

# HCL TECHNOLOGIES

Industry  
Bloomberg  
BSE Code  
NSE Code

IT SOFTWARE  
HCLT  
532281  
HCLTECH

21 June 2018

<b>RATING</b>	<b>Neutral</b>
<b>CMP</b>	<b>912</b>
<b>Price Target</b>	<b>975</b>
<b>Previous Target</b>	<b>1038</b>
<b>Potential Upside</b>	<b>7%</b>

## Stock Info

52wk Range H/L	1107/825
Mkt Capital (Rs Cr)	1,26,978.72
Free float (%)	40%
Avg. Vol 1M (.000)	1,531
No. of Shares (Crore)	14
Promoters Pledged %	0%

## Key Highlights

- Large investments in IP partnerships seems to be new progress to drive future growth.
- Slowing growth in IMS over the past three to four quarters is a concern: HCLTech growth has been primarily driven by its strong positioning in the Infrastructure Services space. Growth of infrastructure management Services or IMS over the past three to four quarters is declining. Even in 4QFY18, Infrastructure Services showed growth due to an expected decline in the India business. The management expects the deal wins to drive growth in IMS practice starting 2QFY19.

- Weak guidance gives little revenue visibility for FY19: HCLTECH guided for CC revenue growth of 9.5-11.5%. Thus, 5.25pp of contribution would come from inorganic investments (including USD200m from C3i solutions) and rest coming from organic growth (5.25%) which is giving clear lack of any upward movement in trajectory.

## 4Q FY18 Result:

HCLTECH 4QFY18 revenue grew by 3% QOQ to Rs 13178 crore mainly impacted by weakness in application Services . EBIT margin for the quarter was flat QoQ at 19.6%.The management guided revenue growth of 9.5-11.5% in constant currency and maintained its margin guidance of 19.5%-20.5%.This quarter saw 15 transformational deals wins. Majority of these wins were powered by Digital, Cloud, Autonomics and AI-based offerings.

## View and Valuation

HCLTECH's 4QFY18 showed a stable performance with revenue growth of 3% QOQ to Rs 13178 crore mainly impacted by weakness in application Services. EBIT margin for the quarter was flat QoQ at 19.6%.Even the core services like Application Services (35% of the revenue) and IMS (35% to 37%)did not aided to the business. Softness was seen in Application Services which grew 1% QOQ whereas Engineering drove growth both organically and through acquired IPs.BPO (Business Services) grew 5% but here may not matter so much given the rather small contribution of BPO to overall revenues (3-4%).

Going forward ,we expect to see better performance from 2QFY19 based on 1) Increasing deal size (in digital) and strong deal wins , (2) Recovery in IMS ahead (investing USD1b in IP partnerships).

However muted performance by its major contributor IMS over the past 3-4 quarters is a concern and even management guidance of 9.5-11.5% CC revenue growth implies 4.25-6.25% organic growth in FY19 is giving a clear lack of any upward movement in trajectory.

**Thus we are NEUTRAL on the stock with the target price of Rs 975(15Xfy19e EPS).**

KEY FINANCIAL/VALUATIONS	FY16	FY17	FY18	FY19E	FY20E
Net Sales	30781	47568	50569	54135	58360
EBITDA	6540	10385	11246	12410	13306
EBIT	6148	9556	9863	10248	10642
PAT	5,661	8,606	8,722	9,047	9,521
EPS (Rs)	40	60	63	65	68
EPS growth (%)	-24%	52%	4%	4%	5%
ROE (%)	22	32	32	30	27
ROCE (%)	24	31	28	25	22
BV	194	231	261	317	376
P/B (X)	4	4	4	3	2
P/E (x)	20	14	15	14	13

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## 4Q FY 18 Results

## Stable Growth

Financials	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	YoY %	QoQ%	FY17	FY18	YoY %
Net Sales	12,898	12,149	12,433	12,809	13,178	2.2%	2.9%	47,568	50,569	6.3%
Other Income	285	313	332	270	302	5.9%	11.9%	1,073	1,217	13.4%
Employee	6,435	5,861	6,233	6,297	6,338	-1.5%	0.7%	22,866	24,729	8.1%
Other Exp	3,416	3,298	3,204	3,336	3,401	-0.4%	1.9%	4,836	4,619	-4.5%
EBITDA	2,747	2,694	2,741	2,789	3,022	10.0%	8.4%	10,385	11,246	8.3%
Dep and	259	227	296	431	429	65.5%	-0.5%	828	1,383	67.0%
EBIT	2,488	2,467	2,445	2,358	2,593	4.2%	10.0%	9,556	9,863	3.2%
Interest	28	18	11	21	19	-31.8%	-9.5%	89	69	-22.6%
PBT	2,746	2,762	2,766	2,607	2,876	4.8%	10.3%	10,541	11,011	4.5%
Tax	274	552	572	532	646	135.3%	21.4%	1,936	2,302	18.9%
Ex Items	-	-	-	-	-			-	-	
PAT	2,475	2,210	2,207	2,075	2,230	-9.9%	7.5%	8,606	8,722	1.3%

**Revenue impacted by softness in Application Services and IMS**

HCLTECH's 4QFY18 showed a stable performance with revenue growth of 3% QOQ to Rs 13178 crore mainly impacted by weakness in application Services

Software Services grew 1.2% QOQ to USD1,187m. Application Services was slow during the quarter whereas Engineering drove growth both organically and through acquired IPs.

IMS grew by 1.9% QOQ to USD760m whereas revenue in BPO had been volatile in last quarter showed a growth of 5% QOQ

**EBIT margin remained flat Q/Q at 19.6%; management guided in 19.5%-20.5% for FY19**

EBIT margin remained flat QOQ at 19.6%. Gross margins (excluding depreciation) increased 70bps to 35%. SG&A as a % of revenue increased 80bps QOQ to 12%

LTM IT services attrition increased to 15.5% in 4Q FY18 (from 15.2% last quarter). BPO quarterly attrition decreased 10bps from 5.5% last quarter to 5.4% in the 4QFY18

**KEY SEGMENTS HIGHLIGHTS**

Segments	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Software Service	6355	6405	6635	7744	7028	7200	7631	7752
IMS	4514	4646	4702	4681	4690	4783	4703	4919
BPO SERVICE	468	468	477	473	431	450	475	507
<b>TOTAL</b>	<b>11337</b>	<b>11519</b>	<b>11814</b>	<b>12898</b>	<b>12149</b>	<b>12433</b>	<b>12809</b>	<b>13178</b>

Growth was driven by Financial Services (2% QoQ CC) and Telecom MP&E (1.8% QoQ CC). Revenue was flat in the verticals of Manufacturing and Life Sciences & Healthcare. The performance in services was led by Engineering and R&D Services had a 4.5%QoQ growth, Application Services at 1%, BPO at 5%.

**Concall Highlights :**

- ✓ Deals wins: This quarter saw 20 transformational deals wins. Majority of these wins were powered by Digital, Cloud, Autonomics and AI-based offerings
- ✓ C3i's revenues had been declining for the past couple of years. The revenues should decline by 10-12% in FY19 too, and growth should pick-up in FY20. Likewise, in Actian, which too was seeing a declining trajectory, the revenue base should stabilize this fiscal and start growing in FY20.
- ✓ Strong client addition: Three new clients added in the 50 million plus category and 6 in the 40 million category, 9 in the 30 million category and 55 in 1 million plus category, strong client addition across categories.
- ✓ In FY 2018, Revenues from Mode 2 and Mode 3 offerings together grew 41.5%. The share of Mode 2 and Mode 3 revenues together stands at 23.4% for FY'18, compared to 18.6% for FY'17.

## Operational Matrix

<i>Geography (%)</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>
Americas	60%	62%	62%	63%	63%	62%	64%	62%
Europe	31%	29%	30%	28%	27%	29%	29%	30%
RoW	9%	9%	9%	10%	10%	9%	8%	9%

<i>REVENUE BY VERTICAL</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>
Financial Services	24%	24%	24%	24%	25%	25%	25%	25%
Manufacturing	33%	32%	34%	35%	35%	35%	37%	36%
Lifesciences & Healthcare	12%	13%	12%	12%	12%	12%	12%	12%
Public Services	12%	11%	11%	12%	11%	11%	10%	11%
Retail & CPG	10%	10%	9%	9%	10%	9%	10%	10%
Telecommunications,	9%	9%	9%	8%	8%	8%	7%	7%
Others	1%	0%	0%	0%	0%	0%	0%	0%

<i>CONTRACT TYPE</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>
F P Projects	61%	61%	63%	62%	60%	60%	61%	62%
Time & Material	39%	39%	37%	38%	40%	40%	39%	38%

<i>CLIENTS (LTM)</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>
100 Million dollar +	7	8	8	8	8	9	9	8
50 Million dollar	20	20	24	25	25	25	25	28
40 Million dollar +	32	34	35	34	35	37	40	40
30 Million dollar +	48	49	48	49	52	52	56	58
20 Million dollar +	80	82	87	85	86	84	85	87
10 Million dollar +	146	146	148	153	154	157	156	160
5 Million dollar +	237	235	241	246	249	259	261	264
1 Million dollar +	482	494	496	506	508	536	552	561

<i>CLIENT CONTRIBUTION</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>
Top 5 Clients	14%	14%	14%	15%	14%	15%	16%	16%
Top 10 Clients	22%	22%	22%	22%	22%	23%	24%	24%
Top 20 Clients	32%	32%	32%	33%	33%	33%	34%	34%

<i>SERVICE MIX</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>
Application Services	38%	38%	38%	37%	36%	36%	35%	35%
Infrastructure Services	40%	40%	40%	39%	39%	39%	37%	37%
Business Services	4%	4%	4%	4%	4%	4%	4%	4%
Engineering and R&D	18%	18%	19%	21%	22%	22%	24%	24%

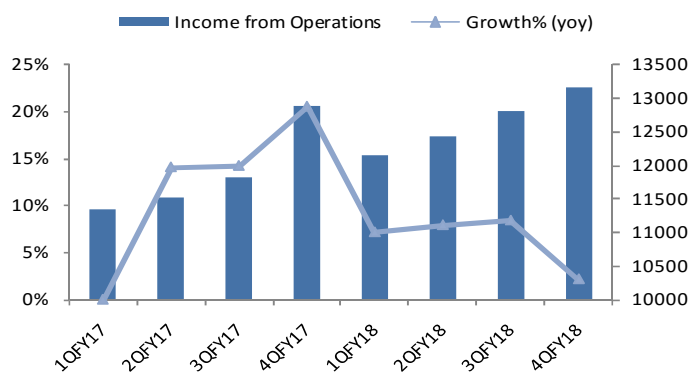
  

<i>Utilization</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>
Gross Addition	10515	9083	8467	10605	9462	8645	7113	7113
Blended Utilization (%)	86%	85%	85%	86%	86%	86%	86%	86%

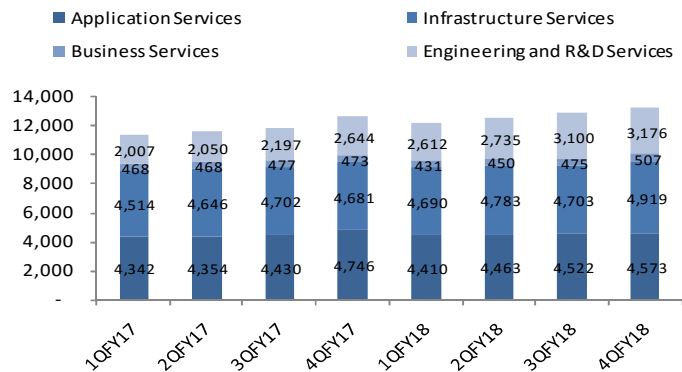
  

<i>AVERAGE RATES</i>	<i>1QFY17</i>	<i>2QFY17</i>	<i>3QFY17</i>	<i>4QFY17</i>	<i>1QFY18</i>	<i>2QFY18</i>	<i>3QFY18</i>	<i>4QFY18</i>
USD - INR	67	67	68	66	65	65	64	65
GBP - USD	1.4	1.3	1.2	1.2	1.3	1.3	1.3	1.4
EUR - USD	1.1	1.1	1.1	1.1	1.1	1.2	1.2	1.2
SEK - USD	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
AUD - USD	0.8	0.8	0.7	0.8	0.8	0.8	0.8	0.8

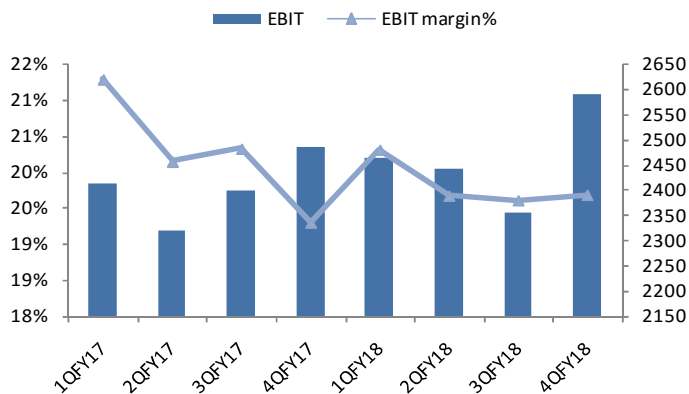
**Exhibit: Engineering drove growth but IMS impacted the revenue**



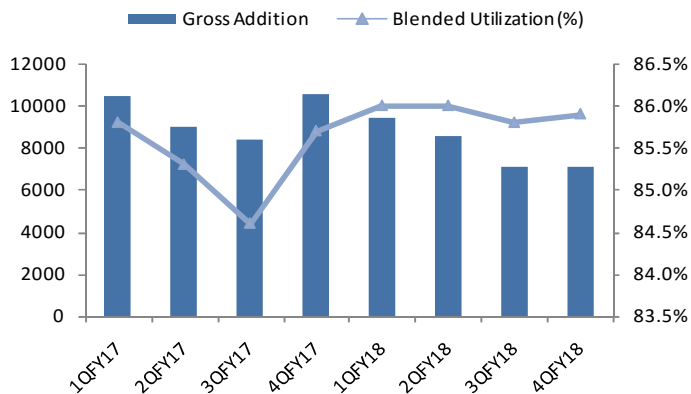
**Exhibit: slowdown in IMS revenue growth**



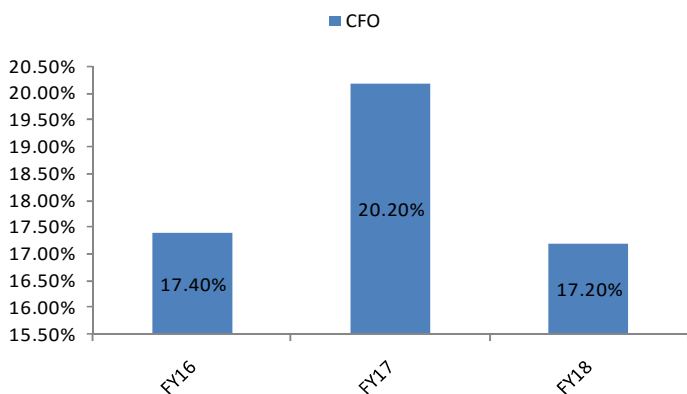
**Exhibit :EBIT margin remained flat Q/Q at 19.6%; management guided in 19.5%-20.5% for FY19**



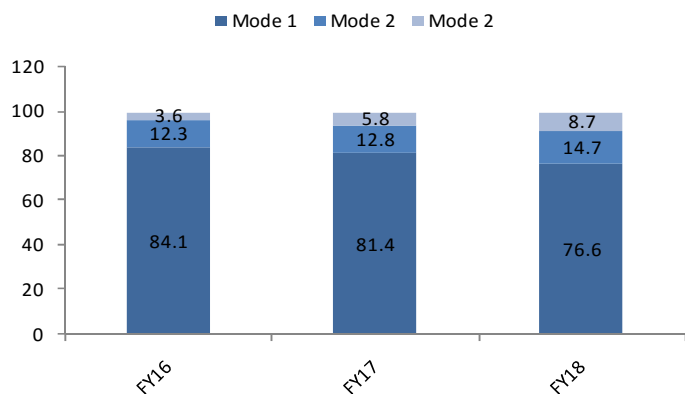
**Exhibit: Utilization has been gradually moving**



**Exhibit: Fee Income/Advances %**



**Exhibit: Other Income/ Total Income %**



## Financial Details

### Balance Sheet

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Share Capital	139	140	281	282	285	278	278	278
Reserves	13,020	19,402	23,943	27,012	32,664	36,108	43,819	52,003
<b>Networth</b>	<b>13,159</b>	<b>19,542</b>	<b>24,224</b>	<b>27,294</b>	<b>32,950</b>	<b>36,386</b>	<b>44,097</b>	<b>52,281</b>
Debt	925	406	523	952	445	380	380	380
Other Non Cur Liab	920	930	825	841	923	1,192	1,192	1,192
<b>Total Capital Employed</b>	<b>14,084</b>	<b>19,949</b>	<b>24,748</b>	<b>28,246</b>	<b>33,395</b>	<b>36,766</b>	<b>44,477</b>	<b>52,661</b>
<b>Net Fixed Assets (incl CWIP)</b>	<b>7,246</b>	<b>7,975</b>	<b>8,827</b>	<b>10,561</b>	<b>9,180</b>	<b>12,274</b>	<b>13,948</b>	<b>16,213</b>
Non Cur Investments	-	-	107	321	34	303	303	303
Other Non Cur Asst	2,519	2,675	3,264	3,602	10,086	10,888	10,888	10,888
<b>Non Curr Assets</b>	<b>2,519</b>	<b>2,675</b>	<b>3,371</b>	<b>3,922</b>	<b>10,120</b>	<b>11,191</b>	<b>11,191</b>	<b>11,191</b>
Inventory	232	122	158	264	276	172	184	198
Debtors	4,497	5,683	6,539	7,682	8,301	9,639	10,319	11,124
Current investments	627	606	763	535	1,146	2,357	2,357	2,357
Short-term loans and advances	1,572	1,590	2,189	3,340	2,528	3,410	3,650	3,935
Cash & Bank	3,577	8,807	9,786	9,285	9,044	4,018	9,127	14,206
Other Curr Assets	2,129	2,521	3,613	5,075	5,175	4,962	5,068	5,194
<b>Curr Assets</b>	<b>12,634</b>	<b>19,330</b>	<b>23,047</b>	<b>24,860</b>	<b>26,470</b>	<b>24,558</b>	<b>30,706</b>	<b>37,015</b>
Creditors	401	468	625	700	801	918	983	1,059
Provisions	1,723	1,462	1,734	1,804	473	530	567	612
Other Curr Liab	5,221	7,105	7,231	7,442	1,722	1,325	1,418	1,529
Others Financial liabilities	-	-	-	-	7,545	6,606	6,606	6,606
Current tax liabilities (net)	-	-	-	-	739	686	686	686
<b>Curr Liabilities</b>	<b>7,345</b>	<b>9,036</b>	<b>9,590</b>	<b>9,945</b>	<b>11,280</b>	<b>10,065</b>	<b>10,261</b>	<b>10,492</b>
<b>Net Curr Assets</b>	<b>5,288</b>	<b>10,294</b>	<b>13,457</b>	<b>14,915</b>	<b>15,190</b>	<b>14,493</b>	<b>20,445</b>	<b>26,523</b>
<b>Total Assets</b>	<b>22,399</b>	<b>29,980</b>	<b>35,245</b>	<b>39,344</b>	<b>45,769</b>	<b>48,023</b>	<b>55,845</b>	<b>64,419</b>

### Income Statement

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Revenue from Operation	25,581	32,144	36,701	30,781	47,568	50,569	54,135	58,360
Change (%)	23%	26%	14%	-16%	55%	6%	7%	8%
Other Operating Income	-	-	-	-	-	-	-	-
<b>EBITDA</b>	<b>5,661</b>	<b>8,035</b>	<b>8,473</b>	<b>6,540</b>	<b>10,385</b>	<b>11,246</b>	<b>12,410</b>	<b>13,306</b>
Change (%)	53%	42%	5%	-23%	59%	8%	10%	7%
Margin (%)	22%	25%	23%	21%	22%	22%	23%	23%
Depr & Amor.	637	681	404	393	828	1,383	2,162	2,664
<b>EBIT</b>	<b>5,024</b>	<b>7,354</b>	<b>8,069</b>	<b>6,148</b>	<b>9,556</b>	<b>9,863</b>	<b>10,248</b>	<b>10,642</b>
Int. & other fin. Cost	106	115	91	74	89	69	76	76
Other Income	351	677	1,139	895	1,073	1,217	1,531	1,751
<b>EBT</b>	<b>5,270</b>	<b>7,917</b>	<b>9,117</b>	<b>6,969</b>	<b>10,541</b>	<b>11,011</b>	<b>11,703</b>	<b>12,317</b>
Exp Item	-	-	-	-	-	-	-	-
Tax	1,225	1,410	1,815	1,364	1,936	2,302	2,657	2,796
Minority Int & P/L share of Ass.	(4)	2	40	56	2	13	-	-
<b>Reported PAT</b>	<b>4,040</b>	<b>6,510</b>	<b>7,342</b>	<b>5,661</b>	<b>8,606</b>	<b>8,722</b>	<b>9,047</b>	<b>9,521</b>
<b>Adjusted PAT</b>	<b>4,040</b>	<b>6,510</b>	<b>7,342</b>	<b>5,661</b>	<b>8,606</b>	<b>8,722</b>	<b>9,047</b>	<b>9,521</b>
Change (%)	66%	61%	13%	-23%	52%	1%	4%	5%
Margin(%)	16%	20%	20%	18%	18%	17%	17%	16%

## Financial Details

### Cash flow

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
<b>PBT</b>	<b>5,270</b>	<b>7,917</b>	<b>9,117</b>	<b>6,969</b>	<b>10,543</b>	<b>11,011</b>	<b>11,703</b>	<b>12,317</b>
<i>(inc)/Dec in Working Capital</i>	<i>(149)</i>	<i>(244)</i>	<i>(1,188)</i>	<i>(1,456)</i>	<i>321</i>	<i>(635)</i>	<i>(1,282)</i>	<i>(1,282)</i>
<i>Non Cash Op Exp</i>	<i>635</i>	<i>228</i>	<i>(615)</i>	<i>(317)</i>	<i>139</i>	<i>1,430</i>	<i>2,151</i>	<i>2,151</i>
<i>Int Paid (+)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Tax Paid</i>	<i>(1,264)</i>	<i>(1,445)</i>	<i>(1,774)</i>	<i>(1,400)</i>	<i>(2,007)</i>	<i>(2,302)</i>	<i>(2,657)</i>	<i>(2,796)</i>
<i>others</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<b>CF from Op. Activities</b>	<b>4,492</b>	<b>6,457</b>	<b>5,539</b>	<b>3,796</b>	<b>8,995</b>	<b>7,475</b>	<b>10,366</b>	<b>11,186</b>
<i>(inc)/Dec in FA &amp; CWIP</i>	<i>(619)</i>	<i>(720)</i>	<i>(1,208)</i>	<i>(917)</i>	<i>(1,278)</i>	<i>(4,477)</i>	<i>(3,837)</i>	<i>(4,929)</i>
<b>Free Cashflow</b>	<b>3,873</b>	<b>5,737</b>	<b>4,331</b>	<b>2,879</b>	<b>7,717</b>	<b>2,998</b>	<b>6,529</b>	<b>6,257</b>
<i>(Pur)/Sale of Inv</i>	<i>(4,771)</i>	<i>(7,852)</i>	<i>(8,205)</i>	<i>(6,869)</i>	<i>(11,666)</i>	<i>(1,211)</i>	<i>-</i>	<i>-</i>
<i>others</i>	<i>(7,744)</i>	<i>(13,412)</i>	<i>(11,427)</i>	<i>(9,940)</i>	<i>(16,761)</i>	<i>(11,377)</i>	<i>(7,674)</i>	<i>(9,857)</i>
<b>CF from Inv. Activities</b>	<b>(2,354)</b>	<b>(4,840)</b>	<b>(2,014)</b>	<b>(2,154)</b>	<b>(3,817)</b>	<b>(5,688)</b>	<b>(3,837)</b>	<b>(4,929)</b>
<i>inc/(dec) in NW</i>	<i>34</i>	<i>34</i>	<i>10</i>	<i>1</i>	<i>0</i>	<i>(7)</i>	<i>-</i>	<i>-</i>
<i>inc/(dec) in Debt</i>	<i>48</i>	<i>73</i>	<i>582</i>	<i>52</i>	<i>197</i>	<i>(20)</i>	<i>-</i>	<i>-</i>
<i>Int. Paid</i>	<i>(114)</i>	<i>(184)</i>	<i>(24)</i>	<i>-</i>	<i>(8)</i>	<i>(19)</i>	<i>-</i>	<i>-</i>
<i>Div Paid (inc tax)</i>	<i>(769)</i>	<i>(1,173)</i>	<i>(2,824)</i>	<i>(2,697)</i>	<i>(4,068)</i>	<i>(1,336)</i>	<i>(1,336)</i>	<i>(1,336)</i>
<i>others</i>	<i>(344)</i>	<i>73</i>	<i>151</i>	<i>(151)</i>	<i>(143)</i>	<i>(234)</i>	<i>(20)</i>	<i>-</i>
<b>CF from Fin. Activities</b>	<b>(2,086)</b>	<b>(1,308)</b>	<b>(3,140)</b>	<b>(2,237)</b>	<b>(4,533)</b>	<b>(1,408)</b>	<b>(1,336)</b>	<b>(1,336)</b>
<i>Inc(Dec) in Cash</i>	<i>52</i>	<i>309</i>	<i>385</i>	<i>(595)</i>	<i>645</i>	<i>378</i>	<i>5,193</i>	<i>4,921</i>
<b>Add: Opening Balance</b>	<b>669</b>	<b>719</b>	<b>953</b>	<b>1,319</b>	<b>676</b>	<b>1,321</b>	<b>1,699</b>	<b>6,808</b>
<b>Closing Balance</b>	<b>721</b>	<b>1,027</b>	<b>1,339</b>	<b>724</b>	<b>1,321</b>	<b>1,699</b>	<b>6,892</b>	<b>11,729</b>

### Key Ratio

Y/E March	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
ROE	35	40	34	22	32	32	30	27
ROCE	36	43	36	24	31	28	25	22
Asset Turnover	3	3	2	1	2	2	2	2
Current Ratio	2	2	2	3	2	2	3	4
Debt/Equity	7	3	2	3	2	1	1	1
Inv Days	3	1	2	3	2	1	1	1
DPS	6	8	30	16	24	8	8	8
Payable Days	6	5	6	8	6	7	7	7
Debtor Days	64	65	65	91	64	70	70	70
Earnings Per Share	58	93	52	40	60	63	65	68
Book Value Per Share	189	279	172	194	231	261	317	376
P/E	14	15	19	20	14	15	14	13
<i>Price / Book Value</i>	<i>4.2</i>	<i>5.0</i>	<i>5.7</i>	<i>4.2</i>	<i>3.8</i>	<i>3.7</i>	<i>2.9</i>	<i>2.4</i>
EV/EBITDA	9.3	11.1	15.2	16.0	11.2	11.7	9.5	8.5
EV/Sales	2.1	2.8	3.5	3.4	2.4	2.6	2.2	1.9
Div Payout%	10%	9%	57%	40%	40%	13%	12%	12%
EPS GROWTH		60%	-44%	-24%	52%	4%	4%	5%

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