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Ashok Wadhwa [left], founder and CEO, Ambit Group; and Nitin Bhasin, MD and head of equities research, institutional equities, Ambit Capital

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MONEY MANAGERS

A ROARING RETURN

With their balance sheets fairly cleaned up and a steady third quarter, banks will be at the forefront of earnings growth in FY20, believe Ambit Group's Ashok Wadhwa and Nitin Bhasin. By Jui Mukherjee

AFTER A LONG PERIOD of pain due to ballooning bad loans, disruption because of the implementation of the Insolvency and Bankruptcy Code (IBC), and a slump in credit growth, India's banks are now poised to lead the recovery in corporate earnings growth. Ashok Wadhwa, founder and CEO of Ambit Group, and Nitin Bhasin, head of equities research, institutional equities, Ambit Capital, firmly believe that FY20 will be the year of banks. In an interview to *Fortune India*, Wadhwa and Bhasin also talked about the impact of the general election on stock markets and the outlook for sectors like automobiles and telecom. Edited excerpts:

How will the general election impact the markets? What are some of the other major factors that are influencing the Street?

Wadhwa: The markets are not directly influenced by the political outcome, unless that outcome can result in political instability. No matter which government is in power, it does not necessarily influence the markets beyond a point, perhaps the week of the [election] results.

For the markets, the two most important determinants are global crude oil prices and corporate earnings—one is a big macro factor, one is micro. As long as oil prices remain stable at around $60 per barrel, it is a very positive sign for the markets. Oil at $60 per barrel means the current account deficit is low; fiscal deficit is not a challenge; the government doesn't have to worry too much about inflation so the Reserve Bank of India can be a little more benign with the interest rate regime. All of these factors together contribute more to market determination than the political outcome of an election.

Oil at $60 per barrel and a good stable government, regardless of who comes to power, augur well for the markets. What also helps is seeing a significant positive movement in corporate earnings.

So we seem to have a scenario in which we have a low oil price, fairly stable political outlook, and strengthening corporate earnings—which are favourable for a bullish market.

Bhasin: What investors are looking for is stability in Parliament. Even if it is a coalition, it will matter. A strong coalition with a strong leader or a weak coalition with no clear leader—investors are on the lookout to see that if there is a coalition then who will lead it.

On the corporate earnings side, banks, the corporate lenders, showed a significant turnaround when it comes to NPA [non-performing assets] recognition and resolution. So we see banks leading the earnings recovery from the front, going forward. Hopefully, we will break the jinx of the very low corporate earnings growth we have been seeing in the past five or six years. We should be able to do that in FY20.

What has been holding earnings growth back from touching high double-digit figures? When will we see such high growth?

Bhasin: If you look at the Nifty, you can largely divide the sectors into four buckets—secular consumption theme, secular rise of financialisation, global knowledge exports (where information technology or IT falls), and anything else. I think the challenge is the last bucket; that is where the problem lies. We have not been able to build a massive manufacturing, infrastructure, or housing sector. These sectors many times behave in very short cycles, and because of that their impact on the banking sector too has become visible.

Sectors like IT and pharmaceuticals saw a period of a boom years ago. But the entire IT industry is going through its own global disruption. The political regime completely changed in the U.S. Similarly with pharma, challenges in terms of generics and pricing have impacted the sector. However, we have seen IT companies, largely those present in the U.S., benefit from the corporate tax cut there. Even in pharma, we seem to have hit the bottom.

The more crucial factor is getting the corporate capex cycle back on track. So that is probably the third most important factor to watch out for. Will it return in FY20? That is doubtful. Can it be in FY21? Let's hope so.

The next fiscal year will be a function of the banking sector leading growth.

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Government spending and consumption seem to be the largest engines powering India's economic growth as of now. When do you see the private investment cycle kicking in?

Wadhwa: In the past five years, the Indian economy has really been supported by well-defined government expenditure and, to some extent, consumption. Lack of private capital expenditure (capex) prevents us from growing faster. I would argue that consumption has been a little inconsistent over a five-year period. There has been a period when rural consumption has shown strong growth, particularly when direct benefit transfers kicked in and the monsoon was good. But it has been relatively weak for the past 12-18 months due to stress in the farm sector. Going forward, the expectation is that consumption will continue to grow steadily.

The National Democratic Alliance (NDA) government has shown greater direction and focus on government expenditure. They have tried to curtail subsidies and improve the efficiency of government-sponsored programmes. So, one hopes that this will continue in case they come to power.

We firmly believe the banking sector over the next two years will power a lot of the growth—to the extent where non-banking finance companies (NBFCs) will start feeling the competitive heat. Remember, the NBFCs grew in the absence of public sector banks (PSBs). But with the banks' balance sheets cleaned up, they will show their competitive strength. This will contribute to the growth of the economy. ▷▷

▷▷ The return of private capex... has been coming for a while but I believe the turnaround in the cycle is at least 18-24 months away. We still don't see the private sector excited in terms of capacity creation or new capex. We see companies announcing large investments at various state summits. But we need to move beyond MoUs [memoranda of understanding] and see the implementation. There is a big gap between the intention and actually investing the capital. Debt and equity capital were not easy to obtain in the past 18 months or so. So that has impacted private capex as well. Once consumption becomes more consistent, we will see companies announcing more investments.

Would you rate the IBC as a success? What lies ahead for the banks when it comes to the battle against bad loans?

Wadhwa: The IBC is as crucial as the GST [goods and services tax] to India's growth. I rate the IBC as one of the most successful visions of the government at this point. We see some of the bigger cases stuck in court proceedings, but what we don't see is the sword of the IBC leading the resolution in hundreds of other cases outside the court process. There is a lot of debate on whether the implementation could have been smoother with fewer changes. But implementing something like the IBC or even the GST... it is a long process before you get a smooth curve of implementation. There is no formula that you can apply, each country's needs are different.

So I laud the government for not only implementing the IBC but also being prepared to acknowledge that changes were required. Without those changes, the IBC would not have been as effective as we have seen it become.

I believe by the end of this fiscal year, the government's ambitious target of resolving the 12 biggest cases will be achieved. In terms of the NPA problem, the true test of how well we have learnt from the past mistakes will be how banks lend once the private capex cycle kicks in.

The automobile sector did not have an impressive third quarter, with disappointing sales figures, especially during the festive season. What is your outlook for this sector?

Bhasin: The December quarter was disappointing for auto firms due to various factors such as financing issues after the NBFC crisis and lower sentiment due to the jobs picture in India. In the financial year 2019-20, we see steady volume growth for the sector, provided the job sentiment improves and rural India's aspirations continue to grow.

There could be some pain due to readjustment to new emission norms, but we are long-term positive on the auto space.

In terms of electrification, if it has to happen, it has to be done only in the two-wheeler [space] first. But we are very far away from total electrification.

In the telecom business, are we likely to see an end to the raging price war anytime soon?

Wadhwa: I think the consumer will remain happy for a while.

Bhasin: The fastest-growing telecom operator has clearly articulated its ambition in terms of getting subscribers on board and offering them a gamut of digital services. So until it reaches its target and starts raising prices, the price war will continue.

What worries me is that we have debt of close to ₹4-5 trillion [₹4-5 lakh crore] in this sector. But this is a service that consumers want to use and there is an inherent pricing power in the hands of the companies. If a consumer can, he/she will pay an extra sum for the service. So I hope to see some of this debt serviced, going forward.

I think this sector will see huge investments in the coming 5-10 years in terms of optic fibre and technology upgrade.

The aviation sector too went through a period of turbulence due to volatile crude oil prices. What lies ahead?

Bhasin: The volatility in crude oil prices is largely behind us.

Wadhwa: The government needs to have a long-term policy in terms of the dos and don'ts for government support. We can't have a situation where oil price volatility eliminates one of the four airlines.

If the government wants to treat this as a truly free market, it needs to make it clear that there will be no support to any player no matter what. When support is discretionary, it becomes a problem. The government must tell airlines that they need to have a mechanism to battle the volatility in crude oil prices on their own. ■

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Ashok Wadhwa
Founder and CEO of Ambit Group