

Escorts Ltd.

No. of shares (m)	134.8
Mkt cap (Rs crs/\$m)	24297/3264.9
Current price (Rs/\$)	1802/24.2
Price target (Rs/\$)	1750/23.5
52 W H/L (Rs.)	1831/1100
Book Value (Rs/\$)	526/7.1
Beta	0.8
Daily volume NSE (avg. monthly)	2721930
P/BV (FY22e/23e)	2.6/2.2
EV/EBITDA (FY22e/23e)	16.9/13.5
P/E (FY22e/23e)	22.5/18.5
EPS growth (FY21/22e/23e)	64.6/-9.7/21.5
OPM (FY21/22e/23e)	16.1/13.7/14.5
ROE (FY21/22e/23e)	21.6/13.3/12.9
ROCE(FY21/22e/23e)	21.2/13.6/13.2
D/E ratio (FY21/22e/23e)	0.0/0.0/0.0
BSE Code	500495
NSE Code	ESCORTS
Bloomberg	ESC IN
Reuters	ESCO.NS

Shareholding pattern

	%
Promoters	36.6
MFs / Banks / FIs/Others	9.7
FPIs	21.5
Govt. Holding	0.0
Public & Others	32.2
Total	100.0

As on Sep 30, 2021

Recommendation

HOLD

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Company Brief

Escorts is involved in production of agri-machinery, construction and material handling equipment and railway equipment from its plants at various locations. The company sells a wide range of tractors under the Farmtrac, Powertrac and Steeltrac brands.

Highlights

- Escorts's agri machinery business reported 28.9% drop in EBIT as margins swooned (15% vs 19.7% in Q2FY21) not least due to adverse product mix and high inflation in commodity prices. As indication of adverse product mix, Escorts derived 60% of its total tractor volumes from 40 hp or more as against 63% in the same period last year. Tracking some 14% drop in tractor volumes, overall agri machinery revenues fell by 6.5% to Rs 1246 crs as compared to Rs 1332.50 crs in the same quarter a year ago.
- Escorts tractor market share anything but rose (down 171 bps quarter on quarter) not least due to 19% drop in industry dispatches in Escorts stronghold Northern Central India whereas industry in its opportunity markets of Southern and Western India was down by just 3%. Yet the company managed to exhibit strong growth in higher HP tractor sales due to new product launches as well as on account of higher penetration in Southern markets.
- Though Escorts railway equipment business has perceived higher order tendering, traction in order execution (as demonstrated in higher revenue booking) is yet to come by. Its revenues grew by just 6.2% to Rs 170 crs while EBIT margins tumbled 300 bps to 17.3%. Its construction equipment has seen improved revenue recognition as Covid restrictions are getting eased with capacity utilization rising to 45% in Q2 from 27% in Q1. With 77% rise in revenues in Q2 (compared to Q1), the construction equipment business managed to post a profit of Rs 8.95 crs when compared to a loss of Rs 3.29 crs in Q1.
- The stock currently trades at 22.5x FY22e EPS of Rs 80.02 and 18.5x FY23e EPS of Rs 97.20. Earning is projected to grow by some 28% next fiscal on mid teen revenue growth and improved margins. Despite recovery in its construction equipment and railway equipment businesses next fiscal, its agri-machinery business would hold much of the sway for it would account for nearly 90% of total EBIT. Pending "strategy blueprint", impact of Kubota deal is hard to decipher. Weighing odds, we assign 'hold' rating on the stock with revised target of Rs 1750 (previous target: Rs 1610) based on 18x FY23e earnings.

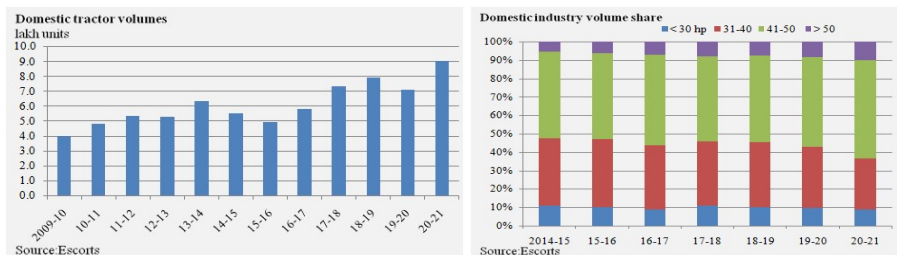
(Figures in Rs crs)	FY19	FY20	FY21	FY22e	FY23e
Income from operations	6262.02	5810.09	7014.42	7486.13	8502.87
Other Income	99.85	97.60	160.38	272.70	387.14
EBITDA (other income included)	824.38	750.78	1287.14	1295.20	1622.00
Profit after EO	472.93	478.16	868.65	840.46	1074.03
EPS (Rs)	53.21	53.80	88.57	80.02	97.20
EPS growth (%)	35.2	1.1	64.6	-9.7	21.5

Outlook & Recommendation

India Tractor Industry Outlook

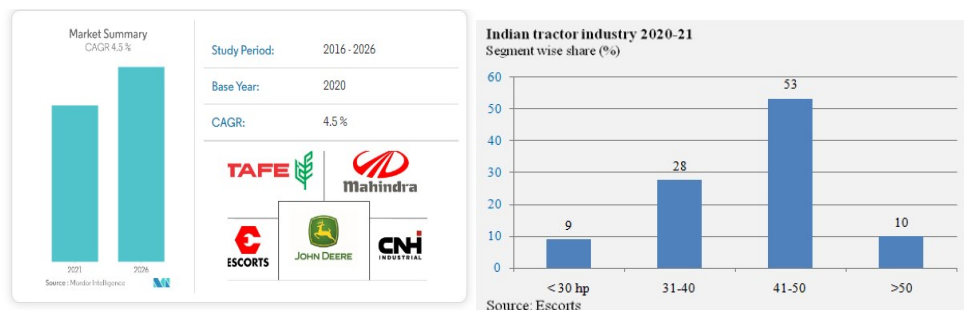
Strengthened by historically low interest rates in India, the domestic tractor industry made a comeback of sorts in Covid ravaged economy to post 26.9% growth last fiscal, thus taking overall dispatches to 0.9 mn units - an all time high. Demand got a tailwind in the second half of last fiscal not least due to increase in MSP of crops and strong pent up H1 demand. Farm oriented schemes of GOI such as Pradhanmantri Gram Sinchai Yojana and PM-KISAN scheme have also bolstered spending capacity of rural India.

M&M reckons that farm mechanization is poised for greater adoption in India due to increasing labor cost and labor scarcity. Further liquidity with farmers has increased all thanks to GOI's rural development sanctions and direct benefit transfer schemes. It further states that increasing farm mechanization, emergence of new technologies in farming sector and increasing government spends will support Indian domestic tractor industry over the next few years. With dramatic pick up in agri-activities in India last fiscal, the domestic tractor industry witnessed a healthy rise in demand in >40 hp segment.



Modor Intelligence estimates that the Indian agricultural tractor industry will grow at a CAGR of 4.5% during 2021-26 all thanks to government initiatives regarding rural development and farm mechanization and various other factors like enhancing rural wages and scarcity of farm labor. It reckons that India remains a high lucrative tractor market because of decreasing availability of farm labor and emergence of innovative business models such as custom hiring solutions for tractors.

Modor Intelligence also believes that various loan schemes, easy installments break down to crop cycle and low interest rate plans have generated funding for mechanization. Various GOI concessions like excise duty exemption on tractors less than 1800 cc capacity have helped small farmers. Further under central sector extension programs the GOI provides subsidies for purchase of tractors below 18 hp which has the ability to buoy demand for smaller tractors.



Source: Modor Intelligence

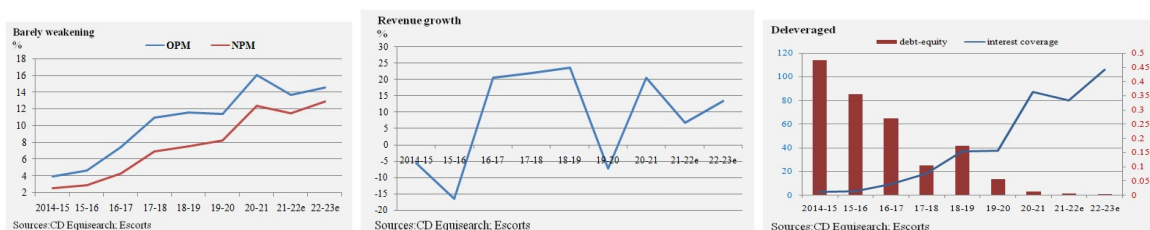
Kubota deal

To fortify leadership in global agri-machinery industry, Escorts has decided to raise almost Rs 1873 crs from Kubota Corporation by issuing 9.36 mn shares at a price of Rs 2000 per share, which would raise Kubota's stake to 14.99% (pre-capital reduction scheme filed with NCLT) and trigger a 26% open offer to public shareholders of Escorts in accordance with SEBI Regulations. To intensify their partnership, Escorts and Kubota will undertake feasibility studies to merge Kubota's subsidiaries in India, namely, Kubota Agricultural Machinery India Pvt Ltd and Escorts Kubota India Pvt Ltd into Escorts. Post the conclusion of private placement, open offer and cancellation of Escorts Benefit and Welfare Trust shares, shareholding of Kubota in Escorts will rise to 53.5%.

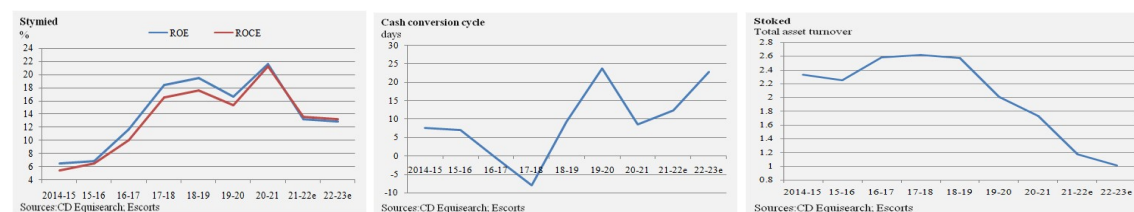
Financials & Valuation

Mirroring much of the slowdown in Indian tractor industry, Escorts tractor dispatches during the current fiscal would drop in low single digit before recovering next fiscal (10% growth estimated for FY23). Ruffled by rising raw material price inflation, Escorts has managed to demonstrate no great pricing power as it has increased prices in range of 8-10% in the last one year with EBIT margins in its agri-machinery business falling precipitously from 20% in Q3 last fiscal to 15% in Q2 - though supply disruptions due to Covid 19 accounted for strong margin gains last fiscal.

Though Kubota's specialization in wet land tractors could help tap some of the domestic market share in years to come, but meaningful gains in overall domestic tractor market may be hard to come by. Escorts agri-machinery business may get a facelift not least due to Kubota's entrenched position in this business globally but scaling of this business may take no small time as the domestic market for agri-equipments such as harvesters, transplanters, straw reapers and implements such as cultivators, harrows and ploughs are in a nascent stage right now. Yet no small opportunities exist for Kubota's global sourcing from India - though no blueprint for this strategy is available now.



Notwithstanding adverse impact of lockdowns in Q1 of current fiscal, Escorts construction equipment business has reported capacity utilization of just 45% in Q2 (though on improved EBIT margins 3.6% vs -2.3% in Q1). With easing of Covid 19 restrictions, its margins would improve by next fiscal, though no big runaway in earnings is expected - impact of Kubota on this business cannot be assessed now. Despite Escorts railway equipment business initiative on new product launches - it also received RDSO approval for new products air Spring, brake disc and brake pads for passenger coaches last fiscal - this business has shown little signs of big 'scaling' in last few years.



The stock currently trades at 22.5x FY22e EPS of Rs 80.02 and 18.5x FY23e EPS of Rs 97.20. Post tax earnings would marginally decline this fiscal before accelerating 27.8% next fiscal. Margins would start to inch upwards as raw material prices soften and impact of previous price hikes starts to reflect. Free cash flows dramatically fell in H1 as big increase in inventories lengthened working capital. Kubota deal has doubtlessly opened new business frontiers with strong liquidity expected to support resurrection. Yet business scaling in domestic tractor markets (reflected in increased market share) would face no small headwinds. On balance, we assign 'hold' rating on the stock with revised target of Rs 1750 (previous target: Rs 1610) based on 18x FY23e earnings. (For more info refer to our January report).

Cross Sectional Analysis

Company	Equity*	CMP	Market cap*	Sales*	Profit*	OPM	NPM	Int. coverage	ROE	Mkt cap / sales	P/BV	P/E
Escorts	135	1823	24582	7647	901	15.1	11.9	83.2	18.4	3.2	3.4	20.2
M&M	622	955	118744	89780	5360	12.0	3.4	1.8	13.3	1.3	2.8	22.2
VST	8.64	3177	2744	825	100	12.4	12.1	87.4	15.0	3.3	3.9	27.5

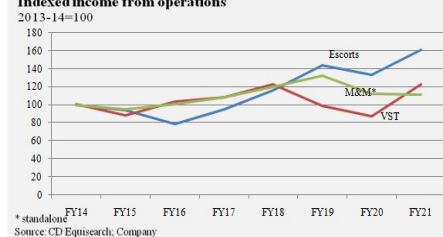
*figures in crores; calculations on ttm basis

Book value adjusted for goodwill and revaluation reserves where applicable; Escorts valuation ratios adjusted for treasury shares

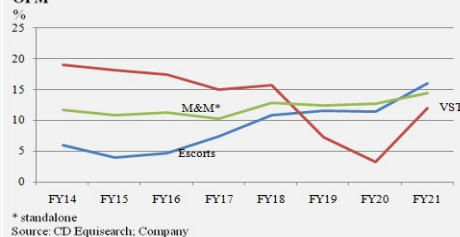
Mahindra & Mahindra is greatly banking on its newly unveiled K2 series - light weight tractor programme - as it plans to introduce products across four new tractor platforms, in multiple categories, and various HP points. After growing by some 45% in FY21, M&M's far machinery business is poised for strong growth as it strives to partner with global COEs. To capitalize on this emerging opportunity, M&M is setting up a dedicated facility for farm machines at Pithampur in Madhya Pradesh which will go on stream next fiscal. M&M would launch 15 products in the far machinery space over the next four years, which will include products that are tractor mounted or tractor trailer and those that self propelled.

For its tractors business, VST has recently focused on strengthening its product portfolio by launching new products such as 27 HP High torque, Virraaj Face lift, 30 HP and NGT. Its international business got a facelift as it strengthened its distributor network across various countries including Germany, Hungary, Nepal, Bangladesh, Sri Lanka, Guinea, Tunisia, Liberia and Congo. Last fiscal the company added 42 new dealers in Europe and 10 new dealers in Asia & Africa. Its international business strives to leverage on the capability of its state of the art factories producing a full range of agri-machinery. VST's capacity utilization is expected to get a boost from its tie up with global players such as Zetor, Monarch and Pubert.

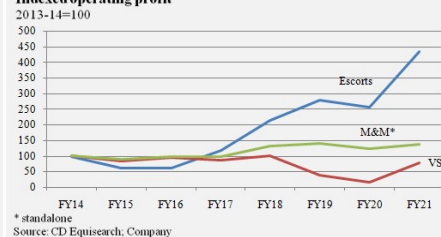
Indexed income from operations



OPM



Indexed operating profit



Financials

Quarterly Results

Figures in Rs crs

	Q2FY22	Q2FY21	% chg.	H1FY22	H1FY21	% chg.
Income from operations	1673.85	1654.18	1.2	3375.64	2743.44	23.0
Other Income	65.51	39.19	67.2	114.33	69.78	63.8
Total Income	1739.36	1693.37	2.7	3489.97	2813.22	24.1
Total Expenditure	1463.59	1356.12	7.9	2928.98	2323.40	26.1
PBIDT	275.77	337.25	-18.2	560.99	489.82	14.5
Interest	4.10	3.77	8.8	7.58	6.18	22.7
Depreciation	33.49	28.00	19.6	65.44	55.08	18.8
PBT	238.18	305.48	-22.0	487.97	428.56	13.9
Tax	60.88	77.25	-21.2	121.83	106.30	14.6
PAT	177.30	228.23	-22.3	366.14	322.26	13.6
MI	0.30	0.35	-14.3	0.56	0.47	19.1
Profit of investments	-3.83	-1.01	279.2	-14.22	-2.46	478.0
Reported PAT	173.17	226.87	-23.7	351.36	319.33	10.0
Extraordinary Item	-	-	-	-	-	-
Adjusted Net Profit	173.17	226.87	-23.7	351.36	319.33	10.0
EPS (F.V. 10)	17.12	25.53	-32.9	34.74	35.93	-3.3

Segment results

Figures in Rs crs

	Q2FY22	Q2FY21	% chg.	H1FY22	H1FY21	% chg.
Segment Revenue						
Agri Machinery Products	1246.13	1332.50	-6.5	2682.43	2309.21	16.2
Railway Equipments	170.16	160.21	6.2	289.56	215.12	34.6
Construction Equipments	249.20	156.92	58.8	390.02	209.41	86.2
Others	10.85	4.55	138.5	16.12	9.70	66.2
Sub Total	1676.34	1654.18	1.3	3378.13	2743.44	23.1
Inter - Segment Revenue	2.49	0.00	-	2.49	0.00	-
Net Segment Revenue	1673.85	1654.18	1.2	3375.64	2743.44	23.0
Segment EBIT						
Agri Machinery Products	186.90	262.95	-28.9	410.22	403.69	1.6
Railway Equipments	29.37	32.50	-9.6	46.77	33.92	37.9
Construction Equipments	8.95	2.73	227.8	5.66	-14.06	-140.3
Sub Total	225.22	298.18	-24.5	462.65	423.55	9.2
Interest	4.10	3.77	8.8	7.58	6.18	22.7
Other Unallocable Exp.	-17.06	-11.07	54.1	-32.90	-11.19	194.0
Exceptional inc./(expense)	-	-	-	-	-	-
PBT	238.18	305.48	-22.0	487.97	428.56	13.9

Consolidated Income Statement

Figures in Rs crs

	FY19	FY20	FY21	FY22e	FY23e
Income from operations	6262.02	5810.09	7014.42	7486.13	8502.87
<i>Growth (%)</i>	23.8	-7.2	20.7	6.7	13.6
Other Income	99.85	97.60	160.38	272.70	387.14
Total Income	6361.87	5907.69	7174.80	7758.83	8890.01
Total Expenditure	5537.49	5156.91	5887.66	6463.63	7268.01
EBITDA (other income included)	824.38	750.78	1287.14	1295.20	1622.00
Interest	19.54	17.23	13.34	14.54	13.92
EBDT	804.84	733.55	1273.80	1280.66	1608.08
Depreciation	87.21	107.22	118.28	132.05	145.37
Tax	237.77	153.53	283.15	287.15	365.68
Net profit	479.86	472.80	872.37	861.46	1097.03
Minority interest	-1.03	-0.53	0.17	1.00	1.00
Profit of investments	-1.96	-1.08	-0.74	-20.00	-22.00
Reported PAT	478.93	472.25	871.46	840.46	1074.03
Extraordinary item	6.00	-5.91	2.81	-	-
Adjusted Net Profit	472.93	478.16	868.65	840.46	1074.03
EPS (Rs.)	53.21	53.80	88.57	80.02	97.20

*adjusted for treasury shares

Segment Results

Figures in Rs crs

	FY19	FY20	FY21	FY22e	FY23e
Segment Revenue					
Agri Machinery Products	4798.51	4472.49	5732.26	5982.43	6867.18
Railway Equipments	394.07	477.22	478.96	549.56	604.52
Construction Equipments	1054.07	839.76	776.11	918.02	991.44
Others	15.90	20.69	27.09	36.12	39.73
Sub Total	6262.55	5810.16	7014.42	7486.13	8502.87
Inter - Segment Revenue	0.53	0.07	0.00	0.00	0.00
Net Segment Revenue	6262.02	5810.09	7014.42	7486.13	8502.87
Segment EBIT					
Agri Machinery Products	666.04	572.49	1032.55	938.22	1133.08
Railway Equipments	78.32	85.83	76.75	88.37	102.77
Construction Equipments	37.81	30.22	27.81	28.10	39.66
Auto Ancillary Products	1.89	0.00	0.00	0.0	0.00
Sub Total	784.06	688.54	1137.11	1054.69	1275.51
Interest	19.54	17.23	13.34	14.54	13.92
Other Unallocable Exp. (net of income)	52.45	35.76	-31.75	-108.46	-201.11
Exceptional income/(expense)	5.56	-9.22	0.00	0.00	0.00
PBT	717.63	626.33	1155.52	1148.62	1462.71

Consolidated Balance Sheet

Figures in Rs crs

	FY19	FY20	FY21	FY22e	FY23e
SOURCES OF FUNDS					
Share Capital	122.58	122.58	134.83	131.94	110.50
Reserves	2550.91	2994.82	4891.30	7643.99	8876.48
Total Shareholders Funds	2673.49	3117.40	5026.13	7775.93	8986.97
Minority Interest	5.64	5.10	-0.91	0.09	1.09
Long term debt	3.53	24.47	49.35	48.60	47.85
Total Liabilities	2682.66	3146.97	5074.57	7824.62	9035.91
APPLICATION OF FUNDS					
Gross Block	2622.80	2764.78	2942.17	3202.17	3352.17
Less: Accumulated Depreciation	975.57	1062.37	1145.94	1277.99	1423.36
Net Block	1647.23	1702.41	1796.23	1924.18	1928.81
Capital Work in Progress	79.96	124.66	64.69	60.00	50.00
Investments	490.79	797.36	1938.02	4242.75	4720.84
Current Assets, Loans & Advances					
Inventory	857.42	883.36	718.16	897.70	1077.24
Sundry Debtors	931.05	731.86	657.58	756.22	869.65
Cash and Bank	243.30	324.88	1321.76	1313.76	1813.99
Other Assets	334.52	319.92	271.58	354.59	385.60
Total CA & LA	2366.29	2260.02	2969.08	3322.27	4146.48
Current liabilities	1798.64	1649.71	1593.41	1617.55	1695.32
Provisions	120.04	125.75	101.68	111.05	113.16
Total Current Liabilities	1918.68	1775.46	1695.09	1728.61	1808.48
Net Current Assets	447.61	484.56	1273.99	1593.66	2337.99
Net Deferred Tax	-51.65	-29.27	-23.30	-25.30	-27.30
Other Assets (Net of liabilities)	68.72	67.25	24.94	29.33	25.57
Total Assets	2682.66	3146.97	5074.57	7824.62	9035.91

Key Financial Ratios

	FY19	FY20	FY21	FY22e	FY23e
Growth Ratios					
Revenue (%)	23.8	-7.2	20.7	6.7	13.6
EBIDTA (%)	30.9	-8.6	70.1	-9.3	20.8
Net Profit (%)	35.2	1.1	81.7	-3.2	27.8
EPS (%)	35.2	1.1	64.6	-9.7	21.5
Margins					
Operating Profit Margin (%)	11.6	11.4	16.1	13.7	14.5
Gross Profit Margin (%)	12.7	12.8	18.1	17.1	18.9
Net Profit Margin (%)	7.6	8.2	12.4	11.5	12.9
Return					
ROCE (%)	17.6	15.4	21.2	13.6	13.2
ROE (%)	19.5	16.7	21.6	13.3	12.9
Valuations					
Market Cap / Sales	1.6	1.4	2.5	3.2	2.9
EV/EBIDTA	11.5	9.5	11.3	16.9	13.5
P/E	15.0	12.3	14.6	22.5	18.5
P/BV	2.7	1.9	2.6	2.6	2.2
Other Ratios					
Interest Coverage	37.3	37.8	87.3	80.0	106.1
Debt-Equity Ratio	0.2	0.1	0.0	0.0	0.0
Current Ratio	1.4	1.6	2.6	4.1	4.6
Turnover Ratios					
Fixed Asset Turnover	3.9	3.5	4.0	4.0	4.4
Total Asset Turnover	2.6	2.0	1.7	1.2	1.0
Debtors Turnover	8.2	7.0	10.1	10.6	10.5
Inventory Turnover	7.8	5.9	7.4	8.0	7.4
Creditors Turnover	4.5	4.1	4.7	5.4	5.9
WC Ratios					
Debtor Days	44.4	52.2	36.2	34.5	34.9
Inventory Days	46.9	61.7	49.6	45.6	49.6
Creditor Days	81.8	90.1	77.1	67.6	61.5
Cash Conversion Cycle	9.5	23.8	8.7	12.5	23.0

Cumulative Financial Data

Figures in Rs crs	FY15-17	FY18-20	FY21-23e
Income from operations	11690	17131	23003
Operating profit	634	1941	3384
EBIT	617	1922	3805
PBT	475	1856	3763
PAT after MI	385	1301	2783
OPM (%)	5.4	11.3	14.7
NPM (%)	3.3	7.6	12.3
Interest coverage	4.4	29.0	91.0
ROE (%)	7.4	18.4	15.4
ROCE (%)	6.7	16.9	15.5
Fixed asset turnover	2.4	3.5	4.2
Debtors turnover	9.4	9.6	9.6
Inventory turnover	7.1	7.6	6.7
Creditors turnover	4.1	4.6	5.1
Debtors days	38.8	38.0	38.1
Inventory days	51.4	48.1	54.7
Creditors days	88.1	79.4	71.0
Conversion cycle	2.1	6.6	21.9

FY15-17 implies three years ending fiscal 17; *as on terminal year

Better product mix (above 40 hp accounted for 62% of domestic sales vs 51% in FY20) coupled with no weakish tractor volume growth in FY21 (24.1% overall, explains much of the perceptible rise in OPMs in FY21-23e period (14.7% Vs 11.3%) with EBIT margins in Escorts agri machinery business zoomed to record 18% from a miserable 12.8% in FY20. Bolstered by series of price hikes each ranging 2-4% in the last few quarters - triggered by nearly unprecedented raw material price inflation -and 22% cumulative tractor volume growth, cumulative revenues during FY21-23e is projected to rise by 34.3% compared to that in the preceding three year period (see table) and cumulative post tax earnings would more than double in the projected period.

Yet return on equity will hardly rise (15.4% in FY21-23e Vs 18.4% in FY18-20 period) not least due to no small amassment of liquid assets - over Rs 5300 crs projected for FY22; piled up from private placements to Kubota Corporation and record free cash flow generation in FY21 when post tax earnings surged by some 82%. Despite some stress in inventory and debtor days, conversion cycle would be all but contained at some 22 days from some 7 days in the preceding three period (see table).

Financial Summary – US dollar denominated

million \$	FY19	FY20	FY21	FY22e	FY23e
Equity capital	17.7	16.3	18.3	17.7	14.8
Shareholders funds	382.7	410.7	673.5	1037.4	1200.2
Total debt	40.6	5.5	6.8	6.6	6.5
Net fixed assets (incl CWIP)	249.7	242.4	253.2	266.6	265.9
Investments	71.0	105.8	263.7	570.1	634.4
Net current assets	60.9	61.4	163.0	206.7	306.7
Total assets	384.1	414.6	680.1	1044.0	1206.8
Revenues	896.0	819.7	945.3	1005.9	1142.6
EBITDA	116.7	107.0	173.0	174.0	218.0
EBDT	113.9	104.6	171.2	172.1	216.1
PBT	101.4	89.5	155.2	154.3	196.5
Profit after MI & others	67.7	67.5	117.1	112.9	144.3
EPS(\$)	0.76	0.76	1.19	1.08	1.31
Book value (\$)	4.31	4.62	6.66	9.39	10.86

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rate (\$74.42/\$)

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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.