

JUNE 27, 2019

	26-Jun	% Chg		
		1 Day	1 Mth	3 Mths
<b>Indian Indices</b>				
SENSEX Index	39,592	0.4	0.4	3.6
NIFTY Index	11,848	0.4	0.0	3.2
NSEBANK Index	31,162	1.0	(0.2)	4.3
NIFTY 500 Index	9,683	0.5	(0.4)	1.8
CNXMcap Index	17,644	1.0	(0.3)	(0.9)
BSESMCAP Index	14,175	0.5	(3.6)	(3.5)
<b>World Indices</b>				
Dow Jones	26,537	(0.0)	3.7	3.6
Nasdaq	7,910	0.3	3.6	3.5
FTSE	7,416	(0.1)	1.9	3.1
NIKKEI	21,087	(0.5)	0.4	(0.5)
Hangseng	28,222	0.1	4.3	(0.9)
Shanghai	2,976	(0.2)	3.6	(0.9)

<b>Value traded (Rs cr)</b>	26-Jun	% Chg Day
Cash BSE	2,070	17.0
Cash NSE	30,977	3.9
Derivatives	1,338,979	15.6

<b>Net inflows (Rs cr)</b>	25-Jun	MTD	YTD
FII	2,420	(1,064)	76,983
Mutual Fund	939	5,711	8,213

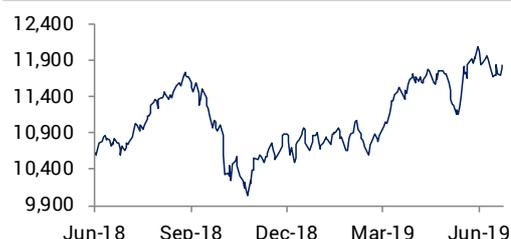
<b>Nifty Gainers &amp; Losers</b>	Price	Chg	Vol
26-Jun	(Rs)	(%)	(mn)
<b>Gainers</b>			
Vedanta	178	4.4	11.1
Power Grid Corp	210	4.0	17.5
JSW Steel	277	3.8	6.9
<b>Losers</b>			
Birtannia Ind	2,733	(2.7)	1.4
Indiabulls Housing	612	(1.5)	15.6
Infosys	739	(1.2)	5.5

<b>Advances / Declines (BSE)</b>					
26-Jun	A	B	T	Total	% total
Advances	286	609	39	934	100
Declines	172	365	37	574	61
Unchanged	2	35	12	49	5

	26-Jun	% Chg		
		1 Day	1 Mth	3 Mths
<b>Commodity</b>				
Crude (US\$/BBL)	66.4	(0.2)	(5.4)	(2.2)
Gold (US\$/OZ)	1,409.1	(1.0)	9.2	7.5
Silver (US\$/OZ)	15.3	(0.6)	4.5	(0.2)

<b>Debt / Forex Market</b>	26-Jun	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	6.9	6.9	7.2	7.3
Re/US\$	69.2	69.3	69.5	68.9

## Nifty



Source: Bloomberg

## News Highlights

- ▶ RBI issued Rupee Interest Rate Derivatives Directions consolidating and simplifying all previous regulations with a view to protect small and retail participants. (Mint)
- ▶ Promoters can take part in liquidation process once their companies are out of the purview of the Insolvency and Bankruptcy Code (IBC), a senior government official told. (BS)
- ▶ The **Emami** Group is in exploratory talks with investors such as **UltraTech** Cement and private equity funds including KKR and Temasek Holdings to sell stakes in the cement business, valuing it at Rs50-55bn, said people aware of the matter. (ET)
- ▶ **HDFC Bank Ltd**, is eyeing an initial public offering (IPO) of its non-bank lending unit, HDB Financial Services that could see the company raise more than \$1 billion, said two people aware of the development. (Mint)
- ▶ The founders of **Mindtree** are likely to sell their stake to **Larsen & Toubro**, as the engineering conglomerate gets ready to take control of the \$1 billion mid-tier IT services provider they co-founded two decades ago, people familiar with the development said. (ET)
- ▶ **JM Financial** and Suraksha Asset Reconstruction Company have acquired about Rs20bn loans extended by **HDFC, HDFC Bank and ICICI Bank** to crisis-hit realty firm **Unitech**, as well as will infuse funds to restart construction on 23 stalled projects, sources said. (Mint)
- ▶ **Reliance Infrastructure** said it has bagged Rs70bn Versova-Bandra Sea Link project contract from Maharashtra State Road Development Corporation (MSRDC) in Mumbai. (Mint)
- ▶ The government clarified there is no proposal to close state-run **BSNL** and **MTNL**, which are facing financial stress due to stiff competition and high employee costs, and added that a comprehensive plan for their revival is under preparation. (BS)
- ▶ **Dewan Housing Finance Corporation Ltd (DHFL)** said it will shortly divest its full stakes in subsidiary firms DHFL Pramerica Asset Managers and DHFL Pramerica Trustees. (Mint)
- ▶ **Mindtree** Chief Executive Officer Rostow Ramanan is likely to resign in the coming weeks with infrastructure major **L&T** becoming a majority shareholder in the mid-sized IT company, according to sources. (ET)
- ▶ In a fresh hit for the lending major **IL&FS**, Hongkong and Shanghai Banking Corporation (HSBC) has issued a notice to the former's arm ITNL Offshore Private Ltd asking it to pay 1 bn Chinese Yuan (\$145 mn). (Mint)
- ▶ **Adani Port & Special Economic Zone (APSEZ)** has raised \$750 million by selling overseas bonds, the proceeds from which would be used to fund expansion and reduce high-cost debt. (ET)

## What's Inside

- ▶ **Company Update:** Chennai Petroleum Corporation Ltd (CPCL)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, BQ = BloombergQuint, ToI = Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol

## Company Update

### Stock Details

Market cap (Rs mn)	:	31368
52-wk Hi/Lo (Rs)	:	345 / 197
Face Value (Rs)	:	10
3M Avg. daily vol (Nos)	:	495,035
Shares o/s (m)	:	149

Source: Bloomberg

### Financial Summary - Standalone

Y/E Mar (Rs mn)	FY19	FY20E	FY21E
Revenue	522,012	519,422	536,001
Growth (%)	18.1	-0.5	3.2
EBITDA	5,692	10,205	18,289
EBITDA margin (%)	1.1	2.0	3.4
PAT	-2,053	1,110	7,130
EPS	-13.8	7.5	47.9
EPS Growth (%)	NM	NM	NM
BV (Rs/share)	232	236	269
Dividend/share (Rs)	-	1.9	11.7
ROE (%)	NM	3.2	19.0
ROCE (%)	2.2	5.8	12.2
P/E (x)	NM	28.2	4.4
EV/EBITDA (x)	16.6	8.2	4.3
P/BV (x)	0.9	0.9	0.8

Source: Company, Kotak Securities - PCG

### Shareholding Pattern (%)

(%)	Mar 19	Dec-18	Sep-18
Promoters	67.3	67.3	67.3
FII	9.0	9.0	9.0
DII	12.9	12.9	12.9
Others	10.8	10.8	10.8

Source: Bloomberg

### Price Performance (%)

(%)	1M	3M	6M
Chennai Pet	(3.3)	(20.1)	(25.0)
Nifty	0.0	3.2	10.4

Source: Bloomberg

### Price chart (Rs)



Source: Bloomberg

# CHENNAI PETROLEUM CORPORATION LTD (CPCL)

PRICE RS.210

TARGET RS.239

ADD

**Weak refining margin, rupee appreciation and potential inventory losses will lead to pressure on earnings.**

- ❑ **Margin under pressure:** Benchmark Singapore refining margin has declined ~30% qoq to US\$ 2.8/bbl (average) and is currently trading around US\$3.34/bbl due to global demand-supply mismatch. Singapore refining margins are under pressure mainly due to fall in Diesel cracks (-1.6% qoq), Jet/SKO cracks (-7.8% qoq), Naphtha cracks (-10.3% qoq), and FO cracks fallen further.
- ❑ We expect CPCL to report lower GRMs due to decline in benchmark refining margins and marginal inventory losses. CPCL is a standalone and simple refiner and hence it has a very high earning sensitivity to GRMs.
- ❑ We do believe quarterly earnings volatility will continue for CPCL with wide swings in crude and product prices.
- ❑ **Modest inventory losses:** Brent crude oil price has corrected by 3.5% from US\$ 68.4/bbl (as on 31st March'19) to ~US\$66.0/bbl (as on 26th June'19). We expect refiners to report marginal inventory losses which will put further pressure on the earnings.
- ❑ **Rupee appreciation against US\$ negative for refiners:** In Q1FY20, INR has appreciated by ~1.3% qoq (average) to INR69.6/US\$ resulting in pressure on the margins. We would like to highlight that petroleum products whether sold domestically or exported are priced in US dollar terms and hence rupee appreciation impacts negatively.
- ❑ However, CPCL's GRM should see some gains accruing from the recently commissioned Rs. 31 bn residue up-gradation project and the Rs. 3 bn revamp of the diesel hydro desulphurization unit, we opine.

### Valuation & outlook

We expect regional GRM to remain stable in H2FY20 as concerns of trade-war are fading. Though overall margins are under pressure but it will be partly set-off as CPCL's GRM should see some gains accruing from the residue up-gradation project and the diesel hydro desulphurization unit.

We have tweaked our earnings and now expect CPCL to report an EPS of Rs.7.5 in FY20E (earlier ~Rs.8) and Rs. 47.9 in FY21E (earlier ~Rs.51.3) supported by better distillate yields and higher crude throughput. We believe that the stock is reasonably valued at 4.3x EV/EBITDA on FY21E. We continue to recommend ADD on the stock with a revised price target of Rs.239/share (earlier Rs.257/share). We have valued CPCL based on PE multiple of 5x FY21, which is at a significant discount to its peers considering its size, NCI, and lower refining margin profile. Also, CPCL is a standalone and simple refiner and has a very high earning sensitivity to GRM. Hence, earnings disappointment is high on account of weak GRMs.

**Sumit Pokharna**

sumit.pokharna@kotak.com

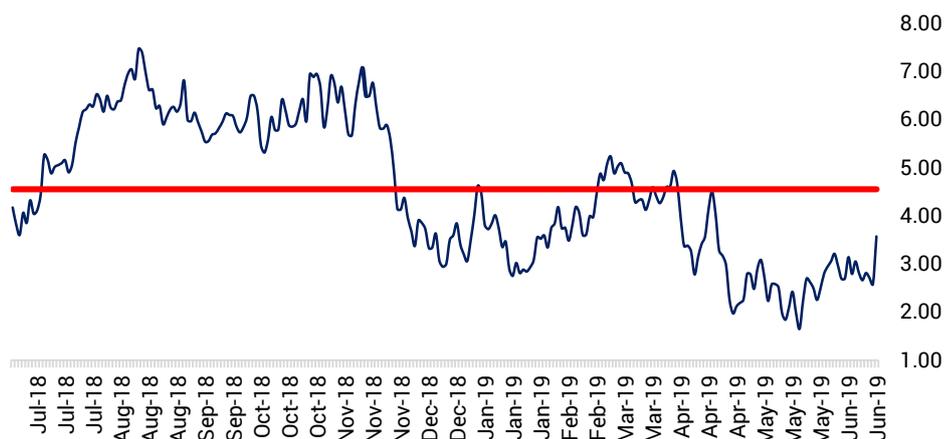
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## Key Developments

### Refining margin is under pressure

- Benchmark Singapore refining margin has declined ~30% qoq to US\$ 2.8/bbl (average) and is currently trading around US\$3.34/bbl due to global demand-supply mismatch. During monsoon, demand for transportation fuel in some parts of the region goes down.
- We expect CPCL to report lower GRMs due to decline in benchmark refining margins and marginal inventory losses.

### Singapore Refining margins (US\$/bbl) trading significantly lower than averages



Source: Bloomberg

- Brent crude oil price has corrected by 3.5% from US\$ 68.4/bbl (as on 31st March'19) to US\$ 66.0/bbl (as on 26th June'19). We expect refiners to report marginal inventory losses which will put further pressure on the earnings.

### Average product spread with Dubai crude (\$/bbls)

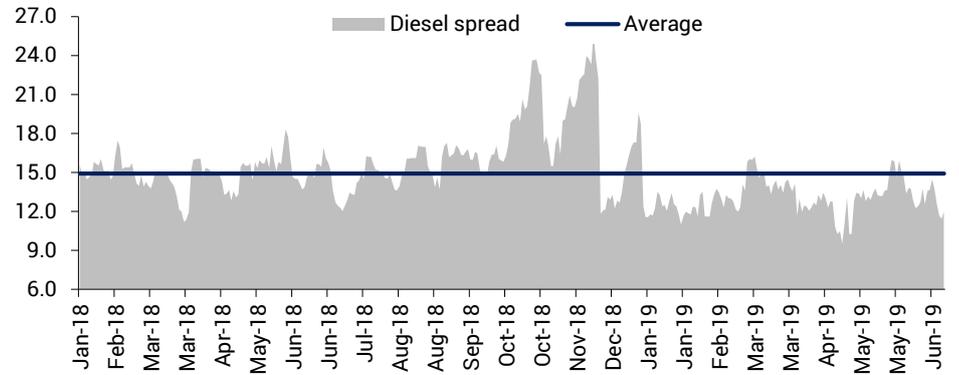
	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20*	QoQ Chg	QoQ chg (%)
INR/USD	67.1	70.1	72.1	70.5	69.6	(0.9)	(1.3)
Diesel	15.1	15.3	18.1	13.1	12.9	(0.2)	(1.6)
Jet/SKO	12.9	12.3	16.2	11.5	10.6	(0.9)	(7.8)
Petrol	8.8	8.3	4.1	(0.1)	4.6	4.7	
Naphtha	15.8	17.2	10.7	7.7	6.9	(0.8)	(10.3)
FO	(15.4)	(12.9)	(6.8)	(8.7)	(13.1)		
Dubai Crude price	71.7	73.9	67.4	63.2	67.4	4.1	6.5
Brent crude oil	75.0	75.8	68.6	63.8	68.5	4.7	7.3
Singapore GRM	5.4	5.9	5.4	4.0	2.8	(1.2)	(30.1)
Arab light-heavy	3.1	2.3	2.2	1.4	1.7	0.3	23.5
SPOT LNG (\$/mmbtu)	8.5	10.4	9.5	6.4	4.6	(1.8)	(27.4)
FO (\$/bbls)	56.3	60.9	60.8	54.5	55.0	0.5	0.9
Naphtha	87.6	91.1	78.1	71.0	70.6	(0.3)	(0.5)
Crude Closing price	79.4	82.7	53.8	68.4	66.0	(2.4)	(3.5)
INR Closing price			69.8	69.2	69.4	0.2	0.3

Source: Bloomberg. Note: \*Q1FY20 is till 25th June'19.

### Diesel cracks corrected for third consecutive quarter

Diesel spread has declined by ~2% qoq to US\$12.9/bbl in Q1FY20 (till date). The same has declined for third consecutive quarter and has corrected from US\$18.1/bbl in Q3FY19 (average) to US\$ 12.9/bbl (average) in Q1FY20.

#### Gasoil spread (US\$/bbl) under pressure

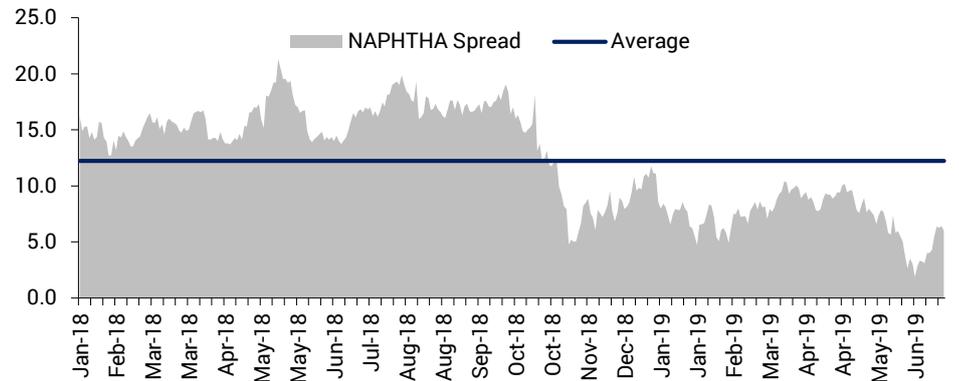


Source: Bloomberg

### Naphtha Spreads (US\$/bbl) corrected

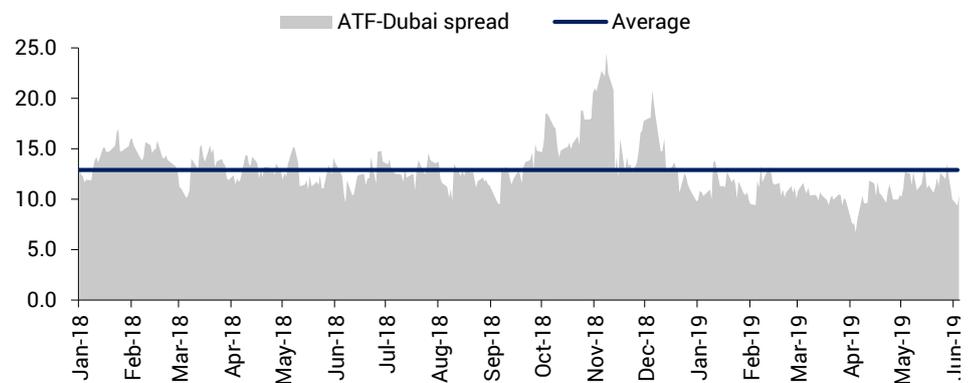
Naphtha spread has declined by ~10% qoq to US\$6.9/bbl in Q1FY20 (till date). The same has declined for fourth consecutive quarter and has corrected from US\$17.2/bbl in Q2FY19 (average) to US\$ 6.9/bbl (average) in Q1FY20.

#### Naphtha Spreads (US\$/bbl)



Source: Bloomberg

### ATF spread (US\$/bbl) fallen



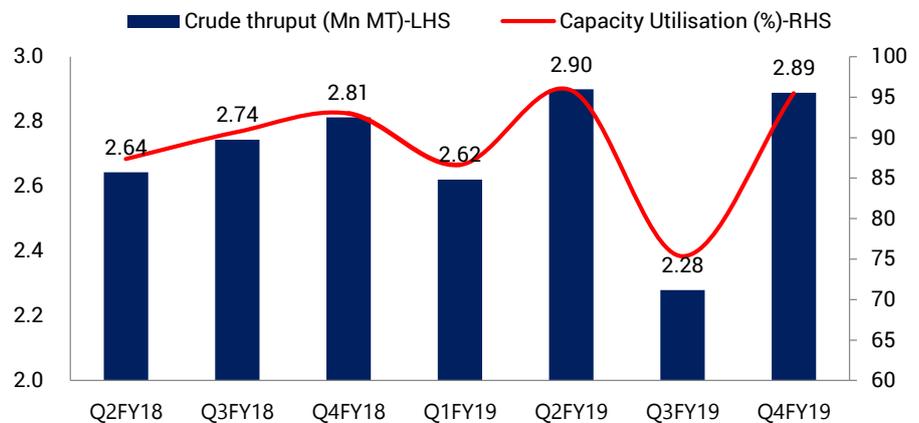
Source: Bloomberg

Jet/SKO spread has declined by ~8% qoq to US\$10.6/bbl in Q1FY20 (till date). The same has declined for third consecutive quarter and has corrected from US\$16.2/bbl in Q2FY19 (average) to US\$ 10.6/bbl (average) in Q1FY20.

## CPCL's crude throughput and capacity utilization

We expect improvement in crude throughput and capacity utilization in Q1FY20.

### CPCL's crude throughput and capacity utilization



Source: Company

- **Expansion Plans:** IOC (promoter of CPCL) has indicated that Iran (Naftiran Intertrade, the Swiss subsidiary of National Iranian Oil Company, holds a 15.4% stake in CPCL) is looking to invest in CPCL for expansion and up-gradation of its refinery. CPCL plans to shut down the 1 million tonne per year (i.e ~20,000 bbl/d) Nagapattinam refinery and replace it with a new 9 million tonne per annum unit (i.e ~1,80,000 bbl/d) over the next 5-6 years with an investment of around Rs.356.98 bn (US\$ 5.1 bn). CPCL plans to achieve financial closure of the refinery expansion in 2019. It also plans to build a petrochemicals plant of about 0.475 mmtpa. We have not modeled the same as we await a financial closure.
- With the completion of the new crude oil pipeline project, the BS-VI Project is likely to be completed in FY20.
- CPCL is also planning to set up a 9 mmtpa refinery at Cauvery Basin, Nagapattinam at an estimated cost of Rs.274.5 bn (plus or minus 30%). In principle approval has been obtained for this project. The proposed new project will play an important role in meeting future energy needs of Tamilnadu State. Preparation of detailed feasibility report is underway.

### Key Risk and Concerns:

- Wide fluctuations in crude, forex and product prices can impact the margins.
- If global fuel supply exceeds demand then margins can be under pressure and vice-versa.
- Any delay in executing the project can significantly impact the valuations.
- Large outlay for new projects exposes CPCL to significant project implementation risks.

## Maintain ADD

We expect regional GRM to remain stable in H2FY20 as concerns of trade-war are fading. Though overall margins are under pressure but it will be partly set-off as CPCL's GRM should see some gains accruing from the residue up-gradation project and the diesel hydro desulphurization unit.

We have tweaked our earnings and now expect CPCL to report an EPS of Rs.7.5 in FY20E (earlier ~Rs.8) and Rs. 47.9 in FY21E (earlier ~Rs.51.3) supported by better distillate yields and higher crude throughput. We believe that the stock is reasonably valued at 4.3x EV/EBIDTA on FY21E. We continue to recommend ADD on the stock with a revised price target of Rs.239/share (earlier Rs.257/share). We have valued CPCL based on PE multiple of 5x FY21, which is at a significant discount to its peers considering its size, NCI, and lower refining margin profile. Also, CPCL is a standalone, simple refiner and has a very high earning sensitivity to GRM. Hence, earnings disappointment is high on account of weak GRMs.

## Valuation

Particulars	Unit	FY21E
EPS (FY21E)	Rs./share	47.9
Target – P/E	x	5
<b>Target price (Rs/share)</b>	<b>Rs. Mn</b>	<b>239</b>
CMP	Rs. Mn	210
<b>Potential upside/(downside)</b>	<b>%</b>	<b>14</b>

Source: Kotak Securities - Private Client Research

## Company Background

Incorporated in 1965, Chennai Petroleum Corporation Limited (CPCL), formerly known as Madras Refineries Limited (MRL) was formed as a joint venture between the Government of India (74%, GoI), AMOCO (13%) and National Iranian Oil Company (13% equity stake) In 1985, AMOCO sold its equity stake to GOI and the shareholding pattern of GOI and NIOC changed to 84.62% and 15.38% respectively. Later in 1992, GOI disinvested 16.92% of the paid up capital in favor of Unit Trust of India, Mutual Funds, Insurance Companies and Banks, thereby reducing its holding to 67.7 %. CPCL came out with a public issue in 1994 wherein GoI and NIOC divested part of their equity stakes and CPCL's shares were listed on stock exchanges. As a part of the restructuring steps taken up by the Government of India, Indian Oil Corporation Ltd. acquired equity from GoI in FY 2001. In July 2003, NIOC transferred their entire shareholding to Naftiran Inter trade Company Limited, an affiliate, in line with the formation agreement, as part of their organizational restructuring.

## Financials: Consolidated

### Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
<b>Revenues</b>	<b>441,892</b>	<b>522,012</b>	<b>519,422</b>	<b>536,001</b>
% change YoY	8.8	18.1	-0.5	3.2
<b>EBITDA</b>	<b>20,916</b>	<b>5,692</b>	<b>10,205</b>	<b>18,289</b>
% change YoY	7.2	(72.8)	79.3	79.2
Other Income	(208.6)	519	525	590
Depreciation	3,402	4,525	4,556	4,732
<b>EBIT</b>	<b>17,739</b>	<b>1,157</b>	<b>5,649</b>	<b>13,557</b>
% change YoY	8.7	(93.5)	388.1	140.0
Net interest	3,209	4,198	4,446	3,741
<b>Profit before tax</b>	<b>14,530</b>	<b>(3,040)</b>	<b>1,203</b>	<b>9,816</b>
% change YoY	7.0	(120.9)	NM	NM
Tax	5,453	(847)	253	2,847
as % of PBT	37.5	27.9	21.0	29.0
<b>Profit after tax</b>	<b>9,077</b>	<b>(2,193)</b>	<b>950</b>	<b>6,970</b>
Minority interest	0	0	0	0
Share of profit of associates	195	140	160	160
<b>Net income</b>	<b>9,272</b>	<b>(2,053)</b>	<b>1,110</b>	<b>7,130</b>
% change YoY	(11.8)	NM	NM	NM
Shares outstanding (m)	149	149	149	149
<b>EPS (reported) (Rs)</b>	<b>62.3</b>	<b>(13.8)</b>	<b>7.5</b>	<b>47.9</b>
CEPS (Rs)	85.1	16.6	38.0	79.7
DPS (Rs)	18.5	0.0	1.9	11.7

Source: Company, Kotak Securities – Private Client Research

### Cash flow Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBIT	17,739	1,157	5,649	13,557
Depreciation	3,402	4,525	4,556	4,732
Change in working capital	13,684	(5,271)	16,069	4,759
Operating cash flow	34,825	412	26,274	23,048
Interest	(3,209)	(4,198)	(4,446)	(3,741)
Tax	(5,453)	847	(253)	(2,847)
<b>Cash flow from operations</b>	<b>26,163</b>	<b>(2,938)</b>	<b>21,575</b>	<b>16,460</b>
Capex	(10,182)	(13,061)	(10,056)	(10,232)
(Inc)/dec in investments	(125)	(65)	-	-
<b>Cash flow from investments</b>	<b>(10,307)</b>	<b>(13,126)</b>	<b>(10,056)</b>	<b>(10,232)</b>
others	(202)	(3,211)	-	-
Increase/(decrease) in debt	(11,088)	19,286	(11,231)	(4,130)
Proceeds from share premium	-	-	-	-
Dividends	(4,649)	-	(335)	(2,097)
<b>Cash flow from financing</b>	<b>(15,939)</b>	<b>16,075</b>	<b>(11,567)</b>	<b>(6,227)</b>
Opening cash	169	87	98	50
<b>Closing cash</b>	<b>87</b>	<b>98</b>	<b>50</b>	<b>51</b>

Source: Company, Kotak Securities – Private Client Research

### Balance sheet (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Cash and cash equivalents	87	98	50	51
Accounts receivable	15,695	16,237	15,654	16,153
Inventories	47,591	48,470	45,538	46,991
Loans and Adv & Others	4,928	5,824	5,821	5,832
Current assets	68,301	70,629	67,063	69,028
Misc exp.	0	0	0	0
LT investments	1,526	1,591	1,591	1,591
Net fixed assets	73,233	81,768	87,268	92,768
<b>Total assets</b>	<b>143,059</b>	<b>153,987</b>	<b>155,922</b>	<b>163,387</b>
Payables	44,437	37,375	41,841	47,806
Others	4,208	14,710	22,808	23,505
Current liabilities	48,645	52,085	64,649	71,311
Provisions	8,434	2,941	2,928	2,989
LT debt	43,889	63,175	51,944	47,813
Min. int and def tax liabilities	2,123	1,221	1,221	1,221
Equity	1,489	1,489	1,489	1,489
Reserves	38,480	33,076	33,691	38,563
<b>Total liabilities</b>	<b>143,059</b>	<b>153,987</b>	<b>155,922</b>	<b>163,387</b>
BVPS (Rs)	268	232	236	269

Source: Company, Kotak Securities – Private Client Research

### Ratio Analysis

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBITDA margin (%)	4.7	1.1	2.0	3.4
EBIT margin (%)	4.0	0.2	1.1	2.5
Net profit margin (%)	2.1	(0.4)	0.2	1.3
Receivables (days)	10.8	11.2	11.0	11.0
Inventory (days)	39.3	33.9	32.0	32.0
Sales/gross assets(x)	5.1	5.8	5.7	6.1
Interest coverage (x)	5.5	0.3	1.3	3.6
Debt/equity ratio(x)	1.1	1.8	1.5	1.2
ROE (%)	24.9	NM	3.2	19.0
ROCE (%)	14.2	2.2	5.8	12.2
EV/ Sales	0.2	0.2	0.2	0.1
EV/EBITDA	3.6	16.6	8.2	4.3
Price to earnings (P/E)	3.4	NM	28.2	4.4
Price to book value (P/B)	0.8	0.9	0.9	0.8

Source: Company, Kotak Securities – Private Client Research

## RATING SCALE

### Definitions of ratings

<b>BUY</b>	–	We expect the stock to deliver more than 15% returns over the next 12 months
<b>ADD</b>	–	We expect the stock to deliver 5% - 15% returns over the next 12 months
<b>REDUCE</b>	–	We expect the stock to deliver -5% - +5% returns over the next 12 months
<b>SELL</b>	–	We expect the stock to deliver < -5% returns over the next 12 months
<b>NR</b>	–	<b>Not Rated.</b> Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
<b>SUBSCRIBE</b>	–	We advise investor to subscribe to the IPO.
<b>RS</b>	–	<b>Rating Suspended.</b> Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
<b>NA</b>	–	<b>Not Available or Not Applicable.</b> The information is not available for display or is not applicable
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<b>NOTE</b>	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

### FUNDAMENTAL RESEARCH TEAM

<b>Rusmik Oza</b> Head of Research rusmik.oza@kotak.com +91 22 6218 6441	<b>Arun Agarwal</b> Auto & Auto Ancillary arun.agarwal@kotak.com +91 22 6218 6443	<b>Amit Agarwal</b> Transportation, Paints, FMCG agarwal.amit@kotak.com +91 22 6218 6439	<b>Krishna Nain</b> M&A, Corporate actions krishna.nain@kotak.com +91 22 6218 7907	<b>K. Kathirvelu</b> Support Executive k.kathirvelu@kotak.com +91 22 6218 6427
<b>Sanjeev Zarbade</b> Cap. Goods & Cons. Durables sanjeev.zarbade@kotak.com +91 22 6218 6424	<b>Ruchir Khare</b> Cap. Goods & Cons. Durables ruchir.khare@kotak.com +91 22 6218 6431	<b>Jatin Damania</b> Metals & Mining, Midcap jatin.damania@kotak.com +91 22 6218 6440	<b>Deval Shah</b> Research Associate deval.shah@kotak.com +91 22 6218 6425	
<b>Teena Virmani</b> Construction, Cement, Buildg Mat teena.virmani@kotak.com +91 22 6218 6432	<b>Sumit Pokharna</b> Oil and Gas, Information Tech sumit.pokharna@kotak.com +91 22 6218 6438	<b>Pankaj Kumar</b> Midcap pankajr.kumar@kotak.com +91 22 6218 6434		

### TECHNICAL RESEARCH TEAM

<b>Shrikant Chouhan</b> shrikant.chouhan@kotak.com +91 22 6218 5408	<b>Amol Athawale</b> amol.athawale@kotak.com +91 20 6620 3350	<b>Faisal Shaikh, FRM, CFTe</b> Research Associate faisalf.shaikh@kotak.com +91 22 62185499	<b>Siddhesh Jain</b> Research Associate siddhesh.jain@kotak.com +91 22 62185498
---	---	--	--

### DERIVATIVES RESEARCH TEAM

<b>Sahaj Agrawal</b> sahaj.agrawal@kotak.com +91 79 6607 2231	<b>Malay Gandhi</b> malay.gandhi@kotak.com +91 22 6218 6420	<b>Prashanth Lalu</b> prashanth.lalu@kotak.com +91 22 6218 5497	<b>Prasenjit Biswas, CMT, CFTe</b> prasenjit.biswas@kotak.com +91 33 6625 9810
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