Dear Fellow Investors,

At the outset we wish to thank you for the faith reposed in us by investing in our Plan.

We will communicate with you every quarter; in part to inform you about the quarterly performance, but also to elaborate on some aspect of our investment philosophy or process. Over the course of time you will observe that we emphasise as much, if not more on the latter as on the former. This is borne out of our belief that a sound investment philosophy executed through a process that is unfailingly adhered to, will over the long term, inevitably lead to satisfactory investment returns.

We would like to caution you against laying too much emphasis on the quarterly performance numbers. In compiling our quarterly scorecard we are obliged to measure our performance against the market. You will observe that there will be months where our performance will be superior to the market (as reflected by the 'Sensex') as well as months when our performance lags the market. This should come as no surprise. Short term movements of the market are capricious reflecting the unpredictable and often exaggerated sentiments of the sum total of market participants as they react to the sum total of developments in the political and economic fields. This by nature is a combination of an (un)healthy dose of impulse together with reason. Our struggle is to tune out precisely this 'noise' emanating from the market place, whilst we attempt to assay the intrinsic worth of individual securities. Quarterly performances vis-à-vis the market are therefore more a measure of how 'in sync' we are with the prevalent moods of Mr Market – a goal that we have no particular skill or desire to pursue.

Analytical Framework: Non Moat Businesses

It will be our endeavour in these letters to flesh out some aspect of our investment process. ***In the previous letter we dwelt at length on valuing securities which have economic moats***. ***In this letter we will focus on our process of valuing businesses which do not have economic moats.*** These companies are therefore subject to the vagaries of competition apart from the general economic forces which accompany business cycles. Whereas companies with economic moat have the ability to ward of competitive pressure to some extent, companies of a more commodity nature lie exposed to the full brunt of competitive onslaught.

In the face of this competitive onslaught, companies with a commodity character having limited ability to protect their profit margins are subject to a significant volatility in their profitability. Given this volatility in profitability it is impossible to predict annual profit margins going forward. Under these circumstances, a discounted cash flow (DCF) methodology of estimating the value of the business is rendered useless (as is, by the way, a P/E basis of valuation, which is nothing but an abbreviated DCF).

To value businesses having this commodity like characteristic, we seek refuge in elementary economic theory. Economic theory suggests that industry cycles are brought about by the law of supply and demand. During periods where demand outstrips supply in any industry, prices of the product of that industry rise. And with that, the profits of that industry rise. Entrepreneurs enticed by the prospect of rising profits plan new capacities. Fuelled by an enthusiasm attendant to burgeoning demand, the capacities implemented are often far in excess of demand. This results in the virtuous cycle turning into a vicious cycle of reduced product prices and diminishing profits (often to the point of marginal producers in the industry making losses). Capacity is shut down, mothballed or bought over by stronger players. But under these

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circumstances no fresh capacity is created. As demand rises with the passage of time, in the absence of capacity creation, prices are fuelled as are profits and the cycle is repeated.

In this ebb and flow of the industry's profits, strong players in the industry are confronted with a choice when contemplating capacity expansion. They can either create fresh capacity through a greenfield or brownfield expansion. Or they can go to the stock market and takeover existing weaker players in the industry. This is the typical 'make versus buy' decision. At a simplified level the calculation is what would it take for me to create anew, the capacity that already exists. If it is cheaper to buy than make, then takeovers ensue until such time as the prices of stocks of existing players reflect the 'replacement' value of their capacity. Any stock price lower than this, would invite bids from stronger players in the industry who want to expand their capacities.

In a frothy industry situation, when the profitability of the industry is rising, stock market valuations of the companies in the industry rise. Often, to valuations which are far in excess of the underlying replacement cost of the company's assets. Under these circumstances, entrepreneurs float companies in a market which is willing to pay them more than what it costs them to create the assets. The resulting capacity creation serves to dampen the prices of the products in the industry and the participating company's profitability.

In either case you will notice the strong pull that replacement costs exert. Stock prices in commodity based companies tend to fluctuate around the replacement cost of assets. During bad times they tend to be at a fraction of the replacement cost. At times when the industry is performing well, they tend to quote at somewhat of a premium.

We use the replacement cost metric in our valuation studies, and value stocks in such businesses on the basis of this metric.

Performance: latest quarter

Whilst your individual returns are with you, we have given the weighted average results of all portfolios in the plan for December quarter (before our management fees but inclusive of all other expenses and charges). We would once again urge you to interpret quarter by quarter returns of any fund manager with some caution.

Benchmark (Sensex) returns	2.97%
Weighted average Portfolio Returns of Value Trek Plan	(0.90)%
Proportion of cash held at the beginning of period	24.24%
Proportion of cash held at end of Period	40.86%#

- Weighted average portfolio return is for less than 1 year and is not annualized.
- The benchmark return is also for a period less than one year and is also not annualized. Benchmark return is absolute change between start of the period to end of the period without any adjustment for fund flows during period.
- Portfolio return is based on weighted average returns of portfolio compounded monthly.
- The actual returns of clients may differ from client to client due to differences in composition of the portfolio and timing of investment/divestment.
- Past performance is not a guarantee for future performance.

Cash held at the end of the period is higher due to addition of new client(s) during last month, wherein no equity investment was done by month end. Excluding this, for the existing portfolios, cash and debt investment at the end of the period amounted to 24.60%.

We have in the past sought not to elaborate on quarterly performance. However given the large 'draw down' in last six months we believe that a few words are in order. We have chosen the Sensex as the benchmark index for comparison purposes largely due to the ease of interpretation. Simply put, it is a widely followed

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and disseminated index. However, at this point our portfolio composition comprises of many mid cap stocks mainly in the financial sector and other cyclical sectors. These have been out of favour in the recent past, but especially so in the last two quarters as is evident from the table below:

	Return for the quarter ended	
Index	31st March 2013	30th June 2013
BSE Mid Cap	-13.6%	-2.9%
BSE Metals	-20.9%	-11.5%
BSE Capital goods	-17.0%	1.0%
BSE Bankex	-9.1%	1.7%

We once again wish to reiterate what we had written in our last letter.

It is not uncommon for out of favour sectors (which is why they are cheap) to experience marked downside volatility and become cheaper. We have examined our holdings and are satisfied that none of the diminution in value represents permanent destruction of capital.

Please do contact us for any further clarification.

Regards

Vinay Parikh
(Portfolio Manager)

Pramod Dangi, CA, CFA
(Portfolio Manager)

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General risk factors

i). Securities investments are subject to market risks and bear no assurance or guarantee that the objective of the investments will be achieved.

ii). Past performance does not guarantee future performance.

iii). Investors are not being offered any guaranteed or assured returns i.e either of principal or appreciation on the Portfolio.

iv). The Portfolio Manager is neither responsible nor liable for any losses resulting from the operations of the Portfolios.

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