

Profit recovery, albeit at a slower pace

SFCL delivered 7% YoY consolidated EBITDA growth after three consecutive quarters of decline led by strong volume growth (+24% YoY), lower costs (-4% YoY) amid poor pricing (-5% YoY). We expect profit growth to improve going ahead led by increasing utilisation & plant efficiency, lower coal cost, stable overheads and expected price recovery from H2FY17. Receipt of subsidy backlog (~50% of dues expected in H2FY17) should further enhance SFCL's balance sheet. SFCL's reverse-merger with Star Cement (by end of FY17) will simplify corporate structure without any equity dilution. Maintain BUY with revised TP of Rs130.

- SFCL continues to increase its market share lead by strong volume growth momentum:** SFCL delivered 28% YoY cement sales volume growth and 24% total sales volume growth (cement + clinker). SFCL registered 23% growth in cement sales in NE region (ahead of regional demand growth of 13%) and 36% growth in outside NE region, gaining market share across all its market. SFCL sold 61% of its cement in NE region vs 63% YoY. Increased production at the on-lease grinding units in West Bengal (14% of SFCL total cement sales vs 11% YoY) is helping SFCL expand its sales outside NE region. In NE region, SFCL has increased its market share to 28%+ vs 23% YoY at the expense of smaller players.
- EBITDA growth returns led by strong volume and cost reduction; realisation still a drag:** SFCL's own plant utilisation increased 1300bps YoY to 67% boosting plant efficiency and operating leverage gains as fixed costs largely remained flat YoY. SFCL also highlighted that they have been able to get ~10% reduction in locally procured coal (since Q1FY17) amid lower external demand for Meghalaya coal. Advertisement and promotion expenses remained stable YoY and are expected to remain flat YoY, which should lead to lower cost on unitary basis during FY17. While these lead to 4% YoY reduction in SFCL's opex/MT, aggressive supply pressure across eastern region resulted in 5% lower NSR (down 2% QoQ), negating cost reduction benefits. Hence, EBITDA/MT dipped 14% YoY to Rs959 (11% lower vs our estimate), moderating EBITDA growth to 7% YoY to Rs589mn (recovery after declining trend in the last three consecutive quarters). Subsequently, lower capital charges led to adj PAT of Rs4mn vs net loss of Rs80mn YoY.
- Capex, subsidy and corporate restructuring updates:** Amid, uncertainty on land clearance from the West Bengal government, Siliguri grinding unit expansion is not expected before end of FY18. Meanwhile, SFCL is also working towards expanding its clinker capacity by ~0.4-0.5 mn MT through debottlenecking in Meghalaya by early FY19. Management remained hopeful of receiving at-least 50% of Rs8bn (total receivables from the Government as freight and capital subsidy) during H2FY17. SFCL expects its reverse merger (non-equity dilutive for SFCL) with Star Cement (earlier CMCL) to be completed by end of FY17.
- Valuation and risks:** We cut our EBITDA estimates for FY17E/18E by 17%/14% each as we lower our NSR estimates for FY17/18 by 4%/5% respectively. We also build in 0.5% reduction in FY18 opex/MT to factor in lower coal prices and increasing cost efficiencies. SFCL expects to maintain strong volume offtake during FY17/18 led by pick-up in demand from both retail (rural demand recovery post good monsoon) and infrastructure (government projects) segments. We expect cement prices to recover H2FY17 onwards led by better demand and recovery in supply discipline. We lower our TP to Rs130 from Rs150 earlier (valuing SFCL's 70.5% holding in the cement business at 7.5x its FY18E EBITDA), factoring in estimates reduction. We retain BUY. We expect cement price recovery in east, the long due subsidy receipt from the government and corporate structure simplification to trigger valuation re-rating for SFCL. Key downside risks are continued weak pricing in east, further delays in subsidy receipt and sharp rise in input costs.

Y/E Mar (Rsmn)	Q2FY17	Q2FY16	YoY (%)	Q1FY17	QoQ (%)	Q2FY17E	Variance %
Net Sales	3,658	3,115	17.4	4,491	(18.6)	3,672	(0.4)
Op. cost	3,069	2,563	19.8	3,575	(14.2)	3,015	1.8
EBITDA	589	552	6.6	915	(35.7)	657	(10.4)
EBITDA margin (%)	16.1	17.7	(163) bps	20.4	(429) bps	17.9	(180) bps
Depreciation	358	428	(16.3)	342.4	4.7	340	5.4
Interest	199	216	(8.3)	209.6	(5.3)	200	(0.7)
PBT	37	(81)		367.4	(89.9)	122	(69.8)
Taxes Paid	14	16	(13.7)	5.4	150.3	24	(44.5)
Minority Interest	19	(16)		126.0	(84.6)	31	(36.6)
Adjusted PAT	4	(80)		235.9	(98.3)	67	(94.1)

Source: Company, Centrum Research Estimates; Consolidated financials

Y/E Mar (Rs mn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	APAT	YoY (%)	DEPS Rs.	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY14	11,734	77.9	2,550	21.7	70	(71.7)	0.3	0.6	3.1	334.9	20.3
FY15	14,304	21.9	4,351	30.4	834	1,091.9	3.8	12.3	10.6	28.1	10.3
FY16	17,150	19.9	3,979	23.2	925	10.9	4.2	13.2	11.0	25.3	11.4
FY17E	19,167	11.8	4,231	22.1	1,179	27.5	5.3	14.2	11.3	19.9	10.0
FY18E	22,927	19.6	5,321	23.2	2,037	72.7	9.2	20.8	16.4	11.5	6.2

Source: Company, Centrum Research Estimates, Consolidated Financials; FY14 Financials include the financials for demerged Ferro alloy business.

In the interest of timeliness, this document is not edited.

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Target Price	Rs130	Key Data	
CMP*	Rs106	Bloomberg Code	SFCL IN
Upside	23%	Curr Shares O/S (mn)	222.2
Previous Target	Rs150	Diluted Shares O/S(mn)	222.2
Previous Rating	Buy	Mkt Cap (Rsbn/USDmn)	23.4/351.1
Price Performance (%)*		52 Wk H / L (Rs)	140/95.2
	1M	6M	1Yr
		5 Year H / L (Rs)	189/13.3
SFCL IN	(0.1)	(8.6)	(21.8)
NIFTY	(2.1)	10.1	7.1
		Daily Vol. (3M NSE Avg.)	51459

*as on 4 November 2016; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Sep-16	Jun-16	Mar-16	Dec-15
Promoter	64.4	66.7	66.6	66.4
FII's	0.1	0.1	0.1	0.1
Dom. Inst.	1.8	0.0	0.0	0.0
Public & Others	33.7	33.2	33.2	33.6

Source: BSE, *as on 4 November 2016

Operational performance trends

	Q2FY17	Q2FY16	YoY (%)	Q1FY17	QoQ (%)
Sales Vol					
Net sales (mn MT)	0.61	0.50	23.3	0.76	(19.0)
Gross sales (mn MT)	0.66	0.53	24.2	0.80	(17.1)
NSR (Rs/MT) ^^	5,526	5,844	(5.4)	5,624	(1.7)
RM & Traded Goods	1,439	868	65.8	1,227	17.3
Power & Fuel	607	863	(29.6)	844	(28.1)
Employee	482	572	(15.7)	367	31.4
Freight	848	957	(11.3)	977	(13.1)
Other expenses	1,260	1,548	(18.6)	1,062	18.6
Opex (Rs/MT) ^^	4,637	4,808	(3.6)	4,477	3.6
EBITDA (Rs/MT) **	959	1,109	(13.5)	1,208	(20.6)

Source: Company, Centrum Research

Gross sales imply total cement and clinker sales including clinker sold to on-lease GUs in West Bengal and includes cement purchased from these units and resold BY SFCL

Net sales is excluding clinker sales to on-lease GUs

^^ NSR and Op costs items calculated on gross sales volume

** EBITDA per MT calculation on net sales volume

Earning Revisions

Particulars (Rs bn)	FY17E			FY18E		
	New	Old	Chg (%)	New	Old	Chg (%)
Sales	19.2	19.8	(3.2)	22.9	23.1	(0.7)
EBITDA	4.2	5.1	(17.2)	5.3	6.2	(14.3)
Ebitda margin (%)	22.1	25.8		23.2	26.9	
Adj PAT	1.2	1.9	(37.4)	2.0	2.5	(17.8)

Source: Centrum Research Estimates

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Con-call highlights

- **Production and sales details:** SFCL's total cement production and sales (through owned and on-leased units) rose 28% YoY to 0.6mn MT. Total clinker production rose 2% YoY to 0.46mn MT. SFCL's gross sales volume of cement and clinker (including sales to on-lease GUs) rose 24% YoY to 0.66mn MT. External sales volume (excluding clinker sales to on-lease units) rose 23% YoY to 0.61 mn MT.
- **Market share gains continue:** During the quarter, NE accounted for 61% of SFCL's total cement sales vs 63% YoY and 61% QoQ. SFCL continued to gain market share across both NE region and outside NE region. SFCL registered 23% growth in cement sales in NE region (ahead of regional demand growth of 13%) and 36% growth in outside NE region. SFCL continues to be market leader in NE region with ~28%+ market share.
- **NSR declined 5% YoY and 2% QoQ** led by aggressive supply pressure in the whole of the eastern region amid weak demand during monsoon. Average NSR dip QoQ is higher on higher share of low value clinker sales at 9% in Q2FY17 vs 6% in Q1FY17. Management suggested that pricing has bottomed out and it should see QoQ recovery from Q3FY17.
- **SFCL's consolidated gross and net debt** stood at Rs8.8bn/Rs8.7bn at end of H1FY17 – lower by Rs0.6bn/Rs0.5bn compared to that end of FY16.
- SFCL's total **subsidy receivable** (Rs5.5bn of freight subsidy and Rs2bn of capital subsidy) stands at Rs7.5bn as of end of Q2FY17. It remains hopeful of receiving Rs4-5bn in H2FY17. It will use the cash to reduce debt on books.
- **Expansion plans:** SFCL recently debottlenecked its Assam grinding unit, leading to 0.2mn MT capacity increase. Hence, its own clinker/grinding capacity currently stands at 2.6/3.3mn MT. SFCL will debottleneck its clinker capacity by early FY19 to increase it by 0.4-0.5mn MT. It will also add 1mn MT of GU in Siliguri (expected by end of FY18E once land acquisition issue is resolved).
- **Simplification of corporate structure to be completed in FY17E:** The listed company SFCL is currently a purely holding company, which holds 70.48% in its unlisted subsidiary – Star Cement (earlier known as CMCL). CMCL and its two wholly owned subsidiaries own all of the cement assets and 51% of the thermal CPP. As the remaining 29.52% of Star Cement is also owned by same promoter group of SFCL, the promoters have decided to reverse merge the listed SFCL into Star Cement and subsequently make Star Cement as the listed company. This transaction would entail issuing the current shareholders of SFCL's 1.33 share of the new entity – Star Cement. This will not lead to any equity dilution and simplify the corporate structure as Star Cement will truly reflect the cement business; moreover, the layers of subsidiary will reduce to one from the current two layers. This transaction is expected to be accomplished by end of FY17.

Valuations and key assumptions

Exhibit 1: 1 year forward EV/EBITDA chart

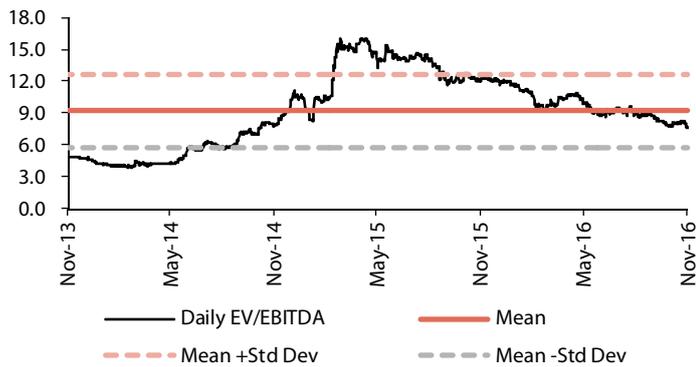
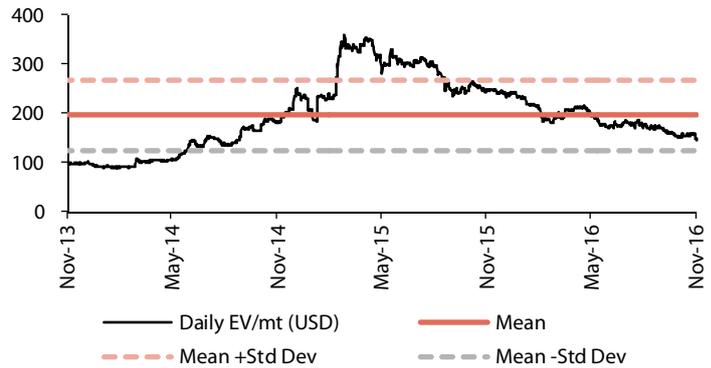


Exhibit 2: 1 year forward EV/MT chart



Source: Bloomberg, Company, Centrum Research Estimates

Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 3: Comparative Valuations

Company	Mkt Cap (Rs bn)	CAGR FY16-18E (%)			EBITDA margin (%)			RoCE (%)			RoE (%)			EV/EBITDA (x)			EV/MT(USD)		
		Rev.	EBITDA	PAT	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
SFCL	23.4	15.6	15.6	48.4	23.2	22.1	23.2	11.0	11.3	16.4	13.2	14.2	20.8	11.4	10.0	6.2	227	192	116
UltraTech Cement	1,058	23.9	38.0	37.3	19.1	22.5	23.7	7.7	10.2	11.4	11.0	15.1	16.1	22.8	17.1	13.3	245	237	202
Shree Cement	586	20.6	41.7	98.3	23.7	31.0	32.7	7.4	20.1	21.4	9.3	23.2	24.3	32.1	19.1	14.7	334	302	288
JK Lakshmi	55.0	15.1	56.2	316.8	10.3	15.1	19.0	2.1	5.9	10.1	1.3	9.1	18.7	25.5	15.1	10.0	127	100	94
JK Cement	59.9	13.7	38.7	170.0	13.6	17.8	20.2	3.6	8.2	11.5	3.7	15.1	22.5	16.6	11.6	8.4	94	93	88
Orient Cement	35.0	28.2	75.1	107.6	12.1	18.6	22.7	4.8	7.9	13.7	6.2	9.4	22.3	24.6	13.0	7.7	87	89	83

Source: Company, Centrum Research Estimates

Exhibit 4: Key Operational Assumptions

Particulars	FY13	FY14	FY15	FY16	FY17E	FY18E
Total Sales Volume (mn MT)	1.3	3.1	3.1	3.1	3.4	4.4
YoY change (%)	1.1	1.8	2.4	2.8	3.2	3.5
(Rs/ MT trend)	(3.6)	64.4	34.5	17.0	15.0	9.8
NSR	5,554	5,854	5,845	5,785	5,617	5,786
YoY change (%)	13.5	5.4	(0.2)	(1.0)	(2.9)	3.0
RM & Traded goods	704	855	944	1,169	1,268	1,305
Power & Fuel	1,017	941	707	729	758	781
Freight costs	1,183	1,086	998	1,002	947	984
Employee cost	368	419	375	367	363	359
Other expense	1,131	832	763	1,190	1,042	1,014
Total Opex	4,403	4,570	4,093	4,457	4,377	4,443
EBITDA per MT	1,150	1,284	1,846	1,443	1,334	1,429

Source: Company, Centrum Research Estimates

Exhibit 5: Quarterly financials trend - Consolidated

Y/E Mar (Rs mn)	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17
Net Sales	3,382	5,069	4,087	3,115	4,287	5,632	4,491	3,658
Total Expenditure	2,202	3,522	2,874	2,563	3,370	4,365	3,575	3,069
Raw Materials	227	1,074	549	463	958	1,485	980	952
Employee	246	227	231	305	278	271	293	319
Others	666	757	834	825	908	951	848	834
EBITDA	1,180	1,548	1,213	552	917	1,267	915	589
Depreciation	552	600	417	428	430	440	342	358
EBIT	629	948	796	124	487	828	573	230
Interest	234	201	202	216	199	216	210	199
Other Income	8	(9)	17	12	13	2	4	5
PBT	403	738	611	(81)	301	614	367	37
Taxes	29	(19)	5	16	8	26	5	14
Adjusted PAT (before minority)	374	757	605	(96)	293	588	362	23
Exceptional expense/ (income)	8	3	(0)	2	(5)	(2)	0	3
Minority Interest	129	210	190	(16)	102	188	126	19
Reported PAT	253	550	415	(79)	186	398	236	7
Adjusted PAT	245	547	415	(80)	190	400	236	4
Adj EPS (Rs)	1.1	2.5	1.9	(0.4)	0.9	1.8	1.1	0.0
YoY Growth (%)								
Revenue	0.8	33.1	26.7	18.6	26.8	11.1	9.9	17.4
EBITDA	29.0	30.8	8.3	9.9	(22.3)	(18.1)	(24.5)	6.6
PBT	40.8	31.6	68.6	n/m	(25.3)	(16.8)	(39.8)	n/m
Adj PAT	16.4	51.0	70.3	n/m	(22.2)	(27.0)	(43.2)	n/m
Margins (%)								
EBITDA	34.9	30.5	29.7	17.7	21.4	22.5	20.4	16.1
EBIT	18.6	18.7	19.5	4.0	11.4	14.7	12.8	6.3
PBT	11.9	14.6	14.9	(2.6)	7.0	10.9	8.2	1.0
Adj PAT	11.0	14.9	14.8	(3.1)	6.8	10.4	8.1	0.6
Operational Trend								
Cement & clinker Sales Vol								
Gross sales volume (mn MT)	0.58	0.87	0.69	0.53	0.74	0.99	0.80	0.66
YoY growth (%)	24.2	54.7	29.4	18.0	28.3	14.0	15.6	24.2
Net sales volume (mn MT)	0.56	0.81	0.65	0.50	0.67	0.93	0.76	0.61
YoY growth (%)	21.0	44.1	22.2	10.2	19.8	15.3	16.1	23.3
NSR (Rs/ MT) ^^	5,857	5,836	5,914	5,844	5,790	5,689	5,624	5,526
Opex (Rs/MT) ^^	3,813	4,055	4,159	4,808	4,551	4,409	4,477	4,637
EBITDA (Rs per MT) **	2,098	1,913	1,858	1,109	1,361	1,358	1,208	959

Source: Company, Centrum Research

^^ NSR and Op costs items calculated on gross sales which include clinker sales to the on-lease GUs in West Bengal for conversion to cement for sale

** EBITDA per MT calculation on total external cement and clinker sales (excluding clinker sales to on-lease GUs)

Financials - Consolidated

Exhibit 6: Income Statement

Y/E Mar(Rs mn)	FY14	FY15	FY16	FY17E	FY18E
Net Sales	11,734	14,304	17,150	19,167	22,927
Raw Materials	2,018	1,798	1,860	2,492	3,210
as % of sales	17.2	12.6	10.8	13.0	14.0
Employee	786	913	1,084	1,238	1,424
as % of sales	6.7	6.4	6.3	6.5	6.2
Others	2,828	2,599	3,516	3,555	4,017
as % of sales	24.1	18.2	20.5	18.5	17.5
EBITDA	2,550	4,351	3,979	4,231	5,321
EBITDA margin (%)	21.7	30.4	23.2	22.1	23.2
Depreciation	1,616	2,237	1,715	1,357	1,197
EBIT	933	2,113	2,264	2,874	4,124
Interest	872	874	834	790	540
Other income	24	8	14	20	55
PBT	85	1,247	1,445	2,104	3,639
Tax	27	48	55	420	730
Tax rate (%)	32.0	3.8	3.8	20.0	20.1
Adj PAT Pre-minority	58	1,199	1,389	1,684	2,909
Minority Interest	12	(365)	(464)	(505)	(873)
Adj PAT (post minority)	70	834	925	1,179	2,037
EO items	(9)	0	(5)	-	-
Reported PAT (post minority)	61	834	920	1,179	2,037

Source: Company, Centrum Research Estimates

Exhibit 7: Key Ratios

Y/E Mar	FY14	FY15	FY16	FY17E	FY18E
Growth Metrics (%)					
Net Sales	77.9	21.9	19.9	11.8	19.6
EBITDA	115.4	70.6	(8.5)	6.3	25.8
Adj PAT	(71.7)	1,091.9	10.9	27.5	72.7
Profitability Metrics (%)					
EBIT margin	8.0	14.8	13.2	15.0	18.0
PBT margin	0.7	8.7	8.4	11.0	15.9
Adj PAT margin	0.5	8.4	8.1	8.8	12.7
Return Ratios (%)					
RoE	0.6	12.3	13.2	14.2	20.8
RoCE	3.1	10.6	11.0	11.3	16.4
RoC	3.2	10.7	11.2	11.5	17.4
Turnover ratios (No of days)					
Inventory period	55	28	45	42	40
Collection period	44	79	96	84	80
Creditors period	26	20	30	27	27
Cash conversion cycle	73	87	110	99	93
Solvency Ratio (x)					
D/E	1.1	0.9	0.8	0.6	0.3
Net D/E	1.0	0.9	0.8	0.5	0.2
Interest coverage	1.1	2.4	2.7	3.6	7.6
Current ratio	3.4	3.8	3.7	3.6	3.0
Dividend					
DPS (Rs)	0.3	0.0	1.0	0.5	0.9
Dividend yield (%)	0.3	0.0	0.9	0.5	0.9
Dividend pay-out (%)	119.2	8.0	24.0	11.8	11.8
Per share (Rs)					
Basic EPS- reported	0.3	3.8	4.1	5.3	9.2
Basis EPS- adjusted	0.3	3.8	4.2	5.3	9.2
FDEPS- reported	0.3	3.8	4.1	5.3	9.2
FDEPS- adjusted	0.3	3.8	4.2	5.3	9.2
CEPS	7.6	13.8	11.9	11.4	14.6
BVPS	30.9	30.6	33.7	38.4	46.5
Valuations Metrics (x)					
P/E	334.9	28.1	25.3	19.9	11.5
Price/Cash earnings	13.9	7.6	8.9	9.2	7.2
Price/BV	3.4	3.4	3.1	2.7	2.3
EV/EBITDA	20.3	10.3	11.4	10.0	6.2
EV/ton (USD \$)	228	223	227	192	116

Source: Company, Centrum Research Estimates

Exhibit 8: Balance Sheet

Y/E Mar(Rs mn)	FY14	FY15	FY16	FY17E	FY18E
Sources of Funds:					
Share Capital	222	222	222	222	222
Reserves	6,641	6,578	7,276	8,316	10,113
Shareholders Fund	6,863	6,800	7,498	8,538	10,335
Debt	9,917	8,805	9,398	7,208	4,615
Net deferred tax	45	87	112	212	312
Minority Int	2,529	3,231	3,596	4,102	4,974
Total Liabilities	19,354	18,922	20,604	20,060	20,237
Application of Funds:					
Gross Block	15,839	16,124	16,738	17,208	17,508
Accumulated Depn	4,116	5,845	7,547	8,903	10,100
Net Fixed Assets	11,722	10,280	9,191	8,305	7,408
Capital WIP	995	410	490	490	2,490
Investments	15	15	15	15	15
Inventories	1,755	1,091	2,092	2,204	2,522
Sundry Debtors	1,416	3,098	4,488	4,428	5,044
Cash & Liquid Investments	126	204	245	266	2,137
Loans & Advances	6,037	6,802	8,140	8,625	5,732
Other Current Assets	5	4	5	2	2
Total Current Assets	9,339	11,200	14,970	15,525	15,437
Sundry creditors	829	770	1,404	1,438	1,720
Other liabilities & provisions	1,889	2,212	2,658	2,837	3,393
Total Current Liabilities	2,718	2,982	4,062	4,274	5,113
Net Current Assets	6,621	8,218	10,908	11,251	10,324
Total Assets	19,354	18,922	20,604	20,060	20,237

Source: Company, Centrum Research Estimates

Exhibit 9: Cash Flow

Y/E Mar(Rs mn)	FY14	FY15	FY16	FY17E	FY18E
PBT & extraord. Items	76	1,247	1,445	2,104	3,639
Add: Depreciation	1,616	2,237	1,715	1,357	1,197
Add: Interest	872	874	834	790	540
Add: Others	(24)	(12)	(27)	(20)	(55)
Operating profit before WC changes	2,541	4,346	3,966	4,231	5,321
Trade & other receivables	(1,606)	(2,632)	(2,464)	(421)	2,277
Inventories	(255)	463	(1,000)	(113)	(318)
Trade payables	919	636	1,080	212	838
Net change - WC	(941)	(1,532)	(2,384)	(322)	2,798
Direct taxes	-	(208)	(285)	(320)	(630)
Net cash from operating activities	1,599	2,606	1,297	3,589	7,489
Capital expenditure	(1,173)	(434)	(808)	(470)	(2,300)
Others	(1)	27	12	20	55
Net Cash from investing activities	(1,175)	(407)	(796)	(450)	(2,245)
Net free cash flows	425	2,199	501	3,139	5,244
Issue of share capital	-	2	-	-	-
Debt change	409	(1,231)	694	(2,190)	(2,593)
Dividend paid	(122)	(67)	(222)	(139)	(240)
Interest paid	(872)	(874)	(834)	(790)	(540)
Net cash from financing activities	(585)	(2,170)	(362)	(3,118)	(3,373)
Net change in cash	(160)	29	139	21	1,871

Source: Company, Centrum Research Estimates

Appendix A

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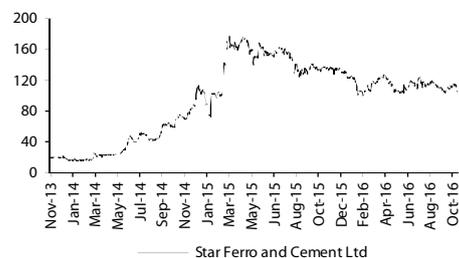
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SFCL price chart



Source: Bloomberg, Centrum Research

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