



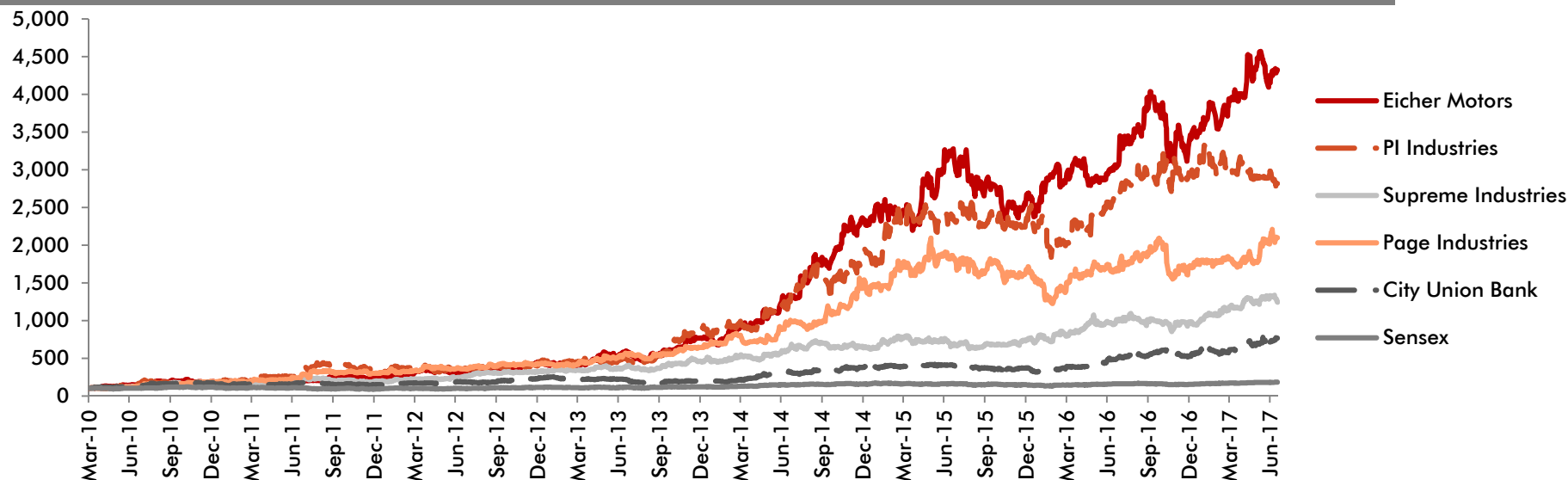
**Asset Management**

GOOD & CLEAN  
by Ambit

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**Good & Clean India Fund**

# What drives success for corporate India?



Source: Bloomberg, Ambit Capital research. Note: \*Prices have been rebased to 100 as on 31 Mar 2010. Prices are in INR terms.

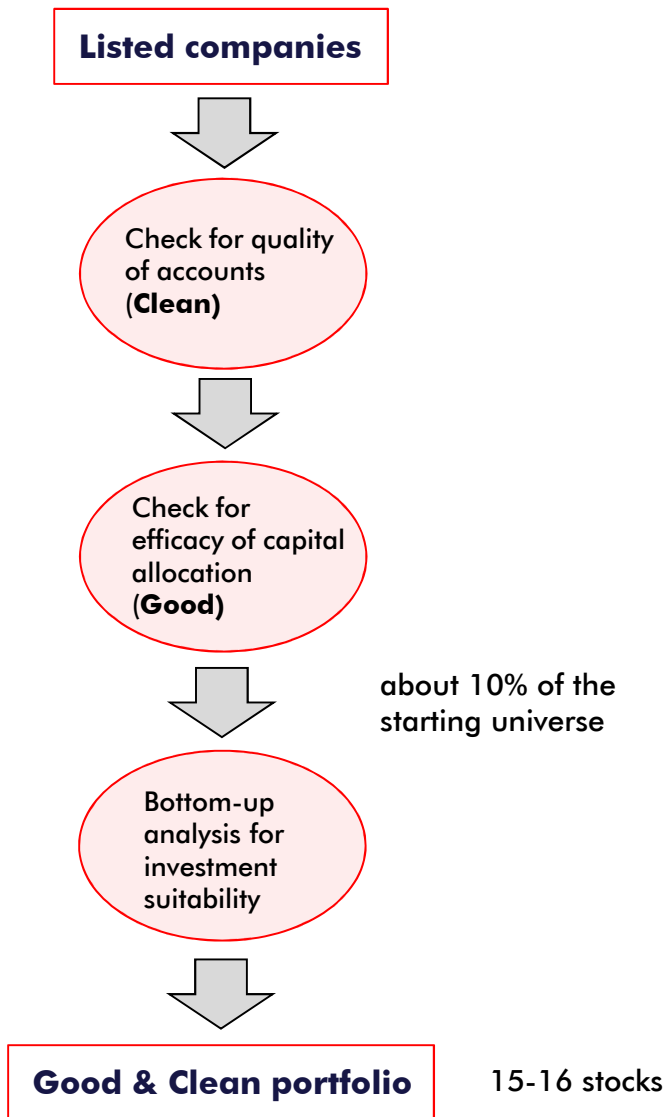
## Three factors are common to successful Indian firms

Our research over the past five years shows that over and above firm-specific competitive advantages, three factors are essential for a company to consistently outperform:

- **Clean accounting:** The bottom 40% of the BSE500 stocks on accounting quality have underperformed the top 60% by a whopping 12% per annum since Nov 2010.
- **Lack of political connectivity:** Firms whose central competitive advantage is political connectivity seldom outperform in India.
- **Conservative capital allocation:** Indian companies are amongst the most aggressive capital allocators in the world and that aggression costs their shareholders dear.

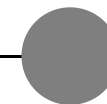
Our 'Good & Clean' (G&C) philosophy developed as a response to these central drivers of share prices in India.

# Ambit's Good & Clean philosophy



- Invest in firms which are:
  - (a) **Good**- On the basis of capital allocation track record and quality of improvement in financial metrics over the past six years, and
  - (b) **Clean**- Based on the quality of their accounts and corporate governance.
- The focus on 'good' helps generate upside while not compromising on 'clean' reduces downside risk. Essentially, while the objective is to generate returns, the even bigger goal is to better manage drawdowns because we believe doing the latter successfully is critically vital in achieving the former.
- 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 to consistent growth.
- The result is a **concentrated portfolio** of 15-16 stocks that **draws down lesser** than the market in corrections and has **low churn** (not more than 15-20% of portfolio in any year amounting to 2-3 holdings being replaced).

# Ambit's Forensic Accounting framework

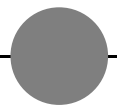


## Ambit's forensic accounting model helps steer clear firms with questionable accounts

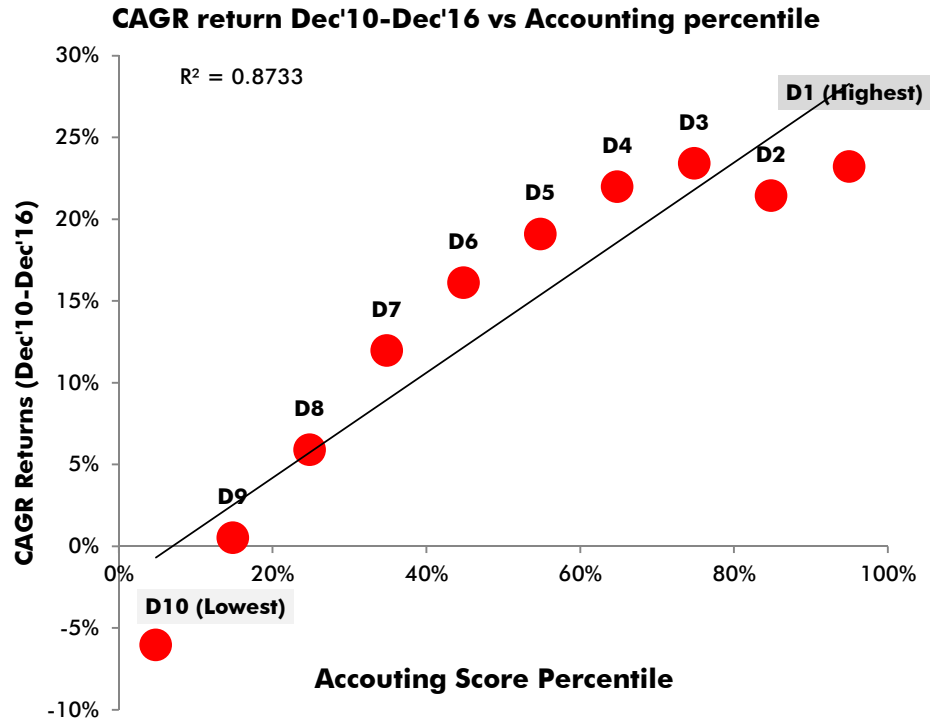
Category	Ratios	Rationale
P&L mis-statement checks	Cum. CFO/cum. EBITDA	<ul style="list-style-type: none"> <li>Low ratio may be indicative of aggressive revenue recognition</li> </ul>
	Volatility in depreciation rate	<ul style="list-style-type: none"> <li>Constant playing around with depreciation rate may indicate intent to manage reported profits</li> </ul>
	Provisioning for doubtful debts as a proportion of debtors more than six months	<ul style="list-style-type: none"> <li>Low ratio raises concerns regarding earnings boost through aggressive provisioning practices</li> </ul>
Balance sheet mis-statement checks	Cash yield	<ul style="list-style-type: none"> <li>Low cash yield may either imply balance sheet misstatement or cash misutilisation</li> </ul>
	Change in reserves (excluding share premium) over net income ex-dividends	<ul style="list-style-type: none"> <li>A ratio less than 1 may imply direct knock-offs from equity without routing through P&amp;L</li> </ul>
	Contingent liability as a proportion of net worth	<ul style="list-style-type: none"> <li>Indicative of the extent of off-balance sheet risk</li> </ul>
Pilferage checks	Miscellaneous expenses as a proportion of total revenue	<ul style="list-style-type: none"> <li>High ratio raises concerns regarding the authenticity of such expenses</li> </ul>
	CWIP to Gross Block	<ul style="list-style-type: none"> <li>High ratio could indicate unsubstantiated capex- may indicate funds being siphoned off</li> </ul>
	Cumulative CFO plus CFI to median revenue	<ul style="list-style-type: none"> <li>Check on ability to generate positive cash flows after investing activities</li> </ul>
Audit quality checks	Related party advances as a proportion of cumulative CFO	<ul style="list-style-type: none"> <li>Penalise firms where advances to related parties are high or increasing</li> </ul>
	CAGR in auditors remuneration to CAGR in consolidated revenue	<ul style="list-style-type: none"> <li>Check on the quality of audits</li> </ul>

Source: Bloomberg, Ambit Capital research

# Not compromising on 'clean' is critical to managing drawdowns

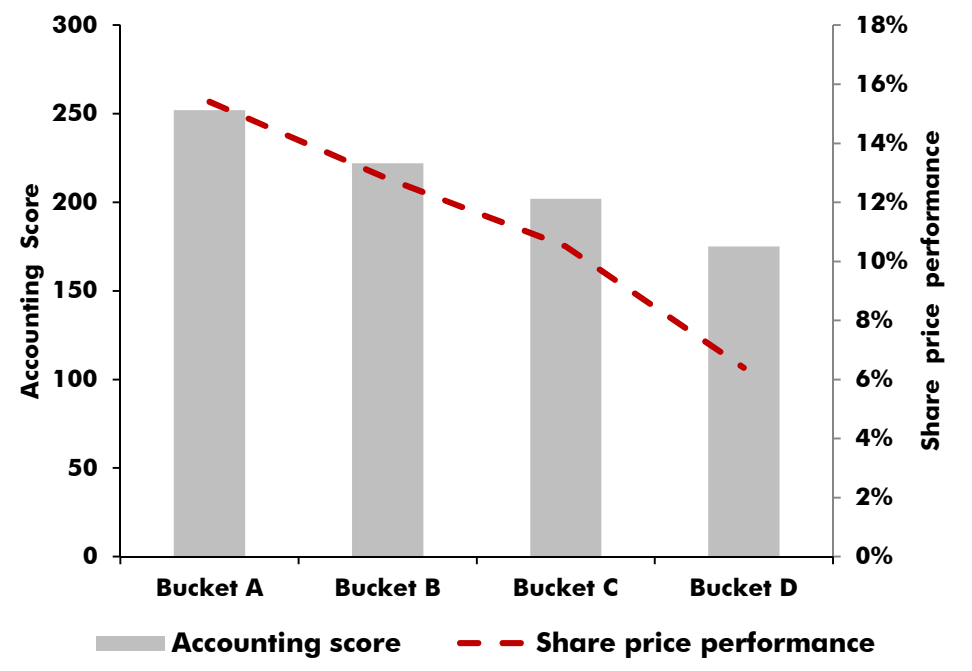


The firms in the highest accounting score decile outperform their bottom placed counterparts by 29%



Source: Bloomberg, Ambit Capital research; Note: This chart plots the median share price performance with median accounting scores for deciles constructed only on the basis of accounting quality. Share price returns are in INR terms.

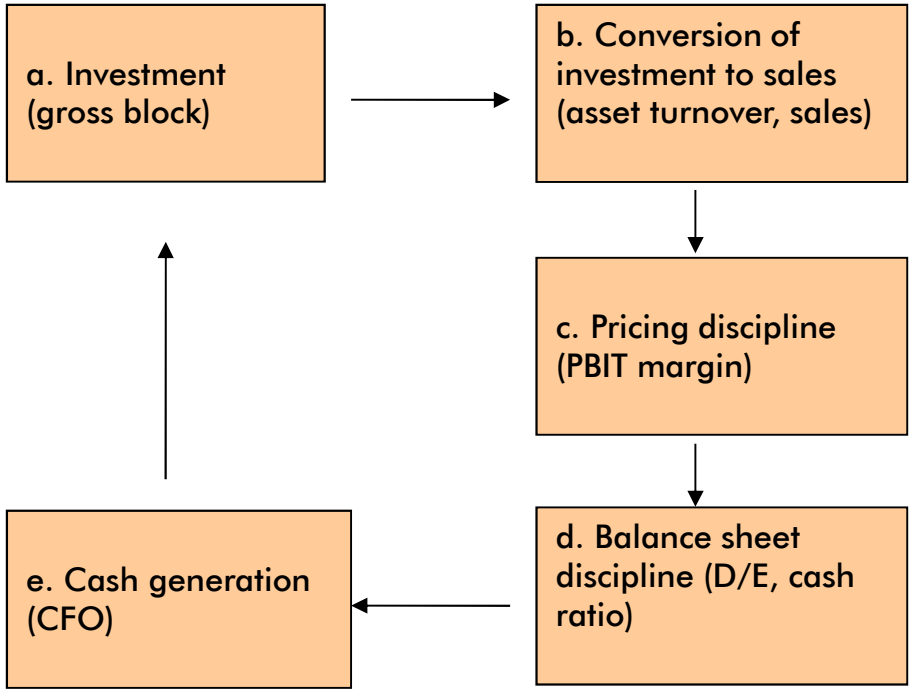
Sector neutral buckets show strong correlation between accounting and investment performance



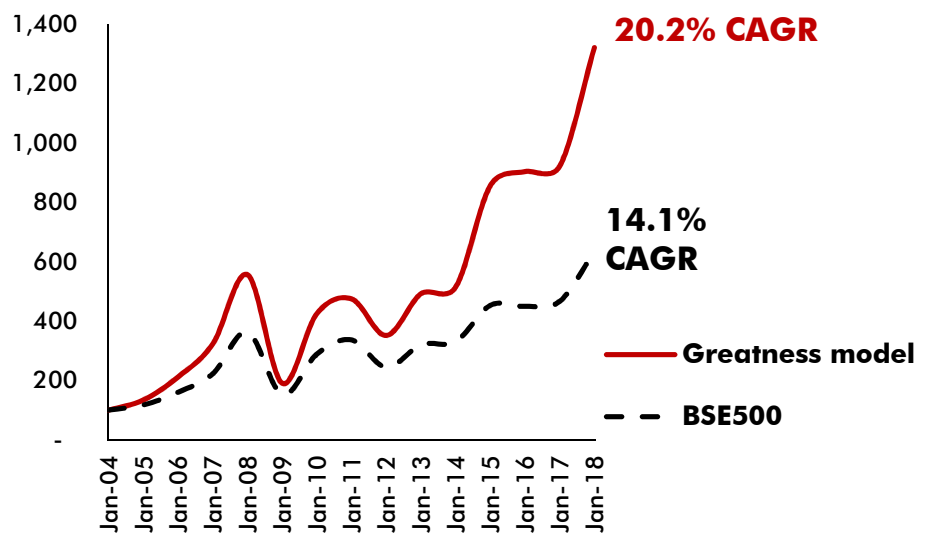
Source: Bloomberg, Ambit Capital research; Note: Sector-agnostic buckets constructed with homogenous sectoral make and differentiated only on accounting quality show accounting quality drives investment performance even after controlling for sector effects.

# Focus on 'good' helps generate upside

**Ambit's 'greatness' framework identifies efficient capital allocators in the country**



**Greatness model has outperformed BSE 500 by a whopping 600bps annually**



Share price returns are in INR terms.

Our greatness framework looks at holistic and consistent growth as the hallmarks of efficient capital allocation- a self sufficient growth engine without the need of tapping external capital frequently is key to long term wealth creation.

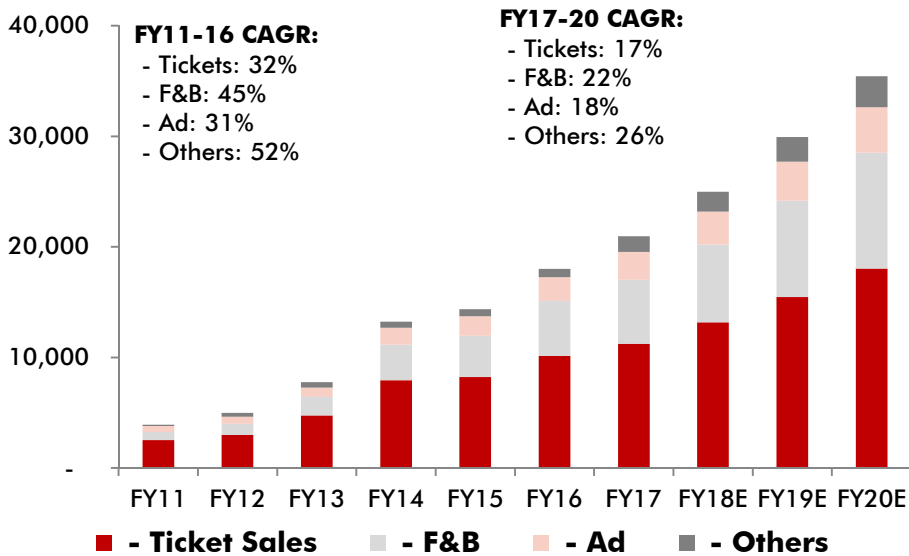


# Who wins on Good & Clean?

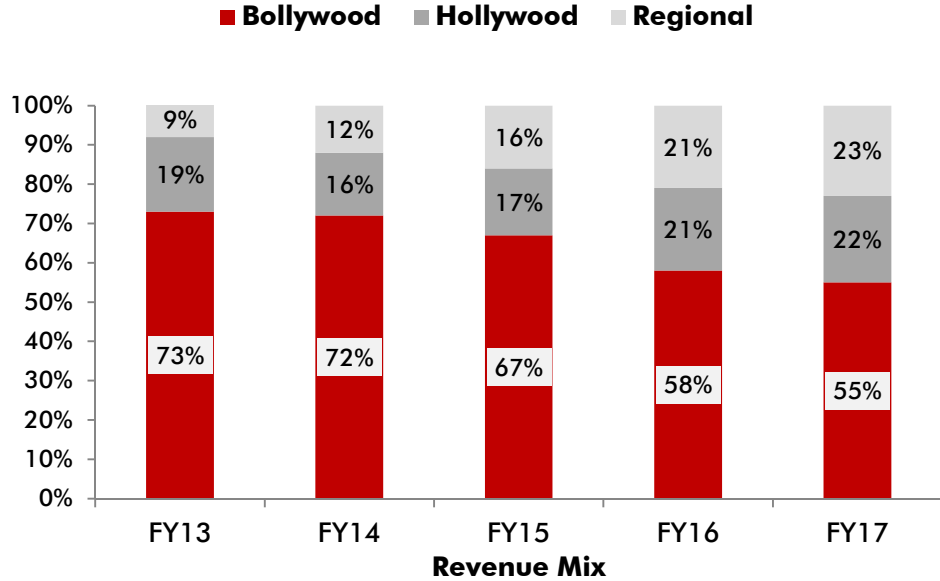
# PVR – The largest entertainment play in India

PVR (PVRL IN) is the largest multiplex in India, with 600 screens across the country - ~25% more than the 2<sup>nd</sup> placed competitor.

## All-round growth, non-ticket revenues rising faster



## Diversifying content mix to boost footfalls and occupancy



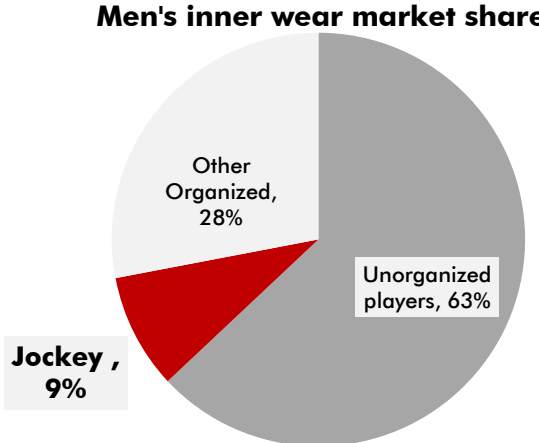
- **Improving construct for multiplexes given** (1) Market share gains for multiplexes (still only ~30% of screens, up from 15% in 2013); (2) Low penetration of screens per million at just ~8 compared to ~130 for the USA and ~16 for China and 3) Increase in share of Hollywood and regional cinema content driving footfalls and occupancy ratios.
- **Differentiated offering powered PVR to the top:** Best in class customer experience through innovation in audiovisual technologies, creative F&B menu and screens locations in premium malls has led to high pricing power: ~15-20% higher ATPs, spends per heads and ad yields.
- **PVR's premium positioning an ideal discretionary play:** Strong positioning for PVR given 60% screens are in top 8 cities of India whose per capita GDP is 7x that of India. Rising per capita income and growing aspirations should result in the leisure segment being the biggest beneficiary of the discretionary spend basket.
- **Fundamentals to improve further:** Increasing share of F&B (40% of ATP vs 60% for global leaders) and advertising revenue to aid operational margins while boosting growth. Similarly, the share of mature screens for PVR is now in excess of 70% vs 20% 10 years ago- implying high operating leverage and cash generation.



# Page Industries- Aspirational yet affordable consumption play

Page Industries (PAG IN) is the dominant player in the underpenetrated branded innerwear category in India. Page's foundation is built on: a) 60-year association with Jockey; b) strong focus on capital allocation and ROCEs; and c) Incentivizing and empowerment of professionals

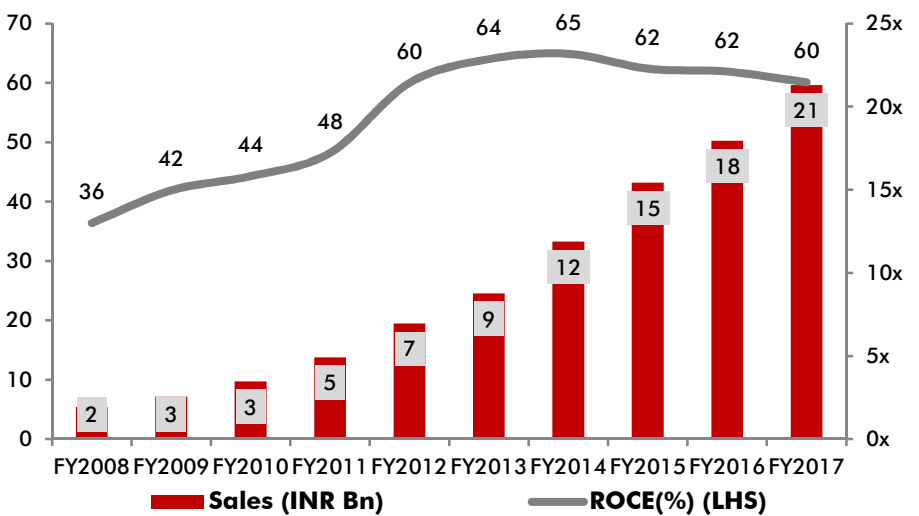
## Large opportunity for share gains by "Jockey"



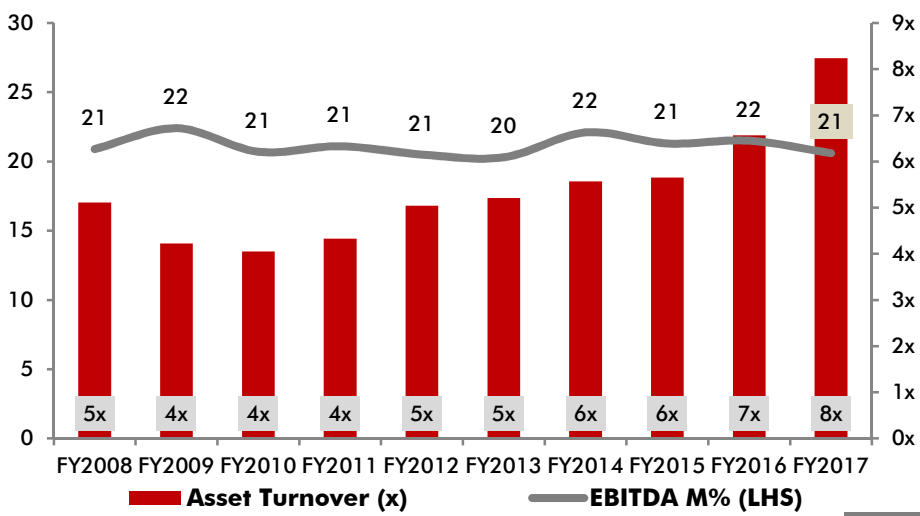
## Investment Case

- **Structural growth potential immense:** Men's innerwear has a ~63% share of local/unorganised players which are losing share to national players. Page is gaining share from a low base of 9% (4.7% in 2010).
- **Women's innerwear ~(20% of sales) and leisurewear (30%) to aid growth:** With organized penetration in the women's innerwear segment at just 14%, Page is likely to continue gaining share (6% now vs 2.7% in 2010). Further, leisurewear has been growing as a share of the apparel market, providing an additional positive for Page. Both these segments are also higher in realizations, aiding margins.
- **Page's competitive advantages are centred on:** a) in-house manufacturing to deliver product differentiation in a labour-intensive industry; b) maintaining an aspirational connect with consumers; and c) an entrenched distribution channel spanning hosiery stores to exclusive brand outlets through distributors

## Robust growth is underpinned by stellar RoCEs..



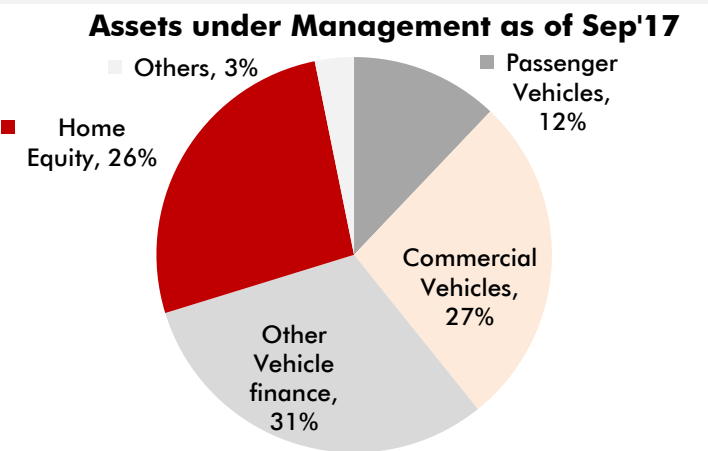
## ..due to high asset turns and strong, steady margins



# Cholamandalam Finance- Financing the India growth story

Incorporated in 1978, Cholamandalam Investment and Finance Company (CIFIC IN) is primarily a vehicle financier with a rural focus. It operates over 700 branches across India and has an AUM of INR 364bn. CIFIC also has a presence in the home equity loan segment.

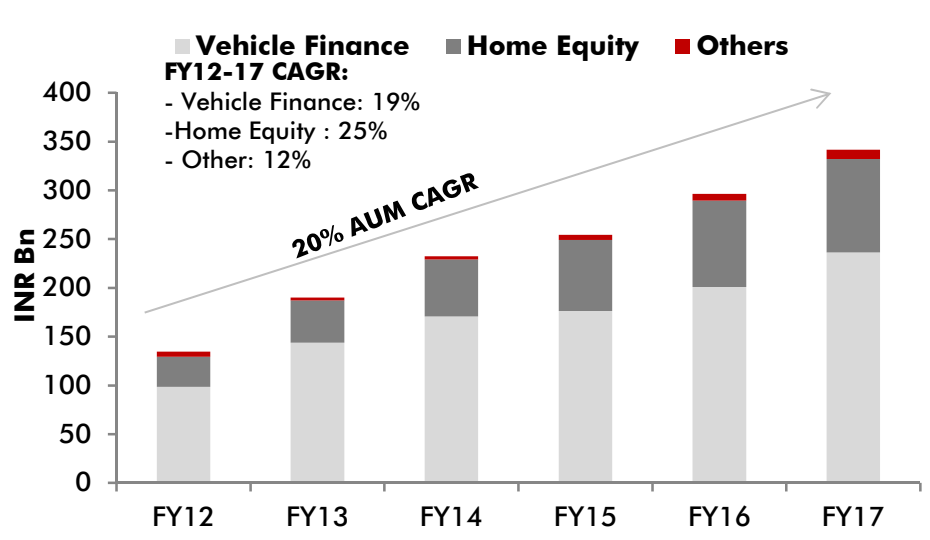
## Play on Indian Infrastructure and Logistics



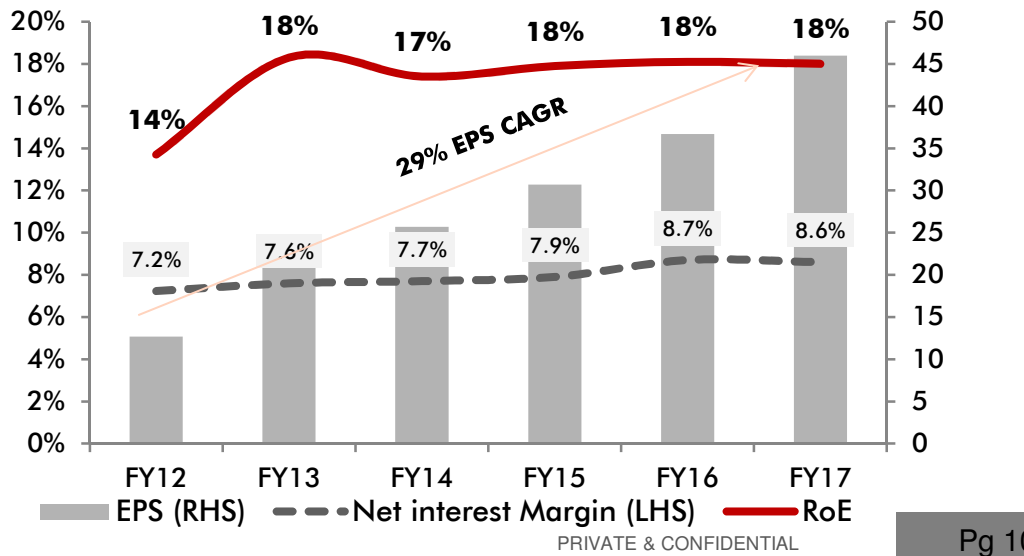
## Investment Case

- **CIFIC's core competencies center on:** a) Prudent management of risk, as exhibited in their pullback from financing ahead of down cycles in commercial vehicles and real estate in the past b) Focus on technology to aid collection efficiency and speed up processes; c) Broad Pan-India distribution network and d) Ecosystem view of their customer base
- **Evolution into related segments to power growth:** CIFIC is evolving from an LCV/used-CV financier to a credible challenger in other auto segments such as tractors, HCVs and car financing (market share has already doubled this year). Additionally, CIFIC is scaling up other businesses such as housing loans, SME finance and trip financing.
- **Logistics to drive core segments:** Consolidation of India's logistics sector into a hub-and-spoke model due to the advent of GST would drive sales of CIFIC's core CV segment, which is CIFIC's key driver of profitability.

## Robust growth driven by core business and home equity loans



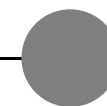
## Tight control on asset quality and margins have led to expanding RoEs



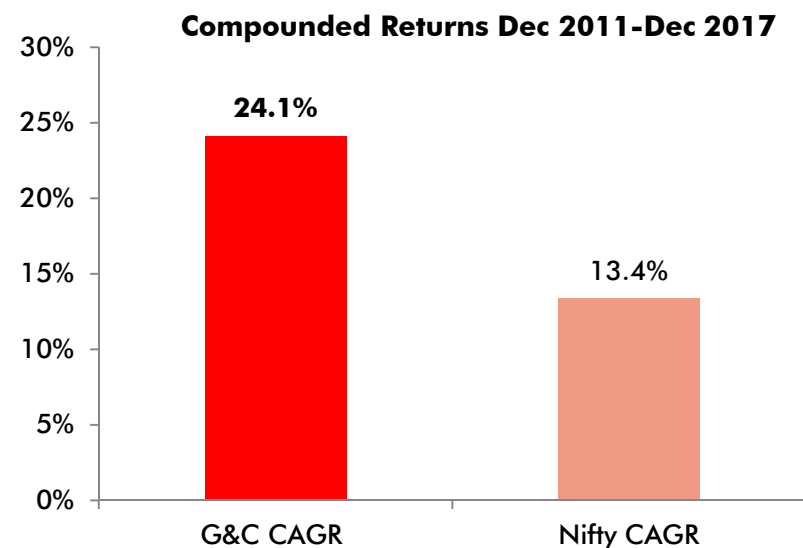
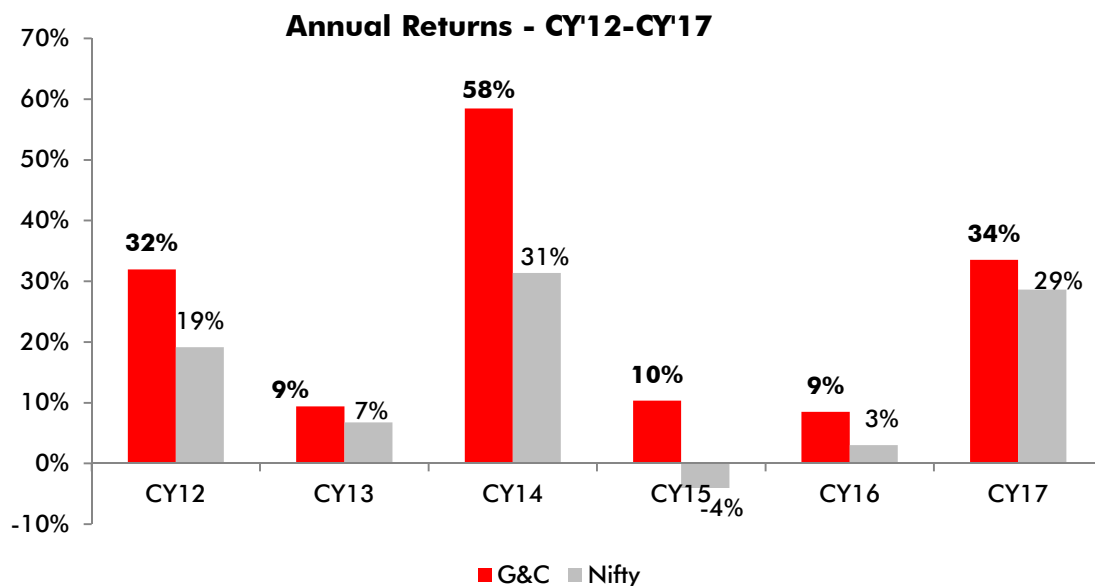


# **Good & Clean's track record**

# Good & Clean philosophy delivers in practice



## Consistent performance



## Superior risk adjusted returns and drawdown track record

Performance (since inception)	Net Returns (CAGR)	Standard Deviation	Sharpe Ratio	Maximum Drawdown
<b>G&amp;C</b>	24%	13.1%	1.31	-13%
Nifty	13%	13.4%	0.48	-22%

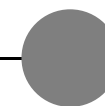
Source: Bloomberg, Ambit

**Note:** Date of inception of the Good & Clean model portfolios is 19 Jan' 12, while that of the domestic fund is 12 Mar'15. Hence performance till 12Mar'15 is that of the model portfolio, and from 12Mar15 is that of the live fund. Data as of 31Dec17.



# Portfolio Construct

# Construct & structure for Indian high net worth investors



## **Construct & Structure**

Fund Type	SEBI Registered PMS
Fund Tenure	Open Ended
Structure	Discretionary PMS
Minimum investment	INR 25 lacs
Stock selection	Investible universe is stocks that perform well on the two frameworks noted earlier. A further subjective assessment then leads to a more concentrated stock portfolio
Number of stocks	< 20
	25% per sector, 10% per stock
	All cap with BSE500 as the benchmark
Time horizon and turnover	The investment horizon is 1-3 years and longer; turnover therefore should not exceed 30-35% in a year
Cash calls	Not to take aggressive cash calls; this is keeping in mind the longer term investment horizon of the fund and is suitable from a taxation standpoint

# Fund Manager

## **Gaurav Mehta, CFA**

With over 11 years of experience in Indian equities, Gaurav has been with Ambit for over 9 years now. Before moving to the Asset Management arm, he worked as Strategist with the Institutional Equities team of the firm, where he was consistently rated amongst India's best strategists. It is in that stint, that he incepted Ambit's Good & Clean investment philosophy which became very popular amongst institutional investors in India as well as globally. The same strategy now forms the core of the portfolio that Gaurav manages.

Before Ambit, Gaurav worked with Edelweiss Capital, a leading financial services firm in India, managing funds on their Proprietary Trading book delivering improved risk-adjusted returns.

**Professional Qualification:** He has a B.Tech. (Bachelor in Technology) from Indian Institute of Technology (IIT) Bombay, India's top ranked engineering college and a Post-graduate diploma in Management from Indian Institute of Management (IIM) Lucknow, India. Gaurav is also a CFA charter holder from CFA Institute, USA.



# Investment Analyst

## Ashvin Shetty, CFA

Ashvin has more than 10 years of experience in equity research, having led the coverage on automobile sector at Ambit Capital since October 2010. He was ranked in the Starmine Analyst Awards 2013 and 2016 for his stock picking abilities during his stint at Ambit Capital. Prior to joining Ambit, he worked with Execution Noble as an equity research analyst covering companies in consumer and media space.

He has also worked with KPMG and Deloitte as statutory auditor from 2004 to 2007 gaining extensive experience across Indian accounting standards and financial statement analysis.

**Professional Qualification:** Ashvin is a commerce graduate from Narsee Monjee College (Mumbai, India). He is a qualified Chartered Accountant (India, 2004) and Chartered Financial Analyst from CFA Institute, USA (2007).





# Investment Analyst

## Pranoy Kurian, CFA

Pranoy Kurian has over 5 years of experience in financial services and Indian equities. He has worked as a Senior Analyst in the Institutional Equities team of IDBI Capital. During this period, he extensively researched and wrote on India's Automotive & Consumer sector. Pranoy has also worked with Centrum Capital as an Analyst, where he specialized in discovering multi-baggers across sectors. His expertise primarily lies in finding cleaner companies in the heap of mid and small sized Indian listed companies.

**Professional Qualification:** He holds a Bachelors in Management degree from H.R. College (Bombay, India) and a Masters in International Business from the Curtin University of Technology (Singapore). Pranoy is also a CFA charter holder from the CFA Institute, USA.



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