



DMZ Partners Investment Management LLP  
SEBI Registration No.: INP000005944

**First Quarter Fiscal Year 2018-19 Investor Letter**

3rd July, 2018

Dear Partners,

I take this as an opportunity to welcome you as co-investors through our inaugural quarterly letter. Since commencement of portfolio management activities in late March 2018, we've been consciously focussed on "curating" the right kind of investors onto our platform. We are proud to have partnered only with investors whose value systems, mindsets toward wealth, and philosophy toward long-term investing align well with our own. While most investment management firms focus on aggressively growing their assets under management - we have no such motivations. We are conscientiously focussed on three key metrics in how we measure ourselves - 1) our long-term returns to families and institutions that entrust us with their capital; 2) our underwriting quality (selection of underlying companies and their composition); and 3) the quality of our investor base. I believe that we are off to a very good start on all three counts.

**1) Long-term returns** - We have a clear mandate in terms of our investment operations - to compound capital over decades. Although periodic reports are available online through our fund accounting portal - we do not manage our investments to maximize quarterly returns! **It's important not to confuse something which is measured with something which ought to be managed.** We have very little (if any) control over what returns may look like on a monthly/quarterly basis and we don't want to confuse the ability to measure these statistics with the intention to manage them! The essence of our investment approach of buying exceptional businesses works only over multi-year horizons (much like a marriage, hopefully). By consequence, our long-term returns are strongly tethered to the underlying fundamental performance of our portfolio companies over the coming years - a factor I find great comfort in.

*"Investing should be more like watching paint dry or watching grass grow. If you want excitement, take \$800 and go to Las Vegas." - Paul Samuelson*

**2) Underwriting Quality** - We intend to underwrite cautiously but boldly. We have evolved from owning 6-7 companies in our older avatar to owning close to twice as many today. Our greatest mistakes in our prior avatar have been errors of omission (great things we didn't buy even after meaningful due diligence) as opposed to errors of commission (things we bought that turned out to be lemons) - we intend to course-correct slightly to minimize both risks. However, the important point is that this is not a divergence from our concentrated approach. Our top 5 holdings still account for an unusually large percentage of our portfolio - in other words our conviction in select companies at their prevailing prices is very well aligned with our high portfolio concentration in them. What has lengthened is the "tail" of our portfolio - i.e. companies we have, what one could call "toehold" positions in. These positions may escalate over time subject to a few factors, including: 1) deeper conviction in tail companies' business models and long-run prospects; 2) tail companies' prices quoting at more rational/ compelling levels due to either time or price corrections; and 3) our high concentration positions becoming excessively frothy in terms of valuations creating large opportunity costs if left untouched. At the risk of alienating my audience, as odd as it may seem, we may be significant net beneficiaries of our smaller holdings getting cheaper over time so that we may build them and "fatten the tail"!

In addition to our high concentration and tail positions, our portfolio consists of two "pseudo-cash" positions - we believe both these companies have incredibly stable business models yet



they may be unlikely to help us compound capital at over 20% CAGR over the next decade. That said, they are substantially better alternatives, in our view, than sitting on cash. Finally, we want to keep the quality threshold high when we think of adding companies to our existing portfolio - an opportunity ought to be at least as good if not materially better than existing opportunities. Hence it is highly unlikely that we will ever own more than a dozen positions in the portfolio.

**Our underwriting competency is augmented by three factors** - learning, meeting & thinking. **"Learning"** involves learning in (relative) isolation - reading voraciously about business models of portfolio companies and great global businesses, appreciating the characteristics of their owners, managers and the edges or moats they have over their competitors, technological changes which may impact their long-term resilience and success, industry evolutions over long periods of time and so on. This bucket also includes exchanging thoughts in-house with my (sometimes impatient) partner (& father) whose attention inadvertently shifts at the one hour mark towards a plant on our office terrace garden - in the interest of our co-investors we've added blinds to our meeting rooms so that conversations with him can continue uninterrupted, an investment I think will pay handsomely over the long-run.

**"Meeting"** involves hitting the road & kicking the tyres, getting out of the ivory tower, so to speak by visiting portfolio companies and "watchlist" companies which might be on our radar - not just learning from MDs or CEOs at their offices but also spending meaningful time at branches, stockists, wholesalers, retailers, development sites and with their customers. Learning about a business at a grassroots level helps us appreciate nuances which are impossible to ascertain from a quiet and comfortable office in Mumbai. Additionally, this helps balance, tally or counter what managements would like investors to believe - **as Dad often says, "I'd rather we soil our hands than our reputation."** I'm happy to report that we invested meaningful "meeting" time in Bangalore & Delhi/ Gurugram in this past quarter - better appreciating business models of companies we own, learning a lot more about companies we may perhaps like to own in the future and clearly eliminating opportunities which looked appealing only on paper - the last point being the most valuable. In Charlie Munger's words, "avoiding stupidity is a lot easier than seeking brilliance" - and this is a lot more than half the battle in our business.

In writing about research, I'm tempted to digress a little. **All the data we have about a company is by definition "historical", yet all the value a company will create for shareholders over time will come from its efforts and the results of said efforts in the future.** Solely "running the numbers" in isolation has never been the recipe of our investment research effort. The bulk of our work involves "qualitative research" - appreciating characteristics which are difficult to quantify and are hence by definition less widely appreciated. We call this "qualitative arbitrage" - having an edge over widely held perception. This could involve being aware of misaligned incentives of founding families, learning about nuances from their lesser known corporate history, realizing the relationships they have forged or disrupted with their past suppliers/ customers, or understanding their rationale for making seemingly "strategic decisions" for suboptimal reasons which may do little justice to minority shareholders.

**"Thinking"**, although self-explanatory, requires an enabling ecosystem - an environment which fosters long-term thinking, investigative research which goes beyond superficial statistics or widely-held assumptions, and creativity. Such an ecosystem is not built naturally, it is to be created. I think we've been successful in doing just that thanks to our focus on eliminating distractions and nourishing the right principles and priorities.



**3) Curating our investor base** - I'm confident that all of our investors understand that we, by virtue of being stockholders are part owners of our portfolio companies. We would assess decisions of a company's management team based on their impact on the long-term earnings power of the company - not on whether said actions affect the next quarter's earnings slightly negatively or not. **I believe our investor base understands that short-term accounting realities are sometimes different from long-term economic ones.** For example, I could run a business which makes it look like it has taken a suboptimal decision a few quarters out although said decision may be exceptionally lucrative when reviewed three-four years out. We take gratification in the fact that the investors we've let in through our doors understand this and think as business owners of our portfolio companies as opposed to short-term speculators of stocks.

We can only invest successfully when our investors understand these foundational principles. Much like our portfolio companies can perform exceptionally only when their stakeholders appreciate their long-term priorities. In essence, **we can't do "normal" things and expect exceptional outcomes.** In search of substantially "above-average" long-term returns we will have unconventional ideas and we will see periods of short-term volatility. At such times we will remain unfazed and given the opportunity, we will build on our highest convictions. Much like a factory owner may opportunistically stock up on raw material which is unusually cheap in an adverse environment.

The conducting ecosystem I spoke of earlier comes from the quality of our investor base. **You would be pleased to know that we have known most of our investors for over 20 years** - and the one's we haven't known for that long have largely come on-board after clear assurances to us from the one's we have! If I had investors who called me every week asking me questions like - "Why are markets up/down?" or "What do you think of oil prices?" or "Why is a portfolio company's price going down?" - I wouldn't be able to think patiently and focus on the questions that matter over the long run. Our curated investor base understands that the answers to the above questions are largely irrelevant, even if I had them! At the risk of sounding silly, It's a lot like asking a pilot on your flight to Zurich exactly what town you are flying over every 20 minutes - the answer will have little relevance as long as you get to Zurich safely in about eight hours.

Most mass-market funds which are more reminiscent of "sales" organizations than "investment" firms will happily initiate a new relationship irrespective of a client's attitude, philosophy or approach. Colleagues at such firms are frequently amused by our approach and tell me, **"You realize that they [clients] want to give you money right, not take money!"** Our rationale for being picky though runs a lot deeper than simply satiating some type of ego. Our approach involves taking ownership for our decisions - success is jointly ours (of all our investors), but mistakes are solely mine (which despite our best efforts, will occur). That ownership requires that I am always deeply connected to our research process and to our investors - there is no sales team, there are no relationship managers - and there will never be. If I were to dilute the quality of our investor base in pursuit of growth, I will have eroded my own peace of mind and diluted my focus. Nonetheless, **I humbly apologize if I've been dismissive of new relationships you may have proposed to us** - we will certainly accept like-minded investors over time - in fact we are likely to require that new investors come with a reference from existing ones.

*"It is impossible to produce superior performance unless you do something different from the majority." - John Templeton*



**Housekeeping** - I hope all of you have accessed your holdings and a variety of other available reports, some of which are mandated from a regulatory standpoint, on the online fund accounting portal - I will warn you though that checking prices daily (an activity even I avoid!) is injurious to your long-term sanity. Additionally, although our average quarterly returns have been exceptional in an environment where the broader markets (and especially several mid-cap companies) have seen very dramatic corrections, I'd like to emphasize that evaluating returns is completely futile over such short time periods. Importantly, if you have any trouble accessing your reports or interpreting them, please reach out to us (frontdesk@dmzpartners.in). Finally, as many of you already know, I'm always happy to get on a call and share our thoughts on the portfolio, our investing philosophy or anything else - please do not hesitate to take me up on it.

**Gratitude** - Our team has worked tirelessly in our inaugural quarter and I owe them all my gratitude. We are also blessed to have exceptional service providers collaborating with us, including our Custodian (Kotak Mahindra Bank), Fund Accountant (Orbis Financial) and our Brokers (Ambit Capital & Kotak Securities). We also remain appreciative of our advisors, Mr. Ajay Zaveri and Mr. Rohinton Shroff, who have been very patient listeners and sounding boards while providing insightful inputs and suggestions along the way. Finally, I wouldn't have been able to build out such an incredible platform which is beginning to take shape without Dad, and I'm humbled by the goodwill and mutual trust all of you share with him - he deserves all the glory I ever enjoy. To repeat a phrase we use often, we will always have gratitude in times of opportunity, rationality in times of distress, integrity in all our dealings, and humility in the event of our success. Our reasons are selfish - as this will ensure repeatability!

Warmly,

Soumil S. Zaveri  
Partner  
~On behalf of our entire team~

Soumil's contact details:  
mobile: (+91) 9821127440  
email: soumil@dmzpartners.in

*Document Reference #: 0718*