

Tech Mahindra

Performance Highlights

(₹ cr)	3QFY17	2QFY17	% chg (QoQ)	3QFY16	% chg (YoY)
Net revenue	7,558	7,167	5.4	6,701	12.8
EBITDA	1,187	1,070	10.9	1,135	4.5
EBITDA margin (%)	15.7	14.9	77bp	16.9	(124)bps
Adj. PAT	845	645	31.0	759	11.2

Source: Company, Angel Research;

For 3QFY2017, Tech Mahindra posted results much better than expected on all fronts. The company posted sales of US\$1,116mn (US\$1,091mn expected) v/s US\$1,072mn, a qoq growth of 4.1%. In Constant Currency (CC) terms, company posted a 5.4% qoq growth. On EBIT front, the company posted EBIT of 12.4% (12.1% expected) v/s 11.5% in 2QFY2016. The utilization levels improved to 83.0% v/s 82.0% in 2QFY2016. Consequently, PAT came in at ₹845cr (₹733cr expected) v/s ₹645cr in 2QFY2016, growth of 31.0% qoq. The growth in the net profit was aided by the lower taxes during the quarter, which dipped 25.1% yoy.

We maintain our Buy rating on the stock.

Result highlights: The company posted sales of US\$1,116mn (US\$1,091mn expected) v/s US\$1,072mn, a qoq growth of 4.1%. In Constant Currency (CC) terms, company posted a 5.4% qoq growth. The strong sales growth was aided by ROW (which contributed around 23.9% v/s 22.0% of sales in 2QFY2017), while USA (which contributed 46.7% v/s 48.3% of sales in 2QFY2017) and Europe (which contributed 29.4% v/s 29.7% of sales in 2QFY2017). On EBIT front, the company posted EBIT of 12.4% (12.1% expected) v/s 11.5% in 2QFY2016. The utilization levels improved to 83.0% v/s 82.0% in 2QFY2016. Consequently, PAT came in at ₹845cr (₹733cr expected) v/s ₹645cr in 2QFY2016, growth of 31.0% qoq.

Outlook and valuation: We expect a CAGR of 10.6% and 11.5% in USD and INR revenue respectively over FY2016-18E. The PAT is expected to grow at a CAGR of 11.4% over FY2016-18E. **We maintain our Buy rating on the stock with a Target Price of ₹600.**

Key financials (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2015	FY2016	FY2017E	FY2018E
Net sales	22,621	26,494	29,673	32,937
% chg	20.1	17.1	12.0	11.0
Net profit	2,628	3,118	3,173	3,866
% chg	(10.4)	18.7	1.8	21.9
EBITDA margin (%)	18.4	16.3	15.5	17.0
EPS (₹)	27.1	32.2	32.8	39.9
P/E (x)	16.6	14.0	13.8	11.3
P/BV (x)	3.6	3.0	2.7	2.3
RoE (%)	21.5	21.7	19.6	20.6
RoCE (%)	24.0	20.8	19.8	21.6
EV/Sales (x)	1.9	1.5	1.3	1.1
EV/EBITDA (x)	10.2	9.2	8.3	6.5

Source: Company, Angel Research; Note: CMP as of January 31, 2017

BUY

CMP	₹452
Target Price	₹600

Investment Period 12 Months

Stock Info

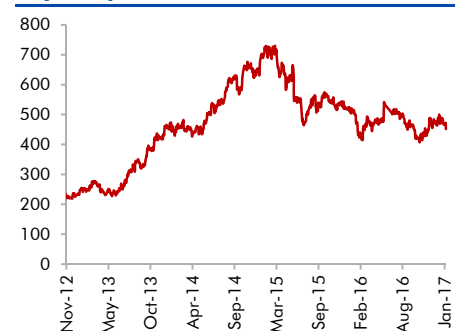
Sector	IT
Market Cap (₹ cr)	43,962
Net Debt (₹ cr)	(6,370)
Beta	1.1
52 Week High / Low	564/405
Avg. Daily Volume	218,321
Face Value (₹)	5
BSE Sensex	27,656
Nifty	8,561
Reuters Code	TEML.BO
Bloomberg Code	TECHM@IN

Shareholding Pattern (%)

Promoters	36.2
MF / Banks / Indian Fls	17.2
FII / NRIs / OCBs	35.5
Indian Public / Others	11.1

Abs.(%)	3m	1yr	3yr
Sensex	(1.0)	11.2	34.8
Tech Mahindra	2.8	(9.9)	0.9

3-year price chart



Source: Company, Angel Research

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Exhibit 1: 3QFY2017 performance (Consolidated, Indian GAAP)

(₹ cr)	3QFY17	2QFY17	% chg (qoq)	3QFY16	% chg (yoy)	9MFY17	9MFY16	% chg (yoy)
Net revenue	7,558	7,167	5.4	6,701	12.8	21,646	19,611	10.4
Cost of revenue	5,235	4,972	5.3	4,607	13.6	14,103	13,058	8.0
Gross profit	2,322	2,196	5.8	2,094	10.9	7,543	6,553	15.1
SG&A expense	1,136	1,126	0.9	959	18.4	4,258	3,433	24.0
EBITDA	1,187	1,070	10.9	1,135	4.5	3,286	3,120	5.3
Dep. and amortization	248	245	1.3	174	42.5	695	542	28.2
EBIT	939	825	13.7	962	(2.4)	2,591	2,579	0.5
Interest	35	35	1.2	24	99.3	97	63	53.7
Other income	155	139	11.9	64	59.0	540	284	90.0
PBT	1,059	930	13.9	1,002	5.7	3,034	2,800	8.4
Income taxes	214	286	(25.1)	233	12.4	747	638	17.1
PAT	845	644	31.2	769	9.8	2,287	2,162	5.8
Minority interest	0	(0)	-	10	(98.5)	-	1	
PAT after minority interest	845	644	31.2	759	11.2	2,285	2,162	5.7
Profit from associates	-	-	-	-	-	-	-	
Exceptional item	-	-	-	-	-	-	-	
Reported PAT	845	644	31.2	759	11.2	2,285	2,162	5.7
Adj. PAT	845	645	31.0	759	11.2	2,285	2,162	5.7
Diluted EPS	8.8	6.7	31.0	7.9	11.2	23.8	22.5	5.7
Gross margin (%)	30.7	30.6	9bp	31.2	(52)bps	34.8	33.4	143bp
EBITDA margin (%)	15.7	14.9	77bp	16.9	(124)bps	15.2	15.9	(73)bp
EBIT margin (%)	12.4	11.5	90bp	14.4	(194)bps	12.0	13.1	(118)bp
PAT margin (%)	11.3	9.0	233bps	11.3	0bps	10.6	11.0	(47)bp

Source: Company, Angel Research

Exhibit 2: 3QFY2017 – Actual Vs Angel estimates

(₹ cr)	Actual	Estimate	% Var
Net revenue	7,558	7,361	2.7
EBITDA margin (%)	15.7	15.6	10bps
PAT	845	733	15.2

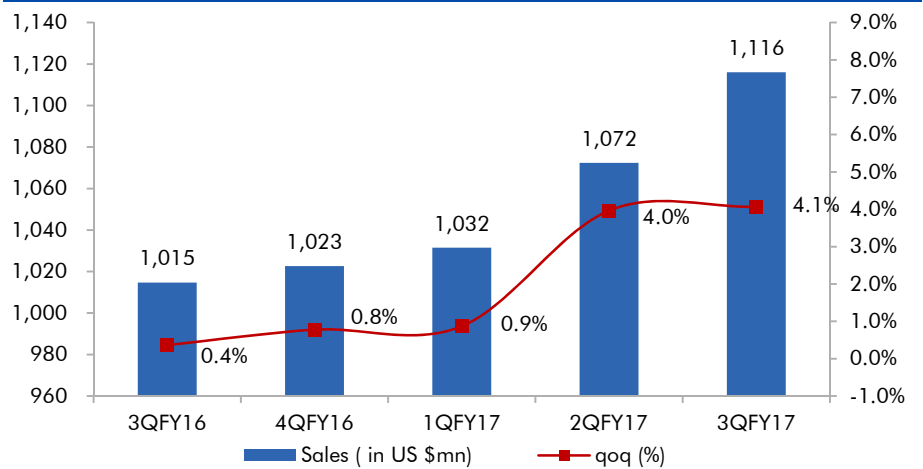
Source: Company, Angel Research

Revenue growth led by ROW

In sales, the company posted sales of US\$1,116mn (US\$1,091mn expected) v/s US\$1,072mn, a qoq growth of 4.1%. In Constant Currency (CC) terms, company posted a 5.4% qoq growth. In Rupee terms, the company posted sales of ₹7,558cr (₹7,361cr expected) v/s ₹7,167cr in 2QFY2017, a qoq growth of 5.4%.

The strong sales growth was aided by the ROW (which contributed around 23.9% v/s 22.0% of sales in 2QFY2017), while USA (which contributed 46.7% v/s 48.3% of sales in 2QFY2017) and Europe (which contributed 29.4% v/s 29.7% of sales in 2QFY2017).

Vertical wise, BFSI (contributed around 13.1% v/s 11.7% in 2QFY2017), Retail, transport & Logistics (contributed around 7.6% of sales v/s 6.8% of sales in 2QFY2017) performed well.

Exhibit 3: Trend in revenue growth


Source: Company, Angel Research

Exhibit 4: Growth in industry segments

Particulars	% to revenue	% growth (QoQ)	% growth (YoY)
Telecom	47.3	0.4	0.1
Manufacturing	18.4	(0.3)	18.3
TME	6.4	(7.5)	(4.9)
BFSI	13.1	18.6	47.0
RTL	7.6	16.3	22.9
Others	7.1	8.7	2.7

Source: Company, Angel Research

In terms of geographies, ROW posted a growth of 13.1% qoq, while Europe and US posted a growth of 3.0% and 0.6% qoq respectively.

Exhibit 5: Growth trend in geographies

Particulars	% to revenue	% growth (QoQ)	% growth (YoY)
Americas	46.7	0.6	7.5
Europe	29.4	3.0	11.9
RoW	23.9	13.1	14.3

Source: Company, Angel Research

Hiring and client metrics

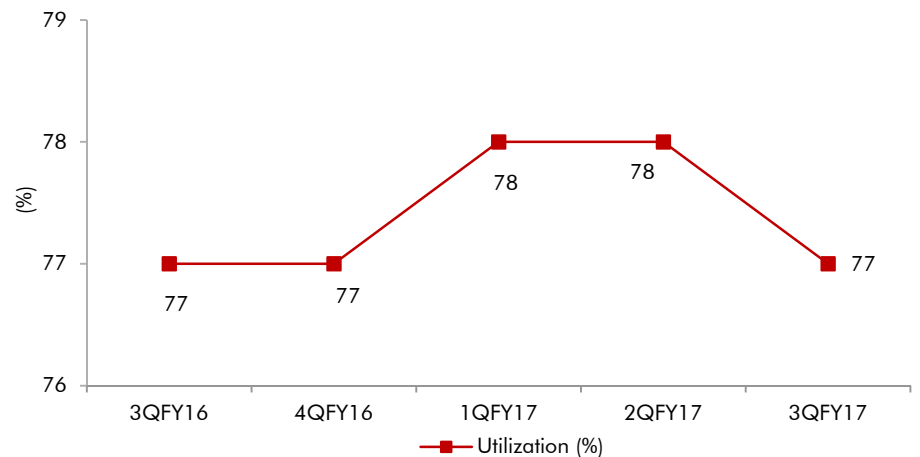
During the quarter, the company reported a net addition of 4,209 employees, taking its overall headcount to 117,095. The BPO headcount currently stands at 29,372 and was the only division to witness additions. Attrition (on LTM basis) was at 18%.

Exhibit 6: Employee metrics

Particulars	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17
Software professionals	71,892	72,125	73,590	78,404	80,858
BPO professionals	28,279	27,254	27,326	27,669	29,372
Sales & support	6,966	6,053	6,300	6,813	6,865
Total employees	1,07,137	105,432	107,216	112,886	117,095
Attritions (%)	20	21	21	19	18

Source: Company, Angel Research

Exhibit 7: Trend in utilization rate



Source: Company, Angel Research

The company added 19 new clients during the quarter, taking the active client base to 837 (v/s 818 in 2QFY2017), with 5 clients added in US\$10mn-20mn+ bracket and other additions mainly in the US\$5mn-10mn+ bracket.

Exhibit 8: Client metrics

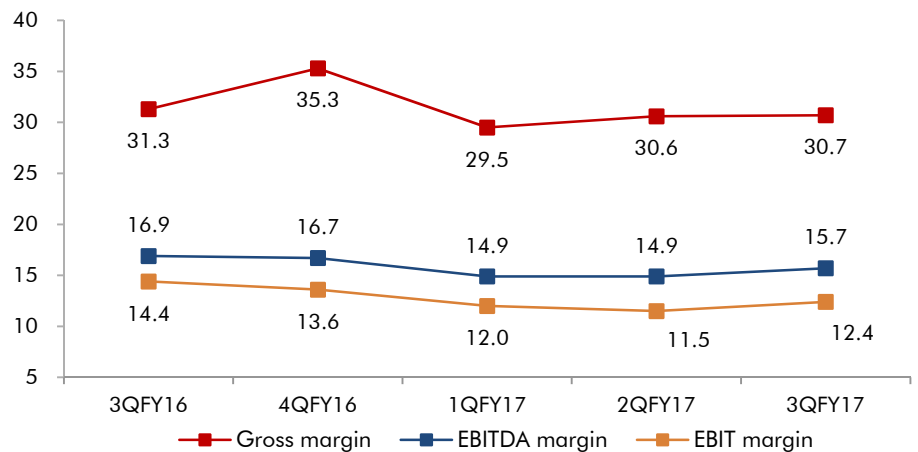
Particulars	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17
Total active clients	767	801	807	818	837
US\$1mn–5mn	195	221	207	197	228
US\$5mn–10mn	40	42	49	56	63
US\$10mn–20mn	21	26	23	22	27
US\$20mn–50mn	22	23	26	28	24
US\$50mn+	13	14	14	14	14

Source: Company, Angel Research

Operating margin expands

On EBIT front, the company posted EBIT of 12.4% (12.1% expected) v/s 11.5% in 2QFY2016. In 2QFY2017, the company took a one-time hit of ~USD13m (-100bps) i.e. expenses associated with restructuring. The absence of these costs in 3QFY2017 proved to be a tailwind for EBIT margin improvement. The utilization levels improved to 83.0% v/s 82.0% in 2QFY2016.

Exhibit 9: Margin trend (%)



Source: Company, Angel Research

Investment arguments

Growth prospects decent: The Management is more optimistic about the Communications vertical (excluding LCC, where a lot of portfolio rationalization has taken place). Communication has been showing continued improvement in both revenue growth and deal wins. We expect a CAGR of 10.6% and 11.5% in USD and INR revenue respectively over FY2016-18E.

Deal pipeline healthy: Tech Mahindra remains confident of improving revenue growth, citing healthy deal pipeline along with pick up in discretionary spending, primarily in the US. The Management sounded confident of demand from BFSI, Healthcare, Manufacturing and Retail. Tech Mahindra is following a two-pronged strategy to expand its enterprise business i.e. providing end-to-end offerings in leadership areas like manufacturing and following a niche offerings-led entry strategy in areas like BFSI, where it is a challenger. Better cross-sell of services can help grow marquee accounts post the recent acquisitions. We expect the enterprise segment growth to be led by broader revival in the markets and deepening of existing relationships. During 3QFY2017 the company won deals worth TCV of US\$350mn. The pipeline has been healthy and supported by a couple of large deal wins in Telecom and BFSI.

Inorganic growth initiatives to augment well for company: The company has been active in the M&A space, with it having acquired Satyam a few years back, to acquiring LCC and Softgen recently. Softgen's and LCC's acquisition was consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry with an estimated annual revenues of more than US\$400mn (CY2014), with workforce of over 5,700 network professionals across five continents and more than

50 countries. With this acquisition, Tech Mahindra will also be addressing a rapidly growing market opportunity, as telecommunications companies and enterprises accelerate their network upgrade cycle.

Outlook and valuation

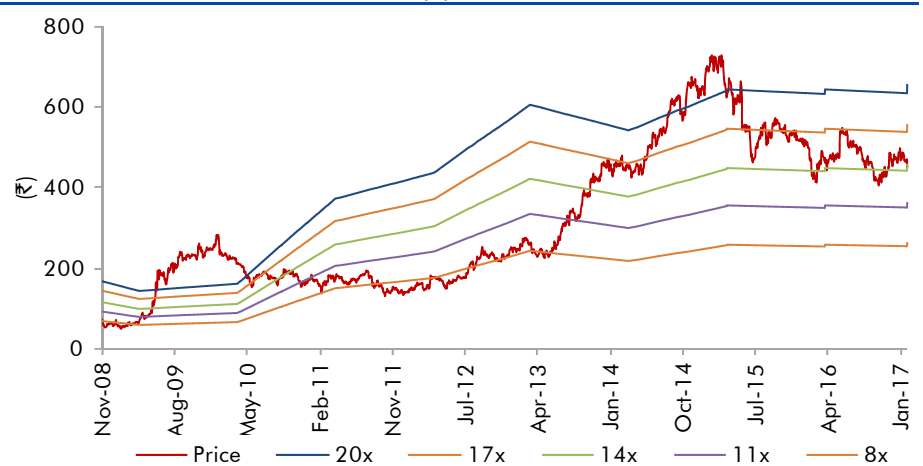
Given the recent acquisitions and healthy order pipeline, the company is expected to post a healthy US\$ and INR CAGR of 10.6% and 11.5% respectively over FY2016-18E. However, the acquisition of LCC will be margin dilutive in the near term, leading the FY2016 EBDITA margin to drop to 16.3% from 22.2% in FY2014. The company, given its success in turnaround of its earlier acquisition (Satyam), believes it would be able to do the same with the recent acquisitions and would be able to get close to achieving the 20% EBIT levels in future. Given the favorable valuation on EV/sales front, where it trades at a significant discount to its peers, we believe the stock should witness uptrend once the profitability returns to its mean average. **We maintain a Buy rating on the stock.**

Exhibit 10: Key assumptions

	FY2017E	FY2018E
Revenue growth (US\$)	10.3	11.0
USD-INR rate (realized)	66.0	66.0
Revenue growth (₹)	12.0	11.0
EBITDA margin (%)	15.5	17.0
Tax rate (%)	23.4	23.4
EPS growth (%)	1.8	21.9

Source: Company, Angel Research

Exhibit 11: One-year forward PE (x)



Source: Company, Angel Research. Note: P/E includes profits of Mahindra Satyam from FY2012

Exhibit 12: Recommendation summary

Company	Reco	CMP (₹)	Tgt Price (₹)	Upside (%)	FY2018E EBITDA (%)	FY2018E P/E (x)	FY2016-18E EPS CAGR (%)	FY2018E EV/Sales (x)	FY2018E RoE (%)
HCL Tech	Buy	809	1,000	23.6	20.5	12.6	9.6	1.8	17.9
Infosys	Buy	929	1,249	34.4	27.0	13.4	8.4	2.2	21.6
TCS	Accumulate	2,230	2,620	17.5	27.6	15.3	8.5	3.1	33.1
Tech Mahindra	Buy	452	600	32.8	17.0	11.3	11.4	1.1	20.6
Wipro	Buy	457	583	27.5	18.1	11.5	4.0	1.6	17.6

Source: Company, Angel Research.

Company Background

Tech Mahindra was founded in 1986 as a joint venture between Mahindra Group and British Telecom (BT) to service the latter. Later on, the company started servicing other external clients as well (solely in the telecom industry). In June 2009, Tech Mahindra acquired a 42.7% stake in erstwhile Satyam Computers (now Mahindra Satyam) and now the latter is entirely merged with the company.

The company has recently acquired the companies - LCC and Softgen. These two acquisitions have been consolidated in 4QFY2015. LCC is one of the world's largest independent global providers of network engineering services to the telecommunications industry. LCC is estimated to have annual revenues of more than US\$400mn (CY2014), with workforce of over 5,700 network professionals across five continents and more than 50 countries.

Profit and loss statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Net sales	18,831	22,621	26,494	29,673	32,937
Cost of revenues	12,427	15,920	18,323	20,177	22,068
Gross profit	6,404	6,701	8,172	9,495	10,869
% of net sales	34.0	29.6	30.8	32.0	33.0
SG&A expenses	2,220	2,549	3,853	4,896	5,270
% of net sales	11.8	11.3	14.5	16.5	16.0
EBITDA	4,184	4,153	4,318	4,599	5,599
% of net sales	22.2	18.4	16.3	15.5	17.0
Depreciation and amortization	522	611	762	861	955
% of net sales	2.8	2.7	2.9	2.9	2.9
EBIT	3,662	3,541	3,556	3,739	4,644
% of net sales	19.4	15.7	13.4	12.6	14.1
Interest expense	80	30	96	96	96
Other inc., net of forex gain/(loss)	233	106	557	557	557
Profit before tax	3,815	3,618	4,017	4,199	5,105
Provision for tax	752	960	860	983	1,194
% of PBT	19.7	26.5	21.4	23.4	23.4
PAT	3,063	2,659	3,157	3,217	3,910
Exceptional item	-	-	-	-	-
Minority interest	34	31	44	44	44
Reported PAT	3,029	2,628	3,118	3,173	3,866
Adjusted PAT	2,933	2,628	3,118	3,173	3,866
Fully diluted EPS (₹)	30.3	27.1	32.2	32.8	39.9

Balance sheet (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Equity capital	234	480	484	484	484
Preference capital	-	-	-	-	-
Share premium	-	-	-	-	-
Profit and loss	8,947	11,768	13,882	15,696	18,204
Other reserves	2	0	0	0	-
Net worth	9,182	12,249	14,367	16,181	18,688
Secured loans	309	621	806	806	806
Unsecured loans	54	54	54	55	56
Total debt	363	675	859	860	861
Other long term liability	376	376	376	377	377
Long-term provisions	414	414	414	415	415
Minority interest	144	160	203	145	145
Amount pending investigation	1,230	895	895	895	895
Total capital employed	11,709	14,768	17,114	18,872	21,380
Gross block	5,460	7,811	8,811	9,811	10,811
Accumulated dep.	(2,866)	(3,477)	(4,239)	(5,099)	(6,055)
Net block	2,594	4,334	4,572	4,712	4,757
Capital WIP	266	266	266	267	268
Total fixed assets	2,861	4,601	4,839	4,979	5,025
Investments	36	2,103	2,103	2,103	2,103
Long term loans and adv.	914	1,306	1,502	1,727	1,986
Interest in TML benefit trust	-	-	-	-	-
Deferred tax asset, net	383	390	390	390	390
Other non-current assets	16	-	-	-	-
Inventories	10	24	11	11	11
Sundry debtors	4,349	5,206	5,987	6,896	7,980
Cash and cash equiv.	4,756	2,405	5,127	6,486	8,612
Loans and advances	2,616	3,813	2,998	2,999	2,999
Current investments	-	-	-	-	-
Unbilled revenue	-	-	-	-	-
Sundry creditors	(1,549)	(1,654)	(1,903)	(2,188)	(2,516)
Other liabilities	(1,415)	(1,627)	(1,871)	(2,152)	(2,474)
Provision	(1,267)	(1,799)	(2,068)	(2,379)	(2,736)
Working capital	7,500	6,368	8,280	9,673	11,876
Total capital deployed	11,709	14,768	17,114	18,872	21,380

Cash flow statement (Consolidated, Indian GAAP)

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Pre tax profit from operations	3,063	2,659	3,157	3,217	3,910
Depreciation	522	611	762	861	955
Exp. (deferred)/written off/others	-	-	-	-	-
Pre tax cash from operations	3,585	3,270	3,919	4,077	4,865
Other income/prior period ad	233	106	557	557	557
Net cash from operations	3,818	3,376	4,475	4,634	5,422
Tax	(752)	(960)	(860)	(983)	(1,194)
Cash profits	3,066	2,417	3,615	3,651	4,227
(Inc)/dec in					
Sundry Debtors	(980)	(857)	(781)	(909)	(1,085)
Inventories	1	(15)	13	-	-
Loans and advances	(1,324)	(1,197)	815	(1)	-
Sundry creditors	692	105	248	285	328
Others	(623)	212	244	281	323
Net trade working capital	(2,233)	(1,752)	540	(344)	(434)
Cashflow from operating activities	832	665	4,155	3,307	3,794
(Inc)/dec in fixed assets	(369)	(1,740)	(238)	(140)	(46)
(Inc)/dec in investments	-	(2,067)	-	-	-
(Inc)/dec in other non current assets	104	16	-	-	-
Cashflow from investing activities	(265)	(3,791)	(238)	(140)	(46)
Inc/(dec) in debt	490	(311)	(185)	(1)	(1)
Inc/(dec) in deferred revenue	-	-	-	-	-
Inc/(dec) in equity/premium	(2)	1	-	-	0
Inc/(dec) in minority interest	(9)	(16)	(43)	59	-
Dividends	(231)	(679)	(1,359)	(1,359)	(1,278)
Others	479	1,781	392	(507)	(343)
Cashflow from financing activities	726	775	(1,195)	(1,808)	(1,622)
Cash generated/(utilised)	1,294	(2,351)	2,722	1,359	2,126
Cash at start of the year	3,463	4,756	2,405	5,127	6,486
Cash at end of the year	4,756	2,405	5,127	6,486	8,612

Key Ratios

Y/E March	FY2014	FY2015	FY2016	FY2017E	FY2018E
Valuation ratio (x)					
P/E (on FDEPS)	14.9	16.6	14.0	13.8	11.3
P/CEPS	12.3	13.5	11.3	10.8	9.1
P/BVPS	4.8	3.6	3.0	2.7	2.3
Dividend yield (%)	1.1	1.1	2.7	2.7	2.7
EV/Sales	2.1	1.9	1.5	1.3	1.1
EV/EBITDA	9.5	10.2	9.2	8.3	6.5
EV/Total assets	13.8	9.2	8.2	7.7	7.2
Per share data (₹)					
EPS	30.3	27.1	32.2	32.8	39.9
Cash EPS	36.7	33.5	40.1	41.7	49.8
Dividend	5.0	5.0	12.0	6.0	7.0
Book value	94.9	126.6	148.4	167.2	193.1
Dupont analysis					
Tax retention ratio (PAT/PBT)	0.8	0.7	0.8	0.8	0.8
Cost of debt (PBT/EBIT)	1.0	1.0	1.1	1.1	1.1
EBIT margin (EBIT/Sales)	0.2	0.2	0.1	0.1	0.1
Asset turnover ratio (Sales/Assets)	6.6	4.9	5.5	6.0	6.6
Leverage ratio (Assets/Equity)	0.3	0.4	0.3	0.3	0.3
Operating ROE (%)	33.0	21.5	21.7	19.6	20.7
Return ratios (%)					
RoCE (pre-tax)	31.3	24.0	20.8	19.8	21.7
Angel RoIC	54.8	29.3	30.3	30.8	37.2
RoE	31.9	21.5	21.7	19.6	20.7
Turnover ratios (x)					
Asset turnover (fixed assets)	6.6	4.9	5.5	6.0	6.6
Receivables days	78	92	89	90	93
Payable days	26	29	28	28	29

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Disclosure of Interest Statement

Tech Mahindra

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)