Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Schaeffler India Ltd

Profitability measures continue to improve in Q1CY2022

Automobiles	Sharekhan code: SCHAEFFLER
Reco/View: Buy ↔	CMP: Rs. 2,240 / Price Target: Rs. 2,650 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 22.37

Updated Feb 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

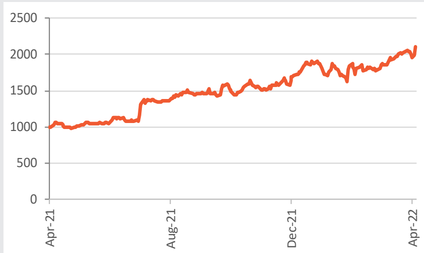
Company details

Market cap:	Rs. 35,012 cr
52-week high/low:	Rs. 2,278 / 965
NSE volume: (No of shares)	38.5 lakh
BSE code:	505790
NSE code:	SCHAEFFLER
Free float: (No of shares)	4.0 cr

Shareholding (%)

Promoters	74.1
FII	5.1
DII	15.4
Others	5.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.4	11.9	34.7	108.2
Relative to Sensex	13.0	16.4	41.1	88.0

Sharekhan Research, Bloomberg

Summary

- We retain our Buy recommendation on Schaeffler India Limited (SIL) with a revised PT of Rs. 2,650, led by a strong outlook for its automotive and industrial businesses and continuous improvement in margin profile.
- SIL's Q1CY2022 performance was led by higher-than-expected expansion in EBITDA margin, though revenue marginally missed expectations.
- Exports is a high-growth area for SIL, given the pedigree of its parent company. Greater localisation and focus on market share gains would aid revenue and EBITDA growth going forward. We expect its earnings to report a 33.4% CAGR during CY2021-CY2023E.
- The stock trades at a P/E of 31.3x and EV/EBITDA of 19.8x its CY2023E estimates.

We remain positive on Schaeffler India Limited (SIL), driven by a strong outlook for its automotive and industrial businesses and continuous improvement in margin profile. The company's Q1CY2022 results were mixed. Sales missed expectations by 6.4%, while EBITDA margin expanded by 40 bps higher than expectations. Overall, the company continues to maintain its sales and profitability growth. Revenue, EBITDA, and PAT grew by 19% y-o-y, 44.9% y-o-y, and 48.4% y-o-y, respectively, in Q1FY2022. SIL's sales mix remains robust with automotive, industrial, and exports contributing 47%, 37%, and 16%, respectively, in Q1CY2022. EBITDA margin improved by 80 bps q-o-q at 19.7% in Q1CY2022, led by improved product mix and focus on cost reductions. As a result, EBITDA and PAT was up 44.9% y-o-y and 48.4% y-o-y at Rs. 308 crore and Rs. 207 crore in Q1CY2022, respectively. The company's management has given a positive outlook for its business, led by volume growth across its verticals. SIL would benefit from the industrial and automobile aftermarket segments, strong growth traction in export markets, and better prospects for the bearings business. We reiterate our Buy rating on the stock with a revised price target (PT) of Rs. 8,861.

Key positives

- SIL continues to report record sales and profitability growth, outpacing the automobile industry's growth in a tough environment.
- EBITDA margin improved by 80 bps q-o-q at 19.7% in Q1CY2022, led by improved product mix and focus on cost reductions.
- SIL has won significant business orders in both automotive and industrial businesses and has consolidated its leadership position.
- The company has been approved for PLI scheme in the component champion incentive scheme.

Key negatives

- The company had higher working requirement in Q1CY2022 due to inventory increases to improve on service levels. Free cash flow (FCF) for Q1CY2022 was negative Rs. 20.8 crore versus Rs. 184.2 crore in Q1CY2021.

Management Commentary

- The company's management has given a positive outlook for its business, led by volume growth across its verticals.
- The company's board has approved stock split in 5:1 ratio and targets dividend payout ratio of 30-50% of the annual standalone net profit.

Revision in estimates – We have revised our earnings estimates by 12% and 19.1% for CY2022E and CY2023E, respectively, driven by continued strong performance both at revenue and EBITDA levels.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 2,650: SIL has been consistently outperforming the industry's growth rate, driven by its technological edge and established relationships with leading OEMs/ clients in India and globally. After a dip in performance led by COVID-induced lockdown in Q2CY2020, the company's performance has improved steadily, aided by strong recovery in the automotive segment and industrial segment. Exports continue to do well and contributed ~16% to revenue in Q1CY2022. We expect robust performance by the company going forward, driven by normalisation of economic activity, improvement in content per vehicle, strong growth in the wind power and railways businesses, and launch of new products in the aftermarket segment. We expect its earnings to report a 33.4% CAGR during CY2021-CY2023E, driven by a 27.9% revenue CAGR and a 110-bps improvement in EBITDA margin from 17.5% in CY2021 to 18.6% in CY2023E. The stock is trading at P/E of 31.3x and EV/EBITDA of 19.8x its CY2023E estimates. Premium valuations are justified, given the pedigree of its parent company and its capability to outperform the industry and peers. We reiterate our Buy rating on the stock with a revised price target (PT) of Rs. 2,650.

Key Risks

Delayed approval from industrial customers and late launches by automotive players can impact growth. Moreover, growth momentum might get derailed if COVID hits as severely in future.

Valuation (Standalone) Rs cr

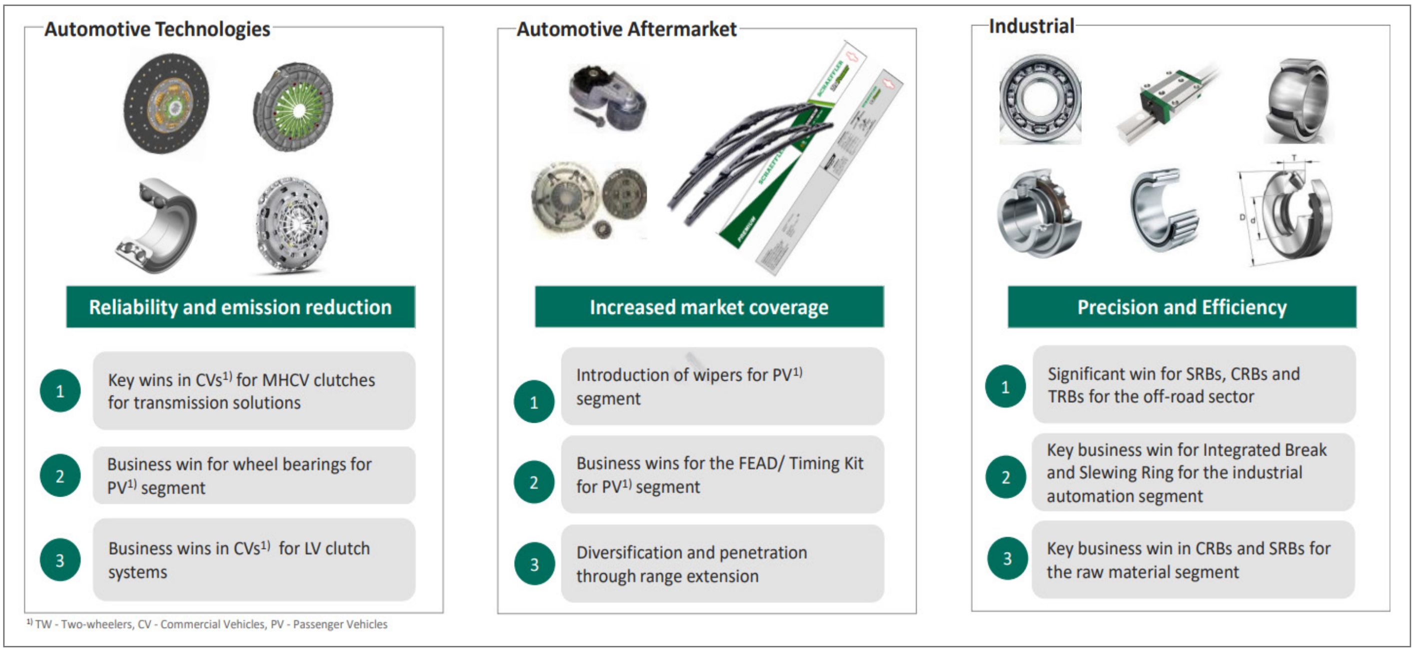
Particulars	CY20	CY21E	CY22E	CY23E
Net Sales	3,762	5,561	7,368	9,092
Growth (%)	(13.7)	47.8	32.5	23.4
EBIDTA	536	972	1,341	1,691
OPM (%)	14.3	17.5	18.2	18.6
Recurring PAT	291	629	876	1,119
Growth (%)	(20.9)	116.2	39.3	27.8
EPS (Rs)	18.6	40.3	56.1	71.6
PE (x)	120.3	55.7	40.0	31.3
P/BV (x)	11.8	11.1	13.2	9.9
EV/EBIDTA (x)	63.0	35.7	25.5	19.8
RoE (%)	9.3	23.7	24.8	24.9
RoCE (%)	12.4	30.7	32.2	32.3

Source: Company; Sharekhan estimates

Mixed results in Q1CY2022, amid higher-than-expected expansion in EBITDA margin: The company's Q1CY2022 results were mixed results. Sales missed expectations by 6.4%, while EBITDA margin expanded by 40 bps higher than expectations. Overall, the company continues to maintain sales and profitability growth. SIL's revenue increased by 19% y-o-y at Rs. 1,568 crore, driven by 15.9% y-o-y growth in the mobility business and 31.5% y-o-y growth in other business. Automotive technologies and aftermarket businesses were up 6.1% y-o-y and 15.5% y-o-y at Rs. 609 crore and Rs. 125 crore, respectively. Industrial and export businesses were up 21.7% y-o-y and 61.5% y-o-y to Rs. 586 crore and Rs. 248 crore, respectively. EBITDA margin improved by 80 bps q-o-q at 19.7% in Q1CY2022, led by improved product mix and focus on cost reductions. As a result, EBITDA and PAT increased by 44.9% y-o-y and 48.4% y-o-y at Rs. 308 crore and Rs. 207 crore, respectively, in Q1CY2022. SIL's sales mix remains robust with automotive, industrial, and exports contributing 47%, 37%, and 16%, respectively, in Q1CY2022.

Increasing market coverage: SIL continues to focus on increasing its market coverage through new launches, expansion of new product range, and improvement in service levels. The company's performance has improved, aided by improved mix and sustained countermeasures. SIL continues to win new contracts in both automotive and industrial businesses. Key wins during the quarter include MHCV and LV clutches for transmission solutions in commercial vehicles (CVs) and wheel bearings for the passenger vehicle (PV) segment. The company increased its product coverage by introduction of wipers and business wins for the FEAD/Timing Kitin PV segment. Moreover, the company has been approved for PLI scheme in the component champion incentive scheme. The theme of PLI scheme matches with SIL's product portfolio and focus. Mobility business and focus on technology are the company's key focus areas.

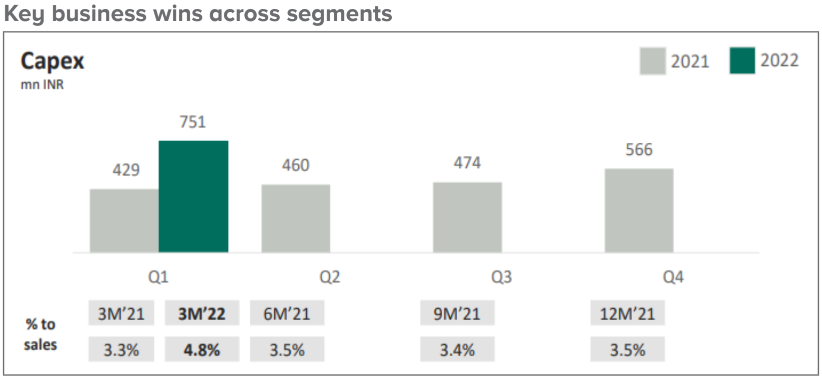
Key business wins across segments



Source: Company Investor Presentation; Sharekhan Research

Capex plan remains intact: The capex strategy remains intact at 4.8% of sales in Q1CY2022. The company had higher working requirement in Q1CY2022 due to inventory increases to improve on service levels.

Key business wins across segments



Source: Company Investor Presentation; Sharekhan Research

Positive management guidance: The company's management has given a positive outlook, as the company expects volumes to recover going forward. Management sees CY2022 to be a strong year and expects its businesses to perform well this year, driven by an expected normalisation of economic activity and recovery in rural demand. The company has a robust order book outlook, led by strong customer engagement. The company has won significant business orders in both automotive and industrial businesses and has consolidated its leadership position during Q1CY22. Management expects sustained operational performance across its plants and normal capacity utilisation. However, management highlighted headwinds due to geopolitical situations and increasing inflation.

Well positioned to benefit from electrification and hybridization trend: The company is likely to be a key beneficiary of electrification and hybridization trend for the domestic business, as India is expected to witness faster growth in electric and hybrid vehicles going forward. The company expects electrification to be in high single digits by 2030, while hybridization is expected to be at 25-35%. The company has a strong product portfolio and is well placed to benefit from this trend. The internal combustion engine (ICE) technology is expected to remain a significant driver for the industry going forward. The company will continue to benefit from its existing product portfolio. Since all hybrids will also have an ICE, there will be continuous improvement in the technology of internal combustion engines, which will drive content per car for the company, given its technological edge over peers and established relationships with OEMs. Moreover, the company has exposure to all the key markets, viz. North America, Europe, China, and India. The company is well positioned to benefit from the electrification trend in the mass markets of these geographies. In addition, management expects the two-wheeler (2W) and three-wheeler (3W) markets to witness faster electrification compared to other segments.

Strong growth prospects: SIL would benefit from industrial and automobile aftermarket segments, strong growth traction in export markets, and better prospects for the bearings business. The company is focusing on introducing new products in the industrial and automotive aftermarkets by bringing in localisation and boosting its market share. SIL will be the key beneficiary of this trend, as it focuses on increasing content per vehicle. In the industrial OEM segment, the company is witnessing strong growth in the railways segment with the introduction of new products and supplies to Metro Rail projects. With new additions of customers in the wind power business, we expect SIL to report strong growth in this space. Exports is a high-growth area for SIL, given the pedigree of its parent company. We expect SIL to benefit from industrial and automobile aftermarkets, strong growth traction in railways and export segments, and better prospects for the bearings business amid stricter norms. We are positive on the automobile sector and expect the industry to post double-digit growth in FY2023.

Earnings revised upwards: We have revised our earnings estimates by 12% and 19.1% for CY2022E and CY2023E, respectively, driven by continued strong performance both at revenue and EBITDA levels. Given the robust outlook for SIL's business, we expect its earnings to report a 33.4% CAGR during CY2021-CY2023E, driven by a 27.9% revenue CAGR and a 110-bps improvement in EBITDA margin from 17.5% in CY2021 to 18.6% in CY2023E.

Change in estimates Rs cr

Particulars	Revised		Earlier		% Change	
	CY22E	CY23E	CY22E	CY23E	CY22E	CY23E
Revenue	7,368	9,092	7,030	8,296	4.8	9.6
EBITDA	1,341	1,691	1,223	1,460	9.6	15.8
EBITDA margin	18.2	18.6	17.4	17.6	80 bps	100 bps
PAT	876	1,119	782	940	12.0	19.1
EPS	56.1	71.6	50.1	60.2	12.0	19.1

Source: Company; Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q1CY22	Q1CY21	Y-o-Y %	Q4CY21	Q-o-Q %
Net revenue	1,568	1,317	19.0	1,523	2.9
Operating expenses	1,259	1,104	14.0	1,236	1.9
EBIDTA	308	213	44.9	287	7.4
Depreciation	50	48	5.5	51	(1.3)
Interest	1	1	(7.7)	1	(3.4)
Other Income	20	22	(8.4)	22	(8.0)
PBT	277	186	49.1	257	7.9
Tax	70	46	50.9	66	5.8
Reported PAT	207	140	48.4	191	8.6
Adjusted PAT	207	140	48.4	191	8.6
EPS	13.3	8.9	48.4	12.2	8.6

Source: Company; Sharekhan Research

Key Ratios (Standalone) Rs cr

Particulars	Q1CY22	Q1CY21	Y-o-Y %	Q4CY21	Q-o-Q %
Gross margin (%)	39.2	35.9	330	38.9	30
EBIDTA margin (%)	19.7	16.2	350	18.9	80
EBIT margin (%)	16.5	12.5	390	15.5	100
Net profit margin (%)	13.2	10.6	260	12.5	70
Effective tax rate (%)	25.3	25.0	30	25.8	(50)

Source: Company; Sharekhan Research

Segment-wise performance (Standalone) Rs cr

Segment Revenue	Q1CY22	Q1CY21	Y-o-Y %	Q4CY21	Q-o-Q %
(a) Mobility components and related solutions	1,215.8	1,049.4	15.9	1,276.8	(4.8)
- Automotive Technologies	609.4	574.3	6.1	567.2	7.4
- Automotive Aftermarket	124.7	107.9	15.5	152.2	(18.1)
- Industrial	286.0	257.1	11.2	375.8	(23.9)
- Exports & Others	195.8	110.1	77.9	181.6	7.8
(b) Others	351.7	267.5	31.5	246.4	42.7
- Industrial	299.7	224.1	33.7	213.8	40.2
- Exports & Others	52.0	43.4	19.9	32.6	59.6
Net revenue	1,567.5	1,316.8	19.0	1,523.2	2.9
EBIT (Rs cr)	Q1CY22	Q1CY21	%YoY	Q4CY21	%QoQ
(a) Mobility components and related solutions	193.0	121.6	58.7	198.4	(2.7)
(b) Others	65.0	43.4	49.9	37.6	72.9
Total	258.0	165.0	56.4	236.0	9.3
EBIT Margin (%)	Q1CY22	Q1CY21	YoY (bps)	Q4CY21	QoQ (bps)
(a) Mobility components and related solutions	15.9	11.6	428	15.5	34
(b) Others	18.5	16.2	226	15.3	322
Total	16.5	12.5	393	15.5	97
EPS	13.3	8.9	48.4	12.2	8.6

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector outlook – Demand picking up in the automotive and industrial sector**

The passenger segment, both for 2W and four-wheelers, is expected to remain strong amid COVID-19, as a preference for personal transport. Rural demand is expected to recover given positive rural sentiments. We expect sequential improvement in M&HCV sales to continue, driven by rise in e-commerce, agriculture, infrastructure, and mining activities. We expect multi-year upcycle in the CV segment, driven by improved economic activities, low interest rate regime, and better financing availability. We expect M&HCVs to outpace other automobile segments in the medium term, followed by growth in the tractor, PV, and 2W segments. Moreover, exports provide a huge growth potential, given India's cost-effective manufacturing, being geographically closer to key markets of Middle East and Europe, and being the second-largest producer of key raw-material – steel. Auto component exports are expected to grow from $15 billion to $80 billion by FY2027.

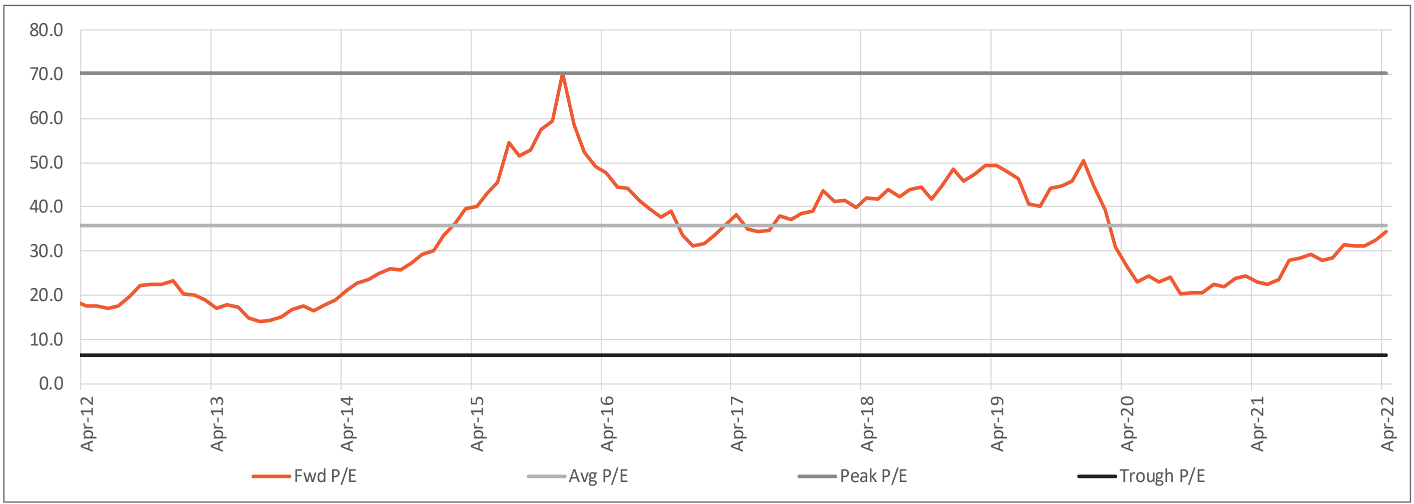
■ **Company outlook – MNC company with strong technological parentage and robust balance sheet**

SIL is part of the German Schaeffler Group. The Schaeffler Group has a strong research and development (R&D) DNA. In CY2019, the group filed 2,400 patents, making it the second most innovative company in Germany. The company has established strong relationships with global OEMs worldwide. SIL would benefit from its strong parentage and is expected to receive new businesses going forward. Moreover, SIL's parent has identified it as a manufacturing base for supply to Asia-Pacific region. This provides a huge growth potential for the company. SIL is a debt-free company with strong return ratio profile. The company is expected to generate strong FCF of Rs. 1,200 crore over the next three years. We remain positive on the company's growth prospects.

■ **Valuation – Maintain Buy with a revised PT of Rs. 2,650**

SIL has been consistently outperforming the industry's growth rate, driven by its technological edge and established relationships with leading OEMs/clients in India and globally. After a dip in performance led by COVID-induced lockdown in Q2CY2020, the company's performance has improved steadily, aided by strong recovery in the automotive segment and industrial segment. Exports continue to do well and contributed ~16% to revenue in Q1CY2022. We expect robust performance by the company going forward, driven by normalisation of economic activity, improvement in content per vehicle, strong growth in the wind power and railways businesses, and launch of new products in the aftermarket segment. We expect its earnings to report a 33.4% CAGR during CY2021-CY2023E, driven by a 27.9% revenue CAGR and a 110-bps improvement in EBITDA margin from 17.5% in CY2021 to 18.6% in CY2023E. The stock is trading at P/E of 31.3x and EV/EBITDA of 19.8x its CY2023E estimates. Premium valuations are justified, given the pedigree of its parent company and its capability to outperform the industry and peers. We reiterate our Buy rating on the stock with a revised PT of Rs. 2,650.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	Rs/Share	FY21*	FY22E*	FY23E*	FY21*	FY22E*	FY23E*	FY21*	FY22E*	FY23E*
Schaeffler India	2,240	120.3	55.7	40.0	63.0	35.7	25.5	12.4	30.7	32.2
Sundram Fasteners	819	47.6	37.3	24.4	26.3	21.7	15.8	18.4	21.4	22.0
Suprajit Engineering	355	34.4	25.9	19.3	21.9	17.0	13.0	16.0	18.9	22.1

Source: Company, Sharekhan estimates

About company

SIL (erstwhile FAG Bearings), with four plants and 11 sales offices, has a significant presence in India with three major widely known product brands – FAG, INA, and LuK. SIL produces a wide range of ball bearings, cylindrical roller bearings, deep groove balls, spherical roller bearings, and wheel bearings sold under the brand name of FAG. The company manufactures engine and transmission components for front accessory drive systems, chain drive systems, valve train, shift systems, and a range of needle roller bearings and elements under the brand, INA. SIL also produces clutch systems and dual mass flywheels for passenger cars, LCVs, heavy commercial vehicles, and tractors, which are sold under the brand of LuK. In addition to this, SIL has dedicated engineering and R&D support based in India to augment its product teams. SIL also has one of the largest aftermarket networks serving industrial and automotive markets. SIL derives 47% of its revenue from the automotive segment, 42% from the industrial segment, and 11% revenue from exports.

Investment theme

SIL is among the largest automotive and industrial suppliers with a strong parentage of the Schaeffler Group. The company is present in India since the past 50 years and has established strong relationships with leading OEMs in India and globally. Having strong manufacturing capabilities and R&D, SIL's parent company has identified it as a manufacturing base for supply to Asia-Pacific region. This provides a strong opportunity to the company to expand its export business. With the Indian Government focussing on 'Make in India,' 'Atma-Nirbhar,' and PLI programmes, SIL is well positioned to benefit from these programmes. Moreover, the company has a diversified portfolio – with automotive, industrial, and export businesses contributing 48%, 42%, and 10%, respectively, to revenue. The company's strategies to increase content per vehicle through product innovation and launches, while identifying new business divisions in the industrial sector, are likely to keep growth traction intact. The company's strong technological parentage and established relationships with global OEM clients would continue to provide growth opportunities. We remain positive on SIL and expect strong earnings growth, driven by revenue growth and margin expansion.

Key Risks

- Delayed approval from industrial customers and late launches by automotive players can impact growth.
- Pricing pressures from automotive OEM clients can impact profitability.
- Growth momentum might get derailed if the third wave (Omicron) of COVID-19 hits as severely as the second wave.

Additional Data

Key management personnel

Avinash Gandhi	Chairman
Harsha Kadam	Managing Director & CEO
Satish Patel	Director Finance & CFO
Ashish Tiwari	Company Secretary

Source: Company Website

Top shareholders

Sr. No.	Holder Name	Holding (%)
1	Fag Kugelfischer Gmbh	27.3
2	Schaeffler Buhl Verwaltungs Gmbh	20.6
3	Schaeffler Verwaltungsholding Sechs Gmbh	15.0
4	Industriewerk Schaeffler Ina-ingenieurdienst Gmbh	11.3
5	Kotak Emerging Equity Scheme	4.2
6	Uti Flexi Cap Fund	2.3
7	Sbi Magnum Global Fund	2.2
8	Sundaram Mutual Fund	1.4
9	Hdfc Life Insurance Co Ltd	1.2

Source: Bloomberg

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 detoriating 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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

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