Presentation at
Foundation for Liberal And Management Education (FLAME) Institute

14 Nov 2009
Rakesh Jhunjhunwala
R^RE Enterprises
Outline

- History of Markets
- India’s Economic Growth and its Equity Markets
- Inevitability of India’s Economic Growth
- Indian Equity Markets in the Long-Run
- Asset Allocation and Compounding
- Investment Approach
- Exiting from an Investment
- My Life and Career
- Advice
HISTORY OF MARKETS
CAPITAL MARKETS | EVOLUTION

Industrial Revolution

Financing/Risk Sharing

Separation of ownership from management

Investors

EXIT / LIQUIDITY

RAISON D’ÊTRE OF CAPITAL MARKETS
• Temples of Capital Allocation . . .
• . . . To channelise Capital to most productive Assets
• Condition precedent for Risk Capital to exist and to grow
• Barometer of Economic environment, Corporate confidence and Capital flows
• In an Efficient Capital Market, appropriate Valuation may be delayed, but cannot be denied
• Valuation are a slave of Earnings

• Earnings are a function of Economic growth

• Earnings growth = 1-1.5x of Nominal GDP growth
  – If Real GDP growth = 9%, Inflation is 5%,
  – Then Nominal GDP growth= 9%+5%=14%
  – Hence, Earnings growth = 14 - 21% (1-1.5x of NGDP)

• The bull market in Indian equities (present and future) is a direct derivative of India’s economic growth
INEVITABILITY OF INDIA’S ECONOMIC GROWTH
INGREDIENTS OF INEVITABLE GROWTH

- Culture of Tolerance
- Skill-sets
- Entrepreneurship
- Democracy
- Demographics
- Savings rate
- Orderly evolution
- Take-off
CONFLENCE OF REFORMS ➔ TAKE OFF

Confluence of Reforms

- Financial sector
- Telecom
- Insurance
- Power
- Capital Market
- Infrastructure Development
- Tariff reduction
- Competition Bill
- VAT / Indirect taxes
- Direct taxes
INDIAN EQUITY MARKETS IN THE LONG RUN
**MARKET INFRASTRUCTURE IN PLACE**

- **Infrastructure for equity flows in place**
  - Modernized trading system + Dematerialization
  - Corporate governance thru market’s sword
  - Effective Regulatory environment
  - Competitive private sector Mutual Fund industry
  - Blossoming Insurance Sector
  - Inevitability of FII Investments

- **Tax paradise**
  - Short term capital gains at 15%
  - No Long term capital gains tax (STT regime)
  - Dividend tax free
POTENTIAL TO ENHANCE EQUITY OWNERSHIP

Distribution of Financial Savings

- FY 91: 17.4% Cash, 60% Deposits, 8% Life Insurance, 1.1% Govt schemes, 15% Equity & debentures
- FY 96: 8.9% Cash, 80% Deposits, 6% Life Insurance, 5% Govt schemes, 1% Equity & debentures
- FY 01: 5.1% Cash, 70% Deposits, 4% Life Insurance, 7% Govt schemes, 1% Equity & debentures
- FY 05: 1.1% Cash, 80% Deposits, 4% Life Insurance, 1% Govt schemes, 6% Equity & debentures
- FY 06: 4.9% Cash, 80% Deposits, 4% Life Insurance, 1% Govt schemes, 6% Equity & debentures
- FY 11: 15.0% Cash, 60% Deposits, 8% Life Insurance, 1% Govt schemes, 15% Equity & debentures
## FUND FLOW FOR EQUITY MARKETS

### Savings Composition

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>274</td>
<td>323</td>
<td>601</td>
<td>694</td>
<td>798</td>
<td>904</td>
<td>1,026</td>
<td>1,163</td>
<td>1,319</td>
<td>1,496</td>
</tr>
<tr>
<td>Gross domestic savings</td>
<td>62</td>
<td>80</td>
<td>174</td>
<td>202</td>
<td>235</td>
<td>271</td>
<td>315</td>
<td>365</td>
<td>425</td>
<td>494</td>
</tr>
<tr>
<td>Savings to GDP %</td>
<td>22.5%</td>
<td>24.8%</td>
<td>28.9%</td>
<td>29.1%</td>
<td>29.5%</td>
<td>30.0%</td>
<td>30.7%</td>
<td>31.4%</td>
<td>32.2%</td>
<td>33.0%</td>
</tr>
<tr>
<td>Financial savings</td>
<td>35</td>
<td>46</td>
<td>83</td>
<td>97</td>
<td>133</td>
<td>156</td>
<td>184</td>
<td>216</td>
<td>253</td>
<td>299</td>
</tr>
<tr>
<td>- % of GDP</td>
<td>12.8%</td>
<td>14.4%</td>
<td>13.8%</td>
<td>14.0%</td>
<td>16.7%</td>
<td>17.3%</td>
<td>17.9%</td>
<td>18.6%</td>
<td>19.2%</td>
<td>20.0%</td>
</tr>
<tr>
<td>Savings in Equity/Deb/MF</td>
<td>4.7</td>
<td>5.5</td>
<td>0.1</td>
<td>1.1</td>
<td>6.5</td>
<td>5.9</td>
<td>11.8</td>
<td>21.2</td>
<td>34.0</td>
<td>44.9</td>
</tr>
<tr>
<td>- % of Financial Savings</td>
<td>13.5%</td>
<td>11.9%</td>
<td>0.1%</td>
<td>1.1%</td>
<td>4.9%</td>
<td>3.8%</td>
<td>6.4%</td>
<td>9.8%</td>
<td>13.4%</td>
<td>15.0%</td>
</tr>
</tbody>
</table>

### Fund flow for market

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sources of funds</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic savings</td>
<td>4.7</td>
<td>5.5</td>
<td>0.1</td>
<td>1.1</td>
<td>6.6</td>
<td>5.9</td>
<td>11.8</td>
<td>21.2</td>
<td>34.0</td>
<td>44.9</td>
</tr>
<tr>
<td>FII investment</td>
<td>3.6</td>
<td>3.8</td>
<td>11.4</td>
<td>8.9</td>
<td>12.5</td>
<td>8.0</td>
<td>10.0</td>
<td>13.0</td>
<td>16.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Total</td>
<td>8.3</td>
<td>9.4</td>
<td>11.5</td>
<td>10.0</td>
<td>19.0</td>
<td>13.9</td>
<td>21.8</td>
<td>34.2</td>
<td>50.0</td>
<td>64.9</td>
</tr>
<tr>
<td>Uses of funds</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic equity issues</td>
<td>3.2</td>
<td>5.5</td>
<td>4.8</td>
<td>6.5</td>
<td>7.1</td>
<td>6.5</td>
<td>7.5</td>
<td>10.5</td>
<td>14.8</td>
<td></td>
</tr>
<tr>
<td>Secondary market</td>
<td>5.1</td>
<td>3.8</td>
<td>6.7</td>
<td>3.5</td>
<td>11.9</td>
<td>7.4</td>
<td>14.3</td>
<td>23.7</td>
<td>35.2</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>8.3</td>
<td>9.4</td>
<td>11.5</td>
<td>10.0</td>
<td>19.0</td>
<td>13.9</td>
<td>21.8</td>
<td>34.2</td>
<td>50.0</td>
<td></td>
</tr>
</tbody>
</table>
ASSET ALLOCATION AND COMPOUNDING
BELIEF SYSTEMS

1. Realism - a Conviction
2. Rigidity - a Taboo
3. Safety of Capital - a Religion
4. Absolute Returns - a Passion
ASSET ALLOCATION

- 1971 – 80 Gold 30% p.a. compounded
- 1981 – 90 Nikkei 21% p.a. compounded
- 1991 – 2000 NASDAQ 26% p.a. compounded
- Stock, bonds and gold
- 1987 – 2006 Sensex 19% p.a. compounded
- Why Equities have / will deliver superior returns
## IMPORTANCE OF CONSISTENCY

<table>
<thead>
<tr>
<th>Years</th>
<th>5%</th>
<th>10%</th>
<th>15%</th>
<th>20%</th>
<th>25%</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>127628</td>
<td>161051</td>
<td>201136</td>
<td>248832</td>
<td>305176</td>
</tr>
<tr>
<td>10</td>
<td>162889</td>
<td>259374</td>
<td>404556</td>
<td>619174</td>
<td>931323</td>
</tr>
<tr>
<td>15</td>
<td>207893</td>
<td>417725</td>
<td>813706</td>
<td>1540702</td>
<td>2842171</td>
</tr>
<tr>
<td>20</td>
<td>265330</td>
<td>672750</td>
<td>1636654</td>
<td>3833760</td>
<td>8673617</td>
</tr>
<tr>
<td>25</td>
<td>338635</td>
<td>1083471</td>
<td>3291895</td>
<td>9539622</td>
<td>26469780</td>
</tr>
</tbody>
</table>
CHOOSING AN INVESTMENT
WHAT TO LOOK FOR

• Attractive, addressable external opportunity

• Sustainable competitive advantage

• Scalability + operating leverage

• Management quality + integrity

• EVA positive over investment horizon

• Valuation: Price – Value divergence
TEN COMMANDMENTS FOR INVESTING

• Be an optimist! The necessary quality for investing success.
• Expect a realistic return. Balance fear and greed.
• Invest on broad parameters and the larger picture. Make it an act of wisdom, not intelligence.
• Caveat emptor. Never forget this four-letter word - R-I-S-K.
• Be disciplined. Have a game plan.
• Be flexible. For Investing is always in the realms of possibilities.
• Contrarian investing. Not a rule, not ruled out.
• It's important what you buy. It’s more important at what price you buy.
• Have conviction. Be patient. Your patience may be tested, but your conviction will be rewarded.
• Make exit an independent decision, not driven by profit or loss.
EXITING AN INVESTMENT
EXITING AN INVESTMENT

- Asset Allocation
- Review of Critical Factors
- Relative Opportunity
- EPS or EPS Expectation Peaks
- PE Absurdity
- Not Driven by Profit/Loss - Independent
MY LIFE & CAREER
• Independent thinker
• Passion for equities. Measured risk taker
• A trader, an investor, a venture capitalist
• Not afraid to make mistakes, but affordable ones
• No religion, no emotion, no ego, no rules. But, means remain more important than the ends
• Accept with an open heart and mind that the only constant is change. The urge to learn is a journey, not a destination
• Magic of emotion-less leverage, with discipline
• Patience born out of conviction. Be greedy, but be long-term greedy – understanding the role of time
• His word is his bond, highest integrity
• Loves his independence
MY ETHOS

• Prayer
  – God’s Grace, Elder’s Blessings

• Aim
  – To win all wars despite losing many a battle

• Motto
  – Where the head is held high, and the mind is without fear . . .

• Logo - R^RE Enterprises
  – Rare, Enterprises, Green, Compounding

• Baseline
  – Insight, Intellect, Integrity
• Early days (1984-89)

• Learning curve (1990-1994)

• Defining time (2001-2009)

• Aspiration (2009 - . . . .)
EARLY DAYS (1984-1989)

- Humble beginning – Rs 5000
- Initial hurdles
- Self-belief
- Inspiration – healthy influences
- No pain, no gain
- Initial trades
- Capital protection
- Tax compliance and efficiency
PARADIGM SHIFT (1990 -1994)

- Inflexion point – Madhu Dandvate budget
- First market cycle experience – agony & ecstasy
- Shorting and pyramiding
- Prudent betting
- Ambitions cannot overshoot market opportunity
- Understanding the importance of liquidity

- Rudder-less period
- Introspection
- Importance of reading, experiencing and learning
- Participation in tech boom
- Private equity learning – the value of scale
- Value picks – PSU jackpot
DEFINING TIME (2001 – 2009)

- Once in a lifetime opportunity – India and its equity markets
- Growth stories
- Concentrated and diversified portfolio
- Maturity
- Buy right, hold tight – exit in frenzies
- Meaningful stakes
- Value adding investor
- Organization building
- Resisting temptations
ASPIRATION: 2009 AND BEYOND

- Institutionalization
- Perpetual view
- Other asset classes
- Other geographies
- Investor of choice
- Philanthropy
- De-leveraging
- Strategic thinker
- People, skill focused
AS YOU EMBARK ON PROMISING LIVES

• Whatever you can do or dream you can, begin it. Boldness has genius, power and magic in it.

• Do something you love

• The means are as important as the end

• Aspire, but never envy

• Be paranoid of success – never take it for granted

• Build a fighting spirit – take the bad with the good

• Though the horizon seems far and difficult, when you reach a horizon, you realise how many more horizons are beyond it . . .
Thank you!