

Siemens India

Q1FY10/Rating change

1 February 2010

Buy

Target Price: Rs710

CMP: Rs643*

Upside: 10.5%

*as on 29 January 2010

New orders push prospects

Siemens Q1FY10 numbers surprised on the margin and order flow fronts. EBITDA margin increased 908bp YoY to 19.5% and was 906bp higher than our estimate. New orders surged 191% to Rs51.7bn setting the base for higher earnings growth. We therefore upgrade the stock to Buy.

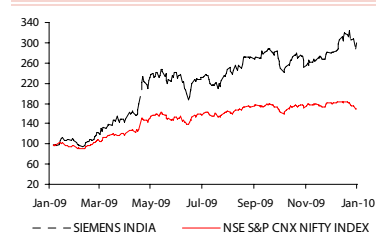
- **Q1 margin surprises but not sustainable:** EBITDA margin increased 908bp YoY to 19.5% and was 906bp higher than our estimate. Superior margin more than compensated for the lower sales, which was 20.6% below our estimate at Rs18.7bn and led to 25% YoY growth in PAT to Rs2.4bn, 48% higher than our estimate.
- **Order flow surges 161% YoY to Rs51.7bn, sets the base for higher growth:** New order flow during the quarter surpassed our expectation at Rs51.7bn. This higher order inflow in the first quarter of the year itself has set the base for higher sales and consequent profits. This coupled with the possibility of winning one or two mega High Voltage Direct Current (HVDC) projects (in addition to higher margin in Q1) put Siemens in a sweet spot.
- **Upgrade to Buy; target price revised to Rs710:** The stock currently trades at 24.5x FY10E P/E, at a 30% discount to ABB. Surge in order flows coupled with the likelihood of mega orders in the near future have led us to raise our target price to Rs710 at 27x FY10E PE. We upgrade the stock to Buy from Hold.

Key Data

Bloomberg Code	SIEM IN
Reuters Code	SIEM.BO
Current Shares O/S (mn)	337.2
Diluted Shares O/S(mn)	337.2
Mkt Cap (Rsbn/USDbn)	216.8/4.7
52 Wk H / L (Rs)	678/190
Daily Vol. (3M NSE Avg.)	514,008
Face Value (Rs)	2

1 USD = Rs46.2

One year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Siemens	10.4	33.5	211.6
NIFTY	(6.1)	5.3	69.8

Source: Bloomberg, Centrum Research
*as on 29 January 2010

Madanagopal R

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

Amit Sinha

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

Y/E Sep (Rsmn)	Q1FY10	Q1FY09	YoY (%)	Q4FY09	QoQ (%)	Q1FY10E	Variance (%)
Net sales	18,666	16,399	13.8	25,180	(25.9)	23,501	(20.6)
Purchases	12,447	12,412		19,826		18,096	
% of sales	66.7	75.7	(901) bp	78.7	(1,206) bp	77.0	(1,032) bp
Employee costs	1,290	1,131		1,587		1,575	
% of sales	6.9	6.9		6.3		6.7	
Other expenditure	1,297	1,154		1,298		1,387	
% of sales	6.9	7.0		5.2		5.9	
Operating profit	3,632	1,702	113.4	2,470	47.1	2,444.1	48.6
OPM (%)	19.5	10.4	908 bp	9.8	965 bp	10.4	906 bp
Depreciation & amortisation	212	181		213		204	
Interest				-			
EBT	3,421	1,521	124.9	2,257	51.6	2,240	52.7
Other income	157.2	178.5		40.0		143.2	
PBT	3,578	1,700	110.5	2,297	55.8	2,383	50.1
Exceptional Item		(2,219.0)					
Prior Period Adjustment							
Provision for tax	1,214	613		715		787	
-effective tax rate	33.9	36.1		31.1		14.6	
PAT (reported)	2,364	3,306	(28.5)	1,582	49.4	1,597	48.0
Exceptional Item	-	(1,419)					
PAT (adj. for deferred tax)	2,364	1,887	25.3	1,582.0	49.4	1,597	48.0
NPM (%)	12.7	11.5	116 bp	6.3	638 bp	6.8	587 bp

Source: Company, Centrum Research

Y/E Sep (Rsmn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)	P/BV (x)
FY06	44,989	63.1	3,588	8.0	3,571	40.2	10.6	38.2	38.0	60.8	57.9	20.0
FY07	77,170	71.5	5,923	7.7	4,747	32.9	14.1	35.5	31.2	45.7	35.9	13.6
FY08	83,125	7.7	5,669	6.8	3,993	(15.9)	11.8	21.8	16.5	54.3	36.7	10.5
FY09E	84,585	1.8	10,232	12.1	6,427	61.0	19.1	25.8	24.2	33.8	19.8	7.4
FY10E	111,036	31.3	13,420	12.1	8,860	37.8	26.3	27.0	27.0	24.5	14.8	6.0

Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Result beats expectations; margin surprises

Siemens' Q1FY10 EBITDA margin rose 908bp YoY to 19.5% and 906bp higher than our estimate. Higher-than-expected margin more than compensated the disappointing sales, which was 20.6% below our estimate at Rs18.7bn. Higher margin led to 25% YoY growth in PAT to Rs2.4bn, 48% higher than our estimate.

While the power segment reported around 1,071bp higher-than-estimated margin at 23%, industrial margin at 9% was 250bp higher. The power segment primarily contributed to the superior margin with margins in both these segments expanding by 950bp and 200bp YoY, respectively. During the Sep 2009 quarter, margins in the power segment were lower at mere 1.5%. We believe these higher margins are not sustainable, given the pricing pressure in the power T&D space (due to competition even in the extra high voltage (EHV) segment). However, we raise our full year margin assumption by 100bp to 12.2% on the back of higher margins in Q1.

Real estate is witnessing continuous surge in margins, Dec'09 margin was 219% and EBIT was Rs266mn compared to Rs65mn loss recorded during the same period last year.

While topline in the power segment disappointed with 46% lower-than-estimated sales at Rs6.9bn, the industry segment reported 34% higher-than-estimated sales at Rs9.5bn. Moreover, even though the mobility division is yet to stabilize on a quarterly basis, revenues here have grown consistently QoQ.

Exhibit 1: Quarterly movement of sales, EBIT and margins

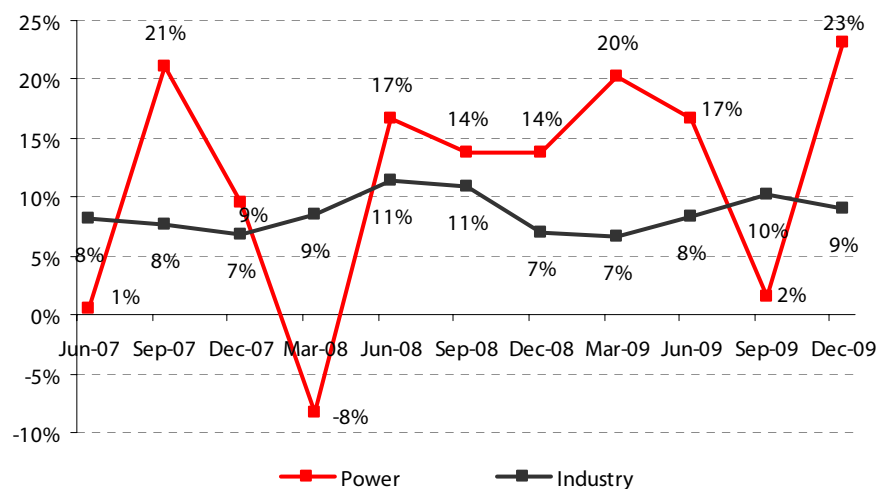
Sales (Rsmn)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	YoY (%)	QoQ (%)	Dec09E	Variance
Power	6,733	12,896	8,529	9,630	6,920	2.8	(28.1)	12,736	(45.7)
Industry	7,761	9,085	8,333	14,104	9,537	22.9	(32.4)	7,094	34.4
Healthcare	1,171	1,223	1,137	1,901	1,319	12.7	(30.6)	1,681	(21.5)
Mobility	2,237	2,346	2,742	2,936	3,126	39.7	6.5	2,992	4.5
Real estate	152	183	151	167	159	4.6	(5.0)	265	(40.1)

PBIT (Rsmn)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	YoY (%)	QoQ (%)	DEC'09 (E)	Variance
Power	924	2,610	1,419	146	1,606	73.9	1,003.6	1,592	0.9
Industry	545	611	689	1,436	860	57.8	(40.1)	461	86.5
Healthcare	(12)	108	(4)	321	61	N.A	(80.9)	84	(27.0)
Mobility	(65)	(76)	102	(38)	266	N.A	N.A	150	77.6
Real estate	133	143	175	394	348	162.5	(11.6)	159	119.0

PBIT Margin (%)	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	YoY (%)	QoQ (%)	DEC'09 (E)	Variance
Power	14	20	17	2	23	950 bp	2,170 bp	13%	1071 bp
Industry	7	7	8	10	9.0	200 bp	(116) bp	6.5%	252 bp
Healthcare	(1)	9	0	17	5	569 bp	(1,223) bp	5%	(35) bp
Mobility	(3)	(3)	4	(1)	8	1141 bp	978 bp	5%	350 bp
Real estate	87	78	116	236	219	13194 bp	(1,641) bp	60%	15,930 bp

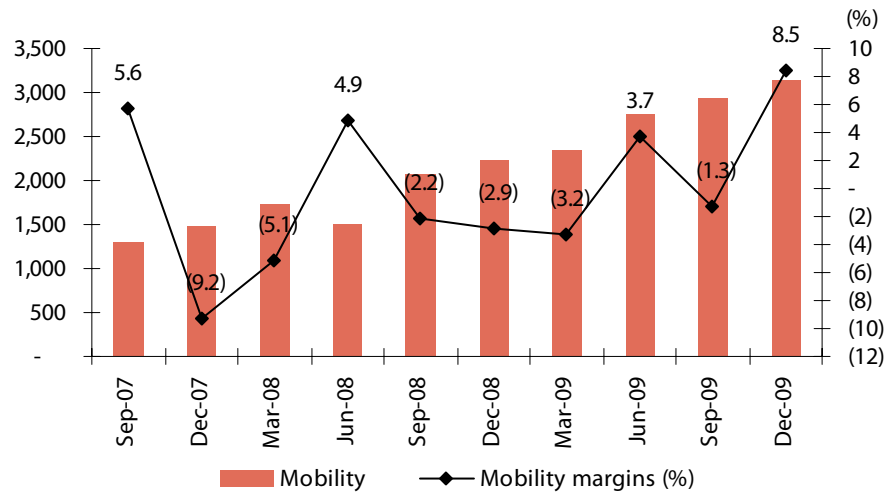
Sources: Company, Centrum Research Estimates

Exhibit 2: Volatile but higher power sector margins and stable industrial margins



Sources: Company, Centrum Research

Exhibit 3: Consistently improving sales in mobility segment; but margins yet to stabilize

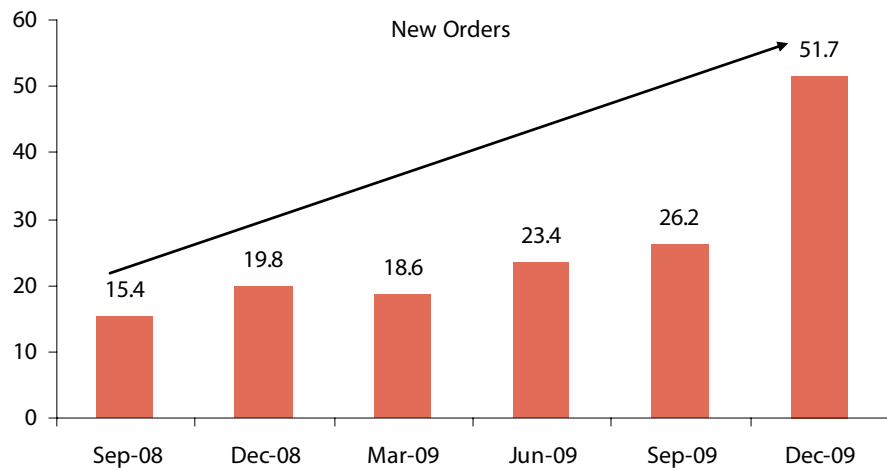


Sources: Company, Centrum Research

Order flow surges 161% YoY to Rs51.7bn; sets the base set for higher growth

New order flow during the quarter surpassed our expectation of Rs25bn and stood at Rs51.7bn during the quarter with a run rate of Rs20-26bn. The higher order inflow has set the base for higher sales and consequent profits, going forward. The company recently won an order worth Rs29.6bn from Qatar General Electricity & Water Corporation, of which a significant portion of about Rs25bn was booked by Siemens India, which resulted in the surge in order flow. The order is to be executed over 40 months. For the remaining 9 months of the year we expect the company to book around Rs5-Rs6bn incremental revenues on our earlier estimate of Rs102.4bn for FY10. In addition to this, the likelihood of the company winning one or two mega HVDC projects and stable margin in FY10 puts Siemens in a sweet spot.

Exhibit 4: Surging order flow



Sources: Company, Centrum Research

Few mega T&D projects closer to announcement - advantage Siemens

We estimate orders worth around Rs200bn from HVDC transmission and EHV (extra high voltage) projects to flow within the next 2 years. Competition in the HVDC segment is particularly low with players such as ABB, Siemens and Areva T&D operating in this space. Further, orders for ultra mega power projects (UMPP) are likely to start flowing from FY11 and major beneficiaries again would be ABB, Areva T&D and Siemens.

First $\pm 800\text{kV}$ HVDC project in final stages - ABB-BHEL and Siemens in fray

Power Grid Corporation of India (PGCIL) is likely to announce an order for few big ticket EHV projects in the near future. The $\pm 800\text{kV}$ HVDC project connecting north east to Bihar is one of the famous project. It is referred to as the chicken neck project and is the first $\pm 800\text{kV}$ HVDC project in India with an approximate capex of Rs35-40bn. Part of the transmission tower package of this was recently awarded to L&T, but the main package (substation) for transmitting roughly 6,000MW between Biswanath to Agra is yet to be awarded. The project will be awarded only to a single player and is to be constructed in 2 phases – the first phase in 36 months and second in 42 months. There would be two substations - one in Biswanath and the other in Agra. The contract would be awarded under the international competitive bidding route and is likely to influence the performance of any player who gets the order in the current scenario of low industrial activity.

Exhibit 5: PGCIL's proposed $\pm 800\text{kV}$ HVDC project

Projects	Year	KV	Capacity (MW)	Target	Order (Rsbn)
Biswanath	2010-11	$\pm 800\text{kV}$ HVDC	3,000	Mar-11	20
Agra	2010-11	$\pm 800\text{kV}$ HVDC	3,000	Mar-11	20

Source: Centrum Research

PGCIL is looking to place the order in 3 months and Siemens and ABB-BHEL combine are the only two players qualified for the final bid. The HVDC project does not have a foreign component requirement as is required for the 765kV project, which in our opinion should enable a substantial portion of the order being booked in the Indian subsidiary of these companies, which we estimate at about 50% of the total order value of Rs35-40bn. Whoever wins the order, be it Siemens or ABB, the order would contribute atleast 40-50% of the T&D segment order flow estimate for FY11 for these companies and roughly 30% of the total order flow estimate. This makes the project quite significant. Further, the project would also take care of margins, as globally HVDC projects are currently being handles by ABB, Areva T&D and Siemens.

Other visible mega transmission projects

1. Another Rs25bn worth 660 kV HVDC and 500kV HVDC projects are likely to come for bidding before FY10 end and Q1FY11 respectively. Whoever wins the 800kV HVDC project would in high likelihood opt out from bidding other HVDC projects, since they would be using most of their capacity for the big project. Therefore all the three players Siemens, ABB and Areva stand a good chance to bag atleast one of these mega HVDC orders.
2. UMPPs are likely to announce their switch yard orders going forward since only Mundra is over until now. BHEL bagged Mundra's switch yard project (about Rs12bn) for transformers (Rs10bn) and ABB bagged orders for other equipments worth Rs2bn. Going forward if 765kV is chosen in place of 400kV, the order size from UMPPs could be roughly ~Rs20bn, in our view. Since 3 more UMPPs already awarded are pending for switch yard orders and another atleast 3 UMPPs are likely to be awarded soon, we expect total orders worth about Rs120bn to flow from this space alone.

Order flow for switch yards likely to flow for ~80GW project under construction

Around 80GW of projects is already under construction and another ~40GW is likely to place BTG orders over the next 12 months, to be constructed over 4 years. Switchyard orders for these are to likely be placed over next 3 years, in our opinion and the value of these orders would alone constitute Rs400-600bn, in addition to the Rs550bn to be spent by Power Grid and State Power Utilities (SPUs) each during 11th Plan.

Estimates raised

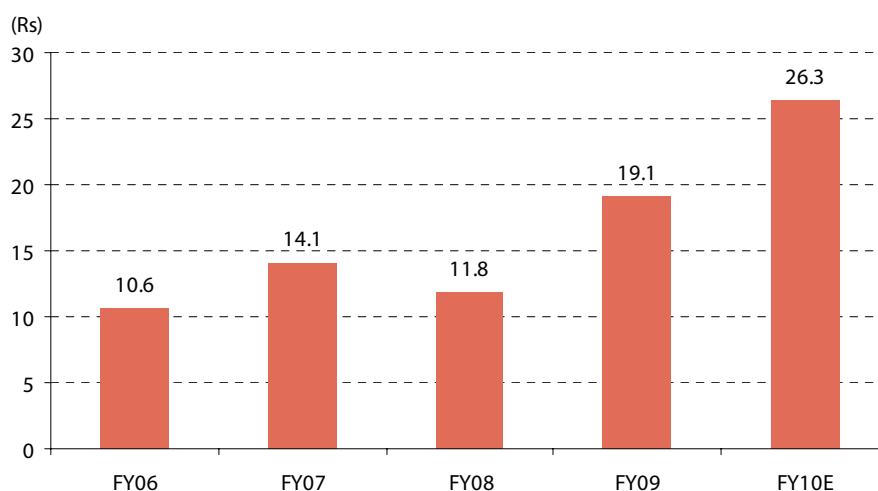
Due to surprising surge in order flow and margins in Q1, we have raised our FY10 estimate by 8% to Rs111bn, margins by 900bp to 12.1% and PAT by 17.1% to Rs8.86bn. EPS therefore stands revised at Rs26.3, 37.7% higher YoY.

Exhibit 6: Revised estimates

	FY10E		
	Earlier	Revised	Change (%)
Sales	102,398	111,036	8.4
EBITDA	11,438	13,420	17.3
EBITDA Margins (%)	11.2	12.1	900bp
PAT	7,566	8,860	17.1
EPS	22.5	26.3	17.1

Source: Centrum Research Estimates

Exhibit 7: Adjusted EPS



Source: Centrum Research Estimates

Upgrade to Buy; target price revised to Rs710

The stock currently trades at 24.5x FY10E P/E, a 30% discount to ABB's valuation. With significant surge in order flows setting the base for higher FY10E sales & profits and possibilities of bagging further mega orders in the near future we raise our target multiple to 27x and thereby the target price to Rs710 from Rs476. Further we upgrade the stock to Buy from Hold. This is the only Buy rated stock within our capital goods universe (ABB, Areva T&D and BHEL).

We had recommended a switch from Areva T&D and ABB India to Siemens India in our previous quarterly update "Early signs of recovery" dated 30th Nov'09 and since then stock has delivered a strong 24% return compared with 5% downside in the case of Areva T&D and 11% return in ABB. We continue to recommend the switch option. With superior margins, earnings growth & return ratios, higher order flows and better cash flows, we believe Siemens deserves a premium over ABB and Areva T&D.

Exhibit 8: Peer comparison

Companies	Rating	Mkt Cap	CMP	EPS		EPS growth (%)		PE (x)		ROE (%)		ROCE (%)	
				CY09E/ FY10E	CY10E/ FY11E	CY09E/ FY10E	CY10E/ FY11E	CY09E/ FY10E	CY10E/ FY11E	CY09E/ FY10E	CY10E/ FY11E	CY09E/ FY10E	CY10E/ FY11E
Siemens	Hold	216,777	643	19.1	26.3	61.0	37.8	33.8	24.5	25.8	27.0	24.2	27.0
ABB	Sell	171,857	811	19.7	23.5	(29.3)	19.3	41.2	34.5	18.3	18.8	19.8	19.2
Areva T&D	Sell	64,893	271	9.2	11.4	(16.4)	23.9	29.5	23.8	27.2	27.4	20.6	20.1

Note: BHEL- Y/E Mar, ABB and Areva T&D - Y/E Dec, Siemens - Y/E Sep

Source: Centrum Research Estimates

Financials (Standalone)

Exhibit 9: Income Statement

Y/E Sep (Rsmn)	FY06	FY07	FY08	FY09E	FY10E
Revenues	44,989	77,170	83,125	84,585	111,036
Growth in revenues (%)	63.1	71.5	7.7	1.8	31.3
Cost of Raw Material	34,639	62,667	67,972	63,977	83,560
% of Revenue	77.0	81.2	81.8	75.6	75.3
Employee cost	2,829	4,045	4,476	5,499	7,226
% of Sales	6.3	5.2	5.4	6.5	6.5
O&M expenses	3,933	4,535	5,009	4,878	6,831
% of Sales	8.7	5.9	6.0	5.8	6.2
EBITDA	3,588	5,923	5,669	10,232	13,420
EBITDA Margin	8.0	7.7	6.8	12.1	12.1
Depreciation	442	492	637	778	781
PBIT	3,146	5,430	5,031	9,454	12,639
Interest expenses	-	-	-	-	-
PBIT from operations	3,146	5,430	5,031	9,454	12,639
Other non operating income	1,864	1,526	970	464	633
PBT before extra-ordinary items	5,010	6,957	6,002	9,918	13,273
Extra-ordinary income/ (exp)	45	1,786	2,916	4,401	-
PBT	5,055	8,742	8,918	14,319	13,273
Provision for tax	1,454	2,777	2,984	3,870	4,413
Effective tax rate	28.8	31.8	33.5	27.0	33.2
Minority interest	-	-	-	-	-
PAT	3,601	5,965	5,933	10,448	8,860
Adjustment for Extraordinary items	30	1,218	1,940	4,021	-
Adjusted PAT	3,571	4,747	3,993	6,427	8,860
Growth in PAT (%)	40.2	32.9	(15.9)	61.0	37.8
PAT margin	7.9	6.2	4.8	7.6	8.0

Source: Company, Centrum Research Estimates

Exhibit 10: Balance Sheet

Y/E Sep (Rsmn)	FY06	FY07	FY08	FY09E	FY10E
Share Capital	337	337	674	674	674
Reserves	10,534	15,572	20,017	28,493	35,680
Shareholders' fund	10,871	15,910	20,691	29,167	36,354
Debt	20	15	11	11	11
Deferred Tax Liability	-	-	-	-	-
Advance against depreciation	-	-	-	-	-
Minority Interest	-	-	-	-	-
Total Capital Employed	10,891	15,925	20,701	29,178	36,365
Gross Block	6,473	8,701	9,911	10,881	10,981
Accumulated dep.	3,851.75	4,063.78	4,339.33	5,117.12	5,897.63
Net Block	2,621.18	4,637.45	5,571.65	5,763.99	5,083.48
Capital WIP	1,541.62	932.93	870.13	-	-
Total Fixed Assets	4,163	5,570	6,442	5,764	5,083
Investments	4,640	4,676	5,236	5,260	5,260
Inventories	4,842	7,491	7,621	9,057	12,809
Debtors	11,098	22,243	34,328	28,501	51,412
Cash & bank balances	9,394	4,636	9,131	14,318	18,223
Loans and Advances	4,164	6,618	6,173	6,173	6,173
Total current assets	29,502	40,987	57,253	58,048	88,617
Current lia & provisions	27,690	35,582	49,140	40,805	63,506
Net current assets	1,812	5,405	8,113	17,243	25,111
Deferred Tax Assets	277	273	910	910	910
Total Assets	10,891	15,925	20,701	29,178	36,365

Source: Company, Centrum Research Estimates

Exhibit 11: Cash flow

Y/E Sep (rsmn)	FY06	FY07	FY08	FY09E	FY10E
CF from operating					
Profit before tax	5,055	8,742	8,918	14,319	13,273
Depreciation	465	492	637	778	781
Interest expenses	14	2	21	-	-
OP profit before WC change	3,747	6,409	7,644	10,232	13,420
Working capital adjustment	5,679	(7,459)	1,243	(3,943)	(3,963)
Gross cash from operations	9,426	(1,286)	8,887	6,288	9,457
Direct taxes paid	(1,720)	(2,675)	(3,970)	(3,870)	(4,413)
Cash from operations	7,706	(3,961)	4,917	2,418	5,044
CF from investing					
Capex	(1,881)	(1,965)	(1,947)	(100)	(100)
Investment	-	2,493	2,445	-	-
Cash from investment	(2,805)	(17)	(299)	4,741	533
CF from financing					
Proceeds from sh cap & prem.	-	-	-	-	-
Borrowings/ (Repayments)	-	-	-	-	-
Interest paid	(15)	(2)	(21)	-	-
Dividend paid	(377)	(729)	(946)	(1,686)	(1,429)
Cash from financing	(399)	(736)	(971)	(1,972)	(1,672)
Net cash increase/ (dec)	4,502	(4,714)	3,647	5,187	3,905

Source: Company, Centrum Research Estimates

Exhibit 12: Key Ratios

Y/E Sep	FY06	FY07	FY08	FY09E	FY10E
Margin Ratios (%)					
EBITDA Margin	8.0	7.7	6.8	12.1	12.1
PBIT Margin	7.0	7.0	6.1	11.2	11.4
PBT Margin	11.2	11.3	10.7	16.9	12.0
PAT Margin	7.9	6.2	4.8	7.6	8.0
Growth Ratios (%)					
Revenues	63.1	71.5	7.7	1.8	31.3
EBITDA	4.4	65.1	(4.3)	80.5	31.2
Net Profit	40.2	32.9	(15.9)	61.0	37.8
Return Ratios (%)					
ROCE	38.0	31.2	16.5	24.2	27.0
ROIC	(83.3)	744.8	60.1	91.6	75.1
ROE	38.2	35.5	21.8	25.8	27.0
Turnover Ratios					
Asset turnover ratio (x)	4.1	4.8	4.0	2.9	3.1
Inventory holding (days)	42.8	35.9	40.6	47.6	47.8
Avg collection period (days)	74.7	78.8	124.2	135.6	131.3
Avg payment period (days)	138.9	112.8	155.2	177.3	156.9
Per share (Rs)					
Reported EPS	10.7	17.7	17.6	31.0	26.3
Adjusted EPS	10.6	14.1	11.8	19.1	26.3
CEPS	11.9	15.5	13.7	21.4	28.6
Book Value	32.3	47.2	61.4	86.5	107.9
Solvency ratios					
Debt/ Equity	0.0	0.0	0.0	0.0	0.0
Valuation parameters (x)					
P/E	60.8	45.7	54.3	33.8	24.5
P/BV	20.0	13.6	10.5	7.4	6.0
EV/ EBITDA	57.9	35.9	36.7	19.8	14.8
EV/ Sales	4.6	5.4	6.5	4.9	6.6
M-Cap/ Sales	4.8	2.8	2.6	2.6	2.0

Source: Company, Centrum Research Estimates

Appendix A

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T. S. Baskaran
Sanjeev Patni

Managing Director & CEO
Head - Institutional Equities

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

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

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	Infra, Power, Capital Goods	r.madanagopal@centrum.co.in	91-22-4215 9684
Abhishek Anand	Analyst	Telecom, Education, Hotels	a.anand@centrum.co.in	91-22-4215 9853
Adhived Chattopadhyay	Analyst	Real Estate	adhived@centrum.co.in	91-22-4215 9632
Ankit Kedia	Analyst	Media, FMCG	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
Pranshu Mittal	Analyst	Food & Bev, 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	Food & Bev, 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
Vishal Desai	Associate	Technology	vishal.desai@centrum.co.in	91-22-4215 9930

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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CDSL DP ID: 12200. **SEBI REGISTRATION NO.:** IN-DP-CDSL-20-99
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