

Aarti Industries Ltd.

No. of shares (m)	362.5
Mkt cap (Rs crs/\$m)	33878/4587.4
Current price (Rs/\$)	935/12.7
Price target (Rs/\$)	765/10.4
52 W H/L (Rs.)	987/484
Book Value (Rs/\$)	133/1.8
Beta	0.5
Daily volume NSE (avg. monthly)	1114780
P/BV (FY22e/23e)	6.6/5.8
EV/EBITDA (FY22e/23e)	29.1/23.9
P/E (FY22e/23e)	54.1/42.8
EPS growth (FY21/22e/23e)	-1.1/15.1/26.4
OPM (FY21/22e/23e)	21.8/23.9/24.9
ROE (FY21/22e/23e)	16.3/14.5/14.4
ROCE(FY21/22e/23e)	10.6/10.8/11.7
D/E ratio (FY21/22e/23e)	0.8/0.5/0.4
BSE Code	524208
NSE Code	AARTIIND
Bloomberg	ARTO IN
Reuters	ARTINS

Shareholding pattern

	%
Promoters	44.9
MFs / Banks / FIs	13.6
Foreign Portfolio Investors	11.9
Govt. Holding	0.0
Public & Others	29.6
Total	100.0

As on June 30, 2021

Recommendation

REDUCE

Analyst

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Company Brief

AIL is one of India's leading manufacturers of chemicals and pharmaceutical intermediates: dyestuff; pigment; agro chemicals; speciality chemicals; API.

Quarterly Highlights

- Aided by the specialty chemicals business - whose revenues surged by an eye-popping 56.6% in Q1 and EBIT by gravity-defying 84.2% - Aarti Industries posted 40.5% growth in overall sales and 98.4% rise in post tax earnings on yoy basis. Despite sharp increase in raw material prices, freight and fuel prices, operating profit advanced by 72.4% to Rs 313.81 crs, thus pulling up OPMs to 23.8% from 19.4% (21.5% in Q4); finance costs though rose sharply not least due to M2M impact on unhedged ECBs. Much of the business growth last quarter was aided by higher capacity utilization and better product mix with value added products contributing 70%.
- Margins of the pharmaceuticals business declined to 19.8% from 21.2% in Q4 due to higher inventories awaiting shipments. Yet its growth would be driven by higher volumes from regulated markets, increased revenue share of value added products and launch of intermediates. Expected commissioning of additional capacities of APIs and intermediates in the second half of current fiscal would buoy volumes.
- To preserve margins, Aarti Industries continues to pass on higher input costs (including freight), though shipments could get impacted due to tighter container availability. Its speciality chemicals business would be little stymied by higher utilization of new capacities of chlorination at Jhagadia and phase 2 unit at Dahej SEZ.
- The stock currently trades at 54.1x FY22e EPS of Rs 17.28 and 42.8x FY23e EPS of Rs 21.85. Earnings this fiscal will all but match our previous EPS estimate of Rs 18.50 (though on higher equity capital which increased post recently concluded QIP issue). Yet sales velocity would barely catch up with humongous investments in capital assets, thus inflicting return on capital - ROE estimated to decline to 14.4% by FY23 from 16.3% in FY21. Weighing odds, we advise "reduce" rating on the stock with revised target of Rs 765 (previous target: Rs 555) based on 35x FY23e earnings.

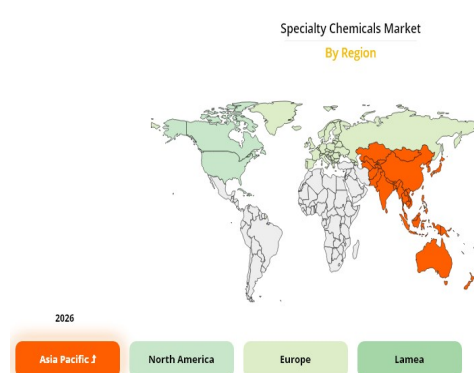
Consolidated (Rs crs)	FY19	FY20	FY21	FY22e	FY22e
Income from operations	4167.56	4186.29	4506.10	5153.89	6045.80
Other Income	2.11	8.84	0.70	14.86	16.99
EBITDA (other income included)	967.20	986.16	982.23	1248.66	1519.95
Profit after MI	490.38	529.27	523.19	626.56	792.11
EPS(Rs)	15.08	15.19	15.01	17.28	21.85
EPS growth (%)	49.5	0.7	-1.1	15.1	26.4

Outlook & Recommendation

Global Specialty Chemicals Update

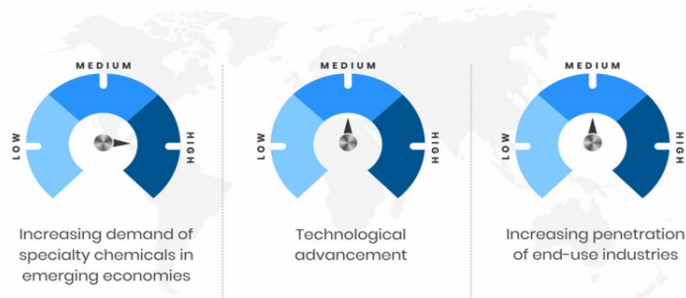
According to ResearchAndMarkets, the global specialty chemical industry was moderately impacted by the pandemic in 2020 as the demand declined by just 1%. Asia -Pacific region bucked the trend for it recorded growth of about 1% while all other major regions witnessed a negative growth of about 2% in 2020. The research firm believes that evolutionary nature of the specialty chemicals business has meant that the traditionally dominant regions of North America, Europe and Japan have made way for fast growth in emerging Asian, South America and Middle Eastern & African economies. It attributes buoyancy in this region to rapid industrialization, improved standards of living in several developing regions, perceptible shift in the global chemical industry towards the Middle East due to the abundant availability of cheap petrochemical feed stocks and Asian markets offering cheap labor coupled with fast economic growth.

ResearchAnd Market pegs growth of the global specialty chemicals market at 5.5% during 2020 and 2030, which it believes would be driven by growing automobile, textile, and food and beverage industries, especially in developing countries. Robust urbanization and industrialization in emerging economies of China, Brazil, and India would fuel the consumption of cosmetics, packaged food items, and pharmaceuticals. It contends that among all the user categories, lubricant & oilfield chemicals category will display the fastest growth in the forecast period due to the increase in the production of shale gas.



Source: Allied Market Research

DRIVERS FOR SPECIALTY CHEMICALS MARKET: IMPACT ANALYSIS



Source: Prescient Strategic Intelligence

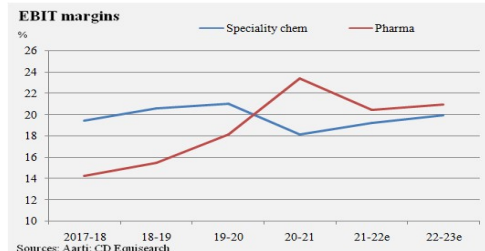
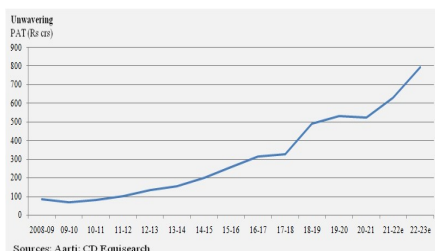
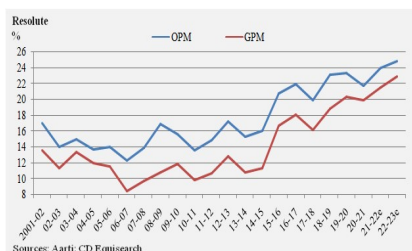
By some industry reports, the Indian specialty chemical industry would nearly double by 2025 driven by consumption growth and export opportunity. Consequently, the Indian specialty chemicals industry which has grown at a CAGR of around 11% from 2014-2019 and is expected to grow at 12% CAGR in the next 5 years. Some of this growth would be fueled by shift in overseas business to India as many chemical units in China now face stricter environmental norms. Moreover, the production cost of Chinese chemical companies has also gone up due to increase in pollution control norms and this has narrowed down the cost differential between Indian and Chinese companies to an extent.

India's share in the global specialty chemical markets stands at a meager 3%, which would provide ample opportunities for growth. Other factors which will support Indian specialty chemical industry growth include domestic availability of petrochemical intermediates, increasing capital expenditure incurred for expanding portfolio of value-added/customized products, backward integration and increasing R&D spends to enter into new age products and new chemistry.

Financials & Valuation

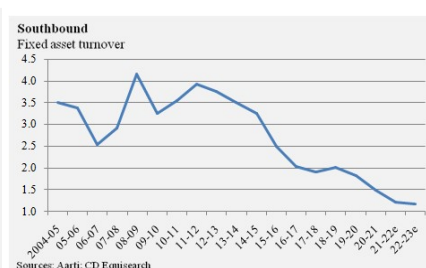
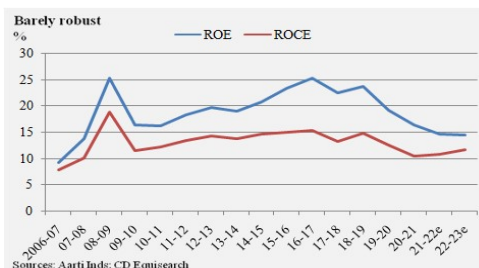
The Indian specialty chemicals industry growth at over 10% over the next few years would surpass average global growth of 3-4% not least due to China plus one strategy adopted by global majors to reduce sourcing dependence on China. Muted growth of developed markets such as Americas, Europe and Japan can be attributed to demand saturation in these markets. Increased usage intensity of specialty chemicals in end-use markets in India has the potential to boost its per capita consumption, which is currently less than a fourth of global average in value terms.

After commercializing the new chlorination plant in Jhagadia last fiscal - capacity enhanced from 1.1 lakh tpa to 1.75 lakh tpa - plans have laid out to commission the second and third long term contracts at Dahej SEZ and Jhagadia respectively, sometime in the second half of current fiscal. Other projects include NCB capacity expansion at Vapi, expansion cum asset up gradation for acid unit at Vapi and expansion at Tarapur and Vapi USFDA approved units. Capacity enhancements projects would gobble up some Rs 1500 crs this fiscal on the back of some Rs 1300 crs invested last fiscal.



With focus on value added products and downstream products barely waning, downstream products through processes like high value chlorination, hydrogenation, ammonolysis would gain traction. No less important are Aarti's plan to new value chains such as chlorotoluene by leveraging on existing chemistry expertise. Its pharmaceutical business, though not big by comparison, will strive to gain global prominence by increasing throughput from regulated markets, launching value added products and expanding pipeline of new intermediates.

The stock currently trades at 54.1x FY22e EPS of Rs 17.28 and 42.8x FY23e EPS of Rs 21.85. Increased traction in its speciality chemicals business - partly visible in Q1, though partly due to increase in raw material costs, would push post tax earnings growth to 19.8% this fiscal before earnings momentum gain traction next year. Yet scaling of business would scarcely catch up with stock of capital assets, resulting in relentless fall in fixed asset turnover ratio - fixed asset turnover estimated to decline to 1.2 by FY23 from 1.5 in FY21. Weighing odds, we advise "reduce" rating on the stock with revised target of Rs 765 (previous target: Rs 555) based on 35x FY23e earnings. For more info, refer to our October report.



Cross Sectional Analysis

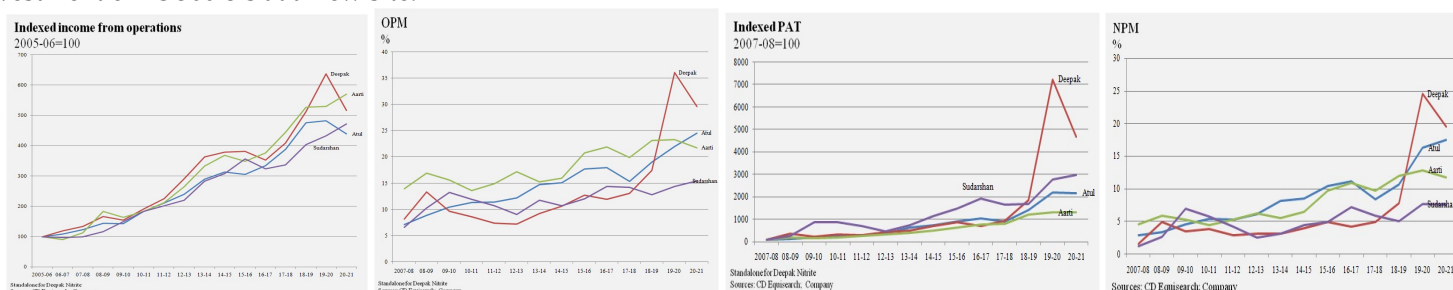
Company	Equity (Rs crs)	CMP (Rs crs)	Mcap (Rs crs)	Inc. from ops. (Rs crs)	Profit (Rs crs)	OPM (%)	NPM (%)	Int. cov.	ROE (%)	Mcap / IO	P/BV	P/E
Aarti Inds.	181	935	33878	4566	606	24.4	13.5	8.7	18.2	7.4	7.0	53.7
Atul Ltd	30	9409	27839	4151	703	24.0	16.8	107.5	19.3	6.7	6.9	39.6
Deepak Nit.	27	2442	33309	5211	979	29.2	18.8	21.7	46.2	6.4	12.9	34.0
SudarshanChem	14	667	4617	1989	149	14.9	7.5	11.7	22.5	2.3	6.4	31.0

calculations on ttm basis; Aarti income from operations approximated
Companies not truly comparable due to product dissimilarity

Helped by base effect (from the pandemic), Atul's income from operations by 63.5% to Rs 1080.20 crs from just Rs 660.56 crs in the same quarter a year ago. Performance and other chemicals business accounted for most of the swell for its sales advanced by a blistering 79.2% on yoy basis, while life science chemicals increased by 30.1%. Though operating profit leapt by 48.8% to Rs 236.11 crs in Q1, yet operating margin declined barely unstrikingly to 21.9% from 24% and 22.8% in Q4. Post tax consolidated earnings though rose by 40.9% to Rs 165.94 crs from Rs 117.78 crs in the same quarter a year ago.

Driven by its pigments business - which operated at some 81% utilization, Sudrashan Chemical posted some 44% growth in post tax earnings on 34.5% growth in overall sales. Its pigment business has of late seen input cost escalation across multiple intermediates and also cost increases due to disruption in logistics (tighter container availability). Domestic pigment revenues fell by over 25% thanks to localized lockdowns due to second wave of the pandemic. With motives of cost improvement and enhancing value chain integration projects, Suadrshan would commence some capital projects in future.

Increased churn at Deepak Nitrite's phenolics business over the last few quarters - 110% average utilization in Q1 - helped boost earnings. Higher utilization at phenol was intended at capitalizing the favorable demand trends and appealing pricing. New plans were unveiled recently to invest Rs 700 crs in downstream of phenol and acetone to make new import substitute solvents, which will find use in life science industry such as pharmaceuticals and agro-chemicals, besides doubling the capacity of its IPA plant is planned. With an aim of expanding its specialty product lines, it plans to add new chemistries like fluoroination with an investment of Rs 300 crs at a new site.



Financials

Quarterly Results - Consolidated

Figures in Rs crs

	Q1FY22	Q1FY21	% chg.	FY21	FY20	% chg.
Income from operations	1316.76	937.33	40.5	4506.10	4186.29	7.6
Other Income	0.05	0.22	-77.3	0.70	8.84	-92.1
Total Income	1316.81	937.55	40.5	4506.80	4195.13	7.4
Total Expenditure	1002.95	755.34	32.8	3524.57	3208.97	9.8
EBIDTA (other income included)	313.86	182.21	72.3	982.23	986.16	-0.4
Interest	38.29	25.32	51.2	86.37	124.78	-30.8
Depreciation	68.59	51.99	31.9	231.31	185.21	24.9
PBT	206.98	104.90	97.3	664.54	676.16	-1.7
Tax	41.90	21.70	93.1	129.33	129.42	-0.1
PAT	165.08	83.20	98.4	535.21	546.74	-2.1
Minority Interest	0.22	1.34	-83.6	11.75	10.68	10.0
PAT post MI	164.86	81.86	101.4	523.46	536.06	-2.4
Extraordinary Item	-	-	-	0.27	6.79	-96.0
Adjusted Net Profit	164.86	81.86	101.4	523.19	529.27	-1.1
EPS (F.V. 5)	4.55	2.35	93.6	15.01	15.19	-1.1

Segment Results

Figures in Rs crs

	Q1FY22	Q1FY21	% chg.	FY21	FY20	% chg.
Segment Revenue						
Speciality Chemicals	1263.12	840.85	50.2	4151.40	3864.95	7.4
Pharmaceuticals	240.23	194.27	23.7	871.88	755.74	15.4
Total	1503.35	1035.12	45.2	5023.28	4620.69	8.7
Less GST	186.59	97.79	90.8	517.18	434.38	19.1
Net	1316.76	937.33	40.5	4506.10	4186.29	7.6
Segment EBIT						
Speciality Chemicals	237.15	129.62	83.0	752.75	814.11	-7.5
Pharmaceuticals	47.65	45.31	5.2	204.58	137.46	48.8
Total	284.80	174.93	62.8	957.33	951.57	0.6
Interest	38.29	25.32	51.2	86.37	124.78	-30.8
Other Unallocable Exp. (net of income)	39.53	44.71	-11.6	206.41	150.61	37.0
PBT	206.98	104.90	97.3	664.54	676.16	-1.7

Income Statement - Consolidated

Figures in Rs crs

	FY19	FY20	FY21	FY22e	FY23e
Income from operations (net)	4167.56	4186.29	4506.10	5153.89	6045.80
<i>Growth (%)</i>	18.7	0.4	7.6	14.4	17.3
Other Income	2.11	8.84	0.70	14.86	16.99
Total Income	4169.67	4195.13	4506.80	5168.74	6062.80
Total Expenditure	3202.47	3208.97	3524.57	3920.08	4542.85
EBITDA (other income included)	967.20	986.16	982.23	1248.66	1519.95
Interest	182.54	124.78	86.37	140.61	136.83
EBDT	784.66	861.38	895.86	1108.05	1383.11
Depreciation	162.68	185.21	231.31	309.11	376.71
Tax	117.80	129.42	129.33	161.39	203.29
Net profit	504.17	546.74	535.22	637.56	803.11
Minority interest	12.44	10.68	11.75	11.00	11.00
Net profit after MI	491.73	536.06	523.46	626.56	792.11
Extraordinary item	1.35	6.79	0.27	0.00	0.00
Adjusted Net Profit	490.38	529.27	523.19	626.56	792.11
EPS (Rs.)	15.08	15.19	15.01	17.28	21.85

Segment Results

Figures in Rs crs

	FY19	FY20	FY21	FY22e	FY23e
Segment Revenue					
Speciality Chemicals	3979.70	3864.95	4151.40	4732.60	5584.46
Pharmaceuticals	725.81	755.74	871.88	993.94	1133.10
Total	4705.51	4620.69	5023.28	5726.54	6717.56
Less GST	537.95	434.38	517.18	572.65	671.76
Net	4167.56	4186.29	4506.10	5153.89	6045.80
Segment EBIT					
Speciality Chemicals	819.57	814.11	752.75	911.02	1116.89
Pharmaceuticals	112.68	137.46	204.58	203.76	237.95
Sub Total	932.25	951.57	957.33	1114.78	1354.84
Interest	182.54	124.78	86.37	140.61	136.83
Other Unallocable Exp. (net of income)	127.74	150.61	206.41	175.23	211.60
PBT	621.98	676.17	664.55	798.95	1006.41

Consolidated Balance Sheet

Figures in Rs crs

	FY19	FY20	FY21	FY22e	FY23e
SOURCES OF FUNDS					
Share Capital	43.33	87.12	87.12	181.25	181.25
Reserves	2587.44	2891.65	3415.78	5039.23	5722.59
Total Shareholders Funds	2630.77	2978.77	3502.90	5220.48	5903.84
Minority Interest	83.95	94.62	12.24	23.24	34.24
Long term debt	814.80	580.84	1268.05	1168.05	1068.05
Total Liabilities	3529.52	3654.23	4783.19	6411.77	7006.13
APPLICATION OF FUNDS					
Gross Block	3361.80	3837.04	5155.49	6755.49	7755.50
Less: Accumulated Depreciation	1215.12	1368.55	1562.91	1872.02	2248.73
Net Block	2146.68	2468.49	3592.58	4883.47	5506.77
Capital Work in Progress	794.57	1417.64	1297.91	1000.00	900.00
Investments	33.16	37.01	63.52	63.51	63.51
Current Assets, Loans & Advances					
Inventory	771.79	835.68	935.68	1010.53	1111.59
Sundry Debtors	776.04	753.44	793.73	849.29	917.23
Cash and Bank	804.20	247.29	412.32	336.04	518.76
Other Assets	225.08	168.46	225.87	243.54	262.94
Total CA & LA	2577.11	2004.87	2367.60	2439.40	2810.53
Current liabilities	1889.75	1876.47	2360.02	1886.59	2246.96
Provisions	42.42	39.91	40.12	45.97	49.53
Total Current Liabilities	1932.17	1916.38	2400.14	1932.55	2296.49
Net Current Assets	644.94	88.49	-32.54	506.85	514.03
Net Deferred Tax (net of liability)	-193.01	-211.00	-233.94	-253.94	-273.94
Other Assets (Net of liabilities)	103.19	-146.40	95.66	211.89	295.76
Total Assets	3529.52	3654.23	4783.19	6411.77	7006.13

Key Financial Ratios

	FY19	FY20	FY21	FY22e	FY23e
Growth Ratios					
Revenue (%)	18.7	0.4	7.6	14.4	17.3
EBIDTA (%)	37.8	1.3	0.4	27.2	21.7
Net Profit (%)	49.5	7.9	-1.1	19.8	26.4
EPS (%)	49.5	0.7	-1.1	15.1	26.4
Margins					
Operating Profit Margin (%)	23.2	23.3	21.8	23.9	24.9
Gross Profit Margin (%)	18.8	20.4	19.9	21.5	22.9
Net Profit Margin (%)	12.1	12.9	11.9	12.4	13.3
Return					
ROCE (%)	14.8	12.6	10.6	10.8	11.7
ROE (%)	23.8	19.2	16.3	14.5	14.4
Valuations					
Market Cap / Sales	3.3	3.2	5.1	6.6	5.6
EV/EBIDTA	15.8	15.6	25.9	29.1	23.9
P/E	26.2	25.2	43.9	54.1	42.8
P/BV	5.3	4.5	6.7	6.6	5.8
Other Ratios					
Interest Coverage	4.4	6.4	8.7	6.7	8.4
Debt-Equity Ratio	0.9	0.7	0.8	0.5	0.4
Current Ratio	1.3	1.0	1.0	1.2	1.2
Turnover Ratios					
Fixed Asset Turnover	2.0	1.8	1.5	1.2	1.2
Total Asset Turnover	1.4	1.2	1.1	0.9	0.9
Debtors Turnover	5.8	5.5	5.8	6.3	6.8
Inventory Turnover	4.2	4.0	4.0	4.0	4.3
Creditors Turnover	10.1	10.3	7.6	7.2	8.7
WC Ratios					
Debtor Days	62.7	66.7	62.7	58.2	53.3
Inventory Days	86.6	91.4	91.7	90.6	85.3
Creditor Days	36.3	35.5	47.7	51.0	42.1
Cash Conversion Cycle	112.9	122.6	106.7	97.8	96.5

Cumulative Financial Data

Figures in Rs crs	FY12-14	FY15-17	FY18-20	FY21-23e
Income from operations	6402	8638	11864	15706
Operating profit	1012	1692	2642	3718
EBIT	792	1397	2150	2833
PBT	507	1025	1711	2470
Profit after MI & associate profit	391	772	1348	1942
OPM (%)	15.8	19.6	22.3	23.7
NPM (%)	5.7	9.1	11.7	12.6
Interest coverage	2.8	3.8	4.9	7.8
ROE (%)	18.7	23.1	20.8	14.7
ROCE (%)	13.4	14.7	14.3	11.4
Debt-equity ratio*	1.2	1.1	0.7	0.4
Fixed asset turnover	3.4	2.3	1.9	1.3
Debtors turnover	5.5	5.9	6.2	6.3
Inventory turnover	4.0	3.9	4.4	4.1
Creditors turnover	7.1	6.9	9.5	9.1
Debtors days	66.3	61.3	59.0	58.2
Inventory days	91.4	92.8	83.5	88.9
Creditor days	51.4	52.7	38.3	39.9
Cash conversion cycle	106.4	101.5	104.2	107.2

FY12-14 implies three years ending fiscal 14; *as on terminal year

Revenue recognition from second and third long term contracts coupled with expansion of NCB capacity and ramp up of newly commenced capacities of chlorination and phase 2 unit at Dahej SEZ would little suppress revenues during FY21-23 – cumulative revenues estimated to rise by 32.4% (see table). Higher scaling would anything but diminish OPMs – projected at 23.7% Vs 22.3% during FY18-20 - as ramp up in volumes of speciality chemicals would spark benefits of operating leverage. Yet revenue scaling would fail to catch up with addition to fixed assets for the fixed asset turnover is projected to decline to 1.3 during FY21-23e from 1.9 in FY18-20. Wherefore, over 40% growth in cumulative post tax earnings during FY21-23 period would fail to galvanize ROE which is estimated to decline to 14.7% from 20.8% (see table). Strong cash flows would help finance capex largely through internal accruals, thus supporting buoyancy in interest coverage ratio.

Financial Summary – US dollar denominated

million \$	FY19	FY20	FY21	FY22e	FY23e
Equity capital	6.3	11.6	11.9	24.5	24.5
Shareholders funds	369.8	392.8	469.2	699.5	792.1
Total debt	347.1	278.3	386.9	320.7	293.6
Net fixed assets (incl CWIP)	425.2	515.5	665.3	796.7	867.5
Investments	4.8	4.9	8.6	8.6	8.6
Net current assets	82.7	9.4	-11.8	61.3	62.2
Total assets	499.7	482.4	643.3	860.9	941.3
Revenues (Gross)	596.3	590.6	607.3	697.9	818.7
EBITDA	138.1	137.9	132.3	169.1	205.8
EBDT	112.0	120.3	120.7	150.0	187.3
PBT	88.8	94.2	89.5	108.2	136.3
Profit after MI	70.2	74.7	70.5	84.8	107.3
EPS(\$)	0.22	0.21	0.20	0.23	0.30
Book value (\$)	1.07	1.13	1.35	1.93	2.19

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rates(Rs 73.85/\$). All dollar denominated figures are adjusted for extraordinary items.

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

Exchange Rates Used- Indicative

Rs/\$	FY18	FY19	FY20	FY21
Average	64.45	69.89	70.88	74.20
Year end	65.04	69.17	75.39	73.50

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.