Sharekhan Top Picks

The stock market took a breather in July after the sharp run-up in the previous two months. Though the benchmark indices, Nifty and Sensex, are only marginally down by 0.1-0.4% each since our revision in the Top Picks basket last month, but there has been a substantial correction in the broader market especially in the high-beta mid-cap space. The CNX Mid-cap Index has declined by 3.6% and the CNX Small-cap Index is down by close to 8.2% in the same period.

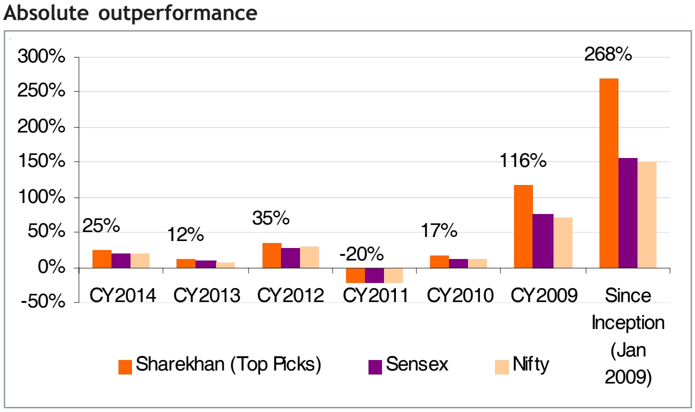
After healthy gains of the previous two months, the Top Picks basket (down 4.8%) has lagged the benchmark indices due to a double-digit decline in Larsen and Toubro (which announced unexpectedly weak results for Q1FY2015; a loss of Rs942 crore in the hydrocarbon business due to cost over-runs and execution delays) and LIC Housing Finance (regulatory changes that put banks at an advantage to the housing finance companies further dented sentiment towards the stock after not so encouraging Q1FY2015 results of the company).

We are making three changes this month. First, within the non-banking finance companies space, we are replacing LIC Housing Finance with PTC India Financial Services on which we have recently initiated coverage with a very positive view. Second, we are booking profit in Gabriel India after gains of close to 18% in the last two months and re-introducing TVS Motor Company (which has corrected by over 6% and offers a decent upside to our price target now). Lastly, as a tactical call, we are replacing Crompton Greaves with Persistent Systems (one of our best performing mid-cap IT picks which is witnessing substantial interest from foreign investors due to its niche positioning in the cloud, mobility and analytics areas).

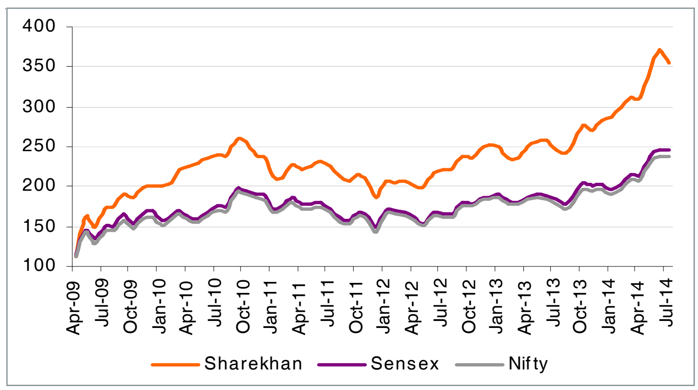
Consistent outperformance (absolute returns; not annualised) (%)

	1 month	3 months	6 months	1 year	3 years	5 years
Top Picks	-4.8	13.3	23.6	43.4	57.0	105.1
Sensex	-0.1	13.8	24.4	33.1	42.6	63.3
Nifty	-0.4	13.6	25.0	33.7	41.9	66.3
CNX Mid-cap	-3.6	22.0	42.7	60.6	31.4	86.7

Absolute outperformance



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



Name	CMP* (Rs)	PER (x) FY14	PER (x) FY15E	PER (x) FY16E	RoE (%) FY14	RoE (%) FY15E	RoE (%) FY16E	Price target (Rs)#	Upside (%)
Apollo Tyres	**169**	8.7	8.2	7.2	25.2	21.4	19.9	**210**	25
Federal Bank	**118**	12.0	10.4	8.6	12.6	13.3	14.5	**142**	20
Gateway Distriparks	**234**	17.8	16.5	14.0	17.5	18.0	20.3	**	-
ICICI Bank	**1,476**	17.4	15.5	13.1	14.0	14.5	15.7	**1,728**	17
Larsen & Toubro	**1,472**	27.8	24.5	20.3	15.6	15.6	17.1	**1,840**	25
Lupin	**1,165**	28.4	20.5	17.9	26.5	27.7	24.4	**1,300**	12
Persistent Systems	**1,255**	20.1	16.2	13.8	22.3	23.1	22.7	**1,400**	12
PTC India Financial Services	**33**	6.6	6.1	4.5	16.1	15.4	18.5	**44**	32
TVS Motors	**152**	27.8	21.6	16.7	19.7	21.8	23.6	**175**	15
UltraTech Cement	**2,471**	33.0	25.3	22.0	12.0	13.7	13.8	**2,868**	16
Zee Entertainment	**289**	31.1	29.2	22.2	20.6	19.1	22.3	**367**	27

*CMP as on August 01, 2014 # Price target for next 6-12 months ** Under review

Sharekhan
Your guide to the financial jungle

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Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Apollo Tyress	**169**	8.7	8.2	7.2	25.2	21.4	19.9	**210**	25

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 H2FY2015 with a pick-up in the economy.
- The profitability of the tyre companies has improved given the soft natural rubber prices and this benefit is expected to continue in FY2015-16 as global supply of natural rubber is expected to outstrip demand.
- Apollo's European operations too have reported a strong performance with a strong volume growth and high profitability. The company will be investing EUR200mn 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, Apollo 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). We have a Buy recommendation on the stock with a price target of Rs210.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
Federal Bank	**118**	12.0	10.4	8.6	12.6	13.3	14.5	**142**	20

Remarks:

- Federal Bank undertook structural changes in the balance sheet, viz increasing the proportion of the better rated assets and improving the retail deposit base, and is thus better prepared to ride the recovery cycle. As the economy is gradually showing signs of a revival, the bank is much better capitalised (tier-1 capital adequacy ratio of ~15%) compared with its peer banks to expand the balance sheet.
- Asset quality has improved substantially over the past three to four quarters and is likely to improve further in the coming period. Higher provision coverage ratio of over 80% and a possibility of recovery from one large-ticket account (likely in the next two to three quarters) would further increase the comfort on asset quality.
- The valuation of 1.2x FY2016E BV is attractive when compared with the regional banks and other old private banks. The expansion in the return on equity (RoE) led by a better than industry growth (FY2014-16) will lead to an expansion in the valuation multiple. We have a Buy rating on the stock with a price target of Rs142.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY14	FY15E	FY16E	FY14	FY15E	FY16E	target (Rs)	(%)
Gateway Distriparks	234	17.8	16.5	14.0	17.5	18.0	20.3	**	-

Remarks:

- An improvement in exim trade along with a rise in port traffic at the major ports are signalling an improving business environment for the logistic companies. Gateway Distriparks being a major player in the 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 GDL'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. First, we believe the listing of SLL will unlock the inherent value and the potential of the cold chain operations. Second, the coming on stream of the Faridabad facility and the strong operational performance will further enhance the performance of the rail operations. Third, the expected turnaround in the global trade should have a positive impact on the CFS operations. We maintain our Buy rating on the stock.

Name	CMP	FY14	FY15E	FY16E	FY14	FY15E	FY16E	Price target (Rs)	Upside (%)
ICICI Bank	1,476	17.4	15.5	13.1	14.0	14.5	15.7	1,728	17

Remarks:

- With an improvement in the liability profile, ICICI Bank is better positioned to expand its market share especially in the retail segment. We expect its advances to grow at ~19% compound annual growth rate (CAGR) over FY2014-16 leading to a CAGR of 17.0% in the net interest income.
- ICICI Bank's asset quality has stabilised and fresh NPA additions are within manageable limits. We believe the strong operating profits should help the bank to absorb the stress which anyway is expected to recede due to an uptick in economy.
- Led by a pick-up in the advance growth and a significant improvement in the margin, the RoE is likely to expand to ~16% by FY2016 while the return on assets (RoA) is likely to improve to 1.8%. This would be driven by a 15.3% growth (CAGR) in the profit over FY2014-16.
- The stock trades at 1.9x FY2016E BV. Moreover, given the improvement in the profitability led by lower NPA provisions, a healthy growth in the core income and improved operating metrics, we recommend a Buy with a price target of Rs1,728.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Larsen & Toubro	1,472	27.8	24.5	20.3	15.6	15.6	17.1	1,840	25

Remarks:

- Larsen & Toubro (L&T), the largest engineering and construction company in India, is a direct beneficiary of the strong domestic infrastructure development and industrial capital expenditure (capex) revival now.
- L&T continues to impress us with its order inflow growth achievement and good execution skills even in a slowdown. Now it is looking at better days ahead with the domestic environment improving. We believe in such a situation, L&T would be a major beneficiary as it is placed much ahead of its peers with a strong balance sheet. Moreover, monetisation of various assets (including listing of subsidiary) would help the company to improve the RoE.
- Owing to poor results in its hydrocarbon subsidiary, L&T reported weak performance for Q1FY2015 and the stock corrected significantly. We recommend investors to consider this as an opportunity to enter at a lower price as L&T is one of the best bets to play the cyclical (revival benefit yet to reflect in numbers) and its management expects the performance of the hydrocarbon business to improve in future.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
Lupin	1,165	28.4	20.5	17.9	26.5	27.7	24.4	1,300	12

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 company has shown a sharp improvement in the base business' margin in Q1FY2015 on the back of cost rationalization measures and better products mix. The management has given a guidance to sustain the OPM at 27% to 28% in FY2015 (vs 25% in FY2014), which especially impress us.
- The company 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 97 abbreviated new drug approvals pending approval including 86 first-to-files) 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 FY2015. We expect revenue and profit CAGR of 21% and 26% over FY2014-16.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Persistent Systems	1,255	20.1	16.2	13.8	22.3	23.1	22.7	1,400	12

Remarks:

- Persistent Systems has proven expertise and an early movers advantage in the digital technologies (Social, Mobile Analytics and Cloud; SMAC). Additionally, strength to improve its IP base and the best-in-the-class margin profile which sets it apart from the other mid-cap IT companies.
- The distinctive advantage of PSL's lies in SMAC oriented business model (a big growth area), strong balance sheet (Rs663 crore, at 41% of the balance sheet size) and good corporate governance.
- Despite trading at a valuation (trading at 14.5x FY2016E earnings) that is closer to that of the large-cap IT companies after a steep re-rating in the last six months, PSL continues to attract investors' interest (FIIs have increased the stake in company from 20.6 in March 2014 to 27.4% in June 2014). Given the huge potential in the SMAC space, we see PSL as a long-term value creator for investors.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
PTC India Financial Services	33	6.6	6.1	4.5	16.1	15.4	18.5	44	32

Remarks:

- Given its strong parentage (PTC India) and domain knowledge of the power sector, PTC India Financial Services (PFS) is among the specialised lenders in the energy value chain. Going ahead, an improving scenario for the power sector and an outstanding sanction of over Rs5,500 crore will drive the growth in the advances (45% CAGR over FY2014-16).
- PFS has a fairly diversified loan book with the renewable energy segment constituting about 35% followed by the thermal segment. The renewable sector projects have a lower gestation period, do not face risk of fuel and environmental clearances, and receive regulatory and fiscal support. The asset quality remains robust (GNPA of 0.09% and nil net NPA) and we expect the quality to sustain going ahead.
- PFS has delivered strong results for Q1FY2015 led by healthy margins which, in turn, have helped it to maintain superior return ratios. Going ahead, the cost of borrowing may moderate led by higher borrowings from bonds/ ECBs. The company also plans to exit one of its equity investments in FY2015 which will boost the profit (it exited three to four investments in the past with an average return of 25%). With close to doubling of its advances book over the next two years, we expect PFS' earnings to grow at 44% CAGR over FY2014-16. We have a Buy rating and price target of Rs44 on the stock.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
TVS Motors	**152**	27.8	21.6	16.7	19.7	21.8	23.6	**175**	15

Remarks:

- TVS Motor Company (TVS), the fourth largest two-wheeler manufacturer in India, continues to impress with its robust volume growth on the back of new launches, ie Jupiter in the scooter segment and Star City + in the motorcycle segment. A wide product range in motorcycles, scooters and mopeds, a healthy market share in the fast growing scooter segment (a 12.5% market share) along with new launches (new Scooty Zest in Q2FY2015 and two motorcycles in H2FY2015) are expected to drive the volume and revenue growth.
- Its two-wheeler exports after a dismal performance in FY2013 rebounded with a 16% growth in FY2014. Its three-wheeler exports maintain the momentum with a 103% growth in FY2014. Further, it has entered into a partnership with BMW Motorrad for development of a new range of motorcycles in the sub-500cc category. The partnership will leverage the technical strength of BMW Motorrad and the benefits of TVS' low-cost manufacturing. The first product from the tie-up is expected in H2FY2015.
- During FY2010-13, TVS invested in its Indonesian subsidiary and other group companies. However, going forward no major investment is expected outside the core business which would help the company to generate better cash flow to de-leverage the balance sheet. With an improvement in the profitability coupled with debt reduction, we expect the company to report both RoCE and RoE in excess of 20% in FY2015-16. We recommend a Buy with a price target of Rs175.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
UltraTech Cement	**2,471**	33.0	25.3	22.0	12.0	13.7	13.8	**2,868**	16

Remarks:

- We expect the demand environment to improve with a cyclical upturn in the economy aided by policy push driving investments in the infrastructure sector. The cement prices across India have risen recently which can boost the OPM of pan-India players like UltraTech.
- UltraTech being an industry leader with a strong balance sheet is placed comfortably to grow inorganically by acquiring assets at reasonable valuations and maintaining its dominant position. The company is slated to increase its current capacity to 70MMT by 2016 from 55MMT currently.
- We like UltraTech on account of its pan-India presence and a strong balance sheet. We maintain our Buy recommendation on the stock with a price target of Rs2,868.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY14	FY15E	FY16E	FY14	FY15E	FY16E	target (Rs)	(%)
Zee Entertainment	**289**	31.1	29.2	22.2	20.6	19.1	22.3	**367**	27

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 ongoing digitalisation theme and the overall recovery in the macro economy. Also, the phase-wise rate hikes in the channel rates would augur well for the subscription revenues. We maintain our Buy rating on the stock with a price target of Rs367.

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