Ambit Asset Management

MONTHLY NEWSLETTER

FEBRUARY 2022

DECIPHERING THE 10X CONUNDRUM

Dear Patron,

It is well known that investment returns from equity have outperformed other asset classes across time frames when compared over a longer duration. The return which is often cited is that of the benchmark – Sensex – which is a large cap index and constitutes <1% of all listed companies. In the mid/small cap universe, fortunes across companies has been contrasting. Let alone make it big, many of those are barely able to survive, thus leading to sharp wealth erosion. But the ones that are able to execute successfully have led to outsized returns – far greater than the benchmark.

Our analysis of Top-1000 companies by market Cap over a 12-14 year rolling period from 2000-2019 indicates that roughly 15-20% of these companies have been able to grow their earnings (PAT) 10x or more over that time frame. This implies a CAGR of 18-21%.

So what is the trick to identifying these companies? How should investors implement the same?

We will try to address it in this newsletter using our STOICISM inspired framework which helps in recognizing the winners of tomorrow.

Stoicism – A Behavioral Finance Methodology

Stoicism is a school of philosophy that hails from ancient Greece and Rome in the 3rd century, BC. Stoics believed that everything around us operates according to a web of cause and effect resulting in a rational structure of universe. According to Stoicism, while one may not have control over events affecting them, they can have control over how they approach those events. This resonates well with investing **(Refer to Exhibit: 1,2).**

While business environment keeps changings with the onset of events such as GST, covid, etc. we at Ambit keep working towards improving our approach to generate superior returns.

While it is hard to completely separate human judgement from investing, we have developed several filters and framework to minimize human biases. Institutionalization of these systems and processes is what differentiates Ambit from other franchises. One of the frameworks that we actively use to find investable ideas is "STOICISM".

Exhibit 1: Stoics turn Obstacles into Opportunities – Perception Is Key

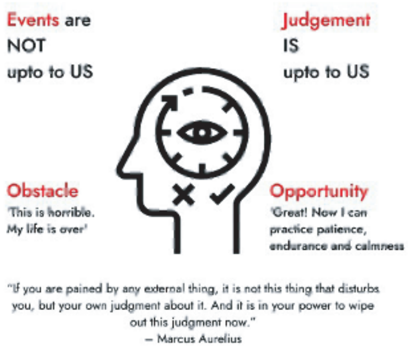
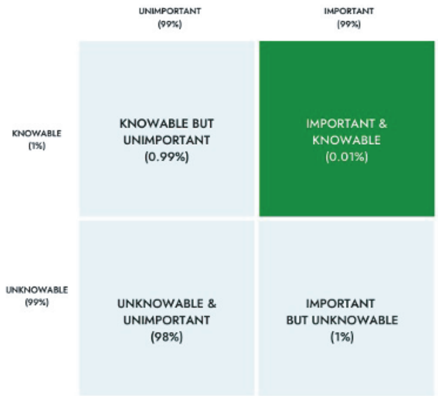


Exhibit 2 : Stoics keep it simple and focus on what is upto them. So should investors focus on knowable and important



Source: Ambit Asset Management

Our Investment methodology

We present below our methodology for identifying future leaders of tomorrow with an example of companies that have implemented those and grown their earnings 10x over the last 12-14 years.

1. Scope for horizontal/ backward integration:

A. **In horizontal integration**, company grows by acquiring a similar company in their industry or expanding their presence into adjacent categories. This provides two benefits:

a. **Scale** – Scale provides significant competitive advantage as it helps in cheaper sourcing of raw materials and getting favorable terms from the trade channel.

b. **Lower competitive intensity** – which helps in providing better and stable margins.

B. **In vertical integration**, companies gain control over the operations that come before or after them in the value chain, viz. forward or backward integration.

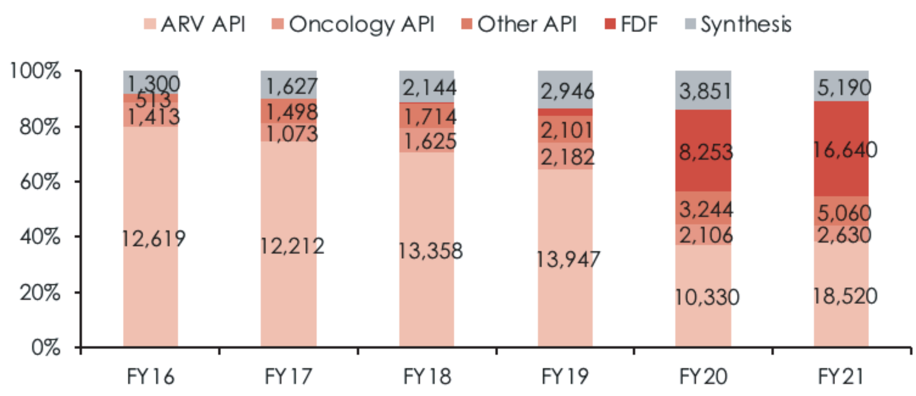
c. **Forward integration:** When a company acquires control over distributors or start opening stores to sell their products.

d. **Backward integration:** When a company acquires control over its suppliers. This provides better control on the product quality and reduces the impact of the volatility in raw material prices.

Laurus Labs: Laurus Labs is one company that has successfully forward integrated in the pharmaceuticals sector from API to formulations (which are higher margin). The company leveraged its expertise in ARV (Anti-Retroviral) API to Formulation and gain decent market share in a short span of time. Laurus is also investing in other sectors like Biologics, Custom Synthesis and CAR-T cell therapy. The company has a policy of investing 5-10% of profits in Disruptive technologies.

Laurus Labs' PAT grew 10x from FY14-21 while Dr. Reddy's PAT was almost same during the same period.

Exhibit 3: Laurus' forward integration is visible in changing revenue concentration in favour of Formulation, while also growing its ARV API revenue during that time frame



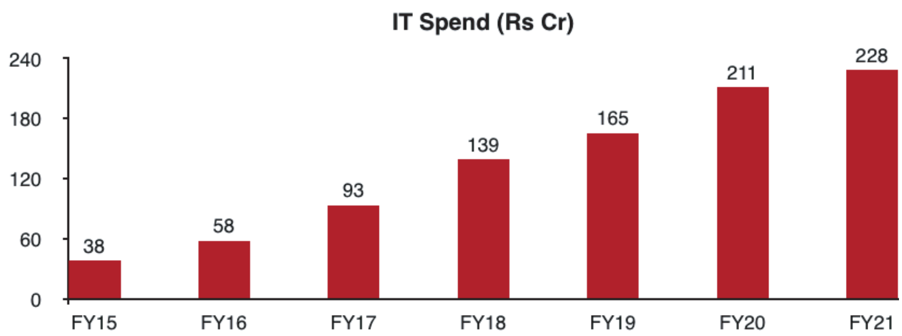
Source: Ambit Asset Management, Company

2. Leveraging Technology for consistent innovation: In today's world, there is no business that can function without using technology. Technology plays a crucial role in smooth functioning of business. Technology not only helps in optimizing processes and reducing cost but also in reducing human error. Right from taking orders from customers to inventory management to warehousing, automated systems have reduced human intervention. Companies that invest regularly in upgrading their technology have a better chance to fight the competition. Also, post covid, digital adoption has accelerated, which will favor technologically advanced companies.

Bajaj Finance: Bajaj Finance (BAF) has delivered exceptionally strong performance in the last decade creating large wealth for shareholders. Small ticket consumer lending is a difficult business as one should provide frictionless customer experience at the point of sale without diluting underwriting standards. Bajaj Finance invested heavily in technology and analytics (35% FY15-21CAGR), which helped in creating a strong customer franchise with high cross selling opportunities. Bajaj had a free run as they didn't have any meaningful competition in this category, resulting in sustainable loan growth and superior margins.

Bajaj Finance' PAT grew 10x from FY12-20 while Mahindra and Mahindra financial services has gone 1.7x during the same period.

Exhibit 4: BAF tech spend grew at a CAGR of 35% from FY15-21



Source: Ambit Asset Management, Company

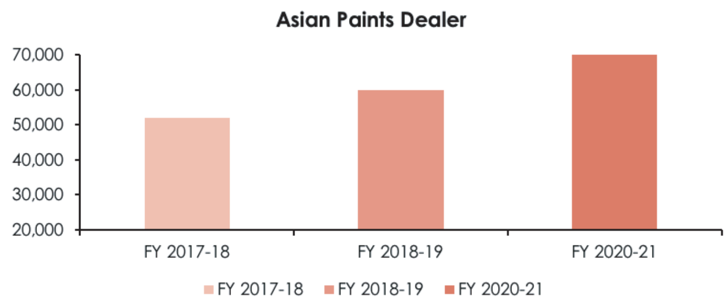
3. **Optimization of Distribution & network:** Distribution is a key lever for volume growth across industries. It is especially more important in impulse purchase categories such as snacks, biscuits, QSR etc. where reach and penetration is far more important. Apart from traditional distribution channels, there are several other ways – like Direct Distribution – to reach the customer. Direct reach to retailers and customers is more preferred over wholesalers as it not only allows brands to influence the retailers with product positioning but also provides customer insights. Companies with direct reach also find it easier to expand into newer categories by leveraging their existing network. Therefore a large distribution network with direct reach acts as a significant competitive advantage.

Asian Paints: Asian Paints has a strong dealer network of >70,000 as of FY21 compared to ~52,000 in FY18. This strong network aids in penetration of tinting machines which acts as an entry barrier. Due to lack of space at dealer's end, most dealers prefer to keep 1 or at max 2 tinting machines.

Asian paints is able to deliver finished goods within 6 hours due to its strong supply chain network and predictive analysis. This results in lower dealers' inventory (6-10 days vs. 15-20 days for peers) and higher no. of SKU. This generates better ROI for dealers even at low margins (3-5% v/s 8-10% for peers). This strong distribution moat of Asian Paints has helped in increased penetration and significant market share gains.

Asian Paint's PAT grew 10x from FY2007-2021 while Akzo Nobel's PAT grew 2.3x during the same period.

Exhibit 5: Asian Paints' growing dealer network strength



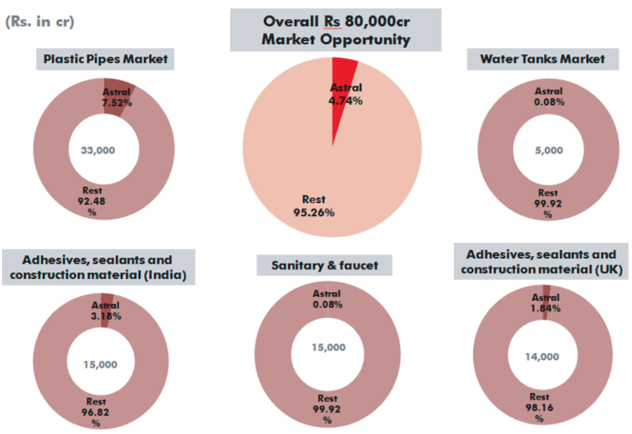
Source: Ambit Asset Management, Company

4. **Industry opportunity size with entry barriers:** There are few companies which keep innovating and disrupting their own business models to stay relevant to consumers. This helps in creating stronger entry barriers. In today's world, companies do not want to sell just a product but want to provide a complete solution. This helps in increasing customer's mind and wallet share. It not only increases the total addressable market but also creates significant competitive advantage.

Astral: Astral, which started as CPVC (small segment of plastic pipes) player has now transformed into a complete building material company (Rs800bn market). Astral acquired Resinova and Seal IT to enter into the adhesives and sealant industry. Company also recently entered plastic water tanks and sanitary ware industry. Each of these segment is set to witness high growth owing to underlying industry growth, representing a huge headroom for the company to become a one stop destination for building material.

Astral's PAT grew 10x from FY2008-2020 while Finolex's PAT grew 4.5x during the same period.

Exhibit 6: Huge opportunity size and scope for growth in each of the segment Astral is present in



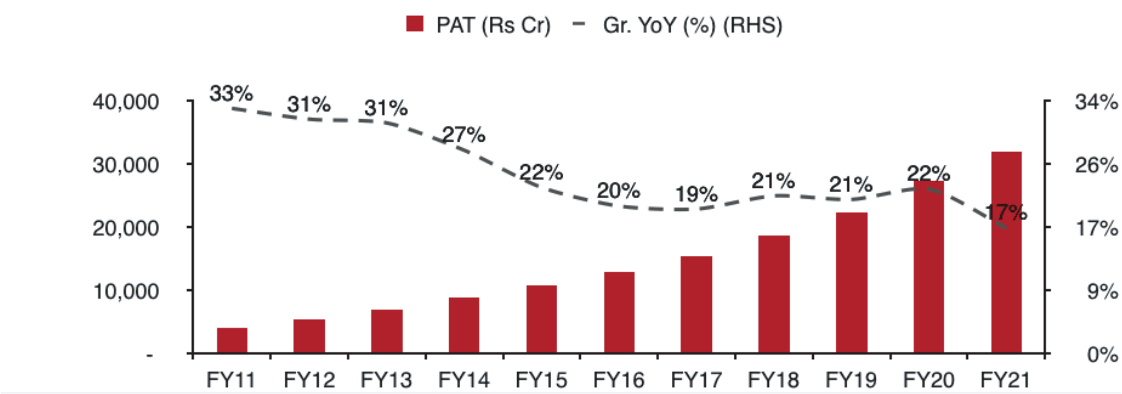
Source: Ambit Asset Management, Company

5. **Competency & execution with consistency:** Stock markets reward companies that give a steady performance in terms of earnings growth. In this VUCA (Volatile, Uncertain, Complex and Ambiguous) world, where everything is uncertain and volatile, it requires a strong competent management with a strong execution track record that can deliver sustainable growth across industry and macro-economic cycles. Few industries such as retail are even more challenging as consumer preferences keep changing.

HDFC Bank: The largest private bank, with over 12 lakh crore of loan book has consistently outperformed its peers. Bank used counter cyclical approach to gain market share over last decade. HDFC Bank grew its retail portfolio book aggressively during the retail crisis in 2009-10, when all other banks shied away. It also didn't participate in the infrastructure lending boom which resulted in lower NPA in corporate crisis in 2016-19. HDFC bank not only came unscathed from both retail and corporate cycle but also gained industry dominance.

HDFC bank's profit grew 10x over 2010-2021 while SBI's profit grew 1.8x during the same period

Exhibit 7: HDFC Bank's profit has consistently grown at ~20% — A far cry from its peers



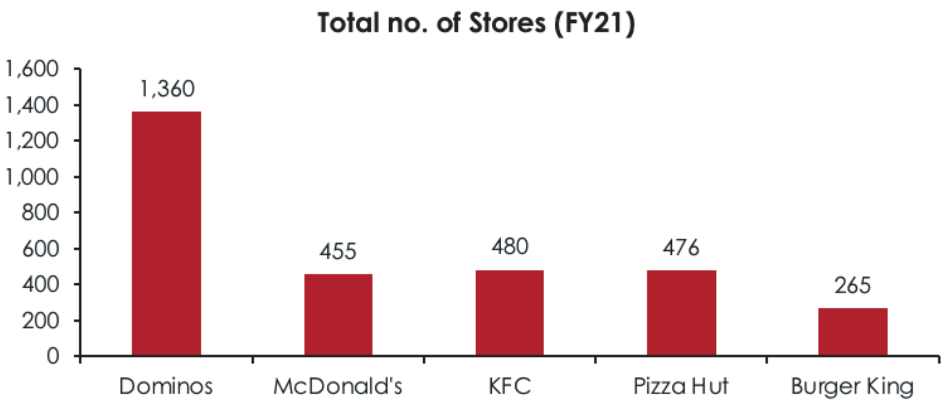
Source: Ambit Asset Management, Company

6. Increased Scope for Penetration: While India is a huge market, a large chunk of consumption (in value terms) still happens in urban areas, especially in metro cities. Most discretionary products and services (QSR, Multiplex) have higher salience in metros due to higher disposable income. Therefore, it is natural for companies to have a higher presence in large cities before penetrating into small cities. It becomes imperative for companies to expand to sub urban region as they are growing at a faster pace and maintain growth rates as Urban penetration and growth plateaus. Those companies that have aspirational brands at an affordable price point are far more likely to expand their presence in small towns. At Ambit, we keep looking for these companies as they have a long runway for growth.

Jubilant Foodworks: JUBI has the master franchise to sell Dominos pizza across the country. Dominos opens smaller stores (1000-1200 sqft) compared to McDonalds/Burger King (2500-4000sqft). Small stores require low capital expenditure and become profitable even in small towns. Even with a large base of ~1400 stores pan India, Dominos continues to aggressively expand stores (175 annually) This is a far cry from other QSR chains. Dominos has a larger total addressable market and longevity of growth compared to its peers.

Jubilant Foodworks's profit grew ~10x over 2010-2019 while other QSR players struggled to stay profitable consistently.

Exhibit 8: No of Stores across QSR chains



Source: Ambit Asset Management, Company

7. **Strong brand equity & customer experience:** In a highly competitive market, it becomes difficult to stand out. Brands help in cutting through the noise and giving customers a reliable experience. Creating a strong brand is a difficult and long journey as it takes decades to gain trust of consumers. Once you have created a loyal customer base, repeat purchases generate stable cashflows. It also becomes easier for strong brands to expand into adjacent categories.

Kajaria: Over the years, Kajaria has pioneered a number of sizes and product types for the Indian customers, ensuring that Kajaria becomes the first brand of recall for tiles across India. In keeping with this passion, the company introduced 256 new SKUs (floor and wall tiles) in FY21. It's association with high decibel national sporting events and its presence in high footfall areas has strengthened its connect with the masses and magnified the brand multifold. Its continued association with national youth celebrities – Akshay Kumar for the tile business, Anushka Sharma for the bathware segment and Ranveer Singh for the plywood segment – as its brand ambassadors has positioned the brand out of the clutter. These initiatives have positioned Kajaria as the No.1 tile brand in India.

Kajaria's PAT grew 10x during 2009-2021, while Somany's PAT grew 6.5x

Exhibit 9: Kajaria Branding with Akshay Kumar

Source: Ambit Asset Management, Company

8. **Management Bandwidth & Strong leadership:**

We all have seen how business have turned around after management change. Good management is critical for any business's success. Right management is even more important in plain vanilla sectors such as banking, where there is almost no product differentiation.

At Ambit, we look for three key attributes:

- **Competency**: Management should have deep understanding and experience in their industry. Experience helps in anticipating the future of the industry and making their business future ready.
- **Hungry for Growth:** Management should have a growth mindset, which includes getting into newer geographies and leveraging their existing distribution to introduce new categories. Inorganic growth at reasonable valuations can improve the fundamentals of the company.
- **Integrity:** It is extremely important to invest in companies with transparent and honest management. Strong franchise have loyal customers, suppliers, employees and investors as they are treated fairly.

L&T Infotech: is one company which has been able to implement that successfully. Since the current MD & CEO Mr. Sanjay Jalona took over in 2015, the company has successfully turned around its operations, arrested top-management attrition and improve its positioning in Digital services across verticals. The results of the same over the last 5 years are visible in the following parameters – (1) LTI has almost doubled the number of clients across key buckets like US$50mn, US$20mn, US$10mn, US$5mn and US$1mn (2) Addition of 22 Fortune-500 Logos. (3) Revenue contribution from the New logos in the last twelve months was >US$0.5bn (4) Won 30 large deals over the last 5 years with a total TCV >US$1.5bn out of which new logos contributed >50%

LTI's PAT grew 10x during 2006-2021, while Wipro's PAT grew ~4x

Exhibit 10: Marquee client list and ability to add F-500 clients differentiates LTI from its other Tier-2 IT peers

Source: Ambit Asset Management, Company

Exhibit 11: Strong client addition across buckets has boded well to well diversify revenue stream

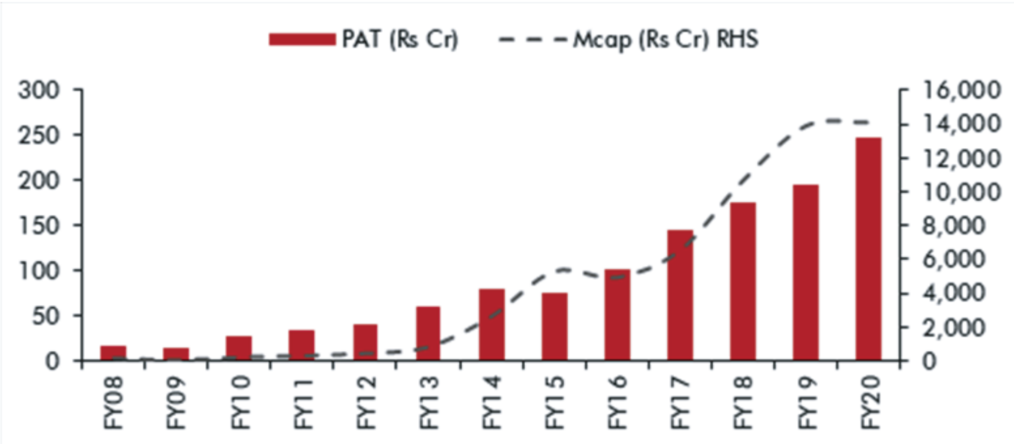
	FY16	FY17	FY18	FY19	FY20	FY21
100 Million dollar +	1	1	1	1	1	1
50 Million dollar +	3	4	4	5	6	5
20 Million dollar +	10	11	13	17	16	18
10 Million dollar +	17	23	23	26	27	35
5 Million dollar +	35	35	44	49	53	63
1 Million dollar +	85	96	109	123	165	167

Source: Ambit Asset Management, Company

CONCLUSION

Apart from the names mentioned above, Relaxo, LA Opala, Pidilite are some other companies that have grown their earnings 10x over a 12-14 years period. Majority of these companies had the above characteristics that we've mentioned which have helped them achieve that feat. Identifying such small / mid-cap companies in positively aligned sector that can deliver 10x esrnings growth over the next 12-14 years is key. (Refer to Exhibit: 12)

Exhibit 12: 25% CAGR in Astral's PAT from FY08-20 – translated into 44% Market Cap CAGR

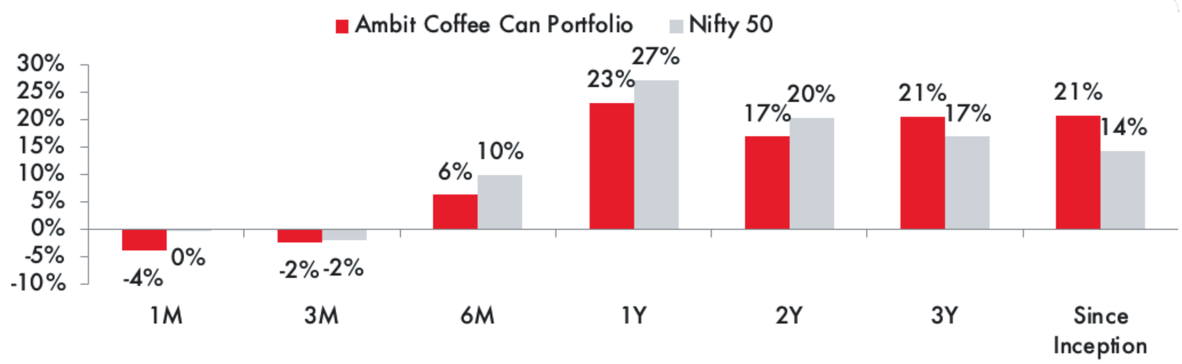


Source: Ambit Asset Management, Screener, Bloomberg

AMBIT COFFEE CAN PORTFOLIO

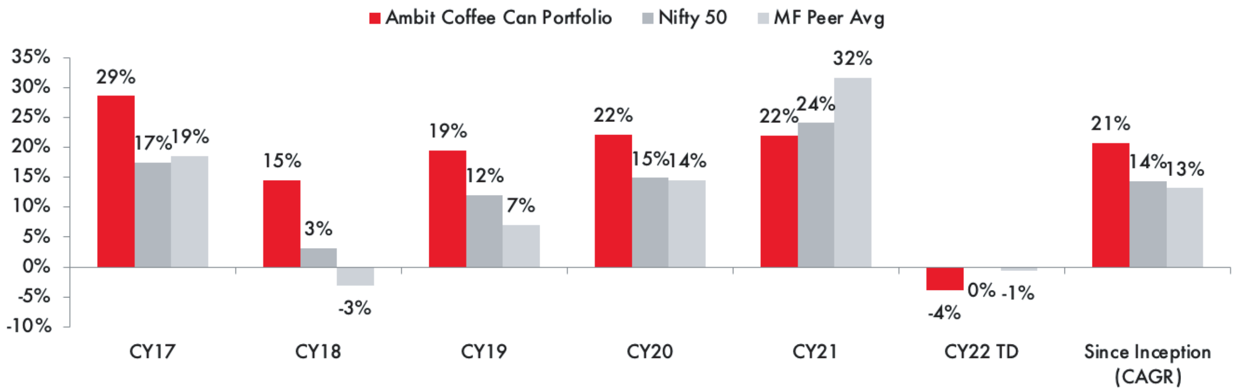
In Ambit Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail & consumption oriented sectors. The Coffee Can philosophy has unwavering commitment to companies that have consistently sustained their competitive 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 13: Ambit Coffee Can Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 31st January, 2022; 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 14: Ambit Coffee Can Portfolio calendar year performance



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 31st January, 2022; 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.

AMBIT GOOD & CLEAN MIDCAP PORTFOLIO

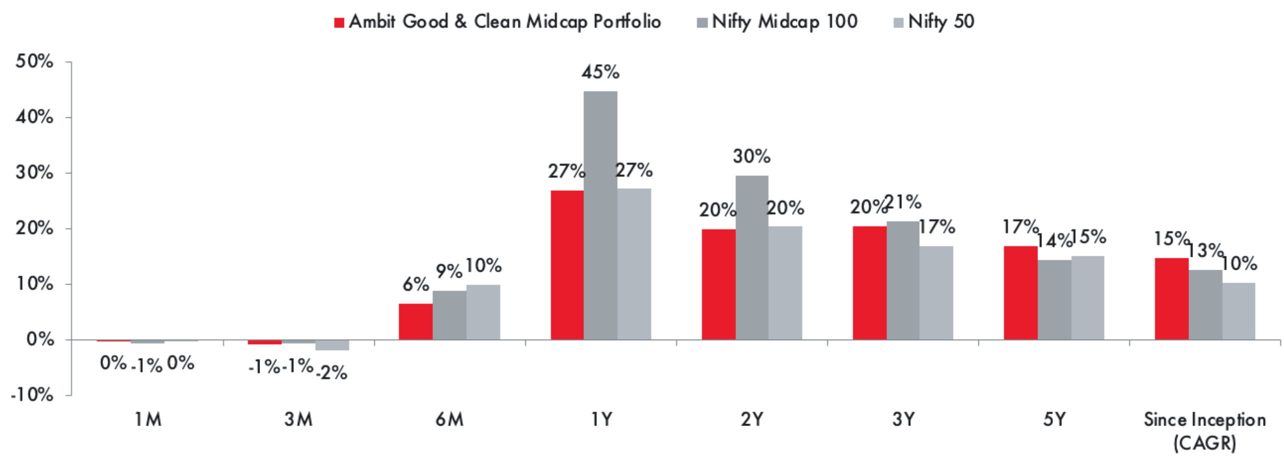
Ambit's Good & Clean strategy provides long-only equity exposure to Indian businesses that have an impeccable track record of clean accounting, good governance, and efficient capital allocation. Ambit's proprietary 'forensic accounting' framework helps weed out firms with poor quality accounts, while 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.

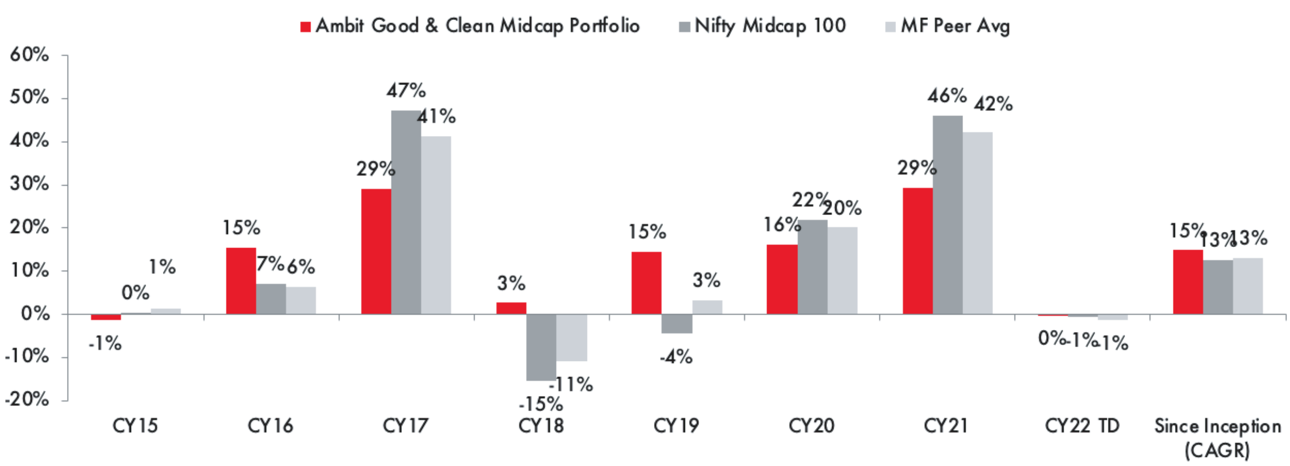
Low drawdowns: The focus on clean accounting and governance, prudent capital allocation, and structural earnings compounding allow participation in long-term return generation while also ensuring low drawdowns in periods of equity market declines.

Exhibit 15: Ambit Good & Clean Midcap Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31st Jan, 2022, All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 16: Ambit Good & Clean Midcap Portfolio calendar year performance



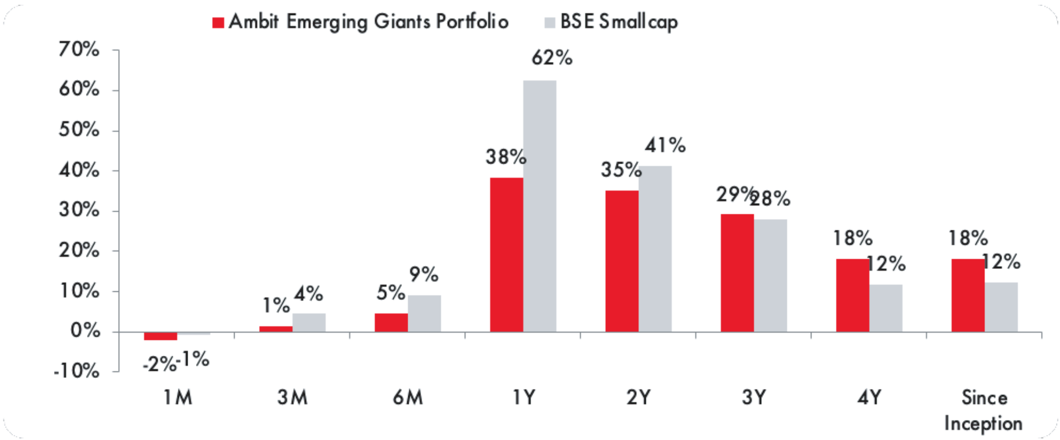
Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31st Jan, 2022, All returns above 1 year are annualized. Returns are net of all fees and expenses

AMBIT EMERGING GIANTS

Smallcaps with secular growth, superior return ratios and no leverage

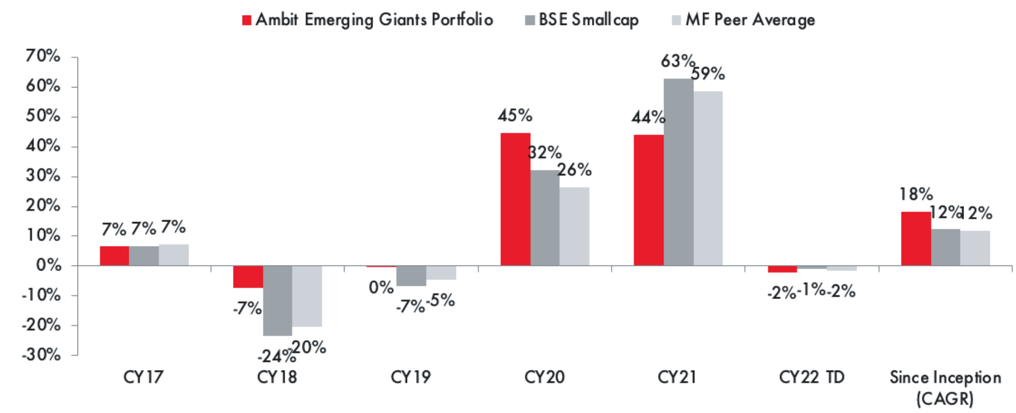
Ambit's Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than Rs. 4,000cr. These companies have excellent financial 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 17: Ambit Emerging Giants Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 31, 2017; Returns as of 31st Jan, 2022; All returns above 1 year are annualized. Returns are net of all fees and expenses

Exhibit 18: Ambit Emerging Giants Portfolio calendar year performance



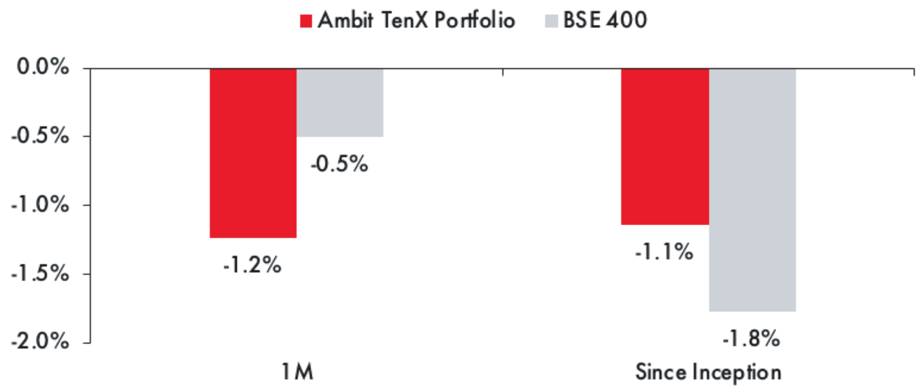
Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 31st Jan, 2022; All returns above 1 year are annualized. Returns are net of all fees and expenses

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 follow:

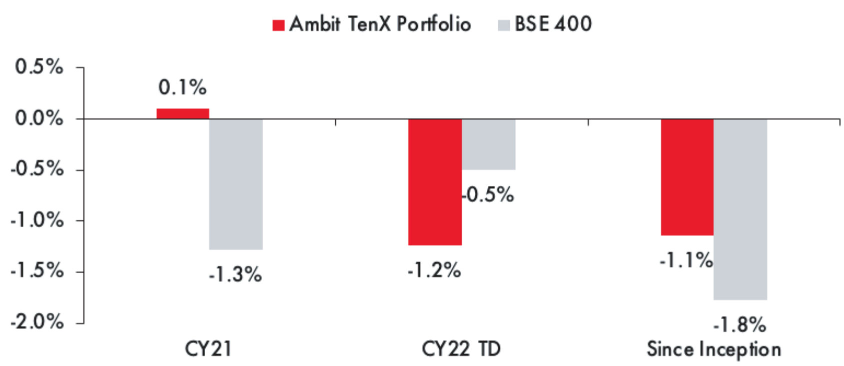
- **Longer-term approach with a concentrated portfolio:** Ideal investment duration of >5 years with 15-20 stocks.
- **Key driving factors:** Low penetration, strong leadership, light balance sheet
- **Forward-looking approach:** Relying less on historical performance and more on future potential while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

Exhibit 19: Ambit TenX Portfolio point-to-point performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of 31st Jan, 2022; All returns are post fees and expenses;

Exhibit 20: Ambit TenX Portfolio calendar year performance



Source: Ambit; Portfolio inception date is December 13, 2021; Returns as of 31st Jan, 2022; All returns are post fees and expenses;

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The product 'Ambit Coffee Can Portfolio' has been migrated from Ambit Capital Private Limited to Ambit Investments Advisors Private Limited. Hence some of the information in this presentation may belong to the period when this product was managed by Ambit Capital Private Limited.

You may contact your Relationship Manager for any queries.

The performance data for coffee can product between 6th march 2017 - 19th June 2017 represents model portfolio returns. First client was onboarded on 20th June 2017. The performance data for G&C product between 1st June 2016 to 1st April 2018 also includes returns for funds managed for an advisory offshore client. Returns are calculated using TWRR method as prescribed under revised SEBI (Portfolio Managers) Regulations, 2020