

# 'I don't think India's economy has ever seen such a sunny time'

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**I**t needs a valuation froth, a commitment froth and heavy leverage to create a dangerous market peak, says leading investor Rakesh Jhunjhunwala, adding none of these are present in the Indian markets now. In an interview, he said the Indian economy has never seen such a sunny time with stable interest rates and good currency value. Edited excerpts:

**Let me start by asking you, if you were to write a headline for the market today, what would it be?**

Market, any runner has to take rest. So, the market, in the speed at which it was running, it had to take rest somewhere at some point. However, they say that bull markets corrections are severe and short-lived—sharp, severe, and short-lived.

**Do you believe we are going to see a sharp correction?**

It is just the first race which we have to predict. We had a rise from 7,800 to 9,400-9,500. So, even if market were to correct a little, I think it will become healthier. It is difficult to predict whether—if you see two-three days of continuous fall with good volume, then we could say market would go into a correction.

**I was not asking you for a headline for today's market movement. I was asking you for a headline for what we have actually seen happen over the past few months as far as our market is concerned. If you look at the numbers, Sensex up 26%, Nifty up 32%, midcap index up 95%.**

But I will only say one thing that we should not count the good things of life—a woman's age, a man's wealth or the number of drinks. But one thing I can only say that happy days are here again and we should welcome them.

**So, let me get the headline out of the way as far as you said we should not count things, but the market is probably waiting to hear from you. The debate is on, close to the peak, have we already peaked, valuations, so on and so forth. Where do you see things from here on?**

When people talk of peaks, that is the time when peak is not near and the bull market, it is too short a time period for the bull market to have finished. For bull markets or for a stock to correct, you need three things. First, you need tremendous valuation froth.

**And you do not believe we are in that territory?**

We are not in that stage at all—maybe selectively but not in that stage at all. Second, you need commitment froth. Everybody in the market should be committed and leveraged, most players. And third then, you need bad news.

So what happens, when you have valuation froth and then you get bad news and everybody is committed, when the market falls, the leveraged buyer has no choice but to sell and because there is a lot of valuation froth and everybody is committed and there is bad news, it is very difficult to find a buyer. So, the bull market will really eclipse when all these three factors are present substantially—valuation froth, commitment froth, that means there is a lot of leveraged buying or even in investing, people are completely committed and third thing is bad news. So then on bad news when people sell, you do not find a buyer. But there may be valuation froth but there is no commitment froth, there is bad news, people sell but you find buyers. So, we are far, far away from that.

**That is very emphatically put. I cannot remember the number of fars that you added there, but we are far, far away from that scenario.**

But I also want to add that it is not that we are having this bull market as a function of just commitment. What has happened is I think India is too—like three years of the government has passed—to change anything in India is very difficult, India is an elephant. But the kind of change which Mr Modi is bringing and because it is going to take time, I have always predicted that India is going to grow double digit and I have been predicting and I also predicted that a tsunami of local money will come into the markets.

Now, to change India, you need a lot of time. Even when Mr Modi became the Gujarat Chief Minister, he took the first term to basically understand everything and prepare for change. He is doing similarly in this Prime Ministership. And, his attitude, you know how I will compare his attitude to other politicians? That suppose you want to put water through a pipe, the pipe is leaking, it is rusty, but the politician will say put more water. So, Mr Modi is trying to put more water, but his bigger priority is to see that the rustiness goes away, the leakages are blocked. So, to do that takes time, so the effect of what he is doing is going to take time. But I do not see it is more than 2-3 years away and then you are going to have that explosive 10-11% growth. Remember one thing that he has transferred so much money into the states, he is increasing spending and still he is maintaining fiscal responsibility.

I do not think the Indian economy has ever seen such a sunny time where you have stable interest rates, good currency value; you are on threshold of major growth. I think the non-performing asset (NPA) problem now also will be resolved in the next 12-24 months.

**Since you spoke about the NPA problem, let me start by talking to you about that specific issue. We have seen this deci-**

tion that has been taken by the government. We are still awaiting more clarity on the fine print from the RBI on how this is actually going to work. But, has this changed your view on public sector banks? We have seen a significant rally and how do you see this playing out? The jury is still out on how soon we will actually see this play out.

The problem is that there is cancer, it is known. Now you are afraid to treat or have an operation for the cancer because what will happen, first of all, the banks were not admitting the NPAs, so Mr

Raghuram Rajan made them admit it. So, there has been NPA recognition, yes. Second is, you have to resolve the matter. Suppose there is a loan of Rs45,000 crore, now Rs30,000 crore is good, but still the entire amount may not be provided for and you cannot get ahead in life. There have been even more severe financial crises in the world, in Sweden, in America, but those crises have been solved if the economy has been on an upswing. The Indian economy is on an upswing.

So, the question is what the RBI could do is, it is still in the framing stage, it will force the banks to recognise the NPAs and provide for it. That is not going to solve the problem for public sector banks in my opinion because they should need capital to provide for it. That has to be found. Second, at Pedder Road, 14 banks will be there of a common owner

which is the government of India so their cost-income ratios do not go down. So, how do you work on their efficiency? And third is there is a big shyness to lend after the experience. So, that shyness has to go away. So at least for the banks that have adequate capital, the cancer will be operated upon and the result will be known and I think the results will be good. So, banks that are well run, who are efficient, for them it is the last 18 months of difficulties.

**So, you think the pain at least for the likes of State Bank of India (SBI), etc...**

I do not want to take any names. But for banks which are efficiently run, which have got adequate capital, will be out of the woods in the next 12-18 months.

**So does this make you more confident about the state as far as the Indian banking sector is concerned?**

Absolutely. Another thing that is going to happen is, most of the bank NPAs are arising out of lending taken place between 2009 and 2013. Now, those NPAs will be recognised. Post 2013-2014, banks have been very careful in giving money.

So, I do not anticipate much NPAs once the legacy NPAs are solved. So, after that the banks—if the credit cost goes down, they will perform well. Then I also see an upswing in credit growth.

**So, let me ask you about how all of this translates into earnings growth and do you believe that we are now going to see a significant pick up as far as earnings are con-**



Rakesh Jhunjhunwala.

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cerned? I do not look at earnings on a broad basis. There are sectors. Private sector banks are doing well, non-banking finance companies (NBFC) are doing well, metals are doing well. It is only pharmaceuticals and software which is a good constituent of the Nifty which is not doing well. Pharmaceutical I think has made or is near a bottom and software, growth rates in the future, according to me, are going to be better than what the markets are predicting, maybe not this year, the years ahead.

**So, you are confident about the tech sector?**

I will not say this year would necessarily be very good, but I surely think that with a period of time, these growth rates will improve.

**But, what are you basing your confidence on because if you look at a commentary that is coming in, whether it is on the visa related issues or generally as far as the environment, which is perhaps overblown.**

I am basing my confidence basically on one thing that I do not agree, I think software spending is set go up in the world.

Now, the model has changed and I am confident on the Indian companies' abilities to change to the model. They may take time, there may be less work in maintenance but more work in digital. So, with time, the Indian companies will respond and the Indian cost and ability, I do not say only cost, cost and ability advantage is unmatched. So, there is no question Indian companies are going to take the market. So, I see no reason

why tech will not come back. **So, you see a revival for the tech sector?**

Yes, but I am not recommending to buy anything. **I made that disclaimer right at the start, no recommendations here, it is just a conversation.**

I feel that the Indian companies have changed their business and I feel that Indian companies are doing far greater growth, far greater and better quality work than just linear work.

So, there is under appreciation of the quality of work that Indian companies are doing. And I see with their cost advantage and their ability advantage, I see no reason why they will not adjust to the new models. It is taking time and that is all.

**You said pharmaceutical also perhaps at the bottom at this point in time. What gives you the confidence that we are going to see a revival there?**

There are three factors why the bearishness. One is the genericization which Government of India is claiming which I think is a night-keeper's dream. You can do genericization if you have a control on the quality of the manufacturer.

**So, you do not agree with the move towards to moving to generics?**

It is impractical. I do not say agree or disagree, I say it is impractical; it is unimplementable because you do not know the quality of who is making where, what.

**What about greater price control?**

Greater price control, they are having price control—50%

of the materials are already under price control. Second thing is the problem of erosion and enhanced competition and consolidation in America. That is coming to a climax. And third is your rupee. I personally feel rupee will also go back to 66-67 per dollar levels. So, I do not say they have bottomed. They might have bottomed, but they might be in the process and I can be wrong.

**But, what about the Food and Drug Administration (FDA) related issues that most Indian companies seem to be burdened by?**

I think it will be a legacy issue because more than a technical issue, it was a cultural issue. But now Indian companies have realised that you have got to be very careful.

**So, you are keeping the faith in pharmaceuticals?**

I am keeping the faith. I think it is going to be one of India's very large industries. It is a skilled based industry and you cannot get chemists and this ability anywhere easily. I have an investment in a company—what Pfizer makes at 100, Mylan makes at 75. What Mylan makes at 75, Lupin makes at 60. What Lupin makes at 60 that company makes at 40. You can hire a B-Pharm at Rs30,000 a month. Look at the cost differences.

And I always have and will have faith in Indian entrepreneurs that they will be able to capture markets. People forget that Sony started by assembling transistors. So, if there is a learning curve and now India companies have huge \$250,000 million of research budget. But that was only possible when the profits went up. There may be consolidation, all companies may not do well, but in general, pharmaceuticals will do well.

**One of the other sectors, in fact, we had Warren Buffett on CNBC for about three-four hours actually, last week talking about the sectors that he believes in and has faith in, he said airlines and the aviation business is no longer a suicidal business. You have kept the faith in Indian aviation as well, Interglobe Aviation (IndiGo) and SpiceJet. How confident do you continue to feel?**

I do not want to talk about my positions, but I am bullish. Let us talk of IndiGo. 84% return on capital, 92% payout, still Rs9,000 crore cash, industry growing at 20% a year. So, I do not know. A company which is constantly return on capital is over 60-70% and you have a cash to marketcap ratio, this is 7%, less-less 3%. So, I do not see any reason why there should be bearishness in airlines stocks, not that I am recommending you buy.

**I heard you ask Aditya Ghosh on the IndiGo conference call about aviation turbine fuel (ATF) prices. There is not much that he can actually do as far as ATF prices are concerned. That is something that the government has to work on.**

I felt very disappointed with the call because at least he must keep a table ready. He knows what the constituents of ATF prices are. He must know that at this dollar rate and this international aviation fuel rate, this should be the

price in India. That is what I asked him.

And then I asked him, how is your price realisations. He said we do not talk about the future. I said tell us for April and he says we do not. This is the past. You are on a conference call; he does not know what his realisations are. Then tell me about industry, he says no, I do not know. Odd!

**I have been listening to you on the conference calls. I heard you on the Titan Company's conference call, I heard you the previous quarter on the Tata Motors conference call, this quarter on IndiGo. Is there some degree of impatience that is creeping in?**

In me? Not at all. I am asking a very legitimate question. I am not asking them anything which is confidential and I am asking them publicly.

**But do you believe that there needs to be greater effort in being more upfront in communications? That is one of the issues that you were raising, for instance, with the Tata Motors management on the forex strategy.**

It is too complicated and it is difficult to understand the strategy. So I was just asking them that if you tell us, and after that, they did reveal how much they have hedged. I think agreed later and they revealed, not to me, but to analysts.

**So, what is the bull case as far as the aviation sector is concerned? Double digit growth that we have seen for the sector, your faith has been reaffirmed by the performance at least - I am not asking you about the stocks, but for the sector?**

I feel if this growth of 20% continues and there is limited capacity addition, then pricing will be better and I do not see oil prices going up any time soon.

**You talked about steel and we had Deepak Parekh of HDFC and Koushik Chatterjee of Tata Steel on the channel and Mr Parekh's bet was that over the next five years, he believes the affordable housing scheme is going to be the big multiplier. Koushik Chatterjee, Seshagiri Rao of JSW Steel, also seem to say very clearly that they believe the steel demand is going to be very robust going forward. Are you feeling as confident?**

Steel demand being robust is no reason for robustness in steel shares because you can always import steel. So, there has to be parity with international price despite the antidumping. So, what is more important is the cost structure of each manufacturer. Steel can be imported freely. It is like cement. So, demand going up on steel is not going to affect the balance sheets of a lot of Indian companies. India is exporting a lot of steel.

I just read in JSW that they exported a lot of steel. So, I do not feel that robustness in housing demand in India is a big reason for bullishness in steel.

**But in general, do you feel confident about the steel sector, about metals?**

It depends individually, company to company. It is a company to company matter.