

Tata Power

Q2 consolidated review

1 December 2009

Hold

Target Price: Rs1,321

CMP: Rs1,355*

Downside: 2.5%

*as on 30 November 2009

Madanagopal R

r.madanagopal@centrum.co.in
91 22 4215 9684

Amit Sinha

amit.sinha@centrum.co.in
91 22 4215 9927

Dollar impact

Tata Power's consolidated Q2FY10 disappointed on lower-than-expected margins and higher-than-expected depreciation. However, we expect realizations to improve next quarter on the back of rising Asian coal prices and thus reiterate our Hold rating on the stock.

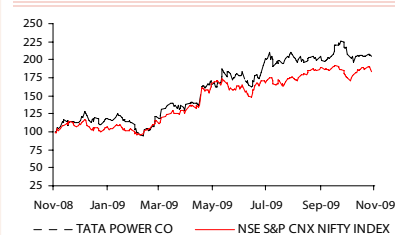
- **Coal revenue stable QoQ in rupee terms but superior QoQ in dollar terms:** The coal business reported in line revenues of Rs11.3bn. Growth QoQ was even better in US\$ terms at 12.9% owing to improved realizations and volumes, but compensated by unfavorable exchange rate.
- **Repayment of SPV loans on fast track:** We have estimated a repayment of US\$116mn during the year and a closing balance of US\$648mn in FY10. However, we see a likelihood of higher repayment, as the existing balance is already US\$640mn with mere 6 more months to go.
- **Reiterate Hold** At CMP, the stock trades at 2.9x FY10E P/BV, which we feel is fairly valued and inline with peers. Factoring in the dilution impact, we cut our target price to Rs1,321, but retain our Hold rating on the stock with a positive bias.

Key Data

Bloomberg Code	TPWR IN
Reuters Code	TTPW.BO
Current Shares O/S (mn)	237.2
Diluted Shares O/S(mn)	237.2
Mkt Cap (Rsbn/USDbn)	321.3/6.9
52 Wk H / L (Rs)	1,490/602
Daily Vol. (3M NSE Avg.)	493,674
Face Value (Rs)	10

1 USD = Rs46.5

One year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Tata Power	1.2	26.5	102.6
NIFTY	4.9	11.1	79.4

Source: Bloomberg, Centrum Research
*as on 30 November 2009

Y/E March (Rsmn)	Q2FY10	Q2FY09	YoY (%)	Q1FY10	QoQ (%)	Q2FY10E	Variance (%)
Net sales	45,792	46,374	(1.3)	44,555	2.8	41,944	9.2
Purchases	30,237	32,303		29,553		26,005	
% of sales	66.0	69.7	(363) bp	66.3	(30) bp	62.0	403 bp
Employee costs	2,484	1,635		1,849		1,867	
% of sales	5.4	3.5		4.1		4.5	
Other expenditure	3,573	3,776		3,669		3,559	
% of sales	7.8	8.1		8.2		8.5	
Operating profit	9,498	8,660	9.7	9,483	0.2	10,512	(9.6)
OPM (%)	20.7	18.7	207 bp	21.3	(54) bp	25.1	(432) bp
Depreciation & amortisation	2,244	1,788		2,011		1,971	
Interest	1,877	1,695		2,055		1,897	
EBT	5,377	5,177	3.8	5,417	(0.7)	6,644	(19.1)
Other income	496.4	440.6		687		450	
PBT	5,873	5,618	4.5	6,105	(3.8)	7,094	(17.2)
Exceptional item (as reported)	287	764		2,567		-	
Provision for tax	2,387	1,048		2,846		2,604	
-effective tax rate	38.7	18.7		46.6		36.7	
Minority int/Share of associates	86	(35.3)		299		390.0	
PAT (reported)	3,687	5,369	(31.3)	5,528	(33.3)	4101	(10.1)
Exceptional item (post tax)	-226	114		1,535		450	
PAT (adjusted)	3,913	5,255	(25.5)	3,993	(2.0)	4,551	(14.0)
NPM (%)	8.5	11.3	(279) bp	9.0	(42) bp	10.8	(230) bp

Source: Company, Centrum Research

Y/E Mar (Rsmn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	RoE (%)	RoIC(%)	P/E (x)	P/B(x)
FY07	63,730	15.1	9,868	15.5	5,056	1.6	38.4	9.8	20.1	52.7	4.9
FY08	108,909	70.9	21,221	19.5	7,023	38.9	47.8	10.8	14.4	42.3	3.9
FY09	173,769	59.6	34,390	19.8	9,955	15.5	55.0	12.2	10.0	29.9	3.5
FY10E	172,188	(0.9)	45,518	26.4	14,796	30.3	60.0	14.7	12.4	22.4	2.9
FY11E	195,174	13.3	55,989	28.7	19,881	25.2	83.8	16.2	12.9	16.7	2.6

Source: Company, Centrum Research Estimate

Please refer to important disclosures/disclaimers inside

Results let down but coal realization shows signs of improvement

Tata Power reported disappointing consolidated Q2FY10 on the back of lower margins from the coal business and higher-than-expected depreciation. Sales remained stable at Rs45.8bn, both YoY and QoQ, but was 9.2% higher than our estimate on improved sales from North Delhi Power Ltd. (NDPL). EBITDA grew 9.7% to Rs9.5bn YoY and remained stable QoQ, but was 9.6% below our estimate due to lower margins from the coal business. PBIT margins too fell 600bp short of our estimate of 36% due to increase in cost of coal mining and unfavorable exchange rate. Lower margins from the coal business combined with higher-than-expected depreciation led to adjusted PAT falling 14% lower-than-expected. PAT fell 25.5% YoY primarily due to higher tax rate on the back of revised MAT rate and higher forex gains recorded last year during the same quarter.

Unfavorable currency movement mitigates realization & volume gains in coal

The coal business reported in line revenues of Rs11.3bn in rupee terms with 12.9% QoQ growth in US\$ terms to US\$755mn due to improvement in realizations and volumes. However, unfavorable exchange rate mitigated the gains. Gross realizations improved 7.6% QoQ to RsUS\$57.9/tonne due to uptrend in Asian coal prices in the last quarter. Volumes grew 20% YoY and 4.9% QoQ to 15 million tonne (MT) due to recovery in the Asian region and higher imports from China, which aided volumes in the Asia Pacific region. However, due to dollar pressure in INR terms sales declined 2.4% QoQ to Rs11.3bn. Cash cost of production remained stable QoQ at US\$31.6/tonne but other costs have increased bringing down the PBIT margin in the coal business by 210bp QoQ.

Exhibit 1: Coal business improving (QoQ)

	Q1FY09	Q2FY09	Q1FY10	Q2FY10	YoY (%)	QoQ (%)
Sales Volume (in million tonne)	12.9	12.5	14.3	15.0	20.0	4.9
Gross Realisation US\$/ton	61.0	82.0	53.8	57.9	(29.4)	7.6
Net Realisation (US\$/ton)	53.1	71.3	46.8	50.4	(29.4)	7.6
Revenue (US\$m)	684.6	891.8	669.3	755.6	(15.3)	12.9
Cash cost of production (US\$/ton)	34.6	38.7	31.6	31.1	(19.6)	(1.6)
PBIT (US\$m)	238.3	408.0	217.4	289.1	(29.1)	33.0
Sales (Rsmn)	10,118.4	12,132.6	11,584.3	11,307.7	(6.8)	(2.4)
PBIT (Rsmn)	2,968.5	4,129.8	3,731.6	3,403.9	(17.6)	(8.8)
PBIT margin (%)	29.3	34.0	32.2	30.1	4 bp	2 bp

Source: Company, Centrum Research

Exhibit 2: Performance of other joint ventures

NDPL (Rsmn)	Q1FY09	Q2FY09	Q1FY10	Q2FY10	YoY (%)	QoQ (%)	Remarks
Revenue	5,645	7,283	7,150	10,326	42	44	higher growth due to change in tariff norms and higher incentives
Operating Profit	61.6	878	760	691	(21)	(9)	
PBT	391	482	550	463	(4)	(16)	
PAT	340	379	491	257	(32)	(48)	lower PAT due to higher MAT rate includes Q1FY10 tax adjustment too
effective tax (%)	13	21	11	45			
Power Links Transmission (Rsmn)	Q1FY09	Q2FY09	Q1FY10	Q2FY10	YoY (%)	QoQ (%)	
Revenue	556	558	715	751	35	5	YoY growth due to change in tariff factoring due to new CERC norms
Operating Profit	531	535	691	726	36	5	
PBT	102	117	269	323	176	20	
PAT	90	103	186	206	100	11	
effective tax (%)	12	12	31	36	-	-	
Tata Power Trading (Rsmn)	Q1FY09	Q2FY09	Q1FY10	Q2FY10	YoY (%)	QoQ (%)	
Trading volume (in Mus)	-	635	-	807	-	-	
Revenue	4,120	4,489	6096	4,529	1	(26)	
Operating Profit	17	20	21	22	10	5	
PBT	20	22	21	23	5	10	
PAT	14	15	18	16	8	(10)	
effective tax (%)	30	32	14	30	-	-	

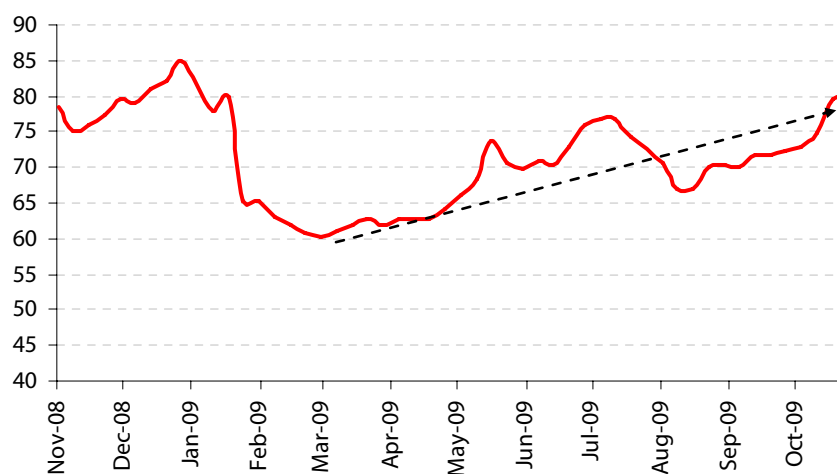
Source: Company, Centrum Research

Coal price realization for H2 likely to be higher

Newcastle index, the benchmark for coal prices in Asia, has registered gains for the sixth week to end at about US\$80/tonne on the back of strengthening Chinese coal prices. Three factors that are likely to determine the prices of coal in the short term include 1) Contract prices between Japanese and Australian utilities, 2) Chinese demand on the back of opening of small mines post the recent deadly coal mine accident and 3) Cold snap, which is increasing the demand for heating. Japanese utilities have begun negotiations with Australian miners Xstrata and Peabody and we estimate the contracts to hover at US\$75-85 per tonne (adjusted for calorific value). If the contracts go through at US\$80/tonne we believe the realizations of coal assets would be 15% higher compared to the current quarter. We expect gross realization to increase 15% to ~US\$67/tonne from US\$57.9/tonne registered during the quarter.

Risk to our call: Demand from China, which has already risen due to coal weather conditions might ease, if weather conditions improve. Chinese and Japanese are looking to diversify their coal sources from Australia to South Africa and Russia since the price differential has increased by more than 25%.

Exhibit 3: Strengthening coal prices, close to 52-week high



Source: Company, Centrum Research

Repayment of SPV loans on fast track

The outstanding loan at the SPV level taken for funding the acquisition of a coal mine stands at US\$740mn and cash at US\$100mn. The net debt therefore is US\$640mn. The loan at the beginning of the year was about US\$764mn, of which we had estimated that a total US\$116mn would be repaid during the year with a closing balance of US\$648mn. However, it likely that the repayment could be higher, as the balance now stands at US\$640mn with six more months to go.

Exhibit 4: Project Coal SPV loan repayment schedule

in US\$ mn	FY08	FY09	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E
Non Recourse Loan - Closing bal.	590	454	378	302	226	150	74	-	-
Repayment	-	(136)	(76)	(76)	(76)	(76)	(76)	(74)	-
Interest	-	20	16	13	10	7	4	1	-
Recourse Loan - Closing bal.	270	270	270	270	270	270	135	-	-
Repayment	-	-	-	-	-	-	(135)	(135)	-
Interest	-	5	5	5	5	5	4	1	-
Short Loan - Closing bal.	-	40	-	-	-	-	-	-	-
Repayment	-	-	(40)	-	-	-	-	-	-
Interest	-	-	-	-	-	-	-	-	-
Total									
Closing balance	-	950	764	648	572	496	420	209	-
Repayment	-	(136)	(116)	(76)	(76)	(76)	(211)	(209)	-
Interest cost	-	25	21	18	15	12	8	3	-

Source: Centrum Research Estimates

Target price cut Rs1321; reiterate Hold

At CMP, the stock trades at 2.9x FY10E P/BV, which we feel is fairly valued and inline with peers. In our opinion, any further upside is possible only from its Indonesian coal assets due to expected higher coal prices. We do not see the possibility of further dilution. The company recently completed US\$300mn FCCB issue convertible at Rs1,455 after 5 years at a coupon rate of 1.75% and yield to maturity of 3.5%. We have factored in a 4.1% impact from dilution in our estimates and thereby cut our target price to Rs1,321. However, our Hold rating with a positive bias remains unaltered.

Exhibit 5: Revised SOTP value

Rs/share	Value (Rsbn)	Rs/share
Power Business - incl. JVs, subsidiaries and associates	167.8	680
Investments, cash and cash equivalents	53.5	217
Coal Assets - 30% stake in Indonesian coal mines @14x FY10E EPS	104.6	424
Total Value	326.0	1,321

Source: Centrum Research Estimates

Exhibit 6: Peer comparison

Companies	Rating	Mkt Cap	CMP (Rs)	TP (Rs)	PE (x)		P/BV (x)		ROE (%)		ROCE (%)	
					FY10E	FY11E	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
NTPC	Sell	1,729,899	210	192	20.0	17.9	2.8	2.6	22.8	24.0	11.1	11.7
Power Grid	Hold	420,042	100	118	19.6	15.1	2.7	2.4	14.1	16.7	9.0	9.8
Tata Power	Hold	321,296	1,355	1321	22.4	16.7	2.9	2.6	14.7	16.2	12.4	12.9
Reliance Power	Hold	342,263	143	156	84.0	32.5	2.4	2.2	2.8	7.0	1.9	4.4
CESC	Buy	48,275	386	417	11.0	10.9	1.3	1.2	12.3	11.2	8.5	8.1

Source: Centrum Research Estimates

Financials (Consolidated)

Exhibit 7: Income Statement

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Revenues	63,730	108,909	173,769	172,188	195,174
<i>Growth in revenues (%)</i>	15.1	70.9	59.6	(0.9)	13.3
Fuel cost	45,168	71,161	112,511	107,639	118,130
% of Sales	70.9	65.3	64.7	62.5	60.5
O&M expenses	8,694	16,527	26,869	19,031	21,056
% of Sales	13.6	15.2	15.5	11.1	10.8
EBITDA	9,868	21,221	34,390	45,518	55,989
<i>EBITDA Margin</i>	15.5	19.5	19.8	26.4	28.7
Depreciation	4,148	5,593	6,565	7,614	8,475
Other Income	2,316	1,259	2,709	2,574	3,327
PBIT	8,036	16,887	30,534	40,479	50,841
Interest expenses	2,833	4,881	8,129	13,832	15,975
PBT before extra-ordinary items	5,203	12,007	22,405	26,646	34,866
Extra-ordinary income/ (expenses)	1,398	3,528	2,233	2,324	-
PBT	6,601	15,534	24,638	28,970	34,866
Provision for tax	(991)	3,765	11,651	10,662	12,276
<i>Effective tax rate</i>	(15.0)	24.2	47.3	36.8	35.2
PAT before MI (reported)	7,592	11,770	12,987	18,308	22,590
(+/-) Minority Int & Sh. of associates	5	(1,219)	(800)	(2,427)	(2,710)
PAT after MI (reported)	7,596	10,551	12,187	15,881	19,881
Extra-ordinary income/ (expenses)	2,540	3,528	2,233	1,085	-
Adjusted PAT	5,056	7,023	9,955	14,796	19,881
<i>Growth in PAT (%)</i>	1.6	38.9	15.5	30.3	25.2
<i>PAT margin</i>	7.9	6.4	5.7	8.6	10.2

Source: Company, Centrum Research Estimates

Exhibit 8: Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Share Capital	1,979	2,207	2,214	2,371	2,371
Reserves	52,124	74,323	83,975	112,337	127,678
Shareholders' fund	54,103	76,530	86,189	114,708	130,050
Minority Interest	2,496	8,062	9,444	13,198	16,689
Debt	51,784	91,136	141,434	176,119	229,379
Deferred Tax Liability	458	3,320	6,146	6,146	6,146
Capital Contributions and Grants	6,134	6,918	7,440	7,440	7,440
Total Capital Employed	114,975	185,966	250,652	317,611	389,703
Total Fixed Assets	63,001	140,901	205,780	255,361	321,121
Investments	30,833	31,253	32,512	32,512	32,512
Inventories	4,662	6,529	10,146	13,905	14,723
Debtors	17,382	25,318	30,235	30,612	31,585
Other Current Assets	291	603	499	499	499
Cash and bank balances	14,024	5,623	11,780	22,088	28,519
Loans and Advances	6,958	13,890	21,805	21,805	21,805
Total current assets	43,317	51,964	74,466	88,909	97,130
Current liabilities and provisions	22,238	40,454	67,812	64,864	66,753
Net current assets	21,079	11,510	6,654	24,045	30,377
Misc. Expenditure	63	2,302	5,706	5,692	5,692
Total Assets	114,975	185,966	250,652	317,611	389,703

Source: Company, Centrum Research Estimates

Exhibit 9: Cash flow

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
CF from operating activities					
Profit before tax	6,601	15,534	24,638	28,970	34,866
Depreciation	4,148	5,593	6,565	7,614	8,475
Interest expenses	2,760	4,881	7,087	13,832	15,975
Other Non operating (income)/exp.	(2,238)	(4,851)	-	(2,574)	(3,327)
CF from operations bef WC change	11,272	21,157	38,290	47,842	55,989
Working capital adjustment	(3,853)	(4,104)	(6,083)	(7,083)	98
Gross CF from operations	7,418	17,053	32,207	40,760	56,087
Direct taxes paid	100	(142)	(2,806)	(10,662)	(12,276)
CF from operations	7,518	16,912	29,401	30,098	43,811
CF from investing activities					
Capex	(11,085)	(25,527)	(53,349)	(57,195)	(74,235)
Investment - Cash equivalents	(2,436)	(44,429)	(1,217)	-	-
Investment - Subsidiary / Strategic	1,221	1,400	1	-	-
Other Income	(900)	4,859	1,507	2,574	3,327
CF from investments	(13,200)	(63,698)	(53,058)	(54,621)	(70,908)
CF from financing activities					
Proceeds from share capital & premium	384	7,544	1,492	17,344	781
Borrowings/ (Repayments)	9,852	41,378	39,513	22,734	52,816
Interest paid	(2,807)	(5,160)	(7,944)	(13,610)	(15,531)
Dividend paid	(2,002)	(2,365)	(3,333)	(3,378)	(4,539)
CF from financing activities	5,426	41,398	29,728	23,089	33,527
Net cash increase/ (decrease)	(256)	(5,388)	6,072	(1,434)	6,431

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Margin ratios (%)					
EBITDA Margin	15.5	19.5	19.8	26.4	28.7
PBIT Margin	12.6	15.5	17.6	23.5	26.0
PBT Margin	8.2	11.0	12.9	15.5	17.9
PAT Margin	7.9	6.4	5.7	8.6	10.2
Growth ratios (%)					
Revenues	15.1	70.9	59.6	(0.9)	13.3
EBITDA	9.4	115.0	62.1	32.4	23.0
Net Profit	1.6	38.9	15.5	30.3	25.2
Return ratios (%)					
ROIC	20.1	14.4	10.0	12.4	12.9
ROE	9.8	10.8	12.2	14.7	16.2
Turnover ratios (x)					
Asset turnover ratio (x)	0.6	0.6	0.7	0.5	0.5
Inventroy (days)	27.6	18.8	17.5	25.5	26.8
Average Collection period (days)	85.4	71.6	58.3	64.5	58.2
Average payment period (days)	58.9	43.2	41.2	57.9	52.6
Solvency Ratios (x)					
Debt-Equity ratio (x)	0.5	0.4	0.4	0.4	0.4
Interest coverage ratio	3.5	4.3	4.2	3.3	3.5
Per share ratios (Rs.)					
Reported EPS	38.4	47.8	55.0	67.0	83.8
EPS (Diluted)	25.5	31.8	45.0	60.0	80.6
CEPS (Diluted)	46.5	57.2	74.6	90.8	114.9
Book Value (Diluted)	273.4	346.8	389.3	464.9	527.1
Solvency ratios					
Debt/ Equity	1.0	1.2	1.6	1.5	1.8
Interest coverage	2.8	3.5	3.8	2.9	1.0
Valuation parameters (x)					
P/E (Diluted)	52.7	42.3	29.9	22.4	16.7
P/BV (Diluted)	4.9	3.9	3.5	2.9	2.6
EV/ EBITDA	33.9	18.0	12.4	9.9	8.9
EV/ Sales	5.3	3.5	2.5	2.6	2.6

Source: Company, Centrum Research Estimates

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Sanjeev Patni
T. S. Baskaran

Head - Institutional Equities
Joint Head – Institutional Equities

sanjeev.patni@centrum.co.in
ts.baskaran@centrum.co.in

91-22-4215 9699
91-22-4215 9620/87

Research

Dhananjay Sinha	Economist	Economy & Strategy	dhananjay.sinha@centrum.co.in	91-22-4215 9619
Niraj Shah	Sr Analyst	Metals & Mining, Pipes	niraj.shah@centrum.co.in	91-22-4215 9685
Mahantesh Sabarad	Sr Analyst	Automobiles/Auto Ancillaries	mahantesh.sabarad@centrum.co.in	91-22-4215 9855
Madanagopal R	Sr Analyst	Power, Capital Goods	r.madanagopal@centrum.co.in	91-22-4215 9684
Abhishek Anand	Analyst	Media, Education	a.anand@centrum.co.in	91-22-4215 9853
Adhidev Chattopadhyay	Analyst	Real Estate	adhidev@centrum.co.in	91-22-4215 9632
Ankit Kedia	Analyst	Media	ankit.kedia@centrum.co.in	91-22-4215 9634
Manish Kayal	Analyst	Infrastructure	manish.kayal@centrum.co.in	91-22-4215 9313
Nitin Padmanabhan	Analyst	Technology	nitin.padmanabhan@centrum.co.in	91-22-4215 9690
Piyush Choudhary	Analyst	Telecom	p.choudhary@centrum.co.in	91-22-4215 9862
Pranshu Mittal	Analyst	Sugar, Retail	p.mittal@centrum.co.in	91-22-4215 9854
Rajan Kumar	Analyst	Cement	rajan.kumar@centrum.co.in	91-22-4215 9640
Rajagopal Ramanathan	Analyst	Banking & Financial Services	rajagopal.ramanathan@centrum.co.in	91-22-4215 9644
Rohit Ahuja	Analyst	Oil & Gas	rohit.ahuja@centrum.co.in	91-22-4215 9636
Saikiran Pulavarthi	Analyst	Banking & Financial Services	saikiran.pulavarthi@centrum.co.in	91-22-4215 9637
Siddhartha Khemka	Analyst	Logistics	siddhartha.khemka@centrum.co.in	91-22-4215 9857
Sriram Rathi	Analyst	Pharmaceuticals	s.rathi@centrum.co.in	91-22-4215 9643
Amit Sinha	Associate	Power, Capital Goods	amit.sinha@centrum.co.in	91-22-4215 9927
Janhavi Prabhu	Associate	Sugar, Retail	janhavi.prabhu@centrum.co.in	91-22-4215 9864
Jatin Damania	Associate	Metals & Mining, Pipes	jatin.damania@centrum.co.in	91-22-4215 9647
Komal Taparia	Associate	Economy & Strategy	komal.taparia@centrum.co.in	91-22-4215 9195
Rahul Gaggar	Associate	Hotels & Healthcare	rahul.gaggar@centrum.co.in	91-22-4215 9683
Sarika Dumbre	Associate	Telecom	sarika.dumbre@centrum.co.in	91-22-4215 9194
Shweta Mane	Associate	Banking & Financial Services	shweta.mane@centrum.co.in	91-22-4215 9928
Vijay Nara	Associate	Automobiles/Auto Ancillaries	vijay.nara@centrum.co.in	91-22-4215 9641

Sales

V. Krishnan		+91-22-4215 9658	v.krishnan@centrum.co.in	+91 98216 23870
Ashish Tapuriah		+91-22-4215 9675	ashish.tapuriah@centrum.co.in	+91 99675 44060
Ashvin Patil		+91-22-4215 9866	ashvin.patil@centrum.co.in	+91 98338 92012
Siddharth Batra		+91-22-4215 9863	s.batra@centrum.co.in	+91 99202 63525

Centrum Securities (Europe) Ltd., UK

Dan Harwood	CEO	+44-7830-134859	dan.harwood@centrum.co.in
Michael Orme	Global Strategist	+44 (0) 775 145 2198	michael.orme@centrum.co.in

Centrum Securities LLC, USA

Melrick D'Souza		+1-646-701-4465	melrick.dsouza@centrumsecurities.com
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PMS REGISTRATION NO.: INP000000456
Website: www.centrum.co.in
Investor Grievance Email ID: investor.grievances@centrum.co.in

REGD. OFFICE Address

Bombay Mutual Bldg., 2nd Floor, Dr. D. N. Road, Fort, Mumbai - 400 001

Correspondence Address

Centrum House, 6th Floor, CST Road, Near Vidya Nagari Marg, Kalina, Santacruz (E), Mumbai 400 098.
Tel: (022) 4215 9000