9th October, 2021

**Semi-Annual Letter to Partners (Financial Year 2021-22)**

**The DMZ Partners Owner’s Manual**

Dear Partners,

I hope that you and your loved ones are well. In 2015, well before we set up the portfolio management firm, inspired by the Berkshire Hathaway Owner’s Manual, I had published our 15 principles of allocating our family capital. I had written how experience may compel us to build on or calibrate these principles over time. In refreshing these principles, I take the opportunity to share what we believe will serve as an effective “DMZ Partners Owner’s Manual” for all who have chosen to allocate capital alongside us. True-to-tradition, I have refrained from performance-related comments – your routine reports speak for themselves. I prefer to remain focussed on the process that is likely to sustain such outcomes over time and steer our letters accordingly. The overarching ethos that guides our principles is best expressed by the following Warren Buffett quote:

“I’ve never believed in risking what my family and friends have and need in order to pursue what they don’t have and don’t need”

1. **We will only accept capital on behalf of three categories of people or entities**: 1) family, friends, and entities whom we may have already known for long periods of time, 2) close acquaintances of (1) above and, 3) individuals or entities with whom we spend enough time to be able to assess an alignment of mindset and investing philosophy. In the absence of past precedent, we need to have enough reason to believe that potential partners possess a long-term, business-owner orientation. Without this clarity, we risk initiating disagreeable relationships founded on shaky foundations. We would rather have a handful of carefully curated relationships that persist over several years, than hundreds of relationships that revolve often. We recognize that this is difficult to achieve, and will therefore initiate only very few new relationships each year. We will never actively solicit clients. We have no sales teams or distributors. Building a larger client count or asset base does not add to our contentment. In effect, we are investors who happen to be in the asset management business, rather than asset managers who happen to be investors. While there is nothing wrong with the latter approach, the difference in our view is non-trivial.

2. **I do not believe that ours is the most superior investing approach, and find no joy in peddling that mistruth to others.** Ours is simply an approach that has worked well for us and suits the common ground between our skill-set & mind-set. Truth be told, we would be utterly incapable of investing any differently. We remain humbled by the conviction of our partners to invest alongside us and strive to remain worthy of it by channelling our bandwidth and focus to investing & research-related activities that improve the odds of robust outcomes for our partners, rather than business building or marketing/promotional activities that invariably divert finite energy and resources away from our core purpose. Seeking out and investing in exceptional businesses, run by a rare set of high-performing, high-integrity people, and continually growing our understanding of such entities, their inimitable cultures and their stewardship is our true calling, and this is where we will devote almost all of our bandwidth.

3. **We will only invest in, and alongside, entities whose founding-families, management teams, cultures, and businesses we respect.** We find it important to feel gratitude in our associations with people and their firms. Our respect will be easily earned by individuals whose
actions tend to largely match their promises. We recognize though, that invariably, good people will sometimes err too – a lapse in business judgment is par for the course but actions reflective of foul intent or an erosive culture are not. We’ve come to appreciate that the behavioural difference between mediocre people versus great people is quite nominal in sunny weather. However, this variance gets rapidly stark as thunderstorms roll in. It is in the deepest of crises, when uncertainty is elevated and catastrophic risks abound that the incentive to behave badly is highest. Jarringly, bad people will disappoint us at our most vulnerable moments. To safeguard against this, we will avoid sub-optimal people at all times. A cheaper price or unusually favourable terms will never bait us into partnering with less-than-ideal people.

4. **We will only own businesses well within our circle of competence.** In doing so, we will keep in mind Richard Feynman’s caution that, “**knowing the name of something is not the same as knowing something.**” We will always continue to fortify how we define “knowing”. The threshold of understandability we require of our investments will only get higher over time. We are also incapable of, and disinterested in, having any meaningful or differentiated views on a variety of subjects, including GDP growth rates, industrial output, unemployment statistics, inflation trends, commodity prices, foreign exchange fluctuations, domestic or global policymaking, impending regulatory changes, political trends, quarterly earnings expectations, market sentiment changes, fund flows across asset classes, thematic trends etc. In general, we will refrain from making, and be dismissive of interpreting, all manner of forecasts – no point attempting to be even mildly opinionated on factors which are likely to have only a nominal, if any, impact on long-term outcomes. We will steer clear of investing opportunities which are predicated on accurately “guessstimating” the above. Further, we are incapable of predicting the supply-demand dynamics of any commodity. Accordingly, we will avoid owning commodity-based businesses or companies whose products or services are likely to get commoditized over time. We will fervently seek out wide-moat businesses with durable competitive advantages. We will attempt to pick those whose moats are likely to be endurable over time.

5. **At any given time, we are likely to be agnostic to, and ignorant of, whether broader markets are overvalued or undervalued.** We have no opinion on the qualities or prospects of the vast majority of listed businesses, let alone how they ought to be valued. Rather than feebly holding a wide breadth of opinions, we will vigorously work toward nourishing context-rich, depth of insight on about 30-odd compelling companies and the management teams or founding families that run them. Choosing depth over breadth allows us to hold an unusual degree of conviction in a few businesses which empowers us to build a concentrated portfolio of companies which we typically view as a conglomerate of owned businesses rather than a portfolio of rented stocks. In turn, concentration allows us to benefit disproportionately in the success of businesses which we can confidently underwrite upfront and hold onto with fortitude and equanimity regardless of exogenous conditions which lie outside our control.

6. **We will remain cognizant of, and be positively biased toward the sheer longevity of “compounding machines” – businesses capable of exemplary capital allocation – retaining and compounding the bulk of their earnings at superior rates of return for unusually long periods of time.** We will be vigilant not to trade away such a business solely because it may appear expensive relative to conventional metrics. That said, neither will we remain irrationally committed to a successful investment if it condemns our capital, in our assessment, to meaningfully sub-par future returns when assessed even over a sufficiently generous timeframe. We will own an asset based on its expected long-term productivity – that is, the earnings power we think it can comfortably generate over decades. We will seek only those
businesses whose longer-term trajectories we can hold conviction in. In doing so, we will remind ourselves that the quality of inputs directly affects the quality of output. We will steadfastly focus on underlying economic realities and adjust for both the positive and negative illusory effects of accounting standards.

7. **We will invest in a business only if we are willing to potentially own it for a decade.** This is important to us for four reasons: 1) It ensures we focus on quality businesses whose fundamentals are likely to persist over time. As per Nassim Taleb’s advice, **we will think long and hard about resilience in alternative future outcomes** (say, in times of regulatory, economic or competitive stress). 2) We are not too excited by the prospect of getting rewarded on the basis of how an asset ought to be valued by catalysts in the medium term – nor do we want to deceive ourselves into believing that we have any expertise in being able to do so. Even if successful, such an investing style may deviate us from the prospect of compounding capital over decades by remaining patiently invested in exemplary companies. We would be deceiving ourselves in assuming that we can be better capital allocators than the people that run among the most outstanding companies we can find. 3) We are blessed with the privilege of patience - we intend to monetize it by identifying exceptional management teams, building franchises with immense scalability prospects over decades. This importantly allows us to partake in the “optionality value” that emanates from the bounty of unforeseeable surprises that accompany the actions of exceptional people. Experience has shown that it would be a folly to discount this phenomenon. Finally, 4) Taking an unusually long-view also gives us the advantage of an uncrowded spot as institutional imperatives often force professionals to check their relative performance scorecard every quarter, half-year or year. Our approach, if deployed well, is designed to help us deliver superior outcomes over a decade. Having an exemplary outcome over a decade is not the same as having ten exceptional one-year outcomes, much like a five-year-plan is not five good one-year plans.

8. **We will never choose to own an asset solely based on valuation.** No point bringing home junk for free - it still occupies valuable and limited space. Opportunity costs are very real, which we will remain acutely aware of. Gregory Mankiw wastes no time reminding microeconomics students that "the cost of something is what you give up to get it." We take his advice to heart. To put it in practical terms, if you own a poorly governed, mediocre business solely because it is seemingly a mouth-watering bargain – time is effectively your enemy. The longer you must wait for your value to be realized, the greater the chances that the mediocre business faces setbacks or that inept management commits grave errors – in effect, permanently impairing your investment. We want time to be firmly on our side. In owning wonderful businesses run by exemplary people, time is an exceptionally potent tailwind!

9. **We will make all assessments of valuation with a 10-year view and not from a myopic and static view of 1y/2y/3y forward earnings valuations.** The perspective of a decade makes cheap mediocre businesses look a lot more expensive and expensive exceptional businesses a little more reasonable. Of course, we will not hesitate to load up on cheap exceptional businesses! In deliberating a fair price, we will be attentive to “white-spaces” (new business verticals or product-profiles, as examples) that exemplary managements may engender over time. Experience has proven that great people deliver substantially more over time than we may be able to comfortably envision upfront. Accepting that many aspects of a 10-year view are simply unknowable, allows us to stretch our comfort a little in terms of a potential purchase price. We would be remiss to miss out on investing in a company which could potentially be 7-10x larger in terms of earnings power over 10-12 years simply because
we are unwilling to pay say 20% more upfront than our “conservative” analysis suggests – this is a folly we’ve seen many exceptionally intelligent people commit far too often. In some respects, we believe that this is an example of “misplaced-conservativism” rather than “true-conservativism”. We exercise extreme caution in terms of the qualities of people we are willing to partner with, but once we’ve done so diligently, nourishing a little more faith in exemplary people who are running businesses with large reinvestment opportunities can go a long way in compensating us generously despite our own intellectual limitations vis-à-vis the experts!

10. I will make mistakes of commission but I will make many more mistakes of omission. I can deal with regret (over a missed opportunity) a lot better than guilt (over a flawed decision), and will act accordingly. I would be forlorn if I were to allow the greed of great gains to veil even mild unease. Our omissions will usually have their roots in skepticism related to either the quality of the business under review or the characteristics of the people that run it. This is deliberate – our approach is well defined to cater to the nature of capital we manage, which is likely permanent but undoubtedly irrereplaceable. This implies that we can underwrite some risks, but not others. In paying a little more for an exceptional company, we may earn a lower return than we would have ideally preferred to, over a decade. However, in partnering with a management team with a slightly questionable background or a poor track-record, we would be running the risk of a large capital write-off – this to us, is not an option ever worth considering regardless of the potential pay-off. We will make few decisions. In swinging infrequently, we can focus on committing energy to swinging rather than double guessing whether we should have. We will use the benefit of experience to tinker our process. Although outcomes will be measured over years, we will not be stubborn and will make quick amends when we err. We will not waddle in denial. Finally, faith in even a highly-trusted expert's judgement on a company that sits outside our comfort zone will never induce us to make an investment. True to Buffett’s wisdom, we will applaud the effort but skip the ride.

11. We will never aim to be the highest-returning investment firm over any time period. Returns are an output of a good process, not an input! For example, if I were to explicitly have a target of earning a 100% return in a particular year, I would be forced to own a collection of distressed assets which might have relatively low chances of revival – of course, in the event that they do revive, the pay-off would be large. Pre-decided return expectations will not determine the risks we are willing to underwrite. While we are certainly seeking superior long-term returns, we recognize that an investment manager has countless lives but an investor has only one!

12. We will continue to exercise an unusually strong grip on exceptional companies once we’ve bought them. Most analysts are capable of identifying the most dominant listed businesses. However, few can retain the emotional fortitude required of holding these companies for decades. It can be devilishly hard to resist temptations that may lead one to part ways with his is, but once we’ve done so diligently, nourishing a little more faith in exemplary people who are running businesses with large reinvestment opportunities can go a long way in compensating us generously despite our own intellectual limitations vis-à-vis the experts! ..
we are not hesitant to trim these positions at times, to scale up our unlevered platform-style or consumer-oriented portfolio constituents. That said, we recognize that **portfolio sizing and pruning can often be more art than science and hence will not restrict ourselves to arbitrary, pre-defined, one-size-fits-all rules.** Context is everything.

13. Analytical rigour in fundamental analysis of financial statements, studying and interpreting publicly available historical filings and the like are now mere table stakes. Our focus on qualitative factors that cannot be easily quantified or commoditized will define our approach - **often the most valuable characteristics are immeasurable!** These “hard-to-quantify, but critical to long-term success” aspects include appreciating the existence of attributes like management teams having immense clarity of thought and consistency of execution; and company cultures that encourage entrepreneurial risk-taking and abolish bureaucratic lethargy. Many relatively passive, institutional investors are unwilling to consider these “soft-factors” as they are hard to quantify, model and project forward. Yet it is these very attributes that tend to play a decisive role in long-term outcomes for truly patient investors who think and act like business owners. We are aware that companies that we find worthy may not always be available at prices conducive to long-term compounding. If so, we will not change our approach. We do not expect exceptional results to accrue every year. Instead, we will prefer to use the free time to sit back, read voraciously and wait for bargain season to come back.

14. **We will be accepting of evidence that runs contrary to our opinions and will process it diligently.** To be better prepared, we will pay attention to Charlie Munger’s view on the importance of inversion. We will not take undue comfort from opinions that conform to our thinking. As author John le Carre said, "**A desk is a dangerous place from which to view the world.**" We will balance what we read with what we experience. We will be rigorous in pursuing our “scuttlebutt” work – a single factory-visit or channel-check is of little relevance in isolation, and at best, makes for just an anecdote. However, an aggregation of such experiences over years forms an important repository to draw from. Especially at times of duress, when prices of some of our holdings may as much as halve in value, conviction drawn from such extensive grass-roots-level-insight, tips the odds in favour of our mouths watering rather than our legs shivering. This contributes to an abundance of emotional fortitude precisely when it is most warranted but hardest to nurture.

15. **We will always remember that hoping for something doesn't improve its chances of happening.** We will retain gratitude for our opportunities, integrity in our dealings, and humility in the event of our success. Our reasons are selfish, as we like to believe that this alone will ensure long-term repeatability!

Warmly,

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