

Telecom Products remain stronger; Witnessed margin expansion.

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CMP: INR 64

Rating: BUY

Target Price: INR 112

Stock Info

BSE	500183
NSE	HFCL
Bloomberg	HFCD:LI
Reuters	HFCL.NS
Sector	Cables
Face Value (INR)	1
Equity Capital (INR cr)	137.6
Mkt Cap (INR cr)	8,768
52w H/L (INR)	88.8 / 55.8
Avg Yearly Volume (in 000')	7,970

Shareholding Pattern %

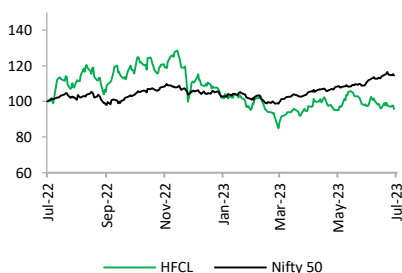
(As on Jun, 2023)

Promoters	39.24
Public & Others	51.22

Stock Performance (%) 3m 6m 12m

HFCL	0.6	-6.3	-4.3
NIFTY	6.3	11.7	14.6

HFCL vs Nifty



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HFCL Ltd reported numbers, Q1FY24 revenue stood at INR 995cr (-5.3% YoY/-30.6% QoQ); below our estimates of INR 1,066cr due to lower revenue in Turnkey contracts and services. Gross Profit stood at INR 307Cr (+15.8% YoY/-7.5% QoQ); above our estimates of INR 284cr. Gross margins improved by 563 bps YoY (up by 770 bps QoQ) to 30.9% vs 25.3% in Q1FY23. The raw material cost in terms of sales stood at 69.1% vs 74.7% in Q1FY23. Optical Fibres prices have come down from INR 450/fkm to INR 350-360/fkm, overall fibre prices and other raw material prices have come down to 10%-15% in Q1FY24 which reflected on margins. EBITDA stood at INR 146cr (+33.3% YoY/-5.2% QoQ); In-line with our estimates of INR 145cr. EBITDA margin improved by 426 bps YoY (up by 394 bps QoQ) to 14.7% vs 10.5% in Q1FY23. PAT stood at INR 76cr (+42.3% YoY/-4% QoQ); vs our estimates of INR 79cr. PAT margin improved by 254 bps YoY (up by 210 bps QoQ) to 7.6% vs 5.1% in Q1FY23.

Telecom Products revenue stood at INR 662cr (+6.8% YoY/+1.3% QoQ). EBIT stood at INR 130cr (+100.2% YoY/+4% QoQ); EBIT margin improved by 914 bps YoY (up by 51 bps QoQ) to 19.6% vs 10.5% in Q1FY23. The margins are expected to sustain around 18%-20% and gradual improvement is expected due to products mix and exports. Telecom Products revenue share increased to 67% vs 59% in Q1FY23 and expected to be around 65%-70% going forward.

Turnkey Contracts and Services revenue stood at INR 333cr (-22.8% YoY/-57.2% QoQ). EBIT stood at INR 6cr (-86.1% YoY/-73.9% QoQ); EBIT margin contracted by 788 bps YoY (down by 110 bps QoQ) to 1.7% vs 9.6% in Q1FY23. The margins are expected around 7%-8%, however fluctuations will be there on a quarterly basis due to execution and others. The company is selecting projects based cash flows and margins. The project's revenue is expected to decline gradually going forward.

Key Highlights

Capacity expansion will drive business growth: HFCL is expanding optical fibre cable (OFC) capacities from 25.08 mn fkm to 34.75 mn fkm in FY25E. As part of its backward integration, HFCL is expanding its optic fibre capacities from 10 mn fkm to 33.9 mn fkm in FY25E. The Capex stood at INR 80cr in Q1FY24 and Capex is expected around INR 350cr in FY24E. The Capex is expected to be around INR 900cr – INR 1,000cr for OF & OFC capacity and setting up new facilities for telecom and networking products and continued R&D over the next 2-3 years. Optical fibre capex is around INR 470cr, Post capex, more than INR 150cr additional revenue is expected on yearly basis. Out of INR 900cr – INR 1,000cr capex, the company has been granted to avail incentives up to ~INR 652cr under the PLI scheme over the next 4 to 5 years. The phased capacity expansion will increase competitiveness and help to reduce operating costs which is expected to result in an increase in margins and profitability.

Witnessing traction on exports: Exports revenue stood at INR 176cr (+156% YoY). The exports revenue share stood at 17.1% in Q1FY24. The company is catering to more than 80 clients in more than 40 countries. Exports order book stood at INR 250cr, majorly from telecom equipment. The company is targeting export revenue of INR 1,300cr – INR 1,500cr in FY24E. HFCL has focused on building global customer relations, strengthening export footprints over the next 3 years, and emerging as the largest global player.

Focused on telecom & defence product portfolio expansion: HFCL has focused on telecom products expansion, especially margin accretive products leading to an increase in product revenue share from 31% (Q1FY22) to 67% in Q1FY24. Telecom and 5G products revenue is expected between INR 350cr – INR 400cr in FY24E. Out of INR 400cr, INR 200cr revenue is expected from 5G. Margins are expected around 18%-20%. Defence tenders are expected for electronic fuses and others. Software defined radios are under development and revenue is expected from FY25E onwards. The change in product mix will improve the working capital cycle going forward.

Outlook & Valuation: HFCL has a strong order book of INR 6,600cr (~1.4x of FY23 TTM revenue) and regular order inflows in Telecom products. The increase in telecom products revenue along with ~20 margins will improve business and profitability going forward. Exports revenue is expected to grow more than 1.5x backed by strong demand; Post telecom products and OF capex, additional revenue is expected around INR 800cr – INR 1,000cr and more than INR 150cr per annum respectively. HFCL has focused on strong exports, capacity expansion, product portfolio expansion, and a strong client base would drive the business going forward. We maintain a “BUY” rating with a Target Price of INR 112 per share based on DCF; an upside of 75.4%.

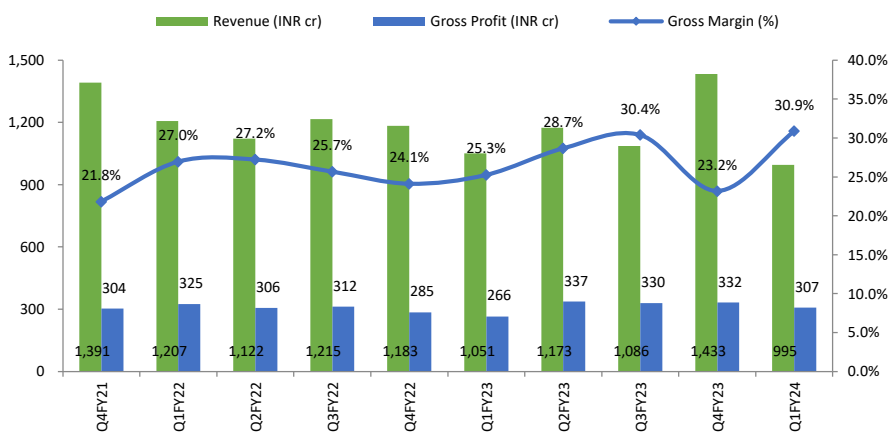
Q1FY24 Results

Income statement summary

Particular (INR cr)	Q1FY23	Q4FY23	Q1FY24	YoY (%)	QoQ (%)
Revenue	1,051	1,433	995	-5.3%	-30.6%
Net Raw Materials	786	1,101	688	-12.5%	-37.5%
Employee Cost	82	92	91	11.5%	-0.8%
Other Expenses	74	86	70	-5.5%	-18.9%
EBITDA	110	154	146	33.3%	-5.2%
EBITDA Margin (%)	10.5%	10.8%	14.7%	+426 bps	+394 bps
Depreciation	20	21	21		
Interest expense	38	38	36		
Other income	19.9	13.7	13.2		
Profit before tax	71	109	103	44.5%	-5.9%
Taxes	18	30	27		
PAT	53	79	76	42.3%	-4.0%
PAT Margin (%)	5.1%	5.5%	7.6%	+254 bps	+210 bps
Other Comprehensive income	0.2	2.3	(0.9)		
Net profit	53	81	75	39.9%	-7.9%
Net profit Margin (%)	5.1%	5.7%	7.5%	+243 bps	+185 bps
EPS (INR)	0.4	0.6	0.5		

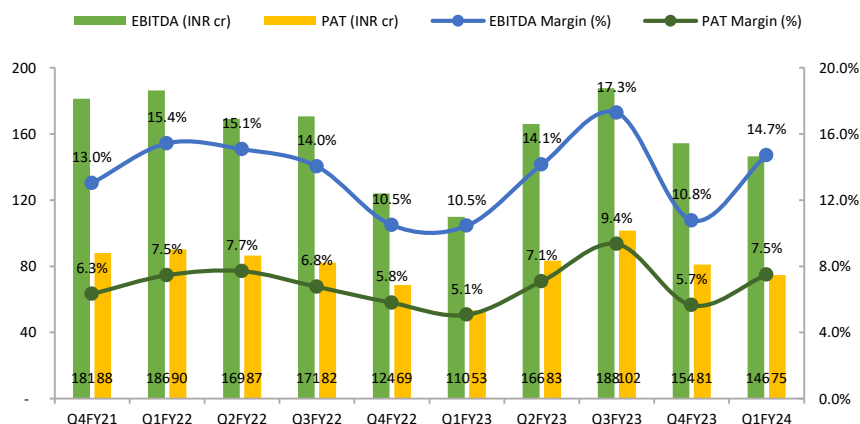
Source: Company Reports, Aриhant Capital Research

Exhibit 1: Gross margins improved by 563 bps YoY to 30.9% due to lower RM costs in Q1FY24.



Source: Company Reports, Aриhant Capital Research

Exhibit 2: EBITDA Margin improved by 426 bps YoY due to reduction RM and other expenses in Q1FY24.



Source: Company Reports, Aриhant Capital Research

Q1FY24 Concall Highlights

Margins

- EBITDA margin stood at 14.7% in Q1FY24 and expected to be sustainable due to increase in telecom products share and exports.
- EBITDA margins are expected to be 14% - 15% going forward.

Order book

- The order book stood around INR 6,600cr; 70% is from EPC, and the remaining 30% is from products. Projects are coming in large orders. The current order book is sustainable and Products order book coming regularly. Small orders keep coming in INR 80cr – INR 100cr.

OF and OFC Prices

- OF prices have come down from INR 450/fkm to INR 350-360/fkm, overall fibre prices and other raw material prices have come down to 10%-15%.
- OFC average realization is around INR 1,300/fkm compared to INR 1,260/fkm and INR 1,100/fkm in Q4FY23 and Q1FY23 respectively.

Capacity and utilization

- Optical fibre capacity is expected to increase from 10mn fkm to 33.9mn fkm and Optical Fibre Cable capacity is expected to increase from 25.08mn fkm to 34.75mn fkm going forward.
- The capex stood at INR 80cr in Q1FY24 and overall capex is expected INR 350cr in FY24.
- Capacity utilisation stood at 86% in Q1FY24. Utilisation varies based on types of cables. The plant is running 24/7 in a week.

PLI

- The company is expected to receive PLI incentive of INR 652cr over next 4 to 5 years.

Market share

- The company has 22%-22.5% market share in Outdoor WiFi-7 access points and 30% market share in UBR.

Segmental mix

- Telecom products and Turnkey mix stood at 67:33 and expected to be 65:35 going forward.

Exports

- Exports revenue stood at INR 176cr (+156% YoY). The exports revenue share stood at 17.1% in Q1FY24. The company is catering to more than 80 clients in more than 40 countries. Exports order book stood at INR 250cr, majorly from telecom equipment.
- The company is targeting export revenue of INR 1,300cr – INR 1,500cr in FY24.

Telecom and 5G products

- Telecom and 5G products revenue is expected between INR 350cr – INR 400cr in FY24, INR 200cr revenue is expected from 5G. In FY25, around INR 800cr – INR 1,000cr revenue is expected and 70% of revenue is expected from 5G products. Margins are expected around 18%-20%.

Defence

- Defence revenue has come down, because other players have not constructed networks. Defence products are expected to improve going forward.
- Revenue from defence products is expected in FY25. Software defined radios are under development.
- In defence tenders are expected for electronic fuses and others. The orders are expected to be a few hundred crores.

Other highlights

- The company has partnered with BEL for electronics products in defence, railways and telecoms.
- The company is serving 35 different customers in India.
- HFCL has secured 5 patents for 5G radios.
- The company is considering fundraising.

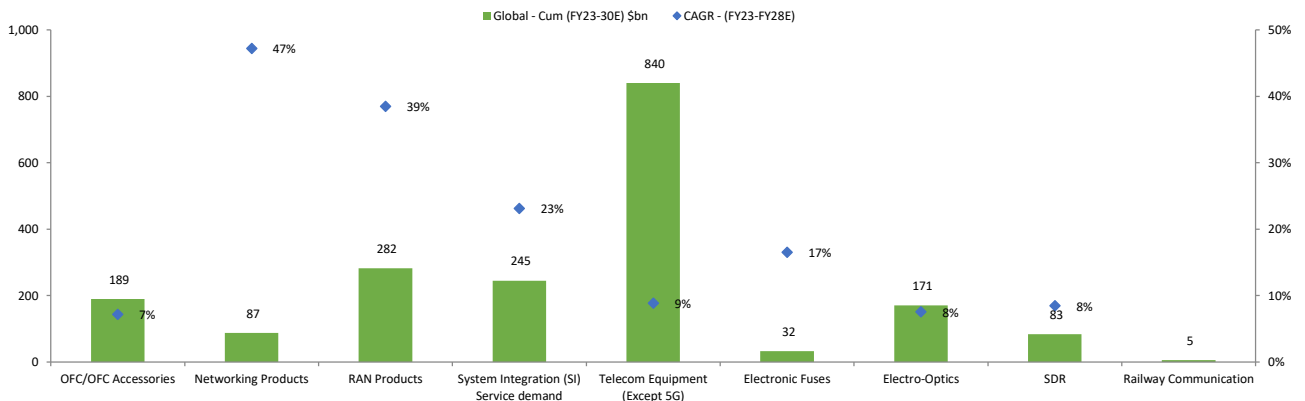
Products and Addressable markets

Exhibit 3: Product Offerings

Telecommunication Products	Defense Electronics Products	Optic Fiber/Optical Fibers Cables	Passive Connectivity Solutions	Products Under Development
<ol style="list-style-type: none"> Point to Point and Point to Multipoint backhaul radio Indoor & Outdoor Wi-Fi 5 and 6 Access Points Cloud based Network management system Ethernet L2/L3 Switches Home Mesh Router 	<ol style="list-style-type: none"> Thermal Weapon Sights (TWS) Electronic Fuses High capacity radio relay VMS & Video Analytics Radar 	<ol style="list-style-type: none"> Optic Fiber Armoured and Unarmoured Cable Micro Cable Micro Module Cable Ribbon Cable FTTH Cable 	<ol style="list-style-type: none"> Cable Assemblies High Density Cabinets Fiber Termination Box PLC Splitters Joint Closures Aerial/FTTH Accessories 	<p>Telecommunication</p> <ul style="list-style-type: none"> 5G Indoor & Outdoor FWA CPE 5G Macro Radio Unit Products (8T8R) 5G Indoor & Outdoor Small Cell (2T2R and 4T4R) Cell Site Router and Centralized Unit Aggregation Router Point-to-point and Point-to-Multipoint UBRs Wi-Fi 7 Access Points IBR Cable <p>Defense Communication & Electronics</p> <ul style="list-style-type: none"> Software defined radio

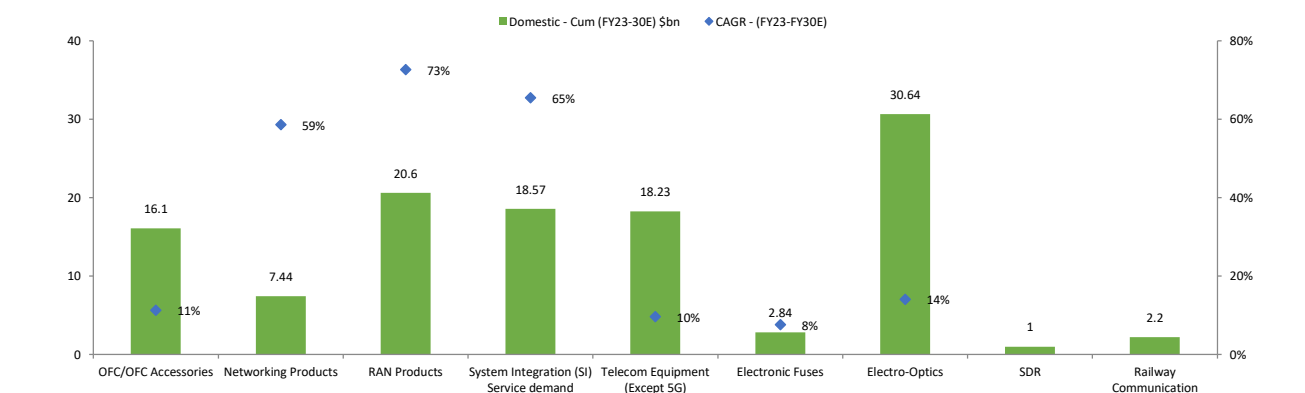
Source: Company reports, Arianth Capital Research

Exhibit 4: 5G segments such as Networking products and RAN products are expected to grow at faster rate over the period of FY23-FY30E. Global markets has more than 90% of addressable market.



Source: Company reports, Arianth Capital Research

Exhibit 5: Domestic addressable market is expected to grow faster than global markets. Networking and RAN products are expected higher growth rate over the period of FY23-FY30E.



Source: Company reports, Arianth Capital Research

Outlook & Valuation

HFCL has a strong order book of INR 6,600cr (~1.4x of FY23 TTM revenue) and regular order inflows in Telecom products. The increase in telecom products revenue along with ~20 margins will improve business and profitability going forward. Exports revenue is expected to grow more than 1.5x backed by strong demand; Post telecom products and OF capex, additional revenue is expected around INR 800cr – INR 1,000cr and more than INR 150cr per annum respectively. HFCL has focused on strong exports, capacity expansion, product portfolio expansion, and a strong client base would drive the business going forward. We maintain a “BUY” rating with a Target Price of INR 112 per share based on DCF; an upside of 75.4%.

DCF Valuation

Valuation Assumptions

g (World Economic Growth)	3%
Rf	7%
Rm	13%
Beta	1.1
CMP	64

Valuation Data

Total Debt (long term borrowings) (2023)	117
Cash & Cash Equivalents (2023)	323
Number of Diluted Shares (2023)	138
Tax Rate (2024)	27%
Interest Expense Rate (2024)	14%
MV of Equity	8,768
Total Debt	117
Total Capital	8,884

WACC

We	98.7%
Wd	1.3%
Ke	13.6%
Kd	10.2%
WACC	13.5%

FCFF & Target Price

FCFF & Target Price Particular (INR cr)	Explicit Forecast Period						Linear Decline Phase					Terminal Yr
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
EBIT * (1-Tax Rate)	441	515	685	948	1,314	1,826	2,428	3,083	3,730	4,289	4,675	4,815
Dep	84	105	108	112	114	119	158	201	243	279	304	313
Purchase of Assets	(386)	(499)	(98)	(120)	(116)	(103)	(136)	(173)	(210)	(241)	(263)	(271)
Changes in Working Capital	330	114	(184)	(225)	(500)	(472)	(628)	(797)	(964)	(1,109)	(1,208)	(1,244)
FCFF	469	236	511	715	811	1,370	1,822	2,314	2,799	3,219	3,508	3,614
Terminal Value											34,272	
Total Cash Flow	469	236	511	715	811	1,370	1,822	2,314	2,799	3,219	37,781	

Enterprise Value (INR cr)	15,170
Less: Debt (INR cr)	117
Add: Cash (INR cr)	323
Equity Value (INR cr)	15,376
Equity Value per share (INR)	112

% Returns 75.4%

Rating BUY

Sensitivity Analysis

		Terminal Growth (%)								
		2.0%	2.3%	2.5%	2.8%	3.0%	3.3%	3.5%	3.8%	4.0%
WACC (%)	112	119	122	124	127	129	132	135	138	141
	12.5%	116	118	120	122	125	127	130	133	136
	12.8%	112	114	116	118	120	123	125	128	131
	13.0%	108	110	112	114	116	118	121	123	126
	13.3%	105	107	108	110	112	114	117	119	121
	13.5%	102	103	105	107	109	111	113	115	117
	13.8%	99	100	102	103	105	107	109	111	113
	14.0%	96	97	99	100	102	104	105	107	109
	14.3%	93	94	96	97	99	100	102	104	106

Source: Company reports, Aриhant Capital Research

Financial Statements

Income statement summary

Y/e 31 Mar (INR cr)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Revenue	3,839	4,423	4,727	4,743	5,069	5,645	6,945
Net Raw Materials	2,934	3,404	3,499	3,479	3,721	4,121	5,042
Employee Cost	224	253	311	348	365	401	486
Other Expenses	186	217	268	298	296	313	371
EBITDA	494	550	650	619	688	811	1,046
EBITDA Margin (%)	12.9%	12.4%	13.8%	13.0%	13.6%	14.4%	15.1%
Depreciation	(42)	(69)	(78)	(83)	(84)	(105)	(108)
Interest expense	(115)	(175)	(166)	(152)	(160)	(153)	(143)
Other income	22	35	43	47	71	209	227
Profit before tax	358	337	442	431	515	762	1,022
Taxes	(121)	(91)	(116)	(113)	(139)	(206)	(276)
Net profit	237	246	326	318	376	556	746
Reported Netprofit Margin (%)	6.2%	5.6%	6.9%	6.7%	7.4%	9.9%	10.7%
Other Comprehensive income	1	5	2	2	-	-	-
Net profit	238	251	328	319	376	556	746
EPS (INR)	1.9	2.0	2.4	2.3	2.7	4.0	5.4

Source: Company Reports, Arianth Capital Research

Balance sheet summary

Y/e 31 Mar (INR cr)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity capital	128	128	137	138	138	138	138
Reserves	1,540	1,788	2,661	2,970	3,324	3,848	4,550
Net worth	1,668	1,916	2,798	3,108	3,461	3,985	4,688
Minority Interest	(0)	7	20	37	37	37	37
Provisions	43	49	45	53	28	31	23
Debt	1,218	1,348	1,172	1,137	1,122	1,057	992
Other non-current liabilities	-	-	-	29	30	34	42
Total Liabilities	2,929	3,320	4,035	4,363	4,678	5,144	5,781
Fixed assets	437	443	465	487	824	1,205	1,216
Capital Work In Progress	15	12	47	71	36	49	28
Other Intangible assets	40	42	74	215	215	215	215
Goodwill	26	26	26	26	26	26	26
Investments	87	46	87	102	101	113	139
Other non current assets	37	45	47	57	51	56	69
Net working capital	1,535	1,931	2,366	2,537	2,206	2,092	2,276
Inventories	344	435	573	758	673	734	829
Sundry debtors	1,730	3,056	2,492	2,309	2,083	2,011	2,283
Loans & Advances	21	18	37	31	20	23	28
Other current assets	341	318	401	548	528	526	533
Sundry creditors	(815)	(1,748)	(1,037)	(878)	(996)	(1,099)	(1,293)
Other current liabilities & Prov	(85)	(148)	(99)	(232)	(101)	(102)	(104)
Cash	192	306	528	323	660	822	1,186
Other Financial Assets	560	468	395	546	558	565	625
Total Assets	2,929	3,320	4,035	4,363	4,678	5,144	5,781

Source: Company Reports, Arianth Capital Research

Financial Statements

Cashflow summary

Y/e 31 Mar (INR cr)	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Profit before tax	358	337	442	431	515	762	1,022
Depreciation	42	69	78	83	84	105	108
Tax paid	(121)	(91)	(116)	(113)	(139)	(206)	(276)
Working capital Δ	(504)	(396)	(434)	(171)	330	114	(184)
Operating cashflow	(225)	(81)	(30)	230	790	776	670
Capital expenditure	(228)	(72)	(135)	(128)	(386)	(499)	(98)
Free cash flow	(452)	(153)	(166)	101	403	277	572
Equity raised	15	9	588	33	-	-	0
Investments	6	41	(41)	(15)	1	(12)	(26)
Others	47	81	39	(302)	(6)	(13)	(74)
Debt financing/disposal	422	130	(176)	(35)	(15)	(65)	(65)
Dividends paid	(15)	-	(19)	(24)	(22)	(33)	(44)
Other items	10	6	(4)	37	(24)	7	(0)
Net Δ in cash	32	115	222	(206)	338	162	364
Opening Cash Flow	159	192	306	528	323	660	822
Closing Cash Flow	192	306	528	323	660	822	1,186

Source: Company Reports, Aриhant Capital Research

Ratio analysis

Y/e 31 Mar	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Growth matrix (%)							
Revenue growth	-19.0%	15.2%	6.9%	0.3%	6.9%	11.4%	23.0%
Op profit growth	18.9%	11.2%	18.3%	-4.8%	11.1%	17.9%	29.0%
Profitability ratios (%)							
OPM	12.9%	12.4%	13.8%	13.0%	13.6%	14.4%	15.1%
Net profit margin	6.2%	5.6%	6.9%	6.7%	7.4%	9.9%	10.7%
RoCE	12.1%	12.1%	12.4%	10.3%	11.1%	13.8%	15.8%
RoNW	15.3%	13.7%	13.8%	10.8%	11.4%	14.9%	17.2%
RoA	8.1%	7.4%	8.1%	7.3%	8.0%	10.8%	12.9%
Per share ratios (INR)							
EPS	1.9	2.0	2.4	2.3	2.7	4.0	5.4
Dividend per share	0.1	-	0.1	0.2	0.2	0.2	0.3
Cash EPS	2.2	2.5	2.9	2.9	3.3	4.8	6.2
Book value per share	13.0	14.9	20.4	22.6	25.1	29.0	34.1
Valuation ratios (x)							
P/E	34.3	32.6	26.7	27.5	23.3	15.8	11.8
P/CEPS	29.3	26.0	21.7	21.9	19.1	13.3	10.3
P/B	4.9	4.3	3.1	2.8	2.5	2.2	1.9
EV/EBITDA	18.5	16.7	14.3	15.3	13.3	11.0	8.1
Payout (%)							
Dividend payout	6.5%	0.0%	5.8%	7.7%	5.8%	5.8%	5.8%
Tax payout	33.8%	26.9%	26.3%	26.2%	27.0%	27.0%	27.0%
Liquidity ratios							
Debtor days	157	197	214	185	158	132	113
Inventory days	38	42	53	70	70	62	57
Creditor days	92	121	125	85	78	79	74
WC Days	103	118	142	170	150	116	95
Leverage ratios (x)							
Interest coverage	3.9	2.8	3.4	3.5	3.8	4.6	6.5
Net debt / equity	0.6	0.5	0.2	0.3	0.1	0.1	-0.0
Net debt / op. profit	2.1	1.9	1.0	1.3	0.7	0.3	-0.2

Source: Company Reports, Aриhant Capital Research

Story in Charts

Exhibit 6: Revenue is expected to grow at 13.5% CAGR over the period of FY23-FY26E.

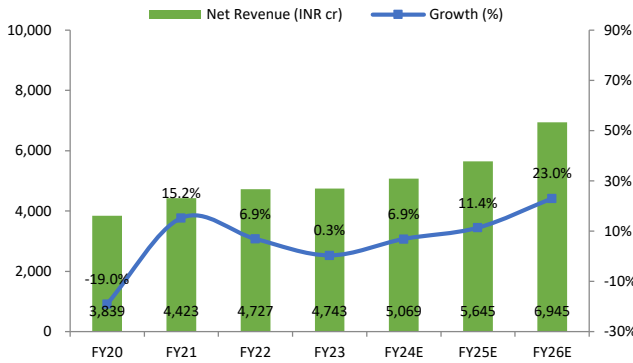


Exhibit 7: Softening of RM costs will lead to improvement in gross margins.

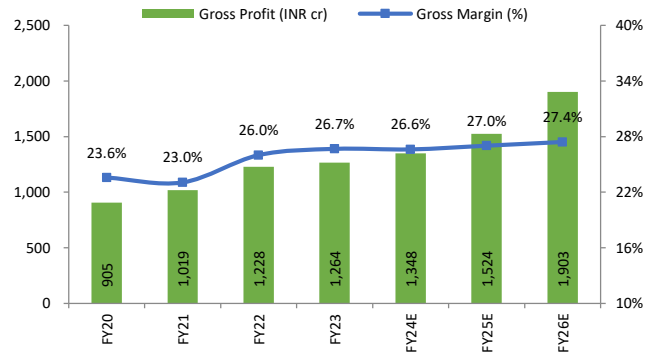


Exhibit 8: Growth in EBITDA & PAT levels

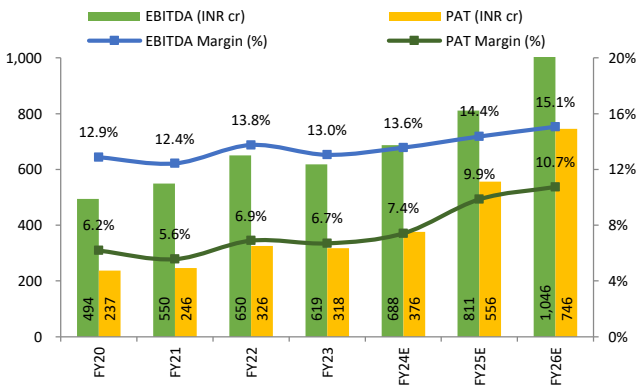


Exhibit 9: Return ratios to be improve

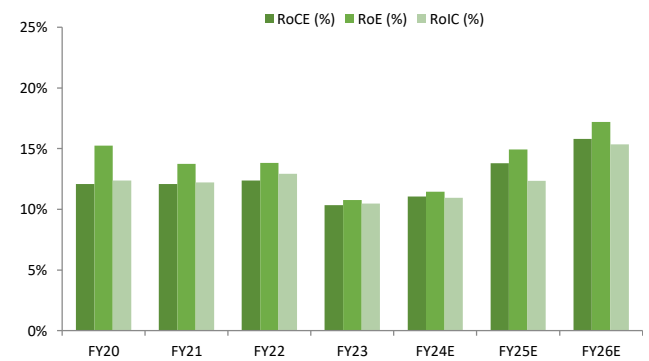


Exhibit 10: Working capital days to be improve

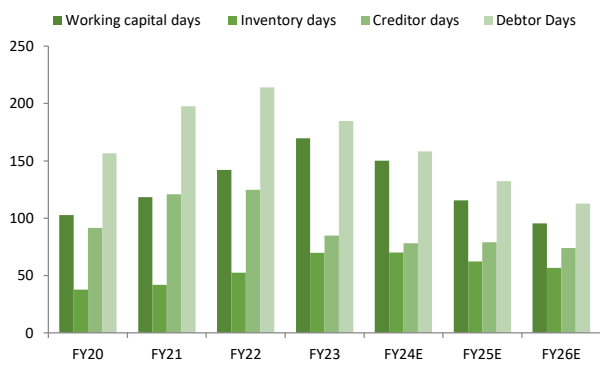
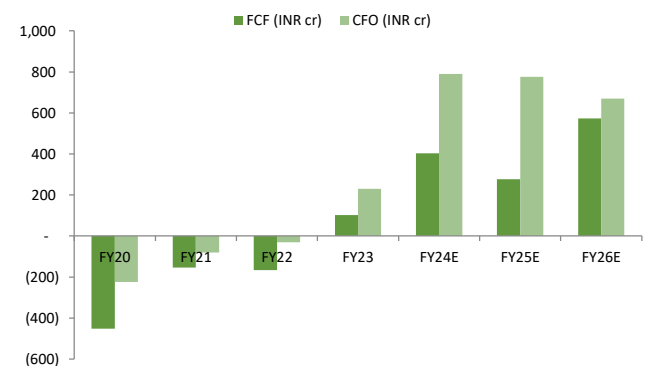


Exhibit 11: Cash flows to be improve



Source: Company reports, Arianth Capital Research

Story in Charts

Exhibit 12: Working capital in-terms of sales is expected to reduce going forward due to change in products mix.

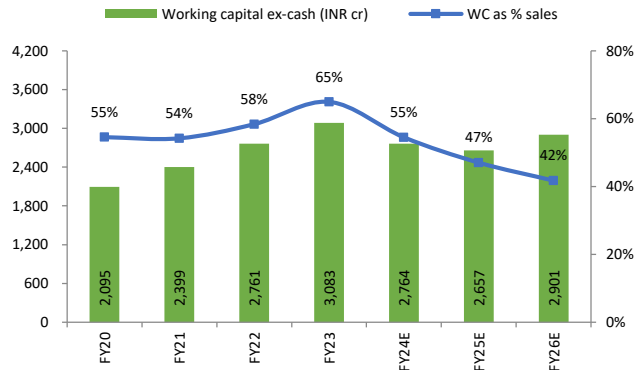


Exhibit 13: Interest cost as % of EBIT is expected to reduce going forward.

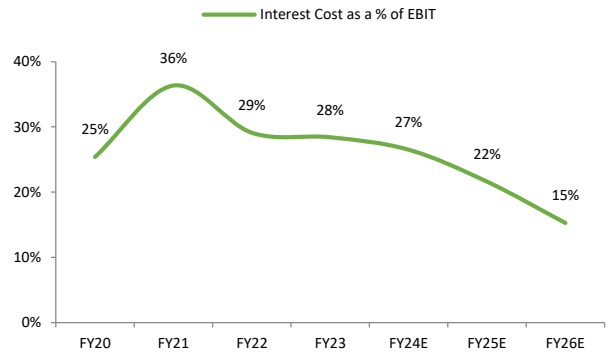


Exhibit 14: Exports revenue is expected to reach ~INR 1,300cr – INR 1,500cr by FY24E.

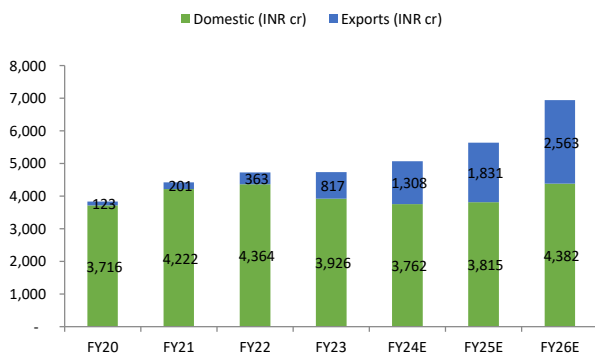


Exhibit 15: Exports revenue share is expected to reach ~26% in FY24E.

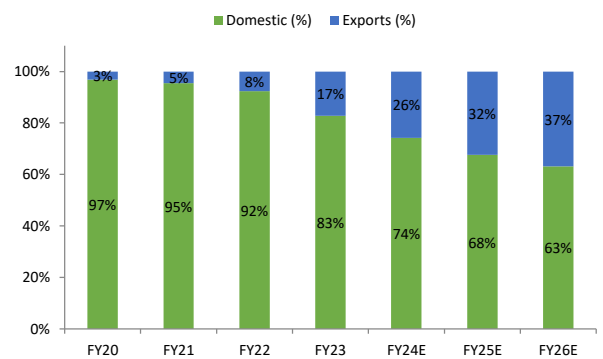


Exhibit 16: Telecom products is expected faster growth, while EPC revenue is expected to remain stagnant.

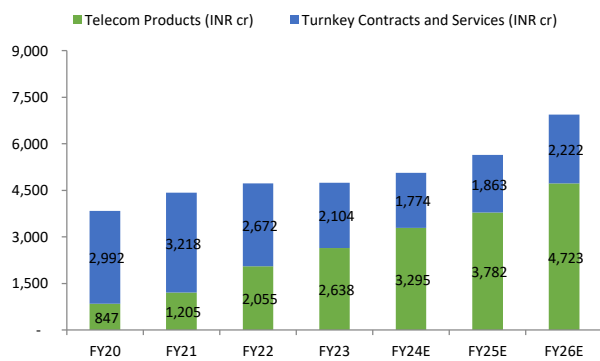
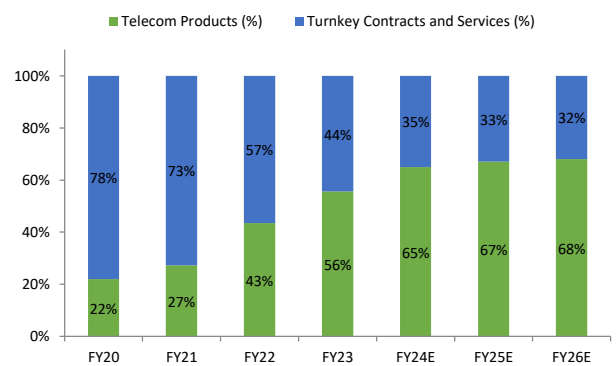


Exhibit 17: Telecom products share is expected to be 65%-70% going forward.



Source: Company reports, Arianth Capital Research

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Exhibit 18: The order book stood at INR 6,600+cr which shows revenue visibility going forward.

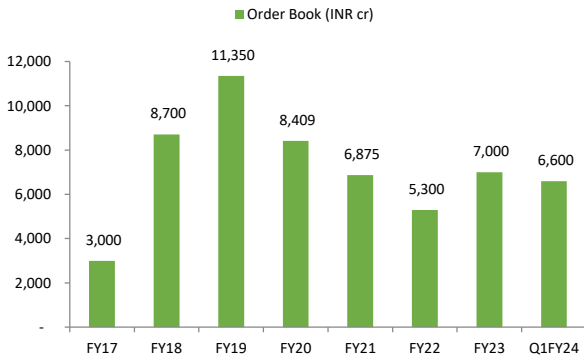


Exhibit 19: Public telecommunication revenue accounts 83% in FY23.

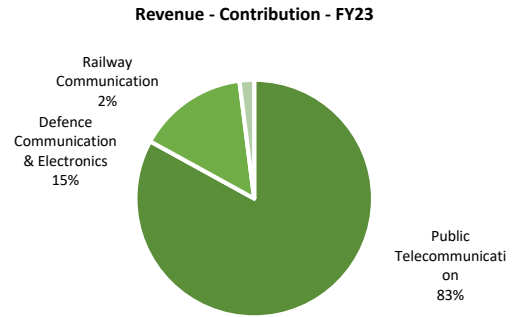


Exhibit 20: Telecom order book is accounted for 30% as of Q1FY24. However, Telecom orders keep coming on regular basis.

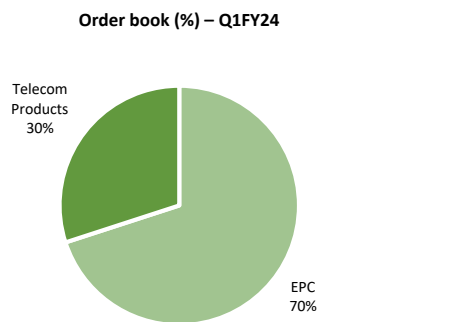


Exhibit 21: Telecom products margin witnessed improvement in Q1FY24.

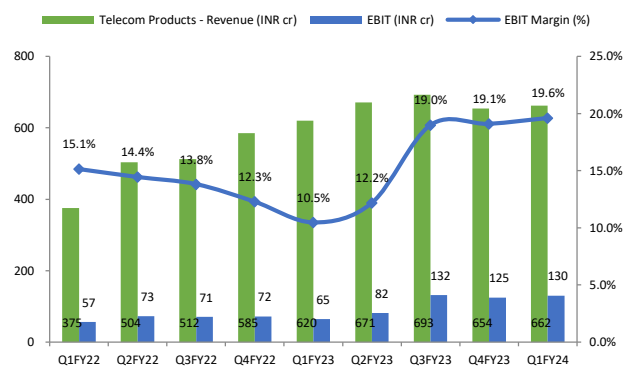


Exhibit 22: EPC margins under pressure in Q1FY24.

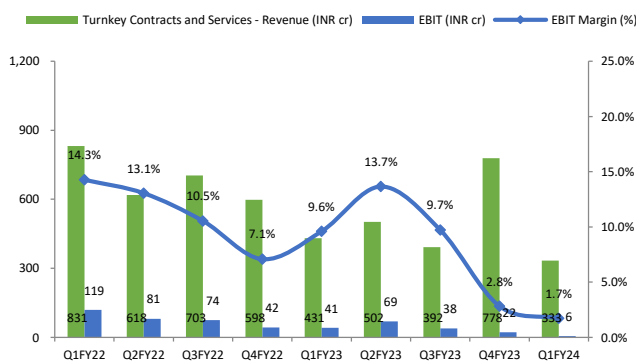
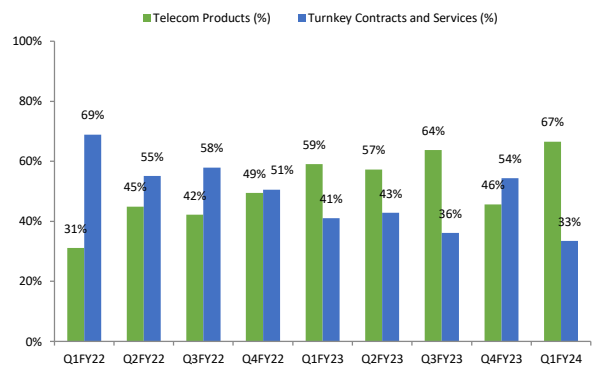


Exhibit 23: Telecom products revenue share stood at 67% as of Q1FY24. it's expected to reach 65%-70% going forward.



Source: Company reports, Arianth Capital Research

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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