

Deepak Nitrite Ltd. (DNL)

No. of shares (m)	136.4
Mkt cap (Rs crs/\$m)	11148/1503.6
Current price (Rs/\$)	817/11.0
Price target (Rs/\$)	938/12.7
52 W H/L (Rs.)	888/310
Book Value (Rs/\$)	135/1.8
Beta	1.1
Daily volume NSE (avg. monthly)	803000
P/BV (FY21e/22e)	5.3/4.2
EV/EBITDA (FY21e/22e)	12.0/11.1
P/E (FY21e/22e)	19.1/17.4
EPS growth (FY20/21e/22e)	253.8/-5.4/9.8
OPM (FY20/21e/22e)	24.5/25.9/23.7
ROE (FY20/21e/22e)	47.2/31.8/26.9
ROCE(FY20/21e/22e)	28.8/23.1/22.0
D/E ratio (FY20/21e/22e)	0.7/0.4/0.3
BSE Code	506401
NSE Code	DEEPAKNT
Bloomberg	DN IN
Reuters	DPNT.NS

Shareholding pattern

	%
Promoters	45.7
MFs / Banks / FIs	12.0
Foreign Portfolio Investors	12.7
Govt. Holding	-
Public & others	29.6
Total	100.0

As on Sep 30, 2020

Recommendation

ACCUMULATE

Analyst

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Highlights

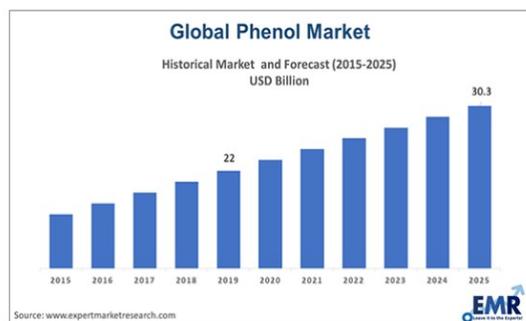
- Supported by no measly rise in revenues of fine & specialty chemicals (52%) and phenolics (25.7%), DNL reported just 1.6% drop in overall revenues in Q2 while operating profit jumped by 10.2% to Rs 275.95 crs, thus raising OPM to 27.9% from 25% in the same period a year ago. Boosted by higher exports, DNL's phenolics business reported higher capacity utilization flinging its EBIT margin to 22.3% compared to just 5.6% in Q2 of last year and 20.8% in Q1 of current fiscal.
- Aided by lockdown restrictions, domestic revenues fell in double digits with the basic chemicals bearing the brunt for it published nearly 30% drop in revenues and EBIT last quarter. Little suppressed by process competency, DNL's fine and specialty chemicals margins further expanded to a dizzying 48.6% (Vs 27.4%) thus enabling well nigh trebling of EBIT. Helped by lower depreciation and interest expense,
- PBT rose by 18.3% to Rs 228.84 crs compared to Rs 193.43 crs in the same period a year ago. Post tax earnings advanced by 13.2% to Rs 170.19 crs on yoy basis. Despite lower earnings, DNL reported higher cash flow from operations (post interest expense) not least due to fall in receivables by some Rs 87 crs in the first half of current fiscal.
- Lower of take in textiles and paper industry coupled with base effect, took sheen off from DNL's performance products business for it reported nerve-wracking fall in EBIT (Rs 4.92 crs Vs Rs 116.79 crs) on nearly two-third fall in revenues. Thence EBIT margin fell to 6.7% in Q2 compared to 54.6% for last financial year.
- The stock currently trades at 19.1x FY21e EPS of Rs 42.72 and 17.4x FY22e EPS of Rs 46.92. Earnings growth has largely being misaligned with revenue growth in last few quarters not least due to unprecedented surge in margins in its performance products and FSC business - a trend which barely escaped some other specialty chemical manufacturers. Whence fixed asset turnover, which has dipped in the last two years, is not expected to show any perceptible elevation next fiscal. With anything but rise in debt, interest coverage ratio would gradually rise. On balance we advise accumulating the stock with revise target of Rs 938 (previous target: Rs 541) based on 20x FY22e earnings.

Consolidated (Rs crs)	FY18	FY19	FY20	FY21e	FY22e
Income from operations	1651.45	2699.92	4229.71	3745.85	4409.52
Other Income	12.29	15.12	35.20	20.25	26.53
EBITDA (other income included)	210.87	432.32	1064.10	989.14	1070.32
Profit after associate profit (adjusted for EO)	66.86	174.04	615.83	582.63	640.00
EPS**(Rs)	5.08	12.76	45.15	42.72	46.92
EPS growth (%)	38.4	151.3	253.8	-5.4	9.8

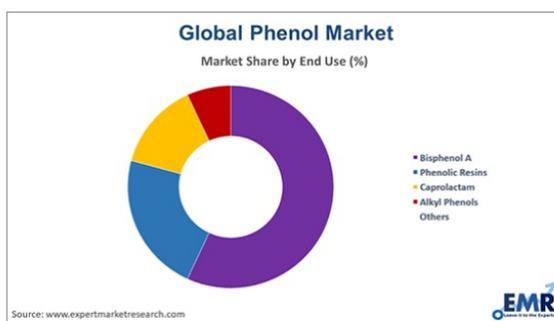
Outlook & Recommendation

Global Phenol Update

According to an industry report, the global phenol market is estimated to grow by 3.4% CAGR during 2020-2025 driven by its increasing use in industrial cleaner for machines and electronic equipment, production of drugs and intense colored dyes etc. Further, market growth would also get a leg up from rapid economic growth and increasing construction activities in the residential and commercial sectors. However, the report contends, that market growth for phenol has been adversely impacted by lockdowns imposed by governments of several countries, which have resulted in the unavailability of labor, supply chain disruptions and limited availability of raw materials.

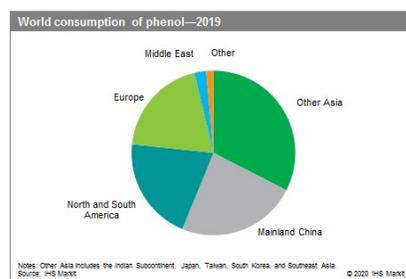


Source: EMR



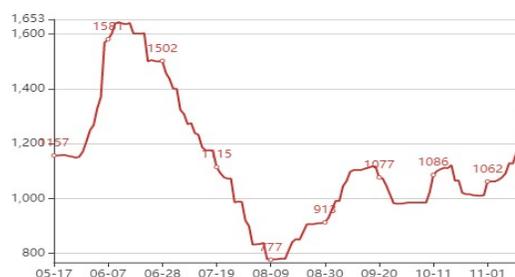
Source: EMR

But a report by Expert Market Research pegs the phenol value growth at some 5.5% during 2020 and 2025 with end value of \$30.3 bn. It posits that global phenol market growth has been buttressed by increasing urbanization, changing lifestyles and rise in disposable incomes. It further states that growth has been stimulated by strong demand from emerging economies and technological advancements in its production techniques. The end-use sector is led by Bisphenol A which accounts for some 48% of industry share. Further downstream products of phenol have started to find greater applications in automobile and construction sectors. By this report the construction industry is estimated to grow by 85% during the projected period with China, US and India accounting for 57% of the estimated growth. Thus use of phenol derivatives such as polycarbonate and epoxy resins in automobile and construction sectors is further propelling the growth of phenol market globally.



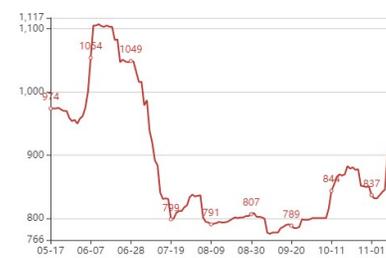
Source: IHS Markit

Acetone Prices (USD/mt)



Source: echemi.com

Phenol Prices (USD/mt)

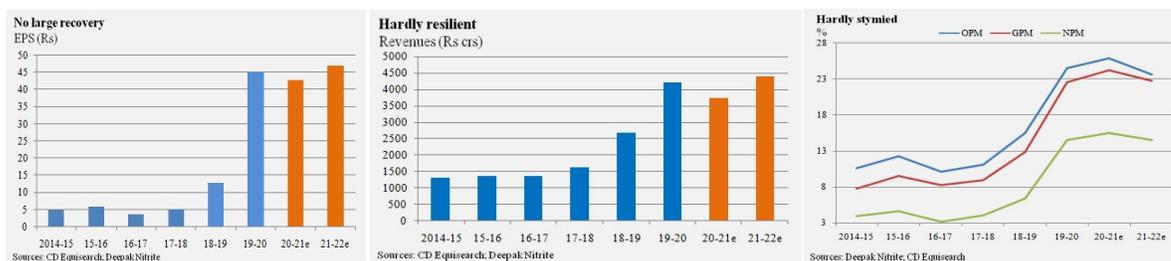


Source: echemi.com

IHS Markit in its latest update states that the global phenol market is driven predominantly by demand for BPA and the demand for BPA is in turn driven by demand for polycarbonate products - which is used mainly in automotive, OEM, construction, optical media, and appliance industries. Demand for epoxy resins, which finds application in OEM and automotive production, and construction and remodeling activity, also influences the demand for BPA. Phenol-formaldehyde resins, which remain the second largest consumer of phenol, have seen demand resurgence from the construction industry. The report further mentions that China will continue to lead the phenol market not least due to strong demand from automotive, consumer and construction sectors.

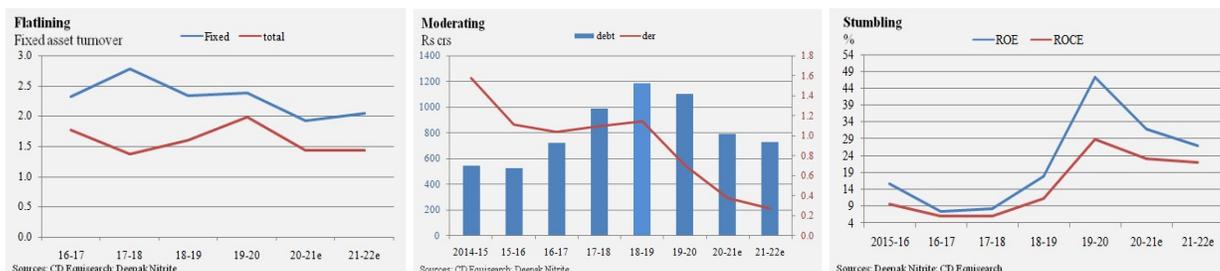
Financials & Valuation

With little grounds for denial about India's growing clout in global chemical industry - be it an alternative source of supply to China or growing domestic demand for chemicals in agriculture and pharmaceuticals or more recently due to the Covid 19 pandemic. By some estimates the Indian chemical industry is estimated to grow between 15-20% over the next few years as the Government of India increasingly focus on import reduction and growing domestic demand. DNL with its covetous expertise in nitration, hydrogenation and oxidation coupled with its import substitution strategy has not done little to ward off competition. Yet little forbearance to external stressors - be it pandemic induced lockdowns or shortfall of key raw materials (nitric acid shortfall case in point) or barely smooth fluctuations in prices of key finished products (eg: DASDA) could astray businesses.



Notwithstanding delay in capex execution due to the grueling impact of the pandemic - capex in H1FY21 amounted to some Rs 63 crs from Rs 154 crs in the same period a year before - capital investments is estimated to scarcely diminish in the second half of current fiscal for DNL hastens to execute brown field expansions for its FSC and basic chemicals businesses and also expand capacity of iso-propyl alcohol (IPA) by some 30000 mt, thus further speeding up roll out of downstream derivatives of phenol and acetone. Its operating cash flows (post finance costs) of Rs 649 crs last fiscal was sufficient to meet its capex of some Rs 400 crs, though the same was little stymied by largely unsustainable bump in earnings of its performance products business (Rs 419 crs Vs Rs 83 crs in FY19).

Favorable product mix aligned with robust export markets has supported DNL's FSC business margin over the last few quarters with EBIT margin at a record (though seemingly unsustainable) 48.6% in Q2. Though its FSC business EBIT will all but double this fiscal but we expect a moderation in earnings next fiscal. Its phenol business, which has seen record capacity utilization over the last few months, has been barely stoked by buoyant export markets that has anything but depressed margins - phenolics EBIT margin at 22.3% in Q2 compared to just 5.6% in the same quarter a year ago. Notwithstanding focus on derivative products, phenolics business margins are estimated to anything but rise next fiscal not least due to rebound in domestic dispatches



The stock currently trades at 19.1x FY21e EPS of Rs 42.72 and 17.4x FY22e EPS of Rs 46.92. Though valuation hardly appear unreasonable by historical yardsticks, it would be scarcely prudent to rely on sustainability of current margins of DNL's phenolics and FSC businesses, more so due to the commodity nature of the former. Post tax earning is estimated to marginally decline this fiscal - more so due to high base of last fiscal - before modestly rising next fiscal. Return on capital would accordingly align with earnings for margins of its performance products business which peaked at some 55% last fiscal would normalize to mid-teens. With better than expected outcome of FSC and phenol business in H1 we upped our current year EPS estimates by more than a quarter. On balance we advise accumulating the stock with revise target of Rs 938 (previous target: Rs 541) based on 20x FY22e earnings. For more info refer our April report.

Cross Sectional Analysis

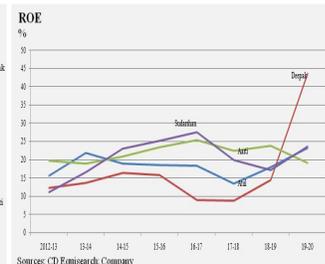
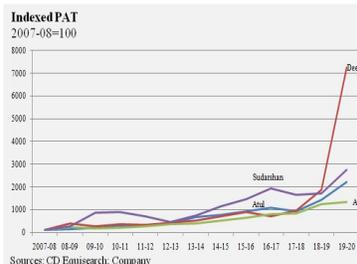
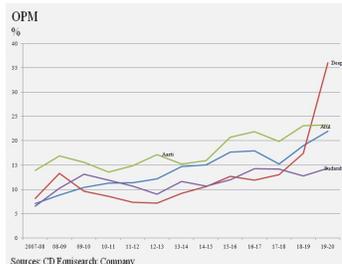
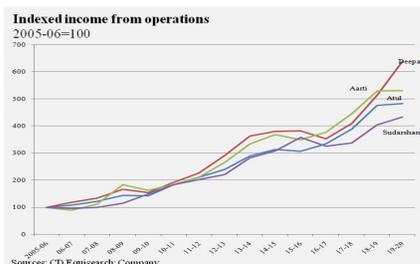
Company	Equity (Rs crs)	CMP (Rs crs)	Mcap (Rs crs)	Inc. from ops. (Rs crs)	Profit (Rs crs)	OPM (%)	NPM (%)	Int. coverage	ROE (%)	Mcap / IO	P/BV	P/E
Aarti Inds.	87	1136	19787	4270	466	21.3	11.1	6.3	15.4	4.6	6.2	42.5
Atul Ltd	30	6399	18981	3670	602	23.4	16.4	79.2	18.8	5.2	5.4	31.5
Deepak Nitrite	27	817	11148	3837	603	25.8	15.7	8.7	38.2	2.9	6.1	18.5
Sudarshan Chem	14	451	3123	1654	105	14.4	6.4	10.0	16.9	1.9	4.9	29.6

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

Despite a strong show from Aarti's pharmaceutical business in Q2, its specialty chemicals business struggled to gain perceptible ground in Q2 for it reported 11.1% drop in EBIT on 24% rise in revenues. EBIT margins as a consequence dipped to 17.2% from 23.9% in the same quarter a year ago which was attributed to higher sale of products in discretionary spends in non-regular markets which yielded lower margins. Margins somewhat took a knock from higher operating costs on commercialization of new units, particularly chlorination unit at Jhagadia. Yet the pharmaceutical business kept up its momentum for it two-thirds growth in EBIT on some 22% growth in revenues helped by increasing contribution from regulated markets and value added products.

Sudarshan Chemical posted no small rebound in business activity in Q2 for it showed 1% growth in revenues (yoy) and 21.7% growth (q-o-q) partially helped restoration of production with the month of September logging the highest ever production volume. Aided by cost optimization and increased efficiencies, operating profit jumped 2.1% to Rs 67.69 crs and OPMs swelled to 15.8% from 15.6% in the year ago period. Gross margins improved too helped by improved pricing and stable raw material prices. Sudarshan expects the demand pick up to sustain as the domestic economy further reopens to pre-Covid levels.

No restricted rise in business activity explains unhindered surge in revenues of both life science chemicals (Rs 348 crs Vs 271 crs in Q1) and performance and other chemicals (Rs 690 crs Vs Rs 420 crs) in Q2 of this fiscal. Despite reporting marginal drop in revenues Atul's most worthy performance and other chemicals business showed 12.2% growth in its EBIT, a no mean feat considering its EBIT was just Rs 85.55 crs in Q1 - now Rs 159.36 crs. Overall operating profit rose not unremarkably by 16.4%, while the PBT, hindered by lower other income, rose by just 10%. Little wavered by lower earnings, Atul reported higher free cash flows in the first half at some Rs 244 crs (Rs 204 crs last year), though somewhat supported by lower capex - consolidated capex at Rs 146 crs Vs Rs 208 crs in the first half of last fiscal.



Financials

Quarterly Results -Consolidated

Figures in Rs crs

	Q2FY21	Q2FY20	% chg.	H1FY21	H1FY20	% chg.
Income from operations	987.34	1003.33	-1.6	1661.83	2054.31	-19.1
Other Income	3.70	7.85	-52.9	10.45	19.44	-46.2
Total Income	991.04	1011.18	-2.0	1672.28	2073.75	-19.4
Total Expenditure	711.39	752.86	-5.5	1204.25	1550.02	-22.3
PBIDT (other income included)	279.65	258.32	8.3	468.03	523.73	-10.6
Interest	19.57	29.75	-34.2	44.30	60.71	-27.0
Depreciation	31.24	35.14	-11.1	62.25	68.36	-8.9
PBT	228.84	193.43	18.3	361.48	394.66	-8.4
Tax	58.65	43.02	36.3	92.34	112.64	-18.0
PAT	170.19	150.41	13.2	269.14	282.02	-4.6
Extraordinary Item	-	-	-	-	-	-
Adjusted Net Profit	170.19	150.41	13.2	269.14	282.02	-4.6
EPS (F.V. 2)	12.48	11.03	13.2	19.73	20.68	-4.6
Equity	27.28	27.28	0.0	27.28	27.28	0.0

Segment Results

Figures in Rs crs

	Q2FY21	Q2FY20	% chg.	H1FY21	H1FY20	% chg.
Segment Revenue						
Basic Chemicals	165.84	236.26	-29.8	318.73	462	-31
Fine & Speciality Chemicals	209.9	138.11	52	349.67	254.03	37.6
Performance Products	72.9	211.78	-65.6	126.86	437.48	-71
Phenolics	545.85	434.22	25.7	876.53	934.85	-6.2
Total	994.49	1020.37	-2.5	1671.79	2088.36	-19.9
Inter segment revenue	7.15	17.04	-58	9.96	34.05	-70.7
Income from operations	987.34	1003.33	-1.6	1661.83	2054.31	-19.1
Segment EBIT						
Basic Chemicals	40.73	58.09	-29.9	77.29	94.5	-18.2
Fine & Speciality Chemicals	102.11	37.84	169.8	164.44	65.77	150
Performance Products	4.92	116.79	-95.8	11.42	247.93	-95.4
Phenolics	121.92	24.21	403.6	190.54	83.21	129
Total	269.68	236.93	13.8	443.69	491.41	-9.7
Interest	19.57	29.75	-34.2	44.3	60.71	-27
Other Unallocable Exp. (net of income)	21.27	13.75	54.7	37.91	36.04	5.2
PBT	228.84	193.43	18.3	361.48	394.66	-8.4

Financials

Income Statement - Consolidated

Figures in Rs crs

	FY18	FY19	FY20	FY21e	FY22e
Income from operations	1651.45	2699.92	4229.71	3745.85	4409.52
<i>Growth (%)</i>	18.9	65.5	56.9	-11.4	17.7
Other Income	12.29	15.12	35.20	20.25	26.53
Total Income	1663.75	2715.04	4264.91	3766.10	4436.05
Total Expenditure	1452.87	2282.72	3200.81	2776.96	3365.72
EBITDA (other income included)	210.87	432.32	1064.10	989.14	1070.32
Interest	47.42	86.55	117.97	80.71	65.63
EBDT	163.45	345.78	946.13	908.43	1004.69
Depreciation	52.60	77.79	139.73	126.38	145.63
Tax	31.84	94.32	195.37	199.42	219.06
Net profit	79.02	173.67	611.03	582.63	640.00
Profit of associate	0.00	0.00	0.00	0.00	0.00
Net profit after associate profit	79.02	173.67	611.03	582.63	640.00
Extraordinary item	12.15	-0.38	-4.80	0.00	0.00
Adjusted Net Profit	66.86	174.04	615.83	582.63	640.00
EPS (Rs.)	5.08	12.76	45.15	42.72	46.92

Segment Results

Figures in Rs crs

	FY18	FY19	FY20	FY21e	FY22e
Segment Revenue					
Basic Chemicals	761.61	893.19	940.32	725.30	942.89
Fine & Speciality Chemicals	463.24	535.64	585.26	749.67	843.38
Performance Products	300.00	402.88	767.12	276.86	387.60
Phenolics/ others	196.33	908.01	2000.86	2014.45	2257.80
Total	1721.18	2739.71	4293.56	3766.28	4431.68
Inter segment revenue	45.00	39.80	63.85	20.43	22.16
Income from operations	1676.18	2699.91	4229.71	3745.85	4409.52
Segment EBIT					
Basic Chemicals	106.69	145.35	209.35	174.87	221.58
Fine & Speciality Chemicals	114.79	126.55	175.24	336.44	320.48
Performance Products	-8.14	83.23	418.62	29.42	62.02
Phenolics/ others	-6.41	95.79	187.31	395.37	395.12
Sub Total	206.93	450.92	990.52	936.09	999.20
Interest	45.15	83.24	115.14	75.91	60.83
Other Unallocable Exp. (net of income)	50.94	99.70	68.98	78.13	79.30
PBT	110.85	267.98	806.40	782.05	859.07

Consolidated Balance Sheet

Figures in Rs crs

	FY18	FY19	FY20	FY21e	FY22e
SOURCES OF FUNDS					
Share Capital	27.28	27.28	27.28	27.28	27.28
Reserves	894.86	1044.31	1544.63	2127.27	2705.90
Total Shareholders Funds	922.14	1071.59	1571.91	2154.55	2733.18
Long term debt	550.46	869.86	792.89	727.89	662.89
Total Liabilities	1472.60	1941.46	2364.80	2882.44	3396.07
APPLICATION OF FUNDS					
Gross Block	671.53	1876.26	2128.53	2478.53	2828.53
Less: Accumulated Depreciation	83.97	160.43	296.55	422.92	568.55
Net Block	587.56	1715.83	1831.98	2055.60	2259.98
Capital Work in Progress	954.51	33.87	172.27	200.00	200.00
Investments	31.77	2.39	2.38	2.39	2.39
Current Assets, Loans & Advances					
Inventory	325.42	410.73	394.50	393.31	451.98
Sundry Debtors	411.77	574.96	612.72	582.08	640.29
Cash and Bank	48.20	25.77	31.40	127.96	384.67
Other Assets	178.07	150.26	117.68	95.64	98.42
Total CA & LA	963.46	1161.72	1156.30	1199.00	1575.36
Current liabilities	1044.06	876.01	736.91	481.82	516.05
Provisions	3.54	7.62	12.04	13.86	14.49
Total Current Liabilities	1047.59	883.63	748.95	495.68	530.54
Net Current Assets	-84.13	278.09	407.35	703.32	1044.82
Net Deferred Tax (net of liability)	-45.40	-77.46	-79.61	-109.61	-139.61
Other Assets (Net of liabilities)	28.29	-11.27	30.43	30.73	28.49
Total Assets	1472.60	1941.46	2364.80	2882.44	3396.07

Key Financial Ratios

	FY18	FY19	FY20	FY21e	FY22e
Growth Ratios					
Revenue (%)	18.9	65.5	56.9	-11.4	17.7
EBIDTA (%)	29.3	123.3	147.3	-7.6	8.2
Net Profit (%)	55.1	160.3	253.8	-5.4	9.8
EPS (%)	38.4	151.3	253.8	-5.4	9.8
Margins					
Operating Profit Margin (%)	11.1	15.5	24.5	25.9	23.7
Gross Profit Margin (%)	9.0	12.8	22.5	24.3	22.8
Net Profit Margin (%)	4.1	6.5	14.6	15.6	14.5
Return					
ROCE (%)	6.1	11.2	28.8	23.1	22.0
ROE (%)	8.4	17.9	47.2	31.8	26.9
Valuations					
Market Cap / Sales	2.1	1.4	1.2	3.0	2.5
EV/EBIDTA	22.2	11.3	5.9	12.0	11.1
P/E	49.0	21.5	8.5	19.1	17.4
P/BV	3.8	3.6	3.3	5.3	4.2
Other Ratios					
Interest Coverage	3.0	4.1	7.9	10.7	14.1
Debt-Equity Ratio	1.1	1.1	0.7	0.4	0.3
Current Ratio	0.9	1.3	1.5	2.2	2.6
Turnover Ratios					
Fixed Asset Turnover	2.8	2.3	2.4	1.9	2.0
Total Asset Turnover	1.4	1.6	2.0	1.4	1.4
Debtors Turnover	4.2	5.5	7.1	6.3	7.2
Inventory Turnover	5.9	6.2	7.9	7.0	8.0
Creditors Turnover	4.1	4.7	7.6	7.8	9.3
WC Ratios					
Debtor Days	86.5	66.8	51.2	58.2	50.6
Inventory Days	62.1	59.0	46.0	51.8	45.8
Creditor Days	88.8	77.1	47.8	46.9	39.3
Cash Conversion Cycle	59.8	48.7	49.4	63.0	57.1

Cumulative Financial Data

Figures in Rs crs	FY17-19	FY20-22e
Income from operations	5696	12385
Operating profit	738	3048
EBIT	598	2718
PBT	428	2454
PAT	284	1838
Dividends	73	210
OPM (%)	13.0	24.6
NPM (%)	5.0	14.8
Interest coverage	3.5	10.3
ROE (%)	12.5	33.2
ROCE (%)	8.3	24.2
Debt-equity ratio*	1.1	0.3
Fixed asset turnover	1.6	2.1
Debtors turnover	4.3	6.8
Inventory turnover	6.1	7.2
Creditors turnover	5.1	7.3
Debtors days	85.3	53.7
Inventory days	60.2	50.6
Creditor days	71.4	49.7
Cash conversion cycle	74.1	54.6
Dividend payout ratio (%)	20.9	11.5

FY17-19 implies three years ending fiscal 19; *as on terminal year; consolidated data

No murky rebound in fortunes of both fine & specialty chemicals business and phenolics business coupled with little dismal turnaround in performance products business in FY20 - when EBIT jumped from Rs 83 crs to Rs 419 crs triggered increased realizations of DASDA - explain over fourfold rise in cumulative operating profit during three year ended FY22, thus propelling OPM to 24.6% from 13% in FY17-19 period (see table). Anything but puny growth in EBIT allayed with no large rise in interest expense explains perceptible rise in interest coverage during FY20-22 period (see table).

Spectacular rise in cumulative post tax earnings (Rs 1838 crs Vs Rs 284 crs in FY17-19 period) helped by anything but little jump in fixed asset turnover (2.1 Vs 1.6) will prod ROE to seeming unsustainable level of 33.2% during FY20-22e period when compared to 12.5% in the three year ended FY19, all that on lower financial leverage. Cash conversion cycle will swell to some 55 days in FY20-22 period from 74 days not least due to glaring reduction in debtor days though mitigated by drastic fall in creditor days (see table).

Financial Summary – US dollar denominated

million \$	FY18	FY19	FY20	FY21e	FY22e
Equity capital	4.2	3.9	3.6	3.7	3.7
Shareholders funds	138.5	150.2	208.5	282.3	358.5
Total debt	151.7	171.5	146.6	106.9	98.2
Net fixed assets (incl CWIP)	237.1	253.0	265.9	304.2	331.8
Investments	4.9	0.3	0.3	0.3	0.3
Net current assets	-16.2	35.4	54.0	86.6	130.8
Total assets	223.1	275.9	313.7	380.5	447.9
Revenues	252.8	385.8	596.8	505.2	594.7
EBITDA	30.1	61.9	151.0	133.4	144.4
EBDT	22.7	49.6	134.4	122.5	135.5
PBT	14.6	38.4	114.7	105.5	115.9
Profit after associate profit	10.4	24.9	86.9	78.6	86.3
EPS(\$)	0.08	0.18	0.64	0.58	0.63
Book value (\$)	1.02	1.10	1.53	2.07	2.63

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rates (Rs 74.14/\$). All dollar denominated figures 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/\$	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.