



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. 963	
Price Target: Rs. 1,150	↔

↑ Upgrade
↔ Maintain
↓ Downgrade

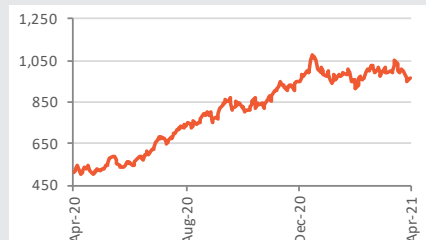
Company details

Market cap:	Rs. 93,273 cr
52-week high/low:	Rs. 1,081 / 490
NSE volume: (No of shares)	44.9 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	62.0 cr

Shareholding (%)

Promoters	35.8
FII	39.2
DII	15.0
Others	10.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.3	-0.9	13.3	88.2
Relative to Sensex	-1.8	-1.0	-6.1	35.8

Sharekhan Research, Bloomberg

Tech Mahindra Limited

Powered by the right deals

IT & ITes

Sharekhan code: TECHM

Result Update

Summary

- We maintain a Buy rating on Tech Mahindra (TechM) with an unchanged PT of Rs. 1,150 given improving revenue visibility and reasonable valuation.
- Q4 revenue missed headline estimates, but continued margin expansion, healthy FCF generation, and stronger deal win TCVs were impressive. Deal TCVs jumped 2.3x on q-o-q.
- The management guided double-digit revenue growth in FY2022, led by strong deal wins and a healthy deal pipeline. It expects EBIT margin to remain at over 15% despite wage revision, aided by revenue growth and operational efficiencies.
- We prefer TechM because of a strong growth potential in enterprise segment, 5G opportunities, and scope for margin improvement. We estimate TechM would report USD revenue/earnings CAGR of 10.2%/16.5%, respectively, over FY2021-23E.

Though Tech Mahindra (TechM) clocked below-than-expected revenue growth in Q4FY21, continued margin expansion, healthy FCF generation and strong large deal wins were impressive. Constant currency (CC) revenue grew by 0.7% q-o-q (down 0.5% y-o-y), lagging our estimates. Revenue growth of both enterprise and communication business moderated to 0.2% q-o-q and 1.1% q-o-q respectively in CC terms. Reported US Dollar revenue grew by 1.6% q-o-q to \$1,329.6 million. However, EBIT margin surprised positively and expanded by 60 bps q-o-q to 16.5%, above our expectations, led by operational efficiency, delivery transformation and lower depreciation expenses. Adjusted net profit came in at Rs. 1,030.8 crore, 17% lower to our estimates, owing to a lag in other income (down 85% q-o-q) and higher-than-expected tax provision (31.3% versus 24.8% in Q3FY2021). TechM's mega deal win TCVs were significantly higher at \$1.04 billion (equally distributed between the enterprise and communication business) compared to average quarterly run rate of \$400-500 million. Further, the management indicated potential similar kind of deal win TCVs in Q1FY2022 given strong deal pipeline and demand environment as well. A strong deal pipeline in the enterprise segment was led by greater adoption of the cloud transformation program and a more structured go-to-market approach, while deal inflows continued to improve in communication segment given its end-to-end capability and sharpening focus on legacy modernisation. The management guided double-digit revenue growth in FY2022 because of strong deal wins, strong recovery in the communication business and double-digit growth in enterprise business. With higher spends on digital transformation initiatives, modernisation of networks by service providers, and 5G opportunity in enterprise, we believe that TechM would clock 10.2% CAGR revenue growth over FY2021-23E. Management guided EBIT margin at over 15% in FY2022 despite wage revisions and reversal of COVID-19 savings, aided by delivery transformation, strong revenue growth and operational efficiencies.

Key positives

- EBIT margin at 16.5%, highest over last six years
- FCF generation of \$187 million (FCF to net profit conversion at 127%)
- Management expects deal win momentum to continue in Q1FY2022

Key negatives

- Revenue declined by 0.5% y-o-y on CC terms in Q4FY2021
- Retail, transport and logistics vertical revenue declined 3.2% q-o-q

Our Call

Valuation – Expect strong growth momentum in FY2022E: We have broadly maintained our earnings estimates for FY2022E/FY2023E, factoring in impressive margin performance in Q4FY2021 and mega-deal momentum. We believe enterprise segment could outperform peers on growth going ahead given strong recovery in its sub-verticals, healthy deal pipeline, improved competencies and a sharper go-to-market strategy. Tech M is well placed to benefit from the expansion of 5G value chain across networks and IT services, when a pick-up in investments by service providers and higher 5G adoption by enterprise would happen. At CMP, the stock is trading at reasonable valuation of 16x/14x of its FY2022E/FY2023E earnings, trading at significant discount to large peers despite acceleration of mega deal wins rate, 5G opportunities, and scope for margin improvement. Hence, we maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,150.

Key Risks

Any hostile development with respect to the current US 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.

Valuation

	Rs cr				
Particulars	FY19	FY20	FY21	FY22E	FY23E
Revenue	34,742.1	36,867.7	37,855.1	42,691.9	47,189.0
OPM (%)	18.2	15.5	18.1	18.4	18.6
Adjusted PAT	4,297.6	4,250.5	4,493.7	5,293.7	6,099.4
% YoY growth	13.1	-1.1	5.7	17.8	15.2
Adjusted EPS (Rs.)	47.7	45.9	50.1	60.6	69.8
P/E (x)	20.2	21.0	19.2	15.9	13.8
P/B (x)	4.2	3.8	3.4	3.0	2.7
EV/EBITDA (x)	13.4	15.1	11.9	10.1	8.5
RoNW (%)	22.0	19.2	19.3	20.1	20.5
RoCE (%)	24.0	20.5	20.5	21.2	22.2

Source: Company; Sharekhan estimates

Revenue missed, margin surprised positively; strong FCF generation

TechM's headline revenue missed our estimates in Q4FY21. However, the company continued to impress with margin expansion, strong FCF generation and strong large deal wins. CC revenue grew by 0.7% q-o-q (down 0.5% y-o-y), below our estimates. The enterprise business and communication segment reported CC revenue growth of 0.2% q-o-q and 1.1% respectively. Reported US Dollar revenue grew by 1.6% q-o-q to \$1,329.6 million. EBIT margin surprised positively and expanded by 55 bps q-o-q to 16.5%, above our expectations. Sequential margin improvement was led by (1) higher utilisation, (2) operational efficiency, (3) delivery transformation, (4) automation and (5) lower depreciation expenses (owing to conservative capital expenditure over last one year), partially offset by higher SG&A expenses. Adjusted net profit came in at Rs. 1,030.8 crore, 17% lower to our estimates, owing to lower-than-expected other income and higher-than-expected tax provision (due to a one-time tax charge). Free cash flow (FCF) generation remained strong at \$187 million during the quarter, translating into FCF to net profit conversion ratio of 127%.

Expect double-digit growth in FY2022; deal win momentum to continue

The management guided double-digit revenue growth in FY2022 because of anticipated strong double-digit growth in the enterprise segment and high-single digit growth in communication vertical. The strong recovery in both communication and enterprise verticals during H2FY2021 provides a foundation for strong growth momentum in FY2022. Management expects strong growth in enterprise business would be driven by strong double-digit growth in its BFSI, manufacturing, retail and healthcare verticals. Further, mega deal win TCVs were significantly higher at \$1.04 billion compared to average quarterly run rate of \$400-500 million. Further, the management indicated potential similar kind of deal wins momentum in Q1FY2022. TechM has a strong deal pipeline in enterprise segment given strong demand for cloud transformation program and a more structure go-to-market approach in enterprise segment. In communication vertical, the company focuses on legacy modernization which includes IP modernization and system upgradation for 5G ready. Further, 5G-related activities have started to scale up across three segments such as 5G in ecosystems, 5G in enterprises and 5G in service providers. With higher spends on digital transformation by enterprises, strong deal wins across segments and modernisation of networks by service providers, we believe TechM is well positioned to report strong revenue growth over the next couple of years.

Management expects to improve in FY2022

Management indicated that its cost-optimisation measures along with focus on structural changes, higher offshoring, delivery transformation and portfolio synergies would drive margin improvement in the subsequent quarters. Management guided EBIT margin of above 15% in FY2022 compared to 14.2%/16.5% in FY2020/Q4FY2021. Though wage revision (effective from April 1, 2021) and possibilities of return of costs related to travel and admin expenses post normalcy would have an adverse impact on margin in FY2022, the management expects these headwinds would be partially mitigated by delivery transformation, revenue growth, operational efficiencies and portfolio synergies.

Key result highlights from earnings call

- ♦ **FY2021 performance:** The company reported US Dollar revenue of \$5,111 million in FY2021, or in other words, a decline of 1.4%. CC revenue declined by 2.5% in FY2021. The growth was impacted owing to the outbreak of COVID-19 at the beginning. The enterprise business grew by 1.2% on CC terms in FY2021, while communication business declined 7.6% on a CC basis. BFSI, technology and retail verticals reported positive growth during the years, while the manufacturing and communication verticals recovered during H2FY2021. EBIT margin improved 260bps y-o-y to 14.2% in FY2021, led by operational efficiency, higher utilisation, higher offshoring, reduction in sub-contracting expenses, lower travel and facility expenses and currency tailwinds. Other income declined by 34% y-o-y owing to absence of one-time income and lower forex gain (\$13 million versus \$42.7 million in FY2020). However, net profit grew by 9.8% to Rs. 4,428 crore during FY2021.
- ♦ **Revenue missed estimates:** TechM reported below-than-expected revenue growth of 0.7% on CC basis. Reported US Dollar revenue grew by 1.6% q-o-q and 2.7% y-o-y to \$1,329.6 million, below our expectations of \$1,340 million. The enterprise business' USD revenue grew 1.8% q-o-q, while communication vertical grew 1.4% q-o-q during the quarter. The enterprise business' growth was driven by strong growth in the BFSI (4.9% q-o-q) and manufacturing (1.9% q-o-q) verticals. Revenue of retail, transport and logistics verticals declined 3.2% q-o-q. However, all large accounts grew above company's growth rate on a q-o-q basis.

- ♦ **Margin walkthrough:** EBIT margin increased by 60 bps q-o-q to 16.5% (highest over the last six years). Sequential margin improvement was aided by operational efficiencies, delivery transformation, increasing utilisation, and automation. Depreciation was lower because of conservative capital expenditure in the last one year. Margin tailwinds during the quarter was partially offset by higher SG&A expenses (SG&A to revenue increased to 13.7% from 13.3% in Q3FY2021) owing to higher recruitment costs.
- ♦ **Margin outlook:** The management believes there are still operating levers that can help for further margin improvement. It guided for an EBIT margin of above 15% in FY2022. In FY2021, EBIT margin was at 14.2%. Management stated that it has rolled out a wage hike effective April 1, 2021. Though it would have an adverse impact on margin in Q1FY2022, management expects to mitigate the impact of wage revision through operational efficiencies. Management also indicated that expenses related to salary, travel, and facility would come back to some extent post normalcy. These margin headwinds would be partially mitigated by delivery transformation, revenue growth and portfolio synergies.
- ♦ **Expect double-digit revenue growth in FY2022E:** The company has been focusing on balancing growth between communication business and enterprise business. Management guided double-digit revenue growth in FY2022, led by strong deal wins, health deal pipeline, recovery in communication vertical and a structured go-to-market strategy in the enterprise segment. Management expects its enterprise vertical would grow at double digit in FY2022, while the communication vertical would grow at high single digit. Further, management indicated that the recovery in both the communication and enterprise verticals during H2FY2021 would provide the foundation for growth in FY2022.
- ♦ **Commentary on the communication vertical:** The company focuses on legacy modernisation, including IP modernisation and system upgradation for 5G-ready. Further, the company also wins deals in Cloud space. TechM's recent communication deals includes modernisation of its clients' entire customer engagement platforms, including the underlying cloud-native architecture what is required for 5G. Apart from network modernisation, the company focuses on the system and the back end process modernization.
- ♦ **BPS services:** BPS business growth moderated to 0.8% in US dollar terms after two consecutive quarters of strong performance (31.1% and 11.4% growth in Q2FY2021 and Q3FY2021 respectively). The company's margin improved to 28% from 23.7% in Q3FY2021.
- ♦ **Decent deal win TCVs:** The company signed deals with a total contract value (TCV) of worth \$1,043 million versus \$455 million in Q3FY2020. Net new deal TCVs remained significantly higher than the average quarterly deal wins of \$400-500 million. Deal TCVs were divided equally between the communication and enterprise vertical. Deal win TCVs grew by 49% q-o-q to \$525 million for the enterprise segment, while deal wins TCVs grew by 5x q-o-q to \$518 million for the telecom segment (powered by the Telefonica deal). Management expects strong deal wins momentum would continue in Q1FY2022.
- ♦ **Revenue grew across regions except US:** The Europe business reported revenue growth of 2% q-o-q (versus 8.3% q-o-q in Q3FY2021), while revenue in rest of the world (RoW) business grew by 6.2% q-o-q (versus 4.9% q-o-q in Q3FY2021). US business revenue declined by 1.3% q-o-q.
- ♦ **DSO days improved:** DSO days further declined to 92 days in Q4FY2021 from 95 days in Q3FY2021, led by reduced working capital requirements, which stood at a 17-quarter low.
- ♦ **Strong cash generation:** TechM generated quarterly FCF of \$187 million, aided by strong collections versus \$226 million in Q3FY2021. The FCF to PAT conversion ratio stood at 127% (versus 127% in Q3FY2021). FCF stood at \$965 million in FY2021 compared to \$522.6 million in FY2020, aided by improved collections. Cash & cash equivalents increased to \$1,781 million compared to \$1,625 million in Q3FY2021.
- ♦ **Headcount added:** Total headcount stood at 1,21,054 during the quarter, with a net reduction of 847 employees q-o-q, owing to headcount decline in the BPO business. The BPO segment saw headcount reduction of 707 as compared to a reduction of 1,630 employees in Q3FY2021. The company is operating at an all-time high utilisation rate of 87%. The company expects to add 5,000 employees over the next quarters. The attrition rate increased to 13.3% in Q4FY2021 versus 12.4% in Q3FY2021.
- ♦ The Board has recommended a total dividend of Rs. 30 per share, including a special dividend of Rs. 15 per share. This takes total dividend to Rs. 45 per share in FY2021.

Results

Rs cr

Particulars	Q4FY21	Q4FY20	y-o-y (%)	Q3FY21	q-o-q (%)
Revenues in USD (mn)	1,329.6	1,294.6	2.7	1,308.7	1.6
Revenue	9,729.9	9,490.2	2.5	9,647.1	0.9
Cost of Services	6,449.7	6,689.6	-3.6	6,470.8	-0.3
Gross profit	3,280.3	2,800.6	17.1	3,176.3	3.3
SG&A	1,332.1	1,452.8	-8.3	1,280.8	4.0
EBITDA	1,948.2	1,347.8	44.5	1,895.4	2.8
Depreciation	344.4	398.2	-13.5	358.4	-3.9
EBIT	1,603.8	949.6	68.9	1,537.1	4.3
Other Income	32.6	285.2	-88.6	220.9	-85.2
PBT	1,594.7	1,181.6	35.0	1,715.9	-7.1
Provision for taxes	499.8	239.2	108.9	426.3	17.2
Reported net profit	1,132.2	1,021.4	10.8	1,309.8	-13.6
Adjusted net profit	1,182.9	1,238.9	-4.5	1,309.8	-9.7
EPS (Rs.)	12.3	11.6	5.5	14.9	-17.6
Margin (%)			BPS		BPS
EBITDA	20.0	14.2	582	19.6	37
EBIT	16.5	10.0	648	15.9	55
NPM	12.2	10.8	139	13.6	-142

Source: Company; Sharekhan Research

Results

Rs cr

Particulars	Revenue	Contribution	\$ Growth (%)	
	(\$ mn)	(%)	q-o-q	y-o-y
Revenue (\$ mn)	1,330	100	1.6	2.7
Geographic mix				
America	605	45.5	-1.3	-2.1
Europe	352	26.5	2.0	2.7
RoW	372	28.0	6.2	11.5
Industry verticals				
Communication	527	39.6	1.4	-0.2
Manufacturing	217	16.3	1.9	-5.4
Technology, media, and entertainment	123	9.3	0.5	28.6
BFSI	219	16.5	4.9	10.6
Retail, transport, and logistics	100	7.5	-3.2	5.8
Others	144	10.8	1.6	-3.6
Clients contribution				
Top 5	296	22.3	3.7	6.8
Top 10	412	31.0	3.0	2.7
Top 20	575	43.2	3.4	1.8
Revenue by services				
IT	1,185	89.1	1.7	-0.1
BPO	144	10.9	0.8	28.3

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 6-9% over CY2021-CY2024E as compared to the 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.

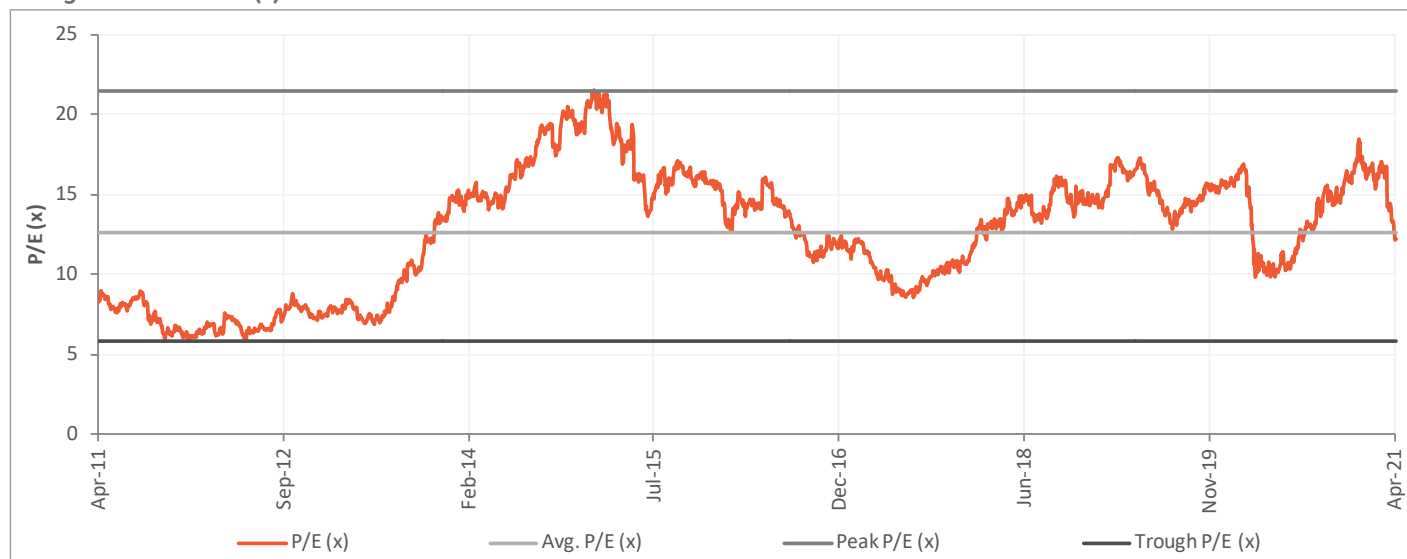
■ Company outlook – Well-placed to capture 5G opportunity

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

■ Valuation – Attractive valuation

We have broadly maintained our earnings estimates for FY2022E/FY2023E, factoring in impressive margin performance in Q4FY2021 and mega-deal momentum. We believe enterprise segment could outperform peers on growth going ahead given strong recovery in its sub-verticals, healthy deal pipeline, improved competencies and a sharper go-to-market strategy. Tech M is well placed to benefit from the expansion of 5G value chain across networks and IT services, when a pick-up in investments by service providers and higher 5G adoption by enterprise would happen. At CMP, the stock is trading at reasonable valuation of 16x/14x of its FY2022E/FY2023E earnings, trading at significant discount to large peers despite acceleration of mega deal wins rate, 5G opportunities, and scope for margin improvement.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
HCL Tech	928	271	2,51,937	18.5	16.4	11.3	10.1	3.8	3.4	21.4	21.8
Infosys	1,344	423	5,68,308	24.9	21.6	17.3	15.2	3.8	3.5	28.9	31.2
Wipro	480	548	2,63,054	25.2	23.2	17.0	16.0	5.2	4.6	18.2	17.9
Tech M	963	97	93,273	15.9	13.8	10.1	8.5	3.0	2.7	20.1	20.5

Source: Company, Sharekhan estimates

About company

Incorporated in 1986, TechM was formed with 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, TechM 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. TechM offers a bouquet of services including 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

TechM 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 likely to accelerate across the globe, TechM 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

- ♦ Any hostile development against the current visa regime would affect employee expenses as lower proportion of local resources are deployed onsite.
- ♦ Rupee appreciation or/and adverse cross-currency movements might affect earnings.
- ♦ Delay/loss of accounts in the enterprise segment.
- ♦ Macro uncertainties could impact earnings.
- ♦ Delay in pick-up of 5G-related spends.

Additional Data

Key management personnel

Mr. Anand Mahindra	Chairman
CP Gurnani	Chief Executive Officer
Milind Kulkarni	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	9.73
2	First State Investments ICVC	4.90
3	First State Global Umbrella Fund	4.09
4	BlackRock Inc	3.86
5	SBI Funds Management Pvt Ltd	2.69
6	Life Insurance Corp of India	2.03
7	ICICI Prudential Asset Management	1.86
8	Vanguard Group Inc/The	1.79
9	Government Pension Fund	1.75
10	Norges Bank	1.74

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

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

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