Multi-Act Equity Consultancy Pvt. Ltd.
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CIN: U67120PN1993PTC074692

Date: 2nd January 2017

Dear Investors,

Below is the performance of the Moats & Special Situations Portfolio (MSSP) as of 31st December 2016.

Portfolio Performance	Equity Allocation as on 31.12.2016	Total Portfolio Returns	Benchmark Returns
Since Inception (annualised)		15.2%	8.0%
December Quarter	~88%	-1.9%	-7.2%
1st April 2016 – 31st December 2016		5.5%	10.8%

- 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 quarter gone by saw volatility across all markets driven by the unexpected US election outcome. India additionally got impacted by PM Modi's big bang reform of demonetization of high denomination notes. The markets have undergone a big decline post this event. Nifty has corrected sharply by 4.9% in the quarter and the midcap index has fallen by approximately 8.6%. It is understood that such a measure would have significant short to medium term impact on the economy considering that economists have estimated the parallel economy to be around ~20-25% of GDP[1]. As money in circulation contracts because they need to deposit it in the banking system or an inability to do so, domestic consumption will perforce be dented in the medium term, impacting short term revenues and corporate profitability. To that extent the negative impacts of demonetization are quite real and visible.

The long term benefits from this action in our opinion will depend **a lot** on what policy action the government takes to ensure that (a) money does not flow back into the informal economy and (b) provide enough incentives and disincentives for participants in the informal economy to come into the formal channels. The second part depends a lot on the successful implementation of GST. If the government is able to deliver on this, there could be positive implications for the compliant organized sector which had some competitive disadvantage against non-compliant businesses in the "parallel" economy. With improved tax compliance and an increasing tax base, overall tax rates could be reduced for those who were so far being compliant. The coming two quarters should give us a fair idea of government's follow on policy actions and of how demonetization shapes up for the country as whole.

2016: Year of the Unexpected!

Year 2016 can really be termed as the year of the unexpected and unanticipated. We have multiple events that took place where markets and Main Stream Media (MSM) assigned low probabilities to at the start of the year – be it Brexit, an unexpected US election outcome & Demonetization (which may perhaps be characterized by almost a "Black Swan" event).

No one can really predict "black swans" and thus it is difficult to prepare for one. But one can still construct a portfolio which can *relatively* hold its ground, even if such an event transpires. Ideally the first thought

[1] Source: https://en.wikipedia.org/wiki/Indian_black_money

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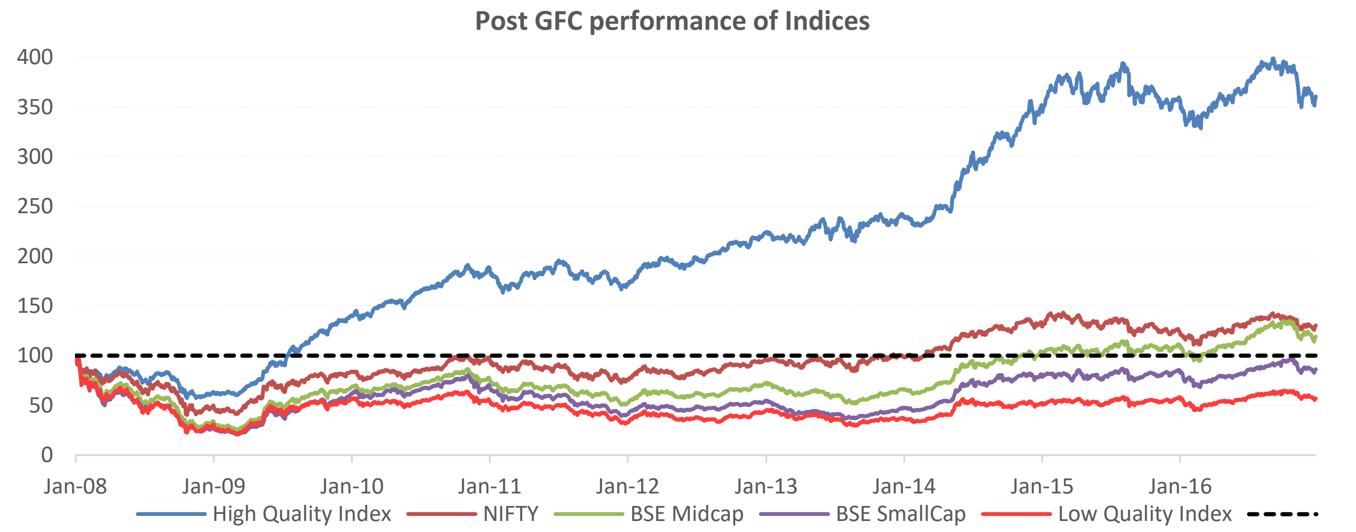
that would come to anyone's mind when it comes to protecting the portfolio against risk of a "black swan" or a shock is diversification. But for us diversification in itself is an outcome of two other factors – Quality of Business and Valuation.

By quality of business we mean the strength of the business model and its sustainability. To be sure when businesses go through a "black swan" event (it could be company specific like for instance the Maggi issue for Nestle or a macro issue like Demonetization) we are not postulating that they would be unscathed. Such businesses may indeed face minor short term severe impact, but the long term earnings power is not really affected. Thus they are able to withstand the blow and bounce back quickly. On the other hand imagine a business with poor cash flows, high leverage with a need to constantly depend on capital market for funds <u>or</u> further still imagine a business that does not have pricing power or the ability to protect their normalized long term margins. Nor indeed any sort of cost advantage and is therefore at mercy of actions taken by competitors or customers. Such businesses might find it difficult to cope with a sudden shock. The long term earnings power of such businesses could also be materially impacted and an investor in such a business could suffer a "permanent loss of capital".

Just to highlight this point, let us take the example of the Global Financial Crisis (GFC) and the Lehman Bankruptcy in 2008. Even though there were glaring macro-economic imbalances and therefore warning signals that suggested such an event could occur, investors who did not focus or understand the macro situation it came as a "black swan" event.

If you look at the chart below, we have compared our proprietary Multi-Act High Quality index which is an index of 30 High Quality stocks with the NIFTY, Midcap Index, Small Cap index and our proprietary Low Quality Index (We use this index to assess froth in the market). *It took only 1.5 years for the Multi-Act High Quality Index*[2] *to recover, while the NIFTY took almost 3 years and the BSE Midcap index took almost 7 years. The Small Cap index took almost 9 years to recover. Our proprietary Multi-Act Low Quality Index hasn't yet recovered from the shock.*



2 Multi-Act High Quality Index and Multi-Act Low Quality Index are 30 stock equal weighted indices with annual rebalancing. Top 30 stocks by Market capitalisation are selected from the Multi-Act High Quality and Low Quality universe respectively every year for rebalancing. Multi-Act identifies Quality of a business based on quantitative evaluation of long term fundamentals of the business and qualitative assessment of the business model and corporate governance. High Quality Businesses would generally have displayed across cycles high return on capital, strong Cash flows and no/insignificant leverage coupled with barrier to entry and good corporate governance. Low Quality Businesses on the other hand may comprise companies which have low ROCE, poor or mostly negative cash flows, high leverage, dilution of equity, and/or poor corporate governance.

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Thus our index that tracks the High Quality stocks that have good cash flows, strong balance sheets and sustainable business models was the fastest to recover from the post crisis correction. Our main point is that we believe High Quality stocks will bounce back faster from any *unanticipated shock* as compared to average businesses.

The second factor is Valuation. Valuation is like gravity, you can't defy it for long! Thus if you are buying a stock which is very expensive and is factoring most of the expected positive developments, a "black swan" event could seriously impact the price of the stock. Needless to say, buying an average or poor quality business at expensive valuations is a recipe for wealth dissipation. Again going back to the GFC example, at the peak of the market in 2008 the NIFTY was trading at a PE of ~28x vs it's long term average of 15x, which in itself would suggest a possibility of ~45% correction. Thus only a trigger and a catalyst – unexpected by the market- was required for the market to correct to reasonable valuations. Post GFC, the market went much below the long term average PE, to as low as ~12x's thereby resulting in a 60% correction from the peak. Even if an investor was aware of the deteriorating and shaky global macro-economic environment, the gross overvaluation in the overall markets itself should have warranted caution about the non-trivial probability of a "permanent loss of capital". A more recent episode is the massive overvaluation in the mid and small cap space which we have now been highlighting for more than a year. Demonetization is most probably going to lead to, we believe, normalization in the valuations of most of the stocks in that sector. The correction that we have seen so far in the mid and small cap space is sharp but still not enough of a magnitude to make valuations that would allow the long term investor to earn the required return on equity.

Our weights are a factor of the quality of the business and valuation (and also to some extent earnings momentum in the business). The quality of the business and strength of the business model constraints the full potential weight that we can take in the stock. A very high quality business with a strong competitive advantage would have a much higher potential weight than a business with a relatively lower competitive advantage. Valuation (and to some extent earnings momentum) then helps us to decide what portion of the full potential weight should be taken given the current price. *This process helps us to construct our portfolio*. *We term this process* ***evidence based*** *investing*. Diversification and our cash-call is a by-product of the process and not determined *a priori*. We believe this allows our portfolio to be relatively less affected by unanticipated negative events and more importantly should allow our investors to sleep well at night!

Asset Allocation:

With the recent correction in the markets our equity exposure has gone up to ~88% in the older accounts & 60-65% in client accounts with a 1 year seasoning. This is the highest equity allocation since the inception of our fund (the only other time we were at similar level was September 2013) indicating an attractive reward -risk ratio in the Large Caps, as shown in the chart below: We believe markets could be mis-pricing the potential underlying growth in Large Cap securities over the next 2-3 years.

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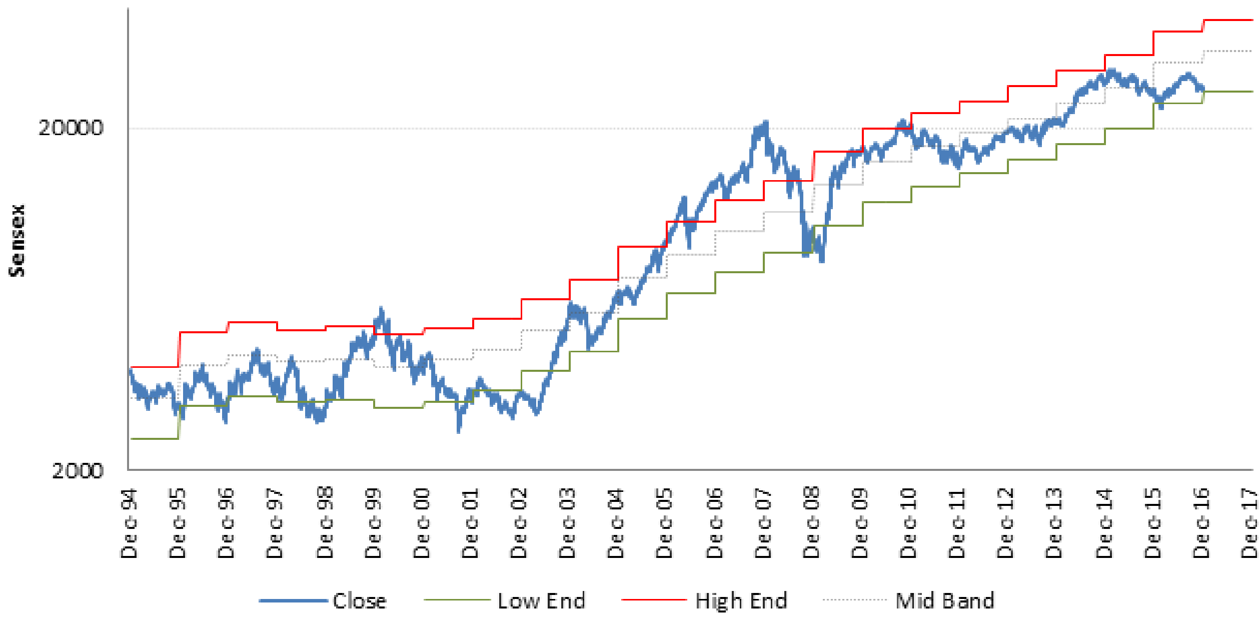
Sensex and Top Down Valuation Range



Return Cycle:

In the last couple of years the markets have gone through a couple of up & down cycles. What we would like to confess is that over this last cycle (Peak to Peak) our performance has slightly lagged the benchmark though it has outperformed the Nifty by a fair margin even though we have almost 70% of our equity exposure to Large Caps. We believe this again speaks to our focus on stock picking.

Peak to Peak 2015 - 2016

Nifty	Benchmark	MSSP
-0.5%	11.4%	8.6%

Bottom to Peak - 2016

Nifty	Benchmark	MSSP
28.4%	36.6%	20.0%

Our portfolio's tilt to 70% large cap in an environment of great excitement for the Mid and Small Cap sectors amongst the general public and the media is a function of our estimates that the prospective return over a 2-3 year period is quite healthy in Large caps and quite adverse in the broader smaller cap indices. Markets seem to be willing to pay a huge risk premium for the "hope" of very short term and temporary gains in the midcap space.

In terms of drawdowns from "Peak to Trough", the defensive characteristics have been consistent with past episodes, with far lower drawdowns than the market averages this time around as well.

Drawdowns:	Nifty	Benchmark	MSSP
Global Sell off Jan/Feb 2016	-22.5%	-18.5%	-9.5%
Demonetisation	-11.7%	-13.5%	-7.1%

Portfolio Activity:

Business Model and Sector Allocation:

Moat/Limited Moat	Mar-16	Jun-16	Sep-16	Dec-16
Moat	35%	35%	37%	36%
Limited Moat	36%	35%	34%	38%
Moat + Limited Moats	***71%***	***71%***	***71%***	***74%***
Special Situations	18%	18%	19%	16%
Regulated Utility	12%	11%	10%	10%
Grand Total	**100%**	**100%**	**100%**	**100%**

Sectors	Mar-16	Jun-16	Sep-16	Dec-16
FMCG	22%	23%	21%	20%
Information Technology	16%	15%	17%	19%
Financials & Financial Services	20%	21%	22%	18%
Auto & Auto Ancs	17%	15%	14%	12%
Utility	12%	11%	10%	10%
Pharma	5%	5%	5%	9%
Materials	5%	5%	6%	7%
Industrials	3%	3%	3%	3%
Capital Goods	-	2%	3%	2%
Grand Total	**100%**	**100%**	**100%**	**100%**

Portfolio Activity during the quarter:

Due to increased volatility in the IT sector in this past quarter we have increased our weights since we believe the nature of market concerns surrounding the industry are not structural in nature. We have also added weights in certain consumer names in the FMCG space where prices have corrected due to demonetization concern and the adverse impact is short term in nature. Amidst this short term uncertainty the franchises of the business remain strong.

During the quarter, the IT services company we added in our portfolio has a slightly different business model than the majority in the sector. It earns almost half of its revenues from carrying out product development work on behalf of the major tech companies such as Microsoft, IBM and others. Balance comes from newer technology segments which have high underlying growth. Due to the nature of the business, in some of its newer segments developmental costs need to be incurred upfront, this supresses current profitability of the business but as and when the segment scales up in revenues, profitability is greatly improved. Market’s general pessimism about the IT sector as a whole and specifically due to the fact that the company’s earnings will take time to develop, give us a time arbitrage opportunity to enter and build our position at an attractive price – effectively getting some potential recurring revenue streams of the business for free- from what is currently incorporated in prices.

We have initiated weights in a pharma company as a special situation opportunity. The business model of this company is different than a typical Indian Generic pharma company. Unlike the generic pharma model that competes with the global innovator, this company actually caters to the global innovator companies.

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Theirs is therefore more of a B2B model wherein they work very closely with the innovator company in the initial product R&D phase. The company recently received a few observations from the USFDA. There is a possibility that there could be an import alert issued by the USFDA which could impact the sales of the company to the US. As per our assessment however the stock price is factoring such a possibility at the current price. The concerns of the markets are that this issue could go beyond their US sales and affect their relationship with the global innovators as well, who are very quality conscious. As per our assessment the issues raised against the company are not related to quality. Their relationships with these clients have been in excess of a decade or so. We believe therefore that the risk of this issue affecting its other business is low and there is a case to be made here since the current reward-risk is favorable.

We take this opportunity to wish you and yours compliments of the Season and prosperous 2017!

Regards,

Jinal Sheth	Rohan Samant
Sr. Portfolio Manager	Portfolio Manager

Statutory Details: Portfolio Manager – Multi-Act Equity Consultancy Private Limited (Registration No. INP000002965)

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.

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