PORTFOLIO MANAGEMENT SERVICES

Newsletter July 2017

DHFL Pramerica

Dear Investor,

We write this when the monsoon has begun in right earnest.

An analysis of the components of the major indices in the last 6 months.

The two major indices that we analysed (Nifty 50 and the Nifty 500) have delivered 16.98% and 17.96% in the 6 month period ending 31st May 2017.

Sector	Nifty 50	Nifty 500
Overall	**16.98**	**17.96**
Consumer discretionary	17.07	25.1
Consumer staples	31.72	24.7
Energy	20.87	14.6
Financials	26.84	27.0
Healthcare	(23.8)	(13.0)
Industrials	27.58	25.2
IT	4.52	8.3
Materials	21.53	18.8
Real Estate	—	52.5
Telecom	12.83	7.2
Utilities	11.23	12.9
Insurance	—	38.4
Retailing	—	54.6
Media	—	20.7

As can be observed, IT and pharma have significantly underperformed in the past 6 months. Over the past 6 months, in line with our mandate, we have increased our exposure to these sectors.

Why do we buy when the sector isn't doing well?

We believe that when a sector is unpopular (as evidenced by low valuations) for reasons that are temporary, that is when stocks are available at attractive levels, providing margin of safety for the purchaser.

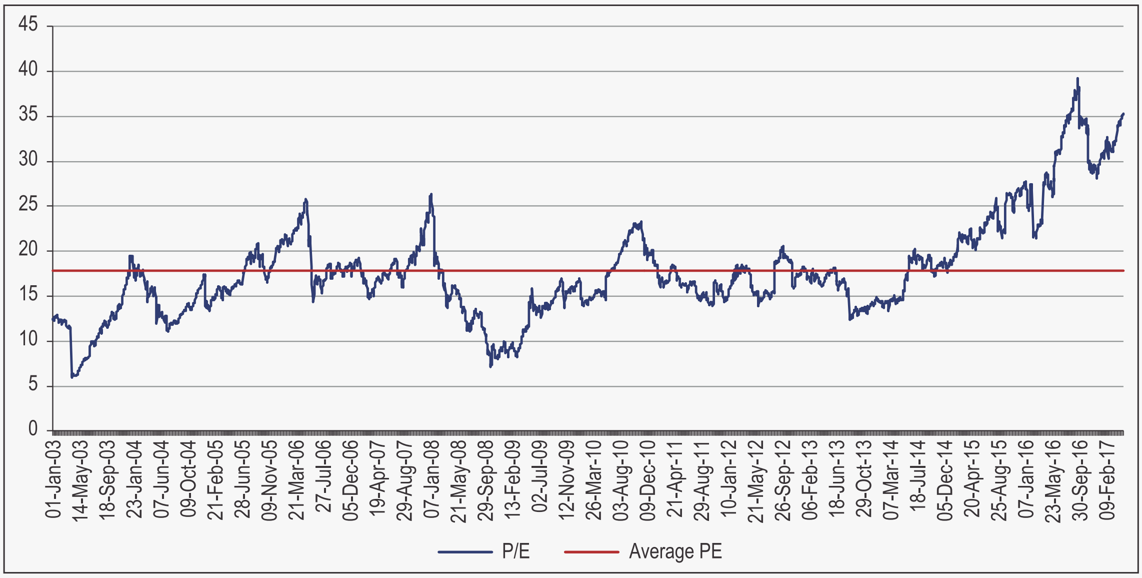
We do not compromise on the following principles:

(a) The company concerned is fundamentally very strong, and has not lost its ability to compete, and

(b) There is reason to believe, after careful study, that the difficulty that the company is going through is not a terminal difficulty.

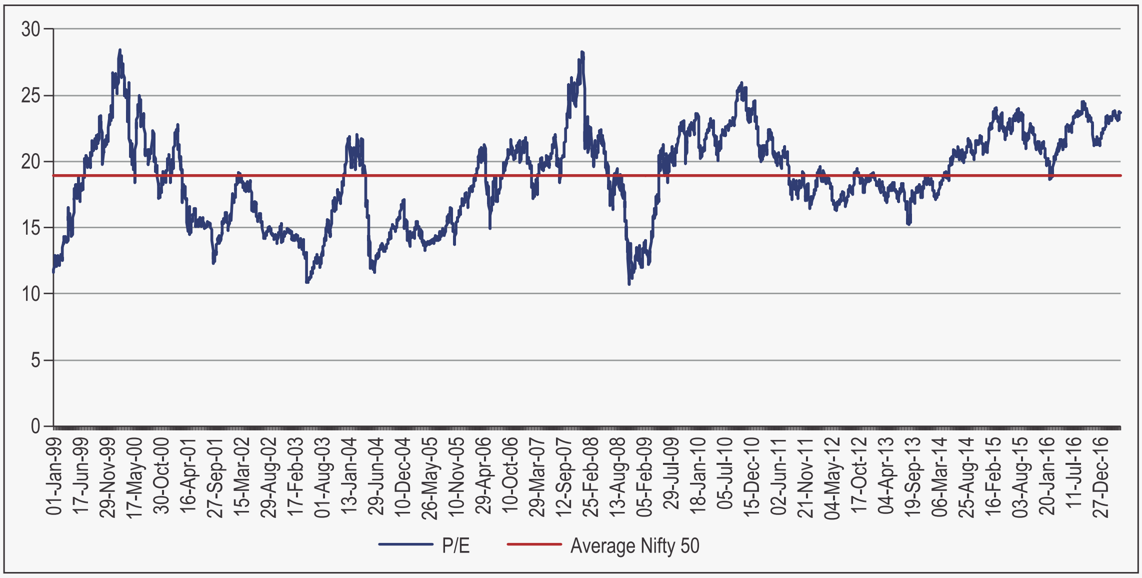
One would have also observed that our exposure to the mid and small cap stocks has significantly reduced over the past couple of years, for the same reason. In terms of valuations, these segments of the market are quoting at significantly higher valuations compared to their own history. In comparison, the Nifty 50 is quoting at just slightly higher than its average valuation.

Valuation history of the Midcap Freefloat 100 Index (updated till 3rd May 2017)



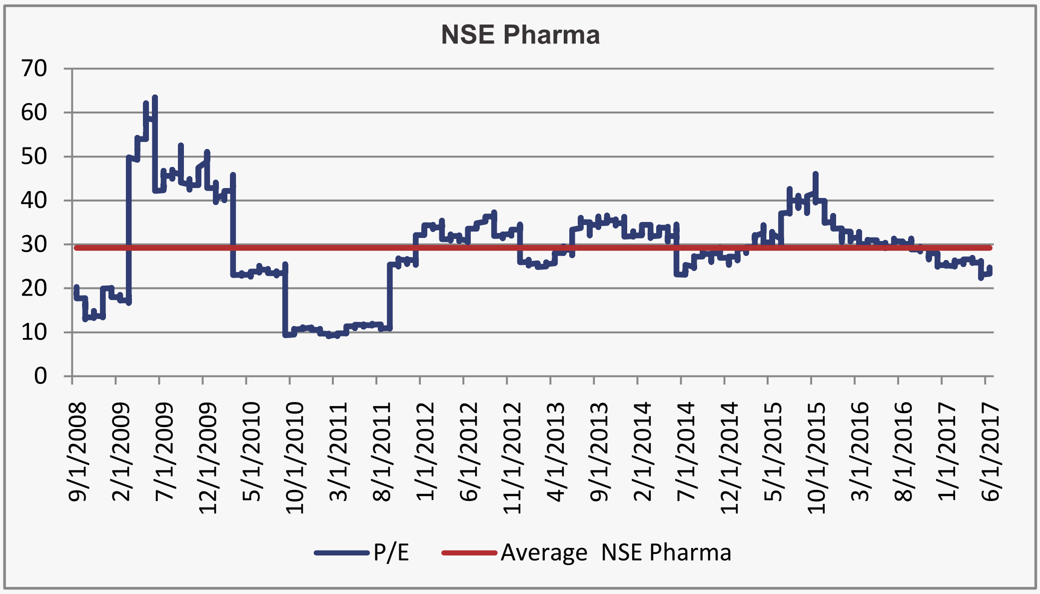
Data source: nseindia.com

Valuation history of the Nifty 50 Index (updated till 3rd May 2017)

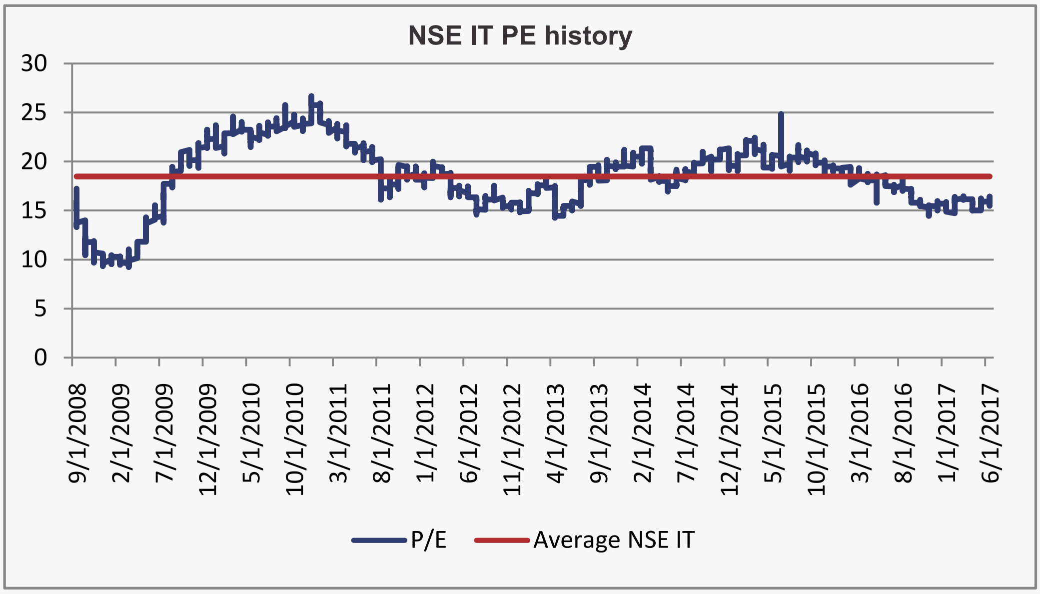


Data source: nseindia.com

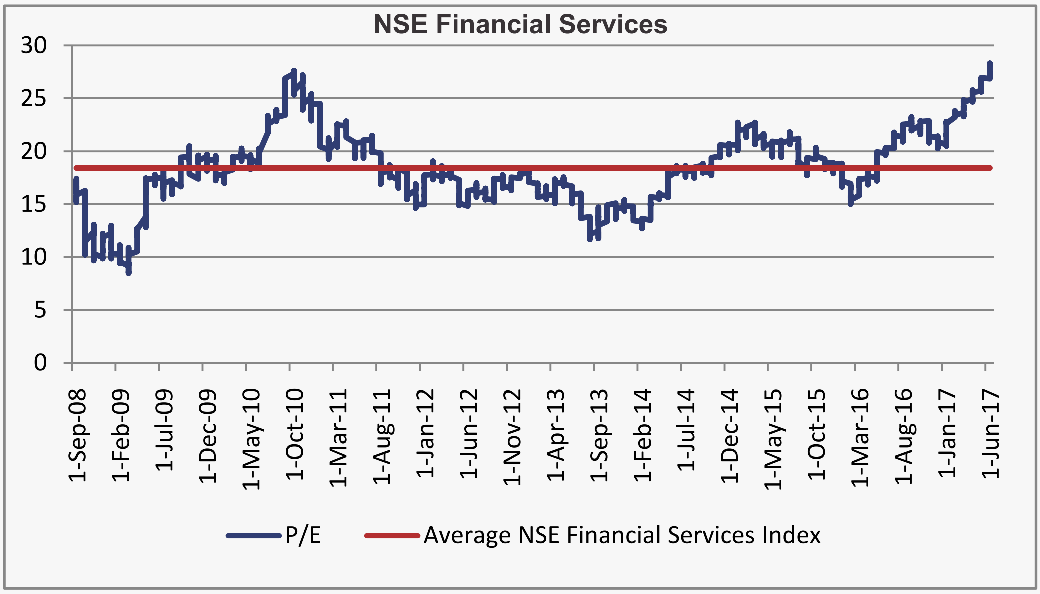
You would have also observed that different sectors are quoting at different levels of valuations. We have consciously reduced our exposure in sectors that have exceeded their average valuations.



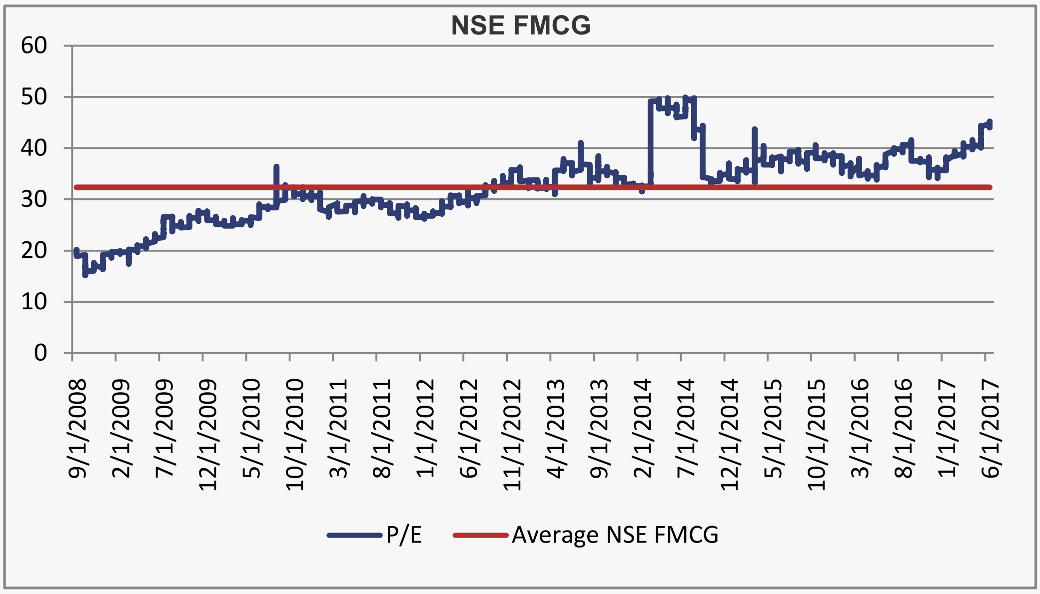
Source: Bloomberg



Source: Bloomberg



Source: NSE



Source: Bloomberg

As you can observe, consumer and financial sector stocks are quoting at valuations well above their average valuations. The reverse is true in pharma and IT. The opportunities clearly are in these two sectors, considering the fact that on a PE/Growth basis, these two sectors are more attractive.

Some of our recent purchases….

(1) Infosys, Oracle Financial Services Software and Persistent (in IT)

(2) Sanofi, Abbott and Divi's Laboratories (Pharma)

(3) United Spirits (Alcoholic Beverages)

We provide our thoughts on some of these stocks:

IT Exposure

Infosys Ltd

This company needs little introduction. It has one of the finest track records in this business, and is now in the midst of transforming itself from an IT services company, to a company that is more adept at AI, software automation, data analytics and product orientation.

Infosys' 5-year average RoCE is 34.57%. Its present PE is 15.21, compared to a 14-year average of 18.58. The stock trades at a dividend yield of 2.64%. The company has announced an enhanced dividend payout and a stock buyback to the combined extent of Rs.13000 crores (out of a total cash reserve of Rs. 36000 crores).

The reasons for the lower level of enthusiasm in the stock are as follows:

(a) Slower growth

(b) Perception of problems relating to H1B visa

(c) Perception of a rift between the promoters and the present board

We however believe that the company is taking steps to transform itself from a code-writing company to a problem-solving company. Of course there are risks in this investment, but the present valuation provides a margin for error.

We have also supplemented this IT exposure with Oracle (a products company), and Persistent Systems, a company with a different business model compared to these two.

We do not believe that the heady days of 1999-2000 will ever come back for the IT sector. But these present depressed prices provide a margin of safety in these times of extreme valuation skewness.

Pharma exposure

In consonance with our philosophy of buying quality businesses when they are unpopular, we have increased our exposure to Divi's Labs and Sanofi (besides buying a new stake in Abbott). Amongst these three names, there is a good diversification within Pharma

(a) An intermediates and CRAMS play (Divis)

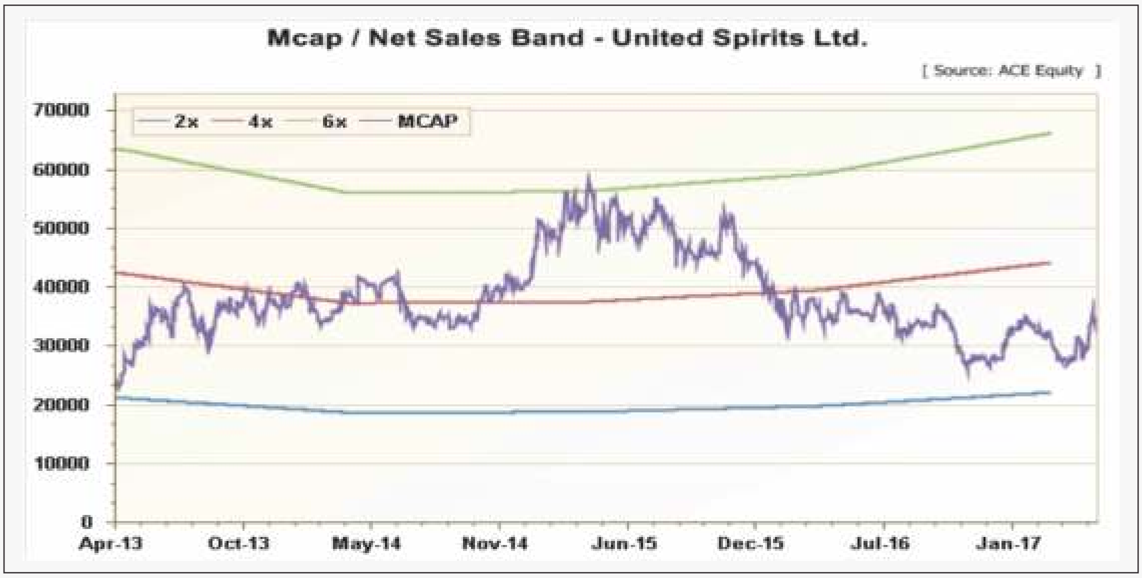
(b) Formulations with specialization in Anti-diabetes and cardiovascular drugs (Sanofi)

(c) Formulations with specialization in Women's healthcare, vaccines (plus some exposure to anti-diabetes) – Abbott.

All three companies are highly profitable and cash generating. Despite the reservations of the market in Divi's, the company's net profit in 2016-17 did not fall beyond 4.6%, and most of this fall can be attributed to forex fluctuations. The stock has corrected nearly 50% in the last 6 months. In our opinion, this is an over-reaction.

Valuation history of Divi's Labs

Another new addition – United Spirits



We were waiting for more than 3 years to buy into this company. At our purchase price, we were confident that this stock was close to our intended purchase price.

(a) The balance sheet is now much stronger, with debt levels reduced from Rs.8000 crores to about Rs.4000 crores now.

(b) The management team is now more professional, with both the Chairman and MD being old Hindustan Unilever veterans and the CFO from Holcim and the head of Prestige Brands from TAS and Tata Global Beverages.

(c) The process of clean-up is now more or less complete

(d) The company has a great set of brands, good distribution network

(e) The slew of bad news in this sector (Supreme Court judgement, Prohibition announced in some states) provided a good entry point.

(f) Valuation at multi-year lows, with a multi-decade growth potential ahead in a country like India.

Valuation history of United Spirits

Please note that in this case, we have taken the valuation history since the time the company was acquired by Diageo.

The consensus estimate of earnings growth for this company shows an above average growth rate in earnings over the next 2 years (albeit from a low base) (Source – Bloomberg).

In conclusion

Let us understand the basic purpose of this PMS.

We want to build a portfolio of strong businesses, purchased when such businesses are not exorbitantly expensive. Both these conditions are important, because

(a) Strong businesses eventually translate into a better return on the markets, &

(b) Buying a stock when it is not exorbitantly expensive enhances the chances of success in that investment.

In this endeavour, there will be times when we will be tested, and tempted by some sectors that are continuously rising, despite valuations being way out of whack. The temptation is to "ride the wave" as long as it lasts, and get out just before it falls.

Alas, it is simply not possible to get out just before the fall. We will know that the sector or stock has peaked out only after it has crossed the peak. We have to traverse this route by reducing risk to the extent possible.

Risk comes because of (a) investing in businesses with weak fundamentals and a lower ability to compete and (b) buying shares at very high prices. We believe that our clients stand a better chance to succeed in their investments if investments are made at reasonable valuations.

Let us remember that stocks rise because of a fulfillment of expectations; and they are sustained at higher levels only because of increasingly higher levels of expectations around it. Conversely, a stock falls because the expectations around the stock have been belied.

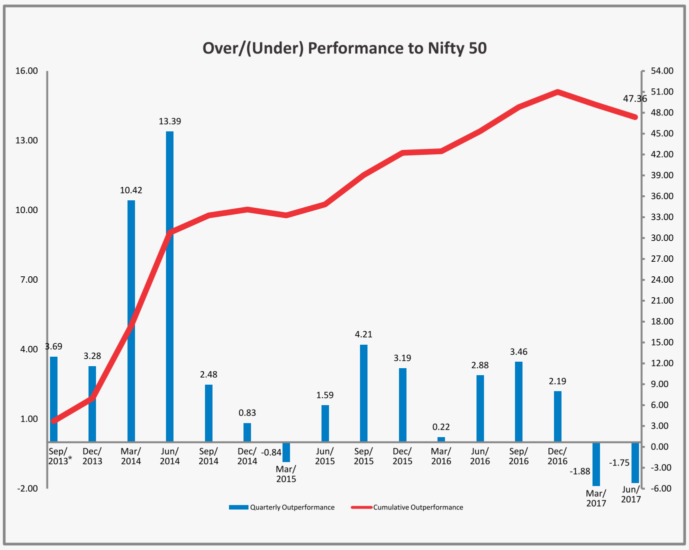
It is therefore in our interest to stay away from stocks where the level of expectation is already high (as evidenced by valuations well above historical highs).

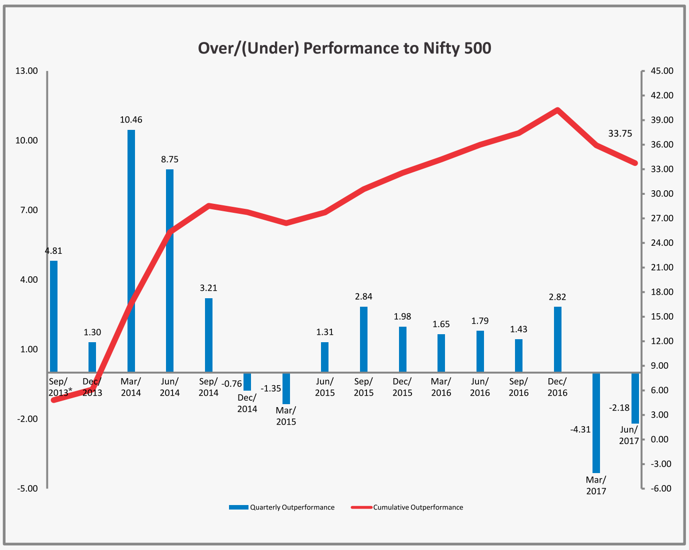
Warm regards,

(E A Sundaram)

"Nothing sedates rationality like large doses of effortless money" – Warren Buffett

DHFL PRAMERICA DEEP VALUE STRATEGY
KEY PORTFOLIO PERFORMANCE INDICATORS





* Returns for the period 8th July, 2013 to 30th September, 2013. Performance depicted as at the above stated date is based on all the client portfolios under the Regular Portfolio of DHFL Pramerica Deep Value Strategy existing as on such date, using Time Weighted Rate of Return (TWRR). Past performance may or may not be sustained in future.

Top 15 Holdings of DHFL Pramerica Deep Value Strategy Discretionary Portfolio Regular Plan as on June 30th, 2017

Date of Purchase	Equity	Sector	%
Jul/2013	Container Corporation of India Ltd	Logistics	5.12%
May/2014	Infosys Ltd	IT Services	5.08%
Sep/2015	State Bank of India	Banking / Financial Services	5.04%
Jul/2013	Indraprastha Gas Ltd	City Gas Distribution	4.34%
Aug/2013	Cummins India Ltd	Engineering	4.12%
Mar/2015	Castrol India Ltd	Lubricants / oils	3.85%
Apr/2016	Sanofi India Ltd	Pharmaceuticals	3.74%
Jan/2016	Oracle Financial Services Software Ltd	IT Services / Products	3.64%
Jun/2015	ITC Ltd	FMCG	3.48%
Jul/2013	Siemens Ltd	Engineering	3.44%
Jul/2016	Rallis India Ltd	Pesticides And Agrochemicals	3.06%
Oct/2013	Divis Laboratories Ltd	Pharmaceuticals	3.04%
Jul/2013	VST Tillers Tractors Ltd	Agricultural Equipment	3.02%
Jun/2016	Jagran Prakashan Ltd	Printing and Publishing	3.02%
Apr/2014	CRISIL Ltd	Credit Rating	3.01%
	Total		**57.00%**

Portfolio Details

Portfolio Details as on June 30th, 2017	
Weighted average RoCE	29.77%
Portfolio PE (1-year forward)	18.08
Portfolio dividend yield	1.50%
Average age of companies	58 Years

Portfolio Composition as on June 30th, 2017	
Large Cap	41.75%
Mid Cap	36.25%
Small Cap	8.50%
Cash	13.50%

Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on 30th June 2017

Midcap: Market cap below 100th company to the market cap of the 300th company in the Nifty 500 (sorted by market cap in descending order) as on 30th June 2017

Small Cap: Market cap lower than the 300th company in the Nifty 500 (sorted by market cap in descending order) as on 30th June 2017

The above holding represents top 15 holdings of DHFL Pramerica Deep Value Strategy – Regular Portfolio based on all client portfolios existing as on the date stated above, excluding any temporary cash investments. The above holdings do not represent the model portfolio being offered to the clients (including prospective clients) and hence it is possible that these stocks may not be part of the portfolios constructed for new clients. The above holdings are for illustration purpose only and it should not be considered as investment recommendation or analysis or advice or opinion from the Portfolio Manager on the above mentioned stocks. The above portfolio holdings are provided on an "as is" basis, and the Portfolio Manager makes no express or implied warranties or representations with respect to the accuracy, completeness, reliability, or fitness of the above portfolio holdings or any financial results you may achieve from their use. In no event shall the Portfolio Manager, its directors or employees or its affiliates have any liability relating to the use of the portfolio holdings.

DHFL Pramerica Deep Value Strategy Portfolio Performance as on 30th June 2017

Period	Portfolio	NIFTY 50	NIFTY 500
1 Month	0.78%	-1.04 %	-0.23 %
3 Months	2.21%	3.78 %	4.21 %
6 Months	13.39%	16.31 %	19.32 %
1 Year	18.60%	14.88 %	19.35 %
2 Years	13.97%	6.66 %	9.90 %
3 Years	15.43%	7.75 %	10.50 %
Since inception date 08/07/2013	31.60%	12.93 %	16.50 %
Portfolio Turnover Ratio*	11.31%		

*Portfolio Turnover ratio for the period 1st July 2016 to 30th June 2017

Important Disclosures regarding the consolidated portfolio performance: Performance depicted as at the above stated date is based on all the client portfolios under the Regular Portfolio of DHFL Pramerica Deep Value Strategy existing as on such date, using Time Weighted Rate of Return (TWRR) of each client and then computing an arithmetic average for the overall strategy. Past performance is no guarantee of future returns. The above portfolio performance is before charging of any expenses (as depicted above). 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. 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 above.

Investment objective of DHFL Pramerica Deep Value Strategy: DHFL Pramerica Deep Value Strategy seeks to generate returns by investing in a portfolio of value stocks which have the potential of superior wealth creation over long term.

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This document is dated July 07, 2017. **C51/17-18**