

## Natco Pharma

### Performance Highlights

Y/E March (₹ cr)	4QFY17	4QFY16	% chg (yoy)	FY17	FY16	% chg (yoy)
<b>Net Sales</b>	<b>578</b>	<b>394</b>	<b>46.5</b>	<b>2,065</b>	<b>1,080</b>	<b>91.2</b>
EBITDA	241	93	158.7	683	266	157.3
EBITDA Margin (%)	41.7	23.6	1809 bp	33.1	24.6	850 bp
<b>Adj. PAT</b>	<b>176</b>	<b>63</b>	<b>178.6</b>	<b>486</b>	<b>155</b>	<b>213.8</b>

Source: Company, Angel Research

**Tamiflu lifts 4Q numbers:** Natco reported strong earnings in 4QFY17 owing to strong sales of generic Tamiflu during the quarter. Company reported 47% yoy growth in its top line to ₹578cr. EBITDA in the quarter came in at ₹241cr, vs. ₹93cr in 4QFY16 and ₹195cr in 3QFY7. EBITDA margin was at 41.7%, up by more than 1800bps on yoy basis due to the higher sales and profit sharing of gTamiflu. Company during the quarter reported yoy 2.8x jump in the PAT from ₹63cr to 176cr. Employee cost increased 49% during the quarter mainly due to the ESOP and bonus to employees. From the conference call, we understand that the company is almost launch ready for gCopaxone however the final decision to launch the drug lies with Mylan. gCopaxone launch is expected to significantly boost its top line and bottom line due to the limited competition and complex nature of the drug. Besides, company is also expected to benefit from observations on facility of Momenta, the existing generic manufacturer in 20mg.

**Outlook and valuation:** The bumper earnings in 4QFY17 were mostly expected and there was no surprise element. We however believe that company is almost launch ready for gCopaxone in June-2017. We gain significant confidence that Mylan/Natco are most likely to launch the drug soon which is the most important trigger for the Natco at the moment. Company has responded all the queries on gCopaxone and from the commentary in the conference call, it's just a matter of time before the company launches this gCopaxone 20mg and 40mg. **We value Natco's base business at 24x of its FY19E EPS to 587 per share and add NPV of R&D pipeline of ₹471 to derive new price target of ₹1,060. Our target indicates 10% upside from the CMP of ₹968.**

#### Key financials (Consolidated)

Y/E March (₹ cr)	FY15	FY16	FY17	FY18E	FY19E
<b>Net Sales</b>	<b>825</b>	<b>1,080</b>	<b>2,065</b>	<b>1,988</b>	<b>2,131</b>
% chg	11.7	30.9	91.2	(3.7)	7.2
<b>Net Profit</b>	<b>213</b>	<b>266</b>	<b>683</b>	<b>670</b>	<b>653</b>
% chg	19.0	24.5	157.3	(2.0)	(2.5)
OPM (%)	25.9	24.6	33.1	33.7	30.7
<b>EPS (₹)</b>	<b>8.1</b>	<b>8.9</b>	<b>27.9</b>	<b>25.7</b>	<b>24.5</b>
P/E (x)	119.4	108.8	34.7	37.6	39.5
P/BV (x)	19.0	13.0	10.1	8.6	7.5
RoE (%)	15.9	11.9	29.2	22.9	19.1
RoCE (%)	14.3	15.2	33.1	27.5	23.3
EV/Sales (x)	20.8	15.7	8.3	8.3	7.8
EV/EBITDA (x)	80.4	63.8	25.0	24.7	25.3

Source: Company, Angel Research; Note: CMP as of June 05, 2017

## ACCUMULATE

CMP	₹968
Target Price	₹1,060

Investment Period	12 Months
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#### Stock Info

Sector	Pharma
Market Cap (₹ cr)	16,865
Net Debt (₹ cr)	187
Beta	0.6
52 Week High / Low	1,015/480
Avg. Daily Volume	46,541
Face Value (₹)	2
BSE Sensex	31,309
Nifty	9,675
Reuters Code	NATP NS
Bloomberg Code	NTCPH IN

#### Shareholding Pattern (%)

Promoters	<b>51.2</b>
MF / Banks / Indian FIs	20.5
FII / NRIs / OCBs	6.3
Indian Public / Others	22.1

Abs. (%)	3m	1yr	3yr
Sensex	8.6	16.6	26.0
Natco Pharma	26.1	102.5	544.0

#### 3-year price chart



Source: Company, Angel Research

#### Shrikant Akolkar

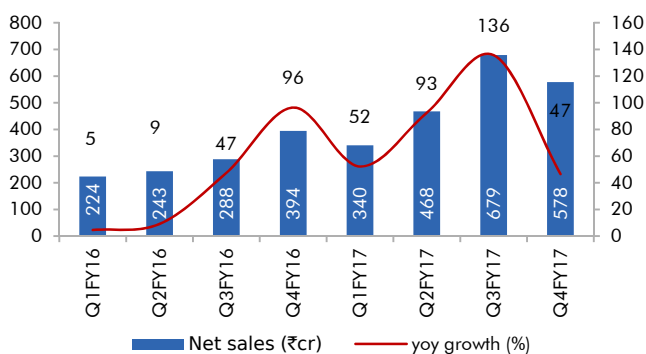
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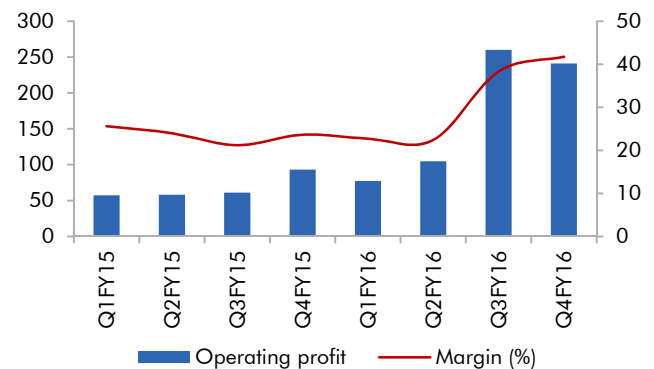
**Exhibit 1: Quarterly financial performance**

Y/E March (₹ cr)	4QFY17	4QFY16	% chg (yoy)	3QFY17	% chg (qoq)	FY17	FY16	% chg (yoy)
<b>Net sales</b>	<b>578</b>	<b>394</b>	<b>46.5</b>	<b>679</b>	<b>(14.9)</b>	<b>2,065</b>	<b>1,080</b>	<b>91.2</b>
Consumption of RM	117	100	17.4	206	(43.0)	599	271	121.4
(% of Sales)	20.3	25.3		30.3		29.0	25.1	
Staff costs	80	53	49.3	61	31.1	243	180	35.3
(% of Sales)	13.8	13.5		8.9		11.8	16.6	
Other expenses	140	148	(5.5)	153	(8.4)	539	364	48.1
(% of Sales)	24.2	37.6		22.5		26.1	33.7	
<b>Total Expenditure</b>	<b>337</b>	<b>301</b>	<b>11.8</b>	<b>419</b>	<b>(19.6)</b>	<b>1,382</b>	<b>815</b>	<b>69.6</b>
<b>Operating Profit</b>	<b>241</b>	<b>93</b>	<b>158.7</b>	<b>260</b>	<b>(7.3)</b>	<b>683</b>	<b>266</b>	<b>157.3</b>
OPM	41.73	23.63	1809 bp	38.3	342 bp	33.1	24.6	850 bp
Depreciation	14	12	9.8	14	(1.5)	54	51	7.1
Other income	(1)	0	(250.0)	6	(109.8)	14	10	44.8
Finance cost	6	4	77.8	5	39.1	19	23	(19.2)
<b>PBT (excl. Extr. Items)</b>	<b>221</b>	<b>78</b>	<b>183.9</b>	<b>248</b>	<b>(11.0)</b>	<b>624</b>	<b>202</b>	<b>209.9</b>
<b>Extr. Income/(Expense)</b>	<b>0</b>	<b>0</b>		<b>0</b>		<b>0</b>	<b>0</b>	
PBT (incl. Extr. Items)	221	78	183.9	248	(11.0)	624	202	209.9
(% of Sales)	38.2	19.7	1847 bp	36.5	166 bp	30.2	18.7	1158 bp
Tax	44	14	213.5	53	(16.8)	140	48	191.2
(% of PBT)	20.0	18.1		21.4		22.3	23.8	
<b>Reported PAT</b>	<b>176</b>	<b>64</b>	<b>177.4</b>	<b>195</b>	<b>(9.4)</b>	<b>485</b>	<b>154</b>	<b>215.7</b>
Minority interest and Associate Company	(0)	(0)	(25.0)	(0)	50.0	(1)	(1)	(15.4)
<b>Adj PAT</b>	<b>176</b>	<b>63</b>	<b>178.6</b>	<b>195</b>	<b>(9.5)</b>	<b>486</b>	<b>155</b>	<b>213.8</b>
Adj. PATM	30.5	16.0		28.7		23.5	14.3	
<b>Equity capital (cr)</b>	<b>35</b>	<b>35</b>		<b>35</b>		<b>35</b>	<b>35</b>	
<b>Adjusted EPS (₹)</b>	<b>10</b>	<b>4</b>	<b>177.1</b>	<b>11</b>	<b>(9.4)</b>	<b>28</b>	<b>9</b>	<b>213.8</b>

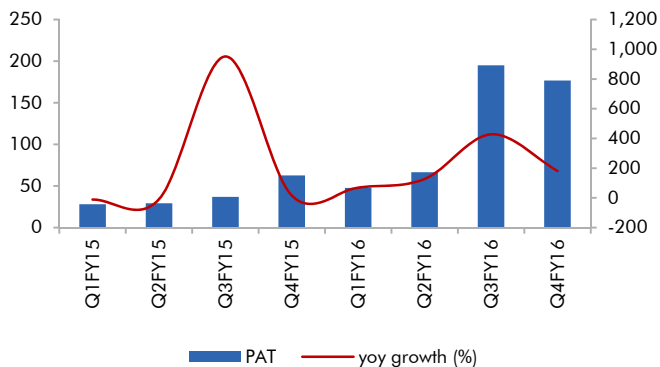
Source: Company, Angel Research

**Exhibit 2: Tamiflu inspires strong Topline growth**


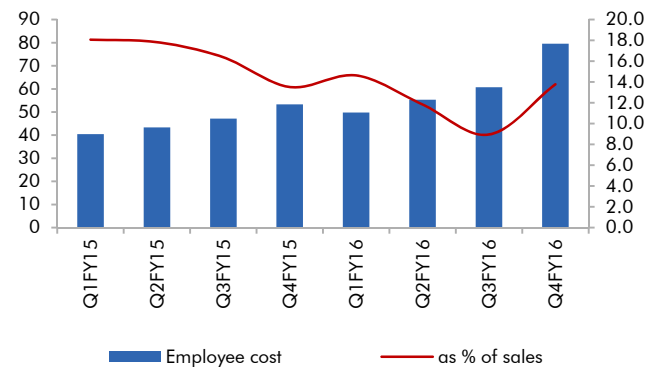
Source: Company, Angel Research

**Exhibit 3: Operating margins improve significantly**


Source: Company, Angel Research

**Exhibit 4: ~2.8x yoy growth in PAT**


Source: Company, Angel Research

**Exhibit 5: Employee costs soars on one off payments**


Source: Company, Angel Research

### Conference call – Key highlights

- Company has indicated of tough business environment due to the pricing pressure in the US.
- Natco will focus more on the domestic business and will be selective of low competition products in the US. The higher free cash flow earned this year will be used for debt repayment.
- gCopaxone launch is almost certain in FY18. Company has said that there is not much price erosion expected at the moment in gCopaxone franchisee.
- gTamiflu sales in FY17 were ₹705cr which included ₹404 in profit sharing.
- HepC business during the quarter done well and company expects 20-25% growth in FY18. Onco revenue during FY17 was ₹322cr.
- 1QFY18 revenue will also see some positive effect of gTamiflu sales. Company has filed for suspension of gTamiflu.
- Company expects a conservative ₹1,700cr revenue in FY18 (ex-Copaxone) with ₹420cr in PAT. This estimate includes new product launches in India.
- Capex for FY18E would be ₹350cr.
- Company is planning to add another line in Guwahati and invest in API capacity.
- Vizag capacity will be ready soon and has not filling from there as of now. Rest all plants of Natco are current with USFDA.
- Company has said that the domestic drug regulator has increased scrutiny of manufacturing plants and has made plant inspection mandatory for new drug approvals.
- Total debt at the end of the quarter was ₹80cr and cash position is ₹230cr.

## Investment arguments

- **Niche therapeutic player in domestic formulations:** Natco is a niche therapeutic segment player in the domestic formulations business (57% of revenues). It mainly focuses on oncology and Hepatitis C segments. The oncology segment continues to grow as market dynamics favor while Hepatitis C franchisee is expected to grow by 20-25% rate over next couple of years due to huge cost advantage and limited competition. Owing to this, we expect 25% CAGR in domestic formulations over FY16-FY19E.
- **Copaxone approval remains a near term trigger:** Natco and its marketing partner Mylan believe that they are the FTF filers on multiple sclerosis drug Copaxone 40mg. The US District Court has already invalidated several patents on this drug and Natco/Mylan have successfully addressed all queries on this drug to the regulator. Additionally the generic manufacturer of 20mg version, Momenta, has received form 483 on its manufacturing facility which will delay Teva/Momenta's gCopaxone 40mg copy. With the June-17 as mostly likely launch month of gCopaxone 40mg and 20mg, Natco/Mylan are expected to emerge as the biggest beneficiary from this.
- **Revlimid opportunity significantly big:** Natco has several low competition drugs in its pipeline which includes gVidara, gDoxil, gForsenol, etc. We believe that Natco has a significant large opportunity in another limited competition multiple myeloma drug gRevlimid. Natco has settled litigation regarding Revlimid (US sales of \$4.4bn) with its innovator Celgene and will be able to launch this drug in 2022E. This will be a very large opportunity considering the size and growth rate of this drug.
- **Proven track record in execution and regulatory compliance:** Natco has been able to keep its facilities USFDA compliant since beginning, this is especially good when several India drug makers have seen adverse regulatory action on their manufacturing sites. Natco is also going through a period of extraordinary growth and USFDA compliance is paramount at this stage. We believe that Natco is a big league player with ability to manufacture limited competition niche drugs and partner with big companies to sell them.

## Outlook and valuation

The bumper earnings in 4QFY17 were mostly expected and there was no surprise element. We however believe that company is almost launch ready for gCopaxone in June-2017. We gain significant confidence that Mylan/Natco are most likely to launch the drug soon which is the most important trigger for the Natco at the moment. Company has responded all the queries on gCopaxone and from the commentary in the conference call, it's just a matter of time before the company launches this gCopaxone 20mg and 40mg. **We value Natco's base business at 24x of its FY19E EPS to 587 per share and add NPV of R&D pipeline of ₹471 to derive new price target of ₹1,060. Our target indicates 10% upside from the CMP of ₹968.**

## Company background

Natco pharma is a Hyderabad based R&D driven organization. The company has presence in domestic and global markets and has two main business segments i.e. API and Formulations. It has seven manufacturing facilities which are approved by various medical regulatory authorities and prominent ones include US FDA, WHO GMP, ANVISA. The company mainly operates in the niche therapeutic segments i.e. Oncology and Hepatitis-C. Natco was earlier pure oncology play in the domestic market however in 2015; company forayed in the Hepatitis C segment, diversifying its domestic operations. Further in 2017, company has forayed in Diabetology and cardiology. In the overseas markets, company is present in US, Canada, Europe, Australia, Brazil etc. The company mainly focuses on limited competition products with high margin. In the domestic markets, company is ranked as #1 in oncology segment while in Hepatitis-C; it has been able to grow faster than the competition due to early mover's advantage. IN the US, company focuses on limited competition products and has partnered with several Indian as well as overseas partners which helps it mitigate risk and launch products. Natco's logistics network in India is well-knit with about 150 marketing personnel and distributors at strategic points to ensure product availability pan-India.

**Profit and loss statement**

Y/E March (₹ cr)	FY15	FY16	FY17	FY18E	FY19E
<b>Total operating income</b>	<b>825</b>	<b>1,080</b>	<b>2,065</b>	<b>1,988</b>	<b>2,131</b>
% chg	11.7	30.9	91.2	(3.7)	7.2
<b>Total Expenditure</b>	<b>612</b>	<b>815</b>	<b>1,382</b>	<b>1,318</b>	<b>1,478</b>
Cost of Materials	242	271	599	537	586
Personnel	137	180	243	304	380
Others Expenses	233	364	539	477	511
<b>EBITDA</b>	<b>213</b>	<b>266</b>	<b>683</b>	<b>670</b>	<b>653</b>
% chg	19.0	24.5	157.3	(2.0)	(2.5)
(% of Net Sales)	25.9	24.6	33.1	33.7	30.7
Depreciation & Amortisation	47	51	54	67	78
<b>EBIT</b>	<b>166</b>	<b>215</b>	<b>629</b>	<b>603</b>	<b>576</b>
% chg	11.6	29.3	192.8	(4.1)	(4.6)
(% of Net Sales)	20.1	19.9	30.5	30.3	27.0
Interest & other Charges	32	23	19	24	24
Other Income	15	10	14	24	24
(% of PBT)	10.0	4.8	2.2	4.0	4.2
Share in profit of Ass.	-	-	-	-	-
<b>Recurring PBT</b>	<b>149</b>	<b>202</b>	<b>624</b>	<b>604</b>	<b>576</b>
% chg	4.1	50.1	209.9	(3.3)	(4.6)
Prior Period & Extra. Exp.	15	-	-	-	-
<b>PBT (reported)</b>	<b>134</b>	<b>202</b>	<b>624</b>	<b>604</b>	<b>576</b>
Tax	4	48	140	157	150
(% of PBT)	2.9	23.8	22.3	26.0	26.0
<b>PAT (reported)</b>	<b>130</b>	<b>154</b>	<b>485</b>	<b>447</b>	<b>426</b>
Add: Share of earnings of ass.					
Less: Minority interest (MI)	(4)	(1)	(1)	(1)	(1)
<b>PAT after MI (reported)</b>	<b>135</b>	<b>155</b>	<b>486</b>	<b>448</b>	<b>427</b>
<b>ADJ. PAT</b>	<b>150</b>	<b>155</b>	<b>486</b>	<b>448</b>	<b>427</b>
% chg	45.8	3.4	213.8	(7.8)	(4.6)
(% of Net Sales)	18.1	14.3	23.5	22.5	20.1
<b>Basic EPS (₹)</b>	<b>8.1</b>	<b>8.9</b>	<b>27.9</b>	<b>25.7</b>	<b>24.5</b>
<b>Fully Diluted EPS (₹)</b>	<b>8.1</b>	<b>8.9</b>	<b>27.9</b>	<b>25.7</b>	<b>24.5</b>
% chg	45.8	3.4	213.8	(7.8)	(4.6)

**Balance Sheet Statement**

Y/E March (₹ cr)	FY15	FY16	FY17E	FY18E	FY19E
<b>SOURCES OF FUNDS</b>					
Equity Share Capital	33	35	35	35	35
Reserves & Surplus	813	1,263	1,632	1,923	2,201
<b>Shareholders' Funds</b>	<b>846</b>	<b>1,298</b>	<b>1,667</b>	<b>1,958</b>	<b>2,236</b>
Minority Interest	5	5	4	4	4
Total Loans	312	113	236	236	236
Deferred Tax Liability	12	14	15	15	15
Other long term liabilities	1	1	1	1	1
Long-term provisions	9	12	12	12	12
<b>Total Liabilities</b>	<b>1,185</b>	<b>1,443</b>	<b>1,935</b>	<b>2,226</b>	<b>2,504</b>
<b>APPLICATION OF FUNDS</b>					
Gross Block	886	972	1,149	1,228	1,548
Less: Acc. Depreciation	222	268	322	389	466
Net Block	<b>664</b>	<b>705</b>	<b>827</b>	<b>839</b>	<b>1,081</b>
Intangible assets	<b>46</b>	<b>9</b>	<b>6</b>	<b>6</b>	<b>6</b>
Capital work-in-progress	129	212	363	313	263
Non-current investments	2	0	0	0	0
Long-term loans and advances	57	62	62	62	62
Other non-current assets	4	4	4	4	4
Current Assets	483	832	1,063	1,527	1,650
Inventories	220	357	351	381	409
Sundry Debtors	192	262	475	436	467
Cash	13	45	47	524	579
Loans & Advances	55	104	134	129	139
Other Assets	2	64	56	56	56
Current liabilities	199	380	391	525	563
<b>Net Current Assets</b>	<b>284</b>	<b>452</b>	<b>672</b>	<b>1,001</b>	<b>1,087</b>
Deferred Tax Asset	-	-	-	-	-
Mis. Exp. not written off	-	-	-	-	-
<b>Total Assets</b>	<b>1,185</b>	<b>1,443</b>	<b>1,935</b>	<b>2,226</b>	<b>2,504</b>

Note: Cash includes cash with scheduled banks on dividend current accounts

**Cash flow statement**

Y/E March (₹cr)	FY15	FY16	FY17E	FY18E	FY19E
Profit before tax	134	207	624	604	576
Depreciation	47	51	54	67	78
Change in Working Capital	(86)	(150)	(219)	149	(31)
Interest / Dividend (Net)	30	21	19	24	24
Direct taxes paid	(24)	(46)	(139)	(157)	(150)
Others	(9)	20	-	-	-
<b>Cash Flow from Operations</b>	<b>93</b>	<b>102</b>	<b>340</b>	<b>685</b>	<b>497</b>
(Inc.)/ Dec. in Fixed Assets	(117)	(157)	(328)	(29)	(270)
(Inc.)/ Dec. in Investments	2	2	3	-	-
<b>Cash Flow from Investing</b>	<b>(115)</b>	<b>(155)</b>	<b>(325)</b>	<b>(29)</b>	<b>(270)</b>
Issue of Equity	-	334	0	-	-
Inc./(Dec.) in loans	71	(199)	123	-	-
Interest paid	(30)	(25)	(19)	(24)	(24)
Dividend Paid (Incl. Tax)	(12)	(25)	(117)	(156)	(148)
Effect of currency translation adjustment	(5)	(1)	0	0	0
<b>Cash Flow from Financing</b>	<b>24</b>	<b>85</b>	<b>(13)</b>	<b>(179)</b>	<b>(172)</b>
Inc./(Dec.) in Cash	2	32	1	478	55
<b>Opening Cash balances</b>	<b>11</b>	<b>13</b>	<b>45</b>	<b>47</b>	<b>524</b>
<b>Closing Cash balances</b>	<b>13</b>	<b>45</b>	<b>47</b>	<b>524</b>	<b>579</b>



**Key ratios**

Y/E March	FY15	FY16	FY17E	FY18E	FY19E
<b>Valuation Ratio (x)</b>					
P/E (on FDEPS)	119.4	108.8	34.7	37.6	39.5
P/CEPS	88.4	81.9	31.2	32.8	33.4
P/BV	19.0	13.0	10.1	8.6	7.5
Dividend yield (%)	0.1	0.2	0.7	0.9	0.9
EV/Sales	20.8	15.7	8.3	8.3	7.8
EV/EBITDA	80.4	63.8	25.0	24.7	25.3
EV / Total Assets	14.5	11.7	8.8	7.4	6.6
<b>Per Share Data (₹)</b>					
EPS (Basic)	8.1	8.9	27.9	25.7	24.5
EPS (fully diluted)	8.1	8.9	27.9	25.7	24.5
Cash EPS	10.9	11.8	31.0	29.5	29.0
DPS	1.2	1.5	6.8	9.0	8.6
Book Value	50.9	74.5	95.7	112.4	128.3
<b>Dupont Analysis</b>					
EBIT margin	20.1	19.9	30.5	30.3	27.0
Tax retention ratio	1.0	0.8	0.8	0.7	0.7
Asset turnover (x)	0.7	0.8	1.1	1.2	1.1
ROIC (Post-tax)	14.1	12.0	26.3	26.8	22.5
Cost of Debt (Post Tax)	0.10	0.16	0.06	0.07	0.07
Leverage (x)	0.4	0.1	0.1	(0.1)	(0.2)
Operating ROE	19.0	12.6	29.3	22.8	19.1
<b>Returns (%)</b>					
ROCE	14.3	15.2	33.1	27.5	23.3
Angel ROIC (Pre-tax)	14.5	15.7	33.9	36.2	30.4
ROE	15.9	11.9	29.2	22.9	19.1
<b>Turnover ratios (x)</b>					
Asset Turnover (Gross Block)	0.9	1.1	1.8	1.6	1.4
Inventory / Sales (days)	97	121	62	70	70
Receivables (days)	85	88	84	80	80
Payables (days)	55	93	46	70	70
WC cycle (ex-cash) (days)	127	116	100	80	80
<b>Solvency ratios (x)</b>					
Net debt to equity	0.4	0.1	0.1	(0.1)	(0.2)
Net debt to EBITDA	1.4	0.3	0.3	(0.4)	(0.5)
Interest Coverage (EBIT / Interest)	5.2	9.4	34.0	25.6	24.4

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### Disclosure of Interest Statement

### Natco Pharma

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)