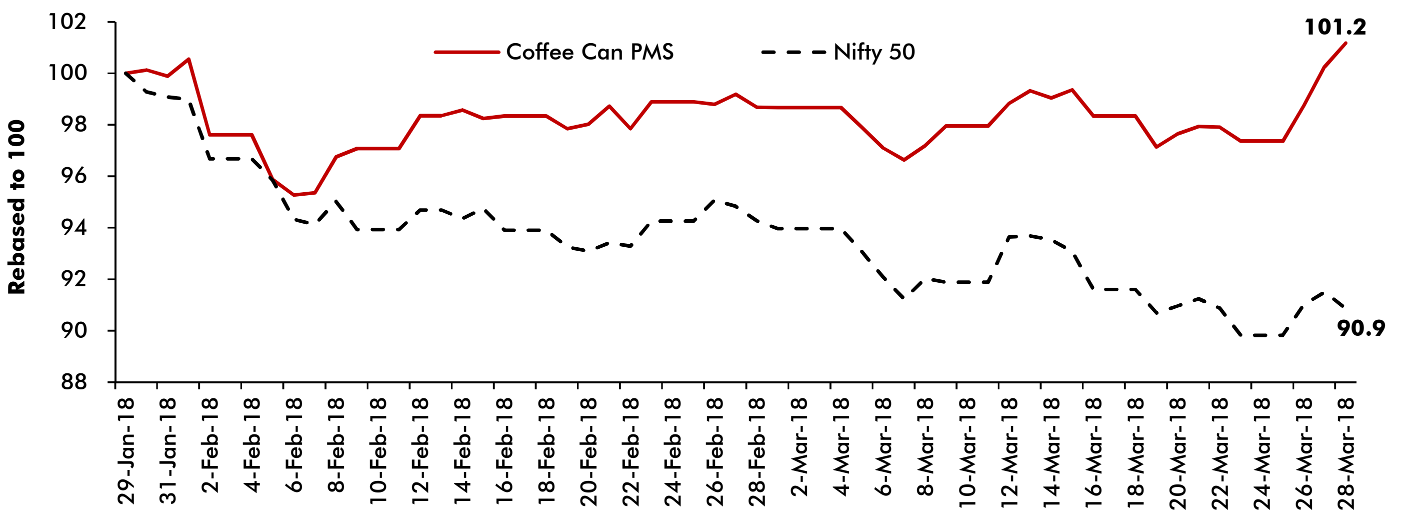
Ambit Coffee Can Newsletter – Apr'18

When the going gets tough…

In our December'17 newsletter (click here), we had used Asian Paints' example to demonstrate that the type of stocks the Coffee Can philosophy seeks show remarkable resilience, even during stressed market conditions. This resilience is delivered because of the ability of such companies to sustain healthy fundamental performance even during weak economic conditions due to which either: a) earnings growth of such companies more than offsets the ripple effect of a stressed market's P/E de-rating; or b) P/E does not de-rate for such companies because the market incrementally factors in longevity of earnings.

In our March'18 newsletter, we had highlighted that whilst Sensex's returns since FY15 have been entirely driven by an increase in its P/E multiple (there has been no earnings growth), performance of CCP stocks has been entirely driven by their earnings growth. Over the past three years (FY15-18E), Coffee Can PMS stocks (weighted by portfolio allocations) have delivered 18.1% earnings growth compared to -0.6% delivered by the Sensex over the same period. As a result, during the recent fall in the broader stock market (~10% or higher decline in most indices since 29th Jan 2018), Ambit's Coffee Can PMS has shown remarkable resilience (see chart below).

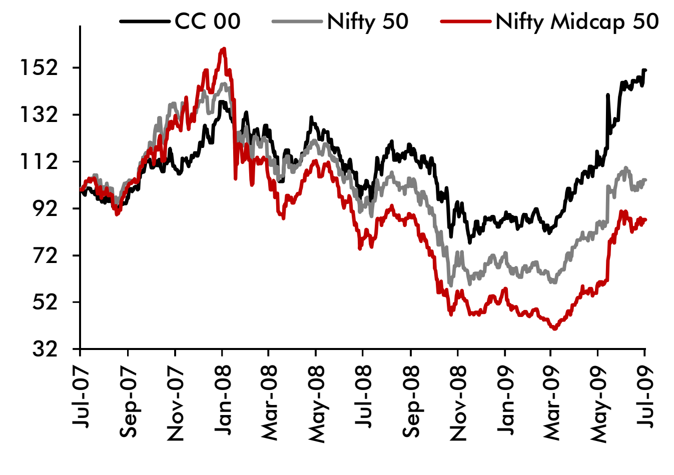
Performance of Ambit's Coffee Can PMS during the recent period of stock market stress (Nifty 50 peaked on 29th Jan 2018)



Source: Ambit Capital research, Bloomberg

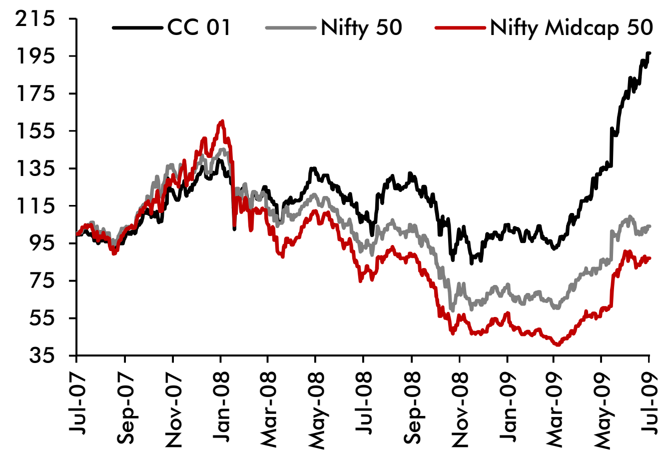
Such resilience is commonly experienced by portfolios constructed using the Coffee Can Philosophy. For instance, most of the back-tested filter-based Coffee Can Portfolios that have been highlighted in the books "The Unusual Billionaires" and "Coffee Can Investing" have also seen similar resilience during periods of market stress – see the two charts below for the 2000 and 2001 iterations. It is interesting to note that during the six-month period just before the market's fall, these portfolios might have delivered zero outperformance (might have even underperformed) compared to the broader stock market indices. However, during the market crash, they tend to fall less, and recover sooner and sharper than the broader market.

2008 stock market stress - Coffee Can 2000 iteration



*Source: Ambit, Bloomberg; Portfolio value and indices are rebased to 100 as on 1st July 2007. *CC 00 = Portfolio of companies which delivered >10% revenue growth and >15% RoCE each year over FY91-FY00, equal weighted portfolio constructed on 1st July 2000 with zero churn subsequently*

2008 stock market stress - Coffee Can 2001 iteration



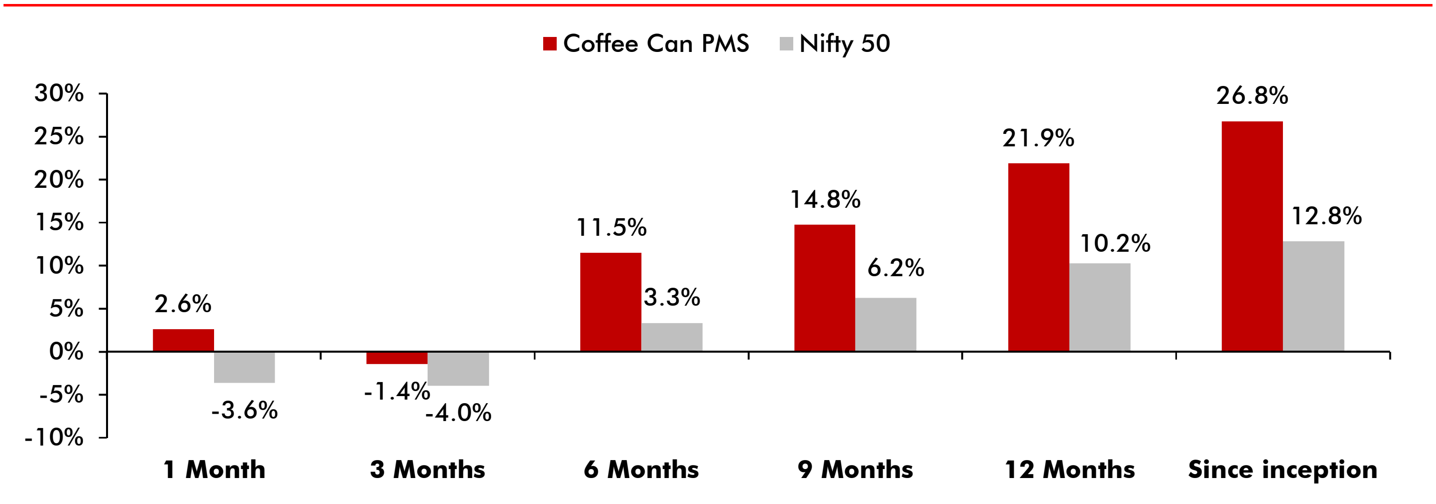
*Source: Ambit, Bloomberg; Portfolio value and indices are rebased to 100 as on 1st July 2007. *CC 01 = Portfolio of companies which delivered >10% revenue growth and >15% ROCE each year over FY92-FY01, equal weighted portfolio constructed on 1st July 2001 with zero churn subsequently*

Performance update – Ambit's Coffee Can PMS – as on 31st March 2018

Ambit's Coffee Can philosophy shows commitment to franchises that consistently sustain their competitive advantages despite being faced by disruptions at regular intervals. Hence, we expect our portfolio companies to gain market share and capitalize on the opportunities created by evolutionary/disruptive changes in the economy. We expect our portfolio companies to deliver an average 3-year earnings CAGR of 20-25% over FY18-21. **There has been no change in the list of stock holdings (i.e., zero churn) in the portfolio since inception of the PMS.** Going forward, given the longevity of fundamentals that we seek in our portfolio companies, we don't see Ambit's Coffee Can PMS churning more than one stock per year on an average (i.e., no more than 5-10% expected average churn in the portfolio in future).

The exhibit below shows the performance of Ambit's Coffee Can PMS since inception (6 March 2017). The portfolio consists of 11 stocks of high quality companies, spread across Financials (2 stocks), Home Building Materials (3 stocks), Consumer Discretionary (3 stocks) and Consumer Staples (3 stocks).

Ambit's Coffee Can PMS performance update (as on 31st March 2018)



*Source: Ambit, Bloomberg; *Date of inception= 6th March 2017; All returns are absolute returns net of fees and expenses*

Regards

Rakshit

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