



Power Grid

STOCK INFO.	BLOOMBERG
BSE Sensex: 15,590	PWGR IN
S&P CNX: 4,510	REUTERS CODE N.A

7 September 2007

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IPO Price Band: Rs44-Rs52

Y/E MARCH	2004	2005	2006	2007
Sales (Rs m)	22,630	25,131	31,453	35,899
EBITDA (Rs m)	18,428	20,886	26,662	29,592
NP (Rs m)	8,041	7,674	10,905	13,793
EPS (Rs)	1.7	1.9	2.2	2.6
EPS Growth (%)	12.3	15.1	15.2	16.2
BV/Share (Rs)	26.3	27.6	27.2	28.0
P/E (x)*	31.0	26.9	23.4	20.1
P/BV (x)*	2.0	1.9	1.9	1.9
EV/EBITDA (x)*	14.9	14.1	12.5	12.8
EV/Sales (x)*	12.1	11.7	10.6	10.6
RoE (%)	9.2	9.6	10.0	10.6
RoCE (%)	7.9	7.9	9.1	8.6

*At upper band of Rs52/sh

MARKET CAP (POST ISSUE EQUITY CAPITAL)	(RS M)
Lower Band (Rs44/sh)	185,189
Upper Band (Rs52/sh)	218,860

SHAREHOLDING PATTERN (%)	PRE-IPO	POST-IPO
Government of India	100.0	86.4
Free Float	0.0	13.6

IPO DETAILS

Issue Size: 573.9m shares(Rs24.6b-Rs29.1b)

Price Band: Rs44 to Rs52 per share

Issue Date: 10 Sep-2007 to 13 Sep-07

ISSUE ALLOCATION

Retails	Not less than 35% of issue
Non Inst. bidders	Not less than 15% of issue
Qualified Inst. buyers	At least 50% of issue

PGCIL is a central transmission utility (CTU) with a mini-navratna status, which owns and operates most of India's interstate and inter-regional power transmission system. It has been identified as a nodal agency by the Government to set up inter-regional transmission capacity in India.

Significant ramp up in transmission capacity: During the Eleventh Five Year Plan (FY08 - FY12), planned capex on inter-state and inter-regional transmission network stands at Rs700b. Of this, PGCIL's share stands at Rs550b, which is 1.9x FY07 gross block of Rs290b.

Assured return business, new avenues to further boost overall returns: As per CERC norms, the returns in transmission sector are regulated at 14% ROE, plus incentives (based on normative parameters). Post factoring in the efficiency incentives, PGCIL can earn ROE of 15.5-16.0%. Diversification into telecom and consultancy services will also enable to improve return profile. The company earns services fees ranging from 12-14% for implementation of RGGVY and APDRP schemes, resulting in revenue potential of ~Rs22b during FY08-FY12.

Comparison with NTPC: Post factoring in incentives, PGCIL could earn ROE of 15.5-16.0%, while NTPC could potentially earn 18-20%. This is primarily because of UI charges (1% of generation) and heat rate (fuel consumption on normative parameters), which are absent for PGCIL. Going forward, NTPC could further improve returns through setting up merchant power plants, projects on competitive based tariff, coal mining, etc. Given the better reinvestment rates for NTPC (at 18-20% ROE), we believe that PGCIL should trade at a discount to NTPC.

Recommend Subscribe: We expect PGCIL to report net profit of Rs12.9b in FY08E (up 19% YoY) and Rs17.2b in FY09E (up 33% YoY), a CAGR of 25.7%. At upper price band of Rs52/sh, the stock is valued at P/E of 17.0x FY08E, 12.7x FY09E and P/B of 1.6x FY08E, 1.5x FY09E. For FY09E, this is a substantial discount of 33.6% on PER and 43.6% on P/BV basis, v/s NTPC.

Company background

Power Grid Corporation of India Limited (PGCIL) is the central transmission utility (CTU) in India with a mini-navratna status and owns and operates inter-state and inter-regional transmission lines. It currently handles 45% (298b units) of the total power generated in the country with a network 61,875 ckt kms and 106 substations (as of June-07). It has completed 101 transmission projects valued at Rs251.8b till date. The company forayed into telecom business to leverage its existing resources and domain expertise and currently owns 19,000 kms of optical fiber cable network covering 60 cities. PGCIL is also a nodal agency nominated by the GoI to provide consultancy services for the investment lined up under Rajiv Gandhi Gramin Vidyutikaran Yojana (RGGVY, PGCIL's outlay of Rs94b) and Accelerated power development and Reforms Programme (APDRP, PGCIL's outlay of Rs84b).

PGCL: TREND IN CAPACITY BUILD UP

	FY04	FY05	FY06	FY07	JUL-07
Transmission network (Ckt kms)	47,757	50,745	55,120	59,461	61,875
Substations (nos)	82	85	93	104	106
Trasformation capacity (MVA)	46,461	49,442	54,377	59,417	61,307
Plant availability	99.3	99.74	99.64	99.2	99.52

Source: RHP

Issue details

PGCIL is coming out with an issue of 573.9m shares (Face value of Rs.10) comprising of 382.6m fresh issue of equity shares and offer for sale of 191.3m shares by GoI. Post issue paid up capital stands at 4,208.8m, with GoI's holding at 86.4%. The issue is priced at Rs44/sh to Rs52/sh, resulting in an equity valuation of Rs185.2b - Rs.218.9b. PGCIL will raise Rs16.8b to Rs19.9b through the fresh issue of 382.6m shares, which represents 10% of the pre-issue paid up capital of the company (Rs38,262m) and 9.1% of the post issue paid up capital (Rs42,088m). The issue opens for subscription on September 10, 2007 and closes on September 13, 2007.

ISSUES DETAILS (M SHARES)

Pre-issues paid-up capital	3,826.2
Add: Fresh issue of shares	382.6
Post issue paid up capital	4,208.8

FUNDS RAISED THROUGH IPO (RS M)

	FRESH ISSUE BY PGCIL	OFFER FOR SALE BY GOI	TOTAL
Lower Band of Rs44/sh	16,835	7,803	24,638
Upper Band of Rs52/sh	19,896	9,221	29,118

Source: RHP

Issue to part fund the capex plans

The objective of the proposed IPO is to part fund its equity component of identified projects (capital cost Rs127.1b, financed on DER 70:30). The company has already spent Rs58.6b on these projects and total outstanding investment stands at Rs84.3b. These projects are to be executed during FY08-10, which will increase the total installed capacity by 13,022 ckt kms (current capacity 61,875 ckt kms). As of June 2007, the company is working on 45 transmission projects which are at various stages of implementation. During the Eleventh Five Year Plan (FY08 - FY12), the GoI has set a target to create National Transmission Grid at an investment of Rs700b, of which PGCIL's share is Rs550b.

TREND IN CAPEX (IDENTIFIED PROJECTS, RS M)

	PROJECT COST (RS M)	COD	TILL FY07	FY08	FY09	FY10
Project capex for identified project						
Western region system strengthening Scheme 1	2,065	Nov-07	1,490	898	68	-
Trans systems with Teesta V hydro power project	2,516	Nov-07	1,784	824	222	-
Trans systems with Sipat stage 1 power project	23,311	Dec-07	19,515	3,840	2,330	-
System strengthening VI in southern region	1,137	Dec-07	833	339	204	-
Tran system associated with Kaiga - 3 & 4	5,883	Dec-07	4,097	2,163	956	-
Upgradation of Talcher-Kolar HVDC Bipole link	1,183	Dec-07	532	502	437	-
Trans system associated with NLC - 2	7,781	Dec-07	3,385	3,856	1,869	-
Bina-Nagda transmission line	3,878	Mar-08	2,944	1,172	388	-
Trans systems assoc with Rajasthan atomic power (5 & 6)	5,098	Mar-08	3,680	1,935	-	-
Northern region system strengthening scheme	2,657	Mar-08	1,853	909	229	-
National load dispatch centre	450	May-08	17	81	262	90
Tran system associated with Sipat Stage 2	8,315	Jun-08	1,577	2,407	3,339	2,090
Tran system associated with Kadankulam power project	17,793	Nov-08	7,660	6,712	3,149	2,672
Northern region system strengthening scheme V	7,213	Jun-09	1,027	1,945	2,352	2,000
Trans system assoc with Barh Generation project	37,795	Sep-09	8,234	7,895	10,512	10,250
Total	127,075		58,628	35,478	26,317	17,102

Source: RHP

The company has also initiated the steps to develop certain transmission project on Public-Private Partnership (PPP) basis. It has already developed the 2,000 MW Tala transmission line projects in partnership with Tata Power wherein PGCIL owns 49% stake (investment of Rs2.23b). PGCIL has also entered into JV with Torrent Power with (26% stake) and with Jaiprakash Hydro (20.63% stake) power for Karcham Wangtoo hydro power project.

Assured return business, new avenues to further boost overall returns

As per CERC norms, the returns in transmission sector are set at 14% ROE plus incentives (based on normative parameters). The ROE for the project is calculated on a 30% (equity component) of the total project cost as approved by CERC. The recovery of the fixed charges for the PGCIL is subject to plant availability of 98% for AC systems and 95% for HVDC systems.

Post factoring in the efficiency incentives, we calculate PGCIL's potential ROE at 15.5-16.0%, vs regulated returns of 14.0%. We forecast regulated returns for PGCIL to increase from ~Rs9.1b in FY07 to Rs9.7b in FY08E and Rs13.3b in FY09E (CAGR of 20.7%).

Besides this, the company is eligible for efficiency incentives as follows:

- 1) **Plant availability:** PGCIL earns an incentive based on the availability of its transmission lines beyond the normative availability prescribed by CERC. The target availability prescribed for an alternating current (AC) system is 98% and for an HVDC system is 95%. The incentive is allowed at 1% of equity for each percentage point of increase in annual availability beyond the target availability. No incentives is allowed beyond plant availability of 99.75%.
- 2) **Operation and Maintenance Incentives:** The company can retain the difference (efficiency gain) arising out of the actual operation and maintenance (O&M) expenditure vs the normative as prescribed by CERC. Currently, the normative O&M expenses are specified on number of circuit kilometers (Ckt kms) of transmission lines and the number of bays in substations.

NORMATIVE STANDARDS FOR O&M INCENTIVE (RS M)

	FY05	FY06	FY07	FY08	FY09
Rs m per bays	2.812	2.925	3.042	3.163	3.290
Rs m per ckt kms	0.0227	0.0236	0.0246	0.0255	0.0266

Source: CERC

- 3) **Working capital:** The working capital incentive is again the difference between the normative specified as per the CERC regulation vs the actual working capital. The company can retain savings due to better working capital management.

Calculation of normative working capital

- 1) Operation and Maintenance expenditure for one month,
- 2) 1% of the gross block of an asset for maintenance spares and
- 3) Receivables equivalent to two months' average billing calculated on a normative availability level.

The rate of interest on working capital is equal to the Prime Lending Rate (PLR) of the State Bank of India and the savings on account of lower interest rate can be retained.

New avenues to boost overall returns

The company has forayed into the telecom infrastructure provider business and consultancy business to derive synergy out of its existing assets and core competence. This enables the company to earn higher overall returns of its existing assets.

- 1) **Telecom business:** PGCIL has forayed into Telecom operation in 2001 and it has Infrastructure Provider License. It has laid out 19,000 kms of optical fiber network on its existing towers, which it leases to various telecom operators. The company has incurred a capex of Rs7.5b for this business as of March 2007. During 1QFY08, the division reported revenue of Rs315m (vs Rs773m in FY07) and EBIT of Rs91m (vs. loss of Rs37m in FY07) in 1QFY08. EBIT margins for the division stood at 28.9%.

TREND IN TELECOM BUSINESS PERFORMANCE (RS M)

	FY02	FY03	FY04	FY05	FY06	FY07	1QFY08
Revenues	25	84	75	269	376	773	315
EBIT	(9)	(7)	(74)	(131)	(220)	(37)	91
<i>EBIT margins (%)</i>	-	-	-	-	-	-	28.9

Source: RHP

2) Consultancy Services: PGCIL is appointed as nodal agency by the government to facilitate and supervise the investments planned up under Rajiv Gandhi Gramin Vidyutikaran Yojana (RGGVY, PGCIL's outlay of Rs94b) and Accelerated power development and Reforms Programme (APDRP, PGCIL's outlay of Rs84b). The company earns services fees ranging from 12-14% for implementation of project under RGGVY and APDRP scheme on the total project cost. The targeted investment under both the schemes are to be implemented by the end of the 11th plan i.e. FY2012. Thus company can earn potential revenues of Rs22b+ from these projects over FY08-12.

TREND IN CONSULTANCY BUSINESS PERFORMANCE (RS M)

	FY02	FY03	FY04	FY05	FY06	FY07	1QFY08
Revenues	-	148	370	1,283	1,556	2,263	600
EBIT	-	47	228	1,031	1,193	1,575	382
<i>EBIT margins (%)</i>	-	31.4	61.8	80.4	76.7	69.6	63.7

Source: RHP

Net profit to grow at a CAGR of 25.7% till FY09

During FY07, PGCIL reported revenue of Rs35.9b (up 14% YoY), reported net profit of Rs12.4b and pre-exceptional net profit of Rs10.9b (up 16% YoY). We expect PGCIL to report net profit of Rs12.9b in FY08E (up 19% YoY) and Rs17.2b in FY09E (up 33% YoY), resulting into an EPS of Rs3.1/sh in FY08E and Rs4.1/sh in FY09E.

NET PROFIT COMPOSITION (RS M)

	FY06	FY07	FY08E	FY09E
Transmission business (incl. incentives)			9,681	13,250
Telecom business			116	178
Consultancy services			717	1,091
Other Income (net of tax)			3,034	3,425
Less: Rebate, Provisions, etc			648	751
Total	9,362	10,877	12,901	17,193
<i>Growth (%)</i>		16	19	33

Note: Segment wise net profit composition for FY06 and FY07 not available

Source: RHP/Motilal Oswal Securities

Valuation and view

Comparison with NTPC: Post factoring in incentives, PGCIL could earn ROE of 15.5-16.0%, while NTPC could potentially earn 18-20%. This is primarily because NTPC also eligible for UI charges (1% of generation) and heat rate incentives (fuel consumption on normative parameters) which are large contributors to its overall RoE of 18-20%. Going forward, NTPC could further improve returns through setting up merchant power plants, projects on competitive based tariff, coal mining, etc.

Given the better reinvestment rates for NTPC (at 18-20% ROE), we believe that PGCIL should trade at a discount to NTPC. At upper price band of Rs52/sh, the stock is valued at P/E of 17.0x FY08E, 12.7x FY09E and P/B of 1.6x FY08E, 1.5x FY09E. For FY09E, this is at substantial discount of 33.6% on PER and 43.6% on P/BV basis. We recommend subscribe.

COMPARATIVE VALUATIONS V/S NTPC

PER (X)	FY07	FY08E	FY09E
NTPC	23.5	20.4	19.2
PGCIL	20.1	17.0	12.7
Discount to NTPC (%)	14.5	17.0	33.6
P/BV (x)			
NTPC	3.1	2.9	2.6
PGCIL	1.9	1.6	1.5
Discount to NTPC (%)	40.6	43.8	43.6

Source: Motilal Oswal Securities

FINANCIALS SNAPSHOT (RS M)

	FY06	FY07	FY08E	FY09E
Revenues	31,453	35,899	44,121	56,024
<i>Growth (%)</i>		14.1	22.9	27.0
EBIDTA	20,886	26,662	29,592	36,238
<i>Growth (%)</i>		27.7	11.0	22.5
Profit After Tax	9,362	10,877	12,901	17,193
<i>Growth (%)</i>		16.2	18.6	33.3
Per Share Data				
EPS (Rs/sh)	2.2	2.6	3.1	4.1
Book Value (Rs/sh)	27.2	28.0	32.3	35.1
Return ratios				
RoE (%)	10.0	10.6	10.6	12.1
RoCE (%)	9.1	8.6	8.6	9.3
Valuations (at upper band of Rs52/sh)				
P/E (x)	23.4	20.1	17.0	12.7
P/BV (x)	1.9	1.9	1.6	1.5

Source: RHP/Motilal Oswal Securities

SEGMENTAL RESULTS (RS M)

	FY02	FY03	FY04	FY05	FY06	FY07	1QFY08
Segment Revenue							
Transmission	22,261	23,985	28,824	25,971	30,586	34,757	9,113
Consultancy	-	148	370	1,283	1,556	2,263	600
ULDC/RLDC	245	1,257	1,713	1,536	1,750	1,933	484
Telecom	25	84	75	269	376	773	315
Total Income	22,530	25,475	30,981	29,059	34,268	39,726	10,512
EBIT							
Transmission	13,376	13,155	19,423	15,792	18,852	22,241	5,880
Consultancy	-	47	228	1,031	1,193	1,575	382
ULDC/RLDC	(4)	796	939	771	788	997	218
Telecom	(9)	(7)	(74)	(131)	(220)	(37)	91
Total	13,363	13,990	20,516	17,463	20,614	24,776	6,570
Less : Interest and Fin. Chgs	6,580	7,004	9,910	8,087	9,475	11,404	1,128
Profit Before Tax	6,782	6,986	10,607	9,376	11,139	13,372	5,442
EBIT margins (%)							
Transmission	60.1	54.8	67.4	60.8	61.6	64.0	64.5
Consultancy		31.4	61.8	80.4	76.7	69.6	63.7
ULDC/RLDC	(1.6)	63.3	54.8	50.2	45.0	51.6	45.0
Telecom	(35.9)	(8.6)	(98.7)	(48.8)	(58.3)	(4.8)	28.9
Segment Capital Employed							
Transmission	135,896	156,694	174,273	190,819	214,745	270,871	282,946
Consultancy (including APDRP)	-	(85)	(2,736)	(5,127)	(6,557)	(8,982)	(6,456)
ULDC/RLDC	10,003	12,145	11,548	11,874	14,615	13,817	13,705
Telecom	2,072	2,820	5,513	7,404	7,523	7,545	7,176
Total Segment Capital Emp.	147,970	171,573	188,598	204,971	230,325	283,252	297,372

Source: RHP

INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006	2007
Net Sales	21,400	22,630	25,131	31,453	35,899
Change (%)		5.7	11.0	25.2	14.1
Cost of Goods Sold	1,864	2,353	2,272	2,568	3,389
Staff Cost	2,770	1,850	1,973	2,224	2,918
EBITDA	16,766	18,428	20,886	26,662	29,592
% of Net Sales	78.3	81.4	83.1	84.8	82.4
Depreciation	4,626	6,064	6,423	7,443	8,276
Preliminary Exps written-off	1,396	-1,549	643	648	-1,307
Interest	7,004	9,910	8,087	9,475	11,404
Other Income	3,927	3,698	3,170	3,410	3,590
PBT	7,518	7,143	9,084	11,690	14,820
Tax	1,092	-339	1,228	1,601	2,526
Rate (%)	14.5	-4.7	13.5	13.7	17.0
Reported PAT	6,426	7,482	7,855	10,089	12,294
Extra-ord. Inc. (net of expen:	-138	-420	274	-727	-1,417
Adjusted PAT	6,288	7,062	8,130	9,362	10,877
Change (%)		12.3	15.1	15.2	16.2

BALANCE SHEET					
Y/E MARCH	2003	2004	2005	2006	2007
Equity Share Capital	30,741	30,741	32,041	36,234	38,262
Reserves	41,435	50,247	56,441	62,494	68,763
Less : Misc Exps	-450	1	1	0	0
Net Worth	72,626	80,986	88,480	98,729	107,026
Loans	114,433	122,664	133,880	150,261	193,255
Deferred tax liability	1,867	1,974	2,427	3,125	4,193
Advance against depreciati	2,091	3,953	6,103	8,222	12,012
Grant in Aid	3,352	2,975	2,902	2,730	2,644
Development Surcharge	0	1,952	0	0	0
Capital Employed	194,368	214,505	233,793	263,067	319,130
Gross Fixed Assets	188,595	198,743	218,841	248,883	290,146
Less: Depreciation	43,409	49,895	56,285	63,720	71,986
Net Fixed Assets	145,186	148,848	162,557	185,163	218,161
Capital WIP	26,076	38,901	50,390	64,156	94,554
Investments	18,838	19,980	20,293	21,395	19,670
Deferred Tax Asset	0	0	0	0	0
Curr. Assets	21,270	31,138	28,636	29,591	35,096
Inventory	1,607	1,969	1,843	1,802	1,841
Debtors	2,582	4,777	5,713	4,403	4,904
Cash & Bank Balance	1,184	7,754	6,040	5,890	11,968
Other Current Assets	3,050	3,329	1,785	1,554	1,470
Loans & Advances	12,848	13,309	13,255	15,941	14,913
Current Liab. & Prov.	17,000	24,361	28,081	37,237	48,355
Net Current Assets	4,270	6,777	555	-7,645	-13,258
Application of Funds	194,369	214,505	233,794	263,068	319,130

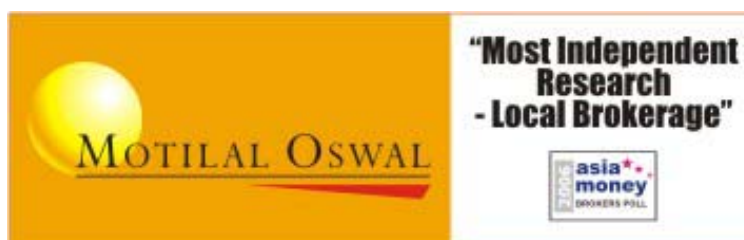
E: MOSt Estimates

RATIOS					
Y/E MARCH	2003	2004	2005	2006	2007
Basic (Rs)					
Consolidated EPS	1.5	1.7	1.9	2.2	2.6
Growth (%)		2.3	15.1	15.2	16.2
Cash EPS	4.0	3.8	4.7	4.8	4.7
Book Value	23.6	26.3	27.6	27.2	28.0
DPS	0.2	0.1	0.5	0.4	0.8
Equity Div.Payout (incl. Div.	15.7	7.5	30.7	20.7	30.6
Valuation					
P/E	34.8	31.0	26.9	23.4	20.1
Cash P/E	13.0	13.8	11.0	10.8	11.1
EV/EBITDA	16.3	14.9	14.1	12.5	12.8
EV/Sales	12.8	12.1	11.7	10.6	10.6
Price/Book Value	2.2	2.0	1.9	1.9	1.9
Dividend Yield (%)	0.5	0.2		0.8	1.5
Profitability Ratios (%)					
RoE	0.0	9.2	9.6	10.0	10.6
RoCE	16.5	7.9	7.9	9.1	8.6
Turnover Ratios					
Debtors (Days)	44	77	83	51	50
Asset Turnover (x)	0.3	0.2	0.2	0.2	0.2
Leverage Ratio					
Debt/Equity (x)	16	15	15	15	18

CASH FLOW STATEMENT					
Y/E MARCH	2003	2004	2005	2006	2007
PBT before Extraordinary It	7,563	8,809	12,417	14,727	14,727
Add : Depreciation		6,064	6,423	7,443	8,276
Interest		9,910	8,087	9,475	11,404
Less : Direct Taxes Paid		-339	1,228	1,601	2,526
(Inc)/Dec in WC		4,064	4,507	8,051	11,691
CF from Operations	27,940	26,598	35,785	43,572	43,572
CF from Oper. incl. EO	27,519	26,872	35,058	43,664	43,664
(Inc)/Dec in FA		-22,551	-31,620	-43,815	-71,672
(Pur)/Sale of Investments		-1,142	-313	-1,102	1,725
CF from Investments	-23,693	-31,933	-44,917	-69,947	-69,947
(Inc)/Dec in Networth		1,443	2,047	2,248	-229
(Inc)/Dec in Debt		11,776	11,795	19,026	47,766
Less : Interest Paid		9,910	8,087	9,475	11,404
Dividend Paid		564	2,408	2,089	3,768
CF from Fin. Activity	2,745	3,347	9,710	32,365	32,365
Inc/Dec of Cash	6,571	-1,715	-149	6,082	6,082
Add: Beginning Balance		1,184	7,754	6,040	5,890
Closing Balance	7,754	6,040	5,890	11,972	11,972

E: MOSt Estimates

N O T E S



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Power Grid

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