

**END MARKETS– THE HOLY GRAIL**

The potential end market size remains the most reliable pillar on which the optimism on Indian stocks rests. Over the years, Indian valuations have remained higher than most other markets and have in many instances gone higher and stayed put in a higher range. In many pockets, this has been underpinned by the growth driven by a large end market emerging. IT services and generic pharma in earlier years, insurance, segments in lending, infrastructure, EMS and more recently the defence sector, have all seen investor interest due to this. Let us look at why the potential of end markets is so critical for Indian stocks.

1. Most developed countries suffer from the lack of end markets in their turf due to low or no population growth and saturation in several areas. The lack of economic growth and stagnation of end markets are two sides of the same coin for most of them. They have to rely on exports (Europe's reliance on China) and/or productivity gains (the growth in US) are examples that stand out over the last few decades.
2. China has seen end market stagnation. Demographic challenge is primarily behind this. Earlier, China built a disproportionate market share for several consumption items of common use across the world and by definition, there has been saturation. China is increasingly looking at leading the charge into the next big moves in technology to wriggle out of the corner they have found themselves in.
3. Indian companies have relied on good execution in capital allocation and balance sheet efficiencies, operating efficiencies and entrepreneurial drive in selecting the right areas to create shareholder value in the past. There are hardly any Indian companies that can boast of intellectual property on which their success is dependent on. The size of the end markets is therefore critical for them.

India is in an interesting situation. Everyone knows about the Indian demographic story. I have personally seen it in every presentation for over 30 years now. We need to look beyond. Indian incomes have lagged expectations though they have grown. End market size in the consumer space has therefore been over-estimated. This is evident in most consumer segments. We need to be discerning in assessments of market or revenue potential. The geopolitics as well as supply chain compulsions are creating new opportunities which will piggy-back ride on India's favourable demographics. For India, we are at a phase where a more nuanced approach to gauging potential end market size will be rewarding.

Industry Market size	FY25E*	FY25 P/A	Comments
QSR (Rs.bn)	532	586	Higher than Expectation
Quick Commerce (Rs.bn)	573	427	Lower than Expectation
Gross Loan Portfolio of Microfinance (Rs.tn)	4.63	3.75	Lower than Expectation
Cement (Volume in MMT)	475	460-475	Broadly met Expectation
Real Estate (\$.bn)	650	564	Lower than Expectation
EMS (\$.bn)	40	99	Much Higer than Expected
Plywood (Rs.bn)	292	235	Lower than Expectation
Renewable Capacity (GW)	209	223	Higher than expectation
Paints (Rs.bn)	788	733.5	Lower than Expectation

Note: E*: Estimate post Covid; P/A: Provisional or Actuals.

Source: News media Articles, Industry Reports, Company, Spark Fund Research

Apart from topline potential, we should look at a possible trade-off between market potential being realised and the profitability level. In China, the market potential was met in many cases, but enterprises ended up with excess capacity. The huge supply and cut-throat pricing may have aided demand generation. Valuations disappointed. In India, to discuss that is akin to sacrilege in equity investor settings.



HUNTING FOR OPPORTUNITIES

Here is a table that provides food for thought on how we assess the opportunities.

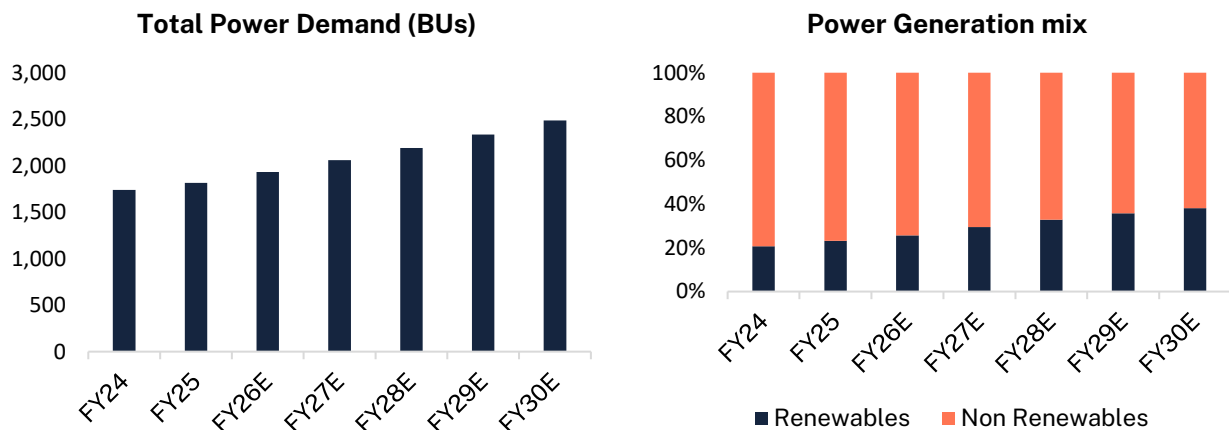
Segment	Expected Growth	Remarks
Consumer Staples	< Nominal GDP Growth	Consumer Income is spread across too many competing priorities. Brands don't mean moats. Valuation is unsustainable.
Consumer Appliances	< Nominal GDP or close	Depends on the category. Often, the moat is over-hyped.
QSR/ Snacks	> Nominal GDP Not by too much	Too much disruption. Valuations don't make sense most of the time.
Organised Retail	> Nominal GDP	Disruption from e-commerce and quick commerce are factors.
Quick commerce/ Food delivery	>> Nominal GDP	Will they get some pricing power? When will they trade like normal stocks?
Hospitals	>> Nominal GDP	Absence of public healthcare infrastructure. Income levels mean morbidity cannot be brushed aside (eg – cardiac issues – affordability leads to demand).
Diagnostics	>>> Nominal GDP	Fragmented market. Many demand drivers. Consolidation is key.
Automobiles	= Nominal GDP	Execution is key. Cyclical and hence that matters.
Traditional IT services	<< Nominal GDP	High growth phase is done. Niche areas may stand out. Gen AI can be a disruptor.
Banking	= Nominal GDP +	Financialization has more room. Credit growth has lagged. Credit to GDP ratio can increase.
Insurance	>> Nominal GDP	Penetration has lot of room. Social security & safety nets weak in India. Social safety nets are withering. Policy will drive penetration. Regulated business – market share is consolidating.
Capital Markets services	>> Nominal GDP	Growth is there; Addressable market may be getting over-estimated due to excessive optimism.
Power and power chain	>> Nominal GDP	Per capita power consumption is still lagging. Power chain has opportunities across – Generation, Distribution, Transmission, Data Centers, Renewables.
Physical Infrastructure	>> Nominal GDP	Opportunities exist everywhere. Specific sub-segments may grow faster.
EMS	>>> Nominal GDP	Large end market; Excessive optimism.
Drugs & pharma	> Nominal GDP	Export opportunities are specific to companies. Specific therapies in India have large end markets.
Fintech	>>> Nominal GDP	Specific to the business or Technology niche. Scalability is a challenge and valuations do not reflect this most of the time.

A lot of areas may hold promise in a country like India. Some areas stand out as distinct. Following are a few opportunities that stand out in the clutter.



Power Chain

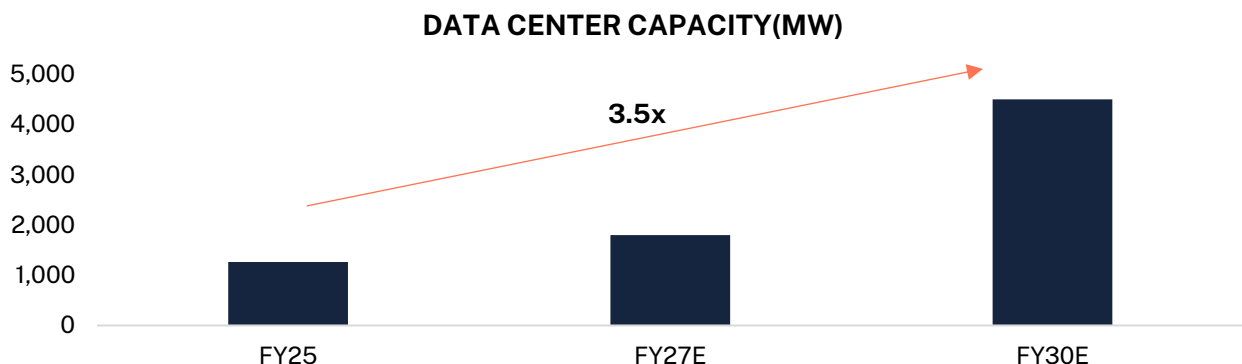
The per capita power consumption in India lags even some of the smaller countries and the implications are obvious. The point to note is that the growth in GDP and power demand growth will need to go hand in hand. Several areas within the power sector ecosystem look hugely promising. Renewables are a case in point. Yet another area is data centres. The confluence of an explosion in data use and the fresh impetus from what Gen AI could do are likely to push this niche into a high growth phase. We have seen this happening in IT services, fintech, EMS and several other areas in the past.



Note: Renewables: Solar and Wind; BU – refers to billion units.

Source: Ministry of New and Renewable Energy, Spark Fund Research

The main investment hypothesis in the power sector, as is the case in banking, is moving ahead from overall demand for the base product/service. Specific sub-segments/niche areas are more rewarding in a scenario where the overall sector remains critical to India's growth. The key difference from the consumer sector is that this business is regulated with not-so-apparent moats in execution. Execution is the key moat. Investors have consistently hyped up the visual appeal of many consumer segments while ignoring competition and lack of profitability. In the power chain, regulation in a way acts as a brake on mindless competition. The institutional memory of losses and mega write-downs of the past has made capital allocation more sensible. With growth in sub-segments taking off, we see opportunities emerge. Needless to state, valuations are not at rock bottom levels and this is the reality of the Indian market now.



Source: News/Media Articles, Industry Reports, Company, Spark Fund Research

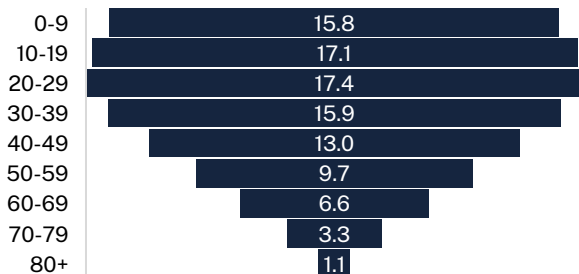
Insurance & Pension savings

Indian government will remain hard pressed to offer a social security net other than to the really poor. The wealthy in India will of course be expected to find their own solutions and they may have already bought whatever insurance they need. The large middle class will see penetration going up in the coming

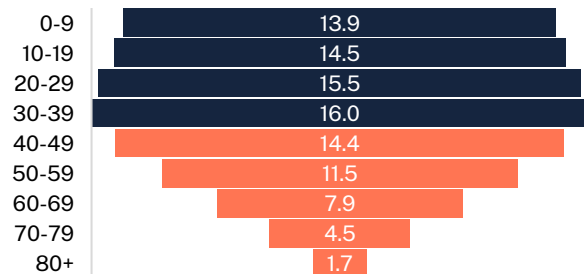


years due to demographic, social and economic trends as well as the governmental push driven by its own compulsions. These areas will continue to present opportunities at least for the foreseeable future.

India Estimated Population by age group in 2025 (%)



India Estimated Population by age group in 2035 (%)

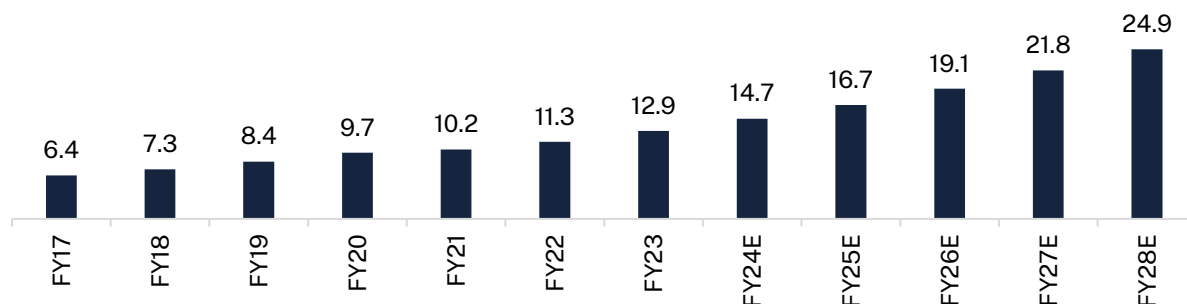


Source: United Nations, Spark Fund Research

Diagnostics

Spending on preventive healthcare has a lot of room in India. Several societal and economic trends will keep demand going for a long time. Rising cost of healthcare will influence attitude towards preventive healthcare and therefore diagnostics. Availability of more sophisticated tests and falling unit prices will be drivers too. Rising life expectancy and the need to remain healthy go hand in hand. There are so many tailwinds that will keep this area humming. In a country like India, the real demand will lag latent demand in a cyclical manner even for a niche like this. This was witnessed in the post-Covid years. Demand seems to be picking up again. Entry of Amazon has raised some concerns over pricing pressure. Pricing pressure has been there for a long time now. Market expansion, customer adoption of more sophisticated tests and affordability, quality and reliability will be bigger drivers here.

Indian Diagnostics Market (US \$ bn)



Source: News/Media Articles, Spark Fund Research

THE QUEST FOR END MARKETS

This will remain a key pursuit for investors. Investible ideas will depend on whether the market has sized up the end markets properly and the competitive landscape. The glut in private equity and investor flows into stocks have led to several areas ending up as over-researched and over-hyped. That is the landmine we need to watch out for. Our stance has been that the stock indices will not be trending up one way in the current environment of higher cost of global capital amidst several other risks. The resultant volatility will open up opportunities to get invested into areas where end market potential remains large. No other country offers so much of opportunity and confusion both at the same time.

Warm regards,

P Krishnan (CIO) and Team Spark Fund



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