

A guide to Alternative Investing

Companies which champion strong values and have the courage to live them are companies which people prefer to work for and it is precisely because of this that they give the market economy a legitimacy which it otherwise lacks

It is my belief that for the market economy to be accepted it requires a certain culture expressing certain values, the roots of which are outside the field of economics and also the field of politics, and which in fact reach deep down into the philosophical and religious foundations of our civilization

- Lord Griffiths of Fforestfach
International Advisor, Goldman Sachs International
Speech, - The Business of Values

Unifi's Alternative Investment Strategy is based on identification and quick execution of low risk-moderate gain opportunities in the capital markets. Sometimes these opportunities are driven by corporate events like mergers, acquisition, and buyback of shares through an "open offer" for purchase of shares and some times from inefficiencies in the market which provide "arbitrage opportunities" and exceptionally "high dividend yields". In the following section we briefly describe how these strategies actually work.

Corporate events like mergers, acquisition, enhancement of stake in the companies, buy back of shares etc. are taking place with increasing frequency in India. On announcement of such events, following could happen depending upon the type of transaction.

- Share of one company is swapped with shares of another company in a pre-specified ratio.
- An entity, other than promoters, acquires more than 15 percent stake in a company. He is required to make open offer to the shareholders to acquire another 20 percent as per the SEBI Substantial Acquisition of Shares and Takeover Regulations, 1997.
- An existing promoter wants to increase the stake in the company or de-list the company, hence gives open offer to acquire additional shares.
- A company decides to buyback its own shares

In case of swap of shares there could be differences in the market price of the two companies, which do not correctly reflect the swap ratio. When open offers are made, on most occasions, the price at which the buyer makes an offer for purchase is higher compared to the prevailing price, to induce shareholders to offer their shares. Our expertise lies in identifying and quickly converting these opportunities into profit.

From time to time, market conditions also provide access to exceptionally high dividend yields from strong companies with sustainable profitability – such situations, if carefully evaluated, offer steady annual income with potential for significant capital gains. IPO activity tends to peak in buoyant markets. Selective participation in IPOs through larger applications in order to take advantage of the “proportionate allotment” system could be quite profitable. Such IPO arbitrage requires a very disciplined approach in timely exit.

Generally, we participate in those opportunities where:

- There is sufficient liquidity in the scrip
- The management is reasonably sound
- The process of share acquisition is completely transparent, and
- Where the balance of risk-reward after taking into account the possibility of non- acceptance of shares offered (in case of public tenders) and the capital loss/risk on the shares not accepted is reasonably estimated to be in our favour.

Arbitrage opportunities in Derivatives

Unifi is a registered member of both cash market segment and derivatives segment of the National Stock Exchange. Having access to both the markets, we are able to locate arbitrage opportunities across the two markets and execute them in quick time to offer risk-free high returns to the investors.

3 Types of event driven opportunities

The innovative organization takes the chance that there's more to be gained by taking risk, by collaboration and mutual exploration between customers suppliers than by secrecy. The innovative organization balances strategic and tactical elements of its portfolio. It concentrates on projects with strategic breakthrough potential that also align with its human resources and technological strengths and operational processes.

- Fred G Steingraber
CEO, A T Kearney Inc. USA
The Paradox of successful growth, 1998

	Expected mean return	Optimistic return	Pessimistic return	Level of risk
	(% Pa)	(% Pa)	(% Pa)	
Debt/Fixed income - type opportunities through equity instruments and arbitrage	9	12	6	Low
Corporate events based opportunities (M&A/IPOs and High dividend yield stocks)	15	40	-10	Medium
Equity/Derivatives	20	80	-40	High

Three categories of opportunities

Our Debt/ Fixed-Income-type opportunities through equity Instruments and Arbitrage category is characterized by relatively low returns and low risk. Indicative returns for this category could be broadly pegged in the range of 6-12% p.a. Instruments such as highly rated corporate debt, Liquid Mutual Funds, Certificate of Deposits, Arbitrage between market segments and unconditional tender offers would fall into this category.

The second category of investments - 'Corporate Events based Opportunities, IPOs & High Dividend Yield stocks' occupies the middle ground between the two other investment categories described herein above, in terms of risk and return. In the former we attempt to take advantage of market imperfections after a corporate event such as merger and acquisition, buyback of shares, tender offer for purchase of shares etc. has been publicly announced by the company. In many of the investments falling under this category it might be possible, but not necessarily so, to limit the losses because purchase and sale price can be estimated with reasonable clarity based on publicly available information. Gains from these investments could be as high as 35-40% on an annualized basis. However, possibility of losses cannot be eliminated in such investments. Therefore, we have indicated a range of +40 % –10 % with an average of 15% against this category.

On Equity/ Derivative investments we also allocate a portion of capital (usually less than 30% & only if specifically mandated) for investments into businesses purely for their growth/value potential. While we may aim at a 20% p.a. return, investors must be aware that because of inherent volatility of the stock markets the actual return could be at substantial variance from the indicated returns.

Risk and Return Profile of Investments

Risk can be defined as that the actual outcome of an investment will differ from the expected outcome. If an asset's return has no variability, i.e. if one is certain to get that return, there is no risk. Thus, a 364 – day Treasury bill purchased to yield 10 percent and held to maturity will, in fact, yield 10 percent. No other outcome is possible, barring default by the government, which is not considered a reasonable possibility.

The following table summarizes how different investments have behaved over the past three decades

Year	Bank Deposit Rates - 1-3 yrs	Long term Govt. Bonds - 15 yrs and above	Return on the Stock market index
FY1974	6	5.37	19.43
FY1975	7.38	6.16	-18.89
FY1976	8	6.28	0.59
FY1977	8	6.25	2.16
FY1978	6	6.25	6.69
FY1979	6	6.43	22.95
FY1980	7	6.59	0.8
FY1981	8	6.97	31.83
FY1982	8.5	7.23	31.11
FY1983	8.5	7.73	-4.82
FY1984	8.5	8.24	16
FY1985	8.5	9.22	44.23
FY1986	8.75	9.94	64.33
FY1987	8.75	10.19	-12.03
FY1988	9.5	10.34	-22.13
FY1989	9.5	10.55	79.14
FY1990	9.5	10.93	9.45
FY1991	9.5	11.45	49.42
FY1992	12	11.15	267.18
FY1993	11	10.65	-46.78
FY1994	10	13.14	65.71
FY1995	11	12.62	-13.71
FY1996	12	12.43	3.24
FY1997	11.5	11.6	-0.17
FY1998	10.75	11.09	15.82
FY1999	10	11.73	-3.92
FY2000	9	11.45	33.73
FY2001	8.75	11.24	-27.94
FY2002	8	9.14	-0.75
FY2003	5.13	7.43	-14.11
FY2004	4.63	6.58	80.00
FY2005	5.50	7.30	13.00
FY2006	6.50	7.85	74.00
FY2007	9.00	8.20	15.88
FY2008	9.50	8.65	19.67
FY2009	10.00	7.50	-37.94
Average	8.60	9.03	13.51

Source: RBI Handbook of Statistics on Indian Economy

The things which hurt,
Instruct

- Benjamin Franklin

As can be seen, average of annual returns from investment in stocks over the past three decades is about 14.86%. But we cannot be sure how much the return will be in the next one year. During the next one year return could be +40%, -40% or even higher on either side. Therefore, knowing the average return is not enough. We must understand riskiness or the variability in returns.

Average of annual returns from bank deposit, Govt. bond and equities over the past three decades is 8.60 percent, 9.03 percent and 13.51 percent respectively. But the best and worst yearly returns are much different. In best years Bank Deposit earned 12 percent, Long-term Govt. securities yielded (capital gains not included) 13.5 percent and Equities gave a return of whopping 267 percent. In the worst year, the three investment categories yielded 4.63 percent, 5.37 percent and a negative 47 percent respectively. Bank Deposits give steady and predictable returns but no great upside. Long-term Government bonds have a similar profile. But if you happened to be invested in equities in FY1992 you would have earned as much as your bank deposit would have earned for you in fifteen years. But in the next year you would have lost about half of your investment.

In short, for gaining a higher return you need to take a higher risk. It means that if you aim for a higher return you must be prepared to see a lower return or possibly a negative return as well during a given period of time. On the other hand, a lower return is possible to earn without much uncertainty.

Power of Consistent Returns

If you have a very high expectation of return from investments or if someone has promised you such a return, just consider the fact that the most successful investor of our times, operating in the most vibrant economy of the world, has generated an average annual post-tax return of 22.6 percent (1964-2001). He is the legendary Warren Buffett. This average looking return has generated for him more than \$35 billion because for the last 37 years this average looking return translates into a cumulative gain of 194936 percent.

Let us now consider two portfolios A and B.

Years->	1	2	3	4	5
Return on portfolio A	40%	40%	40%	-40%	40%
Return on portfolio B	20%	20%	20%	20%	20%

If you had invested in Portfolio A your gain would have been 130 percent. But the second portfolio would have given you a higher return of 149 percent.

A higher return on portfolio B has been possible because returns have been consistent. Power of consistent returns is at work here. However, such consistency can be achieved if we set moderate targets before ourselves. High target for return invariably leads to higher volatility and ultimately generates a lower return as in the case of portfolio A above.

We strongly feel that the portfolio B kind of investment is a better approach to follow. In the investment world slow and steady probably still wins the race. Our investment approach is aimed at providing a good return as well as a worry-free good sleep to our clients.



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