

## India Battles to Win Back Confidence of Investors

Investors trying to make sense of the recent destruction of Indian technology valuations may conclude the country has a unique ability to disappoint. Despite reforms that put it on a par with Asian rivals in terms of, say, settlements, Indian equity markets still struggle to meet expectations.

The picture could scarcely be more difficult across the border, where the Karachi exchange earned the accolade of the fastest-growing market last year. Yet it is India that offers a wider choice of assets as well as the better longer-term potential, say fund managers.

India's benchmark Sensex Index has weakened 3.4% since April, an erosion of value that disguises a substantial re-rating of technology stocks and one that marks the break with the past. The Sensex has shed 11.4% since April 2002. The cause of the upheaval in India was a poor profits outlook, on April 10, by Infosys Technologies, the bellweather IT stock, which wiped out 27% of its market capitalization at one point during the day. Selling pressure was so intense that the value of trading in Infosys' shares rose fourfold, from Rs1,031m on April 9 to Rs5,187m on April 10. Other casualties included Wipro, India's largest listed IT company.

**"The upshot is that the first time we have a horizontal Indian market," says Jon Thorn of India Capital Fund in Hong Kong.** This means IT premium valuations have given way to more rational pricing. That has cheered professional investors who have long pointed to the restructuring of Indian industry as evidence of genuine undervalued long-term investment opportunities.

The Indian market trades at about nine times forward earnings, which is about half the average

multiple for the past five years, and compares favourably with other Asian markets. The average return on equity in India is about 22%, one of the highest in Asia and a sign of more efficient use of capital.

In the quarter to December 2002, a survey of 1,500 companies that represent 95% of the capitalization of the Bombay stock exchange revealed an average top-line growth of 13%, income tax receipts up by 37% and profits after tax improved by 53%. The trend continued in the quarter to March 2003.

"This is evidence of the reduction in the divergence between old and new economy. After painful restructuring, we can now judge on parameters such as the quality and sustainability of growth," says Mr Bharat Shah, chief executive of ASK Raymond James, in Bombay. The economic backdrop to this widespread fixing of Indian balance sheets is also benign. Liquidity is generous, with interest rates at 30-year lows. The central bank last week forecast economic activity would expand 6% this year, though economists dismissed it as fanciful.

So why is the stock market not reflecting these positive variables? One reason is shallow foreign portfolio investments. This year, foreign institutional investor flows have reached \$849m. FII flows reached a peak of \$2.8bn in 2001.

The biggest potential support is retail interest. In India, domestic investors account for just 2-3% of all financial assets, down from about 20% in the mid-1990s. "Risk love is extremely low among domestic investors," says Ajay Kapur, regional strategist at Citigroup in Hong Kong.

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