



April 03, 2015

Letter to partners CE5-Mar15

Review of FY 2014-15

Dear Partners,

"Don't confuse brains with bull market"

- Humphrey B. Neill

We saw improvements in intrinsic values as well as share prices of our businesses this year. Share prices grew more so, thanks to optimism propelled by the *NaMo* wave in the first half and a sharp 50% fall in crude oil prices in the second half of the year. We, however, remember Warren Buffet's advice that a rising tide lifts all boats and it's only when the tide goes out do we know who are swimming naked. With a primary focus on fundamentals and a reasonable discipline on buying price, we believe that we are swimming with our pants up! Welcome to the fifth edition of this letter as we cruise along the value investing way of building wealth, keeping partners first in our incentives, conduct and communication.

A. PERFORMANCE

A1. Fundamental Performance of our portfolio businesses

Period Ended	Business Metrics of Our Portfolio				Stock Metrics of Our Portfolio			
	"Earnings" / "Our Cost of investment"	Implied Underlying Profit Growth	"Book value" / "Our Cost of investment"	Trailing Return on Equity	Dividend Yield	Trailing P/E	Portfolio Turnover	Personal hedge cover
Favourable If...	↑	+VE	↑	↑	↑	↓	↓	-
Mar 31, 2015	11.9%	0.0%	0.67x	21.9%	1.1%	18.7x	0.0%	0%
Mar 31, 2014	11.9%	18.0%	0.58x	29.0%	2.9%	12.2x	6.7%	25%
Mar 31, 2013	6.8%	20.0%	0.33x	31.6%	2.4%	14.0x	8.0%	0%

For the financial year ended March 31, 2015:

- Our share of **earnings** in our businesses grew by 0.0% (earnings of Nifty companies fell by 2.3%)
- Our share in their **net assets** grew by 15.5%
- With share price growth, the P/E multiple increased from 12.2x to 18.7x indicating market optimism
- We intend to build the hedge cover gradually over the next year

A2. NAV Performance

Period Ended	Compound Everyday			Nifty		Outperformance	
	NAV	Firm's Return	Return to Partners	Nifty	Return [#]	Firm	Partners
March 31, 2015 (A)	286.3	84.1%	50.5%	8492	28.0%	56.2%	22.5%
March 31, 2014 (A)	155.5	62.2%	37.3%	6704	19.4%	42.8%	18.0%
March 31, 2013 (A)	95.9	-4.1%	4.9%	5682	6.8%	-10.9%	-1.9%
August 18, 2012*	100			5366			
Cumulative		186.3%	116.8%		63.1%	123.2%	53.7%
Annualised		49.5%	34.4%		20.6%	28.9%	13.8%

A = Audited; * Date of incorporation; # Total return including dividends

For the financial year ended March 31, 2015:

- Firm's **NAV** grew by 84.1%, without use of any leverage or derivatives. The partners gained 50.5% on average, this year and 34.4% annually since our inception.
 - **On IRR basis (term used by Mutual Funds), they gained between 35%-55% annually since inception.**
- NSE Nifty rose 28.0% with dividends reinvested. Partners' returns could outperform the Nifty by 22.5% this year and by 13.8% p.a. since our inception.

Ending this year, our NAV has grown 3x in 2 years. However, before patting our back if we look outside our windows, we will see 21% of actively traded Indian stocks, 200 in number, also followed suit (Source: Capital IQ). We thus humbly attribute much of our NAV performance to **beginner's luck**. We started in 2012 when there was pessimism on the street that offered good companies at reasonable prices. And, suddenly in 2014, the mood changed from despair to exuberance as reflected in share prices. The performance till date is due to amalgam of these unusually favourable factors which may or may not repeat in future. Partners are urged to be mindful of this and we should therefore moderate our expectations.

Notably, we did not sell any of our holdings in this year. As a result, over 77% of our holdings are over 1 year old now. Thanks to the Indian Tax laws that exempt long term capital gains on listed equity shares one year old, we will pay **no capital gains taxes** when we sell these. We are and will be delighted to be in this situation.

We welcome two new members to our partnership (to take us to total 8 partners). They along with existing partners introduced new capital of INR 55 lacs (INR 5.5 mn) this year. There were no capital redemptions during the year, save an internal funds exchange among family members of your managing partner for personal tax reasons (Please refer partners' capital account in financial statements for details). With majority stake, your managing partner along with his family continues to have his skin in the game alongside you.

Audited accounts, NAV statement, capital account cum IRR statement and inputs for your tax returns are sent to you separately. Please look at marked to market (MTM) statements to get the full picture of performance. Owing to tax accounting reasons, our income statement ignores unrealised profits on our holdings and hence gives incomplete picture.

As promised, no expenses (except share expenses and audit fees) stand charged to the partnership. Website expenses are and will be borne *personally* by your managing partner. We hate financial misappropriations by way of *overstatement of expenses* and, so would you. So let's keep expenses, altogether, away.

B. DETAILS ON PERFORMANCE

Again, for the benefit of new partners, we reiterate our three principles relating to performance review:

1. We like to mention our mistakes upfront. And, we dislike repeating past mistakes.
2. For measuring our performance, we look at changes in fundamentals of our businesses with a near indifference to short term price movements (one year is 'short term' for us).
3. Mention of what did not go well precedes mention of what went well.

B1. MISTAKES & LEARNINGS

A rising market can postpone discovery of mistakes. This might have been such a half year. In this second half, we did not find ourselves committing any major mistake. From our past mistake we have learned that we need to be lazy in selling good businesses especially if bull markets are nearby (Ref: Cera Sanitaryware, last letter). As usual, we will continue to remain forthwith with our mistakes.

C. OTHER THOUGHTS

DIFFICULTIES OF BEING IN A BULL MARKET

I don't predict future. I understand human nature

Lord Krishna to Arjun in The Mahabharata

Thanks to our genetic wiring; envy, greed and fear (of losing out) are three primary human emotions every bull market stimulates. We acknowledge usefulness of these human emotions. Emotions including envy, greed and fear have been instrumental in *human survival* and *superiority* over other species since life's origin. Being envious forced us to compete and improve. Being greedy made us accumulate and overcome scarcity. And, being fearful triggered the fight/ flight responses necessary for survival. These emotions therefore, with generations, are so etched into human consciousness that they operate automatically and indiscreetly, including, in a bull market. Unfortunately, going by financial markets' history, these emotions when drive actions, lead to bubbles and crashes.

Our take is that we might have just stepped on to a possible bull market and are nowhere near the top. Armed with the above knowledge this is what we are going to see and do in next 2-3 years if this bull market continues: **We will continue to focus on business value.** As envy, fear of losing out and greed sets in, prices will get higher and we will begin to find lesser opportunities and may even choose to sell and hold cash. And like *every* value oriented investor, we may, by not chasing momentum, see temporary and reversible periods of underperformance. Being patient is never easy, especially if your neighbour is getting richer in a bull market. But this is exactly what we will try to do! This approach is better than chasing hot stocks and burning fingers in next correction. A thoughtful investment approach focuses at least as much on risk as on return. Whenever it has been easy to make money in equity markets, it has been even easier to lose it. Earning 16% for 10 years each will leave us with more money than earning 20% in 9 years each and losing 15% in the 10th.

Your continued trust motivates us to work harder towards our common goal of risk adjusted wealth creation. Thank you once again for reposing your trust in form of your capital contributions in the firm. Should you have any queries or feedback regarding above or otherwise, please feel free to share them with me.

Kind Regards

Sumit B. Sarda
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