

Finolex Industries Ltd.

No. of shares (m)	124.1
Mkt cap (Rs crs/\$m)	7162/980.1
Current price (Rs/\$)	577/7.9
Price target (Rs/\$)	518/7.1
52 W H/L (Rs.)	675/283
Book Value (Rs/\$)	184/2.5
Beta	0.7
Daily volume NSE (avg. monthly)	69610
P/BV (FY21e/22e)	2.6/2.3
EV/EBITDA (FY21e/22e)	9.9/10.4
P/E (FY21e/22e)	15.7/16.7
EPS growth (FY20/21e/22e)	-11.8/40.1/-5.9
OPM (FY20/21e/22e)	15.0/20.7/18.0
ROE (FY20/21e/22e)	15.1/19.6/14.7
ROCE (FY20/21e/22e)	13.0/18.1/13.9
D/E ratio (FY20/21e/22e)	0.1/0.1/0.1
BSE Code	500940
NSE Code	FINPIPE
Bloomberg	FNXP IN
Reuters	FINX.NS

Shareholding pattern

	%
Promoters	52.5
MFs / Banks / FIs/Others	12.9
FPIs	2.3
Govt. Holding	0.0
Public & Others	32.4
Total	100.0

As on Dec 31, 2020

Recommendation

REDUCE

Analyst

KISHAN GUPTA, CFA, FRM

Phone: + 91 (33) 4488 0043

E- mail: kishan.gupta@cdequi.com

Company Brief

Headquartered in Pune, Finolex Industries is a leading manufacturer of PVC - U pipes & fittings and PVC resin.

Highlights

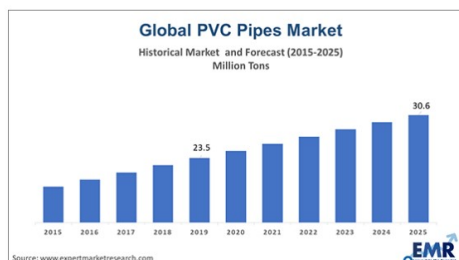
- V-shaped recovery in global PVC resin prices since May with corresponding surge in PVC/EDC delta (above long term average of \$550-600/mt) explains much of the rise in Finolex's PVC resin EBIT in Q2 - Rs 99.10 crs Vs Rs 45.13 crs in the same quarter a year ago.; though external sales (volumes) fo PVC resins rose by just 38.1% to 9665 tons. As indication of its barely subdued impact, Finolex's PVC resin realizations were at \$920 / mt compared to \$740/ton in Q1 while PVC/EDC delta stood at \$653/mt compared to \$547/mt in Q1. Supply constraints of PVC resins have believed to have triggered a global price rally.
- Higher realizations for agri pipes, which constitute over two-thirds of overall PVC pipes business, helped rise in EBIT margin to 7.8% from 4.6% in the same period a year ago, though volumes declined by 9.2% largely due to lower dispatches of agri pipes. Yet its EBIT grew by 64.8% to Rs 39.30 crs on yoy basis. Buoyancy in demand manifested itself in higher realizations for pipes & fittings for the average price / ton rose to Rs 1.15 lakhs compared to Rs 1.08 lakhs in the second quarter of previous fiscal.
- Hardly unfavorable cost structure also helped for other operating expenses declined by 21.3% and employee expenses rose by insignificant 3.9%. Little tepidness in PVC resin business supported 76.6% growth in operating profit when revenues well-nigh flat lined. Thence OPMs surged to 24.7% compared to 14.2%. PBT rose by some 97% but to lower taxes last fiscal, post tax earnings advanced by just 16.6%.
- The stock currently trades at 15.7x FY21e EPS of Rs 36.67 and 16.7x FY22e EPS of Rs 34.52. Finolex's rebound in earnings post no small volume loss in Q1 would be no puny not least due to its direct exposure to PVC resin market, which has seen hectic activity in last few months. Thence Finolex's PVC resin business allocable EBIT share would zoom past 62% this fiscal from some 50% in FY20, thus propelling its pretax earnings growth to over 53%. Yet little perceptible "specialization" in PVC pipes & fittings business (through pinching value addition), which manifests itself in EBIT margins, lends no great alloy like benefits to business. Weighing odds, we assign reduce rating on the stock with revised target of Rs 518 (previous target: Rs 480) based on 15x FY22e earnings.

(Figures in Rs crs)	FY18	FY19	FY20	FY21e	FY22e
Income from operations	2737.79	3091.32	2985.98	3079.43	3308.20
Other Income	25.32	41.57	30.83	61.60	69.99
EBITDA (other income included)	509.25	617.97	478.90	697.51	664.19
Profit after EO	298.82	368.05	324.74	455.05	428.35
EPS (Rs)	24.08	29.66	26.17	36.67	34.52
EPS growth (%)	-15.2	23.2	-11.8	40.1	-5.9

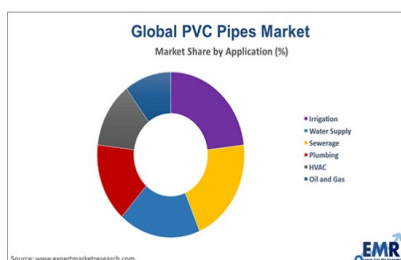
Investment Thesis

PVC Pipes Industry

According to a report by Expert Market Research, global PVC pipes industry is projected to grow at a CAGR of 4.3% during 2021-2026 to reach 30.25 mn tons by terminal year driven by growing urbanization which would demand larger and cost effective sewage lines, rising construction activities, buoyancy in infrastructure development and growing demand in chemical, oil & natural gas industry. Of being cost effective, light in weight, easy to install and long lasting compared to GI, cast iron and cement pipes, PVC pipes has become the most popular plastic pipes all over the world.



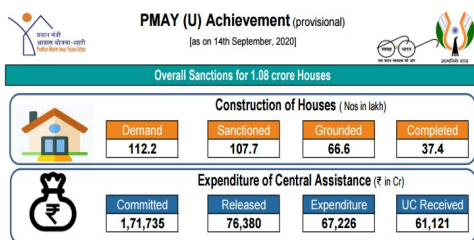
Source: Expert Market Research



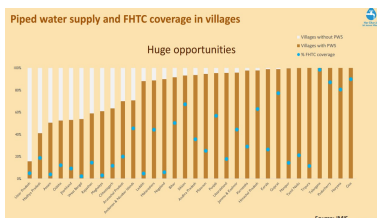
Source: Expert Market Research

IMARC Group contends that the environmental footprint of PVC pipes is far smaller than alternate piping materials which make it so very popular. Further the production of PVC pipes consumes around four times lesser energy and incurs lower losses of the raw material in comparison to concrete pipes. Their excellent heat and electrical insulation properties have greatly boosted their usage in electrical fittings.

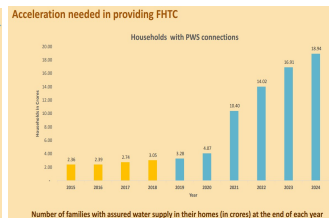
Industry reports opine that India's plastic piping industry has grown at a CAGR of 10% in the past five years with organized players accounting for 60-65% market share. No small growth in Government of India's infrastructural spending, construction spending, irrigation spending and replacement of aging pipelines, among others, explain much of the buoyancy in plastic piping industry over the last few years. Increased adoption of PVC/CPVC pipes owing to its corrosion resistant, flame resistant, increased durability and environmental friendly features. Further, market growth in India is expected to be propelled by GOI's greater focus on end user application.



Source: PMAY (U)



Source: Ministry of Jal Shakti, GOI



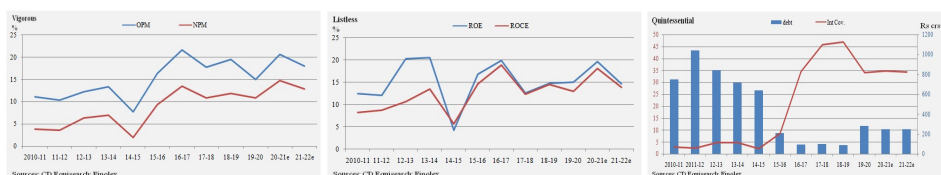
Source: Ministry of Jal Shakti, GOI

No sluggish market growth in plastic piping industry is estimated due to GOI schemes like Housing for All” by 2022, “Nal se Jal” by 2024, project AMRUT & Swachh Bharat Mission and National Rural Drinking Water Programme. Aimed at providing basic services such as water supply and sanitation (WSS), cleanliness, sewage connection and assured water supply for drinking, these schemes have the ability to generate large scale demand for plastic piping business.

Financials & Valuation

According to a report by Transparency Market Research, global PVC market is estimated to grow at 4% CAGR during 2019 to 2027 to reach \$88 bn all thanks to growing population, rapid urbanization and increasing construction volumes. It noted that online trading and increase in disposable incomes would also influence demand. These factors as per the report would largely support the growth of APAC market - the largest regional PVC market. Pipe & fittings market is estimated to dominate the PVC industry over the forecasted period.

Though supply constraints induced by COVID-19 has galvanized the global PVC resin markets in the last few months thus benefitting organized PVC pipe manufacturers. Yet demand resistance from relentless increase in PVC prices is expected from the agriculture sector as opined by Supreme Industries and it expects resin prices to moderate by March. Its effect are scarcely contained for All-India Federation of Plastic Industries (AIFPI) has recently urged the Central Government to remove anti-dumping duty on PVC resin used by the plastic processing units and footwear industry so as to enable them to maintain production which has taken a toll due to sharp jump in resin prices.



Incessant rise in resin prices may prompt Finolex Industries to post some inventory gains in Q3 which would hardly belittle PVC resin EBIT in the second half of current fiscal, though external sales of the material would flat line this fiscal. PVC resin business would seemingly support much of the expected surge in earnings this fiscal though odds hardly favour on the sustainability of PVC resin margins next fiscal. Wherefore post tax earnings is expected to decline by some 6% next fiscal; not a runaway rise in earnings is projected for PVC pipes & fittings business next fiscal.

Macro-economic trends in form of higher budgetary spending in GOI scheme such as Pradhan Mantri Avas Yojana (PMAY), Swachh Bharat Mission and Pradhan Mantri Krishi Sinchayee Yojana (PMKSY) would continue to prop up demand for PVC pipes. Resolute efforts are made by Finolex to boost its market share of non-agri pipes by expanding the distribution network, forming exclusive distribution channels and granting liberal credit terms. For PVC pipes & fittings business expansion of product portfolio coupled with further consolidation in plumbing space is on the anvil.



The stock currently trades at 15.7x FY21e EPS of Rs 36.67 and 16.7x FY22e EPS of Rs 34.52. Despite the grueling impact of the pandemic bruising much of the output in Q1, post tax earnings this fiscal is estimated to perceptibly surpass last year's - belying expectations of sharp decline in earnings. Buoyancy in PVC resin business - its EBIT estimated to rise to Rs 363 crs from some Rs 200 crs - would lend much needed "velocity" in the pandemic year. Yet equity valuation faces no small friction from peaking out of PVC resin prices and missing catalysts in its PVC pipes business. Weighing odds we assign reduce rating on the stock with revised target of Rs 518 (previous target: Rs 480) based on 15x FY22e earnings. For more info refer to our May report.

Cross Sectional Analysis

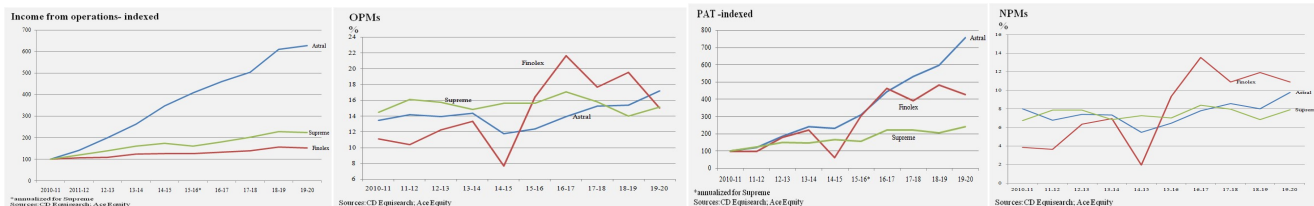
Company	Equity*	CMP	Mcap*	Sales*	Profit*	OPM (%)	NPM (%)	Int. Cov.	ROE (%)	DER	Mcap / sales	P/BV	P/E
Astral Poly	15	1717	25869	2444	226	17.6	9.6	11.6	18.1	0.1	10.6	19.3	114.5
Finolex	124	577	7162	2613	324	18.2	12.4	30.2	13.9	0.1	2.7	3.1	22.1
Supreme Inds	25	1808	22970	5703	645	18.4	9.9	30.7	25.6	0.0	4.0	8.4	35.6

*figures in crores; calculations on ttm basis

Book value adjusted for goodwill and revaluation reserves where applicable

Astral recently announced commencement of commercial production of its plastic water storage tanks facility at Aurangabad. Its new piping facility in Odisha is expected to come on stream by the second quarter of next fiscal. Recovery in overall business activity was barely hidden in Q2 for the company posted revenues of Rs 747 crs compared to Rs 404 crs in Q1 - a growth of 85%. Pipe sales volumes expanded too: published 62.4% growth in of take in Q2 when compared to the first quarter. Thanks to benefits of operating leverage, operating profit all but trebled to Rs 143.60 crs, thus posting OPM of 19.2% Vs 13.4% in Q1 and 17.5% in the same quarter a year ago with its plastic pipe business accounting for most of the jump in profits.

Little put off by nerve-wracking lockdown in Q1, Supreme Industries have rebounded well with its post tax earnings up by a startling 50.7% in the first nine months of the current fiscal though revenues are up by a meager 4.7%. Little surprisingly, overall plastic goods volumes are down by a little over 3% to 2.98 lakh tons and volumes of its flagship plastic piping system business are down 2.2%. Margin has done the trick for OPM expanded for nearly all its main business segments in the second and third quarter with plastic piping system recording margin of 24% in Q3 aided by inventory gain on PVC resin of Rs 80 crs. Despite the pandemic, the company has made little deferment to its capex program for an investment of Rs 400 crs is planned for the current fiscal, excluding carried forward investment commitment of Rs 182 crs.



Financials

Quarterly Results

Figures in Rs crs

	Q2FY21	Q2FY20	% chg.	H1FY21	H1FY20	% chg.
Income from operations	585.79	576.67	1.6	1147.85	1520.48	-24.5
Other Income	32.46	17.42	86.3	40.78	23.13	76.3
Total Income	618.25	594.09	4.1	1188.63	1543.61	-23.0
Total Expenditure	441.01	494.67	-10.8	914.84	1314.90	-30.4
EBIDTA (other income incl.)	177.24	99.42	78.3	273.79	228.71	19.7
Interest	0.77	0.23	234.8	4.05	1.11	264.9
Depreciation	19.34	19.40	-0.3	38.17	36.17	5.5
PBT	157.13	79.80	96.9	231.57	191.43	21.0
Tax	37.40	-22.88	-263.5	56.74	16.25	249.2
Net Profit	119.73	102.68	16.6	174.83	175.18	-0.2
Extraordinary Item	-	-	-!	-	-	-
Adjusted Net Profit	119.73	102.68	16.6	174.83	175.18	-0.2
EPS	9.65	8.27	16.6	14.09	14.12	-0.2

Segment results

Figures in Rs crs

	Q2FY21	Q2FY20	% chg.	H1FY21	H1FY20	% chg.
Segment Revenue						
PVC	368.06	302.65	21.6	662.34	837.54	-20.9
PVC Pipes & Fittings	500.83	517.04	-3.1	1007.81	1368.25	-26.3
Total	868.89	819.69	6.0	1670.15	2205.79	-24.3
Less: Inter-segment revenue	283.11	243.02	16.5	522.30	685.31	-23.8
Income from operations	585.79	576.67	1.6	1147.85	1520.48	-24.5
Segment EBIT						
PVC	99.10	45.13	119.6	122.31	86.44	41.5
PVC Pipes & Fittings	39.30	23.84	64.8	90.74	96.20	-5.7
Total	138.40	68.97	100.7	213.05	182.64	16.7
Interest	0.77	0.23	234.8	4.05	1.11	264.9
Unallocable exp.(net of income)	-19.49	-11.05	76.4	-22.57	-9.89	128.2
PBT	157.13	79.80	96.9	231.57	191.43	21.0

CD Equisearch Pvt Ltd

Income Statement

Figures in Rs crs

	FY18	FY19	FY20	FY21e	FY22e
Income from operations	2737.79	3091.32	2985.98	3079.43	3308.20
<i>Growth (%)</i>	5.2	12.9	-3.4	3.1	7.4
Other Income	25.32	41.57	30.83	61.60	69.99
Total Income	2763.11	3132.89	3016.81	3141.03	3378.19
Total Expenditure	2253.86	2514.92	2537.91	2443.52	2714.00
EBIDTA (other income incl.)	509.25	617.97	478.90	697.51	664.19
Interest	9.82	12.27	11.91	17.83	16.98
EBDT	499.44	605.70	466.99	679.68	647.20
Depreciation	60.60	70.08	73.81	76.96	79.85
Tax	140.29	185.82	68.99	147.67	139.00
Net Profit	298.54	349.80	324.19	455.05	428.35
EO	-0.27	-18.25	-0.55	0.00	0.00
Adjusted Net Profit	298.82	368.05	324.74	455.05	428.35
EPS (Rs)	24.08	29.66	26.17	36.67	34.52

Segment results

Figures in Rs crs

	FY18	FY19	FY20	FY21e	FY22e
Segment Revenue					
PVC	502.57	516.52	432.03	547.04	552.50
PVC Pipes & Fittings	2328.84	2574.80	2553.95	2532.39	2755.70
Power	0.00	0.00	0.00	0.00	0.00
Total sales	2831.41	3091.32	2985.98	3079.43	3308.20
Segment EBIT					
PVC	348.76	377.28	199.79	362.81	292.50
PVC Pipes & Fittings	136.17	182.82	202.68	221.06	243.89
Power	0.00	0.00	0.00	0.00	0.00
Total	484.92	560.09	402.47	583.87	536.39
Interest	9.82	12.27	11.91	17.83	16.98
Unallocable exp.(net of income)	36.28	12.22	-2.65	-36.68	-47.94
PBT	438.84	535.62	393.18	602.72	567.35

Balance Sheet

Figures in Rs crs

	FY18	FY19	FY20	FY21e	FY22e
SOURCES OF FUNDS					
Share Capital	124.10	124.10	124.10	124.10	124.10
Reserves	2640.47	2404.33	1805.71	2709.22	3124.41
Total Shareholders Funds	2764.57	2528.42	1929.80	2833.31	3248.50
Long term debt	-	-	-	-	-
Total Liabilities	2764.57	2528.43	1929.80	2833.31	3248.50
APPLICATION OF FUNDS					
Gross Block	2063.71	2199.44	2,334.27	2,404.27	2504.27
Less: Accumulated Depreciation	1179.47	1248.55	1,317.38	1,394.33	1474.18
Net Block	884.24	950.89	1016.89	1009.94	1030.09
Capital Work in Progress	90.34	90.25	7.28	10.00	10.00
Investments	1555.24	1303.02	584.66	1444.18	1655.15
Current Assets, Loans & Advances					
Inventory	611.55	620.47	857.81	646.68	694.72
Sundry Debtors	43.14	74.31	73.17	75.00	78.75
Cash and Bank	23.43	28.04	93.20	384.56	558.35
Loans and Advances	76.33	102.49	70.98	79.40	82.15
Total CA & LA	754.45	825.31	1095.16	1185.65	1413.97
Current Liabilities	489.64	511.99	688.37	754.86	795.36
Provisions	1.43	2.40	3.01	3.64	4.17
Total Current Liabilities	491.07	514.39	691.38	758.50	799.52
Net Current Assets	263.38	310.92	403.78	427.15	614.45
Net Deferred Tax	-120.68	-151.33	-115.82	-116.00	-118.00
Other Assets (Net Of Liabilities)	92.06	24.68	33.01	58.05	56.81
Total Assets	2764.57	2528.43	1929.80	2833.31	3248.50

Key Financial Ratios

	FY18	FY19	FY20	FY21e	FY22e
Growth Ratios (%)					
Revenue	5.2	12.9	-3.4	3.1	7.4
EBIDTA (other income included)	-13.2	26.7	-25.8	45.4	-4.8
Net Profit	-15.2	23.2	-11.8	40.1	-5.9
EPS	-15.2	23.2	-11.8	40.1	-5.9
Margins (%)					
Operating Profit Margin	17.7	19.5	15.0	20.7	18.0
Gross Profit Margin	18.3	20.5	15.7	22.1	19.6
Net Profit Margin	10.9	11.9	10.9	14.8	12.9
Return (%)					
ROCE	12.4	14.5	13.0	18.1	13.9
ROE	12.6	14.7	15.1	19.6	14.7
Valuations					
Market Cap / Sales	3.0	2.0	1.6	2.3	2.2
EV/EBIDTA	16.1	9.1	10.2	9.9	10.4
P/E	27.4	16.5	14.9	15.7	16.7
P/BV	3.1	2.6	2.5	2.6	2.3
Other Ratios					
Interest Coverage	45.7	46.9	34.1	34.8	34.4
Debt-Equity Ratio	0.0	0.0	0.1	0.1	0.1
Current Ratio ^a	1.3	1.6	1.8	2.0	2.2
Turnover Ratios					
Fixed Asset Turnover	3.1	3.4	3.0	3.0	3.2
Total Asset Turnover	1.2	1.2	1.4	1.3	1.1
Debtors Turnover	57.3	52.6	40.5	41.6	43.0
Inventory Turnover	3.9	4.0	3.4	3.2	4.0
Creditors Turnover	9.4	9.3	9.8	9.0	8.5
WC Ratios					
Debtor days	6.4	6.9	9.0	8.8	8.5
Inventory days	94.7	90.4	106.3	112.4	90.2
Creditor days	38.7	39.2	37.2	40.4	43.0
Cash conversion cycle	62.3	58.1	78.1	80.7	55.7

Cumulative Financial Data

Figures in Rs crs	FY14-16	FY17-19	FY20-22e
Income from operations	7411	8431	9374
Operating profit	925	1652	1679
EBIT	846	1557	1611
PBT	664	1520	1564
PAT	451	1019	1208
Dividends	281	471	398
PVC pipe sales (lakh tons)	5.7	7.2	7.5
PVC resin production (lakh tons)	7.3	7.7	7.3
PVC resin sales (lakh tons)	3.5	2.2	1.8
OPM (%)	12.5	19.6	17.9
NPM (%)	6.1	12.1	12.9
Interest coverage	4.7	41.6	34.5
ROE (%)	14.0	17.9	14.6
ROCE (%)	12.2	17.0	13.8
Fixed asset turnover	2.9	3.1	3.2
Debtors turnover	87.7	61.1	40.8
Inventory turnover	4.6	4.2	3.9
Creditors turnover	10.1	8.6	8.3
Debtors days	4.2	6.0	8.9
Inventory days	78.5	86.2	93.6
Creditor days	36.1	42.6	43.7
Cash conversion cycle	46.6	49.6	58.8
Dividend payout ratio (%)	59.5	47.1	32.9

FY14-16 implies three years ending fiscal 16; *as on terminal year

Little buoyancy in PVC resin business over the three year ending FY22 proves tepidness in operating profit growth over this period - cumulative operating profit estimated to rise by just 1.6% to Rs 1679 crs during FY20-22e period compared to Rs 1652 crs in the previous three year period. Seeming strength in cumulative EBIT of PVC pipes & fittings business during this period would barely make up for the decline in earnings of PVC resin business (Cumulative EBIT: Rs 855 crs Vs Rs 1081 crs in FY17-19 period) partly due to miserable volume growth (3.1% estimated) in PVC pipes & fittings business during FY20-22 period. Little "velocity" in margins of PVC pipes & fittings - partly due to barely small share of agri pipes - coupled with lower saleable volumes (cumulative) of PVC would cap cumulative post tax earnings growth to 18.6% - Rs 1208 crs during FY20-22 as against Rs 1019 crs in FY17-19 period, thus providing little catalyst for business growth.

Redundancies in installed capacities of PVC pipes & fittings - average utilization at some 70% - coupled with seeming "inertia" in its margins would hardly support the rise in fixed asset turnover in the ensuing period (see table). Scarcely diminishing stock of liquid assets together with flat lining of post tax earnings (cumulative) would stymie return on capital - ROE estimated to decline to 14.6% in FY20-22 period from 17.9% in the previous period - thus casting doubt on 'scaling' potential of its backward integration initiatives. Cash conversion cycle though is estimated to improve to 59 days from some 50 days (see table).

Financial Summary – US dollar denominated

million \$	FY18	FY19	FY20	FY21e	FY22e
Equity capital	19.1	17.9	16.5	17.0	17.0
Equity shareholders' funds	402.0	343.9	256.0	370.8	427.6
Total debt	15.5	12.9	37.5	34.2	34.2
Net fixed assets (incl CWIP)	149.8	150.5	135.9	139.6	142.3
Investments	239.1	188.4	77.6	197.7	226.5
Net current assets	17.5	23.3	53.6	41.5	67.1
Total assets	402.0	343.9	256.0	370.8	427.6
Revenues	424.8	442.3	421.3	421.5	452.8
EBITDA	79.1	92.4	67.7	95.5	90.9
EBDT	77.6	90.7	66.0	93.0	88.6
PBT	68.2	80.6	55.6	82.5	77.6
PAT	46.4	52.7	45.8	62.3	58.6
EPS(\$)	0.37	0.42	0.37	0.50	0.47
Book value (\$)	3.24	2.77	2.06	2.99	3.45

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rate (\$73.07/\$)

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Registered Office: 37, Shakespeare Sarani, 3rd Floor, Kolkata – 700 017; Phone: +91(33) 4488 0000; Fax: +91(33) 2289 2557 Corporate Office: 10, Vasawani Mansion, 5th Floor, DinshawWachha Road, Churchgate, Mumbai – 400 020. Phone: +91(22) 2283 0652/0653; Fax: +91(22) 2283, 2276 Website: www.cdequi.com; Email: research@cdequi.com

buy: >20% accumulate: >10% to ≤20% hold: ≥-10% to ≤10% reduce: ≥-20% to <-10% sell: <-20%

Exchange Rates Used- Indicative

Rs/\$	FY17	FY18	FY19	FY20
Average	67.09	64.45	69.89	70.88
Year end	64.84	65.04	69.17	75.39

All \$ values mentioned in the write-up translated at the average rate of the respective quarter/ year as applicable. Projections converted at current exchange rate. Cumulative dollar figure is the sum of respective yearly dollar value.