

Tata Consultancy Services (TCS)

Performance highlights

(₹ cr)	1QFY17	4QFY16	% chg (qoq)	1QFY16	% chg (yoy)
Net revenue	29,305	28,449	3.0	25,668	14.2
Adj. EBITDA	7,065	7,883	(10.4)	6,982	1.2
Adj. EBITDA margin (%)	26.7	27.7	(50)bp	27.2	(50)bp
Adj. PAT	6,317	6,341	(0.4)	5,709	10.6

Source: Company, Angel Research

TCS posted a 3.7% sequential growth in USD revenues to US\$4,362mn for 1QFY2017 (V/s US\$4,375mn expected), which was mostly volume led (3.4% qoq growth). On constant currency (CC) basis, the revenue growth is of 3.1% qoq. On the operating front, the EBITDA and EBIT margins came in at 26.7% and 25.1%, a dip of ~97bp and ~98bp qoq respectively, which is mostly in line with our expectations. Consequently, the PAT came in at ₹6,317cr (V/s ₹6,151cr expected), a de-growth of 0.4% qoq. **We maintain our Buy on the stock.**

Quarterly highlights: The company posted a 3.7% sequential growth in USD revenues to US\$4,362mn for 1QFY2017 (V/s US\$4,375mn expected), which was mostly volume led (3.4% qoq growth). On constant currency (CC) basis, the revenue growth is of 3.1% qoq. In terms of geography, USA posted a CC qoq growth of 2.5%, while Latin America posted CC qoq growth of 0.3%. In terms of verticals, its key industries BFSI, Retail & CPG, and Manufacturing posted a CC qoq growth of 1.7%, 2.7%, and 3.1%, respectively. On the operating front, the EBITDA and EBIT margins came in at 26.7% and 25.1%, a dip of ~97bp and ~98bp qoq respectively, which is mostly in line with our expectations. Consequently, the PAT came in at ₹6,317cr (V/s ₹6,151cr expected), a de-growth of 0.4% qoq.

Outlook and valuation: With headwinds from Diligenta and Latin America behind, still an uncertain BFSI may mar the company's growth (although the same is not currently being encountered). However, even on conservative estimates, we expect TCS to post a revenue CAGR of 12.0% in USD as well as INR terms over FY2016-18E. The stock trades at 16.6x its FY2018E EPS, which is attractive.

Key financials (Consolidated, IFRS)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	94,648	1,08,646	1,21,684	1,36,286
% chg	15.7	14.8	12.0	12.0
Net profit	21,696	24,215	26,432	29,369
% chg	13.5	11.6	9.2	11.1
EBITDA margin (%)	28.2	28.3	27.3	27.3
EPS (₹)	110.9	123.7	135.0	150.1
P/E (x)	22.5	20.2	18.5	16.6
P/BV (x)	8.5	6.7	6.1	5.6
RoE (%)	34.2	33.1	33.2	33.9
RoCE (%)	33.9	31.6	26.9	27.5
EV/Sales (x)	4.9	4.2	3.6	3.2
EV/EBITDA (x)	17.3	14.9	13.2	11.5

Source: Company, Angel Research; Note: CMP as of July 20, 2016

BUY

CMP	₹2,493
Target Price	₹2,867

Investment Period	12 Months
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Stock Info

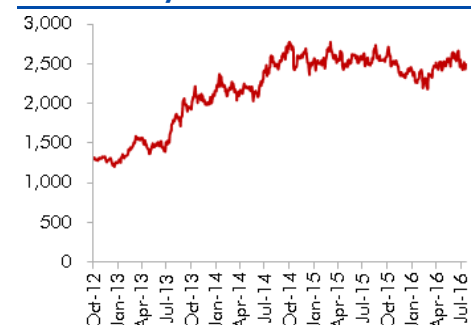
Sector	IT
Market Cap (₹ cr)	491,277
Net Debt (₹ cr)	(14,442)
Beta	0.6
52 Week High / Low	2,769/2,119
Avg. Daily Volume	71,114
Face Value (₹)	1
BSE Sensex	27,916
Nifty	8,566
Reuters Code	TCS.BO
Bloomberg Code	TCS@IN

Shareholding Pattern (%)

Promoters	73.3
MF / Banks / Indian Fls	5.5
FII / NRIs / OCBs	17.0
Indian Public / Others	4.2

Abs.(%)	3m	1yr	3yr
Sensex	8.0	(1.8)	38.5
TCS	1.7	(3.3)	43.1

3-Year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 1QFY2017 performance (Consolidated, IFRS)

(₹ cr)	1QFY17	4QFY16	% chg (qoq)	1QFY16	% chg (yoy)	FY2016	FY2015	% chg(yoy)
Net revenue	29,305	28,449	3.0	25,668	14.2	1,08,646	94,648	14.8
Cost of revenue	16,312	15,592	4.6	13,984	16.6	59,459	53,227	11.7
Gross profit	12,993	12,857	1.1	11,684	11.2	49,187	41,421	18.7
SG&A expense	5,156	4,975	3.6	4,452	15.8	18,956	17,353	9.2
EBITDA	7,837	7,883	(0.6)	7,232	8.4	30,231	24,068	25.6
Dep. and amortisation	490	471	4.1	484	1.2	1,441	1,272	13.3
EBIT	7,347	7,412	(0.9)	6,748	8.9	28,790	22,796	26.3
Other income	963	905	6.4	771	24.9	3,050	3,140	
PBT	8,310	8,317	(0.1)	7,519	10.5	31,840	25,936	22.8
Income tax	1,992	1,970		1,747	14.0	7,503	6,083	23.3
PAT	6,318	6,347	(0.5)	5,772	9.5	24,338	19,853	22.6
Earnings in affiliates	-	-	-	-	-	-	-	-
Minority interest	1	6	(82.1)	64	(98.4)	123	205	(40.1)
Reported PAT	6,317	6,341	(0.4)	5,709	10.6	24,215	19,648	23.2
Adj. PAT	6,317	6,341	(0.4)	5,709	10.6	24,215	21,696	11.6
EPS	32.1	32.2	(0.4)	29.1	10.2	123.2	110.8	11.2
Gross margin (%)	44.3	45.2	(86)bp	45.5	(118)bp	45.3	43.8	151bp
EBITDA margin (%)	26.7	27.7	(97)bp	28.2	(143)bp	27.8	25.4	240bp
EBIT margin (%)	25.1	26.1	(98)bp	26.3	(122)bp	26.5	24.1	241bp

Source: Company, Angel Research

Exhibit 2: Actual vs Angel estimates

(₹ cr)	Actual	Estimate	Var. (%)
Net revenue	29,305	29,362	(0.2)
EBIT margin (%)	25.1	25.1	1.1bps
Adj. PAT	6,317	6,151	2.7

Source: Company, Angel Research

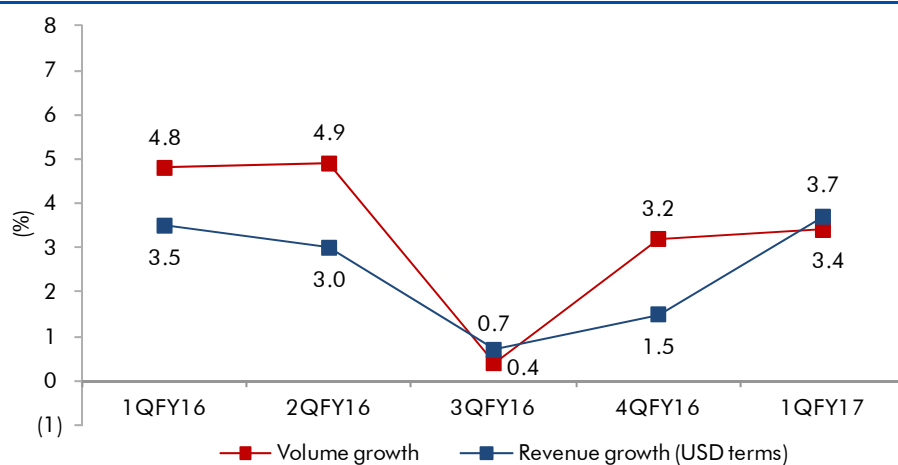
Numbers mostly in line of expectations

TCS posted sales in line of expectations for the quarter, while it outperformed on the net profit front on back of higher than expected EBIT and other income. The company posted a 3.7% sequential growth in USD revenues to US\$4,362mn (V/s US\$4,375mn expected), which was mostly volume led (3.4% qoq growth). On CC basis, the company posted a revenue growth of 3.1% qoq; while in INR terms revenues grew 3.0% qoq to ₹29,305cr (V/s ₹29,362cr expected).

In terms of geography, USA and Latin America grew 2.5% qoq and 0.3% qoq (CC), respectively. In Europe - UK grew 3.8% qoq (CC) while Continental Europe grew 4.6% qoq (CC). India posted an 8.5% CC qoq growth.

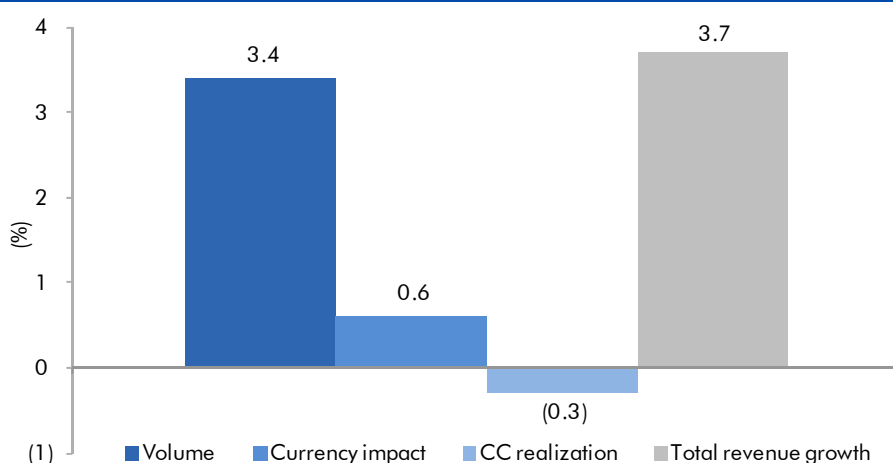
In terms of verticals, BFSI posted a CC qoq growth of 1.7%, Retail & CPG posted a CC qoq growth of 2.7%, Communication & Media posted a CC qoq growth of 7.0%, Manufacturing posted a CC qoq growth of 3.1%, Life Sciences & Healthcare posted a CC qoq growth of 3.9%, Energy & Utilities posted a CC qoq growth of 7.4%, Travel & Hospitality posted a CC qoq growth of 8.6% and Hi-Tech posted a CC qoq de-growth of 0.3%.

Exhibit 3: Trend in volume and revenue growth (qoq)



Source: Company, Angel Research

Exhibit 4: Revenue drivers for 4QFY2016



Source: Company, Angel Research

BFSI growth lagged remaining business, owing to an uncertain macro environment; the company expressed that the potential ramifications of the Brexit on BFSI are still not totally clear. Digital continued showing strength as it grew by 6.4% qoq to US\$694mn and accounted for 15.9% of total revenue during the quarter.

Exhibit 5: Revenue growth (Industry wise on CC basis)

	% to revenue	% chg (CC qoq)	% chg (yoy)
BFSI	40.4	1.7	10.1
Manufacturing	10.4	3.1	13.9
Telecom & Media	11.3	7.0	13.0
Life sciences and healthcare	7.3	3.9	15.6
Retail and distribution	14.0	2.7	11.1
Transportation & Hospitality	3.9	8.6	21.0
Energy and utilities	4.2	7.4	19.3
Hi-tech	5.4	(0.3)	(0.2)
Others	3.1	3.0	(20.7)

Source: Company, Angel Research

Service line wise, Infrastructure Services reported a sequential growth of 5.4% on CC basis. In the company's anchor service line - IT Solutions and Services - ADM grew 0.4% qoq on CC basis, and Enterprise Solutions and Assurance Services grew by 6.7% qoq and 3.2% qoq on a CC basis. The BPO segment grew by 2.8% qoq on a CC basis during the quarter. Asset Leveraged Solutions (3.2% of sales) grew by 2.5% qoq on CC basis.

Exhibit 6: Revenue growth (Service wise on CC basis)

	% to revenue	% chg (CC qoq)	% chg (yoy)
IT solutions and services			
ADM	38.5	0.4	4.9
Enterprise solutions	17.7	6.7	8.1
Assurance services	8.8	3.2	14.8
Engg. and industrial services	4.8	7.0	18.4
Infrastructure services	15.5	5.4	15.4
Asset-leveraged solutions	3.2	2.5	42.4
BPO	11.5	2.8	11.2

Source: Company, Angel Research

Geography wise, growth in INR sales in key geographies was as follows: - USA (2.5% qoq on CC basis), Latin America (0.3% qoq on CC basis), Continental Europe (3.8% qoq on CC basis), India (8.5% qoq on CC basis) and MEA (3.3% qoq on CC basis). The UK and Asia Pacific posted a growth of 3.8% qoq and 1.3% qoq on CC basis, respectively.

Exhibit 7: Revenue growth (Geography wise in INR terms)

	% of revenue	% chg (CC qoq)	% chg (yoy)
U.S.	53.5	2.5	9.7
Latin America	2.0	0.3	24.3
U.K.	14.8	3.8	7.4
Continental Europe	11.5	4.6	12.9
India	6.2	8.5	11.6
Asia Pacific	9.6	1.3	7.7
MEA	2.4	3.3	20.0

Source: Company, Angel Research

Attrition rate declines

In 1QFY2017, TCS witnessed a gross addition of 17,792 employees and net addition of 8,236 employees, taking its total employee base to 3,62,079. During the quarter, the attrition rate (last twelve month [LTM] basis) for the company decreased to 13.6% from 14.7% in 4QFY2016.

Exhibit 8: Hiring and attrition trend

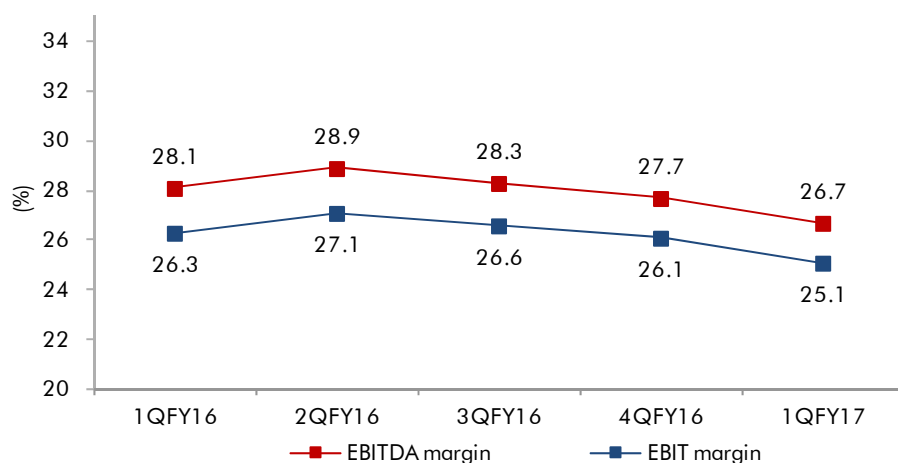
Particulars	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17
Gross addition	25,186	25,186	22,118	22,576	17,792
Net addition	5,279	10,685	9,071	9,152	8,236
Total employee base	3,24,935	3,35,620	3,44,691	3,53,843	3,62,079
Attrition (%) - LTM basis	15.9	16.2	15.9	14.7	13.6

Source: Company, Angel Research

Margin dips

On the operating front, the EBITDA and EBIT margins came in at 26.7% and 25.1% a dip of ~97bp and ~98bp qoq respectively, which is more or less in line with our expectations. Margins breakup for the quarter was as follows - wage hikes (-200bp), currency movement (-20bp) and others (+120bp).

Exhibit 9: Adj. Margin profile



Source: Company, Angel Research

Client metrics

The client pyramid during the quarter witnessed a qualitative improvement with client additions seen in higher revenue brackets. The clients in \$50mn+ revenue band increased by 4, in \$20mn+ revenue band by 2 and in \$5mn+ revenue band by 10.

Exhibit 10: Client pyramid

	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17
US\$1mn–5mn	391	415	425	400	408
US\$5mn–10mn	123	130	132	131	141
US\$10mn–20mn	96	103	108	125	119
US\$20mn–50mn	103	106	108	100	102
US\$50mn–100mn	39	32	31	36	40
US\$100mn plus	30	33	34	37	37

Source: Company, Angel Research

Investment Argument

Guidance – Outlook unchanged: The Management refrained from giving any additional color on FY2017E revenue growth outlook, but expects FY2017 to be better than FY2016 as most of the headwinds (like Diligenta and Japan’s underperformance) that were effecting the company’s growth in FY2016, seem to be diminishing. However uncertainty on back of the Brexit and its impact could impair growth in the near term, though the Management expects ramp up in deal execution. We expect the company to post a US\$ revenue CAGR of 12.0% over FY2016-18E.

Deal pipeline outlook healthier: The company has given a positive outlook for FY2017. It expects a strong demand environment across the board in most areas that it focuses on. TCS, post 4QFY2016, is in a much better position relative to the end of FY2015. The key reasons behind the same are - dramatic acceleration in the adoption of digital technologies; good resilience and strong momentum in BFSI, North America and Continental Europe; major headwinds of Diligenta, Insurance vertical, Japan and Latin America are now behind; strong order book and pipeline; and robust growth in platforms.

Outlook and valuation

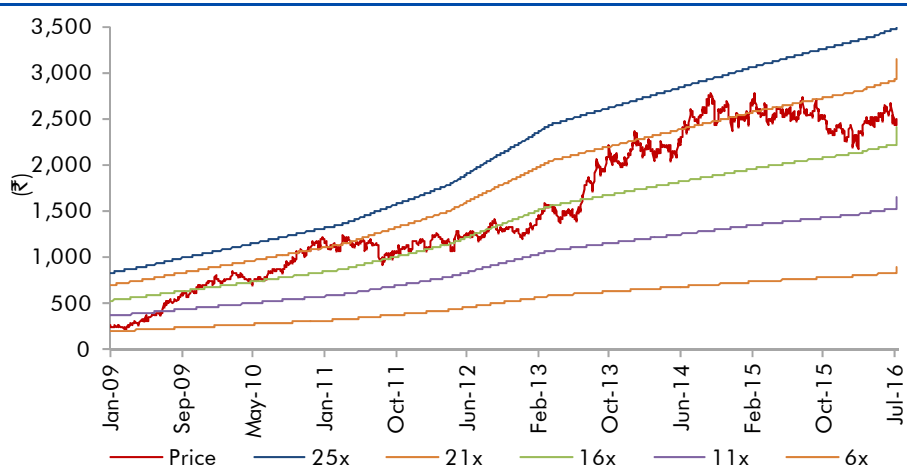
Over FY2016-18E, we expect TCS’ revenue to post a CAGR of 12.0% in USD and INR terms. The company highlighted that it stands comfortable of sustaining the EBIT margin in the range of 26-28%. On the EBIT and PAT fronts, we expect the company to post an 11.1% and 10.1% CAGR over FY2016-18E, respectively. The stock is trading at 16.6x FY2018E EPS of ₹150. **We maintain our Buy rating on the stock with a target price of ₹2,867.**

Exhibit 11: Key assumptions

	FY2017E	FY2018E
Revenue growth (USD)	12.0	12.0
USD-INR rate (realized)	65.7	65.7
Revenue growth (₹)	12.0	12.0
EBITDA margin (%)	27.3	27.3
Tax rate (%)	23.5	23.5
EPS growth (%)	9.2	11.1

Source: Company, Angel Research

Exhibit 12: One-year forward PE chart



Source: Company, Angel Research

Exhibit 13: Recommendation summary

Company	Reco	CMP (₹)	Tgt. price (₹)	Upside (%)	FY2018E EBITDA (%)	FY2018E P/E (x)	FY2016-18E EPS CAGR (%)	FY2018E EV/Sales (x)	FY2018E RoE (%)
HCL Tech	Buy	729	1,000	37.2	20.5	11.4	9.6	1.2	17.9
Infosys	Buy	1,083	1,370	26.5	27.5	15.0	10.4	2.6	22.3
TCS	Buy	2,493	2,867	15.0	27.3	16.6	10.1	3.2	33.9
Tech Mahindra	Buy	505	700	38.6	17.0	12.2	13.2	1.2	20.7
Wipro	Buy	539	680	26.1	23.8	11.8	9.9	1.5	19.6

Source: Company, Angel Research

Company background

TCS is Asia's largest IT services provider and is amongst the top 10 technology firms in the world. The company has a global footprint with an employee base of over 3.0 lakh professionals, offering services to more than 1,000 clients across various industry segments. The company has one of the widest portfolios of services offerings, spanning across the entire IT service value chain – from traditional application development and maintenance to consulting and package implementation to products and platforms.

Profit & Loss statement (Consolidated, IFRS)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Net sales	81,809	94,648	1,08,646	1,21,684	1,36,286
Cost of revenue	42,207	50,599	58,952	65,709	73,594
Gross profit	39,603	44,049	49,695	55,975	62,691
% of net sales	48.4	46.5	45.7	46.0	46.0
SGA expenses	14,471	17,353	18,956	22,755	25,485
% of net sales	17.7	18.3	17.4	18.7	18.7
EBITDA	25,132	26,696	30,738	33,220	37,206
% of net sales	30.7	28.2	28.3	27.3	27.3
Dep. and amortization	1324	1272	1948	1535	1655
% of net sales	1.6	1.3	1.8	1.3	1.2
EBIT	23,808	25,424	28,790	31,685	35,551
% of net sales	29.1	26.9	26.5	26.0	26.1
Other income, net	1589	3140	3050	3050	3050
Profit before tax	25,397	28,564	31,840	34,735	38,601
Provision for tax	6,071	6,083	7,503	8,163	9,071
% of PBT	23.9	21.3	23.6	23.5	23.5
PAT	19,326	22,481	24,338	26,572	29,530
Minority interest	209	205	123	141	161
Extra-ordinary (Exp.)/ Inc.		-2627.9			
Reported PAT	19,117	19,648	24,215	26,432	29,369
Adj. PAT	19,117	21,696	24,215	26,432	29,369
Diluted EPS (₹)	97.6	110.9	123.7	135.0	150.1

Balance sheet (Consolidated, IFRS)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Assets					
Cash and cash equivalents	1,469	1,862	1,862	1,267.2	939.0
Other current financial assets	18,107	16,383	4,833	27,366	35,229
Accounts receivable	18,230	20,440	24,073	26,272	29,424
Unbilled revenues	4,006	3,827	3,992	5,347	5,348
Other current assets	-	6,414	5,975	5,975	5,975
Property and equipment	10,364	11,572	11,790	12,790	13,790
Intangible assets and goodwill	4,157	3,931	3,946	3,946	3,946
Investments	3,449	9,619	22,822	22,822	22,822
Other non current assets	-	906	11,919	11,919	11,919
Total assets	68,913	74,954	91,212	1,17,704	1,29,393
Liabilities					
Current liabilities	10,906	14,428	15,407	35,112	39,325
Short term borrowings	170	243	162	162	162
Redeemable preference shares	-	-	(0)	-	1
Long term debt	127	114	83	83	83
Other non current liabilities	1,684	1,778	2,017	2,333	2,613
Minority interest	691	914	354	495	656
Shareholders funds	55,335	57,477	73,190	79,520	86,554
Total liabilities	68,913	74,954	91,212	1,17,704	1,29,393

Cash flow statement (Consolidated, IFRS)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Pre-tax profit from oper.	23,808	22,481	24,338	26,572	29,530
Depreciation	1,324	1,272	1,948	1,535	1,655
Exp. (deferred)/written off	209	160	174	-	-
Pre tax cash from oper	24,923	23,913	26,460	28,107	31,185
Other inc./prior period ad	1,589	1,272	1,948	1,535	1,655
Net cash from operations	26,512	25,185	28,408	29,642	32,840
Tax	6,071	6,083	7,503	8,163	9,071
Cash profits	20,441	19,102	20,905	21,479	23,768
(Inc)/dec in acc. recv.	(4,154)	(2,210)	(3,633)	(2,199)	(3,153)
(Inc)/dec in unbilled rev.	(846)	179	(165)	(1,355)	(1)
(Inc)/dec in oth. current asst.	(6,650)	(6,414)	439	-	-
Inc/(dec) in current liab.	2,223	(1,207)	(218)	(1,000)	(1,000)
Net trade working capital	(9,427)	(9,652)	(3,577)	(4,554)	(4,154)
Cash flow from oper. actv.	11,015	9,450	17,328	16,925	19,615
(Inc)/dec in fixed assets	(3,494)	(1,207)	(218)	(1,000)	(1,000)
(Inc)/dec in investments	(1,409)	(4,446)	(1,653)	(22,533)	(7,863)
(Inc)/dec in intangible asst.	(651)	(226)	16	-	-
(Inc)/dec in non-cur.asst.	(1,335)	(906)	(11,013)	-	-
Cash flow from invt. actv.	(6,889)	(6,786)	(12,869)	(23,533)	(8,863)
Inc/(dec) in debt	203	61	(113)	-	-
Inc/(dec) in equity	34	223	(559)	141	161
Inc/(dec) in minority int.	(14,666)	(19,923)	(18,415)	(20,101)	(22,335)
Dividends	9,929	17,369	14,629	26,622	11,989
Cash flow from finan. actv.	(4,500)	(2,271)	(4,459)	6,661	(10,185)
Cash generated/(utilized)	(374)	393	-	(595)	(328)
Cash at start of the year	1,843	1,469	1,862	1,862	1,267
Cash at end of the year	1,469	1,862	1,862	1,267	939

Key ratios

Y/E March	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation ratio(x)					
P/E (on FDEPS)	25.5	22.5	20.2	18.5	16.6
P/CEPS	23.9	23.3	18.7	17.5	15.7
P/BVPS	8.8	8.5	6.7	6.1	5.6
Dividend yield (%)	1.3	1.7	1.6	1.8	2.0
EV/Sales	5.7	4.9	4.2	3.6	3.2
EV/EBITDA	18.5	17.3	14.9	13.2	11.5
EV/Total assets	6.8	6.1	5.0	3.7	3.3
Per share data (₹)					
EPS	97.6	110.9	123.7	135.0	150.1
Cash EPS	104.4	106.8	133.6	142.8	158.4
Dividend	32.0	43.5	40.2	43.9	48.7
Book value	283	294	374	406	442
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.8	0.8	0.8	0.8	0.8
Cost of debt (PBT/EBIT)	1.1	1.1	1.1	1.1	1.1
EBIT margin (EBIT/Sales)	0.3	0.3	0.3	0.3	0.3
Asset turnover ratio (Sales/Assets)	1.2	1.3	1.2	1.0	1.1
Leverage ratio (Assets/Equity)	1.2	1.3	1.2	1.5	1.5
Operating ROE	34.9	39.1	33.3	33.4	34.1
Return ratios (%)					
RoCE (pre-tax)	34.5	33.9	31.6	26.9	27.5
Angel RoIC	51.9	54.0	46.7	47.8	50.5
RoE	34.5	34.2	33.1	33.2	33.9
Turnover ratios(x)					
Asset turnover (fixed assets)	7.9	8.2	9.2	9.5	9.9
Receivables days	81	79	81	79	79

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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)
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