HDFC securities

INSTITUTIONAL RESEARCH



# Model Portfolio Update

**HDFC sec Model Portfolio***

| Portfolio Return | NIFTY Return |
|---|---|
| 52.50% | 37.87% |
| OPF : 1,462 bps | |

** Launched 9 Oct 2013*

## 2015 : the year of alpha...

***As the new year dawns, investors in Indian stockmarkets recognise that the 'Modi reset' has been the highlight of 2014, but is now a fait accompli. It was driven by a surprisingly clear poll verdict (the weak, left of centre command-and-control dispensation was replaced with a pragmatic, right-wing regime). Equally, luck has played its part with falling crude prices helping to contain the fisc, CAD and inflation. The ~31% jump in the NIFTY over 2014 confirms that India's twin Achilles heels (poor governance and external dependence on oil) are on the mend, whether via fortuitous or crafted paths.***

***A further broad market reset is unlikely, ergo we believe 2015 holds alpha opportunities for the diligent investor.***

- Stock markets are emotional creatures, but we feel 2015 is going to be a year of reality checks. It is unlikely that a tide of events (and hence, emotions) of the magnitude witnessed over 2014 will be repeated easily. **For the broader market, a further re-rating is unlikely.**
- Instead, this may well be a year that mirrors incremental achievements (or stumbles) on the part of individual corporates. It is these deltas that hold utmost importance for us and it is here that rational alpha can be generated.
- This is because, unlike an election outcome or the price of crude, these incremental achievements can be rationally explored and confidently predicted for businesses. Earnings growth now matters more than perception changes (which are unlikely to undergo further resets). We feel that bottom-up, well-researched stock picking (backed by performance delivery) can earn significant alpha over 2015.
- We will also be mindful of policy changes, especially as expressed through the upcoming Union Budget and in pragmatic and mature responses to the holdups in Parliament.
- **With almost 1,500 bps OPF in fifteen months the HDFC sec Model Portfolio has performed well enough to warrant a close look (see inside for details).** We have mostly benefited from the reset, but now see scope to re-align the portfolio as 2015 kicks in.

**SUMMARY OF PORTFOLIO CHANGES**

- **EXIT :** TCS, Maruti, Shree Cement, Grasim, Bharti Infratel
- **REDUCE :** L&T, Powergrid
- **BUY :** Cholamandalam Finance, Tech Mahindra, Gulf Oil Lubricants, Orient Cement, JSW Steel, Carborundum Universal, SML Isuzu, Idea Cellular, MCX

**Dipen Sheth, *Head - Research***
dipen.sheth@hdfcsec.com
+91-22-6171-7339

**Parag Thakkar, *Head - Sales***
parag.thakkar@hdfcsec.com
+91-22-6171-7332

## FINANCIALS

- **Our tilt in FINANCIALS continues to favour quality rather than beta**. Darpin and Shivraj (our FINANCIALS team) will soon add **Cholamandalam Finance** to their coverage. Chola is well poised to capitalise on the imminent cyclical uptick in CV financing and is available for under 2x FY17E ABV for a high quality (1.8% RoA), well capitalised (13% Tier 1), fast-growing franchise.
- We think the falling interest rate cycle is better captured via large PSBs like SBI rather than bottom fishing for value in the smaller plays, which remain vulnerable to asset quality and capital adequacy issues.

## IT SERVICES

- **We are replacing TCS with Tech Mahindra.** Madhu (our IT lead) is most confident on USD revenue growth at TechM, assigning it a weight of 3.1% in the model. We retain our constructive view on **Mindtree** (whose valuations are now at par with Tech Mahindra's), while being persistent with our hope in **Wipro**'s recovery.
- **Infosys** remains a core holding, especially in view of US strength, relatively low exposure to Europe and the anticipated business recovery spearheaded by Vishal Sikka.

## OIL & GAS

- Our OIL & GAS portfolio remains unchanged even as we maintain our constructive theses on **Reliance** (core capex yields incremental profits even as telecom remains an overhang), **ONGC** (will benefit from pragmatic government policies on oil subsidy sharing, but faces falling profits in overseas operations) and **BPCL** (upstream investment kickers have played out in the stock, the downstream business is now ripe for rerating).

## FMCG

- Our initial Alpha pick **Pidilite** has doubled in the trailing fifteen months. We continue to hold half our original investment here, and are BUYing **Gulf Oil Lubricants** with a 2% weight in the HDFC sec Model Portfolio. This aggressive upstart in the lubes space is a direct beneficiary of falling crude (and hence, base oil) prices even as it mostly retains pricing power in branded lubricants. Post demerger from the erstwhile Gulf Oil Corp, this entity is now a pure play in branded lubes, posting steady volume growth in a hitherto sluggish market and offers further visibility on volume growth over FY15-17 in a business with high return ratios.
- We will look to ADD **ITC** should the upcoming budget spring a nasty excise hike and offer an opportunity to buy a fundamentally strong business.

## INDUSTRIALS

- Industrials typically offer the best plays on revival in the capex and infra cycle, as anticipated under the present regime. However, the initial uptick will be visible in consumables rather than asset creation as capacity utilisation is running low across industries. Abhinav, our INDUSTRIALS lead, has initiated on **Carborundum Universal** recently. With strong operating leverage likely in its domestic business and restructuring of overseas operations, CUMI offers an early cycle opportunity. We are assigning it a 1.5% weight by trimming both **Powergrid** and **L&T**.

## AUTOS

- This is a space where we are building a somewhat contrarian mix. After a 90% gain over 2014, we think the best gains have already been made at **Maruti**. As tax reliefs are withdrawn, concerns may resurface on the arrangement with its parent over the Gujarat facility and volume growth can sag a bit with falling consumer sentiment. We think the stock may underperform hereon.

- Navin, our AUTOs lead, argues for a significant OW in **Tata Motors** instead. He feels that JLR's volume and margin levers accruing from the China JV will keep earnings growth in good stead. An initial fall in margins is actually an opportunity.
- Our alpha idea in this space is **SML Isuzu**, an apparently marginal player in the LCV/MCV space straddling both goods and passenger segments. This is actually a high pedigree business that is steadily increasing marketshare from mid single-digit levels. Capacity utilisation is low, margins are set for an uptick and valuations at under 10x on EV/e are enticing. Especially since the balance sheet is debt free and capex needs are minimal.

**MATERIALS**

- We have more than doubled our money in **Shree Cement** since we launched the HDFC sec Model Portfolio in Oct-13. Our exit here is driven purely by high valuations (~$200/t on FY16 exit basis). Our patience on Grasim's holdco discount has worn thin.
- Instead we prefer to season this part of the HDFC sec Model Portfolio with **Orient Cement** (still at under 100$/t and new levers under a dynamic management; we think this story is far from over) and **JSW Steel.** For the latter, capital allocation is set to improve with the shelving of the Bengal project and higher visibility on domestic brownfield capacity additions). Margin levers continue to play out at Dolvi, even as raw material (iron ore) pains have peaked. Ankur's TP of Rs 1,475 assigns 6.5x EV/e and is fair given the likely jump in EBITDA/t over FY14-16 from $113 to 136.

  Both JSW and Orient are operating cost leaders in their respective spaces and are hence relatively immune to commodity price shocks.

**TELECOM, MEDIA & NEW AGE BUSINESSES**

- Vivekanand, our telecom lead, says the big money has already been made on **Bharti Infratel**, where we are now making a hugely profitable EXIT. Cash flow yield has halved to 4% and valuation has risen to 10.5x EV/e on FY16 basis. Fresh triggers are unlikely especially as higher spectrum availability will spur telcos to incrementally spend on backhaul and fibre for delivering data, rather than increase tower sites.
- Instead, **Idea Cellular** offers an attractive entry point. We prefer to BUY his view that spectrum challenges are overstated. Spectrum availability is being increased and is unlikely to lead to as ugly a scramble as implied in Idea's CMP. After building in Rs 206 bn of spectrum liability in the upcoming auctions, Idea trades for a comfortable 6.5x EV/e and continues to be India's fastest growing cellular operator, with data levers in place.
- Vivek is also poised to initiate soon on **MCX**, where the business has actually emerged stronger after the 'fire in the house'. We anticipate a board position for Kotak Bank, the largest shareholder, now at 15%. Despite adverse regulatory conditions such as the backbreaking CTT and restrictions on banks/FIIs trading in commodity futures, MCX retains ~80% marketshare in the commodities futures market in India and trades for a mere 3x FY15e BV. This holds the hope of rerating dramatically if MCX stays the course. We are convinced the change in ownership and management is positive for shareholders.

## HDFC sec MODEL PORTFOLIO

| Sector | CMP | Stock | NIFTY wt (%) | Portfolio wt (%) | OW/(UW) bps |
|---|---|---|---|---|---|
| **FINANCIALS** | | | **31.4%** | **33.5%** | **211** |
| | 353 | ICICI Bank | 7.3% | 9.2% | 188 |
| | 312 | State Bank Of India | 3.5% | 8.8% | 532 |
| | 502 | Axis Bank | 3.0% | 4.2% | 118 |
| | 803 | Indusind Bank | 1.2% | 3.6% | 239 |
| | 300 | Power Finance Corporation | | 2.5% | |
| | 152 | Federal Bank | | 3.2% | |
| | 474 | Cholamandalam Investment and Finance | | 2.0% | |
| **IT SERVICES** | | | **15.8%** | **15.7%** | **-4** |
| | 1,971 | Infosys | 6.8% | 7.2% | 39 |
| | 2,592 | Tech Mahindra | 1.4% | 3.1% | 170 |
| | 554 | Wipro | 1.3% | 2.2% | 89 |
| | 1,282 | Mindtree | | 3.2% | |
| **OIL & GAS** | | | **9.3%** | **8.7%** | **-64** |
| | 891 | RIL | 5.3% | 5.2% | -11 |
| | 341 | ONGC | 2.2% | 2.1% | -12 |
| | 646 | BPCL | 0.6% | 1.4% | 82 |
| **FMCG** | | | **10.5%** | **8.8%** | **-174** |
| | 368 | ITC | 7.4% | 4.5% | -291 |
| | 543 | Pidilite | | 2.3% | |
| | 514 | Gulf Oil Lubricants India | | 2.0% | |
| **INDUSTRIALS & UTILITIES** | | | **7.9%** | **8.7%** | **76** |
| | 1,497 | L&T | 4.4% | 6.0% | 166 |
| | 178 | Carborundum Universal | | 1.5% | |
| | 138 | Power Grid Corporation Of India | 1.1% | 1.2% | 6 |
| **AUTOMOBILES** | | | **9.3%** | **9.5%** | **15** |
| | 496 | Tata Motors | 3.2% | 5.0% | 180 |
| | 3,103 | Hero Motocorp | 1.3% | 3.0% | 166 |
| | 817 | SML Isuzu | | 1.5% | |
| **MATERIALS & COMMODITIES** | | | **6.9%** | **7.1%** | **21** |
| | 384 | Coal India | 0.9% | 3.1% | 221 |
| | 153 | Orient Cement | | 2.0% | |
| | 1,048 | JSW Steel | | 2.0% | |
| **PHARMACEUTICALS** | | | **6.1%** | **4.9%** | **-115** |
| | 1,428 | Lupin | 1.2% | 1.2% | -7 |
| | 826 | Sun Pharma | 2.2% | 2.1% | -11 |
| | 445 | Alembic Pharmaceuticals | | 1.6% | |
| **TELECOM & OTHERS** | | | **2.7%** | **3.0%** | **28** |
| | 154 | Idea Cellular | | 1.5% | |
| | 841 | Multi Commodity Exchange | | 1.5% | |
| **Cash** | | | | **0.1%** | **6** |
| **TOTAL** | | | **100%** | **100%** | |

| Portfolio Return | NIFTY Return |
|---|---|
| 52.50% | 37.87% |
| OPF : 1,462 bps | |

*Launched 9 Oct 2013*

***Cholamandalam (BUY)***

***TCS (EXIT)***

***Tech Mahindra (BUY)***

**Alpha idea**

**Big OW vs NIFTY**

**Big UW vs NIFTY**

***Gulf Oil Lubricants (BUY)***

***L&T (REDUCE)***

***Power Grid (REDUCE)***

***Maruti (EXIT)***

***SML Isuzu (BUY)***

***Shree Cement, Grasim (EXIT)***

***Orient Cem, JSW Steel (BUY)***

***Bharti Infratel (EXIT)***

***Idea Cellular (BUY)***

***MCX (BUY)***

## HDFC SEC MODEL PORTFOLIO : STOCK RETURNS

| Stock | CMP | *Returns* | Portfolio wt |
|---|---|---|---|
| Axis Bank | 502 | **110%** | 4.2% |
| Pidilite | 543 | **103%** | 2.3% |
| Indusind Bank | 803 | **95%** | 3.6% |
| Federal Bank | 152 | **91%** | 3.2% |
| BPCL | 646 | **90%** | 1.4% |
| State Bank Of India | 312 | **83%** | 8.8% |
| Mindtree | 1,282 | **79%** | 3.2% |
| Power Finance Corporation | 300 | **75%** | 2.5% |
| ICICI Bank | 353 | **73%** | 9.2% |
| Lupin | 1,428 | **56%** | 1.2% |
| Alembic Pharmaceuticals | 445 | **51%** | 1.6% |
| Coal India | 384 | **51%** | 3.1% |
| Power Grid Corporation of India | 138 | **42%** | 1.2% |
| Hero Motocorp | 3,103 | **30%** | 3.0% |
| Tata Motors | 496 | **21%** | 5.0% |
| Sun Pharma | 826 | **32%** | 2.1% |
| L&T | 1,497 | **25%** | 6.0% |
| ONGC | 341 | **25%** | 2.1% |
| Infosys | 1,971 | **24%** | 7.2% |
| Wipro | 554 | **7%** | 2.2% |
| ITC | 368 | **6%** | 4.5% |
| RIL | 891 | **4%** | 5.2% |
| Tech Mahindra | 2,592 | **0%** | 3.1% |
| Orient Cement | 153 | **0%** | 2.0% |
| Cholamandalam Investment and Finance | 474 | **0%** | 2.0% |
| Gulf Oil Lubricants India | 514 | **0%** | 2.0% |
| JSW Steel | 1,048 | **0%** | 2.0% |
| Carborundum Universal | 178 | **0%** | 1.5% |
| Idea Cellular | 154 | **0%** | 1.5% |
| SML Isuzu | 817 | **0%** | 1.5% |
| Multi Commodity Exchange | 841 | **0%** | 1.5% |

**Disclosure:**

We, Dipen Sheth & Parag Thakkar, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.
Research Analyst or his/her relative or HDFC Securities Ltd. does not have any financial interest in the subject company. Also Research Analyst or his relative or HDFC Securities Ltd. or its Associate may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Further Research Analyst or his relative or HDFC Securities Ltd. or its associate does not have any material conflict of interest.
Any holding in stocks – No

**Disclaimer:**

This report has been prepared by HDFC Securities Ltd and is meant for sole use by the recipient and not for circulation. The information and opinions contained herein have been compiled or arrived at, based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This document is for information purposes only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments.
This report is not directed to, or intended for display, downloading, printing, reproducing or for distribution to or use by, any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject HDFC Securities Ltd or its affiliates to any registration or licensing requirement within such jurisdiction.
If this report is inadvertently send or has reached any individual in such country, especially, USA, the same may be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published for any purposes without prior written approval of HDFC Securities Ltd .
Foreign currencies denominated securities, wherever mentioned, are subject to exchange rate fluctuations, which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk.
It should not be considered to be taken as an offer to sell or a solicitation to buy any security. HDFC Securities Ltd may from time to time solicit from, or perform broking, or other services for, any company mentioned in this mail and/or its attachments.
HDFC Securities and its affiliated company(ies), their directors and employees may; (a) from time to time, have a long or short position in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.
HDFC Securities Ltd, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.
HDFC Securities Ltd and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report, or may make sell or purchase or other deals in these securities from time to time or may deal in other securities of the companies / organizations described in this report.
HDFC Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.
HDFC Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction in the normal course of business.
HDFC Securities or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither HDFC Securities nor Research Analysts have any material conflict of interest at the time of publication of this report. Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. HDFC Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.
Research entity has not been engaged in market making activity for the subject company. Research analyst has not served as an officer, director or employee of the subject company. We have not received any compensation/benefits from the subject company or third party in connection with the Research Report.

**HDFC securities**
**Institutional Equities**
Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,
Senapati Bapat Marg, Lower Parel, Mumbai - 400 013
Board : +91-22-6171 7330    www.hdfcsec.com