MONTHLY NEWSLETTER

AMBIT
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AMBIT
ASSET MANAGEMENT

COFFEE CAN PMS

Coffee Can Portfolio

EQUITY INVESTMENTS & PMS ARE SUBJECT TO MARKET RISKS,
READ ALL SCHEME RELATED DOCUMENTS CAREFULLY BEFORE INVESTNG

Value trap in the Indian Markets

India has proved to be a graveyard for traditional value investing strategies. Almost always, companies with Low PE trade at those values deservedly so due to 1) Poor Accounting quality 2) Fraudulent Management and 3) Inefficient Capital Allocation. As shown in exhibit below earnings of value stocks (as measured by lowest PE ratio or the 4th quartile) remain the weakest over the long term.

Exhibit 1: Earnings of value stocks are weakest in the long term

Quartiles based on starting P/E multiple	Subsequent Median earnings growth (%)		
	3Y	5Y	10Y
Q1 (high P/E)	16%	9%	14%
Q2	11%	8%	10%
Q3	5%	6%	7%
Q4 (low P/E)	**-16%**	**-5%**	**7%**

Source: Ace Equity, Ambit Research; Note: Universe represents all the listed companies whose data are available for subsequent periods; Stocks with negative P/E and P/E above 200 are excluded; 10Y represents PAT cagr from FY08 to FY18; 5Y represents PAT cagr during FY13-FY18; 3Y represent PAT cagr during FY15-FY18;

Firstly, accounting is as much an art as it is a science. Creative means are used by companies' management to show the best possible reflection of financial performance to maximize earnings, the stock price and ultimately their own stakes through ownership/stock options. Generally accepted accounting principles or GAAP are nothing more than what it is called i.e. "generally accepted" and provide enough maneuverability to the management to distort the reality.

Secondly, companies with shady managements & promoters go a step further and commit blatant fraud rather than just window-dress books of accounts. Siphoning off precious funds from public companies by fraudulent promoters is all too common.

Finally, very few companies maintain focus on their core business and aim to build and grow sustainable competitive advantages. Rather, as soon as a company grows in size, hubris sets in and the company looks at high growth opportunities entering into new business lines and expensive acquisitions. Very few managements and companies look at relative value addition (returns over cost of capital) for capital allocation decisions.

How do we at Ambit overcome these challenges?

While quantitative filters are a good starting point to stock picking, many a times, numbers are not as they seem. A further deep-dive into the business model, growth prospects, governance & management provides a complete picture and is required to build a high quality & high return generating stock portfolio, especially in the Indian context.

Forensic Accounting framework: Our robust accounting framework penalizes companies that conduct accounting jugglery to show a distorted picture different from the true economic reality. We extensively screen and avoid companies that have aggressive revenue recognition policies, aggressive provision practices, questionable related party transactions and poor quality of auditors. Our valuation models further focus on actual cash flows earned rather than accounting earnings which are calculated on accrual basis.

Focus on highest quality corporate governance: We only focus on companies with a truly independent board, empowered management & strong corporate governance. We stay away from questionable companies & management and undertake several checks to ascertain quality of management and corporate governance.

Companies with undeterred focus on core business: We like companies that have unwavering focus on core competencies and laser-like focus on core business. This enables them to build structural competitive advantages, grow their competitive moats and gain market share from other players who lack the same amount of dedication & focus.

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. 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. 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.

Coffee Can portfolio companies continue to deliver healthy earnings growth

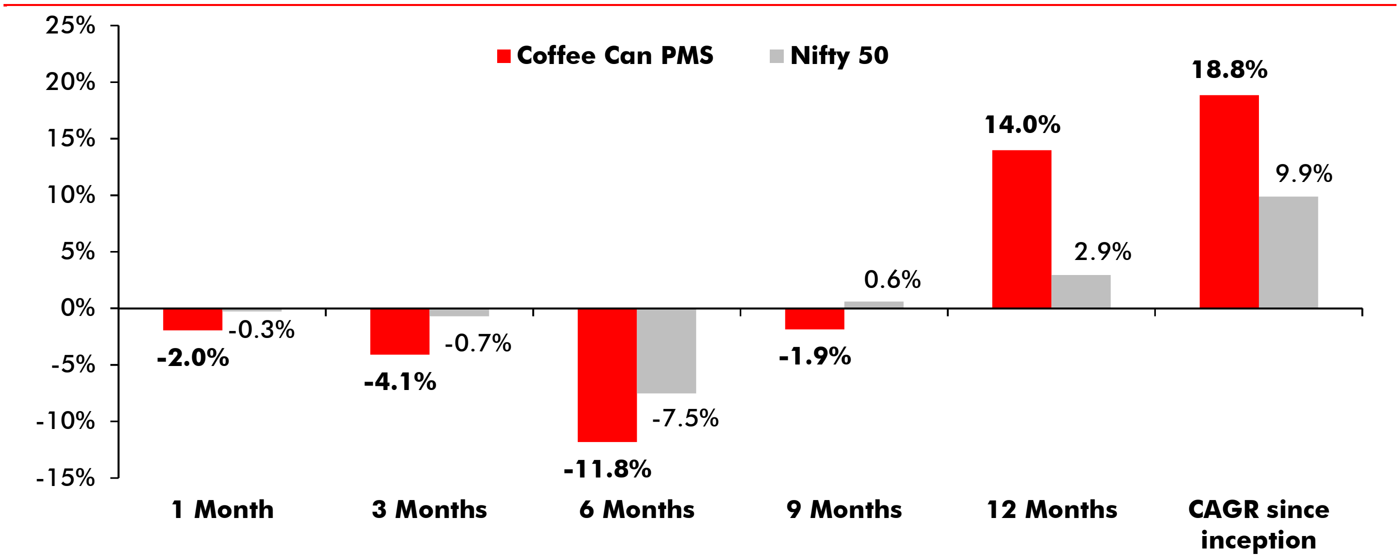
3QFY19 results season panned out well for the Coffee Can portfolio with healthy revenue growth and strong earnings. As shown in the exhibit below, the portfolio companies showed an average Revenue/EBITDA growth of 17%/13%. We continue to believe that portfolio stocks will maintain strong earing momentum in ensuing quarters.

Exhibit 2: Coffee Can Portfolio Companies Q3-19 Performance

Growth	Average		Median	
	YoY	QoQ	YoY	QoQ
Revenue	17%	4%	17%	3%
EBITDA	13%	4%	15%	9%
PAT	13%	4%	14%	10%

Source: Ambit Capital Research; Note: For BFSI companies, Revenue/EBITDA growth represents growth in Interest Income/Pre-Provision income respectively; Average is computed by taking the current weights of portfolio stocks.

Exhibit 3: Ambit' Coffee Can Portfolio Performance Update



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of Feb 28, 2019; All returns (except Since inception) are absolute returns. ***All returns are net of fees & expenses.***

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