



# ICRA EQUITY RESEARCH SERVICE

## KAVVERI TELECOM PRODUCTS LIMITED (KTPL)



June 25, 2013

Industry: Telecom

Q4 FY13 Update

### Key Updates

Kavveri's standalone and consolidated FY13 revenue and profitability experienced a significant downturn, especially in Q4. In the fourth quarter revenues turned negative, due to significant sales returns, which also wiped out the profitability of the first three quarters and pushed the company in to cash losses.

Sales return has resulted in build up of inventory, thereby increasing the working capital intensity of the company. The losses have been funded through debt thereby worsening the capitalisation indicators for the company. Besides, there were plans to introduce ~Rs 27 crore through allocation and conversion of 15.8 lakh warrants to the promoters at conversion price of Rs 170/ share; however the promoters have withdrawn this proposal thereby increasing the debt dependence of the company. Further we note that the company has been classified as a Non-Performing Asset (NPA) by the State Bank of India.

There have been important developments on the shareholding and group structure front. The stake of the promoter group has reduced from ~32% as on 30<sup>th</sup> June 2012 to ~27% as on 31<sup>st</sup> March 2013; 46.36% of these shares have been pledged, thereby reducing the economic interest of the promoters to less than 15%. Besides, there is also a proposal to merge Kavveri Telecom Infrastructure Limited (KTIL), a 51% subsidiary of KTPL engaged in-Building solution business, with KTPL. The promoters would get KTPL shares for their 49% stake in KTIL. The board of directors, approved a share swap ratio of 1:11.27 i.e. 11.27 share of KTPL for every 1 shares in KTIL. This will increase the holding of promoter-shareholders by 98 lakh shares (from 27% to ~51% based on shareholding pattern of 31st March 2013)

### Outlook

We revise the fundamental grade of the company to '1/5' (indicating 'weak fundamentals') from '3/5' (indicating 'good fundamentals') assigned to Kavveri on account of significant weakening in the business and financial profile of the company over the last fiscal.

Since our last update in Sep'12, the stock price of Kavveri has declined by ~80%. However, the impact of the stock price decline on price multiples has been partially offset by the equity dilution planned in KTPL in the near term through merger with KTIL. Besides, as mentioned earlier there has been significant deterioration in the business profile of the company. Going forward, given the sales return during Q4, there can be possible inventory write downs which can result in further losses; hence we believe a further correction in price is warranted and thereby revise Kavveri's valuation grade to 'D', indicating moderately overvalued from 'C' indicating fairly valued on relative basis.

Table 01: Key Financials (Consolidated)

(Rs. crore)	FY11A	FY12A	FY13A
Operating Income	312.7	457.1	239.3
EBITDA Margin (%)	23.1%	16.1%	-7.0%
PAT Margin (%)	12%	11%	-18.0%
EPS (Rs.)	35.7	26.9	-20.8
EPS Growth (%)	40%	-25%	-177%
RoE (%)	25%	19%	-17%
RoCE (%)	23%	22%	-3%
P/E (x)			-1.67
P/BV (x)			0.34
EV/EBITDA (x)			-16.81

Source: Company, ICRA Online Estimates

### ICRA Online Grading Matrix

		Valuation Assessment				
Fundamental Assessment		A	B	C	D	E
	5					
	4					
	3					
	2					
1				1D		

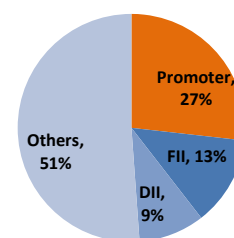
- Fundamental Grading of 1/5' indicates "weak fundamentals"
- Valuation Grading of 'D' indicates "moderately overvalued" on a relative basis

### Key Stock Statistics

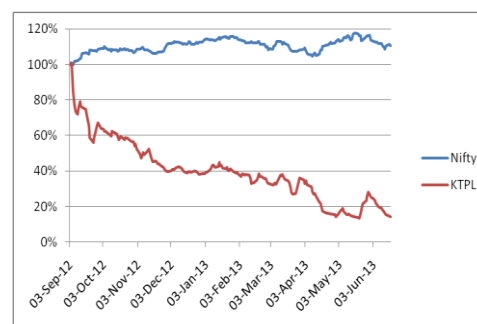
Current Market Price* (Rs.):	34.85
Shares Outstanding (crore):	2.01
Market Cap (Rs. crore)	70.13
52-Week High (Rs.)	271.0
52-Week Low (Rs.)	28.10
Free Float (%)	68%
Price/Book Value (x)	0.34

\*As on June 25, 2013

### Shareholding Pattern (March 31, 2013)



### Share Price Movement (Since Sep 2012)



**Q4FY13 performance**

The financial performance of the company has experienced substantial deterioration over the last quarter. For the first nine months of the fiscal, the turnover and EBDITA margins stood at Rs. 364 crore and 12.7% respectively; however, the top line was negative on account of significant sales returns in the last quarter thereby resulting in negative revenues in Q4 and bleeding bottom-line for the fiscal year 2013. Even the significant rupee depreciation (other income of Rs. 16.43 crore for FY13) could not support the net profitability for the company.

**Standalone Financial**

	Q-o-Q comparison			Y-o-Y comparison		
	Q4-FY13	Q3-FY13	Q-o-Q Change	Q4-FY13	Q4-FY12	Y-o-Y Change
<b>Operating Income</b>	-83.5	61.4	-173%	-83.5	85.7	-197%
<b>COGS</b>	-37.0	60.1	-162%	-37.0	79.4	-147%
<b>EBDITA</b>	-47	1.3	-3757%	-47	6.3	-836%
<b>EBDITA margin</b>		2.1%			7%	
<b>Depreciation</b>	1.1	1.3		1.1	0.7	
<b>Interest</b>	3.9	4.4		3.9	3.2	
<b>Other income</b>	5.4	5.4		5.4	1.9	
<b>Exceptional gain (loss)</b>	-0.7	0.0		-0.7	-0.2	
<b>Tax</b>	-6.4	0.3		-6.4	-3.2	
<b>PAT</b>	-38.9	0.7	-6017%	-38.9	7.2	-639%
<b>PAT margin</b>		1%			8%	
<b>NCA</b>	-37.8	1.9	-2076%	-37.8	7.9	-576%

Source: Company; bp: basis points

**Consolidated Financial**

	Q-o-Q comparison			Y-o-Y comparison		
	Q4-FY13	Q3-FY13	Q-o-Q Change	Q4-FY13	Q4-FY12	Y-o-Y Change
<b>Operating Income</b>	-125.3	120.4	-196%	-125.3	150.9	-220%
<b>COGS</b>	-62.4	109.5	-157%	-62.4	141.8	-144%
<b>EBDITA</b>	-63.0	10.9	-680%	-63.0	9.2	-786%
<b>EBDITA margin</b>		9.0%			6%	
<b>Depreciation</b>	3.1	3.3		3.1	3.9	
<b>Interest</b>	3.1	5.7		3.1	2.6	
<b>Other income</b>	-6.1	5.9		-6.1	4.2	
<b>Exceptional gain (loss)</b>	-0.3	-0.4		-0.3	-0.3	
<b>Tax</b>	-1.3	0.4		-1.3	-0.4	
<b>PAT</b>	-73.0	7.0	-1146%	-73.0	7.0	-1146%
<b>PAT margin</b>		6%			5%	
<b>NCA</b>	-69.9	10.3	-781%	-69.9	10.9	-740%

Source: Company; bp: basis points

### ***Sales returns and Steep Decline in Profitability***

KTPL experienced significant sales return (Rs. 130 crore) in the 4th quarter. This resulted in negative revenues at the standalone and consolidated levels for KTPL in Q4FY13. This resulted in cash losses for KTPL. We note that although the company managed positive PAT and EBDITA margins for the first three quarters, substantial losses in Q4 led to erosion of the profits accumulated over the first three quarters, thereby resulting in negative margins for FY13.

### ***Revenue Concentration***

KTPL caters to a concentrated customer base with a single customer contributing in excess of 50% of FY12 revenue. We believe that the significant sales returns (Rs. 130 crore) experienced in the 4th quarter could be because of loss of business for the single largest customer.

### ***Proposed merger with KTIL***

KTIL, 51% subsidiary of KTPL engaged in capital intensive in-building solution business, is proposed to be merged with KTPL. The merger would help the group to monetize the CENVAT and custom duty credits accumulated in KTIL books and get income tax benefits on account of high depreciation cost of KTIL. The promoter group holds the balance 49% stake in KTIL and would get ~98 lakh shares of KTPL in exchange of their stake shareholding in KTIL. (The board of directors, approved a share swap ratio of 1:11.27 i.e. 11.27 share of KTPL for every 1 shares in KTIL on 26th November 2013). This will reduce holding of promoter-shareholders to 51% from ~27% based on shareholding pattern of 31st March 2013. Based on KTPL's market price as on 26<sup>th</sup> November, the promoter's stake in KTIL was valued at ~Rs. 90 crore (valued at ~Rs. 30 crore based on current market price). We note that this transaction is at a significant premium to the book value of promoter's stake in KTIL (minority interest in the consolidate B/S as on 31<sup>st</sup> March 2013 is Rs. 0.19 crore<sup>1</sup>) and can be one of the major factors contributing to decline in KTPL's stock prices over the last few months.

### ***Cancellation of proposed warrant issue***

During the previous update, we had highlighted that the group's capital structure had been adversely impacted on account of KTIL repaying Rs 40 crore of long term interest-free loan from promoter group. However, the promoters had planned to infuse nearly Rs 27 crore through allocation and conversion of 15.8 lakh warrants @ Rs 170 / share. However, this warrant issue was cancelled on 29<sup>th</sup> Sep'12 perhaps on account of the decline in KTPL's share prices as compared to the conversion value of warrants (KTPL's shares were hovering ~Rs.140 in the last week of Sep'12). This, coupled with net losses, has adversely impacted the capital structure of the group.

### ***Delays in Debt repayment; Classified as NPA***

All the losses in FY13 have been largely funded through debt as there hasn't been any equity influx into the company. The liquidity position of the company was further stretched on account of delays in collection of receivables. This resulted in defaults in debt repayment on part of the entity. KTPL is currently classified as an NPA by the State Bank of India. Besides we note that KTIL has also been delaying its debt repayments by more than 2 months.

### ***Change in auditors and resignation of an independent director***

Since April'2013, there have been some other major developments such as change in the board structure and resignation of auditors. In April'2013, the statutory auditor of the company 'M/s S. Janardhan & Associates, resigned thereby resulting in a casual vacancy which was filled by 'P. Murali & Company'. Besides, in June 2013, Mr. C. V. Jagadish, Independent Director, resigned as Director of the Company due to his other commitments.

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<sup>1</sup> We have assumed that the book value of promoter's holding in KTIL is equal to the minority interest showed in the consolidated Balance sheet.

**Reduction of dividend**

Another major issue noted since the last update is the reduction of dividend; in the AGM dated 29<sup>th</sup> Sep 2012, the dividend was decided to be revised downwards from 40% to 15%. This was perhaps on account of the strained liquidity and cash crunch that the company experienced the fiscal. We note that the share prices have experienced a free fall since then.

**Valuation**

Since our last update in Sep'12, the stock price of Kavveri has declined by ~80%; as compared to this, Nifty, CNX 500, and CNX Mid Cap went up by 4% to 8%, and CNX Small Cap declined by almost 8%. The stock price decline is largely attributable to the significant deterioration in the financial and business profile of the company coupled with various other factors listed earlier. Moreover, a level of discount against these indices is justified considering high competitive intensity of the industry, technology obsolescence risk associated with business, current weak domestic telecom scenario, recent deterioration in financial and business profiles, and the company's high customer concentration. Going forward, given the sales return during Q4, there can be possible inventory write downs which can further result in losses. Considering the above aspects, we revise Kavveri's valuation grade to 'D', indicating moderately overvalued from 'C' indicating fairly valued on relative basis.

**Table 02: Index Comparison**

ICRA Online	Nifty	CNX 500	CNX Small Cap	CNX Mid Cap	Kavveri*
	<b>FY13</b>	<b>FY13</b>	<b>FY13</b>	<b>FY13</b>	<b>FY13</b>
<b>Price/Earnings</b>	16.97	16.86	29.76	15.87	-1.67
<b>Price /Book Value</b>	2.95	2.39	1.02	1.60	0.34

*Source: NSE, ICRA Online*

*\* based on share price as on June 25, 2013;*

## Company Profile

Kavveri, founded by Mr. Shivkumar Reddy in the year 1996, is mainly into design, development and marketing of Rf products and antennas. The company has in-house research and development facility driven by 60 member core R&D team. Its key manufacturing facility is located in Bangalore, India. During FY12, the company also started contract manufacturing activity which helped in its export sales. During last seven years, Kavveri has acquired six entities in order to broad base its product portfolio and expand its geographical reach. The company has also ventured into the In-Building Solution business in September 2008, through its 51% owned subsidiary, KTIL. This is a capital intensive business model requiring significant upfront expenditure by KTIL on infrastructure development. Going forward, KTIL is expected to be amalgamated with KTPL. At consolidated level the company has generated a net loss of Rs. 43.10 crore on an Operating Income of 239.27 crore in FY13 against a PAT of Rs 48.4 crore on an Operating Income of Rs 457.1 crore during FY12.

**Table 03: Company Fact Sheet**

<b>Name of the Company</b>	<b>Kavveri Telecom Products Limited (Kavveri)</b>	
<b>Year of Incorporation</b>	1996	
<b>Corporate Status</b>	Public Limited Company	
<b>Registered Office</b>	Kavveri Telecom Products Limited, Kavveri Industrial Complex, Ist main, 2nd Stage, Arakere Mico Layout, Banerghatta Road, Bangalore – 560076	
<b>Auditors</b>	P. Murali & Company	
<b>Board of Directors</b>	<u>Director Name</u>	<u>Designation</u>
	C. Shivkumar Reddy	Chairman & Managing Director
	Mrs. R H Kasturi	Director (HR and Admin)
	Mr. L Nicholas	Director (R&D)
	Mr. L. R. Venugopal	Independent Director
	Mr. B. S. Shankarnarayanan	Independent Director
<b>Key subsidiaries/ associate companies</b>	<u>Subsidiaries</u> <ul style="list-style-type: none"> <li>• Eaicom India Private Limited [100% subsidiary]</li> <li>• Kavveri Technologies Inc. Canada [KTIC, 100% subsidiary]</li> <li>• Kavveri Telecom Infrastructure Limited [KTIL, 51% subsidiary]</li> <li>• Til-Tek, Canada [100% held by KTIC]</li> <li>• DCI Digital Communication, Canada [100% held by KTIC]</li> <li>• Spotwave Wireless Inc. [100% held by KTIC]</li> <li>• Trackcom Systems International Inc. [67% held by KTIC]</li> <li>• Kavveri Realty 5 Inc. [100% held by KTIC]</li> <li>• Kavveri Telecom Espana [KTE, 100% subsidiary]</li> <li>• Rymex [99.99% held by KTE]</li> <li>• Kavveri Technologies Americas Inc (KTA, 100% subsidiary)</li> <li>• Quality Communications Systems Inc., Lakewood New Jersey, USA (100% held by KTA)</li> <li>• New England Communication Systems Corp. USA (100% held by KTA)</li> <li>• Kavveri Technologies Asia Pte Ltd., Singapore (100% subsidiary)</li> </ul>	

Source: Company

## Corporate Governance

Kavveri is managed by a 5-member Board, which includes 2 independent directors. We note that one of the independent directors, Mr. C.V. Jagdish had resigned in June 2013 sighting other commitments. Besides, the auditor of the company, M/s S. Janardhan & Associates had also resigned in April 2013 sighting similar reasons. Moreover, other factors such as dilution of non-promoter stakeholders' share raises concerns on governance.

**Annexure 1: P&L (Consolidated)**

Rs Crore	FY11A	FY12A	FY13A
<b>Net Sales</b>	308.7	454.3	239.3
<b>Other Related Income</b>	4.0	2.8	0.0
<b>Operating Income</b>	312.7	457.1	239.3
<b>EBITDA</b>	72.1	73.6	-16.7
<b>Depreciation</b>	7.2	9.2	12.1
<b>EBIT</b>	64.0	79.4	-12.4
<b>Interest Expenses</b>	12.5	14.8	23.6
<b>Other Income</b>	2.0	15.7	16.4
<b>PBT</b>	51.1	64.3	-35.4
<b>PAT</b>	38.9	48.4	-43.1
<b>Minority Interest</b>	0.0	0.0	-1.2
<b>PAT (Concern Share)</b>	38.9	48.4	-41.9
<b>No. of shares (Cr)</b>	1.1	1.8	2.0
<b>DPS</b>	1.5	1.5	0.0
<b>EPS</b>	35.7	26.9	-20.8
<b>CEPS</b>	40.7	32.0	-15.4

Source: Company

Note 1: Amounts are presented in Rs. Crore; EBITDA: Earnings Before Interest, Tax, Depreciation and Amortization; EBIT: Earnings Before Interest and Tax; PBT: Profit Before Tax; PAT: Profit After Tax; DPS: Dividend Per Share; EPS: Earnings Per Share; CEPS: Cash Earnings Per Share

**Annexure 2: Balance Sheet (Consolidated)**

Assets (Rs Crore)	FY11A	FY12A	FY13A
<b>Net Fixed Assets</b>	187.4	180.8	225.3
<b>Capital Work-in-Progress</b>	24.0	81.5	34.8
<b>Total Net Fixed Assets</b>	211.5	262.3	260.0
<b>Other Long-Term Investments</b>	0.0	0.0	5.0
<b>Cash and Bank Balances</b>	7.6	23.6	1.2
<b>Receivables</b>	100.3	174.2	91.8
<b>Inventories</b>	72.2	78.0	86.1
<b>Loans &amp; Advances</b>	47.0	59.3	138.9
<b>Other Current Assets</b>	13.6	19.4	15.7
<b>Total Assets</b>	452.2	616.8	598.7

Liabilities (Rs Crore)	FY11A	FY12A	FY13A
<b>Net Worth</b>	203.6	311.9	208.8
<b>Minority Interest</b>	1.1	1.4	0.2
<b>Total Debt</b>	157.8	156.4	212.1
<b>Deferred Tax Liability</b>	9.1	10.7	16.8
<b>Trade Creditors</b>	17.1	50.3	91.5
<b>Other Current Liabilities and Prov.</b>	63.6	86.1	45.9
<b>Total Liabilities</b>	452.2	616.8	575.3

**Annexure 3: Cash Flow (Consolidated)**

Cash Flows (Rs Crore)	FY11A	FY12A	FY13A
<b>PBT</b>	51.1	64.3	-35.4
<b>Taxes Paid</b>	12.1	14.2	7.7
<b>Depreciation</b>	7.2	9.2	12.1
<b>Change in net working capital</b>	(23.8)	(43.5)	2.4
<b>Cash flow from operating activities</b>	22.3	15.8	(28.6)
<b>Investments</b>	0.0	0.0	18.4
<b>Capital Expenditure</b>	(68.9)	(59.3)	(9.3)
<b>Cash flow from investing activities</b>	(68.9)	(59.3)	9.1
<b>Equity Raised / (Buyback)</b>	57.5	62.1	0.3
<b>Loans Raised / (Repaid)</b>	(15.2)	(1.4)	55.7
<b>Others (Including Extra-ordinaries)</b>	1.9	1.6	(55.4)
<b>Dividend</b>	(2.0)	(2.8)	(3.5)
<b>Cash Flow from Financing activities</b>	42.2	59.5	(2.9)
<b>Cumulative cash flow</b>	(4.4)	16.0	(22.4)
<b>Opening Cash Balance</b>	11.9	7.6	23.6
<b>Closing Cash Balance</b>	7.6	23.6	1.2



**Annexure 4: Key Financial Ratios (Consolidated)**

<b>Key Financial Ratios</b>	<b>FY11A</b>	<b>FY12A</b>	<b>FY13A</b>
<b><u>Growth Indicators</u></b>			
<b>Sales Growth</b>	26%	47%	-48%
<b>EBITDA Growth</b>	29%	2%	-123%
<b>EPS Growth</b>	40%	-25%	-177%
<b>Cash EPS Growth</b>	38%	-21%	-148%
<b><u>Profitability Indicators</u></b>			
<b>EBITDA Margin</b>	23.1%	16.1%	-7.0%
<b>EBIT Margin</b>	20.5%	17.4%	-5.2%
<b>PAT Margin</b>	12.4%	10.6%	-18.0%
<b>RoE</b>	25.0%	18.8%	-16.5%
<b>ROCE</b>	22.6%	22.3%	-2.9%
<b><u>Liquidity Ratios</u></b>			
<b>Debtor Days</b>	118	139	140
<b>Inventory Days</b>	107	78	142
<b>Net Working Capital/ Sales</b>	0.5	0.4	0.8
<b><u>Capitalization Ratios</u></b>			
<b>Total Debt/ Equity</b>	0.8	0.5	1.0
<b>Interest Coverage</b>	5.8	5.0	-0.7
<b>Total Debt/EBITDA</b>	2.2	2.1	-12.7
<b><u>Valuation Ratios</u></b>			
<b>Price/Sales</b>			0.29
<b>Price/Earnings</b>			-1.67
<b>Price/Book Value</b>			0.34
<b>EV/EBITDA</b>			-16.81



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