Multi-Act Equity Consultancy Pvt. Ltd.
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Date: 31st December 2014

Dear Fellow Investors,

Below is the performance of the Moats & Special Situations Portfolio (MSSP) as of 31st December 2014.

Portfolio Performance	Equity Allocation as on 31.12.2014	Equity Returns	Total Portfolio Returns After Expenses	Benchmark Returns
Since Inception (annualised)		30.0%	19.5%	9.8%
December Quarter	~66%	10.6%	7.7%	7.1%
1st April 2014 – 31st December 2014		62.1%	39.7%	37.8%

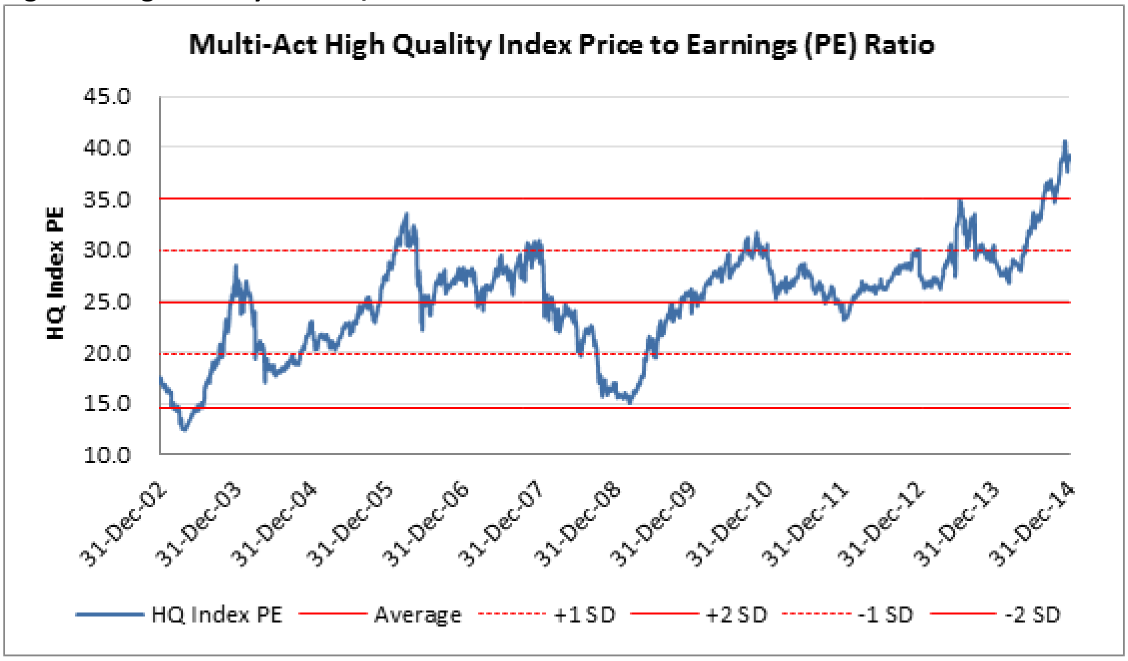
- Benchmark returns are based on BSE 500 and BSE Mid Cap in equal weight.
- Equity allocation mentioned above is for older accounts. For newer accounts our equity allocation would be lower.
- Returns are cash flow adjusted and time (Daily) weighted returns after expenses.
- The actual returns of clients may differ from client to client due to different portfolio and timing of investment.
- Past performance is not guarantee for future performance.
- Inception Date is 27th January 2011.

Long term investors of ours would have noticed a pattern whereby our cash allocation drops to lows during market downturns and increase when most market observers forecast a strong bull market.

A few investors have asked us about our increased "cash" allocation *(currently at ~34%)* when the entire market appears to be poised for a big bull run on the back of the upcoming budget, cyclical upturn and possible reforms. We would like to address this specific concern of those investors concerned about our high cash allocations, in this communication.

Regular readers of our newsletters would be aware of our constant complaint about the lack of value in the High Quality sector of the market, which is our preferred hunting ground. We would like to illustrate this point with the following chart.

Figure 1: High Quality Index P/E ratio chart



High Quality index is an equal weighted 30 stock index with annual rebalancing. High Quality Index PE represents the weighted average ratio of Price to trailing four quarter Earnings of the constituents.

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The chart represents the Price to earnings ratio (PE) of 30 stocks that represent our proprietary High Quality Index. We would generally get a lot of actionable ideas closer to the long term average (~25x or below) which has last been touched towards the end of 2011. Currently, the PE ratio at ~40x is at an all-time high for the available history and is way above +2 Standard deviation from its long term average, highlighting an extreme deviation. In the past at least such extreme overvaluation has resulted in poor, if not negative, prospective returns.

The next logical question that investors could ask is, why not look at average or slightly lower quality businesses that provide value?

As a fiduciary, we believe our first responsibility is to protect the wealth/capital of our investor and the second responsibility is to grow it on a sustainable basis. In a sense because of the effect of compounding the two objectives are not mutually exclusive. We should be rewarded for returns generated without taking undue risk with an investor's capital. To put it other way, we won't put the investor's capital at risk to maximize reward.

With that thought in mind, let us try to find out what kind of risk is involved in the different buckets of quality. At Multi-Act we grade all companies that we cover into A, B+, B, B- and C. Grade A and B+ being high quality businesses which, in addition to other parameters, have long track record of high return on capital employed (ROCE), high Free Cash flow generation and good corporate governance standards. Businesses that we classify as Grade B- and C have low ROCE, poor or negative cash flows or might have poor corporate governance standards. Balance companies fall in the average "Grade B" category.

As we want to assess the risk involved in losing investors capital, we should check how many companies in each Grade lost value in various market periods. The tables below show the percentage of stocks in each category that lost money in a particular period. As we need to see the risk across business/market cycles, a trough to trough and peak to peak analysis would help.

Figure 2: Percentage of Companies that lost money – Trough to Trough:

Trough to Trough	Grade			
	A	B+	B	B- & C
Apr 2003 - Mar 2009	-	-	10%	15%
Mar 2009 - Aug 2013	-	2%	15%	41%

These tables represent % of stocks that in a particular period lost money in each Grade bucket as per grading done by Multi-Act over time. Multi-Act has graded over 604 Indian companies over time.

Figure 3: Percentage of Companies that lost money – Peak to Peak:

Peak to Peak	Grade			
	A	B+	B	B- & C
Jan 2008 - Nov 2010	-	7%	41%	67%
Nov 2010 - Current	-	8%	34%	67%

Above tables are suggesting that as one moves down the quality curve, the probability of losing capital increases. But the more crucial point is, if one is caught in the wrong leg of the cycle, the outcome would be even worse as shown in the table below.

Figure 4: Percentage of Companies that lost more than 50% value from Peak to Trough:

Peak to Trough	Grade			
	A	B+	B	B- & C
Jan 2008 - Mar 2009	-	40%	82%	94%
Nov 2010 - Aug 2013	-	8%	32%	69%

"Only when the tide goes out do you discover who's been swimming naked" – Warren Buffett.

In a stressed environment the real test is which stocks will survive serious drawdowns. Thus in the above table we have used percentage of stocks that lost more than 50%. As can be seen, being in the lower end of the quality curve would seriously hurt an investor in such an environment. During the Global Financial Crisis, almost all (94%) B-/C grade companies lost more than 50% of their value. Across business cycles Grade A businesses have retained their value and even in a stressful situation like the 2009 crash have not lost more than 50% value (actually no Grade A company lost more than 10% value in that particular period- though the sample size is very small). Though the percentage of companies losing money is higher in our stocks with a Grade B+, it is still significantly lower than in stocks graded B, B- and C.

The key point we are illustrating here is - If we reduce the quality of the portfolio (to chase value), we would end up with a substantial portion in the average and lower quality businesses at a potential peak of the market. If we and other market participants have misjudged the timing of the next decline such action could seriously put investor's capital at risk as seen in above table. We believe therefore that we serve investors better by not lowering our guard when market participants are very optimistic. As the bull market progresses investors are better served by increasing the quality of the portfolio.

Thus to answer the question, does it make sense to reduce the quality of portfolio to improve the return potential; the answer is a clear "No", as it would amount to putting the investors capital to risk of a "permanent loss of capital".

A follow up logical question would be; Can there be a "permanent loss of capital" from here on in the High Quality space considering the stretched valuations?

We have endeavored to invest in HQ stocks that have the strongest underlying business returns. Thus any corrections in the market from a "richly" valued zone will be countered by the high underlying returns of the business and so the time to recovery from drawdown will be as low as possible. Losses if any would be expected to be mostly temporary *(notional).*

Our investors can be rest assured that even in this stretched environment we have been taking action wherever necessary and the High Quality stocks that we continue to hold in the portfolio would be those that in our opinion are the least stretched stocks in the high quality space.

Between a rock and a hard place:
So far we have been able to find pockets of value in the High Quality sector every now and then – (for e.g. High Quality cyclicals in Sep 2013 or certain FMCG names in Sep 2014). But in the current market where a rational investor would like to increase the quality of the portfolio, we are finding it increasingly difficult to find ideas in the High Quality space, where valuations are close to astronomical levels. Most importantly these valuations are not supported by an actual uptick in business. Global Emerging market funds and Asian fund allocations towards India are at an all-time high and a change in this allocation for

reasons extraneous to India could be a potential threat as well. Thus, at this juncture we would prefer to sit on cash and increase our cash allocations rather than bring down the quality of the portfolio in favor of value and expose the investor's capital to a "permanent loss" of capital

"The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs." – Warren Buffett

Asset Allocation:

Figure 5: Business Model and Sector Allocation:

Moat/Limited Moat	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Moat	37%	33%	32%	40%	39%
Limited Moat	42%	45%	42%	35%	36%
Moat + Limited Moats	***79%***	***78%***	***74%***	***75%***	***74%***
No Moat	10%	12%	14%	12%	12%
Regulated Utility	11%	11%	12%	13%	14%
Grand Total	**100%**	**100%**	**100%**	**100%**	**100%**

Sectors	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
FMCG	5%	5%	13%	20%	22%
Auto & Auto Ancs	20%	24%	21%	20%	19%
Financials & Financial Services	20%	21%	19%	16%	16%
Industrials	19%	20%	21%	14%	12%
Utility	11%	11%	12%	12%	12%
Information Technology	-	-	3%	7%	8%
Telecom	4%	4%	3%	4%	5%
Pharma	5%	-	-	3%	3%
Materials	-	-	-	-	2%
Capital Goods	10%	9%	8%	3%	-
Logistics	5%	6%	-	-	-
Other	2%	2%	-	-	-
Grand Total	**100%**	**100%**	**100%**	**100%**	**100%**

We have started seeing some correction in the IT sector where we believe there could be possibilities of finding some value with some further correction. With the fall in the global commodity prices, we have seen sharp correction in some of the natural resources stocks. We have taken an initial weight in one mining company. We believe, the key to investing in natural resource companies is to focus on companies which are among the lowest cost producers in a particular resource and maintain relatively clean balance sheets with low leverage.. Howver we still feel that a much bigger correction is required in the Natural Resources sector to take any significant exposure in that sector..

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Portfolio Activity during the quarter:

We have completely exited Bharat Electronics. The stock has surpassed the higher end of our valuation range assuming a full cyclical recovery. The stock moved up sharply in the quarter as FII restrictions in defence were relaxed.

We have taken an initial weight in a mining company. The company is one of the lowest cost producers in the world of that particular resource. We would look to increase our weight on further correction.

Wish all of you a Very Happy New year & a prosperous 2015!

Regards,

Jinal Sheth	Rohan Samant
Portfolio Manager	Asst. Portfolio Manager

Statutory Details: Portfolio Manager – Multi-Act Equity Consultancy Private Limited

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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.

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