

SUREFIN INVESTMENTS

November 29, 2008

From: Amitabh Singhi

To: Investors in Surefin India Value Fund

Subject: September 2008 Quarterly Update

Dear Investor,

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

So, What Happened to the Markets?

We had written the following in our September 2007 letter:

“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.”

A lot of Foreign Institutional Investors (FIIs) money and domestic mutual fund money came into the Indian capital markets during 2003 to 2007. Much of it came at not-so-cheap valuations. What has to be remembered now is that the capital that is fleeing the country is what we call “bold capital”. The “smart” capital came into the country from 2001 to 2005 and exited soon after. Then came the “bold” money from 2005 to 2007. Prime examples of this is pension funds, with the group of financial advisors and hedge funds, which is what finds itself still trapped in the markets today.

It is easy for anyone to comment retrospectively, but we have been cautioning against the madness in this section of the market for the last two to three years. Please see past letters on our website www.surefin.com. The party is almost over, but there still may be some interesting shorting opportunities in the near future.

Nothing seems safe anymore to investors in India and elsewhere. There are enough people who prefer stashing their cash in mattresses and those who believe that money itself will lose value are simply piling up on their gold reserves.

We refrain from taking macro calls and prefer focusing on the important and the knowable. The difficulty with macro issues is two-fold. Firstly, that it is virtually impossible to find a correlation between macro factors and the outcome of individual investments in requisite detail for them to be significant enough. And secondly, such correlation often leads to over simplification and futile generalizations that at best lend the investor the psychological comfort of knowing the possible consequences of a certain event.

Our efforts go into focusing on individual investment situations and a few key macro factors. One such factor is expected inflation, and linked more to a hike in expected inflation and interest costs over the next few years. We believe that the single most important change in the world of investments comes from an increase in discount rates around the world. So if we were discounting everything by 10% a year ago, we now do it by 15%, the effect of which is huge. So all of a sudden a 10 times earning investment opportunity does not look cheap at all. The P/E on a government bond in India is now 10 times earnings. So, for equities in general it should not be more than 7 times. Rise in discounting rates reduce prices of all assets that yield a regular cash flow.

The second effect of increasing interest rates and the subsequent reduction in future asset prices is the erosion of what one can call the “wealth effect”. If company X was being spun off from its parent for \$100 even a year ago then one can safely assume that it will now fetch no more than \$75 or maybe just \$50. A lot of large cap companies in India have seen a substantial erosion of the wealth effect they had so far conveniently enjoyed.

We had also written the following in the September 2007 letter:

“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.”

Thirdly, we firmly believe that the real estate party in the country is on the brink of getting over. Although the leverage effects and reflexivity effects of the real estate bubble are yet to be recognized the worst news from India on this front is certainly on its way. We are likely to see more than 50% erosion in the market cap from

today of many companies because of this, and we are obviously not talking about real estate companies that are already down 60% to 80% from their peaks! Some of the banks are also going to have a tough time justifying the loans they have made to the real estate sector and to companies that have land assets as margins-of-safety that are now much cheaper.

The following excerpt is again from our September 2007 letter:

“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.”

The most important thing from an investing point of view is how much liquid and tangible margin-of-safety the business has. We have been staying away from the hype around India for the last two years and have only bought companies that either have good cash reserves, or are very cheap based on tangible albeit illiquid assets and earnings. So, four times last year's earnings and seven times normalized recession years average earnings is what we think is reasonable. We have been buying these types of businesses in the near past apart from sitting on large amounts of cash.

What is great from our point of view is that we are not down as much and have been holding a lot of cash for a while. I think we are reaching the point of firing up some of this gunpowder.

Current Investment Strategy

What we want to do going forward is three-fold. Firstly, buy more cigar butts with 25% to 40% of the portfolio. Cash is always cash. Secondly, try to put 10% to 30% in special situations. And thirdly, buy some decent quality businesses at very good values with 50% of the portfolio. We have been waiting patiently for a while for some of these businesses and I think we might find a few in the next couple of years to pile up on. Our preference has always been to find great businesses with 30% RoEs, growing at 15% per year selling below 10 times earnings and below book value. We may actually find a few going forward. A few that I think we will not get cheap but which are good companies (in the public domain) are Hero Honda, Nestle, Infosys/TCS/Wipro, CRISIL, Castrol, Marico, Pidilite, Monsanto etc. Of course, the prices are not right for someone like us to buy into these high quality names.

But we are seeing quite a few more names that are of decent quality and are much cheaper now. We think that businesses in India have not slowed down yet, and it is inevitable that many will. Once that happens, we may see further reduction in valuation, which may turn out to be great buying opportunities. Many are already almost there.

Irrespective of what we buy we may see a reduction in prices on a marked-to-market basis on our investments. Catching the absolute bottom is not the best approach. So we will buy something that we think is high quality and cheap even if there is a chance that it falls 50% in price from where we bought. We are not insecure on this front given the high quality of investors we have in the fund.

Current Opportunities

We are now excited about many opportunities that we have not seen for the last many years.

We are currently looking at a business that is trading at two times last year's earnings and 6 times recession day earnings. This is a \$0.5 billion company with a 60-year track record and has not lost money over the last 25 years! It is trading at a 25% discount to liquid net worth and makes over 25% ROE. This is a bit of a contrarian bet but that is why we are getting it at a price that is 80% lower than it was a year ago.

Another business we are looking at is a conglomerate with a portfolio of good businesses and good managements. They are good allocators of capital and the whole business is selling for single digit P/E without spinning off their various subsidiaries. Their market capitalization is over \$2 billion and the businesses are growing at 15% per year.

Fixed income type securities with high yields and equity upsides are also becoming available in some high quality companies. Some of them have a 25% yield over a three year period with another 20% annualized upside in the short run.

Another good opportunity is to buy companies that are likely de-listing candidates. Some of the smaller companies we have bought may become such candidates since they have a lot of cash and if the equity valuation is cheap, and they have some cash on the balance sheet we could participate in a de-listing which may yield 50% or more over the next three years.

Quarterly Letter and Annual Letter

As we reported in our last letter, we are going to write one annual letter (March-end every year), which is going to be in much greater detail and the others (this one is longer given the current state of affairs around the world), are going to be briefer. If any of you have an objection to this, please write in to us.

Warm regards,

Amitabh Singhi.

Portfolio Manager

Surefin Investments

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