



**My journey: 0 to 1,000 crores**

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**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?

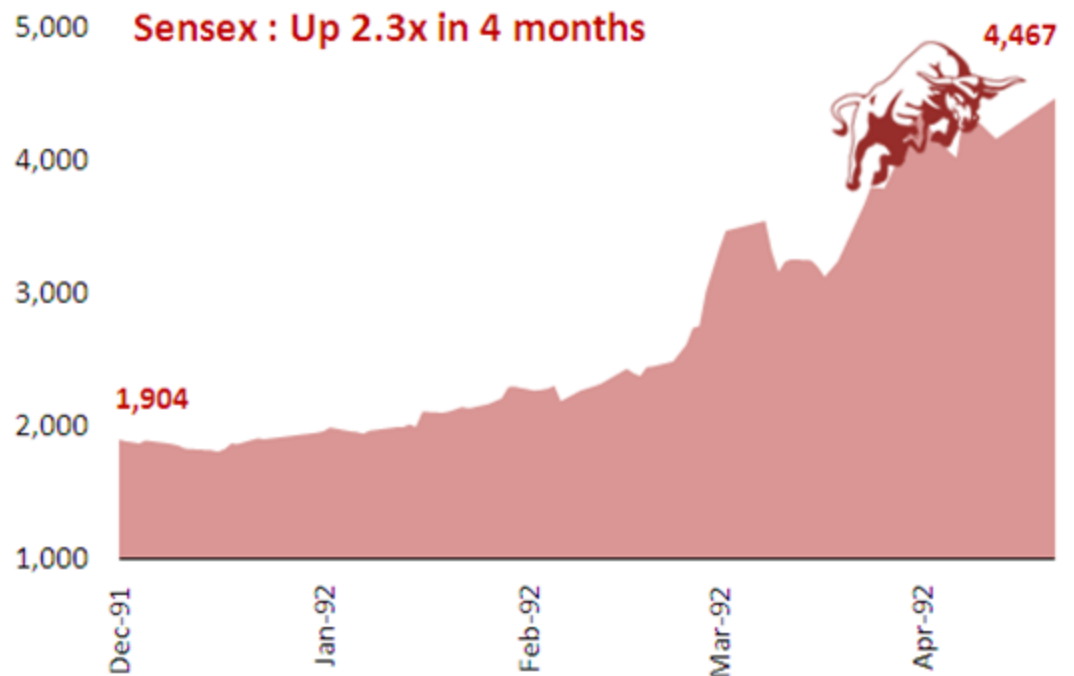


Only mantra !

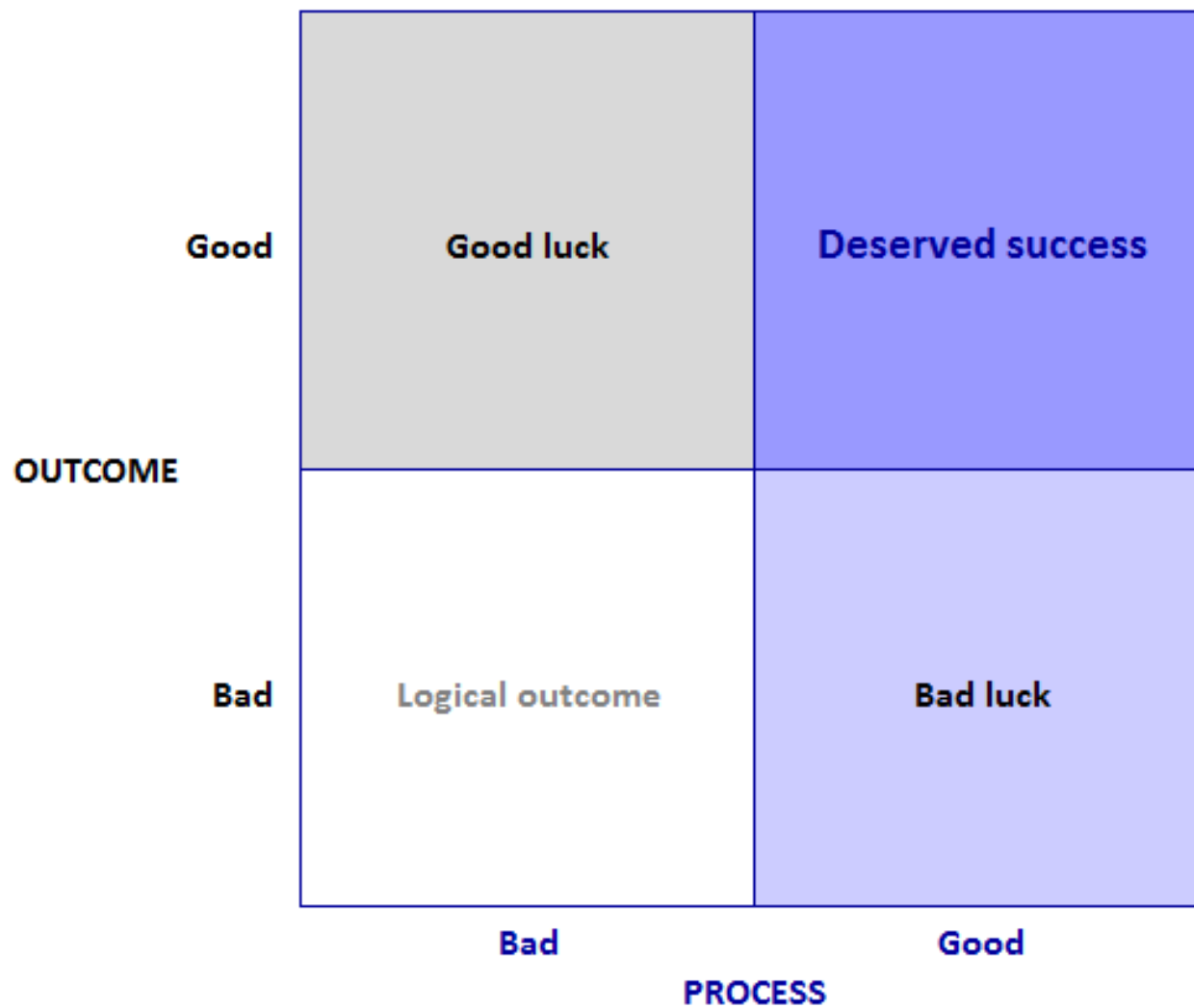
$$\text{Price} = \text{EPS} \times \text{P/E}$$

# 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

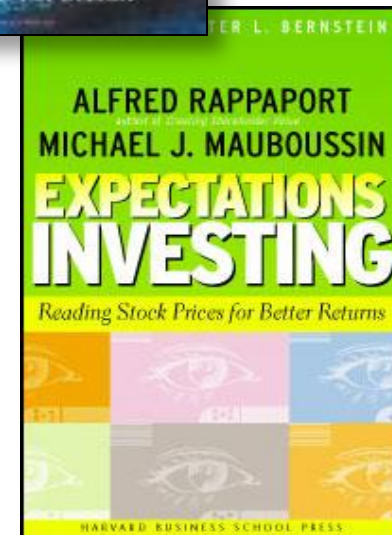
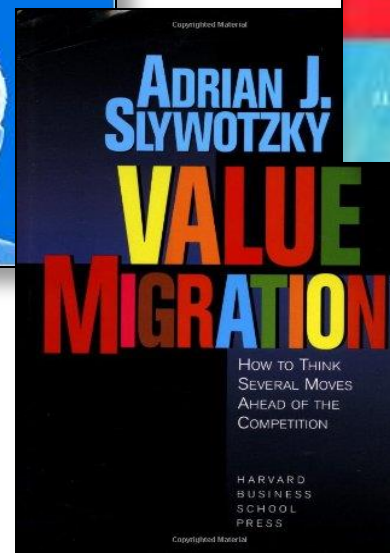
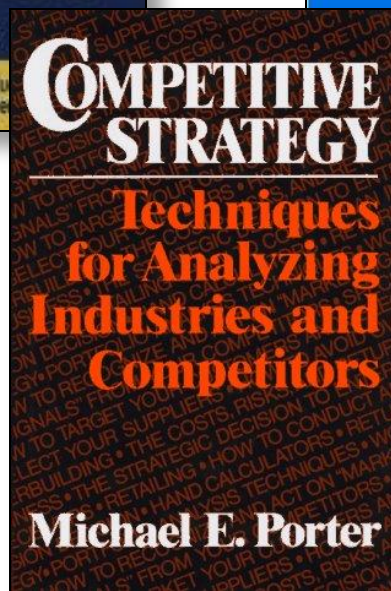
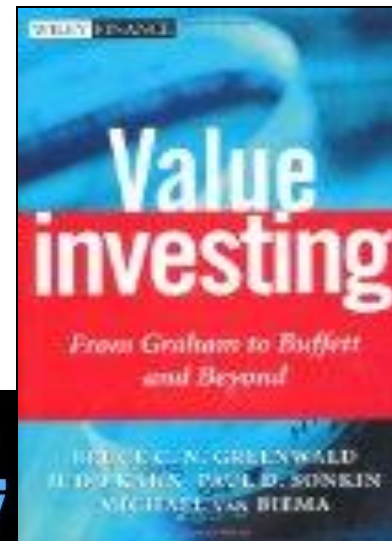
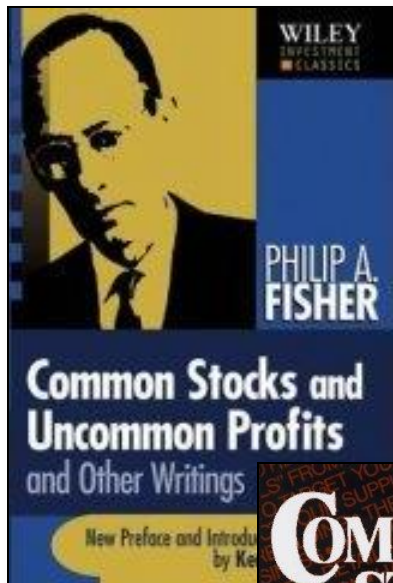


# 1994 ... Found my guru



# Search for investment philosophy begins

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







# **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

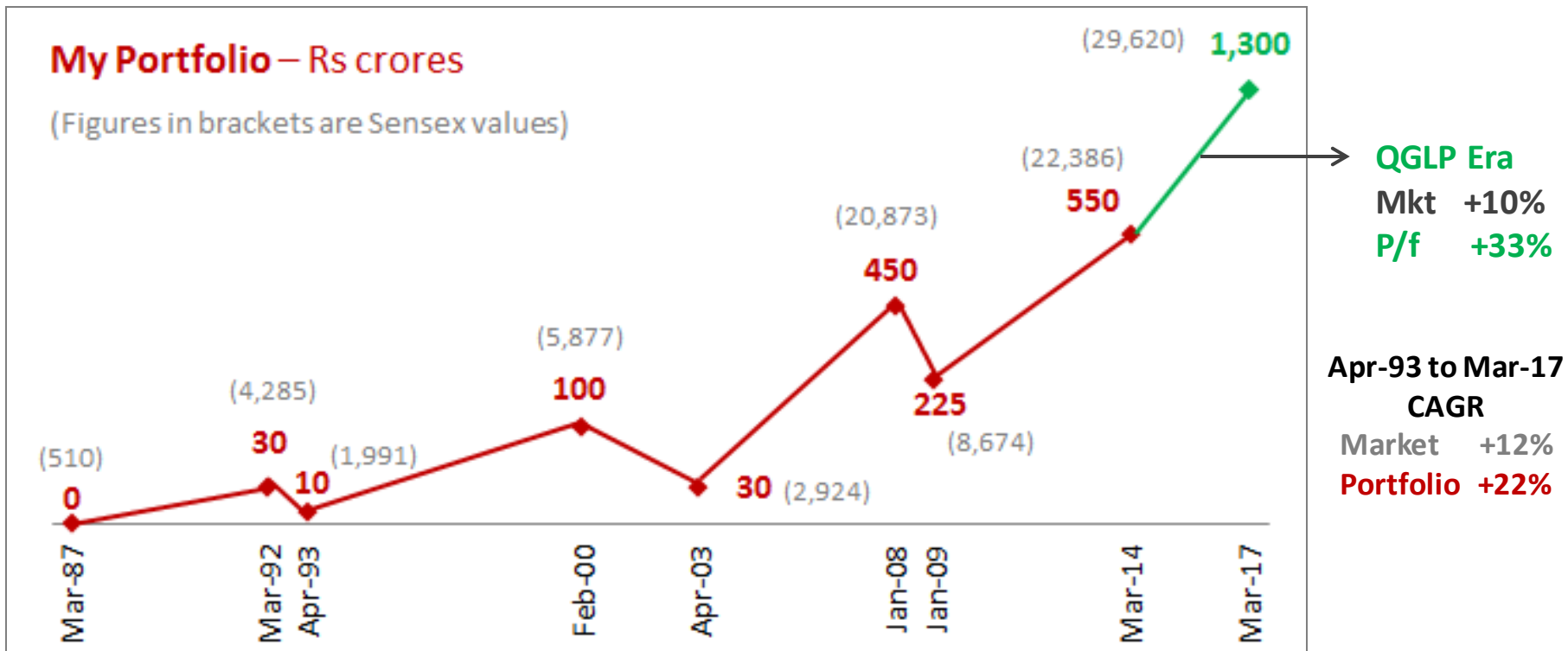
- Reasonable valuation, relative to growth prospects
- High margin of safety
- Prefer stocks with PEG of around 1x

## 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	<b>1,026</b>
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 !

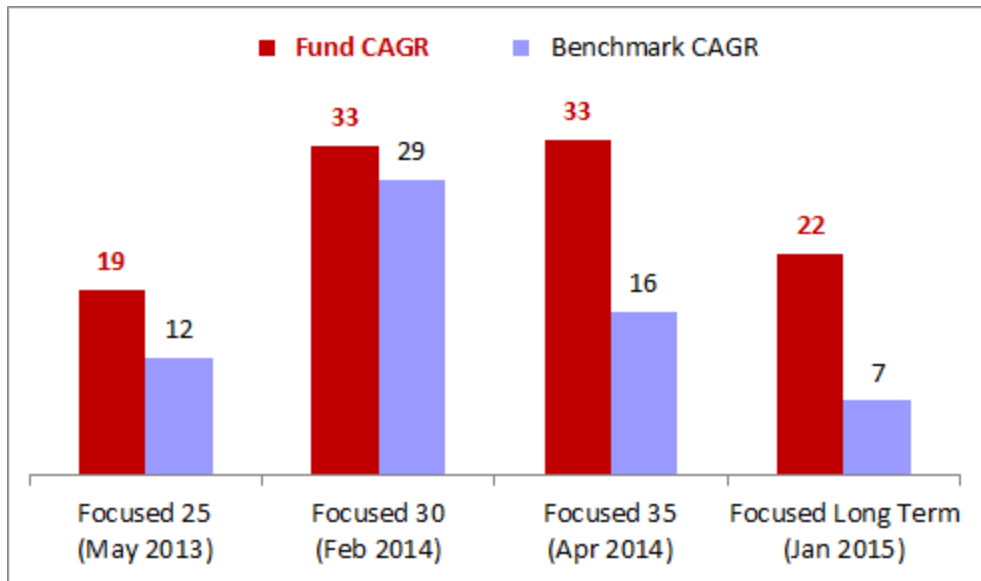
- **Think big, think positive**
- **Understand power of compounding**
- **Don't bother about the market**  
*(any case, markets don't move in a straight line)*
- **Pre-requisites – *Philosophy, Inquisitive Mind***
- **Practice – *Vision, Courage, Patience***
- **Monitor portfolio performance**
- **Continuously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

# MOAMC's Rs 25,000 crore journey

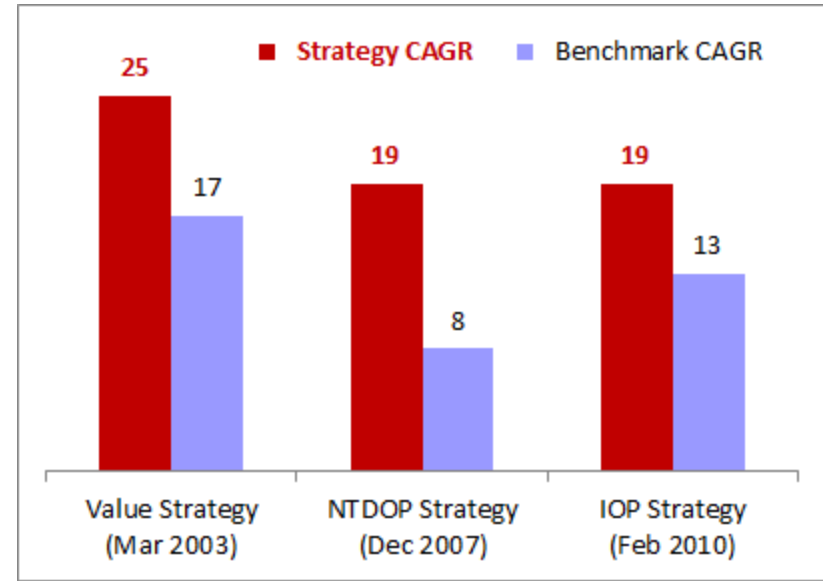


- **P#1 Philosophy** – “Buy Right, Sit Tight”
- **P#2 Process** – QGLP
- **P#3 Performance** – Healthy alpha across products

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%
<b>Portfolio Total</b>		<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Portfolio Return</b>		<b>5.0%</b>	<b>18.5%</b>	<b>-8.5%</b>

# 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

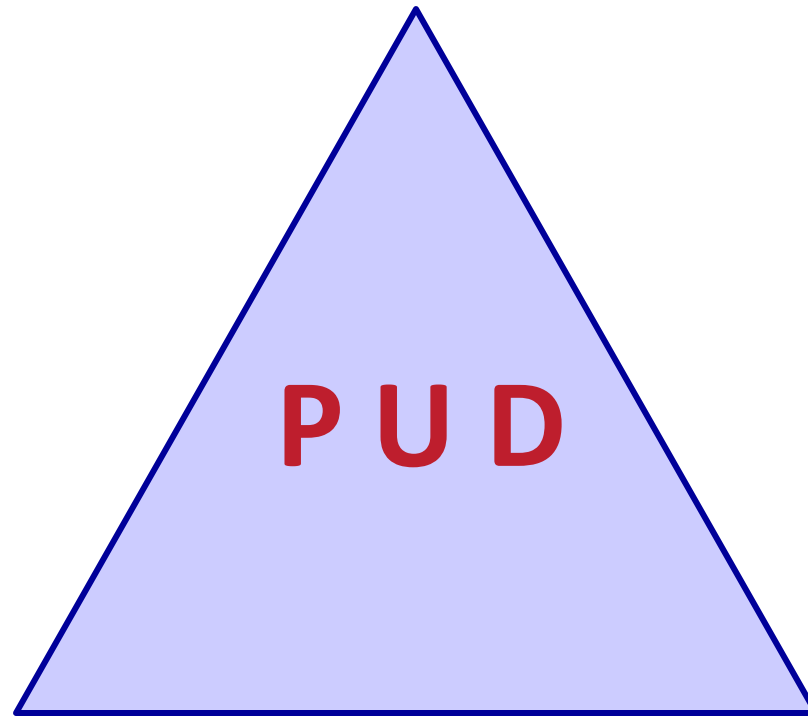
#2 : Create edge i.e. high probability of win

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



# PUD – A sound approach for equity analysis

**P - Probability of win**



**U - Upside**

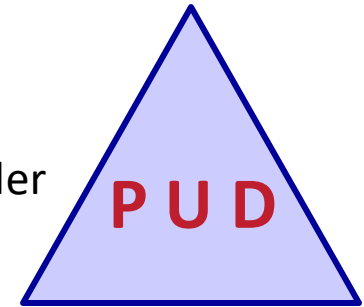
**D - Downside**

# 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

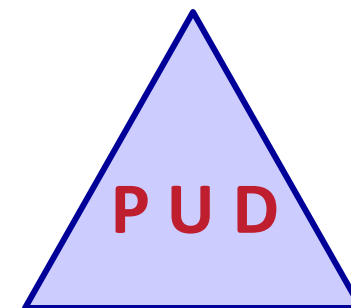
- Terrific business with terrific management at reasonable valuation

## 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%
<b>PAT</b>	<b>19</b>	<b>187</b>	<b>57%</b>
Mkt Cap	450	3,874	54%
P/E	23	21	
<b>Price</b>	<b>23</b>	<b>194</b>	<b>53%</b>

P - Probability of win



U - Upside

D - Downside

## PUD Case #2 – Bharti Airtel in 2003

### U – High

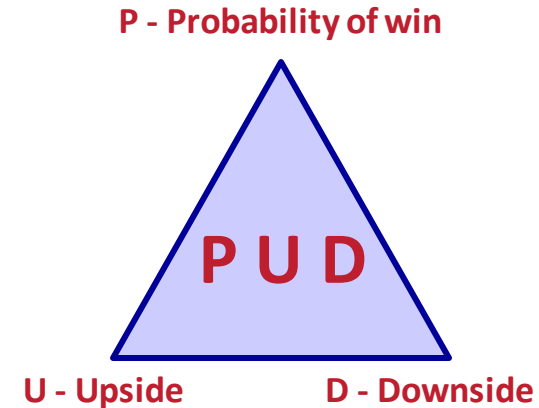
- Massive value migration from wired to wireless telephony
- Bharti was clear market leader
- Sales of only Rs 3,000 crores; long runway ahead

### D – Low

- Market cap of only Rs 5,200 crores

### P – High

- Company had already started clocking cash profit

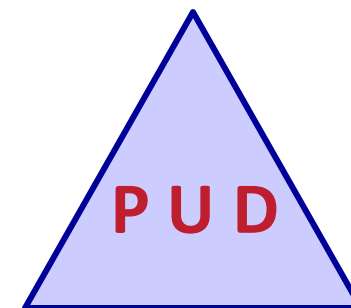


## PUD Case #2 – Bharti Airtel in 2003

### How PUD played out in next 5 years

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

P - Probability of win



U - Upside

D - Downside

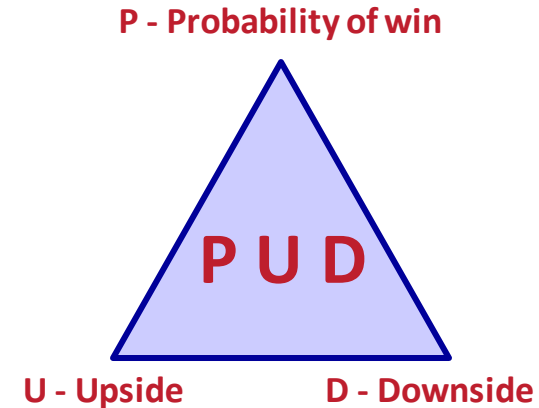
## PUD Case #3 – Ajanta Pharma

### 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

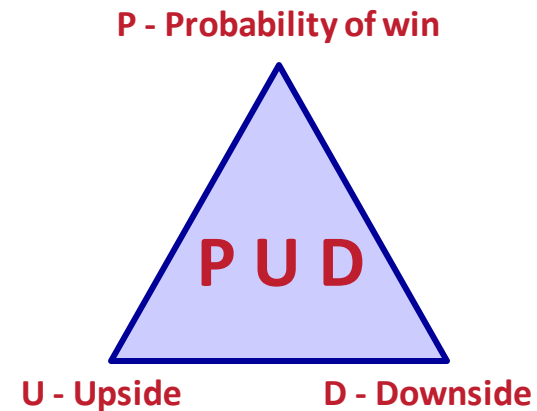
- Value migration in pharma
- Nascent company



## PUD Case #3 – Ajanta Pharma

### How PUD played out

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



# 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**

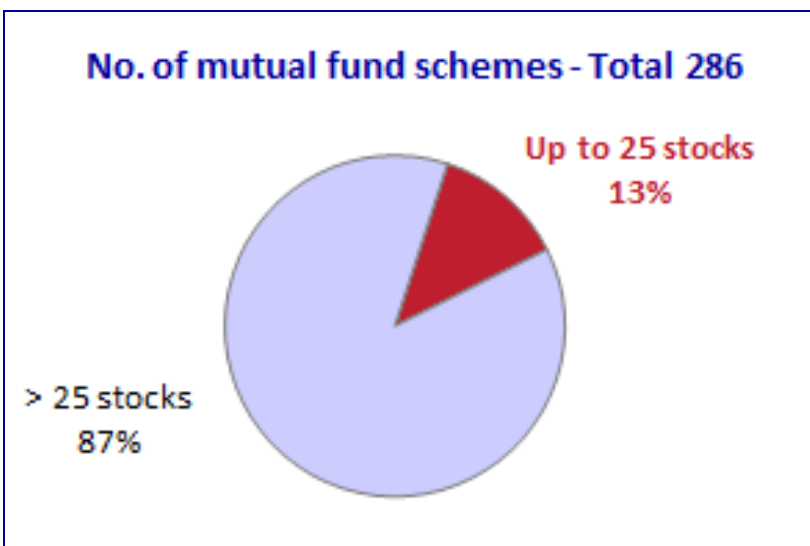
### Concentrated Investing



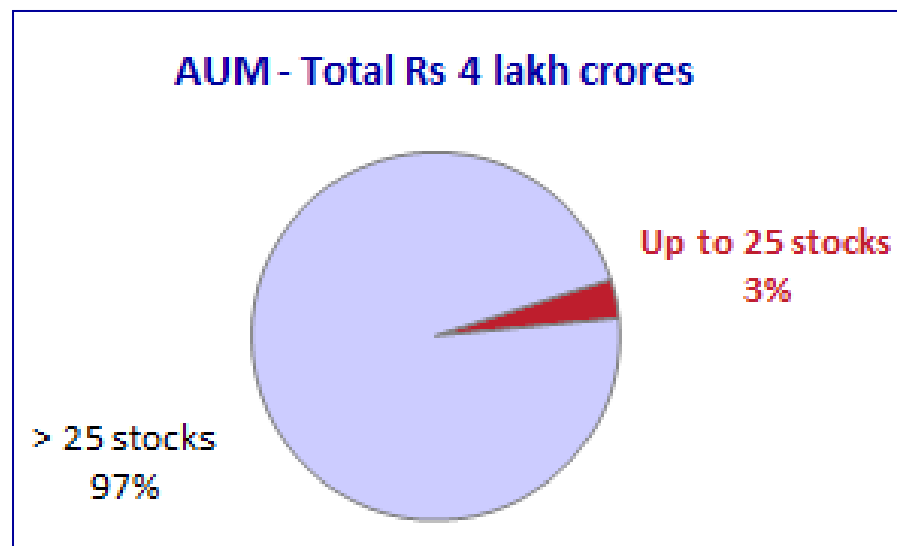
No. of stocks **10 or fewer**  
Volatility **High**  
Return **Exceptional**

# 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
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## Growth in earnings

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## Price

- Reasonable valuation, relative to growth prospects
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## Longevity – of both Q & G

- Long-term relevance of business
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# 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%	
<b>Interglobe Aviation</b>	<b>27%</b>	<b>70%</b>	<b>Multivariate industry</b>
<b>Ratnakar Bank</b>	<b>26%</b>	<b>70%</b>	<b>Short listed history; RoE yet to cross 15%</b>
Bajaj Finance	26%	100%	
BPCL	25%	90%	
HDFC Bank	25%	100%	
Maruti Suzuki	23%	100%	
<b>SBI</b>	<b>23%</b>	<b>80%</b>	<b>NPA situation still uncertain</b>
HPCL	23%	90%	
<b>Manpasand Beverages</b>	<b>22%</b>	<b>70%</b>	<b>Franchise yet to be fully established</b>
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%
<b>Interglobe Aviation</b>	27%	70%	19%	4%
<b>Ratnakar Bank</b>	26%	70%	18%	3%
<b>SBI</b>	23%	80%	18%	3%
<b>Manpasand Beverages</b>	22%	70%	16%	3%
<b>Portfolio Total</b>				<b>100%</b>

# 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 !**