

Telecom Products remain stronger; Turnkey is dragged overall margins.

CMP: INR 67

Rating: BUY

Target Price: INR 122

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)	9,879
52w H/L (INR)	88.8 / 52
Avg Yearly Volume (in 000')	7,988

Shareholding Pattern %

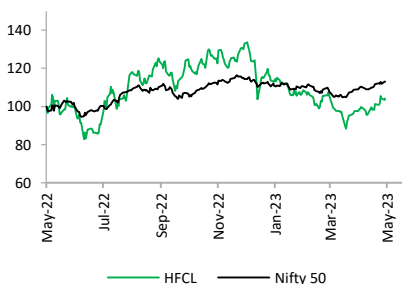
(As on Mar, 2023)

Promoters	39.24
DII	2.78
FII	6.77
Public & Others	51.22

Stock Performance (%)

	3m	6m	12m
HFCL	-4.0	-15.0	4.1
NIFTY	2.3	1.3	13.0

HFCL vs Nifty



Abhishek Jain

abhishek.jain@arihantcapital.com
022-422548871

Balasubramanian A

bala@arihantcapital.com
022-67114780

HFCL Ltd reported numbers, Q4FY23 revenue stood at INR 1,433cr (+21.1% YoY/+32% QoQ) vs our estimates of INR 1,489cr. Gross Profit stood at INR 332Cr (+16.5% YoY/+0.7% QoQ); vs our estimates of INR 387cr. Gross margins contracted by 92 bps YoY (down by 720 bps QoQ) to 23.2% vs 24.1% in Q4FY22. The raw material cost in terms of sales stood at 76.8% vs 75.9% in Q4FY22. EBITDA stood at INR 154cr (+24.4% YoY/-17.7% QoQ); vs our estimates of INR 205cr. EBITDA margin improved by 29 bps YoY (down by 650 bps QoQ) to 10.8% vs 10.5% in Q4FY22. PAT stood at INR 81cr (+18% YoY/-20.2% QoQ); vs our estimates of INR 110cr. PAT margin contracted by 15 bps YoY (down by 370 bps QoQ) to 5.7% vs 5.8% in Q4FY22. Telecom Products revenue stood at INR 654cr (+11.9% YoY/-5.5% QoQ). EBIT stood at INR 124.9cr (+74% YoY/-5% QoQ); EBIT margin improved by 682 bps YoY (up by 11 bps QoQ) to 19.1% vs 12.3% in Q4FY22. Telecom Products revenue share decreased to 46% vs 49% in Q4FY22. Turnkey Contracts and Services revenue stood at INR 778cr (+30.2% YoY/+98.6% QoQ). EBIT stood at INR 22cr (-48% YoY/-42.2% QoQ); EBIT margin contracted by 426 bps YoY (down by 690 bps QoQ) to 2.8% vs 7.1% in Q4FY22.

Key Highlights

Capacity expansion will drive business growth: HFCL is expanding optical fibre cable (OFC) capacities from 25 mn fkm to 35 mn fkm in FY25E. As part of its backward integration, HFCL is expanding its optic fibre capacities from 10 mn fkm to 25 mn fkm in FY25E. The Capex is expected to be around INR 900cr 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 300cr, Post capex expected additional revenue around INR 150cr per annum. Out of INR 900cr capex, the company has been granted to avail incentives up to ~INR 650cr under the PLI scheme over the next 4 to 5 years. The phased capacity expansion will increase competitiveness and helps to reduce operating costs which is expected to result in an increase in margins and profitability.

Witnessing traction on exports: HFCL is exporting optical fibre cables and telecom components to more than 30 countries and serving more than 80 clients globally. Exports revenue stood at INR 817cr (~17% of sales) in FY23. The company is targeting export revenue of INR 1,300cr – INR 1,500cr in FY24. The company has signed an agreement with EPS to expand the business to North and Central America, Europe, the Middle East, and Africa. HFCL has focused to build global customer relations, strengthen export footprints over the next 3 years, and emerging as the largest global payer.

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 22% (FY20) to 56% in FY23. HFCL is focused to launch 5G & telecom products over the period of Q2FY24 to Q1FY25. The company is focused to achieve INR 800cr – INR 1,000cr revenue by FY25 in these segments. HFCL has already participated in tenders for night vision devices and higher revenue is expected from next year onwards. Defence revenue is expected to be around INR 800cr – INR 1,000cr in the next 4 to 5 years. The change in product mix will improve the working capital cycle going forward.

Technology partnerships lead to first mover advantage in 5G and telecom: HFCL has created a technology partnership with Qualcomm for developing 5G RAN and Access products and entered into a partnership with Microsoft to create “Enterprise 5G networks” using equipment designed and manufactured by HFCL. The partnerships lead to developing the products to meet the accelerated rate of fiberization, 5G products demand and its creates first mover advantage for HFCL. HFCL also partnership with Wipro and Capgemini for designing the latest generation telecom products such as 5G, routers, switches, backhaul radios, Wi-Fi access points, etc.

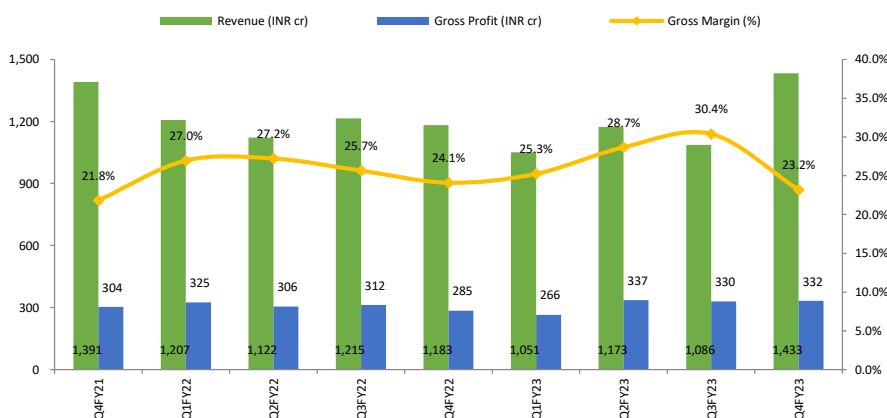
Outlook & Valuation: HFCL has technology partnerships that will lead to first mover advantage in 5G and telecom, Exports revenue is expected to grow more than 1.5x backed by strong demand; Post telecom products and OF capex, additional revenue is expected around INR 800cr – INR 1,000cr and INR 150cr per annum respectively. HFCL has focused strong exports, capacity expansion, product portfolio expansion, and a strong client base such as Jio, Airtel, Tata, etc would drive the business going forward. We maintain a “BUY” rating with a Target Price of INR 122 per share based on DCF; an upside of 83.2%.

Q4FY23 Results

Particular (INR cr)	Q4FY22	Q3FY23	Q4FY23	YoY (%)	QoQ (%)
Revenue	1,183	1,086	1,433	21.1%	32.0%
Net Raw Materials	898	756	1,101	22.6%	45.6%
Employee Cost	72	84	92	28.8%	9.3%
Other Expenses	90	58	86	-4.3%	47.8%
EBITDA	124	188	154	24.4%	-17.7%
EBITDA Margin (%)	10.5%	17.3%	10.8%	+29 bps	-650 bps
Depreciation	23	20	21		
Interest expense	38	37	38		
Other income	29.6	5.7	13.7		
Profit before tax	93	137	109	16.7%	-20.4%
Taxes	25	35	30		
PAT	68	102	79	15.5%	-22.6%
Other Comprehensive income	0.5	(0.1)	2.3		
Net profit	69	102	81	18.0%	-20.2%
Net profit Margin (%)	5.8%	9.4%	5.7%	-15 bps	-370 bps
EPS (INR)	0.5	0.7	0.6		

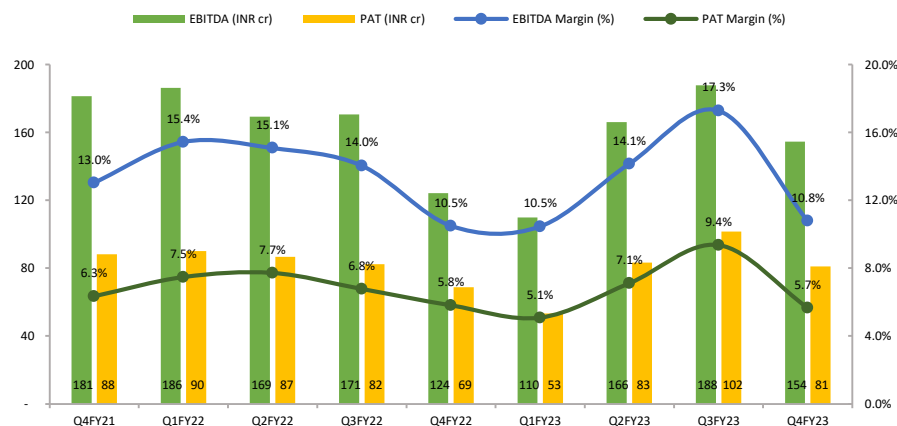
Source: Company Reports, Arihant Capital Research

Exhibit 1: Gross margins declined by 92 bps YoY to 23.2% due to higher RM costs.



Source: Company Reports, Arihant Capital Research

Exhibit 2: EBITDA Margin improved by 29 bps YoY due to reduction in other expenses.



Source: Company Reports, Arihant Capital Research

Q4FY23 Concall Highlights

Revenue and EBITDA

- The company focused to grow 15% to 20% in FY24.
- EBITDA margins are expected to be 14% - 15% going forward.
- Telecom products EBITDA margins are around 35% - 40% and Net margins around 15% to 20%.
- Turnkey margins are expected to be around 8% - 12% based on projects.

Order book

- Out of the INR 7,000+cr order book, 70% is from EPC, and the remaining 30% is from products. Products orders come on a regular basis. Product share is expected to increase going forward.
- Out of the INR 7,000+cr order book, 10% is from optical fibre.

PLI Incentives

- The company is eligible for ~INR 650cr PLI incentives from the government.

Capacity utilization

- Optical Fibre capacity utilization is almost ~100%, and plants are operating 24/7.

Exports

- Exports revenue stood at INR 817cr (~17% of sales) in FY23. The company is targeting export revenue of INR 1,300cr – INR 1,500cr in FY24.
- The company has signed an agreement with EPS to expand the business to North and Central America, Europe, the Middle East, and Africa.

Defence

- The company has already participated in tenders for night vision devices and higher revenue is expected from next year onwards. Defence revenue is expected to be around INR 800cr – INR 1,000cr in the next 4 to 5 years.
- Defence budget of INR 2.5 lakh cr, around 40% for capital acquisition. The company has the opportunity in indigenously developed defence electronics.

Industry

- The global optical fibre market has projected \$250bn and the Domestic market around \$10bn over the period of FY23-FY28.

Telecom Products

- The company is launching 5G fixed wireless customer permitting equipment, 5G small cell, UBR, and routers. The addressable market is estimated for these products to be around \$550bn by FY28. The company focused to achieve INR 800cr – INR 1,000cr revenue by FY25 in these segments.

OF and OFC cables

- Optical fibre capex is around INR 300cr, Post capex expected additional revenue around INR 150cr per annum.
- The average fibre price is \$4 per fibre km. recommendation of Anti-dumping duty lead to 0.5\$ per fibre km which is a 10% to 12% increase in prices.
- OFC realization is around INR 1,100 per fibre km in Q1FY22 and INR 1,234 per fibre km in Q4FY23.

Other highlights

- The company has technology partnerships with Qualcomm, Microsoft and Wipro, etc. 5G products are expected to launch in FY24.
- The company focused on capacity expansion and geography expansion going forward.
- Working capital days is around 90 days.
- Free cash flows are expected to be positive in FY24.

Products and Addressable markets

Exhibit 3: Product Offerings

Optic Fiber/ Optical Fibers Cables



1. Optic Fiber
2. Loose tube armoured and Unarmoured Cable
3. Micro Cable
4. Ribbon Cable
5. IBR Cable
6. FTTH Cable
7. FTTH Cable

Telecommu- nication Products



1. Point to Point and Point to Multipoint backhaul radio
2. Indoor & Outdoor Wi-Fi 5 and 6 Access Points
3. Cloud based Network management system
4. Ethernet L2/L3 Switches
5. Home Mesh Router

Passive Connectivity Solutions



1. Cable Assemblies
2. High Density Cabinets
3. Fiber Termination Box
4. PLC Splitters
5. Joint Closures
6. Aerial/ FTTx Accessories

Defence Electronics Products



1. Thermal Weapon Sights (TWS)
2. Electronic Fuses
3. High capacity radio relay
4. VMS & Video Analytics
5. Ground Surveillance Radar

Products Under Development

Telecommunication

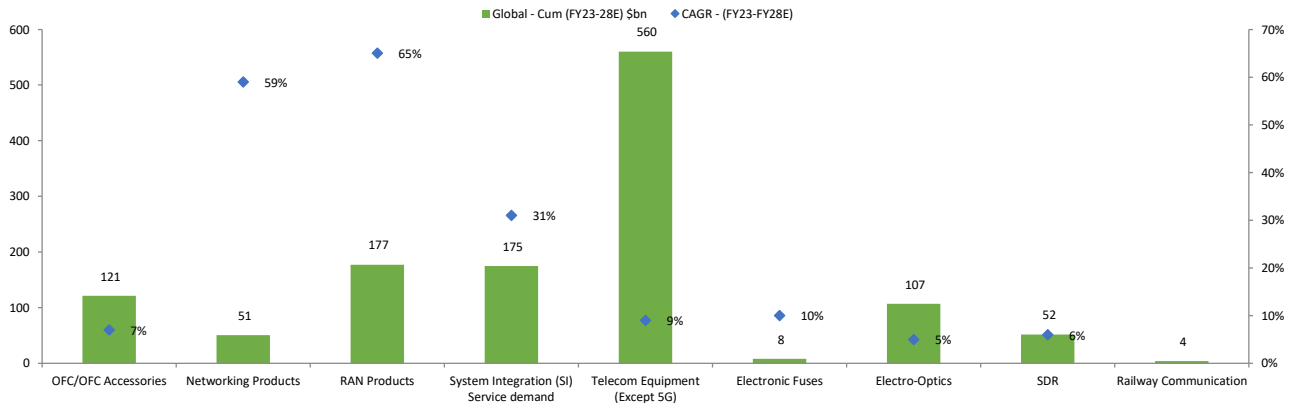
- 5G Indoor & Outdoor FWA CPE
- 5G Radio Access Network Products (8T8R)
- 5G Indoor & Outdoor Small Cell (2T2R and 4T4R)
- Access and Aggregation Routers
- Ultra High Capacity Point-to-point and Point-to-Multipoint UBRs
- Wi-Fi 7 Access Points

Defence Communication & Electronics

- Software defined radio

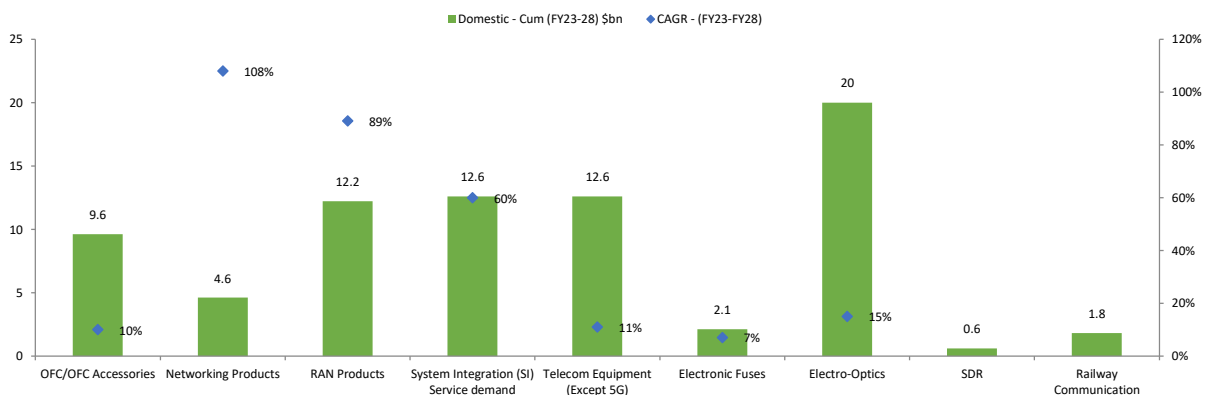
Source: Company reports, Arianth Capital Research

Exhibit 4: 5G segments such as Networking products and RAN products are expected to grow at faster rate over the period of FY23-FY28E. 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-FY28E.



Source: Company reports, Arianth Capital Research

Outlook & Valuation

HFCL has technology partnerships will leads to first mover advantage in 5G and telecom, 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 INR 150cr per annum respectively. HFCL has focused strong exports, capacity expansion, product portfolio expansion, and a strong client base such as Jio, Airtel, Tata, etc would drive the business going forward. We maintain “BUY” rating with Target Price of INR 122 per share based on DCF; an upside of 83.2%.

DCF Valuation

Valuation Assumptions

g (World Economic Growth)	3%
Rf	7%
Rm	13%
Beta	1.1
CMP	67

Valuation Data

Total Debt (long term borrowings) (2023)	117
Cash & Cash Equivalentents (2023)	323
Number of Diluted Shares (2023)	138
Tax Rate (2024)	27%
Interest Expense Rate (2024)	14%
MV of Equity	9,167
Total Debt	117
Total Capital	9,283

WACC

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

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)	463	593	793	1,088	1,498	2,072	2,743	3,472	4,189	4,807	5,235	5,392
Dep	90	111	114	118	119	124	165	209	252	289	314	324
Purchase of Assets	(489)	(501)	(99)	(121)	(118)	(104)	(138)	(175)	(211)	(242)	(263)	(271)
Changes in Working Capital	294	(34)	(238)	(195)	(412)	(571)	(756)	(957)	(1,155)	(1,325)	(1,443)	(1,486)
FCFF	358	168	569	889	1,087	1,521	2,014	2,549	3,075	3,529	3,843	
Terminal Value												37,504
Total Cash Flow	358	168	569	889	1,087	1,521	2,014	2,549	3,075	3,529	41,347	

Enterprise Value (INR cr)	16,588
Less: Debt (INR cr)	117
Add: Cash (INR cr)	323
Equity Value (INR cr)	16,794
Equity Value per share (INR)	122

% Returns	83.2%
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Rating	BUY
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Sensitivity Analysis

		Terminal Growth (%)								
		2.0%	2.3%	2.5%	2.8%	3.0%	3.3%	3.5%	3.8%	4.0%
WACC (%)	12.5%	131	133	136	138	141	144	147	151	154
	12.8%	126	129	131	134	136	139	142	145	148
	13.0%	122	124	127	129	132	134	137	140	143
	13.3%	118	120	123	125	127	130	132	135	138
	13.5%	115	117	119	121	123	125	128	130	133
	13.8%	111	113	115	117	119	121	123	126	128
	14.0%	108	110	111	113	115	117	119	121	124
	14.3%	105	106	108	110	111	113	115	117	120
	14.5%	102	103	105	106	108	110	112	114	116

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	5,338	6,426	7,965
Net Raw Materials	2,934	3,404	3,499	3,479	3,918	4,691	5,783
Employee Cost	224	253	311	348	384	456	558
Other Expenses	186	217	268	298	312	356	425
EBITDA	494	550	650	619	724	923	1,200
EBITDA Margin (%)	12.9%	12.4%	13.8%	13.0%	13.6%	14.4%	15.1%
Depreciation	(42)	(69)	(78)	(83)	(90)	(111)	(114)
Interest expense	(115)	(175)	(166)	(152)	(160)	(153)	(143)
Other income	22	35	43	47	64	206	225
Profit before tax	358	337	442	431	538	866	1,168
Taxes	(121)	(91)	(116)	(113)	(145)	(234)	(315)
Net profit	237	246	326	318	393	632	852
Reported Netprofit Margin (%)	6.2%	5.6%	6.9%	6.7%	7.4%	9.8%	10.7%
Other Comprehensive income	1	5	2	2	-	-	-
Net profit	238	251	328	319	393	632	852
EPS (INR)	1.9	2.0	2.4	2.3	2.9	4.6	6.2

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	3,340	3,935	4,737
Net worth	1,668	1,916	2,798	3,108	3,477	4,072	4,875
Minority Interest	(0)	7	20	37	37	37	37
Provisions	43	49	45	53	29	35	26
Debt	1,218	1,348	1,172	1,137	1,122	1,057	992
Other non-current liabilities	-	-	-	29	32	39	48
Total Liabilities	2,929	3,320	4,035	4,363	4,697	5,240	5,977
Fixed assets	437	443	465	487	918	1,296	1,304
Capital Work In Progress	15	12	47	71	39	51	29
Other Intangible assets	40	42	74	215	215	215	215
Goodwill	26	26	26	26	26	26	26
Investments	87	46	87	102	91	109	135
Other non current assets	37	45	47	57	53	64	80
Net working capital	1,535	1,931	2,366	2,537	2,242	2,276	2,515
Inventories	344	435	573	758	666	745	856
Sundry debtors	1,730	3,056	2,492	2,309	2,194	2,289	2,619
Loans & Advances	21	18	37	31	21	26	32
Other current assets	341	318	401	548	556	599	611
Sundry creditors	(815)	(1,748)	(1,037)	(878)	(1,087)	(1,267)	(1,483)
Other current liabilities & Prov	(85)	(148)	(99)	(232)	(107)	(116)	(119)
Cash	192	306	528	323	525	558	956
Other Financial Assets	560	468	395	546	587	643	717
Total Assets	2,929	3,320	4,035	4,363	4,697	5,240	5,977

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	538	866	1,168
Depreciation	42	69	78	83	90	111	114
Tax paid	(121)	(91)	(116)	(113)	(145)	(234)	(315)
Working capital Δ	(504)	(396)	(434)	(171)	294	(34)	(238)
Operating cashflow	(225)	(81)	(30)	230	776	709	727
Capital expenditure	(228)	(72)	(135)	(128)	(489)	(501)	(99)
Free cash flow	(452)	(153)	(166)	101	288	208	628
Equity raised	15	9	588	33	-	-	(0)
Investments	6	41	(41)	(15)	11	(18)	(26)
Others	47	81	39	(302)	(38)	(66)	(90)
Debt financing/disposal	422	130	(176)	(35)	(15)	(65)	(65)
Dividends paid	(15)	-	(19)	(24)	(23)	(37)	(50)
Other items	10	6	(4)	37	(21)	12	0
Net Δ in cash	32	115	222	(206)	202	33	398
Opening Cash Flow	159	192	306	528	323	525	558
Closing Cash Flow	192	306	528	323	525	558	956

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%	12.5%	20.4%	23.9%
Op profit growth	18.9%	11.2%	18.3%	-4.8%	17.0%	27.5%	30.0%
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%	9.8%	10.7%
RoCE	12.1%	12.1%	12.4%	10.3%	11.4%	15.2%	17.3%
RoNW	15.3%	13.7%	13.8%	10.8%	11.9%	16.7%	19.1%
RoA	8.1%	7.4%	8.1%	7.3%	8.4%	12.1%	14.3%
Per share ratios (INR)							
EPS	1.9	2.0	2.4	2.3	2.9	4.6	6.2
Dividend per share	0.1	-	0.1	0.2	0.2	0.3	0.4
Cash EPS	2.2	2.5	2.9	2.9	3.5	5.4	7.0
Book value per share	13.0	14.9	20.4	22.6	25.3	29.6	35.4
Valuation ratios (x)							
P/E	35.9	34.1	28.0	28.7	23.3	14.5	10.8
P/CEPS	30.6	27.2	22.7	22.9	19.0	12.3	9.5
P/B	5.1	4.5	3.3	2.9	2.6	2.3	1.9
EV/EBITDA	19.2	17.4	14.9	16.0	13.4	10.4	7.6
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	154	127	112
Inventory days	38	42	53	70	66	55	51
Creditor days	92	121	125	85	78	78	74
WC Days	103	118	142	170	143	104	89
Leverage ratios (x)							
Interest coverage	3.9	2.8	3.4	3.5	4.0	5.3	7.6
Net debt / equity	0.6	0.5	0.2	0.3	0.2	0.1	0.0
Net debt / op. profit	2.1	1.9	1.0	1.3	0.8	0.5	0.0

Source: Company Reports, Aриhant Capital Research

Story in Charts

Exhibit 6: Revenue is expected to grow at 16.3% CAGR over the period of FY23-FY25E.

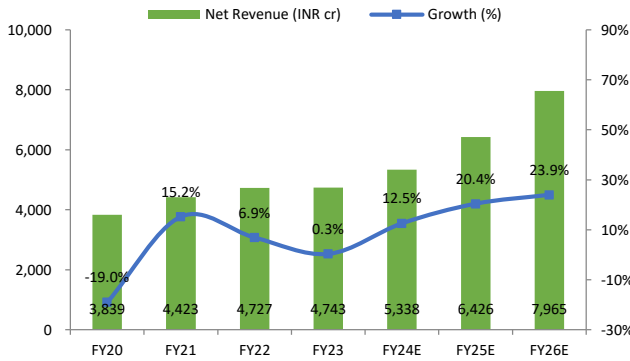


Exhibit 7: Softening of RM costs will lead to improvement in gross margins.

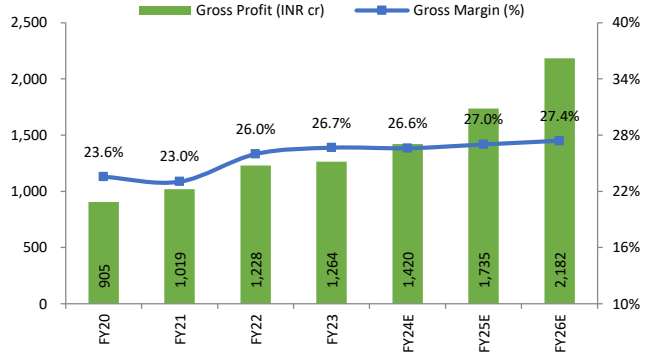


Exhibit 8: Growth in EBITDA & PAT levels

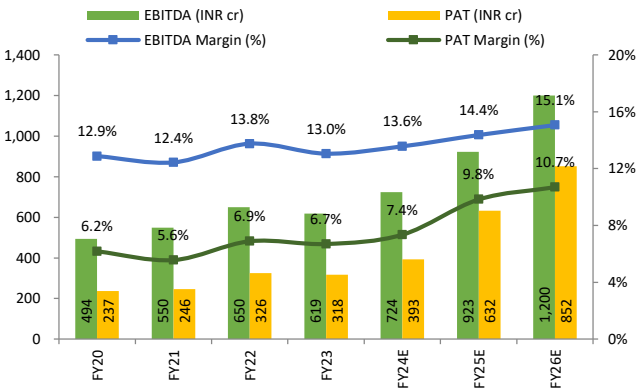


Exhibit 9: Return ratios to be improve

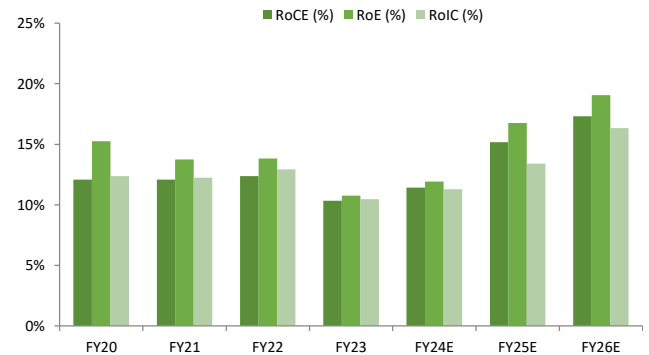


Exhibit 10: Working capital days to be improve

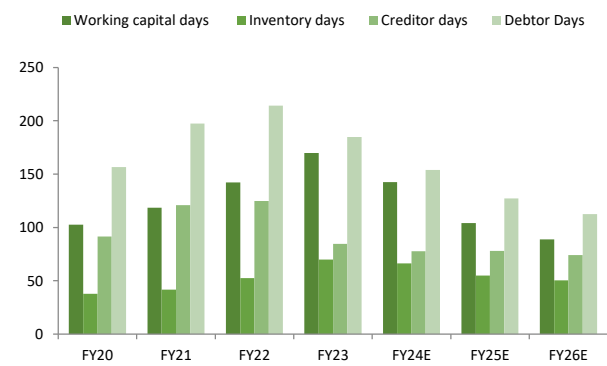
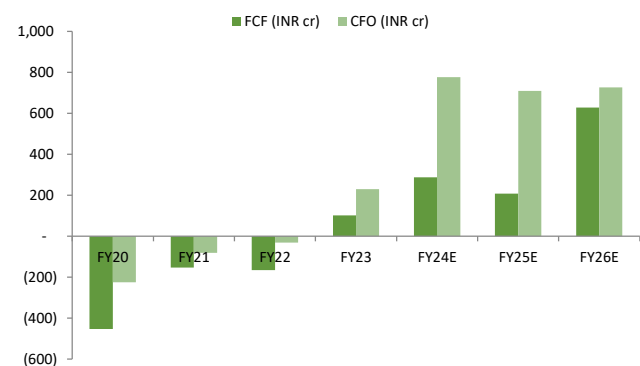


Exhibit 11: Cash flows to be improve



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.

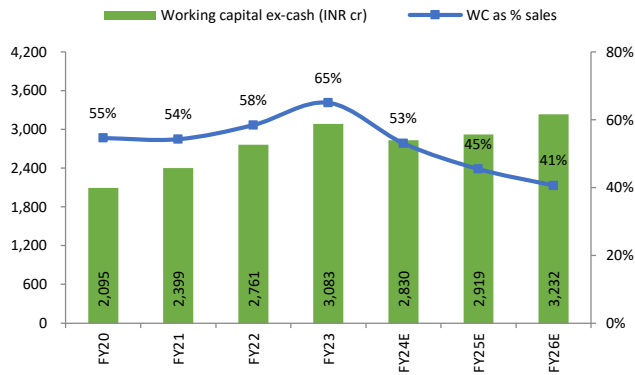


Exhibit 13: Interest cost as % of EBIT is expected to reduce going forward.

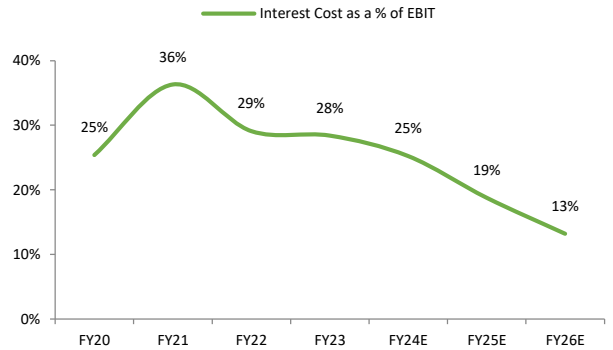


Exhibit 14: Exports revenue is expected to reach ~INR 1,300cr – INR 1,500cr by FY24E.

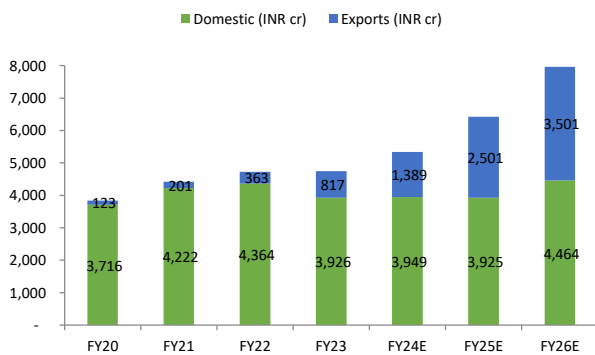


Exhibit 15: Exports revenue share is expected to reach ~26% in FY24E.

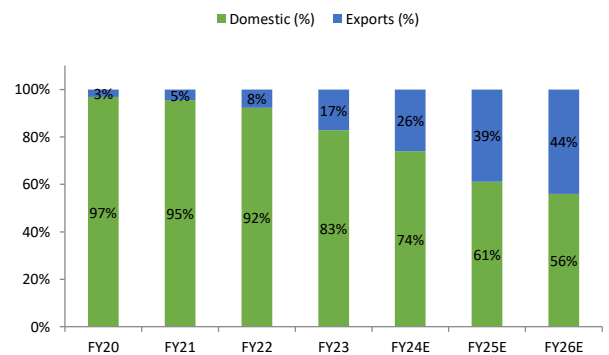


Exhibit 16: Telecom products is expected faster growth, while EPC revenue is expected to remain stagnant.

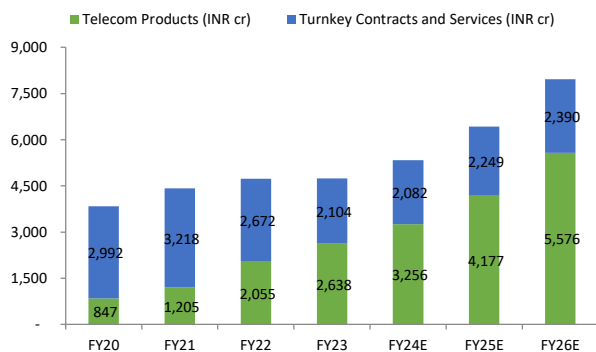
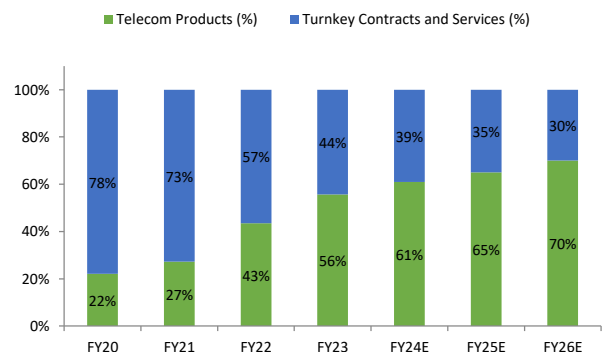


Exhibit 17: Telecom products share is expected to reach 70% going forward.



Source: Company reports, Arianth Capital Research

Story in Charts

Exhibit 18: The order book stood at INR 7,000+cr which shows revenue visibility going forward.

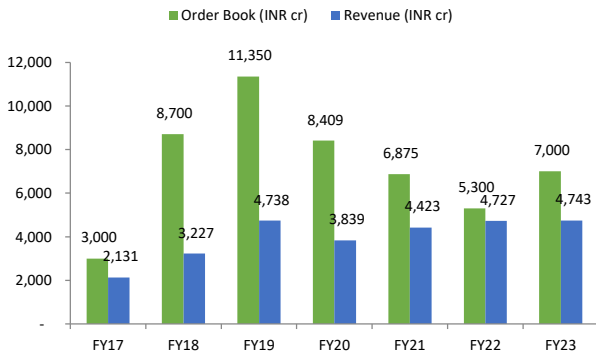


Exhibit 19: Public telecommunication revenue accounts 83% in FY23.

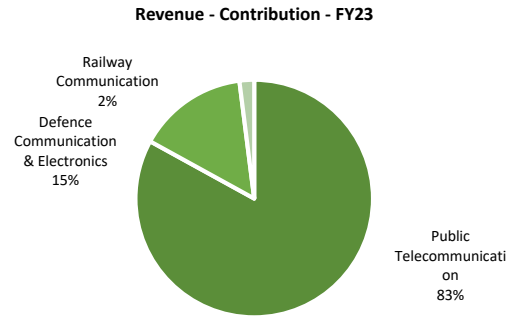


Exhibit 20: Telecom order book is accounted for 30% as of FY23. However, Telecom orders keep coming on regular basis.

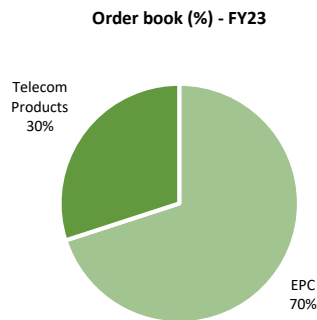


Exhibit 21: Telecom products margin witnessed improvement in Q4FY23.

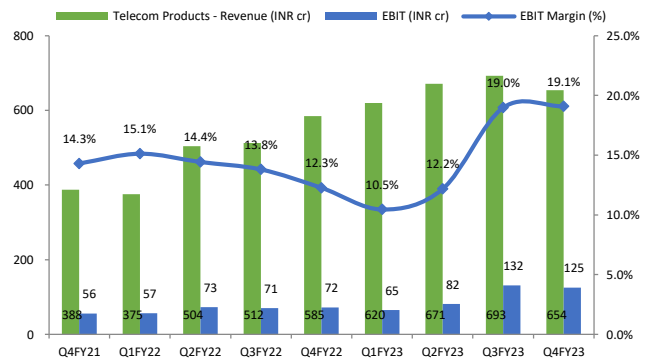


Exhibit 22: EPC margins under pressure in Q4FY23.

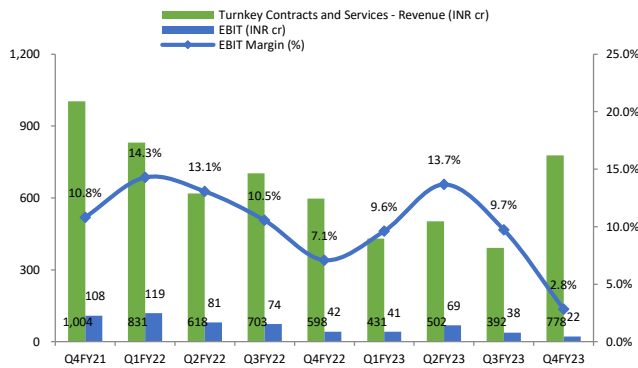
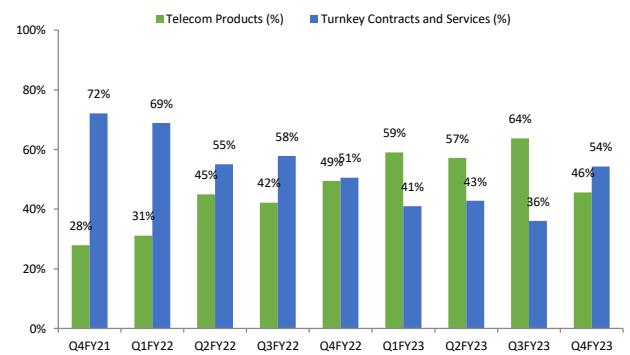


Exhibit 23: Telecom products revenue share stood at 46% as of Q4FY23. it's expected to reach 70% going forward.



Source: Company reports, Arianth Capital Research

Peer Comparison

Exhibit 24: HFCL is expected to grow at ~16% CAGR over the period of FY23-25E.

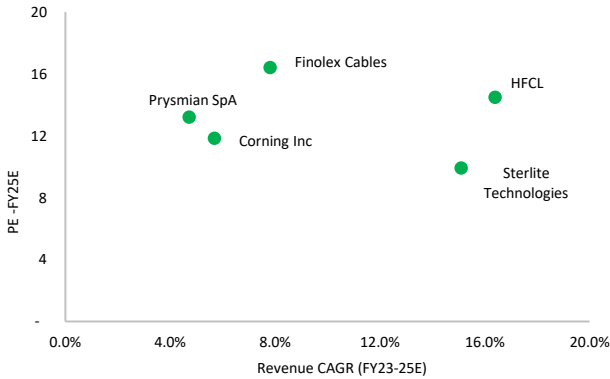


Exhibit 25: HFCL EBITDA margin is expected around 10% by FY25E. Sterlite tech margins are slightly higher than HFCL, because HFCL is importing glass preform for manufacturing while Sterlite technologies have backward integration for glass preform.

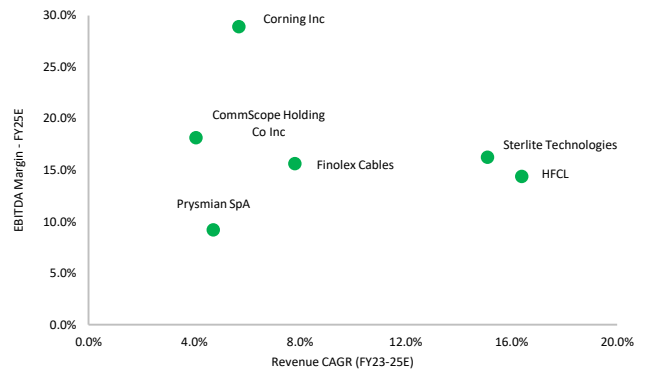


Exhibit 26: HFCL Margin is expected to improve going forward.

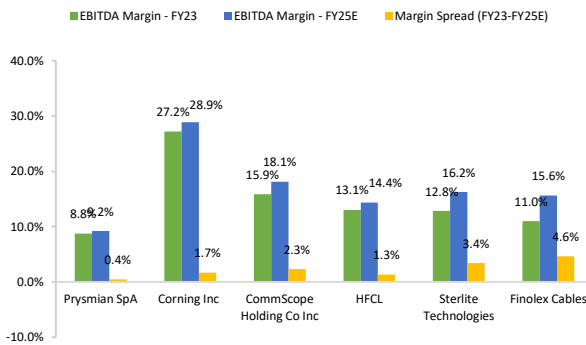


Exhibit 27: HFCL EVA spread is better the peers.

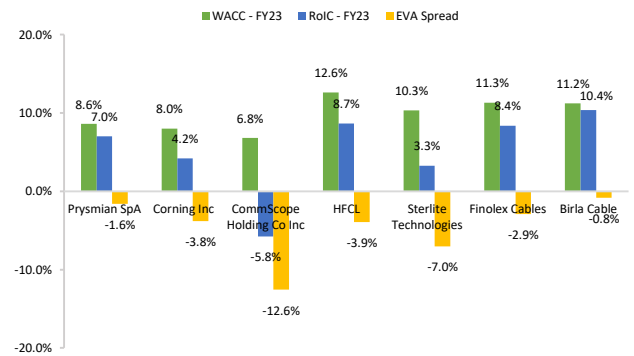


Exhibit 28: HFCL RoIC was enough to cover its WACC compared to peers.

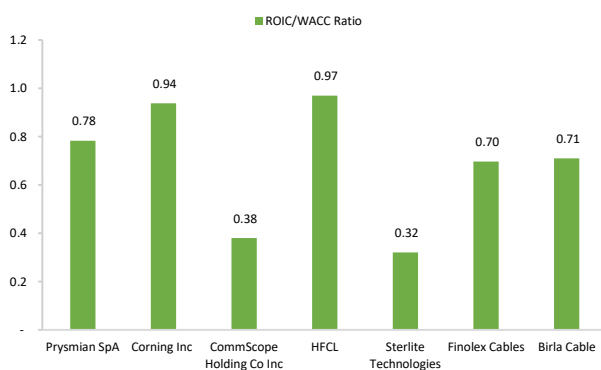
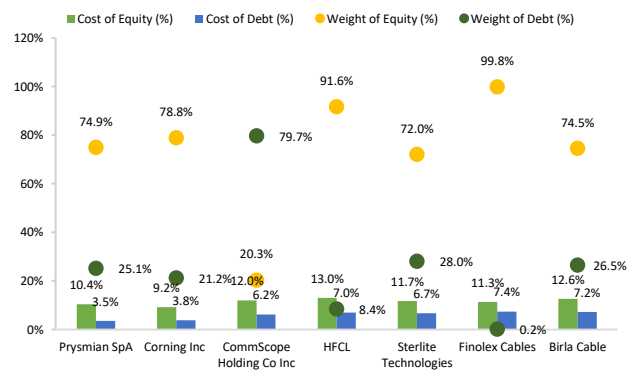


Exhibit 29: HFCL has lower weight of debt which indicates healthier balance sheet.



Source: Bloomberg, Arianth Capital Research

Arihant Research DeskEmail: instresearch@arihantcapital.com

Tel. : 022-42254800

Head Office	Registered Office
#1011, Solitaire Corporate Park Building No. 10, 1 st Floor Andheri Ghatkopar Link Road Chakala, Andheri (E) Mumbai – 400093 Tel: (91-22) 42254800 Fax: (91-22) 42254880	Arihant House E-5 Ratlam Kothi Indore - 452003, (M.P.) Tel: (91-731) 3016100 Fax: (91-731) 3016199

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%

Research Analyst Registration No.	Contact	Website	Email Id
INH000002764	SMS: 'Arihant' to 56677	www.arihantcapital.com	instresearch@arihantcapital.com

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Arihant Capital Markets Ltd.
1011, Solitaire Corporate park, Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road, Chakala, Andheri (E)
Tel. 022-42254800 Fax. 022-42254880