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top picks

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Sharekhan top picks

In the November 2006 issue, we had recommended the best 12 of our Stock Ideas as Sharekhan Top Picks. As on December 7, 2006, the return on this basket of stocks has been 2.2% as compared to the Sensex, which has given 6.1% returns and the S&P CNX Nifty, which has given 6.6% returns.

We have made two changes in the portfolio. We have taken out Cipla and Infosys Technologies from the portfolio. We have introduced two new stocks—State Bank of India and Sun Pharma—in the portfolio.

Name	CMP* (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Bharat Heavy Electricals	2,649.3	38.6	26.8	21.1	23.0	26.2	26.4	**	
Cadila Healthcare	325.7	26.9	18.0	13.9	21.7	23.0	23.0	425.0	30.0
ICICI Bank	878.2	30.8	23.9	19.9	13.6	14.0	15.1	1,020.0	16.0
India Cements	230.5	121.3	11.5	8.1	4.3	31.1	30.8	315.0	37.0
ITC	186.7	30.6	25.2	21.2	26.8	28.2	28.1	220.0	18.0
Mahindra & Mahindra	846.9	30.6	22.8	19.5	29.5	27.6	23.2	870.0	3.0
Madras Cement	3,218.0	48.6	12.5	10.6	20.3	46.2	36.6	4,000.0	24.0
Sanghvi Movers	796.4	18.1	12.8	9.3	39.6	26.7	24.4	1,150.0	44.0
SBI	1,346.2	16.1	15.0	11.8	17.1	16.0	17.7	**	
Subros	254.4	12.5	9.1	6.3	18.9	20.3	22.1	370.0	45.0
Sun Pharma	1,004.0	32.5	29.5	21.9	42.2	24.1	20.4	1,200.0	20.0
UltraTech Cement	958.3	51.8	17.8	15.7	22.1	40.8	32.7	1,100.0	15.0

* CMP as on December 07, 2006

** Price target under review

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY06	FY07E	FY08E	FY06	FY07E	FY08E	price	(%)
BHEL	**2,649.3**	38.6	26.8	21.1	23.0	26.2	**26.4**	**	

Remarks:

- Bharat Heavy Electricals Ltd (BHEL), a leading supplier of power equipment, will be the prime beneficiary of a four-fold increase in the investments (Rs500,000 crore in the 11th Five-Year Plan as against Rs112,000 crore in the 9th Five-Year Plan) being made in the power sector.
- BHEL's current order book of Rs45,700 crore, ie 3.4x its FY2006 revenue, provides high earnings visibility.
- The power ministry has proposed around five ultra mega power projects entailing a capacity addition of 20,000MW (4,000MWx5) with the combined turnkey value of at least Rs80,000 crore.
- BHEL's recent technology transfer agreement with Alstom for design and manufacture of large-sized (500MW+) super-critical boilers will enable it to bid for the ultra mega power projects. We expect BHEL to bag a fair share out of this huge Rs80,000-crore potential investment, which in turn will maintain the growth momentum in the company's order book.
- The stock trades at a PER of 21.1x its FY2008E earnings. BHEL's valuation looks attractive as compared with that of its peers, such as Siemens, ABB and Larsen and Toubro.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
Cadila Healthcare	**325.7**	26.9	18.0	13.9	21.7	23.0	23.0	**425.0**	30.0

Remarks:

- A strong research-based, integrated pharma player, Cadila is now spreading its wings to the high-margin regulated markets. It has a strong research and product pipeline with 30 products expected to receive generic approval by FY2007.
- Cadila is ranked number five in the domestic formulation business. It plans to introduce over 40 products in the Indian market in the next two years.
- Cadila has subsidiaries in France, the USA and Brazil, and these were making losses until FY2005. We expect these subsidiaries to collectively make a profit of over Rs32 crore in FY2008 as compared with a loss of over Rs30 crore in FY2005.
- We expect Cadila's earnings to grow at a compounded annual growth rate (CAGR) of 38.4 % over FY2006-08E. The stock is trading at a PER of 13.9x FY2008E earnings.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
ICICI Bank	**878.2**	30.8	23.9	19.9	13.6	14.0	15.1	**1,020.0**	16.0

Remarks:

- ICICI Bank is India's second-largest bank. Its strong positioning in the retail advance segment gives it dual advantages of a healthy growth in both loans and fee income.
- A key concern regarding non-performing assets (NPAs) is now receding with its NPAs now below 1%.
- Various subsidiaries (life insurance, general insurance, ICICI Securities) add Rs150 to the overall valuation.
- The stock trades at a PER of 19.9x its FY2008E earnings and 2.7x its FY2008E book value. ICICI Bank's valuation looks attractive as compared with that of its peers, such as HDFC Bank.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
India Cements	**230.5**	121.3	11.5	8.1	4.3	31.1	30.8	**315.0**	37.0

Remarks:

- India Cements (ICL) is the prime beneficiary of the upturn in the southern cement cycle, which saw the highest consumption growth of 25% in the country. With this buoyancy expected to continue in the future, we expect India Cements, the largest player in the south, to be on an exponential growth trajectory on account of its highest leverage to the prices of cement.
- The Rs350 crore capital expenditure plan of the company to raise the cement capacity from 8.8 million tonne to 11 million tonne per annum by December 2007 will drive the growth of the company going forward.
- With the funds raised from various sources, the company's balance sheet has undergone a major transformation. Going ahead, with the strong cash flows from operations, we expect the debt/equity ratio to come down to 0.3:1 in FY2008, which will improve the return ratios with the return on capital employed (RoCE) of 29.3% and the return on net worth (RoNW) of 27.7% in FY2008.
- ICL is trading at 8.1x its FY2008E earnings, and on an enterprise value (EV)/tonne basis at US$110 per tonne of cement. Given the steep earnings growth trajectory and the massive transformation in its balance sheet, we believe the valuation discount to its other peers is unjustified.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
ITC	**186.7**	30.6	25.2	21.2	26.8	28.2	28.1	**220.0**	18.0

Remarks:

- ITC is the undisputed market leader in the cigarette business in India. Over the years ITC has gained substantial pricing power in the market and has been posting a good volume growth in the business.
- ITC has diversified its revenue stream by successfully channelising the huge cash flows generated from the cigarette business into new and upcoming businesses like hotels, fast moving consumer goods (FMCG), paperboards and agri-marketing.
- ITC's huge investment in these businesses has now started reflecting in a robust growth in the revenues and the profits.
- ITC's venture into agri-marketing through e-Choupal is now set to replicate the urban mall mania in rural areas through Choupal Sagars. Choupal Sagars are expected to be major revenue and profit drivers for ITC over the long term.
- With earnings CAGR of 20.2% over FY2006-08E the stock is attractively quoting at a PER of 21.2x its FY2008E earnings.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Mahindra & Mahindra	**846.9**	30.6	22.8	19.5	29.5	27.6	23.2	**870.0**	3.0

Remarks:

- The government's increasing thrust on agriculture and the easy availability of credit would benefit M&M's tractor sales.
- Its product mix would be further enriched with a number of new launches, including a new UV platform, a mid-sized car Logan (in collaboration with Renault) and other products in collaboration with International Trucks. Another multi-purpose vehicle (code named Ingenio) is slated for a launch in FY2008.
- A better product mix and higher operating efficiencies have helped improve the margins of the company.
- Subsidiaries like Tech Mahindra, Mahindra Gesco, and MMFSL are rendering strong performances.
- Currently M&M is quoting at 19.5x its stand-alone earnings.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Madras Cement	**3,218.0**	48.6	12.5	10.6	20.3	46.2	36.6	**4,000.0**	24.0

Remarks:

- It is amongst the leading and most efficient producers of cement; it will be a prime beneficiary of the upturn in the cement cycle down south.
- To make the most of the big opportunity, the company plans to increase its cement capacity by 60% to 10 million tonne per annum by Q1FY2009. Moreover its 36MW captive power plant and the addition of another 18MW of capacity shall result in substantial savings in the power cost.
- The higher volume growth, strong cement prices and lower sales tax rate (14.5% as compared with 23.5% earlier) would result in a CAGR of 94.3% in its earnings over FY2006-08.
- The stock is quoting at 10.6x its FY2008E earnings and EV/tonne of US$151, which is cheaper as compared with its peers.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Sanghvi Movers	**796.4**	18.1	12.8	9.3	39.6	26.7	24.4	**1,150.0**	44.0

Remarks:

- Sanghvi Movers Ltd (SML) is the fourth largest crane-hiring company in Asia and is ranked 24th in the world by Cranes International, an international crane magazine. It has a fleet of 190 cranes of capacities ranging from 20 tonne to 800 tonne. The capacity expansion exercise undertaken by India Inc in recent times has led to a strong demand for cranes.
- SML has added cranes worth Rs170 crore in FY2006. It is further looking at adding cranes worth Rs130 crore in FY2007, which will lead to sustained earnings growth over FY2006-08.
- Currently SML is running at 95-100% utilisation levels. The company has adopted a strategy to have a back-to-back tie-up for most of its cranes, which shall ensure strong cash flows going forward.
- We expect the company to report EPS of Rs61.1 in FY2007E and of Rs79.5 in FY2008E, but the CEPS will be significantly higher.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
SBI	**1,346.2**	16.1	15.0	11.8	17.1	16.0	17.7	**	

Remarks:

- State Bank of India is the largest Indian bank. Its reach and size makes it a proxy investment on the growth of the Indian economy.
- The bank is targeting higher growth rates than achieved in the past. With system credit growth at 28% and corporate India hungry for funds, SBI expects the credit growth momentum to be maintained.
- The bank's CAR as in September 2006 stood at 12.6% with Tier-I CAR at 8.74%. The bank has room for Rs4,000 crore of hybrid Tier-I and plans to raise Rs2,000 crore in Tier-II debt by March 2007.
- In the winter session of the Parliament, the government is likely to table the amendments to the Banking Regulation Act, 1949 and the State Bank of India (SBI) Act, 1955 allowing the banks including SBI to issue preference share capital. This would provide further capital raising options to SBI and would be a positive for the banking sector. The bank could also raise fresh equity capital in FY2008 once the banking law is amended.
- The stock trades at a PER of 11.8x its FY2008E earnings and 1.9x its FY2008E stand-alone book value.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Subros	**254.4**	12.5	9.1	6.3	18.9	20.3	22.1	**370.0**	45.0

Remarks:

- Subros will be a direct beneficiary of the strong volume growth expected for two of its major clients, Maruti Udyog and Tata Motors. Both the companies have chalked out a huge capacity expansion plan for the next two years, which augurs well for Subros.
- Subros has been de-risking its business strategy by adding new clients as well as new products in its portfolio. Subros intends to tap the huge potential of the AAC system for commercial vehicles and utility vehicles, thereby de-risking its client portfolio. To diversify its client base it has added Mahindra and Mahindra to the list of its clients for its new platform cars.
- In line with the strong demand, Subros is expanding its capacity from 5 lakh units to 7.5 lakh units in the first phase and further to 10 lakh units in the second phase.
- At the current levels the stock is discounting its FY2008E earnings by 6.3x.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Sun Pharma	**1,004.0**	32.5	29.5	21.9	42.2	24.1	20.4	**1,200.0**	20.0

Remarks:

- Sun Pharma maintains the numero uno ranking with neurologists, cardiologists, diabetologists and orthopedics.
- With 56 abbreviated new drug applications (ANDAs) pending US FDA approval and a filing rate of 30+ ANDAs per year, Sun Pharma has one of the strongest product pipelines for the US market. The company is amongst the top three players in around 15 of the 25 products that it sells in the US market.
- Sun Pharma is likely to show a CAGR of about 60% in ROW markets in FY2006-08. It has 750 products registered and another 300+ products pending approval in these markets.
- With a strong cash position of over Rs1,500 crore, Sun Pharma is well placed to unlock value from potential acquisitions. The demerger of its innovative research and development research unit into a separate arm is likely to trigger substantial value unlocking going forward. The company's disclosed innovative R&D pipeline consists of one new chemical entity and two novel drug delivery system products.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
UltraTech Cement	**958.3**	51.8	17.8	15.7	22.1	40.8	32.7	**1,100.0**	15.0

Remarks:

- The prices of cement in the country have risen in the past one-year and are expected to remain buoyant owing to a rising demand, a depleting surplus supply and a slow-down in capacity addition. We expect UltraTech Cement Ltd (UCL) to be the biggest beneficiary of the upswing in the cement prices due to its high leverage to them.
- The freight cost, which is one of the major costs for cement producers, is very high for UCL. However it shall reduce as the company explores the synergies with Grasim Industries.
- UCL has lined up a capex plan of Rs1,003 crore to be implemented over the next two years. As part of the plan it shall set up a 92-megawatt thermal power plant at a cost of Rs540 crore for captive use; this shall reduce its power cost substantially.
- The stock is quoting at an enterprise value of US$165 per tonne of cement; we believe the valuation is attractive considering the stock's steep discount to the valuation commanded by its peers.

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