



Prospecting for Compounding Machines
In a Minefield of Value Traps!
Value Investing Congress, Pasadena, May 2011



Benjamin Graham

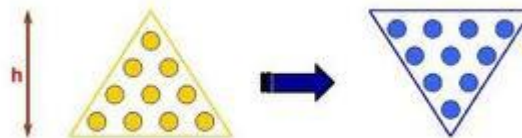
How the price of a stock converges with its intrinsic value is one of the mysteries of our business



Charlie Munger

Invert, always invert!

- Carl Jacobi



What PREVENTS the price of a stock from converging with its intrinsic value?

Who Am I?



Rahul Saraogi
Managing Director
Atyant Capital

- Atyant Capital India Fund
- Long only, Value. \$15MM AUM
- 11 years India experience
- Wharton School
- Recent track record

2006	-1.5%
2007	+65.9%
2008	-71.4%
2009	+113.9%
2010	+40.4%

India – Rich Hunting Ground

Tailwinds

- Demographics
- Domestic demand
- Depth of markets

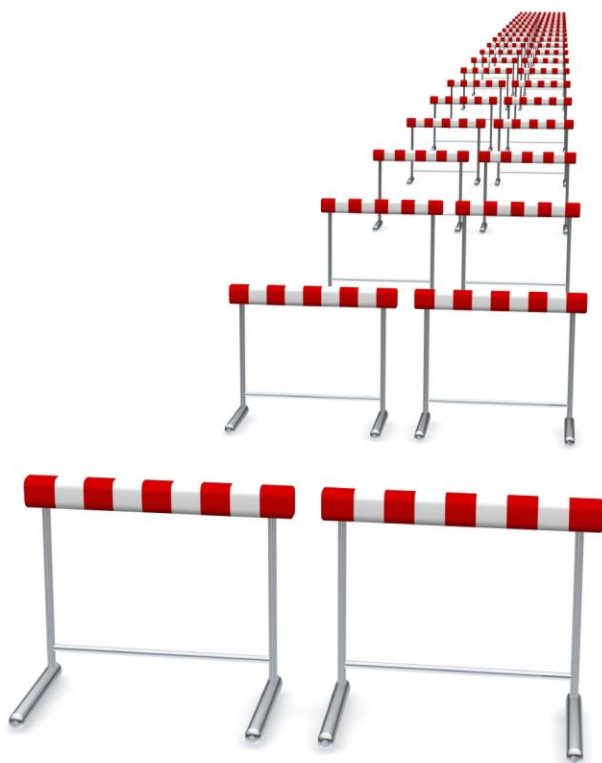
Paradise for value investors

- Time horizon advantage
- Liquidity advantage
- Information advantage

Risk – Minefield of value traps

What PREVENTS the price of a stock from converging with its intrinsic value?

My Framework



- Corporate Governance
- Stewardship of Capital
- Business Fundamentals
- Financial Strength
- Relative Opportunity

Corporate Governance



- Not just fraud/embezzlement
- Minority shareholders = Partners
- How is it violated?
- How to identify mis-governance?

Stewardship Of Capital

Good

- \$1 of market value for \$1 retained earnings?
- Rising or sustained return on equity?
- Return of capital to shareholders

Bad

- Empire building
- Vanity
- Frequent equity dilutions

Business Fundamentals

Factors worth exploring:

- Demand strength – domestic or export?
- Competition – domestic and foreign
- Cost competitiveness
- Pricing power and price dependence
- Distribution strengths
- Unique strengths/moats

Financial Strength



- Capital structure / debt
- Cash generating power
- Need for reinvestment
- Unlevered return on equity
- Financial condition of competitors

Relative Valuation

- Relative to market
- Relative to industry and peers
- Ranking within fund's buy list
- Price history
- Major holders
- Insider transactions



Case Study 1: Videocon Industries

- Leading player in consumer durables
- Demand exploding (30%+ per year)
- Well recognized brand
- Competes head-on with MNC brands
- Understands Indian consumer mindset
- Strong financial position











Case Study 2: GSFC

- Large producer of complex fertilizers
- Lowest cost producer
- Advantageous port location
- Entrenched distribution – 4 states / 8000 villages
- Debt free with significant cash
- Competitors carry substantial debt

Compounding Machine or Value Trap?

	Videocon	GSFC
Price/Book Value	0.74	0.98
Price / Earnings	7.40	3.60
Net Debt/Equity	833 MM / 1818 MM	Cash 370 MM / 670 MM
Business Fundamentals	Strong Franchise	Commodity Producer
External Environment	Domestic Demand Growing at 30%	Agricultural Yields Need To Rise

Applying Framework

	Videocon	GSFC
Corp Governance		
Stewardship of Capital		
Business Fundamentals		
Financial Strength		
Relative Valuation		

History

	Videocon	GSFC
BV 2006	1489 MM	260 MM
BV 2011	1818 MM	670 MM
CAGR - BV	4%	21%
M-Cap 2006	2072 MM	304 MM
M-Cap 2011	1340 MM	658 MM
CAGR – M-Cap	- 8%	17%

GSFC - Stock Price



GSFC - Earnings/Debt

	Earnings	Cashflow	Debt (Cash)	Equity
2007	61 MM	93 MM	(48 MM)	310 MM
2008	54 MM	87 MM	(77 MM)	334 MM
2009	114 MM	146MM	(146 MM)	439 MM
2010	58 MM	90 MM	(234 MM)	487 MM
2011	180 MM	214 MM	(370 MM)	670 MM

How Much Can We Make?

- Complex fertilizers growth business
- Balance sheet supports growth
- Prudent management
- Double earnings in 3 years: INR 200 / share
- Stock re-rating: P/E of 8
- Stock price: $8 * 200 = 1600$ (vs. 360)
- 4.4X in 3 years

Conclusion

- India big opportunity but infested with value traps
- Robust framework can help
- Investing not just financials/fundamentals
- Corporate Governance not a given
- Stewardship of Capital not a given
- Sufficient universe of qualifying stocks

Thank You For Listening

Rahul Saraogi

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