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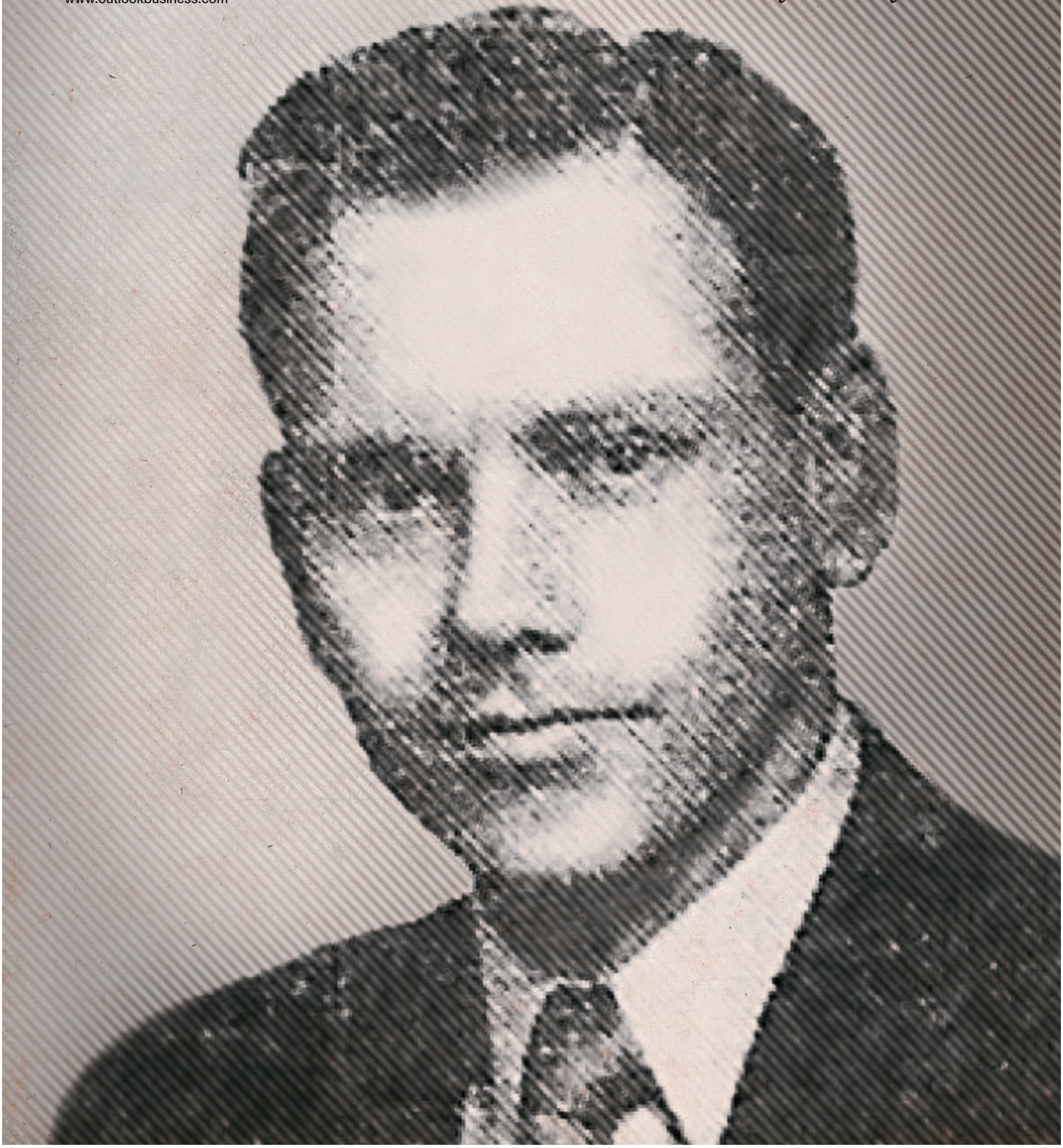

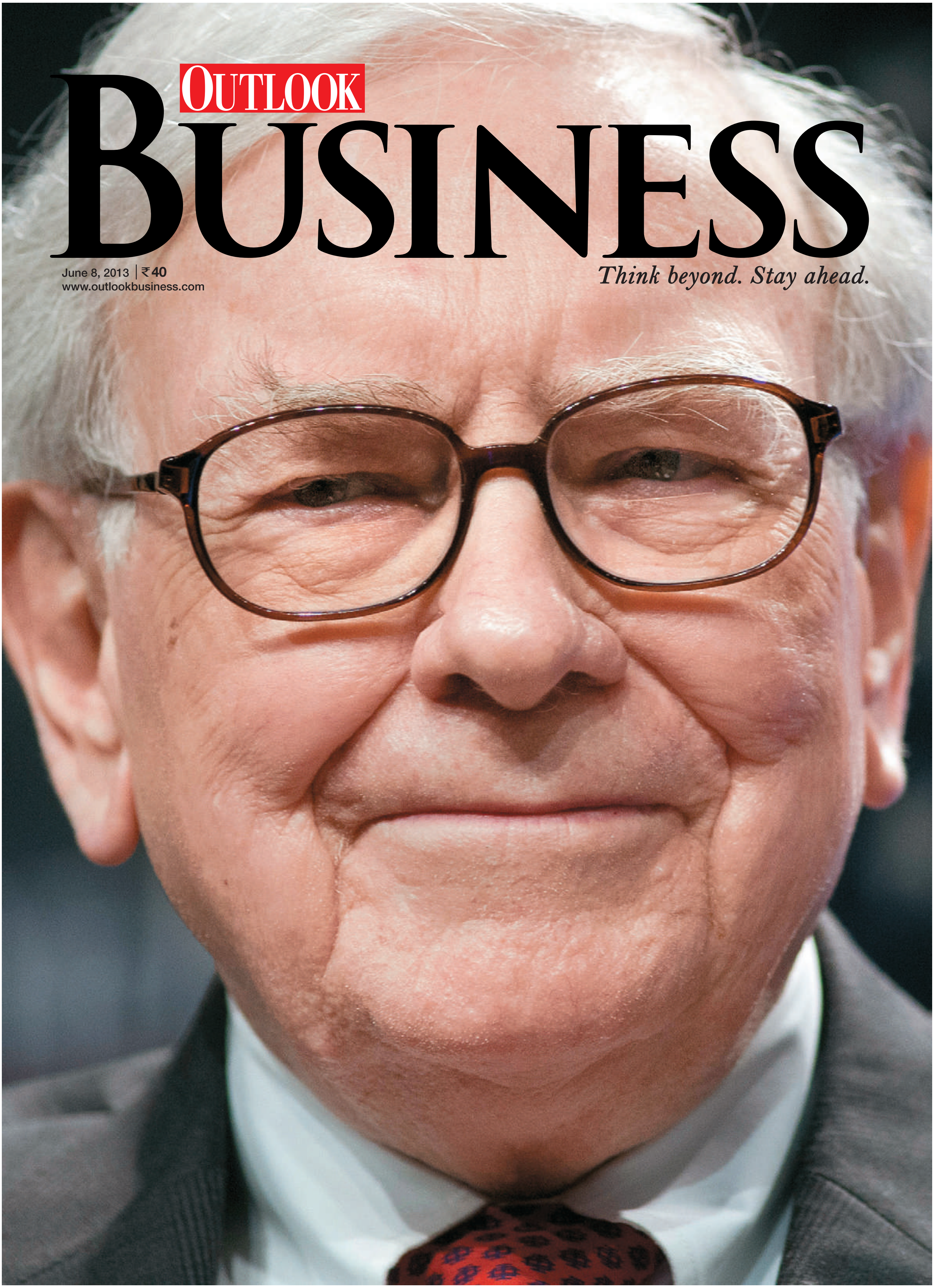
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WARREN E. BUFFETT, CHAIRMAN

June 18, 2013

N Mahalakshmi
Editor
Outlook Business
Windsor, 7th Floor
C.S.T. Road
Kalina, Santacruz (E)
Mumbai

Dear Mahalakshmi:

You did a terrific job in covering our meeting. Clearly you understand Berkshire very well.

If you're ever again in Omaha, I will be glad to do a short interview with you. In the meantime, if you have a few more copies of the magazine, I know our directors would be interested.

Sincerely,

Warren E. Buffett

WEB/db

The right moral compass

HIS STYLE IS MORE GRAHAM THAN BUFFETT GIVEN THE AMOUNT OF MONEY HE MANAGES CURRENTLY. BUT **AMITABH SINGHI** HAS GOT BUFFETT'S RULE NO.1 NAILED

Rajesh Padmashali

PHOTOGRAPHS BY VISHAL KOUL

He may not be as lanky as the superstar whose name he shares but he stands tall and his ideals sure are lofty. That is why when he set up his portfolio management company, he was clear he will not charge an asset management fee, the driving thought being: it is unethical to make money if the client himself has not made any money. This ground rule was laid down and practised six decades ago by a homely Nebraskan who started his own investment company. Now, Warren Buffett needs no introduction in the world of investing but Amitabh Singhi does. He is not yet the superstar Buffett is, but Singhi could very well get there. His portfolio management services company, Surefin, has delivered a return of 24.7% compared with a Sensex return of 15.7% over the past 11 years. So far, the 33-year-old Singhi has deliberately kept a low profile. "This business is humbling. That is why you need to be low ego and self effacing," he says. But the healthy return has generated its own fan following. A Canada-based overseas investor who has been investing with Surefin since 2006 says Singhi's focus on the small cap space offers investors a unique way to play the Indian market. "Not only has the stock picking been excellent, Amitabh regularly communicates with his investors to articulate his thought process," he adds.

CHEAP START

Like most value investors, Singhi's foundation can be traced to reading up Ben Graham during his college days at Wharton. "Overdosing on *Security Analysis* makes you extremely loss averse. Your mind says I cannot go bankrupt and I need to invest such that I get above market returns but I cannot have a permanent loss of capital." Singhi takes Buffett's Rule No.1 — the concept of permanent loss of capital — very seriously. He says for someone like him, with low capital, practising the Graham style of investing was the only way to grow.

Singhi started in 2001 at the age of 21 on his return from Wharton. His parents gave him a table and a chair behind the operator's desk at their office at Udyog Vihar, Gurgaon. He started with managing his family's equity portfolio, then worth about ₹30 lakh. His parents and family friends had all lost money in the tech bubble, so they handed over their portfolios to him for a rescue job. In 2004, he was one of the first to apply for a portfolio management services licence but got it only 12 months after he applied. Sebi actually asked him to certify that Wharton was a good school and get his certificate attested. In response, he sent a copy of *BusinessWeek* that had a story on B-school rankings.

The focus in the initial years was on fixed-income instruments. Yields were falling and Singhi made huge capital gains. He advocates that any wet-behind-the-ears investor venturing out on his own should first start with fixed income. He explains, "Despite equities being the riskiest piece of the capital structure, your mind tends to focus on the upside. Credit is always downside focused, where you keep wondering, can they pay it back?" This conservative approach also influences the kind of return that he seeks in equities. He wants to earn at least twice the 10-year bond yield in an equity investment over a compounded period.

Reading up and investing in small companies has drilled into him that irrespective of size, all revenue is significant. After he began investing full-time, Singhi says, his admiration for his parents went up manifold as they, too, are first-generation entrepreneurs and have grown a business from scratch. Incidentally, he still takes time out to manage the family's finances. If you want to be a good public equity investor, it is very important to have a foot in a private business that affects you daily, he reiterates. "This private business interaction keeps me away from doing stupid things. It also keeps me real as I meet real people and see real businesses. I respect that ₹30, 50 or 100 crore of revenue."

Investing in small companies has drilled into Singhi that, irrespective of size, all revenue is significant

While the preoccupation with the family business keeps his mental clock ticking, Singhi continues to derive vicarious pleasure from finding a small company that is a good business and is extremely cheap. The smallest company he ever invested in had a market cap of ₹25 crore. The Jaipur-based Compucom Software had ₹25 crore of cash and ₹5 crore in profits; he sold it after making 3X and after that, the stock further tripled from there.

It is highly unlikely that someone who has overdosed on Graham does not count Warren Buffett and Charlie Munger among his heroes and so is the case with Singhi.

Analysts who have worked with him say that given his value orientation, there was always the possibility that he would be seen as dogmatic by those who don't know him well. Pramod Baid, who spent two years as an analyst at Surefin and is now an equities manager with the Sovereign Wealth Fund of Oman, says, "Value investing seems a little incompatible with youth given the patience and in-depth analysis it warrants. Moreover, it involves sectors that are non-happening and present very limited quick-rich strategies. It was a little odd to see Amitabh so passionate about it despite being so young."

BASIC PRINCIPLES

Investing is always a probabilistic bet, never an absolute one. So, when you approach investing with a fine toothcomb, the way Surefin does, it automatically filters out many risks. So, it is unlikely you will invest in companies whose managements you don't trust. You will also end up passing a company where everything looks great but just one small thing looks wrong. It also means that you stay away from technology and commodity businesses where change or regulatory developments can mar earnings assessment. This morbid fear of losing your capital ensures you will, by default, end up doing a good job of protecting the downside. Singhi says, "Even if the investment can be a three- or eight-bagger, but has a 60-70% of capital erosion, we won't do it. We are looking for a situation where we cannot lose money under any circumstance."

This strict discipline also percolates into the work routine of analysts working with Singhi. Says Nitasha Shankar, the first analyst hired at Surefin and who now heads the small-cap research team at Equitymaster Agora, "Amitabh is committed to improving his own knowledge and that of people who work with him. He gave me *Security Analysis* and *The Intelligent Investor* the day I joined Surefin. I was expected to spend a month just reading and understanding the two books he considers the Bibles of investing."

The downside of this selective approach is a lot of waiting, more so in buoyant markets. Until December 2012, Singhi had bought nothing new and had only added to some existing holdings. He says, "I am a little sad now. In 2009 I was hugging random people — it was a phenomenal time to buy. It will come again. India is almost 30-40% more volatile than the US." Singhi likes a market that is more down than up because then he can get bargains. Also, bad times bring out the character of managements. He elaborates, "In a growing environment, which we had from 2003 to 2010, it is nice and sexy to be ethical. I want to see five years of drought and promoters still holding on to their principles."

MY FIRST STOCK

The first stock I purchased was Himatsingka Seide. Though it was part of my family's portfolio, I added to the holding based on my assessment of the company's prospects. Himatsingka has been a bittersweet investment. I made money on it twice and then lost some. The learning was that one should not let over-familiarity with a business influence one's investment decisions, more so when the business model itself is undergoing a change

But investors do not give you cash to sit on it — you are supposed to earn a return. The patient yet concentrated style of investing that Singhi practises can only thrive if his investors are also equally evolved. Fortunately, clients don't seem to be complaining. The earlier-mentioned Canada-based investor says, "Amitabh is comfortable waiting for an investment to grow and is not focused on near-term results. His portfolio has about 10 names at any given time, large enough if you are looking to diversify but small enough for you to not lose track."

HITS AND MISSES

Given that the entry price is the only thing that you can control in the market, value investors are pretty finicky about the price they pay. In Singhi's case, because he started out with a small capital base, he was just as wary when his stocks would start running up. Besides his conservative approach, bolting for the exits once the stock had doubled or tripled meant a historically high cash level. Singhi says, "The returns that we have made have been with an average of 35-45% cash."

Right now, Surefin manages ₹50 crore with a cash component of 30%. A strong sense of conviction is necessary when your investing style is at odds with the market at large. And that Singhi possesses in plenty, says

Baid. "Amitabh would rarely get swayed by noise and knew how to keep sentiments and fundamentals separate. He would never be bothered by adverse movement in stock prices/markets as he carried strong convictions in what he held."

Because he lives by Buffett's Rule No.1, Singhi has kept track of the number of losses he has had since inception. "We have looked at 30 different industries and of the 70 investments we have made, we have been above zero on 65 or more over the past 10 years. That will continue because we say no a lot." Past successes and too much cash can also play havoc, something Singhi realised when he invested in Himatsingka Seide for the third time. He lost 50% of his investment and that amounted to a 4% portfolio loss, his biggest so far. Having made money on it twice, and having cash to deploy, Singhi went in believing that he had an edge over everyone else in the market. He says, "That is when a saying Mohnish Pabrai is fond of sunk in: 'You only get to know a company two years after you own it.' We missed the structural shift as demand had undergone a change and they had morphed from high margin designing to a textile company that claimed to have a designing edge."

Another investment on which he lost 60%, amounting to a portfolio loss of 1.8%, was Consolidated Finvest, a Jindal group holding company. Though Singhi had done his homework, the management's sleight of hand caught him unawares. He says, "When you are starting out, you think something complicated and opaque is always good. You think nobody else is doing the work, hence there has to be an edge. But that is not always the case."

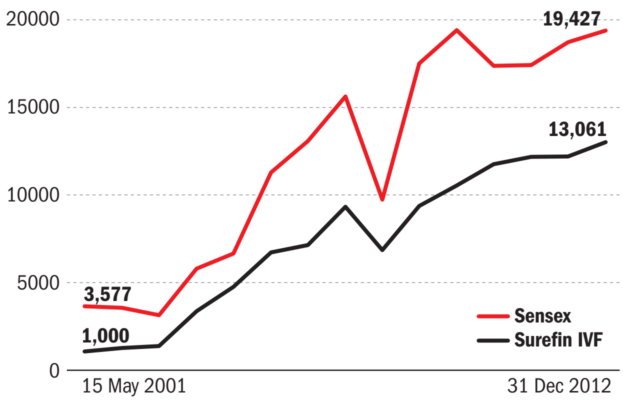
The investing junk taught in B-schools is like going to medical college and being told your heart is in your ass

The rationale here was that the management had sold some assets and the anticipated cash infusion was expected to be much more than the market cap. But before the money could be reflected in the books, the management had already invested it in the preference share of another holding company. "The simple thing I had to do was study their governance history but I was more focused on how much the cash was going to be. It was an example of looking at the wrong thing." Ironically, had he held on to Consolidated, he would have doubled his money; it went up 6X from the price he sold at.

Singhi talks about his mistakes upfront in his client letters. He has been writing since 2001 without naming companies bought and sold every time; the exception is when he is reasonably sure he doesn't want to buy a stock again. Singhi says, "We look at our losers very seriously. In fact I am going to put up a 'wall of shame' in our office. Pabrai has one where he puts up the annual reports of the losers." The way to avoid crowding the wall of shame is by narrowing down to the three key variables. "Whenever Buffett is asked about a company, he rattles the three most important variables. Identifying the key variables in an investment, or the capital structure, or an industry is very important."

Outrunning the benchmark

Surefin has delivered a compounded return of 24.7% compared with 15.7% for the Sensex

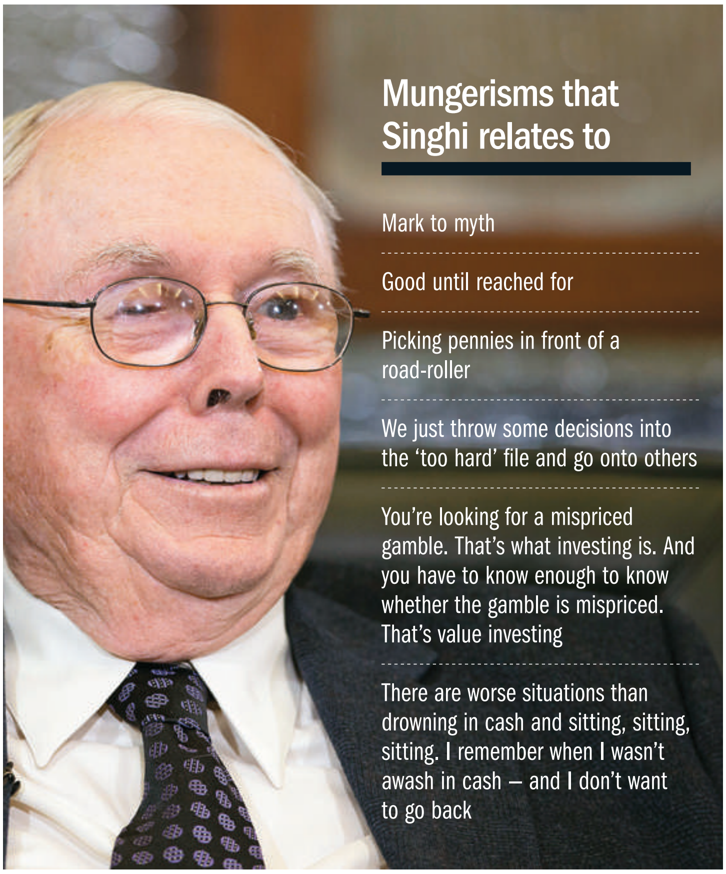


LESSONS LEARNT

The Surefin office at Gurgaon is full of company files that have either been studied or are being looked at. Research work and scuttlebutting take up most of Singhi's and his analysts' waking hours. "Since many businesses here have become global, a lot of my time is now spent looking outside the country for research. If you don't know how the world is pricing things, you might end up buying something that has fallen and looks like 5X earnings." Along the way, Singhi's investing style has undergone a subtle change. When he started, he constantly bought tiny caps but now they do not move the needle as much as they did six or eight years ago. He explains, "I have realised I am not going to find more than three or four good ideas a year; so, compared with conventional Graham, we are concentrating much more than five-six years ago."

Singhi also relies on a checklist of every item in the balance sheet and the income statement, and then of all the mistakes that he has made in the past. Numbers aside, when his team starts gathering information, one of the first things it checks is how employees in the company are incentivised. Much of the ground work on smaller companies centres on the supply chain, auditors and ex-employees. "I want to know all the unlisted businesses of the promoter. I want to know how much it means to him," says Singhi. Similarly, if he is evaluating a financial services company, Singhi likes to closely scrutinise the history of the CFO. Where has he come from and what was he up to earlier? "If you have a dishonest guy running finance you will end up looking at manufactured numbers and book value will not mean anything." The operating mantra at Surefin continues to be, "If something looks too good, be suspicious till you are proven wrong."

As of December 2012, Surefin had about 13 positions of which five belonged to what Singhi terms an "expansion bucket". He explains, "25 to 30% of my portfolio is in companies that are growing very fast and they are all expanding 2X or 3X in capacity and trading at 4X forward or 7X current earnings. So, if the expansion happens we will make 3X; if the expansion does not happen then we will lose 30-40% of that individual stock, which is a big thing for us. That is why we have spread it over a basket of five stocks." The rest 70-75% of the portfolio is in carefully chosen conservative bets. It is because of the basket that the portfolio has swelled to 13, otherwise Singhi usually works with eight to 10 stocks.



Mungerisms that Singhi relates to

Mark to myth

Good until reached for

Picking pennies in front of a road-roller

We just throw some decisions into the 'too hard' file and go onto others

You're looking for a mispriced gamble. That's what investing is. And you have to know enough to know whether the gamble is mispriced. That's value investing

There are worse situations than drowning in cash and sitting, sitting, sitting. I remember when I wasn't awash in cash — and I don't want to go back

AP

CURRENT AFFAIRS

Nothing lights up Singhi's face more than the words "fiduciary responsibility". That is what he has strived to honour right from the day he set up Surefin. He only makes money if Surefin compounds over long periods of time at high rates of return and since he does not charge a management fee, for him asset garnering is a spectator sport.

Critics may carp that what Singhi has achieved is on a very small capital base. He is all too aware of that, which is why over the next few years he wants to move up the next level from Graham to Munger. "Right now, I have to survive. Therefore, we will stick to sure, conservative bets and grow from the current size. But once we grow, we will have to find larger positions that we can hold for a while."

Over the past 10 years, Singhi has attended nine Berkshire annual meetings, testimony to his admiration of Buffett and Munger. Like his hero Munger, Singhi seems determined to achieve his holy grail of having an entire portfolio of only three or four stocks. He cites how Munger's *Daily Journal* sat on millions in cash for about 10 to 12 years and then over a week or so in March 2009, used the entire hoard to buy Wells Fargo at around $9. Now it trades at $40.

Surprisingly, it was only in 1999 that Singhi first heard of Buffett when he visited the Wharton campus; a full auditorium meant Singhi had to be content with watching the video of his visit over the campus intranet. Naturally, once you become aware of Buffett, Graham and a recommendation to read *The Intelligent Investor* cannot be far behind. Shortly afterwards, Singhi started reading *Security Analysis* and was so impressed, he asked his professor Jamshed Gandhi why the book wasn't part of the standard curriculum. Gandhi's reply: "There is nothing to teach in this book. It's all there. Just read it."

His grouse with the way investing in taught in B-schools continues. "The junk they teach you at business schools needs to be made illegal. It is like going to medical college and being told that your heart is in your ass," he fumes. "It amazes me that nobody questions how market premium is calculated. Plus, why they don't teach *Security Analysis*? How can a fund manager invest without reading *Security Analysis*, because at some point in your career, you are going to have a Bill Miller moment?" OB