QUEST FOUNDATION

QuestPMS

QUEST INVESTMENT ADVISORS PVT. LTD.

February 02, 2018

(Post Budget)

Synopsis

- Investment Outlook
- Investment Philosophy
- Valuation Fundamentals
- Performance
- Portfolio Strategies
- Quest Foundation
- Stock Picking – Case Studies

Investment Outlook

Rising bond yields and LTCG to remove froth from the market

- Supported by global markets and unprecedented domestic inflows, valuation excesses were seen in several pockets of the Indian market
  - Slight improvement in earnings was rewarded disproportionately as other asset classes became unattractive
- Rising crude & metal prices and higher MSP means higher inflation in India
  - US inflation too, after remaining low for almost 9 years, expected to head higher given almost full employment there
- Rising bond yields (both in India and the United States) impacting the already faltering macro environment
- Budget for 2018-19 continues with aggressive spending plan given political compulsions and lack of private capex
  - Revenue expenditure in 2017-18 were much higher than budgeted; same trend may continue in the current year as well given impending state and general elections
  - Capital expenditure was supported by extra budgetary resources; trend likely to continue in the current year as well
- Higher MSP and infra spending positive for rural & infra focused companies

Tussle between faltering macro & improving micro to determine market outcome

Earnings trend, as expected, has been positive for Q3FY18

- On the ground business environment, aggravated by demonetization and GST, bottomed out in June / July last year
- GDP growth after declining for 5 quarters and printing 5.7% in June quarter improved to 6.3% in the September quarter, partly assisted by GST induced restocking
- Industrial Production was up 8.4% in November 2017; Manufacturing surged in double digits at 10.2%
- September quarter numbers were quite decent; December quarter numbers are turning out to be better, though supported by the demonetization base
- Global earnings have been strong for the last few quarters; trend continues in December quarter as well
- Global growth after remaining strong in 2017, expected to pick up further pace in 2018
- Indian economy too expected to return to its status of fastest growing large economy
- Improving economic growth and higher earnings amidst rising inflation and interest rates is the most likely scenario for 2018
- The outlook towards impact of rising inflation and interest rates on future earnings will determine market outcome as we move forward

Tussle between faltering macro & improving micro to determine market outcome

Valuations will be looked at closely, once again!

- Despite rich valuations in several segments of the market, strong & synchronous global growth and ample liquidity ensured that market continued to inch up
- Faster than anticipated rise in bond yields has forced markets to relook at valuations both in India and developed markets
- Rise in interest rates not only makes 'deposits' and bonds held to maturity an attractive asset class, but also raises cost of capital for equities impacting PE multiples
- Return of debt as a remunerative asset class is leading to closer scrutiny of rich valuations that companies in several segments have enjoyed in the last few quarters
- Valuations in the broader market in India have already seen reasonable correction in the last few weeks
  - Various mid cap and small cap indices have already corrected anywhere between 10-15% from their peaks
- Going forward, companies with reasonable valuations supported by earnings trajectory are likely to find greater support in an increasingly volatile market
- Quest PMS philosophy of bottom up stock picking at reasonable valuations and investing in ignored stocks is more relevant than ever before in the current market environment

Tussle between faltering macro & improving micro to determine market outcome

Key risks as we see it

- After recent Rajasthan by-election results, market perception of BJP not getting absolute majority in 2019 general election and difficulty for Modi to work under coalition pressures
- Rise in inflation and bond yields
- Risk to global liquidity as US Federal reserve increases the pace of shrinking its balance sheet and European Central Bank tapers off its bond buying program
- Correction in the global equity markets
- Further increase in metal and crude prices
- Ability of the Modi government to keep reforms going in the midst of electoral pressures
- Geo political risks emanating from North Korea and Iran
- Disruption caused by new technologies such as artificial intelligence, electric cars, internet of things, biotechnology, etc.

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QuestPMS

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***

Tussle between faltering macro & improving micro to determine market outcome

Our Investment Philosophy

Investment Universe

- Macro economic factors, technology, commodity prices, market movements

Focus List

- Sound businesses backed by management with vision, having crisis management capabilities and hunger for growth

Portfolio

- Sound businesses as above that are available at discount to their intrinsic value

Tussle between faltering macro & improving micro to determine market outcome

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
- *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
- *Successful investing is about managing risk, not avoiding it* – Benjamin Graham
- *The important quality for an investor is temperament, not intellect* – Warren Buffet

Valuation Fundamentals

QuestPMS Valuation Fundamentals

Current Index - PEs				
	SENSEX	NIFTY 50	Nifty-Midcap50	Nifty Full Small100
Index Value	35,066	10,760	5,065	8,251
PE as reported by exchange (TTM basis)	24.53	26.04	75.78	59.79

QUESTPMS Companies – Composite PE	
FY-2018E	24.2
FY-2019E	19.0
FY-2020E	15.0
Estimated weighted average CAGR growth for 3 years till FY20	
Revenue	12%
EPS	26%

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 ~26% CAGR over the next 3 years (FY17-20)

QuestPMS portfolio's weighted average price-earnings multiple is 24.2 times FY18 and 19.0 times FY19 estimated 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

Tussle between faltering macro & improving micro to determine market outcome

Performance

Flagship Performance as on Feb 02, 2018 - XIRR

Period	XIRR Performance %						
	Portfolio	Sensex	Nifty 50	BSE Midcap	Nifty Midcap 50	BSE Smallcap	Nifty Small 100
3 Months	2.6	4.4	3.2	(0.9)	(1.7)	0.4	(4.7)
6 Months	6.7	8.0	6.7	7.5	5.5	11.1	6.5
1 Year	24.5	24.2	23.2	25.5	26.8	34.4	27.0
2 Years	30.2	19.5	20.1	26.9	29.0	28.8	28.8
3 Years	15.7	6.4	6.9	15.4	12.9	15.9	14.1
5 Years	25.1	12.1	12.4	18.9	16.9	20.4	17.8

- The Above returns are of a Model Client as on Feb 02, 2018.
- Returns shown above are post all billed 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 Feb 02, 2018 - Absolute

Period	XIRR Performance %						
	Portfolio	Sensex	Nifty 50	BSE Midcap	Nifty Midcap 50	BSE Smallcap	Nifty Small 100
3 Months	2.6	4.4	3.2	(0.9)	(1.7)	0.4	(4.7)
6 Months	6.7	8.0	6.7	7.5	5.5	11.1	6.5
1 Year	24.5	24.2	23.2	25.5	26.8	34.4	27.0
2 Years	69.6	42.9	44.3	61.0	66.4	65.8	65.9
3 Years	54.8	20.4	22.3	53.5	44.1	55.8	48.7
5 Years	206.3	77.3	79.4	137.9	118.7	152.9	126.5

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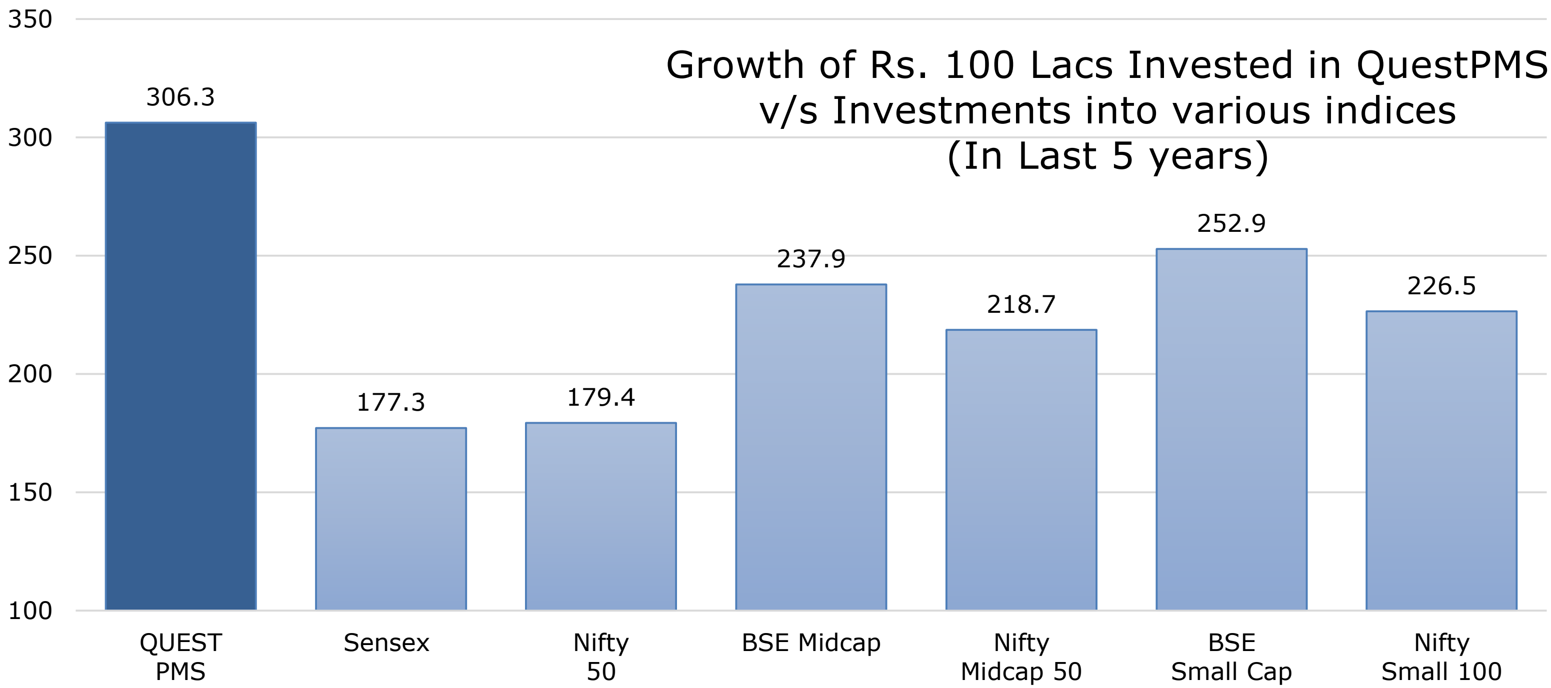
Consistent outperformance across benchmarks and time periods

Flagship Performance as on Feb 02, 2018



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Consistent outperformance across benchmarks and time periods

Focus Performance as on Feb 02, 2018 - XIRR

Period	XIRR Performance %						
	Portfolio	Sensex	Nifty 50	BSE Midcap	Nifty Midcap 50	BSE Smallcap	Nifty Small 100
3 Months	2.8	4.7	3.5	(1.0)	(1.8)	0.2	(4.9)
6 Months	8.3	8.2	7.0	7.1	5.1	10.6	5.9
1 Year	44.6	24.0	22.9	24.1	25.0	32.6	25.1
Since Inception – 27-May-2016	43.5	18.0	18.0	23.8	25.5	31.0	29.1

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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. 32.2 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
  - KEM and 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)

Our obligation to Society

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)

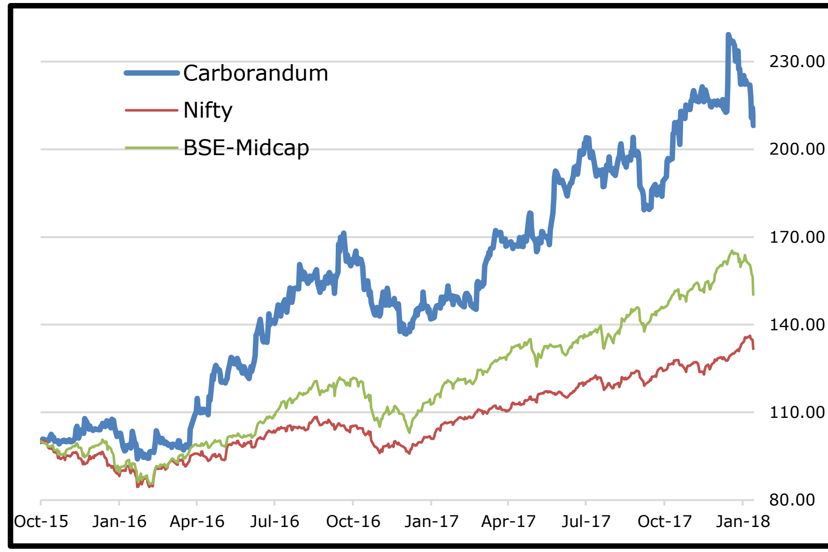
Investment Date: 17-Oct-2015

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. 366, share trades at P/E of 24.2 times FY 2019E earnings

Source: Internal Research

Tussle between faltering macro & improving micro to determine market outcome

Federal Bank

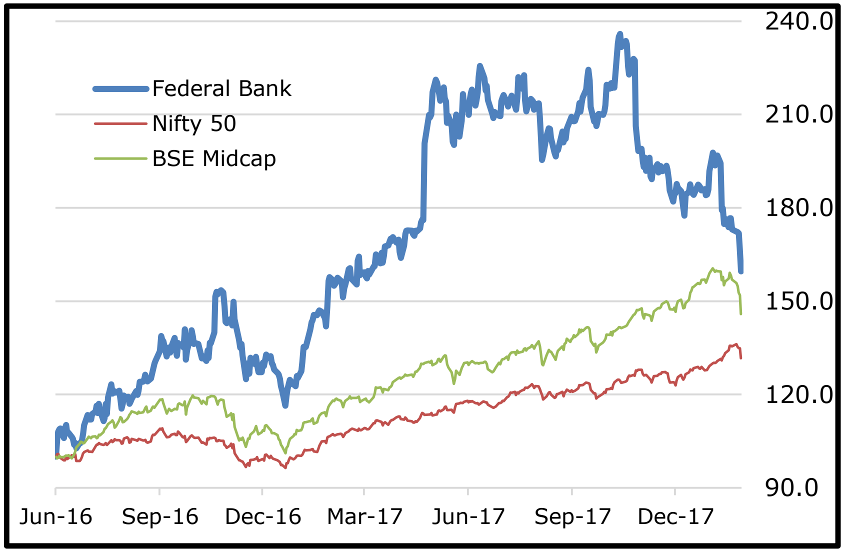
Investment Date: 06-Jun-2016

Rationale at time of Investment:

- Slippage & provisioning was expected to improve in FY17: Federal's FY16 financial performance was marred by higher slippages and provision. And large part of stress was recognised in FY16. **Hence it was a turnaround story**
- Federal was strengthening management bandwidth along with beefing up of credit appraisal processes
- Federal has one of the best liability franchise: Retail deposit represented ~98% of the total
- Value of Federal's holding in NBFC (100%) and Life insurance (26%) was ~Rs 8/share

Current Outlook:

- While the banking industry is reeling under credit growth pressure, Federal is expected to achieve a advance growth of 25% in FY18. QIP of Rs 2,500 cr in Jun '17 is expected to support growth over next couple of years
- Contribution from Fee income is likely to improve
- Cost-to-income (C/I) ratio is well under control. C/I is estimated at 50.4% in FY18 v/s 53.4% in FY17
- Fresh slippage is broadly contained and Federal has not reported asset quality divergence (v/s RBI list)
- NII is likely to grow @ CAGR of ~18% (FY17-20). PAT is expected to grow @ CAGR of ~24% (FY17-20)



Valuation then: Was available at 1.1 times FY 2017 estimated adjusted book value (ABV) of Rs. 45.4

Current Valuation: At CMP of Rs. 93, Federal is trading at 1.5 times FY 2019E ABV of Rs 63.2.

Source: Internal Research

Tussle between faltering macro & improving micro to determine market outcome

KEC International

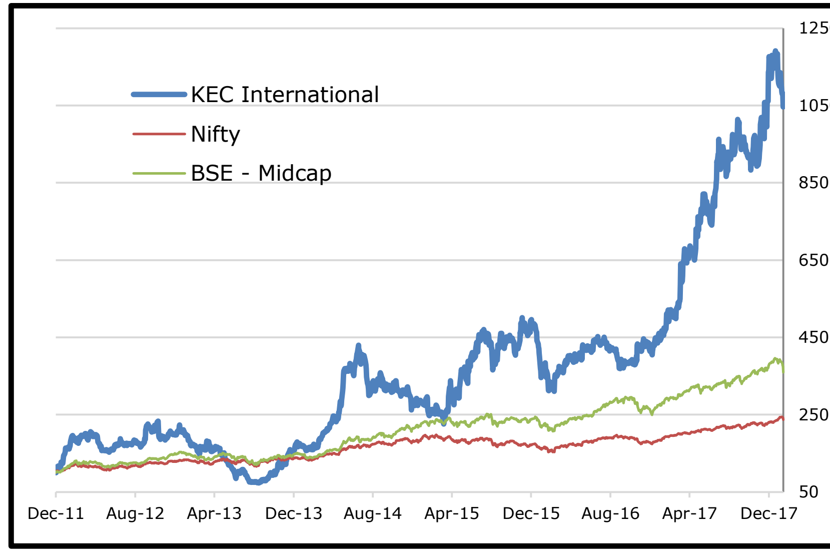
Investment Date: 20-Dec-2011

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:

- Outlook in the international markets such as MENA, SAARC & LATAM is improving.
- Slowdown in PGCIL will be offset by higher investments in intra-state T&D projects.
- Traction in Railway business to continue for next few years.
- Recently it has forayed into Civil EPC segment – see good traction in this space.
- Topline expected to grow @ CAGR of ~12% for next 3 years (FY17-20)
- Improvement in EBIDTA margin coupled with interest savings would enable PAT to grow at faster pace than top line. Earnings are expected to grow @ CAGR of >25% for next 3 years (FY17-20)



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

Current Valuation: At CMP of Rs. 340, share trades at P/E of 17.4 times FY 2019E earnings

Source: Internal Research

Tussle between faltering macro & improving micro to determine market outcome

The Ramco Cement (TRCL)

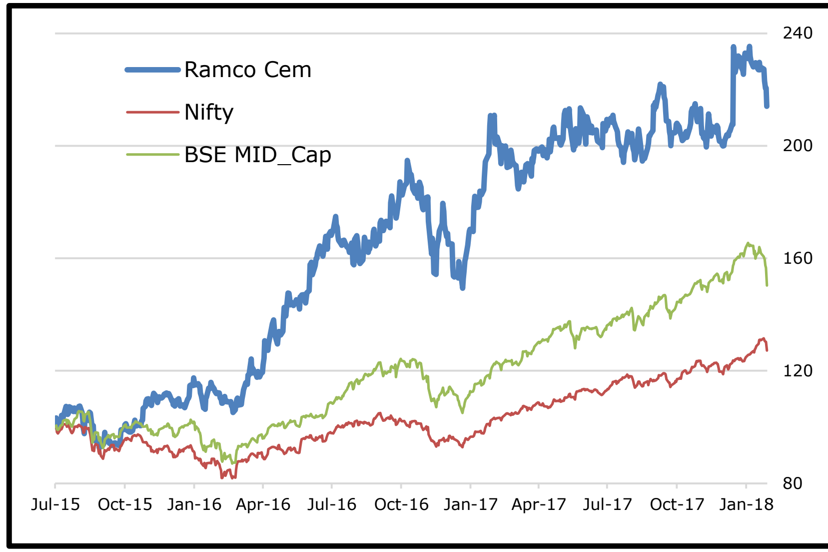
Investment Date: 06-JULY-2015

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 70-75% and higher operating leverage benefit will be realized once these utilization levels improve (with strong demand emanating from AP / Telangana / Karnataka region and relatively improved growth visibility in TN).
- Management is targeting volume growth (10% YoY in FY18 & 12-13% YoY in FY19) and improving EBITA to Rs 1500 per ton in medium term
- 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 expecting good amount of savings in interest cost over the coming two years



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

Current Valuation: At CMP of Rs. 736, share trades at P/E of 22.3 times FY 2019E earnings

Source: Internal Research

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