DMZ Partners Investment Management LLP
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Third Quarter Fiscal Year 2019-20 Investor Letter

- ***Why we invest like we're the pie***
- ***Veblen Investments - buyer beware***
- ***Avoiding suboptimal partners (at any price)***
- ***Takeaways from our annual partners meeting***

Dear Partners,

We recently concluded our annual partners meeting through which we had the opportunity to interact with a majority of partners on our platform. We started off with 45 minutes of prepared remarks followed by a spirited Q&A session. Dad & I enjoy the opportunity to interact with everyone on the platform through meaningful discussion and I would like to express our gratitude to all of you for attending and participating actively. For the benefit of attendees as well as a few partners who couldn't attend due to scheduling difficulties or last minute exigencies, I'd like to use this note to reiterate a few high points shared through the evening. We kicked off the evening by speaking about the importance of keeping at the fore the foundational elements of our philosophy of allocating capital - preserving the safety of invested capital on one hand and retaining the sanctity of long-term returns on the other.

In retaining the sanctity of long-term returns we elaborated on why we may not own some exceptional businesses due to the relatively euphoric prices at which these securities currently trade - we often call these ***Veblen investments***. Much like the characteristics of Veblen products where price increases raise (rather than reduce) the level of demand of these unconventional products (think of a Hermes Birkin Bag, as an example), ***we believe a handful of investable securities have similar characteristics - rising prices push in incremental (retail and institutional) investors who rush in, often driven by the fear of missing out.*** We used as examples, two prominent publicly traded businesses between the years 2000 and 2010 - investing a substantial quantum of your capital in either of these securities would have condemned that capital to what we admonishingly call, the lost decade of investment returns - the opportunity cost of that capital would have been immense! In one case underperformance was largely driven by relatively subpar earnings growth even though the business was operating in a landscape which had a long growth runway and was helmed by a diligent management team. In the other case, the business grew earnings power almost 20 fold through the decade however returns eluded even decade-long investors due to the euphoric valuations ascribed to the business by incoming investors in the year 2000. Needless to say, there are businesses we deeply admire today but don't currently own largely because sizable amounts of capital have flown into a handful of securities which, we worry, may not be able to meet our threshold level of return expectations over time. As we have mentioned frequently in the past, managements and founding families are not obliged to live up to the expectations ascribed by others. As a matter of prudence, please note, that we hold these views despite a rather liberal assessment of the non-linearity of some of these business models as well as the embedded optionality value which comes from partnering with exceptional people who will likely make very accretive decisions which we cannot envision today. Nonetheless, incoming investors in Veblen investments often rightly view some of these underlying businesses as safe havens. However, in thinking of the price at which one gains admission to these opportunities, I like to bear in mind Dad's comment - ***If safe havens get too crowded they run the risk of becoming unsafe!***

On the other hand we spoke about the importance of preserving the safety of allocated capital by avoiding what are often referred to as, investment landmines. As many of you are well aware, in speaking of landmines we refer not just to businesses with glaring corporate governance issues but also companies which may be run by capable and honest managements and sincere founding families but may be operating in relatively vulnerable ecosystems (either plagued by regulatory uncertainty, cyclical market dynamics or commoditized product or service categories, by means of examples) - their long-term success and sometimes even solvency, is contingent on too many factors outside their domain of control. We also stressed on why we avoid binary outcomes like early-stage turnarounds or restructurings - opportunities which may either provide a quick return or may lead to a substantial write-off - given our concentrated investment approach impairments take us two steps back for every one step forward. It is crucial to remember that, ***one can only learn from the mistakes one survives!*** We also stressed on how turnarounds rarely turn and the opportunity cost of capital allocated to situations where time becomes your enemy starts to rise dramatically vis-a-vis owning the kind of compounding machines that our portfolio consists of currently. We spoke of how, by virtue of our investment philosophy and approach, no price is cheap enough for us to partner with suboptimal management teams or co-invest alongside less than optimal founding families. ***In partnering with suboptimal people, an investor's entire focus shifts from thinking about the return <u>on</u> capital to worrying about whether there will be any return <u>of</u> capital!***

Our general risk aversion takes root in the idea that we are investing irreplaceable capital belonging to our immediate family & friends - relationships that have been built and nurtured over multi-decade timeframes. We routinely remind ourselves that ***for a number of relationships on our platform, we are not a sliver of the pie as much as the pie itself and we ought to act accordingly.*** In retaining this level of paranoia, we do <u>not</u> believe that we need to be compromising of the long-term returns we seek. However, we certainly need to heighten our level of patience! In ecosystems like India, we don't believe you need to carry out exotic investment operations to earn exceptional returns. In fact, the pursuit of the exotic, esoteric and complex theses are slippery slopes which may lead on astray from one's longer run objectives. One of the only befitting ways we believe we can add value to our investor-base as allocators of their irreplaceable capital is by owning irreplicable assets - businesses whose competitive advantages (or moats) competitors would find very difficult to replicate irrespective of the quantum of capital they are able to deploy. We want to own businesses which have durable and sustainable sources of irreplicability which are unlikely to get breached and can potentially even grow increasingly pronounced over time. We subsequently highlighted the key source of irreplicability of each of our holdings within the DMZ Partners Conglomerate and why we view these underlying businesses as having immense wealth creation potential over a decade with immense resilience embedded in potential future outcomes. We specifically highlighted that ***owning these businesses in our view does not constitute a large macro-call on India - especially since these businesses inhabit a small sliver of their potential addressable markets*** and by extension, barring extreme scenarios (beyond the realm of likelihoods), these companies are difficult to derail off of the long reinvestment runways that lie ahead of them, irrespective of broader social, political or even economic outcomes.

An important facet we highlighted through our prepared comments was on the topic of edges we seek to curate and sharpen as allocators of client capital. Beyond the basic groundwork - conducting fundamental analysis, appreciating the critical elements of the business model, competitive advantages, scalability prospects, reading past annual reports, conference call transcripts, attending management meetings, researching the background of promoters/ founding institutions, assessing the alternative future scenarios under which a business may (or may not)

thrive, appreciating the reinvestment runways and how incremental profits and capital will be reinvested among several other considerations - all of these are basic groundwork or table stakes in our business. It is unlikely any of these will be a meaningful contributor to an investors' edge over time - some have been commoditized away while others are now widely appreciated. What are the avenues then, that we seek to explore to sharpen our edge? We categorize the three key sources of edge that we seek to sharpen as 1) analytical rigour - a confluence of scuttlebutt work and qualitative analysis; 2) time - having an unusually long time horizon and measuring things that matter while muting out things that don't; and 3) emotional fortitude - allowing rationality, prudence and equanimity to have precedence in times of euphoria and distress alike. Emotional resilience also involves battling the deep-seated biases all of us hold, especially commitment and consistency bias - a test we attempt to hold ourselves accountable to is as follows - ***Fifteen minutes of rational conversation should be sufficient to change your mind on something you may have owned for fifteen years.*** Additionally, we often speak about the businesses we own during meetings with our investors - in doing so, we routinely remind ourselves that we hold ourselves responsible to the capital under our stewardship rather than staying consistent to a viewpoint we may have shared on a particular holding (solely for the sake of consistency). In other words, ***in doing justice to the capital we allocate, we ought to retain the flexibility to change our minds and act consistently with our evolved point-of-view even at the risk of seeming inconsistent to a narrative we may have shared***. We spent a meaningful amount of time exploring each of these three contributors to our edge as allocators and illustrated a number of anecdotes on how they are likely to contribute to our efforts to earn robust returns over time.

There were a number of thought-provoking questions which stimulated lively discussion across partners and I would like to thank all of you for making it an interactive session and for your interesting questions, observations and comments. In the event that there are any incremental questions that may have arisen, please do not hesitate to reach out to us. I am grateful to our team for their ownership-led efforts. I also remain humbled by your conviction to invest alongside us and strive to remain worthy of it.

Warmly,

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