

# 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%
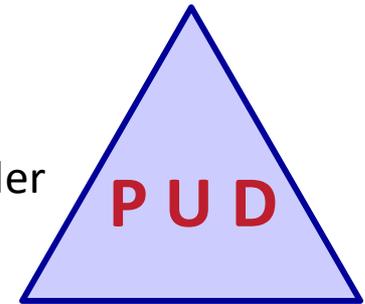
## P – High

- Terrific business with terrific management at reasonable valuation

**P - Probability of win**

**P U D**

**U - Upside**        **D - Downside**

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# 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**

P U D

**U - Upside**          **D - Downside**

27
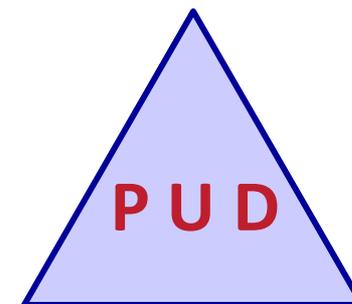
# PUD Case #2 – Bharti Airtel in 2003

## 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

**P - Probability of win**

**P U D**

**U - Upside**       **D - Downside**

28
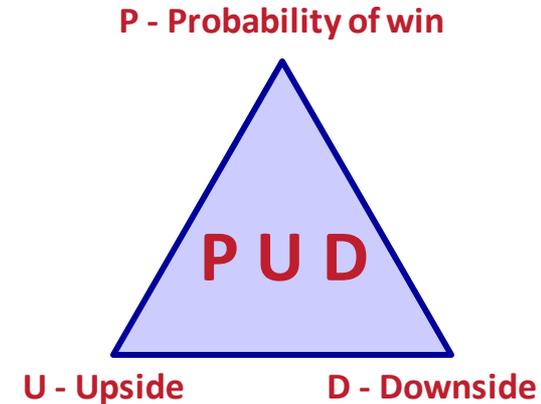
**PUD Case #2 – Bharti Airtel in 2003**

# 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**

**P U D**
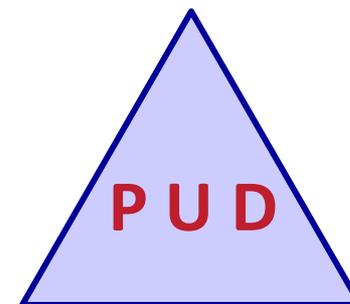
**U - Upside**  **D - Downside**

# 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

**P - Probability of win**

**P U D**

**U - Upside**          **D - Downside**
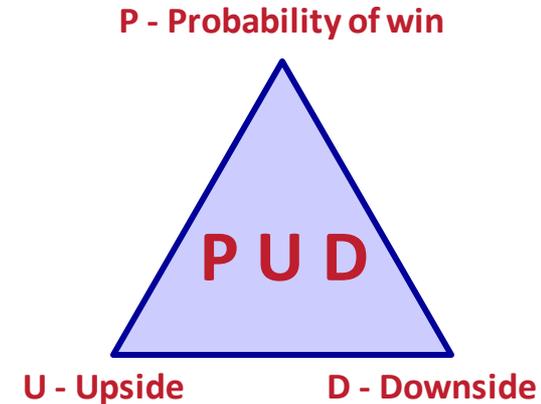
## How PUD played out

| 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%** |

**P - Probability of win**

**P U D**

**U - Upside**    **D - Downside**
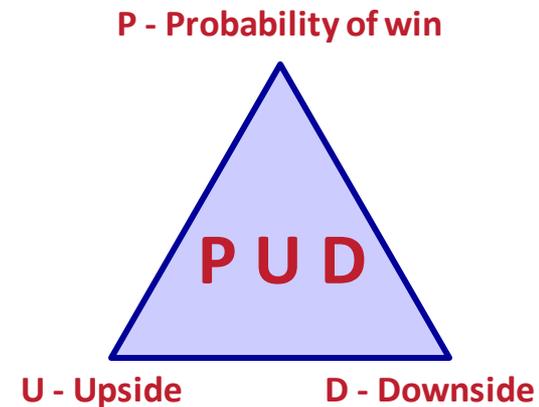
# Kelly's insight #2: Create edge

## 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



# 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

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**36 Focused Portfolios …**
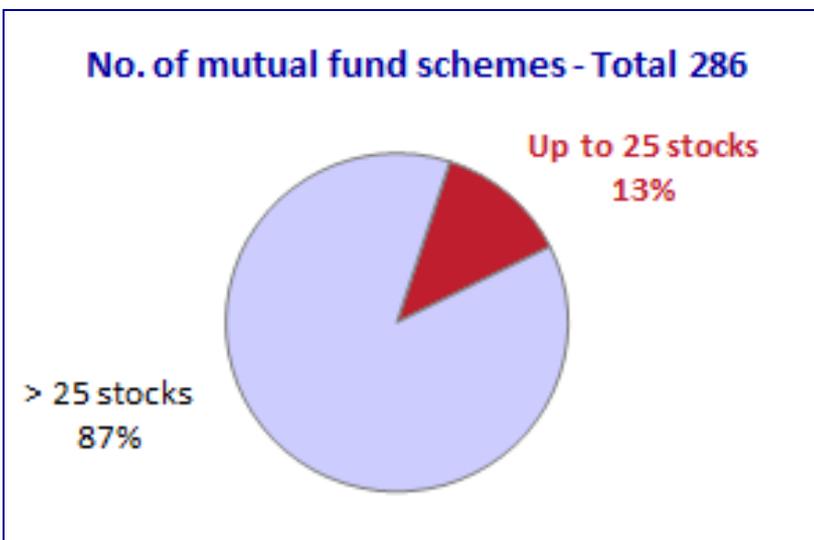
**… managing Rs 14,000 crores**

### No. of mutual fund schemes - Total 286

Up to 25 stocks
13%

> 25 stocks
87%

### AUM - Total Rs 4 lakh crores

Up to 25 stocks
3%
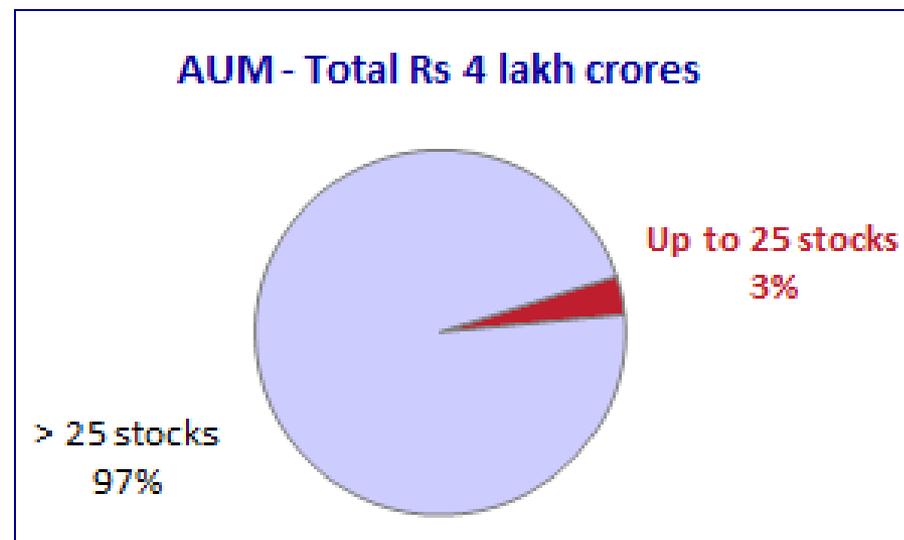
> 25 stocks
97%

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 <u>at least 10 percentage points per annum superior to the Dow</u>."**

*– 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

**QGLP**

Quality · Growth · Price · Longevity

**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. Upside x 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**

**F CUSED INVESTING !**

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