



Powered by the Sharekhan 3R Research Philosophy

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 **33.41**
Updated Dec 08, 2022

High Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 15,056 cr
52-week high/low:	Rs. 1,230 / 731
NSE volume: (No of shares)	2.6 lakh
BSE code:	532497
NSE code:	RADICO
Free float: (No of shares)	8.0 cr

Shareholding (%)

Promoters	40.3
FII	19.7
DII	23.2
Others	16.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.3	17.5	19.2	15.5
Relative to Sensex	3.3	18.3	17.5	10.1

Sharekhan Research, Bloomberg

Radico Khaitan Ltd

Soft Q3; risk-reward unfavorable

Consumer Goods	Sharekhan code: RADICO		
Reco/View: Hold	↓	CMP: Rs. 1,126	Price Target: Rs. 1,205 ↑
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- Radico Khaitan Limited's (RKL's) Q3FY2023 numbers were muted, affected by sluggish volume growth, while higher input cost inflation affected margins. Net revenues grew by just 3%, while PAT decreased by 23% y-o-y (OPM down by 331 bps y-o-y to 12%).
- Sales volumes of Prestige & Above (P&A) segment grew by 14% in Q3 and 21% in 9MFY23. Volume growth momentum would sustain with Rampur Single Malt Whiskey and Jaisalmer Gin expected to grow strongly ahead of industry in FY2024.
- Backward-integration, price hikes undertaken in the key markets and better mix will help EBITDA margin to improve from Q1FY2024. EBITDA margins to stand at 15% in FY2024 and will consistently improve in stable input cost environment.
- Stock has seen good run-up of 18% in the past three months and is currently trading at 62.5x, 43.2x and 34.6x its FY2023E, FY2024E and FY2025E EPS, respectively. With risk-reward unfavourable and persistent near-term margin pressures, we downgrade our rating on stock to Hold from Buy earlier.

Radico Khaitan Limited's (RKL's) Q3FY2023 performance was impacted by rationalisation of regular brand volumes in some key states to protect margins and sustained high input cost and fuel inflation putting stress on margins. Net revenue growth moderated to 3.4% y-o-y to Rs. 792.2 crore. Indian Made Foreign Liquor (IMFL) sales volume (excluding royalty brands) decreased by 10.3% y-o-y to 6.12 million cases due to a 23% y-o-y decrease in volumes of regular and other brands to 3.53 million cases. However, including brands on royalty, IMFL sales volumes stood flat at 6.99 million cases. Premium & above brands (P&A) brands maintained good growth momentum with sales volume growing by 14% y-o-y to 2.59 million cases during the quarter. Higher input prices led to a 489 bps y-o-y decline in gross margins to 41.3%, while EBITDA margin declined by 331 bps y-o-y to 12.2%. EBITDA decreased by 19% y-o-y to Rs. 96.8 crore and reported PAT decreased by 23% y-o-y to Rs. 61.2 crore. The management has maintained its guidance of mid-teen volume growth in P&A brands in the medium to long term on account of strong traction. EBITDA margin is expected to recover to mid-teens in FY2024 with the commencement of backward-integration project, price hikes undertaken in key states, and improved mix.

Key positives

- P&A segment's sales volumes grew by 14% y-o-y to 2.59 million cases; net revenues grew by 19.1% y-o-y to Rs. 402.5 crore.
- Morpheus Super-premium brandy crossed sales volume of one million cases.

Key negatives

- Higher raw material prices resulted in a 489 bps y-o-y decline in gross margins.
- Regular brands' sales volumes fell by 23% y-o-y to 3.53 million cases affected by rationalisation strategy.

Management Commentary

- P&A segment's sales volumes will continue to clock growth of above 15%. Regular brands affected by rationalisation of brands due to conscious stance of selling lesser volumes of low-priced products and change in the route-to-market strategy. However, management is confident of regular brands' volumes to grow by 4-5% in FY2024.
- Morpheus Brandy became the sixth brand to cross 1 million cases in January 2023. 1965 Victory rum will cross 1 million cases by FY2023-end. 8PM whiskey will reach 3 million cases sales volume in FY2023. New launches such as Royal Ranthambore Whiskey and Jaisalmer Gin are gaining strong traction.
- Cumulative price increase in state of West Bengal, Rajasthan and Kerala stands at around 3%. Uttar Pradesh government has increased Non IMFL segment prices by 15% from April, 1 2023.
- Price hikes in key markets in IMFL & non-IMFL segment, better mix and backward integration benefits of Rampur Facility would help EBITDA margins to recover to mid-teens in FY2024. The company targets consistent margin improvement over the next 3-4 years.

Revision in earnings estimates : We have reduced our earnings estimates for FY2023, FY2024 and FY2025 to factor in lower volumes in the regular segment and lower-than-earlier-expected EBITDA margins.

Our Call

View – Downgrade to Hold with revised PT of Rs. 1,205: RKL is consistently growing ahead of the industry due to strong traction to its premium products in the domestic market, which is scaling up well in key markets. Volatile raw material prices will keep up the pressure on the margins in the near term. However, price hikes in key states, benefits of backward integration and better mix would help margins to gradually recover from H1FY2024. RKL's stock price has moved up by ~18% in last three months and is currently trading at 62.5x, 43.2x and 34.6x its FY2023E, FY2024E and FY2025E earnings, respectively. In view of near-term margin pressure and unfavourable risk reward ratio we downgrade our rating on stock to Hold from Buy earlier with revised price target (PT) of Rs. 1,205.

Key Risks

Any change in liquor policies in key states/sustained increase in excise rate on liquor or sustained high raw-material inflation would act as a key risk to our earnings growth in the near to medium term.

Valuation (Consolidated)

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenue	2,399	2,868	3,201	3,730	4,298
OPM (%)	17.0	14.0	12.2	14.8	15.9
Adjusted PAT	264	249	241	348	435
Adjusted EPS (Rs.)	20.8	19.7	18.0	26.0	32.5
P/E (x)	54.3	57.2	62.5	43.2	34.6
P/B (x)	8.4	7.5	6.9	6.0	5.2
EV/EBIDTA (x)	37.0	37.3	39.6	27.5	22.1
RoNW (%)	14.7	12.4	11.0	14.0	15.1
RoCE (%)	17.1	15.1	12.2	16.7	18.4

Source: Company; Sharekhan estimates

Muted Q3 – Revenue growth at 3% y-o-y; OPM down 331 bps y-o-y

Net revenues grew by 3.4% y-o-y to Rs. 792.2 crore, with IMFL volume reported flat y-o-y at 7 million cases. P&A category (42.3% of total IMFL volume and 63.4% of total IMFL revenue) registered revenue growth of 19.1% y-o-y to Rs. 402.5 crore with underlying volume growth of 14.1% y-o-y to 2.6 million cases. Due to sustained raw material inflation, gross margins declined by 489 bps y-o-y to 41.3% and OPM contracted by 331 bps y-o-y to 12.2%. Gross margin and OPM stood stable on a sequential basis aided by stabilizing trend in certain commodities. Operating profit declined by 18.6% y-o-y to Rs. 96.8 crore. In line with fall in the operating profit coupled with higher interest expense, adjusted PAT declined by 25.6% y-o-y to Rs. 57 crore. Reported PAT stood at Rs. 61.2 crore. RKL's brand, Morpheus Super Premium Brandy joined the millionaire club in January 2023, making it the sixth brand from the company's portfolio to achieve the million-case mark. The company commissioned the dual feed plant at Rampur and commenced the bottling operations at the Sitapur plant in January 2023.

Volume-led growth continued in P&A brands

P&A brands reported net sales of Rs. 402.5 crore, up 19.1% y-o-y, led by volume growth of 14.1% y-o-y to 2.6 million cases in Q3FY2023. P&A brands' contribution to total IMFL's revenues increased from 54.5% in Q3FY2022 to 63.4% in Q3FY2023 due to higher volume contribution to 42.3% in Q3FY2023 versus 33.2% in Q3FY2022, in line with the company's strategy to grow its premium portfolio. During 9MFY2023, the company's Prestige & Above category brands have shown robust growth including core brands such as Magic Moments Vodka and Morpheus Brandy where 9MFY2023 volumes have surpassed the full year numbers of FY2022.

Net debt higher q-o-q

Net debt increased by Rs. 310.7 crore since March 2022 after capex Rs. 471.9 crore on new projects. Net debt stood at Rs. 426.7 crore as on December 31, 2022, consisting of long-term debt of Rs. 259 crore and short-term debt (including current maturities) of Rs. 272 crore, taking the total debt to Rs. 531 crore. Cash and cash equivalents as of December 31, 2022, stood at Rs. 104.3 crore. The management has guided that the company aims to reduce debt to negligible or zero in the next three years and the ongoing capex would be funded through a mix of internal accrual and debt.

Capacity expansion on track

RKL successfully commissioned a dual feed plant at Rampur in January 2023 within the committed capex estimate and timelines. In January 2023, the company also commenced the bottling operations at the Sitapur plant, which is the first phase of the green field project. The company has incurred capex of Rs. 540.6 crore on Rampur Dual Feed and Sitapur Green Field projects since inception.

Key conference call highlights

- ◆ **Volume growth trajectory in P&A segment to be maintained:** P&A volumes registered double-digit (~11%) CAGR over pre-Covid level and the management has maintained its guidance of achieving more than a 15% growth in P&A volumes in the coming quarters. The company has reported outperformance versus the industry for past six quarters, registering growth across every category and segment. As per the management, 1965 *Victory Rum* is likely to touch million cases in FY2023 itself.
- ◆ **Brand-wise expansion continued:** Jaisalmer Gold Gin is now available in Dubai Duty Free and has witnessed good response. The company will continue to expand the brand in the domestic and international markets. *Royal Ranthambore* is currently present in 12 states and the company plans to expand the brand to pan-India in FY2024. RKL expects Rampur volumes to improve from H2FY2024. The management has also guided that the company will be launching one brown spirit and one white spirit in FY2024.
- ◆ **Price increase implemented in IMFL and non-IMFL segments:** In its IMFL segment, the company received price increase in Kerala, Rajasthan and in some southern states. In the non-IMFL segment, price increase (to the tune of 15%) has been approved in Uttar Pradesh and will effective from April 01, 2023. The price increase in the non-IMFL segment will bring out the non-IMFL profitability from negative to positive range and support overall margins in FY2024.

- ◆ **Muted quarter for regular brands:** Regular brands witnessed a decline of 19% y-o-y o Rs. 225 crore affected by volume decline of 22.6% y-o-y to 3.5 million cases in Q3FY2023. Changes in route-to-market (RTM) strategy and conscious stance of selling lesser volumes of low-priced products led to moderation in regular brands' volumes. Management has stated that the volume decline due to changes in RTM is temporary and volume growth in the regular segment is expected to be back in the coming quarters. The management is confident of regular brands' volumes to grow by 4-5% in FY2024.
- ◆ **Input costs remain volatile:** Glass prices have increased in Q1FY2023 (up by ~12%) and inflation in ENA cost is continued (5% increase in cost q-o-q). As per the management, while the raw material scenario remains volatile, the company has seen early signs of deflation in certain commodities like paper, etc.
- ◆ **Non-IMFL segment mainly dragged down gross margins:** As per the management, the actual contraction in gross margins was to the extent of 700-800 bps, with non-IMFL segment largely dragging down the margins. However, decline of ~300 bps was mitigated by price increases in the IMFL segment and premiumisation. With the recent price increases received in the non-IMFL business in UP, margins are expected to improve in FY2024.
- ◆ **EBITDA margin to recover to 16% aided by multiple levers:** The management has indicated that the EBITDA margin would be range bound in near term and is expected to expand in the long term to its historical level of over 16% (expected in H2FY2024) aided by premiumisation and backward integration. Multiple factors would help margins rise including backward integration which will help the branded business (Rs. 4 per litre difference between manufacturing and buying it from outside), rise in volume of Rampur Single Malt and Jaisalmer Gin, Rampur Indian Single Malt gaining momentum in defence, price hikes in the IMFL and non-IMFL segment and natural growth in the premium portfolio (better mix).
- ◆ **Export volumes to recover:** The company registered improvement in exports in value terms, while volumes continued to be impacted. However, with the stabilisation in freight rates and good traction to the luxury products, the volumes are expected to stabilise in coming quarters. RKL's brands are currently available in 88 countries and the company would continue to expand its distribution in the international market.
- ◆ **Vodka cocktail well accepted by customers:** RKL has already launched the Vodka cocktail in premium outlets in Bengaluru and plans to extend its distribution to Maharashtra, Daman and Goa in the coming months. The company is benefiting from the first mover advantage for Vodka cocktail and the response is better than expected. The company has launched this product with a purpose to strengthen the Magic Moments brand.
- ◆ **Other Concall highlights**
 - ◆ Tax rate is expected to remain at 25% in FY2023 and FY2024.
 - ◆ Royalty brands mainly include Morpheus brandy, 8PM Black Whiskey and Magic Moments vodka
 - ◆ Employee cost is higher in Q3FY2023 (up by 29% y-o-y and 13% q-o-q) due to one-off expenses related to incentives.

Results (Consolidated)

Particulars	Rs cr				
	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Net Sales	792.2	766.0	3.4	761.4	4.0
Raw material cost	464.8	412.0	12.8	445.0	4.4
Employee cost	45.5	35.3	28.9	40.2	13.4
Advertisement & Publicity	78.6	86.1	-8.7	73.2	7.4
Other expenses	106.4	113.5	-6.3	112.9	-5.8
Total operating expenses	695.3	647.0	7.5	671.3	3.6
Operating profit	96.8	119.0	-18.6	90.1	7.5
Other income	2.7	1.6	69.2	0.9	-
Interest expense	6.1	3.1	94.8	4.0	50.4
Depreciation	17.1	16.9	0.7	17.2	-0.7
Profit before tax	76.4	100.5	-24.0	69.8	9.5
Tax	19.4	23.9	-19.0	18.0	8.0
Adjusted PAT (before MI)	57.0	76.6	-25.6	51.8	10.0
Minority interest (MI)	4.2	2.5	66.8	2.7	57.7
Reported PAT	61.2	79.1	-22.6	54.5	12.4
EPS (Rs.)	4.3	5.7	-25.6	3.9	10.0
			BPS		BPS
GPM (%)	41.3	46.2	-489	41.6	-23
OPM (%)	12.2	15.5	-331	11.8	40
NPM (%)	7.2	10.0	-280	6.8	39
Tax rate (%)	25.4	23.8	157	25.7	-36

Source: Company; Sharekhan Research

Segment-wise performance

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
IMFL Volumes (Million cases)					
Prestige & Above	2.6	2.3	14.1	2.3	11.2
Regular & Others	3.5	4.6	-22.6	3.8	-7.6
Total Volume	6.1	6.8	-10.4	6.2	-0.5
<i>Prestige & Above as % of Total IMFL Volume</i>	42.3	33.2		37.9	
Royalty brands	0.9	0.2	-	1.0	-
Total IMFL volume	7.0	7.0	0.1	7.2	-2.6
Revenue Break up (Rs. crore)					
IMFL (A)	634.6	619.7	2.4	610	4.0
-Prestige & Above	402.5	337.9	19.1	361.1	11.5
-Regular & Others	225.0	279.2	-19.4	241.1	-6.7
-Others	7.2	2.6	-	7.8	-7.7
Non IMFL (B)	157.5	136.9	15.0	151.3	4.1
Revenue from Operations (Net) (A+B)	792.1	756.6	4.7	761.3	4.0
<i>Prestige & Above as % of Total IMFL Revenue</i>	63.4	54.5		59.2	
<i>IMFL as % of Total Revenue</i>	80.1	81.9		80.1	

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Structural change in the alcohol industry

Indian Made Indian Liquor (IMIL) is evolving from a restricted quota-based, commoditised market to a consumer-driven brand-based industry. Its main attractiveness lies in its sizeable base, comprising SEC-D, below which could translate into ~40% of the total population (excluding the Below Poverty Line). Growth in this segment is expected to be driven by a growing consumer base, rising rural income, consumption, conversion from illicit/toddy to IMIL with increasing awareness about health and quality, conducive regulatory policies, and growth in population. In the short run, the IMIL industry could benefit from lower discretionary incomes, which would push up demand for lower-priced liquor. The government is targeting to achieve 20% blending of ethanol by 2025, which would result in higher demand for grain-based molasses in the coming years.

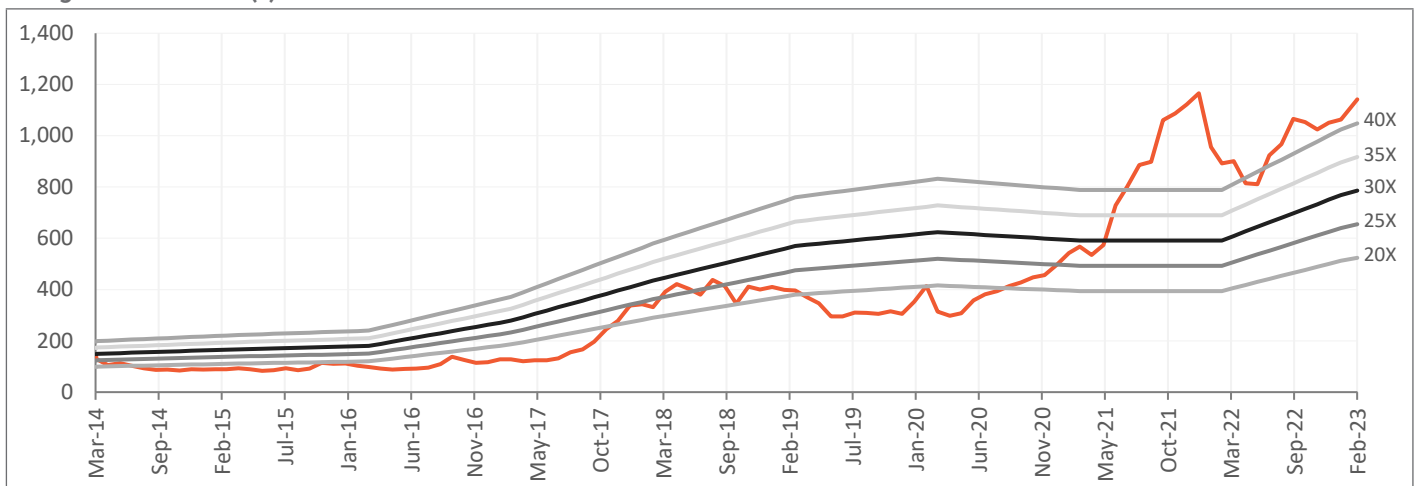
■ Company Outlook – Premiumisation remains the key growth driver

With consumers shifting to premium IMFL brands, RKL's focus on improving the presence of each brand in key markets and emergence of favourable liquor policies in key states would help in faster growth of branded liquor products in the near to medium term. Demand remained strong in most key markets. The company expects double-digit volume growth in the P&A segment to sustain in the medium term due to strong traction to its premium brands. The company continues to gain market share in some of its top states (including Uttar Pradesh), while it is focusing on expanding base in some of the newly entered states. Inflationary pressure will continue to put stress on margins in the near term. However, the management has maintained its medium-term guidance of achieving high-teen OPM over the next 2-3 years due to improved mix of the P&A segment and backward integration to secure raw-material supply in the long run.

■ Valuation – Downgrade to Hold with a revised PT of Rs. 1,205

RKL is consistently growing ahead of the industry due to strong traction to its premium products in the domestic market, which is scaling up well in key markets. Volatile raw material prices will keep up the pressure on the margins in the near term. However, price hikes in key states, benefits of backward integration and better mix would help margins to gradually recover from H1FY2024. RKL's stock price has moved up by ~18% in last three months and is currently trading at 62.5x, 43.2x and 34.6x its FY2023E, FY2024E and FY2025E earnings, respectively. In view of near-term margin pressure and unfavourable risk reward ratio we downgrade our rating on stock to Hold from Buy earlier with revised price target (PT) of Rs. 1,205.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
United Spirits	70.4	48.3	55.5	27.2	27.7	26.5	24.4	21.0	18.8
Globus Spirits	11.4	13.6	9.5	6.7	8.6	6.0	28.0	18.0	22.8
Radico Khaitan	57.2	62.5	43.2	37.3	39.6	27.5	15.1	12.2	16.7

Source: Company, Sharekhan estimates

About company

RKL, formerly known as Rampur Distillery, commenced its operations in 1943. Over the years, the company has evolved from being just a distiller of spirits for others to a leading IMFL company. Currently, the company has five millionaire brands, which are 8PM Whisky, 8PM Premium Black Whisky, Contessa Rum, Old Admiral Brandy, and Magic Moments Vodka. RKL has three distilleries in Rampur (Uttar Pradesh) and two in joint venture with RNV in Aurangabad (Maharashtra) in which RKL owns 36% equity. The company operates five own and 28 contract bottling units spread across the country with a combined capacity of 160 million litres. RKL is one of the largest providers of branded IMFL to Canteen Stores Department (CSD) and exports its products to more than 85 countries.

Investment theme

RKL has transformed itself into a leading IMFL brand player from just a distillery player with premiumisation at the core of its growth strategy. The company's P&A segment reported a 19% CAGR over FY2017-FY2022, contributing 31% to IMFL's sales volume (53% to IMFL's sales value). Going ahead as well, the company expects the strong growth trajectory in premium brands to continue. Efficient working capital management and improved profitability would help the company generate high free cash flows (FCF) in the coming years. The company is investing Rs. 740 crore (mix of debt and internal accruals) in backward integration to secure extra neutral alcohol (ENA) supply (largely grain-based). It will help to retain its guidance of high-teen margins over the next two years.

Key Risks

- ♦ **Decline in demand for the company's products:** Slowdown in global economic growth and other declines or disruptions in the Indian economy, in general, may result in reduction in disposable income of consumers and slowdown in the IMFL industry. This could adversely affect the company's business and financial performance.
- ♦ **Risk due to stringent regulation norms:** The Indian spirit industry is highly regulated and complex as each state has its own regulations governing the manufacture and sale of spirits. Any change in rules and regulations by the respective state governments and non-compliance with laws and regulations could adversely impact the business.
- ♦ **Increased raw-material prices:** ENA and packaging materials are two key raw-material components. Any price volatility in the prices of these components may have a bearing on the company's profitability.

Additional Data

Key management personnel

Dr. Lalit Khaitan	MD and Chairman
Abhishek Khaitan	MD
Dilip K Banthiya	CFO
Dinesh Kumar Gupta	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	TIMF Holdings	4.63
2	Aditya Birla Sun Life AMC Ltd	3.37
3	Tata Asset Management Pvt Ltd	3.22
4	Nippon Life India Asset Management Company	3.10
5	HDFC AMC	2.20
6	Vanguard Group Inc	1.93
7	Classic Fintrex Pvt Ltd	1.93
8	PGIM India Asset Management Pvt Ltd	1.88
9	DSP Investment Managers Pvt Ltd	1.87
10	Massachusetts Institute of Technology	1.64

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

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Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. 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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