



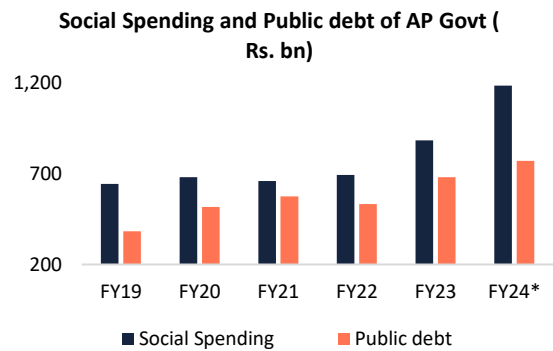
**The jigsaw that does not resolve**

It is that time of the year. The armchair analysts correlate the advent of monsoon with rural demand and a narrative is built around consumer staples (or FMCG). There are even some random observations whenever there is flooding in Mumbai, that the rains are good in India and FMCG should benefit.

This year, the debate is exacerbated by the outcome of the elections. Wherever the BJP has done badly, pundits have concluded that agrarian distress has been a factor. From the market perspective, rural consumption is supposedly weak. Hindustan Unilever, long considered a barometer of rural demand, reported muted volume growth in FY24. They expect volume growth to recover to "mid-single digits." Is that good or bad? Perhaps that depends on what is that mid-single digit.

| Period | HUL Volume Growth (%) | Period | HUL Volume Growth (%) |
|--------|-----------------------|--------|-----------------------|
| FY11   | 13                    | FY18   | 6                     |
| FY12   | 9                     | FY19   | 10                    |
| FY13   | 7                     | FY20   | 2                     |
| FY14   | 4                     | FY21   | 3                     |
| FY15   | 5                     | FY22   | 3                     |
| FY16   | 6                     | FY23   | 5                     |
| FY17   | 1                     | FY24   | 2                     |

Source: Company, Spark Fund Research



Note: FY24\* - Revised Estimate  
Source: Govt of Andhra Pradesh, Spark Fund Research

If Hindustan Unilever was a proxy, the data above clearly demonstrates that the rural demand was not sustainably strong at any point in the last 12 years at the least. Andhra Pradesh, which is as rural (or nonurban) as you may get after Hyderabad was hived off, saw a bizarre election outcome, if elections can be won by emptying the state coffers. The people voted out the incumbent after an unprecedented welfare wave hit the state. Mega city Bangalore voted the incumbent federal government. Mumbai which should have benefitted from all the stock market gains that the "suit-boot ka Sarkar" is supposed to have engineered, voted largely against the benefactor. UP and Bihar would have suffered from the same rural distress that is ostensibly constraining demand. UP is that state where the Prime Minister's plane manages to land on roads. Bihar is the perennial bride's maiden. Yet the electoral outcome seemed to suggest the opposite if this was the yardstick.

**Takeaway One** – There is utter randomization of expectations and confusion over outcomes resulting in hair-splitting of the highest order.

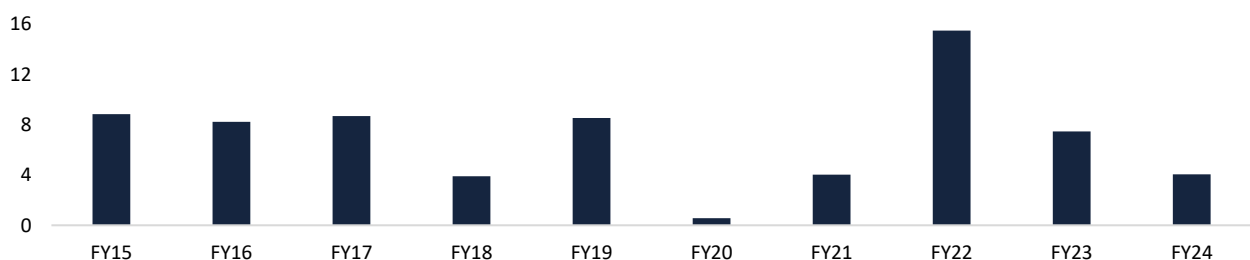
Sample this – the media is magnifying this narrative that the incumbent government lacks a clear mandate even as the pre-election alliance got over 290 seats. This is only the third time that a pre-election alliance won outright in 40 years. All three were under Mr. Modi. The noise is deafening and is best left alone.

**Will consumption revive?**

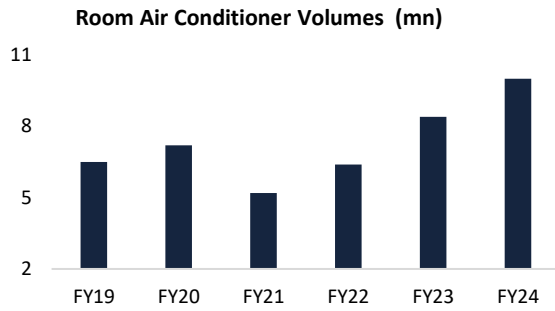
Depends on what is viewed as consumption.

Certain types of consumption did not slow down much. Let us start with the GDP numbers. The consumption growth, at the aggregate level, has slowed to below 6% which is below the growth prior to Covid and below the GDP growth rate. Some segments like travel, certain parts of automobiles, education, private healthcare, certain types of durables (take ACs), digital products/services and many other categories have seen robust growth. Others have struggled. The K-shaped recovery that we wrote about a few months back is a reality.

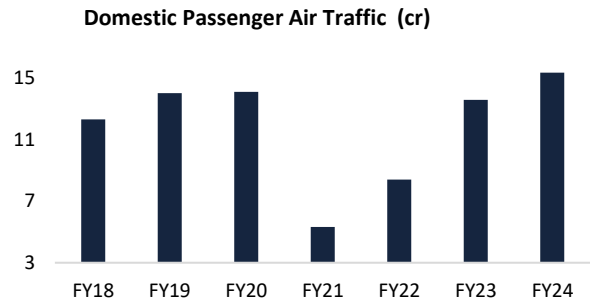
**Paint Industry Volume Growth shows a tepid recovery (%)**



Source: Ace Equity, Company Data, Ministry of Commerce and Industry, Spark Fund Research



Source: Motilal Oswal, Spark Fund Research



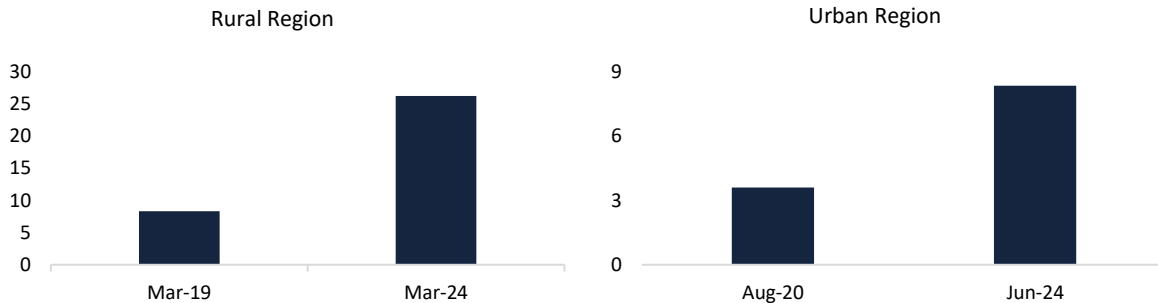
Source: DGCA, Spark Fund Research

The pandemic resulted in activities that were digitally empowered to accelerate. But that is not the whole truth. Leisure travel is not a digital activity. But it has now come back and how. Infra building cannot be done from home and that is booming. It is not only a K-shaped recovery but also a different shape for different segments. The government has done what it can to spur the economy and shield the worst affected from the shock to the extent possible. The data below demonstrates this fact.

| Period | Total number of PMGKAY Beneficiaries (cr) |
|--------|-------------------------------------------|
| FY21   | 69                                        |
| FY22   | 75                                        |
| FY23   | 81                                        |

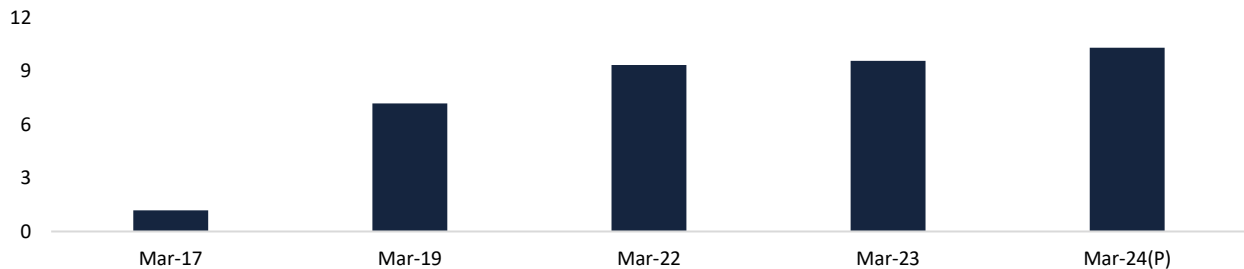
Note: Beneficiaries under the Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY) at the end of each FY.  
Source: Department of Food and Public Distribution, Spark Fund Research

**Total number of houses completed under Pradhan Mantri Awas Yojana (mn)**



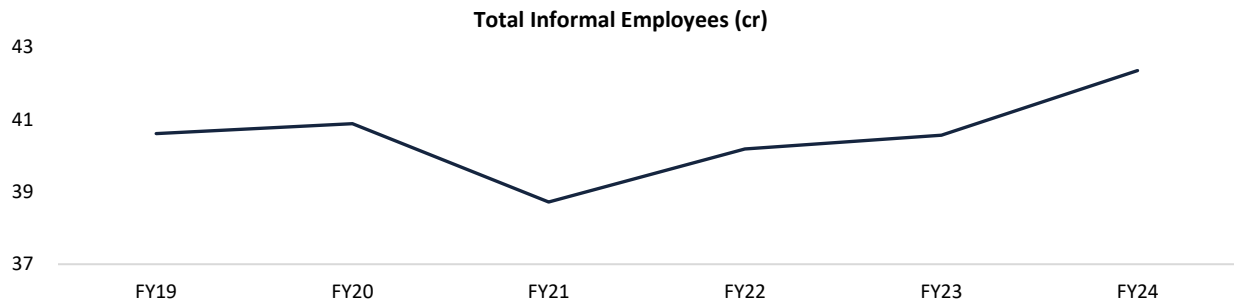
Source: Ministry of Housing and Urban Affairs, Spark Fund Research

**Total number of gas connections under Pradhan Mantri Ujjwala Yojana (cr)**



Source: Ministry of Petroleum & Natural gas

Despite this, there are challenges in employment. Data, particularly from CMIE, seems to suggest that the labour participation rate has come down. It suggests that many went back to farming. To be sure, there was huge dislocation of labour. The survey-based methodologies may not capture the whole truth in the aftermath of this. The temp jobs or the GIG economy may have flourished.



Source: Avendus Spark, Spark Fund Research

The degree of dissatisfaction amongst the youth cannot be attributed solely to the lack of jobs or to the inability of the government to intervene. The divide that the pandemic forced in society is one that is pan-global. This crack was already in the works for years before the pandemic. Covid may have yanked it open. India has done a better job of handling this compared to much of the developed or the developing world.

The government of the day may have a political imperative to address the issues that may have costed them votes. It is possible that rural outlay may be stepped up. Rural interests were never really ignored. Infra spending always had a cascading positive impact on employment in the rural areas. Just that nothing is likely to be enough given the magnitude of the challenge. Considering this, MSP has been increased for over a dozen agricultural items after the election results and this was one of the first moves of the new government. This may seem to enrich the farmers. At the same time, it ends up being inflationary. Food inflation is already sticky and the drag this induces will constrain consumption even as the government is trying to direct the flow of money to the hands of the farmers. Operation successful. Patient may struggle to survive.

Meanwhile, the digitally enabled are marching ahead because the circumstances have landed them in a better place. To disable their progress and make everyone feel equally miserable is no sensible policy – and the government of the day seems to have grasped this so far. The buoyant tax revenues in part are due to the thick upward stroke in the “K” shaped recovery.

**Takeaway Two** – Even if the government gives a fillip to the demand side or to the rural economy, consumption may recover in patches and may continue to show uneven progress. Establishing a generalised correlation between government push to rural spending and revival across the so-called spectrum of rural (or other) demand may be an exercise in futility.

#### **Welcome to the melting pot. We are in the hot seat within**

This is the real deal. We are holding stocks in companies whose head honchos may be sitting in Mumbai and whose accounts are prepared in a back office somewhere out of sight. They may have factories/operations in Jharkhand or Tamil Nadu. The business may have customers all over and could be selling products or services that a farmer's daughter consumes while working in a semi-urban locale that is categorised rural by some. Expectations are set by shareholders in cold Europe or hedge funds in Singapore. In the background could be the private equity lot in Bangalore whose opening negotiations start at 10x. There is often a regulator who sits in Delhi or Mumbai and governments that are not clear where the control is. Amidst all this, we are an investment manager somewhere in the scatter plot. Often, no one knows better.

The challenge is to cut through the clutter. Muting the surround sound. Building the portfolio stock-by-stock. Believe me – it is not getting easier and is unlikely to.

Warm regards,

**P Krishnan (CIO) and Team Spark Fund**

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