

August 8, 2019

Q2CY19 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	CY19E	CY20E	CY19E	CY20E
Rating	HOLD		HOLD	
Target Price	347		339	
Sales (Rs. m)	56,121	67,221	56,324	67,169
% Chng.	(0.4)	0.1		
EBITDA (Rs. m)	8,879	10,430	8,780	10,422
% Chng.	1.1	0.1		
EPS (Rs.)	21.8	25.2	20.8	24.4
% Chng.	4.6	3.2		

Key Financials - Standalone

Y/e Dec	CY17	CY18	CY19E	CY20E
Sales (Rs. m)	39,420	46,477	56,121	67,221
EBITDA (Rs. m)	6,903	7,709	8,879	10,430
Margin (%)	17.5	16.6	15.8	15.5
PAT (Rs. m)	4,994	5,833	6,485	7,486
EPS (Rs.)	16.8	19.6	21.8	25.2
Gr. (%)	21.8	16.6	11.2	15.4
DPS (Rs.)	4.0	6.9	7.4	8.8
Yield (%)	1.1	1.9	2.0	2.4
RoE (%)	26.6	26.5	25.2	25.2
RoCE (%)	33.5	32.1	31.3	31.7
EV/Sales (x)	2.7	2.2	1.7	1.4
EV/EBITDA (x)	15.2	13.2	11.0	9.0
PE (x)	22.1	18.9	17.0	14.7
P/BV (x)	5.5	4.6	4.0	3.5

Key Data

HEXT.BO | HEXW IN

52-W High / Low	Rs.502 / Rs.294
Sensex / Nifty	37,327 / 11,032
Market Cap	Rs.111bn / \$ 1,566m
Shares Outstanding	298m
3M Avg. Daily Value	Rs.654.07m

Shareholding Pattern (%)

Promoter's	62.66
Foreign	17.14
Domestic Institution	10.97
Public & Others	9.23
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	3.6	4.2	(22.5)
Relative	7.5	2.0	(21.3)

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Margin Surprise

Hexaware 2QCY19 results were broadly inline with our estimates, with beat on margins. Hexaware has given revenue guidance of 19% for CY19E (earlier:20%), trimmed as they are facing headwinds from client specific issues in BFSI vertical. Hexaware delivered better EBIT margins of 14.6% (vs Ple: 13.5%, Cons: 13.7%) due to better onsite-offshore mix, higher billing rates & improved utilization. Hexaware expects EBIT margins to improve in CY2019, an aggressive assumption against the backdrop of high industry attrition and talent shortage in the US. Hexaware management mentioned BFSI vertical will continue to face headwinds in CY19E. Gross margin improved in this quarter to 32.7% from 30.5% in Q1CY19, rising proportion of offshore mix & better utilization helped in improvement. We believe key negative for Hexaware is softness in BFS (41% of revenue) mainly focused in capital markets & buy side for new deals which have longer sales cycles. We remain watchful on expanded attrition levels of 18% (6-year high) along with supply side constraints. Led by revision of ETR at 18.5% for CY19E (earlier 20%), marginally raised our EPS estimates by ~2% to Rs20.9/24.8 for CY19/20E. We expect revenue & EPS CAGR of 18.2% & 13.2% respectively over CY18-20E. We value Hexaware at 14x CY20E EPS with changed target price of Rs347 (earlier Rs339). Stock is currently trading at 17.7x CY19E & 15x CY20E. Maintain Hold.

- **Inline revenue performance:** Revenues came at \$188.5mn up 4.7% QoQ/12% YoY and inline with our estimates. CC growth for the quarter stood at 5% QoQ (Ple: 5.1% CC growth). Growth components were Volume growth (+700bps), billing days' improvement (+210bps) and cross currency impact (-50bps).
- **Strong beat on margins:** EBITDA margin (excluding ESOP cost) for the quarter came at 16.5% up ~120bps QoQ and above our ests (Ple: 15.5%). EBITDA improved by 120bps during the quarter. Headwinds from higher SG&A expenses (-90bps), H-1B visa Cost (-70bps) and INR appreciation (-20bps) was more offset by tailwinds from Billing rates (+90bps), Higher utilisation (+60bps), improve in offshore-onsite mix (+50bps), Lower other costs (+70bps) and calendar (+40bps). PAT at Rs1513mn was 5% above our estimates (Ple: Rs1443mn) led by strong beat on margins and higher other income. There was exception cost related to transaction cost of acquisition amounted to Rs171mn impacted PAT.
- **Weak performance in BFSI vertical offset by growth in other verticals:** Among verticals, Travel (up 11% QoQ), Professional services (up 10.2% QoQ) and Healthcare (up 10.1% QoQ) remains strong. BFSI grew by 2% QoQ and continue to remain weak. Hexaware management mentioned BFSI vertical will continue to face headwinds in CY19E. Manufacturing remain tepid (de-grew by 2.5% QoQ). Among Geographies, Europe up 16.1% QoQ and America grew by 5.8% QoQ. Asia Pacific declined by 14.6% QoQ. Revenue growth in Asia pacific geography, IMS service line and manufacturing and consumer vertical declined during the quarter mainly because of project closure covering all the 3 sub-segments. In IMS service offering, company remained confident of recovering and delivering strong growth in next quarter with strong deal pipeline.

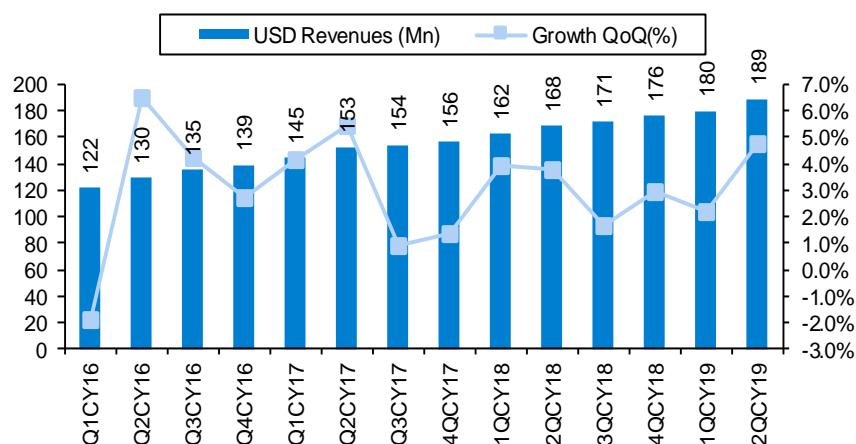
Exhibit 1: Q2CY20: Quick view on results

Y/e March (Rs mn)	Q2CY19	Q1CY19	QoQ gr.	Q2CY18	YoY gr.	PL Estimates	Variance (Actual vs Ple)
Revenues (USD mn)	188.5	180	4.7%	168	12.0%	188.8	-0.2%
Revenues (INR mn)	13,083	12,640	3.5%	11,367	15.1%	13,310	-1.7%
EBITDA	2,158	1,930	11.8%	1,869	15.5%	2,063	4.6%
EBITDA Margins	16.5%	15.3%	123 bps	16.4%	5 bps	15.5%	99 bps
EBIT	1,912	1,739	9.9%	1,591	20.2%	1,793	6.6%
EBIT Margins	14.6%	13.8%	86 bps	14.0%	62 bps	13.5%	114 bps
PAT	1,513	1,385	9.2%	1,534	-1.4%	1,443	4.9%
EPS	5.0	4.6	9.4%	5.1	-2.0%	4.8	5.0%

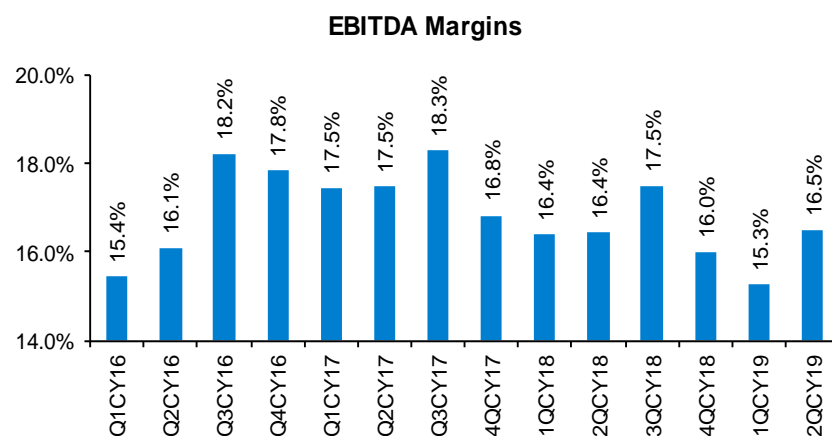
Source: Company, PL

Revenues came at \$188.5mn up 4.7% QoQ/12% YoY and inline with our estimates. CC growth for the quarter stood at 5% QoQ (Ple: 5.1% CC growth).

EBIDTA margin (excluding ESOP cost) for the quarter came at 16.5% up ~120bps QoQ and above our ests (Ple: 15.5%).

Exhibit 2: Revenue growth inline with estimates


Source: Company, PL

Exhibit 3: Strong beat on margins


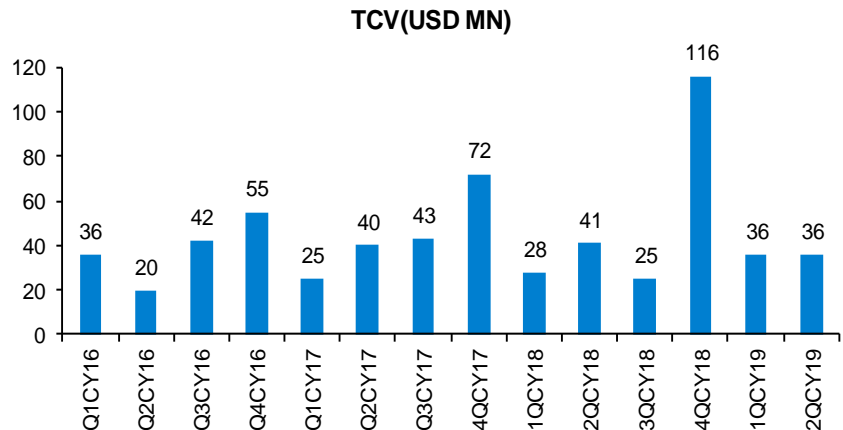
Source: Company, PL

Key Concall Highlights

- Management expects Q3CY19 performance to be better than Q2CY19 with strong revenue growth momentum on back of strong deal pipeline and steady margin performance.
- Headcount at end of quarter stood at 18,294 with net addition of 1,785 employees. Management cited that out of these net addition, ~700 employees added with acquisition of Mobiquity.
- There is no attrition in Mobiquity from acquisition by Hexaware.
- As cited in last quarter, margins improved during the quarter mainly with various operational levers
- US labor market is even tighter than beginning of CY19.
- Acquisition of Mobiquity has led to addition of four clients in Top 20clients of company.
- Utilisation improved by 170bps QoQ to 80.7% in Q2CY19 aided margins during the quarter. Management guided utilisation at higher levels and expect to dip little in coming quarters.
- Revenue growth in Asia pacific geography, IMS service line and manufacturing and consumer vertical declined during the quarter mainly because of project closure covering all the 3 sub-segments.
- In IMS service offering, company remained confident of recovering and delivering strong growth in next quarter with strong deal pipeline.
- On adoption of Ind AS 116, company guided that there is no impact of new accounting policy on Hexaware have Calendar year accounting closure. Ind AS-116 would be effective for company from 1st January,2020.
- EBITDA improved by 120bps during the quarter. Headwinds from higher SG&A expenses (-90bps), H-1B visa Cost (-70bps) and INR appreciation (-20bps) was more offset by tailwinds from Billing rates (+90bps), Higher utilisation (+60bps), improve in offshore-onsite mix (+50bps), Lower other costs (+70bps) and calendar (+40bps)
- Management marginally reduced revenue growth guidance for CY19 to ~19% (earlier 20%) due to client specific issue in BFSI vertical. However, organic growth guidance is retained. Guidance for EBITDA growth retained at to be inline with revenue growth. Also, expects EPS to improved due to lower ETR.
- ETR for the quarter stood at 17.9% led by increase in transaction cost due to Mobiquity acquisition. Company has revised ETR downwards to 18.5% (earlier 20%) for CY19.
- On Margins, cited that Q2 & Q3 are generally higher margin quarter in comparison to Q1 & Q4 due to seasonality impact of business. However, remain confident on delivering margins in guided range for full year despite of volatility of quarterly performance on margins.
- Healthcare & Insurance business delivered strong growth on back of deal wins with the help of guidewire.

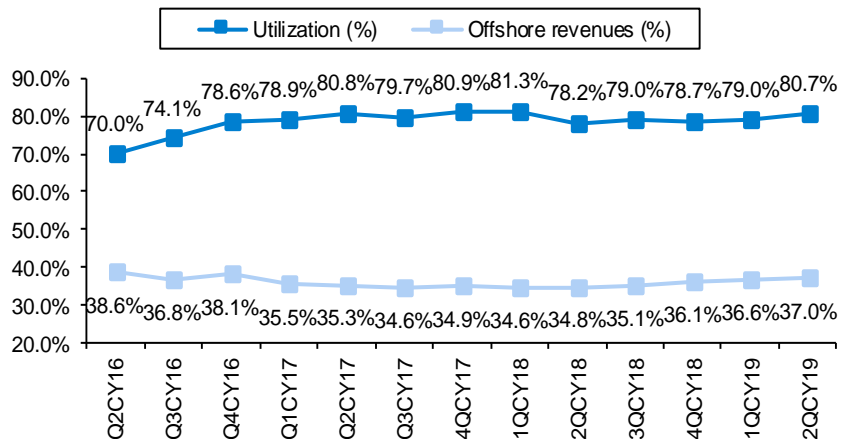
Company signed five new deals with TCV of \$36mn.

Exhibit 4: TCV back to new normal after large deal win in 4QCY18



Source: Company, PL

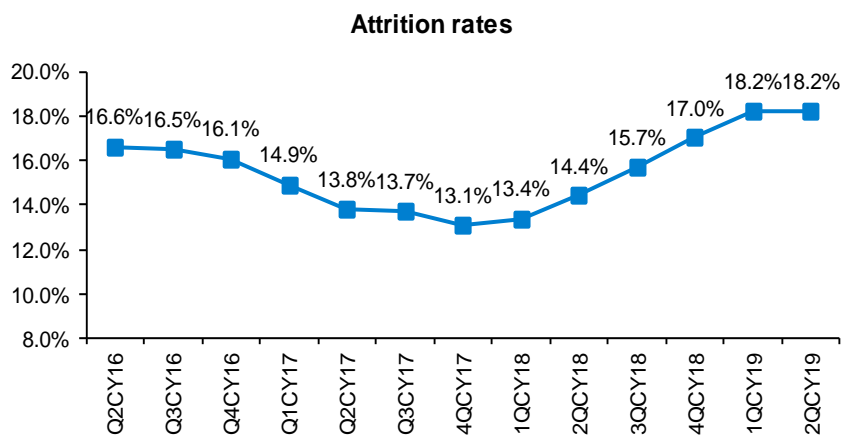
Exhibit 5: Utilization continue to remain strong



Source: Company, PL

Attrition continue to remain elevated at 18.2%, flat QoQ.

Exhibit 6: Attrition rate now at new normal level



Source: Company, PL

Exhibit 7: Vertical-wise revenues

USD mn	Q2CY19	Q1CY19	QoQ gr.	Q2CY18	YoY gr.
BFSI	75.0	73.4	2%	72.0	4%
Travel & Transportation	19.0	17.1	11%	18.7	2%
Healthcare & Insurance	36.2	32.9	10%	28.8	26%
Manufacturing, Consumer & Others	30.2	31.0	-3%	27.1	11%
Professional services	28.1	25.7	9%	21.7	29%
Total	188.5	180.2	5%	168.3	12%
as a % of total					
BFSI	39.8	40.8	-100 bps	42.8	-300 bps
Travel & Transportation	10.1	9.5	60 bps	11.1	-100 bps
Healthcare & Insurance	19.2	18.3	90 bps	17.1	210 bps
Manufacturing, Consumer & Others	16.0	17.2	-120 bps	16.1	-10 bps
Professional services	14.9	14.3	60 bps	12.9	200 bps

Source: Company, PL

Exhibit 8: Geography-wise revenues

USD mn	Q2CY19	Q1CY19	QoQ gr.	Q2CY18	YoY gr.
Americas	144.8	137.0	6%	129.6	12%
Europe	26.4	22.7	16%	21.4	23%
Asia Pacific	17.3	20.3	-15%	17.3	0%
Total	188.5	180.0	0%	168.3	0%
as a % of total					
Americas	76.8	76.1	70 bps	77.0	-20 bps
Europe	14	12.6	140 bps	12.7	130 bps
Asia Pacific	9.2	11.3	-210 bps	10.3	-110 bps

Source: Company, PL

Exhibit 9: Revenue by Service-lines

USD mn	Q2CY19	Q1CY19	QoQ gr.	Q2CY18	YoY gr.
ADM	69.7	62.1	12%	61.6	13%
Enterprise Solutions	17.7	17.1	4%	17.7	0%
Testing / QATS (Quality)	33.4	31.5	6%	31.0	8%
BI and Analytics	23.2	23.6	-2%	22.7	2%
Business Process Services	15.1	13.7	10%	12.1	24%
IMS	29.4	32.0	-8%	23.2	27%
Total	188.5	180	5%	168.3	12%
as a % of total					
ADM	37.0	34.5	250 bps	36.6	40 bps
Enterprise Solutions	9.4	9.5	-10 bps	10.5	-110 bps
Testing / QATS (Quality)	17.7	17.5	20 bps	18.4	-70 bps
BI and Analytics	12.3	13.1	-80 bps	13.5	-120 bps
Business Process Services	8.0	7.6	40 bps	7.2	80 bps
IMS	15.6	17.8	-220 bps	13.8	180 bps

Source: Company, PL

**Exhibit 10: Revenue concentration from Top clients shifting**

As a % of total Revenues	2QCY16	3QCY16	4QCY16	Q1CY17	Q2CY17	Q3CY17	Q4CY17	Q1CY18	Q2CY18	Q3CY18	Q4CY18	Q1CY19	Q2CY19
Top 5 client	43.1	47.0	46.3	45.6	46.1	43.5	42.8	42.1	42.4	42.1	42.0	41.7	37.3
Top 10 clients	55.2	58.3	57.4	56.7	56.5	54.8	52.9	52.8	52.8	52.2	51.6	51.1	46.4

Source: Company, PL

Exhibit 11: Strong Capital Allocation Strategy

In Rs	2QCY16	3QCY16	4QCY16	Q1CY17	Q2CY17	Q3CY17	Q4CY17	Q1CY18	Q2CY18	Q3CY18	Q4CY18	Q1CY19	Q2CY19
Dividend	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	2.5	2.5	2.5	2.5	1.5

Source: Company, PL

Exhibit 12: Client Metrics

	2QCY16	3QCY16	4QCY16	Q1CY17	Q2CY17	Q3CY17	Q4CY17	Q1CY18	Q2CY18	Q3CY18	Q4CY18	Q1CY19	Q2CY19
1 mn	76	77	78	81	81	82	88	89	93	95	99	99	120
1 mn - 5 mn	62	63	64	67	66	64	71	69	71	70	72	71	85
5 mn - 10 mn	6	6	6	6	7	9	7	10	12	15	18	19	24
10mn -20mn	3	3	3	3	3	4	6	6	6	6	4	4	6
> USD 20 mn	5	5	5	5	5	5	4	4	4	4	5	5	5

Source: Company, PL

Exhibit 13: Headcount Metrics

Billable Personnel (IT Services +BPS)	Q4CY16	1QCY17	2QCY17	3QCY17	4QCY17	1QCY18	2QFY18	3QCY18	4QCY18	1QCY19	2QCY19
Onsite	21.0%	20.9%	20.9%	19.9%	19.7%	19.0%	18.8%	18.4%	19.0%	19.1%	19.2%
Offshore	70.7%	71.0%	71.2%	72.1%	72.5%	73.3%	73.7%	74.2%	73.6%	73.3%	73.2%
Total	91.7%	91.9%	92.1%	92.0%	92.2%	92.3%	92.5%	92.6%	92.6%	92.3%	92.4%
Marketing (incl. Sales Support)	3.3%	3.2%	3.3%	3.3%	3.3%	3.2%	3.0%	3.0%	3.0%	3.2%	3.0%
Others (incl. tech Support)	5.0%	4.9%	4.6%	4.7%	4.5%	4.5%	4.5%	4.4%	4.4%	4.5%	4.6%
Grand Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Dec	CY17	CY18	CY19E	CY20E
Net Revenues	39,420	46,477	56,121	67,221
YoY gr. (%)	11.5	17.9	20.7	19.8
Employee Cost	25,700	31,122	38,107	45,363
Gross Profit	13,720	15,355	18,013	21,858
Margin (%)	34.8	33.0	32.1	32.5
SG&A Expenses	6,817	7,646	9,135	11,428
Other Expenses	-	-	-	-
EBITDA	6,903	7,709	8,879	10,430
YoY gr. (%)	15.2	11.7	15.2	17.5
Margin (%)	17.5	16.6	15.8	15.5
Depreciation and Amortization	633	650	809	991
EBIT	6,270	7,059	8,070	9,439
Margin (%)	15.9	15.2	14.4	14.0
Net Interest	-	-	-	-
Other Income	135	206	(147)	(280)
Profit Before Tax	6,405	7,265	7,923	9,159
Margin (%)	16.2	15.6	14.1	13.6
Total Tax	1,411	1,432	1,438	1,673
Effective tax rate (%)	22.0	19.7	18.1	18.3
Profit after tax	4,994	5,833	6,485	7,486
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	4,994	5,833	6,485	7,486
YoY gr. (%)	19.7	16.8	11.2	15.4
Margin (%)	12.7	12.6	11.6	11.1
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	4,994	5,833	6,485	7,486
YoY gr. (%)	19.7	16.8	11.2	15.4
Margin (%)	12.7	12.6	11.6	11.1
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	4,994	5,833	6,485	7,486
Equity Shares O/s (m)	297	297	297	297
EPS (Rs)	16.8	19.6	21.8	25.2

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Dec	CY17	CY18	CY19E	CY20E
Non-Current Assets				
Gross Block	7,731	8,383	8,383	8,383
Tangibles	6,994	7,704	7,704	7,704
Intangibles	737	679	679	679
Acc: Dep / Amortization	3,974	4,451	5,260	6,250
Tangibles	3,414	3,877	4,605	5,595
Intangibles	560	574	655	655
Net fixed assets	3,757	3,932	3,123	2,133
Tangibles	3,580	3,828	3,100	2,109
Intangibles	177	105	24	24
Capital Work In Progress	2,563	2,244	2,244	2,244
Goodwill	1,656	1,809	1,809	1,809
Non-Current Investments	424	412	412	412
Net Deferred tax assets	1,336	1,784	1,784	1,784
Other Non-Current Assets	1,182	1,283	1,383	1,483
Current Assets				
Investments	189	101	101	101
Inventories	-	-	-	-
Trade receivables	5,360	8,031	7,688	9,208
Cash & Bank Balance	5,298	8,205	12,630	16,798
Other Current Assets	678	636	736	836
Total Assets	25,453	31,335	35,374	40,924
Equity				
Equity Share Capital	594	595	595	595
Other Equity	19,479	23,324	26,978	31,310
Total Network	20,073	23,919	27,573	31,904
Non-Current Liabilities				
Long Term borrowings	-	-	-	-
Provisions	179	230	240	250
Other non current liabilities	-	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	-	-	-	-
Trade payables	2,204	3,300	3,075	3,683
Other current liabilities	2,966	3,810	4,410	5,010
Total Equity & Liabilities	25,453	31,335	35,374	40,924

Source: Company Data, PL Research

Cash Flow (Rs m)

Y/e Dec	CY17	CY18	CY19E	CY20E
PBT	6,406	7,266	7,754	9,159
Add. Depreciation	633	651	809	991
Add. Interest	1	0	-	-
Less Financial Other Income	135	206	(147)	(280)
Add. Other	371	328	-	-
Op. profit before WC changes	7,411	8,245	8,563	10,150
Net Changes-WC	(901)	(1,166)	62	(1,054)
Direct tax	(1,748)	(1,592)	(1,438)	(1,673)
Net cash from Op. activities	4,762	5,487	7,187	7,422
Capital expenditures	(954)	(606)	-	-
Interest / Dividend Income	17	63	-	-
Others	(1)	88	(100)	(100)
Net Cash from Invt. activities	(938)	(455)	(100)	(100)
Issue of share cap. / premium	(1,367)	4	-	-
Debt changes	-	-	-	-
Dividend paid	(1,428)	(2,506)	(2,661)	(3,155)
Interest paid	(1)	0	-	-
Others	-	-	-	-
Net cash from Fin. activities	(2,796)	(2,502)	(2,661)	(3,155)
Net change in cash	1,029	2,530	4,425	4,168
Free Cash Flow	3,806	4,878	7,187	7,422

Source: Company Data, PL Research

Key Financial Metrics

Y/e Dec	CY17	CY18	CY19E	CY20E
Per Share(Rs)				
EPS	16.8	19.6	21.8	25.2
CEPS	19.0	21.8	24.5	28.5
BVPS	67.6	80.4	92.7	107.3
FCF	12.8	16.4	24.2	25.0
DPS	4.0	6.9	7.4	8.8
Return Ratio(%)				
RoCE	33.5	32.1	31.3	31.7
ROIC	33.5	36.3	44.5	51.4
RoE	26.6	26.5	25.2	25.2
Balance Sheet				
Net Debt : Equity (x)	(0.3)	(0.3)	(0.5)	(0.5)
Debtor (Days)	50	63	50	50
Valuation(x)				
PER	22.1	18.9	17.0	14.7
P/B	5.5	4.6	4.0	3.5
P/CEPS	19.6	17.0	15.1	13.0
EV/EBITDA	15.2	13.2	11.0	9.0
EV/Sales	2.7	2.2	1.7	1.4
Dividend Yield (%)	1.1	1.9	2.0	2.4

Source: Company Data, PL Research

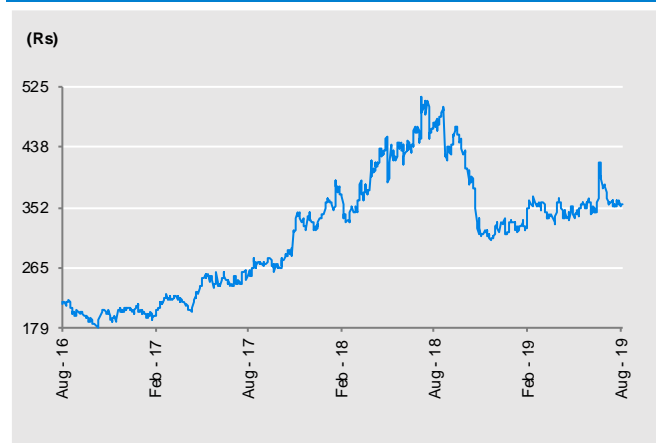
Quarterly Financials (Rs m)

Y/e Dec	Q3CY18	Q4CY18	Q1CY19	Q2CY19
Net Revenue	12,096	12,524	12,640	13,083
YoY gr. (%)	21.8	24.6	20.5	15.1
Raw Material Expenses	8,038	8,476	8,781	8,808
Gross Profit	4,058	4,048	3,859	4,275
Margin (%)	33.5	32.3	30.5	32.7
EBITDA	2,023	1,913	1,887	2,117
YoY gr. (%)	16.7	19.7	16.1	19.4
Margin (%)	16.7	15.3	14.9	16.2
Depreciation / Depletion	159	158	148	205
EBIT	1,864	1,755	1,739	1,912
Margin (%)	15.4	14.0	13.8	14.6
Net Interest	-	-	-	-
Other Income	264	(215)	(42)	99
Profit before Tax	2,128	1,540	1,697	2,011
Margin (%)	17.6	12.3	13.4	15.4
Total Tax	406	306	312	329
Effective tax rate (%)	19.1	19.9	18.4	16.4
Profit after Tax	1,722	1,234	1,385	1,682
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	1,722	1,234	1,385	1,682
YoY gr. (%)	21.3	1.9	3.1	9.6
Margin (%)	14.2	9.9	11.0	12.9
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	1,722	1,234	1,385	1,682
YoY gr. (%)	21.3	1.9	3.1	9.6
Margin (%)	14.2	9.9	11.0	12.9
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	1,722	1,234	1,385	1,682
Avg. Shares O/s (m)	302	302	302	302
EPS (Rs)	5.7	4.1	4.6	5.6

Source: Company Data, PL Research

Price Chart

Recommendation History



No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	4-Jul-19	Hold	339	373
2	17-Jun-19	HOLD	339	345
3	10-Jun-19	Reduce	325	344
4	25-Apr-19	Reduce	325	333
5	5-Apr-19	Reduce	325	360
6	31-Jan-19	Accumulate	384	323
7	7-Jan-19	Accumulate	430	332
8	25-Oct-18	Accumulate	430	351
9	5-Oct-18	Hold	475	409

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Cyient	Hold	500	544
2	HCL Technologies	BUY	1,210	1,023
3	Hexaware Technologies	Hold	339	373
4	Infosys	Accumulate	782	727
5	L&T Technology Services	Accumulate	1,693	1,599
6	Larsen & Toubro Infotech	Accumulate	1,701	1,576
7	Mindtree	Reduce	755	750
8	Mphasis	Accumulate	1,042	930
9	NIIT Technologies	Accumulate	1,445	1,354
10	Persistent Systems	Hold	520	561
11	Redington (India)	BUY	114	107
12	Sonata Software	Accumulate	400	352
13	Tata Consultancy Services	BUY	2,291	2,133
14	TeamLease Services	Hold	3,203	3,079
15	Tech Mahindra	Reduce	610	640
16	Wipro	Reduce	238	260
17	Zensar Technologies	Accumulate	260	217

PL's Recommendation Nomenclature (Absolute Performance)

Buy	: > 15%
Accumulate	: 5% to 15%
Hold	: +5% to -5%
Reduce	: -5% to -15%
Sell	: < -15%
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly



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