THE ECONOMIC TIMES

Stock advice: Shares that can gain from a fall in yen and euro

By *Sanket Dhanorkar*, ET Bureau | 10 Nov, 2014, 09.18AM IST

Post a Comment

The recent unwinding of the US quantitative easing programme, a long-time liquidity boosting measure by the US central bank, was expected to leave the other markets gasping. Instead, the withdrawal of the prolonged stimulus has been cast aside in a perfunctory manner. The reason is the simultaneous rollout of a massive stimulus by the central banks of Europe and Japan. A couple of weeks ago, the Bank of Japan sprung a surprise on global markets by ramping up its stimulus programme. It announced its intention to accelerate its buying of government bonds, while tripling its purchases of exchange-traded funds and real estate investment trusts. Meanwhile, in Europe, the European Central Bank has been stepping up its own stimulus measures to revive the stuttering euro-area economy. It has already outlined its intention to spend 1 trillion as part of its asset purchase programme. This is likely to ensure that global markets remain flush with liquidity. These actions are likely to boost FII interest in Indian equities as a whole, and could benefit certain companies in particular.

The huge stimulus from the European and Japanese central banks will weaken their currencies and could boost some Indian stocks.

Editor's Pick

- Arun Jaitley pledges ‘rational’ tax policy, changes in labour laws, fuel price deregulation and natural resources auctions
- Markets turn rangebound after hitting record highs
- Black money: 1st round to Delhi in Liechtenstein case
- India to support global meet on exchange of info
- WTO to take up demand for permanent food security

ET SPECIAL: Save precious time tracking your investments

Currency play

Whenever there is an oversupply of money in any economy, the local currency loses some of its value. This is playing out in both Europe and Japan at the moment. The unexpected push by the Japanese central bank has led the yen to slump to a nearly sevenyear low against the dollar. Similarly, the euro recently slipped to a two-year low against the dollar. With both the economies likely to keep pumping money for some time, the respective currencies are also expected to exhibit continued weakness. Yogesh Nagaonkar, VP, institutional equities, Bonanza Portfolio, says, "The unprecedented stimulus by Japan has caught everyone by surprise. We expect the yen to depreciate further amid high volatility. Meanwhile, Europe has no other option but to continue the stimulus measures to prop up the ailing region. So, the euro will also continue to slide." This has a direct impact on some stocks that are linked to these currencies and has already sparked off a rally in these stocks.

There are several India-based subsidiaries of Japanese companies which could enjoy some spillover effects. These companies are expected to benefit from lower cost of raw material imports from the country as well as a lower royalty outgo in some cases. India's premier auto-maker, Maruti Suzuki, is the best example. With a yen exposure of nearly 20% of its revenues, any movement in the Japanese currency influences its earnings. Even a 1% weakness in the yen against the dollar helps boost Maruti Suzuki's earnings by around 4%. In India, the rupee has gained nearly 8% against the yen in the past fortnight.

JAPANESE COMPANIES OPERATING OUT OF INDIA

COMPANY	ROYALTY (₹ cr)	NET SALES (₹ cr)	ROYALTY AS % OF SALES
MARUTI SUZUKI	2,486	44,451	6%
RICOH INDIA	-	1,049	0%
HONDA SIEL POWER	35	541	7%
HITACHI HOME	24	1,100	2%
LUMAX	21	1,117	2%

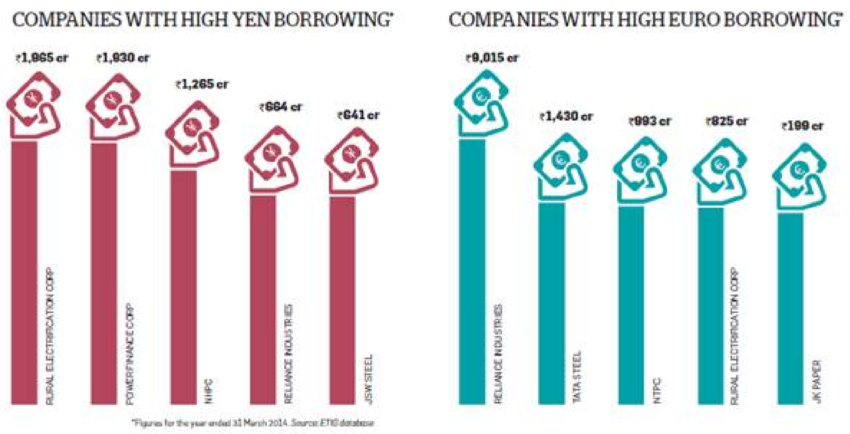
Not surprisingly, analysts say, a weak yen outlook augurs well for Maruti's profitability. "The EBITDA margin should expand in the second half on lagged currency gains," says Morgan Stanley. Maruti Suzuki's stock has already jumped 12% over the past month. However, the yen weakness will not soften Maruti's massive royalty outgo towards its parent Suzuki for long. This is because Maruti has decided that to limit risks from foreign exchange fluctuations for all future models, it will make royalty payments to its parent, Suzuki Motor Corp, in rupee instead of yen. The company paid Rs 2,486 crore, or nearly 6% of its net sales, as royalty to Suzuki for the last financial year.

Besides Maruti, Ricoh India, Honda Siel Power, Lumax Industries, Hitachi Home Appliances and Sharp India, among others, stand to gain from a weakened yen. The currency depreciation means that these companies will have to shell out lower in rupee terms for their raw material purchases and also towards royalty payments to their Japanese parent. Analysts say the positive effect of currency depreciation is likely to start reflecting in the next quarter financials. Vikas Gupta, executive vice-president, Arthveda Fund Management, says, "The yen weakness does throw up opportunities for some of the Japanese companies in the near term." There are also companies with no linkage to Japanese firms that stand to gain from a weaker yen. These are the ones that have borrowings in yen. These include Rural Electrification Corporation (REC), Power Finance Corporation and NHPC, among others.

As the yen weakens, the borrowing company has to pay back fewer rupees for every borrowed yen. This will improve the profitability of these companies as the interest outgo will come down. Nagaonkar points out, "The actual benefit to these companies will depend on how much of their borrowings have been hedged. If a major chunk is left unhedged, it will surely boost profitability in the near term."

For the same reasons, the weakness in the euro may work in favour of some companies—Indian subsidiaries that shell out royalty payments to Europen parents, firms that source raw material from the regions, as well as companies with euro-denominated borrowings. Companies such as Reliance Industries, ICICI Bank, Tata Steel, NTPC and REC have huge borrowings in euros.

There is also a flipside to this currency movement. Any firm with substantial exports to these regions will have an adverse impact on its revenues, as every sale will translate into lower revenue in rupee terms.



Major exporters to these regions include companies in information technology, pharmaceuticals, textiles, automobiles and auto ancillaries. Gupta, however, feels that these exporters will not lose much as the stimulus efforts will help boost the demand for their products in these regions. "The stimulus is intended to boost consumption in the local market. If this happens, volumes for these companies from that region will pick up, thus mitigating the impact of currency depreciation."