I-direct Top Picks

January 8, 2016

Market outlook

The Chinese market remained the centre spot of the investors after its currency "Yuan" was devalued further triggering its market to hit lower circuit twice in the last fortnight. On the domestic front, Q3FY16E corporate earnings has taken a front seat which are expected to remain subdued. The benefit of lower commodity prices would result into margin expansion for some of the companies. Though a ramp up in earnings would take some time, profitability would be aided by lower input costs and declining interest rates. We expect sectors like auto, cement and capital goods to benefit from this strong operating and financial leverage. Rupee depreciation affirm our positivity on IT and Pharma sector. We continue to maintain our negative bias on metals, infrastructure and real estate. We expect Sensex earnings to grow 7.6% and 20% in FY16E and FY17E to ₹ 1462 and ₹ 1755, respectively. We assign a P/E of 16.5x on FY17E Sensex EPS to arrive at a 12 month forward fair value of 29000 with the Nifty reaching 8800 levels.

What's in : Supreme Industries

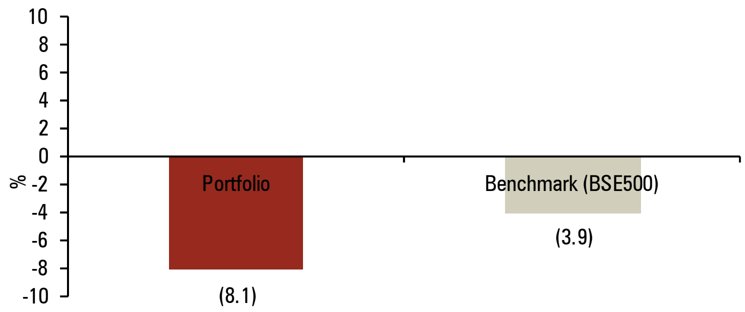
What's out : Indrapastha Gas Limited (IGL)

Top Picks

Company	Recommended Price	CMP	Market Cap	P/E (x)		P/BV (x)		RoE (%)	
	(₹)	(₹)	(₹ crore)	FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
ITC	343	310	248500	24.4	21.2	7.9	7.6	32.5	36.0
Pidilite Industries	587	554	28402	42.3	37.0	10.6	9.3	27.6	27.8
Supreme Industries	694	694	8806	51.2	21.1	6.6	5.5	12.9	26.3
Bharat Forge	1,179	825	19203	17.7	15.2	5.0	4.2	24.2	23.7
Concor	1,653	1418	24664	26.0	19.5	3.4	3.0	13.0	15.5
Voltas	331	289	9570	25.1	21.1	4.0	3.7	15.8	17.4
Timken India	602	524	3563	34.5	26.4	7.3	6.1	22.3	23.1
Star Ferro Cement	158	128	2863	23.2	11.3	3.6	2.8	15.5	24.8
Inox Leisure	232	249	2247	40.2	24.5	3.0	2.7	7.4	10.8

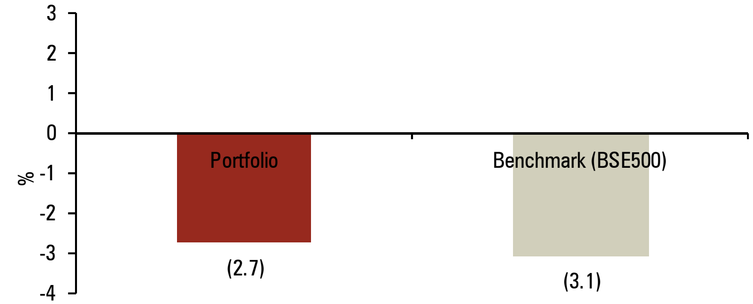
Performance* so far …

Portfolio performance since inception (June 2015)



- The portfolio performance (during July 2015 – December 2015) was driven by PVR (21%), Indrapasthas Gas Ltd. (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 (-30%). 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 (December 2015)



- The portfolio underperformance during December 2015 was mainly due weak global sentiments. Stocks like Bharat Forge, Inox and ITC, which impacted the portfolio returns. Positive performance in Indrapastha Gas Ltd. and resilience from Pidilite Industries and Voltas partially offset the negative return. During the month, we have excluded Indrapastha Gas Limited and has included Supreme Industries in our portfolio

Source: Reuters, ICICIdirect.com Research

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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. Its 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. The C&B segment contributes ~79% to Pidilite's 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 (FY14)
- The specialty industrial segment contributes ~21% 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 revenues growth at ~13% CAGR (FY15-17E) led by a pick-up in demand of industrial adhesives & resins
- We estimate lower revenue CAGR of ~11% while a sharp margin expansion of ~500 bps for FY15- 17E 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 & 35x 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) and 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 portfolio of brands like Aashirvaad, Sunfeast, Bingo, Vivel, Fiama Di Wills, 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" & foray into the dairy industry with Aashirvaad ghee
- We estimate revenue & net profit CAGR of 8.8% & 6.6%, 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, structural decline in commodity prices has increased visibility of earnings growth in segment

Key Financials		FY15	FY16E	FY17E
Net sales	₹ crore	36,083.2	37,339.8	42,755.9
Growth	%	9.7	3.5	14.5
EBITDA margins	%	36.9	38.9	37.7
PAT	₹ crore	9,607.7	10,188.7	11,706.7
PAT growth	%	9.4	6.0	14.9
P/E	x	25.8	24.4	21.2
P/BV	x	8.1	7.9	7.6
RoE	%	31.3	32.5	36.0
RoCE	%	43.2	45.8	48.9

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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 top line and bottom-line 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	52.0	35.4	27.1
P/BV	x	9.6	7.5	6.2
RoE	%	18.4	22.3	23.1
RoCE	%	26.5	32.4	30.2

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 activities coupled with rising demand for quality products in India, we believe plastic piping, packaging products volume will record a CAGR of ~15%, ~13%, 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%, 13% for FY15-18E. SIL is taking concrete steps to increase Value Added Product 's contribution 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 and margin. We believe, EBITDA margin would see moderate growth of ~130 bps to ~16% for FY17E & FY18E.
- We expect the company to maintain high RoE and RoCE considering 1) Healthy top line 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	3,017.0	4,997.8
Growth	%	8.0	-28.5	65.7
EBITDA margin	%	14.9	12.7	15.9
PAT	₹ crore	322.4	168.8	410.4
PAT growth	%	13.7	-47.6	143.1
P/E	x	26.8	51.2	21.1
P/BV	x	7.1	6.6	5.5
RoNW	%	26.6	12.9	26.3
RoCE	%	32.4	18.4	34.2

*For nine months only

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Bharat Forge (BFL)

- 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 and remains a key driver for overall growth. BFL expects the truck segment in the US market to remain strong till FY17. On the domestic side, BFL is a clean play on a recovery of the domestic CV cycle, as it commands > 60% market share in M&HCV components. Thus, BFL remains a strong play on economic recovery
- BFL has remained extremely cautious on capital expenditure and working capital leading to a decline in D/E to 0.7x (1.5x FY10). BFL looks set to increase capacity & utilisation in coming years as the management aims at ~₹ 7,000 crore standalone revenue by FY18E. These factors will keep both margins as well as revenue growth above industry trend. The management is confident of achieving more orders from defence, energy, mining and railways under the 'Make in India' theme
- For Q2FY16, revenues declined 1.9% YoY to ₹ 1,117 crore mainly due to 8.5% YoY decline in export revenues. After adjustment for exchange loss, EBITDA margins came in at 30.1% for Q2FY16 vs. 29.1% for Q2FY15. Consequently, PAT came at ₹ 175.1 crore flat YoY, down 10.4% QoQ. We believe BFL's business franchise is unique and provides investors a great opportunity to own one of the few India listed global ancillary suppliers

Key Financials		FY15	FY16E	FY17E
Net sales	₹ crore	7,625.0	8,700.0	9,671.0
Growth	%	13.5	14.1	11.2
EBITDA margins	%	19.3	19.0	19.5
PAT	₹ crore	764.0	935.0	1,092.0
PAT growth	%	53.2	22.4	16.8
P/E	x	25.2	17.7	15.2
P/BV	x	5.8	5.0	4.2
RoE	%	22.2	24.2	23.7
RoCE	%	18.6	22.3	25.1

Inox Leisure (INOX)

- Inox, with 19% share of the multiplex screens in India and ~8% share of the domestic box office collections ranks second after PVR, which has about 474 screens as on Q2FY16. Inox, enjoys a well distributed presence across India with 67, 151, 86, 89 screens in East, West, North and South regions, respectively. The company has a track record of adding about three screens every month in the past decade and is targeting 435 screens by FY16E and 620 screens over 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 over 90% of the screen. Inox, the second largest player will be well placed to increase prices. We expect Inox' ATPs to grow at 3.5% CAGR in FY15-17E to ₹ 175.7 by FY17E. The spends per head (SPH) is expected to expand to ₹ 59 by FY17E from ₹55 in FY15. In addition, the advertising revenues and other operating revenues is the focus area for the management due to its high EBITDA accretive. nature The stream of income has grown at 40.8% CAGR in FY12-15 from ₹ 29.2 crore to ₹ 81.5 crore. Going ahead, with the in-cinema advertising gaining traction we expect Adv revenues to grow at 23% CAGR over FY15-17E to ₹ 123.2 crore in FY17E.
- Inox is striving to curtail the fundamental divide between itself and the market leader PVR. We feel the re-rating of the stock is imminent.

		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	108.3	40.2	24.5
P/BV	x	3.2	3.0	2.7
RoE	%	3.1	7.4	10.8
RoCE	%	6.0	11.0	14.6

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Voltas (VOLTAS)

- Voltas is primarily an assembler of ACs with outsourcing component and assembles in its Pantnagar plant (Uttarakhand). The segment contributes ~39% to the consolidated topline and recorded sales CAGR of ~16% during FY010-15. A strong brand coupled with over 6500 dealers has helped Voltas to improve its market share from 14% in FY10 to 20.3% 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	5,561.5	6,343.6
Growth	%	-1.6	9.7	12.1
EBITDA margins	%	7.9	8.4	8.9
PAT	₹ crore	349.6	373.6	452.9
PAT growth	%	42.5	6.9	21.2
P/E	x	24.9	25.1	21.1
P/BV	x	4.5	4.0	3.7
RoE	%	16.6	15.8	17.4
RoCE	%	17.0	17.3	19.1

Star Ferro Cement (SFCL)

- Star Ferro Cement (SFCL) is the largest cement player in the North-East region (NER) with over 23% market share. Demand growth in the region has consistently stayed higher than growth at the pan-India level. SFCL expanded its capacity from 1.5 MT in FY13 to 3.6 MT in FY15. This, in turn, helped SFCL to gain market share in NER. With the government's thrust on infrastructure development, demand growth in NER is expected to remain healthy over the next three or four years. Given this backdrop, SFCL is expected to clock 26% revenue CAGR in FY15-17E
- SFCL enjoys various fiscal benefits under NE industrial policy (NEIIPP 2007). SFCL also has cost advantage due to its own captive limestone mines, proximity to large reserves of coal and self sufficiency in terms of power requirement. As a result, it generates healthy EBITDA/tonne, which is over ~2.2x of cement players at pan-India level
- 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 will 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	47.2	23.2	11.3
P/BV	x	4.5	3.6	2.8
RoE	%	9.4	15.5	24.8
RoA	%	3.6	6.8	13.5

Pankaj Pandey Head – Research pankaj.pandey@icicisecurities.com

ICICIdirect.com Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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