Sharekhan top picks

Financial year 2009-10 was highly rewarding for investors with the equity markets delivering handsome returns on a smart economic recovery. For the year while the benchmark indices, the Sensex and the Nifty, put up a strong show registering gains of 71.2% and 64.9% respectively, our recommended monthly portfolio of top picks outperformed in a big way with a gain of 121.2%.

March 2010 was no different with our top picks portfolio posting a handsome gain of 7.7%, far outperforming the Sensex and the Nifty that gained 4.1% and 3.8% respectively during the month. Among our recommendations for March, Torrent Pharmaceuticals, Shiv-Vani Oil & Gas and Greaves Cotton substantially outperformed the broader market with their stock prices increasing by 18.2%, 16.3% and 12% respectively.

For April 2010 we make two changes in our top picks portfolio, we replace Godrej Consumer Products with Indian Hotels and Bharat Heavy Electricals Ltd (BHEL) with Grasim Industries. Godrej Consumer Products has been the top performer in the fast moving consumer goods space in the past year. However, we opine that the stock is likely to take a breather in the near term. In its place we prefer Indian Hotels that is expected to deliver strong results for Q4FY2010 and is likely to ride on the recovery in the hotel industry over the next two to three years. Also, we replace BHEL with Grasim Industries on expectations of strong Q4FY2010 results.

We remain optimistic that the corporate growth trajectory shall be maintained in the coming years, which will drive the equity markets higher. However, we believe the Q4FY2010 results and the guidance from companies need to be monitored for the near-term performance of the markets. To take advantage of intermittent corrections we continue to favour partial cash allocation in the immediate term and thus continue with our recommendation of holding 10% cash.

Name	CMP* (Rs)	PER (x) FY09	PER (x) FY10E	PER (x) FY11E	RoE (%) FY09	RoE (%) FY10E	RoE (%) FY11E	Target price	Upside (%)
Allahabad Bank	143	8.3	5.2	4.7	13.9	20.5	20.4	163	13.7
Grasim	2,829	15.7	10.7	12.3	17.4	20.4	15.5	2,877	1.7
Greaves Cotton	315	28.1	14.3	11.0	13.9	24.3	26.7	365	16.0
Indian Hotels	103	171.0	54.0	25.7	1.9	4.6	9.3	111	8.2
ITC	264	30.7	24.7	21.3	25.3	27.2	26.6	278	5.3
Lupin	1,617	25.1	21.2	17.2	37.5	29.0	27.4	1,916	18.5
Pratibha Industries	378	14.1	10.9	7.7	21.9	23.0	25.7	450	19.1
Reliance Ind	1,092	22.5	21.0	15.3	12.3	12.4	14.5	1,130	3.5
Shiv Vani Oil & Gas	442	10.1	9.5	7.7	14.7	14.4	14.6	520	17.8
Torrent Pharma	543	19.6	18.3	13.7	40.4	32.6	32.5	638	17.5

* CMP as on April 01, 2010

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY09	FY10E	FY11E	FY09	FY10E	FY11E		
Allahabad Bank	**143**	8.3	5.2	4.7	13.9	20.5	20.4	**163**	13.7

Remarks:

- The bank's performance over the last four quarters clearly marks its return to consistency compared to the tumultuous journey during FY2009. Some of the key areas where the bank has improved are the net interest margin (NIM), asset quality, CASA balance and provisioning coverage.
- Frequent change in top management has resulted in profitability swings for the bank. However, the current chairman, who took charge in December 2009, has been appointed for a period of three years. This long-duration appointment would allow the chairperson the required time frame to formulate and implement strategies.
- The improvement in above-mentioned key areas has resulted in a consistent performance at bottom line level. This translates into a return on asset (RoA) of about 1.3% in the last three quarters, which is much better than the 0.9% RoA in FY2009.
- The business growth has picked up in the recent quarters with a strong focus on deposit mobilisation, which should drive the balance sheet expansion in future. Further, the bank has been shoring up its CAR, which stands strong at 15% currently and may go up further after capital infusion by the Government of India.
- Given the improving operating parameters, the bank's focus on expansion in western and southern India and its strong and stable management, we believe that the bank is a potential re-rating candidate. At current market price, the stock trades on par with FY2011E book value per share. We have a Buy recommendation with target price of Rs163.

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE FY09	RoE FY10E	RoE FY11E	Target price	Upside (%)
Grasim	**2,829**	15.7	10.7	12.3	17.4	20.4	15.5	**2,877**	1.7

Remarks:

- Grasim Industries (the cement division) is benefited due to its presence in high-growth markets like northern and central regions. In order to achieve higher volume growth and to retain its market share, the company has expanded its capacity in a phased manner to 19.6MMT (on a stand-alone basis) and may raise it further to 25.5 MMT by the end of FY2011. The incremental volumes through capacity addition will augur well for the company.
- On the other hand, due to revival in demand for VSF, the profitability of the division has improved significantly. The company is planning to add another 80,000 tonne capacity by FY2013 with an investment of Rs1,000.
- To ensure availability of power and to operate efficiently, the company has installed 23MW captive power plant (CPP) at Kotputli. With this, the company's total CPP capacity stands augmented to 268MW and sufficient to meet around 80% of its power requirement.
- We believe, the company will benefit from its strong balance sheet, as imost of its capex will be met through internal accrual.
- However, the upcoming capacity will pressurise cement prices. Though the capacity addition will provide volume growth, the anticipated price fall will restrict the growth of the cement division.
- At the current market price of Rs2,829 the stock trades EV/EBDITA of 6.7x and 5.1x its FY2011 and FY2012 earning estimates on a stand-alone basis.

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY09	FY10E	FY11E	FY09	FY10E	FY11E	price	(%)
Greaves Cotton	**315**	28.1	14.3	11.0	13.9	24.3	26.7	**365**	16.0

Remarks:

- Greaves Cotton Ltd (GCL)'s core competencies are in three-wheeler diesel/petrol engines, power gensets, agro engines and pumpsets (the engine segment) and construction equipment (the infrastructure equipment segment).
- GCL is likely to be the key beneficiary of the uptick in the demand for the three-wheeler engines (which constitute 60% of the company's total revenues). The infrastructure equipment business (constitutes about 15% of the company's total revenues) is a direct play on the growth in the construction and road building activity in the country. We believe with much improved fund availability, low interest rates, and a pick-up in industrial and real estate sectors, the business is in for a sharp revival.
- GCL has a strong balance sheet and is a zero net debt company. Moreover, the company does not have any major capex plans in the near future. With a hefty increase in its profits and a low capex the company is expected to generate free cash flows in excess of Rs100 crore in FY2010 and FY2011.
- We believe that a slower than expected recovery in the construction and road building activity in the country could affect the revival of sales for GCL's construction equipment division and thus poses a risk to our estimates. Also, the lower than expected sales of three-wheelers by Piaggio (which accounts for a high proportion of sales in the automotive engine division) may have a direct impact on the performance of the automotive engine segment.
- We expect GCL to post a robust CAGR of 20.5% in revenues and that of 59.9% in its net profit respectively over FY2009-11. At the current market price, the stock trades at 14.3x and 11x its FY2010E and FY2011E EPS respectively. We have a Buy recommendation on the stock.

Name	CMP	PER FY09	PER FY10E	PER FY11E	RoE FY09	RoE FY10E	RoE FY11E	Target price	Upside (%)
Indian Hotels	**103**	171.0	54.0	25.7	1.9	4.6	9.3	**111**	8.2

Remarks:

- The improvement in macro environment and consequential improvement in foreign tourist arrivals and domestic corporate travels have created a favourable business environment for a rebound in the hotel Industry. We believe, Indian Hotels Company being the largest hotelier in the country with its presence in India and key destinations across the world is on track to capitalise on the growth opportunities in the coming years.
- Hotel occupancies have shown a remarkable improvement and this is likely to be followed by an improvement in ARRs. Thus, we foresee the company witnessing a substantial improvement in its profitability in the near to medium term. The profit growth will be also aided by new property additions.
- Turnaround in international properties and improvement in ARRs are the key monitorables in the coming quarters.
- We believe, rampant increase in new property addition as one of the key risk to the performance of the industry and Indian Hotels Company in the coming years. Also, failure/delay in the turnaround of International properties pose a risk to the performance of the company.
- At the current market price the stock trades at 25.6x its FY2011E EPS of Rs4.0 and 18.8x its FY2012E EPS of Rs5.4. We maintain our Buy recommendation on the stock.

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY09	FY10E	FY11E	FY09	FY10E	FY11E	price	(%)
ITC	**264**	30.7	24.7	21.3	25.3	27.2	26.6	**278**	5.3

Remarks:

- The cigarette business that dominates the category continues to be a cash cow for ITC. The company endeavors 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 a new portfolio of personal care products its FMCG business competes with the likes of Hindustan Unilever and Procter & Gamble.
- Where the Union Budget FY2009-10 spared the cigarette industry from any excise duty hike, the Union Budget FY2010-11 has proposed a steep excise duty of 11-18% on cigarettes. However, the business has shown sound resilience in the past in the face of similar harsh taxation moves. Thus, while we expect a flat volume growth in the existing portfolio on a year-on-year basis, the incremental volumes from the likely launch of micro filter cigarette would result in lower single-digit volume growth in the cigarette business in FY2011.
- ITC' other businesses such as hotel, agri, non-cigarette FMCG business and paper, paperboard and packaging are showing strong up-move and will provide a cushion to the overall profit in FY2011.
- An increase in taxation and the government's intention to curb consumption of tobacco products remain the key risks to ITC' cigarette business over the longer term.
- We expect ITC' bottom line to grow at a CAGR of 17.8% over FY2009-12. At the current market price, the stock trades at 21.3x its FY2011E earnings. We maintain our Buy recommendation on the stock.

Name	CMP	PER FY09	PER FY10E	PER FY11E	RoE FY09	RoE FY10E	RoE FY11E	Target price	Upside
Lupin	**1,617**	25.1	21.2	17.2	37.5	29.0	27.4	**1,916**	18.5

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 among the mid-cap players in the generic space.
- With a leadership position in the anti-TB and other anti-infective segments, and a 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 oral contraceptives and ophthalmology products along with a strong presence in the branded space through a paediatric antibiotic, Suprax, and a medical inhalation device, Aerochamber, has enabled Lupin's US business to grow at a staggering CAGR of 77% over FY2004-08. With the expansion in the branded portfolio through the recent addition of Antara and the launch of Allernaze, we expect the US branded business to grow at a CAGR of 30% over FY2010-12.
- 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. We anticipate a CAGR growth of 37% in the emerging markets over FY2010-12.
- The strong core business and a differentiated strategy auger well for Lupin and now the clean chit of the Mandideep facility from the USFDA would drive the performance of the stock.
- We expect Lupin to report an earnings CAGR of 22% over FY2010-12 with strong margins at the operating level. At 21.2x FY2010E and 17.2x FY2011E earnings, Lupin is among the cheapest front-line pharmaceutical stocks. We maintain our Buy recommendation on the stock with a price target of Rs1,916.

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY09	FY10E	FY11E	FY09	FY10E	FY11E	price	(%)
Pratibha Industries	**378**	14.1	10.9	7.7	21.9	23.0	25.7	**450**	19.1

Remarks:

- Pratibha Industries (Pratibha) is one of the fastest growing small construction companies with expertise in water, surface transport and civil construction. The order book of Rs3,500 crore, which is over 4x its FY2009 revenues, provides strong revenue visibility. It has gradually moved up the value chain by diversifying into high-margin segments like urban infrastructure, tunneling and oil & gas.
- Given its dominance in water segment, Pratibha entered into manufacturing HSAW pipes in FY2008. This backward integration exercise enabled Pratibha to bid for pipeline related projects at a very competitive rate and save on cost and time. Given the huge impetus by the Government on urban infrastructure especially water segment, Pratibha stands to benefit.
- With an order book standing at 4x its FY2009 revenues, the timely execution of projects remain key to Prathibha's success. Further, any hike in interest rate or raw material cost could put pressure on the margin.
- At the current market price, the stock trades at 7.7x its FY2011E earnings. We maintain our Buy recommendation on the stock.

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE FY09	RoE FY10E	RoE FY11E	Target price	Upside (%)
Reliance Ind	**1,092**	22.5	21.0	15.3	12.3	12.4	14.5	**1,130**	3.5

Remarks:

- With the start of the commercial production of gas in April 2009 and that of crude oil in September 2008 (both from the KG basin), Reliance Industries Ltd (RIL) holds a great promise in the E&P business. The E&P business is expected to add significantly to the company's earnings and to its cash flow from FY2010 onwards with the majority of the earnings coming from the less volatile natural gas business. The company is currently producing 60mmscmd of gas and targets to ramp the output to 80mmscmd by the end of March 2010. At present, the company's reserves are estimated at 9 billion barrels of oil equivalents.
- We expect the gross refining margin (GRM) of RIL to contract in the near term, as new refineries with total capacity of 1.5-2.0 million barrel per day (including Reliance Petroleum Ltd [RPL]) are expected to come on-stream in the environment of weak demand. However, we expect RIL to fetch a premium over Singapore Complex' GRM due to its superior refinery complexity and benefit of using captive gas from KG D-6. The refining volumes were also doubled as RPL's has been merged with RIL with effect from April 1, 2008.
- We believe that RIL would be able to maintain superior margin in the petrochemical business, given its increased focus on the domestic market (a strong demand and a high price realisation environment).
- In view of RIL's cash and treasury shares worth USD8 billion and thrust on expansion of its assets through overseas acquisitions, we believe that news flow on the company's acquisition targets would remain strong.
- A delay in the ramp-up of the KG D-6 gas production and an adverse verdict of the Supreme Court of India on its legal feud with RNRL and another legal case with National Thermal Power Corporation (NTPC) are the key risks to our estimates. Further, there is still ambiguity related to the likely change in the section 80IB, which could take away the benefit of the seven-year tax holiday from gas production. Any further fall in the refining and petrochemical margins could result in deviation from our estimates.
- At the current market price, the stock is trading at 15.3x FY2011E consolidated earnings.

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE (%) FY09	RoE (%) FY10E	RoE (%) FY11E	Target price	Upside (%)
Shiv Vani Oil & Gas	**442**	10.1	9.5	7.7	14.7	14.4	14.6	**520**	17.8

Remarks:

- Shiv-Vani Oil & Gas Explorations is India's largest onshore oil and gas service provider in the private sector having a fleet of 40 rigs and ten seismic survey crews. The company offers a wide range of services including seismic, drilling and other specialised services, such as work over, gas compression services and coal bed methane (CBM) integrated services.
- The extremely strong order book of Rs3,700 crore, which is close to 4.2x its FY2009 revenues, renders strong visibility to the company's earnings. The company has gone for timely expansion of its assets in the past and all its assets are already backed by contracts in hand.
- The company has shown an exponential growth in its financial performance in M9FY2010 and the same is likely to be maintained in the last quarter of the fiscal with the deployment of all the eight rigs for a large order worth Rs1,610 crore from ONGC. The company has raised Rs93.4 through the issue of new equity shares to Franklin Templeton. Further, the company is planning to raise additional funds of Rs600 crore through a QIB issue to augment its fleet.
- Softening day rates, and curtailment and deferment of worldwide E&P capex pose a risk to the company's revenue going forward. Moreover, any delay in contracts or any renegotiation of contracts going forward could potentially hamper its cash flows and thus remain a risk for the company. However, we see little probability of renegotiation of the contracts, as the bulk of contracts are from public enterprises like ONGC and OIL.
- At the current market price, the stock trades at 7.7x its FY2011E earnings. We maintain our Buy recommendation on the stock with a price target of Rs520.

Name	CMP (Rs)	PER FY09	PER FY10E	PER FY11E	RoE (%) FY09	RoE (%) FY10E	RoE (%) FY11E	Target price	Upside (%)
Torrent Pharma	**543**	19.6	18.3	13.7	40.4	32.6	32.5	**638**	17.5

Remarks:

- Torrent Pharmaceuticals (Torrent Pharma) is a well-known name in the domestic branded formulation market with strong focus on the fast-growing chronic lifestyle segment.
- Torrent Pharma has been one of the under-owned stocks in the mid-cap pharma space due to realignment in domestic formulations, impending turnaround in the Heumann business and lower margins at the operating levels.
- However, with the domestic market back on track, the completion of the investment phase in the emerging markets and the turnaround in the Heumann business, we expect Torrent Pharma's earnings to post a CAGR of 24% over FY2010-12E. The cost restructuring initiatives will lead to operational efficiencies in the long term, resulting in the expansion of the operating profit margins.
- With the completion of the investment phase, robust field presence and new product introductions, we expect Torrent Pharma's emerging market (Brazil, Russia and Europe) business to post a strong CAGR of 19% over FY2010-12E. Further, a scale-up in the US business would add to its growth. We believe the company has been trading at a significant discount (at 13.6x its FY2011E) to its peers and should get higher valuation.
- We believe Torrent Pharma is on the right track for good revenue growth and significantly higher earnings growth driven by margin expansion. At the current market price of Rs543, the stock is discounting its FY2010E earnings by 18.3x and its FY2011E earnings by 13.7x. On account of continued traction in the growth we maintain our buy recommendation on the stock with a price target of Rs638.

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