DHFL Pramerica
MUTUAL FUND

Investor Communication: Update on Dewan Housing Finance Corporation Limited (DHFL)

Ajit Menon
CEO

Dear Investors,

My team and I have been painfully aware of the impact on our investors due to the ongoing stress in the fixed income markets. While the default at IL&FS last year had a cascading effect on the non banking Finance Companies and Housing Finance sector, some names have been affected more than others. Our co-sponsor Dewan Housing Finance Corporation Ltd. (DHFL) has been also affected deeply. In this overall environment of risk aversion, many investors have exercised their option to ignore the independent nature of the Mutual Fund business, DHFL Pramerica Asset Managers, and redeem their investments with us.

It is your right and I understand the difficulty of taking a decision given the volume of news on this from multiple media sources, some balanced, some sensational and some carrying wrong data that causes further confusion and panic. The media is only doing its job of bringing their readers the news, and I must admit that we probably failed a bit at managing this storm of news better. I can only wish that you will come back to us when we give you enough good reasons to join back and soon.

For those investors still with us, I would like to assure you that we are working hard in making sure that we exercise our fiduciary responsibility to the fullest and do everything in your best interest and within regulations.

In the wake of recent developments concerning DHFL, our investors have many queries pertaining to the impact of these developments on their investments with us. We have answered the most frequently asked questions in the form of Q & A and in as reader friendly a manner as possible.

Just as preamble, DHFL Pramerica Asset Managers Pvt. Ltd. is an independent board managed company with two share holders. It is a 50:50 joint venture between Prudential Financial Inc., US and Dewan Housing Financial Corporation Ltd. Pramerica is a brand name used by Prudential Financial Inc, outside US jurisdiction. PFI, with a strong legacy of 140 years, is a global player and manages $ 1.2 trillion[1] through its asset management arm PGIM and it has signed a binding agreement to acquire DHFL's stake in the AMC.

❖ Media reports indicate that NAVs of debt schemes of DHFL Pramerica MF have fallen significantly. Why?

The mutual fund industry as a whole had an exposure of Rs. 5,169 Crores to DHFL papers as on April 30, 2019. Out of this, our exposure to DHFL was approximately Rs. 230 Crores as on April 30, 2019 which reduced to Rs. 160 Crores as on May 31, 2019, which constitutes approximately 3% of our total AUM.

DHFL missed interest payment in some of its bonds due on June 4, 2019 due to liquidity challenges. In light of this, valuation agencies prescribed a 75% hair cut on valuation of all secured bonds of DHFL and a 100% write down on all unsecured exposures in the company. This lead to a sizeable impact on NAVs of a few of our schemes which had high exposure to these bonds.

DHFL Pramerica Medium Term Fund, DHFL Pramerica Floating Rate Fund and DHFL Pramerica Low Duration Fund held sizeable exposures to DHFL Bonds. The revaluation of these bonds in line with the regulatory prescription and reversal of interest accruals thereon lead to a sizeable drop in NAV of these funds.

We have to clarify here that none of these schemes took active exposures to DHFL bonds beyond the regulatorily permitted caps. The higher current exposure to DHFL bonds in these schemes was on account of sizeable outflows from these funds coupled with very scant liquidity for NBFC and HFC securities in the market.

❖ Why did you hold such high exposure to DHFL bonds in your schemes?

Our exposure to DHFL was restricted to select debt schemes only. Our active exposures to these schemes were also well within the regulatorily stipulated 10% limit for a single issuer. All such exposures were taken keeping in mind the best interest of our investors and our fiduciary obligations towards them. DHFL was an AAA rated paper, representing highest credit quality, till January, 2019.

In light of the crisis of confidence and the flight towards perceived safety, we witnessed sizeable outflows from some of our debt schemes. With scant buyer appetite for the sector over the last few quarters, we encountered challenges liquidating our exposure in these papers at valuations that would have been in the best interest of our investors. This lead to a passive increase in exposure in these bonds in some of our schemes.

Our Medium Term Fund had an AUM of Rs. 557 Crores in April, 2018. At this stage our exposure to DHFL Bonds was at 6% (Regulations permit exposure up to 10% to a single issuer's bond). Over the last few months, due to sizeable outflows, the scheme's AUM has depleted to a meagre 18 Crores as of end of May, 2019. While we managed to reduce our absolute exposure to DHFL paper by over 60% despite very scant liquidity in the paper, given the fall in AUM, our DHFL exposure in the fund as on May 31, 2019 stood at Rs. 12 Crores (67% of the AUM). Similarly, our Floating Rate Fund saw sizeable outflows leading to a passive increase in our exposure in the scheme.

❖ Why did you not bring down your exposure to DHFL in the impacted schemes before ?

Ever since the IL&FS Crisis hit the markets a few quarters ago, there has been very scant liquidity for the NBFC and HFC Sector due to the crisis of confidence looming large in investor's minds. DHFL yields were adversely impacted due to sale affected by some of the market participants in the last week of September, 2018.

Our investments in DHFL were purely based on the merit of the security, its suitability to the concerned fund and its credit quality at the stage of the investment. DHFL was rated AAA (symbolising highest credit quality) till January, 2019. We have not taken any fresh exposure to DHFL since May, 2018.

In our endeavour to bring down our exposures to these papers, we continue to conduct ourselves in the best interest of our unit holders. A sale at valuations that are not representative of the intrinsic value of our holdings would have been adverse to the interest of our investors. Besides, it could have further fuelled a crisis in a market already battling turbulence.

Despite these challenges, over the last 6 months, we have reduced our DHFL exposure across our funds by over 250 Crores. We continue to work towards bringing down our exposure further keeping in mind the best interest of our unit holders.

❖ Why did this impact some of your schemes and not others?

The valuation changes impacted some of our Debt Schemes which held DHFL bonds.

Many of our debt schemes like the DHFL Pramerica Dynamic Bond Fund, DHFL Pramerica Premier Bond Fund, DHFL Pramerica Banking and PSU Debt Fund, DHFL Pramerica Ultra Short Term Fund and DHFL Pramerica Insta Cash Fund had NIL DHFL exposure and were not impacted. Likewise, all except 6 of our Fixed Duration Funds have no DHFL exposure.

We had no exposure to DHFL shares in any of our equity-oriented schemes. Likewise, our PMS strategies had no exposure to any DHFL papers.

❖ How do you propose to deal with the high DHFL concentration that you hold in some of your debt schemes?

We continue to explore available opportunities in the market to bring down our concentration of DHFL in the impacted schemes.

We are also in the process of merging our DHFL Pramerica Floating Rate Fund (AUM – Rs. 7.79 Crs.) into our DHFL Pramerica Ultra Short Term Fund and our DHFL Pramerica Medium Term Fund (AUM – Rs. 17.67 Crs.) into our DHFL Pramerica Credit Risk Fund. These funds have depleted in AUM to levels where it is not viable to continue running the funds independently in the best interest of the unit holders in the fund. The merger is expected to be concluded on June 22, 2019 after fulfilment of applicable regulatory requirements. Post merger, the concentration of DHFL in the continuing schemes is expected to be way below the regulatory permitted limits.

❖ How would you protect the interest of unit holders in schemes which have been impacted by the drop in valuation of DHFL?

To protect interests of unit holders, in schemes where we perceive a material risk of dilution in value through entry of new investors, we have discontinued subscriptions temporarily. This would ensure that the benefits of recovery in value accrue to the unit holders who have taken the hit on account of drop in valuation.

We will continue to evaluate other available options that help protect the interests of our unit holders in the schemes.

❖ When will the NAV of the impacted schemes recover from here?

The DHFL papers held by us across schemes are, today valued as below:

a) Secured Bonds - 75% discount to its face value; and

b) Unsecured Bonds - 0

This can recoup under the following conditions:

1. If the rating of the security is upgraded by the rating agencies. Today, the rating agencies have rated the paper as 'D' (signifying Default grade). This would lead to a revision in the valuation of the security by the valuation agencies;
2. Upon receipt of interest on the bonds on the defined interest payment dates;
3. Upon receipt of principal repayments on the papers from the issuer (DHFL) to the extent of the amount realised beyond the valuation in the books.
4. Sale of DHFL Paper at a price above the price at which it is currently valued in the books.

The gains, if any, from, any of the above outcomes will accrue to unit holders in the fund.

Based on our available information, since September 2018, DHFL has made repayments of approximately Rs. 40,000 Crores to its creditors. It has received RBI approval for sale of its education loan business, Avanse Financial Services to Warburg Pincus on June 4, 2019 (Source: Exchange filing by DHFL). Media reports suggest that DHFL is likely to receive nearly Rs. 2,500 crores from Blackstone group for the sale of Aadhar Housing Finance Ltd. by June 10, 2019(Source: CNBC TV 18 – June 5, 2019). Across various media interactions, DHFL management has stated its intent to onboard a strategic investor. Mr. Kapil Wadhawan, Chairman of DHFL, in his recent media appearance has expressed confidence that the process is progressing well and DHFL expects this to be completed by mid-July, 2019.

As these milestones are achieved, we expect easing in the liquidity situation of DHFL and a possible rating revision.

❖ What if an investor redeems today from the impacted schemes and the scheme receives money from DHFL at a later date?

The prescribed valuation hair-cuts are already represented in the NAV of the schemes in compliance with regulatory stipulations on valuation. All redemptions are processed at applicable NAV based on the date of submission of the redemption request. Resultantly, any redemptions received today in schemes holding DHFL bonds, would be processed at NAVs that value the DHFL bonds as per the prescribed hair cuts. Hence, redeeming investors would not be entitled to any possible future upside resulting from an appreciation in the current valuation of the bonds.

Unit holders who hold the investment on the day of receipt of dues from the bond issuer will stand to benefit from any possible appreciation in the value of the bonds.

❖ Media reports suggest side-pocketing as a solution to protect investor's interest. What is side pocketing? Why can you not resort to side pocketing?

Segregation of portfolios commonly known as side-pocketing was allowed by SEBI in December 2018. This feature allows segregation of investments that carry a below investment grade credit rating from the main portfolio of the scheme. The objective of segregation is to prevent risk and rewards transfer between existing and new unit holders in a scheme which is adversely impacted by a credit event in its portfolio.

No fresh inflows are allowed into the side pocketed / segregated component of the fund to avoid new investors to make short term gains in the NAV. Investors holding units of the segregated portfolio receive the money as and when recovery is made. However investors can redeem other units, which have not been side pocketed at any point of time.

DHFL Pramerica Mutual Fund has obtained regulatory approvals to enable the feature of segregation of portfolios across its schemes. This requires compliance with certain regulatory requirements and a mandatory exit window to all unit holders in the scheme and can be prospectively implemented for any credit event after the feature is enabled. We are working towards enabling this feature across all our schemes in compliance with regulatory requirements.

However to safeguard existing investors' interest and not let short term opportunistic investors make gains, we have restricted purchases in the impacted schemes.

❖ **I have heard about Pramerica taking over the DHFL stake, is the deal going through post the recent development?**

There is absolutely no change to the commitment of Pramerica in taking over DHFL's stake in the AMC. We are eagerly awaiting regulatory approval for the change of sponsors for the Asset Management Business. The new entity will be a part of a 140 year old strong Prudential Financial Inc., US that manages USD 1.4 trillion[2] globally with USD 1.2 trillion under its Asset Management Business, PGIM.

Glen Baptist, CEO - PGIM Global Partners in his communication to our investors and all our stake holders has stated "PGIM stands ready to take full control of DHFL Pramerica Mutual Fund as soon as we receive approval from the regulators. We look forward to launching PGIM India as a 100% owned subsidiary of PFI and to offering our clients in India the highest quality products and services as part of one of the world's leading asset managers."

I hope that this serves to clarify the current context better. Apologies for a long note but I wanted to make sure that in all transparency, we give you all the answers that you may be looking for currently. Let me assure you once again that we are monitoring the situation closely. While there will continue to be challenges, I am confident that my team and I will do our best and make sure that we do everything in your best interest. Thank you for your patience and we hope that you will be part of our family and also part of our journey in continuing to build a best in class asset manager in the months and years ahead. If you have an advisor, I urge you to speak to him or her to review your portfolio and get any more information and guidance that you may need. Please feel free to reach out to me, any of my team members or write to us at customercare@dhflpramericamf.in, if you need any further clarification or assistance.

With warm regards,

Sincerely,

Ajit Menon

1. Includes all assets managed by PGIM, the principal asset management business of Prudential Financial, Inc. (PFI). Assets include public and private fixed income, public equity (both fundamental and quantitative), and real estate,. Effective December 31, 2012. International Investments became part of PGIM (today known as PGIM Global Partners), historical financial results have been restated to reflect the combined businesses. AUM are based on company estimates and are subject to change. Totals may not sum due to rounding.

2. Worldwide AUM include assets managed by PFI's Asset Management business and non-proprietary AUM.
