

BUY

Delayed remote ramp-ups, cost normalisation hurts Q3 performance

- Nucleus revenues declined 9.5% QoQ at Rs 1.24bn way lower than our estm of 6.7% QoQ growth. Performance was impacted by delayed ramp up in certain implementations in remote mode, although orders still stand intact. Product segment (83% of rev) were down by 10% QoQ.
- Order book stood at Rs4.5bn down 6% QoQ at Rs 4.5bn, (up 3% on YoY basis). This implies very modest Net New order additions of about Rs941mn for the quarter down 14% YoY (down 7% on TTM basis).
- EBIT margin declined 340bps QoQ at 18.6% (DE 27.9%) as company made another provision towards special bonus payout to employees of about Rs75mn (in Q2 it was Rs150mn), and thus cost decline was lower. Also its other operating expenses jumped up by 20.7% QoQ as it now has resumed to normalized cost level (ex-travel). Other expenses are still down by 41% on YoY basis.
- Despite soft quarter, management commentary remained confident backed by 3 new client wins and 5 product orders in the quarter. However, we expect further softening of order-to-revenue conversion and poor order addition as a constraint for growth/margin improvement. Given its robust long term potential we remain cautiously optimistic on the stock and maintain Buy rating on the stock with TP of Rs 650 (implies 12x on FY23E earnings).

Challenge are temporary and limited to few clients, Order intact

Nucleus have not witnessed any cancellation of orders and attributes the entire slip-up restricted to weaker ramp-up on few clients as they were not pretty comfortable on remote implementations. Despite the delays the orders have remained as is and are likely to rampup in H1CY21 (can lead to some pent-up demand). The demand continues to remain healthy across markets as it also added 3 new client logos and in all 5 new product orders.

Order bookings down 6% QoQ; Go lives going as scheduled

Order booking in Product segment stood at Rs 4.2bn, (up 3.6% QoQ,) but down 5% on QoQ basis. Total order book is down 6% at Rs4.5bn. Also, it witnessed 9 module implementation go-live in the quarter. Despite the weak performance management is confident on sustained traction. During the quarter Co. launched new version of FinnOne Neo 5.5 and also announced internal replacement for CEO/CFO roles during Q3.

Q3FY21 Result (Rs Mn)

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Revenue	1,240	1,303	(4.8)	1,370	(9.5)
Total Expense	975	1,067	(8.6)	1,033	(5.6)
EBITDA	265	236	12.2	337	(21.3)
Depreciation	35	39	(10.8)	36	(3.3)
EBIT	231	198	16.8	301	(23.4)
Other Income	103	90	14.0	91	13.8
Interest	4	3	46.4	3	51.9
EBT	330	285	15.6	389	(15.3)
Tax	81	53	53.3	95	(13.9)
RPAT	248	232	7.0	295	(15.7)
APAT	248	232	7.0	295	(15.7)
			(bps)		(bps)
Gross Margin (%)	33.0	36.9	(390)	33.3	(29)
EBITDA Margin (%)	21.4	18.1	325	24.6	(321)
NPM (%)	20.0	17.8	221	21.5	(148)
Tax Rate (%)	24.7	18.6	607	24.3	40
EBIT Margin (%)	18.6	15.2	344	22.0	(338)

CMP	Rs 555
Target / Upside	Rs 650 / 17%
NIFTY	13,635

Script Details

Equity / FV	Rs 290mn / Rs 10
Market Cap	Rs 16bn
	USD 221mn
52-week High/Low	Rs 755/ 156
Avg. Volume (no)	73,062
Bloom Code	NCS IN

Price Performance	1M	3M	12M
Absolute (%)	(12)	(5)	79
Rel to NIFTY (%)	(10)	(21)	66

Shareholding Pattern

	Jun'20	Sep'20	Dec'20
Promoters	67.6	67.6	67.6
MF/Banks/FIs	1.9	0.9	0.9
FIIIs	6.4	7.1	7.0
Public / Others	24.1	24.4	24.5

Valuation (x)

	FY21E	FY22E	FY23E
P/E	13.5	11.9	10.6
EV/EBITDA	7.4	5.7	4.5
ROE (%)	19.8	19.5	19.0
RoACE (%)	20.0	19.7	19.1

Estimates (Rs mn)

	FY21E	FY22E	FY23E
Revenue	5,210	6,039	6,950
EBITDA	1,290	1,490	1,633
PAT	1,195	1,358	1,527
EPS (Rs.)	41.2	46.8	52.6

VP - Research: Rahul Jain

Tel: +9122 40969771

E-mail: rahulj@dolatcapital.com

Associate: Divyesh Mehta

Tel: +91 22 40969768

E-mail: divyesh.mehta@dolatcapital.com

Exhibit 1: Quarterly performance versus estimates

(in Rs mn)	Actual	Estimates		% Variation		Comment
		Dolat	Consensus	Dolat	Consensus	
USD Revenue	16.8	19.7	17.5	(14.4)	(3.9)	Revenue missed on delayed rampup on implementation
INR Revenue	1,240	1,450	1,309	(14.5)	(5.3)	
EBIT	231	405	400	(43.0)	(42.3)	EBIT margins crashed on weak revenues despite cost savings
EBIT, margin	18.6	27.9	15.0	(930 bps)	360 bps	
PAT	248	376	367	(33.9)	(32.4)	Better other income (up 14% QoQ) narrow results miss.

Source: DART, Company

Change in Estimates

Factoring in weak results and soft order addition for the quarter we have curtailed our revenue growth estimates by about 6-7% over FY21-23E. Weaker growth assumption has also resulted in softer OPM assumptions for FY21/22E by 396bps/51bps respectively (we expect FY23 would still turn better as operating leverage gains would pave in). These assumptions have led to sharp drop in our earnings estimates by 16%/9%/4% respectively. Note profitability estimates are likely to remain volatile in near term given conflicting action from operating leverage gains as well as cost normalization headwinds in coming quarters.

Exhibit 2: Change in Estimates

In Mn	FY20	FY21E			FY22E			FY23E		
	Actual	Old	New	% chg	Old	New	% chg	Old	New	% chg
USD Revenue	73.9	76.1	70.5	(7.4)	86.9	81.0	(6.7)	98.0	92.0	(6.1)
YoY growth, %	7.6	3.0	(4.7)	762	14.1	15.0	(85)	12.8	13.6	(80)
INR Revenue	5,208	5,626	5,210	(7.4)	6,516	6,039	(7.3)	7,446	6,950	(6.7)
Growth %	5.6	8.0	0.0	798	15.8	15.9	(10)	14.3	15.1	(80)
EBIT	796	1,450	1,136	(21.6)	1,461	1,324	(9.4)	1,518	1,451	(4.5)
EBIT Margin, %	15.3	25.8	21.8	(396)	22.4	21.9	(51)	20.4	20.9	48
PAT	890	1,419	1,195	(15.8)	1,499	1,358	(9.4)	1,591	1,527	(4.1)
EPS (Rs. Abs)	30.6	48.9	41.2	(15.8)	51.6	46.8	(9.4)	54.8	52.6	(4.0)

Source: DART, Company

Exhibit 3: Key Revenue Assumptions in Our Estimates

Key Assumptions	FY20A	FY21E	FY22E	FY23E
Growth in INR revenues (%)	7.6	0.0	15.9	15.1
Growth in Product business (%)	7.9	5.1	16.4	15.1
Growth in Services business (%)	5.7	-19.7	13.5	14.9
EBIT Margin %	15.3	21.8	21.9	20.9
EPS Growth (%)	19.2	34.3	13.6	-4.0

Source: DART, Company

Exhibit 4: Quarterly and YTD Trend

Rs mn	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	YoY (%)	QoQ (%)	YTD FY20	YTD FY21	YoY (%)
USD Revenue	18	18	19	17	18	17	-8.6	(8.7)	55	53	(3.6)
INR Revenue	1,282	1,303	1,382	1,284	1,370	1,240	-4.8	(9.5)	3,826	3,894	1.8
Operating Expense	1,074	1,067	1,067	910	1,033	975	-8.6	(5.6)	3,199	2,918	(8.8)
Cost of revenue	806	822	772	759	913	830	1.0	(9.1)	2,451	2,502	2.1
as % of sales	63	63	56	59	67	67			66	59	
SG&A expense	268	245	296	151	120	145	-41.0	20.7	748	416	(44.4)
as % of sales	21	19	21	12	9	12			19	12	
EBITDA	209	236	315	373	337	265	12.2	(21.3)	627	976	55.6
Depreciation	32	39	34	36	36	35	-10.8	(3.3)	101	107	5.4
EBIT	177	198	281	337	301	231	16.8	(23.4)	526	869	65.2
Other Income	111	88	100	127	88	99	13.0	12.6	261	314	20.3
PBT	288	285	381	464	389	330	15.6	(15.3)	787	1,183	50.3
Total Tax	77	53	100	101	95	81	53.3	(13.9)	178	277	55.4
Reported PAT	211	232	281	363	295	248	7.0	(15.7)	609	906	48.9
Reported EPS	7.3	8.0	9.7	12.5	10.1	8.6	7.0	(15.7)	21	31	48.9
Margins (%)							(bps)	(bps)			
EBIDTA	16.3	18.1	22.8	29.1	24.6	21.4	325	(321)	16.4	25.1	867
EBIT	13.8	15.2	20.3	26.3	22.0	18.6	344	(338)	13.7	22.3	857
EBT	22.4	21.9	27.6	36.2	28.4	26.6	470	(182)	20.6	30.4	982
PAT	16.4	17.8	20.4	28.3	21.5	20.0	221	(148)	15.9	23.3	736
Effective Tax rate	26.6	18.6	26.2	21.8	24.3	24.7	607	40	22.6	23.4	76

Source: DART, Company

What to expect Next Quarter

We expect sharp revival led by sustained traction and pent-up volumes from Q3 that may lead to sequential growth of 6.5% QoQ in Q4FY21. We also expect 273bps gains in OPM at 21% led by operating leverage gain and some potential cost cut towards lower provisioning for incentives in Q4 (it may also remain flat on QoQ basis).

Exhibit 5: What to expect Next Quarter

(Rs Mn)	Q4FY21E	Q3FY21	Q4FY20	QoQ (%)	YoY (%)
USD Revenue	17.9	16.8	19.4	6.5%	-7.7%
INR Revenue	1,316	1,240	1,382	6.2%	-4.8%
EBIT	276	227	278	22.1%	-0.6%
PAT	289	248	281	16.5%	2.8%
EPS (Rs. Abs)	10.0	8.6	9.7	16.5%	2.8%
EBIT Margin (%)	21.0	18.3	20.1	273	87

Source: DART, Company

Valuation

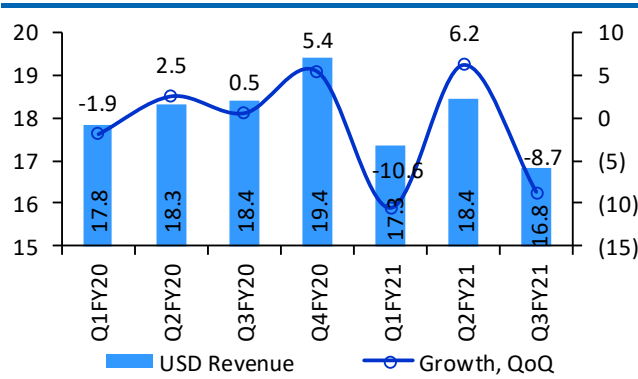
Unlike the consistent secular growth trends in IT Services business, Software companies' performance can be bit volatile on annualized basis and thus it is better to be valued on DCF basis to capture the true potential in near-to-medium term. We have factored in Revenue CAGR of 12% over FY21-25E, stable EBIT margin at ~21.5% and Terminal growth rate of 3%. Taking these assumptions, we have arrived at TP of Rs. 650 per share (from Rs. 740) and UNCHANGED Rating of BUY.

Key Highlights of the Earning Call

- **Revenues** Nucleus Software reported degrowth in revenues of 9.5% QoQ (DART estim: growth of 6.7%) in INR Revenues in Q3. The weakness revenues were on account of delays in deal ramp up and some impact of decision making freeze in the remote environment (certain customers need on-site presence for implementation) in some clients (as was hinted by management in Q2 commentary). INR Revenue stood at Rs. 1,240Mn (down 9.5% QoQ) v/s Esti of 1,450Mn (implying growth estimate of 6.7%).
- **Employee Benefit Expense** degrew by 9% QoQ to INR 830mn as the incentive related provisions were lower at Rs75mn as against Rs150mn in Q2. Company expects there could be similar provision in Q4 as well. So overall on annualized basis the Employee cost is likely to go up by ~3% despite proactive cuts it introduced in March'20 and possibly flat revenues for the year.
- **Other Expenses** stood at INR 145mn up 20.7% QoQ but still down 41% on YoY basis. Company expect this to be steady state run rate and just expect the travel-related cost addition on top of this over, coming quarter.
- **EBIT margin** declined 350bps QoQ at 18.3%. EBIT at Rs 231Mn (down 23.4% QoQ) v/s Esti of Rs. 405Mn.
- **PAT:** Rs. 248Mn (down 15.7% QoQ) way below our estimate of Rs. 376Mn. The Pat miss was slightly negated by higher Other Income performance during the quarter at Rs103mn (v/s estimate of Rs92mn).
- **Cash and cash equivalents**, including investments stood at **Rs6.7bn in Q3FY21 vs Rs 6.5bn in Q2FY21 – no plans for payouts shared on the call. Cash/MktCap is now over 40%.**
- **Geography:** India (38% of Rev) degrew by 11% QoQ, while revenues from Australia (5.2% of rev) were down by 36%. Client related issues were probably belongs to these markets.
- **Segmental:** Product (83% of Rev) degrew by 10% QoQ, Project and Professional (17% of Rev) degrew by 6.7% QoQ basis. Top 5 clients accounted for 29% of revenues
- **Order book:** stood at INR 4.5bn (includes Rs4.2bn in Products, Rs0.3bn in Services) were down on QoQ basis by 6%. The weakness in order booking suggest potential pain in weaker execution in Q4 as well.
- **Product Launches:** Launched FinOne Neo 5.5 – Design to help rapidly expand, build new customer streams. Launched Global Transaction Banking, Finnaxia – 7.5. FinAxxia – Finaxxia takes care of corporate side of banking v/s FinnOne is retail banking. FinnOne now has corp lending as well. Finaxxia is very sticky. It is used by only banks. It is layered on top of core banking system. There are more adjacent products that the company is exploring possibilities on and would share more inputs, when they get any real outcomes.
- **Leadership changes:** RP Singh stepped down as CEO due to retirement but would stay on the board, Mr Parag Bhise (spent 3 decades with Nucleus) would take over the role. Also appointed Mr Anurag Mantri (25 years with nucleus) for the role of CFO. Both these gentlemen has also joined Board as Executive Directors.
- **9MFY21 performance:** Despite the weak results the company has achieved 2% revenue growth in YoY basis, with ~860bps improvement in OPM, driving the earnings growth by 49% and thus still not much of a concern.

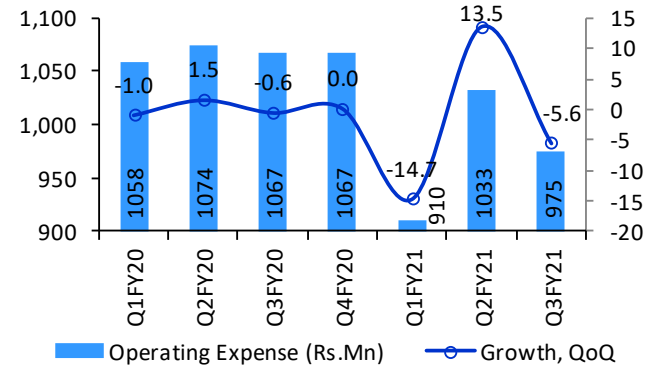
Charts

Exhibit 6: Revenue declined by 8.7% QoQ



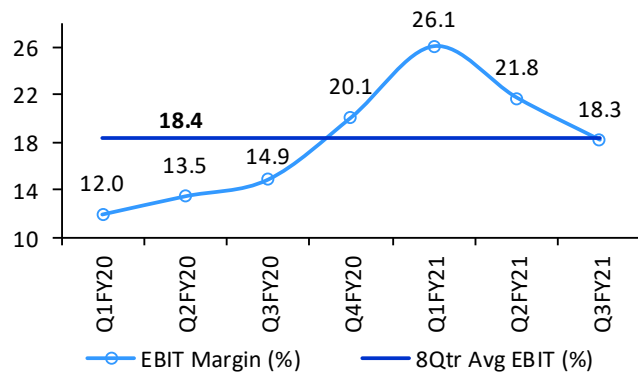
Source: Company, DART

Exhibit 7: Employee Benefit Exp stood at Rs 913mn grew 20.3% QoQ



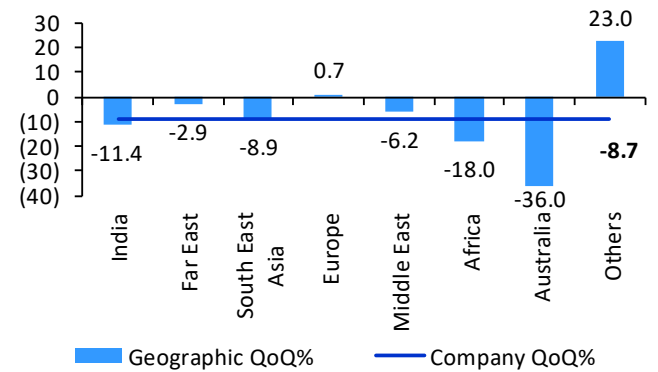
Source: Company, DART

Exhibit 8: EBIT Margin declined by 240bps QoQ due to negative operating leverage



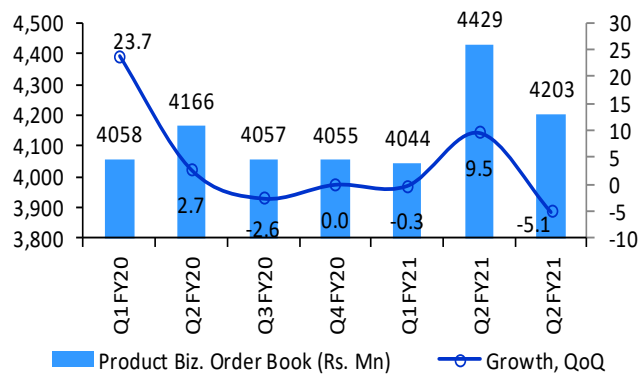
Source: Company, DART

Exhibit 9: Geography Growth v/s Company Growth



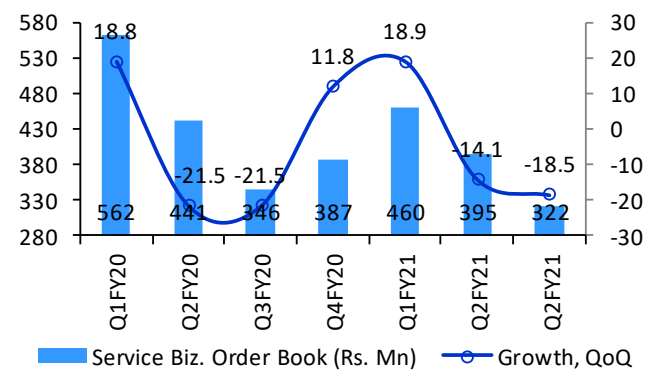
Source: Company, DART

Exhibit 10: Product Biz. Order book has declined by 5.1% QoQ



Source: Company, DART

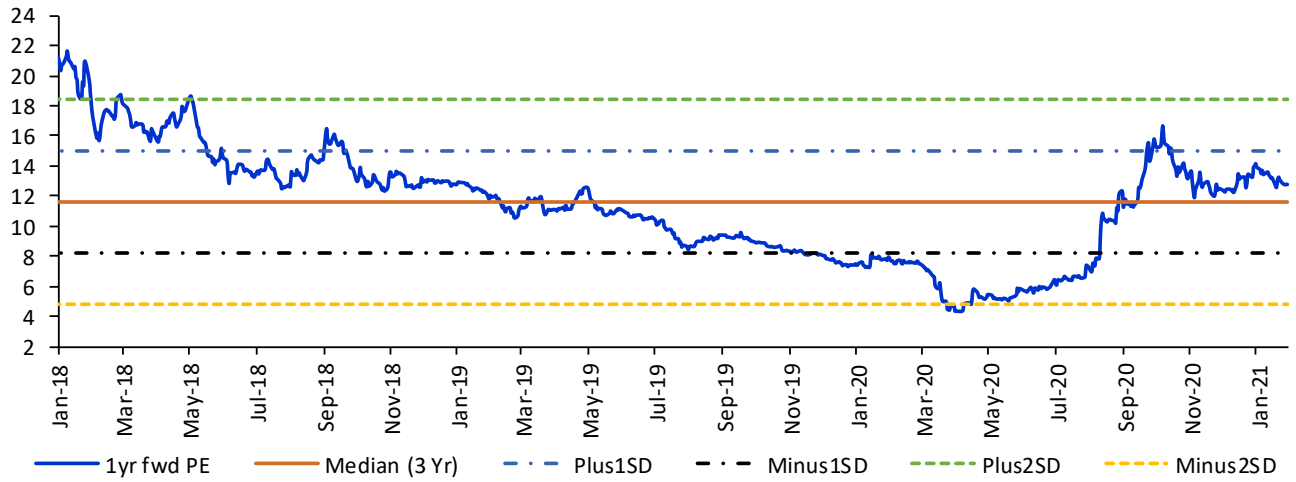
Exhibit 11: Service Biz. Order Book has declined by 18.5% QoQ



Source: Company, DART

Band Chart

Exhibit 12: Nucleus Software is trading near Median Valuation with PER of ~12.1



Source: DART, Company

Exhibit 13: Operating Metrics 1

Operating Metrics	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21
Segment Amount										
Own Products	952	961	1,002	965	1,005	1,032	1,117	1,068	1,145	1,031
Trading Products	7	6	8	6	8	8	3	3	3	2
Projects & Services	255	262	268	268	269	265	263	213	222	207
Segment YoY Growth										
Own Products	21.9	14.1	13.8	8.1	5.5	7.4	11.5	10.6	13.9	(0.2)
Trading Products	(4.5)	(21.6)	(13.7)	(31.1)	5.5	27.2	(63.9)	(58.6)	(64.4)	(68.3)
Projects & Services	18.2	24.9	21.4	19.6	5.5	1.0	(2.1)	(20.5)	(17.6)	(21.7)
Order Book										
Product Biz.	3,310	3,320	3,280	4,058	4,166	4,057	4,055	4,044	4,429	4,203
Service Biz.	470	398	473	562	441	346	387	460	395	322
Order Book Growth										
Product Biz.	(3.2)	(2.1)	(4.4)	18.1	25.9	22.2	23.6	(0.3)	6.3	3.6
Service Biz.	51.6	(11.6)	15.9	11.3	(6.2)	(13.1)	(18.2)	(18.1)	(10.4)	(6.9)
Order Revenue Coverage										
Product Biz.	91.9	89.3	85.4	103.8	105.1	100.6	97.9	95.3	101.2	96.2
Service Biz.	51.7	41.4	46.9	53.4	41.3	32.3	36.4	45.6	41.1	35.6
Net New Orders										
Product Biz.	834	977	969	1,751	1,121	930	1,118	1,059	1,533	807
Service Biz.	220	190	343	357	148	170	304	286	157	134
Net New Order YoY Growth										
Product Biz.	(28.7)	19.1	4.1	93.2	34.4	(4.9)	15.3	(39.5)	36.8	(13.2)
Service Biz.	57.5	(45.7)	91.9	11.2	(32.6)	(10.7)	(11.6)	(19.9)	5.8	(20.9)
Wins										
Customer Wins	8	4	4	5	5	8	4	4	4	3
Order Wins	10	5	6	8	7	9	8	6	10	5
Headcount	2,082	2,072	2,054	2,058	2,128	2,125	2,137	2,117	2,064	2,125

Source: DART, Company

Profit and Loss Account

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Revenue	5,208	5,210	6,039	6,950
Total Expense	4,266	3,920	4,550	5,317
COGS	3,223	3,347	3,739	4,257
Employees Cost	0	0	0	0
Other expenses	1,044	573	811	1,061
EBIDTA	942	1,290	1,490	1,633
Depreciation	135	141	154	172
EBIT	807	1,149	1,336	1,461
Interest	11	13	12	10
Other Income	372	427	463	585
Exc. / E.O. items	0	0	0	0
EBT	1,168	1,563	1,787	2,036
Tax	278	368	429	509
RPAT	890	1,195	1,358	1,527
Minority Interest	0	0	0	0
Profit/Loss share of associates	0	0	0	0
APAT	890	1,195	1,358	1,527

Balance Sheet

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
Sources of Funds				
Equity Capital	290	290	290	290
Minority Interest	0	0	0	0
Reserves & Surplus	5,318	6,163	7,171	8,348
Net Worth	5,609	6,454	7,462	8,638
Total Debt	0	0	0	0
Net Deferred Tax Liability	1	1	1	1
Total Capital Employed	5,610	6,455	7,462	8,639

Applications of Funds

Net Block	428	407	374	322
CWIP	0	0	0	0
Investments	0	0	0	0
Current Assets, Loans & Advances	7,206	8,115	9,203	10,483
Inventories	0	0	0	0
Receivables	902	956	1,076	1,181
Cash and Bank Balances	5,773	6,612	7,569	8,731
Loans and Advances	302	306	306	306
Other Current Assets	229	240	252	265
Less: Current Liabilities & Provisions	2,024	2,068	2,114	2,165
Payables	150	156	164	175
Other Current Liabilities	1,874	1,912	1,951	1,990
<i>sub total</i>				
Net Current Assets	5,181	6,047	7,089	8,317
Total Assets	5,610	6,455	7,462	8,639

E – Estimates

Important Ratios

Particulars	FY20A	FY21E	FY22E	FY23E
(A) Margins (%)				
Gross Profit Margin	38.1	35.8	38.1	38.8
EBIDTA Margin	18.1	24.8	24.7	23.5
EBIT Margin	15.5	22.1	22.1	21.0
Tax rate	23.8	23.6	24.0	25.0
Net Profit Margin	17.1	22.9	22.5	22.0
(B) As Percentage of Net Sales (%)				
COGS	61.9	64.2	61.9	61.2
Employee	0.0	0.0	0.0	0.0
Other	20.0	11.0	13.4	15.3
(C) Measure of Financial Status				
Gross Debt / Equity	0.0	0.0	0.0	0.0
Interest Coverage	72.0	90.5	107.7	146.1
Inventory days	0	0	0	0
Debtors days	63	67	65	62
Average Cost of Debt				
Payable days	11	11	10	9
Working Capital days	363	424	428	437
FA T/O	12.2	12.8	16.2	21.6
(D) Measures of Investment				
AEPS (Rs)	30.6	41.2	46.8	52.6
CEPS (Rs)	35.3	46.0	52.1	58.5
DPS (Rs)	0.0	10.0	10.0	10.0
Dividend Payout (%)	0.0	24.3	21.4	19.0
BVPS (Rs)	193.1	222.2	256.9	297.5
RoANW (%)	16.6	19.8	19.5	19.0
RoACE (%)	16.9	20.0	19.7	19.1
RoAIC (%)	-	-	-	-
(E) Valuation Ratios				
CMP (Rs)	555	555	555	555
P/E	18.1	13.5	11.9	10.6
Mcap (Rs Mn)	16,119	16,119	16,119	16,119
MCap/ Sales	3.1	3.1	2.7	2.3
EV	10,346	9,507	8,549	7,388
EV/Sales	2.0	1.8	1.4	1.1
EV/EBITDA	11.0	7.4	5.7	4.5
P/BV	2.9	2.5	2.2	1.9
Dividend Yield (%)	0.0	1.8	1.8	1.8
(F) Growth Rate (%)				
Revenue	7.6	0.0	15.9	15.1
EBITDA	18.9	36.9	15.5	9.6
EBIT	16.4	42.4	16.3	9.3
PBT	21.2	33.9	14.3	13.9
APAT	19.2	34.3	13.6	12.4
EPS	19.2	34.3	13.6	12.4
Cash Flow				
(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	747	882	964	1,047
CFI	(291)	(370)	(320)	(320)
CFE	(334)	77	113	235
FCFF	624	762	844	927
Opening Cash	445	568	1,157	1,914
Closing Cash	568	1,157	1,914	2,876

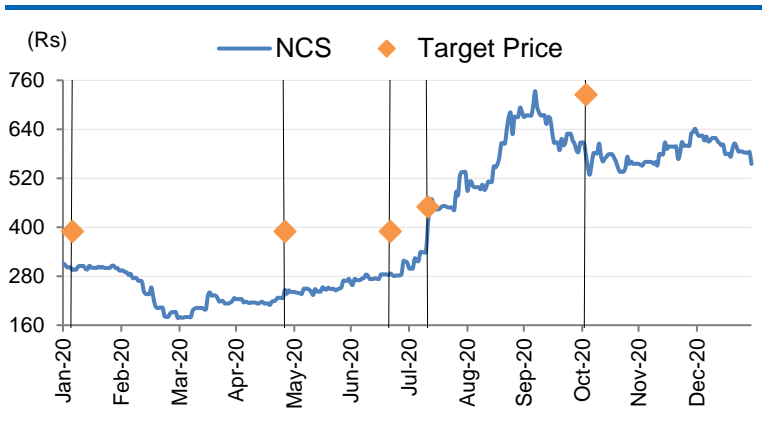
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	> 20%
Accumulate	10 to 20%
Reduce	0 to 10%
Sell	< 0%

Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Feb-20	Buy	390	296
May-20	Buy	390	246
Jul-20	Buy	390	287
Aug-20	Buy	450	406
Nov-20	Buy	725	577

*Price as on recommendation date

DART Team

Purvag Shah **Managing Director** purvag@dolatcapital.com **+9122 4096 9747**

Amit Khurana, CFA **Head of Equities** amit@dolatcapital.com **+9122 4096 9745**

CONTACT DETAILS

Equity Sales	Designation	E-mail	Direct Lines
Dinesh Bajaj	VP - Equity Sales	dineshb@dolatcapital.com	+9122 4096 9709
Kapil Yadav	VP - Equity Sales	kapil@dolatcapital.com	+9122 4096 9735
Yomika Agarwal	VP - Equity Sales	yomika@dolatcapital.com	+9122 4096 9772
Jubbin Shah	VP - Derivatives Sales	jubbins@dolatcapital.com	+9122 4096 9779
Ashwani Kandoi	AVP - Equity Sales	ashwanik@dolatcapital.com	+9122 4096 9725
Lekha Nahar	AVP - Equity Sales	lekhan@dolatcapital.com	+9122 4096 9740
Equity Trading	Designation	E-mail	
P. Sridhar	SVP and Head of Sales Trading	sridhar@dolatcapital.com	+9122 4096 9728
Chandrakant Ware	VP - Sales Trading	chandrakant@dolatcapital.com	+9122 4096 9707
Shirish Thakkar	VP - Head Domestic Derivatives Sales Trading	shirisht@dolatcapital.com	+9122 4096 9702
Kartik Mehta	Asia Head Derivatives	kartikm@dolatcapital.com	+9122 4096 9715
Dinesh Mehta	Co- Head Asia Derivatives	dinesh.mehta@dolatcapital.com	+9122 4096 9765
Bhavin Mehta	VP - Derivatives Strategist	bhavinm@dolatcapital.com	+9122 4096 9705

Dolat Capital Market Private Limited.

Sunshine Tower, 28th Floor, Senapati Bapat Marg, Dadar (West), Mumbai 400013

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Member: BSE Limited and National Stock Exchange of India Limited.

SEBI Registration No: BSE - INZ000274132, NSE - INZ000274132, Research: INH000000685

Registered office: Office No. 141, Centre Point, Somnath, Daman – 396 210, Daman & Diu

Board: +9122 40969700 | Fax: +9122 22651278 | Email: research@dolatcapital.com | www.dolatresearch.com
