



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. 1,128	
Price Target: Rs. 1,300	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 109,292 cr
52-week high/low:	Rs. 1152 / 643
NSE volume: (No of shares)	35.0 lakh
BSE code:	532755
NSE code:	TECHM
Free float: (No of shares)	62.0 cr

Shareholding (%)

Promoters	35.7
FII	37.0
DII	17.2
Others	10.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.6	15.5	17.3	66.9
Relative to Sensex	3.4	9.7	3.5	28.5

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy rating on Tech Mahindra (TechM) with a revised PT of Rs. 1,300 given healthy deal win TCVs, strong deal pipeline, 5G opportunity and reasonable valuation.
- Strong beat on all fronts; new deal win TCVs stood at \$815 million, in-line with our expectation and higher than its average quarterly deal win TCVs of \$400 mn-\$500 mn.
- Management reiterated its double-digit organic revenue growth with an upward bias, given healthy deal wins and broad-based growth across verticals; expect sustainable margin performance with an upward bias in subsequent quarters.
- We continue to prefer TechM because of improving deal wins, 5G opportunities, and anticipation of stable margin performance. TechM is expected to report USD revenue/earnings CAGR of 11%/17%, respectively, over FY2021-FY23E.

Tech Mahindra (TechM) reported a strong set of numbers for Q1FY2022, beating on all fronts, led by strong growth across key markets and verticals. Constant currency (CC) revenue growth remained at 3.9% q-o-q, ahead of our estimates, led by strong growth in both enterprise segment and communication, media and entertainment (CME) segment. Reported US Dollar revenue grew by 4.1% q-o-q to \$1,383.6 million. EBIT margin contracted by 133 bps q-o-q to 15.2%, owing to wage revision, visa costs, and higher subcontractor expenses. However, the decline in EBIT margin remained lower than our estimates, aided by higher utilisation, improved offshoring, and better operational efficiencies. Net profit stood at Rs. 1,353 crore (up 19.5% q-o-q) and was 13% ahead of our estimates. Management indicated that the company's investments in the areas of 5G, customer experience, data analytics, artificial intelligence (AI), Internet of Things (IoT), and cloud through organic or inorganic routes over the past few quarters have started yielding results in terms of higher deal wins in hi-tech, BPS, and platform businesses. The company has signed deals with a total contract value (TCV) of \$815 million, in-line with our expectations and higher than the average quarterly deal wins of \$400 million-500 million. Management indicated that almost 60-70% of its new signings in the telecom segment will be in the area of 5G. Hence, management expects strong deal flow in the 5G space from telecom players and enterprises in the coming quarters, given its strong capabilities in product development and product engineering around 5G, building IPs, and sharpening focus on core digitalisation of underlying systems. Given strong Q1FY2022 performance, strong deal wins, healthy deal pipeline, and broad-based growth across verticals, management believes there would be an upside potential to its earlier organic double-digit revenue growth guidance. Management remains confident on delivering sustainable margin performance with an upward bias, supported by operating leverage, operational efficiencies, automation, and portfolio synergies.

Key positives

- Revenue returned to double-digit growth on y-o-y after five quarters of revenue decline
- Hi-tech vertical grew by 8% q-o-q
- Added clients on a q-o-q basis in \$20 million and \$50 million categories

Key negatives

- Subcontractor costs to revenue increased to 14.8% from 12.7% in Q4FY021
- Attrition rate inched up to 17.2% from 13.3% in Q4FY2021

Our Call

Valuation – Improving outlook: We have raised upward our earnings estimates for FY2022E/FY2023E/FY2024E due to strong all-round beat in Q1FY2022, healthy deal wins, and strong deal pipeline in the communication vertical. TechM is well invested in capturing opportunities from the expansion of 5G value chain across networks and IT services from both telecom service providers and enterprises. The company's investments and multiple small acquisitions for enhancing capabilities in newer areas have resulted in consistent deal flows in the enterprise segment. Healthy deal wins and strong deal pipeline in communication verticals create a strong platform for double-digit organic revenue growth in FY2022. At the CMP, the stock is trading at reasonable valuation of 18x/16x/14x its FY2022E/FY2023E/FY2024E earnings, at a significant discount to large peers despite healthy deal wins, 5G opportunities, and scope for margin improvement. We assume TechM would continue to generate higher free cash flow (FCF) in the coming years, which would increase dividend/buyback payouts. We have a Buy rating on the stock with a revised price target (PT) of Rs. 1,300.

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

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	37,855.1	42,852.2	47,591.9	52,616.2
OPM (%)	18.1	18.6	18.9	18.8
Adjusted PAT	4,478.8	5,505.4	6,129.8	6,865.5
% YoY growth	5.4	22.9	11.3	12.0
Adjusted EPS (Rs.)	51.2	63.0	70.1	78.6
P/E (x)	22.0	17.9	16.1	14.4
P/B (x)	3.9	3.6	3.3	3.0
EV/EBITDA (x)	14.2	12.0	10.3	9.1
RoNW (%)	19.0	21.2	21.7	22.2
RoCE (%)	20.5	23.2	24.0	24.9

Source: Company; Sharekhan estimates

Strong all-round performance; FCF growth moderated

TechM reported a strong set of numbers, beating on all fronts, led by robust growth across key markets and verticals. The company reported better-than-expected CC revenue growth of 3.9% q-o-q, ahead of our estimates, led by 4.5% growth in the enterprise segment and 2.9% q-o-q in CC growth in the CME segment. Reported US Dollar revenue grew by 4.1% q-o-q to \$1,383.6 million. BPS business revenue grew by 11% q-o-q during the quarter. EBIT margin contracted by 133 bps q-o-q to 15.2%, owing to wage revision, visa costs, and higher subcontractor expenses. The decline in EBIT margin remained lower than our estimates, led by higher utilisation, improving offshoring, tight cost-control measures, and operational efficiencies. Net profit came at Rs. 1,353 crore (up 19.5% q-o-q) and was 13% ahead of our estimates, led by strong revenue growth and higher other revenue (primarily aided by forex gain). FCF declined by 8% q-o-q and 46% y-o-y to \$172 million during the quarter, translating into FCF to net profit conversion ratio of 94% versus 127% in Q4FY2021 and 246% in Q1FY2021.

Key result highlights from earnings call

- ◆ **Revenue beats estimates in a seasonally weak quarter (specific to TechM):** TechM reported strong revenue growth of 3.9% q-o-q and 10.8% y-o-y on CC basis in Q1FY2022. Reported US Dollar revenue grew by 4.1% q-o-q and 14.6% y-o-y to \$1,383.6 million, exceeding our expectations. The enterprise business' USD revenue grew by 4.7% q-o-q and 16% y-o-y, while the CME vertical grew by 3.2% q-o-q and 12.6% y-o-y during the quarter despite a seasonal decline in its mobility business. The enterprise business' growth was driven by strong growth in the technology (8.1% q-o-q), manufacturing (4.5% q-o-q), and hi-tech verticals. Revenue of BFSI and retail, transport and logistics verticals grew by 3.7% q-o-q and 3.2% q-o-q, respectively. The BPS business segment reported strong revenue growth of 11% q-o-q and 63.6% y-o-y during the quarter. Revenue from the top 5 and top 10 accounts grew above the company's growth rate on a q-o-q basis.
- ◆ **Margin surprised positively:** EBIT margin declined by 133 bps q-o-q to 15.2%, owing to higher subcontractor expenses, wage revision, visa cost, and weak seasonality in Comviva business. However, the decline in EBIT margin remained lower than our expectation as the above headwinds were partially offset by operating leverage, operational efficiencies, delivery transformation, increasing utilisation, and higher offshoring. The company expects margin improvement in the coming quarters.
- ◆ **Investment is expected to yield results going ahead:** Management indicated the company's investments in the areas of 5G, customer experience, data analytics, AI, IoT, and cloud through organic or inorganic routes (multiple small acquisitions) over the past few quarters have started yielding results in terms of higher deal TCVs and strong revenue growth. Multiple small acquisitions (DigitalOnUS, EventUS, Perigord, BrainscaleInc, and among others) have been well integrated. Management witnesses increased traction in some of those investment areas. For instance (1) hi-tech vertical, which includes product engineering and hyperscalers companies, reported the highest growth of 8% q-o-q during the quarter, given investments in capabilities and leadership teams, (2) digital BPS and customer experience reported strong 11% q-o-q growth given its investments, and (3) platforms segment is a new business unit for the company, which requires high investments going ahead. The company has 60+ new wins and 58 new accounts in this platform business. Further, the company would continue to invest on talents, talent supply chain, and M&A activities to enhance capabilities. The company's partner ecosystem is also getting stronger as it is creating new solutions by entering partnerships with both traditional players and new-age companies.
- ◆ **Reiterated double-digit revenue growth in FY2022E:** Management had guided double-digit organic revenue growth for FY2022. Given strong Q1FY2022 performance, strong deal wins, healthy deal pipeline, and broad-based growth across verticals, management believes there would be an upside potential to its earlier double-digit revenue growth guidance.
- ◆ **Sustainable margin performance with an upward bias:** Management believes there are still operating levers that can enable further margin improvement. Management has guided sustainable margin performance with an upward bias in the remaining quarters of FY2022. EBIT margin was at 15.2% in Q1FY2022. Though margins would be impacted by higher recruitment expenses and return of expenses relating to travel and facility, management expects these headwinds to be offset by delivery transformation, operating leverage, operational efficiencies, automation, and digitisation of assets across IT services and BPS segments and portfolio synergies.

- ◆ **Commentary on the communication vertical:** The company remains positive on 5G opportunity. The framework for 5G is – (1) the company would continue to work for telecom service providers in the area of network and digitalisation, (2) 5G for ecosystem, and (3) 5G for enterprises. The company's strategy remains to capture transformation spends in 5G areas by telecom players, but is not only limited to network deployment. Management highlighted it continues to progress well as it continues to sign and scale these projects around 5G. Moreover, 5G is now deeply integrated in every telecom transformation projects. Management believes almost 60-70% of its new signings in the telecom segment would be around in 5G area in FY2022E. Further, the company would not focus on any high-volume and low-margin business in the 5G space. The company is getting strong response in 5G for the enterprise space. The company expects to remain at the forefront in participating in opportunities in 5G areas from the enterprise side, given its early investments.

The company focuses on more integrated holistic transformation projects in the 5G area. The company expects strong deal flow from telecom players as these TSPs would transform their customer experiences to generate better momentum on both enterprise and consumer business. Further, the company has been driving greater product development and product engineering around 5G. The company sees strong demand in both device and equipment area. The company is building IP and focusing on core digitalisation of underlying systems, which would drive its growth going ahead, given strong traction for these offerings. The company expects the acceleration in signings of large transformation deals in 5G area in the coming quarters.

- ◆ **BPS services:** BPS business grew by 11% in US Dollar terms during the quarter. The company's margin contracted to 21.3% in Q1FY2022 from 28% in Q4FY2021. The company has won a large deal in BPS area, which would drive its growth in the coming quarters.
- ◆ **Commentary on the technology vertical:** The company's technology vertical is not highly concentrated to any one customer. The top customer in this vertical contributes 15% to total revenue of this vertical. This vertical generates revenue from 1) hyperscaler, 2) product engineering, 3) semiconductor companies. Management expects revenue growth momentum in this vertical to continue given recent large deal wins.
- ◆ **Decent deal win TCVs:** The company signed deals with a total TCV of \$815 million versus \$1,043 million/\$290 million in Q4FY2021/Q1FY2021. Net new deal TCVs remained significantly higher than the average quarterly deal wins of \$400 million-500 million. Deal win TCVs declined by 12% q-o-q to \$463 million for the enterprise segment, while deal win TCVs declined by 32% q-o-q to \$352 million for the CME segment. During the quarter, the company won large deals in BPS (digital integrated back-office) and healthcare (hospital modernisation) segments.
- ◆ **Revenue grew across key regions:** Europe business reported revenue growth of 6.6% q-o-q (versus 2% q-o-q in Q4FY2021), while revenue in America business grew by 6.8% q-o-q (versus a decline of 1.3% q-o-q in Q4FY2021). RoW business revenue declined by 3.1% q-o-q.
- ◆ **DSO days improved:** DSO days increased by one day to 93 days in Q1FY2022 from 92 days in Q4FY2021.
- ◆ **Healthy cash generation:** TechM generated quarterly FCF of \$172 million, down 8% q-o-q and 46% y-o-y. FCF to PAT conversion ratio stood at 94% (versus 127% in Q4FY2021). Cash and cash equivalents increased to \$1,818 million in Q1FY2022 compared to \$1,781 million in Q4FY2021.
- ◆ **Headcount added:** Total headcount stood at 1,26,263 during the quarter, with net addition of 5,209 employees q-o-q, owing to headcount addition in both BPS and IT services businesses. The BPO segment saw headcount addition of 3,543 in Q1FY2022 as compared to a reduction of 707 employees in Q4FY2021. The company is operating at an all-time high utilisation rate of 88%. Attrition rate increased to 17.2% in Q1FY2022 versus 13.3% in Q4FY2021.
- ◆ **Acquisition intensity continues:** The pace of small acquisitions is consistent with its historic trend and is focused to increase digital capabilities or expansion into geographies or verticals. During the quarter, the company is likely to acquire Brainscale Inc. for a consideration of up to \$28.8 million including earnouts. Brainscale is a cloud-focused asset having expertise in cloud consulting, enablement, allocation development, and data analytics.
- ◆ **Effective tax rate:** Management expects effective tax rate to be at 24-26%, though ETR was 23.9% in Q1FY2022.

Results (Consolidated)

Particulars	Rs cr				
	Q1FY22	Q1FY21	y-o-y (%)	Q4FY21	q-o-q(%)
Revenues in USD (mn)	1,383.6	1,207.5	14.6	1,329.6	4.1
Revenue	10,197.6	9,106.3	12.0	9,729.9	4.8
Cost of Services	6,968.2	6,510.5	7.0	6,449.7	8.0
Gross profit	3,229.3	2,595.8	24.4	3,280.3	-1.6
SG&A	1,353.0	1,295.3	4.5	1,332.1	1.6
EBITDA	1,876.4	1,300.5	44.3	1,948.2	-3.7
Depreciation	331.1	383.2	-13.6	344.4	-3.9
EBIT	1,545.3	917.3	68.5	1,603.8	-3.6
Other Income	287.3	416.1	-31.0	32.6	781.3
PBT	1,794.5	1,283.1	39.9	1,594.7	12.5
Provision for taxes	428.6	327.6	30.8	499.8	-14.2
Reported net profit	1,353.2	972.3	39.2	1,182.9	14.4
Adjusted net profit	1,353.2	972.3	39.2	1,132.2	19.5
EPS (Rs.)	15.3	11.0	38.6	13.0	18.2
Margin (%)			BPS		BPS
EBITDA	18.4	14.3	412	20.0	-162
EBIT	15.2	10.1	508	16.5	-133
NPM	13.3	10.7	259	11.6	163
Tax rate	23.9	25.5	-165	31.3	-746

Source: Company; Sharekhan Research

Revenue mix: Geographies, industry verticals, and other operating metrics

Particulars	Revenue	Contribution	\$ Growth (%)	
	(\$ mn)	(%)	q-o-q	y-o-y
Revenue (\$ mn)	1,384	100	4.1	14.6
Geographic mix				
America	646	46.7	6.8	8.5
Europe	376	27.2	6.6	20.6
RoW	361	26.1	-3.1	20.0
Industry verticals				
CME	554	40.0	3.2	12.6
Manufacturing	229	16.5	4.5	12.2
Technology	122	8.8	8.1	22.7
BFSI	227	16.4	3.7	19.7
Retail, transport and logistics	106	7.7	3.2	16.4
Others	147	10.6	4.3	11.1
Clients contribution				
Top 5	306	22.1	3.6	16.4
Top 10	429	31.0	4.1	14.2
Top 20	598	43.2	4.1	13.9
Revenue by services				
IT	1,224	88.4	3.3	10.3
BPO	160	11.6	11.1	63.6

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Expect acceleration in technology spending going forward

Industry analysts such as Gartner estimate that IT services spending would grow by 7-9% over CY2021-CY2024E as compared to the average of 3.6% achieved in CY2010-CY2020. 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. 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.

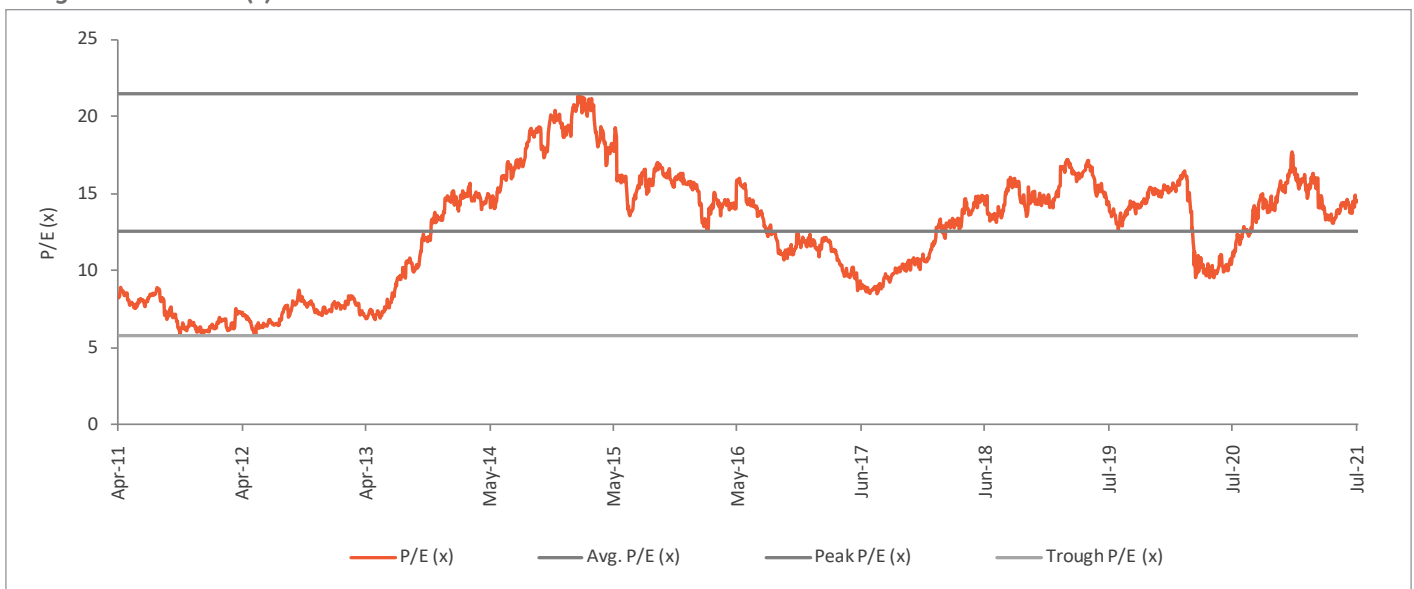
■ Company outlook - Well-placed to capture 5G opportunity

TechM is well placed to capture 5G-related spending from TSPs 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 - Improving outlook

We have raised upward our earnings estimates for FY2022E/FY2023E/FY2024E due to strong all-round beat in Q1FY2022, healthy deal wins, and strong deal pipeline in the communication vertical. TechM is well invested in capturing opportunities from the expansion of 5G value chain across networks and IT services from both telecom service providers and enterprises. The company's investments and multiple small acquisitions for enhancing capabilities in newer areas have resulted in consistent deal flows in the enterprise segment. Healthy deal wins and strong deal pipeline in communication verticals create a strong platform for double-digit organic revenue growth in FY2022. At the CMP, the stock is trading at reasonable valuation of 18x/16x/14x its FY2022E/FY2023E/FY2024E earnings, at a significant discount to large peers despite healthy deal wins, 5G opportunities, and scope for margin improvement. We assume TechM would continue to generate higher free cash flow (FCF) in the coming years, which would increase dividend/buyback payouts. We have a Buy rating on the stock with a revised price target (PT) of Rs. 1,300.

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/EBITDA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HCL Tech	1,008	271	2,73,429	20.1	17.5	13.0	11.2	4.1	3.7	21.5	22.1
Infosys	1,617	426	6,88,630	30.6	26.3	21.1	18.4	4.6	4.3	27.7	30.0
Tech M	1,128	97	1,09,292	17.9	16.1	12.0	10.3	3.6	3.3	21.2	21.7

Source: Company, Sharekhan Research

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

1. Any hostile development against the current visa regime would affect employee expenses as 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. Macro uncertainties could impact earnings.
5. 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: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	TML BENEFIT TRUST	9.73
2	BlackRock Inc	3.36
3	First State Investments ICVC	3.08
4	SBI Funds Management Pvt Ltd	2.66
5	Life Insurance Corp of India	2.64
6	ICICI Prudential Asset Management	2.12
7	Vanguard Group Inc/The	2.12
8	Norges Bank	1.74
9	Government Pension Fund	1.73
10	UTI Asset Management	1.07

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

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Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

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