

# SUPRAJIT ENGINEERING

## Growth story intact

India Equity Research | Automobiles

We reiterate 'BUY' on Suprajit Engineering (SEL) with a revised target multiple of 20x (earlier 15x; close to historical peak, but at 20% discount to Motherson's domestic business) and raise our FY22E EPS 8%. The revision factors in tailwinds including: 1) Order book postponement in export automotive cables (delayed model launches) can lead to sharp revenue surge in FY22/23. 2) Market share gain in Wescon driven by competitors' weakness as well as SEL's ability to ramp up production. 3) Success of the *survival of the fittest* strategy in Phoenix. As a No. 3 player, SEL has leveraged its low-cost manufacturing to convert the top-2 players from competition to customers; Osram is a case in point. Besides, a vast replacement market (~28-32bn lamps) versus SEL's capacity (~110mn) provides huge addressable market.

### Resilient performance by subsidiaries

SEL's consolidated revenue contracted ~51% YoY (INR1.8bn). Weakness in the domestic market (revenue declined ~65%) was offset by relatively resilient performance of Wescon (revenue decline of 24% YoY) and Phoenix (18%)—both of which managed to gain market share. Consolidated gross margin improved 310bps QoQ (to 44.4%) as a result of improved product mix, benign commodity prices and cost cutting efforts by SEL.

### Profitable market share to drive growth

Across each of the businesses we are enthused by SEL's focus on gaining profitable market share. Using its low cost of operations as well as value-oriented product proposition, the company continues to deepen penetration among existing customers even as new order wins sustain (made entry in China market in Q1FY21).

### Outlook and valuation: Story intact; maintain 'BUY'

For FY20–22, we estimate consolidated EPS CAGR of ~10%. Despite near-term weakness, we believe the franchise remains robust and well placed to leverage on revival. We maintain 'BUY/SO' with TP of INR219, valuing it at 20x March 2022E EPS. The stock is trading at a FY21/22 PER of 26.2x/16.5x.

#### EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

#### MARKET DATA (R: SUPE.BO, B: SEL IN)

CMP	: INR 183
Target Price	: INR 219
52-week range (INR)	: 220 / 99
Share in issue (mn)	: 139.9
M cap (INR bn/USD mn)	: 25 / 337
Avg. Daily Vol. BSE/NSE ('000)	: 74.1

#### SHARE HOLDING PATTERN (%)

	Current	Q4FY20	Q3FY20
Promoters *	44.6	44.6	44.6
MF's, FI's & BKs	13.1	9.2	6.8
FII's	2.9	8.1	11.3
Others	39.4	38.1	37.3
* Promoters pledged shares (% of share in issue)	:		NIL

#### PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	3.2	(0.7)	(3.9)
3 months	14.2	23.8	9.7
12 months	1.3	(8.8)	(10.1)

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#### Financials

(INR mn)

Year to March	Q1FY21	Q1FY20	% Chg	Q4FY20	% Chg	FY20	FY21E	FY22E
Net revenues	1,775	3,634	(51.2)	3,890	(54.4)	15,628	13,738	16,469
EBITDA	(48)	513	NA	549	NA	2,188	1,719	2,409
Adjusted Profit	(145)	248	NA	304	NA	1,265	966	1,529
Adjusted Diluted EPS	(1.0)	1.8	NA	2.2	NA	9.0	6.9	10.9
Diluted P/E (x)						20.0	26.2	16.5
EV/EBITDA (x)						11.5	14.1	9.7
ROACE (%)						16.3	13.0	18.9

### Q1FY21 conference call: Key highlights

#### Highlights

- Re-iterate the target that Group will continue outperforming domestic auto market
- Across group (not just in India) – July/August have seen a good order ramp up. Because of product mix – August revenues should be in line with last year. So far, order book for September looks very optimistic (almost similar to last year's). Aftermarket is doing very well.
- OEMs are coming back to normalcy, although not entirely there yet
- Exports (auto and non-auto) are also seeing good traction. In the Export cables business, seeing some postponement in order book. Due to COVID 19, OEMs have delayed certain new launches. Company believes these orders can however come back sharply in FY22/23
- Ex of any resurgence in covid-19 cases, expect Q2 to be stronger.
- Three primary areas of focus in Q1FY21:
  1. Addressed fixed costs by way of temporary measures (like salary cuts, which will be restored once normalcy sets in) and more permanent ones (headcount cut of about 8-10%). Also evaluating overheads to find avenues of permanent savings.
  2. Cash collection across each level (debtors, OEMs, tier 1/2 suppliers etc)
  3. Ramping up production at not just SEL, but for the entire vendor business
- **Cable business**
  1. Month of July/August are very robust.
  2. Clients have also ramped up quickly
  3. Won couple of huge orders from VW in North America and Europe for new platforms being launched in 2021/22. Also, won order from Ford for their EV. With EVs - there is potential to increase cable content, as chargers require an additional cable.
- **Inventory** – Don't have meaningful inventory lying with company, as they don't build to stock.
- No new business development with MSIL.
- Cable wallet share (direct + indirect) - 70% with 2Ws and 30% with 4Ws.
- **Narasapuram plant** – Was set up to deliver products for Honda 2Ws. Before Narasapuram, SEL was supplying to Honda from an old plant. So, there is no new new business at Narasapuram. Idea is to be located closer to Honda and take advantage of the same. SEL's share with Honda is currently at 55-60%.
- No major capex for this or next year. Expect capex in both years to largely be maintenance capex (~2% of revenues).
- **Inorganic opportunities** – No major updates at the moment.

**Wescon/SENA**

- Over a long term (3-5 years), SEL is very optimistic about this business.
- Strategy here is to gain market share from competition. However right now, difficult to make business pitches for additional business as OEMs themselves are struggling to revive business, manage supplies and ramp up production.
- In Q1FY21, overall market weakness persisted, but SEL continued to improve efficiency and focused on restructuring efforts
- Financial troubles of one SEL's competitors worked in SEL's favour. SEL gained some market share and also won new orders. Orders were serviced from Unit 9 in Bangalore and Wichita plant in USA. Of this, some of the new business may remain with SEL, but unlikely they will retain all the new business in the near term.
- In SENA – trying to wean customers off from some of the weaker competitors
- SEL believes that there is good headroom for growth in WESCON/SENA, primarily because, some competitors are weak. Also, SEL expects its 3 plant strategy to bear results over the course of next few years. Currently, the strategy of manufacturing and supplying form plants in Mexico and India (lower cost of operations) is working well.
- Received a PPP loan of about \$2.2mn for paycheck support. In UK (less than £100k) and Luxemburg (less than €50k) it was not meaningful. So far, this grant is accounted for as a loan, not adjusted in P&L.

**Phoenix Lamps (PHLL + Trifa + Luxlite)**

- SEL is the third largest company for halogen lamps from a manufacturing capacity stand point. OSRAM and Lumilite are the leaders, with DH Lighting (Korean) coming in fourth. Osram and Lumilite have capacities of ~200mn lamps each versus 110mn for SEL.
- SEL believes that there is a vast addressable replacement market for halogen lamps. Over the past 8-10 years, global vehicle parc would be at ~700-800mn vehicles with 4 lamps each. This brings the addressable replacement market size to 2,800-3,200mn lamps.
- Over a long run, LED could be a potential threat
- Plant in Chennai is fully loaded and seeing good sales here. From August, got into second shift in the PLD division, and now planning to add a third shift as demand remains robust
- SEL has been consolidating business and expects to see increased market share and higher utilisation. Company has used its lower cost of operations as an advantage and converted a few competitors (who had a much higher cost of operations) in to customers (Osram for example). Winning in this business is survival of the fittest. SEL believes they offer a strong value proposition to continue winning in this segment.
- Looking to supply into China, USA and Russia (made initial moves), which will help increase opportunity size. Entered the Chinese market via a tier 1 supplier. In China, some competitors have a weak balance sheet (due to COVID) and so there is opportunity for organic as well as inorganic growth
- At the moment there is no plan to get into USA and Europe OEMs, will continue with aftermarket as opportunity is vast

- Triffa and Luxlite
  1. Warehouse consolidation is now done and dusted.
  2. South American markets (Brazil specifically) has been significantly impacted

### **Gross margin improvement and other expenses**

- Better product mix (higher aftermarket, exports)
- RM cost fall has been modest
- Cost reduction efforts by SEL
- That said, seeing an inflationary trend in commodity prices globally.
- Other expenses – Should have a one off of ~\$60k, due to a one time impairment.

## Financial snapshot

(INR mn)

Year to March	Q1FY21	Q1FY20	% change	Q4FY20	% change	FY20	FY21E	FY22E
Net revenues	1,775	3,634	(51.2)	3,890	(54.4)	15,628	13,738	16,469
Raw material costs	987	2,073	(52.4)	2,283	(56.8)	9,151	7,956	9,567
Staff costs	596	720	(17.2)	712	(16.3)	2,926	2,725	3,021
Other expenses	241	329	(26.8)	347	(30.6)	1,364	1,338	1,471
EBITDA	(48)	513	NA	549	NA	2,188	1,719	2,409
Depreciation	138	128	7.3	145	(4.8)	581	524	538
EBIT	(186)	385	NA	405	NA	1,606	1,196	1,871
Interest	55	66	(16.0)	57	(3.8)	227	210	224
Other income	58	61	(6.0)	42	36.4	224	305	396
Add: Exceptional items				(274)	(100.0)	(274)		
Profit before tax	(183)	380	NA	390	NA	1,329	1,290	2,043
Provision for taxes	(38)	132	NA	86	NA	289	325	514
Minority interest								
Reported net profit	(145)	248	NA	30	NA	1,040	966	1,529
Adjusted Profit	(145)	248	NA	304	NA	1,265	966	1,529
Diluted shares (mn)	140	140		140		140	140	140
Adjusted Diluted EPS	(1.0)	1.8	NA	2.2	NA	9.0	6.9	10.9
Diluted P/E (x)	-	-		-		20.0	26.2	16.5
EV/EBITDA (x)	-	-		-		11.5	14.1	9.7
ROACE (%)	-	-		-		16.3	13.0	18.9

## As % of net revenues

Raw material	55.6	57.0		58.7		58.6	57.9	58.1
Employee cost	33.6	19.8		18.3		18.7	19.8	18.3
Other expenses	13.6	9.0		8.9		8.7	9.7	8.9
EBITDA	(2.7)	14.1		14.1		14.0	12.5	14.6
Adjusted net profit	(8.2)	6.8		7.8		8.1	7.0	9.3
Reported net profit	(8.2)	6.8		0.8		6.7	7.0	9.3
Tax rate	20.8	34.7		22.0		18.0	25.2	25.2

## Change in Estimates

	FY21E			FY22E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	13,738	13,573	1.2	16,469	15,929	3.4	
EBITDA	1,719	1,702	1.0	2,409	2,258	6.7	
EBITDA Margin	12.5	12.5		14.6	14.2		
Adjusted Profit	966	953	1.4	1,529	1,416	8.0	
After Tax							
Net Profit Margin	7.0	7.0		9.3	8.9		
Capex	500	500	0.0	500	500	0.0	

### Company Description

The Suprajit Group (SEL) comprises Suprajit Engineering, Suprajit Automotive, Suprajit Europe and Phoenix Lamps. Incorporated in 1985, it is India's largest automotive cable maker with an annual cable capacity of 250mn. Through acquisition of Phoenix Lamps, the company has also entered automotive lighting. The company's customer list includes most Indian automotive majors. It also exports to many marquee global customers.

### Investment Theme

SEL has clocked a robust (>20%) revenue/APAT CAGR over FY08-18, further complemented by best-in-class RoCE (>30%). This has been driven by customer diversification, prudent cost control, market share gains and high capital efficiency. The company's strategy to diversify its customer base and geography has been key catalyst for the above industry growth over the past decade. The replacement market holds immense potential.

While the domestic demand environment remains challenging, SEL is banking on exports and Wescon (post restructuring) to drive growth. We continue to like SEL for its focus on 1) expanding the product offering – drop-in-solution for LED lamps, power sports and agri - machinery cables and expanding into mechanism as an extension to its cables and 2) strong traction in exports among European OEMs as reflected from upward revision in cable capacity expansion. However, post the run up in stock price, we see limited upside potential. Our HOLD rating largely reflects our concerns on near term demand and valuations rather than business.

### Key Risks

Slowdown in demand: SEL derives ~90% revenue from OEMs. Hence, any slowdown in the overall industry can impact the company's revenue. Similarly, slowdown in demand in US/Europe can impact SEL's revenue.

Commodity risk: Steel is a major raw material for SEL which is sourced locally as well as from China. While any steep changes in input costs are passed on to domestic OEMs (with a lag), the arrangement in exports markets are different with risk largely borne by SEL.

Currency risk: SEL derives ~17% revenue from exports (of which ~7% revenue is billed in INR). Also, it imports ~10% of revenue and thus has a natural hedge. With exports becoming a key growth driver, we believe it will lose the natural hedge, exposing the company to currency risks.

## Key Assumptions

Year to March	FY19	FY20	FY21E	FY22E
<b>Macro</b>				
GDP(Y-o-Y %)	6.1	4.8	(4.0)	7.0
Inflation (Avg)	3.4	4.3	3.5	4.0
Repo rate (exit rate)	6.3	4.4	3.0	4.0
USD/INR (Avg)	70.0	70.7	75.0	73.0
<b>Sector</b>				
4W - domestic vol (% YoY)	2.0	(18.0)	(15.0)	18.0
2W - domestic vol (% YoY)	7.7	(17.0)	(14.0)	15.0
<b>Company</b>				
4W	7.0	(31.9)	(14.0)	22.0
2W	12.0	(30.7)	(15.0)	22.0
Aftermarket - Revenue assumptions	12	105	(8)	25
Non-Auto	-	379.6	(11.0)	14.0
Export - Revenue assumptions	15	15	15	15
Avg. Interest rate (%)	8.2	7.0	9.8	10.5
Depreciation rate (%)	8.0	9.1	7.6	7.3
Tax rate (%)	34.8	18.0	25.2	25.2
Dividend payout (%)	16.2	19.3	20.7	18.4
Capex (INR mn)	590	1,063	500	500
Net borrowings (INR mn)	819	(158)	(1,057)	(2,029)
Debtor days	67	66	68	56
Inventory days	88	95	92	68
Payable days	71	78	78	51
Cash conversion cycle	83	84	82	73

## Income statement

(INR mn)

Year to March	FY19	FY20	FY21E	FY22E
Income from operations	15,899	15,628	13,738	16,469
Materials costs	9,148	9,151	7,956	9,567
Manufacturing expenses	1,386	1,364	1,338	1,471
Employee costs	3,037	2,926	2,725	3,021
Total operating expenses	13,571	13,441	12,019	14,059
EBITDA	2,328	2,188	1,719	2,409
Depreciation	410	581	524	538
EBIT	1,918	1,606	1,196	1,871
Less: Interest Expense	246	227	210	224
Add: Other income	379.95	223.84	304.85	396.3
Profit Before Tax	2,052	1,329	1,290	2,043
Less: Provision for Tax	714	289	325	514
Add: Exceptional items	-	(274)	-	-
Reported Profit	1,338	1,040	966	1,529
Exceptional Items	-	(225)	-	-
Adjusted Profit	1,338	1,265	966	1,529
Shares o /s (mn)	140	140	140	140
Adjusted Basic EPS	9.6	9.0	6.9	10.9
Diluted shares o/s (mn)	140	140	140	140
Adjusted Diluted EPS	9.6	9.0	6.9	10.9
Adjusted Cash EPS	12.5	13.2	10.6	14.8
Dividend per share (DPS)	1.6	1.8	1.4	2.0
Dividend Payout Ratio(%)	19.0	22.6	24.3	21.5

## Common size metrics

Year to March	FY19	FY20	FY21E	FY22E
Materials costs	57.5	58.6	57.9	58.1
Staff costs	19.1	18.7	19.8	18.3
S G & A expenses	8.7	8.7	9.7	8.9
Operating expenses	85.4	86.0	87.5	85.4
Depreciation	2.6	3.7	3.8	3.3
Interest Expense	1.5	1.4	1.5	1.4
EBITDA margins	14.6	14.0	12.5	14.6
Net Profit margins	8.4	8.1	7.0	9.3

## Growth ratios (%)

Year to March	FY19	FY20	FY21E	FY22E
Revenues	11.1	(1.7)	(12.1)	19.9
EBITDA	(1.6)	(6.0)	(21.4)	40.1
PBT	6.1	(35.2)	(2.9)	58.3
Adjusted Profit	(3.4)	(5.4)	(23.7)	58.3
EPS	(3.4)	(5.4)	(23.7)	58.3

# Automobiles

Balance sheet		(INR mn)			
As on 31st March	FY19	FY20	FY21E	FY22E	
Share capital	140	140	140	140	
Reserves & Surplus	7,611	8,398	9,129	10,330	
Shareholders' funds	7,751	8,538	9,269	10,469	
Long term borrowings	974	719	351	351	
Short term borrowings	2,008	2,497	1,794	1,794	
Total Borrowings	2,981	3,216	2,144	2,144	
Def. Tax Liability (net)	635	563	563	563	
<b>Sources of funds</b>	<b>11,367</b>	<b>12,317</b>	<b>11,976</b>	<b>13,176</b>	
Gross Block	5,152	6,378	6,878	7,378	
Net Block	4,115	4,760	4,736	4,698	
Capital work in progress	272	152	152	152	
Intangible Assets	1,418	1,375	1,375	1,375	
Total Fixed Assets	5,805	6,286	6,262	6,224	
Cash and Equivalents	2,162	3,375	3,201	4,174	
Inventories	2,710	2,762	1,920	2,211	
Sundry Debtors	2,916	2,750	2,334	2,707	
Loans & Advances	52	65	452	451	
Other Current Assets	827	568	266	266	
Current Assets (ex cash)	6,505	6,144	4,970	5,635	
Trade payable	1,751	2,140	1,242	1,444	
Other Current Liab	1,354	1,348	1,216	1,413	
Total Current Liab	3,106	3,489	2,458	2,856	
Net Curr Assets-ex cash	3,400	2,656	2,512	2,778	
<b>Uses of funds</b>	<b>11,367</b>	<b>12,317</b>	<b>11,976</b>	<b>13,176</b>	
BVPS (INR)	55.4	61.0	66.3	74.9	

Free cash flow		(INR mn)			
Year to March	FY19	FY20	FY21E	FY22E	
Reported Profit	1,338	1,040	966	1,529	
Add: Depreciation	410	581	524	538	
Interest (Net of Tax)	160	186	157	168	
Others	130	(231)	(252)	(340)	
Less: Changes in WC	590	(744)	(143)	266	
Operating cash flow	1,448	2,320	1,538	1,629	
Less: Capex	590	1,063	500	500	
<b>Free Cash Flow</b>	<b>858</b>	<b>1,258</b>	<b>1,038</b>	<b>1,129</b>	

Cash flow metrics				
Year to March	FY19	FY20	FY21E	FY22E
Operating cash flow	1,448	2,320	1,538	1,629
Financing cash flow	(418)	(607)	(1,516)	(553)
Investing cash flow	(890)	(1,565)	(345)	(254)
Net cash Flow	140	148	(323)	822
Capex	(590)	(1,063)	(500)	(500)
Dividend paid	336	631	234	328

Profitability and efficiency ratios				
Year to March	FY19	FY20	FY21E	FY22E
ROAE (%)	18.7	12.8	10.8	15.5
ROACE (%)	22.9	16.3	13.0	18.9
Inventory Days	88	95	92	68
Debtors Days	67	66	68	56
Payable Days	71	78	78	51
Cash Conversion Cycle	83	84	82	73
Current Ratio	2.8	2.7	3.3	3.4
Gross Debt/EBITDA	1.3	1.5	1.2	0.9
Gross Debt/Equity	0.4	0.4	0.2	0.2
Adjusted Debt/Equity	0.4	0.4	0.2	0.2
Net Debt/Equity	0.1	-	(0.1)	(0.2)
Interest Coverage Ratio	7.8	7.1	5.7	8.3

Operating ratios				
Year to March	FY19	FY20	FY21E	FY22E
Total Asset Turnover	1.5	1.3	1.1	1.3
Fixed Asset Turnover	2.9	2.7	2.2	2.7
Equity Turnover	2.2	1.9	1.5	1.7

Valuation parameters				
Year to March	FY19	FY20	FY21E	FY22E
Adj. Diluted EPS (INR)	9.6	9.0	6.9	10.9
Y-o-Y growth (%)	(3.4)	(5.4)	(23.7)	58.3
Adjusted Cash EPS (INR)	12.5	11.6	10.6	14.8
Diluted P/E (x)	18.9	20.0	26.2	16.5
P/B (x)	3.3	3.0	2.7	2.4
EV / Sales (x)	1.6	1.6	1.8	1.4
EV / EBITDA (x)	11.2	11.5	14.1	9.7
Dividend Yield (%)	0.9	1.0	0.8	1.1

## Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Suprajit Engineering	337	26.2	16.5	14.1	9.7	10.8	15.5
Amara Raja Batteries	1,685	23.7	17.9	11.9	9.5	13.0	15.0
Exide Industries	1,936	26.8	18.2	12.5	9.6	7.6	10.5
Motherson Sumi Systems	4,969	39.4	16.1	10.4	6.1	7.6	17.0
Median	1,811	26.5	17.2	12.2	9.5	9.2	15.2
AVERAGE	2,232	29.0	17.2	12.2	8.7	9.8	14.5

Source: Edelweiss research



## Additional Data

### Directors Data

Mr K Ajith Kumar Rai	Chairman & MD	Mr Diwakar S Shetty	Non-Executive Independent Director
Mr Ian Williamson	Non-Executive Independent Director	Mr B S Patil	Non-Executive Independent Director
Mr M Jayarama Shetty	Non-Executive Independent Director	Mohan Srinivasan Nagamangala	Executive Director
Suresh Shetty	Non-Executive Independent Director	Supriya Rai	Non-Executive Director
Mrs. Bharti Rao	Additional Independent Director	Mr. M. Lakshminarayan	Additional Independent Director
Akhilesh Rai	Whole-time Director	Harish Hassan Visweswara	Independent Director

Auditors - S.R. Batliboi & Associates LLP

*\*as per last available data*

### Holding – Top10

	Perc. Holding		Perc. Holding
HDFC AM	5.45	Bajaj Allianz	1.45
First State	5.29	Emerging Securities	1.36
DSP IM	4.62	Mitsubishi UFJ	1.04
Sundaram-Clayton	4.13	Malabar India	1.00
TVS Motor	2.07	Dimensional Fund	0.42

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
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No Data Available

*\*as per last available data*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
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No Data Available

*\*as per last available data*

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

Ashok Leyland, Amara Raja Batteries, Bajaj Auto, Ceat Ltd, Eicher Motors, Exide Industries, Hero MotoCorp, Minda Corporation, Mahindra & Mahindra Ltd, Maruti Suzuki India Ltd, Motherson Sumi Systems, Suprajit Engineering, Tata Motors Ltd

### Recent Research

Date	Company	Title	Price (INR)	Recos
21-Aug-20	<b>Motherson Sumi Systems</b>	Looking beyond FY21; Post Conference Notes	118	Buy
21-Aug-20	<b>Bajaj Auto</b>	Balanced risk-reward; Post Conference Notes	3,053	Hold
19-Aug-20	<b>Maruti Suzuki</b>	Product cyclicality could weigh on market share; Post Conference Notes	6,990	Hold

### Distribution of Ratings / Market Cap

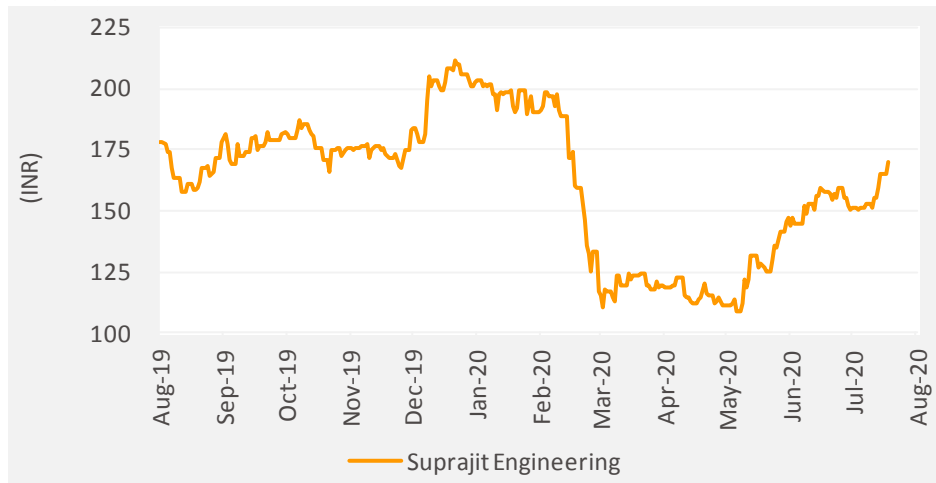
Edelweiss Research Coverage Universe

	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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