8th January, 2016

Aurum Small Cap Opportunities & Aurum Growth Portfolio

12th Quarterly Update – QE December 2015

Dear Investor,

We are pleased to announce the completion of three years for our small cap strategy. What started out as a high conviction concept has played out well, delivering significant outperformance during this period. We would like to take this opportunity to thank our investors, especially our early investors, who believed in us during times of risk aversion and showed courage of conviction in our investment philosophy.

At the risk of sounding repetitive, we wish to once again highlight that key to risk mitigation in our universe is better business understanding to differentiate 'wheat from the chaff' and buying quality businesses at reasonable valuations.

So what did we do right? We did rigorous research, did not give into short term pricing temptations, stayed away from businesses we could not get our head around and steadfastly followed our disciplined portfolio process. We did some lateral thinking and looked for ideas under the stone, like change in leadership, social & structural pain points, emerging & declining trends, etc. Often, during this journey, we had little to showcase in the short term and had to wait patiently for our investment thesis to play out over time. We kept our head down, stuck to our knitting and kept faith in ourselves.

Platforms like Uber allow platform owners, service providers and users to constantly co-create and consume value in an exponential manner by virtue of network effect.

Participants use platform technology on the demand side to disrupt supply side economies of scale.

Business disruption, order of the day

We cannot afford to rest on our laurels as we see the world morph & change rapidly around us into a multi-platform centric world. In a platform connected world, business & technologies that appeared robust are looking progressively vulnerable and disruption is the order of the day. It is our continued endeavor to look beyond the horizon and try to anticipate the impact of disruptions and if possible, the disruptions themselves.

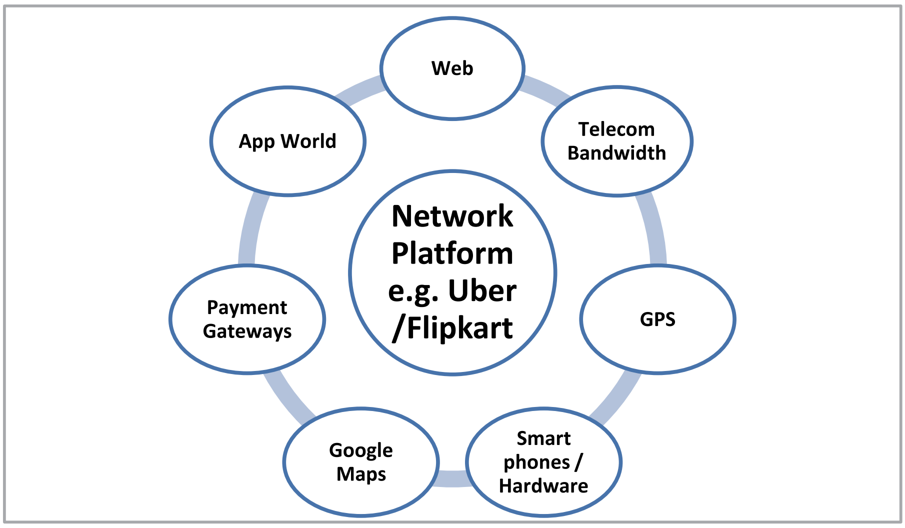
Platform connected world

Uber needs no introduction! In fact, Uber is one of the few nouns added to our vocabulary, which has assumed proportions of verb *(to uber)* and adjective (*uberised*). The other word that comes to our mind, which assumed such proportion, was Google and Xerox, prior to that! Google transformed the way we seek information, view & interact with the world. Uberization is changing the way commerce is practiced. This is our attempt to understand the mechanics and economics of a platform centric, non-linear world.

Mechanics and economics of platform centric world

In traditional business models, economies of scale are sought to be achieved at supply / production side (upstream) and the products consumed downstream, in linear flow. In contrast, platforms like Uber allow platform owners, service providers and users to constantly co-create and consume value in an exponential manner by virtue of network effect. In other words, they use platform technology on the demand side to disrupt supply side economies of scale.

The co-creation & consumption happens at the confluence of web, telecom bandwidth, GPS, smartphone, google map, payment gateway and finally the App world.



Source: NRC Research, Fig 1

A few such platforms plays which are transforming our landscape are given below:

Poster boys of platform centric business

Company	Sector	Business description	Impact
oyo ROOMS	Hospitality	Platform to discover & book curated non chain, standard hotel properties.	Knock-on effect on mid tier hotel chains, as stand alone hotel properties are more optimally utilized on the back of curated minimum quality assurance
hola chef	Food & Bev	Chef market place. Brings together independent chef / house cook, managed and curated by the platform.	Makes housewife & independent chef an economically productive person and in turn dents business of quick service restaurants (QSR)
Bla Bla Car	Transport	P2P car ride. Connecting people to share a car ride between cities.	Reduce business for pure taxi services and in long run reduce demand for owned car

A more exhaustive list is given in the Appendix at the end of this Quarterly Update

Platform entities like Uber does not own the car or taxi license, AirBnB / OyO don't own any hotel rooms, Hola Chef does not employ any chef or own the kitchen! Etsy or Craftsvilla does not have manufacturing or employee artisans.

The list above is representative and not exhaustive. To state the obvious, platform entities like Uber does not own the car or taxi license, AirBnB / OyO don't own any hotel rooms, Hola Chef does not employ any chef or own the kitchen! Etsy or Craftsvilla does not have manufacturing or employee artisans.

In other words, the owner of asset, the service provider and the platform owner are distinct entities, with a multitude of asset owners, service providers and consumers, converging on a platform.

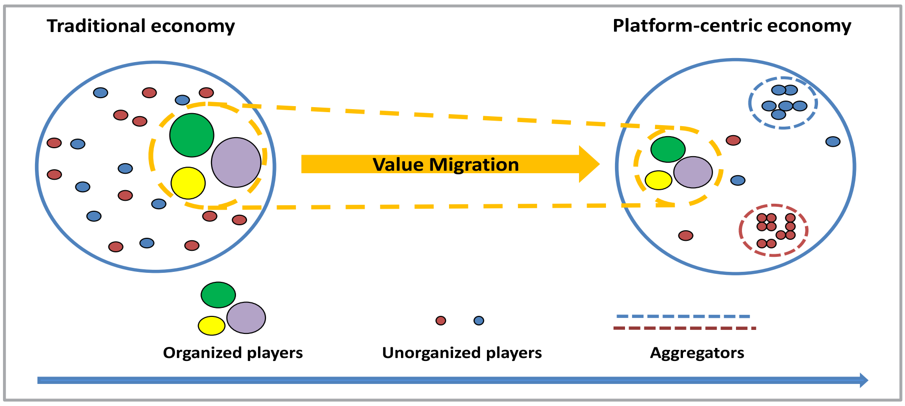
Together on a platform, they create a network effect, which in turn has a cascading knock-on effect on established & traditional business models

As they come together on a platform, they create a network effect, which in turn has a cascading knock-on effect on established & traditional business models and finally results in migration of value away from traditional business models.

Mechanics of platform centric business - Network effect (Metcalfe's law) creates knock on effect & leads to migration of value

Network effect is also known as demand-side economies of scale and is not to be mistaken for supply or production side economies of scale. More the people using a product or service more valuable it becomes. Mobile phone is a classic example of network effect. The more people own mobile phone, the more valuable the mobile phone is to each owner. Online social networks like Twitter, Facebook, Linkedin, YouTube, market place like Amazon, Flipkart, Alibaba, work in the same way and thrive on network effect. An important factor that positively impacts network effect is interoperability (open systems) with other systems as seen in the case of Android and Microsoft Office. In extreme cases, network effect skews the ecosystem, wherein it creates a Winner Takes All situation, as evident in case of Microsoft, Google Chrome, Facebook, YouTube and Wikipedia.

Network effect creates a knock on effect & leads to migration of value

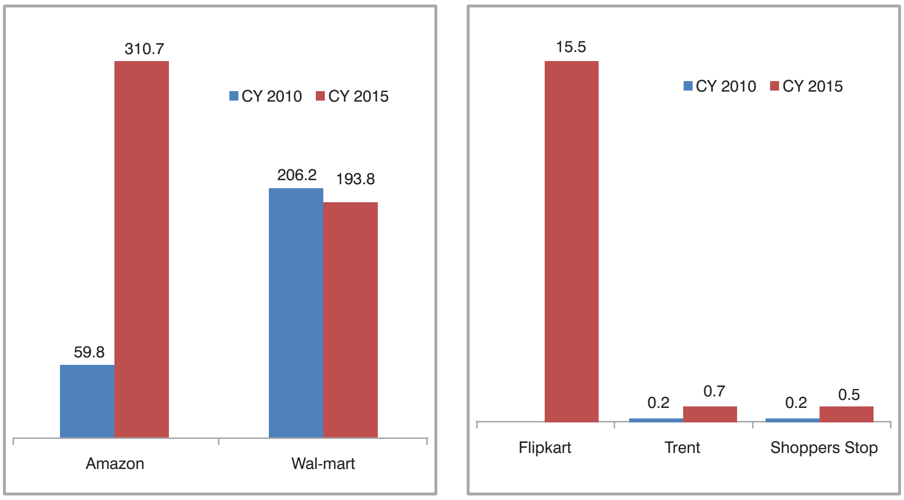


Source: NRC Research, Fig 2

Platform centric business models lead to efficient aggregation of participants on a platform and better utilization of assets. Resultantly, the competitive intensity increases significantly across the value chain. This has a cascading *knock on* effect on the traditional & established participants, both in terms of market share and price point.

As the traditional participants feel the competitive pressure (Fig 2 & 3), value tends to migrate to platform based business models, away from traditional business models. *Value migration* happens in anticipation of either deteriorating financial matrices of traditional business models or on the expectation of a platform based or technology dominated new normal.

Value migration: Traditional to platform centric business (USD bn)



Source: NRC Research, Fig 3

Philosophically, a platform centric economy can also be looked upon as system where the small and the unorganized gain strength by coming together on a platform.

As would be evident from Fig 3, the economic value of brick & mortar companies *(Wal Mart or Trent & Shopper Stop in India)* have largely remained unmoved compared to the value accretion in case of Amazon or Flipkart.

This is in no way an attempt to justify the multi-billion dollar valuation being enjoyed by some of the platform centric companies, even as they continue to lose money, year after year. It is more an indication of the direction of the new and evolving business models, as was seen during the dotcom boom. While most dotcom companies did not survive the bust, the survivors like Google & Amazon more than justified the valuation bestowed on the sector during the dotcom bubble and thereafter. We are likely to see the same being played out in this leg of business evolution as well.

Philosophically, a platform centric economy can also be looked upon as system where the small and the unorganized gain strength by coming together on a platform. It is a democratic, capitalistic system in full play, wherein participants are free to join, leave, migrate, oppose or create.

Impact of the New Normal

Even as they gain traction, significant regulatory and social headwind is likely to be faced by Uber-like companies as they disrupt the labor market, business of intermediaries & brokers and tax revenues of governments. Furthermore, the disruptive can also be quickly disrupted out of business. But at the end of the day, they are here to stay. The new normal is happening and disruption is the order of the day.

Industries ripe for Uberization are those where the service quality is poor, mismatch between price and value perception and where delivery model has remained largely unchanged.

We believe, industries ripe for Uberization are those where the service quality is poor (government services, brokers & intermediaries, handymen services), mismatch between price and value perception (short stay luxury hotels, car ownership) and where delivery model has remained largely unchanged (transport, finance, government.)

We believe, industries likely to get significantly impacted are Automobile (passenger), Financial Services, Hospitality and certain segment of Luxury Consumption.

We look at these fundamental changes as both an opportunity & a threat. Thus, while evaluating industries and companies for investment, we try to incorporate possible disruptions and opportunities thereof, with 3-5 year time frame.

Listed below are some organized industries that could get significantly impacted in the short to medium term are (disruption already having started in some):

Automobile industry: Possibly seeing the largest disruption with likes of Uber, ZipCar, BlaBlaCar. Further advent of ***'Androidation'*** (google software in driverless car) of car may well impact the ownership and usage pattern of cars and eventually size of the auto industry.

Financial services: P2P lending & crowd funding of social impact projects could impact the microfinance and SME lending portfolio of banks. It can also enable social innovation.

Hospitality: This sector is seeing a significant impact as the traveler are opting for out of the way and less well known accommodation options using the likes of Oyo, AirBnb.

Luxury Consumption: It's only a matter of time before a luxury item or an object of desire is manufactured bespoke on a platform and shipped to consumer. This could have an impact on luxury products industry and the way they are consumed.

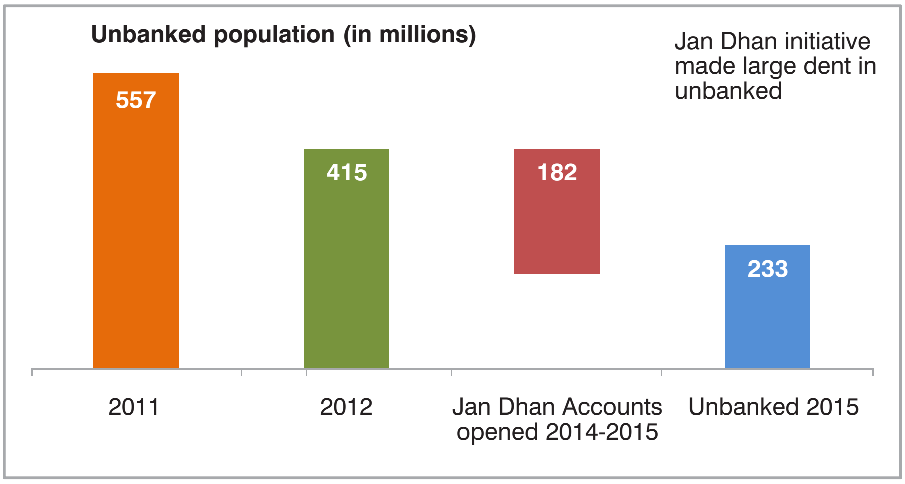
While the economic impact of platform centric business model is obvious, the long term social and cultural impact is well beyond comprehension. We believe that it will change us as a population as we are exposed to new people, ideas, cultures & systems and as our acceptance of the same grows over time.

The disruption that we spoke of is sweeping into unprecedented corners of the economy, through a confluence of technology and scale. Banking/ Finance is no exception to this tsunami of disruption.

India – Coming digital financial revolution

While millions of Indians historically did not have access to the banking system, the number has seen dramatic reduction from 415m (FY14) to 233m (FY15), since the launch of Pradhan Mantri Jan Dhan Yojana. We expect this trend to continue and see this as a beginning of a technology enabled financial revolution in the country.

Banking for all



UPI (Unified Payment Interface) basically entails convergence of banking system with telecom networks and will provide a single interface for all payment systems.

Ample evidence of this can be seen in the success of M-Pesa in Kenya, where technology was used to circumvent infrastructure issues, to bring low-income, isolated populations into the financial eco system. Resultantly, today, half of all mobile money transactions in the world take place in Kenya, where annual transfers have reached $10 billion.

Something similar is underway in India. In a few months, we will experience a transformation in the way m2m, p2p and b2b transactions occur. At the heart of this metamorphosis is the UPI (Unified Payment Interface, NPCI). It basically entails convergence of banking system with telecom networks and will provide a single interface for all payment systems. This will mean that account holders across banks will be able to send/receive money from their smartphones using either their Aadhaar identity number or mobile phone number or virtual payments address without having to enter bank account details. The resultant interoperability will also allow money transfers from bank to mobile wallets and the network effect of the same is likely to be revolutionary.

Going forward, convergence of Jan Dhan, Aadhaar & smart mobile phones (JAM) will create a unique platform for credit appraisal & availability. Once the primary need of transfer & credit is satisfied, a whole gamut of secondary services like medical insurance, life insurance, crop insurance, etc. will come into play.

We expect credit availability to small and mid-sized players to get revolutionized and better priced.

JAM & UPI, in conjunction with the roll out of new small and payment banking licenses, makes us very sanguine about the credit environment in the country. In the next 5 years, there is likely to be a dramatic build out of consumer financing to the bottom of the pyramid population. We expect credit availability to small and mid-sized players to get revolutionized and better priced, helped in part by credit score and a slew of government initiatives.

Some of these government initiatives are factoring exchange, by RBI, to ease the working capital pressure on MSMEs) and Mudra bank (for MFI financing). Also the quality of data analytics done by Bank/NBFC is improving dramatically due to the availability of data and credit history of consumers. Therefore, underwriting credit will become faster. With 94% of the workforce in the country being self- employed; the potential for credit penetration is huge.

As these initiatives gather steam, we anticipate incomes of the rural and urban poor to increase. Studies have shown that in Kenya, rural households have seen an increase in their incomes anywhere between 5-30% when they used M-Pesa. The marginal propensity to consume is much higher in the poorer section of the society and as their income increases we expect a consumption boom in the country in the coming years.

The social, economic and political impact of the aforementioned changes would be extraordinary and far reaching. The corollary impact of these changes would be a move towards a cashless economy, bringing more people in the tax net and an eventual reduction in corruption. We believe there would be rush to aggregate customers in the bottom of the pyramid – by banks, telecom players or entities with widespread distribution such as consumer goods companies etc. With more money in the hands of the consumer, we clearly see investment opportunities in the consumption space catering to the BoP segment, agri implements, media (vernacular newspaper, DTH), financial services, home building etc.

The economy is facing deflationary pressure and most industrial capacities are operating at sub optimal levels. Thus, going forward it would be fair to assume that the investment cycle can only be kick started with government investments and an uptick in consumption. Fortunately, subdued oil price provides the necessary cushion to the Government to undertake such investments on its own, as is evident from the large number of infra contracts that have been awarded in recent times. That being the case, we are working towards discovering ideas which fit the aforesaid investment & consumption pattern.

Please feel free to call or write to me for any further information.

Warm regards,

Sandeep Daga

ANNEXURE

Company	Sector	Business description	Impact
airbnb onefinestay couchsurfing	Hospitality	P2P accommodation. Enables you to rent someone's house or non-hotel room while on long travel.	Ensures optimal utilization of hospitality cum housing assets, , impacting demand for standard hotel rooms. Knock on effect on hotel industry.
zipcar	Transport	Car usage by day /hours	Disrupt car ownership, rental business and impact OEMs car sales. As per reports, every sharing car can replace 13 regular owned cars
local oye UrbanClap TaskRabbit	General Service	Connects handymen for jobs like plumbing, electrical, repairs, designing, marketing, etc. with consumers	Enable handymen & freelance professional to be more optimally employed, enhancing their earning potential and drawing them closer to the formal sector
shaadi.com tinder	Service	Connects men & women directly with each other while maintaining confidentiality and distance	Disrupts business of curated matchmaking, value of which was in closely managing access to & information of potential bride & groom

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Company	Sector	Business description	Impact
Craftsvilla Etsy	Consumption	Connect local artisans & designers directly to customers across a larger geography	Exponentially increase the market reach of freelance craftsmen, disintermediate middlemen, help create/promote local brand and skill, wherever applicable
Kabbage LendingClub Funding Circle	Finance	P2P lending& equity funding. Micro loans for small business men, approved and disbursed online	Impact traditional microfinance and SME lending business of banks
BMTFT sociotransit zaldee.com	Logistics	P2P shipping of small items by travelers	Impact courier business at the margins
MOOC	Education	On line learning & corporate training	Traditional colleges and training institutes likely to feel the pinch

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