Motiwala Capital LLC

www.motiwalacapital.com

Fourth Quarter 2014 Letter

Dear Investors,

The year 2014 ended on a strong note with the US equity market as reflected by S&P 500 up \sim 14% The US markets are in an amazing six year bull market with the S&P 500 having tripled from the lows of March 2009. Motiwala Capital had a below average year with consolidated net return (after all fees and expenses) of \sim 4%. The consolidated number means some accounts performed below this number and some above it. See important notes at the end of the letter for more information. The performance information is shown in the table below:

Year	S&P 500	Motiwala Capital
2011*	-1.7%	4.9%
2012	16.0%	20.3%
2013	31.9%	33.2%
2014	13.7%	3.9%

2014 Performance

Overall our performance in 2014 was poor both on absolute and relative basis. There were more winners than losers but two large positions suffered large declines hurting overall performance. Positions detracting from performance included North Atlantic Drilling (-80%), Prosafe (-57%), CTC Media (-33%), Blucora (-27%) and International Housewares (-22%). Our biggest winners were Microcap H (+90%), Microcap L (+48%), Apple (+42%), Visteon (+40%), Microsoft (+25%) and Oracle (+20%).

In addition, 14 of the 17 special situation investments during 2014 were profitable (or breakeven) and positively impacted our portfolio returns. We will continue to invest in this area and believe it distinguishes our management style.

Discussion on winners

Microcaps H and L were purchased at low valuations. Both exhibited strong earnings growth and were rewarded with higher valuations resulting in superb gains. Apple had a fantastic year, releasing exciting new products and continuing to return capital to shareholders via share buybacks and dividends. Investors were more optimistic and the share price headed higher. Visteon continued to divest non-core businesses and investors were happy. Recently, the company announced the sale of its majority stake in publicly traded Halla-Visteon for \$3.6 billion. Visteon will be left with only one business segment and could be potentially acquired. Microsoft and Oracle reported business as usual generating solid free cash flow and continued buybacks and dividends.

Discussion on mistakes

High leverage, capex and high dividend payout The positions in North Atlantic Drilling (NADL) and Prosafe (PRSEY) hurt the portfolio returns by 6%. These were the biggest mistakes since 2011. Both companies are in the energy service industry, cyclical in nature and dependent on capital spending by large oil producers, which in turn depends on crude oil pricing. NADL and PRSEY had significant capital expenditures and high levels of debt. To add fuel to the fire, they had a high (75-100%) dividend payout policy. The combination of these three factors in a cyclical business is too risky. I will guard against this in the future.

Prosafe warned about weakening demand and potential dividend cuts in its Q2 earnings. The stock price fell and I felt that the bad news was priced in. In the case of NADL, its agreement with Rosneft did not close due to sanctions against Russian entities. NADL suspended its dividend given the weak outlook. From mid September, crude oil prices started declining and there was a meltdown in late November. Most energy related stocks including NADL and PRSEY declined sharply as result.

When the situation changes I purchased shares of Russian media company CTCM Media (CTCM) in March 2014. My argument then was "CTCM has a solid balance sheet and produces attractive free cash flows. CTCM was purchased for 10%+ FCF yield. When Russia moves out of the front-page news, I hope the stock would be higher." After purchase, the stock appreciated by 25% despite Russia continuing to be in the headlines. The stock was still cheap and I continued to hold. However, in late September Russia passed a law restricting ownership of Russian media companies to 20% from the prior 50%. This was unexpected and the stock price took a 20% hit. Later the stock was also hurt by the rapid depreciation of the Rubble, which was caused by the rapid decline in crude oil prices. CTCM indirectly became linked to energy prices. My mistake here was not selling immediately after the media law change, which would have reduced our losses.

Portfolio Composition

Our portfolios are divided into two sections. The 'Generals' are generally undervalued equity investments that fit the value framework. The rest of the portfolio is invested in special situations (short term investments with a specific event that unlocks value) or cash. Average cash balance at the end of 2014 was 45%. The top 5 positions add up to 25% of the portfolio.

We have 16 regular positions (Generals) in our portfolio. This makes up \sim 45% of the portfolio. The rest of the portfolio is currently in special situations (10%) and cash (45%). Cash is 30% higher over last quarter end due to heavy selling as explained later.

Portfolio Characteristics

Weighted average P/E = 12 (P/E is based on 12-month trailing earnings) Portfolio dividend yield = 2.4% Weighted average Market Cap = \$55 billion

Price to Value (P/V)

For every stock we purchase, we estimate a range of fair values. We compute a ratio of current market price (price) to estimated value (value). Price to value on the invested portfolio was 0.83. Lower P/V means better upside and limited downside. A higher P/V points to lower future upside potential for the portfolio. We will continue to look for attractive investments that will help to lower the P/V at the portfolio level.

Top 7 Positions (some clients will not have all the positions and in the same weights)

Company name (Ticker)	% of portfolio	B/S	Div	FCF	ROIC	Val
Visteon (Equity and Warrants)	7.5%	Y				Y
Microcap H	5.6%	Y	Y	Y	Y	Y
Outerwall	5.4%			Y	Y	Y
Oracle	3.6%	Y	Y	Y	Y	Y
Blucora	3.3%	Y		Y	Y	Y
Qualcomm	3.1%	Y	Y	Y	Y	Y
Conrad Industries	3.1%	Y	Y	Y	Y	Y

For the above stocks, we have provided information about which characteristics they satisfy

B/S = strong balance sheet

Div = pays a dividend

FCF = solid free cash flow

ROIC = solid Return on Invested Capital (ROIC)

Val = low/reasonable valuation

Portfolio by Market Cap

Micro cap	18%	less than \$250m
Small Cap	15%	\$250m to \$2billion
Mid Cap	9%	\$2 billion to \$10 billion
Large Cap	8%	\$10 billion to \$200 billion
Mega Cap	5%	\$200 billion +

We have invested across the market cap spectrum and are market cap agnostic.

Portfolio by Sector

Sector	Weight
Technology	12%
Consumer Discretionary	12%
Financials	7%
Energy	6%
Telecom	3%
Consumer Staples	3%
Industrials	1%
Special Situations	11%
Cash	45%

We do not seek investments by sector. We make our investments one stock at a time. However, as part of risk management, we want to make sure that our investments are across multiple sectors.

Portfolio Activity

Special Situations: Share tenders

We participated in two special situations in the quarter that were profitable.

<u>Generals: Portfolio exits</u>: We sold out of seven positions in the quarter. Some positions were sold as they hit our price targets, while some were sold when I was concerned about the business or the situation had changed.

Microsoft (MSFT): We purchased shares of Microsoft in early 2011 around \$26. During our 3+ years holding period, Microsoft has continued to be very profitable, generate lot of free cash flow, paid dividends and buyback shares. A new CEO has come in and the market perception has improved. We sold our shares around \$46 as the stock price appreciated to our price target.

Vodafone (VOD): Vodafone shares were also purchased in early 2011. It owned 45% of Verizon wireless back then. After the sale of its stake in Verizon wireless, VOD made some acquisitions in Europe and decided to invest heavily in its network. The major part of its business is in Europe and has been struggling for several years. The negatives from Europe are greater than the positives from the rest of its business in Asia and Africa. Finally, VOD has gone from net cash to net debt on its balance sheet to finance the dividend and capex. These combined factors swayed us to sell the position.

Amcon Distributing (DIT): DIT was purchased in the second quarter of 2013. DIT is a wholesale distributor of consumer products to convenience stores. Since our purchase, business results have been soft with declining earnings and ROE on increasing competition. Despite this, the stock price appreciated, seemed fairly valued and we sold.

Hess Corp (HES): We sold our remaining shares of HES. HES was purchased as a special situation when it was selling assets, paying down debt and buying back shares. HES has now become a pure play E&P company. I had no interest to own HES beyond the asset sales. I was holding on for the announced spinoff of an MLP. However, with declining crude oil prices, it made sense to close the position.

National Oilwell Varco (NOV): NOV was another energy services company in the portfolio. It is a high quality albeit cyclical business with a solid balance sheet and generates good free cash flow. NOV was sold in response to the sharp decline in crude oil prices. A major part of NOV business is providing equipment and parts for rig systems. I do not know how this business will perform 2016 onwards given the excess supply of deep-water rigs.

CTC Media (CTCM): We sold our shares as explained earlier.

Generals: New Positions:

GameStop (GME) makes a second appearance to our portfolio. GME is the largest video game retailer in the world and sells new and used video game software, hardware, accessories for video game systems from Sony, Nintendo and Microsoft. Recently, GME has diversified into other concepts such as Cricket wireless stores and Simply Mac stores. GME has generated annual free cash flow of \$450 million. The capital allocation policy is impressive and allows for the distribution of up to 100% of free cash flow to share holders. We purchased shares at a dividend yield of 4% and 10x P/E. Last time we purchased shares of GME, the video game console cycle was long in its tooth. The new consoles from Sony and Microsoft were released in 2013. Sales of games for the older consoles have declined faster than the increase in sales for new consoles. This is weighing on recent results. Once software sales for newer consoles pick up, I feel the shares should get re-rated higher.

Generals: Reduced positions:

We reduced our large position in Conrad Industries (CNRD) as we grew concerned about the demand for new barges that CNRD builds. The stock appears cheap on a trailing basis but this is a cyclical business and we wanted to be a bit cautious after a superb multi year run.

We sold half of our remaining position in Apple (AAPL) after the stock doubled since our investment in Q2 2013.

We sold half of our position in Franklin Resources (BEN) as it traded close to our conservative price target. My initial assessment on the valuation was higher due to the large net cash of \$8 billion (25% of market cap). However, this cash is held overseas and is unlikely to be returned to shareholders. Also, recent asset flows have stagnated at this asset management firm.

Generals: Increased positions

During the quarter we increased our positions in Visteon warrants (VSTOW) and International Housewares (1373) as they were attractively priced.

High Cash levels

Cash in the portfolio grew to an all time high of 45%. The reason for this is simply because we sold (33%) a lot more than what we bought (5%) in this quarter. It has become increasingly difficult to find attractive investments as markets overall have run up. However, I continue to look for investments to deploy some of the cash. Often investors question when there are high cash levels as it can detract from performance in a period of rising markets. The value of cash is two fold: it acts as a buffer in declining markets and the optionality it provides to make purchases.

Special dividends: Once again Conrad (CNRD) gave us a Christmas gift and declared a special dividend of \$1/share. On our original purchase price of \$15, we have already received \$5/share in dividends. Conrad also instituted a regular quarter dividend of \$0.25/share. Asset manager Franklin resources (BEN) declared a \$0.5/share special dividend and raised it dividend.

Other news: I am happy to report that I have moved into my new office. At year-end, our AUM was \$5.4 million.

We wish everyone a prosperous and happy new year 2015. Please contact me if you are interested in our managed account services.

Sincerely,

Adib Motiwala

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