

# Initiating Coverage Report

11th Dec 2019



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**Brief Overview**

CMP (INR) (As on 10th Dec 2019)	547
Target (INR)	829
Upside(%)	52
Recommendation	<b>Strong Buy</b>

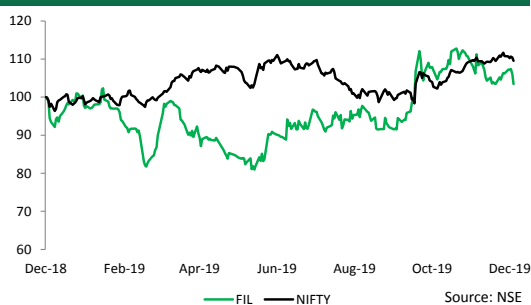
BSE Code	500940
NSE Code	FINPIPE
Reuters Ticker	FINX.BO
Bloomberg Ticker	FNXP BN

**Stock Scan**

Market cap (INR Cr.)	7022
Outstanding Shares (Cr.)	12.41
Face Value (INR)	10.00
Dividend Yield(%)	1.77
TTM P/E (x)	19.12
Industry P/E (x)	16.18
Debt/Equity (x)	0.04
Beta vs. Sensex	0.76
52 Week High/ Low (INR)	635/440
Avg. Daily Volume (NSE)/1yr	39760

**Shareholding Pattern (%)**

	Sept-19	June-19	Mar-19
<b>Promoters</b>	52.47	52.47	52.47
<b>Institutions</b>	14.37	13.56	12.97
<b>Non-Institution</b>	33.16	33.97	34.56

**Stock vs. Nifty (Relative Returns)**

**Finolex Industries Ltd: Possible re-rating in pipeline**

**We initiate a coverage on Finolex Industries Ltd (FIL) with a Strong Buy rating.** FIL is a uniquely positioned player in the PVC industry as it has integrated manufacturing facilities from a 2,72,000MT plant of PVC Resins at Ratnagiri to a 370,000 MT capacity of Pipes and fittings spread across Ratnagiri, Pune and Gujarat. About 70% of FIL's pipes are sold for irrigation purposes while the balance is sold to housing and other industries. FIL is a market leader in the Agricultural pipes segment (~13% market share). Given the Government's strong focus on agriculture and irrigation, demand for pipes for this segment is expected to remain robust. Also the company has been fast ramping up its Non-Agricultural segment which commands a higher margin. With decreasing external sale of PVC resin and increasing revenue from Pipes & Fittings segment the company is on the process of **transforming its B2B business model to a B2C business model with reducing earnings volatility and a case for a possible re-rating in the stock.**

- **Capacity Expansion to augur growth:** The company is expanding its Pipes & Fittings business by 30,000-40,000MT per annum for the next 3 years with an estimated capex of INR100-120cr every year. Given a strong brand recognition, good monsoon, and increasing dealer counts we expect the revenue from Pipes segment to grow at a CAGR 15-18%, higher than the Industry growth rates driven by volume CAGR of 14% for the next 3 years.
- **CPVC booster:** Finolex tied up with Lubrizol in 2017 to manufacture and sell CPVC pipes and fittings in India under the brand "Flowguard". CPVC pipes & fittings commands a higher margin than PVC pipes & fittings. Fast ramping up of CPVC pipes & fittings volume would give further impetus to the margins going forward.

We value the company on a SOTP basis by assigning a multiple of 15x to FY22E standalone EPS of INR52.27 and taking a value of INR44.7 per share for its investments in Finolex Cables, Finolex Plasson and land in Pune to arrive at **Target price of INR829.**

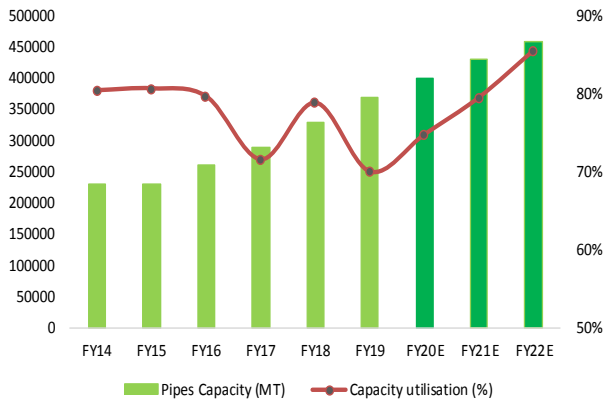
**Financial Performance at a glance (Standalone)**

Particulars (INR Cr)	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	2738	3091	3434	3970	4422
Growth %	5.2%	12.9%	11.1%	15.6%	11.4%
EBITDA	484	604	577	748	916
EBITDA Margin (%)	17.7%	19.5%	16.8%	18.8%	20.7%
Net Profit	299	350	392	520	649
Net Profit Margin (%)	10.9%	11.3%	11.4%	13.1%	14.7%
EPS	24.12	28.17	31.61	41.87	52.27
BVPS	222.88	203.83	220.07	239.07	259.66
P / E (x)	22.7	19.4	17.3	13.1	10.5
P / BV (x)	2.5	2.7	2.5	2.3	2.1
ROE (%)	11.8%	13.2%	14.9%	18.2%	21.0%
ROCE(%)	12.1%	14.7%	15.8%	19.0%	21.7%

Source: Company Data, SMIFS Research

## Investment Rationale

### Pipes & Fittings capacity trend



Source: Company Data, SMIFS Research

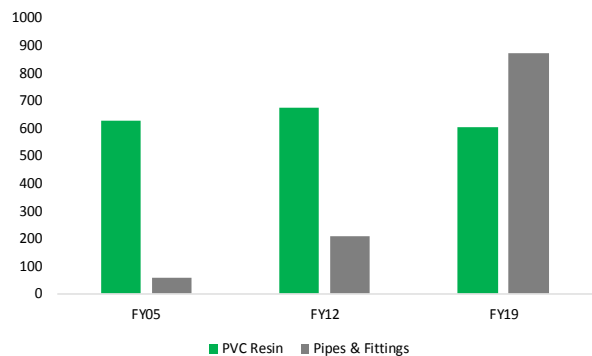
### Capacity Expansion

The company has been expanding its Pipes & Fittings business since FY16. On an annual basis the company is adding 30,000MT of capacity to its Pipes & Fittings segment at an investment of INR100cr p.a.

The current capacity in the Pipes & Fittings segment is 370,000MT with a utilisation rate of around 70%. The management intends to add another 30000-40000MT in FY20E at an investment of INR100-120cr. We expect similar levels of capex over the next 3 years to reach an annual capacity of around 460,000MT by FY22E by which the PVC resin capacity of 272,000MT will be fully utilized for captive consumption.

We believe the capacity expansion would aid volume growth over the next 2-3 years. Given the Government focus on agriculture, good monsoons, strong brand recognition and increasing dealer counts we expect the revenue from Pipes segment to grow at a CAGR 15-18%, higher than the Industry growth rates.

### Capital employed trend (INR Cr.)

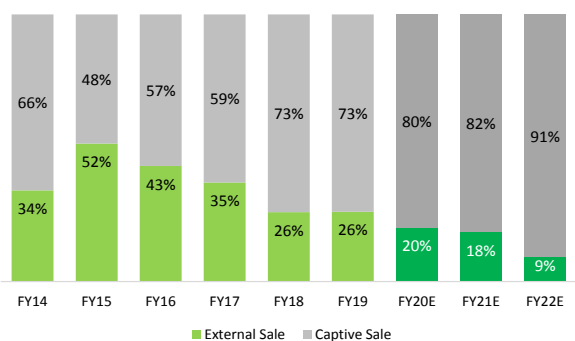


Source: Company Data, SMIFS Research

### Transformation from B2B to B2C model

FIL is the only PVC pipes player in India which is backward integrated for making PVC resin. The company is the second largest PVC resin manufacturer in the country with a capacity of 272,000MT (250K of suspension resin & 22k of emulsion resin). It can, therefore, maintain a steady supply of raw material as well as right quality for its PVC pipes business. The company has commissioned its resin capacity in 2 phases :1994 Phase-1 and 2006 Phase-2. **PVC resin is a highly capital intensive business where the current replacement cost of the capacity is estimated around INR3500-4000cr**

### External & Captive Sale Mix trend

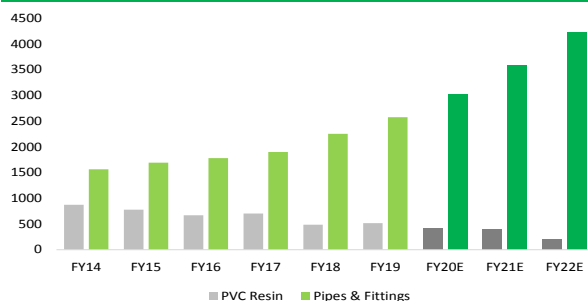


Source: Company Data, SMIFS Research

Over the years, the company had added capacities aggressively in the Pipes & Fittings business from 70000MT in FY08 to 370000MT in FY19. This in turn increased the captive consumption of PVC resin, currently at 75%, and decreased the external sales of PVC resin. Going ahead with management's aim to add further capacities in Pipes & Fittings segment, **we expect the percentage of captive consumption of PVC resin should go up to 90% by FY22E.**

## Investment Rationale

### Segmental Revenue mix (INR Cr.)



Source: Company Data, SMIFS Research

Hence, as captive consumption continues to grow, the company is less dependent on open market sale of PVC resin which in turn should lead to transforming from a B2B business model of PVC resin to a B2C business of PVC pipes and fittings. We believe this transformation would reduce the volatility of earnings in PVC segment and can command a much better control of margins over its peers.

### Segmental Revenue mix (%)

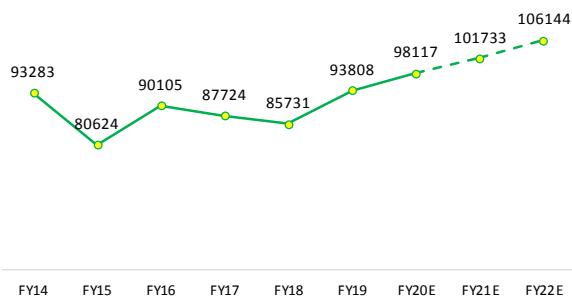
Segment	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
PVC Resin (External)	36%	32%	27%	27%	18%	17%	12%	10%	4%
Pipes & Fittings	64%	68%	73%	73%	82%	83%	88%	90%	96%

### Segmental pre-Tax ROCE (%)

Segment	FY14	FY15	FY16	FY17	FY18	FY19
PVC Resin	26%	8%	40%	63%	65%	62%
Pipes & Fittings	39%	29%	38%	31%	20%	21%

Source: Company Data, SMIFS Research

### Improvement in blended realisation per MT (INR)



Source: Company Data, SMIFS Research

### Changing product mix

The company had been a late entrant to Non-agri segment. Compared to its peers, Finolex's margin had been lower due to high exposure to agri segment. Given farmers are very price conscious at the time of buying agri pipes and presence of high no. of suppliers in the market, bargaining power currently lies with the farmers and hence, margin is relatively low in the agri segment.

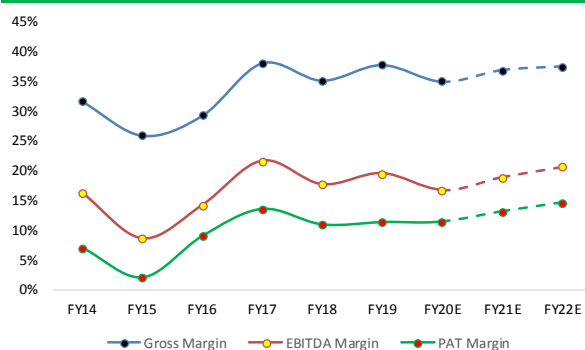
Currently only 30% of the Pipes segment revenues come from Non-agri i.e. housing PVC segment. However, over the last 4 years the company added new capacities every year with a capex of INR300cr. and has fast increased its product portfolio in the non-agri segment.

The management aims to further increase the proportion in the next 2 years from Non-agri segment. Non-agri segment commands a higher margin because of higher realisation and more fittings required per unit of Pipes compared to agri segment. PBIT margin of Pipes generally commands around 6-8% in agri segment whereas in Non-agri segment pipes margin is around 10-12%.

Moreover, in Non-agri segment fittings component required is 15% of volume of pipes compared to only 5% of fittings required in agri segment.

For FIL, Fitting commands a margin of 12-13% as compared to 8% in case of PVC Pipes. Thus we believe with increasing percentage of revenue from non-agri segment would improve the margins going forward.

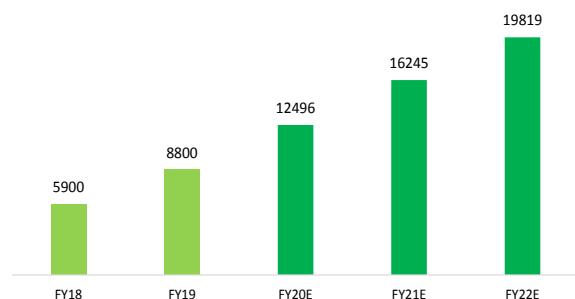
### Improvement in margins going forward



Source: Company Data, SMIFS Research

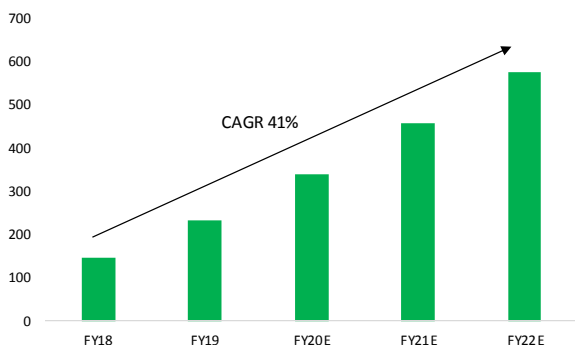
## Investment Rationale

### CPVC Volume trend (MT)



Source: Company Data, SMIFS Research

### CPVC Revenue trend (INR Cr.)



Source: Company Data, SMIFS Research

### CPVC: big booster

Finolex tied up with Lubrizol in 2017 to source CPVC compound. Under the partnership, Lubrizol will supply CPVC compound for manufacturing and selling of Finolex “FlowGuard” Plus pipes and fittings in India.

Finolex’s offering until then was limited to uPVC pipes and fittings, which are not designed for hot water transportation.

CPVC pipes and fittings can withstand high temperature of water making them suitable for residential, commercial and industrial applications. These pipes find utility in residential apartments, hospitals, swimming pools, manufacturing plants, hotels and resorts etc. Because of these added benefits, CPVC pipes and fittings are priced at a premium and compared to PVC pipes, has better margins.

The CPVC market is still at a nascent stage in India, accounting for less than 10% of the overall pipes and fittings volume within the industry, however, it is the fastest growing segment and has significant opportunities for the future.

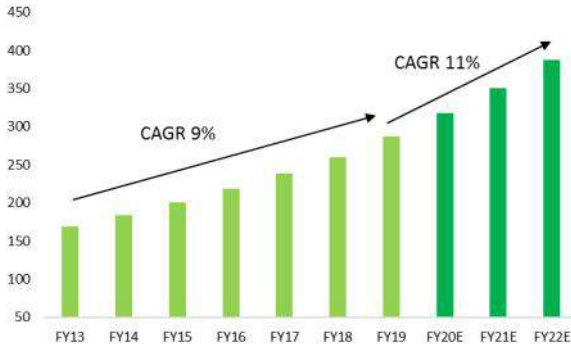
We believe the introduction of CPVC pipes will help Finolex to supply to non-agri sector where it will be able to complement its existing offering and be at par with its peers in terms of its product offerings. It will also be able to diversify its exposure away from the agri-business from where it derives 70% of its sales.

**EBIT margins of CPVC are in the range of 12%-13% v/s 8-9% for PVC. Similarly, the margins in CPVC fittings are even more attractive at around 18-20% as compared to 16-17% margins in PVC fittings.** Currently, the CPVC pipes and fittings volumes are currently small at around 3%; the management aims to increase the capacity to 20000 MT from current 10000MT. This would give further impetus to the margin going forward.

FIL introduced CPVC pipes and fittings in FY18 with sales volume of 5900MT and revenue of INR147cr. In FY19 FIL sold 8800MT of CPVC pipes and fittings and a revenue of INR232cr.

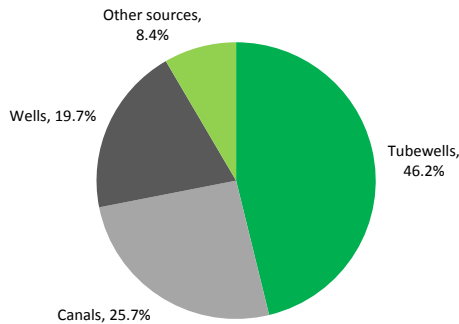
## Investment Rationale

### Plastic Pipes demand in India (MT'000)



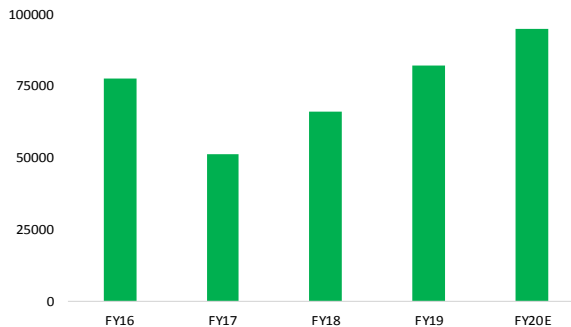
Source: Industry, SMIFS Research

### Most of the farmers depend on Tube well for irrigation; Tube well water level in turn depends upon monsoon



Source: Industry, SMIFS Research

### Yearly PMKSY budgetary allocation (INR Cr.)



Source: Budget data, SMIFS Research

### Growing Pipes market:

India's plastic pipe industry has grown at a CAGR of 9% from FY 2013 to FY2018 and is estimated to reach a value of approx INR318 billion in FY 2019-20. The demand for PVC pipes and fittings is likely to expand at a CAGR of 14.7% during FY 2018 to FY 2026. This can be segregated into Agri demand and Non-Agri demand.

**Agri demand:** PVC pipes are extensively used in the agricultural sector for field irrigation. The demand depends on the availability of rivers/ canals/bore wells which then be connected to farmland via pipes. Currently, about 51% of the agricultural area cultivating food grains is covered by irrigation. The rest of the area is dependent on rainfall (rain-fed agriculture). Sources of irrigation include ground water (wells, tube-wells) and surface water (canals, tanks). As shown in the charts of various sources of irrigation used in agriculture. Most of the farmers depend on Tube well for irrigation; Tube well water level in turn depends upon monsoon

Also, continuous depletion of water tables across the country, forcing people to source water from far flung places. Hence, to support the rural economy and farmer's income cultivable land under irrigation has become the need of the hour.

From the FY2015-16 Union budget the Government has increased its focus on irrigation developments. A national mission to improve farm irrigation (Pradhan Mantri Krishi Sinchai Yojna) was launched in 2015-16 and its budget allocation in 2019-20 was increased by 18% to INR3500cr.

The major objective of PMKSY is to achieve convergence of investments in irrigation at the field level, expand cultivable area under assured irrigation, improve on-farm water use efficiency to reduce wastage of water, enhance the adoption of precision-irrigation and other water saving technologies through underground piping systems and drip irrigation and promoting farmer oriented activities.

## Investment Rationale

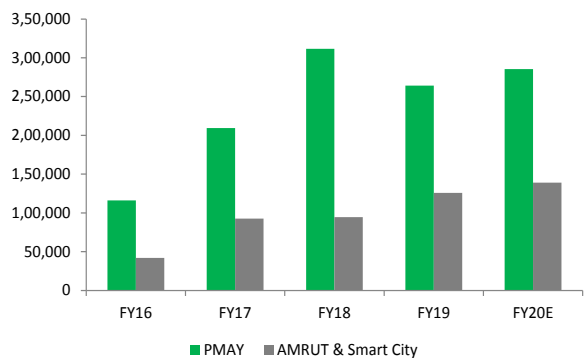
**A good monsoon in a year is directly correlated to a high Agricultural GDP growth in the next year**

Years	Monsoon Index	Agriculture GDP growth (%)
2008-09	77.51	-0.24
2009-10	102.56	0.89
2010-11	100.99	8.79
2011-12	92.08	6.4
2012-13	105.25	1.49
2013-14	87.36	5.57
2014-15	85.46	-0.22
2015-16	96.85	0.65
2016-17	94.53	6.27
2017-18	90.34	4.98
2018-19	102.25	2.75
<b>2019-20 E</b>	<b>101.65</b>	<b>6.2</b>

\* 100.00 pts is the indexed as the normal level of monsoon

Source: IMD, NCAER, SMIFS Research

## Yearly budgetary allocation on housing schemes (INR Cr.)



Source: Budget data, SMIFS Research

Actual construction generally take a year after funds are allocated. And assuming a housing project can take atleast 1 year, demand for pipes would be towards the end of the construction period. Hence, funds allocated during FY17-18, demand pipes to accrue in FY19-20.

Some of the other initiatives taken by the Government are as follows:-

- The Government has approved a corpus of INR5000 crore for setting up a dedicated micro irrigation fund (MIF) under the National Bank for Agriculture and Rural Development (NABARD).
- Kisan Credit Cards will be given to farmers to help them meet their working capital needs.

Also a good monsoon in 2018 and 2019 could lead to higher spending capacity of the farmers and thereby result in buoyant growth for the PVC pipe industry as well. We believe that demand for PVC pipes will remain good driven by better monsoon.

**Non-Agri demand**– This demand can be bifurcated into two demand i.e. Base and Replacement demand.

**Base demand**- The urban population is growing in India and because of this, opportunities are increasing as well. According to country data, the urbanization in India is mainly due to the expansion of cities and the migration of people. Investments are made in housing, road network, urban transport, water supply, power-related infrastructures, smart cities, shopping malls, hospitals and other forms of urban management.

Besides this, growth will continue from rural pockets led by “Housing for all”- affordable housing projects and increased focus on sanitation funded by Government. Strong growth in demand is attributed from these segments in the urban as well as rural segments.

**Replacement Demand**- There is an additional demand to replace Galvanised Iron (GI) pipes, which were traditionally used in the past. PVC pipes are almost 25-30% cheaper with more lifespan as conventional GI pipes corrode over time. Hence, it is fast replacing traditional GI pipes in the country. As of now, there is still an immense potential left for the plastic pipe industry to tap into the huge opportunity in the replacement market.



## Investment Rationale

**Only one in every five or 21.4 per cent households in India has piped drinking water connections in India**

Source	All India	Urban	Rural
Tubewell	11%	10%	11%
Handpump	31%	7%	43%
Piped Water	35%	58%	23%
Well	6%	3%	5%
Tanker	3%	1%	0.5%
Public Tap	9%	7%	10%
Others	6%	13%	8%

Source: NSS Report, SMIFS Research

## Present duty structure

Particulars	BCD	ADD
PVC resin/compound	10%	-
CPVC resin/ compound	10%	10%
EDC	-	-
Ethelyne	2.5%	-
VCM	2.5%	-

Source: Industry, SMIFS Research

Also in the Union Budget 2019-20- The Government has announced 'Nal se Jal' scheme, which intends to give piped water association to every household unit by 2024, will probably prompt a huge jump in the investment in water and sanitation sector. With the introduction of this scheme, water and sanitation sector is probably going to invest in this new scheme worth INR6.3 lakh crore (USD 87.57 billion) in the next five years. The government has constituted a new ministry 'Jal Shakti Ministry' that will overlook implementation of the 'Nal se Jal' scheme.

In our view there is strong demand scenario exist over the next 10 years for the plastic pipe industry. Finolex being key player in the industry would be highly benefitted from the growth drivers.

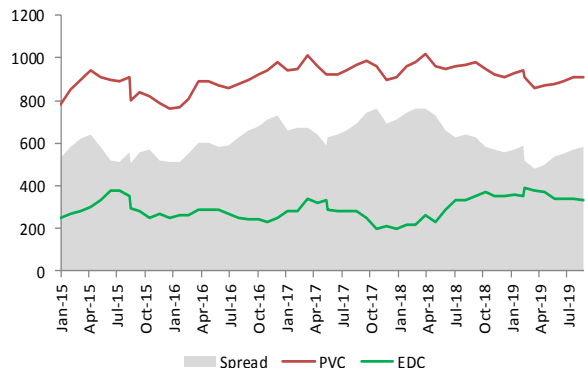
## Anti-dumping duty on CPVC

The Govt of India has recently on August 2019- imposed anti-dumping duty (ADD) of 10% on CPVC resin/compound originating from China and Korea. For this the Govt has fixed a base rate of USD2000 per MT. The ADD would make the Chinese and Korean imports (constituting 30% of India's overall imports of CPVC resin/compound) non-competitive v/s major US and Japan CPVC suppliers. This has likely to pave the way for Indian CPVC pipe players, sourcing resin/compound from US/ Japan, to not only take sizeable price hikes in near future, but also consolidate market share.

FIL sources its CPVC compounds from Lubrizol which manufactures CPVC compounds from resin in India. As a result FIL have benefitted from the imposition of this duty in terms of higher realisation and gaining market share from unorganised market. Further FIL was also a beneficiary when in the Union Budget for FY20, Basic Customs Duty (BCD) on CPVC resin/ compound originating from China and Korea was also hiked from 7.5% to 10% leading to a price hike of 3% on CPVC products take by all major CPVC pipes players in India.

## Key Raw material dynamics

### Price trend of PVC-EDC (USD/ton)



Source: Industry, Company Data, SMIFS

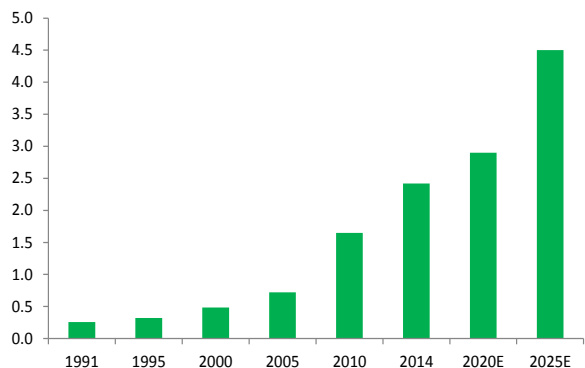
### Raw Materials

FIL generates around 70% of its earnings from the PVC resin business and is, therefore, highly levered to improving PVC prices and margins. Although volatile in the past PVC margins have been increasing steadily in the last three years, as the chart shows, mainly driven by PVC supply tightness.

Main metric of profitability for PVC resin segment is the spread between EDC (Ethylene Di-Chloride) and PVC resin prices. A healthy spread attributes to good margins.

To understand the linkages between the various moving parts in the PVC manufacturing process it is important to understand a) the demand and supply for PVC in India, b) the manufacturing process and key feed stock's & c) the demand supply dynamics of each feed stock and its impact on pricing.

### Demand of PVC in India (MT)

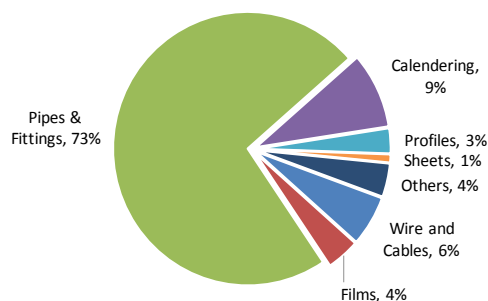


Source: FICCI Research, SMIFS Research

**Demand in India-** India's PVC demand has grown at a CAGR of 10% for the last decade – the highest globally to clock 7% of Global demand 10%. According to Industry experts it is expected to drive 18-20% of global demand in the next decade. In India, approx. 73% of the total resin is consumed by pipe manufacturers. It is also a preferred plastic material for application in flooring, films and sheets etc.

Upsurge in the demand for pipes in the irrigation sector and building & construction industry and medical hospitals are the major driving factors in India for the PVC pipes market. Moreover, increased focus of government on rural water management supports the demand for PVC pipes in India. With the increase in demand for pipes, the consumption of PVC resin is estimated to grow at a consistent rate.

### Usage of PVC in India

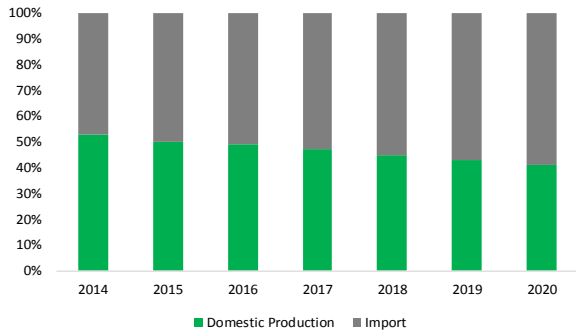


Source: FICCI Research, SMIFS Research

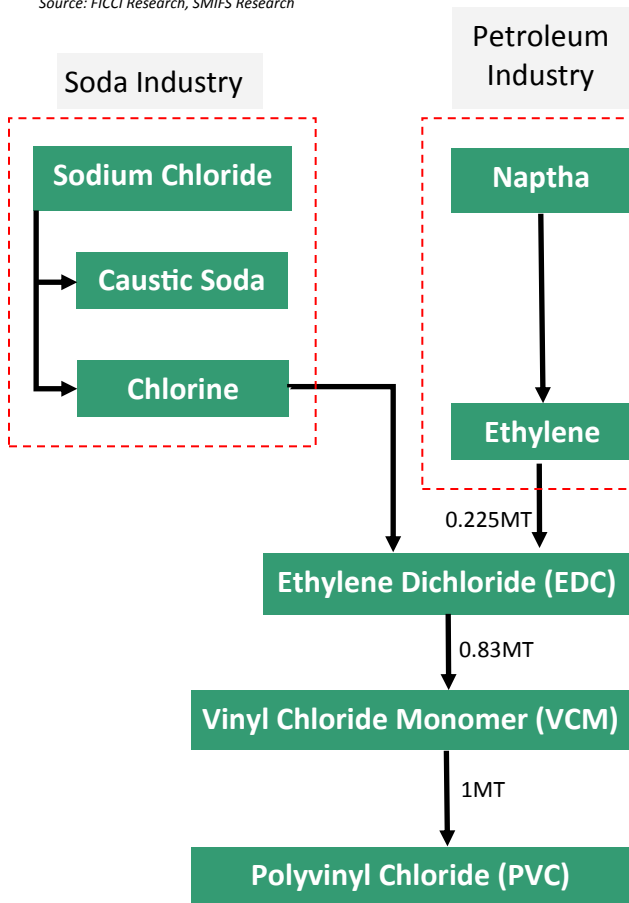
The manufacturing capacity of domestic resin had been growing at a CAGR of 2.2% between CY 2010-2018 while the consumption requirement grew at a CAGR of 9.5% during the same period which makes the sector to heavily depend on the import of PVC. India is the largest importer of PVC resins in the world – sourcing more than 50% of its needs from import. Going forward we believe that its dependence on imports should only increase going forward.

## Key Raw material dynamics

### Domestic and Import mix of PVC resin(%)



Source: FICCI Research, SMIFS Research



Source: Industry, SMIFS Research

China has long been responsible for the largest capacity overhang of the global PVC market with 45% of global supply, operating at mid-60% levels, a coal-based cost structure, and a propensity to export when prices become attractive. However, since Sept-2016 higher coal prices and pollution-related production curtailments in China have led to lower utilisation rates for China's PVC supply and a decline in China's net exports of PVC.

Now, with China's supply being cut back, that overhang has been lifted, driving PVC ethylene spreads in Asia to higher levels. We believe high coal prices and continued enforcement of anti-pollution norms will likely to continue. In the absence of China's PVC swing volumes, there is very limited additional global PVC capacity being built over the next 3-4 years, which should mean a very positive cycle for pricing and margins.

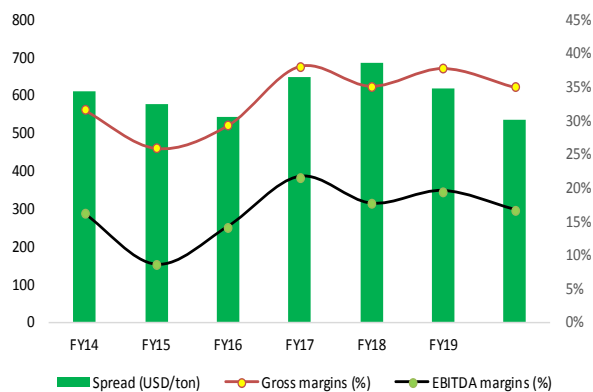
**B) Manufacturing Process:** Finolex manufactures PVC through two processes: 1) EDC (Ethylene Dichloride) -ethylene, and 2) directly from VCM (Vinyl Chloride Monomer). The mix depends on the prices of the Raw Materials. Currently, the EDC-ethylene route is the most profitable part of Finolex's business as the EDC prices are lower compared to the imported prices of VCM. FIL currently manufactures 60% PVC resin through EDC-Ethylene route and 40% from VCM route.

EDC is obtained from a crude derivative (Naptha) and Chlorine which is a byproduct from the production of caustic soda.

This is then converted to VCM through the process of polymerization. Further, one tonne of VCM is converted into one tonne of PVC, while 0.825 tonnes of EDC + 0.225 tonnes of ethylene are converted into one tonne of PVC.

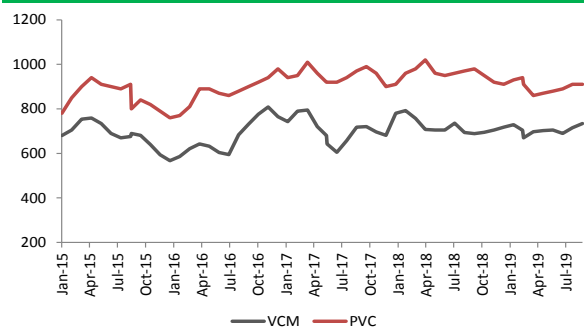
## Key Raw material dynamics

### Margins have been highly correlated to PVC-EDC spread in the past



Source: Industry, SMIFS Research

### VCM – broadly tracks PVC price (USD/ton)



Source: Industry, SMIFS Research

**C) Significance of spread-** Ethylene is the key input for EDC. Oversupply in the ethylene due to capacity expansions in Middle East as a result of higher shale gas production resulting into lower Ethylene prices.

While EDC is a derivative of crude, it generally follows its own demand-supply equation. Many of the EDC manufacturers are forward integrators from the caustic soda industry and produce EDC only because they cannot store Chlorine, a byproduct in the manufacturing of caustic soda. Hence, with the increase in caustic soda production and as a result high chlorine production, the manufactures are actually selling EDC at breakeven prices just to monetize its chlorine production.

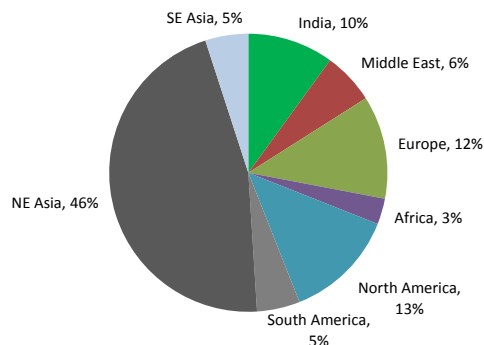
VCM is the key precursor for the production of PVC through both the ethylene-EDC route as well as the acetylene route. Almost all the VCM produced globally is used for the production of PVC and, therefore, its prices have very closely tracked PVC historically. PVC-VCM has maintained a broadly constant spread and we don't expect this to change.

Hence, the volatility in the PVC/EDC spread needs key monitoring from the company, and could potentially affect profitability. (Charts of spreads). Also, any sharp upturn or down turn in crude prices may lead to an inventory gain and loss respectively for the company.

***In this we believe, since company's exposure to external sale of PVC resin is reduced with increasing sales from Pipes & Fittings where any increase in PVC prices are immediately passed on, the volatility of earnings due to the volatility of PVC/EDC spreads to gradually reduce going forward.***

## Industry Overview

### Global PVC demand break up



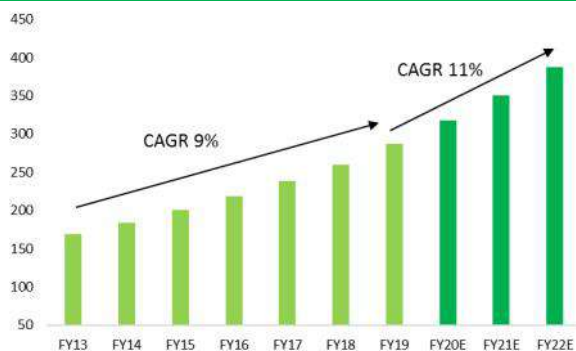
Source: FICCI Research, SMIFS Research

### PVC Resin- Domestic Manufacturers

Particulars	Capacity (MTPA)
Reliance	625000
Finolex Industries	272000
DCW	90000
DCM Shriram	70000
Chemplast	270000

Source: Industry, SMIFS Research

### Plastic Pipes demand in India (MT'000)



Source: Industry, SMIFS Research

### PVC Pipes market split (MT)



Source: Industry, SMIFS Research

**PVC resin** is derived from the polymerization of vinyl chloride and is the third largest polymer in terms of production and consumption. It is custom-made for utilization as a common plastic material in the agriculture and construction sector and is used in pipes and fittings, window frames and shutters, wires and cables and coating etc. It is also a preferred plastic material for application in flooring, films and sheets etc. In India, approx. 73% of the total resin is consumed by pipe manufacturers. With the increase in demand for pipes, the consumption of PVC resin is estimated to grow at a consistent rate.

The total installed capacity of the domestic PVC industry is about 15.57 lakh tonnes. There are mainly 5 players in the industry, Reliance Industries Limited being the market leader with a market share of 20-30%. More than 50% of the domestic PVC demand is met via imports due to limited capacity available in the domestic market. Major players have not planned any capacity addition in this space due to the capital intensive, long gestation nature of PVC resin projects.

Pipe and other users of PVC import PVC resins from Korea, Japan, Singapore etc. Raw materials like EDC / VCM are generally imported from the Gulf. PVC resin prices in the domestic market are kept in parity with the import market after taking the impact of currency.

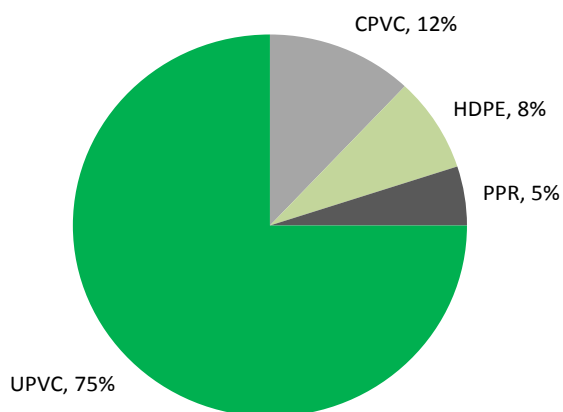
### Pipes and Fittings

India's plastic pipe industry has grown at a CAGR of 9% from FY 2013 to FY 2019 and is estimated to reach a value of approx INR318 billion in FY 2019-20. The demand for PVC pipes and fittings is currently at 20 lac MT and is likely to expand at a CAGR of 14.7% during FY 2018 to FY 2026.

The primary growth drivers of this market in India are well supported by the government investments in irrigation, and housing & sanitation, through scheme such as Housing for All, Atal Mission for Rejuvenation and Urban Transformation (AMRUT) and Pradhan Mantri Krishi Sinchayee Yojana (Prime Minister Agriculture Irrigation Scheme). India has very low per capita plastic consumption of approximately 11 kg compared with the global average of 30kg. Traditional materials dominate the application areas of plastic.

## Industry Overview

### Plastic Pipe market split



Source: Industry SMIFS Research

The CPVC pipe in India had been growing at a faster rate than the existing plastic pipe system. The Indian CPVC market stood at INR30-35bn (10-13% of overall piping market) and has been growing faster pace than the overall plastic piping industry. We expect the CPVC market to continue to grow at more than 20% over the next 4-5 years.

### PVC Pipes & Fittings market presence

Players	Presense	Capacity (MTPA)
<b>Finolex Industries</b>	<b>Mostly Agriculture, recently added Non-Agri and CPVC</b>	<b>272000</b>
Supreme Industries	Plumbing, Industrial, Agriculture,	418000
Astral Poly	Mostly Plumbing, recently added Agriculture	221000
Ashirwad	Mostly Plumbing and Industrial	108000

Source: Industry SMIFS Research

### Types of Pipes and applications

Partuculars	Ductile Iron Pipes	Galvanised Iron Pipes	Plastic Pipes	Cement Pipes
<b>Application Size</b>	<b>Large</b>	<b>Medium</b>	<b>Small</b>	<b>Large</b>
<b>Application Areas</b>	Potable water transmission Sewer lines Water supply for Industrial	Internal water transportaion Plumbing Irrigation	Internal water transportaion Plumbing Hot water supply Waste discharge Irrigation	Sewage Sanitation Drainage water
<b>Advantage</b>	Duarable waitstand high pressure Easily welded	Duarable waitstand high pressure	Cheaper Corrosive free Light weight	Cheaper suitable for all water withstand to high presssure
<b>Disadvantage</b>	Expensive Not Corrosive free Heavy High transportation cost	Expensive Not Corrosive free Heavy	Low withstand to heat Reactive to acidic water	Heavy Difficult to maintain & repair High transportation cost

Source: Industry SMIFS Research

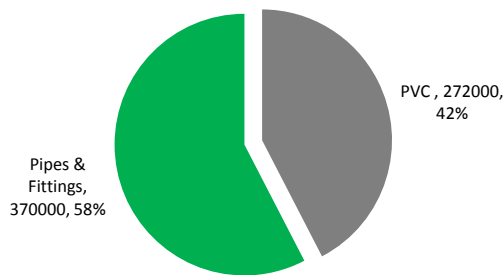
## Company Overview

**2nd largest Pipes & Fittings capacity**

Finolex Industries Ltd. (FIL) is India's leading manufacturer of PVC Pipes & Fittings and the second largest PVC Resin manufacturer. The company has its headquarters in Pune. FIL operates through its state of the art manufacturing plants located in Pune, Ratnagiri in Maharashtra and Masar in Gujarat. Unlike its peers – Supreme and Astral – FIL is 'backward integrated into manufacturing of PVC resin of capacity 272,000MT (includes emulsion grade capacity of 22,000MT) as well.

Finolex Industries Ltd (FIL) was incorporated in 1981 and is a part of Finolex group. The Finolex group comprises of two listed companies, Finolex Industries which is managed by Mr. Prakash Chhabria (Executive Chairman) and Finolex Cables which is managed by Mr. D.K Chhabria (Executive Chairman). There is a cross holding between the group companies. **Finolex Cables holds 32.4% of FIL and FIL holds 14.5% of Finolex Cables.**

### Capacity mix (MT)



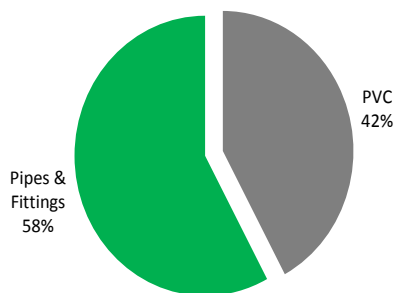
Source: Company Data, SMIFS Research

FIL has two business units- 1) PVC resin; 2) Pipes and Fittings

**PVC Resin-** Finolex is the second largest player in PVC resins after Reliance Industries. PVC finds applications in manufacturing of pipes, insulation of cables, window profiles, flooring, blister packaging, etc.

The company has its resin manufacturing plant in Ratnagiri spreading across an area of over 650 acres. The plant has been set up in technical collaboration with Uhde GmbH, Germany with Hoechst technology. This plant manufactures both suspension and emulsion PVC and has an annual output of 272,000 m.t.p.a.

### Revenue mix (%)



\* includes revenue of captive consumption of PVC resin

Source: Company Data, SMIFS Research

#### Grades of PVC resin:

- Suspension PVC - Rigid and Semi Rigid applications eg. pipes, conduits, hoses and tubes, wire and cable coating, calendered films/sheets, extruded profiles cable/footwear compounds etc. This form dominates FIL's production.
- Emulsion PVC – Flexible applications eg. leather cloth, foam leather, undercoating of expensive cars (to conceal noise), crown caps, conveyor belting and tarpaulin coating etc.

## Company Overview

**PVC**  
Pipes: 400+ SKU's  
Fittings: 1000+ SKU's

**CPVC**  
Pipes: 37+ SKU's  
Fittings: 175+ SKU's

The Company's association with Lubrizol, USA from 2017, provides the Company with the technological setup to manufacture and market FlowGuard Plus CPVC pipes and fittings in India. FlowGuard technology enabled pipes are ideal for the continuous flow of hot and cold potable water. These pipes are used in the following areas: manufacturing plants, hospitals, educational institutions, swimming pools, hotels and resorts, corporate houses, etc.

### 2) Pipes & Fittings

FIL is the largest PVC pipe manufacturer in India. FIL offers a wide range of PVC pipes and fittings for diverse applications in agriculture and housing. The pipes range between 20 mm to 400 mm diameter (max length of 6 m).

The current capacity of Pipes and Fittings stands at 370000MT which include CPVC capacity of 10000MT. The Pipes & Fittings segment is currently contributing 83% of Total Revenue and 35% share in EBIT. Around 75% of PVC resin production is captive consumed by the Pipes segment and since transfer price is fixed at market price, the incremental margins from the captive consumption are reflected in the PVC resin segment.

The management furthers aims to increase the capacity by 30000MT each year with a capex of INR100 cr p.a.

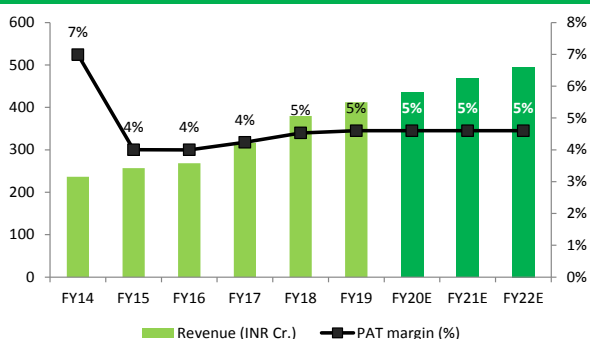
As a part of its PVC Complex, FIL has also set up an open sea cryogenic jetty, the first of its kind in the Indian private sector, through which the feedstock is transported to the plant from the importing ships. The jetty closes for four months in a year during the monsoon – from mid-May to mid- September – and, therefore, the feedstock for these months is stored in tanks next to the jetty.

### Segment dynamics

Particulars	Agri Pipes	Non-Agri Pipes
Diameter	4-8 inches	1/2-3 inches
Key Products	Rigid PVC and Coulumnn Pipes	UPVC, CPVC, SWR,ASTM
Fittings required (as a % of total volume)	5%	15%
Price	Relatively Cheaper	20-25% higher than Agri Pipes
Margin	6-8%	10-12%
Usage	linking canals to farmlands	plumbing, water discharge

Source: Industry SMIFS Research

### Finolex Plasson



Source: Company Data, SMIFS Research

**Land bank:** Finolex owns 70 acres of land in Pune of which 15 acres are used for offices and warehousing. The market price of land in the area is approximately INR10cr per acre, as per channel check. The management currently intends to monetize this asset.

Besides this, **FIL owns 46% stake in Finolex Plasson Ltd which is in the operation of Micro Irrigation business.** It provides solution in Drip and Sprinkler Irrigation Systems and Turn- Key projects for all Agriculture sectors such as Row Crops, Horticulture, Green Houses, Plantations, Nurseries. In FY19 the company earned a revenue of INR412cr and a PAT of INR19cr.



## Company Overview

**850+ Dealers network**

**1800+ Retail touch points**

## Plant Location



Source: Company Data, SMIFS Research

## Product Portfolio

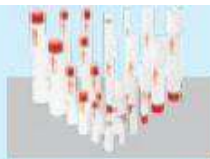
### Agri Segment (70%)



Agriculture Pipes & Fittings



Casing Pipes



Column Pipes



Solvent Cement & Lubricant



PVC Resin

### Non-Agri Segment (30%)



FlowGuard Plus  
CPVC Pipes & Fittings



Plumbing Pipes & Fittings



Sewerage Pipes



SWR Pipes & Fittings



Solvent Cement & Lubricant

Source: Company Data, SMIFS Research

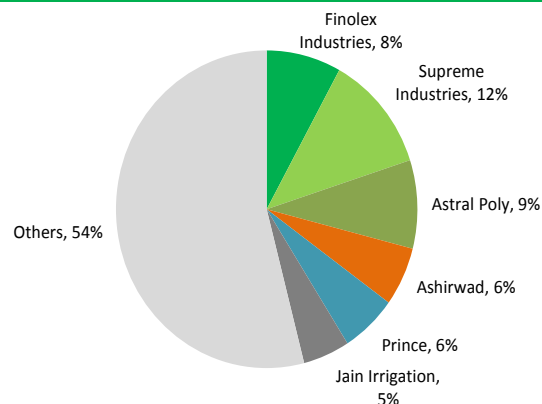
## Competitive Analysis

### Types of Pipes and major players

Types of Pipes	Major Players
PVC-Non Agri	Supreme, Astral, Ashirwad, Finolex
PVC-Agri	Finolex, Jain Irrigation, Supreme
CPVC	Supreme, Astral, Ashirwad

Source: Company Data, Industry, SMIFS

### PVC Pipes market share by top players



Source: Company Data, Industry, SMIFS

### Revenue mix (%)

Company	Non-Agricultural	Agricultural
Finolex	30%	70%
Supreme	35%	65%
Astral	15%	85%

Source: Company Data, Industry, SMIFS

### PVC Pipes market share by top players

Players	Capacity (MTPA)
<b>Finolex Industries</b>	<b>272000</b>
Supreme Industries	418000
Astral Poly	221000
Ashirwad	108000

Source: Company Data, Industry, SMIFS

### Region mix (%)

Regions	Demand split	Major Players
West	30%	Finolex, Astral, Supreme, Jain Irrigation
South	35%	Astral, Finolex, Supreme, Prince, Ashirwad
North	20%	Astral, Supreme, Finolex, Prince
East	15%	Supreme, Astral, Ashirwad, Finolex

Source: Company Data, Industry, SMIFS

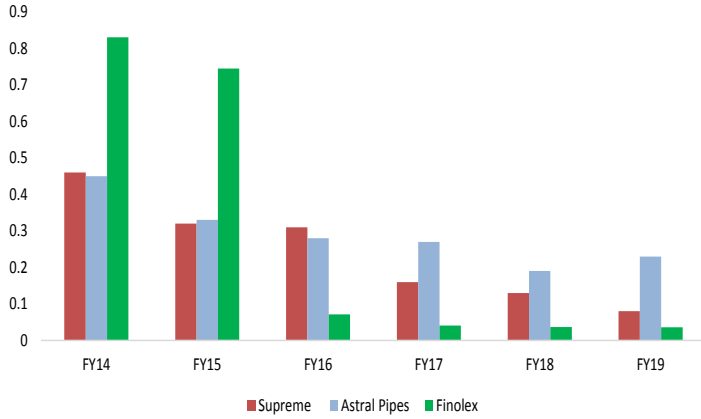
### Advertisement Expense as % to Revenue

Company	FY19	FY18
Finolex	2.2%	1.4%
Supreme	1.4%	1.2%
Astral	3.3%	3.6%

Source: Company Data, Industry, SMIFS

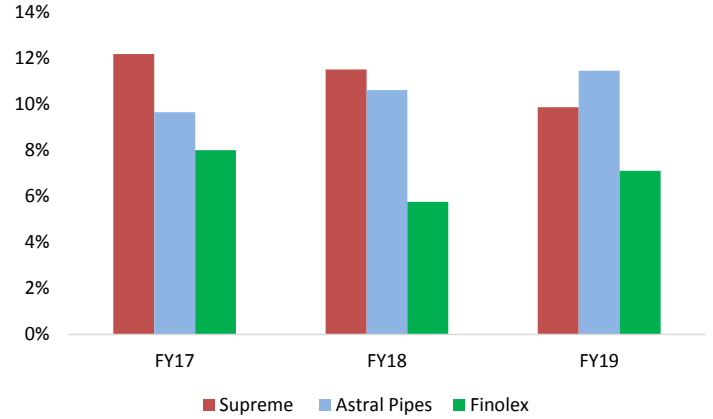
## Competitive Analysis

### Debt-Equity (x)



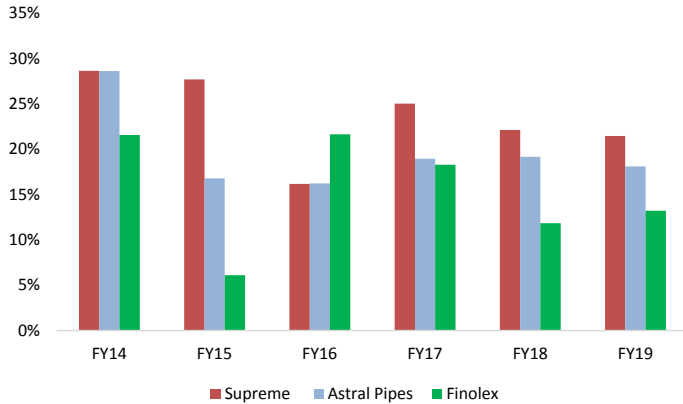
Source: Company Data, SMIFS Research

### EBIT margin from Pipes segment (%)



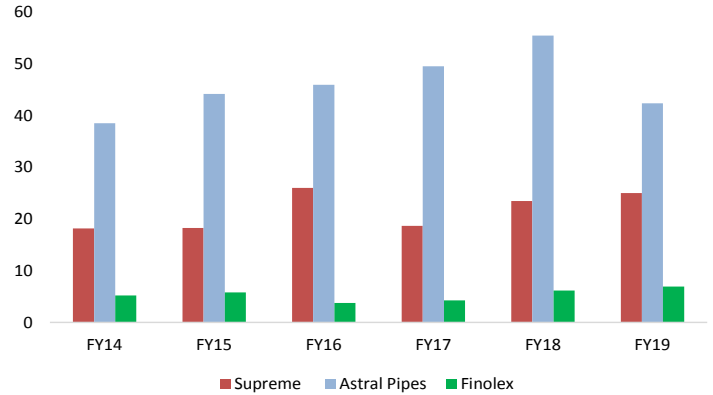
Source: Company Data, SMIFS Research

### ROE at company level (%)



Source: Company Data, SMIFS Research

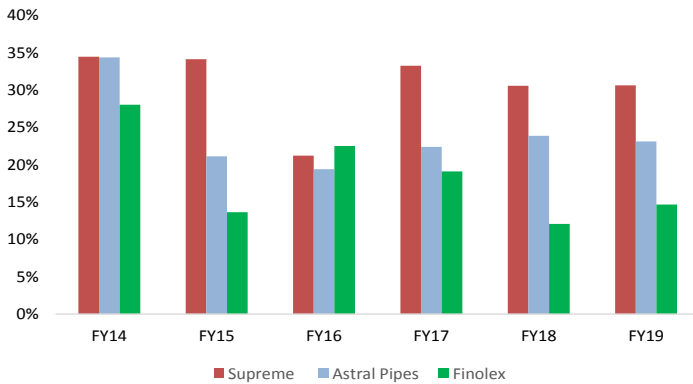
### Receivable days lowest for Finolex Industries



Source: Company Data, SMIFS Research

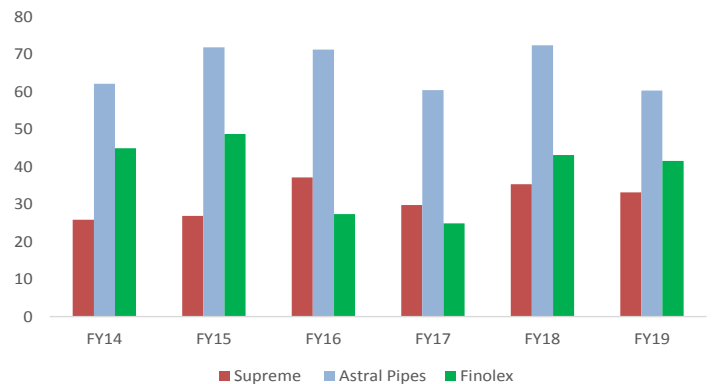
Finolex Industries follows "Cash-and-Carry" model for its sale in Agri segment. This has let the company to enjoy a very low receivable days in the past.

### ROCE at company level (%)



Source: Company Data, SMIFS Research

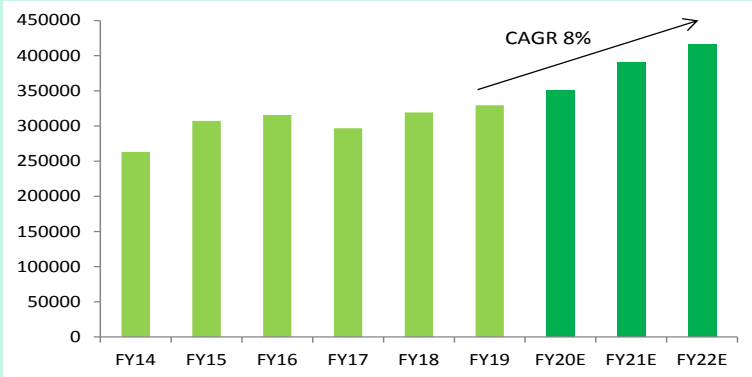
### Working Capital days



Source: Company Data, SMIFS Research

## Key Performance Indicators

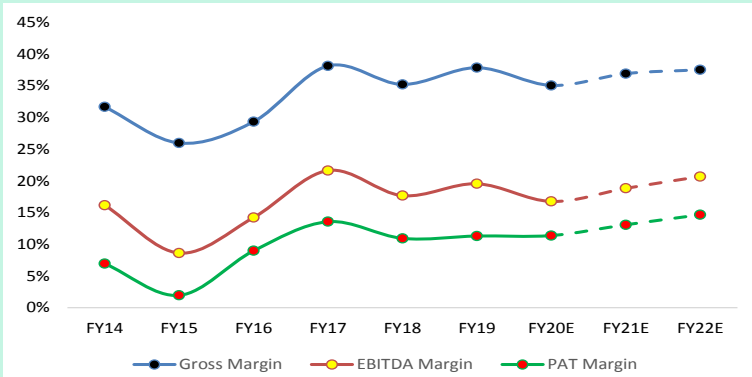
### Volume growth (MT)



Capacity expansion in the Pipes & Fittings segment to augur growth in Total Volume sold. We expect the total volumes to grow at a CAGR of 8% going forward.

Source: Company Data, SMIFS Research

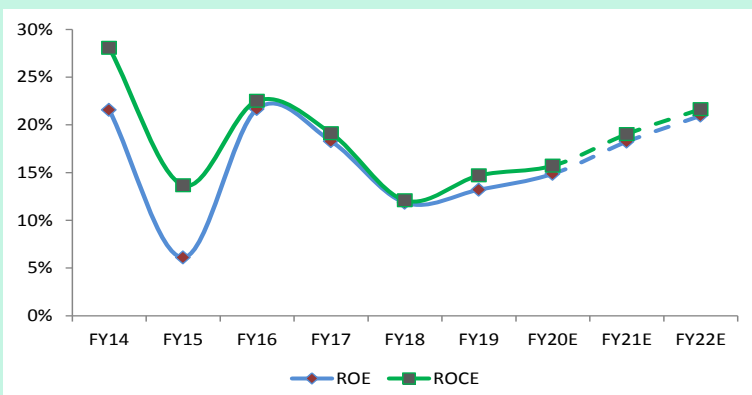
### Margins (%)



With share of revenue from Non-Agri Pipes & Fittings increasing and within that share of CPVC segment growing, we expect the margins to improve and remain stable going forward.

Source: Company Data, SMIFS Research

### Profitability Ratios (%)

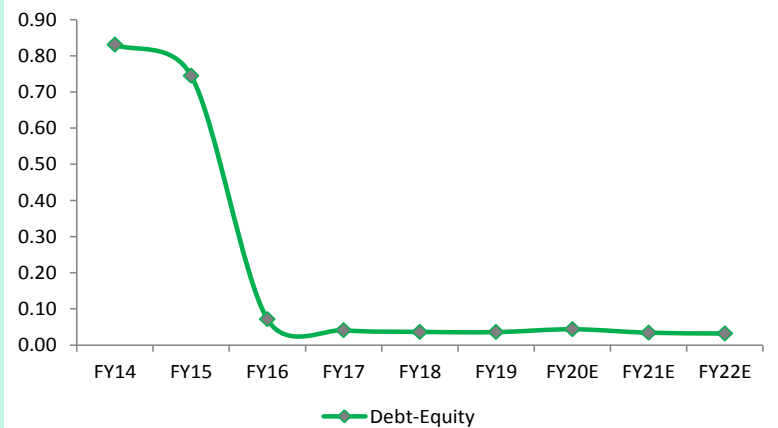


With improved margins coming from increased volumes sold in the PVC pipes as well as CPVC pipes segment, ROE (%) and ROCE (%) are likely to improve going forward.

Source: Company Data, SMIFS Research

## Key Performance Indicators

### Strong Balance Sheet

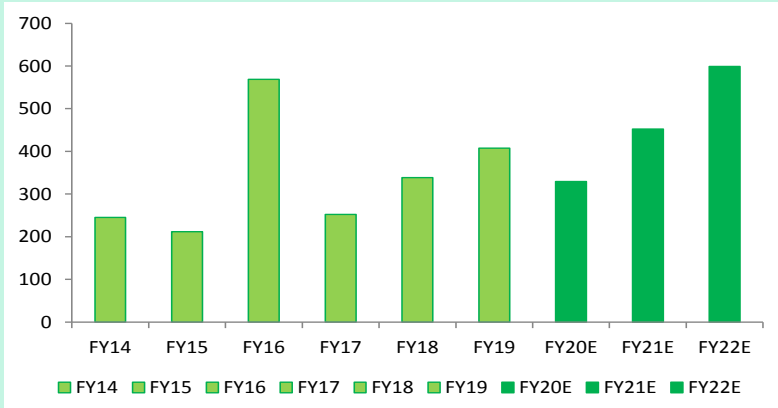


Source: Company Data, SMIFS Research

The company has become a Zero Debt company after it discharged its long term debt in FY16.

Also strong cash flow generated from operations every year due to low working capital cycle remained sufficient to fund any capacity expansion in Pipe segment.

We expect the dividend payout ratio to increase going forward on the back of high cash flow from operations and low capex.



Source: Company Data, SMIFS Research

## Outlook & Valuation

**Transformation from B2B to B2C could gradually reduce the earnings volatility going forward and builds a case for a re-rating in the stock price valuations.**

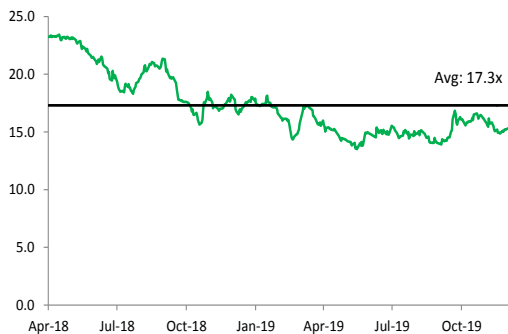
FIL is a market leader in the Agri pipes segment. Given the Government's strong focus on agriculture and the increasing disposable incomes of farmers, the demand from irrigation is expected to remain robust.

The company has been late entrant to the Non-Agri segment where its peers have enjoying high margins. However, over the last few years FIL has been fast ramping up its Non-Agri business. From FY18, the company has tied up with "Lubrizol" and introduced CPVC pipes & fittings under the brand "Flowguard" which typically trades at a premium over normal PVC pipes and used for hot water flow in household plumbing.

Earlier with higher exposure coming from external sale of PVC resins, the profitability has remained highly volatile due to high volatility in PVC-EDC spread. However, with the company expanding capacities of PVC pipes and increasing the captive consumption of PVC Resins, the exposure towards volatility of PVC-EDC spread or PVC prices gets reduced as any price increase in raw materials are immediately passed on. Hence, the transformation from B2B to B2C could gradually reduce the earnings volatility going forward and builds a case for a re-rating in the stock price valuations.

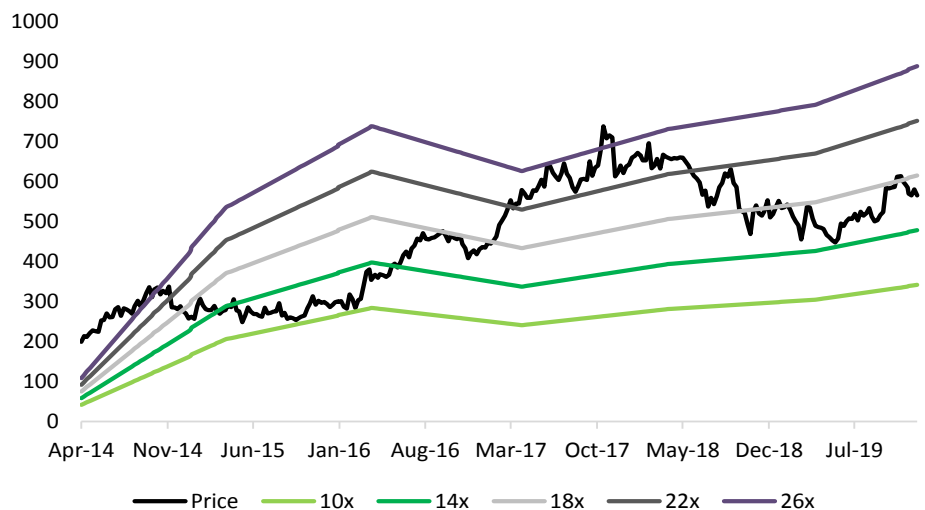
FIL is known for its strong brand "Finolex" leveraged from a very large distribution network built over the years. Currently the company has 805+ dealer network and 1800+ retail touch points across India.

### Finolex Ind: 1 Year Fwd P/E



Source: NSE, SMIFS Research

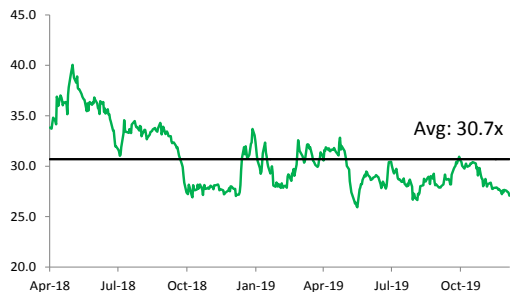
### 1 year forward Price Band



Source: Company Data, SMIFS Research

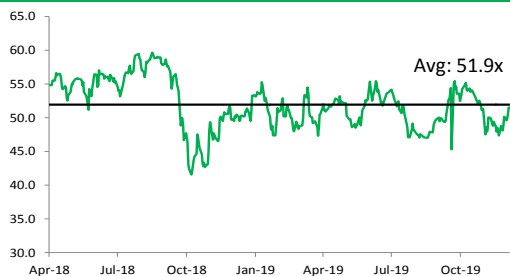
## Peer Analysis

### Supreme Ind: 1 Year Fwd P/E



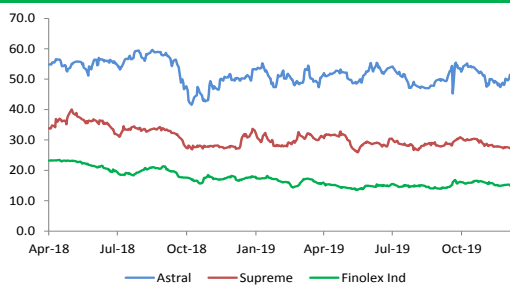
Source: NSE, SMIFS Research

### Astral Poly: 1 Year Fwd P/E



Source: NSE, SMIFS Research

### 1 Year Fwd P/E: Peer comparison



Source: NSE, SMIFS Research

At the CMP we believe that the market is not factoring the benefits of the transformation from B2B to B2C business model and that there is scope for a re-rating. We believe FIL has traded at a discount over its peers because of earnings volatility in the past. Supreme and Astral are not integrated to the feedstock PVC resin and, therefore, have much more stable margins.

Currently the stocks trades at 10.5x times FY22E EPS which is at a 50% discount to Supreme and 70% to Astral. Going forward we believe the discount gap to narrow and emulate valuation as its peers based on the 1) high volume growth aided by capacity expansion of Pipes & Fittings segment; 2) higher margins from ramping up CPVC segment; and 3) reduced volatility in earnings due to transformation from B2B to B2C business model.

We value the company on a SOTP basis by assigning a multiple of 15x to its FY22E standalone EPS of INR52.27 and taking a value of INR44.7 per share for its investments in Finolex Cables, Finolex Plasson and a land in Pune to arrive at **Target price of INR829**.

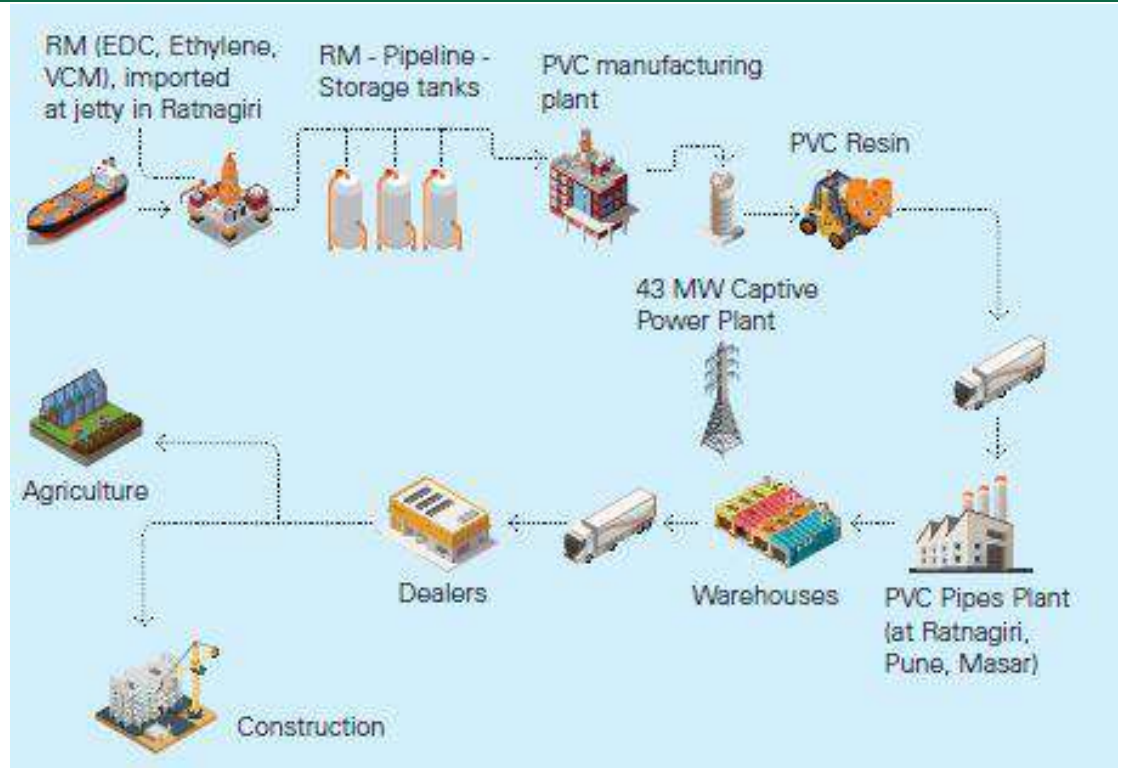
Particulars	Method	Multiple	FY22E EPS	Value	Discount	Net Value	
Finolex Industries	P/E		15	52.27	784	-	784
<b>Value of Other Investments</b>							<b>554.2</b>
Finolex Cables Ltd	14%	Market Value	-	3175*	50%	222	
Finolex Plasson	46%	P/E	5	22.8	50%	57	
Land		Market Value		550	50%	275	
<b>No. of shares</b>						<b>12.41</b>	
<b>Total Value per share</b>						<b>829</b>	

## Key Risks

- **Spread Risk (High):** Any sharp and sudden decrease in global demand for PVC could lead to a fall in PVC resin prices which in turn could narrow the spread of PVC/EDC adversely impacting profitability and also result in inventory losses. Similarly, a rise in prices of key feedstock i.e. EDC, Ethylene and VCM could also reduce the spread of PVC/EDC/VCM and impact the profitability adversely.
- **Slowdown in housing risk (Medium):** A slowdown in demand for pipes might affect the demand for PVC Pipes the business of the company.
- **Threat of competition (Medium):** About 40% of the PVC pipe industry is dominated by the unorganized sector. The capex requirements for the industry are low and hence the fragmented nature of the industry. FIL products currently command about a 25% premium to the unorganized players and a 5% premium to other organized players given its leadership position. Increase in competition or an attempt to increase market share could lead to this premium shrinking.
- **Currency Risk (Medium):** PVC pricing is on import parity and import parity value of sales of the Company approximately equates the USD payables on a six monthly rolling basis due to which a natural hedge exists and hence the Company does not generally need to resort to hedging by way of forward contracts, options, etc. However it is still highly exposed to currency fluctuation risk since it imports its Raw Materials for manufacturing PVC resin. Hence, any sharp fluctuation in currency can negatively impact the earnings for FIL.
- **Investments in group company (Low):** FIL currently hold 14% stake in their group company - Finolex Cables Ltd. Currently the market cap of Finolex cable stands at around INR5400 cr. Any sharp drop in value of the group company can reduce the investment value of FIL.



**Appendix-1: PVC manufacturing process**



Source: Company Data, SMIFS Research

## Financial Details

Income Statement (Standalone)					INR Cr.
Particulars (Y/E March)	FY18	FY19	FY20E	FY21E	FY22E
<b>Net Revenue</b>	<b>2738</b>	<b>3091</b>	<b>3434</b>	<b>3970</b>	<b>4422</b>
COGS	1773	1921	2229	2503	2762
<b>Gross Profit</b>	<b>964</b>	<b>1170</b>	<b>1206</b>	<b>1466</b>	<b>1661</b>
Other Operating Expenses	480	566	629	718	745
Total Operating Expenses	2254	2487	2857	3222	3507
<b>EBITDA</b>	<b>484</b>	<b>604</b>	<b>577</b>	<b>748</b>	<b>916</b>
Depreciation & Amortisation	60	69	73	77	81
Other Income	25	42	32	31	32
<b>EBIT</b>	<b>449</b>	<b>577</b>	<b>536</b>	<b>702</b>	<b>867</b>
Interest Cost	10	12	13	14	13
<b>PBT</b>	<b>440</b>	<b>535</b>	<b>523</b>	<b>687</b>	<b>854</b>
Tax expense	140	186	131	168	205
<b>PAT</b>	<b>299</b>	<b>350</b>	<b>392</b>	<b>520</b>	<b>649</b>

Source: Company Data, SMIFS Research

Balance Sheet (Standalone)					INR Cr.
Particulars (Y/E March)	FY18	FY19	FY20E	FY21E	FY22E
Share Capital	124	124	124	124	124
Reserves & Surplus	2642	2405	2607	2843	3098
<b>Networth</b>	<b>2766</b>	<b>2529</b>	<b>2731</b>	<b>2967</b>	<b>3222</b>
Long term Borrowings	(0)	(0)	(0)	(0)	(0)
Other Non-Current Liabilities	199	230	209	213	217
Short term Borrowings	101	91	119	101	103
Other Current Liabilities	390	425	436	466	514
<b>Total Equity &amp; Liabilities</b>	<b>3456</b>	<b>3275</b>	<b>3495</b>	<b>3747</b>	<b>4056</b>
Net Tangible Asset	881	949	1024	1097	1165
CWIP	90	90	101	94	95
Non Current Investments	1490	1077	1077	1077	1077
Other Non-Current Assets	173	104	104	104	104
Inventories	612	620	705	785	902
Trade Receivables	43	74	172	276	344
Cash and Cash Equivalents	25	30	5	9	62
Current Investments	66	226	226	226	226
Other Current assets	76	103	81	79	81
<b>Total Assets</b>	<b>3455</b>	<b>3275</b>	<b>3495</b>	<b>3747</b>	<b>4056</b>

Source: Company Data, SMIFS Research

Source: Company Data, SMIFS Research

## Financial Details

Cash Flow Statement (Standalone)					INR Cr.
Particulars (Y/E March)	FY18	FY19E	FY20E	FY21E	FY22E
<b>PBT</b>	<b>440</b>	<b>535</b>	<b>523</b>	<b>687</b>	<b>854</b>
Depreciation & Amortisation	60	69	73	77	81
Dividend & Interest earned	(8)	(18)	(10)	(10)	(11)
Interest expense	10	12	13	14	13
(Increase)/Decrease in CA	(31)	(50)	(180)	(182)	(187)
Increase/(Decrease) in CL	(10)	37	30	24	46
Taxes Paid	120	177	121	159	197
<b>Cash Flow from Operating Activities</b>	<b>338</b>	<b>407</b>	<b>329</b>	<b>452</b>	<b>599</b>
Capital Expenditure	(172)	(103)	(161)	(143)	(151)
Interest & Dividend Received	8	10	10	10	11
<b>Cash Flow from Investing Activities</b>	<b>(162)</b>	<b>(237)</b>	<b>(151)</b>	<b>(133)</b>	<b>(140)</b>
Increase/(Decrease) in Borrowings	7	(10)	29	(18)	2
Dividend Paid	(172)	(150)	(189)	(282)	(391)
<b>Cash Flow from Financing Activities</b>	<b>(175)</b>	<b>(172)</b>	<b>(174)</b>	<b>(314)</b>	<b>(402)</b>
<b>Net Cash Flow</b>	<b>1</b>	<b>(1)</b>	<b>4</b>	<b>5</b>	<b>56</b>
<b>Closing Balance</b>	<b>8</b>	<b>9</b>	<b>5</b>	<b>9</b>	<b>62</b>
Key Ratios					
Particulars (Y/E March)	FY18	FY19	FY20E	FY21E	FY22E
Margins					
Gross Margin	35.2%	37.9%	35.1%	36.9%	37.5%
EBITDA Margin	17.7%	19.5%	16.8%	18.8%	20.7%
PBT Margin	16.1%	17.3%	15.2%	17.3%	19.3%
PAT Margin	10.9%	11.3%	11.4%	13.1%	14.7%
Per Share Data					
BVPS	222.88	203.83	220.07	239.07	259.66
EPS	24.12	28.17	31.61	41.87	52.27
Cash EPS	27.27	32.84	26.51	36.42	48.26
DPS	11.50	10.00	12.64	18.84	26.14
No. of Shares	12.41	12.41	12.41	12.41	12.41
Profitability Ratios					
RoE	11.8%	13.2%	14.9%	18.2%	21.0%
ROCE	12.1%	14.7%	15.8%	19.0%	21.7%
RoA	8.7%	10.7%	11.2%	13.9%	16.0%
Valuation Ratios(x)					
P/E	22.7	19.4	17.3	13.1	10.5
P/BV	2.5	2.7	2.5	2.3	2.1
EV/EBITDA	14.0	11.0	11.6	8.9	7.2
Du-Pont Analysis					
Particulars	FY18	FY19	FY20E	FY21E	FY22E
PBT Margin	16.1%	17.3%	15.2%	17.3%	19.3%
Asset Turnover(x)	0.85	0.92	1.01	1.10	1.13
Financial Leverage(x)	1.27	1.27	1.29	1.27	1.26
Tax Burden	31.9%	34.7%	25.0%	24.4%	24.0%
ROE	11.8%	13.2%	14.9%	18.2%	21.0%

Source: Company Data, SMIFS Research

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