

Deepak Nitrite Ltd. (DNL)

No. of shares (m)	136.4
Mkt cap (Rs crs/\$m)	3347/494.9
Current price (Rs/\$)	245/3.6
Price target (Rs/\$)	295/4.4
52 W H/L (Rs.)	299/139
Book Value (Rs/\$)	66/1.0
Beta	1.2
Daily volume NSE (avg. monthly)	140830
P/BV (FY19e/20e)	3.3/2.8
EV/EBITDA (FY19e/20e)	11.5/7.6
P/E (FY19e/20e)	26.1/16.6
EPS growth (FY18/19e/20e)	36.4/88.1/56.8
OPM (FY18/19e/20e)	10.8/13.6/13.7
ROE (FY18/19e/20e)	8.3/13.5/18.4
ROCE(FY18/19e/20e)	5.9/9.4/12.0
D/E ratio (FY18/19e/20e)	1.1/1.3/1.3
BSE Code	506401
NSE Code	DEEPAKNT
Bloomberg	DN IN
Reuters	DPNT.BO

Shareholding pattern

	%
Promoters	
MFs / Banks / FIs	
Foreign Portfolio Investors	
Govt. Holding	
Public & others	
Total	100.0

As on June 30, 2017

Recommendation

BUY

Analyst

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Company brief

Sorted into basic chemicals, fine & speciality chemicals (FSC) and performance products, DNL's product portfolio comprises organic, inorganic and fine chemicals - for use in detergents, colorants, paper, agro chemicals, rubber etc.

Highlights

- Sluggish overall volume growth (5%) failed to scupper business growth for overall revenues surged by 19.4% in Q4 - markedly improved from 6.1% in Q1- and operating margin rose by some 30 bps. Striking increases in both interest (34.1%) and depreciation expenses (14.3%) scarcely put brakes on PBT - which rose by a stunning 46.5%. Yet post tax earnings (adjusted for exceptional item) increased by an abysmal 15.4%.
- Normalization of operations of fine & specialty chemicals business at Roha - which got impacted due to fire in Q3 and Q4 of FY17- saw its revenues unbridled - rose by 22.6% (though not truly comparable due to current quarter sales net of GST) and EBIT margins astonishingly surged both yoy and q-o-q - EBIT: Rs 30.06 crs Vs Rs 14.56 crs (\$4.7m Vs \$2.2m) in the same quarter a year ago; though marginally rose from that in third quarter (Rs 27.08 crs/\$4.2m) Performance products business continued to show some traction with revenues rising by some 10% but loss marginally widened.
- Domestic revenue growth outpaced growth in exports as supply disruption in China buoy off take of key product chemical intermediates from some large domestic customers. Propitious demand from key consumer industries did buoy export growth of 16% in Q4.
- The stock currently trades at 26.1x FY19e EPS of Rs 9.42 and 16.6x FY20e EPS of Rs 14.76. Strenuous rebound in earnings rests on modest growth in basic chemical and performance products businesses and firm phenol prices globally. Yet setbacks in cornering domestic phenol and acetone markets could unsettle earnings estimates. Yet backward integration of Roha unit would boost capacity utilization of most propitious fine & specialty chemicals business. Wherefore margins could scarcely remain subdued. We recommend buying the stock with revised target of Rs 295 (previous target: Rs 251) based on 20x FY20 earnings.

Consolidated (Rs crs)	FY16	FY17	FY18	FY19e	FY20e
Income from operations	1372.93	1370.70	1651.45	2637.13	4032.88
Other Income	1.59	81.39*	12.40	10.19	8.20
EBITDA (other income included)	168.39	216.86	208.60	369.02	558.71
Profit after associate profit (adjusted for EO)	63.88	43.12	65.91	128.44	201.34
EPS**(Rs)	5.94	3.67	5.01	9.42	14.76
EPS growth (%)	17.3	-38.3	36.4	88.1	56.8

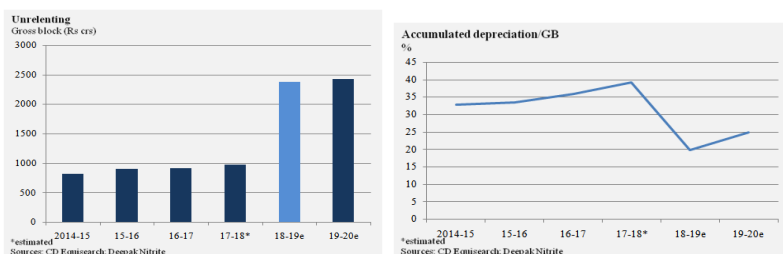
*includes Rs 70.48 crs profit on sale of land and surrender of leasehold rights; ** calculated on weighted average equity.

Outlook & Recommendation

Capex

Delays barely elude gargantuan sized projects - not unlike Deepak's phenol and acetone project - for Deepak's phenol project would not see light of the day before July, thus holding up commercial start by at least six months. With capital commitment of over Rs 1100 crs (\$162.7m), this forward integrated king sized project has seen start of pre-commissioning activities with DNL's marketing team arduously undertaking customer outreach program. Yet project delay often do not have only direct impact for the recent rise in crude oil prices have not imperceptibly widened cracks for the phenol business, not feebly costing stakeholders.

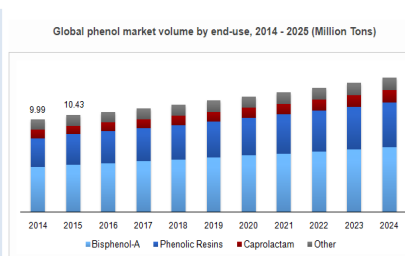
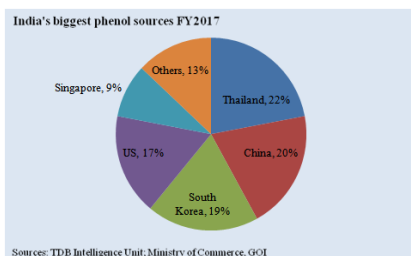
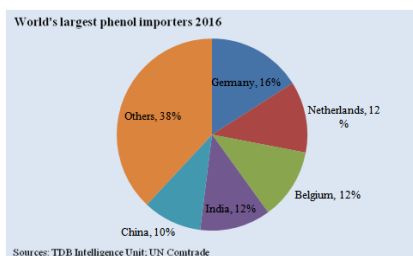
Capital investment to the tune of some Rs 80 crs (\$11.8m) this fiscal is intended to fortify its fine & specialty chemicals and basic chemicals businesses. Recent commissioning of fine & specialty chemicals backward integrated unit at Roha would help expand segment margins by at least 100 bps this fiscal.



Phenol update

According to a recent report, the global phenol market is estimated to grow at 6.8% CAGR during the period 2017-2022 driven by diversity of phenol use ranging from paints to refineries to reins to fuel additives to abrasives. Demand would also surge on account of industrial sector growth in several countries. Owing to various factors such as easy availability, cost effectiveness and efficacy, Bisphenol-A remains the most sought after phenol - accounting for nearly half of the revenue share of global market. Market wise, Asia Pacific excluding Japan (APEJ) continues to be the largest phenol market, enjoying relatively lax phenol production regulations, thus suppressing exports from phenol exports from highly regulated European and North American markets.

Another industry reports posits that rising demand for derivatives such as epoxy resins, polycarbonates, nylon, phenolic resins, detergents and pharmaceuticals would galvanize the global phenol market in the years to come. Robust demand in China and India for derivative products have doubtlessly buttressed off take from Asia Pacific region - expected to grow by 4.9% CAGR during 2014-2025, while Europe and North American markets would grow modestly thanks to stringent government norms in these regions. It's expected that phenolic resins - fastest growing segment in terms of both volume and revenue - is expected to fuel market over the forecast period. Ever-growing environmental regulations implemented by EPA and European Commission would increase entry barriers for new players in this industry.



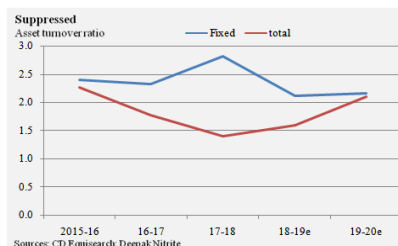
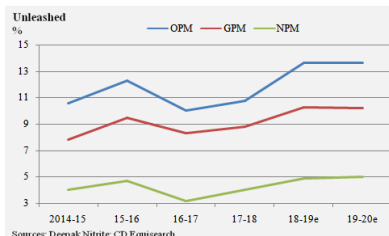
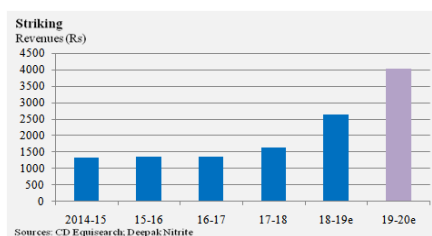
Source: Hexa Research

Financials & Valuations

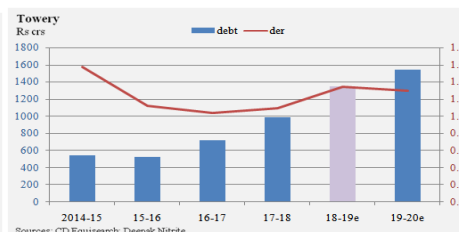
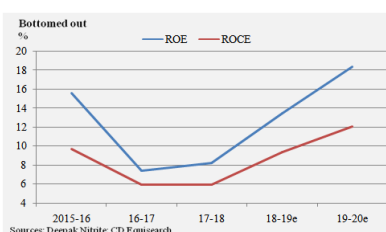
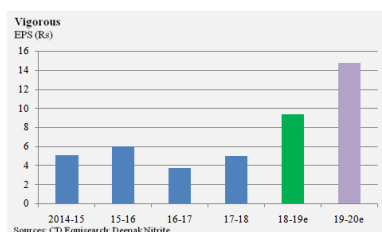
Industry reports portend Indian phenol industry - which has been buttressed by growth in PF resin manufacturing over the last few years - to grow by nearly 8% annually between 2016 and 2021. Other growth drivers in domestic market are its widespread usage in manufacture of agro chemicals, alkyl phenols and pharmaceuticals. Increasing use of phenol derivatives in production of electronic goods and automobiles in some of the Asia Pacific countries namely China, India, Japan, South Korea and Taiwan has unbridled demand, thus compensating for languid growth in American and European markets.

To restructure a largely import filled Indian phenol market, Deepak Phenolics would commence a 2 lakh tonne phenol plant some time in Q2 which would drastically cut India's phenol import share to sub 15% (by DNL internal estimates) from nearly 80% now; for acetone - 1.2 lakh tonne capacity planned - the trends would barely diverge for Deepak's production is estimated to substitute four-fifths of total imports. Yet the delay in start of Deepak Phenolics phenol project - with sharp rise in phenol prices of late - has cost shareholders dear.

Commencement of the backwardly integrated unit of fine & specialty chemicals segment at Roha would not scarcely prop up margins - 26% in FY19 from 24.8% a year ago - volume growth too would get a boost. Yet not indistinguishable gains would arise from commercial production of phenol & acetone project which is estimated to account for a third of FY19 allocable EBIT and half of FY20s. Greater domestic consumption of Chinese phenol output for downstream products coupled with shutdown of a large phenol facility in US did little to stymie phenol prices.



The stock currently trades at 26.1x FY19e EPS of Rs 9.42 and 16.6x FY20e EPS of Rs 14.76. Delay start from the phenol project would barely hasten optimum utilization of both phenol and acetone capacities this fiscal, containing full blown resurrection in earnings. Further delay in commercial production or uncertainties in global phenol market cannot be patently ignored. Yet heady rebound in earnings coupled with free cash flows at firm level - since repayments for the phenol project will only start 2020 - would not constrain expansion in return on capital - ROE to jump to 18.4% in FY20 from a measly 8.3% in FY18. we reckon the stock merits a buy rating with revised target of Rs 295 (previous target: Rs 251) based on 20x FY20 e earnings, over a period of 9--12 months. For more info refer to our October report.



Cross Sectional Analysis

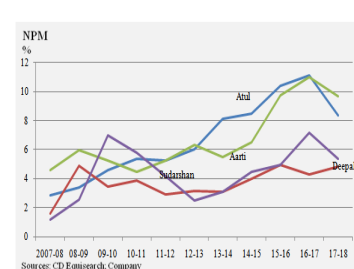
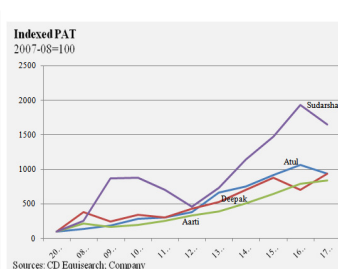
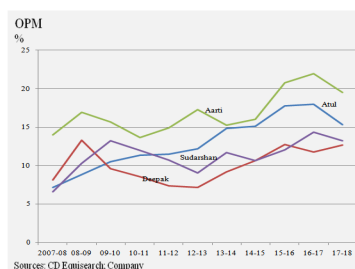
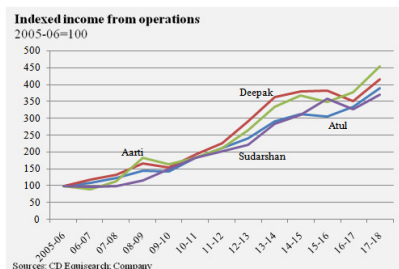
Company	Equity (Rs crs)	CMP (Rs crs)	Mcap (Rs crs)	Inc. from ops. (Rs crs)	Profit (Rs crs)	OPM (%)	NPM (%)	Int. coverage	ROE (%)	Mcap / IO	P/BV	P/E
Aarti Inds.	41	1236	10049	3578	333	19.5	9.7	4.3	22.8	2.8	6.4	30.2
Atul Ltd	30	2775	8231	3296	281	15.3	8.4	33.0	13.8	2.5	3.8	29.3
Deepak Nitrite	27	245	3347	1651	65	10.8	3.9	3.0	8.3	2.0	3.7	50.0
Sudarshan Chem	14	484	3352	1455	78	13.3	5.4	5.3	19.9	2.3	7.9	42.9

*figures in crores; calculations on ttm basis; consolidated data
Companies not truly comparable due to product dissimilarity

Supported by its flagship pigments business - revenues up over 20% - Sudarshan Chemical posted not palpable expansion in its OPMs last quarter - 14.6% Vs 11.3% in the same period a year ago - and post tax earnings (from continued operations) surged some 32%. Yet its pigments business reported not savory growth in EBIT (consolidated) - slid by 9.6% in FY18. With planned capex of Rs 250 crs this fiscal, its initiatives are directed at tapping focused international markets which would help in courting more product approvals.

After bagging some multi-year global deals, Aarti would now focus on commencing a new R&D and Innovation facility in Navi Mumbai by end of FY19 which would help in roll out of value added products and chemistries with niche opportunities. Galvanized by 9% volume growth, Aarti's specialty chemical business posted 16.9% growth in its EBIT in Q4, while its pharmaceuticals business posted stunning gains in margins - over 400 bps - on account of operating leverage emanating from higher volumes. Its nitro toluene facility have barely seen ramp of sorts for current utilization scarcely exceeded 40%, lengthening its payback period.

Powered by robust growth (24%) in domestic business, Atul posted overall sales growth of 16% in FY18 (12% volume growth). Its bulk chemicals business targets higher market share of resins and launch of chlorine downstream products, while the colors business - which posted 13% volume growth - plans to commercialize high performance pigments and enhance product portfolio of textile chemicals. Atul's pharmaceuticals business - part of life science chemicals business - targets enhanced CRAMS business with strategic customers and debottleneck capacities. Expansion of resins and formulations and specialty intermediates is on the agenda of its polymer business.



All consolidated data except Deepak Nitrite

Financials

Quarterly Results -Standalone

	Figures in Rs crs					
	Q4FY18	Q4FY17	% chg.	FY18	FY17	% chg.
Income from operations	392.95	329.16	19.4	1454.98	1232.70	18.0
Other Income	6.45	5.05	27.7	11.70	84.12	-86.1
Total Income	399.40	334.21	19.5	1466.68	1316.82	11.4
Total Expenditure	344.00	288.92	19.1	1252.31	1089.45	14.9
PBIDT (other income included)	55.41	45.29	22.3	214.37	227.37	-5.7
Interest	11.13	8.30	34.1	40.34	30.89	30.6
Depreciation	13.38	11.70	14.3	51.95	47.60	9.1
PBT	30.90	25.30	22.2	122.08	148.88	-18.0
Tax	10.58	4.19	152.5	38.63	38.24	1.0
PAT	20.32	21.10	-3.7	83.46	110.64	-24.6
Extraordinary Item	0.00	3.50	-100.0	12.57	57.67	-78.2
Adjusted Net Profit	20.32	17.60	15.4	70.88	52.97	33.8
EPS (F.V. 2)*	1.49	1.35	10.6	5.38	4.51	19.4
Equity	27.28	26.14	4.3	27.28	26.14	4.3

*quarterly EPS on quarter end equity; yearly EPS on weighted average equity; income from operations net of GST / excise

Segment Results

	Figures in Rs crs					
	Q4FY18	Q4FY17	% chg.	FY18	FY17	% chg.
Segment Revenue						
Basic Chemicals	197.46	183.72	7.5	746.98	695.97	7.3
Fine & Speciality Chemicals	121.19	98.86	22.6	463.24	374.82	23.6
Performance Products	81.97	75.09	9.2	299.31	261.83	14.3
Unallocable	-	-	-	0.07	0.00	#DIV/0!
Total	400.61	357.67	12.0	1509.60	1332.62	13.3
Inter segment revenue	7.66	6.22	23.3	30.37	17.35	75.0
Income from operations	392.95	351.45#	11.8	1479.23	1315.26#	12.5
Segment EBIT						
Basic Chemicals	28.49	28.49	0.0	106.65	88.11	21.0
Fine & Speciality Chemicals	30.06	14.56	106.5	114.79	82.36	39.4
Performance Products	-2.83	-0.66	329.1	-8.08	-13.88	-41.8
Total	55.72	42.39	31.5	213.36	156.59	36.3
Interest	11.13	8.30	34.1	40.34	30.89	30.6
Other Unallocable Exp. (net of income)	13.70	8.80	55.7	50.94	-23.19	-319.7
PBT	30.90	25.30	22.2	122.08	148.88	-18.0

#gross sales

Financials

Income Statement - Consolidated

Figures in Rs crs

	FY16	FY17	FY18	FY19e	FY20e
Income from operations	1372.93	1370.70	1651.45	2637.13	4032.88
Growth (%)	3.4	-0.2	20.5	59.7	52.9
Other Income	1.59	81.39	12.40	10.19	8.20
Total Income	1374.52	1452.09	1663.85	2647.31	4041.08
Total Expenditure	1206.13	1235.23	1455.26	2278.29	3482.37
EBITDA (other income included)	168.39	216.86	208.60	369.02	558.71
Interest	39.71	34.13	45.15	98.58	147.15
EBDT	128.67	182.74	163.45	270.44	411.55
Depreciation	39.54	48.04	52.60	90.31	129.17
Tax	26.23	38.25	31.84	51.70	81.04
Net profit	62.90	96.45	79.02	128.44	201.34
Profit of associate	-0.17	-0.15	0.00	0.00	0.00
Net profit after associate profit	62.73	96.30	79.02	128.44	201.34
Extraordinary item	-1.15	53.19	13.11	0.00	0.00
Adjusted Net Profit	63.88	43.12	65.91	128.44	201.34
EPS (Rs.)	5.94	3.67	5.01	9.42	14.76

Segment Results

Figures in Rs crs

	FY16	FY17	FY18	FY19e	FY20e
Segment Revenue					
Basic Chemicals	674.56	695.97	746.98	821.68	917.77
Fine & Speciality Chemicals	393.37	374.82	463.24	514.76	569.36
Performance Products	273.68	264.71	300.00	345.00	379.50
Others - unallocable	42.99	136.57	196.33	995.84	2206.98
Total	1384.60	1472.06	1706.55	2677.28	4073.61
Inter segment revenue	11.67	17.35	30.37	40.16	40.74
Income from operations	1372.93	1454.71#	1676.18	2637.13	4032.88
Segment EBIT					
Basic Chemicals	79.59	88.18	106.69	119.14	135.37
Fine & Speciality Chemicals	97.19	82.36	114.79	133.84	150.88
Performance Products	-8.71	-18.45	-8.14	-3.45	9.49
Unallocable	0.00	0.00	0.00	124.48	286.91
Sub Total	168.07	152.10	213.34	374.01	582.65
Interest	37.65	34.12	45.15	98.58	147.15
Other Unallocable Exp. (net of income)	41.29	-16.73	57.34	95.30	153.12
PBT	89.13	134.70	110.85	180.14	282.38

#gross sales

Consolidated Balance Sheet

Figures in Rs crs

	FY16	FY17	FY18	FY19e	FY20e
SOURCES OF FUNDS					
Share Capital	23.26	26.14	27.28	27.28	27.28
Reserves	449.61	688.72	894.86	1001.92	1181.88
Total Shareholders Funds	472.87	714.87	922.14	1029.20	1209.16
Long term debt	158.93	218.44	550.46	849.93	799.93
Total Liabilities	631.79	933.30	1472.60	1879.13	2009.09
APPLICATION OF FUNDS					
Gross Block	899.03	913.45	967.68	2380.95	2420.95
Less: Accumulated Depreciation	301.31	327.52	380.12	470.42	599.60
Net Block	597.72	585.93	587.56	1910.52	1821.35
Capital Work in Progress	31.93	349.19	954.51	0.00	20.00
Investments	86.60	118.08	31.77	12.35	12.35
Current Assets, Loans & Advances					
Inventory	121.02	167.15	325.42	413.28	640.58
Sundry Debtors	313.19	360.33	411.77	597.07	925.46
Cash and Bank	6.49	14.49	48.20	28.50	7.31
Other Assets	56.67	94.27	178.07	263.71	403.29
Total CA & LA	497.37	636.24	963.46	1302.56	1976.64
Current liabilities	577.73	803.20	1044.06	1326.55	1859.38
Provisions	20.25	4.10	3.54	3.81	4.19
Total Current Liabilities	597.98	807.30	1047.59	1330.36	1863.57
Net Current Assets	-100.61	-171.06	-84.13	-27.80	113.07
Net Deferred Tax (net of liability)	-56.65	-39.08	-45.40	-107.14	-108.94
Other Assets (Net of liabilities)	72.81	90.24	28.29	91.21	151.27
Total Assets	631.79	933.30	1472.60	1879.13	2009.09

Key Financial Ratios

	FY16	FY17	FY18	FY19e	FY20e
Growth Ratios					
Revenue (%)	3.4	-0.2	20.5	59.7	52.9
EBIDTA (%)	20.2	-13.0	28.7	94.0	51.4
Net Profit (%)	20.6	-32.5	52.9	94.9	56.8
EPS (%)	17.3	-38.3	36.4	88.1	56.8
Margins					
Operating Profit Margin (%)	12.3	10.0	10.8	13.6	13.7
Gross Profit Margin (%)	9.5	8.3	8.8	10.3	10.2
Net Profit Margin (%)	4.7	3.2	4.0	4.9	5.0
Return					
ROCE (%)	9.7	5.9	5.9	9.4	12.0
ROE (%)	15.6	7.4	8.3	13.5	18.4
Valuations					
Market Cap / Sales	0.6	1.3	2.1	1.3	0.8
EV/EBIDTA	7.2	15.6	22.6	11.5	7.6
P/E	11.4	35.8	49.7	26.1	16.6
P/BV	1.7	2.5	3.8	3.3	2.8
Other Ratios					
Interest Coverage	3.3	2.9	3.0	2.8	2.9
Debt-Equity Ratio	1.1	1.0	1.1	1.3	1.3
Current Ratio	1.0	0.9	0.9	1.0	1.1
Turnover Ratios					
Fixed Asset Turnover	2.4	2.3	2.8	2.1	2.2
Total Asset Turnover	2.3	1.8	1.4	1.6	2.1
Debtors Turnover	4.4	4.1	4.3	5.2	5.3
Inventory Turnover	10.7	8.6	5.9	6.2	6.6
Creditors Turnover	9.9	7.1	4.2	4.1	4.8
WC Ratios					
Debtor Days	83.0	89.7	85.3	69.8	68.9
Inventory Days	34.3	42.6	61.8	59.2	55.2
Creditor Days	36.8	51.4	87.4	88.9	75.6
Cash Conversion Cycle	80.5	80.9	59.7	40.1	48.5

Cumulative Financial Data

Figures in Rs crs	FY17-18	FY19-20e
Income from operations	3022	6670
Operating profit	315	909
EBIT	237	708
PBT	158	463
PAT	109	330
Dividends	40	44
OPM (%)	10.4	13.6
NPM (%)	3.6	4.9
Interest coverage	3.0	2.9
ROE (%)	7.9	15.8
ROCE (%)	5.9	10.9
Debt-equity ratio*	1.1	1.3
Fixed asset turnover	2.6	2.8
Debtors turnover	4.2	5.0
Inventory turnover	6.0	6.0
Creditors turnover	4.4	4.4
Debtors days	87.6	73.2
Inventory days	60.6	61.2
Creditor days	83.6	82.2
Cash conversion cycle	64.6	52.2
Dividend payout ratio (%)	22.9	13.5

FY17-18 implies two years ending fiscal 18; *as on terminal year; consolidated data

Commencement of Deepak Phenolics phenol and acetone project sometime in Q2 would do little to stymie business for cumulative revenues would more than double in FY19-20 period from that in previous two year period (see table) accompanied by higher margins - margin expansion also accruing from loss trimming in DNL 's performance products business and backward integration gains at fine & specialty chemicals Roha facility. Surge in both interest costs and depreciation (post capitalization of phenol capacity) would barely prevent spurt in post tax earnings (see table)

Menacing effect of one-off factors such as demonetization, fire at Roha facility and pollution control order at its DASDA facility which stoked rise in return on capital in last few years have now started to strikingly wane. Full blown utilization of phenol facility in FY20 - some 90% expected - would help push ROE to 18.4% by FY20 from just 8.3% in FY18. Conservation of resources to pay out creditors would thwart dividend payouts - estimated to slide to 13.5% in FY19-20 period from 22.9% in the previous two year period. Debt amassment for the illustrious phenol project would push debt - equity ratio to 1.3 by the end of FY20 (see table)

Financial Summary – US dollar denominated

million \$	FY16	FY17	FY18	FY19e	FY20e
Equity capital	3.5	4.0	4.2	4.0	4.0
Shareholders funds	71.2	107.2	138.4	148.9	175.3
Total debt	79.7	111.6	151.7	199.8	227.9
Net fixed assets (incl CWIP)	94.8	144.1	237.0	282.4	272.2
Investments	13.1	18.2	4.9	1.8	1.8
Net current assets	-15.2	-29.3	-16.2	-7.3	13.3
Total assets	95.1	140.9	223.0	274.6	293.6
Revenues	209.7	204.3	256.2	389.9	596.3
EBITDA	26.0	22.0	29.5	54.6	82.6
EBDT	19.9	17.0	22.5	40.0	60.9
PBT	13.9	9.8	14.3	26.6	41.8
Profit after associate profit	9.8	6.4	10.2	19.0	29.8
EPS(\$)	0.09	0.05	0.08	0.14	0.22
Book value (\$)	0.61	0.82	1.01	1.09	1.29

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rates (Rs 67.63/\$). 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/\$	FY14	FY15	FY16	FY17	FY18
Average	60.5	61.15	65.46	67.09	64.45
Year end	60.1	62.59	66.33	64.84	65.04

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.