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top picks

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Sharekhan top picks

In the October 2006 issue, we had recommended the best 12 of our Stock Ideas as Sharekhan Top Picks. As on November 1, 2006, the return on this basket of stocks has been 4.3% as compared to the Sensex, which has given 5.2% returns and the S&P CNX Nifty, which has given 5.6% returns.

We have made three changes in the portfolio. We have taken out: BASF India, SKF India and Union Bank of India. We have introduced three new stocks: Mahindra & Mahindra, Infosys Technologies and Subros.

Name	CMP* (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Bharat Heavy Electricals	2,459.0	35.8	24.9	19.6	23.0	26.2	26.4	2,650.0	8.0
Cadila Healthcare	351.4	29.0	19.5	15.0	21.8	23.0	23.0	425.0	21.0
Cipla	257.0	32.9	26.2	21.4	30.6	22.2	22.0	300.0	17.0
ICICI Bank	775.9	27.2	21.1	17.6	13.6	14.0	15.1	**	
India Cements	218.6	115.1	10.9	7.6	4.3	31.1	30.8	315.0	44.0
Infosys Technologies	2,103.0	47.2	30.8	23.4	35.3	39.8	39.5	2,430.0	15.5
ITC	190.6	31.2	25.8	21.7	26.8	28.2	28.1	220.0	15.0
Madras Cement	3,471.1	52.4	13.5	11.4	20.3	46.2	36.6	4,000.0	15.0
Mahindra & Mahindra	778.7	28.1	21.0	17.9	29.5	27.6	23.2	870.0	12.0
Sanghavi Movers	786.7	18.0	12.3	9.5	39.6	30.5	29.4	1,150.0	46.0
Subros	263.1	13.0	9.4	6.5	18.9	20.3	22.1	370.0	40.6
UltraTech Cement	880.6	47.6	16.4	14.4	22.1	40.8	32.7	1,000.0	14.0

* CMP as on November 01, 2006

** Price target under review

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Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY06	FY07E	FY08E	FY06	FY07E	FY08E	price	(%)
BHEL	**2,459.0**	35.8	24.9	19.6	23.0	26.2	26.4	**2,650.0**	8.0

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 Rs45,700 crore, ie 3.4x 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 19.6x 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	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
Cadila Healthcare	**351.4**	29.0	19.5	15.0	21.8	23.0	23.0	**425.0**	21.0

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 38.4 % over FY2006-08E. The stock is trading at a PER of 15.0x FY2008E earnings.

Name	CMP	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
Cipla	**257.0**	32.9	26.2	21.4	30.6	22.2	22.0	**300.0**	17.0

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 21.4x on its FY2008E earnings.

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY06	FY07E	FY08E	FY06	FY07E	FY08E	price	(%)
ICICI Bank	**775.9**	27.2	21.1	17.6	13.6	14.0	15.1	**	

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 17.6x its FY2008E earnings and 2.4x its FY2008E book value. ICICI Bank's valuation looks attractive as compared with that of its peers, such as HDFC Bank.

Name	CMP	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
India Cements	**218.6**	115.1	10.9	7.6	4.3	31.1	30.8	**315.0**	44.0

Remarks:

- India Cements (ICL) is the prime beneficiary of the upturn in the southern cement cycle, which saw the highest consumption growth of 25% in the country. With this buoyancy expected to continue in the future, we expect India Cements, the largest player in the south, to chart on the exponential growth trajectory on account of its highest leverage to the prices of cement.
- The Rs350 crore capex plan of the company to raise the cement capacity from 8.8 million tonne to 11 million tonne per annum by December 2007 will drive the growth of the company going forward.
- With the funds raised from various sources, the company's balance sheet has undergone a major transformation. Going ahead, with the strong cash flows from operations, we expect the debt/equity ratio to come down to 0.3:1 in FY2008, which will improve the return ratios with a RoCE of 29.3% and RoNW of 27.7% in FY2008.
- ICL is trading at 7.6x its FY2008E earnings, and on a EV/tonne basis at US$105 per tonne of cement. Given the steep earnings growth trajectory and the massive transformation in its balance sheet, we believe the valuation discount to its other peers is unjustified.

Name	CMP	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
Infosys Technologies	**2,103.0**	47.2	30.8	23.4	35.3	39.8	39.5	**2,430.0**	15.5

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 steeply upgraded its annual guidance to 45.5-46.0% (Rs13,400-13,899 crore) growth in the revenue and a 46.6% (Rs66 per share) growth in the earnings. The steep upgrade in the annual guidance 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 the large deals and a possible ramp-up through the inorganic initiatives.
- The stock currently trades at an attractive valuation of 23.4x its FY2008 estimated earnings.

Name	CMP	PER			RoE (%)			Target	Upside
	(Rs)	FY06	FY07E	FY08E	FY06	FY07E	FY08E	price	(%)
ITC	**190.6**	31.2	25.8	21.7	26.8	28.2	28.1	**220.0**	15.0

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 21.7x its FY2008E earnings.

Name	CMP	PER			RoE (%)			Target	Upside
Madras Cements	**3,471.1**	52.4	13.5	11.4	20.3	46.2	36.6	**4,000.0**	15.0

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 94.3% in its earnings over FY2006-08.
- The stock is quoting at 11.4x its FY2008E earnings and EV/tonne of US$162.7, which is cheaper as compared with its peers.

Name	CMP	PER			RoE (%)			Target	Upside
Mahindra & Mahindra	**778.7**	28.1	21.0	17.9	29.5	27.6	23.2	**870.0**	12.0

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 FY2008 launch.
- A better product mix and higher operating efficiencies have helped improve the margins of the company.
- Subsidiaries like Tech Mahindra, Mahindra Gesco, and MMFSL rendering strong performances.
- Currently it is quoting at 17.9x its standalone earnings.

Name	CMP	PER			RoE (%)			Target	Upside
Sanghavi Movers	**786.7**	18.0	12.3	9.5	39.6	30.5	29.4	**1,150.0**	46.0

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 Rs150 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 Rs61.2 in FY2007E and of Rs78.8 in FY2008E, but the CEPS will be significantly higher.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY06	FY07E	FY08E	FY06	FY07E	FY08E		
Subros	**263.1**	13.0	9.4	6.5	18.9	20.3	22.1	**370.0**	40.6

Remarks:

- Subros will be a direct beneficiary of the strong volume growth expected for two of its major clients, Maruti Udyog and Tata Motors. Both the companies have chalked out a huge capacity expansion plan for the next two years which augurs well for Subros.
- Subros has been derisking its business strategy by adding new clients as well as new products in its portfolio. Subros intends to tap the huge potential of the AAC system for commercial vehicles and utility vehicles, thereby de-risking its client portfolio. To diversify its client base it has added Mahindra and Mahindra to the client list for its new platform cars.
- In line with the strong demand, Subros is expanding its capacity from 5 lakh units to 7.5 lakh units in the first phase and further to 10 lakh units in the second phase.
- At the current levels the stock is discounting its FY2008E earnings by 6.5x

Name	CMP (Rs)	PER FY06	PER FY07E	PER FY08E	RoE FY06	RoE FY07E	RoE FY08E	Target price	Upside (%)
UltraTech Cement	**880.6**	47.6	16.4	14.4	22.1	40.8	32.7	**1,000.0**	14.0

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$155 per tonne of cement; we believe the valuation is attractive considering the stock's steep discount to the valuation commanded by its peers.

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