DAILY VOICE | India Inc better prepared to deal with COVID curbs in FY22: Sampath Reddy of Bajaj Allianz Life

Earnings are likely to grow by around 25 percent in FY22, however, investors should keep an eye on the impact of the second COVID wave and partial lockdowns, says Reddy

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Sampath Reddy, Chief Investment Officer, Bajaj Allianz Life, expects earnings to grow by around 25 percent in FY22 but advises investors to keep a watch on coronavirus cases and restrictions, though companies are better prepared for disruptions this year.

Sampath, who has more than 20 years of experience in the investment management industry, manages assets of more than Rs 70,000 crore. Prior to Bajaj Allianz, he has been a fund manager at Principal Mutual Fund and Hedge Fund.

In an interview to Moneycontrol's Kshitij Anand, Reddy says he expect the key drivers of Q4 FY21 earnings to be sectors like commodities, private banks & large NBFCs and autos. Edited excerpts:

The RBI's April policy was largely dovish but do you think it is enough to battle another phase of lockdown if the surge in coronavirus infections continues?

Yes, the RBI policy was quite dovish and that was reflected in yields softening post the policy. The central bank has indicated that it wants to support the ongoing economic recovery and has given precedence to that.

The RBI's intention is to keep borrowing costs low and reduce the term premium. Therefore, it has announced various measures like GSAPs, OMOs, and other liquidity measures to help manage the large upcoming market borrowing programme in a smooth and efficient manner.

This should help the RBI to manage the yield curve better and may reduce volatility in yields—to some extent. Overall, we feel that the central bank will continue to remain accommodative till economic recovery is clearly visible and established, while closely monitoring the evolving inflation trajectory.

How are the March quarter results likely to pan out for India Inc? Which sectors can outperform and which will lag?

The March quarter results are expected to be quite strong (in % YoY terms) and will be helped to some extent by the lower base effect of the corresponding quarter a year ago (where we saw a stringent lockdown, and therefore a contraction in earnings).

However, corporate earnings for the past two quarters also have been better than expectations (helped by cost control and margin expansion), and we believe that the earnings recovery will continue—going forward.

Therefore, we now estimate Nifty index EPS growth of around 20 percent in FY21. This has been a big surprise to the market vis a vis estimate at the beginning of FY21 (amidst the pandemic).

And further, earnings are likely to grow by around 25 percent in FY22. However, investors should keep an eye on the impact of the second COVID wave in India and partial lockdowns and restrictions on earnings, though we feel that companies are better positioned to deal with it this year.

We expect the key drivers of Q4 FY21 earnings to be sectors like commodities (strong pricing environment and pick-up in volumes), private banks & large NBFCs (lower than expected NPAs and credit costs), and Autos (pick up in volumes, despite some commodity cost pressures)

Life insurance and AMCs are two sectors that proved their worth in 2020 and stand to gain from COVID-19 and lockdown. Do you think they are good for a decade and can produce the next set of multibaggers?

Life Insurance in India is fairly under-penetrated and has a long runway of growth ahead of them. COVID-19 has highlighted the utility of insurance and the customer has become more aware of the benefits of life insurance, which augurs well for the sector.

AMCs are a play on the increasing financialisation of savings in India. Similar to insurance, mutual fund penetration in India is also significantly lower compared to some of the other countries, which allows potential space for robust growth over the next few years.

The most recent data point (for the month of March 2021) is indicating a reversal in mutual fund flows, which is positive for the sector.

Hence, both these sectors have the underlying ingredients to produce potential big winners in the long term in spite of current premium valuations in this sector.

If we see another phase of lockdown, do you think IT and pharma specialty chemicals will lead the charge? The trade will once again skew in favour of sectors that did well during the 2020 lockdown

Defensive sectors like IT, pharma and consumers typically outperform in periods of market volatility. Export-oriented sectors like IT and pharma could benefit from the recent rupee depreciation and are also witnessing strong business momentum and deal wins—driven by global recovery.

The second COVID wave in India could lead to more lockdowns and restrictions and this may impact the pace of economic recovery to some extent and therefore lead to some volatility in domestic cyclicals in the short term.

However, we feel that the impact is unlikely to be as severe as seen in the first stringent lockdown in March-June 2020.

Also, with the vaccination drive expanding rapidly in India, the focus will be back on domestic growth.

Many interesting companies hit D-Street in 2021 and many more are lining up to raise money in the near future. Can you share a checklist that one should follow to avoid traps? More than 20 companies have listed so far in 2021 but most are trading with marginal gains after the initial pop?

With buoyancy in markets over the past year, we have seen equity fundraising activity pick up substantially (via IPO/FPO/OFS/QIP route) in FY21 to around Rs. 1.6 trillion, coming close to the earlier record of Rs. 1.7 trillion raised in FY18.

The IPO pipeline remains quite strong and we have seen massive oversubscription in some of the recent IPOs from investors.

With recent market volatility, some of the IPOs may have seen only marginal gains but activity should once gain pick up once buoyancy in market returns.

Also, the government has an ambitious privatisation/divestment drive lined up for FY22 (with divestment/ privatisation targeted in some large PSU entities) and that should keep primary markets active and help sentiments as well.

Investors should go in for companies with strong business fundamentals and competitive advantage, where the business opportunity size is large, and have good corporate governance.

Investors should also look for companies with metrics like healthy ROE/ROCE, free cash flow, moderate leverage and offering strong growth visibility at a reasonable price/valuation.

Is managing debt an important parameter, especially after the COVID outbreak? Should investors avoid companies that have high leverage on books?

Corporate India has been deleveraging over the past few years and reducing the debt burden on their balance sheets.

In the 2008-09 global financial crisis, we have seen how companies with large debt on the balance sheets were severely impacted from servicing their interest burden, especially during the growth/business cycle slowdown.

We prefer companies with relatively lower debt or cash-rich companies in our portfolios. Having a strong balance sheet with low or moderate leverage is important amidst the growth slowdown as a result of the COVID-19 pandemic.

We have also seen various companies raising capital—to strengthen their balance sheets, to better deal with the pandemic. Some of the highly leveraged companies in sectors like steel are also benefiting from price increases.

Which stocks are likely to be in focus after the cabinet approved production-linked incentive (PLI) schemes for white goods and solar modules?

The PLI scheme should help in encouraging domestic manufacturing and also attract foreign investment in these sectors.

This also ties in well with the government's Atmanirbhar initiative and could help to provide a fillip to the domestic manufacturing sector, which has been somewhat lacklustre in recent years. We are in the process of evaluating which companies are going to embrace this scheme.

What does the MF data say about investment trends ? Will outflow continue from equity funds? Is it a short-term trend?

Equity mutual funds have seen record outflows in FY21. However, recently in the month of March, we saw a reversal of flows in equity funds. Equity funds registered the first monthly net inflow since June 2020 and the highest monthly net inflow since the month of March 2020.

SIPs also registered a record high monthly inflow of around Rs 92 billion in March 2021 compared to Rs 75 billion in the previous month. If the buoyancy in equity markets continues then we could see mutual fund equity flows pick up gradually again.