PL PMS FORTUNE (MID/SMALL CAP) STRATEGY UPDATE

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Dear Investors,

The performance across Mid-small cap stocks for 2-3 years prior to the correction that started in January 2018 was stunning, primarily on account of improvement in earnings and expansion of P/E Multiples. This was led by lower finance costs, better growth prospects and ample liquidity. Benign raw material (RM) prices due to soft commodities had led to margin expansion for most businesses. However, since the start of 2018 we have observed significant correction due to: **1**. Rise in Crude Oil Prices, **2.** Rise in interest rates and **3.** Trade wars triggered due to protectionist policies. Also, SEBI mandate on Mutual Funds (MF) that they have to be true to schemes' stated objective in so far as investment in stocks across various market capitalizations in concerned led to some selling from MFs in mid/small cap companies. Auditor's resignations, Nirav Modi scam and Additional Surveillance measures (ASM) imposed by exchanges further dampened sentiments resulting in negative breadth for the broader markets.

The funnel of performing stocks has got narrower over the past 2-3 months resulting in severe erosion in most portfolios. However, as the asset class has delivered almost 18-20% CAGR for the past few years, a drawdown was due and that is what is happening currently. Needless to say, Midcap/Small-caps had risen significantly over the past 2 years without offering even a 15-20% correction which is the usual trend in equities every year barring CY2017. This had resulted in mid/small cap valuations rising to an almost 28% premium Vs large-caps. Some course correction was due which is happening currently and making markets healthy from a long-term perspective.

Historically, Market Capitalization has an inverse relationship with both risk and return. Companies with larger Market Caps tend to grow more slowly, on average, than mid/small-cap stocks. However, large caps tend to be less volatile during rough markets as investors fly to quality and become more risk-averse. This is precisely the opportunity for buying into mid/small-cap space as a result of attractive valuations Vs their long term historical valuation multiples. The primary advantage of investing in mid/small-cap stocks is significant upside growth potential that is unmatched by mature companies. This potential growth motivates investors to buy mid/small-cap stocks despite their higher risk profile for long-term investing.

Also, I would like to point out that at this point in time one-year forward multiple for Midcap100 index has corrected from 23x to 19.9x in the current fall and is now trading at a mere 5-8% premium to large caps Vs 28% Premium at the start of the year. Considering the opportunity for growth coming back due to progressive reforms and low-earnings base, the delta swing in earnings may be higher in Midcaps over the next 12-24 months, making them reasonably priced Vs large caps if you have a 2-3 year investment horizon.

Fortune Portfolio construct hovers around quality franchises which are leaders in their respective sectors. Focus has always been on strong balance sheets and free cash generation which gives us comfort from long-term compounding potential. Some of the franchises on the consumption side may appear expensive, but considering their strong brands and addressable multi-year growth opportunity, they may still be attractively priced considering a 5-7 year period. The key is whether the business is growth-ready, has strong brand power and has huge moat to keep the cash register ringing. To balance the portfolio away from only Business-to-consumer (B2C) franchises, we have concentrated on some value stocks as well where the valuations are attractive considering the business potential and balance sheet strength. This has resulted in the Fortune portfolio construct trading at 16.3x FY19 and 14x FY20 PER which increases the chance of generating stronger returns as the earnings match expectations. With this I urge investors to start PMS SIPs in the current downtrend as most wealth is created by investing in times of uncertainly.

My personal experience says that the earnings revival in most strong mid-sized franchises over the next 2-3 years will surprise the markets and their returns will be stronger then the index.

Some of the businesses which we own and our thought process:

Home Improvement Stocks like **Kajaria Ceramics** and **Greenply** are growth-ready and leaders in their respective segments. Both businesses are the key beneficiaries of shift from unorganized to organized entities which may play out from second half of FY19. We are confident that as per capita GDP rises and affordability improves, home improvement may continue to be a large part of discretionary spending. A vibrant product range, aggressive brand spending, extensive distribution network of 1,100 dealers and 4,000 associate dealers and sustained capacity expansion will continue to anchor Kajaria's outperformance versus peers. Similarly, Greenply is the preferred partner of choice for a large number of office and home builders having a comprehensive product portfolio servicing clients at every point of the price spectrum under brand names of Greenply Plywood, Green Club Premium Ply, Optima Red, Ecotec, Green Panelmax and Green Floormax. Business is growth-ready with large capex of Rs8bn in setting up MDF facility shall get stabilized in coming 2 quarters which can easily help business growth in excess of 15% for the next 5 years if demand improves.

TV Today Networks (TVTN) is the market leader in News Channels, has strong cash flows and Ad Revenues. They enjoy market share of 20-24% in the Hindi News category and have strong clientele spread across different businesses. What excites us is the secular 10-12% Ad revenues growth and Strong cash flows of Rs 1.2-1.5bn/annum. No wonder, this company is sitting on Rs2.5b cash pile. Further, the business owns three radio channels (Mumbai/Delhi/Bangalore) which is to be sold to ENIL at ~Rs1.5bn. What is further interesting is that 2018 (State Elections) and 2019 (General Elections) normally sees 20% plus ad revenue growth.

Greaves Cotton (GCL), a dominant player in the domestic three-wheeler (3W) market, has now made significant inroads into the emerging four wheeler small commercial vehicle (SCV) segment ensuring earnings sustainability. The business was struggling for growth in the past 3-4 years, however considering its cost leadership in low ticket vehicle segment, and the recovery observed in the LCV cycle, GCL is in a sweet spot. Uptick in auto volumes, high growth in agriculture business & ramp up in construction equipment sales will drive up the utilizations for GCL. Also, imminent operating margin and RoE expansion over FY18-20E make it a prime candidate for a valuation re-rating. Further, management focus towards scaling up high margins aftermarket sales and rollout of more Greaves Auto care outlets is a step in the right direction. The business is available at attractive valuations of Rs34bn Mcap with net cash of Rs5bn on books and a FY18 PE of 17x with RoE in excess of 20%.

Sinclair Hotels owns and manages a chain of hotels in India under the brand "Sinclairs". At present the company operates seven hotels majorly located in Eastern India in the 3-4 star categories. Altogether the company offers 341 rooms, 20 suites, and 2 villas and operates 10 food and beverage outlets and 15 banquet facilities. Sinclairs is amongst very few small hoteliers posting operating at margins above 40%, consistently distributing dividends, Cash rich balance sheet (Rs450m cash on books) and available around 7x EV/EBIDTA on FY18 basis. The replacement value of this company assuming 363 rooms @Rs8m/room is Rs2.8bn. Considering that smaller hotel stocks command valuations in excess of 13-16x EV/EBIDTA, we believe that Sinclair is mispriced and a valuation re-rating will happen over the next 9-12 months. The debt-free status and reasonable multiples limits any significant downside from current levels. Further, there is a strong possibility of M&A opportunity to play for in this company.

Looking to the rest of 2018, we expect India's economic growth to bounce back and inflation to remain range-bound. Earnings growth is expected to kick-start in FY19 which shall cushion market declines. Further, considering the growing trend for higher allocations to equities and aggressive marketing by fund houses to channelize household savings through the SIP route post-demonetization, we feel Equity markets should remain buoyant. Our strategy is best placed considering most businesses are leaders in what they do with strong parentage, balance sheets and free cash flows. We would request you to invest in this strategy with a slightly longer term horizon considering the recent turbulence observed in Mid/small-cap stocks.

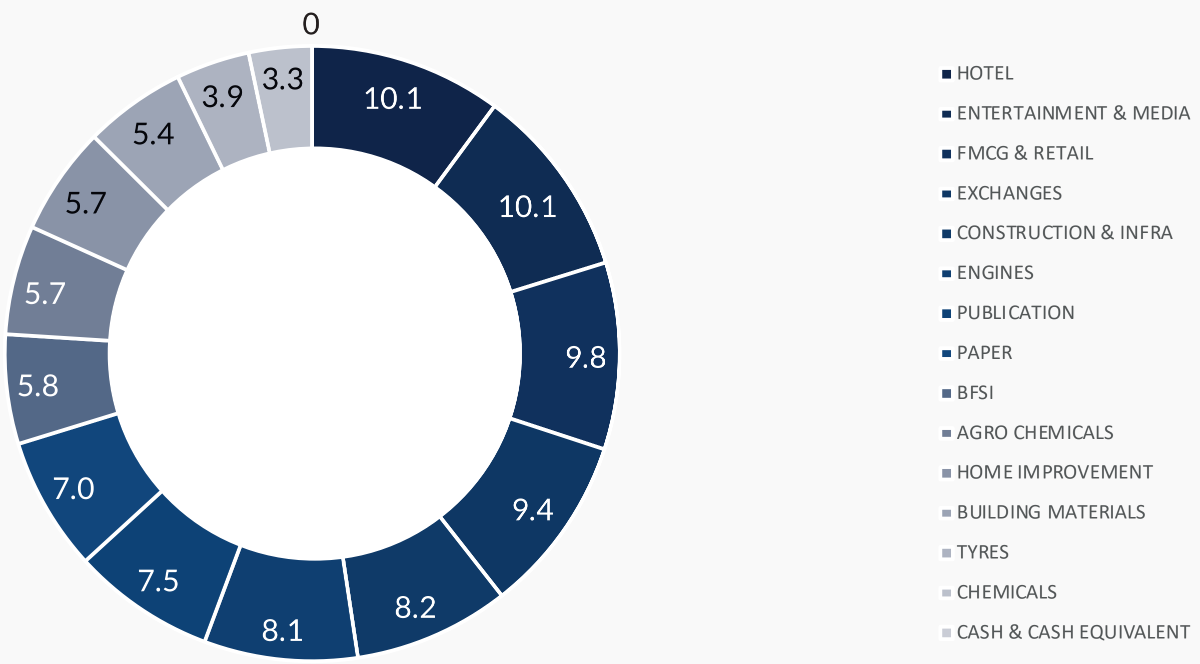
Finally, would like to conclude with two quotes,

"The stock market is a device for transferring money from the impatient to the patient" – Warren Buffet

"You get recession, you have stock market declines. If you don't understand that's going to happen, then you're not ready, you won't do well in the markets" – Peter Lynch

Best Regards,
Nishna Biyani

FORTUNE (MID/SMALL CAP) STRATEGY HOLDINGS



FORTUNE (MID/SMALL CAP) STRATEGY PERFORMANCE AS ON 30-06-2018		
FORTUNE STRATEGY	PORTFOLIO	NIFTY MIDCAP 100
SINCE INCEPTION	3.3	- 0.9
HALF YEARLY	-14.4	-14.0

FOR MORE DETAILS OR TO INVEST IN PL PMS PORTFOLIOS, PLEASE CONTACT

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