

Result Update

CMP : INR 282
Rating : Buy
Target : INR 328

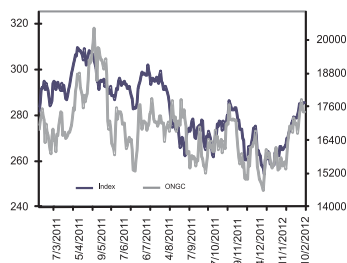
KEY DATA

Market Cap (INR bn)	2495.7
Market Cap (USD bn)	50.7
52 WK High / Low	325 / 226
Avg Daily Volume (BSE)	356711
Face Value (INR)	5

BSE Sensex	17749
Nifty	5382
BSE Code	500312
NSE Code	ONGC
Reuters Code	ONGC.BO
Bloomberg Code	ONGC IN

Shareholding %	1Q	2Q	3Q
Promoters	74.0	74.0	74.0
MF/Banks/Indian FIs	7.0	7.0	7.0
FII/ NRIs/ OCBs	5.0	5.0	5.0
Indian Public	14.0	14.0	14.0

Performance Chart



PRICE PERFORMANCE (%)

	3 M	6 M	12 M
Absolute	3.8	0.6	2.8
Relative	1.5	(3.0)	1.2

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ONGC

In Q3FY12, Oil and Natural Gas Corporation (ONGC.IN) (ONGC.BO) results were below our estimates both on the top line as well as bottom line front on account of higher than expected subsidy burden for the company.

Increase in subsidy drags the profit down but Cairn India's royalty adjustment saves the day...

ONGC revenue declined 11% Y-o-Y and 19.2% sequentially to Rs.185.2 bn while PAT declined 4.8% Y-o-Y and 22% sequentially to Rs.67.4 bn. The company's adjusted PAT declined 33% Y-o-Y and 45% sequentially to Rs.47.5 bn. Revenue and PAT were below our estimates on account of higher than expected subsidy burden. ONGC subsidy burden increased 197% Y-o-Y and 119% sequentially to Rs. 125.3 bn on account of increase in the subsidy sharing of upstream oil companies.

Oil and gas production to increase on account of IOR/EOR projects, marginal field development and ramp up in Rajasthan field production...

In Q3 FY12, ONGC's crude output declined 4.1% Y-o-Y and 1.4% sequentially to 6.74 mmt which was marginally lower than our assumption while gas production increased 0.8% Y-o-Y and 0.3% sequentially to 6.4 bcm which was in line with our estimates. We expect ONGC crude oil and gas production to increase on account of increase in production at the Rajasthan field coupled with increase in production at the marginal fields and IOR/EOR projects which will more than compensate for the natural decline in nomination fields. It should be noted that the company target to produce 28.76 mmt (domestic: 25.04 mmt and JV: 3.72 bcm) of oil and 27.02 bcm (domestic: 24.87mmt and JV: 2.14 bcm) of gas in FY13. The company expects oil production to increase from 24.4 mn tonnes in FY11 to 27-28 mn tonnes in FY14.

Production hiccups at OVL but high crude oil prices for rescue...

We cut down production estimates at OVL to 8.8 mmtoe and 8.7 mmtoe for FY12E and FY13E respectively in line with the company's target on account of decline in production at blocks in Syria and Sudan. However, we note that, OVL's crude oil realization exhibits direct correlation with Brent crude oil prices. For the last three years, OVL's crude oil realization stood at around 10% discount to the Brent crude oil prices.

Uncertainty over Subsidy mechanism will remain a drag...

For 9M FY12, the share of subsidy of upstream oil companies increased to 37.9% as against 33.3% in HF1Y12 and 38.8% in FY11. The uncertainty over the subsidy sharing mechanism will continue to be a drag on the stock. We increase subsidy burden to Rs. 1,362 bn and Rs.988 bn, as against the earlier estimates of Rs. 1,168 bn and Rs. 820 bn for FY12E and FY13E respectively, to factor in higher than expected crude oil prices and depreciation in the rupee vis-à-vis dollar. We increase the subsidy share of upstream companies to 40% on account of a weaker fiscal position of the government.

Valuation

We revise EPS estimates to Rs. 29.5 and Rs. 32.6 as against the earlier estimates of Rs. 31.6 and 34.0 for FY12E and FY13E respectively to account for increase in the gross under recoveries of OMCs, change in subsidy sharing mechanism and a lower production volume at OVL. At CMP, ONGC is trading at 9.5x FY12E and 8.6x FY13E EPS of Rs. 29.5 and Rs. 32.6 respectively and at an EV/EBIDTA of 4.0x FY12E and 3.4x FY13E. We value ONGC standalone business at Rs.263 per share at a EV/ EBIDTA of multiple 4x and OVL at Rs.48 per share at EV/ boe of \$5 per bbl for its 2P reserves. We value investments at Rs 17 per share, a 20% discount to the market value. We maintain buy rating on the stock and based on sum-of-parts valuation (SOTP), we arrive at a revised fair value of Rs.328 (earlier target price of Rs. 331 per share), implying a 16.4% upside from the current levels and a 30% upside from our initiating price of Rs. 252 per share.

Quarterly Result Analysis

(YE March 31) (Rs. bn)	Q3 FY12	Q3 FY11	% change Y-o-Y	Q2 FY12	% change Q-o-Q	9M FY12	9M FY11	% change Y-o-Y
Total Revenue	185.2	208	-11.00%	229.3	-19.20%	578.4	530.6	9.00%
Net Raw Materials	1.2	1.9	-33.90%	1.4	-11.10%	3.4	3.8	-9.70%
Royalty and Cess	38.7	38.9	-0.40%	46.5	-16.80%	122.5	106.2	NM
Personnel Expenses	3.4	2.9	15.70%	3.3	2.90%	9.7	8.8	11.20%
Miscellaneous Expenses	31.3	29.1	7.80%	33.4	-6.00%	92.8	81.3	14.20%
Total Cost	74.7	72.7	2.70%	84.6	-11.70%	228.5	200.1	14.20%
EBIDTA	110.5	135.3	-18.30%	144.7	-23.60%	349.9	330.5	5.90%
Less: Depreciation	45.3	36.4	24.50%	32.8	38.20%	119.3	111.6	7.00%
EBIT	65.2	98.9	-34.10%	111.9	-41.70%	230.6	218.9	5.30%
Less: Interest	0.02	0.1	-65.80%	0.07	-71.50%	0.1	0.1	36.10%
Other Income	9.6	6.7	43.20%	11.3	-15.40%	28.2	19.8	42.10%
Extraordinary Income	31.4	0		0		31.4	0	
PBT	106.2	105.5	1%	123.2	-13.80%	290	238.6	21.50%
Less: Total Tax	38.8	34.7	11.70%	36.7	5.50%	95.3	77.3	23.20%
Profit After Tax	67.4	70.8	-4.80%	86.4	-22.00%	194.8	161.3	20.70%
Profit After Tax excl Extra ordinary	47.5	70.8	-33.00%	86.4	-45.10%	174.8	161.3	8.40%
Adjusted no. of Sh. Outstanding (bn)	8.56	8.55		8.56		8.56	8.55	
Diluted EPS (In. Rs.)	7.9	8.3	-4.90%	10.1	-22.00%	22.8	18.9	20.60%
Diluted EPS Excl. extraordinary (Rs.)	5.5	8.3	-33.00%	10.1	-45.10%	20.4	18.9	8.20%

Margin Analysis			Change in Bps		Change in Bps			Change in Bps
EBIDTA Margin (%)	59.70%	65.00%	-536.3	63.10%	-343.3	60.50%	62.30%	-179.6
EBIT (%)	35.20%	47.50%	-1,233.70	48.80%	-1,360.80	39.90%	41.30%	-139.9
PBT Margin (%)	57.30%	50.70%	660.6	53.70%	361.2	50.10%	45.00%	516.3
NPM (%)	36.40%	34.00%	235.9	37.70%	-129.1	33.70%	30.40%	326.7
Effective Tax Rate (%)	36.50%	32.90%	361.7	29.80%	667.1	32.80%	32.40%	44.6

NA - Not Applicable

NM - Not Meaningful

- In Q3 FY12, ONGC's crude output declined 4.1% Y-o-Y and 1.4% sequentially to 6.74 mmt, though the company's natural gas production increased 0.8% Y-o-Y and 0.3% sequentially to 6.4 bcm. Moreover, there was an increase 4.1% Y-o-Y and 0.1% sequentially in the value added products production to 0.81 mmt.
- The gross realization for crude sold increased 25.4% Y-o-Y but declined 4.5% sequentially to \$111.7/bbl, on account of a sequential decline in benchmark crude oil prices.
- ONGC's subsidy share increased 196.9% Y-o-Y and 119.4% sequentially to Rs.125.3 bn, with the sequential rise being driven by increase in the subsidy share contribution of the upstream oil companies (ONGC, OIL and GAIL) coupled with increase in the gross under recoveries for the quarter.

- In Q3FY12, upstream oil companies shared 47% of the gross under recovery of 324.1 bn taking the total share of upstream oil companies to 37.91% for 9M FY12, as the upstream oil companies had shared one-third of the gross under recoveries in H1FY12. The net crude oil realization of the company declined 30.6% Y-o-Y and 46.3% sequentially to \$45/bbl as a result of increase in the subsidy sharing.
- In the quarter, subsidy share of ONGC amongst the upstream oil companies increased to 82.2% as against 80.2% in Q2FY12.
- EBDITA margin declined 536 bps Y-o-Y and 343 sequentially to Rs.59.7%, primarily on account of decline in the net crude oil realization.
- **Depreciation, depletion and amortization (D,D and A) costs increased 24.5% Y-o-Y and 38.2% sequentially to Rs.45.3 bn on account of a 50.6% Y-o-Y and 73.4% sequential increase in the dry well cost to Rs. 20.5 bn and a 32.8% Y-o-Y and 22.3% sequential increase in the depletion charges to 18.3 bn.**
- In the quarter, the effective tax rate of the company increased 362 bps Y-o-Y and 667 bps sequentially to 36.5%. Company reported one time exceptional income of Rs. 31.4 bn to factor in the company's royalty payment on Rajasthan field production till Q2FY12.
- Adjusted PAT declined 33.0% Y-o-Y and 45.1% sequentially to 47.5 bn primarily on account of a weaker operating performance coupled with a higher DDA charges while net PAT declined 4.8% Y-o-Y and 22% sequentially to 67.4 bn.

Gross under recoveries of Oil marketing companies (OMCs) to increase...

The under recoveries of OMCs is expected to increase on account of higher than expected depreciation in the rupee. We, now, model higher a subsidy burden of Rs. 1,362 bn and Rs.988 bn for FY12E and FY13E respectively as against the earlier assumption of Rs 1,167 bn and Rs 820 bn factoring in the depreciating INR. We have modelled for an exchange rate of Rs 48.7 per dollar and Rs. 49/USD for FY12E and FY13E respectively as against the earlier expectation of Rs.47.4/USD and Rs. 47/USD.

Under recovery estimates for FY12E-13E in Rs bn

	Revised Estimates		Earlier Estimates	
	FY12E	FY13E	FY12E	FY13E
Brent crude, USD per bbl	113	100	111	100.0
Exchange rate, Rs per USD	49	49	47	47
Under recoveries				
Diesel	782	385	634	259
SKO	275	243	264	228
LPG	305	360	269	334
Total subsidy burden	1362	988	1167	820

Source: Company, FQ Research

Cut down production estimate at OVL

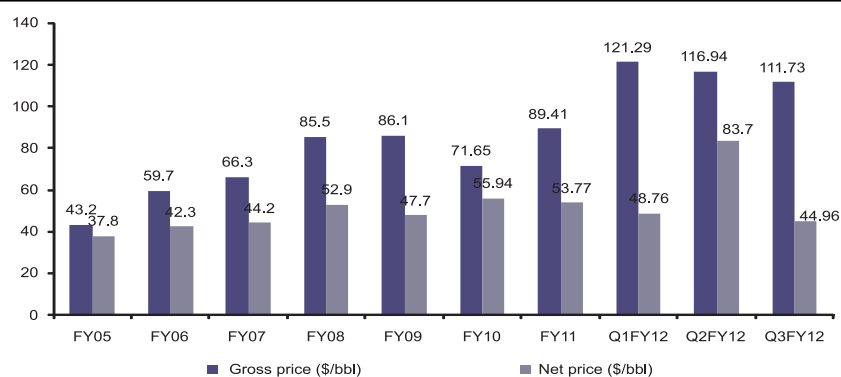
We cut down the production estimate at OVL to 8.8 mmtoe and 8.7 mmtoe for FY12E and FY13E respectively on account of lower production at Syria and Sudan. Syria production impacted on account of sanctions imposed by US and European Union while the production at Sudan block has declined to 57 kbpd from 120 kbpd on account of the ongoing strife between south Sudan and North Sudan.

Assumptions

Parameter	FY12	FY13
Domestic crude oil production (including JV's) (mmt per annum)	27.3	28.7
Domestic natural gas production (including JV's) (bcm per annum)	25.3	26.9
Overseas crude oil and natural gas production (mmtoe per annum)	8.8	8.7
Brent crude oil price (\$/bbl)	113	100
ONGC's share of under- recoveries (Rs. bn.)	446.5	323.9

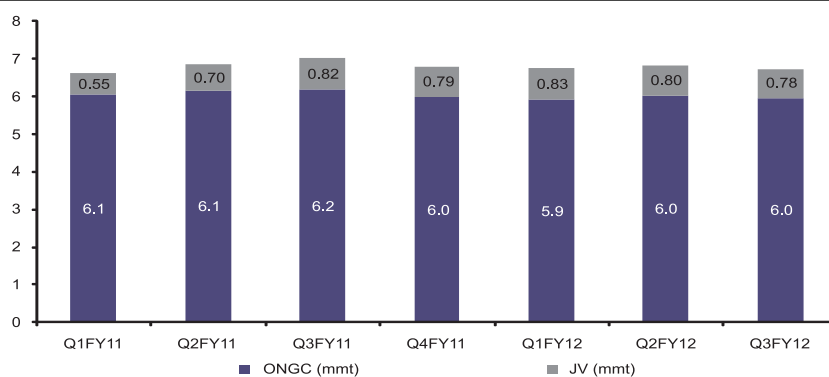
Source: Company, FQ Research

Net crude oil realization declined 30.6% Y-o-Y and 46.3% sequentially to \$45/bbl



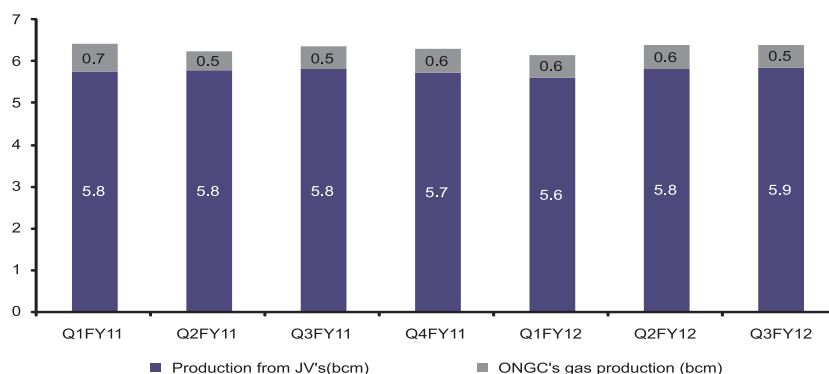
Source: Company, FQ Research

Crude output declined 4.1% Y-o-Y and 1.4% sequentially to 6.74 mmt



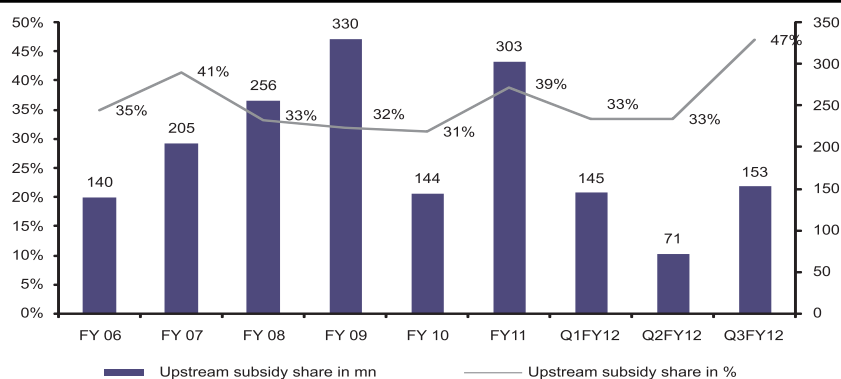
Source: Company, FQ Research

Natural gas production increased 0.8% Y-o-Y and 0.3% sequentially to 6.4 bcm



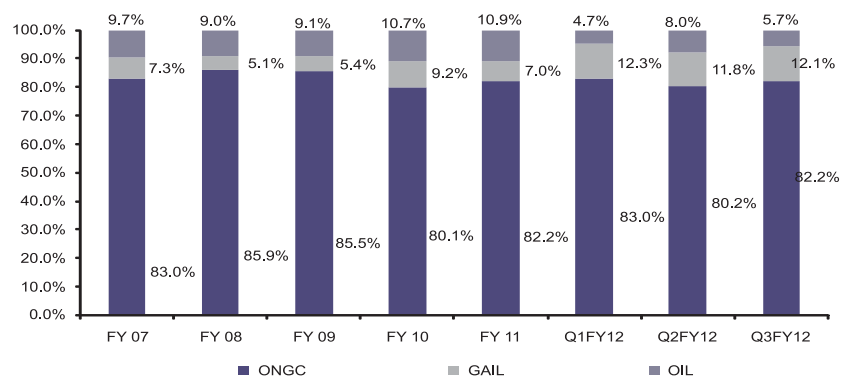
Source: Company, FQ Research

Upstream oil companies under recoveries share increased to 47% of the gross under recovery



Source: Company, FQ Research

ONGC shared 82.2% of upstream oil companies subsidy burden



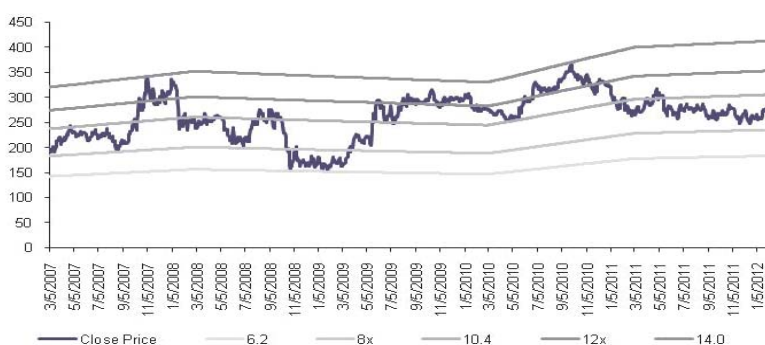
Source: Company, FQ Research

ONGC 1y forward EV/EBIDTA band



Source: Company, FQ Research

ONGC 1y forward PE band



Source: Company, FQ Research

ONGC 1y forward P/BV band



Source: Company, FQ Research

Comparative Valuations

Indian

Units	Price		EPS		P/E		P/S		P/BV		EV/EBITDA		RoE	Annual	Annual	
	Rs.	Rs. bn	Rs. bn	Rs.	(x)	(x)	(x)	(x)	(x)	(x)	(%)	EPS	Sales			
	Price	Mcap	EV	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	(13E/12E)	(13E/12E)
INDIAN UPSTREAM COMPANIES																
ONGC	282	2,495	2,237	29.5	32.6	9.5	8.6	1.7	1.5	1.9	1.7	4.0	3.4	18.1	10.4	10.3
RIL	844	2,763	3,214	65.7	69.9	12.8	12.1	0.9	0.9	1.5	1.4	8.7	8.6	12.9	6.4	-0.6
CAIRN	373	710	692	42.0	50.4	8.9	7.4	5.0	4.0	1.5	1.3	6.7	5.5	18.2	20.2	25.2
OIL	1,315	316	209	138.4	146.3	9.5	9.0	3.2	3.0	1.8	1.6	4.5	4.2	19.7	5.7	6.0
Average						10.0	9.2	2.7	2.4	1.7	1.5	6.0	5.5	17.8	9.7	9.4
INDIAN REFINERIES																
IOC	275	670	1,104	25.7	35.6	10.7	7.7	0.2	0.2	1.1	1.0	7.5	6.2	9.5	38.4	2.7
BPCL	594	215	397	32.8	47.8	18.1	12.4	0.1	0.1	1.3	1.2	8.9	7.7	7.5	45.5	-2.0
HPCL	295	100	363	36.3	42.3	8.1	7.0	0.1	0.1	0.7	0.7	10.5	8.4	8.5	16.7	0.0
Average						12.3	9.0	0.1	0.1	1.0	1.0	9.0	7.4	8.5	33.5	0.2

Source: Bloomberg, FQ Research

Consolidated Financials

Profit and Loss Statement

Particulars (INR mn)	FY10	FY11	FY12E	FY13E
Total Revenues	1,026,976	1,219,293	1,476,782	1,628,946
Revenue Growth (Y-o-Y)	(2.6%)	18.7%	21.1%	10.3%
Total Expenditure	574,050	691,743	904,503	955,495
EBIDTA	452,926	527,550	572,279	673,452
EBIDTA Margin (%)	44.1%	43.3%	38.8%	41.3%
EBIDTA Growth (Y-o-Y)	6.6%	16.5%	8.5%	17.7%
Other Income	43697	26271	62874	32154
Depreciation/Amortization	187188	206284	229827	256304
Interest	5022	4374	5833	7353
PBT	304,414	343,163	399,492	441,949
PBT Margin (%)	29.6%	28.1%	27.1%	27.1%
Net Profit	194,035	224,569	261,418	288,666
Net Profit Excl. extra-ordinaries	193,775	224,569	240,523	288,666

Ratios

Particulars	FY10	FY11	FY12E	FY13E
Valuation Ratio (x)				
P/E (x)		11.1	9.5	8.6
P/BV (x)		2.1	1.9	1.7
P/CEPS (x)		5.8	5.3	4.6
EV/EBIDTA (x)		4.2	4.0	3.4
Market Cap./ Sales (x)		2.0	1.7	1.5
Net cash/Market Cap (%)		12.4%	9.3%	10.3%
Dividend Yield (%)		3.0%	3.9%	4.2%
Leverage Ratios				
Debt/Equity (x)	0.1x	0.1x	0.1x	0.1x
Interest Coverage (x)	90.2x	120.6x	98.1x	91.6x
Per Share Data				
Diluted EPS (Rs.)	22.7	25.4	29.5	32.6
Diluted EPS Excl(Rs.)	22.6	25.4	27.2	32.6
Diluted Cash EPS	44.5	48.7	53.1	61.6
Book Value Per share (Rs.)	117.5	135.2	151.8	170.7
Returns (%)				
ROE	19.3%	19.6%	18.1%	19.4%
ROCE	14.6%	15.0%	14.0%	15.0%
Dividend Payout	42.6%	38.9%	43.8%	42.0%
Du-Pont Analysis				
EBIDTA/Sales (%)	44.1%	43.3%	38.8%	41.3%
Sales/Operating assets (x)	104.8%	112.3%	118.2%	112.5%
EBIDTA/Operating Assets (%)	46.2%	48.6%	45.8%	46.5%
Operating Assets/Net Assets (x)	74.3%	73.2%	73.8%	76.2%
Net Earnings/EBIDTA (%)	42.8%	42.6%	42.0%	42.9%
Net Assets/Net Worth (x)	131.6%	129.6%	127.6%	127.7%
RoE (%)	19.3%	19.6%	18.1%	19.4%
Margins (%)				
EBIDTA margin	44.1%	43.3%	38.8%	41.3%
PBT margin	29.6%	28.1%	24.9%	27.1%
PAT margin	18.9%	18.4%	17.7%	17.7%
Growth Ratios (%)				
Net Sales	(2.6%)	18.7%	21.1%	10.3%
EBIDTA	6.6%	16.5%	8.5%	17.7%
PAT	(2.0%)	15.7%	16.4%	10.4%
APAT	(1.9%)	15.9%	7.1%	20.0%
Operating Cycle				
Debtors	25	29	30	30
Creditors	81	98	90	90
Inventory	52	45	48	48

Balance Sheet

Particulars (INR mn)	FY10	FY11	FY12E	FY13E
Liabilities				
Equity Capital	21,389	42,778	42,778	42,778
Reserves & Surplus	992,678	1,161,719	1,308,523	1,475,818
Equity	1,014,066	1,204,497	1,351,301	1,518,596
Net Worth	1,014,066	1,204,497	1,351,301	1,518,596
Minority Interest	16,432	20,019	24,323	29,613
Net Deferred tax liability/(Asset)	102,912	111,527	131,153	145,092
Other Liabilities	174,590	198,504	198,930	215,669
Total Loans	62,669	62,912	82,912	100,912
Capital Employed	1,370,670	1,597,458	1,788,619	2,009,881
Assets				
Gross Block	2,043,743	2,280,125	2,574,125	2,914,125
Less: Depreciation	1,192,931	1,349,649	1,579,477	1,835,781
Net Block	850,812	930,476	994,648	1,078,344
Capital WIP	176,039	273,786	399,786	484,786
Investments	51,593	49,733	49,733	49,733
Others - A	80,125	102,379	125,526	138,460
Current Assets				
Inventories	82,400	85,676	118,948	125,654
Sundry Debtors	71,424	97,724	124,052	136,283
Cash and Bank Balance	223,842	321,935	264,796	307,538
Loans and Advances	120,567	109,906	178,098	195,658
Other Current Assets	7,431	9,130	10,561	11,868
Total Current Assets	505,664	624,370	696,455	777,001
Less:Current Liabilities & Provisions				
Sundry Creditors	126,817	186,540	223,028	235,601
Provisions	75,158	50,880	65,714	69,715
Other Current Liabilities	100,002	153,826	196,748	221,087
Total Current Liabilities & Provisions	301,977	391,246	485,491	526,403
Miscellaneous Assets	8,413	7,961	7,961	7,961
Capital Applied	1,370,670	1,597,458	1,788,619	2,009,881

Cash Flow Statement

Particulars (INR mn)	FY10	FY11	FY12E	FY13E
Cash Inflow from Operations				
Profit Before Tax	304,414	343,163	399,492	441,949
Depreciation	187,188	206,284	229,827	256,304
Less:				
Dividend Payout	82,575	87,270	114,614	121,371
Tax Paid	107,138	114,913	133,830	148,053
Operating cashflow before WC changes	301,889	347,264	380,876	428,829
Changes in Capital Structure				
Increase in Equity Share capital	0	21,389	0	0
Increase in Share premium	0	(168)	0	0
Increase in other reserves	(22,869)	28,230	(4,244)	(5,230)
Increase in Others	13,821	32,528	20,053	30,678
Inc/(Dec) in Loans	(2,922)	243	20,000	18,000
Inc/(Dec) in Minority Interest	2,318	3,587	4,304	5,290
Inc/(Dec) in Equity/Loans/MI	(9,653)	85,808	40,112	48,737
Adjustments				
Diff.in Depreciation	(64,368)	(49,566)	0	(0)
Total Inflows	227,869	383,506	420,988	477,567
Cash Outflows				
Working Capital Changes				
Inc/(Dec) in Provisions	3,295	(24,277)	14,834	4,001
Inc/(Dec) in Current Liabilities	16,292	113,547	79,410	36,912
Inc/(Dec) in Inventory	16,976	3,276	33,273	6,706
Inc in Debtors	(390)	26,300	26,328	12,231
Inc/(Dec) in Loans & Adv.	(12,077)	(10,661)	68,192	17,560
Inc/(Dec) in other Current Assets	(3,878)	1,699	1,431	1,306
Inc/(Dec) in Working Capital	(18,956)	(68,656)	34,980	(3,109)
Capex/Investments				
Inc/(Dec) in Investments	16,790	(1,861)	0	0
Addition to Gross Block	221,658	236,381	294,000	340,000
Inc/(Dec) in Capital WIP	10,817	97,747	126,000	85,000
Inc/(Dec) in other assets	(2,234)	22,254	23,147	12,934
Inc. in Misc. Assets	1,907	(453)	0	0
Inc/(Dec) in Fixed assets/ Investments	248,938	354,069	443,147	437,934
Inc/(Dec) in Cash/Bank Balance	(2,113)	98,093	(57,140)	42,742
Total Outflows	227,869	383,506	420,988	477,567

Recommendation Summary

Event	Date	Price	Rating	Target
Initiating Coverage	22-11-2011	252	Buy	331
Result Update (Q3F12)	13-02-2012	282	Buy	328

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BUY

More than 10% return

HOLD

Between 5-10% return

SELL

Less than 5% return