

# HAVELLS INDIA

## Cost efficiency makes good for subdued volumes

India Equity Research | Consumer Durables

Havells India (Havells) posted better PAT, despite the top-line miss, led by improved OPM across businesses. Key highlights: a) 12-13% price hike in cables & wires, reversal of promotional schemes post GST/DeMon and better profitability in Lloyd led to 8-9% EBIDTA beat; b) Re-stocking was poor as dealers deferred buying leading to 12-14% top-line miss; and c) While management expects low double digit revenue growth in FY18, they were more confident about profitability, especially in Lloyd business. While we trim our FY18/19E top-line by 8.5/4% to reflect channel deferments, impact on PAT is contained at 6/0.5%. Despite near-term growth challenges, we believe Havells is the best play on rising penetration/premiumisation in durables/electrical space and estimate 33% earnings CAGR over next 2 years. We maintain 'BUY' with TP of INR564 (with target PE at 25% premium to sector PE multiple at 30x).

### Profitability normalises post GST/DeMon; volumes trip

Cables & wires and switchgears posted low single digit value growth, which adjusted for commodity price rise, seems to have de-grown in Q2FY18, purely attributed to deferred re-stocking by channel partners. However, in consumer durables and Lloyd segment (70% ACs) growth was slightly lower at 11% YoY (net of excise) despite the festival quarter this year. Amid weak volumes, Havells posted strong EBIDTA margin at 14.5% (10% in Q1FY18), which implies benefits from price hike (in cables business), and reversal of trade schemes. EBIT margin of Lloyd, which jumped by 480bps QoQ and far exceeded street's/our estimates, was driven by consolidation/efficiency benefits.

### What to expect of HAVL going ahead?

Given strong core demand outlook for Havells' traditional segment, we expect HAVL to post 15-20% top-line growth over FY17-19E. However, scope for improvement in Lloyd's profitability remains a key trigger in near to medium term as Havells fully derives benefits of change in business model versus Lloyd's push model.

### Outlook and valuations: Growth outlook intact; maintain 'BUY'

We believe Havells with its best coverage (>85%) of the consumer durables/electricals market is well geared to reap the benefits of rising penetration/premiumisation over next 3-5 years. Moreover, with rising focus on tier-III/IV cities, we expect Havells to post better-than industry growth going ahead. At CMP, the stock trades at 37x FY19 PE.

#### Financials (Standalone)

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	FY17	FY18E	FY19E
Net revenues	17774	14522	22.4	18605	-4.5	61353	86640	108606
EBITDA	2569	2104	22.1	1854	38.5	8241	10834	13950
Adj. profit	1710	1458	17.3	1344	27.3	5969	6966	9233
Diluted EPS (INR)	2.7	2.3	17.3	2.2	27.3	9.6	11.2	14.8
Diluted P/E (x)						56.5	48.4	36.6
ROAE (%)						19.2	20.0	23.6

#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Low
Sector Relative to Market	Overweight

#### MARKET DATA (R: HVEL.BO, B: HAVL IN)

CMP	: INR 541
Target Price	: INR 564
52-week range (INR)	: 565 / 303
Share in issue (mn)	: 625.1
M cap (INR bn/USD mn)	: 338 / 5,207
Avg. Daily Vol.BSE/NSE('000)	: 1,417.9

#### SHARE HOLDING PATTERN (%)

	Current	Q1FY18	Q4FY17
Promoters *	61.6	61.6	61.6
MF's, FI's & BK's	3.5	3.2	2.7
FII's	25.7	26.3	26.5
Others	9.3	8.9	9.2
* Promoters pledged shares (% of share in issue)	:	NIL	

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	9.3	0.4	(5.0)
3 months	17.2	3.2	(1.6)
12 months	31.3	17.1	16.5

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### Q2FY18 conference call: Key takeaways

#### Guidance

- 3.0-3.5% of revenues to account for advertisements, sales and promotional expenses.
- Capex: INR2bn annually in FY18 and FY19.
- Low double digit top-line growth, ex Lloyd.

#### Cables & Wires

- Inventory gains and lower advertisement spends aided margins. However, as per management, these margin levels are not sustainable. Pre-demonetisation margin levels of 13.5-14% should be achieved over next few quarters.
- Some price hikes were undertaken by the company in Q2FY18 to offset the rise in commodity prices. Management is actively monitoring the rise in commodity prices.
- Cables and wires registered 2% value growth, while wires/cables volumes declined 5%/12-14%.

#### Switchgear

- Business was impacted by slowdown in construction activity.

#### Lighting

- Shift to LED benefitted the division.

#### Consumer Durables

- Management expects pre-buying in ACs in Q3FY18 on account of shift to new rating norms with effect from January'18 and Havells is prepared for this transition.

#### Others

- Restocking as expected by management was not seen in Q2FY18. As per management, lower inventory levels may be the new normal or there could be a marginal pickup in restocking from current levels.
- With GST rate for most products in the 28% bracket, management expects the shift from unorganised to organised to be unlikely. A dip in GST rates could speed up the shift to organised sector.
- Festive uptick was not visible as traders / dealers / distributors were adjusting to the new GST transition.

#### Lloyd:

- Havells has not taken any price increase in its product range.
- Synergy benefits are visible with changes in distribution network and warehouse integration, which helped improve Lloyd's margins to 19.5% in Q2FY18 from 14.7% in Q1FY18.

**Table 1: Segmental snapshot**

Year to March	Q2FY18	Q2FY17	% change	H1FY18	H1FY17	% change
<b>Segment revenue (INR mn)</b>						
Switchgear	3,299	3,474	(5.1)	6,688	7,003	(4.5)
Cable & Wire	5,693	5,592	1.8	12,057	10,921	10.4
Lighting & Fixtures	2,868	2,371	21.0	5,466	4,667	17.1
ECD	3,216	3,085	4.2	6,798	6,599	3.0
Lloyd Consumer Division	2,698	0	NA	5,370	0	NA
<b>Total</b>	<b>17,774</b>	<b>14,522</b>	<b>22.4</b>	<b>36,379</b>	<b>29,190</b>	<b>24.6</b>
<b>Segment revenue mix (%)</b>						
Switchgear	18.6	23.9		18.4	24.0	
Cable & Wire	32.0	38.5		33.1	37.4	
Lighting & Fixtures	16.1	16.3		15.0	16.0	
ECD	18.1	21.2		18.7	22.6	
Lloyd Consumer Division	15.2	0.0		14.8	0.0	
<b>EBIT (INR mn)</b>						
Switchgear	1,363	1,444	(5.6)	2,670	2,879	(7.3)
Cable & Wire	1,133	793	43.0	1,992	1,512	31.7
Lighting & Fixtures	775	631	22.8	1,540	1,223	25.9
ECD	894	821	8.9	1,710	1,734	(1.4)
Lloyd Consumer Division	527	0	NA	921	0	NA
<b>Total</b>	<b>4,692</b>	<b>3,688</b>	<b>27.2</b>	<b>8,833</b>	<b>7,348</b>	<b>20.2</b>
<b>EBIT margin (%)</b>						
Switchgear	41.3	41.6		39.9	41.1	
Cable & Wire	19.9	14.2		16.5	13.8	
Lighting & Fixtures	27.0	26.6		28.2	26.2	
ECD	27.8	26.6		25.2	26.3	
Lloyd Consumer Division	19.5	0.0		17.2	0.0	
<b>Total</b>	<b>26.4</b>	<b>25.4</b>		<b>24.3</b>	<b>25.2</b>	
<b>EBIT mix (%)</b>						
Switchgear	29.0	39.2		30.2	39.2	
Cable & Wire	24.2	21.5		22.6	20.6	
Lighting & Fixtures	16.5	17.1		17.4	16.6	
ECD	19.1	22.2		19.4	23.6	
Lloyd Consumer Division	11.2	0.0		10.4	0.0	

Source: Edelweiss research

## Consumer Durables

### Financial snapshot

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	YTD18	FY18E	FY19E
Net revenues	17,774	14,522	22.4	18,605	(4.5)	36,379	86,640	108,606
Direct costs	10,251	8,462	21.2	11,965	(14.3)	22,217	53,584	67,161
Employee expenses	1,617	1,216	33.0	1,619	(0.1)	3,235	6,580	7,910
Other expenses	3,336	2,742	21.7	3,167	5.3	6,504	15,641	19,586
EBITDA	2,569	2,104	22.1	1,854	38.5	4,424	10,834	13,950
Depreciation	349	308	13.4	336	3.9	685	1,493	1,613
EBIT	2,220	1,796	23.6	1,519	46.2	3,739	9,342	12,337
Other income	287	253	13.4	348	(17.6)	635	724	918
Interest	67	19	253.7	34	97.6	101	254	252
Add: Prior period items								
Profit before tax	2,440	2,030	20.2	1,833	33.1	4,273	9,811	13,004
Provision for taxes	730	572	27.5	489	49.3	1,219	2,845	3,771
Reported net profit	1,710	1,458	17.3	1,344	27.3	3,054	6,966	9,233
Adjusted Profit	1,710	1,458	17.3	1,344	27.3	3,054	6,966	9,233
Equity capital(FV INR 5)	624	624		624		624	624	624
No. of shares (mn)	624	624		624		624	624	624
Diluted EPS (INR)	2.7	2.3	17.3	2.2	27.3	4.9	11.2	14.8
As % of net revenues								
Raw material	57.7	58.3		64.3		61.1	61.8	61.8
Employee cost	9.1	8.4		8.7		8.9	7.6	7.3
Other expenses	18.8	18.9		17.0		17.9	18.1	18.0
EBITDA	14.5	14.5		10.0		12.2	12.5	12.8
Depreciation	2.0	2.1		1.8		1.9	1.7	1.5
EBIT	12.5	12.4		8.2		10.3	10.8	11.4
Interest expenditure	0.4	0.1		0.2		0.3	0.3	0.2
Other income	1.6	1.7		1.9		1.7	0.8	0.8
Reported net profit	9.6	10.0		7.2		8.4	8.0	8.5
Tax rate	29.9	28.2		26.7		28.5	29.0	29.0

### Change in Estimates

	FY18E			FY19E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	86,640	94,788	(8.6)	108,606	113,438	(4.3)	Building in lower than expected re-stocking and cost efficiencies leading to margin ramp up.
EBITDA	10,834	11,446	(5.3)	13,950	14,007	(0.4)	
EBITDA Margin	12.5	12.1		12.8	12.3		
Adjusted Profit	6,966	7,416	(6.1)	9,233	9,278	(0.5)	
After Tax							
Net Profit Margin	8.0	7.8		8.5	8.2		
Capex	2,000	2,000	0.0	2,000	2,000	0.0	

## Company Description

Incorporated in 1983, HAVL is one of the largest and fastest growing manufacturers of electrical components and systems in India. It is the market leader in light-duty power distribution products. Its offerings include electrical products like circuit protection equipment (domestic and industrial switchgears), cables and wires, and consumer durables like fans, CFLs, and lighting fixtures. Havells recently acquired (Feb 2017) the Consumer segment of Lloyd electricals (which the company plans to continue) which would give HAVL access to Lloyds' strong distribution network with 10k touch points along with leadership in room AC segment (12-14% market share)

## Investment Theme

We expect Havells to continue to grow its domestic business on the back of strong product portfolio. The company is currently one of the fastest growing fan brands in the Indian market with market share at ~15%. In the switchgear market, HAVL is the market leader in the low voltage segment with ~28% share. In India, the company has a network of ~7,000 distributors spread across the four regions servicing ~100,000 retailers/ touch points. HAVL has been highly successful in bolstering market share of existing products along with launching new products, which have received good response, driven by high brand visibility. Recent buyout of Lloyd brand imparts access to a high growth larger white good market adding USD2-5bn new market.

## Key Risks

Slowdown in domestic business; increased competition could put pressure on margin

Slowdown in key consumer segments of construction and industrial capex could impact the domestic business.

Slowdown in power T&D could impact the demand for its cables and wires business.

Slower than expected revenue growth and profitability turnaround in Lloyd's consumer business poses risk to estimates and valuations.

## Financial Statements

### Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
<b>Macro</b>				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.5	67.1	65.0	66.0
<b>Company</b>				
Cables & Wires	0.8	20.4	8.8	30.3
Switchgears	0.6	10.5	6.1	28.3
Lighting & Fixtures	8.2	32.5	23.2	10.0
Consumer durables	11.0	30.9	17.3	38.0
Depreciation	7.1	6.5	7.6	7.5
Tax rate (%)	21.7	27.5	29.0	29.0
Capex (INR mn)	1,766	2,386	2,000	2,000

### Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	53,783	61,353	86,640	108,606
Materials costs	31,735	36,485	53,584	67,161
Employee costs	3,708	5,004	6,580	7,910
Other mfg expenses	10,791	11,623	15,641	19,586
Total operating expenses	46,234	53,111	75,806	94,657
EBITDA	7,549	8,241	10,834	13,950
Depreciation	1,049	1,196	1,493	1,613
EBIT	6,500	7,045	9,342	12,337
Add: Other income	694	1,343	724	918
Less: Interest Expense	127	122	254	252
Add: Exceptional items	2,024	(578)	-	-
Profit Before Tax	9,090	7,688	9,811	13,004
Less: Provision for Tax	1,970	2,298	2,845	3,771
Reported Profit	7,120	5,390	6,966	9,233
Exceptional Items	2,024	(578)	-	-
Adjusted Profit	5,096	5,969	6,966	9,233
Shares o /s (mn)	624	624	624	624
Diluted shares o/s (mn)	624	624	624	624
Adjusted Diluted EPS	8.2	9.6	11.2	14.8
Adjusted Cash EPS	9.9	11.5	13.6	17.4
Dividend per share (DPS)	6.0	3.5	3.9	5.9
Dividend Payout Ratio (%)	88.1	43.3	42.0	48.0

### Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	86.0	86.6	87.5	87.2
EBITDA margins	14.0	13.4	12.5	12.8
Net Profit margins	13.2	8.8	8.0	8.5

### Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	2.7	14.1	41.2	25.4
EBITDA	8.0	9.2	31.5	28.8
Adjusted Profit	9.6	17.1	16.7	32.5

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	625	625	625	625	
Shareholders' funds	29,537	32,736	36,779	41,583	
Long term borrowings	-	1,981	1,981	1,981	
Total Borrowings	-	1,981	1,981	1,981	
Long Term Liabilities	87	137	137	137	
<b>Sources of funds</b>	<b>30,487</b>	<b>35,990</b>	<b>40,033</b>	<b>44,838</b>	
Gross Block	16,268	17,608	19,608	21,608	
Net Block	11,773	11,917	12,426	12,817	
Capital work in progress	205	119	119	119	
Intangible Assets	108	182	179	176	
Total Fixed Assets	12,086	12,217	12,724	13,112	
Non current investments	5,032	5,471	5,471	5,471	
Cash and Equivalents	13,652	19,375	20,680	24,170	
Inventories	7,844	9,284	11,662	14,851	
Sundry Debtors	1,576	2,285	2,374	2,976	
Loans & Advances	60	60	70	83	
Other Current Assets	639	906	639	639	
Current Assets (ex cash)	10,119	12,536	14,744	18,549	
Sundry creditors	9,489	12,508	12,485	15,363	
Provisions	914	1,102	1,102	1,102	
Total Current Liab	10,403	13,610	13,587	16,465	
Net Curr Assets-ex cash	(284)	(1,074)	1,158	2,085	
Net Deferred tax	863	1,138	1,138	1,138	
<b>Uses of funds</b>	<b>30,487</b>	<b>35,990</b>	<b>40,033</b>	<b>44,838</b>	
BVPS (INR)	47.3	52.5	59.0	66.7	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	7,120	5,390	6,966	9,233	
Add: Depreciation	1,049	1,196	1,493	1,613	
Interest (Net of Tax)	(443)	(885)	(334)	(474)	
Others	(1,511)	754	(136)	(193)	
Less: Changes in WC	960	(1,323)	2,231	927	
Operating cash flow	5,254	7,778	5,758	9,252	
Less: Capex	1,766	2,386	2,000	2,000	
<b>Free Cash Flow</b>	<b>3,488</b>	<b>5,392</b>	<b>3,758</b>	<b>7,252</b>	

## Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Havells India	5,207	48.5	36.6	9.2	8.1	20.0	23.6
Bajaj Electricals	631	29.5	22.1	4.2	3.6	15.0	17.6
Voltas	2,768	30.2	26.7	4.8	4.2	16.8	16.7
Median	-	30.2	26.7	4.8	4.2	16.8	17.6
AVERAGE	-	36.0	28.5	6.0	5.3	17.3	19.3

Source: Edelweiss research

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		5,254	7,778	5,758	9,252
Investing cash flow		(781)	(2,275)	(1,276)	(1,082)
Financing cash flow		(4,976)	(724)	(3,177)	(4,680)
Net cash Flow		(503)	4,780	1,305	3,491
Capex		(1,766)	(2,386)	(2,000)	(2,000)
Dividend paid		(4,488)	(2,585)	(2,923)	(4,428)

## Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	19.1	19.2	20.0	23.6
ROACE (%)	26.8	26.1	27.4	32.2
Inventory Days	85	86	71	72
Debtors Days	10	11	10	9
Payable Days	104	110	85	76
Cash Conversion Cycle	(9)	(13)	(4)	5
Current Ratio	2.3	2.3	2.6	2.6
Gross Debt/EBITDA	-	0.2	0.2	0.1
Gross Debt/Equity	-	0.1	0.1	-
Adjusted Debt/Equity	-	0.1	0.1	-

## Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	1.9	1.8	2.3	2.6
Fixed Asset Turnover	5.0	5.2	7.1	8.6
Equity Turnover	2.0	2.0	2.5	2.8

## Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	8.2	9.6	11.2	14.8
Y-o-Y growth (%)	9.6	17.1	16.7	32.5
Adjusted Cash EPS (INR)	9.9	11.5	13.6	17.4
Diluted P/E (x)	66.3	56.6	48.5	36.6
P/B (x)	11.4	10.3	9.2	8.1
EV / Sales (x)	6.0	5.2	3.7	2.9
EV / EBITDA (x)	42.9	38.9	29.4	22.6

## Additional Data

### Directors Data

Rajesh Gupta	Whole-Time Director Finance and Group CFO	Puneet Bhatia	Non-Independent & Non-Executive Director
Surjit Gupta	Non-Independent & Non-Executive Director	S B Mathur	Independent Non-Executive Director
S K Tuteja	Independent Non-Executive Director	V K Chopra	Independent Non-Executive Director
AP Gandhi	Independent Non-Executive Director	Adarsh Kishore	Independent Non-Executive Director
Anil Gupta	Chairman & Managing Director	Pratima Ram	Independent Non-Executive Director
Ameet Kumar Gupta	Whole Time Director	T.V.Mohandas Pai	Non-Independent & Non-Executive Director

Auditors - S.R.Batliboi & Co. LLP

*\*as per last annual report*

### Holding – Top10

	Perc. Holding		Perc. Holding
Qrg enterprises ltd	30.37	Qrg investments	11
Gupta vinod	6.31	Nalanda india equity	5.29
Gupta surjit	5.22	Gupta anil rai	4.9
Norges bank	2.91	Government pension f	2.83
Capital group compan	2.8	Gupta qimat rai	2.17

*\*in last one year*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
29 Mar 2017	Guptajee & Company	Sell	18862400	450.00
29 Mar 2017	Arg Family Trust	Buy	18862400	450.00

*\*in last one year*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
29 Mar 2017	Anil Rai Gupta as Managing Trustee of ARG Family Trust	Buy	18862400.00
29 Mar 2017	Vinod Gupta on behalf of Guptajee & Co.	Sell	13320000.00
29 Mar 2017	Anil Rai Gupta on behalf of Guptajee & Co.	Sell	5542400.00

*\*in last one year*



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Bajaj Electricals	HOLD	SP	M	Crompton Greaves Consumer Electrical	BUY	SO	L
Finolex Cables	BUY	SO	L	Havells India	BUY	SO	L
KEI Industries	BUY	SO	L	Symphony	BUY	SO	L
V Guard Industries	HOLD	SP	L	Voltas	BUY	SO	L
Whirlpool of India	BUY	SO	M				

**ABSOLUTE RATING**

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

**RELATIVE RETURNS RATING**

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

**RELATIVE RISK RATING**

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

**SECTOR RATING**

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Ideas create, values protect

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## Coverage group(s) of stocks by primary analyst(s): Consumer Durables

Bajaj Electricals, Crompton Greaves Consumer Electrical, Finolex Cables, Havells India, KEI Industries, Symphony, V Guard Industries, Voltas, Whirlpool of India

### Recent Research

Date	Company	Title	Price (INR)	Recos
08-Sep-17	<b>Bajaj Electricals</b>	Change underway; <i>Company Update</i>	340	Hold
07-Sep-17	<b>KEI Industries</b>	On a strong growth trajectory; <i>Company Update</i>	264	Buy
07-Sep-17	<b>Symphony</b>	Growth confidence reinstated ; <i>Company Update</i>	1305	Buy

### Distribution of Ratings / Market Cap

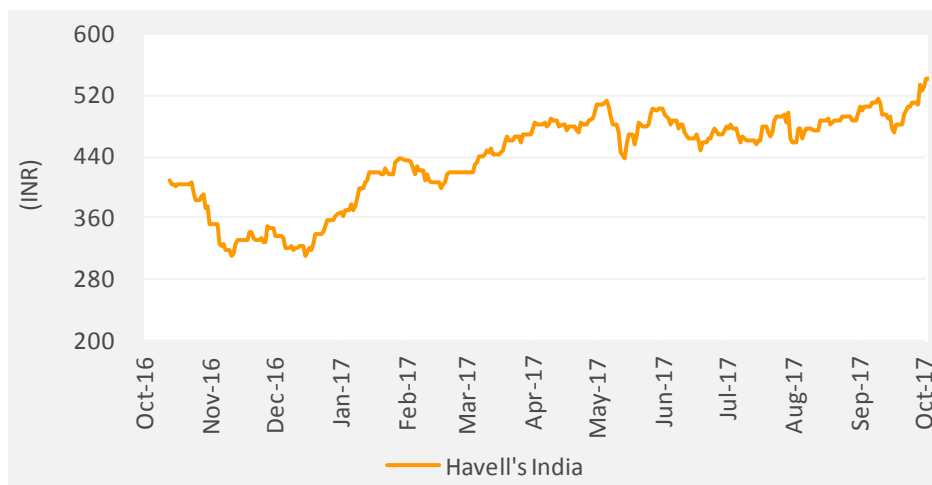
#### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

### One year price chart



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