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Initiating coverage

Diversified

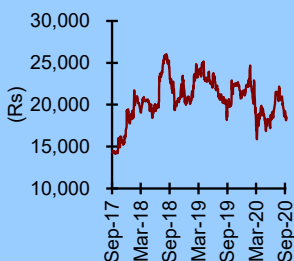
Target price Rs20,000

Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	75.0	75.0	75.0
Institutional investors	9.3	9.3	10.3
MFs and others	3.9	3.9	4.9
FIs/Bank/Ins	0.0	0.0	0.0
FIIIs	5.4	5.4	5.4
Others	15.7	15.7	14.7

Source: BSE

Price chart



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INDIA

3M India

ADD

Steady value generator, initiate with ADD

Rs18,307

3M India (75% subsidiary of 3M USA) follows same template of its parent to steadily launch R&D backed niche products at regular intervals. While 3M products do not cost much to the consumer, they serve critical purposes and add considerable value. Hence, there is high stickiness to 3M products, even in B2B segments. Steady growth (5-10%) in India's key segments (auto, telecom, healthcare, consumer, construction, mining and safety) will lead to sustainable growth for 3M products. 3M India generated RoE > cost of capital and PAT CAGR of 17% over CY08-FY20 due to moats like (1) strong brands (3M, Post-it, Scotch-Brite, Command); (2) strong distribution network and 3M car care centres and (3) access to technology pool of parent. Increase in domestic manufacturing will lead to structural margin expansion bridging the 600bps gap between 3M India and parent's EBITDA margins. We model 3M India to report PAT CAGR of 8.2% over FY20-FY23E. Initiate with ADD and a DCF-based TP of Rs20,000 (55x FY23E).

- **Strategy to focus on R&D-based niche products:** 3M India's strategy is to generate 30% revenues from products launched in the past five years. It continues to launch 4-5 niche products every year and adds new SKUs and brand extensions as well. While its products do not cost much to consumers, they do add strong value (e.g. stethoscopes add huge value to doctors). Steady growth (of 5-10%) in industries such as telecom, healthcare, safety, consumer, automobiles, road construction and mining will lead to sustainable demand for 3M's products in India.
- **Increase in domestic manufacturing; long-term margin driver:** 3M India imports 67% of the raw materials. While limited scale in India deters setting up of new manufacturing units, we do expect 3M India to invest in new manufacturing units over the next decade, which will lead to better margins. As the company's EBITDA margin is ~600bps lower than that of parent, we model the gap to be bridged in next decade.
- **Steady value generator:** 3M India generated an average RoE of >20% (> CoC) and PAT CAGR of 17% over CY08-FY20. 3M's key moats such as: (1) established brands like 3M, Post-it, Scotch-Brite, Command, Littmann and Nexcare; (2) strong distribution across major cities and 3M car care outlets; (3) established relationships with institutions and global players and (4) access to technology pool of parent.
- **Initiate with ADD:** We model 3M India to report revenue and PAT CAGRs of 4.8% and 8.2% respectively over FY20-FY23E. RoE is also expected to remain above the cost of capital over the same timeframe. We initiate coverage on the stock with an ADD rating and DCF-based target price of Rs20,000 (55x FY23E).

Market Cap	Rs206bn/US\$2.8bn	Year ending Mar	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	TMIN.BO/3M IN	Revenue (Rs mn)	29,866	25,683	30,259	34,395
Shares Outstanding (mn)	11.3	Adj Net Profit (Rs mn)	3,222	2,081	3,364	4,082
52-week Range (Rs)	24662/15887	Dil. Rec. EPS (Rs)	286.0	184.7	298.7	362.3
Free Float (%)	25.0	% Chg YoY	(6.1)	(35.4)	61.7	21.3
FII (%)	5.4	P/E (x)	64.0	99.1	61.3	50.5
Daily Volume (US\$'000)	1,548	CEPS (Rs)	338.7	231.2	349.5	418.0
Absolute Return 3m (%)	(2.6)	EV/EBITDA (x)	44.2	75.4	45.8	38.1
Absolute Return 12m (%)	(11.4)	Dividend Yield (%)	-	-	-	-
Sensex Return 3m (%)	9.6	RoCE (%)	24.2	11.2	17.5	18.2
Sensex Return 12m (%)	(0.4)	RoE (%)	20.3	11.4	16.0	16.5

Please refer to important disclosures at the end of this report

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Investment summary

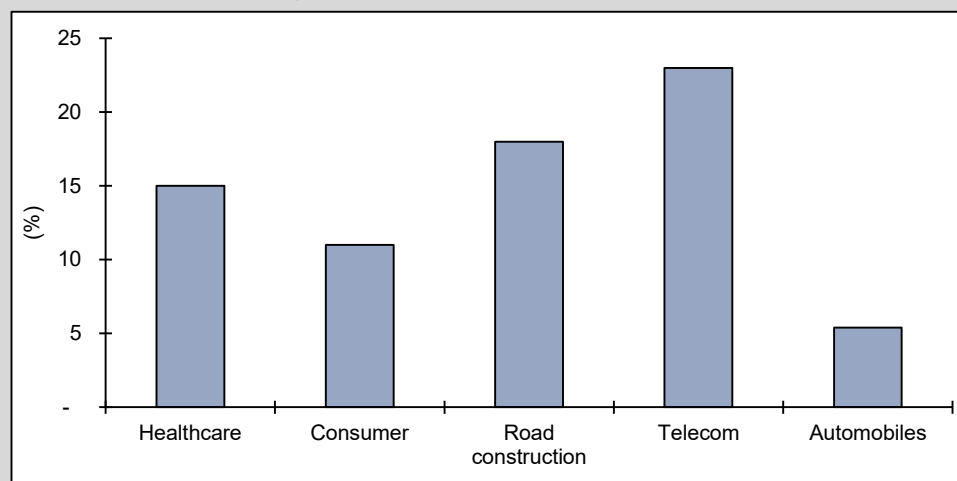
Business

3M India is 75% subsidiary of 3M USA and follows the footsteps of its parent regarding business strategy. It has introduced multiple R&D backed niche products in India. While these products do not cost a lot, they add huge value to the consumers. It caters to multiple segments such as consumer, automotive, technology, electronics, telecom, healthcare, mining and road construction. 3M operates in both B2B (70-75% of sales) and B2C (25-30% of sales) segments and sells its products under key brands such as *3M, Littmann, Post-it, Scotch-Brite, Nexcare* and *Avagard*.

Key client markets growing at CAGR of 5-10%

3M India reported revenue and PAT CAGR of 13.5% and 17%, respectively over CY08-FY20. It operates in multiple industries in India which are growing at 5-10% per annum. We believe steady growth in businesses of clients results in healthy growth prospects for 3M too. 3M India's revenues have direct correlation with nominal GDP growth with multiplier of 1x.

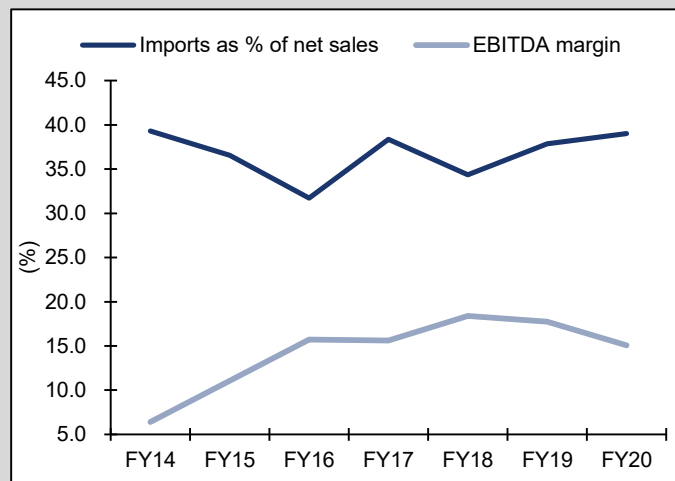
Chart 1: Growth in key client markets of 3M India over past decade



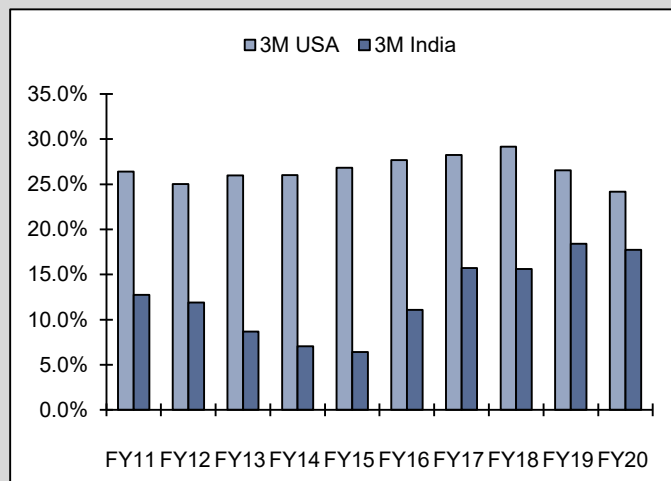
Source: Company, I-Sec research

Domestic manufacturing; long term growth driver

3M India imports 67% of the raw materials in India. It generates only trading margins for a large product portfolio. INR depreciation also impacts the company's EBITDA margins. We expect 3M India's domestic manufacturing to rise in India with increase in scale of operations. There is difference of 600bps in EBITDA margins of 3M USA and 3M India. While 3M USA incurs 6% of net sales on R&D, 3M India pays 6% royalty and corporate management fees to the parent. We believe with rising scale of operations and higher revenue share of Consumer and Healthcare segments, the gap in the margins of 3M India and its parent to get bridged in next decade.

Chart 2: Imports as % of net sales and EBITDA margins

Source: Company, I-Sec research

Chart 3: 3M India EBITDA margin lower than its parent – Scope to improve

Source: Company, I-Sec research

Strong moats developed by 3M India

3M India has developed moats such as brands like *3M*, *Post-it*, *Scotch-Brite*, *Nexcare*, *Avagard*, *Littmann*. It has also created distribution network for B2C products and launched 3M Car care outlets in India. It has strong connects with global players and also benefits from the technology pool of the parent.

Table 1: Moats developed by the company

Competitive advantage	Particulars
Brands	<i>3M</i> , <i>Post-it</i> , <i>Command</i> , <i>Scotch-Brite</i> , <i>Littmann</i>
Distribution network	Established pan India distribution, Also present in Modern trade & E-commerce, 3M car care outlets
R&D	Support provided by parent as well as own R&D team
Established connect with global players	Support of parent and global relations

Source: Company, I-Sec research

Valuation – reverse DCF ask remains high but achievable

While 3M India trades at P/E of 50.5x on FY23E, we note it has traded at average one-year-forward P/E of 65x over past decade. We have valued the stock on DCF basis at target price of Rs20,000 (55x FY23E). As per reverse DCF (Assuming Cost of equity of 10.2% and terminal growth of 5%), the company needs to achieve EBITDA CAGR of 18.3% over FY20-31E. The EBITDA CAGR over CY08-FY20 was 16%.

Table 2: Expected EBITDA CAGR of 18.3% vs. historical CAGR of 16%

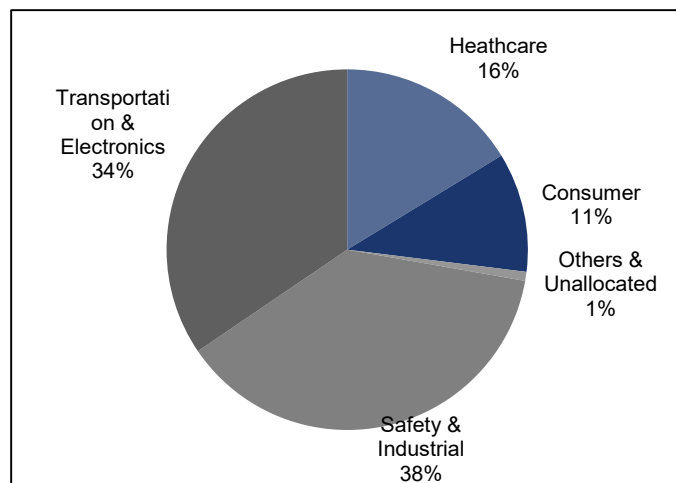
Particulars	Amt (Rs)
Cost of Equity (%)	10.2
Terminal growth rate (%)	5.0
Discounted interim cash flows (Rsmn)	55,368
Discounted terminal value (Rsmn)	1,69,934
Total equity value (Rsmn)	2,25,302
Value per share (Rs)	20,000
EBITDA growth to achieve over FY20-31E (%)	18.3
EBITDA CAGR over CY08-FY20 (%)	16.0

Source: Company, I-Sec research

Focus on niche segments and products

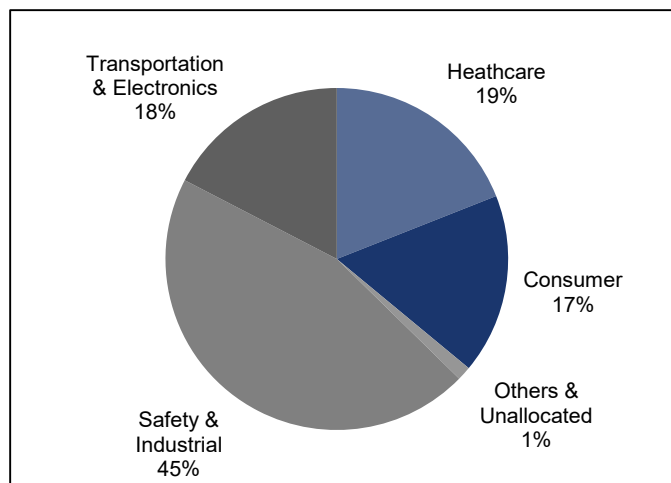
3M India is 75% subsidiary of 3M USA focussed on R&D-based differentiated products in India. It has developed strong brands such as *3M*, *Post-it*, *Littmann*, *Nexcare* in India. It has also developed a strong distribution network for consumer products and is a preferred supplier of products to multiple large institutions and hospitals.

Chart 4: Revenue breakup (FY20)



Source: Company, I-Sec research

Chart 5: EBIT breakup (FY20)



Source: Company, I-Sec research

Key products of the company in India

3M India's major business segments are: Safety & industrials, and Transportation & electronics. It also has strong presence in Consumer and Healthcare products. Company has introduced multiple B2B and B2C products in these segments.

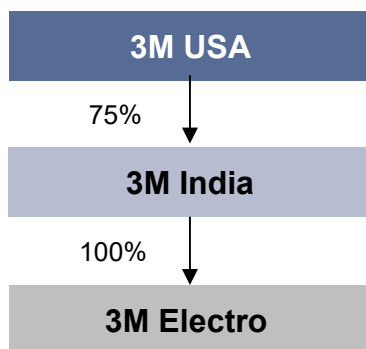
Table 3: Key products of 3M India

Segment	Key products
Healthcare	Medical and surgical supplies, oral care solutions, purification science products, food safety products, inhalation and drug delivery systems
Consumer	Home improvement, stationery and office supplies, home care, consumer health care, retail auto care product line, personal safety products
Safety & Industrial	Personal safety products, industrial adhesives, industrial tapes, abrasives, closure and masking tapes, automotive aftermarket products, roofing granules
Transportation & Electronics	Electronics display materials and systems, electronic material solutions, automotive and aerospace products, commercial solutions, transportation and safety products

Source: Company, I-Sec research

3M structure in India

As said in the foregoing, 3M India is the flagship company of 3M USA in India. It was initially co-promoted by Birla group and 3M USA (Birla group later exited the company). 3M India has 100% subsidiary called 3M Electro and Communications Pvt Ltd. 3M Electro was acquired by 3M India for a consideration of ~Rs6bn in FY19 valuing it at EV/sales of 3x. 3M USA and Murugappa have a JV called Wendt in India which is engaged in super abrasives.

Chart 6: 3M structure in India

Source: Company, I-Sec research

Key financials of 3M Electro

3M Electro is engaged in various electronic products in India with its manufacturing unit at Pune. Its key products are: (1) display films for mobiles, which help improve the image quality as well as reduce energy use; (2) engineering fluids to cool hardware and fit hardware products tightly; (3) fire protection fluids and products; and (4) tapes and adhesives for electronic products.

Table 4: Key financials of 3M Electro

Rsmn	FY18	FY19	FY20	CAGR (%)
Revenues	1,544	2,091	2,222	20.0
EBITDA	176	280	300	30.5
EBIT	159	261	280	32.9
PAT	128	202	233	35.1
Net worth	1,148	1,580	1,809	25.6
Debt	4	2	-	-100.0
Capital employed	1,151	1,582	1,809	25.4
EBITDA margin (%)	11.4	13.4	13.5	
EBIT margin (%)	10.3	12.5	12.6	
PAT margin (%)	8.3	9.6	10.5	
RoE (%)	11.1	12.8	12.9	
RoCE (%)	13.8	16.5	15.5	
Debt/Equity (x)	0.0	0.0	0.0	

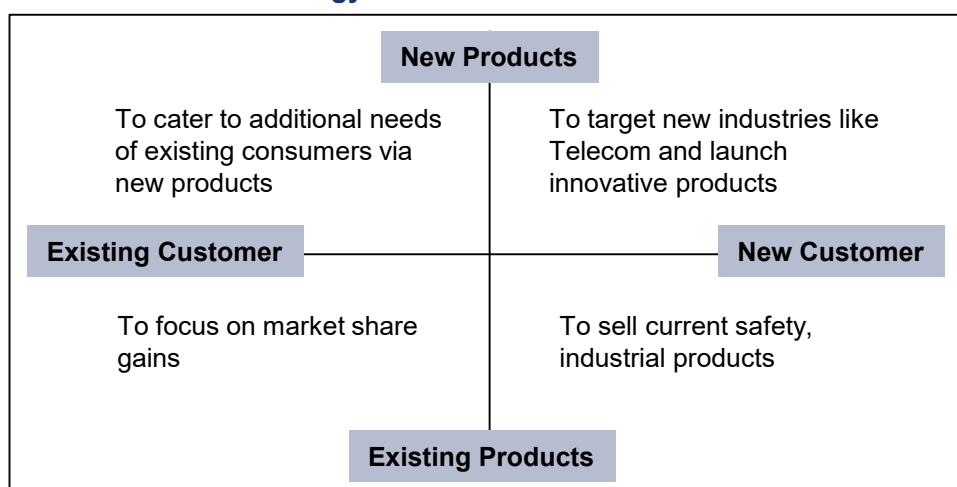
Source: Company, I-Sec research

Business strategy of 3M India

The company is working towards launching new products as well as gaining new customers/ segments; e.g. it has added multiple healthcare and telecom products in India to cater to the respective sectors, which are on a growth trajectory. 3M India also plans to provide additional products to existing consumers; e.g. anti-corrosion and cooling undercoat products for Railways. 3M also supplies its existing products to new customers; e.g. its personal safety and road/pavement markers, office stationery products are used by new industries too.

We expect 3M India to focus on gaining market share in segments where it is already operating.

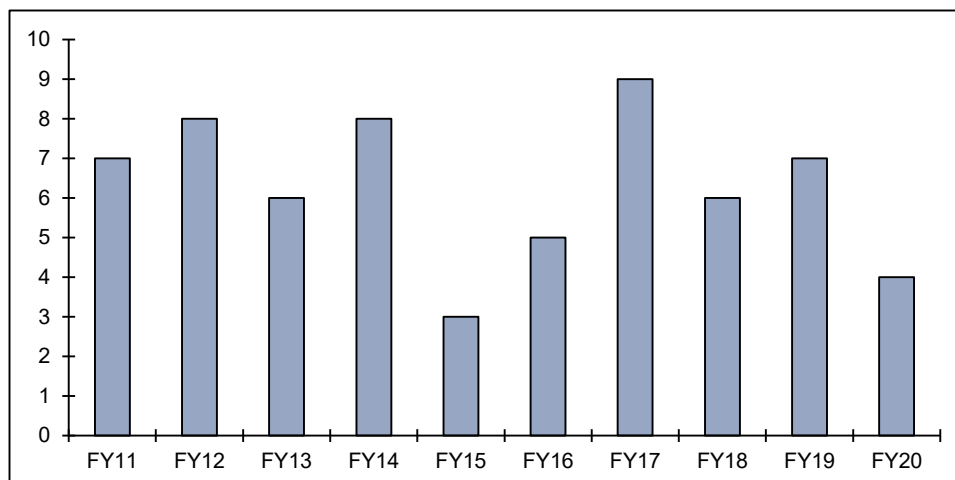
Chart 7: Business strategy of 3M India



Source: Company, I-Sec research

Differentiated products introduced by the company

3M has introduced multiple niche products such as: (1) stethoscopes, (2) dental care products, (3) pavement and median markers, (4) hand sanitizers, and (5) safety products like hand gloves, face masks, respirators, etc. It has also introduced consumables for industry as well as hospitals. We believe these niche products allow 3M India to enjoy higher market share as well as margins. We note the company has added at least 4-5 new products every year. It also launches new SKUs and brand extensions of these products after initial launch of the product to cater to the additional requirements of consumers.

Chart 8: 3M launches 4-5 new products every year

Source: Company, I-Sec research. Note: Major annual product launches

Negligible cost, but high value for customer

Most of 3M India's niche products do not cost much, but carry considerable value to the consumer. The cost of a facemask is negligible considering the benefit of facemask. A pavement marker may not cost a lot to a road company, but can help maintain road discipline and reduce accidents. Cost of stethoscope is negligible for a doctor considering it provides immense help as the primary (and important) tool to assess patients. We believe lower cost but high value to end-consumer allows 3M India to maintain high consumer loyalty and market shares.

Table 5: Negligible cost, but high value for the consumer

Product	Cost details	Value for consumers
Stethoscopes	Rs5,000-10,000	Useful for a period of 4-5 years
Sanitisers & hand gloves	<Rs200 per month	Extremely useful for doctors and nurses
Safety markers	Low cost for road companies	Useful in maintaining road discipline and reduce accidents
Command hooks	<Rs200	Useful life of more than 1-2 years
Anti-corrosion material	<Rs250/Ltr	Improves life of assets
Surgical hand scrub	<Rs500	Essential for doctors and nurses
AC, car cleaners, disinfectant	<Rs500	Essential for maintaining health of consumers
Abrasives	Low cost for auto companies	Important for precision

Source: Company, I-Sec research

Steady flow of new product launches

3M has introduced new products across segments over the past decade. It launches 4-5 new products every year. The details of new product launches are as follows:

Table 6: Steady flow of new product launches

Year	Segment	New product launch	Usage/Comment
FY11	Infrastructure	<i>Scotchkote Dual</i> layer epoxy coating	Corrosion protection coating
	Automotive	Foaming car interior cleaner	Car interior cleaner
	Healthcare	Wound contact dressing	Wound contact dressing
	Home care	<i>Scotch-Brite</i> cleaning solutions	Floor cleaning cloth
	Infrastructure	Raised pavement marker	Pavement marker
	Infrastructure	Median markers	Median markers
FY12	Infrastructure	Dust free sander	Sander which shapes walls with very low dust
	Automotive	Mechanical flush	To clean engines
	Automotive	Undercoat	Undercoat for wood products
	Construction	3M Synthetic Resin Adhesive	Adhesive for wood products
	Healthcare	Surgical skin preparation solution	Body lotion to be applied before any surgery to avoid infection
	Infrastructure	Vertical delineators	Reflectors for night visibility and safety to vehicles
	Infrastructure	<i>Scotchkote</i> coating	Coating, which ensures cooling of power towers
FY13	Retail	Tamper evident labels	Labels, which immediately show any tampering
	Retail	Handheld mops	Handheld floor cleaners
	Automotive	<i>Germkleen</i> anti-bacterial interior treatment	Makes the car bacteria-free
	Healthcare	3M hand sanitiser	Hand sanitiser
	Construction	Pavement markers	Pavement markers
	Construction	<i>Scotchkote</i> coating	Pipe coatings to arrest corrosion
FY14	Home care	<i>Scotch-Brite</i> cleaning solutions	Cleaning solutions
	Skin care	<i>Nexcare</i> skin care and First aid	Skin care and first aid products
	Infrastructure	Adhesive spray	Adhesive spray for wood products
	Infrastructure	<i>Scotchkote</i> coating	Coatings for power & fertiliser industry
	Healthcare	Range of specially developed dressings	Range of specially developed dressings for faster recovery
	Automotive	Multi-layer noise reduction treatment	Internal noise reduction solution for cars
	Home care	<i>Scotch-Brite</i> scrub pads	Scrub pads
FY15	Automotive	Glass repair, polish and finishing solution	Solution to help reduce customer rejection by 50%
	Healthcare	<i>3M Avagard</i> surgical hand scrub	Hand wash prior to surgery
	Infrastructure	Adhesives	Wood adhesives
	Home care	Tubular daylight guidance system	Tubular daylight guidance system
	Automotive	SWISH double wall decoupler	Noise reduction plastic coats
	Home care	<i>Scotch-Brite</i> mop	Mop to clean the floor
FY16	Home care	3M air conditioner cleaner	AC cleaner
	Home care	3M air conditioner disinfectant	AC disinfectant
	Infrastructure	Fusion-bonded epoxy coating	Coating which remains stable up to 130 degree Celsius
	Healthcare	<i>3M Avagard</i> foam hand rub	Foaming hand rub
	Home care	3M Extra Heavy Duty Scouring pads	Scrub to clean oily utensils
FY17	Automotive	Acrylic Foam tapes	Tapes to assemble faster adhesives faster
	Infrastructure	Weather resistant exterior wraps for railways	Exterior wraps for AC coaches
	Infrastructure	Solar raised pavement marker	Solar raised pavement marker
	Home care	<i>Scotch-Brite</i> twister mop	Mop to clean the floor
	Healthcare	CNG bath towels	Wet tissue papers for patients
	Infrastructure	<i>Scotchkote</i> coating	Anti-corrosive coating for pipes
	Automotive	3M dry wash for cars	Car wash liquid for dry washing
	Automotive	3M <i>Aqua</i> undercoat for cars	Undercoat for car (to reduce damage from water)
FY18	Automotive	3M diesel fuel system cleaner	Liquid solution to clean diesel fuel system
	Infrastructure	Participation in project business - Delhi Madame Tussauds	Wraps, adhesives, road markers
	Infrastructure	Messaging signs	Variable messaging signs
	Healthcare	Ear loop respirator	Masks to control pollution
	Infrastructure	<i>Scotchkote</i> Anti corrosive coating	Anti-corrosive coating for steel substrates
	Home care	<i>Scotch-Brite</i> scrub pads	Anti-bacterial scrub pad
FY19	Healthcare	Skin friendly compression tape	Latex-free bandage
	Infrastructure	Participation in project business - <i>Mission Iron Man</i> , Kumbh Mela	Wraps, adhesives, road markers
	Home care	<i>Command</i> hooks	Hooks for usage at home and office
	Home care	<i>Scotch-Brite</i> broom	Broom, bottle brush, scrub pads
	Automotive	3M AC evaporator cleaner	AC cleaner
	Automotive	3M car air refresher	Car refresher
	Infrastructure	Pavement markers	Pavement markers with Honeycomb weld
FY20	Automotive	Products for electric cars	Unit set up to develop products in tie-up with OEMs
	Automotive	<i>3M ScotchKote Solar</i> heat reflective coating	Coatings to reduce the impact of heat in trains
	Automotive	3M aircraft exterior & graphic films	Aircraft and graphic films
	Safety	3M endothermic mats	Mats to reduce threat of fire
	Safety	3M anti-pollution respirators	Face mask to reduce impact of pollution

Source: Company, I-Sec research

Strategy to generate 30% revenues from launches in past five years

3M India operates with the aim of generating 30% of its revenues from products launched in past five years. Steady launches allow the company to reduce sales of low-margin products. Steady launches also allow capturing new technologies and allow catering to new needs of consumers.

Chart 9: Strategy to generate 30% revenues from launches in past 5 years*

We typically look at new products we have always talked about new products launched in the last five years making up approximately 30% of our overall sales I mean it could be plus or minus couple of points based on the years but typically we are talking about in the range of 30% and then and we continue to be pretty much in that ballpark and we do not think that will change dramatically it may go up towards 3% or 4%. Now what is important is I think a lot of the new products are also what we continue to work on and what we continue to be excited about is some of the portfolios we developed here both locally as well as the global portfolios that are available for us to import and sell in India. We also focus a lot of our local R&D and product development efforts around some of our best opportunities in customer sets here whether it is automotive or automotive aftermarket, we have some infrastructure pipe coating businesses of course our consumer portfolio. So we do have some very active engagements here. We develop solutions locally of course we take the advantage and benefit of some of the core platforms that maybe in the IP that is available from 3Ms global portfolio.

Source: Company, I-Sec research *3M India conference call with investors dated 29th Aug 2019

Preferred supplier to large institutions

With high quality of products, 3M is a preferred supplier to large institutions. We note most of the large companies in automobile, oil & gas, healthcare, engineering, telecom, electronics, construction and consumer segments use 3M products. 3M supplies to most market-leading companies in these segments. It also benefits from 3M's global relationships.

Leadership / Strong market shares in niche segments

Due to launches of niche products, 3M is market leader or among top-3 players in the segments in which it operates. Key segments where 3M enjoys strong market position are stated in the table below:

Table 7: Market leadership in key segments

Product	Market position
Medicated toothpaste	Among top-3 players
Sanitizers	Among top-3 players
Respirators	Market leader
Premium road markers	Among top-5 players
Median markers	Market leader
Abrasives	No.3 player
Adhesives	Among top-5 players
Medicated tapes	Among top-5 players
Post-it	Among top-3 players
High-end anti-corrosion coatings	Among top-5 players
Car disinfectant	Among top-3 players
AC disinfectant	Among top-3 players
Pavement markers	Among top-3 players

Source: Company, I-Sec research

Ability to create brands in B2B segments

Creating brands in B2B segments is extremely challenging. Intel microprocessor (B2B product) has done it, so has Tetra Pak, a packaging product. Similarly, we note 3M India too has created brands within B2B segments.

Table 8: Successful companies that have created brands in B2B segments

Company/ Brands	Segment
Intel	Microprocessors
Tetra Pak	Packaging
3M	Multiple products
Pidilite	Waterproofing & adhesives

Source: Company, I-Sec research

Higher reliance on management as the company bets on 'new products'

3M India has always nurtured talent within the organisation. It believes it is necessary to imbibe the 3M culture among young recruits as the company focusses considerably on creating new products and R&D.

Compared to other companies, we believe the reliance on management ability is relatively higher as growth is linked to new products. Investors need to rely on management ability to find niche gaps and launch differentiated products (and variants / brand extensions) at affordable prices in India.

Table 9: Key managerial personnel

Person	Role
Bharat Shah	Chairman
Ramesh Ramadurai	Managing Director
Radhika Rajan	Non-Executive Independent Director
Biren Gabhawala	Non-Executive Independent Director
Jongho Lee	Non-Executive Director
Amit Laroya	Non-Executive Director
Jim Falteisek	Non-Executive Director
Mamta Gore	Chief Financial Officer & Whole time Director
V. Srinivasan	Company Secretary

Source: Company, I-Sec research

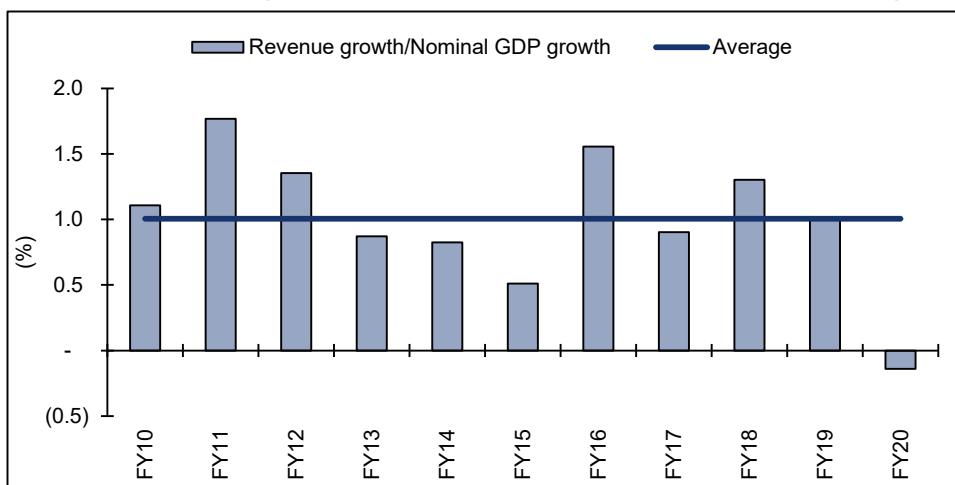
Linkage with GDP growth; new segments emerging

While the company’s business is largely linked to India’s GDP growth, we note it is steadily entering new product segments. Thus, while the existing business will grow with the economy, new launches will help to grow faster.

Revenue growth and nominal GDP growth

3M India’s revenues are directly correlated with India’s nominal GDP growth. As the company operates in multiple segments such as industrial, transportation, telecom, electronics, safety, and engineering, the growth rates are linked with overall GDP growth. Company has operated at a nominal GDP multiplier of 1x over FY10-FY20.

Chart 10: Revenue growth is at a multiplier of 1x the nominal GDP growth

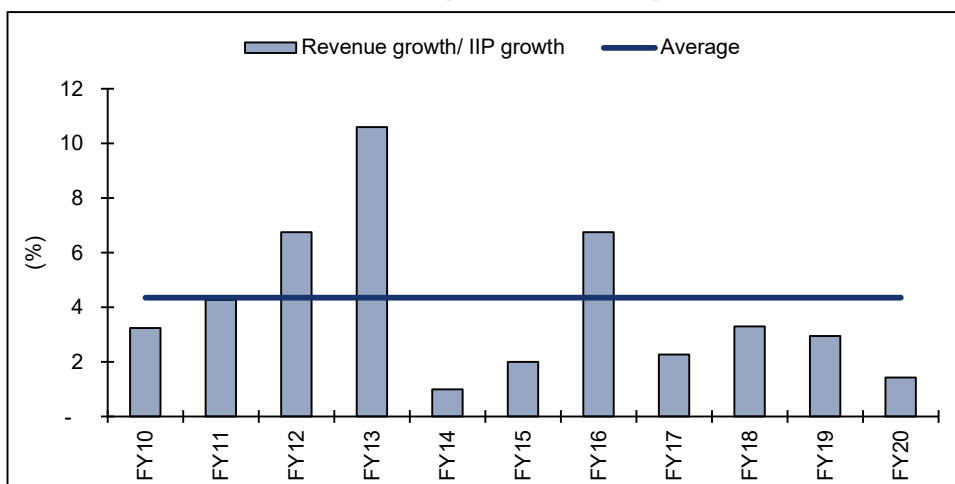


Source: Company, I-Sec research

Revenue growth at 4x multiplier of IIP growth

As some segments of 3M’s business are linked to industrial production, growth in these segments is linked to IIP. We note 3M India’s revenue growth was at a multiplier of 4x IIP growth over FY10-FY20.

Chart 11: Growth of industrial segments and IIP growth

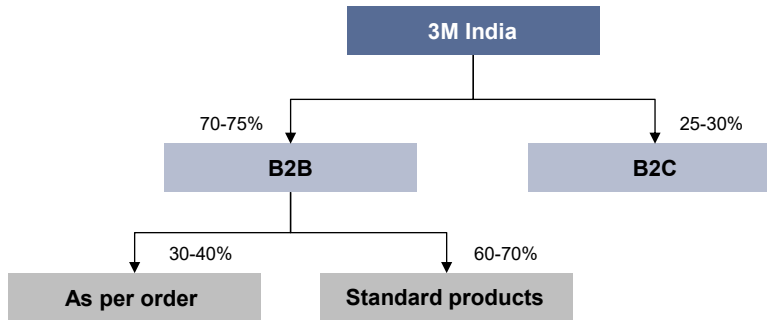


Source: Company, I-Sec research

Business model of 3M India in India

3M India’s business is largely related to industrial production. Consumer and healthcare segments accounted for 27% of total revenues in FY20. We believe the revenue from industrial business is 70-75% of total sales. However, of the total industrial business, the standard products account for 60-70% of sales. We divide the company’s business as follows:

Chart 12: Business model of 3M India in India

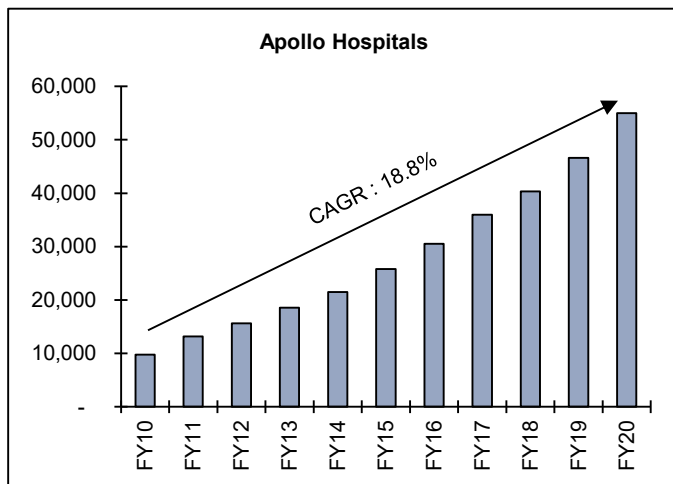


Source: Company, I-Sec research

Emerging segments that will drive growth

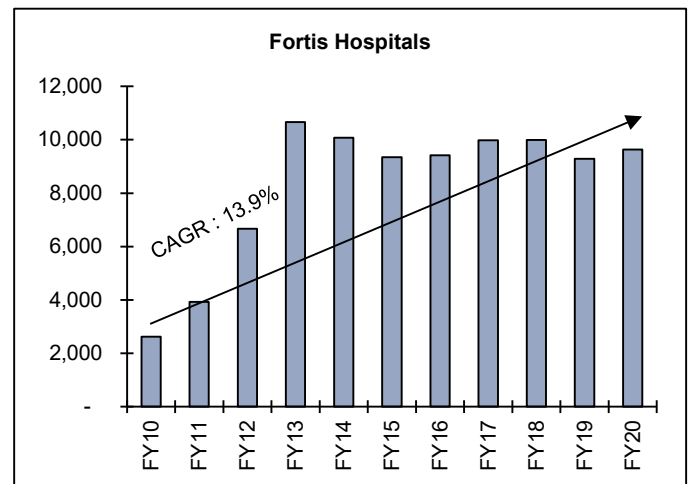
Healthcare: Demand for consumables in hospitals has grown at a CAGR of ~15% over FY10-FY20. With steady increase in demand, we expect 3M India to benefit from this trend.

Chart 13: Consumables bought by Apollo Hospitals



Source: Company, Industry, I-Sec research

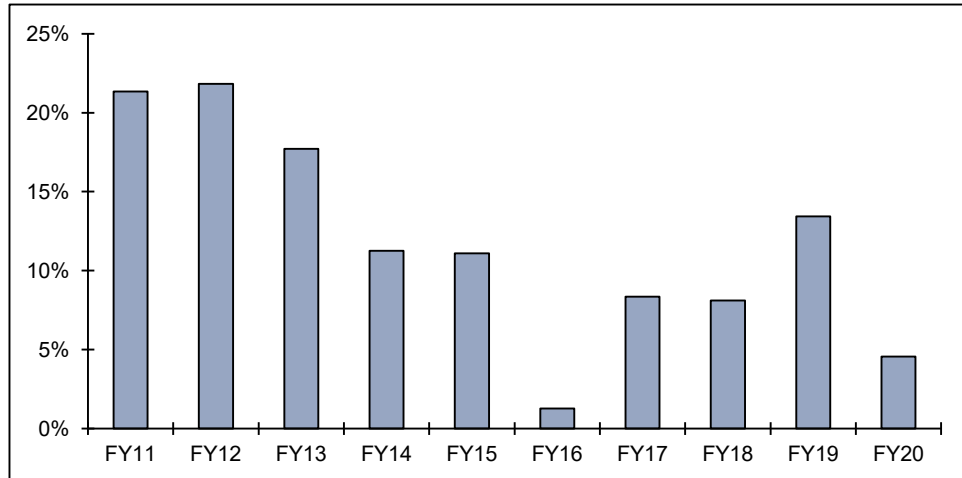
Chart 14: Consumables bought by Fortis Hospitals



Source: Company, Industry, I-Sec research

Consumer: Company’s key offerings in consumer segments are home care products and *Post-it*. We note the consumer sector grew at a CAGR of 11% over FY10-FY20 and expect steady growth to be beneficial to 3M India.

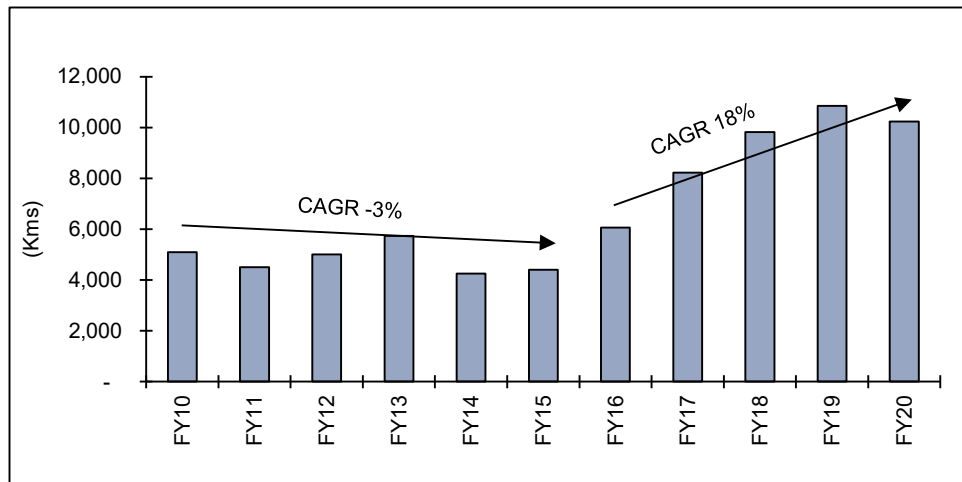
Chart 15: Consumer sector has grown at CAGR of 11% over FY10-FY20



Source: Company, Industry, I-Sec research

Road panels, sign boards and pavement markers: Construction of roads in India (in terms of built-kilometers) has grown at a CAGR of 18% over FY15-FY20. Steady growth in construction activity indicates additional requirement for 3M’s products.

Chart 16: Strong growth in construction of roads in India over FY16-FY20

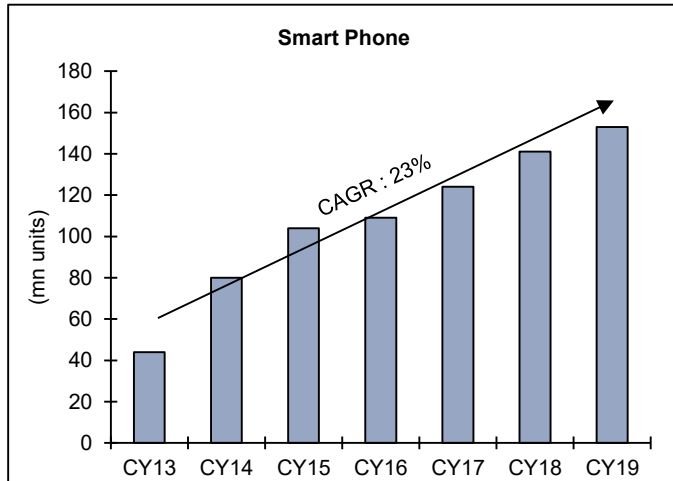


Source: Company, Industry, I-Sec research

Telecom: 3M supplies 2-3% of raw materials used in mobile handsets in value terms. Total mobile sales in India stood at 283mn units in CY19. There is also steady conversion from feature phones to smart phones. Most of these mobile phones are either imported or assembled in India. If the manufacturing of mobiles starts growing in India, 3M India can be a net beneficiary.

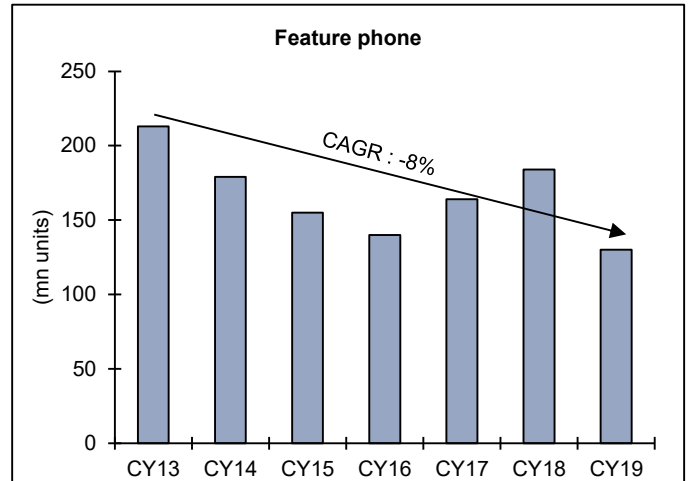
In addition, any increase in exports of mobile handsets from India will lead to additional demand for 3M India’s products.

Chart 17: Strong growth in smart phones



Source: Company, Industry, I-Sec research

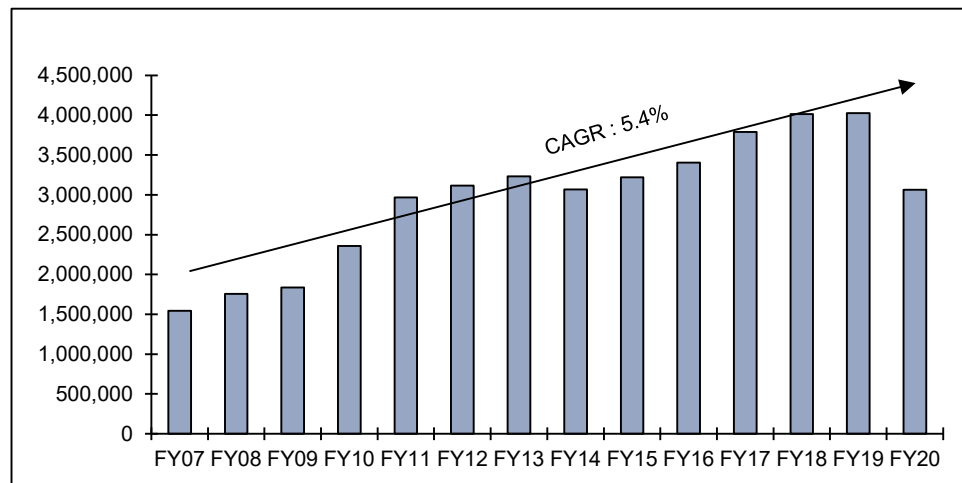
Chart 18: Decline in feature phones



Source: Company, Industry, I-Sec research

Automobiles: 3M supplies abrasives, some adhesive tapes as well as safety products to automotive companies. It also supplies some other consumables to them for use in offices, factories and distribution. As the production of passenger vehicles is growing at a CAGR 5%, we expect steady demand for 3M’s products for automotive sector.

Chart 19: Steady growth in passenger vehicle production



Source: Company, Industry, I-Sec research

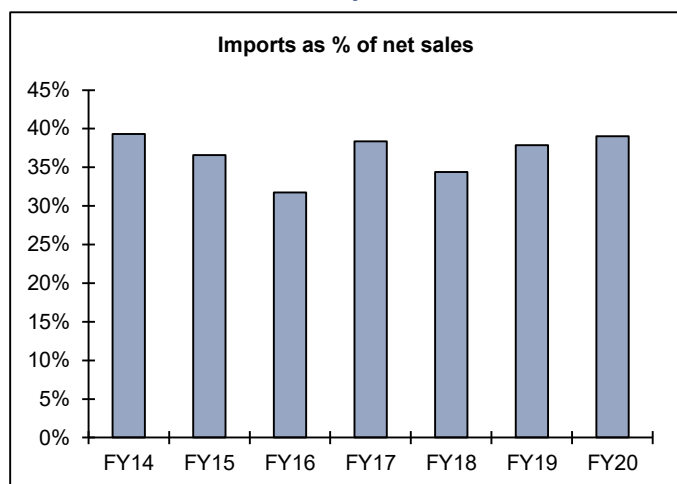
Domestic manufacturing: Long-term margin driver

3M India imports ~67% of the raw materials it uses in India. We believe, if the company starts manufacturing of the currently-imported products in India, it will lead to lower costs and will help tap more consumers. We model domestic manufacturing to expand margins over the medium to long term.

Imports as percentage of net sales and purchases

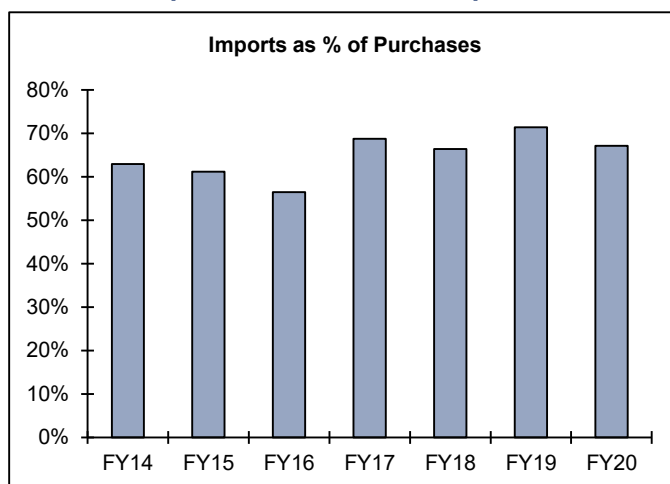
3M India imports ~67% of the goods, it sells in value terms from its global group companies. As it operates in multiple segments, it prefers to import some raw materials instead of manufacturing all. Besides, it is challenging to develop scale to manufacture some products in India. Imports as percentage of net sales and purchases were 39% and 67% respectively in FY20.

Chart 20: Raw material imports as % of net sales



Source: Company, I-Sec research

Chart 21: Imports as % of total RM purchases

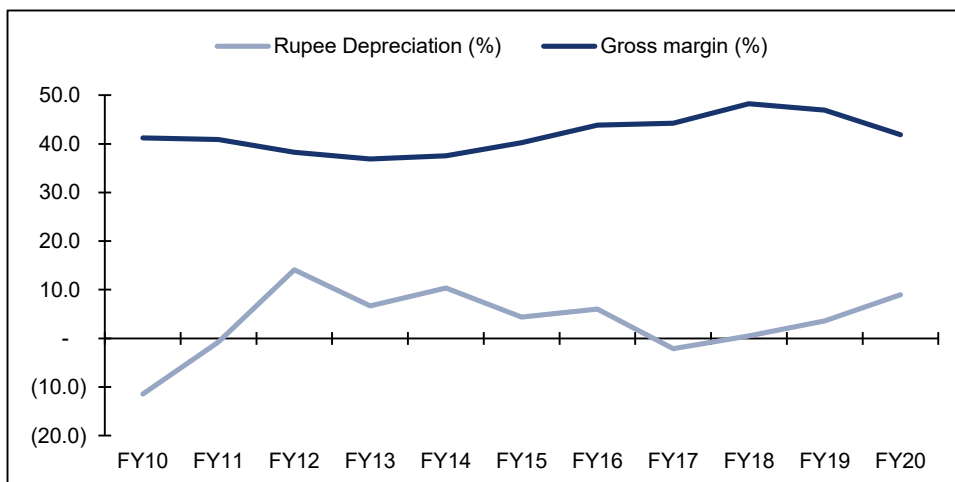


Source: Company, I-Sec research

INR depreciation hurts margins

Due to higher dependence on imports, 3M India's EBITDA margin is impacted whenever there is sharp INR depreciation. While the company has been able to pass on INR depreciation with a lag, we believe higher dependence on imports will continue to weigh on margins.

Chart 22: INR depreciation impacts 3M India’s gross margin



Source: Company, I-Sec research

Current manufacturing units in India

3M India has four manufacturing / assembly units in India: one each in Bengaluru, Ahmedabad, and two in Pune (Pimpri and Ranjangaon). Company is also planning to add capacity for hand sanitisers and masks and also plans to add new lines for automotive products at a capex of Rs650mn.

Chart 23: Current manufacturing units of 3M India

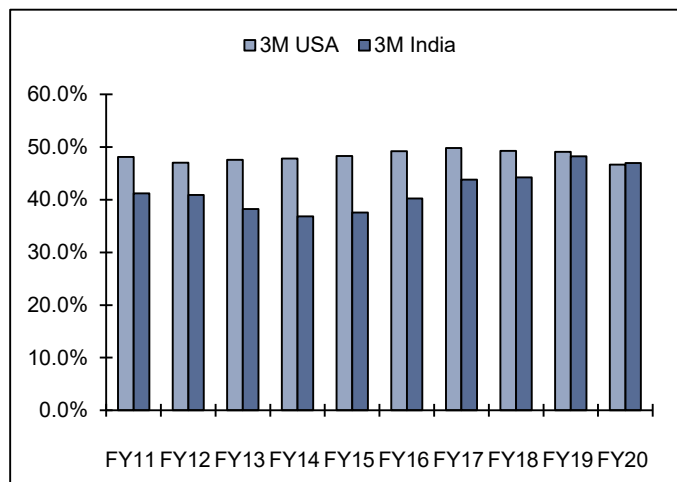


Source: Company, I-Sec research

Margins of 3M India lower than of parent

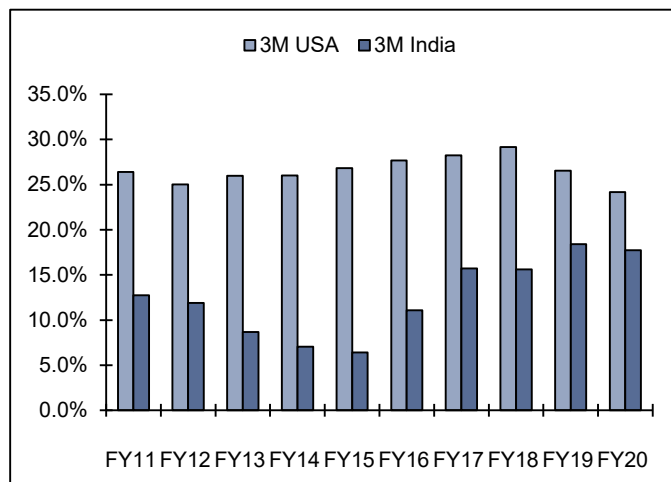
3M India generates an average EBITDA margin of 13% whereas that of 3M USA is ~27%. While 3M India’s pre-royalty EBIT margin is also ~19%, 3M USA’s pre-R&D expenses EBIT margin is 33%. We expect 3M India’s EBITDA margin to inch upwards with rising scale of operations and increase in domestic manufacturing.

Chart 24: Gross margin of 3M India and parent



Source: Company, I-Sec research

Chart 25: EBITDA margin of 3M India and parent

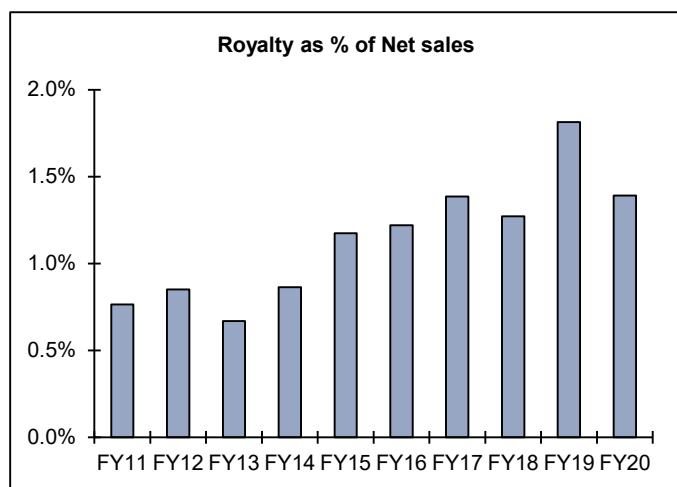


Source: Company, I-Sec research

Royalty and corporate management fee paid by 3M India to parent

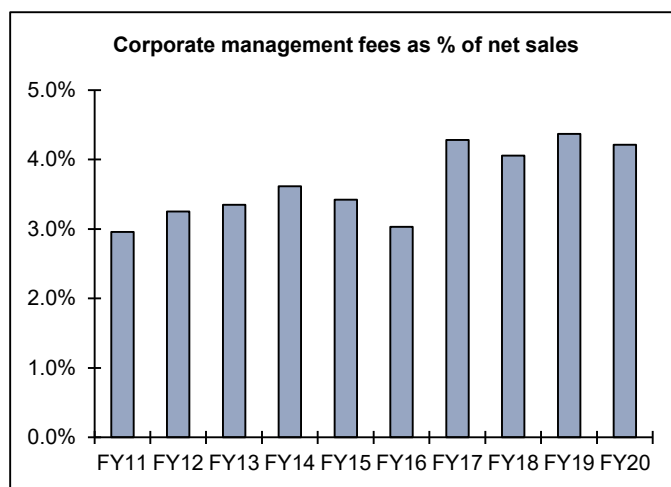
3M India pays royalty of ~1.5% of net sales and ~4.5% net sales as corporate management fees to its parent. It pays a total of ~6% of net sales to the parent. The royalty and corporate management fees as percentage of net sales has increased to 5.6% in FY20 from 3.7% in FY11. Any further increase in royalty and corporate management fees will impact margins.

Chart 26: Royalty as % of net sales



Source: Company, I-Sec research

Chart 27: Corporate management fees as % of net sales



Source: Company, I-Sec research

3M India's plans to import from related parties in FY21-FY23

3M India imports raw materials and pays royalty to its parent. As a regulatory process, it takes approvals from shareholders for these related-party transactions. Based on the notice given to shareholders, we note the company procured goods and services worth Rs11bn in FY20 from related parties and plans to procure the same worth Rs24bn in FY23 indicating a CAGR of 29.2% over FY20-FY23. This indicates higher purchases and scale of operations as well as increase in royalty and corporate management fees.

Table 10: 3M India's plans to import from related parties in FY21-FY23

Rsmn	FY20	FY21E	FY22E	FY23E	CAGR (%)
Purchase of raw materials	9,337	13,040	16,310	20,380	29.7%
Royalty	382	520	590	680	21.2%
Recharge of expenses	44	60	70	70	17.2%
Corporate management fees	1,179	1,570	1,960	2,460	27.8%
Total	10,942	15,190	18,930	23,590	29.2%

Source: Company, I-Sec research

Major related-party transactions

3M India procures most of its required raw materials from group companies. Other major related-party transactions are royalty and corporate management fees.

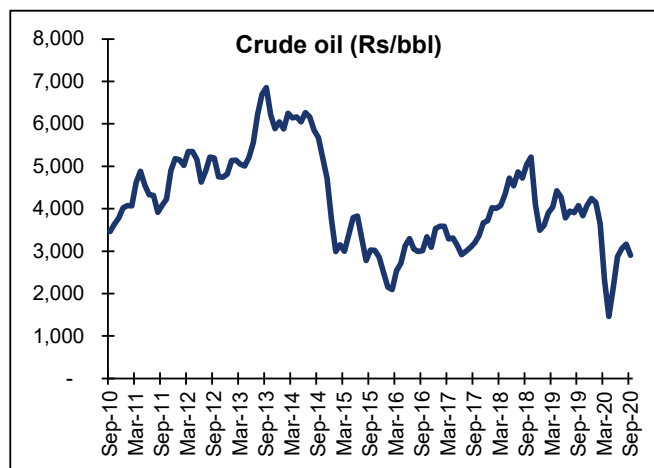
Table 11: Major related party-transactions (expenses)

Rsmn	FY18	FY19	FY20
Purchase of raw materials	7,465	8,860	9,337
Royalty	302	510	382
Re-charge of expenses	44	95	44
Corporate management fees	1,034	1,271	1,179
Total	8,845	10,736	10,942

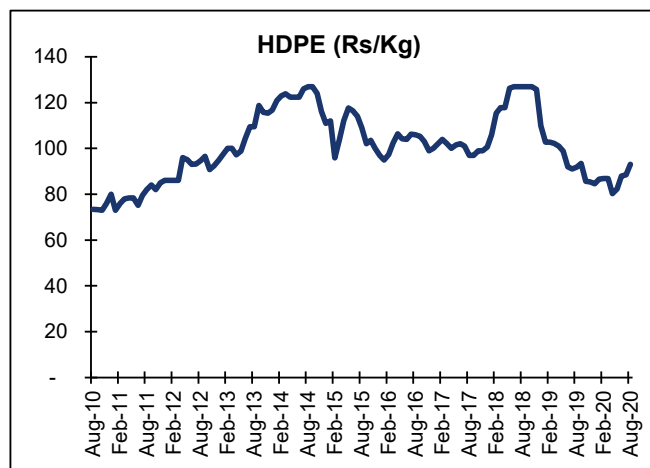
Source: Company, I-Sec research

Negligible inflation in raw material prices

For most products of 3M India, the key raw material is crude oil and its derivatives. For adhesives, anti-corrosion coatings, plastic-based products, the key raw material is crude oil. The other major raw material is HDPE (packaging material). Considering negligible inflation in input prices and strong pricing power, the company is likely to maintain its gross margins in FY21-FY23 at FY20 level.

Chart 28: Crude oil prices

Source: Company, Bloomberg, I-Sec research

Chart 29: HDPE (packaging material) prices

Source: Company, RIL, I-Sec research

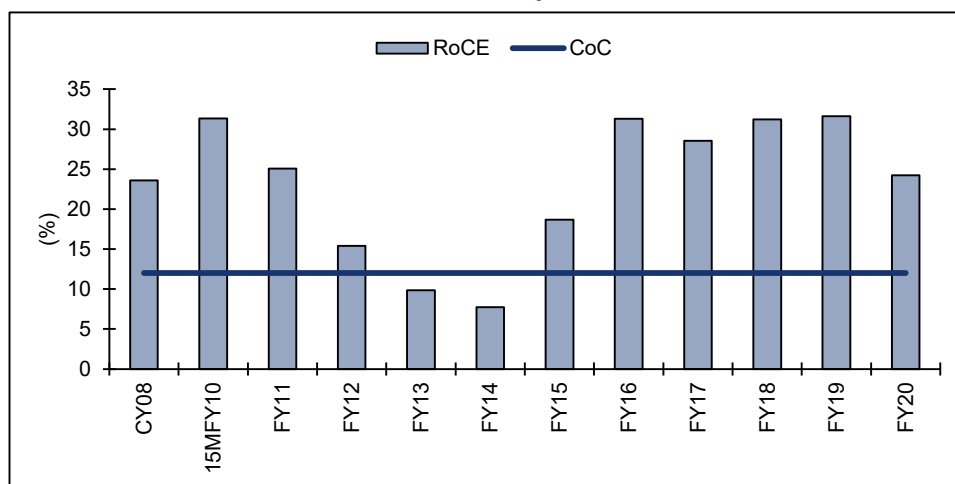
3M India: Steady value generator

The RoCE of any company depends on two factors: EBIT margin and asset turnover. We reckon, achieving minimum 15% RoCE (> cost of capital) is crucial for any company for value creation. We note 3M India scores well on this parameter. Its average EBIT margin over CY08-FY20 is 10.8% and average asset turnover at 2x resulting in RoCE of >20%.

RoCE > Cost of capital

3M India has generated RoCE in excess of cost of capital in almost all the years over the past 12 years. Business model of high-quality R&D-based products, established brands, connects with global players and established distribution has helped the company create strong value. It has generated cumulative FCF of Rs6.5bn over CY08-FY20.

Chart 30: RoCE of 3M India > Cost of capital



Source: Company, I-Sec research

Table 12: Value creation by 3M India

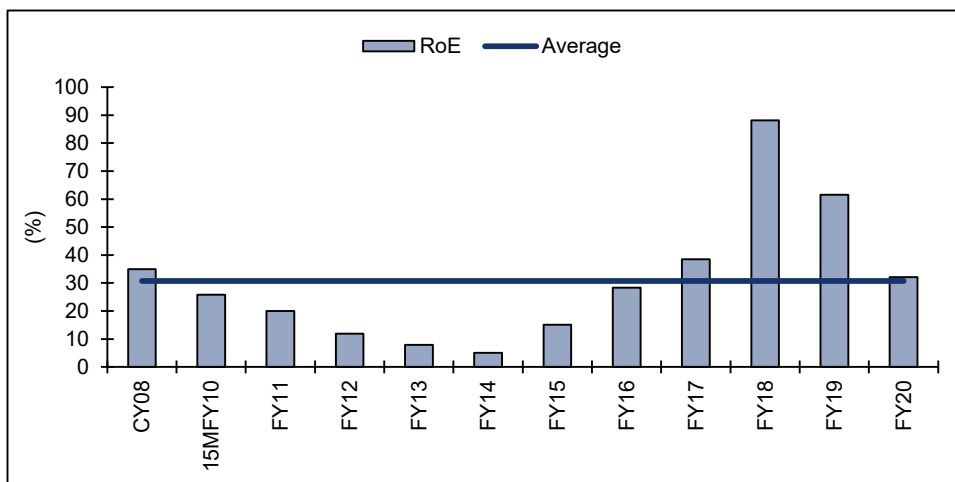
Particulars	15M												Total
	CY08	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19*	FY20	
RoE (%) [A]	16.8	24.0	20.5	11.4	8.4	6.4	14.6	21.8	21.7	29.4	29.9	20.3	
Cost of Equity (%) [B]	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	
Networth (%) [C]	3,426	4,323	5,330	5,998	6,474	6,865	7,981	9,797	12,186	10,478	14,021	17,285	
EVA generated (Rs mn) [(A-B)xC]	225	595	547	74	(118)	(258)	351	1,141	1,399	2,012	2,760	1,749	10,478
FCF (Rs mn)	(435)	531	(670)	(533)	(867)	590	1,696	2,601	3,747	593	(3,009)	2,231	6,476

Source: Company, I-Sec research Note: Acquired 3M Electro in FY19 which impacted FCF

RoE adjusting for excess cash and other income

3M India's average RoE adjusting for cash as well as (tax adjusted) other income is in excess of 30% over CY08-FY20 indicating the company's business is generating strong value.

Chart 31: RoE > 30% (adjusting for excess cash and other income)

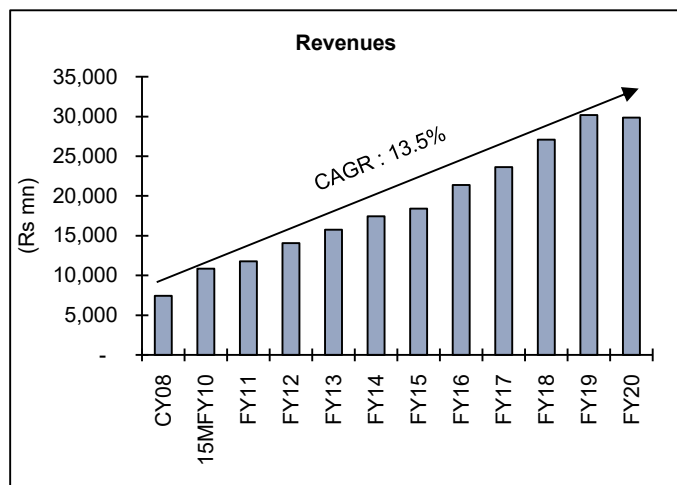


Source: Company, I-Sec research

Steady growth in earnings and revenues

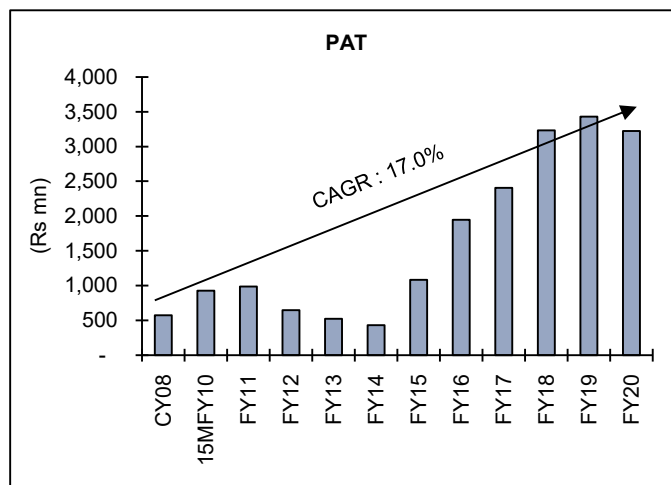
3M India has reported revenue and PAT CAGRs of 13.5% and 17% respectively over CY08-FY20. EBITDA margin has improved from 11.9% in CY08 to 15.1% in FY20. Net working capital days have reduced from 72 in CY08 to 63 in FY20.

Chart 32: Revenue CAGR of 13.5% and...



Source: Company, I-Sec research

Chart 33: ... PAT CAGR of 17.5% over CY08-FY20



Source: Company, I-Sec research

Strong moat creation

Company has created multiple moats including strong brands like 3M, Post-it, Littmann, Scotch-Brite and Command. We also note it has strong established global relations with MNCs, which help generate business in India too. For consumer products, it has developed distribution network pan-India and has also started setting up 3M car care centres which also creates awareness of 3M products.

Table 13: Moats developed by the company

Competitive advantage	Particulars
Brands	3M, Post-it, Command, Scotch-Brite, Littmann, Nexcare
Distribution network	Established pan-India distribution, Also present in modern trade and e-commerce
R&D	Support provided by parent as well as own R&D team
Established connect with global players	Support of parent and global relations

Source: Company, I-Sec research

Key brands of 3M India

3M India has steadily introduced multiple brands in India. Following are its key brands and launch years.

Table 14: Key brands of 3M India

Brand	Launch year
3M	1988
Littmann	1988
Post-it	1990
Scotch-Brite	1990
Scotchkote	2011
Nexcare	2013
Avagard	2014
CHG	2017
Command	2019

Source: Company, I-Sec research

Chart 34: Major brands of 3M India



Avagard



Littmann



Command



Nexcare



Source: Company, I-Sec research

Business model of 3M car care centre

3M has initiated the business of car care centres in India, which offer its products as well as services for cleaning and disinfecting vehicles. It does not offer repairs and maintenance. Combining services with products has helped 3M India to: (1) create a strong business model of car care centres, (2) create awareness among consumers regarding its products, and (3) reach smaller cities and towns.

Chart 35: 3M car care centres



Source: Company, I-Sec research

Business model of 3M car care centres

Roughly, a 3M car care centre requires investment of Rs4.2mn while it generates sales of ~Rs9mn – working out to RoI of ~26%. These car care centres operate on 'franchise owned and franchise operated' (FOFO) model.

Table 15: Investments required for 1,000sq-ft car care centre

Place required (sq. feet)	1,000
Investment in one store	Rs
- Deposit with landlord	12,00,000
- Deposit with 3M	5,00,000
- Machinery	8,00,000
- Furniture & computers	5,00,000
- Inventory	12,00,000
Total	42,00,000

Source: Company, I-Sec research

Table 16: Indicative income statement for a car care centre

Particulars	Rs	Comments
Sales	90,00,000	150 cars & servicing bill per car Rs5,000 per month
Employees	24,00,000	10-12 employees, 1 watchman, 1 accountant
Rent	24,00,000	@Rs200,000 per month
Consumables	22,50,000	Roughly Rs25% of car billing
Electricity	6,00,000	Rs50,000 per month
Other expenses	1,20,000	Phone, internet, etc.
EBITDA	12,30,000	
Depreciation	1,30,000	@10% on machinery & furniture
EBIT	11,00,000	
RoCE (%)	26.2%	

Source: Company, I-Sec research

About 3M India's parent company 3M USA

3M USA is a >100 year old company focussed on innovative products with operations in multiple countries. Its business strategy is to focus on differentiated products. It invests ~6% of net sales in R&D. It is a leading manufacturer of the relevant products for many markets it serves. 3M USA has expertise in product development, manufacturing and marketing.

Table 17: Key financials of 3M USA

US\$ mn	CY14	CY15	CY16	CY17	CY18	CY19	CAGR (%)
Revenues	31,821	30,274	30,109	31,657	32,765	32,136	0.2
EBITDA	8,543	8,381	8,501	9,236	8,695	7,767	-1.9
EBIT	7,135	6,946	7,027	7,692	7,207	6,174	-2.9
PAT	4,956	4,833	5,050	4,858	5,349	4,570	-1.6
Net worth	13,142	11,468	10,343	11,622	9,848	10,126	-5.1
Debt	6,811	10,797	11,650	13,949	14,622	20,313	24.4
Capital employed	19,953	22,265	21,993	25,571	24,470	30,439	8.8
EBITDA margin (%)	26.8	27.7	28.2	29.2	26.5	24.2	
EBIT margin (%)	22.4	22.9	23.3	24.3	22.0	19.2	
PAT margin (%)	15.6	16.0	16.8	15.3	16.3	14.2	
RoE (%)	37.7	42.1	48.8	41.8	54.3	45.1	
RoCE (%)	35.8	31.2	32.0	30.1	29.5	20.3	
Debt/Equity (x)	0.5	0.9	1.1	1.2	1.5	2.0	

Source: Company, I-Sec research

Table 18: 3M USA's growth vision for CY19-CY23

Particulars	Plan
Revenues growth	3-5% organic local currency sales growth
Earnings growth	8-11% growth in earnings per share
RoC	20% return on invested capital
FCF Conversion	100% free cash flow conversion

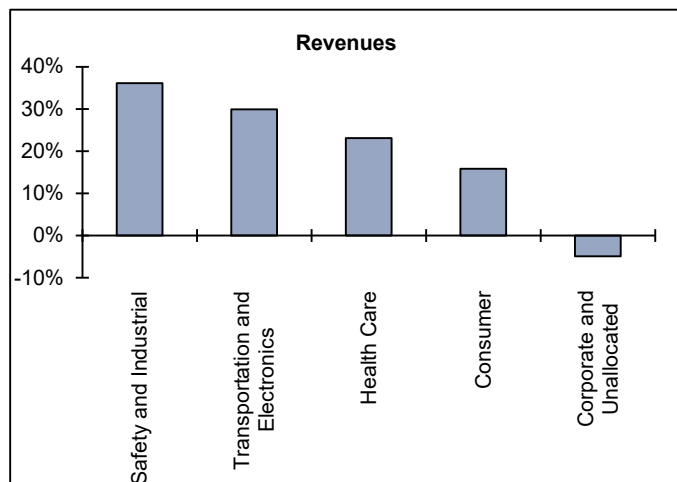
Source: Company, I-Sec research

Segment-wise breakup

3M USA operates the business through four segments, viz. (1) Safety and industrial, (2) Transportation & electronics, (3) Healthcare, and (4) Consumer.

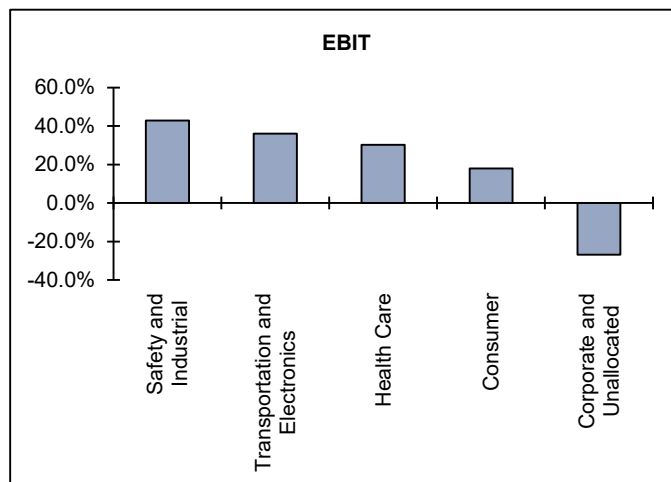
We note the revenue contribution of Healthcare and Consumer segments to global revenues is slightly higher than revenue contribution of the same segments in India. However, we expect, with rising income levels, the awareness about personal safety will improve in India and lead to higher demand for 3M's Consumer and Healthcare products.

Chart 36: Segment-wise revenues of 3M USA



Source: Company, I-Sec research *CY19

Chart 37: Segment-wise EBIT breakup of 3M USA

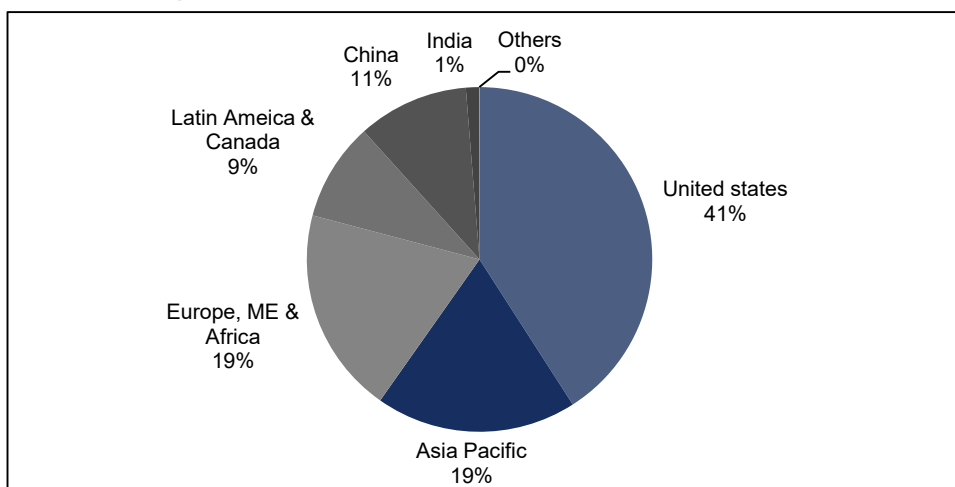


Source: Company, I-Sec research *CY19

Geographical revenue breakup

The US is the largest geography for 3M USA accounting for 40.9% of sales in CY19. Asia-Pacific is the second largest with revenue share of 30.5% in CY19. China accounts for 10% of global revenues and is probably the second-largest country (in revenue terms) for 3M. Europe, Middle East and Africa regions account for 19.4% whereas Latin America and Canada for 9.2% of global revenues. India contributes 1% to the group’s global revenues.

Chart 38: Region-wise sales of 3M USA (CY19)

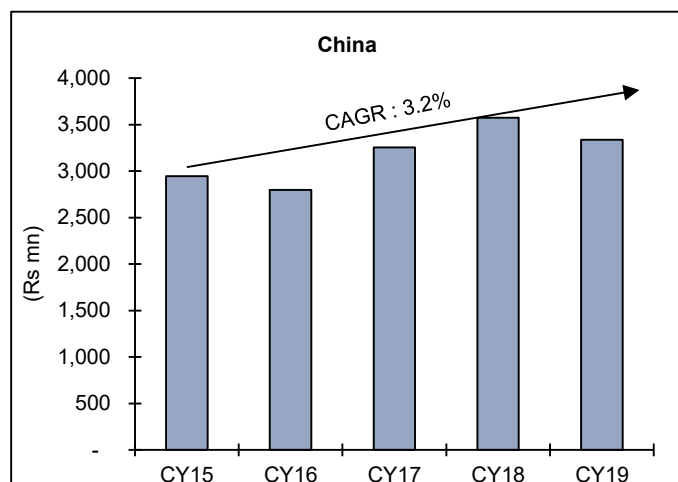


Source: Company, I-Sec research

3M China: One of the largest markets for 3M USA (ex-US)

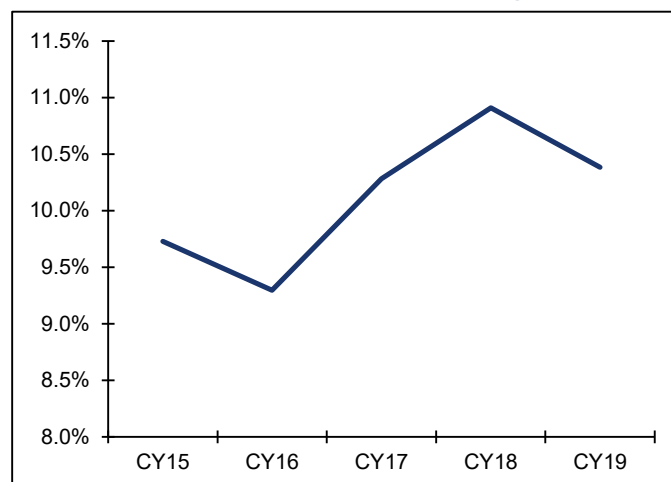
China is probably the second-largest market for 3M globally. We believe aggressive investment in manufacturing in China has generated demand for 3M products. Strong growth in China’s economy has also resulted in higher demand for 3M products in that country, which now accounts for ~10% global revenues of 3M USA.

Chart 39: Growth of 3M China's revenues



Source: Company, I-Sec research

Chart 40: 3M China revenues as % of global sales



Source: Company, I-Sec research

Product-wise revenue breakup of 3M USA

Table 19: Product-wise revenue breakup of 3M USA

Segment	3M USA (%)	Is 3M India present?*
A] Safety & Industrial business group	35.7	
Abrasives	4.3	Yes
Adhesives & tapes	8.7	Yes
Automotive aftermarket	3.9	Yes
Closure & masking systems	3.5	Yes
Communication market	-	No
Electrical materials	3.7	Yes
Roofing granules	1.3	No
Personal safety	10.2	Yes
Other safety & industrial	0.1	Yes
B] Transportation & Electronics business group	31.3	
Advanced materials	4.0	No
Automotive & aerospace solutions	6.1	Yes
Commercial solutions	5.5	No
Electronics	12.5	Yes
Transportation safety	3.3	Yes
Other transportation & electronics	-	No
C] Healthcare business group	21.5	
Drug delivery	1.2	No
Food safety	1.1	No
Health information systems	3.7	No
Medical consumables	9.2	Yes
Oral care	3.9	Yes
Separation & purification	2.4	No
Other healthcare	-	Yes
D] Consumer business group	16.6	
Consumer healthcare	1.2	Yes
Home care	3.0	Yes
Home improvement	7.7	Yes
Stationery & office	4.5	Yes
Other consumer	0.2	Yes
Corporate & Unallocated/Elimination	(5.1)	
Total	100.0	

Source: Company, I-Sec research *As per our understanding

Peer group comparison

While there are no direct competitors to 3M India, there are companies that compete with some of its products. 3M India generates major revenues from two product lines: adhesives, and abrasives. Competitive intensity in these product lines is delineated below:

Key products and major competitors

3M India competes with multiple companies. We note its key competitors in major products are as follows.

Table 20: Key products and major competitors

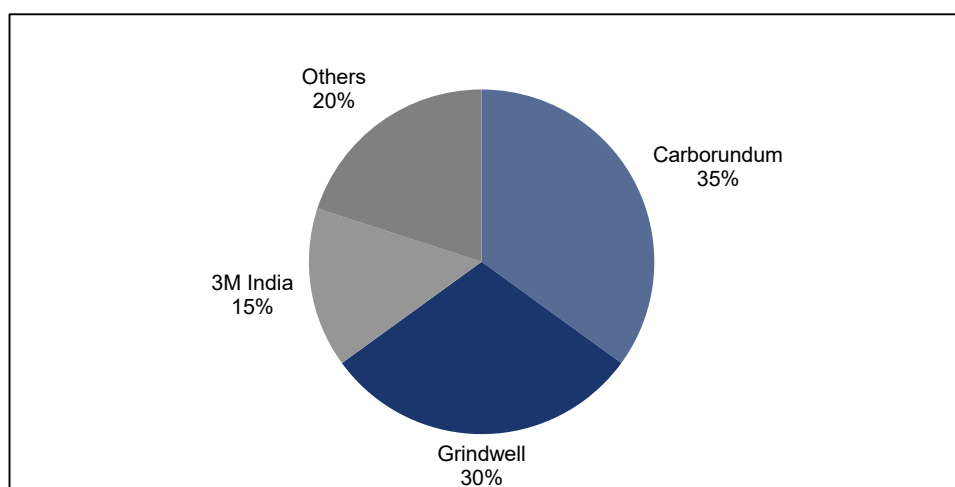
Product	Key competitors
Medicated toothpaste	Colgate, HUL, Glaxo
Abrasives	Carborundum Universal, Grindwell Norton
Adhesives	Pidilite, Astral Poly, Asian Paints
Medicated tapes	J&J
Face masks	Page Industries, Dabur, various smaller players
Hand sanitisers	HUL (Lifebuoy), Reckitt (Dettol)
Post-it	Navneet, various smaller players
Scotch-Brite Home care products	HUL, Gala, various smaller players
Anti-corrosion coats	Asian Paints, Akzo Nobel

Source: Company data, Industry, I-Sec research

Abrasives

Abrasives market is dominated by two players: Carborundum Universal (Murugappa group) and Grindwell Norton (MNC). These two companies have a joint market share of 65-70% in abrasives. 3M India is the third-largest player in abrasives with a market share of ~15%. Apart from these companies, we note Wendt (Joint venture of 3M USA and Murugappa group) operates in the super-abrasive space.

Chart 41: Market shares in abrasive market



Source: Company data, I-Sec research

Table 21: Key financials of Carborundum Universal

Rsmn	FY15	FY16	FY17	FY18	FY19	FY20	CAGR (%)
Revenues	21,626	20,517	22,323	23,745	26,889	25,990	3.7
EBITDA	2,634	3,013	3,346	3,986	4,383	3,986	8.6
EBIT	1,631	2,145	2,381	2,926	3,300	2,941	12.5
PAT	817	1,555	1,838	2,196	2,476	2,750	27.5
Net worth	10,887	11,923	13,828	15,643	17,241	18,583	11.3
Debt	2,768	2,633	1,491	1,248	919	595	-26.5
Capital employed	13,655	14,556	15,319	16,891	18,160	19,179	7.0
EBITDA margin (%)	12.2	14.7	15.0	16.8	16.3	15.3	
EBIT margin (%)	7.5	10.5	10.7	12.3	12.3	11.3	
PAT margin (%)	3.8	7.6	8.2	9.2	9.2	10.6	
RoE (%)	7.5	13.0	13.3	14.0	14.4	14.8	
RoCE (%)	11.9	14.7	15.5	17.3	18.2	15.3	
Debt/Equity (x)	0.4	0.2	0.1	0.1	0.1	0.0	

Source: Company data, Industry, I-Sec research

Table 22: Key financials of Grindwell Norton

Rsmn	FY15	FY16	FY17	FY18	FY19	FY20	CAGR (%)
Revenues	11,104	11,354	12,634	14,310	15,981	15,796	7.3
EBITDA	1,651	1,835	1,931	2,469	2,718	2,645	9.9
EBIT	1,296	1,409	1,509	2,021	2,266	2,067	9.8
PAT	1,010	1,064	1,209	1,509	1,687	1,839	12.7
Net worth	6,125	7,632	8,930	9,905	10,979	11,873	14.2
Debt	149	152	78	0	-	-	
Capital employed	6,274	7,783	9,008	9,906	10,979	11,873	13.6
EBITDA margin (%)	14.9	16.2	15.3	17.3	17.0	16.7	
EBIT margin (%)	11.7	12.4	11.9	14.1	14.2	13.1	
PAT margin (%)	9.1	9.4	9.6	10.5	10.6	11.6	
RoE (%)	16.5	13.9	13.5	15.2	15.4	15.5	
RoCE (%)	20.7	18.1	16.7	20.4	20.6	17.4	
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0	

Source: Company data, Industry, I-Sec research

Adhesives

The adhesive market size is estimated at Rs90bn and is growing at a CAGR of ~12%. Apart from steady growth in market size, we also expect value migration from unorganised to organised sectors.

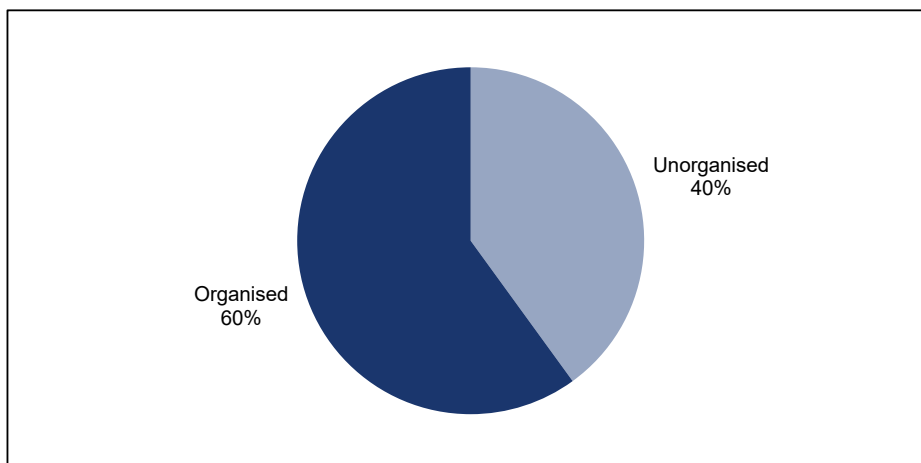
Breakup between consumer and institutional adhesive markets

The adhesive industry is divided between consumer and institutional segments. We believe the share of consumer adhesive market is almost half of institutional adhesives. Key players in the adhesive market in India are Pidilite, 3M, Astral Poly, Anabond, Henkel, Arkema (Bostik India) and H.B. Fuller Company. Paint companies such as Asian Paints and Kansai too have recently entered the adhesive business.

The key industries using adhesives are consumer (for packaging purposes) and pharma. The furniture and home care industries too are big consumers of adhesives.

Breakdown of consumer adhesive market

The consumer adhesive market is divided into unorganised and organised segments. The share of organised market is estimated at 60% (and is steadily increasing) whereas that of unorganised market is 40%.

Chart 42: Unorganised and organised markets in consumer adhesives

Source: Company data, Industry, I-Sec research

Sub-segments of consumer adhesive

The consumer adhesive segment can be broadly divided into six sub-segments. Each adhesive has different characteristics and its usage too is different. We note usage of six major sub-segments as follows: (1) to stick wood; (2) to stick plastic, rubber, crockery; (3) to stick paper; (4) for usage on art materials; (5) for sticking stones such as marbles and granites; and (6) adhesive tapes.

Table 23: Sub-segments of adhesives and key brands

Sub-segments of adhesives	Key products
To Stick wood	<i>Fevicol, Trugrip, Nerofix</i>
To stick Rubber, Plastic, Crockery	<i>Fevikwik, Loctite, M-Seal</i>
To Stick Paper	<i>Fevistik</i>
For use on art material	<i>Fevicryl</i>
For sticking stones	<i>Fevibond, Araldite</i>
Adhesive Tapes	
- Electrical	<i>Steelgrip</i>
- Paper	<i>Post-it</i>
- Medicated	<i>Band-Aid, Hansaplast, Nexcare</i>
- Safety markers	<i>3M</i>

Source: Company data, Industry, I-Sec research

Different approaches in adhesives

Pidilite and Asian Paints have focused more on selling pure adhesives whereas 3M India focusses on adhesives and some tapes. Also, Pidilite focuses on long-lasting effects whereas 3M India sells tapes (with adhesives) which have long as well as short shelf life.

Table 24: Different approaches in consumer adhesive

Particulars	Pidilite	3M India
Pidilite strong areas where 3M is not present	<i>Fevikwik</i> (to stick rubber & plastic)	
	<i>Fevibond</i> (to stick granite, marble)	
	<i>M-Seal</i> (Sealant)	
3M Strong areas where Pidilite is not present		Medicated tapes (medical tapes)
		<i>Post-it</i> (paper-based messaging product)
		Markers on vehicles (yellow/red reflectors on buses and taxis)
		Double-sided tapes
Approach of the company		Hooks to use at home
	Pidilite provides absolute adhesives (<i>Fevicol</i> , <i>Fevikwik</i> , etc.).	3M provides adhesives with some tapes. (<i>Post-it</i> , vehicle markers, medicated tapes, hooks, etc.).
Long lasting effect	Pidilite has adhesives with long-lasting effects such as <i>Fevicol</i> used for furniture.	3M provides adhesives with limited shelf life (medicated tapes, <i>Post-it</i>)

Source: Company data, Industry, I-Sec research

Table 25: Key financials of Pidilite

Rsmn	FY15	FY16	FY17	FY18	FY19	FY20	CAGR (%)
Revenues	48,441	53,612	56,168	60,784	70,780	72,945	8.5
EBITDA	7,708	11,735	12,598	13,412	13,682	15,760	15.4
EBIT	6,985	11,508	12,569	13,698	13,821	15,555	17.4
PAT	5,126	8,028	8,600	9,624	9,249	11,164	16.8
Net worth	22,757	26,814	35,982	37,491	43,552	46,713	15.5
Debt	584	800	975	1,226	1,111	1,691	23.7
Capital employed	23,341	27,614	36,957	38,716	44,663	48,404	15.7
EBITDA margin (%)	15.9	21.9	22.4	22.1	19.3	21.6	
EBIT margin (%)	14.4	21.5	22.4	22.5	19.5	21.3	
PAT margin (%)	10.6	15.0	15.3	15.8	13.1	15.3	
RoE (%)	22.5	29.9	23.9	25.7	21.2	23.9	
RoCE (%)	29.9	41.7	34.0	35.4	30.9	32.1	
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0	

Source: Company data, Industry, I-Sec research

Table 26: Key financials of Astral Poly

Rsmn	FY15	FY16	FY17	FY18	FY19	FY20	CAGR (%)
Revenues	14,294	17,183	18,947	21,060	25,073	25,779	12.5
EBITDA	1,683	2,051	2,638	3,168	3,849	4,429	21.4
EBIT	1,350	1,649	2,227	2,724	3,189	3,471	20.8
PAT	759	1,006	1,447	1,751	1,958	2,479	26.7
Net worth	6,353	7,948	8,591	10,318	12,927	15,197	19.1
Debt	2,026	2,026	2,264	1,875	2,741	1,270	-8.9
Capital employed	8,379	9,974	10,855	12,192	15,668	16,467	14.5
EBITDA margin (%)	11.8	11.9	13.9	15.0	15.4	17.2	
EBIT margin (%)	9.4	9.6	11.8	12.9	12.7	13.5	
PAT margin (%)	5.3	5.9	7.6	8.3	7.8	9.6	
RoE (%)	11.9	12.7	16.8	17.0	15.1	16.3	
RoCE (%)	16.1	16.5	20.5	22.3	20.4	21.1	
Debt/Equity (x)	0.3	0.3	0.3	0.2	0.2	0.1	

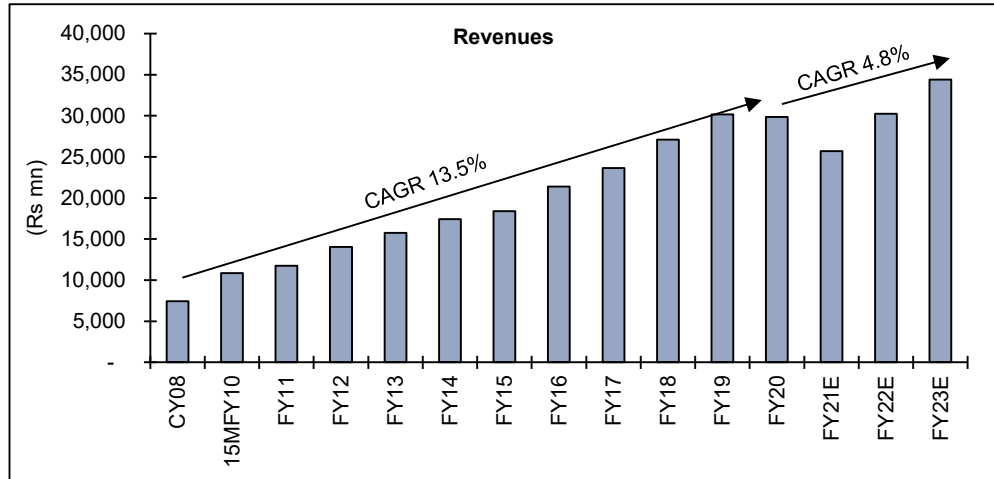
Source: Company data, Industry, I-Sec research

Financial performance

Expect steady revenue growth ahead

3M India reported revenue CAGR of 13.5% over CY08-FY20. The key reasons for such strong growth were: (1) steady launch of new products, and (2) aggressive distribution expansion by the company. We expect the company to report revenue CAGR of 4.8% over FY20-FY23.

Chart 43: Healthy revenue growth ahead

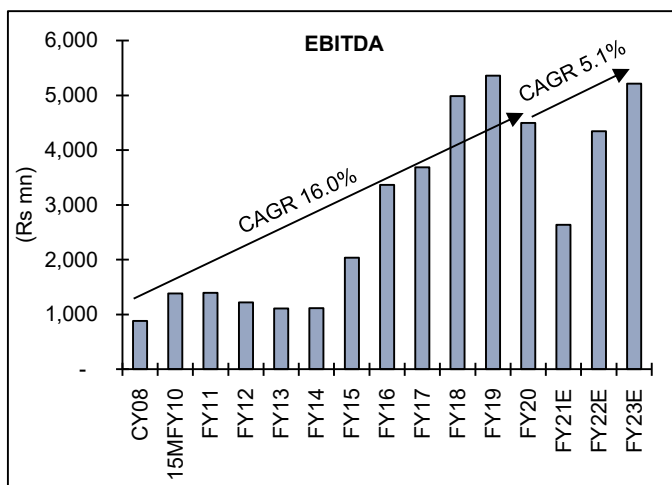


Source: Company data, I-Sec research

EBITDA margin to remain flat over FY20-23

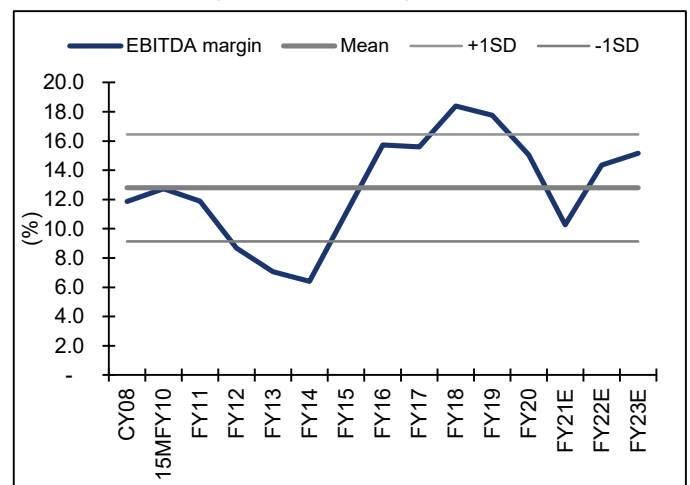
3M's EBITDA margin hovered at ~15% over CY08-FY20. We expect the company to maintain its gross margins in FY21-FY23 but, due to cost saving programs, we model EBITDA margin to be 15.2% in FY23E compared to 15.1% in FY20.

Chart 44: EBITDA CAGR of 5.1% over FY20-FY23E



Source: Company data, I-Sec research

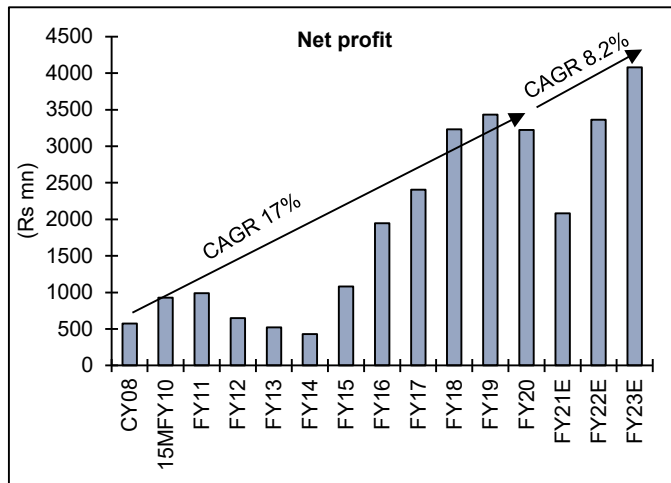
Chart 45: Rising EBITDA margins



Net profit growth to resume in FY22E after hitting breaks in FY20-FY21

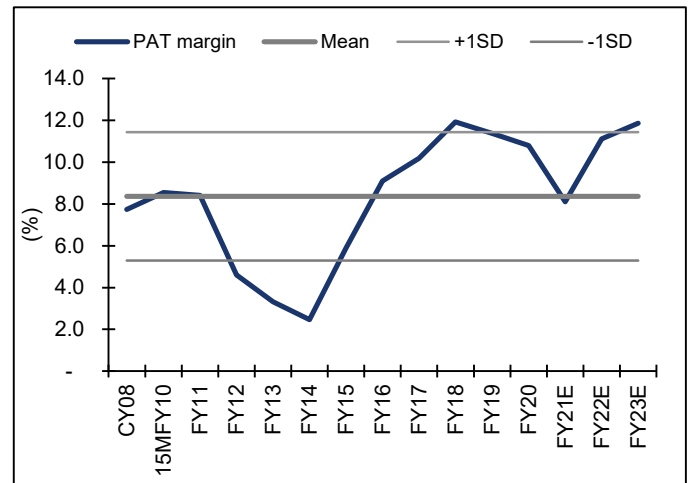
3M India enjoys strong PAT margins (~9%) due to: (1) higher EBITDA margin, (2) lower depreciation and interest cost due to asset-light model and (3) high other income due to excess cash on the balance sheet. We expect the company to report PAT margin of 11.9% in FY23E compared to 10.8% in FY20. We expect net profit CAGR of 8.2% over FY20-FY23E vs. revenue CAGR of 4.8% over the same timeframe.

Chart 46: Steady net profit growth ahead



Source: Company data, I-Sec research

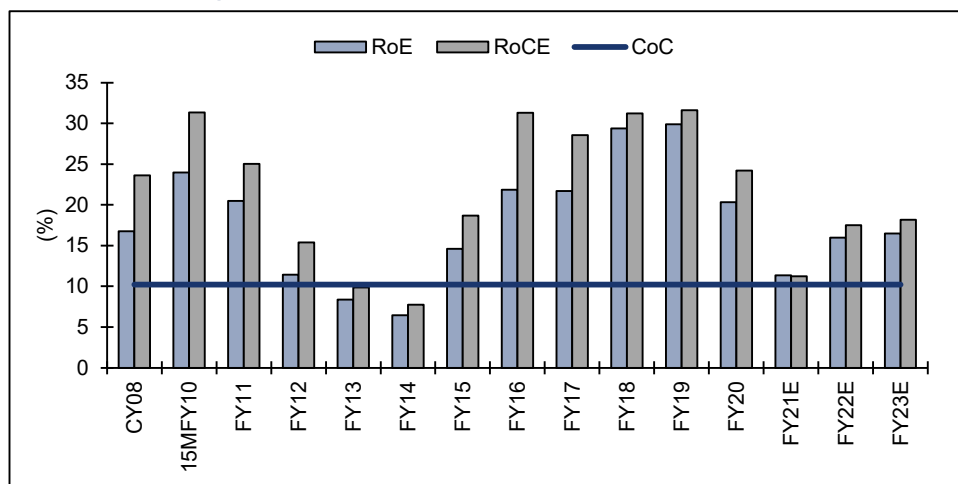
Chart 47: Net profit margins to expand



Return ratios > Cost of capital

3M India has maintained strong return ratios over CY08-FY20 due to strong margins as well as high asset turns. Also, improvement in margin has helped improve return ratios. We expect the company to report return ratios in excess of the cost of capital across FY20-FY23E.

Chart 48: Strong return ratios

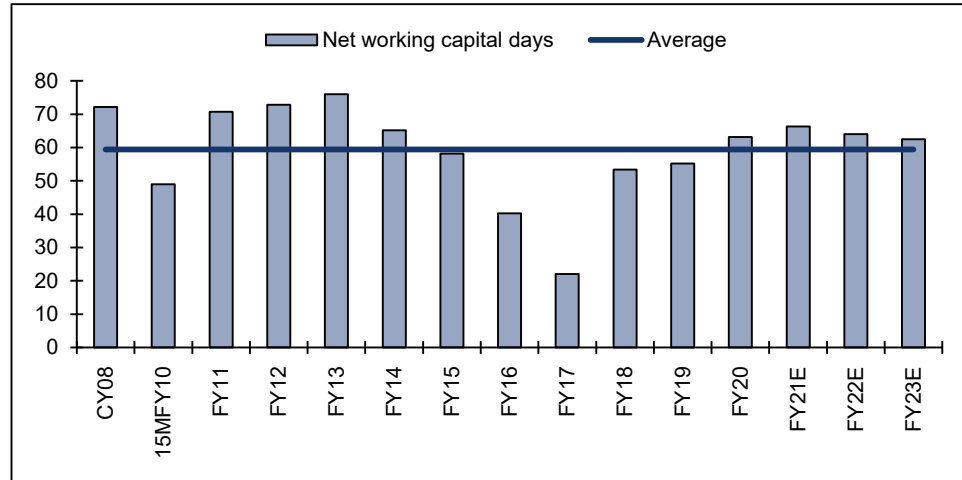


Source: Company data, I-Sec research

Investment in working capital

Due to improving product profile (due to innovations), 3M India will be able to curtail its investment in working capital. Working capital days have reduced from 72 in CY08 to 63 as at FY20. We expect net working capital days at 63 at FY23-end.

Chart 49: Net working capital days



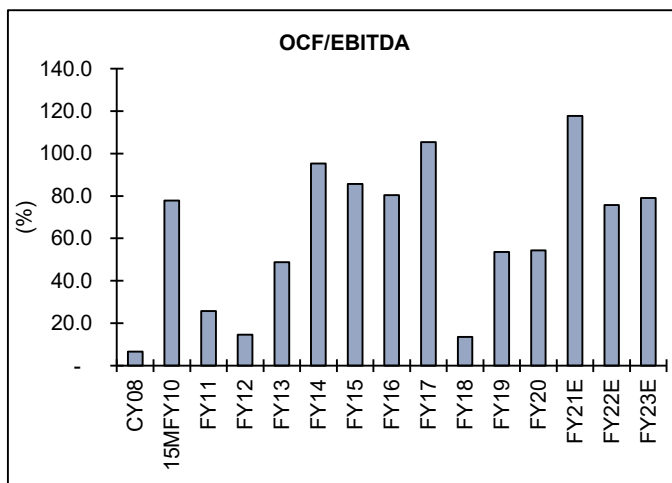
Source: Company data, I-Sec research

Strong FCF generation

3M India has a healthy cash generation record with an average OCF/EBITDA of 55% over CY08-FY20. Company has used the OCF to: (1) expand business and distribution, (2) incur capex and acquire 3M Electro, and (3) launch new products. The company has not declared dividends in FY11-FY20.

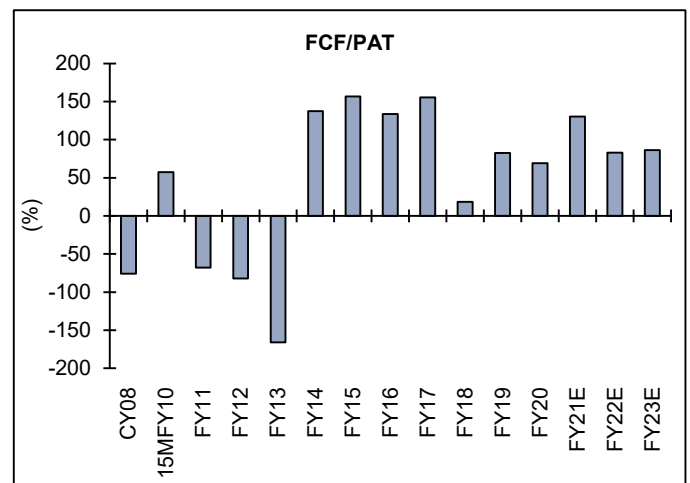
We expect the company to use its OCF generation to strengthen the balance sheet in coming years.

Chart 50: Average OCF/EBITDA of 55%



Source: Company data, I-Sec research

Chart 51: Average FCF/PAT of 50%



Source: Company data, I-Sec research

Key assumptions

Table 27: Key assumptions

(Rs mn)

	FY19	FY20	FY21E	FY22E	FY23E
Net revenues	30,168	29,866	25,683	30,259	34,395
<i>Growth (%)</i>	11.3	(1.0)	(14.0)	17.8	13.7
Gross profit	14,166	12,503	10,318	12,683	14,588
<i>Gross margin (%)</i>	47.0	41.9	40.2	41.9	42.4
EBITDA	5,356	4,497	2,639	4,347	5,215
<i>EBITDA margin (%)</i>	17.8	15.1	10.3	14.4	15.2
PBT	5,275	4,326	2,793	4,516	5,479
<i>PBT margin (%)</i>	17.5	14.5	10.9	14.9	15.9
<i>Tax rate (%)</i>	35.0	25.5	25.5	25.5	25.5
PAT	3,431	3,222	2,081	3,364	4,082
<i>PAT margin (%)</i>	11.4	10.8	8.1	11.1	11.9
<i>PAT growth (%)</i>	6.1	(6.1)	(35.4)	61.7	21.3
Capex	(419)	(212)	(400)	(500)	(600)
Net working capital days	55	63	66	64	63
Operating cashflow	2,872	2,442	3,108	3,294	4,126
Free cashflow	(3,009)	2,231	2,708	2,794	3,526
<i>OCF/EBITDA (%)</i>	53.6	54.3	117.8	75.8	79.1

Source: Company data, I-Sec research

Valuation

We have valued 3M India by the DCF methodology, which leads to a target price of Rs20,000 per share. The implied P/E multiple at our target price and FY23E EPS works out to 55x. We initiate coverage on the stock with an **ADD** rating.

DCF-based valuation

Valuing 3M India on the DCF methodology involves three stages:

- **Stage 1 (FY20-FY23E):** During this period, we expect the company to grow its revenues at a CAGR of 4.8%.
- **Stage 2 (FY23E-FY31E):** During this period, we expect the company to post revenue CAGR of 18% till FY31E.
- **Stage 3 (FY32E onward):** We assume a perpetual growth rate of 5% post FY31.

To arrive at the cost of equity of 10.2%, we have assumed a market return of 12%. Based on these assumptions, we arrive at a valuation of Rs20,000/share.

Table 28: DCF valuation

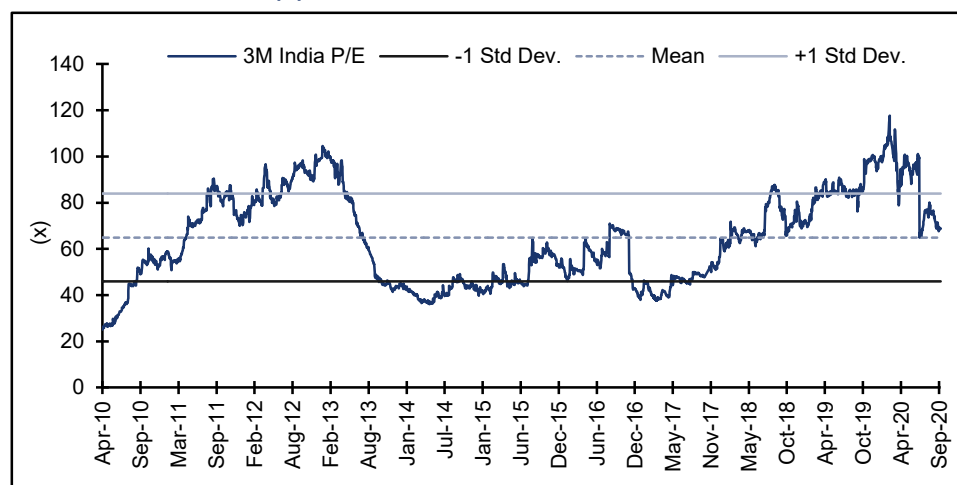
Particulars	Amt (Rs)
Cost of equity (%)	10.2
Terminal growth rate (%)	5.0
Discounted interim cash flows (Rs mn)	55,368
Discounted terminal value (Rs mn)	169,934
Total equity value (Rs mn)	225,302
Value per share (Rs)	20,000

Source: Company, I-Sec research

Mean P/E and standard deviation

Historically, the stock has traded at an average 1-year forward P/E of 65x. Comparing the historical and estimated future return ratios and growth rates, we expect it to trade at a P/E multiple of 55x on FY23E EPS.

Chart 52: Mean P/E (x) and standard deviation



Source: Company data, I-Sec research

Key risks

Steep rise in competitive pressures and input prices: Steep rise in competitive pressures and material increase in production capacities by peers in a short timeframe can hurt 3M India's earnings. Higher cost of production may also impact earnings.

Delays in launch / failure of new products: Any delay in launch of new products and/or failure of new products may impact 3M India's financials. If the company's geographical expansion plans fail, or get delayed, earnings growth may be impacted.

Launch of new subsidiary by parent: If the parent introduces new products by forming a new subsidiary/ joint venture/ Associate in India, it may impact 3M India's growth prospects.

Weak economic outlook and industrial production: The company's growth is dependent on GDP growth as well as industrial production in India. If there is prolonged weakness in India's economy, it will impact company's growth prospects.

Financials

Table 29: Profit & Loss statement

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E	FY23E
Gross Sales	30,168	29,866	25,683	30,259	34,395
Less: Excise Duty	-	-	-	-	-
Net Sales	30,168	29,866	25,683	30,259	34,395
Growth (%)	11.3	(1.0)	(14.0)	17.8	13.7
Expenditure					
Cost of Goods Sold	16,002	17,363	15,365	17,576	19,807
Staff Cost	3,302	3,286	3,339	3,328	3,783
Power & fuel	181	174	205	182	206
Selling, distribution, advt expenses	868	757	745	878	997
Freight outwards	624	571	539	635	688
Other expenses	1,970	1,544	1,387	1,589	1,806
EBITDA	5,356	4,497	2,639	4,347	5,215
EBITDA margin (%)	17.8	15.1	10.3	14.4	15.2
Depreciation	438	593	524	572	627
EBIT	4,918	3,903	2,115	3,774	4,588
Interest Expense & Bank Exps	11	37	30	30	30
Other Income	368	459	708	771	920
Profit Before Tax	5,275	4,326	2,793	4,516	5,479
Income Taxes	1,844	1,104	712	1,152	1,397
Income tax rate	35.0	25.5	25.5	25.5	25.5
Profit After Tax	3,431	3,222	2,081	3,364	4,082
Growth (%)	6.1	(6.1)	(35.4)	61.7	21.3
Share of Profit From Associates	-	-	-	-	-
Pref. Dividends/Minority Interest	-	-	-	-	-
Profit Before X/O	3,431	3,222	2,081	3,364	4,082
Extraordinary Items	230	(41)	-	-	-
Profit for Shareholders	3,661	3,180	2,081	3,364	4,082

Source: Company data, I-Sec research

Table 30: Balance sheet*(Rs mn, year ending March 31)*

	FY19	FY20	FY21E	FY22E	FY23E
Sources of Funds					
Share Capital	113	113	113	113	113
Reserves and Surplus	14,216	17,396	19,477	22,841	26,923
Deferred Tax Liability	(307)	(224)	(224)	(224)	(224)
Net Worth	14,021	17,285	19,366	22,730	26,812
Net Worth Net of Rev. Reserve	14,021	17,285	19,366	22,730	26,812
Pref.Capital/Minority Interest	-	-	-	-	-
Secured Loans	138	176	176	176	176
Unsecured Loans	289	316	316	316	316
Total Loans	427	492	492	492	492
Total	14,448	17,777	19,858	23,222	27,304
Application of Funds					
Fixed Assets					
Gross Block	4,551	5,004	5,473	5,973	6,573
Less: Depreciation	1,691	1,944	2,468	3,040	3,667
Net Block	2,861	3,060	3,005	2,933	2,906
Capital WIP	124	69	-	-	-
Gross Block-Brand value	4,551	5,004	5,473	5,973	6,573
Goodwill	-	-	-	-	-
Liquid Investments	-	-	8,000	13,000	16,500
Other Investments	1,323	1,674	1,674	1,674	1,674
Current Assets	16,568	18,687	11,905	11,183	12,553
Inventories	4,113	4,387	3,596	4,236	4,815
Sundry Debtors	5,866	5,342	4,623	5,447	6,191
Cash & Bank Balances	5,575	7,806	2,514	308	334
Loans & Advances	1,015	1,153	1,173	1,193	1,213
Current Liabilities	6,428	5,713	4,726	5,568	6,329
Liabilities	5,710	5,084	4,109	4,841	5,503
Provisions	718	629	616	726	825
Net Current Assets	10,140	12,974	7,179	5,616	6,225
Total	14,448	17,777	19,858	23,222	27,304

Source: Company data, I-Sec research

Table 31: Cashflow statement*(Rs mn, year ending March 31)*

	FY19	FY20	FY21E	FY22E	FY23E
OCF before W/C changes	3,585	3,362	2,605	3,937	4,709
W/c Changes	(712)	(920)	503	(642)	(582)
OCF After W/C Changes	2,872	2,442	3,108	3,294	4,126
Cashflow from Investing	-	-	-	-	-
Capital Expenditure	(419)	(212)	(400)	(500)	(600)
Disposal	385	1	-	-	-
Investments	-	-	(8,000)	(5,000)	(3,500)
Acquisitions	(5,847)	-	-	-	-
Net Cash used in Investing	(5,882)	(211)	(8,400)	(5,500)	(4,100)
Cashflow from Financing	-	-	-	-	-
Changes in Share Capital	-	-	-	-	-
Changes in Loans	37	-	-	-	-
Dividends	-	-	-	-	-
Net Cash used in Financing	37	-	-	-	-
Extraordinary Items	-	-	-	-	-
Changes in Cash & Equivalents	(2,972)	2,231	(5,292)	(2,206)	26
Opening Cash & Equivalents	8,547	5,575	7,806	2,514	308
Closing Cash & Equivalents	5,575	7,806	2,514	308	334
Free Cashflow	(3,009)	2,231	2,708	2,794	3,526

Source: Company data, I-Sec research

Table 32: Key ratios*(year ending March 31)*

	FY19	FY20	FY21E	FY22E	FY23E
Profitability Ratios					
Gross margin (%)	47.0	41.9	40.2	41.9	42.4
EBITDA Margin (%)	17.8	15.1	10.3	14.4	15.2
EBITDA+Other Income Margin (%)	19.0	16.6	13.0	16.9	17.8
EBIT Margin (%)	16.3	13.1	8.2	12.5	13.3
PBT Margin (%)	17.5	14.5	10.9	14.9	15.9
PAT Margin (%)	11.4	10.8	8.1	11.1	11.9
Income Tax Rate (%)	35.0	25.5	25.5	25.5	25.5
RoE (%)	29.9	20.3	11.4	16.0	16.5
RoCE (%)	31.6	24.2	11.2	17.5	18.2
Major Costs as % of Net Sales					
Cost of Goods Sold (%)	53.0	58.1	59.8	58.1	57.6
Staff Cost (%)	10.9	11.0	13.0	11.0	11.0
Power & fuel (%)	0.6	0.6	0.8	0.6	0.6
Selling, distribution, advt exps (%)	2.9	2.5	2.9	2.9	2.9
Freight outwards (%)	2.1	1.9	2.1	2.1	2.0
Royalty (%)	1.8	1.4	1.5	1.5	1.5
Corporate management fees (%)	4.4	4.2	4.2	4.2	4.0
Other expenses (%)	6.5	5.2	5.4	5.3	5.3
Per Share Data					
Earnings Per Share (Rs)	304.6	286.0	184.7	298.7	362.3
Growth (%)	6.1	(6.1)	(35.4)	61.7	21.3
Book Value per Share (Rs)	1,244.7	1,534.4	1,719.1	2,017.8	2,380.1
Growth (%)	33.8	23.3	12.0	17.4	18.0
Turnover Ratios					
Debtors Turnover ratio (%)	19.4	17.9	18.0	18.0	18.0
Current Liabilities Turnover Ratio (%)	18.9	17.0	16.0	16.0	16.0
Inventory Turnover Ratio (%)	13.6	14.7	14.0	14.0	14.0
Fixed Assets Turnover Ratio (%)	9.9	10.5	11.7	9.7	8.4
Valuation Ratios					
Price Earnings (x)	60.1	64.0	99.1	61.3	50.5
Price/Book Value (x)	14.7	11.9	10.6	9.1	7.7
EV/Sales (x)	6.6	6.7	7.7	6.6	5.8
EV/EBITDA (x)	37.1	44.2	75.4	45.8	38.1
Dividend Yield (%)	-	-	-	-	-
Other Ratios					
Net debt/Equity (x)	(0.4)	(0.4)	(0.5)	(0.6)	(0.6)
FCF/EPS (%)	82.7	69.2	130.1	83.1	86.4
OCF/Sales (%)	9.5	8.2	12.1	10.9	12.0
Div Payout Ratio (%)	-	-	-	-	-

Source: Company data, I-Sec research

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