

Equities

15 February 2011 | 15 pages

Pantaloon (PART.BO)

Another Quarter – Another Disappointment...But Risks Priced In

- Company Update
- Target Price Change
- Estimate Change

- **SSS growth trends remain encouraging...** — Retail demand continues to be buoyant as same-store sales (SSS) growth for lifestyle, value and home remained strong at ~21%, 12% and 18% Y/Y, respectively in 2QFY11. Encouragingly, trends in the key lifestyle and value businesses were in line with 1Q trends. Overall, core retail (lifestyle+ value + home) revenues rose a healthy 31% Y/Y (32% in 1Q).
- **... however, profit growth disappoints** — EBITDA margin contraction of ~150bps Y/Y to ~8.6% for core retail was below expectations. This was on the back of ~220bps gross margin decline Y/Y, disappointing as mgmt had guided to an improvement in margins in 2Q on account of the full-price sales in the festive season. Consequently, core retail PAT rose a modest 6% Y/Y to Rs472m.
- **Balance sheet – the Achilles Heel** — Parent debt remains elevated at Rs18.3bn (Rs13.9bn end FY10). Investments in group concerns rose Rs2bn over 1H; working capital expanded by ~Rs2.6bn. Mgmt noted it ramped inventories ahead of Jan Republic Day Sales and had higher deposits. We do not build in meaningful benefits on working capital – given mgmt’s recent lackluster track record.
- **E-Zone to be hived off** — E-zone would move into a step-down subsidiary, in which mgmt would induct a strategic partner. E-Zone reportedly had an EBITDA loss of Rs120m in 2Q – its hive-off should improve profitability in the core Home Business (which is EBITDA positive). E-Zone will be converted into a digital commerce platform.
- **Maintain Buy; TP Rs338** — Downside risks are largely priced in – we maintain Buy, even as we cut our core retail PAT est. by 28-41% over FY11-13E, tweaking our parent revenues/margins in line with the recent trends and increased interest expense assumptions. Our TP is revised to Rs338, valuing core retail at Rs307 (from Rs486), on 25x June12E EPS. Value ascribed to other parts (FCH, Future Generali & Future Supply Chain) is revised downwards to Rs31 (Rs44 earlier).

Buy/Medium Risk	1M
Price (14 Feb 11)	Rs256.15
Target price	Rs338.00
	from Rs530.00
Expected share price return	32.0%
Expected dividend yield	0.1%
Expected total return	32.1%
Market Cap	Rs56,210M
	US\$1,232M

Price Performance (RIC: PART.BO, BB: PF IN)



Figure 1. Pantaloon — Statistical Abstract

Year to	Parent Net Profit (RsM)	Parent EPS (Rs)	Parent EPS Growth (%)	Parent P/E (x)	Core Retail Net Profit (RsM)	Core Retail EPS (Rs)	Core Retail EPS Growth (%)	Core Retail P/E (x)	Yield (%)
30-Jun									
2009A	1,406	7.39	-6.6	34.7	-	-	-	-	0.2
2010A	1,925	9.34	26.4	27.4	-	-	-	-	0.3
2011E	764	3.52	-62.3	72.8	1,827	8.41	-	30.4	0.1
2012E	1,167	5.38	52.8	47.7	2,664	12.27	45.9	20.9	0.2
2013E	1,875	8.64	60.7	29.7	3,679	16.94	38.1	15.1	0.3

Source: Company Reports and CIRA Estimates

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

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Fiscal year end 30-Jun	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	34.7	27.4	72.8	47.7	29.7
EV/EBITDA adjusted (x)	10.9	10.4	12.2	10.1	8.3
P/BV (x)	2.1	1.9	2.0	1.9	1.8
Dividend yield (%)	0.2	0.3	0.1	0.2	0.3
Per Share Data (Rs)					
EPS adjusted	7.39	9.34	3.52	5.38	8.64
EPS reported	7.39	9.96	3.52	5.38	8.64
BVPS	119.41	133.70	129.07	133.85	141.52
DPS	0.61	0.83	0.34	0.51	0.82
Profit & Loss (RsM)					
Net sales	63,417	59,344	42,838	53,863	62,180
Operating expenses	-58,133	-55,042	-40,154	-50,253	-57,595
EBIT	5,284	4,302	2,684	3,610	4,585
Net interest expense	-3,182	-2,882	-1,802	-2,192	-2,159
Non-operating/exceptionals	61	846	257	323	373
Pre-tax profit	2,162	2,266	1,140	1,742	2,798
Tax	-757	-341	-376	-575	-923
Extraord./Min.Int./Pref.div.	0	129	0	0	0
Reported net income	1,406	2,054	764	1,167	1,875
Adjusted earnings	1,406	1,925	764	1,167	1,875
Adjusted EBITDA	6,684	5,921	4,135	5,164	6,232
Growth Rates (%)					
Sales	25.6	-6.4	-27.8	25.7	15.4
EBIT adjusted	40.1	-18.6	-37.6	34.5	27.0
EBITDA adjusted	45.1	-11.4	-30.2	24.9	20.7
EPS adjusted	-6.6	26.4	-62.3	52.8	60.7
Cash Flow (RsM)					
Operating cash flow	-628	16,685	-41	1,607	2,631
Depreciation/amortization	1,401	1,619	1,450	1,554	1,647
Net working capital	-3,917	13,319	-2,255	-1,114	-891
Investing cash flow	-8,927	-4,786	-4,193	-1,802	-1,539
Capital expenditure	-5,252	0	-2,193	-1,802	-1,539
Acquisitions/disposals	-3,675	-10,489	-2,000	0	0
Financing cash flow	9,438	-11,599	4,728	195	-1,092
Borrowings	6,586	-14,642	5,032	325	-883
Dividends paid	-135	-200	-85	-130	-209
Change in cash	-118	429	495	0	0
Balance Sheet (RsM)					
Total assets	61,508	51,025	55,997	58,501	60,131
Cash & cash equivalent	1,093	1,005	1,500	1,500	1,500
Accounts receivable	1,773	1,236	939	1,181	1,363
Net fixed assets	19,140	11,818	12,561	12,809	12,700
Total liabilities	38,783	23,463	27,975	29,442	29,407
Accounts payable	7,986	7,405	6,681	7,503	8,098
Total Debt	28,504	13,862	18,894	19,220	18,337
Shareholders' funds	22,724	27,563	28,022	29,059	30,724
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	10.5	10.0	9.7	9.6	10.0
ROE adjusted	6.8	7.7	2.7	4.1	6.3
ROIC adjusted	11.9	12.5	10.1	12.1	14.0
Net debt to equity	120.6	46.6	62.1	61.0	54.8
Total debt to capital	55.6	33.5	40.3	39.8	37.4

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2QFY11 Results Summary

Core retail revenue growth of ~31% Y/Y was healthy; overall, same-store sales growth for the quarter was robust with value, lifestyle and home businesses reporting 11.5%, 21% and 18% Y/Y respectively – a sequential improvement

Capital costs – While depreciation increased 29% Y/Y; interest costs rose 12% Y/Y. Recurring PAT increase of 6% Y/Y to Rs472m was disappointing

Retail EBITDA (PRIL + FVRL) is Rs2.4bn for 2QFY11; growth of ~12% Y/Y as margins contracted 150bps Y/Y given lower gross margins and muted margins in the electronics business

Figure 2. Pantaloon Retail (Core Retail) – Results Review

RsM	2QFY10	2QFY11	% Change
Net Sales	21,031	27,586	31.2
Total Expenditure	-18,905	-25,202	33.3
EBITDA	2,125	2,383	12.1
EBITDA Margin (%)	10.1	8.6	-147 bps
Interest	-962	-1,078	12.0
Depreciation	-506	-650	28.5
Other Income	22	52	142.6
PBT	679	708	4.3
Tax	-231	-235	1.9
Tax Rate (%)	34.0	33.2	-77 bps
PAT	448	472	5.5
Key Costs			
Net Sales	21,031	27,586	31.2
Raw Materials and Finished Goods	14,528	19,652	35.3
% of Sales	69.1	71.2	216 bps
Staff Costs	968	1,217	25.6
% of Sales	4.6	4.4	-19 bps
Other Expenditure	3,409	4,334	27.1
% of Sales	16.2	15.7	-50 bps

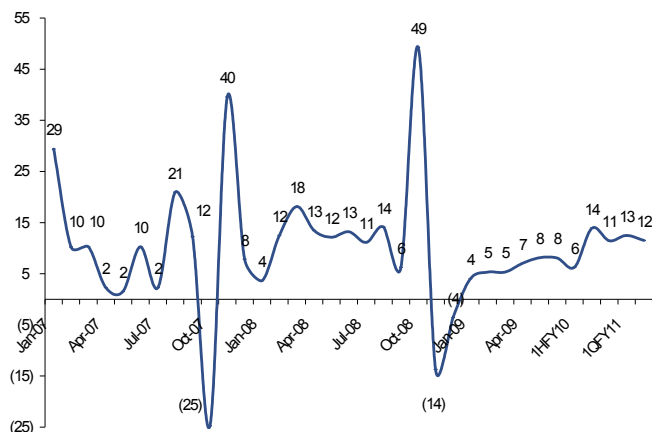
Source: Company Reports

Figure 3. Pantaloon Retail (Parent) – Results Review

RsM	2QFY10	2QFY11	% Change
Net Sales	19,128	10,243	-46.5
Total Expenditure	-17,094	-9,169	-46.4
EBITDA	2,034	1,074	-47.2
EBITDA Margin (%)	10.6	10.5	-15 bps
Interest	-835	-462	-44.8
Depreciation	-452	-351	-22.2
Other Income	20	37	84.7
PBT	768	298	-61.2
Tax	-261	-99	-62.1
Tax Rate (%)	34.0	33.2	-78 bps
PAT	507	199	-60.7
Key Costs			
Net Sales	19,128	10,243	-46.5
Raw Materials and Finished Goods	13,328	6,641	-50.2
% of Sales	63.4	64.8	147 bps
Staff Costs	827	554	-33.0
% of Sales	3.9	5.4	148 bps
Other Expenditure	2,940	1,974	-32.8
% of Sales	14.0	19.3	530 bps

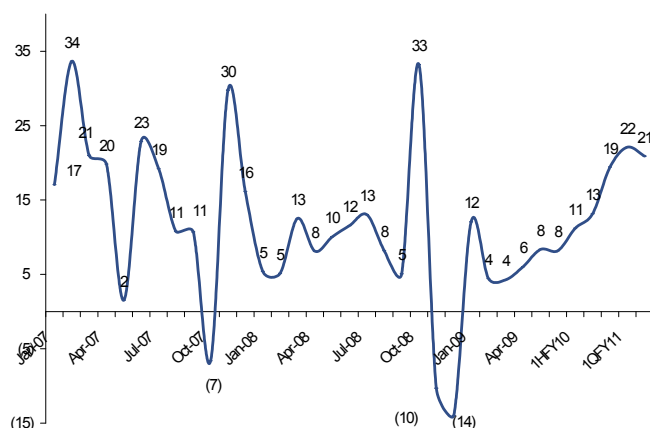
Source: Company Reports; FY10 numbers consist of value +lifestyle retailing and thus is not comparable to FY11 (lifestyle + home).

Figure 4. Same-Store Sales Growth – Value Retailing (% Y/Y)



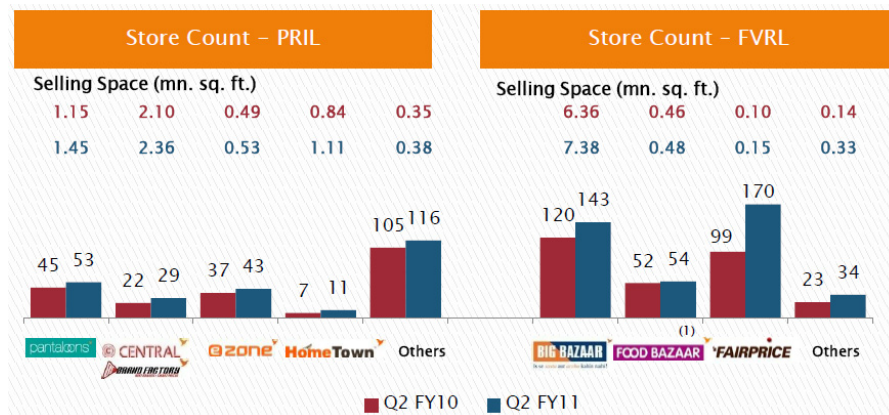
Source: Company Reports

Figure 5. Same-Store Sales Growth – Lifestyle Retailing (% Y/Y)



Source: Company Reports

Figure 6. Store Count and Retail Space Trend



Source: Company Reports

Valuation – Rs338 target price, based on SOTP methodology

The table below depicts our sum-of-the-parts (SOTP) valuation methodology:

Figure 7. Pantaloon — Sum-Of-The-Parts Based Target Price Methodology

	Valuation Methodology	Per Share Value (Rs)	
		NEW	OLD
PRIL (Parent)	Based on 25x FY12E P/E	134	245
FVRL	Based on 25x FY12E P/E	172	241
Core Retail		307	486
Future Capital Holdings	At current market cap with 20% holding company discount	20	32
Future Generali Life + Non Life businesses	Valued at investment (49.8% stake)	9	9
Future Supply Chain	Valued at investment (94.8% stake)	3	3
Per Share Target Price		338	530

Source: Citi Investment Research and Analysis Estimates

Our valuation methodology remains the same across businesses.

- We value the core retail business at ~Rs307/ share (Rs134 for Lifestyle + Home and Rs172 for Future Value). Our target multiple is unchanged – at 25x – as we roll forward to June12E (from Mar12E) EPS. We maintain our target multiple at 25x at a 40% premium to regional peers. We think this is justified given PRIL's superior growth profile, dominant positioning in India and scarcity premium.
- Future Capital is valued at Rs20/share (based on the current market value). A 20% holding company discount has been ascribed to Future Capital. We have revised this value downwards by ~38%.
- We add ~Rs12/share valuing other main subsidiaries Future Generali and Future Supply Chain Solutions at PRIL's investment value.

Figure 8. Core Retail (Parent + FVRL) – Proforma Estimates

	FY11E	FY12E	FY13E
Net Sales (Rs Mn)	109,744	134,690	155,992
% Growth Y/Y		22.7%	15.8%
EBITDA (Rs Mn)	9,167	11,299	13,357
% Growth Y/Y		23.3%	18.2%
EBITDA Margin (%)	8.4%	8.4%	8.6%
PAT (Rs Mn)	1,827	2,664	3,679
% Growth Y/Y	-	45.9%	38.1%

Source: Citi Investment Research and Analysis Estimates

We pare our profit estimates for core retail by 28-41% over FY11-13E; primarily as we tweak our parent business revenues/margin assumptions and increase capital costs – in line with the recent trends.

Figure 9. Pantaloon — Earnings Revision Summary

Parent	OLD			NEW			% Change		
	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E	FY11E	FY12E	FY13E
Sales (Rs Mn)	46,983	60,441	70,496	42,838	53,863	62,180	-9%	-11%	-12%
EBITDA (Rs Mn)	4,062	5,822	7,372	4,135	5,164	6,232	2%	-11%	-15%
PAT (Rs Mn)	1,130	2,311	3,185	764	1,167	1,875	-32%	-50%	-41%
FVRL									
Sales (Rs Mn)	67,648	81,806	96,208	66,905	80,827	93,812	-1%	-1%	-2%
EBITDA (Rs Mn)	4,892	6,293	7,627	5,032	6,136	7,125	3%	-3%	-7%
PAT (Rs Mn)	1,400	2,183	2,802	1,063	1,497	1,804	-24%	-31%	-36%
Core Retail									
Sales (Rs Mn)	114,631	142,247	166,704	109,744	134,690	155,992	-4%	-5%	-6%
EBITDA (Rs Mn)	8,954	12,115	14,999	9,167	11,299	13,357	2%	-7%	-11%
PAT (Rs Mn)	2,530	4,494	5,987	1,827	2,664	3,679	-28%	-41%	-39%

Source: Citi Investment Research and Analysis Estimates

Financial Summary

Figure 10. Pantaloon Retail (Consolidated) – P&L Summary

RsM	FY09	FY10	% Change	1QFY11	2QFY11
Net Sales	76,690	97,869	27.6	27,508	30,619
Total Expenditure	-71,569	-89,608	25.2	-25,156	-28,143
EBITDA	5,122	8,262	61.3	2,352	2,476
EBITDA Margin (%)	6.7	8.4	176 bps	8.5	8.1
Interest	-4,185	-4,934	17.9	-1,234	-1,498
Depreciation	-2,066	-2,783	34.7	-725	-744
Other Income	958	1,261	31.6	136	199
PBT	-172	1,805	nm	528	432
Tax	100	-1,042	nm	-289	-292
Tax Rate (%)	57.9	57.7	-19 bps	54.6	67.7
PAT	-72	764	nm	240	140
Others	173	-89	nm	-3	-16
Reported Profit	101	675	570.0	236	124
Key Costs					
Net Sales	76,690	97,869	27.6	27,508	30,619
Raw Materials and Finished Goods	51,273	66,828	30.3	18,569	20,956
% of Sales	66.9	68.3	143 bps	67.5	76.0
Staff Costs	5,787	6,245	7.9	1,613	1,712
% of Sales	7.5	6.4	-117 bps	5.9	6.2
Other Expenditure	14,509	16,535	14.0	4,974	5,475
% of Sales	18.9	16.9	-202 bps	18.1	19.8

Source: Company Reports

Figure 11. Pantaloon Retail (Parent) – Income Statement Summary

RsM	2009	2010	2011E	2012E	2013E
Net Sales	63,417	59,344	42,838	53,863	62,180
COGS	44,300	40,625	28,332	35,976	41,476
% of net sales	69.9%	68.5%	66.1%	66.8%	66.7%
Gross Profit	19,118	18,718	14,506	17,887	20,704
Gross Margin (%)	30.1%	31.5%	33.9%	33.2%	33.3%
Total Variable Expenses	1,660	1,763	1,507	1,660	1,634
% of Net Sales	2.6%	3.0%	3.5%	3.1%	2.6%
Fixed Expenses					
Employee Costs	2,743	2,796	2,497	3,359	4,085
% of Net Sales	4.3%	4.7%	5.8%	6.2%	6.6%
Other Expenses (SG&A)	8,031	8,239	6,367	7,704	8,752
% of Net Sales	12.7%	13.9%	14.9%	14.3%	14.1%
EBITDA	6,684	5,921	4,135	5,164	6,232
% of Net Sales	10.5%	10.0%	9.7%	9.6%	10.0%
Depreciation	1,401	1,619	1,450	1,554	1,647
% of Net Sales	2.2%	2.7%	3.4%	2.9%	2.6%
EBIT	5,284	4,302	2,684	3,610	4,585
% of Net Sales	8.3%	7.2%	6.3%	6.7%	7.4%
Total other Income	61	846	257	323	373
% of Net Sales	0.1%	1.4%	0.6%	0.6%	0.6%
Interest Expenses	3,182	2,882	1,802	2,192	2,159
% of Net Sales	5.0%	4.9%	4.2%	4.1%	3.5%
Profit Before Tax	2,162	2,266	1,140	1,742	2,798
% of Net Sales	3.4%	3.8%	2.7%	3.2%	4.5%
Tax	757	341	376	575	923
% of PBT	35.0%	15.0%	33.0%	33.0%	33.0%
Recurring PAT	1,406	1,925	764	1,167	1,875
% of Net Sales	2.2%	3.2%	1.8%	2.2%	3.0%
Exceptional Items (net of Tax)	-	(129)	-	-	-
Reported PAT	1,406	1,796	764	1,167	1,875
% of Net Sales	2.2%	3.0%	1.8%	2.2%	3.0%
% Change YoY	11.6%	27.7%	-57.5%	52.8%	60.7%

Source: Company Reports and CIRA Estimates; FY10 numbers consist of 1H of Future Value Retail and merged Home Solutions. Thus, it is not comparable to FY09 or FY11.

Figure 12. Pantaloon Retail (Parent) – Balance Sheet Summary

As of Jun 30 (in RsM)	2009	2010	2011E	2012E	2013E
SOURCES OF FUNDS :					
Share Capital	381	412	1,069	1,069	1,069
Others	229	1,875	1,000	1,000	1,000
Reserves & Surplus	22,115	25,275	25,953	26,990	28,656
Total Shareholders Funds	22,724	27,563	28,022	29,059	30,724
Deferred Tax Liability / Asset	1,161	724	724	724	724
Secured Loans	25,255	12,360	18,894	19,220	18,337
Unsecured Loans	3,249	1,502	-	-	-
Total Debt	28,504	13,862	18,894	19,220	18,337
Total sources of funds	52,389	42,149	47,641	49,003	49,785
APPLICATION OF FUNDS :					
Net Fixed Assets	19,140	11,818	12,561	12,809	12,700
Total Investments	9,540	20,029	22,029	22,029	22,029
Current Assets					
Inventories	17,878	12,707	13,790	15,433	16,673
Sundry Debtors	1,773	1,236	939	1,181	1,363
Cash and Bank Balance	1,093	1,005	1,500	1,500	1,500
Loans and Advances	12,026	4,217	5,163	5,534	5,851
Other Current Assets	58	13	15	15	15
Total current assets	32,827	19,178	21,407	23,663	25,402
Current Liabilities					
Provisions	8,914	8,634	8,181	9,253	9,998
Provisions	205	242	175	245	347
Total current liabilities and provisions	9,119	8,876	8,356	9,498	10,346
Net Current Assets	23,709	10,302	13,051	14,165	15,056
Total Application of Funds	52,389	42,149	47,641	49,003	49,785

Source: Company Reports and CIRA Estimates; FY10 numbers consist of 1H of Future Value Retail and merged Home Solutions. Thus, it is not comparable to FY09 or FY11.

Figure 13. Future Value Retail – Income Statement Summary

Year ended Jun 30 (in RsM)	2010A	2011E	2012E	2013E
Net Sales	29,917	66,905	80,827	93,812
COGS	22,437	50,179	60,863	70,922
% of net sales	75.0%	75.0%	75.3%	75.6%
Gross Profit	7,479	16,726	19,964	22,890
Gross Margin (%)	25.0%	25.0%	24.7%	24.4%
Total Variable Expenses	750	1,806	2,042	2,305
% of Net Sales	2.5%	2.7%	2.5%	2.5%
Fixed Expenses				
Employee Costs	1,145	2,527	2,998	3,389
% of Net Sales	3.8%	3.8%	3.7%	3.6%
Other Expenses (SG&A)	3,314	7,362	8,789	10,072
% of Net Sales	11.1%	11.0%	10.9%	10.7%
EBITDA	2,270	5,032	6,136	7,125
% of Net Sales	7.6%	7.5%	7.6%	7.6%
Depreciation	504	1,194	1,320	1,590
% of Net Sales	1.7%	1.8%	1.6%	1.7%
EBIT	1,766	3,838	4,816	5,534
% of Net Sales	5.9%	5.7%	6.0%	5.9%
Total other Income	11	25	30	34
% of Net Sales	0.0%	0.0%	0.0%	0.0%
Interest Expenses	1,030	2,275	2,610	2,877
% of Net Sales	3.4%	3.4%	3.2%	3.1%
Profit Before Tax	747	1,587	2,235	2,692
% of Net Sales	2.5%	2.4%	2.8%	2.9%
Tax	241	524	738	888
% of PBT	32.2%	33.0%	33.0%	33.0%
Recurring PAT	506	1,063	1,497	1,804
% of Net Sales	1.7%	1.6%	1.9%	1.9%

Source: Company Reports and CIRA Estimates; FY10 numbers consist of 2H of Future Value Retail and thus is not comparable to FY11.

Figure 14. Future Value Retail – Balance Sheet Summary

As of Jun 30 (in RsM)	2010E	2011E	2012E	2013E
SOURCES OF FUNDS :				
Share Capital	412	412	412	412
Others	229	229	229	229
Reserves & Surplus	9,650	10,607	11,956	13,580
Total Shareholders Funds	10,291	11,248	12,597	14,221
Deferred Tax Liability / Asset	570	570	570	570
Secured Loans	13,039	14,670	16,504	18,612
Unsecured Loans	2,250	3,750	3,750	3,750
Total Debt	15,289	18,420	20,254	22,362
Total sources of funds	26,150	30,239	33,420	37,153
APPLICATION OF FUNDS :				
Net Fixed Assets	14,310	14,516	16,310	19,338
Current Assets				
Inventories	11,330	12,570	13,835	15,186
Sundry Debtors	1,480	4,399	5,315	6,168
Cash and Bank Balance	630	800	800	800
Loans and Advances	6,070	7,149	7,938	8,696
Total current assets	19,510	24,918	27,887	30,850
Current Liabilities	7,480	8,983	10,517	12,740
Provisions	190	212	260	295
Total current liabilities and provisions	7,670	9,195	10,777	13,036
Net Current Assets	11,840	15,723	17,110	17,815
Total Application of Funds	26,150	30,239	33,420	37,153

Source: Company Reports and CIRA Estimates; FY10 numbers consist of 2H of Future Value Retail and thus is not comparable to FY11.

Pantaloon

Valuation

Our Rs338 target price is based on a sum of the parts approach. We value the core retail business at 25x FY12E PE, which gives us Rs307/share - including both parent business (lifestyle + home retailing) and value retail venture, FVRL. Our target multiple is set at around a c40% premium to the average for the regional peer group, to reflect the higher earnings growth profile for Pantaloon and its dominant positioning in India. Future Capital is valued at Rs20/share (current market price, with 20% holding company discount). We add ~Rs12/share for the other main subsidiaries (Future Generali and Future Logistics), at the investment value.

Risks

We assign a Medium Risk rating to Pantaloon as suggested by our quantitative risk-rating system. The main downside risks to our target price include: 1) Initial trend of encouraging sales growth fades away; 2) Delay in store opening plans; 3) Increase in competitive intensity and/or irrational competition; and 4) Any pressure on rentals, which could result in lower than expected margins. The main upside risks to our target price: 1) Value unlocking in subsidiaries through listing / stake sales, 2) Any significant acquisitions, JVs or partnerships perceived to be creating value; and 3) Legislative changes that allow FDI in retail could be perceived as a sentiment positive from a funding perspective.

Appendix A-1 Analyst Certification

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IMPORTANT DISCLOSURES

Pantaloon (PART.BO) Ratings and Target Price History Fundamental Research

Analyst: Jamshed Dadabhoy
Covered since May 6 2008



Chart current as of 12 February 2011

	Date	Rating	Target Price	Closing Price
1	14-Jan-09	3M	*184.00	189.70
2	26-Apr-09	3M	*180.00	202.05

	Date	Rating	Target Price	Closing Price
3	18-Aug-09	*1M	*370.00	299.10
4	11-Mar-10	1M	*456.00	374.95

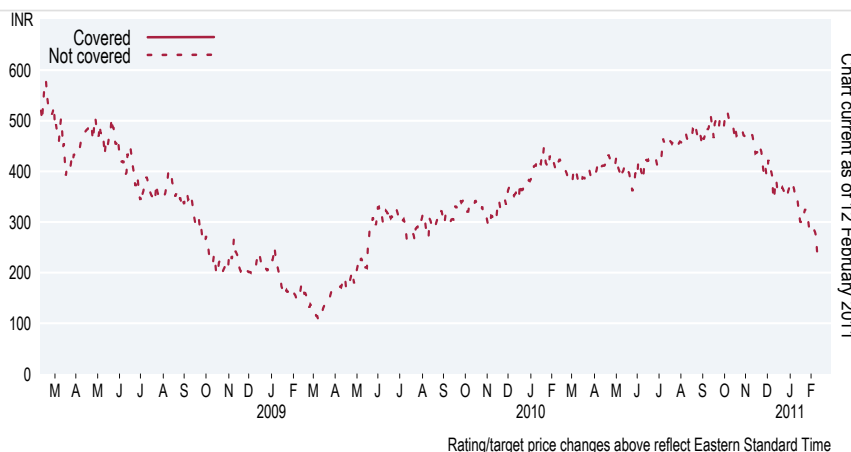
	Date	Rating	Target Price	Closing Price
5	14-Sep-10	1M	*590.00	495.75
6	16-Nov-10	1M	*530.00	436.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Pantaloen (PART.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Jamshed Dadabhoy
Covered since May 6 2008



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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
52%	37%	11%	0%	100%	0%
45%	44%	40%	0%	44%	0%

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