Sharekhan top picks

In the September 2006 issue, we had recommended the best 12 of our Stock Ideas as Sharekhan Top Picks. As on October 5, 2006, the return on this basket of stocks has been 5.6% as compared to the Sensex, which has given 5.2% returns and the S&P CNX Nifty, which has given 3.8% returns.

We have made four changes in the portfolio. While we have taken out: Bajaj Auto, Godrej Consumer Products, Infosys Technology and Tata Consultancy Services, we have introduced four new stocks: Union Bank of India, BASF India, India Cements and SKF India.

Name	CMP* (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
BASF	235.5	14.6	11.7	8.3	17.1	19.2	23.8	300.0	27.0
Bharat Heavy Electricals	2,311.6	33.0	23.0	18.1	22.8	26.1	26.2	2,650.0	15.0
Cadila Healthcare	320.1	26.6	18.6	14.4	21.8	23.0	23.0	425.0	33.0
Cipla	257.1	33.6	26.0	21.0	30.6	22.2	22.0	300.0	17.0
ICICI Bank	705.5	24.8	20.1	15.2	17.0	12.7	14.8	770.0	9.0
India Cements	223.3	116.6	13.2	8.8	4.3	25.9	27.9	315.0	41.0
ITC	187.4	31.2	25.7	21.6	26.8	28.2	28.1	220.0	17.0
Madras Cements	3,344.3	50.5	16.6	13.4	20.3	39.7	34.2	**	
Sanghavi Movers	720.2	15.2	10.9	8.5	39.6	29.6	28.8	1,150.0	60.0
SKF India#	320.3	20.0	14.0	10.7	24.4	27.5	28.4	406.0	27.0
UltraTech Cement	878.9	47.5	16.4	14.4	22.1	40.8	32.8	1,000.0	14.0
Union Bank of India	136.0	10.1	7.5	6.1	15.8	18.8	20.0	150.0	10.0

* CMP as on October 05, 2006

Calendar year ending company

** Price target under review

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY06	FY07E	FY08E	FY06	FY07E	FY08E	price	(%)
BASF	**235.5**	14.6	11.7	8.3	17.1	19.2	23.8	**300.0**	27.0

Remarks:

- BASF's products are used in industries like white goods, textiles, home furnishing, paper, construction and automobiles all of which have been growing at a fast pace in contemporary times.
- To capitalise on the resulting opportunity, BASF is expanding the capacity of its two key products, expandable polystyrene and polymer dispersion, which are used in the white goods industry and the paper industry respectively.
- BASF has seen consistent return ratios in the past five years. It has RoCE of 24.8% and RoNW of 17.1% for FY2006; the same are expected to improve to 33.8% and 23.8% respectively by FY2008E.
- With an earnings CAGR of 32.8% over FY2006-08E the stock is attractively quoting at a PER of 8.3x its FY2008E earnings, besides offering an attractive dividend yield of 3.1%.

BHEL	**2,311.6**	33.0	23.0	18.1	22.8	26.1	26.2	**2,650.0**	15.0

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 Rs39,300 crore, ie 2.9x 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 (4,000MW x 5) 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 18.1x its FY2008E earnings. BHEL's valuation looks attractive as compared with that of its peers, such as Siemens, ABB and Larsen and Toubro.

Cadila Healthcare	**320.1**	26.6	18.6	14.4	21.8	23.0	23.0	**425.0**	33.0

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 CAGR of 38.4 % over FY2006-08E. The stock is trading at a PER of 14.4x FY2008E earnings.

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY06	FY07E	FY08E	FY06	FY07E	FY08E	price	(%)
Cipla	**257.1**	33.6	26.0	21.0	30.6	22.2	22.0	**300.0**	17.0

Remarks:

- Cipla is the only Indian company to have shown consistent organic growth in both sales and profitability for last ten years.
- Cipla's model of developing partnerships with generic companies enables it to leverage local market knowledge from its partners; and enhance its own R&D, product development and manufacturing skills.
- With over 300 products across 65 therapies, product registrations in over 160 countries and a renewed thrust on growing exports, we see Cipla as strongly positioned to rapidly expand its share in the global generics market.
- The company's partnership agreements will result in a stable growth and increased revenues from the regulated markets.
- The stock is currently quoting at a PER of 21.0x on its FY2008E earnings.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
ICICI Bank	**705.5**	24.8	20.1	15.2	17.0	12.7	14.8	**770.0**	9.0

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 15.2x 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	**223.3**	116.6	13.2	8.8	4.3	25.9	27.9	**315.0**	41.0

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 chart on the exponential growth trajectory on account of its highest leverage to the prices of cement.
- The Rs350 crore capex 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 a RoCE of 29.3% and RoNW of 27.7% in FY2008.
- ICL is trading at 8.8x its FY2008E earnings, and on a EV/tonne basis at US$109 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.

<table>
<tr><th rowspan="2">Name</th><th>CMP</th><th colspan="3">PER</th><th colspan="3">RoE (%)</th><th>Target</th><th>Upside</th></tr>
<tr><th>(Rs)</th><th>FY06</th><th>FY07E</th><th>FY08E</th><th>FY06</th><th>FY07E</th><th>FY08E</th><th>price</th><th>(%)</th></tr>
<tr><td>ITC</td><td>187.4</td><td>31.2</td><td>25.7</td><td>21.6</td><td>26.8</td><td>28.2</td><td>28.1</td><td>220.0</td><td>17.0</td></tr>
<tr><td>Remarks:</td><td colspan="9">
◆ 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 as 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 Sagar. Choupal Sagar is expected to be a major revenue and profit driver for ITC over the long term.
◆ With an earnings CAGR of 20.2% over FY2006-08E the stock is attractively quoting at a PER of 21.6x its FY2008E earnings.</td></tr>
<tr><td>Madras Cements</td><td>3,344.3</td><td>50.5</td><td>16.6</td><td>13.4</td><td>20.3</td><td>39.7</td><td>34.2</td><td>**</td><td></td></tr>
<tr><td>Remarks:</td><td colspan="9">
◆ 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 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 13.4x its FY2008E earnings and EV/tonne of US$143, which is cheaper as compared with its peers.</td></tr>
<tr><td>Sanghvi Movers</td><td>720.2</td><td>15.2</td><td>10.9</td><td>8.5</td><td>39.6</td><td>29.6</td><td>28.8</td><td>1,150.0</td><td>60.0</td></tr>
<tr><td>Remarks:</td><td colspan="9">
◆ 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 capacity 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 Rs61.2 in FY2007E and of Rs78.8 in FY2008E, but the CEPS will be significantly higher.</td></tr>
<tr><td>SKF India#</td><td>320.3</td><td>20.0</td><td>14.0</td><td>10.7</td><td>24.4</td><td>27.5</td><td>28.4</td><td>406.0</td><td>27.0</td></tr>
<tr><td>Remarks:</td><td colspan="9">
◆ SKF India Ltd (SKFIL), a 54% subsidiary of world leader SKF, Sweden, is a leading technology and solution provider of bearings and related systems. It also provides services to the aerospace, automotive, electrical and industrial sectors.
◆ SKFIL enjoys good visibility in the high-margin replacement market which is a huge positive for the company. Factors such as the company's market dominance (a 29% share of the organised market), limited capex plans for the next two years, a debt-free status by CY2006 and higher returns on the capital employed (over 22%) are some other investment positives.
◆ We believe that the substantial de-risking of the company's business portfolio (like reduced dependence on the automobile industry, which is cyclical in nature) and a significant increase in its free cash flow will trigger a re-rating in its stock's price.
◆ The stock quotes at a PER of 10.7x its CY2007E earnings. We believe the stock's valuation is attractive as compared with that of the other auto component companies.</td></tr>
</table>

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Ultra Tech Cement	**878.9**	47.5	16.4	14.4	22.1	40.8	32.8	**1,000.0**	14.0

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$153 per tonne of cement; we believe the valuation is attractive considering the stock's steep discount to the valuation commanded by its peers.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
Union Bank of India	**136.0**	10.1	7.5	6.1	15.8	18.8	20.0	**150.0**	10.0

Remarks:

- Union Bank of India's (UBI) FY2006 results were marred by the pressure on the net interest margins (NIMs) and a one-time provision on the bond portfolio.
- The NIMs are likely to rebound in FY2007 as reflected in Q1FY2007 results. The net interest income is likely to grow at a compounded annual growth rate (CAGR) of 16.1% over FY2006-08E.
- With only 27% of its investment portfolio lying in the available-for-sale category and with a duration of less than two years, UBI has de-risked itself from the fluctuation in the interest rates.
- UBI's earnings are expected to grow at a CAGR of 29.6% over FY2006-08E, one of the fastest amongst the public sector banks.
- The stock is currently trading at attractive valuations of 3.2x FY2008E pre-provisioning profits, 6.1x FY2008E EPS and 1.3x FY2008E adjusted book value.

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