Honesty and Integrity Investment (HNI Investment)

Email for Sep 2022

Dear Friends,

Here are the details of performance of Honesty and Integrity Investment based on the share prices as on 30th Sep 2022:

Annualised Returns (IRR) (1) (2) (3) (4)(5)	HNI Portfolio	Nifty	Sensex
FY13	-10.6%	-5.3%	-3.7%
FY14	112.2%	21.1%	21.3%
FY15	21.6%	25.0%	23.0%
FY16	86.0%	-7.0%	-7.7%
FY17	168.3%	21.9%	20.1%
FY18	*66.4%*	*17.0%*	*18.8%*
FY19	*-19.2%*	*16.9%*	*18.3%*
FY20	*-45.8%*	*-28.6%*	*-26.9%*
FY21	*104.7%*	*71.1%*	*68.2%*
FY22	15.6%	21.7%	20.7%
From Inception till 30th June 2022	***24.1%***	***13.9%***	***13.8%***
From Inception till 30th Sep 2022	***33.1%***	***15.5%***	***15.4%***

(1) For all HNI clients and promoters (2) Inception was in August 2012 (3) Gross IRRs excluding the impact of HNI investment fees (4) Return during the quarter is reported only when it's adverse i.e. negative or lower than Sensex/Nifty. Quarterly IRRs looks overblown due to compounding effects of short periods (5) Absolute change is calculated based on IRR numbers for the quarter

At the same time last year in Sep 2021 quarterly newsletter, I had mentioned that "for last one year from Sep 2020 to Sep 2021, our returns are substantially lower than indices. Our portfolio generated only around 14.5% return while index is up by nearly 57%!!" I also mentioned that "But this is the situation at this point in time (As on Sep 2021). Given the concentrated portfolio we have, things can swing a lot in a matter of few quarters".

This quarter turned out to be exactly that. The value of the portfolio during the quarter was up by around 53%!!!. In fact for the last one year (Sep 2021 to Sep 2022), our portfolio has given a return of 46.3% while Nifty/Sensex is down by 1.3%.

We sold one more stock during the quarter at an IRR of 5.6% for the period of 4 years including dividends. Investing in this stock turned out to be a mistake. What is worse is that, I am unable to identify reasons behind it. Admittedly, the business performance during our holding period was not great but the long term cash flows of this utility business is fairly certain in nature and hence market should have seen value in it. But unfortunately, it didn't and I do not know why? The underperformance of this stock should be attributed to my misjudgement. I do not think there is any significant role of luck here.

Next, I would like share some of my assessment/thoughts on future of oil and Electric Vehicles (EV) and how that might impact Indian economy over long term.

The Future of Oil

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It was a widespread belief since 2016, that Oil has no future and sooner or later, the increased adoption EVs will lead to highly depressed demand for oil. That view, has changed somewhat due to the war. However, war or no war, EVs or no EVs, oil is here to stay. Why? Simply because, we do not just burn oil, believe it or not, we drink oil, we eat oil, we live on oil, we sit on it, we sleep on it, we walk with it, we work on it, we wear it and I can go on and on. Most of the pharmaceutical products that we eat/drink have petrochemicals as a primary source. Thousands of products that you use while living in your house (steel, plastic etc.) use petrochemicals as one of the ingredients in manufacturing process. Plastic chair we sit on is made from polypropylene which is a by-product of oil refining. The foam on which you sleep have oil in it. The shoes/slippers that you walk in, use petrochemicals in manufacturing process. The laptops you work on, the watches you wear, mobiles you use, everything is made of something which uses petrochemicals in its manufacturing process. We can find the alternate to burn oil in form of EVs but is it possible to find alternates to all other thousands of uses of petrochemicals? It is not and simply because of this, demand for oil will continue. Markets will have to provide, fair price to the producers of oil because we do not just need oil, we need all of its by-products as well. If you do not pay as owners of vehicle, you will have to pay as consumers of petrochemicals.

The Future of EV

EVs have tremendous future but in my view, for a different reason than what markets perceive it for. As of now, all case for EVs adoption is based on need for greener environment. It may have that benefit and it’s good. But the real case for EVs in my view is the saving of most scare resource of human civilization i.e. **Time**. Because EVs have fewer parts, the total effective time required to produce an EV across the value chain is significantly less than internal combustion powered vehicles. This benefit will, sooner or later, be reflected in its price. It’s just a matter of time because value of time keep increasing all the time. EVs do not need government subsidies to be competitive, they just need scale. Subsidies are just a small help in reaching that scale. So in my view, EVs are inevitable, greener or not!! But all of it, is subject to the fact that we can find a resource for batteries which is sufficiently available. Currently its lithium which seems to be sufficiently available (not in India but in the world as a whole).

The Future of India

The future of oil and EVs can have a significant adverse impact on future of India because of unique attributes of India’s economic, political and natural environment.

First due to natural environment, lithium is scarce resource in India. There are not many known lithium reserves found in India nor India have aggressively moved to purchase it in countries where it’s available. So should the EVs adoption become widespread, India will have one more commodity in its import list, that too in addition to oil. The implications for current account deficit will be adverse. To what extent, depends on price of lithium and extent of viable technology for recycling it, which is uncertain. But certainly, the impact on current account deficit will be negative unless large lithium resources are found in India.

Second, the consumption of oil at consumer’s end brings huge amount of tax revenues for central and state governments. E.g. excise duty on fuel makes up about 18 per cent of Centre’s gross tax revenues!! Should the sale of oil stop, this large revenue stream for the government will vanish. Implications of it for fiscal deficit of central and state governments can be mind boggling.

Third, India has another unique feature in its political economy – politicisation of power. Due to politics, it has become a norm across states to offer cheap power to residential consumers and farmers in exchange of votes and not to upgrade electricity infrastructure to continue to allow power theft. This loss is partly being cross subsidized with high charges on industrial units and partly being funded through ballooning debt in state distribution companies. Politicisation of power has already become a large hurdle in competitiveness of manufacturing sector in India. Now imagine what could happen, when home chargeable EVs are widely adopted in India. The power consumption intensity of the vote bank will grow substantially, so would be the political incentive to offer cheap power, so would be the power theft and hence there would be more cross subsidization. India's manufacturing sector will pay a very heavy price for EVs adoption in India unless somehow it becomes imperative to charge EVs only at commercial charging stations.

The future of oil and EVs looks bright. But the future of India, in the new world of EVs, need lots of introspection, careful thinking, planning and radical changes. After all, India should not only be greener but should also be economically powerful, more so in the world of increasing geo-political tensions.

That's it for the quarter from my side. Happy to answer any questions that you might have.

P.S. Wish you a very happy and prosperous Diwali ☺