Rahul Lingala’s Investment Journey

ValuePickr Chintan Baithak - Jun 2019

Brief Intro

- Born and Brought up in Hyderabad
- Graduated in B. Tech., Computer Science & Engineering at IIT Bombay - 2017
- Working as a Strat at Goldman Sachs Bengaluru

Investment Journey - Phase I

- Started in January 2018 by reading my first book on Investing
- Played with some formula-based investing without studying the business
- Tasted some disasters - Kwality Ltd

Investment Journey - Phase II

- Used to read lots of books before venturing into investing.
  So pivoted my choice of books from regular non-fiction to investment books - Peter Lynch, Joel Greenblatt, Philip Fischer, Benjamin Graham…
- Investment process still not well defined after reading the books
- Something was missing - Lack of guidance

Investment Journey - Phase III

- Joined VP - October 2018
- Have read almost each and every post of classic threads like:
  Ambika Cotton Mills, Shemaroo Entertainment, Eicher Motors….
- Tried understanding mental models of fellow VP’ers
- Studied many successful investments / companies from 2013 to 2018
- Created (updating with new learnings) my own model for stock price - next few slides

Modelling Stock Price - Three Factor Model

Price = Price / Earnings X Earnings
Earnings = Revenue X Earnings / Revenue

=> Price = PE Ratio X Revenue X PAT Margins

Let's assume
Price increase by P%,
PE Ratio increase by *F1%*, Revenue increase by *F2%*, PAT Margins increase by *F3%*

=> (1 + P%) = (1 + F1%) X (1 + F2%) X (1 + F3%)

PE Ratio Growth (F1%) Drivers

- Market Sentiment
- Industry Economics
- Practically, PE Ratio can’t keep growing or can’t keep falling forever
  Can easily hit end saturation points
  => *F1%* can’t be continuously positive or continuously negative over years

Revenue Growth (F2%) Drivers

- Size of Company / Size of Opportunity
- Smart capital deployment
- Competition
- Branding
- New Products
- Industry Economics
- Practically, Revenue can keep increasing or decreasing in lots of companies / industries
  Saturation points are very stretched as India has lots of underpenetrated markets
  Notice this difference between F2% and *F1%*

Margins Growth Rate (F3%) Drivers

- Improving efficiency
- Premiumization of Products
- Operating Leverage
- Again, margins similar to PE Ratios can't keep increasing or decreasing forever
  Can easily hit end saturation points
  => F3% can't be continuously positive or negative over the years

Relation - PE Ratio (F1), Revenue Growth (F2) & Margin Growth (F3)

F1% is a derived factor, especially if it is not at its practical end saturation points.

- High *F2%* or High *F3%* => High *F1%*
- Low / Negative *F2%* => Negative *F1%*
- Negative *F3%* => Negative *F1%*

Sometimes, *F2%* and *F3%* are interdependent via operating leverage.

- High *F2%* => High *F3%*
- Negative *F2%* => Negative *F3%*

Signal to Enter

Upside visibility in at least two factors among the three with limited downside on the third

- Upside visibility in Revenue + PE (not margins) => Allocate 6-7%
- Upside visibility in Margins + PE (not revenues) => Allocate 6-7%
- Upside visibility in Revenue + Margins (not PE) => Allocate 6-7%
- Upside visibility in Revenue + Margins + PE => Allocate 10-12%

Depending on upside of a single factor doesn't provide enough margin of safety.
When allocating 6-7%, buying in two to three steps.
When allocating 10-12%, buying in four to five steps.

Signal to Exit

If you enter using two factors upside, start staggered selling after realizing upside in one factor.
And exit completely if you can’t see visibility in any of the factors.

If you enter using three factors upside, start staggered selling till 6-7% after realizing first factor.
And some more staggered selling to 3-4% after realizing second factor.
And exit completely once there is no visibility.

Great Companies leading to Multibaggers

Wealth Creator	Price (P%)	PE (F1%)	Revenues (F2%)	Margins (F3%)
Maruti Suzuki (FY12-FY18)	600%	60%	127%	111%
VIP Industries (FY13-FY18)	640%	82%	66%	141%
Nilkamal Plastics (FY13-FY18)	962%	240%	27%	161%
Eicher Motors (FY12-FY18)	971%	75%	45%	178%
Kajaria Ceramics (FY13-FY18)	400%	134%	75%	30%

Great Companies with Decent Returns

Great Company	Price (P%)	PE (F1%)	Revenues (F2%)	Margins (F3%)
Zee Entertainment (FY13-FY18)	153%	22%	85%	11%
Bajaj Auto (FY13-FY18)	75%	26%	32%	6%
TTK Prestige (FY13-FY18)	107%	7%	35%	43%
Gillette India (FY13-FY18)	139%	-29%	44%	124%
Exide Industries (FY13-FY18)	92%	50%	82%	-29%

Observations

Companies with upsides on two factors typically lead to multibaggers.

Based on my sample (can be biased), the top two factors were mostly Margin Expansion & PE Expansion contrary to my initial opinion of Revenue Growth.

However, if you take a time frame of decades instead of years for the model, Revenue Growth would be the primary factor but not Margin Expansion / PE Expansion

After a sharp run-up, one upside is typically realized and then the company compounds with impact from single factor leading to decent returns. You may want to start moving your money then.

Notes

Since I have begun building my portfolio recently, I have NOT exited any stock using the exit signal yet.

However, bought couple of companies using the entry signal recently.

Model is prepared based on hindsight bias / analysis.

Model to be used only for simplifying thoughts / strategy.
Real work lies in understanding which factor would grow by how much amount.

Investment Journey - Phase IV

Studying companies to look for opportunities which have upside on two factors from the above model.

Focussing more on those which have scope for margin expansion (but not limited to).

Circle of competence is still tiny.
60% portfolio is in cash.
In the process of expanding circle of competence and preparing my portfolio.

Thank
You
For
The
Opportunity