



THE TORTOISE AND THE BEAR

In the fable immortalised over the eons, the tortoise wins. It is a story of perseverance over speed. Indian consumer economy has a fabled grandeur to it. The carefully cultivated market narrative has been that this is a high growth sector and moreover a secular growth sector with good return metrics. The nature of household consumption is that a certain part of it is not volatile. In a country like India which is still poor by any standards, that basket may stand out at the aggregate level. The yardstick for secular growth cannot be pegged such that positive growth year after year can be construed as secular or high growth. Equity investors have not based their expectations on mere positive growth. Stocks have priced in higher growth than nominal GDP at the least and in fact the bar was always much higher. Figures like 20% CAGR for revenues and higher numbers for profits have been casually bandied about. The reality is vastly different.

Many high-profile consumer segments now resemble the tortoise in action. Unfortunately, it is not perseverance over speed that is at work here. It is greed over logic. Due to a variety of factors at work, the Indian middle-class consumer has become a burden of beast. Incomes are growing lower than expectations. Aspirations are galloping. The market, as has been the case in India with many other pockets, paid in advance for a future that is threatening to slip away from reach. The looming shadow over the tortoise is from a beast that the street dreads. It does not look good.

Having said that, the consumer sector is a massive kaleidoscope in India. We agree with the much-touted assertion that things are stock specific. It is just that we need to state the obvious truth. The specific stocks are not large in number. The consumer space is not just limited to the FMCG, knick-knacks or (junk) food. The opportunity can be viewed from a B2C lens. This widens the scope and makes room for opportunities consistent with India's economic growth. That, as well as demystifying the hoax about too many investment moats in the consumer sector, are the challenges in front of us as investors.

The moats that dissolved

The most compelling case for the traditional consumer staples/consumer discretionary stocks has been that they possess moats that give them an uninterrupted growth run. The refrain has also been that they possess debt free balance sheets, free cash flow generation and high return ratios.

First on growth. Let us have a look at numbers.

Industry	Revenue CAGR (%)			PAT CAGR (%)			P/E (x)
	6 Yr	3Yr	1Yr	6 Yr	3Yr	1Yr	
e-Commerce	55	52	44	-7	-17	20	-
QSR	16	22	24	-39	-67	-96	5,158.2
Jewellery	15	28	27	16	20	-2	76.3
Footwear and Luggage	4	8	0	-8	-5	-33	74.1
Alcohol	7	14	9	6	9	-10	71.3
Beverages	19	19	18	23	21	12	62.8
Foods	10	11	-1	7	8	-18	59.7
FMEG	11	17	21	2	-2	13	56.1
Haircare	6	4	11	2	0	-16	53.5
Home and Personal Care	8	6	2	3	-3	-12	52.5
Paints	9	7	-2	4	2	-42	50.0
Apparel	9	7	6	2	-10	-16	48.4
Oral Care	5	6	6	4	1	-19	46.5
Edible Oil	16	10	21	32	5	71	38.2
Dairy	9	14	10	11	90	2	36.2
Healthcare	21	10	16	13	4	33	35.7
Cigarettes/Tobacco	10	12	18	1	0	-25	26.7
Sugar	9	9	5	7	-13	-48	21.7
Paper & Stationary	7	10	-4	-7	-8	-66	15.1

Note: 6 Yr, 3 Yr, 1 Yr CAGR Calculation as on FY25 for listed entities. P/E as on 30-05-2025. "-" indicates profit numbers are negative or negligible.

Source: Ace Equity, Company, Spark Fund Research



Numbers don't lie. The growth in revenues for a lot of categories is lower than nominal GDP over several years. Where there is revenue growth, that is due to inflation (eg- Jewellery) or because of the category being new and having zero base (eg- QSR). Profitability seems to elude the new categories. The moats have dissolved or were over-hyped. It is probably the latter.

Now, the strength of capital structure. Yes- the traditional names continue to have good return ratios. This has supported valuations even earlier. Before the GFC, PEs of 30 or thereabouts were considered sustainable for established consumer business models. Valuations have expanded to 50/60 & more- but growth is a no show. And here are some questions now

1. Are these companies reluctant to take up big investments because the return ratios will take a hit?
2. Are MNC names not taking risk because their parents want uninterrupted dividends and that is their priority? In which case, is there merit in public market investors (Indians or FPIs) continue giving them rich valuations?
3. Are the established companies recognising that the incremental opportunity is some sort of chimera and therefore holding on to margins (while they last) and not take capital calls?
4. Are the super-growth categories (From the data, these are categories where there has been a disruption in traditional channels of buying or where the categories are literally novel in nature) struggling to establish a profitable business model on a sustained basis?

The incremental return ratios for the incumbents on new investments may not be as impressive as legacy returns. This brings us to the new breed of consumer companies that have emerged as disruptors or companies opening up new markets.

Consumer stocks that listed from FY21 and having market cap of Rs. 3000 crores or more

Company Name	Revenue CAGR (%)		PAT CAGR (%)		FY 25 PAT Rs. Cr	P/E (x)
	6Yr	1Yr	6Yr	1Yr		
Devyani International	29	39	-	-	-7	-
Brainbees Solutions	57	18	-	-	-265	-
Swiggy	54	35	-	-	-3,117	-
Restaurant Brands Asia	26	5	-	-	-233	-
FSN E-Commerce Ventures (Nykaa)	38	24	-	81	40	1,462.30
Sapphire Foods India	20	11	-	-68	17	612.5
Eternal	61	67	-	50	527	437.2
Campus Activewear	23	10	20	36	89	99.3
Bikaji Foods International	19	14	25	-26	194	98.6
Metro Brands	13	6	14	-14	354	92.6
Vishal Mega Mart	46	20	75	37	632	91.2
Kalyan Jewellers India	22	35	59	20	714	81.0
Medplus Health Services	18	9	39	129	150	77.2
Ethos	19	25	44	19	96	72.4
Mrs. Bectors Food Specialities	16	15	28	2	140	63.7
Allied Blenders and Distillers	2	-54	63	-	195	57.3
Vedant Fashions	10	1	13	-6	388	49.9
Go Fashion (India)	20	11	20	13	93	49.2
Patanjali Foods	18	8	60	70	1,301	46.7
Indigo Paints	17	3	32	-4	142	36.2
Senco Gold	17	21	-9	-12	181	34.3
AWL Agri Business	14	24	21	582	1,226	29.1
Electronics Mart India	27	11	22	-13	160	28.9
Dodla Dairy	15	19	31	56	260	28.5

Note: CAGR Calculation for 6Yr and 1Yr as on FY25. P/E as on 30-05-2025; "-" indicates profit numbers are negative or negligible.

Source: Ace Equity, Spark Fund Research

These companies have been funded by equity and are debt free in general. Revenue growth is impressive in most cases. The thesis has been that profits will magically follow revenue growth and then grow non-linearly. The market caps upon listing warranted much bigger profit figures by now. The profit streams have been shaky. The figures have missed investor expectations and are behind on timelines in most cases. When you



juxtapose valuations and profit growth/absolute profit levels, it gets uncomfortable. There are losses or small profit streams relative to the hype (as revealed by market cap). When compared with Chinese names, the difference in scale is palpable and we start wondering what the investors are smoking.

1. Established consumer companies have good balance sheets with healthy cash flows (up until now). They lack growth and the visibility of a path to higher growth is patchy at best. They have rich valuations.
2. Disruptors or creators of new categories (QSR, Quick commerce, brand hopefuls) may have been growing fast (and yet lower than expectations that were built up when they listed) but profits are inconsistent, elusive and thin compared to market cap.

For example, a profit of Rs 19 crores in the latest quarter which almost doubled YOY may look impressive in percentage terms. Look at the absolute number. Think about the fact that the market cap has been in tens of thousands of crores and that too for a few years. We begin to come closer to getting the picture right.

However, the street and analysts are not willing to throw in the towel on valuations. How long can this continue?

Here are a few pointers on what we think is at work

1. **Over-optimism on end market size** – India has always hyped up its potential as a consumer economy. While the economy has performed well, the end market size in many consumer segments has been overblown. Chicken comes home to roost in the end.
2. **K-Shaped recovery after Covid** – Economic policy has broadly been found wanting on the count of distribution of wealth, and not just in India. For India, the better-positioned households have fared far better. Disposable income growth has been uneven, and this shows up on consumption.
3. **Spiralling aspirations** – The consumer basket has been growing faster than consumer income. This has resulted in disparity in growth across segments and margin pressure for all.
4. **Inflation that does not show up** – The CPI does not capture cost increases in healthcare spending or in school/college fees. This strains consumer budgets, and it is here to stay.
5. **Sachetisation of big-ticket consumption** – The high decibel promotion of instant gratification has assumed a life of its own. I-Phones, foreign holidays and everything under the sun are bought in bulk and repaid in instalments. Now, we notice that even the relatively small-ticket items are being broken into miniature repayments with a few clicks prompted by incessant push.

Here are a few pointers on what could lie ahead

1. If IT services slows down, as is likely, we have more trouble ahead. Suffice to say that in the coming quarters, corporates and cheerleaders will blame the same. Earlier, they were blaming rains and draught. Now, they will blame Mr. Trump.
2. Household debt is already a matter of concern. While the aggregates are bad enough, what is alarming is the dispersion. There are those who have savings and then there are those who have debt. We want to stop short of generalising this and making extrapolations. Suffice to state that this is a problem which does not even have an easy solution.

Amidst all this, the consumer stocks across the spectrum refuse to back down to levels reflecting reality. The problem is more acute in mid & small caps. It is even bigger in the unlisted space. The problem starts from the unlisted space now. The lack of disclosure requirements has opened a Pandora's box. We reckon we are headed for nothing but disaster.

To be clear, the above views are not intended to be a recommendation or sector call. The consumer space is vast and B2C is how we would like to look at the sector at large. We may have holdings in many B2C names obviously reflecting our positivity in those names. Everyone including us believe that stock-picking is the solution to the market challenge. However, we need to be humble in stating this that the



notion of “Our stocks are different” has seldom stacked up in the past when the tide ebbed away. We need to remain grounded on the limitations of unconditional optimism.

What is the whisper from the tea leaves

For investors, the message is clear. Indian valuations re-rated across the board when global interest rates came down after GFC from over 5-6% to 0-1% post-Covid. That was the main trigger. Note that Indian interest rates did not come down by much. Nor was Indian growth (including in consumer names) outstanding to warrant that level of euphoria. Now, the US bond yields are back to levels from before GFC. Global valuations reflect that or are in the process of doing so. Indian stocks cannot have it both ways. Growth in the Indian consumer sector has been patchy. This is a double whammy. If the consumer sector does not adjust to this reality, the risk is that we have zombie stocks in the sector for years to come. So far, we have seen that many stocks in the sector have started resembling a slow-motion train wreck with flat, low or negative returns over 3-4 years.

The tortoise is not up against a hare. The animal looming large is not interested in the trophy at the end. It is interested in the game. Investors will do well to pay attention.

Warm regards,

P Krishnan (CIO) and Team Spark Fund



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