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Ambit
Asset Management

MONTHLY NEWSLETTER

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THE RISE OF D2C BRANDS

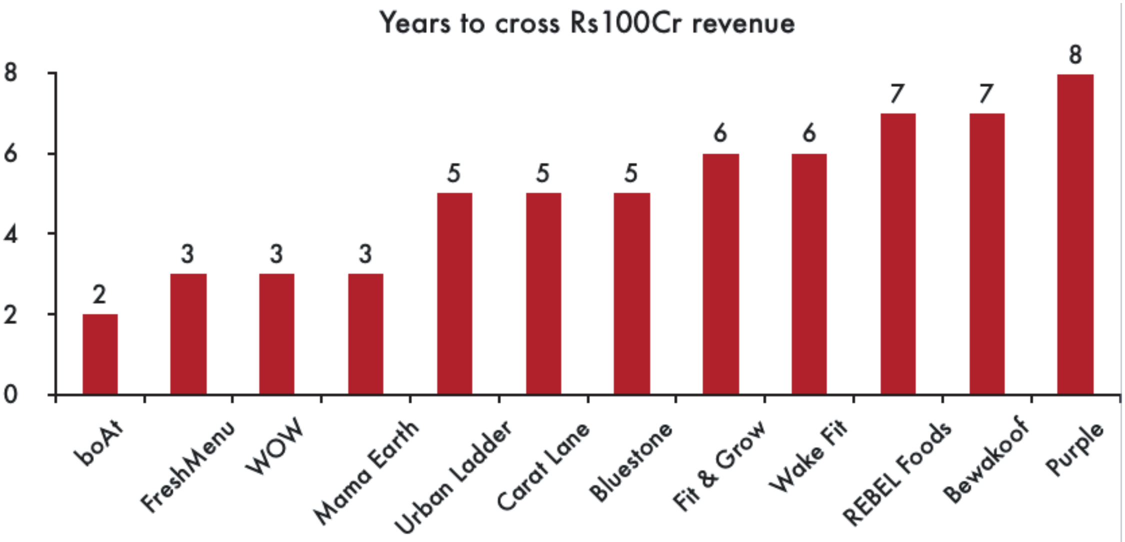
Dear Patron,

Over the last few years, several Direct-To-Consumers or D2C Brands have mushroomed in India, disrupting traditional and online retailers. New age digital companies are finding innovative ways to serve customers' needs, which were ignored by large/traditional players. These brands initially start with a niche consumer insight to cut through the noise. As they fulfill unmet consumer needs and generate traction, they further broaden their product portfolio. Customers in India are increasingly willing to try out new brands and pay a premium for better quality products. **In this note we take a look at the business model of D2C brands with some examples and try to understand their impact on Incumbents and consumers.**

Understanding D2C brands and businesses

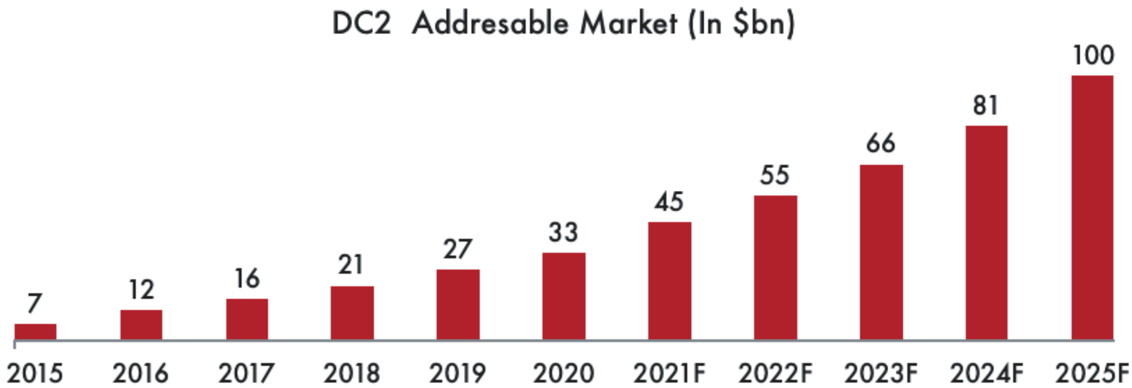
D2C is a retail model where brands sell directly to customers through an online store. Brands use in-house or rental fleets to directly ship their products at the customer's doorstep. Unlike D2C brands, traditional brands reach customers through distributors and wholesalers.

Exhibit 1: Several D2C brands have crossed Rs. 100cr revenue in a short span



Source: Ambit Asset Management, MCA Filings, PGA Labs, Tracxn

Exhibit 2: D2C market is expected to grow @ 25% CAGR over the next 5 years



Source: Ambit Asset Management, Inc42 Plus Analysis

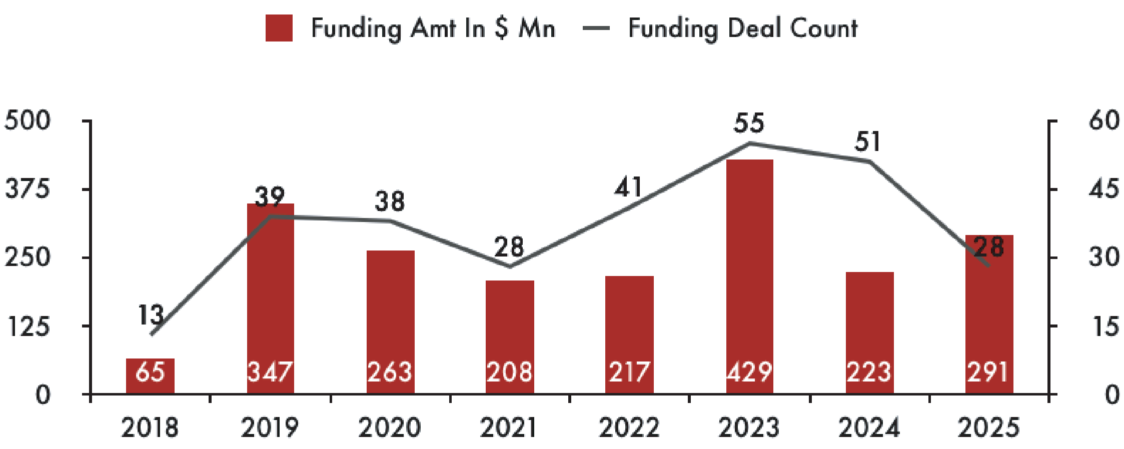
The Secret Sauce

D2C companies seemed to have cracked the code to cater to niche consumer segments. These brands are chasing the top 30-40mn online customers (out of ~100mn) who have high disposable income. These Brands mostly operate in premium categories which augurs well for delivery (high average order value) and provide high gross margins. High margins are required to absorb customer acquisition cost (CAC) as well as higher logistics cost. Platforms spend heavily on digital marketing, primarily on Google and Facebook, to drive traffic. The idea is to keep the CAC lower than customer lifetime value (LTV). Brands also create content (blogs, videos, polls) to drive customer engagement. While D2C brands are pushing the customer to shop on their platforms, majority of the sales still comes from marketplaces such as Amazon, Flipkart, Myntra, etc. After establishing a strong online presence, most of these brands are opening their offline stores to provide a holistic experience.

Increased salience during COVID –

Covid also gave a significant boost to D2C platforms at a time when offline retailers where struggling. This was visible in ~90% YoY increase in consumer demand on D2C websites in 2020, which did not go unseen by PE/VCs. Indian D2C startups have raised $784mn across 66 funding deals during Jan-Aug 2021. D2C has now become a new channel to directly reach out to customers, showcase curated offerings, generate insights and serve the unmet needs of the customer.

Exhibit 3: India D2C Startups raised $2bn in last 8 years



Source: Ambit Asset Management, Inc42 Plus Analysis

Advantages of going D2C:

1. Better engagement: Brands are able to control the entire customer experience – includes curation of product portfolio, content to educate customers, packaging, and other services such as subscription, etc. – leading to a seamless experience, better customer engagement and retention.

2. Generate Insights: Brands collect vast amount of data throughout the journey of the customer from the first click to the final checkout. This data is used to generate insight to launch better products and provide a better customer experience.

3. Better Reach: Going digital enables brand to reach millions of customers across all corners of the country. According to a recent Bain Report, 97% of postal codes in India ordered at least 1 item online in the last year. Nykaa, a beauty and personal care retailer, generates 64% GMV from Tier2/3 cities. Customers in these areas have aspirational needs and want to associate with new age brands.

4. Lower cost of Failure: FMCG companies are using D2C to launch new products before rolling them out in the offline market. This entails much lower upfront investment and much faster consumer feedback. Marketing expense on digital platforms such as Facebook, Instagram is much lower than traditional channels viz. TV, print. New age brands pivot through different business models as the cost of failure has come down.

5. Better Margins: Companies are able to improve their Gross Margins as they are able to sell their products at full price. Also, reaching the customer directly saves distribution charges.

6. Booming Online Shopping: Online channel has been growing at an accelerated pace in last few years especially after Covid disrupted offline operations. Ecommerce platforms have expanded the digital channel, both in terms of reach and categories. D2C platforms have benefitted from the increased adoption of online shopping post COVID.

Some examples of leading D2C brands

boAt

1. boAt is an electronics brand launched in 2015 by Aman Gupta and Sameer Mehta. In a short span of 6 years, company has crossed Rs700cr revenue while being profitable. Even in a crowded market with players such as JBL, Bose, Bragi, SkullCandy, Sennheiser and Sony, Boat has become 5th largest wearable brand globally. As of Q3 FY20-21, company is leading the ear-wear category with a 32.4% market share. Boat saw a steep rise in customer base from 0.8 million in 2018 to 2 million by 2020.

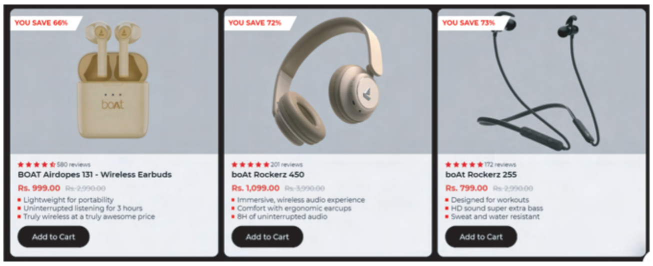
Boat has been able to connect with customers due to its distinct brand persona and effective digital marketing. It is aiming to sell fashionable, innovative products with a premium feel at an affordable price. Going fully D2C has helped the management to understand customer needs. According to Aman, "In the D2C world, the consumer's feedback is instant and that is what we listen to build our brand".

While company continues to nudge customers to purchase on their platform as it offers consumer insights and better margins, marketplace accounts for ~80% of revenue. According to Gupta "What people don't get is that selling your products on your own website also means attracting customers to your own site over platforms such as Amazon and Flipkart. This is very tough."

Exhibit 4: boAt is targeting millennials through cricketers and film stars

Source: Ambit Asset Management , Company

Exhibit 5: Bestselling products



Source: Ambit Asset Management , Company

Licious™ BORN TO MEAT

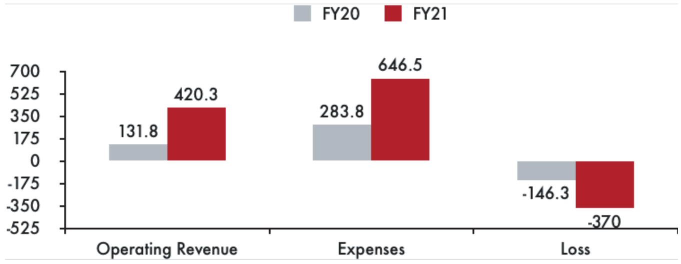
2. Founded in 2015 by two meat lovers, Abhay Hanjura and Vivek Gupta, Licious is focused on meat delivery, spreads, etc. Licious became India's first D2C food-tech unicorn post the recent fund raise of $52m from IIFL AMC. It is also one of the fastest growing D2C brands today with revenue of Rs421Cr in FY21. Three key factors stand out for Licious –

a) Efficient Supply Chain Management: is key in online delivery of highly perishable produce as it requires cold storage from farm to customer. Licious is able to supply high quality products as it owns the entire supply chain. It works with the farmers to monitor the quality of produce. Produce is sent to one of the 5 processing centers and 100 delivery centers before reaching consumers' doorsteps.

b) Innovation and product extensions: Licious has been able to innovate and provide better offerings compared to its peers. Its Ready To Eat (RTE) and Ready To Cook (RTC) segment has grown well and now accounts for 20% of sales. It not only adds new customers but also provide higher gross margins compared to meat. Customers are willing to pay a premium for variety, convenience and better quality products.

c) Aggressive Offline presence: Licious started with two offline stores in Delhi and Bangalore in 2019 and are looking to expand their presence aggressively. Offline stores help in showcasing the entire product offerings, improve brand presence and recruit new customers. As founder Anurag Gupta said, "Online will always be our core. Offline will mostly enable our online focus,"

Exhibit 6: Licious- scaling operations at a rapid pace



Source: Ambit Asset Management, Tofler

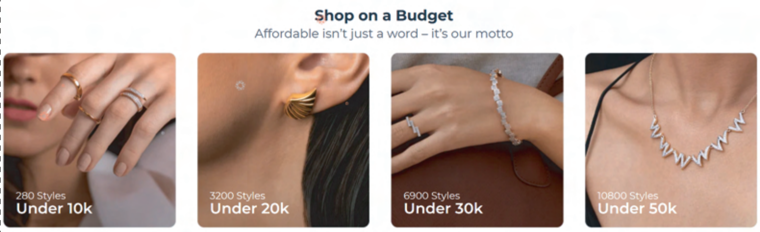
MELORRA

3. Melorra was founded in 2016 by Saroja Yeramilli, who had previously worked in Tanishq (India's largest jewelry retailer). Melorra is an online jewelry retailer focusing on every day light-weight, non-ethnic jewelry at a low ticket size. The brand offers over 10k designs and 80% of its products are below Rs50,000. It has been growing at 200% and currently has revenue of Rs350Cr.

Melorra operates through a unique model where it carries no inventory. Products are manufactured after the order is placed. This helps in offering a large variety of designs without sacrificing on working capital. Company wants to bring the fast-fashion model into jewelry, where they launch 75 new designs every Friday. Customers are willing to pay higher making charges for better designs and product quality.

Company is getting orders from across the country and has already delivered to 2,700 towns. Melorra recently raised $24 million, which will be used in marketing and offline expansion. Company has 7 offline stores and is looking to add 350 stores in next 5-6 years.

Exhibit 7: Broad range of designs at affordable prices



Source: Ambit Asset Management , Company

Exhibit 8: Recently roped-in Shraddha Kapoor as brand Ambassador

Source: Ambit Asset Management , Company

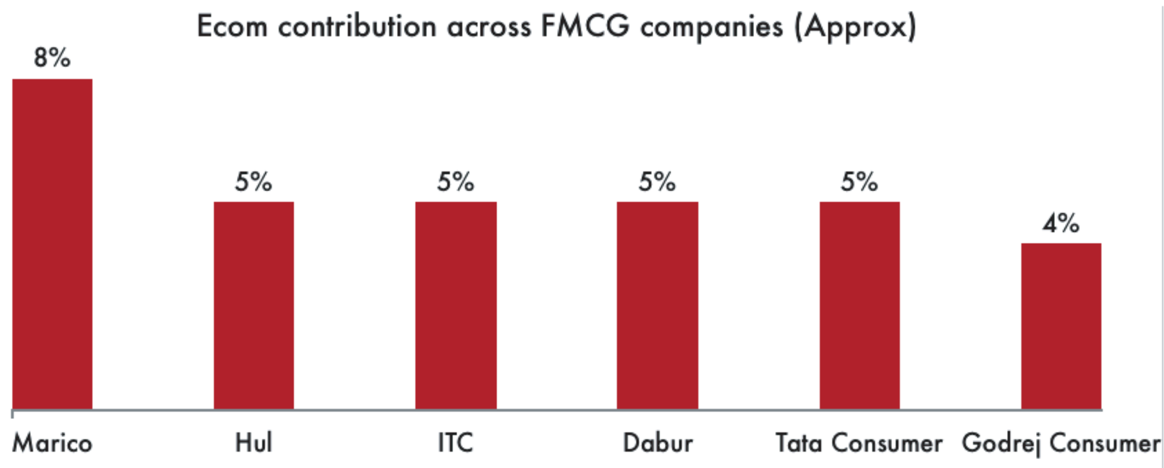
Large Incumbents Playing Catch-up

Over last few years, several new-age brands such as Mamaearth, Sugar Cosmetics have gained traction. Incumbents were caught off-guard as they did not anticipate these new-age brands to cross Rs100crs turnover in such a short span. We mentioned in our November 2021 Newsletter that brand loyalty remains low and companies have to continuously innovate to retain their market share. Large brands have lagged innovation as they were hiding behind their biggest competitive advantage – traditional distribution. This moat has been severely challenged by D2C companies. Large brands also didn't have the incentive to enter niche product segments as they were focused on large scalable opportunities. Currently incumbents are facing heat as their premium customers are moving towards these new age brands.

Traditional companies are left with no option but to join the party. Companies are looking at both, organic as well as inorganic ways to improve their D2C presence.

1. Marico is targeting Rs450-500Cr D2C revenue by FY24. Unlike its strategy for traditional channels, Marico's digital strategy is focusing on premium products. Marico launched D2C platform, Saffola store and acquired 60% stake in Just Herbs, shortly after acquiring Beardo.
2. ITC launched D2C platform called ITC e-Store and acquired 16% stake in mother and baby care brand, Mother Sparsh.
3. Titan acquired majority stake in Caratlane in 2016 and increased its stake to ~70% in 2019. CaratLane, which started as online retailer, predominantly sells diamond jewelry at low ASP.

Exhibit 9: Marico is leading the pack in Digital Sales



Conclusion:

D2C is a win-win strategy where customer gets superior experience and innovative offerings while brands are able to develop a strong connect with the customers. The digital rush is not limited to our domestic market but is a global phenomenon. Companies such as L'Oreal, PepsiCo, and Nike have started engaging with customers directly.

"We know that digital is the new normal. The consumer today is digitally grounded and simply will not revert back," said Nike CEO John Donahoe.

While D2C has gained traction and is expected to grow at a faster pace, offline retail still remains the mainstay. Also, within online retail, aggregator platforms such as Amazon and Flipkart still rule the roost. However, Digital brands have democratized the power of reaching the masses and serve their unmet needs. This has led to fresh spurt of competition, which is always a positive sign. It has become clearer that entrepreneurs with right ideas can build powerful retail brands today.

D2C companies are increasingly taking share from the large incumbents. However, disruption from D2C players is impacting some categories more than others (Refer to Exhibit: 10). Categories such as beauty, personal care and electronics are more susceptible to disruption than food & beverages, jewelry, and mass footwear/apparel. Therefore, companies such as Nestle, Titan, Bata and Relaxo are insulated from the increasing threat of D2C.

Exhibit 10: Some categories are more susceptible to D2C disruption

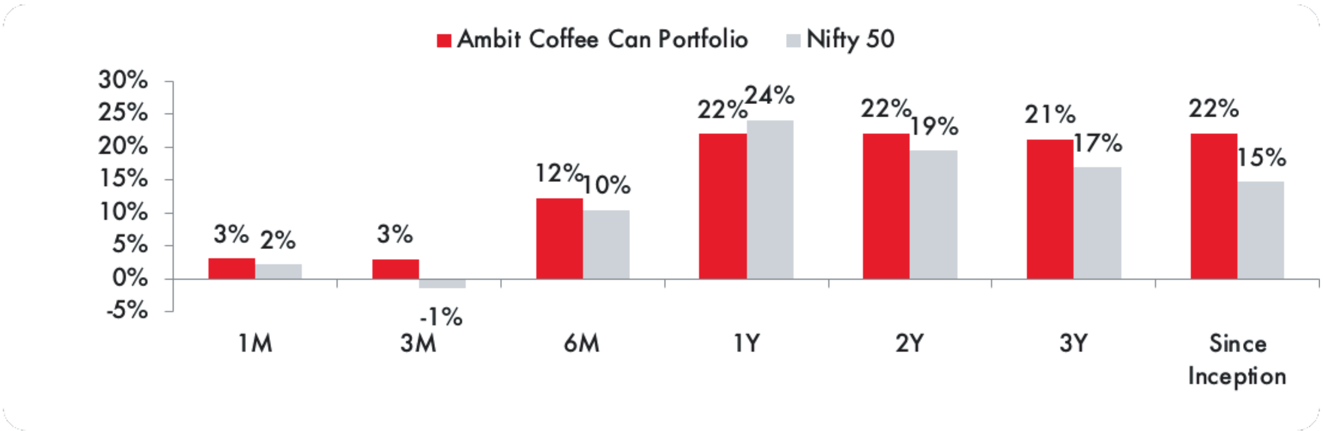
Categories	Size ($Bn)	Current D2C Penetration	Susceptible to disruption	Rationale	Current Players
Beauty & Personal care	16	Medium	High	High GM, Conducive for delivery, High frequency purchase, Branding is critical	WoW, Mamaearth, Beardo, Plum
Food and Beverages	29	Low	Low	Disruption is in niche categories with high gross margin but not in mass market	Sleepy Owl, Country Delight, Zappfresh,
QSR	60	Medium	High	High GM, Conducive for delivery, High frequency purchase	Rebel Foods, Jubilant Foodworks, Box8
Jewelery	60	Low	Low	Wedding contributes 50-60% of Industry sales, which is high ticket size, low frequency purchase	Caratlane, Melorra, Giva
Apparel	66	Low	Medium	Easier trial and return, Low ticket size, High frequency purchase, High discounting and Digital marketting	Bewakoof, Zivame, Damensch, The Souled Store
Footwear	10	Low	Medium	Share of digital channel will gather pace, Similar to global economies	Solethreads, Rapawalk
Electronics	51	Medium	Medium	High online penetration in mobile, accessories, TV but low in white goods such as refrigerator, washing machine etc due to low frequency purchase, high touch & feel items, bulky products	MI, boAt, Noise, Crossbeat
Health and Wellness	23	Low	Medium	Increased awareness towards healthy living with organic products and supplements	1mg, PharmEasy, Oziva, Healthkart
Homecare and personal services	NA	Low	Medium	Providing standard experience and convenience	Urban Company, Livspace, QuikrEasy,

Source: Ambit Asset Management

AMBIT COFFEE CAN PORTFOLIO

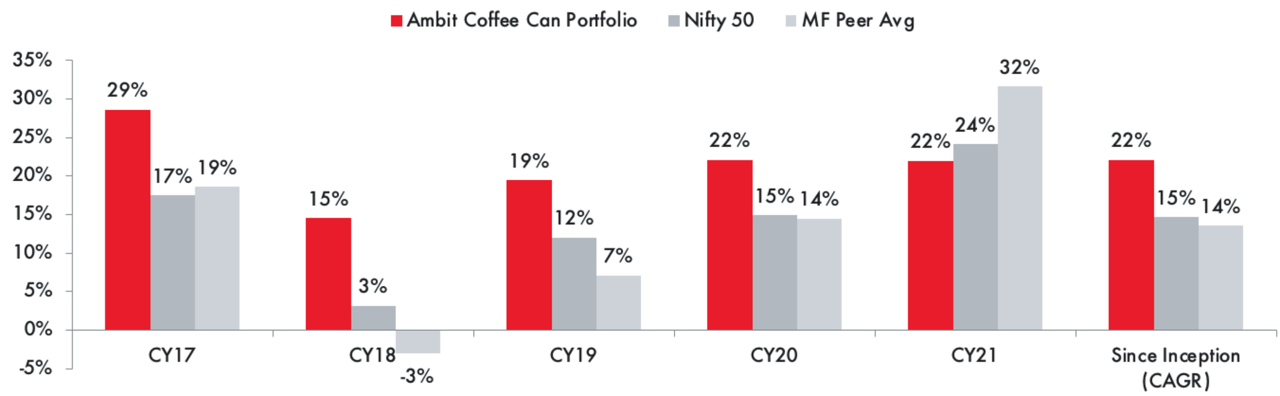
In Ambit Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail & consumption oriented sectors. The Coffee Can philosophy has unwavering commitment to companies that have consistently sustained their competitive 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.

Exhibit 11: Ambit Coffee Can Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 31st Dec, 2021; 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.

Exhibit 12: Ambit Coffee Can Portfolio calendar year performance



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AMBIT GOOD & CLEAN MIDCAP PORTFOLIO

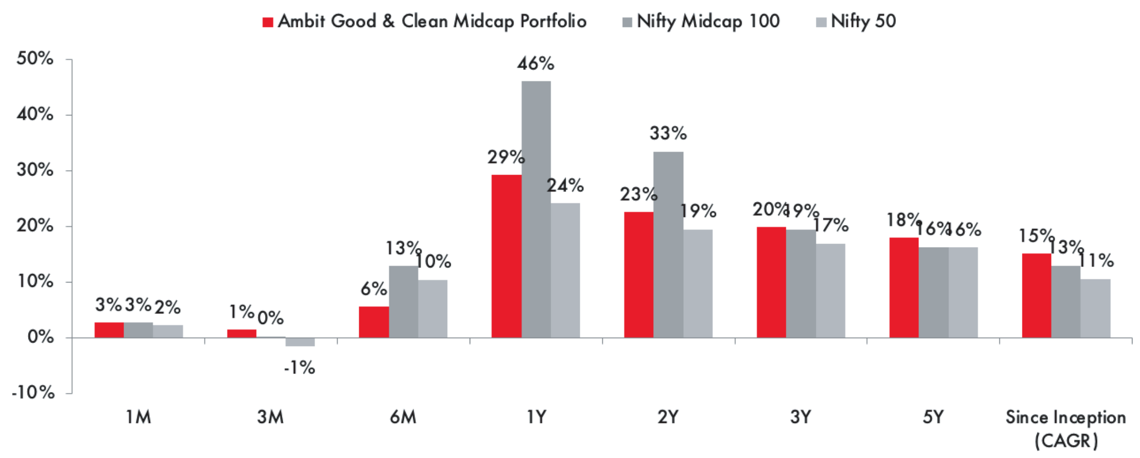
Ambit's Good & Clean strategy provides long-only equity exposure to Indian businesses that have an impeccable track record of clean accounting, good governance, and efficient capital allocation. Ambit's proprietary 'forensic accounting' framework helps weed out firms with poor quality accounts, while 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 this compounding earnings acting as the primary driver of investment returns over long periods.

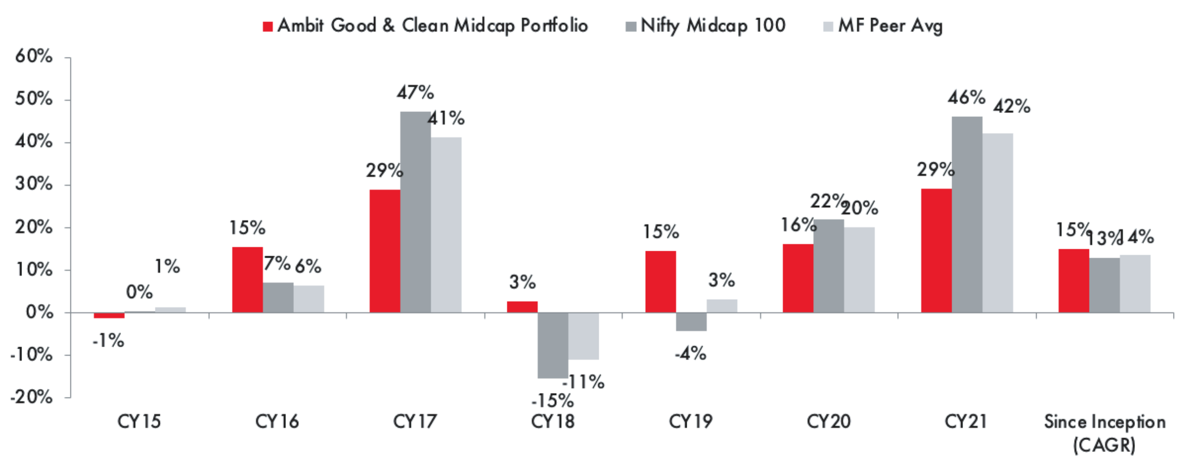
Low drawdowns: The focus on clean accounting and governance, prudent capital allocation, and structural earnings compounding allow participation in long-term return generation while also ensuring low drawdowns in periods of equity market declines.

Exhibit 13: Ambit Good & Clean Midcap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31st Dec, 2021, All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 14: Ambit Good & Clean Midcap Portfolio calendar year performance

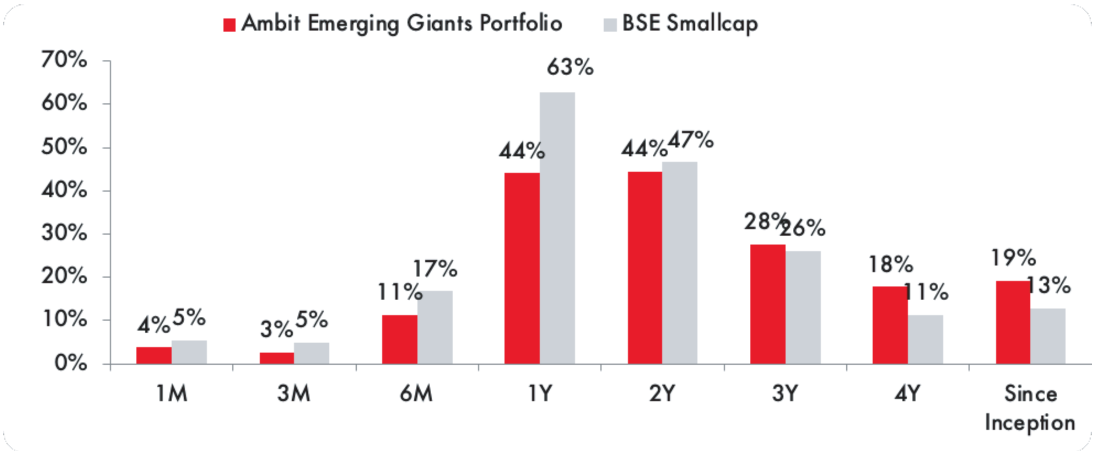


Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31st Dec, 2021, All returns above 1 year are annualized. Returns are net of all fees and expenses

AMBIT EMERGING GIANTS

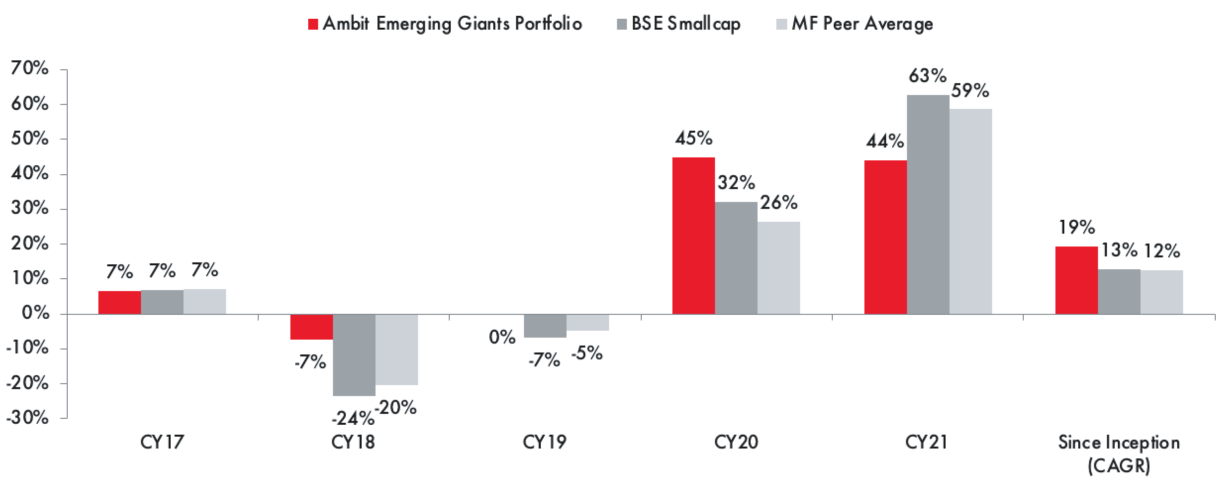
Smallcaps with secular growth, superior return ratios and no leverage
Ambit's Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than Rs. 4,000cr. These companies have excellent financial track records, superior underlying fundamentals (high RoCE, low debt) and 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 lead us to a concentrated portfolio of 15-16 emerging giants.

Exhibit 15: Ambit Emerging Giants Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 31st Dec, 2021; All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 16: Ambit Emerging Giants Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 31st Dec, 2021; All returns above 1 year are annualized. Returns are net of all fees and expenses

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