



# **CARNELIAN COMPOUNDER STRATEGY**

AUGUST, 2021

# Carnelian – who are we?

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- A boutique investment management firm founded by industry veterans in April 2019 with an aspiration to create a global scale asset management platform known for its “values & expertise”
- Specialize in Indian equity investments for HNI’s, family offices, institutions & partners’ own capital, across two strategies, across caps & sectors
- Founding team of four motivated, passionate professionals with complimentary skill set & strong track record of building leadership businesses in the capital market domain and enduring research platform
- Supported by an equally motivated and passionate team of 10 professionals
- Technology, risk & compliance and process driven DNA
- We believe investing success is about generating “risk adjusted returns” “consistently” over “a long period of time”



# Founder's profile

(1)

## **VIKAS KHEMANI, FOUNDER**

- Chartered Accountant & CFA Charter holder, having ~ 25 years of capital markets experience, most recently as the CEO of Edelweiss Securities Ltd, where he spent 17 years incubating & building several businesses to leadership including Institutional Equities business and Equity Research
- He has a strong business acumen & deep understanding of Capital markets; enjoys strong reputation with Corporate India.
- He is Associated with several industry bodies and committees:
  - Served as a member of the CII National Council on Corporate Governance & FICCI Capital Markets Committee
  - Serving as an invited member of Executive Council of Bombay Management Association
  - Member of Young Presidents Organization (YPO) a global forum for entrepreneurs and CEOs
- He was awarded the Young Professional Achievers Award for the service sector by the Institute of Chartered Accountants of India (ICAI) in 2014
- His passion for investing took shape during his college days and continues to drive him. He is obsessed with risk reward spectrum
- Besides being an avid reader and poker player, Vikas enjoys yoga/meditation and has been running marathons since last 17 years

## **MANOJ BAHETY, CO-FOUNDER**

- Chartered Accountant & CFA Charter holder, having ~ 22 years of rich & diverse financial services experience with the marquee institutions - Edelweiss Securities, Morgan Stanley, RIL, HPCL
- Manoj has spent 11 years at Edelweiss Securities as Dy. Head - Institutional equity research, Head - forensic, thematic & mid cap research
- He is known in the industry for his non-consensus research. Pioneered differentiated forensic research, popularly known as "Analysis Beyond Consensus" (ABC research)
- ABC research has helped investors across the globe to take informed investment decisions based on true numbers instead of reported numbers, thus "avoiding pitfalls"- One of Carnelian's virtues
- Represented various committees of The CFA Institute, including Chairperson of India Advocacy Committee, member of US based global CDPC committee
- Manoj is a fitness freak and has been running marathons since the last 10 years



# Founder's profile

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## **SACHIN JAIN, CO-FOUNDER**

- Chartered Accountant, having ~ 18 years of diverse experience in the financial services domain having worked at reputed institutions like ICICI Bank, Edelweiss Securities and H&R Johnson India
- Sachin, Last worked at Edelweiss for over 11 years; last as the COO of the Capital Markets business overseeing Risk, Technology, HR, Strategy and Operations. A key member of the Management Committee, he founded one of the industry's best Prime Brokerage Business at Edelweiss, which under his able leadership, achieved significant scale and profitability. He was also a part of the Senior Leadership Group at Edelweiss, besides serving as a director in several group entities
- He believes in long term value investing and enjoys understanding different businesses
- He is an advisory member of "Leap for Word", an NGO aiming to resolve English literacy problem in rural Maharashtra
- An avid poker player, Sachin is fascinated by behavioral psychology and studies the impact of EQ on overall life in general and markets in particular

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## **SWATI KHEMANI, CO-FOUNDER**

- Chartered Accountant, having ~12 years of experience in financial service industry including 7 years at Edelweiss Financial Services across Investment Banking and Institutional Equities businesses including equity research and institutional sales
- Swati has actively covered the Financial Sponsors and enjoys a good relationship with the investor & corporate community
- While on a break to look after family, she started her entrepreneurial journey with NewEdge Consulting (HR consultancy focused on financial services) and managing the family office
- Over the last couple of years, she has found interest in angel investing and been investing & mentoring in the start-up world
- Her strength lies in understanding businesses/investing and relationship building
- Besides reading, Swati enjoys traveling, music and meeting people



# Team Carnelian



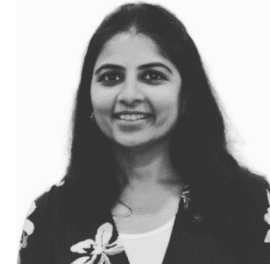
VIKAS KHEMANI  
FOUNDER (CA, CFA, CS)



MANOJ BAHETY  
CO-FOUNDER (CA, CFA)



SACHIN JAIN  
CO-FOUNDER (CA)



SWATI KHEMANI  
CO-FOUNDER (CA)



PANKAJ NAMDHARANI  
COO (CA, CS)



SHAILESH KHATRI  
HEAD - SALES & BD



KUNAL SHAH  
ANALYST (CA)



SAMEER DOSANI  
ANALYST (CA, CFA L2)



TANAY PATNI  
COMPLIANCE (CA)



MONICA SHARMA  
COMPLIANCE (BMS)



MEENAKSHI KAMBLE  
OPERATIONS (M.COM)



MAYUR JAIN  
ACCOUNTS (ATC, B.COM)

To know more about our team, visit our [webpage](#)



# Carnelian values

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Capital Protection: Margin of safety **precedes** returns



Excellence: Excellence in inputs **precedes** outcomes



Law abiding: Compliance **precedes** rewards



Reputation: Reputation **precedes** rewards



Know what you don't know: Stay within core, expand core



Customer first: Customer interest **precedes** everything



Patience & trust: Patience **precedes** impulsiveness



# Carnelian investment philosophy

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We believe in investing in good growth businesses, managed by great managements at fair valuations



We obsess about risk reward and believe in risk adjusted returns



We believe there are certain catalytic moments in the life of a company which can catapult it into a different growth trajectory, if captured well, can generate superior risk adjusted returns



We are happy to be contrarian when risk reward is compelling: mimicking herd = regression to mean



We stringently follow "Carnelian filters" and "forensic checks" to generate sustainable returns & alpha



We believe investing success is an outcome of making good decisions consistently over a long period.  
Good decisions = "objective, free of any bias" + consider "probability of outcome" + factor "risk reward".



# Carnelian Capital Compounder Strategy

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- Long only, multi-cap, sector agnostic strategy focussing on capturing India growth
- Fundamental growth driven investing; bottom-up stock picking
- Absolute return-oriented *approach*
- Unique & unconventional blend of companies - Magic (accelerated growth), Compounder (stable growth) & Opportunistic
- Apply stringent Carnelian filters & forensic checks (CLEAR framework)
- Stock universe : 20-25; benchmark against BSE 200
- Available in PMS format





# Carnelian Investment framework (PIU)

## WE INVEST IN

### Good Business PROFITS

Profitable  
Robust cost leadership  
Opportunity & market size  
Free cash flow generation  
Incremental return on capital  
Time tested & easy to understand  
Sustainable moat



### Great Management IMPRESS

Integrity  
Modesty & capability  
Passionate & driven  
Realistic but aggressive  
Efficient capital allocator  
Skin in the game  
Strong governance & risk management culture



### Favorable Risk Reward US

Upside potential  
Safety margin encompassing

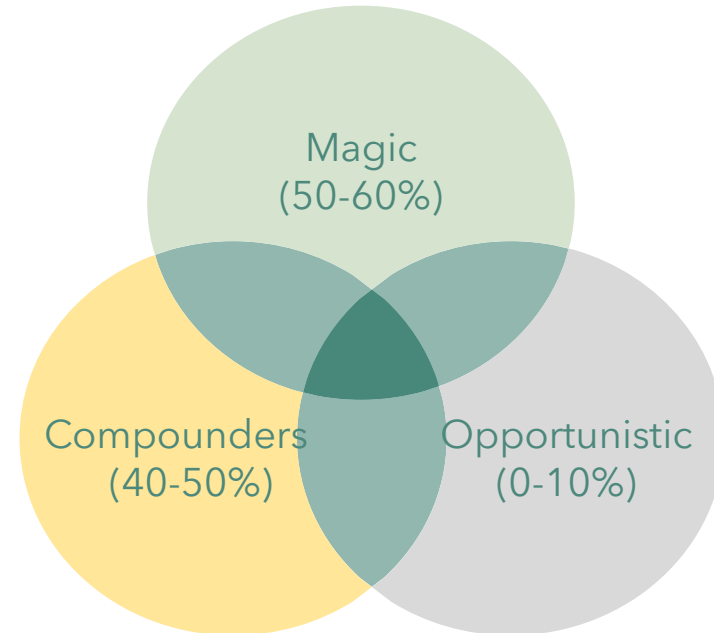
- Business risk
- Balance sheet risk
- Valuation risk



We track ~200 companies under this framework



We see opportunities in 3 baskets..



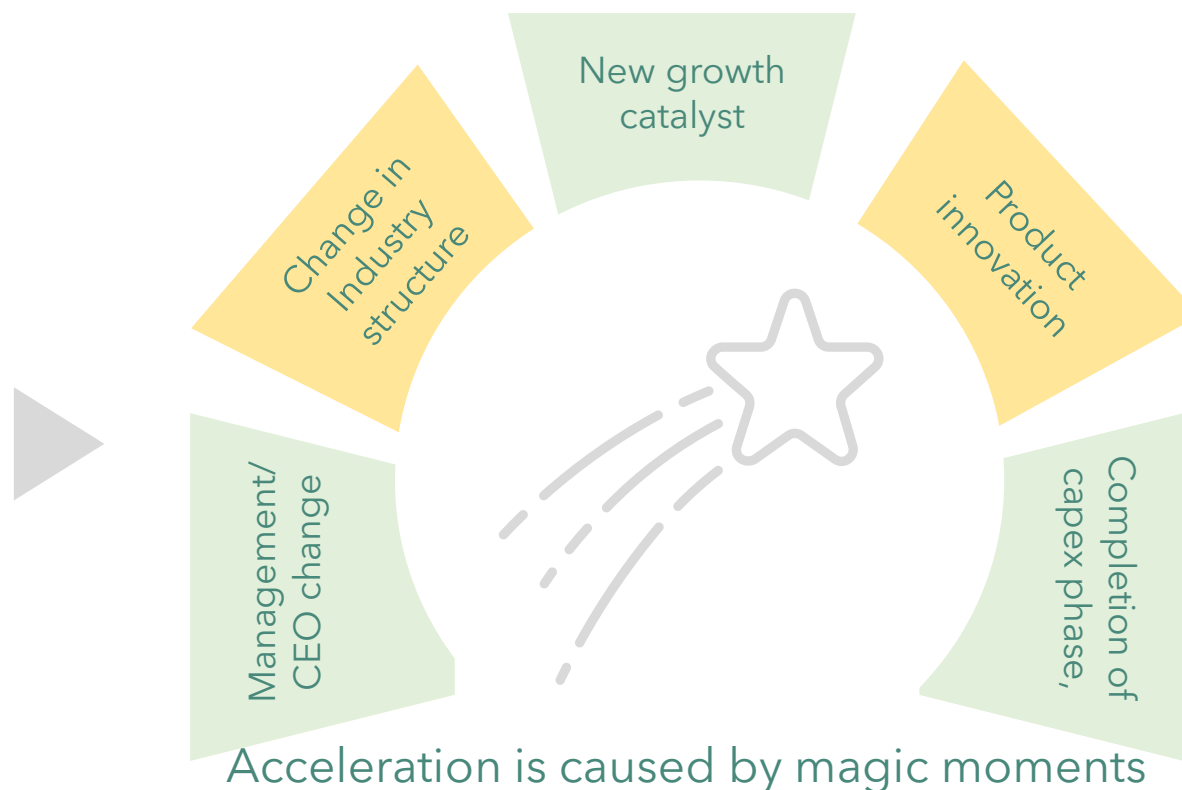
# We love the Magic basket!

**Carnelian Magic Basket** : Aims at capturing magic moments in the lifecycle of a company resulting in *Growth & Valuation re-rating (50-60% of the Portfolio)*

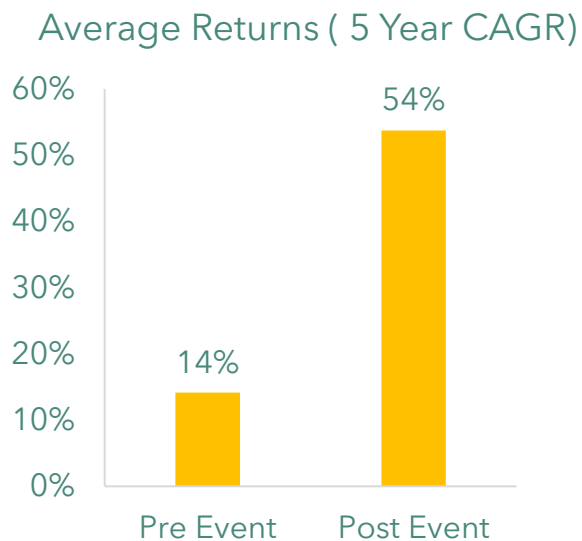
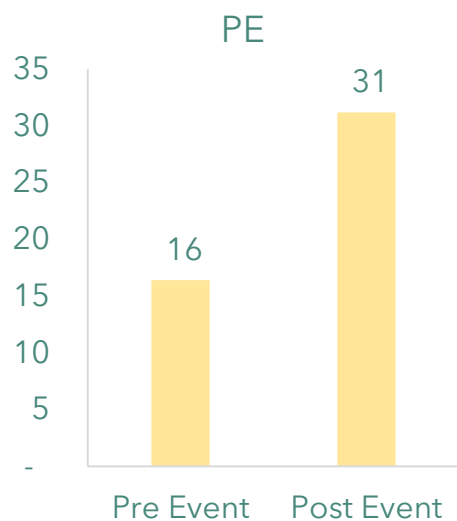
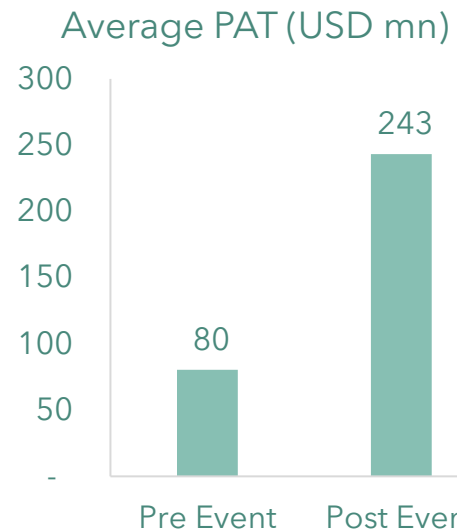
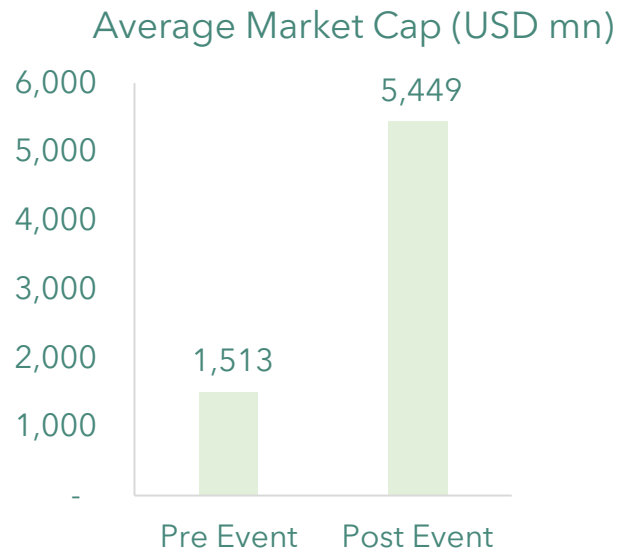
Invest in businesses with significant acceleration in growth profile vis-à-vis historic growth trajectory with an objective to capture re-rating driven by the following magic moments which is yet to be recognized by the markets

Historically,

- Good business + **average management/CEO**
- Good management + **industry facing structural headwinds**
- Good management + good **business lacking growth**
- Good management + **low returns due to long gestation investment**



# Magic basket returns at a glimpse - 1



# Magic basket returns at a glimpse - 2

Company	Magic Moment	Event Year	Returns pre event (CAGR)	Years	PE Pre Event	PAT (USD mn)	Returns post event (CAGR)	Years	PE post event	PAT (USD mn)	Return in times
TCS	New CEO	2009	-6%	4	10	728	27%	5	22	2,748	3
PI	New segment	2009	27%	4	5	3	95%	5	34	34	28
Aarti	Capex over + Industry change	2013	23%	5	5	12	71%	5	27	47	15
Bajaj Fin	New CEO	2009	1%	4	13	12	71%	5	29	175	15
Britannia	New CEO	2012	19%	5	35	27	57%	5	59	138	10
Whirlpool	New CEO	2015	10%	4	24	17	20%	4	55	56	2
Canfin Homes	New CEO	2013	15%	5	5	7	64%	5	18	41	12
Atul	Change in Industry Structure	2013	17%	5	6	13	54%	5	28	38	9
Bata	New strategy/CEO	2017	23%	5	30	30	58%	2	55	45	2
Chola	New CEO	2010	-7%	4	12	7	40%	5	19	79	5
SRF	Change in Industry Structure	2013	12%	5	4	52	63%	5	24	63	12
Sudarshan	Change in Industry Structure	2013	36%	5	10	5	69%	5	36	12	14
TVS Motors	New strategy	2014	13%	5	8	27	37%	5	31	99	5
Dabur	New CEO	2002	-5%	3	11	9	56%	5	28	46	9
Maruti	Strategy change	2012	8%	5	16	316	36%	5	25	1,005	5
Jubilant	New CEO	2017	19%	5	86	13	62%	2	60	44	3
Biocon	Capex over	2016	11%	5	18	72	56%	3	37	137	4
KEI	New strategy	2014	9%	5	8	2	62%	4	19	25	7
VIP	New Product	2005	0%	5	6	1	46%	5	15	7	7
<b>Average</b>			<b>12%</b>	<b>4.6</b>	<b>16</b>	71	<b>55%</b>	<b>4.5</b>	<b>33</b>	<b>255</b>	<b>7</b>



# We like the Compounder Basket

Carnelian Compounders: Superior stable return led by - MRFG (40-50% of the Portfolio)

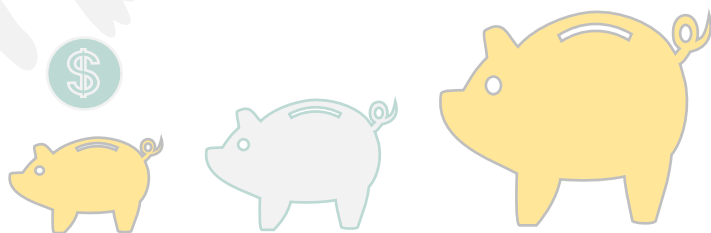
Invest in stable & sustainable growth, capital efficient businesses with an objective to capture smooth compounding over an investment horizon of 5 years with the following traits:-

**Moat:** stable business, large opportunity size & sustainable moat

**High ROE** - efficient capital allocation

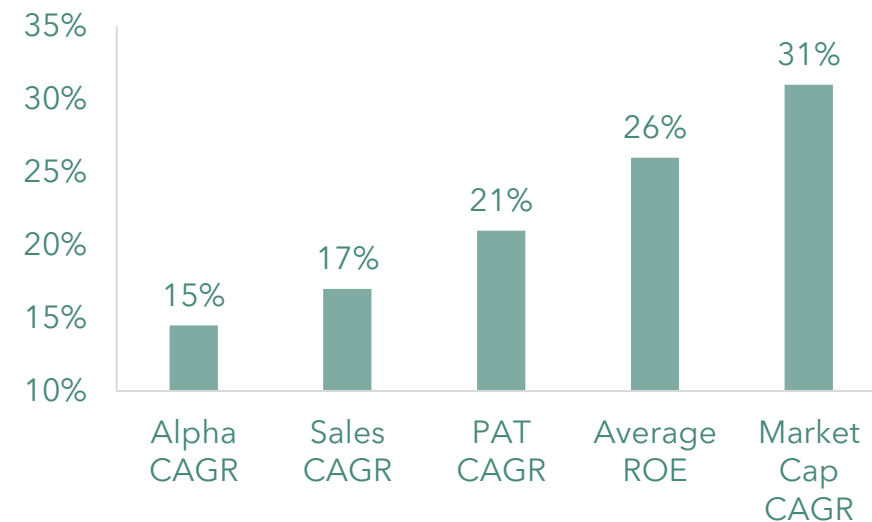
**Growth & Governance**

**Robust Free Cash flows**  
generation: well established business model tested across cycles



Stable business at "Fair" valuations leads to compounding!

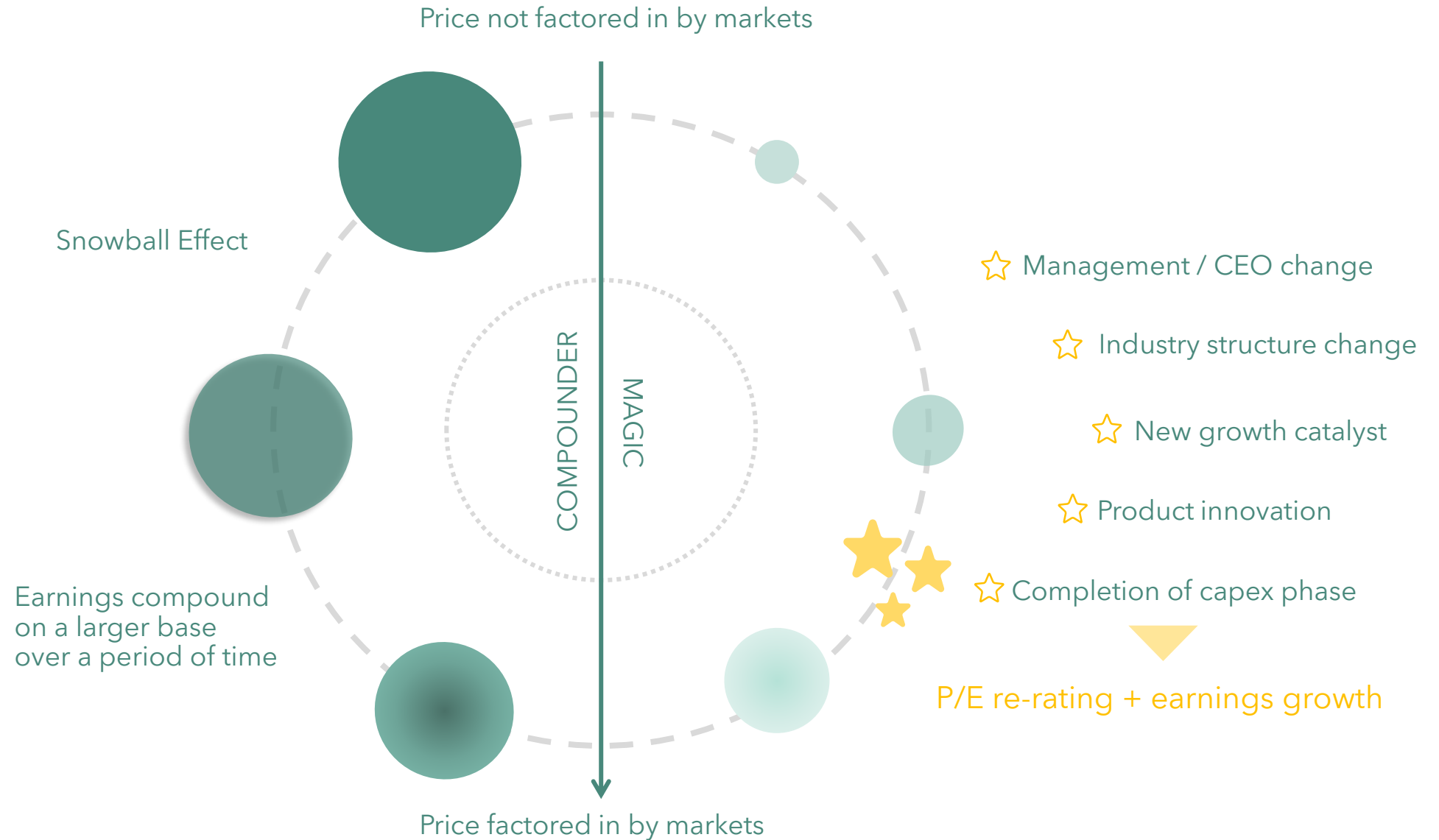
Compounder Portfolio - 10 year data



Source: Carnelian Research

Compounder portfolio has outperformed BSE 200 every year since the last 10 years

# The journey from Magic to Compounder...



# We look for opportunistic situations

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Special Situations like

- IPOs, Mergers, Demergers, Open Offer, Buyback, Delisting,
- Potential takeover target,
- Valuation Dislocations - Deep value with cash flows



While maintaining risk reward







# Investment Process

# Carnelian investment process



# Investment process – ideation

## Carnelian Magic Basket

- Regular tracking of corporate announcements, open offers to capture change in management, Promoters
- Periodic meeting with corporates, channel checks & calls with Industry experts
- Sudden spurt of revenues, operating profits, margins, improvement in working capital – running of screeners with identified parameters post quarterly and six-monthly results
- End of capex cycle – running screeners for additions in gross block



## Carnelian Compounder Basket

- Structural screeners covering Carnelian parameters – based on 10 years historic data such as revenue/EPS CAGR, ROE, cash flow conversion and debt equity levels above our threshold
- Business should be non-cyclical, non-commoditized with no material regulatory headwinds and not complex either



# Carnelian investment filters

## Growth filters

- Minimum expected revenue growth (> nominal GDP growth) >12%
- Minimum expected EPS growth >15%

## Capital allocation filters

- Minimum threshold ROCE/ROE >15%
- No significant deterioration in incremental ROCE/ROE

## Cash flow filters

- OCF to EBITDA conversion >60%
- Source of OCF should be cash profits vis-à-vis increase in payables

## Balance Sheet filter

- Debt/Equity <1.5x, Debt /EBITDA < 2x
- Total liabilities/equity <3x
- Asset quality ratios - non core assets as % of net worth <25%
- Asset/Liability mismatch - funding long term assets with short term liabilities

## Governance filter

- Avoid companies with material related party transactions (off & on BS)
- Avoid companies with complex holding structure - many subsidiaries/JVs
- Low Direct and indirect tax incidence
- Auditors, Independent directors reputation



# Carnelian forensic filters

Our forensic analysis involves a 2-step approach:

## 1. Carnelian forensic check

An automated template screening last 10 years of historical data, highlighting potential minesweepers, which get rejected at this stage.

## 2. Forensic deep dive - **CLEAR Framework**

Subsequently, our dedicated forensic team will deep dive/analyse the annual reports & financials which will be presented in a prescribed format to the Investment Committee (IC).

**C - Cash flow Analysis**, sustainable cash flows vs reported cash flows

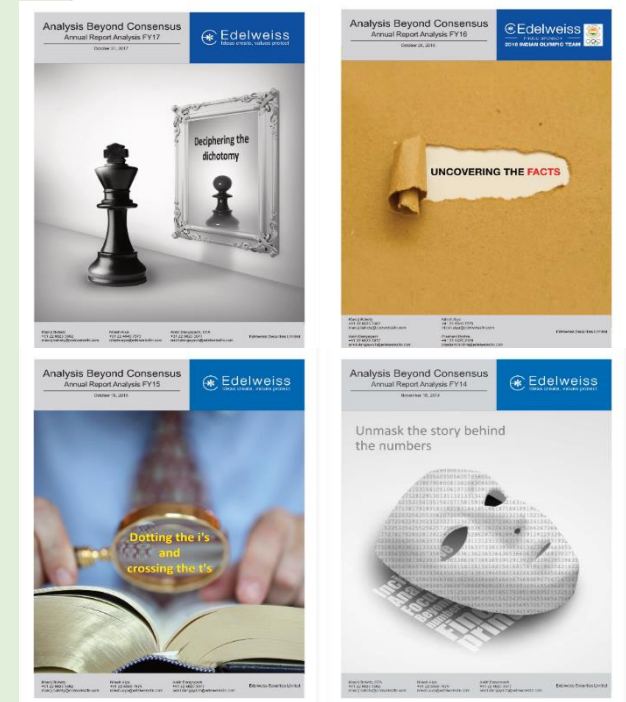
**L - Liability Analysis**, True debt vs reported debt, contingent liability & likely impact on future earnings

**E - Earning Quality Analysis**, True economic profit vs reported profit, discretionary vs non-discretionary profit

**A - Asset Quality Analysis**, core vs non-core assets

**R - Related party transaction & Governance issues**

Any stock not qualifying the above test, will be rejected by the IC



# Carnelian risk management parameters & process

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- Single stock exposure - 10%
- Sector exposure limit - 40%
- Single promoter group exposure - 20%
- Exposure to illiquid stocks (subject to strategy mandate)
  - Usually, 70% of the portfolio that can be liquidated in 5 trading sessions
- Check against human biases
  - Any portfolio stock falling >20% vis-à-vis benchmark requires the PM to revisit & re-evaluate the investment hypothesis & present to the IC within 7 days
  - Any fresh buying in the stock will be halted till IC approval
  - Stock will be sold if the IC is not convinced with the re-evaluation finding



# Carnelian valuation & stock exit process

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## VALUATION FRAMEWORK

- Proprietary financial models capturing 5 years earning growth, ROE & cash flow trajectory.
- Relative valuation assigned considering growth, ROE, cash flow and BS health.
- Valuation is compared with industry peers following relative multiple framework – P/E & P/B.
- We avoid valuing companies as a multiple to EBITDA, revenue, order book etc

## WHEN DO WE SELL?

- Material change in initial investment hypothesis
- Error in initial investment hypothesis
- Valuation stretching significantly outside fundamental valuation zone
- Other lucrative investment opportunities offering better risk reward metrics
- Stock falling > 20% vis-à-vis benchmark & not qualifying the IC post re-evaluation findings

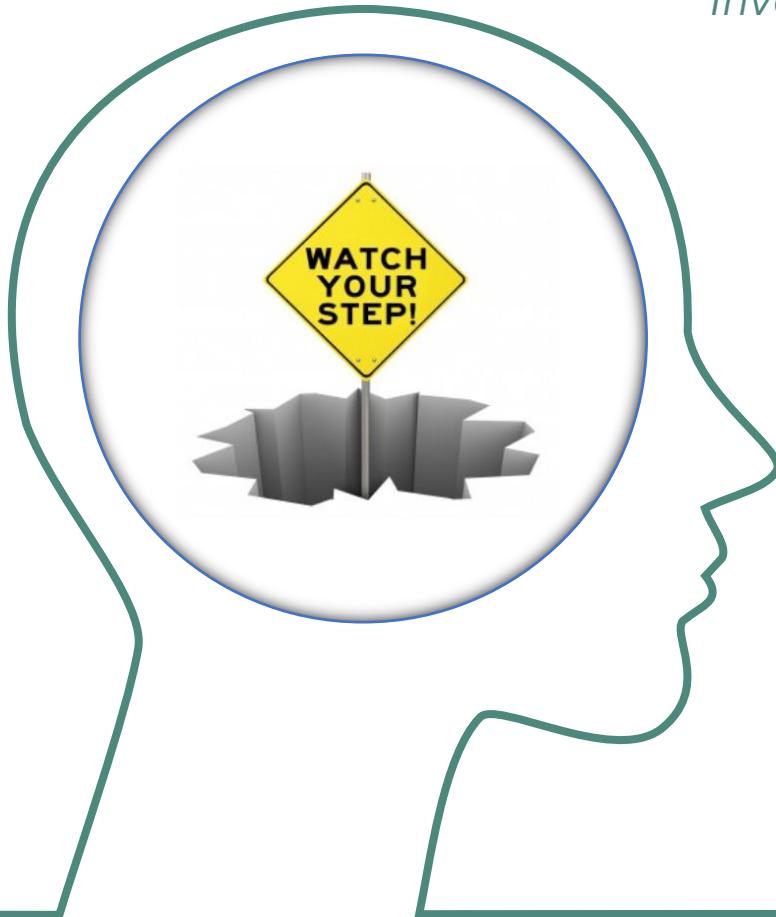


# Pitfalls we avoid

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*"Invert, always invert. Tell me where I will die, I won't go there."*

*- Charlie Munger*



- Aggressive accounting practices
- High financial leverage
- Low tax incidence
- Management having no skin in the game or misaligned objective
- Management with a consistent poor governance track record
- Management in a hurry to create value





# In a nutshell..

Business Score	Management Score	Valuation Score	Overall Score	Action
				Opportunity
				Wait for "MAGIC "(Change in management)
				Wait for "MAGIC" (Change in business /industry structure)
				Wait for valuation correction
				Avoid





# **STRATEGY INFORMATION AND PERFORMANCE**

# Strategy features

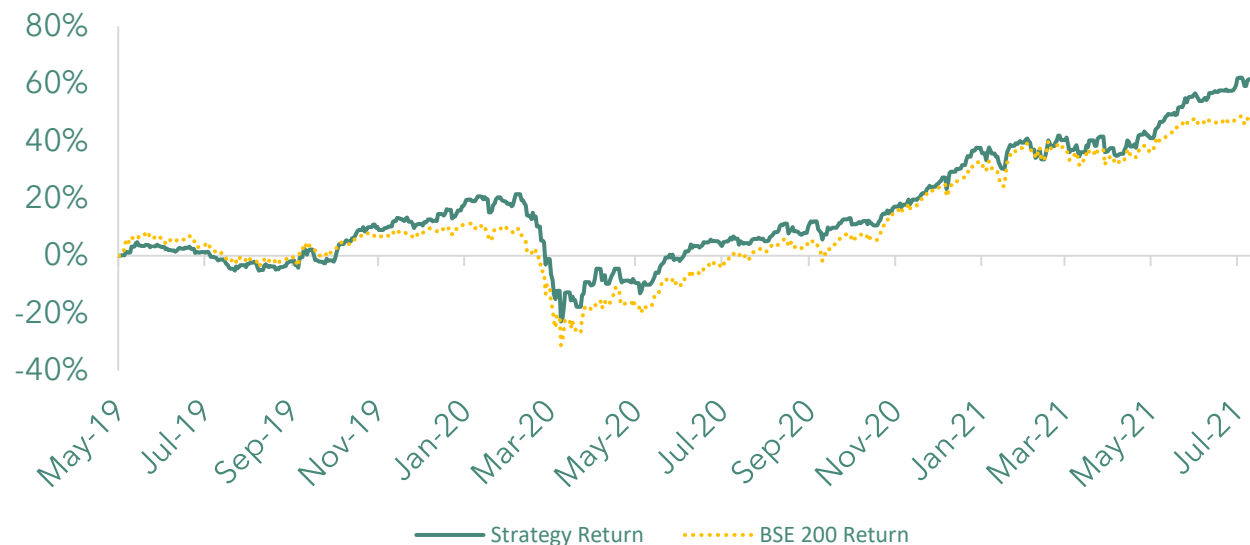
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Key Terms	
Strategy Name	Carnelian Capital Compounder Strategy
Investment Manager	Carnelian Asset Advisors Pvt Ltd
Benchmark	S&P BSE 200
Custody	Edelweiss Custodial Services Limited
Taxation	As per investor's tax bracket: Currently long-term capital gains @ 10% and short-term capital gains @ 15% as applicable

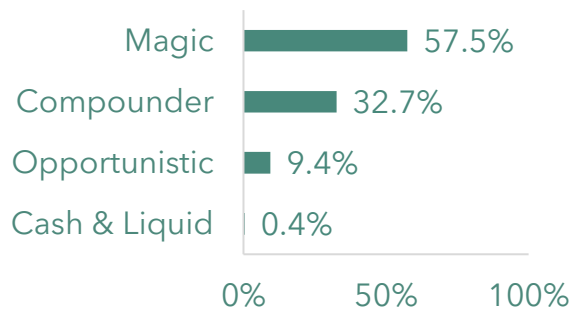


# Capital Compounder Strategy portfolio attributes

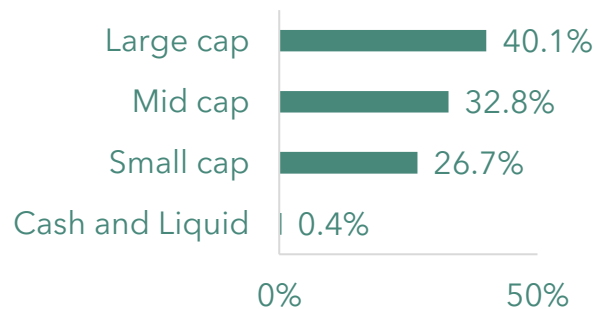
Performance chart since inception



Basket Allocation



Market cap allocation



Cumulative Performance (%)

Return	1M	3M	Inception CAGR	Inception Absolute
Strategy	3.3%	17.5%	24.5%	62.3%
BSE 200	0.8%	9.2%	19.6%	47.6%

Above mentioned returns are at strategy level and post expenses. Individual returns may vary.

Portfolio Fundamentals

Portfolio ROE FY23E	24%
Portfolio Earning CAGR (FY21-23)	30%
Portfolio PE FY23E	28X
Portfolio Beta	0.84
Sharpe Ratio	1.1
PEG Ratio	0.9
Positive alpha / total month	70%
Max. Drawdown from inception	-23%
Max. Drawdown from peak	-38%

Size	% Deployed	Average Market Cap*
Large cap	40.1%	47,018
Mid cap	32.8%	4,836
Small cap	26.7%	664
Cash and Liquid	0.4%	-
<b>Total</b>	<b>100%</b>	<b>20,616</b>

\* Market cap is in USD mn.

# Qualitative attributes of Capital Compounder portfolio

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- Defensive yet participative portfolio through carefully picked up trends and stocks -  
Overweight on IT and Pharma - Current weightage in IT - 24.2% and Pharma & API - 8.6%
- In BFSI space large exposure to non-credit space (insurance, broking) provides good participation as well as adequate cushion of cycle reversal. Credit and non-credit weightage at 15.7% and 16.7% respectively
- Most names in our portfolio are still in comfortable valuation zone. All portfolio stocks have good governance track record & ROEs ~20% + and minimum leverage as well as very good cash flow generation.



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# Contact us

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Carnelian Asset Advisors Private Limited,  
B -1405, One BKC, G Block, Plot C-66  
Bandra Kurla Complex, Bandra (East),  
Mumbai-400051.



+91-22 6691 4023 / +91 - 22 6691 4024



[www.carneliancapital.co.in](http://www.carneliancapital.co.in)



[swati@carneliancapital.co.in](mailto:swati@carneliancapital.co.in)

