

## Ujjivan Financial Services

### IPO Note

**Ujjivan Financial Services (Ujjivan) is the third largest micro finance company on AUM basis and one of the largest in terms of geographical reach with 470 branches across 24 states in India. It is one of the 10 NBFCs which were granted an in-principle approval for setting up a small finance bank.**

**Transition to small finance bank to be smooth; will enable scalability:** The proposed small finance bank (SFB) will have access to low cost funds, ie below the current 11.8% rate via deposits. However, there will be initial expenses while transitioning to be a SFB as new processes will have to be implemented along with maintenance of CRR and SLR. Meeting the 75% Priority Sector Lending (PSL) target will however not be a challenge for Ujjivan as its entire portfolio qualifies for PSL; hence, the migration from being an NBFC to a SFB should be smooth. With leverage of only 5.6x, we believe there is enough scalability without further dilutions.

**Huge scope in the micro finance business as reflected in its strong AUM CAGR:** Ujjivan reported a CAGR of 59% in its AUM over FY2013-9MFY2016 to ₹4,589cr. There is a huge untapped opportunity in this segment as micro finance is targeted to the lower income segment which often lacks access to formal financing sources. With a loan portfolio of ~₹43,300cr the micro finance industry is expected to report 30% CAGR over the next 3-4 years and Ujjivan with its pan-India presence will be able to encash on the opportunity.

**Geographically diversified AUM with historically low NPAs:** Ujjivan is present across 24 states and has successfully diversified its AUM with no single state contributing more than 20% to its AUM, thereby mitigating concentration risk. Karnataka, West Bengal, Maharashtra and Tamil Nadu together account for 56% of its AUM; this makes a key differentiating point for Ujjivan as other micro finance institutions are largely focused on the southern states of India. Though the company largely extends loans in a joint lending system, it also offers individual loans which accounted for ~10% of the AUM. We expect the company's overall individual loans portfolio to see strong growth going ahead.

**Improving Cost/Income ratio:** The company has been able to reduce its costs over the past few years, thereby leading its Cost/Income ratio to come down to ~52% in 9MFY2016 from 60% in FY2015. However, as the company migrates to becoming a SFB, the cost structure might spike up again. Nevertheless, we believe new avenues of lending should help in maintaining the ratio in the long run.

**Outlook Valuation:** At the upper end of the offer price band (₹210), the issue is priced at 1.8x its diluted BV of ₹118 (2.1x pre-dilution). The company has decent ROE and ROA of 19.9% and 3.6%, respectively. Although the return ratios might get a bit compressed post the company's conversion to a SFB, but we expect the same to scale up subsequently. We believe the issue is attractively priced looking at the growth options the company offers in the long run. **We recommend a SUBSCRIBE on the issue.**

### Key Financials

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	9MFY2016
NII	87.3	140.4	208.0	327.9	407.6
% chg	(15.9)	60.8	48.1	57.6	24.3
Net profit	0.1	32.9	58.4	75.8	122.3
% chg			77.7	29.7	61.4
NIM (%)	11.26	13.76	13.57	11.62	12.31
Book Value (₹)	42.0	48.5	56.8	85.5	99.7
P/ABV (x)	5.0	4.3	3.7	2.5	2.1
RoA (%)	0	2.9	3.4	2.5	3.6
RoE (%)	0.1	11.8	16.9	13.7	19.9

Source: Company, Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

## SUBSCRIBE

Issue Open: April 28, 2016  
 Issue Close: May 02, 2016

### Issue Details

Face Value: ₹10  
 Present Eq. Paid up Capital: ₹86.1crs  
 Fresh Issue\*\*: ₹358crs (1.7cr Shares)  
 Offer for sale: ₹525crs (2.5cr Shares)  
 Post Eq. Paid up Capital: ₹103crs  
 Market Lot: 70 Shares  
 Fresh Issue (amount): ₹358crs

Price Band: ₹207-210

Post-issue implied mkt. cap ₹2,136\*-  
 2,167cr\*\*

Note:\*at Lower price band and \*\*Upper price band

### Book Building

QIBs	50%
Non-Institutional	15%
Retail	35%

### Post Shareholding Pattern(%)

Promoters	0.0%
Foreign Holding	77.1%
Others	22.9%

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## Company background

Ujjivan is one of the fastest growing micro finance companies in India. Incorporated in 2005 and headquartered in Bengaluru, Ujjivan operates across 24 states through 470 branches. Ujjivan has emerged as the third largest micro finance company in the country over the last few years and we believe its ability to spread across the country will drive its next leg of growth. The company has also received in-principle approval from the RBI to set up a small finance bank and expects to start operations from April 1, 2017 as a new SFB.

### Exhibit 1: Regulatory aspects pertaining to Small Finance Bank (SFB)

Key Regulations	Company's Plan of Action
50% of a SFB's loan portfolio should constitute of loans not exceeding ₹25 lakhs.	With micro finance institutions' average ticket size of ₹9,364 and that of vehicle finance and MSEs at ₹3.8lakhs and ₹2.1 lakhs respectively, the proposed SFB will meet the guidelines.
As per FDI rules, foreign stake holders share holding in a SFB is capped at a maximum of 49%.	The proposed IPO will reduce the foreign investors holding from 93% to 35%.
SFBs need to operate 25% of their branches in unbanked rural areas.	Existing branches of the company can be converted to SFB branches.
CRR & SLR to be maintained as per RBI norms.	
SFBs need to have 75% of their loans under the priority sector.	Will be complied to as per the guidelines of the RBI.
Maximum exposure to single entity and group to be capped at 10% & 15% of net worth respectively.	
SFBs are not permitted to set up any subsidiary.	
Minimum CAR of 15% of RWA, with Tier of 7.5%.	With the proposed IPO, capital not to be a concern factor.

Source: Company, Angel Research

### Key Management Personnel:

- Mr K.R. Ramamoorthy is the Non-executive Chairman and Independent Director of the company. He holds a bachelors degree in arts from Delhi University and a bachelor's degree in Law from Madras University. He is also a fellow member of the Institute of Company Secretaries of India. He is the former chairman and managing director of Corporation Bank and former chairman & CEO of ING Vysya Bank. He has served as an advisor to CRISIL and as consultant to The World Bank.
- Mr Smit Ghosh is the MD & CEO. He founded Ujjivan Financials in 2005. Mr. Ghosh has an experience of 30 years as a banker and has also served in South Asia and the Middle East. He started his career with Citibank in 1975 and later worked with Standard Chartered Bank, HDFC Bank and Bank Muscat. He holds a Master of Business Administration degree from the Wharton School of Business at the University of Pennsylvania. He was the past President of Microfinance Institutions Network and the chairman of Association of Karnataka Microfinance Institutions Network and the chairman of Association of Karnataka Microfinance Institutions (AKMI). He has been the driving force behind the growth of the company.
- Ms Sudha Suresh is the CFO of the company. She is a Chartered Accountant with a corporate career spanning over 18 years. She is also a qualified Cost Accountant. At Ujjivan, she is responsible for areas of strategic business planning and budgetary controls, treasury management, accounts and taxation, and management of board and regulatory compliance.

## Issue details

The company is raising ₹358cr through fresh issue of equity shares in the price band of ₹207-210. The fresh issue will constitute 19.8% of the pre-issue and 16.5% post-issuance paid-up equity share capital of the company assuming the issue is subscribed at the upper end of the price band. Along with the fresh issue of equity shares, there is also an Offer for Sale (OFS) of 2.5cr equity shares from the existing shareholders.

### Exhibit 2: Offer Details

Offer Details	No. of equity shares ( In cr)	Amount (in crs.)
Fresh Issue	1.7	358
Offer for Sale	2.5	525
<b>Total Offering</b>	<b>4.2</b>	<b>883</b>

Source: Company, Angel Research

The top 10 shareholders of the company are as follows:

### Exhibit 3: Top10 Shareholders – Pre Issue

Name of the Shareholder	Shareholding %
CDC Group Plc	10.8
Alena Private Ltd	10.7
IFC	10.1
New Quest Asia Investments Ltd	8.1
Elevar Equity Mauritius	6.3
Sarva Capital LLC	5.8
Women's World Banking Capital Partners	5.3
Bajaj Holdings & Investment Ltd	5.1
Sequoia Capital Investments III	4.2
India Financial Inclusion Fund	3.5
<b>Total</b>	<b>69.8</b>

Source: Company, Angel Research

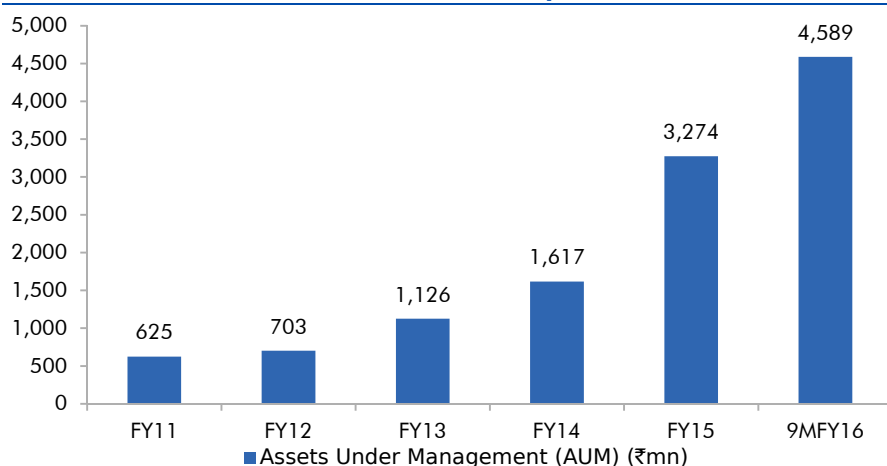
## Objects of the offer

- Ujjivan have received the in-principle approval for operating as a SFB. Post conversion to a SFB, the new bank will need additional capital and hence the Management intends to use the entire proceeds from the fresh issue of equity to shore up its capital base.
- As per RBI norms, foreign ownership in banks can't be more than 49%. In order to reduce its existing foreign ownership, which is at 77.1%, the company needs its existing foreign shareholders to sell their stake. Post the issue, the foreign share holding in the company will come down to 40.2%.

## Investment rationale

**Micro finance business has huge scalability:** Ujjivan's AUM has reported a CAGR of 59% over FY2013-9MFY2016 to ₹4,589cr. There is a huge untapped opportunity in this segment as micro finance is targeted to the lower income segment which often lacks access to formal financing sources. Ideally the ticket size of the loans ranges from ₹2,000-₹35,000 (in the group lending scheme) and more than 90% of the borrowers are female, who access loans via group borrowings (Self Help Group) for very small businesses. Sharing the group liability has resulted in maintaining credit discipline and hence the delinquency in this type of business has been very low despite it being an unsecured form of loan. EMI's are collected on 14 days or 28 days basis, which reduces the risk of any bad loans. With a loan portfolio of ~₹43,300cr the micro finance industry is expected to report 30% CAGR over the next 3-4 years and Ujjivan with its pan-India presence will be able to encash on the opportunity. Given the government's focus on financial inclusion together with better clarity on regulatory aspects, the micro finance industry can look forward to healthy growth going ahead.

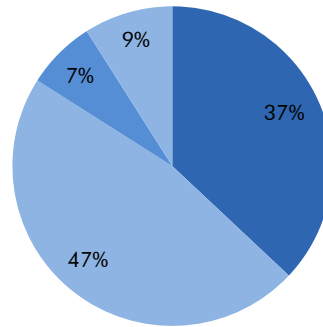
**Exhibit 4: 59% AUM CAGR over the last 3 years**



Source: Company DHRP, Angel Research

**Diversified product offerings has helped in growing customer base:** The company has various types of loan products like small and micro business loans, education loans, house renovation loans as well as emergency loans. Backed by a strong network and customer satisfaction it has been able to achieve very high repeat customer ratio and repeat group loans account for ~47% of the loan book, while new group loans accounted for 37% of the loan book. Ujjivan also has a product called loyalty loans which is extended to existing customers who have satisfactorily repaid on time. The company's customer friendly approach has resulted in 45% CAGR in number of loan accounts, ie from 1mn in FY2013 to 3.1mn by 9MFY2016.

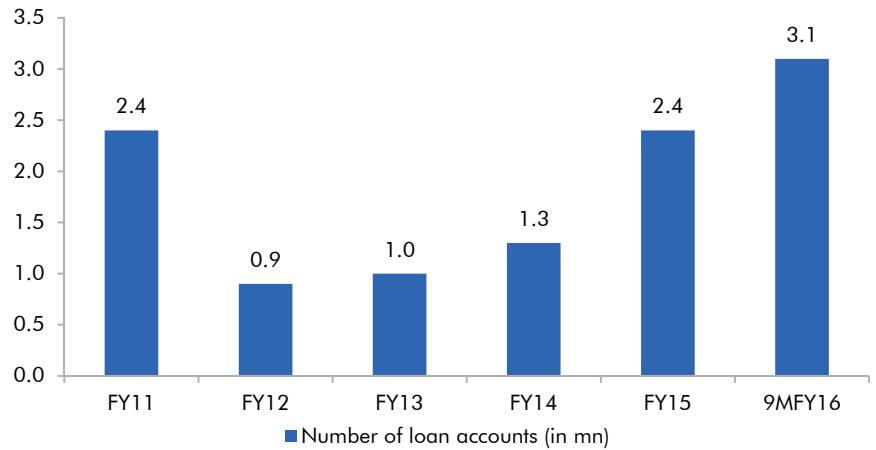
**Exhibit 5: Diversified loan offerings**



■ New Group Loans ■ Repeat Group Loan ■ Loyalty ■ Individual Loans

Source: Company, Angel Research

**Exhibit 6: Growing Customer Base**

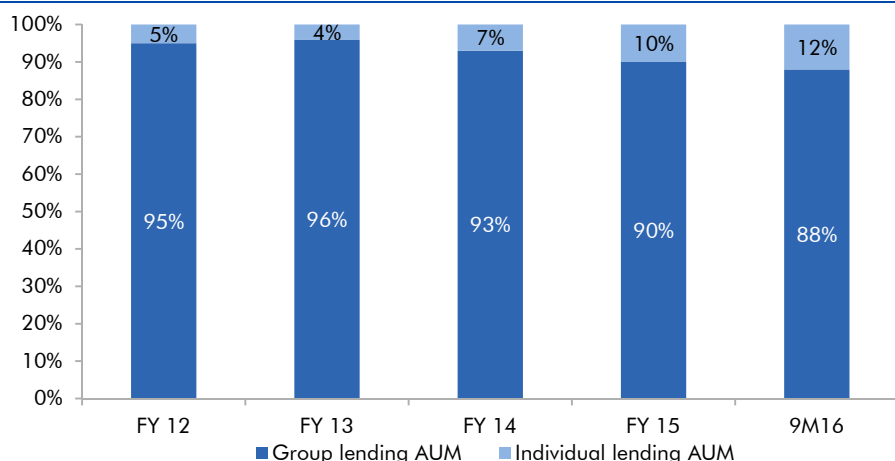


Source: Company DHRP, Angel Research

**Advances out of group lending scheme should result in new scope of growth**

Though the company largely lends in joint lending system, it also offers individual loans which account for ~10% of the overall AUM. Individual loans could see strong growth going ahead. Post conversion to a SFB and in order to scale up its balance sheet the company will have to grow its individual loan portfolio.

**Exhibit 7: Portfolio Distribution**

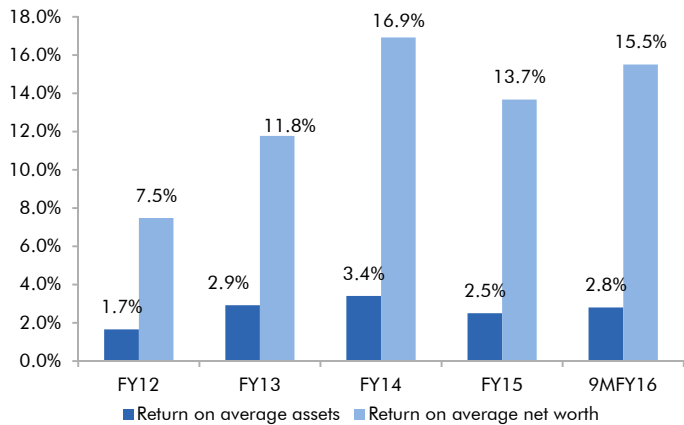


Source: Company, Angel Research

**Expect smooth transition to a SFB:** Ujjivan is amongst the ten players to have received a SFB license from the RBI. Migrating to become a SFB from being a NBFC has its own pros and cons. On the positive side the proposed SFB will have access to low cost funds via deposits and even borrowing costs could reduce further via NCDs and CP/CDs. It can also start other retail loans at par with other banks. While on the flip side there will be initial expenses associated with being a bank as new processes will have to be implemented. Further, the SFB will have to comply with CRR and SLR requirements. Meeting 75% Priority Sector Lending (PSL) target will not be a challenge for the company as its entire portfolio qualifies for PSL and hence the migration from NBFC to SFB should be smooth. These will impact the overall NIM and ROA during the initial 2-3 years. Having said that, we believe with an experienced Management the migration from NBFC to SFB would be smooth.

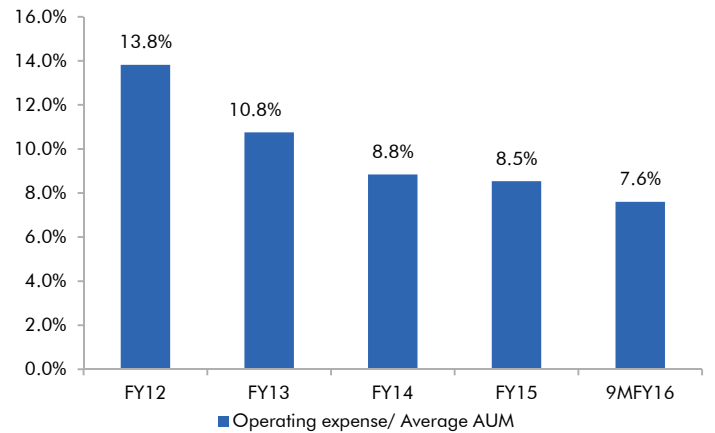
**Enjoys strong return ratios and is backed by reducing cost structure:** In the last few years Ujjivan has been able to improve its leverage from 4x in FY2013 to 5.5x in 9MFY2016. This has resulted in ROE improving from 11.8% to 19.9% during the same period. With a new capital base the company will have further scope for leveraging and hence we believe its ROE will remain strong. However, during the process of migration to the SFB the company might see its cost structure escalating which will temporarily pressurize the ROE.

**Exhibit 8: Return ratios decent; lower leverage allows scope for RoA & RoE expansion**



Source: Company, Angel Research

**Exhibit 9: Operating expense/Average AUM**

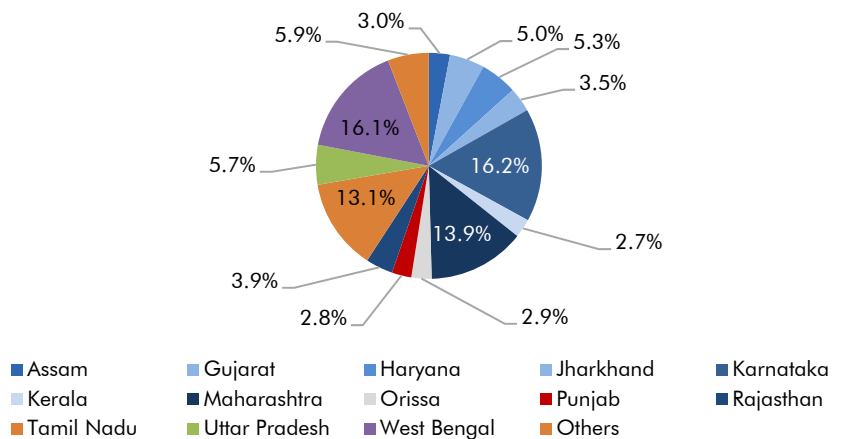


Source: Company, Angel Research

### Geographically diversified AUM

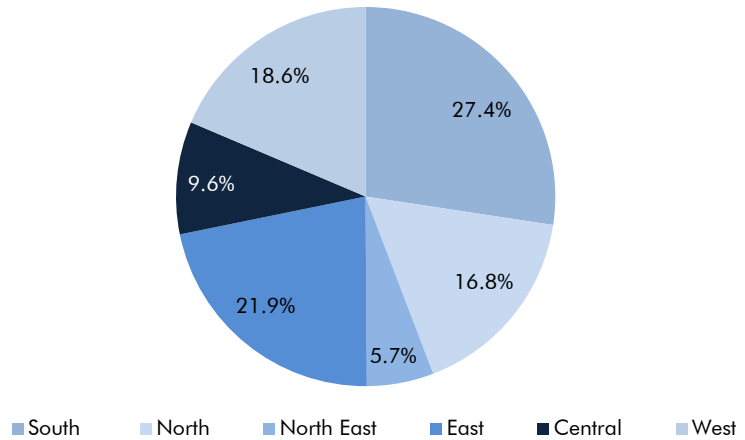
Ujjivan is present across 24 states and has successfully diversified its AUM with no single state contributing >20% to the overall AUM. This mitigates the concentration risk. Karnataka, West Bengal, Maharashtra and Tamil Nadu account for 56% of the AUM; this makes a key differentiating point for Ujjivan as other micro finance institutions are largely focused on the southern states of the country. Once the company converts itself into a SFB, its diversified presence will come in as a great help in scaling up the balance sheet as it already has the operating knowledge and brand name in respective geographies.

**Exhibit 10: State-wise distribution of AUM**



Source: Company, Angel Research

**Exhibit 11: Geographical distribution of branches**



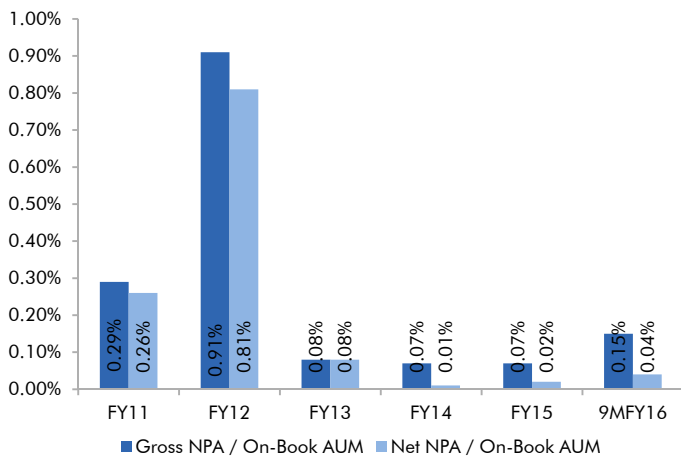
Source: Company, Angel Research

**Ujivan has maintained impressive NIM and Asset Quality**

The company has managed its NPA level quite strong despite aggressive growth in the last 3-4 years. Micro finance is an unsecured form of loan, but still the company has achieved an excellent track record of maintaining Gross NPA below 0.15% which is a commendable job. The same is also much lower than its nearest peer and newly listed micro finance company - Equitas Holdings Ltd (Equitas).

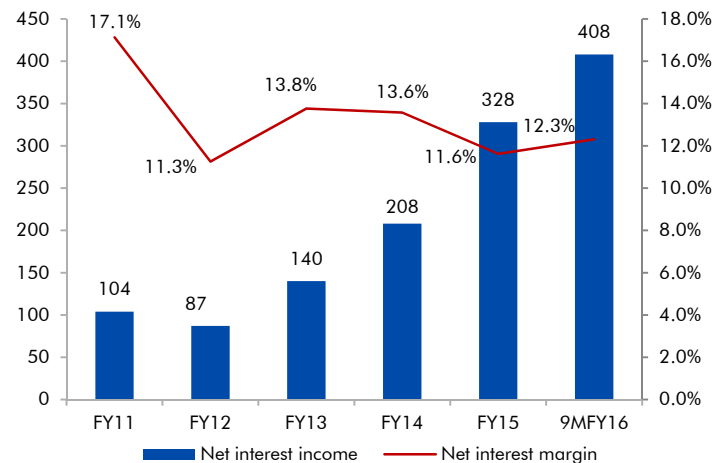
However, unlike Equitas, Ujivan’s presence so far is largely concentrated in the micro finance business and once the company gets into other segments of lending the asset quality could come under pressure initially. This will be a key area of observation going ahead. The company’s NIM has been on a declining trend over the past few years and we expect the same to decline further over the next few quarters before it stabilizes.

**Exhibit 12: Reducing Gross & Net NPA (%)**



Source: Company, Angel Research

**Exhibit 13: Healthy NII growth & NIM**



Source: Company, Angel Research



### Overview of Micro finance industry:

The micro finance industry witnessed rapid growth after 2001, after the RBI granted priority sector status to bank loans advanced to micro finance companies. However, the micro finance industry had a problem of high cost of funds; in order to tackle the problem the Union Budget 2016 announced setting up MUDRA Bank to refinance the micro finance sector. As a result micro finance companies have better access to funds at lower costs and can now scale up. Though there are ~60 micro finance companies in India, nearly 70% of the gross loan portfolio is accounted by the top 10 players.

#### Exhibit 14: Top10 Micro Finance Companies in India

Top MFIs, gross loan portfolio (Rs. cr)	Q3FY16	Market Share (%)
Janalakshmi	8,096	19.1
SKS	6,177	14.5
<b>Ujjivan</b>	<b>4,088</b>	<b>9.6</b>
Satin	2,538	6.0
Equitas	2,320	5.5
Grameen Koota	1811	4.3
L & T Finance	1700	4.0
ESAF	1495	3.5
Spandana	1221	2.9
Grama Vidiyal	1147	2.7
<b>Total of Top 10</b>	<b>30,593</b>	<b>72.0</b>

Source: MFIN

#### Exhibit 15: State-wise distribution of gross loan portfolio of the industry

State-wise distribution of gross loan portfolio	Q3FY16
Tamil Nadu	16.1%
Karnataka	13.8%
Maharashtra	11.9%
Uttar Pradesh	10.9%
Madhya Pradesh	7.8%
Odisha	6.1%
West Bengal	5.8%
Bihar	5.4%
Kerala	4.4%
Gujarat	3.7%
Others	14.1%
<b>Total</b>	<b>100.0%</b>

Source: MFIN

## Valuation

At the upper end of the offer price band (₹210), the issue is priced at 1.8x its diluted BV of ₹118 (2.1x pre-dilution). The company has decent ROE and ROA of 19.9% and 3.6%, respectively. Although the return ratios might get a bit compressed post the company's conversion to a SFB, but we expect the same to scale up subsequently. We believe the issue is attractively priced looking at the growth options the company offers in the long run. **We recommend a SUBSCRIBE on the issue.**

## Comparative table

Within the listed space, we believe SKS Microfinance is the best comparable company. Recently another micro finance company and expected SFB, Equitas Holdings, came out with an IPO. We believe Equitas would be the best comparable company for Ujjivan while on other parameters we have tried to make a comparison with other listed NBFCs as well.

### Exhibit 16: Comparative – Micro Finance

Micro-Finance	Equitas	SKS	Janlakshmi	Ujjivan	Satin
Gross Loan Portfolio (crs)	2,935	6,177	8,096	4,088	2,538
Avg loan o/s per client	9,634	14,857	21,146	15,739	15,873
Branches	377	1,167	338	469	364
Employees	4,255	11,086	7,978	7,786	3,419
Clients (lakhs)	24.1	41.6	38.3	26.0	16.0

Source: MFIN

### Exhibit 17: Comparative – Micro Finance

	Ujjivan	Equitas	SKS Micro Fin
NIM (%)	12.3	11.1	5.6
ROA (%)	3.6	2.9	4.5
ROE (%)	19.9	19.1	25.0
CAR (%)	19.6	21.0	23.9
GNPAs (%)	0.2	0.2	0.1
NNPAs (%)	0.0	0.1	0.1
P/BV (x)	2.1	2.3	4.2
Leverage (%)	5.5	4.0	4.5

Source: Company, Angel Research

## Risks

**No prior experience of secured lending:** Ujjivan is largely present in the micro finance business only and doesn't have any prior experience in large scale secured lending. Post conversion to SFB, Ujjivan will have to lend secured loans as well with higher average ticket size and this could be a testing time. Though secured loans are considered to be safer, higher ticket sizes need close monitoring of the accounts and hence the company will have to set up proper systems for the same.

**Ability to scale up its operations fast:** The company is raising ₹358cr through fresh issuance of shares, amounting to 56% of the existing net worth. Inability to scale up its operations will result in ROE dilution in the near term.

**Ability to meet deposit targets post SFB conversion:** Post conversion to a SFB, Ujjivan will be allowed to raise deposits from customers. Ability to raise deposits from its existing client base will be limited looking at the average income profile of the said borrowers. It might have to offer higher rates vis-a-vis other banks which might have a negative impact on the NIM.

**Income statement**

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	9MFY2016
<b>Nil</b>	<b>87.3</b>	<b>140.4</b>	<b>208.0</b>	<b>327.9</b>	<b>407.6</b>
- YoY Growth (%)		60.8%	48.1%	57.6%	24.3%
<b>Other Income</b>	<b>8.1</b>	<b>11.4</b>	<b>9.8</b>	<b>12.6</b>	<b>16.4</b>
- YoY Growth (%)		41.6%	-14.3%	28.6%	30.8%
<b>Operating Income</b>	<b>95.4</b>	<b>151.9</b>	<b>217.8</b>	<b>340.5</b>	<b>424.1</b>
- YoY Growth (%)		59.2%	43.4%	56.3%	24.5%
<b>Operating Expenses</b>	<b>89.8</b>	<b>97.2</b>	<b>120.7</b>	<b>204.9</b>	<b>219.4</b>
- YoY Growth (%)		8.3%	24.1%	69.8%	7.0%
<b>Pre - Provision Profit</b>	<b>5.6</b>	<b>54.6</b>	<b>97.1</b>	<b>135.6</b>	<b>204.7</b>
- YoY Growth (%)		872.8%	77.9%	39.6%	51.0%
<b>Prov. &amp; Cont.</b>	<b>5.8</b>	<b>6.9</b>	<b>8.3</b>	<b>21.0</b>	<b>17.0</b>
- YoY Growth (%)	!	19.8%	20.1%	153.8%	-19.1%
<b>Profit Before Tax</b>	<b>-0.1</b>	<b>47.7</b>	<b>88.8</b>	<b>114.5</b>	<b>187.7</b>
- YoY Growth (%)			86.3%	28.9%	63.9%
<b>Prov. for Taxation</b>	<b>-0.3</b>	<b>14.8</b>	<b>30.4</b>	<b>38.7</b>	<b>65.4</b>
- as a % of PBT		31.1%	34.2%	33.8%	34.8%
<b>PAT</b>	<b>0.1</b>	<b>32.9</b>	<b>58.4</b>	<b>75.8</b>	<b>122.3</b>
- YoY Growth (%)			77.7%	29.7%	61.4%

**Balance sheet**

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	9MFY2016
Share Capital	57.3	65.6	65.6	86.1	86.1
Reserve & Surplus	183.0	252.4	306.9	650.3	813.4
Loan Funds	639.2	1,018.5	1,675.4	3,179.6	3,814.6
- Growth (%)	9.7%	59.3%	64.5%	89.8%	20.0%
Other Liab.& Prov.	16.0	20.0	31.0	60.0	39.0
<b>Total Liabilities</b>	<b>895.5</b>	<b>1,356.5</b>	<b>2,078.9</b>	<b>3,976.0</b>	<b>4,753.2</b>
Cash and Cash Equivalents	161	179	394	645	56
Investments	3	3	5	7	14
Advances	700	1,136	1,626	3,229	4,588
- Growth (%)	10.1%	62.4%	43.1%	98.6%	42.1%
Fixed Assets	11	11	13	18	22
Other Assets	182	206	435	723	129
<b>Total Assets</b>	<b>895.5</b>	<b>1,356.5</b>	<b>2,078.9</b>	<b>3,976.0</b>	<b>4,753.2</b>

**Ratio analysis**

Y/E March	FY2012	FY2013	FY2014	FY2015	9MFY2016
<b>Profitability ratios (%)</b>					
NIMs	11.26%	13.76%	13.57%	11.62%	12.31%
RoA	0.0	2.9	3.4	2.5	3.6
RoE	0.1	11.8	16.9	13.7	19.9
<b>Asset Quality (%)</b>					
Gross NPAs	0.91%	0.08%	0.07%	0.07%	0.15%
Net NPAs	0.81%	0.08%	0.01%	0.02%	0.04%
<b>Per Share Data (₹)</b>					
EPS	0.0	5.0	8.9	8.8	14.2
BVPS	42.0	48.5	56.8	85.5	99.7
<b>Valuation Ratios</b>					
PER (x)		41.9	23.6	23.9	14.8
P/ABVPS (x)	5.0	4.3	3.7	2.5	2.1
<b>DuPont Analysis</b>					
NII	10.9	12.5	12.1	10.8	12.0
(-) Prov. Exp.	0.7	0.6	0.5	0.7	0.5
Adj. NII	10.2	11.9	11.6	10.1	11.5
Other Inc.	1.0	1.0	0.6	0.4	0.5
Op. Inc.	11.2	12.9	12.2	10.6	12.0
Opex	11.2	8.6	7.0	6.8	6.4
PBT	0.0	4.2	5.2	3.8	5.5
Taxes	(0.0)	1.3	1.8	1.3	1.9
<b>RoA</b>	0.0	2.9	3.4	2.5	3.6
Leverage	4.5	4.0	5.0	5.5	5.6
RoE	0.1	11.8	16.9	13.7	19.9

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