CRISIL
An S&P Global Company

CRISIL IER

Independent Equity Research

Enhancing investment decisions

Hero MotoCorp Ltd

Q2FY17 Results Update

Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Fundamental Grade	Assessment	CRISIL Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (negative 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

Research Analysts

Bhaskar Bukrediwala
bhaskar.bukrediwala@crisil.com

Sayan Das Sharma
sayan.sharma@crisil.com

Client servicing desk

+91 22 3342 3561
clientservicing@crisil.com

Hero MotoCorp Ltd

December 09, 2016

Operating margin at 10-quarter high

Fundamental Grade: 5/5 (Excellent fundamentals) **Valuation Grade:** 3/5 (CMP is aligned)

Industry: Automobiles **Fair Value:** ₹3,404 **CMP:** ₹3,316

Hero MotoCorp Ltd's (Hero's) Q2FY17 revenue was in line, but earnings were above CRISIL Research's estimates. Revenue increased 14% y-o-y to ₹76.7 bn led by volume growth of 16% y-o-y. However, net realisations slipped 1.4% y-o-y. Operating margin continued to expand for the second consecutive quarter to 17.6% (up 147 bps y-o-y), aided by soft input prices and benefits of the LEAP programme. Consequent to robust EBITDA growth, adjusted PAT increased 28% y-o-y to ₹10 bn. Pick-up in rural demand on the back of normal monsoon and healthy urban demand resulted in strong 17% y-o-y growth in domestic two wheeler volumes, led by the economy and scooter segments. The company's market share in the domestic motorcycle segment stood at 35.6% compared with 37.6% in Q2FY16. The demonetisation move is likely to impact two wheeler sales in the short run. However, on the back of sustained recovery in rural demand, Hero is expected to post healthy volume growth given its dominant positioning in the key economy and executive segments, and a wide distribution network. Its ability to maintain market share amidst intensifying competition remains a key monitorable. We maintain our fundamental grade of **5/5**.

Volume to pick-up in H2FY17; ability to sustain market share is a monitorable

Domestic volume rose 17% y-o-y in Q2FY17; the motorcycle segment (84% of total volumes) grew 13% y-o-y. However, this was below the category growth of 25.3%, translating into a market share loss of 500 bps y-o-y (50% vs 55% in Q2FY16). Although scooter volumes increased a healthy 53% y-o-y, driven by new launches in October 2015 (Maestro Edge and Duet), growth moderated sequentially leading to market share slide to 17.7% from 19.1% in Q1FY17. Exports declined 21% y-o-y, which was below our expectations, owing to persistent demand headwinds in major export markets (Nigeria, Congo, Egypt and Latin America). As mentioned, pick-up in rural spending is expected to drive Hero's domestic volumes over the next few quarters. However, exports are likely to remain under pressure owing to slowdown in its key export markets in Africa and Latin America. We maintain our volume growth estimate of 11% CAGR over FY16-18E.

Operating margin at a 10-quarter high, to moderate during H2FY17

Lower commodity prices and cost-control initiatives led to 147 bps y-o-y rise in EBITDA margin to a 10-quarter high of 17.6%. However, as guided by management, rise in commodity prices and higher ad spends during the Diwali period are expected to put pressure on margin in H2FY17. We maintain our FY17 EBITDA margin estimate at 15.8%.

Fair value raised to ₹3,404 per share

We maintain our FY17 and FY18 estimates. Considering the sustained decline in government security (G-sec yields), we revise the base cost of equity by 100 bps. Consequently, we raise the discounted cash flow (DCF)-based fair value to ₹3,404 per share from ₹3,251 per share. At the current market price of ₹3,316 per share, the valuation grade is **3/5**.

KEY FORECAST

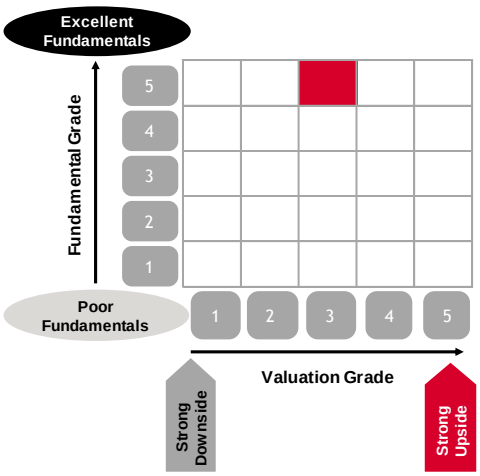
(₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Operating income	253,135	275,327	284,231	316,752	358,724
EBITDA	35,533	34,895	41,956	50,029	56,165
Adj net income	20,743	25,209	30,897	35,640	39,683
Adj EPS (₹)	103.9	126.2	154.7	178.5	198.7
EPS growth (%)	(2.1)	21.5	22.6	15.3	11.3
Dividend yield (%)	2.0	1.8	2.2	3.0	4.1
RoCE (%)	45.9	48.0	50.3	50.3	50.5
RoE (%)	39.0	41.4	42.4	41.3	41.1
PE (x)	31.9	26.3	21.4	18.6	16.7
P/BV (x)	11.8	10.1	8.3	7.2	6.6
EV/EBITDA (x)	17.6	18.2	15.0	12.6	11.2

NM: Not meaningful; CMP: Current market price;

Source: Company, CRISIL Research estimates

Note: *The common independent director on CRISIL's and Hero MotoCorp Ltd's board did not participate in the Equity Grading Committee Meeting, and the grading process, for this report.*

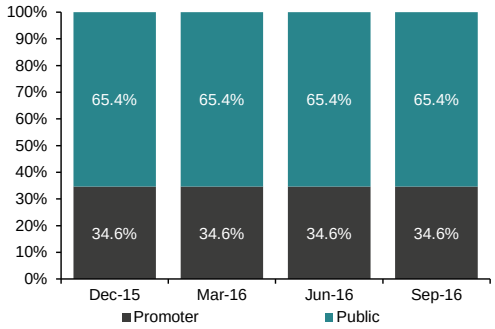
CFV MATRIX



KEY STOCK STATISTICS

NIFTY/SENSEX	8247/26694
NSE/BSE ticker	HEROMOTOCO
Face value (₹ per share)	2
Shares outstanding (mn)	199.7
Market cap (₹ mn)/(US$ mn)	662,214/9,798
Enterprise value (₹ mn)/(US$ mn)	628,779/9,304
52-week range (₹)/(H/L)	3,740/2,377
Beta	1.0
Free float (%)	65.4%
Avg daily volumes (30-days)	523,798
Avg daily value (30-days) (₹ mn)	1,642.1

SHAREHOLDING PATTERN



PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
Hero MotoCorp	-2%	-10%	5%	27%
NIFTY 500	-4%	-7%	3%	9%

For detailed initiating coverage report please visit: www.crisil.com

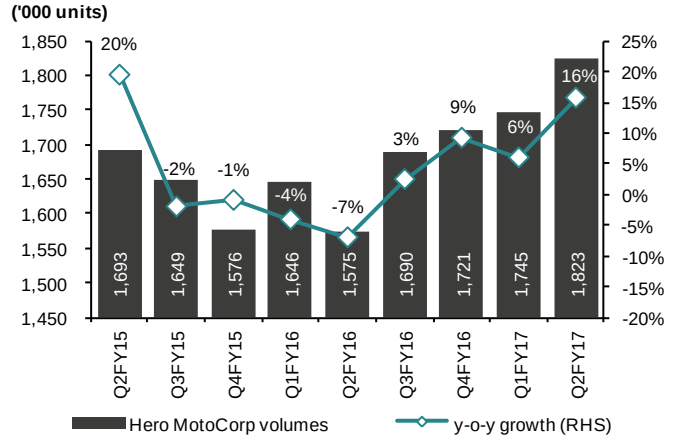
CRISIL Independent Equity Research reports are also available on Bloomberg (CRI <go>) and Thomson Reuters.

Q2FY17 Results Summary

(₹ mn)	Q2FY17	Q1FY17	Q2FY16	q-o-q (%)	y-o-y (%)	H1FY17	H1FY16	y-o-y (%)
Net Sales	**76,695**	**72,896**	**67,158**	**5.2**	**14.2**	**149,591**	**135,209**	**10.6**
Other Operating Income	1,268	1,093	935	15.9	35.6	2,361	1,931	22.2
Operating Income	**77,963**	**73,989**	**68,093**	**5.4**	**14.5**	**151,952**	**137,140**	**10.8**
Consumption of raw materials	51,191	50,337	46,302	1.7	10.6	101,527	94,996	6.9
(Increase)/decrease in stock in trade	642	(683)	360	194.1	78.2	(41)	(229)	82.3
Raw materials cost (% of sales)	*66.5*	*67.1*	*68.5*	*-63bps*	*-204bps*	*66.8*	*69.1*	*-231bps*
Employees cost	3,575	3,362	3,084	6.3	15.9	6,937	6,214	11.6
Other expenses	8,867	8,672	7,391	2.2	20.0	17,539	14,783	18.6
EBITDA	**13,689**	**12,301**	**10,956**	**11.3**	**24.9**	**25,990**	**21,376**	**21.6**
EBITDA margin	**17.6**	**16.6**	**16.1**	**93bps**	**147bps**	**17.1**	**15.6**	**152bps**
Depreciation and amortisation	1,193	1,152	1,091	3.5	9.4	2,345	2,120	10.6
EBIT	**12,496**	**11,148**	**9,865**	**12.1**	**26.7**	**23,645**	**19,256**	**22.8**
EBIT margin	**16.0**	**15.1**	**14.5**	**96bps**	**154bps**	**15.6**	**14.0**	**152bps**
Interest and finance charges (net)	16	15	12	3.3	26.0	31	24	25.0
Other Income	1,524	1,204	1,115	26.6	36.6	2,727	2,159	26.3
PBT	**14,004**	**12,337**	**10,968**	**13.5**	**27.7**	**26,342**	**21,390**	**23.1**
Tax	3,962	3,506	3,107	13.0	27.5	7,468	6,054	23.4
Adj PAT	**10,042**	**8,831**	**7,861**	**13.7**	**27.7**	**18,873**	**15,337**	**23.1**
Adj PAT margin	**12.9**	**11.9**	**11.5**	**95bps**	**134bps**	**12.4**	**11.2**	**124bps**
No of equity shares (mn)	199.7	199.7	199.7	-	-	199.7	199.7	-
Adj EPS (₹)	**50.3**	**44.2**	**39.4**	**13.7**	**27.7**	**94.5**	**76.8**	**23.1**

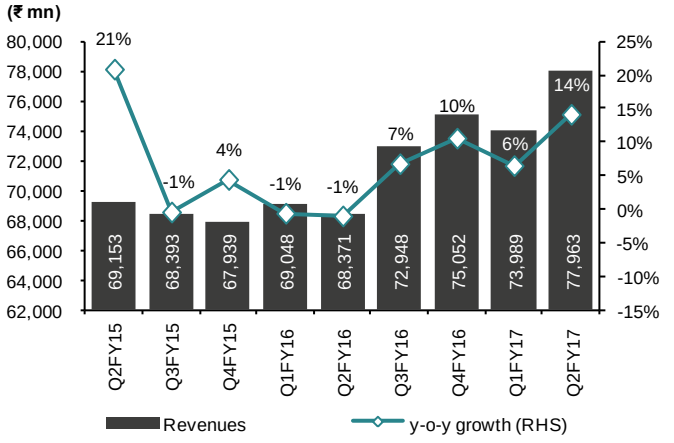
Source: Company, CRISIL Research

Volume grew a healthy 16% y-o-y



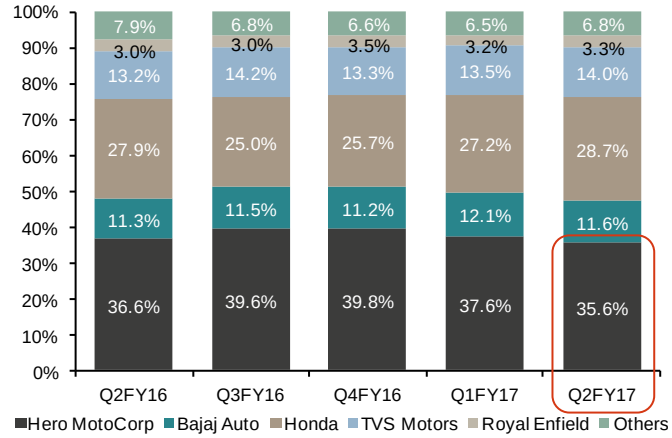
Source: SIAM, CRISIL Research

Revenue increased 14% y-o-y



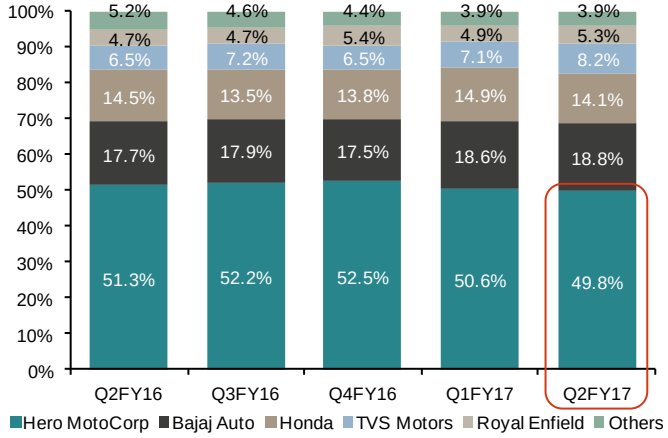
Source: SIAM, CRISIL Research

2W domestic industry market share declined marginally



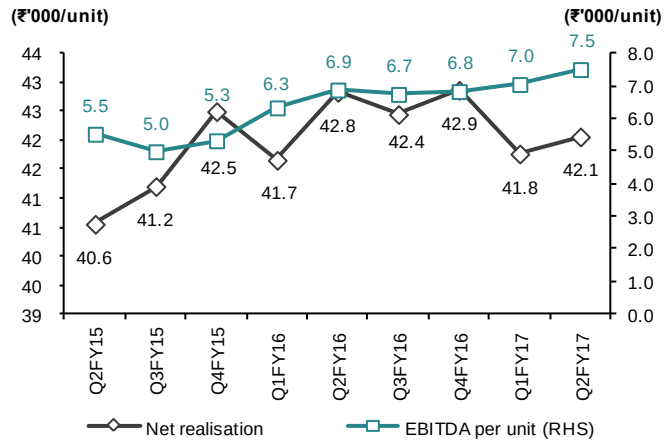
Source: SIAM, CRISIL Research

Motorcycles market share slid for second straight quarter



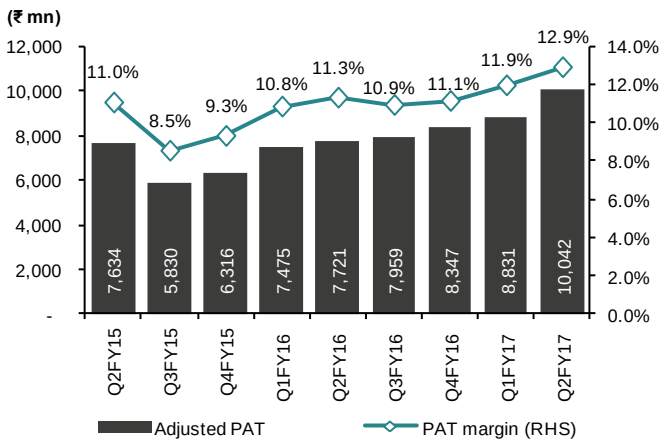
Source: SIAM, CRISIL Research

EBITDA per vehicle increased ~14% y-o-y



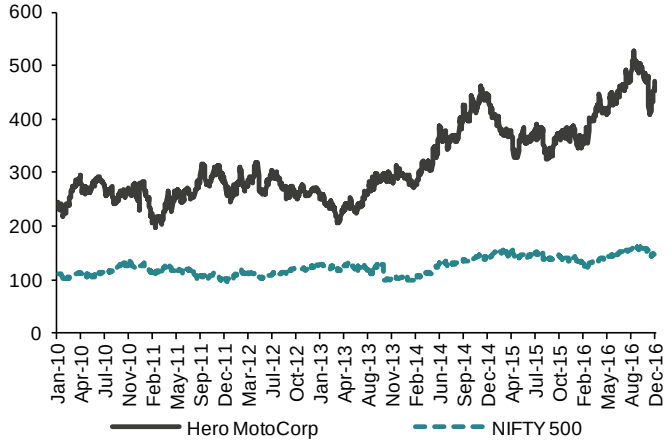
Source: Company, CRISIL Research

Adjusted PAT recorded healthy growth of 27% y-o-y



Source: Company, CRISIL Research

Share price movement



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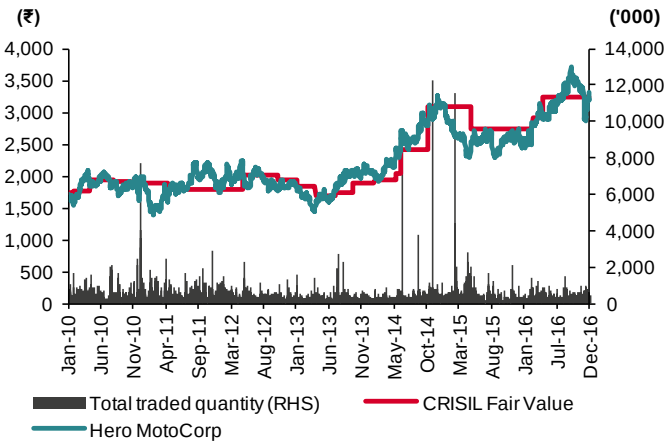
Source: NSE, CRISIL Research

Fair value movement since initiation

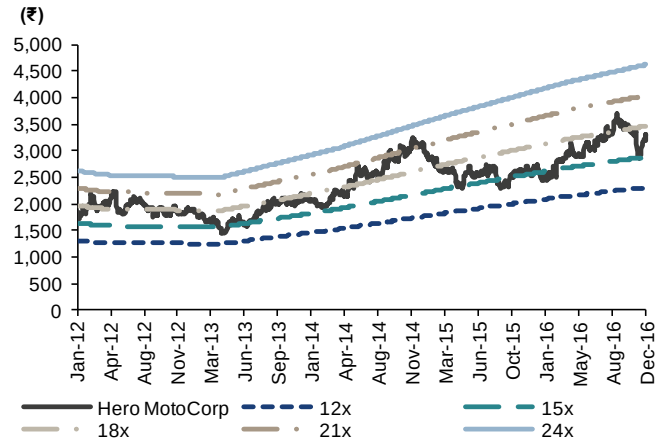


Source: NSE, BSE, CRISIL Research

Valuation Grade: 3/5

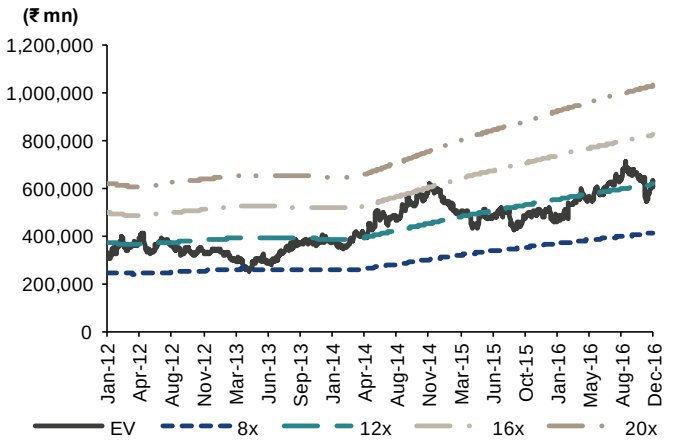
We maintain our FY17 and FY18 earnings estimates. Considering the sustained decline in G-sec yields, we revise the base cost of equity by 100 bps. Consequently, we raise the DCF-based fair value to ₹3,404 per share from ₹3,251 per share. The fair value implies P/E multiples of 19.1x FY17E and 17.1x FY18E EPS. At the current market price the valuation grade is **3/5.**

One-year forward P/E band



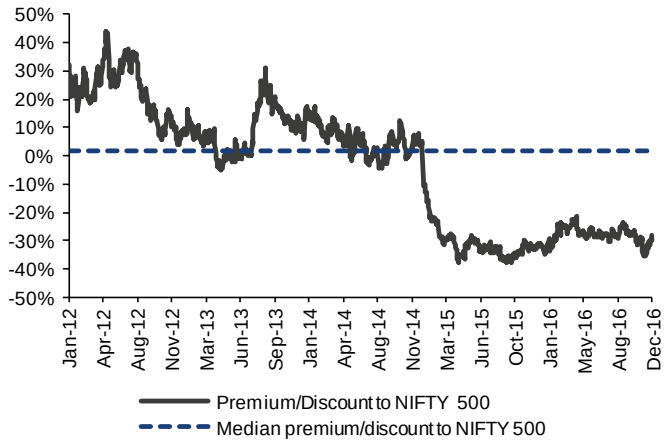
Source: NSE, CRISIL Research

One-year forward EV/EBITDA band



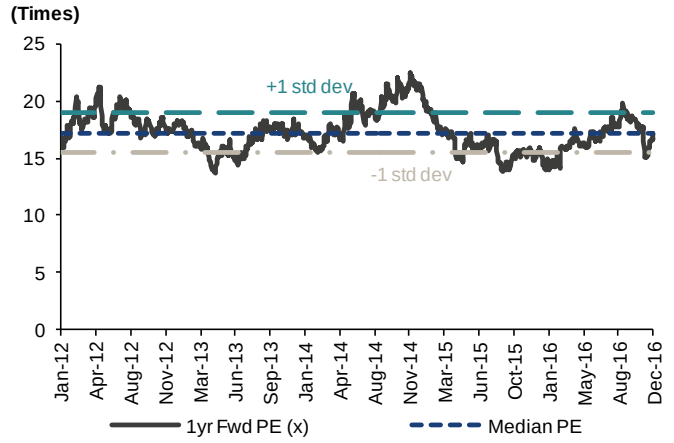
Source: NSE, CRISIL Research

P/E – premium / discount to Nifty 500



Source: NSE, CRISIL Research

P/E movement



Source: NSE, CRISIL Research

CRISIL IER reports released on Hero MotoCorp Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	CMP (on the date of report)
03-Dec-09	Initiating coverage	5/5	₹1,747	3/5	₹1,693
28-Jan-10	Q3FY10 result update	5/5	₹1,775	4/5	₹1,565
21-Apr-10	Q4FY10 result update	5/5	₹1,937	3/5	₹1,852
10- Aug-10	Q1FY11 result update	5/5	₹1,910	3/5	₹1,865
09- Nov-10	Q2FY11 result update	5/5	₹1,893	3/5	₹1,829
25-Feb-11	Q3FY11 result update	5/5	₹1,893	5/5	₹1,505
05-May-11	Q4FY11 result update	5/5	₹1,797	4/5	₹1,598
22-Jul-11	Q1FY12 result update	5/5	₹1,797	3/5	₹1,789
20-Sep-11	Detailed Report	5/5	₹1,797	2/5	₹2,201
25-Oct-11	Q2FY12 result update	5/5	₹1,797	2/5	₹2,071
25-Jan-12	Q3FY12 result update	5/5	₹1,890	3/5	₹1,888
10-May-12	Q4FY12 result update	5/5	₹2,023	3/5	₹1,871
20-Jul-12	Q1FY13 result update	5/5	₹2,023	3/5	₹2,082
25-Oct-12	Q2FY13 result update	5/5	₹1,939	3/5	₹1,838
24-Jan-13	Q3FY13 result update	5/5	₹1,842	3/5	₹1,783
02-May-13	Q4FY13 result update	5/5	₹1,684	3/5	₹1,618
01-Aug-13	Q1FY14 result update	5/5	₹1,733	3/5	₹1,820
24-Oct-13	Detailed Report	5/5	₹1,882	3/5	₹2,085
06-Feb-14	Q3FY14 result update	5/5	₹1,939	3/5	₹1,985
02-Jun-14	Q4FY14 result update	5/5	₹2,033	2/5	₹2,391
08-Aug-14	Q1FY15 result update	5/5	₹2,433	3/5	₹2,592
03-Nov-14	Q2FY15 result update	5/5	₹3,090	3/5	₹3,011
20-Feb-15	Q3FY15 result update	5/5	₹3,090	4/5	₹2,659
18-May-15	Q4FY15 result update	5/5	₹2,729	3/5	₹2,521
01-Sep-15	Q1FY16 result update	5/5	₹2,729	3/5	₹2,384
03-Nov-15	Q2FY16 result update	5/5	₹2,729	3/5	₹2,583
07-Mar-16	Q3FY16 result update	5/5	₹2,910	3/5	₹2,836
29-Apr-16	Detailed report	5/5	₹3,251	4/5	₹2,897
01-Jun-16	Q4FY16 result update	5/5	₹3,251	3/5	₹3,089
29-Aug-16	Q1FY17 result update	5/5	₹3,251	3/5	₹3,412
09-Dec-16	Q2FY17 result update	5/5	₹3,404	3/5	₹3,316

Annexure: Financials

Income statement

(₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Operating income	**253,135**	**275,327**	**284,231**	**316,752**	**358,724**
EBITDA	**35,533**	**34,895**	**41,956**	**50,029**	**56,165**
EBITDA margin	**14.0%**	**12.7%**	**14.8%**	**15.8%**	**15.7%**
Depreciation	11,076	5,405	4,470	5,492	6,263
EBIT	**24,458**	**29,490**	**37,486**	**44,537**	**49,901**
Interest	118	117	119	132	150
Operating PBT	**24,339**	**29,373**	**37,367**	**44,405**	**49,752**
Other income	4,266	5,152	6,157	5,095	5,364
Exceptional inc/(exp)	276	(1,803)	(5)	-	-
PBT	**28,881**	**32,722**	**43,519**	**49,500**	**55,116**
Tax provision	7,862	9,316	12,622	13,860	15,432
Minority interest	-	-	**-**	-	-
PAT (Reported)	**21,019**	**23,406**	**30,897**	**35,640**	**39,683**
Less: Exceptionals	276	(1,803)	-	-	-
Adjusted PAT	**20,743**	**25,209**	**30,897**	**35,640**	**39,683**

Ratios

	FY14	FY15	FY16	FY17E	FY18E
Growth					
Operating income (%)	5.6	8.8	3.2	11.4	13.3
EBITDA (%)	7.9	(1.8)	20.2	19.2	12.3
Adj PAT (%)	(2.1)	21.5	22.6	15.3	11.3
Adj EPS (%)	(2.1)	21.5	22.6	15.3	11.3
Profitability					
EBITDA margin (%)	14.0	12.7	14.8	15.8	15.7
EBIT margin (%)	9.7	10.7	13.2	14.1	13.9
Adj PAT Margin (%)	8.2	9.2	10.9	11.3	11.1
RoE (%)	39.0	41.4	42.4	41.3	41.1
RoCE (%)	45.9	48.0	50.3	50.3	50.5
RoIC (%)	191.8	129.1	103.4	90.7	84.4
Valuations					
Price-earnings (x)	31.9	26.3	21.4	18.6	16.7
Price-book (x)	11.8	10.1	8.3	7.2	6.6
EV/EBITDA (x)	17.6	18.2	15.0	12.6	11.2
EV/Sales (x)	2.5	2.3	2.2	2.0	1.8
Dividend payout ratio (%)	61.8	51.2	46.5	55.6	68.4
Dividend yield (%)	2.0	1.8	2.2	3.0	4.1
B/S ratios					
Inventory days	12	15	13	13	13
Creditors days	49	49	50	49	49
Debtor days	15	17	15	19	19
Working capital days	(29)	(17)	(10)	(6)	(1)
Gross asset turnover (x)	7.6	6.8	5.3	4.7	4.5
Net asset turnover (x)	13.4	11.6	8.4	7.3	7.1
Sales/operating assets (x)	10.5	9.2	7.1	6.3	6.3
Current ratio (x)	1.4	1.5	1.6	1.7	1.7
Debt-equity (x)	0.0	0.0	0.0	0.0	0.0
Net debt/equity (x)	(0.6)	(0.4)	(0.4)	(0.3)	(0.4)
Interest coverage (EBIT/ Interest)	207	252	316	337	333
Interest coverage (EBITDA/Interest)	301	298	353	378	375

Per share

	FY14	FY15	FY16	FY17E	FY18E
Adj EPS (₹)	103.9	126.2	154.7	178.5	198.7
CEPS	159.3	153.3	177.1	206.0	230.1
Book value	281.6	328.4	400.9	463.4	503.1
Dividend (₹)	65.1	60.0	72.0	99.1	135.9
Actual o/s shares (mn)	199.7	199.7	199.7	199.7	199.7

Balance Sheet

(₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Liabilities					
Equity share capital	399	399	399	399	399
Reserves	55,836	65,186	79,664	92,138	100,074
Minorities	-	-	-	**-**	**-**
Net worth	**56,235**	**65,585**	**80,063**	**92,537**	**100,474**
Convertible debt	-	-	-		
Other debt	-	1,000	2,322	2,322	2,322
Total debt	**-**	**1,000**	**2,322**	**2,322**	**2,322**
Deferred tax liability (net)	(1,060)	(735)	2,278	2,278	2,278
Total liabilities	**55,175**	**65,850**	**84,663**	**97,137**	**105,074**
Assets					
Net fixed assets	18,974	28,509	39,070	47,308	53,389
Capital WIP	7,159	5,275	6,730	7,000	5,345
Total fixed assets	**26,133**	**33,784**	**45,800**	**54,308**	**58,734**
Investments	**6,536**	**6,627**	**8,820**	**8,820**	**8,820**
Current assets					
Inventory	6,696	8,614	7,620	8,678	9,828
Sundry debtors	11,406	13,718	12,821	17,356	19,656
Loans and advances	7,121	11,292	12,225	19,005	21,523
Cash & bank balance	687	1,545	747	447	4,111
Marketable securities	35,034	25,171	34,168	34,168	34,168
Total current assets	**60,944**	**60,341**	**67,581**	**79,655**	**89,286**
Total current liabilities	**44,824**	**39,956**	**42,054**	**45,646**	**51,766**
Net current assets	**16,120**	**20,385**	**25,527**	**34,009**	**37,520**
Intangibles/Misc. expenditure	**6,386**	**5,055**	**4,517**	**-**	**-**
Total assets	**55,175**	**65,850**	**84,663**	**97,137**	**105,074**

Cash flow

(₹ mn)	FY14	FY15	FY16	FY17E	FY18E
Pre-tax profit	28,605	34,525	43,524	49,500	55,116
Total tax paid	(10,246)	(8,992)	(9,609)	(13,860)	(15,432)
Depreciation	11,076	5,405	4,470	5,492	6,263
Working capital changes	(734)	(13,270)	3,057	(8,782)	153
Net cash from operations	**28,702**	**17,668**	**41,442**	**32,350**	**46,099**
Cash from investments					
Capital expenditure	(9,712)	(11,725)	(15,948)	(9,483)	(10,689)
Investments and others	(4,871)	9,773	(11,190)	-	-
Net cash from investments	**(14,583)**	**(1,952)**	**(27,138)**	**(9,483)**	**(10,689)**
Cash from financing					
Equity raised/(repaid)	-	-	9	**-**	**-**
Debt raised/(repaid)	(210)	1,000	1,322	-	-
Dividend (incl. tax)	(15,199)	(14,219)	(17,304)	(23,166)	(31,747)
Others (incl extraordinaries)	628	(1,639)	871	0	0
Net cash from financing	**(14,781)**	**(14,858)**	**(15,102)**	**(23,166)**	**(31,747)**
Change in cash position	(662)	858	(798)	(300)	3,663
Closing cash	687	1,545	747	447	4,111

Quarterly financials

(₹ mn)	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Operating Income	**68,371**	**72,948**	**75,122**	**73,989**	**77,963**
Change (q-o-q)	-1.7%	6.7%	3.0%	-1.5%	5.4%
EBIT	**9,744**	**10,260**	**10,604**	**11,148**	**12,496**
Change (q-o-q)	3.1%	5.3%	3.3%	5.1%	12.1%
EBIT margin	**14.3%**	**14.1%**	**14.1%**	**15.1%**	**16.0%**
Reported PAT	7,721	7,959	8,142	8,831	10,042
Adj PAT	**7,721**	**7,959**	**8,142**	**8,831**	**10,042**
Change (q-o-q)	2.9%	3.1%	2.3%	8.5%	13.7%
Adj PAT margin	**11.3%**	**10.9%**	**10.8%**	**11.9%**	**12.9%**
Adj EPS	**38.7**	**39.9**	**40.8**	**44.2**	**50.3**

Source: Company, CRISIL Research

CRISIL Research Team

Senior Director

Nagarajan Narasimhan	CRISIL Research	+91 22 3342 3540	nagarajan.narasimhan@crisil.com

Analytical Contacts

Prasad Koparkar	Senior Director, Industry & Customised Research	+91 22 3342 3137	prasad.koparkar@crisil.com
Binaifer Jehani	Director, Customised Research	+91 22 3342 4091	binaifer.jehani@crisil.com
Manoj Damle	Director, Customised Research	+91 22 3342 3342	manoj.damle@crisil.com
Jiju Vidyadharan	Director, Funds & Fixed Income Research	+91 22 3342 8091	jiju.vidyadharan@crisil.com
Ajay Srinivasan	Director, Industry Research	+91 22 3342 3530	ajay.srinivasan@crisil.com
Rahul Prithiani	Director, Industry Research	+91 22 3342 3574	rahul.prithiani@crisil.com
Bhaskar S. Bukrediwala	Director	+91 22 3342 1983	bhaskar.bukrediwala@crisil.com
Miren Lodha	Director	+91 22 3342 1977	miren.lodha@crisil.com

Business Development

Prosenjit Ghosh	Director, Industry & Customised Research		+91 99206 56299	prosenjit.ghosh@crisil.com
Megha Agrawal	Associate Director		+91 98673 90805	megha.agrawal@crisil.com
Neeta Muliyil	Associate Director		+91 99201 99973	neeta.muliyil@crisil.com
Dharmendra Sharma	Associate Director	(North)	+91 98189 05544	dharmendra.sharma@crisil.com
Ankesh Baghel	Regional Manager	(West)	+91 98191 21510	ankesh.baghel@crisil.com
Sonal Srivastava	Regional Manager	(West)	+91 98204 53187	sonal.srivastava@crisil.com
Sarrthak Sayal	Regional Manager	(North)	+91 95828 06789	sarrthak.sayal@crisil.com
Priyanka Murarka	Regional Manager	(East)	+91 99030 60685	priyanka.murarka@crisil.com
Sanjay Krishnaa	Regional Manager	(Tamil Nadu & AP)	+91 98848 06606	sanjay.krishnaa@crisil.com

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