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Ambit
Asset Management

MONTHLY NEWSLETTER

March 2023

QUARTERLY INSIGHTS: ASSESSING THE IMPACT OF BUSINESS DYNAMICS

3QFY23:– Seasonally strong quarter; Panned out well!

Dear Patron,

3QFY23 earnings season saw wide divergence across sectors as well as companies. (1**) IT companies**' results were better than feared with hopes of easing macro and supply challenges heading into FY24. (2) **Financials** continue to report a strong quarter fuelled by healthy loan growth, (3) **Auto OEMs** benefitted from healthy volume growth (4) High inflation led to muted/low volume growth for companies in the **consumer universe.** (5) Within the **discretionary space,** most sectors saw a sequential slowdown, given the lull post-festive season. The third quarter results have displayed that the pent up demand post COVID has started to normalize for the Indian economy. In this newsletter, we will cover broad sector-specific performance in 3QFY23 and the expected outlook.

Exhibit 1: Moderate quarter, healthy earnings across our portfolios during the quarter

	Net Sales YoY%			EBITDA YoY%			PAT YoY%		
Coffee Can PMS	Q3FY23	Q2FY23	Q3FY22	Q3FY23	Q2FY23	Q3FY22	Q3FY23	Q2FY23	Q3FY22
Weighted avg	13%	17%	22%	7%	10%	6%	7%	13%	9%
Median	15%	18%	22%	12%	11%	10%	9%	19%	8%
Nifty	18%	18%	24%	13%	2%	25%	11%	0%	45%
Nifty 50 Ex – Banks	18%	30%	28%	9%	8%	18%	2%	0%	22%
Good & Clean PMS	Q3FY23	Q2FY23	Q3FY22	Q3FY23	Q2FY23	Q3FY22	Q3FY23	Q2FY23	Q3FY22
Weighted avg	22%	46%	60%	18%	31%	14%	28%	14%	39%
Median	19%	21%	18%	13%	24%	1%	20%	22%	11%
Nifty Midcap 100	7%	59%	-7%	11%	1%	7%	9%	7%	39%
Ambit Emerging Giants PMS	Q3FY23	Q2FY23	Q3FY22	Q3FY23	Q2FY23	Q3FY22	Q3FY23	Q2FY23	Q3FY22
Weighted avg	20%	27%	37%	38%	21%	24%	46%	33%	40%
Median	20%	27%	30%	6%	18%	-3%	12%	19%	11%
BSE smallcap	15%	16%	44%	15%	3%	16%	20%	14%	9%
Ambit TenX PMS	Q3FY23	Q2FY23	Q3FY22	Q3FY23	Q2FY23	Q3FY22	Q3FY23	Q2FY23	Q3FY22
Weighted avg	26%	20%	23%	32%	16%	13%	35%	18%	30%
Median	25%	30%	29%	14%	23%	8%	25%	17%	16%
BSE 400	15%	13%	24%	24%	2%	6%	10%	3%	24%

Source: Ambit Asset Management

Performance of different sectors for the Q3FY23 quarter

1. Consumer – Staples:

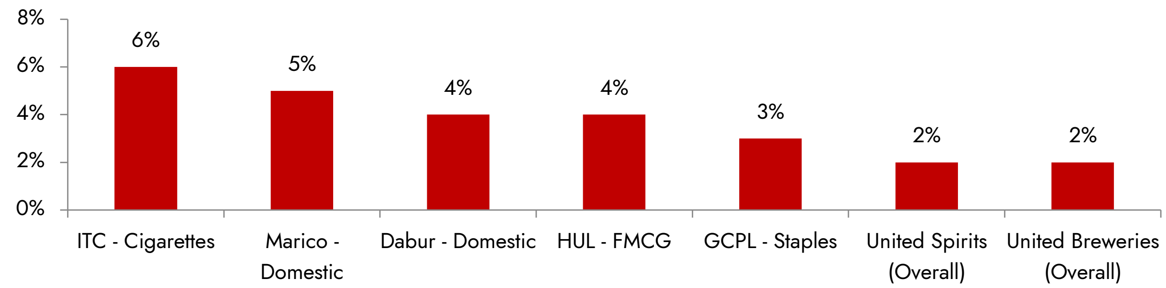
3QFY23 posted another quarter of soft performance for consumer companies. Key Sectorial highlights are:

- **Slowdown in Demand:** The consumer staples universe posted another quarter of soft performance, with the slowdown in rural consumption and high input prices affecting the sector's earnings growth. Sustained high prices of certain RMs like agri-related RMs & high cost inventories led to continued margin pressure. A&P spending seems to have normalised; continued focus on cost optimisation; innovations / new launches have returned.

- **Price led growth for most consumer companies:** (1) Prolonged rains in the north, (2) delayed winter and (3) weak rural demand driven by sticky food and fuel inflation have led to muted aggregate volume growth for the sector in Q3FY23 led by macro challenges, particularly in the rural segment. 3-year value growth, however, for most companies was still healthy aided by material price increases taken across categories.

Outlook: The management commentaries indicated that there were some green shoots with respect to rural consumption towards the end of the quarter that persisted in Jan'23. A good Rabi harvest along with a decline in CPI inflation would spur staples demand

Exhibit 2: Company-wise 3 year volume CAGR for Q3FY23 (%)



Source: Company, Ambit Asset Management

2. Consumer – Discretionary:

3QFY23 exhibited normalcy in the outlook for discretionary companies. Key trends observed during the quarter

- **Key Trends in the Discretionary segment:** Quarterly demand saw some sequential sluggishness due to inflation (hurting mass-end demand), seasonality (delayed winter and extended monsoon), and the split festive season sales in 2Q whereas on a 3-Year CAGR basis growth has still been good. This indicates that pent up demand has started to normalize. Further the increase in competitive intensity with the return of small and unorganized peers due to Supply Chain normalization

- **Squeeze in Margins:** High cost inventory lying in the books of the Companies and resumption in media spend dented margins of most of the companies. Nearly all the firms in the sector are below pre-COVID levels and this pressure is likely to continue for at least one more quarter.

Outlook: Discretionary lifestyle categories may face growth headwinds for 1-2 more quarters. This could be owing to near term demand slowdown and high base effect, especially in travel and wedding related spending.

3. Auto & Auto Ancillaries:

3QFY23 witnessed a strong demand environment in Auto companies. Key trends observed during the quarter –

- **Healthy volumes:** Improvement in the supply of semiconductor chips and healthy demand momentum in the domestic markets supported volume momentum across segments (except 2Ws) in the 3QFY23. PV demand is sustained on the back of healthy order backlogs. Stable freight rates and the government's infrastructure push aided CV demand. The 2Ws industry is lagging due to the weak performance of the entry-level segment.

- **EV expansion -** New launches and variants launched by EV manufacturers in 3Q. Saw higher volume sales in the 2W scooter segments as companies expanded distribution in the quarter.

- **Auto-ancillary companies:** have announced capex to cater to the rising demand for EV/Hybrid vehicles. Some have even received large orders from domestic and foreign OEMs for the same. Some companies reported good after-market revenue as mobility has picked up and service/maintenance related activity picked up. Softening commodity costs was visible in the 3Q which aided margin expansion.

- **Exports** - North America CV and PV volumes continue to grow on the back of fleet replacement and strong demand for personal mobility. In 2W, retail sales were ahead of wholesales in some markets; there are some green shoots visible in 4Q (January month).

Outlook: Domestic booking trends continue to be healthy as new launches have received positive responses. The rural uptick has been slower than that of urban. Green shoots were seen in rural geographies in states such as MP, UP, Bihar, etc. Export markets may take another 2 quarters to return to normalcy.

Exhibit 3: Industry volumes increased by 13% yoy in 3QFY23 owing to strong order book in PV & CV segment

Industry: domestic volumes (units)	Sales volume (units)			Change (%)		FYTD		Change
	3QFY23	3QFY22	2QFY23	yoy	qoq	2023	2022	yoy
Scooters	1,144,236	1,018,200	1,471,683	12%	-22%	3,768,306	2,946,143	28%
Motorcycles	2,532,781	2,444,410	3,001,489	4%	-16%	7,939,498	6,796,004	17%
Mopeds	105,064	131,309	116,218	-20%	-10%	332,684	363,868	-9%
EV	217,899	67,318	148,853	224%	46%	500,542	123,434	306%
Total two-wheelers	3,999,980	3,661,237	4,738,243	9%	-16%	12,541,030	10,229,449	23%
Three Wheelers	138,511	82,356	120,319	68%	15%	335,123	117,923	184%
M&HCV's	85,678	63,964	79,650	34%	8%	241,013	146,601	64%
LCV's	141,433	130,748	152,037	8%	-7%	442,297	320,162	38%
Total CV's	227,111	194,712	231,687	17%	-2%	683,310	466,763	46%
Passenger cars	419,877	348,635	468,513	20%	-10%	1,299,831	1,029,765	26%
Utility vehicles	487,138	382,457	517,898	27%	-6%	1,469,594	1,036,006	42%
Vans	27,940	30,174	39,898	-7%	-30%	102,270	83,067	23%
Total Pv's	934,955	761,266	1,026,309	23%	-9%	2,871,695	2,148,838	34%
Tractors	247,247	223,827	221,588	10%	12%	734,453	664,659	11%
Total	5,547,804	4,923,398	6,338,146	13%	-12%	17,165,611	13,627,632	26%

Source: Company, Ambit Asset Management.

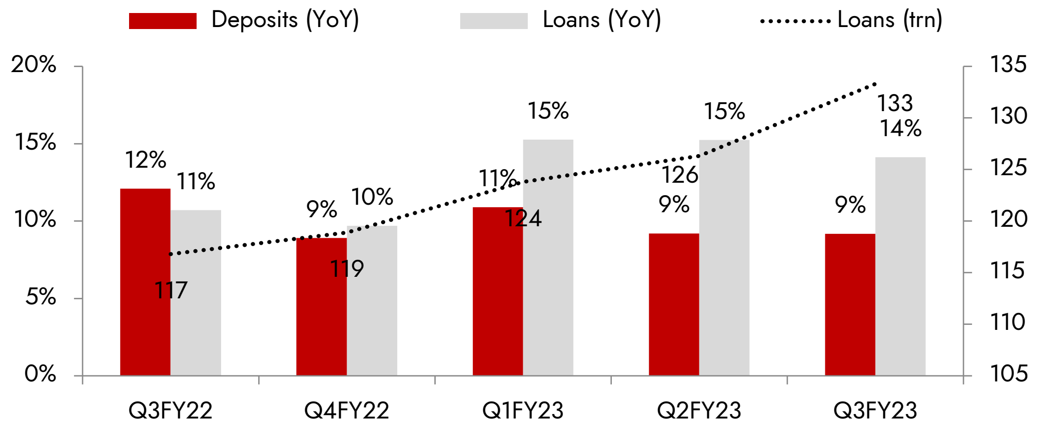
4. Financials:

BFSI sector is on the forefront again. Key highlights during the quarter:

- **Operating Performance:** Operationally strong quarter due to higher NII growth leading & better treasury gains resulting in strong operating profit for the sector. Opex is elevated for most of the banks at 15.6% YoY, higher for the private banks, mainly on account of higher disbursement of loans QoQ, higher spending on digital & branch expansion, and wage provisions especially at PSU banks end.

- **Advance growth:** further improved sequentially by 2-5% & was at 18.3% on a YoY basis. On a YoY basis, however, PSU Banks grew 18.6% YoY & Private sector banks grew 18.1% YoY. Affordable Housing finance companies continue showing healthy signs of AUM & disbursement growth. Credit to large Industries has also improved to 7% YoY. Retail loan growth at 20% YoY. Within the retail side, unsecured loans led by credit cards & PL continue to drive higher growth.

Exhibit 4: Consistent double digit loan growth maintained

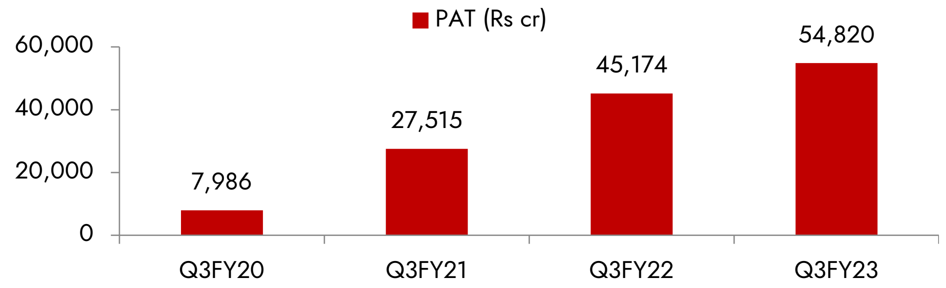


Source: RBI, Ambit Asset Management

- **Deposits growth:** 11% YoY deposit growth continues to lag advance growth during Q3FY23 leading to a higher CD ratio. CASA mix continues to deteriorate for most banks but the term deposits mix increased on account of higher rates. PSU banks stand with relatively lower CD ratios & hence better positioned on the liquidity front.

- **Profitability:** The banking sector reported healthy earnings growth, led by strong operating profit & declining provisions. RoE is reaching closer to long-term averages for larger banks.

Exhibit 5: NII growth aids margin expansion with moderation in slippages

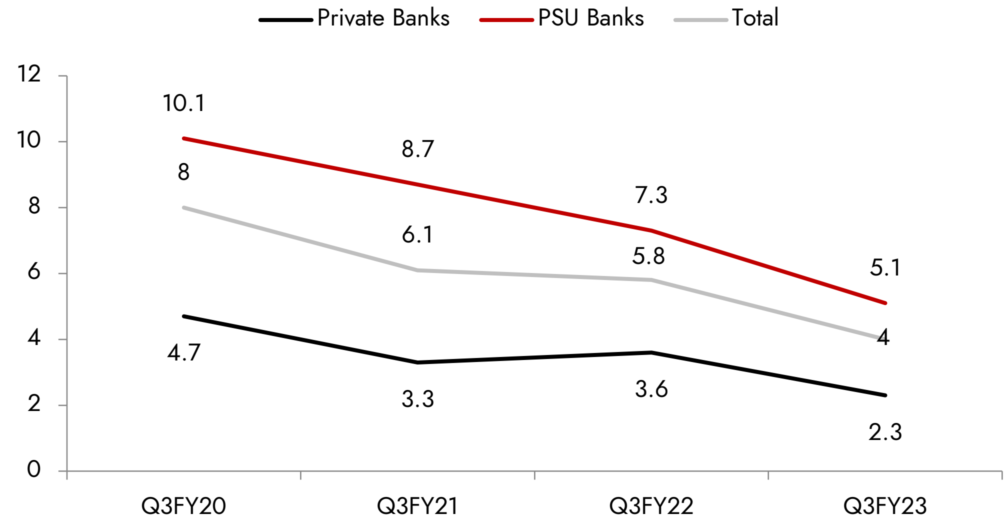


Source: Company, Ambit Asset Management

- **Margins**: NIM expanded for most of the players led by interest rate hike transmission, and banks expect the same to continue for the next 1-2 quarters. The cost of deposits increased at a slower pace. NBFCs margins have expanded sequentially for most, reflecting recent lending rate hikes.

- **Asset Quality:** Credit cost came at a multi-year low & there is further improvement in asset quality. GNPA at a 7-year low & NNPA at a 10-year low. Restructured advances improved sequentially from 1.4% to 1.2% in Q3FY23. Asset Quality for HFCs & NBFCs improved sequentially but remains sub-par to the banks.

Exhibit 6: Benign credit cost and consistent improvement in asset quality



Source: Company, Ambit Asset Management

Outlook: The incremental focus is on policy rate movements that will determine further lending rate hikes & consequent impact on demand. The risk of NIM contraction or weaker loan growth is gaining traction. Credit cost has hit the bottom, it will continue to be at a benign level as most banks have created adequate buffers in terms of PCR.

5. Pharmaceuticals / Healthcare:

Q3FY23 was a mixed quarter for healthcare companies. We highlight the main themes observed

- **Strong momentum in US generics:** US business of leading Indian exporters grew by a median of 22% YoY led by (1) Stabilizing price erosion in base business (2) Severe flu season (3) gRevlimid windfall. CY23 is expected to be a good year for US exporters on the back of easing price pressure, gRevlimid opportunity, and new launches.

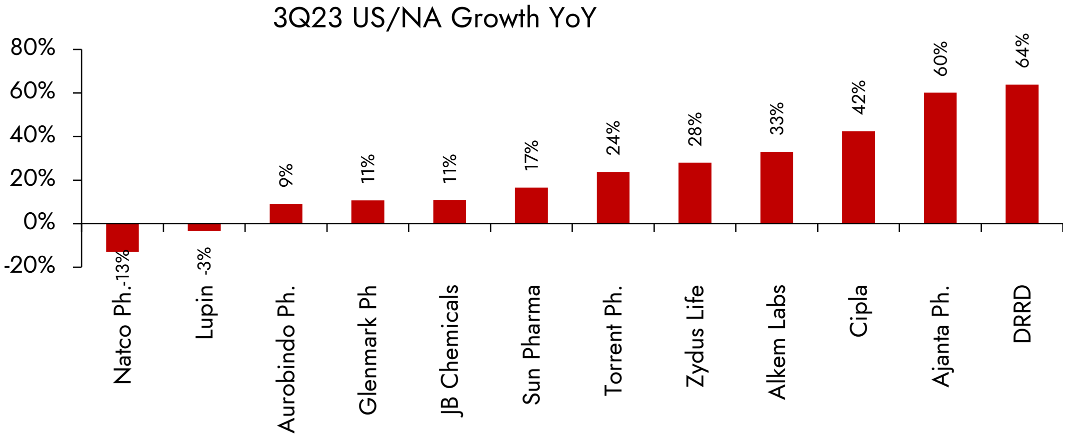
- **Steady recovery in API:** API sales of leading companies recovered from the lows of Q4FY22 and were up 13% YoY – however, still below the COVID peak seen in Q2FY21.

- **Weak CDMO business:** CRAMS/CDMO division of leading players – except Laurus Labs – saw a sharp decline YoY owing to the normalization of COVID product revenue. Longer term outlook for this segment however remains strong.

- **Normalizing India business:** India business sales for leading companies normalized from an erratic COVID base as patient footfalls returned to normal and acute therapies bounced back.

Outlook: Outlook for Indian Pharma seems positive on the back of easing input cost prices, stabilizing price erosion in the US, and resumption of Global ARV tenders. Resumption of client audits for CDMO players and encouraging client conversations lend confidence in a positive long term outlook and possible benefit from China +1.

Exhibit 7: Sharp uptick in US led by seasonality, gRevlimid contribution and stabilizing price erosion



Source: Company, Ambit Asset Management

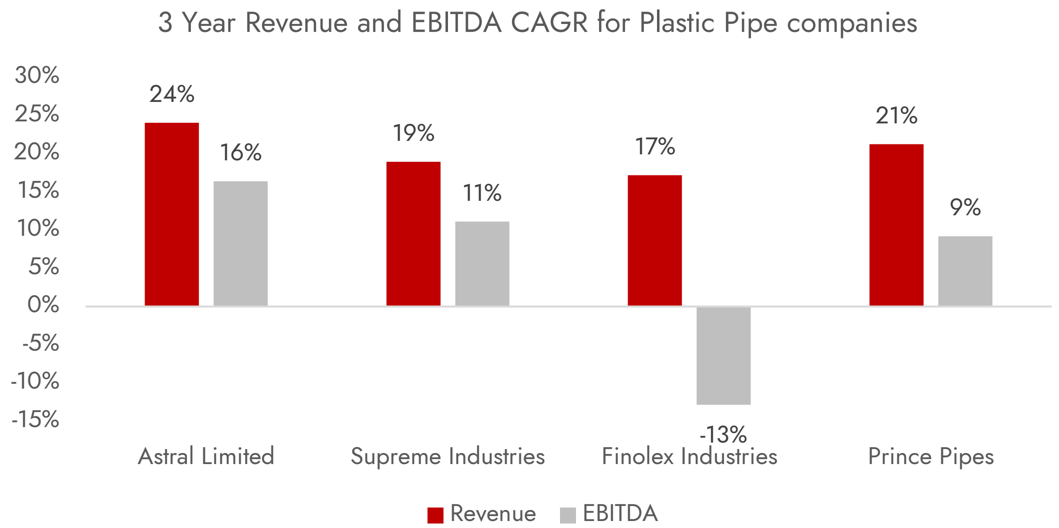
6. Building Material:

- **Key Sectorial trends:** Q3FY23 was a moderate quarter for building material companies. Demand scenario affected by a higher base and demand slowdown was seen in the larger basket of building materials – particularly in ceramics, paints and adhesives led by sharp price hikes, rural slowdown and a higher base. As highlighted in our December newsletter, festive demand was weakly led by an extended monsoon and a general slowdown in the economy. Green shoots were visible in plastic pipes and bath-ware space as demand remained robust (in line with our expectations – Refer December Newsletter), especially after a massive correction in PVC prices from the start of the Financial Year.

- **Delay in Margin recovery:** Margins were still below the normalized range for most players though we anticipate margins to recover sequentially with sharper margin recoveries seen in the Adhesives, Tiles and Pipes segment on account of lower input costs and waning off of inventory losses.

Outlook: Overall, we remain optimistic about building the material segment despite slight challenges both on growth and on the margin front and we anticipate a sequential recovery in profitability for a majority of our portfolio companies

Exhibit 8: Astral and Supreme continued to lead the 3 Year's Revenue and EBITDA growth due to the higher share of value added products



Source: Company, Ambit Asset Management

7. Chemicals:

Q3FY23 was a mixed quarter for chemical companies. We highlight the main themes observed

- **Muted performance:** The chemical industry continued to post a big contrast in operating performance with Agrochemical players reporting healthy numbers while other pockets faced several headwinds, primarily companies catering to end user segments in dyes and pigments. These headwinds are expected to subside by Q1 FY24.

- **Export** oriented Agro-chemical companies continued to scale up well on the exports front led by PI Industries. Challenges were seen in domestic businesses during the quarter owing to unseasonal rains however the outlook for Rabi remains optimistic.

- **Demand tailwinds remained robust** with most chemical companies in the capacity expansion or utilization of expanded capacity phase. Cool-off in several raw material prices and drop in shipping rates will also provide an impetus to margin improvement going forward.

Outlook: Our portfolio companies in the chemical space remain on track to deliver industry leading growth and we remain optimistic about the sector.

8. Information Technology:

- **Better than feared:** Seasonally weak quarter coupled with lower working days and higher furloughs implied -160bps QoQ lower CC growth for Tier-1 companies (2Q23: 3.8%; 3Q23: 2.2%). ER&D companies benefitted from strong.

- **Margin bounce-back:** Almost all leading companies – barring Infosys and LTIM – saw QoQ margin expansion on the back of easing attrition, lower sub-contracting costs and better utilization. This improving trend is expected to continue up till the wage increase cycle starting 1Q24

Outlook: Guidance for 4Q was muted, however better than expected. There are pockets of slowdown such as Retail, Mortgage and Capital markets. While deal wins for 3Q were moderate indicating some delay in decision making, the long-term Digital Transformation story remains intact. CY23 is expected to be a muted year YoY, however, most of that is currently priced in. Early indications on budgets of large banks signal 5-8% growth. 4Q management commentary around client budgets and the evolving macroeconomic situation will be the key trigger to watch out for. Expect polarized performance from companies in the near term

CONCLUSION:

This quarter witnessed (1) waning domestic consumer spending and fading post-pandemic pent-up demand (2) high costs of borrowing and sticky core inflation further raising the risk of interest rate hikes, and (3) a global slowdown weighing on export demand. However, we anticipate these headwinds to dissipate given (1) capex oriented budget, (2) healthy credit growth, and (3) an uptick in rural wages to revive rural consumption. The continued resilience shown by Indian Economy and Corporate India has stood out globally; with visible signs of '+1' benefits.

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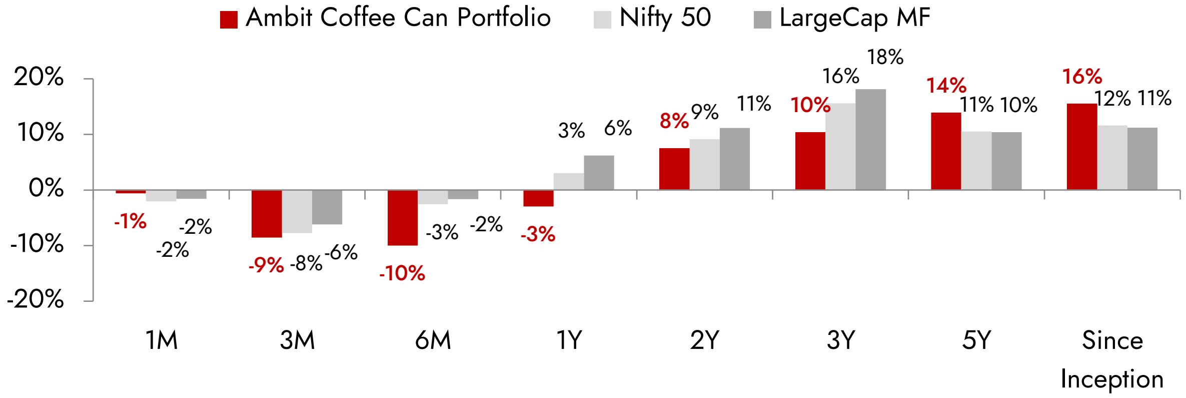
Ambit Coffee Can Portfolio

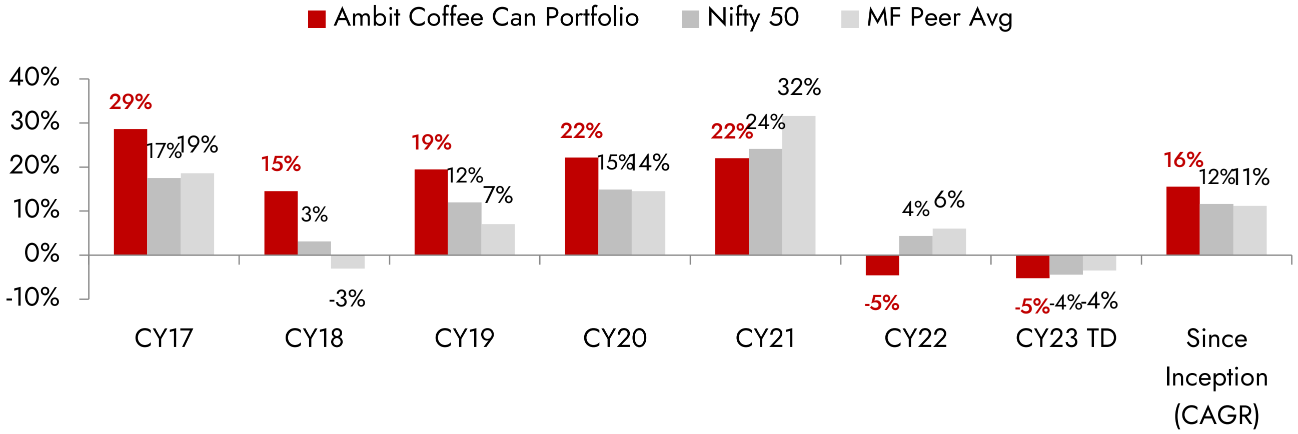
At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail and consumption-oriented sectors. The Coffee Can philosophy has an unwavering commitment to companies that have consistently sustained their competitive advantages in core businesses despite being faced with disruptions at regular intervals. As the industry evolves or is faced with disruptions, these competitive advantages enable such companies to grow their market shares and deliver long-term earnings growth.

Exhibit 9: Ambit's Coffee Can Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of February 28, 2023; 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 10: Ambit's Coffee Can Portfolio calendar year performance



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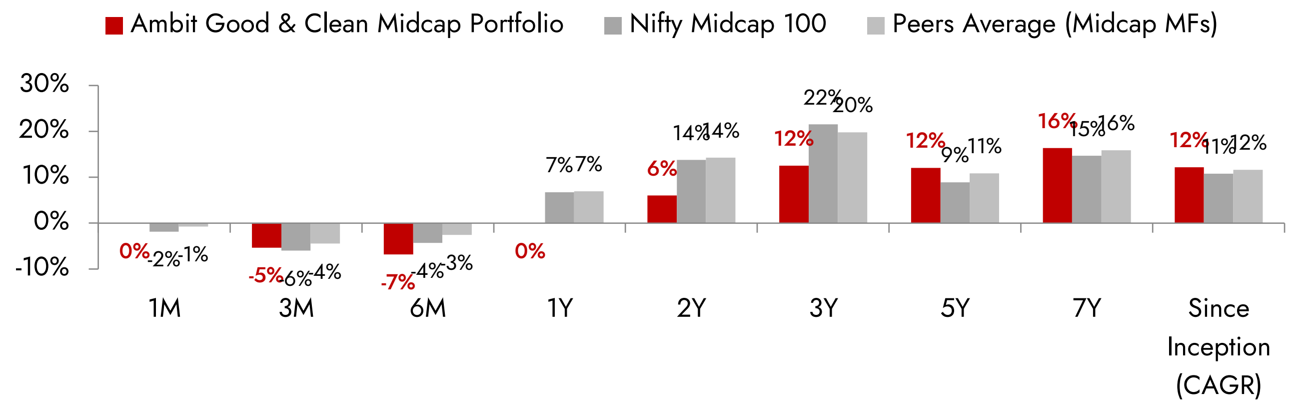
Ambit Good & Clean Midcap Portfolio

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:

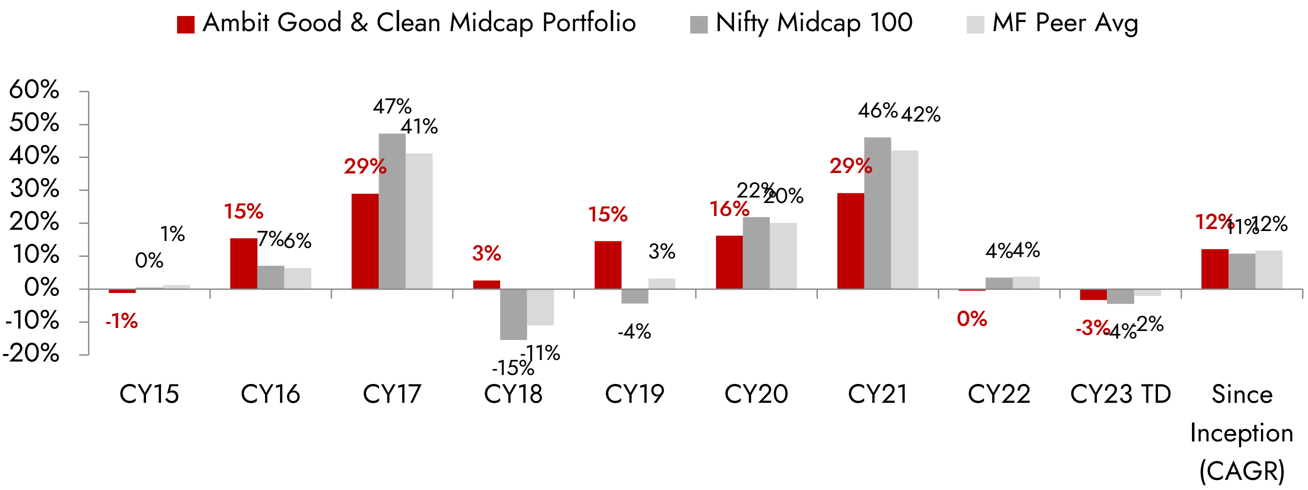
- **Process-oriented approach to investing:** Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated 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 these 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 11: Ambit's Good & Clean Midcap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of February 28, 2023; All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 12: Ambit's Good & Clean Midcap Portfolio calendar year performance

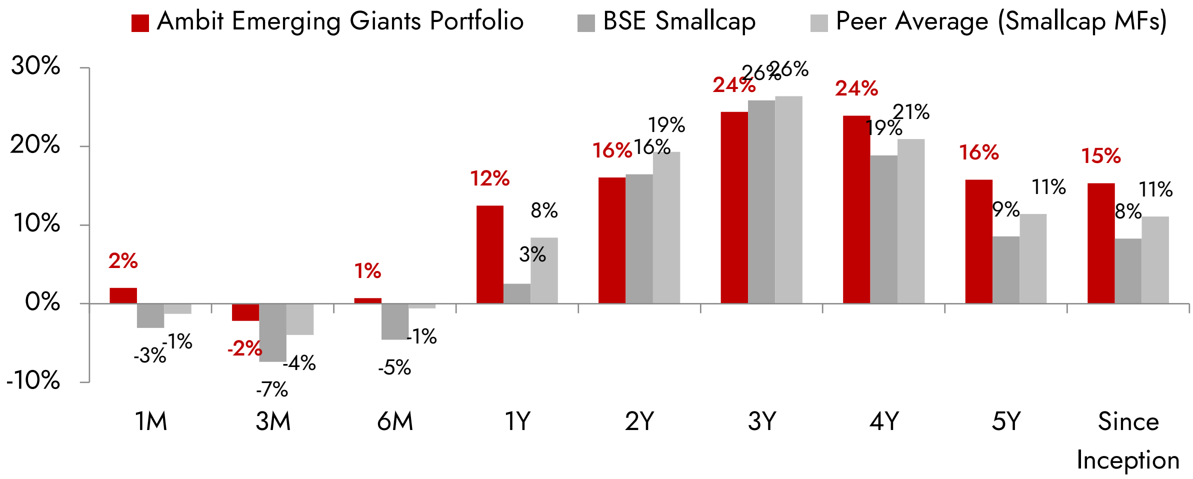


Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of February 28, 2023. Returns are net of all fees and expenses

Ambit Emerging Giants Portfolio

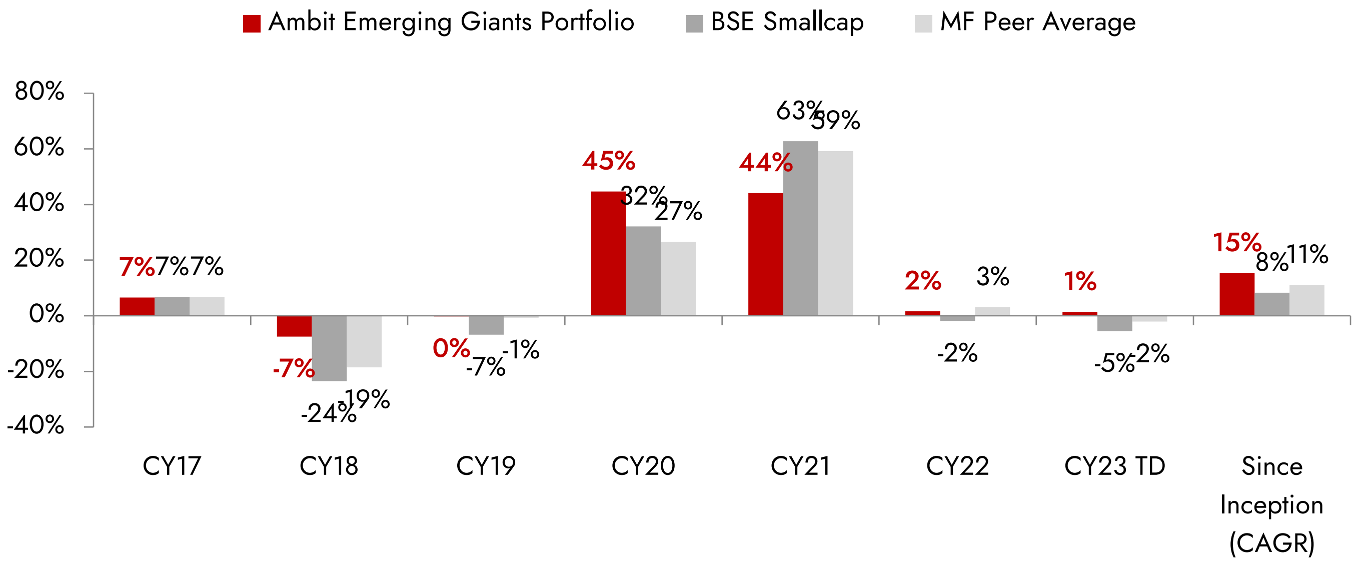
Small caps with secular growth, superior return ratios and no leverage – Ambit's Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than Rs4,000cr. These companies have excellent financial track records, superior underlying fundamentals (high RoCE, low debt), and the 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 13: Ambit Emerging Giants Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of February 28, 2023; All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 14: Ambit Emerging Giants Portfolio calendar year performance



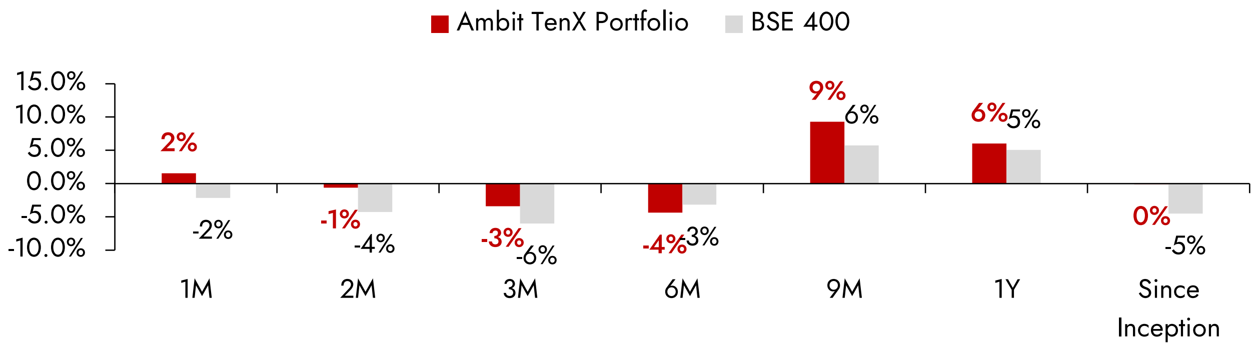
Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of February 28, 2023. Returns are net of all fees and expenses

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:

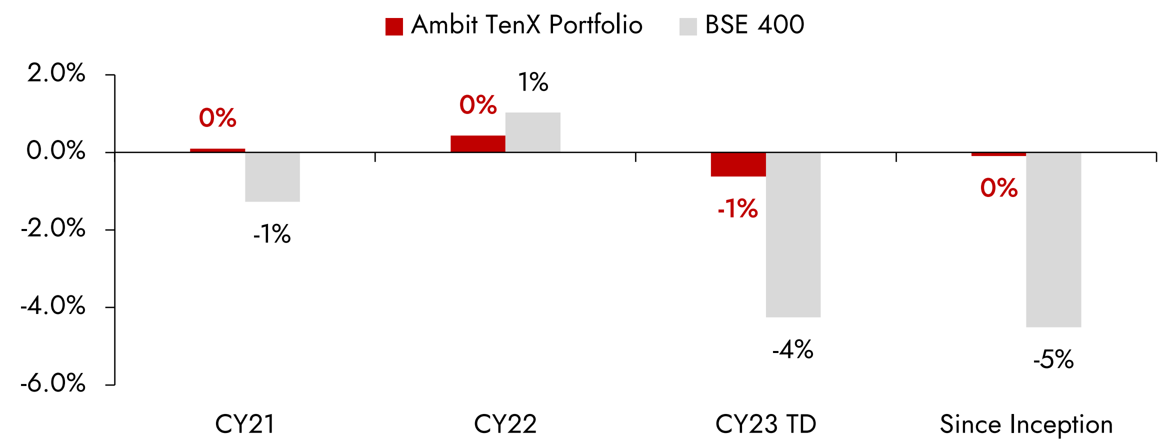
- **Longer-term approach with a concentrated portfolio:** Ideal investment duration of >5 years with 15-20 stocks.
- **Key driving factors:** Low penetration, strong leadership, light balance sheet
- **Forward-looking approach:** Relying less on historical performance and more on future potential while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

Exhibit 15: Ambit TenX Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of February 28, 2023; Returns are net of all fees and expenses

Exhibit 16: Ambit TenX Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of February 28, 2023. Returns are net of all fees and expenses

For any queries, please contact:
Umang Shah- Phone: +91 22 6623 3281, Email - aiapms@ambit.co

Ambit Investment Advisors Private Limited -
Ambit House, 449, Senapati Bapat Marg,
Lower Parel, Mumbai - 400 013

Risk Disclosure & Disclaimer