

Escorts Kubota

Estimate changes

TP change

Rating change



Bloomberg	ESC IN
Equity Shares (m)	135
M.Cap.(INRb)/(USDb)	248.3 / 3.3
52-Week Range (INR)	1927 / 1098
1, 6, 12 Rel. Per (%)	1/47/16
12M Avg Val (INR M)	2121

Financials & Valuations (INR b)

Y/E March	2023	2024E	2025E
Sales	84.3	91.1	100.4
EBITDA	7.8	11.1	13.8
EBITDA Margin (%)	7.4	10.4	12.0
Adj. PAT	6.8	9.2	11.5
EPS (INR)	51.3	75.3	94.1
EPS Gr. (%)	-22.9	46.7	24.9
BV/Sh. (INR)	620	734	819
Ratios			
RoE (%)	8.6	10.7	12.1
RoCE (%)	11.5	14.6	16.4
Payout (%)	14.5	10.6	10.6
Valuations			
P/E (x)	39.9	27.2	21.8
P/BV (x)	3.3	2.8	2.5
EV/EBITDA (x)	31.7	21.3	16.5
Div. Yield (%)	0.3	0.4	0.5
FCF yield (%)	0.1	4.9	4.0

Shareholding pattern (%)

As On	Mar-23	Dec-22	Mar-22
Promoter	72.9	72.9	28.1
DII	8.1	8.5	0.4
FII	6.3	5.6	5.4
Others	12.7	13.0	66.1

FII Includes depository receipts

CMP: INR2,049
TP: INR1,900 (-7%)
Neutral

Benefit of lower RM costs aids margin expansion

FY24 industry growth guidance at low-to-mid single digit

- Escorts Kubota (ESC)'s 4QFY23 performance surprised us as better-than-estimated gross margin led to EBITDA beat at INR2.4b (v/s est. INR2.0b). FY24 domestic tractor volumes are likely to post low-to-mid single digit growth, despite weak 1QFY24, due to: a) good MSP prices, b) high water reservoir levels, and c) healthy growth in non-agri tractor sales.
- We raise our FY24E/FY25E EPS by 7.5%/6.6% to factor in margin expansions in all the verticals. **Retain Neutral with a TP of INR1,900.**

Agri business PBIT margin yet to scale up to FY22 levels

- ESC's revenue grew ~17% YoY to INR21.8b while EBITDA declined 6% YoY to ~INR2.4b with PAT remaining flat YoY in 4QFY23. FY23 revenue grew ~16% YoY while EBITDA/PAT declined 22%/8% YoY.
- Tractor volumes grew ~13% YoY while net realizations remained flat at INR628.9k (est. INR613k). Tractor /construction equipment/ Railways' revenue grew 14.0%/20.5%/ 37.0% YoY.
- Gross margin contracted 1.4pp YoY (+3pp QoQ) to 28.5% (v/s est. 26.0%). Consequently, EBITDA came in at INR2.4b (-6% YoY, est. INR2.0b). EBITDA margin contracted 270bp YoY/+240bp QoQ to 10.8% (est. 9.1%) during the quarter.
- PBIT margin for tractors contracted 5.5pp YoY to 9.9%. Railways margin was at 14.0% (+90bp YoY/QoQ) and CE was at 8.1% (+450bp YoY/+590bp QoQ) in 4QFY23.
- Adj. PAT stood at INR2b (above est.), flat YoY.
- The Board declared a dividend of INR7/share for FY23 similar to FY22.
- FCFF stood at INR336m (v/s negative INR1.4b in FY22) driven by operating cashflow of INR2.2b (v/s INR323m in FY22). Capex stood at INR1.9b in FY23 (v/s INR1.7b in FY22).

Highlights from the management commentary

- FY24 domestic tractor volumes are likely to post low-to-mid single digit growth, despite weak 1QFY24, due to: a) good MSP prices, b) high water reservoir levels, and c) healthy growth in non-agri tractor sales.
- Tractor PBIT margin to reach 14-15% level by 4QFY24 driven by: a) further savings in RM cost, b) mix improvement and c) cost-cutting initiatives. It is expecting further softening of prices for steel, casting and rubber (yet to see the benefit of correction in rubber prices).
- Construction Equipment business is likely to grow 10-12% in FY24**, with margins expanding further over FY23 levels led by RM savings and operating leverage.
- Railways business to grow in double digit** driven by new products and exports. ESC's Mar'23-end order book stood at INR10.5b. It expects localization benefits on the new products to reflect in P&L only in FY25, driving margin improvement.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Valuation and view

- Near-term demand outlook continues to remain positive led by healthy agri sentiments. This should be further benefitted by lower channel inventory and the company's focus on market share gains. Hence we expect ~7% volume CAGR over FY23-25. However, high base of FY23, uncertain monsoon forecast for CY23 and the impact of implementation of TREM-4 norms for <50HP tractors (likely in FY25) would be the key monitorables. Faster recovery in other businesses and a ramp-up in its partnership with Kubota would partially dilute the cyclical impact of the tractor industry on ESC.
- The stock trades at ~27.2x/21.8x consolidated FY24E/25E EPS, at a premium to its 10-year average of ~13.3x, driven by an improvement in operating parameters as well as the Kubota partnership. The valuations are already factoring in positive tractor industry outlook as well as the benefit from Kubota partnership. We raise our FY24E/FY25E EPS by 7.5%/6.6% to factor in margin expansions in all the verticals. **Maintain Neutral with a TP of INR1,900 (premised on 20x Mar'25E consolidated EPS).**

Standalone Quarterly Performance

(INR m)

Y/E March	FY22				FY23				FY22	FY23	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			4QE
Net Sales	16,715	16,788	19,575	18,696	20,149	18,835	22,637	21,830	71,969	83,450	21,985
YoY Change (%)	57.4	2.4	-3.0	-15.4	20.5	12.2	15.6	16.8	3.9	16.0	17.6
Total Expenditure	14,383	14,522	16,929	16,181	18,133	17,308	20,733	19,471	62,014	75,645	19,990
EBITDA	2,332	2,267	2,646	2,515	2,016	1,527	1,903	2,358	9,955	7,804	1,995
Margins (%)	14.0	13.5	13.5	13.5	10.0	8.1	8.4	10.8	13.8	9.4	9.1
Depreciation	314	329	325	330	364	365	376	380	1,298	1,484	383
Interest	30	36	33	29	26	23	26	28	127	103	25
Other Income	472	473	400	538	354	776	913	763	1,688	2,806	799
PBT	2,461	2,374	2,688	2,695	1,981	1,187	2,414	2,470	10,219	8,051	2,386
Rate (%)	24.8	25.6	25.0	25.0	25.6	26.1	22.8	24.9	25.1	24.6	25.4
Adj. PAT	1,852	1,767	2,015	2,022	1,475	1,425	1,864	2,039	7,656	6,802	1,779
YoY Change (%)	101.0	-23.1	-28.2	-25.5	-20.4	-19.4	-7.5	0.8	-12.4	-11.2	-12.0
Margins (%)	11.1	10.5	10.3	10.8	7.3	7.6	8.2	9.3	10.6	8.2	8.1

E: MOFSL Estimates

Key Performance Indicators

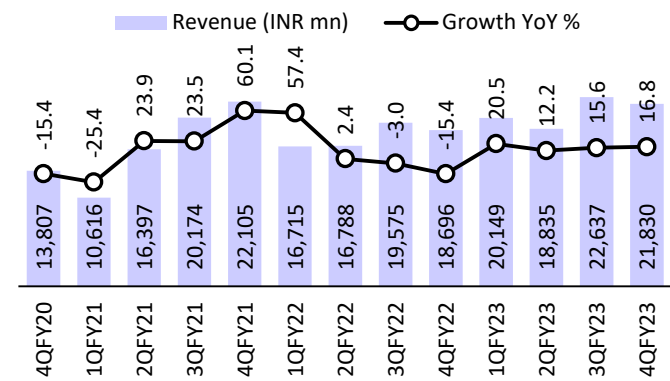
	FY22				FY23				FY22	FY23	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			4QE
Volumes ('000 units)	25,935	21,073	25,325	21,895	26,797	23,703	28,025	24,765	94,228	1,03,290	24,765
Change (%)	42.9	-13.8	-19.8	-32.8	3.3	12.5	10.7	13.1	-11.7	9.6	13.1
Net Realn (INR '000/unit)	544.2	596.5	594.5	626.1	595.5	613.8	609.5	628.9	590.5	611.5	613.1
Change (%)	3.6	10.3	13.5	17.3	9.4	2.9	2.5	0.5	11.2	3.6	-2.1
Cost Break-up											
RM Cost (% of sales)	68.3	65.9	70.2	70.1	72.2	72.4	74.5	71.5	68.5	72.7	74.0
Staff Cost (% of sales)	8.2	8.3	6.8	6.4	6.8	7.9	6.7	7.2	7.3	7.1	6.7
Other Cost (% of sales)	9.6	12.3	9.5	10.1	11.0	11.6	10.3	10.5	10.3	10.8	10.2
Gross Margins (%)	31.7	34.1	29.8	29.9	27.8	27.6	25.5	28.5	37.6	31.4	26.0
EBITDA Margins (%)	14.0	13.5	13.5	13.5	10.0	8.1	8.4	10.8	13.8	9.4	9.1
EBIT Margins (%)	12.1	11.5	11.9	11.7	8.2	6.2	6.7	9.1	12.0	7.6	7.3
Segmental PBIT Margin (%)											
Agri Machinery	15.6	14.9	15.8	15.4	10.6	8.4	8.3	9.9	15.4	9.3	0.0
Railway Equipment	14.6	17.3	14.3	13.1	13.6	14.6	13.1	14.0	14.8	13.8	0.0
Construction Equipment	-2.3	3.6	2.5	3.6	1.0	-2.6	2.2	8.1	2.4	2.9	0.0

E:MOFSL Estimates

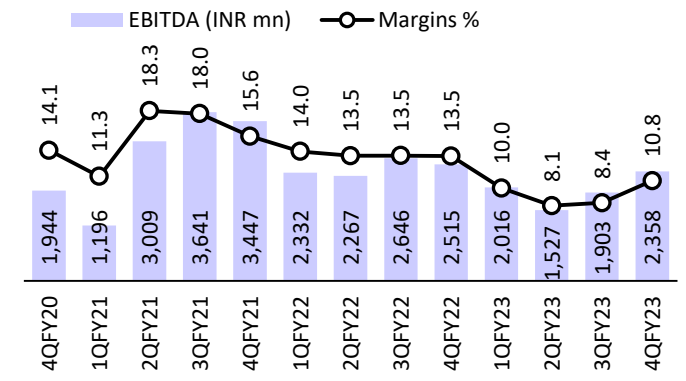


Highlights from the management commentary

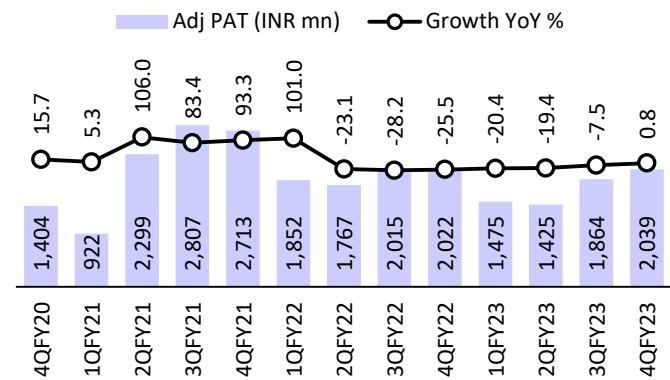
- FY24 domestic tractor volumes are likely to post low-to-mid single digit growth, despite weak 1QFY24, due to: a) good MSP prices, b) high water reservoir levels, and c) healthy growth in non-agri tractor sales.
- Tractor PBIT margin to reach 14-15% level by 4QFY24 driven by: a) further savings in RM cost, b) mix improvement and c) cost-cutting initiatives. It is expecting further softening of prices for steel, casting and rubber (yet to see the benefit of correction in rubber prices). The entire cost inflation has been passed on without contribution margins.
- Tractor sales to non-agri segment, which is ~30% of the market (including 15-20% for pure haulage use), is expected to see 15-20% growth in FY24 driven by higher investments in infra.
- 4QFY23 retails grew 14%, which were lower than expected, benefitting from Navratras but hit by unseasonal rains. However, inventory levels are normal at 4.0-4.5 weeks as retails were higher than wholesales.
- Tractor PBIT margin improved 160bp QoQ (-550bp YoY) to 9.9%, led by better realization and soft commodity cost.
- Domestic tractor market share improved 40bp QoQ to 10.9% in 4Q.
- Exports through Kubota channel was at ~40% of total export in 4QFY23 (30% for FY23).
- Manufacturing JV is currently exporting components to a few countries. This JV also imports parts of engines, which will be localized as more products get introduced over next 2-3 years. This will further aid exports of components from India.
- Market share improvement would be driven by new products for domestic and exports, most of which will be launches by FY26. Modification to existing products may happen earlier.
- Trem-4 would result in cost increase of 10-15% in >50hp tractors; however, price increases will be gradual as these tractors get introduced.
- Over the next five years, ESC will increase capacity to 300k by adding a Greenfield plant from current capacity of 170k (incl. 50k at JV).
- **Construction Equipment business is likely to grow 10-12% in FY24**, with margins expanding further over FY23 levels led by RM savings and operating leverage.
- **Railways business to grow in double digit** driven by new products and exports. ESC's Mar'23-end order book stood at INR10.5b. It expects localization benefits on the new products to reflect in P&L only in FY25, driving margin improvement.
- Merger of two JVs with Kubota is delayed due to delay in regulatory approvals and is now expected by Dec'23-Jan'24. Merger would be w.e.f. 1st Apr'23.

Exhibit 1: Revenue and revenue growth trends

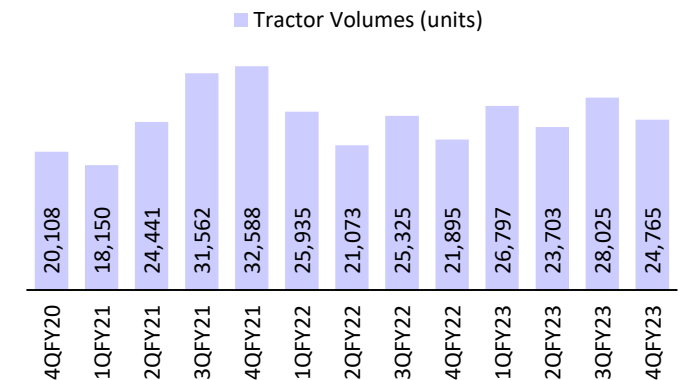
Source: MOFSL, Company

Exhibit 2: EBITDA and EBITDA margin trends

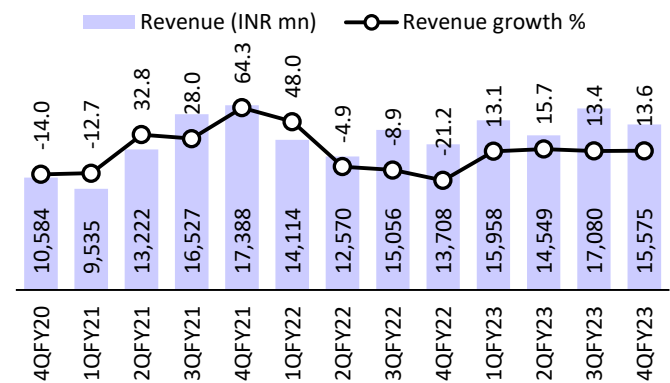
Source: MOFSL, Company

Exhibit 3: Adjusted PAT and growth trend

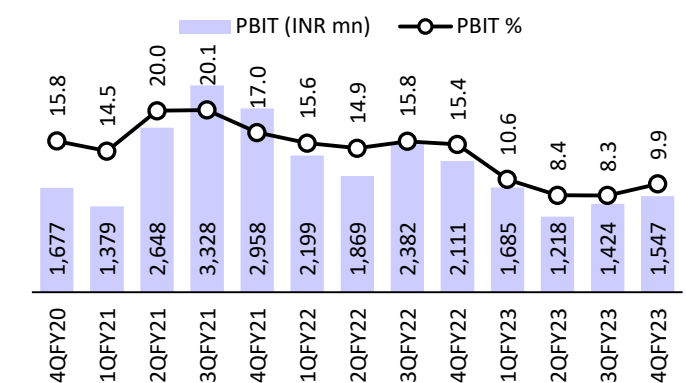
Source: MOFSL, Company

Exhibit 4: Trend in Tractor volumes

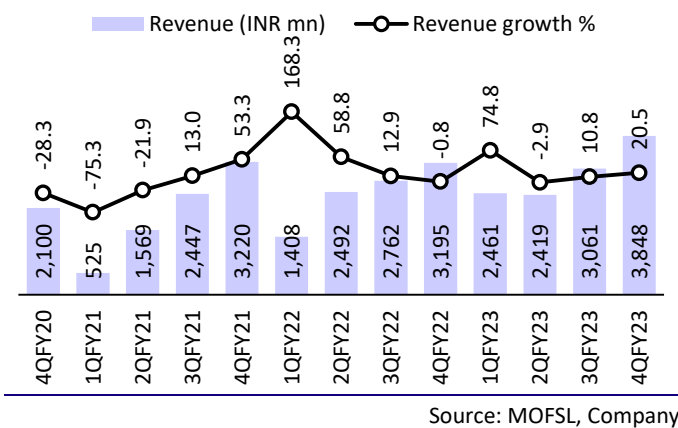
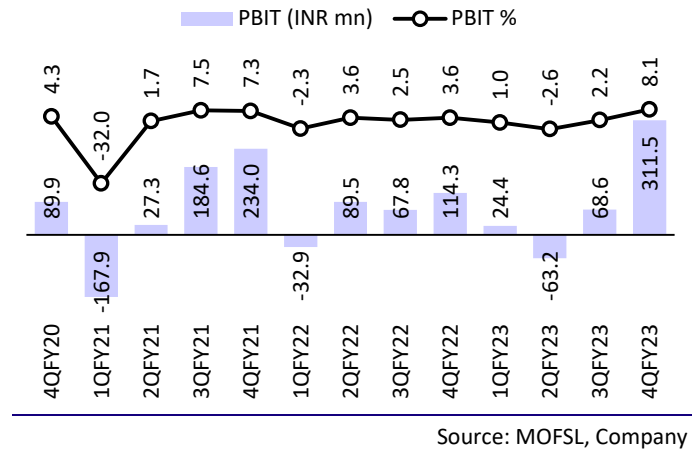
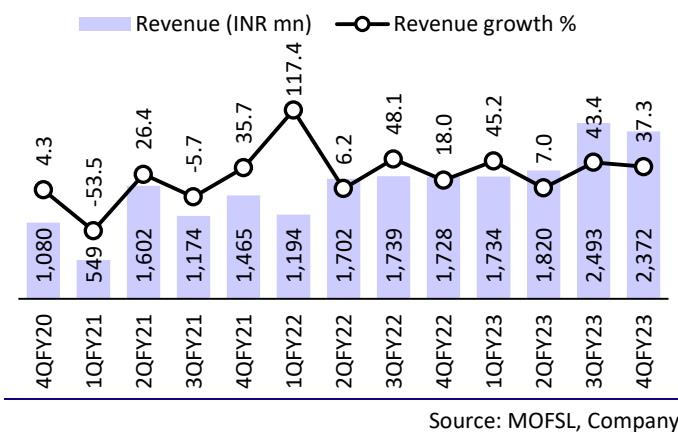
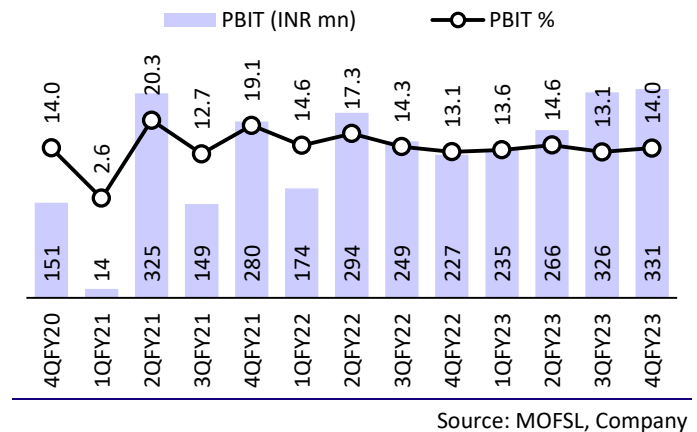
Source: MOFSL, Company

Exhibit 5: Revenue and growth in Tractor segment

Source: MOFSL, Company

Exhibit 6: PBIT trend in Tractor segment

Source: MOFSL, Company

Exhibit 7: Revenue and growth in Construction Equipment**Exhibit 8: PBIT trend in Construction Equipment segment****Exhibit 9: Revenue and growth in Railways segment****Exhibit 10: PBIT trend in Railways segment**

Valuation and view

- **Near-term demand outlook positive despite weak 1QFY24:** FY24 domestic tractor volumes are likely to post low-to-mid single digit growth, despite weak 1QFY24, due to: a) good MSP prices, b) high water reservoir levels, and c) 15-20% growth in non-agri tractor sales. We estimate tractor industry volumes to report 5-6% CAGR over FY23–25. However, we believe uncertainty in the tractor cycle would continue led by the uncertain monsoon forecast for this year and the impact of implementation of TREM-4 norms for <50HP tractors (likely in FY25). This along with high base of FY23 would keep volume growth under check in the foreseeable future.
- **Kubota parentage can unleash many synergies:** Kubota's parentage would help ESC improve its competitive positioning in: a) small tractors (less than 30HP), b) the export markets (through leveraging Kubota's distribution network), c) the Agri Implements business, d) component sourcing, and e) the Construction Equipment business (Kubota is a global leader in small excavators). Through this partnership, ESC gains access to: a) global product know-how (in Tractors and Implements), b) a global distribution network, and c) a global supply chain (by leveraging its India cost base).
- **Healthy recovery in Railways, Construction Equipment to dilute cyclical impact of tractors:** We expect the Railways business to deliver a ~16% CAGR over FY23–25, benefitting from the ramp-up in new products by FY25. Revenue from Construction Equipment is estimated to grow at 13% over

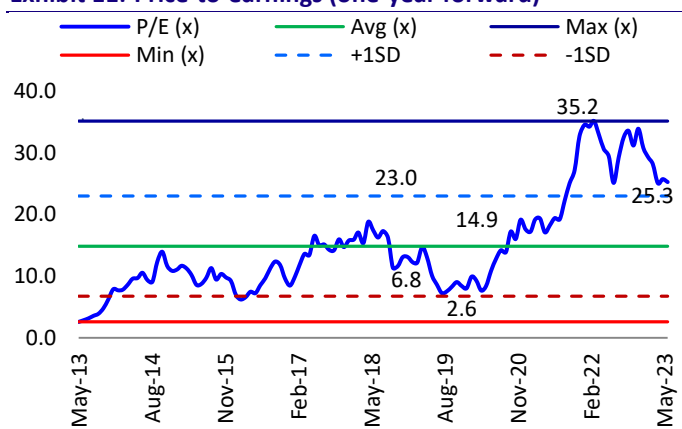
FY23–25. The benefits related to localization and cost savings would elevate its margin profile in both segments.

- **Tractor cycle showing initial signs of recovery:** With expected recovery in its core Tractor business, we estimate 7% revenue CAGR over FY23–25. This would result in margin expansion of ~450bp (over FY23–25E) to ~13.7% in FY25E and 35% EPS CAGR. Our estimates do not factor in the merger of Kubota's India businesses.
- **Valuation and view:** We raise our FY24E/FY25E EPS by 7.5%/6.6% to factor in margin expansions in all the verticals. While the near-term outlook has improved, recovery in margins is getting delayed. Exports, a leaner cost structure, recovery in Railways / Construction Equipment, and a strong balance sheet would offset the impact on the P&L. After Kubota's first acquisition of a stake in ESC, the stock got substantially re-rated. The stock trades at ~27.2x/21.8x consolidated FY24E/25E EPS, at a premium to its 10-year average of ~13.3x, driven by an improvement in operating parameters as well as the Kubota partnership. The valuations are already factoring in positive tractor industry outlook as well as the benefit from Kubota partnership. **Maintain Neutral with a TP of INR1,900 (premised on 20x Mar'25E consolidated EPS).**

Our revised forecasts (Consol.)

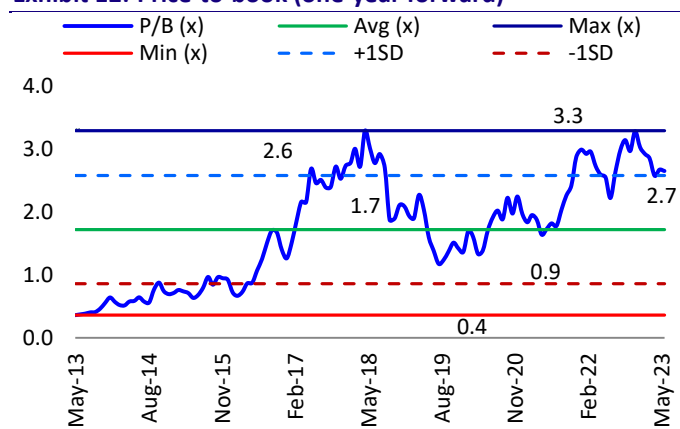
(INR M)	FY24E			FY25E		
	Rev	Old	Chg (%)	Rev	Old	Chg (%)
Net Sales	91,077	91,192	-0.1	1,00,448	99,588	0.9
EBITDA	11,066	10,031	10.3	13,761	12,847	7.1
EBITDA (%)	12.2	11.0	120bp	13.7	12.9	80bp
Adj. PAT	9,233	8,588	7.5	11,537	10,821	6.6
EPS (INR)	75.3	70.1	7.5	94.1	88.3	6.6

Exhibit 11: Price-to-earnings (one-year forward)



Source: MOFSL, Company

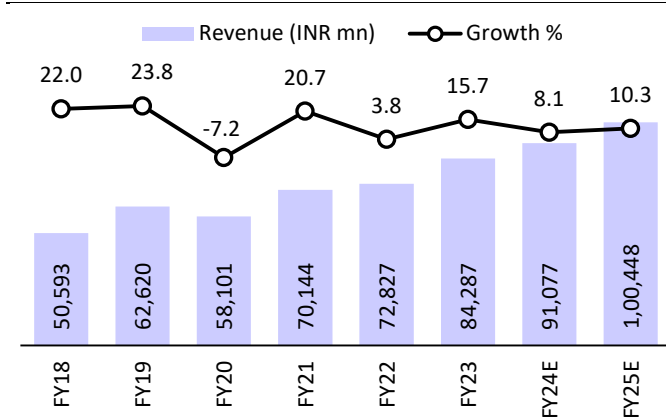
Exhibit 12: Price-to-book (one-year forward)



Source: MOFSL, Company

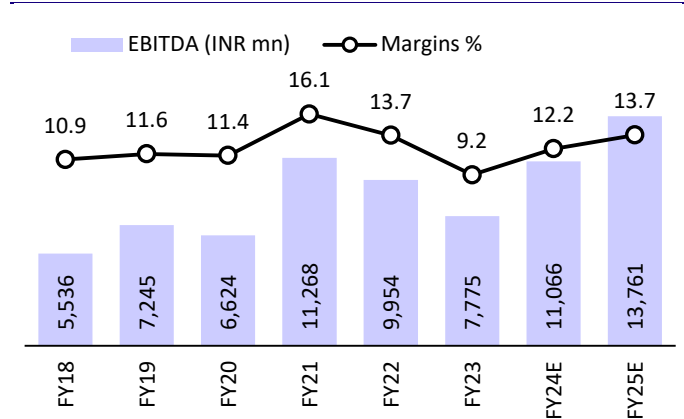
Story in charts

Exhibit 13: Revenue and revenue growth trends



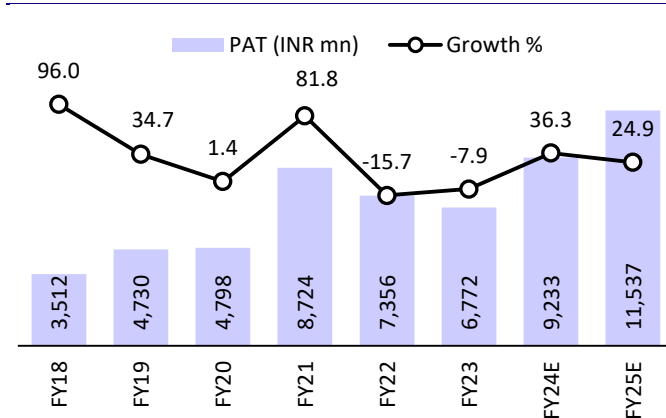
Source: MOFSL, Company

Exhibit 14: EBITDA and EBITDA margin trajectories



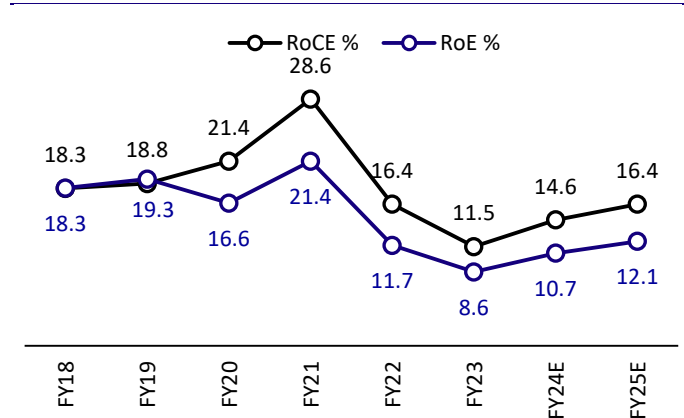
Source: MOFSL, Company

Exhibit 15: PAT and PAT growth trends



Source: MOFSL, Company

Exhibit 16: RoE and RoCE trends



Source: MOFSL, Company

Financials and valuations

Consolidated - Income Statement

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Total Income from Operations	50,593	62,620	58,101	70,144	72,827	84,287	91,077	1,00,448
Change (%)	22.0	23.8	-7.2	20.7	3.8	15.7	8.1	10.3
EBITDA	5,536	7,245	6,624	11,268	9,954	7,775	11,066	13,761
Margin (%)	10.9	11.6	11.4	16.1	13.7	9.2	12.2	13.7
Depreciation	732	872	1,072	1,183	1,321	1,501	1,630	1,728
EBIT	4,804	6,373	5,552	10,085	8,634	6,275	9,435	12,034
Int. and Finance Charges	295	195	172	133	150	133	120	120
Other Income	653	924	976	1,604	1,738	2,809	3,120	3,600
PBT bef. EO Exp.	5,162	7,102	6,356	11,555	10,222	8,951	12,435	15,514
EO Items	-68	56	-92	0	0	-531	0	0
PBT after EO Exp.	5,094	7,157	6,263	11,555	10,222	8,421	12,435	15,514
Current Tax	1,625	2,371	1,535	2,832	2,572	1,979	3,127	3,902
Deferred Tax	0	0	0	0	0	0	0	0
Tax Rate (%)	31.9	33.1	24.5	24.5	25.2	23.5	25.1	25.2
Less: Minority Interest	4	20	0	0	294	75	75	75
Reported PAT	3,466	4,767	4,728	8,724	7,356	6,367	9,233	11,537
Adjusted PAT	3,512	4,730	4,798	8,724	7,356	6,772	9,233	11,537
Change (%)	96.0	34.7	1.4	81.8	-15.7	-7.9	36.3	24.9
Margin (%)	6.9	7.6	8.3	12.4	10.1	8.0	10.1	11.5

Consolidated - Balance Sheet

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Equity Share Capital	1,226	1,226	1,226	1,348	1,319	1,319	1,226	1,226
Total Reserves	20,926	25,509	29,948	48,913	74,680	80,548	88,800	99,111
Net Worth	22,151	26,735	31,174	50,261	75,999	81,867	90,026	1,00,337
Minority Interest	-4	56	51	-9	-38	-39	-39	-39
Deferred Liabilities	197	529	307	233	373	646	646	646
Total Loans	147	2,810	192	17	0	0	0	0
Capital Employed	22,492	30,130	31,724	50,502	76,334	82,475	90,634	1,00,944
Gross Block	24,960	26,213	27,834	29,350	30,799	32,003	34,547	37,434
Less: Accum. Deprn.	9,082	9,741	10,608	11,388	12,389	13,890	15,520	17,248
Net Fixed Assets	15,878	16,472	17,227	17,962	18,411	18,114	19,027	20,187
Capital WIP	657	800	1,044	647	878	1,137	1,093	1,205
Total Investments	5,490	4,908	7,974	19,380	48,358	48,465	48,465	48,465
Curr. Assets, Loans&Adv.	17,700	24,890	23,895	30,792	23,431	33,137	41,100	52,098
Inventory	5,657	8,574	8,834	7,182	8,466	12,177	10,517	11,393
Account Receivables	5,920	9,311	7,319	6,576	7,926	11,797	9,981	11,008
Cash and Bank Balance	3,173	2,433	3,249	13,218	2,718	4,719	15,712	24,319
Loans and Advances	2,949	4,572	4,494	3,817	4,320	4,445	4,889	5,378
Curr. Liability & Prov.	17,242	16,952	18,430	18,279	14,743	18,378	19,051	21,011
Account Payables	15,746	15,495	16,867	16,771	13,341	16,912	17,467	19,264
Provisions	1,495	1,458	1,563	1,508	1,402	1,466	1,584	1,747
Net Current Assets	458	7,938	5,465	12,513	8,687	14,760	22,049	31,087
Deferred Tax assets	8	12	14	0	0	0	0	0
Misc Expenditure	0	0	0	0	0	0	0	0
Appl. of Funds	22,493	30,130	31,724	50,502	76,334	82,475	90,634	1,00,944

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Basic (INR)								
EPS (ex-treasury)	39.5	53.2	54.0	86.3	66.6	51.3	75.3	94.1
BV/Share	249.2	300.8	350.7	497.0	687.8	620.5	734.4	818.5
DPS	2.0	2.5	2.5	7.5	7.0	7.0	8.0	10.0
Payout (%)	6.2	5.6	5.7	8.7	10.5	14.5	10.6	10.6
Valuation (x)								
P/E	51.8	38.5	38.0	23.7	30.8	39.9	27.2	21.8
P/BV	8.2	6.8	5.8	4.1	3.0	3.3	2.8	2.5
EV/Sales	3.5	2.9	3.1	3.4	3.4	2.9	2.6	2.3
EV/EBITDA	32.3	25.2	27.0	15.0	20.5	31.7	21.3	16.5
Dividend Yield (%)	0.1	0.1	0.1	0.4	0.3	0.3	0.4	0.5
FCF per share	28.9	-31.6	50.2	75.3	-10.7	2.5	100.0	81.8
Return Ratios (%)								
RoE	18.3	19.3	16.6	21.4	11.7	8.6	10.7	12.1
RoCE	18.3	18.8	21.4	28.6	16.4	11.5	14.6	16.4
RoIC	24.5	24.2	20.2	41.5	31.0	18.3	26.4	34.4
Working Capital Ratios								
Asset Turnover (x)	2.2	2.1	1.8	1.4	1.0	1.0	1.0	1.0
Inventory (Days)	61	73	84	56	62	73	60	60
Debtor (Days)	43	54	46	34	40	51	40	40
Creditor (Days)	114	90	106	87	67	73	70	70
Leverage Ratio (x)								
Net Debt/Equity	-0.4	-0.1	-0.3	-0.6	-0.6	-0.6	-0.7	-0.7

Consolidated - Cash Flow Statement

(INR m)

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
OP/(Loss) before Tax	5,091	7,157	6,253	11,548	9,928	8,346	12,435	15,514
Depreciation	732	872	1,072	1,183	1,321	1,501	1,630	1,728
Interest & Finance Charges	-26	-301	0	0	-906	-1,620	120	120
Direct Taxes Paid	-1,021	-2,166	-1,748	-2,527	-2,547	-1,864	-3,127	-3,902
(Inc)/Dec in WC	-181	-7,449	3,272	2,748	-6,526	-4,102	3,704	-431
CF from Operations	4,596	-1,887	8,849	12,952	1,270	2,260	14,762	13,028
Others	5	-456	-877	-1,639	-948	-21	0	0
CF from Operating incl EO	4,601	-2,343	7,972	11,313	323	2,239	14,762	13,028
(inc)/dec in FA	-1,059	-1,529	-1,822	-1,157	-1,732	-1,904	-2,500	-3,000
Free Cash Flow	3,541	-3,873	6,150	10,155	-1,409	336	12,262	10,028
(Pur)/Sale of Investments	-2,934	994	-2,390	-20,778	-17,898	1,167	0	0
Others	252	362	0	0	1,066	116	0	0
CF from Investments	-3,742	-174	-4,212	-21,936	-18,564	-621	-2,500	-3,000
Issue of Shares	2,501	28	0	10,576	19,021	206	-94	0
Inc/(Dec) in Debt	-2,134	2,309	-2,644	-221	-87	0	0	0
Interest Paid	-216	-138	-100	-76	-98	-91	-120	-120
Dividend Paid	-161	-289	-260	-245	-737	-757	-981	-1,226
CF from Fin. Activity	-10	1,906	-3,001	9,991	17,805	-712	-1,269	-1,421
Inc/Dec of Cash	849	-611	758	-632	-436	906	10,993	8,607
Opening Balance	693	1,542	931	1,689	1,057	622	1,528	12,521
Closing Balance	1,542	931	1,689	1,057	622	1,528	12,521	21,128

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NOTES

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BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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