

Power Grid Corporation of India (PGRD.BO)

Delivers A Solid Set Of Numbers Again

■ Company Update

- **Significant recurring PAT beat** — PGCIL's 2QFY13 recurring PAT at Rs11.1bn was up 57% YoY which was 28% ahead of Citi at Rs8.7bn. (For investors who like to adjust FERV and look at the numbers, adjusted PAT at Rs10.2bn up 31% YoY was also significantly ahead of expectations). 1HFY13 recurring PAT at Rs19.8bn is up 40% YoY, which could suggest upside risk to our FY13E estimates.
- **Operationally robust** — Cash flow from operations (CFO) at Rs45bn v/s reported PAT of Rs19.9bn suggests improvement in working capital in 1HFY13. Capitalization in 1HFY13 at Rs67.7bn is up 67% YoY and appears on track to meet Citi FY13E expectations of Rs120bn. Capex in 1HFY13 at Rs71bn is behind Citi FY13E expectations of Rs165bn, but we expect improvements in 2HFY13E.
- **Does PGCIL plan to raise equity?** — If PGCIL does Rs1000bn in the XIth plan there might be a marginal equity shortfall in FY13E/14E. But in these years the company may do capex at leverage > 70:30 and make up for the same over FY15E-17E. From FY15E onwards there is no mismatch, in our view. There is a regulatory cap of 75:25 and we believe PGCIL does not want to fully utilize this leeway.
- **Does Government of India (GoI) plan to sell down stake?** — GoI has discussed this with PGCIL, but we understand that management has asked that GoI not sell down its stake. The GoI stake is not that large and it could become tricky if it sells down its stake now and 5 years later PGCIL needs to raise equity for growth.
- **Ministry of Power also does not want stake sell down** — According to the *Hindustan Times*, in a letter to the finance minister the outgoing power minister said that disinvestment in PGCIL has already taken place twice. Any further disinvestment in PGCIL may be deferred by GoI as this could be detrimental to the company's growth.
- **Top India Electric Utility pick** — PGCIL continues to be our top pick along with JP Power (JAPR.BO; Rs38.40; 1). Our top sells are Tata Power (TTPW.BO; Rs105.50; 3) and Adani Power (ADAN.BO; Rs48.80; 3).

Buy	1
Price (31 Oct 12)	Rs114.05
Target price	Rs140.00
Expected share price return	22.8%
Expected dividend yield	2.0%
Expected total return	24.8%
Market Cap	Rs528,020M US\$9,814M

Price Performance
(RIC: PGRD.BO, BB: PWGR IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2011A	25,437	5.49	11.9	20.8	2.5	13.6	1.5
2012A	32,710	7.07	28.6	16.1	2.2	14.6	1.9
2013E	39,092	8.44	19.5	13.5	2.0	15.7	2.0
2014E	45,143	9.75	15.5	11.7	1.8	16.3	2.1
2015E	51,624	11.15	14.4	10.2	1.6	16.5	2.2

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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PGRD.BO: Fiscal year end 31-Mar						Price: Rs114.05; TP: Rs140.00; Market Cap: Rs528,020m; Recomm: Buy					
Profit & Loss (Rsm)	2011	2012	2013E	2014E	2015E	Valuation ratios	2011	2012	2013E	2014E	2015E
Sales revenue	81,862	100,353	124,172	144,160	162,609	PE (x)	20.8	16.1	13.5	11.7	10.2
Cost of sales	-13,420	-15,396	-17,831	-20,364	-23,274	PB (x)	2.5	2.2	2.0	1.8	1.6
Gross profit	68,442	84,958	106,341	123,796	139,336	EV/EBITDA (x)	12.2	10.8	9.7	9.0	8.5
Gross Margin (%)	83.6	84.7	85.6	85.9	85.7	FCF yield (%)	-16.7	-24.3	-16.0	-13.0	-10.1
EBITDA (Adj)	68,442	84,958	106,341	123,796	139,336	Dividend yield (%)	1.5	1.9	2.0	2.1	2.2
EBITDA Margin (Adj) (%)	83.6	84.7	85.6	85.9	85.7	Payout ratio (%)	32	30	27	25	22
Depreciation	-21,994	-25,725	-31,390	-36,593	-41,343	ROE (%)	14.5	14.5	15.7	16.3	16.5
Amortisation	0	0	0	0	0	Cashflow (Rsm)	2011	2012	2013E	2014E	2015E
EBIT (Adj)	46,448	59,232	74,951	87,203	97,993	EBITDA	68,442	84,958	106,341	123,796	139,336
EBIT Margin (Adj) (%)	56.7	59.0	60.4	60.5	60.3	Working capital	-34,718	-15,779	5,212	4,178	3,772
Net interest	-17,282	-20,567	-26,771	-30,908	-34,333	Other	-15,422	-22,464	-30,859	-36,560	-41,369
Associates	0	0	0	0	0	Operating cashflow	18,302	46,714	80,694	91,415	101,738
Non-op/Except	7,101	7,497	7,604	7,779	7,971	Capex	-106,529	-174,815	-165,000	-160,000	-155,000
Pre-tax profit	36,266	46,163	55,785	64,074	71,631	Net acq/disposals	0	0	0	0	0
Tax	-10,830	-13,452	-16,693	-18,930	-20,007	Other	549	1,139	1,495	1,495	1,495
Extraord./Min.Int./Pref.div.	1,532	-161	0	0	0	Investing cashflow	-105,980	-173,676	-163,505	-158,505	-153,505
Reported net profit	26,969	32,550	39,092	45,143	51,624	Dividends paid	-9,426	-11,339	-12,359	-12,897	-13,434
Net Margin (%)	32.9	32.4	31.5	31.3	31.7	Financing cashflow	91,702	113,530	83,439	71,009	51,371
Core NPAT	25,437	32,710	39,092	45,143	51,624	Net change in cash	4,024	-13,432	629	3,918	-396
Per share data	2011	2012	2013E	2014E	2015E	Free cashflow to s/holders	-88,227	-128,101	-84,306	-68,585	-53,262
Reported EPS (Rs)	5.83	7.03	8.44	9.75	11.15						
Core EPS (Rs)	5.49	7.07	8.44	9.75	11.15						
DPS (Rs)	1.75	2.11	2.30	2.40	2.50						
CFPS (Rs)	3.95	10.09	17.43	19.75	21.98						
FCFPS (Rs)	-19.06	-27.67	-18.21	-14.81	-11.50						
BVPS (Rs)	46.15	50.73	56.51	63.47	71.72						
Wtd avg ord shares (m)	4,630	4,630	4,630	4,630	4,630						
Wtd avg diluted shares (m)	4,630	4,630	4,630	4,630	4,630						
Growth rates	2011	2012	2013E	2014E	2015E						
Sales revenue (%)	14.9	22.6	23.7	16.1	12.8						
EBIT (Adj) (%)	18.7	27.5	26.5	16.3	12.4						
Core NPAT (%)	23.0	28.6	19.5	15.5	14.4						
Core EPS (%)	11.9	28.6	19.5	15.5	14.4						
Balance Sheet (Rsm)	2011	2012	2013E	2014E	2015E						
Cash & cash equiv.	36,801	23,369	23,997	27,916	27,520						
Accounts receivables	31,621	28,463	35,219	40,888	46,121						
Inventory	3,815	4,403	5,448	6,325	7,135						
Net fixed & other tangibles	609,369	758,458	892,068	1,015,475	1,129,133						
Goodwill & intangibles	0	0	0	0	0						
Financial & other assets	75,610	107,468	107,973	108,478	108,983						
Total assets	757,216	922,161	1,064,705	1,199,081	1,318,890						
Accounts payable	18,368	0	0	0	0						
Short-term debt	0	0	0	0	0						
Long-term debt	408,828	534,019	629,918	713,923	778,828						
Provisions & other liab	116,350	153,264	173,177	191,301	208,016						
Total liabilities	543,546	687,283	803,095	905,225	986,844						
Shareholders' equity	213,670	234,878	261,610	293,857	332,046						
Minority interests	0	0	0	0	0						
Total equity	213,670	234,878	261,610	293,857	332,046						
Net debt	372,027	510,650	605,920	686,008	751,308						
Net debt to equity (%)	174.1	217.4	231.6	233.4	226.3						

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For definitions of the items in this table, please click [here](#).

Figure 1. PGCIL: 2QFY13 Results Review

Year End Mar 31 (Rsmn)	1QFY12R	1QFY13	Growth	2QFY12R	2QFY13	Growth	2QFY13E
Transmission Assets CoD	8,020	40,730	407.9%	32,550	27,030	-17.0%	
Capex	19,430	30,070		NA	40,930		
Sales	22,025	28,883	31.1%	22,644	30,858	36.3%	29,518
EBITDA	18,199	24,646	35.4%	18,699	26,693	42.8%	24,795
Margins %	82.6%	85.3%		82.6%	86.5%		84.0%
Depreciation	5,790	7,565		5,966	8,252		7,750
EBIT	12,409	17,081	37.7%	12,732	18,441	44.8%	17,045
- Interest & Other Charges	4,190	6,101		4,593	6,343		
- FERV as adjustment in borrowing cost	(43)	360		683	(1,048)		
Total Interest and Finance Charges	4,148	6,461		5,277	5,296		6,500
Total Other Income	1,390	920		1,942	1,570		1,000
PBT	9,651	11,540	19.6%	9,398	14,715	56.6%	11,545
Total Tax	2,586	2,836		2,331	3,597		2,840
Effective Tax Rate %	26.8%	24.6%		24.8%	24.4%		24.6%
Recurring PAT	7,065	8,705	23.2%	7,066	11,119	57.4%	8,705
Prior Period - Others	(13)	(4)		21	140		0
Reported PAT	7,053	8,701	23.4%	7,087	11,259	58.9%	8,705
PAT ex FERV according CIR calculated	7,010	9,061	29.3%	7,771	10,211	31.4%	8,705

Source: Company data, Citi Research estimates.

Figure 2. PGCIL 1HFY13 CFO

Year End Mar31 (Rsmn)	1HFY13
PAT	19,960
Depreciation	15,817
AAD	(367)
DTL	1,483
WC	8,345
CFO	45,238

Source: Company data, Citi Research.

Figure 3. PGCIL 2QFY13 Segmental Results Review

Rsmn	1QFY12R	1QFY13	Growth	2QFY12R	2QFY13	Growth
Revenues						
Transmission	21,776	28,166	29.3%	22,147	30,403	37.3%
Consultancy	543	612	12.7%	728	678	-6.9%
Telecom	462	571	23.7%	510	611	19.8%
Total Income	22,781	29,349	28.8%	23,385	31,692	35.5%
- Less Intersegment	(7)	(277)		(7)	(29)	
Net Sales	22,774	29,072	27.7%	23,377	31,663	35.4%
PBIT						
Transmission	12,767	17,018	33.3%	12,989	18,802	44.7%
Consultancy	210	321	53.1%	329	401	21.8%
Telecom	126	177	40.5%	169	183	8.6%
Total	13,103	17,517	33.7%	13,487	19,386	43.7%
PBIT Margins %						
Transmission	58.6%	60.4%	1.79%	58.7%	61.8%	3.19%
Consultancy	38.6%	52.4%	13.81%	45.3%	59.2%	13.97%
Telecom	27.4%	31.1%	3.71%	33.0%	29.9%	-3.09%
Total	57.5%	59.7%	2.17%	57.7%	61.2%	3.50%

Source: Company data, Citi Research.

Power Grid Corporation of India

Company description

PGCIL (61.42%-owned by the Government of India) is India's Central Transmission Utility (CTU) mandated to establish and operate regional and national grids to facilitate transfer of power within and across regions. It commenced operations in April 1992 and carries about 45% of India's generated electricity. At 31 March 2012, it had a transmission network of about 92,981 circuit kms with 150 substations, and system availability of above 99.94%. PGCIL also plays an active role in distribution sector reforms initiated by government. PGCIL has also diversified to provide broadband telecom services and consultancy for T&D projects in India and abroad.

Investment strategy

We rate PGCIL Buy to factor in (1) its scarcity value, as it is the only listed play on the regulated transmission business in India vis-a-vis plenty of generation companies to choose from, and (2) EPS CAGR of 17% over FY12-15E with average RoE of 16%. PGCIL plans Rs1000bn of capex during the XIth Five Year Plan (FY13-17). Under the regulatory regime, PGCIL's sales and earnings growth is largely driven by capex and capex that it capitalizes and brings into its gross block. The capex is incrementally funded through a 70:30 debt: equity mix. Capitalization again depends on commissioning transmission lines.

Valuation

DCF is normally preferred when valuing an electric utility company that has regulated earnings and cash flow streams. However, for a company like PGCIL, which we estimate will be FCF negative until at least FY12E and might continue to be FCF negative beyond FY12E depending on the scale of the capex it undertakes in the XIIth Plan (FY13E -FY17E), the DCF approach could either overestimate or underestimate the value of the company based on the terminal year cash-flow assumptions. The entire value would depend on the steady state case assumed when growth capex stops and the company does only maintenance capex and generates substantial amounts of cash. The DCF value would also be extremely sensitive to the maintenance capex assumption in the terminal year. We therefore believe P/BV valuation methodology is more appropriate. Our target price of Rs140 is set at 2.2x P/BV for Mar14E, a ~8% discount to the historical average P/BV of 2.4x since listing, given the sector's generic risks of coal shortage, falling merchant prices and deteriorating SEB finances.

Risks

Key downside risks to our target price include: 1) Creditworthiness of the State Power Utilities; 2) Changes in the regulatory environment; 3) Increased competition; and 4) Project-related risks. Key upside risks are: 1) Faster-than-expected project execution leading to earlier capitalization of capex; 2) Higher-than-expected short-term open access revenues due to a spurt in power trading, and 3) Higher-than-expected revenues and profitability in consulting and telecoms businesses.

Jaiprakash Power Ventures

Investment strategy

We have a Buy rating on JP Power Ventures. The company has an interesting and diversified (fuel wise and off-take wise) portfolio of projects, which includes 1700MW of operational capacity and 3,800MW of under-construction capacity. We expect an EPS CAGR of 65% over FY11-15E with RoE expanding from 8% in FY12 to 21% in FY15E.

Valuation

We value JP Power Ventures at Rs46 a share. The Indian power sector has seen a sea change over the last 4-5 years, moving from an era of: (1) assured RoE, where fuel cost was a pass through; (2) Coal India honored its coal linkages most of the time; (3) imported coal was a small quantum of India's requirement; (4) analysts and investors did not have to bother about merchant prices and fuel costs; and (5) though SEBs were making losses, they were not asking generators to back down generation to an era where: (1) case 1 and case 2 are becoming more common than assured RoE; (2) one is worried if Coal India will honor its coal linkage contracts; (3) imported coal is becoming increasingly important; (4) analysts and investors have to bother about merchant prices and fuel costs; and (5) SEBs are asking generators to back down generation. This means one has to adapt valuation approaches to keep up with the sudden changes in operating outlook for companies. Though DCF using FCFE and cost of equity remains a robust approach for valuation, it prevents maneuverability in a fast-changing environment. We therefore use P/BV to value JP Power Ventures. We use a target P/BV of 1.6x Mar14E considering the company's EPS CAGR of 65% over FY12-15E with RoEs expanding from 8% to 21%.

Risks

Downside risks to our target price include: fuel supply risk, coal mining risk, execution risk, merchant tariff risks, hydrological risk, financial closure risk, dependence on promoter and promoter group companies, receivables risk, regulatory risk, R&R and land acquisition risk and lower-than-expected operating parameters.

Tata Power

Investment strategy

We rate Tata Power a Sell with a target price of Rs89. Over the years investors/analysts have extrapolated rising coal volumes, ASPs and depreciating rupee to build a bull case, ignoring likely losses in Mundra UMPP and possibility of some of the +ve coal drivers reversing. Mundra UMPP losses are a reality now (cannot be undone without tariff hikes not mandated in PPA), coal ASPs are declining and cost of production is increasing.

Our worst fears on Mundra UMPP are also coming true with the company taking an impairment of Rs18bn in FY12 based on upward revision to coal price projections and USDINR.

In order to support Mundra UMPP, management has committed to restructuring under which the company will transfer at least 75% of the ownership of the investments in the Indonesian coal companies to Mundra UMPP in FY12E. The company will also evaluate other alternative options to support Mundra UMPP. The two possible outcomes of the same are (1) some amount of tax arbitrage which is a positive, and (2) more accounting complexity in an already complex accounting company, which is a negative.

Valuation

Our Rs89 target price is based on a sum-of-the-parts approach: 1) The parent business is valued using DCF as of Dec12E, using a WACC of 12.3% (risk free rate of 8.5%, market risk premium of 6%, beta of 1.06, D/E of 67%); 2) Tata Power's 51% stake in NDPL is valued at 0.75x Mar12 P/BV; 3) Tata Power's stake in Powerlinks is valued at 2.5x FY12 P/BV; 4) Holdings in Tata Teleservices (Maharashtra) and VSNL are valued at a 20% discount to the market prices; 5) Stake in Tata Teleservices is valued at a 45% discount to the NTT Docomo valuations; 6) Mundra UMPP using FCFE and Cost of Equity = 13%; 7) The Maithon project is valued like the Mundra UMPP using a CoE=13%; and 8) 30% stake in KPC and Arutmin coal mines at FCF and WACC = 12%.

Risks

Key upside risks that could drive the shares above our target price include: 1) Positive judgment on the MERC order and standby charges case vs. R--Infra could positively impact investor sentiment but have no positive bearing on Tata Power's financials, on our estimates; 2) Tata Power exiting its telecom holdings at a significant premium to their current market value; 3) Significant progress on pipeline of 6.2GW of projects beats expectations and 4) New UMPP win.

Adani Power

Investment strategy

We rate Adani Power Sell. The business model on paper has not panned out in reality. The key spoilers have been (1) slower ramp up (2) higher auxiliary consumption (3) lower merchant sales (4) higher fuel costs (5) higher O&M costs (6) duty on Mundra sales and (7) significant cost over-runs. Post 3 years of operation, the company is staring at an overleveraged balance sheet, PPAs with limited maneuverability, coal shortages and higher fuel costs.

Valuation

The Indian power sector has seen a sea-change over the last 4-5 years from an era of: (1) assured RoE where fuel cost was a pass-through; (2) Coal India honored its coal linkages most of the time; (3) imported coal was a small quantum of India's requirement; (4) analysts/ investors did not have to bother about merchant prices/fuel costs; and (5) though SEBs were making losses, they were not asking generators to back down generation to an era where (1) case 1 and case 2 are becoming more common than assured RoE; (2) concerns are rising as to whether Coal India will honor its coal linkage contracts; (3) imported coal is becoming increasingly important; (4) analysts/investors have to bother about merchant prices/fuel costs; and (5) SEBs are asking generators to back down generation. This means valuation approaches have to be adapted to keep up with the sudden

changes in operating outlook for companies. As a consequence, we now use a pure P/BV multiple set on Dec13E at 1.2x. Our target multiple is well supported by average RoE of 6.4% over FY13-15E.

Risks

Upside risks that could cause the stock to trade above our target price include: 1) Better-than-expected operating parameters; 2) Faster-than-expected execution; 3) Higher-than-expected merchant tariffs; 4) Pass through of costs in low priced PPAs; 5) Significant fall in international coal prices; 6) Allocation of coal mine for Tiroda.

Appendix A-1

Analyst Certification

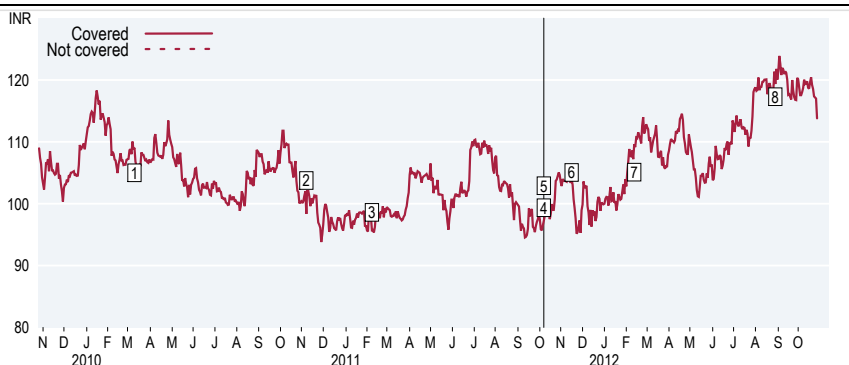
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IMPORTANT DISCLOSURES

Power Grid Corporation of India (PGRD.BO)

Ratings and Target Price History Fundamental Research

Analyst: Venkatesh Balasubramaniam



	Date	Rating	Target Price	Closing Price
1	10-Mar-10	*2L	*116.00	109.05
2	8-Nov-10	*1L	*117.00	98.35
3	8-Feb-11	1L	*118.00	95.70

* Indicates change

	Date	Rating	Target Price	Closing Price
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*1	118.00	97.25
6	16-Nov-11	1	*121.00	103.95

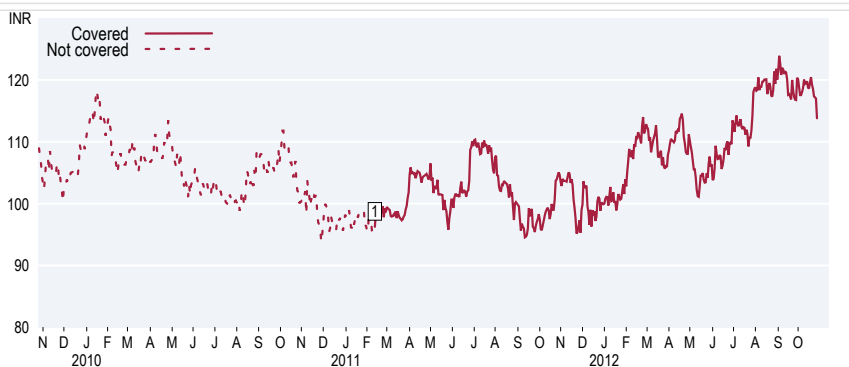
	Date	Rating	Target Price	Closing Price
7	13-Feb-12	1	*126.00	109.60
8	29-Aug-12	1	*140.00	119.35

Rating/target price changes above reflect Eastern Standard Time

Power Grid Corporation of India (PGRD.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Venkatesh Balasubramaniam



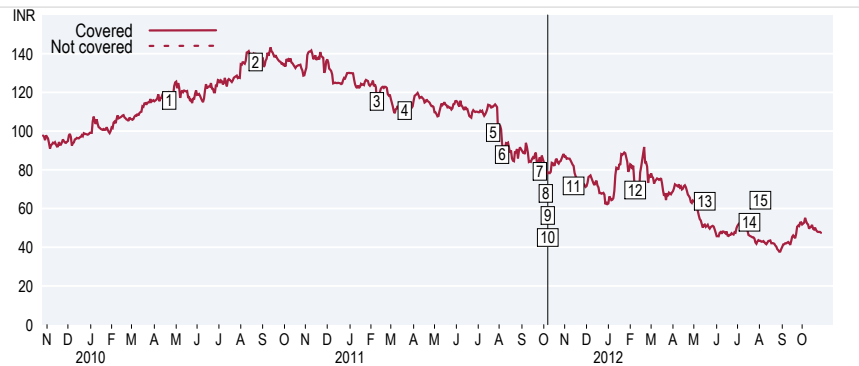
	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD MP	-	96.25

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Adani Power (ADAN.BO)
Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam



Date	Rating	Target Price	Closing Price
1 22-Apr-10	3M	*106.00	119.50
2 23-Aug-10	*1L	*159.00	139.95
3 9-Feb-11	1L	*130.00	115.35
4 21-Mar-11	1L	*125.00	110.60
5 22-Jul-11	1L	*131.00	112.65

* Indicates change

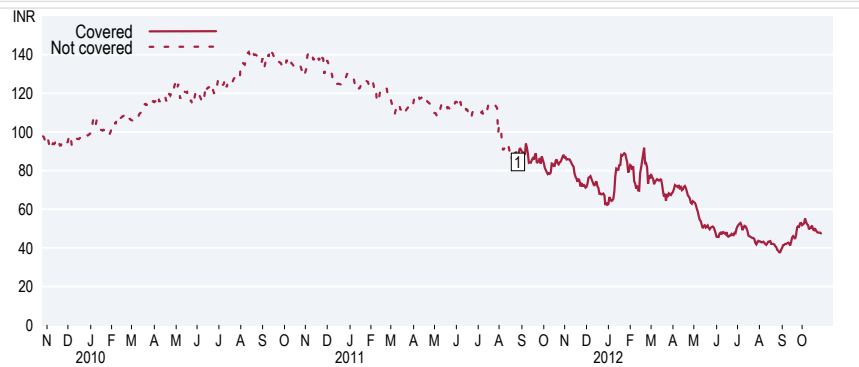
Date	Rating	Target Price	Closing Price
6 4-Aug-11	*2L	*105.00	93.55
7 27-Sep-11	2L	*96.00	86.45
8 5-Oct-11	2L	*87.00	80.25
9 7-Oct-11	Stock rating system changed		
10 7-Oct-11	*2	87.00	78.15

Date	Rating	Target Price	Closing Price
11 14-Nov-11	2	*86.00	82.00
12 8-Feb-12	*3	*70.00	73.25
13 16-May-12	3	*51.00	51.70
14 18-Jul-12	3	*40.00	46.00
15 2-Aug-12	3	*34.00	43.30

Rating/target price changes above reflect Eastern Standard Time

Adani Power (ADAN.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Venkatesh Balasubramaniam



Date	Rating	Target Price	Closing Price
1 26-Aug-11	*ADD LP	-	85.90

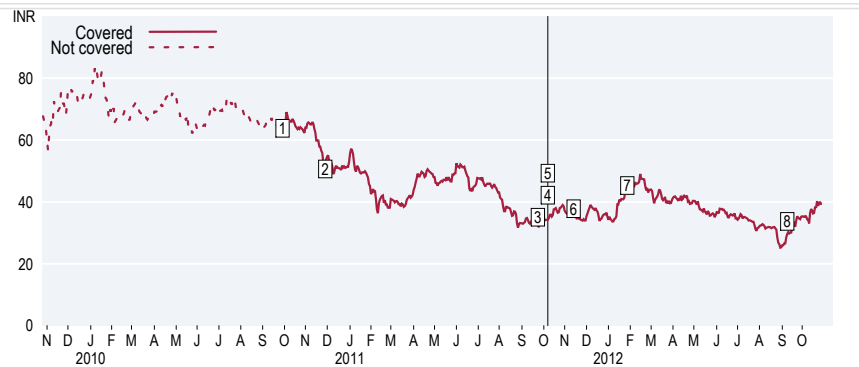
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Jaiprakash Power Ventures (JAPR.BO)
Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam

Covered since September 29 2010



Date	Rating	Target Price	Closing Price
1 29-Sep-10	*2L	*70.00	64.10
2 29-Nov-10	*1L	*65.00	51.30
3 23-Sep-11	1L	*46.00	32.40

* Indicates change

Date	Rating	Target Price	Closing Price
4 7-Oct-11	Stock rating system changed		
5 7-Oct-11	*1	46.00	34.25
6 14-Nov-11	1	*48.00	36.45

Date	Rating	Target Price	Closing Price
7 27-Jan-12	1	*51.00	43.15
8 10-Sep-12	1	*46.00	29.65

Rating/target price changes above reflect Eastern Standard Time

**Jaiprakash Power Ventures
(JAPR.BO)**

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Venkatesh Balasubramaniam
Covered since September 29 2010

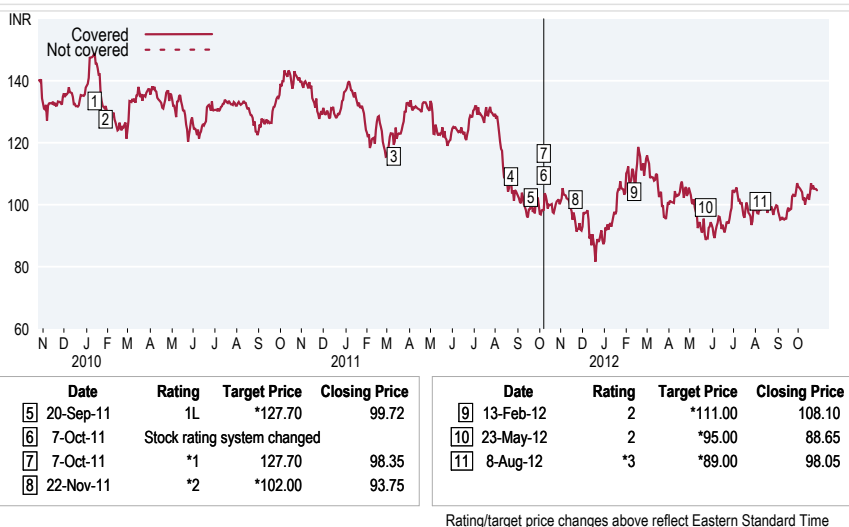


* Indicates change

Tata Power (TTPW.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam



Date	Rating	Target Price	Closing Price
1 13-Jan-10	2L	*156.40	148.87
2 28-Jan-10	*1L	*155.00	131.84
3 10-Mar-11	1L	*146.20	119.34
4 23-Aug-11	1L	*129.00	108.51

Date	Rating	Target Price	Closing Price
5 20-Sep-11	1L	*127.70	99.72
6 7-Oct-11	Stock rating system changed		
7 7-Oct-11	*1	127.70	98.35
8 22-Nov-11	*2	*102.00	93.75

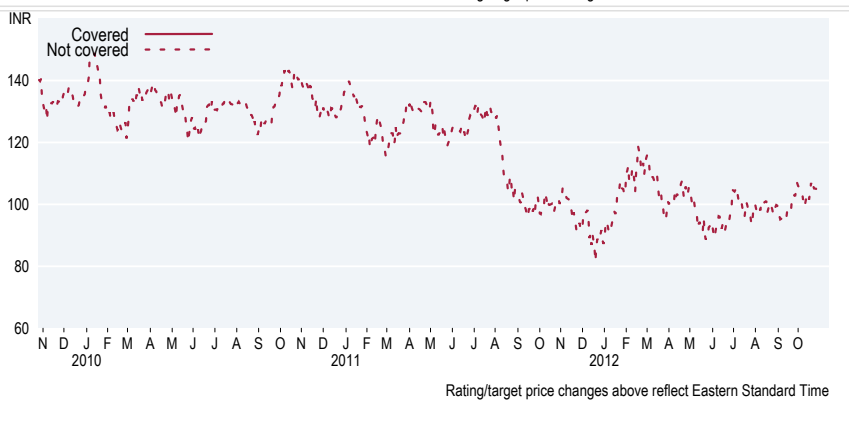
Date	Rating	Target Price	Closing Price
9 13-Feb-12	2	*111.00	108.10
10 23-May-12	2	*95.00	88.65
11 8-Aug-12	*3	*89.00	98.05

* Indicates change

Tata Power (TTPW.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Venkatesh Balasubramaniam



* Indicates change

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Data current as of 5 Oct 2012	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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