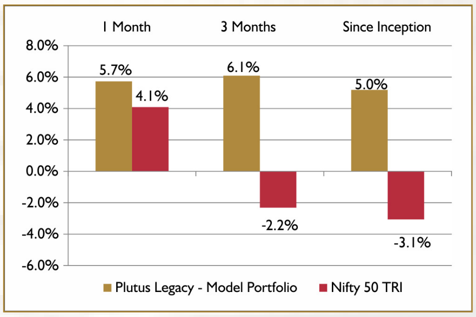
The Bottom Line... PLUTUS LEGACY

TRUSTPLUTUS
Wealth Management with a Conscience

October 2019

Pramod Dangi, CA, CFA
Equity Advisory Services

Performance: Model Portfolio: 30-Sep-19



Dear Investor,

In June 2019, we redesigned our equity advisory service and created an all-weather portfolio of stocks that we thought is best positioned in the long term to capture the opportunity that India presents from a growth perspective. We have branded this portfolio as Legacy and have included companies in the portfolio that clearly demonstrate leadership in their respective lines of business, are showing consistent growth in their top and bottom lines, generate a minimum return on equity and follow good governance practices.

Since inception, our Plutus Legacy model portfolio has returned 4.5% against a (-3.8%) correction in the Nifty50 Index. Although four months is too short a time frame to attribute and analyze, we are pleased that the portfolio is performing in line with our thinking that there will be a flight to quality with the slowdown in the Indian economy. Given heightened geopolitical risk(s) and slowing economic growth, domestically as well as globally, market(s) may remain volatile in the near future and we will use every conceivable opportunity to invest in high quality companies as and when the opportunity presents itself.

The Indian markets got a shot in the arm with the reduction in corporate tax rates announced by the government. Fiscal measures to prop up the economy are required since mere monetary policy cannot carry the load of reinvigorating the Indian economy. While it is early days to gauge the overall impact of this move in terms of increase in employment and improvement in wages, the sentiment has definitely got a boost and India's perceived international competitiveness has improved. Incentives are in place to drive growth in manufacturing though only time will tell in terms of how much capacity is created and the concomitant impact it has in terms of job creation.

Despite the many measures that the government has announced in the past few weeks, certain sectors of the economy continue to struggle. We also see a polarization with two companies in the same sector being perceived differently form an investment standpoint. We continue to remain on the sidelines as far as the automobile sector is concerned. While there is a lot of commentary doing the rounds on the reason(s) for the precipititious fall in sales, we think a structural change is taking place with shared mobility reducing the need for outright ownership. Similarly, in real estate, with rental yields at 2% versus a 8.5% cost of a housing loan and property prices in many cities stagnant or declining, it seems that unless a major reset takes place both in terms of capital values as well as the transaction cost, real estate as an asset class is unlikely to make a comeback in client portfolios in a hurry.

In terms of polarization, we see two clear trends emerging – one in financial services and the other one in information technology. The market is clearly differentiating between Bajaj Finance and all other non-bank finance companies and almost the entire sector has either already reported credit quality issues or is perceived to be heading in this direction. Similarly, other than HDFC Bank and Kotak Bank, all other banks are taking it on the chin and the mid-tier banks are the latest entrants to the "perceived to be fragile" category. The challenge with many such banks has been that their growth has been predicated on lending to the non-prime segment and given the overall stress within the system, there is a worry in the markets that it could be the turn of these banks to take provisions that can impact their profitability. As far as information technology is concerned, TCS and Infosys seem to be in a league of their own given their size and growth ambitions and have outperformed all other stocks in the sector. Our "fortress" portfolio is focused on such names and we believe that the bigger and stronger players will grow on a sustained basis in the years ahead.

Despite the overall outperformance of portfolio, one of our portfolio company Biocon Limited (Biocon) remained volatile. Biocon is a fully-integrated, innovation-led global biopharmaceuticals company. It has evolved from manufacturing pharmaceuticals like statins and immunosuppresants, to discovering, developing and producing **biologics** in chronic therapies such as diabetes, oncology and immunology for global markets. This has translated into a diversified and differentiated pipeline of fermentation-derived complex generics, biosimilars that include insulins and monoclonal antibodies, and novel biologics. Committed to affordable access to biologics and other drugs, **Biocon is the largest biopharmaceuticals company in India.**

Biocon has shaped its business into four key verticals. While the **Research Services** is housed in separately listed subsidiary Syngene, the new growth driver Biologic drugs are now separately managed with its own management team in Biocon Biologics. Biocon has one of the largest global biosimilars portfolios, spanning recombinant human Insulin (rh-Insulin), insulin analogs, monoclonal antibodies and other biologics for diabetes, oncology and immunology. Company has commercialized 5 biosimilars so far: Trastuzumab, Pegfilgrastim, Bevacizumab, rh-Insulin, Insulin Glargine in certain developed markets and are in process of launch in other markets.

The market was disappointed as Amgen/Allergan launched the first US biosimilars of Roche's Herceptin (Trastuzumab) in USA, ahead of expected first launch by Biocon/Mylan, albeit in an unpopular dose form. Further the merger of Mylan with Pfizer's generic business arm Upjohn may create an uncertainty to the roadmap of its ongoing partnership on Biosimilar. We have evaluated both the event(s) and found them to be short term distraction(s). While the launch by Amgen/Allergan will have a limited impact as Biocon/Mylan is about to launch its biologics with the most popular doses form, Upjohn does not have its own biosimilar business. Pfizer had exited the Biologics business much before the merger. Thus there is no overlap in products of the two entities.

We believe the biologics opportunity is large enough for entire sector to grow over the next decade and with the strong pipeline and affordable pricing, Biocon is going to get its share in a market, which is far less crowded then the pure generic API/formulation business. Biocon's strategy to monetize the growth in Biologics with an independent entity and management should help unlock the value in the future.

As far as International Markets are concerned, the US Fed reduced interest rates but refrained from cutting further given that unemployment is at record low and economic conditions other than manufacturing data continue to suggest that the economy is fairly robust. We believe that the US Dollar will strengthen given weakness in all other major economies with Europe proceeding towards another version of QE and Japan unable to get themselves out of the low inflation spiral. Uncertainty on Brexit and continuing geopolitical events should provide support to Gold prices.

The quarterly results start from mid-October and we will wait to see any lift in consumption patterns and the trends as far as automobile sales are concerned. The next few quarters are also crucial for financial services since significant changes to the provisions may lead to rerating of prices. We feel comfortable with our flight to quality strategy and will continue to find opportunities and invest.

Table 1: Performance of the portfolio companies

Company Name	1 Month	3 Month	6 Month	1 Year	3 Year*	5 Year*
Asian Paints Ltd.	9.0%	29.7%	18.1%	36.3%	14.9%	22.9%
Bajaj Finance Ltd.	21.4%	9.9%	33.8%	86.6%	56.5%	71.6%
Biocon Ltd.	-5.4%	-11.0%	-27.0%	-35.5%	12.7%	21.8%
Colgate-Palmolive (India) Ltd.	18.0%	33.4%	19.5%	39.1%	15.7%	11.5%
Divis Laboratories Ltd.	2.5%	4.3%	-2.2%	27.1%	8.9%	13.1%
HDFC Bank Ltd.	10.2%	0.5%	5.9%	22.4%	24.5%	23.0%
Hindustan Unilever Ltd.	5.3%	10.9%	16.1%	23.2%	31.7%	21.6%
Housing Development Finance Corp. Ltd.	-8.7%	-9.8%	0.4%	12.7%	12.4%	13.4%
ICICI Prudential Life Insurance Co. Ltd.	9.2%	19.3%	32.3%	38.9%	-	-
Infosys Ltd.	-1.1%	10.1%	8.3%	10.4%	15.9%	11.5%
Jubilant FoodWorks Ltd.	14.3%	10.3%	-5.9%	10.5%	41.3%	17.2%
Kotak Mahindra Bank Ltd.	14.9%	11.3%	23.2%	44.0%	28.4%	26.6%
Larsen & Toubro Ltd.	11.0%	-5.1%	6.4%	15.9%	15.6%	8.7%
Nestle India Ltd.	7.9%	16.6%	26.7%	43.2%	29.2%	18.4%
Reliance Industries Ltd.	6.7%	6.3%	-2.3%	5.9%	35.0%	23.0%
SBI Life Insurance Company Ltd.	0.9%	17.0%	45.1%	65.4%	-	-
Tata Consultancy Services Ltd.	-7.1%	-5.7%	4.9%	-3.9%	20.0%	8.9%
NIFTY 50	4.1%	-2.7%	-1.3%	5.0%	10.0%	7.6%

Source: Ace Equity. Price appreciation excluding Dividends. *More than 1 Year data is CAGR.

Connect with us