QUEST INVESTMENT ADVISORS PVT. LTD.

Sep 30, 2017

Synopsis

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- Investment Philosophy
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- Performance
- Portfolio Strategies
- Quest Foundation
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Investment Outlook

Indian economy: How long is the transition period?

- Economic growth has been slowing for five quarters, weighed down in part by demonetization and the new nationwide Goods and Services Tax
- Most of us underestimated the time it takes to transform an economy of India's size and diversity
  - Nursing a company back to health takes 2-3 years
  - Impractical to assume that pain of restructuring the Indian economy will last only a few quarters
- Indian stocks have done well despite tepid earnings growth as they factor in longer term benefits of restructured and transformed Indian economy
- Favourable macro picture, buoyant global stock markets and strong domestic inflows have provided support to the markets while the micro economy faces upheavals inherent in any major transformation such as GST
- However, macro economic picture is becoming a big hazy due to rising commodity and oil prices, uptick in current account deficit and bottoming out of inflation cycle
- As earnings take time to revive, strong domestic inflows and buoyancy in global stock markets will be important for Indian stock prices in the next few quarters

Transformation of Indian economy: Huge long term positive for markets

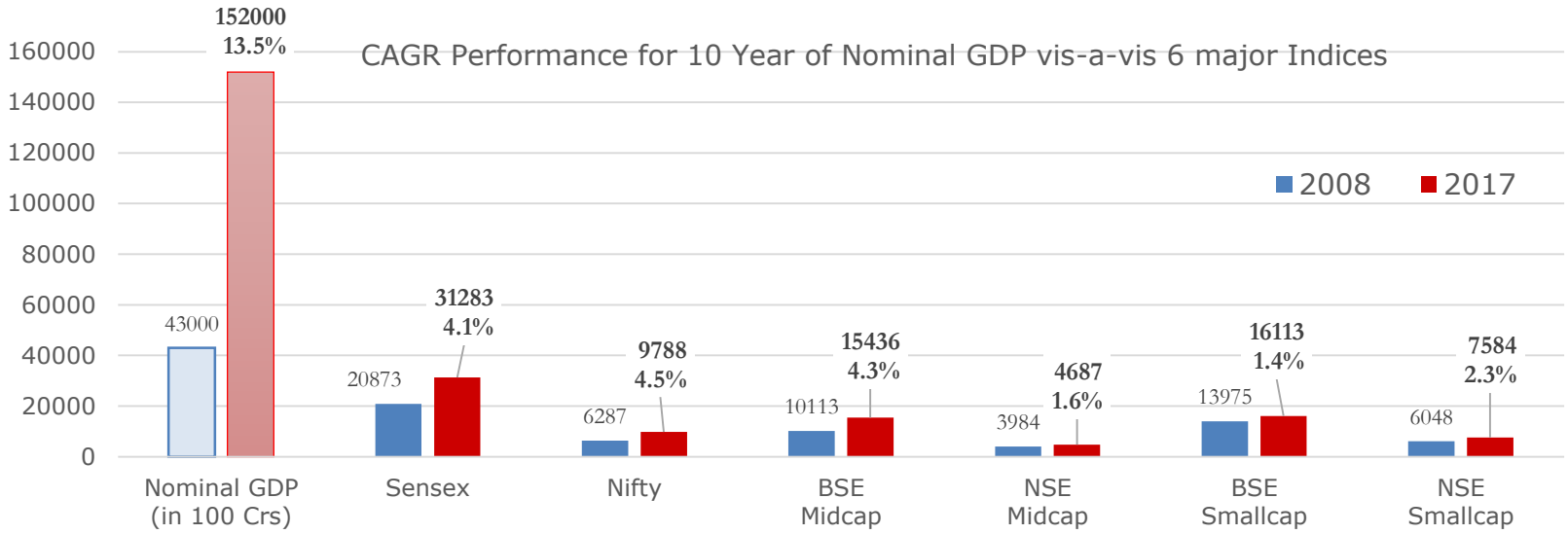
Keeping 'spirits' up crucial for successful transformation

- India clearly moving towards a more stable, transparent and merit based economy
  - Insolvency & Bankruptcy Code, GST, RERA, DBT, e-auction of resources and FDI liberalization in defence and aviation sectors are path breaking reforms
  - Reforms an ongoing process; significant labour and land reforms still need to be carried out to bring about full fledged transformation
- Addressing teething issues in GST implementation, adequate indirect tax collection and speedy resolution of NPA issues under NCLT will be critical in reducing 'transitional pain' over the next few quarters
- Shrewd political management during the transition period critical to keep the support going for key labour and land reforms
- Modi government has been very adept at the fine balancing act of keeping people's hope going amidst extended period of transitional pain
- Its ability to continue to do so will be more important than ever before given the impending state elections and general elections in 18 to 20 months
- While growth and earnings may take more time than anticipated to meet market expectations, Indian economy is moving in the right direction

Bottom up stock picking is more important than ever before

- Benefits of policy reforms to manifest into higher overall growth and broader earnings traction only over a period of time. In the interim:
  - Companies with clean and robust businesses and some signs of improvement in earnings have done extremely well
  - Businesses which earlier prospered due to political patronage or are currently suffering from global or internal challenges have shown little traction even in this bullish phase
- Drivers of superior business performance have changed significantly in the last 3 years
  - Companies aligned with Modi government's vision for India expected to do better
  - Core business strength carry much more weight in the current set up
  - Managements' capability to adapt to rapid technological and other changes has never been more important
- Positioning of not only different sectors put even companies within the same sector vary significantly in the current environment
- Unlike the bull phase of 2003 – 08 when rising tide lifted most boats, bottom up stock picking will be key to superior performance in the current bull phase

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 September 2017 ranged between 1.4% - 4.5%
- Above indices have significantly underperformed GDP growth for several years now
- PE multiples seem elevated due to overall low profitability for the Indian corporate sector vis-à-vis long term averages; this will reverse as benefit of low interest rates, higher capacity utilization and growth in the economy reflects in corporate earnings

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Key risks as we see it

- Ability of the Modi government to keep the popular support going for reforms in the midst of transitional pain
- Impending elections in couple of big states over the next few months
- Inadequate collection through GST putting fiscal deficit target at risk
- Slight deterioration in macro economic picture; increase in metal and crude prices, uptick in current account deficit, likely bottoming out of inflation
- Geo political risks emanating from North Korea and Iran
- Risk to global liquidity as central banks start shrinking their balance sheets
- Build up of debt in China
- Increasing risk of malware attacks
- Disruption caused by new technologies such as artificial intelligence, electric cars, internet of things, biotechnology, etc.

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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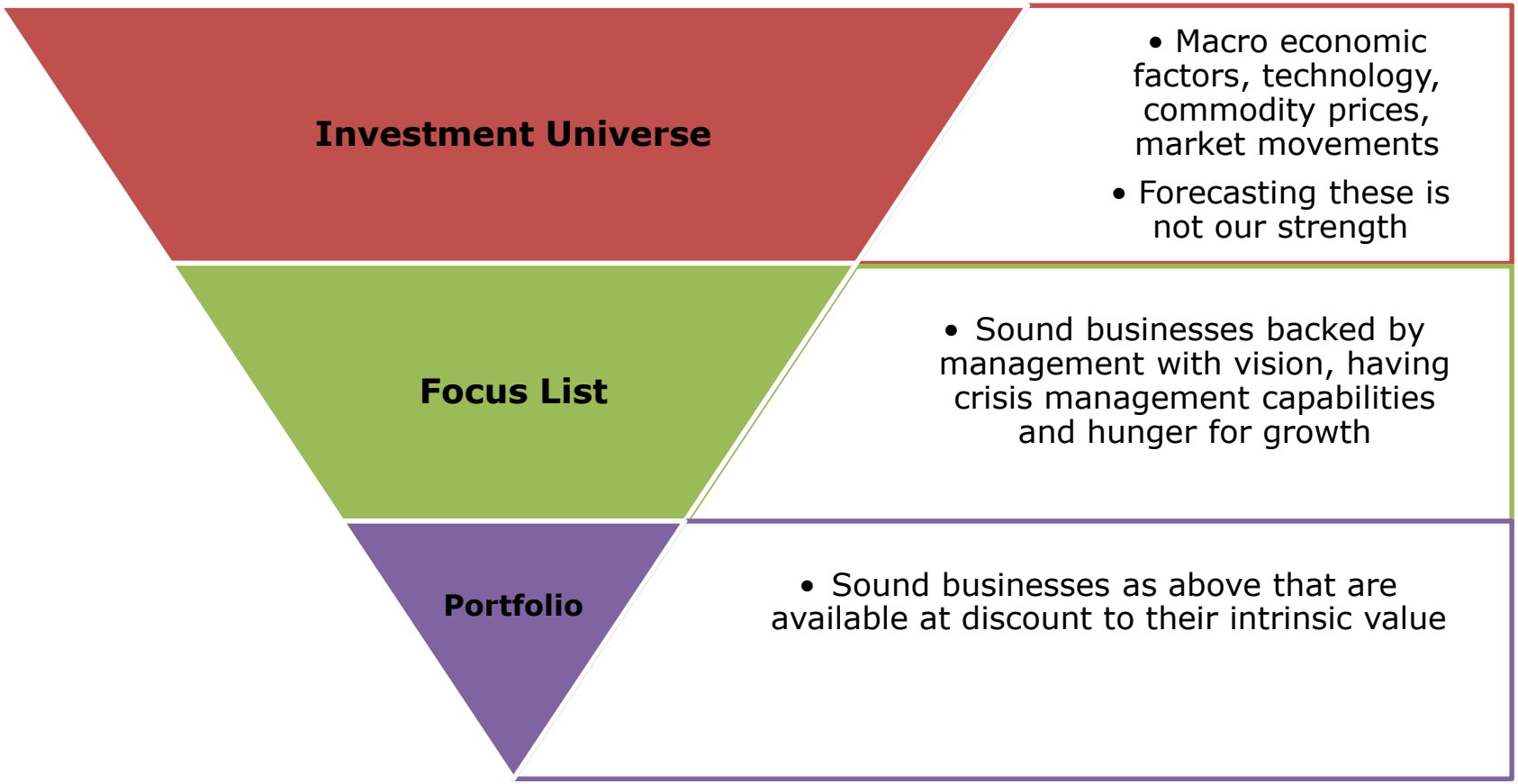
Our Investment Philosophy



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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

Valuation Fundamentals

QuestPMS Valuation Fundamentals

Current Index - PEs				
	SENSEX	NIFTY 50	Nifty-Midcap50	Nifty Full Small100
Index Value	31,283	9,788	4,687	7,584
PE as reported by exchange (TTM basis)	23.4	25.4	83.4	48.9

QUESTPMS Companies – Composite PE	
FY-2017A	26.2
FY-2018E	21.9
FY-2019E	16.9
Estimated weighted average CAGR growth for 3 years till FY20	
Revenue	12%
EPS	25%

QuestPMS portfolio companies' revenues are expected to grow at CAGR of ~12%, however, due to margin expansion, projected earnings are expected to grow at a substantially higher ~25% CAGR over the next 3 years (FY17-20)

QuestPMS portfolio's weighted average price-earnings multiple is 21.9 times FY18 and 16.9 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

Flagship Performance as on Sep 29, 2017 - XIRR

Period	XIRR Performance %						
	Portfolio	Sensex	Nifty 50	BSE Midcap	Nifty Midcap 50	BSE Small Cap	Nifty Small 100
3 Months	1.6	1.4	3.0	6.1	4.2	5.2	3.9
6 Months	7.1	5.9	7.1	10.8	7.3	13.5	10.3
1 Year	23.2	12.4	13.9	19.5	21.5	28.8	26.5
2 Years	25.1	10.2	11.7	20.6	21.9	21.6	21.1
3 Years	20.2	5.6	7.1	17.5	14.3	14.7	15.3
5 Years	24.3	10.8	11.4	18.5	15.8	18.1	17.1

- The Above returns are of a Model Client as on Sep 29, 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

Flagship Performance as on Sep 29, 2017 - Absolute

Period	XIRR Performance %						
	Portfolio	Sensex	Nifty 50	BSE Midcap	Nifty Midcap 50	BSE Small Cap	Nifty Small 100
3 Months	1.6	1.4	3.0	6.1	4.2	5.2	3.9
6 Months	7.1	5.9	7.1	10.8	7.3	13.5	10.3
1 Year	23.2	12.4	13.9	19.5	21.5	28.8	26.5
2 Years	56.4	21.4	24.7	45.4	48.5	47.8	46.6
3 Years	73.6	17.7	22.8	62.2	49.3	50.8	53.2
5 Years	196.5	66.9	71.5	133.6	108.1	129.6	120.1

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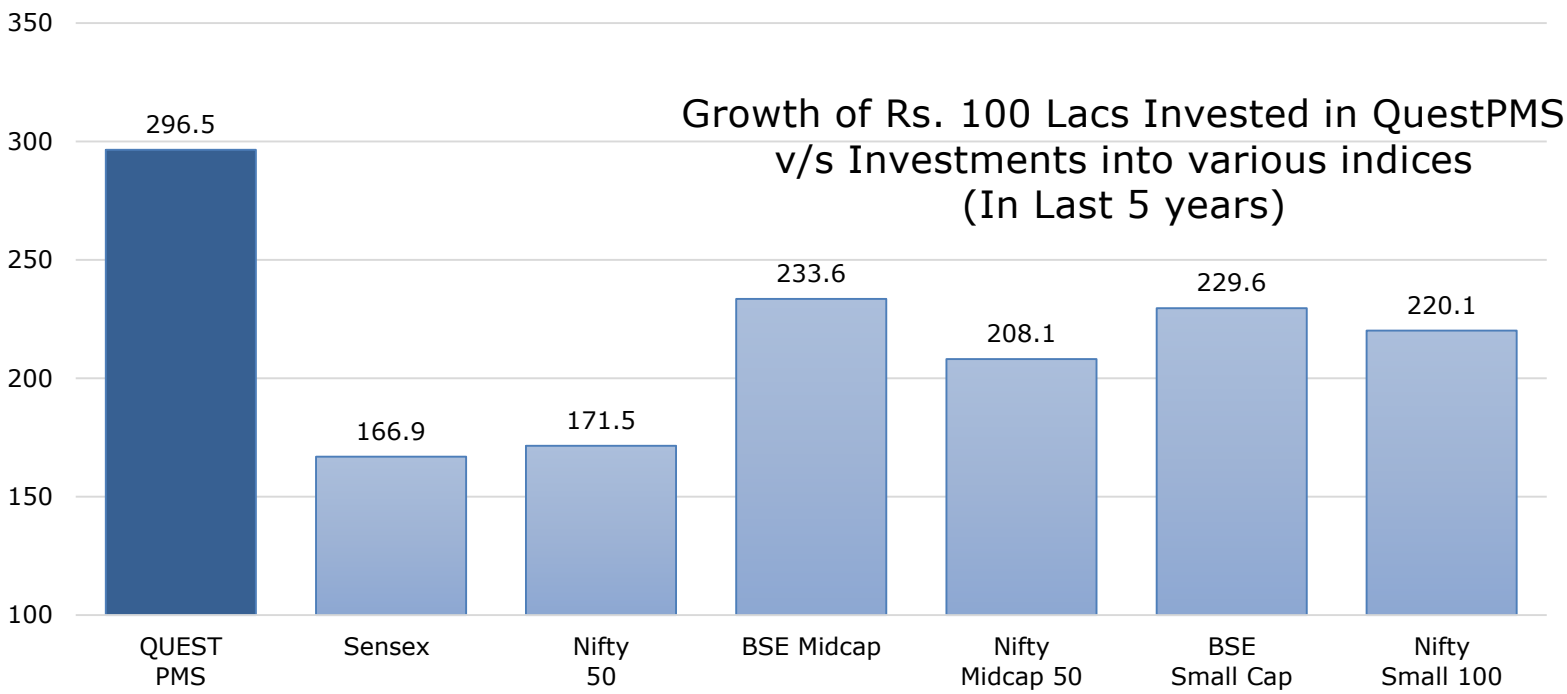
Flagship Performance as on Sep 29, 2017



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Consistent outperformance across benchmarks and time periods

Focus Performance as on Sep 29, 2017 - XIRR

Period	XIRR Performance %						
	Portfolio	Sensex	Nifty 50	BSE Midcap	Nifty Midcap 50	BSE Small Cap	Nifty Small 100
3 Months	4.4	1.4	3.0	6.1	4.2	5.2	3.9
6 Months	24.6	5.4	6.6	10.5	7.0	13.0	9.9
1 Year	52.1	11.7	13.4	19.3	20.8	28.1	25.8
Since Inception – 27-May-2016	50.4	12.0	13.9	24.7	26.4	30.7	30.6

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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. 32 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

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Stock picking case studies

Carborundum Universal (CUMI)

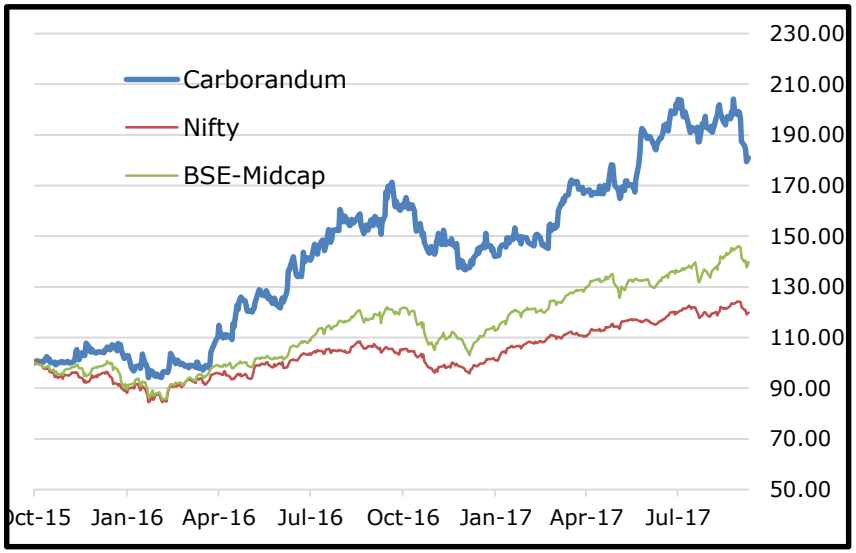
Investment Date: 17-Oct-2015

Rationale at time of Investment:

- EMD business was struggling due to declining sales of micro-grit (a key product used in solar panels) & operational challenges with South African acquisitions However, turnaround was in sight with Management restructuring operations, developing new capabilities and value added products
- Ceramic business to be mainly driven by strong demand for engineered ceramics & acquisition of metallized cylinder plant
- Domestic abrasive growth to be driven by Make in India and infrastructure focus of the Government

Current Outlook:

- Plant relocation (from South Africa to India) has been completed & operations to kick-start in 1Q FY 2018. CUMI has created a strong portfolio of value added products which will augment revenue & margin of EMD business going forward
- Ceramic division to benefit from sustained growth in engineered ceramic coupled with Metz cylinder plant operationalizing in 1Q FY 2018
- Abrasive business to benefit from strong domestic growth coupled with operational break-even to be achieved In China in FY 2018
- Topline expected to grow @ CAGR of ~15% (FY17-20) & margins to expand 220 bps to 18% in FY 2020



Valuation then: Was available at 15 times FY 2017 estimated consolidated EPS of Rs. 11.2

Current Valuation: At CMP of Rs. 318, share trades at P/E of 22.2 times FY 2019E earnings

Source: Internal Research

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Kirloskar Ferrous

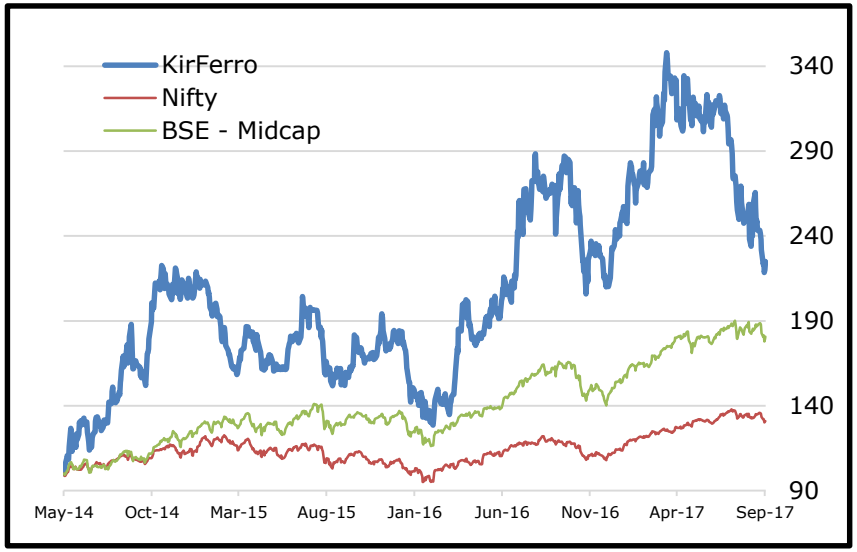
Investment Date: 28-May-2014

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 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. 77, share trades at P/E of 10.3 times FY 2019E earnings

Source: Internal Research

KEC International

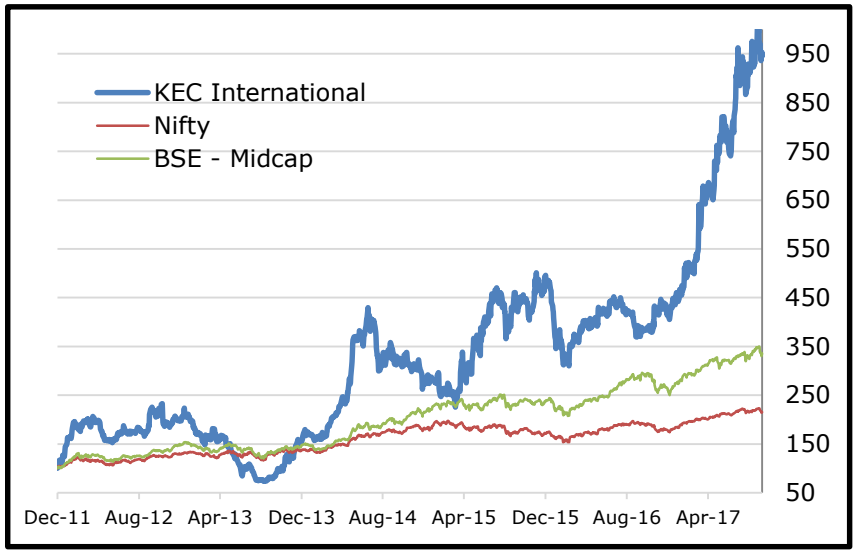
Investment Date: 20-Dec-2011

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 **~**11% for next 3 of years (FY17-20)
- 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 ~23% for next 3 years (FY17-20)
- 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. 307, share trades at P/E of 15.6 times FY 2019 earnings

Source: Internal Research

The Ramco Cement (TRCL)

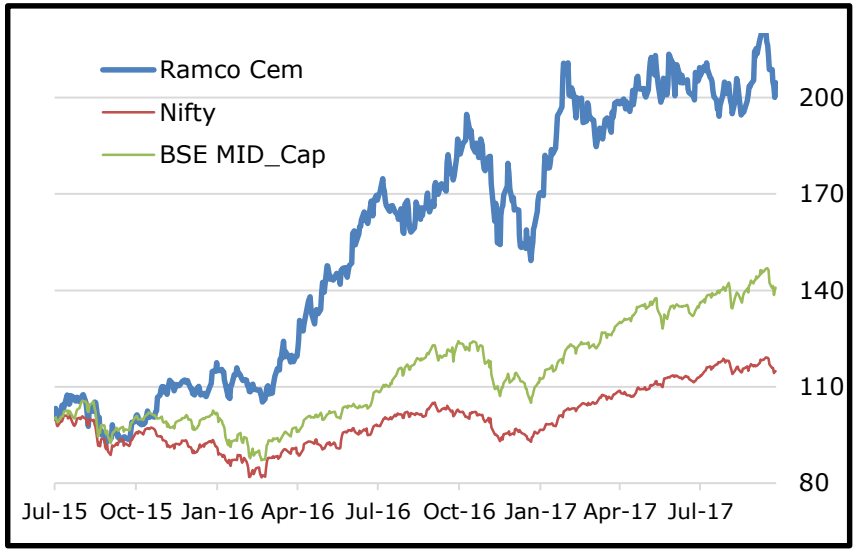
Investment Date: 06-JULY-2015

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
- 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. 692, share trades at P/E of 20.7 times FY 2019E earnings

Source: Internal Research