AMBIT
Acumen at work

Ambit
Asset Management

MONTHLY NEWSLETTER

JULY 2022

SECRETS OF GREAT INVESTORS

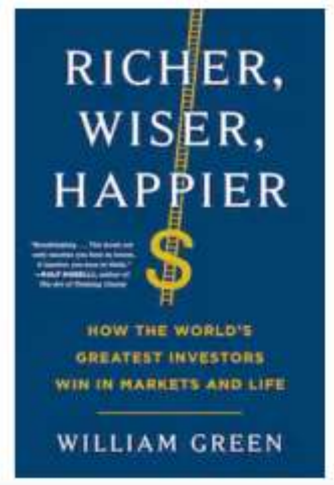
Secrets of Great Investors

Dear Patron,

There are several legendary investors such as Charlie Munger, Howard Marks, John Templeton who have made massive amount of wealth. These investors are worth studying as they are practical philosophers. They continue to seek worldly wisdom and are completely obsessed with knowing the truth. Their field of study is not just limited to finance and investing but ranges across disciplines such as economic history, neuroscience, literature, stoicism to the science of habit formation – something which is famously termed as 'Expert-Generalist'. Their practices and learning can help us become better thinkers and decision makers.

We, at Ambit, continuously try to learn from these great investors. In this newsletter, we highlight our key learning from the book Richer, Wiser, Happier where the author William Green has done an excellent job of listing down his key learning form interviewing the World's Greatest Investors over 20 years. The purpose of this book was to incorporate some of their best practices to enhance our investing journey.

Exhibit: 1 Richer Wiser Happier by William Green



Source: Cover copy. Richer, Wiser, Happier by William Green. | Publisher – Profile Books

Some of the Key Highlights form the book

1. **A Game of Probability:** Quality of our lives depends on the quality of our decision. While some decisions are trite, others can have serious long-term consequences. Fund managers handle a large pool of money and their decisions have a significant impact on investor's wealth. According to Mohnish Pabrai, objective thinking and using probability are one of the most important mental habits to excel in investing. It is no surprise that Warren Buffett enjoys playing Poker – a game of probability. Investors should not only try to improve their chances of winning, but also make non-fatal mistakes. They should regularly ask this question – if this bet doesn't work out, what can be the downside.

   Our Investment in Safari: We invested in Safari at Sep-2020, during the peak of COVID wave. The travel industry had come to a complete halt with no sign of recovery in the near-term. However, we were buying an aspirational brand at a very attractive price in the luggage industry, which has minimal disruption risk from substitutes or competitors. We took a long-term view that the balance sheet strength would help the company weather the storm. Since then, Safari has outperformed the index (~120% returns compared to 60% for BSE Smallcap) and it continues to be one of our high conviction bets.

2. **A Lone Wolf:** Outsized returns are made when we take a position against the consensus. To achieve this one has to be an independent thinker and have the courage to navigate alone. Greatest investors are mavericks and iconoclast. They see the world differently and follow their own peculiar path, not only in investing but also in other walks of life. Most legendary investors are balanced and composed in adversity and therefore don't get over influenced by what others think. William Green believes that they may have a low Emotional Intelligence which might actually be a blessing in disguise. They care more about being right rather than gaining social acceptance.

   Our investment in PVR: We subscribed to the Rights Issue of PVR at the peak of COVID downturn in Jul-2020 when the street was building in a dooms-day scenario for the Multiplex industry. We expected PVR to navigate the difficult times and become the key beneficiary of the consolidating *(K-Shaped Recovery)* industry post COVID, leading to outsized returns. Therefore we remained invested in the company despite COVID uncertainty even during Wave2/3. Our conviction has been rewarded handsomely with stock outperforming BSE Small Cap index in CY22 by 59% and our rights issue investment at Rs.784 fetching 137% return (~33% CAGR) till date

3. **Endurance:** According to Mohnish Pabrai, "All of the best investors share one indispensable trait: the ability to take pain". In the world of stock market, it doesn't take long for the tide to turn. Fund managers who rose to fame by consistently beating the markets, also find themselves in self-doubt when things go south. The ability to take pain and recover in the shortest time with minimum damage is critical to become a top investor. "Pain plus reflection equals progress" is also the philosophy of Ray Dalio, fund manager of the world's largest hedge fund, Bridgewater Associates.

   Example: Jason Karp, CEO and CIO of Tour billion capital partners, recruited people with proven ability to recover from setbacks, using CIA interrogator for the selection process.

4. **Lessons from Nick and Zak:** Nick Sleep and Zakaria started a fund in 2001 called Nomad Investment, which delivered 921% over 13years v/s 117% by MSCI World Index. These are some of the key reasons of their outperformance.

   - **Compounders over Cigar butts:** They started with investing in temporarily depressed business at very cheap valuations. However, they had to sell these business when the stocks rebounded. To overcome the reinvestment risk, they started investing in high quality business that could compound over time.

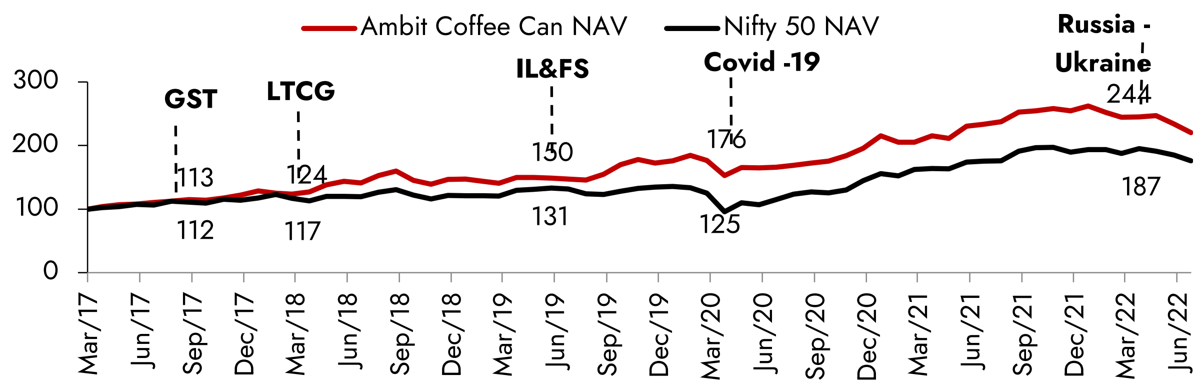
- **Concentration over diversification:** They took very concentrated positions of high quality companies such as Costco, Amazon and Berkshire Hathaway. According to them, they are taking lower risk as they only invested in areas where they have sound knowledge and which were within their circle of competence. Even after closing the fund, 70% of Zak's personal fortune was in a single stock.

- **Long-term over short-term:** They didn't pay attention to the sell-side research which was driven by short-term indicators such as latest economic updates, fund flows etc. They used most of their time reading annual reports and visiting companies. While analysing companies, they gave more attention on the long-term competitive advantage rather than quarterly EPS and 12 month target price.

- **Continuous improvement in competitive advantage:** According to them, economies of scale create a self-reinforcing flywheel that can generate massive wealth over a long period. They had large positions in Costco and Amazon, which used the scale benefits to offer better deals to the customers, thereby improving their competitive advantage.

5. **Aggregation of marginal gains:** According to William Green, a strategy that may be moderately correct yet persistent works far better than a perfect strategy which is extreme and non-sustainable. Not only in investing, but also in life, victory is a result of small improvements over a long period of time. Great investors have given phenomenal returns by using a simple, consistent approach – investing in companies with good earnings outlook at very reasonable valuations. That is what our Coffee Can philosophy is all about. **(Refer to Exhibit: 2)**

Exhibit 2: Coffee Can Philosophy



Source: Ambit Asset Management

6. **The art of subtraction:** Great investors focus exclusively on what matters the most while disregarding countless distractions. In the age of information overload, clarity of thought is paramount to achieve success. Great thinkers look for solitude, enjoy long walks in nature and avoid excessive use of phone. This physical environment is designed to support contemplation and arrive at key variables. Great investors are also aware that while there are several ways to make money, there are only some strategies where they have an edge over the market. They are cognizant of their circle of competence and try to stay within those guardrails.

Our cautious aversion to cyclical industries: We at Ambit Asset Management have tried to stay away from sectors / companies with cyclical performance and re-investment risk. We have also focused on time-in-the market rather than timing the market. While the cyclicals outperformed post covid, we stuck to our guns and remained committed to our investment philosophy. While this may have had some negative impact on our near-term relative performance, this strategy will benefit us when the cycle turns.

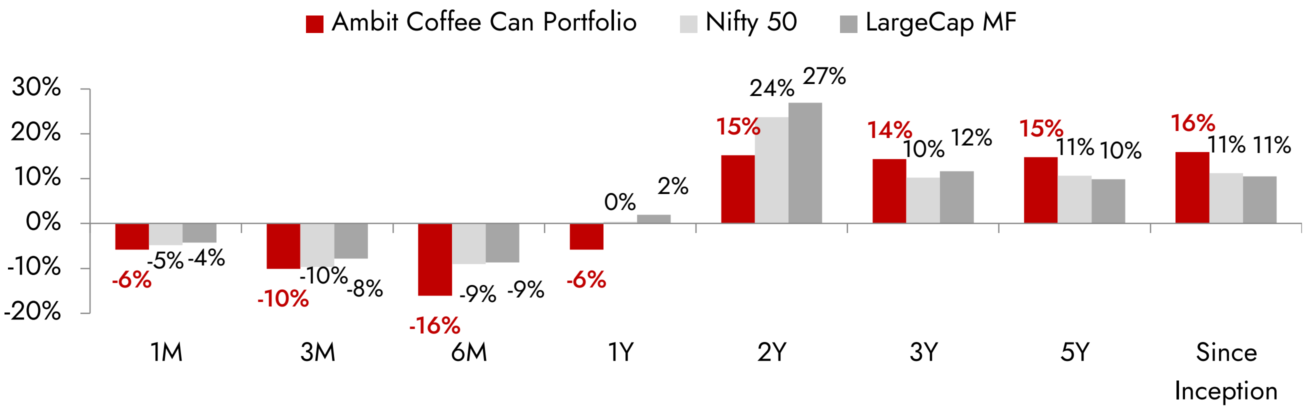
CONCLUSION:

The approach that we follow at Ambit Asset Management is very similar to the ones highlighted in the book. We have a concentrated portfolio of 15-20 stocks, which is a far cry from the industry (60+ stocks). We also follow art of subtraction by not investing in cyclical sectors such as real estate, cement, airlines, commodities etc. Portfolio churn is significantly lower than peers as we focus on finding long-term compounding machines, thereby reducing re-investment risk. Analyst conduct exhaustive channel checks to understand the evolving competitive landscape of their respective coverage stocks. Sharp focus on the processes and continuous learning – via our Disruption Series publication and Knowledge Capsule webinars – have helped us in delivering strong returns for our investors. We believe that all these aspects combined give us an edge to outperform the indices over the long run.

Ambit Coffee Can Portfolio

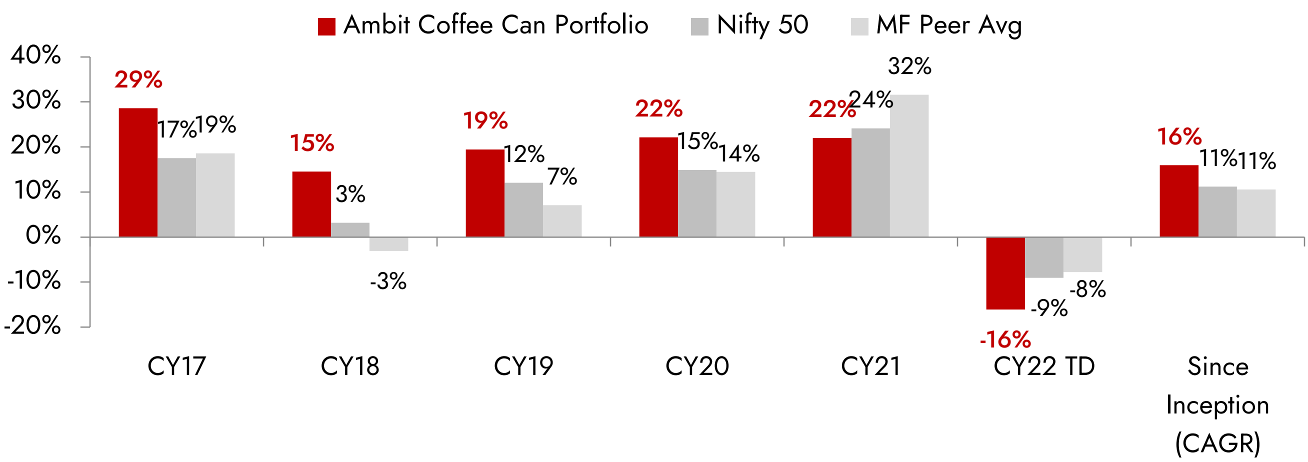
At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail and consumption-oriented sectors. The Coffee Can philosophy has unwavering commitment to companies that have consistently sustained their competitive advantages 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 point-to-point performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 30th June, 2022; All returns are post fees and expenses; Returns above 1-year are annualized; 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.

Exhibit 4: Ambit's Coffee Can Portfolio calendar year performance



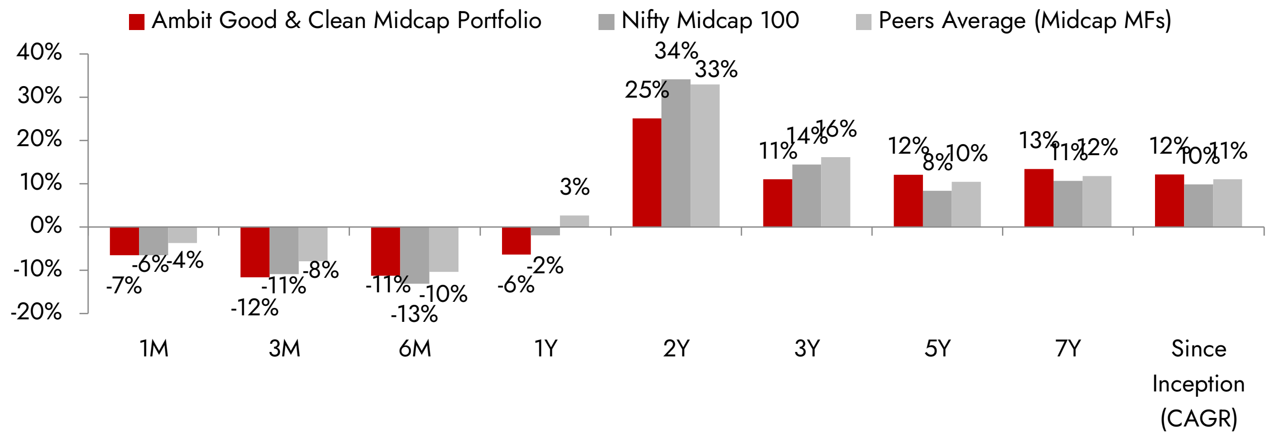
Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 30th June, 2022; All returns are post fees and expenses. Note: Returns prior to Apr'19 are returns of all the Pool accounts excluding non-aligned portfolio, and returns post Apr'19 is based on TWRR returns of all the pool accounts.

Ambit Good & Clean Midcap Portfolio

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:

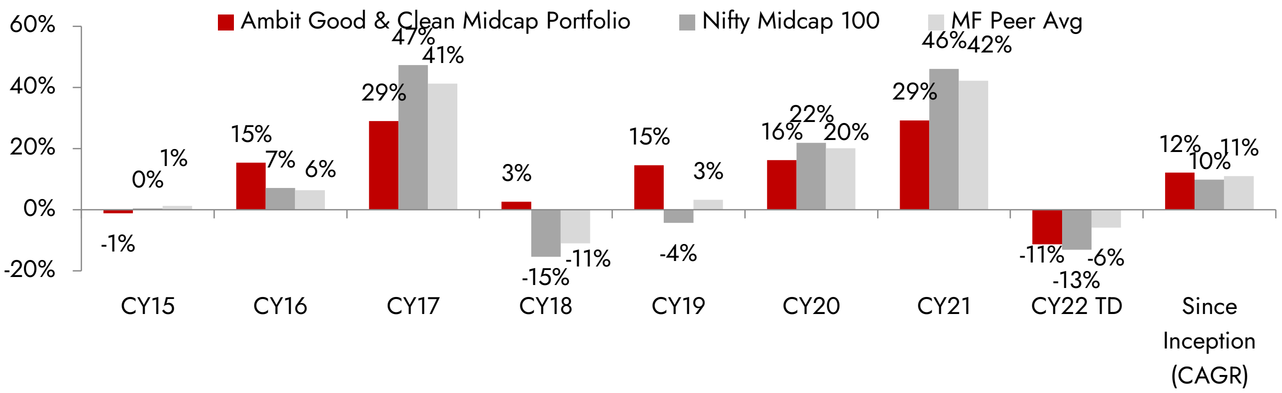
- **Process-oriented approach to investing:** Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated 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 5: Ambit's Good & Clean Midcap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 30th June, 2022; All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 6: Ambit's Good & Clean Midcap Portfolio calendar year performance

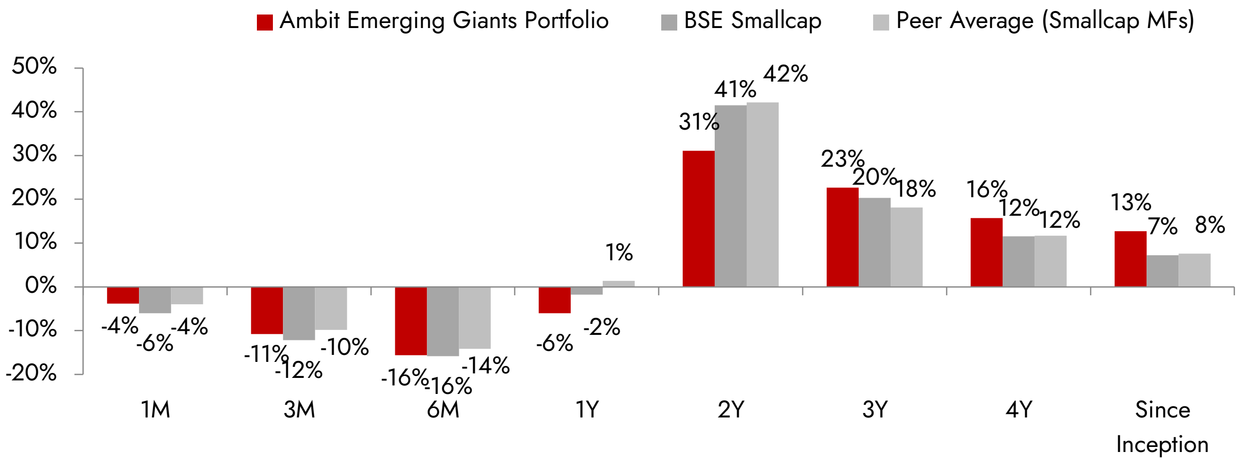


Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 30th June, 2022. Returns are net of all fees and expenses

Ambit Emerging Giants Portfolio

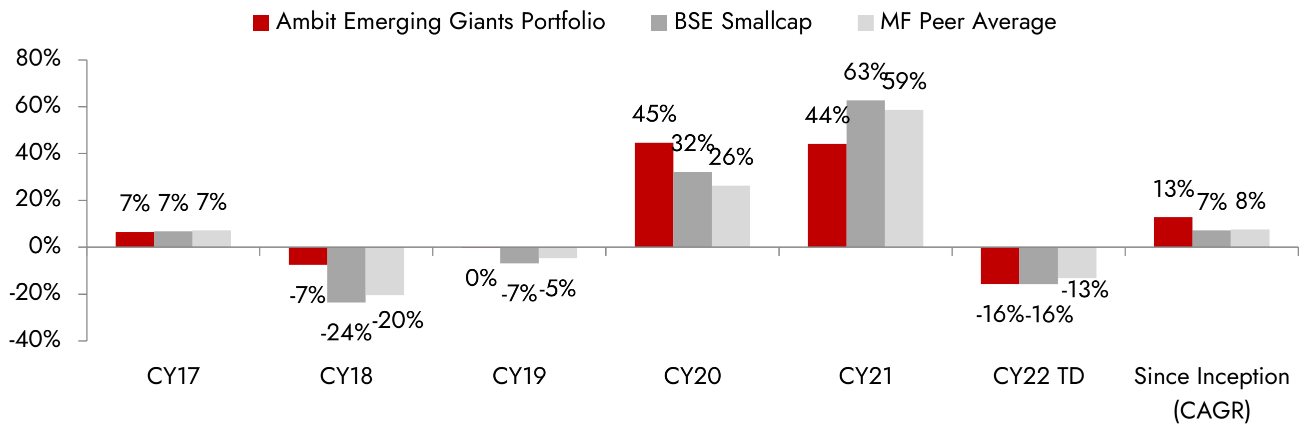
Smallcaps with secular growth, superior return ratios and no leverage – Ambit's Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than Rs4,000cr. 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 7: Ambit Emerging Giants Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 30th June, 2022; All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 8: Ambit Emerging Giants Portfolio calendar year performance



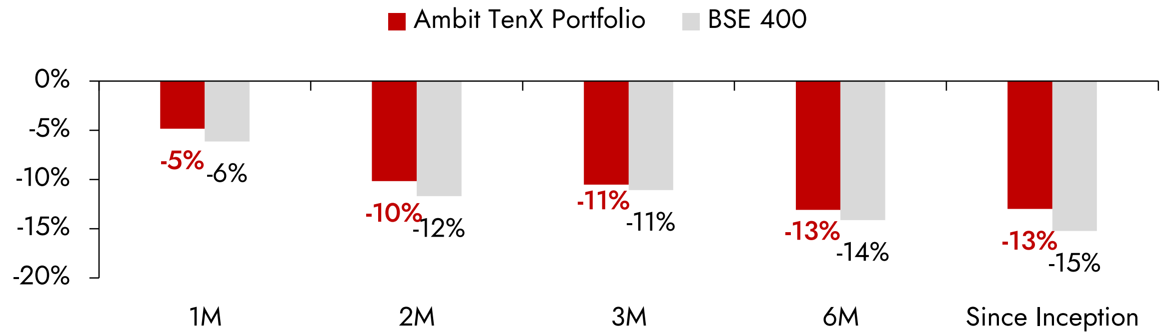
Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 30th June, 2022. Returns are net of all fees and expenses

Ambit TenX Portfolio

Ambit TenX Portfolio gives investors an opportunity to participate in the India growth story as the Indian GDP heads towards a US$10tn mark over the next 12-15 years. Mid and Small corporates are expected to be the key beneficiaries of this growth. The portfolio intends to capitalize on this opportunity by identifying and investing in primarily mid & small cap companies that can grow their earnings 10x over the same period implying 18-21% CAGR. Key features of this portfolio would be as follow:

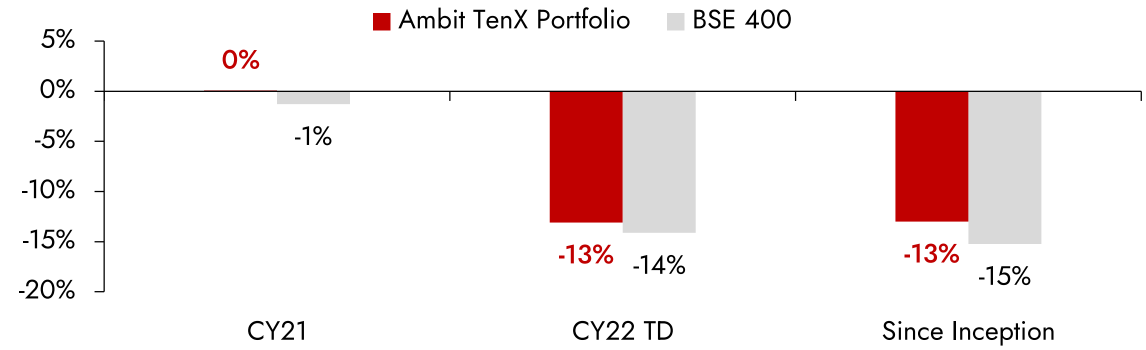
- **Longer-term approach with a concentrated portfolio:** Ideal investment duration of >5 years with 15-20 stocks.
- **Key driving factors:** Low penetration, strong leadership, light balance sheet
- **Forward-looking approach:** Relying less on historical performance and more on future potential while not deviating away from the Good & Clean philosophy.
- **No Key-man risk:** Process is the Fund Manager

Exhibit 9: Ambit TenX Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of 30th June, 2022; Returns are net of all fees and expenses

Exhibit 10: Ambit TenX Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of 30th June, 2022. Returns are net of all fees and expenses

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The performance data for coffee can product between 6th march 2017 - 19th June 2017 represents model portfolio returns. First client was onboarded on 20th June 2017. The performance data for G&C product between 1st June 2016 to 1st April 2018 also includes returns for funds managed for an advisory offshore client. Returns are calculated using TWRR method as prescribed under revised SEBI (Portfolio Managers) Regulations, 2020