Sharekhan Top Picks

Sharekhan's Top Picks basket ended 2014 with a bang by handsomely outperforming the benchmark indices, the Nifty and the Sensex, once again in December. Since the last revision in early December, the Top Picks folio has appreciated by 2.2% as compared with a decline of 3.2% in the Nifty and that of 3.8% in the Sensex during the same period.

During the last month, the performance of our select basket of stocks was boosted by a strong appreciation of close to 26.6% in the stock price of PTC India Financial Services, which was added to the folio in the last month. The sustained buying interest in Gateway Distriparks and Relaxo Footwear also aided the Top Picks folio to do better than the CNX Mid-cap Index as well as the Nifty and the Sensex. Thus, the Top Picks folio not only outperformed in the trending upmove in the market during the October-November period but also sustained the momentum in December to build on the gains of the previous months despite volatility in the month.

We are making a lone change in the folio this month. State Bank of India (SBI) is replacing Axis Bank in which we are booking profits to increase our exposure to the public sector banks. The softening of the bond yield would boost the Q3FY2015 earnings of the public sector banks including SBI, which is our preferred pick in the public sector banking space.

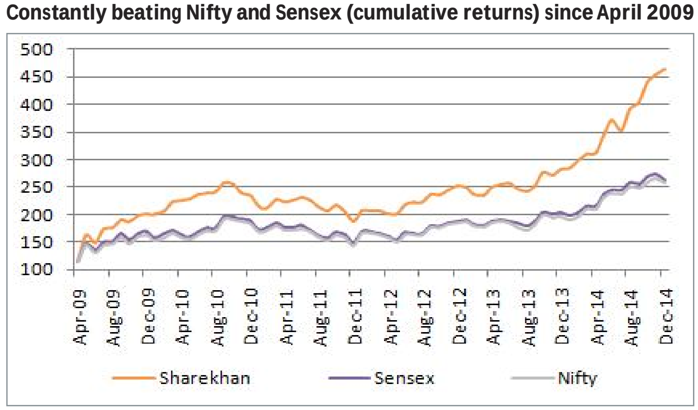
Consistent outperformance (absolute returns; not annualised) (%)

	1 month	3 months	6 months	1 year	3 years	5 years
Top Picks	2.2	14.3	24.7	63.6	148.2	130.6
Sensex	-3.8	3.1	7.5	29.9	77.8	56.2
Nifty	-3.2	4.0	8.0	30.9	79.7	58.9
CNX Mid-cap	1.8	10.2	12.7	55.1	99.2	66.6

Absolute returns (Top Picks vs benchmark indices) %

	Sharekhan (Top Picks)	Sensex	Nifty	CNX Mid-cap
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)	359.2	174.1	171.6	247.4

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



Name	CMP* (Rs)	PER (x) FY14	FY15E	FY16E	RoE (%) FY14	FY15E	FY16E	Price target (Rs)#	Upside (%)
Ashok Leyland	**52**	-28.8	102.2	19.1	-10.7	2.9	13.6	**58**	13
Gabriel India	**89**	27.3	17.2	12.4	17.3	23.7	26.8	**110**	24
Gateway Distriparks	**353**	27.0	23.4	21.0	13.3	14.6	16.2	**	**
ICICI Bank	**353**	20.8	18.5	15.6	14.0	14.5	15.7	**424**	20
Idea Cellular	**153**	27.6	19.9	17.1	12.0	11.9	12.2	**190**	24
Lupin	**1,427**	34.8	25.1	22.0	26.5	27.7	24.4	**1,512**	6
PTC India Financials	**70**	13.8	12.8	9.0	16.1	15.5	19.7	**90**	29
Relaxo Footwears	**565**	38.4	29.6	21.7	21.3	21.2	25.4	**	**
Reliance Industries	**893**	12.8	12.1	10.8	11.3	10.9	11.0	**1,190**	33
SBI	**313**	21.4	16.6	12.7	10.0	11.4	13.5	**378**	21
TCS	**2,557**	26.2	23.4	20.0	31.6	30.0	27.8	**3,010**	18
VA Tech Wabag	**1,474**	36.0	31.2	24.9	14.0	14.1	15.8	**1,900**	29

*CMP as on December 31, 2014 # Price target for next 6-12 months ** Under review For Private Circulation only

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Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Ashok Leyland	**52**	-28.8	102.2	19.1	-10.7	2.9	13.6	**58**	13

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 a pick-up in the economy a sharp recovery in the segment is expected.
- ALL entered the LCV segment with the launch of the Dost in JV with Nissan. The JV has also launched the Partner LCV and the Stile van. Going forward, we expect the company 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 the export market and continues to expand in newer geographies. The diesel genset business is also showing signs of 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 OPM has recovered from the lows on the back of a reduction in discounts and price hikes taken by the company. The margins are expected to expand further given the operating leverage. The company has raised Rs660 crore via QIP and is in the process of selling its non-core assets to pare its debts. With no significant capex planned we expect deleveraging of its balance sheet and improvement in the return ratios.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
Gabriel India	**89**	27.3	17.2	12.4	17.3	23.7	26.8	**110**	24

Remarks:

- Gabriel India is expected to continue to rally led by a strong financial performance due to a strong growth momentum in the two-wheeler segment and its clients.
- We believe the company will continue to enjoy its growth pace in the upcoming years, given the strong growth of its clients, Honda Motorcycle and Scooter India (HMSI) and TVS Motor Company, and the expansion plans of HMSI. Additionally, an early sign of recovery in the passenger vehicle (PV) and commercial vehicle (CV) segments will give impetus to the overall financial performance which would reflect strongly in the FY2017 financials.
- A strong traction in the two-wheeler volume, improving CV and PV segments along with the de-leveraging of the balance sheet would expand the margins and boost the earnings in the next couple of years. We remain positive on the demand outlook for the automobile industry and maintain our Buy rating on the stock.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Gateway Distriparks	**353**	27.0	23.4	21.0	13.3	14.6	16.2	**	**

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 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. We maintain our Buy rating on the stock.

ICICI Bank	**353**	20.8	18.5	15.6	14.0	14.5	15.7	**424**	20

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 non-performing asset (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 the 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 2.3x 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 Rs424.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Idea Cellular	**153**	27.6	19.9	17.1	12.0	11.9	12.2	**190**	24

Remarks:

- Idea Cellular is the fastest growing Indian telecom player with an aggregate market share of 16.7%. Its revenues have grown at a CAGR of 21% over FY2010-14, outperforming the industry, which has grown at a CAGR of 6.1% over the same period. Its market share over the same period has seen a substantial improvement from 11.5% in FY2010 to 16.7% in Q2FY2015. Growing revenues and gaining market share in a cut-throat competitive market with a dozen players is remarkable and displays the company's strong execution and brand-building capabilities.

- With the cancellation of 2G licences by the Supreme Court and emergence of forced consolidation in the telecom market, the operators have turned rational. Over the last two to three quarters, we have witnessed a marked improvement (4-6%) in the voice pricing environment led by a reduction in the discounts and free minutes. The current average realised rate is still at a discount to the headline tariff, presenting an opportunity to further reduce the discounts and freebies, thereby improving the realisation. We expect the voice rates to remain firm in the short term but grow at a CAGR of 6.8% in the medium term over FY2014-17.

- Despite competition in the market place, Idea Cellular has displayed strong execution, resilience, improvement in market share and strength in balance sheet. We continue to believe that the Indian voice and data market is likely to improve and Idea Cellular with its strong brand equity and superior execution capabilities would gain disproportionately owing to its strong execution capabilities, solid asset base and stable balance sheet (its net debt/EBITDA ratio has improved from 2.4x in Q4FY2014 to 1.32x in Q2FY2015 via equity raising and robust cash generation). Hence, we hold a positive view on the stock and expect it to deliver a return of 15-18% from the current levels.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
Lupin	**1,427**	34.8	25.1	22.0	26.5	27.7	24.4	**1,512**	6

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 H1FY2015 on the back of cost rationalisation measures and better product mix. The management has given a guidance to sustain the operating profit margin (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 an agreement with Salix Pharma to in-licence products for the Canadian market, which will support growth in the long term.

- 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 95 abbreviated new drug applications pending approvals 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 CY2015. The company has recently got FIPB clearance to raise FII investment limits to 49% (from 32% currently).

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
PTC India Financials	**70**	13.8	12.8	9.0	16.1	15.5	19.7	**90**	29

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 loan book (35% 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 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 (~4.5%). Any likely downward movement in hedging cost will further reduce the funding cost. The company also has ~Rs240 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 one-off gains in FY2014) without factoring in gains on equity investments. The asset quality is likely to remain robust and the company is likely to deliver high RoAs (~3.5%) which leaves further scope for rerating.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
Relaxo Footwears	**565**	38.4	29.6	21.7	21.3	21.2	25.4	**	**

Remarks:

- Relaxo Footwear is a proxy play on the fast growing mid-priced branded footwear segment, which is expected to grow at high double digits over the next three to five years. The company has integrated operations from manufacturing to branding which enables it to reap the brand benefits with control over quality.
- Over FY2010-14, the company's revenues and earnings have grown at a CAGR of 20.6% and 34.9% respectively. Its balance sheet and return ratios have also been strong. Going forward, we believe that the company's strategy to leverage its brand strength (its advertising and brand promotional push via association with leading Bollywood stars as brand ambassadors) along with favourable demographics would enable it to clock a strong 22.8% revenue growth and a 33.5% earnings growth over FY2014-17.
- Its 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. Thus, we remain positive on the business, with a Buy rating on the stock.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY14	FY15E	FY16E	FY14	FY15E	FY16E		
Reliance Industries	**893**	12.8	12.1	10.8	11.3	10.9	11.0	**1,190**	33

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. However, the gas production from the Krishna-Godavari-D6 (KG-D6) field has fallen significantly in the last two years. With the government approval for additional capex in its allocated gas fields, we believe the production will improve going ahead.
- Though there is uncertainty regarding gas production and pricing of gas from the KG-D6 field, but the traction in volume from shale gas assets is playing positively for the company. Moreover, the upcoming incremental capacities in the petrochemical and refinery businesses are going to drive the future earnings growth as the downstream businesses are on the driving seat and contributing the lion's share of the profitability and cash flow. Hence, the uncertainty related to the domestic gas production and pricing is having a limited material impact.
- In recent past there have been signs of improvement in the benchmark GRM which suggests that there could be a healthy improvement in the GRM of RIL too. The stock is available at attractive valuation considering the size, strong balance sheet and cash flow generating ability of the company.

Name	CMP (Rs)	PER FY14	PER FY15E	PER FY16E	RoE FY14	RoE FY15E	RoE FY16E	Price target (Rs)	Upside (%)
SBI	**313**	21.4	16.6	12.7	10.0	11.4	13.5	**378**	21

Remarks:

- SBI is India's largest bank based on most comparable parameters, such as asset size, branch network (18,000 branches) and customer base. With a revival in the investment cycle and pick-up in consumption, SBI being the largest bank is likely to benefit disproportionately. On the capitalisation front, SBI is better placed (tier-1 CAR at ~10%) compared with the other state-owned banks which should result in lesser equity dilutions.
- SBI has a market share of ~18% and along with its associate banks it commands a market share of ~25% in the banking system. Going ahead, it will merge its associate banks which will give it 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.
- SBI also stands to benefit from the pending reforms in government-owned banks (autonomy, holding company structure, reduction in government stake, easing of investment norms). This builds a genuine case for expansion of its valuation multiples. Even as the asset quality has stabilised, the likely increase in treasury profits (due to a decline in bond yields) will take care of the provisioning requirement and hence cushion the profitability. We have a Buy rating on SBI with a price target of Rs378.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY14	FY15E	FY16E	FY14	FY15E	FY16E	target (Rs)	(%)
TCS	**2,557**	26.2	23.4	20.0	31.6	30.0	27.8	**3,010**	18

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 head winds 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 (%)
VA Tech Wabag	**1,474**	36.0	31.2	24.9	14.0	14.1	15.8	**1,900**	29

Remarks:

- Va Tech Wabag (VTW) is a truly Indian MNC, having global presence in water treatment with superior technology, strong execution capability and professional management. Globally, fresh water supplies are relatively static and the potential scarcity will drive significant investments in this area and a large chunk of this would be from the developing world, where VTW is favourably placed to capture large opportunities ahead.
- While opportunities from new projects are huge, we see a jump in recurring business from the operations and maintenance (O&M) segment, which would be less working capital intensive and have stable margins. Moreover, the efforts by the management to rationalise the cost structure of its overseas business would help the company to improve the overall margin in the coming years.
- We expect the earnings of VTW to grow at a CAGR of 20% in the next two to three years and the RoE to sustain at 15-17%. A presence in a sunrise industry, an asset-light business model and a strong balance sheet (virtually debt-free) are positives to vindicate the belief that VTW is one of the few quality engineering companies in India. We remain positive on the stock.

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