

## Strong growth outlook backed by execution...

Q4 revenues grew 28.7% YoY to ₹ 1788 crore (I-direct estimate: ₹ 1743 crore). Generic segment grew 24.8% YoY to ₹ 917 crore. Custom synthesis grew 25.5% YoY to ₹ 715 crore. Carotenoids grew 83.5% YoY to ₹ 156 crore. EBITDA margins expanded 807 bps YoY to 40.1% (I-direct estimates: 39.0%) due to better gross margin performance (up 458 bps YoY to 67.5%) and lower other expenditure. EBITDA grew 61.2% YoY to ₹ 716 crore (I-direct estimate: ₹ 680 crore). PAT grew 29.3% YoY to ₹ 502 crore (I-direct estimate: ₹ 472 crore) in-line with strong operational performance.

### Established CRAMS player

The custom synthesis (CS) business (40% of FY21 revenues) is a margin accretive one but at times lumpy as it depends on offtake from customers (global top 20 big pharma). However, this business showed good recovery on account of an improved business environment. Strong R&D capabilities and India cost arbitrage along with IP adherence are some legacy strengths, which will drive incremental assignments from MNCs. We expect CS to grow at a CAGR of 22.5% to ₹ 4208 crore in FY21-23E.

### Legacy strength, scalability likely to propel generics growth

Divi's remains committed to a few research driven niche opportunities as was the case when it started commercial operations. Two generics, Naproxen (pain management) and Dextromethorphan (cough suppressant) account for ~26% of overall revenues. Divi's enjoys ~70% global market share in these two products. Besides these two, the company has been meticulously building capacities in few more niche APIs as per the evolving demand scenario in the backdrop of 'China plus one' opportunities. It is also increasing its presence in another niche area of carotenoids after acquiring requisite capabilities. Recent supply constraints from China are likely to propel growth in this segment. With focus on brownfield expansion, the management is committed to addressing capacity constraints. We expect sales from generics to grow at ~21% CAGR to ₹ 6062 crore in FY21-23E.

### Valuations & Outlook

Q4 topline was in line with I-direct estimates whereas profitability was higher than expected amid better gross margin performance. More than strong quarterly performance (the management stresses in a business like this can be lumpy) important narrative for Divi's is unprecedented capex to further augment capacities besides preparing for growing opportunities arising from China plus one factor. The impact of Divi's aggressive capex of ~₹ 3700 crore [₹ 1800 (completed) + ₹ 400 (custom synthesis blocks) + ₹ 1500 crore (greenfield Kakinada plant)] is already visible and expected to reflect in FY22-23. Divi's stays a quintessential play on Indian API/CRAMS segment with its product offering, execution prowess. We maintain **BUY** with a target price of ₹ 4825 (earlier ₹ 4440) based on 42x FY23E EPS of ₹ 114.8.

#### Key Financial Summary

(₹ crore)	FY20	FY21	FY22E	FY23E	CAGR (FY21-23E) %
Revenues	5394.4	6969.4	8527.2	10270.0	21.4
EBITDA	1816.1	2848.7	3410.9	4159.4	20.8
EBITDA margins (%)	33.7	40.9	40.0	40.5	
Adj. Net Profit	1376.5	1984.3	2445.0	3048.3	23.9
Adjusted EPS (₹)	51.9	74.7	92.1	114.8	
PE (x)	79.4	55.1	44.7	35.8	
EV to EBITDA (x)	58.6	36.5	30.5	25.0	
RoNW (%)	18.8	21.3	22.1	22.9	
RoCE (%)	23.9	27.6	28.4	29.5	

Source: ICICI Direct Research; Company

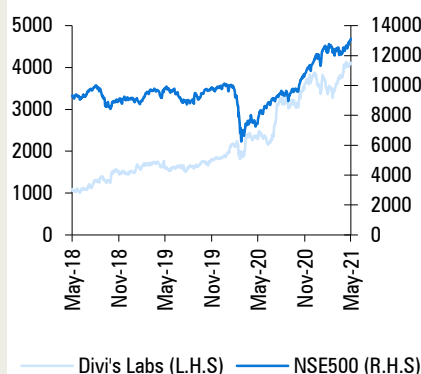


### Divi's Laboratories Limited

#### Particulars

Particular	Amount
Market Capitalisation	₹ 109280 crore
Debt (FY21)	₹ 5 crore
Cash & equivalents (FY21)	₹ 123 crore
EV	₹ 109162 crore
52 week H/L	4203/2095
Equity capital	₹ 53.1 crore
Face value	₹ 2

#### Price performance



#### Key risks to our call

- Delay in execution of capex plans (including Kakinada plant)
- cGMP related regulatory issues for exports

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**Exhibit 1: Variance Analysis**

	Q4FY21	Q4FY21E	Q4FY20	Q3FY21	YoY (%)	QoQ (%)	Comments
Revenue	1,788.2	1,743.0	1,389.7	1,701.4	28.7	5.1	YoY growth supported by strong growth across segments
Raw Material Expense	581.4	592.6	515.4	526.6	12.8	10.4	
Gross Margins (%)	67.5	66.0	62.9	69.0	458 bps	-156 bps	Sharp improvement amid Improved in production process, backward integration and change in product mix
Employee Expenses	215.1	217.9	173.1	233.6	24.2	-7.9	
Other Expenditure	275.5	252.7	256.7	250.0	7.3	10.2	
Total Expenditure	1,071.9	1,063.2	945.3	1,010.2	13.4	6.1	
EBITDA	716.3	679.8	444.5	691.2	61.2	3.6	
EBITDA (%)	40.1	39.0	32.0	40.6	807 bps	-57 bps	Sharp improvement and beat vis-à-vis I-direct estimates mainly due to strong gross margins and better operational leverage
Interest	0.2	0.3	0.4	0.3	-52.3	-22.2	
Depreciation	70.1	68.2	49.8	68.2	40.8	2.8	
Other income	23.5	19.7	76.7	19.3	-69.3	21.7	Forex gain was ₹ 3.91 crore vs gain of ₹ 2.43 crore in Q4FY20
PBT Before EO	669.5	631.1	471.0	642.1	42.2	4.3	
EO	0.0	0.0	0.0	0.0	NA	NA	
PBT	669.5	631.1	471.0	642.1	42.2	4.3	
Tax	167.5	159.0	82.7	171.5	102.4	-2.3	
Net Profit	502.0	472.0	388.2	470.6	29.3	6.7	Strong growth and beat vis-à-vis I-direct estimates mainly in sync with operational performance being partially offset by higher depreciation and tax rate
<b>Key Metrics</b>							
Generic	916.9	881.9	734.9	875.9	24.8	4.7	
CS	715.3	712.3	569.8	680.6	25.5	5.1	
Carotenoid	156.0	144.5	85.0	145.0	83.5	7.6	

Source: ICICI Direct Research

**Exhibit 2: Change in Estimates**

(₹ Crore)	FY22E			FY23E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	8,435.1	8,527.2	1.1	10,157.2	10,270.0	1.1	
EBITDA	3,289.7	3,410.9	3.7	4,012.1	4,159.4	3.7	
EBITDA Margin (%)	39.0	40.0	100 bps	39.5	40.5	100 bps	Improved mainly due to better than expected margins in FY21
Net Profit	2,343.6	2,445.0	4.3	2,945.7	3,048.3	3.5	Changed mainly in sync with operational performance
EPS (₹)	88.3	92.1	4.3	111.0	114.8	3.5	

Source: ICICI Direct Research

**Exhibit 3: Change in Estimates**

(₹ Crore)	Current				Earlier		Comments
	FY20	FY21	FY22E	FY23E	FY22E	FY23E	
Generic API & Intermediates	2,740.0	3,561.6	4,273.9	5,128.7	4,231.9	5,078.3	
Carotenoids	443.0	597.6	746.9	933.7	700.7	875.9	Improved mainly due to better than expected revenues in FY21
Custom Synthesis	2,211.4	2,805.1	3,506.3	4,207.6	3,502.5	4,203.1	

Source: ICICI Direct Research

## Conference Call Highlights

- Revenue bifurcation - Generic: CS: 60:40 mix, Carotenoid: ₹ 156 crore
- US, Europe account for 71% of FY21 revenue
- Exports contribute ~88% of FY21 sales
- Constant currency topline growth of 31% in Q4FY21 and 24% in FY21
- Total capitalisation done during FY21 amounted to ₹ 1184 crore (Q4FY21 - ₹ 173 crore) with a CWIP of ₹ 711 crore
- Margins can be maintained on the back of green chemistry and other efficiency measures such as 'Kaizen'
- Currently at 86% production capacity
- Kakinada - ₹ 600 crore immediate investment
  - Court issue resolved with ₹ 10 lakh paid as directed
  - To begin construction once second wave subsides
- Capex – ₹ 1800 crore of the ₹ 2500 crore planned in 2018 completed
- Growth
  - Generics – Traditional generics, Newer Generics and future generics
    - Traditional – Naproxen, Gabapentin, Dextromethorphan
      - 60-85% market share with market growing at +5%
    - Newer generics
      - Pregabalin, Methylamine - currently 20-30% market share, can go to 60-70% market share
      - Valsartan – can capture majority demand in 6-12 months
    - Future generics - Pipeline of new generic molecules (such as Vildagliptin, Ticagrelor) with patents expiring in 2023-25
      - These have a market size of US\$20 billion in dosage form
  - Custom synthesis– have additional cash to quickly build up capacity for opportunities as and when they come
  - Contrast media market growing at 15-20%, with Divi's Lab servicing less than 10% of demand
- Incoming supply chain hiccups and logistics challenges witnessed amid the second Covid wave
- In FY21 – operationalised brownfield DC, DCV SEZ units and the debottlenecking / backward integration programmes
  - Expanded capacities of Levodopa, Pregabalin, Methylamine and Carbidopa
  - Modernisation and upgradation of waste water treatment plants at the manufacturing sites has been implemented
- Total ₹ 400 crore capex for construction of new blocks for a custom synthesis (CS) project – 1) part of which completed/ operational and 2) the rest to be completed in early FY22
  - For Molnupiravir (MSD)

- three streams – one for India, two for exports
- Stream 1 commercialised shipments, Stream 2 under validation and Stream 3 in development
- FY21 CSR spend at ₹ 34 crore (incl. ₹ 4 crore related to Covid initiatives)
- Nutraceutical capacity has been doubled

**Exhibit 4: Trends in quarterly financials**

(₹ crore)	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	YoY (%)	QoQ (%)
Total Operating Income	1088.0	995.3	1285.0	1342.9	1256.4	1162.9	1445.6	1396.3	1389.7	1730.5	1749.3	1701.4	1788.2	28.7	5.1
Raw Material Expenses	407.6	381.4	473.2	480.2	503.0	452.3	593.7	547.1	515.4	639.8	576.3	526.6	581.4	12.8	10.4
% of revenues	37.5	38.3	36.8	35.8	40.0	38.9	41.1	39.2	37.1	37.0	32.9	31.0	32.5	-45.6	156.1
Gross Profit	680.3	613.9	811.8	862.7	753.5	710.6	851.9	849.1	874.3	1090.6	1173.0	1174.8	1206.8	38.0	2.7
Gross Profit Margin (%)	62.5	61.7	63.2	64.2	60.0	61.1	58.9	60.8	62.9	63.0	67.1	69.0	67.5	45.6	-156.1
Employee Expenses	125.8	121.3	134.7	136.5	138.3	140.9	150.6	156.5	173.1	183.9	193.2	233.6	215.1	24.2	-7.9
% of revenues	11.6	12.2	10.5	10.2	11.0	12.1	10.4	11.2	12.5	10.6	11.0	13.7	12.0	-43.1	-170.2
Other Expenses	168.1	140.7	163.0	203.0	204.1	182.6	210.8	198.7	256.7	206.7	238.7	250.0	275.5	7.3	10.2
% of revenues	15.4	14.1	12.7	15.1	16.2	15.7	14.6	14.2	18.5	11.9	13.6	14.7	15.4	-306.7	71.0
Total Expenditure	701.5	643.5	770.9	819.6	845.3	775.7	955.0	902.4	945.3	1030.4	1008.2	1010.2	1071.9	13.4	6.1
% of revenues	64.5	64.6	60.0	61.0	67.3	66.7	66.1	64.6	68.0	59.5	57.6	59.4	59.9	-807.4	57.0
EBITDA	386.5	351.9	514.1	523.3	411.1	387.1	490.6	493.9	444.5	700.1	741.1	691.2	716.3	61.2	3.6
EBITDA Margins (%)	35.5	35.4	40.0	39.0	32.7	33.3	33.9	35.4	32.0	40.5	42.4	40.6	40.1	80.7	-57.0
Interest	-0.2	0.6	0.2	2.5	0.1	0.3	3.8	1.6	0.4	0.2	0.2	0.3	0.2	-52.3	-22.2
Depreciation	38.8	41.6	42.4	42.5	42.3	43.8	45.9	46.7	49.8	56.2	61.1	68.2	70.1	40.8	2.8
Other Income	48.2	48.8	80.1	34.6	41.7	30.3	47.0	41.7	76.7	17.3	13.6	19.3	23.5	-69.3	21.7
PBT before forex & EO	396.1	358.4	551.6	512.9	410.4	373.3	487.9	487.3	471.0	661.0	693.5	642.1	669.5	42.2	4.3
Total Tax	134.5	92.3	153.9	133.4	121.0	100.9	131.1	128.2	82.7	168.9	173.9	171.5	167.5	102.4	-2.3
Tax rate (%)	33.9	25.7	27.9	26.0	29.5	27.0	26.9	26.3	17.6	25.6	25.1	26.7	25.0	744.8	-168.9
PAT	261.6	266.2	397.7	379.5	289.4	272.4	356.8	359.1	388.2	492.1	519.6	470.6	502.0	29.3	6.7
PAT Margin (%)	24.0	26.7	30.9	28.3	23.0	23.4	24.7	25.7	27.9	28.4	29.7	27.7	28.1		
EPS (₹)	9.9	10.0	15.0	14.3	10.9	10.3	13.4	13.5	14.6	18.5	19.6	17.7	18.9		

Source: ICICI Direct Research

## Company Background

Established in 1990, Divi's Laboratories is engaged in the manufacture of generic APIs and intermediates, custom synthesis of active ingredients and advanced intermediates for pharma MNCs, other speciality chemicals like Carotenoids and complex compounds like peptides and Nucleotides. After successfully developing and marketing generics and intermediates for generic players, the company started custom synthesis of NCEs developed by MNCs by providing generics and advanced intermediates. The company started Carotenoid supplies in FY09. Promoted by Dr Murali K Divi, the company raised ₹ 17 crore through its maiden IPO in March 2003.

DLL's product portfolio comprises two broad segments- (i) generics including nutraceuticals and (ii) custom synthesis of generics, intermediates and speciality ingredients for innovator pharma MNCs. It also includes peptide building blocks.

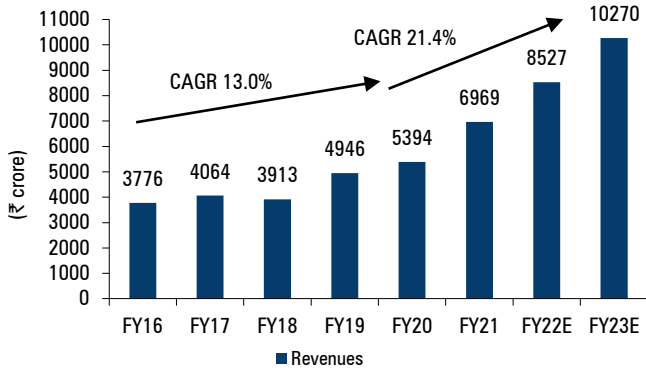
To enter the custom synthesis space in the nineties, the company made its own case to innovators, which, until then, were relying on services provided by major players such as BASF, Degussa, etc. As these players grew and became as big as the innovators themselves, companies like Divi's, on account of their capabilities and commitment towards the strict IP regime, started getting assignments.

The custom synthesis business is a high margin one but at times lumpy as it depends on offtake from customers (global top 20 big pharma). This business had a difficult time in FY10, FY11 as most customers resorted to de-stocking due to the global slowdown. However, this business has shown a good recovery due to improved business environment. Strong R&D capabilities, India based cost arbitrage and IP adherence are some key strengths of Divi's, which will drive incremental assignments from MNCs.

In the generics segment, two generics, Naproxen (pain management) and Dextromethorphan (cough suppressant) account for a significant portion of overall revenues. Divi's enjoys ~70% global market share in these two products. These products are already mature with limited competitors having other priorities. DLL is also increasing its presence in another niche area of Carotenoids after acquiring the requisite capabilities. It has developed various types of Carotenoids including Beta-carotene, the largest in the group.

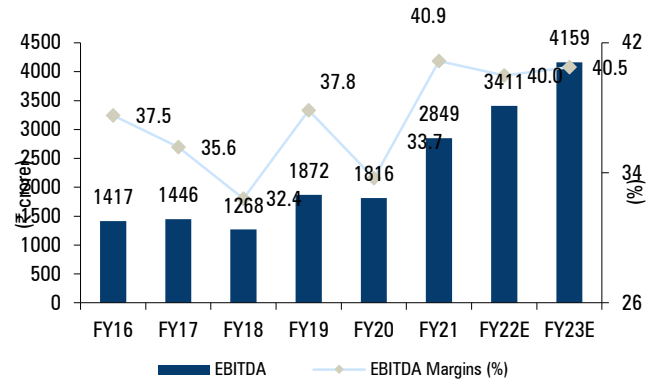
The company has earmarked an aggressive capex of ~₹ 3700 crore [₹ 1800 (completed) + ₹ 400 (custom synthesis blocks) + ₹ 1500 crore (greenfield Kakinada plant)]. This capex will largely be distributed between the Unit 1 (DCF SEZ) & 2 (DCV SEZ) facilities for up-gradation of quality control systems, de-bottlenecking and incremental capacities for a) existing/new products, b) Custom Synthesis. Additionally, part of this huge capex will be utilised for backward integration (~₹ 300 crore) and part will be geared towards a waste water treatment plant.

Exhibit 5: Revenues to grow at CAGR of 21% over FY21-23E



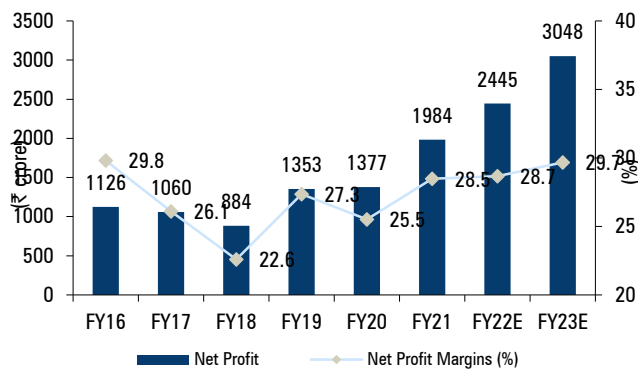
Source: ICICI Direct Research, Company

Exhibit 6: EBITDA & EBITDA margins trend



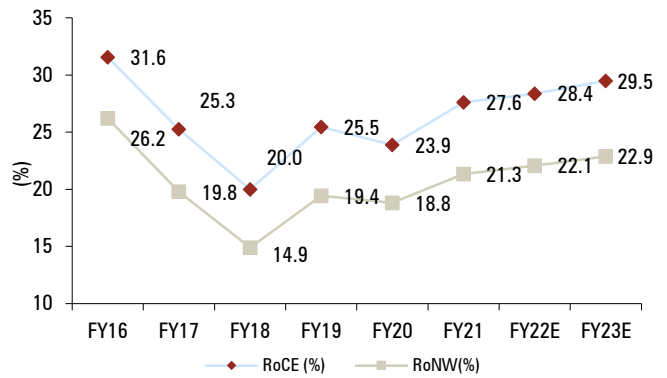
Source: ICICI Direct Research, Company

Exhibit 7: PAT & PAT margins trend



Source: ICICI Direct Research, Company

Exhibit 8: RoE & RoCE trend



Source: ICICI Direct Research, Company

Exhibit 9: Valuation

	Revenues (₹ crore)	Growth (%)	EPS (₹)	Growth (%)	P/E (x)	EV/EBITDA (X)	RoNW (%)	RoCE (%)
FY20	5394	9.1	51.9	1.8	79.4	58.6	18.8	23.9
FY21	6969	29.2	74.7	44.2	55.1	36.5	21.3	27.6
FY22E	8527	22.4	92.1	23.2	44.7	30.5	22.1	28.4
FY23E	10270	20.4	114.8	24.7	35.8	25.0	22.9	29.5

Source: ICICI Direct Research

Exhibit 10: Shareholding Pattern

(in %)	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Promoter	52.0	52.0	52.0	52.0	52.0
Others	48.0	48.0	48.0	48.1	48.1

Source: ICICI Direct Research, Company

## Financial Summary

Exhibit 11: Profit & Loss (₹ crore)				
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Revenues</b>	<b>5,394.4</b>	<b>6,969.4</b>	<b>8,527.2</b>	<b>10,270.0</b>
Growth (%)	9.1	29.2	22.4	20.4
Raw Material Expenses	2,108.5	2,324.1	2,899.3	3,440.5
Employee Expenses	621.1	825.8	1,023.3	1,232.4
Other Expenses	848.8	970.9	1,193.8	1,437.8
<b>EBITDA</b>	<b>1,816.1</b>	<b>2,848.7</b>	<b>3,410.9</b>	<b>4,159.4</b>
Growth (%)	-3.0	56.9	19.7	21.9
Depreciation	186.2	255.6	304.3	320.8
Interest	6.1	0.9	0.1	0.1
Other Income	195.8	73.8	153.5	225.9
PBT	1,819.5	2,666.0	3,259.9	4,064.4
Total Tax	442.9	681.8	815.0	1,016.1
<b>Adjusted PAT</b>	<b>1,376.5</b>	<b>1,984.3</b>	<b>2,445.0</b>	<b>3,048.3</b>
Growth (%)	1.8	44.2	23.2	24.7
<b>EPS (Adjusted)</b>	<b>51.9</b>	<b>74.7</b>	<b>92.1</b>	<b>114.8</b>

Source: ICICI Direct Research

Exhibit 13: Balance Sheet (₹ crore)				
(Year-end March)/(₹ crore)	FY20	FY21	FY22E	FY23E
<b>Liabilities</b>				
Equity Capital	53.1	53.1	53.1	53.1
Reserve and Surplus	7,256.8	9,241.5	11,022.8	13,274.7
Total Shareholders funds	7,309.9	9,294.6	11,075.9	13,327.7
Total Debt	38.9	4.8	4.8	4.8
Deferred Tax Liability	274.0	338.1	378.6	424.1
Non CL & Long Term Provisions	20.5	25.3	28.3	31.7
<b>Total Liabilities</b>	<b>7,643.3</b>	<b>9,662.8</b>	<b>11,487.6</b>	<b>13,788.3</b>
<b>Assets</b>				
Gross Block - Fixed Assets	3,514.3	4,691.9	5,532.7	5,832.7
Accumulated Depreciation	732.4	988.0	1,292.3	1,613.1
Net Block	2,781.9	3,703.9	4,240.4	4,219.6
Capital WIP	919.7	710.6	469.8	769.8
Total Fixed Assets	3,701.5	4,414.5	4,710.2	4,989.4
Investments	971.4	0.0	1,000.0	2,200.0
Inventory	1,863.9	2,145.2	2,946.3	3,548.5
Debtors	1,413.4	1,676.5	2,234.1	2,690.8
Loans and Advances	0.1	0.0	0.0	0.0
Other Current Assets	308.6	196.9	220.6	247.0
Cash	122.6	2,156.0	1,496.7	1,450.3
Total Current Assets	3,708.5	6,174.7	6,897.8	7,936.5
Creditors	590.7	763.2	933.8	1,124.6
Provisions	2.5	2.5	2.8	3.1
Other current Liabilities	299.3	345.6	387.1	433.5
Total Current Liabilities	892.5	1,111.3	1,323.7	1,561.3
Net Current Assets	2,816.0	5,063.4	5,574.1	6,375.2
Other Non CA & LT L & A	154.3	184.9	203.3	223.7
<b>Application of Funds</b>	<b>7,643.3</b>	<b>9,662.8</b>	<b>11,487.6</b>	<b>13,788.3</b>

Source: ICICI Direct Research

Exhibit 12: Cash Flow Statement (₹ crore)				
(Year-end March)/(₹ crore)	FY20	FY21	FY22E	FY23E
Profit/(Loss) after taxation	1,374.2	2,021.7	2,445.0	3,048.3
Add: Depreciation & Amortization	186.2	255.6	304.3	320.8
(Inc)/dec in Current Assets	-326.2	-503.6	-1,382.3	-1,085.2
Inc/(dec) in CL and Provisions	107.9	239.5	212.4	237.6
Other Operating Activities	-126.2	-66.3	0.1	0.1
<b>CF from operating activities</b>	<b>1,215.9</b>	<b>1,946.9</b>	<b>1,579.4</b>	<b>2,521.6</b>
(Inc)/dec in Fixed Assets	-1,182.9	-910.0	-600.0	-600.0
(Inc)/dec in Investments	1,056.3	860.1	-1,000.0	-1,200.0
Other Investing Activities	9.4	171.3	25.1	28.5
<b>CF from investing activities</b>	<b>-117.2</b>	<b>121.4</b>	<b>-1,574.9</b>	<b>-1,771.5</b>
inc/(dec) in Loan	-61.2	-34.0	0.0	0.0
Dividend & Dividend tax	-1024.1	0.0	-663.7	-796.4
Others	-6.1	-0.9	-0.1	-0.1
<b>CF from financing activities</b>	<b>-1,091.4</b>	<b>-34.9</b>	<b>-663.8</b>	<b>-796.6</b>
Net Cash flow	7.4	2,033.4	-659.3	-46.5
Opening Cash	115.3	122.6	2156.0	1496.7
<b>Closing Cash</b>	<b>122.6</b>	<b>2,156.0</b>	<b>1,496.7</b>	<b>1,450.3</b>
<b>Free Cash Flow</b>	<b>33.1</b>	<b>1,036.9</b>	<b>979.4</b>	<b>1,921.6</b>

Source: ICICI Direct Research

Exhibit 14: Key Ratios (₹ crore)				
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Per share data (₹)</b>				
Adjusted EPS	51.9	74.7	92.1	114.8
BV per share	275.4	350.1	417.2	502.0
Dividend per share	19.2	20.0	25.0	30.0
Cash Per Share	4.6	81.2	56.4	54.6
<b>Operating Ratios (%)</b>				
Gross margins	60.9	66.7	66.0	66.5
EBITDA margins	33.7	40.9	40.0	40.5
Net Profit margins	25.5	28.5	28.7	29.7
Inventory days	126.1	112.3	126.1	126.1
Debtor days	95.6	87.8	95.6	95.6
Creditor days	40.0	40.0	40.0	40.0
Asset Turnover	1.2	1.3	1.4	1.6
EBITDA conversion rate	67.0	68.3	46.3	60.6
<b>Return Ratios (%)</b>				
RoE	18.8	21.3	22.1	22.9
RoCE	23.9	27.6	28.4	29.5
RoIC	43.2	72.7	52.7	50.9
<b>Valuation Ratios (x)</b>				
P/E	79.4	55.1	44.7	35.8
EV / EBITDA	58.6	36.5	30.5	25.0
Price to Book Value	14.9	11.8	9.9	8.2
EV / Net Sales	19.7	14.9	12.2	10.1
Market Cap / Sales	20.3	15.7	12.8	10.6
<b>Solvency Ratios</b>				
Debt / EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	4.0	3.6	4.1	4.2

Source: ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



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