

MONTHLY NEWSLETTER



March 2019



AMBIT ASSET MANAGEMENT

GOOD & CLEAN
by Ambit

Good & Clean Portfolio

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

Value trap in the Indian Markets

India has proved to be a graveyard for traditional value investing strategies. Almost always, companies with Low PE trade at those values deservedly so due to 1) Poor Accounting quality 2) Fraudulent Management and 3) Inefficient Capital Allocation. As shown in exhibit below earnings of value stocks (as measured by lowest PE ratio or the 4th quartile) remain the weakest over the long term.

Exhibit 1: Earnings of value stocks are weakest in the long term

Quartiles based on starting P/E multiple	Subsequent Median earnings growth (%)		
	3Y	5Y	10Y
Q1 (high P/E)	16%	9%	14%
Q2	11%	8%	10%
Q3	5%	6%	7%
Q4 (low P/E)	-16%	-5%	7%

Source: Ace Equity, Ambit Research; Note: Universe represents all the listed companies whose data are available for subsequent periods; Stocks with negative P/E and P/E above 200 are excluded; 10Y represents PAT cagr from FY08 to FY18; 5Y represents PAT cagr during FY13-FY18; 3Y represent PAT cagr during FY15-FY18;

Firstly, accounting is as much an art as it is a science. Creative means are used by companies' management to show the best possible reflection of financial performance to maximize earnings, the stock price and ultimately their own stakes through ownership/stock options. Generally accepted accounting principles or GAAP are nothing more than what it is called i.e. "generally accepted" and provide enough maneuverability to the management to distort the reality.

Secondly, companies with shady managements & promoters go a step further and commit blatant fraud rather than just window-dress books of accounts. Siphoning off precious funds from public companies by fraudulent promoters is all too common.

Finally, very few companies maintain focus on their core business and aim to build and grow sustainable competitive advantages. Rather, as soon as a company grows in size, hubris sets in and the company looks at high growth opportunities entering into new business lines and expensive acquisitions. Very few managements and companies look at relative value addition (returns over cost of capital) for capital allocation decisions.

How do we at Ambit overcome these challenges?

While quantitative filters are a good starting point to stock picking, many a times, numbers are not as they seem. A further deep-dive into the business model, growth prospects, governance & management provides a complete picture and is required to build a high quality & high return generating stock portfolio, especially in the Indian context.

Forensic Accounting framework: Our robust accounting framework penalizes companies that conduct accounting jugglery to show a distorted picture different from the true economic reality. We extensively screen and avoid companies that have aggressive revenue recognition policies, aggressive provision practices, questionable related party transactions and poor quality of auditors. Our valuation models further focus on actual cash flows earned rather than accounting earnings which are calculated on accrual basis.

Focus on highest quality corporate governance: We only focus on companies with a truly independent board, empowered management & strong corporate governance. We stay away from questionable companies & management and undertake several checks to ascertain quality of management and corporate governance.

Companies with undeterred focus on core business: We like companies that have unwavering focus on core competencies and laser-like focus on core business. This enables them to build structural competitive advantages, grow their competitive moats and gain market share from other players who lack the same amount of dedication & focus.

Ambit Good & Clean 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.

G&C portfolio companies continue to deliver healthy earnings growth

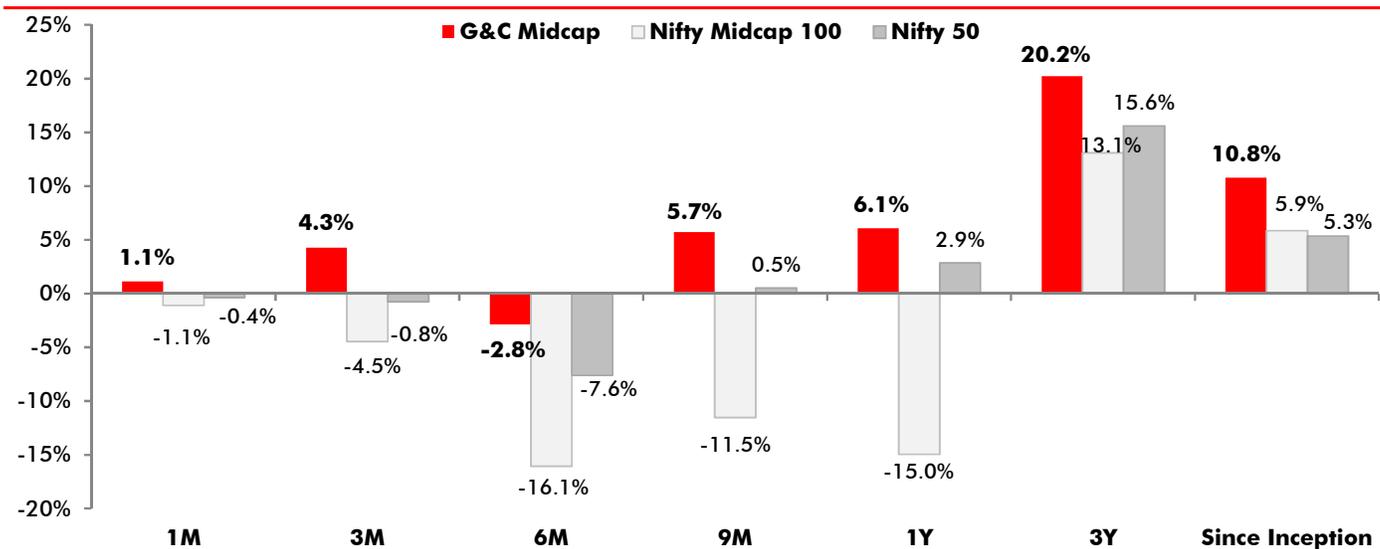
3QFY19 results season panned out well for the Good & Clean portfolio with healthy revenue growth and strong earnings. As shown in the exhibit below, the portfolio companies showed an average Revenue/EBITDA growth of 29%/35%. This is on the back of 19%/17% growth witnessed in the 2QFY19 quarter. We continue to believe that portfolio stocks will maintain this earning momentum in ensuing quarters.

Exhibit 2: G&C Portfolio Companies Q3-19 Performance

Growth	Average		Median	
	YoY	QoQ	YoY	QoQ
Revenue	29%	10%	21%	8%
EBITDA	35%	13%	29%	12%
PAT	54%	21%	19%	10%

Source: Ambit Capital Research; Note: For BFSI companies, Revenue/EBITDA growth represents growth in Interest Income/Pre-Provision income respectively; Average is computed by taking the current weights of portfolio stocks.

Exhibit 3: Ambit Good & Clean Portfolio performance update



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of February 28, 2019; Since inception & 3Y returns are annualized returns. **Returns are net of all fees and expenses**

For any queries, please contact:

Ashu Tomar - Phone: +91 98673 03861, Email - aiapms@ambit.co

Team Ambit Asset Management
Ambit House, 449, Senapati Bapat Marg,
Lower Parel, Mumbai - 400 013

Risk Disclosure & Disclaimer

Ambit Investment Advisors Private Limited ("Ambit"), is a registered Portfolio Manager with Securities and Exchange Board of India vide registration number INP000005059.

This presentation / newsletter / report is strictly for information and illustrative purposes only and should not be considered to be an offer, or solicitation of an offer, to buy or sell any securities or to enter into any Portfolio Management agreements. This presentation / newsletter / report is prepared by Ambit strictly for the specified audience and is not intended for distribution to public and is not to be disseminated or circulated to any other party outside of the intended purpose. This presentation / newsletter / report may contain confidential or proprietary information and no part of this presentation / newsletter / report may be reproduced in any form without its prior written consent to Ambit. If you receive a copy of this presentation / newsletter / report and you are not the intended recipient, you should destroy this immediately. Any dissemination, copying or circulation of this communication in any form is strictly prohibited. This material should not be circulated in countries where restrictions exist on soliciting business from potential clients residing in such countries. Recipients of this material should inform themselves about and observe any such restrictions. Recipients shall be solely liable for any liability incurred by them in this regard and will indemnify Ambit for any liability it may incur in this respect.

Neither Ambit nor any of their respective affiliates or representatives make any express or implied representation or warranty as to the adequacy or accuracy of the statistical data or factual statement concerning India or its economy or make any representation as to the accuracy, completeness, reasonableness or sufficiency of any of the information contained in the presentation / newsletter / report herein, or in the case of projections, as to their attainability or the accuracy or completeness of the assumptions from which they are derived, and it is expected each prospective investor will pursue its own independent due diligence. In preparing this presentation / newsletter / report, Ambit has relied upon and assumed, without independent verification, the accuracy and completeness of information available from public sources. Accordingly, neither Ambit nor any of its affiliates, shareholders, directors, employees, agents or advisors shall be liable for any loss or damage (direct or indirect) suffered as a result of reliance upon any statements contained in, or any omission from this presentation / newsletter / report and any such liability is expressly disclaimed.

You are expected to take into consideration all the risk factors including financial conditions, Risk-Return profile, tax consequences, etc. You understand that the past performance or name of the portfolio or any similar product do not in any manner indicate surety of performance of such product or portfolio in future. You further understand that all such products are subject to various Market Risks, Settlement Risks, Economical Risks, Political Risks, Business Risks, and Financial Risks etc. You are expected to thoroughly go through the terms of the arrangements / agreements and understand in detail the Risk-Return profile of any security or product of Ambit or any other service provider before making any investment. You should also take professional / legal /tax advice before making any decision of investing or disinvesting. Ambit or Ambit associates may have financial or other business interests that may adversely affect the objectivity of the views contained in this presentation / newsletter / report.

Ambit does not guarantee the future performance or any level of performance relating to any products of Ambit or any other third party service provider. Investment in any product including mutual fund or in the product of third party service provider does not provide any assurance or guarantee that the objectives of the product are specifically achieved. Ambit shall not be liable for any losses that you may suffer on account of any investment or disinvestment decision based on the communication or information or recommendation received from Ambit on any product. Further Ambit shall not be liable for any loss which may have arisen by wrong or misleading instructions given by you whether orally or in writing.

The product 'Ambit Good & Clean 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.