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Date: 1st Jan, 2019

Dear Investors,

Performance

Below is the performance of the Emerging Corporates India Portfolio (ECIP) as of 31st December, 2018. Our closing equity allocation as on December 31st, 2018 is ~*75%* spread into 19 companies and balance is in liquid schemes.

Portfolio Performance	Total Portfolio Returns	Benchmark Returns
Since Inception *(Annualised)*	10.1%	1.2%
Q3 FY2019	4.9%	3.3%
Q2 FY2019	1.3%	-6.7%
Q1 FY2019	0.8%	-4.4%
FY18 *(Since April 28, 2017)*	9.7%	10.5%

- Benchmark is an average of the BSE Smallcap and BSE Midcap Index
- Returns are time weighted and after management and performance expenses.
- Management and performance fees are deducted as and when due
- 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
- Benchmark calculations have been changed from this quarter to reflect total returns (including dividends)
- Returns for less than 1 year are not annualised
- Inception Date is 28th April 2017

As we have stated in the past, we will judge ourselves based on at-least three years of performance as our strategy is designed to capture opportunities that, in our understanding and estimation, should work over a three to five year period. Nevertheless, if one were to try to spot a pattern in our performance, it seems that we have outperformed the benchmark significantly in negative quarters but fallen short of the benchmark in positive quarters. In-fact, the Dec'18 quarter has been the first quarter where we have outperformed in a rising benchmark environment. As of the last quarter end, our equity allocation was ~51% which has now moved up to ~75%. The fall in the first half of the quarter allowed us to put some cash to work as prices became reasonable after a long time.

The quarter gone by has been an eventful quarter. The headline grabbing event for the quarter was the IL&FS crisis. When a large triple AAA rated financial institution defaults *(with INR 90,000 crores of borrowings as of FY18)*, the reverberations of the same are felt across an interconnected chain. The Mutual Funds holding the IL&FS paper faced redemptions and redemptions led to panic selling of fixed income instruments spiking yields. This led to further redemptions leading to a crisis of confidence and drying up of liquidity for these NBFCs and raising borrowing cost. NBFCs need constant access to funds for growth and an evaporation of liquidity leads to an inability to grow book. In effect, this choked funding for customers that borrowed from NBFCs to buy homes, two-wheelers, cars, consumer durables, etc. Also, in such an environment, any NBFC that has borrowed short and lent long gets hit badly as re-financing is very difficult and costly. There was a sharp decline in stock prices of companies that were a part of this chain either directly or indirectly. While things are slowly returning to normal as people are coming to this understanding that the crisis was more "liquidity led" than "credit quality led" and liquidity taps have been released by the regulators, the volatility in some of these stocks have been brutal. Only on September 21st, two of these NBFCs fell ~50% in a day putting the volatility bearing ability of investors to a stern test.

While unpleasant, events like these bring out the cracks in the open that get shoved under the rug in good times. It also helps separate the "men" from the "boys". And reduces the willingness of people into believing that *"trees will grow to the sky",* thus leading to more sanity, sensible prices and healthier markets.

As we have stated in the past, we have an exposure to one NBFC which has been in the process of merging into a Bank for a year now. While the stock corrected a bit post the IL&FS event unfolding, the stock is in the green for the quarter *(sequentially) – it received all approvals and the merged Bank is now live*. Apart from the same, we did not have any direct exposure in any NBFC Company. Some of our investee companies had parked a small sum of their surplus money into IL&FS paper and had to take write-offs regarding these investments but they have been non-material in context of their overall size for it to have a meaningful bearing on their valuation.

To sum it, this event reinforced some of our beliefs: -

1. Decide a "quality benchmark" below which you do not want to tread, whatever the valuations, and stick to it. Many a times, we are enamoured by "low valuations" that want to trap us into "low quality". Off-course, there is a trade-off between "valuation" and "quality" but the adherence to "minimum quality" level is paramount.

2. When dealing with levered companies (as all financial institutions are), one needs to be very confident of the management pedigree. As Buffett says, *"When assets are twenty times equity - a common ratio in this industry - mistakes that involve only a small portion of assets can destroy a major portion of equity. Because leverage of 20:1 magnifies the effects of managerial strengths and weaknesses, we have no interest in purchasing shares of a poorly-managed bank at a "cheap" price. Instead, our only interest is in buying into well-managed banks at fair prices."*

The other interesting event for the quarter has been collapse in the price of oil. On October 1st, 2018, Brent oil was USD 84.98. And on Dec 31st, 2018, Brent oil is at USD 53.85, a drop of 37%. Experts and forecasters of oil went into a hiding as they now seem way off the mark *(at-least for now)*. As you might be knowing by now, we are invested into India's largest airline operator and the drubbing that oil has received has been a tailwind for the stock price of the airline we own *(up ~45% for the quarter and now our largest position)*. We are more believers in the structural cost advantage of the airline and its ability to operate profitably across oil prices *(unless they are so high that no one can afford air tickets and people go back to trains)* than it being a pure contra-oil bet. As the industry goes through feasts and famines, this airline starves the least in a famine which was showcased in the last three quarters and it enters a possible period of feast with an enviable balance sheet and a massive on-going expansion plan. We stay committed to our thesis and intend to hold it till the profitability capability of the airline is appreciated by the market participants.

We also exited a diagnostics Company that we had bought in Dec'17 quarter. We had bought this Company building a thesis around the B2C tailwind that we thought it enjoyed with regards to the preventive healthcare tests and more and more Indians wanting to do these voluntary tests. Over our holding period, we realized that the growth tailwind was not as strong and the period that we thought portends a strong demand was artificially bloated by one-off advertisement spend. The management commentary also shifted towards focusing on B2B segments as against B2C earlier. We just realized that we were plain wrong with regards to our thesis around B2C growth prospects and given what we understood now, the valuations looked very expensive. There was also a buyback going on which gave us an exit opportunity. And we decided to exit. Luckily, we did not make any meaningful profit or loss in any account on this stock. Also, once we realize we are wrong, the cost price has no bearing on our decision to sell. Over the last eighteen months since inception, we have made 21 investments and exited 2 because we thought we were wrong. In others, we continue to believe in the investment prospects and the thesis that we've built on those.

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Our learnings from the two investments where we realized we were wrong were: -

1. In an IPO, there is a high probability of "pre-IPO year margin" or "pre-IPO year growth rate" not being representative of long-term growth and margins. Since IPOs generally happen when the market mood is buoyant, investors tend to form opinions about "margins" and "growth rates" based on the eloquence of the management commentary than "cold" long-term data. We think the answer is not in shunning IPOs altogether but trying our best to only go for the exceptional companies that would meet "rarest-of-the-rare" criteria.

2. Companies that are led by a very strong personality *(mostly the founder)* tend to be a double edge sword. Since these companies have lesser bureaucracy and fast decision making, they can scale-up to a point very quickly. However, beyond that point, it requires an ability to attract best-in-class talent. And we've found that some of these Companies do not tend to attract the best of talent at the top management level – *may be because the founders are unwilling to let go off their control*. And that raises doubt on the longevity of the business and ability to execute and expand on higher bases. This is a softer aspect that we think we need to be aware of and appreciate.

3. Focusing on the opportunity landscape *(size and scalability)* is very important. The "industry" rate of growth is a key driver of the "Company" rate of growth. Sometimes, we get tempted into a thesis on the bedrock of margin expansion thinking that even if revenue growth might not be great, margin expansion will lead to profit expansion much higher than revenue growth and thus, the stock will do well as people apply a multiple to higher profits. This might work if you are buying stocks extremely cheap, but our experience suggests it does not when one is buying at even reasonable valuations. This is because margin expansion will happen only once and post that, revenue growth and profit growth will align implying that such a stock deserves a low P/E ratio than what you might initially think based on the profit growth potential in the first few years of margin expansion.

When we look at the last seventeen months of this scheme, another factor that has helped us is our willingness to reduce weights at expensive valuations. This is the most difficult bit of investing and not much has been written about the same in "investment literature". Logically, the only purpose a stock serves in a portfolio is to provide a return. And thus, whenever the return does not justify the risk, one needs to sell. However, there is a temptation to hold on to some winners even after they become very expensive because we do not want to give up on the bragging rights of owning these winners, do not want to get into the discomfort of re-investment where the meter starts from zero again, do not want to be branded as a trader *(rather than the coveted title of an "investor")* by peers, etc. Also, given that stocks go to both extremes of valuation, it is almost heart breaking to let go off a winner that you had identified after so much effort and hard work and it proved to be a winner. But, its important to realize that stocks don't know that we own them and do not love us back.

Our approach towards selling winners is to compare the level of expensiveness with our weight and be brutal at higher weights and more and more tolerant at lower weights. Thus, we brutally cut weights as stocks get expensive until we bring it down to three percent but after that, we are very tolerant of holding expensive winners. Post that, we would go to zero only on a level that looks ridiculous than mere expensive.

Now, moving on the additions, we added three new Companies to the portfolio.

India's best known "value for money" super market chain

A large part of India still buys foods, grocery and FMCG products from mom-and-pop stores. The urban parts of the country have slowly graduated towards the modern supermarkets, but the penetration of modern retail is still in lower single digits. Also, most of the older supermarket companies have not showcased a business model that

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could meaningfully profit from this huge opportunity tailwind. Our investee company stands out as a focused, sustainable, profitable and capital efficient business model for the Indian context that can benefit from this massive opportunity with a very long growth runway. A piece central to their strategy was owning all its stores instead of renting them. The savings on ownership costs were passed on to the customers in the form of lower gross margins. The cheaper prices attracted customers and its asset turns were off the charts relative to competition. As its scale grows, its cost advantage will only widen as it uses economies of scale to bargain with its vendors and passes on the savings to its customer further driving footfalls. The Company runs ~140 stores as of date, most of which are owned *(Company hasn't shut a single shop yet since inception)*.

Interestingly, this stock is also branded in the value investing circles as an extremely expensive stock. The P/E ratio of this stock at our buying price and using trailing FY18 EPS was 103x *(of-course, most brokers use FY20 EPS and the P/E falls to about 65 based on that)*. No doubt that it looks expensive when looked from this view point. But when we look at it from the point of view of the opportunity landscape for growth, scalability of business model and the competitive advantage that ought to only improve with scale – we thought that there is an opportunity to make a respectable IRR over a five-year holding period even if the multiples were to contract significantly at the time of exit. Like we had stated in our first newsletter, we do not believe that a high P/E ratio stock needs to be necessarily expensive and a low P/E ratio stock needs to be necessarily cheap. There is far more analytical rigor required to understand what is "cheap" or "expensive". Over the next few years, we shall keep you updated on how this plays out.

A combination of domestic branded agrochemicals and CRAMS

This Company has proven its competitive strengths over the last decade in the agrochemical value chain right from research and development *(big R&D centre with more than 150 PHDs that have commercialized 23 molecules through successful process research)*, product registration and trials *(launch history of successful patented products),* manufacturing (*several global innovators are their contract manufacturing customer*), brand building (*created extremely strong brands in India*) and distribution (*key products brought by Innovators into India banking on Company's distribution*). It has also proven itself in IP protection for global Innovators by deciding not to enter the branded generic markets globally and thus, avoiding conflict of interest. The Company has best-in-class return metrics with a strong order book on the CRAMS segment aiding visibility and an ongoing capex program with up-coming commercialisation in the next few quarters. Opportunities for export has increased owing to China facing pollution and other issues and the global players preferring India over China for new capacities in an endeavour to diversify. This Company remains a preferred partner for manufacturing bases of Innovators.

A premier Mumbai real estate developer with best-in-class Balance Sheet

This is arguably Mumbai's most reputed real estate developer focused on premium developments primarily in the residential, retail (malls) and commercial real estate. It is an established brand with good track record and management bandwidth to execute large projects. Through its history, the Company has been able to identify attractive development opportunities in the city. Its strategy focuses on buying large land parcels of over 25 acres and immediately start development work on them. The entire property is generally developed in phases over 10-12 years but given the reputation it has built over years and the scale of demand it has seen in some of its projects, it could possibly shorten this development period in the future. Its timely delivery has enabled it to create a trusted brand. This helps its projects to command premium over prevailing rates in the vicinity

We like the following about the Company at this juncture: -

- A near zero-debt Balance Sheet currently which places it amongst the best amongst peers

- Ability to either raise debt at best-in-industry interest rates or dilute equity at good valuations – if it were to see possibilities of large land purchase.
- A favourable land scenario with competitors under stress leading to favourable land prices with this Company best placed to take advantage of the same
- Amongst very few Companies where consumers trust its completion track record and purchase on launch easing out the cash-flows
- An annuity stream of income from its mall and commercial real estate likely to see a sharp rise over the next 5 years *(can possibly rise from annual run-rate of INR 200 crs in FY18 to INR 1000 crs in FY23)* owing to launches.
- Launch pipeline of development properties also looks very robust with large recent land purchase and unutilized land in existing land banks in to be launched in the next 2 years.

We would also like to take this opportunity to wish all the readers a very happy, healthy and a prosperous new year! The year 2019 promises to be a noisy one with the mega event of "general elections". People often ask, *"what would be good for the markets?"*. As we know, on May 17, 2004, the Sensex fell about 800 points as the NDA was voted out of power. And in the next three years, we had a massive bull run. And on May 18, 2009, as the UPA got re-elected *(the same Government that the market feared in 2004)*, the Sensex hit an upper circuit. And then we had five years of very low returns until the market started pricing in a Modi victory. The point to note is that even if the market gets what it wishes for, it does not promise great returns or even if it gets what it fears, it does not foretell any doomsday. In-fact, it could even play out in a reverse fashion. Predicting the markets is very complex. All we can say is that even if someone gave us a guarantee that the election results would be different than what the market is expecting *(or it would be what the market is fearing)*, we would not change a thing in our portfolio. We are investing into Companies and promoters who have performed across different Governments and getting paranoid about elections is good for TRP ratings but has no predictive ability regarding stock performance.

In this context, we leave you with one of our favorite stories – that of "The Chinese Farmer".

Once upon a time there was a Chinese farmer whose horse ran away. That evening, all of his neighbors came around to commiserate. They said, "We are so sorry to hear your horse has run away. This is most unfortunate." The farmer said, "Maybe."

The next day the horse came back bringing seven wild horses with it, and in the evening everybody came back and said, "Oh, isn't that lucky. What a great turn of events. You now have eight horses!" The farmer again said, "Maybe."

The following day his son tried to break one of the horses, and while riding it, he was thrown and broke his leg. The neighbors then said, "Oh dear, that's too bad," and the farmer responded, "Maybe."

The next day the conscription officers came around to conscript people into the army, and they rejected his son because he had a broken leg. Again all the neighbors came around and said, "Isn't that great!" Again, he said, "Maybe."

Take-away: -
The whole process of nature is an integrated process of immense complexity, and it's really impossible to tell whether anything that happens in it is good or bad — because you never know what will be the consequence of the misfortune; or, you never know what will be the consequences of good fortune.

- Allan Watts

Regards
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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.

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