

'Pharma Could Soon be India's Next IT Sector'

Foreign institutional investor (FII) inflows will be higher next year as interest rate hikes in the US are likely to be slow, said **Shiv Puri**, managing director of TVF Capital Management, which advises assets worth \$300 million. In an interview with **Nishanth Vasudevan**, Puri, who is based in Singapore, said high quality mid-cap companies such as Kotak Mahindra Bank, Pidilite, Mico Bosch, Tech Mahindra and Lupin could outperform in the next 12 months. Excerpts:

In your interactions with institutional clients overseas, what is the sense that you are getting about their outlook for India?

India is getting mindshare again and that is usually a leading indicator for inflows. This year, FII equity inflows have been around \$13 billion versus \$24 billion last year, so the optimistic outlook has not yet translated into inflows. The institutional clients invested in public markets in India today are more sophisticated, experienced and of higher quality. They realise that you cannot paint all emerging markets with the same brush. Despite the disappointment in the country's growth rate over the last few years, India is moving decisively in a new direction and staring at a powerful combination of a cyclical and structural upturn. The decline in oil prices and commodity prices is a huge benefit to India. There is a real chance that after a long time we can be close to current-account neutral. Warren Buffet says you can't drive a car by looking in the rear view mirror. I think the foreign institutional investors realise this and, I believe, inflows next year will be higher than this year. There will likely be a significant opportunity cost in waiting for all the evidence to come in over the next 2-3 years.

Will foreign portfolio flows into India be impacted with the Fed set to increase interest rates?

If it does, it will be short-lived. The average spread of the Indian 10-year government bond over its US counterpart prior to the crisis was roughly 3.5%. Today that spread is 6%. So if US rates rise, which is likely to be slow anyway, I don't think it impacts flows materially. There are very few countries in the world where there is some decent growth and where the equity markets have many quality companies and some depth. If one looks around the world today, it pretty much boils down to the US and India. The bigger concern for foreign flows will likely be a geopolitical event or deflation in Europe or a



ON INDIA INC'S EARNINGS

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is in bottom-up fundamental stock selection. In the short term, the market looks fairly valued. But if real GDP growth is roughly 6-7% annually and nominal GDP growth is roughly 12% annually, then many companies will grow revenues in the 15-17% range. Now, if revenue is growing at 15-17% and we are clearly at the start of the upturn of the business cycle, then we have to get operating leverage. Earnings can grow in the 20-25% range over the next 3-4 years. If that happens, the markets can double without assuming any multiple expansion. Having said that, the rising tide will not lift all boats and one has to be very selective on sectors and companies.

Which sectors would you bet on?

We focus on bottom-up opportunities but if you ask me on top-down areas, I think financial services, especially the private sector companies, have just a huge, huge runway ahead of it. It's the cheapest way to play consumer in India and the best way to capitalise on corporate growth. I think pharma may well become the next IT services in India. Auto component companies, especially, those that dominate a sub category are great businesses. The consumer sector has selective niches that are very attractive.

Which are the five stocks that would be outperformers over the next 12 months?

The best opportunities reside in high quality mid-cap companies that have pricing power, healthy growth and where the longevity of the growth in earnings is misunderstood. These companies can become compounding machines and can compound capital at healthy rates over a long time. Some examples today would be Kotak Mahindra Bank, Pidilite, Mico Bosch, Tech Mahindra and Lupin. I also think companies like SKS Microfinance and MCX that have re-emerged in a new avatar look very interesting because they now have strong and capable management teams, little or no competition and a still a big market opportunity.

FUTURE LEADERS

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hard landing in China or debt problem in Japan. Any major event there can impact flows for a slightly longer period but that too will likely be temporary.

Is there scope for valuation expansion even after the recent rally?

The markets are reasonably valued at around 15-16 times forward earnings and in line with historical averages. But the opportunity