



Sharekhan top picks

Volatility was the order of the day for the stock markets in September 2008, after a sharp run-up in the previous month. The Nifty and the Sensex declined by 3.9% and 4.5% respectively during the month as on September 5, 2008. Sharekhan's recommended stocks outperformed the broader markets as the portfolio of Top Picks declined by only 1.2% during the month. The two stocks added last time, Glenmark Pharma and Punj Lloyd, rendered a strong performance, rising by 5.1% and 2.3% respectively.

The performance of the portfolio was dented by the lacklustre performance of Aban Offshore due to certain detrimental

disclosures in the company's annual report. The portfolio's performance was also affected due to corrections observed in L&T and Reliance Industries, after a sharp rally in the two stocks in the previous month. We have made just one change in our recommendation list for September 2008. We have replaced Satyam Computers with HDFC. Satyam Computers has been replaced because of weak result expectations on account of an expected salary hike. On the other hand, we believe that the expectations of a hike in the foreign direct investment limit in the insurance sector would act as a strong trigger for HDFC.

Name	CMP* (Rs)	PER (x)			RoE (%)			Target price	Upside (%)
		FY08	FY09E	FY10E	FY08	FY09E	FY10E		
Aban Offshore	2,280	-	7.3	5.1	34.5	91.7	60.6	3,569	56.5
Bharti Airtel	803	22.8	17.8	14.7	24.9	28.3	27.6	1,100	36.9
Glenmark Pharma	670	26.4	23.4	17.0	37.3	30.1	29.4	754	12.5
HDFC	2,284	33.4	26.2	22.4	21.4	19.4	20.0	2,912	27.5
Hindustan Unilever	245	30.2	25.8	22.3	85.0	121.2	98.9	280	14.3
ITC	190	22.9	20.0	16.6	27.7	27.2	27.3	247	30.1
Larsen & Toubro	2,620	35.3	23.9	17.5	20.0	23.8	25.8	4,044	54.4
Punj Lloyd	296	27.9	17.1	12.9	16.0	17.6	18.5	532	80.0
Reliance Industries	2,083	19.7	15.7	11.6	22.8	19.6	20.0	3,025	45.2
Shiv-Vani Oil & Gas	546	25.3	16.9	11.3	17.3	17.3	19.0	725	32.8
Sun Pharmaceuticals	1,519	21.2	18.6	18.5	29.8	26.3	21.6	1,640	8.0
TCS	840	16.4	14.3	12.5	40.5	35.6	32.3	1,121	33.5

* CMP as on September 05, 2008

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY08	FY09E	FY10E	FY08	FY09E	FY10E		

Aban Offshore	2,280	-	7.3	5.1	34.5	91.7	60.6	3,569	56.5
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- Remarks:**
- ♦ Aban Offshore, one of the largest oil drilling companies in Asia, is benefiting from increased oil exploration and production activities globally. The resulting robust demand environment is leading to firm day rates for the company's assets.
 - ♦ In addition to re-pricing of its assets at higher day rates, the company is also benefiting from the efforts taken to substantially ramp up the asset base through organic and inorganic initiatives. We expect the company to receive three jack-up rigs in the next couple of quarters, which would significantly improve its financial performance going forward.
 - ♦ The company is also looking to raise capital, which we view as a positive, as it would result in reducing the high debt levels of the company.
 - ♦ At the current market price the stock trades at 7.3x FY2009 and 5.1x FY2010 estimated earnings. We maintain our Buy call on the stock.

Bharti Airtel	803	22.8	17.8	14.7	24.9	28.3	27.6	1,100	36.9
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- Remarks:**
- ♦ Bharti Airtel with over 24% market share is a leader in the Indian telecom space. On average, the company has been adding more than 2 million subscribers every month and currently has a subscriber base of approximately 72 million.
 - ♦ The embedded value in the company's tower business offers considerable downside support to the stock price. Bharti Infratel (with 22,000 towers in circles other than the 16 covered by Indus Towers) has raised \$1 billion through placement to the leading foreign institutions. It has been valued in the range of \$10-12.5 billion depending on the actual performance in FY2009. This apart, Bharti Infratel would hold 40% stake in Indus Towers (formed along with Vodafone and Idea Cellular).
 - ♦ Despite the competition led pricing pressures, Bharti has been able to sustain its operating margins at 41-42%.
 - ♦ At the current market price the stock trades at 17.8x FY2009 and 14.7x FY2010 estimated earnings.

Glenmark Pharma	670	26.4	23.4	17.0	37.3	30.1	29.4	754	12.5
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- Remarks:**
- ♦ Through the successful development and outlicensing of three molecules in a short span of six years, Glenmark has proved itself as India's best play on research-led innovation. In a short span of six years and with a cumulative investment of a meagre \$50 million, Glenmark has built a pipeline of 13 molecules.
 - ♦ The company has managed to clinch four outlicensing deals for its developmental molecules collectively worth \$734 million and has already received \$117 million in initial milestone payments for the same.
 - ♦ Glenmark's core business comprising generics in the USA and branded formulations in Latin America, other semi-regulated markets and India, has seen stupendous success due to its focus on niche specialties and brand building. We expect the core business to grow at a CAGR of 34% over FY2008-10 driven by a CAGR of 40% in the generic segment and a CAGR of 29% in the branded formulation business.
 - ♦ Glenmark has recently decided to restructure its business into two separate entities: Glenmark Pharmaceuticals (comprising branded formulations and discovery research) and Glenmark Generics (comprising the generic formulation business). The realignment will not only allow the company to sharpen focus and align management bandwidth but also enable the two entities to shift to the next level of growth. GGL would be a 100% subsidiary of GPL and would be listed on the Indian bourses.
 - ♦ At the current market price, Glenmark is discounting its consolidated FY2009 earnings by 23.4x and its consolidated FY2010 earnings by 17x. We maintain our Buy recommendation on Glenmark with a SOTP-based price target of Rs754 (Rs550 for the base business of branded and generic formulations & APIs, and Rs204 for the discovery R&D business).

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY08	FY09E	FY10E	FY08	FY09E	FY10E		

HDFC	2,284	33.4	26.2	22.4	21.4	19.4	20.0	2,912	27.5
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Remarks:

- ♦ HDFC is engaged in providing housing loans to individuals, corporates and developers. Besides its core business, HDFC holds interest in banking, asset management and insurance through its key subsidiaries.
- ♦ The recent monetary tightening, in the form of a hike in CRR/SLR and other reserve requirements, has leveled the playing field between banks and NBFCs as far as the housing loan space is concerned. Moreover, a close rival (ICICI Bank) has priced itself out from the housing space, which augurs well for the HDFC's core housing finance business.
- ♦ Operationally, the company remains in strong position with a cost-income ratio (excluding treasury) of 9.1% compared with that of 45-50% for major banks. In addition, the asset quality of the company remains robust with GNPA of 0.84% (90+ days outstanding as % of portfolio).
- ♦ Key subsidiaries continue to perform well. HDFC is contemplating listing its life insurance subsidiary (HDFC Standard Life) in the current fiscal, which would help unlock substantial value. Also, implementation of the proposed hike in FDI for insurance sector augurs well for the company.
- ♦ We value HDFC based on sum-of-the-parts model at Rs2,912 (including Rs871 for the subsidiaries). At the current market price of Rs2,281, the stock trades at 3x FY2009E book value/share excluding the value of the subsidiaries.

Hindustan Unilever	245	30.2	25.8	22.3	85.0	121.2	98.9	280	14.3
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Remarks:

- ♦ HUL is the largest FMCG company in India, occupying ~20% of the Indian consumer space. With dominance across categories such as soaps, detergents, personal care products, food and beverages, it stamps its presence as an FMCG giant.
- ♦ With increasing per capita income fueling consumerism and upgradation of lifestyle of the Indian consumer, HUL's revenues and profitability are expected to gain momentum.
- ♦ Further, hefty free cash flow generation has led to huge cash reserves for HUL and rich dividends (dividend yield of ~3.7%) for its shareholders over the years.
- ♦ At the current market price, the stock trades at 22.3x its CY2009E EPS of Rs11. We maintain our Buy recommendation on the stock.

ITC	190	22.9	20.0	16.6	27.7	27.2	27.3	247	30.1
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Remarks:

- ♦ ITC's cigarette business that has dominance in the category continues to be a cash cow for the company. ITC has chalked out aggressive roadmap for making a mark in the Indian FMCG market. With successful brands such as Bingo, Sunfeast and Aashirwaad already in the reckoning among the best in the industry, ITC's non-cigarette FMCG business is on a strong footing. The company has further ventured into the personal care category with the launch of Superia and Fama Di Wills soaps and shampoos that would compete with the likes of the products of HUL and P&G.
- ♦ Aggressive expansion plans in hotels and paper segments would ensure inclusive growth across segments for the company.
- ♦ We believe ITC has a well-diversified business model with multiple revenue drivers that would ensure sustained growth for the company. It thus remains our top pick in the sector. At the current market price, ITC trades at 16.6x its FY10E earnings. We maintain our Buy recommendation on the stock.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY08	FY09E	FY10E	FY08	FY09E	FY10E		

Larsen & Toubro	2,620	35.3	23.9	17.5	20.0	23.8	25.8	4,044	54.4
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Remarks:

- ♦ Larsen & Toubro (L&T), the largest engineering and construction (E&C) company in India, is a direct beneficiary of the strong domestic infrastructure development and industrial capital expenditure (capex) booms.
- ♦ The international business is expected to emerge as one of the key drivers going forward with immense opportunities from the Gulf Corporation Council markets.
- ♦ There lies innumerable opportunities in the new verticals in which the company is entering, namely ship building, defence, railways, thermal and nuclear power.
- ♦ The company is likely to maintain its margins going forward despite rising costs on the back of rising operational efficiencies, larger ticket-size and more complex nature of orders, better raw material sourcing and integration, and higher contribution of its new businesses which carry higher margins.
- ♦ L&T's current order book of Rs58,200 crore provides strong visibility to its future earnings. We value the core business of L&T at 25x FY2010E earnings, or Rs3,038 per share, while we value the subsidiaries at Rs1,006 per share of L&T. At the current levels, the stock is trading at 17.5x its FY2010E consolidated earnings. We maintain our Buy recommendation.

Punj Lloyd	296	27.9	17.1	12.9	16.0	17.6	18.5	532	80.0
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Remarks:

- ♦ Punj Lloyd Ltd (PLL) is the second largest EPC player in the country with a global presence. We believe PLL with SEC and Simon Carves is well integrated and poised to tap the global opportunity available in hydrocarbons and infrastructure sectors.
- ♦ PLL has witnessed a five-fold increase in its average order size from \$30 million to about \$130-140 million. This move-up on the value chain has made PLL more competitive in executing larger and complex orders.
- ♦ We expect the spectacular order flow to continue for PLL. The current order book of Rs20,162 crore is 2.6x its FY2008 sales and imparts strong visibility. We expect PLL's consolidated revenues and profits to grow at a CAGR of 30.5% and 44.1% respectively over FY2008-10E.
- ♦ We recommend a Buy on the stock with a price target of Rs532. At the current market price the stock trades at 17.1x and 12.9x its FY2009E and FY2010E fully diluted EPS respectively.

Reliance Industries	2,083	19.7	15.7	11.6	22.8	19.6	20.0	3,025	45.2
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Remarks:

- ♦ With nine oil and gas discoveries during the year and a portfolio of 34 exploration blocks, the company holds a great promise in the E&P business. At present, the company's reserves are estimated at 9 billion barrels of oil equivalents.
- ♦ On the back of complex configurations of the existing and upcoming refineries of RPL, the company is likely to continue to earn strong gross refining margins. Refining volumes would double as the RPL refinery becomes operational during the third quarter.
- ♦ At the current market price, the stock is trading at 15.7x FY2009E and 11.3x FY2010E consolidated earnings. We maintain our Buy recommendation on the stock with a price target of Rs3,025.

Shiv-Vani Oil & Gas	546	25.3	16.9	11.3	17.3	17.3	19.0	725	32.8
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Remarks:

- ♦ With a fleet of 29 onshore drilling rigs and six seismic survey crew, Shiv-Vani Oil & Gas Exploration (SOGEL) has emerged as the largest onshore service provider catering to oil and gas exploration companies.
- ♦ Augmentation of assets by the company is well timed in the industry up-cycle as heightened exploration activity has led to a severe shortage of resources with service providers, leading to firming up of day rates (or billing rates per km in case of seismic survey) for various services. Moreover, the order backlog of over Rs5,300 crore (over 9x FY2008 revenues) provides strong revenue-growth visibility.
- ♦ The consolidated revenues and earnings are expected to grow at CAGR of 47.3% and 49.8% respectively over the three-year period FY2008-10.
- ♦ Despite the robust growth prospects, the scrip is available at attractive valuations of 16.9x FY2009 and 11.3x FY2010 earning estimates. We recommend Buy on the stock.

Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY08	FY09E	FY10E	FY08	FY09E	FY10E		
Sun Pharmaceuticals	1,519	21.2	18.6	18.5	29.8	26.3	21.6	1,640	8.0

- Remarks:**
- ♦ Sun Pharma's track record of delivering consistent and robust growth while maintaining strong profitability and return ratios makes it the best Indian play in the generic space.
 - ♦ With 98 abbreviated new drug applications (ANDAs) pending USFDA 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.
 - ♦ With a strong focus on the chronic lifestyle diseases, Sun Pharma's domestic formulations business has been outperforming the industry growth by a wide margin. Sun Pharma maintains the numero uno ranking with neurologists, cardiologists, diabetologists and orthopedics.
 - ♦ It is an aggressive participant in the Para IV patent challenge space. Having already monetised three of its Para IV wins (oxcarbazepine, pantoprazole and amifostine), approvals and launch of generic Effexor XR and clarity on Taro acquisition would act as triggers for the stock.
 - ♦ The stock is quoting at 18.6x FY2009E earnings and at 18.5x FY2010E earnings.

TCS	840	16.4	14.3	12.5	40.5	35.6	32.3	1,121	33.5
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- Remarks:**
- ♦ TCS, one of the largest software services exporters from India, is expected to benefit from the increased outsourcing activities due to slowdown in the USA.
 - ♦ TCS has delivered decent performance during FY2008 considering the strong rupee appreciation and will continue to deliver good performance based on its strong global delivery model. Going ahead TCS's restructuring initiatives with put back the company on a strong growth trajectory.
 - ♦ TCS is well poised to achieve back-ended growth on the back of strong pipeline of 25 deals of more than \$50 million. Moreover the company intends to add 30,000-35,000 employees, which clearly gives the revenue visibility.
 - ♦ At the current market price, TCS is trading at attractive valuation of just 12.5x FY2010 estimated earnings. We maintain our Buy recommendation on the stock with price target of Rs1,121.

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

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