Sharekhan Top Picks

The Indian stock market continued to lose ground in April and the index returns turned negative for the calendar year 2015. In fact, the Indian equity market has underperformed the other emerging markets in the last few months due to rising concerns over a subdued growth in the earnings of the domestic corporates, a possibility of a delayed revival in economic activity, unseasonal rains and an initial forecast of a weak monsoon for this year. To top it all, the uncertainties related to the minimum alternate tax applicable to the foreign institutional investors retrospectively added to the weakness in the Indian markets.

The benchmark indices, Nifty, Sensex and CNX Mid-cap Index, closed marginally down by 1% to 2% each for the first four months of CY2015 whereas Sharekhan's Top Picks basket gave a decent positive return of 8.7% (gross of brokerage) in the same period. In April also, the Top Picks basket performed relatively better, declining by 2.8% as against a drop of 3.4% in the Sensex and a fall of 3.6% in the Nifty.

This month, we are not making any changes in the Top Picks folio. We believe that the Indian market could continue to hover around the existing range for the next few weeks, if not months, and the portfolio is largely aligned for the anticipated market condition.

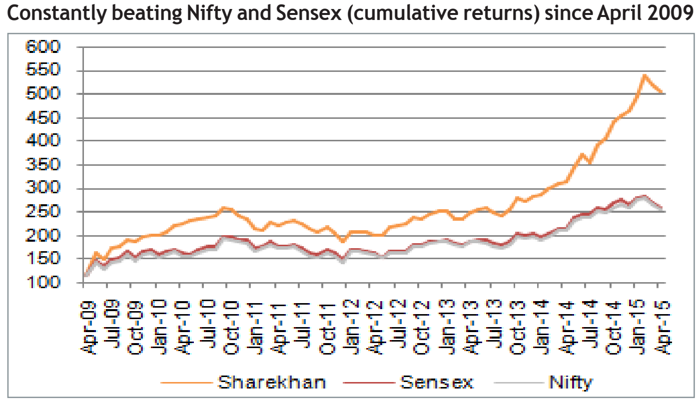
Consistent outperformance (absolute returns; not annualised) (%)

	1 month	3 months	6 months	1 year	3 years	5 years
Top Picks	-2.8	1.7	14.9	61.3	151.2	124.6
Sensex	-3.4	-7.4	-3.2	20.3	60.6	60.1
Nifty	-3.6	-7.1	-1.6	21.8	61.8	62.4
CNX Mid-cap	-2.4	-3.3	7.2	43.8	77.6	64.7

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

Name	Sharekhan (Top Picks)	Sensex	Nifty	CNX Mid-cap
CY2015	8.7	-1.8	-1.1	0.8
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)	399.1	169.2	168.5	250.3

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) FY14	PER (x) FY15E	PER (x) FY16E	RoE (%) FY14	RoE (%) FY15E	RoE (%) FY16E	Price target (Rs)#	Upside (%)
Apollo Tyres	**173**	8.4	7.8	7.3	26.4	21.9	19.4	**260**	50
Ashok Leyland	**70**	NA	99.4	23.2	NA	4.3	15.1	**76**	9
Cadila Healthcare	**1,697**	43.3	35.2	21.3	21.9	21.4	26.7	**2,060**	21
Gateway Distriparks	**354**	27.0	20.4	18.8	17.5	21.5	21.7	**445**	26
HDFC Bank ^	**989**	28.0	24.2	19.9	21.3	19.4	18.8	**1,260**	27
Lupin	**1,773**	43.2	33.4	27.8	26.5	26.4	24.4	**2,300**	30
Maruti Suzuki ^	**3,732**	40.5	30.4	21.7	14.1	16.6	20.1	**4,400**	18
PTC India Financials	**53**	10.4	10.2	7.0	16.1	14.8	19.3	**90**	69
TCS ^	**2,467**	25.2	24.6	20.1	35.2	29.5	29.5	**3,000**	22
Thomas Cook	**231**	18.8	41.3	46.3	12.2	13.3	16.3	**250**	8
Yes Bank ^	**840**	18.7	17.5	15.0	25.0	21.3	18.6	**930**	11
Zee Entertainment	**313**	33.6	30.1	27.4	20.6	19.8	19.5	**400**	28

*CMP as on April 30, 2015 # Price target for next 6-12 months ^Actual numbers for FY2015

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Apollo Tyres	**173**	8.4	7.8	7.3	26.4	21.9	19.4	**260**	50

Remarks:

- Apollo Tyres is a leading player in the domestic passenger car and truck tyre segments. The tyre industry's volume has been subdued, given the weak macro environment. We expect the demand to improve in FY2016 with a pick-up in the economy and higher utilisation of commercial vehicles (CV).
- The profitability of the tyre companies has improved, given the soft natural rubber prices. Additionally, a slide in crude oil prices and its impact on crude derivatives, such as synthetic rubber and carbon black, have led to expansion of the gross profit margin (GPM). This benefit is expected to continue in FY2016 and margins are expected to remain elevated.
- The European operations too have reported a strong performance with a strong volume growth and high profitability. The company will be investing EUR200 million for setting up a greenfield facility in Eastern Europe which will start production in Q4FY2017 and cater to the long-term growth in Europe. Additionally, it will invest Rs2,000 crore in its Indian operations for capacity expansion.
- We like the stock for its consistent performance and long-term growth prospects (expansion in Europe and Chennai) and have a Buy recommendation on it.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
Ashok Leyland	**70**	NA	99.4	23.2	NA	4.3	15.1	**76**	9

Remarks:

- Ashok Leyland Ltd (ALL) is the second largest CV manufacturer in India with a market share of 25% in the heavy truck segment and an even higher share of about 40% in the bus segment. Given the scale of economic slowdown, the segment had halved over FY2012-14. With the pick-up in the economy a sharp recovery is expected in the segment.
- ALL entered the light CV (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. The diesel genset business is also showing signs of a recovery after a tepid performance in FY2013-14. 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 (OPM) 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. ALL has raised Rs660 crore via a qualified institutional placement and sold non-core assets to pare its debts. With no significant capital expenditure (capex) planned, we expect the balance sheet to get de-leveraged and return ratios to improve.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Cadila Healthcare	**1,697**	43.3	35.2	21.3	21.9	21.4	26.7	**2,060**	21

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 145 abbreviated new drug applications (ANDAs) pending approval out of 230 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 see a revenue compounded annual growth rate (CAGR) of 34% over FY2014-17 in the US market.
- We expect the company to record overall revenue and profit CAGR of 20% and 38% over FY2014-17 respectively from the base business. The OPM of the company will see a sustained expansion of over 600BPS in the next three 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. We recommend a Buy rating on the stock with a price target of Rs2,060, which implies 20x FY2017E EPS.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
Gateway Distriparks	**354**	27.0	20.4	18.8	17.5	21.5	21.7	**445**	26

Remarks:

- An improvement in exim trade along with a rise in port traffic at the major ports signals an improving business environment for the logistic companies. Gateway Distriparks being a major player in the container freight station (CFS) and rail logistic segments is expected to witness an improvement in the volumes of its CFS and rail divisions going ahead.
- The improving trend in the rail freight and cold chain subsidiaries would sustain on account of the recent efforts to control costs and improve utilisation.
- We continue to have faith in the company’s long-term growth story based on the expansion of each of its three business segments, ie CFS, rail transportation and cold storage infrastructure segments. The coming on stream of the Faridabad facility and the strong operational performance will further enhance the performance of the rail operations. Also, the expected turnaround in the global trade should have a positive impact on the CFS operations.
- Given the improvement in the profitability led by lower non-performing asset (NPA) provisions, a healthy growth in the core income and improved operating metrics, we recommend a Buy with a price target of Rs445.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY14	FY15E	FY16E	FY14	FY15E	FY16E	target (Rs)	(%)
HDFC Bank	**989**	28.0	24.2	19.9	21.3	19.4	18.8	**1,260**	27

Remarks:

- HDFC Bank has a strong presence in the retail segment (~50% of the book) and therefore has been able to maintain a strong growth in loans even in tough times. Going ahead, with a recovery in the economy and improving sentiment in consumer sectors, the loan growth will improve further which will drive the profitability.
- With a current account and savings account (CASA) ratio of 41% and a high proportion of retail deposits, the cost of funds remains among the lowest in the system and helps to maintain a higher net interest margin (NIM). In addition, the bank's loan growth is led by high yielding products such as personal loans, vehicle loans, credit card, mortgages etc which has a positive impact on the NIM.
- The bank maintains impeccable asset quality and its NPA ratios are among the lowest in the system. Given the bank's stringent credit appraisal procedures and insignificant exposure to troubled sectors, it is expected to maintain robust asset quality.
- HDFC Bank is adequately capitalised and further capital raising of Rs10,000 crore will boost its capital ratios and help to tap the growth opportunities going ahead. The bank is likely to maintain healthy return on equity (RoE) of 19-20% and return on asset (RoA) of 1.8% on a sustainable basis. Therefore, we expect the valuation premium that it enjoys compared with the other private banks to expand further.

Lupin	**1,773**	43.2	33.4	27.8	26.5	26.4	24.4	**2,300**	30

Remarks:

- A vast geographical presence, focus on niche segments like oral contraceptives, ophthalmic products, para-IV filings and branded business in the USA are the key elements of growth for Lupin. The company has remarkably improved its brand equity in the domestic and international generic markets to occupy a significant position in the branded formulation business. Its inorganic growth strategy has seen a stupendous success in the past. The company is now debt-free and that enhances the scope for inorganic initiatives.
- The management has given a guidance to sustain the OPM at 27% to 28% in FY2015 (vs 25% in FY2014) which especially impress us. Lupin has recently forged an alliance with Merck Serono to out-licence select drugs and signed an agreement with Salix Pharma to in-licence products for the Canadian market. These initiatives will support growth in the long term.
- Lupin is expected to see stronger traction in the US business on the back of the key generic launches in recent months and a strong pipeline in the US generic business (over 95 ANDAs pending approvals including 86 first-to-file drugs) to ensure the future growth. The key products that are going to provide a lucrative generic opportunity for the company include Nexium (market size of $2.2 billion), Lunesta (market size of $800 million) and Namenda (market size of $1.75 billion) that will be going out of patent protection in CY2015. The company has recently got the Foreign Investment Promotion Board's clearance to raise the investment limit for foreign institutional investors to 49% from 32% currently.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Maruti Suzuki	**3,732**	40.5	30.4	21.7	14.1	16.6	20.1	**4,400**	18

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 has further strengthened its sales and service network. 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 times of rising competitive intensity; this reaffirms the resilience of MSIL's positioning and business model.
- The recent launches of Celerio and Alto K10 with the new automatic manual transmission have enthused the market and the company plans to offer the same in other models too. 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 LCV 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. The recent depreciation of the Japanese Yen is expected to boost profitability.

PTC India Financials	**53**	10.4	10.2	7.0	16.1	14.8	19.3	**90**	69

Remarks:

- PTC India Financial Services (PFS) stands to benefit from the government's strong thrust on the renewable energy sector (mainly solar and wind) which should result in a robust growth in the loan book (at a 40% CAGR over FY2014-17). About 70% of the incremental disbursement will be from the renewable segments (loan sanction pipeline of ~Rs7,000 crore or 1.2x of the existing loan book) which has lesser quality issues due to a low gestation period and fuel supply risk, thanks to fiscal support from the government.
- Given the favourable interest rate scenario, the interest spreads may sustain at healthy levels (~4.3%). Any likely downward movement in the hedging cost will further reduce the funding cost. The company also has ~Rs300 crore of equity investments in power projects; these have appreciated significantly and will result in substantial gains going ahead.
- We expect PFS to register a strong growth in earnings (~40% CAGR over FY2014-17 excluding the one-off gains of FY2014) without factoring in the gains on its equity investments. The asset quality is likely to remain robust and the company is likely to deliver high RoAs (~3.5%) which leaves scope for more upside.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
TCS	**2,467**	25.2	24.6	20.1	35.2	29.5	29.5	**3,000**	22

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 the earnings performance has put the company on the top of its league. Moreover, the quality of its performance has also been quite impressive, ie it has been able to report a broad-based growth in all its service lines, geographies and verticals consistently.
- Though cross-currency headwinds and softness in some verticals will affect the earnings in the near term, we believe the overall improvement in the USA will drive the growth in the coming years. Also, the company's increasing capabilities in the digital space, which is a high-growth area, consolidates its position among the top-tier global IT companies. We maintain TCS as our top pick in the IT sector and have a Buy rating on the stock.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
Thomas Cook	**231**	18.8	41.3	46.3	12.2	13.3	16.3	**250**	8

Remarks:

- Thomas Cook India Ltd (TCIL) is an integrated leisure travel company with offerings across the value chain including travel services, holiday packages and foreign exchange services. The improvement in the foreign tourist arrivals in India and improving sentiments of the domestic travelers would help TCIL's travel and financial services businesses to post a better performance in the coming years.
- Quess Corp (a human resource management business acquired in early 2013) has exponentially grown its consolidated revenues to Rs1,401 crore in FY2014 from merely Rs49 crore in FY2009. The business is well poised to grow at a CAGR of 30% in the coming years.
- An improving financial performance of Sterling and value unlocking potential in Quess Corp are re-rating triggers. We maintain our Buy rating with a price target of Rs250.

Name	CMP (Rs)	PER (x) FY14	PER (x) FY15E	PER (x) FY16E	RoE (%) FY14	RoE (%) FY15E	RoE (%) FY16E	Price target (Rs)	Upside (%)
Yes Bank	**840**	18.7	17.5	15.0	25.0	21.3	18.6	**930**	11

Remarks:

- Given a decline in inflation and the possibility of further reduction in the policy rates by the Reserve Bank of India, the cost of funds will reduce and benefit Yes Bank. In addition, the bank's investment book stands to benefit from a fall in bond yields due to surplus statutory liquidity ratio securities and substantial corporate bond book (~Rs10,000 crore). The bank will also be included in the Nifty index which will be positive for the stock.
- The bank is well capitalised (tier-I capital adequacy ratio of 12.2%) and is likely to benefit from the revival in the economy which will result in a strong growth in advances. Apart from the decline in the funding cost, there are other structural drivers of margins: (a) a rising CASA ratio, and (b) focus on retail, and small and medium enterprise lending. Hence, we expect an uptick of 15-20 basis points in the margins over FY2017.
- We expect Yes Bank's earnings to grow at healthy rates (about 22% CAGR over FY2014-17) driven by an expansion in the NIM and an uptick in the non-interest income. The asset quality remains robust and the quality is likely to sustain going ahead. The return ratios are expected to improve further (RoA of 1.7% and RoE of 20%) resulting in better valuations. We have rolled over our valuations to FY2017 estimates resulting in a fresh price target of Rs930 (2.4x FY2017E book value). We maintain our Buy rating on the stock.

Name	CMP (Rs)	PER (x) FY14	PER (x) FY15E	PER (x) FY16E	RoE (%) FY14	RoE (%) FY15E	RoE (%) FY16E	Price target (Rs)	Upside (%)
Zee Entertainment	**313**	33.6	30.1	27.4	20.6	19.8	19.5	**400**	28

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 is well placed to benefit from the digitisation theme and the overall recovery in the macro economy. Also, the success of the newly launched channel, "&TV", would augur well and improve the company's position in the general entertainment channel space. We have a Buy rating on the stock with a price target of Rs400.

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