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'Growth should start picking up from July'

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The dismal fourth quarter earnings and decline in stock prices might have prompted some investors to head towards the exit door. But Sunil Singhania, Head - Equities, Reliance Capital Asset Management, the man who manages the equity assets of one of the largest fund houses in the country, feels that investors need to stay put and invest for the long term. Excerpts from an interview:

What is your Sensex EPS projection for FY16, especially with poor earnings growth in the March quarter?

For FY15, obviously the earnings are lower than what people expected six to eight months ago. That is due to a few factors, such as the economic recovery that everyone expected taking a little longer. Second, some sectors have been impacted by the volatility in commodity and currency prices resulting in extraordinary losses. Some commodity companies have been hit by volatility in commodity prices and technology and pharma companies have been hurt by foreign exchange losses.

Our view is that growth should start coming in from July onwards. This quarter, we are already witnessing some consolidation. On a base level, 15 to 17 per cent earnings growth in FY16 looks possible.

It is too early to cut back our estimated earnings. One point to note is that the impact of interest rate cuts will be felt only from now as all the banks cut their base rates only in April.

Do you think the impact of falling commodity prices will continue to aid profitability?

Most manufacturing companies have inventory of between two and three months. In fact, as commodity prices start moving down, the initial phase has a negative impact on earnings as the companies hold raw material bought at higher prices but they may have to cut the price of finished goods. The positive impact of falling commodity prices is already visible in some engineering companies. The top line has not grown but the bottom line has started to grow. For some cement companies, for instance, power and transportation costs have declined quite significantly this quarter, helping improve margins.

So, it will be earnings expansion based on reduced cost. But when will top line start showing an improvement?

Our call is that the first big push in spending has to come from the government. The government in the last one year has announced a lot of high-impact projects that will overall have a $2-trillion impact on the economy.

That will have a multiplier effect. In some pockets we have started witnessing an inch-up, for instance, commercial vehicles and four-wheelers. But sectors such as steel and cement have not picked up because they are core sectors that require massive spending. Government spending is therefore crucial for top line growth.

Isn't a fall in growth of rural wages negative for consumption?

Over the last four-five years, rural wages were high, but so was inflation. So, in real terms, they did not benefit much. Going forward, you are right. Rural demand will not be as buoyant as in the last four-five years but urban demand that was non-existent in this period is showing a positive trend. That is the beauty of India. We are such a diverse country, there are always balancing factors for every negative. Our call is that in the next four or five years, urban consumption will be faster than rural consumption.

So, which sectors will benefit the most from this shift?

We are positive on the banking side that will benefit from the massive under-penetration of financial services in India. That said, our preference from a structural perspective is for private sector banks because they are slowly gaining market share. We are positive on the cement sector because the first sign of revival in housing and infrastructure will benefit this segment. We are better off playing this through the cement sector rather than construction companies as their balance sheets are not too strong. On the urban consumption side, retail, some pockets of FMCG, building materials — sanitaryware, tiles, plywood, paints — are interesting. These stocks are not cheap but whenever they correct, they can be bought into.

Ancillary financial services — mutual funds and insurance — because now we are betting on savings moving from physical to financial assets. Housing finance companies are interesting with falling interest rates, housing-for-all push and so on.

Are you comfortable with valuations in fancied sectors such as FMCG and Retail? Is a correction due here?

That is an opportunity for us, right. It is good if there are pockets of over and undervaluations. We remain under-weight on the consumption side except for a few segments, such as spirits because the penetration is low though valuation is high. You are right about FMCG, with top line not growing, valuations are stretched. You have to balance potential growth with near-term valuation. That is where sometimes we need to take a call. You might think that a stock or sector is expensive in the near term, but growth might be so rapid that the price might be justified.

From that perspective, some small-cap stocks have run up a lot as investors were factoring in high growth. Would you say that they still appear attractive?

I fully agree with you that there is a category of small-cap stocks where there is froth and massive over-valuation. Our request to investors is not to listen to tips and buy stocks at any valuation. We are very clear, we will give a premium to growth but it has to be justified at some point with earnings capability. If the market cap of a company is ₹10,000 crore and after five years it does not earn even ₹500 crore, it does not make sense. Correction is due here, some of which has already taken place.

Your small and mid-cap fund has done quite well over the last one year. So, what is the strategy going to be there?

In any growing economy, smaller companies tend to grow faster. That is what we are playing for. The impact of a fall in interest rates and increase in demand affects smaller companies more. India is a growing economy, so new sectors start out small. IT, telecom, pharma — all started as small sectors and then grew. Any new theme can be played only through small stocks. There is a big opportunity there but you need to be careful. There is slightly higher risk here. But an investor who has clarity from a longer term perspective will make higher return in this segment.

So, you believe there are value picks beyond the top 200 stocks in India? Aren't they more risky?

Risky is a relative term. It does get volatile in the near term but eventually the performance would be higher than the benchmark. There are many companies that started out really small some five to 10 years ago. There is a cutlery company, tile company, sanitary ware company, readymade garment company, small housing finance companies — they all started small. If you were early, you would have made money in these companies. You should have a buy and hold strategy. You cannot trade in these stocks.

Banks cut base rates only in April. The impact of this will be felt in this year's earnings.

SUNIL SINGHANIA, Head - Equities, Reliance Capital Asset Management

Your Reliance Vision and Reliance Growth fund have really improved performance the last one year. How did that happen?

Looking at the last one year is fine but how the fund did in the last 20 years is just as important. When you invest, invest as if you are investing in a business. When you invest in a business, it is not for six months, but for perpetuity. Last two to four years, there was so much scare and flight to safety that people were investing irrespective of the PE multiple.

At that point we were buying stocks that we thought had value. But the moment people realised the opportunities, these stocks have done well and have caught up and it is reflecting in the one-year, three-year, five-year performances and so on.

Can the slowdown in other global economies hurt GDP?

You are right, the world is not growing fast, at the same time there is no deflation. Japan is trying to grow, China is growing at 7 per cent which is not bad and in the Euro Zone also there are pockets such as Germany that are growing fast and the US has managed growth between 2.5 and 3 per cent.

I think this is a good scenario because a fast growing world means high commodity and oil prices that India cannot afford. Second, India's exports contribute just 15 per cent to the country's GDP. Again, India's exports are in sectors that are not impacted too much by global growth.