Sharekhan Top Picks

In spite of the volatility emerging from the Greece bail-out crisis and the speculation over its fall-out on the financial markets globally, the benchmark indices ended June of 2015 with a marginal gain of 0.2-0.7% since we last took stock of the Top Picks basket on May 29, 2015. The Top Picks basket underperformed the indices reporting a marginal decline for the same period largely due to a sharp dip in Persistent Systems after its guidance of soft Q1FY2016 results.

This month, we are making two tactical changes keeping the Q1FY2016 result season in mind. First, we are replacing PTC India Financials with Capital First as part of the churn within the financial services space. The change also reflects our bias towards an expected pick-up in consumer demand and its positive rub-off on the consumer financing-driven businesses.

The other change is that we are re-introducing Reliance Industries in place of Persistent Systems. The near-term outlook for the latter has turned challenging (though we remain positive on Persistent Systems' long-term growth story due to its strong presence in the fast growing digital space of cloud computing, analytics and mobility). On the other hand, Reliance Industries is expected to witness a material improvement in the margins of its refining business.

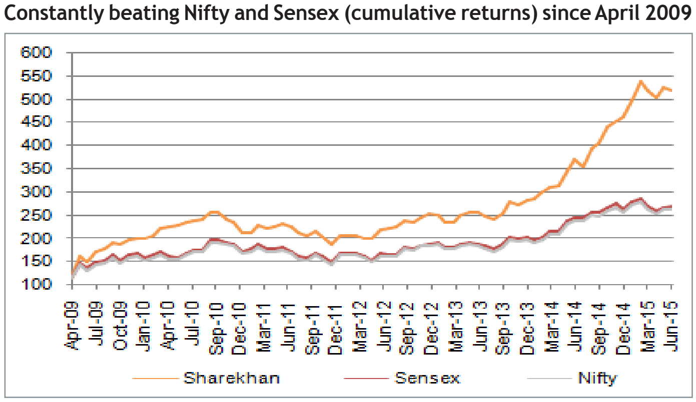
Consistent outperformance (absolute returns; not annualised) (%)

	1 month	3 months	6 months	1 year	3 years	5 years
Top Picks	-0.8	0.3	12.1	39.9	138.9	120.7
Sensex	0.7	0.2	1.9	9.5	60.9	59.5
Nifty	0.2	-0.4	2.1	10.3	61.1	60.8
CNX Mid-cap	0.4	1.8	5.2	18.6	81.8	65.0

Absolute returns (Top Picks vs benchmark indices) (%)

	Sharekhan (Top Picks)	Sensex	Nifty	CNX Mid-cap
CY2015	12.1	1.9	2.1	5.2
CY2014	63.6	29.9	30.9	55.1
CY2013	12.4	8.5	6.4	-5.6
CY2012	35.1	26.2	29.0	36.0
CY2011	-20.5	-21.2	-21.7	-25.0
CY2010	16.8	11.5	12.9	11.5
CY2009	116.1	76.1	72.0	114.0
Since Inception (Jan 2009)	415.0	179.2	177.4	265.5

Constantly beating Nifty and Sensex (cumulative returns) since April 2009



Please note the returns are based on the assumption that at the beginning of each month an equal amount was invested in each stock of the Top Picks basket

Name	CMP* (Rs)	PER (x) FY15	PER (x) FY16E	PER (x) FY17E	RoE (%) FY15	RoE (%) FY16E	RoE (%) FY17E	Price target (Rs)#	Upside (%)
Aditya Birla Nuvo	**1,823**	48.9	44.0	40.6	6.8	7.0	7.1	**2,150**	18
Ashok Leyland	**75**	90.7	23.9	15.7	4.9	16.2	21.2	**	-
Cadila Healthcare	**1,825**	32.5	23.3	17.6	27.3	28.0	27.4	**2,060**	13
Capital First	**391**	31.1	18.7	14.6	8.3	11.6	13.4	**485**	24
Century Plyboards	**197**	29.3	22.6	17.1	40.8	36.2	33.7	**290**	48
Gateway Distriparks	**355**	20.6	18.9	16.0	21.5	21.7	23.9	**445**	25
HDFC Bank	**1,072**	26.3	21.6	17.6	19.4	18.8	20.1	**1,260**	18
Lupin	**1,878**	35.1	31.0	24.5	27.1	23.5	23.2	**	-
Maruti Suzuki	**4,034**	32.8	23.4	17.6	16.6	20.1	22.5	**4,400**	10
Reliance Industries	**1,006**	12.6	13.3	10.8	10.8	9.4	10.5	**1,100**	10
Yes Bank	**867**	18.1	15.5	12.1	21.3	18.6	20.4	**930**	7
Zee Entertainment	**364**	35.7	32.2	27.6	19.5	19.3	20.2	**400**	10

*CMP as on July 01, 2015 # Price target for next 6-12 months ** Under review

Sharekhan
Your guide to the financial jungle

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Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY15	FY16E	FY17E	FY15	FY16E	FY17E	target (Rs)	(%)
Aditya Birla Nuvo	1,823	48.9	44.0	40.6	6.8	7.0	7.1	2,150	18

Remarks:

- Aditya Birla Nuvo (ABN), a conglomerate holding company, is present in different businesses ranging from lifestyle, telecom, fertilisers to financials, with each having either leadership or a strong competitive position in its market. We believe that owing to the holding company structure and composition, the underlying businesses are trading at a discount to their fair value.
- Over the last few years the company has made efforts to consolidate its position in each of the business verticals and gained market share in the respective businesses.
- ABNL strong position in each of its business verticals (life insurance, telecom, lifestyle and asset management) will pave the way for growth. Also, the company's efforts to implement the necessary restructuring steps to unlock value for its minority shareholders through disinvestment of the sub-scale businesses (carbon black and business process outsourcing), demerger of growth businesses or consolidation within the group are likely to enhance the shareholders' value in this quality conglomerate business. Thus, we see scope for further re-rating of the stock as each of its businesses gets valued optimally, does not suffer holding structure and has a diversified business profile (no holding discount). We, therefore, retain our positive stance on the stock and maintain our Buy rating with a revised price target of Rs2,150 (arrived at using the sum-of-the-parts approach, valuing each business vertical and adjusting the stand-alone debt).

Ashok Leyland	75	90.7	23.9	15.7	4.9	16.2	21.2	**	-

Remarks:

- Ashok Leyland Ltd (ALL) is the second largest CV manufacturer in India with a market share of 25% in the heavy truck segment and an even higher share of about 40% in the bus segment. Given the scale of economic slowdown, the segment had halved over FY2012-14. With the pick-up in the economy a sharp recovery is expected in the segment.
- ALL entered the light CV (LCV) segment with the launch of the Dost in joint venture (JV) with Nissan. The JV has additionally launched the Partner LCV and Stile van. Going forward, we expect ALL to gain a foothold in the LCV segment and expand its market share.
- The company is also concentrating on verticals other than CVs to de-risk its business model. It has a strong presence in exports and continues to expand in newer geographies. The diesel genset business is also showing signs of a recovery after a tepid performance in FY2013-14. Additionally, ALL's defence business is expected to get a leg-up due to the government's focus on indigenous manufacture of defence products and FDI in the sector.
- ALL's operating profit margin (OPM) has recovered from the lows on the back of a reduction in discounts and price hikes taken by the company. Its margins are expected to expand further, given the operating leverage. ALL has raised Rs660 crore via a qualified institutional placement and sold non-core assets to pare its debts. With no significant capital expenditure (capex) planned, we expect the balance sheet to get de-leveraged and return ratios to improve.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY15	FY16E	FY17E	FY15	FY16E	FY17E	target (Rs)	(%)
Cadila Healthcare	1,825	32.5	23.3	17.6	27.3	28.0	27.4	2,060	13

Remarks:

- Cadila Healthcare is set to enter a high-growth trajectory, thanks to its aggressive product filings in the USA and Latin America, a recovery in its joint venture business and the launch of niche products in the Indian market including the generic version of Gilead Sciences' Hepatitis C drug, Sofosbuvir, in India under the brand name SoviHep.
- Cadila Healthcare, which generates close to 36% of its total revenues from the US market, is likely to be among the key beneficiaries of a favourable business environment in the generic space. The company has over 161 abbreviated new drug applications (ANDAs) pending approval out of 260 ANDAs filed with the US Food and Drug Administration (USFDA) that will unfold over the next two to three years. We expect the company to see a revenue compounded annual growth rate (CAGR) of 34% over FY2014-17 in the US market.
- We expect the company to record overall revenue and profit CAGR of 21% and 36% over FY2015-17 respectively from the base business. The OPM of the company will see a sustained expansion of over 600BPS in the next three years, mainly on the back of stronger traction in the branded business in India and Latin America, a better generic pricing scenario in the USA and optimisation of capabilities in the joint venture business. We recommend a Buy rating on the stock with a price target of Rs2,060, which implies 20x FY2017E EPS.

Name	CMP	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
Capital First	391	31.1	18.7	14.6	8.3	11.6	13.4	485	24

Remarks:

- Capital First is among the leading NBFCs with assets under management (AUMs) of Rs11,975 crore mainly in the SME and consumer segments (consumer durables, two-wheelers, mortgages), contributing 84% of the total AUMs. With a scale-up in the key businesses, the company will benefit significantly from operating leverage leading to an improvement in the return ratios. Its asset quality remains among the best in the industry due to its stringent underwriting practices and robust technology enabled initiatives.
- Recently, the company raised Rs300 crore via a qualified institutional placement issue at a price of Rs390 per share which was book value accretive (2x FY2017E book value). This has enhanced the company's capital adequacy ratio from about 20% to 23.5%, which should be sufficient to support a growth of over 25% in loans over the next couple of years. The company aims for AUMs of Rs25,000-30,000 crore by FY2019 (that is a growth of 25% CAGR) and return on asset (RoA) of about 2.5%.
- We expect Capital First to deliver an earnings growth of 57% CAGR over FY2014-17 led by a 35% compounded annual growth in the net interest income. Due to the recent capital raising the return on equity (RoE) estimates for FY2016 and FY2017 may get diluted by 200-250 basis points, though the RoA may continue to improve. A likely easing of interest rates or a pick-up in the economy will boost the company's growth. Considering the robust growth outlook, healthy asset quality and experienced management team, we believe that the stock trades at reasonable valuations (1.8x FY2017E book value). We have a Buy rating on the stock with a price target of Rs485.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY15	FY16E	FY17E	FY15	FY16E	FY17E		
Century Plyboards	197	29.3	22.6	17.1	40.8	36.2	33.7	290	48

Remarks:

- Century Plyboards (Century) is a leading player in the fast growing plyboard and laminate segment, with an overall market share of around 25% of the organised plyboard market and an estimated size of Rs4,500-4,800 crore annually. The organised plywood and laminate segment is growing at healthy double-digit growth rates due to an improving demand environment and a shift towards branded products. Century with its strong brand equity, unparallel distribution network (10,000 touch points) and manufacturing presence in the timber-rich region of Myanmar is well poised to cash in on the robust growth opportunity.
- The introduction of the Goods and Services Tax (GST) would create a level playing field for the organised players. The unorganised players are currently out of the tax net and thus enjoy lower costs by evading taxes. After the introduction of GST, the tax advantage enjoyed by the unorganised players would diminish sharply and the market share of the organised players is likely increase significantly, benefiting Century.
- We believe Century with its top-of-the-mind brand recall is well positioned to ride the economic revival-driven recovery in demand and increase its market dominance in the plywood and laminate segments. A robust revenue growth and margin expansion would enable the company to deliver a strong growth ahead. We expect it to post a 31.3% earnings CAGR over FY2015- 17. The implementation of GST would provide a fillip to the revenue and earnings performance. In view of these positives, we maintain our Buy rating on the stock with a price target of Rs290 (valued at 25x FY2017E).

Name	CMP (Rs)	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
Gateway Distriparks	355	20.6	18.9	16.0	21.5	21.7	23.9	445	25

Remarks:

- An improvement in exim trade along with a rise in port traffic at the major ports signals an improving business environment for the logistic companies. Gateway Distriparks being a major player in the container freight station (CFS) and rail logistic segments is expected to witness an improvement in the volumes of its CFS and rail divisions going ahead.
- The improving trend in the rail freight and cold chain subsidiaries would sustain on account of the recent efforts to control costs and improve utilisation.
- We continue to have faith in the company's long-term growth story based on the expansion of each of its three business segments, ie CFS, rail transportation and cold storage infrastructure segments. The coming on stream of the Faridabad facility and the strong operational performance will further enhance the performance of the rail operations. Also, the expected turnaround in the global trade should have a positive impact on the CFS operations.
- Given the improvement in the profitability led by lower non-performing asset (NPA) provisions, a healthy growth in the core income and improved operating metrics, we recommend a Buy with a price target of Rs445.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY15	FY16E	FY17E	FY15	FY16E	FY17E		
HDFC Bank	1,072	26.3	21.6	17.6	19.4	18.8	20.1	1,260	18

Remarks:

- HDFC Bank has a strong presence in the retail segment (~50% of the book) and therefore has been able to maintain a strong growth in loans even in tough times. Going ahead, with a recovery in the economy and improving sentiment in consumer sectors, the loan growth will improve further which will drive the profitability.
- With a current account and savings account (CASA) ratio of 41% and a high proportion of retail deposits, the cost of funds remains among the lowest in the system and helps to maintain a higher net interest margin (NIM). In addition, the bank's loan growth is led by high yielding products such as personal loans, vehicle loans, credit card, mortgages etc which has a positive impact on the NIM.
- The bank maintains impeccable asset quality and its NPA ratios are among the lowest in the system. Given the bank's stringent credit appraisal procedures and insignificant exposure to troubled sectors, it is expected to maintain robust asset quality.
- HDFC Bank is adequately capitalised and further capital raising of Rs10,000 crore will boost its capital ratios and help to tap the growth opportunities going ahead. The bank is likely to maintain healthy RoE of 19-20% and RoA of 1.8% on a sustainable basis. Therefore, we expect the valuation premium that it enjoys compared with the other private banks to expand further.

Name	CMP (Rs)	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
Lupin	1,878	35.1	31.0	24.5	27.1	23.5	23.2	**	-

Remarks:

- A vast geographical presence, focus on niche segments like oral contraceptives, ophthalmic products, para-IV filings and branded business in the USA are the key elements of growth for Lupin. The company has remarkably improved its brand equity in the domestic and international generic markets to occupy a significant position in the branded formulation business. Its inorganic growth strategy has seen a stupendous success in the past. The company is now debt-free and that enhances the scope for inorganic initiatives.
- The management has guided for a revenue growth of 10-15% in FY2016 (vs a 13.6% growth achieved in FY2015) and an EBIDTA margin of 26-28% (vs 27.4% in FY2015) which especially impress us. Lupin has recently forged an alliance with Merck Serono to out-licence select drugs and signed an agreement with Salix Pharma to in-licence products for the Canadian market. These initiatives will support growth in the long term.
- Lupin is expected to see stronger traction in the US business on the back of the key generic launches in recent months and a strong pipeline in the US generic business (over 95 ANDAs pending approvals including 86 first-to-file drugs) to ensure the future growth. The key products that are going to provide a lucrative generic opportunity for the company include Nexium (market size of $2.2 billion), Lunesta (market size of $800 million) and Namenda (market size of $1.75 billion) that will be going out of patent protection in CY2015. The company has recently got the Foreign Investment Promotion Board's clearance to raise the investment limit for foreign institutional investors to 49% from 32% currently.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY15	FY16E	FY17E	FY15	FY16E	FY17E		
Maruti Suzuki	4,034	32.8	23.4	17.6	16.6	20.1	22.5	4,400	10

Remarks:

- Maruti Suzuki India Ltd (MSIL) is the market leader in the domestic passenger vehicle (PV) industry. In FY2015, as against an industry growth of a modest 3.9% MSIL has grown its volumes by 11.1% and in the process expanded its market share by 441BPS to 45%.
- The company has further strengthened its sales and service network. Additionally, the drive undertaken by its management to tap the potential in rural areas paid rich dividends in difficult times for the industry and in times of rising competitive intensity; this reaffirms the resilience of MSIL's positioning and business model.
- The recent launches of Celerio and Alto K10 with the new automatic manual transmission have enthused the market and the company plans to offer the same in other models too. MSIL has a pipeline of new launches over the next few years with the most important being the entry into the compact utility vehicle and LCV segments.
- We expect customer sentiment to improve on the back of a strong government at the centre. Additionally the PV segment is expected to benefit from the pent-up demand over the past two years; this will benefit MSIL the most due to its high market share in the entry level segment. The recent depreciation of the Japanese Yen is expected to boost profitability.

Name	CMP (Rs)	PER FY15	PER FY16E	PER FY17E	RoE FY15	RoE FY16E	RoE FY17E	Price target (Rs)	Upside (%)
Reliance Industries	**1,006**	12.6	13.3	10.8	10.8	9.4	10.5	**1,100**	10

Remarks:

- Reliance Industries Ltd (RIL) has a strong presence in the refining, petrochemical and upstream exploration businesses. The refining division of the company is the highest contributor to its 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 (KG-D6) field has fallen significantly in the last two years. With the government approval for additional capex in its allocated gas fields, we believe the production will improve going ahead.
- Though there is uncertainty regarding gas production and pricing of gas from the KG-D6 field, but the traction in volume from shale gas assets is playing positively for the company. Moreover, the upcoming incremental capacities in the petrochemical and refinery businesses are going to drive the future earnings growth substantially as the downstream businesses are on the driving seat and contributing the lion's share of the profitability and cash flow.
- In recent past there have been signs of improvement in the benchmark GRM which suggests that there could be a healthy improvement in the GRM of RIL too. The stock is available at attractive valuation considering the size, strong balance sheet and cash flow generating ability of the company.

Name	CMP	PER (x)			RoE (%)			Price	Upside
	(Rs)	FY15	FY16E	FY17E	FY15	FY16E	FY17E	target (Rs)	(%)
Yes Bank	867	18.1	15.5	12.1	21.3	18.6	20.4	930	7

Remarks:

- Given a decline in inflation and the possibility of further reduction in the policy rates by the Reserve Bank of India, the cost of funds will reduce and benefit Yes Bank. In addition, the bank's investment book stands to benefit from a fall in bond yields due to surplus statutory liquidity ratio securities and substantial corporate bond book (~Rs10,000 crore). The bank will also be included in the Nifty index which will be positive for the stock.
- The bank is well capitalised (tier-I capital adequacy ratio of 12.2%) and is likely to benefit from the revival in the economy which will result in a strong growth in advances. Apart from the decline in the funding cost, there are other structural drivers of margins: (a) a rising CASA ratio, and (b) focus on retail, and small and medium enterprise lending. Hence, we expect an uptick of 15-20 basis points in the margins over FY2017.
- We expect Yes Bank's earnings to grow at healthy rates (about 22% CAGR over FY2014-17) driven by an expansion in the NIM and an uptick in the non-interest income. The asset quality remains robust and the quality is likely to sustain going ahead. The return ratios are expected to improve further (RoA of 1.7% and RoE of 20%) resulting in better valuations. We maintain our Buy rating on the stock.

Zee Entertainment	364	35.7	32.2	27.6	19.5	19.3	20.2	400	10

Remarks:

- Among the key stakeholders of the domestic TV industry, we expect the 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.
- The management maintains that the advertisement spending will continue to grow in double digits going ahead and ZEEL will be able to outperform the same. The growth in the advertisement spending will be driven by an improvement in the macro-economic factors and the fact the ZEEL is well placed to capture the emerging opportunities being a leader in terms of market share.
- ZEEL is well placed to benefit from the digitisation theme and the overall recovery in the macro economy. Also, the success of the newly launched channel, "&TV", would augur well and improve the company's position in the general entertainment channel space. We have a Buy rating on the stock with a price target of Rs400.

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