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Take Five

Scrip	Reco Date	Reco Price	CMP	Target
♦ Aban Loyd	03-Mar-05	330	914	1,760
♦ Bajaj Auto	15-Nov-05	1,873	2,683	3,500
♦ BHEL	11-Nov-05	1,203	1,829	2,650
♦ Esab India	21-May-04	60	331	575
♦ Infosys	30-Dec-03	1,378	2,973	3,324

ITC

Apple Green

Stock Update

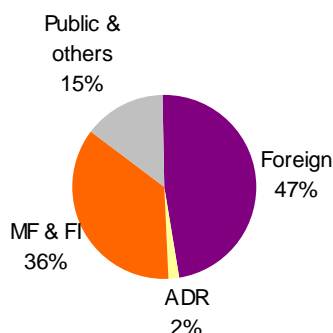
Takeaways from annual report review

Buy; CMP: Rs177

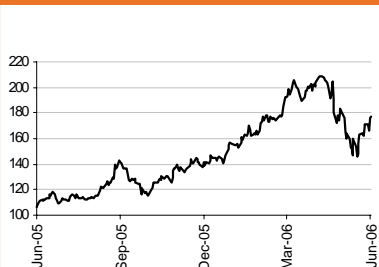
Company details

Price target:	Rs220
Market cap:	Rs66,463 cr
52 week high/low:	Rs213/106
NSE volume: (No of shares)	71.3 lakh
BSE code:	500875
NSE code:	ITC
Sharekhan code:	ITC
Free float: (No of shares)	368 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.8	-8.6	24.7	64.5
Relative to Sensex	2.1	-0.8	13.4	14.0

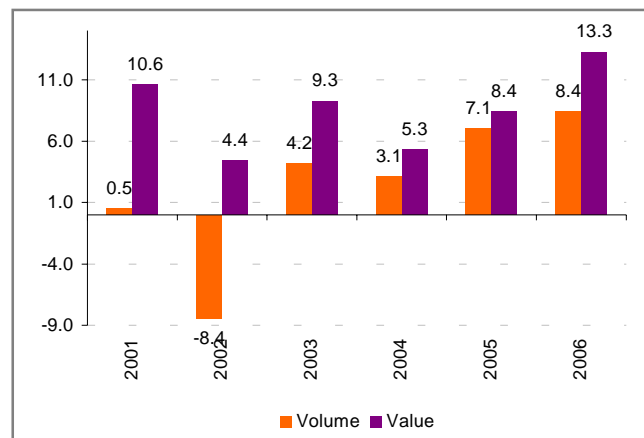
ITC recently released its annual report for FY2005-06. We present the highlights of the report here.

Cigarette business continues to be cash cow

During the year under review the cigarette business of ITC grew by 8.4% year on year (yoy) in volume terms and by 13.3% yoy in value terms. The higher sales growth in value terms came on the back of the hike in the price of its two key brands, viz "Gold Flake" (hiked by 5-7% in May 2005) and "Wills Classic" (raised by 10-17% in July 2005). The profit before interest and tax (PBIT) grew by 18.4% yoy as the PBIT margin expanded by 100 basis points.

We expect ITC's cigarette business to grow at a higher single-digit rate despite its higher base since we expect the consumption of tobacco in the form of cigarette to go up in future. In India, cigarettes constitute only 14% of the total tobacco consumption while worldwide the average is nearly 60-65%. Also the per capita consumption of cigarettes is the lowest in India even when compared with its neighbours like Pakistan and Nepal.

Year-on-year growth in cigarettes sales volume and value (%)



Source: Company, Sharekhan research

However, three impediments stand in the path of growth of tobacco business

Punitive tax structure: The taxes on cigarettes are 34 times of that on the other tobacco products. Cigarettes form 14% of the total tobacco consumption; however the same contribute 85% of the tax revenues generated by the central and state governments from the tobacco sector.

Contraband trade: The illegal imports of foreign brands of cigarettes that evade all taxes are also hurting the industry.

Regulations on advertising: While domestic manufacturers are not allowed to advertise their products on any medium, the foreign companies can advertise their brands on the satellite channels uplinked from outside India. Consequently the contraband trades benefit from such regulations.

Non-cigarette FMCG business—growing by leaps and bounds

The non-cigarette fast moving consumer goods (FMCG) business has grown by leaps and bounds from Rs22.1 crore in FY2002 to Rs1,013.5 crore in FY2006, clocking a compounded annual growth rate (CAGR) of 160.3% over the four years. The other FMCG businesses comprise branded packaged foods, lifestyle retailing products, greeting cards, gifting & stationery items, safety matches and incense sticks.

Packaged food business

During the year under review the packaged food business grew by 83% to Rs653.6 crore. ITC's packaged food business has grown at a CAGR of 137% over the last four years. Over last few years the company has introduced more than 100 food products under five strong brands:

- ◆ "Sunfeast": biscuits and pasta
- ◆ "Ashirwaad": Ready to eat food
- ◆ "Kitchen of India": Indian cuisine
- ◆ "Candyman" and "Minto": Confectionaries

Lifestyle retailing

In the lifestyle retailing business, ITC increased its reach from approximately 80 stores to 140 stores for its brands, namely "Wills Lifestyle" and "John Players". The "Wills Lifestyle" range was further supplemented during the year with the launch of "Essenza Di Wills", an exclusive line of prestige fragrance products, at select "Wills Lifestyle" stores. The "John Players" brand reported a strong growth after the Hrithik Roshan ad campaign.

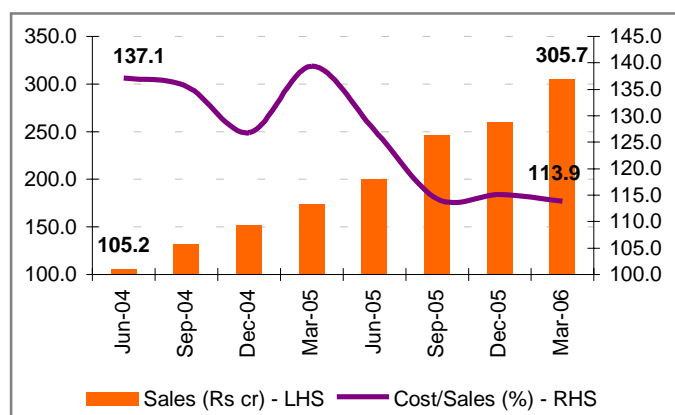
ITC also made a beginning in the area of apparel exports this year, establishing relationships with key customers. ITC is planning to expand its manufacturing capacities in this business to take full advantage of the emerging growth opportunities.

Greeting, gifting & stationery

The sales volume of "Classmate" notebooks trebled over that of last year, making it the most widely distributed notebook brand across the country. However, during the year under review, the greeting card business continued to be adversely affected by the rapid growth of mobile telephony and messaging services.

Magnitude of losses decreasing with scale

The non-cigarette FMCG business continued to make losses in FY2006. However, over the past couple of quarters the magnitude of losses is decreasing. The total cost (including depreciation) as a percentage of sales has decreased from 137.1% to 114%.



Source: Company, Sharekhan research

Hotels—enjoying the holidays

Revenues of the hotel business grew by 35.7% yoy on the back of improved room and occupancy rates. The growth was also aided by ITC Grand Central, ITC's second property in Mumbai that was in operation for full year (it was commissioned in January 2005). The high economies of scale resulted in a healthy 800-basis-point expansion in the PBIT margin and the PBIT grew at 83.0% yoy.

ITC plans to expand its hotel business aggressively through the renovation and upgradation of the existing properties and also through investing in new properties. During FY2006, ITC commissioned a luxury hotel at Bangalore. The company is currently working on one property in Chennai and is actively looking out for appropriate locations in Hyderabad, Delhi and the other key cities to expand its hotel business.

Paperboards, paper & packaging—economies of scale

The sales of the paperboards, paper & packaging business grew by 21.1% on the back of improved volumes, which grew by 21% yoy. The growth in the volumes was achieved on the back of improved capacity utilisation at the Kovai (Coimbatore) facility and capacity addition at the Bhadrachalam (Andhra Pradesh) facility.

The PBIT grew by 25.5% with a 60-basis-point expansion in the margins on the back of economies of scale and the commissioning of an 8-megawatt captive power plant during the year.

ITC plans to augment its capacity by commissioning another paperboard machine by 2008-09 with a view to servicing the growing demand for high quality paperboards. It also plans to widen its product range by setting up capacity for manufacturing uncoated paper including branded copier grades by 2008-09.

The value-added paperboard segment is expected to grow at a high double-digit rate, as the demand for packaging from industries like pharmaceuticals, FMCG and textiles is likely to see a strong growth.

Agribusiness—strong exports drive growth

ITC's agribusiness consists of tobacco exports and other agri-commodities. The revenues under this business grew by 50.5% yoy to Rs1,895 crore on the back of a strong growth in the exports of tobacco and other agri-commodities. However, the PBIT in this business declined by 6% as the margins shrank by 200 basis points to 3.4%. The margins in this business are expected to remain low as the company plans more capital expenditure (capex) in its rural initiative of *e-Choupal*.

***e-Choupal*—expanding network rapidly**

During the year the company expanded its *e-Choupal* network to 6,000 *choupals* by adding 800 new *choupals*. The amount of trade through this channel also doubled to Rs100 crore in FY2006. Through this mammoth network ITC now distributes products of nearly 45 companies, covering industries such as FMCG, consumer durables, vehicles, financial services and agri inputs.

FY2006 also saw a substantial expansion of the *Choupal Sagar* network, ITC's rural hypermarket initiative. The number of *Choupal Sagar*s increased to ten from just one in FY2005. ITC plans to ramp up its rural retailing initiative by adding another 40 *Choupal Sagar*s over the next 12-18 months.

Valuation and view

We have always liked the way ITC has channelised the strong cash flows generated from the cigarette business into the other businesses of FMCG products, hotels, paperboards and now *e-Choupal*. Notably over FY2000-06,

the company has incurred a capex of more than Rs4,500 crore for its various businesses without affecting its return on capital employed which has remained at an average of 33% over the same period.

At the current market price of Rs177, the stock is trading at 20.1x FY2008E earnings per share and 12.8x FY2008E EV/EBIDTA. We reiterate our Buy recommendation on the stock with a price target of Rs220.

Earnings table

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	1,593.7	1,837.5	2,275.8	2,791.3	3,312.4
Shares in issue (cr)	375.5	375.5	375.5	375.5	375.5
EPS (Rs)	4.2	4.9	6.1	7.4	8.8
% y-o-y chg	16.0	15.3	23.9	22.7	18.7
PER (x)	41.8	36.3	29.3	23.9	20.1
Book value (Rs)	17.1	21.0	24.1	28.5	34.3
P/BV (x)	10.4	8.4	7.4	6.2	5.2
EV/EBIDTA (x)	26.9	22.6	19.3	15.6	12.8
EV/Sales (x)	9.9	8.3	6.5	5.2	4.1
RoCE (%)	34.9	32.8	32.7	35.1	35.1
RoNW (%)	27.1	25.7	26.8	28.2	28.1

The author doesn't hold any investment in any of the companies mentioned in the article.

Bajaj Auto

Apple Green

Stock Update

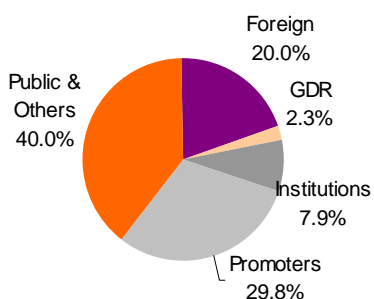
Annual report review

Buy; CMP: Rs2,683

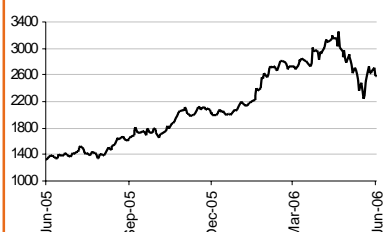
Company details

Price target:	Rs3,500
Market cap:	Rs27,148 cr
52 week high/low:	Rs3,325/1,295
NSE volume: (No of shares)	2.3 lakh
BSE code:	500490
NSE code:	BAJAJAUTO
Sharekhan code:	BAJAJ
Free float: (No of shares)	6.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-11.2	-5.2	26.8	100.1
Relative to Sensex	-5.7	2.9	15.2	38.7

We have analysed the recently released annual report of Bajaj Auto Ltd (BAL) and here are the highlights of the report.

FY2006 performance

- ◆ The company delivered a power-packed performance in FY2006. Its net sales grew by 30.5% to Rs7,469.3 crore during the year. This was backed by a volume growth of 25% to 2,281,230 vehicles. The two-wheeler volumes grew by 26.6% and the three-wheeler volumes grew by 13.5%. Two-wheelers contributed 75% to the total sales, three-wheelers contributed 20% to the sales and the rest was from the sale of spare parts.
- ◆ During FY2006, the operating profit margin (OPM) improved by 270 basis points to 15.7% as the operating profit for the year rose by 57.5% to Rs1,177.7 crore.
- ◆ The improvement in the operating profit was despite the rising cost of raw material such as steel and aluminium. However, the costs were effectively controlled as the company hedged the prices by long-term contracts with the suppliers and tighter control over the costs. The employee costs as a percentage of sales reduced from 4.3% in FY2005 to 3.7% in FY2006 due to higher productivity, workforce rationalisation and increasing outsourcing from its vendors.
- ◆ The net profit for the year grew by 44% to Rs1,101.6 crore.
- ◆ BAL continues to operate on a negative working capital basis. In FY2006, the negative working capital was Rs315.8 crore as compared to Rs48.7 crore in the previous year. BAL's return on operating working capital rose from 80% in 2004-05 to 174% in 2005-06.

Rs in crore	FY2006	FY2005
Fixed assets	996.3	951.7
Technical know-how	1.4	4
Working capital	-315.8	-48.7
Total	681.9	907.0
Operating profit after interest and depreciation	1184.5	724.8
Pre-tax return on operating capital employed	174%	80%

- ◆ There is huge headroom for growth of the motorcycle industry in India, looking at the low penetration of motorcycles in the country at just 31 motorcycles per 1,000 citizens. The ratio is much lower in comparison with that in some of the other developing nations like Indonesia, Vietnam, Malaysia and Thailand. We believe that BAL is in a good position to capitalise on this opportunity and would continue to perform well in the motorcycle market. The management is looking at a 15% growth in motorcycles.

Volume break-up

	2005-06	2004-05	% chg
Motorcycles	1,912,306	1,449,710	31.9
Other two-wheelers	116,870	152,936	-23.6
Total two-wheelers	2,029,176	1,602,646	26.6
Three-wheelers	252,054	222,053	13.5
Total two- and three-wheelers	2,281,230	1,824,699	25.0
Of the above, exports were			
Two-wheelers	174,907	130,945	33.6
Three-wheelers	75,297	65,765	14.5
Total exports	250,204	196,710	27.2

Segmental analysis**Motorcycles**

In the motorcycle segment BAL has been aggressive in launching new products and has established a strong presence across various segments and price points. In 2006, it sold 1,912,306 bikes, marking a volume growth of 31.9%, as compared to the industry growth rate of 18.8% and improved its market share to 30.8%. With its proven and strong research and development (R&D) skills across categories, we expect BAL's market share in motorcycles to rise further in the coming years.

Improvement in BAL's market share

Particulars	2003	2004	2005	2006
Industry	3,757,125	4,316,777	5,217,996	6,200,749
% growth yoy	31.3	14.9	20.9	18.8
Bajaj Auto	868,138	1,023,551	1,449,710	1,912,306
% growth yoy	32.3	17.9	41.6	31.9
Market share	23.1	23.7	27.8	30.8

In the premium segment, the company has *Pulsar*, which has ruled the market for the last four years, and also the recently launched bike, *Bajaj Avenger*. In the value or executive segment, it has its *Discover DTS-I*, which has delivered a strong performance since its launch last year. The sales of Discover grew by 118% to 337,000 units during the year, making it the single largest brand in the segment. In the economy segment, BAL has brands like *CT100*, *Discover 110cc* and more recently *Platina*.

	Segment's contribution to total motorcycle market (%)	Bajaj's Market share (%)
Entry level segment	40	40
Executive segment	50	25
Premium segment	10	62
Overall		31

Scooters

With the decreasing popularity of scooters in comparison with bikes, the company decided to discontinue the

manufacture of geared scooters during the year. The ungeared scooters delivered a marginal growth of 4.7%. The company launched its new *Wave DTS-I* during the year. Next year, it has plans to launch 2 gearless scooters, *Blade* and *Kristal* that were displayed in the Auto Expo 2006.

Three-wheelers

The mood of the three-wheeler industry was buoyant throughout 2005-06, especially in the passenger vehicle segment, which recorded a growth of 22.3% during the year. This was due to the replacement demand for three-wheelers from older vehicles to newer ones, which run on fuels like compressed natural gas (CNG) and liquefied petroleum gas (LPG). Being the market leader in the three-wheeler industry, BAL too delivered an impressive performance with the sales of its passenger vehicles growing by 14.5% and that of goods vehicles growing by 7.7%. The company's market share declined from 86% to 80.2% in the three-seater passenger vehicle market since it did not have a diesel product in its portfolio. However, with the recent launch of *Mega*, a rear-engine diesel autorickshaw, the company expects to regain its market share in FY2007.

Exports

In FY2006, BAL's exports surged by 27% in volume terms and by 29% in value terms, contributing 12% of the net sales. The export surge was led by a 33% growth in the motorcycle exports during the year. The company maintained its leadership position in the markets of Sri Lanka and Central America. The other key export markets for BAL were Columbia, Peru, Bangladesh, the Philippines, the UAE and Egypt. During the year, BAL finalised a distributor in Nigeria for its motorcycles. It intends to capture a significant share of the 1-million-strong two-wheeler market of Nigeria. The company is also exploring new markets like Iran and the other African countries.

Treasury operations

The treasury operations continue to contribute 25.6% to BAL's profit before tax. In view of the continuous deployment of surplus funds in fixed income securities, BAL has changed its accounting principle for investments. Accordingly the premium/discount on acquisition of investment held-till-maturity will now be amortised in the profit and loss account as against considering them in the carrying cost of these investments. The total amount of the amortisation computed on the basis of yield-to-maturity aggregated Rs35.5 crore and reflects in the profit for the year.

The composition of BAL's investments is shown in the following table. The market value of the portfolio is higher than the cost by Rs1,704 crore.

Investment of surplus funds (Rs cr)

	FY2006	% to total	FY2005	% to total
Government securities	2927.1	49.9	2560.9	55.8
Mutual funds	373.6	6.4	93.5	2
Debenture & bonds	1268.5	21.6	984.9	21.5
Certificate of deposits	104.7	1.8	-	-
Preference shares	24.9	0.4	42.1	0.9
Inter-corporate deposits	13.3	0.2	22.8	0.5
Loan to group companies	-	-	4.8	0.1
Fixed income invst	4712.1	80.3	3709.0	80.8
Equity shares/MFs	1158.2	19.7	879.2	19.2
Total cost	5870.3	100	4588.2	100
Market value	7573.9		5329.9	

Investments as a percentage of the average capital employed have gone up from 68% in FY2005 to 75% in FY2006.

Insurance

In the life insurance business, its subsidiary Bajaj Allianz Insurance Company has become the number one player among the private life insurance companies in terms of the gross written premium. The life insurance venture recorded a gross written premium of Rs3,134 crore (up 213%), with a loss of Rs98.5 crore as against a loss of Rs36.8 crore in the previous year. The company maintained its number two position in the general insurance segment, with a gross written premium of Rs1,284 crore that is growing by 50% every year. The profit after tax (PAT) for the year was Rs51.6 crore as against Rs47.1 crore in the previous year.

Retail finance

In 2005-06, the total disbursements of Bajaj Auto Finance grew by 39% to Rs1,955 crore. The stock of hire purchase receivables as of March 31, 2006 is Rs1,981 crore as against Rs1,249 crore last year. The PAT for the year stood at Rs21.1 crore.

New projects

BAL plans to expand its motorcycle capacity from three million vehicles per annum to 4.6 million vehicles by 2009. By 2009, the total capacity would be 5.1 million vehicles, including 0.5 million units of three-wheelers and four-wheelers. By 2007, BAL plans to increase its motorcycle capacity to 3.6 million vehicles. This would be done by setting up two new greenfield plants, one at Pantnagar in Uttaranchal to manufacture one million two-wheelers and three-wheelers per annum; and another at Chakan to manufacture three-wheelers and four-wheelers. It would be also expanding the capacities of its existing plants at Akurdi and Chakan. The company is also setting up a special economic zone at Waluj, Aurangabad and the approval for the same has already been received.

The capacity expansion together with the R&D, new model developments, specialised showrooms and a new learning centre would entail a capital expenditure of around Rs1,500 crore, which would be met through the company's existing resources and internal accruals.

Vision 2010

The company expects the annual sales of motorcycles in India to cross the 10 million mark by 2010, thereby establishing its leadership in the market. The company also plans to increase its presence in the global markets, eyeing newer export destinations. BAL also has a special focus on its two high-growth businesses of retail finance and insurance, citing enormous opportunities in both the arenas.

Rahul Bajaj's vision for the company in 2010 in his own words:

"By 2010, Bajaj should:

Mobilise India—by supplying 4 million motorcycles per year in a market of 10 million customers.

Globalise India—by rapidly enhancing exports and international facilities to become among the three largest global producers in two-wheelers.

Finance India—by ramping up Bajaj Auto Finance's operations to fund the growth aspirations of the country.

Derisk India—by expanding the life and general insurance business across the length and breadth of the land."

Outlook

For FY2007, BAL is targeting a volume of 2.85 million units (2.55 million 2-wheelers and 0.3 million 3-wheelers), including exports of 0.36 million units.

We estimate 2.5 million units of two-wheelers giving a growth of 23% and 0.29 million units of three-wheelers giving a growth of 15%. The sales for the current year are projected to increase by 24% and the PAT is expected to grow by 27%.

Valuations and view

As the company has cited in its annual report, there is huge headroom for growth of the motorcycle industry in India, looking at the low penetration of motorcycles in India at just 31 motorcycles per 1,000 citizens. The ratio is much lower in comparison with that in some of the other developing nations like Indonesia, Vietnam, Malaysia and Thailand. We believe that BAL is in a good position to capitalise on this opportunity and would continue to perform well in the motorcycle market. Further, taking into account

the good track record of the company, its strong brands across segments in the motorcycle business, the emerging opportunities in the retail finance space and the insurance businesses, we maintain our positive outlook on BAL.

We continue to value BAL on the sum-of-parts method.

Sum-of-parts valuation (table)

Business	Total (Rs mn)	Per share (Rs)	Comments
Automobiles	205747.71	2033.48	At 16x its FY2008E core EPS
Insurance business	74,251.7	733.86	At 16x its FY2008E NBAP
Investment book	7195.21	711.13	At 5% discount to market value
Total		3478.47	

At the current market price of Rs2,683, the stock discounts its FY2008 earnings by 16.5x and quotes at an FY2008 enterprise value/earnings before interest, depreciation, tax and amortisation of 10.5x. We maintain our Buy recommendation on the stock with the price target of Rs3,500.

Earnings table

Year to March 31	FY2005	FY2006	FY2007E	FY2008E
EPS (Rs)	79.2	110.4	138.0	166.7
PER (x)	33.9	24.3	19.4	16.1
Book value	408.6	471.5	565.1	676.0
P/BV	6.6	5.7	4.7	4.0
EV/EBIDTA (x)	26.2	17.1	13.1	10.5
RoCE (%)	13.9	19.1	21.5	23.5
RoNW (%)	14.9	18.6	20.7	21.6

The author doesn't hold any investment in any of the companies mentioned in the article.

Evergreen

HDFC Bank
 Infosys Technologies
 Reliance Industries
 Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
 Associated Cement Companies
 Bajaj Auto
 Balrampur Chini Mills
 Bharat Bijlee
 Bharat Heavy Electricals
 Corporation Bank
 Crompton Greaves
 Godrej Consumer Products
 Elder Pharmaceuticals
 Grasim Industries
 Hindustan Lever
 Hyderabad Industries
 ICICI Bank
 Indian Hotel Company
 ITC
 Mahindra & Mahindra
 Marico Industries
 Maruti Udyog
 MRO-TEK
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 Omax Auto
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 Sundaram Clayton
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Cannonball

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Emerging Star

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 Welspun India

Ugly Duckling

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 Ratnamani Metals and Tubes
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 Saregama India
 Selan Exploration Technology
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