Sharekhan top picks

On June 2, 2006 we had recommended the best 12 of our Stock Ideas as Sharekhan Top Picks. As on July 8, 2006, this basket of stocks has given a return of 1%. Continuing with our tradition, we are recommending again a portfolio of the 12 best of our Stock Ideas for the month. The portfolio is fairly diversified with fair representation from different growth sectors and carries moderate risk.

We have reshuffled our portfolio keeping in mind the upcoming quarterly results. In consonance with our overall market strategy, the portfolio has higher proportion of large-cap stocks, representing the domestic consumption-driven sectors. There are two changes this time: We are replacing Orchid Chemicals and Tata Motors with Cipla and Madras Cement.

Name	CMP* (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Bajaj Auto	2,808.9	25.4	20.4	16.9	14.9	18.6	20.7	3,500.0	25.0
Bharat Heavy Electricals	1,973.4	28.8	20.0	15.8	15.5	23.3	27.5	2,650.0	34.0
Cadila Healthcare	554.5	21.1	15.4	11.8	19.9	21.6	23.1	850.0	53.0
Cipla	216.7	31.9	23.3	17.8	25.7	23.1	24.9	300.0	38.0
Godrej Consumer Products	662.9	30.8	25.2	21.0	166.8	161.4	111.4	912.0	38.0
ICICI Bank	507.8	17.8	12.9	10.9	19.0	17.0	14.0	750.0	48.0
Infosys Technologies	3,190.3	35.3	27.4	21.1	44.6	40.6	40.1	3,504.0	10.0
ITC	184.7	30.3	25.0	21.0	25.7	26.8	28.2	220.0	19.0
Madras Cements	2,431.8	37.2	22.0	16.1	16.7	20.2	26.5	3,250.0	34.0
Sanghavi Movers	704.6	16.0	11.6	9.0	24.1	39.4	29.4	1,150.0	63.0
UltraTech Cement	746.7	56.1	26.8	18.0	9.3	16.9	23.5	1,000.0	34.0
WS Industries	48.6	17.4	6.5	4.9	5.8	12.5	25.5	112.0	130.0

* CMP as on July 05, 2006

**Calendar year ending

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Bajaj Auto	**2,808.9**	**25.4**	**20.4**	**16.9**	**14.9**	**18.6**	**20.7**	**3,500.0**	**25.0**

Remarks:

- With the help of new product launches over the last few years, Bajaj Auto Ltd (BAL) is well poised to take advantage of the secular growth in the two-wheeler market. BAL is likely to consolidate its position in the market further as the new product launches continue.
- The three-wheeler segment, which is a high-margin business, is turning around after a brief lull. The changes in the regulatory regime in favour of vehicles using cleaner fuel is likely to boost the demand for three-wheelers where BAL is the undisputed leader.
- With the increased contribution of high-margin vehicles and the softening of the prices of steel, BAL is expected to see a 23% compounded annual growth in its earnings over FY2006-08E.
- The stock is currently quoting at a PER of 16.9x its FY2008E earnings. The investment on the company's books (Rs711 per share) and the insurance subsidiaries (Rs734 per share) add substantial value to BAL's fair value.

BHEL	**1,973.4**	**28.8**	**20.0**	**15.8**	**15.5**	**23.3**	**27.5**	**2,650.0**	**34.0**

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 Rs37,500 crore, ie 2.8x 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 15.8x 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	**554.5**	**21.1**	**15.4**	**11.8**	**19.9**	**21.6**	**23.1**	**850.0**	**53.0**

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 33.4 % over FY2006-08E. The stock is trading at a PER of 11.8x FY2008E earnings.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Cipla	216.7	31.9	23.3	17.8	25.7	23.1	24.9	300.0	38.0

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 17.8x on its FY2008E earnings.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
Godrej Consumer	662.9	30.8	25.2	21.0	166.8	161.4	111.4	912.0	38.0

Remarks:

- Godrej Consumer Products Ltd (GCPL) is a big beneficiary of the expected consumption boom in India. A rising proportion of the middle-income families will translate into a strong demand for its products like soaps, hair colours and toiletries.
- The market share gains in the soap business through the consolidation of brands (Godrej No 1) and the launch of new products will lead to a robust growth, outpacing the growth in the soap market.
- The hair colour segment offers huge opportunity owing to its under-penetration and a strong 16-20% compounded annual growth rate (CAGR). GCPL with its dominant market share and a quality product basket should reap handsome gains.
- Cash flows are expected to grow at a CAGR of 20.2% in the FY2006-08 period; the same will be deployed in purchasing growth by augmenting capacities and through inorganic growth aspirations.
- GCPL trades at a PER of 21.0x its FY2008E earnings, quite attractive in view of the inorganic growth triggers and the shareholders' value maximising strategy.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
ICICI Bank	507.8	17.8	12.9	10.9	19.0	17.0	14.0	750.0	48.0

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 10.9x its FY2008E earnings and 1.7x 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 (%)
Infosys Technologies	3,190.3	35.3	27.4	21.1	44.6	40.6	40.1	3,504.0	10.0

Remarks:

- Infosys is one of the key beneficiaries of the strong momentum in the offshore outsourcing of software services by the large corporations globally.
- It has given a healthy annual guidance of a 29-31% (Rs12,254-12,446 crore) growth in the revenue and a 26-28% (Rs13.9-15.6 per share) growth in the earnings. This is one of the most aggressive guidance in the past five years and shows the management's growing confidence in the growth visibility.
- Moreover, there is scope for positive surprises, as the above guidance does not include the impact of large deals and a possible ramp-up through the inorganic initiatives.
- The stock currently trades at an attractive valuation of 21.1x its FY2008E estimated earnings.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
ITC	184.7	30.3	25.0	21.0	25.7	26.8	28.2	220.0	19.0

Remarks:

- 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 21.0x its FY2008E earnings.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Madras Cements	2,431.8	37.2	22.0	16.1	16.7	20.2	26.5	3,250.0	34.0

Remarks:

- 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 51% in its earnings over FY2006-08.
- The stock is quoting at 16.1x its FY2008E earnings and EV/tonne of US$109, which is cheaper as compared with its peers.

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE (%) FY06	RoE (%) FY07E	RoE (%) FY08E	Target price	Upside (%)
Sanghvi Movers	704.6	16.0	11.6	9.0	24.1	39.4	29.4	1,150.0	63.0

Remarks:

- 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 Rs60.9 in FY2007E and of Rs78.7 in FY2008E, but the CEPS will be significantly higher.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Ultra Tech Cement	746.7	56.1	26.8	18.0	9.3	16.9	23.5	1,000.0	34.0

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$120 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 (%)
WS Industries	48.6	17.4	6.5	4.9	5.8	12.5	25.5	112.0	130.0

Remarks:

- WS Industries, a leading maker of porcelain insulators, will reap the benefits of a three-fold increase in investment in the country's power transmission and distribution segment.
- Further a strong order book of about Rs120 crore and a shift to the higher-margin product of hollow insulators would drive its earnings.
- It plans to develop a 10-lakh-square-feet IT park in Chennai and the fair value of the IT park is about Rs80 per share of WS Industries.
- The stock is trading at attractive valuations of 4.9x its FY2008E earnings.

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