

BGR Energy Systems

Bloomberg: BGRL IN EQUITY
Reuters: BGRE.BO

BUY



COMPANY UPDATE

Order inflows remain elusive

Given weak order inflows, BGR has underperformed the broader market by 24% in the last three months. We are downgrading our order intake assumption by 21% in FY12 and consequently our sales and earnings estimates by 5% and 6% respectively for FY12. However, given the likely finalization of key orders in the near term, we continue to maintain our BUY recommendation.

Strong execution continues in 3Q11: BGR's PAT at Rs876mn came 30% and 25% ahead of our and consensus estimates respectively on account of stronger execution, higher other income and lower tax provision. Revenues at Rs12.5bn (16% ahead of expectations) grew 97% yoy on the back of continued strong execution (revenues from Construction & EPC segment grew 95% yoy). EBITDA at Rs1.4bn was up 98% yoy (in line with revenues) as BGR maintained EBITDA margins of ~11.3%. Thanks to the higher other income and lower tax provision, PAT at Rs876mn increased 109% yoy.

However, order inflows are a major concern: Disappointing order intake (order intake of ~Rs22bn in 9M11 is equivalent to only 16% of the full year guidance of Rs120-150bn) meant that despite strong results, BGR has underperformed broader markets by ~24% since 2Q11 results. Apart from the turnkey BoP order of Rs21.7bn won in the last quarter (3Q11), BGR hasn't won any major orders YTD. Furthermore, delays in the Rajasthan EPC order (initially expected during 3Q11) and the NTPC bulk tender (BGR along with BHEL and L&T, have technically qualified) do not augur well for stock.

Outlook & Valuation: Regarding weak order intake, we give the benefit of doubt to the management as the Letter of Intent (LOI) and the price bids for the Rajasthan and the NTPC bulk tender have been delayed respectively. These delays are now common across the Power & Infra sector in India and are currently being exacerbated by the policy gridlock in Delhi. We continue to believe that the likelihood of BGR bagging at least one of the Rajasthan EPC orders is high due to: (a) only two bidders (BHEL, BGR) being in the fray for the two orders; (b) Rajasthan being a repeat client for BGR; and (c) given the sheer size of each order (~Rs60-61bn), the probability of one order going to each bidder is high. Assuming BGR wins one of the Rajasthan orders, the order book would swell to ~Rs154bn, improving revenue visibility (~3.3x its FY11E revenues). Currently, BGR trades at ~10.3x FY12 P/E which is at a discount of ~50%+ compared to larger peers in the capital goods space (compared to its historical average of 20-25% since listing).

Based on our DCF model (which assumes WACC of 11.5% and terminal growth rate of 4%), we value BGR at Rs715 (25% lower than earlier target price of Rs950) implying 14.4x FY12 P/E.

Exhibit 1: Key financials

Year to March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Operating income	19,303	30,734	47,194	59,651	72,049
EBITDA	2,089	3,442	5,268	6,554	7,887
Net profit	1,154	2,013	3,112	3,594	4,217
EPS (Rs)	16.0	28.0	43.1	49.8	58.5
RoE (%)	22.1	31.6	37.3	32.6	29.7
P/E (x)	31.9	18.3	11.9	10.3	8.8
P/BV (x)	6.5	5.2	3.9	3.0	2.3

Source: Company, Ambit Capital research

Analyst contacts

Puneet Bambha

Tel: +91 22 3043 3259
puneetbambha@ambitcapital.com

Bhargav Buddhadev

Tel: +91 22 3043 3252
bhargavbuddhadev@ambitcapital.com

Recommendation

CMP:	Rs512
Target Price:	Rs715
Previous TP:	Rs950
Upside (%)	40
EPS (FY12E):	Rs49.8
Change from previous (%)	(6%)

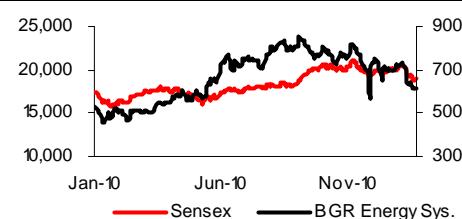
Stock Information

Mkt cap:	Rs37bn/US\$812mn
52-wk H/L:	Rs950/434
3M ADV:	Rs369mn/US\$8.1mn
Beta:	1.7x
BSE Sensex:	18,301
Nifty:	5,482

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	-16.5	-31.5	2.5	-29.6
Rel. to Sensex	-13.6	-23.7	-10.3	-18.8

Performance (%)



Source: Bloomberg, Ambit Capital research

Company Financial Snapshot

Profit and Loss (consolidated)

	FY10	FY11E	FY12E
Net sales	30,734	47,194	59,651
Optg. Exp(Adj for OI.)	27,292	41,927	53,097
EBIDTA	3,442	5,268	6,554
Depreciation	103	148	207
Interest Expense	538	966	1,327
PBT	3,051	4,718	5,448
Tax	1,037	1,604	1,852
Adj. PAT	2,015	3,114	3,596

Profit and Loss Ratios

EBIDTA Margin %	11.2	11.2	11.0
Adj Net Margin %	6.6	6.6	6.0
P/E (X)	18.3	11.9	10.3
EV/EBIDTA (X)	10.5	7.9	7.1
Dividend Yield (%)	1.4	1.5	1.6

Company Background

BGR Energy Systems, incorporated in 1985, has over the last decade diversified its presence and scaled up from being a mere manufacturer of few BoP (balance of plant) packages to executing turnkey BoP projects, followed by implementation of full-fledged EPC contracts. Now, the company has also forayed into the supercritical BTG (boiler, turbine and generator) manufacturing space via a JV with Hitachi. Mr T. Sankaralingam (previously chairman and managing director of NTPC) joined BGR as managing director in September 2009.

Balance Sheet (consolidated)

	FY10	FY11E	FY12E
Total Assets	39,268	53,139	64,985
Net Fixed Assets	1,557	2,159	2,953
Current Assets	37,704	48,973	56,225
Other Assets	7	2,007	5,807
Total Liabilities	39,268	53,139	64,985
Networth	7,092	9,573	12,493
Debt	9,336	14,086	18,086
Current Liabilities	21,289	27,930	32,854
Deferred Tax	1,551	1,551	1,551

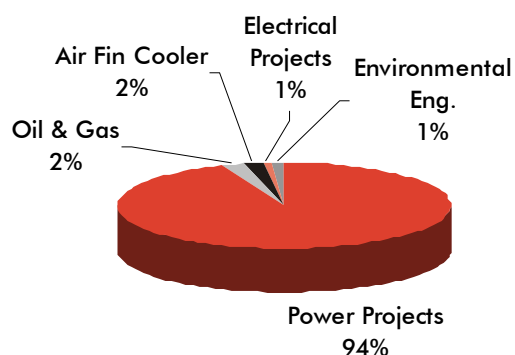
Balance Sheet Ratios

ROE %	31.6	37.3	32.6
ROCE %	15.1	17.4	15.6
Net Debt/Equity	-0.1	0.5	0.8
Total Debt/Equity	1.3	1.5	1.4
P/BV (X)	5.2	3.9	3.0

Cash Flow (consolidated)

	FY10	FY11E	FY12E
PBT	3,051	4,718	5,448
Depreciation	97	148	207
Tax	(288)	2,549	1,852
Change in Wkg Cap	(678)	(4,742)	(3,087)
Others	0	0	0
CF from Operations	2,758	(2,426)	715
Capex	(623)	(750)	(1,000)
Investments	0	(2,000)	(3,800)
CF from Investing	(623)	(2,750)	(4,800)
Change in Equity	0	0	0
Debt	2,246	4,750	4,000
Dividends & others	(253)	(590)	(633)
CF from Financing	1,994	4,160	3,367
Change in Cash	4,129	(1,015)	(718)

Revenue Breakdown

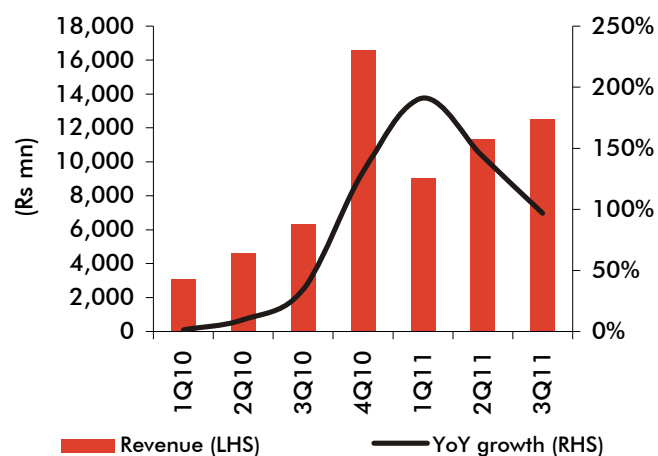


Source: Company, Ambit Capital research

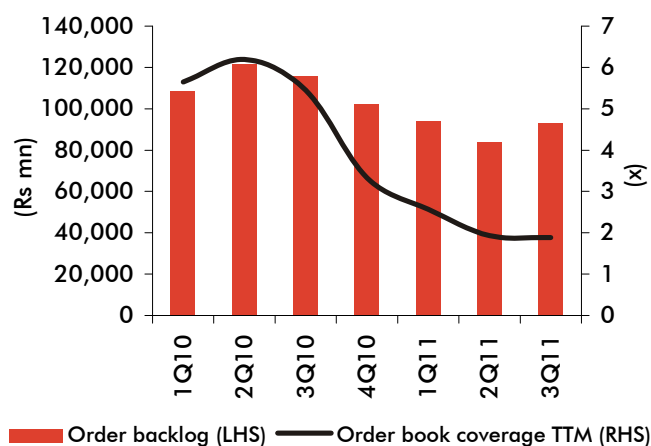
BGR only third player to manufacture entire BTG

Company / Group	Boiler (MW)	Turbine Generator (MW)
BHEL	20,000	20,000
L&T - Mitsubishi	4,000	4,000
BGR Energy - Hitachi	4,000	4,000
GB Engineering - Ansaldo	2,000	-
Thermax - Babcock & Wilcox	3,000	-
JSW - Toshiba	-	3,000
Bharat Forge - Alstom	-	5,000

Source: Industry, Ambit Capital research

Exhibit 2: Whilst execution continues to be strong...


Source: Company, Ambit Capital research

Exhibit 3: ...order intake has been dismal


Source: Company, Ambit Capital research

Exhibit 4: Quarterly snapshot

Rs mn	3Q11	3Q10	YoY Growth	9M11	9M10	YoY growth	3Q11E	Divergence (%)
Net sales	12,511	6,351	97%	32,902	14,122	133%	10,748	16%
Raw materials	10,101	4,964	103%	26,744	11,045	142%	8,835	14%
Employee cost	415	317	31%	1,078	772	39%	363	14%
Other expenses	581	356	63%	1,337	594	125%	371	57%
Total Expenditure	11,097	5,637	97%	29,159	12,412	135%	9,568	16%
EBITDA	1,414	714	98%	3,744	1,710	119%	1,180	20%
Other income	75	37	101%	158	181	-13%	17	335%
Depreciation	34	24	43%	98	67	46%	36	-4%
Interest	168	93	81%	422	419	1%	142	18%
PBT	1,287	635	103%	3,382	1,404	141%	1,020	26%
Tax	411	216	91%	1,124	477	135%	347	19%
PAT	876	419	109%	2,259	927	144%	673	30%
Tax rate	32%	34%		33%	34%		34%	
Raw Material (% of sales)	80.7%	78.2%		81.3%	78.2%		82.2%	
Employee cost (% of sales)	3.3%	5.0%		3.3%	5.5%		3.4%	
Other expenses (% of sales)	4.6%	5.6%		4.1%	4.2%		3.4%	
EBITDA (% of sales)	11.3%	11.2%		11.4%	12.1%		11.0%	
PBT (% of sales)	10.3%	10.0%		10.3%	9.9%		9.5%	
PAT (% of sales)	7.0%	6.6%		6.9%	6.6%		6.3%	

Source: Company, Ambit Capital research

Change in estimates

In light of the scanty order inflows, we downgrade our FY12 order intake assumptions by 21% to Rs87bn. This, coupled with the delay in receipt of Rajasthan order (we now expect this order to come in 4QFY11 instead of earlier 3QFY11), results in us downgrading our FY12 sales and earnings estimates by 5% and 6% respectively.

Exhibit 5: Change to our estimates

	New estimates		Old estimates		Change		Comment
(Rs mn)	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	
Order inflows	85,780	87,010	82,324	109,816	4%	-21%	Factoring in lower orders for FY12E
Order backlog	140,989	168,462	136,960	183,998	3%	-8%	
Sales	47,194	59,651	47,768	62,892	-1%	-5%	Lower order inflows assumptions and slower than expected revenue booking for the delayed EPC order
EBITDA	5,268	6,554	5,339	6,908	-1%	-5%	
EBITDA margin	11.2%	11.0%	11.2%	11.0%	(1)	0	
PAT	3,112	3,594	3,081	3,824	1%	-6%	PAT reduction is in-line with the overall estimates
EPS (Rs)	43.1	49.8	42.7	53.0	1%	-6%	

Source: Company, Ambit Capital research

Key Assumptions

We now expect BGR to report revenue and profit CAGR of 32.8% and 28.0% over FY10-13 driven by the assumptions shown in the table below.

Exhibit 6: Key assumptions and estimates for BGR

(all numbers in Rs mn unless otherwise stated)	FY09	FY10	FY11E	FY12E	FY13E	Comments
Assumptions						
Order Inflow	82,331	36,500	85,780	87,010	87,527	We have assumed that BGR will bag a yearly run rate of 1,320MW of BoP and 1,320 MW of EPC orders in FY12 and FY13
Order Backlog	95,230	102,300	140,989	168,462	184,066	
Bill to Book (x)	0.6	0.3	0.5	0.4	0.4	We have assumed order backlog to increase at a CAGR of 22% over FY10-13 assuming bill to book ratio of 0.4 in FY12 and FY13
Key outputs						
Sales	19,303	30,734	47,194	59,651	72,049	Based on the assumptions highlighted above, we expect revenues to grow at CAGR of 33% over FY10-13 (FY08-10 CAGR has been 42%)
Sales (% change YoY)	27.0	59.2	53.6	26.4	20.8	
EBITDA	2,089	3,442	5,268	6,554	7,887	We expect operating margins to stabilize at ~11% over FY10-13 translating into an EBITDA CAGR of 32% over FY10-13
EBITDA margin (%)	10.8	11.2	11.2	11.0	10.9	
EBITDA (% change YoY)	34.5	64.8	53.1	24.4	20.3	
PAT	1,154	2,013	3,112	3,594	4,217	Consequently, we expect net profit CAGR of 28% over FY10-13 (FY08-10 CAGR has been 52%)
PAT (% change YoY)	32.2	74.4	54.6	15.5	17.4	
Cash flows						
CFO	233	2,758	(2,426)	715	1,679	We expect BGR to return to positive CFO from FY12 onwards
CFI	954	(623)	(2,750)	(4,800)	(4,800)	We model investments to made by the BGR into a JV with Hitachi for the setting up BTG manufacturing plants
CFF	1,894	1,994	4,160	3,367	3,325	
Change in cash	3,081	4,129	(1,015)	(718)	203	

Source: Company, Ambit Capital research

For FY11, our headline numbers are broadly in-line with street estimates. However, for FY12 our earnings estimates are 5% ahead of consensus. This could be because of our higher order inflow assumptions or better order book execution rate compared to consensus (note for FY12, we have assumed order inflows and bill to book ratio of ~Rs87bn and 0.4 respectively).

Exhibit 7: Ambit v/s consensus

	Consensus	Ambit	% Divergence
Sales (Rs mn)			
FY11E	46,974	47,194	1%
FY12E	57,957	59,651	3%
EPS (Rs)			
FY11E	42.4	43.1	2%
FY12E	47.6	49.8	5%

Source: Bloomberg, Ambit Capital research

Valuation

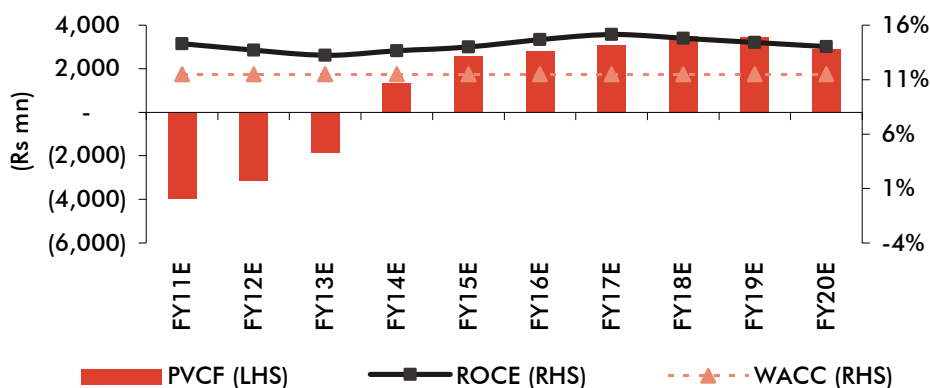
Absolute valuation

Given the delays that BGR is facing in winning new orders, we now value BGR using a free cash flow to firm (FCFF) model (note we earlier used to value BGR using a P/E multiple). Our FCFF metric is 'cash profit – increase in working capital – capex requirements'. Our FCFF model has following distinct phases:

- **FY11-14:** We do explicit valuation until FY14 assuming: (i) revenues will grow at a CAGR of 28% over FY10-14 (FY08-10 CAGR has been 42%); and (ii) EBIT margins would stabilize at ~10.4% by FY14 from current levels of 10.9%.
- **FY15-20:** During this period, we assume that: (i) revenues will grow at a CAGR of 10% over FY14-20; and (ii) EBIT margins would stabilize at ~10.0%.
- **From FY21:** FCFF would grow at a CAGR of 4%.

Based on these assumptions and assuming a weighted average cost of capital of 11.5%, our FCFF model values BGR at Rs715 per share (implied valuation of 14.4x FY12 P/E). We maintain our BUY recommendation on the stock, with a revised Target Price of Rs715 (Rs950), implying 40% upside.

Exhibit 8: DCF valuation for BGR



Source: Company, Ambit Capital research

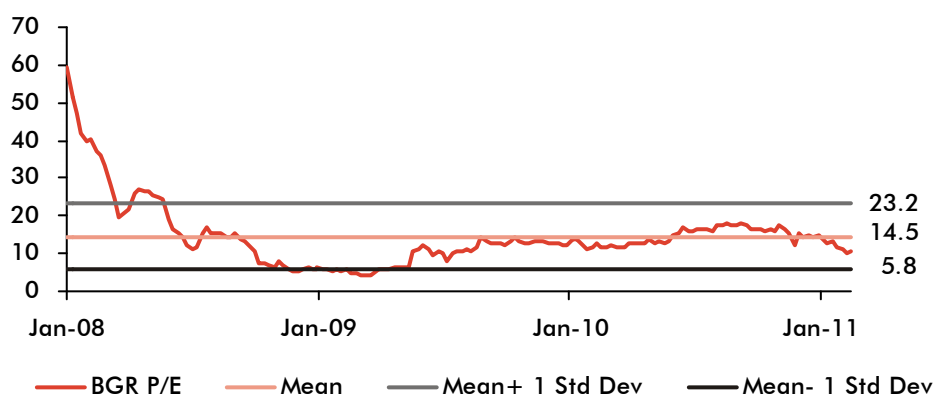
Relative valuation

At 512, BGR trades at ~10.3x FY12 P/E which is at a discount of 50%+ compared to larger peers in the capital goods space. Post the recent correction (32% in the last three month) the discount to larger peers has doubled to 50% from historical average of 20-25% since listing. Whilst we can see the grounds for BGR to trade at a discount to Tier 1 players like BHEL and Thermax, we believe that the current discount of ~50% is too high, given BGR's stellar RoEs (average RoE of 34% v/s 24% for peers) and superior earnings growth rate (34% CAGR over FY10-12 v/s 24% for peers).

Exhibit 9: Relative valuation

Company	Share Price (Rs)	P/E (x)		P/B (x)		EV/EBITDA (x)		RoE (%)		EPS growth (%) FY10-12 CAGR
		FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	
ABB*	661	67.5	29.5	5.1	4.4	46.6	19.9	10.3	16.5	15.7
BGR Energy	512	11.9	10.3	3.9	3.0	7.9	7.1	37.3	32.6	33.5
Thermax	638	20.5	16.5	5.6	4.5	12.3	9.8	30.1	29.3	78.5
BHEL	2,048	18.0	14.8	5.1	4.1	12.7	10.3	30.3	30.0	25.2
Siemens#	838	29.2	23.9	7.0	5.6	18.2	15.1	25.9	26.1	24.8
Crompton Greaves	261	18.4	15.8	5.1	4.0	12.8	11.1	31.5	27.8	10.9
Larsen & Toubro	1,655	22.6	18.8	4.1	3.5	13.6	10.9	18.6	18.8	-2.0
Areva T&D*	288	40.5	29.1	7.0	5.9	20.2	16.1	18.0	21.6	11.0
Average		28.6	19.8	5.4	4.4	18.0	12.5	25.2	25.3	24.7

Source: Bloomberg, Ambit Capital research, Note: # year ending December, * year ending September

Exhibit 10: 1-year forward P/E band mean


Source: Bloomberg, Ambit Capital research

Sensitivity Analysis
Exhibit 11: Sensitivity analysis

	High Case	Base Case	Low Case
Revenue growth	We have assumed that BGR will incrementally bag 1,320MW of BoP and 1,980MW of EPC orders per annum over FY12-14, translating into revenue CAGR of 36% over FY10-14. Thereafter we model revenue CAGR of 12.5% over FY14-20.	We have assumed that BGR will incrementally bag 1,320MW of BoP and 1,320MW of EPC orders per annum over FY12-14, translating into revenue CAGR of 28% over FY10-14. Thereafter we model revenue CAGR of 10.0% over FY14-20.	We have assumed that BGR will incrementally bag 1,320MW of BoP and 660MW of EPC orders per annum over FY12-14, translating into revenue CAGR of 19% over FY10-14. Thereafter we model revenue CAGR of 7.5% over FY14-20.
Operating Margins	We model EBIT margins to gradually decline from 10.8% in FY11 to 10.6% in FY14 and consequently stabilize around 10.3% over the long term.	We model EBIT margins to gradually decline from 10.8% in FY11 and stabilize around 10% over the long term.	We model EBIT margins to gradually decline from 10.8% in FY11 to 10.2% in FY14 and consequently stabilize around 9.8% over the long term.
Working capital cycle	We model working capital cycle on an average of ~88 days over FY11-14. Subsequently, we model this to gradually reduce and stabilize around 66 days over the long term.	We model working capital cycle of ~90 days over FY11-14. Subsequently, we model this to gradually reduce and stabilize around 73 days over the long term.	We model working capital cycle on an average of ~92 days over FY11-14. Subsequently, we model this to gradually stabilize around 80 days over the long term.
Fair value (Rs/share)	1,010	715	477

Source: Company, Ambit Capital research

Key Risks

Given the current political impasse in Delhi, the biggest risk to our BUY stance is the big EPC orders that the company has been banking upon do not arrive.

Exhibit 12: Balance sheet (consolidated)

Year to March (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Cash & equivalents	6,156	10,285	9,269	8,552	8,755
Debtors	12,789	19,803	30,624	38,015	42,916
Inventory	140	162	301	353	437
Loans & advances	6,610	7,455	8,778	9,306	11,240
Investments	1	1	2,001	5,801	9,601
Fixed assets	1,031	1,557	2,159	2,953	3,680
Miscellaneous	6	6	6	6	6
Total assets	26,733	39,268	53,139	64,985	76,635
Current liabilities & provisions	13,229	21,289	27,930	32,854	37,044
Debt	7,090	9,336	14,086	18,086	22,086
Other liabilities	747	1,551	1,551	1,551	1,551
Total liabilities	21,066	32,176	43,567	52,491	60,681
Shareholders' equity	720	720	721	721	721
Reserves & surpluses	4,947	6,372	8,851	11,772	15,232
Total networth	5,667	7,092	9,573	12,493	15,954
Net working capital	6,310	6,130	11,774	14,819	17,549
Net debt (cash)	934	(948)	4,817	9,535	13,331

Source: Company, Ambit Capital research

Exhibit 13: Income statement (consolidated)

Year to March (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
Operating income	19,303	30,734	47,194	59,651	72,049
% growth	27.0	59.2	53.6	26.4	20.8
Operating expenditure	17,214	27,292	41,927	53,097	64,162
EBITDA	2,089	3,442	5,268	6,554	7,887
% growth	34.5	64.8	53.1	24.4	20.3
Depreciation	75	103	148	207	273
EBIT	2,014	3,339	5,120	6,348	7,614
Interest expenditure	579	538	966	1,327	1,657
Non-operational income / Exceptional items	317	250	564	428	437
PBT	1,752	3,051	4,718	5,448	6,394
Tax	596	1,037	1,604	1,852	2,174
PAT before minority	1,156	2,015	3,114	3,596	4,220
Minority Interest	1	1	2	2	2
PAT / Net profit	1,154	2,013	3,112	3,594	4,217
% growth	32.2	74.4	54.6	15.5	17.4

Source: Company, Ambit Capital research

Exhibit 14: Cash flow statement (consolidated)

Year to March (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E
EBIT	2,014	3,339	5,120	6,348	7,614
Other income (expenditure)	317	250	564	428	437
Depreciation	62	97	148	207	273
Interest	579	538	966	1,327	1,657
Tax	14	(288)	2,549	1,852	2,174
(Incr) / decr in net working capital	(1,566)	(678)	(4,742)	(3,087)	(2,814)
Others	0	0	0	0	0
Cash flow from operating activities	233	2,758	(2,426)	715	1,679
(Incr) / decr in capital expenditure	(555)	(623)	(750)	(1,000)	(1,000)
(Incr) / decr in investments	1,509	0	(2,000)	(3,800)	(3,800)
Cash flow from investing activities	954	(623)	(2,750)	(4,800)	(4,800)
Issuance of equity	0	0	0	0	0
Incr / (decr) in borrowings	2,063	2,246	4,750	4,000	4,000
Dividend paid	(168)	(253)	(590)	(633)	(675)
Others	0	(0)	0	0	0
Cash flow from financing activities	1,894	1,994	4,160	3,367	3,325
Net change in cash	3,081	4,129	(1,015)	(718)	203
Closing cash balance	6,151	10,280	9,265	8,548	8,751

Source: Company, Ambit Capital research

Exhibit 15: Ratio analysis

Year to March (%)	FY09	FY10	FY11E	FY12E	FY13E
EBITDA margin	10.8	11.2	11.2	11.0	10.9
EBIT margin	10.4	10.9	10.8	10.6	10.6
Net profit margin	6.0	6.6	6.6	6.0	5.9
Return on capital employed	13.0	15.1	17.4	15.6	14.8
Return on equity	22.1	31.6	37.3	32.6	29.7
Dividend payout ratio	18.7	25.0	17.4	16.1	15.4
Current ratio (x)	1.9	1.8	1.8	1.7	1.7

Source: Company, Ambit Capital research

Exhibit 16: Valuation parameters

Year to March	FY09	FY10	FY11E	FY12E	FY13E
EPS (Rs)	16.0	28.0	43.1	49.8	58.5
Diluted EPS (Rs)	16.0	28.0	43.2	49.8	58.5
Book value per share (Rs)	78.7	98.5	132.7	173.2	221.2
P/E (x)	31.9	18.3	11.9	10.3	8.8
P/BV (x)	6.5	5.2	3.9	3.0	2.3
EV/EBITDA (x)	18.1	10.5	7.9	7.1	6.4
EV/Sales (x)	2.0	1.2	0.9	0.8	0.7

Source: Company, Ambit Capital research

Institutional Equities Team

Saurabh Mukherjea,
CFA

Managing Director - Institutional Equities – (022) 30433174

saurabhmukherjea@ambitcapital.com

Research

Analysts	Industry Sectors	Desk-Phone	E-mail
Amit K. Ahire	Telecom / Media & Entertainment	(022) 30433202	amitahire@ambitcapital.com
Ankur Rudra, CFA	IT/Education Services	(022) 30433211	ankurrudra@ambitcapital.com
Ashish Shroff	Technical Analysis	(022) 30433209/3221	ashishshroff@ambitcapital.com
Ashvin Shetty	Consumer	(022) 30433285	ashvinshetty@ambitcapital.com
Bhargav Buddhadev	Power/Capital Goods	(022) 30433252	bhargavbuddhadev@ambitcapital.com
Chandrani De, CFA	Metals & Mining	(022) 30433210	chandranide@ambitcapital.com
Chhavi Agarwal	Infrastructure	(022) 30433203	chhaviagarwal@ambitcapital.com
Gaurav Mehta	Derivatives Research	(022) 30433255	gauravmehta@ambitcapital.com
Krishnan ASV	Banking	(022) 30433205	vkrishnan@ambitcapital.com
Nitin Bhasin	Infrastructure	(022) 30433241	nitinbhasin@ambitcapital.com
Pankaj Agarwal, CFA	NBFCs	(022) 30433206	pankajagarwal@ambitcapital.com
Parikshit Kandpal	Construction / Real estate	(022) 30433201	parikshitkandpal@ambitcapital.com
Poonam Saney	BFSI	(022) 30433216	poonamsaney@ambitcapital.com
Puneet Bambha	Power/Capital Goods	(022) 30433259	puneetbambha@ambitcapital.com
Rajesh Kumar Ravi	Cement	(022) 30433274	rajeshravi@ambitcapital.com
Ritika Mankar	Economy	(022) 30433175	ritikamankar@ambitcapital.com
Ritu Modi	Metals & Mining	(022) 30433292	ritumodi@ambitcapital.com
Subhashini Gurumurthy	IT/Education Services	(022) 30433264	subhashinig@ambitcapital.com
Vijay Chugh	Consumer (incl FMCG, Retail, Automobiles)	(022) 30433054	vijaychugh@ambitcapital.com

Sales

Name	Designation	Desk-Phone	E-mail
Deepak Sawhney	VP - Ins Equity	(022) 30433295	deepaksawhney@ambitcapital.com
Dharmen Shah	VP - Ins Equity	(022) 30433289	dharmenshah@ambitcapital.com
Dipti Mehta	Senior Manager Equities	(022) 30433053	diptimehta@ambitcapital.com
Pramod Gubbi, CFA	VP - Ins Equity	(022) 30433228	pramodgubbi@ambitcapital.com
Sarojini Ramachandran	Director, Sales	+44 (0) 20 7614 8374	sarojini@panmure.com

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	>15%
Hold	5% to 15%
Sell	<5%

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Ambit Capital Pvt. Ltd.

Ambit House, 3rd Floor
449, Senapati Bapat Marg, Lower
Parel, Mumbai 400 013, India.
Phone : +91-22-3043 3000
Fax : +91-22-3043 3100