

FUTURE CAPITAL HOLDINGS

INR 700-765


Future lies in execution
SUBSCRIBE

We recommend investors to 'SUBSCRIBE' to the IPO of Future Capital Holdings (FCH) - the financial services arm of the Future group, promoted by Pantaloon Retail (India) Ltd (PRIL), Kishore Biyani, MD of PRIL, and Sameer Sain, former MD at Goldman Sachs International. The company offers private equity/real estate investment advisory, retail financing (consumption and personal loans) and plans to distribute Future-ICICI co-branded credit cards and Future Generali insurance products.

* Unique business hypothesis

We believe FCH will be a play on growth opportunities in the financing vertical of organised retail and rising consumer spend in India. It plans to leverage Future Group's deep understanding of the retail and consumption-led sectors, and pan-India distribution network of PRIL to build a scalable financial services platform and aggressively grow its businesses. It focuses on private equity/venture capital investment advisory and research services for investments in its own area of expertise, i.e. retail-related, such as malls and market cities. It also strives to establish a unique customer-centric retail financing model (against product-focused approach followed by banks and financial institutions) by financing purchases at the site where consumption decisions are made.

* Execution is the key risk; betting on the management track record

FCH was incorporated only in 2005 and most of its businesses at a nascent stage at present. Consequently, execution will be key risk for the investors at this stage. However, it has professional and experienced management team in place across various business verticals and we believe it is worth giving the benefit-of-doubt to the management's ability in identifying and monetizing on the emerging opportunities in rapidly growing financial services. It has aggressive plans to grow its investment advisory and retail financing business and wants to rapidly scale up credit card and financial product distribution services. We believe it will also look to capture other existing and emerging opportunities in financial services space (like asset management, broking etc).

* Outlook and valuations: successful scale up to provide upsides; recommend 'Subscribe'

We have valued two of its businesses already on its platter namely investment advisory and retail financing. We expect it to raise investment advisory AUMs to USD 3.0-3.5 bn (from USD 1 bn at present) over the next 24-30 months considering significant investment opportunities available in real estate/retail related sector and the company's keenness to seek new investment advisory engagements. We value this business at INR 22-28 bn expecting an average annual return of 21-24% on equity. We arrive at the value of INR 28 bn for its retail financing business assigning 3.5x book multiple to its net worth of ~INR 8 bn in the next 12 months, during which it is likely to generate RoE of 22-25%. The company's venture into distribution of credit card and insurance products, scale up of businesses ahead of expectations and launch of new businesses, will provide further upsides to its valuation. We recommend investors from longer term perspective to 'SUBSCRIBE' to the IPO, betting on the opportunities available in financial services space and belief in management's execution track record and Future Group's expertise to build an integrated financial services business model.

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Reuters	:	NA
Bloomberg	:	NA

Market Data

52-week range (INR)	:	NA
Post IPO share in issue (mn)	:	63.2
M cap (INR bn/USD mn)	:	NA
Avg. Daily Vol. BSE/NSE ('000)	:	NA

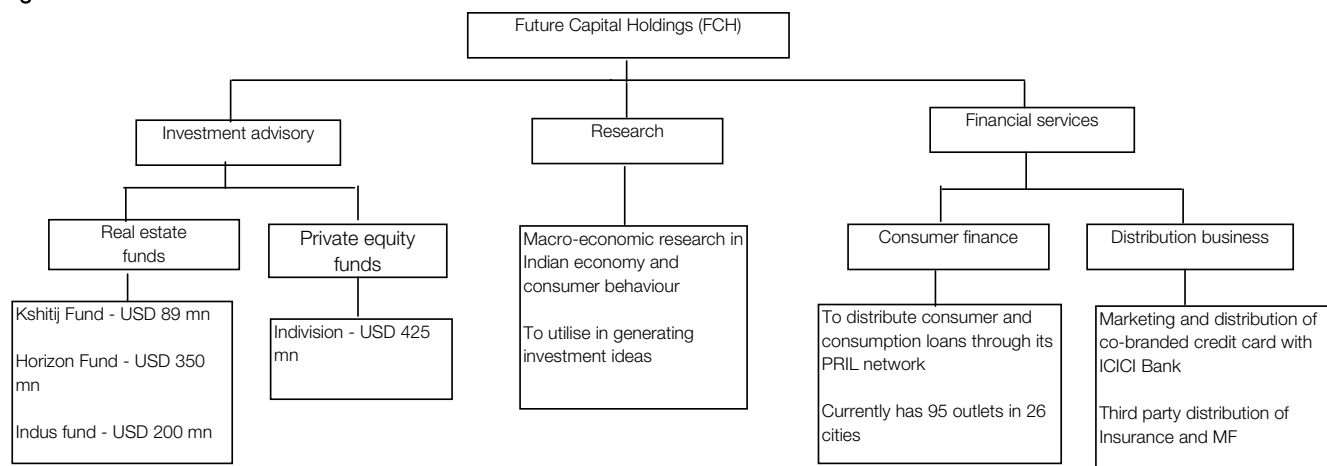
Share Holding Pattern Post IPO (%)

Promoters	:	74.5
Non Promoters	:	25.5

Unique and Scalable Financial Services Model

FCH was incorporated in 2005 to tap growth opportunities in the financing vertical of organised retail and to benefit from the substantial synergies across businesses of the Future group. It is focused on providing equity and real estate investment advisory to onshore and offshore funds (now managing USD 1 bn assets) and research services for evaluating alternative investment options. It launched its retail finance offering - consumption loans and personal loans, under Future Money, in June 2007, to leverage the Future group's deep understanding of the retail and consumption-led sectors, and pan-India distribution network of PRIL. The company also plans to provide distribution services for Future Generali insurance products and Future-ICICI co-branded credit cards, thereby building a scalable and cost efficient financial services platform.

Fig. 1: Business structure of FCH



Source: Company

Table 1: Issue details

	At lower price band	At upper price band
Issue size (# of shares in mn)		6.4
Post issue number of shares (mn)		63.2
Dilution (%)		10.16%
Price band (INR)	700	765
Proceeds to be raised (INR mn)	4,496	4,913
Market cap (INR bn)	44.3	48.4
Net worth (pre issue) (INR mn)	2,421	2,421
Net worth (post issue) (INR mn)	6,917	7,335
Revenues FY07 (INR mn)		390
Revenues H1FY08 (INR mn)		313
PAT FY07 (INR mn)		35
PAT H1FY08 (INR mn)		(124)

Source: Company

Investment Advisory Services - AUMs Likely to Grow Three-folds

* Capitalising growth opportunities in real estate

As a part of its strategy to capitalise on the growth opportunities in retail and consumption-led sectors and leverage capabilities of the Future group, FCH provides private equity and real estate investment advisory to its onshore and offshore clients. Currently, it advises three real estate funds – Kshitij, Horizon, and Indus Hotel Ventures, and one private equity fund – Indivision with total AUMs of USD ~1.06 bn (INR 41.8 bn).

Table 2: Funds advised by FCH

Fund	Launch/Size of the fund	Nature of operation
Real estate		
Kshitij	Launched in Jun 2005 Asset size - USD 89 mn	To develop malls predominantly in Tier II cities Fully committed its fund to develop 4.7 mn sq. ft of retail space - Chennai (1.8 mn), Ahmedabad (0.2 mn), Kolkata (0.4 mn), Kochi (0.4 mn), Vadodara (0.4 mn) Indore (0.3 mn), Jaipur (0.3 mn), Mysore (0.3 mn) Trivandrum (0.3 mn) and Lucknow (0.3 mn)
Horizon	Launched in Dec 06 Asset size - USD 350 mn	To focus on building 'market cities' in the prime location of Mumbai, chennai, Pune, Bangalore, Hyderabad
Indus Hotel	Launched in 2007 Asset size - USD 200 mn	To develop three and four star hotels
Private equity fund		
Indivision	Launched in May 2006 Asset size - USD 425 mn	To invest in high growth companies in retail and consumption led sectors

Source: Company

* Private equity advisory – Evaluating high growth companies in retail sector

Within its private equity advisory business, FCH primarily focuses on evaluating high growth companies in retail and consumption-led sectors such as FMCG, media, entertainment, hospitality, and fashion, backed by entrepreneurial talent. By leveraging the expertise and experience of the Future group, it actively mentors these companies to formulate growth strategies. It also thrives to harness synergies between the companies it has invested in and the Future group; for example, gaining access to shelf space in the Future group stores. FCH has advised on wide range of investments made by the Indivision Fund, namely:

Table 3: Investments made by Indivision

Company	% stake acquired	Investment (INR cr)	Nature of operation
Dish TV	4.9	250	India's first direct-to-home entertainment service provider
Lilliput Kidswear	25	~45	Marketing and retailing of children's wear
VLCC	22	~50	One of the leading fitness, beauty and health firms
Sula Wines	20	~50	India's leading premium wine company
BE Billimoria	26	75	Civil engineering construction company
Capital Foods	33	~25-30	Processed food products; Supplier to big retailer like Target
Global Hospitals	25	~125	Hyderabad based super-speciality corporate hospital
Interarch Building Products		~100	Manufacture metal building systems
Biba Apparel		~20	Retailing of ethnic womenswear
Tops Security	~7	~57	Provides security solutions
Faces Cosmetics	~70	~40	Retail outlets offering colour cosmetics and anti-ageing products

Source: Company, Edelweiss research

In real estate advisory, the company is focused on investments in its own area of expertise, i.e. retail-related, such as malls and market cities with convention centers, residential apartments, commercial space, community centers, and three or four star hotels. The booming retail story, backed by rising income levels and increased consumer spending, will throw open huge opportunity for building of malls in India. FCH, with its experience in real estate business and expertise of the Future group, is poised to benefit from this upsurge.

An onshore venture capital fund, Kshitij Fund, where FCH is an investment advisor, was raised in 2005. This fund has fully committed its capital of USD 89 mn for developing malls (across the space of ~4.8 mn sq ft) predominantly in tier II cities. These malls are expected to be operational in FY08-10. We expect better returns from this fund on account of huge appreciation in real estate prices in the past 24-30 months. FCH earns advisory fees and performance fees based on 2:20 structure.

Another offshore real estate fund, Horizon Fund, aims to develop market cities in the prime location of Mumbai, Chennai, Pune, Bangalore, and Hyderabad in collaboration with the international architectural firms. Its offshore funds are currently owned by Mauritius-based Keystone Company (Keystone) and FCH gets only advisory fees from these funds. The company has applied for approval from RBI to acquire 100% of the stake in Keystone.

Moreover, the company sees significant opportunities for affordable 3-4 star hotels for mid-level Indian executives and business travelers, as there is lack of supply of hotel rooms and no notional chain of 3-4 star business hotels. To address this, Future Group floated an offshore fund, Indus Hotel Ventures, for which, FCH is an investment advisor.

*** Keen to seek new advisory engagements**

FCH also intends to expand selectively into new sectors, to compliment its existing capabilities, and has already entered into a joint venture to build investment advisory expertise in industrial warehousing and logistics. With the availability of significant investment opportunities in real estate and retail related space and the company's keenness to seek investment advisory engagements, we believe it will be able to raise funds under management to USD 3.0-3.5 bn over the next 18-24 months.

*** Investment advisory business valuations**

Based on the various assumptions of - 1) investment advisory fees of 1.8%, 2) hurdle rate of 8%, 3) employee sharing of 25-30%, 4) drawdown over the period of 18-24 months and withdrawals in the last 3 years, and 5) investment appreciation - we arrive at an average annual return of 21-24% on equity for these funds. Applying the same return for the new engagements worth USD 2.0-2.5 bn, we value this business at INR 22-28 bn.

*** Building research to generate and evaluate investment ideas**

Future Capital Research, headed by Ms. Roopa Purushothaman, conducts research on macro-economic trends to identify short and medium term trends as well as long-term structural shifts in Indian economy and consumer behaviour. It then creates proprietary indices to highlight key movements in the consumption trends. FCH utilises this research to generate investment ideas and evaluate investments.

Retail Financial Services – Key Business Driver

To leverage Future group's deep understanding of the retail and consumption-led sectors and pan-India distribution network of PRIL, FCH launched its retail finance offering - consumption loans and personal loans - under the brand 'Future Money' in June 2007. The company strives to establish a unique customer-centric retail financing model (against product focused approach followed by banks and financial institutions) by financing its purchases at the site where consumption decisions are made. It will have 'shop-in-shops' outlets located or kiosks installed within the present and future malls and retail stores of PRIL and its subsidiaries, accessing a network of 400 stores across more than 40 cities in India and one of the largest client base. It currently has 95 Future money outlets located inside PRIL and subsidiaries in 26 cities across India. It will expand its branch network in other PRIL stores with the money raised through the IPO and plans to add independent stores and kiosks in future.

At PRIL malls and retail outlets, the products amenable to financing will contain minimum monthly price (MMP) along with their price tags. If the customers opt for financing, the loans will be processed instantaneously at the point of consumption using information provided by the customers and automated credit check systems (through Credit Information Bureau and credit information system owned by banks). In such a system, FCH will earn either in the form of subvention from dealers/manufacturers or by way of interest from customers.

We expect average yields from consumption financing to be in the range of 22-25%, considering a tenor of 12 months for consumption loans, subvention of 5% from dealers, and three monthly installments collected in advance at the point of purchase. The cost of funding will hover in the range of 10-11%. With scale up in business, opex/assets will be relatively lower for FCH over banks and FIs, as it will not have to pay any commission to PRIL; FCH will only pay a nominal fee of INR 30 mn per year for exclusive rights to provide these loans at PRIL's malls and outlets. Opex will primarily be dominated by collection and recovery costs. We are expecting provisioning for loan loss at 4-5%. This will consequently lead to RoAs of 3.0-3.5%.

We expect Pantaloons sales to grow at ~70% CAGR over FY07-10E and expect 23-26% of the sales to be a target segment for consumption financing through FCH. Assuming that over the next 24-30 months, 30% of this target segment will resort to financing option at PRIL stores for an average tenor of 12-18 months, FCH would be able to build loan book of ~INR 9-10 bn by FY10E and INR 17-18 bn by FY11E. Further, it will also provide financing from its independent outlets, which will constitute ~15-20% of its loan book.

Table 4: Key assumptions for consumption loan growth

	2008E	2009E	2010 E	2011E
FCH's target segment/PRIL sales	23.1%	25.6%	26.2%	26.2%
Actual target segment financed	5%	15%	30%	35%
Expected disbursements (INR mn)	743	3,968	12,846	21,019
Expected loan book (INR mn)	520	2,934	9,872	17,675
Disbursements from independent outlets (INR mn)	-	-	3,211	7,006
Expected loan book (INR mn)	-	-	2,248	5,579
Total consumption loan book (INR mn)	520	2,934	12,120	23,254

Source: Edelweiss research

FCH also offers personal loans that are either small unsecured credit lines or loans against properties with an average ticket size of INR 0.1-0.75 mn and tenor of 18-48 months. PRIL malls and stores will provide FCH access to huge customer base, as they 15-20 mn customers visiting their stores every year. Further, the footfall is expected to grow 2-3 folds over the next 18-24 months, which FCH will be able to leverage to grow its personal loan portfolio. We believe this business is highly scalable, given accessibility to huge customer base and availability of funds. We expect FCH's personal loan business to grow significantly, matching the size of its consumption loan portfolio, going forward.

We value the retail financing business at INR 28 bn, assigning 3.5x book multiple to its net worth of ~INR 8 bn in the next 24 months, during which it is expected to generate RoE of 22-25%.

To Venture Into Distribution of Financial Products

FCH plans to leverage the pan-India presence of PRIL stores and its client base by promoting co-branded credit card with ICICI Bank, named 'Future Card', and venturing into third party distribution of mutual fund and insurance products. FCH will be responsible for the marketing and distribution of these cards and will receive an acquisition fee of INR 600 for every credit card and commission of 0.7% of total spend within Future group stores and 0.2% of total spend in other outlets.

In the table below, we have tried to explain how the economics would work for FCH through distribution of Future Cards and transactions conducted through the same. We have assumed 0.65 mn cards to be issued by FCH by FY10E and average spend of INR 2,000 per month, of which, 10% of card holders' spending occurs at PRIL stores. Considering INR 600 per card as acquisition fee and incentive commission of 0.7% for spends within PRIL stores, we believe this will boil down to revenues of ~INR 140 mn by FY10E.

Table 5: Key assumptions for credit card distribution business

	FY09	FY10	FY11
Number of cards (mn)	0.5	0.8	1.0
New cards acquired (mn)	0.1	0.2	0.2
Acquisition fee (INR)	600	600	600
Average spend per month (INR)	2,000	2,200	2,420
Average spend in PRIL	10%	10%	10%
Average annual spend in PRIL (INR)	2,400	2,640	2,904
Revenue from card acquisition (INR mn)	60	90	120
Revenue from spend in PRIL (INR mn)	5.9	12.0	18.3
Revenue from other spend (INR mn)	15.1	30.9	47.0
Total revenue (INR mn)	81	133	185

Source: Edelweiss research

* FCH will convert existing 0.5 mn 'ICICI Bank Big Bazaar' cards to 'Future' cards over next 18-24 months

FCH does not share any risk in case of slippages and ICICI Bank will be responsible for the collection and recovery.

FCH also intends to distribute insurance products of Future Generali, a 74:26 joint venture of PRIL with Italian insurance major Generali Group, using 'Mall Assurance' model (marketing insurance products in PRIL premises and other malls where it has investments).

Betting on the Management Team

FCH has professional and experienced management team in place across various business verticals and we believe it is worth giving the benefit-of-doubt to the management's ability in identifying and monetizing on the emerging opportunities in rapidly growing financial services. We expect FCH to pursue its scalable and unique business model quite efficiently, supported by execution capabilities of its management team in the fields of financing, private equity, real estate, management consulting, research, and risk management, led by Mr. Sameer Sain - ex-MD, Goldman Sachs, Mr. Shishir Bajjal – Former CEO, Inox Leisure, Mr. Sanjiv Gupta – ex-CEO, Coca Cola India and Southwest Asia, Mr. Rakesh Makkar - ex-risk director and CFO of Citifinancial India, and Ms. Roopa Purushothaman – vice president, Goldman Sachs Int and co-author of “Dreaming with BRICs – The Path to 2050”.

The company has more than 250 professionals currently, with more than ~33% of its workforce in advisory services.

Table 6: Top management team at Future Capital

Management team	Designation	Prior experience
Sameer Sain	CEO & MD	Former MD, Goldman Sachs; 11 Years of experience with GS
Dhanpal Jhaveri	Executive director	Director - corporate strategy, Vedanta Resources
N Shridhar	CFO	Ex-CFO, Britannia Industries
Venkatesh Srinivasan	COO	Associate principal with Mckinsey & Company
Devaiah P M	General counsel	Head of legal and compliance at Carlyle Group, BPL and ICICI Ventures
Pankaj Thapar	Head, Investments and Acquisitions	Ex CFO, Dentsu (India)
Ashutosh Lavakare	Head, Strategy and Corporate Affairs	Ex CFO, Travelex India
Shishir Bajjal	CEO, Kshitij Investment Advisory Company	Former CEO, Inox Leisure
Sanjiv Gupta	MD, Indivision Investment Advisors	Former CEO, Coca-Cola India
Rakesh Makkar	CEO, Future Money	Former Head, Retail Mass Market Business for first India credit, Temasek's financial services business in India
Roopa Purushothaman	Head, Future Capital Research	Former vice-president, Goldman Sachs
Rama Iyer Srinivasan	Head, Portfolio Investments	Portfolio manager with Principal PNB AMC

Source: Company

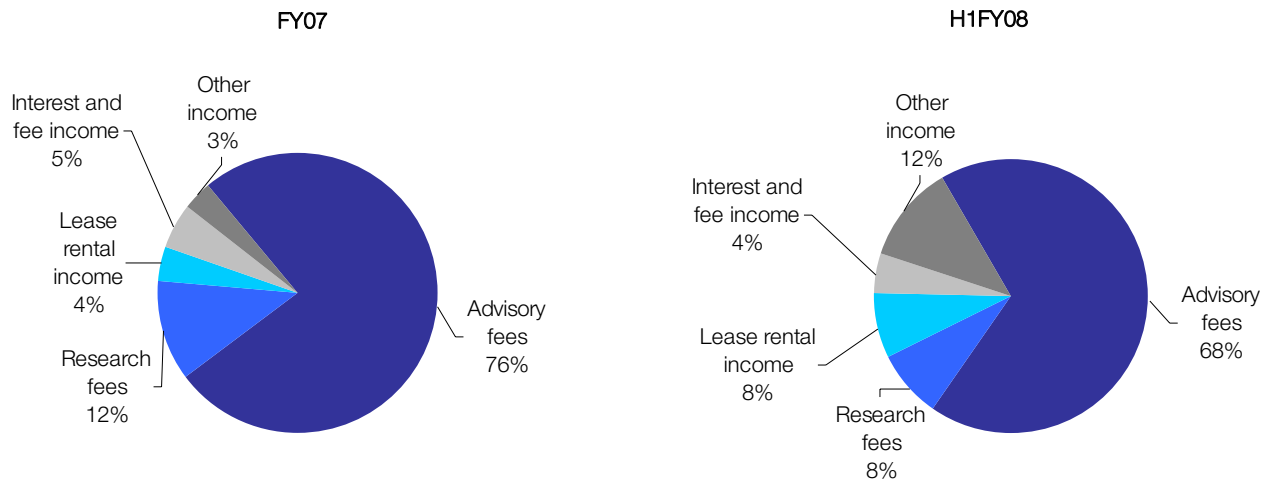
Company description

Future Capital Holdings (FCH), incorporated in October 2005, is a fast growing non-banking financial company, offering a wide range of research, advisory services and retail financial services. It is promoted by Pantaloon Retail (PRIL), one of the leading players in the organised retail, Kishore Biyani, MD of PRIL, and Sameer Sain. Being a part of Future group, one of India's leading retail group with more than ten years of experience in the Indian retail sector, FCH has a deep understanding of the needs of Indian consumers. It is also supported by a well-experienced management team with expertise in diverse fields such as investment banking, finance, real estate, operation, and risk management.

Financials

FCH reported revenue of INR 313 mn in H1 FY08 (INR 390 mn in FY07) with advisory fees contributing ~68% to its overall revenues (~74% in FY07). Contribution of advisory fees is likely to continue to decrease in future, as the company is focusing more on consumer financing and third party distribution services. The company posted a loss of INR 124 mn compared with profit of INR 35 mn in FY07, mainly because of increased operating and administrative expenses due to roll-out of Future Money outlets in H1FY08.

Chart 1: Revenue break-up



Source: Company

Table 7: Shareholding pattern

	Post issue	
	# equity share	%
Promoters		
PRIL	34,779,999	55.0%
Kishore Biyani	3,773,795	6.0%
Sameer Sain	8,528,390	13.5%
	47,082,184	74.5%
Promoter Group		
Pingaksh Realty Private Ltd	618,000	1.0%
Non-Promoter Group		
AMIF I Limited	4,931,949	7.8%
Quantum (M) Limited**	568,051	0.9%
Laxmi Shivanand Mankekar	1,083,000	1.7%
Shivanand Shankar Mankekar	941,000	1.5%
Alok Oberoi	940,000	1.5%
Employees (pursuant to ESPS)***	500,000	0.8%
Kedar Shivanand Mankekar	91,000	0.1%
Shishir Bajjal	50,000	0.1%
	9,105,000	14.4%
Public	6,422,800	10.2%
Total share capital	63,227,984	100.0%

Source: Company

Key risks

- Keystone is the holding company of the three offshore funds, Indivision, Horizon, and Indus Fund, currently advised by FCH through its subsidiaries. Failure in getting RBI's approval for acquiring 100% stake in Keystone will lead to loss of management and performance fees earned by the offshore investment managers.
- Risk of fraud and higher than expected non-performing assets is inherent to the consumer financing business. Any deterioration of the general economic condition can increase the company's NPAs.
- Retail financial services business of the company was recently launched and is expected to be scaled up in the next few quarters, exposing it to execution risks that could adversely affect profitability.
- The company plans to migrate 0.5 mn customer holding ICICI Bank Big Bazaar Card to its new 'Future' Card. Failure in conversion could lead to losses in commission income.

Financial Statement (Consolidated)

Income statement		(INR mn)	
Year to March	FY07	H1FY08	
Advisory fees	295	212	
Research fees	46	25	
Lease rental income	16	25	
Interest and fee income	20	14	
Other income	13	37	
Total revenues	390	313	
Personnel expenses	183	206	
Administration and other expenses	124	170	
Total expenditure	307	376	
EBITDA	83	(64)	
Financial expenses	25	36	
Depreciation / amortisation	8	13	
Preliminary expenses written off	0	0	
PBT	49	(113)	
<i>Taxes</i>	2	10	
PAT before minority interest	48	(122)	
Minority interest in profit/loss of subsidiaries	13	(2)	
PAT	35	(124)	
Diluted EPS (INR)	0.8	(1.9)	

Income statement		(INR mn)	
Year to March	FY07	H1FY08	
Liabilities			
Equity capital	444	568	
Shareholder money pending allotment	110	0	
Reserves	510	1,853	
Networth	1,065	2,421	
Secured loans	555	554	
Minority interest	18	2	
Total liability	1,637	2,978	
Assets			
Goodwill on consolidation	76	76	
Net block	883	939	
Investments	535	1,308	
Current assets			
- <i>Sundry debtors</i>	148	85	
- <i>Cash and bank balances</i>	39	521	
- <i>Loans and advances</i>	178	575	
- <i>Investment held for sale</i>	0	168	
- <i>Stock on hire</i>	0	11	
Current liabilities			
- <i>Current liabilities</i>	149	637	
- <i>Provisions</i>	4	6	
Net current assets	211	718	
Deferred tax assets	8	13	
Total assets	1,637	2,978	

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Recent Research

Date	Report	Title	Price (INR)	Recos
09-Jan-08	Axis Bank	Fast and the furious; <i>Result Update</i>	1,096	Buy
09-Jan-08	ICICI Bank	Bank on non-banking; <i>Visit Note</i>	1,310	Buy
09-Jan-08	Banking	Improving margins; ride The equity wave; <i>Sector Update</i>		
07-Jan-08	PNB	Turnaround in asset; quality; <i>Visit Note</i>	689	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	107	45	18	3	193

* 13 stocks under review /3 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	104	69	20

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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