TOP PICKS

Sharekhan Top Picks

After tough market conditions in August and September, the benchmark indices recovered by 1.5-2.0% during October this year. However, volatility sustained within the range of a few hundred points on the Nifty in the earnings season. The close fight in the Bihar assembly election and mixed global news flow are adding to the nervousness in the Indian equity market.

During the last month, the Top Picks folio marginally lagged the benchmark indices with gains of 0.5% largely due to a correction in Lupin and Tata Consultancy Services after their weaker than expected results. On the other hand, the quarterly performance reported by Top Picks constituents like Reliance Industries, Maruti Suzuki and Zee Entertainment Enterprises was ahead of expectations.

In this month the lone change in the Top Picks basket relates to churn within the pharmaceutical sector. We are replacing Lupin (which has more than doubled since we introduced it in the Top Picks basket at Rs917 in January 2014 and has significantly outperformed the benchmark indices) with Dr Reddy's Laboratories. The change is more of a tactical call as Lupin's financial performance would remain weak for one or two more quarters whereas the near-term growth outlook for Dr Reddy's Laboratories is quite encouraging. Though we would add a caveat that Dr Reddy's Laboratories is facing issues (observations under Form 483; not serious in nature) with the US Food and Drug Administration at its bulk drug facility at Srikakulam but the same, we believe, should get resolved soon.

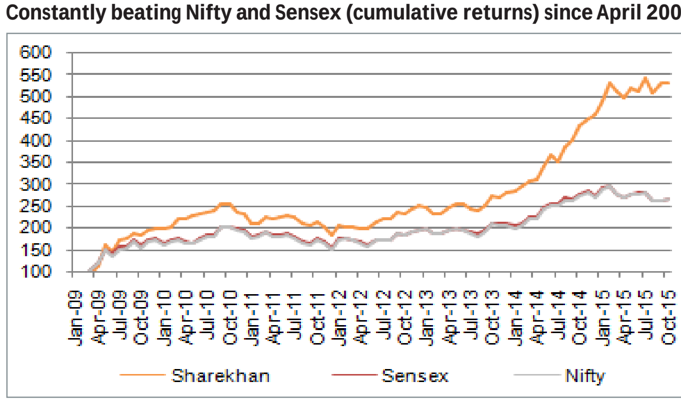
Consistent outperformance (absolute returns; not annualised) (%)

	1 month	3 months	6 months	1 year	3 years	5 years
Top Picks	0.4	-1.6	6.8	22.6	128.2	110.6
Sensex	1.9	-5.2	-1.4	-4.5	43.3	31.0
Nifty	1.5	-5.5	-1.5	-3.1	42.6	31.8
CNX Mid-cap	2.0	-3.6	4.3	11.8	70.1	37.3

Absolute returns (Top Picks vs benchmark indices) (%)

	Sharekhan (Top Picks)	Sensex	Nifty	CNX Mid-cap
YTD CY2015	16.0	-3.1	-2.6	5.2
CY2014	63.6	29.9	30.9	55.1
CY2013	12.4	8.5	6.4	-5.6
CY2012	35.1	26.2	29.0	36.0
CY2011	-20.5	-21.2	-21.7	-25.0
CY2010	16.8	11.5	12.9	11.5
CY2009	116.1	76.1	72.0	114.0
Since Inception (Jan 2009)	432.8	165.5	164.5	265.4

Constantly beating Nifty and Sensex (cumulative returns) since April 2009



Please note the returns are based on the assumption that at the beginning of each month an equal amount was invested in each stock of the Top Picks basket

Name	CMP* (Rs)	PER (x) FY15	PER (x) FY16E	PER (x) FY17E	RoE (%) FY15	RoE (%) FY16E	RoE (%) FY17E	Price target (Rs)#	Upside (%)
Ashok Leyland	**94**	114.0	26.8	17.1	4.9	18.0	23.6	**	-
Bajaj Finance	**5,210**	29.2	23.7	18.4	20.3	19.5	19.2	**6,000**	15
Britannia Industries	**3,220**	71.2	46.0	37.2	53.3	55.5	48.8	**3,650**	13
Cadila Healthcare	**420**	37.5	27.8	20.4	28.4	29.3	29.2	**515**	23
Dr. Reddy's Lab	**4,270**	31.2	25.3	21.2	23.7	23.1	22.8	**5,076**	19
IndusInd Bank	**907**	26.7	21.6	17.1	19.2	20.5	21.5	**1,108**	22
Maruti Suzuki	**4,467**	36.4	25.0	19.7	16.6	20.8	22.2	**4,950**	11
Relaxo Footwear	**527**	61.2	46.2	34.6	23.6	23.2	23.3	**635**	21
Reliance Industries	**947**	11.8	12.1	10.1	10.8	9.7	10.5	**1,100**	16
SBI	**237**	13.5	9.9	7.4	10.6	13.2	15.7	**378**	59
TCS	**2,497**	24.9	20.4	18.2	33.7	32.7	29.7	**3,000**	20
Zee Entertainment	**408**	47.5	41.2	32.8	19.0	18.8	20.6	**470**	15

*CMP as on October 30, 2015 # Price target for next 6-12 months ** Under review

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY15	FY16E	FY17E	FY15	FY16E	FY17E		
Ashok Leyland	**94**	114.0	26.8	17.1	4.9	18.0	23.6	**	-

Remarks:

- Ashok Leyland Ltd (ALL) is the second largest commercial vehicle (CV) manufacturer in India with a market share of 27% in the heavy truck segment and an even higher share of about 40% in the bus segment. The domestic heavy CV industry witnessed a sharp fall in volumes over FY12-14 given an economic slowdown. The industry witnessed a turnaround in FY15 with a 16% growth.
- ALL entered the light commercial vehicle (LCV) segment with the launch of the Dost in joint venture (JV) with Nissan. The JV has additionally launched the Partner LCV and Stile van. Going forward, we expect ALL to gain a foothold in the LCV segment and expand its market share.
- The company is also concentrating on verticals other than CVs to de-risk its business model. It has a strong presence in exports and continues to expand in newer geographies. Additionally, ALL's defence business is expected to get a leg-up due to the government's focus on indigenous manufacture of defence products and FDI in the sector.
- ALL's operating profit margin has recovered from the lows on the back of a reduction in discounts and price hikes taken by the company. Its margins are expected to expand further, given the operating leverage. In FY15, ALL raised Rs660 crore via a qualified institutional placement and sold non-core assets to pare its debts. With no significant capital expenditure planned, we expect the balance sheet to get de-leveraged and the return ratios to improve.

Name	CMP (Rs)	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
Bajaj Finance	**5,210**	29.2	23.7	18.4	20.3	19.5	19.2	**6,000**	15

Remarks:

- Bajaj Finance Ltd (BFL) is among the most diversified NBFCs (financing of mortgages, consumer durables, SME, rural etc) having a strong distribution network (512 branches). We believe a strong growth in customer additions, its unique cross-sell and up-sell capabilities, and robust growth from newer products (rural finance, lifestyle finance etc) should drive a growth of over 25% in the AUMs.
- Despite a strong growth in loans, the asset quality remains among the best in the system (gross NPAs of 1.69% based on 150-day past due [DPD] basis) which along with conservative provisioning adds to the comfort. BFL has already made provisions based on 90-DPD basis, ahead of the Reserve Bank of India (RBI)'s timeline.
- We expect BFL's earnings to grow at a compounded annual growth rate of 28% over FY15-17 resulting in a return on asset (RoA) and return on equity (RoE) of 3.2% and 19.2% respectively. While we have been positive on BFL's business model and strong earnings performance; the valuation after the recent correction has turned more reasonable (2.8x its FY2017E book value). We have a Buy rating on BFL with a price target of Rs6,000.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY15	FY16E	FY17E	FY15	FY16E	FY17E		
Britannia Industries	**3,220**	71.2	46.0	37.2	53.3	55.5	48.8	**3,650**	13

Remarks:

- Britannia Industries (Britannia) is the second largest player in the Indian biscuit market with about 30% market share. It has chalked out an aggressive growth strategy to sustain the double-digit volume growth in the biscuit segment by enhancing its product portfolio. It is also striving to expand to the other categories such as dairy (market size Rs75,000) and adjacent snacking categories (market size Rs30,000 crore).
- It is likely to maintain a 14-15% revenue growth rate with the volume growth standing at 10-11% (largely driven by enhanced both distribution reach and product portfolio). The operating profit margin is expected to remain in the range of 14-15% on the back of benign input cost and operating efficiency.
- The company has a strong balance sheet with the free cash flow consistently improving over the past few years. Its return ratios have improved over the past few years and remained strong in the upward of 50%.
- Under a new leadership, Britannia has been able to leverage and monetise its strong brand and position in the biscuit and snack segments. We believe that the company can sustain its higher than industry growth rates with an improving distribution reach, entry into newer categories and focus on cost efficiency. We recommend a Buy on the stock with a price target of Rs3,650.

Name	CMP (Rs)	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
Cadila Healthcare	**420**	37.5	27.8	20.4	28.4	29.3	29.2	**515**	23

Remarks:

- Cadila Healthcare is set to enter a high-growth trajectory, thanks to its aggressive product filings in the USA and Latin America, a recovery in its joint venture business and the launch of niche products in the Indian market including the generic version of Gilead Sciences' Hepatitis C drug, Sofosbuvir, in India under the brand name SoviHep.
- Cadila Healthcare, which generates close to 36% of its total revenues from the US market, is likely to be among the key beneficiaries of a favourable business environment in the generic space. The company has over 161 abbreviated new drug applications (ANDAs) pending approval out of 260 ANDAs filed with the US Food and Drug Administration (USFDA) that will unfold over the next two to three years.
- We expect the company to record overall revenue and profit CAGR of 21% and 39% over FY2015-17 respectively from the base business. The OPM of the company will see a sustained expansion of over 400BPS in the next two years, mainly on the back of stronger traction in the branded business in India and Latin America, a better generic pricing scenario in the USA and optimisation of capabilities in the joint venture business.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY15	FY16E	FY17E	FY15	FY16E	FY17E		
Dr. Reddy's Lab	**4,270**	31.2	25.3	21.2	23.7	23.1	22.8	**5,076**	19

Remarks:

- The sales of Dr Reddy's Laboratories (DRL) in the USA have now attained a critical mass ($1,113 million in FY2015) and DRL aims to scale up this business to the next level on the back of a strong product pipeline (73 ANDAs are pending approval, of which 47 are Para IVs and 16 are FTFs). DRL's focus is mainly on the niche and complex products, such as oncology injectables, inhalers and transdermal patches, which enjoy a high profit margin due to limited competition. The pay-offs from these efforts are expected to accrue over the next two to three years.
- Besides, approval for the company's three innovative drug applications filed with the US Food and Drug Administration (USFDA) through its subsidiary Promius Pharma is awaited. These should support growth over the next three to five years. The management has guided for a robust growth in the USA over the medium term, driven by the introduction of new products (some of which are also Para IV opportunities). Overall, we expect the US sales (ex exclusivity) to post a compounded annual growth rate (CAGR) of ~24% during FY2016-18.
- On the domestic front the management expects the company's performance to improve and has guided to achieve an above-industry growth rate going ahead. This will be mainly on account of (a) improvement in field force productivity and better cost-control measures; (b) new product launches (including biosimilars); and (c) focus on brand building.
- With a clear focus and visibility of sales growth (19% CAGR) over the next two to three years and improving profitability (21% CAGR) on account of a better product mix, we have a positive view on the stock.

Name	CMP (Rs)	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
IndusInd Bank	**907**	26.7	21.6	17.1	19.2	20.5	21.5	**1,108**	22

Remarks:

- IndusInd Bank is among the fastest growing banks (a 27% CAGR growth over FY10-15) having a loan book of Rs68,700 crore and 811 branches across the country. About 25% of the bank's book pertains to vehicle finance, which is a high-yielding category and is showing signs of recovery.
- Given the aggressive measures taken by the management, the deposit profile has improved considerably (a CASA ratio of 34%). Going ahead, the bank would follow a differentiated branch expansion strategy (a 5% branch market share in identified centers) that would help ensure healthy savings accounts and retail deposit growth.
- Despite a weak economic growth and a higher proportion of vehicle finance book the bank has maintained its asset quality. With total stressed loans (restructured loans + gross NPAs) forming just 1.4% of the book, the bank's asset quality is among the best in the system.
- A likely revival in the economy will further fuel growth in the consumer finance division and strong capital ratios will support the growth plans. The stock is trading at 3.3x its FY17E book value (not factoring in the QIP issue). Given the strong loan growth, high RoAs and healthy asset quality, the stock should continue to trade at premium valuation. We have a positive outlook on the stock.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY15	FY16E	FY17E	FY15	FY16E	FY17E		
Maruti Suzuki	**4,467**	36.4	25.0	19.7	16.6	20.8	22.2	**4,950**	11

Remarks:

- Maruti Suzuki India Ltd (MSIL) is the market leader in the domestic passenger vehicle (PV) industry. In FY2015, as against an industry growth of a modest 3.9% MSIL has grown its volumes by 11.1% and in the process expanded its market share by 441BPS to 45%.
- The company further strengthened its sales and service network, and added 309 outlets in FY15. Additionally, the drive undertaken by its management to tap the potential in rural areas paid rich dividends in difficult times for the industry and in the face of rising competitive intensity; this reaffirms the resilience of MSIL's positioning and business model.
- MSIL's new sedan, Ciaz, has received a positive response from the market and helped MSIL establish a presence in the segment. Also, with the new premium cross-over, ie S-Cross (to be retailed at exclusive Nexa outlets) the company is looking to move up the ladder. Further, the recent launch of the new premium hatchback, ie *Baleno*, which has been priced aggressively as compared with peers, is expected to help further gain market share. MSIL has a pipeline of new launches over the next few years, with the most important being the entry into the compact utility vehicle and light commercial vehicle segments.
- We expect customer sentiment to improve on the back of a strong government at the centre. Additionally the PV segment is expected to benefit from the pent-up demand over the past two years; this will benefit MSIL the most due to its high market share in the entry level segment.

Name	CMP (Rs)	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
Relaxo Footwear	**527**	61.2	46.2	34.6	23.6	23.2	23.3	**635**	21

Remarks:

- Relaxo Footwear is present in the fast-growing footwear category, wherein it caters to customers with its four top-of-the-mind-recall brands, viz, Hawaii, Sparx, Flite and Schoolmate. In the last quarter it also added another brand, Bahamas, to its product portfolio.
- Relaxo has a proactive approach towards both brand building and creating capacities. To build its brand and create pull, like FMCG players it continues to rope Bollywood celebrities and this creates an aspirational quotient for its brands. On the one hand, the company is creating strong consumer centric aspiration for the consumers; on the other hand, it is keeping its eye on quality and thus does not believe in outsourcing. It is in the process of building capacity for future. Despite the current capacity (180 million pieces per annuam) that would take care of growth in the next three years, the company has bought a 15-acre land at Bhiwadi to built additional capacity to serve the future requirements.
- Relaxo's strong presence in the lucrative mid priced footwear segment (through its top-of-the-mind-recall brands like Hawaii, Flite and Sparx) along with its integrated manufacturing set-up, lean working capital requirement and vigilant management puts it in a sweet spot to cash in on the strong growth opportunity unfolding in the footwear category due to a shift from unbranded to branded products. We thus maintain our Buy rating on the stock. We also roll over our multiple from FY2017 estimate to FY2018 estimate (valuing the stock at 33x FY2018E) with a price target of Rs635.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY15	FY16E	FY17E	FY15	FY16E	FY17E		
Reliance Industries	**947**	11.8	12.1	10.1	10.8	9.7	10.5	**1,100**	16

Remarks:

- Reliance Industries Ltd (RIL) has a strong presence in the refining, petrochemical and upstream exploration businesses. The refining division of the company is the highest contributor to its earnings and is operating efficiently with a better gross refining margin (GRM) compared with its peers in the domestic market due to the ability of its plant to refine more of heavier crude. The exploration business remains weak due to low production in the Krishna-Godavari-D6 (KG-D6) field and weak pricing of global fuel prices. However, capital employed and profit contribution from the exploration business is low.
- Moreover, the upcoming incremental capacities in the petrochemical and refinery businesses are going to drive the future earnings growth substantially as the downstream businesses are on the driving seat and contributing the lion's share of the profitability and cash flow.
- After a strong GRM in H1FY2016, we expect the GRM to remain healthy for the whole year. The stock is available at an attractive valuation considering the size, strong balance sheet and cash flow generating ability of the company.

Name	CMP (Rs)	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
SBI	**237**	13.5	9.9	7.4	10.6	13.2	15.7	**378**	59

Remarks:

- SBI is India's largest bank in terms of most comparable parameters such as assets size, branch network (18,000 branches) and customer base. The bank has a market share of ~18% and along with its associate banks it commands a market share of over 25% in the banking system. Therefore, with a revival in the investment cycle and pick-up in consumption the bank is likely to benefit significantly in terms of loan growth and profitability.
- SBI's asset quality is relatively better compared with the other public sector banks (PSBs; its stressed loans stand at ~8.5% vs ~13.5% of the other PSBs) and has been showing improving trends in the past few quarters. While the pressure on the asset quality may continue in the near term, a higher tier-1 CAR (9.6%) and an improving operating performance remain comforting factors.
- Going ahead, SBI will look to merge its associate banks which will give an unmatched hold in the domestic banking sector and boost economies of scale. In addition, the likely monetisation of the insurance and other subsidiaries will strengthen the capital position of the bank. The bank may also benefit from the government's plans to infuse capital into the PSBs. SBI is a better pick among the government-owned banks and is reasonably valued at the current levels.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY15	FY16E	FY17E	FY15	FY16E	FY17E	target (Rs)	(%)
TCS	**2,497**	24.9	20.4	18.2	33.7	32.7	29.7	**3,000**	20

Remarks:

- TCS pioneered the IT services outsourcing business from India and is the largest IT service firm in the country. It is a leader in most service offerings and has further consolidated its position as a full-service provider by delivering a robust financial and operational performance consistently over the years.
- The consistency and predictability of its earnings performance has put the company at the top of its league. TCS's management remains positive on the digital technologies space, which grew by 10.7% QoQ, forms 13.3% of the revenues as compared with 12.5% in Q1FY2016. The management remains confident about the growth trajectory of the digital space for the coming years. Given the usual seasonal weakness in H2, it expects a soft revenue growth in the next two quarters. Further, it expects weakness in Diligenta (insurance) and Japan (integration issues related to the Mitsubishi acquisition) to continue for few more quarters.
- We remain positive on TCS, given its strong positioning, scale advantage and head start in the digital technologies space (the highest among the top Indian IT companies), which justify the valuation premium for TCS over the others.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY15	FY16E	FY17E	FY15	FY16E	FY17E	target (Rs)	(%)
Zee Entertainment	**408**	47.5	41.2	32.8	19.0	18.8	20.6	**470**	15

Remarks:

- Among the key stakeholders of the domestic TV industry, we expect the broadcasters to be the prime beneficiary of the mandatory digitisation process initiated by the government. The broadcasters would benefit from higher subscription revenues at the least incremental capex as the subscriber declaration improves in the cable industry.
- The management maintains that the advertisement spending will continue to grow in double digits going ahead and ZEEL will be able to outperform the same. The growth in the advertisement spending will be driven by an improvement in the macro-economic factors and the fact the ZEEL is well placed to capture the emerging opportunities being a leader in terms of market share.
- ZEEL continues to outperform the broadcasting advertising market. We expect the momentum to continue with an improvement in the macro economy. The management indicated the strong momentum in the advertisement revenue growth would continue led by market share gains and improvement in spending from segments like FMCG, e-commerce, consumer durables and telecom companies. Subscription revenues are also expected to benefit from the run-up phases III and IV of the digitisation process (to be more visible in FY2017 and FY2018). We continue to see ZEEL as the prime beneficiary of the macro revival and digitisation.

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