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AMBIT ASSET MANAGEMENT

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MONTHLY NEWSLETTER

GOOD & CLEAN by AMBIT

Ambit Good & Clean Portfolio

COFFEE CAN PMS

Ambit Coffee Can Portfolio

EMERGING GIANTS by AMBIT

Ambit Emerging Giants Portfolio

**EQUITY INVESTMENTS & PMS ARE SUBJECT TO MARKET RISKS,
READ ALL SCHEME RELATED DOCUMENTS CAREFULLY BEFORE INVESTNG**

Budget your time to do better things

Dear Investor,

If you are concerned about your portfolio and are looking for a solution-the budget may not help you. While you may have got a chance to plug into the Finance minister's budget and go through some of the not so exciting announcements over the weekend, we did some of our own analysis keeping in mind your portfolio companies.

Over the last two months we have consciously taken a step back from all the negative macroeconomic news flow to focus our energy and resources to what we have always believed to be more relevant - building deep sector and stock specific expertise. We choose to achieve this partly through detailed discussions, channel checks and interaction with economy participants and are happy to share this with you.

A forgettable budget…but what's in it for you?

The FY21 budget tilted towards fiscal conservatism, underwhelming high expectations given backdrop of weak macros. While revised estimate for FY20 fiscal deficit at 3.8% overshot the budget estimate by 50bps, FY21 fiscal deficit has been pegged lower at 3.5% - albeit driven by somewhat aggressive assumptions.

The government followed on its stated path of simplifying tax regime and lowering tax rates, its approach seems more gradual. Focus on rural India stayed - with allocation for agri+rural development rising 13% YoY - this should be consumption positive. A key disappointment was lack of material measures to heal the strained NBFC and real estate sectors.

Key winners: Consumer, IT

Key losers: Life Insurance, AMC, cigarettes; Auto OEMs, Real Estate (vs. expectations)

Exhibit 1: Specifically the budget was devoid of any big-bang reform however some read through for your portfolio companies include…

Relevant Announcements to your portfolio	Outcome	Portfolio Impact
1. A new optional personal tax regime – some benefits expected for low/middle income tax payers 2. Abolition of Dividend Distribution Tax (DDT) – while this will reduce taxes at corporate level further, the investor in higher tax bracket will end up bearing more taxes	▪ Possible impact on Consumerism/ Investment	▪ Positive for Consumer spending related stocks ▪ **Impact:** CCP/G&C/EG
3. Decision to grant 100% exemption for sovereign wealth funds investing in infrastructure and notified sectors	▪ Possible impact on Consumerism/ Investment	▪ Positive for Business Investment and Consumer spending related stocks ▪ **Impact:** CCP/G&C/EG
4. Increased basic custom duty on footwear from 25% to 35% and parts of footwear from 15% to 20%	▪ Marginally negative for certain categories of footwear	▪ Positive for a footwear manufacturer in your portfolio. ▪ **Impact:** CCP
5. Increase in Basic Excise Duty (BED) from Rs 200 to Rs 735 per thousand cigarettes and also increased in National Calamity Contingency Duty (NCCD) from the range of Rs 90 to Rs 235 per thousand sticks to Rs 200 to Rs 735.	▪ Both increase in BED and NCCD has increased the incidence of taxation by 5.4% for low end cigarettes to 13.8% per cigarette for high end cigarettes.	▪ Event impacts Cigarette maker in your portfolio: short term negative but long term neutral ▪ **Impact:** CCP
6. Extension of the time limit (eligibility based on loan sanction date till Mar-21) to avail the benefits under Section 80EEA (deduction related to affordable housing loans). 7. Lower tax rates for individuals and HUFs under Sections 115 BAC, which prohibits the utilization of benefits u/s 24(b) and Chapter VI-A , amongst other provisions of the Income Tax Act 8. Increase in the limit on deposit insurance	▪ Banks, NBFCs and HFCs could see an uptick in demand for affordable housing loans. ▪ Banks' distribution income could be impacted by reduced demand for life insurance and mutual fund products.	▪ Marginally positive for Banks, NBFCs and HFCs. ▪ Negative for Banks (esp. PVT with substantial distribution fees) ▪ Positive for Banks ▪ **Impact:** CCP/G&C/EG

from Rs 0.1mn to Rs 0.5mn		
9. The government proposes to raise fish production to 20 mn tonnes by FY23, and hope to raise fishery exports to Rs 1 lakh crore by 2024-25.	▪ This will expand the market for technical fibers required in fishing resulting in increased demand from domestic market and act as an add-on to the existing overseas demand.	▪ Mildly positive over long term for technical fiber company in your portfolio. ▪ **Impact:** EG
10. Basic customs duty increased to 20% from 10% on tableware, kitchenware, and clay items	▪ Impact on industry dynamics and smaller participants that import	▪ Positive for a company in the opal ware/ tableware industry in your portfolio. As its facilities are domestic ▪ **Impact:** EG

Source: Company, Ambit asset management, CCP=Coffee can portfolio, G&C= Good & clean portfolio, EG=Emerging Giants portfolio

How we preferred to spend our time…

Exhibit 2: Some of the major channel checks we did in the last 2 months

Sector	Who we spoke to	What they said
Paints	**Paints Dealer from Navi Mumbai**	▪ **Labour cost** has been increasing over the years (2x in 4 yrs); Prices of premium segment paints have been down by almost 30% since the past 1 and half year (Asian Paints has cut down prices since July, 2018) ▪ **DIY & express painting** has not picked up because a) Uneven space in India homes b) Cluttered Indian homes due to lot of heavy furniture ▪ **Asian Paints** by entering lower end putty segment has gained a lot of customers who can ultimately promote to paints. Putty is sold by Asian Paints at a 30% discount to JK Cement. All companies outsource the manufacturing of putty to a company called Walplast. ▪ **Industrial Paints** has been impacted due to slowdown in Auto and MSME sector; **Berger & Shalimar** will be biggest beneficiary of revival in these sectors ▪ **JSW has been planning a big disruption via their One Color One Price offer**, where they have seen some traction, but Decorative paints is difficult to crack for any new entrant
Premium Bikes	**Royal Enfield Dealer in Ahmednagar**	▪ **Classic remains popular bike at RE:** 70-80% of the sales are from the Classic bike at this dealership. ▪ **Financing available:** 70% of sales is done on financing through HDFC, Cholamandalam and L&T, upto 50% is done on NIP basis too (No income proof). ▪ **BS-VI transition** resulted in, production slowdown, 7-8% price hike (Rs.10k-12k) however sales was not impacted due to this transition. BS-VI compliant Royal Enfield has hit the roads since January, 2020. ▪ **Change in incentive:** No credit period offered to dealer/distributors, margins have been similar over last 2-3 years. Target based incentives have improved however. ▪ **Buying decision** influenced by referral (60-70%), Spare parts availability was earlier inhibitor but RE spare parts availability/delivery improved from 10 days to 5/6 days now
Consumer	**Cookware manufacturer and sellers in Mumbai**	▪ **In cookers the barrier to entry is mostly brand: T**he key hindrance for outsiders remains brand influence in purchase decisions another barrier would be availability of skilled labour ▪ **Consolidation:** During demon, 5-8 brands have been wiped off because these were cash run business. With GST rate being higher than VAT and excise, 3-4 brands further shut down. Fully compliant companies, those parties are doing better now. ▪ Hawkins pressure cooker will usually sell at MRP but the unbranded players can give >15% discount on MRP. Also unbranded players are now getting more focused on after sales to capture branded players share. ▪ **Pressure cooker market influenced by dealers:** Local dealers

		earn a bigger margin from unbranded companies and hence try to push customers towards trusted unbranded products.
Luggage Industry	**Multiple luggage dealers across India**	▪ **Luggage Industry's growth has slowed down due to consumer slowdown,** but organized segment is doing better than unorganised segment. ▪ **Hypermarkets and e-commerce continues to outperform other trade channel,** as they offer convenience and multiple options. ▪ **Overall brand pull is low in Economy segment** (ASP < Rs.3,000), thus the unorganised market is huge compared to organized. ▪ **Not much differentiation between branded and unbranded bags,** but attractive design, better after sales service & replacement warranty are the main feature that makes a customer purchase branded bags.
Two wheelers	**Visit to Pune (Bajaj Auto): meeting with CFO Mr. Soumen Ray**	▪ **Customer focus is on** (1)CC (2)Mileage (3)4-5 yrs use. Biking is a livelihood product and not a lifestyle product category for most of India (cannot delay purchase for too long). Considers product (motorcycle) to be: non-recurring+ discretionary+ high value purchase for most families in India ▪ **Encourage more skin in the game for dealers:** Debtors have been brought down from 1900cr to 900cr (even in these tough times) and was done with the intention that the dealer puts in more of their own money (means they will be more committed to succeed) ▪ **Cruiser space:** Bajaj is not present in cruiser segment (Avenger is not technically a cruiser besides seating style and should not be compared to a cruiser). Triumph-Will be another expert credential product (Niche market). ▪ **Roadblock for EV (industry):** 2.5x capital cost of CNG, CNG still has low penetration In India, battery costs are very high and not been discussed/considered into costs by analysts. Battery cost needs to come down by 50% for the conversation to be more meaningful
Ceramics	**Ceramic Dealer from Morbi**	▪ **200 players (out of total 1100) have closed down in morbi** (no new addition), and additional 100 are expected to shut shop, primarily due to working capital issues ▪ **Cash Sales has been declining** since last decade (from ~80% in 2000 to ~20% in 2018), thus GST and compliance increase has not impacted them much ▪ **Exports are looking better**, as the Indian Players have shifted focus from Middle East (low cost focused) to European/US markets (quality focused) ▪ **Listed players have stopped innovating** and have not lunched any new products in last 2-3yrs ▪ **Pricing for GVT has bottomed out** with most players selling at near-cost levels
Consumer Discretionary	**Page Industries Distributor from Lucknow**	▪ Lucknow has reached its peak in terms of Retail touch point expansion, growth in touch point expansion will largely be from outer areas ▪ Key benefit of ARS (Auto replenishment system) is that month end target based pressure is over now. ▪ Company has become more supportive in the recent times in terms of helping with Visual merchandise, Gondolas, modules, etc ▪ **Products:** There has been no new product launch in Modern classic in last few years. Demand of winter wear like thermals was immense with some companies reporting stock outs as well – same was with room heater ▪ **Critical task in Page factory** - they have a weighting system in place which ensures that none of the package have the wrong size or wrong quantity - this is supercritical ▪ **Facing some liquidity issues**- Credit period increased from 60days to 90-120days
Chemicals	**Chemicals sector dealer/ experts**	▪ **China's HUBEI 'Epicenter' of coronavirus, is a HUB for chemical manufacturing companies.** Hubei Province has several Chemical parks, which are manufacturing hub for salt chemical companies, agrochemical companies ▪ **Earlier due to environmental issues large number of chemical**

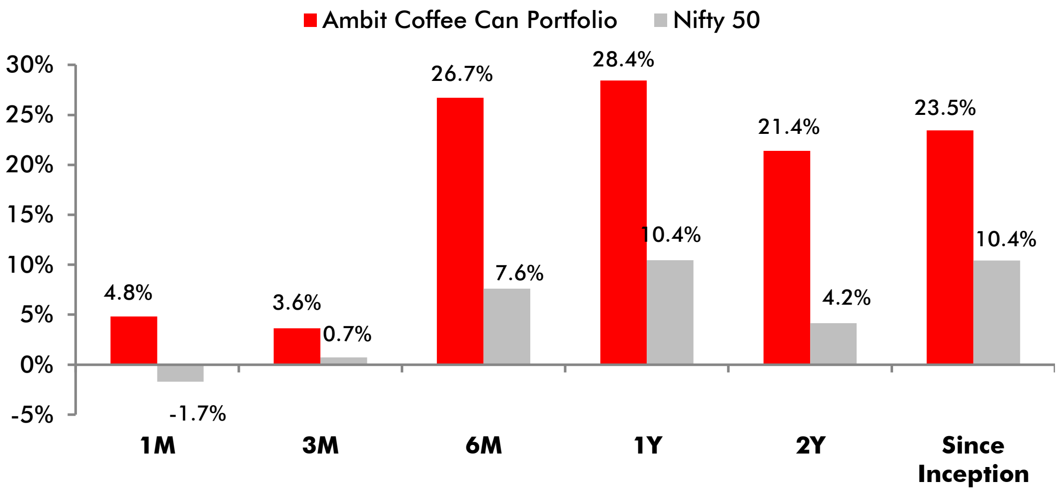
		parks in *JIANGSU were closed affecting large number of Chinese chemical companies ▪ **Indian companies benefit** in chemicals and agrochemicals
Technical Textiles	**Leading unlisted ropes & nets manufacturer in Mumbai**	▪ GTFL has always **focused on providing new solutions** (innovation) and branding (patenting/ new name to products), and the company has been successful in this. ▪ The industry (aquaculture) is solutions-driven and customers are willing to pay for it. ▪ Global peers make nylon nets and have never made polyethylene products. **GTFL is making polyethylene nets (better quality)** since the past 20-25 years (nets used in India) and hence has an advantage.
Opalware	**Management of Borosil Glassworks and Cello**	▪ Borosil's Opalware division is expected to grow 15-20% over the next couple of years, due to recent expansion in capacity. ▪ **Cello is involved in aggressive discounting** in Opalware segment, thus gaining market share from La Opala and unorganized players. ▪ **La Opala is the strongest player** in this segment with very strong brand equity and hence has higher revenue per kg. ▪ La Opala, with its single product focus is expected to witness growth as the segment is expected to grow in mid-teens going ahead.

Source: Company, Ambit asset management

Ambit Coffee Can Portfolio

At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail & consumption oriented sectors. The Coffee Can philosophy has unwavering commitment to companies that have consistently sustained their competitive advantages in core businesses despite being faced by disruptions at regular intervals. As the industry evolves or is faced by disruptions, these competitive advantages enable such companies to grow their market shares and deliver long-term earnings growth.

Exhibit 3: Ambit's Coffee Can Portfolio performance update



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of Jan 31, 2019; All returns (except 2Y and Since inception) are absolute returns net of fees & expenses; **Note:** *Returns prior to Apr'19 are returns of all the Pool accounts excluding non-aligned portfolio, and returns post Apr'19 is based on TWRR returns of all the pool accounts.*

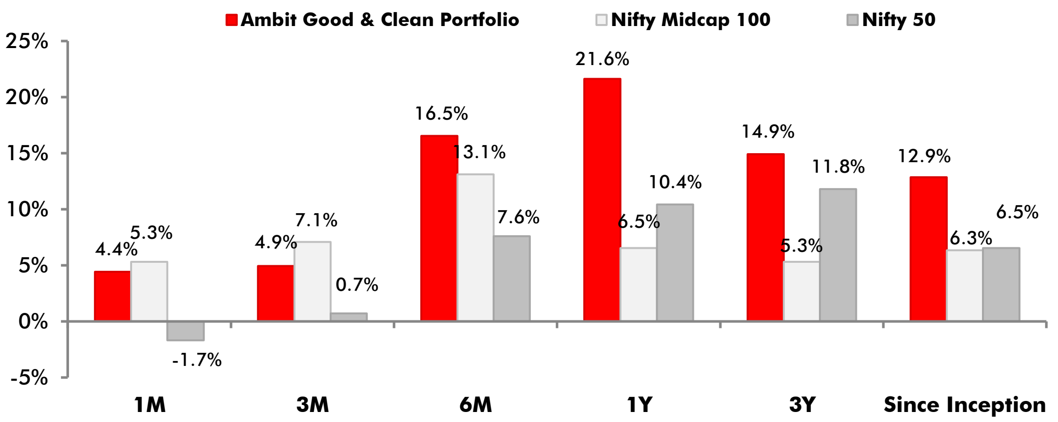
Ambit Good & Clean Portfolio

GOOD & CLEAN by AMBIT

Ambit's Good & Clean strategy provides long-only equity exposure to Indian businesses that have an impeccable track record of clean accounting, good governance, and efficient capital allocation. Ambit's proprietary 'forensic accounting' framework helps weed out firms with poor quality accounts, while our proprietary 'greatness' framework helps identify efficient capital allocators with a holistic approach for consistent growth. Our focus has been to deliver superior risk-adjusted returns with as much focus on lower portfolio drawdown as on return generation. Some salient features of the Good & Clean strategy are as follows:

- **Process-oriented approach to investing**: Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated on bottom-up fundamentals to create a concentrated portfolio of no more than 20 companies at any time.
- **Long-term horizon and low churn**: Our holding horizons for investee companies are 3-5 years and even longer with annual churn not exceeding 15-20% in a year. The long-term orientation essentially means investing in companies that have the potential to sustainably compound earnings, with this compounding earnings acting as the primary driver of investment returns over long periods.
- **Low drawdowns**: The focus on clean accounting and governance, prudent capital allocation, and structural earnings compounding allow participation in long-term return generation while also ensuring low drawdowns in periods of equity market declines.

Exhibit 4: Ambit's Good & Clean Portfolio performance update



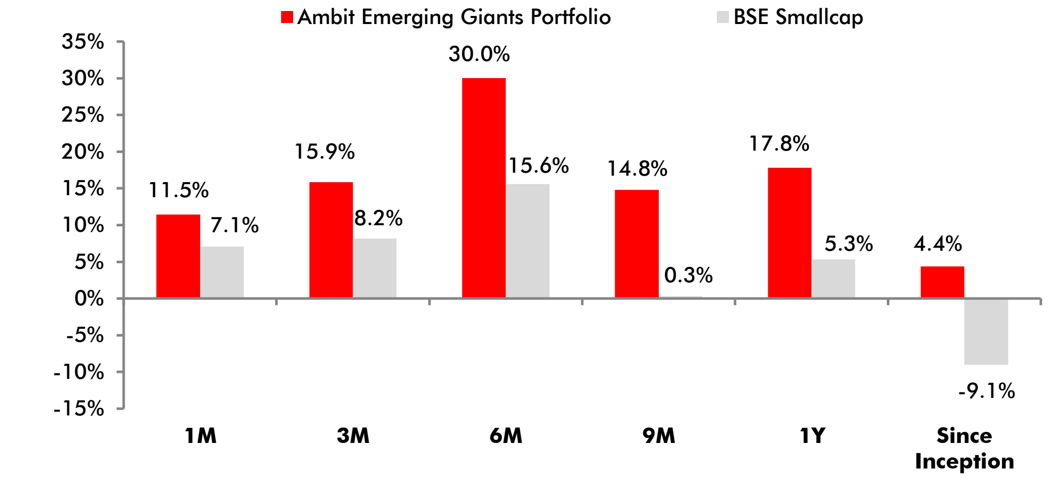
Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of Jan 31, 2019; since inception & 3Y returns are annualized returns. ***Returns are net of all fees and expenses***

Ambit Emerging Giants

Smallcaps with secular growth, superior return ratios and no leverage

Ambit's Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than Rs. 4,000cr. These companies have excellent financial track records, superior underlying fundamentals (high RoCE, low debt) and ability to deliver healthy earnings growth over long periods of time. However, given their smaller sizes these companies are not well discovered, owing to lower institutional holdings and lower analyst coverage. Rigorous framework-based screening coupled with extensive bottom-up due diligence lead us to a concentrated portfolio of 15-16 emerging giants.

Exhibit 5: Ambit Emerging Giants performance update



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of Jan 31, 2019; since inception returns are annualized. ***Returns are net of all fees and expenses***

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