

Equities

26 June 2012 | 13 pages

BOMBARDIER (BBDb.TO)

Some Potential At Farnborough, But Don't Chase Media Stories.

- Company Update
- Target Price Change
- Estimate Change

- **Low point of the cycle?** — while program development risk remains a key question, we see steady progress on new aircraft development, and improvements in medium-term demand for mid-size biz jets/commercial aircraft as allowing Bombardier's investment expenditure to revenue ratios to decline (boosting FCF). As this transition occurs, we see a US\$55B backlog as a *hefty life jacket* for earnings. For these reasons, we continue to identify Bombardier as a preferred long-term Buy.
- **EV/Backlog (erroneously) signaling distress** — at intra-day levels of just 0.15x (ca. 25% below the 6-year average, and 48% below the post credit-crunch peak), and we see Bombardier's EV/Backlog as erroneously suggesting financial distress. While program development risk is not zero, we see Bombardier aero hitting program milestones as a catalyst for multiples returning towards the aforementioned levels.
- **ERJ, BBD and air shows** — we see Farnborough as a potential mover of Embraer's shares, but not (so much) Bombardier's, as the latter seems to enjoy steadier order flow through time. Looking squarely at 2Q12 thus far, Bombardier has won US\$4.8B-worth of orders, vs. US\$178M for Embraer. Assuming that Embraer does have strong order flow from Farnborough, history suggests that we could see the company's shares trade higher, even after the close of this event (slated for the week of July 10th).
- **Target price to C\$6.70** — we soften our (2012) estimates for Bombardier, based in part on our (near-term) caution on the execution of transport contracts (we are still using 2012 as a benchmark). This, (partially offset) by Citi's expectations for a stronger 2012 finish for the US dollar, drive our slightly softer target price (from C\$7.00 to C\$6.70/b-share). Our 2014 estimates increase (consistent with our bullish MT view).

Buy	1
Price (26 Jun 12)	C\$3.81
Target price	C\$6.70
	from C\$7.00
Expected share price return	75.9%
Expected dividend yield	2.4%
Expected total return	78.2%
Market Cap	C\$6,712M
	US\$6,524M

Price Performance (RIC: BBDb.TO, BB: BBD/B CN)



EPS	Q1	Q2	Q3	Q4	FY	FC Cons
2011A	0.12A	0.12A	0.11A	0.12A	0.47A	0.47A
2012E	0.10A	0.11E	0.14E	0.15E	0.50E	0.46E
Previous	0.12E	0.12E	0.16E	0.14E	0.55E	na
2013E	na	na	na	na	0.54E	0.53E
Previous	na	na	na	na	0.57E	na
2014E	na	na	na	na	0.72E	0.63E
Previous	na	na	na	na	0.66E	na

Source: Company Reports and dataCentral, CIR. FC Cons: First Call Consensus.

Stephen Trent
+1-212-816-6901
stephen.trent@citi.com

Raian Santos
raian.santos@citi.com

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

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BOMBARDIER (BBDb.TO)

26 June 2012

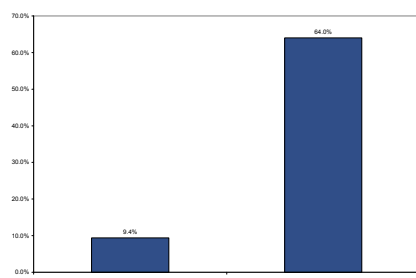
BBDb.TO: Fiscal year end 31-Dec						Price: C\$3.81; TP: C\$6.70; Market Cap: C\$6,712m; Recomm: Buy					
Profit & Loss (US\$m)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	19,366	17,678	18,347	18,143	18,098	PE (x)	9.5	7.9	7.3	6.8	5.2
Cost of sales	-16,700	-15,131	-15,777	-15,612	-15,390	PB (x)	7.1	4.4	10.1	3.9	2.7
Gross profit	2,666	2,547	2,570	2,531	2,708	EV/EBITDA (x)	4.9	4.9	5.9	6.0	4.6
Gross Margin (%)	13.8	14.4	14.0	13.9	15.0	FCF yield (%)	-3.8	4.6	-24.2	-6.8	7.4
EBITDA	1,596	1,244	1,202	1,135	1,215	Dividend yield (%)	3.0	2.4	2.5	1.6	2.1
EBITDA Margin (%)	8.2	7.0	6.6	6.3	6.7	Payout ratio (%)	28	19	18	11	11
Depreciation	-498	-379	-333	-286	-240	ROE (%)	45.0	44.9	47.8	52.9	36.3
Amortisation	0	0	0	0	0	Cashflow (US\$m)	2010	2011	2012E	2013E	2014E
EBIT	1,098	865	869	850	974	EBITDA	1,596	1,244	1,202	1,135	1,215
EBIT Margin (%)	5.7	4.9	4.7	4.7	5.4	Working capital	-798	-41	-1,034	1,421	-42
Net interest	-183	-156	-162	-33	3	Other	-246	195	-258	-2,082	-394
Associates	0	0	0	0	0	Operating cashflow	552	1,398	-90	475	779
Non-op/Except	-9	-14	-4	-19	-20	Capex	-805	-1,094	-1,500	-926	-288
Pre-tax profit	906	695	703	797	958	Net acq/disposals	21	25	737	0	0
Tax	-208	-166	-203	-188	-224	Other	-82	-100	-28	32	0
Extraord./Min.Int./Pref.div.	0	0	0	0	0	Investing cashflow	-866	-1,169	-791	-894	-288
Reported net profit	698	529	500	609	734	Dividends paid	-178	-197	-156	-165	-109
Net Margin (%)	3.6	3.0	2.7	3.4	4.1	Financing cashflow	199	318	-268	433	-90
Core NPAT	698	843	895	974	1,287	Net change in cash	-115	547	-1,149	14	401
Per share data	2010	2011	2012E	2013E	2014E	Free cashflow to s/holders	-253	304	-1,590	-451	490
Reported EPS (\$)	0.39	0.29	0.28	0.34	0.41						
Core EPS (\$)	0.39	0.47	0.50	0.54	0.72						
DPS (\$)	0.11	0.09	0.09	0.06	0.08						
CFPS (\$)	0.31	0.78	-0.05	0.27	0.44						
FCFPS (\$)	-0.14	0.17	-0.90	-0.25	0.27						
BVPS (\$)	0.52	0.84	0.37	0.96	1.37						
Wtd avg ord shares (m)	1,730	1,727	1,724	1,737	1,737						
Wtd avg diluted shares (m)	1,800	1,800	1,775	1,790	1,790						
Growth rates	2010	2011	2012E	2013E	2014E						
Sales revenue (%)	-1.8	-8.7	3.8	-1.1	-0.2						
EBIT (%)	-22.2	-21.2	0.5	-2.2	14.7						
Core NPAT (%)	-30.8	20.8	6.1	8.9	32.1						
Core EPS (%)	-30.8	20.8	7.6	8.0	32.1						
Balance Sheet (US\$m)	2010	2011	2012E	2013E	2014E						
Cash & cash equiv.	3,372	4,195	3,372	3,704	4,345						
Accounts receivables	1,141	1,377	1,408	1,458	1,454						
Inventory	7,630	7,307	7,398	8,356	8,283						
Net fixed & other tangibles	5,663	6,091	6,265	9,001	9,049						
Goodwill & intangibles	2,247	2,358	2,253	2,333	2,333						
Financial & other assets	2,067	2,764	3,168	1,100	1,171						
Total assets	22,120	24,092	23,864	25,952	26,634						
Accounts payable	3,199	3,246	3,210	3,390	3,360						
Short-term debt	0	0	0	0	0						
Long-term debt	4,134	4,645	4,748	5,306	5,306						
Provisions & other liab	13,827	14,680	15,235	15,538	15,519						
Total liabilities	21,160	22,571	23,193	24,233	24,185						
Shareholders' equity	902	1,454	639	1,665	2,377						
Minority interests	58	67	32	53	73						
Total equity	960	1,521	671	1,719	2,450						
Net debt	762	450	1,376	1,602	961						
Net debt to equity (%)	79.4	29.6	205.1	93.2	39.2						

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For definitions of the items in this table, please click [here](#).



We reiterate our Buy rating on
Bombardier and our positive long-term
view on the shares.

Figure 1. Commercial Aero's Contribution To
2011 Revenue (BBD vs. ERJ)



Source: Company Reports

Summary And Portfolio Commentary

We are taking this opportunity to reiterate our positive, long-term view on Bombardier, and to update investors on our view as we approach this year's Farnborough Air Show (slated for the week of July 10th). We reiterate our Buy rating on Bombardier, and we continue to identify Bombardier as our preferred aerospace name (among those commercial oems that produce sub 120-seat aircraft).

This year so far (through Tuesday's intra-day levels) and we would note that Bombardier's B-shares have declined -10.1% (in US dollar terms), underperforming the Toronto Stock Exchange (TSE)'s US dollar move (-8.8%), and below the decline seen in the shares of rival Embraer (-5.2%). However, since the close of May 7th (close to the point at which Embraer's ADRs had hit their ytd peak), and we would note that Bombardier's shares are down -8.9%, versus *US dollar declines* of -25.6% for Embraer and -7.6% for the TSE.

As July's Farnborough Air Show approaches, we would note that we do not regard this particular event as much of a driver for Bombardier's shares (but Farnborough / Le Bourget might be more meaningful for rival Embraer) – among other things, we'd flag Embraer's significantly higher (revenue) exposure to commercial aerospace versus Bombardier's (please see figure 1).

Therefore, Embraer's ADRs might see more of a see saw (positive or negative) depending on the outcome of its Farnborough order flow, as well as on the extent that the media takes a sensationalist posture on its reporting of such order flow.

For Bombardier, *positive catalysts include announcements that the company continues to hit its program milestones (CSeries, Lear 85, Global 7000/8000), continued strong order flow, and a more stable EU (macro) outlook.*

Where Are We In The Cycle?

Backlog multiple seems to signal financial distress

In our view, Bombardier's current enterprise value to backlog (somewhat unfairly) reflects a "perfect storm" – as turmoil continues to swirl in the European Union (Europe accounted for 67% of 1Q12's Transportation top-line, net of a negative US\$91M f/x impact), while the bears on the stock might also highlight program development risk (as the company is developing the CSeries, the Lear 85, with Global 7000/8000 development further out).

In the midst of these factors, we would note that Bombardier is currently trading on a 0.15x EV/backlog, **reflecting a ca. 25% discount to its 6-year historical average of 0.2x, and now also at a more significant 48% discount to its post-credit crunch max of 0.29x** (reached in March 2011). While it would be disingenuous of us to say that Bombardier aerospace's program development risk is zero, it seems unreasonable to us that the shares are trading at multiples (which imply that the company is at risk of some degree of financial distress).

As we move through the next few years, we see Bombardier benefiting from a gradual improvement in demand for both mid-sized commercial aircraft and mid-sized business jets (along with continued good demand for large business jets and for the company's rail products). As this occurs, we also see the company transitioning to materially less onerous investment expenditure to revenue ratios, which should result in higher, sustainable free cash flow.

In our view, the market is assuming that Bombardier's program development will stray wildly off course.

Figure 2. BBD FV/Backlog



Source: Bloomberg and Citi Research

We have also frequently cited Bombardier's ability to win new orders (even in tough economic conditions), as a factor that supports our positive long-term view on the stock. Looking further at what Bombardier has done in 2Q12 so far, and we would note that the company has recorded ca US\$4.8 billion-worth of new orders (at list prices). Although we recognize that a 3-month period is a very small window for a long-term, deep cyclical, we would still highlight Embraer has generated just US\$178 million in new orders over that same period.

As we head for 2Q12's close, we would note that Bombardier has won US\$4.8B-worth of new orders, versus Embraer's announced order flow of US\$178M.

Figure 3. 2Q12 New Order Flow, Bombardier Vs. Embraer

Bombardier					
Date	Order	# units	Client	Country	Value (US\$MM)
Jun-12	Rail - Cars	150	BART San Francisco	USA	266
Jun-12	CRJ1000	12	Nordic Aviation Capital	Denmark	595
Jun-12	Rail - Cars	260	BART San Francisco	USA	631
Jun-12	Learjet 75	5	London Air Services	UK	65
Jun-12	Challenger 300	75	NetJets	USA	
Jun-12	Challenger 605	25	NetJets	USA	2,600
Jun-12	Rail - Cars	300	MTA New York City	USA	599
May-12	Rail - Locomotives	7	Bure	Sweden/Norway	31
Total					4,787

Embraer					
Date	Order	# units	Client	Country	Value (US\$MM)
Jun-12	Legacy 650	5	ICBC Leasing	China	140
Apr-12	E170	1	JAL	Japan	38
Total					178

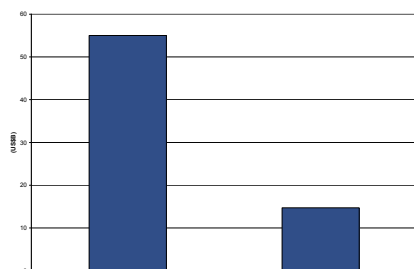
Source: Company Reports and CIRA Estimates

Farnborough Looms Next Month

Aerospace-oriented investors might be tempted to buy commercial aerospace stocks ahead of the Farnborough / Le Bourget Air Shows and then might (perhaps) be inclined to take profits following the conclusion of these events.

Embraer's shares seem to react to Farnborough/Le Bourget Air Shows (but not Bombardier's).

Figure 4. BBD vs. ERJ, Latest Reported Firm Order Backlog (US\$B)



Source: Company Reports

Airlines in Southeast Asia could place orders for ca. sub- 120-seat commercial aircraft next month.

However, looking at historical trends and we would note that Embraer's EV/EBITDA multiples seem to react somewhat more to these events, versus what we've observed for Bombardier. For instance, Embraer's multiples expanded, following 2010's Farnborough Air Show (FlyBe, Republic and Air Lease placed firm orders/LOIs), with this flow shadowed by Brazilian military (and other) order flow/MOUs for the KC-390 (Embraer's military transport aircraft project).

Embraer's multiples had somewhat fizzled on the back of Le Bourget's 2011 Air Show, as JetBlue announced the cancellation of an (old) order, while an Indonesian (preliminary) order appeared to have not been finalized. Conversely, we believe that Bombardier gets less of a boost from these Air Shows, as the company (in our view, thanks in part to its broad product line) **seems to have more success in achieving steady, periodic order flow versus what we see for Embraer** (please once again refer to figure 3 above).

Therefore, without being too obvious, and also considering the media's focus on commercial aero, and we see Bombardier's shares getting a boost from any C-Series order activity during the Air Show. However, we do not see significant downside from a lack of such orders, as (A) investors seem desensitized to the media focusing on the proverbial "ups and downs" of this program, and (B) we see today's buyers as more long-term oriented (we see Bombardier's steady order flow as one of the reasons that the co's backlog has held up so well, vs. Embraer's).

With respect to potential order activity that we could see within the (ca. sub 120-seat) commercial jet category and we would highlight (1) SkyWest, (2) a (re-tooled), independent American Airlines, and (3) Southeast Asian and (perhaps) North Africa / Middle Eastern carriers possibly looking to place orders. However, **we see a very low probability of either abovementioned US carrier as placing such orders during next month's event** (we believe that we could see order flow from these carriers in the next 18 months – and we also see Bombardier favored in potential orders from these US-based carriers, given Bombardier aero's broad product offering as well as the potential fleet needs of these airlines).

Figure 5. Bombardier EV/EBITDA



Source: Citi Investment Research and Analysis

Figure 6. Embraer EV/EBITDA



Source: Citi Investment Research and Analysis

Forecast Adjustments

We are adjusting our estimates for Bombardier, now incorporating slightly softer 2012E EBIT margin figures for the aerospace (from 5.1% to 5.0%) and the transportation segment (from 8% to 7.3%), 1Q results and well as Citi's expectations for a stronger 2012 finish for the US dollar (C\$1.02/US\$ vs. C\$0.98, previously).

In spite of these adjustments, we would also highlight that our 2012 estimates for Bombardier might have found a floor, considering (A) we see upside to our very conservative FCF outlook for the full-year (at just above break-even), vs. the company's expectations for significant FCF generation, and (B) we also believe that Bombardier has passed the low point, with respect to the execution problems that it had experienced on some of its transportation projects.

Figure 7. Forecast Adjustments (US\$MM)

	CY2012	CY2013	CY2014
Revenue New	18,143	18,098	20,437
Revenue Old	19,347	19,003	20,154
% Change	-6.2%	-4.8%	1.4%
EBITDA New	1,421	1,455	1,757
EBITDA Old	1,593	1,604	1,699
% Change	-10.8%	-9.3%	3.4%
EPS New	0.50	0.54	0.72
EPS Old	0.55	0.57	0.66
% Change	-8.8%	-5.1%	9.2%

Source: Citi Investment Research and Analysis

Above all, a US\$55 billion firm order backlog implies that Bombardier has an ample life jacket, as the market waits for medium-term rebounds in (lower gauge) commercial aero and mid-size/super mid-size biz jets.

Figure 8. Selected Global Aerospace Comps

Company	Country	Ticker	Rating	Price 06/26/12	Target Price	PE '12E '13E	EV/EBITDA '12E '13E
Embraer	Brazil	ERJ.N	2	\$24.94	\$35.00	11.7x 9.7x	7.6x 6.8x
Boeing	United States	BA.N	1	\$70.96	\$89.00	15.3x 12.3x	21.4x 10.2x
Lockheed Martin	United States	LMT.N	1	\$83.41	\$105.00	10.7x 9.2x	8.9x 9.8x
Raytheon	United States	RTN.N	1	\$54.32	\$64.00	10.3x 9.1x	5.5x 5.9x
Rolls Royce	United Kingdom	RR.L	1	\$13.04	\$15.11	14.2x 12.7x	11.0x 7.2x
Bombardier	Canada	BBDb.TO	1	C\$3.81	C\$6.70	8.0x 7.5x	5.3x 5.7x
EADS	France	EAD.PA	1	\$32.46	\$45.64	12.0x 8.9x	8.8x 2.9x
Median						11.7x 9.2x	8.8x 6.8x

Notes: Embraer and Bombardier are covered by Stephen Trent. Rolls Royce and EADS are covered by Jeremy Bragg. Boeing, Lockheed Martin and Raytheon are covered by Jason Gursky. NR = Not Rated by Citi Investment Research. NM = Not Material. NA = Not Available. All estimates are calendarized and in USD, except for Bombardier, which are denominated in Canadian Dollars. Prices are intra-day levels.

Source: Citi Investment Research and Analysis

BOMBARDIER

Company description

Initially founded as a snowmobile manufacturer in 1942, Bombardier is currently the world's third largest aircraft manufacturer and the largest global railway rolling stock manufacturer. The Aerospace segment designs, manufactures and provides support services for commercial, business and amphibious aircrafts. The Transportation segment produces a wide range of rail equipment solutions such as rail vehicles, propulsion and controls, bogies, transportation systems, rail control solutions and transit security solutions as well as provides related services.

Headquartered in Montreal, Canada, Bombardier has production facilities in Canada, the United States, Europe, Latin America and Asia, and the company boasts a presence in more than 60 countries. The company's B-shares (the most heavily-traded instrument listed by the company) are listed on the Toronto Stock Exchange (Bloomberg ticker: BDB/B CN; Reuters ticker: BDB.TO).

Investment strategy

On the core aerospace side, we see Buy-rated Bombardier's product diversity as one of its key strengths: The company manufactures small- to mid-size commercial jets (ca. 40- to 100-seats); it has made progress with its foray into larger commercial aircraft (the CSeries); it is a leading manufacturer of turbo-props (propeller planes); and its corporate jet product offerings cover every major category (with the exception of "very light" jets).

Over the next 12 months, we see a generally positive picture for Bombardier's firm order book. On one level, the company's business jet division caters substantially to the (higher margin, higher deposit requirement) large cabin segment (with much of that demand coming from emerging Asia). In commercial aero, we recognize that the company has made important gains, in terms of new CSeries orders. On the flip-side, order flow for the company's other commercial aero products could be more moderate.

On the transportation front, Bombardier has a diversified global customer base, which includes (primarily government) entities in China, Brazil, the Middle East and the EU (with the latter exposure being heavily Franco-German). On top of its customer/product diversity, Bombardier is sitting on consolidated firm order backlog of US\$55 billion (March 2012), or equal to roughly 3 years of production.

Movements in the Canadian markets, overall market movements, (surprise) stimulus-style government spending on transportation infrastructure, and additional CSeries and/or Large Cabin biz jet orders could serve as positive catalysts for Bombardier.

Valuation

We have a 12-month target price on Bombardier of C\$6.70/b-share. We arrive at this valuation using calendar year 2012 (Canadian dollar) multiples of 6.0x-7.0x EV/EBITDA (75% weight) and 15.0x-18x P/E (25%). EV/EBITDA gets us close to C\$4.71, while P/E gets us closer to C\$8.60. The revised multiple ranges reflect "stress-tested" ranges, versus our normalized long-term fair value ranges of 9x-10x (EV/EBITDA) and 17x-20x (P/E), as we accept that investor are unlikely to be willing to pay the same multiples for global aerospace stocks (in light of a questionable

global economic outlook), versus what they might be willing to pay under more normal circumstances.

While we also recognize the merits of other valuation methods (price/book, sum-of-the-parts, etc.) we refrain from employing these tools at the current time – in the case of price/book, we believe that ongoing changes to accounting policy (Canadian companies transitioning over from Canadian GAAP to IFRS accounting), could create too many adjustments. In the case of sum-of-the-parts valuation, trading statistics suggest that Bombardier trades more like an aerospace company, rather than a transportation entity.

Risks

For Bombardier, we see key risks for the company's target price as follows:

1. The long-term cycle for business jets could be much weaker than we currently anticipate, implying that the book-to-bill ratio for this segment could exhibit a trend that is worse than we had expected; 2. In view of the growth of corporate jets vs. commercial aerospace (especially on the lower end of the corporate segment), various governing bodies could act to restrict the use of such jets (higher landing fees, increased requirements on licensing and training, etc.); 3. In the commercial jet segment, we continue to keep a wary eye on the availability of commercial jet financing; 4. On the transportation front, European government budgets for transportation infrastructure could also turn down more quickly than we expect, while China could do the same (in light of recent accidents); 5. The Canadian dollar could strengthen beyond the firm's expectations leading to pressure on Bombardier's operating margins; 6. Bombardier's launch of the C-series aircraft not only risks retaliation from manufacturers of larger jets, but it also remains to be seen exactly how much of this potential investment the company will have to cover; and 7. Investor sentiment towards industrials, deep cyclicals and/or companies with actual (or perceived) significant exposure to the economic cycle could worsen substantially, regardless of how such companies continue to perform from an earnings standpoint. On the upside, corporate jet demand from wealthy private individuals might turn out to be much stronger than we expect (even for aircraft above the "very light" category), leading to a corporate jet cycle that is materially stronger than we expect. If the impact of the above factors is greater than we anticipate, then Bombardier could have difficulty achieving our target valuation (the opposite also holds true).

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

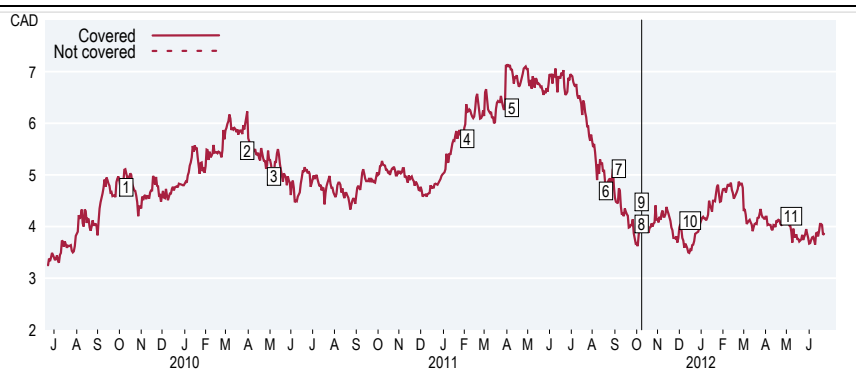
IMPORTANT DISCLOSURES

BOMBARDIER (BBDb.TO)

Ratings and Target Price History

Fundamental Research

Analyst: Stephen Trent



	Date	Rating	Target Price	Closing Price
1	12-Oct-09	*1H	*6.50	5.11
2	31-Mar-10	1H	*8.00	6.23
3	7-May-10	1H	*7.30	5.04
4	4-Feb-11	1H	*7.60	6.22

* Indicates change

	Date	Rating	Target Price	Closing Price
5	8-Apr-11	1H	*9.70	7.05
6	19-Aug-11	1H	*8.60	4.69
7	7-Sep-11	1H	*8.00	4.74
8	8-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
9	8-Oct-11	*1	8.00	3.96
10	16-Dec-11	1	*7.70	3.55
11	8-May-12	1	*7.00	3.90

Rating/target price changes above reflect Eastern Standard Time

BOMBARDIER (BBDb.TO)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Stephen Trent



	Date	Rating	Target Price	Closing Price
1	19-Apr-11	*ADD MP	-	6.71

* Indicates change

	Date	Rating	Target Price	Closing Price
2	20-Jun-11	*REM MP	-	6.92

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Mar 2012

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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