The Transcript

Dec 2022 - Mar 2023

#INVESTFORGOOD

DSP MUTUAL FUND

This is a compilation of observations & comments from AGMs/ Concalls/ Interviews/ Presentations.
The compilation should not be used for investment decisions. Read our disclaimer below and at the end.

Sources: Investor Call Transcripts, Bloomberg, Management Interviews, Company Presentations

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DSP MUTUAL FUND

QUOTE OF THE QUARTER

We do think that EPC business is catching the tiger by the tail. You have to ride it and you will have to ride through several cycles.

R. Shankar Raman

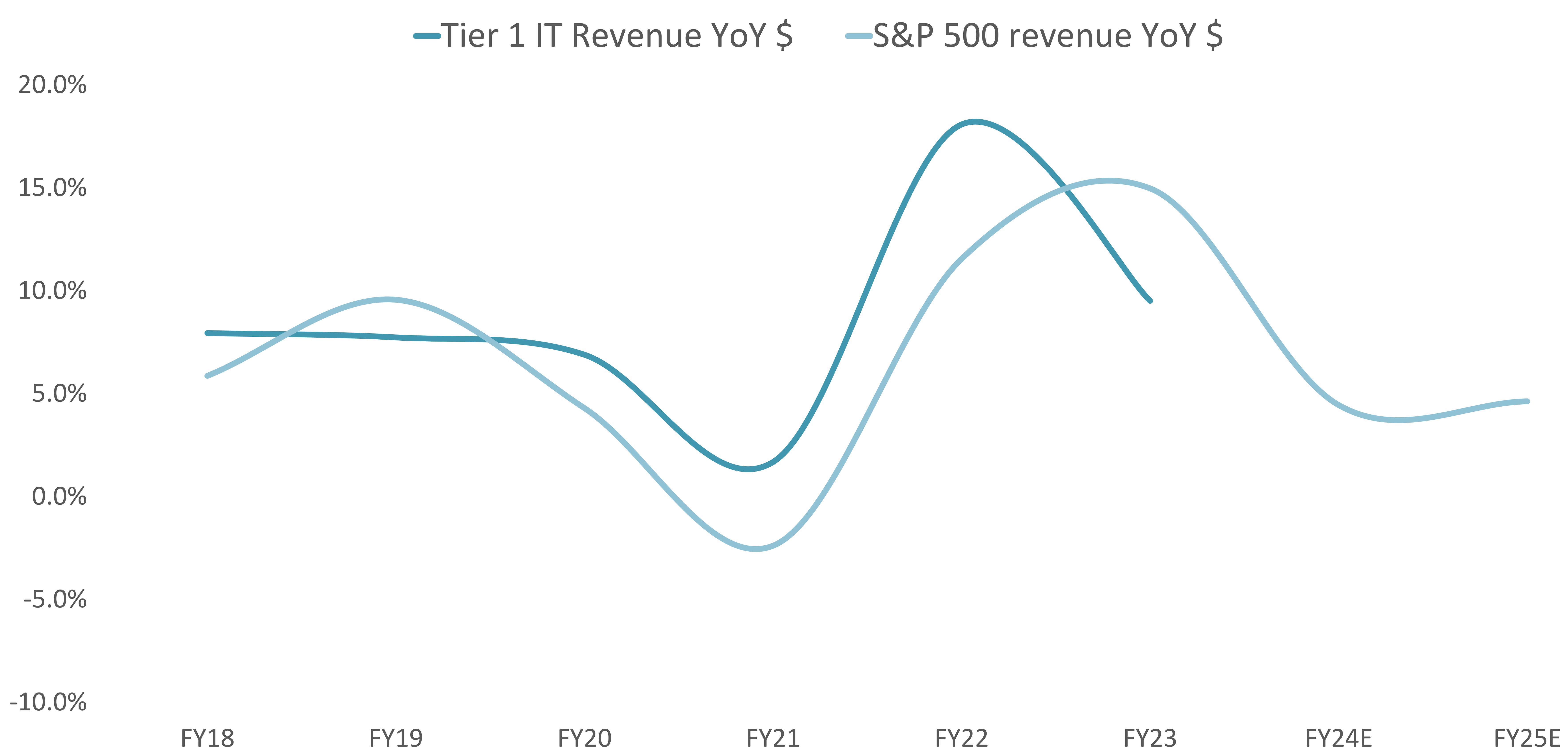
LARSEN & TOUBRO

IT Services: Uncertain Demand

IT majors' commentary has turned cautious, and EPS estimates for the sector have been further downgraded. Initial expectations of gradual recovery have been delayed. Midcap IT growth remains strong, but this need to be monitored as there may be a lead-lag effect. Companies are cutting costs by outsourcing routine tech spending to IT firms through cost takeout deals, which typically have lower profit margins. Investors anticipate resilient margins, but this expectation could be tested in a low-growth environment.

Slowdown is broad-based across all key verticals. Covid driven bump for the sector over the past three years has seen some mean reversion. The guidance of many IT companies is based on quick recovery from 2Q—an aggressive assumption in our view.

The sentiment seems split over the high FCF yield (5% to 7% in some cases) and uncertain demand environment.



Source: Internal, Company Reports, Bloomberg

IT Services: Uncertain Demand

Exactly that type of work (disruptive business models) was largely responsible for significantly stronger growth rates during the last few decades. Unfortunately, it is exactly those programs are all currently showing visible signs of weakness. Instead, during the last three months, it become very clear that the economic environment is more focused than it has been for decades on cost optimization, which, for now, benefiting more traditional outsourcing firms with strong cost takeout offerings. We understand this is likely a continuous story as the markets adjust to the new economic conditions and the investment climate changes.

The demand environment continues to be characterized by slower decision making, caution around spending and program ramp-downs, due to uncertainty in serving client end markets.

The pricing environment is clearly not one that is super-supportive of price increases. And we're finding both clients are cautious in terms of spend and in terms of rates and even sort of new engagements are requiring that we sharpen our pencils a little bit.

IT Services: Uncertain Demand

DSP

Next two years are going to be challenging because after all we did have lot of acceleration during the pandemic and there is some amount of normalization of that demand and top of it there is real recession in large parts of the world.

Satya Nadella Microsoft

In Interview to CNBC-TV18, Jan-2023:
https://www.youtube.com/watch?v=t8WIO7zGZaI

Several industries where we have talked about, Telecom, Retail, Hitech, and parts of Financial Services, there are some clients which are seeing in their own business, whatever constraints they're seeing with the economic environment. As a consequence, we have noticed that some decisions were made during the quarter to stop some parts of the programs, not everything, but some parts of the program.

… Having said that, we have an extremely large pipeline, the largest pipeline we have seen in along while, while there is still a slowing in the cycle of closing the deals, the deals are very strong, and some of them are mega deals.

Infosys

IT Services: Uncertain Demand

DSP

We saw clients deferring newer initiatives which were not critical, and in some cases, completely halt discretionary projects. Anxiety around the stability of the banking sector in March also added to the uncertainty. Consequently, growth decelerated across all verticals.

In our industry, unlike a product industry, discounting and price undercutting is not as easy because an incremental deal is one thing. But once you offer a price, it's very visible across your entire customer universe. So the ability to do that in a very systematic manner is quite restricted. So it's a much more disciplined industry in terms of pricing. That is what's playing out. We'll keep watching it. We will stay tactically responsive in the market, and we'll deal with it as it comes

tcs

We are factoring in the fact that it is a very different macro that we are facing at the beginning of this year as compared to last year. We do hope and expect to some extent that it will change for the better fairly quickly as it has the last few times that we've seen this kind of turbulence. So, we are factoring all of that and we've given you a pretty tight range (of growth guidance).

HCLTech

Generative AI: Vast, Cool & Unsympathetic

DSP

ChatGPT, developed by OpenAI and launched in November 2022, currently boasts approximately 100 million active users. Its introduction has sparked discussions regarding the influence of large language models (LLMs) such as ChatGPT and artificial intelligence (AI) on diverse domains of business and life. It has generated apprehension within certain groups. In a survey conducted among AI researchers in 2022, 48% expressed the belief that there exists a minimum 10% probability of AI's impact being "extremely negative" i.e. human extinction*.

In the early stages of its development, every new technology encounters resistance. However, in the case of AI, the resistance is emerging primarily from within the community of researchers and innovators themselves. Despite this resistance, AI holds significant potential in tackling intricate challenges, such as facilitating new drug discoveries and addressing the issue of climate change. AI models are also being used to generate images (the cover image of this edition of The Transcript has been generated by DALL-E (a deep learning model developed by OpenAI) and videos.

Programmers on GitHub, an open-source coding site, are now using a ChatGPT-based co-pilot to produce nearly half their code*.

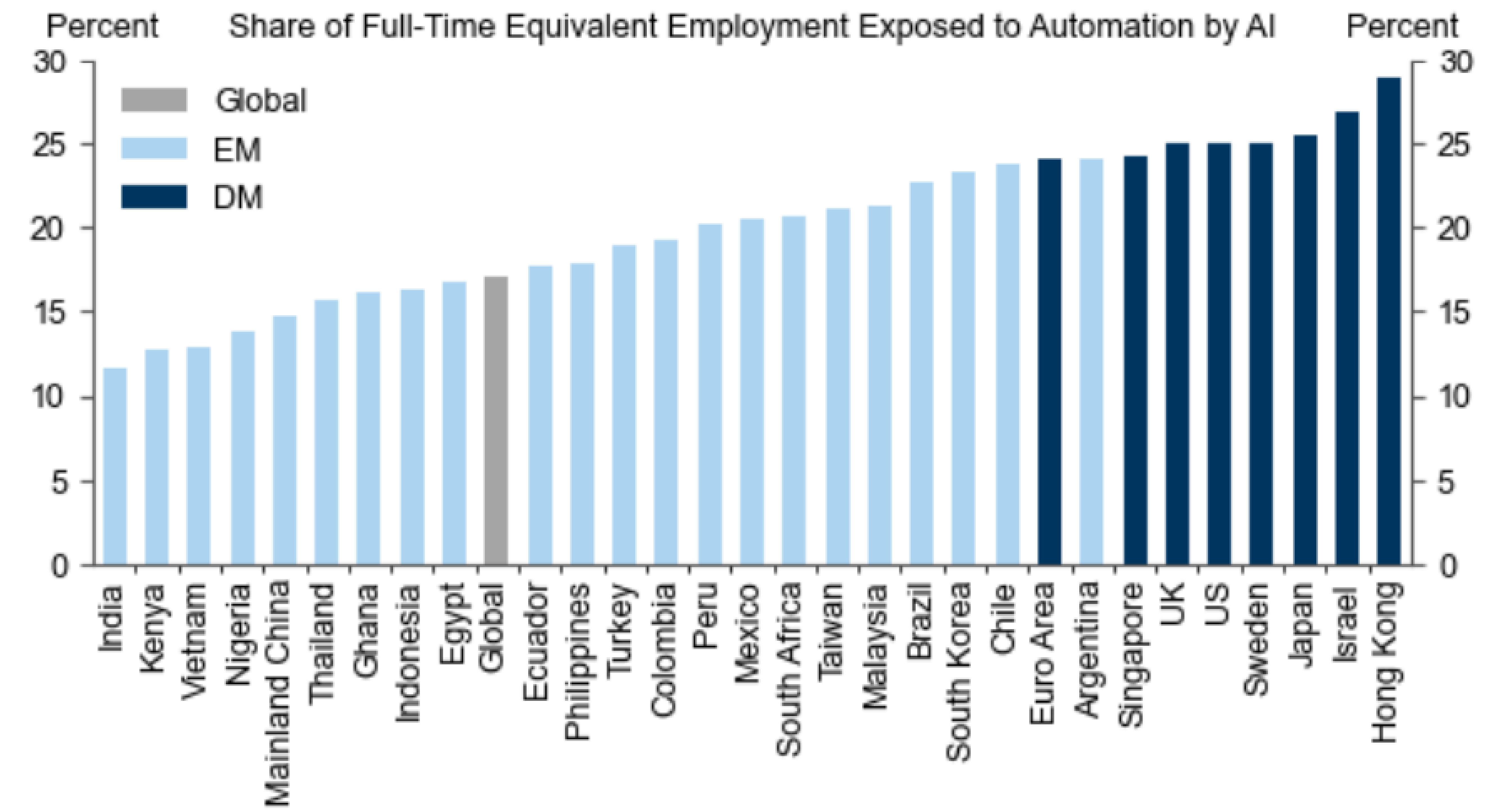
The increasing adoption of these technologies is likely to result in heightened government regulation concerning their usage. Companies are eagerly delving into the possibilities of employing these models to enhance operational efficiencies. Unlike many other disruptive technologies, the incumbent players in the technology sector possess substantial advantages and investments in the field of AI.

*Source: Economist: https://www.economist.com/leaders/2023/04/20/how-to-worry-wisely-about-artificial-intelligence

Generative AI: Vast, Cool & Unsympathetic

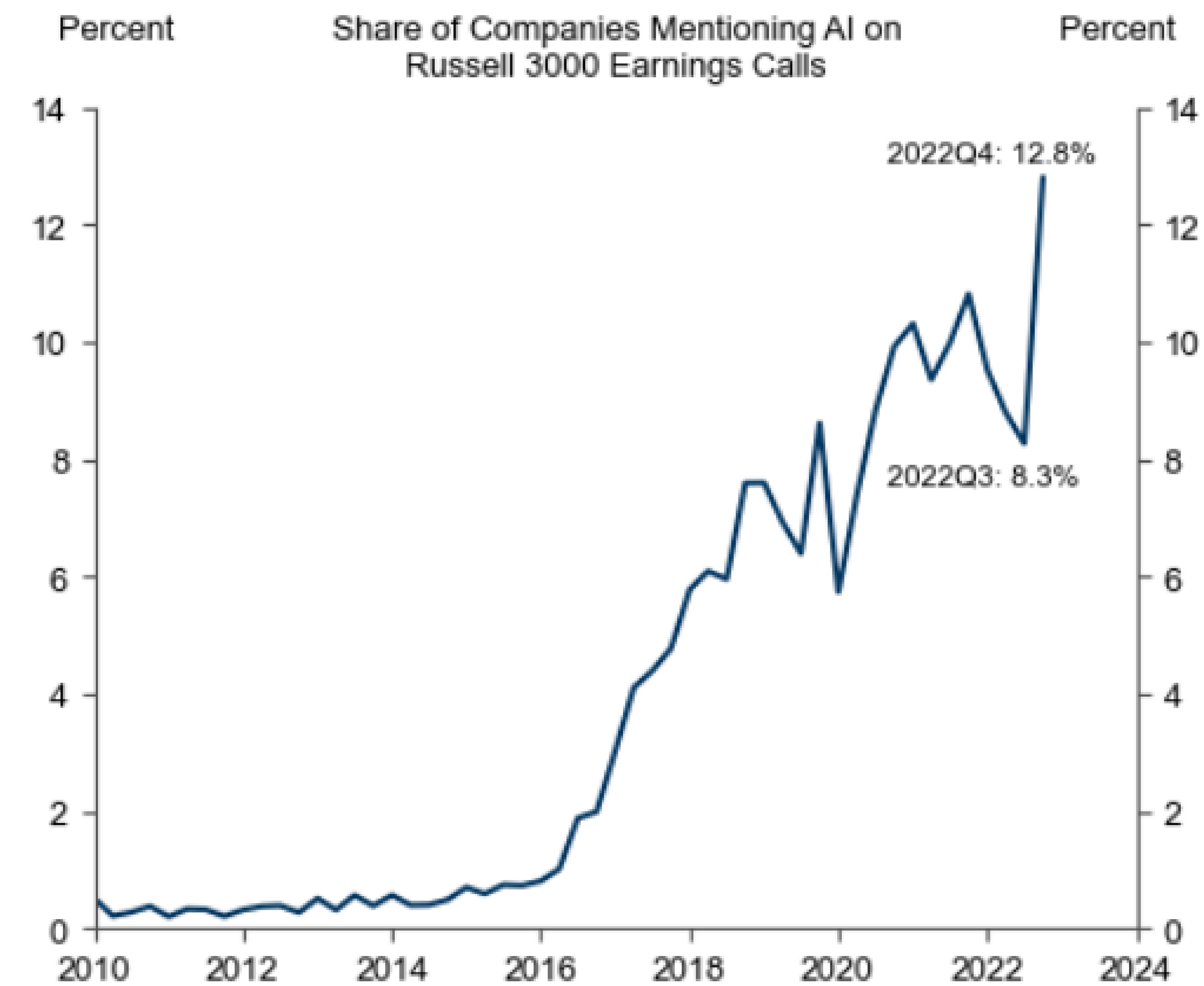
DSP

Globally, 18% of Work Could be Automated by AI, with Larger Effects in DMs than EMs



Source: Goldman Sachs Global Investment Research

Management Teams Are Increasingly Focused on Opportunities from AI on Company Earning Calls



Generative AI: Vast, Cool & Unsympathetic

DSP

Contemporary AI systems are now becoming human-competitive at general tasks, and we must ask ourselves: Should we let machines flood our information channels with propaganda and untruth? Should we automate away all the jobs, including the fulfilling ones? Should we develop nonhuman minds that might eventually outnumber, outsmart, obsolete and replace us? Should we risk loss of control of our civilization? Such decisions must not be delegated to unelected tech leaders. Powerful AI systems should be developed only once we are confident that their effects will be positive and their risks will be manageable. This confidence must be well justified and increase with the magnitude of a system's potential effects. OpenAI's recent statement regarding artificial general intelligence, states that "At some point, it may be important to get independent review before starting to train future systems, and for the most advanced efforts to agree to limit the rate of growth of compute used for creating new models." We agree. That point is now.

Therefore, we call on all AI labs to immediately pause for at least 6 months the training of AI systems more powerful than GPT-4. This pause should be public and verifiable, and include all key actors. If such a pause cannot be enacted quickly, governments should step in and institute a moratorium.

Excerpt from an open letter by Future Of Life Institute
(Signed by Steve Wozniak & Elon Musk amongst others)

Generative AI: Vast, Cool & Unsympathetic

DSP

Some of the advertising, I mean, we did, we've partnered with OpenAI and ChatGPT and DALL-E to run a promotion where you could design Coke advertising, and have it come up on the Times Square billboard.

Coca-Cola

At a time when the world marvels at ChatGPT, we've been deploying artificial intelligence and machine learning in our research labs for some time now, giving us dry lab capabilities that, when applied to biologics development, have already yielded improved success rates and reduced cycle times beyond our initial expectations. This is indeed an exciting time for biologic innovation.

AMGEN

We are leveraging Generative AI capabilities for our clients and within the company. We have active projects with clients working with Generative AI platforms to address specific areas within their business. We have trained open source Generative AI platforms on our internal software development libraries, we anticipate Generative AI to provide more opportunities for work with our clients and to enable us to improve our productivity.

Infosys

Generative AI: Vast, Cool & Unsympathetic

DSP

we primarily use the generative AI, both from ChatGPT and from mid-journey and stable diffusion to create a recipe discovery platform on Blinkit.

We're excited about what generate AI is doing. Right now, I think our best bet was launching it for recipe generation. We are also looking at other parts of the business where some of this might be useful.

zomato

Qualcomm is firmly at the forefront of this upcoming transformation. Further, very large AI models are placing significant incremental demands on energy-intensive and expensive cloud computing infrastructure.

As such, a hybrid AI architecture leveraging accelerated computing at the edge, can offload or support cloud processing by running AI inferencing directly on the device. Beyond cost optimization, additional benefits of running generative AI on device include improved latency, security, privacy, and the ability to meet data compliance requirements. This is a new and exciting opportunity for Qualcomm and one of our priority investment areas. Areas.

Qualcomm

Generative AI: Vast, Cool & Unsympathetic

You will find AI in our personalization products. So, there's a whole range of things that we -- set us apart. We use this as foundational technology. And internally, you can see increasingly so that generative AI might be a good solution for us when it comes to customer service propositions and so forth. So, we're actively engaged on that. Fundamentally though, I think we all have to be aware that the application of AI needs to be done in a principled way.

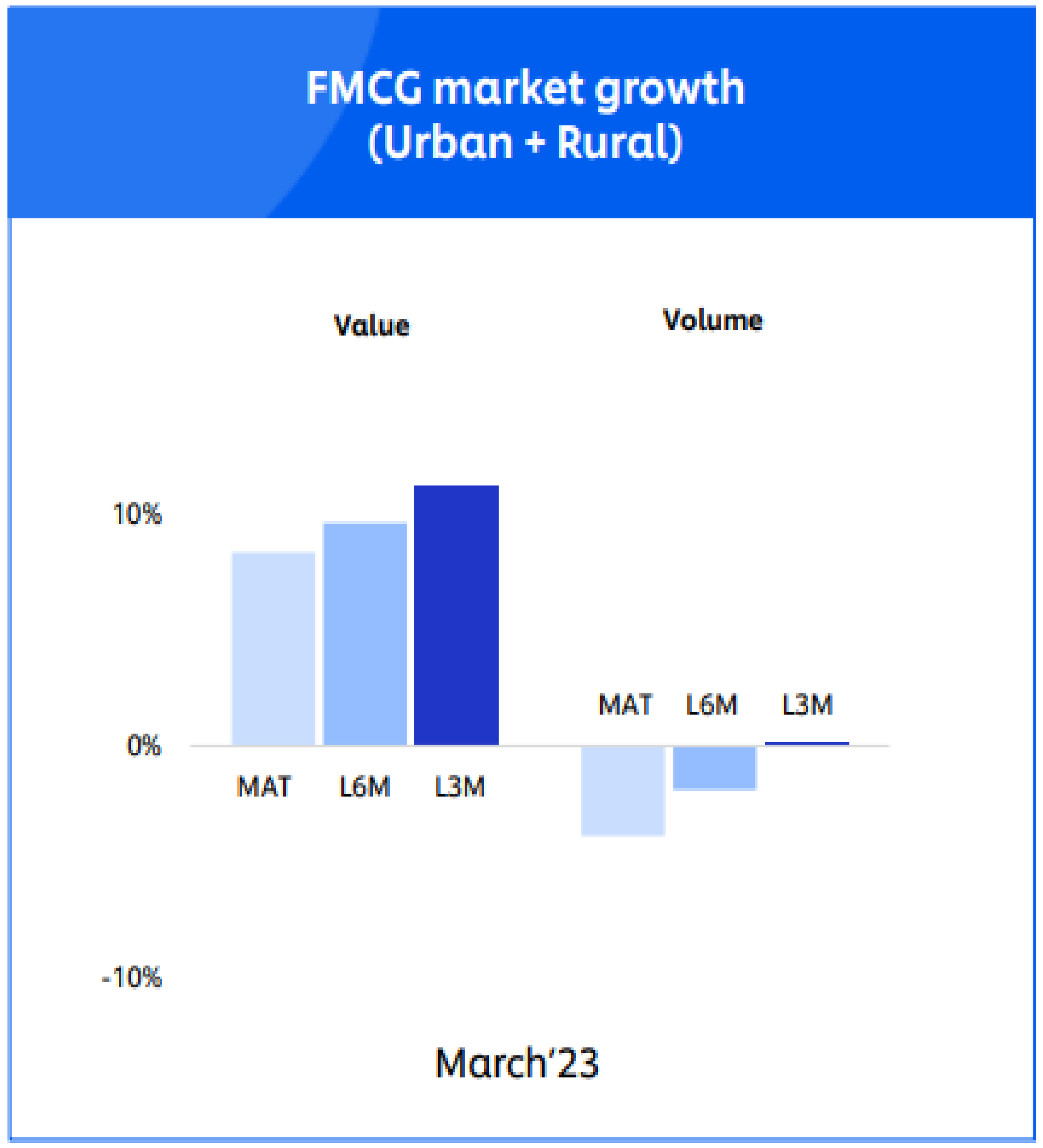
GPT -- the ChatGPT plug-in, which is that is where we have made a plug-in for their environment so that when people are searching, thinking about travel and their environment and want to see if there are hotels near the Eiffel Tower or what flight flew from L.A. to New York on Tuesday, if they have our plug-in, we can provide that.

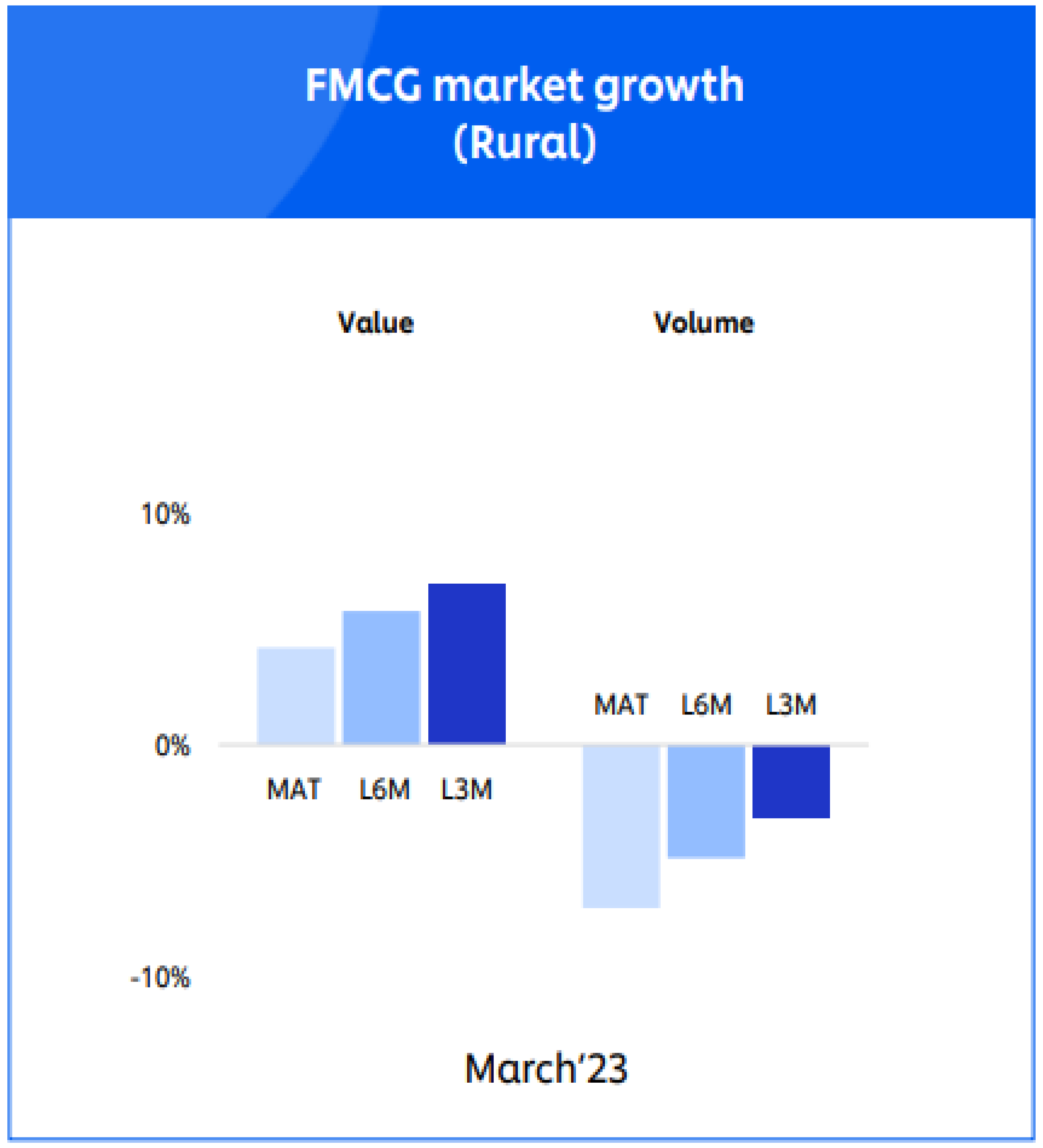
When something can do all kinds of things, I get a little bit worried. Because I know we won't be able to un-invent it and, you know, we did invent, for very, very good reason, the atom bomb in World War II.

Rural Recovery: Long Wait, New Hope

The demand outlook for the consumption sector remains subdued overall. Volumes in FMCG, entry-level two-wheelers, and consumer durables continue to be lackluster compared to pre-COVID levels.

The rural consumer is still facing financial strain, and consumption at the bottom of the pyramid is still suffering. The combined impact of the COVID-19 pandemic and inflation has adversely affected demand. However, the situation could be mitigated by higher urban remittances. Many companies indicated that the pain has bottomed out and they are seeing green shoots of recovery.

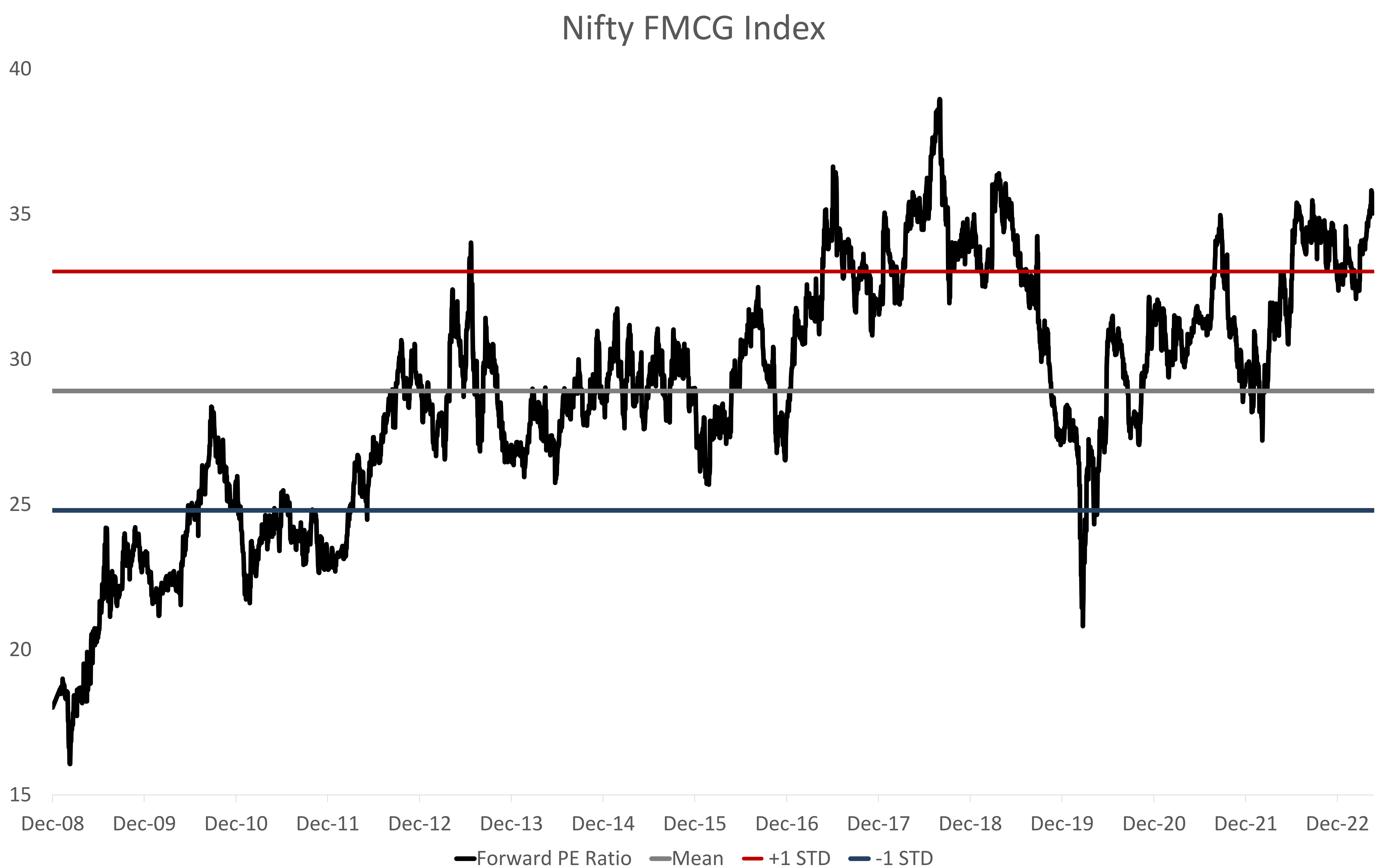




Source: Nielsen, Hindustan Unilever

Rural Recovery: Long Wait, New Hope

The base effect will come into play, eventually leading to improved year-on-year numbers. Some of this recovery might already be reflecting in the valuations of the consumption basket.



Source: Bloomberg, As on 23-May-2023

Rural Recovery: Long Wait, New Hope

DSP

Rural markets have continued to lag urban on account of high inflation and downtrading by consumers. Having said that, the silver lining for the year has been the performance of the new age channels and some green shoots which are emerging in the rural markets towards the end of the quarter, indicating early signs of revival in demand.

Dabur

So we've seen this a little bit of a sinusoidal kind of a curve on rural urban. What I said earlier is that in March, we saw with all the festivals, the Pongal, Ugadi, Padwa, the demand really went up in rural. And it would be a mixed bag, I can understand for the industry because people at this time are careful with their money. They will go with brands that they trust. There are brands that have a customer service which is really deeply rooted, such as ours.

Hero

Rural has shown some signs of improvement with higher value growth sequentially. While volumes continueto decline, the extent of decline has reduced vs last quarter.

Hindustan Unilever Limited

Rural Recovery: Long Wait, New Hope

DSP

Geographically, all the leading indicators are pointing towards sustained momentum in economic activity in the country. However, higher inflation in advanced economies and tightening financial conditions in India has had some impact on demand, particularly in Tier 2 and Tier 3 cities. Last year, during these times, we were witnessing pent-up demand in March and April, and that has been considerably moderated this year. This has impacted our sales in February and March. However, we have seen green shoots in April.

SHOPPERS STOP

As far as consumer discretionary is concerned, the silver lining has been that in the fourth quarter for the first time unlike FMCG, we never had a decline in rural or semi urban sales. It only slowed down, normally we used to grow at 1.5x urban sales in this case rural and semi urban became slower than urban. For the first time in the fourth quarter, we have seen rural and semi urban actually grow faster than urban. Now it is too early to call it a trend. We are very hopeful that this continues over the next three to six months.

Pidilite

Urban recoveries are visible. However, rural recovery is slow, but we are expecting that it may take more time.

TVS

Rural Recovery: Long Wait, New Hope

DSP

HPC (Home & personal care) has different issues going for itself. One is the rural skew which is far more and HPC is far more secular across income classes. Therefore, whenever there is high food inflation and consumption stress, HPC gets more impacted than Foods. The second thing is in some of the HPC categories, there is what I call higher penetration. As a result of this high penetration, significant growth happens. One is the absolute population increase and the second is premiumization. And therefore, whenever there is high inflation, the premiumization journey undergoes a shift to down gradation. And that is what we have seen. Number 3, I think the input cost pressures, which has happened in HPC because of crude and other things, has led to a lot of people managing price points in HPC through shrinkflation.

marico

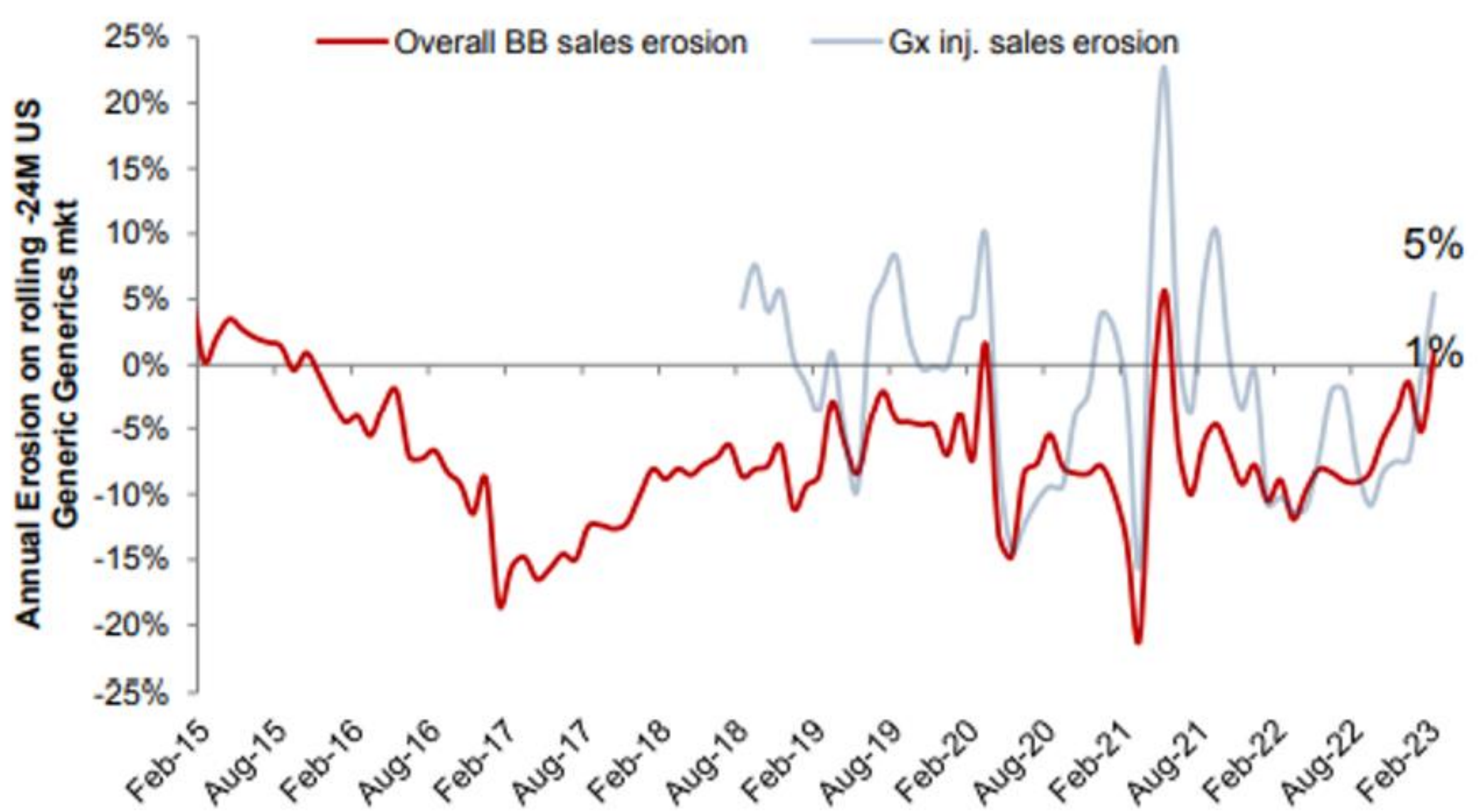
Other than summer products, because what we have seen is encouraging that all the other categories, whether it is pain or Fair and Handsome or Kesh King or healthcare, all are fi ring. So, there is some momentum what we are seeing it from the rural markets and from all other markets, the only issue is the summer portfolio.

emami

US Generics: Brink Of Change?

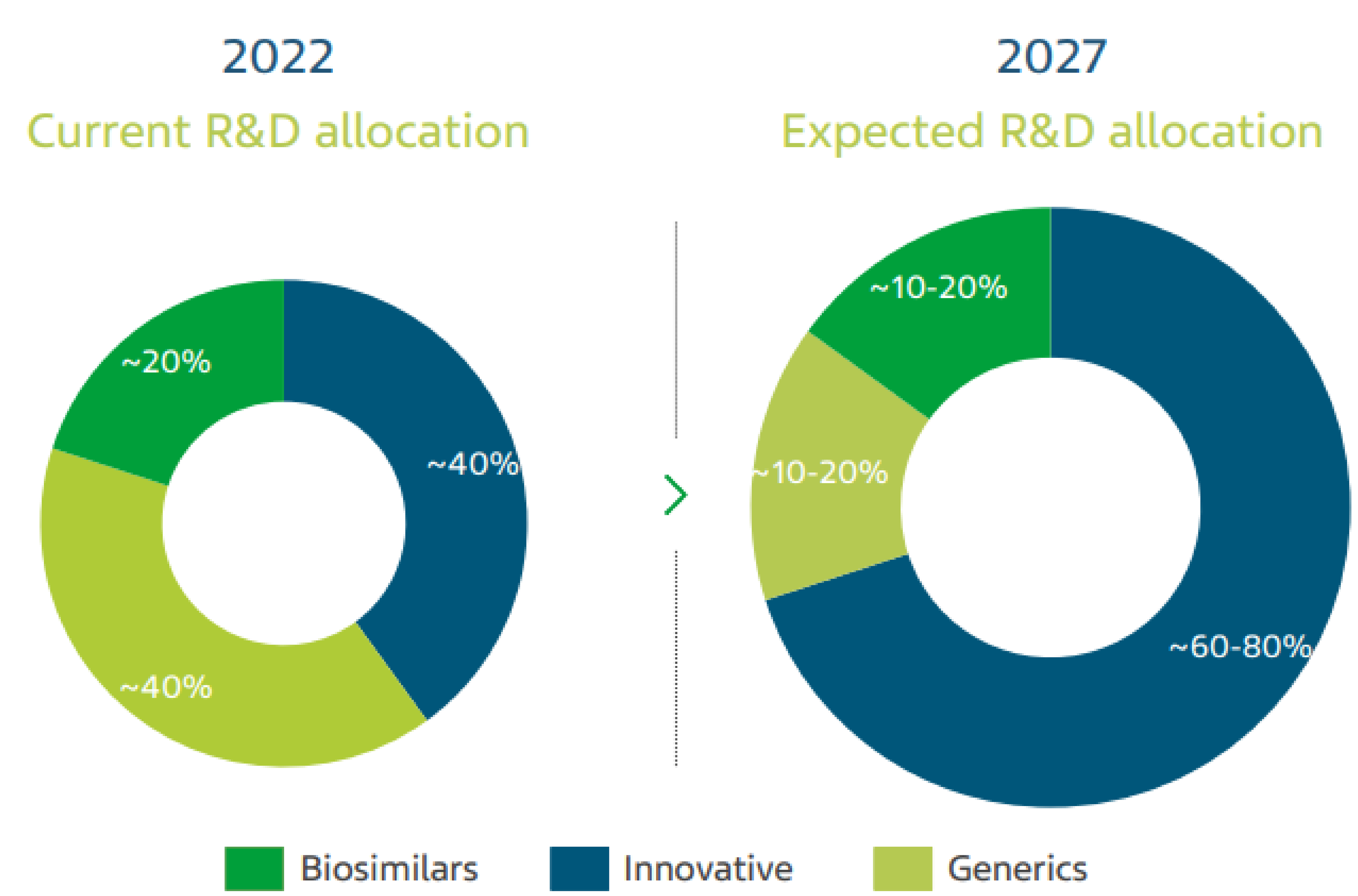
After a high double digit price erosion over the past many quarters, the price erosion on the older commodity product portfolios has now normalized to more manageable levels of single digits. Supply disruptions (some caused by FDA actions), along with bankruptcy proceedings involving key suppliers, have contributed to shortages. Some companies are rethinking their US generics exposure. At inflection points the data and narrative are both noisy. However, numerous participants in this sector have faced challenges with profitability. If we reach a stage in the cycle where capital begins to exit this segment, it could potentially have some positive outcomes. The commentary from companies is suggesting mid to high single digit price erosion but with improving trajectory.

Base business erosion has been moderating over the past few months (Base business trends)



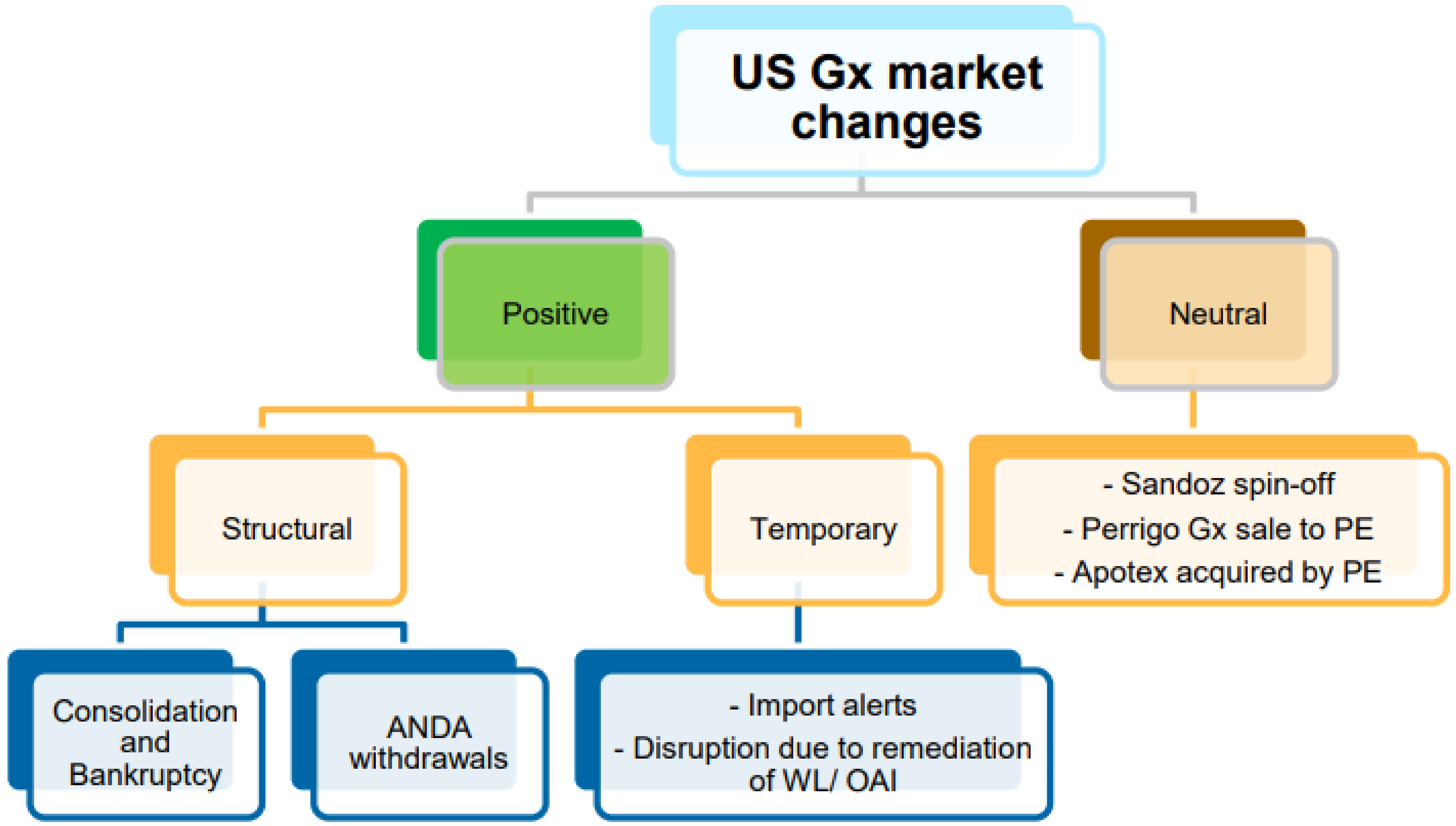
Source: IQVIA, Goldman Sachs Global Investment Research

TEVA: Realigning R&D Spends



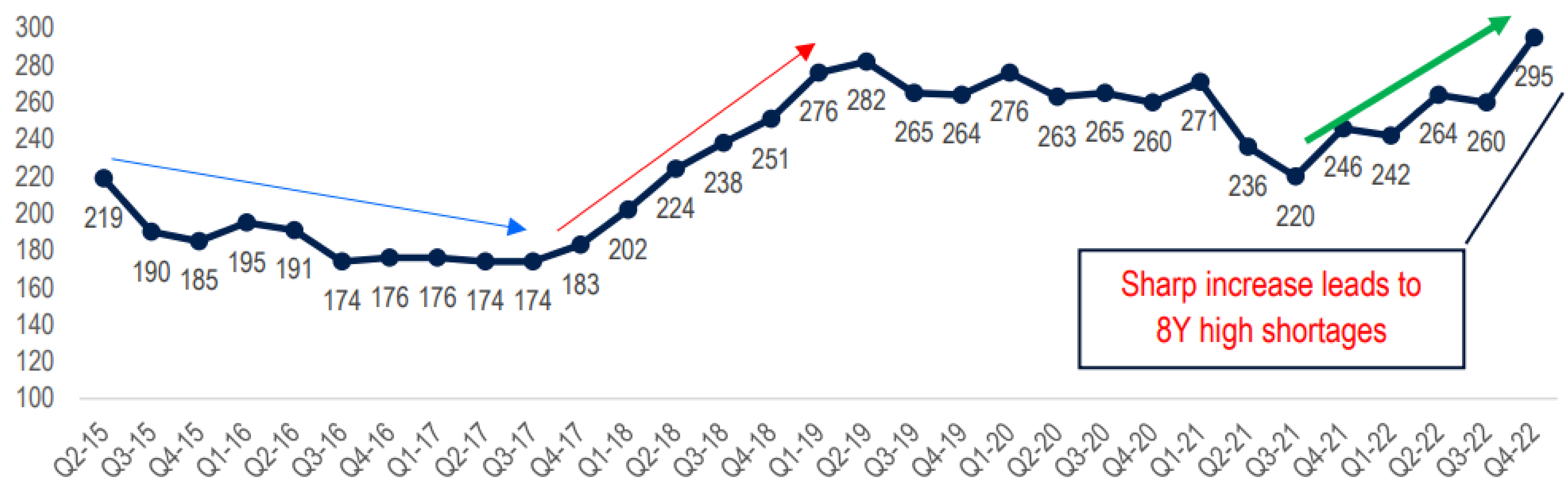
Source: Company

US Generics: Brink Of Change?



Source: Macquarie Research, April 2023

Active Drug shortages – Sharp increase leads to an 8-year high



Source: Industry data, Investec Securities estimates

US Generics: Brink Of Change?

We're starting to see mid-to-high-single digit (price erosion), because that's a normalized level that we saw in previous years. Given the supply chain challenges that companies have had, customers have become, again, very, very focused on reliability of supply and are again, engaging in more longer-term relationships contracts or at least the commitments, which gives us comfort that they are prioritizing reliability of supply over price. I mean, of course, they always like to get the best price, but they've struggled a lot this past year with the flu season products.

So the flu season products, in particular, we are finding that they're engaging with us in a more strategic dialogue on how do we really ensure that we meet the market demand, and how do we partner to meet the market demand. So the partnering dialogue is gaining momentum over the transactional model of business with our China partners.

LUPIN

Pricing has stabilized in the US and there is price normalcy in the market in US, both the RM cost and logistic costs have reduced during the quarter, overall resulting in emanating a better business situation for the coming year.

AUROBINDO

US Generics: Brink Of Change?

DSP

We always build for a single-digit (price erosion). I mean, before we used to see very strong double-digit erosions, but we are building for a single digit price erosion because that's what we expect to happen in FY '24 in the best estimate. Obviously, in the last quarter, we haven't had any major erosion, but knowing the portfolio and knowing competition, we on a conservative side, we should assume a mid single-digit price erosion.

zydus
Dedicated To Life

So there is still price erosion in the US market. Has it slowed down, yes, compared to about a year back, it has slowed down. One of the reasons could be because of people are placing less priority in the US business. We've seen some of our peers prioritize US business lesser. Number two is that they have been inspections, quite a few inspections. So there have been some regulatory issues that some companies have faced. But we do continue to see pricing pressure in the market.

Alembic
Touching Lives over 100 years

The pricing part is similar. We have not really seen any significant change. So, both on our API as well as formulations business, the price erosion would be anywhere between 7% to 10%.

Biocon

US Generics: Brink Of Change?

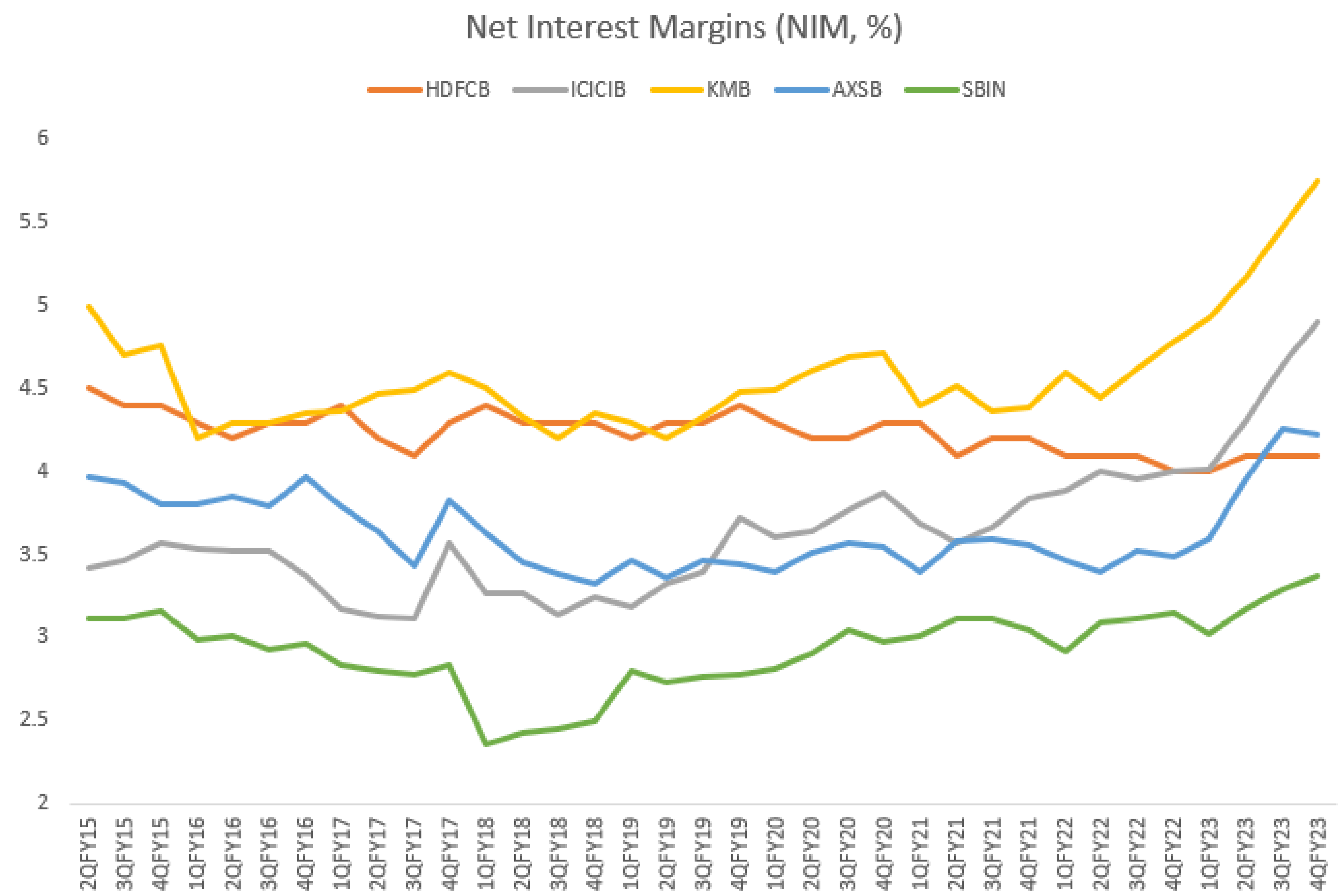
In 2022 we certainly saw low-double-digit, price erosion. And that was pretty consistent throughout the year. And so given that we saw that in the fourth quarter, our expectation and certainly in our guidance, we're expecting to continue to see that trend. I think there are some signs that it could be -- improve next year and that's always our hope that things get better rather than worst and like we're seeing the FDA be significantly more active and inspections could that create disruptions, could competitors have supply chain disruptions et cetera. All those things could help improve the overall environment. But our guidance does contemplate that that low-double digit price erosion will continue into 2023.

I don't see the price stabilization that you are speaking about, so, and not just from Sun perspective, but also from an industry perspective, I don't see that. So I think that basic assumption is probably incorrect. So, in the overall context, I think if I look at the market in general, it's a low growth or a de-growth kind of a generic business in the US, volume growth is there but value growth I do not see from an industry perspective.

Bank NIMs: Familiar Rhythm

DSP

A significant ongoing discussion within the financial sector revolves around the impact of expected moderation in Net Interest Margins (NIM) on the performance of bank stocks and whether such a scenario warrants a change in approach. It is puzzling how the market occasionally reacts to predictable and familiar fluctuations in data, driven by cyclical or seasonal patterns. FY24 NIMs will still be stronger than pre-covid. Market participants are trying to be tactical here. We are not sure such tactics work.



Source: Company, Internal

Bank NIMs: Familiar Rhythm

DSP

We would believe that the NIMs are at kind of peak or near peak levels. And from here, we should see a moderation.

I think what we have seen on the operating profit growth has really been an outcome of the business that we have done, underwriting that we have done, our liability profile and our approach to overall profitability. I think when we really adopted operating profit as the main operative metric for us, we were making significant provision on our historic NPL book. And now, if we look at it, that is largely addressed. And given the kind of provisioning policies that we have now, where there is very little lag between an asset turning delinquent or over 90 days and getting provided for, the operating profit less provisions is a pretty accurate reflector of the earnings of the business or the growth and quality of the business. So that's one thing to keep in mind. Of course, as you know and as we discussed in the past, the kind of margin expansion that we have seen this year, will not be there next year and there will be some pressure on margins. But that, will hopefully get addressed along with growth.

ICICI Bank

Bank NIMs: Familiar Rhythm

DSP

Our margin operates in a very narrow band. And it is narrow band because the modified duration of the book, call it about 1.2 years, 1.3 years thereabout. And within a reasonable lead and lag effect, which can have 10-20 basis points at any time or 10-15 basis points any time it can move up or down. But right now, you are seeing some lead effect. The cost of funds will come. Already in this quarter, the cost of funds has moved up. I think we put up a chart to show sequentially both the yield movement as well as the cost of funds movement.

HDFC BANK

We do see this FY22-23 as an extraordinary year for our margins in banking, which are reflected in our numbers. Assuming the repo rate trajectory is not dramatically lower, our average NIM last year was 5.3%, while fourth quarter is 5.75%. At this stage, there is nothing which tells us that… at this stage, and therefore I'm not making any commitment, there is nothing which tells us that our NIMs need to be lower than 5%.

kotak
Kotak Mahindra Bank

NOBODY KNOWS…

Anyone who buys that (YouTube) is a moron because of potential lawsuits from copyright violations. There is a reason they haven't yet gone public, they haven't sold. It's because they are going to be toasted.

… do you want your advertising dollars spent on a video of Aunt Jenny watching her niece tap dance?

Mark Cuban, Sep-2006

Source: CNET.com

In October 2006, Google (Alphabet) acquired YouTube for $1.65 billion. Today, some analysts estimate that the value of YouTube exceeds that of Disney. YouTube generated $29 billion in revenues in 2022.

People, it seems, love Aunt Jennys & their tap-dancing nieces.

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