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AMBIT ASSET MANAGEMENT

GOOD & CLEAN
by Ambit

Good & Clean Portfolio

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Dear Investor,

With budget around the corner, all eyes will be on the new Finance Minister to initiate steps/reforms to address the recent slowdown in the economy.

We see budget to be a tough one as the government has limited scope of improvement in revenue collection in FY20 given the less-than-desirable tax collection in FY19. However, shortfall in revenue collection is expected to be fulfilled with higher disinvestment target and possibly from transfer of excess capital from RBI to government as based on recommendations from Jalan committee report. However, the latter can't be ascertained as the Jalan report is now likely to be tabled after the budget. Nevertheless, above mentioned steps along with increasing tax compliance could address revenue growth targets. The key task will be to manage expenditure given the fixed commitments in social welfare scheme launches, such as PM Kisan and possible increase in minimum support price (MSP) for the farmers are likely to be continued and rightly so.

Government may also prioritize revival of economic growth rate over fiscal discipline and this will be seen positively in our view. Following will be our wish list for the upcoming budget:

Utmost importance will be given to bringing GDP growth back on track:

- Resolution of liquidity crisis in the NBFC space will be paramount. Recent liquidity crunch has stopped funding/refinancing of projects across industries thereby impacting Housing, MSME and Consumer spending. NBFC sector was financing long-duration projects by relying on short-duration liabilities which was getting refinanced by mutual funds, banks and others. With recent crisis, such refinancing has dried up for majority of the sector due to the trust deficit created with recent defaults and delays in repayments. To restore confidence in the sector, government needs to provide roadmap for liquidity availability so that troubled NBFCs can get breathing space in putting things back in order. Such roadmap may incentivize large investors to infuse equity in the good assets of troubled financiers or providing incentives, such as easing borrowing norms, introduction of housing bonds will bring relief to the sector can bring relief to realty sector
- Government can provide incentives to exporters to boost growth as exports have been slowing for some time. In the recent years, emerging market currencies have depreciated against the dollar in comparison to Indian rupee. As a result, Indian products are losing cost advantage. The double impact of Demonetization and GST led to deterioration of financial health for many Indian players and also made Indian products costlier compared to other emerging markets. In addition to this, US ended preferential trade treatment for $5.6bn of exports that had duty-free status. All this creates a case for providing additional support to the export players and this also will lead to job creation opportunities in the related sectors
- Fast tracking recapitalization plan of the public sector banks (PSBs) can help in improving overall credit growth rate. This will increase effective transmission of rate cuts to the end consumer and would support end consumer and the economy. SME & MSME sector is crucial to growth and relief to this segment can also be provided with PSBs playing a major role once they are recapitalized
- Aggressive push for affordable housing sector by providing deductions on home loan interest rates. Housing sector growth can have multiplier effect on the GDP overall as it drives infrastructure creation as well as discretionary spending. GST relief to industry and tax relief to home buyers can spur demand

Reviving rural economy and addressing the agrarian distress:

- Land Reforms related to land aggregation and allowing of private sector investments in agriculture can help in bringing efficiency as well as economies of scale in the rural economy
- Higher MSP prices, creation of pan-India markets and improvement in logistics network is essential so that the farmers get fair portion on sale of products to end consumers

Over the last few years, government announced multiple reforms/policy changes outside the budget as a continuous exercise. This has limited the importance of budget in pushing structural changes in the economy. As mentioned above, we believe government's immediate focus will be to revive economic growth, provide economic support to exports and MSME sector, expedite the recapitalization process of PSBs, and announce measures to alleviate agrarian distress. Most importantly key watch will be on reforms overhauling the agriculture supply chain with focus on providing the fair economic share to farmers. We will not be surprised if these changes are rolled out in a phased manner in near future and are not extensively covered in the budget.

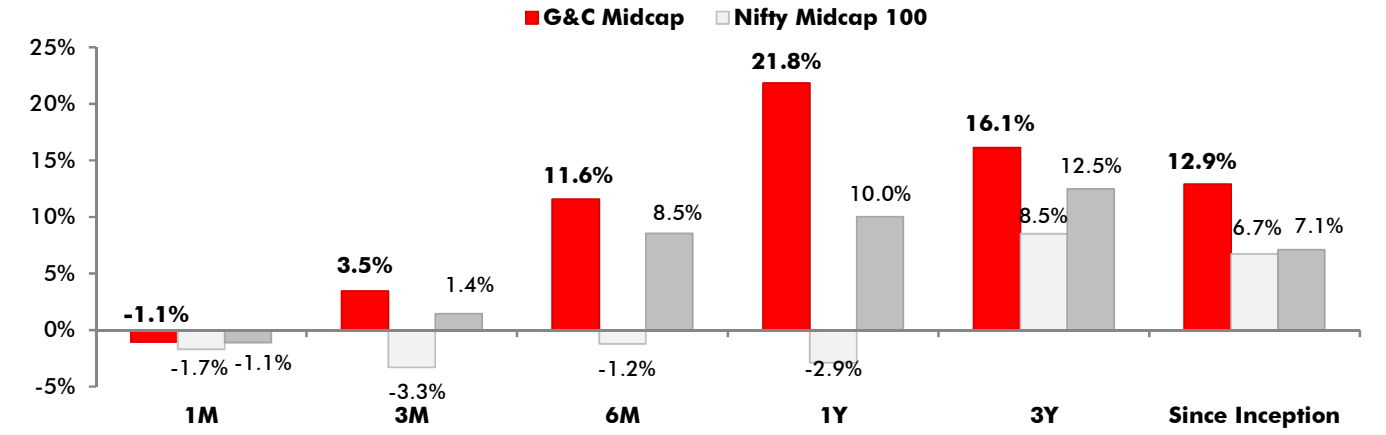
Ambit Good & Clean Portfolio

GOOD & CLEAN by Ambit

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 1: Ambit's Good & Clean Portfolio performance update



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of June 30, 2019; Since inception & 3Y returns are annualized returns. ***Returns are net of all fees and expenses***

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