AMBIT
Acumen at work

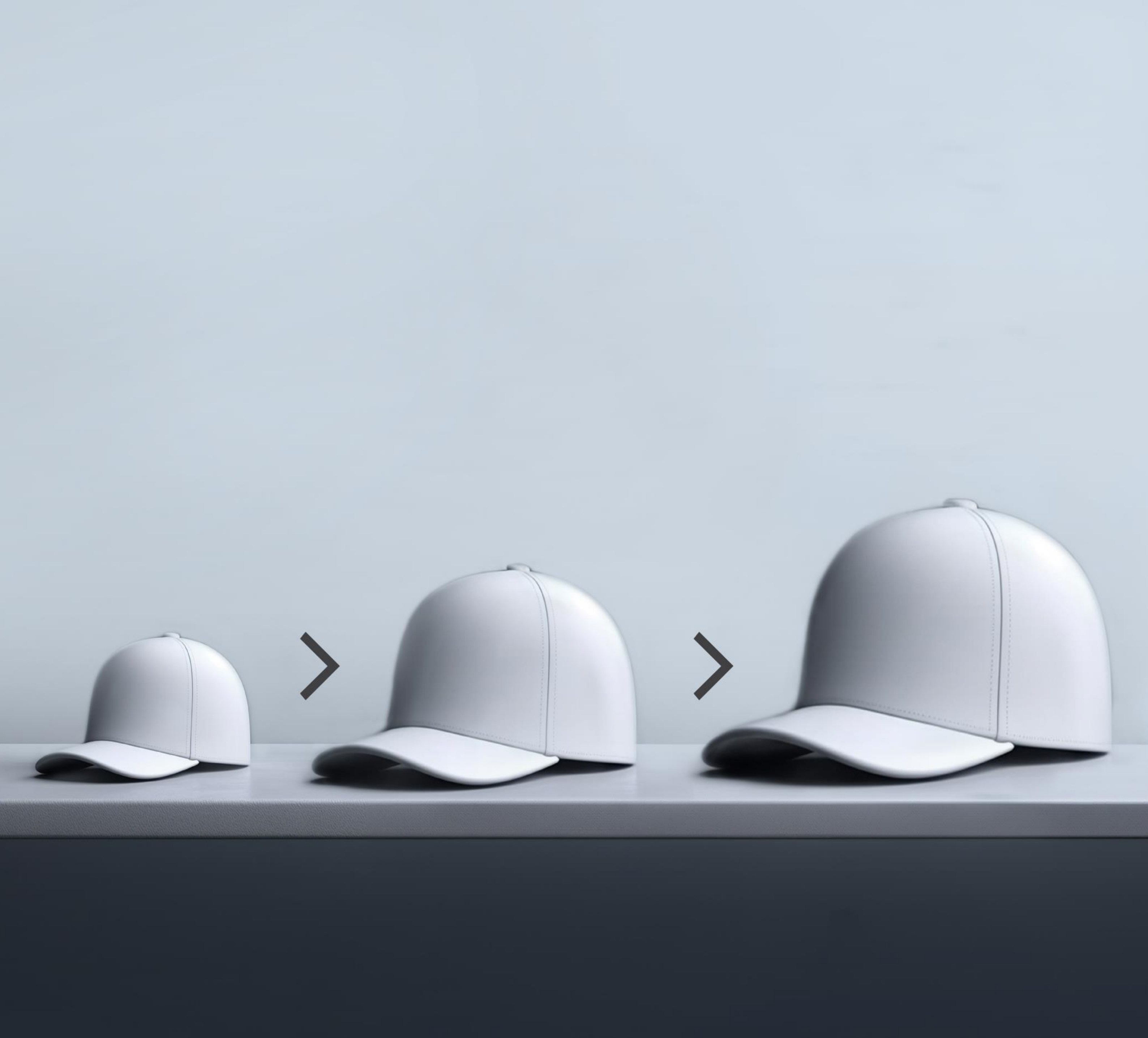
Ambit
Asset Management

MONTHLY NEWSLETTER

OCTOBER 2023

SMALL > MID > LARGE (CAP)

CHANGE OF HATS?



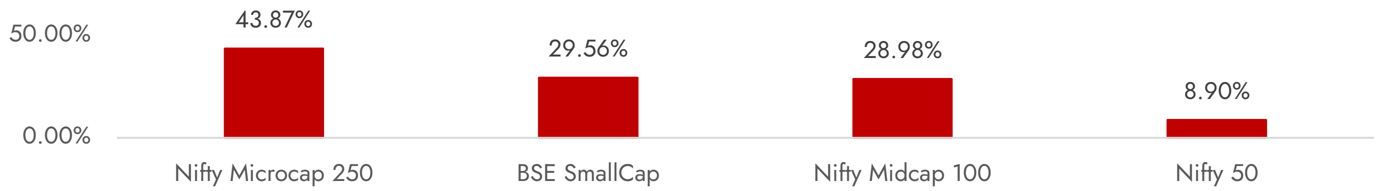
Dear Patron,

The first three quarters of the calendar year have been riveting for Indian equities to say the least.

Indian indices have performed well however there are divergent trends when you look at categories within Indian equities.

Small and mid-caps have taken centre stage and have materially outperformed the Large Caps led by a slew of liquidity and reinvigorated interest in the smaller companies. (Exhibit 1)

Exhibit 1 - YTD Returns



Source: Ambit Asset Management, Investing.com. YTD returns are till 27th September, 2023

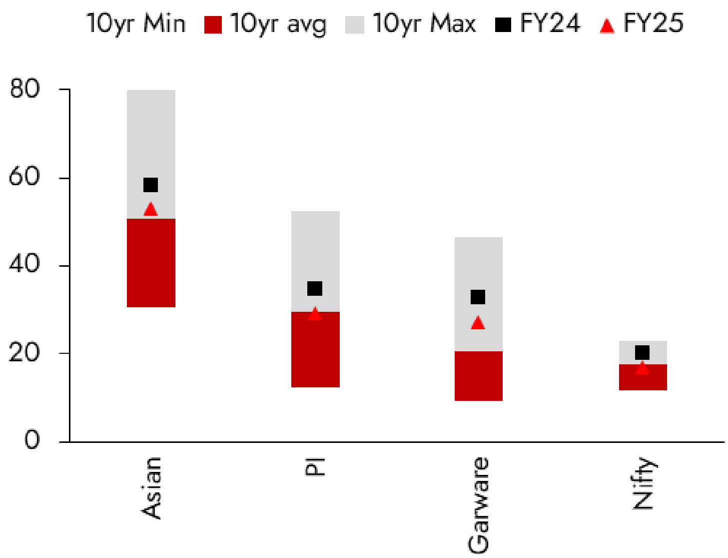
In our latest investor compass, we emphasized market euphoria, the rally in deeper detail, and the reasons for the rally - https://www.ambit.co/publication/199/Investor%20compass

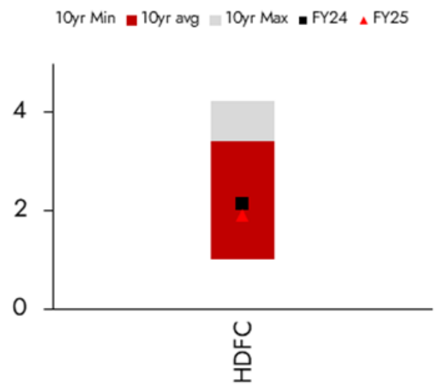
We try to understand the dichotomy between the returns amongst the categories and try to identify what set of companies will lead the next leg of the rally.

Valuations:

Despite markets closer to all-time highs, valuations have materially moderated from all-time highs in a lot of large caps and high-quality mid and small caps. (Exhibit 2)

Exhibit 2 – Forward PE / PB multiples for Nifty 50 and Portfolio companies





Source: Ambit Asset Management, Bloomberg consensus

We analyse reasons for valuation moderation for some of our portfolio companies, key risks and fears for companies, and whether we anticipate them to bounce back strongly.

Asian Paints:

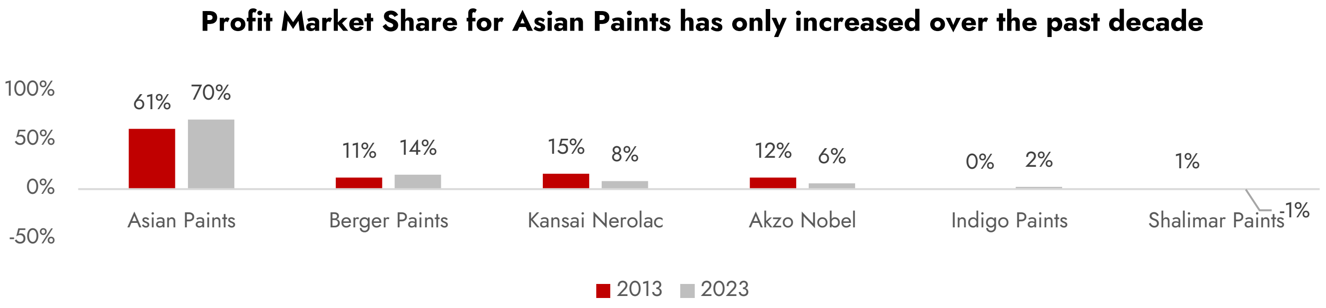
Asian Paints valuation has moderated materially (~85x 1 year forward PE to ~55x FY25E PE) owing to concerns over the sustainability of growth due to -

- Increase in competitive intensity in paints.
- Doubts over the ability to scale up adjacencies

Competitive Intensity:

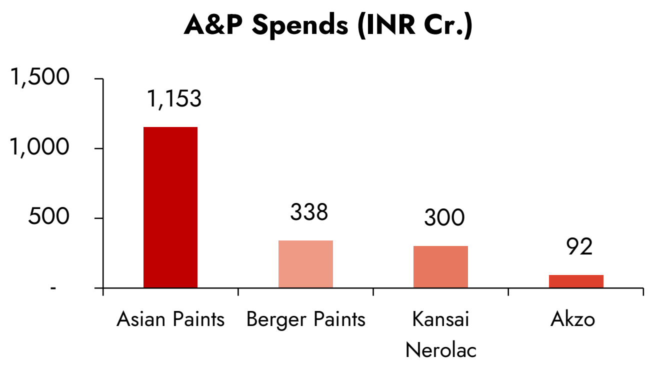
- Over the past 2 decades, MNCs and Indian companies have entered/ intensified - Sherwin Williams, Nippon Paints, Jotun Paints, Akzo Nobel, JSW, and Indigo Paints.
- Despite everything, Asian Paints market share has improved materially over the past decade and revenue and profit pool for newer entrants has been inconsequential. (Exhibit 3)
- Marketing and distribution are 2 important matrices in the paints segment – Asian Paints A&P spending is still substantially higher than all the other paint companies combined. Distribution of Asian Paints is unparalleled with dealers over 75000 and touchpoints over 1,50,000, with MBO's being the bulk of sales for the sector, it will be extremely difficult to gain market share from Asian Paints. (Exhibit 4)
- We acknowledge Grasim's entry, capital employed and anticipated capacity coming on board however, we believe risks to earnings will be faced more by other larger players.

Exhibit 3 – Increase in Profit Market share for Asian Paints

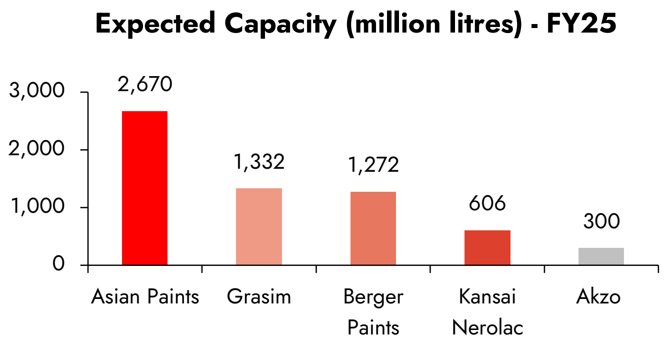


Source: Ambit Asset Management, Company

Exhibit 4 – A&P Spends for Asian Paints is higher than the entire industry combined while Capacity is also ~2x of the nearest competitor



Source: Ambit Asset Management, Company

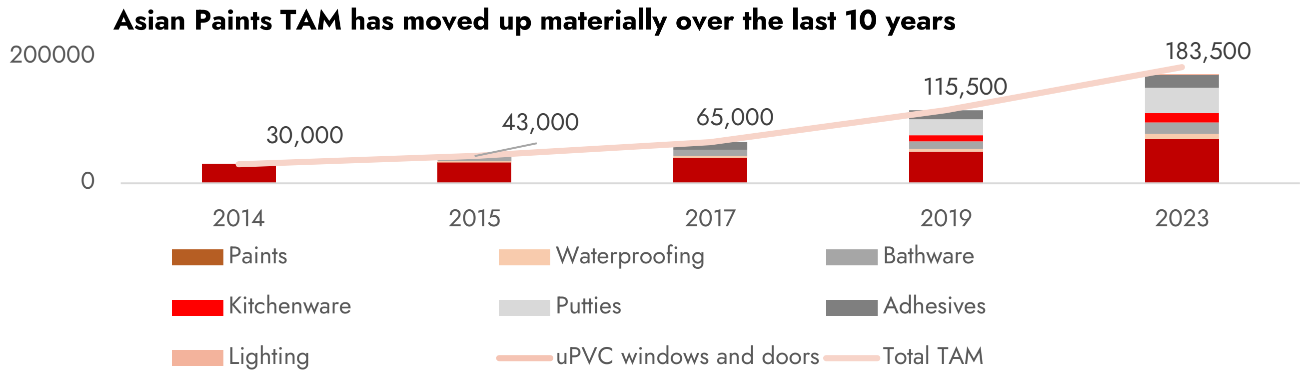


Source: Ambit Asset Management, Company

Doubts over the ability to scale up adjacencies:

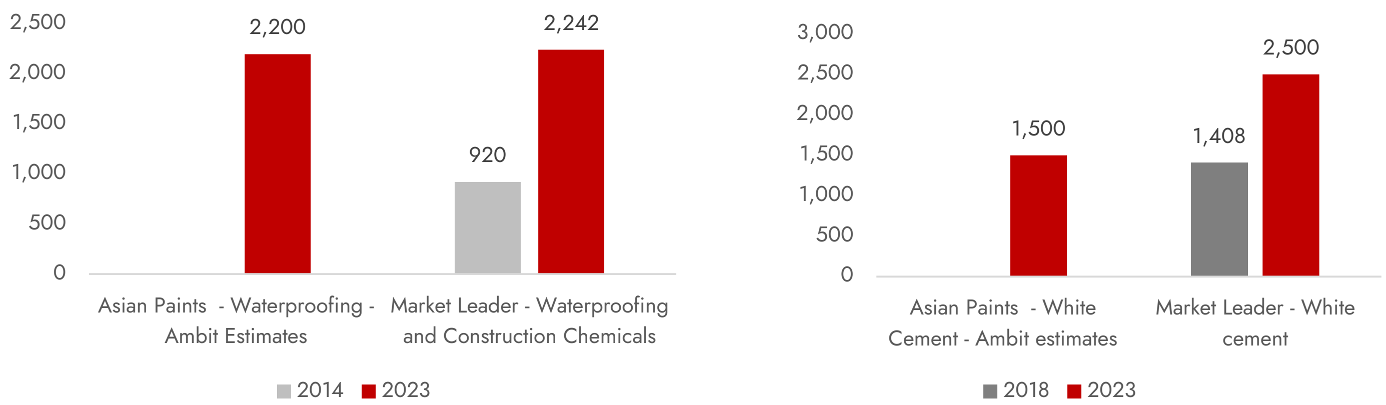
- There are doubts over Asian Paint's execution in non-core areas i.e. – Home improvement and other segments –
- However, the Estimated TAM for Asian Paints has expanded to closer to ~183,500 crores from ~30,000 crores a decade ago, with presence in newer segments having a TAM of <100,000 crores which is incrementally positive in our view. (Exhibit 5)
- Asian Paints' success in scaling up adjacencies in both waterproofing and white cement is proof of execution. (Exhibit 6)
- We anticipate similar success in growing categories and see Asian Paints as a home-building player in the future rather than a paints company.

Exhibit 5 – Increase in TAM for Asian Paints



Source: Ambit Asset Management, Company, Industry sources.

Exhibit 6 – Asian Paints execution in water-proofing and White Cement has been unmatched.



Source: Ambit Asset Management Estimates, Company. Numbers denote Revenue in crores

We anticipate seeing the full brunt of competition by Q1 FY25, and we anticipate Asian Paints to mitigate the competition and continue the growth trajectory post that. Near-term headwinds aside, we anticipate most fears of the market to be allayed by H1FY25 and the company to outperform in the next 12-18 months.

HDFC Bank:

HDFC Bank has moderated from peak valuations (4.2X 1 year forward P/B to 2.1x FY 25E forward P/B) owing to the following concerns:

- **The exit of CEO Aditya Puri** and technical glitches resulted in RBI restrictions on new credit card customers, causing the beginning of a decline in HDFC Bank's premium valuation.
- **Mega-merger:** The merger with HDFC Ltd., has raised concerns over valuation due to potential ROE suppression from additional regulatory requirements of SLR, CRR, PSL, etc. on a merged entity and other technical reasons relating to outflows technical factors.
- **Peers catch-up:** Most of the issues of growth, tech, and asset quality were addressed by both private peers and PSU Banks. Now competing strongly with the bank, unlike pre-covid times.

Exhibit 7 - HDFC Bank demonstrates solid loan growth, ROA, GNPA and ROE

Loan Growth (%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Axis	16.8	22.2	20.5	10.1	17.8	12.5	15.5	7.5	15.2	19.4
HDFC	26.4	20.6	27.1	19.4	18.7	24.5	21.3	14.0	20.8	16.9
ICICI	16.7	14.4	12.3	6.7	10.4	14.5	10.0	13.7	17.1	18.7
IndusInd	24.3	24.8	28.5	27.9	28.2	28.6	10.9	2.8	12.4	21.3
Kotak	9.4	24.8	79.4	14.7	24.7	21.2	6.8	1.8	21.3	17.9
Yes	18.4	35.8	30.0	34.7	53.9	18.7	(29.0)	(2.7)	8.5	10.9
System	14.1	8.0	9.5	9.0	10.2	13.4	6.1	5.0	9.7	15.1
Sys vs HDFC growth x	1.9	2.6	2.9	2.2	1.8	1.8	3.5	2.8	2.2	1.1

ROA (%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Axis	1.7	1.7	1.6	0.6	0.1	0.6	0.2	0.7	1.2	0.8
HDFC	1.9	1.9	1.9	1.9	1.8	1.8	1.9	1.9	1.9	1.9
ICICI	1.7	1.8	1.4	1.3	0.8	0.4	0.8	1.4	1.8	2.2
IndusInd	1.8	1.8	1.8	1.8	1.8	1.3	1.5	0.8	1.2	1.7
Kotak	2.1	2.3	1.8	1.9	2.0	2.0	2.1	2.2	2.4	2.6
Yes	1.6	1.6	1.7	1.8	1.6	0.5	(5.1)	(1.3)	0.4	0.2

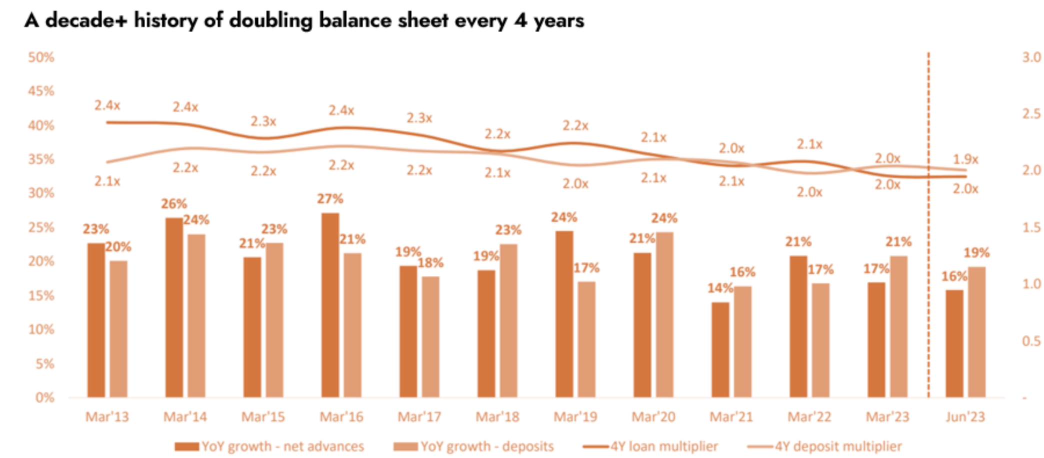
GNPA (%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Axis	1.4	1.4	1.7	5.2	6.8	5.3	4.5	3.6	2.6	1.8
HDFC	1.1	1.0	1.0	1.1	1.3	1.4	1.3	1.3	1.2	1.1
ICICI	3.0	3.8	5.8	8.8	9.9	7.4	6.0	5.3	3.8	3.0
IndusInd	1.1	0.8	0.9	0.9	1.2	2.1	2.5	2.7	2.3	2.0
Kotak	1.5	2.0	1.5	2.4	2.6	2.2	2.1	2.3	3.3	2.3
Yes	0.3	0.4	0.8	1.5	1.3	3.2	16.8	15.4	13.9	1.8
System	3.6	4.2	7.6	9.3	11.5	9.2	8.2	5.4	5.9	3.9

ROE (%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Axis	17.4	17.8	16.8	6.4	0.8	7.2	2.2	7.1	12.0	8.0
HDFC	20.7	18.9	17.8	18.3	18.6	16.8	16.4	16.6	16.7	17.0
ICICI	14.0	14.5	11.6	10.8	6.9	3.3	7.3	12.6	15.0	17.7
IndusInd	17.5	19.0	16.6	15.4	16.9	13.4	14.6	7.3	10.2	14.6
Kotak	14.4	14.8	12.5	13.8	13.9	13.3	13.7	13.1	12.5	12.7
Yes	25.0	21.3	19.9	18.9	18.2	6.7	(68.6)	(12.6)	0.1	2.0

Source: Ambit Asset Management, Company

- HDFC Bank has remained a leader and benchmark in terms of product innovation, growth and asset quality.
- Given the sharp run in small-size banks and PSU banks (now trading at above mean valuations), HDFC bank would become safe heaven once the flight to safety starts happening in other investment segments.
- Given ROE of 16-17% and growth of 17-19% (Exhibit 8), we see HDFC Bank as a fundamentally strong bank with limited potential of de-rating from current levels.

Exhibit 8 - HDFC Bank historical track record has been unparalleled

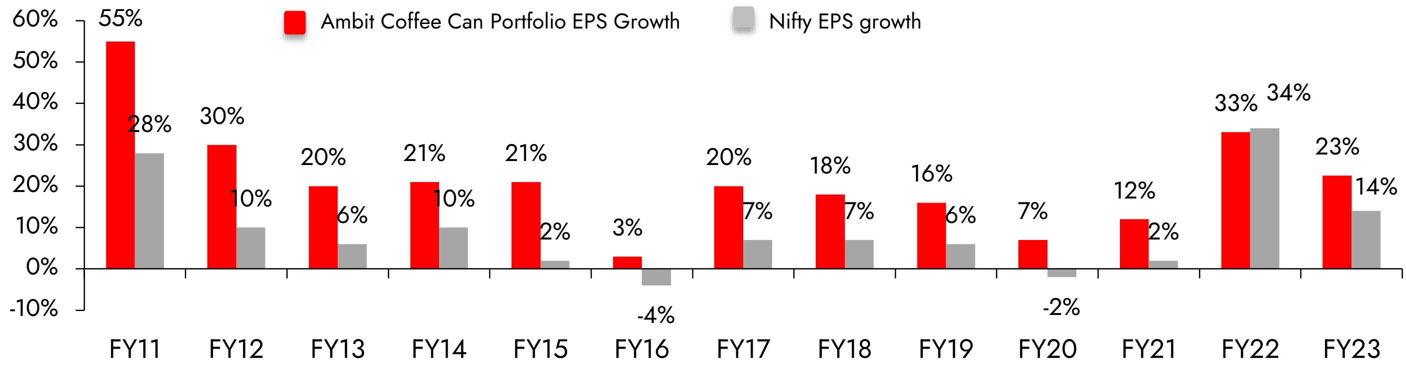


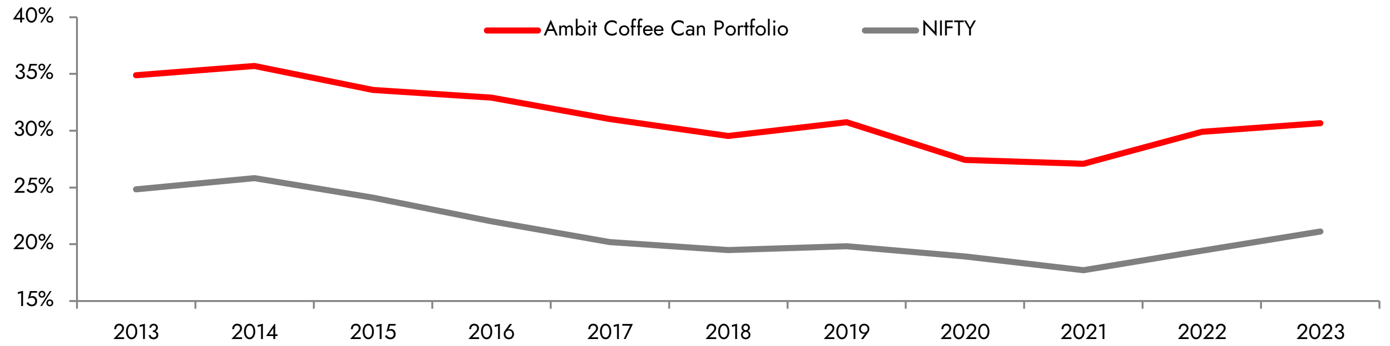
Source: Ambit Asset Management, Company

- HDFC Bank has the potential to re-rate, given its historical track record of strong ROE and higher growth and we anticipate HDFC Bank to outperform in the next 12-18 months.

  We anticipate the next leg of the rally to be fundamentally driven and companies who have not participated in the current rally despite strong operating performance (growth and ROE) and are anticipated to deliver strong future earnings to be at the forefront of the same.

Exhibit 9 - Ambit Coffee Can Portfolio has both better growth and substantially better ROCE (800-1000 bps superior) resulting in consistent wealth creation.





Source: Ambit Asset Management, Bloomberg.

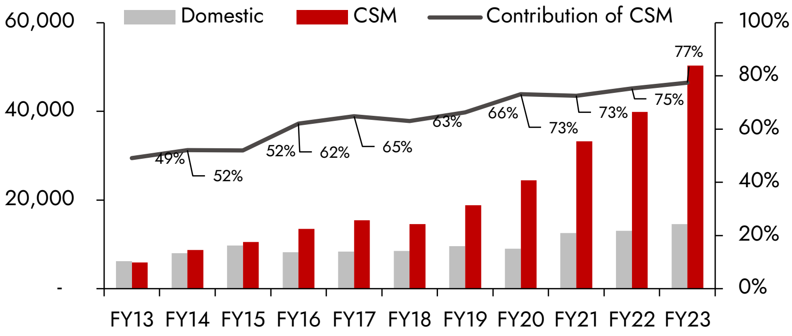
It's not only the large caps where we see outperformance, we also see pockets in mid-caps and small-caps take the case of PI Industries and Garware Technical Fibres—

PI Industries valuation has moderated (from 53x 1 year forward PE to 34x FY 25 PE) owing to concerns over sustainability of growth rate owing to -
1 – Increase in exposure to single-molecule
2 – Ability to scale up the pharma side of business

Exposure to single molecule:

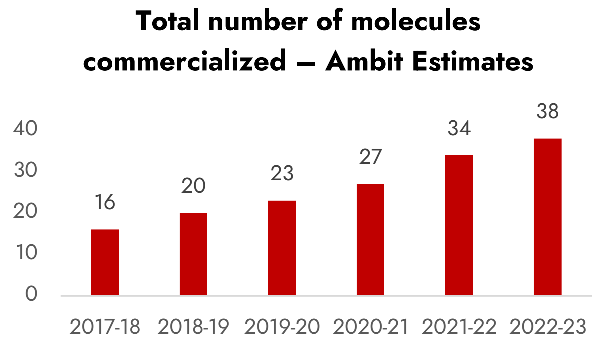
- PI Industries works with all major global ag-chem innovators, however, a large portion of PI's growth has come from working with Japanese innovator – Kumiai Chemicals, particularly the product Pyroxasulfone.
- Pyroxasulfone has grown at ~29% CAGR over the last 5 years. We anticipate the growth owing to better penetration in existing geographies (US and LATAM), an increase in the number of geographies and an increase in applicable crops.
- PI has effectively grown CSM and now contributes over 77% to overall revenues de-risking the domestic portfolio and showcasing PI's diversification and execution skills. (Exhibit 10)
- Over and above, PI Industries has increased the number of molecules commercialized to ~38 from around ~16 in the last 5 years. We expect the increase in commercialization to reduce single-product risk and anticipate the growth trajectory of PI Industries to continue. (Exhibit 11)

Exhibit 10 – CSM growth has grown at a CAGR of 24% over the past decade



Source: Ambit Asset Management, Company. (Denotes Revenue in million)

Exhibit 11 – Number of molecules commercialized has increased materially over the last 5 years

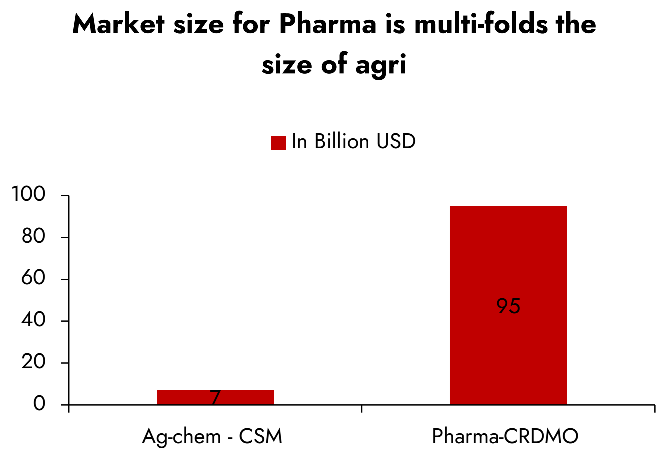


Source: Ambit Asset Management, Company

Ability to scale up Pharma business:

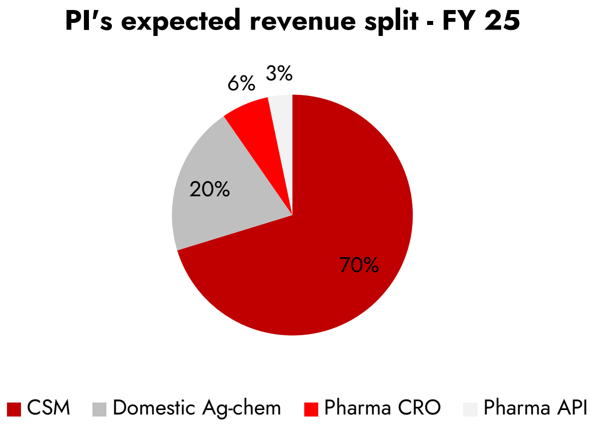
- PI Industries raised ~2000 crores in 2020 primarily for inorganic acquisitions in the pharma space. In May 2023, PI announced acquisitions of ~900 crores for Archimica and TRM which have a presence in CRDMO and API's. In addition to the same, PI has surplus cash of ~2900 crores as of Q1 FY 24 which can further accelerate the pharma push
- Pharma market size opportunity is multi-folds the size of agri-opportunity. (Exhibit 12)
- We believe PI is well set to replicate success in Ag-chem CSM to pharma- CRDMO owing to both organic initiatives and inorganic acquisitions and historical track record. (Exhibit 13)

Exhibit 12 – Market size for Pharma CRDMO is >10x the size of Agri-CSM



Source: Ambit Asset Management Estimates, Company Media sources, Syngene AR

Exhibit 13 – Pharma is anticipated to be around ~10% of revenue by FY 25



Source: Ambit Asset Management Estimates, Company

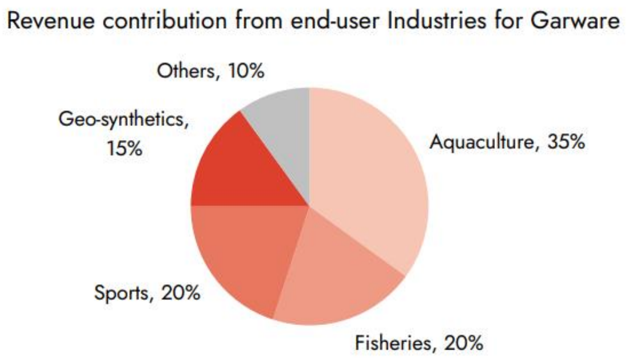
We anticipate PI Industries to continue delivering industry leading growth owing to strong execution, and an increase in opportunity size and expect fears of the market to be allayed by Q1 FY25 and anticipate strong performance in 12-18 months.

Garware Technical Fibres valuations have moderated from – (45x 1 year forward PE to 27x FY25 PE) owing to:

1. Risks to growth profile due to challenges in aqua-culture and sports segments.

- We have written a detailed note on GTFL in March 2023 – (https://www.ambit.co/public/Ambit_Disruption_VOL20_GARWARE.pdf)
- The aquaculture segment which is the most profitable business for Garware Technical Fibres was facing uncertainty due to the proposed Resource rent tax which was finalized at 25% v/s 40% earlier.
- With the resource rent tax now out of the way, we note the growth in aquaculture remains strong due to the focus on innovation by GTFL. In the past few years, innovations such as Sapphire X18 and V2 have helped Garware mop up substantial market share in key geographies in Norway and Chile.
- Sports segment which has been a key growth driver for Garware Technical Fibres over the past few years faced several challenges due to over-stocking. We anticipate the challenges faced last year will ease off in the coming quarters and the sports segment to be a key growth driver going forward for GTFL.
- Geo-synthetics which was a very small part of total revenues a few years back has shown remarkable growth and adds another lever of growth for Garware. Notably, the return on capital employed in Geo-synthetics is the highest in GTFL's portfolio which should enhance Garware's already impressive ~47.2% ROIC.

Exhibit 15 – Revenue contribution from end-user industries for GTFL



Source: Ambit Asset Management Estimates. Actuals may differ slightly

Exhibit 16 – Addressable Market size for GTFL is huge

Particulars	Applications	Market Size (US$ mn)	Garware's presence	Key Products of Garware in the segment
AgroTech	Agriculture, Horticulture, Fisheries and Forestry Textiles	9,847	High	Shade Nets, Insect Nets, Seed production Cages, Anti Hail Nets, Anti Bird Nets, Crop Support Nets, Staking Cords, Fully assembled Trawls, Purse Seine Nets, Gill Nets, Dole Nets, Pelagic Nets, Ropes & Twines
BuildTech	Building and Constructional Textiles	13,923	Limited	Safety Nets, Harnesses, Lifting Slings
ClothTech	Clothing Textiles	11,656	None	None
GeoTech	Geotextiles	7,445	High	Geo Fabrics, Mulch Mats, Boulder Protection Nets, Landfill liners / Fabrics, Polymer and Steel Gabions for Shore Protection etc.
HomeTech	Household Textiles	19,654	Limited	Industrial Ropes, Mooring Ropes for Shipping, High Tenacity Poly Propylene
InduTech	Industrial Textiles	29,157	Limited	Multifilament Yarn, Twine, Stitching Thread, Transport Ropes
MediTech	Medical and Hygiene Textiles	25,214	None	None
MobilTech	Transportation Textiles	36,345	None	None
OekoTech	Environment Protection Textiles	1,363	Limited	Landfill Solutions
PackTech	Packaging Textiles	27,597	Limited	Stitching Threads
ProTech	Protection and Safety Textiles	11,187	Limited	Tarpaulins, Truck Covers, Bio Gas Balloons, Camouflage Nets
SportTech	Sport and Recreation Textiles	24,416	High	Cricket Nets, Soccer Nets, Volley Ball Net, Tennis Nets, Golf Nets etc. - all types of Sports Nets and accessories
	Total Market Size	**217,805**		

Source: Ambit Asset Management, Technical Texile Industry Baseline study, 2020. Dotted lines indicate higher priority for GTFL

- With ~70% of total businesses in an accelerating growth phase, we expect Garware to deliver industry-leading returns over the next 12-18 months.

CONCLUSION:

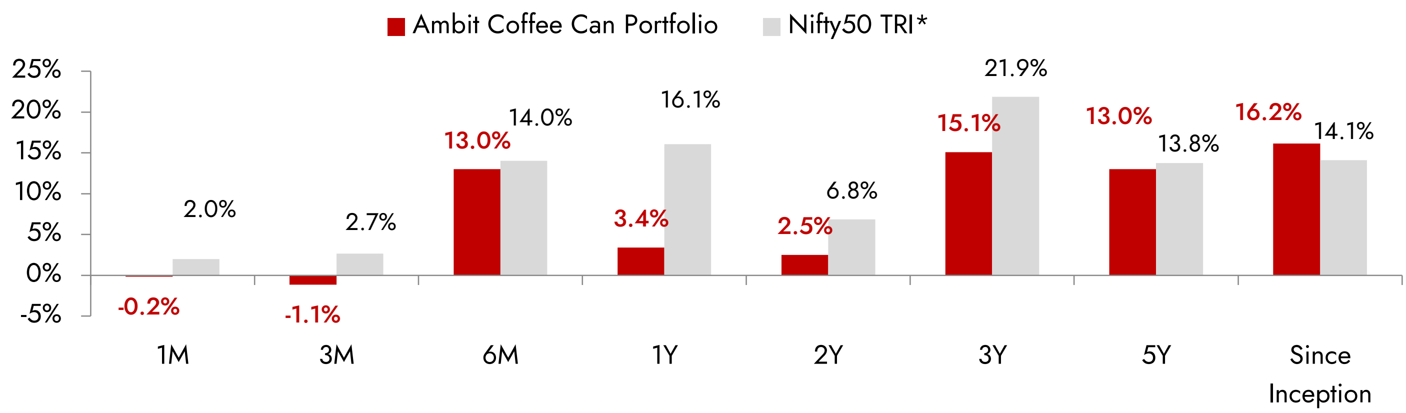
Small > Mid > Large Caps has been the theme over the past 9 months primarily driven by liquidity. We anticipate the next leg of the rally to be driven by fundamentals and earnings growth will be at the forefront. In addition to earnings, valuations have moderated especially amongst large caps and pockets within small and mid-caps which should lead to strong stock performance in the future.

Our portfolio companies across all segments Large, Mid and Small Cap are well poised to deliver industry-leading earnings growth and we anticipate the same to translate into benchmark outperformance in the near to medium term.

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.

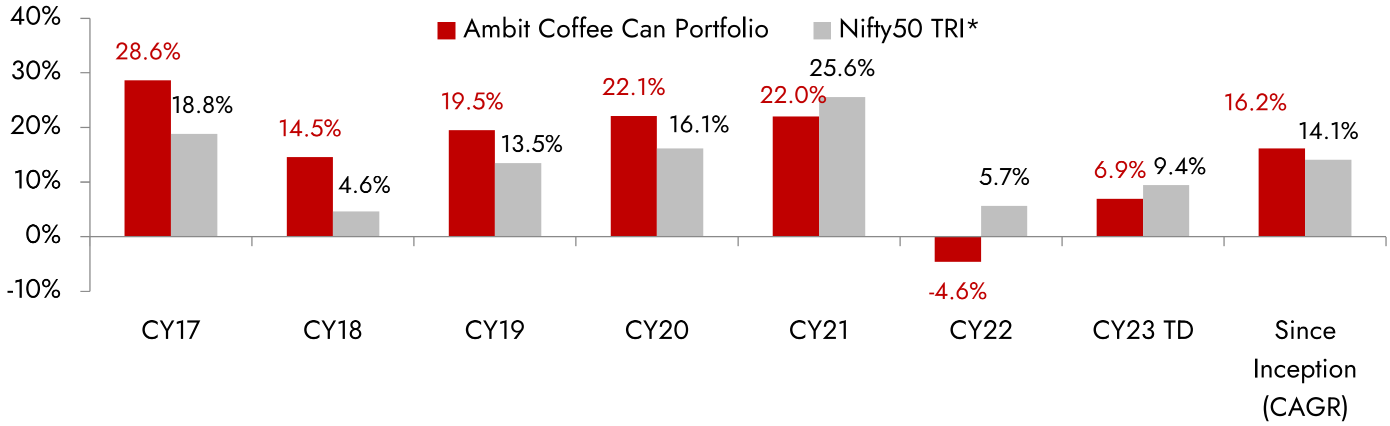
Exhibit 17: Ambit's Coffee Can Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of September 30, 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.

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

Exhibit 18: Ambit's Coffee Can Portfolio calendar year performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of September 30, 2023; All returns are post fees and expenses. 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.

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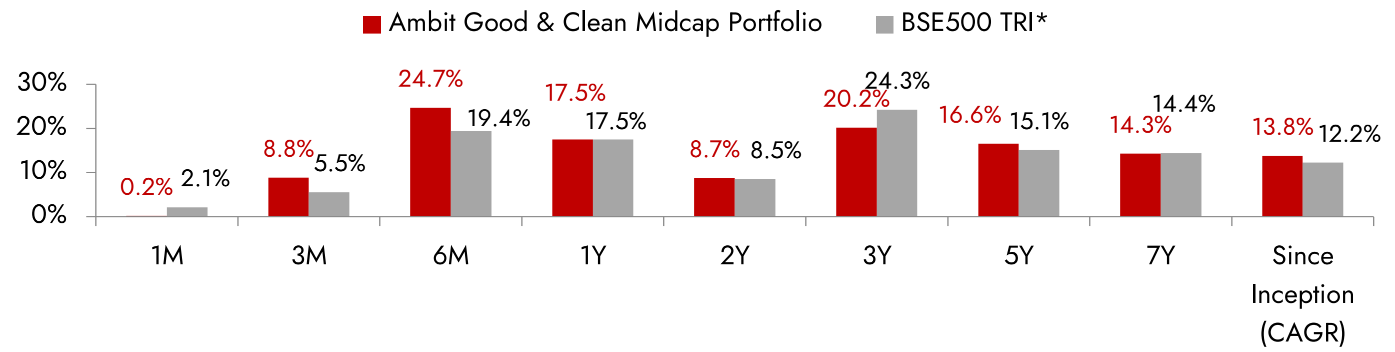
Ambit Good & Clean Midcap Portfolio

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:

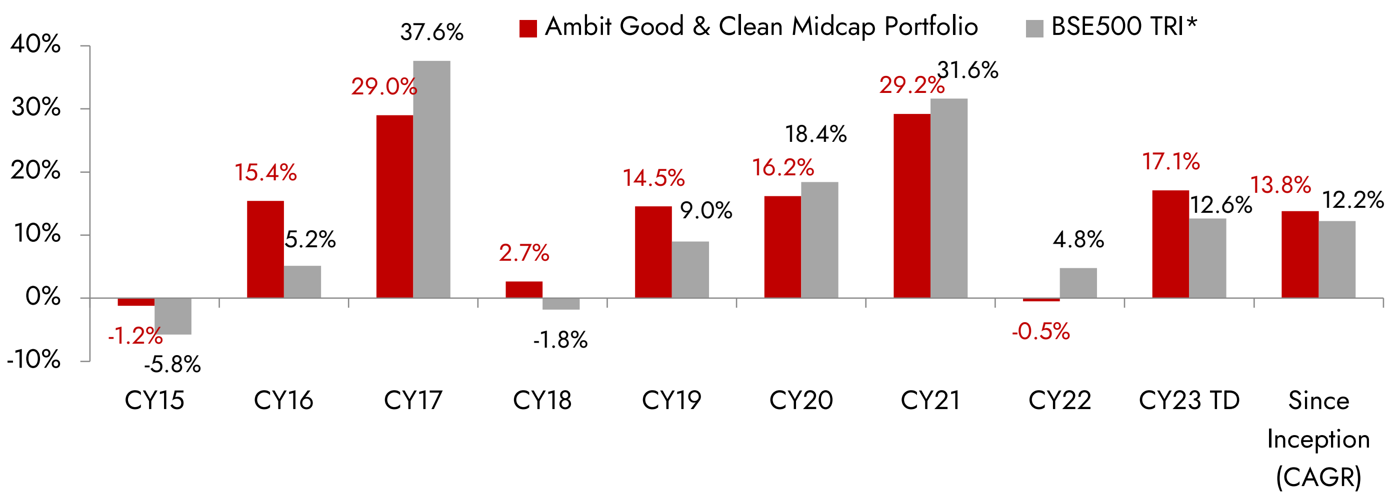
- Process-oriented approach to investing: Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated 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 19: Ambit's Good & Clean Midcap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of September 30, 2023; 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 strategy and the same is reported to SEBI.

Exhibit 20: Ambit's Good & Clean Midcap Portfolio calendar year performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of September 30, 2023. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Good & Clean Midcap strategy and the same is reported to SEBI.

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 led us to a concentrated portfolio of 15-16 emerging giants.

Exhibit 21: Ambit Emerging Giants Portfolio point-to-point performance

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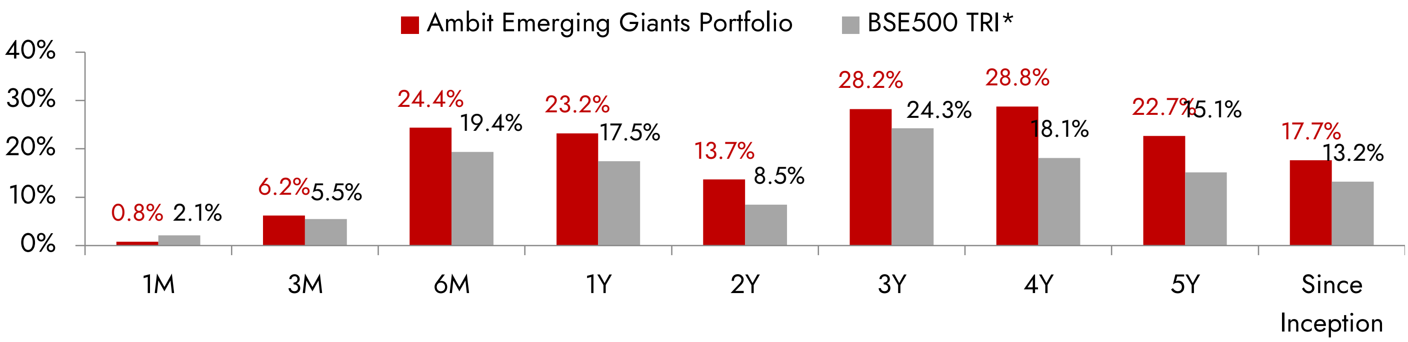
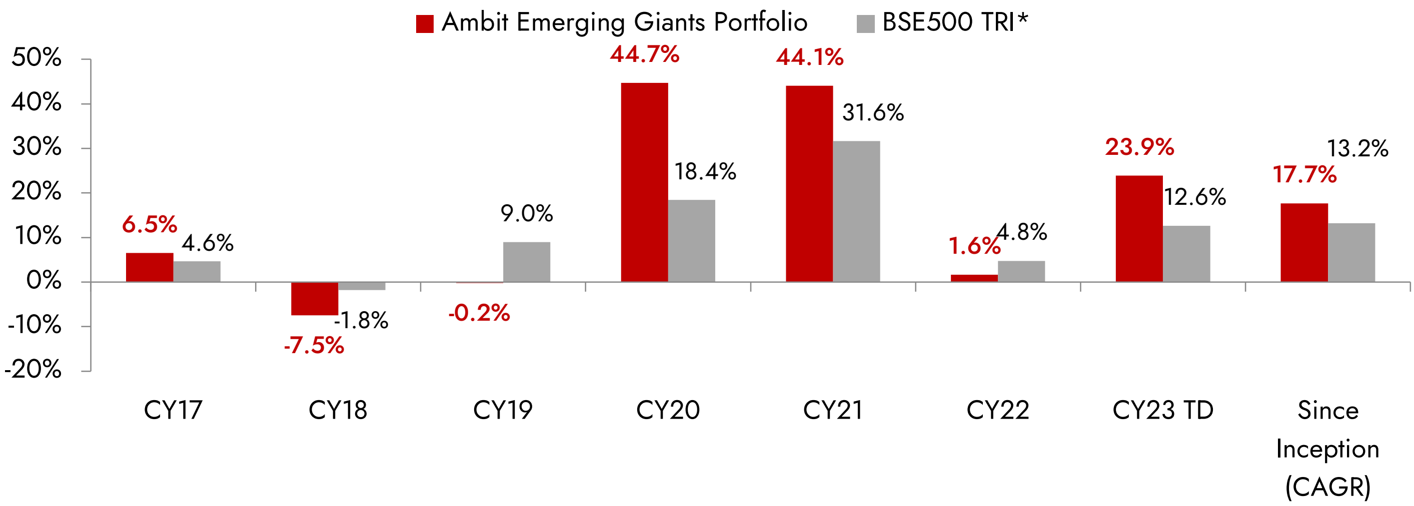


Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of September 30, 2023; All returns above 1 year are annualized. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Emerging Giants strategy and the same is reported to SEBI.

Exhibit 22: Ambit Emerging Giants Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of September 30, 2023. Returns are net of all fees and expenses.
*BSE 500 TRI is the selected benchmark for the Ambit Emerging Giants strategy and the same is reported to SEBI

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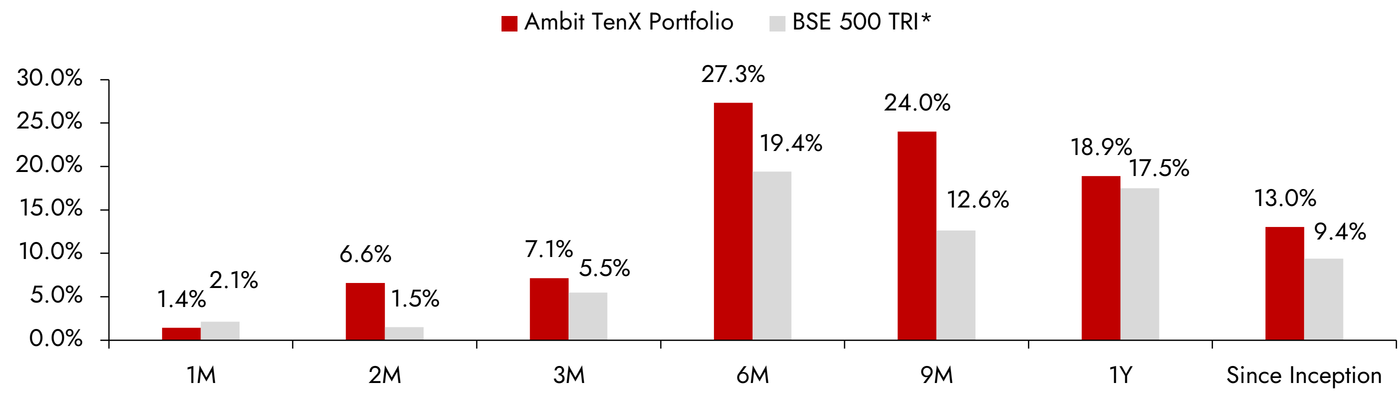
Ambit TenX Portfolio

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:

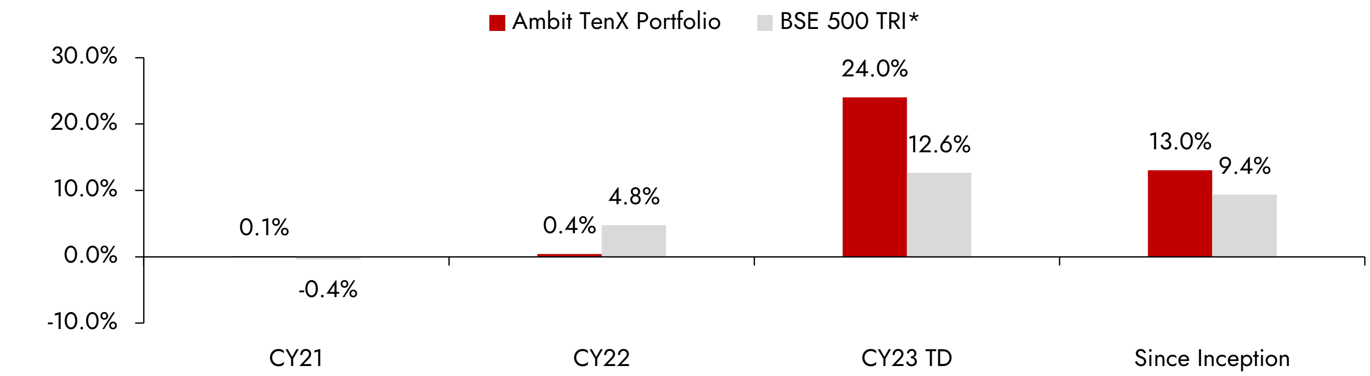
- Longer-term approach with a concentrated portfolio: Ideal investment duration of >5 years with 15-20 stocks.
- Key driving factors: Low penetration, strong leadership, light balance sheet
- Forward-looking approach: Relying less on historical performance and more on future potential while not deviating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

Exhibit 23: Ambit TenX Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of September 30, 2023; 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 24: Ambit TenX Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of September 30, 2023. 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.

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