

Escorts Kubota Ltd. (EKL)

No. of shares (m)	131.94
Mkt cap (Rs crs/\$m)	24500/2982.0
Current price (Rs/\$)	1857/22.6
Price target (Rs/\$)	1575/19.2
52 W H/L (Rs.)	2359/1400
Book Value (Rs/\$)	720/8.8
Beta	0.7
Daily volume NSE (avg. monthly)	273040
P/BV (FY23e/24e)	2.5/2.3
EV/EBITDA (FY23e/24e)	19.3/14.7
P/E (FY23e/24e)	32.4/23.6
EPS growth (FY22/23e/24e)	-18.9/-20.2/37.4
OPM (FY22/23e/24e)	13.6/8.8/11.2
ROE (FY22/23e/24e)	11.6/8.1/10.2
ROCE(FY22/23e/24e)	12.2/8.6/10.6
D/E ratio (FY22/23e/24e)	0.0/0.0/0.0
BSE Code	500495
NSE Code	ESCORTS
Bloomberg	ESCORTS IN
Reuters	ESCO.NS

Shareholding pattern

	%
Promoters *	72.9
MFs / Banks / FIs/Others	8.6
FPIs	4.0
Govt. Holding	0.0
Public & Others	14.5
Total	100.0

As on Dec 31, 2022

Recommendation

REDUCE

Analyst

KISHAN GUPTA, CFA, FRM

Phone: + 91 (33) 4488 0043

E- mail: kishan.gupta@cdequi.com

Company Brief

Escorts is involved in production of agri-machinery, construction and material handling equipment and railway equipment

Highlights

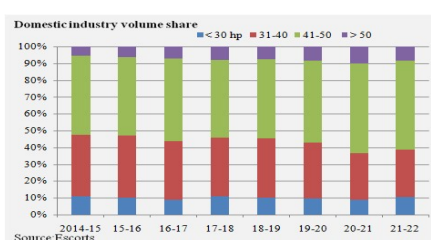
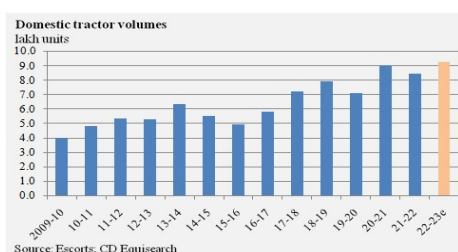
- Unabsorbed material price inflation - steel; tires; casting etc - coupled with adverse product mix resulted in Escorts posting EBIT margin of 8.3% in Q3, though flat QoQ but sharply down from 15.5% in Q3 of previous fiscal. Despite its tractors volumes now making a comeback after declining last fiscal, Escorts's published well-nigh 40% drop in its agri-machinery business EBIT to Rs 144.77 crs last quarter from Rs 238.66 crs in the same period a year back.
- With its construction equipment business reeling under the pressure of lower of take and entrenched raw material inflation and its agri machinery business stoked by margin pressures, Escorts overall post tax earnings grew by 6.8% to Rs 180.82 crs in Q3 (this also includes one -time gain of Rs 12.50 crs on account of contract termination recovery from erstwhile Tadano JV. In November, EKL completed sale of its 49% stake in Tadano Escorts India Private Limited (TEIPL) to Tadano Limited, Japan for a consideration of Rs 0.01 crs. Modest increases in depreciation costs and decline in interest expenses barely helped prevent the carnage in earnings.
- With inexorable focus on expanding the product profile and diversification, Escorts's railway equipment has seen transformation of sorts for its revenues grew by a eye-popping 30.5% in the first nine months of the current fiscal, though its EBIT advanced by just 15.5% to Rs 82.75 crs when compared to Rs 71.63 crs not least due to margin pressures. With this improved show, Escorts's railway equipment business contribution to overall allocable EBIT zoomed to 15.8% in 9MFY23 from 9.8%.
- The stock currently trades at 32.4x FY23e EPS of Rs 57.29 and 23.6x FY24e EPS of Rs 78.74. With unexpected surge in raw material prices over the last few quarters, EKL's has seen no timid erosion in margins in agri-machinery business - EBIT margin 9MFY23 9.1% vs 15.3%, resulting in some 19% cut in earning estimates for next fiscal. Though amalgamation of Kubota JVs (Escorts Kubota Ltd, Pvt Ltd, and Kubota Agricultural Machinery India Pvt Ltd) would galvanize EKL's tractor market share by 3-4%, further gains could face no small friction due to barely fledgling stage of Indian tractor industry. Weighing odds, we assign "reduce" rating on the stock with revised target of Rs 1575 (previous target: Rs 1550) based on 20x FY24e earnings.

(Figures in Rs crs)	FY20	FY21	FY22	FY23e	FY24e
Income from operations	5810.09	7014.42	7274.52	8334.40	9201.07
Other Income	97.60	160.38	181.93	307.61	327.89
EBITDA (other income included)	750.78	1287.14	1169.21	991.87	1359.50
Profit after EO	478.16	868.65	726.11	633.06	870.09
EPS (Rs)	53.80	88.58	71.80	57.29	78.74
EPS growth (%)	1.1	64.6	-18.9	-20.2	37.4

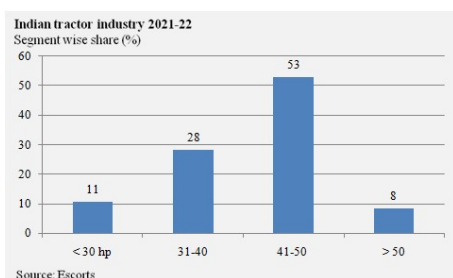
Outlook & Recommendation

India Tractor Industry Outlook

According to a report by Prescient Strategic Intelligence, the Indian tractor industry is expected to show considerable growth over 2020-30 period largely driven by increasing farm mechanization rate, rising construction activities and enhancing urbanization. With increasing sophistication to Indian agriculture, the demand for more than 75hp tractors is expected to grow considerably in the coming years, all thanks to their greater efficiency and power and increased productivity demands of the Indian farmer.



As per Businesswire, much of the growth in the tractor industry in India is expected to come from the southern part of the country as the most mechanized northern zone of the country is expected to saturate in the future. It also reckons that growth enablers for the tractor industry would include financial support to farmers through loans and subsidies, socio-economic changes in India and increasing labor shortage due to rising migration to cities. Growth opportunities in the sector would barely be stymied by increasing adoption of precision farming and enhanced focus on remote monitoring technology in tractors. Yet, lack of awareness of latest agricultural technologies and swelling demand for used and rental tractors could impede market growth.

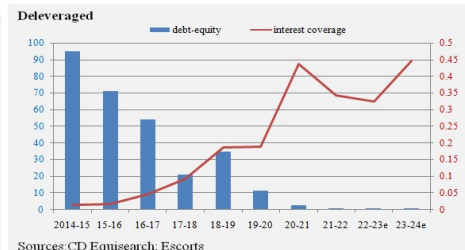
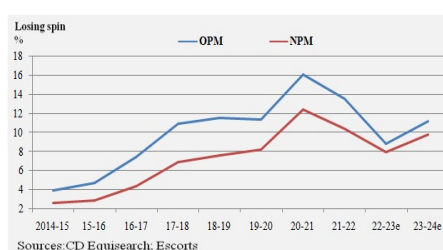
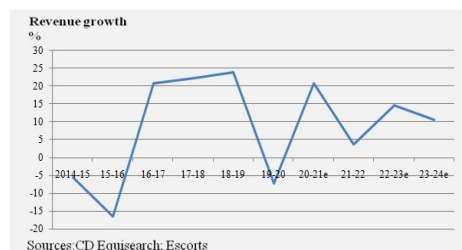


But near term headwinds cannot be undone for Crisil Ratings expect the tractor volumes to halve to 4-6% in FY24 not least due to the base effect. The growth, the agency reckons, would be driven by both the farm and commercial segments with the 5% increase in MSP for wheat for the ongoing crop will boost farm incomes and government's infrastructure push and higher construction activities will drive commercial demand. Yet operating margins of tractor manufacturers would rise to 16-17% from around 15% in FY23 mainly due to softening prices of inputs such as steel and pig iron.

Financials & Valuation

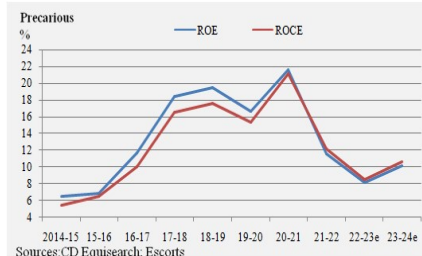
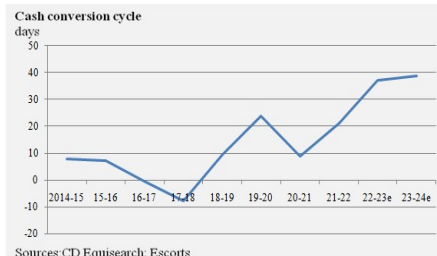
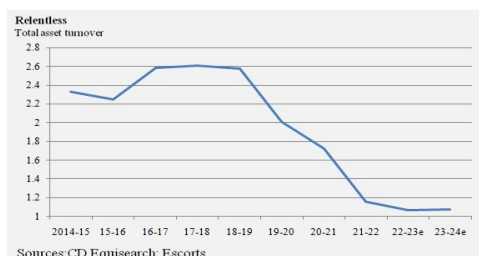
Multitude of factors, mainly higher MSP, increased availability of farm credit and timely monsoons have supported Indian tractor industry in the last few years which would also help the industry post record volumes in the current fiscal. Agrarian schemes of GOI such as Paramparagat Krishi Vikas Yojana, Pradhanmantri Gram Sinchai Yojana and Sansad Adarsh Gram Yojana have made no small impact in bolstering Indian agrarian economy.

Despite attended risks of market acceptance and sub-optimal margins in initial stages, new product launches across business divisions forms one of the cornerstones of Escorts growth strategy. Last fiscal, for instance, saw the launch of six new variants of the Powerhouse series of tractors along with introductions in cranes segment, compaction equipment and backhoe loader segment. Handful of railway equipment such as emergency pull box, coupler and metro dampers also helped enrich Escorts product profile.



Business alliance with Kubota would bring about intertwined benefits for both Indian entity and the Japanese parent ranging from enhanced sourcing of components (engines case in point) to closing product gaps of Escorts to market share gains in India through consolidation of tractor brands to leveraging the global distribution network of Kubota for boosting EKL's exports to increased sourcing opportunities of construction equipments to cross-pollination of market strengths in existing markets of Kubota and EKL in India to implement best production practices of Kubota at EKL plants in India.

Notwithstanding benefits to EKL from Kubota's low cost technology, near unpredictability of Indian consumer (read: brand stickiness) and M&M's iron fisted grip of the Indian tractor market (40% market share) could hinder prospects of great business scalability in India. Catalysts in terms of fivefold increase in EKL's exports over the next few years - by doubling down on Kubota's global network - barely looked unambitious in light of little headway EKL has made in export market in last few years - exports projected to top 8000 units this fiscal from some 4900 units in FY21, an unremarkable feat by any figment of imagination. Enhanced competitive advantage in terms of improved technology and enhanced production processes by no means guarantee market share gains.



The stock currently trades at 32.4x FY23e EPS of Rs 57.29 and 23.6x FY24e EPS of Rs 78.74. With easing material prices, margins would barely stymie next fiscal, resulting in no listless rebound in post tax earnings - estimated to rise by more than a third, though on a small base. With redundancy in tractor capacities and sufficient balance sheet liquidity, ROE would languish at some 10% next fiscal. Though EKL's agri-machinery business has struggled to gain market share in last few years, EKL's railway equipment business has seen transformation of sorts with the division getting its first ever order of brakes disc, HVAC system and Train 18 last quarter. Balancing odds, we assign "reduce" rating on the stock with revised target of Rs 1575 (previous target: Rs 1550) based on 20x FY24e earnings. For more info, refer to our June report.

Cross Sectional Analysis

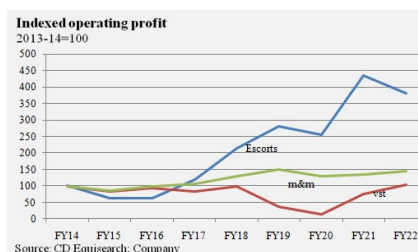
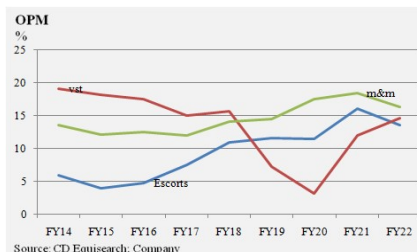
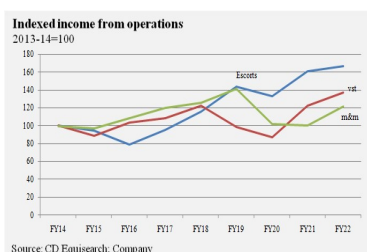
Company	Equity*	CMP (Rs)	Market cap*	Sales*	Profit*	OPM (%)	NPM (%)	Int. coverage	ROE (%)	Mkt cap / sales	P/BV	P/E
Escorts	132	1857	24500	8093	640	9.7	8.2	66.7	9.5	3.0	2.6	32.0
M&M	622	1165	144807	114837	8371	16.5	6.7	2.9	17.7	1.3	2.8	17.3
VST Tillers	9	2321	2006	902	74	11.5	8.2	59.7	9.8	2.2	2.6	27.0

*figures in crores; calculations on ttm basis

Book value adjusted for goodwill and revaluation reserves where applicable; Escorts valuation ratios adjusted for treasury shares

With increased demand visibility for small farm machines, VST has focused on diversifying its offerings from power tillers to a broad range of small farm machineries such as power weeders, power reapers and brush cutters. To make headway in this initiative, the company has forged a strategic partnership with Pubert, a French company, which supplies small agricultural machinery. To drive its market share in the compact tractor segment, the company would relentlessly work towards launching new user friendly products and strengthening its distribution network. To enhance operating efficiency, VST combined its assembly lines for manufacturing compact tractors (17-27 hp) and higher HP tractors (30-50 hp) last fiscal.

Rejoiced by improving prospects of farm mechanization, M&M plans to continue launch new farm machinery products in the country with the help of its centre of expertise in Turkey, Finland and Japan. It would also set up a new plant in Pithampur to manufacture rice transplanters, potato planters and harvesters. Despite 2 % drop in domestic tractor volumes last fiscal, the company managed to gain 1.8% market share in India (40%), a record streak of market leadership. Bolstered by its distribution operations in US, Brazil, Africa and South Asian markets such as Nepal, Sri Lanka and Bangladesh, the farm sector export volumes (tractor) grew by a staggering 65.5% last fiscal, though the absolute volumes was barely large when compared to overall size of M&M tractor operations.



Financials

Quarterly Results

Figures in Rs crs

	Q3FY23	Q3FY22	% chg.	9MFY23	9MFY22	% chg.
Income from operations	2291.35	1998.29	14.7	6214.21	5396.01	15.2
Other Income	91.68	26.71	243.2	205.25	118.96	72.5
Total Income	2383.03	2025.00	17.7	6419.46	5514.97	16.4
Total Expenditure	2100.02	1719.77	22.1	5722.90	4648.75	23.1
PBIDT	283.01	305.23	-7.3	696.56	866.22	-19.6
Interest	3.48	3.83	-9.1	9.64	11.41	-15.5
Depreciation	37.97	33.10	14.7	111.69	98.54	13.3
PBT	241.56	268.30	-10.0	575.23	756.27	-23.9
Tax	54.82	67.91	-19.3	136.78	189.74	-27.9
PAT	186.74	200.39	-6.8	438.45	566.53	-22.6
MI	-0.02	-0.48	-95.8	-0.10	0.08	-225.0
Profit of investments	-5.94	-6.68	-11.1	-18.26	-20.90	-12.6
Reported PAT	180.82	194.19	-6.9	420.29	545.55	-23.0
Extraordinary Item	-	-	-	-39.47	-	-
Adjusted Net Profit	180.82	194.19	-6.9	459.76	545.55	-15.7
EPS (F.V. 10)	16.36	19.20	-14.8	41.61	53.94	-22.9

Segment results

Figures in Rs crs

	Q3FY23	Q3FY22	% chg.	9MFY23	9MFY22	% chg.
Segment Revenue						
Agri Machinery Products	1735.40	1540.54	12.6	4809.06	4244.28	13.3
Railway Equipments	249.29	173.85	43.4	604.65	463.41	30.5
Construction Equipments	306.11	276.50	10.7	794.14	667.29	19.0
Others	4.19	10.96	-61.8	13.25	27.08	-51.1
Sub Total	2294.99	2001.85	14.6	6221.10	5402.06	15.2
Inter - Segment Revenue	3.64	3.56	2.2	6.89	6.05	13.9
Net Segment Revenue	2291.35	1998.29	14.7	6214.21	5396.01	15.2
Segment EBIT						
Agri Machinery Products	144.77	238.66	-39.3	438.26	648.88	-32.5
Railway Equipments	32.62	24.86	31.2	82.75	71.63	15.5
Construction Equipments	6.86	6.78	1.2	2.98	12.44	-76.0
Sub Total	184.25	270.30	-31.8	523.99	732.95	-28.5
Interest	3.48	3.83	-9.1	9.64	11.41	-15.5
Other Unallocable Exp.	-60.79	-1.83	3221.9	-113.93	-34.73	228.0
Extraordinary income	-	-	-	-53.05	0.00	-
PBT	241.56	268.30	-10.0	575.23	756.27	-23.9

Consolidated Income Statement

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
Income from operations	5810.09	7014.42	7274.52	8334.40	9201.07
Growth (%)	-7.2	20.7	3.7	14.6	10.4
Other Income	97.60	160.38	181.93	307.61	327.89
Total Income	5907.69	7174.80	7456.45	8642.02	9528.96
Total Expenditure	5156.91	5887.66	6287.24	7650.15	8169.46
EBITDA (other income included)	750.78	1287.14	1169.21	991.87	1359.50
Interest	17.23	13.34	14.97	13.63	13.41
EBDT	733.55	1273.80	1154.24	978.24	1346.09
Depreciation	107.22	118.28	132.06	149.29	162.07
Tax	153.53	283.15	257.22	198.95	284.16
Net profit	472.80	872.37	764.96	630.00	899.85
Minority interest	-0.53	0.17	-0.86	-0.12	-0.12
Profit of investments	-1.08	-0.74	-29.35	-27.88	-29.88
Reported PAT	472.25	871.46	736.47	602.24	870.09
Extraordinary item	-5.91	2.81	10.36	-30.82	0.00
Adjusted Net Profit	478.16	868.65	726.11	633.06	870.09
EPS* (Rs.)	53.80	88.58	71.80	57.29	78.74

*adjusted for treasury shares

Segment Results

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
Segment Revenue					
Agri Machinery Products	4472.49	5732.26	5621.60	6336.81	6933.44
Railway Equipments	477.22	478.96	636.21	854.65	1008.49
Construction Equipments	839.76	776.11	986.40	1135.59	1249.15
Others	20.69	27.09	37.79	17.25	20.00
Sub Total	5810.16	7014.42	7282.00	8344.29	9211.07
Inter - Segment Revenue	0.07	0.00	7.48	9.89	10.00
Net Segment Revenue	5810.09	7014.42	7274.52	8334.40	9201.07
Segment EBIT					
Agri Machinery Products	572.49	1032.55	859.55	581.87	832.01
Railway Equipments	85.83	76.75	94.32	117.75	141.19
Construction Equipments	30.22	27.81	23.87	11.52	34.35
Auto Ancillary Products	0.00	0.00	0.0		
Sub Total	688.54	1137.11	977.74	711.13	1007.55
Interest	17.23	13.34	14.97	13.63	13.41
Other Unallocable Exp. (net of income)	35.76	-31.75	-59.41	-184.49	-189.87
Exceptional income/(expense)	-9.22	0.00	0.00	-53.05	0.00
PBT	626.33	1155.52	1022.18	828.94	1184.01

Consolidated Balance Sheet

Figures in Rs crs

	FY20	FY21	FY22	FY23e	FY24e
SOURCES OF FUNDS					
Share Capital	122.58	134.83	131.94	131.94	110.50
Reserves	2994.82	4891.30	7467.96	7995.13	9008.17
Total Shareholders Funds	3117.40	5026.13	7599.90	8127.07	9118.67
Minority Interest	5.10	-0.91	-3.75	-3.87	-3.99
Long term debt	24.47	49.35	41.35	37.00	35.00
Total Liabilities	3146.97	5074.57	7637.50	8160.20	9149.68
APPLICATION OF FUNDS					
Gross Block	2764.78	2942.17	3088.39	3198.39	3448.39
Less: Accumulated Depreciation	1062.37	1145.94	1247.34	1396.63	1558.71
Net Block	1702.41	1796.23	1841.05	1801.76	1889.68
Capital Work in Progress	124.66	64.69	87.80	80.00	85.00
Investments	797.36	1938.02	4835.84	4967.29	5637.60
Current Assets, Loans & Advances					
Inventory	883.36	718.16	846.56	1166.82	1242.15
Sundry Debtors	731.86	657.58	792.62	1000.13	1104.13
Cash and Bank	324.88	1321.76	271.84	383.88	529.73
Other Assets	319.92	271.58	317.71	411.59	463.25
Total CA & LA	2260.02	2969.08	2228.73	2962.41	3339.26
Current liabilities	1649.71	1593.41	1257.50	1552.50	1698.97
Provisions	125.75	101.68	97.96	101.82	105.02
Total Current Liabilities	1775.46	1695.09	1355.46	1654.33	1803.99
Net Current Assets	484.56	1273.99	873.27	1308.09	1535.27
Net Deferred Tax	-29.27	-23.30	-37.27	-37.91	-37.91
Other Assets (Net of liabilities)	67.25	24.94	36.81	40.98	40.04
Total Assets	3146.97	5074.57	7637.50	8160.20	9149.68

Key Financial Ratios

	FY20	FY21	FY22	FY23e	FY24e
Growth Ratios					
Revenue (%)	-7.2	20.7	3.7	14.6	10.4
EBIDTA (%)	-7.0	69.2	-10.0	-10.6	31.7
Net Profit (%)	1.1	81.7	-16.4	-12.8	37.4
EPS (%)	1.1	64.6	-18.9	-20.2	37.4
Margins					
Operating Profit Margin (%)	11.4	16.1	13.6	8.8	11.2
Gross Profit Margin (%)	12.8	18.1	15.7	12.2	14.6
Net Profit Margin (%)	8.2	12.4	10.4	7.9	9.8
Return					
ROCE (%)	15.4	21.2	12.2	8.6	10.6
ROE (%)	16.7	21.6	11.6	8.1	10.2
Valuations					
Market Cap / Sales	1.4	2.5	3.1	2.9	2.7
EV/EBIDTA	9.5	11.2	15.1	19.3	14.7
P/E	12.3	14.5	23.6	32.4	23.6
P/BV	1.9	2.6	2.3	2.5	2.3
Other Ratios					
Interest Coverage	37.8	87.3	68.4	64.8	89.3
Debt-Equity Ratio	0.1	0.0	0.0	0.0	0.0
Current Ratio	1.6	2.6	4.8	0.0	0.0
Turnover Ratios					
Fixed Asset Turnover	3.5	4.0	4.0	4.6	5.0
Total Asset Turnover	2.0	1.7	1.2	1.1	1.1
Debtors Turnover	7.0	10.1	10.0	9.3	8.7
Inventory Turnover	5.9	7.4	8.0	7.5	6.8
Creditors Turnover	4.1	4.7	6.0	7.2	6.4
WC Ratios					
Debtor Days	52.2	36.2	36.4	39.3	41.7
Inventory Days	61.7	49.6	45.4	48.4	53.8
Creditor Days	90.1	77.1	60.6	50.5	56.8
Cash Conversion Cycle	23.8	8.7	21.2	37.1	38.8

Cumulative Financial Data

Figures in Rs crs	FY16-18	FY19-21	FY22-24e
Income from operations	12637	19087	24810
Operating profit	1025	2514	2756
EBIT	1000	2545	3104
PBT	887	2495	3062
PAT after MI	628	1820	2229
OPM (%)	8.1	13.2	11.1
NPM (%)	5.0	9.5	9.3
Interest coverage	8.9	50.8	73.9
ROE (%)	11.7	17.0	10.6
ROCE (%)	10.5	16.6	11.1
Fixed asset turnover	2.7	3.8	4.5
Debtors turnover	8.7	10.2	9.4
Inventory turnover	7.6	8.6	7.5
Creditors turnover	3.9	4.5	5.8
Debtors days	41.9	35.8	38.9
Inventory days	48.3	42.4	48.7
Creditors days	92.6	80.3	62.8
Conversion cycle	-2.4	-2.0	24.7

FY16-18 implies three years ending fiscal 18; *as on terminal year

Discernible slowdown in Indian tractor industry in the last few quarters - high inflation one of the few factors - would all but flatline Escorts cumulative volumes in FY22-24e period (6.7% projected growth over the one in previous three year ended period). Yet thanks to unprecedented magnitude and frequency of price hikes during an interval of few quarters, cumulative revenues would still grow by a respectable 30% during FY22-24 period. Unabsorbed price inflation precipitated by no puny surge in prices of raw materials and adverse product mix - impact already visible in EBIT margins of agri machinery business in the last few quarters - would do little to boost overall OPMs during the ensuing period - OPM estimated to slide to some 11.1% from 13.2% in FY19-21 period (see table).

Sclerosis in Escorts's construction equipment business would barely provide any velocity to earnings as cumulative post tax earnings during FY22-24 period would grow by a unstriking 22.5% (see table), thus perceptibly pulling down return on capital - ROE estimated to descend to 10.6% from 17% while ROCE to 11.1% from 16.6%. Given barely large scale of Escorts railway equipment business, overall business scaling would rest on either faster churn of tractors or gains in market share. Helped by reduction in creditor days, cash conversion cycle would increase somewhat during FY22-24 period.

Financial Summary – US dollar denominated

million \$	FY20	FY21	FY22	FY23e	FY24e
Equity capital	16.3	18.3	17.4	16.1	13.4
Shareholders funds	410.7	673.8	992.3	980.0	1100.5
Total debt	5.5	6.9	5.5	4.5	4.3
Net fixed assets (incl CWIP)	242.4	253.2	254.4	229.0	240.3
Investments	105.8	263.7	637.9	604.6	686.2
Net current assets	61.4	164.3	105.0	150.1	177.5
Total assets	414.6	681.3	997.3	984.1	1104.2
Revenues	819.7	945.3	976.3	1014.4	1119.9
EBITDA	107.0	173.0	155.1	125.7	165.5
EBDT	104.6	171.2	153.0	124.0	163.8
PBT	89.5	155.2	135.3	105.8	144.1
Profit after MI & others	67.5	117.1	97.4	77.1	105.9
EPS(\$)	0.76	1.19	0.96	0.70	0.96
Book value (\$)	4.62	6.87	9.81	8.87	9.96

income statement figures translated at average rates; balance sheet and cash flow at year end rates; projections at current rate (\$82.16/\$)

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CD Equisearch Private Limited (CIN: U67120WB1995PTC071521)

Registered Office: 37, Shakespeare Sarani, 3rd Floor, Kolkata – 700 017; Phone: +91(33) 4488 0000; Fax: +91(33) 2289 2557 Corporate Office: 10, Vasawani Mansion, 5th Floor, DinshawWachha Road, Churchgate, Mumbai – 400 020. Phone: +91(22) 2283 0652/0653; Fax: +91(22) 2283, 2276 Website: www.cdequi.com; Email: research@cdequi.com

buy: >20% accumulate: >10% to ≤20% hold: ≥-10% to ≤10% reduce: ≥-20% to <-10% sell: <-20%

Exchange Rates Used- Indicative

Rs/\$	FY18	FY19	FY20	FY21	FY22
Average	64.45	69.89	70.88	74.20	74.51
Year end	65.04	69.17	75.39	73.50	75.81

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.