Pramerica

Portfolio Management Services

Monthly Factsheet - November 2013

This document is of 3 pages and should be read in its entirety.

In our inaugural newsletter last month we discussed our approach to both the PMS business and portfolio construction. This month we share some more details on how our portfolio construction strategy actually works.

As mentioned last month, our primary focus is on the quality of companies we invest in. However, realizing that such declarations are now mandatory for portfolio managers and meaningless without a clear definition of quality, it is incumbent upon us to specify what we mean by it.

Quality

Quality can be defined both quantitatively and qualitatively. We use the former to shortlist our universe and the latter to select appropriate stocks. Following a basic premise that capital markets will reward the most efficient users of capital and the stock price will, over the long term, reflect this efficiency, we use two primary quantitative filters,

1) Return on Capital Employed (RoCE) and
2) Free Cash Flows (FCF)

Consistency is the key

However, generating both RoCe and FCF sporadically is not enough. It is important that a business generates both consistently over a reasonable long period of time to be termed a high quality business. To establish this, we look at the company's track record on both counts over the last 10 year. One point is awarded to a company for each year in which it generates RoCE greater than 20%. Another point is awarded for each year in which it generates positive free cash flow. As such, the maximum points a company can score is 20, 10 each for RoCE and FCF. We apply this filter to all companies of a reasonable size and shortlist companies scoring 14 points or above. The scores of some of our top holdings are,

Company	Industry	Score (Max 20)
Indraprastha Gas	City Utilities	19.0
FAG Bearings India	Bearings	18.0
Siemans Ltd	Engineering	18.0
VST Tillers Tractors Ltd.	Agricultural	18.0
Container Corporation of India	Logistics	20.0

* For illustration purpose only. Please read page 3 for the complete text of the disclaimer.

As such, our investment universe consists of reasonable sized companies that have not only existed for at least 10 years but have generated an RoCE of >20% & positive free cash flows consistently in this time. At the moment, a little over 150 from the 6,000+ listed companies qualify. Almost all of them are either market leaders in their main line of business or a strong second.

While the use of these two filters may seem simplistic, these have an extremely strong ability to identify the most common ailments that a company may suffer from. For example, a highly leveraged company will not be able to gain points on either or both the parameters consistently.

More than 75% of our portfolio at any point of time consists of companies from this universe. For the rest, we may allow some relaxation in the numbers. For example, if a company generates a RoCE of 19% consistently and meets the FCF requirement, it may be included as an exception. The current portfolio does not contain any exceptions.

Strengthening the two filter test

We then analyze qualitatively to ascertain the quality of the management, their treatment of minority shareholders and business prospects in the coming 5 to 10 years. Multiple sources of information are used for this including third party research and management interactions.

In the last leg, these companies are analyzed from a valuation perspective to determine whether prevailing prices are attractive. This will be detailed in a subsequent newsletter.

This investment method has some extremely logical consequences. By insisting on a decade long track record, we effectively exclude any company relying on an untested technology or business model in its main line of business. We believe that this segment is best addressed through venture capital investments and not through our strategy.

Also, our universe is not related to the composition of any index. Our filtering mechanism is different and the resultant universe reflects that. As such, it is extremely probable that our portfolio composition will differ significantly from that of the popular indices. This provides investors with a genuine diversification opportunity. However, the distance from the index also increases the probability that portfolio performance will differ significantly from the index and is not directly comparable. This holds true for both positive and negative variances.

The result is a truly differentiated portfolio consisting of well known, well established companies which offer intuitive comfort to investors through their market leadership and consistent performance spanning, in most cases, many decades.

In our next newsletter we will detail our approach to the financial sector which cannot be analyzed using the above method and our valuation analysis methodology.

Consolidated Portfolio Performance as on 29th Nov 2013

Period	Pramerica Deep Value Strategy	CNX Nifty
1 Month	4.75%	-0.72%
3 Months	14.78%	14.18%
Since inception date 03/07/2013	13.12%	5.44%
	Pramerica Deep Value Strategy	CNX Nifty
Daily Volatility	0.64%	1.39%
Beta	0.34	

Performance depicted above, as at Nov 29, 2013, is based on all the client portfolios under the strategy existing as on such date, using time weighted average methodology. Past performance is no guarantee of future returns. The above portfolio performances are before charging of any expenses. Please read the complete text on the disclosure in this document.

Important Disclosures regarding the consolidated portfolio performance

Performance depicted above as at Nov 29, 2013, is based on all the client portfolios under the strategy existing as on such date, using time weighted average methodology. Past performance is no guarantee of future returns. The above portfolio performances are before charging of any expenses. Please note that the actual performance for a client portfolio may vary due to factors such as expenses charged, timing of additional flows and redemption, individual client mandate, specific portfolio construction characteristics or other structural parameters. These factors may have impact on client portfolio performance and hence may vary significantly from the performance data depicted above.

Neither the Portfolio Manager, nor its directors or employees shall in any way be liable for any variation noticed in the returns of individual client portfolios. The Portfolio Manager does not make any representation that any investor will or is likely to achieve profits or losses similar to those depicted in this document. Return for period upto 1 year is absolute. Since inception date stated is considered to be the date on which the first client investment was made under the strategy.

Disclaimer for the example from the existing portfolio

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