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AMBIT ASSET MANAGEMENT

November 2020

MONTHLY NEWSLETTER

GOOD & CLEAN by AMBIT

COFFEE CAN PMS

EMERGING GIANTS by AMBIT

Ambit Good & Clean Portfolio **Ambit Coffee Can Portfolio** **Ambit Emerging Giants Portfolio**

Dear Investor,

This month's newsletter takes us through some interesting big themes. While some data points talk of hope and revival, some justifiably urge caution. What stands out is that those companies with the ability to withstand pain in the near term are likely to get ahead while others may not be as fortunate.

This pretty much endorses our team's firm belief of a K shaped recovery trajectory of Indian corporates and consequently the Indian stock market alike which we alluded to in our September publication.

Memory Refresh: *K shaped recovery concept rests on the idea that the strong become stronger and weak become weaker.*

1. Consumerism is returning

Online Sales: Amazon & Flipkart
Industry consultants Forrester Research and RedSeer Consulting had expected increase in sales by 30-36% during the 1 week period of Oct 15th -21st. Annually, around 75% of the festive months sale usually happen during this week. India's biggest e-commerce players by market share, Amazon and Flipkart, have together raked in $3.5bn (about Rs 260bn) during the first four days of their flagship festive season sales events this year.

Flipkart also mentions that more than half of all electronic goods purchased by consumers were in the work-from-home segment with large-screen TVs, laptops, IT accessories and peripherals witnessing an increase of over 1.4x from last year's levels (source: Media articles)

Channel check: Croma electronics
We did some in store channel checks at Croma at Phoenix Mills and Fort stores. Many of you that visited electronics stores during COVID may not find it surprising that electronics sales have recovered to a great extent and Croma stores that opened in August are already seeing overall revenues at >50% of pre COVID levels.

Key takeaways from Retail shopping mall companies
Phoenix Mills: The consumption pattern in Electronics is strong (~80% of pre-COVID levels), Jewellery/watches (~55%), Fashion/apparels (~40% with sportswear doing better)

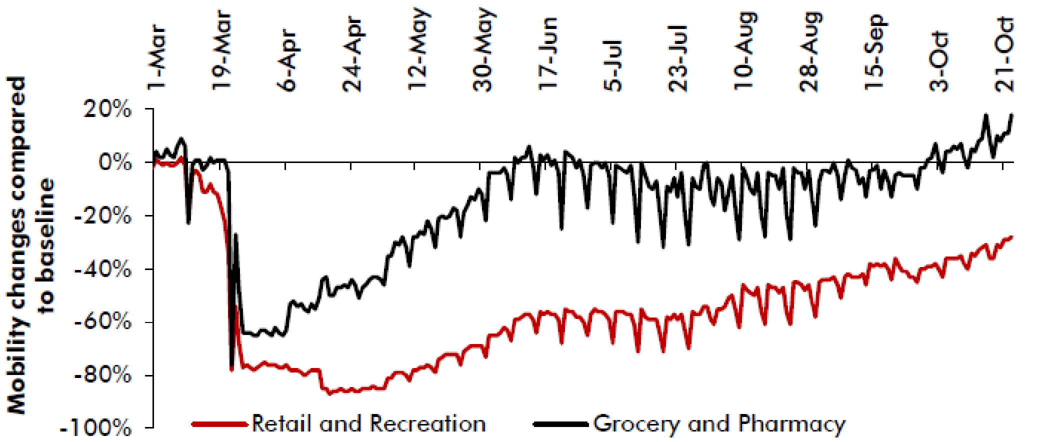
DLF Retail Mall: : Footfall recover in the mall is 50% of pre-COVID levels on weekdays and 70% on weekends. This is expected to reach 70-75% overall by 3QFY21
Infinity Mall: Expected footfall recovery in 3QFY21 of 80-85% of pre-COVID level

Channel checks: Surprise recovery in Diamonds
We conducted our own channel checks across various sectors including the jewellery segment. What we found took us by surprise- We interviewed a large/midsized diamond merchant from Surat employing nearly 1000 workers. Diamond trade is getting back on track!

Since March there has been a significant improvement in purchase patterns globally and since almost 90% of worldwide rough diamonds are cut, polished and certified in India, the entire industry is seeing a pick up far sooner than earlier estimated. Production levels are almost >70% of pre- COVID levels and the demand pipeline is much stronger than earlier imagined. Problem, if any, is availability of labour for production and not demand from consumers.

We see a similar story in the case of larger Jewellers where volumes may have been hit on account of higher gold prices but in value terms the numbers are expected to be far more encouraging than earlier predicted.

Exhibit 1: Google mobility data shows progressive improvement in retail footfalls



Source: Ambit Capital research, Google Mobility report, note - baseline is the median value, for the corresponding day of the week, during the five week period 3 Jan – 6 Feb 2020

Since all three of our Portfolio schemes are consumer focused with an inclination towards essential goods and services our companies face a natural advantage over some of their peersets.

2. Consolidation/Quality migration story intact…

In India organized and established players are gaining revenue share because of one or more of these factors: **a)** supply disruptions at unorganized players, **b)** ability to build trust with consumers on hygiene, and **c)** individual store owners' inability to fund cash burn and working capital constraints.

A snippet from leading jewellery maker – Titan's results:
In line with the diamond market channel checks in the previous section there has been an unequal recovery in jewellery segment as well.

- Titan's Jewellery sales grew 8.8% YoY to Rs38.4bn. Even excluding the bullion sales of Rs3.9bn, recovery rate was a strong 98% YoY for the jewellery segment. Customer sentiment has improved substantially during the quarter which is visible in improved walk-ins.

- The company is using technology and innovation to cater to these customers while consciously trying to advance sales to reduce rush during the peak period. Organized players have been gaining market share post-lockdown as unorganized players suffer with liquidity issue, old inventory and lower footfalls owing to lack of consumer trust on hygiene.

- Titan is gaining market share from both organized national players and unorganized regional players. On the back of this, the company is expecting a complete recovery in Q3FY21 with a return to growth in Q4FY21 on a YoY basis. High single digits growth in first 11 days of the festive season surely points to that.

Snippet from notable Building material company results:

- Kajaria Ceramics/Supreme Industries/Asian Paints are leading players in Tiles/Pipes/Paints, respectively. These companies are currently operating at 110%+ of pre-COVID levels. While, real estate demand is yet to pick-up, housing demand in Tier 2/3 cities has recovered to pre-COVID levels.

- This abnormally high recovery can be explained by market share gains these larger established companies are making from unorganised and scattered players.

  1. On the piping side, smaller players and certain larger players are struggling due to working capital issues.
  2. Paints companies' sales have recovered to pre-COVID levels partly led by upcoming wedding/festive season and partly due to market share gains
  3. Tiles exports in India are expected to increase to Rs80-120bn due to anti-China sentiments. Thus, the mostly unorganised Morbi

players (contributing ~80% of India's Tiles production) have shifted focus towards exports, benefiting larger players like Supreme who cater to domestic markets.

Leading Private Bank: A snippet from HDFC Bank Results:
Despite the air of gloom and doom surrounding Banking sector, the leading private Bank (HDFC Bank) was able to maintain asset quality, by providing excess provisions at 195% of GNPA, industry leading provision coverage ratio at 84.5% and also Liquidity Coverage Ratio at 153%. This strength of Balance sheet and nimbleness to respond to crises enables leaders such as HDFC Bank to thrive through crisis. This can be seen in the reported growth parameters of the Bank: NII growth at 16.7% YoY, Operating Profit growth 18% YoY & PAT growth at 18.4%. The Bank achieved all this while registering a deposit growth higher than advances at 20% YoY. ***(Ref to Exhibit 2 & 3)***

Exhibit 2: Over long periods of time Market leaders (HDFCB, KMB) tend to prosper vs. the system…

	FY10-FY20 CAGR	Growth v System
HDFC Bank	21.30%	1.7x
KMB	25.40%	2x
Axis Bank	17.60%	1.4x
ICICI Bank	11.70%	0.9x
SBI	14.10%	1.1x
System	12.80%	1x

Source: Ambit Asset Management

Exhibit 3: … but especially during crises Market leaders (HDFCB, KMB) outshine and gain at the cost of peers

	COVID		Pre-COVID		
Advance Growth YoY	**Q1FY21**	**Q4FY20**	**Q3FY20**	**Q2FY20**	**Q1FY20**
HDFC Bank	21%	21%	20%	20%	17%
KMB	20%	15%	10%	10%	16%
Axis Bank	13%	16%	16%	14%	13%
ICICI Bank	15%	10%	13%	13%	15%
SBI	8%	6%	7%	10%	14%

Source: Ambit Asset Management

Consolidation story not unique to India: McKinsey survey suggests that smaller European players expected to shut
More than 50% of small and medium-sized businesses (SMEs) operating in Europe's top-five economic powerhouses fear they will have to close in 12 months as they're struggling to stay afloat. The pandemic has pushed down the revenues of more than 70% of European companies, according to the results of the McKinsey survey of over 2,200 SMEs in five European countries: France, Germany, Italy, Spain, and the UK. At the current trajectory, one in 10 SMEs (or 11%) are expected to file for bankruptcy within half a year. The level may be nearly twice as high among the largest French companies, employing between 50 and 249 people.

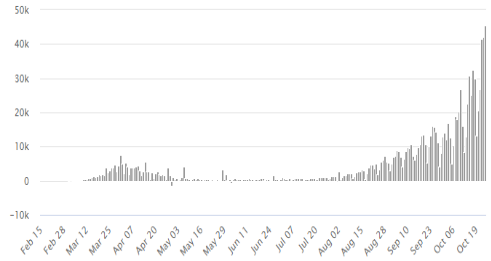
All three of our portfolio schemes are made up of organized players and market leaders across segments leading to safety of operations, ability to capitalize on opportunity and consequently lending higher stability to portfolios without sacrificing returns.

3. Fight is still not over, COVID worry looms:

- While there have been pockets of good news across sectors, Europe is now seen as battling its second wave of COVID cases. Many countries such as France, Germany, Italy, Spain and many others are seeing resurgence in number of daily COVID cases. Cases in UK similarly have also rebounded. ***(Ref Exhibit 4 to 8)***

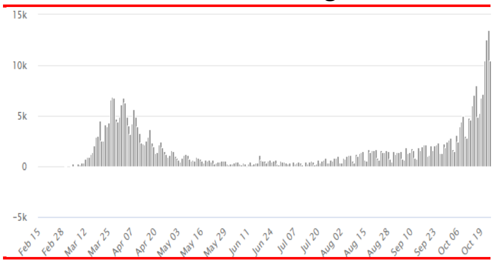
- While the increase in cases is attributed to lack of preparedness, lax attitude or resuming of normal business activity-one thing stands out irrespective of the reason for resurgence-This is not over yet. We need to be prepared while we wait. ***(Ref to Exhibit 9)***

Exhibit 4: France has seen a steep increase in cases (worldometer.info /coronavirus)



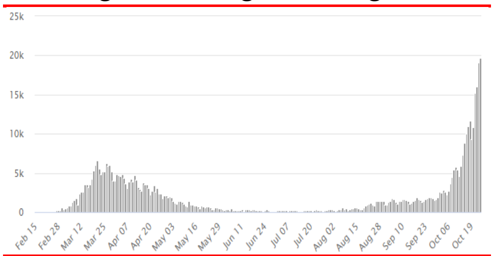
Source: Ambit Asset Management; Data ranges between Feb 15th-Oct 23rd 2020

Exhibit 5: Germany has seen large increase and is considering lockdown



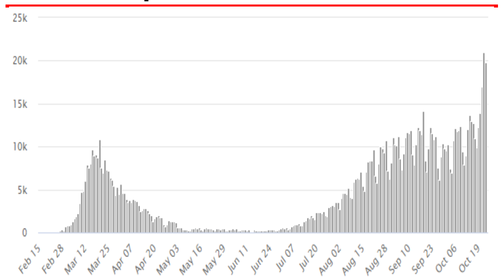
Source: Ambit Asset Management, Data ranges between Feb 15th-Oct 23rd 2020

Exhibit 6: Italy with high cases early on is seeing a much higher resurgence



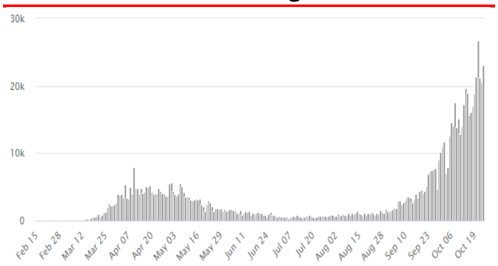
Source: Ambit Asset Management, Data ranges between Feb 15th-Oct 23rd 2020

Exhibit 7: Spain cases on the rise



Source: Ambit Asset Management, Data ranges between Feb 15th-Oct 23rd 2020

Exhibit 8: UK case surge pushed them to announce month long lockdown



Source: Ambit Asset Management, Data ranges between Feb 15th-Oct 23rd 2020

Exhibit 9: COVID-19 cases, death rate by country

Country	Cases (~Lakhs)	Death Rate
USA	90	2.6%
India	**80**	**1.5%**
Brazil	54	2.9%
Russia	15	1.7%
Spain	12	3.0%
France	12	3.0%
UK	9	4.9%
Italy	6	6.7%
Germany	5	2.2%

Source: Ambit Asset Management, Data ranges between Feb 15th-Oct 19th 2020, Source

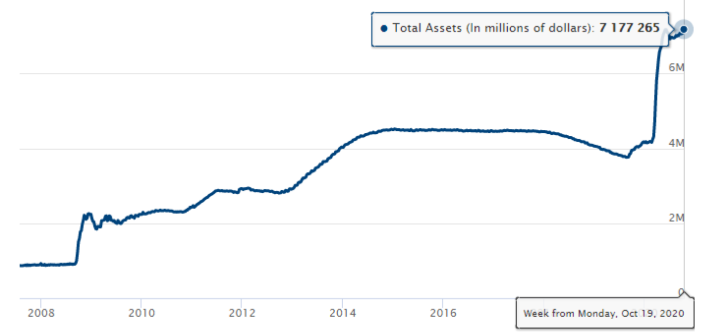
While we understand the risk of such uncertainty and possibility of a second wave we believe our portfolio companies are well placed to combat trying times. All three of our portfolio schemes are made up of low leverage companies with healthy balance sheets.

4. In India we take respite from…

A. Huge stimulus packages (-3.9tn+12 tn =Huge inflows into equities across the world)

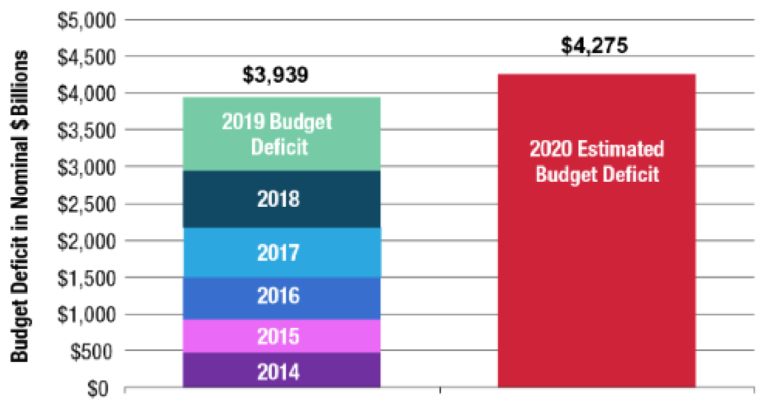
- The IMF says, the global economy will contract by 4.4% this year. On an ~$88 tn world economy, a 4.4% decline = a $3.9 tn hole this year however the IMF's report also states, that to date Governments around the world have committed $12 tn in fiscal stimulus.
- If we look at the US Federal reserve balance sheet alone it has expanded from USD4tn to USD7tn from March to October 2020 alone! To put this in perspective during the Global Financial crisis the Balance sheet of the Federal Reserve had expanded from USD 870bn in August 2007 to ~USD3tn over four years from 2008-12. ***(Ref to Exhibit 10 &11)***
- ***For India this means:*** Lower interest rates globally, more money supply and a weaker dollar will lead to greater need for foreign money to be deployed at higher rates of return (especially for US investors) and for India this will mean larger global inflows as has been the trend from April to October vs. last year.

Exhibit 10: A liquidity response given over 4 years during GFC in 2008 was given over 6 months this time, expansion of USD3tn in 6 months



Source: Ambit Asset Management, Source, Period shown is July 30th, 2007 to October 20th, 2020

Exhibit 11: no holding back on government spending in US is fuelling excess liquidity and investments world over (incl India)



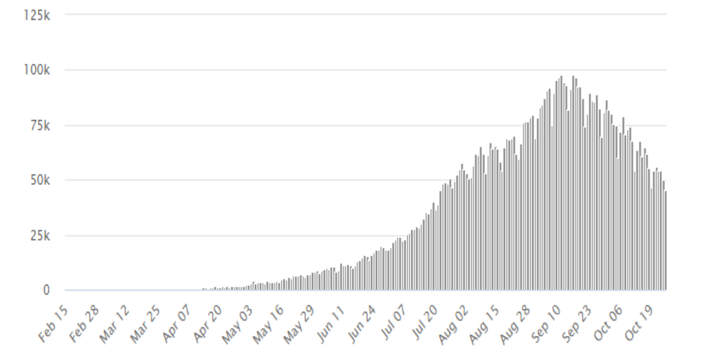
Source: Ambit Asset Management

Global and foreign fund Inflows into India are usually concentrated into well established companies with good trading volumes and high level of corporate governance practices. In other words these are companies with the characteristics we look for and hold in our portfolios which will be larger beneficiaries of investments coming to India (especially into our large cap and midcap portfolio schemes)

B. Lower cases in India+progress on vaccine trial(few in phase 3)

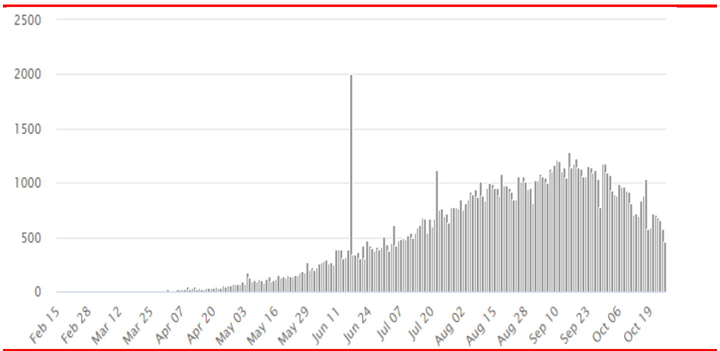
- Over the last 15 days, India has been reporting its smallest daily rise in new COVID cases. Close to about 7mn people have recuperated from COVID, pushing the recovery rate close to 90%, while the fatality rate stands near 1.5%.
- For now the trend in new cases seems to be subdued. It will be key to watch out for cases remaining subdued through an extended festival season coming up ahead.
  (Ref to Exhibit 12 &13)

Exhibit 12: India daily cases are tapering since September



Source: Ambit Asset Management

Exhibit 13: and likewise daily deaths are reducing too



Source: Ambit Asset Management

- While a vaccine seems to be still far away, it is really commendable how many companies have come so far to progress to phase 3 trials in such a short time span. Various estimates peg the vaccine as likely to be launched at different points in time next year itself depending on which study you go by. ***(Ref Exhibit 14,15 & 16)***

Exhibit 14: Various estimates suggest that a vaccine can be out latest by next year and some even hopeful it might release this year itself

Adar Poonawalla CEO Serum Institute of India	Covishield, a vaccine candidate that has shown promise during trials**, may be ready by December 2020 (subject to conditions)**	Source
Kate Bingham, the chair of the UK government's vaccine taskforce	"If the first two vaccines, or either of them, show that they are both safe and effective, **there is a possibility that vaccine rollout will start this side of Christmas**, but otherwise **it's more realistic to expect it to be early next year**".	Source
Dr. Anthony Fauci, the **top US infectious diseases expert**	If all goes well, the first doses of a safe and effective coronavirus vaccine will likely become available to some high-risk Americans **in late December or early January**	Source

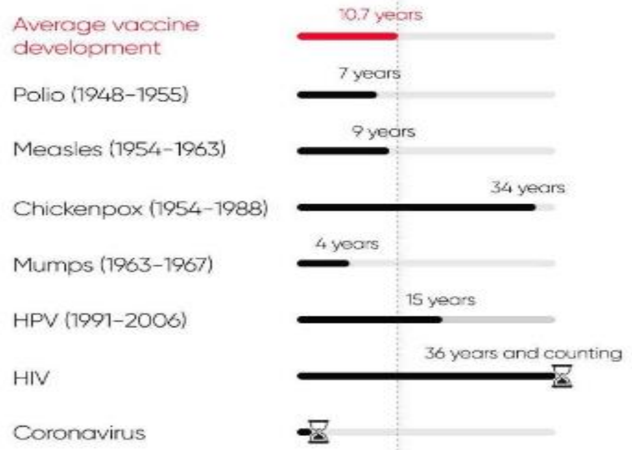
Source: Ambit Asset Management

Exhibit 15: We have made considerable progress…

Candidate	Trial Phase
Ad5-nCoV	Phase 3
AZD1222 (Serum Institute of India)	Phase 3
CoronaVac	Phase 3
JNJ-78436735 (formerly Ad26.COV2-S)	Phase 3
mRNA-1273 (Moderna)	Phase 3
NVX-CoV2373	Phase 3
Bacillus Calmette-Guerin (BCG) vaccine	Phase 2/3
BNT162 (Pfizer, BioNTech)	Phase 2/3
Covaxin	Phase 2
ZyCoV-D (Zydus Cadila)	Phase 2
BBIBP-CorV	Phase 1/2
INO-4800 (Inovio Pharmaceuticals)	Phase 1/2
Sputnik V (Russia)	Phase 1/2
EpiVacCorona (Russia)	Phase 1/2

Source: Ambit Asset Management, Source

Exhibit 16: …if one puts things into perspective



Source: Ambit Asset Management, Media articles

5. Recovery in our portfolio companies...isn't without reason

To sum up our portfolio companies are well placed given they are:

Consumer focused franchises with an inclination towards essential goods and services being well placed to capture any recovery in this segment.

Organized players and market leaders across segments which will have stable operations, ability to capitalize on opportunities and benefit at the cost of their less established or fragmented peers in line with the likely K shape recovery across sectors.

Low leverage companies with healthy balance sheets which will make them outlast their peers, outspend their peers, maintain operating stability and retain top talent through periods of financial crunch and uncertainty. This is important given the uncertainty and possibility of a second wave of COVID infections like we are witnessing across Europe.

Likely beneficiaries of global and foreign fund Inflows into India which are usually concentrated into well established companies (often market leaders) with high level of corporate governance practices and reasonable daily trading volumes like those in our portfolio schemes(especially into our large cap and midcap portfolio schemes).

Exhibit 17: Ambit Coffee Can portfolio's 100% companies are >70% of pre-COVID levels

% of Pre-COVID levels	% of portfolio companies
>100%	36%
80-100%	57%
70-80%	7%
<50%	0%
NA	0%

Source: Ambit Asset Management; Note data is based on information from Company, Media articles, Internal estimates about Revenue/footfall/capacity utilizations

Exhibit 18: Ambit Good & Clean portfolio's 74% companies are >80% of pre-COVID levels

% of Pre-COVID levels	% of portfolio companies
>100%	32%
80-100%	42%
50-80%	11%
<50%	11%
NA	5%

Source: Ambit Asset Management, Note data is based on information from Company, Media articles, Internal estimates about Revenue/footfall/capacity utilizations

Exhibit 19: Ambit Emerging Giants portfolio's 65% companies are >70% of pre-COVID levels

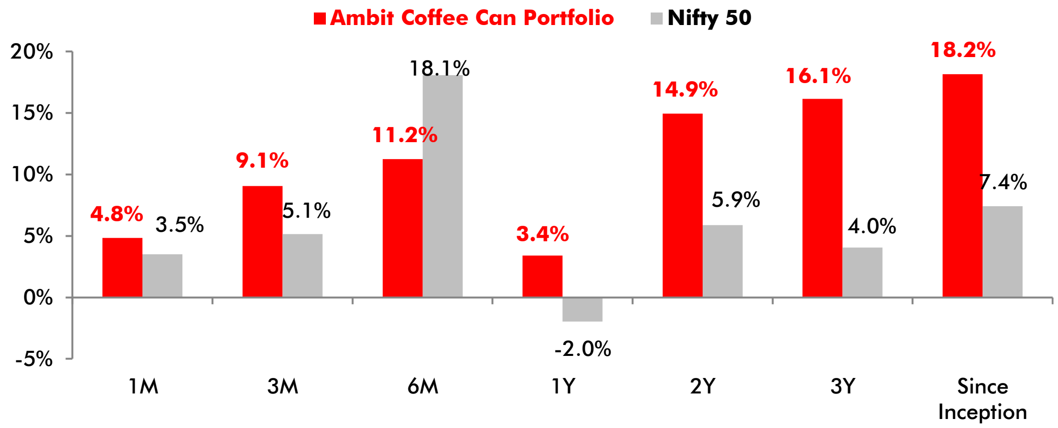
% of Pre-COVID levels	% of portfolio companies
>100%	12%
>80%	29%
70-80%	24%
50-70%	18%
<50%	12%
NA	6%

Source: Ambit Asset Management, Note data is based on information from Company, Media articles, Internal estimates about Revenue/footfall/capacity utilizations

Ambit Coffee Can Portfolio

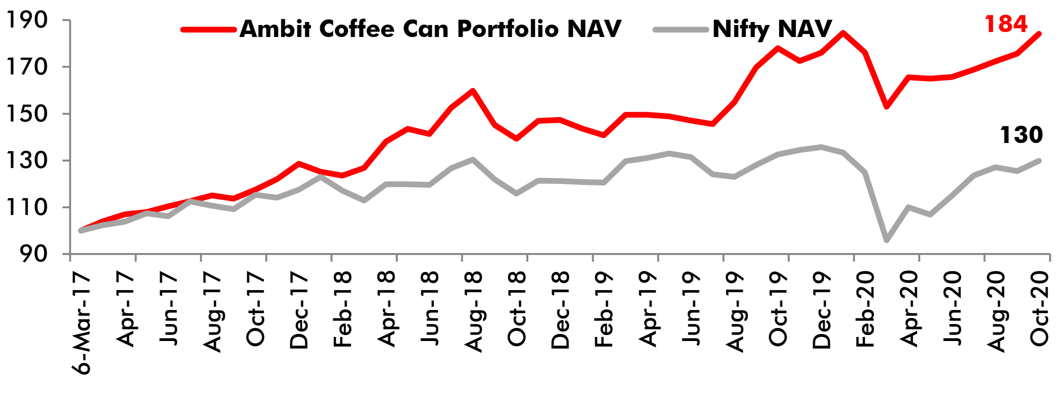
At Coffee Can Portfolio, we do not attempt to time commodity/investment cycles or political outcomes and prefer resilient franchises in the retail & consumption oriented sectors. The Coffee Can philosophy has unwavering commitment to companies that have consistently sustained their competitive advantages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

Exhibit 20A: Ambit's Coffee Can Portfolio performance update



Source: Ambit; Portfolio inception date is March 6, 2017; Returns as of 31st Oct, 2020; 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 20B: Ambit's Coffee Can Portfolio NAV update



Source: Ambit Asset Management

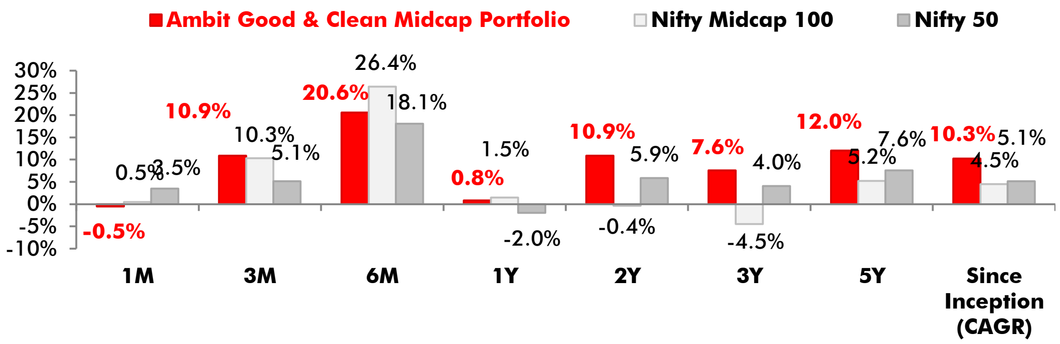
Ambit Good & Clean Portfolio

GOOD&CLEAN by AMBIT

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:

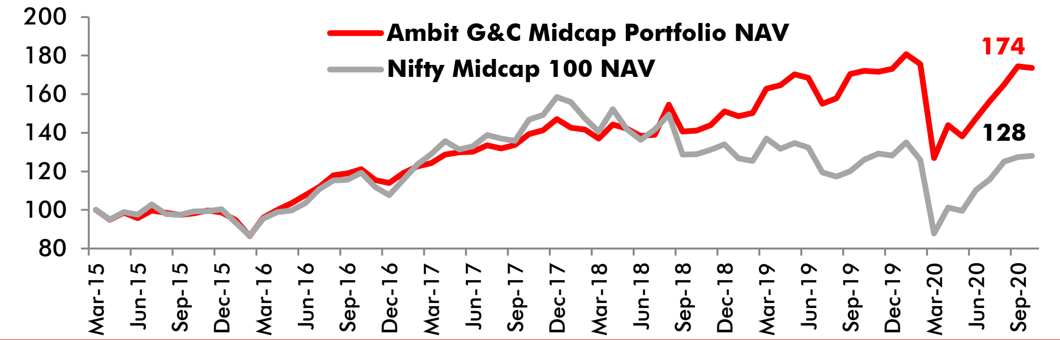
- **Process-oriented approach to investing**: Typically starting at the largest 500 Indian companies, Ambit's proprietary frameworks for assessing accounting quality and efficacy of capital allocation help narrow down the investible universe to a much smaller subset. This shorter universe is then evaluated 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 21A: Ambit's Good & Clean Portfolio performance update



Source: Ambit; Portfolio inception date is March 12, 2015; Returns as of 31st Oct, 2020; All returns above 1 year are annualized. ***Returns are net of all fees and expenses***

Exhibit 21B: Ambit's Good & Clean Portfolio NAV update



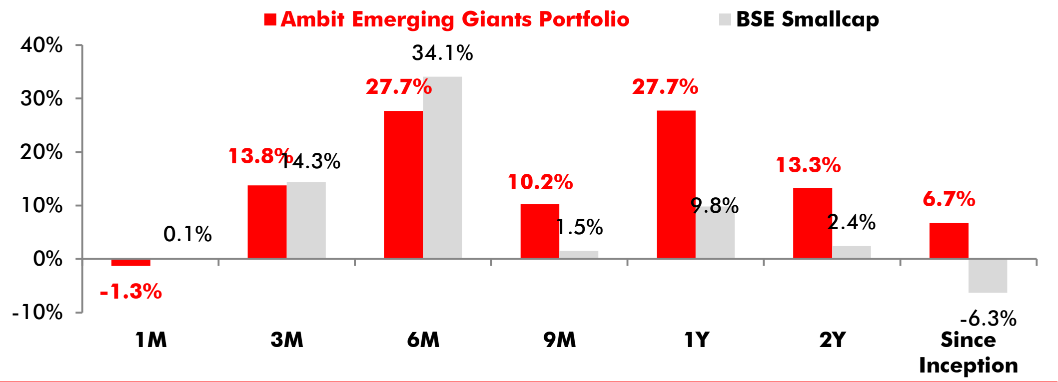
Source: Ambit Asset Management

Ambit Emerging Giants

Smallcaps with secular growth, superior return ratios and no leverage

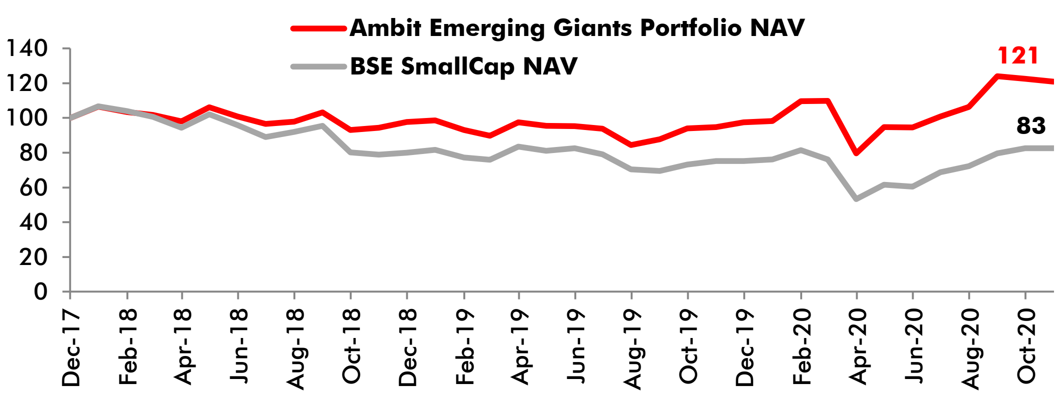
Ambit's Emerging Giants portfolio aims to invest in small-cap companies with market-dominating franchises and a track record of clean accounting, governance and capital allocation. The fund typically invests in companies with market caps less than Rs. 4,000cr. These companies have excellent financial 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 22A: Ambit Emerging Giants performance update



Source: Ambit; Portfolio inception date is December 1, 2017; Returns as of 31st Oct, 2020; All returns above 1 year are annualized. ***Returns are net of all fees and expenses***

Exhibit 22B: Ambit's Emerging Giants Portfolio NAV update



Source: Ambit Asset Management

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