

TRANSFORMERS & RECTIFIERS INDIA

INR 715



Riding the wave

BUY

* **Generation capacity addition in Eleventh Plan ~3x Tenth Plan**

India is expected to add ~60,000 MW of generation capacity in the Eleventh Plan, which is more than what was added in the past fifteen years. Transformers & Rectifiers India (TRIL), one of the leading domestic transformer manufacturers, is likely to benefit from the ~3x increase in generation capacity as it is likely to boost demand for transformers.

* **Vertical integration: Leading to pricing flexibility**

TRIL has a vertically integrated business model wherein it manufactures transformer tanks and steel radiators internally. This offers the company higher pricing flexibility and also lowers the risk profile of an essentially cyclical business.

* **Diversified product portfolio; leader in furnace transformers**

TRIL manufactures a wide range of transformers and caters to a diverse set of industries. The company has a dominant presence in the power and distribution transformers segment and is a leader in the furnace transformers niche with ~40% market share. We believe the diverse product profile results in diversification of end customer base, thus providing greater factor of safety.

* **Outlook and valuations: Robust growth; initiating coverage with 'BUY'**

We believe the domestic macro environment is positive for transformer companies and TRIL's revenue and earnings growth is likely to be strong over the long term (revenues at 53% and earnings at ~57% CAGR for FY07-10E). However, capacity expansion over the next year is likely to dampen the company's return ratios from current levels.

The stock is trading at a P/E of ~19x and ~12x for FY09E and FY10E, respectively. We believe TRIL offers high revenue and earnings growth and superior return ratios compared to other companies in the power transmission and distribution space. We initiate coverage on the stock with a 'BUY' recommendation.

Financials

Year to March	FY07	FY08E	FY09E	FY10E
Revenue (INR mn)	2,212	3,372	5,095	7,928
Rev. growth (%)	69.1	52.4	51.1	55.6
EBITDA (INR mn)	363	639	848	1,323
Net profit (INR mn)	194	359	485	758
Shares outstanding (mn)	7	13	13	13
EPS (INR)	27.4	27.8	37.6	58.7
EPS growth (%)	144.2	1.4	35.1	56.2
P/E (x)	26.1	25.7	19.0	12.2
EV/ EBITDA (x)	25.8	14.2	10.9	7.1
ROAE (%)	63.0	28.6	20.9	26.5
ROACE (%)	64.7	40.5	30.7	38.8

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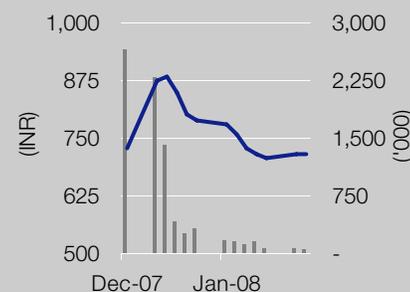
Reuters : TRNF.BO
Bloomberg : TRIL IN

Market Data

52-week range (INR) : 939 / 685
Share in issue (mn) : 12.9
M cap (INR bn/USD mn) : 9.2 / 233.5
Avg. Daily Vol. BSE ('000) : 634.3

Share Holding Pattern (%)

Promoters : 76.8
MFs, FIs & Banks : 7.6
FIs : 5.6
Others : 10.0



Investment Rationale

* Generation capacity addition in Eleventh Plan ~3x Tenth Plan

In the Eleventh Plan, India is expected to add ~60,000 MW of generation capacity, which is more than what was added in the past fifteen years. This target is achievable, as ~52,365 MW of capacity is already under construction. The ~3x jump in capacity addition is likely to boost demand for transformers and leading transformer companies like TRIL are likely to benefit from the same.

* Tight demand-supply situation

In FY07, the transformer industry produced ~130,000 MVA of transformers.

Table 1: Transformer industry in India

Market size in FY07 (March YE)	Production (MVA)	Market size (INR bn)	Growth, Y-o-Y (%)
Power transformers	83,668	33.5	26.1
Distribution transformers	50,068	47.5	22.5

Source: IEEMA Databank

Demand is likely to continue to outstrip supply given the generation capacity addition, replacement demand, and exports in power transformers. Given below is our estimate of annual transformer demand in India, assuming ~ 10 MVA transformation capacity required for every 1 MW of power generated.

Table 2: Transformer demand in MVA

		Replacement demand				
		5%	10%	15%	20%	25%
Power generation capacity	50,000	125,000	130,000	135,000	140,000	145,000
	55,000	137,500	143,000	148,500	154,000	159,500
	60,000	150,000	156,000	162,000	168,000	174,000
	70,000	175,000	182,000	189,000	196,000	203,000
	75,000	187,500	195,000	202,500	210,000	217,500

Source: Edelweiss research

On the basis of our above projection, we believe industry margins are likely to remain strong over the medium to long term. However, industry capacity (Table 1) is likely to be understated due to presence of an unorganized market primarily catering to the distribution transformer segment. Consequently, margin pressure is likely in the distribution transformer segment, which may negate margin gains in the power transformer segment to a certain extent.

* Rural electrification upgradation to gather steam

Under the Rajiv Gandhi Grameen Vidhyutikaran Yojna (RGGVY), electricity distribution infrastructure is envisaged to establish Rural Electricity Distribution Backbone (REDB) with at least 33/11 kV substations and distribution transformers. We believe, distribution reforms like RGGVY addressing rural vote banks are likely to gather steam before the next general elections, which will boost demand for distribution transformers in the medium to long term.

*** Increasing capacity to fuel growth**

TRIL is increasing its annual transformer capacity from ~7,200 MVA to ~23,200 MVA by Q1FY09E. Given high projected capacity utilization of ~83% in FY08, we believe capacity expansion was imminent to fuel growth. Further, TRIL will be able to cater to the higher-end 400 kV transformer class, which is a positive, given the high entry barriers in high-end transformers.

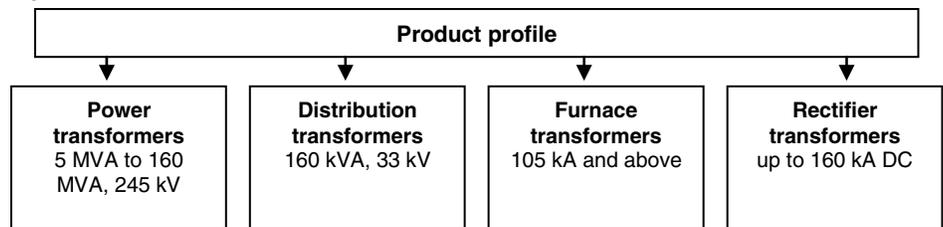
*** Vertical integration: Leading to pricing flexibility**

TRIL has a vertically integrated business model wherein it manufactures transformer tanks and steel radiators internally. The company has two subsidiaries—Transweld and Transpares—which manufacture transformer tanks and steel radiators, respectively. We believe vertical integration offers the company higher flexibility in pricing and also lowers the risk profile of an essentially cyclical business.

*** Diversified product portfolio; leader in furnace transformers**

TRIL offers a wide range of transformers and caters to a diverse set of industries. The company has a dominant presence in the power and distribution transformers segment and is a leader in the furnace transformers niche. It produces up to 63 MVA furnace transformers used in steel and ferro alloy industries.

Fig.1: TRIL—Product profile



Source: Company, Edelweiss research

TRIL has a ~40% market share in the furnace transformers segment. Its key customers include utilities and power transmission companies, and its client base covers various state electricity boards and PSUs like Maharashtra State Electricity Transmission Company and Gujarat Energy Transmission Corporation. Additionally, some of its key private sector customers are Rohit Ferro-Tech, Monnet Ispat & Energy, Inductotherm (India), amongst others. We believe the diverse product profile results in diversification of end customer base, thus providing greater factor of safety.

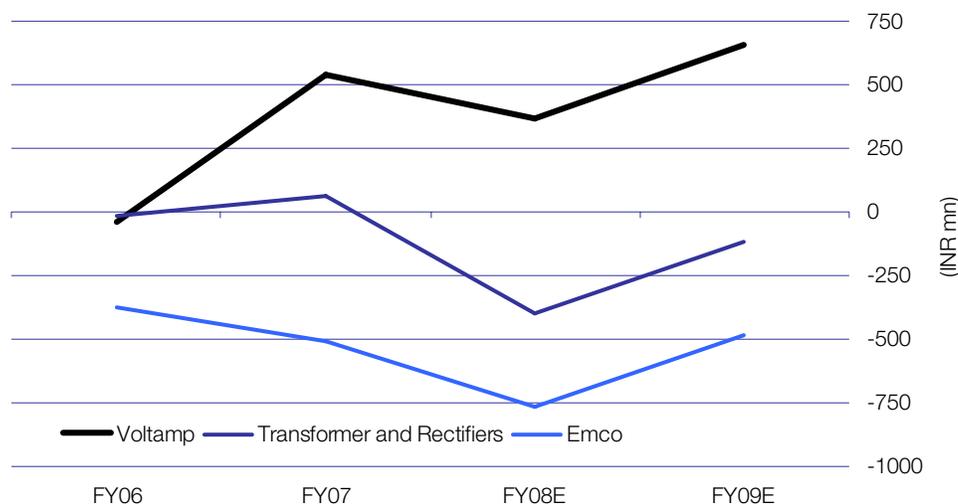
*** Wide customer base and long term relationships**

TRIL is the preferred supplier to many utilities and industrial companies in India, primarily because of its track record in providing transformers to these customers on an uninterrupted basis. The company has received repeat orders from power generation, transmission, and distribution entities and industrial clients.

Valuation

TRIL has strong presence in the power transformers segment, wherein it primarily caters to utilities and SEBs. Since working capital requirements when catering to SEBs are high, TRIL's cash flows and return ratios are impacted negatively. Going ahead, the contribution of SEBs is likely to increase as TRIL diversifies into the 400 kV class of transformers, thus impacting cash flows negatively. While we believe TRIL offers high revenue and earnings growth, its cash flows and return ratios are marginally lower than its peers.

Chart 1: Peer comparison—Operating cash flows



Source: Edelweiss research

We believe the domestic macro environment is positive for transformer companies and TRIL's revenue and earnings growth is likely to be strong over the long term (revenues at 53% CAGR and earnings at ~57% CAGR for FY07-10E). However, capacity expansion over the next year is likely to dampen its return ratios from current levels. The stock is trading at a P/E of ~19x and ~12x for FY09E and FY10E, respectively. We believe TRIL offers high revenue and earnings growth and superior return ratios compared to other companies in the power transmission and distribution space. Valuation upsides can be driven by the new capacity stabilizing earlier than our expectations. We initiate coverage on the stock with a 'BUY' recommendation.

Table 3: Peer comparison RoCEs;

Peer comparison - Transformer manufacturing	P/E			RoCEs		
	FY07	FY08E	FY09E	FY07	FY08E	FY09E
Voltamp	41.7	22.0	16.7	62.7	81.5	67.1
EMCO	39.0	28.3	24.8	22.3	15.7	11.4
Indotech	29.0	NA	NA	44.3	NA	NA
TRIL	26.1	25.7	19.0	64.7	40.5	30.7

Source: Edelweiss research

Key Risks

* **Delay in power generation capacity addition**

Although TRIL has diversified into specialty transformers, power generation and distribution sectors still contribute substantially (~87%) to its total revenue. Any delay in power generation capacity addition could severely impact demand for transformers, thus negatively impacting the company's profitability and growth profile.

* **Volatility in raw material prices**

Copper and CRGO steel typically contribute ~70% to the total raw material cost of a transformer. Volatility in raw material prices can impact TRIL's margins negatively.

* **Execution risk of expanded capacity**

TRIL is aggressively ramping up its capacity from 7,200 MVA to 23,200 MVA by Q1FY09E, implying a two fold growth in capacity. Any slow down or delay in the expansion programme is likely to hamper its growth potential. Further, the company also faces a significant task of successful commencement of commercial production of its expanded capacity, in addition to roping in customers to absorb the increased capacities, which otherwise may lead to underutilization of capacities or result in compressed realizations on expanded capacity.

Company Description

TRIL was originally incorporated as Triveni Electric Company in 1994, by Mr. Jitendra Mamtara. It is a leading transformer manufacturing company in India and has presence in power, distribution, and specialty transformers.

On product classification basis, TRIL manufactures four different types of transformers as given in the table below. Power transformers constituted 75% of sales, while furnace transformers constituted 13% in FY07.

Table 4: TRIL—Product profile

Product wise revenue break up (%), Mar YE	FY06	FY07
Power	73	75
Distribution	5	5
Furnace	19	13
Special	0	3
Others	3	3

Source: Company, Edelweiss research

In terms of customer profile, 51% of TRIL's sales are to SEBs and the balance 49% to the industrial sector. In the industrial sector, it caters to a wide spectrum of transformer users in industries such as metals & mining, petrochemicals, oil refining, cement, and railways. Currently, TRIL exports to North America, South Africa, and Saudi Arabia.

Table 5: TRIL—End user industries

End user industries revenue breakup (%), Mar YE	FY05	FY06	FY07
Utilities	35	46	51
Industries and others	65	54	49

Source: Company, Edelweiss research

The company, currently, operates through two manufacturing units, with total capacity of 7,200 MVA, located at Changodar (6,000 MVA) and Odhav (1,200 MVA) near Ahmedabad. To capitalize on the growing demand for transformers, TRIL raised money through an IPO in November 2007 to set up a 16,000 MVA manufacturing facility at Moraiya to raise its total capacity to 23,200 MVA by June 2008. TRIL, currently, manufactures transformers of 220 kV class. The new capacity will be suitable to manufacture higher-end transformers of 220-765 kV class. However, initially, the ramp up will be up to the 400 kV class.

As part of its strategy to vertically integrate its operations, TRIL has acquired stakes in erstwhile promoter group companies—Transweld Mechanical Engineering Works (TMEWL) and Transpares. TMEWL manufactures transformer tanks and core channels, while the latter pressed steel radiators, all of which are components required to manufacture transformers.

TRIL also plans to expand its radiator manufacturing capacity six fold to process 600 tpm of steel. The company's current order book stands at ~INR 3.6 bn, the breakup of the same is given below:

Table 6: TRIL—Order backlog break up

Category	Amount (INR mn)
220 kV	1,290
132 kV	1,330
66 kV	190
33 kV	330
11 kV	370
Others	90
	3,600

Source: Company, Edelweiss research

Management Overview

Mr. Jitendra Mamtora is the Chairman and Managing Director of the company. He holds a bachelor's degree in Electrical Engineering from Jalpaiguri Government Engineering College. Mr. Mamtora started his career with an electrical equipment manufacturing company in 1969 and has experience of more than 38 years in the transformer industry. He is an Executive Council Member of IEEMA and has been nominated as the Chairman of IEEMA, Transformer Division, since 2007.

Mr. Satyen J Mamtora is the Joint Managing Director of the company. He holds a diploma in Electrical Engineering, from Uxbridge College of Engineering, London, UK. He has over 13 years of experience in the transformer industry, in areas of project management, production, and marketing.

Mr. Bhaskar Sen is the Joint Managing Director of the company. He holds a bachelor's degree in Mechanical Engineering from Jadavpur University. Mr. Sen has over 43 years of experience in overall management of electrical equipment business in various capacities in different organizations. He has previously worked with GEC Alstom and Emco at senior positions.

Industry Overview

The domestic transformer industry was valued at ~INR 81 bn at the end of FY07, with ~59% being contributed by distribution transformers and ~41% by power transformers. We believe, further ~INR 10 bn–12 bn is contributed by the unorganized market, which primarily caters to the distribution transformers segment. The volume growth in the distribution transformer segment at ~20% is likely to exceed that for power transformers at ~15% over FY09E, primarily driven by rural electrification and distribution reforms. However, the power transformer segment has lesser competition than the distribution transformer segment due to higher entry barriers. Rising competition and narrowing demand-supply mismatch are likely to impact margins negatively over the long term. To cater to growth in transformer demand, domestic transformer companies have started expanding capacities and they are likely to be in line with demand by FY09E end. The table below gives a snapshot of key players in the industry.

Table 7: Industry competitive scenario Emco

Parameters	EMCO	Indo Tech	TRIL	Voltamp
Capacity (MVA)	20,000	7,450	7,200	9,000
FY08E Capacity utilization (%)	65	69	83	82
Customer profile	Primarily SEBs and utilities	Primarily SEBs and utilities	Well balanced between SEBs, utilities, and industrial segments	Focused on industrial/retail segment
Product profile	Power transformers: Up to 315MVA/400kV; Distribution transformers: Up to 16MVA/66 kV; Specialized transformers: Furnace, rectifier, and locomotive transformers	Power transformers: Up to 110MVA/220kV; Distribution transformers: Up to 3MVA/ 33 kV; Specialized transformers: Furnace, mobile transformers	Power transformers: Up to 160MVA/245kV; Distribution transformers: Up to 5MVA/33 kV; Specialized transformers: Furnace and rectifier transformers	Power transformers: Up to 50MVA/132kV; Distribution transformers: Up to 5MVA/33 kV; Specialized transformers: Dry type transformers
Future plans	Setting up 270 MW coal-based thermal plant in Chandrapur	Expanded capacity to 7,450 MVA, moving to 400 kV class of transformers	Expanding capacity to 23,200 MVA; moving to 400 kV class of transformers	Capacity addition and range expansion

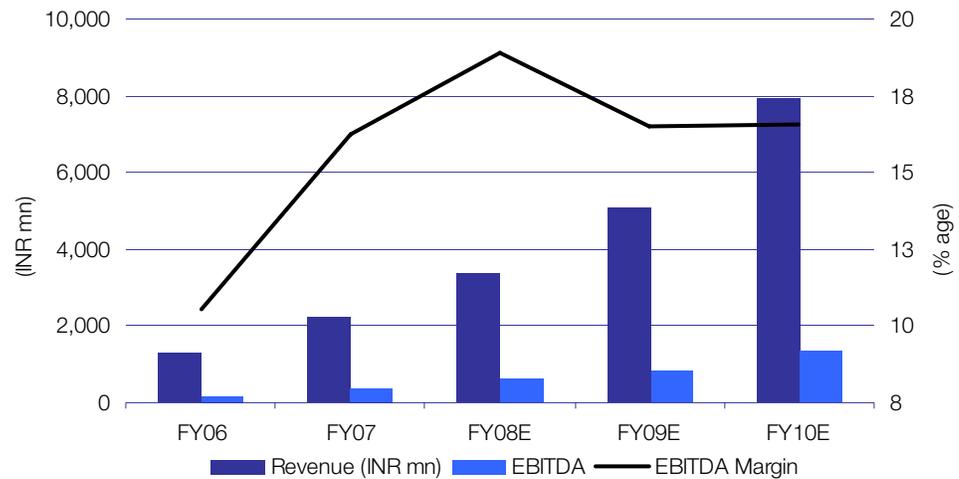
Source: Edelweiss research

Financial Outlook

TRIL posted consolidated revenues of ~INR 2.2 bn in FY07, a ~69% Y-o-Y growth. EBITDA grew by ~154% Y-o-Y to INR 363 mn, driven by ~550bps Y-o-Y improvement in EBITDA margins; EBITDA margins in FY07 were at 16.4%. Adjusted net profit in FY07 was INR 194 mn, up ~152% Y-o-Y. Net margin for FY07 was at 8.8%.

We expect TRIL's revenue to grow at a CAGR of ~53% over the next three years, driven mainly by volume growth, while we expect an EBITDA CAGR of ~54% over the next three years.

Chart 2: TRIL—Revenue and EBITDA growth profile



Source: Company, Edelweiss research

We expect TRIL's interest expense as a percentage of sales to drop significantly on account of money raised through an IPO to fund expansion. However, depreciation as a percentage of sales is expected to increase initially due to the time lag between capacity coming on stream and the corresponding revenue it generates. We expect adjusted PAT to grow at a CAGR of ~57% over the next three years. We expect revenues of ~INR 5.1 bn, EBITDA of ~INR 848 mn, and PAT of ~INR 485 mn in FY09E.

* Capacity expansion could lead to dip in FY09E and FY10E margins

At FY07 end, TRIL's average capacity utilization was ~69%; we expect it to increase to ~83% in FY08E driven by increase in demand for transformers. Consequently, we expect margins in FY08E to be robust, led by operating leverage.

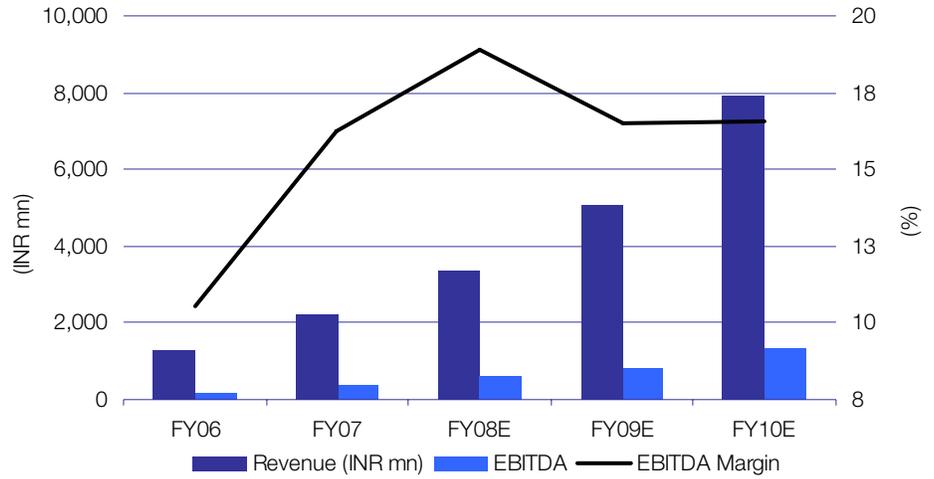
Table 8: TRIL—Capacity utilization

Capacity utilization details	2006	2007	2008E	2009E	2010E
Transformer capacity (MVA)	5,400	7,200	7,200	23,200	23,200
Sales (MVA)	2,789	4,348	5,994	8,394	14,486
Average capacity utilization (%)	59.3	69.0	83.3	55.2	62.4

Source: Company, Edelweiss research

However, increase in capacities in FY09E are likely to lead to higher fixed costs, which in turn is likely to impact margins negatively till the new capacity stabilizes. Hence, we believe margins in FY09E and FY10E are likely to be substantially lower than in FY08E.

Chart 3: TRIL—Capacity utilization and EBITDA margin



Source: Company, Edelweiss research

*** Healthy cash balance; dilution unlikely**

TRIL, like other transformer companies in the power space, has negative operating cash flows, primarily because of much higher working capital requirement, as ~51% of its revenue comes from SEBs. However, subsequent to the IPO, it has a healthy cash balance, adequate to support its expansion and higher working capital requirement going forward. Further, since the company has low debt levels, the management has ample flexibility. Hence, we believe, over the medium to long term, the risk of dilution due to negative operating cash flows and capital expenditure is mitigated to a certain extent.

Financial Statements

Income statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Income from operations	1,308	2,212	3,372	5,095	7,928
Direct costs	1,034	1,576	2,371	3,677	5,740
Employee costs	25	37	55	84	129
Other expenses	107	237	306	486	735
Total operating expenses	1,166	1,849	2,732	4,246	6,605
EBITDA	143	363	639	848	1,323
Depreciation and amortisation	8	17	34	62	89
EBIT	134	346	606	786	1,234
Interest expenses	21	55	66	49	66
Other income	7	8	18	17	9
Profit before tax	120	299	557	753	1,177
Provision for tax	43	100	189	256	400
Extraordinary items	-	18	-	-	-
Reported profit	77	181	367	497	777
Less: Minority interests	-	4	8	12	19
Reported profit after minority	77	176	359	485	758
Adjusted net profit	77	194	359	485	758
Shares outstanding	7	7	13	13	13
Dividend per share	1.5	1.8	1.8	2.5	3.8
Dividend payout (%)	13.4	6.9	6.9	6.9	6.9

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Operating expenses	89.1	83.6	81.0	83.3	83.3
Depreciation	0.6	0.8	1.0	1.2	1.1
Interest expenditure	1.6	2.5	2.0	1.0	0.8
EBITDA margins	10.9	16.4	19.0	16.7	16.7
Net profit margins (adjusted)	5.8	8.8	10.7	9.5	9.6

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Revenues	72.6	69.1	52.4	51.1	55.6
EBITDA	115.9	154.5	76.2	32.7	55.9
PBT	108.8	149.5	86.4	35.3	56.2
Net profit	116.7	135.9	103.5	35.3	56.3
EPS	51.9	144.2	1.4	35.1	56.2

Balance sheet					(INR mn)
As on 31st March	FY06	FY07	FY08E	FY09E	FY10E
Equity capital	68	71	129	129	129
Reserves & surplus	146	332	1,982	2,406	3,068
Shareholders funds	215	403	2,111	2,536	3,197
Secured loans	154	229	150	200	275
Unsecured loans	20	49	50	75	75
Borrowings	174	278	200	275	350
Sources of funds	389	681	2,311	2,811	3,547
Gross block	153	210	310	868	918
Accumulated depreciation	41	56	79	130	208
Net block	111	154	232	737	709
Capital work in progress	10	50	600	60	10
Total fixed assets	121	205	832	797	719
Intangible assets	0	0	0	0	0
Investments	-	18.0	18.0	18.0	18.0
Inventories	310	394	727	1,099	1,712
Sundry debtors	518	690	1,323	2,001	3,117
Cash and equivalents	65	143	342	255	136
Loans and advances	37	57	86	131	204
Total current assets	931	1,283	2,478	3,485	5,168
Sundry creditors and others	627	761	970	1,392	2,186
Provisions	22	50	74	115	179
Total CL & provisions	649	811	1,044	1,507	2,365
Net current assets	282	471	1,435	1,979	2,803
Add / (Less) : Deferred tax asset/ Lia	(15)	(13)	(13)	(13)	(13)
Others	0.5	0.2	40.2	30.2	20.2
Uses of funds	389	681	2,311	2,811	3,547
Book value per share (BV) (INR)	31	57	163	196	247

Cash flow statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net profit	77	194	359	485	758
Add: Depreciation	8	17	34	62	89
Add: E.O.Adjustments	-	(18)	-	-	-
Add: Deferred tax	(1)	(1)	-	-	-
Gross Cash Flow	84	192	393	548	847
Less: Dividends	12	15	27	36	57
Less: Changes in W. C.	87	112	763	632	944
Operating cash flow	(15)	65	(397)	(120)	(153)
Less: Change in Investments	-	18	-	-	-
Less: Capex	44	98	650	17	-
Free cash flow	(59)	(51)	(1,048)	(137)	(153)

Ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROAE (%)	44.5	63.0	28.6	20.9	26.5
ROACE (%)	42.7	64.7	40.5	30.7	38.8
Current ratio	1.4	1.6	2.4	2.3	2.2
Debtors (days)	145	114	143	143	144
Fixed assets t/o (x)	11.3	11.4	5.3	5.2	8.7
Average working capital t/o (x)	6.0	6.7	3.1	3.0	3.0
Gross debt/Equity	0.8	0.7	0.1	0.1	0.1

Valuations parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
EPS (INR)	11.2	27.4	27.8	37.6	58.7
<i>Y-o-Y growth (%)</i>	51.9	144.2	1.4	35.1	56.2
CEPS (INR)	12.5	29.8	30.4	42.4	65.6
P/E (x)	63.7	26.1	25.7	19.0	12.2
Price/BV(x)	22.7	12.6	4.4	3.6	2.9
EV/Sales (x)	7.1	4.2	2.7	1.8	1.2
EV/EBITDA (x)	65.6	25.8	14.2	10.9	7.1

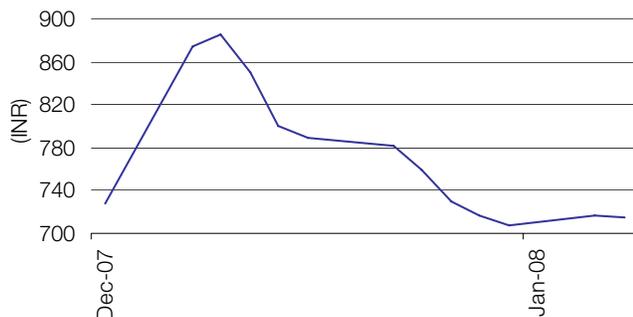
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Coverage group(s) of stocks by primary analyst(s): Power:

KEI Industries, Apar Industries, Emco, Kalpataru Power Transmission, KEC International, RPG Transmission, Jyoti Structures, ABB, BHEL, Voltas, L & T, Siemens, Suzlon Energy and Crompton Greaves

Transformers and Rectifiers



Date	Company	Title	Price (INR)	Recos
24-Dec-07	Techno Electric and Engineering	First among equals; initiating coverage	255	Buy
17-Dec-07	Suzlon Energy	Minor hiccup; Event Update	1,828	Accum.
04-Dec-07	BGR Energy	Strike when the iron is hot; IPO Note	425-480	Subscribe
23-Nov-07	Power	Post conference notes		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	107	45	18	3	193

* 13 stocks under review / 7 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	104	69	20

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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