Sharekhan top picks

In the May 2007 issue, we had recommended the best 12 of our Stock Ideas as Sharekhan Top Picks. As on June 1, 2007, the basket of stocks has given absolute return of 7.9% as compared to a 3.5% appreciation in the Sensex and a 3.52% rise in the S&P CNX Nifty.

We have made two changes in the portfolio. We have taken out Aditya Birla Nuvo and Genus Power from the portfolio and brought in HDFC Bank and Aurobindo Pharma.

Name	CMP* (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Aurobindo Pharma	697.7	52.9	20.9	15.2	8.6	13.5	15.7	914.0	31.0
Bharti Airtel	838.0	70.4	37.2	26.2	20.7	29.1	32.3	900.0	7.0
Bharat Electronics	1,892.1	26.0	21.2	18.0	29.7	26.7	24.1	2,020.0	7.0
Bharat Heavy Electricals	1,414.4	41.2	28.6	22.5	23.0	26.2	26.4	1,563.0	10.0
HCL Technologies**	345.7	28.8	19.5	16.6	19.5	21.7	23.1	395.0	14.0
HDFC Bank	1,152.9	41.5	32.2	27.7	17.7	19.3	15.8	1,355.0	18.0
Hindustan Lever#	201.3	33.5	28.8	23.4	56.8	56.5	57.3	280.0	39.0
ICICI Bank	928.1	32.5	26.8	26.2	13.6	13.3	10.3	1,173.0	26.0
Indo Tech Transformer	348.3	33.2	14.7	12.0	23.3	30.6	28.7	375.0	8.0
M&M	762.5	27.0	21.3	16.9	22.2	27.2	23.2	1,050.0	38.0
Sun Pharma	1,092.0	35.4	27.3	22.8	36.1	19.5	18.7	1,297.0	19.0
Thermax	497.8	58.8	29.8	21.3	22.3	31.4	32.4	585.0	18.0

* CMP as on June 01, 2007 **June ending company # Calendar year ending company

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Aurobindo Pharma	**697.7**	52.9	20.9	15.2	8.6	13.5	15.7	**914.0**	31.0

Remarks:

- With strong process chemistry skills, Aurobindo has graduated from being a mere API player to a strong formulation player in the global markets.
- Aurobindo boasts of a product pipeline of 110 DMFs and 82 ANDA filings for the US market. With major approvals having come through in FY2007, we expect incremental revenue of Rs100 crore from the US generic business.
- Being a strong player in the anti-HIV market, Aurobindo has secured several new product approvals for its ARV products. We expect Aurobindo's ARV formulation revenues to reach $99 million and $128.7 million in FY08 and FY09 respectively.
- The above initiatives are expected to translate into revenue and earnings CAGR of 24.3% and 70% respectively over FY2007-09E, yielding EPS of Rs57.1 in FY2009E. At the CMP of Rs698, the stock trades attractively at 15.2x FY2008E and 12.2x FY2009E earning estimates.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Bharti Airtel	**838.0**	70.4	37.2	26.2	20.7	29.1	32.3	**900.0**	7.0

Remarks:

- Bharti Airtel, the largest wireless telephony service operator, is one of the key beneficiaries of the consumption boom in the country. It has reportedly added subscribers at a healthy CAGR of over 75% in the past three years and is expected to increase its subscriber base at a CAGR of over 35% over the next two years.
- The company's focus on introducing innovative services, cost control measures and growing economies of scale is resulting in an improvement in its margins, despite the continued pressure on the average revenue per unit (ARPU). Consequently, the earnings are estimated to grow at CAGR of over 46% over the three-year period FY2006-09.
- At the current market price the stock trades attractively at 26.2x FY2008 and 20.5x FY2009 earning estimates.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Bharat Electronics	**1,892.1**	26.0	21.2	18.0	29.7	26.7	24.1	**2,020.0**	7.0

Remarks:

- Given its wide range of products, research & development capabilities and proven track record, Bharat Electronics is well poised to effectively tap the huge opportunity in the defence sector.
- It has announced a pending order backlog of Rs9,100 crore as on March end 2007 and would benefit from the over 64% increase in the capital outlay for security and other equipment used by defence forces. Moreover, the recent alliances/tie-ups with leading defence contractors such as Northrop Grumman would further boost the overall growth in the long term.
- At the current market price the stock trades attractively at 21.2x FY2007 and 18.0x FY2008 earning estimates.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
BHEL	**1,414.4**	41.2	28.6	22.5	23.0	26.2	26.4	**1,563.0**	10.0

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 Rs55,000 crore, ie 3x its FY2007 revenue, provides high earnings visibility.
- The power ministry has proposed around five ultra mega power projects entailing a capacity addition of 20,000MW (4,000MWx5) 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 22.5x its FY2008E earnings. BHEL's valuation looks attractive as compared with that of its peers, such as Siemens, ABB and Larsen and Toubro.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
HCL Technologies**	**345.7**	28.8	19.5	16.6	19.5	21.7	23.1	**395.0**	14.0

Remarks:

- HCL Technologies, one of the leading Indian IT service vendors, has been able to successfully bag large-sized deals (multi-million, multi-year) over the past few quarters. This has considerably improved its revenue growth visibility.
- The company has reported higher than expected performance for the past three quarters. Moreover, it has been able to improve its margins, allaying the concerns that execution of large deals might have an adverse impact on its profitability.
- At the current market price the scrip trades at 16.6x FY2008 and 13.8x FY2009 estimated earnings. We recommend Buy call on the stock.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
HDFC Bank	**1,152.9**	41.5	32.2	27.7	17.7	19.3	15.8	**1,355.0**	18.0

Remarks:

- HDFC Bank is the best private sector bank, it delivers a consistent 31% earnings growth under most market situations.
- The bank has shown a significant improvement in net interest margins to 4.4% when the entire banking system is coping with pressure on margins. This has been possible due to the bank's excellent asset liability management, and a high and stable low-cost deposit base of 55%, which helps to keep the costs down under a rising interest rate scenario.
- The bank's management has an excellent track record and the latest capital raising plan of Rs4,200 crore would be book value accretive and help the bank to grow at a robust pace.
- At the current market price the stock is quoting at 21.2x FY2009E earnings per share, 8.2x FY2009E pre-provision profits and 3.1x FY2009E book value. We maintain our Buy recommendation on the stock with a price target of Rs1,355.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
Hindustan Lever#	**201.3**	33.5	28.8	23.4	56.8	56.5	57.3	**280.0**	39.0

Remarks:

- HLL is India's largest fast moving consumer good (FMCG) company. The volume growth is picking up in FMCG sector and HLL is likely to be a key beneficiary.
- The company has regained the pricing power in all the product segments. We believe better pricing power and improved product mix will be the revenue drivers. The turn-around of loss-making businesses, cost-cutting initiatives and increased focus on its food business should help it to improve its profitability.
- At the current market price the stock is quoting at 23.4x its CY2007E earnings per share (EPS) of Rs8.5. We maintain our Buy recommendation on the stock with a price target of Rs280.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
ICICI Bank	**928.1**	32.5	26.8	26.2	13.6	13.3	10.3	**1,173.0**	26.0

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.
- Various subsidiaries (life insurance, general insurance, ICICI Securities) add Rs382 to the overall valuation. Listing of the holding company (insurance and asset management businesses) could unlock significant value going forward.
- The bank plans to raise Rs20,000 crore of equity, which should help it maintain its current high growth rates for the next three years. In the past, the management has improved the return on equity post-dilution.
- Its international operations are also gaining momentum, the only challenge would be to manage the uptick in non-performing assets.
- The stock trades at a PER of 26.2x its FY2008E earnings and 2.1x its FY2008E book value.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Indo Tech Trans	**348.3**	33.2	14.7	12.0	23.3	30.6	28.7	**375.0**	8.0

Remarks:

- Indo Tech Transformers is among the leading manufacturers of transformers and is benefiting from the robust demand environment. It is expanding its manufacturing capacity from 2,450MVA to 7,450MVA to cater to the strong demand emerging from the government's stated policy and mission of providing power for all by 2012.
- The strong order book of around Rs200 crore (2x FY2006 revenues) and high operating margins in the range of 18-20% (the highest in the industry) make it one of our top picks.
- At the current market price, the stock trades attractively at 14.7x FY2007 and 12.0x FY2008 earnings estimates.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
M&M	**762.5**	27.0	21.3	16.9	22.2	27.2	23.2	**1,050.0**	38.0

Remarks:

- The government's increasing thrust on agriculture and the easy availability of credit would benefit M&M's tractor sales.
- Its product mix would be further enriched with a number of new launches, including a new UV platform, a mid-sized car Logan (in collaboration with Renault) and other products in collaboration with International Trucks. Another multi-purpose vehicle (code named Ingenio) is slated for a launch in FY2008.
- A better product mix and higher operating efficiencies have helped improve the margins of the company.
- Subsidiaries like Tech Mahindra, Mahindra Gesco, and MMFSL are rendering strong performances.
- Currently M&M is quoting at 10.8x FY2008 its consolidated earnings.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Sun Pharma	**1,092.0**	35.4	27.3	22.8	36.1	19.5	18.7	**1,297.0**	19.0

Remarks:

- Sun Pharma maintains the numero uno ranking with neurologists, cardiologists, diabetologists and orthopedics.
- With 56 abbreviated new drug applications (ANDAs) pending US FDA approval and a filing rate of 30+ ANDAs per year, Sun Pharma has one of the strongest product pipelines for the US market. The company is amongst the top three players in around 15 of the 25 products that it sells in the US market.
- Sun Pharma is likely to show a CAGR of about 60% in ROW markets in FY2006-08. It has 750 products registered and another 300+ products pending approval in these markets.
- With a strong cash position of over Rs1,500 crore, Sun Pharma is well placed to unlock value from potential acquisitions. The demerger of its innovative research and development research unit into a separate arm is likely to trigger substantial value unlocking going forward. The company's disclosed innovative R&D pipeline consists of one new chemical entity and two novel drug delivery system products.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
Thermax	**497.8**	58.8	29.8	21.3	22.3	31.4	32.4	**585.0**	18.0

Remarks:

- Thermax, with its diversified product and application range, is riding on a sustainable capital expenditure (capex) boom in the industrial and infrastructure sectors.
- The capacity expansion and related projects in the core sectors are leading to higher order intake for Thermax. Thermax' current order book of Rs3,024 crore, ie 1.9x its FY2006 revenue, provides high earnings visibility.
- The robust traction across divisions and a burgeoning order book would drive a 28.9% CAGR in Thermax' consolidated revenues over FY2006-08.
- The improving operating leverage from cost rationalisation measures and economies of scale will lead to a 260-basis-point margin expansion over FY2006-08.
- At the current market price, the stock trades at a PER of 21.3x its FY2008E earnings. Rs43 per share of cash and cash equivalent on the company's books as on December31, 2006 provides a margin of safety.

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