A lot hinges on earnings recovery

VISHAL CHHABRIA

Year 2015 was marked with high volatility that saw foreign investors pull out money from India and other emerging markets (EMs) around the middle of the year, led by worries of a US Fed rate hike, slowing Chinese economy and a fall in crude oil prices that put stress on some sovereign wealth funds' investment capabilities. These worries have not gone off the table and could come back to haunt EMs including India, in 2016. While India is better placed given due to improving macro indicators, benign oil prices, government reforms and increasing capital expenditure, it is not immune to external shocks. Thus, experts say, investors should be stock-specific with focus on domestic themes.

The emphasis on domestic themes also stems from various measures such as power sector reforms, faster environment clearances, higher foreign direct investment limits in some sectors, and efforts to revive infrastructure projects, higher spends on roads and railways etc being undertaken by the government. The government's deal with Qatar's RasGas to bring down liquefied natural gas prices and increase offtake will benefit industries like power and fertilisers, and also ease some pressure on banks' stressed assets. The 7th pay commission will also provide a kicker to the economy next year as states hike salaries.

Credit Suisse analysts led by Neelkanth Mishra wrote in a report, "Hard indicators (oil/auto demand) are improving, pointing to an economic pick-up. Next year, the downstream effects of government spending on roads/railways should show up. By June 2016, the implementation of the 7th pay commission would start an 18-month, ₹4,50,000 crore consumption stimulus to 34 million people." The report added that housing in mainly tier-2/3 towns, and transportation should benefit and a pick-up in small-town real estate (moves around the pay commissions) should help labour demand.

While urban consumption (automobiles, food, airlines, media, telecom, consumer durables) and infra spending (EPC, road construction and railway equipment) plays are among the preferred picks, experts say select companies from global themes like pharmaceutical and information technology, which will gain from a strong dollar and a pick-up in US economic growth, should also do well.

Experts say the Reserve Bank of India's rate cuts, which haven't reflected in earnings yet, will also aid earnings recovery. "The improvement in macro-environment will start reflecting in corporate earnings which ultimately decides market movement," says Rahul Shah, vice president - equity advisory, Motilal Oswal Securities. Investors should focus on companies with good earnings growth and manageable debt, say experts.

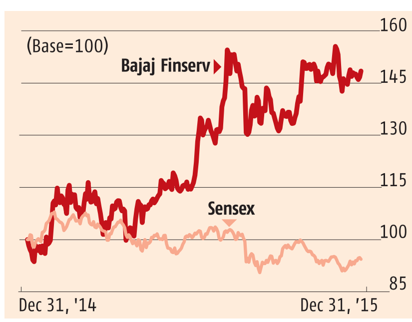
Here are the top 10 stocks selected from the list of picks of leading research houses such as Credit Suisse, Motilal Oswal, Edelweiss, Religare Securities, ICICI Securities, Phillip Capital, Kotak Securities and Deutsche Bank. Happy investing in 2016!

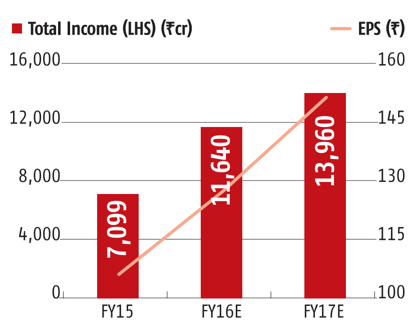
Contributions from Ujjval Jauhari, Ram Prasad Sahu and Hamsini Karthik

BAJAJ FINSERV

CMP (₹)	1,986.8	Buy	11
Target price (₹)	2,308.0	Sell	1
Current PE (x)	16.1	Hold	2

16.2%





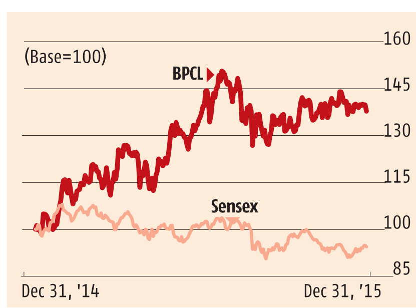
- Strong player in finance, life and general insurance businesses, generating annual profit of ₹1,700 crore
- Niche consumer durable lender having reported a four-fold increase in its loan book during FY11-15, with a strong surge in earnings; should see good growth
- Life insurance business is gradually picking up and there is potential for valuation upgrades after the hike in foreign direct investment limit
- Most profitable and efficient player in the general insurance business
- Return on equity and return on asset consistent at 17 per cent and two per cent, respectively

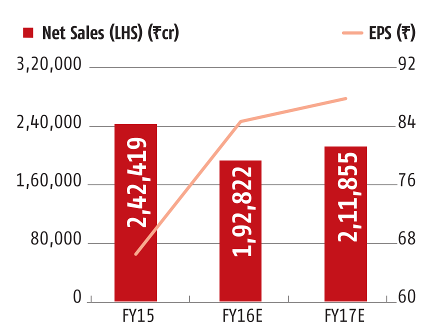
BHARAT PETROLEUM

Buy	28
Sell	4
Hold	4

31.0%

CMP (₹)	893.4
Target price (₹)	1,170.0
Current PE (x)	9.5





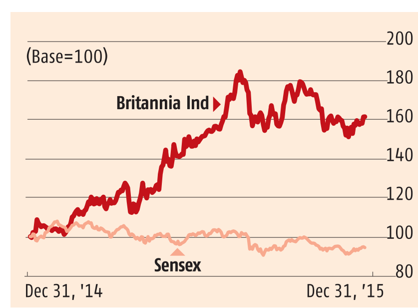
- Benefits from fuel price deregulation, lower oil prices and reduced working capital requirements
- The company has a five-year ₹1,00,000 crore capex plan and given its track record of 15-23 per cent RoE, analysts believe the capex will be value accretive
- Motilal Oswal likes BPCL for its operational efficiencies, targeted strategic approach and sound management

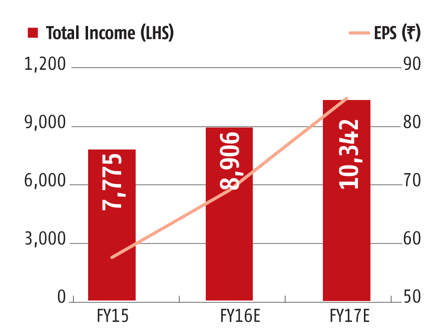
BRITANNIA

Buy	18
Sell	4
Hold	5

21.5%

CMP (₹)	2,963.7
Target price (₹)	3,600.0
Current PE (x)	49.9



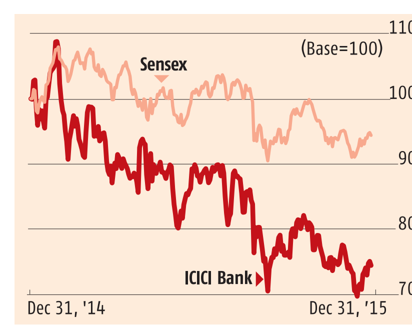


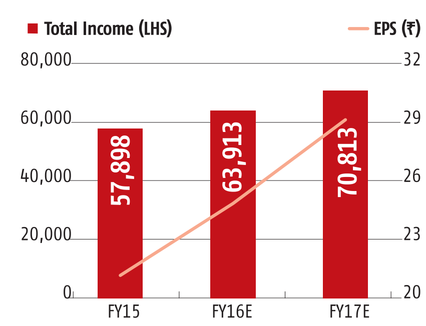
- Focus on fast growing premium biscuit segment and going up the value chain is expected to result in profitable growth
- Aggressive strategy to grow distribution reach in rural areas where it is registering double digit growth
- Falling commodity prices will aid margins going ahead as well
- Good Day brand relaunch and Nutri Choice brand witnessing sales traction

ICICI BANK

CMP (₹)	261.5	Buy	52
Target price (₹)	425.0	Sell	1
Current PE (x)	12.9	Hold	4

62.6%





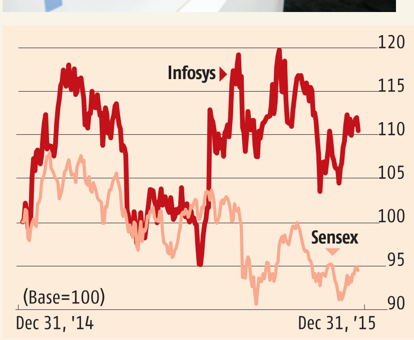
- Quality of liability franchise and a current and savings accounts mix of 45.1 per cent among the best in sector
- Strong net interest margin due to low-cost deposits and better asset-liability management
- Management focused on growth and improving profitability
- Kotak Securites' analysts say market perception of a few large defaults are responsible for stock's recent underperformance, but policy action taken by government will benefit
- RoA and RoE are estimated to remain strong at 1.8 per cent and 15 per cent, respectively
- Excluding subsidiaries, the stock is trading at a reasonable valuation of 1.1 times the book value

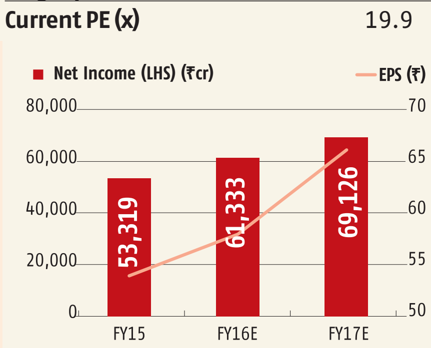
INFOSYS

Buy	50
Sell	2
Hold	11

11.4%

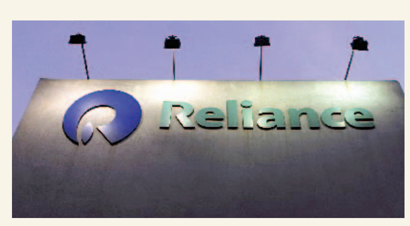
CMP (₹)	1,104.6
Target price (₹)	1,230.0
Current PE (x)	19.9





- The management has taken several measures to improve growth as well as profitability
- Realignment of sales and delivery functions under the New and Renew strategy is showing results and the pace is expected to pick up going ahead
- Near-term issues such as visa charges and a below expectations performance in the September 2015 quarter has led to pressure on the stock price
- Valuations at a reasonable 16 times FY17 earnings and the stock can generate decent returns from these levels

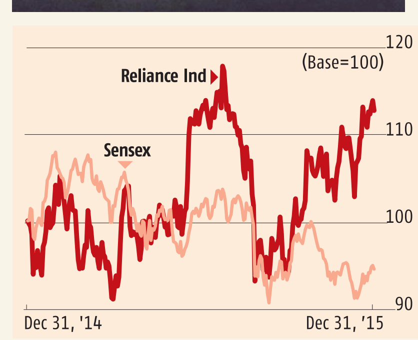
RELIANCE INDUSTRIES

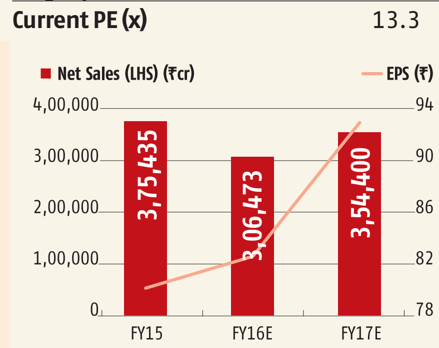


Buy	36
Sell	0
Hold	7

28.4%

CMP (₹)	1,012.6
Target price (₹)	1,300.0
Current PE (x)	13.3



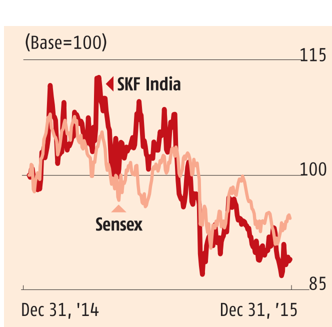


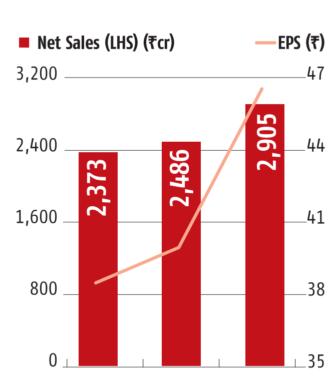
- Benefits from the crude oil oversupply scenario, leading to higher gross refining margins
- Slowdown in global capacity addition and higher demand for gas oil and gasoline will support higher GRMs going forward
- Capex of ₹1,80,000 crore over three-five years in refining and petchem will acrrue from FY18
- Analysts expect RoE to improve from FY17, thereby boosting stock valuation
- Retail business progressing well while telecom will add to revenues from FY17; RJio's success could be a key trigger for the stock

SKF INDIA

CMP (₹)	1,220.9	Buy	8
Target price (₹)	1,550.0	Sell	2
Current PE (x)	34.1	Hold	6

27.0%



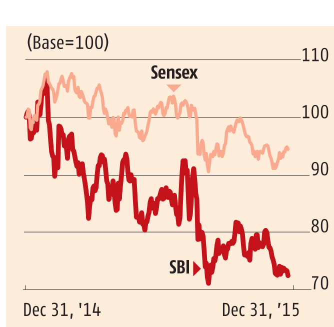


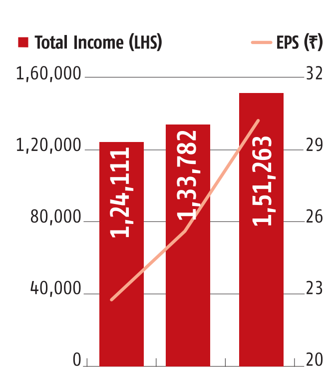
- The leader in bearings industry; enjoys about 31 per cent market share
- Due to its lead in innovation, the company should gain due to the focus on energy/carbon emission reduction and an uptick in industrial recovery
- With high operating leverage analysts at Deutsche Bank say that their base case 26 per cent earnings per share growth estimated for CY15-17 could rise to 40 per cent if sales move up by 7 per cent above their estimates
- The competitive advantage and potential operating leverage gains should help sustain premium valuations

STATE BANK OF INDIA

CMP (₹)	224.4	Buy	50
Target price (₹)	321.0	Sell	2
Current PE (x)	9.6	Hold	3

43.0%



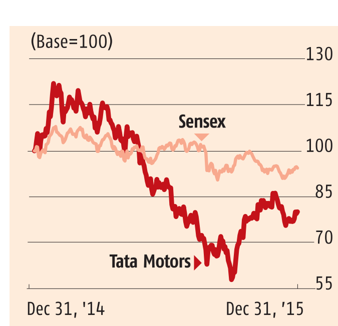


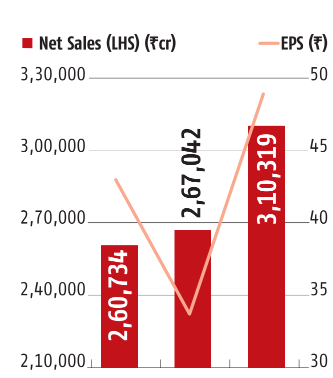
- Well-positioned to capture credit revival
- High provisioning coverage ratio of 70.5 per cent, strong liability franchise and focus on operating profitability are key positives; it also leads in the digital space
- Asset quality and profitability to improve with revival in economy; will benefit as it accounts for stress early
- Slippages and restructuring is estimated to decline in FY16 and improve further in FY17
- Strategic debt restructuring, 5:25 scheme and sale of bad loans to asset reconstruction companies will lower non-performing assets

TATA MOTORS

CMP (₹)	391.3	Buy	44
Target price (₹)	492.0	Sell	4
Current PE (x)	16.7	Hold	3

25.8%



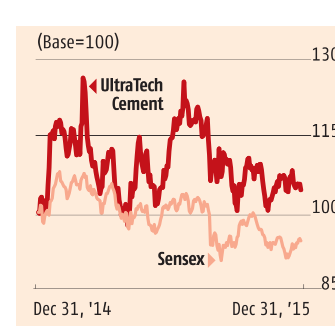


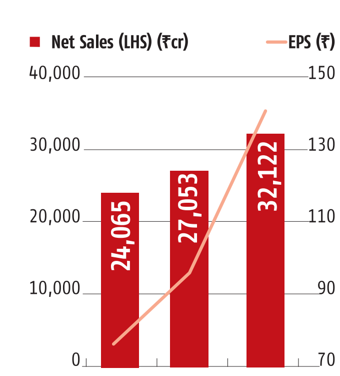
- New product launches, demand recovery to drive sales of Jaguar Land Rover (JLR)
- JLR margins, which have been hit by various issues including product phase-out and ramping up of joint venture in a profitable market such as China, have bottomed out
- Growth in Indian business will be led by volume growth in the commercial vehicle and bus segments over the next couple of years
- While there have been many new product launches in the passenger vehicle market, volume growth may take time to play out

ULTRATECH CEMENT

CMP (₹)	2785.0	Buy	42
Target price (₹)	3,525.0	Sell	7
Current PE (x)	36.8	Hold	7

26.6%





- The pan-India cement player has continued to add capacities, which will drive volumes even as utilisations remain low
- Evenly spread capacities will help it emerge as a strong beneficiary of the expected boost in infrastructure spend
- Operating efficiencies to improve, and lowering fuel costs by increasing pet coke utilisations will drive margins
- Ebitda per tonne of ₹847 was already ahead compared to ACC's ₹448 and Ambuja's ₹643 in September quarter justifying the company's premium stock valuation and edge over peers

Note: P/E are for trailing 12 months ended September 2015; CMP is current market price as on December 31, 2015; Total income, net sales and EPS figures sourced from Bloomberg; Figures for buy/sell/hold denote number of analysts; Figures inside the arrows indicate potential upside for the next 12 months and are based on average target prices of brokerages; E = estimates

Data compiled by BS Research Bureau