

Finolex Industries Ltd.

No. of shares (m)	618.4
Mkt cap (Rs crs/\$m)	8221/997.6
Current price (Rs/\$)	133/1.6
Price target (Rs/\$)	109/1.3
52 W H/L (Rs.)	234/122
Book Value (Rs/\$)	62/0.8
Beta	0.9
Daily volume NSE (avg. monthly)	515220
P/BV (FY23e/24e)	2.3/2.1
EV/EBITDA (FY23e/24e)	39.9/10.5
P/E (FY23e/24e)	150.1/19.6
EPS growth (FY22/23e/24e)	3.4/-92.7/666.9
OPM (FY22/23e/24e)	22.0/1.8/13.2
ROE (FY22/23e/24e)	23.4/1.5/11.3
ROCE (FY22/23e/24e)	22.5/1.8/10.8
D/E ratio (FY22/23e/24e)	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	9.8
FPIs	5.6
Govt. Holding	0.0
Public & Others	32.1
Total	100.0

As on Sep 30, 2022

Recommendation

REDUCE

Analyst

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Highlights

- Sharp correction in PVC prices in Q2 - with resulting fall in prices of PVC pipes & fittings - explains much of the carnage meted out on Finolex's Q2 earnings for its PVC resin business posted loss (EBIT level) of Rs 110.68 crs compared to gain of Rs 230.59 crs in the same quarter a year ago and EBIT of Rs 72.90 crs in Q1 of current fiscal. By some measure, PVC prices have corrected from some \$1450 /ton (average) in Q1 to some \$1020 per ton in Q2 and ended the second quarter with \$900 /ton.
- Margin in PVC pipes & fittings business was also found wanting for it posted a loss (EBIT level) of Rs 47.63 crs as against EBIT of Rs 57.45 crs in Q2 of last year and Rs 42.58 crs in Q1, at a time when volumes of PVC pipes & fittings grew by a barely unimpressive 6.8% to 59218 tons from 55453 tons in Q2 of previous fiscal. As a measure of hit in margins, PVC-VCM delta (average) plunged to \$235 / ton in Q2 to \$235/ton from \$275/ton in Q1 and \$391/ton in Q2 of previous fiscal. Further stress in margins is expected as the spread further declined to \$165/ton by end of Q2.
- Though prices of CPVC pipes and its volumes have hold well but puny volume of CPVC pipes in overall profile has limited scope to make any dent whatsoever. Whence, Finolex posted operating loss of Rs 142.67 crs last quarter compared to profit of Rs 299.51 crs in Q2 of last fiscal and Rs 125.91 crs in Q1 of current fiscal. Loss also surfaced at both pretax and post tax levels, standing at Rs 129.25 crs and Rs 93.92 crs respectively.
- Though PVC prices are expected to fall further - with fall out on PVC pipes & fittings - which may result in more inventory losses in the current quarter, Finolex expects declining prices to spur demand for PVC pipes, particularly agri pipes, at a time when channel inventory continues to remain low. However, relentless focus on non-agri pipes business could resurrect its share of overall volumes.
- The stock currently trades at 150.1x FY23e EPS of Rs 0.89 and 19.6x FY24e EPS of Rs 6.79. Hastened by relentless fall in PVC resin prices in last few months, Finolex's current year earnings stands dramatically cut but with little change in projected revenues, underscoring the stress in margins precipitated by inventory loss. Despite no small market share in agri pipes and growing share of non-agri pipes in overall revenues, Finolex has shown little pricing power, thus barely lending "velocity" to earnings - its EBIT has grown at just 5.8% CAGR in six years to FY22. Balancing odds, we assign "reduce" rating on the stock with revised target of Rs 109 (previous target: Rs 180) based on 16x FY24e earnings over a period of 6-9 months.

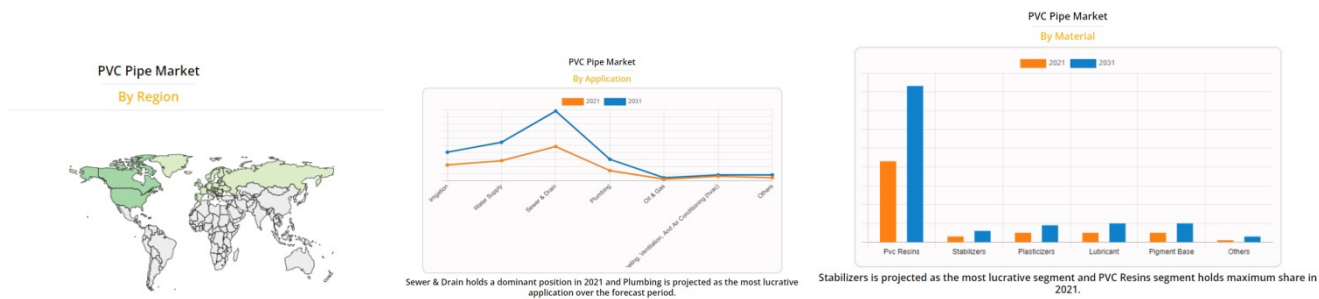
(Figures in Rs crs)	FY20	FY21	FY22	FY23e	FY24e
Income from operations	2984.51	3462.27	4647.42	3995.55	4340.61
Other Income	30.84	72.48	459.22	104.69	104.24
EBITDA (other income included)	478.28	1061.79	1482.96	178.41	675.89
Profit after EO	324.75	728.47	753.32	54.77	420.07
EPS (Rs)	5.23	11.74	12.14	0.89	6.79
EPS growth (%)	-11.8	124.3	3.4	-92.7	666.9

Investment Thesis

PVC Pipes Industry

According to some industry report, global PVC pipe market is projected to grow by a CAGR of 5.5% during 2021-31 period. Much of the growth in demand would accrue from the use of PVC pipes as a viable alternative to metal and concrete pipes in the construction industry. Sector wise, building & construction and irrigation industry would be flag bearers of demand for PVC industry over the next few years. Ease of installation of PVC pipes and its durability would doubtlessly help in boosting demand.

The report further reckons that increasing awareness about clean water supply and investments in developing regions are expected to buoy demand for PVC pipes in future. Further, molecularly oriented polyvinyl chloride (PVC-O) pipes have improved as a result of technological innovation that uses molecular orientation in PVC pipes.



Source: Allied Market Research

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Asia Pacific region, which accounted for some 44.2% share of PVC pipe market in terms of revenues in 2021, is expected to maintain its dominance during the forecast period. Much of this buoyancy is attributed to increase in construction activities in the region - particularly, maintenance and repair activities, owing to increase in government activities and initiatives. Generally speaking, the sewer & drain segment held significant share in PVC pipe market in 2021 and is expected to grow at a CAGR of 5.95 during the forecast period. The report contends that much of the demand for PVC pipes in sewer & drain application will be driven by increased government spending on efficient water management.

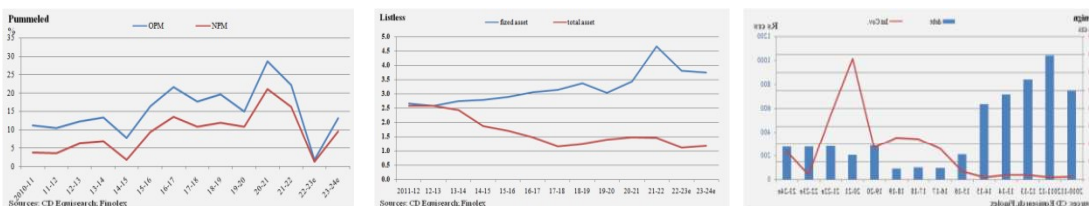
For India, GOI initiatives like Jal Jeevan Mission, and Pradhan Mantri Krishi Sinchayee Yojana (PMKSY) would be demand enablers for PVC pipes industry. Increasing allocations in these national schemes would help sustain the demand momentum. In India, rising demand in irrigation, water supply and sanitation sectors coupled with growing replacement of metal pipes in residential real estate market would support PVC pipes industry in years to come. Rising inflation along with little lessening tax compliance has eroded the competitiveness of unorganized players in domestic industry, thus benefitting the organized pipe manufacturers.

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Financials & Valuation

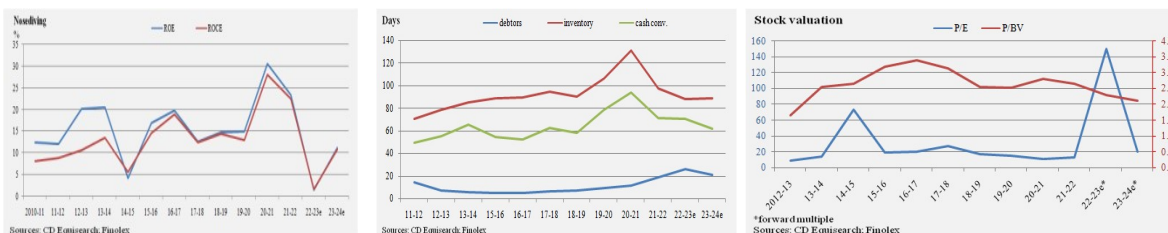
Growing market share of organized plastic piping industry - 65% by some estimate - bodes well for large pipe manufacturers for they also seem to be better equipped to manage cost inflation and mounting tax compliance. By some estimate, top five players form bulk of the market share of PVC pipes and fittings market in India. Organized players thus have a competitive edge in tapping increasing demand in rural India from some of the flagship Government of India schemes such as 'Har Ghar Nal se Jal', which strives to provide tap water to rural households.

With little need to ramp up PVC pipes & fittings capacity, Finolex would channelize much of its planned annual capex of Rs 200-250 crs in to maintenance and building moulds facility. Seemingly, much of the gyrations in its fixed asset turnover emanate from fluctuations in PVC resin prices - fixed asset turnover rose to 4.7 in FY22 from 3.0 in FY20 but is estimated to fall to 3.7 by FY24. With current stress in PVC prices, increasing capacity of PVC pipes & fittings - even though in modular fashion - remains a distant possibility at a time when Supreme Industries have been gradually ramping up capacity of its plastic piping business.



Spooked by inventory losses - in raw materials; semi-finished products; finished products (PVC pipes & fittings) - in last few months, Finolex Industries could see sharp erosion in margins in next few months, resulting in nerve -wracking fall in post tax earnings in the current fiscal. Operational efficiency in PVC resin manufacturing and benefits of backward integration would lend little support to its PVC pipes & fittings business not least due to no small inventory of essential raw materials like VCM, ethylene and EDC. Wherefore, PVC pipes & fittings business is estimated to post EBIT of just Rs 7.99 crs (previous year: Rs 250.24 crs) in the current fiscal - lowest reading in several years.

The stock currently trades at 150.1x FY23e EPS of Rs 0.89 and 19.6x FY24e EPS of Rs 6.79. Earnings are expected to rebound next fiscal with stability in prices of PVC resin, which would help arrest the mismatch between import parity prices of PVC and raw materials. Volumes of PVC pipes & fittings could advance by mid-single digit next fiscal. Yet fragile nature of recovery and little vivacity in Finolex's volumes of PVC pipes & fittings would cap FY24's post tax earnings to well nigh half of FY22's and thus would prevent meaningful recovery in return on equity - projected at 11.3% for FY24 as against 23.4% in FY22. Weighing odds, we assign "reduce" rating on the stock with revised target of Rs 109 (previous target: Rs 180) based on 16x FY24e earnings over a period of 6-9 months. For more info refer to our December report.



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Cross Sectional Analysis

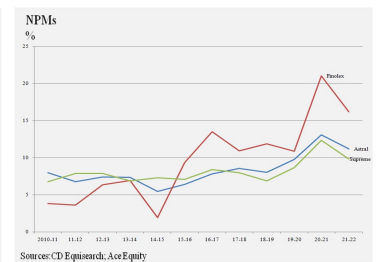
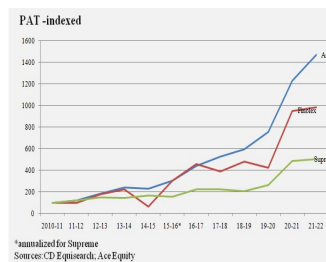
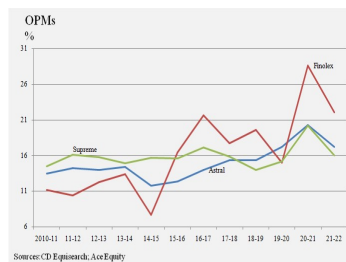
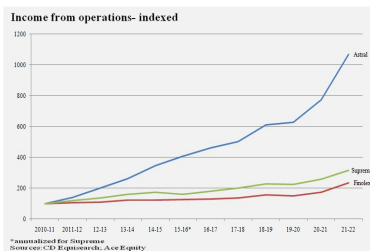
Company	Equity*	CMP	Mcap*	Sales*	Profit*	OPM (%)	NPM (%)	Int. Cov.	ROE (%)	DER	Mcap / sales	P/BV	P/E
Astral Ltd	20	1952	39316	4906	499	16.3	10.4	30.8	26.1	0.0	8.0	18.5	78.8
Finolex Ind.	124	133	8221	4730	378	10.5	8.0	20.9	10.4	0.0	1.7	2.1	21.8
Supreme Inds	25	2037	25880	8637	1012	14.9	9.2	231.0	29.1	-	3.0	6.8	25.6

*figures in crores; calculations on ttm basis

Book value adjusted for goodwill and revaluation reserves where applicable

Bolstered by robust growth in volumes of plumbing business, Astral reported 73.8% growth in standalone revenues to Rs 899.80 crs last quarter compared to Rs 517.80 crs in the same quarter a period ago. Despite no unremarkable growth in volumes, operating growth grew by some 28% to Rs 132.40 crs, resulting in over 500 bps fall in operating margins. Post tax earnings advanced by 26.55 to Rs 73 crs in Q2. In Q2, the company purchased faucets manufacturing ready to use assets at Jamnagar, which will help the company undertake timely production and improve product availability across the country. For its bath ware business, Astral is planning to set up multiple channel partnership-based showrooms in major Indian cities across the country.

Backed by robust growth of its plastic piping business, Supreme Industries reported 25.7% growth in consolidated net profit in Q2 on 64.4% growth in revenues. Moderation in margins in its flagship plastic piping business - 10.6% Vs 17% in Q2 last year vs 14.4% in Q1 - explains much of the moderation in operating margins. For strengthening its plastic piping business, Supreme plans to undertake capacity expansion, launch new products and launch new applications and systems. Overall capex for the current year is earmarked at Rs 700 crs including carry forward commitments of Rs 280 crs. Turnover of value added products did rise by some 47% last quarter when compared to that reported in the same quarter in previous period.



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Financials

Quarterly Results

	Figures in Rs crs					
	Q2FY23	Q2FY22	% chg.	H1FY23	H1FY22	% chg.
Income from operations	941.13	1082.57	-13.1	2130.94	2048.02	4.0
Other Income	39.29	31.82	23.5	64.36	45.22	42.3
Total Income	980.42	1114.39	-12.0	2195.30	2093.24	4.9
Total Expenditure	1083.80	783.06	38.4	2147.70	1537.05	39.7
EBIDTA (other income incl.)	-103.38	331.33	-131.2	47.60	556.19	-91.4
Interest	4.31	0.41	951.2	15.64	5.17	202.5
Depreciation	21.56	20.61	4.6	42.90	40.67	5.5
PBT	-129.25	310.31	-141.7	-10.94	510.35	-102.1
Tax	-35.33	75.23	-147.0	-17.11	128.47	-113.3
Net Profit	-93.92	235.08	-140.0	6.17	381.88	-98.4
Extraordinary Item	-	-	-	-	-	-!
Adjusted Net Profit	-93.92	235.08	-140.0	6.17	381.88	-98.4
EPS	-1.51	3.79	-139.9	0.10	6.15	-98.4

Segment results

	Figures in Rs crs					
	Q2FY23	Q2FY22	% chg.	H1FY23	H1FY22	% chg.
Segment Revenue						
PVC	481.07	654.34	-26.5	1265.65	1281.45	-1.2
PVC Pipes & Fittings	801.73	899.25	-10.8	1933.74	1744.37	10.9
Total	1282.80	1553.59	-17.4	3199.39	3025.82	5.7
Less: Inter-segment revenue	341.67	471.02	-27.5	1068.45	977.80	9.3
Income from operations	941.13	1082.57	-13.1	2130.94	2048.02	4.0
Segment EBIT						
PVC	-110.68	230.59	-148.0	-37.78	388.44	-109.7
PVC Pipes & Fittings	-47.63	57.45	-182.9	-5.05	101.09	-105.0
Total	-158.31	288.04	-155.0	-42.83	489.53	-108.7
Interest	4.31	0.41	951.2	15.64	5.17	202.5
Unallocable exp.(net of income)	-33.37	-22.68	47.1	-47.53	-25.99	82.9
PBT	-129.25	310.31	-141.7	-10.94	510.35	-102.1

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Income Statement

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
Income from operations	2984.51	3462.27	4647.32	3995.55	4340.61
<i>Growth (%)</i>	-3.5	16.0	34.2	-14.0	8.6
Other Income	30.84	72.48	459.22	104.69	104.24
Total Income	3015.35	3534.75	5106.54	4100.24	4444.84
Total Expenditure	2537.07	2472.96	3623.58	3921.83	3768.96
EBIDTA (other income incl.)	478.28	1061.79	1482.96	178.41	675.89
Interest	11.28	7.27	14.09	18.19	18.24
EBDT	467.00	1054.52	1468.87	160.23	657.65
Depreciation	73.81	77.72	83.40	86.70	93.80
Tax	68.99	248.78	332.00	18.75	143.78
Net Profit	324.20	728.02	1053.47	54.77	420.07
EO	-0.55	-0.45	300.15	0.00	0.00
Adjusted Net Profit	324.75	728.47	753.32	54.77	420.07
EPS (Rs)	5.23	11.74	12.14	0.89	6.79

Segment results

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
Segment Revenue					
PVC	430.56	827.52	794.65	388.78	395.20
PVC Pipes & Fittings	2553.95	2634.75	3852.67	3606.77	3945.41
Total sales	2984.51	3462.27	4647.32	3995.55	4340.61
Segment EBIT					
PVC	199.59	696.40	722.78	7.88	288.02
PVC Pipes & Fittings	202.24	251.19	250.24	7.99	221.39
Total	401.83	947.59	973.02	15.87	509.41
Interest	11.28	7.27	14.09	18.19	18.24
Unallocable exp.(net of income)	-2.64	-36.48	-426.54	-75.84	-72.67
PBT	393.19	976.80	1385.47	73.52	563.85

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Balance Sheet

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
SOURCES OF FUNDS					
Share Capital	124.10	124.10	124.10	123.67	123.67
Reserves	1805.71	2948.78	3739.67	3708.05	3991.71
Total Shareholders Funds	1929.80	3072.87	3863.76	3831.72	4115.38
Long term debt	0.00	0.00	0.00	0.00	0.00
Total Liabilities	1929.80	3072.87	3863.76	3831.72	4115.38
APPLICATION OF FUNDS					
Gross Block	2,334.27	2,390.72	2451.40	2,651.40	2,851.40
Less: Accumulated Depreciation	1,317.38	1,388.37	1458.17	1,544.87	1,638.68
Net Block	1016.89	1002.35	993.23	1106.52	1212.72
Capital Work in Progress	7.28	8.15	9.46	8.00	8.00
Investments	580.06	1592.20	2633.29	2559.60	2770.54
Current Assets, Loans & Advances					
Inventory	857.81	918.82	1015.47	879.02	954.93
Sundry Debtors	73.17	147.98	334.46	239.73	260.44
Cash and Bank	93.20	336.26	81.04	245.37	154.94
Loans and Advances	75.58	78.85	62.47	63.97	66.44
Total CA & LA	1099.76	1481.91	1493.44	1428.09	1436.75
Current Liabilities	688.37	932.33	1194.64	1182.11	1238.03
Provisions	3.01	3.83	4.21	4.53	4.88
Total Current Liabilities	691.38	936.16	1198.85	1186.64	1242.91
Net Current Assets	408.38	545.75	294.59	241.45	193.84
Net Deferred Tax	-115.82	-118.51	-115.70	-111.70	-109.70
Other Assets (Net Of Liabilities)	33.01	42.94	48.89	27.84	39.98
Total Assets	1929.80	3072.88	3863.76	3831.72	4115.38

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Key Financial Ratios

	FY20	FY21	FY22	FY23e	FY24e
Growth Ratios (%)					
Revenue	-3.5	16.0	34.2	-14.0	8.6
EBIDTA (other income included)	-25.8	121.8	4.3	-83.9	278.8
Net Profit	-11.8	124.3	3.4	-92.7	666.9
EPS	-11.8	124.3	3.4	-92.7	666.9
Margins (%)					
Operating Profit Margin	15.0	28.6	22.0	1.8	13.2
Gross Profit Margin	15.7	30.5	23.5	4.0	15.2
Net Profit Margin	10.9	21.0	16.2	1.4	9.7
Return (%)					
ROCE	13.0	28.0	22.5	1.8	10.8
ROE	15.1	30.6	23.4	1.5	11.3
Valuations					
Market Cap / Sales	1.6	2.3	2.1	2.1	1.9
EV/EBIDTA	10.3	6.8	7.4	39.9	10.5
P/E	14.9	10.8	12.7	150.1	19.6
P/BV	2.5	2.8	2.7	2.3	2.1
Other Ratios					
Interest Coverage	35.9	135.4	72.7	5.0	31.9
Debt-Equity Ratio	0.1	0.1	0.1	0.1	0.1
Current Ratio	1.8	1.7	2.1	1.9	1.9
Turnover Ratios					
Fixed Asset Turnover	3.0	3.4	4.7	3.8	3.7
Total Asset Turnover	1.4	1.5	1.4	1.1	1.2
Debtors Turnover	40.5	31.3	19.3	13.9	17.4
Inventory Turnover	3.4	2.8	3.7	4.1	4.1
Creditors Turnover	9.9	7.4	8.1	8.3	7.6
WC Ratios					
Debtor days	9.0	11.7	18.9	26.2	21.0
Inventory days	106.4	131.1	97.4	88.2	88.8
Creditor days	36.8	49.0	45.3	44.2	48.3
Cash conversion cycle	78.5	93.8	71.1	70.2	61.6

Cumulative Financial Data

Figures in Rs crs	FY16-18	FY19-21	FY22-24e
Income from operations	7822	9538	12983
Operating profit	1454	2042	1670
EBIT	1367	1966	1698
PBT	1297	1935	1648
PAT	883	1421	1228
Dividends	471	547	743
PVC pipe sales (lakh tons)	6.7	7.3	7.8
PVC resin production (lakh tons)	7.6	7.3	6.9
PVC resin sales (lakh tons)	2.6	2.0	1.4
OPM (%)	18.6	21.4	12.9
NPM (%)	11.3	14.9	9.5
Interest coverage	19.6	63.8	33.6
ROE (%)	14.9	17.4	12.2
ROCE (%)	13.3	16.4	11.9
Fixed asset turnover	3.0	3.4	3.9
Debtors turnover	56.8	33.3	21.2
Inventory turnover	3.6	3.3	4.0
Creditors turnover	9.4	7.3	8.0
Debtors days	6.4	11.0	17.2
Inventory days	100.6	111.8	90.7
Creditor days	38.7	50.1	45.8
Cash conversion cycle	68.3	72.6	62.1
Dividend payout ratio (%)	52.0	39.0	48.6

FY16-18 implies three years ending fiscal 18; *as on terminal year

Little vivacity in earnings in the current fiscal and next veils much of the buoyancy in earnings in FY21 when healthy realizations of PVC resin helped resin business to post record profits. Wherefore, OPMs during FY22-24e period is estimated to tumble to 12.9% when compared to a record 21.4% in FY19-21 period (see table). Cumulative post earnings would anything resurrect for it is projected to decline to Rs 1228 crs in FY22-24e period as against Rs 1421 crs in the previous three year period spoiled by relentless fall in PVC prices globally that has sparked no modest inventory losses.

Flat lining debt (and the resulting rise in interest coverage ratio) would anything but aid resurrection in return on capital - ROE estimated to decline to an abysmal 12.2% from 17.4% in FY19-21 period - not least due to little vitality in earnings over the next few quarters. Little pricing power in Finolex's PVC pipes & fittings business - spoiled by fall in PVC resin prices - would all but undercut rise in volumes of pipes and fittings (7.8 lakh tons in FY22-24e vs 7.3 lakh tons in FY19-21) . Helped by fall in inventory days, cash conversion cycle is estimated to improve to some 62 days in FY22-24 period from some 73 days in the previous three year period (see table).

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Financial Summary – US dollar denominated

million \$	FY20	FY21	FY22	FY23e	FY24e
Equity capital	16.5	16.9	16.4	15.0	15.0
Equity shareholders' funds	256.0	384.3	476.9	434.9	469.4
Total debt	37.5	27.7	36.7	33.4	33.4
Net fixed assets (incl CWIP)	135.9	137.5	132.3	135.2	148.1
Investments	76.9	216.6	347.4	310.6	336.2
Net current assets	54.2	40.5	6.1	-0.7	-6.5
Total assets	256.0	384.3	476.9	434.9	469.4
Revenues	421.1	466.6	623.7	484.8	526.7
EBITDA	67.6	143.2	148.7	21.6	82.0
EBDT	66.0	142.2	146.8	19.4	79.8
PBT	55.6	131.7	135.6	8.9	68.4
PAT	45.8	98.2	101.1	6.6	51.0
EPS(\$)	0.07	0.16	0.16	0.01	0.08
Book value (\$)	0.41	0.62	0.77	0.70	0.76

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rate (\$82.41/\$)

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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	FY22
Average	64.45	69.89	70.88	74.20	74.51
Year end	65.04	69.17	75.39	73.50	75.81

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.