

Publication	Mint
Date	14.11.2011
Description	Earnings will remain under pressure

TARUN KATARIA/RELIGARE CAPITAL MARKETS

Earnings will remain under pressure

By Vivek Law

BLOOMBERG UTV

Tarun Kataria, chief executive, India, at Religare Capital Markets, has turned bullish on the equity market. He also says in an interview that corporate earnings will be under pressure in the next couple of quarters as input costs continue rising. Edited excerpts:

Six months ago, euphoric targets were being put on the Sensex hitting 30,000 in 18 months and 23,000-24,000 by the end of the fiscal year, something you said was not unlikely. Of course, you cautioned it saying there were a lot of global developments—the US is in transition, Europe is having its share of problems, and India has its own headwinds to deal with. Are you still sticking to that target?

Yes, I think Europe has got its own share of problems and I think structurally the euro is flawed. I did a piece for one of the magazines 15 years ago saying you can't build a currency around saying, I want a market to compete with the US and then not sign everything else. So that's the problem.

In the mean time, you have got 17 divergent economies with different agendas. You have got political paralysis. So yes, Europe is in trouble and the structural issue is it has got a declining population, so your pension bills are a problem that needs to hit the press, so you have got a long-term problem. You have got a secular decline in Europe. So there is this massive noise in the meantime, which needs to be resolved, but assuming that it is, you have still got the same long-term fundamental demographic income creation declining, population birth rates, all that in Europe still. But it got worse in the last six months?

Yes, you have got the markets where in some fearing Greece to Italy to France. Why should France be a AAA economy, why should Italy still be a single 'A' economy? So all that needs to filter through. But the other problem is, as long as they continue to dilly-dally, the underlying macro situation starts to deteriorate. In fact it has started to deteriorate. You might say you have got a new government in Italy, you have got a new government in Greece, but the underlying situation remains pretty tenuous. You've heard that inflation in India would peak in the third quarter of the calendar year. There does seem to be a general feeling that we have got under control but it still remains high. RBI (Reserve Bank of India), on the other hand, has indicated that we are probably beneath the tightening and we are going to raise. Last time you raised the point that there are supply side constraints. Nothing seems to have moved. You are right, nothing has moved. In fact, I suspect, if you will do some research, I would have thought in the last several months the projects have probably come to a standstill.

Financing seems to be an issue. There is too much scrutiny on large scale financing of PSU (public sector undertaking) banks to that sector. So that again is a long-term feeder (to inflation). For a while the base rate might come to 7%, which is what we are all

INTERVIEW

trying to convince ourselves, the fact is inflation in this country is well into double digits. If you have got inflation well into double digits, you have got cost of money at 16-19%. It's very hard to run an economy and the headwind to my mind is a bit strong at the moment.

So if the concerns have become only stronger, are you less bullish today than you were six months ago? Yes, I am less bullish today.

To what extent?

If you believe that the 7% number is a number that the market hangs its hat on saying, inflation has peaked, whether the base rate or the fact that inflation is still rampant. If that's peaked and you have a new allocation from FII's (foreign institutional investors) in the new calendar year, you could see some move up in the markets.

The question is, would it be sustainable or not. That is unclear to me. 23-24,000 probably looks like a bit of a stretch at the moment... I would say if we see 20-21,000, we have a good outcome. I asked you whether there would be more pain before we see some kind of a recovery and you had mentioned 8-10%, and that's what we have actually got to. Now, we are back again at that range of 7,000-odd.

If all these factors were to improve, especially globally, the point that you made, if all those pension bits were going to start hitting the press and things were to get worse, would we see deeper pain, would you say another pain is around the corner? What's the minimum floor you are looking at?

I would like to think that most of the bad news on India is in the pricing. You have got some stability now in the US, there was some not-so-pleasant news coming out of the US which seems to have stabilized.

You have got tails of the euro zone imploding, so that's pretty negative. Japan's having its share of problems. We know about the sort of governance, lack of any direction coming out of Delhi, high interest rates since inflation. So I would like to think the worst is behind us. Now can the market have spiked downward 7.5-10%? The answer is yes. That's the nature of the equities business, right? But I would like to think, everything considered, we are close to that floor in our markets and the base, if the sentiment globally improves, would be to move higher.

As we head closer towards our own annual budget, the fact is that there are concerns now on the fiscal deficit issue. We talked last time about the disinvestment bit, nothing's happened there. Do you think that in the next two-three months that becomes the theme and the overhang really in the market?

No, but I think, if you believe as I do, FII's tend to drive our markets and you will find that there is a high correlation between FII flows and our industries. I think I said at that time to



Area of concern: Kataria says the underlying situation in Europe continues to remain pretty bleak.

believe a 4.6 number at the start of the year was tough. We knew that the markets would be hard, to have a \$10-20 billion of disinvestment in the new calendar year, you could see some move up in the markets.

Yes, they have factored it over the last few months that that number, the 4.6 or 4.8, is not going to happen, it's looking close to 5.5.

Disinvestment isn't happening, which was one of the big things. I think 3G was a big elephant in the room, the last time around, that's not happening.

So I would like to think that most of that is factored in to the market. But if it comes to the domestic players and the local investors say, Oh my god, it's 5.5%, we might have a little bit of a downdraft, the thing to watch is the impact on the currency.

I want you to talk a little about that, because that's one big mover and a challenge. It's been a huge move and there is nothing to suggest that and this is despite having high interest rates, the currency is blown out.

So if you believe inflation's peaked, there is a bias for rates to come down, more pressure on the currency, fiscal deficit put more pressure on the currency, the capex numbers will come, all these things will put a downward pressure, upward on the rupee to head 52.

What's the mood among FII's? Does that explain why they have been so much out? Or, because they are bringing in money but the inflows are pretty much going to end this year almost. They are going to end net negative this year and... So what's the mood? Is it more to do with the fact that they get concerned about India or is it more to do with the fact that they have got their own problems and, therefore, are busy grappling with that? No, I mean, it's a bit of both. The whole state of the planet is poor. Investors are concerned about their own jobs these days, but I think when you have India-specific funds, there is a bit of concern about India by itself.

You mentioned last time that as a firm you are generally bullish on banks, information technology and auto. At that time both Infosys Ltd and State Bank of India had disappointed the street with their re-

sults, but you still said that as a firm you would believe in these companies. Do you still remain as positive as you were? When I look at us as guys who advise our clients as to what do you want to do over the next one or two years, not the sort of trading environment, the answer is yes.

I think if we look at State Bank and we look at the PSU banks in general are trading around one times book on either side of it from time to time.

Historically, they have been at least 50% up from there, I-5-1 sometimes they might have even traded at almost two times book. We need to get there. Now that might not be the answer to the man. The mean might be different today but I think PSU banks, we still think generally are undervalued and if you believe as I do that there is pressure on the rupee to weaken, then Infy and TCS (Tata Consultancy Services Ltd) sort of all look interesting from a foreign exchange perspective.

But the concern as far as PSU banks are concerned, is the NPA (non-performing assets, or bad loans) bit is that something that is there you as well? Yes, I think that there is a risk and, therefore, Moody's did what it did. You are in an environment where growth is slowing, interest rates are going up, you have to have some pressure on your NPAs. Despite the nature of the game, you have got SMEs (small and medium enterprises) under pressure, you have got the real estate sector under pressure, you have got the mifa guys under pressure. So yes, you will see it.

Again a lot of it is in the market, the FII's have thought this through many moons ago. There will be pressure but like all good things markets do recover. Sometimes it takes longer than others. You have always heard RBI or the government saying, we don't think growth is getting as affected as you guys are making it out to be. On the other hand you have Indian companies saying, "I am getting throttled, I am getting slaughtered", but the numbers so far don't seem to be reflecting either of the two. In fact, on the contrary, they seem to be reflecting more the government's view. So this resilient India thing, is this some kind of a lag effect and will it probably play out two quarters from now?

If you are building an economy on stuff saying India Inc. is resilient, I think that's wrong, India Inc., and I have seen, I

speak to a lot of promoters, I speak to a lot of sort of CEOs (chief executive officers) and CFOs (chief financial officers), the mood is not very good and the flip side of that is yes, the folks sitting in Delhi, they have got to say India is resilient.

I don't think you can come on any channel to say, "listen this place is about to implode, it's looking pretty negative. We have no control over inflation, equity markets are closed, if you are going to get our infrastructure sorted out", then we can't say that. So there has to be a dip feed over time.

So that's their job, they are doing what they need to do, but if you are talking to people all the time and saying listen, equity markets are closed, if you are going to grow your business even in a 6% GDP (gross domestic product) economy, and I suspect that's where it's going to get to, you are financing you should be getting in and starting to build your portfolio. From an investor's point of view, that's the time when you are excited and that's the time when you really sit out. Though we have seen a very pleasant run in our own markets over the last three-four months where we are not at all nervous, we have perhaps for the first time gone up when the market was down.

Therefore, what would you tell an investor to do right now? I think I would probably say two things: that the fixed income asset class is very attractive, so if in these funds you are getting some close to 10% effectively after tax and if you can compound that for the next 7-10 years, 10% compound after seven years is a massive return. You have to seriously think about having Indian fixed income in your portfolio and equities yes, we will grow somewhere between 6% and 8% for next several years.

I would start drip feeding into equities as well but personally individual equities are for institutions and for research guys who have the time and where-withal to do the work that's required to pick them.

I would certainly ask retail investors to look at funds because you are giving money to a professional, he studies this all day long, retail investor has his primary source of income as his job, he can't be sitting and doing research all day. So yes, SIPs (systematic investment plans) or whatever these things are called, into good mutual fund a fixed income portfolio, may be a little bit of real estate, if people fancy gold commodities a little bit of gold. feedback@vnmmt.com

What are the sectors? You were very conservative on metals and then you talked about the consumer-led theme and that continues to be big. But that's played out, right? Metals have got thinned, consumer stocks are now trading at above 30 times next year, so I think that has played out thankfully to what I said six months ago.

The question is going forward can you continue to, can consumer stocks continue to materially head higher from here trading at 30 times?

Well, if the market sentiments turns to people rotate out of that, where they have had a terrific run into some of these sort of underlooked sectors, PSU banks we have just talked about, I think there is a good chance for that. I want to ask you about gold. As it always happens when you see an asset class rising the way gold has done. That's a lot of retail investors calling in and asking should I invest in equities or gold. Is that something that concerns you because you start treating it like saying I am getting put 70-80% of my portfolio in gold because it's run up so much? Absolutely, from a portfolio

Markets are close to the floor and will rally if the sentiment improves globally

perspective, if you do your sort of corporate finance classic business group they tell you it's all about portfolio allocation and in no more market, at least that I have seen.

You will even have 70% allocation to equities at any one given point of time. So to say listen, I have got in a high beta, high volatility single commodity to say listen I am going to put 70% in gold, I am not sure I would advise anybody to do that.

You can see the way gold is moving. I mean it's held up at 17-odd for the last period of time. So this thing trade down to 200 bucks, can it trade up to 200 dollars? Absolutely, it can, depending on what the dollar does, depending on what risk on, risk off is, but 70% in any asset class, bad idea.

Lots of experts say that when times are bad, when there is a crash, that's the time when you should be getting in and starting to build your portfolio. From an investor's point of view, that's the time when you are excited and that's the time when you really sit out. Though we have seen a very pleasant run in our own markets over the last three-four months where we are not at all nervous, we have perhaps for the first time gone up when the market was down.

Therefore, what would you tell an investor to do right now? I think I would probably say two things: that the fixed income asset class is very attractive, so if in these funds you are getting some close to 10% effectively after tax and if you can compound that for the next 7-10 years, 10% compound after seven years is a massive return. You have to seriously think about having Indian fixed income in your portfolio and equities yes, we will grow somewhere between 6% and 8% for next several years.

I would start drip feeding into equities as well but personally individual equities are for institutions and for research guys who have the time and where-withal to do the work that's required to pick them.

I would certainly ask retail investors to look at funds because you are giving money to a professional, he studies this all day long, retail investor has his primary source of income as his job, he can't be sitting and doing research all day. So yes, SIPs (systematic investment plans) or whatever these things are called, into good mutual fund a fixed income portfolio, may be a little bit of real estate, if people fancy gold commodities a little bit of gold. feedback@vnmmt.com

What are the sectors? You were very conservative on metals and then you talked about the consumer-led theme and that continues to be big. But that's played out, right? Metals have got thinned, consumer stocks are now trading at above 30 times next year, so I think that has played out thankfully to what I said six months ago.

The question is going forward can you continue to, can consumer stocks continue to materially head higher from here trading at 30 times?

Well, if the market sentiments turns to people rotate out of that, where they have had a terrific run into some of these sort of underlooked sectors, PSU banks we have just talked about, I think there is a good chance for that. I want to ask you about gold. As it always happens when you see an asset class rising the way gold has done. That's a lot of retail investors calling in and asking should I invest in equities or gold. Is that something that concerns you because you start treating it like saying I am getting put 70-80% of my portfolio in gold because it's run up so much? Absolutely, from a portfolio

BLOOMBERG UTV


Catch market guru's Christopher Wood, MD & equity strategist, CLSA Asia-Pacific Markets, at 9.10am and Mahesh Nandurkar, executive director, CLSA Asia-Pacific Markets, at 10.10am with Vivek Law on Monday