

# Strategy Memo

January 2024

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## Markets Continue to Remain Strong

Indian markets continued their strong run in Dec'23 with Nifty50 witnessing a 7.94% return in the month. Moreover, the broader BSE500TR Index, which is the benchmark for both our Pure Growth and Pure Contra strategies, reported 8.03% returns over the same period, and thereby outperformed the Nifty50 Index marginally, which otherwise delivered quite strong returns.

Dec'23 was challenging for both our Pure Growth and Pure Contra strategies as they underperformed their benchmark index, BSE500 TR, for the month. This underperformance was influenced by significant movements observed in Adani group stocks, with most companies in the group gaining around 20% or more, notably Adani Green, which surged by 55%. Additionally, the performance of Public Sector Undertakings (PSUs) was notable, delivering a return of 15.3% during the month, post the assembly election results announcement and our exposure to these opportunities was not substantial.

In Dec'23, both our Pure Growth and Pure Contra strategies underperformed their benchmark by 635bps and 345bps respectively (net of expenses). However, it's important to note that both our Pure Growth and Pure Contra strategies have continued to significantly outperform their benchmark – the BSE500 TR index by a huge margin of 871bps and 1155bps respectively for the year (net of expenses).

In Dec'23, we observed that all major sectors posted positive returns for the month with Utilities, Industrials, Materials, Energy, and Real Estate outperforming the index while Financials, Consumer Discretionary, Communication Services, and Healthcare underperformed. Stocks in Pure Growth strategy showcasing notable outperformance were RBL Bank, Varun Beverages, Ultratech Cement, and HDFC Bank. On the flip side, One97 Communications, Praj Industries, KDDL, Religare Enterprises and CIE Automotive were amongst the main laggards.

In our Pure Contra strategy stocks outperforming the markets included TVS Holdings, RBL Bank, Bank of Baroda, GlaxoSmithKline Pharma, SBI, Aarti Industries, Voltamp Transformers, and Suven Pharma, amongst others. On the other hand, Jain Irrigation, Thomas Cook, KDDL, Kirloskar Brothers, SBI Life and CIE Automotive weighed on the overall performance of our portfolio.

In this strategy note, we will discuss one of the stocks that we have recently added to our 'Pure Growth and Pure Contra' strategy – 'HPCL'.



*Nishit, through his diverse experience in both Buy side and Sell side firms brings in a fresh perspective on markets at Axis Securities. As Fund Manager, he is responsible for generating superior risk adjusted returns for customers as per their mandate.*

*Nishit has more than 18 years of experience in the financial services industry and has worked with various companies like ING Investment Management, Kotak Mahindra Bank, Elara Capital, Reliance Securities, AnandRathi, MotilalOswal Financial Services etc.*

### **Complete Energy Behemoth**

HPCL is an energy behemoth that owns and operates two refineries with a combined capacity of 17.8 MMTPA at both East Coast (Vaizag) and West Coast (Mumbai) on a standalone basis. It is also a Joint venture partner in two other refineries i.e. 11.3 MMTPA HMEL refinery and a 15 MMTPA MRPL refinery. Apart from the refining business, the company also has a huge fuel marketing network covering most of the country through more than 21,000 retail fuel stations, over 6,000 LPG distributors, 300+ lubricant distributors, and more than 1,500 CNG outlets. The company also owns 7 Exploration and Production blocks for oil and gas through its 100% owned subsidiary known as Prize Petroleum Company Ltd.

### **The company to Double EBITDA by FY28**

Over the next three years, HPCL's several investments are expected to mature, which will potentially double its consolidated EBITDA from the FY22 levels. It is on track to complete the Vaizag refinery expansion and upgradation by FY24 end or H1FY25. This upgradation can add \$3-4/barrel to its refining margins. Its Greenfield Rajasthan refinery, with an expected Nelsen complexity index of 17, is expected to be commissioned by mid-CY24 while its pet-chem project at the same site is expected to be commissioned by early 2025. This expansion and modernization at Visakhapatnam (Vizag) will enable the company to process challenging crude from Latin America at both sites. This capability can contribute to incremental margins, particularly in the case of pricing abnormalities.

HPCL also plans to participate in the entire gas value chain when it commissions its LNG terminal with a capacity of 5 mntpa in 2024. This will help its 23 new owned areas where it has more than 200 CNG stations. The company also plans to have its own renewal energy portfolio of 2.4 GW by 2027.

The company is guiding for its consolidated EBITDA to cross \$5 Bn if one factor in normalized margins (mid-cycle margin) by FY28 from \$2 Bn in FY22 and an EBITDA loss in FY23 due to the above-mentioned events.

### **Strong Q2FY24 results; FY24 Expected to be the Year of Record Profitability**

HPCL reported strong Q2FY24 results with robust marketing throughput at 10.7 MMT (up 3% YoY) and marketing margins at ~Rs 5.9 per litre (up 8.5x YoY). On the refining front, the company's throughput for the quarter stood at 5.8mmt (up 28% YoY) with a reported GRM of \$13.3/barrel. The company thus reported overall EBITDA for the quarter at Rs 81.2 Bn vs. a loss of Rs 8.9 Bn reported in Q2FY23.

After a robust H1, H2FY24 has been better than expected so far for OMCs (Oil Marketing Companies), except for some intermediate inventory losses in Q3FY24. If oil prices stabilize at \$80-85/bbl, it would mean strong core earnings in Q4FY24. We estimate FY24 to be a record year for all OMC earnings. On a standalone basis, HPCL is expected to report Rs 231 Bn of EBITDA and Rs 121 Bn of adjusted PAT.

### **Financials and Valuations**

On a standalone basis, we expect HPCL's EBITDA to increase by 17% CAGR from FY22 to FY26E, reaching Rs 191 Bn in FY26E from Rs 102 Bn in FY22 and a loss of Rs 113 Bn in FY23. We expect the refining throughput to increase at a CAGR of 17% from FY22 to FY26E on account of capacity expansion at Vaizag. We also expect marketing volumes to witness a growth of 6% CAGR during the same period. We further expect the company's Core GRMs to stabilize at \$9.5/barrel in FY26 on account of improvement in the configuration of the Vaizag refinery while marketing margins are slated to stabilize at Rs4.9 per litre in FY26 from Rs 6.2 per litre which we expect the company to report in FY24.

The stock is trading at EV/EBITDA (standalone) of 5.7x FY26E and a PER of 6.7x FY26E (standalone EPS) after reducing the Rs 100/share value of the company's stake in HMEL and other listed investments. We don't give any value to the Rajasthan integrated refinery which is expected to be commissioned in phases starting from CY24 onwards. We believe that there is a strong possibility of the stock getting re-rated once the refinery starts getting commissioned.

## Risk

- Petrol and Diesel price cuts before the National Elections may affect marketing margins. However, any price cut in petrol below Rs 5/litre should not be a major concern;
- Delay in commissioning of Rajasthan refinery and possible cost overruns;
- Significant increase in oil prices due to geopolitical events.

Standalone (Y/E, March 31)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Revenues (RsBn)	2,688	2,330	3,497	4,348	4,285	4,111	4,221
EBITDA (RsBn)	60	159	102	-113	231	169	191
Reported PAT (RsBn)	26	107	64	-90	129	70	78
Adjusted PAT (RsBn)	20	105	59	-132	121	70	78
Reported EPS (Rs)	17.3	73.4	45.0	-63.2	90.7	49.6	54.9
Adjusted EPS (Rs)	14.2	74.2	41.7	-93.1	85.5	49.6	54.9
Adjusted PE (x)	26.1	5.0	8.9	-4.0	4.3	7.4	6.7
PB (x)	1.8	1.4	1.4	1.9	1.4	1.3	1.1
EV/EBITDA (x)	15.0	5.6	9.2	-10.1	4.9	6.6	5.7
RoE	9%	29%	17%	-32%	35%	17%	17%
RoCE	3%	12%	6%	-13%	14%	8%	9%
Debt: Equity (x)	1.5	1.2	1.2	2.5	1.9	1.6	1.4
Dividend Yield	3%	6%	4%	0%	8%	5%	5%

**Happy Investing!**

Nishit Master

## Summary of Portfolio Changes Made in Dec'23

In Dec'23, we made the following changes to both our portfolios to factor in the changing market dynamics.

### Pure Growth Strategy changes

Scrip Name	Action	Weight	Remark
Bandhan Bank Limited	BOUGHT	4.00%	Growth prospects are improving while valuations are attractive
Kesoram Industries Limited	BOUGHT	3.00%	Proxy to Ultratech at a significant discount
TTK Prestige Limited	SOLD	1.69%	Continues to be a laggard
Bharti Airtel (Partly Paid Up) Limited	SOLD	0.30%	Portfolio adjustment
Hindustan Petroleum Corporation Ltd	BOUGHT	3.00%	Stronger growth prospects available at cheap valuations

### Pure Contra Strategy Changes

Scrip Name	Action	Weight	Remark
Hindustan Petroleum Corporation Ltd	BOUGHT	3.00%	Stronger growth prospects available at cheap valuations
REC Limited	BOUGHT	3.00%	Strong category will help the specialist lender
Thomas Cook (India) Limited	BOUGHT	2.00%	Added to existing position in the OFS
Welspun Corporation Limited	SOLD	3.10%	Rich valuations for a cyclical business

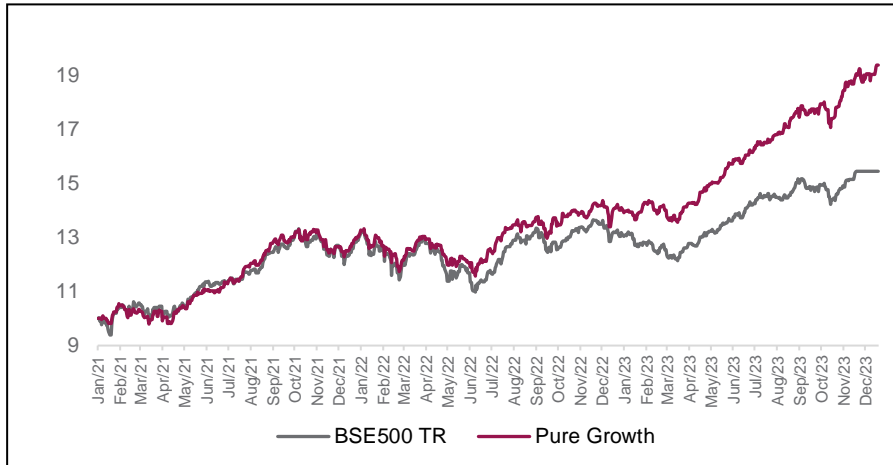
## MANAGED ACCOUNTS

## Axis Pure Growth

29<sup>th</sup> Dec 2023

**Investment Objective:** Axis Pure Growth strategy focuses on parameters comprising sustainable earnings growth, quality, and low volatility. The core investment styles are growth and quality investing while low volatility and alpha investing are other key styles employed depending on the macroeconomic regime.

## Cumulative Performance: Returns



## Annual Performance (%)

Year	Growth	BSE500 TR
2023 (YTD)	35.2%	26.5%
2022	8.7%	4.8%
2021 *	25.5%	25.8%

\*effective 13 Jan 2021

## Portfolio Performance

Particulars	1 month	3 months	6 months	1 year	2 years*	Since inception**
<b>Portfolio</b>	1.69%	8.59%	19.81%	35.26%	21.27%	22.93%
<b>BSE500 TR</b>	8.03%	12.35%	18.51%	26.55%	15.15%	18.78%

(\*CAGR Returns) (\* Net of all charges) (\*\*Since 13th Jan. 2021)

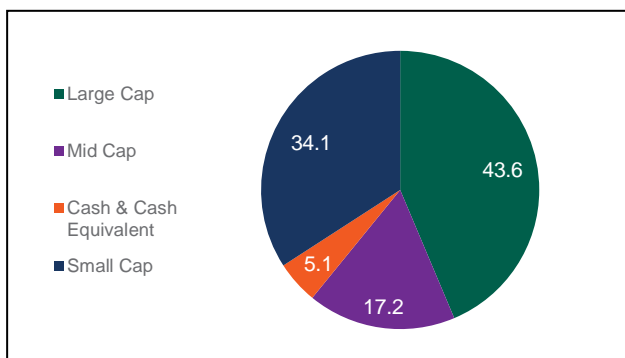
## Risk Assessment

	Growth	BSE500 TR
Sharpe Ratio	1.21	0.81
Volatility	13.0%	14.4%
Portfolio Beta	0.77	1
Max Drawdown	-13.2%	-17.6%
Information Ratio	0.55	
Average Turnover Ratio	1.50	

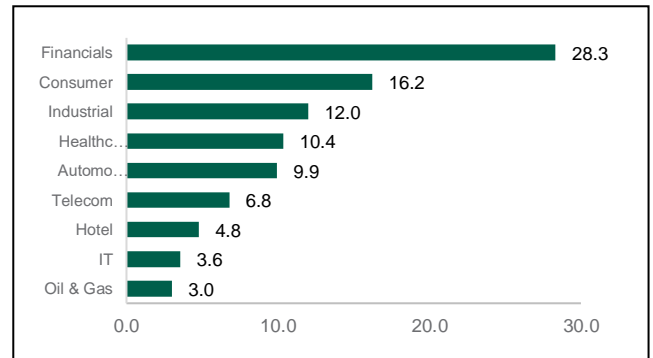
## Key Portfolio Ratios

	Growth	BSE500 TR
PE	32.57	27.85
PB	4.20	3.42
ROE	12.90%	12.28%
Dividend Yield	0.70%	1.11%

## Market Capitalization



## Sector Allocation



## MANAGED ACCOUNTS

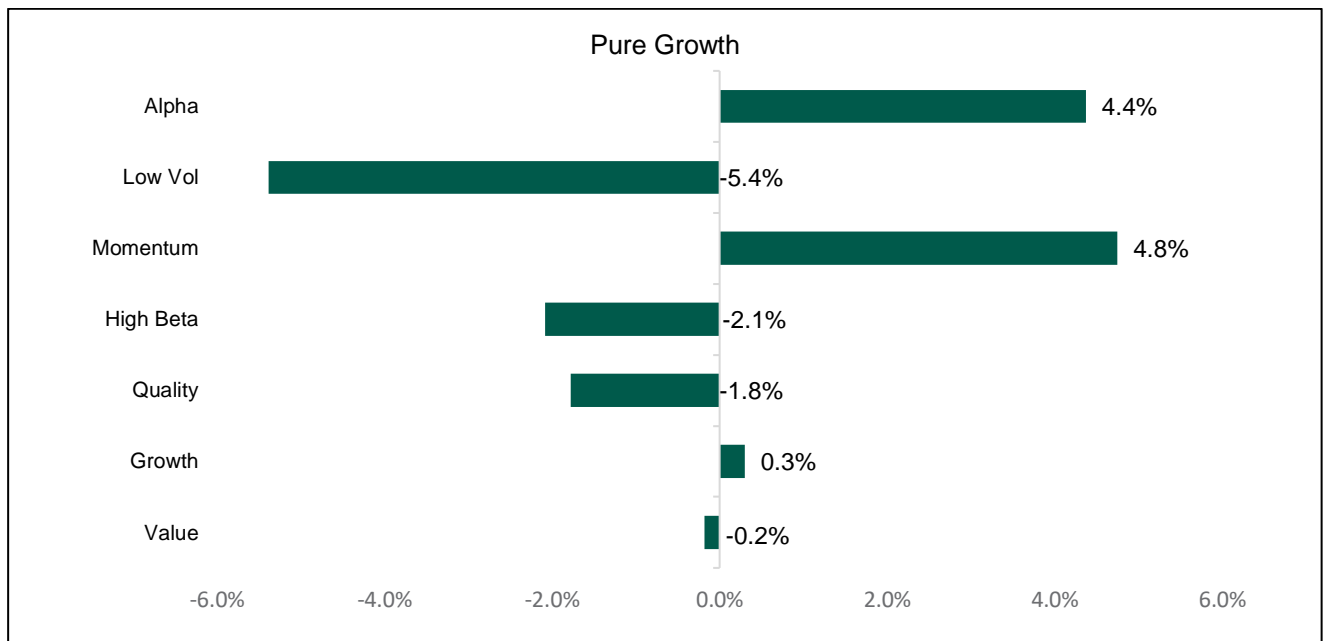
## Top 10 Holdings

Scrip Name	Market Cap (Cr)	Weight
ICICI Bank	6,92,482	7.3%
RBL Bank	17,247	7.0%
Bharti Airtel Ltd	6,15,222	6.8%
Sun Pharmaceutical Indus	3,15,013	6.4%
Varun Beverages Ltd	1,63,701	6.3%
Maruti Suzuki India Ltd	3,14,884	5.3%
Gillette India Ltd	21,220	5.2%
Indian Hotels Co Ltd	65,736	4.8%
KDDL Ltd.	3,543	4.8%
CIE Automotive India Ltd	18,488	4.7%

## Portfolio Characteristics

	Growth
Number of constituents	21
Mcap Largest (Cr)	12,83,775
Mcap Smallest (Cr)	3,543
Mcap Average (Cr)	1,99,840
Mcap Median (Cr)	47,879

## Factor Box



The Factor Box provides relative factor exposure vis-à-vis a given benchmark. For instance, if the Growth factor exposure in a portfolio is 23% and the Growth factor exposure of the Benchmark is 20%, it indicates that your portfolio is "Overweight" on Growth with respect to the benchmark. A positive Value in the above Factor represents that the given portfolio is Overweight in the factor with respect to the benchmark. Similarly, a negative value would represent that the given portfolio is underweight in the factor with respect to the benchmark.

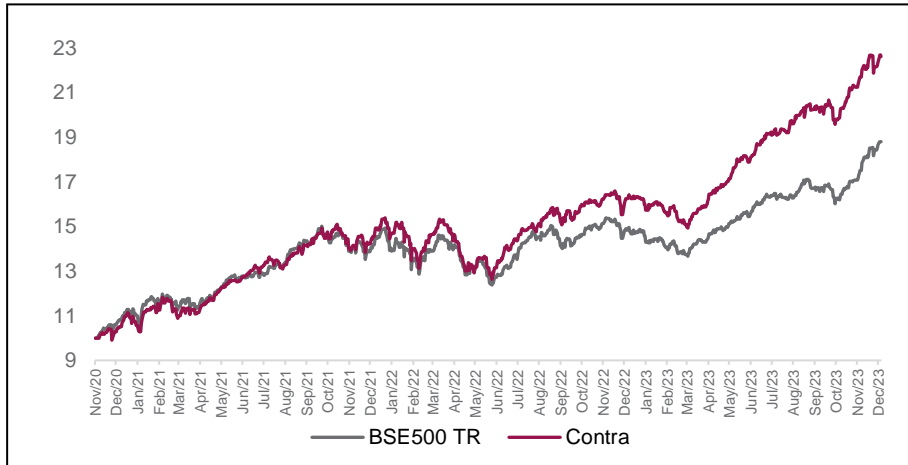
## MANAGED ACCOUNTS

## Axis Pure Contra

29<sup>th</sup> Dec 2023

**Investment Objective:** Axis Pure Contra investment strategy focuses on three primary investment styles – Value, Momentum-Alpha, and Special situations investing. Value, Alpha-Momentum form the core factors while Special Situation investing is employed as a satellite factor.

## Cumulative Performance: Returns



## Annual Performance (%)

Year	Contra	BSE500 TR
2023 (YTD)	38.1%	26.5%
2022	9.7%	4.8%
2021*	36.5%	31.0%

\*effective 01 Jan 2021

## Portfolio Performance

Particulars	1 month	3 months	6 months	1 year	2 years*	3 years*	Since inception**
<b>Portfolio</b>	4.59%	11.24%	24.06%	38.09%	23.09%	27.67%	28.44%
<b>BSE500 TR</b>	8.03%	12.35%	18.51%	26.55%	15.15%	20.41%	22.75%

(\*CAGR Returns) (\* Net of all charges) (\*\*Since 27th Nov, 2020)

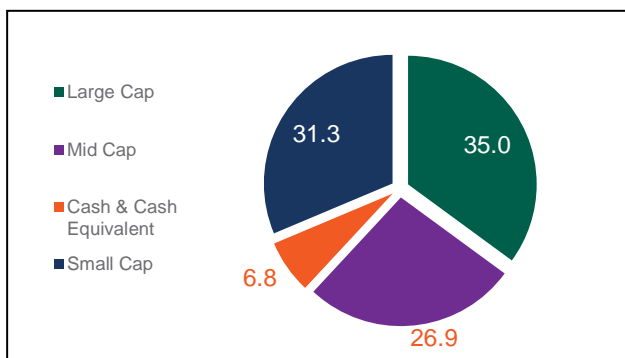
## Risk Assessment

	Contra	BSE500 TR
Sharpe Ratio	1.39	1.08
Volatility	15.3%	14.3%
Portfolio Beta	0.96	1
Max Drawdown	-17.9%	-17.6%
Information Ratio	0.86	
Average Turnover Ratio	2.00	

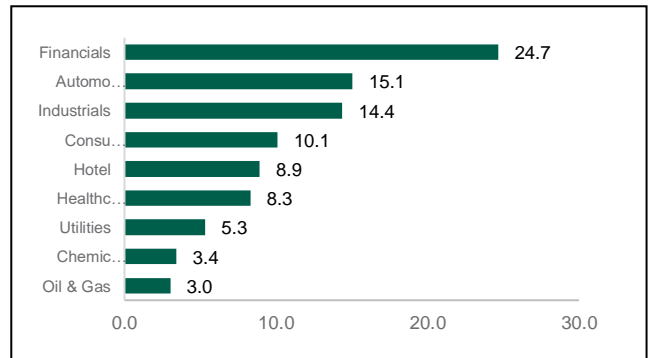
## Key Portfolio Ratios

	Contra	BSE500 TR
PE	17.74	27.85
PB	2.98	3.42
ROE	16.78%	12.28%
Dividend Yield	1.79%	1.11%

## Market Capitalization



## Sector Allocation





## MANAGED ACCOUNTS

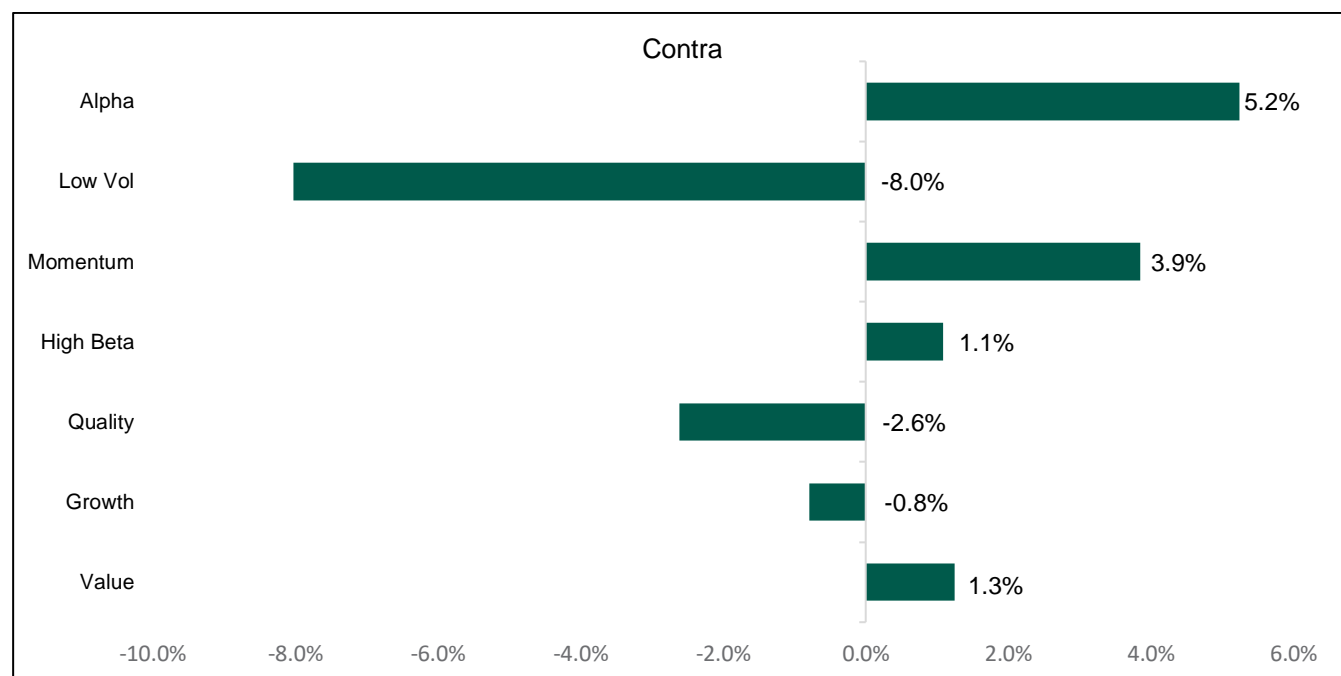
## Top 10 Holdings

Scrip Name	Market Cap (Cr)	Weight
ITC	5,94,338	5.5%
Power Grid Corp Of India	2,24,563	5.3%
RBL Bank Ltd	17,247	5.3%
State Bank Of India	5,73,629	5.3%
KDDL Ltd	3,543	4.6%
Thomas Cook (India) Ltd	7,131	4.5%
Mahindra & Mahindra Ltd	2,04,150	4.5%
Indian Hotels Co Ltd	65,736	4.4%
CIE Automotive India Ltd	18,488	4.3%
ICICI Bank Ltd	6,92,482	4.0%

## Portfolio Characteristics

	Contra
Number of constituents	25
Mcap Largest (Cr)	6,92,482
Mcap Smallest (Cr)	3,543
Mcap Average (Cr)	1,47,289
Mcap Median (Cr)	58,926

## Factor Box



The Factor Box provides relative factor exposure vis-à-vis a given benchmark. For instance, if the Growth factor exposure in a portfolio is 23% and the Growth factor exposure of the Benchmark is 20%, it indicates that your portfolio is “Overweight” on Growth with respect to the benchmark. A positive Value in the above Factor represents that the given portfolio is Overweight in the factor with respect to the benchmark. Similarly, a negative value would represent that the given portfolio is underweight in the factor with respect to the benchmark.

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