

Finolex Industries Ltd.

No. of shares (m)	124.1
Mkt cap (Rs crs/\$m)	5739/820.9
Current price (Rs/\$)	462/6.6
Price target (Rs/\$)	599/8.6
52 W H/L (Rs.)	713/440
Book Value (Rs/\$)	200/2.9
Beta	0.5
Daily volume NSE (avg. monthly)	23900
P/BV (FY19e/20e)	2.4/2.1
EV/EBITDA (FY19e/20e)	9.0/8.2
P/E (FY19e/20e)	15.5/13.9
EPS growth (FY18/19e/20e)	-15.2/23.7/11.8
OPM (FY18/19e/20e)	17.7/19.9/19.7
ROE (FY18/19e/20e)	12.6/14.7/16.1
ROCE (FY18/19e/20e)	12.4/14.5/16.0
D/E ratio (FY18/19e/20e)	0.0/0.0/-
BSE Code	500940
NSE Code	FINPIPE
Bloomberg	FNXP IN
Reuters	FINX.NS

Shareholding pattern

	%
Promoters	52.5
MFs / Banks / FIs/Others	10.6
FPIs	2.4
Govt. Holding	0.0
Public & Others	34.2
Total	100.0

As on Mar 31, 2019

Recommendation

BUY

Analyst

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Company Brief

Headquartered in Pune, Finolex Industries is one of India's leading manufacturers of pvc -U pipes & fittings and pvc resin. Its pipes and fittings largely find use in the agriculture segment followed by construction and industrial segments. Its plants are located in Maharashtra and Gujarat.

Highlights

- Battered by rising EDC prices (with adverse effect on PVC/EDC delta), margins on its flagship PVC resin business nosedived to 16.2% fin Q3 from 18.5% In the same period a year ago - 29.5% in Q2 - resulting in just 11.3% growth in PBT. Yet not imperceptible rise in margins in PVC pipes & fittings segment saved blushes for the overall OPMs expanded by some 80 bps. Restoration of price cuts undertaken in PVC pipes business in FY18 largely helped margins to resurrect.
- Yet PVC pipes & fittings volumes have been skimpy at best falling by 3.8% last quarter and growing by a measly 1% in 9MFY19. No small stress in Indian agriculture sector has dismally impacted off take of agricultural pipes, thus impacting overall volumes. For instance, the off take of pipes emanating from agriculture sector has slid 2% in 9MFY19.
- Stoked by relentless rise in EDC prices, PVC/EDC delta has strikingly tumbled in Q3, thus reaching \$535 / ton from \$733 in Q3FY18 and \$641 in Q2FY19. Plans were foot to ramp up PVC pipes & fittings capacity to 370000 mt by FY19. Some capacity enhancement, including that of new moulds for fittings, has also been planned for next fiscal. Finolex's CPVC business has of late shown traction as its volumes rose by over 50% to 2300 tons in Q3, thus reporting revenues of some Rs 61 crs compared to Rs 38 crs in the same period a year ago.
- The stock currently trades at 15.5x FY19e EPS of Rs 29.78 and 13.9x FY20e EPS of Rs 33.28. Prodded by improved margins in both PVC resin and pipes & fittings businesses, we revise upwards our FY19 EPS estimate by some 10%. Despite ostensible challenges in reviving Indian housing sector, efforts are being put up to augment Finolex's non-agriculture volume share from the current 30%. Robust revival in off take of agricultural pipes is not on anvil for now, though overall PVC pipes volumes are projected to grow in low teens in current fiscal. On balance, we retain our buy recommendation on the stock with revised target of Rs 599 (previous target: Rs 814) based on 18x FY20e earnings over a period of 9-12 months.

(Figures in Rs crs)	FY16	FY17	FY18	FY19e	FY20e
Income from operations	2481.91	2602.36	2737.79	2983.88	3320.29
Other Income	64.12	24.32	25.32	32.82	38.88
EBITDA (other income included)	468.56	587.39	509.25	626.29	694.56
Profit after EO	232.26	352.18	298.82	369.55	413.00
EPS (Rs)	18.72	28.38	24.08	29.78	33.28
EPS growth (%)	381.4	51.6	-15.2	23.7	11.8

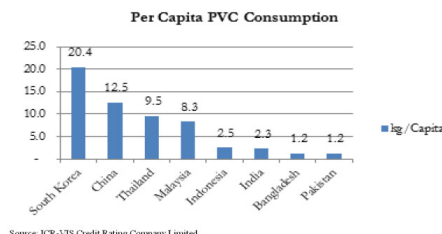
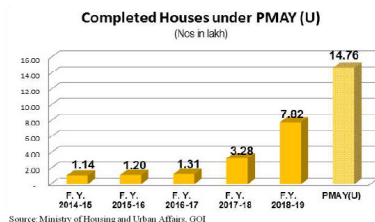
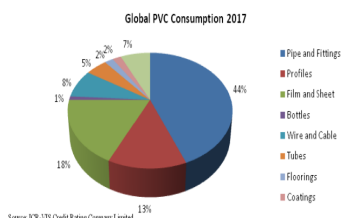
Investment Thesis

PVC Industry

According to Persistence Market Research, Asia Pacific region - accounting for more than 50% of global PVC market - is estimated to grow at decent rate all thanks to high growth potential of building and construction industry. The report posits that demand drivers for PVC market include high growth in building & construction sector, robust growth in automobile industry and growing medical devices. However, demand restraining factors include increasing competition from steel and concrete pipes and prohibited use of PVC in construction of green buildings.

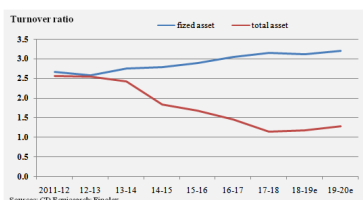
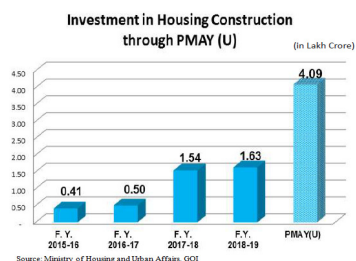
Industry reports also suggest that China continues to be the largest consumer of PVC and against the backdrop of PVC surplus in China and no major capacity expansion projects in the pipeline, there exist little scope of capacity growth over the period 2017 to 2020. Wires & cables coatings is expected to emerge as one of the fastest end use markets driven by increasing demand for high strength and environment friendly plastics.

Driven by increased implementation of some favorable GOI schemes in end-user application sectors, the market for plastic pipes and fittings in India is estimated to grow at double digit during FY19-FY26, according to a report published by Global News Wire. Growth in ground handling services market in India would be hastened by growing demand for housing as population and personal disposable incomes increase. The PVC pipes and fittings market, which grew at a double digit rate during FY13 and FY18, is projected to stay buoyant - Ken Research forecast 14.7% CAGR during the period FY18-FY26 - all thanks to growing government investments in irrigation, housing and sanitation through schemes such as Housing for All, AMRUT and PMKSY. Well directed schemes such as PMKSY would buoy demand for PVC pipes and fittings for installation of irrigation systems in farms and fields.



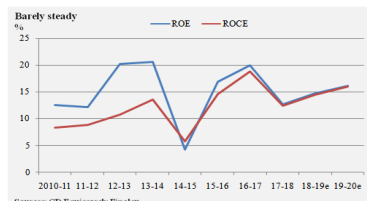
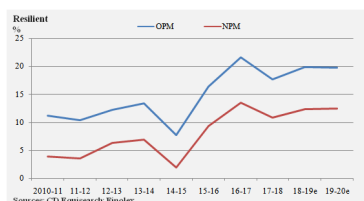
Financials & Valuation

Amply manifested in barely wobbly dispatches of Finolex's PVC pipes and fittings, India's PVC market (about three-fourths of that comes from pipe segment) has grown at mid single digits during five years ending 2016-17. Further India continues to lag behind many of the developing economies in terms of per capita PVC consumption, invoking hope of robust growth potential. Buttressed by GOI's infrastructural projects such as Swachh Bharat Mission, Pradhan Mantri Krishi Sinchai Yojana and the Smart City Programme, India's PVC pipes market is estimated to grow at double digit (though low) over the next few years. Industry reports contend that unparalleled focus on smart water, waste management and rainwater harvesting would give great fillip to Indian piping industry. Deficient and uneven rainfall in the country has the potential to boost demand for long service life sewerage, plumbing and irrigation systems in coming years.



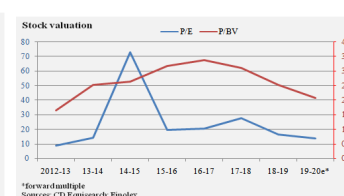
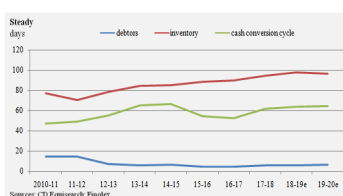
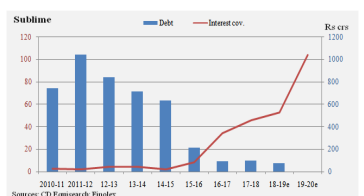
CD Equisearch Pvt Ltd

Trampled by farm distress, Finolex's off take of PVC pipes has abysmally suffered in last few quarters as total dispatches has not grown at all. After growing in Q1 by 7.2%, PVC pipes dispatches have fallen for two consecutive quarters, partially eroding gains ensuing from higher realizations. Sensing no timid recovery in PVC market soon, Finolex plan to further ramp up its PVC pipes & fittings capacity this fiscal, thus supporting its volume growth of some 12% for current fiscal. After growing by 42% (in tonnage) last fiscal, Finolex's CPVC volumes has barely staggered as its 9MFY19 dispatches have already surpassed FY18's total sum of 5878 tons.



Amplifying PVC /EDC delta over the last few quarters (bar Q3) helped Finolex report PVC resin gross margin of 23.1% in 9MFY19 when compared to 17.4% in the same period last year., thus displaying over 38% growth in its EBIT. As expected external sale of PVC resin tumbled 12.3% in 9MFY19 and is estimated to further decline by 8% next fiscal. Galvanized by volume resurrection, Finolex's PVC pipe and fittings margins would jump by some 90 bps to 9% next fiscal.

The stock currently trades at 15.5x FY19e EPS of Rs 29.78 and 13.9x FY20e EPS of Rs 33.28. Restoration of price cuts in PVC pipes undertaken in FY18 coupled with recovery in volumes would help Finolex report earnings growth in low teen next fiscal on overall higher operating margin. Blend of higher capacity utilization and increased margins would doubtlessly spur return on capital - ROE estimated to rise to 16.1% from 12.6% in FY18. Yet risks of little steady demand of PVC pipes from vagaries of monsoons would have no sober effects. On balance, we retain our buy recommendation on the stock with revised target of Rs 599 (previous target: Rs 814) based on 18x FY20e earnings (four year average TTM P/E: 20.9) For more info refer to our May report.



Risks & Concerns

Commodity price fluctuations

For PVC manufacturing, Finolex imports key petrochemical products namely, vinyl chloride monomer (VCM), ethylene and ethylene dichloride (EDC) from international markets. Though its PVC prices are regularly adjusted for import parity price of PVC in international market, little scope exists for evading adverse impact of short term fluctuations in key raw material prices. Crude oil prices continue to exert great impact on prices of its finished goods. By some measure, 5% increases in prices of VCM, ethylene and EDC would adversely impact Finolex's PBT by Rs 29.87 crs, Rs 12.44 crs and Rs 12.10 crs respectively.

Foreign exchange risk

Although Finolex is greatly exposed to exchange rate fluctuations- not least due to its very large import bill (Rs 1231 crs in FY18), its revenues (arising from PVC resin) are linked to import parity pricing of PVC resin, thus acting as a natural hedge.

Cross Sectional Analysis

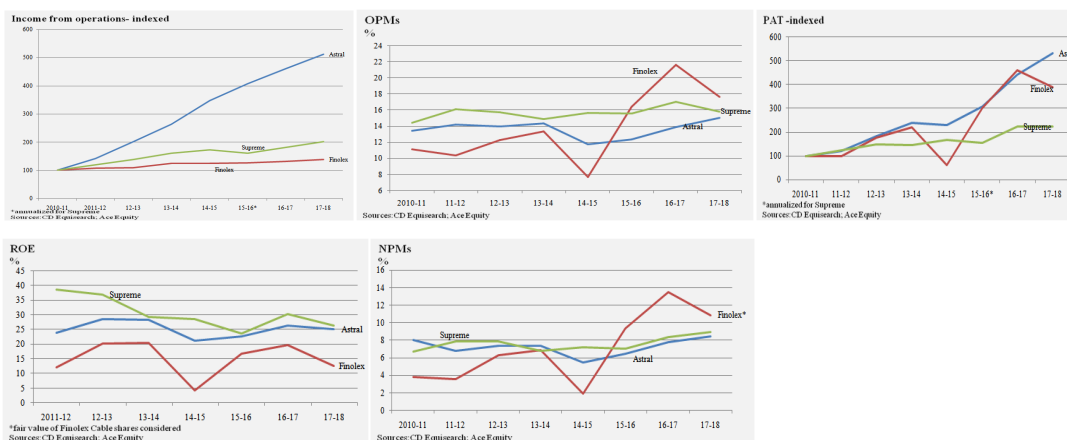
Company	Equity*	CMP	Mcap*	Sales*	Profit*	OPM (%)	NPM (%)	Int. Cov.	ROE (%)	DER	Mcap / sales	P/BV	P/E
Astral Poly	12	1229	14725	2412	200	15.9	8.4	9.3	18.4	0.2	6.1	12.1	73.7
Finolex Ind.	124	462	5739	2936	398	22.1	13.5	46.2	15.5	0.0	2.0	2.3	14.4
Supreme Inds	25	1184	15036	5544	462	15.5	8.1	27.8	24.0	0.1	2.7	7.2	32.5

*figures in crores; calculations on ttm basis

Book value adjusted for goodwill and revaluation reserves where applicable

Restrained by sales volumes of pipes (up by just 4.2%), Astral's standalone revenues rose by 13.6% in Q3 compared to that in the same period last fiscal. But operating profit fared well for it rose by a blistering 41.1% (OPMs 17.3% Vs 13.9%) to Rs 76.61 crs compared to Rs 54.28 crs in year ago period. Large part of the gains in revenues was attributed to higher realizations of CPVC pipes emanating from rupee depreciation. Buffeted by sluggish real estate demand, pipe volumes barely stayed animated so far this fiscal for it rose by a depressing 7.2% in nine months of current fiscal - though the company scarcely feels price cuts are needed to prop up volumes. OPMs for 9MFY19 did not surge indiscernibly (thanks to lower raw material prices and other operating costs) for it expanded in excess of 300 bps. For better management of inventory in South, it has closed down its depots at Coimbatore and Bangalore.

Stoked by disproportionate increase in raw material prices, OPMs plunged nearly 300 bps last quarter to 12.5%, resulting in over 10% drop in PBT. Lackadaisical volume trends, particularly in packaging products (down 10%) and industrial products (+2%) businesses obscured revenue trends last quarter. Despite efforts to the contrary, volumes of plastic goods have failed to resurrect so far this fiscal - up just 6%- thus restricting operating profit growth to 14.7% in 9MFY19. But this barely reveals spectacular gain of Rs 53 crs (PBT level) realized from sale of 38718 sq ft of premises in Q2 of current fiscal, thus buttressing sharp drop in profits from regular business operations. Also share of value added products in overall revenues dipped to 38% in Q3 compared to 40% in the same quarter a year ago.



Financials

Quarterly Results

Figures in Rs crs

	Q3FY19	Q3FY18	% chg.	9MFY19	9MFY18	% chg.
Income from operations	756.59	722.72	4.7	2127.08	1928.66	10.3
Other Income	17.27	10.25	68.6	29.32	25.01	17.2
Total Income	773.86	732.97	5.6	2156.40	1953.68	10.4
Total Expenditure	631.63	609.39	3.6	1697.26	1635.09	3.8
EBIDTA (other income incl.)	142.24	123.58	15.1	459.14	318.58	44.1
Interest	1.71	-0.36	-576.6	9.83	6.45	52.3
Depreciation	19.63	15.37	27.7	52.40	45.01	16.4
PBT	120.90	108.58	11.3	396.91	267.13	48.6
Tax	42.21	39.03	8.1	138.49	89.53	54.7
Net Profit	78.69	69.55	13.1	258.41	177.60	45.5
Extraordinary Item	-	-	-	-18.21	0.00	
Adjusted Net Profit	78.69	69.55	13.1	276.62	177.60	55.8
EPS	6.34	5.60	13.1	22.29	14.31	55.8

Segment results

Figures in Rs crs

	Q3FY19	Q3FY18	% chg.	9MFY19	9MFY18	% chg.
Segment Revenue						
PVC	484.01	459.84	5.3	1314.78	1262.54	4.1
PVC Pipes & Fittings	590.62	532.01	11.0	1783.68	1646.16	8.4
Power	41.63	37.68	10.5	107.15	101.84	5.2
Total	1116.27	1029.53	8.4	3205.62	3010.54	6.5
Less: Inter-segment revenue	359.67	306.81	17.2	1078.54	988.26	9.1
Income from operations	756.59	722.72	4.7	2127.08	2022.28	5.2
Segment EBIT						
PVC	78.60	85.29	-7.8	303.12	219.42	38.1
PVC Pipes & Fittings	46.69	29.67	57.3	137.31	71.81	91.2
Power	6.93	2.24	209.2	5.04	6.56	-23.2
Total	132.21	117.20	12.8	445.47	297.79	49.6
Interest	1.71	-0.36	-576.6	9.83	6.45	52.3
Unallocable exp.(net of income)	9.61	8.98	7.0	38.73	24.21	60.0
PBT	120.90	108.58	11.3	396.91	267.13	48.6

Income Statement

Figures in Rs crs

	FY16	FY17	FY18	FY19e	FY20e
Income from operations	2481.91	2602.36	2737.79	2983.88	3320.29
<i>Growth (%)</i>	0.2	4.9	5.2	9.0	11.3
Other Income	64.12	24.32	25.32	32.82	38.88
Total Income	2546.03	2626.69	2763.11	3016.70	3359.17
Total Expenditure	2077.48	2039.30	2253.86	2390.41	2664.61
EBIDTA (other income incl.)	468.56	587.39	509.25	626.29	694.56
Interest	44.71	15.38	9.82	10.43	5.89
EBDT	423.85	572.01	499.44	615.86	688.68
Depreciation	50.57	55.05	60.60	72.40	81.33
Tax	118.87	164.78	140.29	173.91	194.35
Net Profit	254.41	352.18	298.55	369.55	413.00
EO	22.15	-	-0.27	-	-
Adjusted Net Profit	232.26	352.18	298.82	369.55	413.00
EPS (Rs)	18.72	28.38	24.08	29.78	33.28

Balance Sheet

Figures in Rs crs

	FY16	FY17	FY18	FY19e	FY20e
SOURCES OF FUNDS					
Share Capital	124.10	124.10	124.10	124.10	124.10
Reserves	1445.75	2167.30	2640.47	2446.80	2793.47
Total Shareholders Funds	1569.85	2291.39	2764.57	2570.90	2917.56
Long term debt	-	-	-	-	-
Total Liabilities	1569.85	2291.39	2764.57	2570.90	2917.56
APPLICATION OF FUNDS					
Gross Block	896.52	1982.35	2063.71	2279.05	2,379.05
Less: Accumulated Depreciation	46.87	1127.22	1179.47	1251.87	1,333.20
Net Block	849.65	855.13	884.24	1027.18	1045.85
Capital Work in Progress	6.62	21.75	90.34	20.00	25.00
Investments	817.21	1222.17	1555.24	1190.49	1381.23
Current Assets, Loans & Advances					
Inventory	447.22	557.40	611.55	672.71	739.98
Sundry Debtors	17.63	52.49	43.14	56.08	64.49
Cash and Bank	10.41	16.34	23.43	31.77	34.74
Loans and Advances	123.06	46.48	65.58	68.11	70.04
Total CA & LA	598.32	672.72	743.70	828.67	909.25
Current Liabilities	585.74	458.22	489.64	502.11	456.85
Provisions	1.09	1.23	1.43	1.55	1.71
Total Current Liabilities	586.84	459.45	491.07	503.66	458.56
Net Current Assets	11.48	213.27	252.64	325.01	450.69
Net Deferred Tax	-127.61	-131.61	-120.68	-88.73	-88.73
Other Assets (Net Of Liabilities)	12.50	110.69	102.80	96.95	103.52
Total Assets	1569.85	2291.39	2764.57	2570.90	2917.56

Key Financial Ratios

	FY16	FY17	FY18	FY19e	FY20e
Growth Ratios (%)					
Revenue	0.2	4.9	5.2	9.0	11.3
EBIDTA (other income included)	107.0	34.7	-13.2	22.9	10.9
Net Profit	381.4	51.6	-15.2	23.7	11.8
EPS	381.4	51.6	-15.2	23.7	11.8
Margins (%)					
Operating Profit Margin	16.4	21.6	17.7	19.9	19.7
Gross Profit Margin	15.8	22.0	18.3	20.6	20.7
Net Profit Margin	9.4	13.5	10.9	12.4	12.4
Return (%)					
ROCE	14.6	18.9	12.4	14.5	16.0
ROE	16.9	19.9	12.6	14.7	16.1
Valuations					
Market Cap / Sales	1.8	2.8	3.0	2.0	1.7
EV/EBIDTA	10.4	12.3	16.1	9.6	8.2
P/E	19.5	20.4	27.4	16.4	13.9
P/BV	3.2	3.4	3.1	2.5	2.1
Other Ratios					
Interest Coverage	8.6	34.6	45.7	53.1	104.2
Debt-Equity Ratio	0.1	0.0	0.0	0.0	0.0
Current Ratio ^a	1.0	1.2	1.3	1.4	1.7
Turnover Ratios					
Fixed Asset Turnover	2.9	3.1	3.1	3.1	3.2
Total Asset Turnover	1.7	1.5	1.2	1.2	1.3
Debtors Turnover	74.8	74.2	57.3	60.1	55.1
Inventory Turnover	4.1	4.1	3.9	3.7	3.8
Creditors Turnover	9.4	8.7	9.4	9.1	9.4
WC Ratios					
Debtor days	4.9	4.9	6.4	6.1	6.6
Inventory days	88.5	89.9	94.7	98.0	96.8
Creditor days	39.0	42.1	38.7	40.2	38.7
Cash conversion cycle	54.4	52.7	62.3	64.0	64.7

Cumulative Financial Data

Figures in Rs crs	FY12-14	FY15-17	FY18-20e
Income from operations	6698	7560	9042
Operating profit	809	1161	1733
EBIT	723	1070	1616
PBT	530	939	1590
PAT	383	633	1081
Dividends	224	351	501
PVC pipe sales (lakh tons)	5.0	6.0	7.9
PVC resin production (lakh tons)	7.70	7.34	7.85
PVC resin sales (lakh tons)	4.02	3.15	1.88
OPM (%)	12.1	15.4	19.2
NPM (%)	5.7	8.4	12.0
Interest coverage	3.8	8.2	61.8
ROE (%)	16.4	13.8	14.8
ROCE (%)	11.6	12.6	14.8
Fixed asset turnover	2.6	2.9	3.2
Debtors turnover	27.2	53.9	51.5
Inventory turnover	4.3	4.0	3.8
Creditors turnover	11.1	12.6	9.4
Debtors days	13.4	6.8	7.1
Inventory days	84.3	91.0	97.2
Creditor days	32.8	29.0	38.7
Cash conversion cycle	65.0	68.7	65.6
Dividend payout ratio (%)	58.8	53.6	46.4

FY12-14 implies three years ending fiscal 14; *as on terminal year

Stirred by higher off take of PVC pipes (7.9 lakh tons in FY18-20e period compared to 6 lakh tons in FY15-17), cumulative income from operations would grow by nearly 20% on remarkable increase in OPMs (19.2% Vs 15.4%). Galvanized by sturdy jump in post tax earnings so far this fiscal, cumulative earnings in FY18-20e would barely stay placid (see table). No smallish recovery in margins of PVC pipes & fittings business in 9MFY19 (7.7% Vs 4.4%) coupled with not unstimulating growth in PVC resin earnings (Rs 303 crs in 9MFY19Vs Rs 219 crs) would help explain sturdy jump in operating profit.

Yet cash conversion would only scarcely improve (see table) buffeted by increased inventory stocking. Supported by higher utilization of PVC pipe capacity and firm realizations of PVC pipes this fiscal, fixed asset turnover would somewhat trend higher. Still, striking gains in return on equity would be hard to come not least due to tepidity in earnings growth next fiscal - post tax earnings estimated to rise by 11.8%.

Financial Summary – US dollar denominated

million \$	FY16	FY17	FY18	FY19e	FY20e
Equity capital	18.7	19.1	19.1	17.9	17.8
Equity shareholders' funds	214.1	326.9	402.0	346.8	391.7
Total debt	31.9	14.5	15.5	10.8	-
Net fixed assets (incl CWIP)	129.1	135.2	149.8	151.4	153.2
Investments	123.2	188.5	239.1	172.1	197.6
Net current assets	-20.8	6.4	15.8	22.1	38.8
Total assets	214.1	326.9	402.0	346.8	391.7
Revenues	379.1	387.9	424.8	426.9	475.0
EBITDA	66.6	87.6	79.1	89.6	99.4
EBDT	59.8	85.3	77.6	88.1	98.5
PBT	52.1	77.1	68.2	77.8	86.9
PAT	35.5	52.5	46.4	52.9	59.1
EPS(\$)	0.29	0.42	0.37	0.43	0.48
Book value (\$)	1.73	2.63	3.24	2.79	3.16

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rate (\$69.90/\$)

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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	FY19
Average	60.5	61.15	65.46	67.09	64.45	69.89
Year end	60.1	62.59	66.33	64.84	65.04	69.17

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.