

**Numbers don't lie...**

During my time at Goldman Sachs, the senior associate on my team, Quan Mai, who is now a close friend, routinely proclaimed this phrase while discussing the fundamentals of any given stock, "Numbers don't lie". Quan subsequently transitioned to the franchise risk management desk on the trading floor to trade financials in a proprietary position (ie. on behalf of the firm's own balance sheet). Quan's decree rang true through my time on the desk as markets punished banks for the gaping holes in their balance sheets, evidence of which began to seep into quarterly & annual filings. Clearly this phrase was of tantamount importance to anyone committing capital to a security then. However, a few months into my return back home I learnt that while this phrase was accurate, it was incomplete.

**...but they don't say everything**

Soon after my return, I was fortunate in spotting companies like Gruh and Nestle, which outperformed a market which was lacklustre at best. However, I was eager to continue finding names which possessed substantial investment merit. I typically committed a day a week to screen stocks so as to go through a 'master list' of names that seemed interesting on a prima-facie level, over time. One such name on my list was Dhanlaxmi Bank, which traded at ~Rs. 125. While the story seemed interesting at first glance, and the potential for exciting numbers to materialize over the upcoming quarters seemed plausible (given that the Bank had reinvented itself and seemed underway in building a strong deposit franchise), I never got around to getting interested enough or committing capital, fortunately. It now trades at ~Rs. 68 amidst reports that emerged in early October that the All-India Bank Officers Confederation had raised red-flags over financial inconsistencies at the bank. I have no views on the accuracy or authenticity of allegations, however, I do know that if I had committed capital to such a security, there would be precious little left. To generalize, in the West managers mismanage by lining lobbies with Rembrandt or adding charter flights to the list of perks, here mismanagement is manifested in dubious asset quality.

**What numbers don't say: a decree for investing in India**

It was against this backdrop that I found it befitting to write a note titled "What numbers don't say" and to complete Quan's idiom on the efficacy of numbers - "Numbers don't lie... but they don't say everything." Days after the telecom scandal was exposed, I ran a screener to screen for financial attributes I find attractive. I wrote a note around the findings, "Introducing the *benchmark1 (balanced metrics)* basket" (3rd August 2011). The fact that SunTV Network found a spot on this benchmark is a testament to the idea that numbers don't capture everything. Based on our philosophy, any names marred by scandal or managed by political associates would be off-limits. When a software incapable of qualitative assessments finds names which meet our financial requisites, some outputs are invariably prone to disbelief. Among the central tenets of investing in India, I have started to learn, is understanding what numbers don't say. In this landscape of a large and growing unorganized sector where cash dealings and bribery are commonplace, it is crucial to observe what is unseen to be able to participate in real growth which is worthy of omitting only at your own expense.

**Be willing to pay-up for what is certain because there is so much that isn't**

Hence we choose to invest in sectors where we do have some ability to see beyond the numbers and avoid, like the plague, sectors where we cannot (construction and jewellery, for example). This is why we are never hesitant to pay top-dollar for that which is relatively certain (provided it makes for good business), because we operate in an environment where so few things are. This is why Gruh and HDFC Bank trade at several times book value (in addition to the fact that they grow book rapidly) and why Nestle trades at ~40X earnings (in addition to the fact that it grows earnings like clockwork), because the story may be subject to question but the integrity of people who write it, is not. As I think of a fitting last line, my terminal screen flashes: "IT dept raids major textile retailer".

**I invite your comments** ([soumil@dmzpartners.in](mailto:soumil@dmzpartners.in))



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