



## Akzo Nobel India Ltd.

‘Waiting for revival in demand scenario’

**Buy**

Nov 3, 2015

**Akzo Nobel India Ltd. (AKZO)** reported 8% YoY revenue growth in Q2FY16 mainly driven by increase in the volumes of decorative paints segment amidst subdued low price scenario. Though AKZO's reliance more on urban markets, it is partly insulated to the rural slowdown. However, the demand in urban area is improving at muted pace. Owing to low raw material costs mainly low crude oil prices helped the firm to keep margins at stable level. Besides, the management has been taking measures to improve the operation excellence of the firm through process improvements and energy savings. We are betting on the facts that gradually improving urban consumption, strong operational efficiencies and traction from the restructured product portfolio will augur well for the company's coatings business. We remain positive on the stock and maintain our 'Buy' rating.

**Q2 FY16 Result Analysis:**

**Operating income increases by 8.2% YoY in Q2FY16 driven by high volume growth:** AKZO has reported 8.2% YoY increase in operating income to Rs656.5 cr. Segment wise, revenue from the coating segment increased by 8.2% to Rs613.8 cr as compared to Rs581.5 cr reported in the same quarter of previous fiscal. However, income from other segment rose by significant 69.2% to Rs42.7 cr in the quarter under review from Rs25.2 cr in Q2FY15. On QoQ basis other operating income rose by 7.2% in Q2FY16.

**EBIDTA Margin improves to 9.1% amid low operating costs:** Operating expenditure increased by 7.8% YoY in Q2FY16 to Rs596.8 cr and 2.1% on QoQ basis. Growth in operating cost was lower than operating income growth leading the EBIDTA margin to improve to 9.1% in the quarter under review compared to 8.7% EBIDTA margin in the previous quarter. During quarter, EBIDTA of the company stood at Rs59.7 cr which was 12.5% higher as compared to same quarter in FY15. However, higher growth in employee cost (+22% YoY) and other expenses (+8% YoY) limited EBIDTA margin expansion to 34bps in 2QFY15 over the previous quarter.

**Net Profit increases by 15% YoY to Rs40.9 cr:** The company reported 15% YoY increase in net profit to Rs40.9 cr despite 4% contraction in other income reflecting a strong growth in operating income. Further, the contraction in interest cost and low tax outflow supported the bottom line growth for the company. Net Profit Margin (NPM) also improved to 6.2% in the reported quarter compared to 5.9% in the previous quarter.

**Management View:** Commenting on the results, the management has announced that in line with the company's strategy of achieving profitable growth, all business segments have continued their focus in strengthening their products through innovation, brands and distribution. This has reflected in an increase in demand for the company's products despite the scarce monsoon, driving healthy growth in revenue and profit in this quarter.

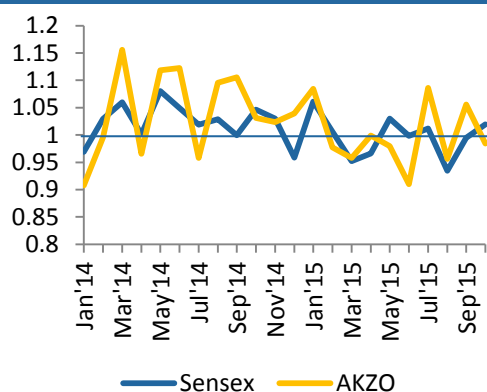
**Valuation and View:** Being a part of the world's leading coatings and chemicals group, AKZO has an unmatched advantage in terms of best brands and cutting-edge technology. Company's emphasis to produce quality, innovate and standardize products, strategy to constantly introducing new products to stay ahead of the general marketplace, operational and internal efficiencies and aggressive advertisement campaigns are the core capabilities of the firm, driving the company growth. Given AKZO's urban oriented premium portfolio of brands, we are of the view that revival of growth in tier 1 and tier 2 cities to provide impetus to business growth. Furthermore, gradual recovery in industrial sector led by macro-economic growth recovery will enable the company to record healthy growth. At CMP of Rs1,355, AKZO's share is trading at TTM P/E multiple of 34.8x, which is at discount to its peers Asian Paints (49.6x), Berger Paints (54.6x) and Kansai Nerolac Paints (42.0x). We maintain our 'Buy' rating on AKZO with a target price of Rs1,561 per share determine on the basis of Relative Valuation.

**Rating Matrix**

CMP	Rs1,355
Rating	Buy
Target Price	Rs1,561
Target Period	12 Months
Upside Potential	15.2%
52 week H/L	Rs1,550/1,201
Face value	Rs10
Sector	Paints
Category	Mid Cap

**Shareholding Pattern as on Sep 2015**

Particulars	Sep'15	Jun'15	Mar'15	Dec'14
Promoters	73.0%	73.0%	73.0%	73.0%
FIIIs	1.9%	2.0%	2.0%	2.3%
DIIIs	8.5%	8.5%	8.6%	8.6%
Non Institutions	16.6%	16.6%	16.4%	15.9%

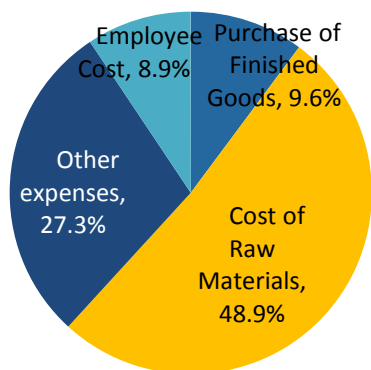
**Relative Capital Market Strength**



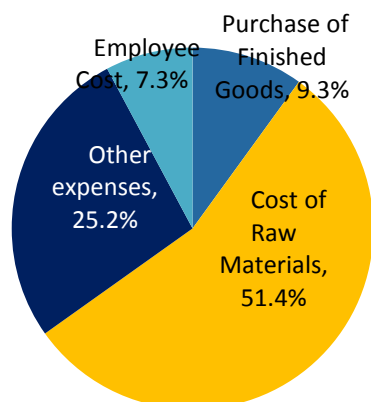
### Key Financials (Standalone)

Particulars (Rs cr)	Q2FY16	Q2FY15	YoY	Q1FY16	QoQ
<b>Operating Income</b>	<b>656.5</b>	<b>606.7</b>	<b>8.2%</b>	<b>658.4</b>	<b>-0.3%</b>
Operating Expenditure	596.8	553.6	7.8%	584.6	2.1%
<b>EBIDTA</b>	<b>59.7</b>	<b>53.1</b>	<b>12.5%</b>	<b>73.8</b>	<b>-19.1%</b>
EBIDTA Margin	9.1%	8.7%		11.2%	
Depreciation/Amortisation	13.6	12.7	6.8%	13.1	3.2%
Total Expenses	6,10.4	5,66.3	7.8%	5,97.8	2.1%
Other Income	14.8	15.4	-3.9%	7.5	97.3%
Finance Costs	0.3	0.4	-29.3%	0.4	-23.7%
Tax Expenses	19.7	19.6	0.3%	22.4	-12.2%
<b>Net Profit</b>	<b>40.9</b>	<b>35.8</b>	<b>14.6%</b>	<b>45.3</b>	<b>-9.6%</b>
NPM (%)	6.2%	5.9%		6.9%	
EPS (Rs)	8.8	7.7	14.6%	9.7	-9.6%

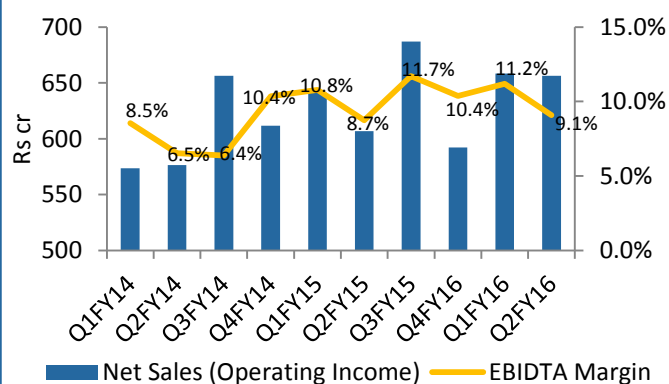
### Operating Expenditure/Sales (Q2FY16)



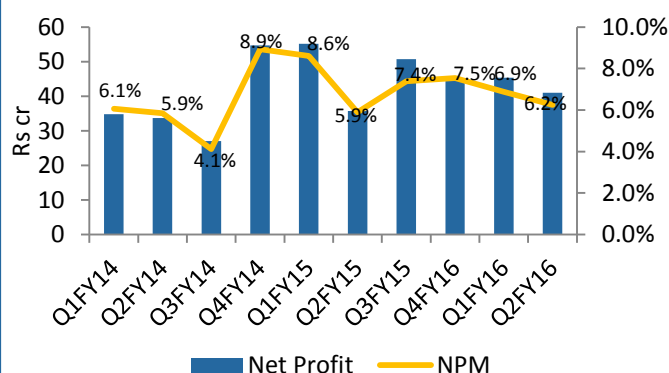
### Operating Expenditure/Sales (Q2FY15)



### Trend in Sales, EBIDTA margin



### NPM declines to 6.2% in Q2FY16





**Paint industry view:** Given that low penetration level of industry in India, the growth potential in paint industry over the next few years is pretty strong and the scope for penetration of paints in domestic market can be explored robustly. Further, consumer shifting from unbranded to branded products will aid the volume growth as around 25-30% Indian paint market is unorganized. Industry market size is likely to witness around double-digit CAGR of about 20% during FY14-FY17E. GDP revival and strong growth potential in domestic market will act as the major driving forces behind the rise in consumption of paints.

**AKZO to remain beneficiary of acceleration in demand growth:** AKZO has an unmatched advantage in terms of best brands and cutting-edge technology. Meanwhile, company's products are more skewed towards the premium category. Though AKZO's reliance more on urban markets, it is also taking initiatives to enhance presence in rural and small towns like launching around 4 products each year and expanding distribution network. Apart from high installed capacity, the company has significantly invested in advertisement and promotional activities and increased employees count. All these ahead of time investments present remarkable opportunities for operating leverage gains as the current cost structure of the company is capable of gripping around 25-30% growth in revenues without any major increase in the cost structure.

**Relative Valuation:** AKZO Nobel India's performance as well margins are in line with industry peers, however company's share is trading at deep discounts to them. AKZO is the subsidiary of Akzo Nobel, a world's leading coatings and chemicals company. This global leader is bringing the global expertise to domestic subsidiary, the move will help AKZO to boost sales as well as the profits going forward. The management is highly aggressive and has curtailed several overlapping expenses to drive margins expansion close to the industry top players's margins. We expects that improving product mix, return of pricing power in industrial paints and softening crude oil prices will lead to further improvement in operating margins, going forward. We maintain our 'Buy' rating on AKZO with a target price of Rs1,561 per share arrived at P/E (30.8) x FY17EPS Rs50.7 and EV/EBIDTA (23.6)x FY17E.

Particulars	FY13	FY14	FY15	FY16E	FY17E
EPS (Rs)	46.9	32.2	39.9	41.1	50.7
EBIDTA (Rs Cr)	188.6	191.8	261.4	247.4	304.2
<b>Valuation Parameters</b>	P/E (x)	EV/EBIDTA (x)			
Applying multiple	30.8	23.6			
<b>Fair Value</b>	<b>Rs1,561</b>				

### Relative Valuation

Companies (Rs)	CMP	6M R(%)	12M R(%)	M. Cap	EPS	BVPS	EBIDTA Margin (%)	NPM (%)
AKZO	1,355.0	-5.1%	4.9%	6,327.9	38.9	17.1	10.6%	7.0%
Asian Paints	830.0	6.7%	27.1%	79,613.6	16.7	49.4	16.8%	11.0%
Berger Paints	218.0	2.8%	11.2%	15,534.7	4.0	18.1	12.4%	6.5%
Kansai Nerolac Paints	247.0	7.4%	28.0%	13,313.3	5.9	29.6	13.9%	8.6%

Companies (Rs cr)	P/E (x)	P/Bv (x)	P/Sales(x)	EV/EBIDTA (x)	D/E	PAT (TTM)	EBIDTA (TTM)	Sales (TTM)
AKZO	<b>34.8</b>	79.4	2.4	22.8	0.0	181.7	275.3	2,594.1
Asian Paints	<b>49.6</b>	16.8	5.5	32.6	0.1	1,605.7	2,447.0	14,590.5
Berger Paints	<b>54.6</b>	12.0	3.5	29.3	0.5	284.5	545.5	4,382.8
Kansai Nerolac Paints	<b>42.0</b>	8.3	3.6	26.1	0.0	316.9	510.4	3,666.3

Companies (Rs cr)	Out. Shares	Net Worth	EV	Debt	FV (Rs)	Cash	Category	PAT G. FY15
AKZO	4.67	920.0	6,267.8	0.0	10	60.1	Mid Cap	24.0%
Asian Paints	95.9	4,742.4	79,851.3	409.9	1	204.4	Large Cap	13.0%
Berger Paints	71.3	1,292.8	15,973.7	608.8	1	169.8	Mid Cap	6.1%
Kansai Nerolac Paints	53.9	1,596.8	13,320.8	41.5	1	34.1	Mid Cap	31.5%

	Sales Growth			PAT Growth			EBIDTA Margin			NPM			ROE		
Companies	FY13	FY14	FY15	FY13	FY14	FY15	FY13	FY14	FY15	FY13	FY14	FY15	FY13	FY14	FY15
AKZO	12.3%	8.3%	4.5%	8.4%	-31.4%	24.0%	13.2%	9.3%	11.7%	8.9%	5.6%	6.7%	17.3%	15.4%	21.1%
Asian Paints	19.0%	17.0%	12.0%	13.6%	8.9%	13.0%	14.7%	14.5%	14.6%	9.2%	8.6%	8.7%	37.8%	34.0%	32.5%
Berger Paints	13.5%	15.6%	11.7%	21.3%	14.2%	6.1%	11.0%	11.0%	11.5%	6.0%	5.9%	5.6%	25.1%	24.1%	22.3%
Kansai Nerolac Paints	9.9%	10.8%	12.2%	35.3%	-29.3%	31.5%	10.4%	10.0%	11.1%	8.7%	5.5%	6.5%	24.9%	15.3%	18.0%

Source: Choice Broking, Company data



### Profit And Loss

Particulars (Rs cr)	FY13	FY14	FY15	FY16E	FY17E
Net Sales	2,232.0	2,417.9	2,526.9	2,716.4	3,042.4
% Growth	12.28%	8.33%	4.51%	7.50%	12.00%
Total Revenue	2,370.1	2,474.6	2,594.6	2,778.2	3,110.2
% Growth	12.9%	4.4%	4.8%	7.1%	12.0%
Staff Costs	175.2	193.9	205.8	217.3	243.4
% of Net Sales	7.9%	8.0%	8.1%	8.0%	8.0%
Other Manufacturing/Operating costs	1,295.5	1,378.5	1,406.2	1,533.9	1,718.9
% of Net Sales	58.0%	57.0%	55.6%	56.5%	56.5%
Other Expenses	572.6	653.8	653.5	717.8	775.8
% of Net Sales	25.7%	27.0%	25.9%	26.4%	25.5%
Total Operating Expenditures	2,043.4	2,226.1	2,265.5	2,469.0	2,738.1
% of Net Sales	91.6%	92.1%	89.7%	90.9%	90.0%
EBITDA	188.6	191.8	261.4	247.4	304.2
EBITDA Margin %	8.4%	7.9%	10.3%	9.1%	10.0%
Growth %	8.0%	1.7%	36.3%	-5.4%	23.0%
Depreciation & Amortisation	38.7	43.7	52.6	48.5	51.4
EBIT	149.9	148.2	208.8	198.9	252.9
Financial Charges	8.9	1.5	1.5	5.0	5.6
Other Income	138.1	56.7	67.7	61.8	67.8
PBT	279.1	203.4	275.0	255.6	315.1
Pre-tax Margin %	12.5%	8.4%	10.9%	9.4%	10.4%
Tax	60.3	53.2	88.7	63.9	78.8
Effective Tax Rate %	21.6%	26.1%	32.3%	25.0%	25.0%
Reported PAT	218.8	150.2	186.3	191.7	236.3
Net Profit Margin %	9.8%	6.2%	7.4%	7.1%	7.8%
Growth in Reported PAT %	8.4%	-31.4%	24.0%	2.9%	23.3%
Extraordinary Income	0.0	0.0	0.0	0.0	0.0
Adjusted PAT	218.8	150.2	186.3	191.7	236.3
Shares In Issue	4.67	4.67	4.67	4.67	4.67
Adjusted EPS	46.9	32.2	39.9	41.1	50.7
Growth %	-14.4%	-31.4%	24.0%	2.9%	23.3%
Dividend paid	370.7	349.9	93.4	82.6	110.9
Dividend pay out ratio	169.4%	232.9%	50.1%	43.1%	46.9%
Net profit transferred to Reserves Account	-151.9	-199.7	92.9	109.1	125.5

### Balance Sheet

Particulars (Rs cr)	FY13	FY14	FY15	FY16E	FY17E
Gross Asset	731.0	904.9	950.3	1,046.0	1,140.5
Accumulated Depreciation	376.2	402.4	455.0	503.5	554.9
Capital WIP	105.7	30.6	33.1	35.7	72.1
Net Fixed Asset	460.5	533.1	528.4	578.1	657.7
Investments & Deposits	270.0	50.0	50.0	13.9	143.1
<b>Current Asset</b>	<b>1,574.7</b>	<b>1,455.8</b>	<b>1,220.8</b>	<b>1,626.9</b>	<b>1,730.0</b>
Cash	85.7	72.2	60.1	87.8	94.6
Inventories	314.9	324.2	364.7	380.3	425.6
Trade Debtors	251.6	307.6	278.4	309.7	346.8
Loans and Advances	220.8	156.4	159.6	213.3	232.2
Current Investments	677.2	578.6	344.4	614.8	610.4
Other Current Assests	24.5	16.8	13.6	21.1	20.4
Current Liabilities & Provisions	1,114.4	1,097.3	791.9	1,089.5	1,264.2
Net Current Asset Excluding Cash	374.6	286.3	368.8	449.6	371.2
<b>Capital Deployed</b>	<b>1,190.8</b>	<b>941.6</b>	<b>1,007.3</b>	<b>1,129.4</b>	<b>1,266.5</b>
Long-term Liabilities and Provisions	85.5	93.8	87.2	100.4	111.9
Total Non Current Liabilities	85.5	93.8	87.2	100.4	111.9
Share Capital	46.7	46.7	46.7	46.7	46.7
Reserve and Surplus	1,058.6	801.1	873.3	982.4	1,107.8
Total Stock Holder's Equity	1,105.3	847.8	920.0	1,029.1	1,154.5
<b>Capital Employed</b>	<b>1,190.8</b>	<b>941.6</b>	<b>1,007.2</b>	<b>1,129.5</b>	<b>1,266.5</b>
DIFF	0.0	0.0	0.1	0.0	0.0
current ratio	1.4	1.3	1.5	1.5	1.4
D\E	0.1	0.1	0.1	0.1	0.1



### Cash Flow Statement

Particulars (Rs cr)	FY13	FY14	FY15	FY16E	FY17E
Profit before tax	279.1	203.4	275.0	255.6	315.1
Depreciation	35.1	26.2	52.6	48.5	51.4
Interest Expense	8.9	1.5	1.5	5.0	5.6
Operating Profit Before WC Changes	323.2	231.0	329.1	309.2	372.1
Changes In WC	621.0	88.3	-82.5	-80.9	78.5
Gross cash generated from Operations	944.2	319.3	246.6	228.3	450.6
Direct taxes paid	60.3	53.2	88.7	63.9	78.8
Cash Flow from Operations	883.9	266.2	157.9	164.4	371.8

### Cash Flow from Investing Activities

Capital Expenditure (CAPEX)	(124.5)	(98.8)	(47.9)	(98.3)	(130.9)
Investments	(185.0)	220.0	0.0	36.1	(129.2)
Net Cash Used In Investing Activities	(309.5)	121.2	(47.9)	(62.2)	(260.1)

### Cash Flow from Financing Activities

Change in Debt	0.9	8.3	(6.6)	13.2	11.5
Change in Equity	9.9	0.0	(0.0)	0.0	0.0
Dividends Paid	(370.7)	(349.9)	(93.4)	(82.6)	(110.9)
Interest Paid	(8.9)	(1.5)	(1.5)	(5.0)	(5.6)
Others	(193.7)	(57.8)	(20.7)	0.0	0.0
Net Cash used in Financing Activities	(562.6)	(400.9)	(122.2)	(74.4)	(104.9)

Net Increase in Cash and Cash Equivalents	11.8	(13.5)	(12.2)	27.8	6.8
Cash and cash equivalents At the beginning	73.9	85.7	72.2	60.1	87.8
Net Increase in Cash and Cash Equivalents	11.8	(13.5)	-12.2	27.8	6.8
Cash and cash equivalents At the end	85.7	72.2	60.0	87.9	94.5
Cash balance as per balance sheet difference	0.0	0.0	(0.1)	0.1	-0.1

### Financial Ratios

Particulars	FY13	FY14	FY15	FY16E	FY17E
<b>Profitability Ratios</b>					
Return on Assets (ROA)	9.5%	7.4%	10.4%	8.6%	9.3%
Return on Equity (ROE)	19.8%	17.7%	20.3%	18.6%	20.5%
Return on Capital Employed (ROCE)	12.6%	15.7%	20.7%	17.6%	20.0%
<b>Dupont Analysis-ROE Decomposition</b>					
PAT/PBT (Tax Efficiency)	0.8	0.7	0.7	0.8	0.8
PBT/EBIT (Interest Burden)	1.9	1.4	1.3	1.3	1.2
EBIT/Sales (OPM)	0.1	0.1	0.1	0.1	0.1
Sales/Total Assets (Asset Turnover)	1.0	1.2	1.4	1.2	1.2
TA/NW (Financial Leverage)	2.1	2.4	2.0	2.2	2.2
<b>ROE</b>	<b>19.8</b>	<b>17.7</b>	<b>20.3</b>	<b>18.6</b>	<b>20.5</b>
<b>Liquidity Ratios</b>					
Current Ratio	1.4	1.3	1.5	1.5	1.4
Acid Test Ratio	1.1	1.0	1.1	1.1	1.0
<b>Efficiency Ratios</b>					
Assets Turnover Ratio	1.0	1.2	1.4	1.2	1.2
Working Capital Turnover Ratio	4.8	6.7	5.9	5.1	6.5
F.A. Turnover Ratio	4.8	4.5	4.8	4.7	4.6
C.A. Turnover Ratio	1.4	1.7	2.1	1.7	1.8
Debtors Velocity	41.1	46.4	40.2	41.6	41.6
<b>Margin Ratios (%)</b>					
EBITDA Margin	8.4%	7.9%	10.3%	9.1%	10.0%
Pre-Tax Margin	12.5%	8.4%	10.9%	9.4%	10.4%
Net Profit Margin	9.8%	6.2%	7.4%	7.1%	7.8%
<b>Growth Ratios YoY (%)</b>					
Net Sales	12.3%	8.3%	4.5%	7.5%	12.0%
EBITDA	8.0%	1.7%	36.3%	-5.4%	23.0%
Adj.PAT	8.4%	-31.4%	24.0%	2.9%	23.3%
Adj.EPS	-14.4%	-31.4%	24.0%	2.9%	23.3%
<b>Working Ratios (Days)</b>					
Inventory	51.5	48.9	52.7	51.1	51.1
Debtors	41.1	46.4	40.2	41.6	41.6
Net Working Capital Excluding Cash	374.6	286.3	368.8	449.6	371.2
<b>Other Ratios (%)</b>					
Other Income/PBT	49.5%	27.9%	24.6%	24.2%	21.5%
Enterprise Value	4007.9	5154.2	6391.5	6377.1	6381.8
FCF Margin (%)	17.3%	1.5%	-0.3%	5.0%	5.0%
Capex/Sales (%)	5.6%	4.1%	2.6%	4.4%	4.4%
<b>Per Share (Rs)</b>					
Adj.EPS	46.9	32.2	39.9	41.1	50.7
CEPS	55.2	41.6	51.2	51.5	61.7
DPS	79.4	75.0	20.0	17.7	23.8
BVPS	236.9	181.7	197.2	220.6	247.4
Cash Per Share	18.4	15.5	12.9	18.8	20.3
<b>Valuation Parameters</b>					
P/E	18.3	34.2	33.9	33.0	26.8
P/CEPS	15.6	26.5	26.5	26.3	22.0
P/BV	3.6	6.1	6.9	6.1	5.5
EV/EBIDTA	21.3	26.9	24.3	25.6	20.8
Market Share Price	859	1100	1,355	1,355	1,355

Source: Choice Broking, Company data

## Choice's Rating Rationale

The price target for a large cap stock represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as Outperform, the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as Underperform, the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as Neutral.

BUY	Absolute Return >15%
Accumulate	Absolute Return Between 10-15%
Hold	Absolute Return Between 0-10%
Reduce	Absolute Return 0 To Negative 10%
Sell	Absolute Return > Negative 10%

Coverage History			
Date	Recommendation	CMP (Rs)	Target Price (Rs)
07-Feb-15	Buy	1,454	1,810
06-Jun-15	Buy	1,319	1,610
03-Nov-15	Buy	1,355	1,561

## Institutional Equity Team

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