Model Portfolio Update

HSec LARGECAP Portfolio*

Portfolio Return	NIFTY Return
52.97%	38.47%
OPF : 1,450 bps	

* Launched 9 Oct 2013

Not really Greek to us Indians…

Markets look unsteady as Greece teeters on the edge of default. While we can scarcely profess to be expert or diligent analysts of the European Union's macro or political woes, a few conclusions are in order.

Firstly, Greece is certainly not the victim of the situation. For years its government had lied (yes, lied) to lenders while making hay in the sunshine of the Western world's most reckless credit expansion in the years leading up to 2008. Hardly the sort of thing sensible governments do under pressure.

Secondly, the Greek government has blown the bailout (shall we call it a 'restructuring' or a '5/25'?) of over US$ 250bn by institutions like the IMF and ECB. The conditions imposed were sensible : a cutback in government spend on pensions and unemployment benefits (overheads), better tax enforcement and improving ease of doing business. But the government consistently avoided taking tough decisions. It blew a golden opportunity to mend the economy, which has shrunk by ~25% from peak. Unemployment is running high, tax collection has dropped and the government is bankrupt. Again.

Thirdly, Greece's reaction to the latest crisis reeks of victimhood and deserves a rap on the knuckles. Especially since Tsipras has called for a referendum as late as five days after the current payment deadline expires. And this, after he and his 'CFO' Varoufakis have engaged with lenders (led by the IMF and ECB) for weeks. The Greeks have irresponsible leadership, to say the least.

Greece's national events hold lessons for Indian banks as they chase errant promoters of defaulting borrower companies. Extending loan tenures is useful only where borrowers are genuinely capable of servicing the debt. And desirous, too...

Meanwhile, the likely slower growth coupled with rich valuations at Mindtree, soft commentary by TechM and tougher prospects for IDEA compel us to suggest a belated EXIT for these three stocks from the HSec LARGECAP Model Portfolio. We are adding HCL Tech and Tata Comm, in view of their superior (and arguably more predictable) growth trajectory despite the Europe's Greek woes.

Summary of Portfolio Changes

SELL
- Mindtree
- Tech Mahindra
- Idea Cellular

BUY
- HCL Tech
- Tata Communications

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Model Portfolio : HSec LARGECAP

The HDFC sec Model Portfolio has delivered at par with NIFTY since the beginning of 2015. We are still a good 1,450 bps ahead of the NIFTY since we launched the Model Portfolio in October 2013. **We are now selling Mindtree TechM and Idea Cellular, while pulling in HCL Technologies and Tata Comm into the HSec LARGECAP.** We are also about 3.7% in cash and will use any correction triggered by Grexit (or otherwise) to add high conviction picks.

PORTFOLIO CHANGES

Mindtree (SELL)

- The stock has run up 82% in absolute terms since we included it in the portfolio; thus, some profit booking would be a pragmatic step.
- Mindtree trades at expensive valuations (nearly 16x FY17E EPS), which leaves little room for upside.
- The current 'digital disruption' being witnessed in the IT industry has complicated budgeting in many buyer organisations. New layers (including business heads) are getting added to the process, leading to longer time frames for decision making. This affects QoQ revenue predictability, a critical monitorable for midcaps. In addition, the 100bps lower EBITDA margin likely in FY16 compels us to exit Mindtree.

Tech Mahindra (SELL)

- Post a disappointing 4QFY15, Tech Mahindra has issued a profit warning for 1QFY16. Co stated that revenue could be sequentially lower owing to slow telecom growth. EBITDA margins are also likely to further decline from already low levels seen in 4QFY15 (15.2%) owing to higher visa costs.
- Thus, even though FY16 is likely to be a margin focus year for Tech M, the lack of growth means that margin can correct nearly 300bps. With the now flagged poor start in 1QFY16, EPS is likely to remain flat.
- We expect a cut in consensus earnings from the current Rs 33.7/41.2 for FY16E/FY17E, which looks far too optimistic (Harit Shah, our IT lead is cutting his estimates to Rs 26.3/32.2 respectively).
- At Harit's revised estimates, Tech M still trades at 15x FY17E EPS, which is not cheap. Ergo, SELL.

HCL Tech (BUY)

- On the other hand, HCL Technologies (HCLT) is India's fourth-largest software company, with US$ 5.9bn FY15E revenue (June-ending fiscal year). The IT major has grown USD revenue at a 13% CAGR over FY12-FY15E (15% over FY11-FY14), significantly beating most of its listed peer set.
- The company's major differentiating factor vis-à-vis competition is its infrastructure management services (IMS) business, which is the second-largest in the industry after TCS (over US$ 2bn in FY15E). This segment has clocked a strong 27% USD revenue CAGR over FY12-FY15E (30% CAGR over FY11-FY14), well above company average.
- We expect HCLT to clock 13% USD revenue CAGR over FY15-FY17E, led by the IMS business, which we expect will clock a 16% USD revenue CAGR over the period. We like HCLT's strong positioning in the IMS segment and expect continued growth to drive further non-

linearity in the business (revenue/employee at US$ 59,726 in FY15E vs US$ 51,465 in FY12).

- We forecast a healthy 15% EPS CAGR over FY15-FY17E (Rs 49.7/55.6/65.8 in FY15E/16E/17E) with RoE at 29% in FY17E. HCLT currently trades at a more affordable 13.9x FY17E EPS (vs 16x historical average). We believe that given growth opportunities in the SMAC space, HCLT's strong positioning in IMS and steadily improving growth in the software services business (11% USD revenue CAGR vs 7% over FY12-FY15E), current valuation is reasonable in context of the solid earnings growth profile and healthy RoE (around 30%).
- We like HCLT given better-than-peers growth, higher RoE and reasonable valuations.

Idea Cellular (SELL)

- Vivekanand, our telecom lead, recommends an exit from Idea Cellular. Co has recently tided over a major crisis (namely the risk of possibly losing spectrum), thereby mitigating business continuity risks. However, this has come at a price : its balance sheet is now admittedly stretched (debt at 2.5x FY15 EBITDA).
- Reliance Jio's launch of telecom services by Dec-15 is likely to result in escalation of competitive pressures in the telecom sector, resulting in a muted 16% EBITDA CAGR over FY15-17E. However, PAT will decline at 2.5% CAGR during the same period. This is a much poorer show than the company's EBITDA and PAT CAGR of 33% and 66% over FY13-15. Idea trades at 7.6/6.2x FY16/17E EV/EBITDA, which we feel is rich, considering the impending overhang of R-Jio's launch.

Tata Communications (BUY)

- Tata Communications possesses a fifth of global submarine cables and is the largest wholesale bandwidth owner globally. The company is making a transition from its traditional role of a 'fat data pipes' seller to being a stickier managed services provider.
- It is focused on balance sheet deleveraging and is selling its loss-making South African subsidiary, Neotel to Vodacom for ZAR 7bn. TCom recently received regulatory approvals for this sale and the deal is likely to fructify by end-2015. This deal will clean up the company's balance sheet, with net debt declining from US$ 1.7bn to ~US$ 1.3bn.
- At CMP of Rs 420, TCom trades at 8.2/6.9/6.1x FY15/16/17E EV/EBITDA (assuming Neotel's sale at ZAR 7bn) against global average of 9-10x 1-year forward EV/EBITDA. We expect the company's EBITDA (ex-Neotel) to grow at 15% CAGR from FY15-17. Plus, operations are set to remain free cash flow positive on a sustained basis. This can easily result in re-rating to 7-8x FY17E EV/EBITDA.

HDFC sec MODEL PORTFOLIO

Sector	CMP	Stock	NIFTY wt (%)	Portfolio wt (%)	OW/(UW) bps
FINANCIALS			**31.5%**	**29.2%**	**-231**
	311	ICICI Bank	6.1%	8.1%	197
	260	State Bank Of India	2.8%	7.3%	452
	562	Axis Bank	3.3%	4.7%	143
	859	Indusind Bank	1.3%	3.9%	261
	147	Federal Bank		3.1%	
	258	Power Finance Corporation		2.2%	
IT SERVICES			**15.2%**	**15.4%**	**16**
	990	Infosys	6.7%	9.7%	298
	931	HCL Tech	1.8%	3.5%	175
	552	Wipro	1.2%	2.2%	94
FMCG			**9.2%**	**9.3%**	**14**
	310	ITC	5.9%	7.0%	108
	555	Pidilite		2.4%	
AUTOMOBILES			**9.6%**	**9.3%**	**-21**
	429	Tata Motors	2.8%	4.3%	154
	3,995	Maruti	1.8%	2.6%	80
	2,538	Hero Motocorp	1.1%	2.4%	132
OIL & GAS			**9.2%**	**11.5%**	**235**
	991	RIL	5.6%	5.7%	17
	729	HPCL		2.0%	
	309	ONGC	1.9%	1.9%	-1
	872	BPCL	0.8%	1.9%	114
INDUSTRIALS & UTILITIES			**8.2%**	**8.4%**	**16**
	1,788	L&T	5.0%	7.2%	223
	140	Power Grid Corporation Of India	1.0%	1.2%	12
MATERIALS & COMMODITIES			**6.7%**	**5.0%**	**-174**
	408	Coal India	1.8%	3.3%	152
	869	JSW Steel		1.7%	
PHARMACEUTICALS			**7.2%**	**5.1%**	**-215**
	850	Sun Pharma	3.1%	3.6%	44
	1,833	Lupin	1.5%	1.5%	-1
TELECOM & OTHERS			**3.3%**	**3.2%**	**-8**
	423	Tata Communications		1.7%	
	356	Zee Entertainment	0.7%	1.5%	81
Cash				**3.7%**	**367**
TOTAL			**100%**	**100%**	

Portfolio Return	NIFTY Return
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Mindtree (SELL)
Tech Mahindra (SELL)
HCL Tech (BUY)

Alpha idea
Big OW vs NIFTY
Big UW vs NIFTY

Idea Cellular (SELL)
Tata Communications (BUY)

HDFC sec MODEL PORTFOLIO : STOCK RETURNS

Stock	CMP	*Returns*	Portfolio wt
BPCL	872	***156%***	1.9%
Axis Bank	562	***135%***	4.7%
Indusind Bank	859	***109%***	3.9%
Pidilite	555	***107%***	2.4%
Lupin	1,833	***100%***	1.5%
Federal Bank	147	***64%***	3.1%
Coal India	408	***60%***	3.3%
ICICI Bank	311	***53%***	8.1%
Power Finance Corporation	258	***50%***	2.2%
L&T	1,788	***50%***	7.2%
Power Grid Corporation of India	140	***43%***	1.2%
State Bank Of India	260	***27%***	7.3%
Sun Pharma	850	***21%***	3.6%
Infosys	990	***19%***	9.7%
RIL	991	***16%***	5.7%
ONGC	309	***13%***	1.9%
HPCL	729	***9%***	2.0%
Zee Entertainment	356	***7%***	1.5%
Maruti	3,995	***7%***	2.6%
Wipro	552	***6%***	2.2%
Hero Motocorp	2,538	***6%***	2.4%
Tata Motors	429	***4%***	4.3%
HCL Tech	931	***0%***	3.5%
Tata Communications	423	***0%***	1.7%
ITC	310	***-5%***	7.0%
JSW Steel	869	***-17%***	1.7%

Rating Definitions

BUY	:	Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL	:	Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL	:	Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

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