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PRADEEP GUPTA Co-founder & Vice-Chairman, AnandRathi Financial Services in an Exclusive chat with the **Financial Express**

We expect recovery in India's capex cycle to start this year

As the Sensex is trading at 13x FY13 earning against the long period average of 15x, valuations are certainly attractive, says Pradeep Gupta, co-founder and vice-chairman, Anand Rathi Financial Services. In an interview to FE's Saikat Neogi, he says that despite muted earning expectations, Indian equities are currently under-valued and even a small positive surprise can lead to significant jump at the index level.

Do you think that the markets will remain range-bound for some more time till there is clarity on the General Anti Avoidance Rules and other retro-tax amendments and also on the traction of Q4 corporate earnings? Yes, the markets have been lackluster and range-bound for the better part of April as the participants await more clarity on GAAR. Also, important reforms like the Goods and Services Tax and Direct Taxes Code need speedy intent and implementation. It has been more of a stock-specific market as earnings within the same sectors have shown diverse trends.

Do you think earnings expectations have whittled down to a lower growth trajectory and, in some sense, supporting the markets at a lower multiples? Sensex is trading at 13x FY13 earning against the long period average of 15x. So, the valuations are certainly attractive. Yes, the consensus earning expectations at 11-12% are also lower than the past averages. Yet, it is important to realise that in 2012, for the sixth successive year, Sensex has hit 16,500 levels. Meanwhile, earnings have grown by 30%. Therefore, our sense is that despite muted earning expectations, Indian equities are currently under-valued. Even a small positive surprise can lead to significant jump at the index level.

Do you think metals is still dragging the earnings growth as the sector is going through its own headwinds like higher prices, interest cost pressure? Metals, due to its dependence on a host of global factors, has underperformed the broader markets and, yes, there are still issues like higher input costs, interest cost pressures, which are hurting the margins and the bottom line.

Are you seeing some initial triggers like softening commodity prices because of the slowdown of Chinese economy, easing of liquidity, rate cut and normal monsoon forecast, which could move the markets? The European situation, along with Chinese slow down, is worsening the demand outlook for commodities and, at the same time, the Federal Open Market Committee is preventing them from falling as any indication of a QE3 would boost the confidence of investors. We expect the RBI to infuse at least R3 lakh crore in liquidity during FY13 through cuts in the cash reserve ratio and open market operations, substantially reducing the average banking sector liquidity shortage of R1,40,000 crore in Q4 FY12. Rate cut has failed to cheer the markets as monetary easing alone wouldn't be able to revive the economy. It will need big bang reforms, along with fiscal prudence, to reduce the burgeoning fiscal deficit. The normal monsoon forecast can revive the sentiment to a certain extent as a good monsoon can help ease food inflation, which, we feel, can be a major concern going forward.

Do you think valuations are looking fairly attractive or is there still more room for correction? Indian equities are currently undervalued vs their own past levels and current peer levels. Currently, around the 17,100-17,300 range, with return on equity (RoE) of 18%, the Sensex trades at 13x FY13E earnings, well below the historical average of 15x.

After a brief lull, the rupee is again depreciating fast. Does that mean that investors should stay away from companies with high FCCB leverage? Companies with high FCCB leverage will bear the brunt of a weak rupee and we have advised investors to stay away from these companies. Refinancing FCCBs with fresh debt will increase the interest burden of companies as most of the FCCBs carry very low or zero-coupon rate. Companies that revise their conversion price downwards could witness a sharp dilution in their equity, which will lead to further decline in their share prices. This would further stretch the company's balance sheet.

Going forward, which are the sectors you are bullish on that could drive earnings growth? Earnings growth is expected to be broad-based with significant contributions from rate-sensitives like financials and auto stocks. We are overweight on Indian healthcare as strong growth prospects in the global generics market, steady growth with better profitability in the domestic market and emerging additional growth avenues are key positives for this sector. We expect recovery in India's capex cycle to start in 2012, led initially by replacement rather than fresh capex. The process is likely to improve the outlook on the Indian economy and companies.