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AMBIT
ASSET MANAGEMENT

Emerging Giants:
G&C Small Cap

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Dear Investor,

The election of NDA 2.0 with a clean verdict provided a sigh of relief to financial market in India. Re-election of incumbent government with such a strong mandate will not only mean policy continuity and predictability but will also be an opportunity to carry out more challenging and significant reforms in ensuing years.

NDA 1.0 carried out massive structural reforms (GST, IBC, RERA, etc.) and boosted the economy through spending on infrastructure. We expect NDA 2.0 to continue on the reforms path and the infrastructure spent. Having earned a stronger mandate, the Government can deliver bolder reforms related to factor of production like Land & Labour.

The fruits of hardwork on reforms during the last five years should be visible in the next few years. Due to effective implementation of E-way bill and rationalization of GST rate, compliance should increase as implementations gets tighter and meaningful evasion becomes virtually impossible. We have already witnessed increased compliance in few sectors in the recent past. This should lead to streamlining of direct tax (with implementation of DTC) and indirect tax (with rationalization of GST), and will probably be on top agenda of government's budget framework during this tenure. Economy has been witnessing slowdown in the recent past, which manifests itself with the weakness in auto sales and now percolated in consumer space too. This is more on account of decline in domestic savings over last couple of years coupled with the stress in rural economy, leading to slower demand creation. Added to that, ongoing NBFC Crisis and liquidity crunch accentuated the consumer demand slowdown. We have seen this impacting our portfolio stock like Page Industries, where growth nosedived and margin slumped due to negative operating leverage.

The top priority for the new government will be to bring back the economy on track. The immediate task should be to fix liquidity conundrum, by accommodating more conducive monetary stimulus. Given the low expected inflation, we expect RBI to cut repo rates along with CRR cuts. Along with the rate cuts, RBI should also focus on injecting liquidity in the system by OMO or FX dollar swaps. This will not only take care of NBFC issues but will also help in reviving the economic growth. Any windfall from the outcome of Jalan committee will help government to inject liquidity or recapitalized PSU bank, leading to overall credit creation. With the electoral success of pro poor scheme and efficient DBT transfer, government will increase the existing schemes' reach and deploy more such schemes, which may help in revival of consumption in rural part of country.

The new government should also focus on creating liquidity through PSU privatization and other assets sales (e.g. SUUTI stakes). Steps to bring in more FDI/FPI will attract more foreign inflows, as India's political risk premium has shrunk. These flows will not only provide stability to Indian exchange rate, but will also help in bridging the gap of domestic saving decline. New elected governments can also revive capex by spending on infrastructure & housing, which can be a boon of economic growth revival. Government will also focus on reviving private capex by creating attractive proposition and focus more on ease of doing business in India. Given that rural stress and job creation will be atop govt's agenda, consumption could also pick up in after its recent weakness.

The Cement sector witnessed announcement of fresh capacity additions during the past few months after a reasonable gap. This aids to our belief that private capex should pick up soon as the capacities reach optimum utilization levels. The success of Make in India program will be tested in the form of FDI flows during next few years. Every global boardroom will probably deliberate on their 'India strategy' as against their 'China strategy' in the previous decade. A combination of domestic and FDI linked capex should boost the economy in the medium to long term.

We are of the opinion that polarization of performance in Indian markets (where 5-7 stocks contributed 80% of Nifty 50 return in FY19) will unwind, with money now chasing other large cap and selective good quality midcaps as they are available at attractive valuations. Broader market continues to underperform in last 15 months and this trend can see reversal in next one to two years because of expected fall in interest rates, easing of liquidity crisis, fixing of the NBFC mess and revival in earning growth with favorable base. We expect crude prices to hover around current levels. With increased FII flows in debt and interest rate cut, we may see sovereign yields below 7%. This money market buoyancy coupled with earning growth revival, could propel equity prices significantly higher in the medium to long term.

Emerging Giants: G&C Small Cap

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 record, 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.

EG portfolio companies continue to deliver healthy earnings growth

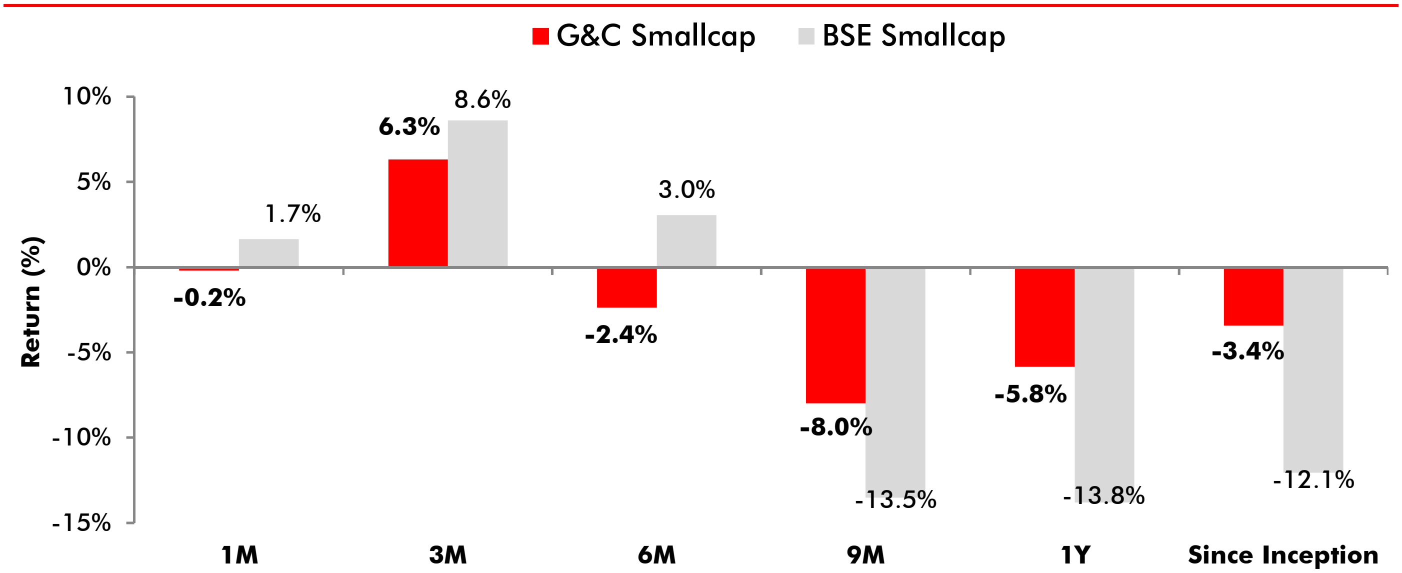
In FY19Q4, Emerging Giants portfolio companies delivered healthy revenue growth and strong earnings, in the midst of economic slowdown. As shown in the exhibit below, portfolio companies delivered an average Revenue/PAT growth of 15%/13%. Profitability for a few companies was under pressure due to higher input costs, which we believe will be passed on to the buyer with a lag. On a portfolio level, the results have panned out well, with 18%/21% Revenue/PAT growth witnessed in the FY19 over FY18. We believe that the stock will continue to deliver strong number going ahead.

Exhibit 1: Emerging Giants Portfolio Companies Q4-19 Performance

Growth	FY19Q4 vs. FY18Q4		FY19 vs. FY18	
	Avg	Median	Avg	Median
Revenue	15%	15%	18%	14%
EBITDA	9%	14%	19%	18%
PAT	13%	20%	21%	19%

Source: Ambit Capital Research

Exhibit 2: Ambit' Emerging Giants: G&C Small Cap performance update



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

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