

Unhedged Forex Debt Spells Trouble for Cos

Canara Robeco's Jain says Q2 may spring negative surprises

Book Value

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Bharti Airtel, Tata Motors, Tata Steel and Reliance Communications, which have piled up foreign currency debt in their acquisition spree of the past few years, may be the unwanted stocks for investors as the Indian currency is whipsawed by foreign funds pulling out and a strong import demand, experts said.

The fact that these companies have not hedged a good portion of their debt amid fears of a double-dip recession could well become a thorn in their balance sheets as international markets turn hostile to lending to emerging market companies.

"Several Indian companies have taken huge working capital loans in foreign currency; these are largely unhedged borrowings," said Ritesh Jain, investment head at Canara Robeco Mutual Fund. "Companies with unhedged foreign exchange exposure on the liability side expose themselves to huge currency losses. We expect negative surprises in the September quarter."

The rupee has fallen nearly 13% since August this year. Currently, trading close to 50 a dollar, the rupee has fallen to a 28-month low on September 22, as the global macroeconomic situation worsened even further. Even though a weakening rupee is beneficial to IT companies, the dollar's strength against other billing currencies, like euro and British pound sterling, will neutralise their 'export receivable earnings'.

Corporate earnings may slow in the next three quarters, said Jain who owns stocks of dairy products and chocolate maker Nestle, soaps and shampoo maker Hindustan Unilever, and cement producer ACC, a unit of Switzerland's Holcim. Apart from a drop in operating margins, Indian companies will also have to wrestle with a general decline in demand. According to analyst reports, consensus earnings for FY12 have fallen 7% over the past six months and are currently hovering at 15% levels.

"Our mid-term outlook for economy is slowing growth along with a stubborn inflation," Jain said.

"The concern is as much local as it is global. Domestic consumption refuses to slow down even after a series of rate hikes. Global uncertainty and regulatory environment are now allowing capital formation needed for broad-based growth of economy and to dampen inflationary pressures," he said.

Despite a 20% correction in the market since January, Jain is not lured by attractive valuations as their performance will be the worst hit during tough times while top companies sail through.

"Blue-chip companies and niche businesses

Expert Take

Canara Robeco MF

Bullish On

Telecom, FMCG, fertiliser and cement

Bearish On

PSU banks, realty, engineering and infrastructure companies

Neutral View On

IT and pharma

Raised Exposure To

Nestle India, HUL, ACC, Gujarat Alkalies and Ultratech Cement

Cut Allocation To

Infosys, TCS, Coal India, Power Grid, L&T, NTPC and PNB

Outside Equities

Invest in short-term debt. Increase allocation to gold



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Ritesh Jain

Head of Investments
Canara Robeco
Asset Management

will continue to command rich valuations while mid-, and small-cap stocks, with not much corporate performance, will remain cheap on valuation front," Jain said, adding,

Investors should invest in companies which can navigate through different business cycles and can adapt to a changing environment

"We'll prefer to stay in good companies, even if it means paying a higher premium for investing in them."

The fund house has sold some shares such as Infosys Technologies and TCS that may face a slowdown in order flows from the West. Some infrastructure-related stocks such as Coal India, Power Grid, L&T and NTPC have also been reduced in the portfolio.

According to him, investors should invest in companies which can navigate through different business cycles and can adapt to a changing business environment. They should look at companies which have free cash flows, he said. "It is companies and not markets that create wealth," Jain said. Jain is also bullish on gold for the next three to four years and he believes that investors should have at least 10-20% of assets in it.