

### Direct Biz, Leading Indicators strong; DXC drags revenue growth

- Results were mixed with \$Revenue growth of 2.0% QoQ (DE: 3.7%) due to 17.5% QoQ decline in DXC Revenue (13% of Rev) while Direct Biz continued to perform well with 5.6% QoQ growth. OPM improved by 25bps to 16.4% (DE: 16.2%) led by offshore leverage (up 100bps QoQ).
- The Direct biz commentary and leading indicators remain strong as they plan to invest in Direct Channel to sustain growth, Added Net New TCV of about US\$274mn (71% New-Gen Services) led by continued proactive deal wins; taking TTM TCV growth to 62% YoY at \$1.06Bn. Pipeline is healthy up 49% YoY (LQ:75% YoY) adding to visibility in CY21.
- DXC Rev declined by 18.2% QoQ at \$44mn well below MRC of \$50mn. Mphasis expect revenues can revive over next three quarters else it is safeguarded by profitability provisions that will kick-in in case MRC is breached. It also has renewed its strategic vendor status with DXC and added new \$27mn deal during Q3 that builds visibility beyond Sept'21. We have limited confidence on DXC channel' given volatile past performance and potential Acquisition by Atos that may bring more uncertainty and thus factored in decline of 20% CAGR over FY20-23E.
- Factoring in strong leading indicators for Direct Revenue but weak Visibility of DXC Revenue, we largely maintain our estimates with modest increase of ~1-2% in EPS for FY21E/FY22E/FY23E. We maintain Accumulate view with TP of Rs1720 valued at 20x FY23E EPS of Rs85.8.

### Investments in Direct Channel to Sustain growth

Mphasis is continuing its investment in Direct Channel (*as DXC continues to underperform*) to maintain revenue traction. It has started investments beyond the Tribes & Squad Model in 1) SG&A efforts with increase of 9.5% QoQ & YTD SG&A up by ~16%, 2) Increase in New Client Acquisition program to cover more verticals and sub-verticals 3) Increments and Wage Hike now based on up-skilling and talent. The some of the existing investments have started to show some results with 1) Increase in Large Deal wins in Scope, Size and Tenure (avg large deal size doubled on LTM basis to \$67mn, avg tenure also increased). 2) Developed a repeatable GTM, standardize pitches for deals 3) Continued high share of proactive deals 4) Improvement in Number of Deals and Client metrics highlighted successful client mining efforts.

### Q3FY21 Result (Rs Mn)

Particulars	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)
Revenue	24,743	22,767	8.7	24,354	1.6
Total Expense	20,089	18,498	8.6	19,830	1.3
EBITDA	4,654	4,269	9.0	4,524	2.9
Depreciation	606	574	5.6	600	1.0
EBIT	4,048	3,695	9.6	3,924	3.2
Other Income	366	362	1.1	261	40.2
Interest	148	190	(22.1)	147	0.7
EBT	4,266	3,867	10.3	4,038	5.6
Tax	1,011	929	8.8	1,046	(3.3)
RPAT	3,255	2,938	10.8	2,992	8.8
APAT	3,255	2,938	10.8	2,992	8.8
			(bps)		(bps)
Gross Margin (%)	31.0	30.2	76	30.3	70
EBITDA Margin (%)	18.8	18.8	6	18.6	23
NPM (%)	13.2	12.9	25	12.3	87
Tax Rate (%)	23.7	24.0	(32)	25.9	(220)
EBIT Margin (%)	16.4	16.2	13	16.1	25

CMP	Rs 1,601
Target / Upside	Rs 1,720 / 7%
NIFTY	14,590

### Scrip Details

Equity / FV	Rs 1,866mn / Rs 10
Market Cap	Rs 299bn
	USD 4bn
52-week High/Low	Rs 1,735/ 630
Avg. Volume (no)	414,847
Bloom Code	MPLH IN

Price Performance	1M	3M	12M
Absolute (%)	13	19	80
Rel to NIFTY (%)	5	(4)	59

### Shareholding Pattern

	Jun'20	Sep'20	Dec'20
Promoters	56.2	56.2	56.1
MF/Banks/FIs	14.2	16.2	16.0
FIIIs	23.7	22.1	22.8
Public / Others	6.0	5.5	5.2

### Valuation (x)

	FY21E	FY22E	FY23E
P/E	24.2	20.7	18.7
EV/EBITDA	16.0	14.0	12.5
ROE (%)	20.0	20.8	20.3
RoACE (%)	19.1	19.9	19.6

### Estimates (Rs mn)

	FY21E	FY22E	FY23E
Revenue	97,607	111,524	126,532
EBITDA	18,153	20,445	22,441
PAT	12,358	14,441	16,024
EPS (Rs.)	66.2	77.3	85.8

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**Exhibit 1: Quarterly performance versus estimates**

(Rs mn)	Actual	Estimates		% Variation		Comment
		Dolat	Consensus	Dolat	Consensus	
Revenue (\$ mn)	334	339	343	(1.6)	(2.5)	Revenue miss led by negative surprise in DXC performance with 18.2% QoQ CC decline.
INR Revenue	24,743	25,057	25,042	(1.3)	(1.2)	
EBIT	4,048	4,059	4,066	(0.3)	(0.4)	EBIT miss led by weaker operating leverage.
EBIT, margin	16.4	16.2	16.2	20 bps	10 bps	
PAT	3,255	3,222	3,164	1.0	2.9	PAT beat led by higher Other Income.

Source: Company, DART

**Change in Estimates**

Factoring in the slight miss in Q3 performance but robust TCV additions up ~60% on TTM basis we have upgraded our revenue growth estimates by 1.4/2.5% for in FY22/23E (FY21E growth lowered by 0.4%). We have also scaled up OPM estimates by 28bps/17bps respectively for FY21/FY22E; however, given the sustained reinvestment approach and normalisations of cost in FY23E we have toned down OPM estimates to 15.7%. The growth assumptions factors in revenue deceleration in DXC by ~20% CAGR over FY20-23E, which is negated by robust traction in Direct Channel (expect CAGR of about 18%).

**Exhibit 2: Change in Estimates**

(Rs mn)	FY20	FY21E			FY22E			FY23E		
	Actual	Old	New	% chg	Old	New	% chg	Old	New	% chg
USD Revenue	1,239	1,320	1,315	(0.4)	1,476	1,497	1.4	1,623	1,664	2.5
YoY growth, %	10.9	6.5	6.1	(42)	11.9	13.8	199	9.9	11.1	121
INR Revenue	88,436	98,198	97,607	(0.6)	110,511	111,524	0.9	123,450	126,532	2.5
EBIT	14,189	15,556	15,732	1.1	17,574	17,925	2.0	19,894	19,829	(0.3)
EBIT margins, %	16.0	15.8	16.1	28	15.9	16.1	17	16.1	15.7	(44)
Net profits	11,849	12,160	12,358	1.6	14,074	14,441	2.6	15,966	16,024	0.4
EPS	63.6	65.2	66.2	1.6	75.4	77.4	2.6	85.6	85.8	0.3
YoY growth, %	13.4	2.5	4.1	160	15.7	16.9	112	13.4	11.0	(249)

Source: DART, Company

**Exhibit 3: Key Revenue Assumptions**

Key Assumptions	FY20A	FY21E	FY22E	FY23E
Growth in Revenues (\$ mn)	10.9	6.1	13.8	11.1
Growth in Direct International (\$ mn)	20.5	18.0	18.4	16.1
Growth in DXC channel revenues (\$ mn)	(7.4)	(30.2)	(10.0)	(20.2)
INR/USD rate	71.2	74.1	74.5	76.0

Source: DART, Company

#### Exhibit 4: Quarterly and YTD Revenue Trend

Rs mn	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	YoY (%)	QoQ (%)	YTFY20	YTFY21	YoY (%)
USD Revenue	305	318	320	305	327	334	5.0	2.0	920	966	5.1
INR Revenue	21,581	22,767	23,462	22,882	24,354	24,743	8.7	1.6	64,974	71,979	10.8
Operating Expenses	18,111	19,073	19,630	19,299	20,430	20,695	8.5	1.3	54,616	60,424	10.6
Cost of revenues	15,554	16,761	16,670	16,737	17,444	17,542	7.2	0.6	46,833	51,723	10.4
as % of sales	72.1	73.6	71.1	73.1	71.6	70.9			72.1	71.9	
SG&A expenses	2,557	2,312	2,960	2,562	2,986	3,153	16.7	5.6	7,783	8,701	11.8
as % of sales	11.8	10.2	12.6	11.2	12.3	12.7			16.6	16.8	
<b>EBITDA</b>	<b>4,052</b>	<b>4,269</b>	<b>4,441</b>	<b>4,178</b>	<b>4,524</b>	<b>4,654</b>	<b>9.0</b>	<b>2.9</b>	<b>12,064</b>	<b>13,356</b>	<b>10.7</b>
Depreciation	582	575	609	595	600	606	5.6	1.0	1,706	1,801	5.6
<b>EBIT</b>	<b>3,470</b>	<b>3,694</b>	<b>3,832</b>	<b>3,583</b>	<b>3,924</b>	<b>4,048</b>	<b>9.6</b>	<b>3.2</b>	<b>10,358</b>	<b>11,555</b>	<b>11.6</b>
Other Income	134	172	319	183	114	218	26.7	91.2	648	515	
PBT	3,604	3,866	4,151	3,766	4,038	4,266	10.3	5.6	11,006	12,070	9.7
Total Tax	871	929	618	1,015	1,046	1,011	8.8	(3.3)	2,688	3,072	14.3
<b>PAT</b>	<b>2,733</b>	<b>2,937</b>	<b>3,533</b>	<b>2,751</b>	<b>2,992</b>	<b>3,255</b>	<b>10.8</b>	<b>8.8</b>	<b>8,318</b>	<b>8,998</b>	<b>8.2</b>
<b>Reported EPS</b>	<b>14.7</b>	<b>15.8</b>	<b>19.0</b>	<b>14.7</b>	<b>16.0</b>	<b>17.4</b>	<b>10.6</b>	<b>8.7</b>	<b>44.7</b>	<b>48.2</b>	<b>7.9</b>
<b>Margins (%)</b>							<b>(bps)</b>	<b>(bps)</b>			<b>(bps)</b>
EBIDTA	18.8	18.8	18.9	18.3	18.6	18.8	6	23	18.6	18.6	-1
EBIT	16.1	16.2	16.3	15.7	16.1	16.4	13	25	15.9	16.1	11
EBT	16.7	17.0	17.7	16.5	16.6	17.2	26	66	16.9	16.8	-17
PAT	12.7	12.9	15.1	12.0	12.3	13.2	25	87	12.8	12.5	-30
Effective Tax rate	24.2	24.0	14.9	27.0	25.9	23.7	-32	-220	24.4	25.5	103

Source: DART, Company

#### What to expect next Quarter

We expect sequential growth in revenues of over 4.3% QoQ led by sustained business traction in Direct business and revival in performance in DXC channel towards MSA cut-off of about \$50mn+. We expect slight decline in profitability of about 6bps QoQ given continued investment approach by the company.

#### Exhibit 5: What to expect next Quarter

(Rs Mn)	Q4FY21E	Q3FY21	Q4FY20	QoQ (%)	YoY (%)
USD Revenue	348	334	320	4.3	8.9
INR Revenue	25,628	24,743	23,462	3.6	9.2
EBIT	4,177	4,048	3,832	3.2	9.0
PAT	3,361	3,255	3,533	3.2	(4.9)
EPS (Rs.)	18.0	17.4	19.0	3.2	(5.0)
EBIT Margin (%)	16.3	16.4	16.3	-6 bps	-3 bps

Source: DART, Company

#### Valuation

We believe MPHASIS and other Tier II IT companies would continue to deliver strong revenue momentum over next 3-4 quarters (translating into double digit revenue growth) and thus would sustain current valuations of ~20x-25x which implies 2x to 3x on PEG basis. We currently value MPHASIS at 20x (from 18 times) on FY23E Earnings of Rs. 85.8 (earlier Rs. 85.5) with TP of Rs. 1,720 per share (from Rs. 1,540) and UNCHANGED Rating of **Accumulate**.

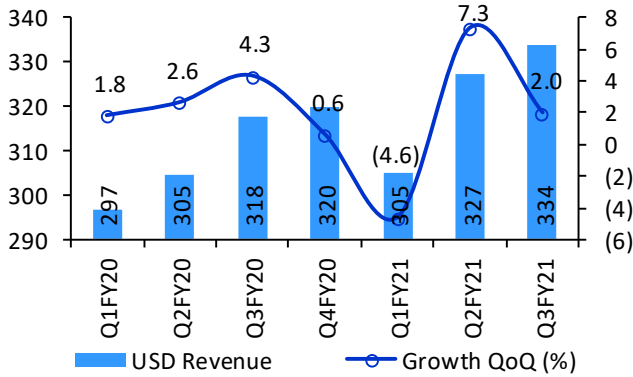
## Key Highlights from Earning Call

- **Revenue:** Revenue grew by 1.6% QoQ on CC basis to \$333.9mn. In USD terms and INR terms, the revenue grew by 2.0% QoQ and 1.6% QoQ, implying 40bps favorable cross currency impact and 40bps impact of Fx and Hedging gains.
- **Operating Margins:** EBIT Margins improved by 25bps to 16.4% (within the guided band of 15.5% - 16.5%). The Cost of Services and General & Administrative Cost increased by 0.6% QoQ and 0.9% QoQ respectively. The SG&A Cost increased by 9.5% QoQ as Mphasis continues its' investments for the Direct Channel (added more headcount for sub-segment in HiTech and also towards new client additions). Mphasis continues to maintain the guidance of margins at 15.5% to 16.5% and expect upward bias on this band in FY22E led by higher offshore leverage. Mphasis expects that some of the cost savings are structural in nature and these are reinvested towards long-term objectives, while other savings on cost that are pandemic related are invested in short-term flexible items, and thus would ensure the margins in narrow band when trend-reverses.
- **DXC (13% of revenues):** Within the DXC Segment, despite the decline in performance in Q3, Mphasis has highlighted that MRC has certain provisions such that if revenue run rate are not met it will be compensated by profitability metric (i.e. it may have limited EBIT impact and only Revenue Impact). Mphasis, has won a new contract worth \$27mn which extends beyond Sept'21 (MRC end date) that adds up to visibility and has also signed agreement to re-affirm itself as a strategic partner that ensures better outcome during vendor consolidation process. We remain negative on DXC biz due to misses in performance w.r.t past commentary and incremental uncertainty due to Atos Bid to buy DXC and have factored decline of about 20% revenue CAGR over FY20-23E.
- **Outlook:** Mphasis remains positive about the outlook in Direct Channel led by 1) Continued investments in business to scale growth, 2) Large Deal Performance improvements (Size, Scope, Tenure) as it added \$100mn/\$200mn deal during the year, 3) Continued Success in Client Mining (increase in count of \$1mn/\$5mn/\$20mn/\$75mn by 4/5/2/1 respectively).
- **Deal Wins / Pipeline:** Mphasis reported Net New TCV in Direct Channel of \$273mn (up 31% YoY). The TTM TCV stood at \$1,067mn (up 6% QoQ and 62% YoY). The New –Gen services TCV stood at \$175mn (up 6.7% YoY). The Pipeline grew by 49% YoY.
- **Vertical Commentary:** BCM grew by ~2.0% QoQ to \$178mn. The traction in BCM vertical is strong with YoY growth at 20% (Mphasis is winning market share in this segment). The Insurance Vertical grew by ~4.0% QoQ in \$ terms. Within Direct Biz, Insurance grew at ~7% QoQ but decline ~1% on YoY basis. Mphasis expects the growth momentum in Insurance Vertical to continue in coming quarters due to recent large deal wins. IT, Comm & Entertainment Vertical grew 11% QoQ in \$ terms to \$43mn. The growth led by ramp-up in recent large deal wins. Within Direct Biz, it grew by 57% QoQ and 67% YoY. Within IT, Comm & Entertainment Biz, Sub-vertical of Hi-Tech (highlighted as strong growth driver by Mphasis with several key sub-segments such as Compute systems, Enterprise software Medical devices, Consumer-tech and Industrial Engg) grew at 47% CAGR for 3 years from Q3FY19 to Q3FY21 on Annualized Revenue basis. (~\$22mn for Hi-Tech Vertical in Q3FY21) The Logistics and Transport Biz grew by 5% QoQ in \$ terms and 8% QoQ in Direct biz.

- **Client Metrics:** The top client declined by ~7% QoQ in INR Terms. The Top 2-5 bucket and Top 6-10 buckets did well with 9.0% and 10.7% QoQ growth in INR Terms. The Non-Top Clients Bucket declined by 2.6% in INR Terms. The Client Metrics Continue to improvement with \$50mn/\$20mn/\$5mn/\$1mn bucket showing improvement of 1 / 1 / 4 / 1 clients respectively in each bucket.
- **Client Requirements:** Mphasis highlighted that it is continuing to see strong demand in Off-shoring by clients. (Off-Shore Revenue Mix on INR basis improved by 100bps). Mphasis also highlighted that Clients are focused on finding the right transformation partners and are looking at more outcome based deals. The value migration from International IT to Indian IT is still on-going.
- **Acquisition:** Mphasis highlighted that Datalytx acquisition (for GBP15mn) has brought strong IT assets Mphasis. Datalytx is one of the largest UK partner for Snowflake and works around Data engineering and Data modernization on snowflake. It has brought sub-100 employees in Mphasis. The acquisition is still in early phase of integration and Mphasis plans to expand their offers to Mphasis clients.

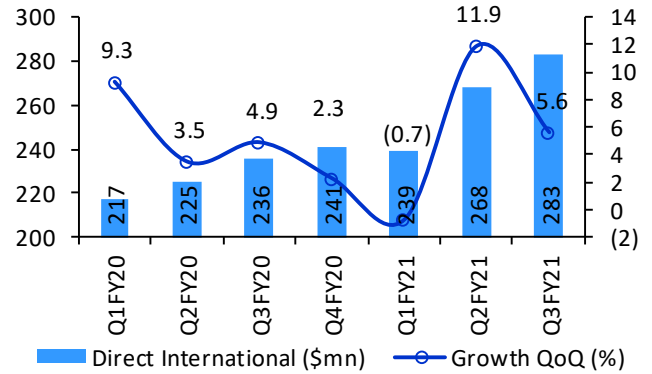
## Story in charts

**Exhibit 6: Revenue grew by 2.0% QoQ in USD Terms**



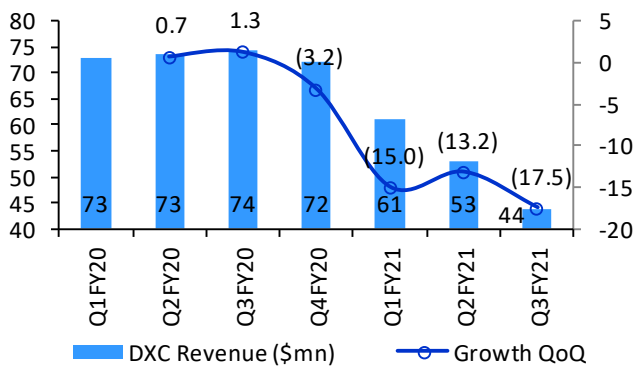
Source: DART, Company

**Exhibit 7: Direct Biz grew at 5.6% QoQ in USD Terms**



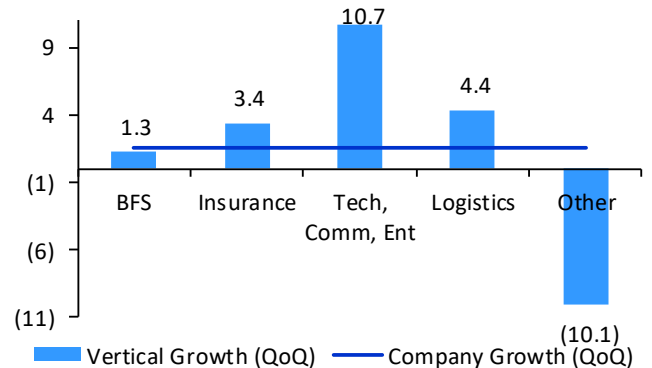
Source: DART, Company

**Exhibit 8: DXC Biz continues to decline with 17.5% QoQ decline in USD Terms**



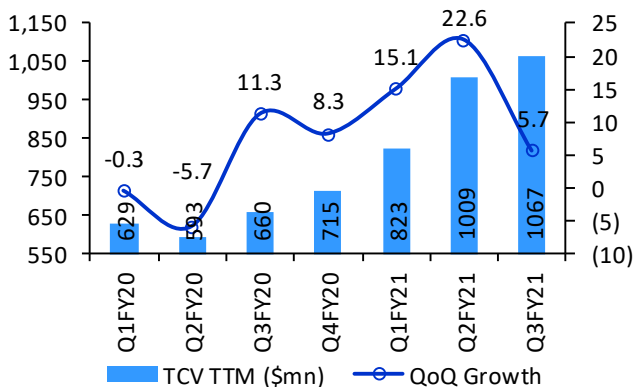
Source: DART, Company

**Exhibit 9: Hi-Tech sub-vertical within Tech, Com, Entertainment led the growth in Mphasis**



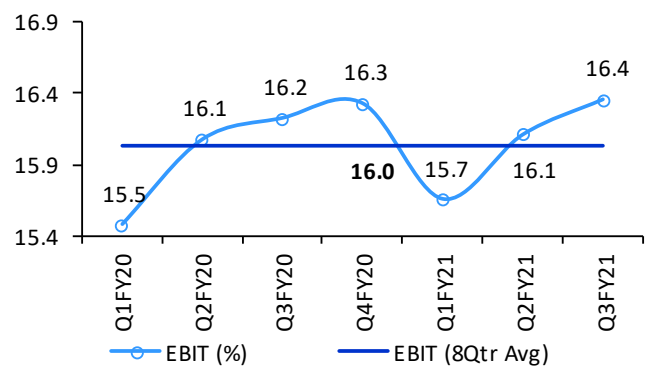
Source: DART, Company

**Exhibit 10: TCV TTM remains strong with \$1.06Bn with QoQ growth of 6%.**



Source: DART, Company

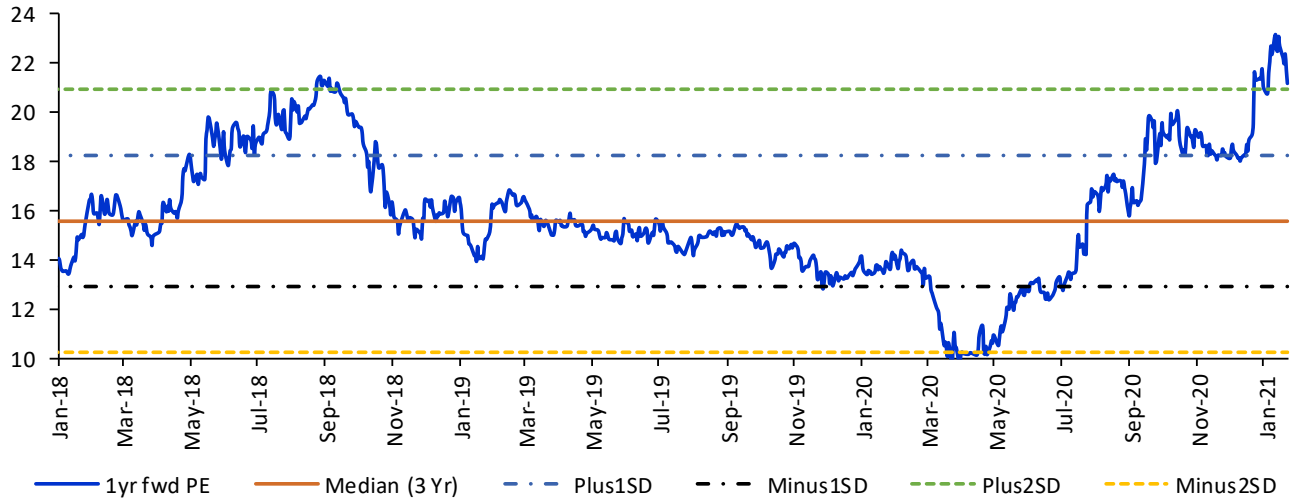
**Exhibit 11: OPM improved by 25bps to 16.4% despite SG&A investments and lower operating leverage.**



Source: DART, Company

## PER Band Chart

**Exhibit 12: Mphasis is trading slightly above Median +2SD with PER of ~21.2x**



Source: DART, Company



**Profit and Loss Account**

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>88,436</b>	<b>97,607</b>	<b>111,524</b>	<b>126,532</b>
<b>Total Expense</b>	<b>71,931</b>	<b>79,453</b>	<b>91,079</b>	<b>104,091</b>
COGS	61,188	67,498	76,916	87,767
Employees Cost	0	0	0	0
Other expenses	10,743	11,956	14,164	16,325
<b>EBIDTA</b>	<b>16,505</b>	<b>18,153</b>	<b>20,445</b>	<b>22,441</b>
Depreciation	2,315	2,421	2,520	2,612
<b>EBIT</b>	<b>14,190</b>	<b>15,732</b>	<b>17,925</b>	<b>19,829</b>
Interest	813	638	602	630
Other Income	1,780	1,380	1,805	2,025
Exc. / E.O. items	0	0	0	0
<b>EBT</b>	<b>15,157</b>	<b>16,474</b>	<b>19,128</b>	<b>21,224</b>
Tax	3,306	4,116	4,686	5,200
RPAT	11,851	12,358	14,441	16,024
Minority Interest	0	0	0	0
<b>Profit/Loss share of associates</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>APAT</b>	<b>11,851</b>	<b>12,358</b>	<b>14,441</b>	<b>16,024</b>

**Balance Sheet**

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
<b>Sources of Funds</b>				
Equity Capital	1,865	1,866	1,867	1,868
Minority Interest	0	0	0	0
Reserves & Surplus	56,431	63,189	72,029	82,447
<b>Net Worth</b>	<b>58,296</b>	<b>65,056</b>	<b>73,896</b>	<b>84,316</b>
Total Debt	5,713	5,513	5,313	5,113
Net Deferred Tax Liability	567	623	686	754
<b>Total Capital Employed</b>	<b>64,575</b>	<b>71,192</b>	<b>79,895</b>	<b>90,183</b>

**Applications of Funds**

Net Block	<b>30,228</b>	<b>29,292</b>	<b>28,367</b>	<b>27,540</b>
CWIP	74	74	74	74
Investments	13,257	16,080	19,559	23,540
<b>Current Assets, Loans &amp; Advances</b>	<b>43,976</b>	<b>49,506</b>	<b>56,851</b>	<b>65,841</b>
Inventories	0	0	0	0
Receivables	17,696	21,157	24,174	27,427
Cash and Bank Balances	11,257	13,012	16,951	22,288
Loans and Advances	0	0	0	0
Other Current Assets	15,024	15,337	15,725	16,126
<b>Less: Current Liabilities &amp; Provisions</b>	<b>22,959</b>	<b>23,760</b>	<b>24,956</b>	<b>26,812</b>
Payables	6,667	7,050	7,800	9,188
Other Current Liabilities	16,293	16,710	17,156	17,624
	<i>sub total</i>			
Net Current Assets	21,017	25,746	31,895	39,028
<b>Total Assets</b>	<b>64,575</b>	<b>71,192</b>	<b>79,895</b>	<b>90,183</b>

E – Estimates



**Important Ratios**

Particulars	FY20A	FY21E	FY22E	FY23E
<b>(A) Margins (%)</b>				
Gross Profit Margin	30.8	30.8	31.0	30.6
EBIDTA Margin	18.7	18.6	18.3	17.7
EBIT Margin	16.0	16.1	16.1	15.7
Tax rate	21.8	25.0	24.5	24.5
Net Profit Margin	13.4	12.7	12.9	12.7
<b>(B) As Percentage of Net Sales (%)</b>				
COGS	69.2	69.2	69.0	69.4
Employee	0.0	0.0	0.0	0.0
Other	12.1	12.2	12.7	12.9
<b>(C) Measure of Financial Status</b>				
Gross Debt / Equity	0.1	0.1	0.1	0.1
Interest Coverage	17.5	24.7	29.8	31.5
Inventory days	0	0	0	0
Debtors days	73	79	79	79
Average Cost of Debt	14.6	11.4	11.1	12.1
Payable days	28	26	26	27
Working Capital days	87	96	104	113
FA T/O	2.9	3.3	3.9	4.6
<b>(D) Measures of Investment</b>				
AEPS (Rs)	63.5	66.2	77.3	85.8
CEPS (Rs)	75.9	79.2	90.8	99.7
DPS (Rs)	25.0	25.0	25.0	25.0
Dividend Payout (%)	39.4	37.8	32.3	29.2
BVPS (Rs)	312.5	348.6	395.7	451.3
RoANW (%)	21.4	20.0	20.8	20.3
RoACE (%)	20.4	19.1	19.9	19.6
RoAIC (%)	26.7	28.2	29.6	30.3
<b>(E) Valuation Ratios</b>				
CMP (Rs)	1601	1601	1601	1601
P/E	25.2	24.2	20.7	18.7
Mcap (Rs Mn)	298,590	298,590	298,590	298,590
MCap/ Sales	3.4	3.1	2.7	2.4
EV	293,046	291,090	286,952	281,414
EV/Sales	3.3	3.0	2.6	2.2
EV/EBITDA	17.8	16.0	14.0	12.5
P/BV	5.1	4.6	4.0	3.5
Dividend Yield (%)	1.6	1.6	1.6	1.6
<b>(F) Growth Rate (%)</b>				
Revenue	14.4	10.4	14.3	13.5
EBITDA	24.7	10.0	12.6	9.8
EBIT	13.7	10.9	13.9	10.6
PBT	7.7	8.7	16.1	11.0
APAT	10.4	4.3	16.9	11.0
EPS	10.2	4.2	16.8	10.9

**Cash Flow**

(Rs Mn)	FY20A	FY21E	FY22E	FY23E
CFO	13,210	10,876	13,357	15,256
CFI	1,408	(3,570)	(3,874)	(4,375)
CFF	(8,238)	(5,551)	(5,544)	(5,544)
FCFF	11,967	9,391	11,762	13,471
Opening Cash	3,520	11,257	13,012	16,951
Closing Cash	9,901	13,012	16,951	22,288

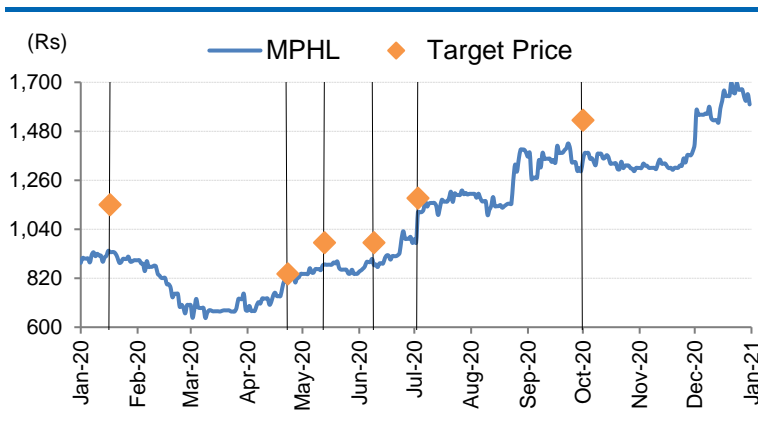
E – Estimates

### DART RATING MATRIX

Total Return Expectation (12 Months)

<b>Buy</b>	<b>&gt; 20%</b>
<b>Accumulate</b>	<b>10 to 20%</b>
<b>Reduce</b>	<b>0 to 10%</b>
<b>Sell</b>	<b>&lt; 0%</b>

### Rating and Target Price History



Month	Rating	TP (Rs.)	Price (Rs.)
Feb-20	Buy	1,150	937
May-20	Buy	840	803
Jun-20	Accumulate	980	882
Jun-20	Accumulate	980	879
Jul-20	Accumulate	1,180	1,117
Oct-20	Accumulate	1,530	1,350

\*Price as on recommendation date

### DART Team

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