

October 19, 2011

| | |
|--------------------------|----------------------|
| Reco | Previous Reco |
| Accumulate | Reduce |
| CMP | Target Price |
| Rs1,985 | Rs 2,250 |
| EPS change FY12E/13E (%) | 5 /5 |
| Target Price change (%) | 5 |
| Nifty | 5,038 |
| Sensex | 16,748 |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|---------------|------|----|----|-----|
| Absolute | (10) | 9 | 12 | 10 |
| Rel. to Nifty | (9) | 21 | 27 | 32 |

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

| | |
|-----------------------------|-------------|
| Sector | Automobiles |
| Bloomberg | HMCL@IN |
| Equity Capital (Rs mn) | 399 |
| Face Value(Rs) | 2 |
| No of shares o/s (mn) | 200 |
| 52 Week H/L | 2,232/1,378 |
| Market Cap (Rs bn/USD mn) | 396/8,035 |
| Daily Avg Volume (No of sh) | 572710 |
| Daily Avg Turnover (US\$m) | 23.0 |

Shareholding Pattern (%)

| | Sep-11 | Jun-11 | Mar-11 |
|--------------|--------|--------|--------|
| Promoters | 52.2 | 52.2 | 52.2 |
| FII/NRI | 34.9 | 33.8 | 32.9 |
| Institutions | 4.2 | 4.6 | 5.2 |
| Private Corp | 1.6 | 1.7 | 1.9 |
| Public | 7.1 | 7.8 | 7.8 |

Source: Capitaline

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- **Results above est. with EBIDTA at 7.1bn (est of Rs 6.8bn) and APAT of Rs 6bn (est. of Rs 5.7bn). Surprised by high treasury income despite a 25% drop in treasury book**
- **Demand outlook remains robust. Revise our FY12/13 EPS est. upwards by 5%/5% to 123/145 due to higher volumes. Upgrade FY12/FY13 by volumes by 2% to 6.35mn/7.1mn units**
- **Factoring in full capacity utilization for 2HFY12 (~13% volume growth in 2H). Capacity ramp up can result in further volume upgrades for FY12**
- **Upgrade rating to ACCUMULATE and revise our TP to Rs2,250 (FY13 PER 15.5x). Continue to have concerns with concentrated product portfolio/ lack of clarity on R&D**

Net Sales – Marginally above est.

Net sales at Rs 58.3bn was marginally ahead of our est. of Rs 57.8bn. Average selling price for the quarter at Rs 37,747 (up 6.6% YoY and 1.6% QoQ) benefited from price hike of Rs 500-700 taken during end June and improved product mix.

| Product Mix % | Q2FY11 | Q3FY11 | Q4FY11 | Q1FY12 | Q2FY12 |
|--------------------|------------------|------------------|------------------|------------------|------------------|
| Motorcycle (Dom) | 93.8 | 93.5 | 92.8 | 93.4 | 93.5 |
| Scooters (Dom) | 6.2 | 6.5 | 7.2 | 6.6 | 6.5 |
| Total (Dom) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Exports | 2.7 | 2.7 | 2.0 | 2.6 | 2.6 |
| Domestic | 97.3 | 97.3 | 98.0 | 97.4 | 97.4 |
| Units Sold | 1,285,934 | 1,428,030 | 1,454,431 | 1,529,577 | 1,544,315 |

| Product Mix % | Q2FY11 | Q3FY11 | Q4FY11 | Q1FY12 | Q2FY12 |
|------------------------------|--------|--------|--------|--------|--------|
| Motorcycle (Domestic) | | | | | |
| Economy | 14.9 | 14.1 | 14.3 | 13.7 | 14.3 |
| Executive | 78.6 | 79.1 | 77.9 | 80.4 | 79.1 |
| Premium | 6.5 | 6.8 | 7.8 | 5.9 | 6.6 |

Source: SIAM, Emkay research

Adjusted EBIDTA ~5% above est.

EBIDTA (adjusted for royalty amortization) came at Rs 7.1bn vs our est. of Rs 6.8bn. EBIDTA margins stood at 12.3% vs our est. of 11.8%. This was largely driven by lower RM costs. RM to sales at 72.5% was significantly lower than our est of 74%. Staff costs at Rs 1.8bn was in line with our est. Other expenses at Rs 6.8 bn (vs our est. of Rs 6.5bn) was impacted by promotion/rebranding costs. Royalty amortization stood at Rs 2bn (Rs 1.77bn royalty and Rs 270mn for MTM due to adverse currency)

Financial Snapshot

| YE- | Net Sales | EBITDA (Core) | EBITDA (%) | APAT | EPS (Rs) | EPS % chg | RoE (%) | P/E | EV/ EBITDA | P/BV |
|-------|-----------|---------------|------------|--------|----------|-----------|---------|------|------------|------|
| Mar | | | | | | | | | | |
| FY10 | 157,702 | 26,620 | 16.9 | 22,318 | 111.8 | 74.0 | 61.4 | 17.8 | 12.7 | 11.4 |
| FY11 | 192,585 | 22,832 | 11.9 | 20,077 | 100.5 | (10.0) | 62.5 | 19.7 | 15.1 | 13.4 |
| FY12E | 236,229 | 27,583 | 11.7 | 24,537 | 122.9 | 22.2 | 77.0 | 16.2 | 12.5 | 11.6 |
| FY13E | 270,842 | 33,455 | 12.4 | 29,028 | 145.4 | 18.3 | 80.6 | 13.7 | 10.2 | 10.5 |

Source: Company, Emkay Research

Quarterly Summary

| Rs mn | Q2FY11 | Q3FY11 | Q4FY11 | Q1FY12 | Q2FY12 | YoY(%) | QoQ(%) | YTD'12 | YTD'11 | YoY(%) |
|--------------------------------|---------------|---------------|---------------|---------------|---------------|-------------|-------------|----------------|---------------|-------------|
| Revenue | 45,520 | 51,617 | 53,909 | 56,833 | 58,293 | 28.1 | 2.6 | 115,127 | 88,486 | 30.1 |
| Expenditure | 39,440 | 45,850 | 47,381 | 50,427 | 51,147 | 29.7 | 1.4 | 101,574 | 76,381 | 33.0 |
| <i>as % of sales</i> | 86.6 | 88.8 | 87.9 | 88.7 | 87.7 | | | 88.2 | 86.3 | |
| Consumption of RM | 33,100 | 38,149 | 39,269 | 42,448 | 42,237 | 27.6 | (0.5) | 84,685 | 63,694 | 33.0 |
| <i>as % of sales</i> | 72.7 | 73.9 | 72.8 | 74.7 | 72.5 | | | 73.6 | 72.0 | |
| Employee Cost | 1,498 | 1,560 | 1,680 | 1,645 | 1,794 | 19.7 | 9.0 | 3,439 | 2,948 | 16.6 |
| <i>as % of sales</i> | 3.3 | 3.0 | 3.1 | 2.9 | 3.1 | | | 3.0 | 3.3 | |
| Other expenditure | 4,842 | 6,141 | 6,432 | 6,334 | 7,116 | 47.0 | 12.3 | 13,450 | 9,739 | 38.1 |
| <i>as % of sales</i> | 10.6 | 11.9 | 11.9 | 11.1 | 12.2 | | | 11.7 | 11.0 | |
| EBITDA | 6,079 | 5,767 | 6,528 | 6,407 | 7,146 | 17.5 | 11.5 | 13,553 | 12,105 | 12.0 |
| Depreciation | 608 | 560 | 603 | 627 | 744 | 22.5 | 18.7 | 1,371 | 1,090 | 25.7 |
| EBIT | 5,472 | 5,207 | 5,925 | 5,780 | 6,402 | 17.0 | 10.8 | 12,182 | 11,015 | 10.6 |
| Other Income | 784 | 620 | 743 | 884 | 798 | 1.8 | (9.8) | 1,682 | 1,318 | 27.6 |
| Interest | (21) | (52) | 81 | (32) | (45) | 116.9 | 41 | (77) | (47) | 62.4 |
| PBT | 6,276 | 5,880 | 6,588 | 6,696 | 7,245 | 15.4 | 8.2 | 13,940 | 12,380 | 12.6 |
| Total Tax | 1,220 | 790 | 1,572 | 1,117 | 1,208 | (1.0) | 8.2 | 2,325 | 2,407 | (3.4) |
| Adjusted PAT | 5,056 | 5,089 | 5,016 | 5,579 | 6,036 | 19.4 | 8.2 | 11,615 | 9,973 | 16.5 |
| (Profit)/loss from JV's/Ass/MI | | | | | | | | - | - | |
| Adj. PAT after MI | 5,056 | 5,089 | 5,016 | 5,579 | 6,036 | 19.4 | 8.2 | 11,615 | 9,973 | 16.5 |
| Extra ordinary items | - | (798) | - | - | - | - | - | - | - | - |
| Reported PAT | 5,056 | 4,291 | 5,016 | 5,579 | 6,036 | 19.4 | 8.2 | 11,615 | 9,973 | 16.5 |
| Reported EPS | 25.3 | 21.5 | 25.1 | 27.9 | 30.2 | 19.4 | 8.2 | 58.2 | 49.9 | 16.5 |

| Margins (%) | | | | | | (bps) | (bps) | | | (bps) |
|--------------------|------|------|------|------|------|-------|-------|------|------|-------|
| EBIDTA | 13.4 | 11.2 | 12.1 | 11.3 | 12.3 | (110) | 99 | 11.8 | 13.7 | (191) |
| EBIT | 12.0 | 10.1 | 11.0 | 10.2 | 11.0 | (104) | 81 | 10.6 | 12.4 | (187) |
| EBT | 13.8 | 11.4 | 12.2 | 11.8 | 12.4 | (136) | 65 | 12.1 | 14.0 | (188) |
| PAT | 11.1 | 9.9 | 9.3 | 9.8 | 10.4 | (75) | 54 | 10.1 | 11.3 | (118) |
| Effective Tax rate | 19.4 | 13.4 | 23.9 | 16.7 | 16.7 | (276) | 0 | 16.7 | 19.4 | (276) |

| Per Vehicle Analysis | | | | | | | | | | |
|----------------------|--------|--------|--------|--------|--------|-------|-------|--------|--------|-------|
| Revenue | 35,398 | 36,145 | 37,066 | 37,156 | 37,747 | 6.6 | 1.6 | 20,961 | 18,828 | 11.3 |
| RM | 25,740 | 26,714 | 26,999 | 27,751 | 27,350 | 6.3 | (1.4) | 15,419 | 13,553 | 13.8 |
| Staff Cost | 1,165 | 1,092 | 1,155 | 1,076 | 1,161 | (0.3) | 8.0 | 626 | 627 | (0.2) |
| Other exp. | 3,765 | 4,301 | 4,422 | 4,141 | 4,608 | 22.4 | 11.3 | 2,449 | 2,072 | 18.2 |
| EBITDA | 4,728 | 4,038 | 4,489 | 4,189 | 4,627 | (2.1) | 10.5 | 2,468 | 2,576 | (4.2) |
| PAT | 3,932 | 3,564 | 3,449 | 3,647 | 3,909 | (0.6) | 7.2 | 2,115 | 2,122 | (0.3) |

Source: Company, Emkay Research

APAT at Rs 6bn, ~6% above est.

APAT at Rs 6bn was ahead of our est. of Rs 5.7bn. Improved operating performance and higher other income led to above est. PAT. Other income plus interest income at Rs 798mn was above our est. of Rs 650 mn. This is despite a 25% decline in treasury book due to dividend payout. Depreciation expense at Rs 744 mn was marginally higher than our est.. Tax rate at 16.7% was in line with our est..

Revision in estimates

We upgrade our FY12 volumes by 2% to 6.35mn units due to capacity ramp up and strong demand. We have factored in average run rate of 545,000 units per month in H2FY12, which is the current capacity. We do not rule out volume upgrades due to further capacity ramp up. Management indicated that they have a capacity to assemble 7 mn units p.a. (current capacity stand at 6.4 mn units p.a.). We retain our FY13 volume growth est. of 12%. We increase royalty amortization to Rs 2bn from Q2FY12 onwards driven by mark-to-market impact of unhedged royalty exposure. We upgrade our FY12/FY13 EPS estimate by 5.3%/5.2% to Rs 122.9/Rs 145.4.

| Rs mn | FY12E | | | FY13E | | |
|--------------------|-----------|-----------|----------|-----------|-----------|----------|
| | Earlier | Revised | % Change | Earlier | Revised | % Change |
| Volumes | 6,228,852 | 6,354,303 | 2.0 | 7,001,707 | 7,142,510 | 2.0 |
| Sales | 230,888 | 236,229 | 2.3 | 264,081 | 270,842 | 2.6 |
| EBIDTA | 26,428 | 27,583 | 4.4 | 32,060 | 33,455 | 4.4 |
| EBIDTA margins (%) | 11.4 | 11.7 | | 12.1 | 12.4 | |
| Net Profits | 23,303 | 24,537 | 5.3 | 27,603 | 29,028 | 5.2 |
| EPS | 116.7 | 122.9 | 5.3 | 138.2 | 145.4 | 5.2 |

Source: Emkay Research

Valuations and View

At CMP of Rs 1,985, the stock trades at PER of 16.2x/13.7x and EV/EBIDTA of 12.5x/10.2x our FY12/FY13 estimates. We raise our target price to Rs 2,250 implying PER of 18.3x/15.5x PER and EV/EBITDA of 14.5/11.8x our FY12/FY13 estimates. We upgrade our rating to ACCUMULATE with ~13% upside from current levels.

Key extracts from conference call

- Demand outlook remains robust, especially in the rural India. Maintain industry growth estimate of ~15% for FY12.
- Current capacity is 6.4mn units. Company is looking to further increase the capacity over next 6 months. It has a capacity to assemble 7 mn units p.a.. Haridwar production stands at ~8,000 units per day which can be increased to ~9,500 units per day in the next 6 months.
- Commodity prices have stabilized/softened. Expect them to soften further in H2FY12.
- Raw material sourcing is primarily done through vendors. Contract duration of vendors vary from 1 month to medium term. Broadly, there is a lag of one quarter for impact of movement in RM prices on margins
- Company has incurred majority of the promotion/rebranding related costs of Rs 1bn in this quarter. Thus, H2FY12 to witness limited advertisement related spends.
- Forex exposure: Hedging policy in place to hedge Yen exposure. Current royalty exposure remains unhedged. Company has given instruction to banks to hedge its exposure at JPY/USDF of 80. Expect the worst is behind for currency and expect positive MTM in financials from next quarter.
- Capex target revised downwards to Rs ~6 bn for FY12. Capex of Rs 1.25 bn completed till date
- Expect announcements related to new plant to come through in this quarter. Targets new plant to be commissioned by Q3/Q4FY13.
- Focused ramp up in new dealerships to continue with a target of ~5,000 touch points by FY12 from ~4,500 in FY11.
- Exports – The cross functional team for exports has finalized three things – understanding of target markets (LatAm, SEA, Africa) in terms of prices points, segments, product gaps, etc. IT has been approached for distribution/assembly. Finalized the strategic roadmap for entry and distribution of exports. Have set a target of 1 mn units (10% of total volumes) over next 5 to 6 years. Does not expect to provide support to the distribution partners in export markets, except for investment in assembly operations.

Financials

Income Statement

| Y/E, Mar (Rs. mn) | FY10 | FY11 | FY12E | FY13E |
|----------------------------------|----------------|----------------|----------------|----------------|
| Net Sales | 157,702 | 192,585 | 236,229 | 270,842 |
| Growth (%) | 27.9 | 22.1 | 22.7 | 14.7 |
| Expenditure | 131,082 | 169,754 | 208,646 | 237,387 |
| Materials Consumed | 107,484 | 141,246 | 173,347 | 197,602 |
| Employee Cost | 5,603 | 6,190 | 7,065 | 8,139 |
| Other Exp | 17,995 | 22,318 | 28,233 | 31,646 |
| EBITDA | 26,620 | 22,832 | 27,583 | 33,455 |
| Growth (%) | 55.7 | (14.2) | 20.8 | 21.3 |
| EBITDA margin (%) | 16.9 | 11.9 | 11.7 | 12.4 |
| Depreciation | 1,915 | 2,253 | 2,870 | 2,897 |
| EBIT | 24,705 | 20,579 | 24,714 | 30,557 |
| EBIT margin (%) | 15.7 | 10.7 | 10.5 | 11.3 |
| Other Income | 3,406 | 4,249 | 4,567 | 4,641 |
| Interest expenses | (206) | (19) | (176) | (202) |
| PBT | 28,317 | 24,846 | 29,457 | 35,400 |
| Tax | 5,999 | 4,769 | 4,919 | 6,372 |
| Effective tax rate (%) | 21.2 | 19.2 | 16.7 | 18.0 |
| Adjusted PAT | 22,318 | 20,077 | 24,537 | 29,028 |
| Growth (%) | 74.1 | (10.0) | 22.2 | 18.3 |
| Net Margin (%) | 14.2 | 10.4 | 10.4 | 10.7 |
| (Profit)/loss from JV's/Ass/MI | - | - | - | - |
| Adj. PAT After JVs/Ass/MI | 22,318 | 20,077 | 24,537 | 29,028 |
| E/O items | - | (798) | - | - |
| Reported PAT | 22,318 | 19,279 | 24,537 | 29,028 |
| Growth (%) | 74.1 | (10.0) | 22.2 | 18.3 |

Cash Flow

| Y/E, Mar (Rs. mn) | FY10 | FY11 | FY12E | FY13E |
|------------------------------|-----------------|----------------|-----------------|-----------------|
| PBT (Ex-Other income) | 24,911 | 20,597 | 24,889 | 30,759 |
| Depreciation | 1,915 | 2,253 | 2,870 | 2,897 |
| Interest Provided | (206) | (19) | (176) | (202) |
| Other Non-Cash items | (19,726) | (3,739) | - | - |
| Chg in working cap | 25,971 | 8,557 | 434 | (700) |
| Tax paid | (5,999) | (4,769) | (4,919) | (6,372) |
| Operating Cashflow | 26,866 | 22,881 | 23,098 | 26,382 |
| Capital expenditure | (1,623) | (28,645) | (8,799) | (2,000) |
| Free Cash Flow | 25,243 | (5,764) | 14,300 | 24,382 |
| Other income | 3,406 | 4,249 | 4,567 | 4,641 |
| Investments | (5,570) | (12,030) | 3,000 | (1,000) |
| Investing Cashflow | (3,653) | 15,422 | 7,567 | 3,641 |
| Equity Capital Raised | - | - | - | - |
| Loans Taken / (Repaid) | (125) | (333) | (200) | - |
| Interest Paid | 206 | 19 | 176 | 202 |
| Dividend paid (incl tax) | (25,676) | (24,369) | (19,963) | (25,303) |
| Income from investments | - | - | - | - |
| Others | 4,501 | 14,792 | - | - |
| Financing Cashflow | (21,093) | (9,892) | (19,987) | (25,101) |
| Net chg in cash | 497 | (234) | 1,880 | 2,922 |
| Opening cash position | 2,196 | 19,072 | 715 | 2,595 |
| Closing cash position | 2,693 | 18,838 | 2,595 | 5,518 |

The difference between the closing cash as per balance sheet and as per cash flow is due to cash credit balances

Note: The balance sheet details for FY11 to FY13E is excluding the recognition of asset and liability pertaining to royalty adjustment of Rs 23bn which shall be nullified over 14 quarters ending June 2014

Balance Sheet

| Y/E, Mar (Rs. mn) | FY10 | FY11 | FY12E | FY13E |
|-------------------------------|-----------------|-----------------|-----------------|-----------------|
| Equity share capital | 399 | 399 | 399 | 399 |
| Reserves & surplus | 34,251 | 29,161 | 33,736 | 37,461 |
| Net worth | 34,650 | 29,561 | 34,135 | 37,861 |
| Minority Interest | - | - | - | - |
| Secured Loans | - | - | - | - |
| Unsecured Loans | 660 | 327 | 127 | 127 |
| Loan Funds | 660 | 327 | 127 | 127 |
| Net deferred tax liability | 1,528 | 17,052 | 9,158 | 995 |
| Total Liabilities | 36,838 | 46,940 | 43,421 | 38,982 |
| Gross Block | 27,510 | 55,385 | 62,385 | 64,385 |
| Less: Depreciation | 10,922 | 14,582 | 25,345 | 36,406 |
| Net block | 16,588 | 40,803 | 37,039 | 27,978 |
| Capital work in progress | 481 | 1,251 | 3,050 | 3,050 |
| Investment | 39,257 | 51,288 | 48,288 | 49,288 |
| Current Assets | 28,826 | 15,046 | 26,869 | 33,330 |
| Inventories | 4,364 | 5,249 | 6,944 | 7,959 |
| Sundry debtors | 1,084 | 1,306 | 8,333 | 9,551 |
| Cash & bank balance | 19,072 | 715 | 2,595 | 5,518 |
| Loans & advances | 4,058 | 7,287 | 8,938 | 10,244 |
| Other current assets | 248 | 489 | 59 | 59 |
| Current lia & Prov | 48,314 | 61,448 | 71,825 | 74,664 |
| Current liabilities | 38,051 | 50,637 | 60,021 | 61,135 |
| Provisions | 10,264 | 10,811 | 11,803 | 13,529 |
| Net current assets | (19,488) | (46,402) | (44,956) | (41,333) |
| Misc. exp | - | - | - | - |
| Total Assets | 36,838 | 46,940 | 43,421 | 38,982 |

Key Ratios

| Y/E, Mar | FY10 | FY11 | FY12E | FY13E |
|----------------------------|---------|---------|---------|---------|
| Profitability (%) | | | | |
| EBITDA Margin | 16.9 | 11.9 | 11.7 | 12.4 |
| Net Margin | 14.2 | 10.4 | 10.4 | 10.7 |
| ROCE | 72.9 | 59.3 | 64.8 | 85.4 |
| ROE | 61.4 | 62.5 | 77.0 | 80.6 |
| RoIC | (262.5) | (145.5) | (293.8) | (208.0) |
| Per Share Data (Rs) | | | | |
| EPS | 111.8 | 100.5 | 122.9 | 145.4 |
| CEPS | 121.3 | 111.8 | 137.2 | 159.9 |
| BVPS | 173.5 | 148.0 | 170.9 | 189.6 |
| DPS | 110.0 | 105.0 | 86.0 | 109.0 |
| Valuations (x) | | | | |
| PER | 20.1 | 22.4 | 18.3 | 15.5 |
| P/CEPS | 18.5 | 20.1 | 16.4 | 14.1 |
| P/BV | 13.0 | 15.2 | 13.2 | 11.9 |
| EV / Sales | 2.5 | 2.1 | 1.7 | 1.5 |
| EV / EBITDA | 14.7 | 17.4 | 14.5 | 11.8 |
| Dividend Yield (%) | 4.9 | 4.7 | 3.8 | 4.8 |
| Gearing Ratio (x) | | | | |
| Net Debt/ Equity | (1.7) | (1.7) | (1.5) | (1.4) |
| Net Debt/EBITDA | (2.2) | (2.3) | (1.8) | (1.6) |
| Working Cap Cycle (days) | (75.5) | (83.5) | (69.1) | (58.8) |

Recommendation History: Hero MotoCorp – HMCL IN

| Date | Reports | Reco | CMP | Target |
|------------|---|--------|-------|--------|
| 21/07/2011 | Hero Honda Q1FY12 Result Update | Hold | 1,789 | 1,840 |
| 04/05/2011 | Hero Honda Q4FY11 Result Update | Hold | 1,600 | 1,775 |
| 08/04/2011 | Hero Honda Management Meet Update | Reduce | 1,695 | 1,590 |
| 02/02/2011 | Hero Honda Q3FY11 Result Update | Reduce | 1,523 | 1,540 |

Recent Research Reports

| Date | Reports | Reco | CMP | Target |
|------------|--|-----------|-----|--------|
| 07/09/2011 | Auto Sector Report Cruising through barriers | | | |
| 11/08/2011 | Tata Motors Q1FY12 Conso Result Update | Buy | 846 | 1,230 |
| 11/08/2011 | Apollo Tyres Q1FY12 Result Update | Reduce | 67 | 66 |
| 10/08/2011 | Escorts 3QSY11 Result Update | Not Rated | 79 | NR |

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