

HERITAGE FOODS

The beginning of dawn

India Equity Research | Dairy

Heritage Foods' (HFL) Q1FY21 EBITDA jumped 25% YoY, surpassing our estimate by 30%. Sales declined 11% YoY (8% below estimate) primarily due to 20% dip in milk volumes sold and 34% fall in value-added (VADP) sales. However, gross margin surged ~261bps YoY and 469bps QoQ to 22.5% owing to higher spreads and declining procurement cost. EBITDA sprung a positive surprise with 265bps YoY margin increase led by 21% fall in other expenses. Post a challenging FY20, margin has bottomed out in the wake of rising procurement volumes (up 15%) and sustenance of retail prices. Hence, we revise up FY21E and FY22E EPS 21% and 12%, respectively. Maintain 'BUY' with revised TP of INR394 (INR300 earlier), valuing core business at 15x FY22E EPS. We remain enthused by B2C nature of HFL's business (90% plus) and strong return ratios underpinned by fresh dairy products portfolio.

Value-driven sales spurt; volumes take a hit

Revenue declined ~11% in Q1FY21 YoY primarily due to value growth in liquid milk sales. VADP growth slowed to ~34% YoY with curd volumes declining 45%. EBITDA margin improved 265bps YoY to 9% led by ~261bps YoY increase in gross margin on account of higher spreads (up 79% YoY). Further, other expenses were well controlled, down 21%YoY. Margin could have been higher if not for fat sales as inventories were lowered to reduce pressure of higher storage costs.

Way ahead: Procurement improving

Procurement had taken a hit in FY20--down 0.3% YoY--due to harsh summer and then heavy rainfall. However, it has improved 15% QoQ in Q1FY21 as covid-19 has triggered spurt in milk and powder supply. Hence, procurement prices, after being up 10.8% in FY20, have cooled off 9%QoQ. But HFL has not taken proportionate pricing action with realisation up 5% QoQ leading to improved gross margin.

Outlook and valuation: Positive; maintain 'BUY'

HFL is well placed led by B2C nature of its business (90% plus). With improving procurement, we expect the company's margin to bottom out in FY20 and expect 29% EBITDA CAGR over FY20-22E. We maintain 'BUY' with revised SOTP-based TP of INR394 (15x FY22E core EPS) plus market value of investment in Future Retail.

Financials

(INR mn)

Year to March	Q1FY21	Q1FY20	% change	Q4FY20	% change	FY20	FY21E	FY22E
Net rev. (INR mn)	6,388	7,212	(11.4)	6,526	(2.1)	27,259	26,139	29,015
EBITDA (INR mn)	579	463	25.1	274	111.2	1,293	1,785	2,156
Adj. PAT (INR mn)	295	200	47.6	79	273.6	484	842	1,082
Adj. Dil. EPS (INR)	6.4	4.3	47.6	1.7	273.6	10.4	18.1	23.3
Diluted P/E (x)						29.8	17.2	13.3
EV/EBITDA (x)						11.6	8.0	6.4
ROAE (%)						(17.5)	16.9	18.7

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EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA (R: HEFI.BO, B: HTFL IN)

CMP	: INR 311
Target Price	: INR 394
52-week range (INR)	: 411 / 146
Share in issue (mn)	: 46.4
M cap (INR bn/USD mn)	: 14 / 193
Avg. Daily Vol. BSE/NSE ('000)	: 51.7

SHARE HOLDING PATTERN (%)

	Current	Q4FY20	Q3FY20
Promoters *	39.9	39.9	39.9
MF's, FI's & BKs	13.9	14.8	14.2
FII's	5.1	4.6	4.6
Others	41.1	40.7	41.4
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	10.8	12.5	1.7
3 months	24.2	23.7	(0.5)
12 months	(11.4)	(35.3)	(23.9)

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Edelweiss Securities Limited

Q1FY21 conference call: Key highlights

- Revenue declined 11.4% YoY primarily led by volumes decline of 20.8% YoY, while realisations were up 16.7%YoY in milk sales.
- Milk procurement expanded 15% QoQ in Q1FY21 to an average of 14.53LLPD after contracting 7% QoQ in Q4FY20.
- **VADP sales lower:** The VADP portfolio momentum declined 34% YoY in Q1FY21 from a growth of 6% YoY in Q4FY20. The slowdown was led by curd volumes declining 45% YoY. VADP contribution stands at ~24.5% in Q1FY21 (Q1FY20: 33.0% of sales).
- EBITDA margin improved 265bps YoY and 487bps QoQ to 9.1%. This was led by growth of 261bps YoY and 469bps QoQ in gross margin, primarily on account of realizations, which expanded 6% YoY to INR42.2/l. Further, other expenses were well controlled, down 21% YoY.
- Heritage Nutrivet subsidiary reported 27% growth in revenue and positive EBIT of INR47mn (margin of 13.6%) versus -3% EBIT margin in Q1FY20.
- The company posted fat sales of ~INR600mn during the quarter as surplus butter in storage of 668t was sold. The company had no SMP sales during the quarter and increased SMP inventories to 3,822t.
- With Future Retail shares up during the current quarter, HFL saw an improvement of INR669mn in its bottom line of INR964mn. Excluding this, PAT was at INR295mn.
- While employee cost jumped during the quarter, this was on account of the company's efforts to ensure food availability and hygiene facilities available for employees. HFL made food available for truckers, loaders and people in logistics value chain, purchased 70,000 masks and gloves and tons of sanitizers. The company also ensured transport availability for employees with no transport available ensuring social distancing.
- The lower other expenses were led by 21% YoY decline in variable expenses like power and freight and travelling costs.

Covid-19 impact

- Covid-19 has led to increase in supply of milk and powder and thereby procurement increased 15% QoQ in Q1FY21.
- As a result, management increased procurement and where excess milk was taken, it was converted into butter and milk powder for internal consumption over the next year. Surplus availability of milk resulted in prices cooling off.
- Procurement prices post being up 10.8% last full year, have cooled off and are down 9% QoQ. However, realization was up 5% QoQ led by price increase of Feb-March reflecting in this quarter.
- Sales were impacted by decline in out-of-home (OOH) sales for HFL. This forms 15-20% of sales in milk sales and 30% of VADP sales. These are to remain impacted until normalcy returns.
- With monsoon being a lean period in terms of demand, management did not see the typical offset from marriage and festive season as celebrations have been muted during the pandemic.
- Peak summer consumption was also impacted owing to the pandemic.
- Management ensured all payments were made to farmers and increased procurement efforts during the quarter to aid farmers.

Others

- Management expects the lactation cycle to be normal this year and does not expect procurement prices to increase.
- **Capex:** In Q1FY21, HFL incurred capex of INR80mn. Further, led by lower demand, it expects 20-30% lower capex than earlier planned INR1.1bn, leading to INR0.8bn capex versus INR1.1bn in FY20. The planned capex will increase its capacity and improve front-end and back-end infrastructure. The investments will be at village level collection centers, chilling centres and bulk coolers, packing stations for milk and products and renewal of old machinery. This includes land acquisition costs for next year and plans for demand in next summer season.
- **Debt:** For the dairy business, long-term debt stands at INR1.85bn and short term at INR380mn. The Nutrivet subsidiary's long-term debt stands at INR140mn and short term at INR40mn.
- The current focus of the company is on tech channels and modern retail formats. Hence, it has also launched an app in Hyderabad for pilot testing which delivers milk via existing partners and logistics.
- Capacity stands currently at 2.5mn litres of chilling capacity, 2.37mn litres of processing capacity and 1.55mn litres of packing capacity and 600ktpd curd packaging capacity. HFL expects to cross 3.0–3.5mn litres over the next five years, which will be funded through a mix of debt and internal accruals.

Long-term vision over FY24-25

- Management remains focused on handling milk procurement volumes of 28LLPD versus 14.53LLPD currently.
- It expects revenue of INR60bn of sales versus INR27bn in FY20.
- VAP contribution to increase from 26.96% to 40.0% of sales.

Future Retail stake

- HFL's stake in Future Retail is of 17.8mn shares, lock-in period for which is over. Management has not taken an opinion on sale of shares currently; however, there are no further stipulations on HFL for the sale of shares.
- Since Future Retail's stock price improved to INR110 in Q1FY21 versus INR78 in Q4FY20, there was a reversal in earlier MTM losses on these shares. Of the total 17.8mn shares, fair value change of 13.3mn shares is routed through the P&L, while the balance is routed through Other Comprehensive Income.
- With capex, the company is planning to expand capacity to 30–35LLPD over the next five years through a mix of debt and internal accruals.

Table 1: SOTP valuation

Particulars	Valuation methodology	Value/Share (INR)	Remarks
Heritage Foods	Earning multiple	360	Valued at 15x FY22E EPS
Future Retail Investment	Market Value	34	Valued at market value with 20% holding company discount
Target Price		394	

Source: Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q1FY21	Q1FY20	% change	Q4FY20	% change	FY20	FY21E	FY22E
Net revenues	6,388	7,212	(11.4)	6,526	(2.1)	27,259	26,139	29,015
Raw material	4,950	5,777	(14.3)	5,363	(7.7)	22,246	20,870	22,995
Staff costs	416	409	1.7	362	14.9	1,564	1,595	1,697
Other expenses	442	563	(21.4)	527	(16.0)	2,157	1,889	2,166
Total expenditure	5,809	6,749	(13.9)	6,252	(7.1)	25,966	24,354	26,859
EBITDA	579	463	25.1	274	111.2	1,293	1,785	2,156
Depreciation	138	126	9.7	125	10.6	509	559	640
EBIT	442	337	30.9	150	194.9	784	1,226	1,517
Interest	63	55	13.1	65	(2.9)	226	200	177
Other income	16	25	(35.5)	19	(17.1)	89	99	107
Add: Exceptional items	669	-		(2,171)	(130.8)	(2,171)	-	-
Profit before tax	1,064	307	246.6	(2,067)	(151.5)	646	1,126	1,447
Provision for taxes	101	117	(14.0)	30	239.1	153	284	365
Minority interest	(3)	(12)	NA	(7)	NA	(1,603)		
Associate profit share	(2)	(1)	NA	(3)	NA	(9)		
Reported net profit	964	200	381.7	(2,092)	(146.1)	(84)	842	1,082
Adjusted Profit	295	200	47.6	79	273.6	484	842	1,082
Diluted shares (mn)	46	46		46		46	46	46
Adjusted Diluted EPS	6.4	4.3	47.6	1.7	273.6	10.4	18.1	23.3
Diluted P/E (x)	-	-		-		29.8	17.2	13.3
EV/EBITDA (x)	-	-		-		11.6	8.0	6.4
ROAE (%)	-	-		-		(17.5)	16.9	18.7

As % of net revenues

Raw material	77.5	80.1		82.2		81.6	79.8	79.3
Employee cost	6.5	5.7		5.6		5.7	6.1	5.8
Other expenses	6.9	7.8		8.1		7.9	7.2	7.5
EBITDA	9.1	6.4		4.2		4.7	6.8	7.4
Reported net profit	4.6	2.8		1.2		1.8	3.2	3.7

Change in Estimates

	New	FY21E Old	% change	New	FY22E Old	% change	Comments
Net Revenue	26,139	28,866	(9.4)	29,015	31,796	(8.7)	Led by hit in volumes due to lower OOH sales due to COVID
EBITDA	1,785	1,607	11.1	2,156	2,023	6.6	Led by lower milk procurement prices
EBITDA Margin	6.8	5.6		7.4	6.4		
Adjusted Profit After Tax	842	691	21.9	1,082	964	12.3	Led by lower capex and higher EBITDA
Net Profit Margin	3.2	2.4		3.7	3.0		
Capex	800	1,050	(23.8)	1,200	1,200	0.0	

Company Description

Heritage was founded by Mr. Chandrababu Naidu in 1992 as a dairy company. Over the years, Heritage has operated in dairy, retail, agri, bakery and veterinary care. However, it has now demerged its loss making retail, agri and bakery businesses, selling them off to Future Retail for a consideration of 17.85mn shares (3.6% stake), rendering the company a pure dairy play. Heritage sells milk and milk products such as curd (largest share), ice cream, paneer, flavoured milk, ghee, butter and milk powders. Entire dairy sales are B2C and are sold under the Heritage brand. Of FY17 dairy revenues, milk constituted ~66%, VADP 24% and fat products 9% share. Curd's contribution within VADP is 77% and ~18% to Heritage's manufactured dairy sales.

Investment Theme

Heritage Foods (HFL), a strong private dairy player in south (AP) and a strong franchisee in liquid milk, is diversifying into VADP. It has set a strong target of INR60bn of sales with procurement of ~2.8 mn litres per day in 5 years. It is focussing on deepening penetration in current markets and expanding reach in new geographies by inorganic acquisition. It is prudently straddling the high RoCE pouch milk segment and high-growth & margin curd, yogurt and ice-cream segments to attain its target. Targeting large categories like curd (INR288bn) with organised penetration at mere 6% and high margin segments like ice-cream are envisaged to spur Heritage's growth and margin.

With improving procurement, we expect HFL's margin to bottom out in FY20 and expect 29% EBIDTA CGAR over FY20-22E.

Key Risks

High dependency on low margin milk business

Pouch milk business, wherein margins are low, contributes a sizeable 65% to Heritage's sales. Hence, an increasing milk price scenario impacts the company's margin adversely as the increase in procurement price is passed on with a lag.

Increasing competition

Increase in competition from co-operatives or private players, either in form of procurement (by increasing prices to farmers) or selling price (via lower prices), can impact Heritage's performance.

Financial Statements

Key Assumptions

Year to March	FY19	FY20	FY21E	FY22E
Macro				
GDP(Y-o-Y %)	6.1	4.8	(4.0)	7.0
Inflation (Avg)	3.4	4.3	3.5	4.0
Repo rate (exit rate)	6.3	4.4	3.0	4.0
USD/INR (Avg)	70.0	70.7	75.0	73.0
Company				
Procurement price (INR/litre)	32.4	35.8	35.2	35.2
Procurement price increase (%)	(4.9)	10.7	(1.8)	-
Procurement (mn litres/day)	1.4	1.5	1.4	-
Growth (%)	9.5	4.5	(9.4)	12.8
Sales growth (%)				
Manufactured				
Milk (%)	5.5	10.2	(3.6)	9.3
Curd (%)	18.4	20.2	(15.8)	12.0
Ice Cream (%)	14.5	(9.1)	(30.8)	16.0
Paneer (%)	18.0	35.0	(10.0)	16.0
Flavoured Milk (%)	15.0	7.0	(15.0)	16.0
Butter milk (%)	15	-	(15)	16
Sweets (%)	15.0	-	(15.0)	15.0
Others (%)	15.0	5.0	-	14.0
Vetca (%)	10.0	10.0	10.0	10.0
Traded (%)	12.3	(12.1)	61.1	10.3
Revenue Share (%)				
Milk (% of Sales)	62.7	63.7	64.1	63.1
Curd (% of sales)	19.0	21.1	18.5	19.4
Other Value Added Products (% of Sales)	3.7	3.8	3.5	3.6
Fat Products (% of Sales)	6.6	4.2	3.8	3.9
SMP (% of Sales)	-	0.6	0.5	0.5
Traded (% of Sales)	6.1	4.9	8.3	8.3
Interest (% of total borrowings) (Assumptions)	8.2	8.7	8.3	8.0

Income statement

(INR mn)

Year to March	FY19	FY20	FY21E	FY22E
Net revenue	25,148	27,259	26,139	29,015
Materials costs	19,730	22,246	20,870	22,995
Employee costs	1,418	1,564	1,595	1,697
Other Expenses	2,112	2,157	1,889	2,166
Total operating expenses	23,261	25,966	24,354	26,859
EBITDA	1,887	1,293	1,785	2,156
Depreciation	483	509	559	640
EBIT	1,404	784	1,226	1,517
Less: Interest Expense	215	226	200	177
Add: Other income	90.17	88.67	99.11	106.66
Profit Before Tax	1,277	(1,525)	1,126	1,447
Less: Provision for Tax	447	153	284	365
Less: Minority Interest	14	(1,603)	-	-
Add: Exceptional items	(3)	(2,171)	-	-
Associate profit share	(4)	(9)	-	-
Reported Profit	812	(84)	842	1,082
Exceptional Items	(3)	(2,171)	-	-
Adjusted Profit	828	484	842	1,082
Shares o /s (mn)	46	46	46	46
Adjusted Basic EPS	17.9	10.4	18.1	23.3
Diluted shares o/s (mn)	46	46	46	46
Adjusted Diluted EPS	17.9	10.4	18.1	23.3
Adjusted Cash EPS	28.3	21.4	30.2	37.1
Dividend per share (DPS)	2.0	2.5	3.0	4.0
Dividend Payout Ratio(%)	11.2	24.0	16.5	17.2

Common size metrics

Year to March	FY19	FY20	FY21E	FY22E
Gross margin	21.5	18.4	20.2	20.7
Depreciation	1.9	1.9	2.1	2.2
Interest Expense	0.9	0.8	0.8	0.6
EBITDA margins	7.5	4.7	6.8	7.4
Net Profit margins	3.4	(4.1)	3.2	3.7

Growth ratios (%)

Year to March	FY19	FY20	FY21E	FY22E
Revenues	6.0	8.4	(4.1)	11.0
EBITDA	45.1	(31.5)	38.1	20.8
PBT	39.6	(219.4)	(173.8)	28.5
Adjusted Profit	48.1	(41.6)	74.0	28.5
EPS	48.1	(41.6)	74.0	28.5

Balance sheet		(INR mn)			
As on 31st March	FY19	FY20	FY21E	FY22E	
Share capital	232	232	232	232	
Reserves & Surplus	7,794	4,364	5,078	6,007	
Shareholders' funds	8,026	4,596	5,310	6,239	
Minority Interest	117	22	22	22	
Long term borrowings	1,666	1,722	1,522	1,322	
Short term borrowings	946	884	884	884	
Total Borrowings	2,612	2,607	2,407	2,207	
Long Term Liabilities	263	224	224	224	
Def. Tax Liability (net)	3,017	122	128	134	
Sources of funds	14,035	7,570	8,090	8,825	
Gross Block	6,934	7,545	8,345	9,545	
Net Block	4,647	4,750	4,991	5,551	
Capital work in progress	109	77	77	77	
Intangible Assets	418	757	757	757	
Total net fixed assets	5,174	5,584	5,825	6,385	
Non current investments	8,350	1,523	1,523	1,523	
Cash and Equivalents	747	583	1,032	1,253	
Inventories	1,384	1,447	1,144	1,260	
Sundry Debtors	424	219	215	238	
Loans & Advances	70	82	81	84	
Other Current Assets	197	445	428	471	
Current Assets (ex cash)	2,074	2,193	1,867	2,054	
Trade payable	686	599	515	567	
Other Current Liab	1,625	1,713	1,643	1,823	
Total Current Liab	2,310	2,312	2,157	2,390	
Net Curr Assets-ex cash	(236)	(120)	(290)	(337)	
Uses of funds	14,035	7,570	8,090	8,825	
BVPS (INR)	175.5	99.5	114.9	134.9	

Free cash flow		(INR mn)			
Year to March	FY19	FY20	FY21E	FY22E	
Reported Profit	812	(84)	842	1,082	
Add: Depreciation	483	509	559	640	
Interest (Net of Tax)	140	249	149	132	
Others	127	468	50	44	
Less: Changes in WC	82	(26)	(176)	(53)	
Operating cash flow	1,480	1,167	1,777	1,951	
Less: Capex	1,270	1,120	800	1,200	
Free Cash Flow	209	47	977	751	

Peer comparison valuation

Name	Market cap (USD mn)	Core EV/EBITDA (X)		Diluted P/E (X)		EV / EBITDA (X)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Heritage Foods Limited	193	8.9	7.2	17.2	13.3	8.9	7.2
Parag Milk Foods Limited	95	5.4	4.6	12.4	9.0	5.9	5.0
Median	-	7.2	5.9	14.8	11.2	7.4	6.1
AVERAGE	-	7.2	5.9	14.8	11.2	7.4	6.1

Source: Edelweiss research

Cash flow metrics		FY19	FY20	FY21E	FY22E
Year to March					
Operating cash flow	1,480	1,167	1,777	1,951	
Financing cash flow	(1,331)	(1,002)	(800)	(1,200)	
Investing cash flow	(33)	(185)	(528)	(530)	
Net cash Flow	115	(20)	449	221	
Capex	(1,270)	(1,120)	(800)	(1,200)	
Dividend paid	(112)	(112)	(128)	(153)	

Profitability and efficiency ratios

Year to March	FY19	FY20	FY21E	FY22E
ROAE (%)	10.5	(17.5)	16.9	18.7
ROACE (%)	14.2	9.7	17.7	20.0
Inventory Days	27	23	23	19
Adjusted RoCE (%)	19.0	20.2	27.4	29.2
Debtors Days	4	4	3	3
Payable Days	13	11	10	9
Cash Conversion Cycle	19	17	16	13
Current Ratio	1.2	1.2	1.3	1.4
Debt/EBITDA (x)	1.4	2.0	1.3	1.0
Debt/Equity (x)	0.3	0.6	0.5	0.4
Adjusted Debt/Equity	0.3	0.6	0.5	0.4
Interest Coverage Ratio	6.5	3.5	6.1	8.6

Operating ratios

Year to March	FY19	FY20	FY21E	FY22E
Total Asset Turnover	1.7	2.5	3.3	3.4
Fixed Asset Turnover	5.5	5.7	5.3	5.4
Equity Turnover	3.1	4.3	5.3	5.0

Valuation parameters

Year to March	FY19	FY20	FY21E	FY22E
Adj. Diluted EPS (INR)	17.9	10.4	18.1	23.3
Y-o-Y growth (%)	48.1	(41.6)	74.0	28.5
Adjusted Cash EPS (INR)	28.3	21.4	30.2	37.1
Diluted P/E (x)	17.4	29.8	17.2	13.3
P/B (x)	1.8	3.1	2.7	2.3
EV / Sales (x)	0.3	0.5	0.5	0.5
EV / EBITDA (x)	8.7	12.8	8.9	7.2
Dividend Yield (%)	0.6	0.8	1.0	1.3

Additional Data

Directors Data

Mrs. N Bhuvaneswari	Vice Chairperson and Managing Director	Mrs. N Brahmani	Executive Director
Mr. D. Seetharamaiah	Non Executive Independent Chairperson	Mr. N Sri Vishnu Raju	Non Executive Independent Director
Mr. Rajesh Thakur Ahuja	Non Executive Independent Director	Dr. V Nagaraja Naidu	Non Executive Director

Auditors - Walker Chandiok & Co LLP

**as per last available data*

Holding – Top10

	Perc. Holding		Perc. Holding
Bhuvaneswari nara	22.98	Nirvana holdings pvt	11.09
Lokesh nara	10.2	Megabid finance inve	5.28
Sundaram asset manag	4.47	Sarada v sudha	3.56
Dorlc asia pacific s	2.81	Kotak mahindra asset	2.49
Investor education &	1.58	Uti asset management	1.47

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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No Data Available

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Dairy

Heritage Foods Limited, Parag Milk Foods Limited, Prabhat Dairy Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
30-Jun-20	Parag Milk Foods	COVID hits; future fluid; Result Update	96	Buy
29-May-20	Heritage Foods	The beginning of dawn; Result Update	240	Buy
31-Mar-20	Dairy	Milk steady; value-added falters; Sector Update		

Distribution of Ratings / Market Cap

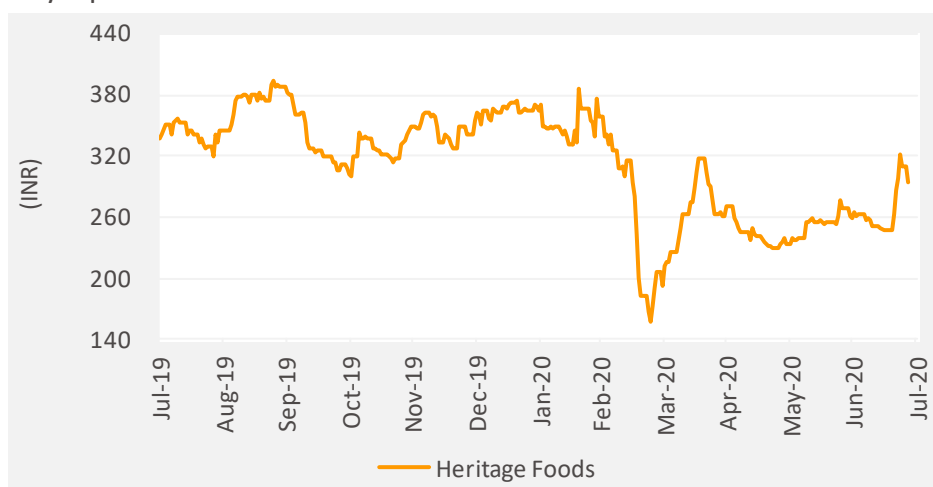
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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