

Indian Investing Conclave

Alpha Series Ep. 10



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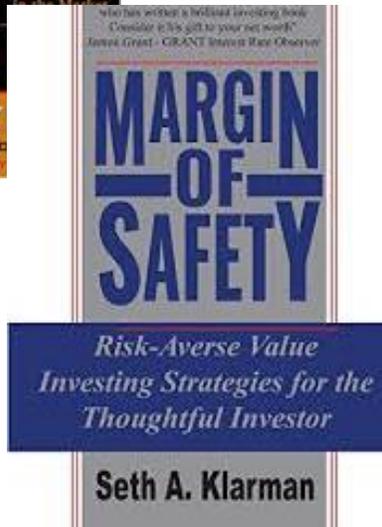
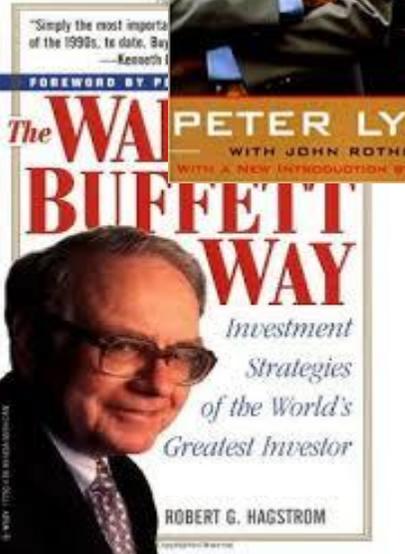
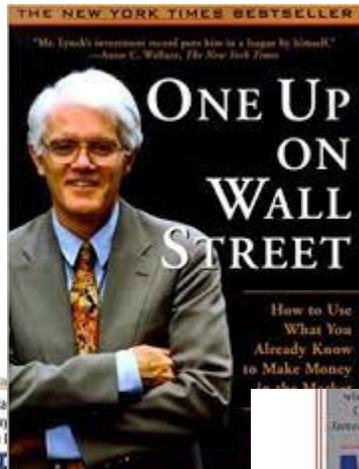
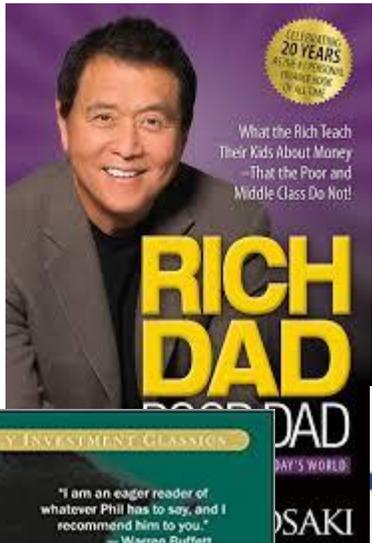
I WILL TRY TO BROADLY COVER THE FOLLOWING

- My Journey
- Investment Philosophy & Approach
- Some Insights and Learnings
- Investment Process – Ideation, Selection, Allocation, Selling
- Mistakes
- Some recent books I enjoyed reading

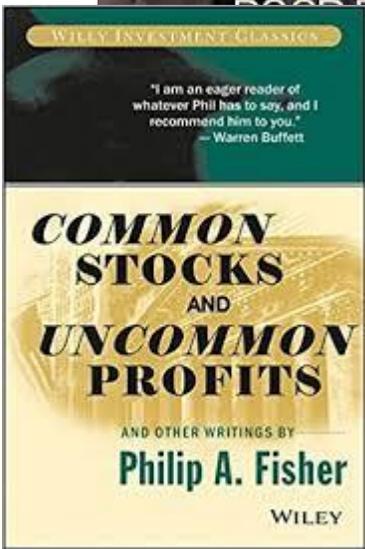


Whoever we are, whatever we are, as people, as investors,
is a culmination of all our past experiences...

STARTING FROM SCRATCH



- Initial impetus came from reading Robert Kiyosaki's *Rich Dad, Poor Dad*. Objective was to attain financial freedom and not to have to work for a living.
- No financial background, which was an advantage. **Nothing to unlearn.**
- First book on investing was *The Warren Buffett Way*. It made immediate sense. **I wanted to be a part-owner of a business.**
- Buffett was the starting point. Discovered Peter Lynch, Seth Klarman, Howard Marks, Phil Fisher, Sir John Templeton and many others over the next decade.



VALUEPICKR HELPED SIGNIFICANTLY IN REFINEMENT OF MY THOUGHT PROCESSES



ValuePickr Research

ValuePickr Forum

- Lot of thought and refinement went into portfolio allocation, business quality, management quality determination
- Provided a platform for collaborative research and benefit of scuttlebutt for retail investors like me
- Focus was on deepening knowledge and discussing company fundamentals threadbare
- Both bulls and bears are equally participative which helps in getting a balanced view, though **need to guard against echo-chamber biases**
- As a moderator, it gives me an opportunity to give back to the investor community
- Extended it to small face-to-face meetups in Kolkata, which can be attended by anyone interested in investing

INVESTMENT PHILOSOPHY HAS EVOLVED IN THE LAST 2 DECADES (AND MAY CHANGE IN THE FUTURE AS WELL)



- Capital is sacred and is to be respected
- Compounding over long periods is the key to wealth creation
- Simple is better than complex
- Keep an open mind and keep learning
- Not focused on any index

“Everyone is a genius in a bull market – so find a bull market!”

THE APPROACH THAT IMPLEMENTS THE PHILOSOPHY



Intelligence &
Common-sense based
approach



Focus on overall
portfolio and not only
on individual stocks



Core and Tactical
approach to portfolio
construction



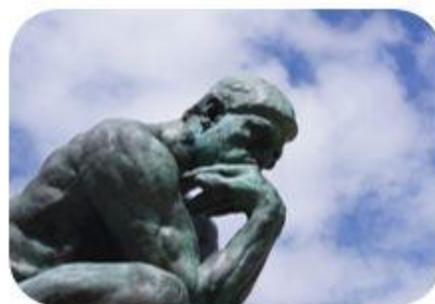
Long-term orientation



Focused on reducing
cognitive biases



Continuously learning
and improving model



Rational decision
making process



Fundamental +
Technical + Quant
approach

INSIGHTS AND LEARNINGS – FOCUS ON THE KNOWABLE

- The market is a complex adaptive system
 - Too many parameters to model for forecasting accurately
 - Practically not possible to time the market consistently
- Better to focus on what is knowable



INSIGHTS AND LEARNINGS – MEAN REVERSION

- Given a long timeframe, nearly all businesses are mediocre businesses
- Don't fall in love with your stocks
- Duration of competitive advantage has reduced drastically



INSIGHTS AND LEARNINGS – PROTECT CAPITAL



- "He that fights and runs away, May turn and fight another day; But he that is in battle slain, Will never rise to fight again." - Tacitus
 - Capital is sacred. It is limited. Need to protect it. Use the concept of stop loss in investing!
- Diversification & portfolio allocation are two ways I manage risk.

INSIGHTS AND LEARNINGS – MANAGEMENT MATTERS MOST

- **All roads lead to ... management**
 - In India, management matters more than business
 - Management accomplishments can be understood from the numbers, not always necessary to meet them
 - Unless one is a very good judge of character, it is probably better not to meet management
- Start an analysis of a company by assuming management may not be telling the truth 😊
- Management has a vested interest in promoting their company. Take their word with a **BIG BOWL** of salt.
- Managements are as much under psychological influence as common people - hubris, endowment effect etc



INSIGHTS AND LEARNINGS – DISCIPLINE, PROCESS & CHECKLISTS TO SAVE ME FROM MYSELF



- *Investment mindset & Rationality* is the differentiator between great and average investors
- Preventing errors (process adherence & knowledge)
 - Use a **personalized checklist**, one which is a living document that gets appended over the years
 - Cover research process, business quality, management quality, valuation, past mistakes & behavioral biases
- Try to keep things simple and get the basics right
- Have a **written down** process & revise over time; it needs to cover:
 - Idea generation
 - Stock selection
 - Allocation
 - Selling

IDEA GENERATION – WHAT EXCITES ME IN A STOCK

- Idea can originate from anywhere ~ fundamental or technical screeners, magazine articles & conversations
- A confluence of more than one of the following factors working together:
 - Opportunity size
 - Low competitive intensity
 - Low debt
 - Industry tailwind
 - Good (preferably great) management
 - Low valuation



USE DIFFERENT MODELS FOR STOCK SELECTION



for QUALITY

Quality denotes
quality of the business
and management



for GROWTH

Growth denotes
growth in earnings and
sustained RoE



for LONGEVITY

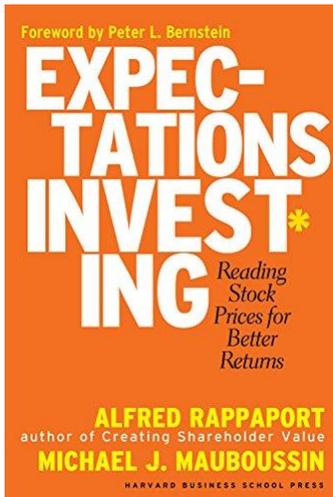
Longevity denotes longevity
of the competitive
advantage or economic
moat of the business



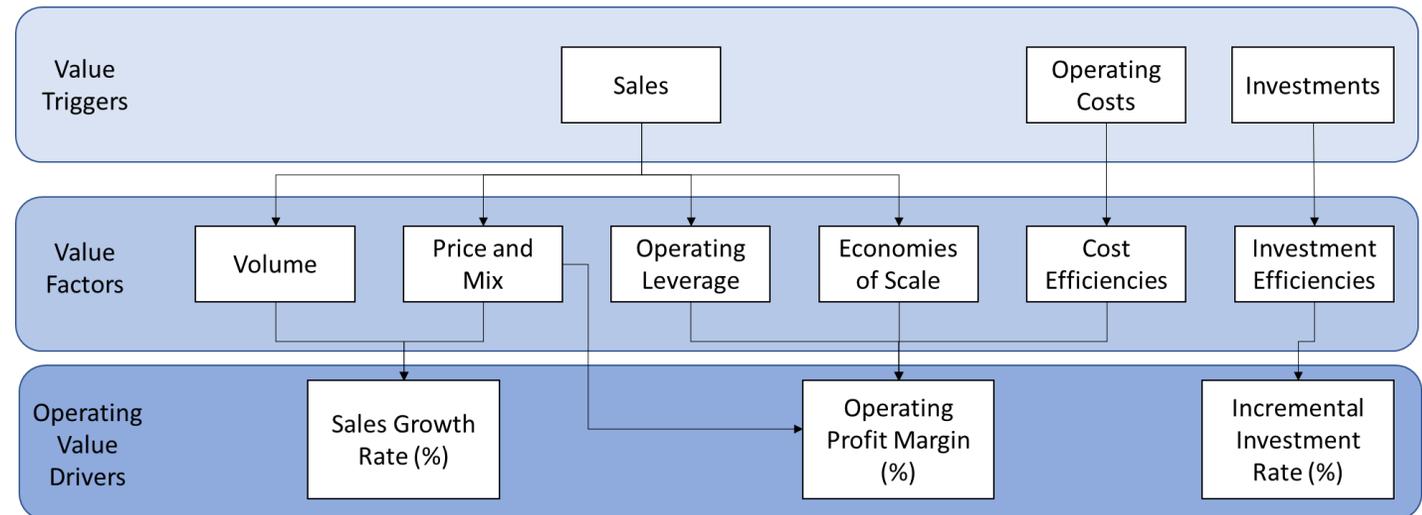
for PRICE

Price' denotes our approach of
buying a good business for a
fair price rather than buying a
fair business for a good price

EXPECTATIONS INVESTING FRAMEWORK PROVIDES A USEFUL MODEL TO THINK ABOUT THE LEVERS OF A BUSINESS



- Expectations Investing Framework
 - How much of the future is already discounted in the stock price?



Understanding market expectation was at least as important as, and often different from, the fundamental knowledge. ~ Michael Steinhardt

1. Identify which value trigger is most important
2. Perform scenario-analysis based on possible changes in value factors
3. Identify the implication for the operating value triggers

THINKING FROM DIFFERENT VANTAGE POINTS ABOUT A BUSINESS

Vantage Point # 1: Business Analyst	Evaluate the business quality
Vantage Point # 2: Prudent Banker	How much money would you lend to the company?
Vantage Point # 3: Ben Graham, Smart Value Investor	Determine the value of the entire business including a margin of safety
Vantage Point # 4: Bond Fund Manager	If the equity was a bond, would you buy?
Vantage Point # 5: Henry Kravis, LBO Artist	How can capital structure of the company be used to create value?
Vantage Point # 6: Modigliani & Miller, Finance Academics, Nobel Laureates	Irrelevance of capital structure based on Efficient market hypothesis ~ Something to ignore 😊
Vantage Point # 7: Value-Oriented Management	Opportunity of corporate actions (special dividend, buyback, and bonus debenture) to enhance shareholder value
Vantage Point # 8: The Civilization	What is the impact of the company on the world

Refer to https://fundooprofessor.wordpress.com/2011/04/24/vantage_point/ for the details

SELLING IS AN ART AND REQUIRES RIGOROUS DISCIPLINE

- Business momentum decelerates
- Business deteriorates or management does something that harms the business long term
- Made a mistake while buying ~ thesis wrong or not playing out
- Switch to a better opportunity
- Stop loss gets triggered ~ typically 20%-30% of buying price or a pre-determined one



OBVIOUS (IN HINDSIGHT) MISTAKES OF OMISSION (ONLY A FEW ILLUSTRATIVE EXAMPLES)



EXAMPLE: SUPREME INDUSTRIES

BUY REASONS:

- Co had dramatically improved its ROCE & RONW, reduced overall debt
- OPM was up nearly 40% on back of premiumisation of products
- PAT was up nearly 70%

GROUPS IN INDUSTRY 21

	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009
Polymers Processed (MT)	67262	68413	83499	91913	100053	95439	118115	130547	139239	172746
Sales	56096.08	53487.76	67466.02	79241.62	90925.15	93150.04	113067.09	132963.00	149882.45	180900.03
Less: Excise Duty	8145.03	6960.63	8339.50	9901.92	11297.96	11740.33	14860.69	16796.94	18860.35	15707.16
Net Sales	47951.05	46527.13	59126.52	69336.70	79627.19	81409.71	98206.40	116166.06	131022.10	165192.87
Other Income	476.32	289.13	338.96	380.59	242.14	1003.30	466.61	666.76	893.91	904.53
Total Income	48427.37	46816.26	59465.48	69717.29	79869.33	82413.01	98673.01	116832.82	131916.01	166097.40
PSIDT / Average Capital Employed	23.16	18.83	22.30	21.88	21.72	21.22	22.72	31.78	32.34	47.47
ROACE (%)	15.87	12.04	13.81	12.78	11.63	11.97	13.50	22.40	23.98	37.37
PSIT / Average Capital Employed										
RONW (%)	11.92	2.01	8.10	9.40	11.09	11.67	19.86	23.83	21.71	36.55
(PAT / Average Net Worth)										
Debt : Equity (Long Term Debt / Total Net worth)	0.96	1.10	1.18	0.59	0.83	0.95	0.65	0.89	1.17	1.02
Debt: Equity (Total Debt / Total Net Worth)	1.55	2.02	1.75	1.33	1.03	1.19	1.20	1.02	1.21	0.87
Employee's Strength	1789	1676	1790	1939	1876	2113	2202	2349	3055	3245

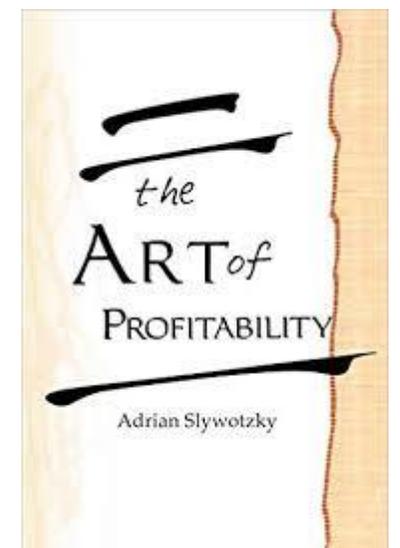
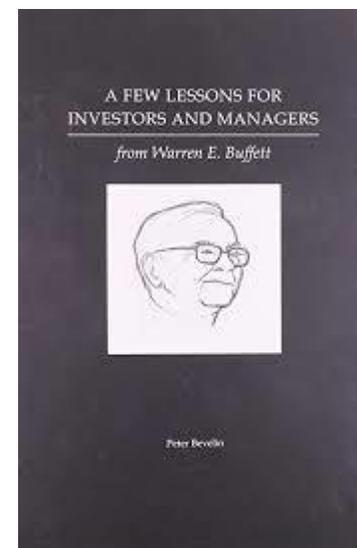
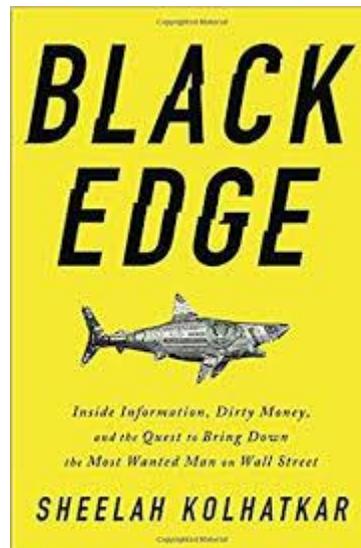
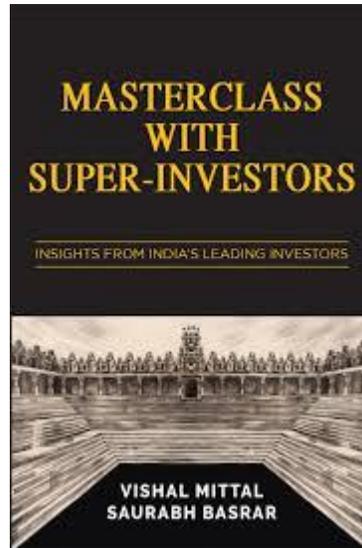
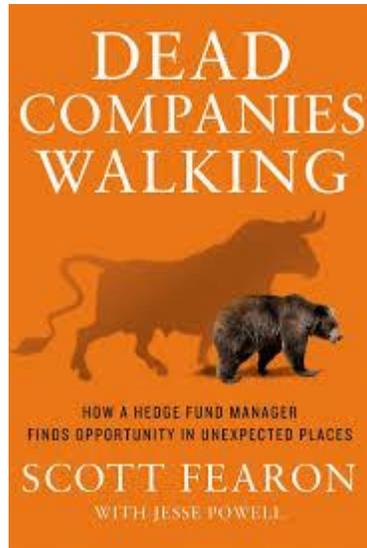
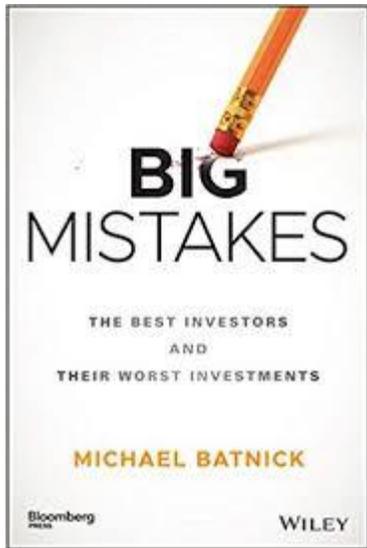
EXAMPLE: SUPREME INDUSTRIES



SELL REASONS:

- Co was being traded at a PE of over 30 and an EPS growth rate of 10%
- Improvement of ROCE of about 30% looked difficult

SOME INVESTING BOOKS THAT I READ RECENTLY WHICH I LIKED



SUMMARIZING, MY TEN COMMANDMENTS OF INVESTING

1. Discipline & investment temperament are the most important aspects of investing ~ 80% of results come from these
2. Respect capital
3. Understand the business you are investing in – what products or services it makes, who are its main customers, what are the key raw materials etc
4. Look for companies with a difference
5. Margin of safety – Buy stocks when it is at a discount
6. Have patience – compounding works wonders
7. Overcome emotions when selling
8. Don't make large losses – use a stop loss even in investing
9. Try to *consciously* avoid following the directions given out by the market; avoid being fearful when the market falls and greedy when it rallies
10. Volatility is a feature of the markets, not a bug. Expect volatility



THANK YOU

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