Compound Everyday Capital
Partners first

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Letter to Partners CE7-Mar16 | Review of FY 2015-16

EXECUTIVE SUMMARY

- Our NAV fell by 7.6%. Nifty fell by 7.4%. This is after earning 99% over Nifty in two preceding years. All's well.
- In hindsight, we made the mistake of buying early. Prices fell further after we bought. We should be buying more gradually in the future.
- Intrinsic values of our businesses are intact/ growing. We added to our existing positions at 6.5% earnings yield.
- We remain aware of difference between price and value. Further, we believe that fear led volatility is usually a good time to buy.

Dear Partners,

"...If you can keep your head when all about you are losing theirs,
...If you can wait and not be tired by waiting..."

- Poem "IF" by Rudyard Kipling

Value investing is a pursuit of bargains, a pursuit of buying a proverbial Rupee for 50 Paise. If only we can keep our head and wait, fear led volatility is usually a good hunting ground for bargains. The year gone by was one such year. Welcome to the 7th edition of this letter as we complete four years of our partnership, 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, 2016	**9.2%**	**-22.7%**	**0.61x**	**18.5%**	**1.1%**	**16.3x**	**3.1%**	**0%**
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, 2016:

- Our "share of **earnings** in underlying businesses as % of our cost" (Earnings yield) fell by 22.7%, mostly due to purchases that we made this year (more on this in next page).
- Our "share in the **net assets** of underlying businesses as % of our cost" fell by 9%, due to the same reason.
- The trailing P/E multiple fell from 18.7x to 16.3x.
- In response to the new dividend tax starting w.e.f. April 1, 2016 many Indian companies announced special dividends. Our dividend yield would have been lower by 0.2% this year if we exclude their impact.
- Hedge cover – we have 6% of our portfolio in cash equivalents. We donot own any put options.

A2. NAV Performance

Period Ended	Compound Everyday			Nifty		Outperformance	
	NAV	Firm's Return	Return to Partners	Nifty	Return#	Firm	Partners
March 31, 2016 (A)	**264.5**	**-7.6%**	**-4.6%**	**7738**	**-7.4%**	**-0.2%**	**2.8%**
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		164.5%	**106.9%**		51.1%	113.4%	**55.8%**
Annualised		30.8%	**22.2%**		12.1%	18.8%	**10.2%**

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

For the financial year ended March 31, 2016:

- Firm's **NAV** fell by 7.6%. The partners lost 4.6% on average this year, but earned 22.2% annually since our inception.
- NSE Nifty fell by 7.4% with dividends reinvested. Partners' returns could outperform the Nifty by 2.8% this year and by 10.2% p.a. since our inception.
- After outperforming Nifty by 99% over last two years, we are happy to have fallen by similar percentage as Nifty this year.

Annual NAV underperformance doesnot bother us and annual NAV outperformance doesnot excite us because that can be due to factors other than fundamentals, especially, *randomness*.

While daily price change is a noise, the emotions they evoke are *real* and many times lead to *wrong actions* (sell low, buy high). To ensure that your emotions remain *outsourced* to us, we limit the number of times we tell you the NAV (twice a year). One of the laziest ways to end up with multibaggers is by *not checking prices daily*.

Of course, telling you prices twice a year doesnot ensure positive return in any one year. It does take emotions out of the equation. While we cannot promise a positive performance *every* year, we can *promise* following:

a. Most of your managing partners' and their family's networth will stay invested in this firm.
b. We will inform you whenever managing partner or their family introduces or withdraws funds and the NAV at which they do so.

c. We will operate with profit share, zero fees/ load, and with almost nil cost structure (frugal office setup, low portfolio turns and low taxes).
d. In long run, we will make more than a fixed deposit.

We welcome 13 new partners who joined us this year. They along with existing partners introduced new capital of INR 1.8 crores (INR 18 mn).

Your managing partner and his family continues to hold major stake in the firm. They have not withdrawn any money since 2012, the year we started this firm. Moreover they lost more money in % terms owing to profit/ loss share structure. **They will remain first to be hit when things go bad.**

Audited results are attached to this letter. As promised, no expense stands charges to the partnership save the audit expenses. Total expense stands at 0.18% of realised income and 0.004% of portfolio this year. Costs saved flow directly to partners' kitty in form of higher NAV.

Old partners may skip this paragraph. The results and NAV that we discuss in this letter are marked to market (includes unrealised profits/ losses). However, for tax purposes our financial statements (sent separately) are recorded on historical cost and exclude the unrealised profit/loss. Inputs for your tax returns are included in the annexure. Your share in the firm's earnings is tax free in your hands. A skim through of past letters should help new partners in understanding our reporting philosophy.

B. DETAILS ON PERFORMANCE

B1. MISTAKES & LEARNINGS

As we look behind, this year we made the mistake of **buying early and quickly** as markets fell. Influx of new capital can be one of the reasons for this. We should have been slow and gradual, for prices fell further after we bought. Of course, timing the bottom is difficult, however overreactions are normal in markets and we should have kept some dry powder for eventuality of cheap getting cheaper.

It is interesting to recall that in Cera Sanitaryware (2013) we made the mistake of selling early and learnt not to do so. This time we bought early and learnt again not to do so. In investing being early is not different from being wrong.

C. OTHER THOUGHTS

Overcoming Fear

If there is one thing that can get in the way of our shared path of wealth creation, it is fear. And if there is one thing that will collectively make us better investors, it is overcoming fear. It is during the darkest hour of fear that greatest bargains are found. And during those times our *greatest mistake* would be selling instead of buying or holding.

The main cause of fear is that normally when stocks are falling, everything else is falling too including cash and confidence. There are no landmarks or shady trees to take shelter under. Investors would take out money from stocks to meet other expenses/ liabilities. We cannot be fearless just by deciding not to be fearful. We need *antidote* that works.

The only antidote to fear from price fall is to PREPARE FOR BAD TIMES; to arrange our affairs in such a manner that we are not hard pressed for cash during recessions – both at individual level and firm level. At firm's level, we do it by not taking any debt, keeping idle cash (currently 6% of portfolio), and also opportunistically buying hedges.

Lollapalooza Effect

Charlie Munger, the partner of Warrren Buffet, talks about "Lollapalooza Effect" –non-linear impact of confluence of powerful forces all acting in tandem. We have tried to create a lollapalooza effect in our investing set up by borrowing what has worked in investing from history.

Specifically, we buy with margin of safety companies that we understand and which can grow their value over time. We are risk conscious both at stock and portfolio level. Our first instinct is protection of capital. We donot take loans or trade in derivatives.

We are small and flexible. Our opportunity set is large as we donot restrict ourselves based on sectors/ size of investments. This allows us to fish in pond with most fishes.

Incentives of managing partners are strongly aligned with partners. Both are working for profit share, there are no fees. By keeping small office, low portfolio turnover and near zero taxes, we work on an absurdly low cost structure. We take pride in the fact that we may have one of the lowest cost structures in the world.

The above features, embedded in the DNA of our firm, create a lollapalooza effect on our investment process and should keep us in good stead.

We feel blessed to have association of long term oriented, rationally thinking partners like you. 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
Compound Everyday Capital
