Prashant Jain
CIO
HDFC Mutual Fund

CHAPTER 1
A BULL ON INDIA

From an early age, he had a remarkable belief in the country's potential, and decided that he would always stay in India and go with its vast opportunities. In the formative years of his career, Prashant neither made any grand plans for his future nor was worried about it; but whenever he was faced with a tough decision or where choices had to be made, he sought the most rational path. That trait has been his hallmark now that he manages billions ofdollars for investors - and it has made him one of India's most successful fund managers.

From his early years, Prashant had a flair for figures, and scored well in mathematics. For youngsters, the choice after junior college was totake up engineering or medicine depending on the subjects one did well in such as mathematics or biology. With his penchant for figures, the natural and rational choice for him was to enrol in engineering.

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For someone who did engineering and wanted to remain in India, a good option was to do a Master's in Business Administration. Once again, when faced with a choice of marketing and finance, Prashant's inclination to mathematics was more fascinating and interesting than marketing jargon - and so he decided to continue in finance.

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On completing his MBA, Prashant had no goal or career in mind, but since finance was his forte and he wanted to remain in India, the youngster applied for jobs in the top Indian financial institutions. Those days these were Industrial Credit Investment Corporation of India and State Bank of India. ICICI was a financial institution then funding corporates, while SBI had a banking businesses and was running an equity-markets business. It was an easy choice for Prashant as ICICI made no offer, while SBI offered him the role of a research analyst in SBI Mutual Fund.

CHAPTER 2
NUMBER CRUNCHING START

For Prashant, that opportunity was the start of one of the most illustrious careers. He took the job and started to crunch numbers as an analyst. For a brief period, he also worked on the fixed-income side, and his acumen with figures and investments, despite his soft communication style, was soon noticed by the top management.

That was the year 1991, when the old economy stocks were the "poster-scrips" of the market and were zooming in on theories such as

replacement value and liberalisation. In 1991, he met Chandresh Nigam and E. A. Sundaram with whom he had an interesting career growth as those were the times when the Indian mutual-fund industry was evolving and growing.

That was when the Indian equity mutual-fund market was opening up. Now for the first time private-sector mutual funds were being allowed in the Indian market.

In 1993, the first private-sector mutual fund, Kothari Pioneer Mutual Fund, now merged with Franklin Templeton, was registered. Soon newer private-sector mutual funds were being launched. Here's where Prashant found his next opportunity. This was when the three of them, Chandresh, Sundaram and Prashant started on a new journey. They moved to the 20th Century Mutual Fund.

Prashant approached his 20th Century days with the same zeal that he still has. But the market was a different beast then.

Researching ideas was not easy as information was restricted. Prashant made some mistakes of investing in weak businesses, and had to weather losses on some of his investments.

Nevertheless, this proved to be one of the most formative years for him as he realized the concept of sustainability. Ever since, Prashant has striven to invest in enduring businesses that have long years ahead.

"In the stock market all businesses are not the same - there are strong, good and weak businesses."

These errors played an important role in turning him insecure and confident simultaneously. The insecurities made him work harder, which in turn led him to more rigorous homework. This resulted in him feeling more confident and secure. He then began to avoid altogether lowly, uncompetitive businesses.

Weak businesses fall much more in bad times than do strong businesses. There are businesses that have competitive advantages. And there are businesses that don't. Investors must acknowledge this fact.

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Companies that have a very strong competitive advantage get higher PEs for a reason. These were some of the lessons Prashant learned in this early phase of career.

It also rendered him stoic in his investment approach, and he began looking for investments that have multiple edges, enabling companies to grow. From 1995 to 1999, he picked stocks with an eye to sustainable growth and profits, and kept a keen eye out on the racing tickers. If prices ran up too high, or did not justify the future expected earnings, Prashant Jain unwound his holdings.

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In 1999, 20th Century Mutual Fund was acquired by Zurich Financial Services, and Prashant and his funds migrated to a new name.

CHAPTER 3

PREVENTING THE 2000 TECHNOLOGY BUST

Prashant is no contrarian, but instead logically looks at prices in relation to future earnings. "I am not a contrarian; I want to be just a rational investor. From 1995 to 1999, we participated in IT stocks. Everyone made money and even we made money. But when IT became too expensive we thought that it's enough and we sold. We automatically became contrarian". Around this time IT companies were trading at PEs of 200-300 times, and began discounting

future earnings far into the future. Infosys was the stock market's darling and was quoting at a PE of over 200.

In those days, Prashant and his colleagues would often look at the valuation ticker and express their doubts about whether this was sustainable. The boys began to doubt the cash-earning models of these businesses. Rational minds did not see any reason why these companies should be quoting so high. Prashant and his colleagues even conducted an exercise: re-pricing IT companies at PE levels of 40-50. Even at these, IT companies had to increase their earnings 5 times to justify their valuations. As Prashant puts it, if they had to grow 5 times, India would have had a large current-account surplus. A current- account surplus would mean that the rupee would appreciate, capping the growth potential of IT stocks. Revenues of such companies arose largely from the wage arbitrage prevailing between India and the US. The stocks were, therefore, pricing more growth than what was achievable. Prashant started to reduce these IT-based stocks from his portfolio.

Those days, a top analyst wanted Prashant to meet the CFO of a top IT company, who tried to convince him of the big potential of the IT sector. After much persuasion, eventually Prashant met the CFO. The analyst hoped that Prashant would once again look at the IT sector favourably. But Prashant stuck to his position, knowing that even while the IT sector as a business had its potential, stock prices were way out of sync with fundamentals.

This insight enabled Prashant to minimise the damage in the ensuing IT carnage. On the contrary, he and his friends delivered stellar returns in their funds: more than 25 percent for five years, till 2003. It was also the year in which Zurich Mutual Fund was acquired by HDFC Mutual Fund, and Prashant appointed Head of Equities.

CHAPTER 4
EVOLVING AS CIO AT HDFC MUTUAL FUND

Though he has never changed jobs, he has many visiting cards, having grown from one job to another because the organization where he worked was being acquired. He joined HDFC as Head of Equities and soon rose to the position of Chief Investment Officer of this fund house. Prashant didn't consider this transition from a fund manager to a leader of fund managers that difficult - since day one he had his set of methods laid out.

All his fund manager colleagues are empowered to run their funds independently. As a CIO, his role is to hire and allocate work, write down investment processes, periodic reviews and discussions, work with colleagues in terms of research, and meeting companies. This is his approach to being a hands-on investor.

At HDFC Mutual Fund, most portfolio managers started their career as analysts. The AMC hires few of them from outside. People who have worked with us for 5-10-15 years, over time some of them will become Portfolio Managers.

A portfolio manager has to have the ability and skill to construct a portfolio and to understand businesses because "Investing is both art and a science." Everyone can understand the science

part of investing (for example, studying ratios, cash-flows, and understanding a business).

The information everywhere is the same and results of these analyses are repetitive; there is no information asymmetry. With this information, what views one takes for the future and how we allocates capital varies from person to person - that is the art part of it.

Prashant hires analysts who have significant experience in a sector, and generally values someone who has spent 5-15 years in a sector more than a person with lesser experience.

"In India research as a career will evolve. The notion that analysts are subordinate to PMs in India should change. In the Western world, for example, some large global firms offer you two career choices; you can be a generalist and graduate as a portfolio manager, or you can be a career analyst."

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However, he agrees with the counter-view that sometimes analysts who are too experienced often cannot think out of the box or come up with fresh approaches – something that would be possible in the case of young bright analysts. This at times does pose some challenges.

Experience can also turn out to be an inhibiting factor, particularly if one fails to keep up the motivation, if one gets too tied down to one's views and are not open to fresh perspectives. That's why one has to put in place checks and balances so that people are incentivized – and performance monitored so that they do not turn complacent. Sometimes old ideas can be good, but one has to be rational. If the facts change, one must change one's opinions.

"I have seen that if individuals persist, persevere, if they are keen to learn and are willing to put in the hours they will succeed."

Prashant puts it this way: we describe ourselves as investors who are rational, willing to learn and change, open to contrary views and guided by long-term fundamentals. At the same time, we are willing to differ from the majority opinion if that is what our research suggests.

The fall of 2008

For Prashant, 2008 was much easier to deal with than the two previous crashes. It was another year of excesses where weak businesses were trading at extremely high multiples. Some businesses did not have plants on the ground, and some of these plants were three to four years away from being commissioned. Yet the scrips of those companies began to quote exorbitantly.

For Prashant, here again the choice was the rational one. He ensured that they stayed away from such momentum stocks, even if it meant that his funds may have had to underperform the markets. While the markets were surfing the utilities wave, Prashant chose to swim away from such momentum stocks and let his fund under-perform the market.

Throughout these bubbles Prashant demonstrated extraordinary levels of conviction. He kept greed and fear in control. It is this extremely uncommon trait that allowed him to steer away from the dot-com and real-estate bubbles and busts.

Even in the heat of short-term under-performance, he was able to look at the larger picture. In the long term, he has so far emerged a winner. This approach ensured that when the markets crashed post lehmen crisis, Prashant's fund 's did better than markets.

Following this crash was the phase that set Prashant Jain apart, the phase which accurately represents his investing style: irrespective of the fact that negative sentiments had thickly clouded the Indian stock markets, Prashant had the confidence to be fully invested in early 2009 at the height of this bear market.

He simply was fully invested at the bottom of the market with the conviction that the cycle would improve. Following the turnaround in May 2009, Prashant's Equity Fund delivered an alpha of 24% in calendar year 2009 as a consequence.

CHAPTER 5

THE SAME STYLE FOR THE PAST TWENTY YEARS

Prashant's style of investment has been the same for the past twenty years, ever since his Zurich days. His broad investment approach has always centered on accumulating good businesses at reasonable prices and waiting patiently -sometimes for years - for them to deliver. He believes in understanding the business very well, and thinking about long-term prospects.

He has covered styles and has read books on John Bogle's style of investing, and even on the Warren Buffett style. Both are at opposite extremes. One focusses on passive management or index investing, a portfolio mimicking an index. Buffett's style has been to pick the under-valued. Prashant is a master at both. He follows the mid-path when there are no new ideas, and grabs them whenever there are opportunities that would deliver outperformance.

"It is not easy to beat the index; but, it is possible. The market can be imperfect in the short term but are nearly perfect in the long term. If you understand a business well and if you take a long-term perspective, the market can throw up opportunities every now and then, which help you beat the index."

Prashant has noticed that investors in equities often feel over-confident about their conclusions. People who have limited knowledge of a business also form opinions very fast. Many will tell you that a company is great because of a product that they are familiar with, but one doesn't know what growth it can deliver or what multiple it is

trading at, based on future earnings. In this context, people think they understand the business, but investors who have less experience do not feel insecure about their decisions. For Prashant, it is okay to feel insecure about investment decisions.

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Another point to note when it comes to investing for Prashant is that the divide between growth and value is not very clear. The longer and faster a company can grow, the higher the PE multiple you should be willing to assign. The key is figuring out the long-term growth rate. Hence, Prashant's investment style can be termed as "growth at a reasonable price."

He has not classified or cottoned on to a particular style of investing such as value or growth. He is also not averse to buying expensive PE stocks, if he believes that the price is worth it. One of his funds owns a super-market chain, which is quoting at 100 times present earnings. These holdings are justified when it is a company that can sustain a very high growth rate.

It's also not all about rapid growth rates. Even if growth is slow for certain businesses, but if the PE is lower than what it deserves, that's a good opportunity to create value. "I endeavour to do what is rational. Sometimes I buy expensive PE stocks when I think the growth that they offer is worth it". "One can even buy a slow-growing company if the price multiple it is available at is lower than what a slow-growing business deserves – even that creates a lot of value."

Prashant's portfolio usually consists of solid, large-cap companies. He is not fixated on the fact that superior or faster growth can come only from smaller companies. For Prashant, large companies can grow faster than smaller companies in the same business. Unless the leaders sleep or turn inefficient or if smaller companies do something differently, the league tables seldom change.

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"Whether you look at aviation, automobiles, mutual funds or insurance - larger companies have more competitive advantages. In 7 of 10 cases, larger companies are probably growing faster than their smaller counterparts." Prashant's logical and rational approach has made him more right than wrong in his

investments. In most of them, he has added the ingredients of patience and thorough homework regarding the opportunities for the underlying business to thrive. The idea that the market is rational in the long run means that

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one has to approach the markets with a long-term mindset. This is one big truth about the market that most common investors often ignore.

It is this rational approach and searches for value that has led to him being tagged as a contrarian investor a number of times by the media. But Prashant is a self-confessed "rational" investor. There are times when he goes as per the market's wisdom, and there are times when he takes positions contradicting popular market wisdom. When he acts against market opinion, he isn't doing so for the sake of being a contrarian investor: his stance is the outcome of his value-oriented approach and, by definition, if something is not preferred by the market it will be available cheap and thus, will come under Prashant's value radar. This reminds one of what Benjamin Graham once said – "You're neither right nor wrong because other people agree with you. You're right because your facts are right and your reasoning is right."

Prashant's engineering background helps. It makes an individual more analytical. The conclusions he reaches rationally through the process of research builds confidence in his actions and allows him to deal with the pressures of underperformance.

Prashant is known to have swapped market darlings for unloved sectors in the past – in'99 he chose to give up his position in the IT sector when everyone was excited buying them, and instead bought commodities and capex stocks. In '07, he decided to stay away from real estate or power utilities and purchased FMCG, pharmaceuticals and automobiles. In last few years, he again took the stance of forgoing his winning positions in the consumption/pharma sector in lieu of capital goods. (The current underdogs in the markets) and corporate banks. He invested in corporate banks (both in public and private sector) in the recent past on the rationale that they are good quality businesses characterized by stable market share, solid retail franchises, and attractive ROE

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across market cycles. Specifically, he believes that large Public Sector Undertaking (PSU)

banks are sustainable and growing businesses that are going through a painful period due to weak asset quality.

Prashant thinks, PSU banks will recover in profitability. The stress on asset quality is being resolved by sale of assets since many of the stressed groups are cash-flow poor but asset rich; this prevents NPAs from turning into complete losses. An improving economic

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outlook, falling interest rates, and the government sharp focus on solving this issue of NPAs would improve the outlook. India is a saver's economy where parking money in banks will sustain for a long time. Banks are and should remain the largest credit providers in the foreseeable future.

One thing to note in this thought process is the clarity; how he effortlessly combines bottom-up and top-down thinking to make decisions. Prashant holds a top-down macro view, which helps set economic direction in perspective, but bottom-up stock-picking is key. Bottom-up thinking forms the much-needed base to invest in the markets, whereas top-down thinking further helps one narrow in on certain sectors or stocks. Prashant has always been an outstanding bottom-up investor; sell-side analysts are impressed that he still attends their meetings with pen and paper and diligently takes down notes.

For Prashant, most global events don't have much impact on Indian businesses. The ability to forecast global events is not in anybody's hands, and so no action can be taken about such events. Prashant keeps the worrying on matters that one can make active decisions. This is where bottom-up thinking comes into the picture. The key to stock picking is to look for "quality businesses" and staying away from "weak" ones. This leads to the question – What is a good quality business? This question is a way simple to answer, some parameters are: good management, high cash-flows, high payouts, transparency, integrity, etc. But we know that the real challenge or difficulty sets in while practicing all of these rules of thumb. Having the discipline to do so is what sets Prashant Jain apart from the rest.
Prashant has not always invested in great businesses, and the reason he admits this is

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the rationale that the price at which one buys a stock is also important.

A business may be great but it need not always be a great investment. Prashant focuses on making a good investment, not simply buying great businesses. A great business at a reasonable price is what makes it a good

investment. If consumer stocks have been underweighted in Prashant's portfolios now, it's not because they are not good businesses, but because they are not great investments.
He has rarely repeated the same mistakes. Even when he did, it wasn't to the extent of '95. Mistakes are of two types (1) Buying a weak business and losing money and (2) missing good businesses. Over the past decades, every investor would have erred on both counts and he did too:

"One is losing money and the other is losing opportunities."

The first type of mistake has two sub-categories - either you buy an unsustainable business, or you grossly overpay. A proper analysis and rigorous number crunching help in making correct decisions. Prashant works with spreadsheets to minimize such errors: "It is always good to have a spreadsheet. It need notbe very detailed but it should be effective. For example, if five cost elements constitute only 2% of the total, one can make broad assumptions. It is not that I must develop an 80-line spreadsheet; instead, it can be veryeffective in five to 10 lines. I have created basic spreadsheets for many businesses but not detailed ones. A spreadsheet is the outcome of your understanding of the business."

The other error of missing good opportunities happens all the time. It's not easy to forecast, and there are many opportunities that are continuously missed in the market all the time. Prashant focusses on keeping on the lookout for good opportunities, but some often go unnoticed till too late. Not having invested to full capacity or for long enough in market leaders with high PE ratios are mistakes which fall in this category.

Many investors view today's prices relative to cost. Prashant does not look at past cost while weighing whether to buy or sell, but he decides on the basis of today's price. The past price at which one buys an investment has little bearing on the decision today. For example, if a stock is priced at Rs 100 today, it does not matter if the purchase price were Rs 50 or Rs 200. If it was Rs 50, you can pat yourself on the back; if it was Rs 200, you can rue your losses, but your wealth is same.

What really matters is this: whether the stock is a buy, sell or hold at the present price: "The

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notion of deciding the outcome of your investments today based on your past costs is illogical. What price you bought your stock at has no bearing on your decision at a different price point. You have to decide at today's price whether it is a good investment or not. The price at which you bought the stock has no bearing on your decision today. If a stock price is 100 today, I might have bought it at 50 or200. In one case I will feel that I have done a good job. In the other, I will feel that I erred. However, the truth is that all of this is irrelevant today. All e has to consider is what can do at the current price - at 100, one can hold, sell or buy more, based on whether one's target price is higher or lower than 100. This is the only way to think. The moment one says that he wants to hold

the stock at a price, it means that he is buying it at that price."

Often there are occasions when you have taken a view but the market doesn't move according to your view. At these times, the market price is not according to your view, but you should go over the issue thoughtfully. Talk to people with a contrary opinion; examine their arguments carefully. If there is a flaw in your earlier argument, change your opinion; if not, continue with more confidence. This is an ongoing process.

Prashant was a nonbeliever in IT in the mid '90s, and turned believer only on evidence to the contrary, only to sell IT stocks in 1999 when valuations turned unjustifiable. After this, these stocks went up nearly 100% before finally correcting. In 2006-07, Prashant also did not buy real-estate stocks because any amount of research did not merit a buy decision.

In the financial world, if you ask anyone what Prashant Jain stands for, the answer you will get will definitely be something related to him being a man of longevity. It is this long-term oriented mindset that has enabled him to deliver returns of around 19.5% CAGR in the past 23 years in his funds. For Prashant, returns from equities are a factor of earnings growth and dividends together. One has to be sure about the long-term growth prospects of the economy and improvements in corporate profitability. Then only equities are the best assets to be acquired.

Prashant observes that returns from equities mimic economic growth in nominal terms (real growth plus inflation) over long periods. It's one of the most important reasons why equities have a high compounding potential, especially in a country such as India.

Compounding is the open secret" of wealth creation, and here's why and how Prashant said it works: A 15% CAGR doubles an investment in five years, multiples it five times in 11 years, becomes a ten-bagger in 17, and grows 20 times, in 22 years. That's the power of a 15% increase in asset prices every year. For this reason, Prashant is known as the perennial bull.

Prashant left me with an image of a down to earth rationale investor - one who is willing to learn and change, who is open to contrary views and one who is guided by long term fundamentals. He seemed open to engage with people having a contrary opinion to the one he is holding. His approach appeared to assess their investment arguments with an open mind and to examine any flaws in his investment rationale. If there are any, he seems open to change else he continues with a renewed conviction in his investments.

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Prashant always looks at price of a stock in relation to its potential future earnings. He believes that investing is confluence of both art and science. While it is easier to understand the 'science' part (based on numbers/logic), investment decisions also involve taking a view of the future- where the 'art' part. He tends to augment this approach with bottom-up research which he believes is the key for making sound investment decisions.