MONTHLY NEWSLETTER

AMBIT
Acumen at work

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AMBIT ASSET MANAGEMENT

Coffee Can Portfolio

After deteriorating macros through the early part of last year, the December quarter saw a favorable macro backdrop. INR appreciated by 4% to $69.5 after reaching all-time low at $74.5 in early October & Brent crude recovered from over $80/bbl to $53/bbl. 10Y bond yields also rallied 60Bps to 7.4% as the RBI undertook several measures to stabilize liquidity post the tightening of financial conditions from IL&FS default.

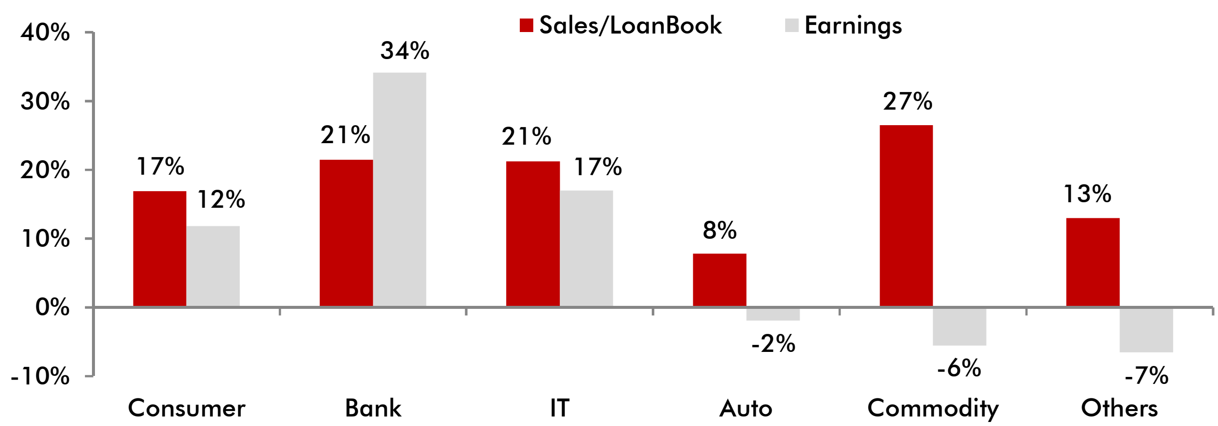
Against the macro backdrop, overall, the quarterly earnings for the BSE Sensex displayed strength led by **corporate lending banks**. In first signs of revival of investment cycle, corporate lenders showed high loan disbursements and the sector signaled the end of NPA cycle. While on the other hand despite lower G-Sec yields, the spreads for **NBFC**'s increased. NBFC earnings were severely impacted by liquidity tightness in wholesale debt markets and the sector showed signs of stress with rising borrowing cost, declining interest margins & declining loan disbursements.

Given that a significant part of **passenger vehicle** is financed by loans from NBFC's, it seems clear that the rise in cost of funding for NBFC's is affecting demand. Volume growth was negative & high promotion expense combined with input cost pressures dented margins for the leading car manufacturer. Even in **2-wheeler space**, rising insurance premiums & fuel costs dented consumer sentiment and the resulting discounts by manufacturers negatively impacted margins.

The resilience of **consumer/FMCG** sector continued. With near normal monsoon, stabilization post demonetization/GST and state intervention to boost farm incomes – consumer companies displayed double digit revenue growth. Further, the cooling off of commodity prices provided strong support for margins expansion.

IT companies continued to deliver strong revenue growth & margin expansion led by strong demand from the US economy & currency tailwinds. Among the other sectors, **Telecom** remained impacted by high competition intensity, discounted pricing & high leverage.

Exhibit 1: BSE 30 Sensex Sales & Earnings growth (Q3-2019 vs. Q3-2018):



Source: Ambit Research; Note: Does not include 6 companies (2 Auto, 3 commodity & 1 other) whose Q3 results have not yet been announced

Interim Budget: The key announcement from the vote on account interim budget was the Rs.6000 handout to small farmers and proposed income tax exemption for up to Rs.5lakh total income. With increased government spending in run up to elections, G-Sec yields are not likely to drop despite the expected RBI rate cuts. All of this will eventually bring more money in the hands of the consumer and signal a huge positive for consumption sector. NBFC sector and consumption growth fuelled by borrowing is likely to continue witnessing a slowdown. Given the deep inter-linkages between NBFC's & real estate, we foresee stress in the NBFC sector to creep into real estate sector as well.

Ambit Coffee Can Portfolio

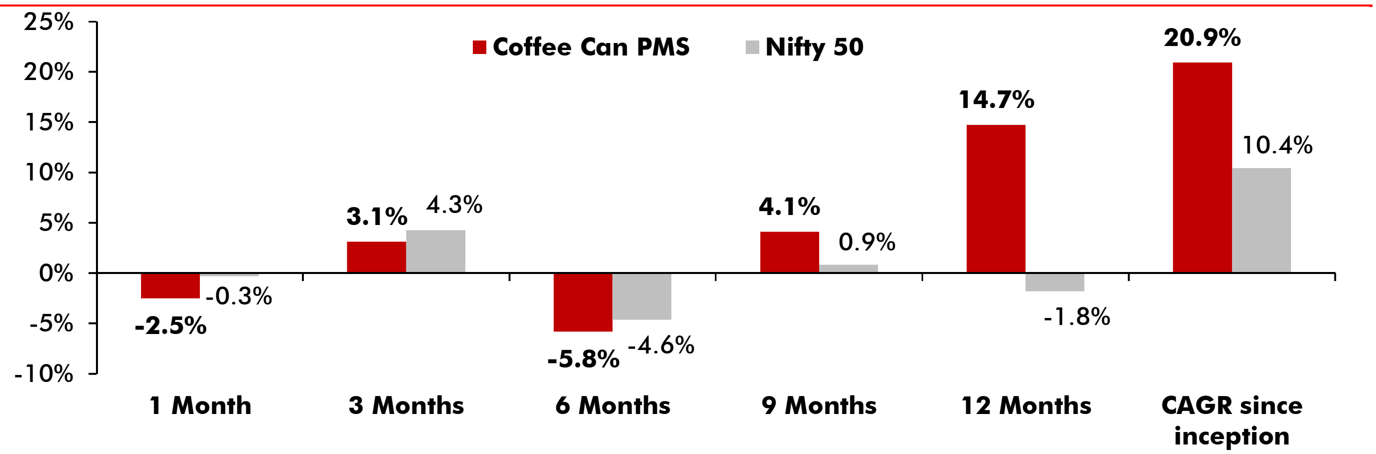
At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail & consumption oriented sectors. While the budget announcement & increased government spending in an election year is a near-term positive, we believe the pricing power and competitive advantages enjoyed by our portfolio companies make them attractive for long term investment horizons no matter how heated the market conditions may seem.

The Coffee Can philosophy has unwavering commitment to companies that have consistently sustained their competitive advantages in core businesses despite being faced by disruptions at regular intervals. As the industry evolves or is faced by disruptions, these competitive advantages enable such companies to grow their market shares and deliver long term earnings growth. As long as the company's fundamental story is intact we do not exit our investment based on short term aberrations.

In case of one of our portfolio stocks -Gruh, we believe the Coffee Can Story has been dented by the recent merger announcement with Bandhan Bank. During the month gone by, we made our first exit and sold the entire holding in Gruh Finance. With Gruh in the medium-term we foresee challenges arising from 1) Integration issues with Bandhan Bank & heightened exposure to risky micro lending business, 2) Question marks on the success of the combined business in unchartered territories and 3) Capital allocation issues as Bandhan will most likely look at another acquisition/entry into new business lines to meet the RBI mandated promoter dilution requirement. Accordingly, due to lack of a clear visibility and uncertainty surrounding long-term earnings, we have decided to remove Gruh from the portfolio.

We will keep you updated on any future changes. We thank you for your continued support & trust towards us in our journey together.

Exhibit 2: Ambit' Coffee Can Portfolio Performance Update



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of January 31, 2019; ***All returns (except Since inception) are absolute returns net of fees & expenses***

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