



| | | |
|-----------|-----------------------|--------------|
| IT & ITes | Sharekhan code: TECHM | Analyst meet |
|-----------|-----------------------|--------------|

3R MATRIX

| | | | |
|----------------------|---|---|---|
| | + | = | - |
| Right Sector (RS) | ✓ | ■ | ■ |
| Right Quality (RQ) | ✓ | ■ | ■ |
| Right Valuation (RV) | ✓ | ■ | ■ |

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

| | | | |
|----|-----|---|-----|
| | Old | | New |
| RS | ■ | ↔ | ■ |
| RQ | ■ | ↔ | ■ |
| RV | ■ | ↔ | ■ |

| | |
|--------------------------------|--------|
| Reco/View | Change |
| Reco: Buy | ↔ |
| CMP: Rs. 907 | |
| Price Target: Rs. 1,000 | ↔ |

↑ Upgrade ↔ Maintain ↓ Downgrade

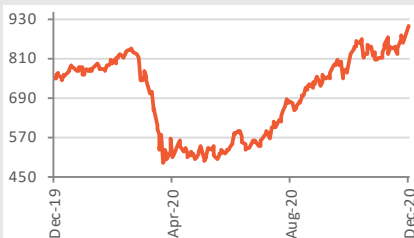
Company details

| | |
|-------------------------------|---------------|
| Market cap: | Rs. 87,685 cr |
| 52-week high/low: | Rs. 914 / 470 |
| NSE volume: (No of shares) | 56.4 lakh |
| BSE code: | 532755 |
| NSE code: | TECHM |
| Free float: (No of shares) | 62 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 35.8 |
| FII | 38.9 |
| DII | 15.1 |
| Others | 10.2 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|------|------|------|------|
| Absolute | 11.4 | 24.5 | 67.0 | 21.2 |
| Relative to Sensex | -0.9 | 9.7 | 32.9 | 11.8 |

Sharekhan Research, Bloomberg

Summary

- We maintain our Buy rating on Tech Mahindra (TechM) with an unchanged PT of Rs. 1,000 considering opportunities in the 5G segment, strong growth potential in enterprise segment and scope for margin improvement.
- A rebranded strategy will focus on capturing opportunities in targeted digital areas, partnerships & alliances, large deal wins, execution and talent transformation.
- Management remains confident that the BFSI, manufacturing and hi-tech verticals would clock revenue of over \$1 billion each in 1-2 years.
- Management has guided for high-single digit revenue growth (led by double-digit growth in enterprise segment and acceleration in communication revenue) with 15% EBIT margin in FY2022E. We expect a higher payout to shareholders, going ahead.

We attended Tech Mahindra's (Tech M) Investor Day 2020, wherein the management highlighted market trends, refreshed strategies for a sustainable growth, augmentation of capabilities, levers for margin improvement and capital allocation policies. Tech M's rebranded strategy (Nxt.Now) will focus on capturing targeted opportunities across the digital space, its skill to capture 5G spends, alliances, large deal wins, execution and talent transformation. A 20% growth in the deal pipeline in the last six months with a potential for 73 large deals reflects the company's augmented service offering capabilities to gain market share. Hence, the management remains confident that BFSI, manufacturing and hi-tech verticals would cross over \$1 billion in revenue annually in 1-2 years. The company has created a centralised team to drive large deals wins proactively. Tech M is well-positioned to derive maximum benefits from 5G opportunities by leveraging its investments in products, platforms, people and partners. Technology spends have been accelerating given higher adoption of tech-centric business model, emerging of commercial models for digital propositions and scaling of digital technologies. With enhanced digital capabilities and investments in IPs, products and platforms, management remains optimistic to deliver sustainable revenue growth by focusing on client mining, accelerating large deal wins and gaining market share in the fast growing areas (experience, intelligence and cloud) of digital. Management expects positive results from its portfolio rationalisation in certain geographies, services and clients in next 3-4 quarters. The company guided high-single digit revenue growth (led by double-digit growth in enterprise segment and acceleration in communication revenue) with 15% EBIT margin in FY2022.

Our Call

Attractive valuation: Though Tech M's refreshed strategy remains broadly same with its earlier strategy, management remains confident that the company's enhanced service offerings and investments in IPs and platforms would help the company to capture opportunities across digital stack. Tech M is well placed to benefit from the expansion of 5G value chain across networks and IT services and 5G will also open up new opportunities from enterprise side. At CMP, the stock is trading at reasonable valuation of 17x/14.5x of its FY2022E/FY2023E earnings. We assume Tech M would continue to generate a higher FCF in coming years, which would increase the dividend/ buyback payouts. We prefer the stock given an anticipated strong revenue growth potential in the enterprise business, opportunities from 5G and scope for margin improvement. We have Buy rating on the stock with a price target (PT) of Rs. 1,000.

Key Risks

Any hostile development with respect to the current visa regime would affect employee expenses as lower proportion of local resources are deployed onsite. Further, a delay in pick-up of 5G-related spends would affect revenue estimates.

Valuations

| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
|--------------------|----------|----------|----------|----------|----------|
| Revenue | 34,742.1 | 36,867.7 | 38,103.9 | 42,231.4 | 46,559.5 |
| OPM (%) | 18.2 | 15.5 | 17.0 | 17.5 | 17.9 |
| Adjusted PAT | 4,297.6 | 4,250.5 | 4,117.8 | 4,749.9 | 5,495.6 |
| % YoY growth | 13.1 | -1.1 | -3.1 | 15.3 | 15.7 |
| Adjusted EPS (Rs.) | 47.7 | 45.9 | 46.8 | 54.0 | 62.5 |
| P/E (x) | 19.0 | 19.8 | 19.4 | 16.8 | 14.5 |
| P/B (x) | 4.0 | 3.6 | 3.3 | 2.9 | 2.6 |
| EV/EBITDA (x) | 12.5 | 14.1 | 12.2 | 10.3 | 8.7 |
| RoNW (%) | 22.0 | 19.2 | 17.9 | 18.6 | 19.3 |
| RoCE (%) | 24.0 | 20.5 | 18.8 | 20.1 | 21.2 |

Source: Company; Sharekhan estimates

Seven-pillar strategies likely to create path for sustainable growth

On the Investor Day 2020, Tech Mahindra's management highlighted its refreshed *Nxt.Now* strategy which would focus on multiple vectors such as customer experience, talent transformation, force multipliers and alliances, large deals, sustainable execution and mergers and acquisitions (M&A). The management indicated seven pillars of competencies - engineering services, BPS, cloud/data and analytics, cyber security, platforms, 5G and network services and CMO, which are expected to address client requirement comprehensively across its six large verticals. Further, the company rebranded its 3-4-3 strategy to 3 *trends* (exponential growth of content, explosion of intelligent devices and power of new technologies), 4 *big bets* (human centered experience, business, platform and cloud) and 3 *objectives* (run better, change faster and grow greater). The management indicated that it has been remained disciplined in terms of M&A activity over last 24 months and its M&A strategy has largely filled white spaces and gaps in the portfolios and strengthened its go-to-market strategy. Apart from the communications vertical, the management expects BFSI (\$774 million on TTM basis), manufacturing (\$870 million) and hi-tech (\$431 million) would cross \$1 billion+ in terms of revenue in next 1-2 years. Further, annuity revenue would contribute 40-50% after the repair phase. Company has also created a centralised team to drive large deals win rate momentum with a proactive approach. Management highlighted that the deals pipeline has increased by 20% in the past six months with 73 large deals in the pipeline. With end-to-end service offerings and augmentation of capabilities, the company is well positioned to focus on account mining, large deal wins and quality of revenue for a sustainable growth momentum going ahead.

Focused on talent transformation to support growth

Tech M has refreshed its leadership by accessing and developing top 200-300 potential leaders. Also, the company recruited external talents across the world in the last couple of months to strengthen its leadership team. The company focuses on building young bunch of leaders, which include in technical and non-technical areas and talent development across the functions to support its sustainable growth momentum ahead.

Comprehensive playbook to capture 5G opportunities

Management indicated that a paradigm shift is happening with 5G technology as it would drive greater customer experience. Tech M has developed IPs and platforms which would help the company to accelerate growth of its communication vertical. Tech M has comprehensive offerings in 5G that include 1) 5G for CSPs – it helps service providers with digital transformation, 2) 5G for enterprise and 3) 5G for ecosystem. The management has identified five areas such as open 5G network, network on cloud, intelligent & cognitive managed operations, digital operations support system (OSS) and enterprise network modernisation to capture 5G spends worldwide.

Tech M has transformed itself to end-to-end solutions in network services, operations support system (OSS), and business support systems (BSS) even through acquisitions and partnerships from just a plain vanilla system integrator. Hence, we believe the company will be key beneficiary from 5G opportunities from the acceleration of investments in 5G infrastructure by operators and adoptions of 5G by enterprises.

Augmented capabilities would capture digital opportunities

Management indicated that technology spends by customers has been accelerating on the back of higher adoption of tech-centric business model, emerging of commercial models for digital propositions and scaling of digital technologies. The management sees higher traction for experience, data & analytics and AI and cloud market segments.

Experience: The management indicated that the market for experiences is expected to grow at an 11.2% CAGR over FY2020-24, reaching \$219 billion. Key elements that affect experiences globally are 1) consumers as hyper personalization is expected to remain going ahead, 2) emerging of new business models, 3) Data, as companies are focusing to collect information across different channel to stay relevant to customers and 4) Foundation of new digital technology which would be led by the ability to use 5G to consume information instantly from anywhere and 5) battle for ready as enterprises want to become operational resilience. Company sees four broad opportunities in telecom segment from experiences perspective such as 1) digitized customer journey, 2) CRM call center modernization (with RPA/AI enabled solutions), 3) digital self-serve portal across multiple channels and 4) digitization of fixed line field force. The refreshed strategy i.e *Nxt.Now*

will help the company to bring all the components like customer experience, service experience, technology experience, data experience, industry experience and process experience, under one roof to deliver end-to-end services to customers. The management indicated that revenue in this segment is growing faster than average industry growth rate over the last couple of years. Hence, management remains confident that it is well positioned to gain market share in the experience space using its proprietary STELLA framework.

Data and AI: Tech M generated \$800 million in revenue from the data and analytics segment in FY2020, with over 10,000 associates and providing services to more than 300 global customers across 50+ countries. Company provides services to 35 Fortune 500 customers. Tech M has identified key trends in data and analytics such as 1) cloud, 2) data and analytics worlds collide, 3) smarter, faster and more responsible AI and 4) X analytics. Management expects higher demand for its data and AI services with the acceleration of cloud adoption. Data on cloud market is expected to grow at 17.5% CAGR to \$800 billion by 2025. Company has four strategies to drive growth in data and AI segment - 1) leveraging the relationship across 1,000 accounts of Tech M, 2) enhancing focus in to growth geographies and growth verticals, 3) collaborate and co-innovating with partners/customers and 4) specialized labs with partners. The company targets to increase its customer base to 1,000 from current customer base of 300+. Tech M has been investing in IPs to participate in the different stages of data life cycle management and partnering with hyperscalers to move data to cloud.

Cloudification: Tech M's integrated cloud services revenue is at over \$900 million and is growing at 22%. The management expects higher growth in cloud segment to continue as enterprises are moving fast to hybrid multi cloud operating model. The cloud market (IaaS, PaaS and SaaS) are expected to grow at 18% CAGR to \$484 billion by 2024. Note that less than 15% of workload has been moved to cloud till date. Tech M's platform in this segment has delivered higher yields. Further, Tech M has booked TCVs of 2x of its TTM over previous period. The company sees opportunities in large AMS deals, data center cave outs, scaling SaaS and hyperscalers and higher cloud adoption by telecom companies leveraging NETOPS.ai IP.

Management guided high-single digit growth in revenue and EBIT margin at 15% in FY2022E

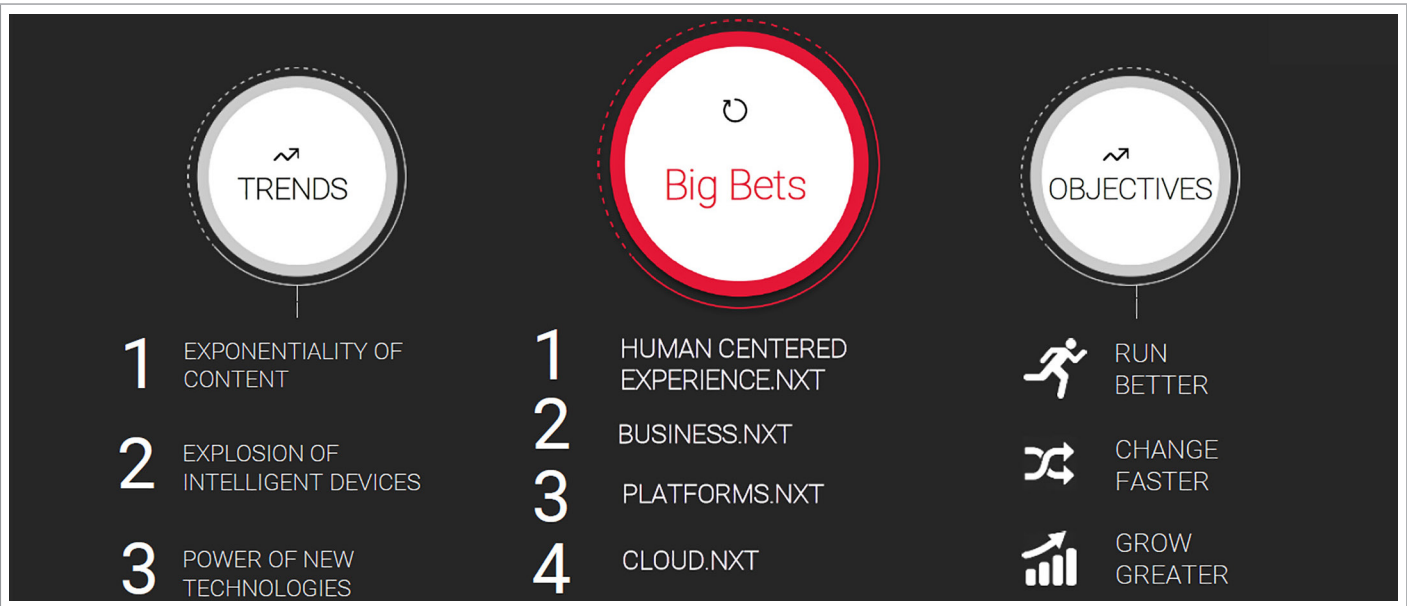
The management highlighted that there was significant focus on cost take-out, automation, process re-design and cyber security by the enterprises during Q1FY2021, while the focus was shifted to productive solutions, traceability, cloudification and carve-outs in Q2FY2021. In the last 30-45 days, customers have been focusing on engagement, experience and service design and new business model. A 20% growth in deal pipeline in last six months with 73 large deal potential reflects the company's augmented service offerings capabilities to gain market shares. Further, the company expects positive results by rationalizing portfolios in certain geographies, services and clients in next 3-4 quarters. Management indicated structural changes will not have any material impact on its revenue, but will provide significant benefit to margin. Tech M's management expects high single-digit growth in FY2022E, led by double digit growth in enterprise segment and acceleration in communication business and EBIT margins at 15% which would be aided by higher offshoring, lower sub-contractor expenses, work-from-home (WFH) efficiencies and portfolio synergies.

Focus on capital allocation policy; expect FCF to improve further and payout as well

Tech M's management indicated that it has remained disciplined in terms of M&A activity in last 24 months. The company's M&A strategy is largely to fill in the white spaces, gaps in portfolio and strengthen the go-to-market strategy. The key focus areas of its M&A strategies are growth in number of clients, account expansion, new capabilities and integration of both company's capabilities. The management stated that the M&A strategies would help the company to grow faster.

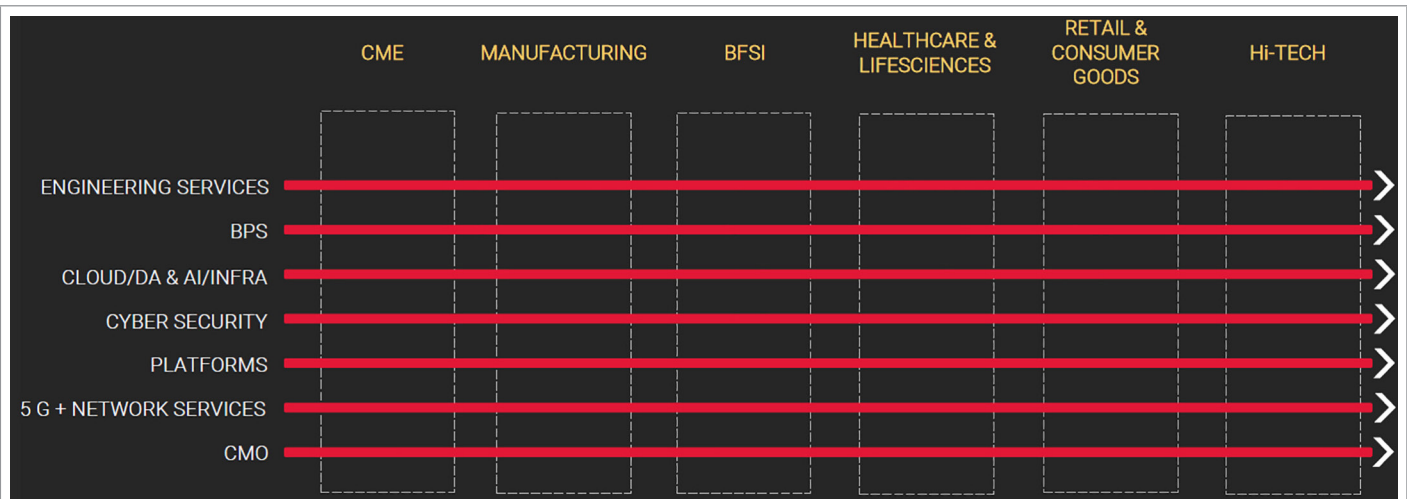
Tech M generated its second highest quarterly FCF of \$236 million, aided by strong collections, versus \$317 million in Q1FY2021. Free cash flow to PAT conversion stood at 164% versus 246% in Q1FY2021. FCF stood at \$552.4 million in H1FY2021, as compared to \$522.6 million in FY2020. The company has declared an annual special dividend of Rs. 15 per share during Q2FY2021. Over last 3 years, Tech M has returned back cumulative cash of over \$1 billion through dividends and buyback. The management also indicated that it has returned back \$400 million of cash to shareholders through dividends, which implies 77% to net profit in last 12 months. We believe that company would continue to generate higher free cash flows going ahead, which would result in higher payout to shareholders.

Refreshed strategy: **NXT.NOW**



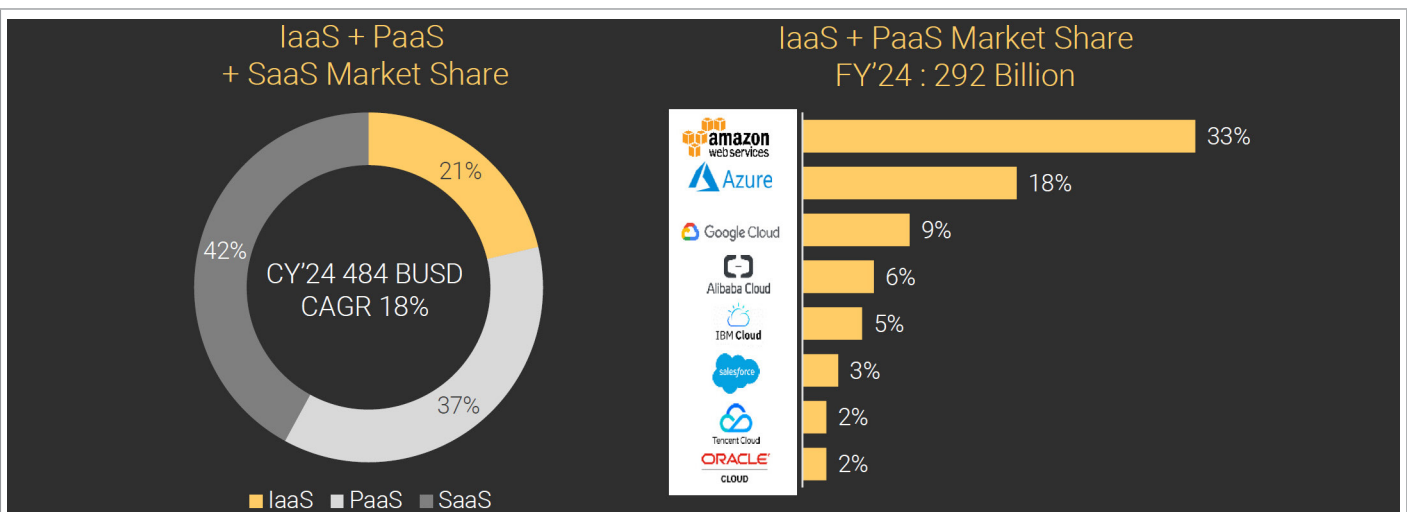
Source: Company, Sharekhan Research

Tech M focuses on seven-pillar strategies



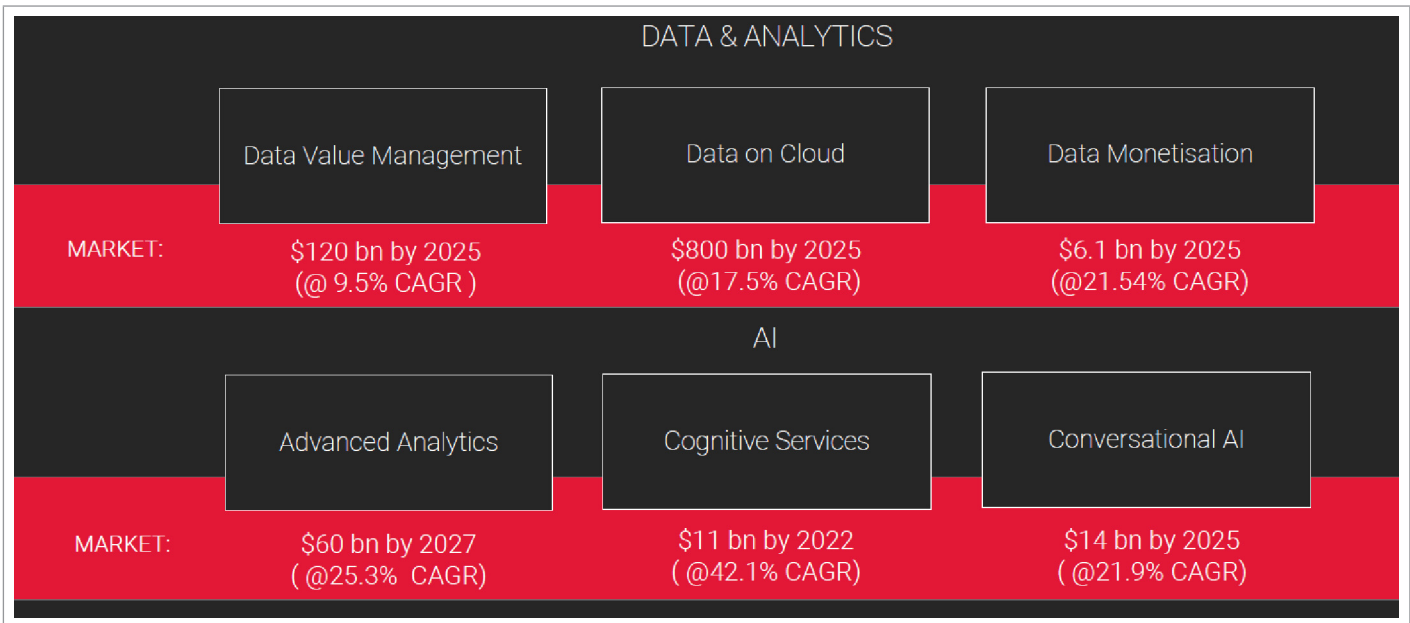
Source: Company, Sharekhan Research

Cloud market trends



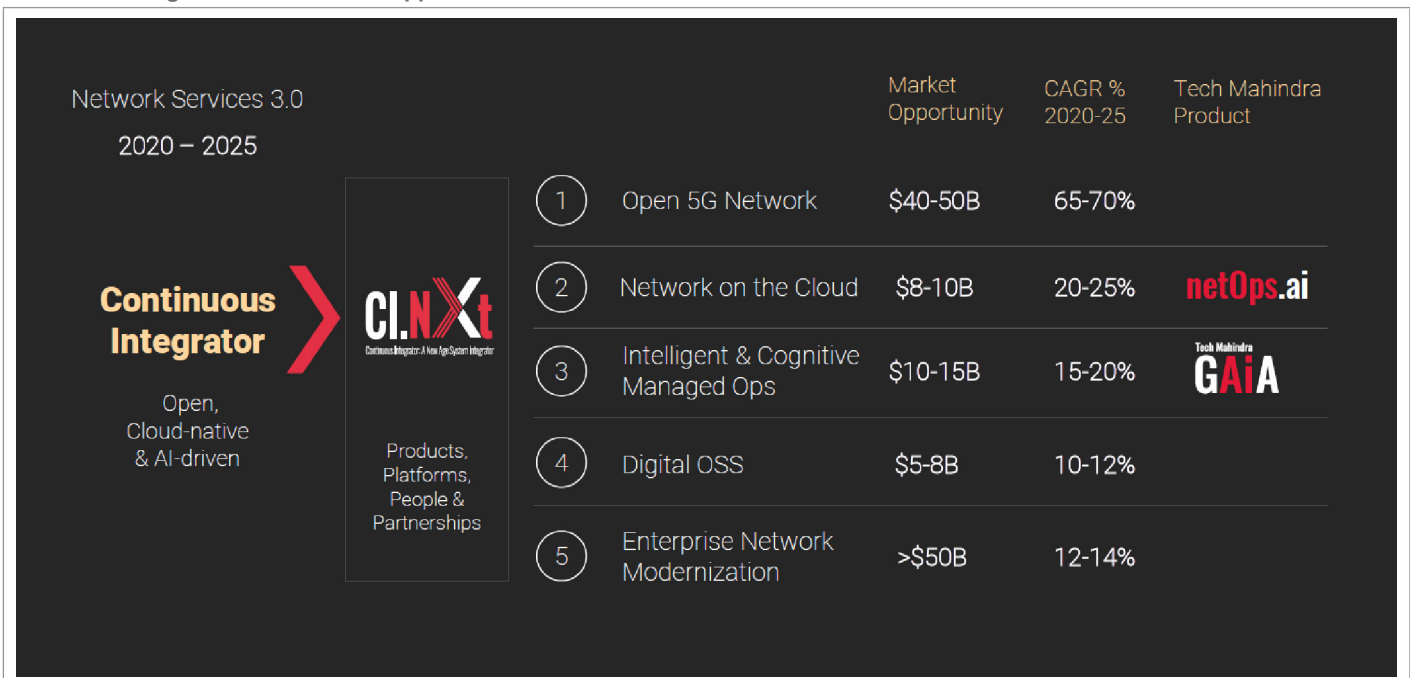
Source: Company, Sharekhan Research

Tech M's bet on Data and Analytics and AI



Source: Company, Sharekhan Research

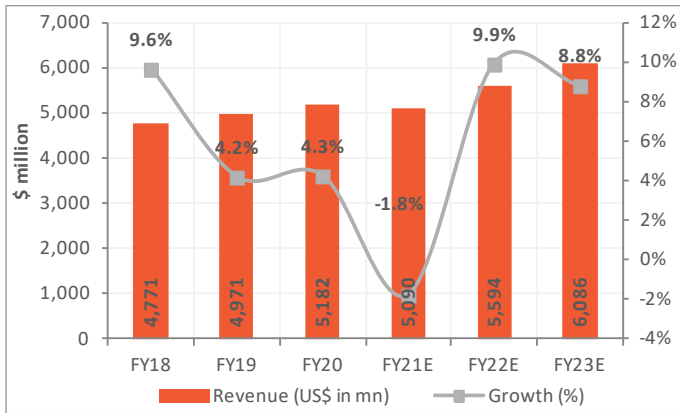
Tech M's management outlined 5G opportunities



Source: Company, Sharekhan Research

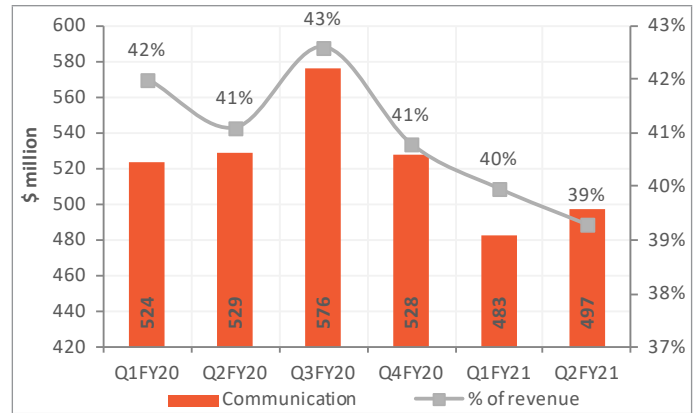
Financials in charts

Revenue (\$ mn) and growth (%)



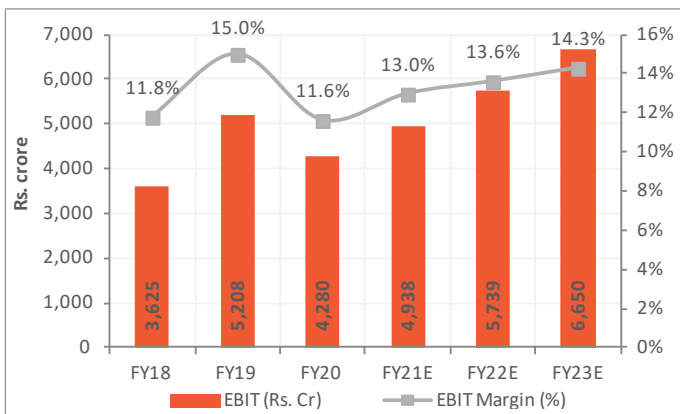
Source: Company, Sharekhan Research

Communication (\$ mn) & % of total revenue



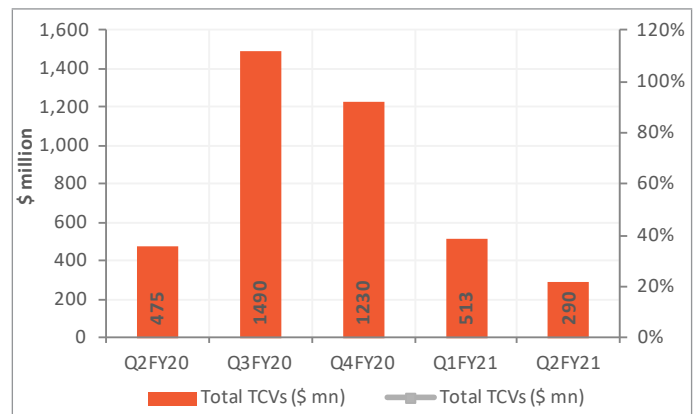
Source: Company, Sharekhan Research

EBIT (Rs. cr) and EBIT margin (%)



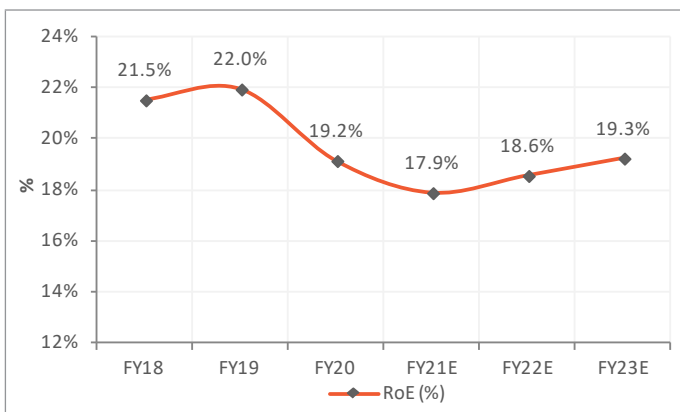
Source: Company, Sharekhan Research

Order book (\$ million)



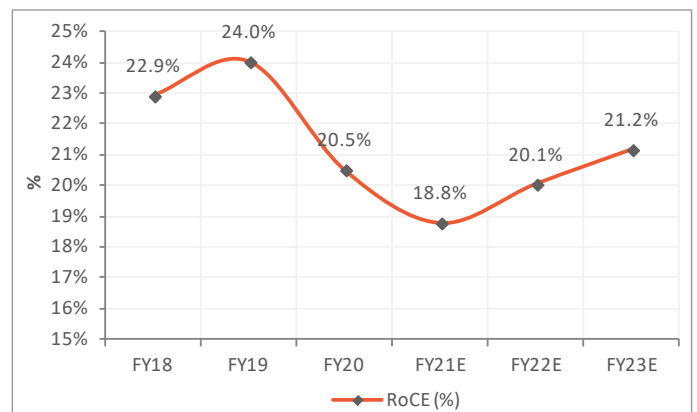
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view – Expect acceleration in technology spending going forward

Industry analysts such as Gartner estimate IT services spending would grow by 5-8% over CY2021-CY2024E compared to average of 4.2% achieved in CY2010-CY2019. Forecasts indicate higher demand for cloud infrastructure services, potential increase in specialised software, potential investments in transformation projects by clients, and increased online adoption across verticals. Implications from the outbreak of the pandemic have accelerated digital activities among large global enterprises, leading to increased spending on workplace transformation and collaboration tools, cyber-security, and higher cloud migration. Further, the increasing need for rapid access to data and automation will enhance focus on network equipment and communications, speeding up 5G network deployments, and adoption of 5G equipment.

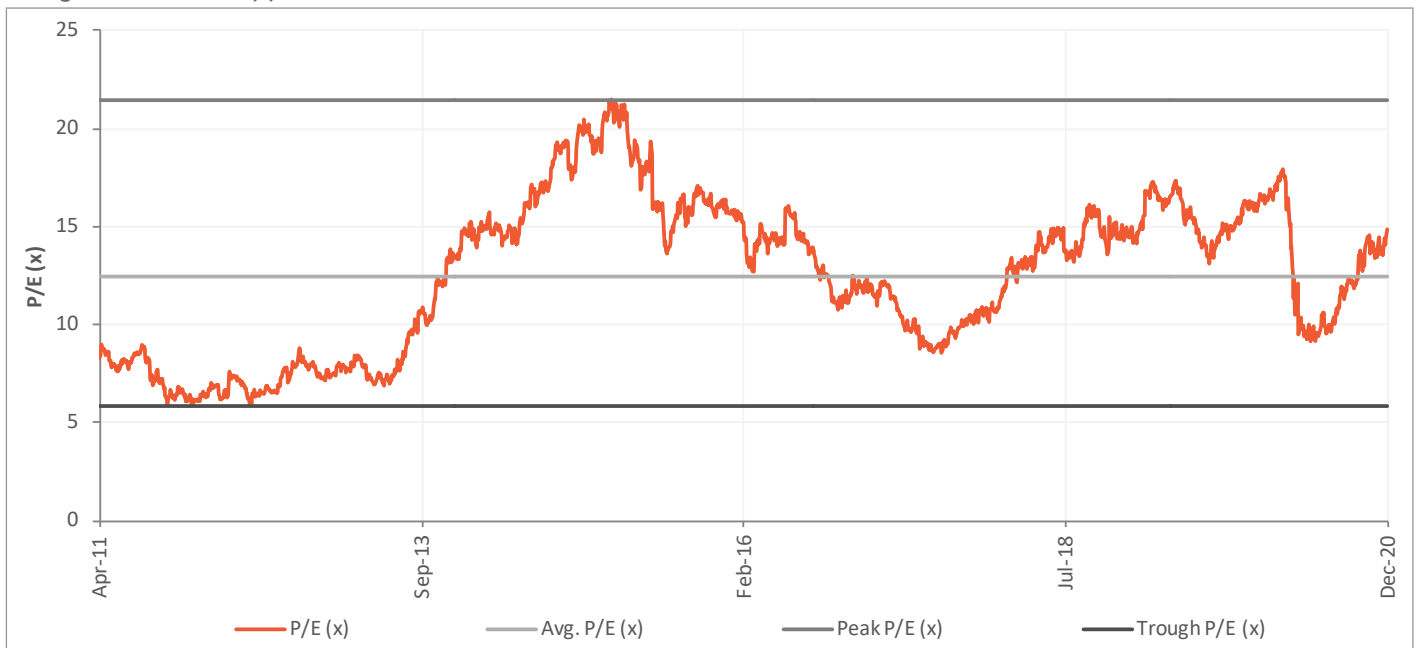
■ Company outlook - Well-placed to capture 5G opportunity

With 40% of revenue arising from the telecom segment, Tech M is well-placed to capture 5G-related spending from telecom service providers and OEMs. We believe Tech M is well positioned to be a key beneficiary from 5G roll out, given its early investments in network capabilities through LCC, investments in IPs and platforms and investments/partnerships (Intel, Rakuten, AltioStar and among others) to develop an ecosystem. We remain positive on the company considering a strong demand environment in telecom, strategic focus on digital acquisitions, improving large deal win rate, and a continuous focus to diversify business.

■ Valuation - Attractive valuation

Though Tech M's refreshed strategy remains broadly same with its earlier strategy, management remains confident that the company's enhanced service offerings and investments in IPs and platforms would help the company to capture opportunities across digital stack. Tech M is well placed to benefit from the expansion of 5G value chain across networks and IT services and 5G will also open up new opportunities from enterprise side. At CMP, the stock is trading at reasonable valuation of 17x/14.5x of its FY2022E/FY2023E earnings. We assume Tech M would continue to generate a higher FCF in coming years, which would increase the dividend/ buyback payouts. We prefer the stock given an anticipated strong revenue growth potential in the enterprise business, opportunities from 5G and scope for margin improvement. We have Buy rating on the stock with a price target (PT) of Rs. 1,000.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer comparison

| Particulars | CMP (Rs / Share) | O/S Shares (Cr) | MCAP (Rs Cr) | P/E (x) | | EV/EBIDTA (x) | | P/BV (x) | | RoE (%) | |
|-------------|------------------|-----------------|--------------|---------|-------|---------------|-------|----------|-------|---------|-------|
| | | | | FY21E | FY22E | FY21E | FY22E | FY21E | FY22E | FY21E | FY22E |
| HCL Tech | 834 | 271 | 226,333 | 18.3 | 16.9 | 11.7 | 10.9 | 3.9 | 3.5 | 22.7 | 22.1 |
| Infosys | 1,137 | 426 | 484,412 | 26.0 | 23.4 | 17.1 | 15.5 | 3.5 | 3.2 | 26.7 | 26.6 |
| TCS | 2,727 | 375 | 1,023,257 | 31.1 | 27.5 | 22.7 | 20.4 | 11.6 | 10.7 | 38.0 | 40.4 |
| Wipro | 353 | 572 | 201,694 | 20.3 | 19.1 | 13.9 | 12.7 | 3.5 | 3.2 | 15.7 | 15.8 |
| Tech M | 907 | 97 | 87,685 | 19.4 | 16.8 | 12.2 | 10.3 | 3.3 | 2.9 | 17.9 | 18.6 |

Source: Company, Sharekhan estimates

About company

Incorporated in 1986, Tech M was formed by a joint venture between Mahindra & Mahindra and British Telecom Plc, under the name of Mahindra British Telecom. The company has been providing end-to-end services to telecom OEMs and service providers. Over the years, the company has acquired Comviva Technologies, LCC and Hutchison Global Services to fill gaps in its service offerings in the telecom space. Notably, post the acquisition of Satyam, Tech M entered the enterprise solutions space and became the fifth largest Indian IT player. The company has now diversified its exposure to other verticals such as BFSI and manufacturing. Tech M offers a bouquet of services, which include IT outsourcing services, consulting, next generation solutions, application outsourcing, network services, infrastructure management services, integrated engineering solutions, business process outsourcing, platform solutions, and mobile value-added services.

Investment theme

Tech M is one of the leading players in providing end-to-end services and solutions to telecom OEMs and major global service providers in the communication space (contributes more than 40% to its total revenue). Historically, this has helped the company whenever there is any uptick in technology spends, led by adoption of new technology. As the pace of spending from the roll-out of 5G network is set to accelerate across the globe, Tech M is well-positioned to capitalise on the 5G opportunity across networks and IT services given its investments in network capabilities, IPs, platforms, and partnerships. This has enabled the company to compete with large peers by striving for large deals in the enterprise segment.

Key Risks

1) Any hostile development against current visa regime would affect employee expenses due to lower proportion of local resources are deployed onsite. 2) Rupee appreciation or/and adverse cross-currency movements might affect earnings. 3) Delay/loss of accounts in the enterprise segment. 4) Delay in pick-up of 5G-related spends.

Additional Data

Key management personnel

| | |
|--------------------|---|
| Mr. Anand Mahindra | Chairman |
| CP Gurnani | Chief Executive Officer |
| Manoj Bhat | Chief Financial Officer |
| Jagdish Mitra | Chief Strategy Officer |
| Manish Vyas | President, Communications, Media & Entertainment Business |
| Vivek Agarwal | Global Head for Enterprise Verticals |

Source: Company Website

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|-----------------------------------|-------------|
| 1 | TML BENEFIT TRUST | 9.75 |
| 2 | First State Investments ICVC | 5.82 |
| 3 | BlackRock Inc | 4.99 |
| 4 | First State Global Umbrella Fund | 4.58 |
| 5 | SBI Funds Management Pvt Ltd | 2.55 |
| 6 | Republic of Singapore | 2.19 |
| 7 | ICICI Prudential Asset Management | 1.88 |
| 8 | SBI-ETF NIFTY 50 | 1.76 |
| 9 | Vanguard Group Inc/The | 1.75 |
| 10 | Government Pension fund | 1.60 |

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

| Right Sector | |
|-----------------|--|
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| Right Quality | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet |
| Right Valuation | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

Source: Sharekhan Research

Sharekhan

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