

INDUSTRY	IT SERVICES		
<b>CMP (as on 15 Jul 2014)</b>	<b>Rs 408</b>		
<b>Target Price</b>	<b>Rs 425</b>		
Nifty	7,527		
Sensex	25,229		
<b>KEY STOCK DATA</b>			
Bloomberg/Reuters	NITEC IN/NITT.BO		
No. of Shares (mn)	61		
MCap (Rs bn) / (\$ mn)	25 / 412		
6m avg traded value (Rs mn)	74		
<b>STOCK PERFORMANCE (%)</b>			
<b>52 Week high / low</b>	<b>Rs 487 / 234</b>		
	3M	6M	12M
Absolute (%)	2.9	8.4	56.2
Relative (%)	(9.3)	(10.1)	30.3
<b>SHAREHOLDING PATTERN (%)</b>			
Promoters	31.05		
FIs & Local MFs	15.90		
FIIIs	33.31		
Public & Others	19.74		
Source : BSE			

### Stumble mars rerating story

*NIIT Tech's 1QFY15 results were below our expectation on topline, EBIDTA margin and PAT front. Higher depreciation and EBIDTA miss led to PAT which was 18% below our estimates.*

*EBIDTA margin at 13.4% for 1QFY15 is at a multi quarter low. Margin trajectory is disappointing especially since it has persistently been at the lower end of the midcap peerset. Recurring client specific weakness in select top accounts has affected growth consistency. FCF generation has also deteriorated owing to higher a capex and debtor days. We believe that fresh order intake trajectory in developed markets is crucial for recovery.*

*Our USD revenue growth assumptions are lowered to 3.3/9% for FY15/FY16 (vs. 6.7/9% earlier). EBIDTA margin stands downgraded to 15.4/16.2% (vs. 16.5/17% earlier). Hence, EPS estimates fall by a hefty 19/15%. Our TP is lowered by 7% to Rs 425/sh (10x FY16E EPS) owing to EPS downgrade. Downgrade to NEUTRAL; better entry points will be available for long term investors.*

FINANCIAL SUMMARY(Rs mn)	1QFY15	4QFY14	QoQ (%)	1QFY14	YoY (%)	FY13	FY14	FY15E	FY16E
Net Sales	5,776	5,885	(1.9)	5,419	6.6	20,213	23,047	24,049	25,992
EBITDA	775	891	(13.0)	782	(0.9)	3,296	3,513	3,705	4,199
PAT	433	620	(30.2)	532	(18.6)	2,134	2,305	2,197	2,583
Diluted EPS (Rs)						35.5	38.1	36.1	42.5
P/E (x)						11.5	10.7	11.3	9.6
EV / EBITDA (x)						6.5	6.3	5.9	5.0
RoE (%)						21.3	19.1	15.7	16.4

Source: Company, HDFC sec Inst Research

- 1QFY15 Highlights :** Revenues for 1QFY15 were at USD 96.6mn up 0.3% QoQ but below estimates (USD 98.3mn). Revenues in INR at Rs 5.77bn were down 1.9% on a sequential basis. EBIDTA margin at 13.4% (vs. est 14.2%) was down 170bps QoQ, hit by wage hikes and currency headwinds. PAT at Rs 433mn (18% below est) was affected by the topline, EBIDTA margin miss and higher depreciation.
- Valuation and View :** NIIT Tech's growth has been disappointing for the fifth quarter in a row. FY14 USD revenue growth was a tepid 3.4%. Owing to the 1QFY15 miss and weak commentary for 2Q, we expect FY15 to be no different and model 3.3% USD revenue growth.
- Margin performance remains weak, even as management guided for 16% exit EBIDTA margin by 4QFY15. We believe that NIIT Tech's favorable hedge position can aid reported EBIDTA margin over the next three quarters (NIIT Tech reports hedge gains in revenues). NIIT Tech's free cash flow yield was muted at 0.2% in FY14. Owing to higher capex guidance of Rs 1.5bn, we expect similar weakness in FY15. **Our NEUTRAL stance is driven by deterioration in operating metrics.**

- **Ramp downs hurt revenue growth** : NIIT Tech indicated that ramp downs owing to client specific issues in two large BFS accounts have hurt revenues for the quarter. Management guided that softness in revenues would continue in 2QFY15. Company guided that acceleration in revenues would pick up only in 2HFY15.
- **Order book position** : Order book executable over next 12 months came at USD 295mn up 1.7% QoQ and 12.6% YoY. Fresh order intake for the quarter was at USD 124mn with higher intake from rest of the world. Management guided for a large deal win in APAC region from an airline.
- **Vertical and Geographic growth** : BFS (down 4.7% QoQ) was weak on vertical front. North America (down 1.9% QoQ), EMEA (down 5% QoQ) were weak on geographic front. Weakness in revenues in EMEA is owing to increased offshoring in few accounts. APAC was (up 18% QoQ) aided by higher growth in India. This was driven by revenues from AAI deal.
- **Key metrics** : Exit headcount came at 8,282 with net decline of 8 employees for the quarter. Attrition at 15.4% LTM was up 100bps QoQ. Management guided for uptick in attrition in the overall sector owing to improved demand. Utilization rates came at 78% up 70bps QoQ. Net cash on balance sheet came at Rs 1.95bn as on 1QFY15 (vs. Rs 2.87bn in 4QFY14). Hedge position stands at USD51mn at average rate of 65.44.

**QUARTERLY FINANCIALS SNAPSHOT**

(Rs mn)	1QFY15	4QFY14	QoQ (%)	1QFY14	YoY (%)
<b>USD Revenues</b>	<b>96.6</b>	<b>96.3</b>	<b>0.3</b>	<b>97.9</b>	<b>(1.4)</b>
Net Sales	5,776	5,885	(1.9)	5,419	6.6
Cost of sales	3,877	3,846	0.8	3,669	5.7
SG&A Expenses	1,124	1,148	(2.1)	968	16.1
<b>EBIDTA Profits</b>	<b>775</b>	<b>891</b>	<b>(13.0)</b>	<b>782</b>	<b>(0.9)</b>
Depreciation	189	156		148	
Other Income	36	(30)		206	
PBT	622	705	(11.8)	840	(26.0)
Minority Interest	27	29		12	
Tax	162	56		296	
<b>APAT</b>	<b>433</b>	<b>620</b>	<b>(30.2)</b>	<b>532</b>	<b>(18.6)</b>

Source: Company, HDFC sec Inst Research

**MARGIN ANALYSIS**

Margin Analysis (%)	1QFY15	4QFY14	QoQ (%)	1QFY14	YoY (%)
Cost of Software Development as a % Sales	67.1%	65.4%	177	67.7%	(58)
SG&A as a % of Sales	19.5%	19.5%	(5)	17.9%	160
EBIDTA Margin (%)	13.4%	15.1%	(172)	14.4%	(101)
Net Profit Margin (%)	7.5%	10.5%	(304)	9.8%	(232)
Tax Rate (%)	26.0%	7.9%	1,810	35.2%	(919)

Source: Company, HDFC sec Inst Research

**Revenues at USD 96.6mn were up by 0.3% QoQ, but below our estimates (USD 98.3mn).**

**EBIDTA margin came at 13.4% down 170bps QoQ below our estimate (14.2%). NIIT Tech's adjusted EBIDTA margins stand at 13.3% down 280 bps QoQ(company reports hedging loss in revenues)**

**Americas and EMEA remained weak on geographic front**

**GEOGRAPHICAL REVENUE MIX(%)**

	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15
Americas	37	37	37	36	38	37	38	39	41	44	45	44
EMEA	38	39	37	39	39	40	37	35	36	38	38	36
ROW	26	24	26	25	23	23	25	26	23	18	17	20

Source: Company, HDFC sec Inst Research

**BFS vertical remained weak for the quarter owing to ramp-downs in North America**

**VERTICAL REVENUE MIX(%)**

	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15
BFS	13	13	13	13	12	12	12	14	17	17	16
Insurance	23	21	21	20	19	19	18	19	18	18	18
Transport	38	39	40	42	42	37	36	37	38	37	39
Manufacturing	7	6	7	6	6	6	7	6	7	7	7
Government	5	7	8	5	8	11	13	10	6	5	6
Others	14	14	11	15	13	15	14	14	14	16	14

Source: Company, HDFC sec Inst Research

**Revenue flow from Airport Authority of India deal (AAI deal) has led to higher traction in Managed services**

**SERVICE LINE MIX (%)**

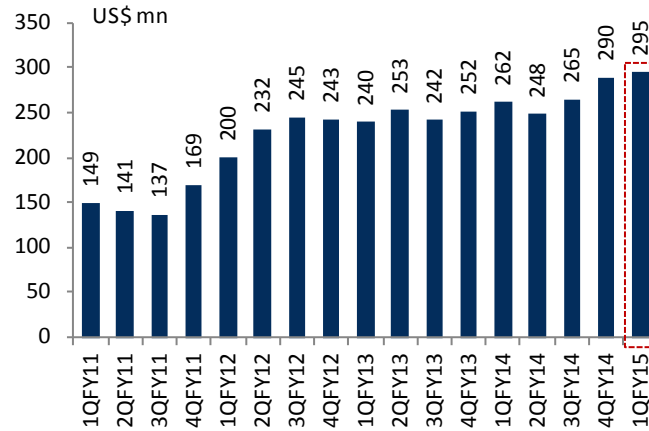
	3QFY12	4QFY12	1QFY13	2QFY13	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15
ADM	62	61	61	64	63	61	60	62	66	64	62
IP assets	13	11	12	10	9	8	9	9	8	9	9
Managed services	12	13	12	11	12	12	13	12	13	12	16
SI and PI	7	9	9	9	10	13	13	12	7	9	7
BPO	6	6	6	6	6	6	5	5	6	6	6

Source: Company, HDFC sec Inst Research

**Order book executable over next twelve months came at USD 295mn up by 12.5% YoY**

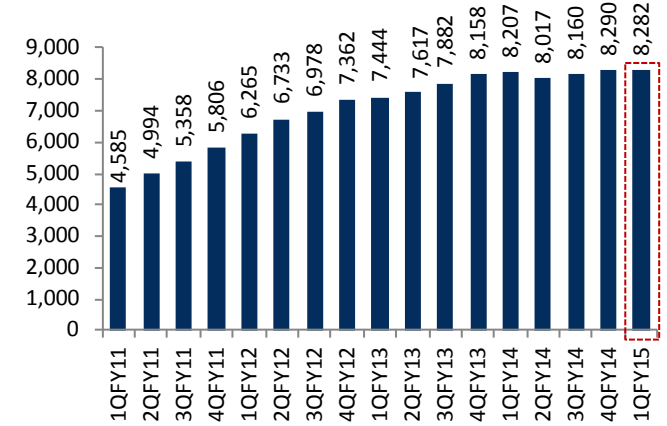
**Net headcount declined marginally QoQ. Attrition has seen an uptick during the quarter.**

**Order book executable over the next 12 months**



Source : Company, HDFC sec Inst Research

**Headcount**



Source : Company, HDFC sec Inst Research

**Fresh order intake stood at USD 124mn. Company had strong deal wins from ROW. NIIT Tech indicated of winning a large contract from an airline in APAC during the quarter**

**FRESH ORDER INTAKE**

Fig in USD mn	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	1QFY13	2QFY13	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15
Fresh Order Intake	116	86	200	75	92	83	93	83	110	145	84	377	144	124
USA	52	14	99	17	35	25	43	31	42	44	16	320	89	34
Europe	31	47	31	56	17	30	44	34	30	26	51	43	30	27
ROW	33	25	70	2	40	28	17	18	38	75	17	14	25	63

Source : Company, HDFC sec Inst Research

**PEER VALUATION**

	CMP (Rs)	Mcap (Rs bn)	EPS				P/E				EV/EBIDTA				ROE(%)			
			FY13	FY14	FY15E	FY16E	FY13	FY14	FY15E	FY16E	FY13	FY14	FY15E	FY16E	FY13	FY14	FY15E	FY16E
Mphasis	439	92.2	35.4	34.5*	35.6	36.9	12.4	12.7	12.3	11.9	7.0	7.2	7.0	6.6	15.9	15.2	14.2	13.8
eClerx	1,175	35.1	57.0	82.9	94.5	108.6	20.6	14.2	12.4	10.8	12.6	8.9	8.0	6.9	44.0	49.8	43.7	40.2
Hexaware*	147	43.6	10.9	12.6	10.8	13.4	13.5	11.7	13.6	11.0	9.6	7.3	7.8	6.7	29.5	28.1	20.5	22.7
<b>NIIT Tech</b>	<b>408</b>	<b>24.3</b>	<b>35.5</b>	<b>38.1</b>	<b>36.1</b>	<b>42.5</b>	<b>11.4</b>	<b>10.6</b>	<b>11.2</b>	<b>9.5</b>	<b>6.4</b>	<b>6.1</b>	<b>5.8</b>	<b>4.9</b>	<b>21.3</b>	<b>19.1</b>	<b>15.7</b>	<b>16.4</b>
Mindtree	871	72.3	40.9	53.8	63.4	75.8	21.3	16.2	13.7	11.5	13.8	10.8	8.9	7.0	29.9	30.5	28.6	27.1
KPIT Tech	183	35.2	10.6	12.6	16.1	19.3	17.3	14.6	11.4	9.5	9.4	8.5	6.8	5.4	22.5	20.5	22.5	22.1
CYIENT	336	37.5	20.8	23.8	30.8	34.6	16.1	14.1	10.9	9.7	9.3	7.2	5.9	4.9	18.6	18.3	20.1	19.5

Source : Company, HDFC sec Inst Research, \*Hexaware's EPS projections are for CY12, CY13 ,CY14E and CY15E respectively , Mphasis FY14 EPS is annualized

**Owing to steep PAT miss of 18% in 1QFY15, we downgrade our profit estimates for the company.**

**Revenue, EBIDTA margin downgrade accompanied by higher depreciation (vs. earlier assumptions) owing to change in useful life of assets lead us to downgrade our EPS estimates**

**CHANGE IN ESTIMATES**

(Rs mn)	FY15E			FY16E		
	New	Old	% Change	New	Old	% Change
Sales	24,049	25,613	(6.1)	25,992	27,542	(5.6)
EBIDTA	3,705	4,363	(15.1)	4,199	4,853	(13.5)
PAT	2,197	2,717	(19.1)	2,583	3,048	(15.3)

Source : HDFC sec Inst Research

**ASSUMPTIONS**

	FY11	FY12	FY13	FY14	FY15E	FY16E
USD Revenue Growth	39.2%	21.1%	14.6%	3.4%	3.3%	9.0%
Average Exchange Rate(USD vs INR)	45.64	48.21	53.93	59.47	60.09	59.6
Cost of Sales	63.0%	62.7%	65.1%	65.8%	65.7%	66.2%
SG&A/ Sales	17.5%	20.3%	18.6%	19.0%	18.9%	17.6%
EBIDTA Margin (%)	19.5%	17.0%	16.3%	15.2%	15.4%	16.2%

Source : Company, HDFC sec Inst Research

**INCOME STATEMENT**

(Rs mn)	FY12	FY13	FY14	FY15E	FY16E
<b>USD Revenues</b>	<b>327.0</b>	<b>374.8</b>	<b>387.5</b>	<b>400.2</b>	<b>436.2</b>
<b>Growth (%)</b>	<b>21.1</b>	<b>14.6</b>	<b>3.4</b>	<b>3.3</b>	<b>9.0</b>
Average Exchange Rate	48.2	53.9	59.5	60.1	59.6
<b>Revenues</b>	<b>15,764</b>	<b>20213</b>	<b>23,047</b>	<b>24,049</b>	<b>25,992</b>
<b>Growth %</b>	<b>27.9</b>	<b>28.2</b>	<b>14.0</b>	<b>4.3</b>	<b>8.1</b>
Cost of Development	9,877	13,159	15,166	15,809	17,215
S&G&A Expenses	3,204	3,758	4,368	4,535	4,579
<b>EBIDTA</b>	<b>2,683</b>	<b>3,296</b>	<b>3,513</b>	<b>3,705</b>	<b>4,199</b>
<b>EBIDTA Margin %</b>	<b>17.0</b>	<b>16.3</b>	<b>15.2</b>	<b>15.4</b>	<b>16.2</b>
<b>EBIDTA Growth %</b>	<b>11.6</b>	<b>22.9</b>	<b>6.6</b>	<b>5.5</b>	<b>13.3</b>
Depreciation	364	567	619	774	780
EBIT	2,319	2,729	2,894	2,931	3,419
Other Income	282	207	288	156	160
PBT	2601	2936	3182	3087	3579
Tax	638	751	803	828	948
PAT	1,963	2,185	2,379	2,260	2,631
Minority Interest / Adj	(7.98)	52	75.0	63.0	48.0
<b>APAT</b>	<b>1,971</b>	<b>2,133</b>	<b>2,304</b>	<b>2,197</b>	<b>2,583</b>
NPM(%)	12.50	10.55	10.00	9.13	9.94
<b>EPS</b>	<b>33.2</b>	<b>35.5</b>	<b>38.1</b>	<b>36.1</b>	<b>42.5</b>
<b>EPS Growth (%)</b>	<b>7.4</b>	<b>7.0</b>	<b>7.3</b>	<b>(5.2)</b>	<b>17.6</b>

Source: Company, HDFC sec Inst Research

**BALANCE SHEET**

(Rs mn)	FY12	FY13	FY14	FY15E	FY16E
<b>SOURCES OF FUNDS</b>					
<b>Share Capital</b>	<b>596</b>	<b>602</b>	<b>607</b>	<b>607</b>	<b>607</b>
Reserves	8,503	10,339	12,632	14,186	16,013
Total Shareholders' Funds	9,099	10,941	13,239	14,793	16,620
Minority Interest	123	173	189	252	300
Long Term Debt	122	60	53	53	53
Short Term Debt	423	-	-	-	-
<b>Total Debt</b>	<b>545</b>	<b>60</b>	<b>53</b>	<b>53</b>	<b>53</b>
Long Term Provisions	3	279	310	310	310
<b>TOTAL SOURCES OF FUNDS</b>	<b>9,770</b>	<b>11,453</b>	<b>13,790</b>	<b>15,407</b>	<b>17,283</b>
<b>APPLICATION OF FUNDS</b>					
Net Block	4,233	4,661	5,820	6,246	6,366
Investments	549	820	551	551	551
Deferred Tax Assets	207	122	223	223	223
LT Loans & Advances	395	369	555	665	775
Inventories	7	4	52	52	52
Trade Receivables	3,314	4,538	5,644	5,798	6,267
Cash & Equivalents	2,223	2,329	2,212	2,369	3,397
ST loans & Advances	988	933	1,316	1,466	1,616
Other Current Assets	1,345	1,612	1,641	1,941	2,241
<b>Current assets</b>	<b>7,869</b>	<b>9,413</b>	<b>10,813</b>	<b>11,574</b>	<b>13,521</b>
Trade Payables	1,284	1,798	1,837	1,515	1,780
Other Current Liabilities	1,257	1,172	1,552	1,443	1,430
Provisions	949	965	836	946	996
<b>Current Liabilities</b>	<b>3,490</b>	<b>3,935</b>	<b>4,224</b>	<b>3,904</b>	<b>4,206</b>
<b>Net Current Assets</b>	<b>4,379</b>	<b>5,478</b>	<b>6,588</b>	<b>7,670</b>	<b>9,315</b>
<b>APPLICATION OF FUNDS</b>	<b>9,770</b>	<b>11,453</b>	<b>13,790</b>	<b>15,407</b>	<b>17,283</b>

Source: Company, HDFC sec Inst Research

**CASH FLOW**

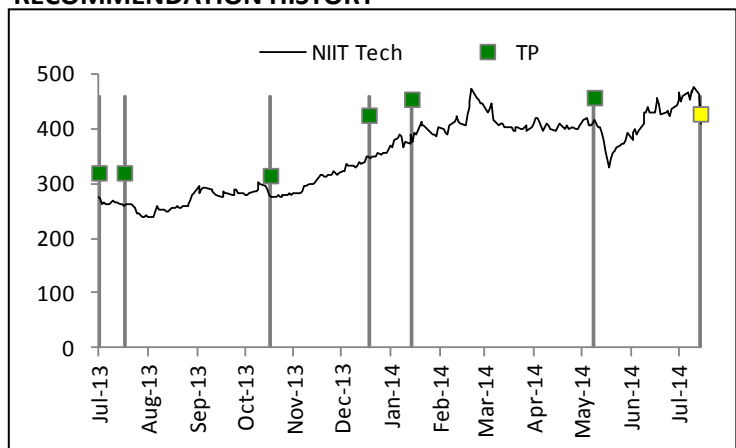
(Rs mn)	FY12	FY13	FY14	FY15E	FY16E
Reported PAT	1,963	2,186	2,380	2,260	2,631
Non operating & Int. Income	(52)	(22)	(93)	(120)	(120)
Other EO Items	120	75	151	0	0
Depreciation	364	567	619	774	780
Working Capital Change	(752)	(453)	(1,606)	(1,035)	(727)
<b>OPERATING CASH FLOW ( a )</b>	<b>1,643</b>	<b>2,353</b>	<b>1,451</b>	<b>1,879</b>	<b>2,563</b>
Capex	(1,197)	(969)	(1,399)	(1,400)	(900)
Free cash flow (FCF)	446	1,384	52	479	1,663
Investments	212	(164)	402	120	120
<b>INVESTING CASH FLOW ( b )</b>	<b>(985)</b>	<b>(1,133)</b>	<b>(997)</b>	<b>(1,280)</b>	<b>(780)</b>
Share capital Issuance	54	87	38	-	-
Debt Issuance	311	(414)	(17)	-	-
Interest expenses	(21)	(21)	(14)	-	-
Dividend	(511)	(566)	(547)	(643)	(755)
<b>FINANCING CASH FLOW ( c )</b>	<b>(167)</b>	<b>(914)</b>	<b>(540)</b>	<b>(643)</b>	<b>(755)</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>491</b>	<b>306</b>	<b>(87)</b>	<b>(44)</b>	<b>1,028</b>
Effect of chg in Exchange rates	118	65	214	-	-
Closing Cash & Equivalents	2,222	2,329	2,212	2,169	3,197

Source: Company, HDFC sec Inst Research

**KEY RATIOS**

	FY12	FY13	FY14	FY15E	FY16E
<b>PROFITABILITY (%)</b>					
Gross Margin	37.3	34.9	34.2	34.3	33.8
EBITDA Margin	17.0	16.3	15.2	15.4	16.2
EBIT Margin	14.7	13.5	12.6	12.2	13.2
APAT Margin	12.5	10.6	10.0	9.1	9.9
RoE	23.7	21.3	19.1	15.7	16.4
RoCE	23.1	20.8	19.2	15.8	16.6
ROIC	27.3	26.9	24.8	18.9	20.1
<b>EFFICIENCY</b>					
Tax Rate %	24.5	25.6	25.2	26.8	26.5
Asset turnover (x)	1.63	1.79	1.73	1.62	1.56
Unbilled Revenues	30.0	22.0	20.52	20.52	20.52
Debtor (days)	77.0	82.0	89.4	88.0	88.0
Payables (days)	30.0	32.0	29	23	25
Cash conversion cycle (days)	77.7	71.6	80.8	85.5	83.5
Debt/EBITDA (x)	0.20	0.02	0.01	0.01	0.01
Net D/E	(0.25)	(0.28)	(0.20)	(0.18)	(0.22)
<b>VALUATION</b>					
EPS (Rs/sh)	33.2	35.5	38.1	36.1	42.5
CEPS (Rs/sh)	39.2	44.8	48.2	48.9	55.4
BV (Rs/sh)	152.6	181.6	218.1	243.7	273.8
DPS (Rs/sh)	8.0	8.5	9.0	9.0	10.6
P/E	12.3	11.5	10.7	11.3	9.6
P/BV	2.7	2.2	1.9	1.7	1.5
EV/EBITDA	8.2	6.5	6.3	6.0	5.0
Dividend Yield (%)	2.0%	2.1%	2.2%	2.2%	2.6%
FCFE/Mcap(%)	1.8%	5.6%	0.2%	1.9%	6.7%
OCF/EV(%)	7.5%	11.0%	6.6%	8.5%	12.2%
FCF/EV(%)	2.0%	6.4%	0.2%	2.2%	7.9%

Source: Company, HDFC sec Inst Research

**RECOMMENDATION HISTORY**


Date	CMP	Reco	Target
1-Jul-13	277	BUY	320
17-Jul-13	259	BUY	320
17-Oct-13	278	BUY	315
18-Dec-13	350	BUY	425
15-Jan-14	389	BUY	454
10-May-14	415	BUY	457
16-Jul-14	408	NEU	425

**Rating Definitions**

- BUY** : Where the stock is expected to deliver more than 10% returns over the next 12 month period  
**NEUTRAL** : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period  
**SELL** : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

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