Portfolio allocation decisions

Three buckets:

- High confidence [>15% returns] (6%)

- Moderate confidence (3-4.5%)

- Low confidence (1-2%)

High confidence (6%)

- HCL Tech (fair, 12-15% growth, 3.4x EV/sales, 19x P/E, sell at >20 P/E)
- ITC (cheap, 10-12% growth, 5x EV/sales, 19x P/E, sell at >8x EV/sales)
- PI Industries (fair/overvalued, 20% growth, 7.6x EV/sales, sell at >8x EV/sales)
- Powergrid (cheap, 12% growth, 1.7x P/B, sell at >2x P/B)
- L&T (fair, 12% growth, 1.3% dividend yield, sell <1.2% dividend yield)

- **TOTAL ~ 30%**

Moderate confidence (3-4.5%)

- Ajanta pharma (fair, 15%+ growth, 24x P/E, sell at >30 P/E)
- Residential real-estate bucket (cheap, potential growth, Ashiana and Kolte at 4.5% each)
- Indigo (fair, 15% growth, 1.9x EV/(FY20 sales), sell at >2.2x EV/sales)
- NESCO (cheap, 15% growth, 18x P/(FY20E), sell at >20x P/E)
- Auto (Suprajit + Bajaj + Ashok Leyland, ~9%, fair, 12% growth on basket, sell when operating margin peaks or at 20% higher price)
- Pharma (Lupin + Cadila + Natco + Biocon, most are undervalued except Biocon, basket bet ~ 8.5%)
- AMC business (HDFC + Nippon ~ 6%, fair + 10-12% growth)
- CARE (cheap, 12% growth, sell at >30x P/E, currently at <20x P/E)
- Financials (Manappuram + HDFC ~ 7%, HDFC fairly valued, Manappuram undervalued)
- **TOTAL ~ 55%**

Low confidence (1-2%)

- Avanti feeds (fair/cheap, 12-15% growth, 1.5x EV/sales, sell >2x EV/sales)
- Cera (expensive, high growth due to real estate recovery, 2% allocation)
- IEX (expensive, 15% growth, 45x P/E, sell at >33x P/E)
- Infy (fair/expensive, 10-12% growth, 30x P/E, sell at >25x P/E)
- Commodities (NALCO + Maithan ~ 4%, cheap, bet on cyclical revival)
- Wonderla + Inox Leisure (3%, bet on consumer discretionary revival)

- **TOTAL ~ 15%**

Compounders vs cyclicals

Over last 10-years

- M1 = # years with positive free cashflow

- M2 = # years with ROCE/ROIC > 20%

- If (M1 + M2) > 14: Compounder

- Else   : Cyclical

Examples

Out of last 10 years financials	ROCE > 20%	Positive FCF	Overall
Ajanta Pharma	8.00	10.00	18.00
Bajaj auto	10.00	10.00	20.00
CARE Ratings	10.00	10.00	20.00
Cera sanitaryware	10.00	8.00	18.00
Divis laboratories	10.00	10.00	20.00
HCL Tech	10.00	10.00	20.00
HDFC	NA	NA	
IEX	6.00	6.00	12.00
Infosys	10.00	10.00	20.00
ITC	10.00	10.00	20.00
NESCO	10.00	9.00	19.00
PI Industries	10.00	7.00	17.00
Reliance nippon asset management	6.00	4.00	10.00

Out of last 10 years financials	ROCE > 20%	Positive FCF	Overall
Ashiana Housing	4.00	1.00	5.00
Ashok Leyland	4.00	9.00	13.00
Avanti feeds	8.00	8.00	16.00
Balkrishna Industries	6.00	6.00	12.00
Biocon	1.00	5.00	6.00
Indigo	6.00	9.00	15.00
INOX Leisure	1.00	6.00	7.00
Kolte Patil	2.00	8.00	10.00
Larsen & Tourbo	3.00	9.00	12.00
Lupin	7.00	9.00	16.00
Maithan alloys	6.00	6.00	12.00
Manappuram finance	NA	NA	
NALCO	1.00	8.00	9.00
NATCO Pharma	3.00	5.00	8.00
Powergrid	NA	NA	
Wonderla holidays	6.00	7.00	13.00

How many have beaten nifty (+43%)?

	1-year returns
Ajanta Pharma	25%
Bajaj auto	50%
CARE Ratings	9%
Cera sanitaryware	64%
Divis laboratories	60%
HCL Tech	74%
HDFC	25%
IEX	79%
Infosys	87%
ITC	18%
NESCO	-5%
PI Industries	49%
Reliance nippon asset management	19%

	1-year returns
Ashiana Housing	32%
Ashok Leyland	84%
Avanti feeds	31%
Balkrishna Industries	50%
Biocon	31%
Indigo	43%
INOX Leisure	-8%
Kolte Patil	15%
Larsen & Tourbo	33%
Lupin	59%
Maithan alloys	36%
Manappuram finance	18%
NALCO	87%
NATCO Pharma	45%
Powergrid	22%
Wonderla holidays	7%

Open questions

- When to exit?
  - Incorrect business assessment (easy)
  - Expensive valuations (<6% expected returns)

- Reallocation among portfolio companies?
  - Make weighted average returns of portfolio as 15%?

- Adding new companies?
  - Expected return differential b/w exiting and entering company?
  - Should a company that might yield 12% return replace a company with 8% return? Or does a new company only enter at 15%+ expected return (relative vs absolute valuations)