September 5, 2012

Quarter: **June 2012 – August 2012**

Dear Investors,

It is my pleasure to be communicating with you for the first time on our investment journey together, via this formal memo. The goal is to provide our investment performance and convey my thoughts on the investment environment going forward.

It has been an honour to be managing your equity investments and we deeply thank you for the trust you have shown in us. As the CIO, I will strive to manage your hard earned money with as much, if not more, care as I manage my own savings. I hope that I will be able to keep your trust forever and exceed your and my own high expectations.

Our Performance So Far

We have sent your individual portfolio performance separately which will show a detailed portfolio position as of late August. We will be providing detailed comparison of our performance vs. the market (Nifty 50) after completing reasonably long period (2 + years). The current period is too short to meaningfully measure the performance, but we are happy that we have performed reasonably well during the prevailing tough economic environment across the globe. Though returns cannot be guaranteed in stock market, we will strive for returns far exceeding the FD returns over a longer time horizon of 2 years and above. Below is the philosophy and process we have employed successfully over the past 4 years for ourself and will follow the same going forward. Bottom-line is to reduce risk by staying focused on quality businesses and by being disciplined on the price we pay.

Investment Philosophy and Process

We have explained to most of you what our investment policy is, but thought we will put it on paper for better clarity. We never forget these words by Charlie Munger (Warren Buffet's partner) in following our process.

"It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent."

We are not striving for brilliance, but for consistency. Following are the qualities that we look for in all our investments.

Superior Business

We look for businesses with long-term competitive advantage, in a stable industry, that has a huge and growing market for its products/services. If a business is inferior then the price of the stock does not matter and it would not interest us. When you look at a business and if you get a feeling "I wish I owned this business", only then it becomes a candidate for potential investment/share ownership.

Competitors should find it extremely difficult to emulate such a company's qualities and new players should find it tough to enter as a worthy competitor.

Financially the business should provide healthy return (profits) on the capital (called ROCE in financial jargon) that has been invested without taking too much leverage (debt). Typically we look for ROCE of at least 20%. The business should have long-term growth potential of above 20% per year and it should not require too much additional investment to achieve such growth.

Competent/Genuine Management

The most important factor in India is to stay away from managements that are here to steal from investors; and believe me we know of many. Here we maintain "zero" tolerance policy and we prefer letting go of a good opportunity even if we have some doubts about the management's integrity. Meeting the management is a must, unless a close associate have met them and provided credible & positive feedback.

Once the management passes the above hurdle, we look for their competence in running the business and allocating capital. We want to associate with managements who use capital wisely and return any excess capital to the shareholders (in form of dividends) if there is lack of highly profitable opportunities available to invest in. This discipline and high ROCE requirement has resulted in most of our portfolio companies been high dividend yielding.

Reasonable Price

For us the price of a stock is a factor of its future earnings growth and dividend yield (or money returned to the shareholder). We only invest in businesses where the price is below its intrinsic value considering its future growth and other quantitative/qualitative factors. Having sufficient margin of safety is very crucial when investing and paying low price provides that. We would rather hold the money and return it to you, than make a bad investment for the sake of it.

Investment Environment

Even though we do follow macroeconomic events around the world very closely, the most important thing is to find businesses that will continue doing well in all kinds of environments. Problems in US, Europe and Middle East are long-term and they cannot be wished away. The way US & European governments and central banks are behaving; it will only temporarily reduce the pain but end up prolonging and worsening it. India in the mean time is facing problems which can be solved with even modest efforts from the government. Please note that Indian businesses are performing in spite of the government hurdles, high interest rates and high input (commodity) prices due to depreciated rupee. Government hurdles cannot get worse, interest rates are more likely to come down in the future and commodity prices can go down if either rupee appreciates; or global slowdown worsens; or central banks reduce intensity of printing money.

Stock market is down 20% since 2007 peak and in the mean time earnings have almost doubled. In addition, the negative economic news flow around the globe and the above India specific factors has provided us with attractive valuations. History tells us that it is more rewarding to invest in such environment rather that during periods when everyone is excited about investments.

Should there be any queries, I’m always available. Please do not hesitate to contact me.

Warm Regards,
Samit Vartak, *CFA*
Chief Investment Officer