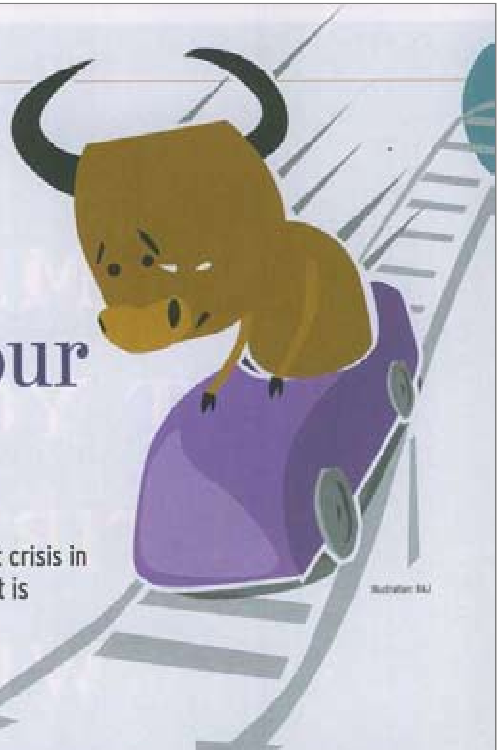
Money Today

STOCKS Indian markets

India: Tighten your Seatbelt



We may not be directly affected by the current crisis in the US. However, FII inflows will be hit and that is bound to hurt the equity and debt markets

By TANVI VARMA and NARAYAN KRISHNAMURTHY

"No man is an island, entire of itself; every man is a piece of the continent, a part of the main. If a clod be washed away by the sea, Europe is the less..." What John Donne said almost 500 years ago is as true today. And that's why, if Wall Street sneezes, the world could quite easily catch a cold. Which is what economists across the world are afraid of now; all that has been said about decoupling (*see page 55*) could well go out of the window as more and more companies tumble. So, how does this affect India in particular? And does all this put your equity holdings in jeopardy? We take a look.

It will take some time before the markets settle, after taking into account the way other global financial players react.

DIPEN SHAH
Kotak Securities

FOREIGN INVESTMENT

"Fundamentally there is nothing wrong with the India growth story. However, financially, we are still dependent on foreign players investing in India," says Amitabh Chakraborty, president, equities, Religare Securities. Collectively, foreign institutional investors (FIIs) hold stocks worth more than $80 billion across 30 firms that constitute the Sensex, or about 18% of their total market value. The collapse of financial behemoths like Lehman Brothers and Merrill Lynch has seen these FIIs step back from any investment or market that they consider even faintly risky. Since January this year, FIIs have been net sellers; in the past three months, they have sucked out Rs 40,320 crore. Says Alex Mathew, head of research, Geojit Financial Services, "FIIs still decide the course the market takes, fundamentally or otherwise."

Apart from the FIIs turning sellers is the fact that there are some stocks that are directly affected by the fall of the Wall Street giants (*see The Merrill and Lehman Effect*). In some cases, the impact is because Lehman or Merrill held a stake in the companies. Companies like ICICI Bank and Punjab National Bank have other exposures to Lehman and are feeling the impact of that on their stock price.

MERGERS AND ACQUISITIONS

Investment banks and bankers play a crucial role in facilitating mergers and acquisitions. And such M&A activity is vital for an economy to grow and for corporate activity to improve. But now that the dealmakers themselves are on a sticky wicket, the fate of several such M&A deals is hanging fire. Take, for instance, the dilution of stake in the

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tower business of Tata Teleservices. The objective was to bring in an investor who could hold a maximum stake of 49%, and the Tatas had authorised Citigroup and Lehman to scout for a suitable investor. Now, till the dust settles, little can be done to take this matter ahead.

Another deal left stranded is the one that Lehman Brother was to execute for Great Offshore. Earlier this year, the company had bought SeaDragon Offshore, an oil-drilling rig based in the Cayman Islands, for $1.4 billion. This gave the company ownership of two rigs, of which it wanted only one. Great Offshore mandated Lehman Brothers to scout for a buyer for the second rig. The fate of that deal is now unclear.

EXPANSION PLANS

Lehman Brothers was expanding into India by investing in companies and looking at taking a stake in many of them. Says P K Agarwal, research head, Bonanza Portfolio: "With small stakes in over 50 companies each, both Lehman and Merrill Lynch were seen as investors who vetted the stock. All that changed when their own fate changed."

Lehman Brothers had a large interest in real estate through its Rs 740 crore investment in Unitech for a project in Mumbai. Apart from that, it held small stakes in Ansal Infrastructure and a few other real estate companies. In the case of Edelweiss Capital, Lehman had invested significantly in the asset management arm, in order to have a retail presence in the country. While Edelweiss has come out with its fund offering, the prevailing sentiment is not encouraging for investors to park funds in a company with a doubtful holding.

SECTORAL IMPACT

The largest sector to feel the pinch will be information technology. That's because the IT sector has a significant exposure to the fallen

THE RETURN OF THE PINK SLIPS

Human resource professionals say that it's not as dire as the slump of 2000, but the latest crash has already resulted in the loss of hundreds of jobs.

Recruiters and human resource consultants are calling it rationalisation; translate that into English and it means a wholesale loss of jobs. Says E. Balaji, CEO, Ma Foi Management Consultants, "With the fundamental situation undergoing a change, many corporate houses' hiring plans have gone for a toss."

The worst hit, say experts, will be the BFSI (banking, financial services and insurance) segment, which is the largest outsourcing vertical for Indian IT players, accounting for some 40% of their revenues. "The financial meltdown could impact about 9% of the people employed in the BFSI, IT and ITeS sectors in India," says Naresh Malhan, managing director, Manpower India.

It's a bleak picture for employees, who will have to brace themselves to deal with slower hiring, low-performance firings and super-slim pay hikes. "During times of uncertainty such as now, companies would surely look at cost cutting and take a relook at their growth strategy," adds Malhan.

The other set of apprehensive workers are those in the finance sector. The sector is bound to feel the pinch, and there are signs that the situation for finance professionals could be as bleak as for their IT brethren. Finance firms had anticipated a certain growth momentum and had drawn out expansion plans accordingly. With events not going according to plan, belts must necessarily be tightened.

The good news is that certain sectors are likely to buck the prevalent negative sentiment. Experts believe that the impact will be specific to sectors; manufacturing and construction, for instance, are unlikely to be affected. But, warns Malhan, "The unprecedented hiring growth is set to be in check."

FACING THE AXE

- HP-EDS plans to reduce its 320,000 workforce by 25,000
- The Indian operation of Lehman Brothers employs 2,500 staff, all of whom face an uncertain future
- Airlines expect business to fall; Jet has let 750 employees go, while Kingfisher plans to cut its staff strength by 300
- Tech major Satyam is likely to axe 4,500 employees
- Both TCS and Infosys are looking to postpone the arrival of fresh recruits and are considering benching staff

Illustration: PRAGATI

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institutions and their clients. "Real estate is another sector which is being impacted by the overall state of the economy and rising interest rates," adds Mathew. There is some respite for exporters with the falling rupee but buyers overseas may now become scarce. And for importers, the oil price fall (and the general fall in commodity prices) will neutralise the impact of the rupee's decline against the dollar. Apart from the direct effect, the crash has badly dented the job market. The problem is compounded because these sectors are all interlinked.

REGULATORY ACTION

The fall of AIG, one of the oldest and biggest insurance companies in the US, caused some panic among Tata-AIG policyholders. However, the Insurance Regulatory and Development Authority acted fast and assured policyholders about the solvency margins of the Indian company. On its part, Tata-AIG issued statements to reiterate its credentials and safety. The market regulator, Securities and Exchange Board of India, also issued a statement that said AIG Investments, the asset management firm, is safe.

Despite settling the immediate panic, experts foresee a bearish undertone from the markets over the next six months. "We are not amid a structural bear market," Chakraborty hastens to add. "The rampant sell-off is associated more with behavioural finance than sensible investment philosophy," he explains.

The key question confronting the Indian economy now is the backlash of the American (or global) financial crisis. The RBI and the finance ministry have moved quickly to check any panic by restating confidence and safety in the Indian financial sector. But at the heart of the problem lie questions of liquidity and confidence. What the RBI needs to do, as it has done by softening the external commercial borrowings (ECB) norms, is to neutralise the outflow of FII money. One way to tide this over is to draw down the dollar reserves to prevent a sudden tightening of liquidity, and also not allow the credit market to overshoot by taking interest rates up too high.

> "There is nothing wrong with the India story. But financially we are dependent on investment by foreign players."
>
> **A. CHAKRABORTY**
> Religare Securities

And finally, for those looking to raise capital, the alternative to funding through fresh equity will not be cheap, since stock valuations have suffered in the wake of the FII pull-out. The delayed IPOs from UTI and MCX, among others, will only add to the uncertainty among small investors who are already afraid of a possible repeat of what happened in 1996. "This time around the situation is much better, but investor sentiment is something that does not see reason when there's the fear of losing money," says Chakraborty. MT

The Merrill and Lehman Effect

A look at eight Indian companies that the two erstwhile giants had a stake in

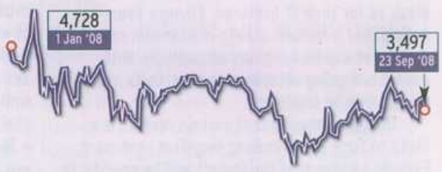
UNITECH

CMP: Rs 124 ROE: 62.37
PE: 21 Net profit 2007-8: Rs 1,031 crore
EPS: Rs 6.3

COMMENT: The company, already under pressure because of the rising interest rates which are hurting liquidity, will have to face up to the Lehman legacy, even though it has already received the Rs 740 crore that Lehman Brothers Real Estate had paid in July. The stock will slip some more.

EDUCOMP

CMP: Rs 3,497 ROE: 35.37
PE: 74.7 Net profit 2007-8: Rs 70 crore
EPS: Rs 40.6



COMMENT: The company has recently raised Rs 700 crore from Axis bank for funding its expansion plans and is fully funded till 2009-10. With its partnership with Dell, Acer and Intel, Educomp is fundamentally sound, but is impacted by the bad market sentiments.

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ICICI BANK

CMP: Rs 600 ROE: 11.75
PE: 16.2 Net profit 2007-8: Rs 4,158 crore
EPS: Rs 37.4

COMMENT: News of the bank's exposure to Lehman Brothers, amounting to Rs 375 crore, comes in at a bad time. The bank is already facing a challenging situation in the changing interest regime in India, where the banking focus is shifting from retail to corporate lending.

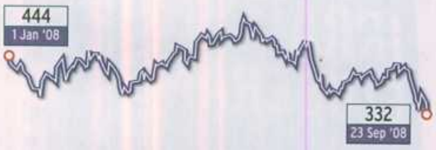
EDELWEISS CAPITAL

CMP: Rs 444 ROE: 3.2
PE: 118.8 Net profit 2007-8: Rs 29 crore
EPS: Rs 3.8

COMMENT: The company's foray into asset management through its mutual fund arm will be hit because it will have to find a buyer for Lehman's 26% stake in it. Owing to the financial market crisis, the trading volumes will deplete and the stock's price is expected to fall.

SATYAM COMPUTERS

CMP: Rs 332 ROE: 26.12
PE: 11.7 Net profit 2007-8: Rs 1,716 crore
EPS: Rs 25.6



COMMENT: Satyam has revised, downwards, its revenue guidance for 2008-9. With the Bank of America buying Merrill Lynch, which contributes over 2% of Satyam's revenues, there are chances that the former will go with its old vendors—Infosys and TCS—adding to the stock's woes.

WEST COAST PAPER MILLS

CMP: Rs 50 ROE: 25.94
PE: 3.4 Net profit 2007-8: Rs 82 crore
EPS: Rs 14.3

COMMENT: The total valuation of the Lehman holding in the firm is about Rs 22 crore. The promoters, Bangurs, are ready to buy back the Lehman stake. But the impact of Lehman association and a slowing paper industry is making the stock take a beating, which may last six months.

MINDTREE

CMP: Rs 328 ROE: 21.49
PE: 10.4 Net profit 2007-8: Rs 104 crore
EPS: Rs 27.5

COMMENT: With AIG accounting for approximately 8% of the company's revenues, the global turmoil will further dampen Mindtree's stock price in the near- or the medium-term. The company is looking at exploring other areas to boost revenues.

AMTEK AUTO

CMP: Rs 172 ROE: NA
PE: 10.5 Net profit 2007-8: Rs 263 crore
EPS: Rs 18.7

COMMENT: The impact on this auto component exporter will be felt more because of recession in the US, which will spill over to the UK, Japan and Germany. That Lehman had an exposure in it only compounds its misery. A further 10-15% cut in stock price is expected.

