A Family Office's investment journey.

Insights into the DNA of fraudulent promoters, our learning's & changing course.

Talk on corporate fraud at the Singapore Management University

17th Mar 2015.

Hemant AMIN – CEO & Business analyst.

Do you know them and their DNA ?

Living proof of the power of compounding finances when absolute power is concentrated in intelligent & extremely Rational individuals with a DNA of non negotiable integrity, over a long period of time.

- Singapore has benefitted from the foundations laid by the partnership of Mr. Goh Keng Swee, Mr. Lee Kuan Yew & Ms. Kwa Geok Choo.
We owe them a huge debt for today's Singapore.

- Their DNA runs through the financial mindset of Singapore for the past 50 years since 1965.

- Singapore GIC reserves are estimated on some SWF forums at US$ 360 bn. Temasek assets estimated at US$ 175 bn. MAS other reserves were US$ 323 billion in 2014. Gold & Forex at MAS at 2014 is US$ 244 bn.

- Reserves of approx. US$ 1 trillion for a population of just 3.5 m = US$ 285,000 per man woman and child.

- Note: Rough personal reserve estimates only.

- Warren Buffett , Chairman & Charlie Munger, Vice Chairman of Berkshire Hathaway, USA.

- Their DNA runs through Berkshire Hathaway for the past 50 years since 1965.
Investors & business men the world over owe them a huge debt for their teachings.

- BRK.A stock was US$ 19 in 1965 & is USD 220,000 + today. Company is worth US$ 360 Billion.

- US$ 100 invested in 1965 in Berkshire Hathaway is now worth US$ 1,826,163

- Compounded growth rate of 21.6 % over 50 years.

- US$ 1,000 invested would be US$ 18.2 million.

- US$ 10,000 would be US$ 182 million

Agenda for the talk

Part 1 – Background about us & Focus is on fraud insights with some case studies

- Brief background & how the family office invests.
- The mindset of fraud – our personal insights and experiences of trusted fellow investors in experiencing corporate fraud.
- Investment Mistakes and case studies of fraudulent practices. See if forensic accounting would have helped !!

Part 2 – Focused on insights about successful businesses & investing and not falling for fraud.

- The insights from Berkshire Hathaway and how we changed track.
  Can you try to comprehend how simple but yet powerful the thoughts are from Warren Buffett & Charlie Munger ?
- Our mindset since 2003 and the benefits of learning from other people's mistakes.
- Characteristics of the type of companies we invest in now to improve our probability of returns.

Part 3 – Focused on students & adults alike.

- Some insights into the concept of compounding & the real cost to society of fraud.
- Some remarks for generation next from our learning's.
- Getting out of the rat race – Basics from Superman – Mr. Li. Ka-Shing .
  Save your first S$ 12,000 and start your own compounding journey.
- Powerful teachings from some Gurus' – Think differently to avoid being defrauded & then compound wealth.

- **Q & A**

Brief Bio – Hemant AMIN, CEO & Business Analyst

- Born & raised in Bombay, India.
- Studied in the UK from 1985 to 1990. B.A. Joint honors (2:1) in Economics & Accountancy. University of Kent, Canterbury.
- Met my wife there. Have 2 young daughters.
- Worked with Coopers & Lybrand, London from 1991 to 1993.
- Relocated to Singapore in 1993 as shareholder and Executive Director of an Indian Japanese manufacturing company from 1993 to 1997.
- Co-founded Kawamin Pacific Pte Ltd. in 1993 – industrial raw materials supply chain. Managing Director from 1997 to 2003. Awarded fastest 50 growing company in Singapore in 2005. Business wound down in 2014.
- Invested money in several firms in India between 1993 & 2000. My talk will focus on lessons from these investments.
- Reason I am here at SMU → Lost 10 years of my investment life to fraud & follow up in reclaiming money invested. Sharing learning's in fraud. ☹
- Promoter & Director of Allindia Technologies Ltd. in India since 2000. India focused IT services firm with about 70 staff.
- Focused full time in managing money from 2004.
- Formally organized as the ASIAMIN Family Office today.

ASIAMIN

FAMILY OFFICE

"It is our objective, as business analysts, to research, understand, invest in at reasonable prices & to partner with, for the longer term, selected, listed companies, with superior business models & durable competitive advantages having predictable & growing corporate cash flows and which are run by shareholder focused & competent management of high integrity, resulting ultimately in superior returns on equity and compounded returns for investors."

Our investment strategy.

- Single family office – no outside money. Managing money full time since 2004.

- Aim to invest in about 15 high quality businesses with pricing power. “Concentrate your energy, thoughts and your capital.” – Andrew Carnegie

- Presently have approx. 20% in legacy real estate and 80% in equities. Aim is 100% equities as part owners of high quality businesses.
  “Risk comes from not knowing what you’re doing” Warren Buffett.

- Present equity allocation is 65% in Indian equities, 20% in US and 15% Singapore / HK. No shorting, derivatives etc. Simple long only concentrated portfolio.

- Based on past losses to fraud, our main focus is on integrity of the promoters first and foremost without compromise.

- Looking for compounders because of moats. Moats are explained later.

- Focus on protecting the downside.
  Heads → I win.
  Tails → I don’t loose much.

- Make few high probability bets annually.

- Motto is “To be – not to be seen”. Don’t seek publicity. No hidden agenda in marketing ourselves. No outside money managed. No marketing needed.

- **We are not forensic accounting experts -->**
  Speaking here today & sharing experiences because of:
  “The best thing a human being can do is to help another human being know more.” Charlie Munger.

- What is the track record of the family office?

Results from keeping things simple, sticking with quality people & businesses, being patient, learning & letting compounding work.

Important Note: *These are internal* ***un-audited*** *management records.*
Global equity investments of the group are treated collectively as if in a fund. All figures with dividends reinvested.
These numbers are being reluctantly shared – only to illustrate that simplicity does work in our experience.
These figures are not shared to solicit any funds – we do not manage third party money.

Average annual total return 2004 to 2014 in **USD** Change over the entire period %	**29.3 %** **1,586 %**	8.0 % 132.4%	How US$ 1,000 invested would have performed.	
Period Ending	**ASIAMIN Fund %**	**S&P 500 %**	**ASIAMIN Fund**	**S&P 500**
01-Jan-04			1,000	1,000
31-Dec-04	69.2%	10.9	1,692	1,109
31-Dec-05	71.9%	4.9	2,908	1,163
31-Dec-06	77.0%	15.8	5,147	1,347
31-Dec-07	33.6%	5.5	6,877	1,421
31-Dec-08	-50.0%	(37.0)	3,439	895
31-Dec-09	10.7%	26.5	3,806	1,132
31-Dec-10	67.0%	15.1	6,354	1,303
31-Dec-11	7.9%	2.1	6,855	1,330
31-Dec-12	38.1%	16.0	9,464	1,543
31-Dec-13	12.2%	32.4	10,620	2,043
31-Dec-14	58.7%	13.7	16,857	2,322

'Investing is simple but not easy." Warren Buffett.

The mindset of corporate fraud.

Insights from actual investments made by us as well as from experiences in fraud shared by members of the investment community who have been victims of fraud.

A few clarifications about this talk ……

- Aim of this talk is to share our and other investors learning's and experiences so others may learn from our mistakes. We intend to contribute materially, financially & otherwise to forums aimed at educating the gullible investing public about corporate fraud.

- Aim is NOT to criticize any particular individuals or companies. We prefer Mr. Buffett's approach to **"praise the person but criticize the category".**

  Hence no names of individuals or companies will be taken. Any resemblance to particular people, promoters or companies is purely co-incidental.

- We or fellow investors in same companies and with similar experiences have sought neither revenge nor criticized any frauds openly, nor sought legal recourse. It serves little purpose if you cant win the battle. Painful but it is the rational way to behave.

  "Generally speaking, envy, resentment, revenge and self-pity are disastrous modes of thoughts. Self-pity gets fairly close to paranoia, and paranoia is one of the very hardest things to reverse. You do not want to drift into self-pity. ... Self-pity will not improve the situation. " Charlie Munger.

- "Life can only be understood backward, but it must be lived forward."
  -Soren Kierkegaard, Danish philosopher.

- We are actually grateful for the experiences and learning's – without those, our results and clarity of thought from 2004 onwards would not be possible. The fraudulent promoters are our 'anti-mentors' – of how NOT to behave in life and how NOT to invest !!

Our story pre 1997 …
Ouch, ouch, ouch…this rings a BIG bell ☺

Wisdom from Warren Buffett

- **“When someone with experience proposes a deal to someone with money, too often the fellow with money ends up with the <u>experience</u>, and the fellow with experience ends up with the money.”**

Berkshire Hathaway annual letter 2006

How we got started – 1993.
Did we deserve to be cheated ?

- Naïve investors – took things at face value.
- 'Looking up in awe' to 'industrialists' who ran listed companies. It is yet considered by society to be a huge achievement to be CEO of a listed company.
- Did not know about Warren Buffett & Charlie Munger. Hence not read Berkshire Hathaway annual letters. That would have helped enormously. Very expensive mistake.
- A fool & his money are soon invited everywhere. Fraudulent promoters don't differentiate between investors.
- Relied on 'my word is my bond' based on my family's history of ethics and no experiences in fraud previously. Its Human nature mostly.
- Blindly Trusting people – especially people you know closely, was very natural behavior. WE WERE WRONG. Forgot to study their past and behavior patterns to judge how much to trust them. Concept applies to family, friends and clients.

- Promoters saw money bags ready to be looted.
- Promoters overhyped investment prospects and return assurances. Promoters rarely under promote themselves.
- We did not understand the concept of 'quality' of business's earnings'. Differences between types of businesses. Fraud is much easier to do in certain businesses.
- "To get what you want, you have to deserve what you want." Charlie Munger
- We largely deserved what we got – taken for a royal ride by the very people we blindly trusted.
- Huge lessons in understanding human nature & people.
- Promoters took advantage by having very minimal paperwork and no written assurances. We naively relied on oral commitments.
- But – would written agreements in India or China have helped much if the core intent of the promoter is indeed fraud ?

Basic fraud 101 – all Three elements are needed.

• Perceived pressure

- **Committed to benefit oneself, an organization or both.**

1. Greed & Envy
2. Living beyond ones means
3. High bills or personal debt
4. Poor credit
5. Personal financial loss
6. Unexpected financial needs.
7. Maintain myth & potency of their infallibility. Peer group pressure to keep up with the Jones's .
8. Fear of failure.

• Rationalization

- **Rationalization helps them hide from the dishonesty of their acts.**

1. The organization owes me
2. I am only borrowing the money – I will pay it back
3. Nobody will get hurt
4. I deserve more
5. Its for a good purpose
6. We'll fix the books as soon as we get over the financial difficulty.
7. Something has to be sacrificed - integrity or reputation. Sacrificing reputation is a NO NO for fraudsters with high ego's.
8. Its OK to cheat stupid people. They deserve it.

- **<u>We rationalize dishonesty by our desire to make other people feel good about you.</u>**

• Perceived opportunity

- **A perceived opportunity to commit fraud, to conceal it, or to avoid being punished.**

1. lack of controls that prevent fraud.
2. Inability to judge quality of performance
3. Failure to discipline fraud perpetrators
4. Lack of access to information.
5. Ignorance, apathy and incapacity.
6. Lack of an audit trail.
7. To flourish, long term, a fraudster needs an intricate grasp of the psychology of his victims. Usually combined with very good manipulating people skills. & a conducive eco system which allows fraud to prosper.

Source: How to detect and prevent business fraud, 1981, and other articles on the net.

A must read to understand human behavior – How did I get sucked into this ?

'24 standard causes of Human misjudgment'.1995 talk by Mr. Charlie Munger at Harvard.

Influence: The psychology of Persuasion. By Dr. Robert Cialdini.

Honorable intent = Persuasion. Dishonorable intent = manipulation. ☺

- **Why & how people behave irrationally.**
- Reciprocity – provide small favors and get a lot more back.
- Contrast caused distortions. First ask for 1 million investment and then reduce it to 300,000. 300,000 does not look much compared to 1 m.
- Use their Authority. Investors fall for the authority figure bias. e.g. of Pilots in a simulator. Staff fall for 'who's bread I eat his song I sing'. Surrounded by 'Yes' men.
- Liking & disliking bias – the more you like someone, the more you will be persuaded by him.
- Scarcity bias – When something is in short supply, you want it more. Promoters create artificial scarcity in persuading investors. Madoff used this – exclusive club.
- Association bias – e.g.. coke with happiness. Use of photographs with top politicians, holy men publicized etc. Associate Chairman of listed companies as being successful by society.
- Social proof – others are doing it so we can do it. Get into unrelated businesses because others are doing it. E.g. finance companies in India in mid 1990's.
- Bias from liking distortion. Tendency to like oneself, their own ideas despite proof they are wrong.
- Appeals to emotions can make one forget the bigger picture. Cajole family & friends.

- **Common traits & biases.**
- Incentive caused biases. Turnover commission. 'This is how I get paid'. Financial strain causes more fraud.
- Psychological denial. What you do will change what you think. The ability to rationalize decisions and fool oneself. Ferocious faith in the rightness of whatever they are doing.
- I figure its 50-50. Lack of use of probabilities and overweigh convenient information.
- Consistency & commitment bias. Once committed to bankers – you massage accounts. Once EPS figures committed, you have to deliver.
- The need for EGO & Power and control.
- They ask for small commitments consistently.
- Fall for envy & Jealousy. "Its not greed that drives the world but envy". Warren Buffett. I want what you have. Everyone's getting rich, so why shouldn't I ?
- Gambling compulsion – not probability inclined. I feel lucky syndrome. Am blessed by a guru !
- Simple psychological denial of reality e.g. war mums.
- Confirmation bias – 'I remember what supports my theory ' People know a couple of models of how the world works and use them. Man with the hammer syndrome !
- Easy to get away – weak restraints and corruption make it easy to succumb to the opportunity.

What victims usually experience about fraudulent promoters.

They master the surroundings.

- They are masters at the ART – one needs the wherewithal's for conducting successful fraud over a long period of time.
- They know the law and the loop holes including inefficiency of the courts system in India. Takes 15 years to hear cases.
- They have political & business connections – at the highest level.
- They had the tax man bribed.
- They had their bankers bribed.
- They had the civil servants bribed.
- They knew how to avoid court – by bribing family doctors to fake heart problems .
- In short – they know how to bribe their way through fraud.
- Need to be a super slick operator thinking about fraud day in and day out. Cant be successful at it as a part time business ☺ !!
- It is their very DNA to be fraudulent by default. It is always on their mind.
- Different communities have different traits towards fraud in our experience determined by social characteristics. Bias from social proof.

They have following personal traits.

- They have a consistent history of fraud. Understand their history and you can understand the person.
- They fool themselves by believing their lies and perpetuating fraud. Self confirmation bias.
- They are super positive – blindly & irrationally optimistic to fool others and in turn fool themselves.
- Unable to comprehend running business without fraud. Every thought about business has a foundation in fraud. Once they have dipped their hands in others pockets, they cant change and the behavior becomes them.
- Very friendly, always cool and very obliging – they will oblige you, understand your weakness as a person, shower you with favor's and you fall for the reciprocation bias.
- They only tell people what they can digest at work and at home. Calculative in words used, when to say what, how to say it. Like pre meditated fraud. Keep information in Silos with no one knowing the whole picture.
- They exaggerate positives and hide all negatives even from family.
- Very image conscious – have photos with politicians, fly first class etc. Live beyond their means to put up an image of prosperity.
- Crave publicity & need to be seen with the who's who in society and then capitalize on the publicity.
- Dominant Alpha personalities – family members can say nothing even when fraud is apparent. Easier for family members to turn a blind eye than to address it.
- They understand human nature very well and manipulate emotions to move things their way.

Investment mistakes & case studies of fraudulent practices studied.

Frauds can & do happen globally - not specific to few countries.
Key is to be aware of tactics used in fraud.

Poor eco systems – corruption levels, poor controls, high taxes, poor law & order, banking corruption , poorly paid civil service & government employees, etc. lead to a more conducive environment for fraud.

But frauds do happen globally. Greed & Envy have no limits !

An over view of top frauds encountered…….world is not like Singapore.

- Witnessed Listed vehicles as best tool for long term fraud. Much better than stealing a bank or robbing a house.
- Promoter stake for free via over inflated land contributed or over-invoiced imported machinery.
- Related party fake transactions – services invoiced , rubber stamped and money siphoned out to related companies.
- Under invoice to friends company and take funds out.
- Use company as debiting machine. Perks, domestic staff, drivers etc. all on company payroll. OPM – Other peoples money.
- Returning of political favors in a high profile lifestyle and political donations require more looting of the company with cash withdrawals.
- Large invoicing to friends and other related companies at year end to boost profits with reversal of entries after year end.
- Very hectic year end periods – not closing deals- closing loopholes and massaging accounts. Year end financial gymnastics. Accounts are what you want them to be. 3 sets of books in China ? ☺
- Export to overseas related parties with large under invoicing to siphon money outside the country.
- Completely erase one or two large liabilities from accounts.
- Witnessed a ‘holy man’ guiding an industrialist. Holy man needs donations as well. Holy man ‘approves’ new projects to CEO and CEO humbly follows. CEO loots company for donation funds. Even ‘GOD’ is being bribed with fraudulent funds. ☺

- Corporate weddings – million dollar expenses debited fraudulently to company. Aircrafts hired for company conference and board meetings coinciding with the wedding.
- CEO’s corporate expenses are not questioned. First class travel, top hotels, politician entertainment, family holidays all debited to the company through various billings.
- Some companies have had prominent board members to put an air of legitimacy. Board members have been blinded by the CEO’s personality to be there. Board meetings don’t discuss much business based on mutual courtesy and courtesy to the CEO ☺ .
- Seen promoters control the corporate purchase function in companies they control. Unorganized businesses like textiles, building materials etc. = more cash purchases = more fraud = more cash funds promoters suck out of businesses.
- Seen promoters get cash delivered to them on ‘per product basis’ for licensing out manufacturing of licensed products. Common in Alcohol, big brand name products owned by families and subcontracted out to produce.
- Land sales to Listed companies for CASH. US$ 60 m in cash, US$ 40 million by cheque. Imagine S$ 40 million in cash. Very common in real estate companies.
- Invoice dates adjusted in Foreign exchange remittances whereby extra exchange rate profits are shown as receipts against other fake invoices lying in the P&L.
- Services company – Consultant joins hands with promoter to hype up the company based on the latest fad. Consultant juggles financials by excessively capitalizing software development costs instead of expensing them. Shows a high net-worth. Consultant gets shares from the promoter for nominal price before the jugglery. Company marketed to friends and family for investments. Promoter in alliance with the consultant raises huge back dated fake invoices to the new hyped up company after the retail shareholders have put in money on trust basis. That money is used to pay the promoter. End result promoter gets paid, Consultant is shareholder for free for his engineering skills and any upside to the business, both of them as larger shareholders are biggest beneficiaries.

Case study 1 – Group Parent company. What we missed.

Business quality red flags

- In the steel business – buy steel and produce low value added steel products.
- Commodity business - No Durable competitive advantage / Moats.
- No pricing power – buy from steel mill on their terms & sell to OEM's on OEM terms.
- Same pricing power as suppliers to IKEA, Wal-Mart etc.
- Long working capital cycle at high interest cost of 15 to 25% per annum.
- Large debtors and special items in the balance sheet.
- Funded by Govt. owned banks – promoter connected to successive Chairmen. 3 % of loan approved as 'service fee' is common knowledge even today.
- Dependence on electricity for productivity. High cost of generators and in house produced electricity.

Promoter red flags

- Promoter highly politically connected – state and National level politics. Visited at home by state and central cabinet ministers.
- Connected to senior officials of public banks. Promotions are from within the bank so promoters have known them for decades.
- Extremely image conscious to be seen with the right people – including 'god-men' and seek publicity through proximity.
- Extravagant life style – from fraudulent money. Keeping up with Jones's, fly First class, top architects & interiors.
- Over 'educated' – unwilling to learn new things – **The educated illiterate.** Do not 'UNLEARN'.
- Ability to fool oneself – blindly optimistic. Reaffirm falsely declared profits.
- Economical with the truth – exaggerate small things , hide all bad things.
- Focus on turnover of the business for publicity & is self validating.
- No focus on profits. No discipline on cash flows as company is a personal kitty.
- Very impressionable – smooth as silk. Create aura of ultimate contacts, rich and successful.
- One man show – partner is a yes man. Main man screws up with grand plans and irrational decisions and the yes man cleans up mess with financial jugglery. Good teamwork indeed to perpetuate fraud ☺
- Family largely in the dark and even when they know the truth, preferred to ignore. Too painful to address with the dominant Family alpha male. Family in denial.
- Master of reciprocity favors by finding week spots of others. Religion, favor to relatives, obligations etc. Anything to 'connect' in a personal way with the other party if he needed something from someone. What is their week spot ?
- Willing to give personal guarantees – with nothing to loose and knowing the law is unenforceable.

Poor business fundamentals + fraudulent promoter = BIG Investor nightmare ☺

- Turnover figures hyped up through related party transactions.
- Related party transactions in the same geographical state to keep tax enquiries within the state where the promoters know the system very well.
- Profit invented by account jugglery to fool bankers who can increase banking lines.
- More banking lines are always needed to fund increased turnover eases ability to drain money from the company.
- Govt. owned banks have govt. appointed senior leadership fro limited period. They sanction loans and retire with no consequences. Their pay is low. Senior staff on retirement then use the industrialist whom they have favored as their retirement financiers & to get their kids educated abroad. Govt. owned banks have the highest Non performing ratios in the country – 5 to 10 times worse than privately owned banks run by competent management. Why such differences in the same economy ?
- Older bank loans are paid down by promoters by borrowing from other new banks through personal high level and political contacts.

- Large scale expenditures for weddings and lifestyle, including lavish family holidays of the promoter are funded by juggling accounts and draining cash from the company through fictitious bills.
- Family members and friends are agents of the company – company can send them stocks at low prices and make payments against fake invoices to drain money from the company.
- There were multiple > USD 1 Million dollar CORPORATE family weddings funded from Group companies. Creditors who are lining up for overdue money are invited and lavishly taken care of as guests for the family wedding. Talk about putting salt in the wound ☺ !!.
- The 'large' mother ship parent Fraudco uses its 'size' to expand into other businesses to perpetuate the cycle of looting shareholders and banks at the subsidiary level.
- Promoter's personal stake in subsidiaries is always 'free' through round tripping – more on this later.
- As personal and lifestyle expenses get bigger, so is the need for fraud to get bigger.
- Loans – personal & inter corporate were taken at any interest rates from individuals, family & friends and other businesses – If you don't intend to repay, how does the interest rate charged matter ?
- Promoter is indifferent to who are the victims – extended family, friends, pensioners – basically anyone who is charmed by the promoters aura of 'success' and contacts and image of a successful entrepreneur and falls for his ability to charm and manipulate.
- This fraud lasted from 1982 right up to 2010. Banks cumulatively lost over Rs. 500 Crores – S$ 110 million and yet the person is a free man with public image intact bragging on about ethics to others.
- Personal lifestyle of the promoters and families expenses virtually unaffected – lifestyle always moved up – through out the nearly 3 decades.
- Smart fraudsters stash money away – business ups and downs don't affect lavish lifestyles ☺ .

Fraudco Parent with ‘size’ sponsors reasonable size subsidiaries.

- Group floats other business ventures.
- Group enters into plant expansion in the same business in a different geography in India under a different subsidiary.
- Enters into a specialized auto related business. Later gets a Japanese company to be 50-50 joint venture partner at highly inflated valuations. Japanese company drives the business through Japanese connections in India and becomes a valuable profitable business because management control is with the Joint venture partner.
- Inundated with losses and loans, owner undertakes a ‘consolidation’ of all other affiliates into second largest company of the group – with ‘expert’ legal advise from one of the top restructuring & tax experts in the country.
- Effect is banks of the parent and of the subsidiaries for the first time see the full picture of intercompany loans and multiple loans to the group and realize that to pull the plug is more damaging than initially realized when they were isolated companies being funded.

- The 50% stake in Japanese JV resides within the entangled holdings and is valuable and keeps the banks from foreclosing on the company.
- Highly connected Promoters are ‘gently nudged’ by the banks to sell their diluted shareholding to a business party in return for partly repaying the bank loans. New owner gets the company for a song including the profitable 50% shareholding in the JV.
- Promoters equity gets wiped out.
- Outside shareholders stake gets diluted over the years as banks convert their loans to equity and then finally sell off for a song at cents on the dollar.
- Promoters lifestyle and attitude not changed an iota……no lessons learnt, continues with earning through fraud. Once you have dipped your hands in someone else’s pocket, very difficult to not repeat it !!.
- What could have been India’s top 100 business groups based on dynamism of the promoter, ability to network, ability to execute large projects in 1990’s is today virtually bankrupt – except for the looted money. Misused phenomenal persuasion skills for manipulation of the system. Intent was fraud.
- Reason – variety of reasons – but primarily an EGO grounded on past academic excellence, Envy of the peer group & a complete inability to LEARN from the top wealth creators in India who are ‘family friends’.

Case study 2 – Steel business in southern India.

- Promoters incorporate a company in personal names in Southern India.
- Company procures a large piece of land on outskirts of a major city in 1986-7. Very cheap agricultural land. Converts usage to industrial land though network of contacts which increases value of land dramatically.
- Parent company takes up stake in this 'new' company owned by the promoters with land valued at highly inflated prices and pays promoters a premium for part shareholding. A joint venture with promoters and parent is established.
- Parent or group company funds this 'investment' from Bank loans at the parent. Bankers are an important element.
- Promoters supply machinery to the JV at inflated prices. Parent company extends loans to the subsidiary to pay for the machinery which goes to the promoters related parties.
- Company manufactures and acts as supplier of steel products based in the South to its OEM's there in Chennai etc.
- Gets bank facilities through Govt. owned banks to expand business.
- Jugglery of accounts then primes the company up for an Initial public offer (IPO) and marketed to naïve retail investors.
- Family and friends are induced to Invest by guaranteeing 21% return on money put in in the IPO if business fails and stock price collapses. 20 to 30% per annum interest rates were common in the 1990's in India for borrowing from non banks.
- Promoter persuades Japanese investor to invest. Gives them personal guarantee – signed by a 'group' firms whose shares are held by friends and family.
- New listed company is used as an expense kitty by promoters including to fund personal lifestyle and political contributions.
- Intercompany transactions with group companies and is looted over 15 years.
- Company falls under bankruptcy but land has become very valuable as the city has expanded into the industrial area.
- Promoter devices a scheme to get hold of the land. Sale of land requires a majority resolution & dummy banker nod.
- Promoter steps down from being a director. His cronies on the board call an EGM. Notices to shareholders are faked and not sent to all shareholders with a clear 21 days advance notice.
- At the EGM, shareholdings – including 19% stake owned by a third party, is fraudulently voted in favor of the sale at a value of approx USD 1.2 m USD. Land value easily at USD approx 7 m in an open fair sale.
- Surprise surprise, buyer is the promoters close family member – but since promoter is not a director anymore, not considered as related party transaction. Pre meditated fraud with extended family being in full participation.
- Approx USD 1.2 million received from the sale is promptly used to pay other creditors – mostly promoter and family firms and siphoned out of the company.
- The piece of valuable real estate soars in value in 2 years after getting permission for conversion from industrial to Hotel use.
- Based on the large size of the land and high value, land is valued at 10x within 2 years and held by the family.
- Company files for bankruptcy.
- Personal guarantees given to investors in the subsidiary IPO are useless as promoter has no assets in his name. Promoters know foreign guarantees cant be enforced in India easily.
- Biggest asset is a palatial luxury bungalow that epitomizes their looting of the companies, but…… is in the name of the spouse. ☺☺
- Investors seeking return on the capital are now begging for the return of their capital. ☺

Fraud case study 3– Building materials business (BMC)

Building materials company. (BMC)

- Project appraisal documents prepared in house and approved by a ‘friendly’ incentivized Govt. bank’s senior management. Project conceived by promoters and company is formed by them – BMC.
- Initial money put in largely by related companies, using their bank lines, at a premium as their share of BMC. Promoters are JV partners through their private vehicles having promoted the new venture.

- From project finance approval, Land is procured by Bank disbursement at inflated prices and promoters get a cut on the purchase.
- Orders placed for Italian sawing and polishing machinery. Machinery vendor enters into a commission agreement with promoters related company in Mauritius whose shares are held by friends & family. More than 30% of machinery cost to be paid as commission to this entity.

- Inflated invoices raised to BMC by the vendors of machinery. BMC uses approved banking project financing lines for procuring machinery.
- Promoter gives the contract for the construction of the plant to related parties at inflated prices and makes money from there as well.

- ‘Commission’ earned from Machinery supplier is then round tripped and funneled into BMC as promoter contribution from friends and family.

- Company is now owned largely by family of promoters without them putting in a dime.
- IPO launched and marketed to retail public and friends and family through motivated and well incentivized aggressive investment bankers.
- Most expensive unviable buildings material project set up with inflated machinery, inflated land and inflated factory construction. IPO is barely successful – but that is all that is needed.
- Key foreign investors are verbally & in writing, guaranteed a 21% return to ensure money comes in the IPO.
- Promoter has a full project with little or no money down and controlling stake to be used as he deems fit.

BMC operational fraud.

- Promoter insists the inauguration is done by a popular ‘holy man’ he knows very well who is also connected to top politicians.
- Promoter ‘Gifts’ the God Man an expensive German top car model at the time, funded by commissions made from the project. Only key insiders know this.
- The God man then ‘gifts’ his old used German car to the promoter and the promoter informs the world that he has been blessed to be gifted such a precious car from his holiness. Devotees of the God man and promoters business circle are in awe of the promoter for being so ‘abundantly’ blessed by the god man. Car used by promoter only for VIP guests travel to impress them.
- Sizeable donations have also been made, (from fraudulently obtained corporate funds siphoned out course ☺) by the promoters to the God Man. A price must usually be paid to get close to the God man’s inner circle ☺ .

- For the plant inauguration, foreign guests, big wigs of corporate India, politicians and Chairmen of Govt. banks show up with added publicity that the God man is inaugurating the plant.
- Over 200 guests are accommodated in five star hotels for over 3 days, with personal cars during their stay ,wined and dined on corporate expenses funded by BMC.
- Board meetings are called to coincide with the inauguration since all directors are in town and large expenses debited as board meeting expenses.
- Group meetings of guests organized with the ‘god man’ which otherwise is impossible to get. Promoter earns huge brownie points with bank chairmen, business associates and politicians. Association bias created. Favors will be reciprocated.

- Promoter and his family are all blindly enthused and on an emotional high with the confidence that because the ‘God man’ has blessed the facility, it will be a success.
- Based on this blind confidence, promoter decides to buy a marble mine outright, without geological proof of quality from a fellow devotee of the God man, for over USD 1 million in 1994 and wastes precious working capital instead of the practice of buying proven quality slabs and converting them into finished tiles. Surprise surprise – mine turns out to be a dud.
- Key man handles cash purchases of Marble blocks and regularly seeps money out of the company for the promoters.
- Another distant family member is the CEO who manages money collected from under-invoicing overseas sales.
- As costs and losses mount, manipulation of accounts gathers pace with related party transactions.
- Promoter has set up companies globally through friends and family. Exports are made to these related firms under open credit basis (payable when able) and export benefits availed of in India.
- Banks are shown large sales to overseas companies but receivables do not show they are from related parties.
- BMC is unable to compete with local low cost operators in an industry which needs experience in slab procurement and cutting and selling to projects for higher realizations rather than to middle men.
- BMC is looted for the next 7 years through intercompany loans etc., sucked dry and put into bankruptcy.
- BMC has never made a dollar of profit but the promoter has been able to suck out about US$ 15 million from the venture over the years on top of using it as a personal ATM.

Case study 4 – Yarn company could be in China or India.

- Yarn spindles.

- End product – cotton yarn

Case study – Yarn company could easily happen in India or China

Business quality red flags

- Turns cotton into threads and then converts some threads into cloth pieces for some value addition.
- Commodity business – No durable competitive advantage / moats.
- No pricing power – buy from farmers at market prices and sell to weaving companies and garment companies who have many suppliers.
- Very poor sales to capex ratio – eg. To sell USD 5 of goods, USD 5 of capex needed. To double sales, you have to double capex.
  Dog with fleas type of a business.
- Cotton is nearly 80 to 85 % of end product price. Very poor gross margins and nil net margins.
- Long working capital cycle at high interest rates.
- Dependence on electricity for productivity. Project cost escalated with need for captive 10 mw power plant added in. Increased working capital needs with diesel requirement etc.

Promoter red flags

- Very similar Modus operandi to other promoters.
- Promoters must have the wherewithal's including political & banking contacts, to get cheap land, project approvals, project funding for the 'loot' to be a success and on going. Cant be a one trick pony – fraud goes on year after year.
- It is a serious modus operandi – takes a particular mindset and capability to pull it off with reputation intact through out by being a smooth operator.

Setting up a yarn company at over USD 30 million – Modus operandi.

- The state government is looking at increasing its popularity by launching more business projects and creating employment.
- Local Govt. can provide land at low cost, clear approvals, and can rope in a govt. linked company to extend loans to the project as well as do 'in house' feasibility studies for the project.
- Yarn project is decided upon. Why, one wonders ? Because cotton is easily available in the state and the - promoter has an advanced degree in textiles ☺ !!.
- Machinery – spindles - is to be imported from Japan through a top listed Japanese trading company.
- Process is to feed in raw cotton, the machinery cleans it, and converts it into threads of different counts based on length and quality of the cotton and which forms the base for making cloth. This can then be converted into cloth for value addition through knitting.
- Feasibility study with massage figures is made, project is approved and Govt. owned banks promptly pass project funding proposal via Govt. & promoter contacts.
- Land is allocated at low cost, construction order for the Factory plant given to a big company at a huge premium to get kick backs.
- Contract for machinery entered into with the Japanese trading company with a 40% commission to be paid to related party.
- Money routed through offshore companies and comes into the project as promoters contribution.
- Kickbacks paid to local government for all the 'help' in the project setup.
- Promoter is left with controlling stake in a world class textile project – at almost double the set up cost of a similar scale new project. Machinery is over invoiced, Factory building and worker residences are of world class quality – but at world class high prices.
- Bank working capital facilities are in place through government contacts and obliging Government linked banks.
- Local government linked company has provided base loans via related companies to show as promoters share of funds to get the project off the ground. Talk about team work !!
- Project is inaugurated by state ministers and Central cabinet minister at the time. Political network is superb.
- Project is unviable from day 1. Promoter has to export all production as it is an EOU (export oriented unit). Siphoning money overseas is easier. Use friends and family as agents for export & under invoice exports to them who then sell at full price and keep the profits offshore for the promoters.
- Money made is stashed overseas to fund promoter's children education, extravagant family holidays like Safaris in Africa etc. Promoters high lifestyle needs regular funding ☺
- Promoter even pays the tuition fees for Ivy league MBA for the son of a civil servant who has passed favors to the promoter.
- Purchases of Cotton from farmers in cash – easy source of fraud. Key man kept here who himself commits fraud against the promoter & sacked !!!.
- Project never makes a profit from day one. As losses mount, massaging of accounts gets more innovative. Bankers are 'managed' through political contacts and by getting in new bankers and partially paying over due interest on old loans.
- At the height of desperation, promoter places a very large order with the Cotton farmers association – a co-operative whose members are poor farmers. Payment terms involve a small credit period.
- The promoter buys and immediately liquidates the cotton stock at a discount by selling it to a whole seller for cash and raises substantial cash to meet personal expenses.
- The farmers association has never been fully repaid even after 5 years of taking the cotton.
- People with fraud as their motivation will stop at nothing. Millionaires looting the poor for Ego & Envy.

Yarn company fraud…contd.

- Ultimately after 10 years of losses, and hopeless economics of the business, promoter's ever optimistic projection of himself and his business is successful in roping in or trapping a US based PE fund.

  The PE fund CEO is 'bowled' over by the hospitality and charisma of the promoter. Wined and dined and before he knows it he has already invested !! ☺ ☺ ☺ And you thought professional private equity guys are always smart ☺ !!

- PE fund money pumped in which pays off bank loans at a huge loss to the banks – 25 cents on the dollar is pre negotiated by the promoter & PE & Bank. Banks persuaded by promoter to 'accept' the offer from the PE through political contacts.

- Even otherwise, banks have little choice as alternative is bankruptcy with no Bankruptcy laws. Banks can't run the textile mills and had been forced to provide working capital to keep machines running. Contrast this with UOB here who can take over businesses and run them as entrepreneurs.

- The PE fund as the new 'major investor' takes the promoter on a US and European tour as a brand ambassador for doing business in India and helping the PE fund raise more money.

- PE fund after 3 years of performance defaults , and having employed top lawyers etc. for paperwork takes over the shares from the promoters in their offshore holding companies at zero cost as was in the contract.

- PE fund sells out to the present owner – a yarn end user at a loss. Yarn user gets state of the art factory at a fraction of the cost to supply his raw material.

- Original promoter acts now a Director for salary and yet influences siphoning of the money for him self. Day to day operational problems in his local area where the plant is located are influenced by the still well connected Director. Hence need to keep him on board for his connections.

- Reputation of the family and Director intact in society as a prominent citizen. ☺ !!

Other frauds experienced – China

- S- chip companies look very cheap from valuations perspective. Which got us started.
- Did 6 to 8 trips to China to undertake 'kick the tires' type of research.
- Accounts were basically fraudulent so no 'on ground' research could have helped.
- Biggest common scam was company funds shown on the balance sheet were collateral to banks for personal loans taken by promoters. Promoters default and bank grabs the company's cash. Notes in accounts never mention collateral. Auditors have no clue as well.
- Many cases of Company with S$ 50 million cash on the balance sheet in the latest quarterly accounts defaults for S$ 10 m of bonds due.
- Annual and quarterly reports of the companies were monuments to fraud any way and hence useless but that was the main basis of research.
- Biggest weakness was we had no advantage in knowing the DNA of the promoters in a foreign land with scarce translations & news in English. We quickly learned that we brought no edge to the investing game in China – if we did not even know the promoters background, what good it the business ?
- Very soon liquidated ALL S-Chip holdings despite losses. Many of the investee companies proceeded to be de-listed from the Singapore stock exchange and is now well known that significant number of S-chips were fraudulent companies from the start.

Case study 5 – use of offshore trading companies.

- Promoter sets up 5 'unrelated by shareholding' overseas trading companies in Singapore, Dubai, Moscow, New York and Tokyo to buy goods from the 'group companies' in India.
- A family member becomes a non resident and stays overseas to operate the 'overseas' fraud.
- Portrayed as independent trading companies and uses Indian banking network to get Banking lines of credit to the trading companies to buy goods from 'un-related' Indian companies.
- Indian group companies show growing sales to these trading companies and debtors are not shown as related parties to banks.
- Easy to siphon off money overseas through bank lines in India which the promoter can 'manage' through his political and banking network.
- Offshore companies sell off goods and keep huge margins overseas with low taxes while Indian company shows losses.
- Have seen a case of 'permanent cargo' where a cargo is rotated between related companies permanently every 6 months or so while bank facilities of discounting bills are used to generate cash.
- Singapore, Dubai common places for 'locating' subsidiaries or 'unrelated group companies owned by family & friends ☺ ' and moving money offshore from India & China by various sales, charging of consultancy fees, technical fees, etc..
- Not just Indian companies – Chinese, Russian, Bangladesh and many others use similar banking networks to move money from operating companies back home to low tax offshore companies.
- Singapore & Dubai are huge beneficiaries of such movement of funds disguised as genuine business dealings. Home country investors are being looted .

A friends experience – Bankrupt promoter bids for USD 350m power project

- With no money in the bank, group companies steeped in debt, this promoter decides on embarking on a 330 megawatt power generation project.
- Every industrialist wanted a finance company and a power project in 1990's. Peer pressure ☺ !
- Modus operandi of fraud is similar to others.
- Huge tracts of Agricultural land are agreed to be bought through Govt. contacts. Promoters will then change use of land to 'industrial use' through political contacts.
- Promoters will inflate the land price and transfer it to the project company as their contribution to the 'power' project once finances are in place.
- Power purchasing agreements (PPA) with local state owned Electricity boards is agreed in principle through top political contacts, Electricity secretary of the sate, Chief minister of the state.
- Based on potential PPA, project viability is shown and feasibility study done. Have you seen a poor feasibility study by consultants ? They will get you the figures you desire. You are paying them after all !!
- Foreign entities from US are invited to join in to fund and invest the venture.
- Promoter was to make a percentage cut on the placement of machinery orders to overseas companies of over US$ 200 million. Make money on awarding of the buildings for the project as well.
- Promoter can make money on machinery maintenance contracts each year for life of the project.
- Project never takes off as foreign investors have smartened up and insisted on sovereign guarantee from the country on the PPA rather than local electricity boards which had bad balance sheets.
- Start up costs of this power project is over US$ 10 million over 4 years. Power projects agreement complexity needs high level law firms to be involved. Promoter and his team fly globally in First class with merchant bankers to attract investors. All this needs money which was sucked out of listed group companies through banking lines. This loss making subsidiary is merged into the parent which then declares bankruptcy.
- Bankrupt parent companies core manufacturing units sold to foreign investors with banks taking 10 cents on the dollar.
- Total loss by the promoters group to the Indian banking system and investors via sheer fraud is in excess of US$ 100 million from 1982 to 2010.
- This promoter too has never been to jail, avoided court appearance by faking heart trouble, has no court cases pending against him in my friends knowledge and regularly gets invited to business forums.
- He gives back to society – sits on local school and on the board of Top management schools where Govt. nominates directors. ☺☺ !!!
- Also active, respected and popular member of the community. Ability to manage image in society is a key asset for fraud.
- Promoter often advises others **'it is much more important to portray an image of honesty than to actually be honest'. ☺**

Public markets practices – Modus operandi for Laundering money through stock markets – a favourite of Politicians and fraudulent business men.

- Need closely held listed shell company in India. IMP – Only key players in the game know about the name of this company for the scheme to be successful.
- Need a registered foreign institutional investor (FII) via Mauritius usually.
- Overseas illegal funds, parked with an obliging fund manager's sub-account as money from an investor.

- Shares of the listed company are officially sold to insiders who need to convert illegal 'black' money into 'white' money without paying taxes. Say for example US$ 30,000 worth each to several 'clients'.
- Manipulation starts and the operator plays up the stock on minimal volumes. Rises by highest level allowed per day on the market by trading just a few shares between related companies.
- Stock can rise say 10x, 20x to 30x over a year.

- Other manipulators see this and start participating. Key manipulator will sell some shares to genuine third parties who join the frenzy as trades are done on the exchange and make more money from sales to genuine outsiders.
- Once stock held by 'clients' is worth say US$ 1 million, after a year (no long term capital gains tax) the FII buys the stock from clients in 'married or matched deals 'using the illegal funds parked with him.
- The Indian client gets paid US$ 1 million for shares sold via the stock exchange. Indian client now has official 'white money' and pays a 'cut' to the manipulator and hands him his black money Plus commission.

- The FII gets a cut as well for using his sub-account.
- Many a times, a lot of naïve stock market traders get caught in these scams.
- Technical chartist's on CNBC say 'what a strong trend this stock has and more naïve traders come in. ☺
- Over time, the stock collapses as insiders sell more shares to third parties.
- Company's share price will collapse over time and will be resurrected again at a later stage after a couple of years by buying out shares at collapsed nominal prices.
- This has been openly happening for years, is well known by investor forums and authorities with budgets to investigate this type of thing can come up with nothing.
- All trades are official and have happened through the stock exchange of the country.
- Nothing is legal about it ……….but technically speaking …..nothing illegal has been done ☺

Part 2

What happened in 1997 ?

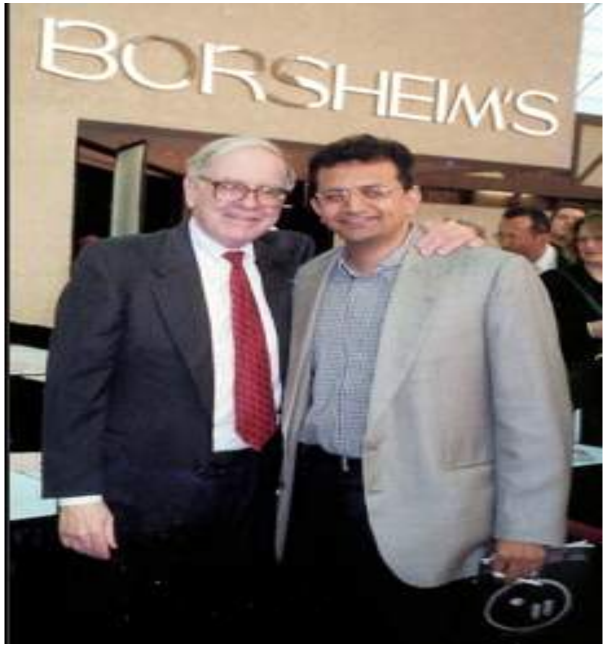
I had an Oh my God ! moment ☺ !

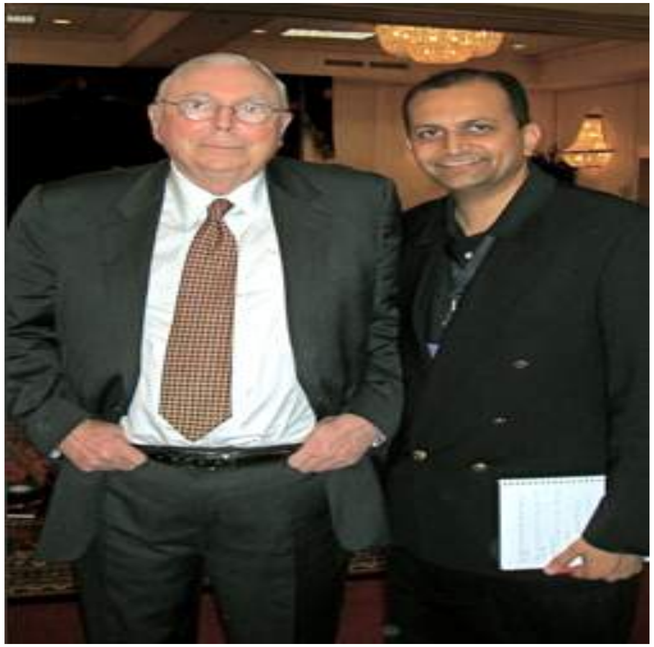
Substantially understood the extent of our stupidity & what we were doing wrong !!


Nancy


Berkshire

The insights from the Berkshire Hathaway overdose post 1997 and how we changed track.





The change of our investing journey.

- We were clearly a victim of corporate fraud – probably well deserved.
- Fighting the fraudulent promoters who are masters in the art of fraud is painful.
- Mentally, as investors, we should be willing to take 'business risks' but cannot accept integrity risks. I was taken to the cleaners by the promoters.
- Fighting management and promoters is a lonely task which makes one very unpopular even if you are right. Do you fight society ? Is fighting for what you believe to be right supposed to be so painful ?
  Promoters well oiled machinery gets started to address any dissent from shareholders or other victims seeking money back from the company. Fraudulent promoters know how to manipulate things in their favor.

- My friend had been to the Berkshire Hathaway AGM in 1996 and shared his experience with me. I went for the first time in 1997 with him.
- The experience changed my life and I have been to the AGM every year since – except 2009 – (was in shock after losing 50% of the portfolios value in the 2008 crash ☹ ☹ .)

- Read all Berkshire Hathaway annual letters from 1965.
- Read Security analysis again, read The Warren Buffett Way by Hagstorm. Read Roger Lowenstein's, Buffett: The making of an American Capitalist.
- I realized immediately that while I was doing investing which I loved, I was going about it in a manner completely opposite to what Warren and Charlie were doing.

- **They chose who they did business with based on integrity and ethics not based on business prospects.**
- Their first filter was ethics and they studied peoples history to find out if they are trustable. People don't change behavior patterns dramatically. "You cant do a good deal with a bad person". Warren Buffett.
- Read '24 causes of human misjudgment and tried to understand how we have been gullible.
- Started focusing on quality of managements and quality of the companies. Understood for the first time the difference between cigar butts made famous by Benjamin Graham and compounders which was the focus of Phil Fisher and Charlie Munger.

- If there is even a whiff of fraud and the management is not trustable, I personally feel digging into accounts to find fraud is a waste of my time. I am out of there.
- I was mesmerized by their genuineness as individuals, simplicity of their lives & power of their minds . Their achievements were staggering and integrity was not negotiable.
- Meeting Warren and Charlie and reading about them and what they said made me ask the question very often – What would Warren & Charlie do ? Not only in investments – but in coping with what life was throwing at me.
- I share some of the thoughts that resonated with me deeply in the following slides.

Some simple but life changing thoughts of Chairman Buffett.

- "You don't need to be a rocket scientist. Investing is not a game where they guy with the 160 IQ beats the guy with the 130 IQ." Fortune 1989.
- "I am a better investor because I am a businessman and a better businessman because I am an investor."
- "The most important quality for an investor is temperament, not intellect. You don't need tons of IQ in this business. You don't have to be able to play three-dimensional chess or duplicate bridge. You need a temperament that derives great pleasure neither from being with the crowd not against the crowd. You know you're right, not because of the position of others but because your facts and your reasoning are right."
- "I'm rational. Plenty of people have higher IQ's and plenty of people work more hours, but I'm rational about things. You have to be able to control yourself; you can't let your emotions get in the way of your mind."
- "Invest within your circle of competence. It's not how big the circle is that counts, it's how well you define the parameters."
- 'We don't believe in the Noah's Ark principle of investing, winding up with two of everything. Then you have a zoo."
- "Billy Rose used to say that if you have a harem of a hundred girls, you never get to know any of them very well. The trick is to know a lot about what you own, and you don't own that many things'
- "The best thing I did was to choose the right mentor"
- "Rule no.1: Never loose money. Rule no.2: Never forget rule number 1."
- "In the end we must work with people who match our principles, not the reverse. - Salomon Brothers report to shareholders 1991.
- You're neither right nor wrong because other people agree with you. You're right because your facts and your reasoning is right. That's the only thing that makes you right"
- "Look at stocks as businesses, look for businesses you understand, run by people you trust and are comfortable with, and leave them alone for a long time".
- "I think you'll probably start looking for a person that you can always depend on; the person who's ego does not get in his way; the person who's perfectly willing to let someone else take credit for an idea as long as it worked ; the person who essentially wouldn't let you down, who thought straight as opposed to brilliantly"
- 'I really like my life. I've arranged my life so that I can do what I want."
- ' I am doing what I would like most to be doing in the world, and I have been since I was 20. I choose to work with every single person I work with. That ends up being the most important factor. I don't interact with people I don't like or admire. That the key. It's like marrying" Fortune Sept 1989.
- "Its far better to buy a wonderful company at a fair price then a fir company at a wonderful price."

Seth Klarman's learning's from Warren Buffett

This year is the 50th anniversary of Warren Buffett taking control of Berkshire Hathaway Inc. (NYSE:BRK.A) (NYSE:BRK.B). "He has provided generations of investors with a great gift. Many, including me, have had our horizons expanded, our assumptions challenged, and our decision-making improved through an understanding of the lessons of Warren Buffett." More on what Seth Klarman has learned from Buffett below, compliments of the Financial Times:

1. Value investing works. Buy bargains.
2. Quality matters, in businesses and in people. Better-quality businesses are more likely to grow and compound cash flow; low-quality businesses often erode and even superior managers, who are difficult to identify, attract, and retain, may not be enough to save them. Always partner with highly capable managers whose interests are aligned with yours.
3. There is no need to overly diversify. Invest like you have a single, lifetime "punch card" with only 20 punches, so make each one count. Look broadly for opportunity, which can be found globally and in unexpected industries and structures.
4. Consistency and patience are crucial. Most investors are their own worst enemies. Endurance enables compounding.
5. Risk is not the same as volatility; risk results from overpaying or overestimating a company's prospects. Prices fluctuate more than value; price volatility can drive opportunity. Sacrifice some upside as necessary to protect on the downside.
6. Unprecedented events occur with some regularity, so be prepared.
7. You can make some investment mistakes and still thrive.
8. Holding cash in the absence of opportunity makes sense.
9. Favour substance over form. It doesn't matter if an investment is public or private, fractional or full ownership, or in debt, preferred shares, or common equity.
10. Candour is essential. It's important to acknowledge mistakes, act decisively, and learn from them. Good writing clarifies your own thinking and that of your fellow shareholders.
11. To the extent possible, find and retain like-minded shareholders (and for investment managers, investors) to liberate yourself from short-term performance pressures.
12. Do what you love, and you'll never work a day in your life.

The true genius of Buffett is his ability to take incredibly complex subjects and knock them down to the basics in a manner so simple you can't help but wonder what was so complicated in the first place. Anyone that has sat in a room listening to Charlie and Warren can appreciate this. In some ways, they are just playing a different game than the rest of us.

Thoughts of Mr. Charlie Munger – a philosopher, thinker & Investor.

- Deserved trust is the most important thing.

  "The highest form that civilization can reach is a seamless web of deserved trust — not much procedure, just totally reliable people correctly trusting one another. ... In your own life what you want is a seamless web of deserved trust. And if your proposed marriage contract has forty-seven pages, I suggest you not enter."

- Those who keep learning, will keep rising in life.

  "I constantly see people rise in life who are not the smartest, sometimes not even the most diligent, but they are learning machines. They go to bed every night a little wiser than they were when they got up and boy does that help, particularly when you have a long run ahead of you."

- Life has terrible and unfair blows. Utilize them in a constructive fashion.

  "Another thing, of course, is that life will have terrible blows in it, horrible blows, unfair blows. It doesn't matter. And some people recover and others don't. And there I think the attitude of Epictetus (Greek philosopher) is the best.
  He thought that every missed chance in life was an opportunity to behave well, every missed chance in life was an opportunity to learn something, and that your duty was not to be submerged in self-pity, but to utilize the terrible blow in constructive fashion. That is a very good idea."

- Wisdom acquisition is a moral duty.

  "Wisdom acquisition is a moral duty. It's not something you do just to advance in life. Wisdom acquisition is a moral duty. 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. You're going to advance in life by what you learn after you leave here."

Thoughts of Mr. Charlie Munger

- Real knowledge is knowing that you don't know.
- "Confucius said that real knowledge is knowing the extent of one's ignorance. Aristotle and Socrates said the same thing…. The survivors know. ... Knowing what you don't know is more useful than being brilliant."
- Spend each day trying to be a little wiser than you were when you woke up.
- "We both (Charlie Munger and Warren Buffett) insist on a lot of time being available almost every day to just sit and think. That is very uncommon in American business. We read and think."
- You don't have to be brilliant, only a little bit wiser than the other guys, on average, for a long, long time.
- It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent. There must be some wisdom in the folk saying, 'It's the strong swimmers who drown.'
- How do you learn to be a great investor?
  First of all, you have to understand your own nature. Each person has to play the game given his own marginal utility considerations and in a way that takes into account his own psychology. If losses are going to make you miserable and some losses are inevitable – you might be wise to utilize a very conservative pattern of investment and savings all your life.
  So you have to adapt your strategy to your own nature and your own talents.
  I don't think there's a one size fits all investment strategy that I can give you.

Thoughts of Mr. Charlie Munger – tips for accountants ☺

- Optimistic accounting leads to 99% of problems.
"Ninety-nine percent of the troubles that threaten our civilization come from too optimistic accounting. And yet these damn accountants with their desire for mathematical purity want to devote exactly as much attention to accounting that is too pessimistic as they do to accounting that is too optimistic — which is crazy. Ninety-nine percent of the problems come from being too optimistic. Therefore, we should have a system where the accounting is way more conservative. "Source – University of Michigan discussion.

- Assets require more scrutiny than the liabilities."
The liabilities are always 100 percent good. It's the assets you have to worry about"

- Three rules for a career:
1) Don't sell anything you wouldn't buy yourself;
2) Don't work for anyone you don't respect and admire; and
3) Work only with people you enjoy.

- Never underestimate the power of incentives and the power of compounding.

What we did post the overdose of the Charlie Munger influence. ☺

Understood our own nature, marginal utility considerations and psychology. Played to our strengths and were cognizant of our weaknesses and rubbed our noses in it.

- Focused on management who were talented but for whom integrity was not negotiable. Most important filter for us.
- Focused on the quality of business these great managers with integrity were running – pricing power, unleveraged returns, quality of moats, stickiness of the high margins, returns on equity of the business etc. Use check lists for reducing mistakes.
- Assessed the ability of the company to historically re-invest the earnings instead of paying them out.
- Invested in a concentrated manner. Top five positions are 60% of the portfolio.
- Practice 'Sit on your ass' investing and let the magic of compounding work over time.
- Did not sell our holdings just because of valuations being high temporarily.
- Focused on the ability and probability of the investee company to be much bigger 3 to 5 years out. This is how we got many multi baggers.
- Never compromised on the quality of people we deal with and co-invest with as partners.
- Stayed away from all negativity.
- Try to be a little cleverer each day, by reading a lot, acquire worldly wisdom and adjust our behavior accordingly while being Rational.

Warren and Charlie on "Moats"

Buffett: "So we think in terms of that moat and the ability to keep its width and its impossibility of being crossed as the primary criterion of a great business. And we tell our managers we want the moat widened every year. That doesn't necessarily mean the profit will be more this year than it was last year because it won't be sometimes. However, if the moat is widened every year, the business will do very well. When we see a moat that's tenuous in any way—it's just too risky. We don't know how to evaluate that. And, therefore, we leave it alone. We think that all of our businesses—or virtually all of our businesses—have pretty darned good moats. And we think the managers are widening them. Charlie?"

Munger: "How could you say it better?"

Buffett: "Sure. Have some peanut brittle on that one."

—From the 2000 Berkshire Hathaway annual meeting

Some examples of types of moats.

Intangible assets – Patents & Govt., Brands regulations. E.g.. Alcohol production licenses, car testing centers.

Cost advantages – lowest cost due to say proximity to a mine.

Switching costs – e.g.. Banks & IT companies.

Network effect – stock exchanges.

Newspapers – now being destroyed.

Culture ?

Some characteristics of portfolio companies we invest in .

- Top quality management – talented and high integrity running high quality businesses.
- 5 years of operational history. We do no private equity.
- High quality business – moats, pricing power – ability to to sustain a durable competitive advantage.
- Scalable businesses – Financial services in India for e.g. we see a very long runway ahead. Plain Vanilla companies doing Housing finance , Consumer finance.
- But financial services, the DNA of the Banker is most important. Banks / financial companies are only as good as the banker or the promoters DNA. Easy to collapse on leverage.
- Finance companies able to reinvest incremental profits at high rates of return instead of dividend payments.
- High degree of recurring revenues. Asset managers, IT services businesses etc. Management has to focus on increasing additional revenues – not replace the entire turnover of the company each year. Minimum profits guaranteed.
- High return on Equity (ROE) companies arising from high margins and pricing power. Consumer goods company work on negative capital.
- Substantial market share due to differentiation in service offerings. Difficult to make a case for an 'also ran' company. Must have something unique.
- Generally avoid Cash heavy businesses – real estate.
- Don't touch poor economics business – high fixed costs and capital intensive businesses like airlines, Commodity companies, steel companies, textiles etc.
- Niche areas with dominant market shares – ratings companies, consumer finance.
- Companies whose product cost is relatively small compared to the benefit received. Hence product sales price is not an important consideration. – cutting tools, diamond processing.
- Avoid any government regulation facing companies – Mining, defense contracts, etc. Corruption and uncertainty likely to be high.
- High probability of profits 3 to 5 years out are materially higher. Growing profits based on pricing power reduces the mistakes in slightly over paying for shares. Opposite is true for poor quality businesses. Likely to get stuck for years with stagnated profits and hence valuations.
- Network effect companies like credit card companies – some are technology companies instead of finance companies. Big internet companies with real earnings and growing cash-flows.
- Pharmaceutical – India lowest cost producer in the world and global markets for Generics. Some of the highest value creators in India. Run by exceptional value creators.
- Our experiences with low quality businesses (pricing power) run by charming fraudulent management has pushed us for QUALITY first.
- May not be right for all – but it suits our mindsets.

Part 3 – for students, budding accountants, and adults alike.

- Understand how compounding works.
- The real price of fraud – if money made from investments is to go back to society.
- Our own key insights over the years.
- Leaving the rat race – making money work for you – not working for money.
  Precious blueprint provided by Mr. Li Ka-Shing.
- Learning to THINK & Living life on your terms.

Compounding – Things may be more expensive than you realize in your early years……

- A Coffee Bean Ice blended coffee with cream …yum….S$ 7. A "llaollao" Sonum yoghurt S$ 6.5. Two crispy chicken and upsized coke & fries meals a day S$ 20 = Snacks cost = **S$ 33.5 per day** = S$ 1,000 per month = S$ 12,000 a year.

- A car costs about S$ 2,500 a month with insurance, fuel, monthly installment etc.= S$ 30,000 per year.

Years from today and needs arising. Compounding from just 1 year of money saved ….	Price of snacks @15% pa	Price of a car @15% pa	Price of snacks @10% pa	Price of a car @10% pa
Year 1 from now → Money saved.	**12,000**	**30,000**	**12,000**	**30,000**
Year 5 → Savings boost confidence ?	24,000	60,000	19,000	48,000
Year 10 from now → marriage ?	49,000	121,000	31,000	78,000
Year 15 from now → Kids ?	98,000	244,000	50,000	125,000
Year 20 from now → Annual family holidays ?	196,000	491,000	81,000	202,000
Year 30 from now – mid life crisis ?	795,000	1,986,000	209,000	523,000
Year 50 from now –> on a Yacht with kids & grandchildren ?	**13 m**	**32.5 m**	**1.4m**	**3.5m**

If having financial freedom is your objective, you will think differently when you think in terms of compounding.
Get out of the rat race – never work for money, make money work for you and lead a life of confidence on your terms….Very basic but very few understand it.
Majority live a Hand to mouth existence…NO Savings and grumpy in bad jobs.

When NOT to Sell a Great Business You Own

25 Aug 2014 10:16 am | Tweet

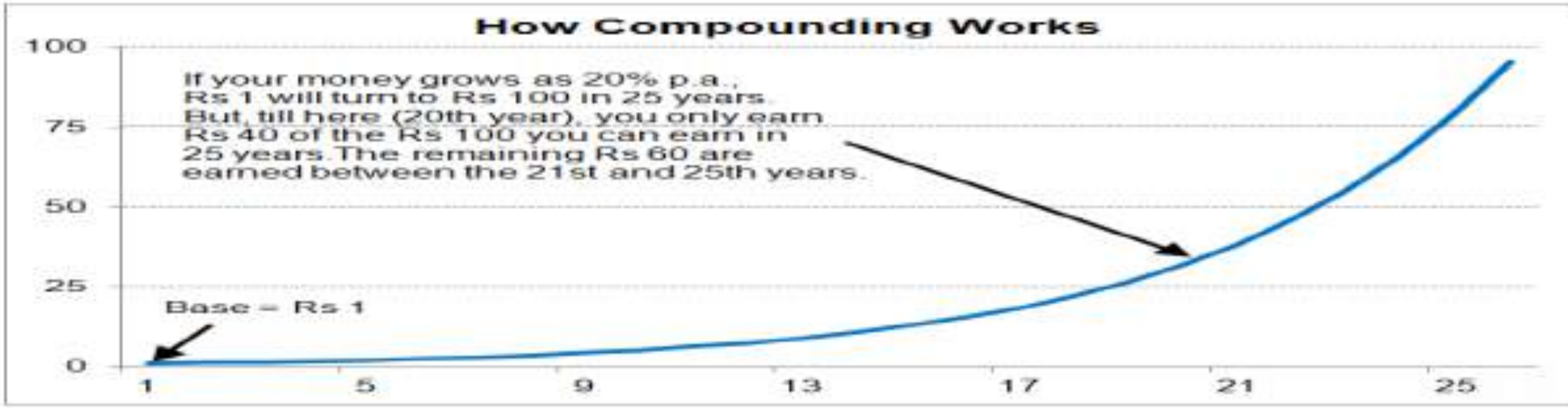
Consider this. If you want to multiply your money 100x in 25 years, you want your investment to return 20% every year.

In other words, Rs 1 growing at 20% per annum will turn to Rs 100 after 25 years, excluding all dividends.

But if you sell this stock after 20 years (instead of holding for 5 more years), you will get just Rs 40. The remaining Rs 60 would come only between the 21st and 25th years.

Even if you earn 15% return per annum, your Rs 1 would turn to around Rs 35 in 25 years. But 50% of these returns would come only between the 21st and 25th years.

That's how compounding works. The longer you let your money grow, the faster will be the incremental return you would earn.



That's why selling the great businesses you own is often a wrong thing to do.

This is especially true when you sell such a business because of any such reason –

- This stock has risen "too high".
- This stock is "fairly valued".
- This stock is not moving. Others are. (Read what I did with Swaraj Engines)
- Competition is rising.
- New government is bad.
- Economy is going downhill.
- Everything is priced in the stock.
- Let me switch to "something better"

The opportunity cost of fraud to society …..with compounded returns.

- "If all you succeed in doing in life is getting rich by buying little pieces of paper, it's a failed life. Life is more than being shrewd in wealth accumulation." Charlie Munger

- The fortunate should give back to society.
  "Those of us who have been very fortunate have a duty to give back. Whether one gives a lot as one goes along as I do, or a little and then a lot (when one dies) as Warren does, is a matter of personal preference." Charlie Munger.

- Someone's sitting in the shade today because someone planted a tree a long time ago. Warren Buffett

Hence giving back to society should always be a big part of the fortunate and the Family office will do the same.

Money for money's sake is a fool's game.

It must have utility to society after you have lived comfortably – but not excessively.

We enjoy the process far more than the proceeds. Warren Buffett.

Detach your EGO from your net worth. Money is your servant – not your master.

In the compounding game USD 1 million invested @ 15% for

10 years = 4.04m 20 years. = 16.3m For 30 years = 66m For 50 years = 1.08 Bn

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Consider these facts today:

It takes US$ 4,000 to get a child tutored to pass IIT entrance exams in India.

This will pull the child's family out of poverty for life (www.dakshana.org)

It takes just USD 12.50 to feed one child one full meal a day for a year in India. (www.akshayapatra.org)

<u>The fraudsters do more damage than we realize to our society by taking resources from the poor as well.</u>

US$ 1.08 Bn can get 270,000 families a chance to get out of poverty for life.

US$ 1.08 Bn can provide a life giving meal to 86.4 million children for a whole year.

Some remarks for generation next……our insights.

- Get yourself the right mentors in life. They can be Living or the eminent dead - does not matter. Get into their minds and emulate what you like about them. Warren Buffett
- “What is the secret of success? - one word answer :"rational”. Charlie Munger
- Adopt your life to who you are…..be true to yourself and to your value system. But be prepared to pay the price for sticking to your values. Mr. Narayana Murthy
- Remove all negativity from your lives. Stay away from Egoistic people and fraudulent mindsets.
- “Acquire worldly wisdom and adjust your behavior accordingly. If your new behavior gives you a little temporary unpopularity with your peer group…then to hell with them.” Charlie Munger
- Do what you enjoy & FOCUS. Think in terms of probabilities and opportunity costs. Warren Buffett.
- Save voraciously, live comfortably but well below your means & compound the savings to be able to live life on your terms. Confidence comes from assurance of financial well being.
Generational wealth does not last so don’t be complacent.
Integrity is not negotiable. If your name is good, you will make your way in life successfully.
You can either work for money or make money work for you. Mr. M K Amin.
- “To get what you want, you have to deserve what you want. The world is not yet a crazy enough place to reward a whole bunch of undeserving people.” Charlie Munger
- Enjoy the journey and create memories you can be proud of – life is too short for regrets.

Li Ka-Shing teaches you how to buy a car & house in 5 years

S$ 2,000 → 30% (600) on living expenses (no rent ☺) 20% (400) on making friends cleverer & richer than you, 15% (300) on books, 10% or (200) on holidays & recharging, & 25% (500) on starting a business to earn, save & invest. Become financially savvy.

Hong Kong billionaire Li Ka-Shing shares some of his money wisdom, outlining an inspirational five-year plan to improve one's lot in life

This article is translated from the original Chinese by Edmund Ng at CeoConnectz.

Suppose your monthly income is only RMB 2,000, you can live well. I can help you put money into five sets of funds. The first $600, second $400, third $300, fourth $200, fifth $500.

1 **The first set of funds is used for living expenses.** It's a simple way of living and you can only be assigned to less than twenty dollars a day. A daily breakfast of vermicelli, an egg and a cup of milk. For lunch just have a simple set lunch, a snack and a fruit. For dinner go to your kitchen and cook your own meals that consist of two vegetables dishes and a glass of milk before bedtime. For one month the food cost is probably $500-$600. When you are young, the body will not have too many problems for a few years with this way of living. AND RENT ?

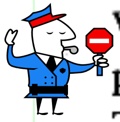
2 **Second set of funds: To make friends, expand your interpersonal circle.** This will make you well off. Your phone bills can be budgeted at RMB 100. You can buy your friends 2 lunches a month, each at $150. Who should you buy lunch for? Always remember to buy lunch for people who are more knowledgeable than you, richer than you or people who have helped you in your career. Make sure you do that every month. After one year, your circle of friends should have generated tremendous value for you. Your reputation, influence, added value will be clearly recognized. You'll also enhance your image of being good and generous.

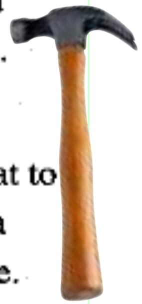
3 **Third set of funds:** To learn. Monthly spend about RMB 50 to RMB 100 to buy books. Because you don't have a lot of money, you should pay attention to learning. When you buy the books, read them carefully and learn the lessons and strategies that is being taught in the book. Each book, after reading them, put them into your own language to tell the stories. Sharing with others can improve your credibility and enhance the affinity. Also save up $200 per month to attend a training course. When you have higher income or additional savings, try to participate in more advanced training. When you participate in good training, not only do you learn good knowledge, you also get to meet like-minded friends who are not easy to come by.

(4) **Fourth set of funds: Use it for holidays overseas.** Reward yourself by traveling at least once a year. Continue to grow from the experience of life. Stay in youth hostels to save cost. In a few years you would have travelled to many countries and have different experiences. Use that experience to recharge yourself so that you'll continually have passion in your work.

(5) **Fifth set of funds: Invest.** Save the $500 in your bank and grow it as your initial startup capital. The capital can then be used to do a small business. Small business is safe. Go to wholesalers and look for products to sell. Even if you lose money, you will not lose too much money. However, when you start earning money, it will boost your confidence and courage and have a whole new learning experience of running a small business. Earn more and you can then begin to buy long-term investment plans and get long-term security on your financial wealth being of yourself and your families. So that no matter what happens, there will be adequate funds and the quality of life will not decline.

WHAT THE ?





Well, after struggling for a year and if your second year salary is still RMB 2,000, then that means you have not grown as a person. You should be really ashamed of yourself. Do yourself a favour and go to the supermarket and buy the hardest tofu. Take it and smash it on your head because you deserve that. LOST IN TRANSLATION PERHAPS ?

If your monthly income is at RMB 3,000, you must still work very hard. You must try to find a part time job. It will be great to find part time sales jobs. Doing sales is challenging, but it is the fastest way for you to acquire the art of selling and this is a very deep skill that you will be able to carry it for the rest of your career. All successful entrepreneurs are good sales people. They have the ability to sell their dream and visions. You'll also meet many people that will be of value to you in the later part of your career. Once you're in sales, you will also learn what sells and what not. Use the sensitivity of detecting market sentiments as a platform for running your business and in the identification of product winners in the future.

PRETTY MUCH SMILE ALL THE TIME REGARDLESS

Being able to smile when being slightly misunderstood is good upbringing. When you're wronged and you smile with calmness, it is generosity. When you're being taken advantage of and you can smile, you're being open-minded. When you are helpless and you can do a philosophical smile, you're in a calm state. When you're in distress and you can laugh out loud, you're being generous. When you're looked down and you can calmly smile, you're being confident. When you're being jilted in relationships and you can smile it off, you're being suave.

☺ – HE HAS A LOT TO SMILE ABOUT THESE DAYS

Parting words of wisdom from the GURU's ……..THINK, THINK, THINK.

RAY DALIO: "To make money in the markets you have to think independently and be humble. You have to be an independent thinker because you can't make money agreeing with the consensus view, which is already embedded in the price."
Institutional Investor - March 6, 2015

"Apply logic to help avoid fooling yourself. Charlie will not accept anything I say just because I say it, although most of the world will."

—Warren Buffett

"In my whole life, I have known no wise people who didn't read all the time -- none, zero. You'd be amazed at how much Warren(Buffett) reads -- at how much I read. My children laugh at me. They think I'm a book with a couple of legs sticking out"."

– Charles T. Munger, *Poor Charlie's Almanack: The Wit and Wisdom of Charles T. Munger*

"We all are learning, modifying, or destroying ideas all the time. Rapid destruction of your ideas when the time is right is one of the most valuable qualities you can acquire. You must force yourself to consider arguments on the other side."

– Charles T. Munger

"We both (Charlie Munger and Warren Buffett) insist on a lot of time being available almost every day to just sit and think. That is very uncommon in American business. We read and think."

– Charles T. Munger

"It's better to hang out with people better than you. Pick out associates whose behavior is better than yours and you'll drift in that direction." — Warren Buffett

Further relevant reading on topics discussed.

Basic books about understanding money & wealth creation.

No university teaches you to manage money to get out of the rat race unfortunately !!

- The Richest Man in Babylon – George S. Clason
- The rules of wealth – Richard Templar
- The millionaire next door – Stanley / Danko

Books on understanding yourself & your weaknesses.

- The Psychology of Influence – Robert B Cialdini
- The 24 standard causes of Human misjudgment – Charlie Munger talk.

Books on the Investment business, mentors, Stocks etc.

- Poor Charlie's Almanack – The wit & Wisdom of Charles T. Munger.
- "The little book that builds wealth" Pat Dorsey
- "Do business with people you can trust" – L. J. Rittenhouse
- Berkshire Hathaway annual letters from 1965.
- The Warren Buffett Portfolio – Hagstrom
- The Education of a value Investor – Guy Spier
- The Essays of Warren Buffett – Cunningham
- Common stocks & uncommon profits – Philip A Fisher
- Where are the customers Yachts? Fred Schwed Jr.
- The art of thinking clearly – Rolf Dobelli
- From Third world to first – Memoirs of Lee Kuan Yew
- Autobiographies' of Andrew Carnegie & Benjamin Franklin

If you don't know how to think, you'll always be a one-legged man in an ass-kicking contest

Thank you for your time.

Q & A.