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MONTHLY NEWSLETTER

August 2022

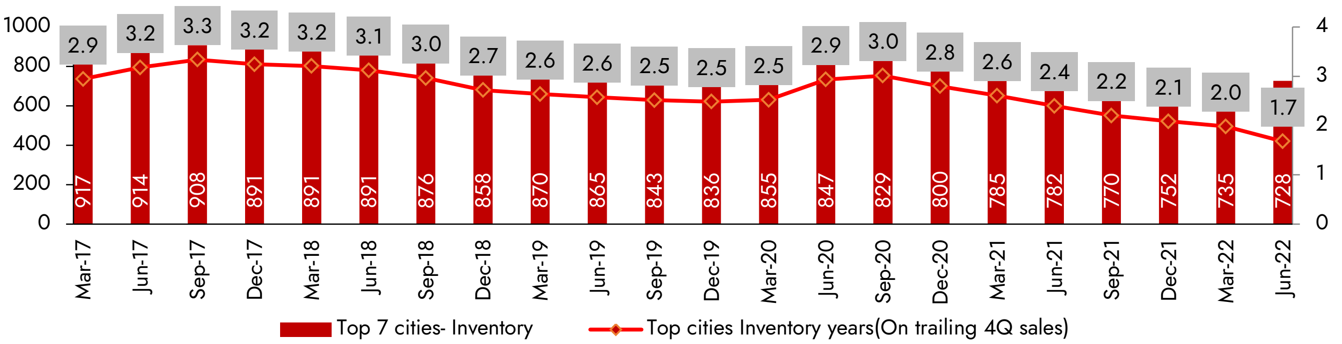
PLAYING THE REAL ESTATE UPCYCLE

Playing The Real Estate Upcycle

Dear Patron,

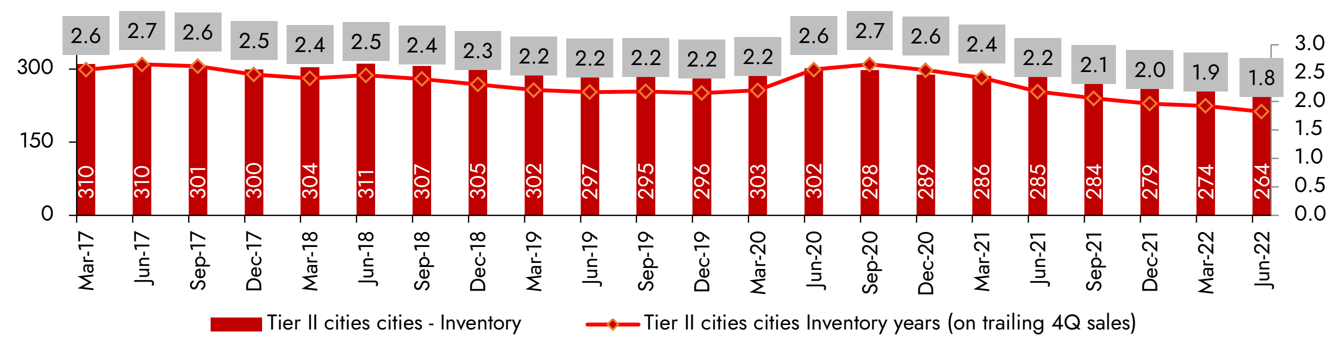
After a prolonged real estate down cycle which started in CY13, the sector has finally shown some signs of recovery. Residential real estate market rebounded swiftly in CY21 with aggregate sales in top seven cities growing by 25% yoy. Boom in the IT sector (contributes ~50% to real estate demand) along with government schemes have resulted in a pickup of real estate sector. Moreover, stagnant property prices over the last decade coupled with lower interest rates (still below 2010 peaks) have improved the affordability considerably. Covid forced people to stay indoors for an extended period, which led to higher demand of bigger houses. The permanent reset in IT salaries is expected to provide a structural tailwind to the sector. We believe that we are at the bottom of the cycle and demand will continue to remain robust in the coming years. Stagnant property prices over the last decade couple with lower interest rates have improved the affordability considerably for the buyers.

Exhibit 1: In Top 7 cities, strong sales and lower launches led Inventory overhang of only 1.7 years



Source: Propequity, Ambit Asset Management
Note: Inventory overhang- years it will take to clear the current inventory based on current sales run rate

Exhibit 2: In Tier 2 cites, inventory overhang also stands at only 1.8 years



Source: Propequity, Ambit Asset Management

Increased formalization with larger players to see outsized gains: Large developers are benefitting from the growing demand as the industry continues to consolidate. Organised players are continuously gaining ground with number of developers declining by 38% in last 8 years. Buyers are willing to pay a premium for the projects developed by established developers to ensure quality and avoid delays. Structural reforms such as RERA, Demonetization and GST have further accelerated formalization of the sector. Unlike small developers, large developers have access to cheaper debt, giving them a big competitive advantage. The smaller players borrow at mid-to-high teen's, while the bigger players borrow at high single-digit rates.

Exhibit 3: While the industry has stayed flat since FY13, sales of top developers has more than doubled

Sales In Mn Sqft	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Godrej Properties	4.1	3	3.9	4.3	3.1	6.3	8.8	8.8	10.8	10.8
Prestige Estates	7.1	7.4	7.7	5	3.8	4.8	7.1	6.5	8.2	15.1
Oberoi Realty	0.4	0.3	1.1	1.3	0.6	0.6	0.8	0.7	1.7	2.1
Sobha	3.8	3.6	3.3	3.4	3	3.6	4	4.1	4	4.9
Brigade Enterprises	1.9	2.6	2.8	2.2	1.6	1.6	3	4.3	4.6	4.7
Mahindra Lifespace Developers	1.1	0.9	1.4	1.2	0.9	1.2	1.7	1.3	1.1	1.3
Total	**18.5**	**17.7**	**20.2**	**17.4**	**13**	**18**	**25.4**	**25.6**	**30.4**	**38.9**

Source: Company, Ambit Asset Management

Despite industry tailwinds coupled with the formalisation of the sector, we continue to stay away from having any direct exposure in the sector. We are however playing this upcycle through real estate proxy industries such as Building Materials, Paints and Housing Finance companies. **In this newsletter, we will share our thesis behind not investing in real estate sector and how our funds are positioned to play the real estate upcycle.**

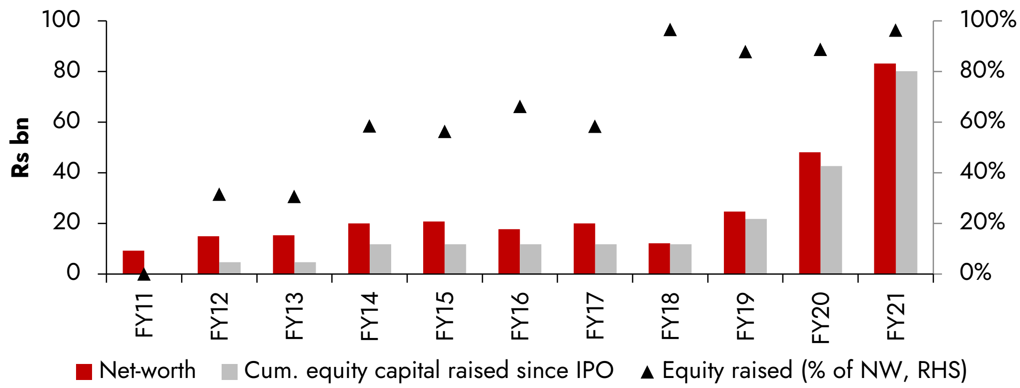
Concerns around Real estate stocks:

1. **Scaling up challenges:** Real estate companies launch several projects in different micro markets as each micro market has a limited absorption capacity. The probability of success of every project is independent of each other as it depends on finding the right product-market fit for each micro market. Therefore, it becomes difficult to develop conviction on large companies operating with 30-80 projects across several micro-markets.

   Even large players such as Oberoi Realty (Mumbai) and DLF (NCR) have struggled to gain pan-India presence. The regulatory hurdles and customer preferences vary significantly across regions. Therefore, Joint Development/Joint Venture works well in newer markets where the local partner has a good understanding of demand and regulatory approvals.

   Only Godrej has been able to leverage its brand and asset light model to become a true pan India players. However, that has also come at a cost. While Godrej has gained significant market share over the last decade, it has failed to generate any shareholder wealth.

Exhibit 4: The amount of capital raised by company over the years almost mirrors the net worth of the company



Source: Company, Ambit Asset Management

2. **High regulatory risk:** A typical project takes 3-4 years for completion. However, these timelines get easily extended due to regulatory hurdles. There are more than 30 approvals required for construction from various government departments, which can be very challenging and time consuming. IRR of the project drops considerably when the project completion gets extended.

3. **Difficult to generate consistent IRR:** Cash flows can not only get delayed due to regulatory hurdles but also the quantum of the cash flows can vary significantly. Realizations can differ depending on the acceptance of the product proposition, competition and timing of launch. Long operating cycle, unpredictable realizations coupled with high leverage, leads to lower predictability of cash flows.

Exhibit 5: ROE of real estate companies has been lower than their cost of capital

Company	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Godrej Properties	9.6	9.9	10.5	11.5	12.6	7.5	13.8	7.4	-2.9	4.1
Prestige Estates	11.7	11.0	9.8	15.3	6.2	8.1	9.3	8.4	24.2	14.6
Oberoi Realty	12.8	7.3	7.0	8.7	6.8	7.8	11.6	8.3	8.2	10.6
Sobha	10.5	10.6	10.1	6.1	6.2	8.0	11.9	12.1	2.6	4.7
Brigade Enterpr.	5.1	7.4	7.2	9.6	9.5	7.0	10.8	5.9	-2.0	3.1
Mahindra Life.	11.5	7.9	19.5	6.1	6.3	5.4	6.0	-10.7	-4.3	9.0

Source: Bloomberg/ Screener

Our investment thesis for backing Real estate proxies -

1. **Pipes:** Pipes is a $4bn industry, growing at 12% CAGR, mainly catering to agriculture and plumbing demand. The industry is largely fragmented with small and regional players accounting for ~50% share, giving headroom for larger players to gain market share.

   Within Pipes segment, we like companies such as Astral, which have highest contribution of CPVC (plumbing pipes). This segment is growing at the fastest pace and is directly linked to real estate demand. Astral has a strong brand pull and distribution reach, especially in the Metro/Tier-1 cities. Astral is also aggressively expanding into other segments such as plastic tanks, valves, sanitary ware, paints and adhesives.

Exhibit 6: Astral has delivered industry leading volume growth on the back of high presence in CPVC

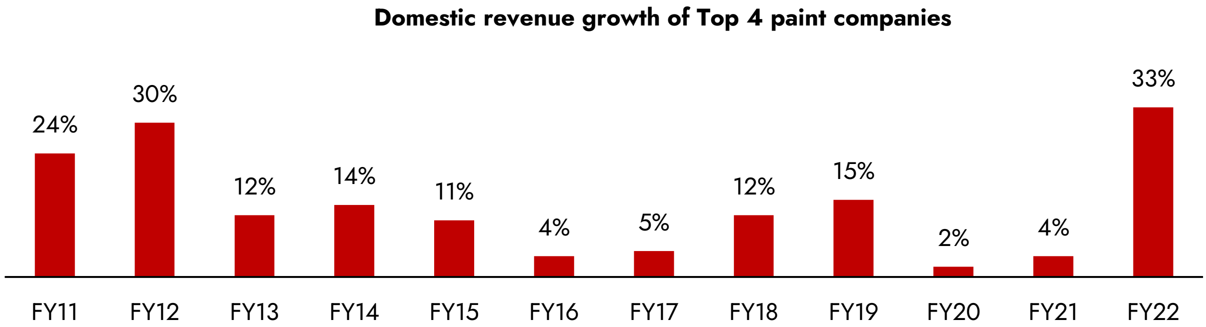
Segment	Ashirvad	Astral	Finolex	Prince	Supreme
Pipes Revenue (Rs Cr)	2,920	2,486	2,635	2,072	4,099
Overall Mkt Share	9.4%	6.6%	8.3%	5.3%	11.1%
5Y Pipers Rev CAGR	NA	14%	5%	16%	12%
5Y Volume CAGR	NA	**12%**	0%	9%	5%
Sales Mix					
Plastic Pipes	100%	74%	86%	100%	63%
PVC	NA	33%	76%	75%	50%
cPVC	NA	**41%**	10%	25%	13%
Others	-	26%(Adhesives)	14%(Resins)	-	37%
Agri: Non -Agri Mix	10:90	**10:90**	63:37	35:65	35:65

Source: Company, Ambit Asset Management

2. **Paints:** Despite real estate cyclicality and macro volatility, paints sector continues to grow higher than nominal GDP growth. This is due to the large component of repeat purchase (~80%), which derives decorative paints demand. Home improvement as a theme has gained salience owing to Covid and paints has been on the forefront of the same. Paints, as a category, is still relatively underpenetrated. With reducing re-painting cycle along with unparalleled pricing power, we continue to remain bullish on the sector. Sub-categories such as waterproofing and lower ended paints such as putty, have seen tremendous growth and we anticipate the same to continue.

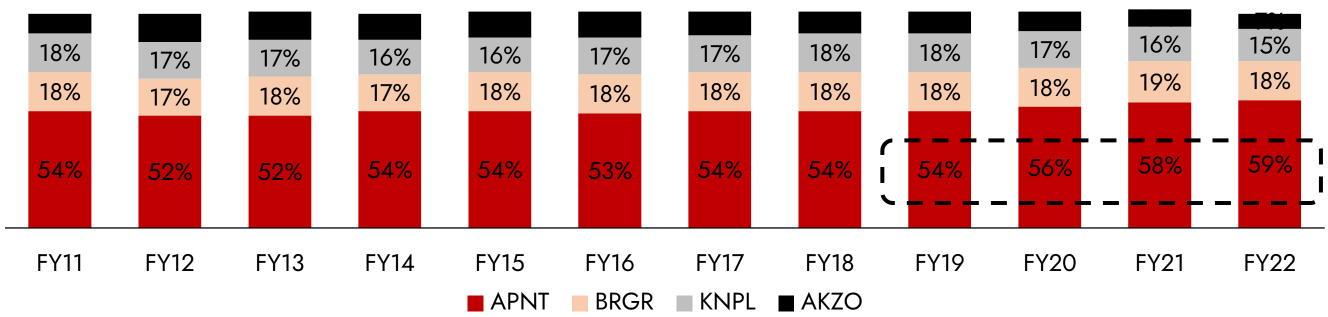
   While there seems to be rising competitive intensity with the entry of newer players such as Grasim/JSW paints, we continue to believe that there will be limited impact on the competitive advantages of Asian Paints. We believe that there are two key moats of Asian Paints - branding and distribution - which cannot be disrupted by just committing higher capital. Paints, thus remains one of the best real-estate proxy play in our view.

Exhibit 7: Large organised players have grown in double digits over the last decade



Source: Company, Ambit Asset Management

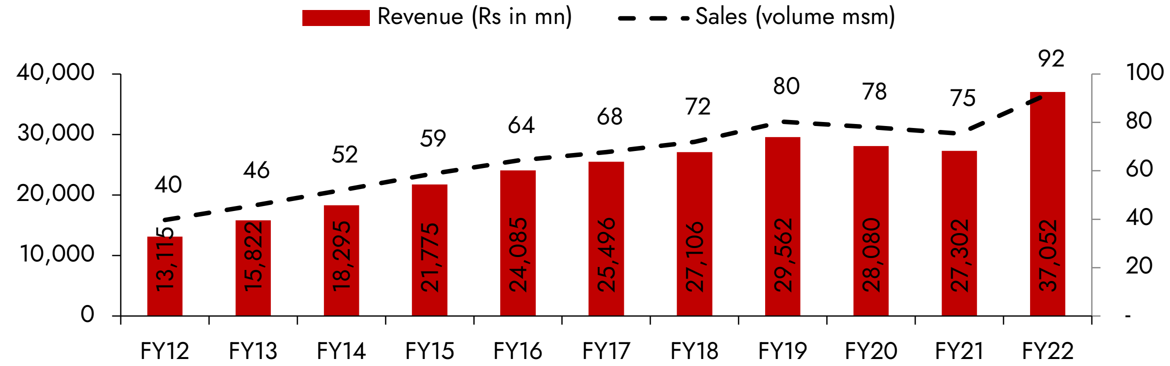
Exhibit 8: Asian Paints continues to gain market share



Source: Company, Ambit Asset Management

3. **Tiles:** Residential sector contributes ~60% of total tiles demand while commercial constructions contributes the rest. A slowdown in real estate sector during the past few years had moderated domestic demand impacting the overall growth. However, with a pickup in the residential space as well as exports, companies such as Kajaria have seen a sharp recovery.
   Kajaria's market share has doubled over the past 10 years to 10%, led by 12% volume CAGR, outpacing industry's 5% CAGR. Company has aggressively expanded distribution network by 60% over the last 5 years. Kajaria's large and premium product portfolio with pan-India distribution has helped in establishing itself as a premium brand in the domestic market.

Exhibit 9: Kajaria delivered strong revenue growth in FY22 backed by improvement in the real estate market

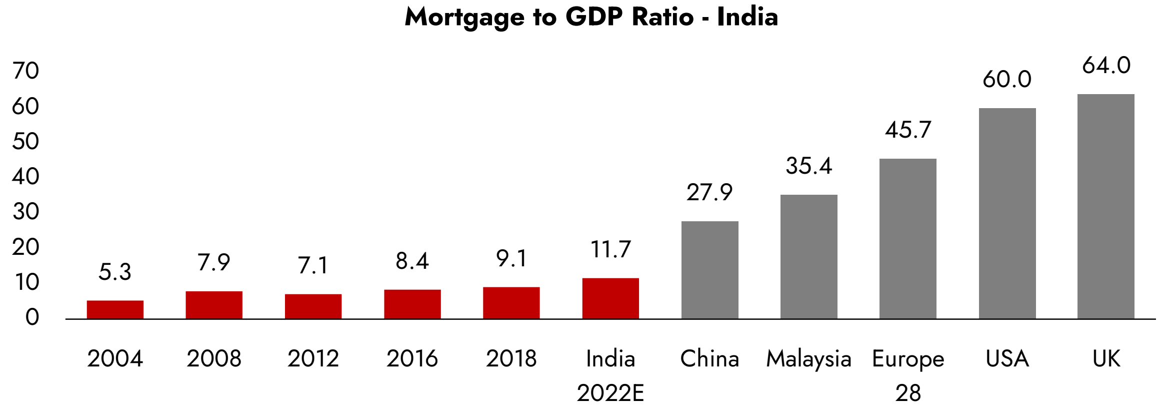


Source: Company, Ambit Asset Management

4. **Wood panel:** The domestic wood panel industry is a ~Rs51,000 crore market, dominated by plywood, with only 20% organised share. With the boost in real estate, wood panel players have a favourable tailwind as wood panel is an integral part of the home improvement sector. Within this segment, we like companies such as Greenlam, which continues to dominate the laminate segment. Company is also aggressively expanding other categories such as particle board and plywood, with a total fresh capex of 950cr. Owing to significant capacity expansion, Greenlam is expected triple its revenue by FY26-27.

5. **Affordable Housing Finance companies (HFC):** Mortgage penetration in India has been on the rise, but remains low at ~11%. Over the last decade, home loan has grown at 1~7% CAGR, regardless of the real cycle as the segment is highly under-penetrated. Unlike mature markets such as US, India's mortgage has shown little correlation with the interest rates. This segment has the largest contribution of retail loans and therefore remains the biggest driver of loan growth for retail lenders.

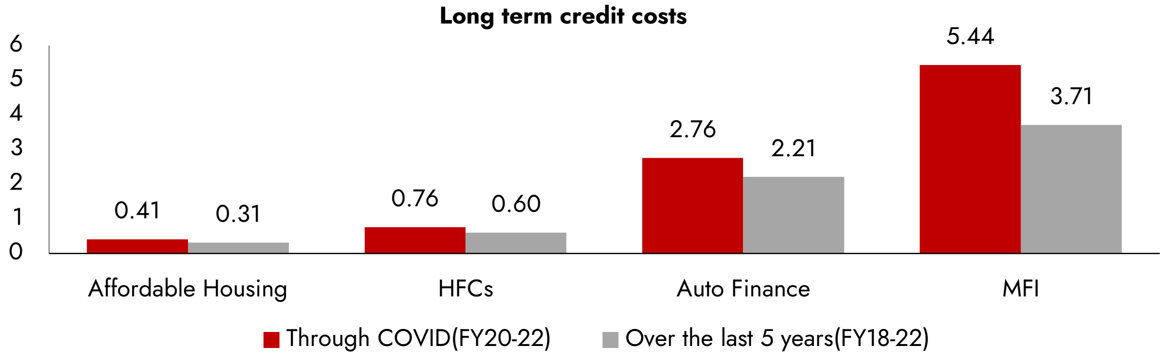
Exhibit 10: Improving Mortgage to GDP ratio albeit below other countries



Source: Aptus DRHP, Ambit Asset Management

Credit growth is picking-up at an accelerated pace in the Tier2/3 cities as they are highly underpenetrated. This is the home ground of affordable HFCs as they try to avoid direct collision with banks. In last 5 years, Aavas/Homefirst grew by 33%/45% CAGR. Even after growing at a break neck speed and catering to the low income segment, credit cost has remained lower than other segments (Large HFC/MFI/VFC).

Exhibit 11: Better Credit cost v/s other segments during COVID



Source: Company, Ambit Asset Management

These companies are playing on information arbitrage and operational efficiencies. They are willing to underwrite small size loans to the informal segment, which are typically difficult to evaluate. Fully in-house sourcing and collection models backed by strong tech based evaluation and underwriting helps in better quality control of the clientele. HFC are improving operational efficiencies by leveraging technology. Home First operates at a turnaround time (TAT- enquiry to approval) of 48hrs, which is superior to that of large banks lending to prime customers.

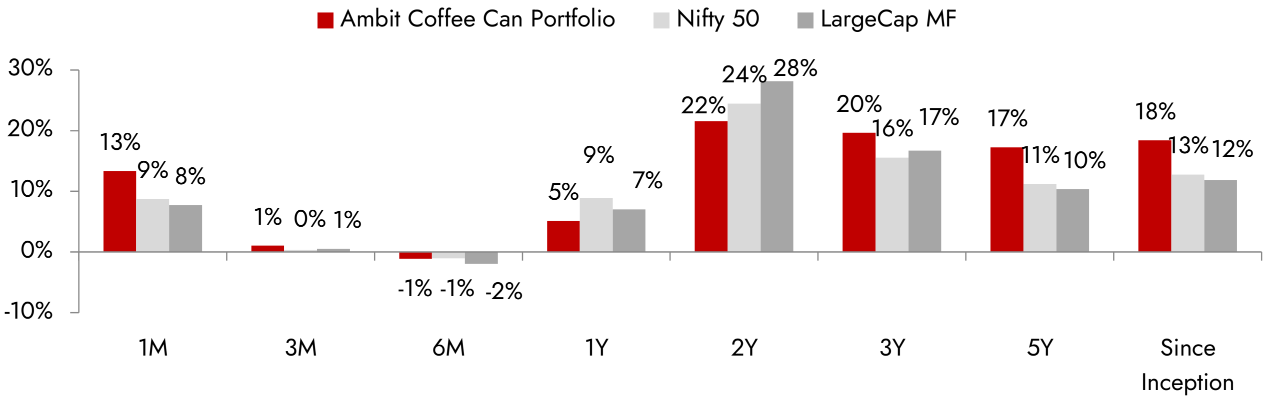
Conclusion

While large real estate developers are gaining share and benefiting from industry tailwinds, we continue to avoid the space. Inherent risks around scaling operations and regulation have made the industry quite unattractive. As highlighted in previous newsletters, we like to back structural plays with the ability to compound wealth over long-term. Companies such as Astral, Asian Paints, Kajaria, Home first, Aavas, etc have shown consistent track record and have developed significant moats in their respective segments to benefit from the real estate upcycle and generate significant shareholder wealth.

Ambit Coffee Can Portfolio

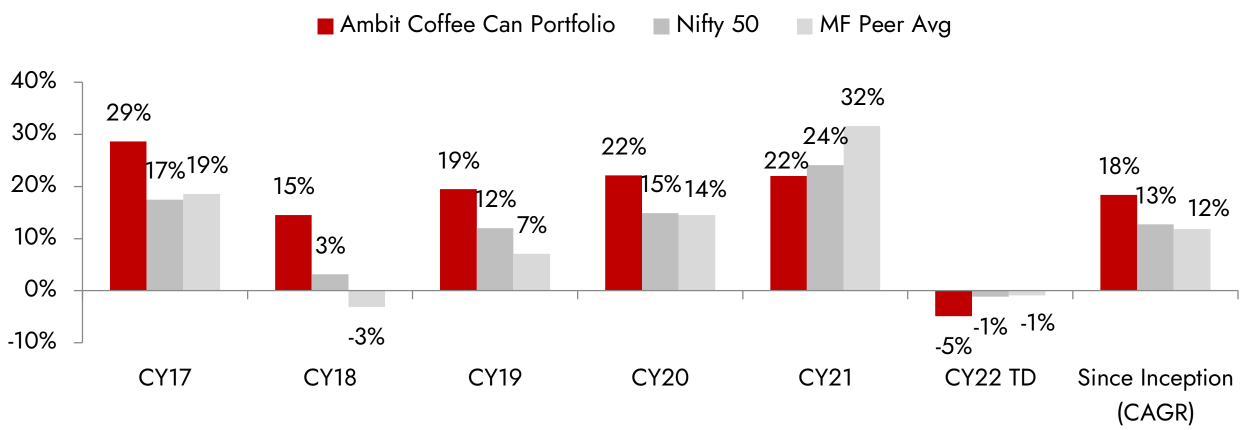
At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail and consumption-oriented sectors. The Coffee Can philosophy has unwavering commitment to companies that have consistently sustained their competitive advantages 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 12: Ambit's Coffee Can Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 31st July, 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 13: Ambit's Coffee Can Portfolio calendar year performance



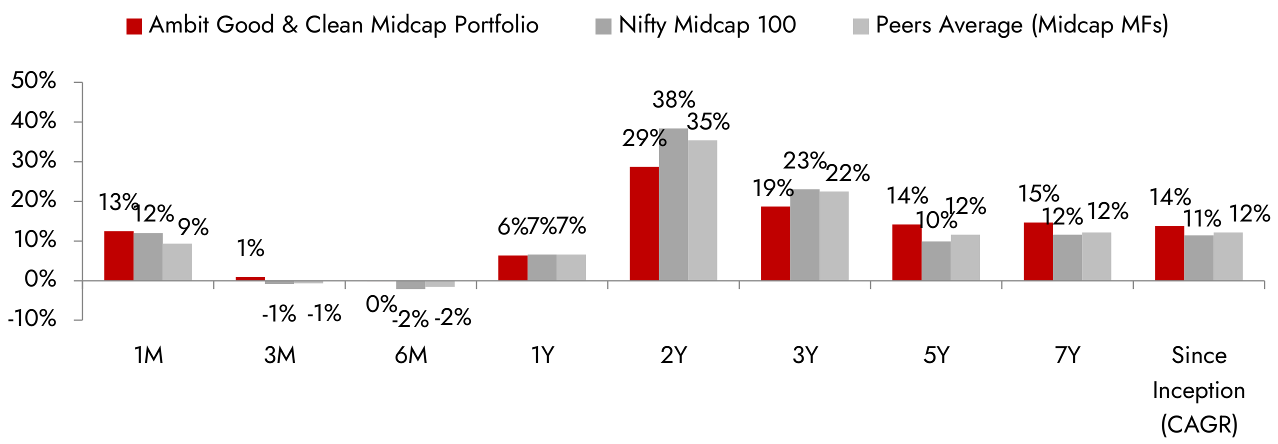
Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 31st July, 2022; All returns are post fees and expenses. Note: Returns prior to Apr'19 are returns of all the Pool accounts excluding non-aligned portfolio, and returns post Apr'19 is based on TWRR returns of all the pool accounts.

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:

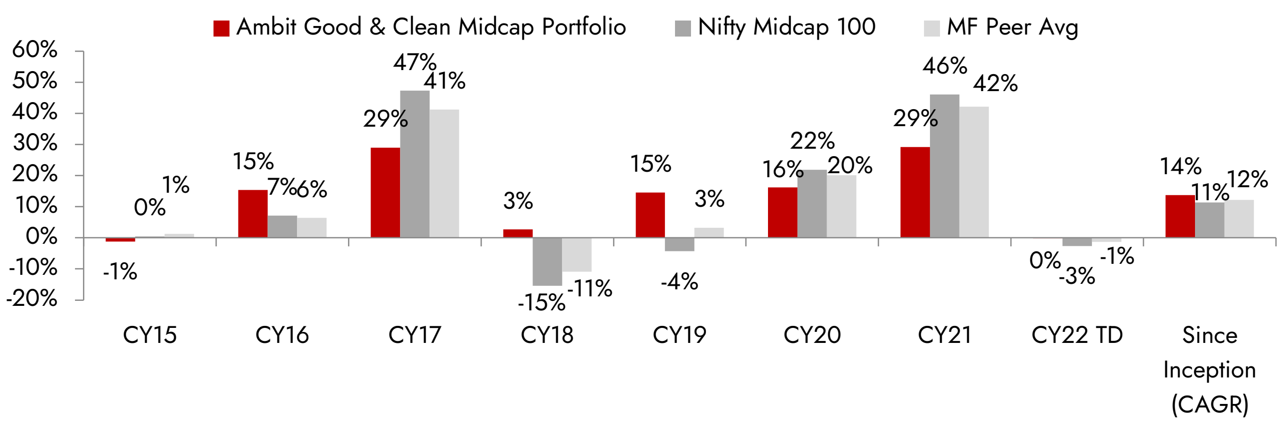
- **Process-oriented approach to investing:** Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated 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 14: Ambit's Good & Clean Midcap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31st July, 2022; All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 15: Ambit's Good & Clean Midcap Portfolio calendar year performance

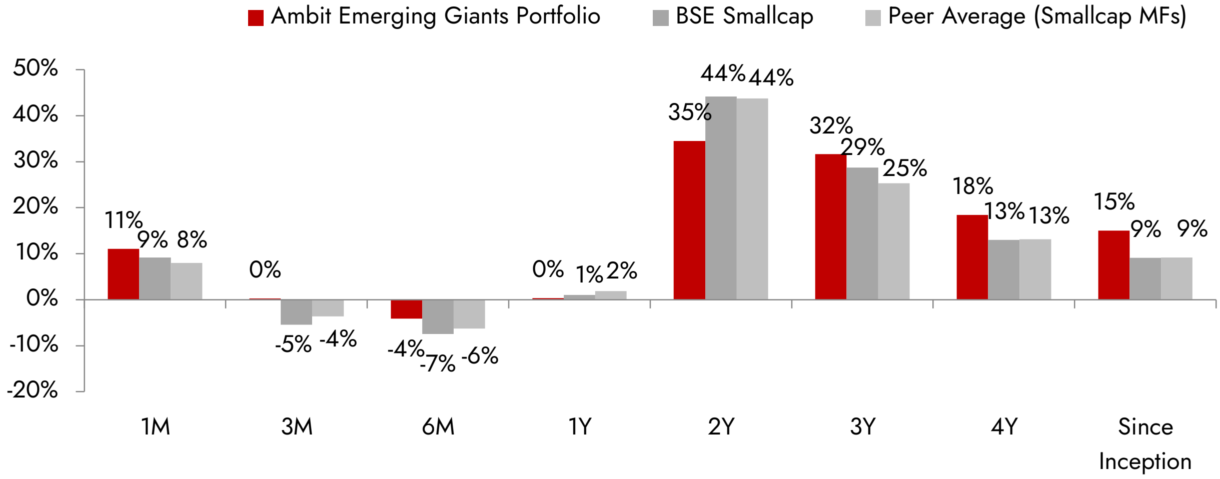


Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31st July, 2022. Returns are net of all fees and expenses

Ambit Emerging Giants Portfolio

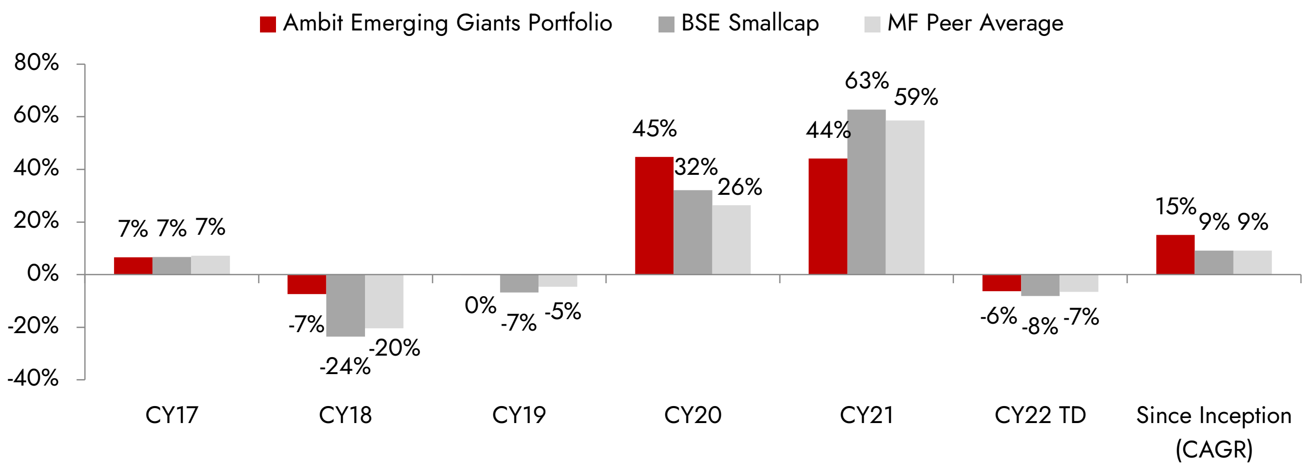
Smallcaps with secular growth, superior return ratios and no leverage — Ambit's Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market 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 16: Ambit Emerging Giants Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 31st July, 2022; All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 17: Ambit Emerging Giants Portfolio calendar year performance



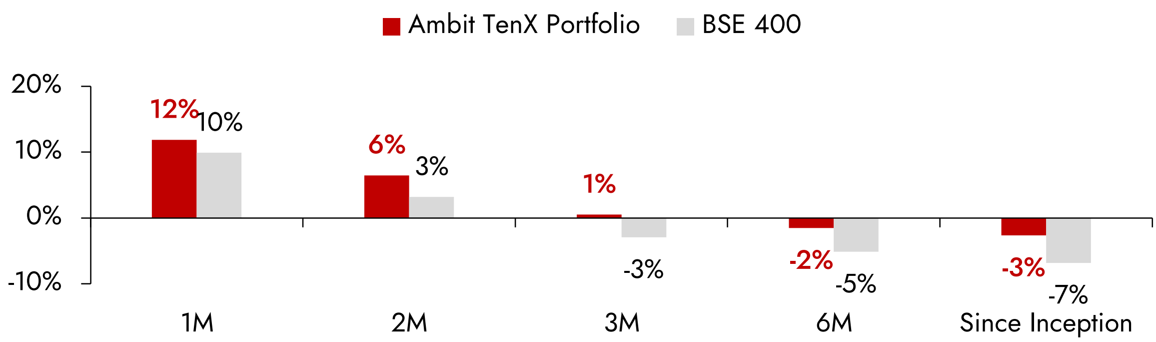
Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 31st July, 2022. Returns are net of all fees and expenses

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:

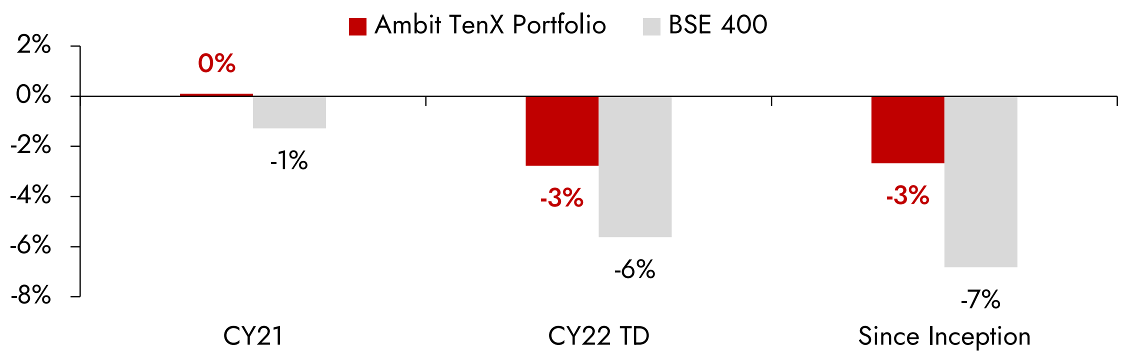
- **Longer-term approach with a concentrated portfolio:** Ideal investment duration of >5 years with 15-20 stocks.
- **Key driving factors:** Low penetration, strong leadership, light balance sheet
- **Forward-looking approach:** Relying less on historical performance and more on future potential while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

Exhibit 18: Ambit TenX Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of 31st July, 2022; Returns are net of all fees and expenses

Exhibit 19: Ambit TenX Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of 31st July, 2022. Returns are net of all fees and expenses

Ambit
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The product 'Ambit Coffee Can Portfolio' has been migrated from Ambit Capital Private Limited to Ambit Investments Advisors Private Limited.

Hence some of the information in this presentation may belong to the period when this product was managed by Ambit Capital Private Limited.

You may contact your Relationship Manager for any queries.

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