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Ambit
Asset Management

RURAL RECOVERY IN SIGHT

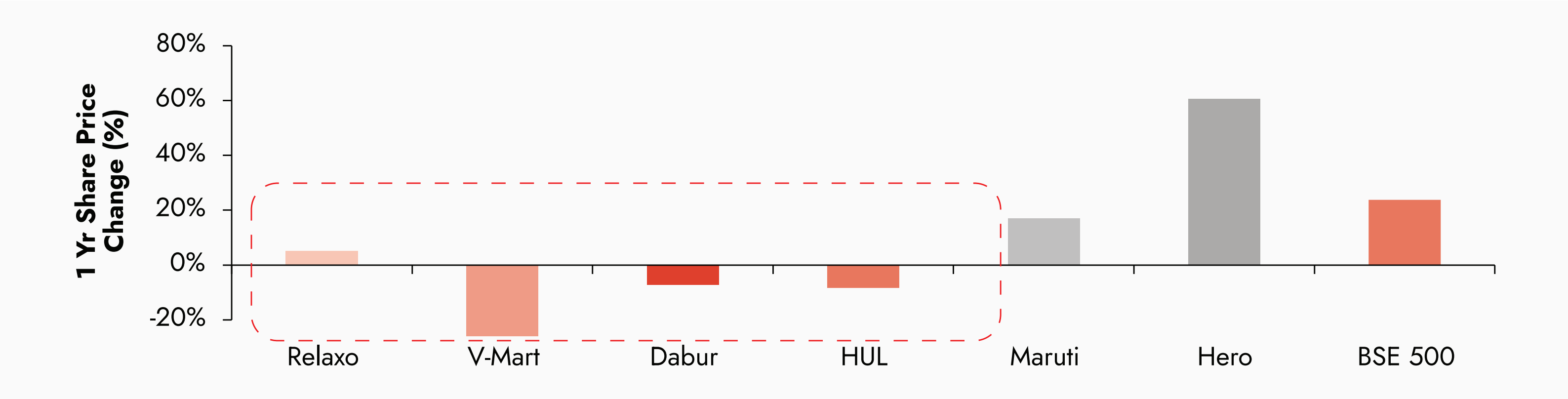
MONTHLY NEWSLETTER • FEBRUARY '24

Dear Patron,

Rural India, with its substantial population (accounting for ~64% of India's population and ~30% of GDP), is a key driver of the nation's economic development, particularly in agriculture, manufacturing, and services. The agricultural sector is integral to rural life. It not only ensures national food security but also supports the livelihoods of millions. Economic growth in rural India is vital for inclusive development, reducing urban-rural disparities, and fostering a balanced economy. Policies focusing on empowering rural communities, improving infrastructure, and promoting sustainability are essential for overall national prosperity and stability.

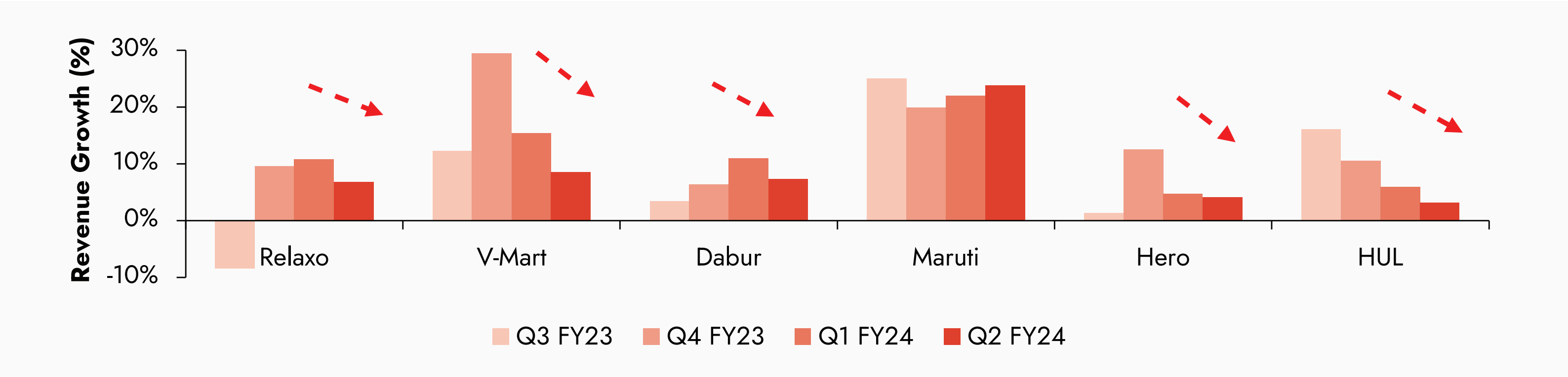
However, during the last few quarters, companies with a focus on the rural markets have been underperforming, in a year in which the BSE 500 index has shown an outstanding performance. In this note, we have studied the performances of some key companies including Relaxo, V-Mart, Dabur, Hindustan Unilever, Maruti, and Hero covering key segments including Retail, FMCG, and Auto respectively.

Exhibit 1: Share price performance has been muted for several companies with a predominant rural focus....



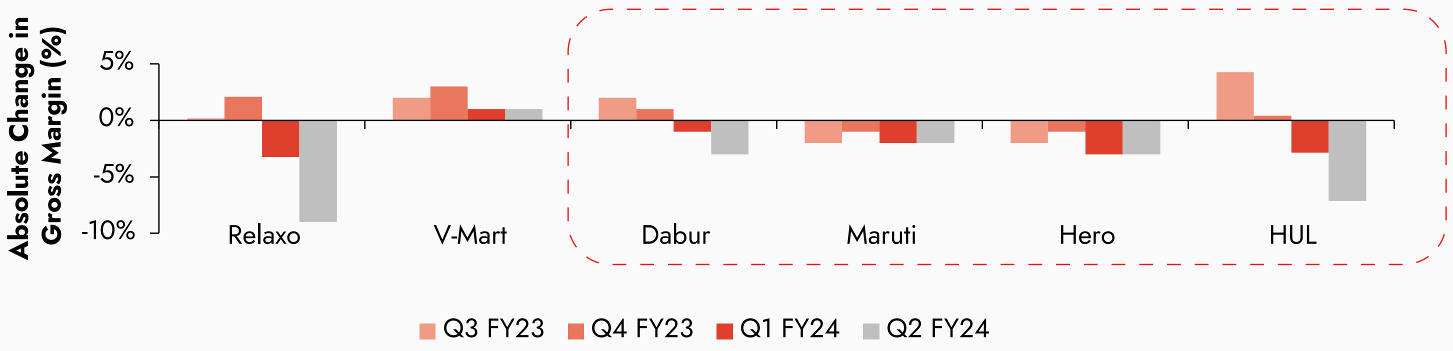
Source: Ambit Asset Management, Bloomberg

Exhibit 2: ...and rightly so given decelerating revenue growth on a YoY basis...



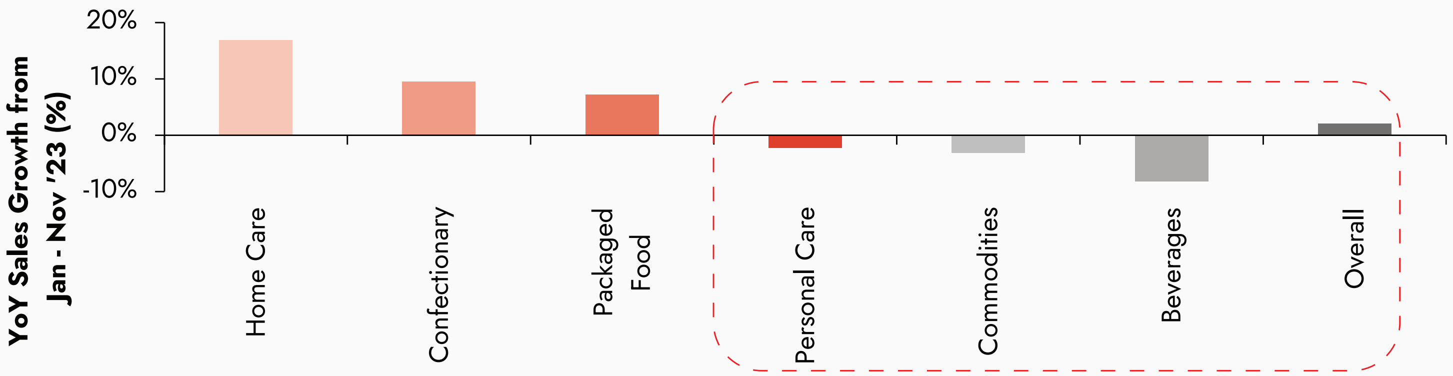
Source: Ambit Asset Management, Bloomberg

Exhibit 3: ...alongside declining gross Margin



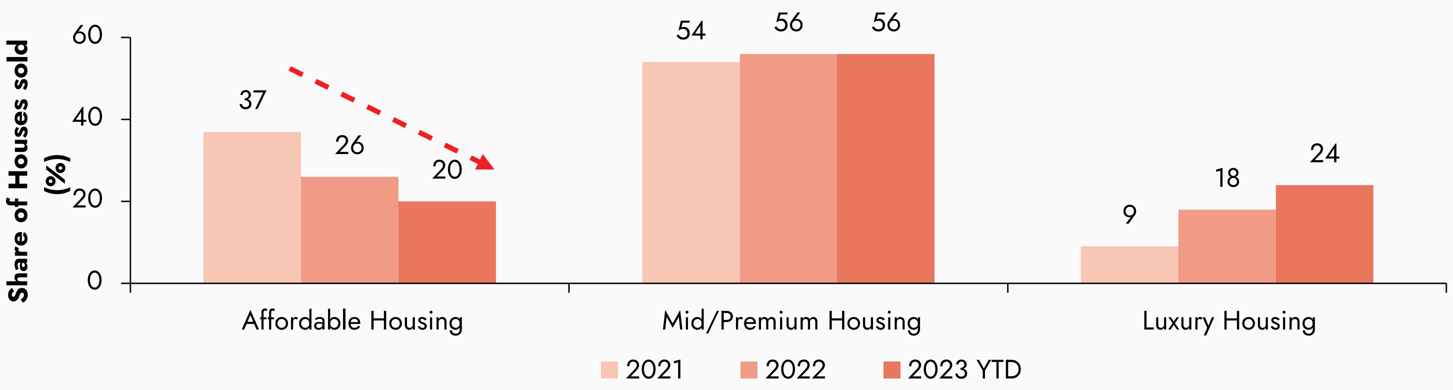
Source: Ambit Asset Management, Bloomberg

Exhibit 4: Sales growth for FMCG categories more focused towards the rural areas have been weak



Source: Ambit Asset Management, Kotak Institutional Equities

Exhibit 5: Affordable housing sales has been struggling while luxury housing has been booming



Source: Ambit Asset Management, Kotak Institutional Equities

In their recent transcripts from November 2023, these companies openly acknowledged higher inflation, uneven rainfall distribution and deficient monsoons as key factors for their prevailing underperformance.

Exhibit 6: Quotes from Q2FY24 earnings transcripts mentioning rural pressures

Company	Name	Comments
Relaxo	Gaurav Dua, Whole Time Director	"This year we were expecting that the industry will grow but last 6-7 months there's no sign of huge uptick in the markets because of again untimely rains, inflation pressure in rural India" "Sentiments are low particularly from rural markets, mass segment".
V-Mart	Lalit Agarwal, Managing Director	"There was a pain, which was existing for those consumers in the rural markets, in those consumers who actually either are from villages or are living in the small town. These consumers had challenges, and we have seen those challenges in the last 2, 3 years, especially after inflationary pressures."
Dabur	Mohit Malhotra, CEO	"While the macroeconomic indicators were showing an improving trend during the quarter, uneven distribution of rainfall and a deficient monsoon impacted rural consumption in quarter two".
HUL	Rohit Jawa, CEO and MD	"Rural demand remained subdued, with volumes continuing to decline marginally on a two-year basis."

Source: Ambit Asset Management, Bloomberg

Exhibit 7: News articles also seem to indicate slowdowns in the rural segment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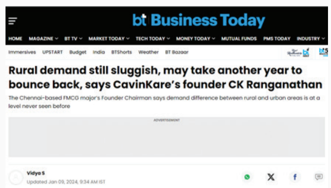
Rural economy sluggishness could impact growth PREMIUM

Updated - November 29, 2023 at 09:17 PM.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Rural demand still sluggish, may take another year to bounce back, says CavinKare's founder CK Ranganathan

The Chennai-based FMCG major's Founder Chairman says demand difference between rural and urban areas is at a level never seen before

Vidya S

Updated Jan 09, 2024, 9:34 AM IST


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Slow rural consumption over several quarters worries FMCGs

By Shuchi Bansal

Jan 19, 2024 09:54 AM IST

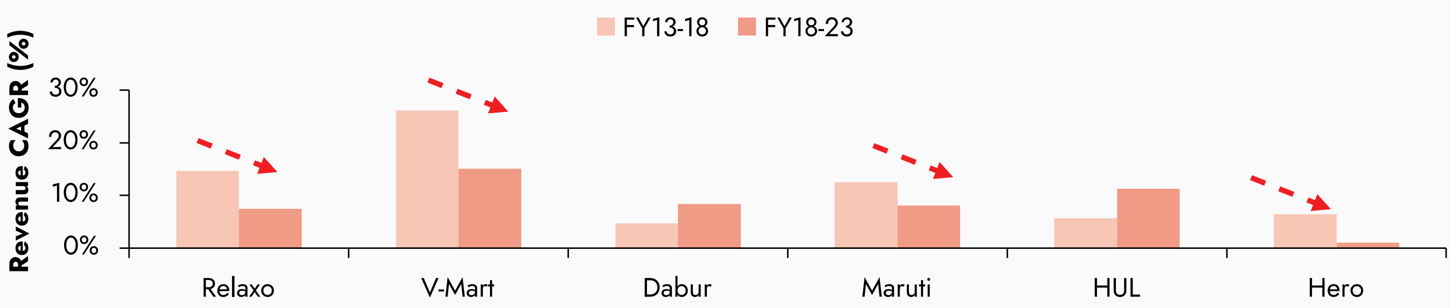
Live Updates

Source: Ambit Asset Management, Business Line, Business Today, Hindustan Times

It seems like a consensus theme that rural companies are struggling; share price underperformance, bearish commentary from companies, decelerating revenue growth and falling gross margins further corroborate this.

Taking a longer-term view and examining post COVID trends, it becomes evident that a majority of the above companies have seen revenue deceleration since COVID and not just the last 4 quarters. This raises a fundamental question: is there a prolonged weakness in the rural sector or are they losing market share?

Exhibit 8: FY18-23 Revenue CAGR has been lower than FY13-18



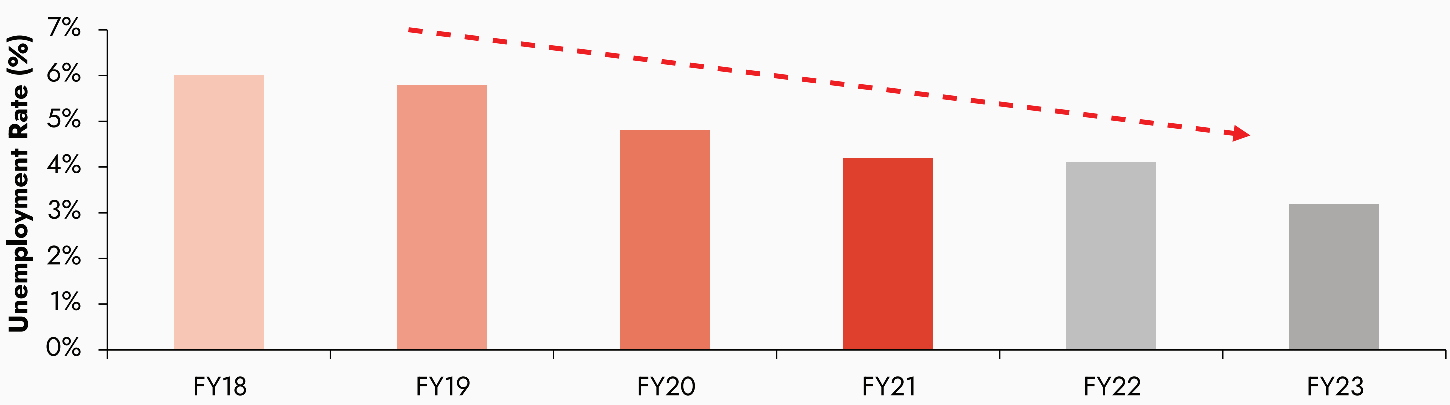
Source: Ambit Asset Management, Bloomberg

In the following section we attempt to provide you our perspective on what might have happened. Prior to arriving at this hypothesis we spoke to a few companies and sought insights from stakeholders like distributors, competitors and suppliers.

Is rural really that bad as highlighted by companies/media articles?

To validate the observed decline in the rural sector's performance, we conducted a comprehensive back-testing analysis, scrutinizing key indicators such as unemployment rates, food grain production figures, commodity price movements, and government support initiatives. Surprisingly, the evidence yielded a dichotomy, as the data pointed towards a relatively positive outlook in the rural sector.

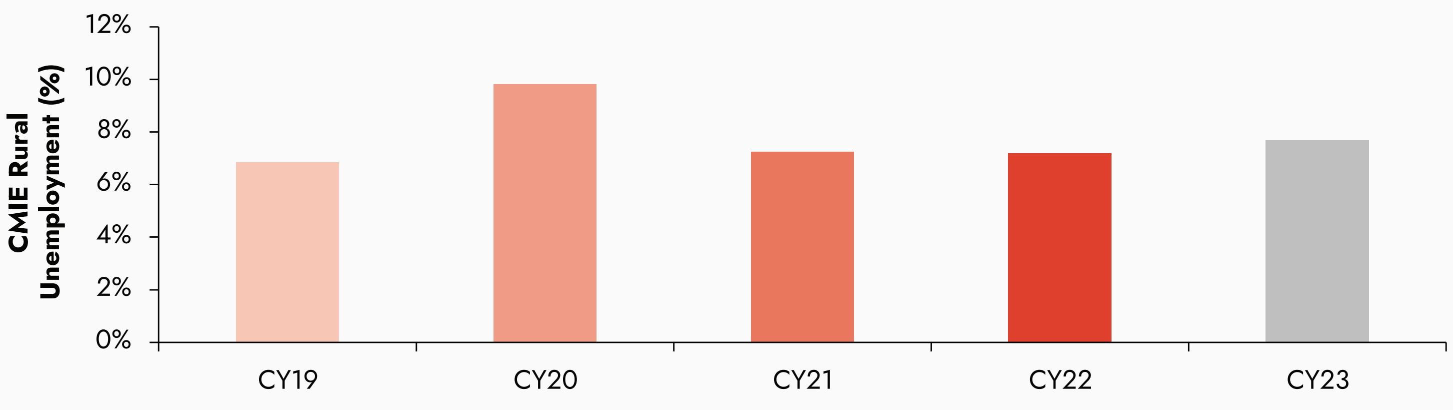
Exhibit 9: All-India Unemployment Rate has been steadily decreasing since FY18



Source: Ambit Asset Management, Media articles

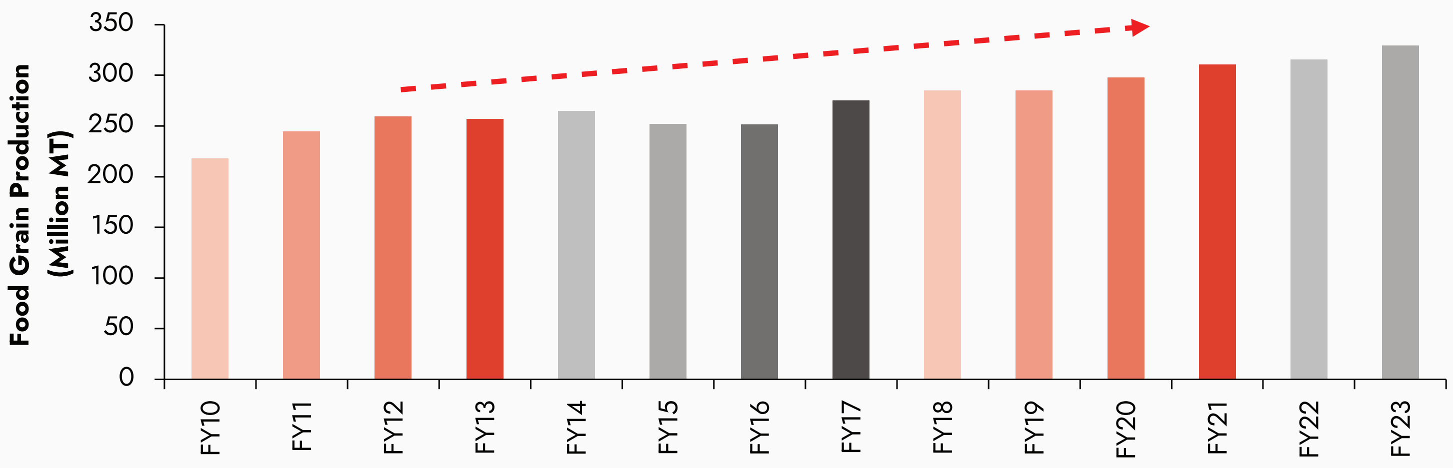
While the overall unemployment rate of India has dropped below pre-Covid levels on a pan-India basis, specifically, in rural regions, the unemployment rates have not worsened as compared to pre-COVID levels according to CMIE rural unemployment data. The Labour Force Participation Rate, which indicates the percentage of the working-age population either employed or actively seeking employment, has increased from 50.7% in FY18 to 60.8% in FY23 for rural regions. Worker Population Ratio, representing the percentage of employed individuals in the population, has also increased in rural India rising to 59.4% in FY23 from 48.1% in FY18.

Exhibit 10: Rural Unemployment has not worsened since Covid



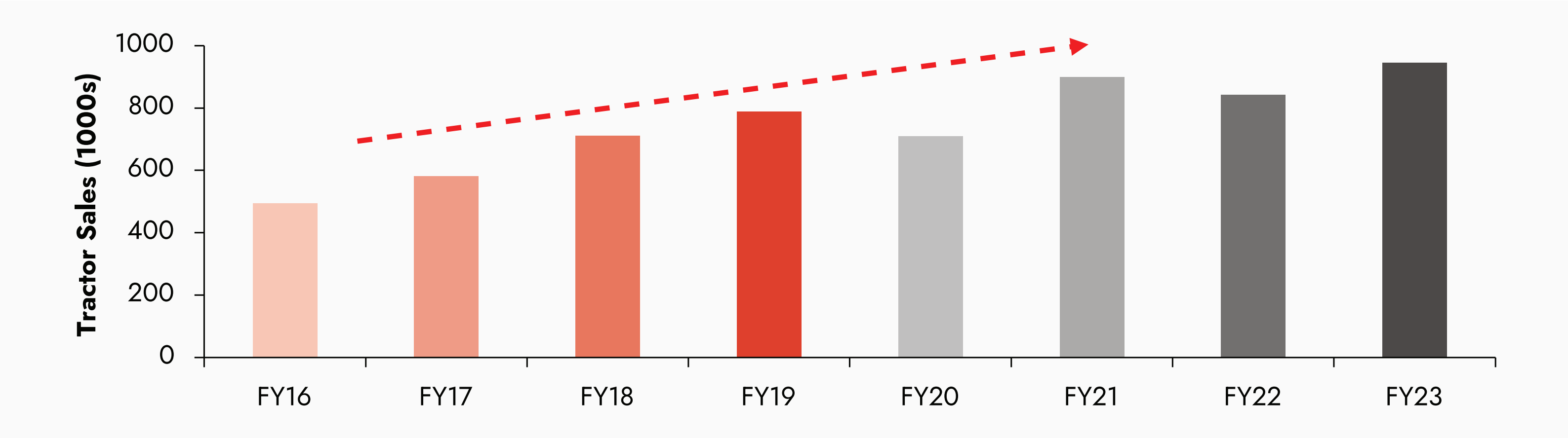
Source: Ambit Asset Management, IIFL Securities

Exhibit 11: Food Grain Production has been above pre-COVID levels....



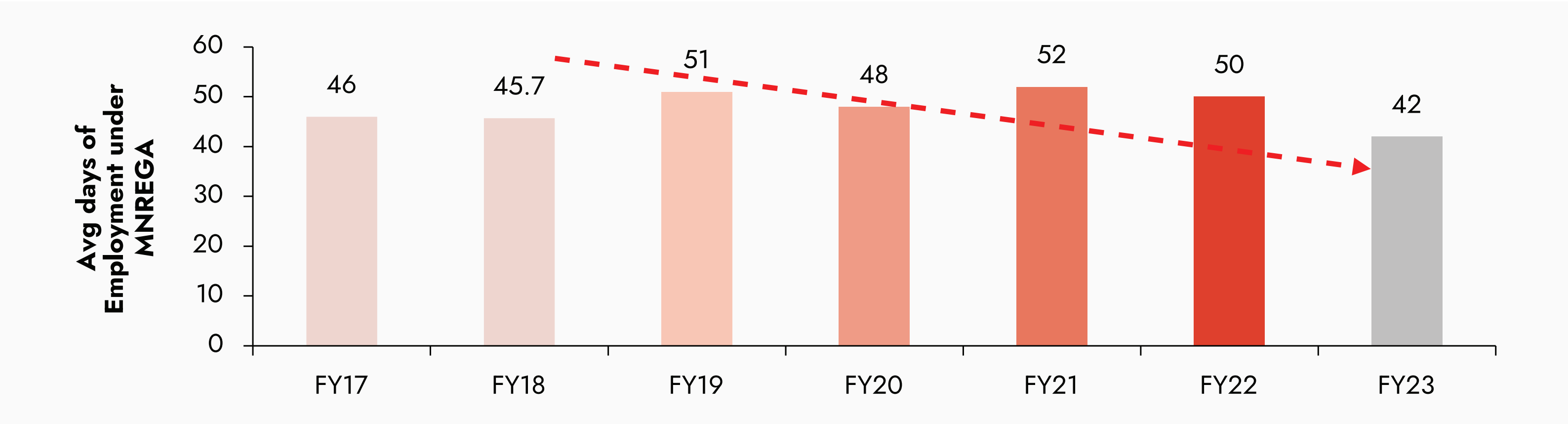
Source: Ambit Asset Management, Statista, Media articles

Exhibit 12: .... As have the tractor sales



Source: Ambit Asset Management, Media articles

Exhibit 13: MNREGA average employment days have fallen below pre-COVID levels



Source: Ambit Asset Management, Media articles

Food grain production has exceeded pre-COVID levels. as indicated by tractor sales surpassing pre-COVID levels in FY23. Also, the average number of days of employment provided per household under MNREGA in FY23 has fallen well below pre-COVID (42 days in FY23 vs 45.7/46 in FY18/FY17) levels as seen in Exhibit 13.

Contrary to concerns flagged by media articles and some companies, our analysis suggests that the rural economy is not under significant stress. So what has led to growth deceleration for these rural-focused companies and will they make a comeback?

Our checks hint at a mix of rising unorganised share + entry of organised players into adjacencies impacting sales of rural focused incumbents

- Rising share of the unorganised players: We believe that several consumption segments are witnessing a rising share of unorganised players. The typical tendency during an inflationary environment is to downtrade, a pattern affirmed through conversations with distributors across mass apparel, footwear, staples, innerwear, electricals. Subsequently when deflation started happening the unorganised were the first to cut prices given their low inventory levels relative to the organised players. Transcripts from several consumption companies also highlight this observation.

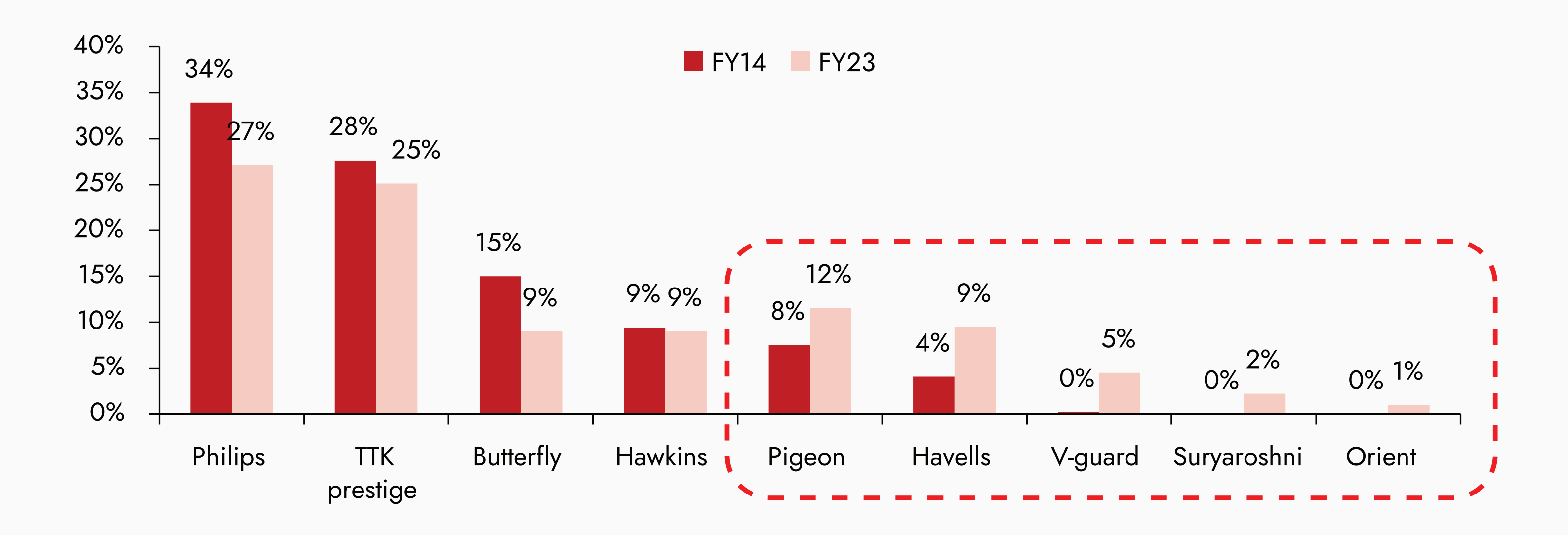
Exhibit 14: Rising share of unorganised has been highlighted by many companies in their 2QFY24 calls

Company	Name	Comments
HUL	Rohit Jawa, CEO	"FMCG market continues to witness heightened competitive intensity. As we spoke during June quarter results, we are seeing the resurgence of small and regional players in select categories and price-points, many of whom had vacated the market during the peak of inflation. For instance, when you look at Tea or Detergent bars, smaller players are growing significantly ahead of large players."
Relaxo	Gaurav Dua, Whole Time Director	"We have mentioned before that there are a lot of competitions, unorganized and organized have entered in this category. So, we are seeing like lot of discounts are being offered by unorganized and other players who have entered in the market. So, it's not going to be too easy to win this market."
Marico	Saugata Gupta, MD and CEO	"Amidst the current cost scenario, the sector also witnessed much more active participation from smaller local players in select mass categories."
Jyothy Labs	M.R. Jyothy, MD	"There has been a lot of intensity both from local, regional players and also some competition. I mean that has always been there, now it is a little more intense."
Berger Paints	Abhijit Roy, MD and CEO	"In certain parts (smaller players) have revived especially in certain products like water-thinnable primer or solvent-thinnable primers which is at the lower end of the spectrum. There is some amount of revival from these local players, but at the same time we have got competitive products now in this price range both in terms in the emulsion category and also even in the primer."

Source: Ambit Asset Management, Bloomberg

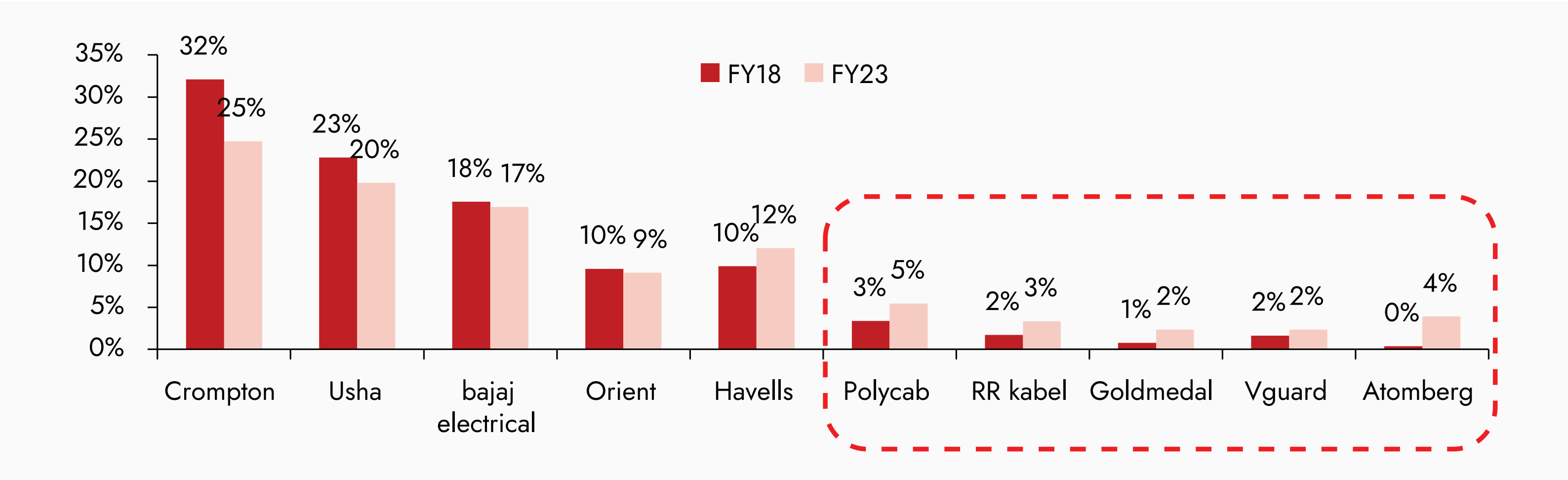
- Rising competition from organised players: Another observation from the trade is the increasing competition due to decisions taken by several companies to enter into new categories. This trend is evident across multiple categories like consumer durables, cables and wires, kitchen appliances, fans, apparel. Resultantly incumbents have faced challenges with many of these new entrants adopting distorted pricing strategies to make in-roads.

Exhibit 15: Kitchen and small domestic appliances market share



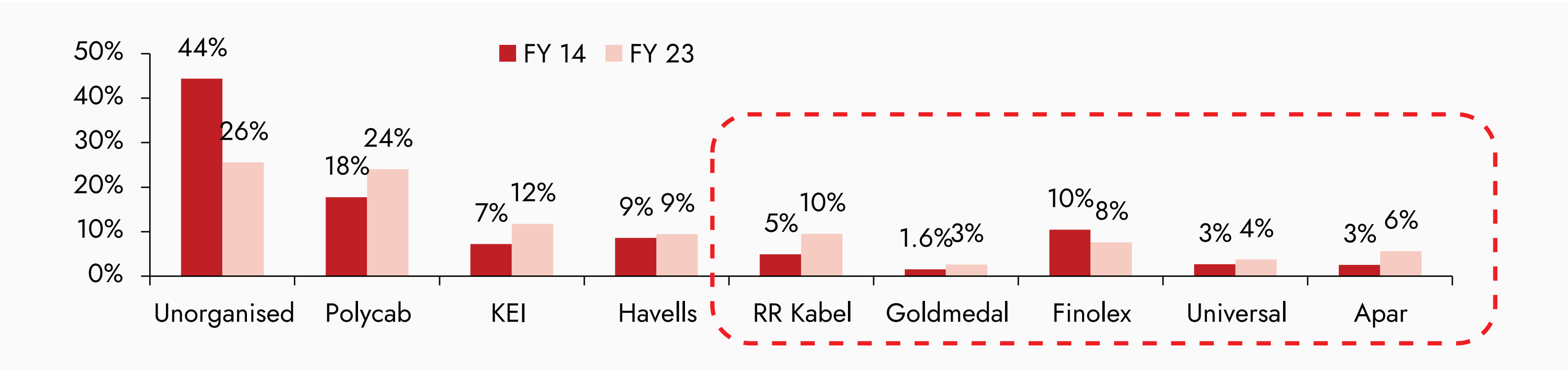
Source: Ambit Asset Management

Exhibit 16: Domestic fans industry market share



Source: Ambit Asset Management

Exhibit 17: Cables and wires industry market share



Source: Ambit Asset Management

So where do we go from here – We believe rural incumbents are staging a come back led by active retailiation

We are seeing signs of aggression across incumbents through increasing trade schemes, price reductions to pass on the benefit of colling raw material prices, and making sourcing more efficient to ensure optimised costing which also includes higher reliance on domestic sourcing vs sourcing from countries like China, Vietnam, Indonesia. Also, incumbents are working to streamline their working capital cycles, particularly foucssing on leaner inventories to ensure better ROCE and lower inventory losses/write-offs.

While this journey could exert some pressure on margins but market share will make a come-back which is the first sign of victory in a battle. Once the market share is regained, margins are likely to recover gradually, as competitive intensity starts receding from both unorganised players and new entrants.

Commentaries from companies in the 3QFY24 results highlight signs of volume recovery led by price cuts - a starting point of incumbents making a come back..

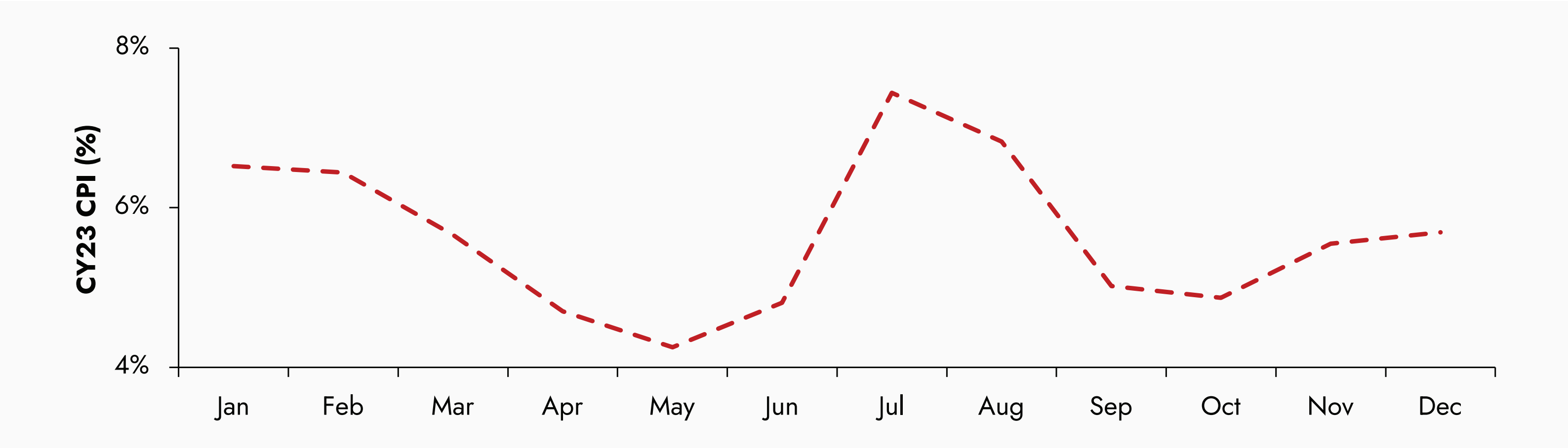
Exhibit 18: 3QFY24 earnings reports speaking of volume recoveries

Company	Name	Comments
Asian Paints	Amit Syngle, MD & CEO	"And when we look at the results for Q3 from a point of view of volume, the results are very strong. 12% volume growth and 5.5% value growth in the Decorative business."
Finolex Industries	Niraj Kedia, CFO	"Our overall sales volume, it's single digits, but our plumbing and sanitation sales in terms of volumes, they are upwards of 15%, even on a YTD basis".
JK Cement	Ajay Kumar Sarogi, Deputy MD and CFO	"The demand is also increasing. If you look at the base has gone, the incremental effective capacity increase is not more than the demand. So we really see that whatever is the incremental capacity that will get absorbed."
Pidilite	Company Presentation	"Both urban and rural markets grew with rural markets outpacing urban growth".
Ultratech	Atul Daga, ED and CFO	"We have already started seeing improvement in demand since the middle of December".

Source: Ambit Asset Management, Bloomberg

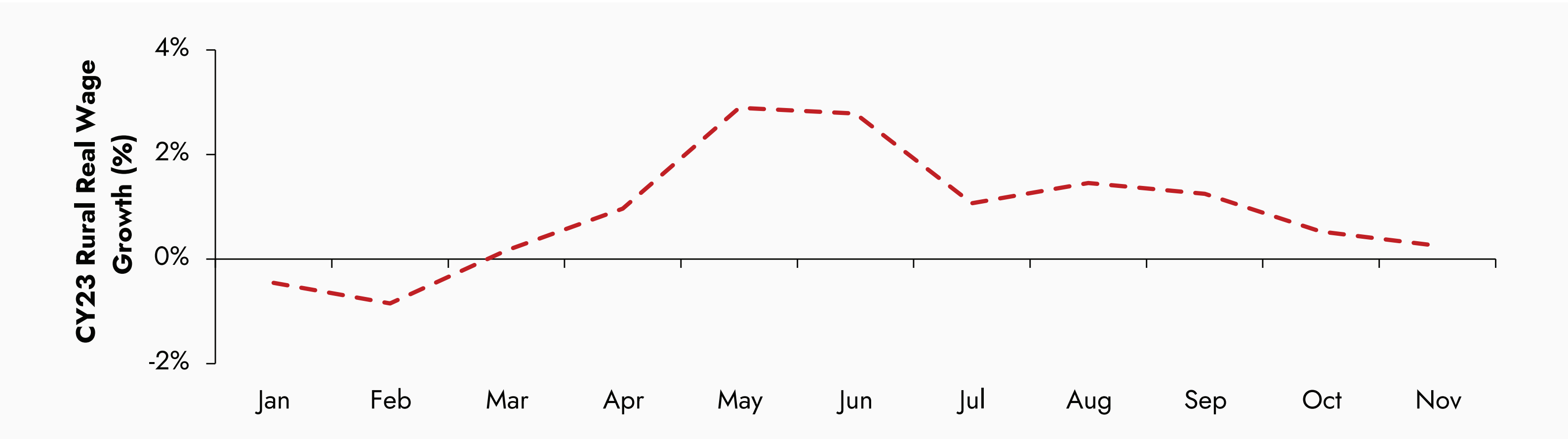
Lastly, inflation, which has been the main demand destructor in rural areas, appreas to be subsiding with total CPI and core CPI starting to show deceleration. Positive rural real wage growth also implies an uptick in the purchasing power of consumers, which will lead to demand generation eventually.

Exhibit 19: CPI started moderating in H2 CY23



Source: Ambit Asset Management, IIFL Securities

Exhibit 20: Rural real wage growth has been in the positive territory since Mar '23



Source: Ambit Asset Management, Ambit Capital

In an election year the Government often announces populist measures which lead to demand generation, especially among the masses. A thorough 15-year analysis by Goldman Sachs on pre-election budgets highlights a recurring pattern of heightened current expenditure, particularly allocated to rural spending and welfare schemes leading up to elections.

In FY19, welfare expenditure surged to 19% of total current expenditure, marking a substantial increase from the FY15-18 average of 8%. Similarly, in FY14, welfare spending experienced a slight uptick from the FY10-13 average of 8.5% to 8.7%. Noteworthy is the increase in rural spending from the FY05-FY08 average of 13% to 20% in FY09. This consistent emphasis on rural development signifies a key aspect of government priorities during crucial pre-election periods.

Themes to be played?

- 2 Wheeler companies:
  - ~55% of sales for 2 wheeler companies comes from rural areas.
  - 2-wheeler sales experienced decline at a CAGR of -3.1% until FY23 over FY20; in FY24TD they have recovered by 10% on a YoY basis but is still below pre-COVID levels.
  - 2-wheeler companies were also impacted by the third party bike insurance being made mandatory by law in FY19 and upgradation of emission norms to Bharat stage VI from April 2020 increased the cost of ownership (note 2-wheeler is a price sensitive segment);
  - We believe, over time, acceptance of this higher cost will lead to demand recovery.

- Mass apparel:
  - Mass retail companies like V-Mart and mass innerwear companies like Lux industries have seen deterioration in performance.
  - While V-Mart has seen a meagre 7.9% CAGR in EBITDA over FY20-23 vs 36.0% CAGR for FY17-20; Lux/Rupa/Dollar have seen -7.2%/-7.9%/-2.3% decline in EBITDA over FY20-23.
  - These companies were also impacted due to high inflation in cotton/yarn prices which has now moderated. Demand is expected to revive.

- Mass retail and consumer durables:
  - Mass retail and durable companies like D-Mart and Whirlpool witnessed sub-dued revenue growth and profitability over the last 3 years.
  - Whirlpool's EBITDA CAGR was -18.0% over FY20-23, while D-Mart showed a 19.9% revenue CAGR over FY20-23 versus a higher 27.9% CAGR over FY17-20.
  - Whirlpool has also realigned its incentive structure and launched several new models across categories to gain market share.
  - D-Mart continues to expand its footprint in North India. As its newer stores, opened in the last 3 years, start going through the gestation period, SSSG may start recovering.

- Mass footwear:
  - Mass footwear companies like Bata/Relaxo witnessed significant decline in profitability;
  - EBITDA CAGR over FY20-23 for Bata/Relaxo has been –1.7%/–6.2%.
  - GST increase in footwear priced below Rs1,000 MRP has also impacted these footwear companies due to the increased prices relative to unorganised players. However, now with the implementation of BIS, this anomaly will be addressed to a large extent.

AS SWIFT AS STABLE

Long term stability or agility in service?

What would you rather choose, when it comes to investing your hard-earned money?

With Ambit Asset Management, you won't have to.

While it uses its deep-dive research and disciplined approach to lend stability to your portfolio, its strong digital outreach ensures an agile and transparent service.

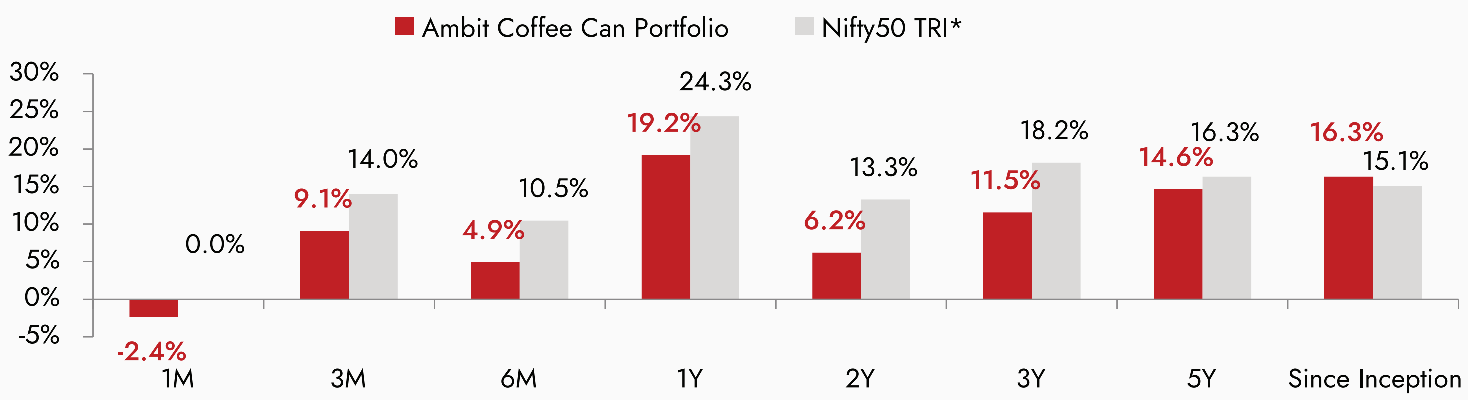
The result?

Consistent growth with an always-available service.

AMBIT COFFEE CAN PORTFOLIO

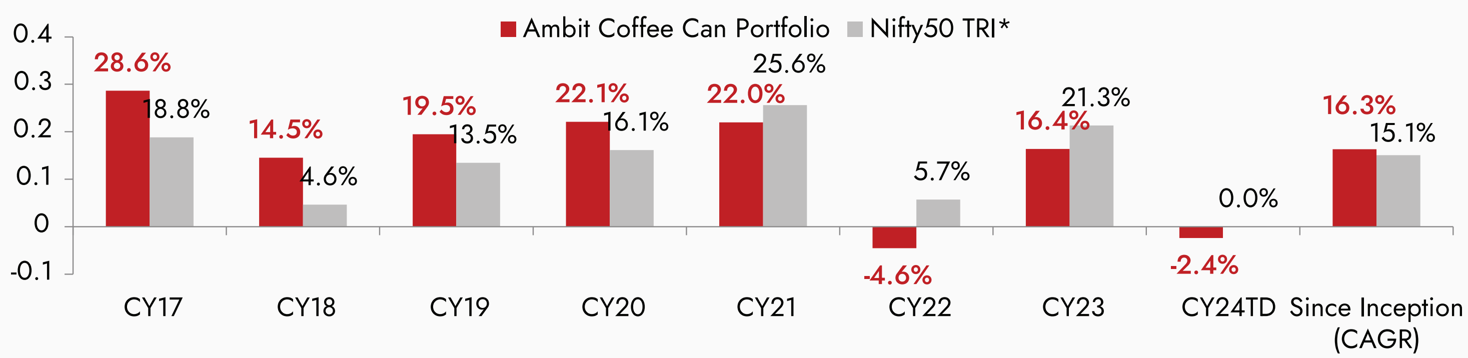
At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail and consumption-oriented sectors. The Coffee Can philosophy has an unwavering commitment to companies that have consistently sustained their competitive advantages 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 21: Ambit's Coffee Can Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of January 31st 2024; 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.
*Nifty 50 TRI is the selected benchmark for the Ambit Coffee Can Portfolio and the same is reported to SEBI.

Exhibit 22: Ambit's Coffee Can Portfolio calendar year performance



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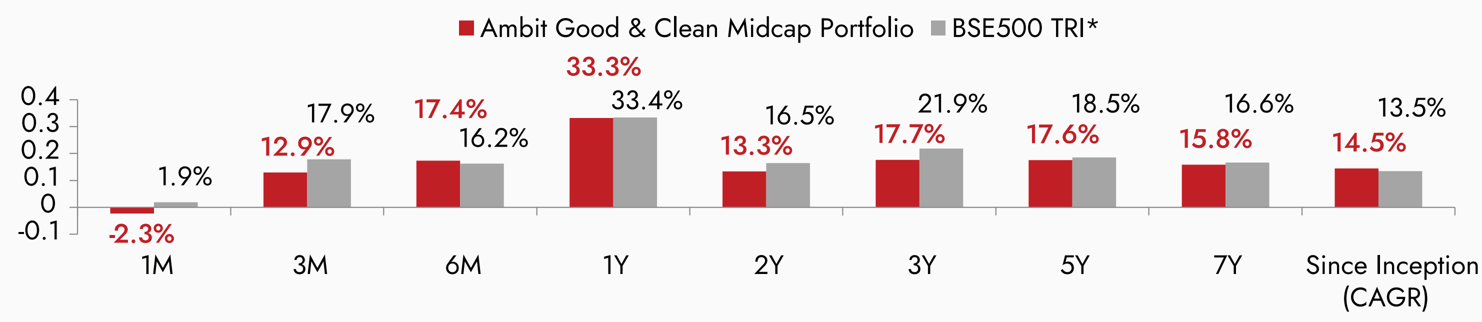
*Nifty 50 TRI is the selected benchmark for the Ambit Coffee Can Portfolio and the same is reported to SEBI.

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:

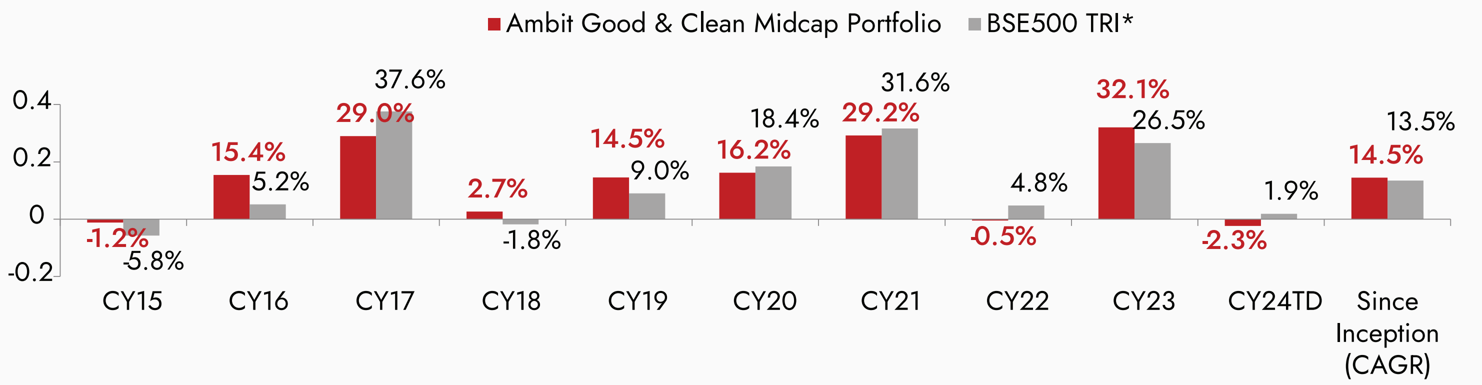
- Process-oriented approach to investing: Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated 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 23: Ambit's Good & Clean Midcap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of January 31st 2024; All returns above 1 year are annualized. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Good & Clean Midcap Portfolio and the same is reported to SEBI.

Exhibit 24: Ambit's Good & Clean Midcap Portfolio calendar year performance

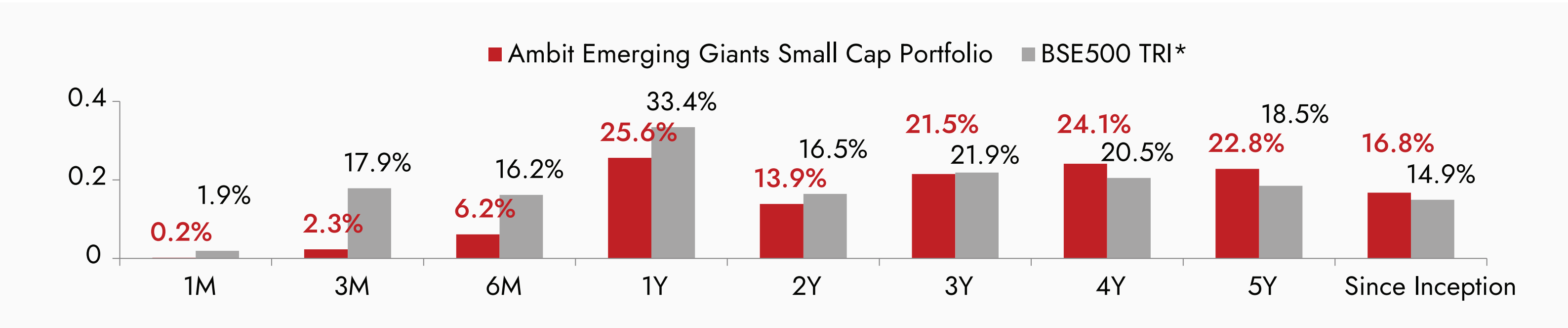


Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of January 31st 2024. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Good & Clean Midcap Portfolio and the same is reported to SEBI.

AMBIT EMERGING GIANTS SMALL CAP PORTFOLIO

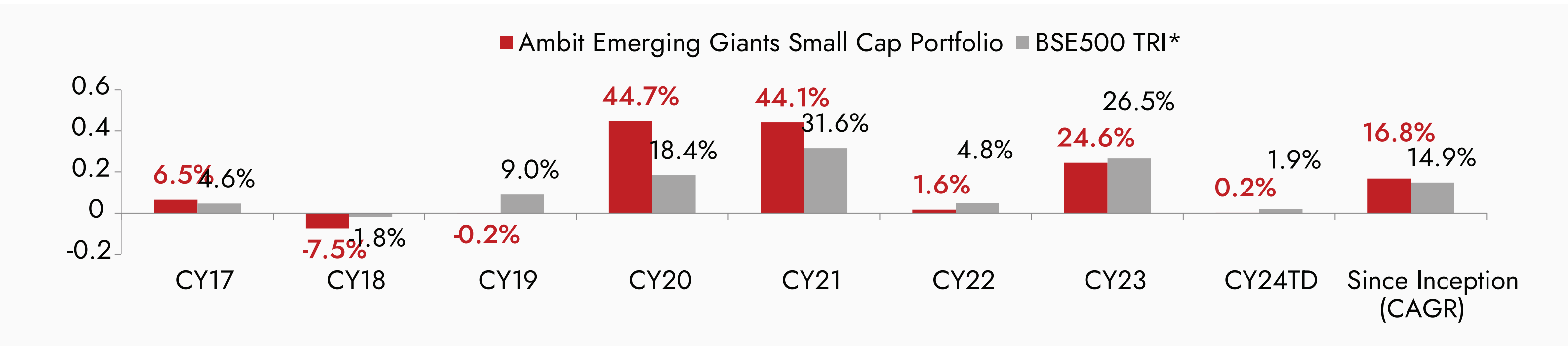
Small caps with secular growth, superior return ratios and no leverage – Ambit's Emerging Giants small cap Portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies 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 led us to a concentrated portfolio of 18-20 emerging giants.

Exhibit 25: Ambit Emerging Giants Small Cap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of January 31st 2024; All returns above 1 year are annualized. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Emerging Giants Small Cap Portfolio and the same is reported to SEBI.

Exhibit 26: Ambit Emerging Giants Small Cap Portfolio calendar year performance



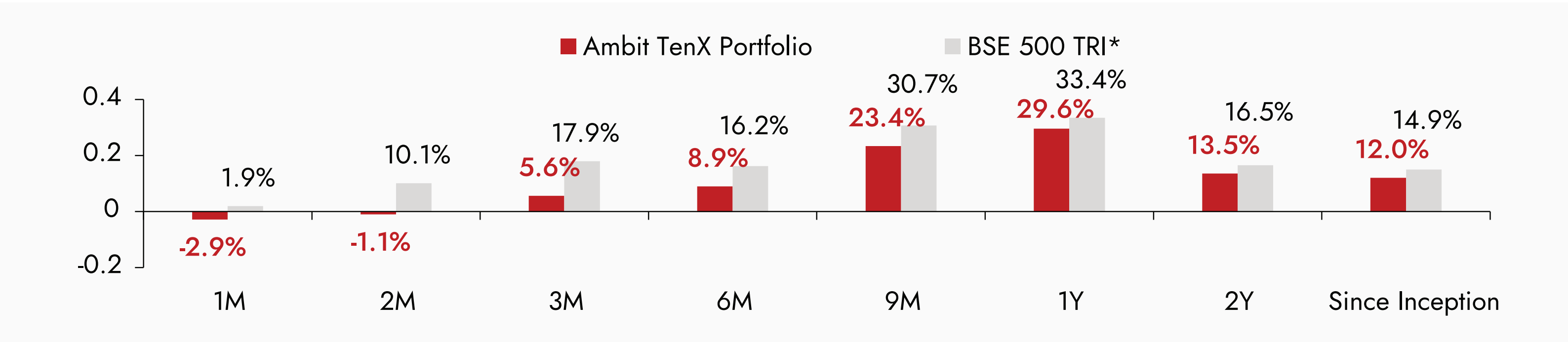
Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of January 31st 2024. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Emerging Giants Small Cap Portfolio and the same is reported to SEBI.

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 follows:

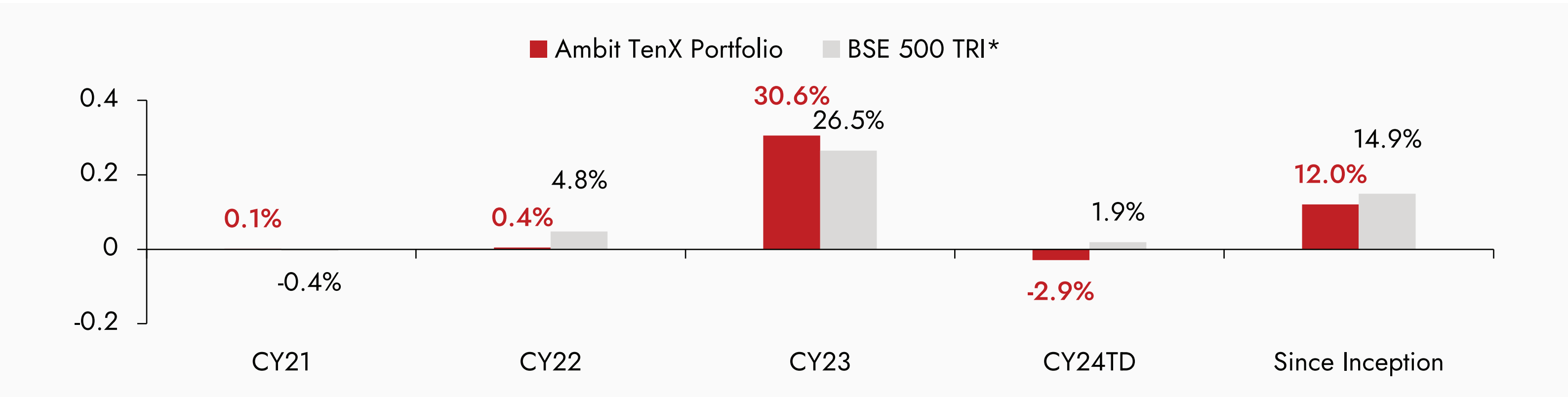
- Longer-term approach with a concentrated portfolio: Ideal investment duration of >5 years with 15-20 stocks.
- Key driving factors: Low penetration, strong leadership, light balance sheet
- Forward-looking approach: Relying less on historical performance and more on future potential while not deviating away from the Good & Clean philosophy.

Exhibit 27: Ambit TenX Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of January 31st 2024; Returns are net of all fees and expenses
*BSE 500 TRI is the selected benchmark for the Ambit TenX Portfolio and the same is reported to SEBI.

Exhibit 28: Ambit TenX Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of January 31st 2024. Returns are net of all fees and expenses
*BSE 500 TRI is the selected benchmark for the Ambit TenX Portfolio and the same is reported to SEBI.

For any queries, please contact:
Umang Shah - Phone: +91 22 6623 3281,
Email - aiapms@ambit.co
Registered Address: Ambit Investment Advisors Private Limited -
Ambit House, 449, Senapati Bapat Marg,
Lower Parel, Mumbai - 400 013

Corporate Address: Ambit Investment Advisors Private Limited -
2103/2104, 21st Floor, One Lodha Place,
Senapati Bapat Marg, Lower Parel, Mumbai - 400 013

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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

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