Sharekhan top picks

After a good rise of ~8% in November 2009, the Indian equity markets consolidated in the last month of 2009. A long holiday season especially for the overseas investors (that led to lower market participation) and rich valuations led the Sensex and the Nifty, the two benchmark indices, to record minor gains of 2.1% and 1.8% respectively in December 2009. Our portfolio of top picks performed broadly in line with these indices, registering a gain of 1.5% in the same month.

Among our top picks, Ipca Laboratories, which had consistently outperformed the market since September 2009, gained another 4.9% in December 2009. The large-cap capital goods major, Bharat Heavy Electricals, outperformed the benchmark indices by a long margin and was the best performer in our portfolio of top picks, gaining a strong 8.8% over the last month.

For January 2010, we have made only one change to our portfolio of recommendations. We have removed Ipca Laboratories, which has consistently climbed up over the past few months and is likely to consolidate in the coming month. We have replaced it with Greaves Cotton, which is a strong play on the revival in the infrastructure and automobile industries and is available at attractive valuations. Also, Greaves Cotton is likely to come out with very good numbers in the forthcoming Q3FY2010 result season.

On a year-till-date basis (since April 2009), our portfolio of top picks has given a cumulative return of slightly over 100% as compared to the 68.9% return given by the Sensex and the 62.1% return given by the Nifty in the same period.

Name	CMP* (Rs)	PER (x)			RoE (%)			Target price	Upside (%)
		FY09	FY10E	FY11E	FY09	FY10E	FY11E		
Apollo Tyres	49	23.3	7.8	7.5	7.9	19.3	16.9	66	35
BHEL	2,403	37.5	26.6	20.6	23.8	26.6	27.0	2,568	7
Dhampur	136	12.8	4.5	4.6	12.0	28.7	22.8	180	33
Godrej Consumer	264	39.4	23.8	20.4	46.9	44.0	39.6	307	16
Greaves Cotton	284	25.3	12.9	9.9	13.9	24.3	26.7	365	29
ITC	251	29.2	23.9	20.4	25.3	26.4	25.8	271	8
Lupin	1,474	22.9	19.3	16.1	37.5	29.0	26.9	1,555	6
Reliance	1,091	22.4	19.3	14.1	12.3	13.3	15.4	1125	3
Shiv Vani Oil & Gas	343	7.8	7.0	6.3	14.7	13.1	13.3	433	26
Torrent Pharma	394	18.1	14.0	11.3	33.2	31.6	30.2	490	24

* CMP as on December 31, 2009

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE (%) FY09	RoE (%) FY10E	RoE (%) FY11E	Target price	Upside (%)
Apollo Tyres	**49**	23.3	7.8	7.5	7.9	19.3	16.9	**66**	35

Remarks:

- Apollo Tyres Ltd (APL) is the market leader in truck & bus tyres and light truck tyres in India. The company also enjoys significant market share in the passenger car tyre segment. While the strong demand in replacement and OEM markets augurs well for the company's top line growth, lower rubber prices on a year-on-year basis will help the company post 3x jump in its net profit from domestic operations in FY2010.
- To improve its market share and expand further, the company is increasing its capacity in India from 850 tonne per day to around 1,000 tonne per day by establishing a new greenfield plant in Chennai. In international markets, APL has presence in South Africa. To further augment its international presence, the company has recently acquired Vredestein Banden BV, a high-end passenger car tyre manufacturer in Netherlands. We believe the above-mentioned organic and inorganic expansions coupled with improving business environment in the domestic market would help APL post strong growth in the coming years.
- Natural rubber prices have increased sharply in recent times, sustenance of rubber prices at these levels remain a key risk to the company's performance. Also, the near-term performance of the recently acquired European business is susceptible to difficult business environment in these markets.
- At the current market price the stock trades at 7.5x its FY2011E standalone earnings and 6.6x its consolidated FY2011E earnings. We maintain our Buy recommendation on the stock.

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE (%) FY09	RoE (%) FY10E	RoE (%) FY11E	Target price	Upside (%)
BHEL	**2,403**	37.5	26.6	20.6	23.8	26.6	27.0	**2,568**	7

Remarks:

- Bharat Heavy Electricals Ltd (BHEL) is a premier power generation equipment manufacturer and a leading EPC company. It has emerged as the prime beneficiary of the four-fold increase in the investments in the power sector in India.
- BHEL currently has strong orders worth Rs125, 800 crore on hand which provides revenue coverage for the next three to four years. With more than 80% of the orders coming from the government and state utilities, the risk of order cancellation is minimal.The company is also confident of bagging orders for at least five boilers and four turbines as far as the bulk tendering by National Thermal Power Corporation (NTPC) is concerned. We believe the order inflow momentum would remain strong for the company. However, the key challenge for BHEL would be the timely execution of projects. Further there is intense competition from the Chinese and the Korean players, along with Larsen and Toubro capacities coming on stream, raising concerns on price cutting and margins.
- The company's programme to expand its capacity to 15GW by December 2009 is largely on track and the new capacity should be available from March 2010. In our view, the stabilisation of the new capacity coupled with the de-bottlenecking of the supply chain would aid BHEL's revenues to grow at a CAGR of 26% over FY2009-11 with the profits growing at a CAGR of 35% over FY2009-11E.
- At the current market price the stock trades at 26.6x and 20.6x FY2010E and FY2011E earnings respectively. We have a Hold recommendation on the stock. However, we continue to like BHEL because of its resilient business model that is expected to provide the highest revenue and profit growth among the Sensex stocks. We, therefore, maintain BHEL amongst our Top Picks.

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY09	FY10E	FY11E	FY09	FY10E	FY11E	price	(%)
Dhampur	**136**	12.8	4.5	4.6	12.0	28.7	22.8	**180**	33

Remarks:

- Dhampur Sugar Mills is the fifth largest sugar producer in India with integrated facilities and is going to be a key beneficiary of the current upturn in the sugar cycle. We expect the profits to triple in FY2010 (ending September 2009) due to higher profits from its sugar business led by a higher sugar realisation, and refining and sale of raw sugar imported at low cost.

- The hefty cash flow generation in FY2009-11 due to rampant increase in its business profits will help the company to bring down its debt-equity ratio to 1.2x in SY2010 and further to 1x in SY2011 from 2.5x in FY2009. However, despite the stupendous profit growth the stock trades at 4.5x FY2010E earnings, which is at steep discount to its peers that are trading at ~10x their FY2010E earnings.

- A higher than expected sugarcane price, possible further government interventions and likelihood of a bumper sugar crop in FY2011 remain the key risks to our estimates.

- At the current market price of Rs136 the stock trades at 4.5x and 4.6x its FY2010E and FY2011E EPS and 4.1x and 4.4x EV/EBIDTA respectively. We maintain our Buy recommendation on the stock with the price target of Rs180.

Godrej Consumer	**264**	39.4	23.8	20.4	46.9	44.0	39.6	**307**	16

Remarks:

- GCPL is a major player in the Indian FMCG market with presence in soap, hair dye and hair colour, liquid detergent and toiletries categories. The acquisition of 49% stake in Sara Lee broadens the limited product portfolio and immensely improves the growth prospects of the company in the long run. With rural demand remaining strong despite monsoon concerns and with the company expanding its reach, GCPL will continue to gain market share in the soap and hair colour segments and would post robust volume growth in the coming quarters. Thus we expect GCPL's top line to grow at a CAGR of 20.3% over FY2009-11 (excluding Sara Lee's financials).

- With steep correction in palm oil prices (the key raw material), the margins of the company have improved substantially and thus we expect a hefty 64.7% y-o-y growth in its net profit in FY2010.

- GCPL board has recently approved raising upto Rs.3,000 crores for acquisitions. These likely acquisitions could act as additional triggers for the stock.

- We see any significant increase in palm oil prices as a key risk to the company's profitability.

- With a 38.3% CAGR over FY2009-11 (excluding Sara Lee's financial), GCPL will outperform the industry and remains one of the better performing companies in the FMCG space. At the current market price the stock trades at 20.4x its FY2011E earnings. We have a Buy recommendation on the stock.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY09	FY10E	FY11E	FY09	FY10E	FY11E		
Greaves Cotton	**284**	25.3	12.9	9.9	13.9	24.3	26.7	**365**	29

Remarks:

- Greaves Cotton Ltd (GCL)'s core competencies are in three-wheeler diesel/petrol engines, power gensets, agro engines and pumpsets (the engine segment) and construction equipment (the infrastructure equipment segment).
- GCL is likely to be the key beneficiary with the uptick in demand for the three-wheeler engines (which constitute 60% of the company's total revenues). The infrastructure equipment business (constitutes ~15% of the company's total revenues) is a direct play on the growth in the construction and road building activity in the country. We believe with much improved fund availability, low interest rates and pick-up in industrial and real estate sectors, the business is in for a sharp revival.
- GCL has a strong balance sheet and is a zero net debt company. Moreover, the company does not have any major capex plans in the near future. With a hefty increase in its profits and a low capex the company is expected to generate free cash flows in excess of Rs100 crore in FY2010 and FY2011.
- We believe that a slower than expected recovery in the construction and road building activity in the country could affect the revival of sales for GCL's construction equipment division and thus poses a risk to our estimates. Also, the lower than expected sales of three-wheelers by Piaggio (which accounts for a high proportion of sales in the automotive engine division) may have a direct impact on the performance of the automotive engine segment.
- We expect GCL to post a robust CAGR of 20.5% in revenues and that of 59.9% in its net profit respectively over FY2009-11. At the current market price, the stock trades at 12.9x and 9.9x its FY2010E and FY2011E EPS respectively. We have a Buy recommendation on the stock.

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE FY09	RoE FY10E	RoE FY11E	Target price	Upside (%)
ITC	**251**	29.2	23.9	20.4	25.3	26.4	25.8	**271**	8

Remarks:

- ITC's cigarette business that has dominance in the category continues to be a cash cow for the company. ITC endeavors making a mark in the Indian FMCG market with successful brands such as Bingo, Sunfeast and Aashirwaad already in the reckoning among the best in the industry. With the company's new portfolio of personal care products its FMCG business competes with the likes of Hindustan Unilever and Procter & Gamble.
- After a sharp increase in the excise duty on cigarettes in the last two union budgets, the government was less lethal in the Union Budget FY2009-10 and did not increase the excise duty. This augurs well for ITC's cigarette business and has led to significant increase in cigarette sales volumes . Rationalisation of the company's biscuit portfolio and an increase in the scale of its personal care business would lower the losses in the non-cigarette FMCG business going ahead. While the hotel business is staging a revival the agri business profitability has improved sharply.
- An increase in taxation and the government's intention to curb consumption of tobacco products remain the key risks to ITC's cigarette business over the longer term.
- We expect ITC's bottom line to grow at a CAGR of 19.3% over FY2009-11. At the current market price, ITC trades at 20.4x its FY2011E earnings. We maintain our Hold recommendation on the stock.

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE (%) FY09	RoE (%) FY10E	RoE (%) FY11E	Target price	Upside (%)
Lupin	**1,474**	22.9	19.3	16.1	37.5	29.0	26.9	**1,555**	6

Remarks:

- Global dominance in certain products, focus on niche, less-commoditised products, a geographically diversified presence in newer markets, such as Japan, and a presence in the US branded segment distinguish Lupin among the mid-cap players in the generic space.
- With a leadership position in the anti-TB and other anti-infective segments and growing exposure to the chronic therapy segments, Lupin is one of the fastest growing pharmaceutical companies in the domestic market.
- A focus on niche products like oral contraceptives and ophthalmology products along with a strong presence in the branded space through a pediatric antibiotic, Suprax, and a medical inhalation device, Aerochamber, has enabled Lupin's US business to grow at a staggering CAGR of 77% over FY2004-08. With the expansion in the branded portfolio through recent addition of Antara and the launch of Allernaze, we expect the US business to grow at a CAGR of 43% over FY2009-11.
- With a strong business in India and the USA, Lupin has also made inroads into the other regulated markets of the UK and France. Further, it has entered markets like Japan, Germany, Australia and South Africa through acquisitions in order to extend its global reach.
- With the strong core business a differentiated strategy augers well for Lupin and the anticipatory positive clearance of the Mandideep facility from the USFDA would drive the upwards performance of the stock.
- We expect Lupin to report an earnings CAGR of 28% over FY2009-11 with strong margins at the operating level. At 19.3x FY2010E and 16.1x FY2011E earnings, Lupin is among the cheapest front-line pharmaceutical stocks. We maintain our Buy recommendation on the stock with a price target of Rs1,555.

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE (%) FY09	RoE (%) FY10E	RoE (%) FY11E	Target price	Upside (%)
Reliance	**1,091**	22.4	19.3	14.1	12.3	13.3	15.4	**1125**	3

Remarks:

- With the start of commercial production of gas in April 2009 and that of crude oil in September 2008 (both from KG basin), Reliance Industries Ltd (RIL) holds a great promise in the E&P business. The E&P business is expected to add significantly to the company's earnings and cash flow from FY2010 onwards with the majority of the earnings coming from the less volatile natural gas business. The company is currently producing 60mmscmd of gas and targets to ramp it to 80mmscmd by end of March 2010. At present, the company's reserves are estimated at 9 billion barrels of oil equivalents.
- We expect the gross refining margin (GRM) of RIL to contract in the near to medium term, as new refineries with total capacity of 1.5-2.0 million barrel per day (including Reliance Petroleum Ltd [RPL]) are expected to come on-stream in 2009 in the environment of weak demand. However, we expect RIL to fetch a premium over Singapore Complex' GRM due to its superior refinery complexity. The refining volumes were also doubled as RPL's has been merged with RIL with effect from 01 April 2008.
- We believe that RIL's all cash but not binding bid to buy a controlling stake in the world's third largest petrochemical company, LynodellBasell (LB), if successful would have synergistic effect for RIL. It would help RIL gain access to LB's ready market of USA and Europe, further post the deal RIL would become near -global monopoly in the polypropylene and polyethylene sector. However we await details on the bid price and the valuation.
- We believe that RIL would be able to maintain superior margin in the petrochemical business given its increased focus on the domestic market (strong demand and high price realisation environment).
- A delay in the ramp-up of KG D-6 gas production and an adverse verdict of the Supreme Court of India on its legal feud with RNRL and another legal case with National Thermal Power Corporation (NTPC) are the key risks to our estimates. Further, there is still ambiguity related to the likely change in the section 80IB, which could take away the benefit of the seven-year tax holiday from gas production. Any further fall in the refining and petrochemical margins could result in deviation from our estimates.
- At the current market price, the stock is trading at 14.1x FY2011E consolidated earnings.

Name	CMP (Rs)	PER FY09	FY10E	FY11E	RoE (%) FY09	FY10E	FY11E	Target price	Upside (%)
Shiv Vani Oil & Gas	**343**	7.8	7.0	6.3	14.7	13.1	13.3	**433**	26

Remarks:

- Shiv-Vani Oil & Gas Explorations is India's largest onshore oil and gas service provider in the private sector having a fleet of 40 rigs and ten seismic survey crews. The company offers wide range of services including seismic, drilling, and other specialised services, such as work over, gas compression services and coal bed methane (CBM) integrated services.
- The extremely strong order book of Rs3,700 crore, which is close to 4.2x its FY2009 revenues, renders strong visibility to the company's earnings. The company has gone for timely expansion of its assets in the past and all its assets are already backed by contracts in hand.
- The company has shown an exponential growth in its financial performance in H1FY2010 and the same is likely to maintained in the second half of the fiscal with the deployment of all the eight rigs for a large order worth Rs1,610 crore from ONGC. Further, the company is planning to raise additional funds of Rs600 crore through QIB issue to further augment its fleet.
- Softening day rates, and curtailment and deferment of worldwide E&P capex pose a risk to the company's revenue going forward. Moreover, any delay in contracts or any renegotiation of contracts going forward could potentially hamper its cash flows and thus remains a risk for the company. However we see little probability of renegotiation of the contracts, as the bulk of contracts are from public enterprises like ONGC and OIL.
- At the current market price, the stock trades at 6.3x its FY2011E earnings. We maintain our Buy recommendation on the stock with a price target of Rs433.

Name	CMP (Rs)	PER FY09	FY10E	FY11E	RoE (%) FY09	FY10E	FY11E	Target price	Upside (%)
Torrent Pharma	**394**	18.1	14.0	11.3	33.2	31.6	30.2	**490**	24

Remarks:

- Torrent Pharmaceuticals (Torrent Pharma) is a well-known name in the domestic branded formulation market with strong focus on fast-growing chronic lifestyle segment.
- Torrent Pharma has been one of the under-owned stocks in the mid-cap pharma space due to realignment in domestic formulations, impending turnaround in Heumann business and lower margins at operating levels.
- However with the domestic market back on track, completion of investment phase in emerging markets and turnaround in Heumann business, we expect Torrent Pharma's earnings to post a CAGR of 23.8% over FY2009-11E. The cost restructuring initiatives will lead to operational efficiencies in the long term resulting in expansion of operating margins.
- With completion of investment phase, robust field presence and new product introductions, we expect Torrent Pharma's emerging market (Brazil, Russia and Europe) business to post a strong CAGR of 20.5% over FY2009-11E. Further, scale-up in the US business would add to its growth. We believe the company has been trading at significant discount (at 12.3x its FY2011E) to its peers and should get higher valuation.
- We believe Torrent Pharma is on the right track for good revenue growth and significantly higher earnings growth driven by margin expansion. At the current market price of Rs395, the stock is discounting its FY2010E earnings by 14x and its FY2011E earnings by 11.3x. On account of continued traction in the growth we maintain our buy recommendation on the stock with a price target of Rs490.

The author doesn't hold any investment in any of the companies mentioned in the article.

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