



## Sharekhan top picks

In January 2010, policy overhang and edgy equity markets globally dragged down the domestic bourses out of the narrow range of the previous two months. The benchmark indices Sensex and Nifty declined by 6.3% and 6.1% respectively during the month. However, amid the volatility the returns from the top picks basket were quite stable with a marginal decline of 0.4% in January 2010. In fact, nine out of the ten stocks in the top picks basket outperformed the benchmark indices.

For February 2010 we are not making any changes in the top picks basket. Though we retain all the top pick stocks,

we advise investors to have cash allocation of 20% as the markets are likely to remain volatile and edgy in the near term. This is in line with our view (given in the Market Outlook report titled "2010: A tale of two halves" released on January 2, 2010) that we expect a challenging market environment in the first half of the year 2010.

Since the beginning of this financial year, ie April 2009, our basket of top picks has given cumulative returns of 100.3% compared with the returns of 58.3% and 52.2% given by the Sensex and the Nifty respectively over the same period.

Name	CMP* (Rs)	PER (x)			RoE (%)			Target price	Upside (%)
		FY09	FY10E	FY11E	FY09	FY10E	FY11E		
Apollo Tyres	53	18.9	6.3	7.1	7.9	22.4	16.7	66	24.8%
BHEL	2,407	37.5	26.6	20.6	24.3	27.4	28.1	2,568	6.7%
Dhampur	130	12.2	3.0	4.1	12.1	38.6	22.2	191	47.1%
Godrej Consumer	235	35.1	21.2	17.5	46.9	43.8	39.8	318	35.3%
Greaves Cotton	269	24.0	12.2	9.4	13.9	24.3	26.7	365	35.9%
ITC	250	29.1	23.2	19.9	25.3	27.2	27.0	303	21.1%
Lupin	1,421	22.1	18.6	15.1	37.5	29.0	27.4	1,602	12.8%
Reliance Industries	1,047	21.5	20.1	14.2	12.3	12.4	14.9	1,148	9.7%
Shiv Vani Oil & Gas	357	8.1	7.3	6.2	14.7	14.4	14.4	433	21.4%
Torrent Pharma	442	16.0	14.9	11.2	40.4	32.6	32.5	554	25.3%

\* CMP as on January 29, 2010

Note: For Apollo Tyres and Godrej Consumer RoE is on stand-alone basis due to non availability of consolidated balance sheet post recent acquisitions.

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Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY09	FY10E	FY11E	FY09	FY10E	FY11E		
<b>Apollo Tyres</b>	53	18.9	6.3	7.1	7.9	22.4	16.7	66	24.8%

- Remarks:**
- ♦ Apollo Tyres Ltd (APL) is the market leader in truck & bus tyres and light truck tyres in India. The company also enjoys significant market share in the passenger car tyre segment. The strong demand environment in replacement and OEM markets augurs well for the company's growth going forward.
  - ♦ To improve its market share and expand further, the company is increasing its capacity in India from 850 tonne per day to around 1,000 tonne per day by establishing a new greenfield plant in Chennai. In international markets, APL has presence in South Africa. To further augment its international presence, the company has recently acquired Vredestein Banden BV, a high-end passenger car tyre manufacturer in Netherlands. We believe the above-mentioned organic and inorganic expansions coupled with improving business environment in the domestic market would help APL post strong growth in the coming years.
  - ♦ Natural rubber prices have increased sharply in recent times, sustenance of rubber prices at these levels remain a key risk to the company's performance. Also, the near-term performance of the recently acquired European business is susceptible to difficult business environment in these markets.
  - ♦ At the current market price the stock trades at 6.3x and 7.1x its consolidated FY2010E and FY2011E earnings. We maintain our Buy recommendation on the stock.

<b>BHEL</b>	2,407	37.5	26.6	20.6	24.3	27.4	28.1	2,568	6.7%
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- Remarks:**
- ♦ Bharat Heavy Electricals Ltd (BHEL) is a premier power generation equipment manufacturer and leading EPC company. It has emerged as the prime beneficiary of the four-fold increase in the investments in the power sector in India.
  - ♦ BHEL currently has strong orders worth Rs134,000 crore on hand which provide revenue coverage for the next three to four years. With more than 80% of the orders coming from the government and state utilities, the risk of order cancellation is minimal. The company is also looking at various new initiatives like transmission, distribution and renewable energy for sustaining robust growth in its business in the long term. However, the key challenge for BHEL would be the timely execution of projects.
  - ♦ The company's programme to expand its capacity to 15GW is largely on track and the new capacity should be available from March 2010. In our view, the stabilisation of the new capacity coupled with the de-bottlenecking of the supply chain would aid BHEL's revenues to grow at a CAGR of 26% over FY2009-11 with the profits growing at a CAGR of 35% over FY2009-11E.
  - ♦ At the current market price the stock trades at 26.6x and 20.6x FY2010E and FY2011E earnings respectively. We continue to like BHEL because of its resilient business model that is expected to provide the highest revenue and profit growth among the Sensex stocks. We, therefore, maintain BHEL amongst our Top Picks and have a Buy recommendation on the stock.

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Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY09	FY10E	FY11E	FY09	FY10E	FY11E		
<b>Dhampur</b>	<b>130</b>	12.2	3.0	4.1	12.1	38.6	22.2	<b>191</b>	47.1%

- Remarks:**
- ◆ Dhampur Sugar Mills is the fifth largest sugar producer in India with integrated facilities and is going to be a key beneficiary of the current upturn in the sugar cycle. We expect the profits to quadruple in FY2010 (ending September 2009) due to higher profits from its sugar business led by a higher sugar realisation, and refining and sale of raw sugar imported at a low cost.
  - ◆ The hefty cash flow generation in FY2009-11 due to a rampant increase in its business profits will help the company to bring down its debt-equity ratio to 1x in SY2010 and from 2.6x in SY2009. However, despite the stupendous profit growth the stock trades at 3.0x FY2010E earnings, which is at a steep discount to its peers that are trading at ~7.5x their FY2010E earnings.
  - ◆ A higher than expected sugar-cane price, possible further government interventions and likelihood of a bumper sugar crop in FY2011 remain the key risks to our estimates.
  - ◆ At the current market price of Rs130 the stock trades at 3.0x and 4.1x its FY2010E and FY2011E EPS respectively and 2.3x and 2.9x FY2010E and FY2011E EV/EBIDTA respectively. We maintain our Buy recommendation on the stock with the price target of Rs191.

<b>Godrej Consumer</b>	<b>235</b>	35.1	21.2	17.5	46.9	43.8	39.8	<b>318</b>	35.3%
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- Remarks:**
- ◆ GCPL is a major player in the Indian FMCG market with presence in soap, hair dye and hair colour, liquid detergent and toiletry categories. The acquisition of 49% stake in Sara Lee shall broaden the product portfolio and immensely improve the growth prospects of the company in the long run. With an increase in its reach in the rural market, thrust on growing its market share in states other than north, GCPL will continue to gain market share in the soap and hair colour segments and would post a steady volume growth in the coming quarters. Thus, we expect GCPL's top line to grow at a CAGR of 17.9% over FY2009-12 (excluding Sara Lee's financials).
  - ◆ With a lower raw material cost, the margins of the company have improved substantially. Thus, we expect a hefty 63.8% y-o-y growth in its net profit in FY2010.
  - ◆ With strong cash flows GCPL has healthy cash on books (Rs400 crore as on March 31, 2009); further, the company recently took a board resolution to enable it to raise up to Rs3,000 crore as it eyes big-ticket acquisitions. We believe acquisitions in the near term could act as additional triggers for the stock.
  - ◆ We believe a significant uptick in palm oil prices, increased competitive activity in the soap segment and the impact of high food inflation on the demand for its products are the key risks to the company's profitability.
  - ◆ With a 40.2% CAGR over FY2009-12 (including Sara Lee's financials) GCPL will outperform the industry and remains one of the better performing companies in the FMCG space. At the current market price the stock trades at 17.5x its FY2011E earnings. We have a Buy recommendation on the stock.

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Name	CMP (Rs)	PER			RoE (%)			Target price	Upside (%)
		FY09	FY10E	FY11E	FY09	FY10E	FY11E		
<b>Greaves Cotton</b>	<b>269</b>	24.0	12.2	9.4	13.9	24.3	26.7	<b>365</b>	35.9%

- Remarks:**
- ♦ Greaves Cotton Ltd (GCL)'s core competencies are in three-wheeler diesel/petrol engines, power gensets, agro engines and pumpsets (the engine segment) and construction equipment (the infrastructure equipment segment).
  - ♦ GCL is likely to be the key beneficiary of the uptick in the demand for the three-wheeler engines (which constitute 60% of the company's total revenues). The infrastructure equipment business (constitutes about 15% of the company's total revenues) is a direct play on the growth in the construction and road building activity in the country. We believe with much improved fund availability, low interest rates, and a pick-up in industrial and real estate sectors, the business is in for a sharp revival.
  - ♦ GCL has a strong balance sheet and is a zero net debt company. Moreover, the company does not have any major capex plans in the near future. With a hefty increase in its profits and a low capex the company is expected to generate free cash flows in excess of Rs100 crore in FY2010 and FY2011.
  - ♦ We believe that a slower than expected recovery in the construction and road building activity in the country could affect the revival of sales for GCL's construction equipment division and thus poses a risk to our estimates. Also, the lower than expected sales of three-wheelers by Piaggio (which accounts for a high proportion of sales in the automotive engine division) may have a direct impact on the performance of the automotive engine segment.
  - ♦ We expect GCL to post a robust CAGR of 20.5% in revenues and that of 59.9% in its net profit over FY2009-11. At the current market price, the stock trades at 12.2x and 9.4x its FY2010E and FY2011E EPS respectively. We have a Buy recommendation on the stock.

<b>ITC</b>	<b>250</b>	29.1	23.2	19.9	25.3	27.2	27.0	<b>303</b>	21.1%
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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 endeavours to make a mark in the Indian FMCG market with successful brands such as Bingo, Sunfeast and Aashirvaad, which are already reckoned among the best in the industry. With the company's new portfolio of personal care products its FMCG business competes with the likes of Hindustan Unilever and Procter & Gamble.
  - ♦ After a sharp increase in the excise duty on cigarettes in the last two Union Budgets, the government was less lethal in the Union Budget FY2009-10 and did not increase the excise duty. This augurs well for ITC's cigarette business and has led to a significant increase in its cigarette sales volumes. The rationalisation of the company's biscuit portfolio and an increase in the scale of its personal care business would further lower the losses in the non-cigarette FMCG business going ahead. While the hotel business is staging a strong revival the agri-business' profitability has improved sharply.
  - ♦ An increase in excise levy and the government's intention to curb consumption of tobacco products remain the key risks to ITC's cigarette business over the longer term.
  - ♦ We expect ITC's bottom line to grow at a CAGR of 20.0% over FY2009-12. At the current market price, ITC trades at 19.9x its FY2011E earnings. We maintain our Buy recommendation on the stock.

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Name	CMP		PER			RoE (%)			Target price	Upside (%)
	(Rs)	FY09	FY10E	FY11E	FY09	FY10E	FY11E			
Lupin	1,421	22.1	18.6	15.1	37.5	29.0	27.4	1,602	12.8%	

- Remarks:**
- ◆ Global dominance in certain products, focus on niche, less-commoditised products, a geographically diversified presence in newer markets, such as Japan, and a presence in the US branded segment distinguish Lupin among the mid-cap players in the generic space.
  - ◆ With a leadership position in the anti-TB and other anti-infective segments, and a growing exposure to the chronic therapy segments, Lupin is one of the fastest growing pharmaceutical companies in the domestic market.
  - ◆ A focus on niche products like oral contraceptives and ophthalmology products along with a strong presence in the branded space through a paediatric antibiotic, Suprax, and a medical inhalation device, Aerochamber, has enabled Lupin's US business to grow at a staggering CAGR of 77% over FY2004-08. With the expansion in the branded portfolio through the recent addition of Antara and the launch of Allernaze, we expect the US branded business to grow at a CAGR of 30% over FY2010-12.
  - ◆ With a strong business in India and the USA, Lupin has also made inroads into the other regulated markets of the UK and France. Further, it has entered markets like Japan, Germany, Australia and South Africa through acquisitions in order to extend its global reach. We anticipate a CAGR growth of 37% in the emerging markets over FY2010-12.
  - ◆ The strong core business and a differentiated strategy auger well for Lupin and now the clean chit of the Mandideep facility from the USFDA would drive the performance of the stock.
  - ◆ We expect Lupin to report an earnings CAGR of 22% over FY2010-12 with strong margins at the operating level. At 18.6x FY2010E and 15.1x FY2011E earnings, Lupin is among the cheapest front-line pharmaceutical stocks. We maintain our Buy recommendation on the stock with a price target of Rs1,602.

Reliance Ind	1,047	21.5	20.1	14.2	12.3	12.4	14.9	1,148	9.7%
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- Remarks:**
- ◆ With the start of the commercial production of gas in April 2009 and that of crude oil in September 2008 (both from the KG basin), Reliance Industries Ltd (RIL) holds a great promise in the E&P business. The E&P business is expected to add significantly to the company's earnings and to its cash flow from FY2010 onwards with the majority of the earnings coming from the less volatile natural gas business. The company is currently producing 60mmscmd of gas and targets to ramp the output to 80mmscmd by the end of March 2010. At present, the company's reserves are estimated at 9 billion barrels of oil equivalents.
  - ◆ We expect the gross refining margin (GRM) of RIL to contract in the near term, as new refineries with total capacity of 1.5-2.0 million barrel per day (including Reliance Petroleum Ltd [RPL]) are expected to come on-stream in the environment of weak demand. However, we expect RIL to fetch a premium over Singapore Complex' GRM due to its superior refinery complexity and benefit of using captive gas from KG D-6. The refining volumes were also doubled as RPL's has been merged with RIL with effect from April 1, 2008.
  - ◆ We believe that RIL's all cash but not binding bid to buy a controlling stake in the world's third largest petrochemical company, LynodellBasell (LB), if successful would have synergistic effect for RIL. It would help RIL gain access to LB's ready market of USA and Europe. Further, after the deal RIL would become near global monopoly in the polypropylene and polyethylene sectors. However, we await details on the bid price and the valuation.
  - ◆ We believe that RIL would be able to maintain superior margin in the petrochemical business, given its increased focus on the domestic market (a strong demand and a high price realisation environment).
  - ◆ A delay in the ramp-up of the KG D-6 gas production and an adverse verdict of the Supreme Court of India on its legal feud with RNRL and another legal case with National Thermal Power Corporation (NTPC) are the key risks to our estimates. Further, there is still ambiguity related to the likely change in the section 80IB, which could take away the benefit of the seven-year tax holiday from gas production. Any further fall in the refining and petrochemical margins could result in deviation from our estimates.
  - ◆ At the current market price, the stock is trading at 14.2x FY2011E consolidated earnings.

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Name	CMP		PER			RoE (%)			Target price	Upside (%)
	(Rs)	FY09	FY10E	FY11E	FY09	FY10E	FY11E			
<b>Shiv Vani Oil &amp; Gas</b>	<b>357</b>	<b>8.1</b>	<b>7.3</b>	<b>6.2</b>	<b>14.7</b>	<b>14.4</b>	<b>14.4</b>	<b>433</b>	<b>21.4%</b>	

- Remarks:**
- ♦ Shiv-Vani Oil & Gas Explorations is India's largest onshore oil and gas service provider in the private sector having a fleet of 40 rigs and ten seismic survey crews. The company offers a wide range of services including seismic, drilling and other specialised services, such as work over, gas compression services and coal bed methane (CBM) integrated services.
  - ♦ The extremely strong order book of Rs3,700 crore, which is close to 4.2x its FY2009 revenues, renders strong visibility to the company's earnings. The company has gone for timely expansion of its assets in the past and all its assets are already backed by contracts in hand.
  - ♦ The company has shown an exponential growth in its financial performance in M9FY2010 and the same is likely to be maintained in the last quarter of the fiscal with the deployment of all the eight rigs for a large order worth Rs1,610 crore from ONGC. The company is also planning to raise money (an amount not exceeding USD20 million or Rs100 crore) through the issue of new equity shares to Franklin Templeton. Further, the company is planning to raise additional funds of Rs600 crore through a QIB issue to augment its fleet.
  - ♦ Softening day rates, and curtailment and deferment of worldwide E&P capex pose a risk to the company's revenue going forward. Moreover, any delay in contracts or any renegotiation of contracts going forward could potentially hamper its cash flows and thus remain a risk for the company. However, we see little probability of renegotiation of the contracts, as the bulk of contracts are from public enterprises like ONGC and OIL.
  - ♦ At the current market price, the stock trades at 6.2x its FY2011E earnings. We maintain our Buy recommendation on the stock with a price target of Rs433.

<b>Torrent Pharma</b>	<b>442</b>	<b>16.0</b>	<b>14.9</b>	<b>11.2</b>	<b>40.4</b>	<b>32.6</b>	<b>32.5</b>	<b>554</b>	<b>25.3%</b>
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- Remarks:**
- ♦ Torrent Pharmaceuticals (Torrent Pharma) is a well-known name in the domestic branded formulation market with strong focus on the fast-growing chronic lifestyle segment.
  - ♦ Torrent Pharma has been one of the under-owned stocks in the mid-cap pharma space due to realignment in domestic formulations, impending turnaround in the Heumann business and lower margins at the operating levels.
  - ♦ However, with the domestic market back on track, the completion of the investment phase in the emerging markets and the turnaround in the Heumann business, we expect Torrent Pharma's earnings to post a CAGR of 24% over FY2010-12E. The cost restructuring initiatives will lead to operational efficiencies in the long term, resulting in the expansion of the operating profit margins.
  - ♦ With the completion of the investment phase, robust field presence and new product introductions, we expect Torrent Pharma's emerging market (Brazil, Russia and Europe) business to post a strong CAGR of 19% over FY2010-12E. Further, a scale-up in the US business would add to its growth. We believe the company has been trading at a significant discount (at 11.4x its FY2011E) to its peers and should get higher valuation.
  - ♦ We believe Torrent Pharma is on the right track for good revenue growth and a significantly higher earnings growth driven by margin expansion. At the current market price of Rs442, the stock is discounting its FY2010E earnings by 14.9x and its FY2011E earnings by 11.2x. On account of continued traction in the growth we maintain our Buy recommendation on the stock with a price target of Rs554.

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

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