

## Earnings Overhang; Downgrade to Hold

February 3, 2012

Reco	Previous Reco
Hold	Accumulate
CMP	Target Price
Rs 522	Rs 495
EPS change FY12E/13E (%)	-7/-11
Target Price change (%)	NA
Nifty	5,326
Sensex	17,605

### Price Performance

(%)	1M	3M	6M	12M
Absolute	26	6	0	(20)
Rel. to Nifty	12	5	(2)	(17)

Source: Bloomberg

### Relative Price Chart



Source: Bloomberg

### Stock Details

Sector	Engineering & Capital Goods
Bloomberg	TMX@IN
Equity Capital (Rs mn)	238
Face Value(Rs)	2
No of shares o/s (mn)	119
52 Week H/L	720/388
Market Cap (Rs bn/USD mn)	62/1,271
Daily Avg Volume (No of sh)	104464
Daily Avg Turnover (US\$m)	1.0

### Shareholding Pattern (%)

	Dec-11	Sep-11	Jun-11
Promoters	62.0	62.0	62.0
FII/NRI	11.3	10.7	10.4
Institutions	11.2	12.0	13.0
Private Corp	2.3	2.2	1.9
Public	13.2	13.1	12.7

Source: Capitaline

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- Below estimates – (1) Revenue up 2% yoy to Rs12.7 bn (2) EBITDA% down 110 bps yoy to 10.7% (3) EBITDA down 7% yoy to Rs1.4 bn (4) APAT down 5% yoy to Rs955 mn
- Order inflows decline 42% qoq to Rs7.5 bn – lower than quarterly run-rate of Rs12 bn. Order book declines 11% qoq to Rs58 bn and order book cover deteriorates to 1.0X revenues
- Running weak order cover at 1.0X Revenues and ambiguity on near-term order inflows; Also investments in super-critical venture remains an overhang
- Cut earnings by 7% and 11% for FY12E and FY13E on reduced order book visibility. No near term re-rating catalysts + risks to earnings exist. Downgrade to Hold with target of Rs495

### Below estimates – Revenues up 19% yoy, Net profits up 14% yoy

After 6 quarters of strong performance, Thermax posted 5% yoy decline in net profits in Q3FY12 (on a high base of Q3FY11) – below estimates. This was due to (1) Muted revenue growth at 2% yoy to Rs12.7 bn – Energy (+0.3% yoy) & Environment (+3% yoy) (2) Continued pressure on operating margins (sequential decline for the 7<sup>th</sup> straight quarter) – down 110 bps yoy to 10.7%. Decline in margins was due to change in revenue mix, increase in raw material costs and forex loss of Rs0.15 bn. (3) EBITDA decreased by 7% yoy to Rs1.4 bn (4) Hence net profit declined by 5% yoy to Rs955 mn.

### Energy revenues flat, Environment up 3% yoy

- **Energy segment** – After 6 quarters of strong performance, revenues remained stable at Rs9.9 bn (+0.3% yoy on a high base). EBIT margins declined 130 bps yoy to 9.5% (below estimate) – due to high contribution of low margin EPC orders. Consequently, segment EBIT declined by 12% yoy to Rs947 mn.
- **Environment segment** - Reported weak performance with (1) 3% yoy revenue growth to Rs3.0 bn - below estimates and (2) 60 bps yoy fall in EBIT margins (on a high base) to 13.0% - but in line with estimates. (3) Segment EBIT declined by 2% yoy to Rs393 mn – below estimates.

### Order inflow down 40% yoy; Order book cover declines to 1.0X revenues

Order inflows declined by 40% yoy & 42% qoq to Rs7.5 bn – lower than quarterly run rate of Rs12.0 bn. Lower order inflows was led by delay in finalizations of power and EPC orders and rising competition. Consequently, Thermax order book declined 19% yoy and 11% qoq to Rs58.1 bn. Its order book cover also dropped sharply to 1.0X revenues. Order inflows were spread across sectors – power (14%), chemicals (8%), food processing (7%), Drugs & Pharma (6%).

### Thermax shared muted growth outlook for FY13E, regain in FY14E

- Thermax reiterated no improvement in macro environment amidst continued delays and deferrals in order finalizations. It indicated continued competitive pricing pressure amidst industry-wide deterioration in order books.

### Consolidated Financial Snapshot

Rs Mn

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS %Chg	ROE (%)	P/E	EV/ EBITDA	P/BV
Mar										
FY10	33,678	4,154	12.3	2,593	21.8	(8.4)	24.4	24.0	12.5	5.8
FY11	53,350	5,855	11.0	3,820	32.1	47.3	28.8	16.3	9.2	4.7
FY12E	55,962	6,124	10.9	4,016	33.7	5.1	24.9	15.5	8.3	3.9
FY13E	56,266	5,813	10.3	3,837	32.2	(4.5)	21.0	16.2	8.2	3.3

## Standalone Quarterly Results

Rs mn	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	YoY (%)	QoQ (%)	YTD'12	YTD'11	Gr (%)
<b>Revenue</b>	<b>12,412</b>	<b>17,713</b>	<b>10,444</b>	<b>13,035</b>	<b>12,693</b>	<b>2.3</b>	<b>-2.6</b>	<b>36,172</b>	<b>31,226</b>	<b>15.8</b>
<b>Expenditure</b>	<b>10,948</b>	<b>15,762</b>	<b>9,307</b>	<b>11,630</b>	<b>11,339</b>	<b>3.6</b>	<b>-2.5</b>	<b>32,276</b>	<b>27,516</b>	<b>17.3</b>
Consumption of RM <i>as % of sales</i>	8,646 69.7	12,831 72.4	7,282 69.7	9,131 70.0	8,689 68.5	0.5	-4.8	25,101 69.4	21,328 68.3	17.7
Employee Cost <i>as % of sales</i>	975 7.9	969 5.5	905 8.7	985 7.6	1,042 8.2	6.9	5.7	2,932 8.1	2,717 8.7	7.9
Other expenditure <i>as % of sales</i>	1,327 10.7	1,962 11.1	1,121 10.7	1,514 11.6	1,608 12.7	21.2	6.2	4,243 11.7	3,471 11.1	22.2
<b>EBITDA</b>	<b>1,464</b>	<b>1,951</b>	<b>1,137</b>	<b>1,405</b>	<b>1,354</b>	<b>-7.5</b>	<b>-3.6</b>	<b>3,896</b>	<b>3,710</b>	<b>5.0</b>
Depreciation	106	116	111	117	120	13.5	2.2	348	316	10.0
<b>EBIT</b>	<b>1,359</b>	<b>1,836</b>	<b>1,026</b>	<b>1,288</b>	<b>1,234</b>	<b>-9.1</b>	<b>-4.1</b>	<b>3,548</b>	<b>3,393</b>	<b>4.6</b>
Other Income	117	133	147	208	157	34.1	-24.6	512	390	31.3
Interest	2	10	4	11	7	242.3	-36.8	22	12	78.9
<b>PBT</b>	<b>1,473</b>	<b>1,959</b>	<b>1,170</b>	<b>1,485</b>	<b>1,384</b>	<b>-6.1</b>	<b>-6.8</b>	<b>4,038</b>	<b>3,771</b>	<b>7.1</b>
Total Tax	471	694	371	468	429	-8.9	-8.2	1,268	1,212	4.6
<b>Adjusted PAT</b>	<b>1,002</b>	<b>1,265</b>	<b>799</b>	<b>1,017</b>	<b>955</b>	<b>-4.7</b>	<b>-6.1</b>	<b>2,771</b>	<b>2,559</b>	<b>8.3</b>
Extra ordinary items	0	0	0	0	0	NA	NA	0	0	NA
<b>Reported PAT</b>	<b>1,002</b>	<b>1,265</b>	<b>799</b>	<b>1,017</b>	<b>955</b>	<b>-4.7</b>	<b>-6.1</b>	<b>2,771</b>	<b>2,559</b>	<b>8.3</b>
<b>Adjusted EPS (Rs)</b>	<b>8.4</b>	<b>10.6</b>	<b>6.7</b>	<b>8.5</b>	<b>8.0</b>	<b>-4.7</b>	<b>-6.1</b>	<b>23.3</b>	<b>21.5</b>	<b>8.3</b>

Margins (%)						(bps)	(bps)				(bps)
EBIDTA	11.8	11.0	10.9	10.8	10.7	-110	-10	10.8	11.9	-110	
EBIT	10.9	10.4	9.8	9.9	9.7	-120	-20	9.8	10.9	-110	
EBT	11.9	11.1	11.2	11.4	10.9	-100	-50	11.2	12.1	-90	
PAT	8.1	7.1	7.6	7.8	7.5	-60	-30	7.7	8.2	-50	
Effective Tax rate	32.0	35.4	31.7	31.5	31.0	-100	-50	31.4	32.1	-70	

- In domestic market, expects strong demand from steel, cement and hydrocarbon (refinery) sectors in FY13E. Power sector witnessing pick-up in demand for small plants, while large projects continue to be delayed.
- Thermax indicated muted demand from chemicals sector in FY13E. It also indicated continuation of government's flagship program (ending in FY13E) imperative to continued demand momentum from water treatment and air pollution control segments.
- Export markets witnessing improvement in investment climate and demand – especially Middle East.
- But, export markets (Middle East, South Asia and Africa) also getting very competitive – witnessed entry of Korean, Chinese and Japanese players. Highlighted instance of Middle East market – where all 4 projects in the petrochemical sector were bagged by Korean players at extremely competitive prices.
- Thermax expects marginal revenue growth in FY13E on the back of low order book cover – though it expects to resume revenue growth in FY14E. Thermax also reiterated that delay in realization of receivables to negatively impact working capital.
- In view of above, the company expects operating margins to remain stressed. Thermax guided for operating margins of 10-11% for FY13E

### Cut earnings by 7% for FY12E and by 11% for FY13E

We have cut our earnings estimates to factor lower order inflows in Q3FY12, sharp decline in order backlog cover to 1.0X (amidst a weak outlook for order inflows over next 2-3 quarters) and resultant decline in revenues. We have reduced our operating margins assumptions for FY12E – in view of continued pressure witnessed in 9MFY12. We had already assumed lower operating margins in FY13E (refer our report “Delusional optimism to reality” dated Oct’11) - hence we have largely maintained our operating margin assumptions for FY13E. Consequently, we have cut our consolidated earnings estimates by 7% for FY12E to Rs33.7 per share and by 11% to Rs32.2 per share for FY13E.

### Revision in Earning Estimates

Y/E, Mar Rs Mn	FY12E			FY13E		
	Earlier	Revised	% Change	Earlier	Revised	% Change
Revenues	58,692	55,962	-4.7	62,563	56,266	-10.1
EBITDA	6,604	6,124	-7.3	6,515	5,813	-10.8
EBITDA Margin (%)	11.3	10.9	-30 bps	10.4	10.3	-10 bps
APAT	4,331	4,016	-7.3	4,298	3,837	-10.7
EPS (Rs)	36.3	33.7	-7.3	36.1	32.2	-10.7
Order Inflows	60,216	50,216	-16.6	65,685	54,777	-16.6
Order Backlog	59,437	52,894	-11.0	62,248	51,554	-17.2

### Downgrade to Hold amidst lack of catalysts and changing risk of business model

Thermax has outperformed the ECG sector over the past 6 months by 25% - on back of strong order inflows (amongst few in the industry) and healthy earnings growth and debt-free balance sheet. It was amongst top pick in our ECG universe. But with order book cover deteriorating to 1.0X revenues and weak outlook for order inflows for next 2-3 quarters, Thermax is heading towards revenue and earnings decline in FY13E. Further, Thermax' investments in the super-critical venture is an overhang, since the investments could yield operating loss in near-term, which remains un-factored in our earnings assumption. With no near-term earnings and re-rating catalysts, we downgrade the stock from Accumulate to Hold with price target of Rs495.

**Segmental Performance**

Rs mn	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	YoY (%)	QoQ (%)	YTD'12	YTD'11	Gr (%)
<b>Segment Revenues</b>										
Energy	9,904	14,299	8,024	10,348	9,931	0.3	-4.0	28,303	24,879	13.8
Environment	2,943	3,826	2,647	2,968	3,024	2.8	1.9	8,640	7,646	13.0
Less: Intersegment	436	412	227	282	262	-	-	771	1,300	-
<b>Total</b>	<b>12,412</b>	<b>17,713</b>	<b>10,444</b>	<b>13,035</b>	<b>12,693</b>	<b>2.3</b>	<b>-2.6</b>	<b>36,172</b>	<b>31,226</b>	<b>15.8</b>
<b>Segment Results</b>										
Energy	1,073	1,494	810	1,102	947	-11.8	-14.1	2,859	2,666	7.2
Environment	399	499	313	320	393	-1.6	22.9	1,025	976	5.0
<b>Total</b>	<b>1,472</b>	<b>1,993</b>	<b>1,123</b>	<b>1,422</b>	<b>1,340</b>	<b>-9.0</b>	<b>-5.8</b>	<b>3,885</b>	<b>3,643</b>	<b>6.6</b>
Add- Unall Income / (Exp)	3	-25	51	73	51	-	-	176	141	-
Less- Interest Exp	2	10	4	11	7	242.3	-36.8	22	12	78.9
<b>PBT</b>	<b>1,473</b>	<b>1,959</b>	<b>1,170</b>	<b>1,485</b>	<b>1,384</b>	<b>-6.1</b>	<b>-6.8</b>	<b>4,038</b>	<b>3,771</b>	<b>7.1</b>
<b>Segment Cap. Employed</b>										
Energy	1,396	1,705	2,598	3,516	3,906	179.8	11.1	3,906	1,396	179.8
Environment	1,152	1,404	1,671	1,826	2,111	83.2	15.6	2,111	1,152	83.2
Unallocated	10,412	9,814	9,462	9,289	9,554	-8.2	2.9	9,554	10,412	-8.2
<b>Total</b>	<b>12,959</b>	<b>12,923</b>	<b>13,731</b>	<b>14,630</b>	<b>15,571</b>	<b>20.1</b>	<b>6.4</b>	<b>15,571</b>	<b>12,959</b>	<b>20.1</b>
<b>Segment Margins (%)</b>										
						<b>(bps)</b>	<b>(bps)</b>			<b>(bps)</b>
Energy	10.8	10.4	10.1	10.7	9.5	-130	-110	10.1	10.7	-60
Environment	13.6	13.0	11.8	10.8	13.0	-60	220	11.9	12.8	-90
<b>Average</b>	<b>11.5</b>	<b>11.0</b>	<b>10.5</b>	<b>10.7</b>	<b>10.3</b>	<b>-110</b>	<b>-30</b>	<b>10.5</b>	<b>11.2</b>	<b>-70</b>

**Order Backlog Details - Consolidated**

Rs mn	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	YoY (%)	QoQ (%)	YTD'12	YTD'11	Gr (%)
Order Inflows	12,496	12,563	16,880	12,840	7,454	-40.3	-41.9	37,174	47,653	-22.0
Order Backlog	71,540	64,460	68,040	65,310	58,090	-18.8	-11.1	58,090	71,540	-18.8

## Key Consolidated Financials

## Income Statement

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
<b>Net Sales</b>	<b>33,678</b>	<b>53,350</b>	<b>55,962</b>	<b>56,266</b>
<i>Growth (%)</i>	-2.5	58.4	4.9	0.5
<b>Expenditure</b>	<b>29,524</b>	<b>47,495</b>	<b>49,838</b>	<b>50,453</b>
Materials Consumed	20,452	36,474	37,757	38,131
Employee Cost	3,300	4,597	4,934	4,961
Manufacturing Exp	2,883	2,918	3,061	3,078
Other Exp	2,891	3,505	4,085	4,283
<b>EBITDA</b>	<b>4,154</b>	<b>5,855</b>	<b>6,124</b>	<b>5,813</b>
<i>Growth (%)</i>	-2.0	4.1	0.5	-0.5
<b>EBITDA margin (%)</b>	<b>12.3</b>	<b>11.0</b>	<b>10.9</b>	<b>10.3</b>
Depreciation	442	541	584	610
<b>EBIT</b>	<b>3,712</b>	<b>5,314</b>	<b>5,540</b>	<b>5,203</b>
<b>EBIT margin (%)</b>	<b>11.0</b>	<b>10.0</b>	<b>9.9</b>	<b>9.2</b>
Other Income	314	467	539	582
Interest expenses	20	41	41	21
<b>PBT</b>	<b>4,005</b>	<b>5,740</b>	<b>6,038</b>	<b>5,765</b>
Tax	1,416	1,967	2,069	1,975
<i>Effective tax rate (%)</i>	35.4	34.3	34.3	34.3
<b>Adjusted PAT</b>	<b>2,589</b>	<b>3,773</b>	<b>3,969</b>	<b>3,790</b>
<i>Growth (%)</i>	-8.5	45.7	5.2	-4.5
<b>Net Margin (%)</b>	<b>7.7</b>	<b>7.2</b>	<b>7.2</b>	<b>6.8</b>
(Profit)/loss from JVs/Ass/MI	-4	-47	-47	-47
<b>Adj. PAT After JVs/Ass/MI</b>	<b>2,593</b>	<b>3,820</b>	<b>4,016</b>	<b>3,837</b>
E/O items	-1,150	-4	0	0
<b>Reported PAT</b>	<b>1,443</b>	<b>3,817</b>	<b>4,016</b>	<b>3,837</b>
<i>Growth (%)</i>	-50.0	164.4	5.2	-4.5

## Cash Flow

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
<b>PBT</b>	<b>4,004</b>	<b>5,737</b>	<b>6,085</b>	<b>5,812</b>
Depreciation	442	516	584	610
Interest Provided	20	41	41	21
Other Non-Cash items	133	-1,149	0	0
Chg in working cap	3,709	-910	347	12
Tax paid	-1,439	-1,911	-2,069	-1,975
<b>Operating Cashflow</b>	<b>6,869</b>	<b>2,324</b>	<b>4,988</b>	<b>4,478</b>
Capital expenditure	-840	-1,507	-500	-500
<b>Free Cash Flow</b>	<b>6,030</b>	<b>818</b>	<b>4,488</b>	<b>3,978</b>
Other income	0	0	0	0
Investments	-2,263	-544	0	0
<b>Investing Cashflow</b>	<b>-2,263</b>	<b>-544</b>	<b>0</b>	<b>0</b>
Equity Capital Raised	0	0	0	0
Loans Taken / (Repaid)	39	1,166	-1,400	0
Interest Paid	-20	-41	-41	-21
Dividend paid (incl tax)	-697	-695	-1,199	-1,037
Income from investments	-82	-84	0	0
Others	0	173.5	0	0
<b>Financing Cashflow</b>	<b>-760</b>	<b>520</b>	<b>-2,640</b>	<b>-1,058</b>
<b>Net change in cash</b>	<b>3,006</b>	<b>794</b>	<b>1,848</b>	<b>2,920</b>
Opening cash position	3,696	6,702	7,496	9,344
<b>Closing cash position</b>	<b>6,702</b>	<b>7,496</b>	<b>9,344</b>	<b>12,265</b>

## Balance Sheet

Y/E, Mar (Rs. mn)	FY10	FY11	FY12E	FY13E
Equity share capital	238	238	238	238
Reserves & surplus	10,544	12,911	15,728	18,527
<b>Net worth</b>	<b>10,782</b>	<b>13,149</b>	<b>15,966</b>	<b>18,765</b>
<b>Minority Interest</b>	<b>94</b>	<b>520</b>	<b>520</b>	<b>520</b>
Secured Loans	80	1,476	76	76
Unsecured Loans	0	4	4	4
<b>Loan Funds</b>	<b>80</b>	<b>1,479</b>	<b>79</b>	<b>79</b>
Net deferred tax liability	144	298	298	298
<b>Total Liabilities</b>	<b>11,099</b>	<b>15,447</b>	<b>16,864</b>	<b>19,663</b>
Gross Block	7,418	10,677	11,531	12,031
Less: Depreciation	2,048	2,824	3,408	4,017
<b>Net block</b>	<b>5,369</b>	<b>7,853</b>	<b>8,124</b>	<b>8,014</b>
Capital work in progress	115	354	0	0
<b>Investment</b>	<b>3,703</b>	<b>2,415</b>	<b>2,415</b>	<b>2,415</b>
<b>Current Assets</b>	<b>23,477</b>	<b>28,650</b>	<b>31,379</b>	<b>34,415</b>
Inventories	4,916	6,155	5,829	5,861
Sundry debtors	7,984	10,672	11,898	11,963
Cash & bank balance	6,702	7,496	9,344	12,265
Loans & advances	3,282	3,596	3,576	3,595
Other current assets	594	731	731	731
<b>Current lia &amp; Prov</b>	<b>21,566</b>	<b>23,826</b>	<b>25,053</b>	<b>25,180</b>
Current liabilities	20,581	22,193	23,420	23,547
Provisions	985	1,633	1,633	1,633
<b>Net current assets</b>	<b>1,912</b>	<b>4,824</b>	<b>6,325</b>	<b>9,234</b>
Misc. exp	0	0	0	0
<b>Total Assets</b>	<b>11,099</b>	<b>15,447</b>	<b>16,864</b>	<b>19,663</b>

## Key Ratios

Y/E, Mar	FY10	FY11	FY12E	FY13E
<b>Profitability (%)</b>				
EBITDA Margin	12.3	11.0	10.9	10.3
Net Margin	7.7	7.2	7.2	6.8
ROCE	38.0	43.6	37.6	31.7
ROE	24.4	28.8	24.9	21.0
RoIC	137.8	184.5	107.7	103.2
<b>Per Share Data (Rs)</b>				
EPS	21.8	32.1	33.7	32.2
CEPS	25.5	36.6	38.6	37.3
BVPS	90.5	110.4	134.0	157.5
DPS	6.0	9.0	10.1	8.7
<b>Valuations (x)</b>				
PER	24.0	16.3	15.5	16.2
P/CEPS	20.5	14.3	13.5	14.0
P/BV	5.8	4.7	3.9	3.3
EV / Sales	1.5	1.0	0.9	0.8
EV / EBITDA	12.5	9.2	8.3	8.2
Dividend Yield (%)	1.1	1.7	1.9	1.7
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	-1.0	-0.6	-0.7	-0.8
Net Debt/EBITDA	-2.5	-1.4	-1.9	-2.5
Working Cap Cycle (days)	29.8	23.0	36.4	50.5

**Recommendation History: Thermax – TMX IN**

Date	Reports	Reco	CMP	Target
23/01/2012	<a href="#">Engineering and Capital Goods Sector Update</a>			
21/10/2011	<a href="#">Thermax Q2FY12 Result Update</a>	Accumulate	425	495
25/07/2011	<a href="#">Thermax Q1FY12 Result Update</a>	Buy	610	735
04/05/2011	<a href="#">Thermax Q4FY11 Result Update</a>	Buy	613	735

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
03/02/2012	<a href="#">TRF Q3FY12 Result Update</a>	Hold	345	282
31/01/2012	<a href="#">Blue Star Q3FY12 Result Update</a>	Hold	171	185
27/01/2012	<a href="#">BHEL Q3FY12 Result Update</a>	Hold	274	275
25/01/2012	<a href="#">Greaves Cotton Q3FY12 Result Update</a>	Buy	83	90

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