

Time for an end of fears?

We expect muted volume growth in 4Q08 even as the sharp INR fall helps margins. Looking forward, even a conservative 16-17% FY09 EPS growth guidance from Infosys should allay concerns about the 'worst-case' demand outlook and revive interest in the sector.

Key recommendations & forecasts

	Reuters	Year end	Recom	Price	Target price	EPS 1fcst	PE 1fcst
Tata Consultcy ¹	TCS.BO	Mar 2008	Buy	Rs850.85	Rs1230.00	51.78	16.4
Infosys Tech ¹	INFY.BO	Mar 2008	Buy	Rs1481.95	Rs2150.00	79.60	18.6
Wipro ¹	WIPR.BO	Mar 2008	Buy	Rs414.40	Rs550.00	21.94	18.9
Satyam Computer ¹	SATY.BO	Mar 2008	Buy	Rs407.25	Rs540.00	25.20	16.2
HCL Tech ¹	HCLT.BO	Jun 2008	Buy	Rs246.75	Rs340.00	17.52	14.1
Tech Mahindra ^{1*}	TEML.BO	Mar 2008	Hold	Rs725.25	Rs1520.00	59.14	12.3
Patni Computer ¹	PTNI.BO	Dec 2008	Hold	Rs233.50	Rs275.00	23.72	9.8
NIIT Tech ^{1*}	NITT.BO	Mar 2008	Buy	Rs105.40	Rs423.00	23.10	4.6
KPIT Cummins ^{1*}	KPIT.BO	Mar 2008	Hold	Rs76.55	Rs140.00	7.68	10.0
HCL Infosystems ¹	HCLI.BO	Jun 2008	Buy	Rs159.95	Rs266.00	18.78	8.5
NIIT Ltd ^{1*}	NIIT.BO	Mar 2008	Sell	Rs93.80	Rs131.00	5.09	18.4

1. Normalised EPS - Post-goodwill amortisation and pre-exceptional items

* Ratings and estimates are under review

Source: Company data, ABN AMRO forecasts

Muted volume growth; INR fall should support margins

We estimate 5.5% qoq revenue growth in 4Q08 in US\$ terms (6% in INR terms) for our IT services universe. Volume growth should slow – we expect average 4.8% qoq growth in billed effort for the top four players (TCS, Infosys, Wipro and Satyam) – from project delays and slower ramp-ups at some clients. However, realisation growth should continue from service mix changes, though slowly, as the currency impact declines. We forecast average qoq realisation growth of 0.6% for onsite and 0.8% for offshore for the top four. A bigger bench could affect margins, but the impact may be offset by the sharp INR depreciation (1.8% qoq vs US\$) in 4Q08. We estimate 2.4% qoq PAT growth (ex-forex); reported PAT growth could be affected by forex-losses, not built into our numbers.

Infosys's FY09 guidance - could raise a smile but not a toast

We believe even a 'cautious' FY09 guidance from Infosys – 20% yoy US\$ revenue and 16% yoy INR EPS growth – should allay investors concerns on the "worst-case" demand outlook. We expect a revival in investor interest in the sector, though at a slower pace, as we anticipate a muted 1Q09 guidance – 3-4% US\$ revenue growth and a 1-2% qoq decline in EPS (INR terms) due to the scheduled wage hikes.

FY09 outlook - which way will the dice land?

We see a continued momentum in the underlying offshore IT spends, independent of changes to the headline IT budgets. Note the in-line new bookings for Accenture's consulting business over the last two quarters. We also believe stricter regulations post the recent credit crisis could drive discretionary IT spends (into new application development). We thus retain our view of a back-ended 25-28% yoy volume growth for the large players for FY09.

What to watch for in the results

Look deeper into: 1) FY09 hiring plans: the sharp 38-94% jump in campus offers by large players for FY09 could affect 1H09 utilisation; 2) growth in average realisation: for pricing flexibility in the current environment 3) growth in top 10 clients: any client-specific issue among these could affect overall growth; and 4) FY09 salary hikes: we anticipate a lower 10-12% hike vs 14-16% in FY08. Infosys, TCS and Satyam remain our key Buy ideas.

India

Sector performance

	(1M)	(3M)	(12M)
Absolute	-218.1	-806.7	-1028.2
Absolute %	-5.6	-18.1	-22.0
Rel market %	5.3	6.4	-38.3

Source: Bloomberg

Sensex: 15750.40

BSE IT: 3644.35

Researched by

**ABN AMRO Institutional
Equities Team**

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4Q08 earnings preview

We anticipate a muted 4Q08 with subdued qoq volume growth, as IT spending remains cautious. The 1.8% qoq INR fall vs US\$ should support margins. However, reported PAT growth could be affected by FX-losses.

Table 1 : ABN AMRO – Indian IT Sector coverage universe: estimates of key financials (January-March 2008)

	Revenues (US\$ m)	Revenues (Rs m)	EBITDA margin (%)	PAT (Rs m)	Comments
IT SERVICES					
Infosys	1,144	45,521	32.5%	12,534	▪ We build in 5.3% qoq growth in volume and 0.2% in blended realisation in IT services ▪ PAT (ex-forex) growth of 5.7% qoq in 4Q08 ▪ Note the 4Q08 realised INR/US\$ rate is 0.9% lower than assumed in guidance, as per our estimates
Change - qoq	5.6%	6.6%	-10bp	6.1%	
Guidance - Lower end	1,136	44,770	-	12,220	
Change - qoq	4.8%	4.8%	-	3.5%	
Guidance - Upper end	1,142	45,010	-	12,220	
Change - qoq	5.4%	5.4%	-	3.5%	
TCS	1,551	62,219	26.4%	12,937	▪ We expect slower IT spend by two large BFS clients to affect qoq volume growth (c3.0%, as per our estimates) ▪ Lower variable salary in 4Q and higher fixed-price contracts should help margin management
Change - qoq	4.0%	5.8%	33bp	-2.8%	
Wipro Technologies	962	38,292	24.3%	-	▪ Factors in 5% volume growth in IT services and flattish qoq revenues from Infocrossing ▪ Salary hikes scheduled for onsite staff could restrict margin expansion from favourable currency ▪ Seasonally strong quarter for Asia-Pacific IT business
Change - qoq	5.7%	6.4%	20bp	-	
Guidance	955		-	-	
Change - qoq	4.9%		-	-	
Wipro – Cons.	1,439	57,287	18.8%	8,502	
Change - qoq	8.3%	9.4%	1bp	2.9%	
Satyam	594	23,642	23.0%	4,914	▪ Our US\$ revenue estimates on Indian GAAP are not comparable to guidance, which is as per US GAAP ▪ Continued momentum in ERP related spend is positive for top line (45% of revenues from Package Implementation) ▪ We expect actual hiring to be ahead of guidance and largely lateral; positive for margins
Change - qoq	6.7%	7.7%	156bp	13.3%	
Guidance - Lower end	594	23,110	-	4,839	
Change - qoq	6.7%	5.3%	-	5.3%	
Guidance - Upper end	597.3	23,220	-	4,839	
Change - qoq	7.3%	5.8%	-	11.6%	
HCL Technologies	475	19,072	19.6%	3,043	▪ HCLT expects issues at 2 large BFSI clients to affect growth – expects 4-5% in 3Q08 and 1-2% in 4Q08 (June year-end) ▪ Our estimates build in ESOP charges of US\$6m
Change - qoq	4.7%	5.0%	-45bp	-10.0%	
Patni	176	7,039	13.5%	663	▪ Tougher macro environment and concentrated client mix should restrict top-line growth ▪ Significant qoq margin decline estimate builds in the cost impact of ESOP repricing (US\$2m) and visa fees (US\$3m), as per management estimates
Change - qoq	1.0%	2.6%	-327bp	-33.5%	
Guidance - Lower end	175	-	-	611	
Change - qoq	0.5%	-	-	-38.8%	
Guidance - Upper end	176	-	-	630	
Change - qoq	1.1%	-	-	-36.8%	
Tech Mahindra	252	10,038	22.5%	1,843	▪ Builds in 2.8% qoq growth in the BT business with higher offshore share; 26bp margin expansion ex US\$6m pass-through revenues of 3Q
Change - qoq	5.4%	3.4%	60bp	-7.6%	
NIIT Technologies	62	2,457	18.8%	349	▪ Builds in flat qoq revenues from ROOM solutions and 12% growth in GIS business
Change - qoq	4.7%	5.1%	-20bp	0.3%	
KPIT Cummins	42	1,655	17.7%	189	▪ Factors in 9.3% and 2.5% qoq in volume and realisation ▪ Our FY08 PAT estimates are lower than the guided range
Change - qoq	11.9%	9.5%	197bp	33.9%	
IT HARDWARE/IT EDUCATION					
HCL Infosystems	-	31,318	3.8%	805	▪ Business transfer to Nokia completed in 2Q08 (June year-end) ▪ Rs90m one-time expense (provisions and advertising) in 2Q08
Change - yoy	-	7.6%	10bp	-8.3%	
NIIT Ltd.	-	2,688	13.5%	249	▪ Builds in a 37% yoy increase in individual business revenues for 4Q08 and Rs290m in new business revenues for FY08
Change - yoy	-	4.8%	558bp	44.6%	

Notes:

1. All number are consolidated Indian GAAP number except for TCS, Wipro and Patni, which are consolidated US GAAP.

2. Estimates do not factor in the impact of forex gains/losses on the other income for the quarter. PAT (ex-forex) assumes full tax-rate on reported forex gains/losses.

3. PAT guidance for Infosys and Satyam is derived from EPS guidance multiplied by 3Q08-end basic shares.

Source: Company data, ABN AMRO forecasts

Table 2 : Hedge position of the top five IT services companies

(US\$ m)	Infosys	TCS	Wipro	Satyam	HCL Tech	Comments
Total hedged position at the end of 3Q08	1,147	3,100	2,450	908	2,507	▪ Wipro and HCLT raised their hedge positions by 123% and 35% respectively in 3Q08; Infosys lowered by 19% from 2Q08 level
- Forward covers	941	620	2,083	349	2,507	
- Options	206	2,480	368	559	0	
Net foreign cash flows - 12-months forward						
Foreign currency revenues (E)	5,091	6,858	4,290	2,749	2,011	▪ Higher share of cover in Wipro, Infosys and HCLT could amplify mark-to-market losses
Total foreign currency costs (E)	1,880	2,495	1,433	967	724	
Net foreign cash inflows *	3,210	4,363	2,856	1,782	1,287	
3Q08 hedge position/FY08F net cash inflows	36%	71%	86%	51%	195%	▪ Higher exposure to options
Reported Forex gains in FY08 till date (Rs m)	570	3,275	-625	340	539	
Post tax Forex gains contribution to PAT	1.1%	5.7%	-1.8%	1.8%	6.0%	

Notes:

PAT (ex-forex) assumes full tax-rate on reported forex gains/losses.

HCL Tech forex gains are for the first two quarters for FY08 ending June-08

Source: Company data, * ABN AMRO estimates

Table 3 : Results calendar and key issues

Company	Result date	Key issues to focus on
Infosys	15 April 2008	<ul style="list-style-type: none"> FY09 financial/headcount guidance Growth in the BFSI and retail verticals in the midst of mortgage crisis and weak retail sales Growth in large accounts - particularly in the top client, BT, which is rationalising vendors
HCL Tech	15 April 2008	<ul style="list-style-type: none"> Further colour on client-specific issues in the 2 BFS clients that could affect growth in 2H08 BPO revenues - last quarter saw a decline in qoq US\$ revenues due to rampdown of a large account Integration of financials of one month of the newly acquired Capital Stream
Wipro	18 April 2008*	<ul style="list-style-type: none"> Infocrossing financials, particularly margins, which were under pressure last quarter Quantum and impact of onsite wage hikes, which are scheduled for this quarter Trend in realisation improvement, which was a positive surprise last quarter
Satyam	21 April 2008	<ul style="list-style-type: none"> FY09 revenue guidance following a likely strong FY08 performance led by package implementation FY09 margin guidance - note that Satyam's operating metrics are stretched relative to peers Realisation improvement - impressive realisation growth has come through in 9M08
TCS	21 April 2008	<ul style="list-style-type: none"> FY09 headcount guidance - note the campus offers for FY09 are highest among peers Changes in large deal pipeline - 30 US\$50m+ deals were under negotiation by mid-February Growth in the BFSI vertical - two of its Top 15 clients have delayed projects during the quarter
HCL Infosystems	24 April 2008*	<ul style="list-style-type: none"> Qoq revenue trend in telecom/OA business - first quarter of full business transfer to Nokia Revenues and order bookings in the Systems Integration business PC business - typically a strong quarter due to budget flush in government business
Patni Computers	27 April 2008*	<ul style="list-style-type: none"> Guidance for the next quarter - organic growth has been weak over the last few quarters Qoq margins - management had signalled a significant decline on visa and ESOP repricing charges Update on buyback programme announced last quarter
KPIT Cummins	Last week, April 2008	<ul style="list-style-type: none"> Realisation growth - management has guided to significant blended realisation improvement of 4% qoq FY09 financial/headcount guidance - KPIT tends to be aggressive vs larger peers in setting guidance Organic business revenue growth - reported numbers include hedging gains (unlike other players)
NIIT Tech	To be confirmed	<ul style="list-style-type: none"> Qoq US\$ revenue growth after weak performance during the last three quarters Update on progress in new version of ROOM solutions product Update on staffing and client sign-ups of the joint-venture with Addecco
Tech Mahindra	2 nd week May 2008*	<ul style="list-style-type: none"> Growth in the BT business, after a lacklustre 9M08 performance due to internal re-org at BT Update on progress on the BTGS contract and joint go-to-market initiatives Non-BT/AT&T accounts - new contract wins and growth in non-Top five accounts
NIIT Ltd.	Early May 2008*	<ul style="list-style-type: none"> Movement in the realisation per student and capacity utilisation in the India individual business Qoq growth in the school learning solutions post decline last quarter on completion of a large contract Margin performance of Element-K and international business

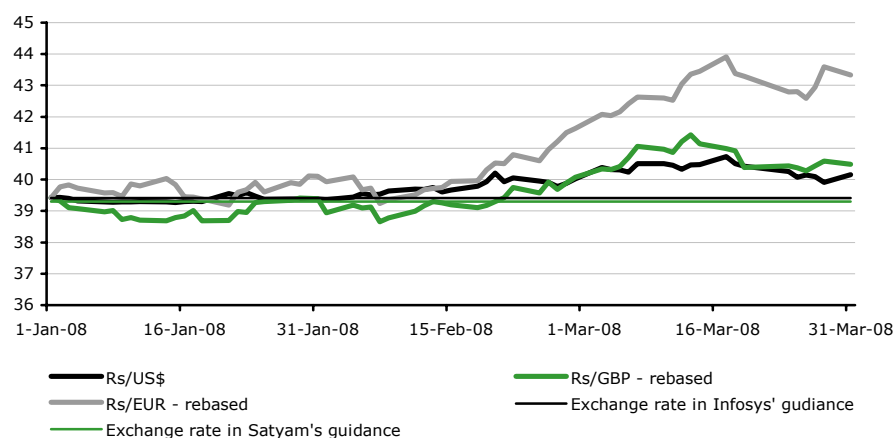
*Tentative

Source: Company data, ABN AMRO

Table 4 : December 2007 - March 2008 – stock and currency performance

	31-Dec-07	31-Mar-07	Change	Comments
Sensex	20,287	15,644	-22.9%	
ABN AMRO coverage universe (Rs)				
TCS	1,079	811	-24.9%	▪ The BSE IT index has performed only marginally better (-21.7% qoq) than the Sensex in the Dec-Mar 2008 quarter.
Infosys	1,768	1,430	-19.1%	
Wipro	460	425	-7.6%	
Satyam	449	395	-12.2%	▪ All the stocks in our coverage universe have given negative returns during this period.
HCL Tech	329	253	-23.0%	
Patni Computers	332	223	-32.8%	
Tech Mahindra	1,132	707	-37.6%	▪ Large cap stocks have performed better than mid/small cap peers.
KPIT Cummins	134	78	-41.9%	
NIIT Tech	236	102	-56.8%	
HCL Infosystems	281	160	-42.9%	
NIIT Ltd	157	98	-37.5%	
Currency movement				
Rs/US\$ - period average	39.47	39.80	0.8%	▪ Trend reversal in INR appreciation vs the US\$ for the first time since 1QFY08.
Rs/US\$ - period end	39.42	40.11	1.8%	
INR/GBP- period average	80.70	78.75	-2.4%	▪ Cross currency movements were mixed – US\$ appreciated vs the GBP but depreciated vs the euro.
INR/GBP - period end	79.24	79.51	0.3%	
INR/Euro - period average	57.18	59.70	4.4%	▪ Companies with higher UK business exposure (Tech Mahindra/NIIT Tech) could be hit by the strength of US\$ vs the GBP.
INR/Euro- period end	57.51	63.35	10.1%	
USD/GBP - period average	2.04	1.98	-3.2%	
USD/GBP - period end	1.98	1.98	-0.1%	
USD/Euro - period average	1.45	1.50	3.5%	
USD/Euro - period end	1.46	1.58	8.3%	

Source: Bloomberg

Chart 1 : Rupee movement against major currencies – January to March 2008

Source: Bloomberg, Company data

- We estimate the average realised exchange rate for Infosys and Satyam will be about 1% better than guided levels for 4Q08
- However, as the quarter-end Rs/US\$ rate was 1.5-1.8% above guidance levels, it could have a bearing on translation of receivables and outstanding hedges in 4Q08

Table 5 : IT services coverage universe – important events/media reports during the quarter

Infosys	<ul style="list-style-type: none"> ▪ Sees offshore wages remaining firm as demand is strong, contrary to expectations in some quarters of wages softening ▪ Said that a major economic slowdown in the US may hurt, but that it and other IT players could benefit in the long run.
TCS	<ul style="list-style-type: none"> ▪ Diligenta won a £100m BPO contract from Sun Life Financial in the UK - TCS has been building platform-based services in BPO ▪ Salary packages of employees cut with annualised impact of 1.5% - we attribute this to under-achievement of EVA in 3Q08
Wipro	<ul style="list-style-type: none"> ▪ Announced large Asian deal wins with Aircel (India-based telecom operator), Pantaloon Retail and Saudi Arabian Airlines ▪ Plans to build electronic warfare systems, radars and flight simulators locally for Lockheed and Northrop under offset contracts
Satyam	<ul style="list-style-type: none"> ▪ Management says it will likely win eight orders each worth more than US\$50m in the current quarter ▪ Sets its sales and marketing operations; plans to open development centres in two countries to expand into South America
HCL Tech	<ul style="list-style-type: none"> ▪ Acquired US-based Capital Stream, provider of lending and processing software to banks and finance companies, for US\$40m ▪ Announces Global Services Partnership with SAP to deliver joint business value through 'Customer Centric Ecosystem'
Tech Mahindra	<ul style="list-style-type: none"> ▪ Signs a five-year US\$350m agreement with BT for application maintenance/support, 70% of deal is renewal of existing contract
NIIT Tech	<ul style="list-style-type: none"> ▪ Plans to buy 100% stake in Softec GmbH, a German company providing IT solutions and services in airlines revenue accounting
NIIT Ltd	<ul style="list-style-type: none"> ▪ Announces partnership with Cisco to develop and enhance the IT Infrastructure management talent pool in Asia-Pacific

Source: Company releases, media reports, ABN AMRO

Table 6 : Coverage universe – price performance and valuation

	BB code	Rating	Price (Rs)	12-m fwd PE (x)	24/12-mth EPS growth	Change from		Stock price change over		
						52-wk high	52-wk low	1month	3month	12month
Infosys	INFO IN	Buy	1,483	15.2	13%	-31%	18%	-4.2%	-15.2%	-22.9%
TCS	TCS IN	Buy	851	14.4	-5%	-36%	17%	-3.0%	-18.9%	-28.4%
Wipro	WPRO IN	Buy	415	16.3	-5%	-35%	28%	-5.0%	-18.8%	-20.0%
Satyam	SCS IN	Buy	408	12.7	5%	-22%	34%	-6.5%	-6.5%	-8.8%
HCL Tech	HCLT IN	Buy	247	11.8	11%	-32%	33%	-11.0%	-21.4%	-9.4%
Tech Mahindra*	TECHM IN	Hold	725	7.8	15%	-58%	26%	5.0%	-35.5%	-45.9%
Patni	PATNI IN	Hold	236	9.9	-1%	-61%	39%	-2.1%	-28.7%	-37.2%
KPIT Cummins*	KPIT IN	Hold	76	5.9	20%	-50%	29%	-9.0%	-41.2%	-41.6%
NIIT Tech*	NITEC IN	Buy	105	3.8	8%	-75%	24%	-19.6%	-56.3%	-62.7%
NIIT Ltd*	NIIT IN	Sell	94	12.5	-	-46%	17%	-24.3%	-39.5%	3.8%
HCL Infoystems	HCLI IN	Buy	160	7.3	-	-45%	27%	-25.3%	-42.0%	25.4%

Note:

1. Stock price data as of 2 April 2008 on the National Stock Exchange (NSE)

2. * Ratings and estimates of Tech Mahindra, KPIT Cummins, NIIT Tech, and NIIT Ltd currently under review

Source: Bloomberg, ABN AMRO estimates

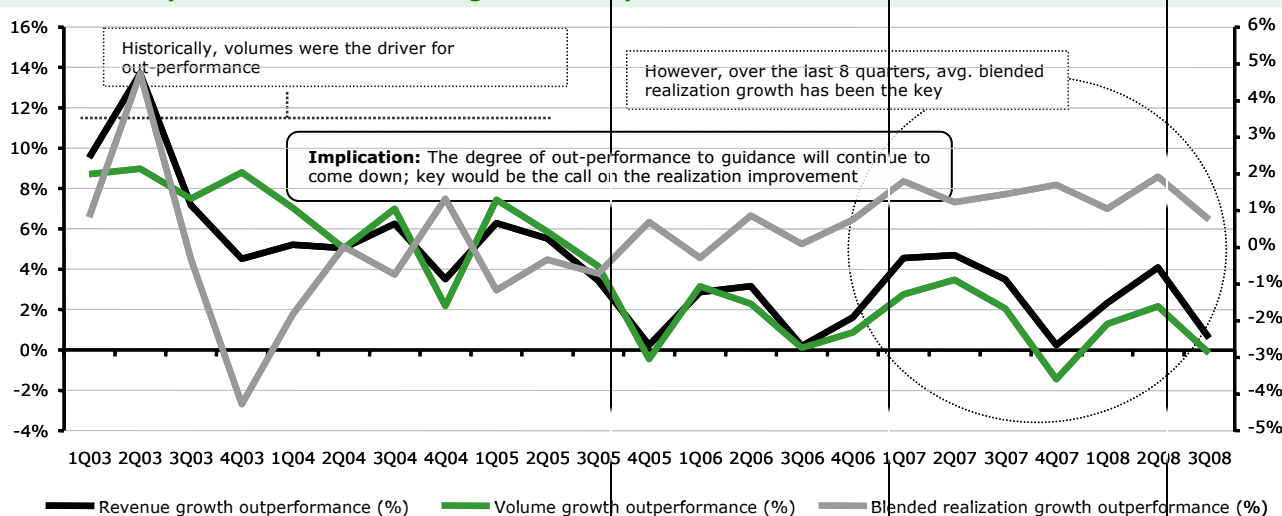
Infosys guidance – good, bad or ugly?

Our take on one of the most anticipated and perhaps overanalysed data points.

Could bring a smile, but not raise a toast

We analyse Infosys's historical outperformance of its guidance, which is given out in April and is considered an indicator of sector outlook and of management's conservatism (thus implying potential for significant outperformance).

Chart 2 : Infosys – what has driven the guidance outperformance?



Source: Company data, ABN AMRO

We believe even a 'cautious' FY09 guidance from Infosys should be for 20% US\$ revenue growth and EPS of Rs92, implying 16% yoy growth (ex-forex). This should be in line with the current market view (as reflected by the current market price and assuming a PEG of 1). We expect this to quantify the 'base-case' demand outlook for the sector and allay investors concerns about the potential downside risks. We also anticipate corporate action – a special dividend and/or a bonus share issue – given the US\$2bn+ cash balance with the company. This should support sentiment, though we expect the re-rating to be gradual as the near-term outlook will likely remain conservative.

We believe an above 16% FY09 EPS growth guidance should be positive for near-term stock-price movement

Table 7 : Infosys – How the FY09 guidance could shape up

(For upper end of guidance)	Cautious		Cautiously optimistic		Optimistic	
Cons. revenues (US\$ -terms) growth - yoy		20%		22%		26%
Implied consolidated revenues (US\$ m)		5,014		5,098		5,265
INR/US\$ exchange rate (as on 31 March 2008)		40.0		40.0		40.0
Implied consolidated revenues (Rs m)		200,659		204,004		210,692
EBIT margin change – yoy	-75bp	-100bp	-75bp	-100bp	-75bp	-100bp
Non-operating income (ex-forex gains/losses) (Rsm)	8,278	8,278	8,278	8,278	8,278	8,278
PAT (Rs m)	53,000	52,574	53,766	53,333	55,298	54,851
Implied PAT growth – yoy	17%	16%	19%	18%	22%	21%
Shares outstanding (m nos) - basic	571.55	571.55	571.55	571.55	571.55	571.55
EPS (ex FX gains/losses) (Rs)	93	92	94	93	97	96
Implied EPS growth - yoy	17%	16%	19%	18%	22%	21%

Source: ABN AMRO estimates

Valuation and price performance

Chart 3 : Infosys – 12-m fwd EPS valuation band


Source: Bloomberg, company data, ABN AMRO

Chart 4 : TCS – 12-m fwd EPS valuation band


Source: Bloomberg, company data, ABN AMRO

Chart 5 : Wipro – 12-m fwd EPS valuation band


Source: Bloomberg, company data, ABN AMRO

Chart 6 : Satyam – 12-m fwd EPS valuation band


Source: Bloomberg, company data, ABN AMRO

Chart 7 : HCL Tech – 12-m fwd EPS valuation band


Source: Bloomberg, company data, ABN AMRO

Chart 8 : Patni – 12-m fwd EPS valuation band


Source: Bloomberg, company data, ABN AMRO

Chart 9 : Tech Mahindra – 12-m fwd EPS valuation band

Source: Bloomberg, company data, ABN AMRO

Chart 10 : NIIT Tech – 12-m fwd EPS valuation band

Source: Bloomberg, company data, ABN AMRO

Chart 11 : KPIT – 12-m fwd EPS valuation band

Source: Bloomberg, company data, ABN AMRO

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