THE TRANSCRIPT

June - Sep, 2022

#INVESTFORGOOD

DSP MUTUAL FUND

This is a compilation of observations & comments from AGMs/ Concalls/ Interviews/ Presentations.
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Sources: Investor Call Transcripts, Bloomberg, Management Interviews, Company Presentations

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QUOTES OF THE QUARTER

It was the best of times, it was the worst of times…

We are probably in one of the most important Cinderella times of the credit cycle.

…only point is we don't know what time of the day it is. We are conscious that this is still probably a little early, well before midnight. But we have to be ready that if and when that clock strikes, we are in a good shape to be able to handle that time.

Uday Kotak kotak Kotak Mahindra Bank

(Biscuits) is a category which is the cheapest form of food and when there is inflation across different categories obviously the impact on the higher categories, will be a lot more. We have the cheapest form of food, and we are wholesome and tasty as well.

Varun Berry BRITANNIA

Telcom: No easy road to summit

DSP

Hendrick Bessembinder (of the famed Bessembinder study that showed 96% of the US stocks fail to beat one-month treasuries over their lifetime) in a recent paper state that Telcom along with Consumer Durables have contributed the least to wealth creation in US public markets since 1926 (4th column in the table below). But since the number of firms in the Telcom sector was also lower the wealth created per firm, per amount of time it was listed, was the highest for the sector (last column). The biggest wealth destroyers have also been from this sector (followed by technology while surprisingly financials come in third).

The sector is capital intensive. The return on invested capital (ROIC) tends to be closer to cost of capital. A slightly higher or lower value can end up drastically altering the fate of the companies.

Lot of interesting observations in a single table below (notice how energy has a better strike rate than technology).

Industry	Lifetime Wealth Creation ($ Millions)	Firm/Months for Industry	Industry % of Weath Creation	Industry % of Firm/Months	Ratio, % of Wealth Creation to % of Firm/Months
1 Consumer Nondurables	3,590,411.9	281,215	7.58%	7.55%	1.00
2 Consumer Durables	1,587,804.0	122,321	3.35%	3.28%	1.02
3 Manufacturing	5,915,559.3	601,476	12.49%	16.15%	0.77
4 Energy	3,393,818.3	180,887	7.16%	4.86%	1.48
5 Technology	8,999,079.6	529,443	18.99%	14.21%	1.34
6 Telecommunications	1,749,579.2	77,588	3.69%	2.08%	1.77
7 Wholesale and Retail	4,074,656.9	368,757	8.60%	9.90%	0.87
8 Healthcare and Pharmaceuticals	4,638,915.5	245,398	9.79%	6.59%	1.49
9 Utilities	2,135,778.2	127,564	4.51%	3.42%	1.32
10 Finance	7,210,235.9	584,916	15.22%	15.70%	0.97
11 Other, incl. Bus Serv and Ent	4,085,124.2	605,853	8.62%	16.26%	0.53
Total	47,380,963.0	3,725,418			

Source: Wealth Creation in the U.S. Public Stock Markets 1926 to 2019, Hendrik Bessembinder, Journal of Investing

Telcom: No easy road to summit

There is a massive investment that is happening today as we speak. At INR 190 ARPU we do have the highest ARPU in the industry. The fact is that this ARPU was actually higher seven years ago at almost INR 200. Secondly, if you look at the pricing structure today in India, whether it is ARPU or whether it is the rate per megabyte, rate per gigabyte, it is the lowest in the world. Lower than Sub-Saharan Africa, lower than our neighboring countries here, lower than Southeast Asia, let alone the developed markets.

Every player will want a return on capital. **Our belief is that 8.5% return on capital is very low**.

And the only way that it will go up is if there is a tariff correction and we're not talking about massive corrections. We're already at INR 190 ARPU. We need to see one round of correction. When it will happen, I am not at liberty to say, because it's not just up to us. **I mean, if we do it and competition doesn't follow then we have a problem.**

Telcom: No easy road to summit

DSP

Pricing in the market is unsustainable, because it provides either very low or almost zero return on that capital invested.

Q2 FY21

We believe the government recognizes the criticality of the sector, as the industry continues to remain under unsustainable financial duress, we remain hopeful that the government will provide the necessary support to address the structural issues faced by the sector and enable operators to run rate returns on their investment.

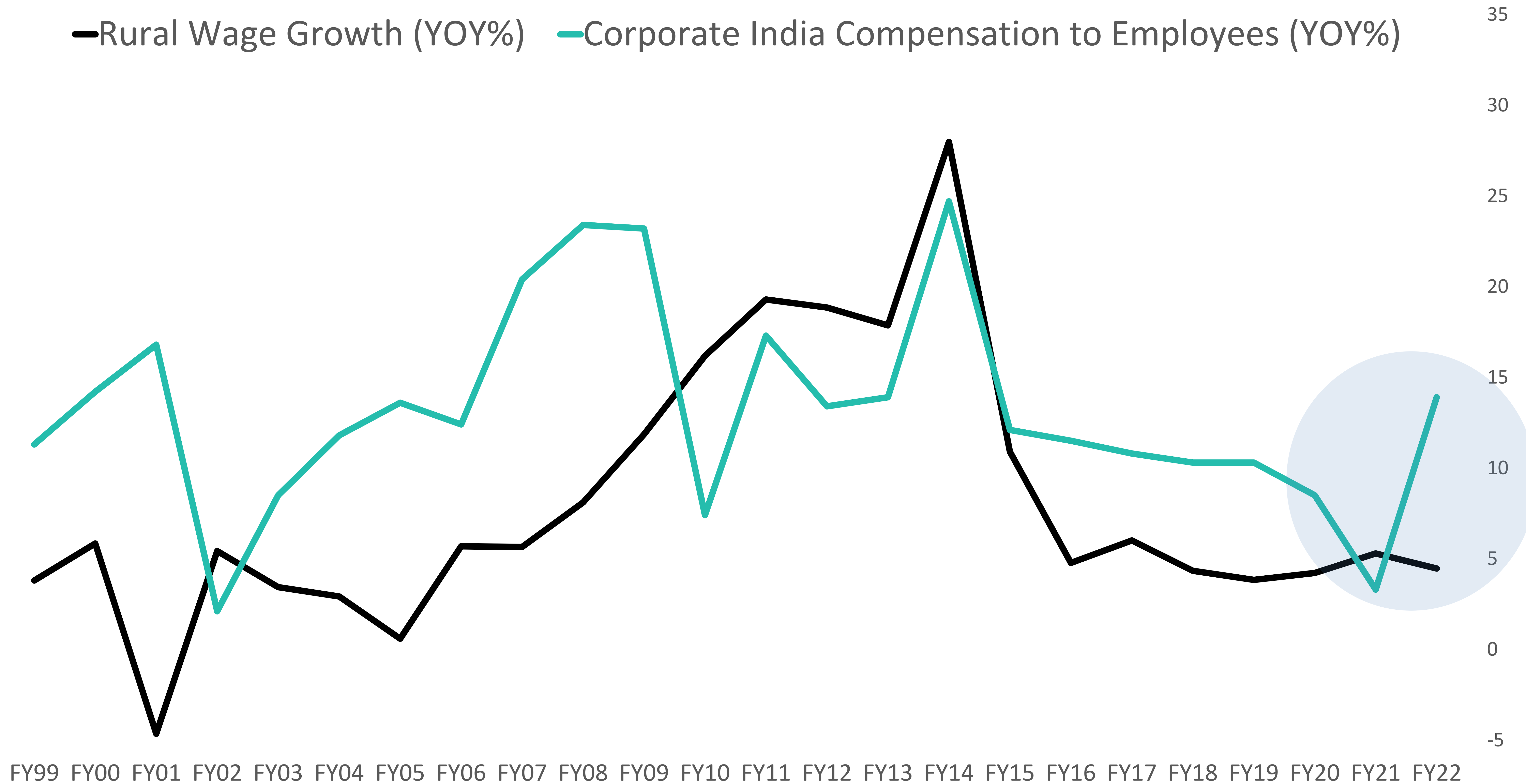
Q1 FY22

It is important to note that despite the price interventions made in the last one year, the tariffs in India continue to remain at unsustainable levels and we believe industry needs further tariff corrections to support the continued investment going forward.

Q2 FY23

Consumption: The haves & have-nots

Inflation has impacted bottom of the pyramid consumption while luxury and premium segments continue to grow. This is what is often referred to as a “K” shaped recovery. A monthly salary of INR 25K in 2019-2020 puts you in the top 10% of the Indian population. “Per capita potential” numbers must be taken with a pinch of salt in India.



Source: CMIE

Consumption: The haves & have-nots

DSP

Nobody seems to be buying just one apartment. People are buying one, two and three apartments, amalgamating them, joining them, making a duplex out of it and all that. Really it is like a **splurge of real estate volume and people are buying 12000 and 14000 square feet**.

I have been to people's homes, and it is such a delight to see them make their own version of the shell that I give them and live so beautifully. So really it is so amazing to see, and these are people with deep pockets, bringing their own set of designers, they have been there, seen the world, they bring the best of the world and put it in.

OBEROI REALTY

There is stress on demand in rural markets, smaller towns, and entry-level products.

That has been there for some time now. I have seen that from the early stage of the commodity run-up and it was initially reflecting in stress for passing input cost increases. The companies were stressed in terms of margins on entry level products because of the inability of the market to absorb.

V-GUARD

Consumption: The haves & have-nots

DSP

The growth on the higher segment is coming more easier, perhaps because different segments of the population have got affected differently. And also inflation has been there both in gold and diamonds over time. So I think that may also be adding to a little bit of stress in the sub-1 lakh segment, at the buyer level.

TITAN COMPANY

FMCG market context hasn't changed significantly in this quarter and continues to remain challenging.

It is quite natural for consumers, especially at lower income levels, to feel the pinch of increased pressure on the wallets due to the high inflation and they do adjust volumes and prioritize essentials over discretionary to manage the household budgets.

Hindustan Unilever Limited

Consumption: The haves & have-nots

DSP

Currently the traction on the premium side is extremely high.

Bata

With consumer facing inflationary pressures affecting affordability, there has been a shift in consumer habits as they moved towards cheaper alternative at the cost of quality.

Well, you all know **richer are becoming richer and poorer are becoming poorer. This mass segment, his affordability has been affected, and that was quite a big share of our business**.

RELAXO

Air Conditioners: Cooling margins

Indian room AC industry has delivered 11% volume CAGR over last 17 years. Industry's dependance on imports is reducing with Government's push towards domestic manufacturing, imposition of import duties and introduction of PLI schemes.

Multiple brands and OEM's (original equipment manufactures) have committed capital to setup manufacturing capacities over next 3 years. There is a possibility that the industry could see surplus capacities over the medium term even after factoring in reasonable growth. Export demand could be a mitigating factor.

AC penetration in the country is lower than that of other consumer durables like Refrigerators or Washing Machines. This fact has often been used as an argument for longer runway for growth and hence high valuation multiples.

Growth/TAM alone are not enough. The competitive intensity matters.

Air Conditioners: Cooling margins

DSP

Given the situation of inventory and the competition which, the market is setting in currently, to go to a trajectory of in excess of double-digit (margins) looks difficult.

This is going to drive the consolidation in the industry as such, whereby the tail end players, may find more and more difficult in order to compete with the leaders in this category. When I say leaders, there is a top five or top six players, who have a, I would say, consistent performance in the overall - on this segment for that matter.

VOLTAS

In room air conditioners, many people are expanding the capacity. There will be more production happening. Everybody have to avail PLI. Therefore, people will have to go ahead and sell more because for PLI, X axis may be the investment; Y axis is the incremental sales over FY '21.

So everybody (will) have to show increment in order to earn the PLI from next year onwards. So therefore there will be intensity. While the market will grow, product will become affordable, there (will be) competitive pressures.

BLUE STAR

Cement & Paints: Mixed up

Some cement companies have announced plans for entry into the paints category. At the same time the largest paint company has announced capex for entry into white cement and backward integration into some chemical intermediaries. The trenches are being dug.

Companies	Gross block (Rs m, FY21)
Dominant incumbents	
Asian Paints	69,155
Kansai Nerolac	25,593
Berger Paints	21,917
Akzo Nobel	11,900
Challengers	
Grasim (likely by FY25)	**100,000**
JSW Paints	5,374
Jotun	3,144
Nippon Paints	2,700
Indigo Paints	2,332

Note: Gross blocks are adjusted for reclassification while transitioning from IGAAP to Ind-AS. Source: Companies, Investec Securities research

Source: Investec

Cement & Paints: Mixed up

DSP

Upcoming demand when you see the projection, we keep doing that projection on a 3-year cycle. And whenever it is required that the investment needs to be made, that is the time when one should make the investment.

I don't see this as a big competitive as some of the commodity categories, like which you scale up and become very big, you tend to gain advantage. In this case, that is not the case. And even if you look at the industry, **this is not like a commodity category, like cement**, if you have a glut and the prices start dropping because we have to have an operating ratio and you have to operate the plant and there's a fixed cost involved, there is no such great issue there. I don't see any of these players impacting so far in any significant way our strategy or our growth plans.

Cement & Paints: Mixed up

DSP

We're looking at another area of backward integration where we are getting into the manufacturing of white cement, and this is a joint venture which we are doing in UAE in Middle East to that extent. Now white cement is a very very key ingredient in the putty which we make. It is almost about 19-20% of the putty which, you know where the white cement goes to that extent and that is something becomes a very key this thing.

Now I think when we are talking of the VAM VAE technology, which is kind of coming. Yes, it (backward integration) would be helpful for us in the entire area of adhesives rightly because the VAM kind of goes into the adhesives in a strong manner. So, it will give us a strong impetus in two ways. One in terms of improving the kind of quality of adhesives which we can give in and second from the point of view of margins which would kind of come in strongly from that point of view

asianpaints

I think there is abundant supply of all kinds of emulsions including VAE emulsions in India. We have not been using that very much in the last few years. We have used that in the past. At the moment, we don't use VAE emulsions because we don't find them very cost effective, but they're abundantly available. And the same goes as far as White Cement is concerned.

INDIGO
Be surprised!

Cement & Paints: Mixed up

Grasim is investing for building its new growth engines in the form of two new high growth businesses, namely Paints and B2B E-Commerce. We are on track for commissioning of our first paint plant by Q4 FY24 and remaining plants by FY25 in a phased manner. Construction is in progress at five of the total six sites for the Paint business. The statutory approval is expected to be in hand soon for the remaining one plant. Other activities for the launch of business are progressing parallelly.

ADITYA BIRLA GRASIM

So we are planning out all the activities for the paint business, and I may be within this calendar year will be able to have a definite timeframe for entering the paint business

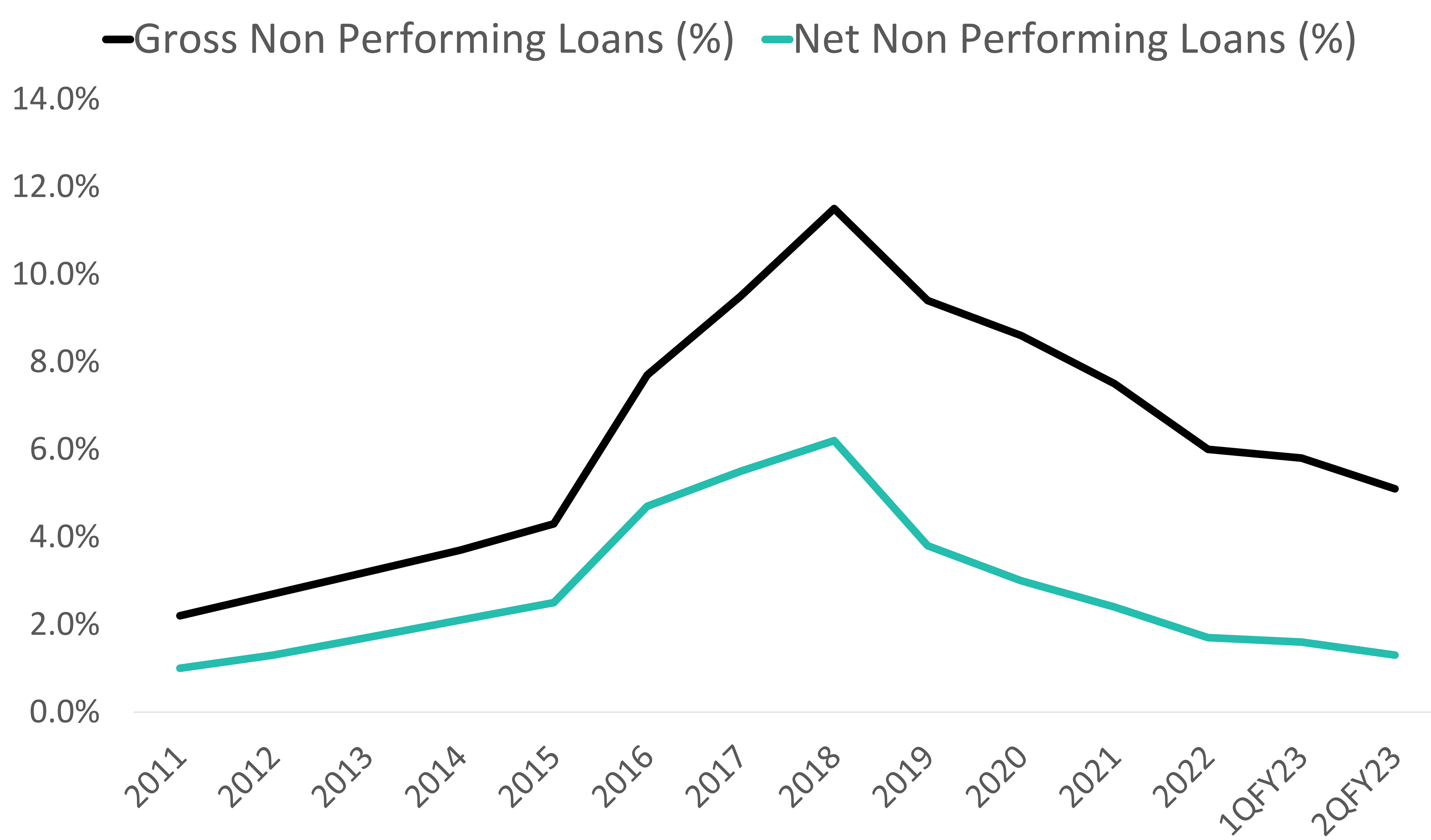
JKcement

Both the new businesses are somewhat complementary to each other, like sanitary ware and faucet has a 65% to 70% overlap with the piping business, because about 65% to 70% of our channel already does that product. And when you look at the paints and the adhesives business, again there is a major channel overlap between the two.

ASTRAL PIPES

Financials: Cinderella times

Banks across the board delivered solid numbers – strong growth, improving asset quality and margin expansion. Gross NPLs are at a seven year low and Net NPLs at a decade low. Investors are wondering if this is as good as it gets. The pandemic led to lot of weaker exposures getting written off and current book being cleaner than before. The anxiety is less on the asset quality and more on the sustenance of growth probably.



Source: Kotak Institutional Equities, For representative sample of both PSU & Private Sector Banks

Financials: Cinderella times

DSP

And as far as credit costs are concerned. So they also are lower than what we had expected. Going ahead also, we would expect the credit costs to trend downwards. We had earlier been guiding at between 1.25% to 1.5%. Now possibly, we would want to revise that to between 1% to 1.25% even taking into account some mishaps in the coming quarters. But for the moment, we believe that the book is robust and things are pretty much under control. So credit costs should continue to trend downwards through the coming quarters of the year.

बैंक ऑफ़ बड़ौदा Bank of Baroda

Annualized credit cost for quarter two was 29 basis points compared to 33 basis points during quarter one in the current year. Credit costs for the six-month period is 31 basis points. As stated in our earlier earnings call, as asset quality related issues get resolved, we should over the next few quarters be in a position to further normalize the credit costs to pre-COVID level. This in turn will have a positive impact on the return on equity.

HDFC HOME LOANS apni jagah banao

Financials: Cinderella times

See, as you could see that our NPA numbers even in absolute terms as well as in percentage terms are coming down both in Stage 2 and Stage 3. And if you go pre-COVID, if you remove the management overlay and look at pre-COVID, our average provisions requirement, our provision coverage is in the range of around 32%, 33%. That's what is expected, I think.

Okay. So we will -- while we may not go down to all that level at least from the perspective as what we are seeing today, we will certainly not be increasing the management overlay because, certainly, we don't see that requirement coming up.

Chola
Enter a better life

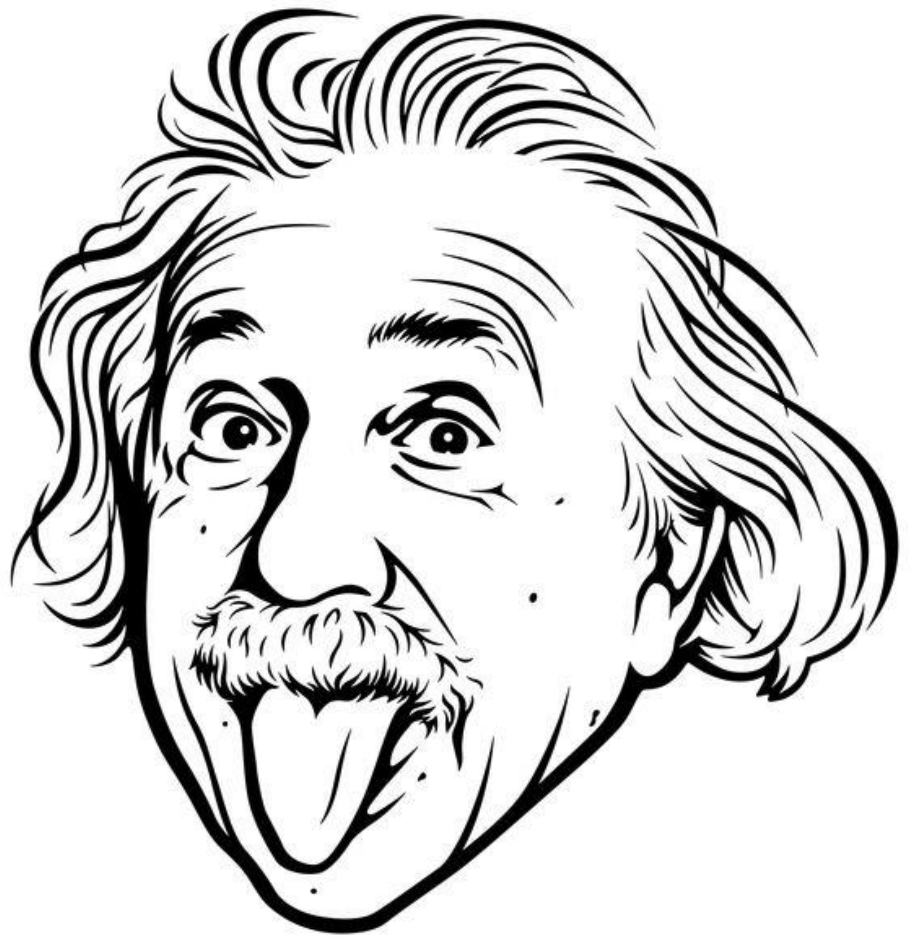
In the near term, we would expect them (credit costs) to kind of significantly undershoot the normalized level. I think the reasons for that are that we are not seeing really any material NPL development on the corporate side. In fact, we are seeing some recoveries. And on the retail MSME side, we are coming off the pandemic-related cycle. So, we are seeing actually recoveries out of those portfolios as well, and incremental additions are also at -- well under control. So, credit costs would be lower than normal for some time.

ICICI Bank

NOBODY KNOWS…

"There is not the slightest indication that nuclear energy will ever be attainable. It would mean the atom would have to be shattered at will."

Albert Einstein, 1932



In 1928 Robert Milliken (Nobel, Physics) said tapping nuclear energy was an 'unscientific utopian dream'. Ernest Rutherford (Nobel, Chemistry) compared the idea to "moonshine" in 1933.

Enrico Fermi (Nobel, Physics) built world's first nuclear reactor, Chicago Pile 1, in 1942.

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