Twitter Thread by Rohit Chauhan

Rohit Chauhan
@rohitchauhan

Among all the risks, regulatory risk hits with no warning https://t.co/oOb1FMg35e

This is not new and will occur again. Gets amplified if the owner and regulator are the same

If you do invest, do it with proper risk management

– Regulatory risk: The Noida toll bridge is a BOT project with an assured 20% return during the operation period (around 30 years). On top of that if the company did not make these returns in any year, the company could just carry forward the shortfall to the subsequent years. This meant that by 2011-12 the company had close 2000 Crs+ of shortfall on its books. The ground reality was that the Noida authority had refused to raise the tolls even by the level of inflation and every time they did, there were protests and dharnas. So the chance of realizing this shortfall was low.

The key point in the above idea was that the upside was limited and there was a regulatory risk which if it materialized, could completely destroy the investment thesis. So in a stroke of brilliance, after having held the stock for 2+ years and with a minimal gain, I decided to wise up and exited the company.

From the same post

The key point is this – If the business model of a company depends on specific regulations, then the company is always exposed to this kind of risk. . The company could be doing well for a long time and then suddenly the regulator or the government can change its mind and put the entire business at risk.

I have noticed that the market is usually sanguine about this risk and it is generally not priced in. However if the risk materializes, the reaction is swift and brutal. The only way to mitigate this risk is either to avoid such companies altogether or hope and pray that the regulator/ government does not change its mind on the key regulation.