Top Picks

August 31, 2017

CESC

Godrej Industries

HDFC Bank

IndusInd Bank

ITC

KEC International

LIC Housing Finance

Maruti Suzuki

Power Grid Corp

Reliance Industries

Sundram Fasteners

ZEE Entertainment

Sharekhan Top Picks

Despite the backdrop of rising volatility, driven by geopolitical uncertainties globally, Sharekhan's top picks portfolio continued its superior performance with positive return of 0.8% as against a decline in Sensex (down 2.4%) and Nifty (down 1.6%) last month. CNX Midcap 100 index also declined by 1.2% in the same period.

Though it was an all-round performance with only 2 out of the 12 stocks in the folio underperforming the Sensex, the strong outperformance was aided by sustained rally in L&T Finance Holdings and the run up in CESC, which was added last month to the folio.

This month, we are suggesting only one change in the folio. We are taking home profits in L&T Finance Holdings and replacing it with LIC Housing Finance. Post the recent correction in LIC Housing, the risk reward has turned favourable. It is a leading player in the fast-growing housing finance segment, which has structural growth drivers in place. On the other hand, L&T Finance Holding has delivered stellar returns of close to 56% in a short span of just three months since its inclusion in Sharekan's Top Picks folio in June 2017. Hence, we believe investors should book profits and shift to LIC Housing - a quality housing finance company.

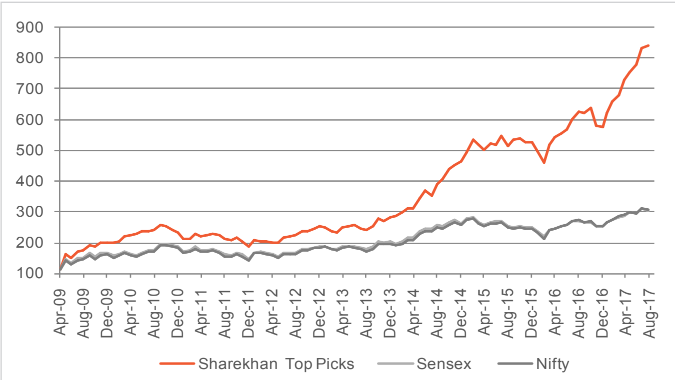
Consistent outperformance (absolute returns; not annualised) (%)

(%)	1 month	3 months	6 months	1 year	3 years	5 years
Sharekhan Top Picks	0.8	11.3	27.2	33.9	114.6	275.8
Sensex	-2.4	1.9	10.3	11.4	17.6	82.5
Nifty	-1.6	3.1	11.7	13.1	23.8	90.4
CNX MIDCAP 100	-1.3	4.4	10.9	18.9	61.2	158.6

Absolute returns (Top Picks Vs Benchmark indices) (%)

	Sharekhan (Top Picks)	Sensex	Nifty	CNX Mid-cap 100
YTD CY2017	46.2	19.1	21.2	27.4
CY2016	8.8	1.8	3.2	7.1
CY2015	13.9	-5.1	-4.1	6.5
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

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)			RoE (%)			Price target (Rs)#	Upside (%)
		FY17	FY18E	FY19E	FY17	FY18E	FY19E		
CESC	**1,016**	15.7	14.5	13.3	6.6	7.9	9.7	**1,165.0**	15
Godrej Industries	**624**	72.5	-	-	14.9	-	-	**685**	10
HDFC Bank	**1,775**	31.3	26.2	21.7	17.9	18.4	19.5	**1,950**	10
IndusInd Bank	**1,665**	34.5	27.0	21.0	16.2	16.7	18.5	**	-
ITC	**282**	33.6	28.8	24.5	23.5	25.5	28.0	**325**	15
KEC International	**313**	26.4	18.3	14.4	21.2	24.3	24.9	**	-
LIC Housing Finance	**674**	17.6	14.7	12.3	19.1	19.3	19.6	**825**	22
Maruti Suzuki	**7,696**	31.7	28.9	22.8	23.0	20.9	21.8	**8,500**	10
Power Grid Corp	**218**	15.3	12.9	10.9	13.8	14.4	15.1	**240**	10
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ZEE Entertainment	**520**	40.9	36.4	27.8	18.3	17.9	20.0	**610**	17

*CMP as on August 31, 2017 # Price target for next 6-12 months ** Under review

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CESC	**1,016**	15.7	14.5	13.3	6.6	7.9	9.7	**1,165.0**	15

Remarks:

- CESC Ltd. (CESC) is a power distributor in Kolkata and Howrah (backed by 1,225MW of power generation capacity), which is a strong cash-generating business, reporting an 11% CAGR in profits from FY2015-FY2017. Further, 600MW of regulated generation capacity (to serve Kolkata distribution) has come on stream recently in Haldia.
- Also, the company's 600MW thermal power project at Chandrapur has signed PPA and started operating. Losses in the retail business are coming down gradually over the past and the company is expected to breakeven soon. The BPO subsidiary, Firstsource, is performing well, in line with expectations.
- Given the steady and regulated business line of the company, we expect CESC to post a 10% CAGR in profits for FY2017E-FY2019E. However, the recent diversification into unrelated businesses such as IPL franchisee would hurt its valuations.
- CESC has announced the demerger of the business into four verticals, namely power distribution, power generation, retail and IT outsourcing. The restructuring looks beneficial for minority shareholders optically. However, we await clarity on the financials of the demerged companies till 1st October 2017.
- We believe the restructuring exercise is a positive for minority shareholders, as it will unlock value in the cash flow-rich power distribution business and enable CESC to sell or bring in a strategic partner into the loss- making retail subsidiary (Spencer's), which is on a recovery path. We remain positive on the stock.

Name	CMP (Rs)	PER FY17	PER FY18E	PER FY19E	RoE FY17	RoE FY18E	RoE FY19E	Price target (Rs)	Upside (%)
Godrej Industries	**624**	72.5	-	-	14.9	-	-	**685**	10

Remarks:

- Godrej Industries (GIL) has a diversified portfolio of established businesses such as FMCG, real estate and agri, which have the potential to register strong double-digit growth in the short to medium term. GCPL (GIL has a 23.8% stake) and Godrej Properties (GIL has a 57.6% stake) constitute 87% of the company's total market capitalisation. This indicates that other businesses such as Godrej Agrovet, the chemical business, and Nature's Basket are available at a deep discount.
- Godrej Agrovet (GAL), a subsidiary of GIL, is a diversified agri company with presence in animal feed, agri inputs and palm oil businesses. GAL has a strong financial track record, with revenue and PAT (before exceptional items) reporting CAGRs of 18% and 22%, respectively, over FY2011-FY2016. GAL's implied market cap comes to Rs.3,800 crore (assigning a discount of 20%) on account of its trailing 12-month adjusted PAT of Rs.215 crore, which is at a significant premium to its holding cost of Rs.144 crore. GIL is planning to raise about Rs.400 crore through public offer of GAL.
- GIL is one of the largest players in the oleo chemicals and surfactant segments with a judicious blend of domestic and international operations. Nature's Basket is another emerging business under GIL's portfolio (present in the online and retail gourmet space) and has been growing consistently above 20% in recent times (FY2016 revenue at Rs.270 crore).
- With businesses such as FMCG and real estate attaining a critical scale, GIL is expected to witness a strong earnings growth trajectory. The value unlocking in GAL will further enhance GIL's overall market value.

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<tr><td>Remarks:</td><td colspan="9">◆ HDFC Bank has a pre-eminent presence in the retail banking segment (~50% of loan book) and has been able to maintain strong and consistent loan book growth, gradually gaining market share. Going forward, economic recovery and improvement in consumer sentiment would be positive growth drivers for the bank's loan growth, which will in turn drive its profitability.
◆ Backed by a current account and savings account (CASA) ratio of 40%+ and a high proportion of retail deposits, the bank's cost of funds remains among the lowest in the system, helping it to maintain higher net interest margin (NIM). In addition, the bank's loan book growth is driven by high-yielding retail products such as personal loans, vehicle loans, credit cards and mortgages, mostly to own customers (which also positively impacts NIMs).
◆ HDFC Bank has been maintaining near impeccable asset quality, with its NPA ratios consistently being among the lowest versus comparable peers. The bank has been able to maintain robust asset quality due to its stringent credit appraisal procedures and negligible exposure to troubled sectors.
◆ HDFC Bank is well poised to tap the growth opportunities going ahead due to strong capital ratios, healthy asset quality and steady revival in consumer spending. As lending and transactions through formal routes increase, HDFC Bank would benefit since it is a leading private sector bank and it is likely that it will gain market share in this segment. The bank is likely to maintain healthy RoE of 18-20% and RoA of 1.8% on a sustainable basis. Therefore, we expect it to sustain the valuation premium that it enjoys vis-à-vis other private banks.</td></tr>
<tr><td>IndusInd Bank</td><td>1,665</td><td>34.5</td><td>27.0</td><td>21.0</td><td>16.2</td><td>16.7</td><td>18.5</td><td>**</td><td>-</td></tr>
<tr><td>Remarks:</td><td colspan="9">◆ IndusInd Bank is among the fastest-growing banks (25%+ CAGR over FY2012-FY2017), with a loan book of~Rs1,164 billion and 1,200+ branches across the country. About 55% of the bank's loan book comprises retail finance, which is a high-yielding category, and is showing signs of growth.
◆ Given the aggressive measures taken by the management, the deposit profile has improved considerably (CASA ratio of ~38%). Going ahead, the bank would follow a differentiated branch expansion strategy (5% branch market share in identified centres) to help in ensuring healthy growth in savings accounts and retail deposits.
◆ IndusInd Bank has maintained its asset quality despite sluggish economic growth and higher proportion of retail finance in its loan book. The bank's asset quality is among the best in the industry, with total stressed loans (restructured loans + gross NPAs) forming less than 1.50% of the loan book.
◆ A likely revival in domestic economy will further fuel growth in the bank's consumer finance division, while strong capital ratios will support future growth plans. Though demonetisation has raised questions regarding delinquencies in certain lending segments, management expects asset quality to remain under control. The stock should continue to trade at a premium valuation, underpinned by strong loan growth, quality management, high RoAs and healthy asset quality. We have a positive outlook on IndusInd Bank.</td></tr>
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Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY17	FY18E	FY19E	FY17	FY18E	FY19E		
ITC	**282**	33.6	28.8	24.5	23.5	25.5	28.0	**325**	15

Remarks:

- ITC's cigarette business, which contributes about 80% to the company's EBITDA, continues to be the cash cow. ITC endeavours to de-risk its business model by becoming an established player in the Indian FMCG market, and with successful brands such as Bingo, Sunfeast and Aashirwaad, it is already reckoned among the best in the Indian FMCG industry. With the new portfolio of personal care products gaining market share, its FMCG business promises to compete with large players in the category.
- The recent cess hike on cigarettes would put pressure on cigarette sales volume in the short term, but price hikes would help maintain margins of the cigarette business on a YoY basis. On the other hand, non-cigarette FMCG business is expected to maintain good growth momentum.
- ITC's other businesses of hotels, agri products and paper, paperboard and packaging are expected to provide good support to the company's revenue and profitability in the long run.
- The stock has corrected sharply post the hike in cess rate and is currently trading at 24.5x its FY2019E. We believe the discounted valuations have priced in all the near-term negatives and do not expect substantial fall in the stock price from the current level.

Name	CMP (Rs)	PER FY17	PER FY18E	PER FY19E	RoE FY17	RoE FY18E	RoE FY19E	Price target (Rs)	Upside (%)
KEC International	**313**	26.4	18.3	14.4	21.2	24.3	24.9	**	-

Remarks:

- KEC International (KEC) is a global power transmission infrastructure EPC major. The company has a presence in the verticals of power T&D, cables, railways, water, renewable (solar energy) and civil.
- Globally, the company has powered infrastructure development in more than 61 countries. KEC is a leader in power transmission EPC projects and has more than seven decades of experience.
- Management of KEC sounded very confident of delivering growth across all verticals such as T&D, railways, solar and cables. They are banking on state transmission companies, private sector under tariff-based competitive bidding (TBCB) route and overseas geographies for growth in the T&D segment.
- While management expects railway business to grow ~80% YoY to ~Rs.800 crore and solar EPC business to grow +3x to ~Rs.500 crore in FY2018. KEC is witnessing improved revenue mix with the execution of extra high voltage (EHV) cables, which has better profitability.
- Over the years, KEC has grown through the organic as well as inorganic route. We estimate the company's OPM to be maintained at the current high level of ~9.5% and the DE ratio is expected to improve to 0.7:1 by the end of FY2019E from 1.3:1 in FY2017.
- We expect earnings to report a CAGR of 35% during FY2017E-FY2019E with strong cash flows and a leaner balance sheet. Thus, we retain our positive outlook on the stock.

Name	CMP (Rs)	PER (x)			RoE (%)			Price target (Rs)	Upside (%)
		FY17	FY18E	FY19E	FY17	FY18E	FY19E		
LIC Housing Finance	**674**	17.6	14.7	12.3	19.1	19.3	19.6	**825**	22

Remarks:

- LIC Housing finance is promoted by India's largest insurance company LIC India. LIC Housing Finance (LICHF) is among the top housing finance companies in India with over 10% share in the mortgage lending segment. Key segments in which LIC Housing finance operates is individual home loans, LAP and developer loans. The company has over 249 marketing of offices and strong network of DSA and Home loan agents.
- Governments push towards affordable housing by way of providing interest subsidy on small home loans could help the company to take up opportunities in this segment as well. Demonetization in all could also help the company as housing prices are expected to remain stable if not correct.
- Demonetization has also brought the lending rates down as liquidity was suddenly flushed into the system hence banks have reduced lending rates on account of lesser cost of funds and also Gsec yields have also fallen since past few months. This inturn will help the LICHF to borrow funds at a lesser rate and hence coushion margins.
- We expect LICHF to be among the better placed non-banking finance companies to grab a pie of the increased housing demand due to a favourable interest rate environment, the government's push for housing for all and a strong pan India network.

Name	CMP (Rs)	PER FY17	PER FY18E	PER FY19E	RoE FY17	RoE FY18E	RoE FY19E	Price target (Rs)	Upside (%)
Maruti Suzuki	**7,696**	31.7	28.9	22.8	23.0	20.9	21.8	**8,500**	10

Remarks:

- Maruti Suzuki India (Maruti) is India's largest passenger vehicle (PV) manufacturer with a strong 47% market share. Over the past two years, the company has been able to gain market share due to new product launches, a vast distribution network (with increased focus on rural markets) and a shift in consumer preference to petrol models from diesel models.
- The recently launched premium hatchback, Baleno, and upgrade of Dzire have received a strong response, which will help Maruti to expand its market share in the segment. The compact sports utility vehicle (SUV) Vitara Brezza has also received an encouraging response. All the three new launches command a waiting period of 2-5 months each.
- Maruti's parent company, Suzuki Motor Corporation, commissioned its Greenfield plant in Gujarat in February 2017. The company is speeding up production at the new Gujarat plant in wake of strong demand for recent launches. Maruti plans to produce 150,000-160,000 units in Gujarat in FY2018 as against earlier guidance of ~130,000 units. Enhanced production at Gujarat (Maruti initially will produce Baleno) will ease capacity constraints and enable Maruti to bring down the waiting periods for its models.
- Maruti has successfully established itself in the big car category (Ciaz, Vitara Brezza, Dzire and Baleno), led by strong product features and success of its premium distribution network Nexa, which offers a unique buying experience. Maruti continues to remain our top bet in the automotive space, given the sustained trend of outpacing the PV industry's growth. We retain our Buy rating on the stock with a PT of Rs.8,500.

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<tr><td colspan="10">Remarks:
◆ Power Grid Corporation of India Ltd. (PGCIL) is India’s largest and the world’s second-largest power transmission utility, deriving its revenue post capitalisation of the transmission line assets.
◆ Higher asset capitalisation will boost PGCIL’s regulated equity base, on which it earns fixed returns, driving the company’s earnings growth momentum. We expect PGCIL’s regulated equity base to report a CAGR of 20% and translate into earnings CAGR of ~18% during FY2017E-FY2019E.
◆ PGCIL has a very healthy balance sheet, sustainable earnings visibility, positive cash flow from operations and stable return ratios.
◆ Nevertheless, after the infusion of equity through follow-on public offer in FY2014, PGCIL is now well capitalised to fund its equity side of the future capex. Therefore, we do not see any dilution risk as of now. PGCIL’s stable, low-risk business model and healthy assured returns provide cushion to long-term investors.
◆ The spate of growth drivers and rub-off from the scheduled initial public offer of a private sector transmission company at possible lofty valuation should re-rate PGCIL.</td></tr>
<tr><td>Reliance Industries</td><td>1,594</td><td>15.8</td><td>15.7</td><td>12.7</td><td>11.2</td><td>10.1</td><td>11.2</td><td>1,750</td><td>10</td></tr>
<tr><td colspan="10">Remarks:
◆ We expect Reliance Industries Ltd.’s (RIL) GRM to remain strong at $11.5/12.0 per bbl in FY2018/FY2019, given the robust global oil demand growth outlook for 2017 at 1.5mbpd (International Energy Agency estimate). Moreover, a likely improvement in diesel cracks would help RIL to maintain a premium of $4bbl-5/ bbl over Singapore Complex GRM. Ethylene margin is also expected to remain firm at $600-650/mt, led by healthy demand and likely delay in the commissioning of incremental capacities in CY2018.
◆ RIL has commissioned the last crystallisation train (Train 3) of the paraxylene (PX) complex at Jamnagar. With this, RIL’s PX capacity has almost doubled to 3.7mmt (from 1.9mmt earlier). RIL has also fully commissioned its Ethane import project and we expect the same to add $270 million to its EBITDA. Moreover, RIL is in the final stage to commission its ROGC and petcoke gasification projects.
◆ We expect EBITDA/PAT CAGR of 23%/12% over FY2017-FY2019E, driven by the commissioning of core downstream projects in FY2018. Any positive surprise in terms of better-than-expected financials of the telecom business would be an important re-rating trigger for RIL going forward.</td></tr>
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<tr><td colspan="10">Remarks:
• Sundram Fasteners (SFL) is the largest organised domestic player in the fasteners segment, commanding ~35% market share. The company manufactures products for CVs, Passenger Cars, Two Wheelers and Tractors. Fasteners constitute ~40% of sales while Motor Vehicle Parts & Accessories contributed the balance 60%.
• SFL has substantially diversified its product portfolio over the past few years with the introduction of new products. This has helped the company to shield itself from over-dependence on fasteners, besides helping it to increase the content per vehicle. This has enabled SFL to significantly move up the value chain.
• Exports too have exhibited traction and are expected to improve further, led by an uptrend in the US Passenger Vehicle market, enhanced supply of new products and overall market share gains. SFL's topline is expected to clock an 12% CAGR between FY2017 and FY2019 as against the likely industry growth of ~8%.
• SFL's consolidated OPM's expanded impressively by 630 BPS in FY2017 to 18.1% due to high share of value added products and improvement in subsidiary performance (subsidiary companies have reported a PAT of Rs22.7 Cr as against a Loss of Rs 16 cr in FY2016). We expect robust PAT CAGR of 17% over the next two years driven by sustained higher margins and lower interest expense.
• A consistently strong performance and improved business prospects gives us ample confidence on the future prospects of SFL. We believe that sustained higher margins would result in the company's return ratios remaining in excess of 25% going ahead. We have a 'positive' view on SFL.</td></tr>
<tr><td>ZEE Entertainment</td><td>520</td><td>40.9</td><td>36.4</td><td>27.8</td><td>18.3</td><td>17.9</td><td>20.0</td><td>610</td><td>17</td></tr>
<tr><td colspan="10">Remarks:
• Zee Entertainment Enterprises (ZEEL) continues to lead the broadcasting industry in terms of growth in advertising revenue. ZEEL is one of the leading players in television broadcasting with a bouquet of 40+ TV channels across genres.
• ZEEL expects domestic subscriptions market to grow at mid-teens for at least the next three years. The company plans to announce its strategy around digital in the coming quarter and will continue to invest in over the top (OTT) content platform (revamping is underway).
• Owing to GST roll out, ZEEL's management has indicated that the months of June and July were soft in terms of advertising revenue and expects things to normalise by H2FY2018E. Nevertheless, for Q1FY2018, performance on both the advertisement and subscriptions revenue front was commendable, despite headwinds in the run up to GST rollout.
• ZEEL continues to focus on its five key pillars strategy to drive long-term growth. We believe the successful execution of this strategy will have a material impact on sustainable growth going forward. We continue to remain positive on ZEEL, as it is a structural India consumption theme. Moreover, the company continues to invest across the media spectrum, including movies, music, events, digital and international markets, to maintain its high-growth trajectory. We maintain our Buy rating on the stock.</td></tr>
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