KEC International

Accumulate

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IN-DEPTH • PRECISE • ACTIONABLE

Annual Report Analysis

KEC International - Strong FY18 enabled by T&D and Rail business

FY18 was a strong year despite facing challenges regarding GST implementation in 1HFY18 with revenue at ₹ 100.9bn grew by 15.3% YoY as EBIDTA grew by 23% to ~ ₹ 10bn and PAT grew by 1.5x to ₹ 4.6bn. Overall order book was up 37% given the strong capex environment in power transmission and rail electrification projects. OCF was down 52% YoY as working capital grew ~1%.FCF decreased by 57% YoY with capex for FY18 at ₹ 1.2bn. It was able to achieve to achieve significant order intake from Brazil (through SAE) and in the SAARC region and see improvement in orders from MENA and Africa with oil prices rising. It has broadened its customer base in setting up transmission projects with various state electricity boards and private players.

Growth in revenue. improved margins, and reduced interest cost enhanced profitability

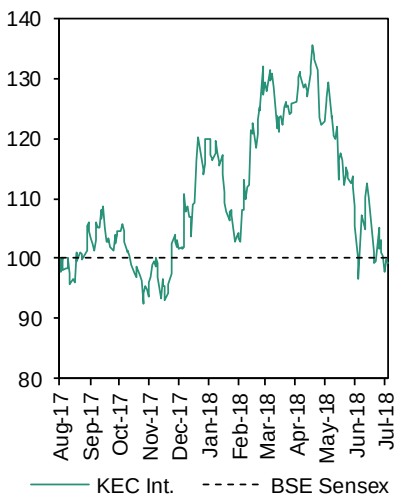
KEC International had a significant revenue growth of 15.3% at ₹100.9bn which was primarily due to T&D and Railways business. The T&D business secured orders of ₹ 9.6bn across both domestic and International markets while the rail business secured orders worth ₹3.9bn amounting to 26% of total order intake of ₹ 150.9bn. There was an improvement in EBITDA margins which increased by 62bps to 10% even after increase in raw materials cost by 24%, driven primarily internal efficiencies and improvement in margin profile of businesses like railways and it's wholly owned subsidiary SAE towers. The operational expenses grew by 15% to ₹ 90.9bn. Its finance cost decreased with decreasing borrowing cost to ₹2.46bn aided by repayment of loans amounting to ~ ₹ 36.8bn with net debt decreasing by ₹3.9bn to ₹1.42bn.

View

Management has guided for a 15% revenue growth in FY19, which we believe is doable. The management expects to double its revenues from railway segment with margins moving closer to T&D. There is focus on reducing interest cost and debt along with better W.C management. We see 16% revenue CAGR over FY18-20E. We maintain our Accumulate rating with TP ₹ 390 based on target multiple of 15xFY20E.

CMP	₹ 333
Target / Upside	₹ 390/17%
BSE Sensex	35,658
NSE Nifty	10,773
Scrip Details	
Equity / FV	₹ 514mn/₹ 2/-
Market Cap	₹ 85bn
	USD 1,242mn
52-week High/Low	₹ 442/254
Avg. Volume (no)	626,915
NSE Symbol	KEC
Bloomberg Code	KECI IN
Shareholding Pattern Mar'18 (%)	
Promoters	51.0
MF/Banks/FIs	20.2
FIIs	11.3
Public / Others	17.5

KEC Int. Relative to Sensex



FINANCIALS (₹ Mn)

Particulars	FY16	FY17	FY18	FY19E	FY20E
Net Sales	85,178	87,550	100,964	117,215	136,430
Growth (%)	0.6	2.8	15.3	16.1	16.4
EBITDA	6,923	8,178	10,062	11,852	13,921
OPM (%)	8.1	9.3	10.0	10.1	10.2
PAT	1,478	3,047	4,604	5,526	6,693
Growth (%)	(8.2)	106.1	51.1	20.0	21.1
EPS (₹)	5.8	11.9	17.9	21.5	26.0
Growth (%)	(8.2)	106.1	51.1	20.0	21.1
PER(x)	57.7	28.0	18.5	15.5	12.8
ROANW (%)	11.3	21.2	25.7	24.8	24.4
ROACE (%)	13.9	17.2	25.0	27.1	28.2

Sr. Analyst: Vinod Chari
Tel: +9122 4096 9776
E-mail: vinodc@dolatcapital.com

Analyst: Jayakanth Kasthuri
Tel: +9122 4096 9771
E-mail: jayakanthk@dolatcapital.com

DOLAT CAPITAL

July 06, 2018

OCF and FCF declines due to increase in Capex and tax outgo

The company witnessed increase in cash positions to ₹2.3bn for FY18 primarily due to decrease in cash from investing activities by 82% YoY to ₹ 0.95bn. Cash from operations declined by 61% to ~₹10.41bn in FY18 compared to ₹21.8bn in FY17 due increase in tax outgo by 44% YoY resulting in OCF/EBITDA declining to 1.0x in FY18 from 2.7x in FY17. Decrease in cash flows from financing activities by 54% at ₹6.83bn due to flattish W.C for FY18 at ₹ 20.8bn with capex increasing from ₹0.55bn to ₹1.17bn YoY resulting in FCF to decline by 56.5% to 9.24bn from 21.2bn YoY. There was slight decrease in W.C days from 86 days to 75 days primarily due to increase in payable days from 124 to 161 YoY.

Increase in government infrastructure spending to be beneficial for the company

With proposed allocation of ₹ 160bn for Sahaj Bijli Har Ghar Yojana (SAUBHAGYA) scheme, to provide free electricity connections to about 4 crore un-electrified households and the government's focus on the last mile connectivity for rural electrification, having achieved 100% rural electrification augers well for the company to meet the increase demand for power transmission but challenges pertaining timely project execution , right of way, land acquisition, environment and forest clearances, etc. are still persistent. The company expects to a larger share of business emerging from private clients and State electricity utilities with currently all new Central Government projects to be awarded through the Tariff Based Competitive Bidding (TBCB) route.

KEC being leader in the power transmission EPC space, it has also grown rapidly in substation segment which now comprises significant part of the orderbook and envisages that the share of investments in substations will rise to about 40-45% of the total investment, with a push towards GIS Technology at voltages of 220/ 400 kV levels. With huge investments being planned in terms of "One Nation- One grid" connectivity with focus on affordability and reliability, including substantial outlays by the state government for expanding intra-state transmission infrastructure in addition to PGCIL increased capital outlay and initiatives like UDAY to improves DISCOMs liquidity position helps states in India gain traction, paving way for improved profitability for the company and sector as a whole in coming years.

The company has a positive outlook for the Railway sector as the government has planned for network expansion along upgradation and modernisation of the existing infrastructure with the FY19 Railway Budget saw an increase in capital outlay from ₹ 1310bn to ₹ 1480bn along with renewal of 3,900 km of tracks and 1,000 km of new line construction. There is a planned 1,000 km of gauge conversion work along with 2,100 km of doubling works. The government has planned to commission ~6,000 km of electrification and modernisation of the signalling system of the Indian Railways in line with the target to complete 100 percent electrification (38,000 km) of broad gauge tracks by FY21,

In line with the rapid urbanisation in the country, coupled with the Government's push for a digital India, the company entered the Smart Infrastructure business. primarily targeting Smart Cities and Communication, Smart Mobility and Smart Utilities. The business model will be like a master system integrator and working closely with central and state governments and utility providers in developing digital infrastructure. Given the synergies with the company's EPC business well developed industry ecosystem, and focus on technology, it is working towards creating value added services to its clients for its customers.

The Indian Government thrust on urban transport infrastructure such as metro and smart cities is expected to provide significant boost to the domestic power cable business which is estimated to grow 12-15% in medium term. The company had consolidated its manufacturing footprint by shifting operations from its manufacturing plant at Silvassa to Vadodara thus creating an integrated facility offering the range of products ranging from EHV, HT and LT Cables. The demand for EHV cables is expected to rise as distribution voltages will go up to improve efficiency and replacement of overhead transmission lines due to increased adoption of underground cabling in urban areas. Cables business margin maintained at 6-7%, which is currently the industry average and is expecting 8-10% by the end of this year

The company solar business grew 80% YoY to ₹ 2.88bn and is expected to be challenging with capacity addition anticipated to be less than the government projection of 10-20 GW. Clarity on various regulatory aspects including GST interpretation and impending safeguard duty on cells and modules will be helpful in improving sentiments and ensuring recovery of momentum. The company sees potential in neighbouring countries like Bangaldesh and Sri Lanka and some countries in the Middle-east and Africa.

MENA market likely to see an uptick

In International markets, during the year owing to depressed oil prices the company witnessed a slowdown in new tenders from the Middle-east. However, with oil prices on the rise and a focus to reduce their dependency on oil revenues, it is anticipated that new projects will be rolled out at a faster pace. Middle East markets like Oman, Egypt, Jordan, Abu Dhabi have started seeing some traction. Electricity demand in the MENA region will continue to be strong, fuelled by population growth, urbanisation, rising income levels, industrialisation, and low electricity prices, rendering investments in the power sector a priority for the governments in the region. The company also sees strong traction in markets like SAARC, Central Asia, Brazil and Africa. In Mexico, the company sees visible orders to evacuate power from wind power generation. It expects Brazil few large EPC opportunities on T&D and tower business with current execution of ~800 km of transmission Lines. With investment in capability building in new segments the company is likely to face margin pressures but the Railways/Sub-station/Civil/Solar segments could be important growth drivers for the company, going ahead.

Domestic Railways business buoyant with international opportunities to be explored

The company is an integrated player in the industry and executes various types of works such as track laying, doubling & tripling of tracks, building railway stations, tunnels & bridges, signalling & telecommunication works, and electrification. During the year there was a significant growth in its Railway Business, with substantial order inflow and a closing order book of ₹ 40bn. The adoption of focussed execution approach has led to the commissioning of close to 807 route km of Railway Electrification works, which is ~20% of the overhead electrification projects commissioned by the Indian Railways in FY18.

It has completed and is in carrying out rail projects for rail companies like RVNL, IRCON, RITES along with rail electrification projects of PGCIL. It is currently executing 31 projects, of which 18 were secured during the year. Furthermore, it has succeeded in diversifying its project portfolio, with ~70% of its order book comprising of composite and signalling & telecommunication works. The company is pre-qualified in some packages of Dedicated Freight Corridor (DFC) projects and is likely bid selectively in consortium for DFC projects. The company is also looking to explore relevant project in internationally.

Overall the order intake of the company grew by 22% YoY and the total order book grew by 37% YoY for FY18 and International order book grew by 28% YoY. The Company is confident about all the project it has undertaken, as most of these projects are funded by multilateral sources so the credibility of these projects is high.

Dividend - The company has recommended final dividend of ₹2.4 per equity share on face value of ₹2 per share. The cash outflow on account of dividend and dividend distribution tax amounted to ₹740 mn for the year ended in Mar'18

Management Discussion and Analysis

- It continues to see growth in India. With initiatives like '24x7 power for all' and 'One Nation, One Grid, One Price'. It expects to see growing demand for power and capacity expansion which will see increased demand for new transmission lines and substantial outlay by state governments and PGCIL. With migration to higher transmission voltages of up to 1,200 kV, new technologies for bulk power transmission are being worked upon, High Capacity Power Transmission Corridors (HCPTCs) are being developed. The company expects the T&D market to grow by 20% between FY17-22 which presents tremendous opportunity.
- The demand for optical fiber cables is expected to grow with focus of the Indian Government on urban infrastructure such as Metros, Smart Cities & Highways is expected to provide significant boost to the domestic power cable market, which is estimated to grow at 12-15% over the medium term with EHV cables being the key focus area for the company as the demand is expected to rise as distribution voltages will go up to improve efficiency and replacement of overhead transmission lines due to increased adoption of underground cabling in urban areas
- Indian Railways electrification targets of 6000kms is a positive indicator including automation for the company as it has also pre-qualified in some packages of dedicated freight corridor projects through consortiums and is also looking out for opportunities in international areas.
- KEC successfully ventured into solar EPC business ~2.5-3 years ago and by leveraging synergies from its T&D business it has was able to commission and execute projects with lowered cost and ahead of scheduled delivery. It successfully commissioned within 88 days from the start of the project one of the largest ground-mounted solar plant (6MW) in the state of Himachal Pradesh. It is currently executing 130 MW turnkey EPC order received from APGENCO and the plant is on track for commissioning in 2018. It has also received solar rooftop orders during the and expects to get further orders from large commercial players.
- With oil prices on rise enabling focus by the respective governments in MENA, Latin American and SAARC regions to develop and revitalise transmission lines along with infrastructure, the management sees visible order pipeline along with rebalancing of existing portfolios to benefit the company.

Operational Performance

- Order intake across verticals showed growth with overall intake increased by 22% YoY as a result order book grew by 37% YoY and closed at ₹172.9bn.
- There was a resurgence in railway business with order intake of ₹41.5bn in FY18.
- In solar business continued presence in single axis tracking technology by commissioning a 10 MW project in Andhra Pradesh for a global, private developer and successful commissioning of a ground mount project in Saudi Arabia.
- In T&D, it has delivered 20% of its projects ahead of schedule in FY18.
- Successful diversification of international business with entry & re-entry into Africa and Middle-east regions
- Broadening of customer base in India by working with state electricity boards and private players.

Financial Performance

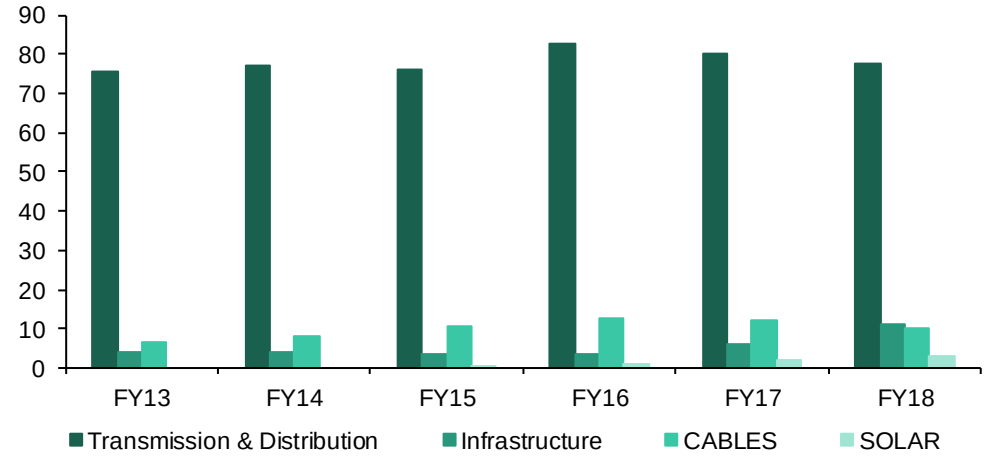
- Company had a revenue of ₹100.9bn in FY18 as against ₹87.5bn a growth rate of 15.3% YoY
- The increase in revenue was primarily driven by increase in revenue from Railways business which grew by 89.2% YoY to ₹8.44bn and T&D business which grew by 11.2 % YoY to Rs 78.2bn.
- There was an improvement in EBITDA margins which increased by 62bps to 10% driven by internal efficiencies and improvement in margin profile of railways business and it's wholly owned subsidiary SAE towers.
- Overall employees cost grew by 9% YoY to ₹ 7.9bn
- Depreciation and amortisation cost declined by 15.4 YoY to ~₹ 1.1bn
- Its finance cost decreased by ~3% YoY which reduced borrowing cost to ₹2.46bn aided by repayment of loans amounting to ~ ₹ 36.8bn with net debt decreasing by ₹3.9bn to ₹1.42bn

Exhibit 1: Revenue Performance - businesswise (₹ mn)

Business	FY13	FY14	FY15	FY16	FY17	FY18
Transmission & Distribution	**57,506**	**61,080**	**64,840**	**72,120**	**70,320**	**78,200**
SAE	10,069	8,630	8,030	8,300	10,020	10,250
Infrastructure	**3,140**	**3,140**	**3,140**	**3,140**	**5,320**	**11,120**
Railways	3,627	1,690	1,330	2,100	4,460	8,440
Water	2,464	1,310	1,320	1,030	860	2,680
CABLES	**5,104**	**6,310**	**9,070**	**11,180**	**10,540**	**10,090**
SOLAR	**-**	**-**	**90**	**930**	**1,590**	**2,880**
Inter SBU	-	-	-	(260)	(220)	(1,330)
Total	**75,819**	**79,160**	**85,170**	**87,110**	**87,550**	**100,950**

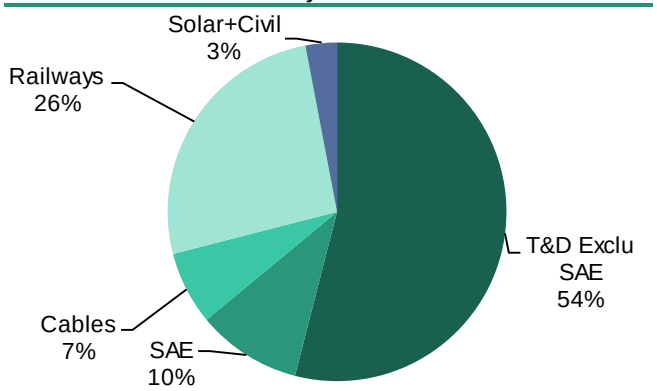
Source: Company, DART

Exhibit 2: Revenue Mix in (%)



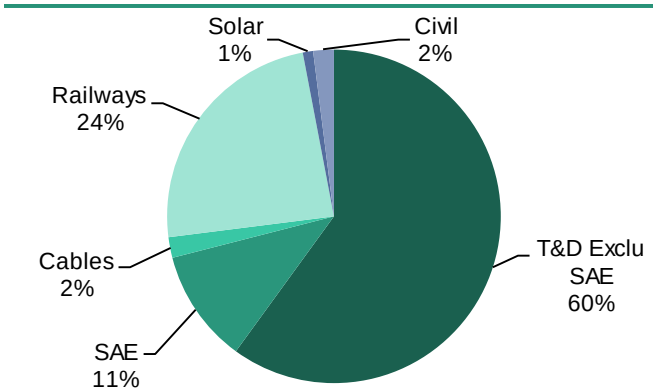
Source: Company, DART

Exhibit 3: Order Intake by business FY18



Source: Company, DART

Exhibit 4: Order Book as on 31st Mar'18



Source: Company, DART

Exhibit 5: Margin performance

	FY13	FY14	FY15	FY16	FY17	FY18
Net Sales (₹ mn)	75,819	79,160	85,170	87,110	87,550	100,964
YoY Growth (%)	17.2	13.2	7.2	0.6	2.8	15.3
EBITDA (₹ mn)	3,814	4,933	5,118	6,923	8,179	10,062
EBITDA Margin (%)	5.5	6.2	6.0	8.1	9.3	10.0
Net Profit (₹ mn)	650	668	1,609	1,479	3,048	4,604
NP Margin (%)	0.9	1.3	1.9	1.7	3.5	4.6

Source: Company, DART

Revenue Cost - The cost of revenue increased by 15% YoY to ₹ 90.9bn in FY18 primarily due to increase in raw material by 58.8% YoY to ₹ 52.4bn due to lower commodity cost of materials like copper, steel and aluminium and erection & subcontracting expense by 19.2% YoY to ₹ 21.2bn.

Other Income - The other income in total for the year ended Mar'18 was ₹ 404mn compared to ₹ 288.7mn for the year ended Mar'17. The increase of ~1.4x for FY18 was due to 2x increase in interest income earned on financial assets which was at ₹ 258mn compared to ₹ 122.6mn in. There was also a decrease in guarantee charges received from ₹ 8.3mn in FY17 to ₹ 7.5mn in FY18

Effective Tax Rate - Total effective tax rate for FY18 was marginally down by ~100bps to 33% which accounts for ₹2.2mn for the year ended Mar'18 as against ₹1.6mn for the year ended Mar'17 as there was a decrease in deferred tax becoming an asset to ₹ 195mn along with increase in current taxation to ₹ 24.9bn in FY18 from ₹ 13.5bn in FY17

PAT - The net profit margin increased to 4.6% during the year-end 2018 compared to 3.5% at the year-end 2017. The net profit stood at ₹ 4.6bn as against ₹ 3bn for FY17.

EPS - EPS has been computed on equity capital base of 257.1mn shares as on 31 March, 2018. EPS stood at ₹ 17.9 in FY17 as compared to ₹ 11.9 in the previous year.

Balance Sheet Analysis

Gross Block - KEC invested ₹ 1.17bn of CAPEX during the year compared to ₹ 0.55bn last year.

Cash Position - The company witnessed an increase in cash position to ₹ 2.3bn primarily due to decrease in cash from investing activities by 82% YoY to ₹ 0.95bn. The cash per share value stood at ₹ 22.2.

Debtors - Receivable collection in FY18 increased with its Debtor days (DSO) increasing to 182 days as against 175 days in FY17 resulting increase in its overall receivables from ₹ 42bn in FY17 to ₹ 50.3bn in FY17.

Cash Flow – Cash from operations declined by 61% to ~₹10.41bn in FY18 compared to ₹21.8bn in FY17 due increase in tax outgo by 44% YoY resulting in OCF/EBITDA declining to 1.0x in FY18 from 2.7x in FY17. Decrease in cash flows from financing activities by 54% at ₹6.83bn due to flattish W.C for FY18 at ₹ 20.8bn with capex increasing from ₹0.55bn to ₹1.17bn YoY resulting in Free cash flow to decline by 56.5% to 9.24bn from 21.2bn YoY. There was slight decrease in W.C days from 86 days to 75 days primarily due to increase in payable days from 124 to 161 YoY

Dividend - The company has recommended final dividend of ₹2.4 per equity share on face value of ₹2 per share. The cash outflow on account of dividend and dividend distribution tax amounted to ₹740 mn for the year ended in Mar'18

Income Statement (₹ mn)

Particulars	Mar17	Mar18	Mar19E	Mar20E
Total Income	**87,550**	**100,964**	**117,215**	**136,430**
Total Expenditure	79,372	90,902	105,364	122,509
Cost of materials cons	59,489	72,715	85,567	99,594
Employee Benefits Exp	12,556	10,203	4,559	5,179
Other Expenses	7,327	7,984	15,238	17,736
Other Income	289	404	222	301
EBIDTA (Excl. OI)	**8,178**	**10,062**	**11,852**	**13,921**
EBIDTA (Incl. OI)	**8,467**	**10,466**	**12,074**	**14,222**
Interest	2,536	2,466	2,189	2,368
Depreciation	1,297	1,097	1,182	1,314
Profit Before Tax	4,634	6,903	8,702	10,540
Tax	1,587	2,298	3,176	3,847
Net Profit	**3,047**	**4,604**	**5,526**	**6,693**

Balance Sheet (₹ mn)

Particulars	Mar17	Mar18	Mar19E	Mar20E
Sources of Funds				
Equity Capital	514	514	514	514
Other Reserves	15,349	19,460	24,097	29,714
Net Worth	**15,864**	**19,974**	**24,612**	**30,228**
Secured Loans	7,903	7,561	8,061	8,561
Loan Funds	**20,228**	**16,571**	**17,071**	**17,571**
Deferred Tax Liability	1,240	1,007	1,007	1,007
Total Capital Employed	**37,331**	**37,552**	**42,690**	**48,806**
Applications of Funds				
Gross Block	15,567	16,012	18,012	19,812
Less: Accum Depr	5,990	6,810	10,000	11,314
Net Block	**9,577**	**9,202**	**8,012**	**8,498**
Capital Work in Progress	51	781	781	781
Investments	6,978	6,754	8,754	9,754
Current Assets, Loans & Advances				
Inventories	3,947	6,274	8,992	10,466
Sundry Debtors	42,004	50,389	56,199	65,412
Cash and Bank Balance	2,080	2,313	3,084	4,099
Loans and Advances	22,512	29,412	35,325	41,116
sub total	70,542	88,388	103,600	121,092
Less: Current Liabilities & Provisions				
Current Liabilities	48,789	66,740	77,491	90,193
Provisions	1,028	832	966	1,125
sub total	49,817	67,572	78,457	91,318
Net Current Assets	20,725	20,816	25,143	29,774
Total Assets	**37,331**	**37,553**	**42,690**	**48,806**

E – Estimates

Cash Flow (₹ mn)

Particulars	Mar17	Mar18	Mar19E	Mar20E
Profit before tax	**4,634**	**6,903**	**8,702**	**10,540**
Depreciation & w.o.	1,297	1,097	1,182	1,314
Net Interest Exp	2,536	2,466	2,189	2,368
Direct taxes paid	(1,587)	(2,298)	(3,176)	(3,847)
Change in Working Capital	14,336	143	(3,556)	(3,616)
(A) CF from Opt. Activities	**21,816**	**10,415**	**5,341**	**6,759**
Capex	(552)	(1,175)	(2,000)	(1,800)
Free Cash Flow	**21,263**	**9,240**	**3,341**	**4,959**
(B) CF from Invt. Activities	**(5,325)**	**(951)**	**(4,000)**	**(2,800)**
Inc./(Dec.) in Debt	(11,984)	(3,657)	500	500
Interest exp net	(2,536)	(2,466)	(2,189)	(2,368)
Dividend Paid (Incl. Tax)	(495)	(740)	(889)	(1,076)
(C) CF from Financing	**(15,015)**	**(6,863)**	**(2,578)**	**(2,944)**
Net Change in Cash	1,227	233	771	1,015
Opening Cash balances	853	2,080	2,313	3,084
Closing Cash balances	2,080	2,313	3,084	4,099

Important Ratios

Particulars	Mar17	Mar18	Mar19E	Mar20E
(A) Measures of Performance (%)				
EBIDTA Margin (excl. O.I.)	9.3	10.0	10.1	10.2
Interest / Sales	2.9	2.4	1.9	1.7
Tax/PBT	34.2	33.3	36.5	36.5
Net Profit Margin	3.5	4.6	4.7	4.9
(B) As Percentage of Net Sales				
Operating Expense	67.9	72.0	73.0	73.0
Employee Benefits Expense	14.3	10.1	3.9	3.8
Other Expenses	8.4	7.9	13.0	13.0
(C) Measures of Financial Status				
Debt / Equity (x)	1.3	0.8	0.7	0.6
Interest Coverage (x)	3.3	4.2	5.5	6.0
Average Cost Of Debt (%)	9.7	13.4	13.0	13.7
Debtors Period (days)	175.1	182.2	175.0	175.0
Closing stock (days)	16.5	22.7	28.0	28.0
Inventory Turnover Ratio (x)	22.2	16.1	13.0	13.0
Fixed Assets Turnover (x)	5.6	6.3	6.5	6.9
WC Turnover (x)	4.2	4.9	4.7	4.6
Non Cash WC (₹ Mn)	18,646	18,503	22,059	25,675
(D) Measures of Investment				
EPS (₹) (excl EO)	11.9	17.9	21.5	26.0
CEPS (₹)	16.9	22.2	26.1	31.1
DPS (₹)	1.6	2.4	2.9	3.5
Dividend Payout (%)	13.5	13.4	13.4	13.4
Profit Ploughback (%)	86.5	86.6	86.6	86.6
Book Value (₹)	61.7	77.7	95.7	117.6
RoANW (%)	21.2	25.7	24.8	24.4
RoACE (%)	17.2	25.0	27.1	28.2
RoAIC (%)	17.8	26.6	29.1	30.6
(E) Valuation Ratios				
CMP (₹)	333	333	333	333
P/E (x)	28.1	18.6	15.5	12.8
Market Cap. (₹ Mn)	85,559	85,559	85,559	85,559
MCap/ Sales (x)	1.0	0.8	0.7	0.6
EV (₹ Mn)	103,707	99,817	99,366	98,852
EV/Sales (x)	1.2	1.0	0.8	0.7
EV/EBDITA (x)	12.7	9.9	8.4	7.1
P/BV (x)	5.4	4.3	3.5	2.8
FCFE Yield (%)	3.9	1.8	1.0	1.8
Dividend Yield (%)	0.5	0.7	0.9	1.1

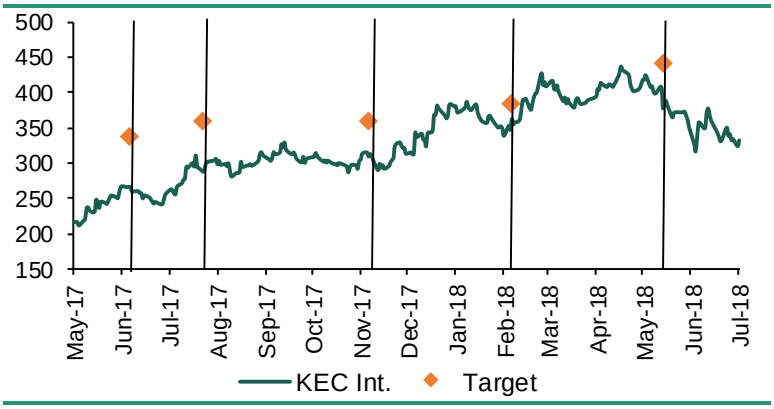
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	**> 20%**
Accumulate	**10 to 20%**
Reduce	**0 to 10%**
Sell	**< 0%**

Rating and Target Price History



Month	Rating	TP (₹)	Price (₹)*
June-17	Buy	338	267
July-17	Accumulate	360	288
Nov-17	Accumulate	360	309
Feb-18	Accumulate	382	348
May-18	Accumulate	440	382

** As on Recommendation Date*

DART Team

Purvag Shah	**Managing Director**	**purvag@dolatcapital.com**	**+9122 4096 9747**
Amit Khurana, CFA	**Head of Equities**	**amit@dolatcapital.com**	**+9122 4096 9745**

CONTACT DETAILS

Equity Sales	**Designation**	**E-mail**	**Direct Lines**
Dinesh Bajaj	VP - Equity Sales	dineshb@dolatcapital.com	+9122 4096 9709
Kartik Sadagopan	VP - Equity Sales	kartiks@dolatcapital.com	+9122 4096 9762
Kapil Yadav	VP - Equity Sales	kapil@dolatcapital.com	+9122 4096 9735
Derivatives Strategist	**Designation**	**E-mail**	
Bhavin Mehta	VP - Derivatives Strategist	bhavinm@dolatcapital.com	+9122 4096 9705
Equity Trading	**Designation**	**E-mail**	
P. Sridhar	VP and Head of Sales Trading	sridhar@dolatcapital.com	+9122 4096 9728
Chandrakant Ware	AVP - Equity Sales Trading	chandrakant@dolatcapital.com	+9122 4096 9707
Derivatives Trading	**Designation**	**E-mail**	
Shirish Thakkar	AVP - Derivatives	shirisht@dolatcapital.com	+9122 4096 9702
Hardik Mehta	Sales Trader	hardikm@dolatcapital.com	+9122 4096 9748

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Dolat Capital Market Private Limited.

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SEBI Registration No: BSE - INB010710052 & INF010710052, NSE - INB230710031& INF230710031, Research: INH000000685
Registered office: Office No. 141, Centre Point, Somnath, Daman – 396 210, Daman & Diu
Board: +9122 40969700 | Fax: +9122 22651278 | Email: research@dolatcapital.com | www.dolatcapital.com