



January 21, 2019

## March 2018 Annual Update on the Surefin India Value Fund

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Dear Investor,

Please find below the performance of the fund. This is the performance of the master series. Each of you will receive your individual performances separately. Please find the performance update also on the website at [http://surefin.com/newsite/?page\\_id=178](http://surefin.com/newsite/?page_id=178).

### Returns Table and Other Important Data

Surefin Investments is down **(5.2%)** in the last quarter, registering a 14.5% return for the year (since April 1st, 2017) and is up 3,841.2% since inception in May 2001 after fees and other expenses<sup>1</sup>.

This fund has grossed a CAGR of 24.4% over the last 17 years after fees and other expenses.

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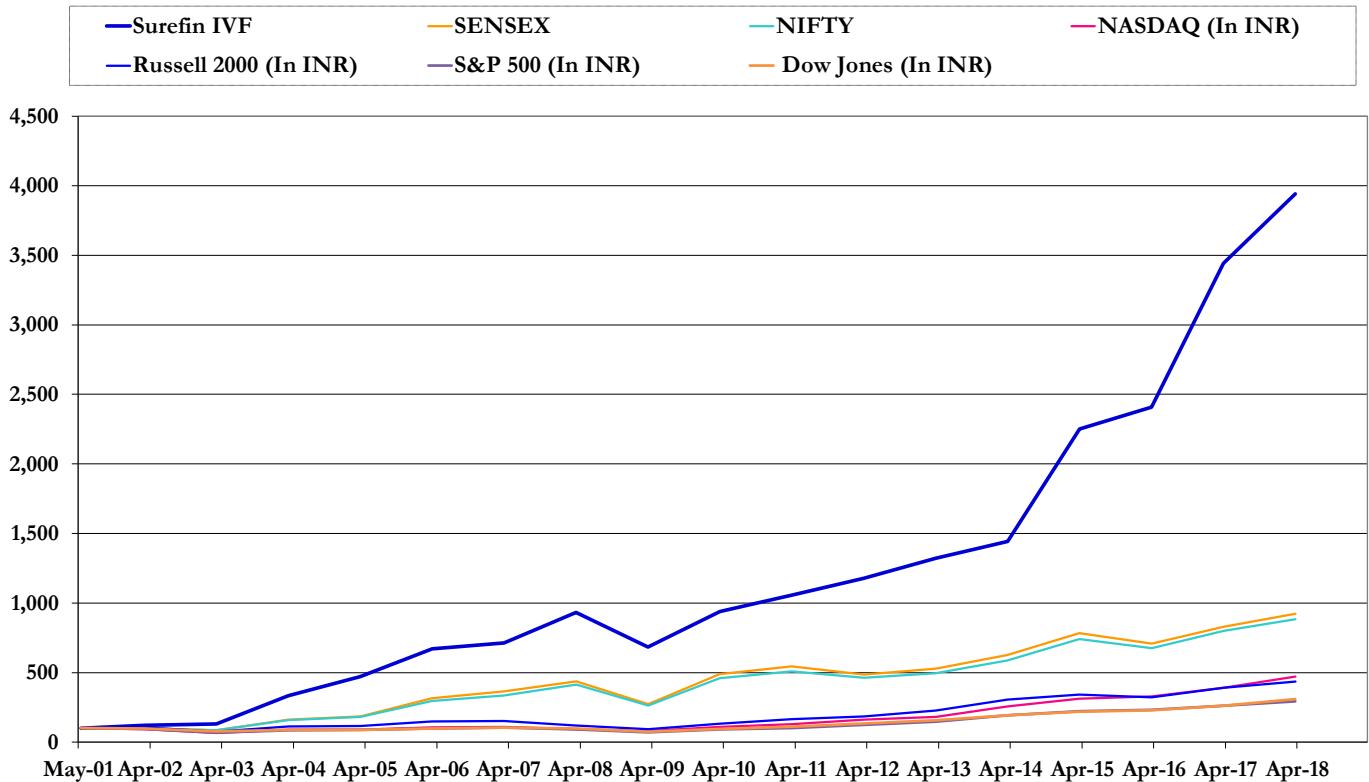
<sup>1</sup> Fees are calculated differently for different clients, depending on when they entered the fund. However, now fees are charged at 0% management fees and 25% carry, over a 5% hurdle rate, with high water marks.

**Percentage Return**

Date	Surefin IVF	SENSEX	NIFTY	NASDAQ (In INR)	Russell 2000 (In INR)	S&P 500 (In INR)	Dow Jones (In INR)
May 15, 2001	-	-	-	-	-	-	-
April-02	20.0%	(2.1%)	(0.6%)	(7.2%)	7.1%	(4.6%)	(1.0%)
April-03	9.0%	(12.0%)	(13.6%)	(29.6%)	(29.0%)	(27.2%)	(24.3%)
April-04	154.0%	86.3%	84.9%	36.7%	47.6%	20.6%	17.5%
April-05	42.0%	15.1%	13.6%	(0.7%)	3.6%	4.5%	1.1%
April-06	42.0%	70.8%	64.6%	20.1%	27.5%	12.5%	8.8%
April-07	6.4%	15.9%	12.3%	1.0%	2.1%	7.0%	8.5%
April-08	30.9%	19.7%	23.9%	(13.2%)	(20.7%)	(14.1%)	(8.4%)
April-09	(26.7%)	(37.9%)	(36.2%)	(15.1%)	(22.2%)	(23.6%)	(21.4%)
April-10	36.9%	80.5%	73.8%	39.1%	42.3%	29.9%	26.5%
April-11	12.6%	10.9%	11.1%	16.4%	24.7%	13.7%	13.8%
April-12	11.6%	(10.5%)	(9.2%)	26.1%	11.7%	20.6%	21.7%
April-13	12.1%	8.2%	7.3%	12.2%	21.7%	18.3%	17.2%
April-14	9.3%	18.8%	18.0%	41.6%	35.8%	31.5%	24.4%
April-15	56.1%	24.9%	26.7%	21.7%	11.3%	15.1%	12.6%
April-16	6.9%	(9.4%)	(8.9%)	5.2%	(5.8%)	5.5%	5.4%
April-17	43.0%	16.9%	18.5%	18.9%	21.8%	12.3%	14.4%
April-18	14.5%	11.3%	10.2%	20.2%	11.0%	12.4%	17.4%
<b>Percent Change</b>	<b>3,841.2</b>	<b>821.7</b>	<b>783.1</b>	<b>370.2</b>	<b>333.7</b>	<b>193.5</b>	<b>207.8</b>

**Comparable Returns**  
**Performance Evaluation of Surefin India Value Fund**

Month-End	Surefin IVF	SENSEX	NIFTY	NASDAQ (In INR)	Russell 2000 (In INR)	S&P 500 (In INR)	Dow Jones (In INR)
May-01	100.0	100.0	100.0	100.0	100.0	100.0	100.0
April-02	120.0	97.9	99.4	92.8	107.1	95.4	99.0
April-03	130.8	86.1	85.9	65.3	76.1	69.4	75.0
April-04	332.2	160.5	158.9	89.3	112.3	83.7	88.1
April-05	471.8	184.7	180.5	88.6	116.3	87.4	89.1
April-06	669.9	315.4	297.1	106.5	148.3	98.3	97.0
April-07	713.0	365.5	333.7	107.5	151.4	105.3	105.2
April-08	933.4	437.4	413.4	93.3	120.0	90.4	96.3
April-09	684.6	271.4	263.8	79.2	93.4	69.0	75.7
April-10	937.0	490.0	458.3	110.2	132.9	89.7	95.7
April-11	1,054.8	543.6	509.4	128.2	165.7	102.1	109.0
April-12	1,177.5	486.6	462.4	161.8	185.1	123.0	132.6
April-13	1,320.1	526.6	496.2	181.6	225.2	145.6	155.4
April-14	1,442.8	625.8	585.4	257.1	305.9	191.3	193.3
April-15	2,251.8	781.6	741.4	312.7	340.5	220.3	217.6
April-16	2,408.3	708.5	675.7	329.1	320.7	232.3	229.2
April-17	3,443.4	828.1	801.0	391.2	390.6	261.0	262.3
April-18	3,941.2	921.7	883.1	470.2	433.7	293.5	307.8
<b>CAGR</b>	<b>24.4%</b>	<b>14.1%</b>	<b>13.8%</b>	<b>9.6%</b>	<b>9.1%</b>	<b>6.6%</b>	<b>6.9%</b>



#### Note:

The returns till 2005 are calculated on an XIRR basis. XIRR is the internal rate of return of an investment that does not necessarily have periodic payments. This function is closely related to the net present value function (NPV). The IRR is the interest rate for a series of cash flows where the net present value is zero. FY is from 1st April to 31st March.

#### Performance Evaluation

The fund is up 14.5% compared with the best of the main indices, which is up 11.3% for the year. In comparison, the BSE mid-cap index in India is up 13.2% and small-cap index in India is up 17.7% during the same period. These indices represent smaller companies.<sup>2</sup>

Our performance for the year was average at best. The returns were just about satisfactory but sometime during the end of the year, and after, the portfolio developed some characteristics of risk that we decided to leave on, although grudgingly. We will go over that ahead in the letter. At the time of this letter going out, the NAVs are suffering minor consequences of that decision.

Investors who have started with us during late 2014 and early 2015 have a higher portion of their portfolios in cash and have outperformed the indices by a very small margin when measured till 31 March 2018. However, since we are down

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<sup>2</sup> We have converted all the international indices to INR for a more relevant comparison. A comparison with USD prices is given in the appendix.

against the market so far in 2019, the returns on those portfolios since inception are only matching or slightly underperforming the Indices. It is not an ideal situation for us. More on that later too.

Our current largest position continues to do well. The main underlying business is now large and still growing fast. However, the risk in the business has grown equally fast as has the valuation. We will leave further discussions on this position for future letters.

## Portfolio Transactions

We sold five positions completely and reduced our holding in two of our existing investments during the year. The details of the positions sold are given below:

Industry / Product	Bought	Sold	Average Months Held	Absolute Return*
Real-estate Linked (i) <sup>3</sup>	Dec, 2014	Aug, 2017 to Sep, 2017	33	1038%
Holding Company (i)	May, 2011 to Nov, 2013	May, 2017 to Dec, 2017	69	596%
Financial Services (i)	Apr, 2016 to May, 2016	Sep, 2017	16	175%
Holding Company (ii)	Apr, 2016 to May, 2016	Sep, 2017	16	147%
Holding Company (iii)	Nov, 2006 to Apr, 2011	Sep, 2017	105	132%
Real-estate Linked (ii)	Aug, 2006 to Oct, 2013	Dec, 2017 to Jan, 2018	70	129%
Media	Feb, 2014	Jun, 2017	49	(12%)

\*Excluding dividends

We sold our position in the Real-estate Linked (i) company with a very high return on a well-sized position. This was a company that was spun out of another company we were holding. We had sold our position in the parent company last year. The company we sold this year was richly valued with scarce floating stock. The management was trying to build a brand in building products which we felt was not going to be easy to do as there are many competitors and the number of product SKUs<sup>4</sup> in the marketplace were too many. For us to make an outsized return (from the price we sold at), this company would need to successfully build multiple brands, manage growing distribution, keep tight control on working capital and also show extreme discipline in capital expenditures on future plants in the coming years. The management of the business was of high quality but we felt that, at the price we sold at, we were being adequately compensated for our level of understanding of their caliber and the economics of the business.

<sup>3</sup> This position was spun-out of another position and our actual cost was zero. The months and return shown here are calculated on the cost of the position assigned for tax purposes by the company at the time of the spin-off.

<sup>4</sup> Stock Keeping Units mean distinct variants of the product in terms of colour or quality

The Financial Services (i) and Holding Company (ii) we sold are a part of something we wrote about last year:

*One of the companies was a conglomerate which had a very fast growing business almost hidden away. This was a position we added during the year in decent size in the portfolio. The company went through various corporate actions while we held for just under two years. We recently sold the resultant positions at the time of writing this letter. Although we made a substantial return on it over a short holding period, we could have made a lot more. We will talk more about that position in our subsequent annual letter to you. That position has some interesting lessons in corporate governance and separately also on how investment operations should be run.*

This was a meaningfully sized position going in and the return was good. Unfortunately we are unable to write about this in greater detail right now as we may have an interest in one of the stocks that pertains to this transaction. It is difficult to mention anything on the situation without giving names or mentioning industries. It was anyway a complicated situation and for anything I write to be even remotely intelligible, I will need to give away more than I want to. It is fair to say though that we should have made a much higher return on this position than we did and we feel blindsided by the decision makers of the transaction. Oh well!

This position illustrates why investing is such an interesting game. While evaluating buying, holding and subsequently selling the position, all within a short span of 16 months, I had to catch up on five holding companies operating in over eight different industries with various transaction related complications in taxation, merger valuations and business operations. At all times there was limited information available and any efforts to “speak to management” would have been futile. It was a little easier because we had been tracking the company and business group for quite some time.

But I am happy to report that I was allowed to dedicate my full time over that one week (before we bought) to this because of the great set of investors I have. I was allowed to focus on activities that matter and not on what many others perceive to be useful but in effect are nothing but asset gathering sales activities – think sponsoring art shows, organizing talks with mayfly macro-economists or promoting wine tastings. (Although I guess if I had to spend an entire evening listening to a panel of cynical economists, some wine would not hurt.) These add nothing to investors’ returns. But the returns to the portfolio manager, flowing from the fee paying assets gathered, is a different story. So thank you for letting me do my job of focusing only on maximizing returns with the ease I am allowed.

In last year’s annual letter we had written about a Holding Company we had sold. Unfortunately we described the wrong Holding Company (as we had more than one in our portfolio). What we said last year, and I am repeating below, actually pertains to the Holding Company (iii) we sold this year:

*“The holding company we sold is something we have held for a long time. It was a holding company that belongs to a reputed business group and it holds equities of companies in the group and outside. We had bought this at a high discount to the underlying NAV when the NAV itself was reasonably valued. The reason for selling was threefold. One, the underlying NAV had gone up. Two, the discount had narrowed and three, the capital allocator had changed since we bought the stock.”*

Even though the stock gave a decent dividend yield, the return without dividends on this position was average at best over nine years of holding it. The Holding Company we sold last year is something we hope to talk about in the future.

The Real-estate Linked (ii) company we sold is something where we still hold some stock in some of the accounts so we may talk about that if and when we have sold out completely.

The Media company we sold was a very small position and we could have sold it earlier at a higher price. In fact this is a position we had bought for clients much later (in addition to some stock we had bought much earlier at much higher prices for proprietary accounts) and we had a positive return on all those accounts within a much shorter duration of time. However I am glad we got out when we did as the stock is down from where we sold. Investing is a forgiving game sometimes.

We bought three new positions and added to two existing positions in the fund this year.

Four of those positions had to be looked at together as they were all a part of a corporate reorganization. We had first bought one of the companies in the previous year and during this year a potential transaction was announced so we added to that position and added three new positions. Today we hold these positions as somewhat independent investment situations.

## **Portfolio Holdings and Mistakes**

As on 31 March 2018 we were holding 11 positions that made up about 42% of the fund. The balance was held in cash, money market mutual funds and other current assets. Here is a break-up of the industries we were holding companies in:

<b>Allocation (March 2018)</b>	<b># of Cos.</b>	<b>% Allocation</b>
Holding Company (Many Industries)	1	26%
Financial Services	6	9%
Media	1	5%
Real-estate Linked	2	3%
Others	1	<1%
Cash, Money Market, Margin Money (if any)		58%
<b>Total</b>	<b>11</b>	<b>100%</b>

Our top five and top eight positions make up 95% and 99% of the non-cash portion of the fund; and 40% and 42% of the total fund, respectively.

One of our holdings that we added to during the year has performed badly. Here is what we wrote about it last year:

*“The third company we bought is one where the industry may get disrupted in the future but the business is cheap if a few things work out over the next few years. This is a position where we may even lose money if things turn against us and we have sized the position accordingly.”*

Clearly we ignored our own warning from last year. Last year I had made it a 6% position and this year I sized it up slightly. The stock price is down about 60% from our highest buying price at the time of this letter going out. Both the business and the stock price have not done well. However there has been a merger and the industry is consolidating and that may reduce the pain for the remaining players. Still, things do not look rosy at least for the next few years.

Even though I think the stock is not expensive at these levels, the mistake here was that I had allocated too much at the beginning (or maybe the mistake was buying it in the first place) especially given that I knew, going in, that there was an existential risk to the business. An existential risk is basically something visible on the horizon that can cause the business to go to zero over time. In a typical case the company can face a slow death - first the growth will decline, then there will be de-growth and eventually the equity value will evaporate rapidly or be frittered away by desperate management.

As a result now that the stock is down I don't have the conviction to add substantially. The stock is down and we are not buying more. Yikes! I am watching painfully (and helplessly I might add). But at the peak price that I bought it at, it may have seemed that I was pricing in some growth in revenues (more through increased pricing and some through increase in number of customers), but which now am certain I was wrong on. I think (or maybe 'hope' is more appropriate) the current stock price is factoring a greater decline in the business than what may actually occur. We will wait and watch.

We have made a few bets in the last year where I have tried to pay for growth (or ignored principles on extreme levels of debt) and been quite wrong on. We bought some of the positions with lower than usual conviction and quickly paid the price in the markets. The two that I mentioned last year are still doing badly in terms of price and business. As a reminder here is what I wrote last year:

*“We have a few stocks that look like mistakes in our portfolio. Their current prices are below our buying price and substantially so in some cases. But we had sized all of them small. We have two positions where we have a loss of almost 50% from our buying price. Both combined were about 0.8% of AUM at cost going in. We are still holding them and plan to do so for a little while.”*

It seems like I have added a third this year and it was not a small position (mentioned above). I am doing more of this when I have cash lying around and not being able to find something sizeable. In such times I lose discipline and I make these relatively smallish bets in haste. Whenever I do sell these positions, please expect a thorough explanation of the journey. I need to ensure that I rub my nose in my mistakes. If I forget, please remind me.

To investors who have partnered with us over the last three to four years, I must confess that I have tried my best to find things to put money into and have failed. The environment has just not been right for us. We did not find anything that we thought would give us adequate downside protection. Apart from only a select few potentially small investments, I do not think we missed any large ones. We did buy some of the existing positions in older portfolios for

the new portfolios so we do have some things which we think should do well going forward. But it is also imperative that we find a few more going ahead for the returns to look good for these accounts.

Some investors have suggested that since we keep so much cash<sup>5</sup>, maybe we can return the cash or only call for additional cash once we have exhausted our current stash. However, that does not work so well for us. One key reason we can make the investments we make is because we know we have the balance lying in cash to deploy when a situation comes up. It is neither psychologically nor practically possible to call for money from all the investors just when we need to put money to work. We are not individual stock pickers alone. I look at the whole portfolio at all times. So if we return the cash lying in the portfolio, I will be forced to sell down all the positions so that the % allocation to each stock is where I want it to be. I always treat the money we receive from investors as all the money we will ever get from them. Often I treat it as all the wealth the investor has. The cash cushion lets me make bolder bets on the investments whenever an opportunity arises. Not having the cash available immediately for deployment would cramp my investing style substantially and would not work.

Investing is not a business where activity is rewarded. Making infrequent but right-sized bets is key. And sometimes those opportunities don't appear for long periods of time.

This is not the first time we have not been able to find sizeable investments for long periods of time. There have been two distinctive periods over the last seventeen years when we have had to sit on the sidelines for years at end. Also when we sat out it was not clear if we were in a bull market or if it would end soon or even how it would end. Also, it was never absolutely clear that it even was an irrationally overvalued market. India always has so many infrastructural problems that if fixed will offer companies huge tail winds to grow and therefore temporary overvaluation of specific companies based on the future growth story can be tempting to accept. We have to make sure that we are sure about our understanding of investment situations that have good potential for growth even beyond what the current numbers are telling us. Our job also is to wait till we get the price that allows for errors in our judgement, and make sure we do not pay-up in the name of say a 20-year growth forecast or some other macro mumbo-jumbo.

## Portfolio Concentration – Important

We are repeating something we have mentioned in our previous annual letters to you because it is going to be important for us going ahead:

Mr. Buffett in his 1965 year letter has an excellent section labeled Diversification. He wrote “*We are obviously following a policy regarding diversification which differs markedly from that of practically all public investment operations. ... We have to work extremely hard to find just a very few attractive investment situations. ... We probably have had only five or six situations in the nine-year history of the Partnership where we have exceeded 25% in a single*

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<sup>5</sup> Almost all the “cash” is invested in liquid funds and/ or money market funds that I select.

*investment]. ... We presently have two situations in the over 25% category – one a controlled company, and the other a large company where we will never take an active part. It is worth pointing out that our performance in 1965 was overwhelmingly the product of five investments. ... If you should take the overall performance of our five smallest general investments in 1965, the results are lackluster (I chose a very charitable adjective).”*

Mr. Buffett said that he had invested more than 25% of the fund in a single investment only five or six times in the last nine years! How many fund managers can say that for themselves today?

Going ahead, especially in a market like the one we are in currently, our top two to three positions or buckets will be most crucial to our overall performance. If we are unable to find them or we get those wrong, we will likely have very mediocre results.

We have consciously allowed our portfolio to get concentrated into one particular industry as everything else seemed to be priced well. We have, to some extent, back-ended into this industry and tried to learn as we went along. I also added to a few companies during the year and as a result am now very committed within this one industry. The industry has characteristics that may seem risky to conventional investors (including to me for more than a decade before I made these bets). The dynamics of the industry usually cause the companies within it to have a lot of volatility in their business numbers. So things can grow very fast or can have some very bad years with losses and even blow-ups. So we expect volatility over the next three years in these businesses and maybe the stock prices too.

## **Whims of the Fund Management Business and Our Constraints**

The investment management profession is unique in terms of how the fund manager is evaluated. Managements of operating businesses are not held accountable to have their performance measured against an alternative. For example one could measure the performance of all managements by comparing the growth in intrinsic value per-share (which may be conservatively approximated by the growth in book value per-share or some other method one prefers) when compared to the returns in the stock indices over a long period of time calculated on a rolling basis. This is almost never done. In contrast, a fund manager must beat the index over time otherwise he or she has no reason to exist.

This constant measurement of performance along with forces of envy which we will touch upon later in the letter, mean that investing is an extremely psychological game. Once a fund manager builds competencies of being able to value individual businesses, he or she must deal with many other nuances. ‘Buy and hold’ doesn’t always work. How long should one hold each position for? One can be stuck in a “cheap” stock for a long time. At the same time selling early is a mistake, albeit a smaller one than if one is stuck holding a dog. Errors of omission should be treated as smaller mistakes than errors of commission. How should one trim or add while holding it? The mistake of not buying more of something one likes as time passes is probably the most underestimated mistake that investment managers make. How should one sell – should one average up or sell all in one shot? Although, selling early is clearly a “good” problem to have. It is only in perennial one-way bull markets that people start complaining about selling early. I could go on. Anyway, the lesson here is that there is no one style or trick that works in investing in the long run. Identifying a company to buy is only one thing. There are many more factors that impact how an investment operation plays out.

Never talking publicly about our actions real-time is extremely important because we may be in the middle of deciding on one of those steps mentioned above and the last thing we need is to be worried about what someone else thinks. We have been blessed with a set of investors who are cognizant of this and I am proud to report that no existing investor has ever prodded me to talk about our positions current or past.

One of the crucial things for us to be able to do our job well has got to do with our like-minded investors and their expectations and our incentives. What we wrote on this last year is as relevant today:

*“We have the benefit of being able to sit on cash and wait for opportunities at the right price partly because our incentive structure aligns our investment goals perfectly with those of our excellent set of business minded investors. We are incentivized to get the maximum risk-adjusted returns on the funds we manage over the long-run and not to simply put money to work in order to earn the management fee.”*

The investment environment this year has become tougher for us to operate in and last year was not easy either. I will be happy if over the next few years we are able to simply keep up with the indices if they go up even moderately. Therefore investors should not expect anything higher than low double-digit annual returns (say 10%) net of fees even if the markets give high double-digit returns and lower if the market returns are lower. Those of you with higher expectations may want to exit and invest elsewhere, perhaps in an index fund, and that will be perfectly fine with us. I do not want to disappoint our partners and it is entirely possible that some mutual funds or other money managers may deliver higher returns going forward in this market. Over the long run though we hope to do okay.

My goal professionally is not to have the largest fund. Don’t get me wrong – I understand that the fund management “business” is one of the best businesses in the world. More so for someone who has no capital to start with. You sit on your ass with reading material, make investments and get a carry on others’ capital. In most cases fund managers charge fees just for breathing. But even if you have a fee structure where only the upside is shared, it is still a great deal. As an example, even with a fee structure similar to that of Mr. Buffett’s early partnerships of taking a 25% carry after a 5% hurdle<sup>6</sup>, if the manager makes a 12% annual return for 25 years, he ends up with 33% of the entire fund’s assets. So if one starts with \$10 million of capital of others’ money, \$0 of one’s own, makes a 12% annual return, takes in no new money and reinvests the fees accrued, the investors end up with \$115 million, with an annual return of 10.25% - not too shabby. But not nearly as good as the manager who ends up with a whopping \$55 million! The total fund AUM becomes about \$170 million after 25 years. Of course as the returns (or capital raised) go higher the numbers become obscene.

I am not suggesting that this is immoral. If someone can compound at that rate each year for 25 years, that person deserves the investors’ faith and the fees. However, I find the level of envy in fund management to be extreme, especially given how good the economics are if you are even mediocre at your job. Many managers mindlessly focus on gathering assets when returns have been mediocre or have been earned over a short period or on small amounts of

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<sup>6</sup> Mr. Buffett’s early investment partnerships initially had slightly differing fee structures and finally settled at a 25% carry over a 6% hurdle. Have rounded off some numbers in this section to get the broad point across.

capital. Whereas the reality is that if your returns are good over the long-term and you have been able to explain clearly what has worked and what has not worked, investors will eventually find you (and at some point they will swim through shark infested waters to invest with you). But it will take time and, just like with everything else, things will slowly compound over time.

My main kick in life is to be a better investor five years from now than I am today. The way to evaluate that is to have good returns and preferably over a gradually rising pool of capital. I do not want to get ahead of my abilities. Managing Rs. 10 crore is different from managing Rs. 100 crores which is different from managing Rs. 1,000 crores and so this geometric progression goes. So today we have above Rs. 200 crores under management<sup>7</sup>. Basically that is all the equity that the world has entrusted us with. Most of our long-term returns were created when we had well under Rs. 100 crores. So first I have to do a first rate job with what I have in hand before I even think of deserving more assets. And to state the obvious it is harder to manage Rs. 200 crores than it is to manage Rs. 100 crores. So today I have to manage this and do well at it and take it from there.

I also do not want to burn myself on both ends. The key is to be on the edge of one's competency, but not far out of one's depth. And I would err on the side of caution because we can never forget that we are managing people's money and the rule #1 is not to lose money (the second rule is to not forget rule #1). That's why when I see people raise billion dollar funds, I am awed by the prospects.

There is so much to learn at each step and only when one feels one is ready or is stagnating should one take steps to get to the next level. The only exception is if we enter a time when things are at an extreme on either side – screamingly cheap or absurdly expensive.

## **Our Journey and the Evolving Structures**

Our assets have always been in different pools and on slightly different terms for various reasons. One, the regulations forced us. We only got our Portfolio Management Services (PMS) license in 2005. Before that there was no PMS regulation and there was no way to pool funds and be able to earn performance based fees. So we did tri-partite agreements and managed people's trading accounts. I was a prepubescent 23 year old asking people for money to invest and that too in India! So we had to take capital in whatever form we got when we started. Even after the PMS regulation was in place, NRIs (Non-resident Indians) and proprietary capital could not be put together into one pool. So we had to put separate buy orders for multiple accounts which meant different prices especially if we were buying small illiquid stocks. Also, the regulation for what could be pooled for domestic investors kept changing. Even today we can pool the bank and mutual fund holdings but cannot pool the equities. To advise foreign capital (non-NRI - enjoy the double negative), it was even more complicated and a different structure was required. Investments in debt, real estate, distressed opportunities etc. – it had to be done separately as these could not be pooled.

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<sup>7</sup> Across all pools and asset classes including within the private company currently investing in real estate projects.

When we started and greatly today also we focused solely on finding interesting investment opportunities and on doing the best we could within the structure available. We tried as best as possible to have uniformity in our investment actions towards all types of investors but there were always exceptions. The structural and regulatory limitations did come in the way of a neat narrative where there is one pool that has one set of neat returns with all the numbers going straight up. I might add that our ability or inability to present a neat narrative to the outside world makes no difference to the interest of the individual investor. It merely plays the limited role of being a broad score card of our own performance.

Today the problem of our structure is that we have too many pools that hold different portfolios under slightly varied terms. We cannot plan for taxes at the fund level. Nor can we make really long-term investments (think over ten years) or buy illiquid assets in the fund. We also cannot borrow against our assets. We cannot invest internationally. We cannot buy private companies. The list goes on. In investing you want to keep the maximum flexibility. I am working to try and evolve a favorable structure that allows greater flexibility and if we find something worthwhile we will reach out promptly to each of you separately.

### **Indian Investment Environment and Business Opportunity**

We had written in a separate section in our last year's letter to you titled "*Valuations of Small-caps - Buyers Beware*" implicitly urging investors to be cautious about investing in small-caps, which had reached very high levels. The bubble seems to have been punctured in the later part of the year. But I think some of the companies still have further room to go down and some may even go to zero. In any case, the froth seems to have gone and I do not think most of those companies are coming back anywhere close to their all-time high valuations.

We had also written in our 2015 annual letter that liquid funds were doing reckless things and rating agencies were rating short-term papers differently than long-term papers for companies and that there was a risk brewing. Here is what we had said:

*"Another area for concern is in the debt markets. Short-term loans (under 6 months duration) for some companies are priced all wrong today. Mutual funds are going crazy buying paper ranked "A1+" or "AA" from one of the few rating agencies. There is an emerging lot of companies that has figured out that borrowing 6-month money in the form of a revolver loan and placing that amount with a rotating set of mutual funds is a great way to reduce interest costs. Because the duration is short, mutual funds do not seem to care about charging an appropriate yield. It is astonishing for us to see that some of these companies are being able to borrow funds at the same rate as super good credits (or maybe only 50 basis points higher). Interestingly many of these loans keep rotating for years. Even though the amount of loans from "bad" companies is still low, it is going to be interesting to see how this party ends. The next time you get pitched the "best performing" short-term debt fund, make sure to check its holdings. If there are companies you would not trust with your money (as equity or as debt), do not invest. Credit ratings be damned."*

Some of that has been highlighted recently (towards the end of 2018). But I think we will not get much change in ratings and in the actions of fund managers at liquid funds till we get a proper debt market where a range of rated

papers trade and the markets price all types of debt. In fact it may be better if debt fund managers are not allowed to see the credit rating reports of agencies or see what other competing mutual fund managers are buying before they give their suggestions to the investment committees of why they want to buy the bonds of certain companies. But obviously that is not going to happen.

Notwithstanding the aforesaid, India as an economy will keep getting larger both in absolute USD terms and relative to almost all the other large economies in the world. Indians as a group will earn more, spend more and most individuals will save more. More importantly, most of our savings will be invested domestically. This is what we wrote last year and want to repeat it here:

*“The Indian consumption boom is going to have a very long runway. The best part is that what goes on in the rest of the world has little to no impact on what goes on in India. Indians will buy cars assembled or manufactured in India, shirts branded and manufactured in India, want banking services provided by Indian old-school banks and new “digital banks”, consume food ranging from high quality staple grains to fast food all produced in India. And of course they will continue to have lavish weddings and produce many babies! We are world leaders in that.*

*...Indian investors will become the largest owners of equity assets within India over the coming decade (as opposed to foreign investors today). They will invest through mutual funds, insurance companies and direct brokerage accounts. The numbers are staggering (think multiple trillions of dollars). This phenomenon of domestic savings flowing into the Indian financial system over the coming decade is probably the single biggest factor for being positive on India and the Indian markets in the long-term. Unless we do something really stupid with our currency, which is a very small probability event (even though the RBI stands slightly weakened in its stature over the recent past), India will get richer relative to the rest of the world in the decades to come. The future looks very bright.”*

India's overall economic output will grow decade after decade into the future. No change in political party, no deterioration in macro-economic variables, no international geo-political disorder, no social upheaval, no threat of technology disruption will be able to affect that. India will grow irrespective even though the news at many times will be dismal and things could look very difficult for a few years in the middle. The reason for this growth is that the spirit of capitalism is now deeply entrenched in the psyche of India's people and it is only getting stronger as people get more empowered. The socialist policies, which are very critical for the vast majority of India that is marginalized, ensure that many people are happily moving into the small but growing middle-class in India and once there, they immediately switch to being ruthless capitalists. As each decade passes, and as education and health services become more pervasive (and at some point in the future they are taken for granted by everyone), the fire of capitalism will be fueled even further. From being helpless worshippers of the “sacred cow” they will switch to wanting to ride the “market bull”. India's hundreds of millions of consumers-in-waiting will devour products and services like never before. And most of those products and services will be produced in India and we will take the world's capital and know-how as we grow.

India remains an exciting place to compound one's wealth over time. It has one of the largest number of listed companies in the world. The capital markets with all types of securities of all types of companies in all types of industries operating within different parts of India offer an amazing opportunity. This gives an opportunity for the patient and prepared investor to benefit over the long-term.

We had written this to you in our last years' letters and repeating here:

*"India remains severely under-invested in equities. The historic trauma of deep volatility and unchecked speculation has left many people born in the 1960s and who were old enough to take care of their finances in the 1990s, permanently biased against equities. What made the bias worse was how well their real-estate investments did during the last decade. But there is a current movement by the government to "squeeze" investors into equities. Long-term bond yields post-tax are under inflation or close to zero. Real estate industry had bubble prices that are finally deflating now. The multi-year metal commodities boom seems to be bursting. Savers in India will be (rightly) forced to invest into long-term equities. The tax treatment of long-term equity investors with 0% capital gains taxes for listed equities and equity Mutual Funds is superb in India. It seems obvious that the only way for investors to make over 10% post-tax return in large quantities is to be invested in equities in India over the next many years."*

All we need to do is to participate in all this capitalistic activity in a low-cost and consistent way while being conservative on the price we pay upfront. We need to make sure we do not do anything stupid like trying to get rich too quickly by employing leverage or cutting corners or trying to do something simply because "others are doing it".

## **Important FYI and Miscellaneous**

We wrote this in our last year's letter to you:

*"Our investment in the private company involved in developing affordable homes continues to do decently. Our assets under management in equities had grown considerably over the year. Sometime during the middle of the year there were some reorganizations that led to some of our proprietary assets leaving the public equity pools and getting swapped for an increased proprietary stake in the real estate business. As a result a larger percentage of my net worth is now invested in the private business than in the public equity pool and the AUM of the public equity pool has fallen. We think the affordable housing space in India is ripe for growth. We will be writing to each of you separately on that."*

Over the year I had written to some of you to participate in the housing company and those equity investment rounds were committed to by select investors promptly and now stand closed. For those of you who did not receive an offer to invest in the housing company, it was for a few reasons. You either did not have sufficient funds invested with us to meet our new minimums in the fund, and therefore I assumed you would not be interested in the housing company opportunity because the minimum investment required was higher. Or we are close personal friends or family and there's no point in mixing a permanent business relationship with personal relationships (especially in a structure where there is no quick and easy way to provide an exit to investors). I know this may be an unusual reason but I have realized in India that very close personal relationships and business don't mix well.

Even though a considerable part of my net worth is invested in the private company, my wife and I still have a significant percentage of our net worth invested in the fund, and any equity investments held within the private company will also be managed by me and invested alongside the fund. I do however, want all the people who are not invested with us in the private company and even the new investors who may come into the fund in the future, to know the reality about the lack of perfect alignment of my interests. I will be vigilant about it and if it interferes with my ability to perform my duties, I will be prompt and transparent about it.

I am blessed to have investors who are contrarian and long-term. I look forward to hearing from you if you have any questions, concerns or suggestions.

Warm regards,

Amitabh Singh.

Portfolio Manager  
Surefin Investments  
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## Appendix

Performance Evaluation of Surefin India Value Fund

Date	Index Value										
	Surefin IVF	SENSEX	NIFTY	NASDAQ	NASDAQ (In INR)	Russell 2000	Russell 2000 (In INR)	S&P 500	S&P 500 (In INR)	Dow Jones	Dow Jones (In INR)
May-01	1,000.0	3,577.0	1,145.3	2,085.6	97,813.7	489.6	22,963.6	1,249.4	58,598.7	10,873.0	509,942.3
April-02	1,200.0	3,500.2	1,139.0	1,862.6	90,784.1	504.5	24,589.3	1,146.5	55,882.4	10,362.7	505,078.0
April-03	1,308.0	3,081.0	984.3	1,348.3	63,882.5	368.7	17,468.5	858.5	40,674.8	8,069.9	382,350.0
April-04	3,322.3	5,740.9	1,819.7	2,015.0	87,300.3	595.3	25,792.2	1,132.2	49,051.3	10,373.3	449,424.5
April-05	4,717.7	6,605.0	2,067.7	1,984.8	86,702.5	611.6	26,714.3	1,172.9	51,236.7	10,404.3	454,491.0
April-06	6,699.1	11,280.0	3,402.6	2,339.8	104,132.8	765.1	34,052.7	1,294.9	57,628.4	11,109.3	494,422.5
April-07	7,129.9	13,072.1	3,821.6	2,421.6	105,142.0	800.7	34,765.0	1,420.9	61,690.5	12,354.4	536,397.5
April-08	9,334.4	15,644.4	4,734.5	2,279.1	91,281.6	688.0	27,554.3	1,322.7	52,976.3	12,262.9	491,148.4
April-09	6,845.5	9,708.5	3,021.0	1,528.6	77,514.6	422.8	21,437.6	797.9	40,459.9	7,608.9	385,847.6
April-10	9,370.1	17,527.8	5,249.1	2,398.0	107,810.4	678.6	30,511.1	1,169.4	52,576.6	10,856.6	488,105.4
April-11	10,548.0	19,445.2	5,833.8	2,781.1	125,440.4	843.6	38,048.4	1,325.8	59,801.7	12,319.7	555,682.7
April-12	11,774.9	17,404.2	5,295.6	3,091.6	158,242.0	830.3	42,498.9	1,408.5	72,092.5	13,212.0	676,258.3
April-13	13,200.8	18,835.8	5,682.6	3,267.5	177,606.0	951.5	51,721.0	1,569.2	85,293.3	14,578.5	792,416.5
April-14	14,428.5	22,386.3	6,704.2	4,199.0	251,447.3	1,173.0	70,244.9	1,872.3	112,121.0	16,457.7	985,530.8
April-15	22,518.3	27,957.5	8,491.0	4,900.9	305,909.5	1,252.8	78,197.0	2,067.9	129,076.2	17,776.1	1,109,573.0
April-16	24,083.2	25,341.9	7,738.4	4,869.9	321,891.7	1,114.0	73,636.2	2,059.7	136,146.5	17,685.1	1,168,965.0
April-17	34,434.2	29,620.5	9,173.8	5,911.7	382,628.9	1,385.9	89,701.7	2,362.7	152,923.6	20,663.2	1,337,397.2
April-18	39,411.8	32,968.7	10,113.7	7,063.4	459,935.9	1,529.4	99,588.8	2,640.9	171,960.3	24,103.1	1,569,474.0
Percent Change	3,841.2	821.7	783.1	238.7	370.2	212.4	333.7	111.4	193.5	121.7	207.8
CAGR	24.4%	14.1%	13.8%	7.5%	9.6%	7.1%	9.1%	4.7%	6.6%	5.1%	6.9%

### Note:

During the early part of the year 2009, SEBI had changed the way that PMS providers operated the accounts. SEBI mandated that each provider open separate Demat Accounts for every client and till a Demat Account had not been opened for every client, the PMS provider could not buy securities on behalf of any of the clients. Given the new laws in opening Demat Accounts and the tedious KYC norms by the NSDL and various custodians, it was impossible to meet the deadlines set by SEBI and our buying was in effect frozen for a good part of May 2009. Most stocks rallied

soon after and it was painful to sit with cash (that we had hoarded so painstakingly for a period like 2009) and not be able to buy anything due to this back-end and regulatory glitch. We estimate that we lost a potential 40% return in addition to the existing return due to this. The substantially lower returns in FY 2010 have lowered our overall return substantially (from a 5-year perspective). We have spruced up our back-end operations and team since then to make sure that this does not repeat itself.