



## Gammon India

|                    |              |
|--------------------|--------------|
| STOCK INFO.        | BLOOMBERG    |
| BSE SENSEX: 13,033 | GMON IN      |
|                    | REUTERS CODE |
| S&P CNX: 3,767     | GAMM.BO      |

1 November 2006

Buy

Previous Recommendation: Buy

Rs405

|                       |           |
|-----------------------|-----------|
| Equity Shares (m)     | 86.7      |
| 52-Week Range         | 589/276   |
| 1,6,12 Rel. Perf. (%) | 7/-32/-50 |
| M.Cap. (Rs b)         | 35.2      |
| M.Cap. (US\$ b)       | 0.8       |

| YEAR  | NET SALES | PAT    | EPS  | EPS        | P/E  | P/BV | ROE  | ROCE | EV/   | EV/    |
|-------|-----------|--------|------|------------|------|------|------|------|-------|--------|
| END   | (RS M)    | (RS M) | (RS) | GROWTH (%) | (X)  | (X)  | (%)  | (%)  | SALES | EBITDA |
| 3/06A | 14,851    | 1,043  | 9.6  | 44.1       | 42.2 | 3.8  | 9.0  | 13.6 | 3.0   | 23.0   |
| 3/07E | 21,493    | 1,182  | 13.6 | 41.7       | 29.8 | 3.4  | 11.5 | 13.3 | 1.6   | 18.0   |
| 3/08E | 30,665    | 1,785  | 20.6 | 51.1       | 19.7 | 3.0  | 15.2 | 19.0 | 1.2   | 12.3   |

Period 12/04A is for 9 months; # 15 month period January 2005 - March 2006

- Strong 2QFY07 Performance:** During 2QFY07, Gammon India reported Revenues of Rs4.8b (up 67.1% YoY), EBITDA Rs418m (down 6.6% YoY) and net profit of Rs262m (up 5.7% YoY). The numbers are better than our expectations for revenue of Rs4.3b, EBITDA of Rs370m and net profit of Rs180m. EBITDA margin during 2QFY07 stood at 8.6% (our expectations of 8.5%), Gammon has not booked margin on revenue of Rs750m during 2QFY07 (not attaining margin recognition threshold).
- Order Book stands at Rs80b:** Gammon's order book as at September, 2006 stood at Rs80b (4.8x FY06 - 15 months period), vs Rs74b in June 2006 and Rs68b in March 2006. During 1HFY07, the order intake for the company was Rs13b.
- Key takeaways from Concall:** (1) Guidance for revenue growth of 35% YoY till FY09 (50% CAGR expected as stretched target) and EBITDA margins of 9% for FY07 (1HFY07 - 7.2%), (2) GIPL submitted financial bids for seven projects (Rs70b) and pre-qualified for financial bid submission for ten projects (Rs150b); current portfolio stands at 10 projects of Rs40b.
- Recommend Buy:** We expect Gammon to report net profit of Rs1.2b for FY07 and Rs1.8b for FY08, respectively. At the CMP of Rs405, the stock trades at reported PER of 29.8x FY07 and 19.7x FY08E. We value Gammon's 82.5% stake in Gammon Infrastructure at Rs11.7b (Rs135/share), 50.9% stake in Gammon and Billimoria at Rs2.3b (Rs26/share), 28.9% stake in Associated Transrail at Rs1.1b (Rs13/share). Adjusting for the value of BOT, Investments, the stock trades at P/E of 15.8x FY07 and 10.4x FY08E. We maintain **Buy** with price target of Rs425.

### QUARTERLY PERFORMANCE

|                        | (Rs Million)             |              |              |              |              |              |              |              |              |                   |               |
|------------------------|--------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------------|---------------|
|                        | FY06 (JAN.05 - MARCH.06) |              |              |              |              | FY07         |              |              |              | JAN-05-<br>MAR-06 | FY07E         |
|                        | 1Q                       | 2Q           | 3Q           | 4Q           | 5Q           | 1Q           | 2Q           | 3QE          | 4QE          |                   |               |
| <b>Sales</b>           | <b>2,806</b>             | <b>2,862</b> | <b>2,891</b> | <b>3,350</b> | <b>4,767</b> | <b>5,539</b> | <b>4,830</b> | <b>4,858</b> | <b>6,267</b> | <b>16,677</b>     | <b>21,493</b> |
| Change (%)             |                          | -0.9         | 10.1         | 2.7          | 69.9         | 93.5         | 67.1         | 45.0         | 31.5         |                   | 28.9          |
| <b>EBITDA</b>          | <b>306</b>               | <b>340</b>   | <b>447</b>   | <b>486</b>   | <b>353</b>   | <b>317</b>   | <b>418</b>   | <b>514</b>   | <b>720</b>   | <b>1,932</b>      | <b>1,959</b>  |
| Change (%)             |                          | 7.6          | 24.9         | 70.5         | 15.5         | -6.9         | -6.6         | 5.7          | 103.9        |                   | 1.4           |
| As of % Sales          | 10.9                     | 11.9         | 15.5         | 14.5         | 7.4          | 5.7          | 8.6          | 10.6         | 11.5         | 11.6              | 9.1           |
| Depreciation           | 61                       | 66           | 63           | 84           | 97           | 83           | 103          | 102          | 101          | 371               | 389           |
| Interest               | 98                       | 102          | 102          | 114          | 55           | 52           | 18           | 35           | 72           | 471               | 176           |
| Other Income           | 0                        | 0            | 1            | 1            | 18           | 3            | 1            | 1            | 9            | 22                | 13            |
| Extra-ordinary income  | 0                        | 0            | 0            | 0            | 0            | 27           | 0            | 0            | -27          | 0                 | 0             |
| <b>PBT</b>             | <b>147</b>               | <b>173</b>   | <b>283</b>   | <b>290</b>   | <b>219</b>   | <b>211</b>   | <b>297</b>   | <b>378</b>   | <b>530</b>   | <b>1,112</b>      | <b>1,407</b>  |
| Tax                    | 4                        | 19           | 36           | 80           | -69          | 25           | 36           | 72           | 92           | 69                | 225           |
| Effective Tax Rate (%) | 2.5                      | 10.8         | 12.5         | 27.7         | -31.5        | 11.9         | 12.0         | 19.0         | 17.5         | 6.2               | 16.0          |
| <b>Reported PAT</b>    | <b>143</b>               | <b>154</b>   | <b>248</b>   | <b>209</b>   | <b>288</b>   | <b>186</b>   | <b>262</b>   | <b>306</b>   | <b>437</b>   | <b>1,043</b>      | <b>1,182</b>  |
| <b>Adj PAT</b>         | <b>143</b>               | <b>154</b>   | <b>248</b>   | <b>209</b>   | <b>288</b>   | <b>159</b>   | <b>262</b>   | <b>306</b>   | <b>464</b>   | <b>1,029</b>      | <b>1,182</b>  |
| Change (%)             |                          | 41.7         | 234.9        | 5.3          | 101.3        | 3.5          | 5.7          | 46.1         | 69.3         |                   | 14.9          |

E: MOST Estimates; \* FY06 = 15 months from Jan 2005 - Dec 2004

### Strong 2QFY07 performance

During 2QFY07, Gammon India reported Revenues of Rs4.8b (up 67.1% YoY), EBIDTA Rs418m (down 6.6% YoY) and net profit of Rs262m (up 5.7% YoY). Reported numbers have been better than our expectations: revenue Rs4.3b, EBIDTA Rs370m and net profit Rs180m. EBIDTA margin during 2QFY07 stood at 8.6% (vs our expectations of 8.5%).

Revenues during 2QFY07 at Rs4.8b (up 67% YoY) came as a positive surprise. This is because management has been guiding for FY07 revenues of Rs20-21b. As against this, 1HFY07 revenues stand at Rs10.4b and given that 2Q is seasonally a lean quarter for construction activities, we believe that there exists possibility of an upgrade. Further, the management has always maintained that the internal target for FY07 is revenues of Rs25b

#### QUARTERLY REVENUE AND YOY GROWTH

|                | JUN-05 | SEP-05 | DEC-05 | MAR-06 | JUN-06 | SEP-06 |
|----------------|--------|--------|--------|--------|--------|--------|
| Revenue (Rs m) | 2,862  | 2,891  | 3,350  | 4,069  | 4,185  | 3,793  |
| YoY Growth (%) | -0.9   | 10.1   | 2.7    | 45.0   | 93.5   | 67.1   |

Source: Company

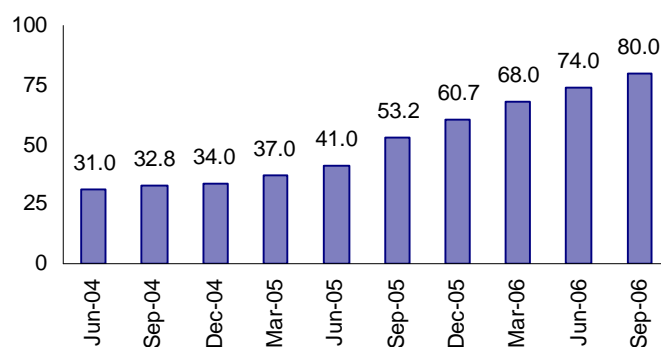
### EBIDTA margins improvement

EBIDTA margins of 8.6% during 2QFY07 also came as a positive surprise, given the strong revenue growth of 67% YoY. This is because, as per the accounting methodology adopted, Gammon accounts for margins on projects with size exceeding Rs2.5b, post 15% completion and for other projects, post 25% completion. Thus, 67% increase in revenues should have resulted in several projects not reaching the margin recognition threshold (during 1QFY07, EBIDTA margins stood at 5.7%, on revenue growth of 94% YoY). Also, Gammon had not booked margins on revenues of Rs750m during 2QFY07 due to non-attainment of threshold limit for margin recognition.

### Order Book stands at Rs80b

Gammon's order book as at September, 2006 stood at Rs80b, vs Rs74b in June 06 and Rs68b in Mar 06. During 1HFY07, the order intake for the company was Rs13b. The EPC work for its BOT project comprises of 17% of the current order backlog and is presently working on 60 projects. The management stated that transport projects and power sector account for ~35% each of the order book, while the rest is accounted from other segments like Irrigation, Pipelines, Transmission, Railways, etc.

#### TREND IN QUARTERLY ORDER BACKLOG (RS B)



Source: Company

### Key Takeaways from the Conference Call:

#### Guidance maintained

Management has provided guidance for:

- ✍ Revenue growth of 35% YoY till FY09 (50% YoY growth as a stretched target)
- ✍ EBIDTA margin of 9% for FY07 (1HFY07 - 7.2%)

#### Gammon Infrastructure Projects Limited (GIPL)

The management indicated that the of the 10 BOT projects, four projects are in operational phase, while six projects are in various stages of implementation. GIPL has also submitted financial bids for seven projects totaling Rs30b, and has been qualified for financial bid submission in the case of ten projects, totaling Rs150b.

## Valuation and View

Given the order book position of Rs80b (4.8x FY06 - 15 months period) and strong order pipeline from Nuclear and Hydro power (Gammon is one of the few companies with necessary pre qualification), we expect strong revenue and profit growth going forward. Also, GIPL could unlock significant value, given the increased level of opportunities on the Public Private Partnership segment. We expect Gammon to report net profit of Rs1.2b for FY07 and Rs1.8b

for FY08, respectively. At the CMP of Rs405, the stock trades at reported PER of 29.8x FY07 and 19.7x FY08E.

We value Gammon's 82.5% stake in Gammon Infrastructure at Rs11.7b (Rs135/share), 50.9% stake in Gammon and Billimoria at Rs2.3b (Rs26/share) and 28.9% stake in Associated Transrail at Rs1.1b (Rs13/share). Adjusting for the value of BOT, Investments, the stock trades at P/E of 15.8x FY07 and 10.4x FY08E. We maintain **Buy**, price target of Rs425.

### SOTP VALUATION

|                                 | BUSINESS SEGMENT          | METHOD<br>(X)        | VALUATION<br>(RS M) | VALUE<br>(RS/SH) | VALUE      | RATIONALE               |
|---------------------------------|---------------------------|----------------------|---------------------|------------------|------------|-------------------------|
| Gammon Standalone               | Construction              | FY08E PER (x)        | 12                  | 21,422           | 247        | Premium to industry avg |
| Investments                     |                           | FY07E                |                     | 102              | 1          | At Book Value           |
| Gammon Infrastructure           | BOT                       | SOTP                 |                     | 11,703           | 135        | Refer Working Below     |
| Sadbhav Engineering             | Construction              | Market Price (Rs/sh) | 285                 | 314              | 4          | Discount of 25% to CMP  |
| Associated Transrail Structures | Power Transmission Towers | FY08E PER (x)        | 8                   | 1,115            | 13         |                         |
| Gammon and Billimoria Ltd       | Construction              | FY08E PER (x)        | 8                   | 2,250            | 26         |                         |
| <b>Total</b>                    |                           |                      |                     | <b>33,227</b>    | <b>425</b> |                         |

*Ignoring the value of Real Estate; transmission company and Punjab HEP 100MW*

### GIPL'S BOT PORTFOLIO

|  | PROJECTS<br>(NOS) | VALUE<br>(RS M) | REMARKS   |
|--|-------------------|-----------------|---|
| Already Operational                    | 4                 | 8,551           | Rajahmundry Expressway, Andhra Expressway, Vizag Port and Cochin Bridge                     |
| Under Implementation                   | 5                 | 26,830          | Mumbai Nashik Expressway, Sikkim Hydro, Punjab Biomass, Kosi River Bridge, Gorakhpur Bypass |
| Recently Awarded                       | 1                 | 11,800          | Adityapur SEZ   |
| Financial bids submitted               | 7                 | 30,000          |   |
| Qualified for Financial Bid Submission | 10                | 150,000         |   |

*Source: Company*

## Gammon India: an investment profile

### Background

Established in 1919, Gammon India is one of the oldest and largest construction companies in India and is amongst the Top 5 contractors to NHAI. The company possesses pre-qualification skills across most sectors. It is one of the leaders in the BOT space with a history of successful execution. The company is headed by Mr. Abhijit Rajan, who has been the managing director since 1991.

### Key investment arguments

- ✍ Possesses pre-qualifications and proven execution capabilities across sectors; will gain from large ticket sized orders in hydro and nuclear sectors
- ✍ Order Book at end September, 2006 was Rs80b. In addition, order intake for Gammon remained buoyant in 2QFY07 at Rs13b.
- ✍ Early mover advantage and consistent performance track-record in BOT space

### Key investment risks

- ✍ Increased competition may put pressure on operating margins
- ✍ BOT projects depress initial RoE
- ✍ Liabilities associated with delays/ other failures in international projects

### Recent developments

- ✍ To fund growth through investments in BOOT/BOT projects, Gammon Infrastructure Projects (82.5% subsidiary of Gammon India) has announced fund raising plans through IPO.

### Valuations and view

- ✍ Based on SOTP methodology, we arrive at a PT of Rs425/share
- ✍ At the CMP of Rs405, the stock trades at reported PER of 29.8x FY07 and 19.7x FY08E. Maintain **Buy**.

### Sector view

- ✍ Increased government commitment towards infrastructure projects has led to several large projects taking off the ground
- ✍ We notice a trend of margin expansion, driven by changing composition of order book and higher margins at bidding stage
- ✍ BOT ventures could unlock sizable value

#### COMPARATIVE VALUATIONS

|           |       | GAMMON | HCC  | NCC  |
|-----------|-------|--------|------|------|
| P/E (x)   | FY07E | 29.8   | 25.0 | 20.0 |
|           | FY08E | 19.7   | 18.2 | 12.9 |
| P/E (x) * | FY07E | 15.8   | 16.7 | 16.1 |
|           | FY08E | 10.4   | 12.2 | 10.3 |
| P/BV (x)  | FY07E | 3.4    | 2.5  | 1.7  |
|           | FY08E | 3.0    | 2.3  | 1.4  |
| RoE (%)   | FY07E | 11.5   | 12.5 | 18.2 |
|           | FY08E | 15.2   | 13.2 | 24.0 |

#### SHAREHOLDING PATTERN (%)

|               | SEP06 | JUN.06 | SEP05 |
|---------------|-------|--------|-------|
| Promoter      | 31.1  | 32.3   | 36.8  |
| Domestic Inst | 15.9  | 14.6   | 6.8   |
| Foreign       | 37.3  | 37.4   | 34.0  |
| Others        | 15.6  | 15.6   | 22.4  |

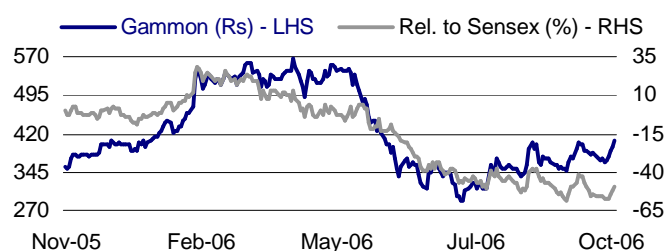
#### EPS: MOST FORECAST VS CONSENSUS (RS)

|      | MOST FORECAST | CONSENSUS FORECAST | VARIATION (%) |
|------|---------------|--------------------|---------------|
| FY07 | 13.6          | 13.2               | 3.0           |
| FY08 | 20.6          | 19.7               | 4.4           |

#### TARGET PRICE AND RECOMMENDATION

| CURRENT PRICE (RS) | TARGET PRICE (RS) | UPSIDE (%) | RECO. |
|--------------------|-------------------|------------|-------|
| 405                | 425               | 5.0        | Buy   |

#### STOCK PERFORMANCE (1 YEAR)



| INCOME STATEMENT                 |              |               |               |               |               | RATIOS                          |              |               |              |               |               |
|----------------------------------|--------------|---------------|---------------|---------------|---------------|---------------------------------|--------------|---------------|--------------|---------------|---------------|
| (Rs Million)                     |              |               |               |               |               |                                 |              |               |              |               |               |
| Y/E MARCH                        | 2004*        | 2006E#        | 2007E         | 2008E         | 2009E         | Y/E MARCH                       | 2004*        | 2006E#        | 2007E        | 2008E         | 2009E         |
| <b>Gross Revenues</b>            | <b>8,666</b> | <b>16,592</b> | <b>21,437</b> | <b>30,600</b> | <b>41,250</b> | <b>Basic (Rs)</b>               |              |               |              |               |               |
| <b>Net Sales</b>                 | <b>8,775</b> | <b>14,851</b> | <b>21,493</b> | <b>30,665</b> | <b>41,315</b> | <b>Adjusted EPS</b>             | <b>6.7</b>   | <b>9.6</b>    | <b>13.6</b>  | <b>20.6</b>   | <b>26.9</b>   |
| Change (%)                       | 4.1          | 15            | 80.9          | 42.7          | 34.7          | Growth (%)                      | 24.7         | 44.1          | 417          | 511           | 30.6          |
| Construction expenses            | 7,593        | 12,521        | 19,012        | 27,013        | 36,365        | Cash EPS                        | 20.6         | 24.0          | 31.7         | 48.9          | 65.5          |
| Office and site establishment ex | 223          | 397           | 522           | 744           | 1,089         | Book Value                      | 51.8         | 106.7         | 118.1        | 135.2         | 157.6         |
| <b>EBITDA</b>                    | <b>959</b>   | <b>1,932</b>  | <b>1,959</b>  | <b>2,907</b>  | <b>3,860</b>  | DPS                             | 0.5          | 0.6           | 2.0          | 3.0           | 4.0           |
| % of Net Sales                   | 10.9         | 11.5          | 9.1           | 9.5           | 9.3           | Payout (incl. Div. Tax.)        | 11.5         | 5.7           | 14.7         | 14.6          | 14.9          |
| Depreciation                     | 165          | 371           | 389           | 451           | 514           | <b>Valuation (x)</b>            |              |               |              |               |               |
| Interest                         | 282          | 471           | 176           | 319           | 518           | P/E (standalone)                | 60.7         | 42.2          | 29.8         | 19.7          | 15.1          |
| Other Income                     | 3            | 21            | 13            | 14            | 15            | Cash P/E                        | 19.7         | 16.9          | 12.8         | 8.3           | 6.2           |
| <b>PBT</b>                       | <b>516</b>   | <b>1,112</b>  | <b>1,407</b>  | <b>2,151</b>  | <b>2,844</b>  | EV/EBITDA                       | 29.3         | 23.0          | 18.0         | 12.3          | 9.3           |
| Tax                              | 134          | 69            | 225           | 366           | 512           | EV/Sales                        | 3.2          | 3.0           | 1.6          | 1.2           | 0.9           |
| Rate (%)                         | 26.1         | 6.2           | 16.0          | 17.0          | 18.0          | Price/Book Value                | 7.8          | 3.8           | 3.4          | 3.0           | 2.6           |
| <b>Reported PAT</b>              | <b>381</b>   | <b>1,043</b>  | <b>1,182</b>  | <b>1,785</b>  | <b>2,332</b>  | Dividend Yield (%)              | 0.1          | 0.1           | 0.5          | 0.7           | 1.0           |
| <b>Adjusted PAT</b>              | <b>381</b>   | <b>1,043</b>  | <b>1,182</b>  | <b>1,785</b>  | <b>2,332</b>  | <b>Profitability Ratios (%)</b> |              |               |              |               |               |
| Change (%)                       | 173.9        | 64.0          | 417           | 511           | 30.6          | RoE                             | 12.9         | 9.0           | 11.5         | 15.2          | 17.1          |
|                                  |              |               |               |               |               | RoCE                            | 17.6         | 13.6          | 13.3         | 19.0          | 22.8          |
|                                  |              |               |               |               |               | <b>Turnover Ratios</b>          |              |               |              |               |               |
|                                  |              |               |               |               |               | Debtors (Days)                  | 73           | 65            | 65           | 65            | 65            |
|                                  |              |               |               |               |               | Creditors. (Days)               | 108          | 70            | 70           | 70            | 70            |
|                                  |              |               |               |               |               | <b>Leverage Ratio</b>           |              |               |              |               |               |
|                                  |              |               |               |               |               | Debt/Equity (x)                 | 0.8          | 0.2           | 0.2          | 0.1           | 0.1           |
|                                  |              |               |               |               |               | <b>CASH FLOW STATEMENT</b>      |              |               |              |               |               |
|                                  |              |               |               |               |               | (Rs Million)                    |              |               |              |               |               |
|                                  |              |               |               |               |               | Y/E MARCH                       | 2004*        | 2006E#        | 2007E        | 2008E         | 2009E         |
|                                  |              |               |               |               |               | PBT before Extraordinary Items  | 516          | 1,112         | 1,407        | 2,151         | 2,844         |
|                                  |              |               |               |               |               | Add : Depreciation              | 165          | 371           | 389          | 451           | 514           |
|                                  |              |               |               |               |               | Interest                        | 282          | 471           | 176          | 319           | 518           |
|                                  |              |               |               |               |               | Less : Direct Taxes Paid        | 134          | 69            | 225          | 366           | 512           |
|                                  |              |               |               |               |               | (Inc)/Dec in WC                 | -1,804       | -2,543        | -214         | -1,504        | -1,667        |
|                                  |              |               |               |               |               | <b>CF from Operations</b>       | <b>-977</b>  | <b>-659</b>   | <b>1,533</b> | <b>1,052</b>  | <b>1,697</b>  |
|                                  |              |               |               |               |               | (Inc)/Dec in FA                 | -436         | -97           | -800         | -1,000        | -1,000        |
|                                  |              |               |               |               |               | (Pur)/Sale of Investments       | -91          | -266          | 4            | 0             | 0             |
|                                  |              |               |               |               |               | <b>CF from Investments</b>      | <b>-527</b>  | <b>-1,182</b> | <b>-796</b>  | <b>-1,000</b> | <b>-1,000</b> |
|                                  |              |               |               |               |               | (Inc)/Dec in Networth           | 1,429        | 4,312         | 0            | 0             | 0             |
|                                  |              |               |               |               |               | (Inc)/Dec in Debt               | 849          | -1,326        | 136          | -400          | 500           |
|                                  |              |               |               |               |               | Less : Interest Paid            | 282          | 471           | 176          | 319           | 518           |
|                                  |              |               |               |               |               | Dividend Paid                   | 44           | 60            | 198          | 297           | 396           |
|                                  |              |               |               |               |               | <b>CF from Fin. Activity</b>    | <b>1,953</b> | <b>2,455</b>  | <b>-238</b>  | <b>-1,016</b> | <b>-414</b>   |
|                                  |              |               |               |               |               | <b>Inc/Dec of Cash</b>          | <b>448</b>   | <b>615</b>    | <b>499</b>   | <b>-964</b>   | <b>283</b>    |
|                                  |              |               |               |               |               | Add: Beginning Balance          | 280          | 728           | 1,343        | 1,842         | 877           |
|                                  |              |               |               |               |               | <b>Closing Balance</b>          | <b>728</b>   | <b>1,343</b>  | <b>1,842</b> | <b>877</b>    | <b>1,160</b>  |

E: MOST Estimates; \* Nine months ended Dec 2004,

#Fifteen months ended Mar 2006

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| <b>Disclosure of Interest Statement</b>                 | <b>Gammon India</b> |
|---|---------------------|
| 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                  |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.