AMBIT INSIGHTS

7 August 2017

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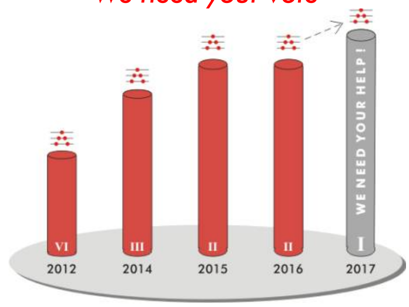
Asia Money polls open.
We need your vote



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Analyst Notes: Coal India: Earnings outlook set to improve?

Parita Ashar, CFA, +91 22 3043 3223

Whilst Coal India's 4MFY17 offtake growth of 4% was significantly lower than our full-year estimate of 7%, recent trends are encouraging. Offtake growth rose to 7% in July-17 driven by a sharp uptick in volumes at subsidiaries SECL, NCL and WCL. We expect the recent pick-up in coal offtake to sustain given end of the de-stocking cycle (with inventory days at 12 days vs 22 in Jul-16) and healthy power demand. Furthermore, regular e-auction realisations have been strong in the past 3-4 months (average of ~Rs1,925/t in 1QFY18 vs Rs1,700/t in FY17) and should drive 2-3% YoY growth in realisations in FY18E. Given the improving outlook for both volumes and realisations, we expect earnings outlook to improve. At 12x FY18 P/E, we reiterate BUY. Key risks: Grade slippage which could impact FSA realisations and settlement of wage revision (due since FY17) above 15%.

Source: Ambit Capital research

Please refer to our website for complete coverage universe

http://research.ambitcapital.com

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Shree Cement

SELL

SCORECARD	SRCM IN EQUITY	August 07, 2017

Challenging the benchmarks

Shree's FY17 annual report was another testament of the company's relentless focus on: (a) resetting benchmarks set by industry/equipment manufacturers; (b) innovation; (c) cost savings; and (d) automation. Key positives include improvement in power consumption per tonne of cement, rotation of auditors, insignificant contingent liabilities and related-party transactions, and continuing capex in new geographies from internal accruals. Key questions for management: Risk of investment in solar power, rise in inventory days to 49 days from 43 days in FY16 (Shree now has one the highest inventory days in the industry), and inadequate rotation of independent directors.

Cement

Research Analysts

Nitin Bhasin
nitin.bhasin@ambit.co
Tel: +91 22 3043 3241

Parita Ashar, CFA
parita.ashar@ambit.co
Tel: +91 22 3043 3223

Evaluation under our SCORECARD framework

Parameter	Page Nos.	Comments	Rating
Strategy	2-4	▪ FY17 was another year of several instances of innovations by Shree such as (a) first Indian cement company to have successfully used the 'Aerial survey by Drone' technology at its mines; (b) 3x increase in life of excavator compared to benchmark of supplier; (c) loading from a station without weighing facilities; (d) use of Cross Belt Analyser on crusher belt; etc. ▪ Power consumption per tonne of cement improved to 70kwh/t in FY17 from 72kwh/t in FY16; fuel consumption (% of clinker) marginally increased to 9.76% from 9.69% in FY16.	☺
CORporate Governance	8-9	▪ Contingent liabilities as well as related-party transactions for Shree are insignificant. The only significant contingent liability is the CCI penalty imposed in FY17 ~₹4bn (6% of net worth) ▪ To meet the requirements of rotation of audit firms under the Companies Act, 2013; Shree has appointed M/s Gupta & Dua to replace B. R. Maheshwari & Co., who have been the statutory auditor for Shree cement more for than 10 years. ▪ Although 7 of total 11 directors are independent, 5 of the independent directors have been with the company for more than five years.	☺
Earnings Quality	5	▪ Shree's working capital days increased from 49 days in FY16 to 51days in FY17 and are significantly higher than peers ex-Ramco. The increase in working capital days was driven by build-up of fuel inventories – inventory days increased to 49 days from 43 days in FY16, possibly to store low cost pet coke given petcoke prices were increasing sharply in FY17. ▪ In addition to the regular working capital analysed above, Shree has other receivables of ₹7.2bn at the end of FY17 (9% of revenues) in the form of Sales tax, Government grants and other dues from Government.	☹
Capital Allocation	7	▪ Against total sources of funds of ~₹30bn, ~₹12bn was invested in capex and ~₹11bn in investments and ~₹5bn was used for dividends. Moreover, another ₹1bn is to be utilized for dividend declared but is yet to be paid.	😐
Accounting	6	▪ Major Ind-AS restatements include: ▪ For FY16, PBT as well as PAT increased from ₹4.5bn under IGAAP to ₹11bn under IFRS mainly due to Government grants in the form of capital subsidy now being credited to P&L under IFRS vs direct credit to capital reserves (net worth) under IGAAP. ▪ For FY16, capital employed increases by ~₹6bn under IFRS due to restatement of long-term bonds and debentures to amortized cost vs cost less provision for permanent diminution in value and restatement of investments in preference shares and mutual funds at fair value. ▪ Capital subsidy is now treated as revenue income instead of capital receipt earlier and, hence, CFO is higher by ~₹5bn and cash from financing is lower by ~₹5bn.	😐
Items/entries **R**equiring more details	10	▪ Shree is evaluating options of setting up MW scale solar power plants near its cement plants in different states. With net cash of ~₹28bn with Shree Cement at the end of FY17, there could be risk of capital being allocated towards non-core segment such as solar power plants.	☹
Director's remuneration	9	▪ Managerial remuneration as a proportion of PBT was largely stable at ~9% in FY15-16, higher than 1-2% for UltraTech and Ambuja and in line with Ramco. However, post Ind-AS, managerial remuneration as a % of PBT declined to 4% in FY17. On a per-tonne basis of cement sales, managerial remuneration for Shree is ₹29/tonne, which is higher than ₹6-7/tonne for UltraTech/Ambuja but lower than ₹35/tonne for Dalmia in FY16 and ₹65/tonne for Ramco.	😐

Source: Company, Ambit Capital research

E&C/ Infrastructure

Power T&D annual reports – Spreading wings

Despite similarities in order book mix and segment, KEC and Kalpataru (KPP) had different fortunes in FY17. Improving business environment in power T&D enhanced earnings quality and growth (66%/22% EPS CAGR for KEC/KPP standalone; FY14-17). Working capital declined (41 days/6 days), EBITDA and PBT margins expanded and, hence, leveraging reduced for both. Unhindered by past capital allocation decisions, KEC's cash flows could be reallocated to the core business whilst KPP continues to reinvest. KPP's consolidated RoCE is still just 7% (10-11% KEC and KPP SA). This is reflected in multiples; whilst KEC trades at 19x one-year forward earnings, KPP's is 15x. With PGCIL investments peaking and with cash to reinvest, both are looking outwards; state transmission, international power T&D, railways and infra proportion could increase. Within the space, we are BUYers on Techno Electric (21x one-year forward earnings). The key monitorables: (i) for KPP, how JMC's improvement sustains; and (ii) whether KEC and KPP can sustain margin improvement even as international share increases.

Snapshot

Parameter	Comments	Rating – KEC	Rating - KPP (SA)
Strategy	▪ Both companies, like previous years, give a detailed scenario of demand in each major geography ▪ KEC tends to provide more nuances but both stop short of providing a detailed analysis of their own business; they do however, in their earnings call ▪ Both also provide an outlook for their company	:|	:|
Corporate Governance	▪ 8 of 11 Board members in KEC are independent; 5 of 10 in KPP - a reasonable proportion ▪ Remuneration of the three KPP promoters has increased significantly in FY17. These directors have been given a 20%/129%/ 49% increase in salaries in FY17. Together, their remuneration is 3% of PBT. The CEO in KEC has been given a 10% hike ▪ Auditor remuneration for KPP at consolidated level is up at 25% CAGR over FY12-17. Auditor is Deloitte	:|	:(
Earnings Quality	▪ Strong earnings quality for both; working capital reduced, leverage reduced ▪ KPP's subsidiaries still a big drag and standalone business is driving the improvement in earnings	:)	:)
Capital allocation	▪ KEC utilised the bumper operating cash flow generated in FY17 towards paring debt ▪ KPP's subs are still a cash drag and the drag has only increased but the company has taken measures to correct its capital allocation	:)	:)
Accounting policies	▪ Significant restatement of capital employed upwards by KEC under the Ind-AS regime vs I-GAAP earlier	:(	:|
Requiring more details	▪ NA	:|	:|
Disclosure Levels	▪ Disclosure levels have largely remained the same in both the companies; KPP earlier used to provide a segmental break up for its T&D, Infra and construction businesses that has now been grouped under EPC	:|	:(

Source: Ambit Capital research

POSITIVE

Quick Insight

Analysis	✓
Meeting Note	
News Impact	

KEC International	NOT RATED
Bloomberg Code:	KECI IN
CMP (₹):	299
TP (₹):	NR
Mcap (₹ bn/US$ mn):	77/1,206
3M ADV (₹ mn/US$ mn):	270/4

Kalpataru Power	NOT RATED
Bloomberg Code:	KPP IN
CMP (₹):	358
TP (₹):	NR
Mcap (₹ bn/US$ mn):	55/1
3M ADV (₹ mn/US$ mn):	33/0.5

Techno E&E Co.	BUY
Bloomberg Code:	TEECIN
CMP (₹):	366
TP (₹):	425
Mcap (₹ bn/US$ mn):	42/657
3M ADV (₹ mn/US$ mn):	18/0.3

Research Analysts

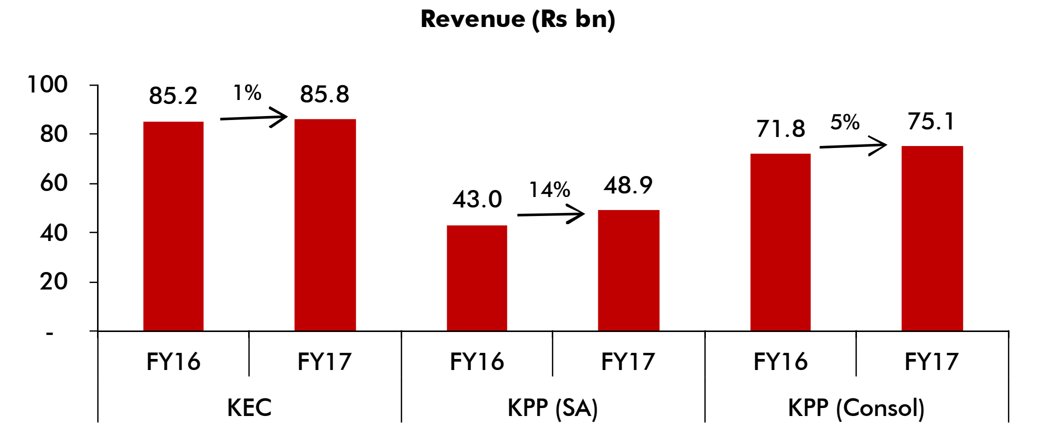
Utsav Mehta, CFA
utsav.mehta@ambit.co
Tel: +91 22 3043 3209

Nitin Bhasin
nitin.bhasin@ambit.co
Tel: +91 22 3043 3241

Setting the ground – the year that was and the mix that is

Revenue growth: Revenue growth was weak for KEC driven by lower commodity prices (thereby impacting the cables division) and due to shortfalls in the international and solar businesses. Kalpataru's standalone unit had a strong year, growing by 14% though revenue downtick in Shree Shubham (primarily) and JMC hit consolidated revenues. KPP (SA) had started the year with a significantly large order book (1.9x FY16 revenue) vis-à-vis KEC (1.1x), which explains the difference in growth.

Exhibit 1: KPP (SA) outpaced KEC due to a materially better opening order book position (1.9x book to FY16 revenue vs 1.1x for KEC)

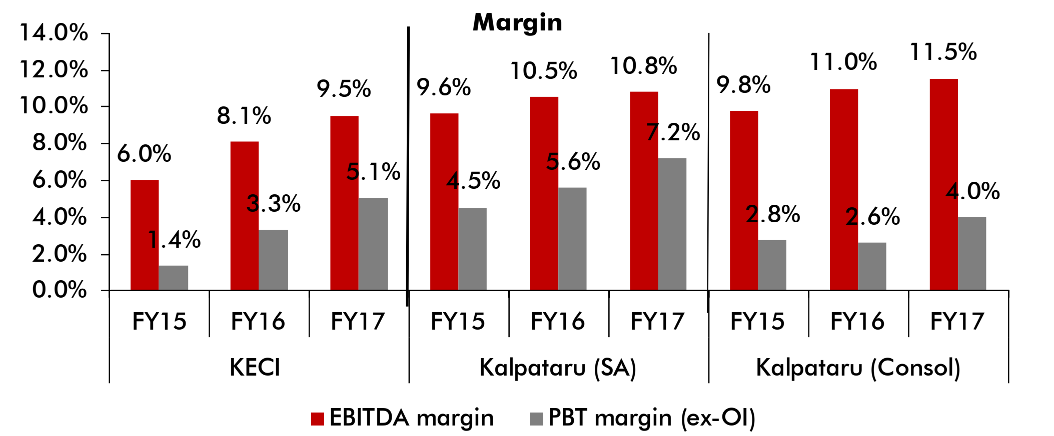


Source: Company, Ambit Capital research

Margins improved for both

EBITDA and PBT margins have been on the uptick for both for the last two years. Due to a lower base (due to legacy projects), KEC's EBITDA margin expanded by 350bps whilst KPP (SA)'s expanded by 120bps. Increase in PBT margin has been sharper due to improvement in cash flows and reduction in debt thereafter. PBT margin for KEC/KPP (SA) expanded by 370bps/ 270bps in the last two years. KPP (consol) continues to struggle under the weight of its assets and Shree Shubham's losses.

Exhibit 2: Margins expanded for both players; the improvement has been sharper for KEC due to its lower base



Source: Company, Ambit Capital research

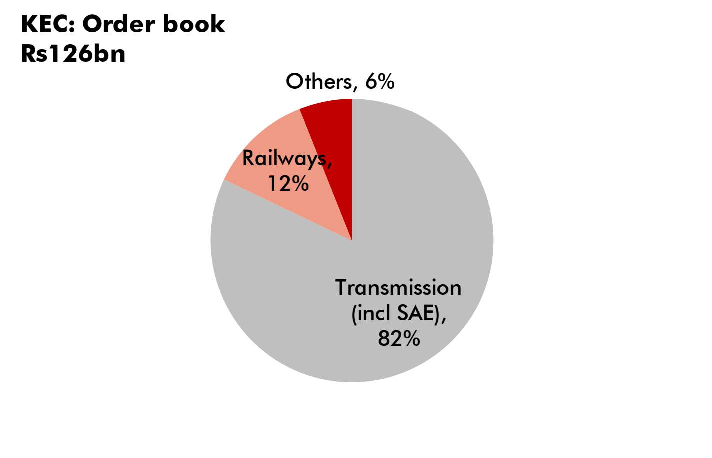
Earnings expand on account of financial leverage

Mediocre growth but a strong expansion in margins combined with financial leverage led to strong earnings growth. Profits for KEC and KPP (SA) increased by 106% and 40% respectively. Consolidated profits for KPP also grew in a similar vein (up 107% YoY) due to a low base and driven purely by an improvement in the standalone business.

Order book mix – international is now larger

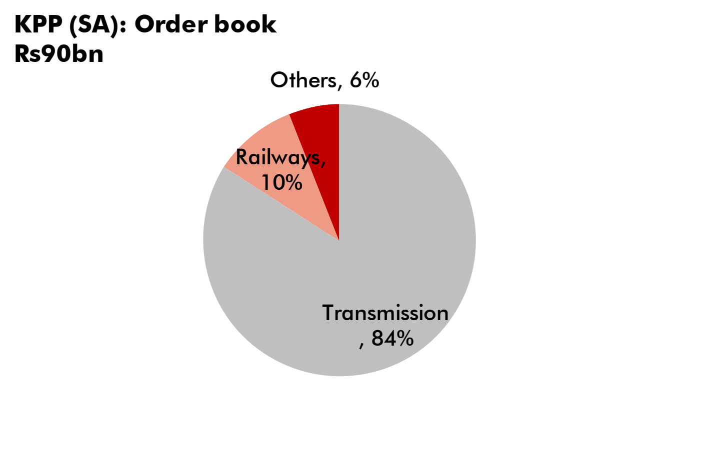
The order book mix for both companies is similar. Both have an overwhelming part of their order book geared towards the transmission business with railways being the fast-growing second segment. On a geographical basis too, 48% of the both companies' order book is domestic (KPP standalone). However, KPP has a larger order book at 1.8x FY17 revenues vs 1.5x for KEC.

Exhibit 3: KEC's mix is similar to KPP (SA) but is small vs its revenues at 1.5x FY17 revenue



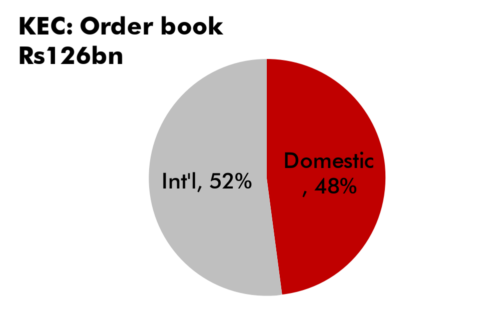
Source: Company, Ambit Capital research

Exhibit 4: Both companies have a similar geographical mix of 48% domestic; KPP (SA)'s book to bill is 1.8x



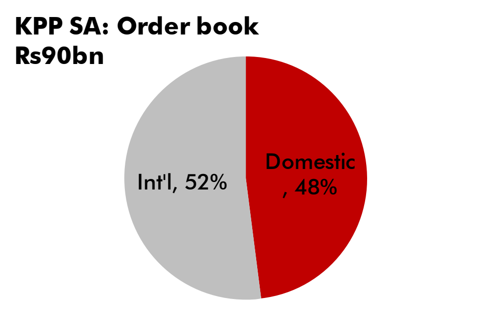
Source: Company, Ambit Capital research

Exhibit 5: KEC's and KPP's international share...



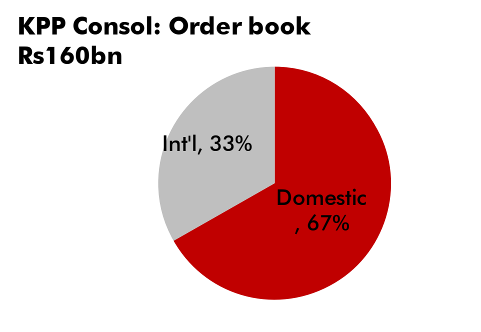
Source: Company, Ambit Capital research

Exhibit 6: ...of order book is similar



Source: Company, Ambit Capital research

Exhibit 7: JMC makes KPP (consol) more domestic



Source: Company, Ambit Capital research

Note that through this note, we will largely compare KEC with KPP's standalone business to restrict it to comparisons to each's power T&D heavy order books. KPP's stakes in JMC Projects and Shree Shubham mean that consolidated financials can be skewed by asset-heavy businesses.

Note that all figures for FY16 and FY17 are in Ind-AS; any prior is I-GAAP

RoE – DuPont analysis

A good place to start would be the profitability of each and the drivers of profitability. The exhibit below shows that KEC has a higher RoE than KPP (SA). However, KEC's impressive 20%+ RoE is a manifestation of its leverage. RoCE for both businesses was largely similar in FY17. Assuming that a significant chunk of Kalpataru's standalone capital employed is in investments and loans to subsidiaries, its RoCE on the core business would likely be superior to KEC. This is due to its superior margins (130bps higher at the EBITDA level)

However, KPP's return ratios are poor on a consolidated level. Capital employed in JMC's road assets and Shree Shubham is a heavy drag on the company's overall performance.

Exhibit 8: KEC's superior RoE is a function of its leverage; KPP's standalone business has better profitability though its investments continue to drag heavily

Rs mn	KEC International				Kalpataru (SA)				Kalpataru (Consol)			
	FY14	FY15	FY16	FY17	FY14	FY15	FY16	FY17	FY14	FY15	FY16	FY17
RoE	**6%**	**13%**	**12%**	**21%**	**8%**	**8%**	**9%**	**11%**	**6%**	**6%**	**3%**	**7%**
PAT margin	0.8%	1.9%	1.7%	3.6%	3.6%	3.7%	4.5%	5.5%	1.7%	1.7%	1.1%	2.1%
Capital emp t/o	2.5	2.4	1.9	2.0	1.6	1.5	1.5	1.7	1.6	1.3	1.3	1.4
WC t/o	*4.6*	*4.0*	*2.7*	*2.9*	*2.3*	*2.1*	*2.1*	*2.5*	*3.9*	*3.1*	*2.7*	*3.1*
Fixed asset t/o	*8.1*	*9.2*	*8.4*	*8.9*	*7.3*	*7.8*	*7.9*	*9.2*	*4.7*	*2.9*	*2.4*	*2.5*
Leverage	2.7	2.8	3.5	2.9	1.4	1.4	1.4	1.3	2.2	2.6	2.4	2.3
RoCE	**7%**	**9%**	**6%**	**11%**	**8%**	**8%**	**8%**	**10%**	**4%**	**5%**	**6%**	**7%**

Source: Company, Ambit Capital research; Note: WC turnover calculation above excludes loans and advances to subsidiaries for KPP (SA); RoCE includes entire capital employed

Margin breakdown – Is there limited headroom for margins to expand further?

The common size statement below shows the main drivers of the profit margin differential between the two businesses. Both companies have witnessed an impressive expansion in margins for differing reasons – gross margin catch up for KEC and operating leverage for KPP (SA). However, the key question remains whether the companies can sustain their EBITDA margin expansion given the international proportion of the business may increase. The past two years witnessed a steady increase in domestic revenues, especially for KPP.

Financial leverage has aided both companies. SG&A costs for both the companies are bloated vis-à-vis Techno, whose employee cost and SG&A are 2.7% and 5.5% of revenues respectively. Until this gap is bridged, we are unlikely to witness either of these companies achieving the heyday EBITDA margins of mid-teens.

Key observations for the two companies:

- **KEC**: There is only small headroom for further improvement in EBITDA margin. Gross margin that was heavily lagging that of Kalpataru has now recovered and is higher than levels maintained by KPP (SA) over the last three years. However, there is headroom for savings on the fixed overheads front. In FY17, there was an 80bps impact of bad debts written off that directly drove SG&A costs higher.

  Slightly more concerning is the heavy investment in employees over the last two years. Employee costs have increased by 12% CAGR and revenue has not increased. If the company's revenue growth remains weak, this will start to erode margins.

- **KPP**: EBITDA margin expansion on the standalone business was purely a function of disciplined control over employee costs. Gross margins seem to have stabilised and have sustained despite changing geographical mix. Employee costs are down 4% CAGR over the last two years. SG&A costs increased in FY17 mainly due to rents, rates and taxes.

Exhibit 9: KEC's margin expansion was due to gross margin expansion and KPP (SA)'s was due to operating leverage; both companies benefitted from financial leverage

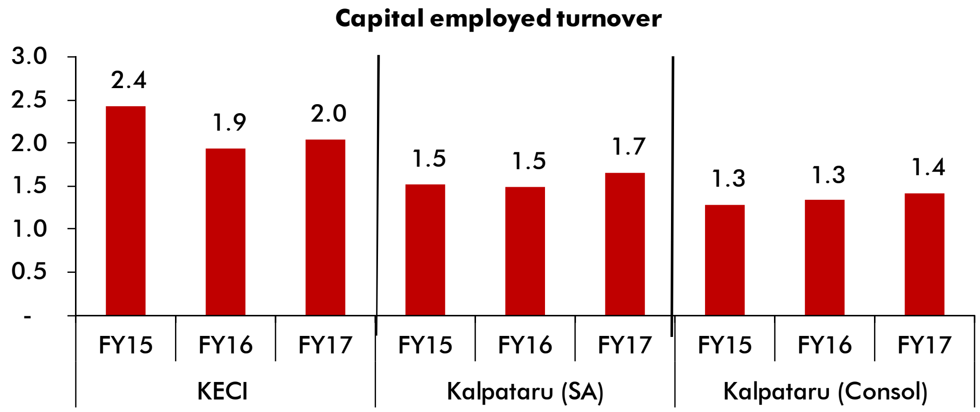
Common size	KECI			Kalpataru (SA)			Kalpataru (Consol)		
	FY15	FY16	FY17	FY15	FY16	FY17	FY15	FY16	FY17
Revenue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Cost of goods sold	53.9	48.7	48.5	42.7	41.4	41.6	40.5	39.8	39.2
Subcontracting costs	22.3	23.8	20.8	27.1	28.7	28.5	31.3	31.4	30.6
Gross margins	**23.8**	**27.4**	**30.7**	**30.3**	**29.9**	**29.9**	**28.2**	**28.8**	**30.2**
Employee costs	6.9	7.5	8.5	7.1	6.8	6.0	7.6	7.7	7.3
SG&A	10.8	11.8	12.6	13.5	12.5	13.1	10.9	10.1	11.4
EBITDA	**6.0**	**8.1**	**9.5**	**9.6**	**10.5**	**10.8**	**9.8**	**11.0**	**11.5**
Depreciation	1.0	1.5	1.5	1.9	1.9	1.6	2.3	2.6	2.4
Interest cost	3.6	3.3	3.0	3.2	3.0	2.0	4.7	5.8	5.1
PBT (ex-oi)	**1.4**	**3.3**	**5.1**	**4.5**	**5.6**	**7.2**	**2.8**	**2.6**	**4.0**
Other income	1.7	0.1	0.3	1.2	1.2	1.0	0.3	0.3	0.3
PBT	**3.1**	**3.4**	**5.4**	**5.7**	**6.9**	**8.2**	**3.1**	**2.9**	**4.3**
Tax	1.2	1.7	1.8	2.0	2.4	2.7	1.5	1.3	1.8
PAT	1.9	1.7	3.6	3.7	4.5	5.5	1.6	1.6	2.5
Minority/ associates	0.0	0.0	-	-	-	-	(0.1)	0.5	0.4
Net profit	**1.9**	**1.7**	**3.6**	**3.7**	**4.5**	**5.5**	**1.7**	**1.1**	**2.1**

Source: Company, Ambit Capital research

Capital employed turnover – investments drag KPP's performance

As shown in the chart below, capital employed turnover for KEC is superior to that of KPP both on standalone and consolidated basis. This is driven by generally lower working capital for the company (barring one-off year in FY16). Kalpataru's asset-heavy subsidiaries tend to drag down the overall capital employed turnover even further. Note that a bulk of the improvement in KPP's standalone working capital improvement was driven by customer advances from its own subsidiary.

Capital employed turns are higher for KEC since KPP's subsidiaries are a drag



Source: Company, Ambit Capital research

Exhibit 10: A large chunk of KPP's standalone capital employed is in investments and loans to subsidiaries

Rs mn	Equity	Loans	Total	As % of capital emp
JMC	3,209		3,209	10%
Saicharan Properties	-	2,347	2,347	8%
Shree Shubham	1,274	586	1,860	6%
Amber Real Estate	10	1,491	1,501	5%
Alipurduar Transmission	750	263	1,013	3%
Satpura Transco	565	77	642	2%
Energy Link	520		520	2%
Jhajjar KT Transco	382	37	418	1%
Kalpataru Metfab	220		220	1%
Kohima Mariani Transmission		130	130	0%
Total	**7,145**	**4,854**	**11,999**	**38%**

Source: Company, Ambit Capital research

Working capital analysis – KEC's improvement clearly stands out

Over the last four years, KEC's working capital has been consistently better than KPP's. KEC's working capital improved sharply in FY17, mainly driven by lower receivables (as its retention money from certain contracts was freed up) and higher payable days. Whilst KEC has maintained even higher payable days in the past, it is worth highlighting that these are consistently more than KPP (SA).

Exhibit 11: KEC's working capital is now better than that of KPP (SA) though its payable days are higher

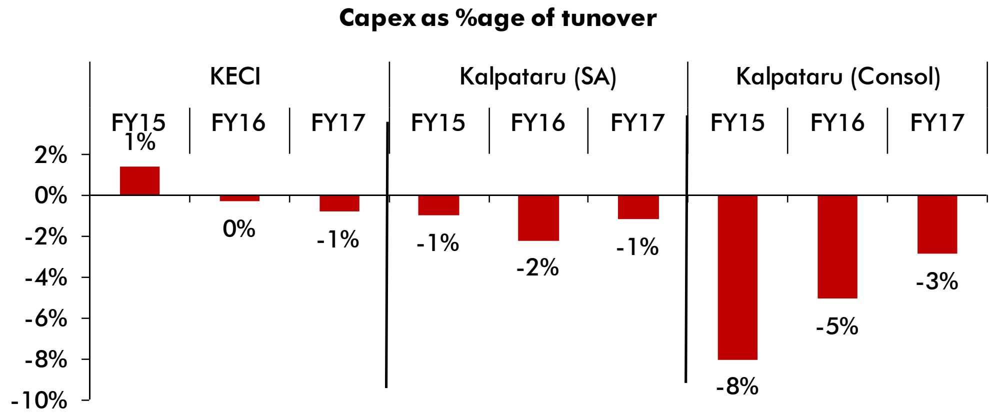
Rs mn	KEC International				Kalpataru (SA)				Kalpataru (consol)			
	FY14	FY15	FY16	FY17	FY14	FY15	FY16	FY17	FY14	FY15	FY16	FY17
Inventory	23	21	15	17	49	49	36	34	63	62	45	45
Receivables	176	166	202	180	147	154	196	212	95	113	156	162
Loans and adv	33	41	5	2	40	29	-	-	40	37	4	5
Other assets	39	42	102	110	45	38	71	60	48	52	102	100
Payables	148	143	121	135	113	112	125	116	104	99	120	118
Other liabilities	31	29	57	69	38	11	56	76	39	32	60	78
Total WC	**92**	**96**	**146**	**105**	**130**	**148**	**121**	**115**	**104**	**132**	**127**	**117**

Source: Company, Ambit Capital research; Note: Working capital excludes loans and advances to subsidiary for KPP SA

Capital investments – nothing material

Both companies are relatively asset-light, hence capital investments have been minimal in context of the revenue. KPP's subsidiaries have throttled off incremental investments as assets got operationalised.

Exhibit 12: Capital investments in the core construction businesses are limited



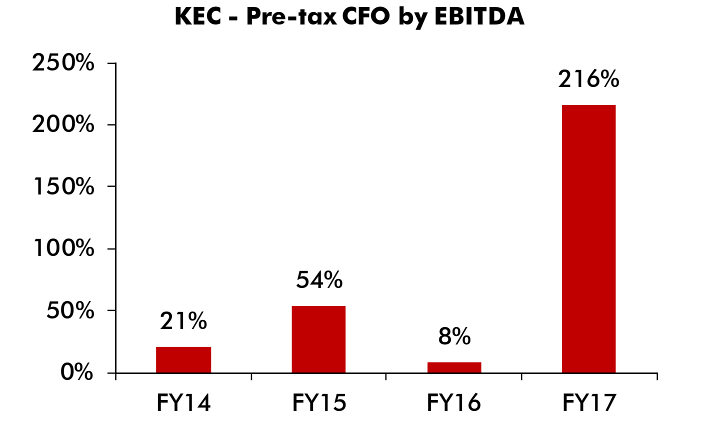
Source: Company, Ambit Capital research

Leverage- improving cash flow has led to deleveraging

Financial leverage has played an important role in profit growth for both companies in the last three years. Working capital reduction for the companies enabled a sharp increase in operating cash flows in the last two years. This enabled them to pare debt and/or maintain current debt levels. Cash conversion has been patchy; but on a 4-year basis, both companies have a similar pre-tax to CFO ratio of ~90%.

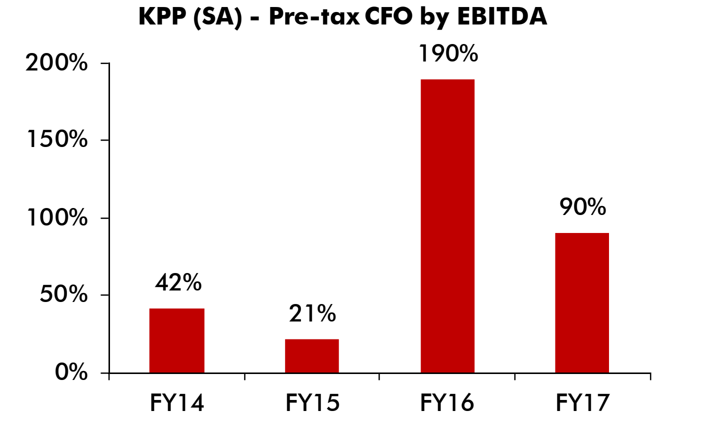
Unhindered by incremental investments required in subsidiaries, KEC has been able to dedicate its cash flows in debt servicing. KPP's asset-heavy businesses are now taking a toll. However, KPP remains largely debt-light at the standalone level and even on a consolidated basis has lower leverage than KEC.

Exhibit 13: Cash flow conversion was particularly strong for KEC in FY17 – last 4 years' cumulative cash conversion is 88%



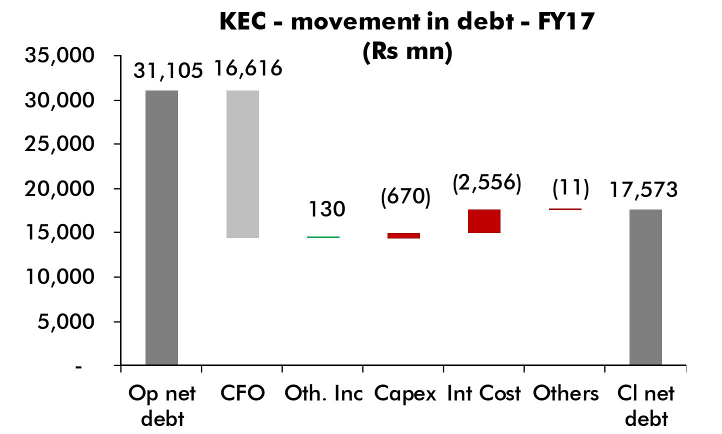
Source: Company, Ambit Capital research

Exhibit 14: KPP (SA) too has a similarly patchy cash conversion track record though the 4-year cumulative figure is 89%



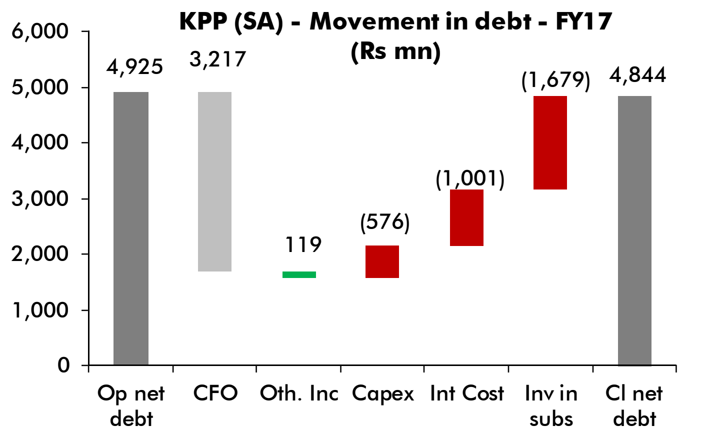
Source: Company, Ambit Capital research

Exhibit 15: KEC's strong cash flows in FY17 were mainly towards reduction in debt…



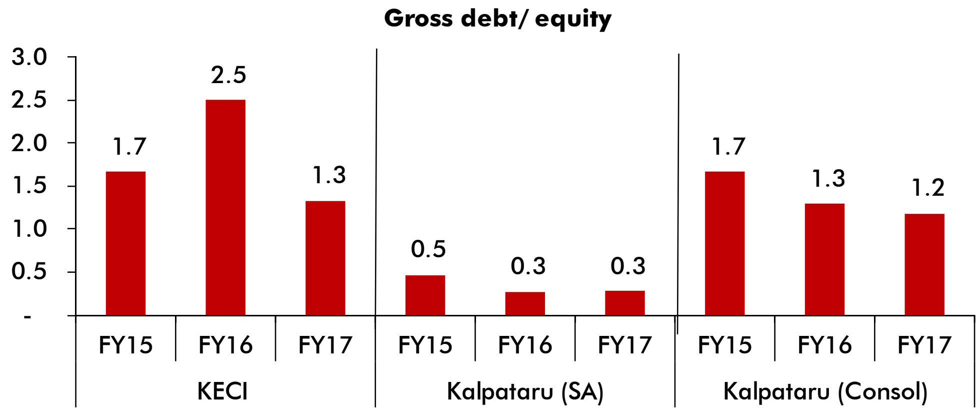
Source: Company, Ambit Capital research; note: is this debt as per the new format of INDAS

Exhibit 16: …while KPP's cash flows had to be partly diverted to its investments



Source: Company, Ambit Capital research note: is this debt as per the new format of INDAS

Exhibit 17: Improving cash flows has led to deleveraging – especially in case of KEC



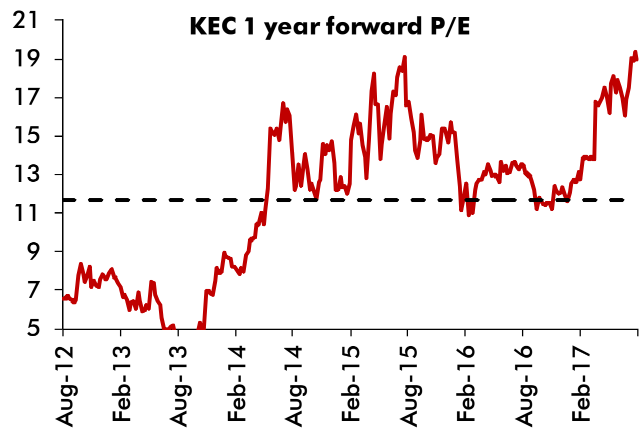
Source: Company, Ambit Capital research

Valuations – KEC trading at a premium; can KPP re-rate too?

KEC and Kalpataru currently trade at 19x and 15x one-year forward EPS (KPP market cap ex-JMC with 20% holding co discount). Consensus expects these companies to grow earnings at 24%/18% CAGR over the next two years (standalone for KPP). Current valuations are at a steep premium to the historical averages of the companies. We do not have a rating on either but do have a BUY on Techno Electric (TP: Rs425). We believe Techno is superior to both these players on project management, which is visible in its lean working capital and superior margins.

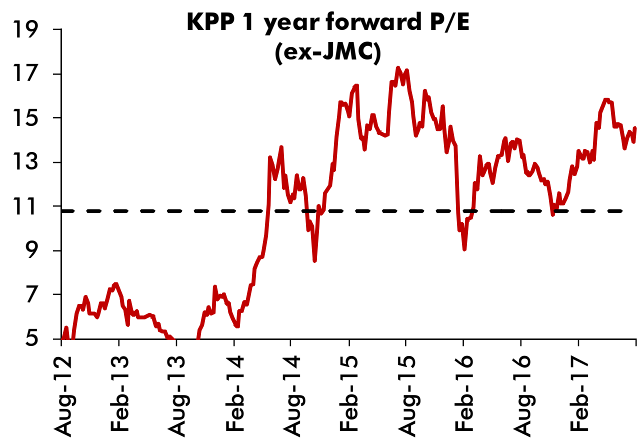
Techno shows all the hallmarks of a top-notch contractor – its working capital requirements are lower than peers, it exhibits strong control over fixed overheads, and is a margin-focused project bidder. Moreover, it has capabilities across the power space, including transmission, distribution and generation, making it highly adaptable to changing trends. It is our preferred play on the power T&D space.

Exhibit 18: KEC is trading at 19x one-year forward earnings, 62% higher than its past average



Source: Bloomberg, Ambit Capital research

Exhibit 19: At 15x, KPP is trading at a material discount but at a 35% premium to its average



Source: Bloomberg, Ambit Capital research; Note, price excludes the then proportionate share of market cap of JMC with a holding co discount of 20%

No major change in the business as per consensus

As shown in exhibits below, consensus doesn't expect any material change in business over the next two years barring an uptick in revenues. Given that order books are less than 2x for each, this would be highly dependent on ordering environment in the transmission space. The street also believes that there are no more upsides in terms of operating margin upsides. In KEC's case, consistent cash flow generation and, therefore, deleveraging are expected. For KPP, potential surprises may happen outside of standalone entity – a consistent improvement in subsidiary profitability and, therefore, lower cash burn could potentially lead to a re-rating of the standalone business.

Exhibit 20: Consensus expects KEC earnings to post 20%+ CAGR over the next two years driven by top-line growth and financial leverage

Rs mn	FY17	FY18	FY19	FY17-19 CAGR
Revenue	85,844	99,007	114,113	15%
EBITDA	8,179	9,485	11,121	17%
EBITDA mgn	9.5%	9.6%	9.7%	
PAT	3,048	3,792	4,716	24%
EPS	12	15	18	24%

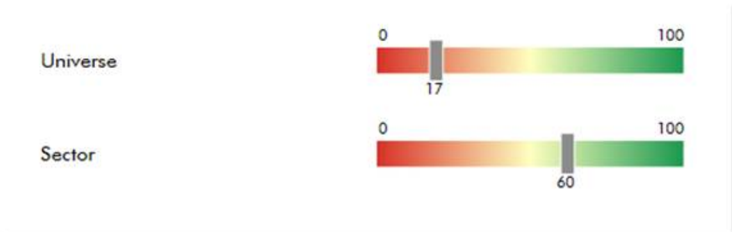
Source: Bloomberg, Ambit Capital research

Exhibit 21: For KPP (SA), consensus expects 18% earnings CAGR driven by revenue growth and a slight expansion in margins

Rs mn	FY17	FY18	FY19	FY17-19 CAGR
Revenue	48,941	56,931	65,281	15%
EBITDA	5,291	6,222	7,193	17%
EBITDA mgn	10.8%	10.9%	11.0%	
PAT	2,691	3,149	3,727	18%
EPS	18	20	24	18%

Source: Company, Ambit Capital research

Accounting score - KPP



Source: Ambit Capital research

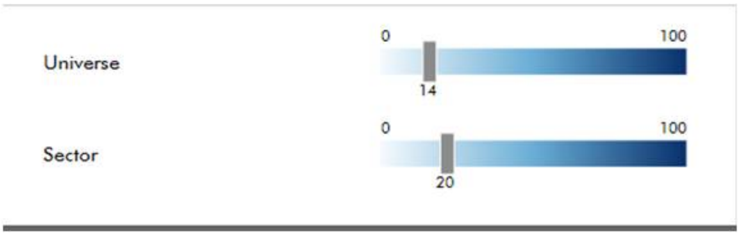
Accounting score - KEC

Source: Ambit Capital research

Greatness framework score - KPP

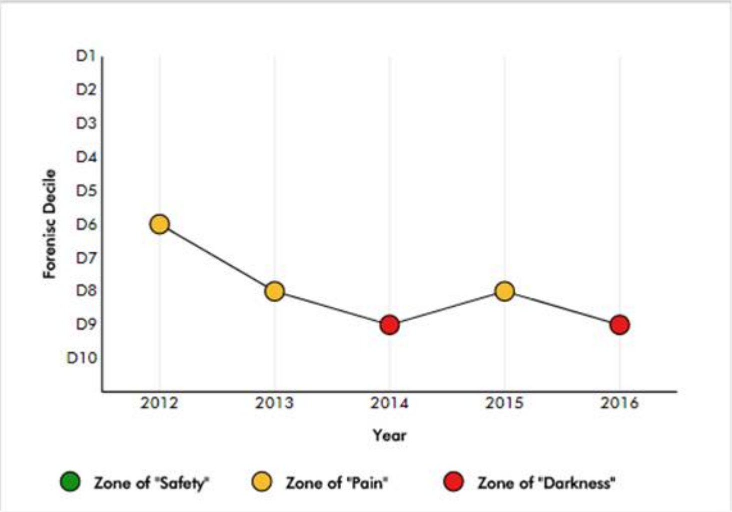
Source: Ambit Capital research

Greatness framework score - KEC



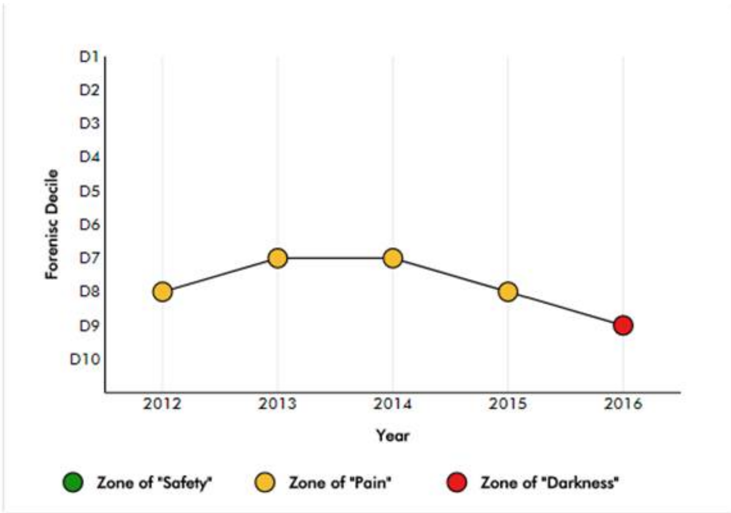
Source: Ambit Capital research

Evolution of accounting score - KPP



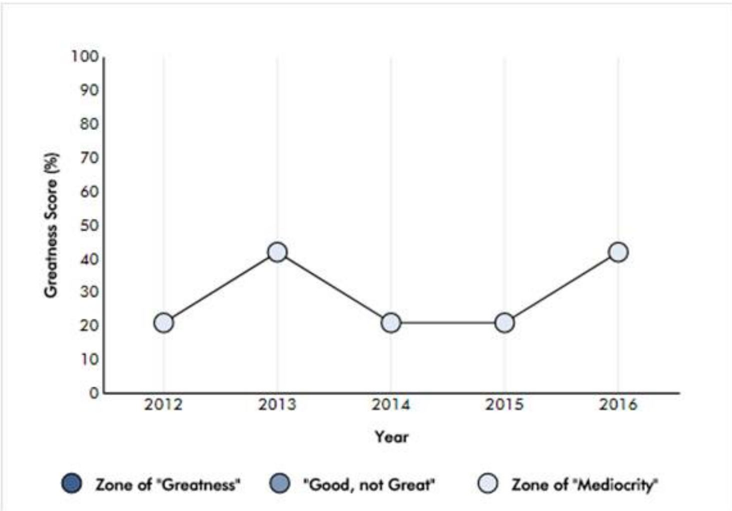
Source: Ambit Capital research

Evolution of accounting score - KEC



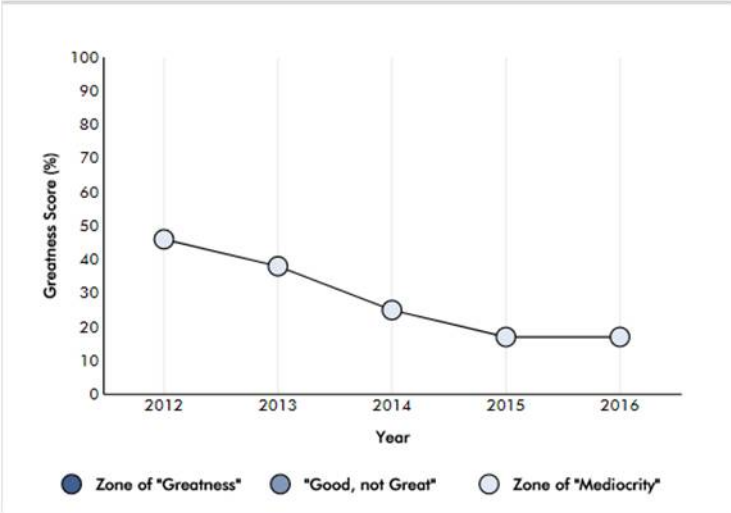
Source: Ambit Capital research

Evolution of greatness score - KPP



Source: Ambit Capital research

Evolution of greatness score – KEC



Source: Ambit Capital research

Exhibit 22: Comparative business summary

	KECI			Kalpataru (SA)			Kalpataru (Consol)		
	FY15	FY16	FY17	FY15	FY16	FY17	FY15	FY16	FY17
Order book (Rs bn)	**95**	**94**	**126**	**52**	**83**	**90**	**108**	**145**	**160**
Book to bill	1.1	1.1	1.5	1.2	1.9	1.8	1.5	2.0	2.1
Transmission (incl SAE)	85%	87%	82%	84%	84%	84%	40%	48%	47%
Railways	5%	6%	12%	NA	NA	10%	NA	NA	6%
Buildings&factories*	0%	0%	0%	0%	0%	0%	45%	33%	34%
Others	10%	7%	6%	16%	16%	6%	15%	19%	13%
Order book mix									
Domestic	51%	54%	48%	44%	50%	48%	73%	81%	67%
International	49%	46%	52%	56%	50%	52%	27%	19%	33%
Revenue (Rs bn)	**84.7**	**85.2**	**85.8**	**44.2**	**43.0**	**48.9**	**72.0**	**71.8**	**75.1**
Transmission (incl SAE)	86%	83%	82%	91%	86%	85%	56%	51%	55%
Railways	2%	2%	5%	NA	NA	NA	NA	NA	NA
Buildings&factories*	0%	0%	0%	0%	0%	0%	NA	NA	NA
Others	12%	14%	13%	9%	14%	15%	NA	NA	NA
Revenue mix									
Domestic	47%	50%	52%	45%	46%	60%	66%	63%	70%
International	53%	50%	48%	55%	54%	40%	34%	37%	30%
Income statement									
Revenue	84.7	85.2	85.8	44.2	43.0	48.9	72.0	71.8	75.1
% growth YoY	7%	NA	1%	9%	NA	14%	2%	NA	5%
EBITDA	5.1	6.9	8.2	4.3	4.5	5.3	7.0	7.9	8.7
% growth YoY	4%	NA	18%	10%	NA	17%	19%	NA	10%
EBITDA margin	6.0%	8.1%	9.5%	9.6%	10.5%	10.8%	9.8%	11.0%	11.5%
PAT	1.9	1.5	3.0	1.7	1.9	2.7	1.2	0.8	1.6
% growth YoY	141%	NA	106%	13%	NA	40%	-2%	NA	107%
PAT margin	2.3%	1.7%	3.6%	3.7%	4.5%	5.5%	1.7%	1.1%	2.1%
EPS (Rs)	7.4	5.8	11.9	10.8	12.5	17.5	7.8	4.9	10.2
Balance sheet									
Networth	13.3	12.9	15.9	20.7	22.1	24.8	22.2	22.5	24.2
Debt	22.1	32.2	21.1	9.7	6.0	7.0	36.8	29.0	28.5
Working capital	22.4	34.0	24.7	17.9	14.3	15.4	26.0	25.1	24.1
% of revenue	26%	40%	29%	40%	33%	31%	36%	35%	32%
Cash flow statement									
CFO	1.5	(0.8)	16.6	0.4	7.6	3.2	0.7	11.0	7.6
Capex	1.2	(0.2)	(0.7)	(0.4)	(0.9)	(0.6)	(5.8)	(3.6)	(2.1)
FCF	2.7	(1.0)	15.9	(0.1)	6.6	2.6	(5.0)	7.4	5.5
CFI	1.2	(0.2)	(1.8)	(0.5)	(1.7)	(2.1)	(6.1)	(3.0)	(0.4)
CFF	(2.2)	(0.3)	(13.8)	0.2	(5.5)	(0.0)	5.5	2.3	2.7
Ratios									
RoE	13%	12%	21%	8%	9%	11%	6%	3%	7%
RoCE	9%	6%	11%	8%	8%	10%	5%	6%	7%
Gross debt/Equity	1.7	2.5	1.3	0.5	0.3	0.3	1.7	1.3	1.2
BVPS	52	50	62	135	144	162	144	146	158
WC days	96	146	105	148	121	115	132	127	117
Receivable days*	187	217	196	204	232	246	175	201	207
Other asset days	83	107	112	67	71	60	89	107	106
Total creditor days	173	178	204	124	181	192	132	180	196
WC turnover	4.0	2.7	2.9	2.7	2.7	3.3	3.1	2.7	3.1
FA turnover	9.2	8.4	8.9	7.8	7.9	9.2	2.9	2.4	2.5
CE turnover	2.4	1.9	2.0	1.5	1.5	1.7	1.3	1.3	1.4

Source: Company, Ambit Capital research

Garware-Wall Ropes

NOT RATED

Quick Insight

Analysis	✓
Meeting Note	
News Impact	

Exports and innovation will drive growth

Management commentary in the FY17 AGM suggests growth would be driven by exports, mainly through GWRL's customized offerings in aquaculture, sports nets and agri nets. Margins should either increase or remain at current level given GWRL's relentless focus on innovation and customized value-added solutions for customers. Management also provided clarity on balance sheet items like trade payables, other provisions and other loans & advances. We continue to expect that GWRL will benefit from rising use of technical textiles in geo-synthetics, agri and Defence in the coming years both in exports and domestic market. Valuation of 23.3x FY17 P/E is inexpensive for a market leader given ~20% FY17 RoE and strong 46% EPS CAGR over FY14-17.

Garware-Wall Ropes	Not Rated
Bloomberg Code:	GWWR IN
CMP (Rs):	888
TP (Rs):	NA
Mcap (Rs bn/US$ bn):	19/0.3
6M ADV (Rs bn/US$ mn):	19.4/0.3

Source: Bloomberg, Ambit Capital research

Stock performance (%)

	1M	3M	12M	YTD
Absolute	7	11	95	45
Rel. to Sensex	3	3	79	24

Source: Bloomberg, Ambit Capital research

Key financials (Rs mn)

	FY15	FY16	FY17
Net revenue	7,822	8,248	8,653
EBITDA	779	976	1,315
EPS (Rs)	19.7	28.3	38.1

Source: Company, Ambit Capital research

Fisheries, ropes and agriculture form the largest revenue pie

As per our interaction with the management, the fisheries segment is the biggest contributor to overall revenue (~25%), followed by ropes (~23-25%) and aquaculture (~20%). Sports nets, geosynthetics and agri nets, albeit still small, are the relatively fast-growing segments led by rising penetration both in export and domestic markets.

Exhibit 1: Nearly two-thirds of GWRL's FY17 revenue came from fishing, ropes and aquaculture

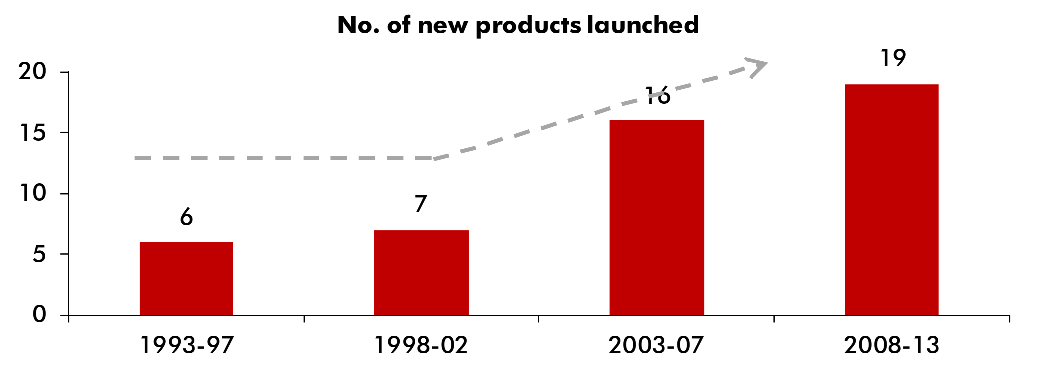
Key Products	Market positioning	FY17 revenue share (%)
Fishing nets	Leading supplier of fishing nets for deep-sea fishing. No.1 in India with 65% market share and top 5 globally.	25%
Ropes	Leading supplier of mooring ropes (used to keep vessels secured) to shipping companies globally.	23%-25%
Aquaculture	Globally renowned for aquaculture cages and predator systems.	18-20%
Sports nets	Leading supplier of nets for tennis, football, cricket, golf, basket-ball, beach volley ball and Ski nets for tournaments globally; largest sports goods exporter from India	10-11%
Infrastructure /Geosynthetics	For industries it provides solutions for tower erection, lifting, material handling and safety net solutions for infra projects.	8-10%
Agri nets	Premium player in various types of agri nets like shade nets, insect protection nets etc.	~6%
Others	Unique player in Defence; supplies flexible helimats, aerostat balloons to the sector. Also, makes tarpaulins, jute bags, woven sacks and reinforcements	5%-10%

Source: Company, Ambit Capital research. Note: This segment-wise revenue break-up is based on management commentary in FY17 AGM as the company does not formally disclose the revenues from its various segments in its annual report.

Continued relentless focus on innovation

GWRL has never shied from innovation; as seen in exhibit 2 below, the pace of innovation has significantly gained pace since Vayu Garware (Chairman) joined in 1996.

Exhibit 2: GWRL has consistently undertaken product innovation and the pace has only increased with time



Source: Company, Ambit Capital research. Note: This exhibit is based on the key milestones achieved by GWRL as disclosed on its website here.

Research Analysts

Bhargav Buddhadev
bhargav.buddhadev@ambit.co
Tel: +91 22 3043 3252

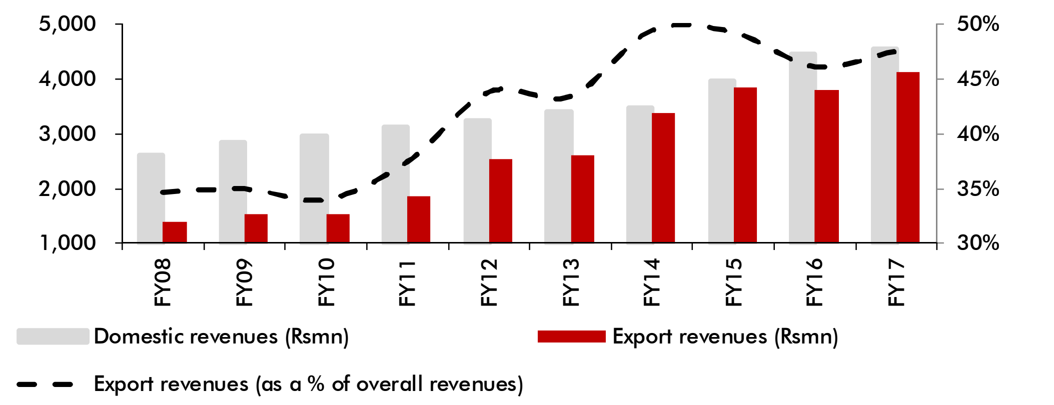
Karan Khanna, CFA
karan.khanna@ambit.co
Tel: +91 22 3043 3251

Even in the AGM, Vayu highlighted relentless focus on application-oriented innovation (through customized value-added solutions for customers). Vayu mentioned that any product innovation is undertaken keeping the end user (i.e. customer) in mind. This could be the reason why share of value-added products has increased from ~45% four years back to more than 60% now. The company website has a lot of videos on the various innovations that Garware has done till date.

Agri, aquaculture and sports nets to drive exports

As per management, growth hereon would be driven by exports; exports already formed nearly half of overall sales in FY17 (vs 35% in FY08).

Exhibit 3: Share of exports in overall revenue has been constantly rising



Source: Company, Ambit Capital research

Further, presently aquaculture and sports nets account for a significant chunk of exports (~37% and ~21% share in exports for aquaculture and sports nets respectively). In aquaculture, GWRL already commands a significant market share in key markets like Canada and Scotland; the company recently hired country managers for Chile and Norway, which are amongst the largest aquaculture markets in the world. As per management commentary, growth in international markets would be driven by increased acceptance of GWRL's innovative solutions in the aquaculture segment.

In sports nets, GWRL is already the largest sports goods exporter from India and should continue to see strong acceptance for its products in the global market.

GWRL is also increasingly tapping the exports markets for its offerings in the agri segment. Whilst agri is still a small proportion of overall revenue, GWRL's new offerings in the agri segment (like Olive Harvesting nets, Vineyard & Orchard nets, etc) should see good demand given GWRL's customized offerings (length and fabrication as per customer requirements) and multiple other application of these products.

Margins to be maintained as focus is on customizing product

GWRL's key competitive advantage is its unique understanding of the chemical composition of polymer. This allows GWRL to study the end-application of the customer and develop customised solutions on a consistent basis.

This is also the reason why the share of value-added products in GWRL's overall revenue mix has increased from ~45% four years back to more than 60% now; this drove ~520bps EBITDA margin expansion from ~10% in FY13 to ~15.2% in FY17.

We expect GWRL to either continue to maintain or improve its existing EBITDA margins driven by its ability to offer customized value-added solutions to its customers.

For instance some of the key new products in the pipeline include sleeping bags that will find application in Indian Defence as also for camping purposes. As per our interactions with the company's employees, the Government of India is now importing ~50,000 pieces of these sleeping bags from Austria. The new product that GWRL will launch would be sold in the range of ~Rs 2,500-8,000. Further, given that these products would largely be used to replace expensive imports from Austria, GWRL should enjoy strong margins in this product as well.

Attained clarity on certain balance sheet items

- In its FY17 annual report, GWRL made certain restatements to its reported numbers for FY16 that needed further clarity. For instance, in current liabilities, GWRL restated the FY16 numbers for short-term borrowings, trade payables and short-term provisions (see exhibits 4 and 5 below). In current assets GWRL restated the FY16 numbers for trade receivables and cash and bank balance (see exhibits 6 and 7 below):

Exhibit 4: Current liabilities as per FY17 annual report

(a) Short-term Borrowings	9	8,571.05	4,068.81
(b) Trade Payables	10	19,190.32	16,090.79
(c) Other Current Liabilities	11	8,047.51	9,705.18
(d) Short-term Provisions	12	15,317.43	12,054.43
		51,126.31	41,919.21

Source: Company, Ambit Capital research. Note: Red box denotes FY16 numbers.

Exhibit 5: Current liabilities as per FY16 annual report

(a) Short-term Borrowings	9	2,983.06	2,754.55
(b) Trade Payables	10	5,210.45	6,631.13
(c) Other Current Liabilities	11	9,705.18	8,653.92
(d) Short-term Provisions	12	22,934.77	17,771.84
		40,833.46	35,811.44

Source: Company, Ambit Capital research. Note: Red box denotes FY16 numbers.

Exhibit 6: Current assets as per FY17 annual report

(a) Inventories	17	14,095.93	12,546.28
(b) Trade Receivables	18	20,923.73	21,239.56
(c) Cash and Cash Equivalents	19	11,290.62	8,053.10
(d) Short-term Loans and Advances	20	20,190.29	17,629.68
		66,500.57	59,468.62

Source: Company, Ambit Capital research. Note: Red box denotes FY16 numbers.

Exhibit 7: Current assets as per FY16 annual report

(a) Inventories	17	12,546.28	13,719.69
(b) Trade Receivables	18	19,884.58	18,207.76
(c) Cash and Cash Equivalents	19	8,322.33	1,057.10
(d) Short-term Loans and Advances	20	17,629.68	16,965.99
		58,382.87	49,950.54

Source: Company, Ambit Capital research. Note: Red box denotes FY16 numbers.

- **Trade payables:** Trade payables of ~Rs1,919mn in FY17 appear high given the nature of the raw materials; GWRL's key raw materials are petroleum-based (such as HDPE, polypropylene, etc), hence it is difficult to understand how such a large quantum of credit is possible given the thin margins at which the suppliers of these raw materials operate.
- Discussions with the management seems to suggest that ~Rs400mn of these trade payables pertains to the geosynthetics projects (this is almost 4 months credit), ~Rs160mn pertains to outstanding payment to be made to transporters (~3-4 months payment outstanding), ~Rs250mn pertains to processing charges relating to outsourcing/ sub-contracting work (~4 months outstanding), and ~Rs125mn pertains to suppliers of stores & spares (~3 months outstanding). There is also some amount pertaining to coal, other expenses, etc. About Rs650mn pertains to payments to be made to suppliers of raw material.
- **Other provisions:** In FY17, other provisions were ~30% of total short-term provisions (~Rs 505mn other provisions in total short-term provisions of ~1,533mn). Management suggested that this entirely pertains to dealer discounts, commission, etc that is given to channel partners.
- **Other payables and other loans & advances:** GWRL's other payables for FY17 were ~Rs680mn. Of this, ~Rs606mn pertained to fair value of foreign exchange forward contracts that are secured against trade receivables. As per the management, the fair value of these forward contracts is shown on a gross basis with the corresponding adjustment shown under 'Other Loans & Advances' on the assets side. This possibly explains a significant proportion of the ~Rs1,061mn clubbed under 'Other Loans & Advances' in GWRL's FY17 balance sheet.

Where do we go from here?

As per its commentary at the AGM, the management expects growth to be driven by GWRL's offerings in international markets, in particular GWRL's customized solutions in the aquaculture and agri nets space. In the domestic market, growth in the fisheries segment seems to have exhausted and would now be driven by offerings in geosynthetics and agri nets. In geosynthetics, the main focus is landfill protection and coastal protection; both growth and margins in this segment are good. In agri nets, the good monsoons should drive growth for GWRL's offerings in the agri segment in the domestic market.

Recently, GWRL also signed an MoU with Israel-based Aero-T for manufacturing advanced aerostats for Indian Defence (click here for the press release). Aerostats are primarily used for surveillance purpose in Defence. As per the MoU, manufacturing will be done by GWRL while Aero-T will provide technology for the development of aerostats. While Defence currently contributes to <1% of overall revenue, as per media articles (click here), GWRL is planning to target at least Rs1bn of revenue from the Defence sector each year over the next 3-4 years. Further, margins in this segment should be very good as GWRL will be replacing expensive material now being imported mainly from Europe.

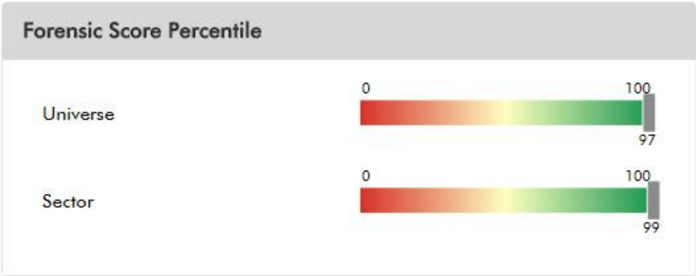
Valuation of 23.3x FY17 P/E is inexpensive for a market leader given ~20% FY17 RoE, 46% EPS CAGR over FY14-17, low capital intensity and GWRL's balance sheet strength to invest for 20%+ growth.

Exhibit 8: GWRL trades at discount to its small-cap peers despite superior fundamentals

Company name	Mcap (US$ mn)	FY16 'greatness' scores	Revenue CAGR (FY14-FY17)	EPS CAGR (FY14-FY17)	EBIT margins (FY17)	RoE (FY17)	RoCE (FY17)	TTM P/E	TTM P/B	TTM EV/EBITDA
GWRL	305	79%	8%	46%	38%	20%	19%	23.3	4.3	14.2
Median for 'D1-D3' companies	292	50%	5%	10%	15%	16%	13%	25.2	3.2	13.8
Nilkamal	419	38%	5%	38%	82%	18%	17%	22.5	3.6	11.8
SML Isuzu	223	21%	16%	53%	43%	17%	16%	22.6	3.5	13.4
KEI Industries	274	79%	18%	100%	13%	23%	17%	17.6	3.7	8.5
Kewal Kiran Clothing	321	54%	10%	8%	69%	26%	25%	25.2	5.7	22.3
Wim Plast	288	83%	6%	14%	40%	20%	20%	37.7	7.0	21.8

Source: Bloomberg, Ambit Capital research

Forensic score analysis

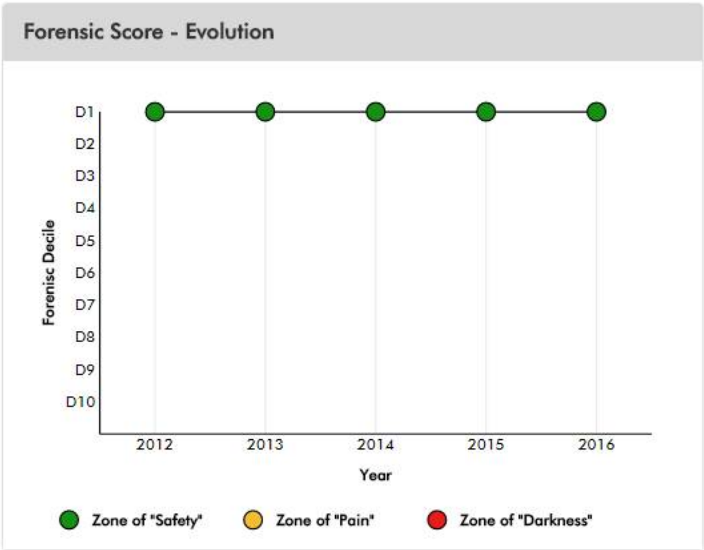


Source: Ambit HAWK, Ambit Capital research

Greatness score analysis

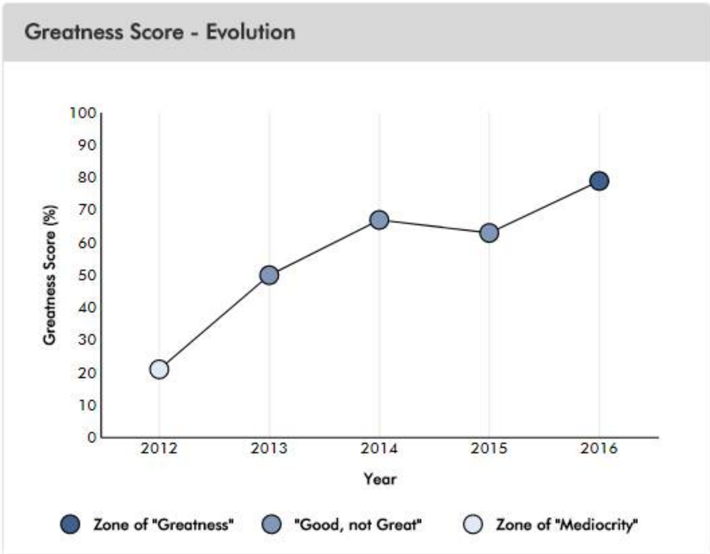
Source: Ambit HAWK, Ambit Capital research

Forensic score evolution



Source: Ambit HAWK, Ambit Capital research

Greatness score evolution



Source: Ambit HAWK, Ambit Capital research

Key financials (Standalone)

Balance Sheet

Year to March (Rs mn)	FY13	FY14	FY15	FY16	FY17
Cash	198	89	106	805	1,129
Debtors	1,404	1,425	1,821	2,124	2,092
Inventory	1,218	1,268	1,372	1,255	1,410
Loans & advances	1,151	1,499	1,815	1,882	2,135
Other assets	17	10	56	63	71
Investments	92	93	90	89	1,139
Fixed assets	1,545	1,601	1,726	1,994	2,036
Misc. Expenditure (not w/off)	-	-	-	-	-
Total assets	**5,624**	**5,987**	**6,985**	**8,212**	**10,013**
Current liabilities & provisions	1,671	2,322	3,263	3,831	4,355
Debt	1,104	713	397	450	857
Other liabilities - Deferred Tax Liability	181	203	225	283	308
Total liabilities	**2,957**	**3,238**	**3,885**	**4,565**	**5,520**
Share Capital (incl. warrants)	237	220	219	219	219
Reserves & surpluses	2,430	2,529	2,881	3,429	4,274
Total networth	**2,667**	**2,749**	**3,100**	**3,648**	**4,492**
Net working capital	2,316	1,970	1,906	2,297	2,482
Net debt (cash)	907	624	292	(355)	(272)

Source: Company, Ambit Capital research

Income Statement

Year to March (Rs mn)	FY13	FY14	FY15	FY16	FY17
Operating income	5,994	6,846	7,822	8,248	8,653
% growth	4%	14%	14%	5%	5%
Operating expenditure	5,397	6,289	7,043	7,272	7,338
EBITDA	597	556	779	976	1,315
% growth	-11%	-7%	40%	25%	35%
Depreciation	163	144	124	131	141
EBIT	433	412	655	845	1,174
Interest expenditure	145	128	102	87	64
Non-operational income	45	107	52	113	109
Exceptional items	-	-	-	-	-
PBT	334	391	605	870	1,218
Tax	87	124	175	252	386
Reported PAT	247	267	431	619	833
Adjustments	-	-	-	-	-
Adjusted PAT	247	267	431	619	833
% growth	3%	8%	61%	44%	35%

Source: Company, Ambit Capital research

Cash Flow Statement

Year to March (Rs mn)	FY13	FY14	FY15	FY16	FY17
PBT	334	391	605	870	1,218
Depreciation	163	144	124	131	141
Interest paid	145	128	102	87	64
Direct taxes paid	(76)	(54)	(141)	(223)	(263)
(Incr) / decr in net working capital	(214)	189	55	596	44
Others	(14)	(7)	(1)	(31)	(72)
CFO	**339**	**791**	**745**	**1,431**	**1,133**
(Incr) / decr in capital expenditure	6	(200)	(255)	(399)	(185)
(Incr) / decr in investments	(1)	(2)	3	1	(1,050)
Others	(1)	7	2	31	72
CFI	**4**	**(195)**	**(250)**	**(367)**	**(1,163)**
Issuance of equity	-	(105)	(7)	-	-
Incr / (decr) in borrowings	(166)	(401)	(305)	(202)	419
Dividends paid	(69)	(69)	(65)	(74)	(2)
Others	(146)	(129)	(102)	(89)	(64)
CFF	**(380)**	**(704)**	**(478)**	**(365)**	**352**
Net change in cash	(38)	(108)	17	700	322
FCF	344	591	490	1,032	947

Source: Company, Ambit Capital research

Ratio analysis

Year to March (%)	FY13	FY14	FY15	FY16	FY17
Revenue growth	4	14	14	5	5
EBITDA growth	(11)	(7)	40	25	35
APAT growth	3	8	61	44	35
EPS growth	3	17	62	44	35
EBITDA margin	10.0	8.1	10.0	11.8	15.2
EBIT margin	7.2	6.0	8.4	10.2	13.6
Net profit margin	4.1	3.9	5.5	7.5	9.6
Reported RoCE	8.3	7.8	13.4	15.8	17.0
Reported RoE	9.5	9.8	14.7	18.3	20.5
Reported RoIC	8.6	7.9	13.3	17.1	23.3
Net Debt:Equity ratio (x)	0.3	0.2	0.1	(0.1)	(0.1)
Current ratio (x)	2.4	1.8	1.6	1.6	1.6

Source: Company, Ambit Capital research

Valuation parameters

Year to March	FY13	FY14	FY15	FY16	FY17
EPS (Rs)	10.4	12.1	19.7	28.3	38.1
Book value per share (Rs)	112.5	125.1	141.7	166.7	205.3
P/E (x)	85.3	73.2	45.1	31.4	23.3
P/BV (x)	7.9	7.1	6.3	5.3	4.3
EV/EBITDA (x)	32.1	34.4	24.6	19.6	14.6
EV/Sales (x)	3.2	2.8	2.4	2.3	2.2
EV/EBIT (x)	44.2	46.5	29.2	22.7	16.3
Working Capital Turnover (x)	2.6	3.2	4.0	3.9	3.6

Source: Company, Ambit Capital research

Dalmia Bharat

A marginal miss

Whilst DBL's 6% volume growth resulted in market-share gains, the volume growth was 2% below our estimate due to lower-than-expected volumes in East India. Volume growth at OCL (East India subsidiary) was only 3% YoY, despite strong industry demand in East India. Despite 7% QoQ jump in realisations, DBL reported unitary EBITDA of Rs1,395/tonne, up 15% QoQ, and the highest in the industry. Absolute EBITDA of Rs5.6bn was up 9% YoY, but 3% below our estimate mainly due to 2% miss both on volumes and EBITDA/tonne. DBL remains our preferred play in the sector given above-industry volume/EBITDA growth and high scope for operating/financial leverage. Whilst we see limited scope for upgrades to near-term estimates, valuation re-rating is likely to continue. We will revisit our estimates and valuation post the earnings call tomorrow. The stock trades at 12x FY18E EBITDA, at a ~30% discount to Ambuja/ACC despite materially high volume growth outlook.

The conference call is scheduled at 10:00am tomorrow – dial in numbers are +91 22 3938 1073 / +91 22 3940 3977. At the conference call tomorrow, key questions for which investors must seek clarity are: (a) reason for OCL's muted volume growth; (b) reason for sharp increase in power & fuel and other expenses; and (c) capital allocation going forward.

Results overview:

Volumes: DBL reported 6% YoY volume growth, but was 2% below our estimate. The negative surprise was due to just 3% YoY volume growth in East India (OCL), despite strong industry demand in the region. Dalmia's volumes, Ex-OCL (South + North East + Bokaro), grew by 8% YoY, likely due to: (a) ramp-up of the Belgaum plant; and (b) strong demand in AP/Telangana/Karnataka.

Realisations: DBL reported 7% QoQ jump in average realisations, 1% above our estimate. OCL as well as DBL (Ex-OCL) reported 7-8% realisation growth QoQ.

Revenues: DBL reported revenues of Rs20.6bn, up 16% YoY, due to realisation growth. Sales for DBL, Ex-OCL, were up 15% YoY, and OCL reported revenue growth of 18%.

Per tonne cost: Overall cost per tonne increased by 5% QoQ given sharp increase in power & fuel and other expenses. The management highlighted that to mitigate the impact of rise in pet coke prices, consumption of imported petcoke was reduced from 62% in 4QFY17 to 55% in 1QFY18.

EBITDA and PAT: Unitary EBITDA stood at Rs1,395/tonne, up 15% QoQ and 2% below our estimate of Rs1,418/tonne mainly due to higher-than-expected power & fuel and other expenses. Absolute EBITDA of Rs5.6bn was up 9% YoY, due to strong realisations. Absolute EBITDA came in 3% below our estimate mainly due to 2% miss on both volumes and EBITDA/tonne. Marginal miss on EBITDA coupled with higher-than-expected interest expense and tax rate resulted in PBT and PAT being 12% and 21% below our estimate respectively.

Debt: The management highlighted that net debt reduced to ~Rs46bn from Rs52bn at the end of FY17 (down by ~Rs6bn, likely due to cash proceeds receivable pursuant to the KKR's sale of stake in DBL).

BUY

Result Update

Stock Information

Bloomberg Code:	DBEL IN
CMP (Rs):	2,570
TP (Rs):	2,650
Mcap (Rs bn/US$ bn):	229/3.6
3M ADV (Rs mn/US$ mn):	358/5.6

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(1)	15	81	90
Rel. to Sensex	(5)	8	64	69

Source: Bloomberg, Ambit Capital research

Ambit Estimates (Rs mn)

	FY17	FY18E	FY19E
Revenues	74,153	85,687	96,759
EBITDA	19,019	24,386	28,727
EPS (Rs)	38.8	86.9	122.6

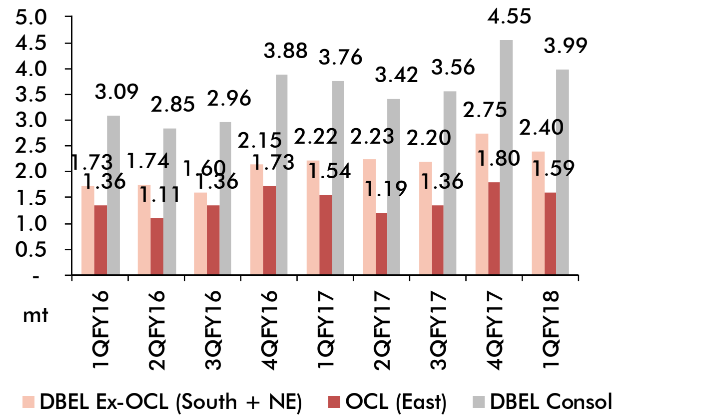
Source: Company, Ambit Capital research

Research Analysts

Parita Ashar, CFA
parita.ashar@ambit.co
Tel: +91 22 3043 3223

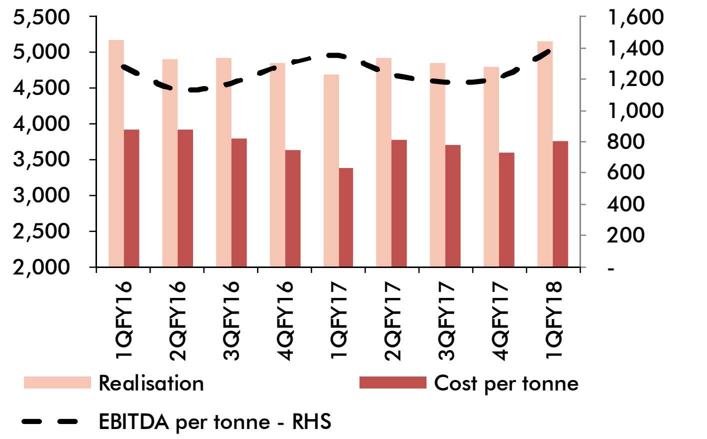
Nitin Bhasin
nitin.bhasin@ambit.co
Tel: +91 22 3043 3241

Exhibit 1: DBL's strong volume growth, Ex-OCL (South + North East + Bokaro) – up 8% YoY; East volumes up 3% YoY



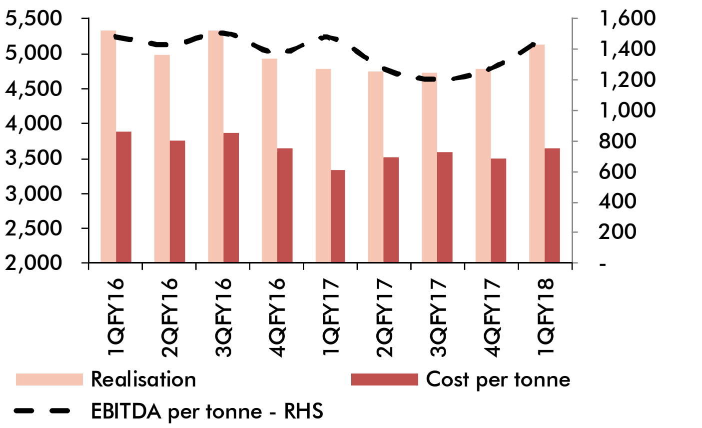
Source: Company, Bloomberg, Ambit Capital research

Exhibit 2: Consolidated EBITDA/tn up ~Rs183/tonne as realisation increase of ~Rs358/tonne was partially offset by Rs175/tonne increase in costs (Rs/tonne)



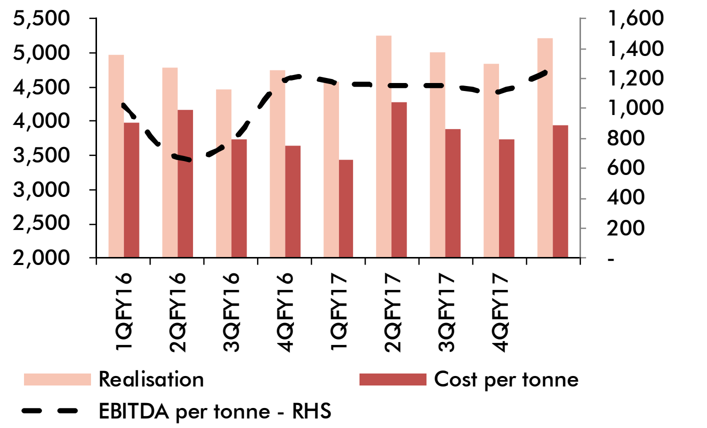
Source: Company ,Bloomberg, Ambit Capital research

Exhibit 3: DBL's realisations, Ex-OCL (South + NE + Bokaro), were up ~Rs350/tonne partially offset by cost increase of ~Rs145/tonne (Rs/tonne)



Source: Company, Bloomberg, Ambit Capital research

Exhibit 4: OCL's realisations were up ~Rs372/tonne partially offset by cost increase of ~Rs219/tonne (Rs/tonne)



Source: Company, Bloomberg, Ambit Capital research

Exhibit 5: Unitary trends (Rs/tonne)

Per tonne analysis	1QFY17	4QFY17	1QFY18	YoY (%)	QoQ (%)	Ambit	Deviation (%)
Sales volume (mt)	3.8	4.6	4.0	6%	-12%	**4.1**	-2%
Realisation	**4,727**	**4,802**	**5,160**	9%	7%	**5,090**	1%
Realisation ex freight	**3,948**	**3,899**	**4,224**	7%	8%	**4,190**	1%
EBITDA/tonne	**1,352**	**1,212**	**1,395**	3%	15%	**1,418**	-2%
Opex/tonne	**3,375**	**3,590**	**3,765**	12%	5%	**3,672**	3%
RM consumed	868	921	717	-17%	-22%	900	-20%
Purch of Trdd Goods	29	7	73	153%	987%	20	264%
Employee cost	408	302	413	1%	37%	404	2%
Power& Fuel	537	695	809	51%	16%	700	16%
Freight & Selling Exp	779	904	936	20%	4%	900	4%
Other Expenses	755	761	817	8%	7%	748	9%

Source: Company, Ambit Capital research

Exhibit 6: Quarterly results snapshot (Rs mn)

	1QFY17	4QFY17	1QFY18	YoY (%)	QoQ (%)	Ambit	Deviation (%)
Net Sales	**17,775**	**21,850**	**20,589**	16%	-6%	**20,671**	0%
Expenditure	**12,691**	**16,334**	**15,023**	18%	-8%	**14,912**	1%
Raw material consumed	3,262	4,189	2,860	-12%	-32%	3,655	-22%
Purchase of Traded Goods	108	31	291	168%	853%	81	258%
Employee Expenses	1,533	1,375	1,646	7%	20%	1,640	0%
Power & Fuel	2,018	3,165	3,229	60%	2%	2,843	14%
Freight & Handling Exp	2,929	4,112	3,735	28%	-9%	3,655	2%
Other Expenses	2,840	3,463	3,261	15%	-6%	3038.8	7%
EBITDA	**5,084**	**5,517**	**5,566**	**9%**	**1%**	**5,759**	-3%
EBITDA margin	**28.6%**	**25.2%**	**27.0%**			**27.9%**	
EBITDA/ton	1,352	1,212	1,395	3%	15%	1,418	-2%
Depreciation	1,338	1,509	1,532	15%	2%	1,500	2%
EBIT	**3,746**	**4,008**	**4,034**	8%	1%	**4,259**	-5%
Other Income	766	715	700	-9%	-2%	700	0%
Interest	2,412	1,998	2,117	-12%	6%	2,000	6%
PBT	**2,100**	**2,724**	**2,617**	25%	-4%	**2,959**	-12%
Total tax	911	565	622	-32%	10%	592	5%
Tax rate	43%	21%	24%			20%	
PAT	**1,189**	**2,159**	**1,996**	68%	-8%	**2,367**	-16%
Minority interest	(250)	(319)	(357)	43%	12%	(300)	19%
Reported PAT	**940**	**1,841**	**1,639**	74%	-11%	**2,067**	-21%
Adjusted PAT	**940**	**1,841**	**1,639**	74%	-11%	**2,067**	-21%

Source: Company, Ambit Capital research

Where do we go from here?

At the conference call tomorrow, key questions for which investors must seek clarity from the management are:

- **Volume growth:** Despite strong volume growth in East India, why did OCL report merely 3% volume growth? How does the company plan to grow volumes in East India, especially in Bihar where its market share is below 10%? Despite weak demand in Tamil Nadu and Kerala, DBL Ex-OCL reported volume growth of 8%. Which region has been the key driver of this growth? What is the outlook for demand growth in TN + Kerala given weak monsoons and political instability?
- **Sustainability of price hikes:** What has driven pricing discipline in a region like East India which has seen several new capacities recently? Does the management see risks to pricing in East India given capacity additions in the region continue?
- **Costs:** Key reason for sharp increase in power & fuel and other expenses?
- **Capital allocation:** Is the management considering any capacity addition plans or is debt repayment likely to continue in FY18-19E?

Our preferred play in the sector: Dalmia remains our preferred play on the sector given our expectations of above-industry volume CAGR over FY17-19E for Dalmia (9%, significantly above industry CAGR of 5-6%) due to market-share gains given its presence in high growth regions of East India, APT and North East and ramp-up of new capacity at Belgaum. We already factor in 14%/23% revenue/EBITDA CAGR over FY17-19E and gains from operating and financial leverage given improvement in capacity utilisation from ~50% in FY16 to ~72% by FY19E. Whilst we see limited scope for upgrades to near-term estimates, valuation re-rating is likely to continue given strong earnings growth profile and significant scope for de-leveraging. We will revisit our estimates and valuation post the earnings call tomorrow. The stock trades at 12x FY18E EBITDA, at a ~30% discount to Ambuja/ACC despite materially high volume growth outlook.

Balance sheet (Rs mn)

Particulars	FY15	FY16	FY17	FY18E	FY19E
Total Networth	**38,452**	**43,308**	**55,778**	**69,211**	**79,828**
Loans	84,797	88,925	80,795	76,795	70,795
Sources of funds	**127,254**	**137,907**	**152,336**	**161,770**	**166,387**
Net block	58,233	76,117	94,814	92,197	90,523
Capital work-in-progress	38,785	29,884	28,273	28,273	28,273
Investments	16,905	25,752	27,434	27,434	27,434
Cash and bank balances	5,281	2,483	1,750	9,872	14,929
Total Current Assets	30,147	27,825	29,258	42,711	52,011
Current liabilities and provisions	16,816	21,671	27,442	28,843	31,854
Net current assets	**13,331**	**6,154**	**1,817**	**13,867**	**20,158**
Application of funds	**127,254**	**137,906**	**152,337**	**161,770**	**166,387**

Source: Company, Ambit Capital research

Income statement (Rs mn)

Particulars	FY15	FY16	FY17	FY18E	FY19E
Revenue	35,141	64,380	74,153	85,687	96,759
EBITDA	6,025	15,786	19,019	24,386	28,727
Depreciation	2,716	4,528	6,027	6,759	7,000
EBIT	3,309	11,259	12,992	17,627	21,727
Interest	4,344	7,256	8,900	7,485	7,010
Other income	933	1,642	2,988	2,256	2,717
PBT	(101)	5,644	7,080	12,397	17,434
Tax	469	2,991	2,762	3,719	5,230
Adjusted PAT	92	1,908	3,448	7,714	10,886
EPS (Rs)	1.1	23.4	38.8	86.9	122.6
DPS (Rs)	2.4	2.6	2.0	10.4	14.7

Source: Company, Ambit Capital research

Cash flow statement (Rs mn)

Particulars	FY15	FY16	FY17	FY18E	FY19E
PBT	(162)	5,644	7,080	12,397	17,434
Change in working capital	689	3,371	300	(3,928)	(1,234)
Direct taxes paid	(1,354)	(458)	(2,762)	(3,719)	(5,230)
CFO	**5,448**	**18,907**	**16,558**	**16,739**	**22,262**
Net capex	(4,953)	(3,852)	(2,585)	1,738	(5,326)
CFI	**9,656**	**(16,704)**	**(3,353)**	**1,738**	**(5,326)**
Proceeds from borrowings	34,985	4,129	(8,186)	(4,000)	(6,000)
Interest & finance charges paid	(5,432)	(8,607)	(5,912)	(5,230)	(4,293)
CFF	**29,345**	**(5,002)**	**(14,098)**	**(10,354)**	**(11,880)**
Net increase in cash	44,449	(2,798)	(894)	8,122	5,056
FCF	**496**	**15,055**	**13,973**	**18,476**	**16,936**

Source: Company, Ambit Capital research

Ratio analysis/Valuation parameters

Year to March	FY15	FY16	FY17	FY18E	FY19E
RoCE	3.0	7.2	5.5	11.2	13.2
RoIC	3.1	8.2	6.7	13.6	15.9
P/E (x)	2,362.0	114.1	68.2	30.5	21.6
P/B(x)	7.0	6.1	4.7	3.8	3.3
Net debt/Equity(x)	2.1	1.6	1.1	0.7	0.4
EV/EBITDA(x)	47.2	18.6	15.5	12.1	10.2
EV/tonne(Rs)	16,531	11,762	11,762	11,762	11,762

Source: Company, Ambit Capital research

BFSI

Weekly tracker

Quick Insight

Analysis
Meeting Note
News Impact ✓

Research Analysts

Pankaj Agarwal, CFA
Tel: +91 22 3043 3206
pankaj.agarwal@ambit.co

BFSI Team
bfsi@ambit.co

In this weekly update, we have compiled all the key news flows, regulatory developments, key management interviews, summary of takeaways from our meetings with management teams/primary data and key notes we published last week. On the negative front; (i) the RBI's decision to create a panel to review banks' lending rate may impact margins negatively; and (ii) leading credit rating agency reported that microfinance institutions could report higher credit costs and losses in FY18. Separately, State Bank of India and Bank of Baroda slashed the deposit interest rates on savings deposits.

Exhibit 1: Key news flows during last week

Title	Description	Implications
After SBI, Bank of Baroda cuts interest rate on savings account by 50bps	**News:** Last week, State Bank of India cut savings deposit interest rates to 3.5% (from 4% earlier) for deposits below Rs10mn. Following the suit, Bank of Baroda also cut the interest rate by 50bps to 3.5% for savings deposits below Rs5mn. Kotak Mahindra Bank also cut the deposit interest rates by 50bps to 5.5% for deposits above Rs10mn and below Rs50mn. (Source: https://goo.gl/q4Xt8L) **Views:** SBI has one of the highest shares of savings bank deposits in its deposits (38% of SBI deposits are SB deposits). A 50bps savings on SB deposits could have potential ~10bps positive impact on RoA for SBI. However, if MCLR framework is followed properly, the bank will have to pass on the benefit immediately. The benefit, strategically, for SBI/BOB then is that it allows bank to become even further competitive on its loan pricing and corner market share.	Neutral
RBI panel to review banks' lending rates	**News:** The RBI said that it will set up a panel to review banks' benchmark lending rate, after it noticed that lenders were not fully passing on reductions in the policy rate. This committee will also look at the possibility of linking the marginal cost of funds-based lending rate (MCLR) to a market-determined benchmark rate. Given a large part of the floating rate loan portfolio of banks is still anchored on the base rate, the RBI is looking to make the base rate more responsive to changes in cost of funds of banks. (Source: https://goo.gl/Ejyjrb) **Views:** We note that SBI's base rate, for example, has fallen by just 30bps since April 2016 vs a 115bps reduction in one-year MCLR during the same period. Most of the MCLR reduction (90bps) occurred on 1 Jan-2017, when only a small proportion of loans were linked to MCLR. Given its focus on making banks' effective lending more sensitive to monetary policy and making floating rate loans "truly floating", we expect the RBI to continue restricting banks' discretion in setting benchmark rates. This will impact the NIMs of the bank negatively going forward.	Negative
Microfinance Institutions could report higher credit costs and losses for 1QFY18-2QFY18	**News:** A leading rating agency, India Ratings and Research, expects microfinance institutions (MFIs, both listed and unlisted) with significant exposure to the states of Maharashtra, Madhya Pradesh, Uttar Pradesh, Uttarakhand and Karnataka to witness 5-10% of December 2016 assets under management as credit costs over FY18-19. (Source: https://goo.gl/ZQUgJX) **Views:** Weak recovery in delinquency trends since December 2016 end stay a key concern for MFIs/SFBs. Events of mass-default and high credit losses on defaults bring the structural weakness of microfinance lending to the fore. For SFBs under our coverage (Ujjivan/Equitas), we expect FY18 credit cost of ~250bps vs 60-120bps pre-demonetisation. We are SELLers on Ujjivan and Equitas.	Negative

Source: Media reports, Ambit Capital research

Exhibit 2: Key interviews given by management during last week

Interview with	Summary
Dinesh Khara, Managing Director and Chief Executive Officer, State Bank of India	**Cost of credit, NPA positioning restricting banks to cut MCLR:** ▪ Factors, apart from policy rates, such as the cost of deposit, cost of credit and level of NPAs are restricting banks from cutting the MCLR. The policy rate is a critical component but not the only component affecting the MCLR. ▪ Most of the retail advances are still linked to base rate while the corporate advances are getting aligned to the MCLR. ▪ The banking system is rolling into a lot of liquidity and they would like to deploy that liquidity into the right kind of investments and projects coming up for consuming this kind of liquidity. (Source: https://goo.gl/qe4gGb)
Dipak Gupta, Joint MD, Kotak Mahindra Bank	**Need to be cautious about cutting rates for accounts below Rs10mn:** ▪ The bulk of the customer base which is really the small-medium depositors, we have not changed deposit rates. ▪ The bank has been buying stressed assets continuously. However, we are currently focusing on mid-market and retail-end of stressed assets. The bank has not really been aggressively looking at very large stressed assets. ▪ When one is looking at tweaking rates below the Rs10mn benchmark, one has to think it through far more cautiously since these customers are sticky and rate sensitive. (Source: https://goo.gl/rTmUv3)
Ramesh Iyer, VC & MD, M&M Finance	**Our credit losses have never exceeded 2%:** ▪ The overall growth on the asset side is not very worrying because of the strong reach and our large customer base. As far as asset quality is concerned, we have been going through difficult times since the entire book is based on earn-and-pay model and therefore when their cash flows are under pressure they delay. ▪ Cashflows are expected to better since we have seen dual cash inflows from farm and infra (roads, etc.) coming through and that is the reason management believes that the rural economy is now poised for a change. ▪ Management very strongly think that at any point of time the credit losses would not exceed this 2.0-2.2% level. Historically also we have never crossed 2% mark. (Source: https://goo.gl/2ibqk4)
Sanjaya Gupta, Managing Director, PNB Housing Finance	**Have sufficient capital for next 30-35 months:** ▪ PNB Housing has a huge task on geographical expansion and if the company will keep on doing distribution networking, the growth rate will be smart enough. ▪ Pure housing will be at 60%, construction financing to be at 13% and non-housing portfolio to be at 27% of the portfolio. ▪ Will maintain spreads at 210-215bps and net interest margin at 335-345bps. Have sufficient capital for next 30-35 months. (Source: https://goo.gl/kM2hHr)

Source: Media reports, Ambit Capital research

Economy

Ambit's qualitative leading indicators' (QLI) tracker

Quick Insight

Analysis	✓
Meeting Note	
News Impact	

Research Analyst

Sumit Shekhar
sumit.shekhar@ambit.co
Tel: +91 22 3043 3229

With qualitative data collected through primary data networks often proving to be a stronger leading indicator of changes in the economy, we collate a weekly tracker that captures these critical qualitative inputs. On the positive front: (1) LPG prices to be increased by Rs4/month to eliminate any subsidy by 31st March 2018, (2) Direct tax collection up by 21% YoY until July 15 2017, and (3) Gold demand surged by 41% in 2QCY17. On the negative front: (1) Both manufacturing and services contract sharply in July on GST worries; (2) Apr-Jun fiscal deficit touches 82% of full-year target, and (3) Core sector growth slows to 0.4% YoY in June from 4.1% in May.

Exhibit 1: Ambit's qualitative indicators' tracker for the week commencing July 31, 2017

Head	Description	Positive/ Negative
LPG prices to be increased by Rs4 per month	▪ The Government has ordered state-run oil companies to raise subsidised cooking gas (LPG) prices by Rs4 per cylinder every month to eliminate all the subsidies by March next year, Oil Minister Dharmendra Pradhan said on July 31. ▪ The Government had previously asked Indian Oil (IOC), Bharat Petroleum (BPCL) and Hindustan Petroleum (HPCL) to raise rates of subsidised domestic LPG (liquefied petroleum gas) by Rs2 per 14.2-kg cylinder per month (excluding VAT). ▪ Now, the quantum has been doubled so as to bring down the subsidy to nil, the minister said in a written reply in the Lok Sabha (source: http://www.business-standard.com/article/current-affairs/lpg-prices-to-be-increased-by-rs-4-per-month-117073100719_1.html).	Positive
Direct tax collection up 21%	▪ The Government has collected over Rs1.8tn in direct tax until July 15 in the current fiscal, an increase of 21.4% YoY. The Government aims to collect Rs9.8tn through direct taxes in FY18. ▪ The current growth rate is higher than the target rate of 15.32% required to achieve the Budget Estimate (source: http://www.business-standard.com/article/economy-policy/direct-tax-collection-up-21-to-rs-1-80-000-crore-till-mid-jul-fy18-117080101198_1.html).	Positive
Indians are stocking up on gold, jewellery demand soars 41% in Q2CY17: WGC	▪ India's insatiable appetite for gold jewellery was evident once again in the second quarter of CY17 (Q2CY17). ▪ The total demand for gold jewellery surged to 126.7 tonnes, rising 41% as compared to the previous corresponding period, suggests the latest report by the World Gold Council titled *'Gold Demand Trends Q2 2017'*. ▪ The strong recovery, WGC believes, had been widely expected after exceptional import figures were reported, hitting an all-time high of 104.6 tonnes in May as the market stockpiled gold ahead of the goods and services tax (GST) rate announcement (source: http://www.business-standard.com/article/markets/indians-stock-up-on-gold-jewellery-demand-soars-41-in-q2cy17-wgc-117080300408_1.html).	Positive
Notes in circulation on July 21 at 86% of pre-demonetisation level: Govt	▪ Notes in circulation as on July 21 were nearly 86% of the pre-demonetisation level and the RBI has made arrangements for supply of adequate banknotes in various denominations, Parliament was informed on August 04. ▪ In a written reply to Lok Sabha, Minister of State for Finance Arjun Ram Meghwal said specific banknotes received are to be reconciled to obviate reporting errors and processed for numerical accuracy and authenticity through machines. ▪ "Remonetisation is taking place ceaselessly at a fast pace and the RBI has made arrangements for supply of adequate quantity of banknotes in various denominations. Notes in Circulation (NIC) as on July 21, 2017 are nearly 86 per cent of NIC as on November 4, 2016," Meghwal said (source: http://www.business-standard.com/article/economy-policy/notes-in-circulation-on-july-21-at-86-of-pre-demonetisation-level-govt-117080400830_1.html).	Neutral
GST Council clears e-way Bill, setting up of anti-profiteering body	▪ The Goods and Services Tax (GST) Council on August 05 gave an in-principle approval to the e-way bill to keep tabs on the movement of goods. It also approved setting up anti-profiteering committees in all states and the Centre in the next 15 days to ensure industries were passing on the benefit of input tax credit to customers. ▪ Once the e-way bill is implemented, likely by October 1, all goods and services worth Rs50,000 or more would need to be registered before these are moved 10 km for sale. ▪ The Council promised there would be very few check posts to ensure the smooth transport of goods. These rules would not be applicable for exempted goods. ▪ The Council also appealed to industries to pass on input tax credit to customers. The state and central anti-profiteering committees would register complaints. The Government is yet to set up the anti-profiteering authority (source: http://www.business-standard.com/article/economy-policy/gst-council-approves-e-way-bill-setting-up-of-anti-profiteering-body-117080600001_1.html).	Neutral

Head	Description	Positive/ Negative
Economy: Expect 25-50bps rate cut hereon in FY18	▪ The Monetary Policy Committee (MPC) decided to lower the repo rate by 25bps to 6% as part of its latest monetary policy review. ▪ The decision was not unanimous - four members voted in favour of a 25bps cut, one voted for a 50bps cut and one for no cuts. ▪ On forecasts, the RBI maintained its inflation and growth forecasts from the last policy review whilst highlighting its concerns about poor monetary policy transmission. We expect the RBI to administer 25-50bps of rate cut in the rest of FY18. ▪ Even as CPI inflation is expected to trend higher in 2HFY18, we expect the RBI to cut rates hereon because: (1) the Central Government's net spends have been heavily front-loaded and hence will slow down from hereon, requiring monetary policy to play a more growth-supportive role; and (2) meaningful pressure is being exerted by the Ministry of Finance on the RBI to cut rates	Neutral

Source: Media reports, Ambit Capital research

Exhibit 2: Ambit's qualitative indicators' tracker for the week commencing July 31, 2017 (continued)

Head	Description	Positive/ Negative
Manufacturing and services both contract in July: PMI	▪ Manufacturing activities contracted to an eight-and-a-half-year low in July following the goods and service tax (GST) roll-out, showed the widely-tracked Nikkei Purchasing Managers' Index (PMI). This led to cutting of jobs, albeit marginally. ▪ Manufacturing PMI stood at 47.9 points in July, down from 50.9 in June. A reading above 50 indicates expansion, while one below it shows contraction. Factory activities had earlier fallen in December 2016 after demonetisation (source: http://www.business-standard.com/article/economy-policy/manufacturing-pmi-at-over-8-year-low-117080101665_1.html). ▪ The introduction of GST has also pushed down activity in the services sector to a nearly four-year low. ▪ PMI for the dominating sector of the Indian economy plunged to 45.9, its lowest level since September 2013. At an eight-month high, PMI had been 53.1 in the previous month of June (source: http://www.business-standard.com/article/economy-policy/gst-pulls-down-july-services-pmi-to-45-9-lowest-level-since-sept-2013-117080300409_1.html).	Negative
June core sector growth falls to 0.4% from 4.1% in May	▪ Core sector output rose a paltry 0.4% in June, as compared to the 4.1% rise in May. ▪ There was contraction or marginal growth in six of the eight segments, with only growth in natural gas and steel pulling up the index. ▪ Data issued by the commerce and industry ministry on July 31 showed the eight core segments - coal, crude oil, natural gas, refinery products, fertiliser, steel, cement and electricity - cumulatively grew 2.4% in the first three months (April-June) of this financial year. This was less than half the 6.9% growth in the corresponding period of 2016-17 (source: http://www.business-standard.com/article/economy-policy/june-core-sector-growth-falls-to-0-4-from-4-1-in-may-117073100812_1.html).	Negative
April-June fiscal deficit hits 82% of FY target	▪ The Centre's fiscal deficit for the April-June quarter was Rs4.42tn, or 81.8% of the full-year target of Rs5.46tn. This compares with 61.1% for the year-ago period. ▪ The jump in fiscal deficit is primarily a result of massive front-loading of expenditure due to the advancement of the Budget from March 28 to February 1. ▪ Additionally, revenue deficit for April-June FY18 was Rs3.83tn, about 119% of the full year target of Rs3.22tn, and compared with 79.6% for the corresponding period last year. This shows that the Centre's revenue expenditure grew at a faster click than capital spending (source: http://www.business-standard.com/article/economy-policy/april-june-fiscal-deficit-hits-82-of-fy-target-117080100012_1.html).	Negative

Source: Media reports, Ambit Capital research

Utilities

Weekly tracker

In this weekly update, we have compiled the key news flows, regulatory developments and management/regulator interviews that occurred last week. The key positive news: Solar tariffs at Rs3/unit may be the new normal. The key negative news: Rooftop solar target of 40GW by FY22 is unachievable.

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Quick Insight

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Research Analysts

Bhargav Buddhadev
bhargav.buddhadev@ambit.co
Tel: +91 22 3043 3252

Deepesh Agarwal, CFA
deepesh.agarwal@ambit.co
Tel: +91 22 3043 3275

Exhibit 1: Key news flows for the week commencing 31 July 2017

Sub-Segment / Company	Title	Implications	Description	Source
Renewables	Solar tariffs at Rs3/unit may be the new normal	Positive	Clearing the concerns over the recent low solar tariffs of Rs2.44/unit, NTPC's CMD highlighted solar tariffs of Rs3-3.2/unit is the new normal. Solar tariff of Rs3-3.2/unit can be achieved without the support of "cheap funds or cheap panels", which have been a concern for the industry. NTPC's capacity expansion would be tilted towards renewables than coal. **Our view:** As per our IRR model at current capex of Rs42.5mn/MW, the cost of debt at 8.5% and PLF at 24%, the equity IRR of solar project is 12% assuming tariff of Rs3/unit. NTPC's foray in renewable would result in RoE dilution given unlike thermal projects, NTPC does not get regulated (15.5% RoE) PPA in renewables, it has to match the recent solar bids which imply at best RoE of 11-13%.	https://goo.gl/cKxudP
Tariff regulation	Power regulator to float approach paper on FY19-24 multi-year tariffs this month	Negative	Central Electricity Regulatory Commission (CERC) will this month float its 'approach paper' on multi-year tariffs for power stations and transmission lines, according to a senior official with the power sector regulator. The tariffs will be effective from April 2019 and the regulator will come out with the new tariff regime before the end of the next financial year, as is usually the case. The CERC tariffs deal with cost-plus projects that are usually given on nomination basis to NTPC, SJVN, NHPC, NLC India, etc. **Our view:** We expect NTPC's regulated RoE to be cut by 250bps to 13% for the control period 2019-24 due to: (a) 200bps fall in G-Sec yield (currently at 6.8% vs 8.8%); and (b) 50bps cut in spread over G-Sec yield as the Government wants to dis-incentivise fresh capacity additions due to the power surplus situation and to facilitate power tariff reduction.	https://goo.gl/22mmvc
Inox Wind	Indian Wind Tender 3X Oversubscribed, New Record Low Tariff Expected	Neutral	In the recent 1GW wind auction, Solar Energy Corporation of India (SECI) received bids of 2,898MW. There is an expectation, the tariffs in this round may be lower than Rs3.46/unit discovered in the first round in Feb'17 given participation at 2.9GW is higher than 2.6GW bids received in the first round. **Our view:** We are not excited about this opportunity for wind equipment players given falling tariffs and cut-throat competition. With IPPs preferring equipment-only supply over turnkey for wind auction projects, the number of serious WTG players has increased from 3 to 6-8. Channel checks suggest Mytra and Ostro (won 250MW each in February auctions) are still evaluating new WTG players for the order. Besides market-share pressure, margins could also remain under duress for Inox Wind given loss of high-margin turnkey business. Further, FY18 is likely to be a washout year for Inox (FY18E loss at Rs1.6bn vs profit of Rs3bn in FY17) as its FIT (feed-in-tariff) order book of ~700MW as on March'17 is virtually cancelled. Reiterate SELL with TP of Rs147 (11.4x FY19 P/E; 14% downside).	https://goo.gl/UgcXhf

Sub-Segment / Company	Title	Implications	Description	Source
PPA	Government plans major change in power purchase noms	Neutral	The Government is planning to change the norms for incremental PPA to link the fixed cost payment by discoms to PLF vs PAF currently. Under the norms, the discom will pay fixed cost only to the extent of the power it procures from the genco. The move is aimed at encouraging discoms to open PPA tenders. **Our view:** It is difficult to say whether the disoms would open PPAs even under the new norms given the power surplus situation. Whilst we don't know the minimum offtake which the discom has to assure, if it is low (i.e. 30-40%) then it is negative for IPPs as they will no longer enjoy the assurity of recovering fixed cost under a PPA. There would be little difference between PPA and merchant plants under the new norms. Given the higher risk profile of PPAs under new norms, the lenders will charge a higher interest rate to such projects. However, if minimum offtake is high at 60-70% then it is positive for IPPs as their exposure to merchant power and prices would reduce. Whilst the specifics of the proposed policy is not available, we believe the policy would be prospective for non-regulated PPAs.	https://goo.gl/hmZUPP
Renewables	Rooftop solar target of 40GW by 2022 'unrealistic': Parliament panel	Negative	A Parliamentary panel said the rooftop solar target of 40GW by FY22 is "unrealistic" and it needs to be "reconsidered". **Our view:** This was expected as the Government's 40GW solar rooftop target was heavily dependent on the rooftop installations at the Government buildings, the progress has been slow. This is because every roof is not suitable for solar installation and before the installation, a study needs to be done on the roof. The progress on the study of the Government buildings has been slow. Lastly, despite the favourable economics of solar rooftop, the private industrial and commercial consumers are not investing in it meaningfully, as they wait for the solar prices to bottom out.	https://goo.gl/ix1ZQP

Source: Media reports, Ambit Capital research

Institutional Equities Team

Saurabh Mukherjea, CFA	**CEO, Ambit Capital Private Limited**	**(022) 30433174**	**saurabh.mukherjea@ambit.co**
Pramod Gubbi, CFA	**Head of Equities**	**(022) 30433124**	**pramod.gubbi@ambit.co**

Research Analysts

Name	Industry Sectors	Desk-Phone	E-mail
Nitin Bhasin - Head of Research	E&C / Infra / Cement / Home Building	(022) 30433241	nitin.bhasin@ambit.co
Aadesh Mehta, CFA	Banking / Financial Services	(022) 30433239	aadesh.mehta@ambit.co
Abhishek Ranganathan, CFA	Retail / Consumer Discretionary	(022) 30433085	abhishek.r@ambit.co
Anuj Bansal	Consumer	(022) 30433122	anuj.bansal@ambit.co
Aditi Singh	Economy / Strategy	(022) 30433284	aditi.singh@ambit.co
Ashvin Shetty, CFA	Automobiles / Auto Ancillaries	(022) 30433285	ashvin.shetty@ambit.co
Bhargav Buddhadev	Power Utilities / Capital Goods	(022) 30433252	bhargav.buddhadev@ambit.co
Deepesh Agarwal, CFA	Power Utilities / Capital Goods	(022) 30433275	deepesh.agarwal@ambit.co
Dhiraj Mistry, CFA	Consumer	(022) 30433264	dhiraj.mistry@ambit.co
Gaurav Khandelwal, CFA	Automobiles / Auto Ancillaries	(022) 30433132	gaurav.khandelwal@ambit.co
Girisha Saraf	Home Building	(022) 30433211	girisha.saraf@ambit.co
Karan Khanna, CFA	Strategy	(022) 30433251	karan.khanna@ambit.co
Mayank Porwal	Retail / Consumer Discretionary	(022) 30433214	mayank.porwal@ambit.co
Pankaj Agarwal, CFA	Banking / Financial Services	(022) 30433206	pankaj.agarwal@ambit.co
Paresh Dave, CFA	Healthcare	(022) 30433212	paresh.dave@ambit.co
Parita Ashar, CFA	Cement / Metals / Aviation	(022) 30433223	parita.ashar@ambit.co
Prashant Mittal, CFA	Strategy / Derivatives	(022) 30433218	prashant.mittal@ambit.co
Rahil Shah	Banking / Financial Services	(022) 30433217	rahil.shah@ambit.co
Ravi Singh	Banking / Financial Services	(022) 30433181	ravi.singh@ambit.co
Ritesh Gupta, CFA	Oil & Gas / Chemicals / Agri Inputs	(022) 30433242	ritesh.gupta@ambit.co
Ritika Mankar Mukherjee, CFA	Economy / Strategy	(022) 30433175	ritika.mankar@ambit.co
Sagar Rastogi	Technology	(022) 30433291	sagar.rastogi@ambit.co
Sudheer Guntupalli	Technology	(022) 30433203	sudheer.guntupalli@ambit.co
Sumit Shekhar	Economy / Strategy	(022) 30433229	sumit.shekhar@ambit.co
Utsav Mehta, CFA	E&C / Infrastructure	(022) 30433209	utsav.mehta@ambit.co
Vivekanand Subbaraman, CFA	Media / Telecom	(022) 30433261	vivekanand.s@ambit.co

Sales

Name	Regions	Desk-Phone	E-mail
Sarojini Ramachandran - Head of Sales	UK	+44 (0) 20 7886 2740	sarojini.r@ambit.co
Dharmen Shah	India / Asia	(022) 30433289	dharmen.shah@ambit.co
Dipti Mehta	India	(022) 30433053	dipti.mehta@ambit.co
Krishnan V	India / Asia	(022) 30433295	krishnanv@ambit.co
Nityam Shah, CFA	Europe	(022) 30433259	nityam.shah@ambit.co
Punitraj Mehra, CFA	India / Asia	(022) 30433198	punitraj.mehra@ambit.co
Shaleen Silori	India	(022) 30433256	shaleen.silori@ambit.co
Singapore			
Praveena Pattabiraman	Singapore	+65 6536 0481	praveena.pattabiraman@ambit.co
Shashank Abhisheik	Singapore	+65 6536 1935	shashankabhisheik@ambitpte.com
USA / Canada			
Ravilochan Pola – CEO	Americas	+1(646) 793 6001	ravi.pola@ambitamerica.co
Hitakshi Mehra	Americas	+1(646) 793 6002	hitakshi.mehra@ambitamerica.co
Achint Bhagat, CFA	Americas	+1(646) 793 6752	achint.bhagat@ambitamerica.co
Production			
Sajid Merchant	Production	(022) 30433247	sajid.merchant@ambit.co
Sharoz G Hussain	Production	(022) 30433183	sharoz.hussain@ambit.co
Jestin George	Editor	(022) 30433272	jestin.george@ambit.co
Richard Mugutmal	Editor	(022) 30433273	richard.mugutmal@ambit.co
Nikhil Pillai	Database	(022) 30433265	nikhil.pillai@ambit.co

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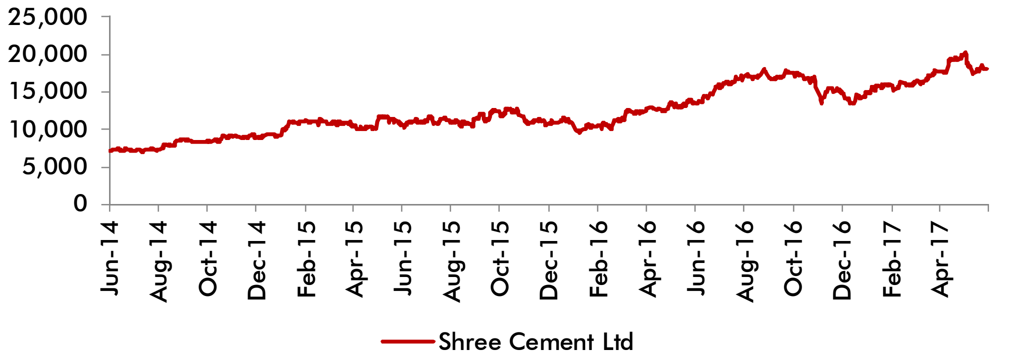

Source: Bloomberg, Ambit Capital research

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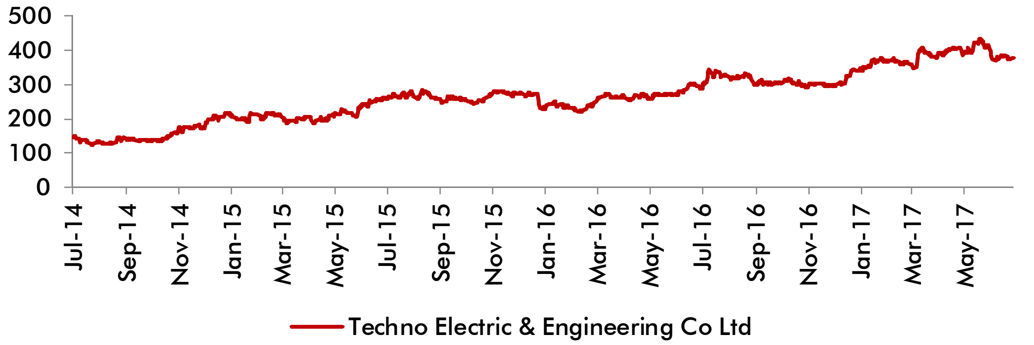

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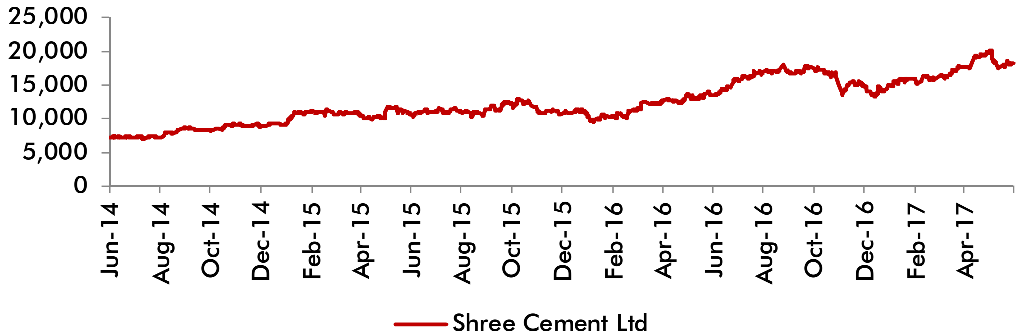

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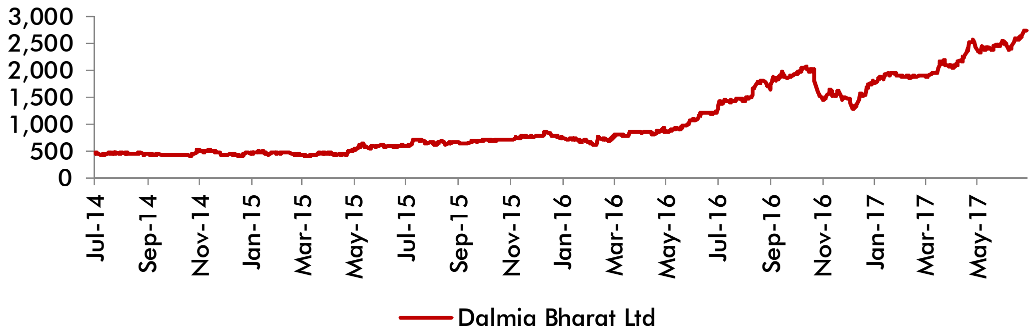

Source: Bloomberg, Ambit Capital research

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Ambit Capital Pvt. Ltd.
Ambit House, 3rd Floor. 449, Senapati Bapat Marg,
Lower Parel, Mumbai 400 013, India.
Phone: +91-22-3043 3000 | Fax: +91-22-3043 3100
CIN: U74140MH1997PTC107598
www.ambitcapital.com