

INDUSTRY IT

CMP (as on 26 May 2017) Rs 583

Target Price Rs 655

Nifty 9,595

Sensex 31,028

KEY STOCK DATA

Bloomberg MPHL IN

No. of Shares (mn) 210

MCap (Rs bn) / (\$ mn) 123/1,905

6m avg traded value (Rs mn) 76

STOCK PERFORMANCE (%)

52 Week high / low Rs 624/425

3M 6M 12M

Absolute (%) (0.8) 12.2 23.0

Relative (%) (8.2) (5.7) 5.3

SHAREHOLDING PATTERN (%)

Promoters 60.41

FIs & Local MFs 9.85

FPIs 20.41

Public & Others 9.33

Source : BSE

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Growth acceleration ahead

Mphasis' 4Q performance was driven by Direct Core (1.2% QoQ and 10.8% in FY17) and HP channel (0.6% QoQ and -11% in FY17), while Digital Risk was soft. Deal wins in Direct International were strong (20.5% growth in TCV in FY17), which provides growth visibility. Mgt indicated (1) Above-industry growth for Direct core, (2) Growth in HP-channel and (3) Flattish Digital Risk for FY18E. Op performance was steady (+23bps QoQ), and the co maintained its EBIT% guidance of 14-16% for FY18E.

Our positive thesis on Mphasis is validated by wins (four logos) from Blackstone portfolio, and the company is targeting a sub-segment of 20 cos within that portfolio. Our expectation of recovery in the HP-channel (now DXC Technologies) seems plausible, with opportunities in IMS and ADM services in the HP-CSC portfolio, supported by the solution partnership with DXC Technology. We maintain our positive outlook on Mphasis based on (1) Strategic accounts-led growth visibility in Direct

Financial Summary

YE March (Rs bn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)	FY15	FY16	FY17	FY18E	FY19E
Net Sales	15.06	15.16	(0.7)	15.36	(2.0)	57.95	60.85	60.76	62.09	68.35
EBITDA	2.38	2.38	0.1	2.40	(0.5)	8.70	9.03	9.69	10.12	11.73
APAT	1.94	1.85	4.4	2.00	(3.4)	6.78	6.87	8.07	7.85	9.01
Diluted EPS (Rs)	9.2	8.8	4.3	9.5	(3.4)	32.3	34.0	38.8	40.7	46.7
P/E (x)						18.1	17.1	15.0	14.3	12.5
EV / EBITDA (x)						11.2	10.5	9.5	9.5	7.9
RoE (%)						12.7	12.1	13.4	13.6	16.0

Source: Company, HDFC sec Inst Research # Consolidated

HDFC securities Institutional Research is also available on Bloomberg HSLB <GO> & Thomson Reuters

Core business (BFSI-heavy), (2) Steadying HP-channel and growth opportunity from HP-CSC (factored in 4.4/6.1% CAGR in FY18/19E), (3) Blackstone's portfolio opportunity, (4) Strong operational levers (high offshore, scalability in FP-contract). We have marginally increased earnings est. (~1.5% for FY19E), and expect USD revenue/EPS growth of 8/10% CAGR over FY17-19E, factoring EBIT% at 15.1/15.8% for FY18/19E. Maintain BUY with a TP of Rs 655, 14x FY19E.

Highlights of the quarter

- Growth acceleration in Direct Core is expected to be back-ended in FY18 (stronger 2H outlook), also as recovery in a large account may take a couple of quarters. Deal volumes and offshoring strategy will support recovery in Digital Risk, going ahead.
- Near-term outlook:** Acceleration in Direct Core, supported by an increase in deal wins, can be a medium-term trigger.

Revenue stood at USD 221.5mn, -0.9% QoQ with Direct international revenue growth (71.1% of revenue) and HP Channel revenue growth (+0.6% QoQ and 24.1% of revenue)

EBITDA% came in at 15.8%, +23bps QoQ, supported by SG&A efficiencies. APAT came at Rs1.94bn, -3.4% QoQ and 4.4% YoY

Quarterly Financials Snapshot (Consolidated)

Particulars (Rs bn)	4QFY17	4QFY16	YoY (%)	3QFY17	QoQ (%)
Revenue USD mn	221.5	225.1	(1.6)	223.5	(0.9)
Net Revenue	15.06	15.16	(0.7)	15.36	(2.0)
Employee Benefit Expenses	8.88	8.67	2.4	9.01	(1.5)
Other Operating Expenses	3.80	4.11	(7.6)	3.95	(3.9)
EBITDA	2.38	2.38	0.1	2.40	(0.5)
Depreciation	0.18	0.25	(25.5)	0.20	(6.6)
EBIT	2.20	2.13	3.1	2.20	0.0
Other Income	0.49	0.49	(1.0)	0.62	(21.4)
Interest Cost	0.02	0.05	(63.8)	0.02	(26.1)
PBT	2.67	2.58	3.5	2.79	(4.5)
Tax	0.73	0.72	1.4	0.79	(7.1)
RPAT	1.84	1.54	19.8	2.00	(8.1)
EO Items (Adj For Tax)	(0.09)	(0.32)	NA	-	NA
APAT	1.94	1.85	4.4	2.00	(3.4)

Source: Company, HDFC Sec Inst Research

Margin Analysis (%)

	3QFY17	3QFY16	YoY (bps)	2QFY17	QoQ (bps)
Employee Benefit Expenses % Net Sales	58.9	57.2	176	58.7	27
EBITDA Margin (%)	15.8	15.7	13	15.6	23
EBIT Margin (%)	14.6	14.1	53	14.3	29
Tax Rate (%)	27.5	28.1	(58)	28.2	(78)
APAT Margin (%)	12.8	12.2	62	13.0	(20)

Source: Company, HDFC Sec Inst Research

Deal bookings in Direct international were strong at USD 90mn in 4Q (USD 365mn in FY17 and 20.5% higher than FY16)

BFSI (63.4% of revenue) softness was linked to decline in Digital Risk

Service-Line Revenue Split

(% of revenue)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Application Maintenance & Other Services	30.3	32.8	34.1	35.8	35.4	37.0	36.9
Application Development	24.0	22.7	24.5	23.2	23.9	23.1	24.5
Customer Service	4.3	2.3	2.0	1.9	1.8	1.9	1.8
Service / Technical Help Desk	1.8	1.7	2.3	2.1	2.4	2.3	2.2
Transaction Processing Service	6.7	7.0	7.1	7.0	7.0	6.2	6.5
Infrastructure Management Services	15.0	14.9	13.6	13.6	13.6	14.2	13.8
Knowledge Processes	17.7	17.9	16.3	16.2	15.7	15.0	13.8
License Income	0.1	0.8	0.1	0.2	0.3	0.4	0.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, HDFC Sec Inst Research

Revenue Growth By Service-Line

(QoQ, %)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Application Maintenance & Other Services	4.9	4.6	2.4	4.7	(1.5)	4.3	(1.1)
Application Development	(2.2)	(8.9)	6.2	(5.6)	3.0	(3.5)	4.8
Customer Service	(18.1)	(48.5)	(13.3)	(8.2)	(4.2)	6.4	(6.2)
Service / Technical Help Desk	(5.2)	(9.9)	30.9	(8.4)	14.8	(5.9)	(3.4)
Transaction Processing Service	4.0	(0.3)	0.6	(2.0)	(0.2)	(11.7)	4.1
Infrastructure Management Services	1.2	(3.9)	(10.4)	0.3	(0.4)	3.9	(3.7)
Knowledge Processes	7.2	(2.3)	(10.9)	(0.6)	(3.6)	(4.6)	(8.9)
License Income	(75.7)	536.8	(83.1)	62.3	30.0	30.1	49.4
Total	1.1	(3.4)	(1.7)	(0.2)	(0.2)	(0.3)	(0.9)

Source: Company, HDFC Sec Inst Research

Within Direct International, Direct Core (55% of revenue and 76% of Direct International) grew 1.2% QoQ (10.8% n FY17)

Revenue-Split By Geography

(% of revenue)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Americas	75.1	76.3	76.8	77.1	77.6	78.0	79.1
EMEA	9.3	10.3	10.7	10.7	10.5	9.6	9.5
India	9.5	7.4	6.7	6.5	6.4	7.3	6.3
RoW	6.0	6.0	5.8	5.8	5.6	5.1	5.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, HDFC Sec Inst Research

Revenue Growth By Geography

(QoQ, %)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Americas	2.8	(1.9)	(1.0)	0.0	0.5	0.3	0.6
EMEA	(4.4)	6.8	2.3	(0.1)	(2.3)	(8.4)	(2.2)
India	(1.2)	(25.0)	(11.4)	(3.5)	(1.6)	13.6	(14.0)
RoW	(7.0)	(3.7)	(5.6)	(0.4)	(3.4)	(8.2)	(1.9)
Total	1.1	(3.4)	(1.7)	(0.2)	(0.2)	(0.3)	(0.9)

Source: Company, HDFC Sec Inst Research

Revenue Segment By Channel

(% of revenue)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
HP channel	26.5	24.2	24.3	23.4	23.9	24.0	24.4
Direct International	66.5	70.4	70.3	72.5	72.2	71.3	72.0
Others	7.0	5.4	5.3	4.1	3.9	4.6	3.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, HDFC Sec Inst Research

Revenue Growth By Channel Segment

(QoQ, %)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
HP channel	(6.8)	(11.8)	(1.2)	(4.2)	1.9	0.5	0.6
Direct International	4.9	2.3	(1.8)	2.8	(0.6)	(1.4)	(0.0)
Others	(1.5)	(25.0)	(3.2)	(23.1)	(3.9)	16.7	(21.8)
Total	1.1	(3.4)	(1.7)	(0.2)	(0.2)	(0.3)	(0.9)

Source: Company, HDFC Sec Inst Research

FP revenue grew 15.5% in FY17 while T&M revenue declined by 7% in FY17

Top-5 and top-10 accounts grew 6.3/9.8% in FY17 as compared to 3.5% decline in overall revenue

Revenue Segment By Onsite-Offshore Mix

(% of revenue)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Onsite	49.3	50.8	51.4	51.4	52.4	51.2	51.2
Offshore	50.7	49.2	48.6	48.6	47.6	48.8	48.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, HDFC Sec Inst Research

Revenue Growth By Onsite-Offshore Mix

(% of revenue)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Onsite	0.8	(0.4)	(0.5)	(0.4)	1.9	(2.6)	(0.9)
Offshore	1.3	(6.2)	(2.8)	(0.3)	(2.4)	2.3	(0.9)
Total	1.1	(3.4)	(1.6)	(0.3)	(0.2)	(0.3)	(0.9)

Source: Company, HDFC Sec Inst Research

Billing Rate

(USD/hr)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Onsite	62.6	61.1	64.4	65.1	66.4	68.4	67.7
Offshore	15.2	14.1	15.0	14.3	14.3	14.8	14.8

Source: Company, HDFC Sec Inst Research

Billing Rate Growth

(QoQ, %)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Onsite	(0.7)	(2.4)	5.5	1.0	2.0	3.1	(1.1)
Offshore	51.1	(7.0)	5.9	(4.3)	0.1	3.5	(0.1)

Source: Company, HDFC Sec Inst Research

Geographical Revenue Break-up

(% of revenue)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
Onsite headcount	4,212	4,070	3,893	3,791	3,827	3,677	3,667
- Application Services	2,370	2,311	2,322	2,340	2,357	2,299	2,353
- ITO Services	167	195	212	215	281	251	274
- BPO Services	1,675	1,564	1,359	1,236	1,189	1,127	1,040
Offshore headcount	18,600	18,172	17,161	17,335	17,225	17,102	17,057
- Application Services	8,488	8,423	8,441	8,495	8,468	8,615	8,807
- ITO Services	3,953	3,730	3,209	3,158	3,196	3,136	3,074
- BPO Services	6,159	6,019	5,511	5,682	5,561	5,351	5,176
Sales and Marketing	327	313	300	289	300	315	325
General and Administration	994	957	948	943	939	940	945
Total Headcount	24,133	23,512	22,302	22,358	22,291	22,034	21,994
Utilisation (%)							
- Application Services	87	83	84	85	82	82	82
- ITO Services	93	95	91	94	94	93	90
- BPO Services	80	94	89	94	93	93	93

Source: Company, HDFC Sec Inst Research

Key Assumptions

Particulars	FY14	FY15	FY16	FY17	FY18E	FY19E
HP channel Revenue growth (%)	(28.1)	(12.1)	(26.1)	(11.0)	4.4	6.1
Direct International Revenue growth (%)	40.2	3.8	13.5	2.6	6.3	12.8
Onsite Revenue growth (%)	26.7	(3.7)	9.3	(0.8)	7.5	12.8
Offshore Revenue growth (%)	(21.6)	1.7	(11.1)	(6.1)	2.9	7.0
Total USD revenue growth (%)	(4.8)	(0.8)	(2.0)	(3.4)	5.3	10.1
USD/INR rate	61.3	61.2	65.6	67.1	66.0	66.0
EBITDA margin (%)	17.4	15.0	14.8	15.9	16.3	17.2

Source: Company, HDFC Sec Inst Research

Change In Estimates

Particulars	Earlier estimates	Revised estimates	% change
FY18E			
Revenue (USD mn)	968	941	(2.8)
Revenue (Rs bn)	63.89	62.09	(2.8)
EBITDA (Rs bn)	10.61	10.12	(4.6)
EBITDA Margin (%)	16.6%	16.3%	(31bps)
EPS (Rs)	41.0	40.7	(0.6)
FY19E			
Revenue (USD mn)	1,062	1,036	(2.5)
Revenue (Rs bn)	70.12	68.35	(2.5)
EBITDA (Rs bn)	12.16	11.73	(3.5)
EBITDA Margin (%)	17.3%	17.2%	(18bps)
EPS (Rs)	46.1	46.7	1.3

Source: HDFC sec Inst Research

Peer Valuation

Company	Mcap (Rs bn)	CMP (Rs)	Reco.	TP (Rs)	EPS (Rs)			P/E (x)			RoE (%)		
					FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
L&T Infotech	136	796	BUY	880	56.9	58.8	67.7	14.0	13.6	11.8	36.9	29.2	28.7
Mphasis	123	584	BUY	655	38.8	40.7	46.7	14.8	14.1	12.3	13.4	13.6	16.0
Mindtree	90	535	NEU	425	24.9	30.6	35.7	21.5	17.5	15.0	16.8	19.1	20.3
eClerx	53	1,324	SELL	1,275	91.9	84.5	98.0	14.4	15.7	13.5	30.1	24.2	25.7
Hexaware *	75	252	NEU	215	13.8	14.9	16.6	18.3	16.9	15.2	26.5	23.9	23.2
Cyient	57	503	NEU	540	33.3	39.5	45.7	15.1	12.8	11.0	18.5	19.7	20.2
Persistent	47	585	BUY	720	38.8	42.1	51.4	15.1	13.9	11.4	17.0	16.5	17.4
Zensar	39	879	BUY	1,023	55.5	69.9	78.7	15.6	12.4	11.0	16.7	19.1	18.6
KPIT Tech	23	119	NEU	130	11.1	10.9	14.6	10.7	10.9	8.2	14.8	13.0	15.7
Sonata	16	150	BUY	243	15.0	17.3	20.2	10.0	8.7	7.4	30.7	30.1	30.1

Source: HDFC sec Inst Research, * Dec Y-E

Income Statement (Consolidated)

YE March (Rs bn)	FY15	FY16	FY17	FY18E	FY19E
Net Revenues (US\$ mn)	944	925	894	941	1,011
Growth (%)	-0.8%	-2.0%	-3.4%	5.3%	10.1%
Net Revenues	57.95	60.85	60.76	62.09	68.11
Growth (%)	1.2%	5.0%	-0.1%	2.2%	10.1%
Employee Expenses	34.69	35.36	35.56	37.12	39.11
SG&A Expenses	14.55	16.46	15.52	14.84	16.11
EBITDA	8.70	9.03	9.69	10.12	11.11
EBITDA Margin (%)	15.0%	14.8%	15.9%	16.3%	17.2%
EBITDA Growth (%)	-12.9%	3.8%	7.2%	4.5%	15.8%
Depreciation	0.98	1.21	0.79	0.77	0.77
EBIT	7.72	7.82	8.90	9.36	10.34
EBIT Margin (%)	13.3%	12.9%	14.6%	15.1%	15.8%
Other Income (Including EO Items)	1.97	1.91	2.39	1.67	1.67
Interest	0.28	0.24	0.14	0.12	0.12
PBT	9.41	9.49	11.14	10.90	12.03
Tax (Incl Deferred)	2.63	2.58	3.08	3.05	3.05
RPAT	6.75	6.33	7.91	7.85	9.03
APAT	6.78	6.87	8.07	7.85	9.03
APAT Growth (%)	-2.0%	1.3%	17.5%	-2.7%	14.8%
Adjusted EPS (Rs)	32.3	34.0	38.8	40.7	46.1
EPS Growth (%)	-2.0%	5.4%	14.0%	5.0%	14.8%

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

YE March (Rs bn)	FY15	FY16	FY17	FY18E	FY19E
SOURCES OF FUNDS					
Share Capital - Equity	2.10	2.10	2.10	1.93	1.93
Reserves	53.09	56.45	59.42	52.25	56.63
Total Shareholders' Funds	55.20	58.55	61.52	54.18	58.56
Total Debt	5.75	4.61	4.17	3.67	3.97
Net Deferred Taxes					
Long Term Provisions & Others	0.61	0.80	0.60	0.62	0.68
TOTAL SOURCES OF FUNDS	57.04	59.71	62.93	55.10	59.84
APPLICATION OF FUNDS					
Net Block	1.17	0.89	1.04	1.46	1.61
Goodwill & intangibles	15.03	15.63	15.27	14.41	14.45
Investments	2.61	3.96	1.37	1.40	1.54
LT Loans & Advances	6.49	7.09	7.47	2.23	2.45
Total Non-current Assets	25.29	27.58	25.15	19.51	20.05
Inventories	-	0.04	-	-	-
Debtors	6.25	6.49	6.28	6.42	7.06
Other Current Assets	3.14	3.40	3.40	8.26	9.58
Cash & Equivalents	30.80	32.32	34.81	30.26	33.42
Total Current Assets	40.20	42.26	44.49	44.93	50.06
Creditors	4.02	4.48	3.88	3.96	4.36
Other Current Liabilities &	4.43	5.64	2.84	5.37	5.91
Total Current Liabilities	8.44	10.12	6.71	9.34	10.28
Net Current Assets	31.75	32.14	37.78	35.59	39.79
TOTAL APPLICATION OF	57.04	59.71	62.93	55.10	59.84

Source: Company, HDFC sec Inst Research

Cash Flow (Consolidated)

YE March (Rs bn)	FY15	FY16	FY17	FY18E	FY19E
Reported PBT	9.38	8.91	10.99	10.90	12.52
Interest expenses	0.28	0.24	0.14	0.12	0.12
Depreciation	0.98	1.21	0.79	0.77	0.95
Working Capital Change	(0.20)	0.28	(3.36)	(2.56)	(0.91)
Tax Paid	(2.63)	(2.58)	(3.08)	(3.05)	(3.50)
OPERATING CASH FLOW (a)	6.16	7.32	6.16	6.19	9.22
Capex	(0.72)	(1.27)	(0.88)	(0.96)	(1.13)
<i>Free cash flow (FCF)</i>	<i>5.44</i>	<i>6.04</i>	<i>5.28</i>	<i>5.23</i>	<i>8.09</i>
Investments	(2.94)	(0.31)	2.52	5.84	(0.36)
Non-operating Income	-	-	-	-	-
INVESTING CASH FLOW (b)	(3.66)	(1.59)	1.63	4.88	(1.49)
Debt Issuance/(Repaid)	0.03	(1.23)	(0.51)	(0.31)	0.19
Interest Expenses	(0.28)	(0.24)	(0.14)	(0.12)	(0.12)
<i>FCFE</i>	<i>5.19</i>	<i>4.57</i>	<i>4.63</i>	<i>4.80</i>	<i>8.15</i>
Share Capital Issuance	0.00	0.00	0.00	(0.17)	-
Dividend	(1.72)	(4.05)	(4.29)	(4.17)	(4.63)
FINANCING CASH FLOW (c)	(1.97)	(5.52)	(4.94)	(4.77)	(4.56)
NET CASH FLOW (a+b+c)	0.53	0.21	2.86	6.30	3.17
Closing Cash & Equivalents	30.80	32.32	34.81	30.26	33.42

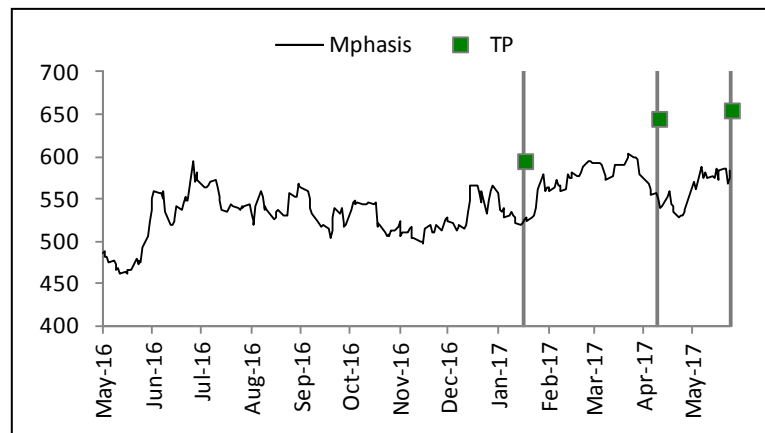
Source: Company, HDFC sec Inst Research

Key Ratios (Consolidated)

YE March	FY15	FY16	FY17	FY18E	FY19E
PROFITABILITY (%)					
GPM	40.1	41.9	41.5	40.2	41.6
EBITDA Margin	15.0	14.8	15.9	16.3	17.2
APAT Margin	11.7	11.3	13.3	12.6	13.2
RoE	12.7	12.1	13.4	13.6	16.0
RoIC (or Core RoCE)	16.6	19.4	22.7	25.8	30.6
RoCE	12.1	11.7	13.2	13.5	15.9
EFFICIENCY					
Tax Rate (%)	28.1%	29.0%	28.0%	28.0%	28.0%
Fixed Asset Turnover (x)	5.5	6.3	6.2	5.8	5.8
<i>Debtors (days)</i>	<i>71</i>	<i>74</i>	<i>65</i>	<i>65</i>	<i>68</i>
<i>Payables (days)</i>	<i>25</i>	<i>27</i>	<i>23</i>	<i>23</i>	<i>23</i>
Cash Conversion Cycle (days)	46	47	42	42	44
Debt/EBITDA (x)	0.7	0.5	0.4	0.4	0.3
Net D/E (x)	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Interest Coverage (x)	28	32	64	76	90
PER SHARE DATA (Rs)					
EPS	32.3	34.0	38.8	40.7	46.7
CEPS	37	38	42	45	52
Dividend	16	20	17	18	20
Book Value	263	279	293	281	304
VALUATION					
P/E (x)	18.1	17.1	15.0	14.3	12.5
P/BV (x)	2.2	2.1	2.0	2.1	1.9
EV/EBITDA (x)	11.2	10.5	9.5	9.5	7.9
OCF/EV (%)	6.3%	7.7%	6.7%	6.5%	9.9%
FCF/EV (%)	5.6%	6.4%	5.7%	5.5%	8.7%
FCFE/Mkt Cap (%)	4.2%	3.7%	3.8%	3.9%	6.7%
Dividend Yield (%)	2.7%	3.4%	2.9%	3.1%	3.4%

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
25-Jan-17	538	BUY	640
11-Apr-17	556	BUY	645
28-May-17	583	BUY	655

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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