



DCX Systems is among the leading players in defence and aerospace sector primarily engaged in system integration and manufacturing of cables and wire harness assemblies. The Company is also one of the largest Indian Offset Partner (IOP) for ELTA Systems Ltd and Israel Aerospace Industries Ltd, System Missiles and Space Division (together, the "IAI Group"), Israel, for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies. The Company has customers from Israel, United States, Korea and India, including certain Fortune 500 companies, multinational corporations and start-ups as of Jun-22.

However, the issue is priced at PE of 22.5x to its FY22 earnings, and The ROE is 55.8%, which seems to be attractive in comparison to its peers. Thus, we recommend "Subscribe for Listing Gains" to the issue



About the Company :

DCX Systems Limited ("DCX Systems") was incorporated on December 16, 2011. DCX Systems is among the leading Indian players in manufacturing of electronic sub-systems and cable harnesses in terms of manufacturing capability and revenue in the defence and aerospace sector. It is preferred Indian Offset Partner ("IOP") for foreign original equipment manufacturers ("OEMs") for executing defence manufacturing projects. DCX Systems primarily engaged in system integration and manufacturing a comprehensive array of cables and wire harness assemblies and is also involved in kitting. It undertakes system integration in areas of radar systems, sensors, electronic warfare, missiles, and communication systems. It provides product assembly and system integration services to address customer's requirements.

Issue details

Price Band (Rs in per share)	197 - 207
Fresh Issue (In Rs. crore)	400
Offer for Sale (In Rs. crore)	100
Total Issue size (in Rs. crore)	500
Issue open date	31-10-2022
Issue close date	02-11-2022
Tentative date of Allotment	07-11-2022
Tentative date of Listing	11-11-2022
Total number of shares (lakhs)	253.81 - 241.55
No. of shares for QIBs (75%) (lakhs)	190.36 - 181.16
No. of shares for NII (15%) (lakhs)	38.07 - 36.23
No. of shares for retail investors (10%) (lakhs)	25.38 - 24.15
Minimum order quantity	72
Face value (in Rs)	2.00
Amount for retail investors (1 lot)	14,184 - 14,904
Maximum number of shares for Retail investors at lower Band	1008 (14 Lots)
Maximum number of shares for Retail investors at upper band	936 (13 Lots)
Maximum amount for retail investors at lower Band- upper band (in Rs)	1,98,576 - 1,93,752
Exchanges to be listed on	BSE, NSE

RESEARCH ANALYST

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A route to making money online

Promoters

- Dr H S Raghavendra Rao
- NCBG Holdings Inc.
- VNG Technology Private Limited

Objective of the Offer

- Funding working capital requirements of the company
- Repayment/ prepayment, in full or part, of certain borrowings availed of by the company
- Investment in the wholly owned Subsidiary, Raneal Advanced Systems Pvt Ltd, to fund its capital expenditure expenses



Brief Financials *				
Particulars (Rs. Cr)	Q1FY-23*	FY 2022*	FY 2021	FY 2020
Equity Share Capital	15.48	15.48	3.50	3.50
Net worth as stated	123.18	117.59	46.79	17.17
Revenue from Operations	213.25	1102.27	641.16	449.26
Revenue Growth (%)	73.5%	71.9%	42.7%	-
EBITDA	24.35	105.90	32.48	45.20
EBITDA Margin (%)	11.05%	9.4%	4.8%	9.7%
Profit before Tax	6.47	75.56	39.81	12.87
Profit for the period	5.57	65.61	29.56	9.74
Net Profit Margin (%)	2.53%	5.84%	4.33%	2.09%
Diluted EPS (₹)	0.72	9.19	4.22	1.39
Net Asset Value (₹)	15.92	15.19	6.68	2.45
PE#	71.91^	22.52	-	-
PB#	13.00	13.63	-	-

Source: RHP, # calculated at upper price band, * Restated consolidated financials, ^ Annualized

Industry Overview

GLOBAL DEFENCE INDUSTRY OVERVIEW

Global Defence Spending

The Global spending touched USD 2.07 trillion in 2021, which was an increase of 6.69% over the corresponding period in 2020. The five largest spenders, accounting for 62% of the total global spend, were India, China, United States, Russia and the United Kingdom. The rise in geopolitical tensions, such as the ongoing dispute between the US and China, was the primary driver of this surge in spending. In 2021, the United States reached the highest military spending with US\$ 800 billion which constituted 38.5% of the total military spending worldwide in 2021. As of 2021, the US military expenditure accounted to 3.5% of the US GDP. China's military expenditure accounts for the second-highest position in the world and accounted to US\$ 293.30 billion in 2021, i.e., 14% of global military spending. India's military spending in 2021 was US\$ 76.6 billion (3.7% of global military spending), ranked third globally and up 5.0 % from 2020. This rise is attributed to India's existing tensions with Pakistan and increasing border tensions with China. In 2021, Russia's military spending increased by 6.7 % to US\$ 65.9 billion (3.2% of global military spending). In 2021, the Americas accounted for 42.5% of world total expenditure, while Asia and Oceania accounted for 27.9% of total global expenditure. In 2021, Europe contributed 20% of worldwide military spending, making it the third-largest spender.

Modernization of Armed Forces

The increase in defence budget has accelerated the modernization programs across countries. These are in terms of new equipment and upgradation of older equipment. The Global programs are focussed on increase of air missile defence systems and unmanned platforms in countries where their assets are relatively in the mid-life stage. In countries like India the prioritization is on modernization of air assets which includes fighters and rotary platforms. The Indian defence market has been primarily an import dependent market; however, the increased focus on self-reliance in defence is expected to create more opportunities for the domestic industry in the future.



Technology Trends

In future battles, technological superiority will become increasingly important. With the impact of new and developing technologies during the last two decades, particularly in the sectors of electronics, miniaturization, materials, and computation, warfare has already undergone rapid changes. This has had a significant impact on the creation of more adaptable systems in a variety of applications, from communications to sensors and guided weaponry. 5G, Quantum Technology and Electronic Warfare are noted to be some of the key technology trends within this market. 5G technology plays a crucial part in the future battle network with the potential to connect millions of transceivers within a given region simultaneously.

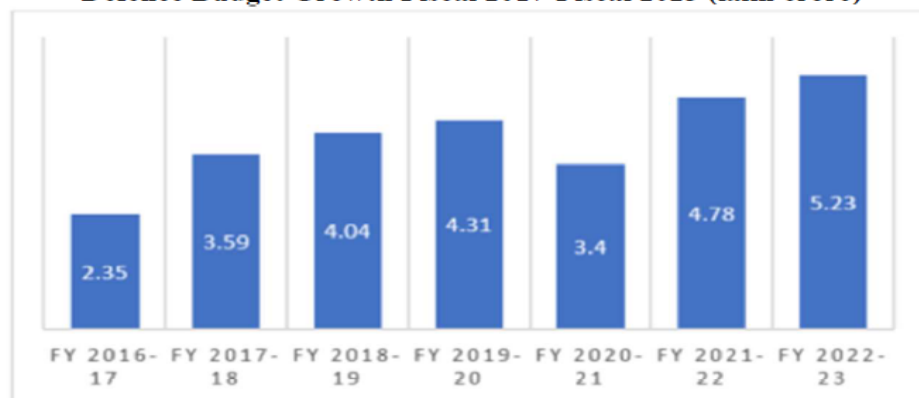
Indian Defence Industry

The Indian Defence Industry is a mix of DPSUs, large private players, and smaller but niche suppliers such as DCX. The DPSUs are a part of the Tier-1; the other major private players in Tier 1 and Tier 2. There are roughly 16 public sector undertakings under the administrative control of the Department of Defence Production, MOD. The DPSUs fuel the growth of Tier 2 and Tier 3 companies. Whilst the origin of Indian DPSU was tied India's ambitions to indigenize production of major defence platforms, the path taken had several drawbacks. DPSUs were driven to cover the entire spectrum of defence manufacturing, including development of platforms, and production of all tiers of subsystems and components. The MOD has undertaken some measures to promote India's "Make in India" defence manufacturing agenda. Foreign direct investment ("FDI") limitations in the defence sector have been lifted to 74%, up from 49% 2020. 68% of capital procurement budget under the Union Budget 2022-2023 to be earmarked for domestic industry to promote self-reliance and reduce import dependency. The Defence Procurement Procedure ("DPP") 2016 has been revised to form the Defence Acquisition Procedure ("DAP") 2020, which is focused on increasing Indian defence sector self-reliance. The government is actively encouraging the involvement of the private sector in defence acquisition to allow the domestic industry to manufacture high-tech weapons and equipment.

Indian Defence Budget Brief and Forecast

India's Defence budget outlay for the financial year 2022-2023 is ₹ 5.25 trillion the annual budget representing a 10% increase over the budget of ₹ 4.78 trillion in 2021-2022. The Indian Defence Budget has experienced a CAGR of 14.3% between the period Fiscal 2017 to Fiscal 2023.

Defence Budget Growth Fiscal 2017-Fiscal 2023 (lakh crore)



Note: Value of Defence budget in ₹ lakh crore

Source: RHP

Capital Outlay Indian Defence Spending Across Forces

The capital outlay for Indian Army has witnessed a reduction of around 12% compared to the previous fiscal. In the previous Fiscal Indian Army could spend ₹ 253,777 million as compared to the allocated budget of ₹ 364, 810 million. The modernization programs across the Indian Army have been slow especially because of policy paralysis on way forward for several high value programmes such as the Boyevaya Mashina Pjehoty ("BMP") replacements. The capital outlay for Indian Navy experienced a 43% increase owing to the threats in the Indian Ocean Region ("IOR"). Indian Navy was able to spend around 90% of the capital outlay allocation for the previous fiscal, which is the highest amongst the three forces. The Indian Air Force retained the largest share of the capital outlay accounting to around 43%, and grew at 4.5% compared to the previous fiscal.



Defence Exports of India

Due to the relaxation of export limitations and policy changes, Indian defence exports are expected to rise rapidly. This is supported by the expanding capabilities of Indian defence suppliers. In comparison to defence public sector entities, the private sector now dominates Indian defence exports, which is expected to drive income prospects. Organizations such as DCX are well positioned to capture the growth in Aerospace and Defence exports. In a report published by India Brand Equity Foundation (“IBEF”) in November 2021, the GOI has set a target for US\$ 25.00 billion for defence production by 2025. It includes US\$ 5 billion in exports. In the next five years, India aims to export military hardware products worth US\$ 5 billion. Additionally, the value of India’s defence exports in Fiscal 2020 was US\$ 1,231.9 million and this moderated to US\$ 771.8 million in Fiscal 2021. A dip in the exports for the year 2020-2021 is largely attributed to manufacturing disruptions and supply chain which have eased now.



Note: The CAGR for Exports is noted to be 52.08% between Fiscal 2017 to Fiscal 2022.

Source: RHP, CBSL

Global Defence Electronics Market

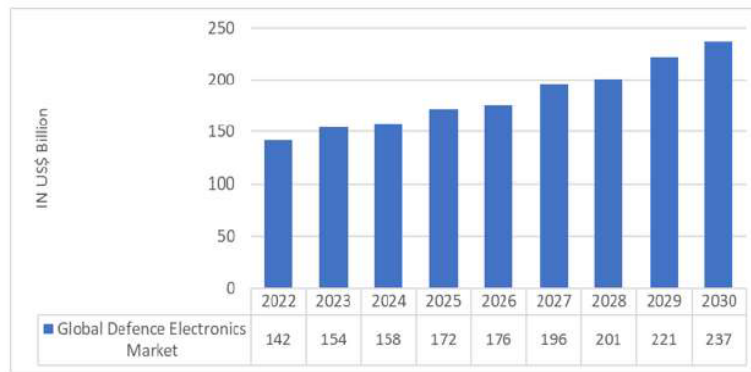
The Defence Electronics market comprises of electrical components which are integrated onto defence technologies. Some of the key focus areas for the global defence electronics market include avionics, military communication systems, UAVs, airborne systems, electronic warfare systems, land system electronics, naval system electronics, C4ISR and weapon as well as missile system electronics. A demand for high performance electronics within the defence sector is poised to be one of the key factors to serve as a market driver. Defence Electronics accounts for roughly 32% of the total defence procurement. With the change in warfare tactics and battlefield management, the need to modernize conventional military equipment has increased. Modernization is the key in keeping pace with technological progress on the battlefield. This demand for upgrading is expected to drive the growth of the market. The traditional defence industrial base is heavily skewed toward expensive, exquisite systems where high performance is the priority. However, the Ukraine Russia war is proving just how much can be accomplished with innovative uses of commercial technology that costs thousands of dollars, not billions.

Semi-conductor Industry as a key contributing market

The segmentation for the semiconductors sector based on its application across verticals including communication systems, radar and electronic warfare have been shown in the Figure below. The semiconductor’s content within the electronic components market is poised to attain a value of roughly US\$ 6.5 billion by the year 2030. A rapid growth in the usage of GaN is another notable observation for the semi-conductor’s market. GaN’s dominant 149 power RF performance is one of the key factors that contribute to this growth. GaAs is another semiconductor variant (widely used in radars) with a III-V direct band gap with a zinc blend crystal structure.

Estimated Market Size and Market Projection

The estimated market size for the Global Defence Electronics Market is expected to be US\$ 142 billion for the year 2022. Driven by the proliferation of multi-domain operations, proliferation of network-centric command and control, and improved forms of surveillance (for example, shift from passive to active radars), further driven as a consequence of the Russia Ukraine war, the market is poised to reach a forecasted value of US\$ 237 billion by the year 2030, with a CAGR of roughly 6.6%. The increasing number of policies related to the nation’s security and mounting demand for digitalized solutions is forecast to fuel the market growth.

**Global Defence Electronics Market, 2022-2030, USD billion**

Note: The Estimated Market Size and the Projected Values for the Global Defence Electronics Sector have been showcased in this figure. A top down and a bottom up approach was used to calculate the estimated market size. The values are mentioned in USD billion and are in calendar year.

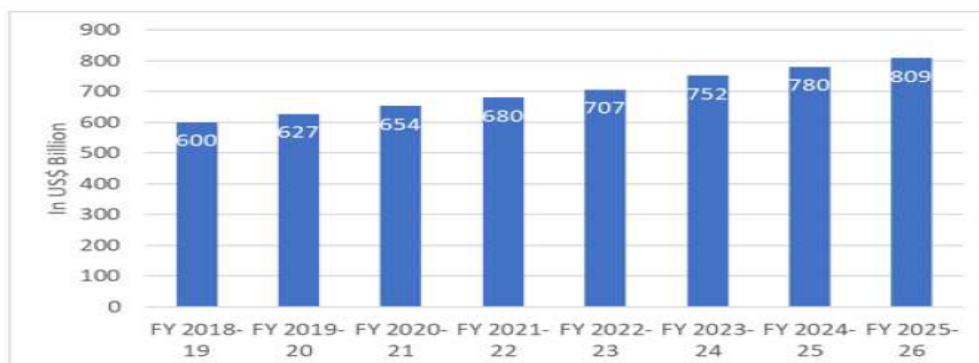
Source: RHP, CBSL

Market Size of Printed Circuit Board Assembly

The Global Electronics Market is estimated at around US\$ 2 Trillion in Fiscal 2019, out of which PCBA is expected to account to around 40%-50% of the total market value of Global Electronics Market. The Global PCBA market is expected to account to around US\$ 600 billion. The key consumer electronics which are key drivers for the PCBA are:

- Mobile phones
- Tablets, notebooks and desktop PCs
- Smart TVs, audio devices, video and music streaming devices
- Consumer appliances (washing machine, refrigerator, AC and heaters)

These four categories account to around 46% of the overall Global Electronics market.

Global PCBA Market, 2019-2026, USD billion

Note: Fiscal 2018-2019 to Fiscal 2020-2021 are actuals| Fiscal 2021-2022 onwards are forecast.

Source: RHP

Indian Defence Electronics Market

The Indian Market is presently focused on the indigenous development of Defence electronics amongst other segments. The country plans on increasing the value add for each step in the integration and manufacturing process for defence equipment. India has a strong IT and software industry. As of 2021, the number of people who are directly employed in the IT-BPM sector was about 4.5 million. The indirect job creation for this market is estimated to be about 12 million. The use of this manpower to increase local development of defence electronics is poised to create additional job opportunities as per the multiplier effect. In 2019, the Indian government undertook financial initiatives that are likely to benefit offset disability. The government also took initiatives to promote the Electronics Manufacturing clusters in order to support the design and manufacturing of electronics manufacturing units. In 2019, the Indian government undertook financial initiatives that are likely to benefit offset disability. The government also took initiatives to promote the Electronics Manufacturing clusters in order to support the design and manufacturing of electronics manufacturing units.



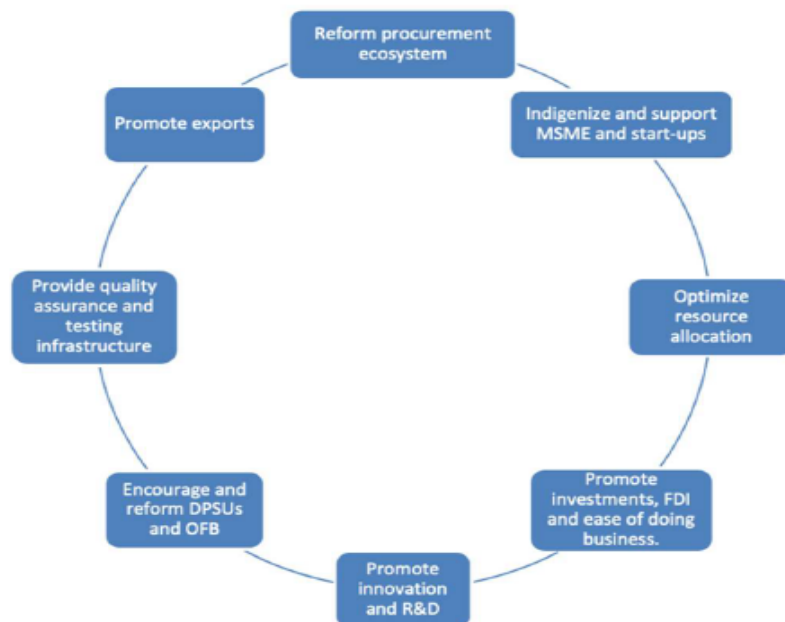
Estimated Market Size and Market Projections

The estimated market size for the Indian Defence Electronics Segment is noted to be US\$ 2,577 million for the year 2022. The market is expected to reach US\$ 7,204 million by the year 2030. The overall growth in market size is due to the increased investment in indigenous programs such as the Future Ready Combat Vehicle ("FRCV") and the Future Infantry Combat Vehicle ("FICV"). India's reliance on external markets is poised to reduce during the forecast period owing to the country's burgeoning defence capability. The market is poised to grow with a CAGR of 13.71% between 2022-2030. There is a strong focus and initiatives by the Government of India in the aerospace and defence sectors especially for Private players including Micro, Small and Medium Enterprises. With defence public sector undertakings focussing on specialisation and integration and sub-component manufacture being outsourced to the private sector, there are significant opportunities for the private sector.

Regulations and Licensing Standards for the Indian Defence Sector

The DPEPP 2020 reforms outline the quality standards imposed on defence production as well as exports. The policy lists goals including increasing the competitiveness of the Indian defence sector by propelling the dynamic and robust production. The aim of the DPEPP 2020 reforms is aimed at reducing imports dependence in India thus furthering the agenda for Atmanirbhar Bharat. India's present import reliance is noted to be 15% of the global market value. The Defence Production and Export Promotion Policy 2020 is based on 8 pillars.

Pillars of Defence Production and Export Promotion



Source: RHP

Increasing the market share for Indian Intellectual property and promoting R&D within the Indian defence infrastructure are also some of the objectives to be attained via the DPEPP 2020 reforms. The OFB and DPSUs proposal is poised to address issues concerning with major source delay and stagnation in the manufacturing domain.

Modernization drive in India including Major programmes of the Indian Army, Navy and Air Force

India has begun a comprehensive military modernization program that includes the purchase of new rifles, combat aircraft, ammunition, carbines, and artillery, rotary-wing aircraft, and force multipliers such as electronic warfare suites, network-centric warfare, and air-Defence systems, among others. Military modernization programs are poised to account for US\$ 130 billion in the coming five years. The Indian Army has lagged in terms of modernization, and numerous projects are planned to be completed in the coming three to seven years. The Abhay Infantry Fighting Vehicle ("IFV"), Arjun MKIII, and TATA Kestrel are the three key indigenous defence platforms being developed by the Indian Army. At present, the T-72 and the T-90 tanks, both procured from Russia and assembled in India, are the mainstay of the Indian Army. However, chunk of this arsenal consists largely of T-72 tanks which have lived their life and are under the process of being upgraded extending their life till 2022. A request for information was sent to 12 Main Battle Tank manufacturers to acquire 1,700 with partly local production to replace the T-72 tank.



Competitive Strengths

Among the preferred Indian Offset Partners for the defence and aerospace industry with global accreditations

DCX is a preferred IOP for foreign OEMs for executing defence manufacturing projects (Source: Company Commissioned F&S Report). It undertakes “build-to-print” system integration and manufacture cable and wire harness assemblies for both domestic and international OEMs. It is also one of the largest IOP for the IAI Group, Israel, for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies. The company holds a number of key certifications that include AS-9100:2016 certification for quality management systems for aviation, space and defence products manufacturing and its Defence Industrial License from the Ministry of Commerce and Industry, Government of India for the manufacture of defence subsystems that includes microwave components, modules for radar and electronic warfare subsystems, microwave submodules, for command and guidance units for missile subsystems only. It also adheres to global standards and have obtained various global certifications. These certifications ensure that the processes comply with customer specific, industry specific, statutory health and safety, as well as environmental and social and governance requirements. Its global certifications help the company to serve its customers’ stringent quality specifications and assists in new customer acquisition.

Technology enabled and scalable end-to-end capabilities

Its system integration services are a part of an array of electronic, electro-mechanical and wired assemblies, and full-system integration services, which can be configured as per the customers requirements. As part of the system integration services, it also do in-house testing to ensure the quality of final products, and reliability of products’ functioning under varying environmental conditions. It also specialise in manufacturing assemblies that are used in applications for land, underwater and airborne use. It possess the skillset and technology to manufacture cable and wire harnesses according to customer requirements for various types including radio frequency, coaxial, mixed signal, power, data, submersible, twinnax cables, shielded cable harness, flexible cables and open and closed type harnesses used in aerospace and defence and other allied segments of the industry. It also manufacture test cables, large mechanical jigs and fixtures, and testing programs to meet desired requirements of customer in testing and qualifying the product. In addition, its products are also subjected to various quality assurance tests. The Company’s manufacturing process allows it to manufacture the products according to the specific requirements and quality expectations of its customers maintaining the required quality standards. Most of the products are manufactured by the skilled workforce and checked by the test equipment to handle manufacturing of proprietary and classified products, the designs of which are provided to the company by the OEM customers.

Well-positioned to capitalize on industry tailwinds

There is a strong focus and various initiatives by the Government of India in the aerospace and defence sectors and in particular for private players including micro, small and medium enterprises. India’s defence budget outlay for Fiscal 2023 is ₹ 5,250 billion, the annual budget representing a 10% increase over the budget of ₹ 4,780 billion in Fiscal 2022. The Indian Defence private sector has witnessed a substantial growth owing to the implementation of government reforms. In Fiscal 2022, 2021 and Fiscal 2020, private players in the Indian defence sector accounted for 70%, 86% and 88%, respectively, of the exports generated. Private players like DCX plays an important role in meeting the offset obligations and helping the goals set by the Government of India with reference to be a US\$ 5 Billion export country by 2025. (Source: Company Commissioned F&S Report) In Fiscal 2022, the company exported US\$ 76 million worth of equipment accounting for 4.7% of the overall Defence Exports from India. (Source: Company Commissioned F&S Report) The Defence Acquisition Policy 2020 (“DAP 2020”) has extended avenues for extending offsets, providing foreign businesses direct credit for transferring vital technologies to the Indian economy. The DAP 2020 ensures that large number of innovations utilised in defence equipment are now available to private entities. With defence public sector undertakings focussing on specialisation and integration and sub-component manufacture being outsourced to the private sector, there are significant opportunities for the private sector.

Strategically located in aerospace Special Economic Zone with an advanced and modern manufacturing facility

In 2020, The Company commissioned its new manufacturing facility at the Hi-Tech Defence and Aerospace Park SEZ in Bengaluru, Karnataka. The facility is spread over an area of 30,000 square feet and is located in the same city as its key domestic customers which ensures shorter delivery times. The facility is secured by digital security cameras coupled with alarm systems with restricted access control for individual manufacturing divisions. The facility is situated within a SEZ that offers it duty free imports, exemption from GST and supplies that are zero rated under extant regulations. Being situated in an SEZ ensures that the company is also not subject to levies imposed by the state government and the operations are eligible for single-window clearance by the relevant authority.



Risk Factors

High Dependence on key customers for sale of products

DCX is dependent on a limited number of key customers and in particular ELTA Systems Limited and Israel Aerospace Industries Limited, System Missiles and Space Division (together, the "IAI Group"), for a significant portion of revenues. It is also one of the largest Indian Offset Partner ("IOP") for the IAI Group, Israel, for the Indian defence market for manufacture of electronic sub-systems and cable and wire harness assemblies. In Q1FY23 The Top 3 customers contribute about 96.83% of the total revenue.

DCX's revenue from operations depends significantly on offset defence contracts. Any changes in the offset defence policy can impact the overall financials of the company

A significant portion of its revenue from operations are generated from the offset defence contracts. In Fiscal 2020, 2021, 2022 and in the three months ended June 30, 2021 and June 30, 2022, the revenue from the offset defence contracts was ₹ 4,331.35 million, ₹ 6,014.89 million, ₹ 9,565.13 million, ₹ 1,038.30 million and ₹ 1,376.39 million, respectively representing 97.86%, 94.23%, 87.00%, 84.47% and 64.54% of the total revenue from sale of products and services, respectively in such periods. The company expect to continue to derive most of its revenue from operations from work performed under such offset contracts. Any changes in the government policy in connection with offset defence contracts could have an adverse impact on the sales, earnings and cash flows.

Significant shortages or disruption in the supply of raw materials could affect the estimated costs, expenditures and timelines, which may have a material adverse effect on the business

The company's operations are dependent on the availability of raw materials that it require for the manufacture of products in the defence and the aerospace industry. Its primary raw materials are electronic assemblies and subsystems such as printed circuit board assemblies, power supplies, integrated circuits, cables and wires, connectors, integrated circuits and mechanical enclosures. It typically source its raw materials from suppliers approved by the customers. Commercially viable, with the select Clients could have an adverse impact on the business, results of operations and financial condition. The company has experienced cost fluctuations of the raw materials, particularly in the aforementioned components due to volatility in the commodity markets. Since the selling prices of products are affected by the prices of raw materials, strong and rapid fluctuations in the prices of these raw materials and the inability to pass on the cost increase to the customers could negatively affect operating results.

Order book received may be modified, cancelled, delayed, put on hold or not fully paid for by the customers, which could adversely affect the business

As many of the contracts that The company enter's into are executed over a period of several years, at any given time it has an order book. The Company's order book has increased from ₹ 19,413.11 million, as of March 31, 2020, to ₹ 23,690.04 million, as of March 31, 2022. As of June 30, 2022, the order book stood at ₹ 25,636.34 million from several customers for projects to be executed between Fiscal 2023 and Fiscal 2025. The growth of the order book is a cumulative indication of the revenues that it expect to recognise in future periods in relation to signed contracts. Further, the company cannot guarantee that the income anticipated in its order book will be realised, or, if realised, will be realised on time or result in profits. In addition, the order book depends on the continued growth of the aerospace and defence sector globally and in India and company's ability to remain competitive. The existing order book and its growth rate may not be indicative of the number of orders the company will receive or its growth in the future.



Peer Comparison

Company	Face Value	Total Income (In INR Crs) for FY-2022	EPS (Basic)	NAV	PE	ROE %	ROCE%
DCX Systems Ltd	2	1,124.33	9.19	15.19	22.52*	55.8	13.2
Bharat Electronics Ltd	1	15,599.72	3.28	16.83	32.03	19.6	26.2
Data Patterns (India) Ltd	2	314.81	19.48	110.72	69.64	33.0	24.0
Paras Defence and Space Technologies	10	185.53	7.78	97.06	83.50	9.3	10.4
Astra Microwave Products Ltd	2	756.84	4.37	67.61	70.96	8.8	15.9

CMP as on 25-Oct-2022, * Upper Price band

OUR VIEWS

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The Company has customers from Israel, United States, Korea and India, including certain Fortune 500 companies, multinational corporations and start-ups as of Jun-22. The Government initiatives like Make In India and Atmanirbhar Bharat is likely to benefit the overall defence sector. Also, The company has order book of INR 2,563.63 Crs as of Jun 2022, which is to be executed in FY 2023-25. The Company's Debt / Equity ratio stands at 4.27x as on FY22. The company's total cash and cash equivalents stood at INR 778.29 Crs as of FY22. However, the issue is priced at PE of 22.5x to its FY22 earnings, and The ROE is 55.8%, which seems to be attractive in comparison to its peers. Thus, we recommend **"Subscribe for Listing Gains"** to the issue.

Sources: Company Website and red herring prospectus



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