Investing – A Practitioner's view

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Founder
DoorDarshi Advisors

IIM Lucknow
Dec, 2018

MANAGEMENT PROFILE

- Rajeev Agrawal is a SEBI Registered Investment Adviser
  - Started DoorDarshi in 2016
  - Did personal investing for 15+ years
- Worked in India as Managing Director at IHS Markit from 2012-2016
- Prior to that worked in US for 12 years
  - Goldman Sachs 2007-2012
  - Bank of America 2005-2007
  - JP Morgan 2002-2004
  - Dresdner Bank 2001-2002
- Educational background
  - CFA Charter holder
  - MBA from IIM Calcutta
  - B. Tech from IIT Bombay

MY EXPECTATIONS

- Keep the session interactive
- Please share your experiences of investing where relevant
- Do not by shy of making counterpoint with examples where relevant
- We are all life-long learners in the game of investing

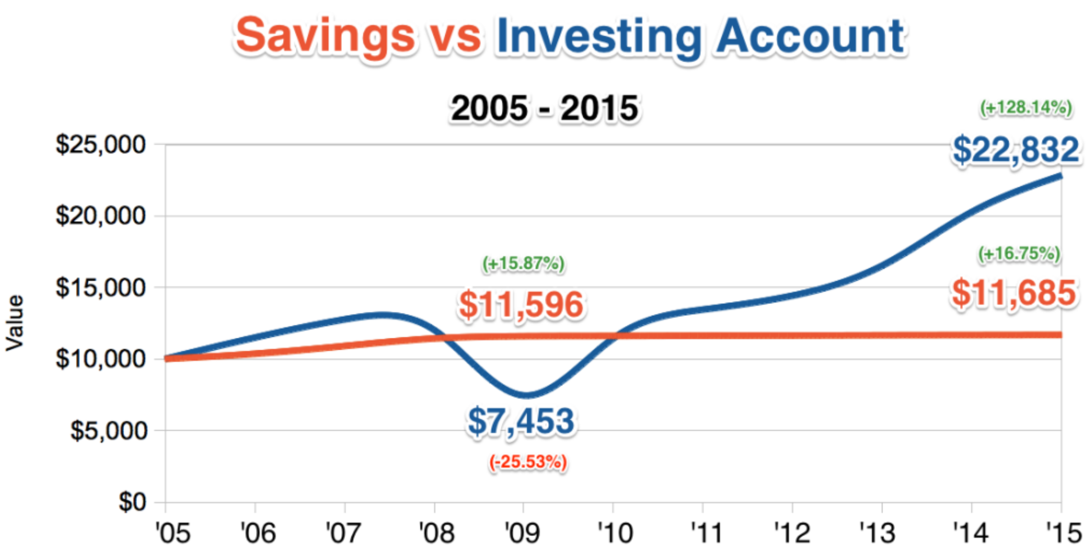
Agenda

- Value Investing – An Introduction
  - What is Investing and why is it important?
  - An Investing Framework – Value Investing
  - Stock Investing – Common Myths
- Value Investing – In Practice
  - DoorDarshi's Investment Approach
  - DoorDarshi's Investment Process
  - DoorDarshi's Portfolio Allocation
  - Case Studies
- Journey of Value Investors
  - Mohnish Pabrai
  - Rajeev Agrawal

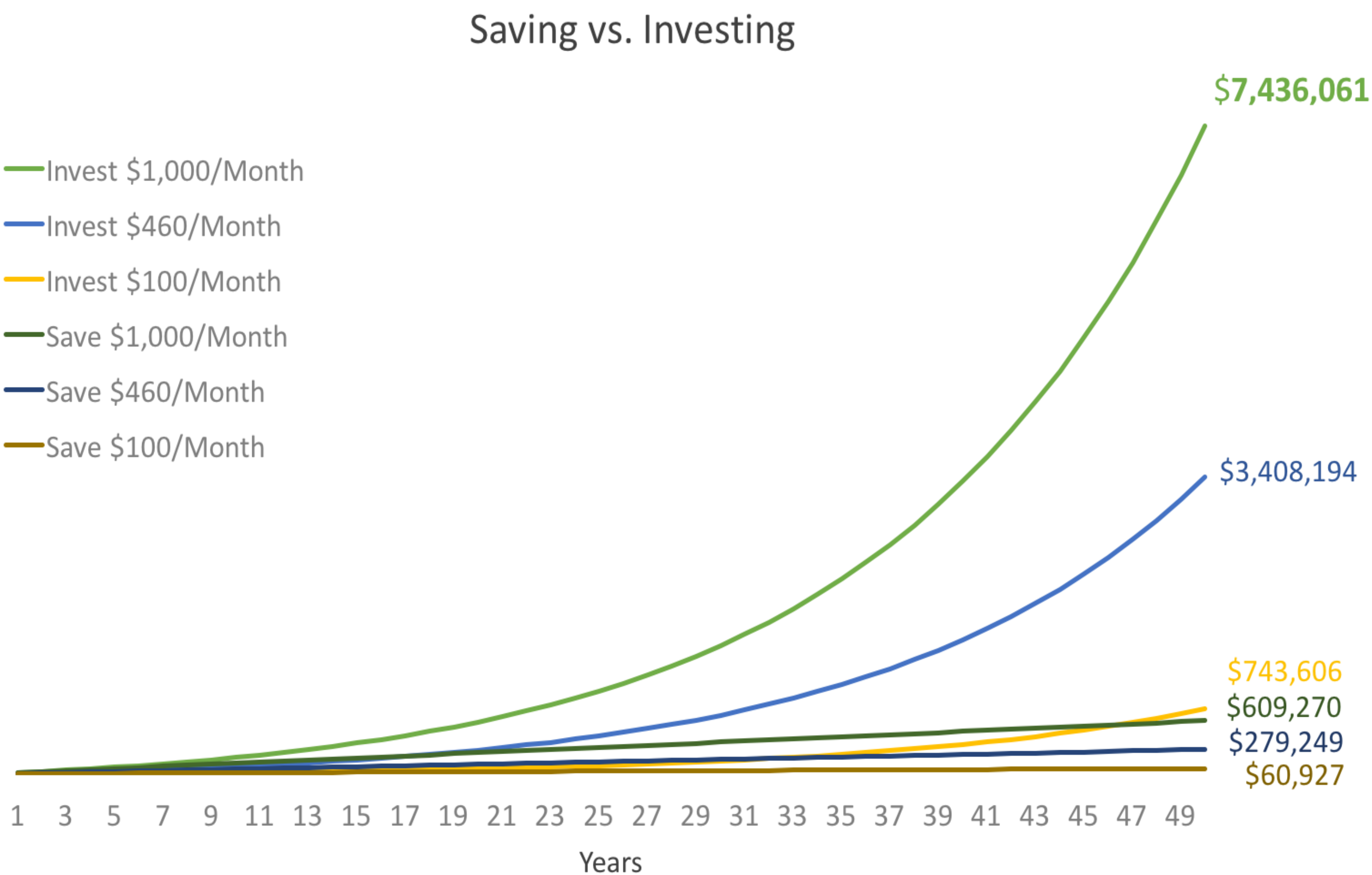
Savings vs Investing

WHAT IS INVESTING?

- Investing is <u>not</u> Savings
  - Savings is money that you earn but don't spend
  - A portion of the Savings should be Liquid – Emergency Reserve
  - Remaining should be invested based on needs and abilities
- Investing is the process of putting your money to work to make even more money for you over long-term.

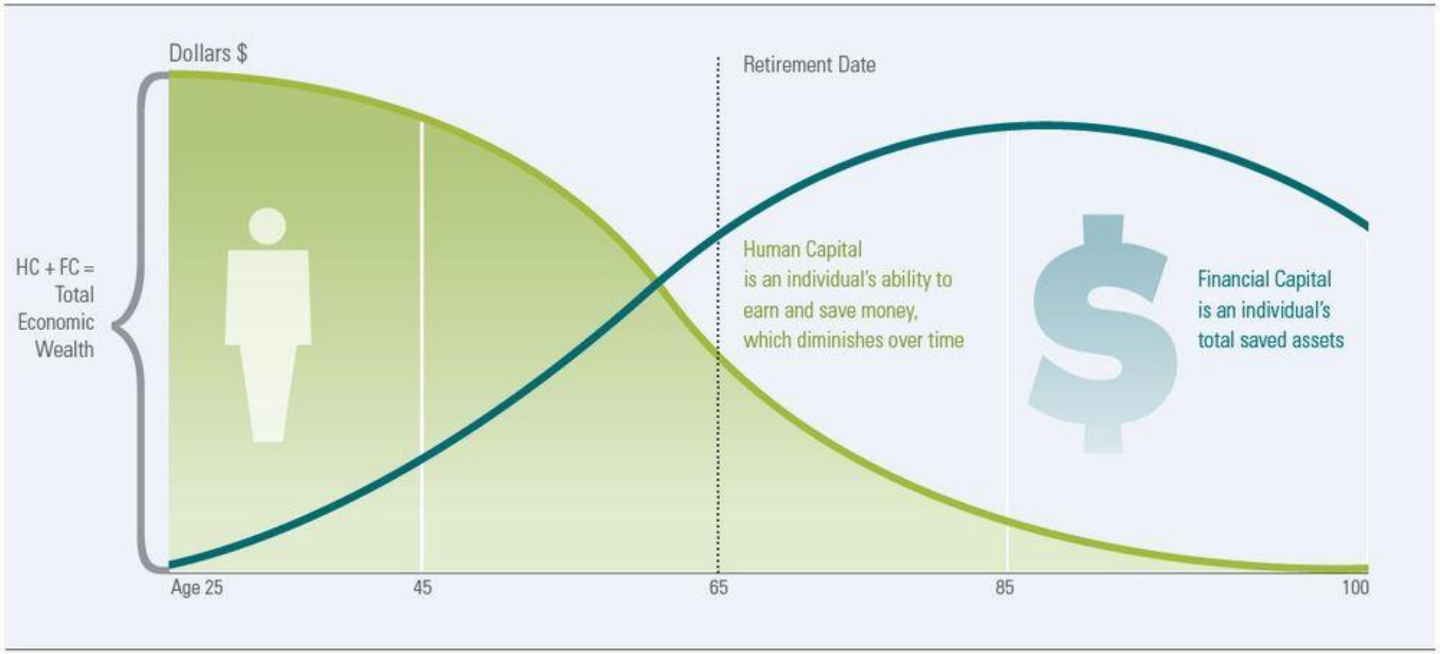


Saving vs Investing



WHY IS INVESTING IMPORTANT?

- Human Capital goes down over-time. Financial Capital goes up.



Source: Ibbotson Associates.

- Keep-up with Inflation & Improve Standard of Living
- Power of Compounding
  - Albert Einstein "Compounding is the 8th wonder of the world"

Value investing

An Introduction

VALUE INVESTING CONCEPTS

- Margin of Safety
  - On a bridge which allows 30 Ton load you only allow 15 Ton vehicles to go
  - Buying a $ for 50 cents

- Warren Buffett's rules
  - Rule #1: Don't lose money
  - Rule #2: Don't forget rule #1
- To Increase Return, reduce Risk
  - Focus on not losing money and the upside will take care of itself
- Equity Investing is being a part-owner in a business

Case for Value Investing

- Value Investing is getting more than you give
  - Works across time periods

Investor	Period	CAGR	S&P	Out-performance
Walter Schloss	1956-84	21.3%	8.4%	12.9%
Tweedy Browne (Tom Knapp)	1968-83	20.0%	7.0%	13.0%
Buffett Partnership	1957-69	29.5%	7.4%	22.1%
Sequoia Fund (Bill Ruane)	1970-84	18.2%	10.0%	8.2%
Charles Munger	1962-75	19.8%	Dow (5%)	14.8%
Pacific Partners (Rick Guerin)	1965-83	32.9%	7.8%	25.1%
Perlmeter Investments (Stan Perlmeter)	1965-83	23.0%	Dow (7%)	16%
FMC Pension Fund	1975-83	17.1%	15.6%	1.5%

Why is everybody not a value investor?

- Value Investing doesn't work all the time
  - Value investing can barely keep up during Bull markets.
  - In 1998-99 tech stocks did way better than Value approach
  - Value of this approach is seen in Bear markets, where portfolio losses are much less
- Requires patience
  - Most people like activity and find it difficult to do nothing!
- Requires lots of work
  - Main activity is to read a lot.
  - Reading Annual Report itself will allow you to be ahead of most of the analysts!
- Requires Discipline and Emotional fortitude
  - Fear is the foe of the faddist and a friend of the fundamentalist

TRAITS OF A SUCCESSFUL INVESTOR

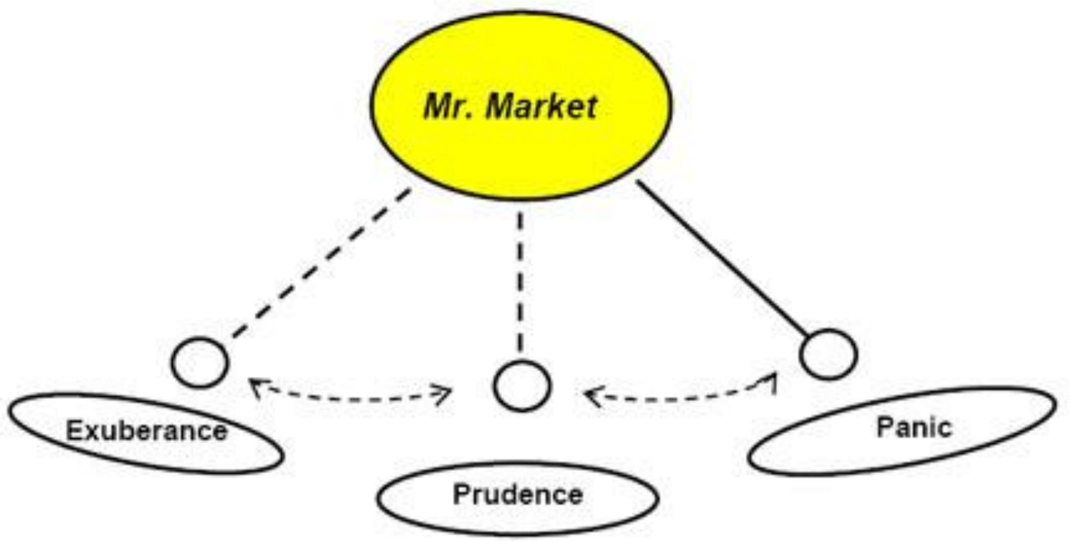
- **Contrarian**: Don't feel pain in buying things that are unpopular / selling things that are popular
  - Stock prices fall for a reason – there is bad news.
  - Trick is to judge whether market valuation is significantly lower than the intrinsic value.

TRAITS OF A SUCCESSFUL INVESTOR

- **Emotional Fortitude**: Take advantage of Mr Market – a manic, depressive, emotional fellow
  - Mr Market is there to serve you, not to guide you.

Exhibit 4

***Mr. Market*'s Mood Swing – From Exuberance to Semi-panic**



Source: Morgan Stanley Research.

TRAITS OF A SUCCESSFUL INVESTOR

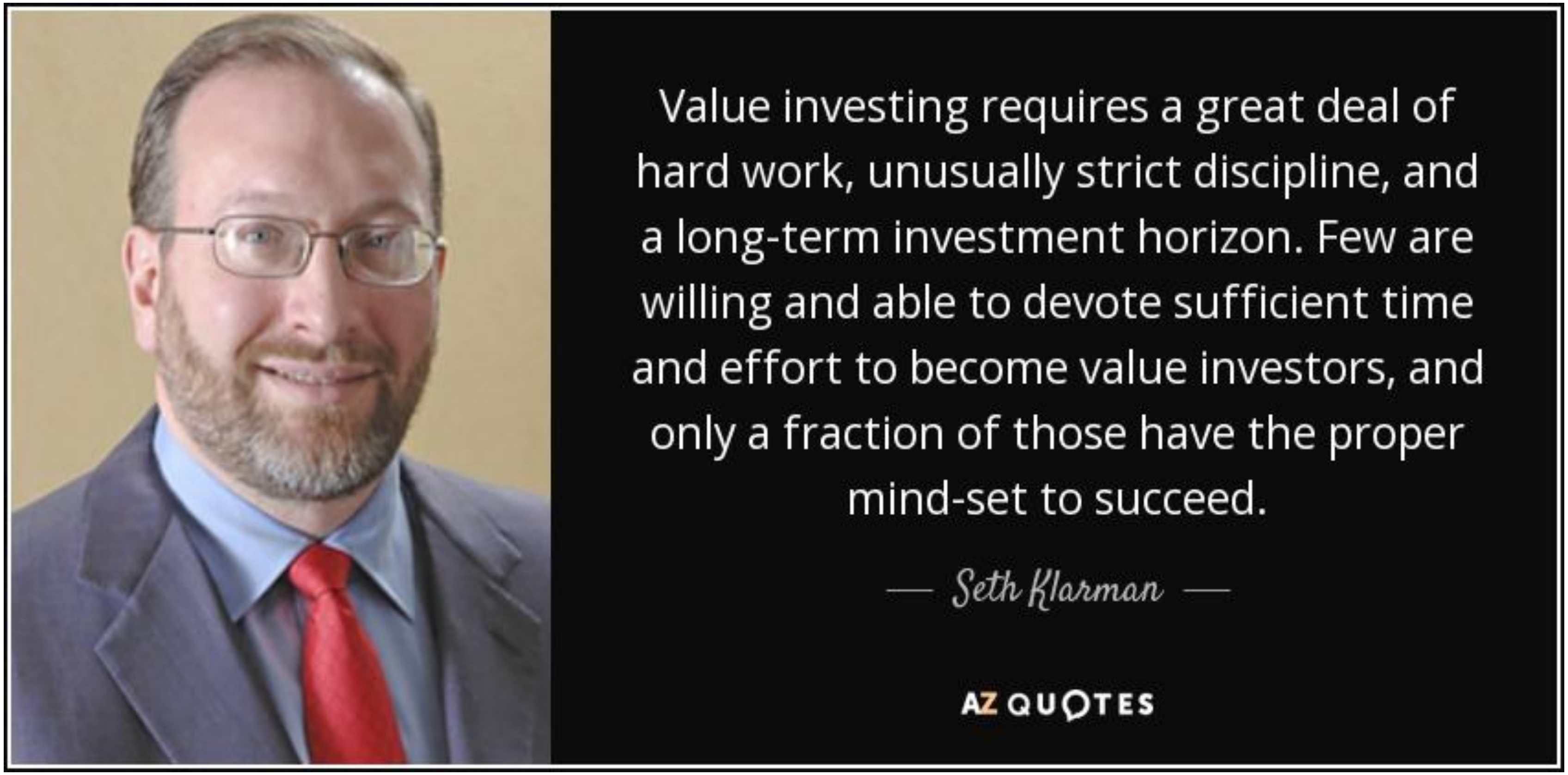
- **Skip Envy**
  - Don't have to keep up with the returns of the next person you meet
  - Have an approach that you can live with and stick to

Traits of a successful investor

- **Think like a Businessman**

Investment
is most intelligent
when it is most
businesslike
Benjamin
Graham

TRAITS OF A SUCCESSFUL INVESTOR



DoorDarshi Advisors

Stock Investing

Common Myths

doordarshiadvisors.com

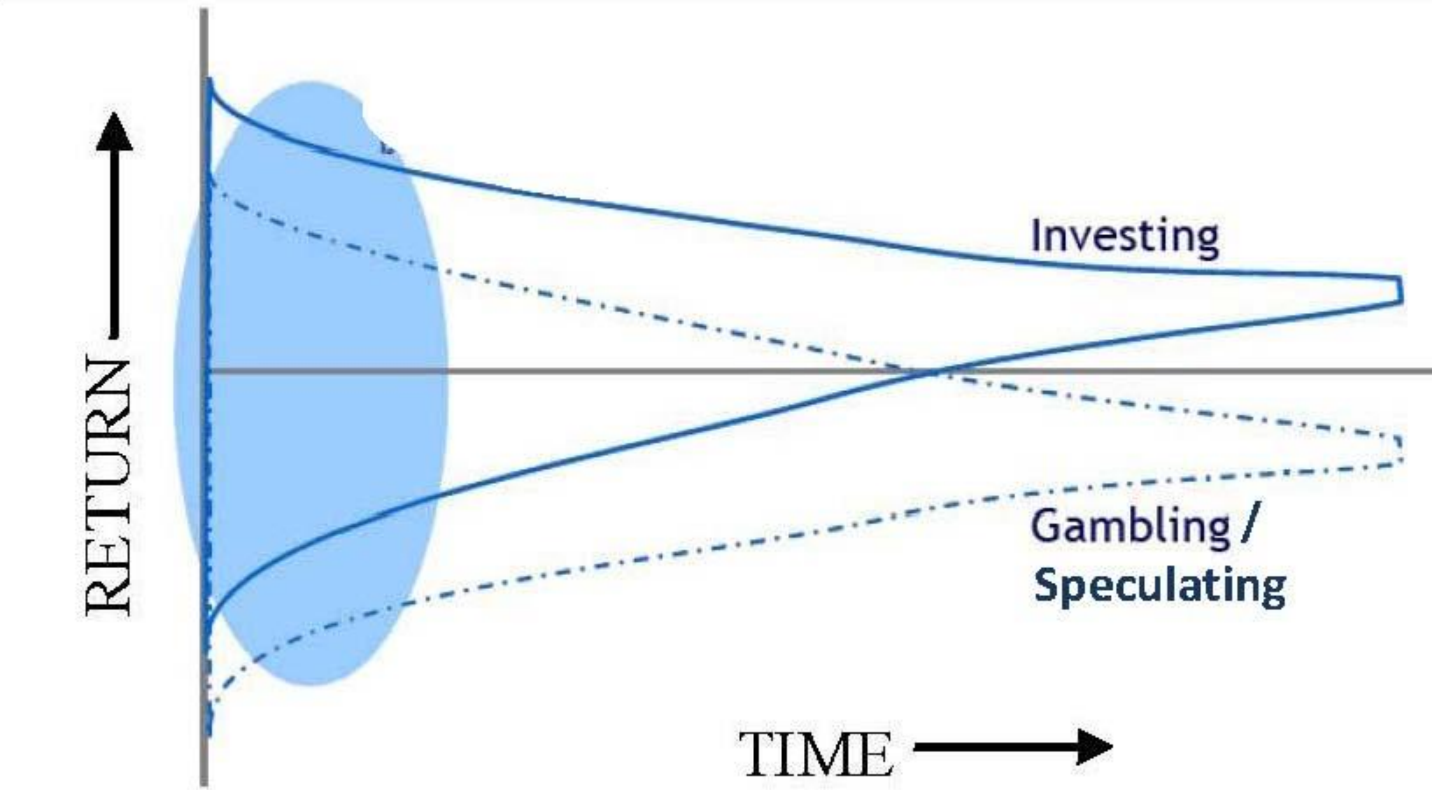
MYTHS OF STOCK INVESTING

- Myth #1: Investing v/s Speculating
- Myth #2: Markets are always efficient
- Myth #3: Investing is easy
- Myth #4: Standard deviation and Beta are good proxy of Risk

Myth #1 – Investing v/s Speculating

- Anybody with a brokerage account and money to invest is an investor!
  - People confuse investing with speculating
  - In short-term the distinction is not apparent because of the role of luck

Myth #1 – Investing v/s Speculating



: LMFM analysis.

Myth #1 – Investing v/s Speculating

- Investors purchases an asset for the cash flow that it will generate
  - Returns received are driven by the financial performance of the asset
  - Returns received are driven by narrowing of the gap between market value and intrinsic value

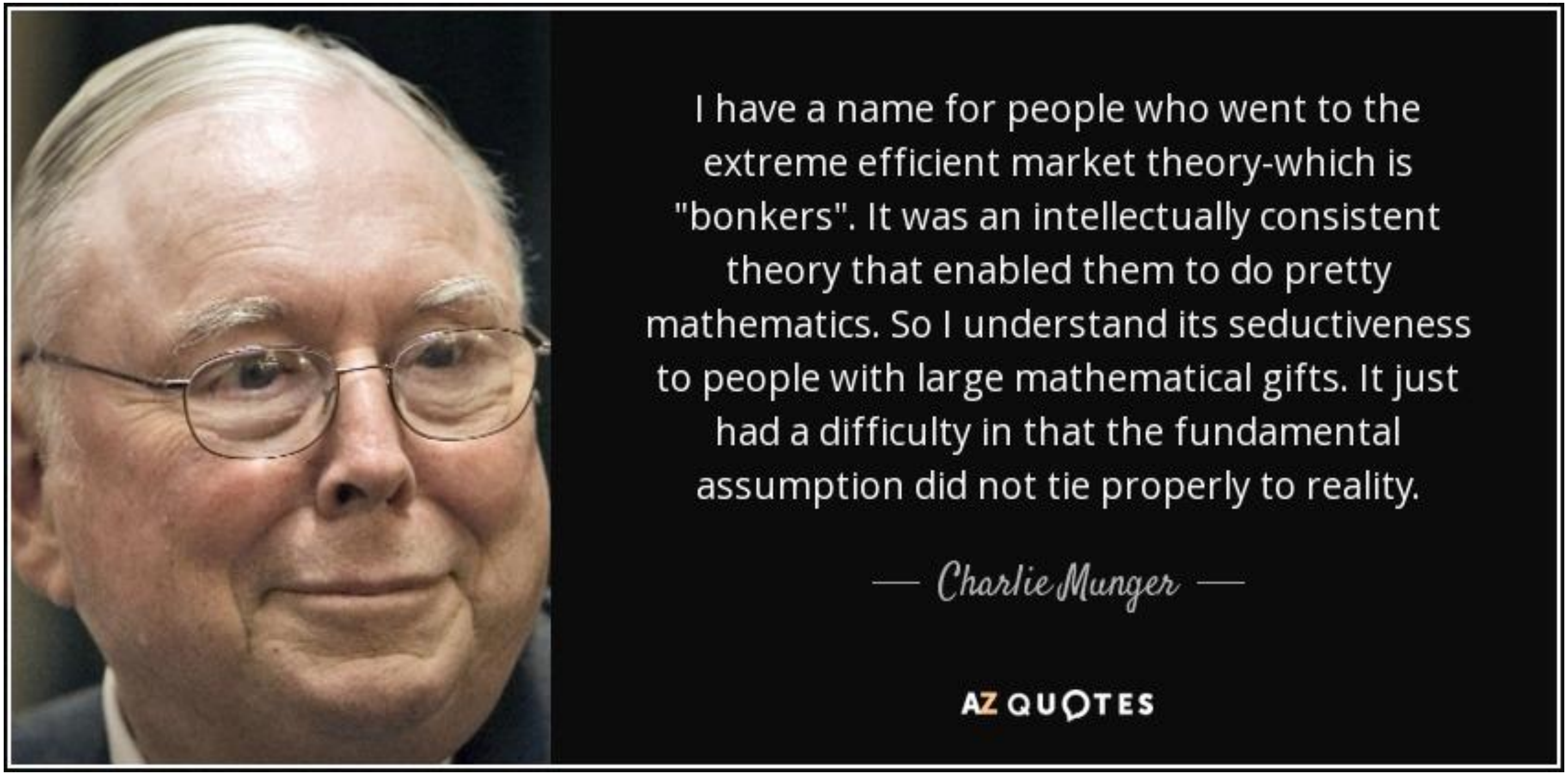
- Speculators purchases asset because they believe others will pay more
  - Returns received are driven based on other actions / gullibility

Myth #2 – Markets are always efficient

- Efficient Market Theory says that Markets are always efficient
  - Impossible to beat the market
  - Hence no point in doing Stock Research!

- Proof by Inversion: If Markets are always efficient we will not observe the following
  - Net – Net
  - Debt capacity bargains
  - Over and under reactions

Myth #2 – Markets are always efficient

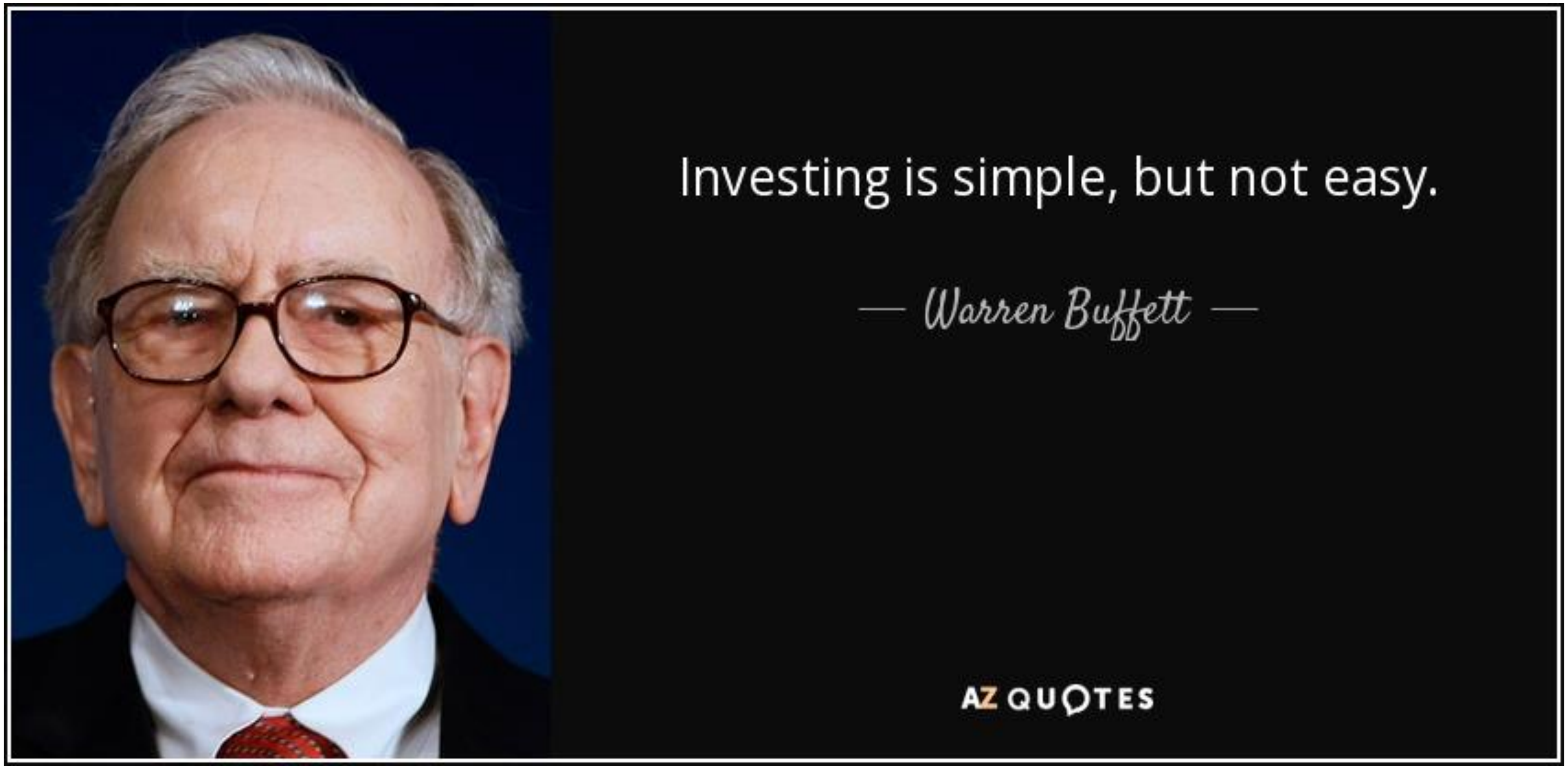


Myth #3 – Investing is easy

- In short-term anybody can make a lot of money because of the role of luck

- However, Investing requires traits that human beings find difficult
  - Indifferent to Herd Mentality
  - Micro vs Macro
  - Patience
  - Diligence

Myth #3 – Investing is easy



Myth #4 – Standard deviation and beta are good proxy of risk

- CAPM suggests that higher the Risk, higher the Return
  - Above implies that if I take Risk I should be well rewarded.
  - However, if Returns are guaranteed to be higher then is it really Risky?
- Empirically, higher beta stocks don't out-perform the indexes

MYTH #4 – STANDARD DEVIATION AND BETA ARE GOOD PROXY OF RISK

- Risk instead is in
  - Our understanding of the business
  - Our confidence of the future outcome

- Thus it embedded in
  - Circle of Competence
  - Time Horizon
  - Quality of Business
  - Quality of Management

Value investing in practice

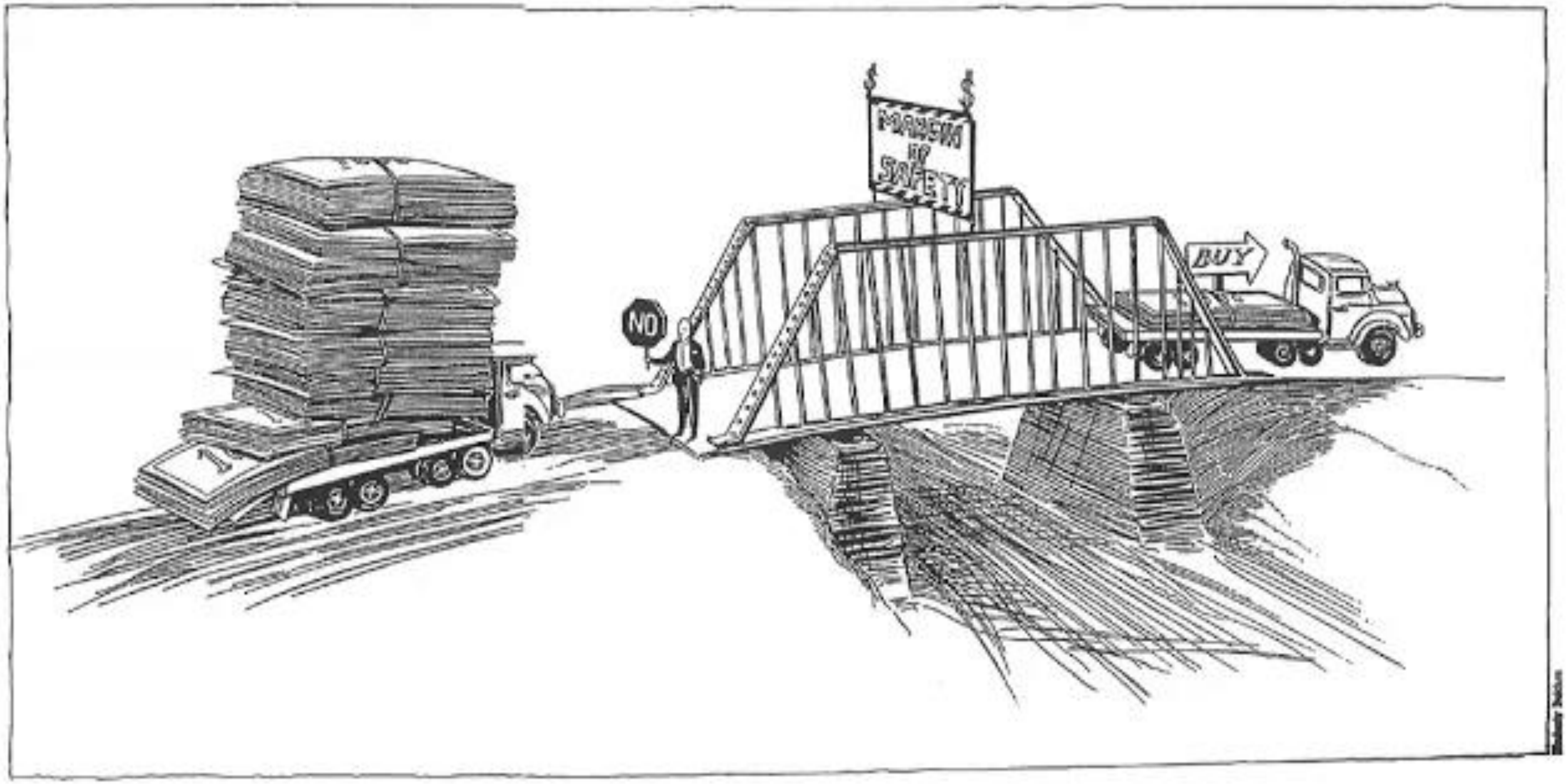
Investment Approach

DoorDarshi's Focus

Objective	Seek superior long-term capital appreciation
Investment Approach	• Value Investing and Margin Of Safety • Concentrated portfolio • Long-term orientation • Skin in the game • Leverage our competitive advantage • Management and Business Quality • Benefit from manic-depressive behavior of Mr Market

DOORDARSHI ADVISORS' APPROACH

- Buy with significant MOS (Margin of Safety)
  - To increase Return reduce Risk



DOORDARSHI ADVISORS' APPROACH

- Concentrated Portfolio
  - Invest more in our best ideas
  - Know our positions better than most – extensive diligence initially and ongoing maintenance diligence

- Skewed portfolio with most of the allocation to ideas with highest conviction
  - Top 5 positions > 60% of the portfolio
  - Top 10 positions > 75% of the portfolio

DOORDARSHI ADVISORS' APPROACH

- Long-term orientation
  - Gardening analogy
    - Right time to reap
    - Right time to harvest
  - In short-term returns may look volatile. Over long-term, returns dominate volatility
  - Leads to better decision making – noise is reduced
- >90% of the returns are long-term and hence benefit from lower taxation

DoorDarshi Advisors' Approach

- Skin in the game
  - We seek ideas where management has significant ownership in the company
  - We charge our clients based on the portfolio performance. Higher the performance, higher the fees.
  - With the above structure, our investee companies, our investors and us have the incentives aligned

- "Never, ever, think about something else when you should be thinking about the power of incentives."
  — *Charlie Munger*

DOORDARSHI ADVISORS' APPROACH

- Leverage our competitive advantage
  - **Illiquid stock**: We capture illiquidity premium
  - **Smaller Cap**: Companies with limited analyst and institutional interest. Capture small-cap premium
    - 50% of the portfolio is in Large cap (>10K Cr)
    - 50% of the portfolio is in Small and Mid cap (<10K Cr)
  - **Variant perception**: Understand Mr Market point of view and how/why our view is different
  - **Focus on Balance-sheet**: Markets are too focused on quarterly earnings

DoorDarshi Advisors' Approach

Management Quality is subjective. We can get better sense by evaluating the following:

- What management says v/s what they do
- Owner operator v/s manager with no ownership
- Capital allocation
- Shareholder return during their tenure
- Compensation of management

Business Quality: Companies in good domains with efficient operations provide better returns

- Judged through return on capital
- Growth rate and how growth is funded
- Cyclical industry v/s secular industry
- Operational efficiency and margin profile
- Future prospects and disruptive forces

DOORDARSHI ADVISORS' APPROACH

- Benefit from Mr Market
  - Mr Market goes through wild swings given short-term impact
    - Recent NBFC liquidity crisis is a prime example
    - Demonetization in 2016 impacted the market severely
    - Liquidity drove the markets in 2017.
  - Buying into companies when price of stock goes down is one of the surest way to make money
    - Warren did it many times in his career with Coca Cola, Washington Post, Geico, etc
  - Similarly selling companies when they have reached the full price is equally important

Value investing in practice

Investment Process

DoorDarshi's Investment Process

DOORDARSHI'S INVESTMENT PROCESS

1. Idea Generation

- Screen on financial metrics
  - High Return on Capital – ROE, ROCE, EBIT/(NFA + WC)
  - Low Leverage – D:E, Interest coverage
  - Reasonable valuation – P/E, EV/OCF, EV/EBIT
  - Good management and business quality – Rev, PAT, CF growth rate, past return to shareholders

- Look at positions of other successful investors
  - These positions have already gone through a layer of diligence

DoorDarshi's Investment Process

1. Idea Generation

- Companies with similar themes / ideas as what we are familiar with
  - Understand the industry / thesis relatively quickly
- Continuously search for new trends / opportunities
- Revisit old investments that may provide new opportunities

DoorDarshi's Investment Process

2. Idea Investigation

- Understand the business
  - Read as many ARs as possible in the reverse chronological order – from the oldest to the latest
  - Read Quarterly reports for the last few years
  - Read investor presentation, research reports & information on internet

- Understand management
  - Investor conference calls
  - Management interviews
  - May reach out to management for further questions

DOORDARSHI'S INVESTMENT PROCESS

2. Idea Investigation

- Summarize key takeaways
  - Make notes as an idea is investigated.
  - Assess whether management does what it says it will do
  - Put aside the notes for a few weeks, come back and read the notes again – ensure we are not being swept away

- Investigate other competitors in the same space
  - Reading about competitors helps us in assessing how the idea compares to its peers.

DoorDarshi's Investment Process

3. Idea Ranking

- Once an idea is investigated, it falls in 3 buckets:
  - Interesting opportunity
  - Not now: re-visit later if not as compelling or if we can't understand the business
  - Never: Bad management, improper governance or bad business

- Interesting opportunities then go through forward return analysis
  - Estimate how the business looks a few years out
  - Any gaps in assessing the future require further research
  - Use reasonable assumption to estimate future stock value
  - Derive forward return based on current and future (expected) price

DoorDarshi's Investment Process

3. Idea Ranking

- All existing positions and new ideas are then stack ranked by:
  - Forward returns CAGR over the next few years
  - Confidence in the idea

- Benefit of stack ranking is that latest price action is always reflected in forward returns.

DoorDarshi's Investment Process

4. Idea inclusion/addition in portfolio

- Once an idea has high forward returns v/s existing holdings it is gradually added to the portfolio
  - We continue to work on determining what is the "right amount"

- Percentage allocated to the idea in the portfolio increases as:
  - Confidence in the idea increases
  - Forward return increases

  Ideally both happens

DoorDarshi's Investment Process

5. Position Maintenance

- All positions are regularly reviewed for company and sector results and any other aspects that may impact its future value
- All positions in the portfolio are continuously assessed against other positions in the portfolio with respect to forward Returns

DoorDarshi's Investment Process

6. Position Selling

- Positions are added and sold gradually

- Position is sold if forward return of the position is significantly below other options
  - Stock price increases dramatically
  - Poor performance of the company which causes future valuation to shrink

DoorDarshi's Investment Process

6. Position Selling

- Position is also sold if
  - Company's management is unfriendly to minority holders – preferential allotment, hoarding cash, exorbitant pay, etc.
  - We are not able to get comfortable with management – their words don't match their actions.
  - New facts come to light which dramatically changes the value of the company

Additional Checks

Position Sizing

- Reflects forward return of the position. Higher the forward return, higher the allocation
- The more opportunities we have of similar return, the more we diversify among them
- Reflects our confidence in the position. Higher the confidence, higher the allocation
- We follow concentrated approach. Top few positions in our portfolio currently account for >50% of the portfolio.

WHAT-IF

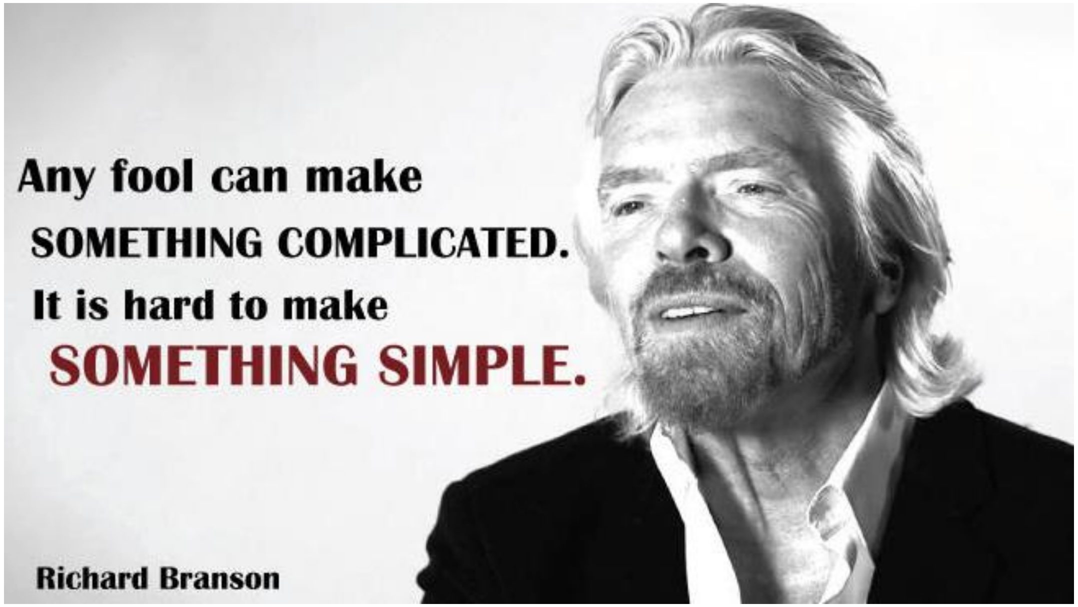
- We conduct what-if on all our positions.
- We pre-consider the action we will take if price of our position were to increase/fall by 10%, 25%
- The above helps us in better understanding our psychology as well as the buy and the sell prices of our positions
- These are soft targets and we may change these targets if the situation warrants
- However, being aware of our targets is of big help when we find ourselves in those situations

ADVANTAGES OF THE PROCESS

- Provides a guide post for buying and selling
  - Set of steps acts as brakes to natural inclination towards activity
  - Makes us likely to buy low and sell high: Higher price reduces forward return and lower price increases forward return

Advantages of the Process

- Manage complexity
  - Comparing across securities becomes easier – look at forward return comparisons
  - Better prepared to act during times of volatility as forward return adjusts quickly with market moves

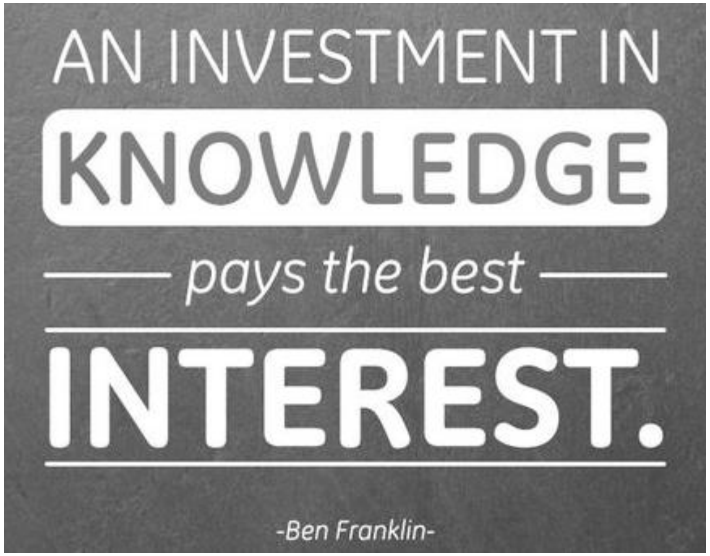


Advantages of the Process

- Feedback loop
  - Comparing projected forward returns with actual returns helps in assessing our analysis and being humble!
  - Creates rich data set to reflect on

ADVANTAGES OF THE PROCESS

- Knowledge compounds
  - Assessing a previous analyzed company is quick
  - Leverage patterns / similarities from previously assessed company in analyzing new companies
  - Set of rules / checklists are put in place to learn from our mistakes / successes and keep improving



Case Studies

CAVEATS

- Case studies being presented are examples of my investment thesis
- They are not recommendations
- They may not be ideas that I am actively investing in
- They may not even be in my holdings
- Before investing please ensure that you do your own diligence to have the best outcome

Case Study – Stock 1

Looked at the stock first in 2011

- Co had sold half its business and all the cash had come into the company
- Co was selling for <50% of the cash
- Co was selling for 60% of the buy back price (buyback in 2010)
- Management had great track record of value creation over the previous 20 years
  - CAGR of Sales 29%
  - CAGR of PAT 35%
  - CAGR of Market Capital 40%

Theme: **Good management, Uncertainty**

CASE STUDY – STOCK 1

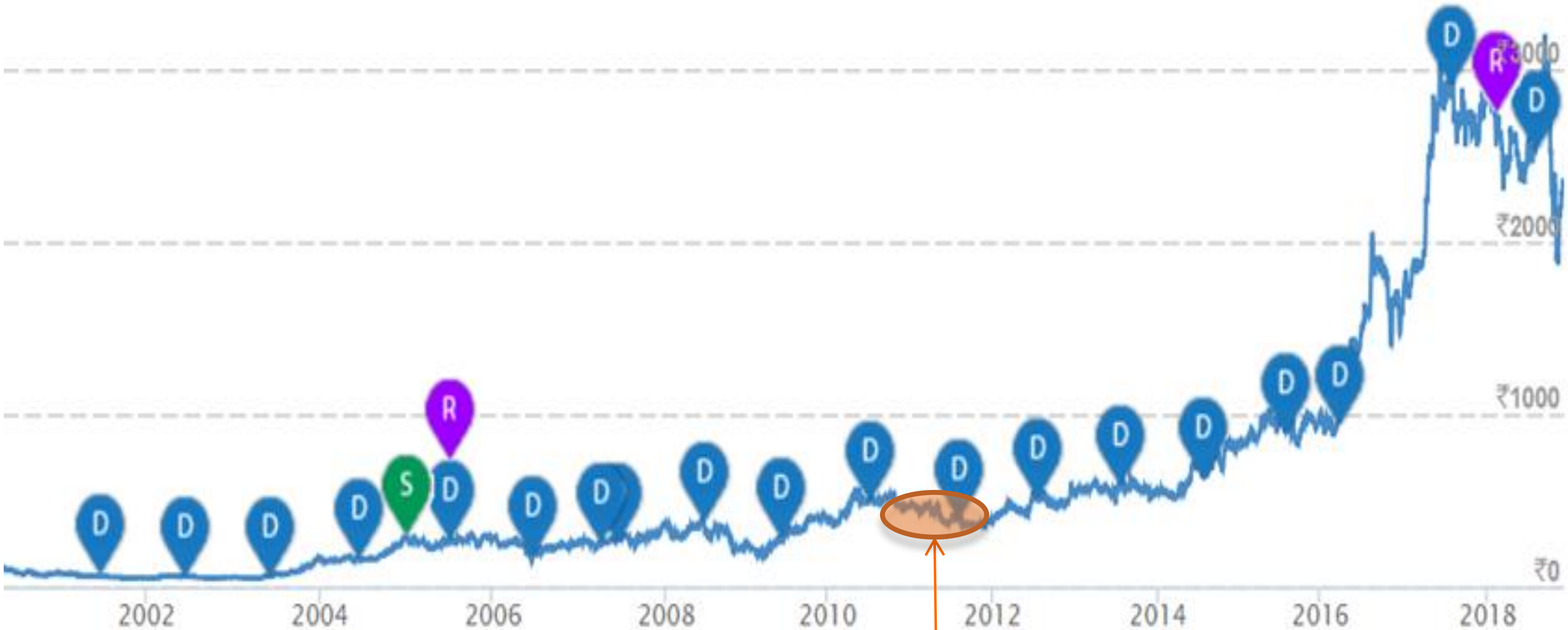
Bought initially in 2011. We have bought more as conviction grew in the company

Current Status

- Stock price is >5X from 2011 buy price
- >300% returns over the entire history of buying
- Largest position in the portfolio
- Management thinking of kicking next leg of value creation – spinning off various businesses

Risk: If something happens to management

CASE STUDY – STOCK 1



Bought the initial position around 360/sh. Additional shares have been bought at higher prices.

CASE STUDY – STOCK 2

Looked at the stock first in 2015

- Co stock had been bought by a prominent investor
- Co has a near monopoly in its business in a particular region
- Co was reasonably priced (not cheap)
- Other competitors in the same sector (different geography) were selling at higher multiples

CASE STUDY – STOCK 2

However,

- Sector is normally considered a black-box for good reason. Very difficult to handicap
- Sector had seen significant growth in the last few years and now cycle was turning
- Government owns majority of the company thus limiting management flexibility
- Management is career oriented rather than ownership oriented

Theme: Oligopoly market position. Long runway

Case Study – Stock 2

Bought initially in 2015 and added as price fell.

Current Status

- Stock price is 1/2 of 2015 buy price
- Since then bought in 2015 and 2016 and sold some in 2016.
- Bought again in 2018 as there is better visibility on results
- Currently down 35% on my investments

Risk: Management indifferent to value creation, unrest in J&K, more NPA in portfolio, government intervention

CASE STUDY – STOCK 2

Bought in 2015 and 2016
Sold a lot in late 2016
Bought some more in 2018 as better visibility of the business

CASE STUDY – STOCK 3

Looked at the stock first in third quarter of 2015

- Co had already done multiple buybacks since going public
- Cash raised in IPO has already been returned through buyback and dividends
- Co had 20%+ CAGR on Revenue over the 5 years
- PAT and EPS had not grown at the same rate as company was investing in building products and expensing these investments
- Co was selling for <10X PAT
- Low volume meant that institution ownership is low

Theme: **Good mgmt, Financials not reflecting value**

CASE STUDY – STOCK 3

Bought first in 2016 Q1 and bought gradually throughout 2016 and 2017.

Outcome

- Promoter conveyed its intention to take the company private in January 2018
- Reverse book building was completed in Oct 2018
- All of our holding was sold at the successful buyout price of 480
- Most successful position in terms of absolute gain in the portfolio

CASE STUDY – STOCK 3

Bought the stock during most of 2016 and 2017 at an average price of 225/sh.
Sold all @480/sh in Oct 2018 in reverse book building

Journey of value investor(s)

Mohnish Pabrai

https://www.youtube.com/watch?v=xa1CH2nK1cM

Start from 23:40 – 5 mins video

http://fundooprofessor.wordpress.com/2014/01/15/mohnish-pabrai-lecture-mdi/

Start from 3:30 – 5 mins video

PAST RETURNS*

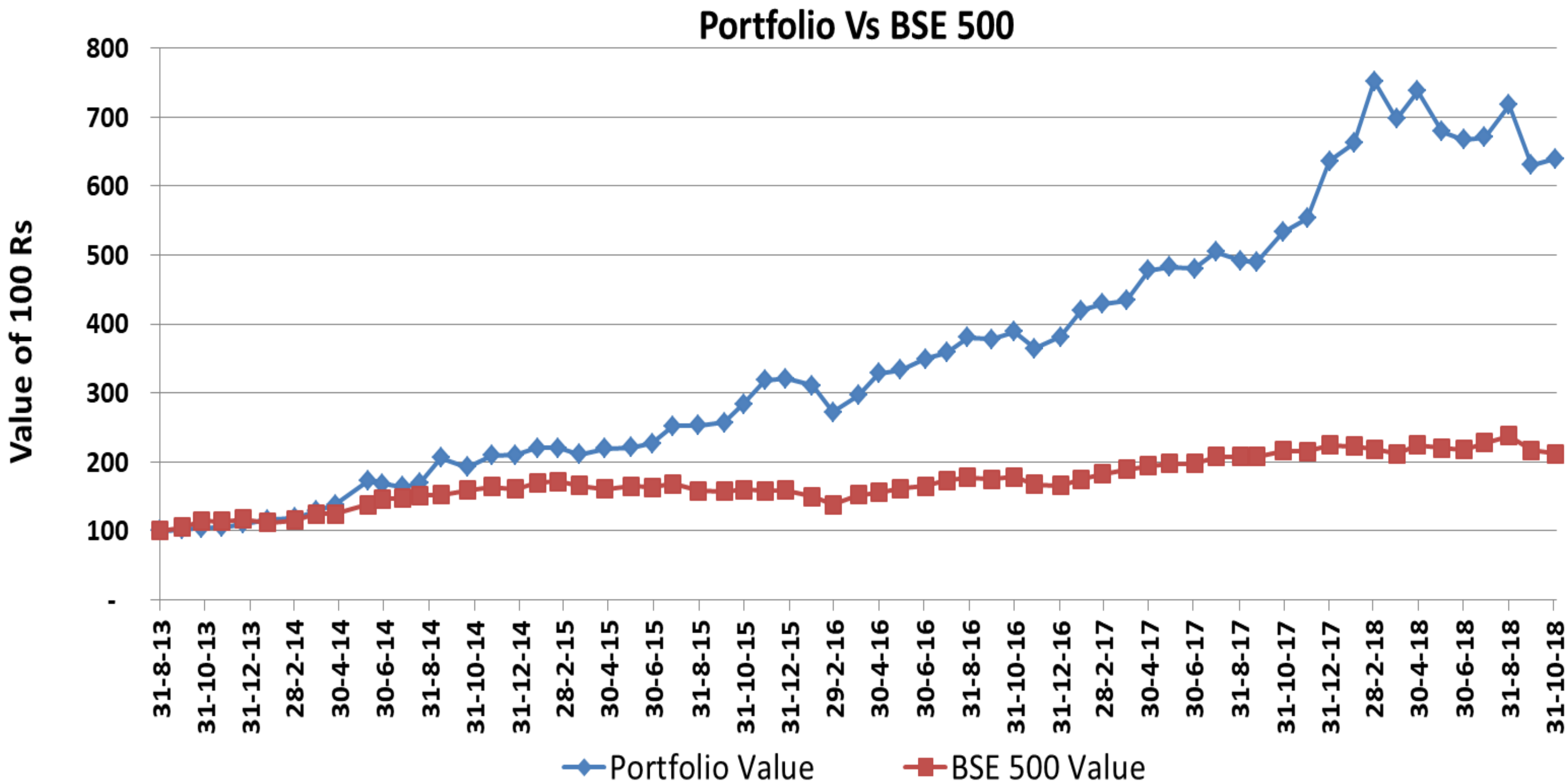
- Good returns since returning from US at the end of 2012

Year	Portfolio Returns	BSE 500 Returns	Relative Returns
CAGR (Sep'13 – Oct'18)	**43.1%**	**15.6%**	**27.6%**
Cumulative (Sep'13 – Oct'18)	**539.6%**	**111.5%**	**428.2%**
2013 (Sep '13 – Dec '13)	10.5%	17.3%	-6.8%
2014	90.4%	37.0%	53.4%
2015	52.4%	-0.8%	53.2%
2016	19.0%	3.8%	15.2%
2017	66.8%	35.9%	30.9%
2018 (till Nov 2nd)	0.5%	-5.9%	6.4%

- Significant out-performance v/s BSE 500

* Past returns are for core portfolio. They may not be a good predictor of future performance.

Past Returns*



- Portfolio has become >6x in the last 62 months v/s
- BSE 500 has become <2.5x in the last 62 months

* Past returns are for core portfolio. They may not be a good predictor of future performance.

Indian Landscape

POST-TAX RETURNS (CAGR) OF ASSET CLASSES

	5-year	10 year	15 year	20 year
Equities	11.0	17.0	13.6	12.9
Gold	9.0	12.9	11.0	8.4
Bank fixed deposit	5.7	5.2	5.1	5.5
Property	8.0	13.4	10.8	6.2
CAGR in WPI index	6.2	5.9	5.7	5.5
Avg Inflation for the period	7.4	6.3	5.9	5.7

in % **Source:** Morgan Stanley

ESTIMATED EQUITY INVESTMENTS BY HOUSEHOLDS

Fig in $bn **Source:** IIFL

FINANCIAL ASSETS & PHYSICAL ASSETS AS PERCENTAGE OF HOUSEHOLD SAVINGS

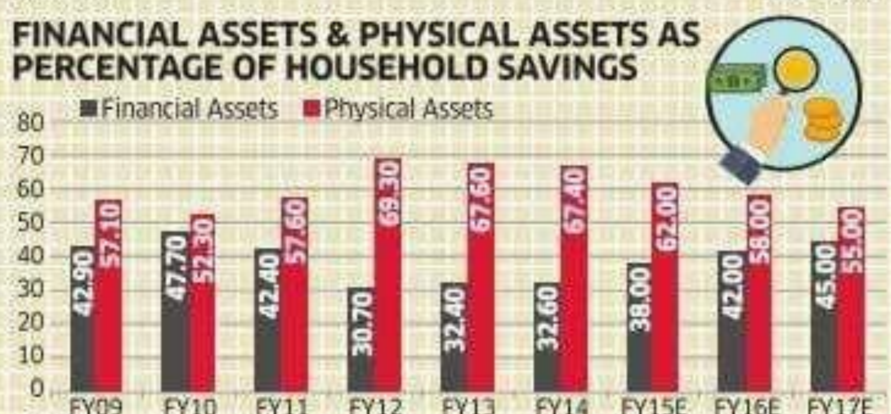


Fig in % **Source:** IIFL

Text: ASHUTOSH R SHYAM

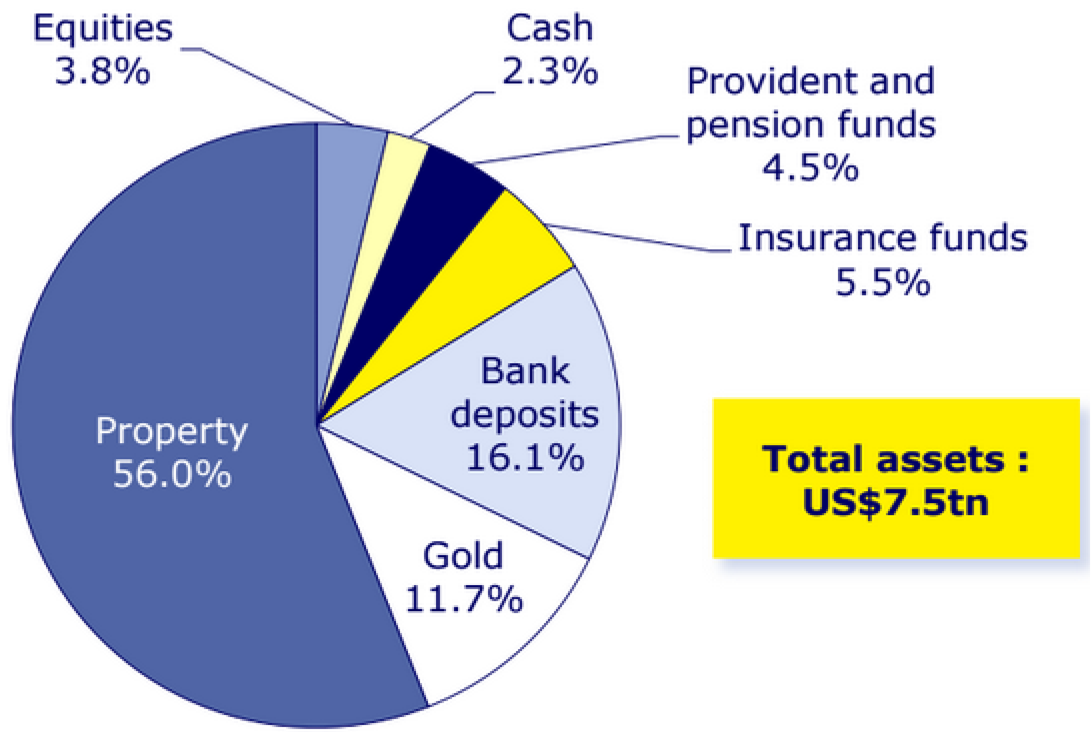
RETURNS IN INDIA

- Over all time periods, Bank Fixed Deposit have given negative Real return (Bank Fixed Deposit Return – Avg Inflation)
- Highest return asset class – Equities – has only 6.1% of the household investment in 2014.
- Too much of wealth is tied in physical assets rather than financial assets

ASSET WISE BREAK-UP OF WEALTH IN INDIA

India's household-wealth split

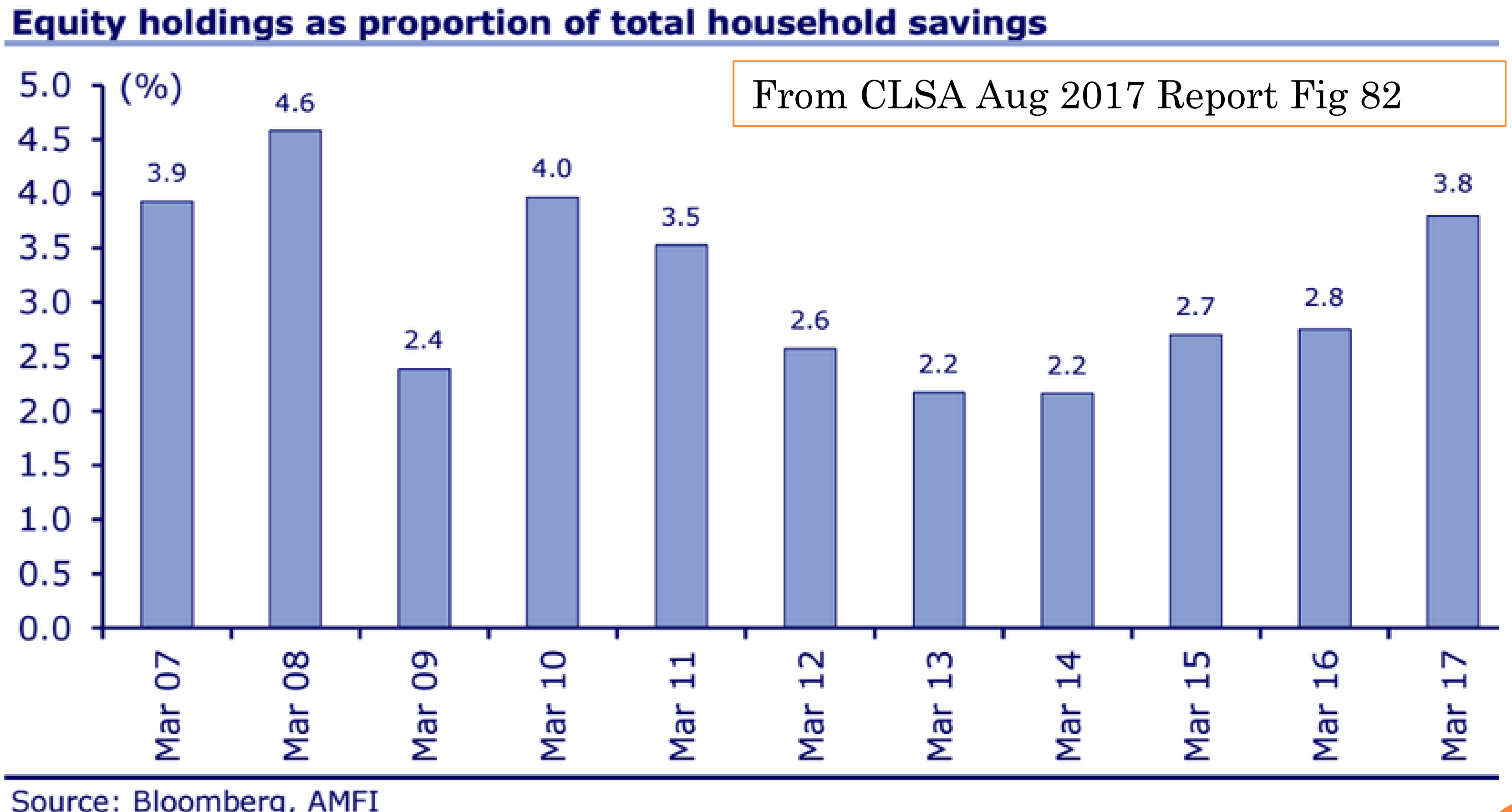
From CLSA Aug 2017 Report Fig 81



Source: AMFI, RBI, Bloomberg

- Of \$7.5Trillion total assets, equity is only 3.8%
- Incremental flow into equities is \$15–18 Bn or only 3-4% of annual incremental household savings of \$400Bn

ALLOCATION TO EQUITY OVER TIME



- However, equity asset allocation has increased since the low in FY 13 and 14.

Appendix – Equity Investing

Case for Equities

- History favors Equities
  - Returns observed in major markets from 1900 – 2010

COUNTRY	Equity Return	Standard Deviation	Bond Return	Standard Deviation
Australia	9.1%	18.2%	2.3%	13.2%
Canada	7.3%	17.2%	2.6%	10.4%
France	5.7%	23.5%	0.8%	13.0%
Germany	8.1%	32.2%	0.8%	15.7%
Japan	8.5%	29.8%	1.6%	20.1%
UK	7.2%	20.0%	2.2%	13.7%
USA	8.3%	20.3%	2.3%	10.2%

- Over the last 35 years, Sensex has returned 17% p.a.

CASE FOR EQUITIES

- Tax policy in India favors Equities
  - 10% L-T Tax on Gains for Equities held > 1 year.
  - 15% S-T Tax on Gains for Equities held < 1 year.
  - Compare this to up to 34% tax for Fixed Income investments.
- Helps protect purchasing power
  - High inflation in India. Equities act as a natural hedge.
  - Ownership of business that can withstand vagaries of time.
- World is getting smaller and India is getting prosperous
  - Provides participation in upside of business.
  - Massive migration of people into middle class with higher disposable income.

Contact Details

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