SURFIN INVESTMENTS

October 8, 2007

From: Amitabh Singhi

To: Investors in Surefin India Value Fund

Subject: September 2007 Quarterly Update

Dear Investor,

Please find the performance update on the website: http://www.surefin.com/newsletter.htm

Performance Review

Speed in the investing world is much like on the roads; it thrills but often also kills. Foreign Institutional Investors have poured in $3.5 billions dollars into the stock markets in the month of September thereby taking the indices to all time highs. In such heady times, it is important to keep our feet firmly on the ground and not get distracted with all the current hype around India. We would be happy with an absolute 15% return with even a 15% underperformance relative to the indices in a bull market as long as we can outperform a down market by more than 10% while ensuring a positive return every year.

Most importantly we are happy to have met our targets of investing in good companies at very cheap prices. We are not in a position to predict when and by how much they will appreciate but it may be instructive to know that in the past most of our positions have unlocked in very short and lumpy periods of time with lots of time in between with little activity.

We feel that sustainable money in the long-run will be made in companies that have a long enough history of performing through down cycles in their particular industry. We also expect to be evaluated as a fund manager in much the same way.

Current Holdings

We are currently holding positions in the following industries: Granite, Fertilizer, Soda Ash, Chemicals, Investment Holding Companies, Leasing, Real Estate and others. Most of our positions have had historical return on equities north of 20% emanating out of a durable competitive advantage in their core businesses. More importantly we have bought them at very low prices which should augur well for us in the future.

Allocation amongst Holdings

Warren Buffett in an interview once said that if he had $1 MM to invest he would guarantee 50% returns per year. He also said that he would do this by, among other things, holding a concentrated portfolio where 5 stocks could hold greater than 80% of the fund's holdings.

We have always believed in holding very concentrated positions. Currently, the top three investments in the fund constitute a little below 50% of the total fund value. We are careful, though, to not hold positions in industries that are correlated so that a single exogenous event does not affect us materially.

A Couple of Examples of Our Holdings

I would like to talk about two of our holdings (and another one later in this letter) in particular:

<u>AAA Bonds at 40% Discount</u>

It is a financial intermediary and holds a lot of (mostly AAA-rated) bonds on its balance sheet, which have almost no interest rate risk. In financial parlance, the modified duration of the bond portfolio is below 4 years. To fund the purchase of these bonds, the company borrows in the short-term debt markets (in addition to investing the equity reserves) and actively monitors the difference in the short-term and long-term debt yields. (In financial parlance, the yield curve). The company is selling on the exchange for exactly half of what we would get if we were to make the company private and do a fire sale of all its assets. In financial parlance, the market capitalization is at less than 0.5 times to adjusted book value. And the all assets can be sold within two hours! Also, the company is starting to pay a healthy dividend yield, is unlikely to lose any money in the near future and is also adding new revenue streams which will go straight to the bottom line. So here we have a company that is not going to loose money (in fact is making decent money), is holding liquid net assets (net of liabilities) that have no real interest rate risk and also getting into new avenues that is trading at half of what a shoddy auction house could fetch it for its assets within two hours. You are basically getting money invested in 4-year bonds at half price. It feels like happy hours on Christmas Eve!

A White Swan among Ugly Ducklings

I am attaching a broad note on a company, which is another one of our holdings. Though we do not usually disclose our reasoning in such detail I think certain positions are worth explaining to investors since they may highlight a lot about our thought process and general investment philosophy.

We have concentrated a large position in this small company and it is a classic value story – an exceptional company in a mediocre industry and trading very cheap with earnings expected to increase fast.

Sub-prime Mess

The increase in risk-premiums around the world is necessary and is a good thing for asset prices to truly reflect underlying values. When interest rates globally are at 40-year lows, many asset prices get out-of-whack making many a frog look like princes. I believe the sub-prime mess will lead to some flight to quality and that will be good for us in the long-term. Nevertheless, in the short-term the sub-prime fiasco may affect the following companies that we hold:

Financial Intermediary: We have invested approximately 10% of our portfolio in the financial intermediary mentioned above. If long-term interest rates go up and short-term rates stay stable then this company may suffer in the short-term. However, earnings over the long-term will increase. If both rates go up in tandem then nothing much should happen. The impact either way will be miniscule since all the bonds are AA or AAA quality.

Leasing Company: We have invested approximately 8% of the portfolio in one of the oldest leasing companies of India. Since the funds of the company are mostly tied up through borrowings the company may have to pay a higher interest rate to continue to borrow. So borrowing costs will go up. But given that the yields leasing companies charge are also invariably linked to competitive interest rates from other sources (banks, equipment finance companies, local money lenders etc) there will also be competitive pressures to lend at higher rates. The net effect will again depend upon the duration of the borrowing versus the lending. Given that the company manages the asset / liability mismatch well, and has over a 30-year history of doing that, there should not be any significant long-term risk from movements in interest rates.

There may be a slowdown in business due to higher rates, which is something that will affect all lenders. However, I don't see any serious slowdown in business going forward unless the 10-year interest rate moves from the current 8% levels to over 11%, which is a very large jump.

Real Estate: We have mentioned earlier our investment into real estate as an industry. The company we have invested in however is actually not into real estate but the real estate is available for free – it is lying on the balance sheet at a very low rate and is lying unutilized in the business. The stock market is also not assigning any value to it. So much so, that the value of the real estate if properly developed can be 3 times the value of the entire company. In addition to this, the company has cash almost equal to the market capitalization and a business that is getting valued at 6 times earnings at current market cap. We must mention that this is the smallest company we have ever invested in. So the quick balance sheet looks like this ($ MM):

Assets	$MM	Liabilities	$MM
Cash and Equivalents	**$7**	Shareholder's Equity	$10.025
Fixed Assets	$3	Debt	$2.5
Free Real Estate	$0.025		
Net Current Assets	$2.5		
Total	$12.525	Total	$12.525

Profit after Tax = $1.5

Market Value of Free Real Estate = $5 to $15

The market capitalization of the company when we bought it was $7.5 MM! This is a classis case of having an extreme margin of safety and the sub-prime issue will have no effect on the value of the real estate. The business is selling at 1/4th of what it would sell to a private owner.

There will be no foreseeable effect of the sub-prime fiasco on the businesses of any of our other holdings. What may happen to the prices is anyone's guess.

Reflexivity and Real Estate

George Soros talked about the concept of Reflexivity. In simple terms it is an unbreakable inter-dependency of price and value (at least in the current context). According to the conventional investment philosophy the price of an asset is driven by its underlying value and not vice-versa. Reflexivity turns that on its head and claims that there are in fact situations where the price of the asset starts to affect the value.

Reflexivity is dominating the Indian markets right now in many places. High valuations are giving Indian companies capital to undertake bigger projects, some of which if successful will lead to even higher valuations for those companies. Also, in the case of real estate the reflexivity has taken the form of an enormous bubble, as big as the US tech bubble in certain cases. High real estate prices have led to irrationally high valuations for some real estate companies and based on those valuations, those and other companies and funds have raised a huge amount of capital to buy more real estate and bid up prices in tenders to dizzying heights.

Internal Brewing and Lessons to Be Learnt

Analysis in paralysis may be disease that I need to cure. Seth Klarman in his classic book **Margin of Safety** talks about an 80/20 rule about information. Uncertainty is a great way to find depressed prices. And uncertainty is caused by information that is not available and cannot be available. So, sometimes if the investor can overlook a lack of certain information that may not be important but that the market thinks is very important and because of which the price is very low, the investor can make a favourable investment. There may be high uncertainty and low risk which is ideal to finding a great investment!

At places he says that it is better to let go of investments that one is not sure about even if there is a substantial gain afterwards that you don't benefit and in another place he says that it is prudent to move with the 80/20 rule. So, it is crucial to know what information is critical and what is just noise. It is this decision that differentiates a good investor from a great one.

On the Lighter Side

I am currently reading Einstein: His Life and Universe by Walter Isaacson. It is a fascinating account of a multi-faceted mind and an absorbing read on how Einstein was deficient in many qualities yet brilliant in others. He was a bold, intellectual revolutionary who fearlessly voiced his opinions and thesis even while he was not only jobless but also considered mediocre. It is also edifying to see how he persistently built on his strengths and interests. Why I enjoyed it is also because the level of detail in the book mirrors the quality of my favorite biography "Buffett - The making of an American Capitalist" and I recommend it strongly to everyone, especially those interested in biographies.

I am sending you a book that is another one of my favourites and that I think encapsulates India very well. India Unbound by Gurucharan Das is a favourite among all India enthusiasts and I hope you enjoy it. Also, enclosed is a book called Men of Steel written by Vir Sanghvi. Although it does not carry the literary tenacity and level of detail that I would have preferred, the book does provide at places some great insights into the minds of some the business stalwarts of contemporary India.

I will write to you again next quarter and look forward to hearing from you in the mean time.

Warm regards,

Amitabh Singhi.
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