

## ExlService Holdings, Inc.

# An intact outlook with good visibility, despite the macro; Buy

Reiterate Rating: BUY | PO: 35.80 USD | Price: 26.25 USD

## Win rates, large deals helping digital operations

Q2 revenue growth of 13.2%yoy (cc basis) was broadly in-line with our estimate and led by another strong quarter for the digital operations business (16.8%yoy). While demand for cost take-out services is benefitting this segment, we think the strength is also being driven by an uptick in win rates as well as deal sizes, on back of integrated operations transformations and data management services. As per company commentary on the call, deal pipeline has been up 20%yoy for each of the past 6 quarters and recent deal wins include \$100mn+ in contract value. New customers signed up during 9MCY23 is also higher than in the prior year. These provide good visibility on growth rates sustaining over the mid-term, in our view. It also updated its CY23 revenue guidance to 15%-16%yoy (cc) vs. 14%-15% earlier.

## Analytics faring well, outside of marketing sub-segment

The analytics segment saw the expected impact in marketing analytics, slowing down to 9.4%yoy. Excluding marketing analytics, the broader analytics business grew at mid-teens, as per company. On generative AI, the company is currently in discussion on about 200 opportunities. This also adds to opportunity in data management for EXLS. Management reiterated its expectations of 10%+ growth rate for the data analytics business for the medium term. We view EXLS as a key beneficiary of genAI adoption.

## Beat on margins but investments to catch up

Adj. EBIT margin of 20.0% expanded 80bps yoy & beat our estimate. This was mainly on account of investments getting pushed out by a quarter that are now expected to catch up from Q4. That said, we think EXLS is likely to maintain the improved margin profile of CY23 going ahead, given the improvement in revenue mix as well as operating leverage that should come by with 10%+ revenue growth. We tweak CY23/CY24E adj. EPS & retain our PO of \$35.8. We reiterate Buy expecting company to benefit from genAI on its analytics business while strong demand for cost take-out services could support growth for digital operations.

Estimates (Dec) (US\$)	2021A	2022A	2023E	2024E	2025E
Net Income (Adjusted - mn)	165	195	235	269	301
EPS	0.966	1.15	1.39	1.60	1.79
EPS Change (YoY)	36.4%	19.0%	21.2%	15.0%	11.9%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	0.834	0.781	1.32	1.58	1.81
<b>Valuation (Dec)</b>					
P/E	27.16x	22.82x	18.83x	16.37x	14.63x
EV / EBITDA*	17.65x	14.44x	12.35x	10.78x	9.80x
Free Cash Flow Yield*	3.17%	2.96%	4.97%	5.95%	6.82%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 8.

27 October 2023

## Equity

### Key Changes

(US\$)	Previous	Current
2023E EPS	1.40	1.39
2024E EPS	1.59	1.60
2025E EPS	1.78	1.79

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## Stock Data

Price	26.25 USD
Price Objective	35.80 USD
Date Established	28-Jul-2023
Investment Opinion	B-1-9
52-Week Range	25.17 USD-38.24 USD
Mrkt Val / Shares Out (mn)	4,406 USD / 167.8
Average Daily Value (mn)	35.40 USD
Free Float	82.0%
BofA Ticker / Exchange	EXLS / NAS
Bloomberg / Reuters	EXLS US / EXLS.OQ
ROE (2023E)	28.4%
Net Dbt to Eqty (Dec-2022A)	-6.97%

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**Refer to important disclosures on page 9 to 11. Analyst Certification on page 7. Price Objective Basis/Risk on page 7.**

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Timestamp: 27 October 2023 02:28AM EDT

# iQprofile<sup>SM</sup> ExlService Holdings, Inc.

Key Income Statement Data (Dec)	2021A	2022A	2023E	2024E	2025E
(US\$ Millions)					
Sales	1,122	1,412	1,628	1,799	1,978
Gross Profit	440	527	618	683	751
Sell General & Admin Expense	(235)	(278)	(330)	(359)	(395)
Operating Profit	156	192	238	259	287
Net Interest & Other Income	(9)	(2)	(3)	6	13
Associates	NA	NA	NA	NA	NA
Pretax Income	147	190	235	265	300
Tax (expense) / Benefit	(32)	(48)	(51)	(66)	(75)
Net Income (Adjusted)	165	195	235	269	301
Average Fully Diluted Shares Outstanding	171	169	169	168	168

## Key Cash Flow Statement Data

Net Income	115	142	185	199	225
Depreciation & Amortization	49	56	50	65	70
Change in Working Capital	(14,636)	(52,890)	(4,741)	(10,177)	(10,409)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	14,657	52,858	4,782	10,228	10,467
Cash Flow from Operations	184	166	276	315	353
Capital Expenditure	(45)	(36)	(57)	(53)	(53)
(Acquisition) / Disposal of Investments	7	(57)	0	0	0
Other Cash Inflow / (Outflow)	77	4	0	0	0
Cash Flow from Investing	39	(89)	(57)	(53)	(53)
Shares Issue / (Repurchase)	(118)	(72)	(30)	(30)	(30)
Cost of Dividends Paid	NA	NA	NA	NA	NA
Cash Flow from Financing	(147)	(82)	(16)	(16)	(16)
Free Cash Flow	140	130	219	262	300
Net Debt	(60)	(53)	(255)	(501)	(785)
Change in Net Debt	(101)	0	(189)	(232)	(270)

## Key Balance Sheet Data

Property, Plant & Equipment	86	83	90	78	61
Other Non-Current Assets	616	648	634	621	609
Trade Receivables	194	259	285	315	346
Cash & Equivalents	320	303	505	751	1,035
Other Current Assets	66	53	57	61	65
Total Assets	1,283	1,346	1,571	1,826	2,115
Long-Term Debt	0	220	220	220	220
Other Non-Current Liabilities	94	90	150	225	307
Short-Term Debt	260	30	30	30	30
Other Current Liabilities	236	248	273	296	322
Total Liabilities	590	588	672	771	878
Total Equity	693	758	898	1,055	1,237
Total Equity & Liabilities	1,283	1,346	1,571	1,826	2,115

## iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	15.4%	17.2%	20.2%	18.7%	17.8%
Return On Equity	23.4%	26.8%	28.4%	27.5%	26.2%
Operating Margin	13.9%	13.6%	14.6%	14.4%	14.5%
EBITDA Margin	21.7%	21.1%	21.4%	22.2%	22.2%

## iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	1.1x	0.9x	1.2x	1.2x	1.2x
Asset Replacement Ratio	1.2x	0.9x	1.6x	1.0x	0.9x
Tax Rate (Reported)	21.7%	25.1%	21.6%	25.0%	25.0%
Net Debt-to-Equity Ratio	-8.7%	-7.0%	-28.4%	-47.5%	-63.5%
Interest Cover	15.6x	18.0x	21.4x	24.2x	26.6x

## Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 8.

## Company Sector

Information Processing

## Company Description

EXL, a top 10 India-leveraged Business Process Management services provider is a leading player in the BPM segment with the Digital Operations & Solutions segment contributing to 54% of revenues & rest from the fast growing analytics segment.

## Investment Rationale

We rate EXLS Buy given strong growth outlook for the analytics segment, aided by opportunities coming from generative AI adoption in the medium-term. EXLS is well-positioned and well-leveraged with 45%+ revenue exposure to the analytics segment. Growth prospects in digital operations have also improved, as reflected in recent consistent track record of new wins, and aided by success in digital offerings.

## Stock Data

Price to Book Value

4.9x

### 3Q highlights

- Revenue growth of 1.5% cc qoq was led by digital operations segment (2.3% qoq cc) whereas analytics vertical grew 0.5% qoq cc.
- In the digital operations segment, growth was led by its largest vertical i.e. Insurance (+6.3% qoq cc) whereas Healthcare & Emerging Business declined 3.6% qoq cc and 2.8% qoq cc respectively. Decline in Emerging Business was on account of a customer bankruptcy which transitioned out in the quarter.
- EBIT margins were flattish qoq to 20% & were ahead of our estimate of 18.2%. Company expects margin to be around 18% levels in Q4 as it incorporates some of the investments that got deferred from Q3 to Q4.
- Attrition was down 40bps on a qoq basis to 26.9%. On a YoY basis, attrition was down 1,110bps from 38% in Q3 2022.
- Employee headcount grew by 3.3% qoq to 50.4k & is up 17% yoy.
- The company updated the CY23 guidance from 14%-15% yoy USD earlier to 15% yoy USD now, implying flattish sequential revenues for Q4. Adjusted earnings per share was revised from \$1.38 to \$1.41, to \$1.40 to \$1.42, up 16%-18% yoy.

#### Exhibit 1: Q3CY23 variance table

Q3 revenue was largely in-line with our expectations

Income Statement (\$ Mil)	3QCY23	2QCY23	QoQ	3QCY22	YoY	BofA e	var
Revenues	411.0	405.0	1.5%	361.4	13.7%	413.1	-0.5%
Cost of revenues	256.0	253.2	1%	230.5	11%	263.3	-2.8%
Gross Profit	155.0	151.8	2%	130.9	18%	149.8	3.4%
Operating expenses							
G&A	52.2	45.6	14%	42.5	23%	47.1	10.9%
S&M	30.9	28.2	10%	23.9	30%	31.5	-1.7%
Depreciation	8.4	8.9	-6%	10.1	-17%	9.1	-7.4%
Amortisation of intangibles	3.2	4.2	n/m	4.2	n/m	4.2	-24.9%
Total operating expenses	94.7	87.0	9%	80.8	17%	91.9	3.1%
EBIT (gaap)	60.2	64.8	nm	50.1	20%	57.9	4.0%
Stock compensation	17.1	11.5	48%	12.2	40%	13.2	29.1%
Adjusted EBIT	82.2	81.1	1%	66.7	23%	75.4	9.0%
Forex gain	0.4	0.3	nm	1.5	n/m	0.3	nm
Interest & other income, net	-2.7	-0.6	311%	-0.3	818%	-0.6	344.5%
PBT	58.0	64.5	na	51.3	13%	57.7	0.6%
Income tax provision	14.2	15.6	nm	12.4	14%	13.9	2.1%
PAT (cont ops - gaap)	43.8	48.9	nm	38.9	13%	43.8	0.1%
PAT (gaap)	43.8	48.9	nm	38.9	13%	43.8	0.1%
PAT (adj gaap)	62.8	61.4	2%	52.1	20%	57.9	8.5%

Source: Company, BofA Global Research estimates

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#### Exhibit 2: Q3CY23 margin variance table

Q3 margins beat our estimates

Margins	3QCY23	2QCY23	QoQ (bps)	3QCY22	YoY (bps)	BofA e	Var (bps)
Gross margin	37.7%	37.5%	23	36.2%	149	36.3%	144
EBIT margin - gaap	14.7%	16.0%	-135	13.9%	79	14.0%	63
EBIT margin - non gaap	20.0%	20.0%	-4	18.5%	153	18.2%	175
Net income margin - gaap	15.3%	15.2%	11	14.4%	85	14.0%	126

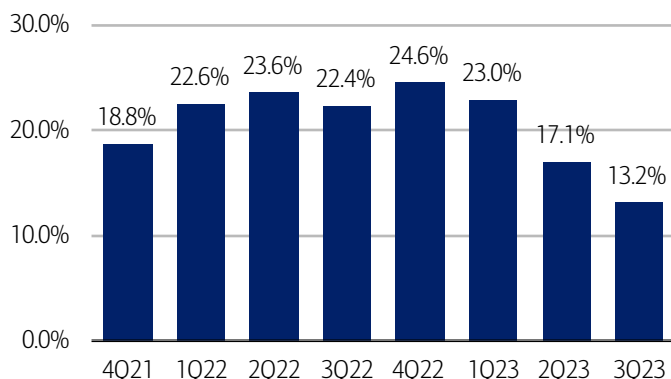
Source: Company, BofA Global Research estimates

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**Exhibit 3: YoY cc organic growth**

YoY constant currency revenue growth at 13.2% in Q3 2023

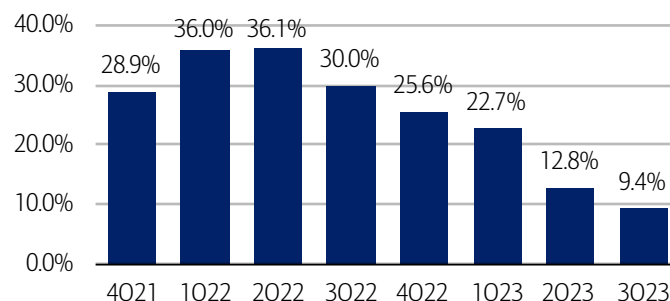


Source: Company, BofA Global Research

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**Exhibit 4: YoY cc organic growth – Analytics segment**

Analytics segment grew slower than overall company given macro headwinds in the marketing analytics segment. Company continues to see a double-digit secular growth opportunity in the analytics vertical on a normalized basis.

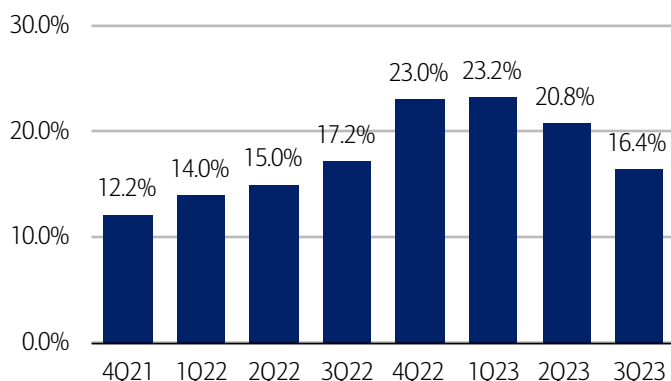


Source: Company, BofA Global Research

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**Exhibit 5: Operations management segment growth (YoY cc)**

Operations vertical remained resilient &amp; is benefitting in the current macro

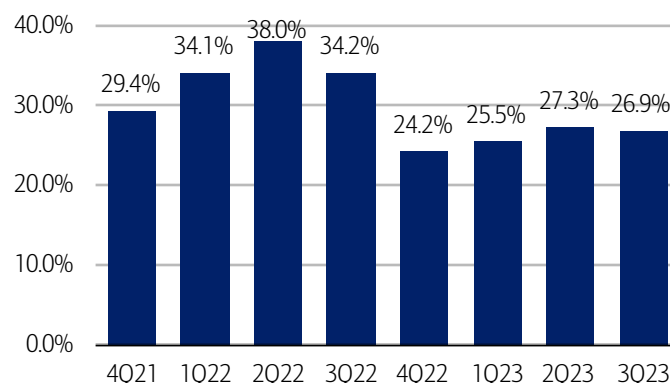


Source: Company BofA Global Research

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**Exhibit 6: Attrition (%)**

Attrition remains lower than trends seen in CY22

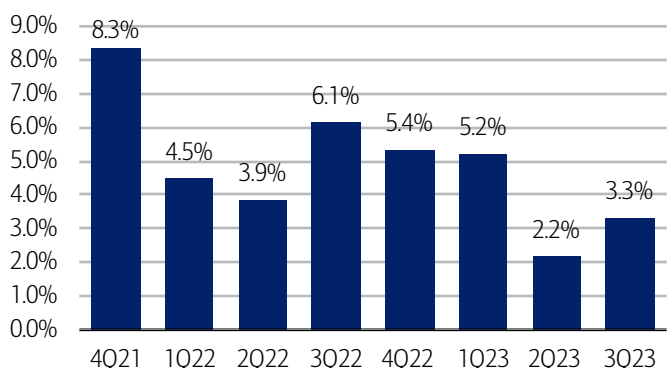


Source: Company, BofA Global Research

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**Exhibit 7: Employee headcount qoq**

Headcount grew 3.3% sequentially

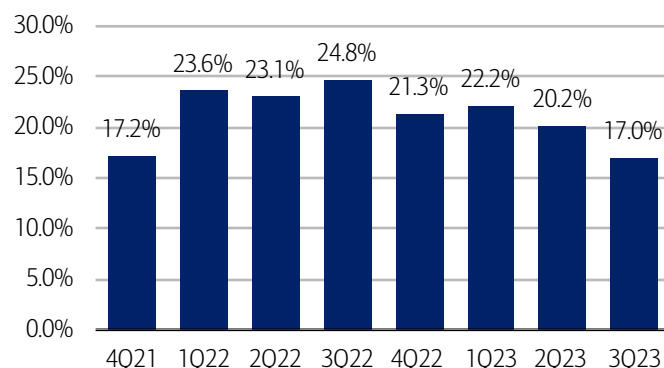


Source: Company, BofA Global Research

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**Exhibit 8: Employee headcount yoy**

Employee headcount is up 17%yoy



Source: Company, BofA Global Research

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# Financial Summary

## Exhibit 9: Profit and Loss Statement (US\$ '000) 20-25E

We expect the company to grow at 16%yoy cc in CY23

USD Million	CY20	CY21	CY22	CY23E	CY24E	CY25E
<b>Revenue</b>	<b>958.4</b>	<b>1122.3</b>	<b>1412.0</b>	<b>1627.6</b>	<b>1799.0</b>	<b>1977.9</b>
YoY Change	-3.3%	17.1%	25.8%	15.3%	10.5%	9.9%
Cost of Revenue	617.5	682.1	885.3	1009.4	1115.8	1226.7
YoY Change	-5.0%	10.5%	29.8%	14.0%	10.5%	9.9%
<b>Gross Profit</b>	<b>341.0</b>	<b>440.2</b>	<b>526.8</b>	<b>618.2</b>	<b>683.2</b>	<b>751.2</b>
YoY Change	-0.2%	29.1%	19.7%	17.4%	10.5%	9.9%
Operating expenses:						
General & Administrative	102.9	127.0	149.8	173.4	185.3	203.7
% of sales	10.7%	11.3%	10.6%	10.7%	10.3%	10.3%
Stock comp expenses	28.2	38.6	49.4	60.1	74.7	82.1
Selling and marketing expenses	49.3	69.5	79.1	96.7	98.9	108.8
% of sales	5.1%	6.2%	5.6%	5.9%	5.5%	5.5%
<b>EBITDA post stock comp charge</b>	<b>160.5</b>	<b>205.0</b>	<b>248.4</b>	<b>288.1</b>	<b>324.3</b>	<b>356.5</b>
EBITDA margin	16.7%	18.3%	17.6%	17.7%	18.0%	18.0%
YoY Change	17.1%	27.7%	21.2%	16.0%	12.6%	10.0%
Amortization of intangibles	14.4	12.8	17.1	14.7	12.6	12.6
Depreciation	36.1	36.4	39.2	35.1	52.2	57.4
Dep as a % of Revenue	3.8%	3.2%	2.8%	2.2%	2.9%	2.9%
<b>EBIT post stock comp and amortization</b>	<b>110.0</b>	<b>155.9</b>	<b>192.2</b>	<b>238.3</b>	<b>259.5</b>	<b>286.6</b>
EBIT margin	11.5%	13.9%	13.6%	14.6%	14.4%	14.5%
<b>Other income (expense):</b>						
Foreign exchange gain (loss)	4.4	4.3	6.2	1.2	1.6	1.6
Interest income	12.6	11.6	4.7	9.8	18.1	25.7
Interest expense	11.8	12.4	13.0	13.7	13.7	13.7
Interest expense - redeemable preferred stock	0.2	0.0	-0.4	-0.2	-0.1	-0.1
Other income (expense):	5.5	3.5	-2.5	-2.9	5.9	13.5
Income before income taxes	115.6	159.4	189.7	235.4	265.4	300.0
YoY Change	39.5%	37.9%	19.0%	24.1%	12.7%	13.1%
Income tax provision	25.6	31.9	47.6	50.9	66.4	75.1
Income tax rate	22.2%	20.0%	25.1%	21.6%	25.0%	25.0%
<b>Net income (loss) before preferred dividend</b>	<b>89.9</b>	<b>127.5</b>	<b>142.1</b>	<b>184.5</b>	<b>199.0</b>	<b>225.0</b>
YoY Change	32.9%	41.8%	11.4%	29.9%	7.8%	13.1%
Dividends and accretion on preferred stock	0.0	0.0	0.0	0.0	0.0	0.0
<b>GAAP Net income (loss) from cont ops</b>	<b>89.9</b>	<b>127.5</b>	<b>142.1</b>	<b>184.5</b>	<b>199.0</b>	<b>225.0</b>
PAT Margin	9.4%	11.4%	10.1%	11.3%	11.1%	11.4%
YoY Change	32.9%	41.8%	11.4%	29.9%	7.8%	13.1%
Income from discount Ops (loss)	0.0	0.0	0.0	0.0	0.0	0.0
<b>GAAP Net income to common stockholders</b>	<b>89.9</b>	<b>127.5</b>	<b>142.1</b>	<b>184.5</b>	<b>199.0</b>	<b>225.0</b>
<b>Non GAAP</b>						
Stock comp expenses	28.2	38.6	49.4	60.1	74.7	82.1
Amortization of intangibles	14.4	12.8	17.1	14.7	12.6	12.6
Reimbursement of transition and disentanglement costs	0.0	0.0	0.0	0.0	0.0	0.0
Less: Tax impact	10.2	9.0	13.9	23.8	17.5	19.0
<b>Non GAAP net income from cont ops</b>	<b>122.4</b>	<b>169.9</b>	<b>194.6</b>	<b>235.4</b>	<b>268.8</b>	<b>300.8</b>
<b>Non GAAP Net income to common stockholders</b>	<b>122.4</b>	<b>169.9</b>	<b>194.6</b>	<b>235.4</b>	<b>268.8</b>	<b>300.8</b>

Source: Company, BofA Global Research estimates

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**Exhibit 10: Key Margins 20-25E**

We expect company to sustain CY23 EBIT margin levels in CY24/25

<b>Margins</b>	<b>CY 2020</b>	<b>CY 2021</b>	<b>CY 2022</b>	<b>CY 2023E</b>	<b>CY 2024E</b>	<b>CY 2025E</b>
Gross margins	35.6%	39.2%	37.3%	38.0%	38.0%	38.0%
GAAP EBIT margins	11.5%	13.9%	13.6%	14.6%	14.4%	14.5%
Non GAAP EBIT margins	15.9%	18.6%	18.3%	19.2%	19.3%	19.3%
GAAP PAT margins	9.3%	10.2%	10.1%	11.4%	11.1%	11.4%
Non GAAP PAT margins (cont ops)	12.7%	14.8%	13.8%	14.5%	15.0%	15.2%

**Source:** Company, BofA Global Research estimates

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## Price objective basis & risk

### ExlService Holdings, Inc. (EXLS)

Our price objective of USD35.8 is based on a target adjusted P/E multiple of 22.5x on 12 months ending Dec-24. Our target adjusted P/E is at parity to its 5 year average adj. PE multiple given our view on EXL's analytics practice being a beneficiary of genAI adoption in the medium-term gets balanced by the near-term demand uncertainty.

Downside risks to our PO are (1) slowdown in deal decision making cycles in the current macro (2) increased competitive intensity from integrated IT/BPM vendors & (3) deflation in non-analytics business from generative AI adoption

Upside risks are faster than expected growth in analytics on account of faster-than-expected adoption of generative AI

## Analyst Certification

I, Kunal Tayal, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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#### India - Software & IT Services Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	ExlService Holdings, Inc.	EXLS	EXLS US	Kunal Tayal
	Genpact Ltd	G	G US	Kunal Tayal
	WNS Holdings Ltd	WNS	WNS US	Kunal Tayal
<b>NEUTRAL</b>				
	HCL	XHCLF	HCLT IN	Kunal Tayal
	Infosys	INFYF	INFO IN	Kunal Tayal
	Infosys Tech - A	INFY	INFY US	Kunal Tayal
	Tata Consultancy	TACSF	TCS IN	Kunal Tayal
<b>UNDERPERFORM</b>				
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	Tech Mahindra	TECHM	TECHM IN	Kunal Tayal
	Wipro	WIPRF	WPRO IN	Kunal Tayal
	Wipro	WIT	WIT US	Kunal Tayal

#### **iQmethod<sup>SM</sup>** Measures Definitions

##### Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

##### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

##### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

##### Numerator

$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

$\text{Cash Flow From Operations} - \text{Total Capex}$

##### Numerator

$\text{Cash Flow From Operations}$

Capex

Tax Charge

$\text{Net Debt} = \text{Total Debt} - \text{Cash \& Equivalents}$

EBIT

##### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

$\text{Cash Flow From Operations} - \text{Total Capex}$

$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} +$

Other LT Liabilities

Enterprise Value

##### Denominator

$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill}$

Amortization

Shareholders' Equity

Sales

N/A

N/A

##### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

##### Denominator

Diluted Earnings Per Share (Basis As Specified)

$\text{Shareholders' Equity} / \text{Current Basic Shares}$

Current Share Price

$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$

Sales

$\text{Basic EBIT} + \text{Depreciation} + \text{Amortization}$

**iQmethod<sup>SM</sup>** is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Technology Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	204	51.52%	Buy	104	50.98%
Hold	95	23.99%	Hold	45	47.37%
Sell	97	24.49%	Sell	27	27.84%

### Equity Investment Rating Distribution: Global Group (as of 30 Sep 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1869	53.48%	Buy	1046	55.97%
Hold	828	23.69%	Hold	461	55.68%
Sell	798	22.83%	Sell	370	46.37%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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