

WCT Holdings Bhd

Get ready for the bounce; Upgrade to Overweight

We upgrade WCT to OW from Neutral, with a Dec-18 PT of M\$1.60, ascribing a 40% discount to SoTP. Value has emerged after the 43% share price drop (underperforming KLCI by 52%) over the last 12 months partially due to election fears and partially due to urgent de-gearing needs (now dissipated somewhat given the rating agency upgrade). Share price does not reflect any value for property (M\$0.41/share) and investment properties (M\$1.04/share). Key re-rating catalysts: 1) new construction order wins, 2) property presales recovery, and 3) eventual REIT listing (we value at M\$993MM or M\$0.71/share). Post elections bounce expected (polling on 9th May) if the elections outcome is within market expectation.

- **Bottoming out.** Sharp share price fall of 43% over the last 12 months (underperforming KLCI by 52%) due to investors' fears of the company's high net gearing of 88%, which warrants further de-gearing. We believe the delay of REITs exercise was the main trigger, and risk of delay is high given ongoing legal suit. However, as per latest rating upgrade by rating agency, the urgency seems to be less dire for now. On our estimates, WCT has adequate interest cover of 4.2x/4.7x in FY18E/19E. The construction sector underperformed the KLCI by 10% YTD probably due to pre-elections jitters (polling on 9th May). WCT was not spared too, falling 28% YTD. Post elections recovery expected, in our view, as per past trend.
- **Value has emerged.** WCT is trading at 57% discount to SoTP (at close to -1SD) compared with the historical average of 32%. To arrive at our Dec-18 PT of M\$1.60 (from Jun-18 PT of M\$2.00), we assume a higher 40% discount to SoTP (vs. 30% earlier), which takes into account the likelihood of 10% dilution to the share base from potential equity raising.
- **What's in the price?** Current share price of M\$1.17 does not reflect the entire property (M\$0.41/share) and property investments division (M\$1.04/share). It only reflects 85% of construction division value of M\$1.37/share. This implies the market is pricing in M\$1.5/2.0B of new construction order wins for FY18/19 against our forecast of M\$2.0/2.5B. Order win prospects are good given Malaysia's infrastructure boom.

WCT Holdings Bhd (Reuters: WCTE.KL, Bloomberg: WCTHG MK)

M\$ in mn, year-end Dec	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue (M\$ mn)	1,934	1,906	3,854	3,470	4,469
Net Profit (M\$ mn)	88	149	161	164	171
Core Net Profit (M\$ mn)	88	149	161	164	171
Adj. core FD EPS (M\$)	0.08	0.11	0.12	0.12	0.12
Net DPS (M\$)	0.00	0.00	0.01	0.01	0.02
Revenue growth (%)	15.9%	(1.4%)	102.2%	(10.0%)	28.8%
Adj. EPS growth (%)	(13.6%)	36.6%	6.9%	1.6%	3.4%
ROE	4.9%	6.0%	5.8%	5.5%	5.5%
ROCE	2.0%	3.3%	3.2%	3.0%	3.2%
Adj P/E (x)	14.7	10.8	10.1	9.9	9.6
P/B (x)	0.5	0.7	0.6	0.6	0.6
EV/EBITDA (x)	15.2	10.7	11.8	11.5	10.9
Net Div yield (%)	0.0%	0.0%	0.6%	1.0%	1.3%

Source: Company data, Bloomberg, J.P. Morgan estimates.

See page 9 for analyst certification and important disclosures, including non-US analyst disclosures.

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▲ Overweight

Previous: Neutral

WCTE.KL, WCTHG MK

Price: M\$1.17

▼ Price Target: M\$1.60

Previous: M\$2.00

Malaysia

Construction

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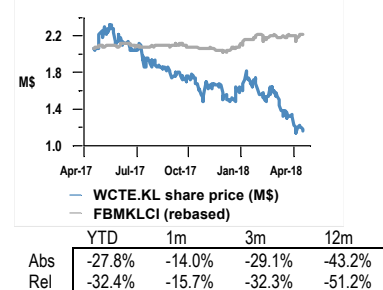
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Price Performance



Company Data

Shares O/S (mn)	1,415
Market Cap (M\$ mn)	1,656
Market Cap (\$ mn)	426
Price (M\$)	1.17
Date Of Price	19-Apr-18
Free Float(%)	
3M - Avg daily vol (mn)	2.90
3M - Avg daily val (M\$ mn)	3.95
3M - Avg daily val (\$ mn)	1.0
FBMKLCI	1879.32
Exchange Rate	3.89
Price Target End Date	31-Dec-18

Key catalysts for the stock price:	Upside risks to our view:	Downside risks to our view:
<ul style="list-style-type: none"> • New construction order wins • Property presales recovery • eventual REIT listing • Removal of elections overhang (polling on 9 May) 	<ul style="list-style-type: none"> • Stronger than expected new construction order wins and margins • Stronger than expected property presales. • Earlier than expected unlocking of property investments • Earlier than expected recovery of proceeds from Meydan Racecourse arbitration 	<ul style="list-style-type: none"> • Slower than expected rollout of infrastructure projects • Sharper than expected property sector slowdown. • Steep increases in building material prices that adversely affect construction margins.

Key financial metrics	FY17A	FY18E	FY19E	FY20E
Revenues (M\$)	1,906	3,854	3,470	4,469
Revenue growth (%)	-1.4%	102.2%	-10.0%	28.8%
EBITDA (M\$)	402.4	405.8	422.0	456.4
EBITDA margin (%)	21.1%	10.5%	12.2%	10.2%
Tax rate (%)	35.0%	27.8%	29.2%	26.9%
Net profit (M\$)	149.0	161.3	164.4	171.0
EPS (M\$ sen)	10.9	11.6	11.8	12.2
EPS growth (%)	36.6%	6.9%	1.6%	3.4%
DPS (M\$ sen)	-	0.8	1.2	1.5
BVPS (M\$)	1.7	1.9	2.0	2.1
Operating cash flow (LC mn)	(81.4)	209.4	209.4	214.5
Free cash flow (LC mn)	(76.9)	175.7	173.4	179.8
Interest cover (X)	6.4	4.4	4.7	5.1
Net margin (%)	7.8%	4.2%	4.7%	3.8%
Sales/assets (X)	24.6%	42.9%	35.3%	43.7%
Debt/equity (%)	104.4%	114.2%	112.5%	109.6%
Net debt/equity (%)	87.6%	96.8%	95.5%	93.0%
ROE (%)	6.0%	5.8%	5.5%	5.5%
Key model assumptions	FY18E	FY19E	FY20E	
New construction order wins (M\$MM)	2,000	2,500	2,500	
New property sales (M\$ MM)	300	335	610	
Construction margins (%)	7.3%	8.4%	6.3%	

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	EPS	
	FY18E	FY19E
Sensitivity to		
M\$1b change to new construction orders	13%	12%
1ppt chg in construction PBT margin	10%	6%
10% chg in property sales	1%	1%
1ppt chg in property PBT margin	2%	2%

Source: J.P. Morgan estimates.

Valuation and price target basis

Our SoTP derived PT is based on 13x PER on FY18E construction earnings, below its historical avg P/E, and similar 13x multiple to property division earnings. WCT's shopping mall leases (currently reflects only AEON Bukit Tinggi (100%-owned), Paradigm PJ mall, 70%-owned) and Gateway@Klia2; all valued based on DCF. We apply an overall discount of 40% at group level.

SoTP table

Segment	Method	M\$ / shr
Construction	P/E of 13x	1.37
Property	P/E of 13x	0.41
AEON shopping mall lease	DCF @ 7.1%	0.41
	WACC	
Paradigm PJ mall lease (70% share)	DCF @ 6.9%	0.24
Gateway@KLIA2 (70% share)	WACC	0.39
Net debt & others		0.03
SoTP		2.87
FD SoTP		2.75
40% discount		(1.10)
Dec-18 PT (FD)		1.60

Source: J.P. Morgan estimates.

JPM vs. consensus, change in estimates

Net profit (M\$MM)	FY18E	FY19E
JPM old	171	198
JPM new	161	164
% chg	-6%	-17%
Consensus	164	182

Source: Bloomberg, J.P. Morgan estimates.

Table 1: Construction sector peer comparison

As at: 19-Apr-17	Ticker	Mkt cap (US\$m)	Price (LC)	Rating	Target (LC)	P/E		2yr EPS CAGR 2017-2019E	ROE		Div Yld		Net gearing FY18E
						CY18E	CY19E		FY18E	FY19E	FY18E	FY19E	
Econpile Holdings	ECON MK	378	1.10	NC	-	14.9	14.1	5.6%	27.4	25.5	2.5%	2.6%	-21.2%
Gamuda	GAM MK	3,269	5.17	OW	6.60	14.8	12.6	17.9%	11.6	13.2	2.7%	2.9%	50.5%
Hock Seng Lee	HSL MK	217	1.54	NC	-	11.8	9.9	8.8%	9.0	10.1	1.8%	1.9%	-15.3%
IJM Corp	IJM MK	2,554	2.74	OW	3.40	17.1	15.1	11.9%	5.6	6.3	2.7%	2.7%	20.0%
Sunway Construction	SCGB MK	727	2.19	NC	-	15.3	13.8	5.4%	30.7	30.2	3.2%	3.5%	-91.2%
WCT Holdings	WCTHG MK	423	1.17	OW	1.60	10.1	9.9	2.5%	5.8	5.5	0.6%	1.0%	96.8%
Weighted average		7,569				15.3	13.4	12.9%	11.8	12.6	2.6%	2.8%	23.7%

Source: Bloomberg, J.P. Morgan estimates

Net profit to rebound from FY18

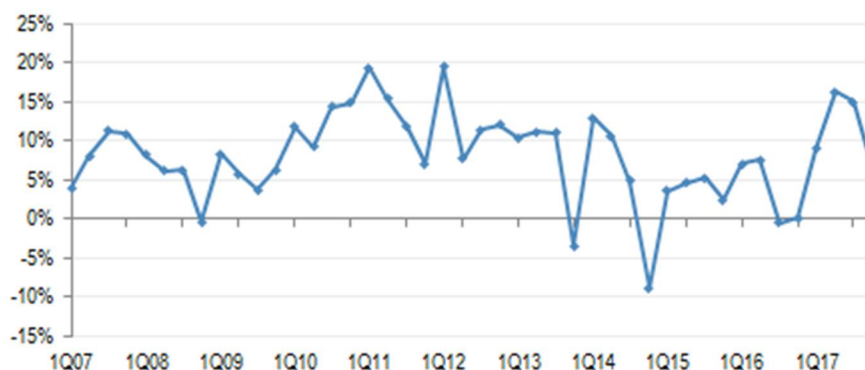
We expect net earnings for FY18E to rebound, rising 8% Y/Y driven mainly by its record construction order backlog of M\$5.6B. We expect FY19E/20E net earnings growth of 2%/4% Y/Y respectively. Note we have lowered our net earnings forecast for FY18E/19E by 6%/17% respectively mainly due to higher interest expense due to delays in WCT's de-gearing exercise.

Given that our FY18/19E net earnings forecasts are 2%/10% below consensus, we expect some share price overhang until after WCT reports its 1Q18 results in May, thereafter resetting investors' expectations.

Construction division margins improved significantly

In line with our expectation, core construction EBIT margins have improved to 11.8% in 2017 from 3.6% in 2016 with the sizeable order backlog of M\$5.6B as of end 2017 representing 3.3x historical revenues, and are a source of earnings growth/clarity. Execution is on track as we understand from management that the company's core construction team including seniors remain intact. Higher proportion of infrastructure jobs secured at 93% vs 7% for building works is a source of margin improvement.

Figure 1: WCT core construction EBIT margins trend



Source: Company data, J.P. Morgan

De-gearing plans underway

The rating agency hopes to see net gearing reduction from 0.85x to 0.65x, but we reckon the pressure has eased. On our estimates, WCT has adequate interest cover estimated at 4.2x/4.7x in FY18E/19E respectively. Net debt to EBITDA stands at 8.2x as of FY17.

WCT's rating outlook has been raised to "Stable" from "Negative" in Oct-17 by rating agency MARC for its MTN Programme and Sukuk Murabahah Programme of M\$1B/M\$0.9B respectively ([link](#)). The outlook revision is premised upon WCT's improving liquidity and leverage positions following a share placement exercise (M\$260.8MM in 1H17 and potentially another M\$204MM in 2018), warrant conversion & asset monetisation (land sale). Completion of Paradigm Mall Johor Bahru in end-2017 reduces cashflow drag with the likelihood of no major capex being incurred in the near term.

While warrant conversion proceeds may not be forthcoming as WCT is trading below Warrant E conversion price of M\$2.08/share, we see possibility of conclusion of a couple of land sales, which should raise M\$200MM. Three conditional SPAs with total proceeds of M\$116MM have been signed.

Table 2: Potential de-gearing initiatives and impact on net gearing

Initiatives	Value (M\$MM)
Private placement of up to 140mn new shares (approved by Bursa Malaysia Securities)*	164
Potential establishment of WCT REIT comprising Paradigm PJ, AEON Mall and Premiere Hotel (assuming WCT retains 30%)	695
Land disposals up to M\$200MM. Signed 3 conditional SPAs for total proceeds of M\$116mn	200
Total proceeds	1,059
Net debt as at Dec-17	2,758
Net debt after netting off total proceeds	1,699
Net gearing ratio post de-gearing initiatives	40%
Net gearing ratio as at Dec-17	88%

Source: Company data, J.P. Morgan estimates. *Assumption: issue price = closing price of M\$1.17 as at 19th Apr 2018.

REIT listing plans for its investment properties is delayed due to the legal suit by AEON. In Nov 2017, AEON filed a legal suit against WCT's wholly owned subsidiary, Gemilang Waras Sdn Bhd to prevent termination of the lease expiring 23 Nov 2017. The suit is in relation to the renewal of lease for AEON Mall Bukit Tinggi ([link](#)).

In the event of termination of lease agreement, we do not see material impact on WCT given its extensive experience in mall management, together with new controlling shareholder Tan Sri Desmond which has 27.9% equity stake in Pavilion REIT.

Potential listing of investment properties could unlock M\$993M or M\$0.71 share in value. Assuming WCT retains 30% in the REIT, this could potentially raise cash of M\$695MM or M\$0.49/share. This represents 42% of market capitalization and 25% of FY17 net debt. Note that the potential REIT's proceeds are likely to go towards debt repayment, which could potentially bring down net gearing to 54%.

Upon completion of WCT's de-gearing plans as per Table 2, net gearing could reduce to 40%.

Table 3: Potential equity value for investment properties likely to be REITed

	Value (M\$ MM)	Value/share (M\$)
AEON shopping mall lease (100%)	578	0.41
Paradigm shopping mall lease (70% share)	340	0.24
Premier Hotel (100%)	75	0.05
Total	993	0.71

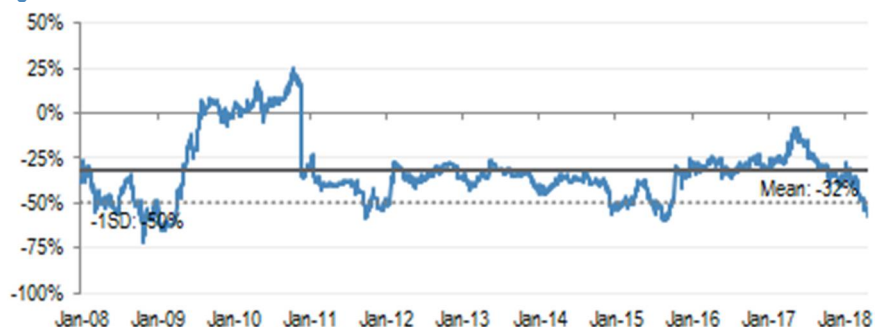
Source: J.P. Morgan estimates

Dec-18 PT of M\$1.60 offers 37% potential upside

To arrive at our Dec-18 PT of M\$1.60, we assume 40% discount to fully diluted SoTP of M\$2.75, which takes into account likelihood of 10% dilution to share base. We previously assumed 30% discount. Our SoTP is now predominantly construction-led (48% of SoTP), while property development is 14% of SoTP given poor presales. Investment properties account for 37% of SoTP.

WCT is trading at 57% discount to SoTP (close to -1SD) compared with historical average of 32%. At our PT of M\$1.60, WCT is trading at implied FY19 P/E of 13.6x, below its historical average P/E of 18x.

Figure 2: WCT discount to SoTP



Source: Bloomberg, J.P. Morgan estimates

Figure 3: WCT PE band



Source: Bloomberg, J.P. Morgan estimates

What's in the price?

After a 43% share price drop (underperforming KLCI by 52%) over the last 12 months, the current share price of M\$1.17 does not reflect the entire property (M\$0.41/share) and property investments division (M\$1.04/share). Only reflects 85% of construction division value of M\$1.37/share. This implies the market is pricing in M\$1.5/2.0B of new construction order wins for FY18/19 against our forecast of M\$2.0/2.5B.

Or it could also be pricing in failure to execute de-gearing exercise (as per Table 2), which suggests that WCT might need to raise M\$550MM to arrive at 0.6x net gearing. If a cash call is required, this could potentially lead to 33% dilution in SoTP/EPS. We believe our SoTP discount of 40% captures this risk. Also, M\$116MM of land sale proceeds is likely in the bag given the signing of conditional SPAs.

Re-rating catalysts

- Construction order wins of M\$2.8B in 2017 has built up sizeable order backlog of M\$5.6B, representing 3.3x historical revenues. This provides more earnings clarity, in our view.
- New construction order wins in our view potentially from sub-contract works from:- i) M\$55B East Coast Rail link, ii) M\$45B MRT Line 3, iii) M\$60-65B KL-SG High Speed Rail, and iv) TRX infrastructure/building works.
- In the medium term, recovery in property presales with M\$10.2B GDV OUG project as key driver.
- Potential listing of investment properties (we value at M\$993MM or M\$0.71/share).

WCT's share price fell 28% YTD (underperforming the KLCI by 33%) probably partly due to pre-elections jitters (polling on 9th May). Post elections recovery expected, in our view as per past trend. The construction sector rose 16.6% Y/Y 1M post polling. See "[Malaysia Strategy: Key trades ahead of the 14th General Election](#)".

Investment Thesis, Valuation and Risks

WCT Holdings Bhd (Overweight; Price Target: M\$1.60)

Investment Thesis

Construction order wins of M\$2.8B in 2017 have built up sizeable order backlog of M\$5.6B, representing 3.3x historical revenues. This provides more earnings clarity, in our view. The company is leveraged to >M\$258B upcoming rail-related infrastructure spending, mainly as a sub-contractor. The competitive landscape is improving with more available construction jobs, reducing risks to construction margins.

Sharp share price fall of 43% over the last 12 months (underperforming KLCI by 52%) partly due to investors' fears of the company's high net gearing of 88%, which warrants further de-gearing. Value has emerged, with WCT trading at 57% discount to SoTP (at close to -1SD) compared with historical average of 32%. Current share price of M\$1.17 does not reflect the entire property (M\$0.41/share) and property investments division (M\$1.04/share).

Valuation

We are OW on WCT, and our Dec-18 PT of M\$1.60 is based on our SoTP valuation. We apply a 13x P/E to FY18E construction earnings, conservatively below the historical average P/E, and a similar 13x multiple to property division earnings. WCT's shopping mall leases currently reflects AEON Bukit Tinggi (100%-owned), the 70%-owned Paradigm shopping mall with 700,000 sqft of net lettable area, and 70%-owned Gateway@Klia2; all are valued based on a WACC between 6.9% and 7.1%. We apply an overall discount of 40% to our SoTP valuation, above the historical average discount of 32% to derive our PT to account for risks of capital raising.

WCT's SoTP table

Segment	Method	M\$/share
Construction @ CY19E net profit	P/E of 13x	1.37
Property	P/E of 13x	0.41
AEON shopping mall lease (100% share)	DCF @ 7.1% WACC	0.41
Paradigm PJ shopping mall lease (70% share)	DCF @ 6.9% WACC	0.24
Gateway @ KLIA2 (70% share)	DCF @ 6.9% WACC	0.39
Net cash/(debt) and others		0.03
SoTP		2.87
FD SoTP		2.75
40% discount		(1.10)
Dec-18 PT (FD)		1.60

Source: J.P. Morgan estimates.

Risks to Rating and Price Target

Downside risks include: i) slower than expected rollout of infrastructure projects; ii) sharper than expected property sector slowdown; and iii) steep increases in building material prices that adversely affect construction margins

Upside risks include: i) stronger than expected new construction order wins and margins; ii) stronger than expected property presales; iii) earlier than expected unlocking of property investments; and iv) earlier than expected recovery of proceeds from Meydan Racecourse arbitration

WCT Holdings Bhd: Summary of Financials

Income Statement						Cash Flow Statement					
	FY16A	FY17A	FY18E	FY19E	FY20E	FY16A	FY17A	FY18E	FY19E	FY20E	
Revenue	1,934	1,906	3,854	3,470	4,469	Cash flow from operating activities	(164)	(81)	209	209	215
COGS	-	-	-	-	-	o/w Depreciation & amortization	84	89	95	104	113
Gross profit	-	-	-	-	-	o/w Changes in working capital	(84)	(329)	391	14	(70)
SG&A	-	-	-	-	-	Cash flow from investing activities	(239)	(119)	(100)	(100)	(100)
Adj. EBITDA	267	402	406	422	456	o/w Capital expenditure	(55)	(37)	(100)	(100)	(100)
D&A	(84)	(89)	(95)	(104)	(113)	as % of sales	2.8%	1.9%	2.6%	2.9%	2.2%
Adj. EBIT	182	313	310	318	343	Cash flow from financing activities	323	401	(100)	(100)	(100)
Net Interest	(62)	(63)	(92)	(90)	(89)	o/w Dividends paid	(0)	0	(7)	(18)	(24)
Adj. PBT	142	225	244	254	254	o/w Shares issued/(repurchased)	0	267	(305)	(305)	(305)
Tax	(57)	(79)	(68)	(74)	(68)	o/w Net debt issued/(repaid)	577	254	(123)	(118)	(113)
Minority Interest	3	3	(15)	(16)	(15)	Net change in cash	(80)	201	9	9	15
Adj. Net Income	131	178	191	194	201	Adj. Free cash flow to firm	(182)	(77)	178	177	181
Reported Net Income	88	149	161	164	171	y/y Growth	(68.4%)	(57.8%)	(331.9%)	(0.6%)	2.4%
Reported EPS(Basic)	0.07	0.11	0.11	0.12	0.12						
Adj. EPS	0.08	0.11	0.12	0.12	0.12						
DPS	0.00	0.00	0.01	0.01	0.02						
Payout ratio	0.0%	0.0%	7.6%	12.0%	14.4%						
Shares outstanding	1,242	1,415	1,415	1,415	1,415						
Balance Sheet						Ratio Analysis					
	FY16A	FY17A	FY18E	FY19E	FY20E	FY16A	FY17A	FY18E	FY19E	FY20E	
Cash and cash equivalents	455	527	610	620	634	Gross margin	-	-	-	-	
Accounts receivable	1,081	1,528	1,901	1,711	2,204	EBITDA margin	13.8%	21.1%	10.5%	12.2%	10.2%
Inventories	132	461	189	167	220	EBIT margin	9.4%	16.4%	8.1%	9.2%	7.7%
Other current assets	913	701	701	701	701	Net profit margin	6.8%	9.4%	5.0%	5.6%	4.5%
Current assets	2,581	3,217	3,401	3,200	3,760	ROE	4.9%	6.0%	5.8%	5.5%	5.5%
PP&E	328	338	427	434	432	ROA	1.9%	2.3%	2.1%	2.0%	2.0%
LT investments	1,125	1,594	1,594	1,594	1,594	ROCE	2.0%	3.3%	3.2%	3.0%	3.2%
Other non current assets	3,306	2,983	4,393	4,613	4,806	SG&A/Sales	-	-	-	-	-
Total assets	7,340	8,134	9,816	9,841	10,592	Net debt/Equity	90.3%	87.6%	96.8%	95.5%	93.0%
Short term borrowings	823	1,028	1,064	1,064	1,064	Net debt/EBITDA	946.7%	685.4%	835.3%	822.9%	778.5%
Payables	972	1,209	1,700	1,503	1,979	Sales/Assets (x)	0.3	0.2	0.4	0.4	0.4
Other short term liabilities	9	11	132	127	124	Assets/Equity (x)	2.6	2.6	2.7	2.8	2.8
Current liabilities	1,804	2,248	2,896	2,695	3,167	Interest cover (x)	4.3	6.4	4.4	4.7	5.1
Long-term debt	2,159	2,257	2,936	3,028	3,123	Operating leverage	(132.7%)	(5003.4%)	(0.9%)	(23.5%)	27.9%
Other long term liabilities	579	482	482	482	482	Tax rate	40.1%	35.0%	27.8%	29.2%	26.9%
Total liabilities	4,542	4,987	6,314	6,204	6,772	Revenue y/y Growth	15.9%	(1.4%)	102.2%	(10.0%)	28.8%
Shareholders' equity	2,764	3,139	3,448	3,567	3,735	EBITDA y/y Growth	(14.0%)	50.8%	0.8%	4.0%	8.2%
Minority interests	34	8	55	70	85	EPS y/y Growth	(13.6%)	36.6%	6.9%	1.6%	3.4%
Total liabilities & equity	7,340	8,134	9,816	9,842	10,592						
BVPS						Valuation					
	FY16A	FY17A	FY18E	FY19E	FY20E	FY16A	FY17A	FY18E	FY19E	FY20E	
BVPS	2.19	1.75	1.92	1.98	2.08	P/E (x)	14.7	10.8	10.1	9.9	9.6
y/y Growth	0.4%	(20.3%)	9.8%	3.5%	4.7%	P/BV (x)	0.5	0.7	0.6	0.6	0.6
Net debt/(cash)	2,527	2,758	3,390	3,472	3,553	EV/EBITDA (x)	15.2	10.7	11.8	11.5	10.9
						Dividend Yield	0.0%	0.0%	0.6%	1.0%	1.3%

Source: Company reports and J.P. Morgan estimates.

Note: M\$ in millions (except per-share data). Fiscal year ends Dec. o/w - out of which

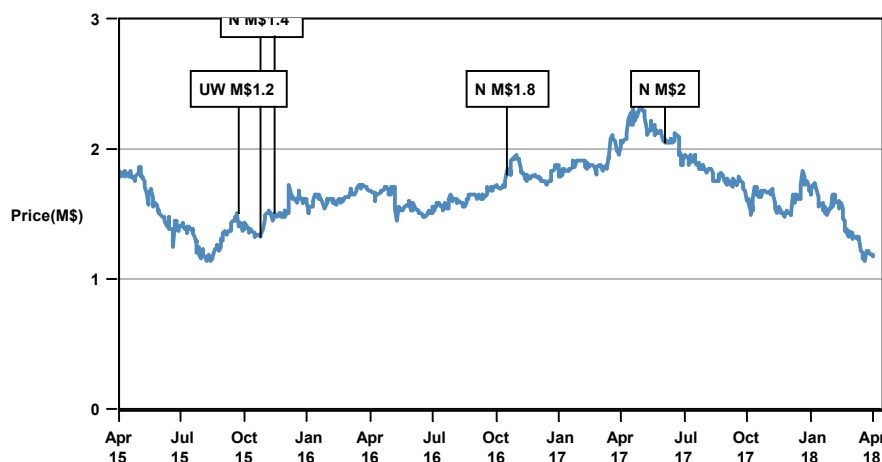
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WCT Holdings Bhd (WCTE.KL, WCTHG MK) Price Chart



Date	Rating	Share Price (M\$)	Price Target (M\$)
12-Oct-15	UW	1.50	1.20
13-Nov-15	N	1.32	1.40
01-Dec-15	N	1.50	1.50
03-Nov-16	N	1.80	1.80
21-Jun-17	N	2.04	2.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Aug 22, 2007.

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