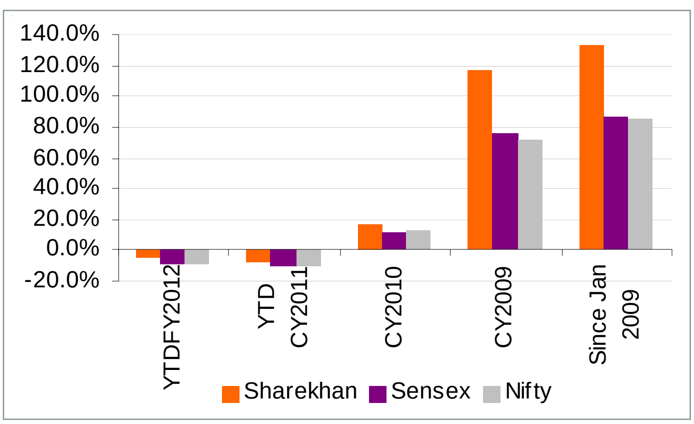
Sharekhan Top Picks

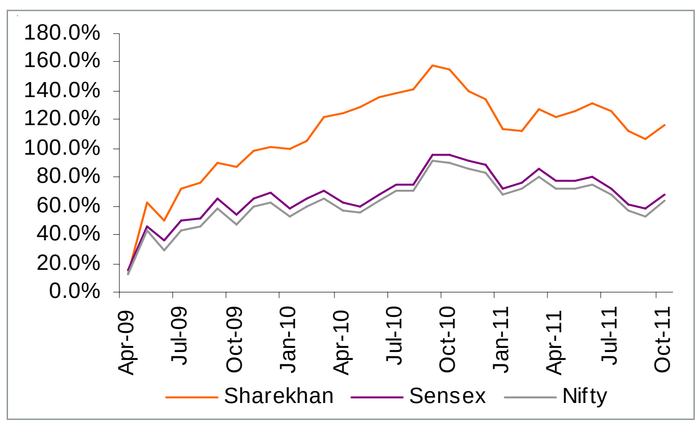
The market surprised positively last month and the benchmark indices, Sensex and Nifty, registered gains of 6.8% and 7% respectively since our last revision in the Top Picks basket. The upsurge was more pronounced in the large caps with the CNX Midcap Index reporting a relatively lower gain of 3.2% for the same period. Given the mix of large-cap and mid-cap stocks in it our Top Picks basket performed better than the CNX Midcap Index with a gain of 4.4%. But it relatively underperformed the benchmark indices after outperforming them smartly for seven consecutive months.

In this month, we are making two changes in the Top Picks basket. We are introducing PTC India in place of CESC as part of the churn within the power sector. Despite being undervalued, PTC India was languishing due to concerns related to the health of the state electricity boards (SEBs), the buyers of electricity. These concerns could now get mitigated by the recent move by the SEBs to increase tariffs. Another change involves the replacement of Orient Paper and Industries with IL&FS Transportation Networks. Orient Paper and Industries reported strong quarterly results but the higher than expected pressure on its margins is a cause for concern and limits the upside in the near term. On the other hand, IL&FS Transportation Networks is our top pick in the infrastructure sector, which could see some improvement in sentiments due to a possible progress in execution accompanied by a pause in interest rate hikes.

Absolute outperformance (returns in %)



Constantly beating Nifty and Sensex (returns in %)



Name	CMP* (Rs)	PER (x) FY11	PER (x) FY12E	PER (x) FY13E	RoE (%) FY11	RoE (%) FY12E	RoE (%) FY13E	Price target	Upside (%)
Bharti Airtel	**398**	25.8	19.9	14.0	18.5	17.9	17.0	**468**	18
Divi's Laboratories	**771**	23.8	20.2	16.2	23.9	24.2	25.9	**1,047**	36
GAIL	**424**	15.1	13.8	13.3	19.8	18.9	17.3	**541**	27
Godrej Consumer	**424**	28.8	24.4	18.9	35.6	28.5	29.0	**516**	22
Grasim	**2,525**	10.7	9.1	8.2	14.8	14.7	13.9	**2,630**	4
IL&FS Transportation	**205**	9.2	8.7	7.6	22.1	16.7	15.2	**330**	61
ITC	**210**	32.9	26.6	22.4	33.2	34.7	33.8	**227**	8
Mahindra & Mahindra	**835**	19.9	17.8	15.3	22.8	23.3	22.8	**865**	4
PTC India	**73**	15.5	14.3	11.2	9.0	9.4	11.3	**98**	35
TCS	**1,099**	24.8	20.4	17.6	42.0	39.8	36.4	**1,250**	14

* CMP as on November 04, 2011

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Name	CMP	PER (x)			RoE (%)			Target	Upside
	(Rs)	FY11	FY12E	FY13E	FY11	FY12E	FY13E	price	(%)
Bharti Airtel	**398**	25.8	19.9	14.0	18.5	17.9	17.0	**468**	18

Remarks:

- Bharti continues to lead the domestic telecom market in terms of both the subscriber base (21% market share) and the revenue market share (32.3%).
- In the last two quarters the subscriber addition for the industry has moderated with the return of rationality and players shifting focus to revenue earning customers. Thus despite a fall in the subscriber net additions, the overall revenue of the industry grew by 6% sequentially in the June 2011 quarter with Bharti gaining market share by 50-basis-point.
- On the back of its improving market share, Bharti has hiked its on-net tariff by 20%, reflecting the return of pricing power. This was followed by tariff hikes by the other GSM players. We view this development as a positive one for the industry specially for the incumbent players like Bharti. The benefits of the same are likely to be reflected in the company's financials by the end of FY2012 and starting FY2013.
- An improving domestic 2G environment, a favorable regulatory regime, (New Draft Telecom policy, TRAI's new set of recommendations on relaxation of M&A norms coupled with share spectrum sharing) are developments in favour of Bharti. Also, visible volume and margin progress on the acquired African operations, and a strong data opportunity in the form of 3G adoption awaiting in the wings coupled with the stock's attractive valuation keep us bullish.
- The stock trades at a trailing EV/EBITDA of 10.0x, which appears attractive in view of the 21.7% EBITDA CAGR over FY2011-13E. The implied EV/EBITDA-to-growth is ~0.52x which compares favourably with the average of 0.64x for the leading emerging market telecom companies (including China Mobile, Telecom, Indosat, Idea Cellular and Bharti). Thus we maintain a Buy on Bharti valuing it at an EV/EBITDA of 8x. This leads to a price target of Rs468.

Name	CMP	PER FY11	PER FY12E	PER FY13E	RoE FY11	RoE FY12E	RoE FY13E	Target price	Upside (%)
Divi's Laboratories	**771**	23.8	20.2	16.2	23.9	24.2	25.9	**1,047**	36

Remarks:

- Coupled with an IPR-respecting and "non-compete with customer" policy, Divi's has an unstinted focus on the contract manufacturing (CM) space, thereby edging over its Indian peers.
- Its India-centric business model develops and produces all APIs/intermediates with a substantial cost advantage. Divi's enjoys an EBITDA margin of about 40%, possibly the highest amongst its peers globally.
- After a full year of inventory downsizing, the outstanding results in H2FY2012 have re-affirmed our confidence in the company's growth potential. The new facility at Vishakhapatnam started production from one of its blocks in June 2011. The remaining blocks are likely to get operational in a phased manner over FY2012-13, which will provide further thrust. The nutraceutical business could become a big opportunity with limited competition.
- A near debt-free balance sheet and a strong cash flow (free cash flow [FCF] likely to reach Rs230 crore by FY2013E) are likely to help build a war chest for pursuing strategic investments (biosimilars).
- The appreciation of the rupee and a slowdown in the research and development (R&D) allocation at the MNC clientele remain the key challenges for the company.
- With the order inflow picking up from H2FY2011 and its new plant getting operational, Divi's has a strong revenue growth visibility and the operating leverage in the business will boost its margins. Consequently, we estimate the company's revenue and earnings to grow at a compounded annual growth rate (CAGR) of 23% and 21% respectively over FY2011-13. At the current market price the stock trades at a price earning (PE) multiple of 20.2x and 16.2x discounting its FY2012E and FY2013E earnings respectively. We maintain our Buy recommendation.

Name	CMP (Rs)	PER (x)			RoE (%)			Target price	Upside (%)
		FY11	FY12E	FY13E	FY11	FY12E	FY13E		
GAIL	**424**	15.1	13.8	13.3	19.8	18.9	17.3	**541**	27

Remarks:

- GAIL (India), a leading gas transmission company, is aggressively expanding its pipeline network and plans to invest more than Rs30,000 crore over FY2010-14 in a phased manner to double its gas pipeline network to over 14,000km and its transmission capacity to around 300mmscmd. This provides strong revenue visibility in its core gas utilities business.
- We also see value accretion from doubling of the petrochemical capacity by FY2014, and from the exploration and production (E&P) and city gas distribution (CGD) businesses going forward.
- A higher than expected fuel subsidy burden and regulatory risk in its core transmission business are the key risks for the company.
- Despite the subsidy burden, the strong growth visibility in its core gas transmission business would drive its earnings.
- At the current market price, the stock trades at a PE of 13.3x and enterprise value (EV)/EBITDA of 9.0x based on our FY2013 estimates. We have a Buy recommendation on the stock with a price target of Rs541.

Name	CMP (Rs)	PER FY11	PER FY12E	PER FY13E	RoE FY11	RoE FY12E	RoE FY13E	Target price	Upside (%)
Godrej Consumer	**424**	28.8	24.4	18.9	35.6	28.5	29.0	**516**	22

Remarks:

- Godrej Consumer Products Ltd (GCPL) is a major player in the Indian FMCG market with a strong presence in the personal care, hair care and home care segments in India. The recent acquisitions (in line with the 3x3 strategy) have immensely improved the long-term growth prospects of the company.
- On the back of strong distribution and advertising & promotional support, we expect GCPL to sustain the market share in its core categories of soap and hair colour in the domestic market. On the other hand, continuing its strong growth momentum the household insecticide business is expected to grow by 19% YoY.
- In the international markets, the Indonesian and Argentine businesses are expected to achieve a CAGR of around 25% and 15% respectively over FY2011-13. This along with the recently acquired Darling group would lead GCPL to post a top line CAGR growth of ~25% over FY2011-13.
- Due to the recent domestic and international acquisitions, the company's business has transformed from a commodities soap business into the business of value-added personal care and home care products. Hence, we expect its OPM to be in the range of 16-18% in the coming years. Overall, we expect GCPL's bottom line to grow at a CAGR of about 23% over FY2011-13.
- We believe increased competitive activity in the personal care and hair care segments and the impact of high food inflation on the demand for its products are the key risks to the company's profitability.
- At the current market price the stock trades at 24.4x its FY2012E EPS of Rs17.4 and at 18.9x its FY2013E EPS of Rs22.4. We have a Buy recommendation on the stock.

Name	CMP (Rs)	PER (x) FY11	PER (x) FY12E	PER (x) FY13E	RoE (%) FY11	RoE (%) FY12E	RoE (%) FY13E	Target price	Upside (%)
Grasim	2,525	10.7	9.1	8.2	14.8	14.7	13.9	2,630	4

Remarks:

- Grasim Industries is well placed to capture the growing opportunity in its core business of VSF in terms of both volume and healthy realisation. In addition, the performance of its cement business (ie its key subsidiary UltraTech Cement) has shown signs of improvement with an increase in the average cement price.
- Due to the improved demand environment, the performance of the VSF division continues to shine. The VSF realisation has increased by 7.1% YoY to Rs125 per kg in Q2FY2012 on account of a pick-up in the global demand with volumes up 17% YoY.
- The cement capacity of the company at the consolidated level is the highest among the other domestic players at 52.75MTPA. Hence the company will be the key beneficiary of a likely pick-up in the demand through government infrastructure projects in the coming couple of months.
- On the other hand, the company is planning to expand its VSF capacity by another 120,000 tonne by FY2013 and its cement capacity by 9.2MTPA by FY2014. We believe the capacity addition will provide volume growth in the longer run.
- We believe the company will benefit due to its strong balance sheet as most of its capex will be met through internal accruals.
- However, in light of the upcoming capacity and stabilisation of the newly-added capacity, the cement prices are expected to come under pressure. Moreover, cost pressure in terms of coal prices and higher freight cost remains a key concern.
- At the current market price the stock trades at a PE of 9.1x and 8.2x its FY2012 and FY2013 earnings estimates on a consolidated basis.

Name	CMP (Rs)	PER (x) FY11	PER (x) FY12E	PER (x) FY13E	RoE (%) FY11	RoE (%) FY12E	RoE (%) FY13E	Target price	Upside (%)
ITNL	205	9.2	8.7	7.6	22.1	16.7	15.2	330	61

Remarks:

- IL&FS Transportation Networks Ltd (ITNL) is India's largest player in the build-operate-transfer (BOT) road segment with 10,269 lane kms in various stages of development, construction or operation. It has a pan-India presence and a diverse project portfolio consisting of 23 road projects, bus transportation and a metro rail project.
- It is well equipped to capitalise on the huge and growing opportunity in the road infrastructure sector due to its established track record in operating BOT road projects, its execution capabilities and the strong support from IL&FS.
- It has a fair mix of annuity and toll projects in its portfolio which provides revenue comfort. Further, it is present across the value chain except the civil construction services which it outsources to the local contractors. This helps the company to handle a large number of projects at a time and diversify geographically, reducing the risk of concentration.
- Thus, we expect the sales and the earnings to grow at a CAGR of 26% and 9% respectively over FY2011-13.
- At the current market price, the stock is currently trading at 8.7x its FY2012E earnings and at a price to book value (P/BV) of 1.2x. We maintain our Buy recommendation with a price target of Rs330.

Name	CMP (Rs)	PER (x)			RoE (%)			Target price	Upside (%)
		FY11	FY12E	FY13E	FY11	FY12E	FY13E		
ITC	**210**	32.9	26.6	22.4	33.2	34.7	33.8	**227**	8

Remarks:

- ITC's cigarette business, which contributes around 60%, continues to be a cash cow for the company. The company endeavours to make a mark in the Indian FMCG market and with successful brands such as Bingo, Sunfeast and Aashirwaad, ITC is already in the reckoning among the best in the industry. With the new portfolio of personal care products gaining market share, its FMCG business promises to compete with the likes of Hindustan Unilever and Procter & Gamble.
- After a sharp increase of 16% in Union Budget FY2010-11, the government has spared cigarettes from an excise duty hike in the FY2012 budget. Also key states including Kerala, Karnataka, Andhra Pradesh and Maharashtra have kept VAT on cigarette unchanged in their respective state budgets. We expect ITC's cigarette sales volume to grow at mid single digits in FY2012.
- ITC's other businesses, such as hotel, agri, non-cigarette FMCG business and paper, paperboard and packaging, are showing a strong up-move and will provide a cushion to the overall profit in FY2012.
- An increase in taxation and the government's intention to curb the 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 about 21.2% over FY2011-13. At the current market price, the stock trades at 26.6x its FY2012E earnings and 22.4x its FY2013E earnings. We maintain our Buy recommendation on the stock.

Name	CMP (Rs)	PER FY11	PER FY12E	PER FY13E	RoE FY11	RoE FY12E	RoE FY13E	Target price	Upside (%)
Mahindra & Mahindra	**835**	19.9	17.8	15.3	22.8	23.3	22.8	**865**	4

Remarks:

- M&M is a strong rural India story benefited by rising agriculture incomes. The farm equipment sector is estimated to grow by 11-13% in FY2012 due to an expectation of better monsoon and greater need for farm mechanisation following labour shortages.
- The automotive sector is expected to grow by 12-15% in FY2012. The new sports utility vehicle (SUV) XUV 500 as well as the existing utility vehicles (UVs) + pick-ups portfolio are expected to deliver a good volume growth for the year.
- The company is expecting partial roll-back of the Maharashtra VAT reversal decision shortly. While negatives have been factored in, any decision on the roll-back by the government will be positive for the company.
- Launches expected in FY2012: new SUV, Reva electric NXR, M&M-Navistar trucks and SsangYong SUVs in India.
- Our SOTP based price target for M&M is Rs865 per share as we value the core business at Rs708 a share and the subsidiaries at Rs157 a share. We recommend Buy on the stock.

Name	CMP (Rs)	PER (x)			RoE (%)			Target price	Upside (%)
		FY11	FY12E	FY13E	FY11	FY12E	FY13E		
PTC India	**73**	15.5	14.3	11.2	9.0	9.4	11.3	**98**	35

Remarks:

- PTC India is the leading power trading company in India with a market share of around 33% in CY2010. Trading volume growth is secured by entering into long-term power purchase agreements (PPA) with power developers.
- Driven by an exponential growth in its traded volumes and an uptick in the trading margins, we expect earnings to grow at a CAGR of 17% over the next two years.
- In the last few years, the company has also made a substantial investment in various areas like power project financing via PFS or taking direct equity stake, coal trading and power tolling which have great growth potential in the future.
- Given its niche positioning and strong growth outlook with improving core return on equity (RoE), the valuations are quite attractive on a sum-of-the-parts basis.

Name	CMP (Rs)	PER FY11	PER FY12E	PER FY13E	RoE FY11	RoE FY12E	RoE FY13E	Target price	Upside (%)
TCS	**1,099**	24.8	20.4	17.6	42.0	39.8	36.4	**1,250**	14

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 is in the process of further consolidating its leadership position through the organic and inorganic route as well by winning large deals.
- TCS has consistently increased its market share amongst the top 5 Indian outsourcers with market share in terms of revenues increasing from 29.2% in the March 2009 quarter to 30.3% in the September 2011 quarter.
- We continue to like TCS amongst the offshore IT vendors on account of its mammoth scale of operations and resilient cost model that allows it to withstand headwinds in the sector. On the other hand, at the current juncture TCS is well placed to garner incremental deals in the sector with the organisational structure in place, unlike Wipro and Infosys that are going through a phase of organisational restructuring.
- At the current market price the stock trades at 20.4x and 17.6x its FY2012E and FY2013E earnings respectively. We have a Buy recommendation on the stock with a price target of Rs1,250.

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

Disclaimer