



#### 3R MATRIX

|                      | + | = | - |
|----------------------|---|---|---|
| Right Sector (RS)    | ✓ | ■ | ■ |
| Right Quality (RQ)   | ✓ | ■ | ■ |
| Right Valuation (RV) | ✓ | ■ | ■ |

+ Positive = Neutral - Negative

#### What has changed in 3R MATRIX

|    | Old |   | New |
|----|-----|---|-----|
| RS | ■   | ↔ | ■   |
| RQ | ■   | ↔ | ■   |
| RV | ■   | ↑ | ■   |

| Reco/View               | Change |
|-------------------------|--------|
| Reco: Buy               | ↑      |
| CMP: Rs. 1,082          |        |
| Price Target: Rs. 1,350 | ↑      |

↑ Upgrade ↔ Maintain ↓ Downgrade

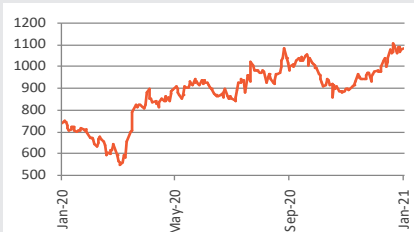
#### Company details

|                               |                |
|-------------------------------|----------------|
| Market cap:                   | Rs. 49,063 cr  |
| 52-week high/low:             | Rs. 1122 / 505 |
| NSE volume:<br>(No of shares) | 37.4 lakh      |
| BSE code:                     | 500257         |
| NSE code:                     | LUPIN          |
| Free float:<br>(No of shares) | 24.0 cr        |

#### Shareholding (%)

|           |       |
|-----------|-------|
| Promoters | 46.9  |
| FII       | 20.8  |
| DII       | 19.9  |
| Others    | 12.46 |

#### Price chart



#### Price performance

| (%)                | 1m   | 3m   | 6m   | 12m  |
|--------------------|------|------|------|------|
| Absolute           | 10.8 | 9.2  | 26.7 | 46.2 |
| Relative to Sensex | 7.9  | -9.6 | -0.1 | 30.0 |

Sharekhan Research, Bloomberg

#### Summary

- We upgrade Lupin to Buy from Hold earlier with revised price target of Rs. 1,350.
- New launches with high market opportunities (such as Metformin Hydrochloride extended release tablets, Sevelamer Carbonate Tablets, Tacrolimus) and faster than expected ramp up in ProAir, would drive US sales.
- Indian Pharmaceutical markets (IPM) has staged a strong revival growing by ~6% y-o-y in Q3FY2021 as compared to a 3% decline in H1FY2021, driven by Chronics. This is likely to benefit Lupin's domestic business.
- Given improved growth traction in the US & India business and cost rationalisation efforts is likely to result in a strong 37% earnings CAGR over FY2021-FY2023.

Lupin Limited (Lupin) is seeing improved traction across its US & India businesses and is better-placed to harness growth opportunities going ahead. In the US business, multiple factors are expected to drive sales. Better-than-expected ramp-up of ProAir (due to strong execution capabilities of the company and absence of a competitor, which is likely to persist) leading to an 8% market share gain of the total gAlbuterol market is one of the key positives. Also, new launches offering high market opportunities (each product has a market size of ~\$300 million) such as Metformin Hydrochloride extended release tablets, Sevelamer Carbonate Tablets and Tacrolimus capsules would drive US sales for Lupin. The India business is also on a strong footing to clock a healthy growth. The Indian Pharmaceutical markets (IPM) has staged a strong revival growing by ~6% y-o-y in Q3FY2021 as compared to a 3% decline in H1FY2021. The outperformance is largely driven by chronic segments of cardiology and anti-diabetics, which were less impacted as compared to the acute therapies segment. This is likely to benefit Lupin as it has a Chronic heavy portfolio constituting 65% of domestic sales. In addition to the above the company is looking to tap new markets with more respiratory assets such as Frostair and Dulera, the approval for which is expected over the next fiscal. Further, Lupin's partner has already launched Biosimilar – Enbrel in three of the European countries and is looking to expand the reach in the other countries as well. Hence, these factors would be the key growth drivers for Lupin going ahead and would support the topline growth. The company's focus on cost control / rationalizing measures would enable margins expansions of around 560 bps over FY21-FY23, leading to a strong 37% earnings CAGR over the same period. Given the better than expected ramp up of gAlbuterol in US and Metformin re-launch coupled with healthy growth in domestic markets, Lupin is expected to stage a strong performance for Q3FY2021 with a potential to surprise positively.

#### Our Call

**Upgrade to Buy with a revised PT of Rs. 1,350:** Lupin's US business is on a strong footing to grow backed by a better than expected ramp up of its respiratory product gAlbuterol with the company gaining an 8% market share of the Albuterol market. Other substantial launches including Metformin (Re launched) and Sevelamer Carbonate Tablets and Tacrolimus tablets in the US would drive the region's growth. Lupin's domestic formulations business is also expected to record a healthy growth going ahead with the expected revival in the IPM and supported by a chronic heavy portfolio. Over the long term the areas of biosimilars and new launches in the respiratory segment would be key growth drivers. Given Lupin's focus on cost-control and rationalization and increasing share of high value new launches, the operating margins are expected to stage an impressive expansion of around 560 bps by FY2023 to 21.8%. Lupin's three plants – Goa, Pithampur and Somerset (US) are under the USFDA scrutiny and resolution has been delayed. A successful resolution of the same is awaited and could result in further earnings upgrades. At CMP, the stock is trading at a P/E multiple of 26.3x and 21.6x its FY2022E / FY2023E EPS, which is lower than the long-term average multiple and provides room for expansion. Also over the past one year, Lupin has underperformed the benchmark BSE healthcare index, however going ahead basis multiple growth triggers across its business, we see Lupin outperforming the healthcare index. Given improved growth traction in the US & India business and cost rationalisation efforts are likely to result in a strong 37% earnings CAGR over FY2021-FY2023. Hence we upgrade our recommendation on Lupin to Buy from Hold earlier with a revised price target of Rs. 1,350.

#### Key Risks

- 1) Delay in resolution of the USFDA scrutiny can impact earnings.
- 2) Adverse change in regulatory Landscape.
- 3) Currency risks.

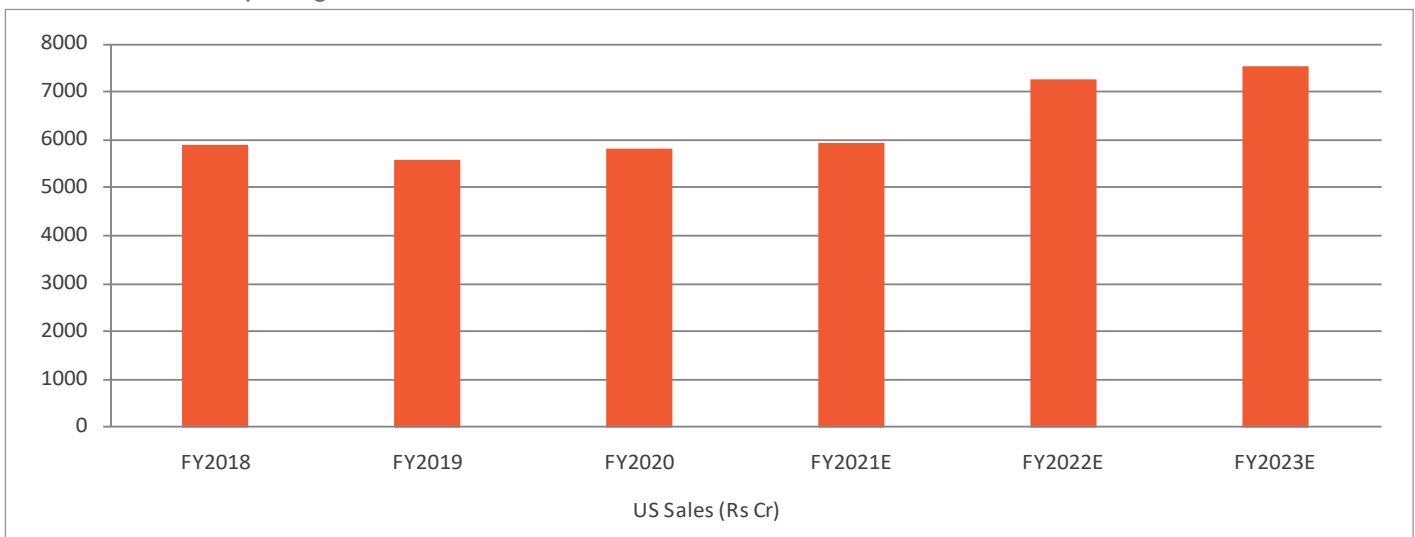
#### Valuation (Consolidated)

|                     | Rs cr    |          |          |          |          |
|---------------------|----------|----------|----------|----------|----------|
| Particulars         | FY19     | FY20     | FY21E    | FY22E    | FY23E    |
| Net sales           | 14,664.6 | 15,374.8 | 15,793.7 | 18,146.5 | 19,238.7 |
| Operating Profits   | 2,560.8  | 2,354.8  | 2,558.5  | 3,496.8  | 4,187.4  |
| OPM (%)             | 17.5     | 15.3     | 16.2     | 19.3     | 21.8     |
| Adjusted net profit | 852.0    | 352.6    | 1,201.1  | 1,862.3  | 2,264.2  |
| Adj. EPS (Rs)       | 18.8     | 7.8      | 26.5     | 41.1     | 50.0     |
| PER (x)             | 57.5     | 139.0    | 40.8     | 26.3     | 21.6     |
| EV/Ebitda (x)       | 22.5     | 23.1     | 17.7     | 12.2     | 9.8      |
| P/BV (x)            | 3.6      | 3.9      | 3.6      | 3.1      | 2.7      |
| RoCE (%)            | 9.3      | 9.0      | 9.7      | 13.2     | 14.5     |
| RoNW (%)            | 6.2      | 2.8      | 8.9      | 11.9     | 12.7     |

Source: Company; Sharekhan estimates

**Ramp-up in albuterol volumes, opportunities from recent launches to aid US business' revival:** Lupin's US business which constitutes ~38% of overall FY2020 sales of the company has improved materially and is set to record a double digit revenue growth. The US sales had clocked a double-digit fall during FY2017 to FY2020 due to multiple factors, including regulatory hurdles. This is also reflected in the quarterly performance of the company with the US sales staging a 5.6% y-o-y growth for Q2FY21 as against a decline in the previous three consistent quarters. Going ahead Lupin's US revenues are expected to stage a strong comeback with expectations of 13% CAGR growth over FY2021 to FY2023. Lupin's version of gAlbuterol – ProAir inhaler is in a ramp-up phase and the company has been able to impressively ramp up the sales ahead of the expectations and has successfully gained around 8% market share of the albuterol market. Absence of one of the key competitors, which is likely to stay, would also enable aid further ramp up of ProAir in the US. This coupled with a relatively stable pricing scenario augurs well for growth of ProAir. Furthermore, Lupin has recently launched / re-launched few new products, which offer substantial growth opportunities. In the anti-diabetics space, Lupin had re-launched Metformin Hydrochloride extended release tablets which offer a significant market size of \$357 million. Lupin has also launched Sevelamer Carbonate Tablets for treating chronic kidney diseases and Tacrolimus capsules indicated for organ transplants. Both the medicines offer a sizeable market potential of \$348 million and \$303 million respectively. In addition to this the company has launched a few more products, which have a comparatively small market size individually, but collectively would make a material contribution towards revival of the US sales. Cumulatively, we expect Lupin's US business to grow by a 13% CAGR over FY2021 to FY2023. Also, the above positives would enable the quarterly revenues run rate to be above \$180 million as guided by the management.

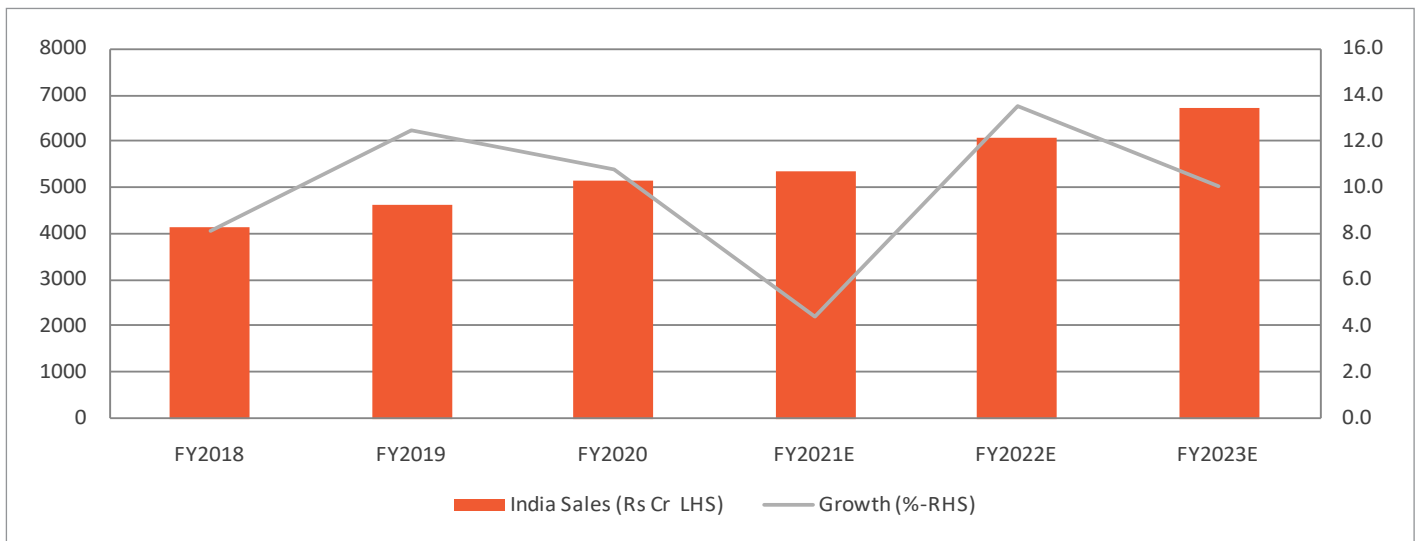
**US revenues on an improving trend**



Source: Company, Sharekhan Research

**India business gradually gaining traction; Lupin well placed to harness growth opportunities:** Lupin's domestic formulations business constitutes around 34% of overall FY2020 sales and clocked a healthy 12.4% and 10.8% y-o-y growth, respectively for FY2019 and FY2020. With the pandemic induced lockdown the performance of the Indian pharmaceutical market (IPM) declined by ~3% in 1hFY2021 with the steepest ~11% drop in the month of April 2020. Against this backdrop the IPM has bounced back impressively and has clocked ~6% growth YoY for the quarter ending December 2020. Lupin's product portfolio in the domestic markets largely consists of chronic medicines and constitutes around 65% of the India sales. This has worked to the benefit of Lupin as Chronic medicines had a comparatively inelastic demand pattern as compared to the acute therapies. The same is also justified by the fact that Lupin's domestic formulations sales declined by around 1% as compared to a 3% decline reported by the IPM. In the IPM, the chronic therapies of cardiac, anti-diabetic and respiratory segments have consistently outperformed and are expected to continue the outperformance. Simultaneously, the acute therapy segment's performance was impacted in the 1hFY2021 and was soft in quarter ending December. Going ahead, acute therapies are also expected to recover gradually. Overall, with a weak performance in 1hFY2021 followed by a bounce back in the growth in Q3FY2021, the Indian market is expected to stage a nearly mid-single digit growth for FY2021 with FY2022 likely to be witness a substantial uptick. Established players such as Lupin are expected to be benefiting significantly from this, supported by a 65% chronic share. We expect Lupin's domestic revenues to stage a 12% CAGR over FY2021-FY2023.

India sales trend



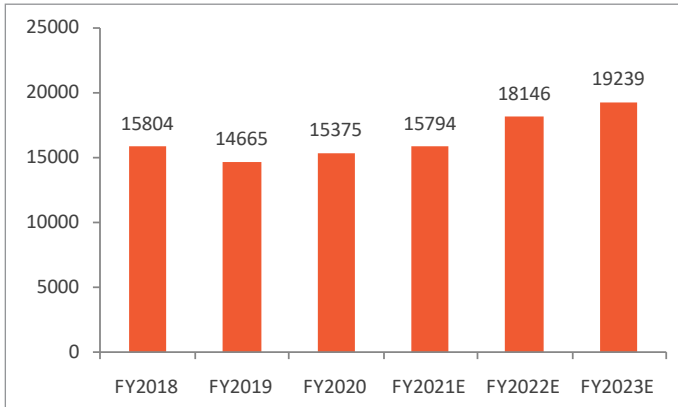
Source: Company, Sharekhan Research

**Other growth drivers such as respiratory provide ample growth visibility; unfavorable outcome of Somerset inspection to have minimal impact:** Lupin has set its eyes on other assets in the respiratory segment and is looking to tap different markets with these respiratory assets. Apart from ProAir, the approval for Frostair in Europe and approval for Dulera are also expected over the next fiscal year. Lupin is also looking to enter the lucrative bio-similars space and its partner has launched bio-similar Enbrel in three of the European countries with more launches in the region to follow over the next 2-3 quarters. Collectively, likely new approvals in the respiratory space and building in the capabilities in the bio-similars would be the key plus points for Lupin, though in the long term. Further, the company's plant at Somerset (US), which was earlier classified as an OAI and consequently, re-inspected, had an unfavorable outcome with the USFDA issuing 13 observations. This is unlikely to materially impact the financial performance of the company. However, a resolution of the Somerset plant along with the Pithapur and Goa plants would be a monitorable and successful resolution of the same could result in earnings upgrades.

**Q3FY2021 expected to be a healthy quarter:** Lupin is expected to report healthy performance for Q3FY2021, with revenues expected to grow by ~5% y-o-y to Rs. 3,893 crore. Year-on-year growth is after a series of quarters with a decline in the topline. The ramp-up of gAlbuterol in the US and re-launch of the Metformin in the US along with the recovery in the domestic markets would aid mid-single digit topline growth. Cost control and rationalization measures are expected to yield a 440 bps y-o-y expansion in the operating margins. Tracking the operating performance and adjusting for one-time expenses in the corresponding quarter of the previous year, Lupin is expected to report an earnings of Rs. 256 crore as against a loss in Q3FY2020.

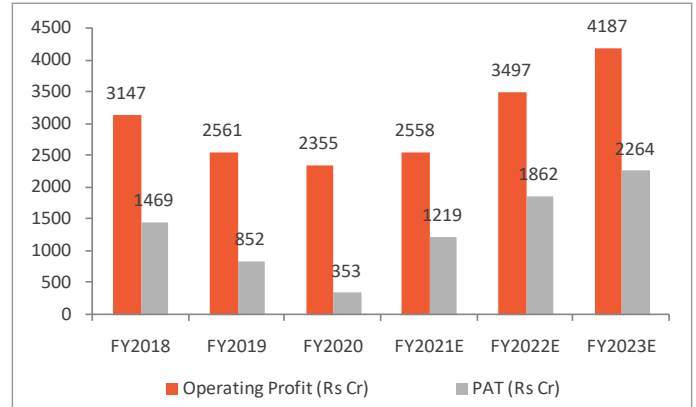
Financials in charts

Sales Trends (RS Cr)



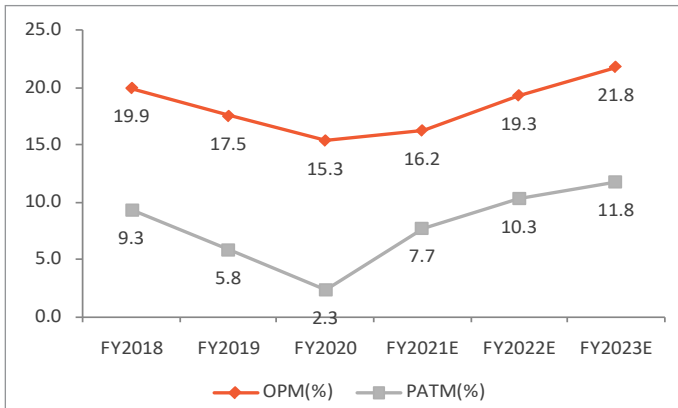
Source: Company, Sharekhan Research

Operating Profit - PAT Trends



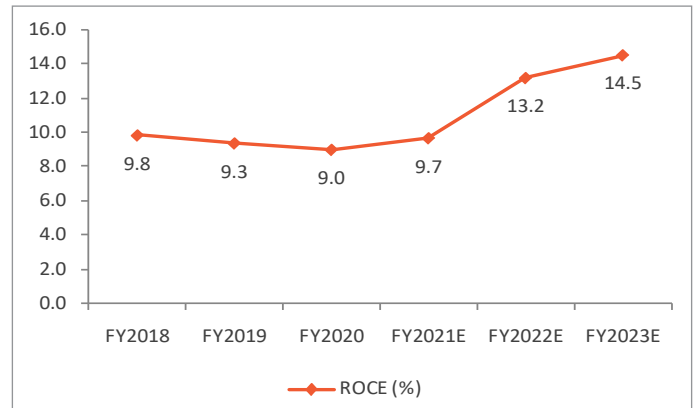
Source: Company, Sharekhan Research

OPM's to improve



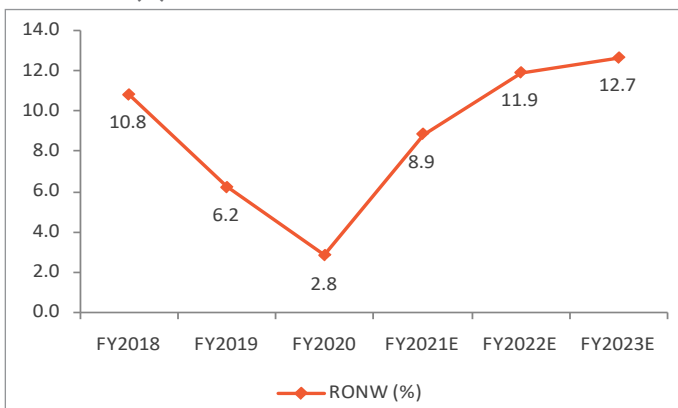
Source: Company, Sharekhan Research

ROCE Trends (%)



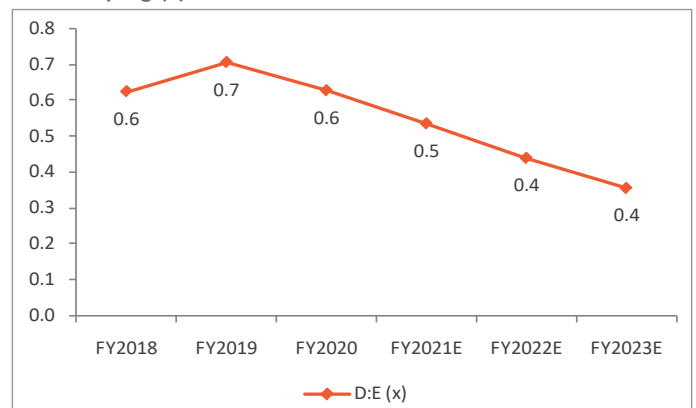
Source: Company, Sharekhan Research

RoE Trends (%)



Source: Company, Sharekhan Research

Debt : Equity (x)



Source: Company, Sharekhan Research

## Outlook and Valuation

### ■ Sector view - Growth momentum to improve

Indian pharmaceutical companies are better placed to harness opportunities and report healthy growth going ahead. Indian companies are among the most competitive ones globally and hold a sizeable market share in most developed as well as other markets. Moreover, other factors such as easing of pricing pressures (especially in US generics market), rise in product approvals, and plant resolutions by the USFDA and strong growth prospects in domestic markets and emerging opportunities in the API space would be key growth drivers. This would be complemented by strong capabilities developed by Indian companies (leading to a shift towards complex molecules and biosimilars) and commissioning of expanded capacities by select players over the medium term. Collectively, this indicates a strong growth potential going ahead for pharma companies.

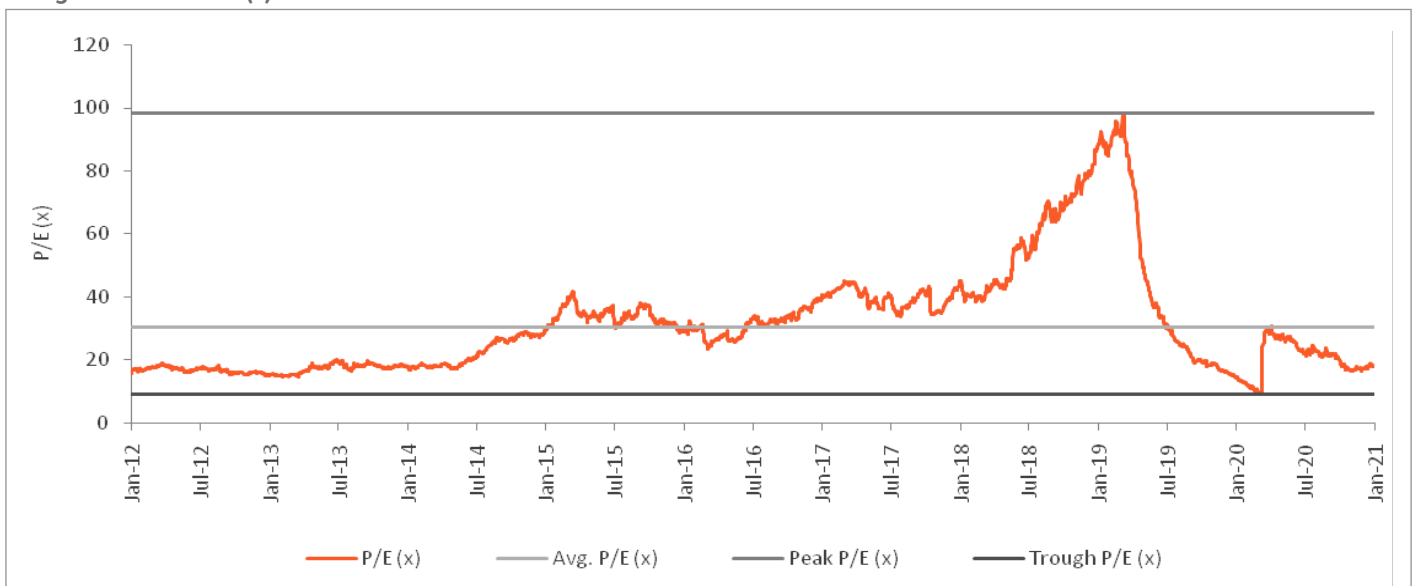
### ■ Company outlook - Gaining traction

Lupin is one of the leading pharmaceutical companies and is present in most markets globally. After establishing itself as a major player in the generics space, the company is making efforts to improve its presence in the specialty business. The US is a key market for Lupin. After two consecutive years of subdued performance, the US business reported mid-single digit growth in FY2020. The momentum continued for quarter ending September 2020 as well with mid-single digit growth, largely driven by the launch of Albuterol and market share gains. Going ahead, Lupin sees a recovery in the US business, led by ramp up of Levothyroxin and Albuterol, growth in the base business, and incremental growth from a slew of new launches / re-launches. With initial signs of revival apparent in the IPM coupled with the Chronic heavy presence on Lupin (in the domestic business), the India formulations segment is also expected to gain traction and is expected to grow at a higher pace in H2FY2021. Lupin is also focusing on cost-control efforts and rationalization of cost, which would result in operating margin expansion. Resolution of USFDA issues at its plants (Goa, Pithampur – Unit-II, and Somerset) would be key watch out for and, if successfully resolved, would lead to earnings upgrades.

### ■ Valuation - Upgrade to Buy with a revised PT of Rs. 1,350

Lupin's US business is on a strong footing to grow backed by a better than expected ramp up of its respiratory product gAlbuterol with the company gaining an 8% market share of the Albuterol market. Other substantial launches including Metformin (Re launched) and Sevelamer Carbonate Tablets and Tacrolimus tablets in the US would drive the region's growth. Lupin's domestic formulations business is also expected to record a healthy growth going ahead with the expected revival in the IPM and supported by a chronic heavy portfolio. Over the long term the areas of biosimilars and new launches in the respiratory segment would be key growth drivers. Given Lupin's focus on cost-control and rationalization and increasing share of high value new launches, the operating margins are expected to stage an impressive expansion of around 560 bps by FY2023 to 21.8%. Lupin's three plants – Goa, Pithampur and Somerset (US) are under the USFDA scrutiny and resolution has been delayed. A successful resolution of the same is awaited and could result in further earnings upgrades.. At CMP, the stock is trading at a P/E multiple of 26.3x and 21.6x its FY2022E / FY2023E EPS, which is lower than the long-term average multiple and provides room for expansion. Also over the past one year, Lupin has underperformed the benchmark BSE healthcare index, however going ahead basis multiple growth triggers across its business, we see Lupin outperforming the healthcare index. Given improved growth traction in the US & India business and cost rationalisation efforts are likely to result in a strong 37% earnings CAGR over FY2021-FY2023. Hence we upgrade our recommendation on Lupin to Buy from Hold earlier with a revised price target of Rs. 1,350.

### One-year forward P/E (x) band



Source: Sharekhan Research

### Peer valuation

| Particulars | CMP<br>(Rs /<br>Share) | O/S<br>Shares<br>(Cr) | MCAP<br>(Rs Cr) | P/E (x) |       |       | EV/EBITDA (x) |       |       | RoE (%) |       |       |
|-------------|------------------------|-----------------------|-----------------|---------|-------|-------|---------------|-------|-------|---------|-------|-------|
|             |                        |                       |                 | FY20    | FY21E | FY22E | FY20          | FY21E | FY22E | FY20    | FY21E | FY22E |
| Lupin       | 1082                   | 45.3                  | 49,063          | 139.0   | 40.2  | 26.3  | 23.1          | 17.7  | 12.2  | 2.8     | 8.9   | 11.9  |
| Sun Pharma  | 587                    | 239.9                 | 140730          | 35.0    | 25.8  | 21.7  | 20.5          | 16.1  | 14.0  | 8.9     | 11.7  | 12.4  |
| Aurobindo   | 998                    | 58.6                  | 58476           | 20.1    | 17.8  | 16.2  | 12.6          | 10.8  | 9.2   | 19.0    | 17.9  | 16.7  |

Source: Company, Sharekhan Research

## About company

Over the last decade, Lupin has established itself as a leading generic player from India. US and India are the company's largest markets and contribute almost 60% to its revenue. The company has a significant presence in Japan (unlike most other generic players). While in India, Lupin is among the top10 companies and among the fastest growing as well. The company is among the top five companies in terms of prescriptions in the US. Moreover, Lupin has entered the Japanese market well before other generic players and is now among the top10 generic companies in Japan.

## Investment theme

The WL/USFDA regulatory hurdles are delaying new approvals and further intensifying pressure on the US business, which is already facing tough competition in base business and lack of significant launches that could offset these. Not only is the growth slowing down, margin trajectory will also be difficult to maintain due to fall in these lucrative US products and remediation expenses inching up, leading to elongated recovery process. Lupin is one of the leading pharmaceutical companies and is present in most markets globally. After establishing itself as a major player in the generics space, the company is making efforts to improve its presence in the specialty business. The US is a key market for Lupin. After two consecutive years of subdued performance, the US business has reported mid-single digit growth in FY2020. The momentum is expected to continue going ahead as well backed by ramp up in existing products and new product launches. With the initial signs of revival apparent in the IPM coupled with the Chronic heavy presence for Lupin (in the domestic business), The India formulations segment is also expected to gain traction. Lupin is also focusing on cost-control efforts and rationalization of cost, which would result in operating margin expansion. Resolution of USFDA issues at its plants (Goa, Pithampur – Unit-II, and Somerset) would be key watch out for and, if successfully resolved, would lead to earnings upgrades.

## Key Risks

- ◆ Delay in the resolution of USFDA issues at its plants
- ◆ Slower-than-expected ramp-up in the gAlbuterol
- ◆ Currency risk
- ◆ Concentration risk in the US portfolio

## Additional Data

### Key management personnel

|                             |                                   |
|-----------------------------|-----------------------------------|
| Mrs. Manju D Gupta          | Chairman                          |
| Dr. Kamal K. Sharma         | Vice Chairman                     |
| Ms. Vinita Gupta            | Chief Executive Officer           |
| Mr. Nilesh Deshbandhu Gupta | Managing Director                 |
| Mr. Ramesh Swaminathan      | Executive Director and Global CFO |

Source: Company

### Top 10 shareholders

| Sr. No. | Holder Name                            | Holding (%) |
|---------|--|-------------|
| 1       | HDFC Asset Management Co               | 4.15        |
| 2       | Life Insurance Corporation of India    | 3.71        |
| 3       | Norges Bank                            | 1.85        |
| 4       | Vanguard Group Inc/The                 | 1.78        |
| 5       | Franklin Resources Inc                 | 1.58        |
| 6       | BlackRock Inc                          | 1.49        |
| 7       | SBI Funds Management                   | 1.47        |
| 8       | Nippon India Asset Management          | 1.32        |
| 9       | Comgest SA                             | 1.21        |
| 10      | ICICI Prudential Life Insurance Co Ltd | 1.1         |

Source: Bloomberg

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## Understanding the Sharekhan 3R Matrix

| Right Sector    |  |
|-----------------|--|
| Positive        | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies   |
| Neutral         | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies  |
| Negative        | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| Right Quality   |  |
| Positive        | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.   |
| Neutral         | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable  |
| Negative        | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet   |
| Right Valuation |  |
| Positive        | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.                        |
| Neutral         | Trading at par to historical valuations and having limited scope of expansion in valuation multiples.  |
| Negative        | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.   |

Source: Sharekhan Research

# Sharekhan

by BNP PARIBAS

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