# Sharekhan top picks

Amidst continued negative news flow from the global markets, recession fears in all major economies and bail-out of the troubled financial giant Citigroup in November 2008, the market continued its slide and extended its losses. The Sensex declined by 10% while the Nifty dropped by 8.7% during the month.

Our portfolio of top picks under-performed the market as the performance was sharply hampered by the battering received by the offshore services sector. The stocks within this sector (Aban Offshore and Shiv-Vani Oil & Gas Exploration Services) saw considerable selling despite steady fundamentals due to softer sentiments caused by the sharp decline in crude oil prices. These stocks also suffered collateral damage due to their high institutional and foreign holdings.

This month, we have replaced Zee News with Marico in an effort to increase our weightage in the fast moving consumer goods sector in order to provide greater stability to our top picks portfolio.

| Name | CMP* | PER (x) | | | RoE (%) | | | Target | Upside |
|---|---|---|---|---|---|---|---|---|---|
| | (Rs) | FY08 | FY09E | FY10E | FY08 | FY09E | FY10E | price | (%) |
| Aban Offshore | 666 | 7.9 | 2.5 | 1.5 | 34.6 | 79.4 | 64.1 | 2,624 | 294.2 |
| Bharat Heavy Electricals | 1,338 | 23.4 | 19.9 | 13.9 | 25.9 | 24.6 | 27.7 | 1,546 | 15.5 |
| Bharti Airtel | 665 | 18.8 | 15.1 | 12.2 | 25.3 | 29.1 | 28.7 | 985 | 48.2 |
| HDFC | 1,430 | 20.9 | 16.4 | 14.0 | 21.4 | 19.4 | 20.0 | 2,805 | 96.1 |
| Hindustan Unilever | 235 | 28.9 | 24.8 | 20.9 | 85.0 | 120.8 | 100.7 | 280 | 19.3 |
| ITC | 169 | 20.5 | 18.7 | 15.6 | 27.7 | 26.1 | 26.5 | 218 | 28.7 |
| Larsen & Toubro | 729 | 19.6 | 13.8 | 10.2 | 20.0 | 23.5 | 25.7 | 1,802 | 147.2 |
| Lupin | 580 | 15.5 | 11.2 | 9.5 | 31.9 | 22.2 | 21.2 | 840 | 44.9 |
| Marico | 51 | 19.3 | 17.6 | 14.2 | 63.3 | 44.9 | 36.6 | 71 | 39.2 |
| Maruti Suzuki | 491 | 8.4 | 8.9 | 7.7 | 20.2 | 16.3 | 16.0 | 635 | 29.4 |
| Reliance Industries | 1,118 | 10.6 | 8.4 | 6.2 | 22.8 | 19.6 | 20.0 | ** | - |
| Shiv-Vani Oil & Gas | 125 | 5.8 | 3.9 | 3.0 | 17.3 | 17.2 | 17.1 | 420 | 237.3 |

* CMP as on December 05, 2008

** Price target under review

| Name | CMP (Rs) | PER FY08 | PER FY09E | PER FY10E | RoE (%) FY08 | RoE (%) FY09E | RoE (%) FY10E | Target price | Upside (%) |
|---|---|---|---|---|---|---|---|---|---|
| Aban Offshore | **666** | 7.9 | 2.5 | 1.5 | 34.6 | 79.4 | 64.1 | **2,624** | 294.2 |

**Remarks:**

- Aban Offshore, one of the largest oil drilling companies in Asia, is benefiting from increased oil exploration and production activities globally. The resulting robust demand environment is leading to firm day rates for the company's assets.
- High day rates, combined with the company's efforts to substantially ramp up its asset base through organic and inorganic initiatives, are likely to benefit the company going forward. In the past couple of months, the company has announced new contracts worth $1.3 billion, thereby increasing the visibility of its revenues.
- The visibility of Aban's revenue remains strong, particularly in view of its $3.2-billion worth of committed contracts. The deployment of its idle assets going forward would act as an important trigger for earnings.
- At the current market price the stock trades at 2.5x FY2009 and 1.5x FY2010 estimated earnings. We maintain our Buy call on the stock.

| Name | CMP (Rs) | PER FY08 | PER FY09E | PER FY10E | RoE (%) FY08 | RoE (%) FY09E | RoE (%) FY10E | Target price | Upside (%) |
|---|---|---|---|---|---|---|---|---|---|
| BHEL | **1,338** | 23.4 | 19.9 | 13.9 | 25.9 | 24.6 | 27.7 | **1,546** | 15.5 |

**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 (Rs5,00,000 crore in the Eleventh Five Year Plan as against Rs1,12,000 crore in the Ninth Five Year Plan) being made in the power sector.
- BHEL currently has orders worth Rs104, 000 crore on hand, which provides revenue coverage for the next three-four years.
- The company would also be awarded four or five sets of 800MW supercritical technology based units from NTPC on a negotiated basis. We believe the order inflow momentum would continue to remain strong for the company.
- At the beginning of 2008, the company brought on stream 4GW of additional manufacturing capacity taking the total capacity of BHEL to 10GW per annum. In our view, stabilisation of new capacity coupled with de-bottlenecking of supply chain would aid BHEL's revenues to grow at a CAGR of 29.4% over FY2008-10E.
- At the current market price BHEL is discounting its FY2010 earnings by 13.9x, which we believe is attractive as the earnings of the company are expected to grow at a CAGR of 30.1% over FY2008-10E.

| Name | CMP (Rs) | PER FY08 | PER FY09E | PER FY10E | RoE (%) FY08 | RoE (%) FY09E | RoE (%) FY10E | Target price | Upside (%) |
|---|---|---|---|---|---|---|---|---|---|
| Bharti Airtel | **665** | 18.8 | 15.1 | 12.2 | 25.3 | 29.1 | 28.7 | **985** | 48.2 |

**Remarks:**

- Bharti Airtel with over 24% market share is a leader in the Indian telecom space. On average, the company has been adding more than 2 million subscribers every month and currently has a subscriber base of approximately 80.2 million.
- Despite the competition led pricing pressures, Bharti has been able to sustain its operating margins at 41-42% on the back of strong growth in minutes of usage.
- In Q2FY2009 the company has reported net cash inflows for the first time, this will ease out cash flow concers regarding the company.
- At the current market price the stock trades at 15.1x FY2009 and 12.2x FY2010 estimated earnings.

| Name | CMP | PER | | | RoE (%) | | | Target | Upside |
|---|---|---|---|---|---|---|---|---|---|
| | (Rs) | FY08 | FY09E | FY10E | FY08 | FY09E | FY10E | price | (%) |
| HDFC | **1,430** | 20.9 | 16.4 | 14.0 | 21.4 | 19.4 | 20.0 | **2,805** | 96.1 |

**Remarks:**

- HDFC is engaged in providing housing loans to individuals, corporates and developers. Besides its core business, HDFC holds interest in banking, asset management and insurance through its key subsidiaries.
- The recent changes in the capital adequacy norms augur well for HDFC as these should result in the release of capital and improve capital adequacy. Moreover, a close rival (ICICI Bank) has priced itself out from the housing space, which augurs well for the HDFC's core housing finance business.
- Operationally, the company remains in strong position with a cost-income ratio (excluding treasury) of 11.5% compared with that of 45-50% for major banks. In addition, the asset quality of the company remains robust with GNPA of 1.04% (90+ days outstanding as % of portfolio).
- Key subsidiaries continue to perform well. HDFC is contemplating listing its life insurance subsidiary (HDFC Standard Life) in the current fiscal, which would help unlock substantial value. Also, implementation of the proposed hike in FDI for insurance sector augurs well for the company.
- We value HDFC based on sum-of-the-parts model at Rs2,805 (including Rs826 for the subsidiaries). At the current market price, the stock trades at 2.6x FY2010E book value/share excluding the value of the subsidiaries.

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Hindustan Unilever | **235** | 28.9 | 24.8 | 20.9 | 85.0 | 120.8 | 100.7 | **280** | 19.3 |

**Remarks:**

- HUL is the largest FMCG company in India, occupying ~20% of the Indian consumer space. With dominance across categories such as soaps, detergents, personal care products, food and beverages, it stamps its presence as an FMCG giant.
- With increasing per capita income fueling consumerism and upgradation of lifestyle of the Indian consumer, HUL's revenues and profitability are expected to sustain the growth momentum.
- Further, hefty free cash flow generation has led to huge cash reserves for HUL and rich dividends (dividend yield of ~3.8%) for its shareholders over the years.
- At the current market price, the stock trades at 20.9x its CY2009E EPS of Rs11.2. We maintain our Buy recommendation on the stock.

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| ITC | **169** | 20.5 | 18.7 | 15.6 | 27.7 | 26.1 | 26.5 | **218** | 28.7 |

**Remarks:**

- ITC's cigarette business that has dominance in the category continues to be a cash cow for the company. ITC has chalked out aggressive roadmap for 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, ITC's non-cigarette FMCG business is on a strong footing. The company has further ventured into the personal care category with the launch of *Superia* and *Fiama Di Wills* soaps and shampoos that would compete with the likes of the products of HUL and P&G.
- Expansion plans in hotels and paper segments would ensure inclusive growth across segments for the company.
- We believe ITC has a well-diversified business model with multiple revenue drivers that would ensure sustained growth for the company. At the current market price, ITC trades at 15.6x its FY10E earnings. We maintain our Buy recommendation on the stock.

| Name | CMP | PER | | | RoE (%) | | | Target | Upside |
|---|---|---|---|---|---|---|---|---|---|
| | (Rs) | FY08 | FY09E | FY10E | FY08 | FY09E | FY10E | price | (%) |
| **Larsen & Toubro** | **729** | 19.6 | 13.8 | 10.2 | 20.0 | 23.5 | 25.7 | **1,802** | 147.2 |

**Remarks:**

- Larsen & Toubro (L&T), the largest engineering and construction (E&C) company in India, is a direct beneficiary of the strong domestic infrastructure development and industrial capital expenditure (capex) booms.
- The international business is expected to emerge as one of the key drivers going forward with immense opportunities from the Gulf Corporation Council markets.
- There lies innumerable opportunities in the new verticals in which the company is entering, namely ship building, defence, railways, thermal and nuclear power.
- The company is likely to maintain its margins going forward despite rising costs on the back of rising operational efficiencies, larger ticket-size and more complex nature of orders, better raw material sourcing and integration, and higher contribution of its new businesses which carry higher margins.
- L&T's current order book of Rs60,931 crore for the E&C division provides strong visibility to its future earnings. We value the core business of L&T at 23x FY2010E earnings, or Rs1,356 per share, while we value the subsidiaries at Rs446 per share of L&T. At the current levels, the stock is trading at 10.2x its FY2010E consolidated earnings. We maintain our Buy recommendation.

| Name | CMP | FY08 | FY09E | FY10E | FY08 | FY09E | FY10E | Target price | Upside (%) |
|---|---|---|---|---|---|---|---|---|---|
| **Lupin** | **580** | 15.5 | 11.2 | 9.5 | 31.9 | 22.2 | 21.2 | **840** | 44.9 |

**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 amongst the mid-cap players in the generic space.
- With a leadership position in the anti-TB and the 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 injectable cephalosporins along with a presence in the branded space through a paediatric antibiotic, Suprax, has enabled Lupin's US business to grow at a staggering 77% CAGR over FY2004-08.
- 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.
- At 11.2x FY2009E and 9.5x FY2010E earnings, Lupin is among the cheapest front-line pharma stocks. We maintain our Buy recommendation on the stock with a price target of Rs840.

| Name | CMP | FY08 | FY09E | FY10E | FY08 | FY09E | FY10E | Target price | Upside (%) |
|---|---|---|---|---|---|---|---|---|---|
| **Marico** | **51** | 19.3 | 17.6 | 14.2 | 63.3 | 44.9 | 36.6 | **71** | 39.2 |

**Remarks:**

- Marico is a major player in the Indian hair care and edible oil markets. Its flagship brand *Parachute* combined with *Nihar* commands a 55% share of the branded coconut oil market in India. Its good for heart edible oil brand *Saffola* is also witnessing good growth.
- Marico has been growing both organically and inorganically, and follows the strategy of adding new products and territories to its portfolio. Apart from domestic operations, its international business covers countries like Bangladesh, Egypt and South Africa.
- We believe apart from the growth in the existing business through product innovations, the expanding new age businesses of Kaya Clinics and weight loss centres promise a great deal.
- With 21% earnings growth expected in FY2010 it remains one of the better performing companies in the current tough macro scenario. At the current market price, the stock trades at an attractive valuation of 14.2x its FY2010E earnings.

| Name | CMP | FY08 | FY09E | FY10E | FY08 | FY09E | FY10E | Target price | Upside (%) |
|---|---|---|---|---|---|---|---|---|---|
| **Maruti Suzuki** | **491** | 8.4 | 8.9 | 7.7 | 20.2 | 16.3 | 16.0 | **635** | 29.4 |

**Remarks:**

- Maruti Suzuki, the market leader in the passenger car market in India, is set to benefit from its strong product portfolio. Its recent launches, such as *Swift Dzire* and *SX4*, have been well received in the market and broadened the company's product portfolio.
- The company has launched its vehicle *A-Star* last month. We expect the domestic volumes as well as the export volumes to get a boost by the new launch.
- With the expansion of its Manesar plant, its exports are also set to go on a top gear. Suzuki has identified India as a hub for manufacture of small cars for its worldwide markets and the company aims to reach a target of one million vehicles in the domestic market and of 200,000 exports by 2010-11.
- At the current levels, the stock is trading at 7.7x its FY2010E earnings. The valuation, we feel, is very cheap.

| Name | CMP (Rs) | PER | | | RoE (%) | | | Target price | Upside (%) |
|---|---|---|---|---|---|---|---|---|---|
| | | FY08 | FY09E | FY10E | FY08 | FY09E | FY10E | | |
| **Reliance Industries** | **1,118** | 10.6 | 8.4 | 6.2 | 22.8 | 19.6 | 20.0 | ** | - |

**Remarks:**

- With the start of crude oil production on September 17, 2008 and the production of gas from the KG basin expected to commence from Q4FY2009, Reliance Industries holds a great promise in the E&P business. At present, the company's reserves are estimated at 9 billion barrels of oil equivalents.
- The gross refining margins of the company are under pressure due to the steep fall in the gas oil and gasoline spread. However, on the back of complex configurations of the existing and upcoming refineries of RPL, the company is likely to continue to command a premium over the Singapore complex gross refining margin. Refining volumes would double as the RPL refinery becomes operational during the fourth quarter of FY2009.
- At the current market price, the stock is trading at 8.4x FY2009E and 6.2x FY2010E consolidated earnings. We maintain our Buy recommendation on the stock while we place our target price under review.

| Name | CMP (Rs) | PER FY08 | PER FY09E | PER FY10E | RoE FY08 | RoE FY09E | RoE FY10E | Target price | Upside (%) |
|---|---|---|---|---|---|---|---|---|---|
| **Shiv-Vani Oil & Gas** | **125** | 5.8 | 3.9 | 3.0 | 17.3 | 17.2 | 17.1 | **420** | 237.3 |

**Remarks:**

- With a fleet of 32 onshore drilling rigs and six seismic survey crew, Shiv-Vani Oil & Gas Exploration (SOGEL) has emerged as the largest onshore service provider catering to oil and gas exploration companies.
- Augmentation of assets by the company is well timed in the industry up-cycle as heightened exploration activity has led to a severe shortage of resources with service providers, leading to firming up of day rates (or billing rates per km in case of seismic survey) for various services. Moreover, the order backlog of over Rs4,700 crore (about 8.2x FY2008 revenues) provides strong revenue-growth visibility.
- The consolidated revenues and earnings are expected to grow at CAGR of 42% and 39.7% respectively over the three-year period FY2008-10.
- Despite the robust growth prospects, the scrip is available at attractive valuations of 3.9x FY2009 and 3.0x FY2010 earning estimates. We recommend Buy on the stock.

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