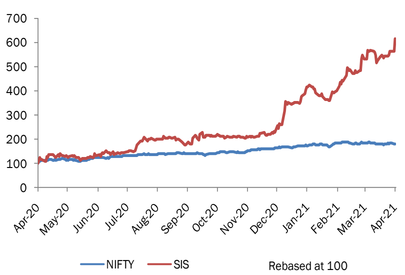
Share India Securities Limited

07 April 2021

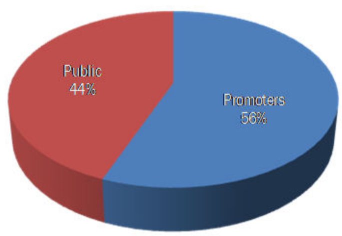
A niche play with rich expertise in tech-driven quant trading — BUY

Sector	: Financial Services
Target Price	: ₹395
Current Market Price	: ₹295
Market Cap	: ₹941 crore
52-week High/Low	: ₹315/92
Daily Avg Vol (12M)	: 34,692
Face Value	: ₹10
Beta	: 1.13
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 540725
NSE Scrip Code	: SHAREINDIA
Bloomberg Code	: SISLTD IN
Reuters Code	: SCAC.BO
Nifty	: 14,684
BSE Sensex	: 49,201
Analyst	: Research Team

Price Performance



Shareholding Pattern



Initiating Coverage

Investment Summary

- Share India Securities Limited (SIS) is a new-age financial service provider offering bespoke capital market solutions by leveraging technology. The company is present across the broking, trading, NBFC, wealth management, insurance broking and merchant banking verticals.
- Leveraging its expertise in quant trading strategies, SIS's prop trading operations contributes over three-fourths of its revenues. The company employs arbitrage strategies, quant trading tools and jobbing/high-frequency trading (HFT) in its prop trading operations while specialising in low-latency algo trades.
- SIS acquired a leading stock broking company, Total Securities Limited (TSL) in December 2019. The merger resulted in an immediate growth spurt, an increase in financial robustness, synergies from the application of TSL's trading strategies to SIS's technology platform, and generation of benefits such as geographical expansion of operations, cost reduction, and strengthening of leadership.
- SIS's broking business focuses on HNI clients, leveraging its strong network of over 500 branches.
- The NBFC business's loan book grew more than 2x to ₹61.6 crore in FY20. The wealth management business enables diversification by generating fee income, albeit at a small scale. Merchant banking and insurance broking provide further diversification but do not generate significant revenues currently.
- We expect SIS to maintain its focus in its prop trading niche by leveraging its rich experience and expertise as it gives the company a competitive advantage in a market where the products and services are largely commoditised. The SIS stock currently trades at an attractive forward P/E level of 9.0 FY23E EPS. Assigning a target multiple of 12.0x FY23E EPS, our valuation generates a price target of ₹395, informing a BUY rating with an upside potential of 34%.

Key Financial Metrics (Consolidated)

Rs lakh	FY19A	FY20A	FY21E	FY22E	FY23E
Total income	20,719	27,935	43,338	53,385	64,116
Growth		*34.8%*	*55.1%*	*23.2%*	*20.1%*
Cost of operations	15,437	20,605	33,329	39,787	47,784
Finance cost	1,140	1,785	1,818	1,792	1,815
PAT	2,499	4,000	6,058	8,501	10,510
PAT margin	*12.1%*	*14.3%*	*14.0%*	*15.9%*	*16.4%*
Diluted EPS (Rs)	7.83	12.54	18.99	26.64	32.94

Source: Company data; Khambatta Research

Tel: +91-(0)22 4027 3300
Fax: +91-(0)22 6641 3377
www.khambattasecurities.com

Company Profile

SIS has a network of 587 branches spread across 14 states

Share India Securities Limited (SIS) is a new-age financial service provider offering bespoke capital market solutions by leveraging technology. The company is present across the broking, trading, NBFC, wealth management, insurance broking and merchant banking verticals.

Incorporated in 1994, the company entered into the equity broking segment by becoming a member of the BSE. Subsequently in 2007 and 2008, SIS entered the F&O and currency markets, respectively. After acquiring memberships of NSE, MSEI and CDSL in 2010, the company registered as a mutual fund advisor with AMFI in 2016. In 2017, the company became a registered Research Analyst, followed by registering as a Category I Merchant Banker and Portfolio Manager with SEBI in 2018. Further in 2018, SIS started its non-banking finance company (NBFC) business via a wholly-owned subsidiary. After acquiring the stock broking company Total Securities Limited (TSL) in 2019, SIS entered the insurance broking business through another wholly-owned subsidiary. In 2020, the company acquired Total Commodities (India) Private Limited, a commodity and equity trading company.

Through a network of 587 branches spread across 14 Indian states, SIS offers personalised services to a diverse client base including both institutional and HNI clients. The company has a strategic focus on the HNI segment.

SIS listed on the BSE SME platform through an IPO in 2017 and migrated to the exchange's main board in 2019.

Industry Overview

The Indian broking industry clocked overall revenues of ₹22,500 in FY20

Broking and Trading: Growing at an average annual rate of 10.5% since FY15, the Indian broking industry clocked overall revenues of ₹22,500 in FY20. The Indian brokerage industry is highly fragmented with over 4,600 registered brokers and thousands of sub-brokers. This offers investors a huge choice and making the broking industry an extremely competitive one. Brokerage houses can be categorised as bank brokerage houses, full-service brokerage houses, and discount brokerage houses. Discount brokerages have risen in prominence over the last 10 years or so, forcing traditional brokerage firms to lower brokerage rates, offer discount plans or offer a flat fee structure. Consolidation in the industry has led to an increase in market share of top brokers.

India's market cap-to-GDP ratio witnessed a rise from 54% in 2008 to 76% in 2019, compared to 93% for the overall global equity market (source: World Bank). This shows a scope for further expansion of the India's market cap, driven by both GDP growth as well as an increase in the market cap-to-GDP ratio. With GDP growth expected to gradually pick up, increasing formalisation of economy and more entities from newer segments getting listed (insurance companies, ecommerce service providers), India's market capitalisation to GDP ratio is likely to increase further in next few fiscals. As the covid vaccination drive picks up pace across the globe, the world economy is set to return to the growth path (+5.5% in CY21E) with India expected to lead the growth revival with a double-digit expansion of 11.5% in FY22. Improvement in global macroeconomic factors and monetary/fiscal stimulus by central banks/governments will continue to supply liquidity in global equity markets and support economic recovery over the next couple of years. The IPO market in India has also been buoyant recently with a number of marquee IPOs expected to hit the market this year.

The Indian commodity market went through structural changes in FY19 when the universal exchange principle came into effect with the commencement of commodity trading on the BSE and NSE in October 2018. Commodity market turnover increased by 24.8% from ₹74.3 lakh crore in FY19 to ₹92.6 lakh crore in FY20.

In the 10 years to FY19, NBFC balance sheets expanded at a CAGR of 18.6%

NBFC: Non-banking finance companies (NBFCs) play a critical role in fulfilling the credit requirements of the unserved and underserved segments of the Indian lending market. Over the years, driven by exponential growth, some NBFCs have become comparable with private sector banks in terms of their scale of operations. Rendering credit access to customers who are unbanked or have low credit profiles or have little to no credit history, NBFCs are a key alternative source for credit access. With a large number of NBFCs focused in specialised market segments, they have a deep understanding of the specific market(s) they operate in. They are also distinguished by their unique business models and technology adoption. Driven by brisk demand from their niche markets, NBFCs registered robust growth during most part of the last decade. Between FY09-end and FY19-end, NBFC balance sheets expanded at a CAGR of 18.6% as assets of scheduled commercial banks (SCBs) grew by an average 10.7% each year, resulting in NBFCs' aggregate balance sheet size increasing from 9.3% to 18.6% of the aggregate balance sheet size of banks. As of FY20-end, total assets of the NBFC sector (including HFCs) stood at ₹51.5 lakh crore as they became the largest net borrowers of funds from the financial system. The source of more than half of the funds was SCBs, followed by Asset Management Companies-Mutual Funds (AMC-MFs) and insurance companies. The sector witnessed liquidity constraints following defaults by some large NBFCs around 4Q CY18. Consequently, the RBI intervened with measures to improve systemic liquidity and strengthen NBFCs' governance framework.

Mutual fund AUM grew 4.5x in 10 years to ₹31.6 lakh crore as of 28 February 2021

Mutual Fund: The total assets under management (AUM) of the Indian mutual fund (MF) industry grew 4.5x in 10 years, from ₹ 7.1 lakh crore in February 2011 to ₹31.6 lakh crore as of 28 February 2021. In the 5 years since February 2016, the AUM increased 2.5x from ₹12.6 lakh crore. The milestone of ₹10 lakh crore AUM was crossed for the first time in May 2014 and within a further 3 years the AUM size doubled to breach the ₹20 lakh crore for the first time in August 2017. The next ₹10 lakh crore was achieved in a little over further 3 years when the AUM touched ₹30 lakh crore for the

Tel: +91-(0)22 4027 3300
Fax: +91-(0)22 6641 3377
www.khambattasecurities.com

first time in November 2020. The total number of folios stood at 9.62 crore while the number of folios under equity, hybrid and solution-oriented schemes, where the maximum investment comes from the retail segment, was 8.07 crore at the end of February 2021. The brisk growth witnessed by the MF sector is attributable to a healthy macroeconomic environment, expanding capital markets, healthy liquidity, inflow of foreign funds and increased investor awareness leading to incremental participation of individual investors (from both the retail and HNI segments).

India was ranked 10th amongst 88 countries with a share of 2.6% of the global life insurance market in 2018

Insurance: There are 24 life insurers operating in India including the public sector life insurer Life Insurance Corporation of India (LIC) and 23 private companies offering life insurance products. Life insurance accounts for 54.3% of the total insurance premium written globally. In comparison, life insurance's share is substantially higher in India at 73.9%. India was ranked 10th amongst 88 countries in life insurance with a share of 2.6% of the global life insurance market in 2018. After growing from 2.15% in 2001 to 4.60% in 2009, life insurance penetration witnessed a declining trend through 2014. It subsequently increased marginally in 2015 to 2.72% and has remained within a narrow range since to end 2018 at 2.74%. From US$ 9.10 in 2001, life insurance density peaked at US$ 55.70 in 2010, followed by a declining trend through 2013. Between 2015 and 2018, density witnessed healthy expansion from US$ 43.20 to US$ 55.00. While the private insurers continue to gain in market share at the cost of LIC, the state-owned life insurer remains the largest player by a big margin, earning 66.4% of the total industry premium income in FY19 (69.4% in FY18) compared to the private sector's share of 33.6% (30.6% in FY18). Amongst the private life insurers, HDFC Life is the leading player with a market share of 14.3%, followed by SBI Life (9.2%) and ICICI Prudential (6.4%).

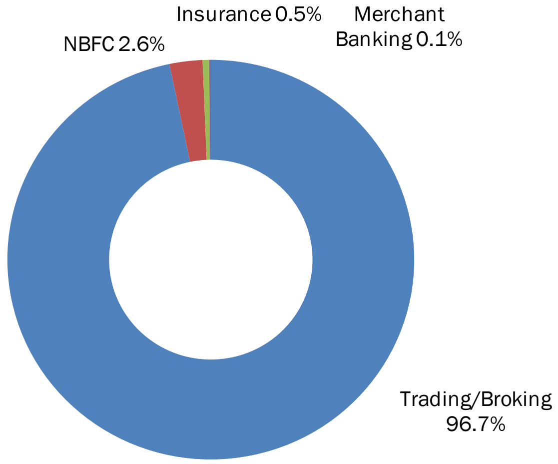
The Indian non-life insurance segment comprises 25 general insurers, 2 specialized insurers and 7 health insurance providers. There are 6 insurers in the public sector and 21 private companies. All 7 standalone health insurers are private. India's share in global non-life insurance premium stood at a humble 1.1% with the country ranking 15th in the global non-life insurance market. Penetration of non-life insurance increased from 0.56% in 2001 to 0.97 in 2018. Non-life density expanded from US$ 2.40 in 2001 to US$ 19.00 in 2018. Direct non-life premium underwritten total increased 12.5% y-o-y to ₹1.69 lakh crore in FY19. The standalone health insurance companies grew 36.6% while the specialized insurers reported a decline of 10.8% (compared to a growth of 10.8% in FY18). The general and specialized insurers together issued 18.33 crore policies in FY19, compared to 17.02 crore policies in FY18. Motor insurance is the largest component of the non-life insurance market, accounting for 38.1% of total non-life premium. Health insurance, the second largest category in the non-life space at 30.0% of the overall non-life market, increased its share by almost 5 percentage points between FY17 and FY19.

Investment Thesis

SIS has 26 years' experience in the financial markets

With rich experience in core broking and trading operations, SIS has diversified its business model by foraying into allied financial services. With 26 years' experience in the financial markets, SIS's operations comprise services typically offered by investment banks (securities broking and capital markets advisory), trading (prop book), lending, wealth management and distribution of financial products. With a strong focus on technology, SIS's diversified business model positions the company as a full-service financial conglomerate. SIS's presence across the financial markets spectrum allows it to tap opportunities in different sections of the market in both the institutional and individual segments. The company follows robust risk management, and ethics and governance practices, which are especially critical areas for financial market participants.

Revenue (consolidated) split by business segment (3Q FY21)



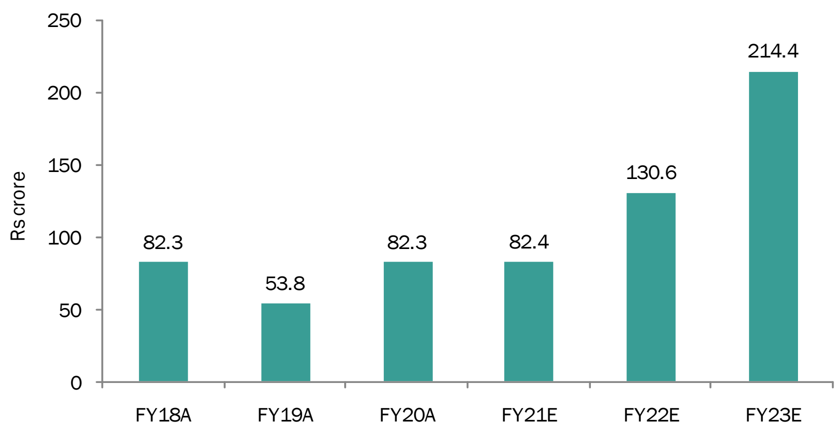
Source: Company data

Leveraging its expertise in quant trading strategies, SIS's prop trading operations is the largest contributor of revenues. SIS generated over three-fourths of its revenues from proprietary trading in FY20. The company employs arbitrage strategies, quant trading tools and jobbing/high-frequency trading (HFT) in its prop trading operations. The company specialises in low-latency algo trades and uses them as a tactical tool to enable its clients and prop desk enhance trading outcomes. Leveraging its experience of more than 2.5 decades in the secondary market and its investment in technology-driven in-house trading platform, SIS has developed an expertise in executing various arbitrage and quant strategies.

SIS acquired Total Securities with a view to enhance its strategy-based trading operations

Acquisition of Total Securities has added to SIS's strength in prop trading. In December 2019, SIS acquired a leading stock broking company, Total Securities Limited (TSL) in an all-equity deal to enhance SIS's strategy-based trading operations, optimise costs and achieve synergies. Incorporated in 2000, TSL was a brokerage house with a focus on proprietary arbitrage trading. The merger resulted in the integration of the two companies' assets and capabilities, leading to an immediate growth spurt, an increase in financial robustness, synergies from the application of TSL's trading strategies to SIS's technology platform, and generation of benefits such as geographical expansion of operations, cost reduction, and strengthening of leadership.

Current financial assets (consolidated)



Source: Company data

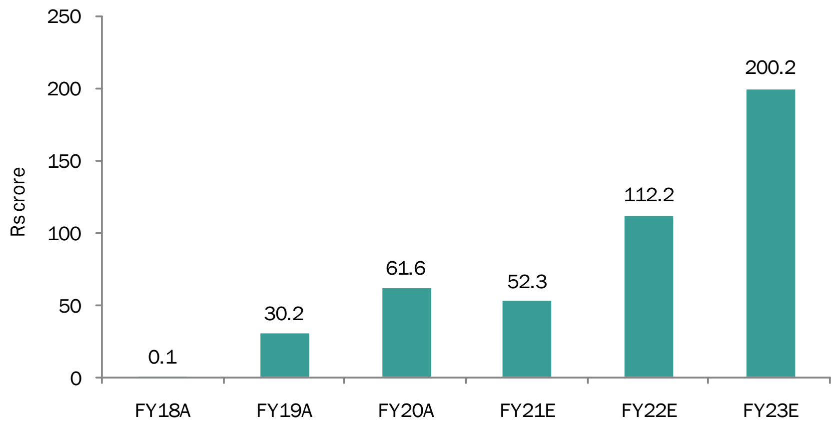
SIS's equity broking value increased at a CAGR of 18% to ₹9.08 lakh crore from FY17 to FY20

SIS's broking business focuses on HNI clients, leveraging its strong network of over 500 branches. SIS's brokerage business offers broking in equity (cash), F&O, commodities and currency segments as the company is a member of all Indian exchanges. Broking income contributes approximately 10% of the company's total revenues. A major part of the company's broking revenues comes from HNIs compared to a much smaller share for the retail segment. SIS offers trading facilities to its clients in both the domestic and international markets, enabled by its presence in the International Financial Services Centre (IFSC). From FY17 to FY20, the company's equity broking value increased at a robust 18% CAGR from ₹5.47 lakh crore to ₹9.08 lakh crore. Commodity broking value grew exponentially from ₹900 crore in FY19 to ₹1.33 lakh crore in FY20. Average broking yield over FY18 to FY20 remained flattish around 25 bps in line with market trends with stiff competition and increasing influence of discount brokerages exerting downward pressure on broking yields. The cornerstone of SIS's reach is its robust franchise network. The number of franchisee branches increased from 300 in FY18 to 587 in FY20 including the addition of 80 branches from the TSL merger. SIS's employee strength, consequently, increased from 690 to 1,297 during the same period. As of the end of FY20, SIS's client base stood at 15,679 with the company focusing on HNI clients.

SIS's loan book grew more than 2x y-o-y to ₹61.6 crore in FY20

Robust growth in NBFC business from a relatively modest base. SIS's NBFC business provides personal loans, business loans, commercial vehicle loans, SME loans, and loan against securities, properties and commodities. The company's loan book grew more than 2x y-o-y to ₹61.6 crore in FY20. Net interest income (NII) increased from ₹1.3 crore to ₹4.0 crore while EBIT went up 1.9x to ₹9.3 crore during the financial year. Going forward, we expect SIS's NBFC business to grow at a rate faster than the overall sector due to the exponential growth potential its low base offers. The company has opened 10 branches in tier 3 towns as management plans to expand the branch count to 25 and expand its personal loan book from ₹25 crore currently to ₹200 crore in the next 3 years. This expansion is expected to be completely funded by internal accruals.

Non-current loans & advances (consolidated)



Source: Company data

SIS's AUM increased by 17.7% y-o-y to ₹112.9 crore in FY20

Comprising mutual fund and PMS, SIS's wealth management business enables diversification by generating fee income, albeit at a small scale. SISL's wealth advisory services include Mutual Fund (MF) advisory and distribution and portfolio management services (PMS). The PMS division is led by an experienced and professional fund management team and offers customized investment solutions to HNI clients. Besides offering debt/equity MFs and other wealth management products, the company also provides cross margin facility to its clients for trading in equities, derivatives and currencies against MF units held by them. SIS leverages its extensive franchise network to distribute MFs and other financial products. AUM increased by 17.7% from ₹95.9 crore in FY19 to ₹112.9 crore in FY20 with the addition of 1,132 new clients during the year to reach a client base of 3,292 as of 31 March 2020. While the AUM is relatively small for the overall size and scale of SIS's operations, the low base offers robust growth potential, given the company's strong distribution reach, and promises to enable diversification through an increasing share of fee-based income going forward.

Merchant banking and insurance broking provide further diversification but do not generate significant revenues currently. Commencing the insurance distribution business in FY20, the SIS had tied up with 35 insurers including market leaders such as Life Insurance Corporation of India (LIC), ICICI Prudential Life Insurance Company (IPru), The New India Assurance Company, HDFC Life and SBI General Insurance by 31 March 2020 to offer insurance solutions in the life, health and general insurance segments. In FY20, the insurance distribution business generated a premium income of ₹1.0 crore for a sum assured of ₹586.4 crore. Going forward, as the business gains traction, this segment is expected to reduce the cyclicity in the consolidated revenue profile of the Group. The insurance broking business realised total premium of ₹6.7 crore while the total sum insured stood at ₹4,100 crore as of June 2020-end. Merchant banking is a small part of the company's overall business. SIS has so far successfully executed 2 SME IPOs and has conducted approximately 30 valuation projects. The merchant banking division is also engaged in ad-hoc consultancy assignments with its client base.

SIS sold insurance policies worth ₹586.4 crore of sum assured in FY20

Valuation

At 12.0x FY23E EPS, we rate SIS a BUY with a target price of ₹395 and an upside potential of 34%. The principal driver and mainstay of SIS's business model is proprietary trading, which contributed a little under 80% of the company's operating revenue in FY20. The company looks to constantly invest in technology in order to update and improve its low-latency algo-based trading platform. In its broking business where SIS focuses on the HNI segment, offering quant and algo trading solutions. We expect the company to maintain its focus in this niche area by leveraging its rich experience and expertise as it gives SIS a competitive advantage in a market where the products and services are largely commoditised. In the NBFC business, management looks to grow the loan book from ₹25 crore to ₹200 crore by expanding the company's branch network from 10 to 25 over the next 3 years. The loan book expansion is expected to be largely funded through internal accruals without the need to take on additional debt. SIS is a net debt-free company at the consolidated level and we find management's policy of expanding the lending business without borrowing external funds credible, contributing to the de-risking of the company's business model. While the mutual fund and insurance broking/distribution businesses are currently nascent, there is an exponential growth potential from a small base. We have modelled 23% revenue growth on average with margin improvement driven by lower finance cost ratio over the next 2 years. The SIS stock currently trades at an attractive forward P/E level of 9.0 FY23E EPS. Assigning a target multiple of 12.0x FY23E EPS, our valuation generates a price target of ₹395, informing a BUY rating with an upside potential of 34%.

The SIS stock currently trades at an attractive forward P/E level of 9.0 FY23E EPS

Relative Valuation: Price-to-Earnings

	High	Low	Average	Current
Share India Securities	19.4	3.1	9.8	19.4
Geojit Financial Services	50.2	8.8	24.0	25.7
Dolat Investments	50.6	6.0	18.8	16.5
Inventure Growth and Securities	33.7	23.4	25.7	N/A
Arihant Capital Markets	23.4	3.0	8.9	8.3

Note: Multiples over last 5 years or since listing; normalised to exclude upper-end outliers
Source: Bloomberg

Profit & Loss Account (Consolidated)

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E
Total income	**14,049**	**20,719**	**27,935**	**43,338**	**53,385**	**64,116**
Growth		*47.5%*	*34.8%*	*55.1%*	*23.2%*	*20.1%*
Cost of operations	10,996	15,437	20,605	33,329	39,787	47,784
Finance cost	541	1,140	1,785	1,818	1,792	1,815
Depreciation & amortization	207	461	447	411	425	446
Impairment/net loss on financial instruments	-	8	30	14	20	24
PBT	2,304	3,672	5,068	7,766	11,361	14,046
Tax expense	770	1,172	1,068	1,709	2,859	3,535
PAT	**1,535**	**2,499**	**4,000**	**6,058**	**8,501**	**10,510**
PAT margin	*10.9%*	*12.1%*	*14.3%*	*14.0%*	*15.9%*	*16.4%*
Diluted EPS (Rs)	**7.15**	**7.83**	**12.54**	**18.99**	**26.64**	**32.94**

Source: Company data; Khambatta Research

Abridged Balance Sheet (Consolidated)

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E
Total shareholders' equity	13,455	15,831	19,293	24,872	33,054	43,245
Total debt	3,936	10,602	12,560	11,685	11,898	11,988
Trade payables	3,810	5,345	8,356	13,592	16,758	20,127
Provisions	948	1,146	1,351	1,386	1,896	2,717
Total equity & liabilities	**23,161**	**34,256**	**46,020**	**58,382**	**72,148**	**88,336**
Fixed assets	3,854	3,519	3,337	3,397	3,572	3,747
Loans & advances (non-current)	7	3,021	6,164	5,227	11,222	20,020
Financial assets (current)	8,234	5,378	8,230	8,243	13,062	21,441
Cash & cash equivalents	425	3,000	4,787	19,092	16,620	9,570
Other bank balance	4,395	8,682	15,158	15,249	16,981	17,153
Total assets	**23,161**	**34,256**	**46,020**	**58,382**	**72,148**	**88,336**

Source: Company data; Khambatta Research

Ratio Analysis

	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E
ROA	6.6%	7.3%	8.7%	10.4%	11.8%	11.9%
ROE	11.4%	15.8%	20.7%	24.4%	25.7%	24.3%
Debt-to-equity ratio	0.29x	0.67x	0.65x	0.47x	0.36x	0.28x

Source: Company data; Khambatta Research

Key Risks

- More than three-fourths of SIS's topline come from prop trading while trading and broking together account for 93% of revenues. This poses a concentration risk for the company's business model.
- SIS's business model is largely dependent on the securities market, which poses a high risk relating to volatility, liquidity and value erosion.
- All of SIS's business verticals are highly-regulated and requires a very degree of compliance. Changes in regulations and a failure to adequately comply with regulations can negatively affect the company's business and financial outcomes.
- Further severe waves of the COVID-19 outbreak or it remaining around for an extended period of time may lead to the underperformance of the securities market and consequently of our estimates.

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Tel: +91-(0)22 4027 3300
Fax: +91-(0)22 6641 3377
www.khambattasecurities.com

Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day , using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

Stock ratings

Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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I/We, Research Analysts and authors, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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