

Tata Consultancy Services (TCS)

Performance highlights

(₹ cr)	2QFY17	1QFY17	% chg (qoq)	2QFY16	% chg (yoy)
Net revenue	29,284	29,305	(0.1)	27,166	7.8
Adj. EBITDA	7,065	7,837	(9.8)	7,389	(4.4)
Adj. EBITDA margin (%)	27.7	26.7	(50)bps	27.2	(50)bps
Adj. PAT	6,586	6,317	4.3	6,055	8.8

Source: Company, Angel Research

TCS has announced its 2QFY2017 results and has posted a 0.3% sequential growth in USD revenues to US\$4,374mn (V/s US \$4,441mn expected). Though the results came in below expectations, the EBIT margins and net profit came in much higher than expected. The constant currency (CC) growth stands at 1.0% qoq, while the volume growth is at 1.3% qoq. On the operating front, the EBIT margins came in at 26.2% (V/s 25.2% expected), an expansion of 93bp. Consequently, the PAT came in at ₹6,586cr (V/s ₹6,377cr), a rise of 4.3% qoq.

We recommend an accumulate stance on the stock.

Quarterly highlights: The company posted a 0.3% sequential growth in USD revenues to US\$4,374mn (V/s US \$4,441mn expected). In INR terms, revenues dipped by 0.1% qoq to ₹29,284cr (V/s ₹29,707cr)by. The constant currency (CC) growth stands at 1.0% qoq, while the volume growth is at 1.3% qoq. On the operating front, the EBIT margins came in at 26.2% (V/s 25.2% expected), an expansion of 93bp. Consequently, the PAT came in at ₹6,586cr (V/s ₹6,377cr), a rise of 4.3% qoq. The clients in \$50mn+ revenue band increased by 2, in \$20mn+ revenue band by 5 and in \$5mn+ revenue band by 13. The attrition rate was at 11.9% in the IT services.

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 revenue CAGR of 10.5% in USD as well as INR terms over FY2016-18E. **The stock trades at 16.5x its FY2018E EPS, which is expected to be positive in the near term. Hence, we recommend an accumulate on the stock.**

Key financials (Consolidated, IFRS)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	94,648	1,08,646	1,19,025	1,33,308
% chg	15.7	14.8	9.6	12.0
Net profit	21,696	24,215	25,685	28,483
% chg	13.5	11.6	6.1	10.9
EBITDA margin (%)	28.2	28.3	27.6	27.6
EPS (₹)	110.9	123.7	131.2	145.5
P/E (x)	21.6	19.4	18.3	16.5
P/BV (x)	8.2	6.4	5.9	5.4
RoE (%)	34.2	33.1	32.4	33.1
RoCE (%)	33.9	31.6	26.3	26.9
EV/Sales (x)	4.9	4.2	3.7	3.2
EV/EBITDA (x)	17.3	14.9	13.4	11.8

Source: Company, Angel Research; Note: CMP as of October 18, 2016

ACCUMULATE

CMP	₹2,398
Target Price	₹2,620

Investment Period	12 Months
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Stock Info

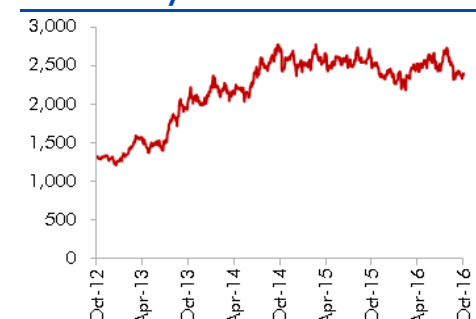
Sector	IT
Market Cap (₹ cr)	472,568
Net Debt (₹ cr)	(14,442)
Beta	0.7
52 Week High / Low	2,740/2,119
Avg. Daily Volume	85,322
Face Value (₹)	1
BSE Sensex	28,051
Nifty	8,678
Reuters Code	TCS.BO
Bloomberg Code	TCS@IN

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	1.1	3.1	34.3
TCS	(1.4)	(3.1)	13.1

3-Year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: 2QFY2017 performance (Consolidated, IFRS)

(₹ cr)	2QFY17	1QFY17	% chg (qoq)	2QFY16	% chg (yoy)	1HFY17	1HFY16	% chg(yoy)
Net revenue	29,284	29,305	(0.1)	27,166	7.8	58,589	52,833	10.9
Cost of revenue	16,038	16,312	(1.7)	14,607	9.8	32,350	26,914	20.2
Gross profit	13,246	12,993	1.9	12,559	5.5	26,239	25,919	1.2
SG&A expense	5,133	5,156	(0.4)	4,662	10.1	10,289	10,896	(5.6)
EBITDA	8,113	7,837	3.5	7,897	2.7	15,950	15,023	6.2
Dep. and amortisation	496	490	1.2	543	(8.7)	986	922	6.9
EBIT	7,617	7,347	3.7	7,354	3.6	14,964	14,101	6.1
Other income	1,052	963	9.2	675	55.9	2,015	1,447	
PBT	8,669	8,310	4.3	8,029	8.0	16,979	15,548	9.2
Income tax	2,066	1,992		1,936	6.7	4,058	3,682	10.2
PAT	6,603	6,318	4.5	6,093	8.4	12,921	11,866	8.9
Earnings in affiliates	-	-	-	-	-	-	-	-
Minority interest	17	-		38	(54.9)	-	-	
Reported PAT	6,586	6,317	4.3	6,055	8.8	12,921	11,866	8.9
Adj. PAT	6,586	6,317	4.3	6,055	8.8	12,921	11,866	8.9
EPS	33.4	32.1	4.3	30.8	8.5	65.5	60.0	9.2
Gross margin (%)	45.2	44.3	90bp	46.2	(100)bp	44.8	49.1	(427)bp
EBITDA margin (%)	27.7	26.7	96bp	29.1	(137)bp	27.2	28.4	(121)bp
EBIT margin (%)	26.0	25.1	93bp	26.0	0bp	25.5	26.7	(115)bp

Source: Company, Angel Research

Exhibit 2: Actual vs Angel estimates

(₹ cr)	Actual	Estimate	Var. (%)
Net revenue	29,284	29,707	(1.4)
EBIT margin (%)	26.0	25.2	80bps
Adj. PAT	6,586	6,377	3.3

Source: Company, Angel Research

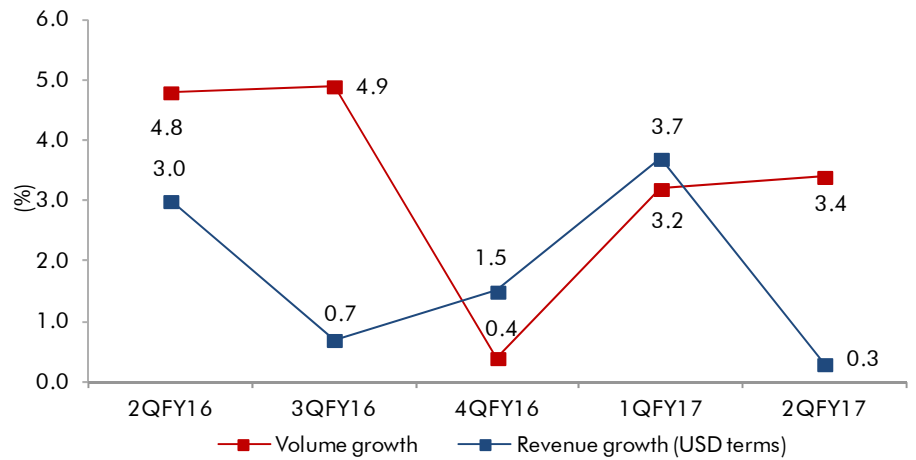
Numbers lower than expectations

TCS posted a 0.3% sequential growth in USD revenues to US\$4,374mn (V/s US \$4,441mn expected). In INR terms, revenues dipped by 0.1% qoq to ₹29,284cr (V/s ₹29,707cr). The constant currency (CC) growth stands at 1.0% qoq, while the volume growth is at 1.3% qoq.

The key geographies like USA grew by 1.4% qoq (CC), while Latin America posted a dip of 0.2% qoq (CC). In Europe, the UK posted a dip of 0.1% qoq (CC) terms, while the Continental Europe posted a growth of 3.7% qoq (CC). India posted a dip of 7.6% qoq (CC), while Asia Pacific and MEA posted a growth of 3.5% qoq and 2.2% qoq (CC).

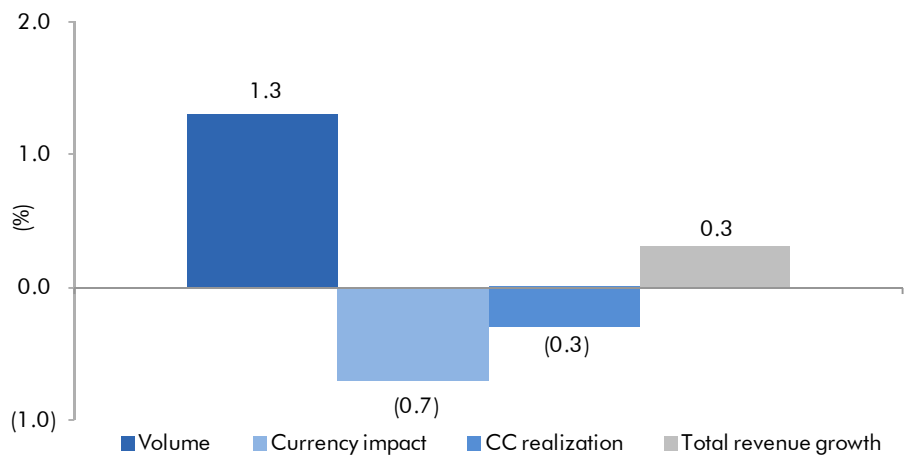
In terms of domain, the BSFI (40.4% sales) posted a CC qoq growth of 1.2%, Retail & CPG (13.4% sales) posted a CC qoq de-growth of 3.1%. Communication & Media (11.4% sales) posted a CC qoq growth of 2.0%, Manufacturing (10.7% sales) posted a CC qoq growth of 3.1%, and Life sciences & Healthcare (7.6% of sales) posted a CC qoq growth of 4.7%.

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



Source: Company, Angel Research

Exhibit 4: Revenue drivers for 2QFY2017



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 segment further continued to show weak numbers by 1.5% qoq to US\$704mn and accounted for 16.1% 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	1.2	7.2
Manufacturing	10.7	3.1	15.1
Telecom & Media	11.4	2.0	12.3
Life sciences and healthcare	7.6	4.7	14.8
Retail and distribution	13.4	(3.1)	1.9
Transportation & Hospitality	3.9	2.3	17.1
Energy and utilities	4.3	3.6	17.3
Hi-tech	5.4	0.1	1.1
Others	2.9	(4.6)	31.0

Source: Company, Angel Research

Service line wise, Infrastructure Services reported a sequential growth of 2.1% on CC basis. In the company's anchor service line - IT Solutions and Services - ADM grew 0.9% qoq on CC basis, and Enterprise Solutions and Assurance Services grew by 2.0% qoq and 3.5% qoq on a CC basis. The BPO segment grew by 2.5% qoq on a CC basis during the quarter. Asset Leveraged Solutions (2.6% of sales) de-grew by 20.1% 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	38.4	0.9	2.5
Enterprise solutions	17.8	2.0	8.6
Assurance services	9.0	3.5	11.9
Engg. and industrial services	4.8	1.1	16.1
Infrastructure services	15.7	2.1	13.7
Asset-leveraged solutions	2.6	(20.1)	(14.5)
BPO	11.7	2.5	10.3

Source: Company, Angel Research

Geography wise, growth in INR sales in key geographies was as follows: USA (1.4% qoq on CC basis), Latin America (-0.2% qoq on CC basis), UK (-0.1% qoq on CC basis), India (-7.6% qoq on CC basis), and MEA (2.2% qoq on CC basis). The Continental Europe and Asia Pacific posted a growth of 3.7% qoq and 3.5% qoq on CC basis, respectively.

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

	% of revenue	% chg (CC qoq)	% chg (yoy)
U.S.	54.0	1.4	7.9
Latin America	2.0	(0.2)	15.8
U.K.	13.8	(0.1)	7.4
Continental Europe	11.8	3.7	14.9
India	5.8	(7.6)	(4.5)
Asia Pacific	10.2	3.5	6.5
MEA	2.4	2.2	8.8

Source: Company, Angel Research

Attrition rate declines

In 2QFY2017, TCS witnessed a gross addition of 22,665 employees and net addition of 9,440 employees, taking its total employee base to 3,71,519. During the quarter, the attrition rate (last twelve month [LTM] basis) for the company decreased to 12.9% from 13.6% in 1QFY2017.

Exhibit 8: Hiring and attrition trend

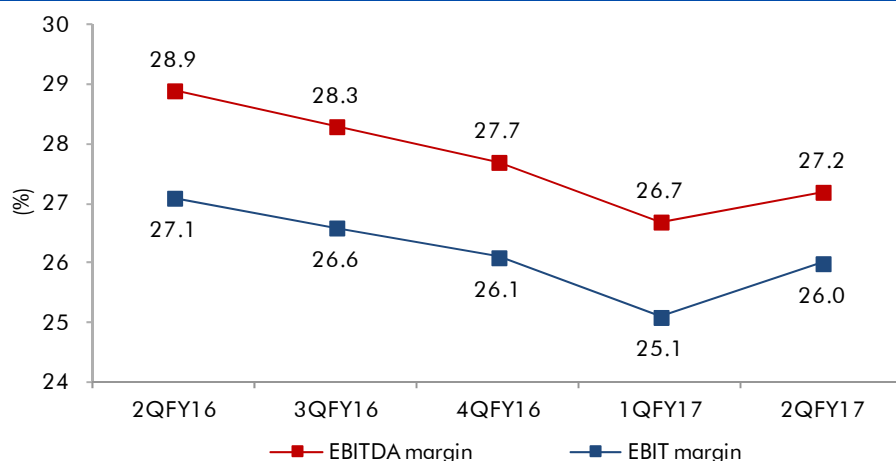
Particulars	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17
Gross addition	25,186	22,118	22,576	17,792	22,665
Net addition	10,685	9,071	9,152	8,236	9,440
Total employee base	3,35,620	3,44,691	3,53,843	3,62,079	3,71,519
Attrition (%) - LTM basis	16.2	15.9	14.7	13.6	12.9

Source: Company, Angel Research

Margin expands

On the operating front, the EBITDA and EBIT margins came in at 27.2% and 26.0%, an expansion of ~50bp and ~90bp qoq respectively, better than expected. The 130bp tailwind from operational efficiencies is more than the offset 40bp headwind from cross currency movements on EBIT margins.

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 2, in \$20mn+ revenue band by 5 and in \$5mn+ revenue band by 13.

Exhibit 10: Client pyramid

	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17
US\$1mn–5mn	415	425	400	408	410
US\$5mn–10mn	130	132	131	141	154
US\$10mn–20mn	103	108	125	119	110
US\$20mn–50mn	106	108	100	102	107
US\$50mn–100mn	32	31	36	40	42
US\$100mn plus	33	34	37	37	36

Source: Company, Angel Research

Investment Argument

Guidance – near term outlook uncertain: The management refrained from giving any additional color on FY2017E revenue growth outlook. 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 10.5% over FY2016-18E.

Growth fundamentals intact: In spite of the near term uncertainty arising out of Brexit, TCS expects revenue growth to make a comeback after current cyclical headwinds are behind. Long term drivers of tech spending will remain intact and new growth areas are emerging like Big data and Analytics. Though the growth in Digital segment weakened, the segmental revenue remained strong with 30% yoy CC basis and will continue to drive business performance. In terms of verticals, the softness in BFSI was expected. The weakness was more pronounced in UK than in the US.

Outlook and valuation

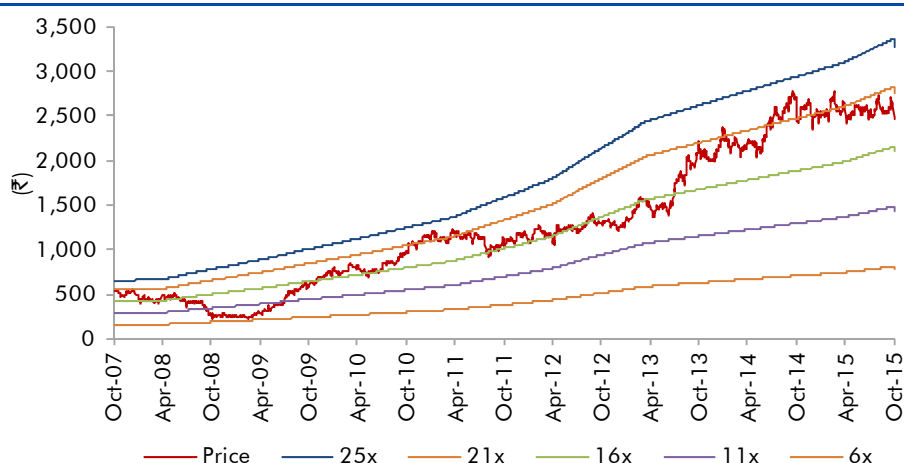
Over FY2016-18E, we expect TCS' revenue to post a CAGR of 10.5% in USD and INR terms. The company highlighted that it stands comfortable of sustaining the EBIT margin in the range of 26-28%. On the EBIT and PAT fronts, we expect the company to post a 9.3% and 8.5% CAGR over FY2016-18E, respectively. The stock is trading at 16.5x FY2018E EPS of ₹145.5. **We reduce our rating on the stock to accumulate from Buy, as we believe that the stock has discounted the near term growth well.**

Exhibit 11: Key assumptions

	FY2017E	FY2018E
Revenue growth (USD)	9.0	11.0
USD-INR rate (realized)	66.0	66.0
Revenue growth (₹)	9.6	12.0
EBITDA margin (%)	27.3	27.3
Tax rate (%)	23.5	23.5
EPS growth (%)	6.9	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	834	1,000	19.9	20.5	13.0	9.6	1.8	17.9
Infosys	Buy	1,038	1,249	20.3	27.0	15.0	8.4	2.5	21.6
TCS	Accumulate	2,398	2,620	9.3	27.6	16.5	8.5	3.2	33.1
Tech Mahindra	Buy	426	700	64.5	17.0	10.3	13.2	0.9	20.7
Wipro	Buy	481	680	41.3	17.9	13.0	1.3	1.7	18.1

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	1,19,025	1,33,308
Cost of revenue	42,207	50,599	58,952	64,273	71,986
Gross profit	39,603	44,049	49,695	54,751	61,322
% of net sales	48.4	46.5	45.7	46.0	46.0
SGA expenses	14,471	17,353	18,956	21,901	24,529
% of net sales	17.7	18.3	17.4	18.4	18.4
EBITDA	25,132	26,696	30,738	32,851	36,793
% of net sales	30.7	28.2	28.3	27.6	27.6
Dep. and amortization	1324	1272	1948	2142	2400
% of net sales	1.6	1.3	1.8	1.8	1.8
EBIT	23,808	25,424	28,790	30,708	34,393
% of net sales	29.1	26.9	26.5	25.8	25.8
Other income, net	1589	3140	3050	3050	3050
Profit before tax	25,397	28,564	31,840	33,759	37,444
Provision for tax	6,071	6,083	7,503	7,933	8,799
% of PBT	23.9	21.3	23.6	23.5	23.5
PAT	19,326	22,481	24,338	25,825	28,644
Minority interest	209	205	123	141	161
Extra-ordinary (Exp.)/ Inc.		(2,627.9)			
Reported PAT	19,117	19,648	24,215	25,685	28,483
Adj. PAT	19,117	21,696	24,215	25,685	28,483
Diluted EPS (₹)	97.6	110.9	123.7	131.2	145.5

Balance sheet (Consolidated, IFRS)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Assets					
Cash and cash equivalents	1,469	1,862	1,862	1,862.2	1,862.2
Other current financial assets	18,107	16,383	4,833	24,974	30,729
Accounts receivable	18,230	20,440	24,073	27,071	31,694
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	1,16,707	1,28,085
Liabilities					
Current liabilities	10,906	14,428	15,407	34,345	38,466
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	2,282	2,556
Minority interest	691	914	354	495	656
Shareholders funds	55,335	57,477	73,190	79,341	86,163
Total liabilities	68,913	74,954	91,212	1,16,707	1,28,085

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	25,825	28,644
Depreciation	1,324	1,272	1,948	2,142	2,400
Exp. (deferred)/written off	209	160	174	-	-
Pre tax cash from oper	24,923	23,913	26,460	27,968	31,044
Other inc./prior period ad	1,589	1,272	1,948	2,142	2,400
Net cash from operations	26,512	25,185	28,408	30,110	33,443
Tax	6,071	6,083	7,503	7,933	8,799
Cash profits	20,441	19,102	20,905	22,177	24,644
(Inc)/dec in acc. recv.	(4,154)	(2,210)	(3,633)	(2,999)	(4,623)
(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)	(5,354)	(5,624)
Cash flow from oper. actv.	11,015	9,450	17,328	16,823	19,021
(Inc)/dec in fixed assets	(3,494)	(1,207)	(218)	(1,000)	(1,000)
(Inc)/dec in investments	(1,409)	(4,446)	(1,653)	(20,141)	(5,755)
(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)	(21,141)	(6,755)
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)	(19,533)	(21,661)
Dividends	10,303	16,976	14,629	23,711	9,234
Cash flow from finan. actv.	(4,126)	(2,664)	(4,459)	4,318	(12,266)
Cash generated/(utilized)	(374)	393	-	-	-
Cash at start of the year	1,843	1,469	1,862	1,862	1,862
Cash at end of the year	1,469	1,862	1,862	1,862	1,862

Key ratios

Y/E March	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation ratio(x)					
P/E (on FDEPS)	24.6	21.6	19.4	18.3	16.5
P/CEPS	23.0	22.5	18.0	16.9	15.2
P/BVPS	8.5	8.2	6.4	5.9	5.4
Dividend yield (%)	1.3	1.8	1.7	1.8	2.0
EV/Sales	5.7	4.9	4.2	3.7	3.2
EV/EBITDA	18.5	17.3	14.9	13.4	11.8
EV/Total assets	6.8	6.1	5.0	3.8	3.4
Per share data (₹)					
EPS	97.6	110.9	123.7	131.2	145.5
Cash EPS	104.4	106.8	133.6	142.1	157.7
Dividend	32.0	43.5	40.2	42.6	47.3
Book value	283	294	374	405	440
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	1.0
Leverage ratio (Assets/Equity)	1.2	1.3	1.2	1.5	1.5
Operating ROE	34.9	39.1	33.3	32.5	33.2
Return ratios (%)					
RoCE (pre-tax)	34.5	33.9	31.6	26.3	26.9
Angel RoIC	51.9	54.0	46.7	45.8	47.3
RoE	34.5	34.2	33.1	32.4	33.1
Turnover ratios(x)					
Asset turnover (fixed assets)	7.9	8.2	9.2	9.3	9.7
Receivables days	81	79	81	83	87

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	TCS
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)