SEBI Registration: INP000005944

1st May, 2023

Annual Letter to Partners

We discuss:

Choosing your Crazy

What's our kind of Crazy?

Being Patient versus Being Wrong

Endogenous Risks versus Exogenous Risks

The Absurdity of "Closely Monitoring" Existential Risks

Dear Partners,

I tend to doggedly focus on long shelf-life topics that hold sway over durations that match our investing timelines rather than ephemeral events with transitory impacts. True to this tradition, in this letter I seek to address a few reflections that emanated from discussions with a few incredibly thoughtful friends with whom I've enjoyed spending time over the past several weeks. While I am grateful for these "intellectual bread crumbs" strewn my way, and ought to give due credit, they remain anonymous in respect of their privacy. That said, their energy and excitement toward India feels relatively unprecedented.

This is my fifteenth letter to partners – the frequency was initially quarterly but subsequently transitioned to a semi-annual format, which was more conducive to our content and context. These letters have enabled us to cover a lot of ground on the philosophical underpinnings of our approach. The progression of our letters may even be reflective of how certain nuances of our style have evolved over time. However, before I am accused of unendingly meandering on platitudes, future letters will likely be more focused on tangible facets of our investing style, including deep dives on portfolio companies, longform discussions on position sizing, portfolio construction and so on. Given this progression, future letters will be addressed exclusively to partners on our investing platform and will not be posted in the public domain online.

Stock-specific references have been redacted from this version of the letter.

Choosing your Crazy

Buffett famously compared interest rates to gravity in explaining the pull that interest rates have on asset prices. The long-term value of companies we own are inevitably and intrinsically intertwined with where rates will be over time. However, we spend no time forecasting any such factors. We do not believe in our ability to take pre-emptive actions on the basis of such forecasts and eschew the very act of forecasting. However, in following such an approach, we

are paranoid about ensuring that we aren't unknowingly making such implicit assumptions. Unbeknownst to one's self, one may well be naïvely making a decadal macro bet by virtue of how one is positioned today. In many ways, we think that choosing an investment programme is a lot like choosing where to sit along the spectrum of, at best, looking crazy and, at worst, actually being crazy. Over different time periods, one's own impression (let alone others') of where one is along this continuum can take big leaps back and forth.

Market forces continually aim to chip away at the "excess returns" that investors earn, much like competitive forces erode the "supernormal" profits companies earn. When companies are doing exceptionally well, and earning lucrative returns on capital, competition is lured. When competitors can easily imitate incumbents, capital gushes in and excess profits get competed away. In investing as well, excess returns keep getting "arbitraged away". The forms of arbitrage keep getting more sophisticated, minimizing the superior returns that investors can earn over time. Against this backdrop, investors ideally seek to develop programmes that can facilitate safe, sustained and accretive long-term investing performances.

I like overlaying an oversimplified framework of banks' business models on the trade-offs embedded in any investing programme. A bank has only a handful of levers it can pull or knobs it can calibrate in its attempt to achieve a particular return on capital threshold. In doing so, it is always engaging in all sorts of trade-offs. In some sense, one could argue that depending on how you define safety, the safest bank in the world will likely be over-capitalized by several-fold, overly-liquid by orders of magnitude, overly cautious in whom it lends to (and for how long) and who it borrows from (and for how long). It should not be surprising then that such a "Safe Bank" will likely struggle to earn anywhere close to a respectable return on assets or equity. Banking is a commoditized business with input costs (the cost of deposits) and output prices (the price of loans) being largely market determined – effectively set by the level of competitive intensity in the marketplace, which is likely a function of how flush or scarce capital is in that specific niche for assets and liabilities. Therefore, banks are often obligated to make (implicit or explicit) directional bets – for example, underwriting seemingly riskier loans that management thinks are significantly less risky (than widely assumed) due to entity-specific underwriting competencies. Absent any "bets" (which need to be consistently correct to ensure the entity survives, let alone thrives), a bank will struggle to earn a respectable return hurdle.

However, different banks may have varied pathways to reach the same goal post. Bank A may, for example, choose to borrow short duration liabilities and lend long duration assets, effectively taking a bet on its ability to refinance liabilities regularly and competitively relative to the price at which assets (loans) have been let out the door! Bank B may be building toward a similar return-on-assets target with very different knob & lever settings. No matter how you adjust those knobs and levers, it is highly likely that in attempting to design a model that is

capable of earning a palatable return threshold, your decisions will likely be reflective of your audacity – the audacity to believe that you can enjoy the robust returns implicit in your design without incurring the manifestation of the extreme risks that may have plagued others pursuing such an approach. In other words, your audacity to hold those beliefs (regardless of whether they are well founded or entirely misplaced) will very likely make you *look* undeniably "*crazy*".

If we zoom out a bit, isn't the act of investing in equities similar? There are gravitational forces (competitive capital arbitraging away excess returns) that anchor returns lower, to offset which, investors are nudged to make implicit or explicit bets on all sorts of "crazy" things. Think about any specific investing approach and identify its unique form of "crazy". For example, you may have a turnaround specialist, who is betting on poorly-run companies turning around their prospects. Isn't that crazy? To bet that mediocre businesses will magically reform based on new management, new approaches, new technologies or evolving industry structure… You may have someone owning exemplary businesses, by virtue of being willing to pay up for quality companies. Isn't that crazy too? To assume that the underlying characteristics of those companies can persist over time and that returns will be able to compensate for the prices paid… My point being, every approach, no matter how rational or reckless it may first appear, is fuelled by a vividly original audaciousness. In effect, choosing any investing style and sticking to it, essentially forces one to cultivate the clear-mindedness to "choose your crazy".

What's our crazy?

Our crazy is shaped by our experiences allocating capital in a specific contextual setting. I'll try to spell out our crazy without explaining or justifying it away – I've always believed that there's a fine line between attempting to clearly communicate and attempting to confusingly convince – while I try to hold myself accountable, at times I might meander, please stick along!

I'd articulate it as something like this: We're crazy in that we're unduly patient after identifying verifiably great businesses (zero tolerance for crazy) run by verifiably great people (zero tolerance for crazy) operating in ecosystems with unusually long, although sometimes difficult to explicitly quantify, scalability prospects. We're crazy in that we're not overly exacting in how quantifiable those scalability prospects should be upfront or even in terms of what those scalability trajectories should look like over time. That is crazy. Although we recalibrate our assessments as trajectories become apparent, it can be highly unsettling to most, to hold a thesis-critical opinion when confronted by thesis-disconfirming data.

As an example, it's hard to build a measurable judgement upfront on whether we will live in an India a decade from now, where higher-powered motorcycles or tech-enabled exchange platforms or prudent, agile private lenders constitute X% or 5X% of industry size. We may have our preconceptions, and each one of those may have varying levels of historical validation, but we don't find the need to have an exactness around it. More so, it's hard to continue to hold that opinion over time when incremental information may fail to provide regular reassurance regarding those trajectories and may in fact engender doubt regarding

the realization of those far down-the-road prospects. That's crazy given how much leverage that one input has on where we land up in terms of long-term returns on specific investments.

Layer on top of that, all the qualitative, optionality value that arises from partnering with great people – here again, we're quite crazy as no rigorous analyst worth their salt will be willing to wager such assumptions in a soundly built-out excel sheet for the (rightful) fear of looking ludicrous. Yet, exemplary people have an uncanny ability to do more than we may be able to anticipate upfront (unfortunately applies to horrible people too). This assessment of optionality value is fuelled as much by managements and founders' past realities as it is by our future fantasies – which can sometimes involve building castles in the air – that's crazy.

We're crazy in that we can be liberal in what we're willing to pay upfront – I'd caveat however that we're not raging crazy here as we recognize that our long-term returns are inescapably tethered to the price we pay today. Having said that, our ability to pay a somewhat liberal price is afforded to us by our patience. Everyone is a long-term shareholder when the share price chart is a smooth, steady "up and to the right" line. If our conviction in our original underwriting thesis remains intact (regardless of the favourability of recent information), we are contented being decadal shareholders even in discomforting times – that is pretty crazy. We've owned companies that "haven't done much" in terms of price appreciation over three-odd years only to do four years' worth of work in year four – we're crazy in that we're indifferent to that and spend no time trying to isolate or identify those year four type step-jumps. To drive this point home, two of our portfolio companies have not contributed to returns despite our patient ownership – however, we don't hold them accountable to that measure – a multi-year flat or declining stock price is not indicative of a failed investment, provided our assessment of the management quality, business fundamentals and scalability prospects remain robust. We intend to write at length about what fuels our decadal optimism on both these companies in future letters.

We find it important to be mindful of two things –

1) Managements of companies aren't obliged to live up to our expectations of seeking smooth and steady growth charts and ought to optimize for long-term value rather than medium term consistency (which can sometimes be at odds with one another); and

2) The real world is very messy – growth can be sporadic and lumpy. For example, we may believe that a specific consumption category (by value) could grow at a low-to-mid teens growth rate over a decade. However, the last five years of data may not be able to provide explicit validation to that worldview. Although, as a side-note, we'd wager that the "catch-up" a handful of such businesses may play over the ensuing decade could engender unusually accretive opportunities.

If my memory serves me well, the CEO of one of our portfolio companies once stated that he couldn't be sure if the tremendous unit growth the company enjoyed over the past decade would've been anywhere close to that rate had he ramped up production capacity a decade earlier than he subsequently did – there's happenstance in terms of how things played out the way they did, even after all the precipitating conditions were present in good measure. That's an instructive thought – despite their best intentions, it can be naïve to assume that our portfolio company managements have incisive clarity on certain topics – holding certain views firmly on the basis of those narratives could leave us misinformed. In other words, if we lean too heavily on narratives from even the most adept and well-intentioned management teams for what the opportunity-set looks like a decade out, the answer will likely be more reflective of the person answering the question rather than the question itself.

If you pause for a moment – that's crazy – the idea that we don't take some of the most respected and acclaimed managers' views on certain things like, potential long-term opportunity sets, too seriously. What we've come to appreciate is that nobody knows some things – what the most accomplished person knows about certain things isn't statistically and materially significant enough to define one's worldview. More importantly, a liberal *guesstimate* from management may be reflective of management's own hopes while an overly restrained one may well be reflective of their conservatism. Oddly enough, I'd wager that managers themselves don't hold some of their own opinions on certain projections too seriously – their answers likely help them frame the opportunity rather than derive a specific data point. In fact, the idea that large swathes of analysts use those commentaries to input a number in a spreadsheet, may likely be a source of structural edge for decadal allocators.

There are perhaps additional "crazy" elements embedded (implicitly and explicitly) in our ways, the above are just the immediately apparent ones. To zoom out, these are the forms of crazy we partake in, in our attempt to earn superior long-term returns. We think the risks embedded in such an approach are entirely palatable to us given the nature of the capital we manage – which is (hopefully) permanent but (assuredly) finite.

Being Patient versus Being Wrong

The revelatory questions to ask investors ought to be built off of their unique form of crazy. I was recovering from a bad bout of dengue in the run-up to our Partners Meeting (no excuses for sounding like an idiot). Amidst some brain fog, I was hit by a fantastic question:

"In the context of your investing style, what is the difference between being patient and being wrong?"

Although I stutteringly muttered half-baked thoughts, this topic is worthy of more discussion. Given that we seek to be potentially perpetual owners of exemplary businesses and given that we ought not to hold them accountable to smooth, steady, upward sloping business metrics, how can we assess how "on point" those businesses are at any reasonable level? What are

the indicators that allow us to "check-in" on them? If we cannot depend on critically assessing the monthly sales volumes or quarterly operating profits then could we be running the risk that our patience is masking the reality that we are in fact, flat-out wrong? Well, if one isn't careful, the answer is a resounding yes. When we have decadal timelines, self-deception can be extremely hazardous. Lumpy business performances can be easier to explain away. How then can we assess whether our portfolio companies remain worthy of the privilege of our patience?

While the answer is case-by-case, here are a few broad (non-exclusive) themes we focus on:

- Do we retain conviction in our initial assumptions?
- Is the decadal structural scalability opportunity still intact?
- Are there sustained changes to key competitive advantages?
- Are there sustained changes to industry structure or marketplace dynamics?
- Is this still the best management team to monetize the long-term opportunity?
- Are the firm's leaders still capable of doing more than we may be able to anticipate?
- Are incentives engendering behaviours that could detract from the decadal trajectory?
- Is the culture evolving in a manner that is conducive to the company's key capabilities?

As is evident, these involve going beyond the apparent quantitative "terra" and digging deep into the qualitative "sub-terra" which is often accessible but largely overlooked. If we are satisfied with the above, we are likely to be perfectly content, happy campers. We are buying into the idea that our companies are positioned with a "if you build it, they will come" mindset.

As a corollary to this idea, certain investors may contend that being too early is the same as being wrong. We disagree. If the precipitating conditions exist, we would prefer to be patiently invested rather than predict inflection points that are usually based upon sheer happenstance. Being early shouldn't preclude us from what we believe can likely be 'a hell of a' multi-decadal compounding journey! Here's an example. The year is 2011. There is an exceptionally well-run consumer discretionary business (we do not currently own this business) – all the enabling conditions for long-term success that we insist upon were evidently existent (I was an idiot to not have owned it). Yet, here is how profits grew over the six ensuing years:

FY 2011 Post-tax profit: INR 430 crores

Fast forward six arduously long years …

FY 2017 Post-tax profit: INR 690 crores

Equating to a shoddy 8% compounded growth rate

Leaving one questioning if their patience ought to even be considered a virtue!

However, those that retained conviction in the underlying fundamentals of the business, the competencies of the disciplined management team, and the structural multi-decadal opportunity-set, benefitted from:

FY 2023 (Expected) Post-tax profit: INR 3,100 crores

Earnings growth of 28% over the subsequent six years

Earnings growth of 18% over the entirety of the twelve-year timeline

Note the dramatic variance between the first six-year trajectory and the subsequent six-year trajectory. This is not to generalize that one is always rewarded for patience – there are many examples one could pick where patience remains unrewarded. However, the point is that when the precipitating conditions are ripe for long-term success, one can get rewarded sporadically and lumpily – this simply comes with the terrain – accepting this reality is usually a precondition to partaking in decadal opportunities. Getting back to how we think we've allocated our capital, in our view, having chosen a handful of the best businesses we can find, run by some of the most exemplary and well-aligned teams one can entrust, and having paid, what we consider, undemanding prices for that privilege, I believe the future will likely be very kind to us. Having calibrated the sizing of each underlying investment in our portfolio based on the underlying resilience of the company's competitive advantages and the innate certainty of the company's scalability prospects, in our view, is a material contributor to our stoic patience.

More than a decade of investing in India has strongly reaffirmed one of my strongly held beliefs – hold an agnosticism about what your returns ought to look like over 3-5 years to partake in opportunities that can be incredibly rewarding over 10-15 years. Why do I use a range-based duration "10-15 years" rather than just a specific duration "10 years"? It reflects a fundamental way we think about long-term returns – long-term scalability, the length of reinvestment runways, and the depth of optionality windows matter a lot more than absolute returns over a specific time-period. What do we mean? Our desire for returns ought to match our investing style – there is very little surety in terms of exactly when the "super-normal" growth years of a business will trigger within a 10–15-year window (think of your own businesses) – our objective is to encapsulate those windows without having to time them. There's only one way to do that – hanging steadfastly on. Hanging on is contingent to having the right expectations upfront – which involves recognizing that we cannot predict whether that lollapalooza effect will occur between years 3-5 or years 9-12. We ought to think just like the founding families of companies we admire – the long-term multiple we generate on our invested capital over time. This is why we're steadfastly focussed only on opportunities where time is a forceful tailwind. Again, as an example, if a specific sub-category consumption growth starts to accelerate a little later than we may have originally envisioned – great, no sweat – we're patiently along for the ride!

As an example, when our portfolio company posts a slower quarterly sales growth relative to the industry, experts may be harshly critical of our company's progress. We will not let the relatively newfound ability to be overly exacting about every minor financial metric to become the very hindrance to our long-term prosperity. I increasingly appreciate that the marginal utility of incremental information (given the context of our investing style and our ecosystem), if taken too seriously, likely declines faster than one appreciates.

In a different context, my dearest friend, lifelong philosophical guide and spiritual mentor, Dad (I'm feeling generous), often says:

> *"Living through something is a lot different than subsequently learning every written detail about it. What's written will often conjure up way more than you might ever remember but almost none of what you felt."*

I relate to that statement a lot more with the benefit of the past decade's life experiences.

Endogenous Risks versus Exogenous Risks

Another nuance-laden conversation centres around our perceptions of risk and uncertainty. Here's an interesting question that helps frame this discussion:

> *"Is the price paid for a business extrinsic or intrinsic to the underlying riskiness of the investment?"*

In other words, is the riskiness of an investment inherent to the business itself or is it dependent on exogenous factors such as the price at which the business can be owned? What can the price paid for a business compensate for? Different investors will have very different answers to this question, which makes it highly revelatory in understanding a philosophy. Are there risks that are offsetable purely based upon a cheap purchase price? For us, the answer to this is largely a "no". Allow me to elaborate on this.

In our investing programme, what risks do we entirely avoid regardless of price?

Compromising on the quality of people: Regardless of price, we are uninterested in owning businesses run by sub-optimal people or in setups where incentives are fundamentally misaligned. A cheap price cannot tempt us to partner with unfair partners. No matter how deep a bargain the market throws up, we will never invest in businesses run by people that don't fit very exacting criteria. There are two categories of frameworks that we deploy to assess qualities of people – one on founding families and another on entrepreneurially-run, institutional-owned business – nonetheless the exacting principles apply. So much so that we are largely agnostic to the vast majority of management teams and founding families of the listed universe. For us, the dictum "guilty until proven innocent" is instructive in assessing people. One critical prerequisite for us is to have demonstratable evidence of when controlling shareholders or managers acted disproportionately in the best interests of their minority partners, even when purely legal or best practice constructs would have held them accountable to a far lower threshold. We recognize that this can lead to a lot of errors of omission – given that the capital we manage is finite, we willingly accept this trade-off.

Compromising on the quality of business: A lucrative price is never inviting enough for us to invest in sub-optimal businesses, which we define as businesses that are incapable of earning resilient, sustainable and robust returns on capital across cycles. Each of those three adjectives – resilient (cannot be fragile to tail risks, as an example), sustainable (cannot be

upended by disruptive competition, as an example) and robust (ought to be lucrative in terms of absolute levels), is intentional. Structural turnaround stories or expectations of sweeping changes to industry structure, or catalytical restructurings by new management, are not the kind of opportunity-sets that appeal to us, regardless of price. As passionate as I am about technology (as proud owners of some cutting-edge technology-enabled companies), and with no disrespect to builders building what we hope will become the leaders of the future, we steer clear of "disruptors disrupting for the sake of disruption", which we define as companies with more hype (investor appetite) than bite (visible business model viability). Even if business model viability eventually emerges, we worry that such businesses may grow old (from a regulatory perspective) before they grow rich (from an earnings power perspective). A lowball price cannot entice us into choosing businesses or people that we simply don't like.

What then are risks that *may potentially be* offsetable by price? To some extent, this is covered by "what's our crazy" – however, here are a few more snippets for reflection:

- Fear of transient or indefinite growth pangs (we may find misplaced)
- Broad concerns of rising competitive intensity (we may find misplaced)
- Frigid regulatory ecosystems or regulatory over-reach (we may find cyclical)
- Concerns on prevailing macroeconomic conditions (we may find irrelevant)
- Concerns on an impending/ ongoing crisis (we may find transitory or irrelevant)
- Mild bets by management who have earned our admiration, that sit at the edges of what we would find "ideal" (lots of caveats here, better suited to a verbal discussion)

These factors may not be unpalatable to us if presented with a compelling price. The comfort to underwrite in this manner is founded in the core edges we curate – time arbitrage, qualitative arbitrage and emotional fortitude. These allow us to hold targeted, unconventional, non-consensus perspectives. This fuels an unusual conviction in select decadal pathways.

Monitoring Existential Risks Closely

Barring specific exceptions, one phrase adopted by corporations and financial market participants that usually makes me wince is "we are closely monitoring the situation." Unfortunately, existential risks don't dissipate away by maniacally staring at them (the equivalent of inundating five large screens with real-time updates). "We are closely monitoring the situation" often seems like the effective equivalent of saying "fingers crossed" while staring down the barrel of a shotgun. Barring exceptions, it's often an indication that it's far too late to do anything else. "Closely monitoring" is perhaps the best manifestation of the last (and least reliable) remnant of a risk management strategy – Hope. Recurrently measuring the closing distance between you and doomsday does not impact the odds of doomsday manifesting, the magnitude of the doomsday's impact, or the chance of one's survival through doomsday. It is perhaps worthwhile to think of it in form of the crude analogy that follows:

Best scenario: Don't lay a picnic basket in the middle of the Serengeti.

Second best scenario: Wind-up and leave regardless of where the lion pride is currently.

Futile plan: "Closely monitor" the closing distance between you and the lion pride; Start wrapping up your picnic basket if the distance starts to get unsettling.

Deliberately entrenching robustness and resilience across cycles is the only true risk mitigant. This is especially true among the levered financial compounders that we own.

Our views on the role of hope can seem contradictory. On the one hand, we lean somewhat liberally on hope with respect to the potential upside of an opportunity while on the other, we ruthlessly eschew the role of hope as a risk mitigant to the downside. In our view, this is not an incongruity – we are full of optimism-fuelled hope for just how big white spaces or opportunity sets for our companies may get over time. However, we deploy absolutely no hope in assessing the underlying resilience of companies, the risk-taking capacities of their managements and the values of institutional cultures embedded by their founding families.

Quick Portfolio Update

In the quarter gone by, we exited one of our smaller positions to take advantage of the market-wide sell-off to stockpile some of our highest conviction, existing positions. Although we are constructive on the exited position's prospects, one's fifteenth best idea can be a detractor, especially when higher-priority positions become available at lucrative prices. We would be remiss not to act on such windows. The exited position was initiated in the post-Covid market euphoria and was funded by positions that were mildly trimmed due to euphoric pricing at the time – opportunities to safely allocate to our best ideas were scarce back then. Today, opportunities seem relatively plentiful and some of those same positions are "on offer". Such fine-tunings are our attempt to keep the portfolio "tightly-wound" basis our best-effort assessments on the robustness and endurance of potential long-term returns.

Our first fifteen letters focused predominantly on our investing philosophy. As we move on, I expect future letters to turn predominantly stock-specific, which necessitates limiting readership to partners on our platform. I must categorically state that my opinions are not prescriptive, I am but a stumbling idiot tinkering along with each passing day – there are multiple ways to do well, mine is designed to simply suit me best.

Warmly,

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