Market outlook

Last month witnessed rollercoaster market movement with the first half mirroring the pain on the back of concerns such as China and Fed uncertainty over the quantum of rate hike coupled with sharp selling by FIIs. However, the market, post the Union Budget witnessed a strong recovery as market participants lauded the government's commitment towards fiscal consolidation. The government, in the Union Budget, continued its effort to boost investment in agriculture, social sector, infrastructure and employment generation, on the one hand, while sticking to the fiscal consolidation path, on the other. We continue to be bullish on domestic oriented sectors like automobiles, cement, capital goods . Defensive sectors like FMCG, pharma and IT could perform in line with broader markets. We are negative on banks, metals and oil & gas. Post the Q3FY16 results and incorporating the requisite index changes, we expect Sensex EPS to decline 3.5% YoY to ₹ 1311 and then showcase back ended recovery with 18.9% YoY growth in FY17E to ₹ 1559, respectively.

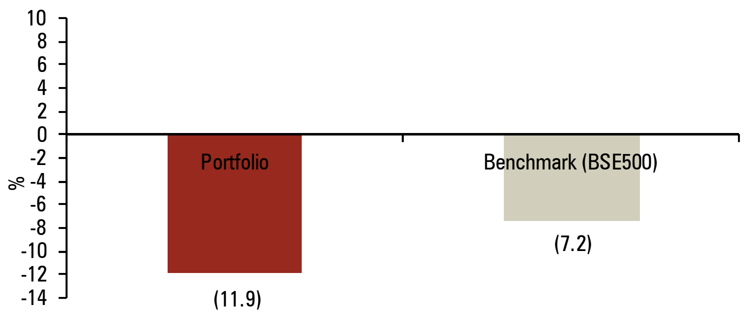
What's in/out : No change

Top Picks

Company	Recommended Price	CMP	Market Cap	P/E (x)		P/BV (x)		RoE (%)	
	(₹)	(₹)	(₹ crore)	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
ITC	343	320	257000	25.7	22.1	8.3	8.0	32.4	36.2
Pidilite Industries	587	600	30800	39.9	37.9	11.7	10.3	29.3	27.2
Supreme Industries	694	757	9600	45.1	22.9	7.2	6.0	15.9	26.0
Bharat Forge	1,179	820	19172	26.5	21.4	5.2	4.6	19.8	21.3
Concor	1,653	1,230	23950	20.4	17.0	2.7	2.4	13.1	13.7
Voltas	331	245	8100	22.1	19.7	3.5	3.2	15.4	16.3
Timken India	602	442	3005	34.2	26.2	6.2	5.3	19.0	20.4
Star Ferro Cement	158	107	2380	20.2	11.1	2.8	2.3	14.1	20.9
Inox Leisure	232	211	2035	38.1	25.7	2.7	2.4	7.4	9.4

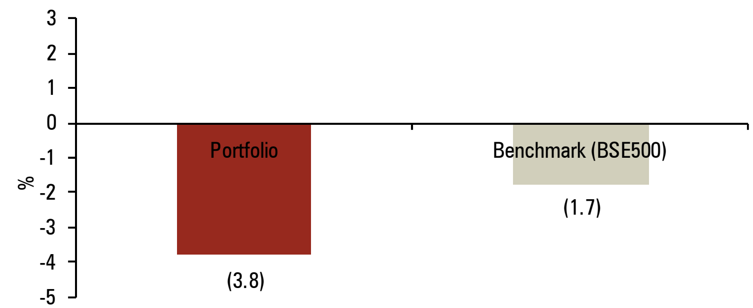
Performance* so far …

Portfolio performance since inception (June 2015)



- The portfolio performance (during July 2015 – January 2015) was driven by PVR (21%), Indraprastha Gas (15%), Bata India (10.2%) and Torrent Pharma (9.1%). Over the period, the portfolio was mainly impacted by the underperformance in MRPL (-28%) and Bharat Forge (-28%). Since inception, we have booked profit in PVR, Bata India, Torrent Pharma, L&T, Maruti Suzuki, Dr Reddy's and Mahindra & Mahindra
- The date of commencement was June 5, 2015

Portfolio performance since last update (February 2015)



- The portfolio underperformance during February 2015 was mainly due to weak global sentiments. Voltas and Star Ferro impacted returns for the month. The impact was partially offset by the positive performance in Supreme Industries and Pidilite. During the month, we have made no changes in our portfolio

Source: Reuters, ICICIdirect.com Research

Pidilite Industries (PIDIND)

- Pidilite is a dominant play in India's growing adhesive and industrial chemical market with a market share of ~70% in its leading brand categories in the organised segment. The company's two major segments, consumer & bazaar (C&B) and speciality industrial chemical have grown at a CAGR of ~19% and ~13% (standalone), respectively, in FY10-15. C&B segment contributes ~82% to standalone revenue. This segment has grown mainly driven by the adhesive and sealants segments that contributed ~50% to the company's C&B segment revenue (FY15)
- The specialty industrial segment contributes ~18% to standalone revenue. This segment grew at 13% CAGR (FY10-15) mainly driven by demand growth from packaging, cigarettes, stickers, labelling, footwear, etc. The specialty industrial segment has three major sub-segments: industrial adhesive, industrial resins and organic pigments & preparations. We have modelled industrial segment revenue growth at ~13% CAGR (FY15-18E) led by a pick-up in demand of industrial adhesives & resins
- We estimate lower revenue CAGR of ~12% while a sharp margin expansion of ~500 bps for FY15- 18E may be supported by benign raw material prices. Also, a recovery in margin coupled with strong return ratios would justify the company's current valuation. At the CMP, the stock is trading at 40x FY16E & 38x FY17E earnings. We believe the stock is a potential candidate for re-rating considering its ability to maintain its market share and enjoy the benefit of lower raw material prices

Key Financials		FY15	FY16E	FY17E
Net Sales	₹ crore	4844.1	5350.7	5993.9
Growth	%	13.1	10.5	12.0
EBITDA margin	%	16.1	20.9	21.1
PAT	₹ crore	512.6	723.9	824.4
PAT growth	%	18.9	41.2	13.9
P/E	x	57.3	40.6	35.6
P/BV	x	13.1	11.3	9.9
RoNW	%	23.1	27.8	27.7
RoCE	%	29.7	38.0	38.0

ITC (ITC)

- ITC is the largest cigarette manufacturer (~75% volume share in FY12) & among the largest paperboard manufacturing companies in India. It also has the second largest hotel chain in the country. ITC's emerging strength is the FMCG (others) business led by robust growth of 20.1% CAGR (FY09-15) & strong brands like Aashirvaad, Sunfeast, Bingo, Vivel, Fiama Di Wills, Superia, Classmate, Paperkraft, Wills Lifestyle & John Players
- ITC has been aggressive in recent times to shape itself into India's leading FMCG company. The company has set before itself an ambitious vision of achieving a topline of ₹ 100000 crore from non-cigarette FMCG business by 2030. This translates into a CAGR of 17.4% in this segment in FY15-30E. After starting the FMCG business from scratch in 2003, it had a topline of ₹ 9038 crore from this segment in FY15. Further, ITC's foods portfolio, on the back of strong brands like Sunfeast, Aashirvaad, Yippee, alone accounted for over ₹ 6000 crore of sales in FY15. Further, the company is aggressively diversifying in newer categories as reflected in the recent acquisition of two brands "Savlon" & "Shower to Shower" and foray into the dairy industry with Aashirvaad Svasti cow ghee
- We estimate revenue & net profit CAGR of 8.7% & 9.7%, respectively, in FY15-17E. We maintain a positive stance on ITC as we believe ITC's focus to grow its FMCG business would be a catalyst to topline growth in the long run. Simultaneously, a structural decline in commodity prices has increased visibility of earnings growth in segment

Key Financials		FY15	FY16E	FY17E
Net sales	₹ crore	36,083.2	36,905.9	42,633.3
Growth	%	9.7	2.3	15.5
EBITDA margins	%	36.9	38.8	37.4
PAT	₹ crore	9,607.7	10,127.7	11,571.1
PAT growth	%	9.4	5.4	14.3
P/E	x	27.0	25.6	22.4
P/BV	x	8.4	8.3	8.0
RoE	%	31.3	32.4	35.8
RoCE	%	43.2	45.9	48.6

I-direct Top Picks

Timken India (TATTIM)

- Timken India has forayed into gear repair services with the Raipur facility. The management pegs the opportunity in the segment, currently served by unorganised players, at ~₹ 2500 crore in India wherein it is looking to garner up to 15% market share in the medium to long term. Furthermore, DFC implementation would also provide an incremental bearing market opportunity of ~₹ 500 crore led by incremental ordering of new wagons. Timken with 50% market share in the segment would be a key beneficiary
- Timken has witnessed the best revenues and earnings growth among its peers led by strong exports (~34% CAGR in FY09-15) and revival of M&H CV segment. In FY15, when its peers revenues grew in single digits, Timken clocked a staggering topline and bottomline growth of 29% and 80%, respectively. Going ahead, the M&H CV segment is expected to continue its robust performance along with the railway freight segment, which has stable demand. Hence, we expect overall revenue growth of 18.3% in FY15-17E with margins expanding 250 bps in the next two years
- Given the leadership in the tapered bearings led by strong parentage, robust balance sheet and strong earning CAGR (~32.3% over FY15-17E), Timken is one of our top picks in the bearings segment with a proxy play on both Railways investment uptick and repairs business potential

Key Financials		FY15	FY16E	FY17E
Net sales	₹ crore	929.0	1,094.8	1,301.1
Growth	%	29.0	17.9	18.8
EBITDA margins	%	14.4	16.1	16.9
PAT	₹ crore	80.7	107.9	141.3
PAT growth	%	80.0	33.7	31.0
P/E	x	37.4	34.2	26.2
P/BV	x	6.9	6.2	5.3
RoE	%	18.4	19.0	20.4
RoCE	%	28.1	28.5	28.9

Supreme Industries (SUPIND)

- Supreme Industries (SIL) is a strong play in the Indian plastic industry with plastic processing capacity of 4.5 lakh tonnes. We believe SIL is well placed to benefit from India's long term structural reform considering its diversified product portfolio with strong brand, widespread geographic reach, strong balance sheet that has enabled SIL to generate attractive RoCE & RoEs consistently
- With the ramp up in infrastructure activity coupled with rising demand for quality products in India, we believe plastic piping, packaging products volume will record CAGR of ~16%, ~14%, respectively, in FY15-18E. With the strong distribution channel (~2500 dealers) in India, we believe sales of piping, packaging segment will likely record CAGR of 16%, 15% for FY15-18E. SIL is taking concrete steps to increase contribution of value added products to total sales from 31.7% in FY13 to 35% by FY20. SIL is further awaiting government approval for a full fledged launch of composite LPG cylinder in India that would further aid its revenue, margin. We believe EBITDA margin would see moderate growth of ~70 bps, 30 bps YoY to ~15.6% and 15.9% for FY17E & FY18E, respectively
- We expect the company to maintain high RoE and RoCE considering 1) healthy topline growth backed by capex plan, 2) maintaining higher operating margin and 3) efficient working capital management turning lower debt/equity ratio. We believe strong brand coupled with sustained growth justify SIL to command premium valuations

Key Financials		FY15	FY16E*	FY17E
Net Sales	₹ crore	4,219.5	3,017.1	5,115.6
Growth	%	8.0	-28.5	69.6
EBITDA margin	%	14.9	14.0	15.6
PAT	₹ crore	322.4	214.1	421.1
PAT growth	%	13.7	-47.6	96.7
P/E	x	29.9	45.1	22.9
P/BV	x	8.0	7.2	6.0
RoNW	%	26.6	15.9	26.0
RoCE	%	32.4	20.3	33.6

*For nine months only

I-direct Top Picks

Bharat Forge (BHAFOR)

- Bharat Forge (BFL) is a leading global automotive forgings supplier, boasting top-5 global OEMs as customers. CV business is ~55-60% of the consolidated business & remains a key driver for overall growth. Of late, moderation of Class 8 truck demand in US and softening of demand from oil & gas segment has impacted its performance. However, BFL has been diversifying its revenue mix, which is reflected in PV's share of exports to increase from 4% in FY15 end to 9% in Q3FY16 and is expected to be 20% by FY18E. On the domestic side, BFL is a play on a recovery of the CV cycle, as it commands > 60% market share in M&HCV components.
- Further increasing focus on new verticals like railways, aerospace, defence, mining & renewable under the Make in India theme would drive its performance. In next two or three years, BFL is aiming to generate revenues of $100 million from aerospace vertical (HAL alone imports ~1000 crore worth forging). BFL is also focusing on defence opportunity where it is looking to use its engineering capabilities to develop indigenous products (e.g. 155 mm artillery gun). These higher margin non-auto businesses will start contributing meaningfully in H2FY17E
- BFL has remained extremely cautious on capital expenditure leading D/E to decline 0.3x (1.5x FY10). We believe BFL's business franchise is unique and provides investors a great opportunity to own one of the few India listed "Global/Local Tier- 1.5" ancillary supplier.

Key Financials		FY15	FY16E	FY17E
Net sales	₹ crore	7,625.0	8,372.0	8,926.0
Growth	%	13.5	9.8	6.6
EBITDA margins	%	19.3	15.7	17.6
PAT	₹ crore	764.0	722.0	893.0
PAT growth	%	53.2	-5.5	23.7
P/E	x	25.0	26.5	21.4
P/BV	x	5.5	5.2	4.6
RoE	%	22.2	19.8	21.3
RoCE	%	18.6	17.1	21.6

Inox Leisure (INOX)

- Inox, with 19% share of multiplex screens in India with 413 screens (Q3FY16) & ~8% share of domestic box office collections is second after PVR (~491 screens (Q3FY16). Inox, enjoys a well distributed presence across India with 67, 162, 89, 95 screens in East, West, North and South regions, respectively. Adding about three screens every month in the past decade, it is aiming at 435 screens by FY16E and 645 screens in the next couple of years. We believe Inox will reach a screen count of 421, 477 screens by FY16E, FY17E, respectively
- We derive confidence from the consolidation in the industry, which has led to four players controlling ~90% of the multiplex screen. As Inox is one of the largest players it is well placed to take price hikes. We expect Inox' ATPs to grow at a CAGR of 3.6% in FY15-18E and reach ₹ 182 by FY18E. The spends per head (SPH) is expected to expand to ₹ 61 by FY18E from ₹ 55 in FY15. The high EBITDA generating advertising revenues & other operating revenues remains the focus area of the management. With the in-cinema advertisement gaining traction, advertising revenues are expected to grow at 18.3% CAGR over FY15-18E to ₹ 134.9 crore
- Despite the narrowing down of the fundamental gap between PVR and Inox, the latter is trading at a significant discount to the market leader. We consider this an opportunity and expect the valuation gap to concomitantly narrow down leading to re-rating of the stock

		FY15	FY16E	FY17E
Net sales	₹ crore	895.4	1,136.0	1,317.1
Growth	%	17.4	26.9	15.9
EBITDA margins	%	13.7	16.3	18.8
PAT	₹ crore	20.0	54.0	88.4
PAT growth	%	-45.7	170.0	63.7
P/E	x	100.6	37.4	22.8
P/BV	x	3.0	2.8	2.5
RoE	%	3.1	7.4	10.8
RoCE	%	6.0	11.0	14.6

I-direct Top Picks

Voltas (VOLTAS)

- Voltas is primarily an assembler of ACs with outsourcing component and assembles in its Pantnagar plant (Uttarakhand). The segment contributes ~48% to the consolidated topline and recorded sales CAGR of ~13% in the last five years. A strong brand coupled with over 6500 dealers has helped Voltas to improve its market share from 14% in FY10 to 20.8% in FY15. Given the relatively stable margin and high operating cash flow, the UCP segment has provided strong support to Voltas' profitability with lower working capital requirement. The company commands strong RoCE of the UCP segment in the range of ~40-43% over the last four years
- Due to adverse macroeconomic conditions, Voltas faced a severe working capital crunch on account of the slow pace of execution in the EMPS business. To reduce working capital requirements and improve profitability, it has adopted a strategy to remain selective in bidding for new project with a ticket size in the range of ₹ 300-400 crore with a minimum operating margin of 5%
- Considering the two different portfolios of consumer and industrial facing business of Voltas, we are valuing consumer and industrial businesses separately using the SOTP method

Key Financials		FY15E	FY16E	FY17E
Net sales	₹ crore	5,183.1	5,743.2	6,336.6
Growth	%	-1.6	10.8	10.3
EBITDA margins	%	7.9	7.6	8.4
PAT	₹ crore	384.3	371.8	416.8
PAT growth	%	56.6	-3.3	12.1
P/E	x	21.3	22.1	19.7
P/BV	x	3.9	3.5	3.2
RoE	%	16.6	15.4	16.3
RoCE	%	17.0	16.2	18.1

Star Ferro Cement (STAFER)

- Star Ferro Cement (SFCL) is the largest cement player in the North-East region (NER) with over 23.0% market share. Demand growth in this region has consistently remained higher than the growth at pan-India level. With the current Budget's focus on infra development coupled with special focus on the NER region, cement demand in NER is expected to remain healthy over the next three to four years. The company aims to increase its market share in NER from 23.0% to 30% in the next five to seven years led by aggressive marketing efforts. Given this backdrop, SFCL is expected to clock revenue CAGR of 22.7% in FY15-17E
- SFCL is expected to report EBITDA/tonne of ₹1,623 (which is 2.2x of pan-India cement players) in FY16E led by various fiscal benefits under the NE industrial policy, cost advantage and close proximity of large reserves of coal. Further, we expect EBITDA/tonne to improve to ₹1,741 led by healthy realisation and higher utilisation
- SFCL is expected to receive ₹ 600 crore of subsidy from the government over the next two years. Hence, with limited capex, the company is better placed to reduce debt significantly over FY15-17E and boost net margins over the next two years. In addition, given SFCL's ability to generate over 2.2x EBITDA/tonne of its peer set and capability to expand through internal accruals, we believe SFCL should trade at premium valuations despite being a midcap cement player

Key Financials		FY15	FY16E	FY17E
Net sales	₹ crore	1,426.8	1,699.0	2,225.5
Growth	%	21.8	19.1	31.0
EBITDA margins	%	29.1	28.5	28.8
PAT	₹ crore	63.4	127.6	263.3
PAT growth	%	939.5	101.2	106.3
P/E	x	42.3	21.0	10.2
P/BV	x	4.0	3.3	2.5
RoE	%	9.4	15.5	24.8
RoA	%	3.6	6.8	13.5

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