QUEST INVESTMENT ADVISORS PVT. LTD.

May 31, 2017

Synopsis

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Investment Outlook

Are we in early stage of the next bull market?

Broad economic upswing underway across developed as well as emerging economies, almost after a decade

- US Federal Reserve raised rates twice in last 6 months; a sign of growing confidence in the US economy as also lowering of global risks
- European Commission's economic-sentiment index at its highest since 2011; euro zone unemployment at its lowest since 2009
- Japanese exports up 7.8% in April after recording biggest gain in March (12%) in more than 2 years; strongest expansion since Jan-2015 and 5th straight monthly gain
- Crude Oil, iron ore and coal prices are all much higher than the lows of early 2016 and seem to be stabilizing now
- Recession coming to an end in Russia and Brazil and both inflation and interest rates are at much more reasonable levels now
- Producer price inflation in China and across Asia is positive again and Yuan seems to be stabilizing; Exports from China up by 14.8% in Yuan terms in Q12017
- South Korea April exports hits near 6 year high and Taiwan exports up 9.4% in April (13.2% in March); countries proxies for global trade indicating robust growth
- Indian exports grew by 28% in March 2017 and 20% in April 2017, indicating a smart recovery after 2 to 3 years

Bottom up stock picking skills key to delivering supernormal returns

Macro economic situation in India reminiscent of early 2000s

India's political and macro economic situation has seldom been better

- Single party majority in Lok Sabha after 30 years; more importantly, visibility of political stability at the center for the next 7 years
- Path-breaking reforms of Modi government has put India on a more sustainable inclusive growth platform
- Governance & transparency on a steadily rising upward curve: Riding the Digital Wave
- 'Ease of doing business' much more than a slogan; Modi government taking concrete steps in this direction
- Formalization of economy quietly underway; GST to provide further momentum
- Fiscal and current account situation approaching the best levels of mid 2000s
- Inflation & Interest rates in single digits and seem to have stabilized at these levels
- Foreign currency reserves at the highest ever levels; rupee is one of the best performing currency globally
- FDI flows breaking new grounds; FIPB being abolished!
- The bane of Indian economy, high crude oil prices, is finally under control and most likely it is for good!

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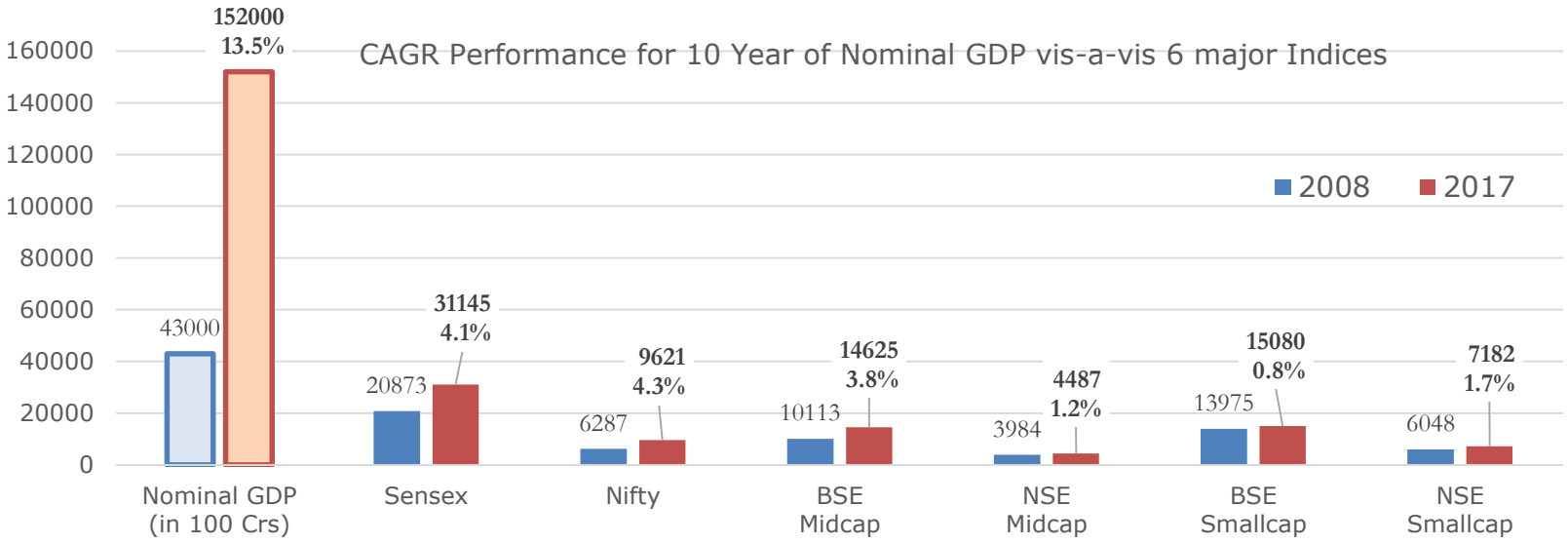
Market at new highs – Can we invest now?



- India's Nominal GDP has grown at a CAGR of 13.5% between FY2007-FY2017
- In comparison, CAGR returns for 6 major indices from highs of 2008 to highs of 2017 ranged between 0.8% - 4.3%
- Above indices have significantly underperformed GDP growth for several years now
- PE multiples seem elevated due to low profitability in several industries viz. metals, infra, PSU Banks; this will reverse as benefit of low interest rates, higher capacity utilization and overall growth in the economy reflects in corporate earnings

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Getting the 'micro' right key to generating super normal returns

Identifying sectoral leadership may not be enough this time around!

- Last bull run (2003-2008) saw emergence of Capital Goods / Banking / Automobiles as the key sectors leading the market rally
- While rising tide during this period lifted all boats, portfolios with overweight position in sectoral leaders turned out to be multi baggers
- New sectoral leadership will emerge in this cycle as well; however, being overweight in such sectors will be an important but not a sufficient condition for outperformance
- A decade of cleaning up of balance sheets, reducing costs, improving competitive positioning has thrown up a very divergent set of companies for investors
  - While some companies are well positioned to capture the next leg of growth, others in the same sector are still trying to grapple with old issues
  - Both Balance sheet status and competitive positioning vary widely among companies that were part of the same peer group only a decade back
  - Further, rapid changes across industries (bordering on disruption) is putting extra onus on quality of management and its ability to adapt to such changes
- Bottom up stock picking skills with bias towards companies that have sectoral tailwind will be key to delivering super normal returns in the coming cycle

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New challenges for the world and Indian economy

Many reasons to fret as well and they will hopefully provide opportunities to savvy investors!

- Rise of economic nationalists in developed countries and the risk of 'protectionism'
- Impending elections in Germany
- Build up of debt in China
- Faster than anticipated increase in interest rates by US Federal Reserve
- Geo political risks emanating from Syria, North Korea and Iran
- Increasing pace of disruption caused by new technologies such as digitization, internet of things, biotechnology, artificial intelligence, etc.
- Effective resolution of the NPA issue continues to be key for credit growth and revival of the capex cycle
- Implementation of GST can be disruptive as well in the short term

Investment Philosophy

Why Quest

- Our Passion to identify tomorrow's blue chip yesterday
- Quest's out performance is due to consistently investing in growth oriented quality stocks at a reasonable price
- Avoid wasting time on understanding global macros – The Lesson of Oil
- Like governance - investing is a long term process

Our Investment Strategy

- Identify ***under research***, ***ignored*** (***out of favour) and/or turn around stories*** whose intrinsic / fair value is not yet reflected in the market price
- Look for fundamentally sound companies that are coming out of slow growth phase vs their long period averages and are moving into much ***higher growth trajectory***
- Construct a ***reasonably concentrated portfolio*** and nurture the investment as a private equity investor over 3 to 5 years
- Remain invested though company's journey from being a mid cap to a large mid-cap - ***gaining from earnings growth, P/E expansion and price discovery***

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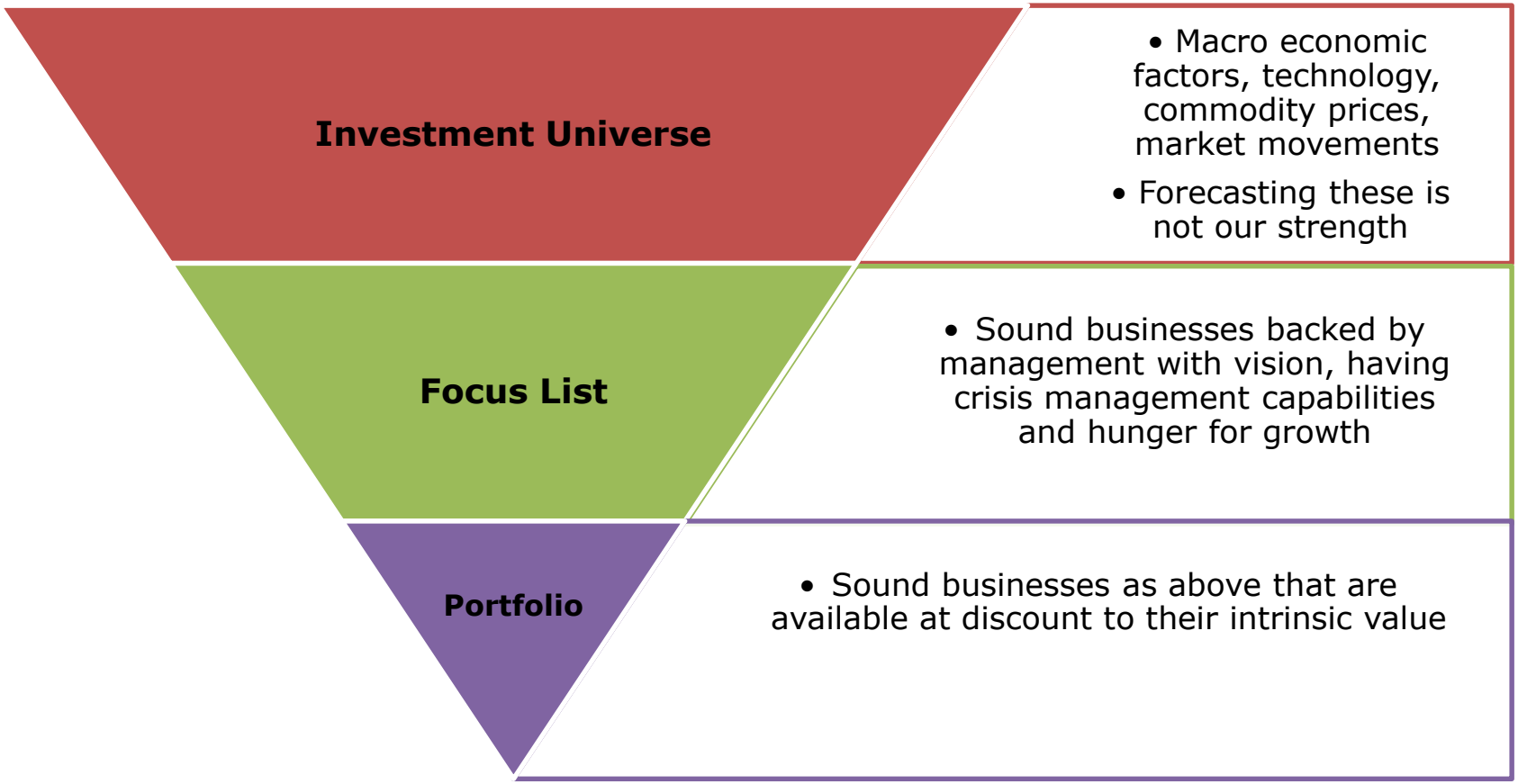
Our Investment Philosophy



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Few Quotes which describe our Philosophy

- *Herd-like stock selection can only lead to herd-like performance. To get to the top of the performance distribution you have to escape the crowd* – Howard Marks

- *Keep all your eggs in one basket, but watch that basket closely.* — Warren Buffett

- *Our portfolios are set up to outperform in bad times, and that's when we think our performance is essential. Clearly, if we can keep up in good times and outperform in bad times, we will have above average results over full cycles and below average volatility, and our clients will enjoy outperformance when others are suffering.* – Howard Marks

- *In stocks as in romance, ease of divorce is not a sound basis for commitment. If you have chosen wisely to begin with, you won't want a divorce.* – Peter Lynch

- *A concentrated portfolio of strong and predictable companies acquired at a price that makes sense will do the job.* - Charles T. Munger

- *You learn quickly in this business that you are not going to look smart all the time, which invariably brings criticism. We always remind ourselves of a quote* ***"I had rather lose clients then lose clients' money"*** – David Samara

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Valuation Fundamentals

QuestPMS Valuation Fundamentals

Current Index - PEs				
	SENSEX	NIFTY 50	Nifty-Midcap50	Nifty Full Small100
Index Value	31145	9621	4487	7182
PE as reported by exchange (TTM basis)	22.6	24.3	54.2	54.5

QUESTPMS Companies – Composite PE	
FY-2017A	24.6
FY-2018E	19.6
FY-2019E	15.4
Estimated weighted average CAGR growth for 2 years till FY19	
Revenue	11%
EPS	26%

QuestPMS portfolio companies' revenues are expected to grow at CAGR of ~11%, however, due to margin expansion, projected earnings are expected to grow at a substantially higher ~26% CAGR over the next 2 years (FY17-19)

QuestPMS portfolio's weighted average price-earnings multiple is 19.6 times FY18 and 15.4 times FY19 earnings

(Source: Quest Internal Research)

QuestPMS portfolio is trading at reasonable valuations providing margin of safety & giving us confidence in its ability to outperform in future as well

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Performance

Quest PMS Performance as on May 31, 2017 - XIRR

Period	XIRR Performance %						
	Portfolio	Sensex	Nifty 50	BSE Midcap	Nifty Midcap 50	BSE Small Cap	Nifty Small 100
3 Months	8.2	8.4	8.4	7.9	7.2	10.1	7.1
6 Months	21.4	16.9	17.0	17.0	19.7	22.3	23.0
1 Year	31.3	16.8	17.9	28.7	32.9	35.3	37.7
2 Years	24.0	5.8	6.8	16.8	15.4	15.6	13.6
3 Years	24.6	8.7	10.0	20.0	13.7	18.7	14.3
5 Years	28.1	13.9	14.3	19.9	17.7	19.2	17.5

- The Above returns are of a Model Client as on May 31, 2017. Returns shown above are post fees & expenses.
- Returns of individual clients may differ depending on time of entry in the Strategy. Returns above 1 year are CAGR
- Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments.

Consistent outperformance across benchmarks and time periods

Quest PMS Performance as on May 31, 2017 - Absolute

Period	XIRR Performance %						
	Portfolio	Sensex	Nifty 50	BSE Midcap	Nifty Midcap 50	BSE Small Cap	Nifty Small 100
3 Months	8.2	8.4	8.4	7.9	7.2	10.1	7.1
6 Months	21.4	16.9	17.0	17.0	19.7	22.3	23.0
1 Year	31.3	16.8	17.8	28.6	32.8	35.2	37.6
2 Years	53.8	11.9	14.1	36.4	33.2	33.6	29.0
3 Years	93.4	28.4	33.1	72.8	47.0	67.2	49.3
5 Years	244.9	91.7	95.1	147.8	125.9	140.6	124.0

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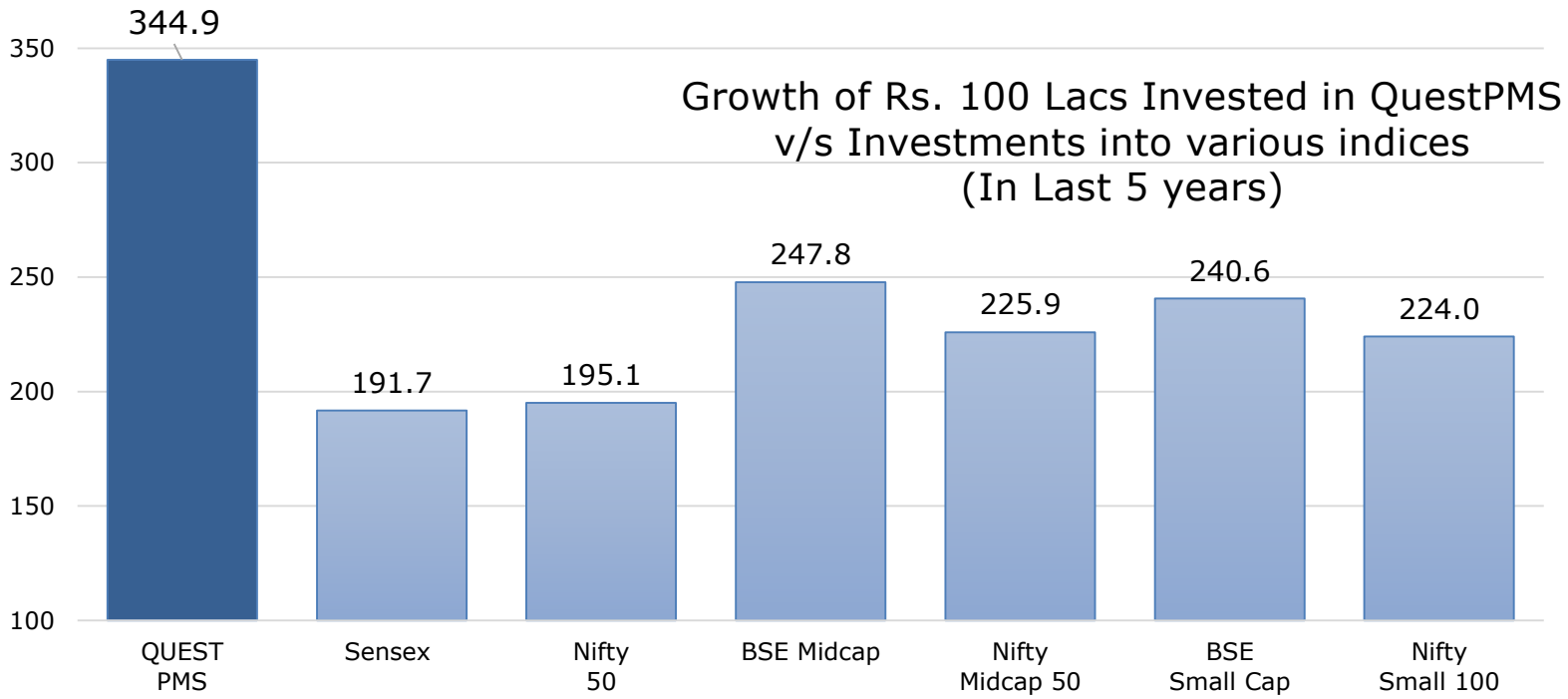
Consistent outperformance across benchmarks and time periods

Quest PMS Performance as on May 31, 2017



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Consistent outperformance across benchmarks and time periods

Quest Foundation

Quest Foundation

Stated objective

- Quest Founders have publicly pledged to use all their profits for charitable and spiritual activities; contributed over Rs. 31.59 crores in ~5 years
- Quest Foundation presently operates Iyengar Yoga classes from a 4,000 sq. ft. premises in Sion
- Quest Foundation also runs Nutun Gyan Dhara, a free public library with over 5,000 titles on various subjects like spirituality, healthcare, etc.
- Currently Quest Foundation is actively associated with
  - Sion Hospital – Mumbai (Medical)
  - SNDT College – Wadala – Mumbai (Education)
  - Tribal Integrated Development Trust – Mumbai (Tribal work)
  - Shri Ram Hospital – Gondal – Gujarat (Rural Healthcare)
  - Bellur BKS Iyengar Trust – Bangalore (Education and Medical)
  - Chinmaya Mission – Mumbai (Spiritualism)

Disclaimer

- Investors are NOT BEING offered any guaranteed / assured returns.
- Investments in equities are subject to market and other risks.
- Value of investments may go up or down due to various factors and forces affecting the capital market.
- Our past performance does not indicate the future performance of the portfolio manager and/or the portfolio management scheme.
- Investors are urged to apply appropriate caution while making investment in the QuestPMS.
- There is no capital guarantee in the QuestPMS.

Thank you

Quest Investment Advisors Private Limited
For more information contact:
Hiten Sampat - Landline +91 22 24066700 (B)/703 (D) Mobile +91 9820131125 Email - hiten@questinvest.com
188/3, Gurukrupa Building, 1st Floor, Next to Jain temple, Jain Society, Near Sion Hospital, Sion, Mumbai - 400 022

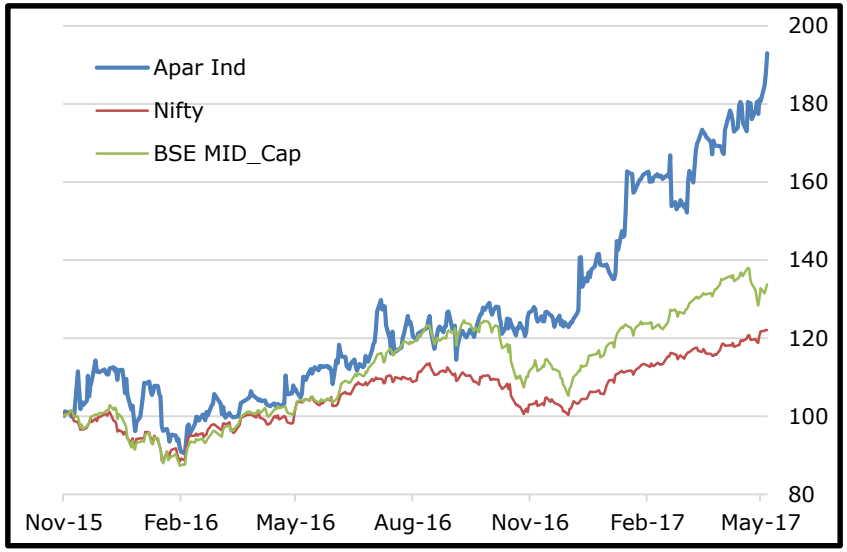
Stock picking case studies

Apar Industries

Investment Date: 25-Nov-2015

Rationale at the time of investment:

- Apar is among the top 5 conductor manufacturers and 4th largest transformer oil manufacturer in the world
- It is the leading manufacturer of conductors (23% market share) and specialty oils (45% market share) in India. Apar entered the cables business through acquisition of Uniflex Cables in 2008
- US $50 bln of investment expected in transmission segment in next 5 years. Order inflows from utilities are gaining traction with focus on higher kva lines
- Recent launch of UDAY will have multiplier impact on domestic T&D investment and will positively impact all businesses of Apar
- It has invested Rs 300 cr in last few years to benefit from increasing investment in T&D sector



Current Outlook:

- Investment envisaged under 13th 5 year plan for Transmission sector is ~30% higher than the 12th plan
- Location advantage of new capacity in Odisha is expected to drive profitability in the long-run. Production ramp-up post GST implementation would improve EBITDA margin by Rs 1,000-1,500/MT
- Increased allocation for higher kva segment in 13th plan coupled with a logistically competitive plant in Sharjah is expected to drive profitability over next 2-3 years
- Higher demand for non-conventional energy and UDAY implementation would help Apar to sustain Cable segment growth and EBITDA margin going forward

Valuation then: At Rs. 454, the share was available at PF of15.3 times FY 16 standalone EPS

Current Valuation: At CMP of Rs. 830, share trades at P/E of 15.9 times FY2018E earnings

Source: Internal Research

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Kirloskar Ferrous

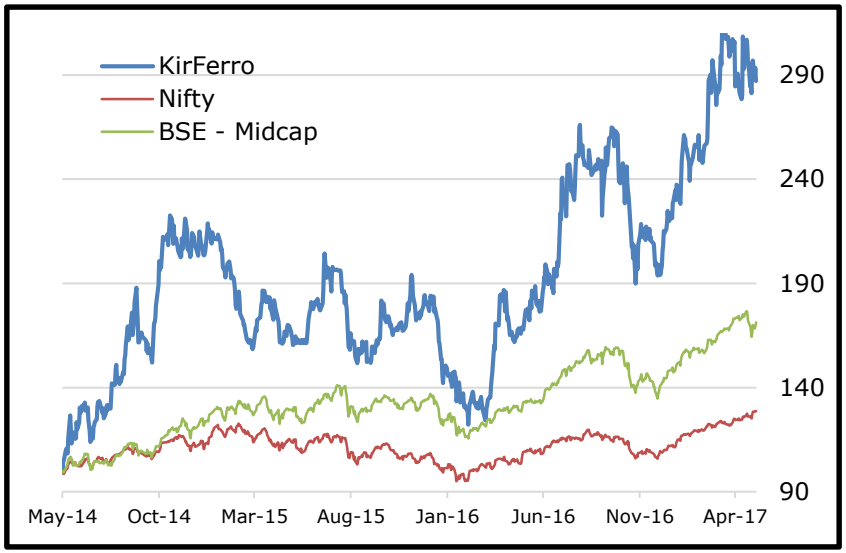
Investment Date: 28-May-2014

Rationale at the time of Investment:

- Post the expansion, KFL would be one of the largest foundries, with capacity of 1.5 lac tons – to manufacture intricate engine blocks for marquee clients like Daimler, Volvo, HINO, M&M and all major domestic tractor manufacturers. It is also one of the most efficient pig iron manufacturer
- Higher contribution from casting business (higher margin) will transform the company from primarily a commodity player to a value added auto component company

Current Outlook:

- We expect gradual improvement in utilization of new foundry to increase profits. Improved profitability and efficient management of working capital will help maintain its borrowings at current levels despite increasing sales
- Acquisition of iron ore mine by the company (to be auctioned by the government in the near future) can have a very substantial positive impact on the Pig Iron business
- Company is confident of achieving superior margins resulting in faster growth in bottomline vis-à-vis topline growth



Valuation then: At Rs. 32, share was available at P/E of 8 times FY 2015 earnings

Current Valuation: At CMP of Rs. 98.35, share trades at P/E of 14.0 times FY 2018E earnings

Source: Internal Research

Bottom up stock picking skills key to delivering supernormal returns

KEC International

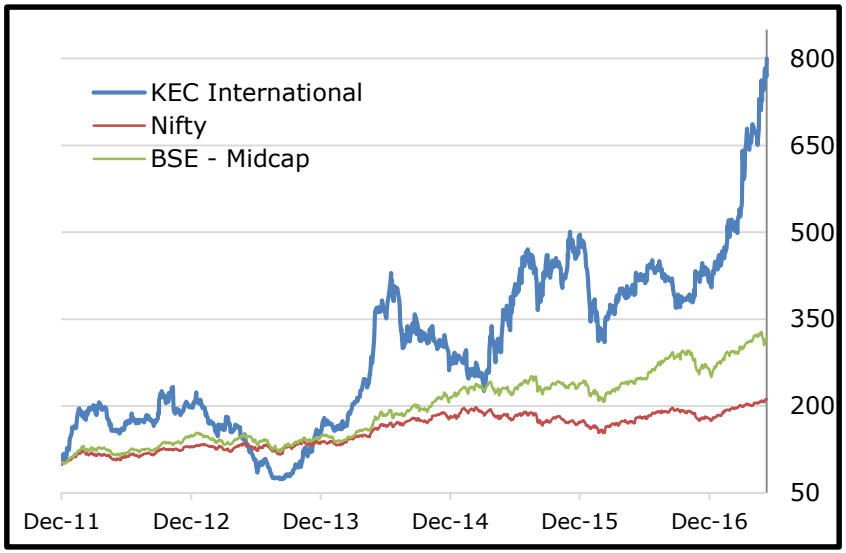
Investment Date: 20-Dec-2011

Rationale at time of Investment:

- A global infrastructure EPC major with presence in the area of power transmission/systems, railways and water. Company is also into manufacturing of power and telecom cables
- Present in 45 countries across South Asia (including India), Middle East, Africa, Central Asia and America
- It is a dominant player in transmission line towers in India and many other countries overseas

Current Outlook:

- Topline expected to grow @ CAGR of ~10% for next 3 of years (FY16-19)
- Improvement in EBIDTA (by 50 bps) coupled with interest savings (Interest to Sales to improve by 25 bps) would enable PAT to grow at faster pace than top line. Earnings are expected to grow @ CAGR of ~30% for next 3 years (FY16-19)
- Savings in interest is expected to be on two counts – reduction in working capital requirements and decrease in interest rate on borrowings



Valuation then: Was available at 5 times FY 2012 estimated consolidated EPS of Rs. 6.54

Current Valuation: At CMP of Rs. 259, share trades at P/E of 16.9 times FY 2018 earnings

Source: Internal Research

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The Ramco Cement (TRCL)

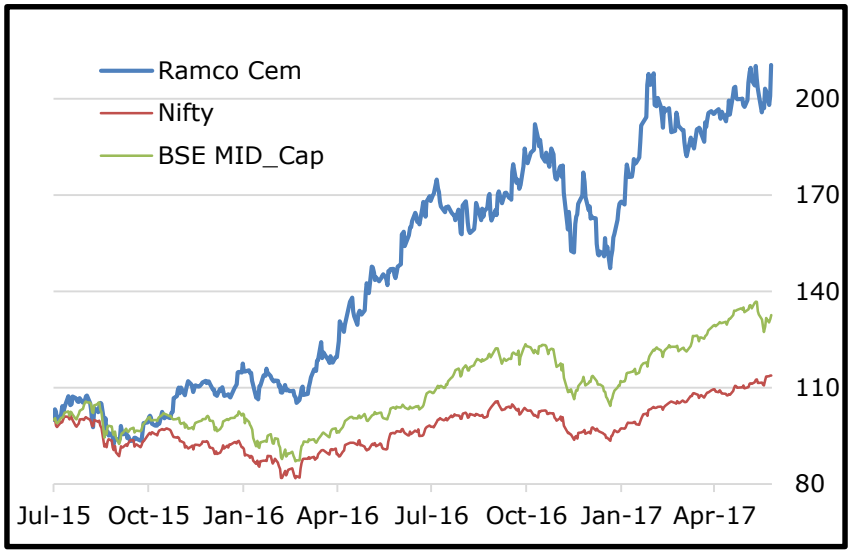
Investment Date: 06-JULY-2015

Rationale at time of Investment:

- Cement demand was languishing in Southern India due to political instability & capacity overhang. Demand revival seemed inevitable & prominent players like TRCL expected to be prime beneficiaries
- Company was planning to increase its usage of petcoke to reduce its fuel cost and improve margins
- Company had plans to expand regionally by further penetrating into newer regions like Orissa

Current Outlook:

- Ramco Cement has emerged as one of the most efficient cement player in India and has clocked highest EBITDA per ton in the country in 1H FY 2017
- Company's current capacity utilization is around 60% and higher operating leverage benefit will be realized once these utilization levels improve (with strong demand emanating from AP/Telangana region) going forward
- Company continues to work on improving its freight (100% coastal shipping used to transport clinker to West Bengal unit) and fuel cost (optimum use of pet-coke which is still 15-20% cheaper than coal on K/Cal basis)
- Company is expected be net debt free within next 2 years



Valuation then: Was available at 18 times FY 2017 estimated consolidated EPS of Rs. 19.1

Current Valuation: At CMP of Rs. 724, share trades at P/E of 21.6 times FY 2018 earnings

Source: Internal Research

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