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A perspective on churn

Finding the right balance between staying invested for compounding and exiting remains the holy grail of long-term investing.

We dislike unnecessary churn – why sell and pay tax if one can keep holding for compounding gains? But we need to view decisions in our context.

- We have defined rolling 5-years as the time context for decision making. "What gets measured gets done." If one invested with a decadal perspective, one would act a bit differently.
- Over 5-year time horizons, one cannot ignore cycles and probabilities. Multiples tend to expand/contract with short term earnings. High starting valuations increase the risk of poor outcomes if there is an earnings shock vs expectation, or if sentiment deteriorates.
- We are allocators of capital in 15-20 best ideas (not 50 ideas). Hence, every idea must count.
- Our size permits flexibility to exit and re-allocate. We must use this advantage.

We want to allocate some capital in undiscovered companies which are not consensus (Phase 1 and 2)

- Phase 2 companies are like Ranji cricketers. You must be really good to get so far, but not all will become great and play for India. Their moats are still being formed. They will give super-sized returns if they evolve to Phase 3 as growth will be accompanied by significant multiple expansionas their moats expand.
- However, that evolution may not happen. Companies often stagnate or stumble. From our past, we have seen technocrats obsessed with quality of their product and ignoring other factors required to win market share, not able to attract talent to scale as they are unable to delegate, trying to grow too fast and end up mis-allocating capital into multiple areas, or taking on excessiverisk by over-leveraging the Balance Sheet to avoid dilution.
- Evolution is unknowable by studying past history alone. Challenges increase with scale. One trulyunderstands promoters when one has owned a company and interacted with them for some time.Ownership elevates the intensity of scrutiny and introspection. If companies are not evolving in line with our expectations, we will exit.

Hence, some churn is unavoidable. It would be the right action to take in the context of 5-year rolling timehorizons as agreed with you.