THE MONITOR

Volume 1 Issue 2 March 13, 2010

The Investor Cometh

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Who could be better to kick start FLAME Investment Lab's guest lecture series than the bull runner himself - Rakesh Jhunjhunwala. Through the session the different facets of the man behind the name became obvious. A family man at heart and a genius in spirit, he is an unopposed trend setter who is also the father of investing. An instantaneous at dialogue delivery, Jhunjhunwala unveiled the pathway that led to his intriguing portfolio.

After cognizing the available course platter at FLAME, he expressed his enthusiasm to become a student all over again - but this time as an FSLE.

His laudable oratory skills enthralled the otherwise nonchalant listeners - combining timing with effortless wit. One who swears to part with his securities only once he reaches the "bears" of his life, Rakesh Jhunjhunwala is the mystic who prophesizes investing fanaticism. Excerpts from the session:

Q) What is your view on failed IPO of Adani, NHPC & India bulls?

RJ: Failure. It is unsuccessful. Investor did not gain from it. The investor expects that they are going to gain everyday as soon as they buy an IPO. I think the construction of the whole IPO market in India is different when compared worldwide. IPO's are not made so that the investors make or lose money on the same day, but at the same time I will say that all the three IPO's are overpriced.

Adani doesn't have 1MW of power in production, a market cap of 3000 crores and while 600 crore is invested, 16000 crore is the value of its personal stake. I mean this is the fastest way of creating the destructive wealth. This wealth is not going to last. I think they did not succeed because of overvaluation.

And I don't know why people subscribed to India bulls, because if you see the kind of corporate governance they have is unbelievable but still the IPO got sold out, which I think is also aggressively valued. At the same time the attitude that just because you don't get 30% on the first day, it's does not constitute a failed IPO

Q) What would you term the recent stock market, is it market driven, fundamental driven or it is just the bubble with too much money chasing the assets?

RJ: In the Indian Sensex, if a company is going to earn say Rs 1000 or Rs 1050 next year, we have had 15 times the earnings with this type of ROE and growth which I think is a very fair valuation for an Indian company.

So I see no reason why index based on earnings be lesser than 15000 or 15500. Hence we can't say it is just a run for money or just a bear market value. We can correct from this level but we are bullish on the long run

Q): Can you give us an insight into your investment decision making process with an example

RJ: See CRISIL. My investment in it is very small as it is a small company. If you see Crisil's profit, what are they compared to the growth of India's financial sector and if you have done any research, today the financial sector is say 2.5% of India's GDP. In USA, during the peak the financial sector was 17% of USA's GDP. In the future India's GDP will grow; financial sector's GDP will grow, so the opportunity for CRISIL would go on expanding. And it's a very very sticky business, good cash flows, big entry barriers, I start buying at 150 and bought up to 350, and that time also I was getting 20 -25 times earnings which is a very good return. So thinking of growth opportunity and competitive advantage, it's a business with big entry barrier and CRISIL is a clear market leader in India. So I bought it and that's the investment decision. So based on India's GDP, growth of financial sector and stickiness of business I bought the stock

"My word is my bond"

Q) How good is it to invest in Public sector Units (PSUs)

RJ: This question is like asking how good is it to marry a Sindhi girl. The deal is always good. But beyond a point I will not invest in the public sector. No clear cut strategy. It changes with every minister changes with and with every chairman. I will invest in PSU's only when it is extremely cheap. And I don't find it cheap. At the moment I am not bullish on investing in PSUs. In 2001-02 they were all available at 5-7% of their current prices. SAIL was available at Rs 6

Q) Has there been a change in your investment philosophy? Is it because of global factor or something else?

RJ: I am too young to have a philosophy. I am still learning, so I would say I have a methodology. Philosophy will take time to develop. And I hope I live long enough to have a philosophy. I don't think that the international trend has changed my methodology as an investor because the true manner of investing is not going to change.

Q) Who/What is your best teacher in life?

RJ: Rather than naming principles it is the attitude which has taught me. Go with an open mind and you will learn - learn to admit a mistake, learn from a mistake. Time has humbled me; it has taught me that I can be wrong. What teaches you is your quest to learn, your quest to accept that things are changing and that your opinions can be wrong.

Q) Your do's and don'ts of investing.

RJ: The first don't is obviously never to invest your father-in-law's money or your father's money. Or take it at a cost. Nothing in life which is granted free is ever valued. Always remember it's a process. Don't bet everything on the 1st day. It is a slow process. Provide for the unknown.

Do's would be that you should always respect the market. Don't say that market is bad and doesn't perform. If you don't accept the market is supreme you will never admit that you are wrong and if you don't admit you are wrong you will never ever learn. Be an independent thinker. Don't necessarily think like the crowd. Don't necessarily think different. Get experience and trade for some time. Make a budget of Rs 50,000 and trade because it gives you the experience of the market. Trading is not bad. *Paisa se paisa bahut jan bana sakte hain, bina paisa se paisa banana is done in trading*(money can always be made from money, but if money is to be made without much investment, do trading). In trading return on capital can be 5000%.

Telecom Sector

Hiren Sheth
www.trai.com

The players in telecom services can be classified into three broad categories: State owned (BSNL, MTNL and VSNL); Private Indian owned companies (Reliance Infocom, Tata Teleservices) and foreign invested companies (Vodafone, Idea, BPL, Airtel, Spice Communications).

The regulator has played a vital role in the development of the Indian telecom market. Hence an understanding of the regulatory framework prevailing in the sector is imperative. The Telecom Regulatory Authority of India (TRAI) regulates telecommunications business in India - some of the functions being fixing or revision of tariffs, introducing new service providers and revocation of license for non-compliance of terms and conditions. The Telecom Dispute Settlement and Appellate Tribunal (TDSAT) were constituted for resolution of disputes in this sector; namely disputes between two or more service providers or between a licensor and a licensee. Department of Telecommunications (DOT) frames policies on matters relating to telegraphs, telephones, wireless, data, facsimile and telemetric services and other like forms of communications.

Sector Analysis

The sector has been analysed in terms of competitive intensity using the Porter's 5 forces as follows:

Rivalry amongst Competitors: Airtel, Reliance, Vodafone, BSNL, Idea, Tata Indicom, Aircel are the major competitors in India. Airtel constituted 24% of the market, Reliance 19%, Vodafone 18%, BSNL/MTNL 12%, Idea 11%, Tata 10%, Aircel 6% and other players 1% as of 30th September 2009. There is intense competition amongst these players as witnessed in the recent tariff wars.

Bargaining Power of Buyers: Now there are several service options being offered. This will lead to more switchers than loyal customers. Number portability will add fuel to this force.

Bargaining Power of Suppliers: Handset suppliers (Nokia, Motorola, Samsung, LG) having collaboration with CDMA service providers (Reliance, Tata Indicom) have strong bargaining power. Software solution providers like TCS, WIPRO, and Infosys have strong bargaining power on telecom companies which do not have their in house software assistance and solutions. Some other suppliers for this industry can be optical fiber suppliers, though the bargaining power is limited

Threat from New Entrants: There are unprecedented opportunities for companies in areas like 3G, Virtual Private Network, International Long Distance Calls and Value Added Service making the playing field open to new entrants.

Threat of Substitute Products: Internet phone call availability, Free SMS facility from the internet by portals like www.way2sms.com and www.160by2.com could become

Service Categories

The services provided by telecom operators can be categorized into core services and non-core services. Core services include Mobile services (using GSM or CDMA), Wireless services, Internet, Tele media Services comprising of broadband (Digital Subscriber Line) data and telephone services (fixed line), Enterprise Services providing communication services to large Enterprise and Carrier customers and Digital TV. Non-core service or value added service include voice mail services, Video text services and Audio text services

Based on the services offered, the telecom subscriber base can be classified into subscribers using broad-band connections, wireless subscribers, mobile subscribers, internet subscribers and telephone subscribers (fixed line).The wireless technologies currently in use are GSM (Global System for Mobile Communications) and CDMA(Code Division Multiple Access). GSM accounts for 75% share of subscriber base and even Reliance and Tata which were originally CDMA players have launched or are in the process of launching GSM services.

The growth drivers for the telecom sector include mobile telephony, tapping the rural market, opening up of international and domestic long distance telephony services, reduced custom duties and change in regulations.

With the introduction of mobile phones the country was divided into circles. Hence a telecom circle is a cellular mobile service area in India classified by subscriber base and revenue potential. The four types of telecom circles are Metro, A, B and C. While a Metro telecom circle has the highest revenue potential, the C telecom circle has the lowest revenue potential and subscriber base.

As per TRAI, the total subscriber base for all telephony services in India has reached 525.65 million at end of October 09 recording a 3.26% growth compared to October 2008. The overall teledensity is recorded at 44.87% as of 31st October 2009(The progress of the telecom sector is measured by a parameter indicating the subscribers using the telecommunication services known as teledensity which means the number of telephone units for every 100 individuals living in that area).

Metro	Delhi, Mumbai, Kolkata, Chennai
A	Maharashtra & Goa, Gujarat, Andhra Pradesh, Karnataka, Tamil Nadu
B	Kerala & Lakshadweep, Punjab, Haryana, Uttar Pradesh (E) , Uttar Pradesh (W), Rajasthan, Madhya Pradesh & Chhattisgarh West Bengal , Sikkim
C	Himachal Pradesh, Bihar & Jharkhand, Orissa, Assam, Jammu & Kashmir, Arunachal Pradesh, Meghalaya , Northeast

There are immense opportunities in the telecom sector in terms of expansion of broadband penetration since the current broadband penetration is 0.25% due to low fixed line penetration of 3.5%.Value added services like M-Commerce, M-Marketing, Special Information and Ring tones are potential avenues to exploit. On an average value added services account for approx. 10% of revenues. Evolution of latest technology like New Generation Network (NGN) and Worldwide Interoperability for Microwave Access (WiMAX) add leading edge to the telecom business. NGN services will be based on Internet Protocol which is accepted as standard for global data networking and is used to support real time services such as voice. In case of NGN all the services will be based on entire networks. Voice, data and multimedia will be treated as a package over the IP network and different services will be available with different QoS (quality of services) or CoS (cost of services). WiMAX is a type of wireless technology that provides internet service over longer distances than standard Wi-Fi. It supports mobile and fixed wireless applications.

The challenges facing the sector are reduction in ARPU's (Average Revenue per User) due to increasing number of players in each circle. The other challenge is delay in spectrum auction resulting in higher cost incurred by operators to cover larger areas. The delay is believed to be due to the defense ministry having reservations on security. Absence of infrastructure readiness in rural areas i.e. less number of towers as compared to the cities leading to lesser broad band connections is yet another challenge which can be turned into an opportunity by telecom players.

The future prospect of the sector suggests that consolidation is inevitable since the industry is over-capacity with new entrants crowding the market. Current expected mobile penetration is 33%. The future mobile penetration is expected to rise to 57% by March 2012. The amount spent on communication is expected to be 3% in 2015 and 6% in 2025 up from 2% in 2005.

India 2020: A Recap

Monitor Correspondents

The "India 2020 Stars" Conference organized by ENAM (Nov 16th – Nov 17th) was an unforgettable encounter with the veteran professionals of India Inc, representing around 60% of India's market cap. The conference witnessed participation of more than 150 fund managers. Some of the eminent personalities who participated in this event included Kumar Mangalam Birla, Keki Mistry, Anil Ambani, Chanda Kochhar, Kishore Biyani among many others. In this midst was our very own FIL selected team of 5 – Bharti Rohra, Vishal Mehta, Aalisha Seth, Monil Nisar and Keval Shah. Besides being blown away by some of the powerful presentations, the team also managed to take down some pointers for our readers on what to expect in the new year.

On Banking

Ms Chanda Kochhar, Chief Excecutive – ICICI Bank Ltd feels infrastructure, telecom and healthcare will be among the top growth sectors for the economy in 2010. India's expected three-year investment of about USD 250 bn for industrial and infrastructure development will be a growth multiplier resulting in an annual credit growth of 18%. Mr Keki Mistry of HDFC believes India has the potential for growth in mortgages, since the GDP to mortgage ratio in India is only 7% as compared to her Asian peers – China (12%), Thailand (17%). Demographics of the Indian population (60% are below 30 yrs of age; average age of a borrower being 35yrs), the rising rate of urbanization(28%) and rise in purchasing power in the hands of the people is expected to result in 20-25% rise in housing loans in the next 5 yrs.

On Energy

Renewable Energy is one of the fastest growing sectors in India. Increasing population, increasing per capital consumption of energy, global warming and climate change leads to more need of renewable energy in the country. Suzlon after its REpower acquisition has now become the second largest wind turbine manufacturer in the world. Through increasing its production capacity and operating efficiency, the company has reduced its total project cost. Mr Tulsi Tanti of Suzlon feels that Asia is a big potential market for renewable energy. According to him this is due to the high unmet demand in the country.

On Retail

Affected by the economic downturn, the Retail sector post 2009 is expected to stay anchored through adopting a conservative approach. Pantaloon Retail (India) Limited, is India's leading retailer that operates multiple retail formats in the value, lifestyle and home segment of the Indian consumer market. The economic downturn has enabled PRIL to restructure its balance sheet. The company is partnering with vendors to reduce inventory and negotiating with transport operators to keep logistics costs in check. It intends to continue to stick to six large formats — Pantaloons, Big Bazaar, Food Bazaar, Central, Home Town and eZone — while integrating several of its smaller formats into the larger ones.

Kishore Biyani, through his consumer oriented methodology, is looking at discovering the latent potential in the highly unpenetrated retail sector. He emphasized modern retail formats to be the key to capitalize on market opportunities and establishing consumer patronage. The organized retail segment is 4-5% leaving a lot of room for improvement.

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Shariah Compliant Investments

Tushanka Nair

Social responsibility and ethical practices are corporate mantras and now catch phrases for investors. Investors are now more aware about corporate governance issues and the social responsibilities of businesses. Interestingly this awareness is slowly enveloping an investors investment decisions. It comes as no surprise then that the world has witnessed a growing interest in socially responsible investments and one such practise that is gaining momentum is the Shariah compliant investments (SCI). India too has seen, in recent years, a number of investment trusts and mutual funds that are Shariah compliant. A report by PWC indicated that the SCI's are growing at nearly 20% a year and the equity fund assets alone are forecasted to jump from $15bn in 2008 to $53bn by 2010.

Shariah (*Islamic Law*) is defined as a as a body of divine laws, rules, code of conduct and teachings which are intended to benefit the individual and society. Shariah-compliant funds on the other hand are investment vehicles which are fully compliant with the principles of Shariah law. The underlining objective of Shariah is the happiness and well being of human beings and achieving this with an equitable balance between wealth creation and consumption.

A Shariah-compliant company must therefore meet certain criteria based on qualitative and quantitative parameters. The qualitative parameters are used to ensure that these companies are not engaging in any of the following activities: Financial services based on Riba (usury), Gharar (conventional insurance), and Maisir (gambling), production or trade of non-halal (prohibited) goods, such as alcohol and pork. With many companies having a diversified array of businesses it becomes difficult to find companies who don't engage in any of these activities. Hence additional criteria are looked into in the case of companies engaging in a mix of activities. First, the public perception of the company is looked into, which ought to be meritorious. Second, the core activity into which the company is engaged must be in public interest, with prohibited elements forming a negligible part of their activity.

The quantitative parameters on the other hand ensure that the non halal (prohibited) activities of the company do not exceed the permissible limit. For example the total debt to total assets ratio should not exceed 33%, the account receivable to total asset ratio should not exceed 45%, and the non-operating interest income to revenue should not exceed 5%. Companies who engage in a considerable amount of non-halal activity can purify their profit by donating a percentage of their income to a charitable organisation, before the distribution of dividends to shareholders.

A question that is frequently asked with regard to SCI's is whether these funds outperform regular conventional funds? This question has faced a lot of conflict and there is no one clear answer to the same. Studies by Margolis & Walsh as well as an award winning paper by Orlitzky et al suggested that there was a positive relationship between a company's social and financial performance. Conversely Geczy et. al (2005), was of the opinion that SCI portfolios underperformed by as much as 3.6% per year. A study conducted by Hakim and Rashidian (2002) on the comparison between the performance of the Dow Jones Islamic Market Index (DJIMI), with Wilshire 5000 Index using data for period 10/12/1999 - 9/4/2002 revealed that on a risk-return basis, there is no loss from the screening process used for DJIMI stocks.

With growing concerns relating to the environment world over as well as the pressing need for the corporate sector to engage in socially responsible projects it may not be too long before the Indian stock market also benchmarks companies on some socially responsive criteria in the lines of Shariah compliant investments. This perhaps would be a third strand for investment analysts who are currently armed with the fundamental and technical analysis to assess the risk–returns of an investment portfolio.

On Display: Arnold Van Den Berg

Vikas Menon

Pic: centman.com

Arnold Van Den Berg is not new to overcoming odds. Living in Nazi occupied Holland, just a few streets away from Anne Frank, Van Den Berg survived when he was smuggled out of the country with his older brother into an orphanage. His parents - who survived Auschwitz, took their children to America, eventually settling in East Los Angeles. Several years of malnutrition at the orphanage had made young Arnold an easy target in a neighbourhood where weak and skinny kids didn't usually survive(He was barely able to walk at age 6)

Determined to change the odds in his favour, he decided to focus all his attention on rope climbing, so as to overcome his physical shortcomings. He took to this sport with such enthusiasm and commitment that he set up a record in this event – climbing 20 feet in 3.5 seconds – a record which lasted till the event was discontinued (about 15 years later).

After completing his high school, Arnold became a salesman at John Hancock Life Insurance Company which specialized in mutual funds. In the downturn of 1969-70, the funds performed poorly and in order to understand why, Arnold came across *The Intelligent Investor* and soon became an avid reader of Ben Graham and a dedicated student of security analysis.

He had already decided he wanted to manage money. But being new to the field and lacking any kind of credentials, he was greeted with closed doors and brick walls – until it was suggested to him that he apply the same commitment that he had applied to rope climbing some 20 years earlier. Then and there, Arnold Van Den Berg made the commitment that, however long it might take; he would begin his own advisory firm. He converted his one room studio apartment into a research office, in the process replacing everything except his bed and his books and worked as a stockbroker for Capital Securities in Los Angeles till 1974.

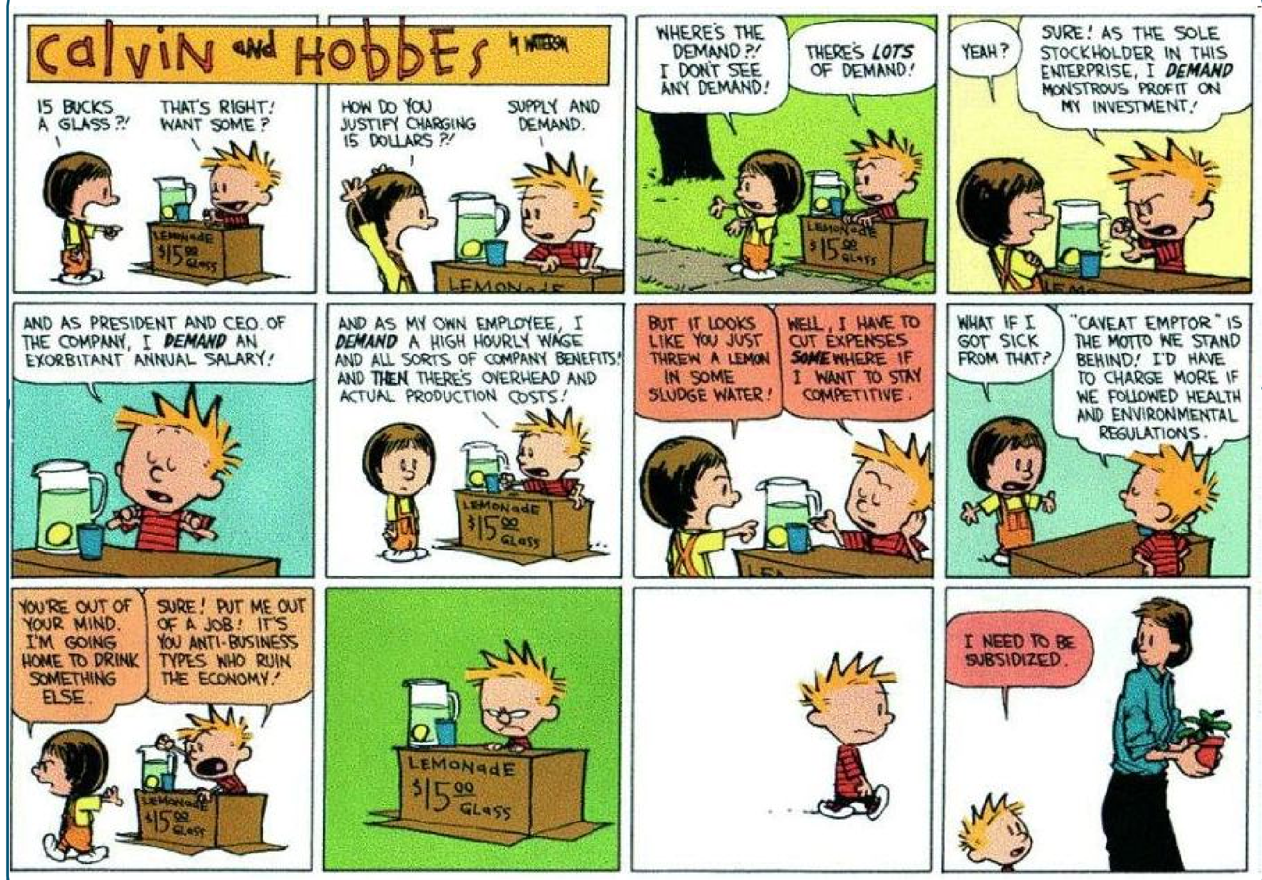
Fast forward 35 years and Arnold Van Den Berg, 64, is the head of Austin, Texas based Century Management. His practice as a value investor has been extremely successful. For starters, he has racked up a 33 year record of average annual compounded gain of 14.88%, compared with 13.88% for the S&P's 500 stock index. The fund manager has also found a way to attract $1.75 billion in assets – mostly from individuals. Heeding what Ben Graham preached, Van Den Berg buys stocks at a 40% to 65% discount to what the he thinks is the company's current intrinsic value. This is his margin of safety. He usually holds 35-40 companies when fully invested, and invests primarily in U.S. headquartered companies.

Currently, more than half his portfolio is invested in blue chip companies. Till recently, roughly two thirds of his investments were in smaller companies, but thanks to the market decline, many of the large cap-stocks reached the price level that warrants his investment. Van Den Berg also has an interesting selling strategy. Once a stock passes fair value, normally he averages out, or sells in stages, as price continues to increase to his maximum sell target. As of September 2009, the average portfolio under his management had 23.46% in cash, up from 19% in June 2009. Since the market has gone up since then, one can be certain that cash is taking a larger portion of the portfolios under his management.

This approach, according to him, is working out well. He says, "The reason we're having cash now is not because we've gotten more conservative; the market has just gotten more and more overvalued. As the market goes higher and higher, we keep selling, but we can't find replacements." He makes it clear to his clients that he won't allot the cash unless he finds good opportunities, and claims this is the time when he and his staff are working harder than ever. He adds, "We are very desperate to find values, and so we're doing everything we can to make sure that when a value comes in, we don't miss it."

Van der Berg's top holdings include Microsoft (8.75%), Walmart (5.01%), Coca-Cola (5.01%), Colgate Palmolive (4.76%), UnitedHealth Group (4.29%).

For a long time, Van Den Berg had to find little jewel among the small and mid-cap stocks. The market decline offered him opportunity to buy into large cap companies at discount. As of now, he is easing out these positions and accumulating cash.



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On Insurance

India's Life Insurance Council projects Indianlife insurance industry to grow by 15% for the financial year ending March 2010. According to the Council, recent proposal to eliminate commission loads on all insurance products by 2011 will impede the growth of insurance sector. Competition has caused a reduction in agent commission as a % of premium from 12% in 1999 to 6% being charged now.

Insurance sector is expected to be a $70 billion industry by 2020 from the present valuation of $41 billion. There is tremendous potential to grow due to factors like market under-penetration, high savings rate, increased income levels and increasing population. Since the penetration level is only 4% there is lot of scope for new entrants to join the industry provided they have a strong distribution network which plays a key role in this sector. The pending proposal to increase the Foreign Direct Investment limit in insurance sector to 49% when passed as a regulation will give a boost to life insurance sector in terms of more foreign capital invested in the sector.

On Metals

The potential for increase in metal consumption is apparent in India from the relation between growing GDP trends of developed countries and their per capita metal consumption. Vedanta is structurally a low cost producer due to the ownership of world class assets, resources having enduring life base and integrated business model leading to sustainability and benefits for the company. Vedanta has features like low project operating cost, access to quality assets, strong balance sheet (Cash $7bn) and access to capital markets which contribute to success of the organization.

Recently ventured in commercial energy production, it plans to capitalize on India's power deficit of around 15%. A trait which benefits the organization is volume driven growth rather than growth driven by commodity prices.