Sharekhan Top Picks

Though the market continued to grind down for better part of the last month, the recovery in the last one week enabled the benchmark indices to close flat since our last issue of the Top Picks dated May 7, 2011. As compared to the flattish Sensex and Nifty, the CNX Midcap Index appreciated by 1.6% and our Top Picks basket gained 1.8% during the same period. The outperformance was aided by a smart upmove of 14.7% in V-Guard Industries (which was added last month) and buoyancy in defensive names like Godrej Consumer Products (up 6.6%) and Lupin (up 8.2%). The distinct underperformer was Bharat Heavy Electricals Ltd (BHEL), which suffered due to the announcement of a possible follow-on public issue rather than any fundamental reason.

We are making two changes to the portfolio this time around. Given the smart gains within a month, we are replacing V-Guard Industries and adding another pharma stock Divi's Laboratories, which has given spectacular results and is poised to gain from the recovery in the contract research and manufacturing space. The other change is the introduction of Mahindra and Mahindra (M&M) due to its compelling valuations. M&M is also a play on the onset of the monsoon season and will replace Max India. The insurance arm of Max India continues to do well and we remain positive on the stock with a slightly long-term view.

Name	CMP* (Rs)	PER (x)			RoE (%)			Price target	Upside (%)
		FY11	FY12E	FY13E	FY11	FY12E	FY13E		
BHEL	**1,934**	15.8	15.2	13.1	29.8	25.4	24.5	**2,596**	34.2
Divi's Laborities	**784**	24.2	20.5	16.5	23.9	24.2	25.9	**1,047**	33.6
Godrej Consumer	**415**	27.9	23.3	19.8	34.6	28.5	27.6	**462**	11.3
ITC	**195**	30.2	25.1	21.1	33.3	34.3	33.5	**223**	14.4
ITNL	**204**	9.2	8.4	6.9	23	18.1	16.9	**383**	87.7
Lupin	**455**	23.6	20.8	17	26.3	22.8	21.6	**520**	14.2
Mahindra & Mahindra	**661**	15.7	15.2	13.2	22.9	22	21.3	**735**	11.2
NIIT Technologies	**187**	6.1	6.6	5.4	27.3	20.7	22.0	**285**	52.2
PTC	**83**	17.6	15.9	11.6	6.2	6.7	8.7	**114**	37.9
Sintex Industries	**184**	12.4	10.1	8.3	19.2	19.2	18.9	**233**	26.8
Yes Bank	**289**	13.8	11.7	9.4	21.1	19.6	18.4	**415**	43.0

* CMP as on June 02, 2011

Sharekhan
Your guide to the financial jungle

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Name	CMP (Rs)	PER (x) FY11	PER (x) FY12E	PER (x) FY13E	RoE (%) FY11	RoE (%) FY12E	RoE (%) FY13E	Target price	Upside (%)
BHEL	**1,934**	15.8	15.2	13.1	29.8	25.4	24.5	**2,596**	34.2

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 orders worth Rs164,130 crore on hand, which provides revenue coverage for the next three to four years. 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.
- The company has already expanded its capacity to 15GW in FY11. Also, the project to expand the capacity to 20GW by FY12 is being executed on a fast track. In our view, the stabilisation of the new capacity coupled with the de-bottlenecking of the supply chain would aid order execution and sustain robust growth in BHEL's revenues in the coming years.
- The near-term positive trigger in the stock is the order inflow in the power equipment business. The current valuation at 15.2x its FY12E earnings are also looking attractive We have, therefore, included BHEL amongst our Top Picks.

Name	CMP (Rs)	PER (x) FY11	PER (x) FY12E	PER (x) FY13E	RoE (%) FY11	RoE (%) FY12E	RoE (%) FY13E	Target price	Upside (%)
Divi's Laboratories	**784**	24.2	20.5	16.5	23.9	24.2	25.9	**1,047**	33.6

Remarks:

- Coupled with an IPR-respecting and "non-compete with customer" policy, Divi's Laboratories (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 EBITDA margin of >40% each, possibly the highest amongst its peers globally.
- After a full year of inventory downsizing, the outstanding results in H2FY11 have re-affirmed our confidence in the company's growth potential. The biggest thrust is likely to come in FY12 as the new facility at Vishakhapatnam is fully operational. The nutraceutical business could become a big opportunity with limited competition.
- A near debt-free balance sheet and strong cash flow (FCF likely to reach Rs306 crore by FY13E) are likely to help build a war chest for pursuing strategic investments (biosimilars).
- The appreciation of the rupee and slowdown in R&D allocation of the MNC clientele remain the key challenges for the company.
- With the order inflow picking up from H2FY11 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 would grow at CAGR of 23% and 21% respectively over FY11-13.

Name	CMP (Rs)	PER (x) FY11	PER (x) FY12E	PER (x) FY13E	RoE (%) FY11	RoE (%) FY12E	RoE (%) FY13E	Target price	Upside (%)
GCPL	415	27.9	23.3	19.8	34.6	28.5	27.6	462	11.3

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 FY11-13. Overall, we expect GCPL's consolidated revenues to grow at a CAGR of about 19% over FY11-13.
- 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 sustain at around 18% in the coming years. Overall, we expect GCPL's bottom line to grow at a CAGR of about 20% over FY11-13.
- 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 23.3x its FY12E EPS of Rs17.8 and 19.8x its FY13E EPS of Rs21.0. 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 (%)
ITNL	204	9.2	8.4	6.9	23	18.1	16.9	383	87.7

Remarks:

- IL&FS Transportation Networks Ltd (ITNL) is India's largest player in the BOT road segment with 10,269 lane km 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 34.2% and 14.7% respectively over FY11-13E.
- At the current market price, the stock is trading at 8.4x and 6.9x its FY12 and FY13 estimated earnings respectively. We maintain our Buy recommendation with a price target of Rs383.

Name	CMP	PER (x)			RoE (%)			Target	Upside
	(Rs)	FY11	FY12E	FY13E	FY11	FY12E	FY13E	price	(%)
ITC	**195**	30.2	25.1	21.1	33.3	34.3	33.5	**223**	14.4

Remarks:

- Its cigarette business, which dominates the category, continues to be a cash cow for ITC. 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 FY10-11, 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 FY12.

- ITC' 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 FY11.

- 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 20% over FY11-13. At the current market price, the stock trades at 25.1x its FY12E earnings and 21.1x its FY13E earnings. We maintain our Buy recommendation on the stock.

Lupin	**455**	23.6	20.8	17	26.3	22.8	21.6	**520**	14.2

Remarks:

- Global dominance in certain products, focus on niche, less-commoditised products, a geographically diversified presence in markets such as Japan and a presence in the US branded segment distinguish Lupin among the mid-cap players in the generic space.

- In FY12, Lupin expects to launch 12 products with at least four in niche therapies, like oral contraceptives in the USA. Along with a strong presence in the branded space through Suprax and Aerochamber, Antara has enabled Lupin's US business to grow at a staggering CAGR of 65% over FY06-10. With the expansion in the branded portfolio through the anticipated launch of Allernaze we expect the US business to grow at a CAGR of 19% over FY11-13. We expect the branded business to contribute about 30% of the total US sales over the next two years.

- With the strong core business and aggressive abbreviated new drug application (ANDA) filings (cumulative 148 ANDA filings till date), a differentiated strategy augurs well for Lupin. Niche product launches like generic Geodon, Fortamet ER, Cipro and OCs would drive upwards performance of the stock.

- Potential delays in the US Food and Drug Administration approval for oral contraceptives and its other niche filings, and ramp-up delays in AllerNaze (expected launch in FY12) are the key challenges for Lupin.

- We expect Lupin to report an earnings CAGR of 18% over FY11-13 with strong margins at the operating level.

Name	CMP (Rs)	PER (x)			RoE (%)			Target price	Upside (%)
		FY11	FY12E	FY13E	FY11	FY12E	FY13E		
M&M	**661**	15.7	15.2	13.2	22.9	22	21.3	**735**	11.2

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 FY12 due to an expectation of better monsoon and greater need for farm mechanisation following labour shortages.
- Automotive sector is expected to grow by 12-15% in FY12. The new sports utility vehicle (SUV) stated to be launched in H2FY11 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 FY12: new SUV, Reva electric NXR, M&M-Navistar trucks and SsangYong SUVs in India.
- Our sum-of-the-parts (SOTP) based price target for M&M is Rs735 per share as we value the core business at Rs599 a share and the subsidiaries are valued at Rs135 a share. We recommend Buy on the stock.

Name	CMP (Rs)	PER FY11	PER FY12E	PER FY13E	RoE FY11	RoE FY12E	RoE FY13E	Target price	Upside (%)
NIIT Technologies	**187**	6.1	6.6	5.4	27.3	20.7	22.0	**285**	52.2

Remarks:

- NIIT Technologies Ltd (NTL), a mid-sized IT services company, has built strong domain expertise in niche industry verticals like insurance, travel, manufacturing & retail. With the recent surveys/channel checks showing signs of a revival in IT spending and the demand environment getting more broad based, the IT spending in these lagging sectors is likely to catch up in 2011. Moreover, the company has the advantage of a well-balanced geographical mix of revenues from North America, Europe and the Asia-Pacific.
- NTL is one of the few mid-cap Indian IT services vendors that have over the years built up a strong non-linear revenue platform through organic and inorganic initiatives. Currently, NTL derives around 27% of its total revenues from its non-linear initiatives like managed services and IP asset-based services rather than commoditisable time & material (T&M) kind of pricing model. NTL's non-linear initiatives would turn out to be a game changer for the company in the coming years.
- With its strong domain expertise in a few niche verticals and competitive advantage in terms of significant contribution from its non-linear initiatives, NTL is well placed to benefit from the overall improvement in the demand environment. Consequently, we expect the company to show a steady growth of 18% CAGR in its net profit over FY10-13. Moreover, the company has healthy cash on the books with minimal debt. This leaves scope for further acceleration in growth through inorganic initiatives and shall act as another re-rating trigger for the stock. We have Buy on NTL with a 12-month price target of Rs285 (8x FY13 earnings).

Name	CMP (Rs)	PER (x)			RoE (%)			Target price	Upside (%)
		FY11	FY12E	FY13E	FY11	FY12E	FY13E		
PTC India	**83**	17.6	15.9	11.6	6.2	6.7	8.7	**114**	37.9

Remarks:

- PTC India is the leading power trading company in India with market share of around 33% in CY10. Trading volume growth is secured by entering into long-term power purchase agreements (PPA) with power developers. We also expect short-term trading volumes to grow at a CAGR of 25% over FY10-13, driven by the rising power generation capacity and rising merchant power capacity. Also, better penetration of the power exchanges would help in boosting the short-term trading market. Overall, the trading volume is estimated to grow 2.3x over FY10-13.
- CERC had earlier fixed a short-term trading margin of 4 paise per unit in 2006. In January 2010, CERC revised the short-term trading margins at a maximum of 7 paise per unit while keeping the base rate at 4 paise per unit. This was a positive move for the power trading firms which were reeling under cost pressure.
- Driven by an exponential growth in its traded volumes and an uptick in the trading margins, we expect the non-operational contribution to PBT to fall down from 56% in FY10 to 20% in FY13. We feel that accordingly the core RoE would also improve.
- The company is estimated to show a robust growth in its earnings over the next few years. In the last few years, the company has also made 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, de-risked business model and strong growth outlook with improving core 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 (%)
Sintex Industries	**184**	12.4	10.1	8.3	19.2	19.2	18.9	**233**	26.8

Remarks:

- Sintex is a diversified play on the booming mass housing construction industry, the rising social infrastructure spent, and the buoyancy in automobiles, electricals and textiles.
- It derives 42% of its revenue from the building material segment (which includes monolithic construction and prefabricated structure). The demand for the same is growing at a robust pace with mass housing initiatives and the government's drive towards building up social infrastructure. It is also a top composite-moulding player with a dedicated clientele and has over the years acquired technical expertise through overseas acquisitions.
- Sintex reported a strong set of results for Q4FY11 (+34% Y-o-Y revenue growth). The over 30% revenue growth has now been seen for the last five quarters while the margin profile has also improved considerably and the future environment continues to look strong on account of a strong order built-up, with synergies on the foreign subsidiaries getting reflected into the margins
- On the back of stupendous order execution, the revenue growth in the monolithic division (+50% YoY), the increase in the order book position to Rs2,900 crore (about 2.4x FY11 revenue) executable over 18-20 months gives us comfort with regard to the revenue visibility and the execution capability of the company. Further, the revenue growth and the margin expansion being witnessed in the custom molding division, the improvement in the working capital cycle and the addresal of the investor concerns by pulling out of the capital-intensive oil and gas investment provide us with fundamental comfort with regard to the business.
- The attractive valuation (at 8.3x FY13 earnings) keeps us bullish on the company. We maintain our Buy rating with a price target of Rs233. At our target price, the stock would be trading at 11x its FY13 fully diluted EPS of Rs21.1.

Name	CMP	PER (x)			RoE (%)			Target	Upside
	(Rs)	FY11	FY12E	FY13E	FY11	FY12E	FY13E	price	(%)
Yes Bank	**289**	13.8	11.7	9.4	21.1	19.6	18.4	**415**	43.0

Remarks:

- Given Yes Bank's robust growth in advances over the initial years (at a CAGR of 54% over FY07-11), the management expects to sustain the growth momentum with a targeted growth of 35% CAGR in advances over FY11-15. The Version 2.0 marks more diversified growth with increased focus on high yielding SME and retail segments.
- The net interest margin (NIM) is expected to decline in the rising interest rate scenario, though not substantially due to the strong re-pricing power on the assets side (about 95% of the assets are on floating rates) and favourable asset liability duration. The management believes that increasing the branch tally to 350-450 (350 branches by June 2012) would be the inflection point and there will be an exponential growth in the deposits (including CASA), which would support the margins.
- Yes Bank maintains the best asset quality in the industry with the lowest NPAs (gross NPAs at 0.23% and net NPAs at 0.03% in FY11). Hence, we do not expect any significant deterioration in asset quality. The bank's total exposure to microfinance institutions (MFIs) is less than 1% of the loan book (ie Rs250 crore) and the portfolio continues to do well.
- Yes Bank's return ratios have consistently remained at higher levels (18-20%) despite several rounds of equity infusion. We believe the bank will maintain its RoEs and RoAs at about 20% and 1.4% respectively over the next two years led by a 28% CAGR in its earnings.
- While the advances growth is likely to moderate from the current levels (52% CAGR over FY07-11), it would substantially be higher than the industry's, which would result in a strong growth in the earnings. We expect Yes Bank's advances to grow at a CAGR of 38% over FY11-13, leading to an approximately 28% growth in the earnings. Currently, the stock is trading at 1.9x FY12 BV and 1.6x FY13 BV. We maintain Buy rating on the stock with a price target of Rs415 (2.7x FY12 BV).

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