



PRUDENTIAL ICICI PORTFOLIO MANAGEMENT SERVICES **DEEP VALUE PORTFOLIO**

Investment Objective

The Deep Value portfolio endeavours to generate capital gains over the long term, by investing in a diversified portfolio of significantly undervalued stocks.

Suitability of the Product

The Deep Value portfolio may be considered suitable for investors with a medium to high-risk appetite and an investment horizon of above 12 to 18 months.

Investment Strategy

The Deep Value portfolio will invest primarily in stocks that are significantly undervalued i.e. a stock which trades at valuations that are significantly below the estimated fair value of the company. The degree of undervaluation of the stock may be judged by various quantitative valuation parameters including, but not limited to, price/earnings, price/book, dividend yield, price/cash flow, replacement cost, sum-of-part valuation etc.

The core investment philosophy of value investing is based on the belief that stocks cannot continue to quote at values that are significantly below their fair values over the long term. At some point in time, the markets are likely to recognize the extent of undervaluation of these companies. The same could lead to a rerating / appreciation in the companies stock price.

There are various reasons why stocks tend to quote at low valuations. Some of these include:

- **Irrational market sentiments:** that drive down the price of a stock to a level lower than justified by fundamentals. This could occur as an overreaction to negative news or as result of market pessimism on corporate/industry fundamentals. Markets also often tend to ignore certain stocks/sectors that appear to have low growth or non-exciting stories.
- **Valuations not factoring in all aspects of the companies earning potential:** Companies may have certain hidden assets on their books or assets whose actual value may not be factored in by the markets. This could include surplus land, equity holdings, cash on balance sheets, trademarks etc. The markets are also at times slow to factor in company developments such as operational or financial restructuring, entry in to new markets, capacity expansions, introduction of new products, change in management etc. that could potentially add significant value to the worth of the business. During cyclical downturns, a number of companies are also often valued based on bottom cycle earnings, which can look very attractive as the industry cycle improves.

The investment process consists of initially preparing a universe of stocks that are quoting at low valuations, and subsequently conducting indepth fundamental research with an aim of understanding the true worth of the business, reasons behind the current undervaluation and the potential drivers that could lead to a rerating of the stock. This is because there are also a large number of companies whose low valuations are justified by weak fundamentals.

The holding periods of individual stocks tend to be high as the necessary drivers for the expected re-rating could fall into place over a period of time. The performance of the Deep Value portfolio may thus not move in line with the overall markets, and could significantly under or outperform the markets at various points in time. We would thus recommend that investors invest in the Deep Value portfolio with a longer-term investment horizon.

Simulation on Value Philosophy

We have undertaken a simulation to gain an understanding of the historical performance of undervalued stocks vis-à-vis the overall markets. The simulation was run on companies comprising the BSE 200 over the period December 1994 to December 2003. The simulation assumes that two portfolios are constructed on the 31st of December every year, consisting of the top 20 most attractively valued stocks in the BSE 200 based on price/earnings and on price/book. These stocks are then held for a period of one year and a new portfolio is constructed on the 31st of December of the following year in a similar manner. (Data Source: Capital Line)

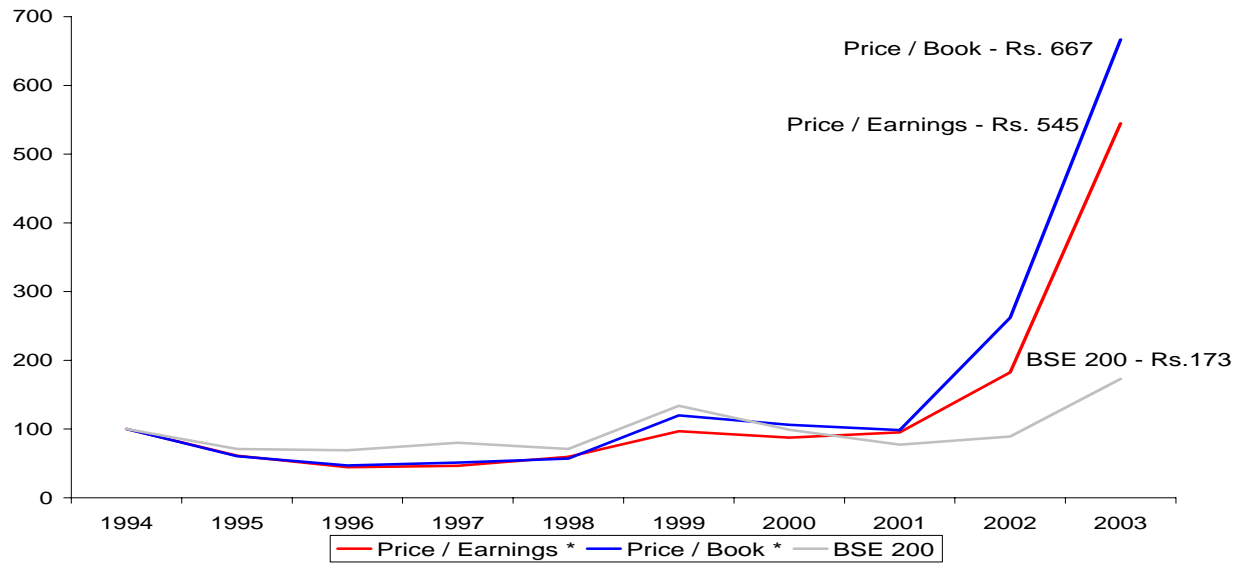
The results of the simulation are as under:

1-year Absolute Returns Earned on 2 Simulated Portfolios vs. BSE 200

| | % performance of portfolios comprising the top 20 most attractively valued stocks in BSE 200 based on | | % performance of the BSE 200 |
|------------------------|---|--------------|------------------------------|
| | Price / earnings | Price / book | |
| 31-Dec-94 to 31-Dec-95 | -39% | -39% | -29% |
| 31-Dec-95 to 31-Dec-96 | -27% | -23% | -3% |
| 31-Dec-96 to 31-Dec-97 | 5% | 9% | 16% |
| 31-Dec-97 to 31-Dec-98 | 28% | 12% | -11% |
| 31-Dec-98 to 31-Dec-99 | 62% | 110% | 89% |
| 31-Dec-99 to 31-Dec-00 | -10% | -11% | -26% |
| 31-Dec-00 to 31-Dec-01 | 9% | -7% | -22% |
| 31-Dec-01 to 31-Dec-02 | 91% | 166% | 15% |
| 31-Dec-02 to 31-Dec-03 | 199% | 154% | 94% |
| CAGR (% p.a.) | 21% | 23% | 6% |

Note: Please note that the intent of the above simulation is only to gain an understanding of the historical performance of undervalued stocks vis-à-vis the overall markets. It is not in any way meant to be indicative of either potential returns or the investment strategy of the Deep Value portfolio.

Value of Rs. 100 Invested on 31, December 1994 in 2 Simulated Portfolios vs. BSE 200



* Portfolios constructed based on Top 20 stocks in BSE 200 based on the mentioned valuation parameters

The important points to note that may be observed the simulation include:

- The 3 portfolios comprising undervalued stocks have outperformed the overall markets by a wide margin over the longer term.
- The outperformance of the 3 value portfolios as compared to the overall market is not secular. i.e. there are extended periods of time when the overall markets outperform the value portfolios and vice-versa.

The results of the simulation appear to indicate that companies that are attractively valued offer the potential for significantly higher returns as compared to the overall markets, if held over the longer term.