

Key Learnings of 2017

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We approach this [article] with the mindset best elucidated by Charlie Munger's speech in 2007 to USC Law School, "Wisdom acquisition is a moral duty. It's not something you do just to advance in life. As a corollary to that proposition which is very important, it means that you are hooked for lifetime learning. And without lifetime learning, you people are not going to do very well. You are not going to get very far in life based on what you already know."

Below are some of the key lessons that we learnt / re-learnt in 2017.

Importance of Management

Management makes a big difference in how an investment thesis plays out. We have been aware of the importance and have increasingly gravitated towards investing in companies where we are comfortable with management.

Once in a while though, an idea looks compelling enough, industry looks ripe for this new idea and company's recent business performance makes the narrative compelling. However, there is this nagging feeling about the management. Our (re)learning from 2017 is to not get involved if there is discomfort with management.

The *mea culpa* we are talking about is Pincon Spirits. If you have not heard about it, don't worry. We also wish we never heard about it. Company talked about how they are converting unorganized liquor business to organized liquor business, the massive opportunity as newer generation is more comfortable drinking openly and so on. The narrative was perfect. However, there were always open questions about management.

We sold our starter position in the company once it came under the scanner of SEBI as a shell company. Subsequent events have confirmed to us that it was the right decision. The saving grace in this ordeal was that the position was a very small position. We were still doing early research to get comfortable with the idea when we hit the pothole.

Don't take profits too quickly

There is an adage on Wall street, "You can't go broke taking small profits." However, following this strategy could cause one to miss out on big profits. In 2017 we got our first 10X since we started focusing on Indian equity markets.

Stock in question is Chaman Lal Setia Exports (CLSE). We had presented a case study on CLSE in Asian Investing Summit in April 2017. [Access the case study](#). If any of the investors would have an interest, we would be happy to forward the copy of the presentation.

In the case study we outlined that CLSE has a very long runway and on a conservative basis the stock could more than double by June 2020 from its April 2017 price. Since our presentation in April 2017

stock has already gone up by 70%. Thus staying invested when we have conviction and not booking small profits is a key to making good returns.

Attractiveness of an idea should reflect in its allocation

We have been using our proprietary forward return analysis framework to evaluate attractiveness of the various ideas in our portfolio. The more attractive an idea is on a probability adjusted basis, the more of the portfolio we are allocating to the idea.

The result of this strategy has been higher allocation to higher return ideas. While the returns don't show up on a yearly basis, over a longer period this approach has worked well for us. We used this approach to take the fifth largest position in the portfolio in 2016 and made it the largest position in the portfolio in 2017. In subsequent annual letters we will keep you updated on how this position works out.

Work with the "right" investors / partners

We like to work with investors who demonstrate the following characteristics:

- Long-term orientation
- Reasonable expectations
- Understand our investment approach
- Recognize that we will make mistakes from time to time

We couldn't be happier with our investor base. The key demonstration of this came when we reached out to them acknowledging the mea culpa with Pincon Spirits. Everyone who had the position understood why we are changing our stance and appreciated our approach of dealing with it.

Given the happy experience, I am encouraged to re-iterate our investment principles so that we and our investors continue to be aligned.

Investment Principles

Investment principles listed below are the North Star that helps guide our approach to investing. At DoorDarshi we have been heavily influenced by Warren Buffett and Charlie Munger. Naturally we have borrowed heavily from what they have taught us. These principles are also available on our home page at <http://doordarshiadvisors.com>

1. Partnership

My approach towards my investors is that of a partnership. In the current setup I am the Managing Partner while my investors are the limited partners. However, my key consideration is always to ensure that structure (fees, communication) would be acceptable to me if our roles were to be reversed. This principle borrows heavily from what Warren Buffett has laid out in his Owner's Manual - "Though our form is corporate our approach is partnership."

2. Long-Term Orientation

In a world where everyone has all the information, we have to stake out our competitive advantage. The key one that we have is long-term orientation. We primarily invest in companies where the thesis may play out over many years. This reduces the competition and allows us to enjoy our returns over the long-term.

We carry the same approach when we work with our investors/partners. We would rather have one investor for ten years rather than twenty investors for one year. This allows us to take long-term view in our relationship with our investors.

3. Invest in our best ideas

We invest majority of the portfolio in the top 5-10 positions. These positions are chosen based on their attractiveness from a future return perspective. In following this approach we subscribe to Charlie Munger's dictum in spirit, "A well-diversified portfolio needs just our stocks." Key advantage of this approach is that it allows us to know our top positions better than most people and take advantage of the decent returns that will come from those positions.

4. Contrarian Bias

We like to buy good stocks when they sell at a discount. This approach, by definition, forces us to go where the crowd is not going – selling things which are going up and buying things which are falling. We are able to have this contrarian bias because we always keep the forward return in mind whenever we invest in any security i.e. what % return we expect from the security from the day of investing to the day the price will match the value.

However, we are not contrarian for sake of being contrarian. We will sell the stock even if it is falling, if we feel that some new information has changed our thesis. This is what led us to sell Pincon even though the price fell.

5. Don't lose money

We take seriously the dictum that the art of making money is to not lose money. Warren Buffett has expressed the same through his famous rules on investing. There is the simple maths that if we lose 50% of our portfolio we need to make 100% to get even. The more pernicious impact though, is psychological. We start doubting ourselves a little more; we don't invest in our best ideas to the extent we should and we start looking for social proof.

To guard ourselves we ask for a high Margin of Safety in our position. This has led us to miss many opportunities. However, we will rather miss opportunities than get into sub-par opportunities which could later turn out to be value traps.

6. Management and Business Quality

Most of the mistakes we have made in our investing journey have been where we misjudged management or business quality of the company. Since many of the Indian businesses are owner operated, quality of the management becomes paramount. However, judging the quality of management is very subjective.

The best we have been able to do is to create mosaic of information about management and use that to reach our decision. We continue to increase the weightage of this element as we consider investing in potential ideas.

7. Continuous Learning

To us Value Investing is more than an investment approach; it is a way of life. This approach requires us to keep learning so that we become a better investor; but more importantly, a better human being. In our experience Value investing draws us towards the "right crowd." This allows us to learn not just from our investment but also from our investors who are a self-selected group of individuals.