

AIM Italia

Target Price: € 2,38
Rating Buy

Year	VoP €k	EBITDA €k	EBIT €k	Net Profit €k	Eps €	EV/Ebitda x	EV/Ebit x	P/E x
2015A	22.647	1.204	(4.033)	(3.284)	-0,119	54,4	nm	nm
2016 F	29.636	(587)	(5.918)	(6.404)	-0,231	nm	nm	nm
2017 F	34.796	3.432	(2.233)	(2.542)	-0,092	19,7	nm	nm
2018 F	40.879	7.408	1.702	1.436	0,052	8,8	38,5	38,3

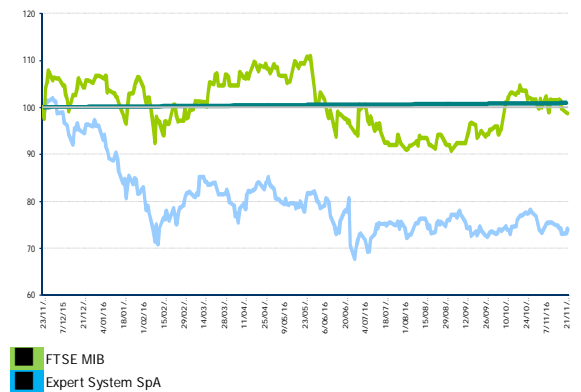
	Old	New
Rating	Buy	Buy
Risk Rating	Medium	Medium
Target Price	2,61	2,38

Market Data (€)

Close Price (€)	1,90
Share Outstanding (k)	27670
Market Cap (€m)	52574
Market Float (%)	41,9
Avg Daily Vol (n.)	22500
Past 12 Months	Max 2,28 Min 1,72

Performance

	3 M	12 M
Absolute	-5,2	-7,4
Relative	3,8	25,6



■ FTSE MIB
■ Expert System SpA



1h16 results, affected by the change in the consolidation perimeter, are worse than our estimates, especially the profitability. The value of production grew by 80,5% yoy to € 13,1 mln (€ 14,8 mln in our previous research), mainly due to some major foreign orders postponed. EBITDA was negative, € -1,9 mln (€ 1,2 mln in our estimates), also due to significant developments costs for international expansion and integration with the other group companies. EBIT was € -4,9 mln (€ -1,7 mln in our estimates) as a consequence of depreciation in R&D (€ 1,4 mln) and consolidation differences. NFP is growing (€ 13,9 mln from € 10,5 mln in December 2015) affected by the investments carried out.

The reference market is growing fast. Several influential studies testify that Big Data have become over time an increasingly important topic with still room for growth. According to the World Text Analytics Market (Opportunities and Forecast 2013-2020), the fastest growing market will be North America. With this regards, Expert System has invested and we expect it will continue to invest in this market in the coming years.

Down our FY16-18F estimates. We have reviewed the estimates based on the results of the 1H16. The massive investments (approximately € 5 mln per year) will benefit the income statement from the FY18. For FY16 we estimate a still negative EBITDA (-€0,6 mln). We estimate that, by FY17F onwards, the net profitability can be significantly improved but only in the FY18F the return on investment can be fully visible.

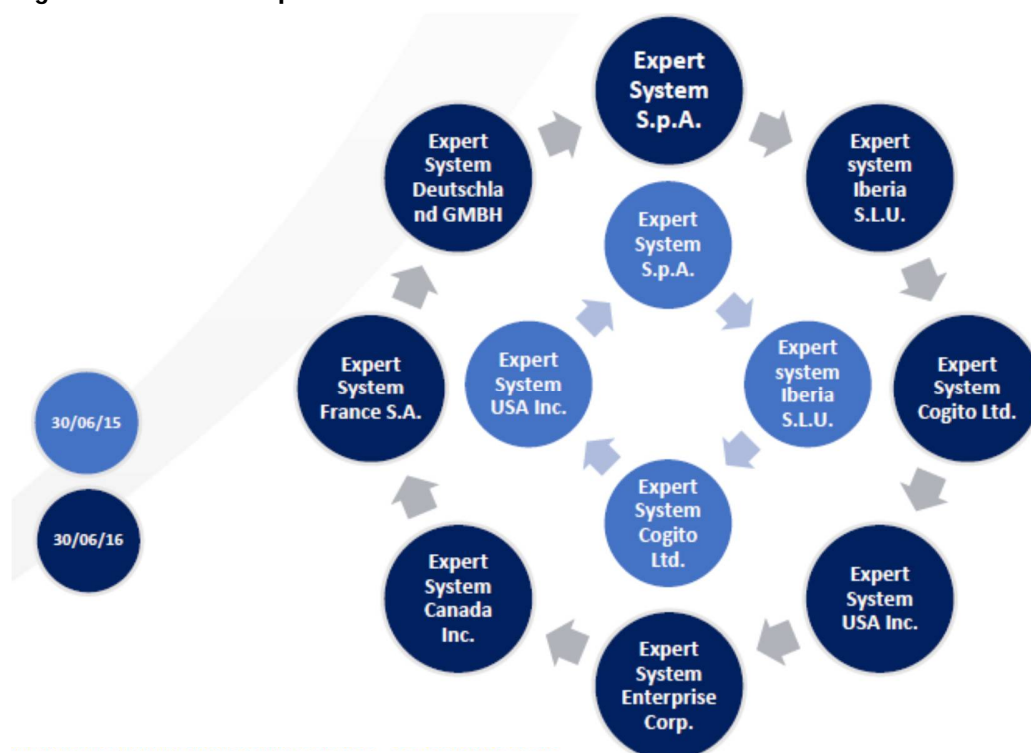
Valuation: rating Buy, Target Price 2,38 (from 2,61 in our previous research), risk medium. The acquisition of Temis and the subsequent complete integration will enable strong results growth from FY18F, with a shift of about one year compared to our previous estimates.

1H16 results and 2016-18F estimates

1H16 results

The results take into account the consolidation perimeter change. Following it is shown the perimeter in the 1H15 and the 1H16 one, in order to understand the magnitude of the change.

Fig. 1 – Consolidation perimeter



Source: Expert System

The value of production grew by 80,5% yoy to € 13,1 mln (€ 14,8 mln in our previous research), mainly due to some major foreign orders postponed. EBITDA was negative, € -1,9 mln (€ 1,2 mln in our estimates), also due to significant developments costs for international expansion and integration with the other group companies. EBIT was € -4,9 mln (€ -1,7 mln in our estimates) as a consequence of depreciation in R&D (€ 1,4 mln) and consolidation differences. NFP is growing (€ 13,9 mln from € 10,5 mln in December 2015) affected by the investments carried out.

Overall, the R&D Group's investments have increased by 80% over the same period in 2015, an increase that is mainly due to the change in perimeter.

At the same time, the expansion of the group led to a greater complexity in the organizational structure level, which has resulted in an increase in overhead costs, primarily personnel. However, if on one hand, the use of highly specialized and expensive workforce is for Expert System a strategic asset for the development of high value products; on the other hand it is reasonable to believe that the progressive integration of the former TEMIS group personnel will result in significant improvements in efficiency and internal organization.

Fig. 2 – Actual data and 2016F estimates

P&L (data in €/000)	30/06/2016		
	Forecast	Actual	% Ch
VALUE OF PRODUCTION	14.800	13.155	-11,1%
Total Costs	13.600	(15.107)	-211,1%
EBITDA	1.200	(1.953)	n.m.
<i>Ebitda margin %</i>	8,1%	n.m.	
Depreciation & Amortization	(2.900)	(2.946)	1,6%
EBIT	(1.700)	(4.898)	188,1%
<i>Ebit margin %</i>	n.m.	n.m.	
NET INCOME	(2.100)	(5.049)	140,4%

Source: Expert System and Integrae SIM

1H16 has been full of events that have affected both industry and internal dynamics. Several influential studies (Forrester™ “Big Data Text Analytics Platforms, Q2 2016: The 10 Providers That Matter Most and How They Stack Up”, together with “Osservatorio Big Data Analytics & Business Intelligence” of Politecnico di Milano) testify that Big Data have become over time an increasingly important topic with still room for growth.

In 2016, the increasing investments were translated in a high demand of software applications and specialized professional services, but also in increasing competition in the sector.

In this scenario, Expert System has undertaken a process in order to consolidate the group's image, thanks to both the major acquisitions that took place during the 2015 and the current European leadership position achieved in the context of cognitive computing. At the same time, it continued its strategy to strengthen the presence in the US market, subject to significant and strategic investments.

The investments carried out have enabled Expert System to be included in the Forrester™ “Big Data Text Analytics Platform Q2 2016” world top ten (out of 200 companies considered).

Estimates for the 2016-18F period

We have reduced the estimates from our previous research, following the 1H16 lower than expected results, the amount of the investment carried out and that we expect to be done in the coming years (€ 5 mln per year until 2021). Investments that, we believe, will begin to benefit the income statement from 2018, but in terms of profitability they will be fully visible from 2019 onwards.

We believe that 2016F and partially the 2017F may still be years in which structural and personnel costs more than double because of TEMIS, investments in the US and the growing depreciation costs.

Compared to our previous estimates of FY16, we reduce the value of production by 9,4% and forecast a negative EBITDA (it was € 2,5 mln in our previous research). This lead to a net loss of € 6,4 mln (from € 3,3 mln in our previous research).

With regards to 2017-18F, we reduce the estimates of the value of production by 11,8% and 8,4% respectively. EBITDA should return positive in FY17F but only in the FY18F investments earnings potential will be shown.

In the medium term (2018-21F), our estimates are based on the investments carried out and that will be carried out in the coming years and the expected growth of the market.

Fig. 3 – Estimates reviewed

P&L (€/000 data)	2016F			2017F			2018F		
	Old	New	% Ch	Old	New	% Ch	Old	New	% Ch
VALUE OF PRODUCTION	32.727	29.636	-9,4%	39.451	34.796	-11,8%	44.606	40.879	-8,4%
Total Costs	(30.223)	(30.223)	0,0%	(32.799)	(31.364)	-4,4%	(36.059)	(33.471)	-7,2%
EBITDA	2.504	(587)	n.m.	6.652	3.432	n.m.	8.547	7.408	n.m.
Ebitda margin %	7,7%	n.m.		16,9%	9,9%		19,2%	18,1%	
Depreciation & Amortization	(5.331)	(5.331)	0,0%	(5.665)	(5.665)	0,0%	(5.706)	(5.706)	0,0%
EBIT	(2.827)	(5.918)	109,3%	987	(2.233)	-326,2%	2.841	1.702	-40,1%
Ebit margin %	n.m.	n.m.		2,5%	n.m.		6,4%	0	
NET INCOME	(3.267)	(6.404)	96,0%	287	(2.542)	n.m.	1.455	1.436	-1,3%

Source: *Integrae SIM*

The disruption introduced by Big Data

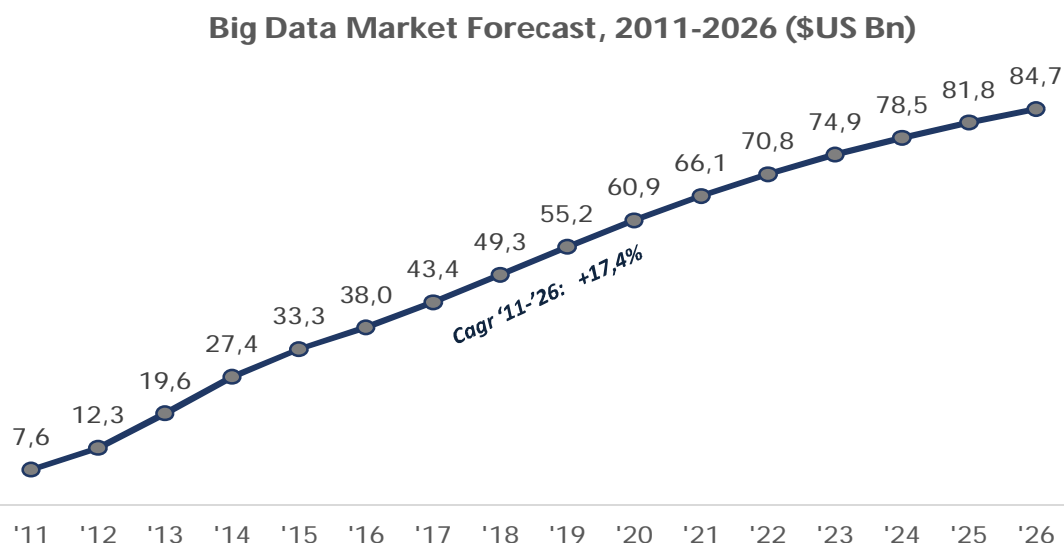
In order to better understand the disruption that Big Data management will have, we report the Wikibon data (Big Data Research) and Accenture data (Big Data Survey) related to the market as a whole and to text analysis.

Fig. 4 – The impact of Big Data management on the organization of enterprises within the next five years.



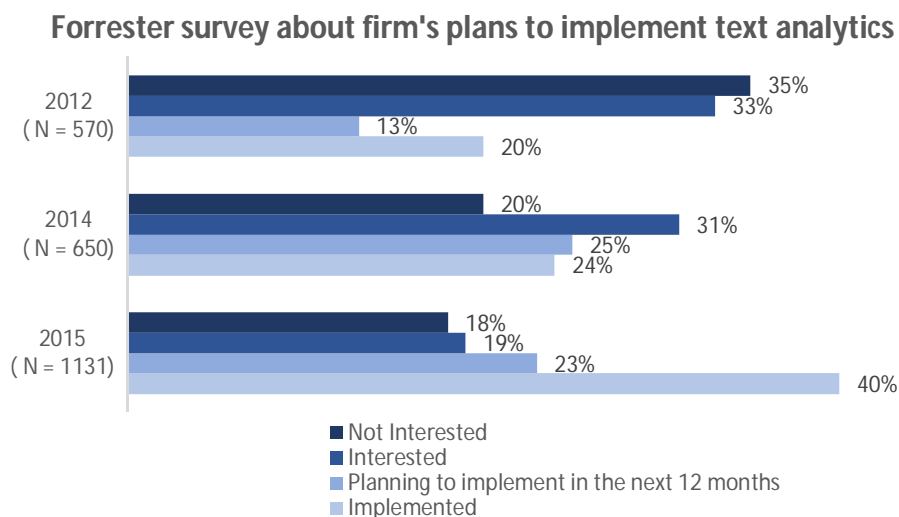
Source: *Accenture Big Success with Big Data Survey, April 2014*

Fig. 5 – Big Data market outlook



Source: Wikibon Big Data Research

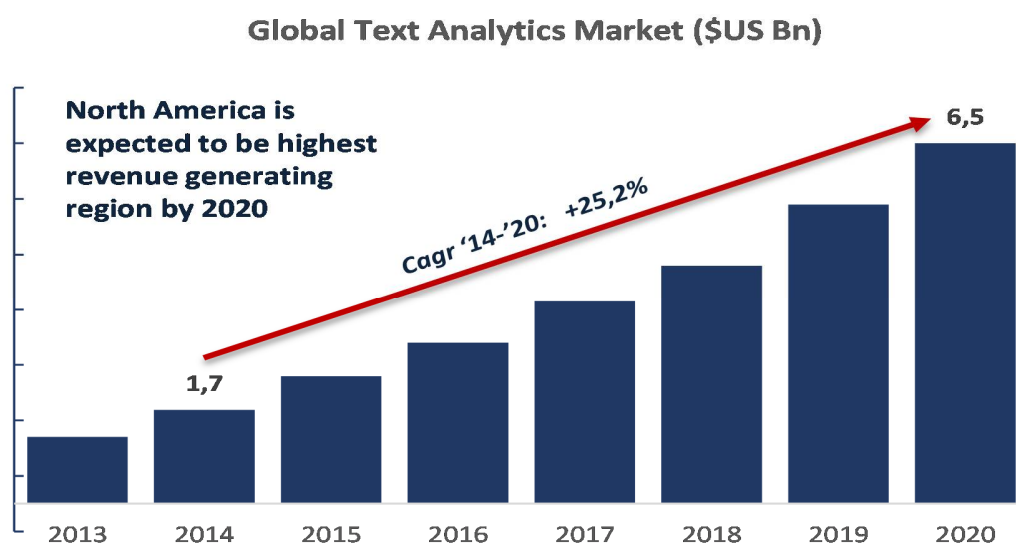
Fig. 6 – Enterprises estimates about investments in text semantic analysis



Source: Forrester's Global Business Technographics® Data and Analytics Survey, 2015-2014-2013

According to the World Text Analytics Market (Opportunities and Forecast 2013-2020), the fastest growing market will be North America. With this regards, Expert System has invested and we expect it will continue to invest in this market in the coming years.

Fig. 7 – North America market



Source: *World Text Analytics Market - Opportunities and Forecasts, 2013 - 2020*

Thanks to the investments in R&D, Expert System has been included in the “Forrester Wave™”. The sample analyzed by Forrester Wave has about 200 suppliers in the Big Data Text Analytics market segment. Although the competitive landscape includes multinational Groups with significant critical mass, Expert System is in the globally Top 10 in the “Big Data Analytics Platform Text”. We made the following assumptions based on the new consolidated estimates and the acquisition of TEMIS:

- Sales force: Strong attention to foreign markets, particularly the United States and Germany. In order to strengthen the Group's position and to increase market penetration we expect the build-up of an indirect sales force dedicated to the selling activity of COGITO to third party distributors;
- Costs: We estimate a significant increase in personnel costs (direct sales). The focus of R&D in the coming years will be directed to the standardization of products, in order to reduce integration activities. By FY16F Expert System should increase the sales force with international sales (US and Germany), project manager and software developers;
- Working capital: We expect government aim for R&D will continue (the estimated collection of 2015-2017F period is €5 mln), combined with a progressive decrease of the working capital absorption mainly related to the expectation of a strong sales increase (we estimated in 10 days the decline between DPO and DSO);
- Investments: we expect around €5 mln yearly investments in R&D for the 2016-21F period, in order to align the quality level of other languages (e.g. Mandarin, Japanese and Korean) and to continue to develop the Cogito technology and its features. Furthermore, we do not rule out the possibility of future acquisitions deals in order to increase the customer base and/or enter new markets.

Fig. 8 – Profit & Loss

Consolidated Profit & Loss (€/000)	2015A	2016F	2017F	2018F	2019F	2020F	2021F
Total Sales	16.339	23.000	27.900	34.060	41.211	45.415	48.623
VALUE OF PRODUCTION	22.647	29.636	34.796	40.879	48.029	52.309	55.594
	<i>Growth YoY</i>	<i>n.m.</i>	<i>30,9%</i>	<i>17,4%</i>	<i>17,5%</i>	<i>8,9%</i>	<i>6,3%</i>
Total Costs	(21.443)	(30.223)	(31.364)	(33.471)	(38.876)	(41.091)	(42.586)
EBITDA	1.204	(587)	3.432	7.408	9.153	11.218	13.008
	<i>Ebitda margin %</i>	<i>5,3%</i>	<i>-2,0%</i>	<i>9,9%</i>	<i>18,1%</i>	<i>19,1%</i>	<i>21,4%</i>
Depreciation & Amortization	(5.238)	(5.331)	(5.665)	(5.706)	(5.461)	(3.305)	(3.500)
EBIT	(4.033)	(5.918)	(2.233)	1.702	3.692	7.913	9.508
	<i>Ebit margin %</i>	<i>-17,8%</i>	<i>-20,0%</i>	<i>-6,4%</i>	<i>4,2%</i>	<i>7,7%</i>	<i>15,1%</i>
NET INCOME	(3.284)	(6.404)	(2.542)	1.436	2.002	4.570	5.562

Source: Expert System and Integrae SIM.

Fig. 9 – Assets & Liabilities

Consolidated Balance Sheet (€/000)	2015A	2016F	2017F	2018F	2019F	2020F	2021F
Total Assets	20.665	24.055	23.660	23.254	23.123	25.178	27.068
Working Capital	11.955	7.470	7.636	7.680	8.283	9.000	9.274
Total Provisions	(1.391)	(1.907)	(2.125)	(2.336)	(2.784)	(3.025)	(3.216)
INVESTED CAPITAL	31.229	29.618	29.171	28.599	28.622	31.152	33.126
Equity	(20.718)	(19.214)	(16.672)	(18.109)	(20.111)	(24.680)	(30.242)
Net Debt	(10.511)	(10.404)	(12.499)	(10.490)	(8.512)	(6.472)	(2.884)
	-	-	-	-	-	-	-
TOTAL FUNDS	(31.229)	(29.618)	(29.171)	(28.599)	(28.622)	(31.152)	(33.126)

Source: Expert System and Integrae SIM

Fig. 10 – Cash Flow

Consolidated Cash Flow (€/000)	2016F	2017F	2018F	2019F	2020F	2021F
EBITDA	(587)	3.432	7.408	9.153	11.218	13.008
Change in Net working capital	(179)	(1.863)	76	(580)	(811)	(287)
Change in Grants receivables/liabilities	1.891	1.697	(120)	(22)	94	13
Change in provision	384	138	130	368	162	110
Extraordinary income/expense						
Taxes	89	200	150	(1.335)	(3.046)	(3.708)
Cash flow from Operating activities	1.598	3.605	7.645	7.584	7.617	9.136
(Inc.)/Decrease in Intangible Asset	(4.778)	(5.000)	(5.000)	(5.000)	(5.000)	(5.000)
(Inc.)/Decrease in Tangible Asset	(110)	(190)	(220)	(250)	(280)	(310)
(Inc.)/Decrease in Financial Asset	(367)					
Cash flow from Investing activities	(5.255)	(5.190)	(5.220)	(5.250)	(5.280)	(5.310)
Net cash flow from Operating activities	(3.657)	(1.585)	2.425	2.334	2.337	3.826
Cash flow before financing activities	1.243	(1.585)	2.425	2.334	2.337	3.826
Change in Equity	4.700					
Financial income/expense	(576)	(509)	(416)	(355)	(297)	(238)
Inc./(Decrease) Bond						
Inc./(Decrease) long term loans	(3.305)	(4.964)	(3.595)	(3.136)	(3.088)	(1.594)
Inc./(Decrease) other financial debt	(389)	(201)	(108)	1		
Cash flow from Financing activities	430	(5.674)	(4.119)	(3.491)	(3.384)	(1.832)
Net Increase / (Decrease) in Cash	(3.227)	(7.259)	(1.694)	(1.157)	(1.048)	1.994
Cash at the beginning of the period	12.595	9.368	2.109	415	(742)	(1.789)
Final cash position	9.368	2.109	415	(742)	(1.789)	204

Source: Expert System e Integræ SIM

Valuation

With reference to Expert System equity range valuation, we applied the DCF and multiples method.

Each valuation method is able to capture one or more aspects of a company's life: income, equity, based on cash flows and based on a comparison of "like" companies listed. For this reason, we believe that the proper mix between the different valuations will be able to better catch the "correct fair value range" of a company like Expert System characterized by some peculiarities (cash flows, management quality, etc.).

The DCF method

The results of the DCF method, for the aim of calculating the equity value of a company, are usually a function of estimates and variables, including the visibility of the business. Visibility that, in the case of Expert System, allow us to extend the time horizon up to 2021F, when the profitability of the projects together with the impact of the TEMIS acquisition will be fully visible. For this reason, thanks to the DCF method we can grasp some aspects of the business that the multiples method would not be able to approximate.

The following input data:

Fig. 11 – Input data

Wacc calculation	
Risk Free Rate	0,57%
Market Premium	9,25%
Beta Unlevered	1,00
Tax Rate (Ires + IRAP)	31,40%
D/E (average)	38,22%
Beta Relevered	1,42
Alfa (specific risk)	2,50%
Ke	16,25%
Wacc	11,09%

Source: *Integrae SIM*

The above-mentioned parameters were based on the following assumptions:

- the risk-free rate is the Rendistato average gross yield (Bank of Italy) of bonds maturing between four years and seven months and six years and six months for the 2015-2016 period;
- the market premium is calculated by Prof. A. Damodaran to Italy is equal to 9.25% (Update September 2016);
- The unlevered Beta was determined based on the average 5 year-Beta for the same sample of comparables used to determine the equity value with the multiples methodology (equal

to 1x). Please note that the choice of time period and the frequency of observations (weekly) was chosen as a function of maximizing the significance of linear regression expressed by the parameter R2. That Beta was then levered based on the average D/E estimates for the 2016-20F period. The Beta levered is thus equal to 1,48x;

Fig. 12 – Average Beta

Company	Unlevered Beta				
	1-Year	2-Year	3-Year	4-Year	5-Year
FleetMatics Group Ltd.	1,06	0,66	0,71	0,71	
Ellie Mae Inc.	0,91	0,87	0,95	0,88	0,74
NO Mobile Inc.	1,62	0,58	0,91	1,01	1,08
Taomee Holdings Ltd.	0,07	0,05	0,00	-0,02	0,05
Tangoe Inc.	1,20	1,00	1,15	1,16	1,19
Imperva Inc.	1,80	1,91	2,03	1,79	1,78
Jive Software Inc.	0,83	0,60	0,55	0,72	1,02
Splunk Inc.	1,71	1,97	2,02	1,88	
Infoblox Inc.	1,61	1,85	1,51	1,43	
Proffpoint Inc.	1,28	1,43	1,37	1,31	
Exa Corp.	0,24	0,46	0,43	0,69	
Qualys Inc.	1,49	1,58	1,49	1,39	
Adobe Systems Incorporated	0,87	0,88	0,91	0,88	0,89
salesforce.com, inc.	1,17	1,37	1,25	1,27	1,38
Open Text Corporation	0,61	0,53	0,54	0,57	0,65
Alphabet Inc.	1,51	1,38	1,43	1,38	1,10
Oracle Corporation	1,20	1,24	1,23	1,27	1,10
Average	1,13	1,08	1,09	1,08	1,00

Source: *Infinancials*

- the growth rate "g" used to calculate the terminal value is conservatively set equal to 3%;
- Alpha, or additional specific risk, typical of equity investments in companies characterized by reduced operating dimensions, assumed to be 2.5%, based on major studies on the subject (Massari, Zanetti, Financial Rating, McGraw-Hill, 2004, p. 145, A. Damodaran, cost of Equity and Small Cap Premium Investment Valuation, Tools and Techniques for Determining the Value of any Assets, third edition 2012, Guatri, Bini, New Treaty on Companies rating, 2009 p. 236);

With our estimates and above-mentioned assumptions, the result is 11.09% WACC.

Fig. 13 – DCF method

Cash Flow	2016	2017	2018	2019	2020	2021	2022	2023	TV
EBIT	- 5.918	- 2.233	1.702	3.692	7.913	9.508	11.410	13.691	
Operating Taxes	1.651	623	(475)	(1.030)	(2.208)	(2.653)	(3.183)	(3.820)	
NOPLAT	- 4.267	- 1.610	1.227	2.662	5.705	6.855	8.226	9.872	
Depreciations	5.331	5.665	5.706	5.461	3.305	3.500	3.640	3.785	
Δ NWC	(179)	(1.863)	76	(580)	(811)	(287)	100	100	
Investments	(4.888)	(5.190)	(5.220)	(5.250)	(5.280)	(5.310)	(3.000)	(2.500)	
FCFO	(4.003)	(2.998)	1.789	2.293	2.920	4.758	8.966	11.257	139.227
Discounted FCFO	(3.968)	(2.675)	1.437	1.658	1.901	2.789	4.730	5.346	66.118
FCFO actualized	11.217								
TV actualized DCF	66.118								
Enterprise Value	77.335								
NFP (2016)	(10.404)								
Equity Value	66.930								

Source: *Integrae SIM*

With this data and by referring to our estimates and assumptions, the result is an equity value of € 66,9 mln, i.e. € 2,58 per share.

Fig. 14 – Sensitivity Analysis (Wacc _ Long Term Growth)

	WACC	WACC						
		9,59%	10,09%	10,59%	11,09%	11,59%	12,09%	12,59%
TV	4,5%	117,9	103,7	91,9	82,0	73,5	66,1	59,7
	4,0%	107,5	95,3	85,1	76,3	68,7	62,1	56,2
	3,5%	98,9	88,2	79,1	71,3	64,5	58,4	53,1
	3,0%	91,5	82,1	74,0	66,9	60,7	55,2	50,3
	2,5%	85,2	76,8	69,5	63,1	57,4	52,3	47,8
	2,0%	79,7	72,2	65,5	59,7	54,4	49,7	45,5
	1,5%	74,9	68,1	62,0	56,6	51,7	47,4	43,5

Source: *Integrae SIM*

Multiples method

Our sample consists of companies operating in the same sector of Expert System, but with higher capitalization and with a different organizational structure. The following companies, used for the multiples method, have been also used for the Beta calculation.

Fig. 15 – Comparables

Company	EV/Ebitda				EV/Ebit				P/E			
	2016	2017	2018	2019	2016	2017	2018	2019	2016	2017	2018	2019
Fleetmatics Group PLC												
Ellie Mae Inc.	24,9	19,0	14,2		30,7	23,7	17,5		38,8	32,8	27,3	
NQ Mobile Inc.					10,8				15,5			
Taomee Holdings Ltd.												
Tangoe Inc.	11,7	8,0			15,1	10,3			23,0	15,3		
Imperva Inc.	nm	nm	nm		nm	nm	nm	nm	nm	nm	nm	nm
Jive Software Inc.	12,4	11,0	9,1		36,2	20,4	13,7		57,1	33,3	22,2	
Splunk Inc.	86,9	52,0	43,7		148,7	85,0	56,7	25,7	194,4	119,0	79,2	43,5
Infoblox Inc.					29,6	20,2	12,8	10,2	61,5	40,1	27,0	20,0
Proofpoint Inc.	98,0	69,4	41,6		184,4	nm	60,9	41,1	nm	175,1	93,4	75,7
Exa Corp.	38,6	25,8			187,3	66,4			nm	194,5		
Qualys Inc.	16,4	13,4	11,0		22,2	18,3	13,8		43,0	37,1	28,9	
Adobe Systems Incorporated	22,0	17,9	14,7		25,7	20,1	16,5	15,0	35,3	27,6	22,3	19,4
salesforce.com, inc.	29,3	22,8	19,0	17,3	46,0	34,0	26,0	22,1	75,2	57,3	44,4	38,6
Open Text Corporation	11,3	10,7	9,5		12,3	11,8	11,4		15,6	14,7	14,3	
Alphabet Inc.	12,7	10,9	9,3	8,3	15,2	13,0	11,1	9,9	22,6	18,9	16,2	14,5
Average	33,1	23,7	19,1	12,8	58,8	29,4	24,1	20,7	52,9	63,8	37,5	35,3

Source: *Infinancials*.

The average equity value calculated through the multiples methodology is € 75,9 mln (excluding negative values as not significant). We have applied a liquidity discount of 25%, reaching a value of € 56,9 mln.

The assessment of the reasonableness of the 25% discount was calculated with regards to a lower stock liquidity than the comparables that feature Expert System stocks. In this regards, the study by W. L. Silber (Discount on restricted stock: the impact of liquidity on stock prices in Financial Analysis Journal, vol. 47, 1997, pp 60-64, more recently confirmed by JD Finnerty, the impact of transfer restriction on stock prices, Working paper, Analysis Group / Economics, Cambridge, in October 2002, which identified an average variable discount of between 15% and 25%), was also considered. The cash discount, unlike the discount minority, is not necessarily incorporated into market prices (T. Onesti, minority discounts and cash discounts, Cedam, 2001). Customers should note that this study, which has great application in the United States, is considered as a tool for the evaluation of the discount for "lack of marketability" of listed securities characterized by low trading volumes (See Landa, Zacchini, Onesti, evaluation of Companies, Giappichelli 2013, p.531 and ss.gg.).

For the calculation of the fair value, the arithmetical average between the two methods was conducted. The fair value is then equals to €61,5 mln, i.e. € 2,38 per share (€ 2,61 in our previous research), based on the average number of shares (25,93 mln).

Disclosure Pursuant to Article 69 ET SEQ. of Consob (Italian Securities Exchange Commission) Regulation No. 11971/1999

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Date	Recommendation	Target Price	Risk	Comment
24/6/15	Buy	3,90	Medium	Temis Acquisition
12/10/15	Buy	2,90	Medium	1H15 Results
4/7/16	Buy	2,61	Medium	FY15 Results

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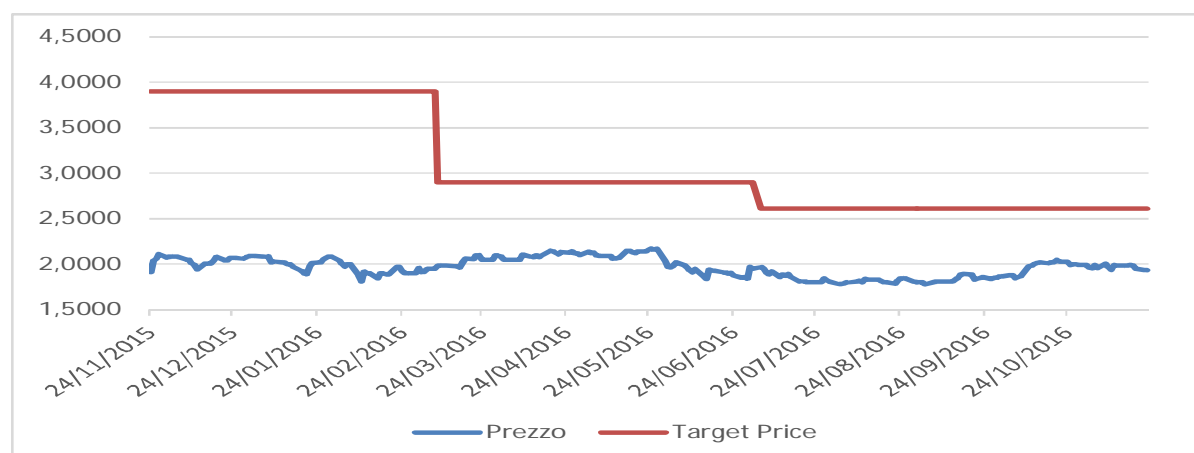
Equity Total Return (ETR) for different risk categories			
Rating	Low Risk	Medium Risk	High Risk
BUY	ETR >= 7.5%	ETR >= 10%	ETR >= 15%
HOLD	-5% < ETR < 7.5%	-5% < ETR < 10%	0% < ETR < 15%
SELL	ETR <= -5%	ETR <= -5%	ETR <= 0%
U.R.	Rating e/o target price Under Review		
N.R.	Stock Not Rated		

Valuation methodologies (long term horizon: 12 months)

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