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Informed Investing

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Introduction

If the year 2017 was a year of hitting highs on different asset classes, the year 2018 has turned out to be a year of moderation. Investors saw their portfolio shrink anywhere between 20 to 60%. The correction was brutal, especially for midcaps and smallcaps. The major indices saw a marginal decline but it hides the pain of all the market participants.

Year 2008 would probably be remembered for the IL&FS fiasco and the subsequent meltdown in NBFC stocks. This year would also be remembered for the twists and turns in the saga at Yes Bank.

Let us first look at the event that captured everyone's attention for all the wrong reasons, i.e. Cryptocurrency.

Cryptocurrency

If 2017 was the year of highs for cryptocurrencies, 2018 would be remembered for the dramatic fall from the top for these virtual currencies. The table below captures the drop in the market capitalization for few of the famous cryptocurrencies.

Cryptocurrency	Market Cap 2017 ($ billion)	Market Cap 2018 ($ billion)	Growth in 2018 (%)
Bitcoin	212	67	-68.4%
Ripple/XRP	92.297	34.52	-62.6%
Ethereum	67.368	11.15	-83.44
Bitcoin Cash	40.378	3.14	-92.22%
Cardano	15.581	0.986	-93.67%

The price of each coin has come down as well which is captured in the table below.

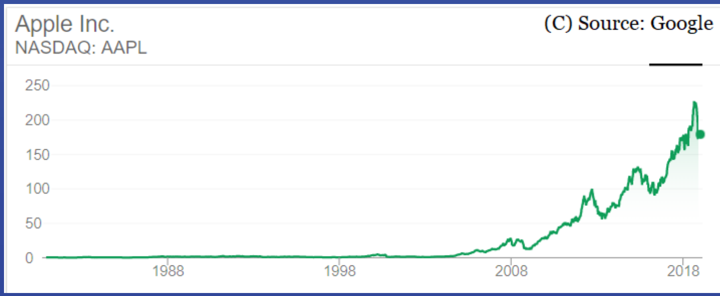
Cryptocurrency	Price per Coin 2017 ($)	Price per Coin 2018 ($)
Bitcoin	12,675	3,844
Ripple/XRP	2.38	0.345
Ethereum	696.93	104.67
Bitcoin Cash	2391.48	180.4
Cardano	0.6	0.038

It was early 2014 when I had first heard about cryptocurrencies. I tried to search for a place to buy them but I could not find an avenue in India. So I dropped the Idea. Having seen the huge price rise from the 2014 level, I did not have the guts to buy hem at their stratospheric valuations in 2017, so I watched the entire show from the sidelines.

People are ideally expected to use the cryptocurrency as a *medium of exchange* and to buy items using them. However, people started to hoard them as an asset. This led to the creation and circulation of multiple cryptocurrencies. Since these virtual currencies do not have any intrinsic value, assigning an arbitrary value will always lead to the price fluctuations that one saw in 2017 and 2018.

Now, the logical question is, would it end up like a tulip mania and die? I have a feeling that cryptocurrencies will go through a painful correction for another few years and eventually, people will start using it as a medium of exchange. It might then get wider acceptability. This is when I would like to own cryptos.

I saw an interesting comparison of Crypto currency's ongoing correction with Apple's performance during the late 90s. At the peak of Internet bubble, Apple's stock quoted a price of about $86 per share. But, by early 2001, its share price had dropped by about 93% to $6. This precipices drop would have broken the resolve of even an ardent fan of Apple. However, when we put the numbers in today's perspective, the 93% fall does not even appear like a blip. Cryptos may not fare as good as Apple but I believe they will eventually bounce back and reach a steady state.



Apple share price over the past 35 years

Initial Public Offerings

As far as IPOs are concerned, 2018 was not a year to boast about. This year saw about 70 companies coming up with IPOs compared to 153 companies in 2017. 2018 saw some big names like Bandhan Bank, ICICI Securities and HDFC Mutual Fund enter the market. The table below, lists the money raised by some of the big names during the IPO.

Company	Issue Size (Rs. Crores)	Issue Price (Rs Crores)
Bandhan Bank	4,473	375
Hindustan Aeronautics	4,144	1,215
ICICI Securities	3,515	520
HDFC Mutual Fund	2,800	1,100
Indostar Capital Fin.	1,846	572
Varroc Engineering	1,372	967
TCNS Clothing Co.	1,125	716
Lemon Tree Hotels	1,039	56
Bharat Dynamics	961	428
CreditAccess Grameen	787	418

Source: AceEquity, Economic Times

The table below shows the returns that shareholders got at the end of 2018 (as of 20/12/2018).

Company	Issue Price	Current Price	Growth (%)
Bandhan Bank	375	542	44%
Hindustan Aeronautics	1,215	783	-35%
ICICI Securities	520	267	-49%
HDFC Mutual Fund	1,100	1563	42%
Indostar Capital Fin.	572	336	-41%
Varroc Engineering	967	688	-29%
TCNS Clothing Co.	716	716	0%
Lemon Tree Hotels	56	71	27%
Bharat Dynamics	428	283	-34%
CreditAccess Grameen	418		

In 2017, we saw a bunch of IPOs. Let us see the performance of some of the big names in 2018 (as of 20/12/2018).

Company	Price in Jan (Rs)	Current Price(Rs)	Growth (%)
GIC India Ltd	382	275	-28%
New India Assurance	305	191	-37%
HDFC Standard Life	390	390	0%
SBI Life	700	580	-17%
ICICI Lombard	846	800	-5%
AU Small Finance Bank	663	633	-5%
Reliance Nippon	300	167	-44%
Cochin Shipyard	552	390	-29%
Avenue Supermarts	1170	1640	40%

Markets in 2018

2018 was the year of consolidation. All major indices saw declines throughout the year. The table below captures the performance of the major indices (as of 20/12/2018)

Index	Returns (%) as of 20/12/2018
S&P BSE Small Cap	-23%
S&P BSE Mid Cap	-13%
S&P BSE Large Cap	3%
S&P BSE Sensex	7%
NSE Nifty 50	5%

Source: BSE & NSE

Despite the mayhem in Smallcap stocks, some of the pharma and chemical companies did well. Table below captures the top performers in small cap space.

Company	Returns (%) as of 20/12/2018
Excel Industries	134%
Merck	119%
IOL Chemicals	104%
Nelco Ltd	100%
V-Mart Retail Ltd.	81%
Excel Corp care	77%
NIIT Technologies Ltd.	74%
Infinite Comp Solutions Ltd.	74%
HEG Ltd.	62%

There were some midcaps that did well too. The table below captures some of the best performing midcaps in the year 2018 (as of 20/12/2018).

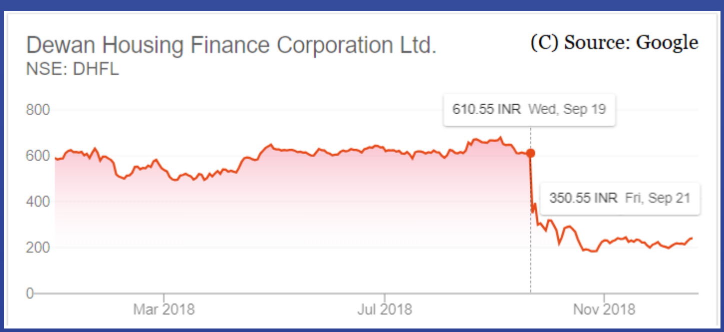
Company	Returns (%) as of 20/12/2018
L&T Infotech Ltd.	50%
Divis Laboratories Ltd.	38%
Mphasis Ltd.	33%
Torrent Pharmaceuticals Ltd.	30%
Havells India Ltd.	27%
The Indian Hotels Company Ltd.	25%
Adani Power Ltd.	24%
Colgate-Palmolive India Ltd.	20%
Biocon Ltd.	18%
3M India Ltd.	17%

NBFC Crisis

2018 saw a crisis unfolding in the Non-Banking financial sector (NBFC). One of India's largest Infrastructure financing firm was not able to repay back the commercial paper borrowings and non-convertible debentures. Now, Commercial paper is issued by companies as a short term lending option (3 to 12 months maturity) and various banks, mutual funds and insurance firms subscribe to it. This specific company started to default on its obligations.

This led to a panic in the market and there was a general impression formed that many other NBFCs and within the NBFCs even the Housing Finance Companies (HFCs) may not be able to repay their debt obligations (ex: Commercial Paper raised by these companies). Now, banks are a major source of lending for these NBFCs. As such, the public sector banks are battling the NPAs and many are undergoing through the PCA process. Such banks would have curtailed their loans to the NBFC sector leading to the sudden drying up of liquidity.

This liquidity crisis led many NBFCs to taper down their own loan disbursals leading to a shortage of loans to customers in different segments like housing, commercial etc. The builders who were dependent on loans from NBFCs might have felt the pinch and they would have slowed down or deferred many construction projects. Hence, what started as a default from one company, resulted in a mini-crisis for the entire NBFC sector. It will take some time for the dust to settle down. By the way, the below graph shows the impact of the crisis on the worst affected NBFC, i.e. Dewan Housing Finance Limited.



Performance of companies we track

In 2016 we started tracking the business performance of Granules India and Ujjivan finance. In 2017 we added PNB Housing finance to the tracking list. In January of 2018 we introduced ourselves to Avenue Supermarts. Let us now have a quick look at the performance of these four companies for 2018.

- PNB Housing Finance, Ujjivan Finance, Granules India & Avenue Supermarts (D-Mart)

PNB Housing Finance

PNB housing Finance is an NBFC specialized in Housing Finance. Though the company started its operations in 1988, it was in 2011 that the company started showing exceptional growth due to the entry of key FIIs that led to major management reshuffle.

The P&L numbers for the past four quarters are listed below. The company managed to retain its "above average" growth.

PNB Housing	Q3 FY18 Growth(%)	Q4 FY18 Growth(%)	Q1 FY19 Growth(%)	Q2 FY19 Growth(%)
Revenue	44%	46%	42%	42%
Expense	40%	47%	39%	44%
PBT	60%	42%	53%	35%
PAT	58%	44%	50%	33%

The P&L numbers for the listed housing finance companies for the calendar year 2018 is listed below. PNB Housing is either ahead of all the other housing finance companies or a close second.

HFC Sector	Q4 FY18 Growth(%)		Q1 FY19 Growth(%)		Q2 FY19 Growth(%)	
	Rev	PAT	Rev	PAT	Rev	PAT
PNB Hsng	***46%***	***44%***	***42%***	50%	***42%***	33%
Indiabulls	23%	22%	24%	30%	23%	21%
Canfin	11%	7%	11%	11%	12%	9%
DHFL	18%	28%	26%	35%	34%	***52%***
HDFC	13%	40%	20%	***53%***	25%	25%
GRUH	16%	18%	12%	20%	15%	20%
Repco	04%	12%	05%	9%	3%	-5%
LIC HF	7%	2%	11%	18%	12%	12%

Ujjivan Finance

2018 saw Ujjivan transform into a small finance bank. Out of 462 branches, 367 of them are now full-fledged SFB branches. MFI loans still constitute 90% of loan book and rest 10% is the MSE and housing loans.

The table below shows the P&L numbers for Ujjivan, for the four quarters this year. The impact of demonetization seems to have ebbed.

UJJIVAN	Q3 FY18 Growth(%)	Q4 FY18 Growth(%)	Q1 FY19 Growth(%)	Q2 FY19 Growth(%)
Revenue	3%	36%	29%	24%
Expense	11%	20%	17%	2%
PBT	-30%	182%	159%	62 Crores
PAT	-12%	235%	160%	44 Crores

Profitability of Ujjivan shall depend on its cost of funds. The company has managed to tap into low cost funds.

Borrowing Profile	Q3 FY18 % of Total	Q4 FY18 % of Total	Q1 FY19 % of Total	Q2 FY19 % of Total
Term loan	25%	16%	12%	5%
Refinance	24%	26%	31%	39%
NCD	9%	8%	8%	6%
Deposits	35%	49%	49%	49%

The borrowing costs have reduced and the NIM has increased in tandem.

	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19
Borrowing Cost	9.6%	9.3%	9%	8.6%	8.5%
NIM	10.5%	11.7%	11.6%	11.6%	12%

Granules India

Granules is a large scale generics manufacturer for select molecules. The company has close to 65% of its sales in Regulated Markets. Granules is one of the top five manufacturers worldwide for some of the analgesic and antipyretic products. The table below shows P&L for four quarters for 2018. Numbers are slowly turning positive. 2020 should be the year to watch out for Granules when Omnichem, Oncology and US facility start to add meaningfully to topline & bottomline.

	Q3 FY18 Growth(%)	Q4 FY18 Growth(%)	Q1 FY19 Growth(%)	Q2 FY19 Growth(%)
Revenue	13%	41.3%	21%	48%
EBITDA	-7.5%		13%	25%
PAT	-16%	-55%	41%	49%

Avenue Supermarts

In 2018 we started tracking Avenue Supermarts (Dmart). Dmart is a discount retail store chain that operates on "every day low cost every day low price" model. The company operates close to 160 stores which are predominantly spread across western and southern parts of India. Dmart operates in three categories, namely, food/grocery (52% of sales), non-food FMCG (20% of sales) and consumer durables/apparels (28% of sales).

Over the past five years the revenue has grown at 26% CAGR. The EBITDA grew at about 39% CAGR and PAT grew at a staggering rate of 62% CAGR. The company has grown its retail space at the rate of 20%. The total 'bill cuts' have grown at the rate of 24%.

Owned by the revered stock market investor Radhakishan Damani and with Ramesh Damani as its chairman, the company boasts of a high quality management ably supported by eminent board members.

2018 was yet another year of excellent growth for the company. The P&L numbers are captured in the table below:

DMART	Q3 FY18 Growth(%)	Q4 FY18 Growth(%)	Q1 FY19 Growth(%)	Q2 FY19 Growth(%)
Revenue	23%	23%	26%	38%
Expense	20%	20%	25%	40%
PBT	64%	65%	44%	19%
PAT	66%	73%	43%	18%

The company does not seem to have any threat from the existing brick and mortar stores. The company is far more efficient than its competitors. The only (perceived) risk in the distant future would be the online retail companies. Online retail is a winner-takes-all game and there are major players with deep pockets like Walmart and Amazon. Online retailing is a loss ridden business. All the major players aka Amazon, Flipkart and Big Basket are in Red and most likely would be in Red in the near future (Driven by deep discounts). Given this environment it will be interesting to see how D-mart manages to carve out its own space. By the way, even Dmart's Online retail numbers are in Red for FY18.

My Learnings from the Stock Market

I started investing in the Indian stock market in the year 2004. With zero knowledge of the stock market, I went by the recommendations that I saw on the TV. I bought whatever was cheap (by cheap I mean stocks with the ticker price less than 100 rupees). I bought stocks like Ashok Leyland (Rs 25 per share), TTML, SAIL, Tata Steel, Bajaj Hindustan, T******* and what not. Completely oblivious to P&L statements, balance sheets, cash flows, I continued to rely on questionable sources beyond me to decide on investment decisions. Hence, between 2003-2008, when the entire world was making money in Telecom and Infrastructure, I was busy buying duds. I completely missed making money during the golden period between 2003 and 2008. The only solace I had was the fact that I had bought Yes Bank post their IPO and sat on it to make some profit.

When the crash of 2008 hit me, I was completely caught off guard. Since this was my first brush with a downturn, I panicked and sold all my shares in 2009. I sold my shares at a loss. Yes Bank was the only one where I made some money. I bid adieu to the stock market with a vow not to return back. Between 2009 and 2012, I kept watching the markets, I saw all my shares reach their hay days, but then, I was not there to see my losses recoup as I had already sold them in the panic of 2008-09.

I learnt my First lesson about the Stock market, sitting on the sidelines all the while:

Lesson 1: Downturns are not forever and the losses are never permanent. Eventually there will be a recovery and good companies tend to bounce back.

During my first stint, I bought T* based on the ticker price and the profits portrayed in the P&L. I received dividend only once even though the company announced frequent dividends (on paper). I never realized that the management was shady till one fine day when the company suddenly vanished. I learnt that:

Lesson 2: Management pedigree is the bedrock of a successful company.

During my hiatus from the stock market, I kept reading though. I learnt about the different sectors in the market. I read about cyclical and non-cyclical sectors. When I looked back at my initial debacle, I realized that most of my bets were on cyclicals. I tried to introspect the reason for this and I realized that I was swayed by the media which was predominantly focused on cyclicals. Moreover the non-cyclicals were called Defensives and I did not like the term 'Defensives' ☺. The 2008-09 downturn exposed the leveraged cyclicals and I got caught in the ambush.

Lesson 3: Long term investors are better off staying away from cyclicals.

With this understanding of cyclicals v/s non-cyclicals, I started off looking for sectors and companies that are inherently non-cyclical (secular growth stories). After reading many books, articles I understood that, in India, the major non-cyclical companies are:

- Pharmaceutical Companies
- Information Technology Companies
- Banks and Financial Institutions
- Consumer based companies

By 2012-13 I was mentally ready to get back in to the market. I started off by investing in a non-cyclical Aurobindo pharma. By sheer luck, Aurobindo multiplied 3-4 times within a span of few months. Due to my apprehensions, I had invested a very tiny amount. Even with this small investment I could see the impact of a 3-4 fold compounder. This was my fourth learning.

Lesson 4: An investable idea with growth potential, has to be backed by substantial capital. Position sizing is a critical part of investment process.

After the initial 3-4 time jump, I realized that I should have invested more when the price was less. I invested more, but the subsequent gains did not match the initial jump. In the mean time I found another non-cyclical in the form of Gruh finance. I invested a decent amount in it and I kept waiting in both Aurobindo and Gruh. I saw appreciation but it was in line with the rise in market. I stayed with Gruh for few years. The 20% odd return was not in-line with my expectation. So I moved out of Gruh. As soon as I moved out, I saw a two fold jump in the stock price of Gruh. This got me thinking. I re-looked at the history of Gruh and did some introspection. This led me to a very important learning for which I am thankful to these companies as well as to another company called Ajanta Pharma.

Lesson 5: Substantial backfilling of fundamentals precedes stock price appreciation. Patience is a virtue.

Let me elaborate it further. In case of Aurobindo pharma, it had gone through years and years of below-par returns. During this phase, there was a backfill of fundamentals taking place. The company was trying new drugs, biosimilars, it was trying to capture market share and all this while the stock price did not inch up. Due to these efforts, one fine quarter in 2013-14, there was a huge jump in the bottom line. The company was able to sustain the profits for the next couple of quarters. This led to a re-rating of Aurobindo. I was lucky to have jumped into the quarter that saw marked improvement. Now, in case of Ajanta Pharma, it had already gone through a huge growth that was accompanied by multifold increase in share price. When I entered Ajanta, it was (and is) going through a backfill. Hence I did not gain much from Ajanta. I have had the same experience with Granules. In case of Granules, it went through a growth cycle around 2013-15 period. The share price also saw a ten-fold increase during this period. From 2016 till date, the company has been backfilling its capacity and gearing up for the next phase of growth (Oncology, US facility, API capacity expansion, filing ANDAs). I do not expect the company doing much till 2020 which is when we should see the next spurt.

In my first shot at investing, I had picked Yes Bank, so, I had some experience owning a bank. When I realized that financial institutions are non-cyclical, I had an 'aha' moment and I set out looking for Financial stocks. Finance is a gamut of companies comprising of public sector banks, private banks, NBFCs, MFIs (SFBs were not invented yet). Now, lending is an inherently leveraged play, the company leverages 8-10 times and a 10% default/NPA will wipe it out. So, lending is a risky business and the company's management is the single most import factor for such institutions. I realized that housing finance was the safest bet and decided to look for them. There were (and are) a handful of listed housing finance companies in India right now.

Among all the available options I had shortlisted PNB Housing and HDFC. The management of both the companies seemed top notch. PNB Housing management's growth ambition and its future growth potential tilted the balance in PNB Housing's favor. As an owner of finance stocks, over the past few years, I have learnt the following:

Lesson 6: Credit is a fundamental building block for any corporation/Individual. Able, stable and believable credit provider(s) should be part of one's core portfolio.

Now, there are many type of credit providers. Banks, Micro-finance Institutes (MFI), Small Finance Banks and a plethora of NBFCs (Gold loan provider, Auto loan providers, Housing finance companies etc). One is spoilt for choices. I decided to invest in housing Finance for the following reasons:

- Housing loans are generally backed by collaterals (the house itself). Housing loans are the last ones that people default (house has a sentiment value).
- Housing loans are a long term contract. The switching cost/process acts like a proxy moat. Hence the Housing finance companies are generally assured of revenues for a sustained period of time from their existing customers (assuming interest rate is competitive).
- In order to grow, housing finance companies have to find only the delta (new customers) which is equal to their planned growth rate.

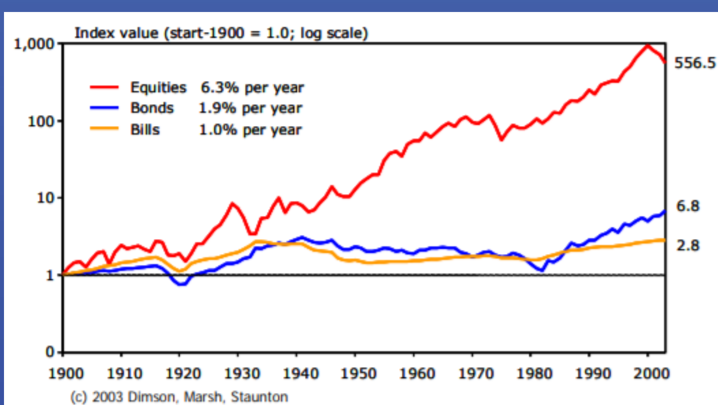
2018 was the first downturn that we experienced in the past five years. For a totally different reason I had stopped investing in stocks from January 2018. All my money was getting accumulated in FDs (for a rainy day). By the time I figured that the rainy day has been pushed to a future date, I had accumulated some cash which got invested during the downward spiral of October and November. I realized the importance of being in cash. Even though it is common sense that investing in dips is prudent, experiencing it first hand was a revelation to me. This was a major learning for me this year.

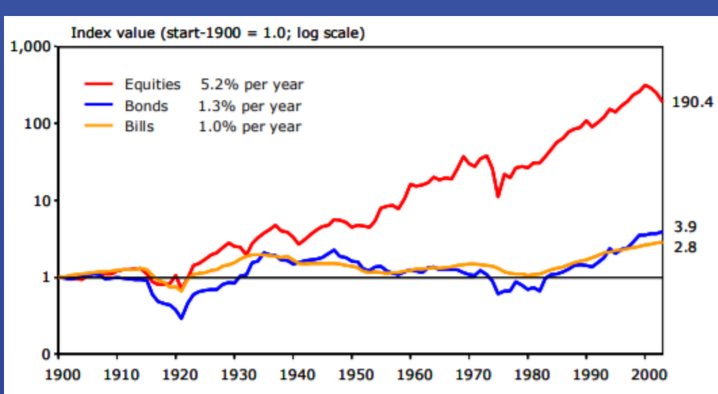
Lesson 7: Being partly in cash is the trait of a smart investor.

My Learnings on Investing

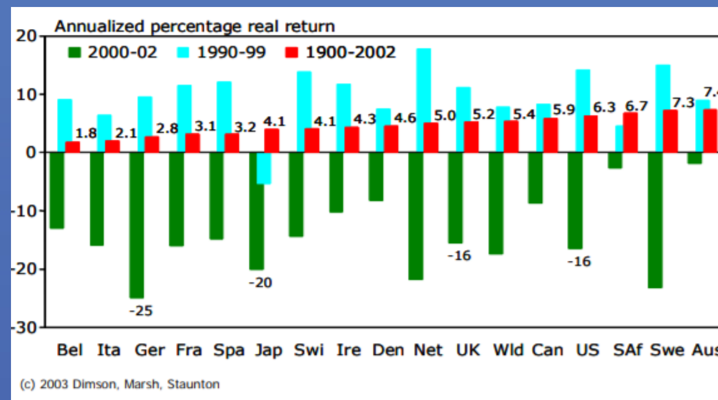
For an investor with surplus money and looking for avenues for investment, there are generally two choices that he/she needs to contend with. Should he/she invest in Equities or in fixed return instruments (Bonds and/or Bills)? The choice will depend on two facts: Risk and Return. Equities are subject to higher risks and fixed return instruments are (presumably) subject to lower risks. Now, with respect to returns, an interesting study was done by Dimson, Marsh and Staunton. They analyzed the 101 years worth of data, from 1900 to 2002, for sixteen different countries. The results were published in a book titled "Triumph of the Optimist". There is an abridged version of their findings at: http://csinvesting.org/wp-content/uploads/2015/03/2781_triumph_of_the_optimists.pdf . I have tried to capture the essence of the article below:

- Over a 100 year period, equity returns outpaced fixed return instruments. Below graphs are for USA and the UK

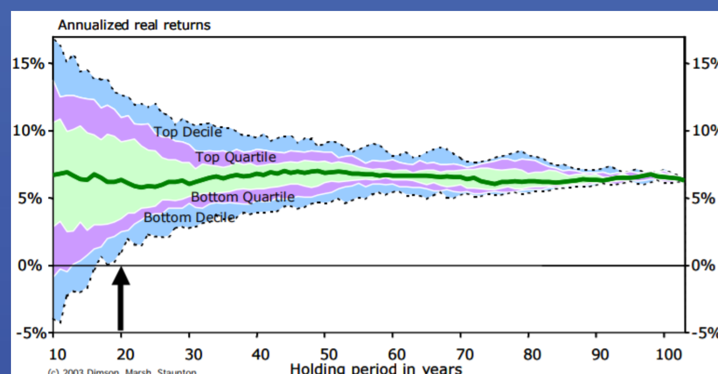




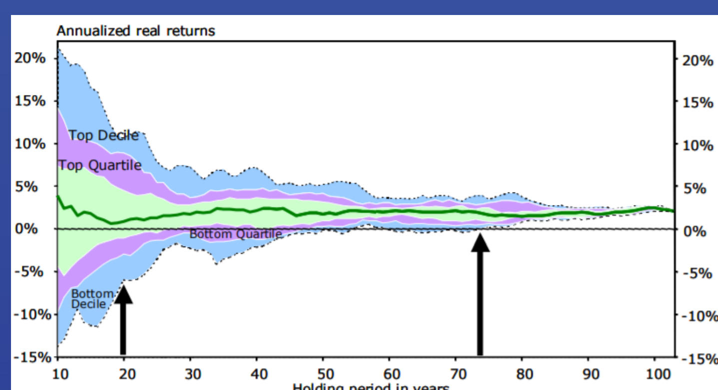
- Returns from Equities over longer periods was found to be positive for all the sixteen countries that were assessed by the authors.



- Over a shorter period of time, the returns from equities can gyrate. But over a longer period of time, they gravitate towards the mean. The below figure is for USA



From the above figure it is amply clear that when the holding period is short (ex: 10 years), variations in returns is noticeable. The top performers generate 15% CAGR returns and bad performers generated -5%. Below figure is for real returns for Italy.



Conclusion

2018 will be remembered as the year of correction. The Cryptocurrencies came off from their highs with a huge thud. Indian markets started on a high note, later on the midcaps and small caps got butchered. This was followed by an across-the-board fall in stock prices. This year was definitely a year of moderation, a year that gave ample opportunities to deploy cash.

Among the companies that we track, PNB Housing and Avenue Supermarts had a very good year. Both Ujjivan and Granules had a decent year as well.

In 2019 we will start tracking at least one additional company. I will introduce the company in January and then we shall start tracking the quarterly results of this company on a regular basis.

I would like to thank you all for your support and encouragement. Let us hope that the 2019 brings joy to all the market participants.

Disclaimer

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