

Tech Mahindra

Performance Highlights

(₹ cr)	1QFY18	4QFY17	% chg (QoQ)	1QFY17	% chg (YoY)
Net revenue	7,336	7,495	(2.1)	6,921	6.0
EBITDA	935	899	4.0	1,029	(9.2)
EBITDA margin (%)	12.7	12.0	75bp	14.9	(213)bps
Adj. PAT	798	588	35.8	750	6.5

Source: Company, Angel Research;

For 1QFY2018 Tech Mahindra posted good set of numbers. The sales came in at US\$1,138mn (US\$1,127mn expected) v/s. US\$1,131mn in 4QFY2017, a qoq growth of 0.6%. In Rupee terms, sales came in at `7,336cr (`7,262cr expected) v/s. `7,495cr in 4QFY2017, a qoq dip of 2.1%. On operating front, the EBIT margins came in at 9.4% (8.6% expected v/s. 8.2% in 4QFY2017, a qoq expansion of 117bps, mainly on the back of base effect. Consequently, the PAT came in at `798cr (`624cr expected) v/s. `588cr in 4QFY2017, a qoq growth of 35.8%. **We maintain our Buy rating on the stock.**

Result highlights: The sales came in at US\$1,138mn (US\$1,127mn expected) v/s. US\$1,131mn in 4QFY2017, a qoq growth of 0.6%. In Rupee terms, sales came in at `7,336cr (`7,262cr expected) v/s. `7,495cr in 4QFY2017, a qoq dip of 2.1%. The sales growth during the quarter was driven by USA, which constituted 46.8% of sales in 1QFY2018 v/s. 45.1% in 4QFY2017, while ROW dipped to 23.4% of sales in 1QFY2018 v/s. 25.3% of sales in 4QFY2017. On operating front, the EBIT margins came in at 9.4% (8.6% expected) v/s. 8.2% in 4QFY2017, a qoq expansion of 117bps, mainly on the back of base effect. Consequently, the PAT came in at `798cr (`624cr expected) v/s. `588cr in 4QFY2017, a qoq growth of 35.8%.

Outlook and valuation: We expect a CAGR of 8.0% and 7.2% in USD and INR revenue respectively over FY2017-19E. The PAT is expected to grow at a CAGR of 8.6% over FY2017-19E. **We maintain our Buy rating on the stock with a Target Price of `533.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2016	FY2017	FY2018E	FY2019E
Net sales	26,494	29,141	31,015	33,496
% chg	17.1	10.0	6.4	8.0
Net profit	3,118	2,813	3,102	3,315
% chg	18.7	(9.8)	10.3	6.9
EBITDA margin (%)	16.3	14.4	15.0	15.0
EPS (₹)	35.8	32.3	35.6	38.1
P/E (x)	10.6	11.7	10.7	10.0
P/BV (x)	2.3	2.0	1.8	1.6
RoE (%)	21.4	17.1	17.0	16.3
RoCE (%)	20.1	15.6	16.1	15.9
EV/Sales (x)	1.3	1.2	1.1	1.0
EV/EBITDA (x)	7.9	8.4	7.5	6.8

Source: Company, Angel Research; Note: CMP as of July 31, 2017

BUY

CMP	₹385
Target Price	₹533

Investment Period	12 Months
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Stock Info

Sector	IT
Market Cap (₹ cr)	37,589
Net Debt (₹ cr)	-6,370
Beta	0.8
52 Week High / Low	515/358
Avg. Daily Volume	2,93,915
Face Value (₹)	5
BSE Sensex	32,515
Nifty	10,077
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)

Promoters	36.2
MF / Banks / Indian Fls	16.7
FII / NRIs / OCBs	36.2
Indian Public / Others	11.0

Abs.(%)	3m	1yr	3yr
Sensex	8.7	16.1	25.6
Tech Mahindra	(7.6)	(21.3)	(28.3)

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 1QFY2018 performance (Consolidated, Indian GAAP)

(` cr)	4QFY17	3QFY17	% chg (qoq)	4QFY16	% chg (yoy)	FY17	FY16	% chg (yoy)
Net revenue	7,336	7,495	(2.1)	6,921	6.0	29,141	26,496	10.0
Cost of revenue	5,282	5,479	(3.6)	4,881	8.2	20,566	18,323	12.2
Gross profit	2,054	2,017	1.9	2,040	0.7	8,575	8,173	4.9
SG&A expense	1,120	1,118	0.2	1,011	10.7	4,390	3,853	13.9
EBITDA	935	899	4.0	1,029	(9.2)	4,184	4,320	(3.1)
Dep. and amortization	247	284	(12.9)	202	22.2	978	762	28.4
EBIT	688	615	11.8	827	(16.8)	3,206	3,558	(9.9)
Interest	37	32	16.4	27	37.0	134	96	39.4
Other income	411	238	72.6	246	67.0	950	557	70.6
PBT	1,062	821	29.3	1,046	1.5	4,023	4,017	0.1
Income taxes	270	232	16.5	247	9.2	1,002	860	16.5
PAT	792	590	34.3	799	(0.9)	3,021	3,157	(4.3)
Minority interest	0	0	-	46	(99.7)	-	39	
PAT after minority interest	792	590	34.3	753	5.1	3,021	3,118	(3.1)
Profit from associates	7	2		(2)		(40)	-	
Exceptional item	-	-		-		-	-	
Reported PAT	798	588	35.8	750	6.5	2,980	3,118	(4.4)
Adj. PAT	798	588	35.8	750	6.5	2,980	3,118	(4.4)
Diluted EPS	8.3	6.1	35.8	7.8	6.5	31.0	32.4	(4.4)
Gross margin (%)	28.0	26.9	110bp	29.5	(147)bps	29.4	30.8	(142)bp
EBITDA margin (%)	12.7	12.0	75bp	14.9	(213)bps	14.4	16.3	(195)bp
EBIT margin (%)	9.4	8.2	117bp	11.9	(257)bps	11.0	13.4	(243)bp
PAT margin (%)	10.9	7.8	304bp	10.8	5bps	10.2	11.8	(154)bp

Source: Company, Angel Research

Exhibit 2: 1QFY2018 – Actual Vs Angel estimates

(` cr)	Actual	Estimate	% Var
Net revenue	7,336	7,262	1.0
EBITDA margin (%)	12.7	12.6	10bps
PAT	798	624	27.9

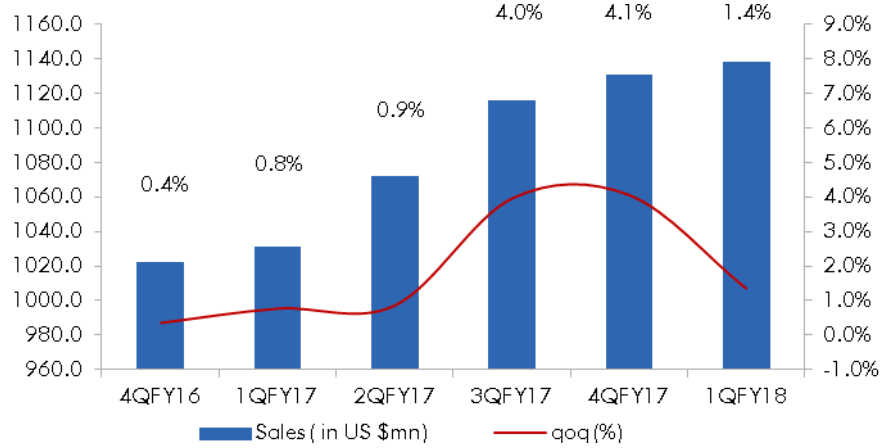
Source: Company, Angel Research

Revenue growth led by USA

For 1QFY2018 Tech Mahindra posted good set of numbers. The sales came in at US\$1,138mn (US\$1,127mn expected) v/s. US\$1,131mn in 4QFY2017, a qoq growth of 0.6%. In Rupee terms, the sales came in at `7,336cr (`7,262cr expected) v/s. `7,495cr in 4QFY2017, a qoq dip of 2.1%. On Constant Currency (CC) terms, the company posted a 0.6% QoQ de-growth during the quarter.

In terms of geography, USA was the major growth driver, it constituted 46.8% of sales, a qoq growth of 4.4%, while ROW was the key damper constituting 23.4% of sales, posting a qoq de-growth of 6.9%. Europe, on the other hand posted a qoq growth of 1.3%.

In terms of the industries, the manufacturing came in at 19% of sales, posting a qoq growth of 1.1%. BFSI was the main driver, which lead the segment, contributing around 14.4% of sales, posting a qoq growth of 2.7%. The key domain Retail, Transport & Logistics, posted a qoq growth of 5.2%. Also, the Technology, Media & Entertainment, posted a qoq de-growth of 2.6%.

Exhibit 3: Trend in revenue growth


Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (QoQ)	% growth (YoY)
Telecom	45.2	(1.8)	1.4
Manufacturing	19.3	1.1	17.6
TME	6.0	(2.6)	(11.7)
BFSI	14.4	2.8	40.6
RTL	6.8	5.3	15.4
Others	8.3	8.4	25.4

Source: Company, Angel Research

In terms of geographies, ROW posted de-growth of 6.9% qoq, while Europe and US posted a growth of 1.3% and 4.4% qoq respectively.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (QoQ)	% growth (YoY)
Americas	46.8	4.4	5.4
Europe	29.8	1.3	16.2
RoW	23.4	(6.9)	13.2

Source: Company, Angel Research

Hiring and client metrics

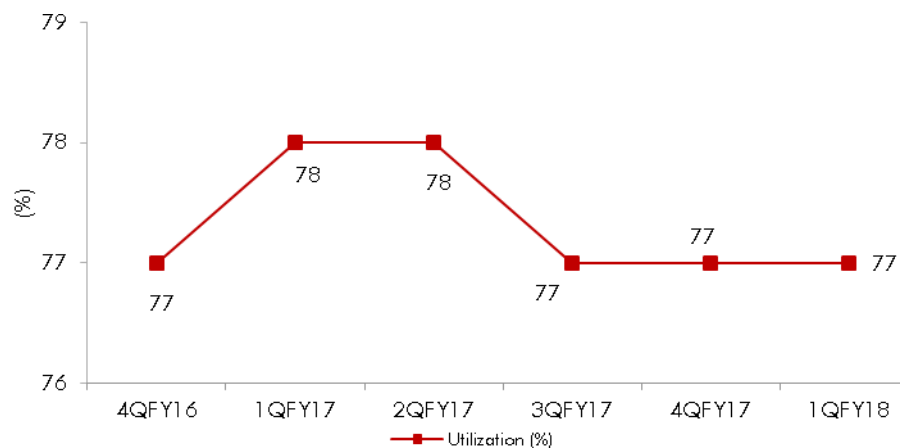
During the quarter, the company reported a net addition of (1,713) employees, taking its overall headcount to 115,980. The BPO headcount currently stands at 30,322 and was the only division to witness additions. Attrition (on LTM basis) was at 17%.

Exhibit 6: Employee metrics

Particulars	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Software professionals	73,590	78,404	80,858	82,403	78,996
BPO professionals	27,326	27,669	29,372	28,414	30,322
Sales & support	6,300	6,813	6,865	6,876	6,662
Total employees	107,216	112,886	117,095	117,693	115,980
Attritions (%)	21	19	18	17	17

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate



Source: Company, Angel Research

The company added 21 new clients during the quarter, taking the active client base to 864 (v/s. 843 in 4QFY2017), with 5 clients added in US\$20mn-50mn+ bracket and other additions mainly in the US\$1mn-5mn+ bracket.

During the quarter, deals with a TCV of US\$325mn were won, which included a large networking deal in Communications and a deal in the Manufacturing vertical.

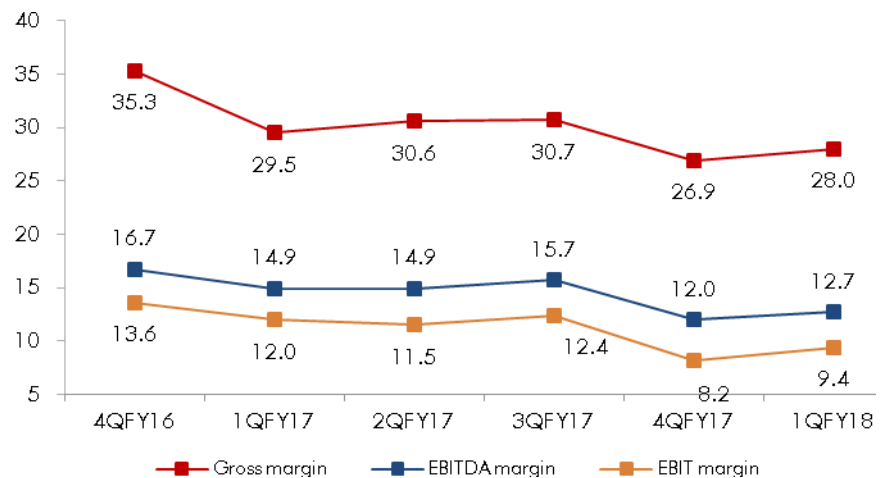
Exhibit 8: Client metrics

Particulars	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18
Total active clients	807	818	837	843	864
US\$1mn–5mn	207	197	228	220	238
US\$5mn–10mn	49	56	63	63	65
US\$10mn–20mn	23	22	27	35	33
US\$20mn–50mn	26	28	24	22	27
US\$50mn+	14	14	14	14	14

Source: Company, Angel Research

Operating margin expands

On operating front, the EBIT margins came in at 9.4% (8.6% expected) v/s. 8.2% in 4QFY2017, a qoq expansion of 117bps, mainly on the back of base effect. Margins were benefited by the absence of one-time costs associated with the LCC restructuring that negatively impacted margins in the previous quarter. The company expects continued margin recovery going forward despite an upcoming wage hike. This would be driven by improvement in LCC margins, improved utilization & increased thrust on Automation.

Exhibit 9: Margin trend (%)


Source: Company, Angel Research

Investment arguments

Growth prospects decent: The Management is more optimistic as compared to what it was at the same time last year. It has also been optimistic about the prospects of recently acquired entities. On Margin front, the company faces the usual 1QFY2018 headwinds of visa expenses and Comviva margin contraction. Any improvement, on back of synergies and productivity gains will only start reflecting from 2QFY2018. We expect a CAGR of 8.0% and 7.2% in USD and INR revenue respectively over FY2017-19E. On EBIT front, we expect the EBIT to be around 15.0% v/s. 14.4% in FY2017.

Inorganic growth initiatives to augment well for company: The company has been active in the M&A space, with it having acquired Satyam a few years back, to

acquiring LCC and Softgen recently. Softgen's and LCC's acquisition was consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry with an estimated annual revenues of more than US\$400mn (CY2014; the effective run-rate for the business is pruned down to US\$200-220mn annualized), with workforce of over 5,700 network professionals across five continents and more than 50 countries. With this acquisition, Tech Mahindra will also be addressing a rapidly growing market opportunity, as telecommunications companies and enterprises accelerate their network upgrade cycle.

Outlook and valuation

Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US\$ and INR CAGR of 8.0% and 7.2% respectively over FY2017-19E. However, the acquisition of LCC will be margin dilutive in the near term, leading the FY2017 EBDITA margin to drop to 14.4% from 16.3% in FY2016. The company, given its success in turnaround of its earlier acquisition (Satyam), believes it would be able to do the same with the recent acquisitions and would be able to get close to achieving the 20% EBIT levels in future. Given the favorable valuation on EV/sales front, where it trades at a significant discount to its peers, we believe the stock should witness uptrend once the profitability returns to its mean average. **We maintain a Buy rating on the stock.**

Exhibit 10: Key assumptions

	FY2018E	FY2019E
Revenue growth (US\$)	8.0	8.0
USD-INR rate (realized)	66.7	66.7
Revenue growth (₹)	6.4	8.0
EBITDA margin (%)	15.0	15.0
Tax rate (%)	26.0	26.0
EPS growth (%)	10.3	6.9

Source: Company, Angel Research

Exhibit 11: One-year forward PE (x)


Source: Company, Angel Research. Note: P/E includes profits of Mahindra Satyam from FY2012

Exhibit 12: Recommendation summary

Company	Reco	CMP (₹)	Tgt Price (₹)	Upside (%)	FY2019E EBITDA (%)	FY2019E P/E (x)	FY2017-19E EPS CAGR (%)	FY2019E EV/Sales (x)	FY2019E RoE (%)
HCL Tech	Accumulate	889	1,014	14.1	20.9	13.2	6.2	1.8	20.6
Infosys	Buy	1011	1,179	16.6	26.0	14.3	5.3	2.2	19.6
TCS	Accumulate	2,494	2,651	6.3	27.6	16.0	7.8	3.1	29.8
Tech Mahindra	Buy	385	533	38.4	15.0	10.1	8.6	1.0	16.3
Wipro	Buy	289	-	-	20.3	15.2	4.4	1.2	13.4

Source: Company, Angel Research.

Company Background

Tech Mahindra was founded in 1986 as a joint venture between Mahindra Group and British Telecom (BT) to service the latter. Later on, the company started servicing other external clients as well (solely in the telecom industry). In June 2009, Tech Mahindra acquired a 42.7% stake in erstwhile Satyam Computers (now Mahindra Satyam) and now the latter is entirely merged with the company.

The company has recently acquired the companies - LCC and Softgen. These two acquisitions have been consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry. LCC is estimated to have annual revenues of more than US\$400mn (CY2014), with workforce of over 5,700 network professionals across five continents and more than 50 countries.

Profit and loss statement (Consolidated, Indian GAAP)

Y/E March (` cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Net sales	22,621	26,494	29,141	31,015	33,496
Cost of revenues	15,920	18,323	20,566	21,400	23,112
Gross profit	6,701	8,172	8,575	9,615	10,384
<i>% of net sales</i>	29.6	30.8	29.4	31.0	31.0
SG&A expenses	2,549	3,853	4,390	4,962	5,359
<i>% of net sales</i>	11.3	14.5	15.1	16.0	16.0
EBITDA	4,153	4,318	4,184	4,652	5,024
<i>% of net sales</i>	18.4	16.3	14.4	15.0	15.0
Depreciation and amortization	611	762	978	1054	1139
<i>% of net sales</i>	2.7	2.9	3.4	3.4	3.4
EBIT	3,541	3,556	3,206	3,598	3,886
<i>% of net sales</i>	15.7	13.4	11.0	11.6	11.6
Interest expense	30	96	129	129	129
Other inc., net of forex gain/(loss)	106	557	778	778	778
Profit before tax	3,618	4,017	3,855	4,247	4,535
Provision for tax	960	860	1,002	1,104	1,179
<i>% of PBT</i>	26.5	21.4	26.0	26.0	26.0
PAT	2,659	3,157	2,853	3,143	3,356
Exceptional item	-	-	-	-	-
Minority interest	31	44	40	40	40
Reported PAT	2,628	3,118	2,813	3,102	3,315
Adjusted PAT	2,628	3,118	2,813	3,102	3,315
Fully diluted EPS (`)	30.2	35.8	32.3	35.6	38.1

Balance sheet (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Equity capital	480	436	439	439	439
Preference capital	-	-	-	-	-
Share premium	-	-	-	-	-
Profit and loss	11,768	14,155	15,998	17,823	19,861
Other reserves	0	0	0	-	-
Net worth	12,249	14,591	16,438	18,261	20,300
Secured loans	621	1,002	1,219	1,219	1,219
Unsecured loans	54	-	-	-	-
Total debt	675	1,002	1,219	1,219	1,219
Other long term liability	376	147	537	537	537
Long-term provisions	414	531	620	620	620
Minority interest	160	193	464	504	545
Amount pending investigation	895	1,230	1,230	1,230	1,230
Total capital employed	14,768	17,695	20,508	22,372	24,451
Gross block	7,811	7,973	11,677	12,677	13,677
Accumulated dep.	(3,477)	(4,239)	(5,217)	(6,272)	(7,410)
Net block	4,334	4,364	6,460	6,406	6,267
Capital WIP	266	629	373	373	373
Total fixed assets	4,601	4,993	6,833	6,778	6,640
Investments	2,103	1,243	2,396	4,483	6,736
Long term loans and adv.	1,306	1,895	2,435	2,696	3,117
Interest in TML benefit trust	-	-	-	-	-
Deferred tax asset, net	390	532	267	267	267
Other non-current assets	-	0	0	-	-
Inventories	24	40	61	61	61
Sundry debtors	5,206	5,770	5,338	7,980	7,981
Cash and cash equiv.	2,405	4,018	3,219	3,500	4,000
Loans and advances	3,813	4,032	5,518	2,999	3,000
Current investments	-	-	-	-	-
Unbilled revenue	-	-	-	-	-
Sundry creditors	(1,654)	(2,276)	(2,312)	(2,658)	(3,057)
Other liabilities	(1,627)	(2,200)	(2,860)	(3,289)	(3,782)
Provision	(1,799)	(355)	(387)	(445)	(512)
Working capital	6,368	9,031	8,577	8,148	7,691
Total capital deployed	14,768	17,695	20,508	22,372	24,451

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2015	FY2016	FY2017	FY2018E	FY2019E
Pre tax profit from operations	2,659	3,157	2,853	3,143	3,356
Depreciation	611	762	978	1,054	1,139
Exp. (deferred)/written off/others	-	-	-	-	-
Pre tax cash from operations	3,270	3,919	3,831	4,197	4,494
Other income/prior period ad	106	557	778	778	778
Net cash from operations	3,376	4,475	4,609	4,975	5,272
Tax	(960)	(860)	(1,002)	(1,104)	(1,179)
Cash profits	2,417	3,615	3,607	3,871	4,093
(Inc)/dec in					
Sundry Debtors	(857)	(565)	433	(2,642)	(1)
Inventories	(15)	(16)	(21)	-	-
Loans and advances	(1,197)	(219)	(1,485)	2,519	(1)
Sundry creditors	105	621	36	347	399
Others	212	573	660	429	493
Net trade working capital	(1,752)	394	(377)	652	890
Cashflow from operating activities	665	4,010	3,230	4,523	4,983
(Inc)/dec in fixed assets	(1,740)	(393)	(1,840)	54	139
(Inc)/dec in investments	(2,067)	860	(1,153)	(2,087)	(2,253)
(Inc)/dec in other non current assets	16	(0)	0	0	-
Cashflow from investing activities	(3,791)	467	(2,992)	(2,033)	(2,114)
Inc/(dec) in debt	(311)	(328)	(217)	-	-
Inc/(dec) in deferred revenue	-	-	-	-	1
Inc/(dec) in equity/premium	1	-	-	0	-
Inc/(dec) in minority interest	(16)	(33)	(271)	(40)	(40)
Dividends	(611)	(1,223)	(917)	(1,278)	(1,277)
Others	1,713	(1,281)	369	(891)	(1,054)
Cashflow from financing activities	775	(2,864)	(1,037)	(2,209)	(2,369)
Cash generated/(utilised)	(2,351)	1,613	(800)	281	500
Cash at start of the year	4,756	2,405	4,018	3,219	3,500
Cash at end of the year	2405	4018	3219	3500	4000

Key Ratios

Y/E March	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation ratio (x)					
P/E (on FDEPS)	12.8	10.8	11.9	10.8	10.1
P/CEPS	10.4	8.6	8.9	8.1	7.5
P/BVPS	2.7	2.3	2.0	1.8	1.7
Dividend yield (%)	1.3	3.1	3.1	3.1	3.4
EV/Sales	1.6	1.3	1.2	1.1	1.0
EV/EBITDA	8.6	8.0	8.5	7.6	6.9
EV/Total assets	7.8	6.9	5.2	5.2	5.2
Per share data (₹)					
EPS	30.2	35.8	32.3	35.6	38.1
Cash EPS	37.2	44.5	43.5	47.7	51.1
Dividend	5.0	12.0	12.0	12.0	13.0
Book value	140.6	167.5	188.7	209.6	233.0
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.7	0.8	0.7	0.7	0.7
Cost of debt (PBT/EBIT)	1.0	1.1	1.2	1.2	1.2
EBIT margin (EBIT/Sales)	0.2	0.1	0.1	0.1	0.1
Asset turnover ratio (Sales/Assets)	4.9	5.3	4.3	4.6	5.0
Leverage ratio (Assets/Equity)	0.4	0.3	0.4	0.4	0.3
Operating ROE (%)	21.5	21.4	17.1	17.0	16.3
Return ratios (%)					
RoCE (pre-tax)	24.0	20.1	15.6	16.1	15.9
Angel RoIC	29.3	27.3	19.0	19.4	19.4
RoE	21.5	21.4	17.1	17.0	16.3
Turnover ratios (x)					
Asset turnover (fixed assets)	4.9	5.3	4.3	4.6	5.0
Receivables days	92	86	70	97	90
Payable days	29	34	30	32	35

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Disclosure of Interest Statement

Tech Mahindra

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)