



Union Bank of India

BSE SENSEX	S&P CNX	Rs338	Buy
19,151	5,743		
Bloomberg	UNBKIN		
Equity Shares (m)	505.1		
52-Week Range (Rs)	427/237		
1,6,12 Rel.Perf.(%)	8/-2/16		
M.Cap. (Rs b)	170.6		
M.Cap. (US\$ b)	3.7		

PAT grew ~8.5% YoY to Rs5.8b (5% higher than our estimate), led by robust NII growth of 48% YoY (9% higher than our estimate). Continued NIM improvement (9bp QoQ) and strong CASA were key positives. Higher slippages of Rs7.7b (annualized slippage ratio of 2.6%) and continued moderation in fee income is disappointing. Key highlights are:

- NII grew 48% YoY and 5% QoQ led by 67bp YoY and 9bp QoQ improvement in NIM to 3.44%. Adjusted for one-offs in 2QFY11, NIM improved 23bp QoQ. Higher yield on loans (up 43bp QoQ) negated the impact of rising cost of deposits (up 12bp QoQ). Management guided margins of 3.25% for FY11.
- CASA ratio improved ~60bp QoQ to 33.3%. CASA grew 27% YoY and 7% QoQ, led by strong growth in savings deposits (33% YoY and 10.4% QoQ). Current deposits grew 12% YoY but declined ~2.5% QoQ. Management targets CASA ratio of 35% for FY12.
- Loans grew ~26% YoY and ~6% QoQ (in line with industry) to Rs1.34t. For FY11, management targets loan growth of 25%, implying a sequential growth of ~14% in 4QFY11.
- Addition to GNPA was higher than expected at Rs7.7b (annualized slippage ratio of 2.6%). High write-offs (Rs4.5b v/s Rs1.5b in 2QFY11) and recoveries (Rs2.6b v/s Rs1.9b in 2QFY11) resulted in stable GNPA QoQ on reported basis. One large account of Rs2b slipped into NPA during the quarter. Management has guided to bring down GNPA ratio to 2.4% by the end of FY11 v/s 2.7% in 3QFY11.
- The bank has maintained its earlier guidance of Rs24b towards second pension option (to be amortized over five years) and of Rs2.5b towards gratuity (to be fully provided in FY11). During the quarter, it has provided Rs1.2b (Rs3.6b till 9MFY11) towards second pension option and Rs635m towards gratuity (Rs1.9b provided till 9MFY11).

Valuation and view: We expect the bank to report EPS of Rs41 in FY11, Rs51 in FY12 and Rs62 in FY13. BV is expected to be Rs248 in FY12 and Rs298 in FY13. The stock trades at 1.4x FY12E BV and 1.1x FY13E BV. Maintain **Buy** with a target price of Rs450 (1.5x FY13E BV).

QUARTERLY PERFORMANCE

	(RS MILLION)									
	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	31,908	32,056	33,183	35,617	36,857	39,522	41,995	45,709	133,027	164,082
Interest Expense	23,737	23,422	22,289	21,656	23,376	24,164	25,836	29,352	91,103	102,729
Net Interest Income	8,172	8,634	10,894	13,961	13,480	15,358	16,158	16,356	41,924	61,353
% Change (Y-o-Y)	3.6	-11.3	-3.2	50.7	65.0	77.9	48.3	17.2	9.9	46.3
Other Income	5,132	5,553	4,400	4,925	4,350	5,096	4,936	5,325	19,747	19,707
Net Income	13,303	14,187	15,294	18,887	17,830	20,455	21,094	21,681	61,672	81,061
Operating Expenses	5,429	6,086	6,152	7,411	7,393	9,149	8,483	8,816	25,078	33,841
Operating Profit	7,875	8,101	9,142	11,475	10,437	11,306	12,611	12,865	36,593	47,220
% Change (Y-o-Y)	27.8	15.8	7.0	25.9	32.5	39.6	37.9	12.1	18.7	29.0
Other Provisions	1,903	1,350	1,611	3,400	1,973	5,989	4,000	3,902	8,264	15,864
Profit before Tax	5,972	6,751	7,531	8,075	8,464	5,317	8,612	8,963	28,329	31,356
Tax Provisions	1,550	1,700	2,190	2,140	2,450	2,284	2,816	2,798	7,580	10,347
Net Profit	4,422	5,051	5,341	5,935	6,014	3,034	5,796	6,164	20,749	21,008
% Change (Y-o-Y)	93.7	39.7	-20.5	27.6	36.0	-39.9	8.5	3.9	20.2	1.2
Interest Exp./Interest Income (%)	74.4	73.1	67.2	60.8	63.4	61.1	61.5	64.2	68.5	62.6
Other Income/Net Income (%)	38.6	39.1	28.8	26.1	24.4	24.9	23.4	24.6	32.0	24.3
Cost/Income Ratio (%)	40.8	42.9	40.2	39.2	41.5	44.7	40.2	40.7	40.7	41.7
Provisions/Operating Profits (%)	24.2	16.7	17.6	29.6	18.9	53.0	31.7	30.3	22.6	33.6
Tax Rate (%)	26.0	25.2	29.1	26.5	28.9	42.9	32.7	31.2	26.8	33.0

E: MOSL Estimates

RESULTS ANALYSIS (RS M)

	3QFY11	3QFY10	YOY GR. %	2QFY11	QOQ GR. %	FY10	FY11E	FY12E
Interest Income	41,995	33,183	27	39,522	6	133,027	164,082	199,841
Interest Expense	25,836	22,289	16	24,164	7	91,103	102,729	129,585
Net Interest Income (Nil)	16,158	10,894	48	15,358	5	41,924	61,353	70,256
Other Income	4,936	4,400	12	5,096	-3	19,747	19,707	22,363
- Fees and others	3,546	2,980	19	2,786	27	12,190	12,707	14,613
- Trading Profits	1,080	1,050	3	1,870	N.A.	5,728	5,500	6,000
- Recovery from w/off	310	370	-16	440	-30	1,830	1,500	1,750
Net Income	21,094	15,294	38	20,455	3	61,672	81,061	92,620
Total Operating Costs	8,483	6,152	38	9,149	-7	25,078	33,841	35,798
- Staff Costs	5,202	3,245	60	5,919	-12	13,545	20,866	20,877
- Other Opex	3,281	2,907	13	3,229	2	11,533	12,975	14,921
Operating Profit	12,611	9,142	38	11,306	12	36,593	47,220	56,822
Provisions	4,000	1,611	148	5,989	-33	8,264	15,864	17,878
- NPAs	3,610	430	740	6,290	-43	6,989	14,109	14,304
- Others	390	1,181	N.A.	-301	N.A.	1,275	1,755	3,575
PBT	8,612	7,531	14	5,317	62	28,329	31,356	38,943
Tax	2,816	2,190	29	2,284	23	7,580	10,347	13,241
Tax payout %	33	29		43		27	33	34
PAT	5,796	5,341	9	3,034	91	20,749	21,008	25,703
Deposits	1,866,550	1,510,850	24	1,777,800	5	1,700,397	2,040,477	2,489,382
CASA Ratio %	33	32		33		32	32	31
Advances	1,337,870	1,065,340	26	1,264,230	6	1,193,153	1,431,784	1,746,776
Gross NPA (Rs B)	35.8	20.9	71	35.2	2	26.7	38.3	42.0
Gross NPA %	2.7	2.0		2.8		2.2	2.6	2.4
Net NPA (Rs B)	16.0	6.1	161	14.6	9	9.7	16.3	16.8
Net NPA %	1.2	0.6		1.2		0.8	1.1	1.0
Yields on Advances %*	10.0	10.0		9.6		9.0	9.1	9.4
Cost of Funds % *	5.2	5.4		5.1		5.6	5.2	5.5
NIM % **	3.4	2.8		3.4		2.6	3.2	3.0
Tier I CAR %	7.4	8.7		7.9		7.9	7.7	7.2
Tier II CAR %	4.4	4.8		4.7		4.6	4.2	3.6

* Reported-Cumulative, **Reported-Quarterly

Asset quality disappoints once again

On a reported basis, GNPA increased by 2% QoQ to Rs36b in absolute terms but declined marginally to 2.7% from 2.8% in 2QFY11 in percentage terms. NNPA remained stable QoQ in percentage terms. PCR including technical write-offs was stable QoQ at ~70%. Addition to GNPA remained high at Rs7.7b (annualized slippage ratio of 2.6%). However higher deductions by way of write-offs (Rs4.5b v/s Rs1.5b in 2QFY11) and recoveries (Rs2.6b v/s Rs1.9b in 2QFY11) resulted in stable GNPA QoQ.

Outstanding restructured loans stood at Rs52.5b (3.9% of the loan book, facility-wise), of which Rs2.2b slipped during the quarter (cumulatively ~18% of the restructured loan book has slipped in to NPA). During the quarter, fresh restructured loans stood at Rs1.4b. Management has guided for lower slippages in 4QFY11 and expects to contain GNPA ratio at 2.4-2.5% as at end-FY11 v/s 2.7% in 3QFY11. For FY12, management has guided slippage ratio of ~1.3% and credit cost to decline to 0.5% (v/s 1.14% for 9MFY11).

NIM improved sharply by 23bp (adjusted) QoQ, a positive surprise

NII grew 48% YoY and 5% QoQ to Rs16.2b; adjusted for one-offs in 2QFY11, NII growth was higher at ~10% QoQ. Reported margins improved 67bp YoY and 9bp QoQ to 3.44% (whereas adjusted margins improved by 23bp) - a positive surprise. YoL improved 43bp QoQ while cost of deposits was up by merely 12bp QoQ, driving NIM expansion. With increase in cost of deposits, management expects margins to compress in 4QFY11, and has guided NIM of 3.25% for FY11 (implying 4QFY11 margin of 3.1%). The current guidance is very conservative in our view and positive surprise is likely.

Loan growth in line with industry trend

Loans grew ~25.6% YoY and ~6% QoQ (in line with the industry) to Rs1.34t, while deposits grew 23.5% YoY and 5% QoQ to ~Rs1.9t. Management targets loan growth of 25% in FY11, implying a sequential growth of ~14% in 4QFY11. CD ratio improved 50bp QoQ to 71.6% in 3QFY11. The bank continues to carry some excess liquidity in its book, which would provide some cushion to NIM in a rising interest rate environment. CASA ratio improved ~60bp QoQ to 33.3%. CASA grew 27% YoY and 7% QoQ, led by robust growth in savings deposits (33% YoY and 10.4% QoQ). Current deposits grew 12% YoY but declined ~2.5% QoQ. Management expects to improve CASA ratio by 100-200bp by FY12.

Fee income performance remains disappointing

Non-interest income grew 12% YoY but declined 3% QoQ (due to lower trading gains). Core fee income growth remained muted QoQ and grew 7% YoY. Trading gains were Rs1.1b (flat YoY) v/s Rs1.9b in 2QFY11. Recoveries during the quarter were Rs310m v/s Rs440m in 2QFY11 and Rs370m in 2QFY10. Although fee income growth has moderated over the period, management expects it to grow ~15% for FY11, driven by traction in loan growth.

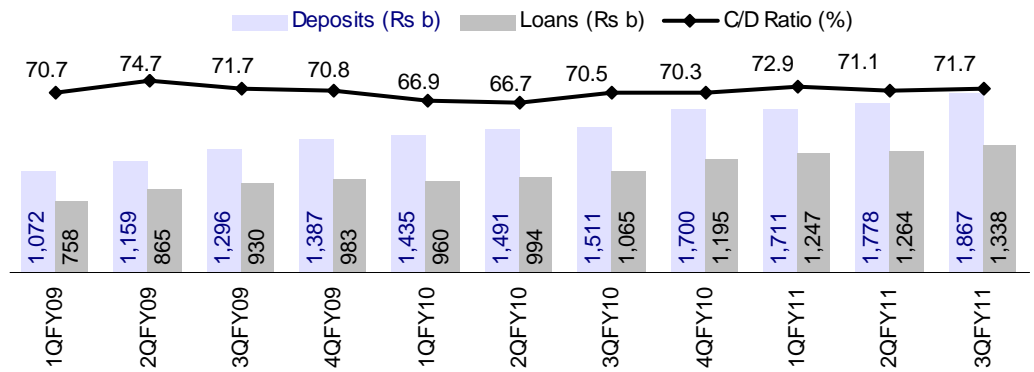
Guidance towards estimated pension remains unchanged

Management has maintained its earlier guidance of Rs24b towards second pension option (to be amortized over five years) and Rs2.5b towards gratuity. During the quarter, the bank provided Rs1.2b (Rs3.6b provided till 9MFY11) towards second pension option and Rs635m towards gratuity (total liability of Rs2.5b to be provided in FY11, Rs1.9b provided till 9MFY11). Operating expenses grew 38% YoY, but declined 7% QoQ to Rs8.5b. Employee expenses declined 12% QoQ, as bulk of provision towards second pension and gratuity related liability was provided in 2QFY11. Cost to income ratio declined to 42.4% v/s 49.2% in 2QFY11 and 43.2% in 3QFY10.

Valuation and view

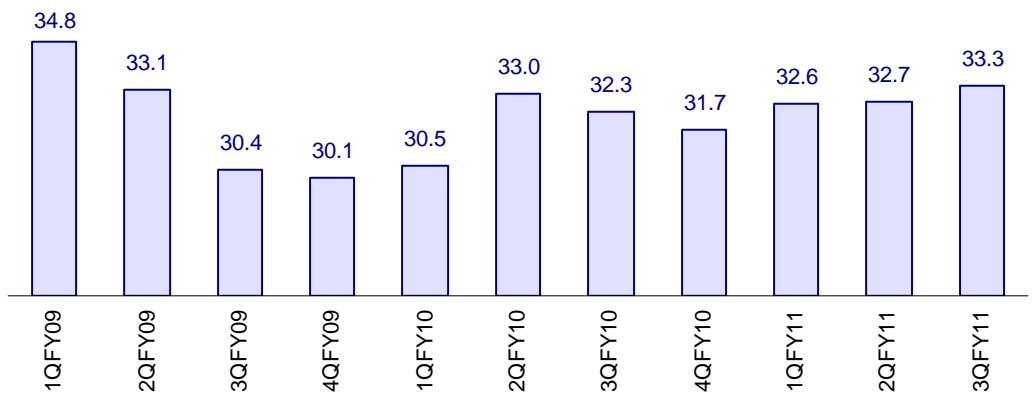
While the margin performance remains impressive, continued negative surprises on asset quality and fee income are likely to remain overhangs for stock performance. We model 15bp decline in NIM in FY12; operating leverage (no gratuity provision in FY12) and fall in credit cost will help the bank to report ~22% profit growth in FY12/13. We estimate 22% EPS CAGR over FY11-13. RoA is likely to be ~1% and RoE 22-23% over FY11-13. We expect the bank to report EPS of Rs41 in FY11, Rs51 in FY12 and Rs62 in FY13. BV is expected to be Rs248 in FY12 and Rs298 in FY13. The stock trades at 1.4x FY12E BV and 1.1x FY13E BV. Maintain **Buy** with a target price of Rs450 (1.5x FY13E BV).

Business growth in line with industry trend



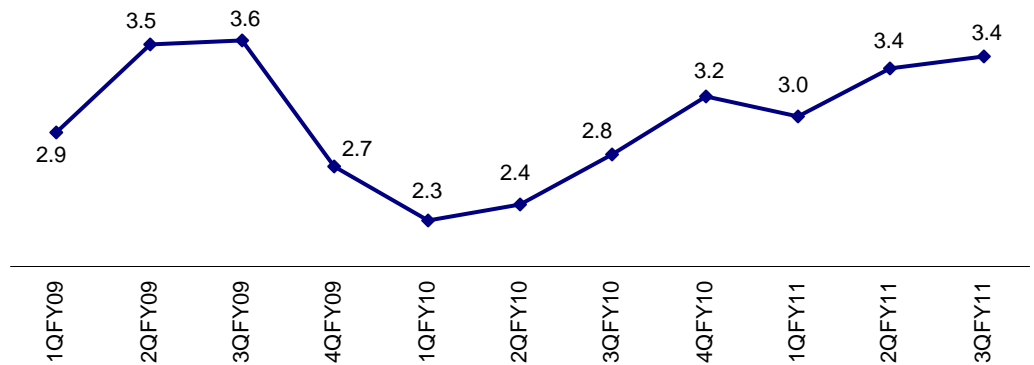
Trend in CASA ratio (%)

CASA grew 27% YoY and 7% QoQ, led by robust growth in savings deposits (33% YoY and 10.4% QoQ)



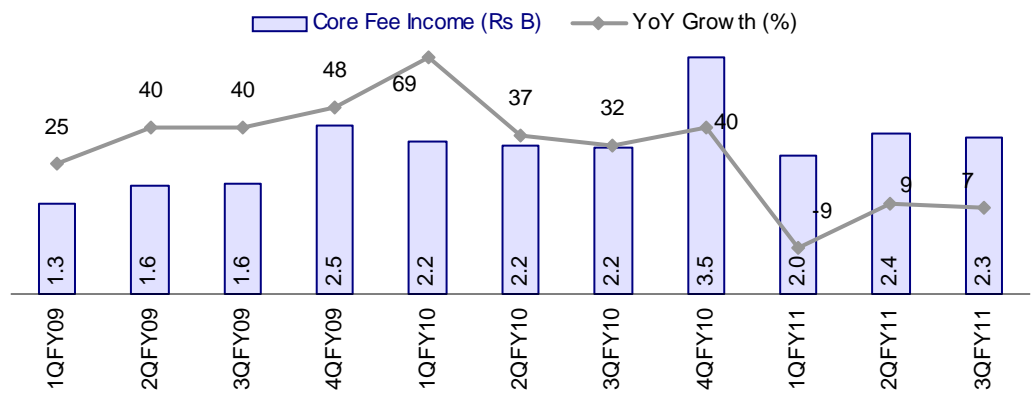
NIM improves QoQ (%)

Healthy improvement in NIM is a positive surprise



Core fee income

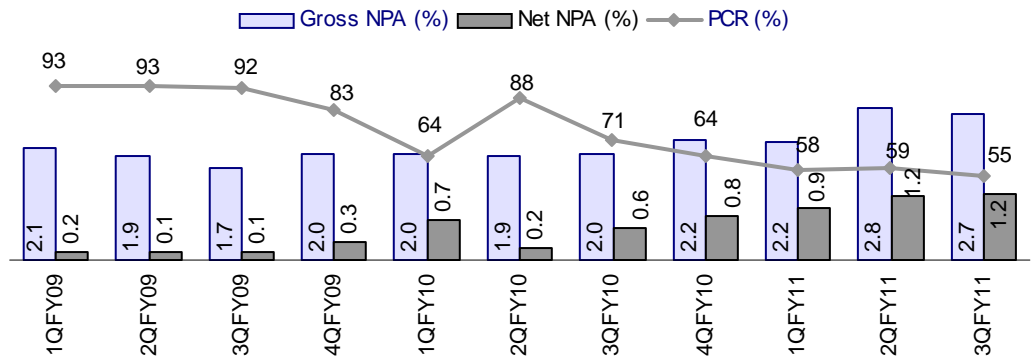
Fee income growth has been disappointing



Source: Company/MOSL

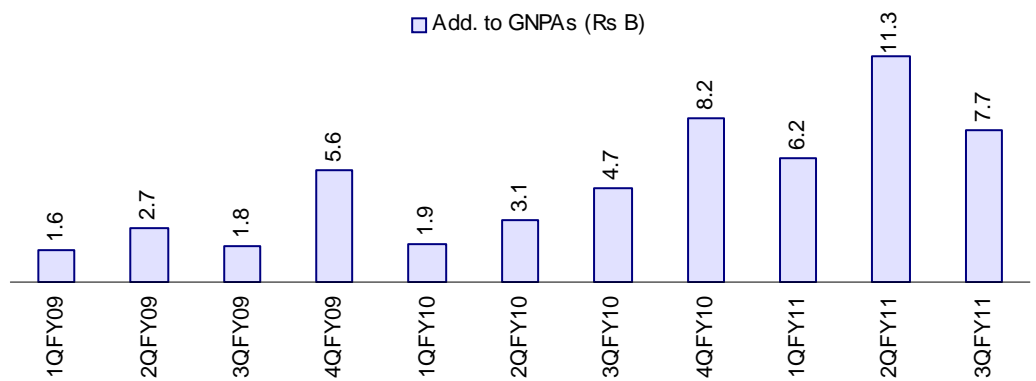
Trend in asset quality

Asset quality stable on the back of higher write-offs



Higher slippages during the quarter

Slippages remain high; management has guided lower slippages in 4QFY11 and expects to contain GNPA ratio at 2.4%-2.5% by end-FY11 v/s 2.7% in 3QFY11



Source: Company/MOSL

Union Bank of India: an investment profile

Company description

Union Bank (UNBK) is a state-owned bank, with a total business of over Rs304b. The government currently holds 55.4% in the bank. UNBK has a pan-India presence, with higher concentration in the western region. It has over 2,993 branches and 2,500+ ATMs in India. All the branches are on the CBS platform.

Key investment arguments

- With improvement in CD ratio, improvement in CASA ratio and increased focus on high yielding SME and retail loans, we expect NIM to improve 60bp (calculated) in FY11 from FY10 levels of ~2.6%.
- While we model margins to decline 15bp in FY12, operating leverage (no gratuity provision in FY12) and fall in credit cost will help the bank to report ~22% profit growth in FY12/13.
- Over FY07-10, fee income CAGR was 27%. However, fee income as a percentage of average assets stands at ~0.7% v/s ~0.9% for peers. Thus, there is considerable scope for improvement.

Key investment risks

- While margin performance remains impressive, continued negative surprises on asset quality and fee income are key things to watch for.
- Delay in obtaining required capital will affect the bank's growth plans.

Recent developments

- UNBK has increased its base rate by 50bp to 9%.

Valuation and view

- We estimate 22% EPS CAGR over FY11-13. RoA is likely to be ~1% and RoE 22-23% over FY11-13. We expect the bank to report EPS of Rs41 in FY11, Rs51 in FY12 and Rs62 in FY13. BV is expected to be Rs248 in FY12 and Rs298 in FY13.
- The stock trades at 1.4x FY12E BV and 1.1x FY13E BV. Maintain **Buy** with a target price of Rs450 (1.5x FY13E BV).

Sector view

- Loan growth is strong but rising inflation and increasing interest rates are near-term headwinds for the sector.
- Our economist expects the current tightness in liquidity to begin to ease in 4QFY11, allaying the pressure of a significant NIM compression.
- We believe margins will compress gradually. With strong loan growth and a high CD ratio, there is strong pricing power with banks.
- Banks with high CASA deposits and a lower proportion of bulk deposits will be preferred bets.

Comparative valuations

		UBI	BoB	Bol
P/E (x)	FY11E	8.2	8.4	9.1
	FY12E	6.7	7.2	7.3
P/BV (x)	FY11E	1.6	1.9	1.6
	FY12E	1.4	1.6	1.4
RoE (%)	FY11E	21.7	24.4	19.5
	FY12E	22.3	23.5	20.6
RoA (%)	FY11E	1.0	1.2	0.9
	FY12E	1.0	1.2	0.9

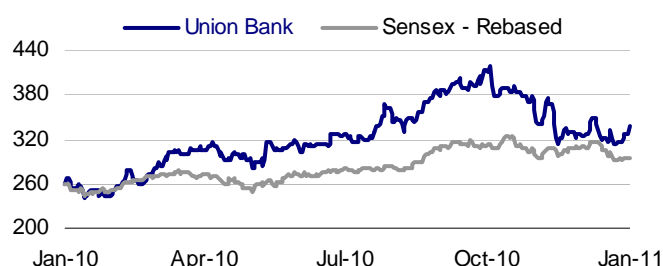
EPS: MOST forecast v/s consensus (Rs)

	Most Forecast	Consensus Forecast	Variation (%)
FY11	41.4	37.8	9.6
FY12	50.7	45.2	12.1

Target Price and Recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
338	450	33.2	Buy

Stock performance (1 year)



Shareholding pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	55.4	55.4	55.4
Domestic Inst	11.9	11.9	13.5
Foreign	16.8	18.6	16.2
Others	15.8	14.1	14.9

Financials and valuation

INCOME STATEMENT				(RS MILLION)		
Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Interest Income	92,146	118,894	133,027	164,082	199,841	247,207
Interest Expense	63,609	80,758	91,103	102,729	129,585	163,977
Net Interest Income	28,537	38,136	41,924	61,353	70,256	83,230
<i>Change (%)</i>	8.3	33.6	9.9	46.3	14.5	18.5
Non Interest Income	13,196	14,826	19,747	19,707	22,363	25,055
Net Income	41,733	52,961	61,672	81,061	92,620	108,285
<i>Change (%)</i>	20.0	26.9	16.4	31.4	14.3	16.9
Operating Expenses	15,930	22,141	25,078	33,841	35,798	41,034
Pre Provision Profits	25,803	30,820	36,593	47,220	56,822	67,251
<i>Change (%)</i>	29.0	19.4	18.7	29.0	20.3	18.4
Provisions (excl tax)	7,289	7,375	8,264	15,864	17,878	19,433
PBT	18,514	23,445	28,329	31,356	38,943	47,818
Tax	4,644	6,180	7,580	10,347	13,241	16,258
<i>Tax Rate (%)</i>	25.1	26.4	26.8	33.0	34.0	34.0
PAT	13,870	17,265	20,749	21,008	25,703	31,560
<i>Change (%)</i>	64.1	24.5	20.2	1.2	22.3	22.8
Prof. Dividend (Incl tax)	0	0	0	90	90	90
Profits for Equity SH	13,870	17,265	20,749	20,918	25,612	31,470
<i>Change (%)</i>	64.1	24.5	20.2	0.8	22.4	22.9
Equity Dividend (Incl tax)	2,020	2,526	2,778	3,566	4,367	5,365
Core PPP*	20,266	26,125	29,035	40,220	49,072	59,001
<i>Change (%)</i>	13.1	28.9	11.1	38.5	22.0	20.2
<i>*Core PPP is (Nil+Fee income-Opex)</i>						
BALANCE SHEET				(RS MILLION)		
Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Share Capital	5,051	5,051	5,051	6,151	6,151	6,151
Equity Share Capital	5,051	5,051	5,051	5,051	5,051	5,051
Preference Share Capital	0	0	0	1,100	1,100	1,100
Reserves & Surplus	68,426	82,352	99,187	115,933	136,436	161,629
Net Worth	73,477	87,404	104,238	122,084	142,587	167,780
<i>Of which Equity Networth</i>	73,477	87,404	104,238	120,984	141,487	166,680
Deposits	1,038,586	1,387,028	1,700,397	2,040,477	2,489,382	3,037,046
<i>Change (%)</i>	21.9	33.5	22.6	20.0	22.0	22.0
of which CASA Dep	362,040	417,112	539,570	659,550	782,534	928,776
<i>Change (%)</i>	23.2	15.2	29.4	22.2	18.6	18.7
Borrowings	85,105	87,749	92,153	102,992	117,610	131,566
Other Liabilities & Prov.	42,750	47,574	54,830	65,719	79,214	95,441
Total Liabilities	1,239,919	1,609,755	1,951,619	2,331,271	2,828,793	3,431,833
Current Assets	100,978	159,849	157,767	197,943	246,499	307,367
Investments	338,226	429,970	544,035	639,241	767,090	920,508
<i>Change (%)</i>	20.9	27.1	26.5	17.5	20.0	20.0
Loans	742,669	965,342	1,193,153	1,431,784	1,746,776	2,131,067
<i>Change (%)</i>	19.0	30.0	23.6	20.0	22.0	22.0
Fixed Assets	22,004	23,352	23,055	23,653	23,981	23,999
Other Assets	36,041	31,242	33,609	38,650	44,448	48,892
Total Assets	1,239,919	1,609,755	1,951,619	2,331,271	2,828,793	3,431,833
ASSET QUALITY				(₹)		
GNPA (Rs M)	16,566	19,234	26,709	38,296	42,039	45,282
NNPA (Rs M)	1,276	3,259	9,653	16,276	16,816	18,113
GNPA Ratio	2.19	1.96	2.21	2.63	2.37	2.10
NNPA Ratio	0.17	0.34	0.81	1.14	0.96	0.85
PCR (Excl Tech. write off)	91.2	80.5	61.5	57.5	60.0	60.0
PCR (Incl Tech. Write off)	0.0	87.5	74.0	71.0	71.9	71.3

E: MOSL Estimates

Financials and valuation

RATIOS

Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Spreads Analysis (%)						
Avg. Yield-Earning Assets	9.1	9.3	8.2	8.5	8.5	8.7
Avg. Yield on loans	9.9	10.4	9.0	9.1	9.4	9.6
Avg. Yield on Investments	7.4	7.4	7.2	6.9	6.9	6.9
Avg. Cost-Int. Bear. Liab.	6.2	6.2	5.6	5.2	5.5	5.7
Avg. Cost of Deposits	6.1	6.1	5.5	5.1	5.3	5.5
Interest Spread	2.9	3.1	2.6	3.2	3.1	3.0
Net Interest Margin	2.8	3.0	2.6	3.2	3.0	2.9
Profitability Ratios (%)						
RoE	26.8	27.2	26.2	21.7	22.3	22.8
RoA	1.2	1.2	1.2	1.0	1.0	1.0
Int. Expense/Int. Income	69.0	67.9	68.5	62.6	64.8	66.3
Fee Income/Net Income	18.4	19.0	19.8	15.7	15.8	15.5
Non Int. Inc./Net Income	31.6	28.0	32.0	24.3	24.1	23.1
Efficiency Ratios (%)						
Cost/Income*	42.0	44.5	44.8	44.8	41.3	40.2
Empl. Cost/Op. Exps.	53.1	52.0	54.0	61.7	58.3	58.2
Busi. per Empl. (Rs m)	63.3	75.1	94.4	106.9	119.6	135.7
NP per Empl. (Rs lac)	5.4	6.3	7.5	7.0	7.9	9.1
* ex treasury						
Asset-Liability Profile (%)						
Loans/Deposit Ratio	71.5	69.6	70.2	70.2	70.2	70.2
CASA Ratio	34.9	30.1	31.7	32.3	31.4	30.6
Investment/Deposit Ratio	32.6	31.0	32.0	31.3	30.8	30.3
G-Sec/Investment Ratio	83.4	81.7	78.7	83.0	84.4	85.8
CAR	12.5	13.3	12.5	11.9	10.9	9.9
<i>Tier 1</i>	7.5	8.2	7.9	7.7	7.2	6.9
VALUATION						
Book Value (Rs)	111.3	139.7	174.4	207.5	248.1	298.0
<i>Change (%)</i>	18.8	25.4	24.9	19.0	19.6	20.1
Price-BV (x)	3.0	2.4	1.9	1.6	1.4	1.1
Adjusted BV (Rs)	109.7	135.5	161.9	186.6	226.5	274.7
Price-ABV (x)	3.1	2.5	2.1	1.8	1.5	1.2
EPS (Rs)	27.5	34.2	41.1	41.4	50.7	62.3
<i>Change (%)</i>	64.1	24.5	20.2	0.8	22.4	22.9
Price-Earnings (x)	12.3	9.9	8.2	8.2	6.7	5.4
Dividend Per Share (Rs)	4.0	5.0	5.5	5.8	7.1	8.7
Dividend Yield (%)	1.2	1.5	1.6	1.7	2.1	2.6

E: MOSL Estimates

N O T E S



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Union Bank of India

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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