Sharekhan Top Picks

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It has been a good beginning of the year. In terms of performance Sharekhan's Top Picks basket stayed ahead of the benchmark indices and sustained the streak of a comprehensive outperformance for the sixth consecutive month. The Top Picks basket appreciated by 6.9% as compared with the returns of 6.1% in the Sensex, 6.4% in the Nifty and 4.3% in the CNX Mid-cap Index in the same period.

Most of the stocks in the Top Picks basket performed well during the month except PTC India Financial Services, which witnessed some profit booking after higher provisions led to a lower than expected earnings growth in Q3FY2015. We believe it was more of an aberration and the growth in the core business remains extremely strong and the asset quality remains among the best in the non-banking finance company space.

This month we are introducing some stocks that could not only benefit from the expected policy announcements in the Union Budget but also have a structural growth story. Thus, we are introducing Century Plyboards (a play on the implementation of Goods and Services Tax) and Bharat Electronics (a play on the government's "Make in India" call and increased defence spending). We are also introducing Maruti Suzuki India and HDFC Bank, which are bellwether stocks in their respective sectors. To accommodate the new inductions, we are booking profits in Relaxo Footwear, Gabriel India and ICICI Bank. Also, taking a cautious view on the spectrum auction after a higher than expected base price for 3G airwaves, we are taking out Idea Cellular from the Top Picks basket. ■

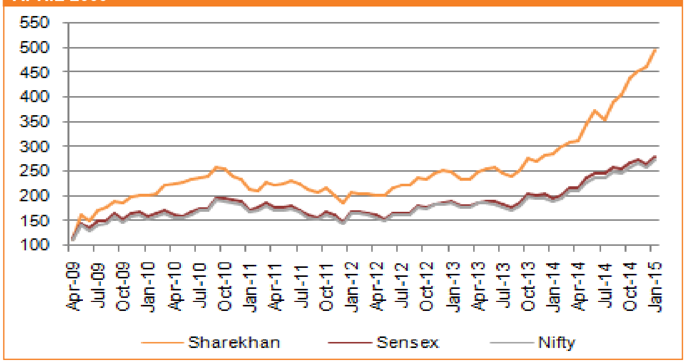
CONSISTENT OUTPERFORMANCE (ABSOLUTE RETURNS; NOT ANNUALISED) (%)

	1 month	3 months	6 months	1 year	3 years	5 years
Top Picks	7	13	40	73	140	147
Sensex	6	5	14	42	66	77
Nifty	6	6	15	44	66	80
CNX Mid-cap	4	11	22	74	73	85

ABSOLUTE RETURNS (TOP PICKS VS BENCHMARK INDICES) %

	Sharekhan (Top Picks)	Sensex	Nifty	CNX MIDCAP
CY2015	6.9	6.1	6.4	4.3
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)	390.9	190.8	189.0	262.3

CONSTANTLY BEATING NIFTY AND SENSEX (CUMULATIVE RETURNS) SINCE APRIL 2009



NAME	CMP* (RS)	PER FY14	PER FY15E	PER FY16E	ROE (%) FY14	ROE (%) FY15E	ROE (%) FY16E	PRICE TARGET (RS)#	UPSIDE (%)
Ashok Leyland	**66**	-36.7	88.7	21.7	-10.7	4.3	15.1	**76**	16
Bharat Electronics	**3,320**	28.5	22.4	19.3	12.9	12.8	12.8	**4,020**	21
Century Plyboards	**184**	52.4	29.6	20.9	23.1	39.1	37.6	**232**	26
Gateway Distriparks	**385**	29.4	22.5	20.1	17.5	21.3	22.1	**465**	21
HDFC Bank	**1,076**	30.4	24.5	19.6	21.3	22.1	23.3	**	-
Lupin	**1,584**	38.6	27.9	24.4	26.5	27.7	24.4	**	-
Maruti Suzuki	**3,645**	31	22.2	16.5	15.8	18.9	21.3	**4,250**	17
PTC India Financials	**63**	12.4	12.0	8.3	16.1	14.8	19.3	**90**	44
Reliance Industries	**915**	13.2	13.4	13.5	11.3	10.1	9.3	**1,045**	14
SBI	**310**	21.2	16.5	12.6	10.0	11.4	13.5	**378**	22
TCS	**2,481**	25.4	22.7	20	35.2	31.6	29.3	**3,100**	25
Va Tech Wabag	**1,613**	39.4	34.1	27.2	14	14.1	15.8	**1,900**	18

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

NAME	CMP (RS)	PER FY14	PER FY15E	PER FY16E	ROE (%) FY14	ROE (%) FY15E	ROE (%) FY16E	PRICE TARGET (RS)	UPSIDE (%)
ASHOK LEYLAND	**66**	-36.7	88.7	21.7	-10.7	4.3	15.1	**76**	16

Remarks:

- Ashok Leyland (ALL) is the second largest CV manufacturer in India with a marketshare 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 in the segment is expected.
- Ashok Leyland entered in LCV segment with the launch of the 'Dost' in JV with Nissan. The JV has additionally launched the Partner LCV and Stile van. Going forward, we expect the company to gain a foothold in the LCV segment and expand marketshare.
- The company is also concentrating on verticals other than CVs to de-risk its business model. The company has strong presence in exports and continues to expand in newer geographies. The diesel genset business is also showing signs of recovery after a tepid performance in FY13-14. Additionally, ALL's defense business is expected to get a leg-up due to the governments focus on indigenous manufacture of defense products and FDI in the sector.
- ALL's OPM has recovered from the lows on the back of reduction in discounts and price hikes taken by the company. 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 non-core assets to pare its debts. With no significant capex planned we expect a de-leveraging of balance sheet and improvement in return ratios.

BHARAT ELECTRONICS	**3,320**	28.5	22.4	19.3	12.9	12.8	12.8	**4,020**	21

Remarks:

- The Make in India initiative will be a boost for India's defence sector incumbents, BEL being the largest beneficiary. BEL being a government-owned company is the largest domestic player in the defence sector with advance technology and strong know-hows. Hence, we see BEL as the biggest beneficiary of the increase in defence spending and the Make in India initiatives.
- BEL is likely to witness strong order flows over the next two to three years and we expect BEL to get an incremental pie of the government spending on defence. The management expects Rs5,000 crore worth of order inflows in FY2015 and Rs7,000-7,500 crore of order intake in FY2016.
- We continue to prefer BEL as a niche PSU play in the fast growing defence sector. In the coming years the order inflow in the defence sector is likely to improve on the back of higher spending, technology transfer and the Make in India initiative. We maintain our Buy rating on the stock with a price target of Rs3,500.

CENTURY PLYBOARDS	**184**	52.4	29.6	20.9	23.1	39.1	37.6	**232**	26

Remarks:

- Century Plyboards (Century) is the leading player in the fast growing plyboard and laminate segment. It has an overall share of around 25% of the organised plyboard market with an estimated size of Rs4,500-4,800 crore annually. The organised plywood and laminate segment is growing at a healthy double-digit growth rate due to an improving demand environment and a shift towards branded products. Century with its strong brand equity, unparallel distribution network (10,000 touch points) and manufacturing presence in the timber rich region of Myanmar is well poised to cash in on the robust growth opportunity.
- The introduction of the GST would create a level playing field between the organised and unorganised players--the unorganised players are currently out of the tax net and thus enjoy lower costs by evading taxes. After the introduction of GST, the tax advantage enjoyed by the unorganised players would plummet and the market share of the organised players is likely surge, benefiting Century.
- We expect the revenues to grow at a CAGR of 22% over FY2014-17 while the benefit on raw material cost reduction, better absorption of fixed overheads and savings on the logistical front owing to a shift in the raw material base are likely to get reflected in improved margins going ahead. This would translate into a strong 49.6% CAGR in the net earnings for FY2014-17. On the back of these positives we maintain our Buy rating on the company with a price target of Rs232 (20x FY2017E EPS).

GATEWAY DISTRIPARKS	**385**	29.4	22.5	20.1	17.5	21.3	22.1	**465**	21

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.
- 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 Rs465.

NAME	CMP (RS)	PER FY14	PER FY15E	PER FY16E	ROE (%) FY14	ROE (%) FY15E	ROE (%) FY16E	PRICE TARGET (RS)	UPSIDE (%)
HDFC BANK	1,076	30.4	24.5	19.6	21.3	22.1	23.3	**	-

Remarks:

- HDFC Bank has a strong presence in the retail segment (~50% of the book) and therefore it 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 CASA ratio of 43% 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. 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 RoE of 18-20% and RoA of 1.8% on a sustainable basis. Therefore, we expect the valuation premium it enjoys compared with the other private banks to expand further.

NAME	CMP (RS)	PER FY14	PER FY15E	PER FY16E	ROE (%) FY14	ROE (%) FY15E	ROE (%) FY16E	PRICE TARGET (RS)	UPSIDE (%)
LUPIN	1,584	38.6	27.9	24.4	26.5	27.7	24.4	**	-

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 FY14	PER FY15E	PER FY16E	ROE (%) FY14	ROE (%) FY15E	ROE (%) FY16E	PRICE TARGET (RS)	UPSIDE (%)
MARUTI SUZUKI	3,645	31	22.2	16.5	15.8	18.9	21.3	4,250	17

Remarks:

- Maruti Suzuki India Ltd (MSIL) is the market leader in the domestic passenger vehicle industry. In M9FY2015, as against an industry growth of a modest 3.7% MSIL has grown its volumes by 13% and in the process expanded its market share by 373BPS to 45%.
- The company has further strengthened its sales and service network. Additionally, the drive undertaken by the company's management to tap the potential in rural areas paid rich dividends in difficult times for the industry and against 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 on other models too. The company 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 space.
- 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.

NAME	CMP (RS)	PER FY14	PER FY15E	PER FY16E	ROE (%) FY14	ROE (%) FY15E	ROE (%) FY16E	PRICE TARGET (RS)	UPSIDE (%)
PTC INDIA FINANCIALS	63	12.4	12.0	8.3	16.1	14.8	19.3	90	44

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 ~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 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 upside.

NAME	CMP (RS)	PER FY14	PER FY15E	PER FY16E	ROE (%) FY14	ROE (%) FY15E	ROE (%) FY16E	PRICE TARGET (RS)	UPSIDE (%)
RELIANCE INDUSTRIES	**915**	13.2	13.4	13.5	11.3	10.1	9.3	**1,045**	14

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.

SBI	**310**	21.2	16.5	12.6	10.0	11.4	13.5	**378**	22

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.

TCS	**2,481**	25.4	22.7	20	35.2	31.6	29.3	**3,100**	25

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.

VA TECH WABAG	**1,613**	39.4	34.1	27.2	14	14.1	15.8	**1,900**	18

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.