

2nd Value Investing Pioneers Summit – New Delhi

Buy and Forget vs. Active Investment Management

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Founder & CIO

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CFA Society
India



SageOne

Investment Advisors LLP

My dream as an investor



Reading balance sheets, industry reports,.....

My dream as an investor



Meeting and quizzing the management

My dream as an investor



Visiting factories

My dream as an investor



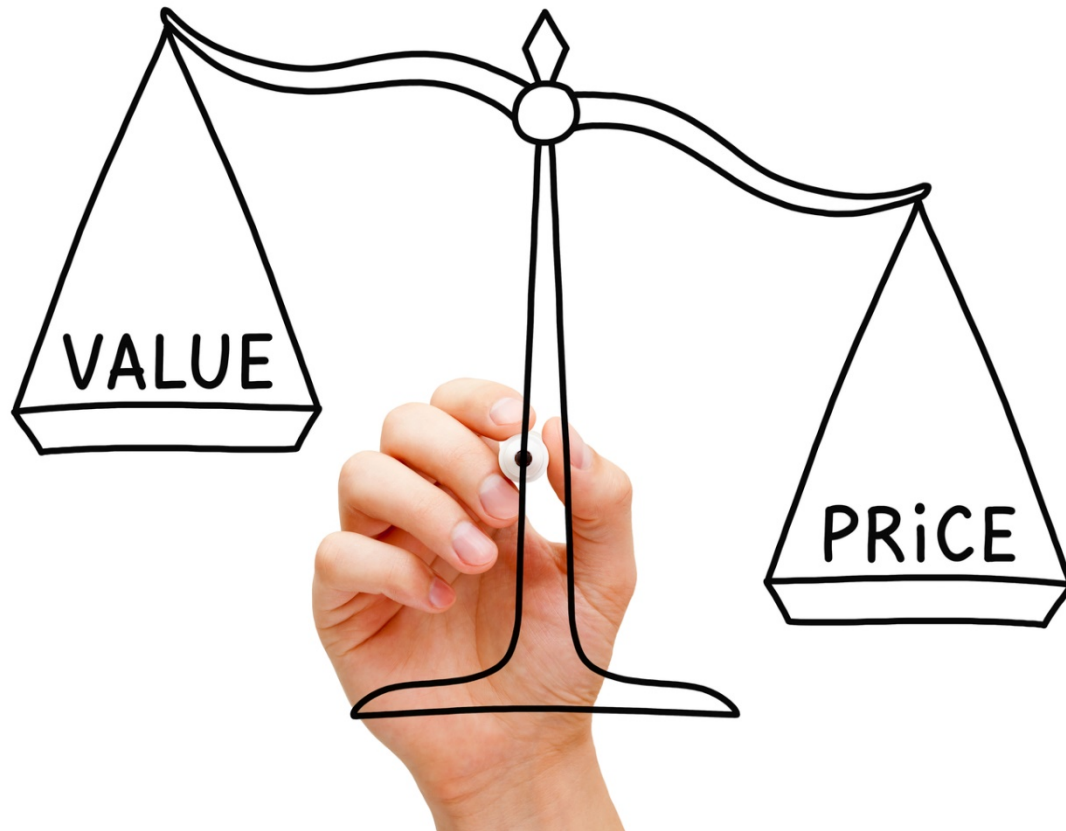
Detective, Staying away from frauds

My dream as an investor



Calling around the supply chain

My dream as an investor



Is the Valuation right?

**EVEN AFTER THIS I AM NOT
COMPLETELY SURE**

+

LONELY

+

AM I A FOOL?

Is this a better dream?



Mr. Super Quality Joe

www.SageOneInvestments.com



MY
SITUATION
WAS
SIMILAR TO
ARJUN -
CONFUSED
ABOUT
WHAT'S
RIGHT



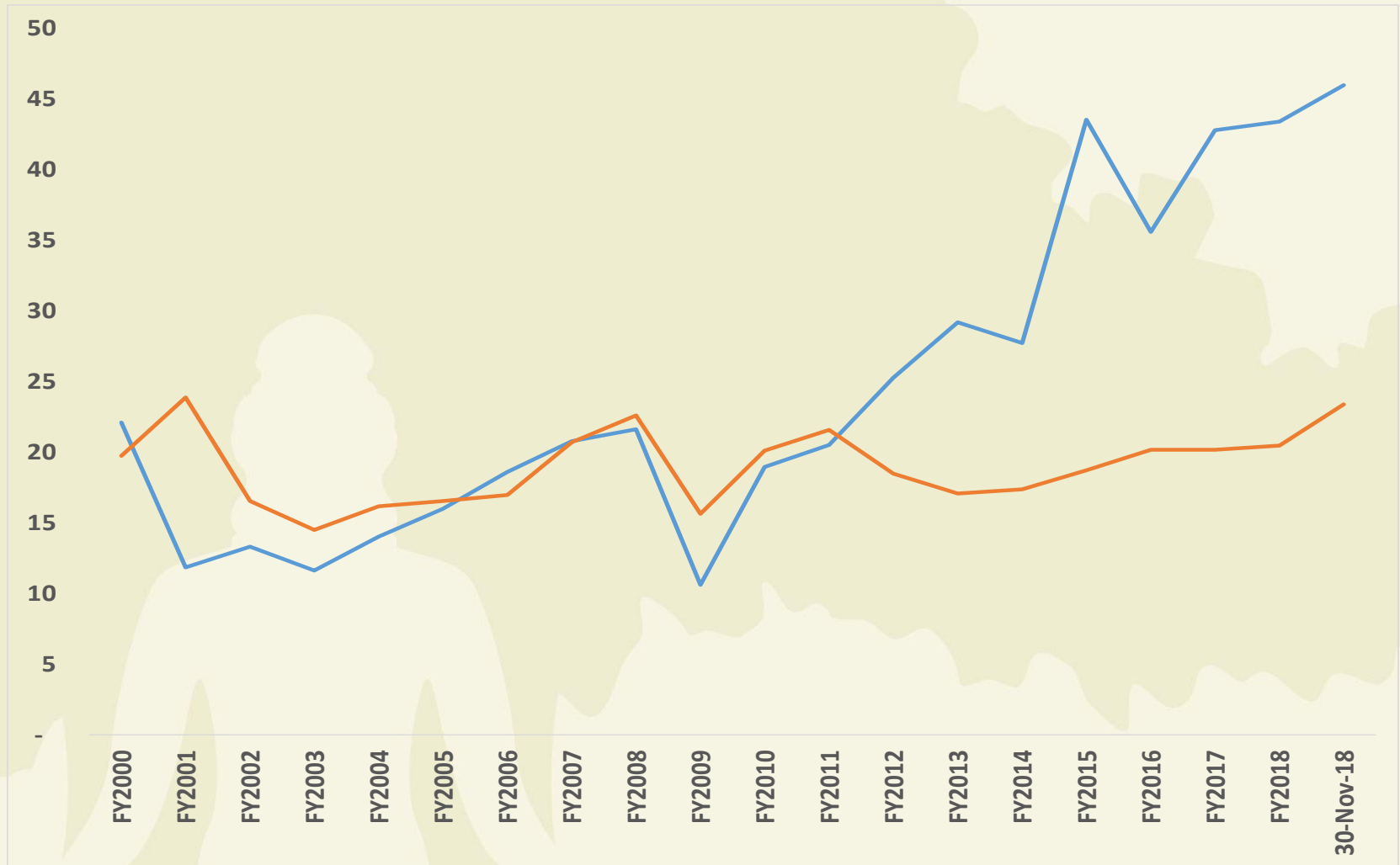
**KRISHNA DIDN'T
APPEAR**

**BUT SOMEONE DID
APPEAR**



**TELL ME MY SON, WHAT'S
YOUR CONFUSION?**

Quality PE vs Sensex PE



Herd going nuts to buy what Mr. Super Quality Joe owns

Quality stock premium jumped from 0% to 100% post FY2011

Quality Sustained Earnings Growth

Period	PE x Range		Earnings Growth		Returns	
	Quality Portfolio	Sensex	Quality Portfolio	Sensex	Quality Portfolio	Sensex
2000-08	11 - 22	14 - 23	15%	15%	15%	15%
2008-18	13 - 47	14 - 23	11%	5%	18%	8%

- With growth sustainability, the multiples doubled for quality stocks
- 6% earnings growth differential delivered 10% alpha for 10 years
- 18% compounding is 5.2x; 8% is 2.2x in 10 years

Qualitative Factors Favoring Consistency

- Consistency pays off by being much resilient during rough markets
- Avoiding “landmines” key to avoiding pain
- Many decision makers may lose job by looking foolish vs underperformance during bull run
- Many managers value “not going wrong” much highly vs. missing out on extra returns
- For FIIs, emerging markets itself are riskier asset class. Why increase further risk by getting into emerging companies
- Longer one stretches his holding period, lesser impact high valuation has on returns

Should I do the same thing? Why bear the pain?



**WARREN SHOWING HIS
“VISHWAROOP”**

Buffett's 1950s and 1960s

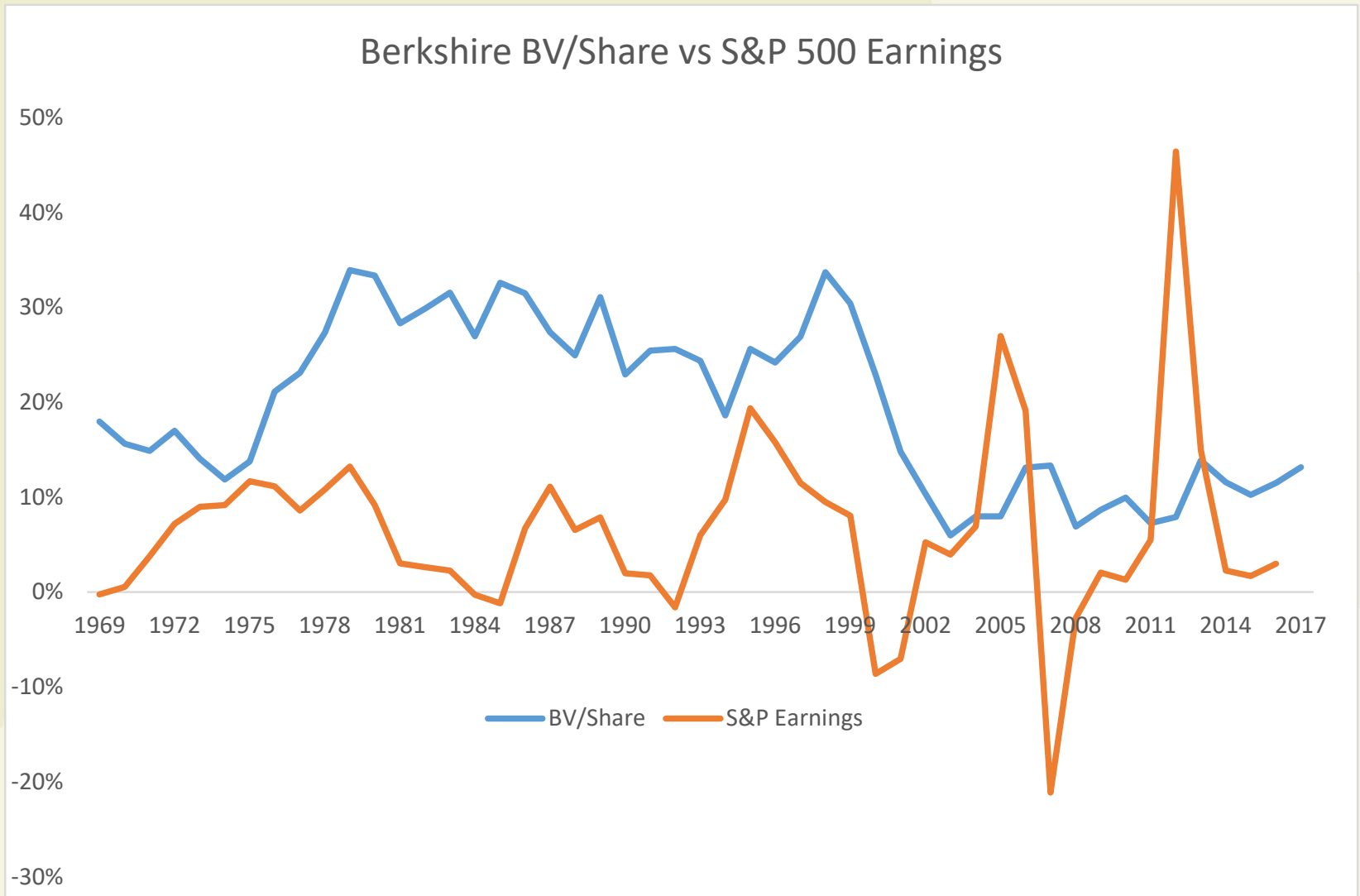
- In 1950s annualized returns of 50%
 - Early 1960s annualized returns of 30%
- } 2.5x of Indices
- Bought over 400 stocks in 13 years
 - Geico exited in 18 months at 2x
 - Bought Western Insurance between \$12-20/sh when EPS was \$16 in 1952-53. Share traded at \$95 in 1955
 - Marshall Wells \$200 price and \$62 EPS
 - Commonwealth Bank bought 12% stake at 5x PE and sold at 60% profit

Berkshire's Alpha vs S&P500

By Decade	BRK Earnings Growth	BRK Returns	S&P Earnings Growth	S&P Returns	Alpha in Earnings	Alpha in returns
1965-1970	15.6%	17.3%	-0.2%	4.1%	15.9%	13.2%
1970-1980	23.2%	26.3%	11.2%	8.4%	12.0%	18.0%
1980-1990	27.7%	31.7%	3.7%	13.8%	24.0%	17.9%
1990-2000	24.3%	26.7%	8.9%	17.5%	15.4%	9.2%
2000-2010	9.0%	5.4%	4.5%	1.4%	4.5%	4.0%
2010-2017	12.1%	13.8%	3.8%	13.8%	8.3%	0.0%
Total	19.2%	21.0%	5.9%	10.0%	13.3%	11.0%

Consistent high earnings growth was the key

Five Year Rolling Average of Growth

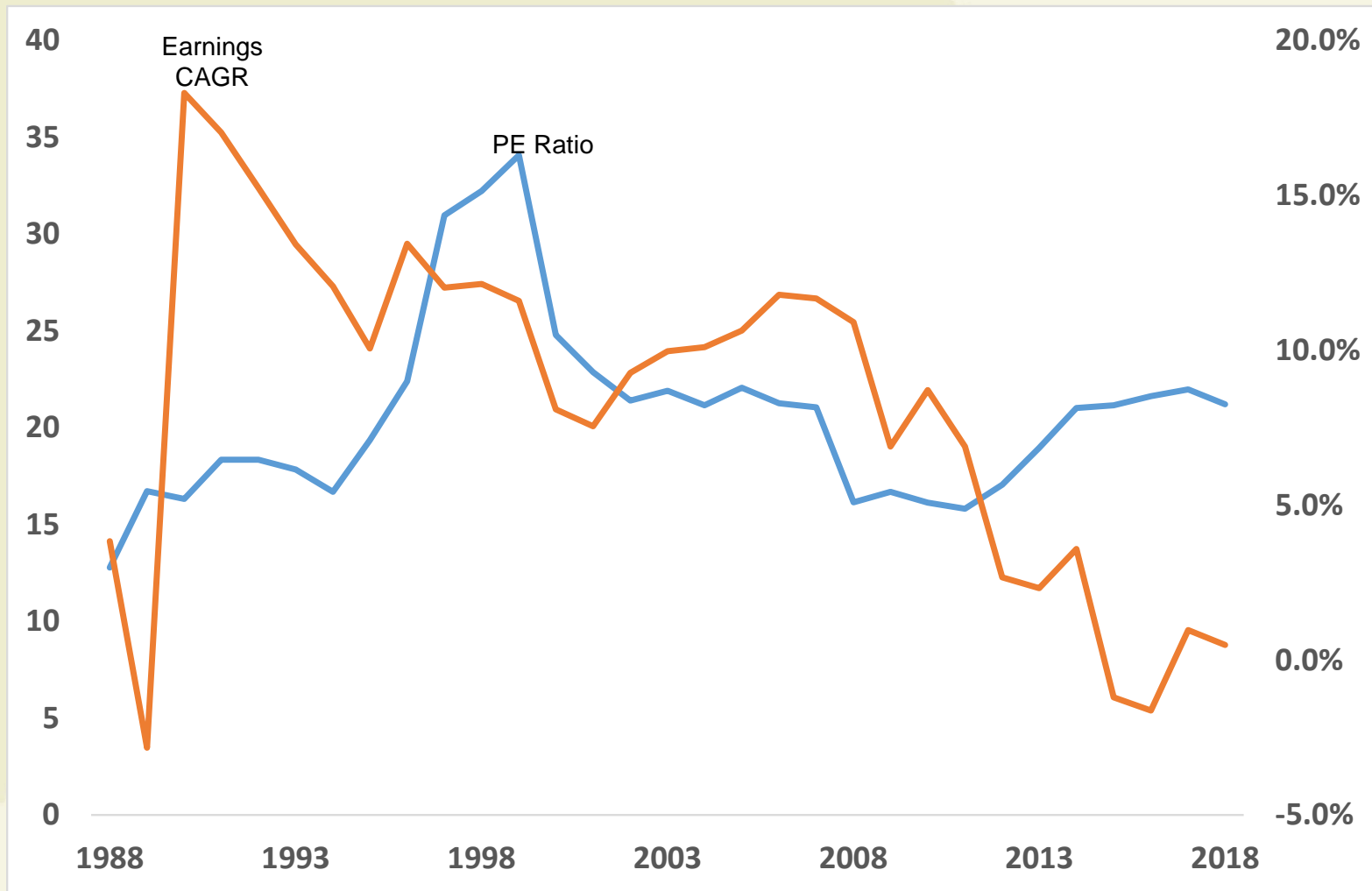


Phenomenal earnings growth even during de-growth for S&P 19

Buffett's Entry Points

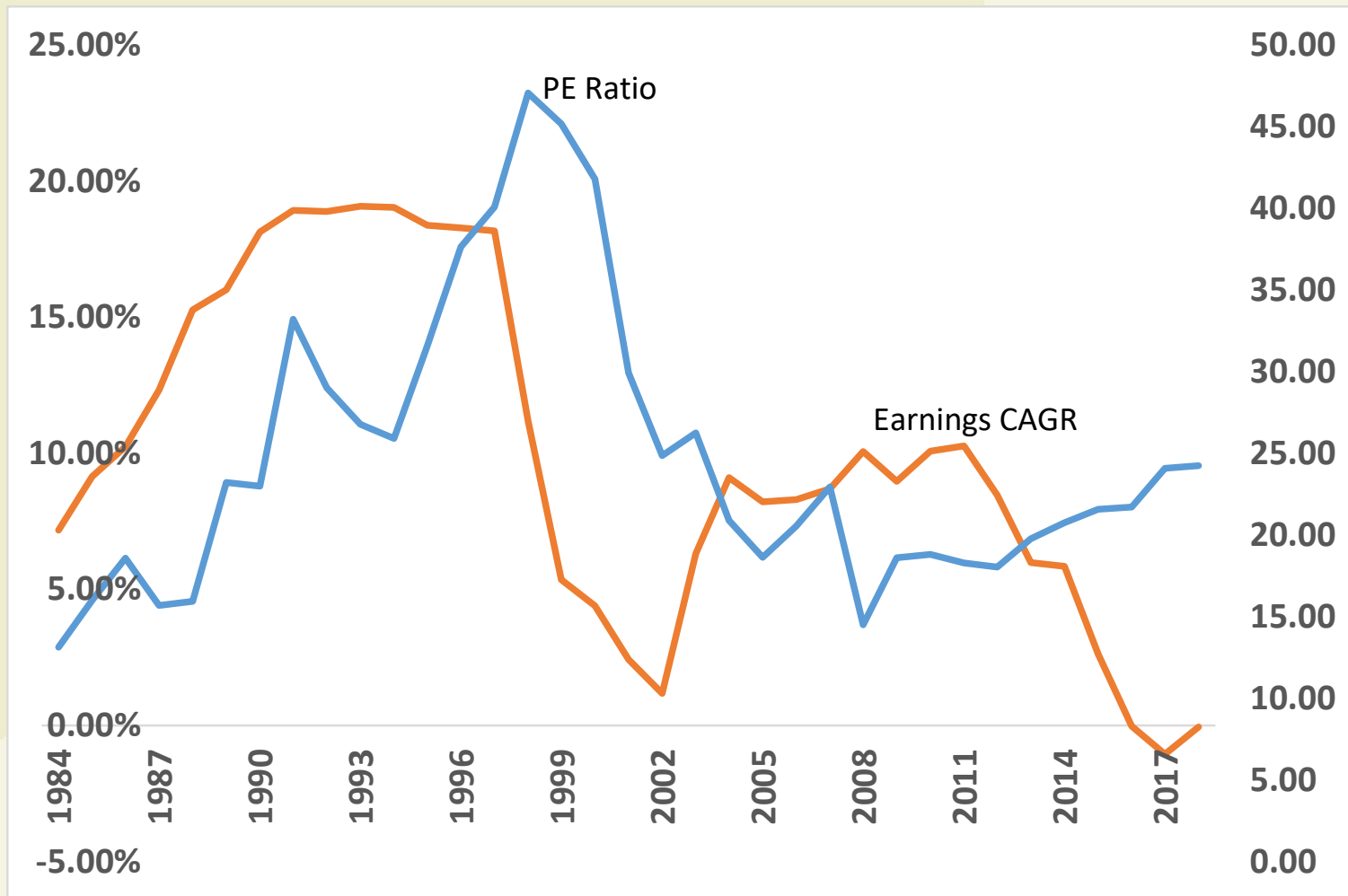
	Entry Year	PE at Entry
Coca Cola	1988	13.98
American Express	1964	13.52
General Foods Corporation	1979	6.18
Geico	1976	4.24
Washington Post	1973	8.13

P&G 5 yr Earnings CAGR vs. PEx



- High growth during 1980s & 90s
- PE above 25x for a very brief period

Coca Cola 5 yr Earnings CAGR vs. PEx



- High growth during 1980s & 90s
- PE above 25x for a very brief period

**IS GOING FOR
CONSISTENCY
STRATEGY INVINCIBLE?**

No Common Stock in the Last Two Decades

Best Performers During 1998 - 2008		Best Performers During 2008 - 2018
63 Moons Technologies Ltd.	Panacea Biotec Ltd.	Aarti Industries Ltd.
Aban Offshore Ltd.	Patel Engineering Ltd.	Ajanta Pharma Ltd.
Amtek Auto Ltd.	Praj Industries Ltd.	Atul Ltd.
Anant Raj Ltd.	Shriram Transport Finance Company Ltd.	Avanti Feeds Ltd.
Ansal Properties & Infrastructure Ltd.	Shristi Infrastructure Development Corpo	Bajaj Finance Ltd.
Bilcare Ltd.	Simplex Infrastructures Ltd.	Can Fin Homes Ltd.
Blue Dart Express Ltd.	Unitech Ltd.	Eicher Motors Ltd.
Havells India Ltd.	UPL Ltd.	Gruh Finance Ltd.
Himadri Speciality Chemical Ltd.		IFB Industries Ltd.
Hindustan Construction Company Ltd.		IndusInd Bank Ltd.
ICICI Bank Ltd.		Kajaria Ceramics Ltd.
ICSA (India) Ltd.		La Opala RG Ltd.
IVRCL Ltd.		Manappuram Finance Ltd.
Jai Corp Ltd.		Natco Pharma Ltd.
Jain Irrigation Systems Ltd.		PI Industries Ltd.
JM Financial Ltd.		Relaxo Footwears Ltd.
Kalpataru Power Transmission Ltd.		Sudarshan Chemical Industries Ltd.
Kotak Mahindra Bank Ltd.		Symphony Ltd.
Mercator Ltd.		TTK Prestige Ltd.
Moser Baer India Ltd.		VenkyS (India) Ltd.
Motherson Sumi Systems Ltd.		Vinati Organics Ltd.
NCC Ltd.		Zydus Wellness Ltd.

What happened to the US Nifty-Fifty Stocks in 1970s

"Cheap" Nifty Fifty Stocks

<u>Company</u>	<u>Symbol</u>	<u>Starting P/E</u>	<u>Subsequent Annualized Total Returns</u>			
			<u>10-yr</u>	<u>20-yr</u>	<u>30-yr</u>	<u>40-yr</u>
Philip Morris	MO	25.9	6.85%	18.71%	16.94%	16.53%
Bristol-Myers	BMJ	27.6	5.35%	13.10%	11.76%	10.17%
Pfizer	PFE	29	2.63%	11.41%	14.45%	10.40%
Pepsico	PEP	29.3	2.83%	13.55%	13.63%	11.42%
Procter & Gamble	PG	32	-1.59%	8.57%	10.76%	9.50%
IBM	IBM	37.4	-2.53%	1.95%	6.14%	7.20%
Dow Chemical	DWDP	25.5	-0.85%	8.50%	8.74%	7.22%

"Expensive" Nifty Fifty Stocks

<u>Company</u>	<u>Symbol</u>	<u>Starting P/E</u>	<u>Subsequent Annualized Total Returns</u>			
			<u>10-yr</u>	<u>20-yr</u>	<u>30-yr</u>	<u>40-yr</u>
McDonald's	MCD	85.7	1.75%	12.06%	11.53%	12.17%
Int'l Flavors & Fragrances	IFF	75.8	-5.24%	6.93%	5.50%	5.87%
Walt Disney	DIS	81.6	-3.78%	10.81%	9.40%	9.12%
Johnson & Johnson	JNJ	61.9	1.72%	10.48%	13.38%	10.62%
Coca Cola	KO	47.6	-6.93%	11.83%	11.52%	9.98%
Eli Lilly	LLY	46	-0.72%	8.26%	11.17%	7.99%
Merck	MRK	45.9	-0.23%	14.31%	13.11%	9.75%

Start date 6/1/72

Sources: Brooklyn Investor; Morningstar

Sensitivity of Returns to Valuation Drop

Assuming 15% annualized earnings growth

		Holding Period in Yrs				
		7%	3	5	10	20
% Drop in Valuation during the Holding Period	20%	7%	10%	12%	14%	
	30%	2%	7%	11%	13%	
	40%	-3%	4%	9%	12%	
	50%	-9%	0%	7%	11%	
	60%	-15%	-4%	5%	10%	
	70%	-23%	-10%	2%	8%	

- Current 44x multiple dropping to 22x means no returns for 5 yrs
- Bear market is not a necessity for the multiples to drop
- Many consumer stocks in the US which traded above 30x in the 1990s bull market came back to historical levels in the 2000s

FRUITS OF “KARMA”

Bajaj Finance - Quality?

Bajaj Finance	TTM	FY18	FY17	FY16	FY15	FY14	FY13	FY12	FY11	FY10	Gr x	CAGR
Sales		13,442	9,967	7,294	5,382	4,032	3,092	2,163	1,392	910.1	14.8	40%
PAT		2,674	1,836	1,279	898	719	591	406	247	89.4	29.9	53%
ROE		20.5	21.7	21.1	18.7	19.6	22.0	24.1	19.7	8.0	2.6	
PEx	54.9	38.1	35.0	29.0	22.8	12.4	9.7	8.3	10.4	13.0	2.9	
PBx	8.4	6.2	6.7	5.1	4.3	2.2	1.7	1.7	1.9	1.0	6.1	
Mcap	146,750	101,787	64,206	37,106	20,481	8,905	5,719	3,370	2,559	1,165.7	87.3	75%
% of Float owned by FIIs	45%	43%	46%	43%	35%	30%	18%	13%	13%			

Max Drawdown from recent peak -36.2%

- Cheap valuations for multiple years after performance started as market takes time to digest. Now PBx = PEx 6 years ago
- Earnings increase by 30x and market value by 87x in 8 years
- Business now considered worth holding for 10 years, but returns for decades made in 3-5 years

Valuation is super sensitive to discount rate

Years		1	2	3	4	5
Capital		100.00	120.00	144.00	172.80	207.36
PAT		25.00	30.00	36.00	43.20	51.84
Return on Capital (ROCE)		25%	25%	25%	25%	25%
Reinvest		80%	80%	80%	80%	80%
	growth 20%	20.00	24.00	28.80	34.56	41.47
Payout		5.00	6.00	7.20	8.64	10.37
Extected Return	12%	0.89	0.80	0.71	0.64	0.57
		4.46	4.78	5.12	5.49	5.88
Present Value	1,538.75					
	fwdPE 61.5 ttmPB 15.39					



Years		1	2	3	4	5
Capital		100.00	120.00	144.00	172.80	207.36
PAT		25.00	30.00	36.00	43.20	51.84
Return on Capital (ROCE)		25%	25%	25%	25%	25%
Reinvest		80%	80%	80%	80%	80%
	growth 20%	20.00	24.00	28.80	34.56	41.47
Payout		5.00	6.00	7.20	8.64	10.37
Extected Return	18%	0.85	0.72	0.61	0.52	0.44
		4.24	4.31	4.38	4.46	4.53
Present Value	267.57					
	fwdPE 10.7 ttmPB 2.68					



Avanti Feeds - Quality?

Avanti Feeds	TTM	FY18	FY17	FY16	FY15	FY14	FY13	FY12	FY11	Gr x	CAGR
Sales		3,393	2,616	2,018	1,781	1,132	648	393	208	16.3	49%
PAT		465	227	159	117	70	30	28	4	131.7	101%
ROE		55.8	42.9	46.4	52.4	45.8	27.6	34.4	5.2	10.8	
PE _x	14.9	22.7	15.6	11.5	12.0	6.7	3.0	2.7	8.2	2.8	
PB _x	4.4	9.8	5.3	4.3	5.3	2.6	0.7	0.8	0.4	23.6	
Mcap	4,695	10,137	3,366	1,809	1,396	472	91	77	29	350.0	131%

Max Drawdown from peak -65.2%

- Cheap valuations for multiple years after performance started as market takes time to digest
- Earnings increase by 131x and market value by 350x in 7 years
- Business probably not worth holding for 10 years, but returns for decades made in 3-5 years

La Opala - Quality?

La Opala	TTM	FY18	FY17	FY16	FY15	FY14	FY13	FY12	FY11	FY10	Gr x	CAGR
Sales		259	235	249	223	178	154	115	96	75.0	3.5	17%
PAT		73	62	59	42	30	23	13	9	2.8	26.5	51%
ROE		15.7	18.7	28.1	29.5	34.9	35.3	25.0	22.4	7.5	2.1	
PEx	33.8	42.9	48.0	56.1	50.2	25.1	14.6	9.0	6.8	15.3	2.8	
PBx	5.0	6.3	6.9	14.2	11.3	7.7	4.5	2.1	1.4	1.1	5.6	
Mcap	2,464	3,149	2,986	3,293	2,093	751	334	114	63	42.4	74.2	71%

Max Drawdown from recent peak -49.9%

- Cheap valuations for multiple years after performance started as market takes time to digest
- Earnings increase by 26x and market value by 74x in 6 years
- Business probably not worth holding for 10 years, but returns for decades made in 3-5 years

PI Industries - Quality?

PI Ind	TTM	FY18	FY17	FY16	FY15	FY14	FY13	FY12	FY11	FY10	Gr x	CAGR
Sales		2,277	2,277	2,096	2,097	1,762	1,246	957	792	595.3	3.8	18%
PAT		367	460	312	246	188	97	104	65	41.9	8.8	31%
ROE		20.8	33.1	30.3	31.0	30.8	22.9	39.4	38.8	37.5	0.6	
PEx	30.2	33.3	25.1	25.0	33.8	20.1	18.0	12.9	10.0	7.1	4.7	
PBx	5.8	6.4	7.1	6.7	9.3	5.5	3.3	4.1	3.2	2.3	2.8	
Mcap	11,095	12,245	11,520	7,781	8,313	3,787	1,750	1,333	654	298.6	41.0	59%

Max Drawdown from recent peak -33.2%

- Cheap valuations for multiple years after performance started as market takes time to digest
- Earnings increase by 9x and market value by 41x in 7 years
- Business probably not worth holding for 10 years, but returns for decades made in 3-5 years

Key to Active Investment

- Most importantly realize that it's **HARD WORK**
- Stay away from BIG Blunders
- Generate market returns for 80% of your portfolio (market returns ~ 13%/yr)
- BUT, for the 20% of your companies find companies from the top 30 performing stocks during the decade (average return 40%/yr)
- Your returns would be double of the market (25%/yr)
- **IF goal is to beat the market by 4-5%, don't bother about this hard work. Just sit back and relax, but don't forget**

13% Compounding for 20 years	11.5 x
18% Compounding for 20 years	27.4 x
25% Compounding for 20 years	86.7 x

**“SET YOUR HEART UPON
YOUR PROCESS AND
NOT ON ITS REWARDS”**

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