CD Equisearch Pvt Ltd

CHANGING DIMENSIONS
CD EQUISEARCH

May 31, 2021

Orient Refractories Ltd.	
No. of shares (m)	120.1
Mkt cap (Rs crs/$m)	3680/508.0
Current price (Rs/$)	306/4.2
Price target (Rs/$)	276/3.8
52 W H/L (Rs.)	337/139
Book Value (Rs/$)	38/0.5
Beta	1.0
Daily volume NSE (avg. monthly)	314890
P/BV (FY21e/22e)	6.1/7.1
EV/EBITDA (FY21e/22e)	20.9/24.0
P/E (FY21e/22e)	33.6/37.7
EPS growth (FY20/21e/22e)	-3.3/-7.2/20.9
OPM (FY20/21e/22e)	17.4/16.1/16.4
ROE (FY20/21e/22e)	23.6/19.1/20.3
ROCE(FY20/21e/22e)	23.6/19.1/20.3
D/E ratio (FY20/21e/22e)	0.0/0.0/0.0
BSE Code	534076
NSE Code	ORIENTREF
Bloomberg	ORIENT IN
Reuters	ORRE.NS

Shareholding pattern	%
Promoters	66.5
MFs / Banks / FIs	11.9
Foreign Portfolio Investors	1.5
Govt. Holding	-
Public & Others	20.2
Total	**100.0**

As on 31.03.2021

Recommendation

HOLD

Phone: + 91 (33) 4488 0011

E- mail: research@cdequi.com

Quarterly Highlights

- The World Steel Association (WSA) forecasts the global steel demand to grow by 5.8% in 2021 primarily supported by a robust consumption growth of 9.1% in China and by substantial fiscal stimulus measures in most of the advanced economies. Domestically, India's steel demand is expected to rebound by 19.8% in 2021 after declining 13.7% in 2020, while the growth in 2022 is expected to be lower at 5.9%. The economy has been recovering strongly since August last year, much sharper than expected, with the resumption of government projects and pent-up consumption demand. However, the devastating second wave and renewed rounds of localized lockdown have slowed down the industrial activities and raised the level of business uncertainty.
- Driven by an uptick in the domestic steel market and soaring prices, ORL clocked revenues of Rs 200.88 cr in the third quarter, an increase of 19.4% year-over-year. This robust top-line performance helped the company's operating profit grew 25.8% to Rs.35.10 cr, despite the rise in cost of raw materials consumed. However, ORL is currently facing some difficulties in procuring raw materials from China and has also witnessed few rounds of increase in freight prices.
- Pre-tax earnings in the third quarter improved 22.6% y-o-y to Rs.32.34 cr, whereas post tax earnings increased by over 23% to Rs.24.39 cr. For the nine month period, PAT declined by almost 20% to Rs.54.75 cr partially due to the unrestrained effects of the pandemic in the first quarter.
- The stock currently trades at 45.6x FY21e EPS of Rs.6.71 and 37.7x FY22e EPS of Rs.8.11. The continued surge in steel industry and additional contribution from Manishri plant this fiscal should uplift revenue by 15.2% to Rs 824 crs. Net Profit is expected to near Rs.100 cr on the back of gains due to operating leverage. ROE will improve to 20.3% this fiscal, but down from 23.6% in FY20. However, difficulty in sourcing certain raw materials like magnesite (one of its main raw materials) from abroad due to restriction in mining activities in China could pressurize future gross margins. On balance we assign hold rating on the stock with a target of Rs 276 (previous target Rs 225) based on 34x FY22e earnings.

Consolidated (Rs crs)	FY18	FY19	FY20	FY21e	FY22e
Income from operations	628.42	747.95	699.69	715.37	824.14
Other Income	10.62	18.17	6.61	6.95	11.44
EBITDA (other income included)	137.67	146.15	128.42	121.79	146.71
PAT after EO	85.95	89.84	86.85	80.59	97.40
EPS(Rs)	7.15	7.48	7.23	6.71	8.11
EPS growth (%)	24.7	4.5	-3.3	-7.2	20.9

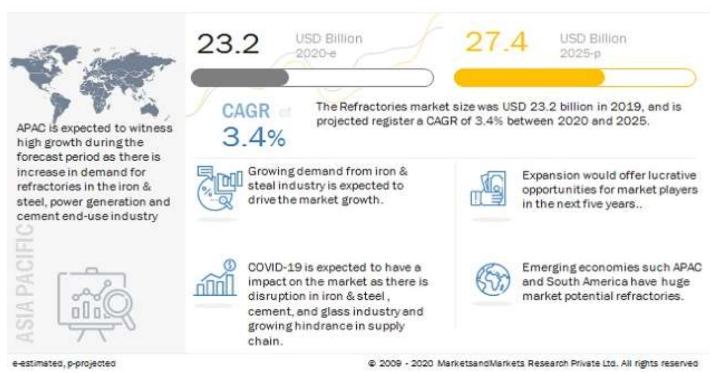
Outlook & Recommendation

Refractories Industry

The rebound of demand in the end-user industries, such as iron and steel, cement, ceramics, etc., is supporting the growth of the global refractories industry. Last year, around the same time pandemic-induced lockdowns led to a temporary halt in industrial activities, and the refractories market also witnessed its repercussion in terms of both productions and demand. Currently, leading companies are primarily focused on strengthening their supply chains to revive their business and exploring new methods to tackle the challenges posed by the novel corona virus. According to a recently published report by Markets and Markets, the global market for refractories stood at $23.2 billion in 2020 and is projected to reach USD 27.4 billion by 2025, growing at a CAGR of 3.4% during the forecast period.

Asia-Pacific countries are the global frontrunner in refractories market in terms of consumption in the iron and steel industry, followed by Europe and North America. Rising urbanization and industrialization over the years in emerging countries like China and India has led to substantial spending on construction activities and improvement in the existing infrastructure. These developments are expected to have a significant impact on the refractories market.

Source: Mordor Intelligence



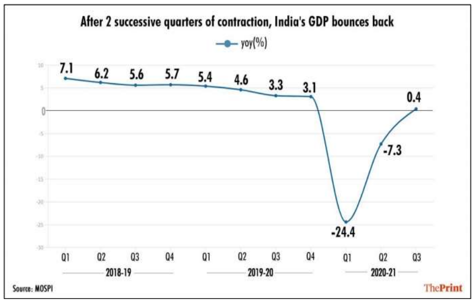
Source: Markets and Markets

On the domestic front, refractory industry has managed to increase its revenues steadily over the years, driven by the government's proactive approach towards boosting infrastructural growth. Indian refractory market was sized an estimated Rs 9,000 crs as of last year, with the domestic steel industry by far its largest customer. However, the industry is heavily dependent on China in terms of production due to the lack of local availability of raw materials such as magnesite and bauxite. Additionally, they are available at cost effective price as compared to other producers.

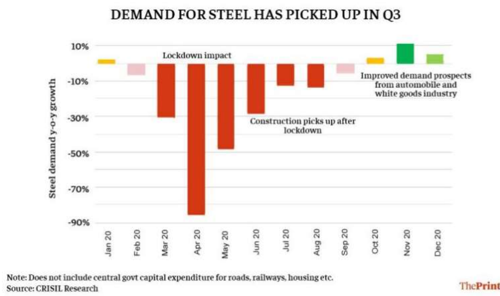
Steel Industry

In the recent Short Range Outlook April 2021, the World Steel Association (WSA) forecast the global steel demand to grow by 5.8% in 2021 to reach 1,874.0 million tonnes (Mt). Despite the disastrous impact of the pandemic on global demand, the overall steel industry witnessed only a minor contraction of 0.2% in 2020 in global demand. This support was primarily due to a robust growth of 9.1% in China and due to substantial fiscal stimulus measures in advanced economies, which led to a quick rebound in the second half of the last year. It is largely assumed that the ongoing second or third waves of infections will stabilize by mid-2021 due to worldwide rammed-up vaccination efforts, which will further pave way for steel demand to grow by 2.7% in 2022. In fact, the world crude steel production totaled 315.0 Mt during the initial two-month period of the current year, 6.6% higher compared with the corresponding 2020 period.

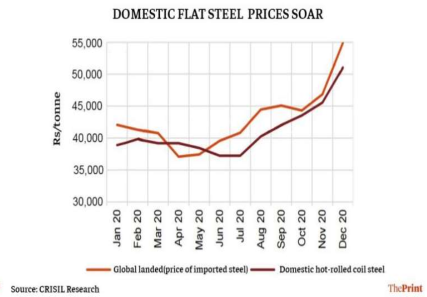
On the domestic front, according to WSA, India suffered severely from an extended period of severe lockdown that led to a downfall in steel demand by 13.7% in 2020. However, a sharp rebound in construction and manufacturing helped the Indian economy move back into positive territory after two successive quarters of contraction. In fact, according to Joint Plant Committee, Ministry of Steel, FY21 third quarter total steel output of Jindal Steel and Power Ltd., JSW Steel Ltd., SAIL and Tata Steel India stood at 14.95 MT, a 6% year-over-year increase. These four companies contribute around 45% to India's annual steel production. WSA forecasts India's steel demand to rebound by 19.8% to exceed the 2019 level in 2021, primarily driven by the growth-oriented government agenda.



Source: MOSPI



Source: Crisil Research



Source: Crisil Research

Offsetting the negative impact of pandemic on the steel industry, the Union Budget 2021-22 enhanced investments in the infrastructure and related segments (allocation of Rs 5.54 lakh crores, a 26% increase from 2020-21 RE), which is expected to create a demand spike for steel in the economy. However, due to the concerns over cartelization of industry and increasing steel prices raised by Union Minister Nitin Gadkari and the Federation of Indian Mineral Industries (FIMI), the government had little choice but to bring its protectionist policies down by facilitating steel imports. In the Budget, the government reduced import duties marginally and did away with anti-dumping duty and countervailing duties for a specific time period.

Amalgamation

The Scheme of Amalgamation of RHI Clasil Private Limited (RHI Clasil), RHI India Private Limited (RHI India) and Orient Refractories Limited (ORL) had received the required approval by the Hon'ble National Company Law Appellate Tribunal, (NCLAT) on 19 January, 2021. Moreover, the Hon'ble National Company Law Tribunal (NCLT), Mumbai bench has sanctioned the amalgamation through an order dated 5 May, 2021.

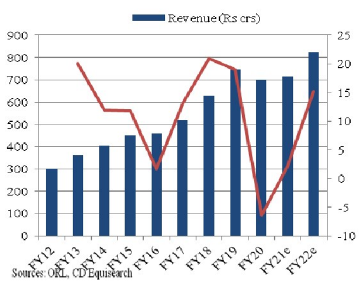
RHI India with its FY20 revenues of around Rs.566 crs is in the business of trading refractories items and rendering management services related to refractories for steel and non-ferrous industry. The company is primarily engaged in the lining business and mainly imports majority of its products. RHI Clasil, on the other hand, with revenue of Rs.290 crs, is engaged in the manufacture and sale of refractory bricks and other refractory products.

The management has communicated that the integration of these three separate legal entities would result in improved capital allocation and cash flows optimization; and enhancement of shareholder value pursuant to economies of scale and business efficiencies. However, one must not expect any major operational gains as all the three businesses operate in different product segments. Nevertheless, there would be some administrative cost savings. The idea was to provide total customer solutions under one umbrella. Furthermore, the merger would enable ORL to serve integrated steel plants under Make-in-India scheme. Since financials of the merging entities are not publically available, we have not considered them in our projections.

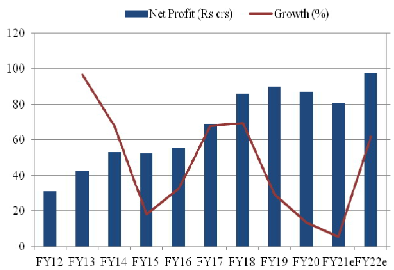
Financials & Valuation

There has been a strong rally in metal stocks due to the rise in metal prices, especially steel. This momentum is driven mainly by a global demand recovery in key end-markets, such as automotive, manufacturing, construction and infrastructure, along with some consolidation in major steel markets that is increasing capacity utilization. Orient Refractories has been one of the direct beneficiaries of the metal bull market. With capacity utilization being sub-optimal in the first-half of the year due to the pandemic imposed restrictions, strong demand in the later part of the year has helped the company ramp-up capacity to near-full.

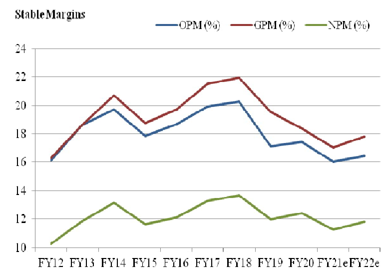
Although the overall market for the company remains positive, but shortage of raw materials and adequate labour force pose strong headwinds that could take months to stabilize. The company is currently focused on maintaining a healthy inventory position of raw materials. Raw material prices are going up due to restrictions on mining by Chinese government leading to scarcity of materials. Due to supply disruptions, lead time has gone up and the company has also witnessed relentless increase in freight prices. These factors might put the future gross margins of ORL under pressure.



Sources: ORL, CD Equisearch

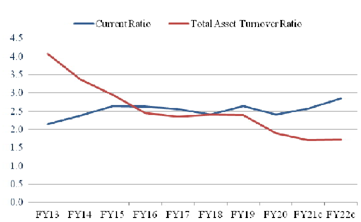


Sources: ORL, CD Equisearch

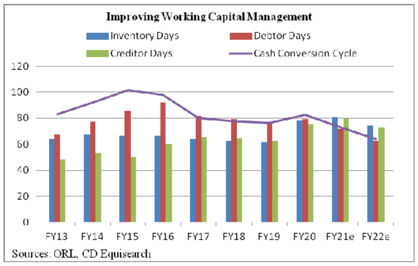


Sources: ORL, CD Equisearch

ORL delivered a strong performance in the December 2020 quarter i.e. Q3FY21. Its consolidated revenue for the quarter came in at Rs 200.88 crs, registering a growth of 19.4% from the same period last fiscal mainly led by a rise in the demand from the steel industry. EBITDA for the quarter grew by 22.4% year-over-year to Rs 36 crs, compared to Rs 29.42 crs in Q3 of previous fiscal. Given the strong quarter, we revise our revenue growth expectations for FY21 from a decline of 11.7% to a slight yearly growth of 2.2% now. We expect sales to grow by 15.2% to Rs 824.14cr this fiscal, partially accentuated by higher steel demand and higher contribution from the Manishri plant (this forecast is based on the assumption of not much disruption due to the pandemic this fiscal).



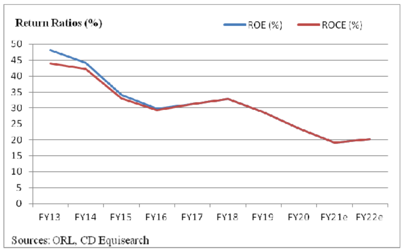
Sources: ORL, CD Equisearch



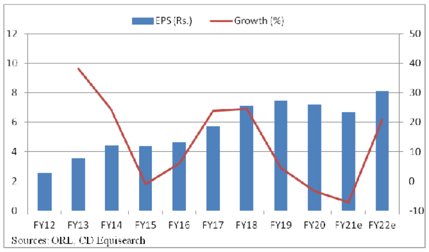
Sources: ORL, CD Equisearch

As far as the lately acquired assets from Manishri Refractories are concerned, its throughput would get a boost from infrastructural modifications undertaken recently, thereby propelling its production capacity to 15000 mt. As per media reports, being a market leader in supply of special refractories to local steel blast furnaces, ORL is planning to enter the steel foundry segment for special casting and forged products, demand for which is rapidly rising from key industries like automobiles, engineering, and plant and equipment manufacturing. Furthermore, with the purpose of expanding the product portfolio with Indian markets at the forefront of its focus, ORL is setting up a R&D Unit in Bhiwadi, Rajasthan.

The stock currently trades at 45.6x FY21e EPS of Rs 6.71 and 37.7x FY22e EPS of Rs 8.11. While the steel market has grown substantially since the beginning of the year, the refractory industry is largely dependent on the continuity of this growth. Our earnings forecast is based on the premise that the ongoing second wave of the infections would stabilize by the first half and that steady progress on vaccinations would allow a gradual return to normality. Earnings are estimated to rise up by 20.9% in the current fiscal as the company ramps up production of Manishri plant, thus boosting return of capital – ROE estimated at 20.3% vs 19.1% in FY21. Balancing odds, we maintain our hold rating on the stock with revise target of Rs 276 (previous target: Rs 225) based on 34x FY22e earnings. For more info refer to our November report.



Sources: ORL, CD Equisearch



Sources: ORL, CD Equisearch

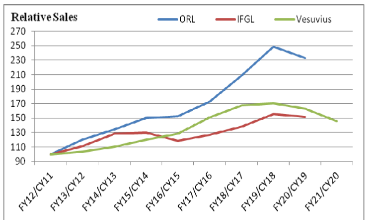
Cross Sectional Analysis

Company	Equity*	CMP	MCAP*	Sales*	Profit*	OPM (%)	NPM (%)	Int. Cov.	ROE (%)	Mcap/sales	P/BV	P/E
Orient Refrac.	12	306	3680	659	73	16.2	11.1	-	17.1	5.6	8.1	50.2
IFGL Refrac.	36	367	1323	961	60	13.7	6.2	28.1	8.0	1.4	1.7	22.1
Vesuvius	20	1011	2053	834	51	9.0	6.1	-	6.1	2.5	2.4	40.6

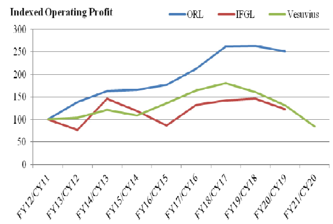
*figures in crores; calculations on ttm basis; book value adjusted for goodwill where applicable; standalone or consolidated data as available.

IFGL reported record sales, EBITDA and PAT in the third quarter of FY21. Revenues improved by around 33% to Rs.289 cr y-o-y- with majority of the growth coming from domestic markets. It expects the steel demand to gradually reach pre-Covid levels mainly aided by government investments in infrastructure. Despite its gross material margins declining by 282 bps to 4.7% in Q3 on a y-o-y basis, on quarter-over-quarter basis it improved by 252bps – the company attributes this to several cost optimization efforts. OPM stood at 16.9%, a 710 bps increase y-o-y. EPS, on the other hand, improved 413% over the same period to Rs.10.34. Also as a part of its capacity expansion plan, IFGL has acquired 10 acre of land in Viskhapatnam for manufacturing new products including monolithic, precast shapes, etc. It expects to complete Phase I of Vishakhapatnam project costing Rs.30 cr by June 2021.

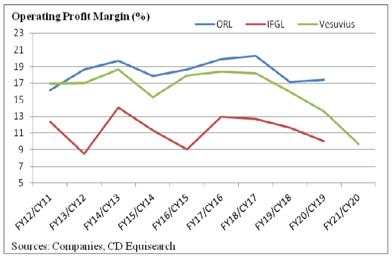
The COVID-19 pandemic had its ultimate impact on the financials of Vesuvius India causing imbalances in the market dynamics, with supplies chasing demands. Due to a turbulent first half its revenues in CY20 declined by some 11% to Rs 791.51cr. This decline was broadly in line with steel production decline of 12% y-o-y. However, large mills' production dipped mere 2% over the same period. Even margins were hit sharply in CY20 with a gross margin (material) dip of ~170bps to 40.7% and OPM declining ~390bps to 9.7%. Net profit declined 13.51% to Rs 16.13 cr in the quarter ended March 2021 as against Rs 18.65 cr.



Base Year FY12/CY11=100
Sources: Companies, CD Equisearch



Base Year FY12/CY11=100
Sources: Companies, CD Equisearch



Sources: Companies, CD Equisearch

Note: Graphs on standalone or consolidated data as available.

Financials

Consolidated Quarterly Results

Figures in Rs crs

	Q3FY21	Q3FY20	% chg	9MFY21	9MFY20	% chg
Income From Operations	**200.88**	**168.24**	**19.4**	**496.87**	**537.30**	**-7.5**
Other Income	0.89	1.52	-41.7	4.66	5.19	-10.2
Total Income	**201.77**	**169.76**	**18.9**	**501.53**	**542.49**	**-7.5**
Total Expenditure	165.78	140.34	18.1	417.90	443.28	-5.7
EBITDA (other income incl.)	**35.99**	**29.42**	**22.4**	**83.64**	**99.20**	**-15.7**
Interest	-	-	-	-	-	-
Depreciation	3.65	3.04	19.9	10.32	8.06	28.1
PBT	**32.34**	**26.37**	**22.6**	**73.31**	**91.14**	**-19.6**
Tax	7.95	6.61	20.3	18.56	22.82	-18.7
PAT	**24.39**	**19.77**	**23.4**	**54.75**	**68.32**	**-19.9**
Extraordinary Item	-	-	-	-	-	-
Adjusted Net Profit	**24.39**	**19.77**	**23.4**	**54.75**	**68.32**	**-19.9**
EPS	2.03	1.65	23.4	4.56	5.69	-19.9

Consolidated Income Statement

Figures in Rs crs

	FY18	FY19	FY20	FY21e	FY22e
Income From Operations	628.42	747.95	699.69	715.37	824.14
Other Income	10.62	18.17	6.61	6.95	11.44
Total Income	**639.04**	**766.12**	**706.30**	**722.32**	**835.58**
Total Expenditure	501.37	619.97	577.87	600.53	688.87
EBITDA (other income incl.)	**137.67**	**146.15**	**128.42**	**121.79**	**146.71**
Interest	-	-	-	-	-
Depreciation	6.83	8.63	11.09	14.10	16.56
PBT	**130.85**	**137.52**	**117.33**	**107.69**	**130.16**
Tax	45.01	47.70	30.46	27.11	32.76
PAT	**85.83**	**89.83**	**86.87**	**80.59**	**97.40**
Extraordinary Item	-0.12	-0.01	0.01	-	-
Adjusted Net Profit	**85.95**	**89.84**	**86.85**	**80.59**	**97.40**
EPS (Rs)	7.15	7.48	7.23	6.71	8.11

Note: Merger not considered for FY21 and FY22 projections.

Consolidated Balance Sheet Figures in Rs crs

	FY18	FY19	FY20	FY21e	FY22e
Sources of Funds					
Share Capital	12.01	12.01	12.01	12.01	12.01
Reserves & Surplus	310.80	364.22	414.29	464.84	532.20
Total Shareholders' Funds	**322.81**	**376.24**	**426.30**	**476.85**	**544.22**
Long Term Debt	-	-	-	-	-
Total Liabilities	**322.81**	**376.24**	**426.30**	**476.85**	**544.22**
Application of Funds					
Gross Block	52.98	81.40	165.90	197.60	217.60
Less: Accumulated Depreciation	12.81	21.40	32.63	46.73	63.28
Net Block	**40.17**	**60.00**	**133.27**	**150.87**	**154.31**
Capital Work in Progress	14.01	2.72	3.70	2.00	2.00
Investments	107.68	103.16	-	-	-
Current Assets, Loans & Advances					
Inventory	91.06	117.44	130.99	133.61	146.97
Trade Receivables	159.43	157.43	146.41	135.92	148.35
Cash and Bank	12.72	27.87	119.40	159.75	198.49
Other Assets	15.74	32.58	41.20	48.06	53.22
Total CA & LA	**278.94**	**335.33**	**438.00**	**477.34**	**547.02**
Current Liabilities	122.21	129.79	151.93	156.12	161.92
Provisions-Short term	2.73	0.34	0.00	0.00	0.00
Total Current Liabilities	**124.94**	**130.13**	**151.93**	**156.12**	**161.92**
Net Current Assets	154.00	205.20	286.07	321.22	385.11
Net Deferred Tax	1.47	-1.01	-0.53	-0.43	-0.43
Net long term assets	5.48	6.15	3.79	3.19	3.22
Total Assets	**322.81**	**376.24**	**426.30**	**476.85**	**544.22**

Note: Merger not considered for FY21 and FY22 projections.

Key Financial Ratios

	FY18	FY19	FY20	FY21e	FY22e
Growth Ratios (%)					
Revenue	21.0	19.0	-6.5	2.2	15.2
EBITDA	23.5	6.0	-12.2	-5.2	20.5
Net Profit	24.7	4.5	-3.3	-7.2	20.9
EPS	24.7	4.5	-3.3	-7.2	20.9
Margins (%)					
Operating Profit Margin	20.2	17.1	17.4	16.1	16.4
Gross profit Margin	21.9	19.5	18.4	17.0	17.8
Net Profit Margin	13.7	12.0	12.4	11.3	11.8
Return (%)					
ROCE	32.8	28.7	23.6	19.1	20.3
ROE	32.8	28.7	23.6	19.1	20.3
Valuations					
Market Cap/ Sales	3.0	3.8	2.0	3.8	4.5
EV/EBITDA	13.0	18.7	10.0	20.9	24.0
P/E	22.3	31.9	16.2	33.6	37.7
P/BV	6.7	8.4	3.6	6.1	7.1
Other Ratios					
Interest Coverage	-	-	-	-	-
Debt Equity	0.0	0.0	0.0	0.0	0.0
Current Ratio	2.4	2.6	2.4	2.6	2.8
Turnover Ratios					
Fixed Asset Turnover	16.2	14.9	7.2	5.0	5.4
Total Asset Turnover	2.4	2.4	1.9	1.7	1.7
Debtors Turnover	4.6	4.7	4.6	5.1	5.8
Inventory Turnover	5.8	5.9	4.7	4.5	4.9
Creditor Turnover	5.7	5.9	4.9	4.6	5.0
WC Ratios					
Debtor Days	79.4	77.3	79.3	72.0	62.9
Inventory Days	62.8	61.4	78.5	80.4	74.3
Creditor Days	64.5	62.1	74.9	79.5	73.1
Cash Conversion Cycle	77.7	76.6	82.8	72.9	64.2

Cumulative Financial Data

Rs crs	FY14-16	FY17-19	FY20-22e
Income from operations	1314	1896	2239
Operating profit	246	359	372
EBIT	243	374	355
PBT	243	374	355
PAT	161	245	265
Dividends	59	109	90
Sales growth (%)	-	44.3	18.1
PAT growth (%)	-	51.9	8.2
OPM (%)	18.7	18.9	16.6
GPM (%)	19.7	20.9	17.7
NPM (%)	12.3	12.9	11.8
ROE (%)	35.0	30.0	20.7
ROCE (%)	34.4	30.0	20.7
Debt-Equity ratio*	-	-	-
Fixed asset turnover	13.7	13.4	7.0
Total asset turnover	2.9	2.3	1.7
Debtors turnover	4.6	4.6	4.9
Creditors turnover	6.2	5.6	4.9
Inventory turnover	5.9	5.6	4.7
Debtor days	79.2	79.7	74.8
Creditor days	59.1	65.3	73.8
Inventory days	62.1	64.7	77.5
Cash conversion cycle	82.2	79.1	78.5
Dividend payout ratio (%)	36.4	44.4	34.0

FY14-16 implies three year period ending fiscal16;*as on terminal year.

Much of the vibrancy in cumulative sales of FY20-22e has been thwarted by demand disruptions in FY20 & FY21 due to pandemic induced slowdown last year in Indian steel industry hurting dispatches of refractories. Cumulative revenues grew only 18.1% in FY20-22e. This will be followed by fall in OPM over the cumulative 3 year period from 18.9% in FY17-19 to 16.6% in FY20-22e. There would be a slump in ROE by almost 930 bps in FY20-22e mainly due to weak profitability in first half of last fiscal and lower asset turnovers - fixed asset turnover is expected to fall from 13.4 in the previous three year period to 7 in FY20-22e (see table).

Buoyancy in earnings would largely depend upon the robustness of growth of the Indian steel industry and ability to manage supply chain disruptions of raw materials. However, effect of higher inventory days would be counterbalanced by higher creditor days (73.8 days in FY20-22e vs 65.3 days in FY17-19), keeping cash conversion cycle almost flat over the years (see table).

Financial Summary- US Dollar denominated

million $	FY18	FY19	FY20	FY21e	FY22e
Equity capital	1.8	1.7	1.6	1.6	1.7
Shareholders funds	44.1	49.2	52.6	60.8	71.0
Total debt	0.0	0.0	0.0	0.0	0.0
Net fixed assets (incl CWIP)	8.3	9.1	18.2	20.8	21.6
Investments	16.6	14.9	-	-	-
Net current assets	18.1	24.4	34.0	39.6	49.0
Total assets	44.1	49.2	52.6	60.8	71.0
Revenues	97.5	107.0	98.7	96.4	113.8
EBITDA	21.4	20.9	18.1	16.4	20.3
PBDT	21.4	20.9	18.1	16.4	20.3
PBT	20.3	19.7	16.6	14.5	18.0
PAT	13.3	12.9	12.3	10.9	13.4
EPS($)	0.11	0.11	0.10	0.09	0.11
Book value ($)	0.37	0.41	0.44	0.51	0.59

Income statement figures translated at average rates; balance sheet at year end rates; projections at current rates (Rs 72.44/$).
All dollar denominated figures are adjusted for extraordinary items.

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CD Equisearch Private Limited (CIN: U67120WB1995PTC071521)
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/$	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.