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THE MOVERS & SHAKERS IN A VOLATILE MARKET

The correction in Indian equities has opened up opportunities for investors; quality firms have attractive valuations

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Destroyed houses. Burnt vehicles. Debris and smoke. Dead bodies. Over the last three weeks, we have gotten used to these visuals from Ukraine. The country's conflict with Russia is still escalating—ceasefire talks haven't made much progress.

All this is bad news for the global economy still struggling with supply-chain nightmares post the covid-19 pandemic. In India, rising crude and commodity prices have stoked fears of high inflation, which in turn, could put a lid on the economic recovery. The war has also delivered bad news to India's equity markets. It paused a rally. Uncertainties have now led to significant corrections and volatility.

Here is the snapshot. The broader indices—Nifty and Sensex—are down about 5% year-to-date. The indices are down by more than 8% since their January highs. The fall could have been worse. While foreign portfolio investors have been net sellers and have sold more than ₹1.1 trillion worth of equity in 2022, domestic institutions have utilized the opportunity and bought equity worth about ₹0.94 trillion during the year.

Any correction also opens up fresh opportunities to invest. Market pundits believe that there are certain pockets which long-term value seekers can tap into. For instance, there are many sectors and stocks where the holdings of foreign institutional investors (FIIs) were high. Now, relentless selling by the FIIs have led to a correction. Valuations have therefore become attractive in stocks with strong fundamentals.

"On the equity market outlook, we believe volatility will remain in the near-term till there is clarity over the cessation of this attack (Russia's attacks on Ukraine). The recent correction allows long-term investors to load up on quality companies with sustainable growth visibility," Pankaj Pandey, head of research at brokerage firm ICICI Direct, said.

Pharma, IT and metals are resilient sectors and also an easy pick for analysts for the near and medium term. What explains this?

The rupee is under pressure. Because of the Russia-Ukraine war, of course, but also due to the expected hike in US interest rates. "With interest rates set to increase in the developed world, we expect rupee depreciation to be a recurrent theme even after a possible conflict resolution between Ukraine and Russia," said Nishit Master, portfolio manager, Axis Securities Ltd, another brokerage firm.

The rupee's depreciation may lead to inflationary pressure and is negative for the overall economy. And yet, depreciation could shore up the earnings growth of export-oriented sectors. Technology and the pharmaceutical sector can potentially outperform as the rupee's fall directly improves a company's bottom line in these sectors, said Shrikant Chouhan, head of equity research (retail) at stock broking company Kotak Securities Ltd.

Mint takes a closer look at some of these sectors and why they represent an opportunity in the new normal.

SWEET PILLS

Pharmaceutical companies are in a sweet spot as most companies in the sector have a significant presence in the US and other global markets. Many pharma companies were already expecting good growth in 2022-23, led by strong product launches. Besides, companies in the sector have ventured into new segments such as biosimilars and specialty products. Now, a favourable currency movement is icing on the cake—it would add to their earnings growth.

Indian pharmaceutical companies have also sensed opportunities in the active pharmaceutical ingredients (API) and contract drug manufacturing space. Large global drug makers are facing competitive headwinds and are looking at cost controls. Thereby, they are expected to increase the outsourcing of product manufacturing and research services. Indian companies in the contract manufacturing segment may stand to gain, say market watchers.

Indian manufacturers may also benefit from the 'China plus one' strategy. Large pharmaceutical and chemical companies around the world are looking at reducing their reliance on China. Indian companies with strong relationships with these multi-

Since Russian supplies of steel have dropped, it presents a window of opportunity to Indian steel companies to increase exports to Europe and Asia.



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nationals may reap the benefits. Many of them also have manufacturing facilities that are compliant with the regulatory standards and good manufacturing practice norms of the US and the European drug regulators.

Meanwhile, exporters who faced bottlenecks on growth due to logistic challenges—led by low container availability and rising shipping costs during the pandemic—are also seeing some respite. Input costs of key imported ingredients are set to normalize, while export volumes will improve.

Notably, the domestic market for pharma companies is expected to do well, too, with growth anticipated in both chronic and acute segments.

TECH TONIC

A stronger dollar also helps India's IT services exporters—the likes of Tata Consultancy Services (TCS), Infosys, Wipro, and HCL Tech.

The tech sector has had a lot going for it ever since the pandemic struck. As companies pivoted to the digital, their services were in high demand. Companies, subsequently, reported strong numbers over the next many quarters.

The correction in certain stock prices here is because of FII selling. The expected tightening of liquidity in the developed economies has been forcing foreign portfolio investors to unwind their positions across sectors irrespective of growth prospects. Hence, Indian investors may be better off not reading too much into this sort of selling, analysts say.

The revenue momentum of Indian IT players, all of whom have significant offshore presence, is likely to continue. And the drivers of growth will continue to be digital transformation and cloud migration.

Investor concerns have largely focused on the phenomena of the 'Great Resignation'—high voluntary attrition rates have plagued the industry over the past quarters. However, despite high employee turnover, the IT firms have managed to maintain their margin trajectory.

Analysts say that companies in the sector continue to sound more confident of their pricing strength in an inflationary environment and expect stability on attrition over

the next couple of quarters.

Analysts at JM Financial, an investment banking firm, stated in a report that though they remain confident of the underlying demand strength heading into 2022-23, they reckon some relative growth differentials will emerge as the tech up-cycle matures. Hence, they remain selective on companies.

MADE OF STEEL

The metals sector finds itself in the limelight, all of a sudden. They are a direct beneficiary of rising metal prices. Higher prices are likely to boost the realizations of Indian manufacturers. The sector is already trading at attractive valuations and analysts believe investors may view companies here from a medium to long-term perspective.

"With strong undercurrents of inflation, we expect supply-side imbalances to continue in various commodities (steel, aluminium, zinc, nickel, etc.)," analysts at ICICI Securities Ltd wrote in a report.

High energy prices and a power crisis had led to smelter closures in Europe and China as well as in many other geographies. In October 2021, about 60 coal mines in China's top coal-producing region closed because of floods, for instance.

Now, the war in Europe has started impacting supplies—export restrictions out of Russia are in place.

The curtailed supplies from Russia are driving aluminium prices higher. Since Russian supplies of steel are lower, it presents a window of opportunity to Indian steel companies to increase exports to Europe and Asia.

Investors, nevertheless, are watchful on the margins front, especially when it comes to steel companies. Coal and iron-ore prices, which are key raw materials for steel production, are on the rise. Higher input costs can squeeze the margins, going ahead. Even then, the higher realization in the exports market may offset the impact from rising costs, analysts feel. Also, many manufacturers have backward integration with coal and iron-ore supplies and these companies could make for sound investment, they add.

Aluminium companies, in the meantime, remain better placed and will continue seeing regular earnings growth.

HEALTHY FINANCIERS

Meanwhile, the banking and financial services (BFSI) sector stocks have seen a deep correction. Similar to

MINT SHORT STORY

WHAT

The war in Europe paused a rally in India's equity markets. Uncertainties have now led to significant corrections and volatility. The broader indices are down about 5% year-to-date.

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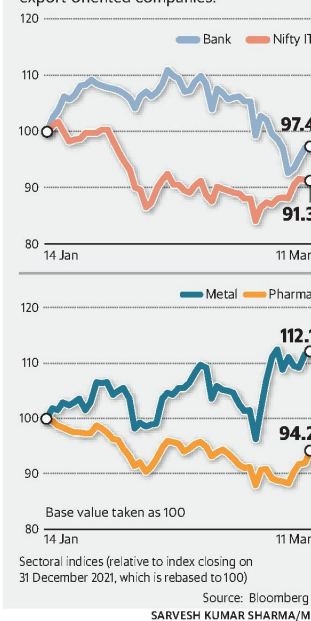
Market pundits believe that there are pockets which long-term value seekers can tap into. Valuations are now attractive in stocks with strong fundamentals.

MOREOVER

The rupee is under pressure. Export-oriented businesses, such as IT and pharma, can potentially outperform as the rupee's fall directly improves a company's bottom line.

RESILIENT SECTORS?

Markets are expected to remain volatile in the near-term. However, the rupee's depreciation may shore up earnings for export-oriented companies.



MEDIUM & LONG

During volatility, many investors find hope in 'defensive stocks' or those that provide stable earnings irrespective of the market trend.

Mitul Shah, head of research at brokerage firm Reliance Securities, said the time is probably right for defensive sectors like fast-moving consumer goods (FMCG). He expects volatility to remain high over the near-term because of the geopolitical tensions and advises following the 'buy on decline' strategy when it comes to quality stocks.

Over the medium and longer time frame, analysts believe that the central government's thrust on increasing infrastructure investments will result in upsides in stocks connected to domestic capex-linked capital goods. Upsides are also expected in companies that could benefit from the pro-

duction linked incentive (PLI) scheme. The PLI is the fulcrum of India's new manufacturing thrust and has a triple objective—attract foreign direct investment (FDI), help domestic manufacturers scale, and make the country globally competitive in exports.

Analysts at Jefferies India Pvt. Ltd believe India may have entered a period of economic up-cycle, driven by an expected revival in capex through government push and housing. This could eventually drive a broad-based investment cycle. "Historical analysis suggests that mid-cap tend to outperform during phases of growth acceleration," analysts at Jefferies stated. Thus, the recent correction could provide a good opportunity for investors to evaluate bottom-up stock ideas.

SLIPPERY SLOPE

Meanwhile, oil and gas upstream producers may benefit due to the sharp rise in crude prices. But sectors that depend on crude oil as a direct or indirect input would face turbulence. Rising crude prices can add to inflationary pressure pushing up logistic and input costs for many sectors—thus, leading to margin pressures.

"As energy costs continue to rise, we are of the view that with a medium-term outlook, select cement and auto stocks should be avoided," said Chouhan of Kotak Securities.

For cement manufacturers, rising crude prices have a twin impact mentioned above. It means higher logistic costs and higher petroleum coke prices, a key input. Cement manufacturers are already facing margin pressures since they aren't able to pass on the full costs to customers.

The automobile sector also has an inverse correlation with crude price movement, points out Shah of Reliance Securities. Auto companies have already experienced the rising cost of ownership impact their sales. Particularly, demand has suffered in two-wheeler and entry-level cars. Higher fuel prices will add to the woes of vehicle manufacturers, impacting demand.

Meanwhile, the bright spot in the auto market is clearly exports, with many auto-makers reporting good exports volumes. Such export-oriented auto makers remain a good bet in the current scenario, market watchers believe.

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