

Cravatex

Cravatex Ltd. (Cravatex) is a market leader in providing fitness equipment distribution under its brand *Proline Fitness* and represents the 100-year old Italian brand, *FILA*, in India. Cravatex has recently acquired sub-license to distribute the products of *FILA* in the United Kingdom (UK) and Ireland. The company has also been forming strategic partnerships with various health club chains in India such as Talwalkars and Gold Gym in the fitness equipment segment. Cravatex is trading at an attractive 9.8x PE and 0.5x EV/Sales on FY2014E. We recommend Buy on Cravatex with a target price of ₹800, based on target PE of 12x and implied EV/Sales of 0.6x for FY2014E

Investment rationale

Strategic partnership and organic growth to drive 45% growth

Owing to robust organic growth and strategic partnerships the net revenue for the fitness equipment segment is expected to grow at 45% CAGR over FY2011-14E. Cravatex is a market leader in fitness equipment distribution and operates through a wide network of 51 retail stores across India. The company has recently entered into strategic partnership with reputed health club chains in India such as Talwalkars and Gold Gym to provide them with high-quality equipment and customer service.

Sportswear segment to grow at 67% CAGR

On the back of acquisition of subsidiary, M/s BB (UK) Ltd, Cravatex aims to acquire sub-license for certain distribution channels for *FILA* in the UK and Ireland. The subsidiary will design, develop and supply *FILA* apparel to other markets in Europe. The acquisition is expected to deliver potential annual revenue of around ₹10mn for the next two years. Overall revenue from the sportswear segment is therefore expected to grow at CAGR of 67% over FY2011-14E.

Strong parentage of *FILA*

FILA is a 100-year old Italian sportswear brand with a strong parentage in sports apparel, sports accessories and sports footwear industry. The brand plans to set up 60-70 stores across India by 2014. *FILA* has plans to be present in almost all large retail formats such as *Shoppers Stop*, *Westside* and *Lifestyle*. *Kim Clijsters*, US open singles champion is the brand ambassador for *FILA*.

Outlook and valuation

Cravatex' net revenue is expected to grow at a 58% CAGR over FY2011-14E. EBITDA for the company is expected to grow from ₹6.9cr in FY2011 to ₹21cr in FY2014E, at a 45% CAGR. Net profit of the company is expected to grow from ₹6.4cr in FY2011 to ₹17.2cr in FY2014E. At the CMP of ₹655, the stock is trading at PE of 9.8x and EV/Sales of 0.5x of FY2014E. **We recommend Buy on Cravatex with a target price of ₹800, offering an upside of 22% from current levels.**

Key financials

Cravatex	Net sales (₹ cr)	OPM (%)	PAT (₹ cr)	EPS (₹)	ROIC (%)	P/E (x)	P/BV (x)	EV/EBITDA (x)	EV/ Sales (x)
FY2011	93	7.4	6	25	15	26.5	7.1	27.1	2.0
FY2012E	230	5.7	9	36	21	18.1	5.3	14.7	0.8
FY2013E	301	4.3	11	42	18	15.5	4.0	14.9	0.6
FY2014E	361	5.8	17	67	24	9.8	2.9	9.1	0.5

Source: Company, Angel Research

BUY

CMP	₹655
Target Price	₹800
Investment Period	12 Months

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Investment arguments

Strategic partnership and organic growth to drive 45% growth

Cravatex is a market leader in fitness equipment distribution through its brand *Proline Fitness*. The company distributes products of Johnson Health Tech, the third largest fitness company in the world. Cravatex operates through a wide network of 51 retail stores across India.

The company has recently entered into strategic partnership with reputed health club chains in India such as Talwalkars and Gold Gym to provide them with high-quality equipment and customer service. Talwalkars' expectation of around 30% growth in its business provides growth visibility for Cravatex.

Owing to robust organic growth and strategic partnerships the net revenue for the fitness equipment segment is expected to grow at 45% CAGR over FY2011-14E.

Healthy lifestyle and underpenetration provide growth visibility

The base for people using fitness equipment or enrolling for fitness programs is expanding rapidly, with an increase in the standard of living of people and increased awareness about fitness.

In 2010, ~39% of India's total population of 1.2bn was in the 20-44 years age group. According to Planning Commission of India, the country's population is expected to increase to 1.3bn by 2020. Thus, the company will also have a significant base of potential consumers – even if a modest 1% of the country's population aged 20-44 years is concerned about fitness.

The Indian fitness industry is highly underpenetrated compared to developed countries, with only 0.4% population compared to 16% in the US possessing membership in fitness clubs in 2008 (as per The IHRSA Asia Pacific Market Report 2008). This provides a potential opportunity to the company.

Increased urban disposable income

According to Mckinsey Global Institute's recent research study, India's urban population is expected to rise from 340mn in 2008 to 590 mn in 2030, urbanization rate of 40% (lower than seen in most Asian countries due to strict definition of Indian Census). The average household disposable income in urban areas is expected to grow at CAGR of 6.4% from ~₹60,000 in 2008 to ~₹239,000 in 2030 with an overall growth rate of 6.1% to ~₹136,000 considering the GDP growth rate of 7.4%. Thus, with such a rise in disposable income it provides strong growth visibility for the company's fitness segment.

Sportswear segment to grow at 67% CAGR

Cravatex has acquired 100% of M/s BB (UK) Ltd., which is its wholly owned subsidiary with effect from February 2011. Through this subsidiary, Cravatex aims to acquire sub-license for certain distribution channels for *FILA* in the UK and Ireland. The subsidiary will design, develop and supply *FILA* apparel to other markets in Europe. The acquisition is expected to deliver potential annual revenue of around £10mn for the next two years. Overall revenue from the sportswear segment is therefore expected to grow at CAGR of 67% over FY2011-14E.

Strong parentage of *FILA*

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Sports events to provide growth opportunities

The Indian sportswear industry is at a nascent stage with increasing organized retail space. Increasing number of sports events and activities such as CWG and IPL are also providing scope and growth opportunities for players in the industry. Thus, on the back of mounting popularity of sports with increasing number of events the sportswear industry is expected to grow at a CAGR 15% over 2011-14 as per the company's estimation.

Financials

Key assumptions

Revenue from the sportswear segment is expected to grow at a CAGR of 67% over FY2011-14E, owing to acquisition of the sub-license for distribution through specified channels in the UK and Ireland. It is also expected that the retail-led approach of *FILA* along with government's reform to allow up to 51% FDI in the retail sector will together enhance the company's earnings.

In case of the fitness equipment segment, revenue is expected to grow at a CAGR of 45% over FY2011-14E on the back of expansion plans of health club chains such as Talwalkars and Gold Gym, with whom the company has signed strategic partnerships. Also, Cravatex plans to expand its existing network of retail stores, which will provide it greater visibility among retail consumers.

Exhibit 1: Key assumptions

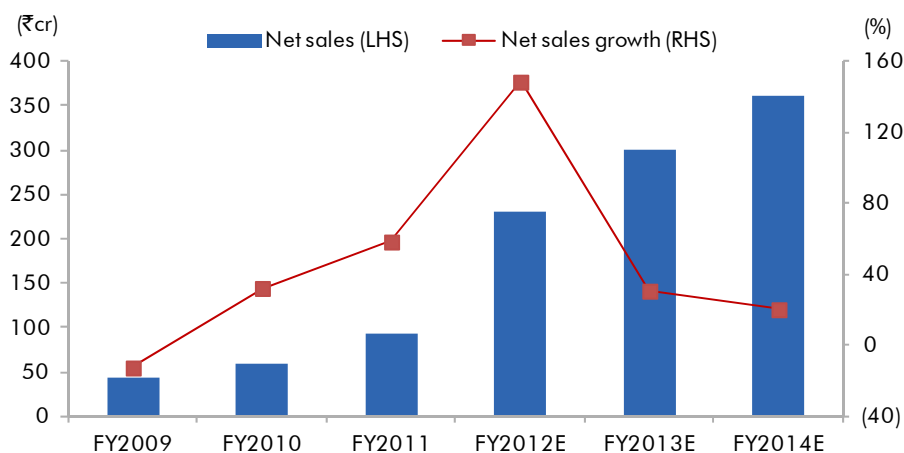
Particulars	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Total revenue growth (%)	32.2	58.4	148.5	30.7	20.2
Sportswear segment					
Volume growth (%)	66.1	49.0	125.0	5.0	5.0
Change in price/unit (%)	49.5	33.4	22.2	33.4	14.3
Revenue growth (%)	148.2	98.8	175.0	40.0	20.0
Fitness equipment segment					
Volume growth (%)	(10.2)	12.8	90.0	10.0	14.0
Change in price/unit (%)	5.1	7.9	10.5	7.3	7.9
Revenue growth (%)	(5.6)	21.7	110.0	18.0	23.0

Source: Angel Research

Net sales to grow at 58% CAGR over FY2011-14E

We expect the company's net sales to register a CAGR of 58% over FY2011-14E, increasing from ₹93cr in FY2011 to ₹361cr in FY2014E.

Exhibit 2: Net sales and net sales growth

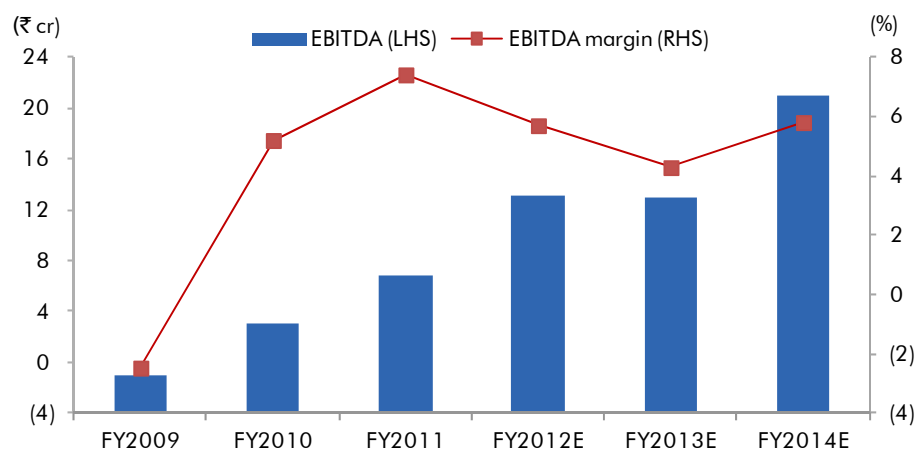


Source: Company, Angel Research

EBITDA to grow at a CAGR 45% over FY2011-14E

On the back of robust top-line growth of 58%, the company's EBITDA is expected to grow at a CAGR of 45% over FY2011-14E, from ₹6.9cr in FY2011 to ₹21cr in FY2014E.

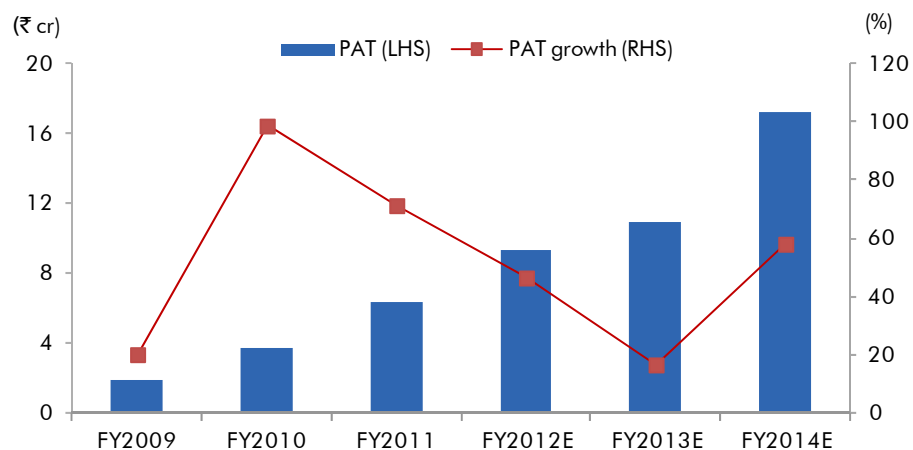
Exhibit 3: EBITDA and EBITDA margin



Source: Company, Angel Research

Net profit of the company is expected to grow at a CAGR of 39% over FY2011-14E, from ₹6.4cr in FY2011 to ₹17.2cr in FY2014E.

Exhibit 4: PAT and PAT growth



Source: Company, Angel Research

Risks

High cost of equipment

India does not have quality equipment manufacturers due to which majority of the equipment are been imported (largely from USA). The duty structure on imported equipment is around 23%. Thus, considering the original cost of fitness equipment, imports duty inflates their cost, which further leads to higher fixed cost for consumers both individuals and institutions.

Euro slowdown

Subsidiary in UK which, Cravatex has recently acquired is expected to deliver potential annual revenue of around £10mn for coming two years. This revenue potential may be adversely impacted due to recent slowdown in Euro zone.

Currency Impact

Cravatex imports most of its equipment from outside country. Rupee depreciation will make the imports expensive and increase the cost of acquiring the equipment. High procurement cost will thereby impact the margins of the company.

Lack of government focus

Unlike most developed countries, the fitness equipment and sportswear sectors in India lack industry status. Consequently, the government's focus to enhance awareness regarding fitness and sports-related products is quite low.

Inflation to impact growth

Rising inflation has caused the RBI to continue interest rate hikes and, thereby, sacrifice growth to stabilize inflation. Higher inflation, rising interest rates and a weak economic environment are expected to hold up consumers' disposable income and, thereby, impact growth.

Fitness equipment industry

The fitness equipment industry is witnessing significant growth as Indians are increasingly becoming conscious about their health and fitness and since only a fraction of urban India practices regular workout sessions. The industry is presently estimated to reach ₹63.3bn by 2012 and grow by 25% for at least next five years as quoted by *Stag International*. The end-user segment includes individuals using fitness equipment at home and institutions such as health clubs and corporate houses.

The Indian fitness industry is highly underpenetrated as compared to developed and several developing countries in the world. For instance, 16% of the population in the US possesses fitness club membership compared to mere 0.4% (considering the top seven cities) in India.

In 2010, ~39% of India's total population of 1.2bn was in the 20-44 years age group. According to Planning Commission of India, the country's population is expected to increase to 1.3bn by 2020. Thus, the company will also have a significant base of potential consumers – even if a modest 1% of the country's population aged 20-44 years is concerned about fitness.

The fitness industry in India continues to grow at a rapid pace on the back of expansion of health club chains such as Talwalkars and Gold's Gym and entry of foreign fitness chains/clubs in the country. Penetration of these brands is creating awareness about healthy lifestyles among people. The key trends identified include health chains entering the equipment retail market, introduction of innovative products and emergence of new distribution channels.

Foreign brands are known for their quality and durability in the Indian market. Therefore, a large share of fitness equipment is imported from the US and Europe. Various government policies such as FDI and franchise route of market entry in India have a significant impact on the development of the fitness equipment industry in India.

Key challenges identified in the industry include:

- Lack of R&D facilities in the country
- Lack of consumer confidence in Indian equipment
- Lack of good trainers
- Lack of space in residential complexes

Sportswear industry

The sportswear industry in India includes sports apparel, sports footwear and accessories. The market for premium sports apparel and footwear industry in India is currently worth ₹2,500cr as specified by the management. On the back of mounting popularity of sports, higher disposable income and changing lifestyle and consumer preferences, the sports apparel and footwear industry is expected to grow at 15% CAGR over FY2011-14 as per the company's estimations.

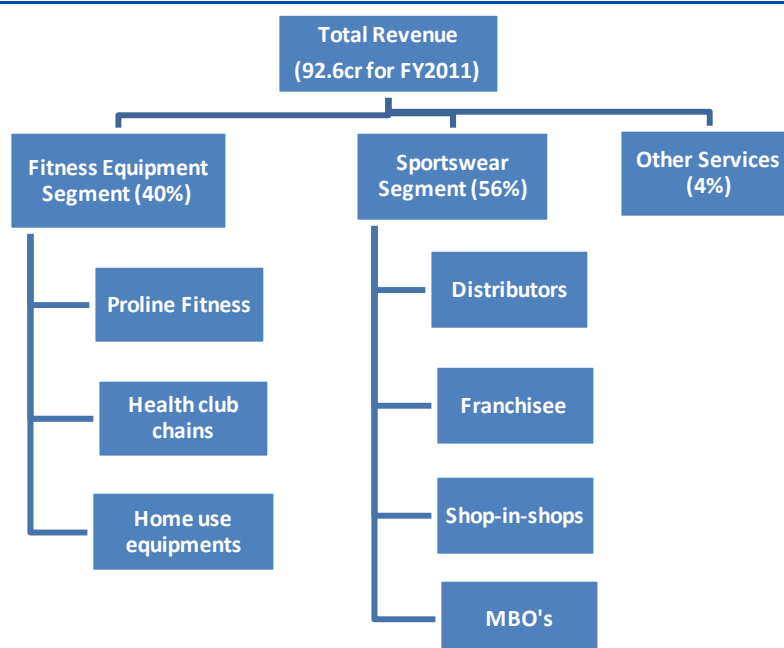
Increasing number of sports events and activities such as CWG and IPL are providing scope and growth opportunities for players in the industry. The Indian sportswear industry is at a nascent stage with increasing organized retail space. Moreover, the trend of sportswear brand endorsements by prominent celebrities is helping in boosting awareness among people. However, the industry has to cope with price-conscious customers, extensive competition and limited channels for distribution. Key challenges identified in the sportswear industry include poor state of sports infrastructure in the country, imposition of excise duty and competition from unorganized players. Further, competition from organized, international players such as *Nike*, *Adidas*, *FILA* and *Reebok* continues to grab the industry share of players in the Indian sportswear industry.

Company background

Cravatex mainly operates in two segments a) distribution of fitness equipment and b) distribution of sports footwear and apparel of the brand *FILA*. Contribution from the sportswear segment to the company's revenue has increased from 24% of the total revenue in FY2007 to 56% in FY2011, while contribution of the fitness segment has reduced from 49% in FY2007 to 40% in FY2011.

Cravatex has recently issued bonus shares in the ratio of 1:1 by capitalizing the subsequent amount from the General Reserve account of the company.

Exhibit 5: Revenue streams



Source: Company, Angel Research

Distribution of fitness equipment

Cravatex is a market leader in fitness equipment distribution through its brand *Proline Fitness*. The company distributes products of several international brands like Johnson Health Tech (the third largest fitness company in the world), Horizon, Vision, Body Solid and Magnum. Cravatex is the only ISO certified public listed company dealing with fitness equipments.

In context to fitness at home, *Proline Fitness* has created the retail network of around 51 stores with a complete range of home-use fitness equipment. The company is also concentrating retail expansion by opening more stores and maintaining a competitive product mix.

The company has been continuously forming strategic partnerships with various health club chains such as Talwalkars and Gold Gym and is providing them with high-quality equipment and customer service. Talwalkars, which has a presence in nearly 50 cities including metros, mini metros and tier II and tier III cities with over 100 health clubs on a consolidated basis, provides promising growth visibility to the company.

Distribution of sports footwear and apparel

In the sports apparel and footwear industry, Cravatex represents the 100-year old Italian brand *FILA*. In India, *FILA* has entered by opening four retail stores this year and plans a more retail-led approach in the coming years. The company is present in over 1,135 footwear stores, 105 apparel stores and 200 shop-in-shops stores in large retail formats. *FILA* aims to have a market share of 12-15% in next 2-3 years, with a yoy growth rate of 25-30% as quoted by the company's management.

Sports footwear: On the global front, Cravatex has acquired 100% of M/s BB (UK) Ltd., which is its wholly owned subsidiary with effect from February 2011. Through its subsidiary, Cravatex aims to acquire sub-license for certain distribution channels for *FILA* in the UK and Ireland. The subsidiary will design, develop and supply *FILA* apparel to other markets in Europe. The acquisition is expected to deliver revenue of around £10mn in the next two years.

Founded in Italy in 1926, *FILA* is one of the most famous fashion sports shoes in the world. *Kim Clijsters*, US open singles champion is the brand ambassador for *FILA*.

Sports apparel: *FILA* entered India in 2009 and is now focusing on increasing its presence by expanding its product portfolio and retail stores. The brand has launched its sports apparel range and plans to set up 60-70 stores across India by 2014.

Cravatex management quotes that the sports apparel industry in India is growing at a healthy rate of 15-18% per year. In large retail formats, as per availability of space, the brand is present in shop-in-shops stores and expects to be present in all large retail formats such as *Shoppers Stop*, *Westside* and *Lifestyle*. Starting with metros and then mini metros and smaller towns, the company is also looking forward to penetrate tier II-III cities. The company may opt for a franchise depending on its location and store size.

Profit and loss statement (Standalone)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Gross sales	44	58	93	230	301	361
Less: Excise duty	-	-	-	-	-	-
Net Sales	44	58	93	230	301	361
Other operating income	-	-	-	-	-	-
Total operating income	44	58	93	230	301	361
% chg	(12.6)	32.2	58.4	148.5	30.7	20.2
Net Raw Materials	28	33	51	148	194	227
(% of Net Sales)	62.2	56.8	54.9	64.5	64.4	62.9
Other Mfg costs	1	1	3	6	8	10
% chg	48.9	(25.4)	159.0	148.7	30.7	20.2
Personnel	4	5	9	18	29	34
% chg	0.5	19.3	84.5	109.1	55.2	20.2
Other	12	16	23	44	57	69
% chg	2.2	31.9	42.9	86.1	30.7	20.2
Total Expenditure	45	55	86	217	288	340
EBITDA	(1)	3	7	13	13	21
% chg	(138.1)	(378.9)	125.7	91.1	(1.7)	62.8
(% of Net Sales)	(2.5)	5.2	7.4	5.7	4.3	5.8
Depreciation & Amortization	1	1	1	1	1	1
EBIT	(2)	2	6	12	12	20
% chg	(202.1)	(218.4)	160.2	100.9	(1.8)	67.4
(% of Net Sales)	(4.4)	4.0	6.5	5.3	3.9	5.5
Interest & other charges	1	1	2	3	2	3
Other Income	6	6	5	4	6	8
(% of Net Sales)	13.2	9.5	5.2	1.7	2.1	2.1
Extraordinary Expense/(Inc.)	(0)	(0)	-	-	-	-
PBT (reported)	3	7	9	13	16	25
Tax	1	3	3	4	5	7
(% of PBT)	31.2	47.5	31.4	30.0	30.0	30.0
PAT (reported)	2	4	6	9	11	17
PAT after MI (reported)	2	4	6	9	11	17
ADJ. PAT	2	4	6	9	11	17
% chg	20.3	98.7	71.4	46.6	16.7	58.1
(% of Net Sales)	4.2	6.4	6.9	4.1	3.6	4.8
Basic EPS (₹)	7	14	25	36	42	67
Fully Diluted EPS (₹)	7	14	25	36	42	67
% chg	20.3	98.7	71.4	46.6	16.7	58.1
Dividend	0	1	1	1	1	1
Retained Earning	1	3	6	8	10	16

Balance sheet (Standalone)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012E	FY2013E	FY2014E
SOURCES OF FUNDS						
Equity Share Capital	1	1	1	1	1	1
Preference Capital	-	-	-	-	-	-
Reserves & Surplus	14	17	22	31	41	57
Shareholders' Funds	15	18	24	32	42	58
Minority Interest	-	-	-	-	-	-
Total Loans	11	13	18	25	25	25
Deferred Tax Liability	3.4	3.4	3.4	3.4	3.4	3.4
Total Liabilities	29	35	45	60	70	86
APPLICATION OF FUNDS						
Gross Block	20	20	21	24	26	28
Less: Acc. Depreciation	9	8	9	10	11	12
Net Block	11	11	12	13	15	16
Capital Work-in-Progress	1	1	-	-	-	-
Lease adjustment	-	-	-	-	-	-
Goodwill	0	0	-	-	-	-
Investments	2	2	0	0	0	0
Current Assets	27	41	60	108	137	167
Cash	3	2	1	1	2	3
Loans & Advances	11	12	13	23	25	31
Inventory	7	12	21	39	50	61
Debtors	7	16	25	46	60	72
Current liabilities	13	21	27	62	82	97
Net Current Assets	15	20	32	47	55	70
Misc. Exp. not written off	-	-	-	-	-	-
Deferred Tax Asset	0	0	0	0	0	0
Total Assets	29	35	45	60	70	86

Cash flow statement (Standalone)

Y/E March (₹ cr)	FY2009	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Profit Before Tax	3	7	9	13	16	25
Depreciation	1	1	1	1	1	1
Other Income	(6)	(6)	(5)	(4)	(6)	(8)
Change in WC	2	(6)	(13)	(14)	(7)	(14)
Direct taxes paid	(1)	(3)	(3)	(4)	(5)	(7)
Others	6	5	5	-	-	-
Cash Flow from Operations	5	(2)	(6)	(8)	(2)	(3)
(Inc.)/ Dec. in Fixed Assets	0	1	(2)	(2)	(2)	(3)
(Inc.)/Dec. In Investments	(2)	0	2	0	0	0
Other Income	6	6	5	4	6	8
Others	(6)	(7)	(4)	-	-	-
Cash Flow from Investing	(2)	(1)	1	2	4	5
Issue of Equity/Preference	0	0	0	0	0	0
Inc./ (Dec.) in Debt	(1)	3	4	7	0	0
Dividend Paid (Incl. Tax)	(0)	(1)	(1)	(1)	(1)	(1)
Others	0	0	0	-	-	-
Cash Flow from Financing	(2)	2	4	6	(1)	(1)
Inc./ (Dec.) In Cash	1	(1)	(1)	0	1	1
Opening Cash balance	2	3	2	1	1	2
Closing cash balance	3	2	1	1	2	3

Key ratios

Y/E March	FY2009	FY2010	FY2011	FY2012E	FY2013E	FY2014E
Valuation Ratio (x)						
P/E (on FDEPS)	90.4	45.5	26.5	18.1	15.5	9.8
P/CEPS	61.9	38.0	23.4	16.3	14.2	9.2
P/BV	11.3	9.4	7.1	5.3	4.0	2.9
Dividend yield (%)	0.3	0.3	0.4	0.6	0.6	0.6
EV/Net sales	4.0	3.1	2.0	0.8	0.6	0.5
EV/EBITDA	(160.4)	58.7	27.1	14.7	14.9	9.1
EV / Total Assets	6.0	5.1	4.2	3.2	2.7	2.2
Per Share Data (₹)						
EPS (Basic)	7	14	25	36	42	67
EPS (fully diluted)	7	14	25	36	42	67
Cash EPS	11	17	28	40	46	71
DPS	2	2	3	3	3	3
Book Value	58	69	92	124	162	225
DuPont Analysis						
EBIT margin	(4.4)	4.0	6.5	5.3	3.9	5.5
Tax retention ratio	0.7	0.5	0.7	0.7	0.7	0.7
Asset turnover (x)	2.3	2.2	2.3	3.9	4.4	4.3
ROIC (Post-tax)	(6.9)	4.7	10.2	14.3	12.2	16.7
Cost of Debt (Post Tax)	7.9	3.3	6.0	7.7	7.0	7.7
Leverage (x)	0.4	0.5	0.7	0.7	0.5	0.4
Operating ROE	(12.7)	5.4	13.2	19.2	15.1	20.1
Returns (%)						
ROCE (Pre-tax)	(6.7)	6.6	13.4	20.1	16.9	23.0
Angel ROIC (Pre-tax)	(10.0)	8.9	14.9	20.5	17.5	23.9
ROE	12.5	20.7	26.9	29.2	26.0	29.6
Turnover ratios (x)						
Asset TO (Gross Block)	2.2	3.0	4.3	9.8	11.6	12.7
Inventory / Net sales (days)	61	59	63	61	61	62
Receivables (days)	67	70	81	72	72	72
Payables (days)	99	110	103	104	104	104
WC cycle (ex-cash) (days)	108	95	99	97	64	68
Solvency ratios (x)						
Net debt to Equity	0.4	0.5	0.7	0.7	0.5	0.4
Net debt to EBITDA	(5.4)	3.1	2.5	1.8	1.7	1.0
Int. Coverage (EBIT/ Int.)	(1.6)	2.7	3.9	4.4	4.8	7.3

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Disclosure of Interest Statement

Cravatex

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):

Buy (> 15%)

Reduce (-5% to 15%)

Accumulate (5% to 15%)

Sell (< -15%)

Neutral (-5 to 5%)