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CIN: U67120PN1993PTC074692

Date: 4th October 2017

Dear Investors,

Below is the performance of the Moats & Special Situations Portfolio (MSSP) as of 30th September 2017.

| Portfolio Performance | Equity Allocation as on 30.09.2017 | Total Portfolio Returns | Benchmark Returns |
|---|---|---|---|
| Since Inception (annualised) | | 16.0% | 10.8% |
| September Quarter | ~80% | 4.7% | 4.3% |
| 1st April 2017 – 30th September 2017 | | 6.8% | 8.6% |

• Benchmark is an average of the BSE 500 and BSE Mid Cap index.
• Equity allocation mentioned above is for older accounts. New accounts equity allocation would be lower.
• Returns are time weighted and after management and performance expenses.
• The actual returns of clients may differ from client to client due to different portfolio and timing of investment.
• Past performance is no guarantee for future performance.
• Inception Date is 27th January 2011.

The indices have continued their strong momentum in this most recent quarter. Excitement about IPO's seems to be back. The High Networth Investors (HNI) have been active participants in IPO's with valuations, in our estimate, in a "bubble" zone. Almost INR 38,000 Crore (~$6 Billion) have been raised in the primary markets for the 9 months in 2017; with the additional issues lined up, fund raising is expected to exceed 2010's high of $8.5bn. In fact worldwide public listings are on track to register their best year since 2007 with IPO's having raised $127bn, attributed to strong flows in equity markets.

However, there was a sell-off in the later part of the quarter due to global geo-political tensions on account of the US-North Korea standoff. FPIs have been net sellers in the market for the last 2 months. Domestic fund flows have more than compensated for this and continue to be very strong. The end-September quarter saw inflows of INR 45,000 Crore in the equity markets which has been the highest ever. How long this urgency to invest continues is what will drive the direction of the market in the short term.

By contrast in the real economy, GDP growth has slowed over the last few quarters. Excluding government expenditure the slowdown is even sharper as highlighted in our June quarter newsletter. It is very difficult to ascertain how much of the slowdown is on account of GST led destocking and how much is on account of a general slowdown. The government has taken cognizance of the slowdown and is planning to come out with a stimulus that they believe could get the economy back on a faster growth path. If such a plan involves contravening the fiscal path they have laid out, it may provide a short term push to the economy but could lead to inflation which has usually been the Indian economy's "Achilles heel".

This quarter marked a new era with GST getting implemented and the entire business community has been grappling with the logistics involved with its implementation. Lately there has been concern reported in the media channels that reforms that have been implemented in the past year; demonetization, GST seem to be having a negative impact on demand and jobs. We believe that while there certainly will be short term negative implications as the trade channels get accustomed to a successful implementation of the processes, in the longer term there should be a positive impact as the very large unorganized channel starts getting factored into the measured economy.

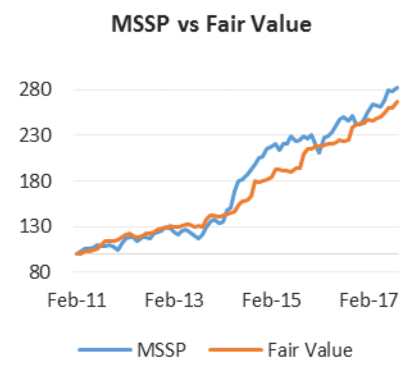
While growth continues to be a challenge across the board for "Corporate India"; valuations are pricing in a full-fledged recovery across the broader market with valuations above earlier peaks of 2007. We believe it is imperative at such times that portfolios are constructed to cushion any major setback or unexpected shocks, which are not being priced in.

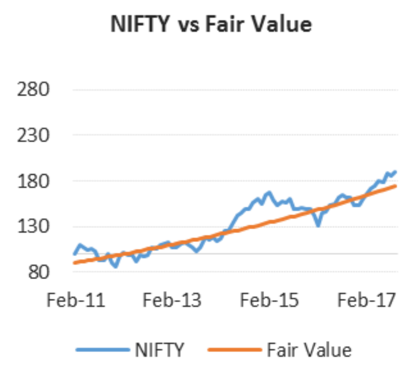
**How is the portfolio placed?**

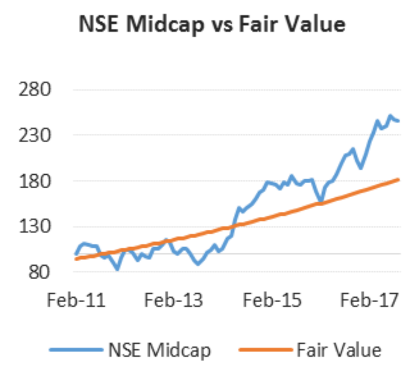
Markets often move to extremes both on the upside as well as downside. We believe therefore as portfolio managers not to get distracted by the "mark-to-market'' value of the portfolio as it could lead an investor to take wrong decisions. In a strong bull market the market value of a portfolio might give one a false sense of comfort, leading to overconfidence and an increased risk appetite. On the other hand, in a bear market one may fear to look at the market value of the portfolio and fall into paralysis as only risk seems to be visible at that point.

We believe it is better therefore to focus on the "fair" or "intrinsic" value of the portfolio. Over the long run the performance of the portfolio would converge with the growth in the "fair" value of the portfolio. Analyzing the portfolio in relation to the "fair" value of a portfolio will allow one to remain more objective during either of the extremes in the indices due to investor euphoria or despair. Focus on a portfolios "fair" value therefore helps to cut out the "noise" in the market and directs attention to where it's really needed i.e. towards growing the "fair" value of a portfolio. The value of a portfolio would grow with the underlying growth of businesses in the portfolio AND also by reducing stocks that are significantly above "fair" value (expensive) and buying stocks which are below "fair" value (cheap). Thus we believe our role as portfolio managers is to find businesses that have strong and sustainable underlying growth at or below "fair" value and contemplate an exit only until their valuations go much beyond our estimate of their "fair" value.

To illustrate: the chart below shows the movement of MSSP portfolio along with the movement of the underlying estimate of fair value. Along with MSSP chart we have charts of NIFTY and NSE Midcap index for the same period along with their estimated "fair" values arrived at by using the long term historical trend EPS and mean PE for these indices. Trend EPS for the Indices have been used as current EPS could be depressed from a cyclical perspective. Thus by taking trend EPS we are in effect using normalized earnings. If we would have used actual EPS of these indices, the estimated fair values would have been much lower.




*MSSP, NIFTY and NSE Midcap have been rebased to 100 as of Feb 2011.*

The MSSP portfolio and our estimated "fair" value of the portfolio has largely moved in line with each other. This is to some extent on account of the underlying growth of the businesses in the portfolio and to a larger extent due to our portfolio activity -reducing our exposure to "expensive" stocks and redeploying the proceeds in stocks available in "cheap" stocks over time.

When we observe how far we are from "fair" value, unlike the NIFTY (9% above estimated Fair value) or the Midcap index (~35% above estimated fair value), our portfolio is not significantly above its fair value (~6%) and thus the downside of our portfolio is limited. Any mark to market correction below fair value for our portfolio would be temporary in nature and to us more of a buying opportunity to take up our equity weights in the existing positions.

Another important thing to note is that our portfolio holdings have sustainable business models with underlying business growth in double digits. Thus the fair value of the portfolio would continue to grow along with the underlying business growth.

Since the market has continued to remain expensive, opportunities to deploy capital below fair value are restricted to business which are facing short term headwinds or issues. For an investor with a slightly longer horizon, they provide a very good opportunity as our assessment is that there is no breakdown in the underlying business model in these businesses. This in a way reduces our correlation with the market as these stocks are out of favor and may not participate in a rally currently. But if the issues or headwinds abate there is significant upside in these stocks. Moreover even if there is a correction in the market, some of these stocks could move in a different direction (up) if these temporary issues are resolved.

## Asset Allocation:

In the current quarter our equity exposure has remained broadly the same as we have increased weights in some stocks where there has been some improvement in earnings visibility. Our older portfolios continue to have around 80% equity weights while those portfolios constructed in the last 6-9 months have around 60% equity weights. At the same time we have reduced some of our holdings which had significantly exceeded the high end of our valuation estimates and if markets continue to move up we will further reduce weights where we believe there is a gap between fundamentals of the business and justified valuations and market prices.

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## Portfolio Activity:

In our assessment there seems to be value in IT & pharma stocks today and both seem to be facing issues i.e. growth related in IT and structural changes in pricing and margins in the case of pharma. We believe some of these issues in IT are temporary in nature and hence with time as underlying growth starts to pick up markets will start to reward these companies again.

**Business Model and Sector Allocation:**

| Moat/Limited Moat | Dec-16 | Mar-17 | Jun-17 | Sep-17 |
|---|---|---|---|---|
| Moat | 36% | 37% | 34% | 33% |
| Limited Moat | 38% | 39% | 39% | 41% |
| ***Moat + Limited Moats*** | ***74%*** | ***76%*** | ***73%*** | ***74%*** |
| Special Situations | 16% | 17% | 20% | 20% |
| Regulated Utility | 10% | 7% | 7% | 7% |
| **Grand Total** | **100%** | **100%** | **100%** | **100%** |

| Sectors | Dec-16 | Mar-17 | Jun-17 | Sep-17 |
|---|---|---|---|---|
| Information Technology | 19% | 19% | 21% | 21% |
| Financials & Financial Services | 18% | 20% | 20% | 18% |
| FMCG | 20% | 20% | 16% | 18% |
| Auto & Auto Ancillaries | 12% | 12% | 12% | 12% |
| Pharma | 9% | 9% | 11% | 11% |
| Capital Goods | 2% | 4% | 6% | 8% |
| Utility | 10% | 7% | 7% | 7% |
| Materials | 7% | 7% | 6% | 6% |
| Industrials | 3% | 3% | 2% | - |
| **Grand Total** | **100%** | **100%** | **100%** | **100%** |

## Portfolio Activity during the quarter:

We have exited Vesuvius in the quarter as we believe the stock is trading at pretty steep valuations. The current production growth that the steel industry is witnessing is being aided by the MIP (minimum import price) which was introduced last year to protect the domestic industry from Chinese producers. We believe the growth isn't backed by strong demand being a cyclical business the umbrella given by the MIP will lead to poorer longer term capital allocation decisions in the industry. Currently market participants are focusing on relative valuations and not on absolute valuations. Though we believe it's a good quality business, we are not comfortable with the premium being assigned by the market at this point.

Regards,

| | |
|---|---|
| Jinal Sheth | Rohan Samant |
| Sr. Portfolio Manager | Portfolio Manager |

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**Risk factors**

**General risk factors**

a. Securities investments are subject to market risks and there is no assurance or guarantee that the objective of the investments will be achieved.

b. Past performance of the Portfolio Manager or its affiliates does not indicate its future performance.

c. Investors are not being offered any guaranteed or assured returns i.e either of principal or appreciation on the Portfolio.

d. As with any investment in securities, value of the Client's Portfolio can go up or down depending on the factors and forces affecting the capital market.

e. The Portfolio Manager is neither responsible nor liable for any losses resulting from the operations of the Portfolios.

f. The investments made are subject to external risks such as war, natural calamities, and policy changes of local / international markets which affect stock markets.

g. The Portfolio Manager has renewed SEBI PMS registration effective October 14, 2014 and has commenced its portfolio management activities with effect from January 2011. However, the Portfolio Manager has more than 10 years of experience in managing its own funds invested in the domestic market.