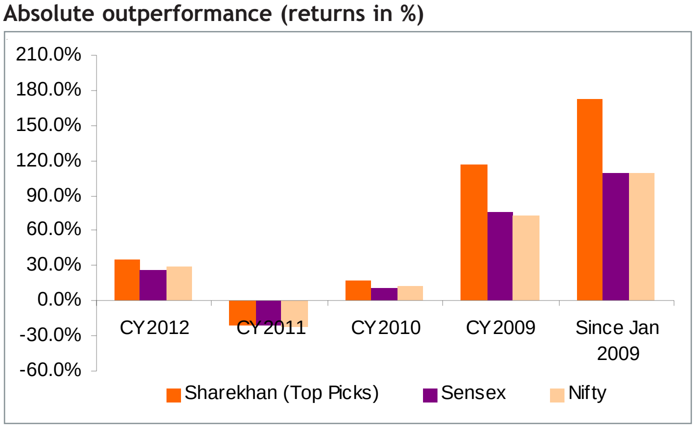
Sharekhan Top Picks

Despite the uncertainties related to the deal on fiscal cliff in the USA and the continued selling by the domestic investors, the market ended higher in the last month on the back of positive global cues, continued foreign fund flow and the ability of the government to push through some pending legislative bills in the winter session of the Parliament.

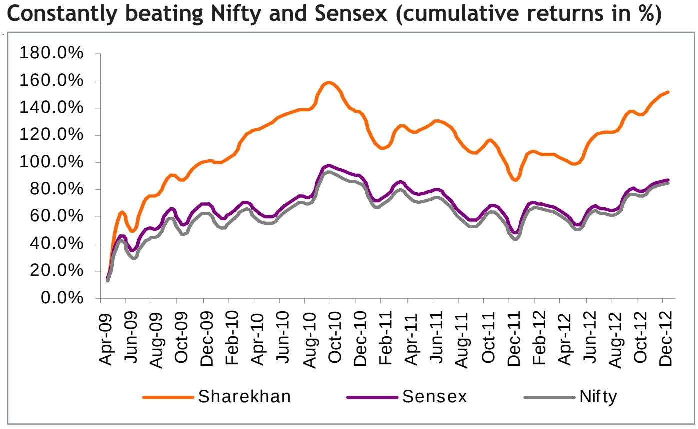
The late surge enabled the equity market to end with gains of 1.3% and 1.2% in the Nifty and the Sensex respectively. Our basket of Top Picks performed better than the benchmark indices yet again and registered gains of 2.7% during the same period. Our performance was aided by an 11% gain in Federal Bank, which was introduced in the Top Picks basket in the last month itself.

This month, we are replacing Axis Bank and Cadila Healthcare with Zee Entertainment Enterprises and CanFin Homes. We see a much higher potential for upside in Zee Entertainment Enterprises than Axis Bank among the large-cap stocks. The introduction of CanFin Homes is prompted by the need to maintain the weightage on the financials as well as to add some mid-cap flavour to the Top Picks basket.

Absolute outperformance (returns in %)



Constantly beating Nifty and Sensex (cumulative returns in %)



Name	CMP* (Rs)	PER (x) FY12	FY13E	FY14E	RoE (%) FY12	FY13E	FY14E	Price target	Upside (%)
BHEL	233	8.1	8.6	9.3	27.7	22.2	17.9	250	8
CanFin Homes	161	7.5	6.2	4.8	13.3	14.3	16.5	220	37
Dishman Pharma	116	16.7	10.8	6.8	6.1	8.7	12.4	135	16
Federal Bank	540	11.9	10.6	8.8	14.4	14.4	15.5	-	-
GCPL	722	43.0	31.1	24.1	26.3	26.8	28.2	796	10
ICICI Bank	1,162	20.7	17.2	15.5	11.2	12.3	12.7	1,230	6
Larsen & Toubro	1,624	19.9	16.5	14.9	17.0	17.5	16.8	1,788	10
M&M	940	20.8	17.9	18.5	22.8	22.3	18.7	1,046	11
Relaxo Footwears	800	24.0	18.5	13.7	20.3	20.4	20.6	885	11
Reliance	841	13.8	13.7	13.0	11.5	10.4	9.9	915	9
Zee Entertainment Enterprises	224	36.7	31.1	24.6	18.1	18.8	20.8	255	14

* CMP as on January 01, 2013

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Name	CMP (Rs)	PER (x) FY12	PER (x) FY13E	PER (x) FY14E	RoE (%) FY12	RoE (%) FY13E	RoE (%) FY14E	Price target	Upside (%)
BHEL	233	8.1	8.6	9.3	27.7	22.2	17.9	250	8

Remarks:

- Bharat Heavy Electricals Ltd (BHEL) is a premier power generation equipment manufacturer and a leading engineering, procurement and construction company.
- BHEL has witnessed a severe downgrade in its valuation multiples in the last couple of years on account of policy inaction-driven slowdown in the demand environment. However, the proposed initiatives to restructure the debt on the books of the state electricity boards would kick-start the reforms in the power sector.
- In terms of the existing order book, we believe that the concern over the cancellation of the orders from the private power developers seems overplayed as the Inter Ministerial Group hasn't de-allocated any coal mine of BHEL's private clients after scrutinising 29 coal mines.
- The company is also focusing on the non-BTG segments, like railways, logistics, and transmission and distribution (T&D), that have a significant growth potential.
- The relatively lower order intake in recent years would reflect on its revenue growth and result in a marginal decline in the earnings over the next two years. However, a lot of negatives are reflected in the serious de-rating of the stock over the last two years and we believe the current valuation is attractive at 9.3x its FY2014 earnings. Therefore, we have included BHEL in our Top Picks basket.

Name	CMP (Rs)	PER (x) FY12	PER (x) FY13E	PER (x) FY14E	RoE (%) FY12	RoE (%) FY13E	RoE (%) FY14E	Price target	Upside (%)
CanFin Homes	161	7.5	6.2	4.8	13.3	14.3	16.5	220	37

Remarks:

- CanFin Homes has renewed its focus on growth and the recent aggressive expansion of its branch network has put it on a high-growth path for the next few years. It has added 25 branches since March 2011 which amounts to an increase of close to 60% in its current branch network of 66 outlets. Consequently, we expect the company's disbursement to grow at about 60% CAGR resulting in a 38% CAGR in the loan book over FY2012-14.
- The company's branches are strategically located (outside cities) and serve customers requiring relatively smaller loans (of below Rs10 lakh), which are eligible for interest subvention. Further, the company gets refinancing from the National Housing Board at competitive rates due to lending in semi-urban rural areas (that account for about 40% of its loan book). Thus, we expect CanFin's NIM to sustain at over 3% going ahead.
- The asset quality of the company is strong as its gross NPAs were a meagre 0.9% of the advances and its net NPAs were nil in FY2012. This is mainly possible due to stringent credit appraisals (customer referrals preferred) and efficient recoveries. The CAR as of Q2FY2013 is 15.44% (17.44% in FY2012) against the minimum requirement of 12%. According to the management, the current capital will suffice till FY2014.
- We believe the operational performance and return ratios of CanFin are improving which should lead to a re-rating of the stock. We value the company at 1x FY2014E BV and recommended Buy with price target of Rs220.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target	Upside (%)
		FY12	FY13E	FY14E	FY12	FY13E	FY14E		
Dishman Pharma	**116**	16.7	10.8	6.8	6.1	8.7	12.4	**135**	16

Remarks:

- After four years of lull, Dishman is all set to capitalise on its capabilities in the contract, manufacturing and research services (CRAMS) space and the marketable molecules (MM) business, thanks to its enhanced capacities and the up cycle in the CRAMS business.
- In H1FY2013, the net revenues of Dishman jumped by 19.4% YoY to Rs604.5 crore on the back of a 17.6% Y-o-Y rise in the CRAMS business and a 22.5% jump in the MM business (which includes the vitamin-D business). The oprating profit margin (OPM) improved by 925 basis points YoY to 23.5% which led the net profit to turnaround to Rs65.3 crore during H1FY2013.
- The up cycle in the CRAMS business and the enhanced capacities (it commercialised three new units in Q3FY2012) will help achieve a 16% revenue CAGR over FY2012-14. We expect an improvement in the operating profit margin and a reduction in the fixed costs during this period, which should lead the profit after tax (PAT) to grow at a CAGR of 55% over FY2012-14. Strong cash flows are likely to help reduce its debts significantly. We expect the debt/equity ratio to reduce to 0.5x in FY2014 from 0.9x in FY2012.
- Being an export-oriented player and having a substantial portion of foreign debts on its balance sheet Dishman is vulnerable to foreign exchange fluctuations. The chequered past performance and the management's inability to meet the stated guidance in the past are also causes for concern in the prevailing market where management quality and transparency carry a premium.
- The stock is currently trading at 6.8x FY2014E EPS, which is a 58% discount to its five-year average P/E multiple and close to a 65% discount to Divi's Laboratories. We expect the valuation gap to narrow on a strong operating performance and an improved financial health. We recommend a Buy on the stock with a price target of Rs135 (8x FY2014E EPS).

Federal Bank	**540**	11.9	10.6	8.8	14.4	14.4	15.5	**-**	-

Remarks:

- Federal Bank is an old private bank with a network of 1,010 branches and a dominant presence in south India. Under a new management the bank is working on a strategy to gain pan-Indian presence, shift the loan book to better-rated corporates, increase the fee income, become more efficient and improve the asset quality.
- The asset quality of the bank has remained steady after showing some strain initially. The slippages from the SME and retail accounts have declined substantially while the slippages from the corporate accounts remain stable. Going forward, with the initiatives undertaken the recoveries could pick up and the NPAs may decline.
- Federal Bank's loan growth has slowed over the past few quarters as the bank is cautious in view of the weakness in the economy. However, the loan growth is likely to be in line with the industry while risk adjusted margins may improve, thereby driving the operating performance.
- The bank's return ratios are likely to go up led by an increase in the profits. We expect an RoE of ~15.5% and an RoA of around 1.2% by FY2014 led by a 16% CAGR in the earnings. Currently the stock is trading at an attractive valuation of 1.2x FY2014 book value. We recommend Buy.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target	Upside (%)
		FY12	FY13E	FY14E	FY12	FY13E	FY14E		
GCPL	**722**	43.0	31.1	24.1	26.3	26.8	28.2	**796**	10

Remarks:

- Godrej Consumer Products Ltd (GCPL) is a major player in the Indian fast-moving consumer goods (FMCG) market with a strong presence in the personal care, hair care and home care segments in India. The recent acquisitions (in line with the 3x3 strategy) have immensely improved the long-term growth prospects of the company.
- On the back of strong distribution network, and advertising and promotional support, we expect GCPL to sustain the market share in its core categories of soap and hair colour in the domestic market. On the other hand, continuing its strong growth momentum, the household insecticide business is expected to grow by ~20% YoY.
- In the international markets, the Indonesian and Argentine businesses are expected to achieve a CAGR of around 20% and 35% respectively over FY2012-14. This along with the recently acquired Darling Group would help GCPL to post a top-line CAGR of ~23% over FY2012-14.
- Due to the recent domestic and international acquisitions, the company's business has transformed from a commodities soap business into the business of value-added personal care and home care products. Therefore, we expect its OPM to be in the range of 16-18% in the coming years. Overall, we expect GCPL's bottom line to grow at a CAGR of above 30% over FY2012-14.
- We believe the increased competitive activity in the personal care and hair care segments and the impact of high food inflation on the demand for its products are the key risks to the company's profitability.
- At the current market price, the stock trades at 31.1x its FY2013E EPS of Rs23.2 and 24.1x its FY2014E EPS of Rs29.0.

Name	CMP (Rs)	PER FY12	PER FY13E	PER FY14E	RoE FY12	RoE FY13E	RoE FY14E	Price target	Upside (%)
ICICI Bank	**1,162**	20.7	17.2	15.5	11.2	12.3	12.7	**1,230**	6

Remarks:

- ICICI Bank continues to report strong growth in advances with stable margins of 2.8%. We expect the advances of the bank to grow by 20% CAGR over FY2012-14. This should lead to a 19.5% CAGR growth in the net interest income in the same period.
- ICICI Bank's asset quality has shown a turnaround as its NPAs have continued to decline over the last eight quarters led by contraction in slippages. This has led to a sharp reduction in the provisions and an increase in the profitability. Going forward, we expect the NPAs to decline further which will lead to lower NPA provisions and hence aid the profit growth.
- Led by a pick-up in the business growth and an improvement in the margins the RoEs are likely to expand to about 13% by FY14 while the RoA would improve to 1.5%. This would be driven by a 16% CAGR in profits over FY2012-14.
- The stock trades at 1.9x FY2014E BV. Moreover, given the improvement in the profitability led by lower NPA provisions, a healthy growth in the core income and improved operating metrics we recommend Buy with a price target of Rs 1,230.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target	Upside (%)
		FY12	FY13E	FY14E	FY12	FY13E	FY14E		
Larsen & Toubro	**1,624**	19.9	16.5	14.9	17.0	17.5	16.8	**1,788**	10

Remarks:

- Larsen & Toubro (L&T), the largest engineering and construction company in India, is a direct beneficiary of the strong domestic infrastructure development and industrial capital expenditure (capex) boom.
- L&T continues to impress us with its good execution skills, reporting decent numbers throughout this year despite the slowdown in the industrial capex cycle. Also we have seen order inflow traction in recent quarters.
- Despite challenges like deferral of award decisions and stiff competition, the company has given robust guidance of 15-20% growth in revenue and order inflow for FY2013. We believe the company will manage to meet its guidance.
- Sound execution track record, bulging order book and strong performance of its subsidiaries reinforce our faith in L&T. With the company entering new verticals, namely solar and nuclear power, railways, and defence, there appears a huge scope for growth.
- At the current market price, the stock is trading at 14.9x its FY2014E consolidated earnings.

M&M	**940**	20.8	17.9	18.5	22.8	22.3	18.7	**1,046**	11

Remarks:

- Mahindra & Mahindra (M&M) is a strong rural India story benefiting from the rising agriculture incomes. The farm equipment sector is estimated to grow by 10% in H2FY2013 as compared with a decline in H1FY2013. Continued farm mechanisation following labour shortages and increasing non-agri uses would support the demand for tractors in the long term.
- The automotive sector is expected to grow by 19% in FY2013. The new launches, such as Quanto and Rexton, have expanded the existing UV portfolio. The pick-ups portfolio has benefited from the shift towards large pick-ups where M&M has a higher market share.
- The company's pricing power is better compared with the other OEMs because of its strong brand equity. It took price hikes aggressively to maintain the margins in both the automotive and the farm equipment division. The company is expected to launch Reva electric NXR and sub-four meter Verito in Q4FY2013.
- Our SOTP-based price target for M&M is Rs1046 per share as we value the core business at Rs883 a share and the subsidiaries at Rs164 a share. We recommend Buy on the stock.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY12	FY13E	FY14E	FY12	FY13E	FY14E	target	(%)
Relaxo Footwears	**800**	24.0	18.5	13.7	20.3	20.4	20.6	**885**	11

Remarks:

- Relaxo Footwears is present in the Indian organised footwear market and is involved in the manufacturing and trading of footwear through its retail and wholesale networks. The company's top brands, namely Hawaii, Sparx, Flite and Schoolmate, have an established presence among their respective segments.
- The company has displayed an impressive growth rate in its top line and bottom line in the last couple of years and is expected to maintain the performance going forward.
- With an established distribution set-up and aggressive plans of opening own retail outlets called "Relaxo Retail Shoppe", the company should be able to gain market share in the coming years.
- The softening rubber prices should provide a boost to the company's margins and profitability.
- We believe a rise in the raw material prices and a continuous slowdown in the discretionary spending remain the key risks to our volume and profitability estimates.
- At the current market price, the stock trades at 18.5x its FY2013E EPS of Rs43.2 and 13.7x its FY2014E EPS of Rs58.3.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY12	FY13E	FY14E	FY12	FY13E	FY14E	target	(%)
Reliance	**841**	13.8	13.7	13.0	11.5	10.4	9.9	**915**	9

Remarks:

- Reliance Industries Ltd (RIL) has a strong presence in the refining, petrochemical and upstream exploration business. The refining division of the company is the highest contributor to the company's earnings and is operating efficiently with a better gross refining margin (GRM) compared with its peers in the domestic market due to the ability of its plant to refine more of heavier crude. However, the gas production from the Krishna-Godavari-D6 field has fallen significantly in the past one year. With the government approval for additional capex, we believe production will improve going ahead.
- In case of refining, the GRM, which had improved sharply in Q2FY2013, showed signs of correction in recent times. We believe the GRM is likely to be stable in the coming quarters.
- In the petrochemical business, the company's margins are close to bottoming out (with a sharp correction in Q1FY2013). In H2FY2013, we could see an improvement in the margin that will support the overall profitability of the company.
- In case of the upstream exploration business, the company has recently got the nod for further investments in exploration at the Krishna-Godavari basin, which augurs well for the company and could address the issue of falling gas output. Further, the new gas pricing formula recommended by the Rangarajan panel augurs well for the company and could provide further upside to the earnings.
- The key concern remains in terms of a lower than expected GRM, profitability of the petrochemical division and the company's inability to address the issue of falling gas output in the near term.
- At the current market price the stock is trading at PE of 13x its FY2014E EPS.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target	Upside (%)
		FY12	FY13E	FY14E	FY12	FY13E	FY14E		
Zee Entertainment Enterprises	**224**	36.7	31.1	24.6	18.1	18.8	20.8	**255**	14

Remarks:

- Among the key stakeholders of the domestic TV industry, we expect broadcasters to be the prime beneficiary of the mandatory digitisation process initiated by the government. The broadcasters would benefit from higher subscription revenues at the least incremental capex as the subscriber declaration improves in the cable industry.
- In the last three quarters Zee TV, the flagship channel of ZEEL, has consistently gained market share among the top four Hindi general entertainment channels. Zee TV's market share has improved from 16.5% in Q3FY2012 to 22% in Q2FY2013, with gross rating points of 237 in Q2FY2013.
- By FY2015, we expect ZEEL's cash flow to improve significantly with a jump of around 75% from the FY2012 cash and cash equivalents of Rs1,060.7 crore. In the last three years, the dividend pay-out ratio has been around 25-30%, which will increase in the coming years. Also, in the last two years the company has initiated two share buy-back programmes acquiring shares of cumulative value of Rs290 crore.
- ZEEL's earnings are expected to grow at a CAGR of 25% over FY2013- 15. Further, strong cash levels would drive the management's inclination to reward the shareholders which would act as a positive trigger for the stock. At the current market price of Rs223, the stock trades at 31.1x on FY2013 and 24.6x FY2014 earnings estimates.

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