

TRANSCRIPT: EPISODE 356

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[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. India's economy is evolving fast, we explore how structural shifts are influencing the market and what that means for investors. From valuation resets to global trade tensions.

Chris Salih (CS): I'm Chris Salih, and today we're joined by Ajay Tyagi, manager of the Elite Rated UTI India Dynamic Equity Fund. Ajay, once again, thank you very much for joining us today.

Ajay Tyagi (AT): Hi, Chris. Pleasure to be on the show.

[INTERVIEW]

CS: Great. Good to have you. All the listeners will be waiting for a Donald Trump question, so let's just start with it and be done with it. When you saw that big old board come up and you saw India and is it 26-27% reciprocal tariff what was your sort of first impression, and obviously that is now three weeks ago, maybe just give us a bit of a timeline with your thoughts on that. There's estimates it's gonna cost like \$7 billion for India, but then there's obviously things like it and pharma have been sort of pulled out of that number. Just give us your view on it and the impact.

AT: Chris, on a lighter note, the first reaction was, thank God we are much lower than our neighbour. **[CS: Yes.]** So we are much better place compared to many other countries, but you know, quite frankly, I think it's a very evolving situation right now. Whatever we say and comment right now possibly is something which will not hold for, you know, possibly a few weeks down the line.

But let me give you a high level view around how we are looking at the situation. It's very clear to us that you know the current Trump administration certainly wants to make it a more even field compared to all

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their trading partners, not just partners in Asia, but across Europe and North America as well. At the same time, they are wanting to move ahead with signing trade agreements with their partners, whoever you know, is in the initial phase of signing the agreements such trade agreements would be the ones who would benefit.

So the way we look at it here is that if India in the next couple of months can actually go out there and decide on tariffs on different industries that we are charging to them and sign a you know, trade agreement that is good for both parties, India may actually benefit out of this whole exercise. And if you just delay things, if you just kind of spend more time trying to see who blinks first, maybe you could lose out. So that's how we are looking at the equation right now. US is not a very big trading partner for us, but it is a very important trading partner for us. So to our mind, there is merit in actually going out there, sitting across the table, resolving most of these issues and finally signing a trade agreement.

CS: Yeah. Do you think it, I mean, for example, with the UK, he seems to be quite sort of kind and generous towards us, or at least that's how he sees it. Does he have a similar view within India? Does he sort of put you in the "good boys" bucket versus China? Is there a perception of that with India for Trump?

AT: Absolutely, Chris, and that's why I said that our first reaction has been that we are much lower than many others. Of course, China is an outlier completely. The kind of tariffs that have been imposed on China basically mean that there's nothing which can be exported out of China to the US. It's all unviable, so to speak. But yes, on balance, India seems to be in the good boys bucket. We talk about emerging markets you know, as a universe.

CS: Yeah. Okay. We're gonna go into the portfolio in a bit more detail in a little bit, but maybe just from a sort of top level view here has any of the announcements or the buildup to the announcements has had any impact on the portfolio whatsoever in sort of recent weeks and months? I mean, for example, just looking at your factsheet, you don't have any exposure to, like energy or utilities. Is that long term, is that a trade view? Just give us an a view on whether there has been any impact on the portfolio with these trade tensions.

AT: Sure. So first of all let me just speak about our exposure to energy, utilities and so on. That's by design. You know, it's not because of our view on the tariff force and so on. So by design, we've been not liking this part of the Indian economy because of the simple fact that, you know, we feel that the most lucrative part of Indian economy is basically the one which is going to ride on India's growing middle class. And therefore you know the growing consumption by this middle class.

So anything which is to do with consumption, anything which is to do with you know demand increasing on account of disposable income, increasing for the middle class is the one bit that we like the most. And on top of that, we want those businesses which really have the pricing power and the strong brand recall. So that's why, you know, many of these commoditised sectors, many of these cyclical, many of these sectors which have global linkages or are global cyclical, by the way, are usually not there in our portfolio at all by design.

CS: Okay. I mean, I was gonna ask the question a bit later, but maybe you mentioned the middle class there, there now how has the outlook for middle class in terms of wages and they're not growing as quickly as possible, and is debt on the rise? Does that not impact the Indian economy itself?

AT: So, you know when we look at data, we look at data in terms of let's say increase in per capita income. That's the surest way of trying to figure out whether wages are increasing or not. If you look at the progress of per capita income, then you'll be very reassured about the fact that you know, this particular vector has

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shown the highest growth amongst all other emerging markets. And obviously an increasing per capita income is a reflection of increasing wages and therefore increasing disposable income eventually.

CS: Okay. I wanted to touch on the economy because even before the announcements, so the last few weeks, there's been a few ups and downs. Let's start with the positive. The IMF figures came out, I think it was yesterday. They've lowered them for India, but they've lowered them for everyone else, and it's still well above 6.2, 6.3, something along those lines. Does the GDP figure again affect your outlook in terms of how you build your portfolio? Or is it all about valuations?

AT: I would say, Chris, it's a mix of mix of both GDP growth and the trends around that growth do determine, you know, which are going to be the growthy businesses. So obviously GDP growth does lead to stronger or weaker consumption trends depending on how this number pans out. So if GDP growth is weak, obviously the consumption trends would be weak. India, as we all are aware, is predominantly a domestic consumption oriented economy, 65-70% of India's GDP's domestic consumption. So if GDP is weak, consumption would be weak. And if consumption is weak, then earnings estimates have to be brought down. And it also means that valuations have to be reset. So we do try and form an opinion about the growth of the economy into the foreseeable future. More importantly, because sometimes predicting this growth from quarter to quarter can be difficult.

More importantly, we try to predict which are those sectors, which in terms of the penetration are fairly low and therefore can continue seeing penetration led growth regardless of whether the GDP number is 4% or 6%. So, you know, certain industries and sectors where penetration is high are the ones which are always impacted by even a slight moderation in GDP growth, whereas that may not be true when penetration numbers of that particular category is very low. So that's the one bit where we emphasise a lot on. It tells us how long can be the growth runway for such businesses. And once we establish that, then the valuation framework has to be always put front and centre. We all are aware, no matter how great a business, no matter how growthy and how profitable a business is, if you buy it at insane valuations, you may have to, you know, wait for a few years before you start making money on those investments. So that's something which we typically try to avoid, not overpaying and not getting carried away by the thought that the company can grow endlessly and therefore any amount of valuations can be you know given to such companies.

CS: Yeah. Just quickly off the back of that, just for listeners who may not know as much about India as perhaps they want to learn a bit more, what sort of sectors come jump out as you as the ones with that low penetration for the longer term?

AT: That's a great question. For instance, let me talk about the entire food services industry by which I mean quick service, restaurants, casual dining, restaurants, hotel and hospitality industry. Look, these are discretionary items, so to speak. India for the longest time was less than \$1,000 per capita income. Just put that in context of where UK is today, and you'll imagine what I'm talking about. When you are on an average only earning thousand dollars per capita, you are basically only spending towards the basics and the essentials and the staples items. You're not making what is called as discretionary expenditure. Today we're talking about an economy which has already moved to \$2,500, and therefore, you know, the ability of households to spend on discretionary items is increasing.

Just to give an example, because I said food services you know, when I was a kid, I'm talking about you know, the early to mid eighties. And also when I was growing up and I was in college in the nineties, a typical family in a large city in India would go out eating with their family possibly once in three months. That frequency has already now come down to maybe you know a couple of times in a month. So yet the penetration is very low because a typical family in the UK may be eating out a couple of times in a week. So

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these are industries which give us that comfort that there is a long, long road and a long runway ahead of us for growth to happen.

CS: Yeah. Okay. Talk a bit more about valuations now. I think most people would be aware of the fact that in India's valuations have always been seen as high versus their peers in emerging markets, et cetera. First, the narrative earlier this year was about, well, the end of last year, start this year was about that correction and whether it was anything more than a correction, we then had the budget, which was quite supportive. I always like to think of valuations a bit like a sweet shop.

How open is the sweet shop for business at the moment? Are things looking a bit more attractive than they were before? Is it sector specific? Is it company specific? Just give us an insight because I think the smaller and mid-caps in particular look very expensive prior to what's happened. Large caps may be less so. I think that's correct. How does that landscape look now?

AT: That's a great question, Chris. Truth be told, yes, small and mid-caps have certainly seen a much higher correction, and therefore, to that extent, their valuations are looking a wee bit better than what they were at the beginning of the year. But we would still call those valuations as, you know, unattractive or certainly if not unattractive, higher than long-term averages. So you know, we are still cautious and selective about mid and small-caps. Through this correction of the last one and a half, two months, we've been selectively buying into certain names where we think that you know, the valuations are now getting very close to the fair valuation band or to the long-term averages, but that's not true of the entire universe of small and mid-caps.

Large-caps, you rightly mentioned, are certainly in the fair valuation zone already. They weren't too expensive in any case, even before you know, the corrections started. So they were reasonably valued, certainly slightly higher than long-term averages, but not outrageously expensive. And after the correction, they've certainly come into the fair valuation, man. So our comfort level in the large caps is certainly much higher.

CS: Okay. I want to go back to the mid and small. Just could you give us an examples or some examples of areas that you've been looking at or areas you find attractive in those spaces?

AT: Sure. So for instance you know, in the mid-cap space, there are a few companies which are you know let's say into household appliances, which are into let's say electrical durable space. So these are the companies where you know, we did see a 15-20% correction in some cases even higher. And we find them attractive because of the distribution moats that they have created. It's very difficult for a Chinese company or a multinational company to come to India and have that kind of distribution network and reach you know even if they try to sink in a billion dollars or more. So while they were correcting, we thought it's a great opportunity to increase exposure in there.

CS: Yeah. Okay. And then just quickly on small-caps, we move on. Obviously the market's quite buoyant, a whole host of new small-caps coming on the radar. Do you think long term you will have to look a bit more at that market in terms of the portion of portfolio just because the number of companies available to invest in is growing so rapidly?

AT: Absolutely. Chris you know, and that's where we have an advantage being a local asset manager, being the oldest asset manager in the country, we have an extremely strong team of analysts and associates, which basically help us in terms of going out there, scrubbing the universe, trying to figure out which are those new companies or the smaller companies which are worthy of tracking. And therefore you know, the there's

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something called a new idea generation, which is part of the KRA for our entire analyst team. We are always pushing them to say that, look, it's great to actually go deep into the existing companies within our universe, but do spend time in terms of discovering new ideas.

And with a very strong 16 member analyst team, I think we are one of the most capable out there in terms of, you know, hunting for these newer ideas in smaller companies. But we also know that the mortality in these smaller companies is very high. So we don't get overly excited. We do a good job in terms of you know trying to have a deep and hard look at most of these companies. But the ratio of companies that make the cut and finally land up in the universe is not more than 20%. So yeah, we have to scan all a hundred percent. What makes the cartage just about 20%.

CS: Given you've said that, again, I had a question a little later, but I feel like now's the time to ask it. Is there a good example of a company you could explain that that has come out of that process on the smaller side?

AT: Absolutely. Let me give you an example of one of the large hospital chains in India. While it is one of the large hospital chains, but it is still a small-cap in terms of its market cap, the company iPod you know, sometime in 2023 while we knew this hospital chain and we've actually, you know as patients, we've also, some of us in the team have also been to that, that chain. But, you know, we wanted to actually meet the management a few times. We wanted to be sure about how their numbers are panning out. We also wanted to be sure about the consistency between what the management is telling us to be their strategy, and also seeing it in terms of execution. So we did take about a year and 18 months to get excited.

Finally, we started building exposure sometime in the middle of 2024. And the sell off that we saw post September October of 2024 allowed us a very good level to jump in and make a meaningful exposure. So yes in India if I give you the big picture on hospitals, the government has realised, unlike the very successful NHS in the US, the government has realised that they don't want to run a medical system where everything flows from the government ex checker on.

On the other hand, they just feel that the private sector can do a much better job of providing healthcare, and the government is only focusing on providing medical insurance to the population at large. So that's where the government is acting, enabling everybody to have a medical insurance. And using that medical insurance, they can go to the private sector and get themselves treated because the government feels that the private sector can run hospitals much more efficiently than they can.

So that's a concept that has just evolved in the last seven, eight years. Companies like Ante, and that's the company that I'm referring to, which over which on which we build exposure over the last 12 months, has been a poster child of that.

CS: Yeah, okay. And you are happy to hold these companies as I mean, let's just use Moderna as an example. This is just in general, you're happy to hold these companies as they get bigger to mid or even hopefully large cap at one point. I mean, is that that's not an issue for you, is it, you're not thinking, right, this company's we've got what we want, let's move on. You're happy to hold a company like that for as long as possible?

AT: Chris, I can just say that if the company from small big becomes mid and from mid becomes large, it's the sign of one of the most successful investments any investor would have made. So just because it's crossing one compartment and moving to the other compartment doesn't mean that we have to sell it. So, you

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know, such kind of business models, which are scalable, which are improving their profitability year after year, and the market is rewarding them for that are, are, are our businesses, which shouldn't be you know, exited till such time that this bootstrapping continuous.

CS: Okay. Just a couple more quick questions. Firstly I should ask something on politics. We've obviously lots been mentioned with Modi and 10 years of success with him. The most of the consensus I got was that the budget in earlier this year was positive for pro business. Are you of the same opinion? Could they have done more? Could you maybe give us some insight on that, please?

AT: Sure. I would say you know, we always expect the government to do more. And obviously in a country like India where we still have a large part of our population which is below the poverty line obviously the government you know, cannot cannot be sanguine about how they're carrying on their affairs. But yes, on balance, I would say the budget was a very good exercise because the government was able to pick up, and rightfully so, the fact that consumption part of the economy has been slightly weak. The government has been spending a lot in the previous four years on CapEx because CapEx and infrastructure, because it obviously has a much higher multiplier effect. But they also realised that you know, the consumption trends have been weakening and therefore they have done the right thing in this budget to actually support that consumption.

They've affected income tax cuts, which basically that the disposable income for everyone increases. They've also come out with certain welfare schemes and certain direct benefit transfers for the lower most Strat of lower most economic Strat of our population, that also would put money in the pockets of people to go out there and consume. So I think that's the template possibly for the next two, three years, not just for this year. We feel that these schemes will be rolled out and extended over the next two, three years that should eventually get consumption back on track, which has been slowing down in the last you know, couple of years. And yeah, I mean to that extent we thought that the government was smart enough to react to the situation of, you know in a way taking the foot off the pedal on CapEx and you know pressing hard on consumption.

CS: Yeah. And I just wanna finish with a sort of sort of special specialty sector really, and that is the chemical sector, specialty chemical sector that's an area of the market that's projected to sort of grow very quickly around 40 billion in 2025. How is the fund capsizing growth in that sector?

AT: Sure. So Chris, we do have a few companies in specialty chemicals companies like PI Industries and specialty chemicals companies like clean sciences into specialty chemicals. We do have a couple of other names which derive 30-40% of their income from specialty chemicals. And here I'm talking about companies like <inaudible>, which on one part are catering and making active pharmaceutical ingredients for the pharma sector, but on the other are also curated into the chemical sector. Now, you start the conversation by what's our view on tariffs and how is how has been the tariff to India? The way we look at it is that you know the global majors, the global chemical giants around the world will be reducing their reliance on China. They can't replace China in a year or two. In fact it'll take a couple of decades to completely replace China, and I don't think anybody would want to replace China completely.

But if they were reliant to the extent of 80-90% on one single country, which is China, they would want to reduce that reliance from at least 80% to 50-60%. And that's where quite too few Indian chemical companies would benefit. The ones which already have relationship with the Bears and the Monsantos and the the Japanese chemical giants like Umai. All of these Indian companies would definitely see a very sharp ramp up in terms of their you know, overall volumes dispatched to their partners. Because to our mind, tariffs or no tariffs, the messaging by the US administration is clear. The reliance on China must go down.

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CS: Yeah. On that note, I'm going to end it there. Ajay, thank you very much for your time once again.

AT: Pleasure. Chris, thank you very much for having me on podcast.

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