

SPECIAL EDITION

OUTLOOK BUSINESS

February 28, 2020 | ₹50

THINK BEYOND. STAY AHEAD.



INDIA'S BEST FUND MANAGERS

THE OUTLOOK BUSINESS-VALUE RESEARCH
ANNUAL RANKING OF FUND MANAGERS

EXCLUSIVE INTERVIEW Neelesh Surana, CIO, Mirae Asset



“ Our portfolio has fewer construction or real estate businesses because RoCE in many of these companies do not meet our filters

NEELESH SURANA
MIRAE ASSET



“ If you are not disciplined about liquidity, you will have to sell your higher quality stocks during redemption pressure

HARSHAD PATWARDHAN
EDELWEISS MUTUAL FUND



“ It isn't absolutely black and white, but you can eliminate the most egregious violators by looking at past behaviour

RAJEEV THAKKAR
PPFAS MUTUAL FUND



“ Every decision we make can have a binary outcome. It can be either right or wrong with 50% probability

ASIT BHANDARKAR
JM MUTUAL FUND



“ My companies trade at 40-50x valuation, but I am confident about their quality. So, I don't think it is risky

ATUL BHOLE
DSP MUTUAL FUND



“ Large corporate banks will do well over two to three years. They have pricing power and cost of funds is also low

RAHUL BAIJAL
SUNDARAM MUTUAL FUND



“ There is a myth that high risk means high return. Sometimes, it may lead to high return, but not all the time

SHRIDATTA BHANDWALDAR
CANARA ROBECO MF



“ Because of sharp focus on cash-generating businesses with low debt, overall portfolio risk reduces

AJAY TYAGI
UTI MUTUAL FUND



HARSHAD PATWARDHAN

Edelweiss Mutual Fund

EDUCATION

B.Tech, MBA, CFA

YEARS AS FUND MANAGER

14

CAREER

Worked with JP Morgan Asset Management and Deutsche Equities India

AUM (₹ BILLION)

23.13

SCHEMES**

- Edelweiss Large & Mid-Cap Fund
- Edelweiss Mid-Cap Fund
- Edelweiss Multi-Cap Fund
- Edelweiss Small-Cap Fund

RETURN¹ IN %

1-YEAR

-1.08

3-YEAR

12.75

5-YEAR

8.95

10-YEAR

13.25

😊 BEST YEAR*

106.68/148.33/52.73

😞 WORST YEAR*

-58.95/-68.46/-17.97

**Only equity schemes have been considered

#Average return of the diversified equity schemes managed by the fund manager

*Best Year: Mar, '09-10/
Mar, '09-10/Dec, '16-17

*Worst Year: Jan, '08-09/
Jan, '08-09/Mar, '15-16

Data as on December 31, 2019



Tactical strategist

Edelweiss Mutual Fund's Harshad Patwardhan trusts in diligent research to spot opportunities, and in detachment to make timely exit

FAISAL MAGRAY

Shruti Venkatesh

Would gladiators have been considered as glorious if they had been thrown into an arena against a hapless goat? Nope. You need a worthy rival to claim glory. An institutional sell-side broker and his buy-side investment manager aren't exactly adversaries, but one's selling skill is pitched against the other's critical analysis. And every sales pitch could be a learning opportunity, realised Harshad Patwardhan, CIO, Edelweiss Mutual Fund, early in his career.

He entered the capital markets as a broker in 1994. For the next 12 years, he worked with various organisations including Marlin Partners, Caspian Research India and Deutsche Equities, covering sectors such as oil, gas, auto and engineering. The clients were mostly foreign institutional investors since the domestic mutual fund industry was just taking off, and Patwardhan says, interacting with these highly experienced fund managers and observing the kind of questions they asked, gave him "invaluable perspective".

For instance, from Edward Pulling of JP Morgan Asset Management, Patwardhan learnt the lesson of looking at the bigger picture. Analysts are trained to think from a bottom-up perspective, but Pulling taught him to appreciate linkages of a business to other sectors and the economy. "He taught me when to look at the bigger picture and when to focus on the smaller details," Patwardhan recalls. From others, he learnt the importance of looking at parameters besides valuation and how to research a stock thoroughly even when it has minimal coverage.

This arsenal of advice came in handy for Patwardhan when he stepped onto the buy side with JP Morgan Asset Management in 2006 as a fund manager. There, he managed the Equity Fund, Smaller Companies Fund and Economic Resurgence Fund. In 2016, after JP Morgan's India business was acquired by Edelweiss AMC,

the schemes continued to remain under Patwardhan's purview. Currently, he looks after Edelweiss' Large and Mid-Cap Fund, Multi-Cap Fund, Mid-Cap Fund, Long-Term Equity Fund and Small-Cap Fund. Managing schemes as diverse as these is a tall task for any fund manager. Despite these challenges, data from Value Research shows that Patwardhan's funds, with an AUM of ₹23.13 billion, have delivered a return of 13.25% over the past ten years.

He does not care much for the large, mid or small cap classifications and says that it is a myth that mid and small-caps are of inferior quality. He invests in them by scouting for leaders in their industry. Therefore, he prefers to go by the categories of "well-researched" stocks and the "less-researched" ones. Similarly, he does bother much about "fads and fashions" in the market. Sectoral weightages are important to mitigate risk but otherwise he follows the bottom-up approach. For this, he looks for companies that display growth and reinvestment opportunities in markets that aren't saturated. For example, private sector banks and consumer companies that have compounded growth consistently, over a long period of time. While asserting that no one formula fits all, he looks at the quality of management, balance sheet and cash flow of a company.

Meanwhile, valuation holds minimal weightage in his checklist. He cites the example of several consumer businesses or retail private sector banks that have always appeared expensive, but there was never a reason to sell them. His bets have paid off as they have given strong 20% compounded return. Similarly, there are stocks that always look cheap, and no one makes any money buying them. So, Patwardhan relies on a company's earnings progression, valuation and dividend yield together to evaluate its stock price return, a learning he picked up during his days as an analyst.

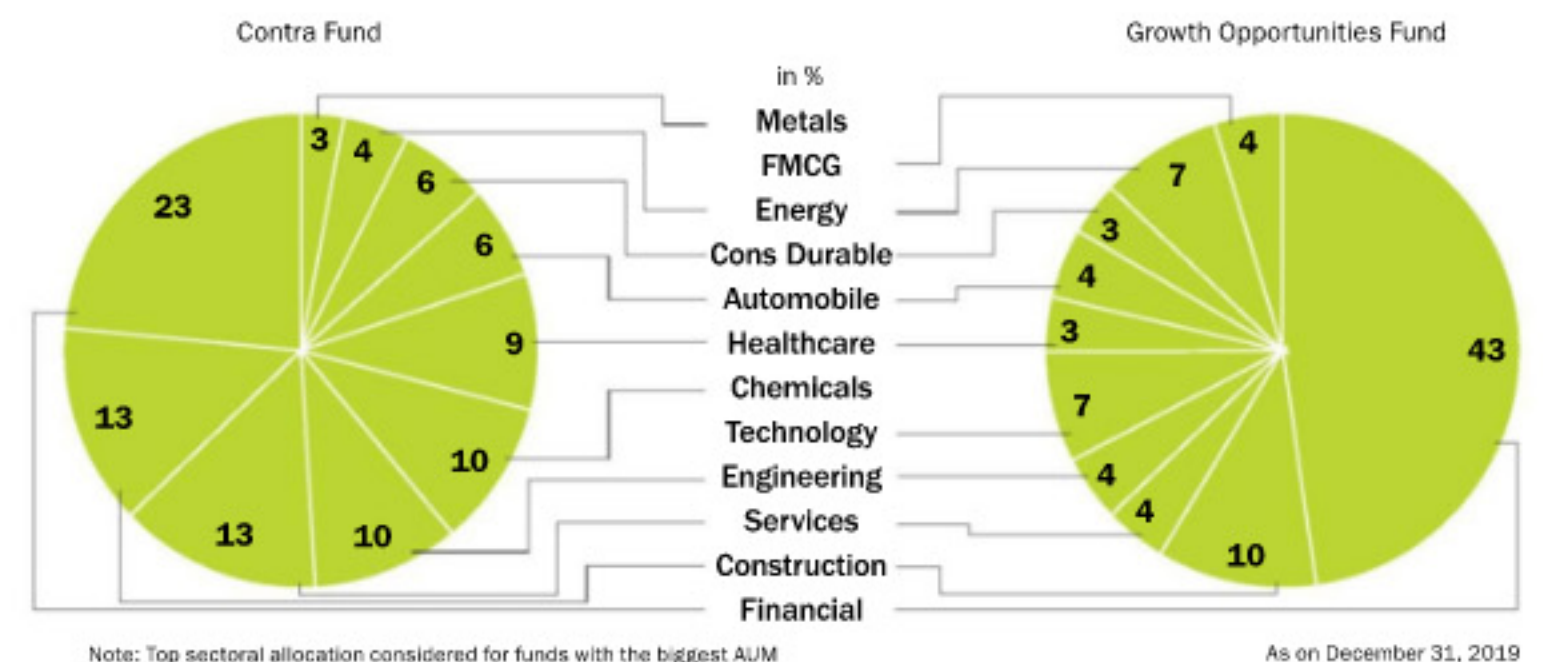
Before the final go, Patwardhan looks at it through a risk-reward framework - assessing the potential upside and downside. His IndusInd Bank buy in 2009 is an

HARSHAD PATWARDHAN'S SCORECARD

	2014	2015	2016	2017	2018	2019	3-YEAR	5-YEAR	10-YEAR
Edelweiss Large & Mid-Cap Fund	44.72	2.68	0.49	38.11	-3.33	11.10	14.03	8.87	11.19
Edelweiss Mid-Cap Fund	83.36	9.38	2.49	52.25	-15.62	5.15	10.50	8.63	15.05
Edelweiss Multi-Cap Fund			0.38	47.37	-4.89	8.38	14.93	—	—
Edelweiss Small-Cap Fund	—	—	—	—	—	—	—	—	—

Return in %

SECTOR ALLOCATION



Note: Top sectoral allocation considered for funds with the biggest AUM

As on December 31, 2019

example of this trade-off. That year, Romesh Sobti had just taken over as the CEO of the bank, which did not have any retail product barring vehicle financing, and had several regulatory and compliance issues. Sobti put forth a clear plan to tackle compliance problems, and extend the product offering in retail and then corporate lending in three-year phases each. At the time, the stock was trading close to book-value and Patwardhan decided to buy into it. As the management delivered on its promise of growth, Patwardhan kept increasing his position. Over the past ten years, the stock delivered a CAGR return of 43% and he exited the stock in 2018. The risk proved worth the reward.

A similar example is from 2013. At the time, emerging markets, including India, weren't doing well. There was a big sell-off that followed, as a result of which small and mid-cap stocks especially in the construction space began trading at extremely cheap valuations of 0.3-0.4x P/BV. Upon some research, Patwardhan managed to find a few good companies in this space, and among them was Action Construction Equipment. The company was a leader in construction equipment in select categories, and was hardly covered by analysts. But Patwardhan drew from his experience from the 'sell' side to evaluate the opportunity and found it a lucrative one. The stock turned out to be a multibagger, and he exited the stock with six-year CAGR return of 34%. The trick, in small and mid-caps, is to identify winners early. "It is not easy. But if you can, you benefit from compounding of earnings and valuation rerating," says Patwardhan.

While these are his ground rules for stock picking, Patwardhan has a plan for the overall holding as well. All his bets fall into four buckets. There are 'strategic' stocks, to be bought and held for a long period of time. The second is 'tactical stocks', which are cyclical in nature. "You don't want to hold these over a

long period of time, but you want to buy them at the right time in the cycle," says Patwardhan.

The third category is 'option stocks'. The outcome of such stocks can be zero or one, says Patwardhan, which means they can either be multibaggers or can go down significantly. These are typically businesses that don't have a long track record for business or management, but from a topdown (economy-sector-stock) perspective, appears to be very attractive. "It is called 'option' to remind ourselves that it is that, and we don't get carried away and own too much of it," he says. The fourth are 'defensive stocks', usually from the large and mid-cap category and are a big part of the benchmark. "I may not be very positive on them. However, I am not so confident to own zero," he says.

The allocation of stocks across these four categories varies based on circumstances. For instance, when conviction is high, allocation to strategic stocks tend to be high. But at inflection points (such as upcycle of a sector), tactical bets rise. Defensive and Option tend to remain a smaller part of his portfolios.

He is also a stickler for maintaining sufficient liquidity in his portfolio. "If you are not disciplined about maintaining liquidity, what tends to happen is that when redemption pressure comes, you will be forced to sell your higher quality liquid stocks," he says. He also keeps in mind the number of days it will take to exit a stock because of the position he holds. Patwardhan says that this planning is done at the design stage itself, and not as an afterthought.

LEVERAGING EXPERIENCE

He spares no effort in designing a watertight portfolio, but he takes care not to get too attached either. "I have learnt that it is very important to not fall in love with any stock. Otherwise, it is difficult to be ruthless

when time comes," he says. For instance, he had identified the growth story in Eicher Motors way back in 2009, and reaped multibagger return when the company's two-wheeler sales picked pace. But he was also quick to exit the stock at a CAGR of 74%, when he saw the risk-reward ratio tip unfairly in 2015.

Mistakes cannot be wished away but they have to be accepted and rectified immediately, according to him. In 2014, the government had made several announcements pertaining to micro-irrigation. Buoyed by the possibility of growth in this sector, Patwardhan had picked up a stake in a leading irrigation company. However, within six months, it was clear that while 'Per Drop More Crop' was a good slogan, it wasn't exactly a

TOP HOLDINGS

% of net assets (average allocation) as on Dec 31, 2018

Edelweiss Large & Mid Cap Fund/Edelweiss Mid Cap Fund/
Edelweiss Multi Cap Fund/Edelweiss Small Cap Fund

ICICI Bank	8.04/8.55
HDFC Bank	7.67/9.07
Reliance Industries	4.83/7.41
Infosys	3.83/4.61
HDFC	3.58/5.77
Axis Bank	3.42/3.87
State Bank of India	2.87/3.25
Larsen & Toubro	2.78/3.16
Bajaj Finance	2.57
Bharti Airtel	2.52/2.74
Muthoot Finance	3.56
Info Edge (India)	3.45
Federal Bank	3.31
Indraprastha Gas	3.28
PI Industries	3.27
Cholamandalam Investment	3.18
Apollo Hospitals Enterprise	3.09
City Union Bank	2.97/2.35
Kotak Mahindra Bank	3.93
JK Cement	2.75
VIP Industries	2.66
INOX Leisure	2.62
Blue Star	2.53
L&T Finance Holdings	2.41
Deepak Nitrite	2.28
Grindwell Norton	2.25

Source: Value Research

RAPID FIRE

Biggest hits in five years

Apollo Hospitals, Vinati Organic, Indraprastha Gas

Key success factors

Ability to know how to size a bet

Identifying mistakes and ruthlessly correcting it

Fund managers you admire

Edward Pulling, Austin Forey

My return is driven by

Identifying growth companies with reasonable valuation

Currently bullish on

Industrials, Corporate Banks

Key learning

To not get emotionally attached to stocks you are buying or selling

priority for the government, and Patwardhan made an exit. "Translating top-down announcements into bottom-up stock picking is tricky. Sometimes it can take a long while for the companies to start doing well, and sometimes, it may never happen. That is a big learning," says Patwardhan. Besides keeping an eye on one's portfolio, he says, it is also important to keep an eye on stocks one doesn't own. "In 2016, there was a big commodity stock price rally, and we missed that because commodities are not compounding stories," he recalls.

CHANGING TIMES

Patwardhan has learnt to be flexible the hard way. He has always been overweight on financial, banks and consumer durables, but from being skewed towards retail private banks, his portfolio is now overweight on corporate banks over the past two years. "Corporate banks have more to run as economy recovers and NPA cycle turns," he opines.

Similarly, he entered steel and telecom sectors recently. "For long, we were away from telecom because competitive intensity was high and companies made huge losses," he says. But few months ago, it seemed like the end game was near. In the steel sector, he believes the cycle is turning based on global developments, such as improvement in demand from emerging markets such as China and price rise in domestic market.

Through it all, Patwardhan stays steadfast to his mandate. "I have to generate alpha, that is outperformance vis-a-vis the benchmark and try to be ahead of median in terms of competition," he says. And, in this quest, his flexible approach to picking stocks is sure to come in handy. ☺