

Result Focus

Osprey Medical Inc. (OSP.ASX)



Tuesday, 30 October 2018

Promoted to the Premier league, whilst short term sales stumble

Recommendation: Positive

Last price **\$0.15**
Valuation **\$0.37**

| TSR | |
|--------------------------|--------|
| Upside to valuation | 146.8% |
| Dividend yield | 0.0% |
| Expected total SH return | 146.8% |

OSP.ASX share price history v XJO.ASX

Source: EAP Research, IRESS



Trading Data

| | |
|------------------------------|-----------------|
| Last Price | \$0.15 |
| Valuation | \$0.37 |
| 12 month range | \$0.14 - \$0.45 |
| Market Cap | \$51m |
| Free Float | \$25m (50%) |
| 12 month return (historical) | (59.5%) |

Earnings revisions

| | FY18 | % chg | FY19 | % chg |
|---------------|---------------|----------------|-------|---------|
| REVENUE (\$m) | 2 | (16.7%) | 5 | (43.5%) |
| EBITDA (\$m) | (17) | (17.2%) | (17) | (18.1%) |
| Adj. EPS (c) | (4.2) | 3.0% | (3.7) | 15.3% |
| Val | \$0.37 | (22.9%) | | |

3Q18 Disappoints, short term reprieve unlikely

The 3Q18 result was a ~20% miss to EAP(f) sales estimates with DyeVert Plus unit growth of +2.9% sequentially. Whilst 3Q is the weakest seasonally and North Carolina was impacted by Hurricane Florence, +3% sequential growth remains very disappointing. In addition, re-directing the sales force to Group Purchasing Organisation (GPO) impacted the acquisition of new customers. During 3Q18, only 6 new hospitals were added vs 13 on average across 1H18. Importantly, 5 of the 6 Hospitals added were GPO accounts, in line with the communicated sales strategy. The focus on GPO accounts is sound given the increased credibility in engaging with hospitals and the reduced administrative burden in converting sales.

Signing Premier, Raising Capital

OSP's 3Q18 result coincided with 2 key announcements. The first was the agreement reached with Premier, one of the largest GPOs in the US with 4,000 member hospitals, significantly increasing the addressable market for OSP (currently selling into 130 hospitals). This was followed by a proposed capital raise of A\$20.5m (at a price of 15.5c) with \$10m from a private placement and \$10.5m through a rights issue already backed by its 26.9% majority shareholder. The cash proceeds will primarily fund the sales efforts within Premier hospitals.

Valuation remains compelling

We are hamstrung between short term volume volatility and the opportunity represented by the signed GPO's. Short term, we are faced with no option but to remove expectations around growth (hence the downgrade to FY19 sales by 41%) pushing out the time frame for breakeven, again. Management are now focussed on mobilising its sales force to penetrate the additional hospitals which we don't expect will be materially evident until FY20 due to disruption from the change in focus. Based on healthcare economics, cardiology guidelines and studies completed to date the rationale for DyeVert use in the hospital setting is compelling. However, converting hospitals is much slower than expected but is on the cusp of increasing again. Once the capital raising is complete, approximately 65% of the market cap is backed by cash. Maintain Positive Recommendation.

Earnings Forecasts

| Yr to December | 15A | 16A | 17A | 18E | 19E | 20E |
|----------------------------|---------|--------|--------|--------|--------|---------------|
| EBITDA (\$m) | (12) | (12) | (14) | (17) | (17) | (8) |
| Rep NPAT (\$m) | (12) | (12) | (14) | (17) | (17) | (8) |
| Adj NPAT (\$m) | (12) | (12) | (14) | (17) | (17) | (8) |
| Adj. EPS (c) | (7.9) | (6.2) | (5.0) | (4.2) | (3.7) | (1.7) |
| Adj. EPS Gth (%) | - | (21.2) | (19.1) | (16.5) | (13.1) | (53.3) |
| PER (x) | NM | NM | NM | NM | NM | NM |
| PEG Ratio (x) | - | 0.1 | 0.2 | 0.2 | 0.3 | 0.2 |
| DPS (c) | - | - | - | - | - | - |
| Yield (%) | - | - | - | - | - | - |
| Franking (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| ROE (%) | (106.9) | (70.5) | (53.1) | (49.8) | (62.8) | (54.4) |
| EV/EBITDA (x) | NM | NM | NM | NM | NM | NM |
| Net Debt/EBITDA (x) | 1.0 | 1.9 | 2.3 | 2.1 | 1.1 | 1.3 |
| Int. Cover (x) | - | - | - | - | - | - |
| Valuation (blended) | | | | | | \$0.37 |

Source: EAP Research

EARNINGS REVISIONS

Chart 1. Earnings Revisions

Source: E&P estimates

| Metric Yr to June | Units | | | Sales (\$m) | | | EBITDA (\$m) | | | NPAT (\$m) | | |
|----------------------|--------|--------|---------|-------------|------|---------|--------------|--------|---------|------------|--------|---------|
| | Old | New | % Chg | Old | New | % Chg | Old | New | % Chg | Old | New | % Chg |
| 2018E | 8,992 | 7,574 | (15.8%) | 3.0 | 2.5 | (17.0%) | (14.5) | (17.0) | (17.1%) | (14.7) | (17.0) | (15.8%) |
| 2019E | 25,213 | 14,986 | (40.6%) | 8.5 | 4.8 | (42.9%) | (14.4) | (17.0) | (18.0%) | (14.6) | (17.2) | (17.7%) |
| 2020E | 57,245 | 35,380 | (38.2%) | 19.1 | 11.4 | (40.1%) | (6.3) | (7.8) | (22.2%) | (6.6) | (8.0) | (21.1%) |
| DCF Valuation | | | | | | | \$0.48 | \$0.37 | (22.9%) | | | |

The 3Q18 unit sales of 1933 units (1839 DyeVert Plus, 94 DyeTect) was a ~20% miss to EAP(f) sales estimates. Looking forward we revise our earnings estimates as follows;

Sales

We reduce our FY18 unit estimates by 15.8%, forecasting ~+12% sequential unit growth in 4Q18. We understand 3Q18 unit sales across key territories, experienced seasonally subdued volume in procedures with the softness in North Carolina (key sales territory) exacerbated by Hurricane Florence in September 2018. Consequently, 4Q18 unit sales is expected to benefit as doctors and specialists resume normal levels of procedure volumes. Partially diluting this rebound in our view, is the potential for further disruption to the sales process in the short term as OSP shifts focus targeting GPO customers.

Whilst the potential from GPO contracts (particularly Premier), is certainly appealing, we are cautious on the timeframe involved in converting this potential to sales. The 3Q18 result despite being seasonally weak, provided little evidence that OSP’s sales process outside the GPO track can meaningfully assist during this transition. Extrapolating quarterly results is often futile, however we believe it prudent to rebase unit sales expectations, downgrading FY19 by 40.6% and FY20 by 38.2%.

EBITDA

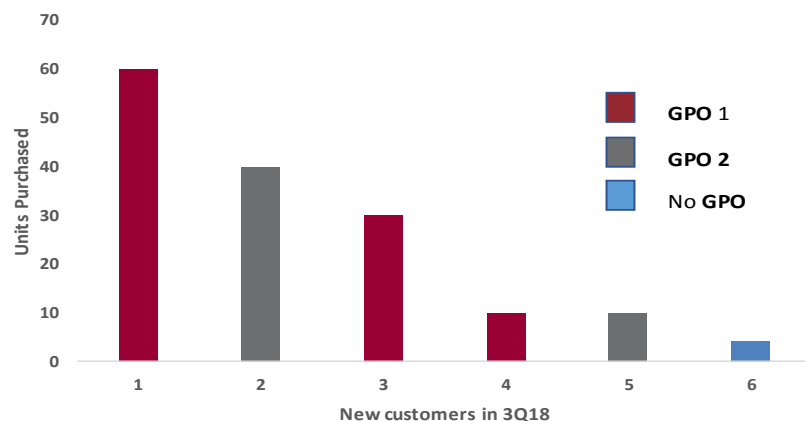
The proposed capital raise for A\$20.5m to fuel the GPO focused strategy will likely reflect a step up in OSP cost base. We forecast a monthly cash burn of \$1.4m across FY19 before an expected step down in FY20 to \$0.7m primarily from lower R&D spend and advertising/marketing costs.

5 OF 6 NEW CUSTOMERS VIA GPO CONTRACTS IN 3Q18

Chart 2. New customers

Source: OSP

OSP added 6 new customers (hospitals) in 3Q18. 5 of these were through the 2 GPOs signed in 2Q18 with the largest purchasing 60 units



FINANCIAL SUMMARY

| Osprey Medical Inc. | | OSP.ASX | | | | | | | | | |
|------------------------------------|------------|-----------------|-------------|-------------|------------|----------------------------|--------------|------------|------------|------------|------------|
| As at: | 30/10/2018 | Recommendation: | | | Positive | Share Price: | \$0.15 | | | | |
| Year end | December | 2017A | 2018E | 2019E | 2020E | Year end | December | 2017A | 2018E | 2019E | 2020E |
| INCOME STATEMENT | | | | | | VALUATION METRICS | | | | | |
| Sales revenue | \$m | 2 | 2 | 5 | 11 | PER | x | NM | NM | NM | NM |
| EBITDA | \$m | (14) | (17) | (17) | (8) | Dividend Yield | % | - | - | - | - |
| Depreciation | \$m | 0 | 0 | 0 | 0 | EV/EBITDA | x | NM | NM | NM | NM |
| EBIT (ex associates) | \$m | (14) | (17) | (17) | (8) | EV/EBIT | x | NM | NM | NM | NM |
| Equity accounted profits | \$m | - | - | - | - | P/FCF | x | NM | NM | NM | NM |
| EBIT (incl associates) | \$m | (14) | (17) | (17) | (8) | P/BV | x | 1.6 | 2.0 | 3.8 | 6.6 |
| Net interest | \$m | 0 | 0 | 0 | 0 | BLENDED VALUATION | | | | | |
| Pre-tax profit | \$m | (14) | (17) | (17) | (8) | Discounted Cash Flow | \$/sh | 0.37 | 100.0% | | |
| Tax expense | \$m | 0 | 0 | 0 | 0 | Capitalisation of Earnings | \$/sh | 0.00 | 0.0% | | |
| Net profit | \$m | (14) | (17) | (17) | (8) | PER | \$/sh | 0.00 | 0.0% | | |
| Oth./Outside equity interests | \$m | 0 | 0 | 0 | 0 | SOTP | \$/sh | | | | |
| NPAT attributable to s'hers | \$m | (14) | (17) | (17) | (8) | EARNINGS | | | | | |
| Net abnormal items | \$m | 0 | 0 | 0 | 0 | Blended Valuation | m | 0.37 | 100.0% | | |
| Reported NPAT | \$m | (14) | (17) | (17) | (8) | Closing shares on issue | m | 340 | 472 | 472 | 472 |
| BALANCE SHEET | | | | | | EFPOWA | ¢ | 285 | 406 | 472 | 472 |
| Assets | | | | | | Adj. EPS | ¢ | (5.0) | (4.2) | (3.7) | (1.7) |
| Cash | \$m | 32 | 35 | 18 | 10 | DPS | % | - | - | - | - |
| Working Capital | \$m | 1 | 1 | 2 | 4 | FINANCIAL RATIOS | | | | | |
| PP&E | \$m | 1 | 1 | 1 | 1 | Franking | % | 0.0 | 0.0 | 0.0 | 0.0 |
| Intangibles | \$m | 0 | 0 | 0 | 0 | Sales Growth | % | 178.7 | 53.0 | 93.4 | 137.0 |
| Investments | \$m | - | - | - | - | EBITDA Growth | % | 22.6 | 19.1 | 0.2 | (54.4) |
| Other | \$m | 0 | 0 | 0 | 0 | EBIT Growth | % | 22.9 | 19.2 | 0.1 | (53.3) |
| Total Assets | \$m | 34 | 37 | 21 | 15 | Adj. EPS Growth | % | (19.1) | (16.5) | (13.1) | (53.3) |
| Liabilities | | | | | | Tax Rate | % | 0.0 | 0.0 | 0.0 | 0.0 |
| Debt | \$m | 0 | 0 | 0 | 0 | EBITDA Margin | % | (873.6) | (680.2) | (352.5) | (67.8) |
| Working Capital | \$m | 1 | 0 | 1 | 3 | EBIT Margin | % | (885.7) | (689.9) | (356.9) | (70.3) |
| Other | \$m | 1 | 1 | 1 | 1 | ROA | % | (50.6) | (48.2) | (59.2) | (45.0) |
| Total Liabilities | \$m | 2 | 1 | 2 | 4 | ROE | % | (53.1) | (49.8) | (62.8) | (54.4) |
| Net Assets | \$m | 32 | 36 | 19 | 11 | ROCE | \$m | (394,676) | (2,522.2) | (2,018.0) | (1,355.1) |
| Ordinary Equity | \$m | 32 | 36 | 19 | 11 | Net Debt (cash) | % | (32) | (35) | (18) | (10) |
| Minority Interests | \$m | - | - | - | - | Net Debt/Equity | % | (99.3) | (96.8) | (97.0) | (94.2) |
| Total Shareholders' Funds | \$m | 32 | 36 | 19 | 11 | Net Debt/Debt + Equity | x | (14,348) | (3,059.4) | (3,225.3) | (1,633.5) |
| Capital Employed | \$m | 0 | 1 | 1 | 1 | Net Debt/EBITDA | % | 2.3 | 2.1 | 1.1 | 1.3 |
| CASH FLOW | | | | | | Working Capital/Sales | % | 31.6 | 44.7 | 11.4 | 5.2 |
| EBITDA | \$m | (14) | (17) | (17) | (8) | D&A/PP&E | x | 29.0 | 37.4 | 32.8 | 42.7 |
| Change in Working Capital | \$m | 0 | 0 | 1 | 0 | DIVISIONAL SUMMARY | | | | | |
| Other | \$m | 1 | 0 | 0 | 0 | EBIT Interest Cover | | - | - | - | - |
| Gross Operating Cash Flow | \$m | (14) | (17) | (16) | (8) | | \$m | - | - | - | - |
| Net interest paid | \$m | 0 | 0 | 0 | 0 | | | | | | |
| Tax paid | \$m | 0 | 0 | 0 | 0 | | | | | | |
| Net Operating Cash Flow | \$m | (14) | (17) | (16) | (8) | | | | | | |
| Maintenance capex | \$m | 0 | 0 | 0 | 0 | | | | | | |
| Free Cash Flow | \$m | (14) | (17) | (17) | (8) | | | | | | |
| Dividends paid | \$m | - | - | - | - | | | | | | |
| Net acquisitions/Growth capex | \$m | 0 | 0 | 0 | 0 | | | | | | |
| Equity raisings/Buybacks | \$m | 24 | 21 | 0 | 0 | | | | | | |
| Net borrowings | \$m | 0 | 0 | 0 | 0 | | | | | | |
| Other | \$m | 0 | 0 | 0 | 0 | | | | | | |
| Net change in cash | \$m | 10 | 3 | (17) | (8) | | | | | | |
| GOCF/EBITDA | % | 97.2 | 100.8 | 96.7 | 100.6 | | | | | | |
| Total Capex/Sales | % | 19.7 | 7.8 | 4.1 | 2.6 | | | | | | |
| Total Capex/Depreciation | x | 1.6 | 0.8 | 0.9 | 1.0 | | | | | | |

Source: Company data, E&P estimates

RESEARCH RECOMMENDATION DEFINITIONS

| | |
|-----------------|--|
| Positive | Stock is expected to outperform the S&P/ASX 200 over the coming 24 months |
| Neutral | Stock expected to perform in line with the S&P/ASX 200 over the coming 24 months |
| Negative | Stock is expected to underperform the S&P/ASX 200 over the coming 24 months |
| Speculative Buy | Stock has limited history from which to derive a fundamental investment view or its prospects are highly dependent on event risk, <i>eg.</i> Successful exploration, scientific breakthrough, high commodity prices, regulatory change, etc. |
| Suspended | Stock is temporarily suspended due to compliance with applicable regulatory and/or Evans & Partners policies in circumstances where Evans & Partners is acting in an advisory capacity. |
| Not Rated | Stock is not included in our investment research universe. |

Research Criteria Definitions

Recommendations are primarily determined with reference to how a stock ranks relative to the S&P/ASX 200 on the following criteria:

| | |
|-------------------------|--|
| Valuation | Composite of Rolling 12 month prospective multiples and discounted cash flow (DCF), or DCF for resource stocks. |
| Earnings Outlook | Forecast 2 year EPS growth. |
| Earnings Momentum | Percentage change in the current consensus EPS estimate for the stock (rolling 1 year forward basis) over the consensus EPS estimate for the stock 3 months ago. |
| Shareholder Returns | Composite of forecast ROE (rolling 1 year forward basis) and the percentage change in ROE over 2 years. |
| Debt Servicing Capacity | Rolling 12 month EBIT Interest Cover ratio. |
| Cyclical Risk | Qualitative assessment of the 2 year outlook for a stock/industry's profit cycle. |
| Industry Quality | Qualitative assessment of an industry's growth/returns potential and company specific management capability. |
| Financial Transparency | If we don't understand it, we won't recommend it. |

For stocks where Evans & Partners does not generate its own forecasts, Bloomberg consensus data is used. Analysts can introduce other factors when determining their recommendation, with any material factors stated in the written research where appropriate.

Australian Equity Research Team

Lorraine Robinson – Head of Research

P: +61 3 9631 9838
E: lrobinson@eandp.com.au



Steve Wheen - Senior Analyst

Healthcare
P: +61 2 8070 6654
E: swheen@eandp.com.au



Andrew Hines – Senior Analyst

Bulks, Metals, Energy
P: +61 3 9631 9849
E: ahines@eandp.com.au



Phillip Kimber – Senior Analyst

Retail
P: +61 3 9631 9873
E: pkimber@eandp.com.au



Keith Chau – Senior Analyst

Building Materials, Steel, Chem, Packaging
P: +61 2 8070 6616
E: kchau@eandp.com.au



Michael Clark - Analyst

Bulks, Metals, Energy
P: +61 3 9631 9848
E: mclark@eandp.com.au



James Holston – Associate

Telco, Media, Technology
P: +61 3 9235 9716
E: jholston@eandp.com.au



Rushil Paiva - Associate

Building Materials, Steel, Chem, Packaging
P: +61 2 8070 6641
E: rpaiva@eandp.com.au



Simon Fitzgerald - Senior Analyst

Diversified Financials
P: +61 2 8070 6634
E: sfitzgerald@eandp.com.au



Julian Mulcahy – Senior Analyst

Small Caps
P: +61 3 9235 9713
E: jmulcahy@eandp.com.au



Robin Young - Senior Analyst

Banks, REITs, Infrastructure
P: +61 3 9235 9730
E: RYoung@evansandpartners.com.au



Paul Mason - Senior Research Analyst

Technology
P: +61 3 9631 9867
E: PMason@evansandpartners.com.au



Cameron McDonald – Senior Analyst

Transport, Infrastructure
P: +61 3 9235 9709
E: cmcdonald@eandp.com.au



Johnny Huynh – Associate

Small Caps
P: +61 3 9235 9737
E: jhuynh@evansandpartners.com.au



Davin Thillainathan - Associate

Healthcare
P: +61 2 8070 6645
E: dthillainathan@eandp.com.au



Vibhu Vyas – Associate

Healthcare
P: +61 2 8070 6663
E: vyas@eandp.com.au



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|----------|--|
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| BRG | A director of Evans Dixon Limited, the ultimate holding company of Evans and Partners Pty Ltd, is a director of Breville Group Limited. |

| | |
|----------|--|
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| CVF | <p>The Issuer has appointed Evans and Partners as Broker to an on-market buy-back. Accordingly, Evans and Partners is unable to give sellers advice in respect to a sale of this security.</p> |
| DUI | <p>The Issuer has appointed Evans and Partners as Broker to an on-market buy-back. Accordingly, Evans and Partners is unable to give Sellers advice in respect to a sale of this security.</p> |
| EAF | <p>The Responsible Entity (RE) and Investment Manager (IM) of Evans and Partners Asia Fund (EAF), other entities that provide services to EAF and Evans and Partners Pty Ltd are wholly owned subsidiaries of Evans Dixon Ltd and related bodies corporate. Each of the RE, IM and other entities will receive fees for services provided to EAF. Directors or employees of Evans Dixon and/or its related bodies corporate are directors of the RE and/or IM of EAF. The Portfolio Manager and Assistant Portfolio Manager of EAF are employees of Evans Dixon and/or its related bodies corporate. Each individual receives remuneration from Evans Dixon and/or its related entities.</p> |
| EFF | <p>The Responsible Entity (RE) and Investment Manager (IM) of Evans and Partners Australian Flagship Fund (EFF), other entities that provide services to EAF and Evans and Partners Pty Ltd are wholly owned subsidiaries of Evans Dixon Ltd and related bodies corporate. Each of the RE, IM and other entities will receive fees for services provided to EFF. Directors or employees of Evans Dixon and/or its related bodies corporate are directors of the RE and/or IM of EFF. Directors or employees of Evans Dixon and/or its related bodies corporate are members of the EFF Investment Committee and/or Portfolio Consultants to the EFF Investment Committee. Each individual receives remuneration from Evans Dixon and/or its related entities.</p> |
| EGD | <p>The Responsible Entity (RE) and Investment Manager (IM) of Evans and Partners Global Disruption Fund (EGD) and Evans and Partners Pty Ltd are wholly owned subsidiaries of Evans Dixon Ltd and related bodies corporate. The RE and IM will receive fees for acting as RE and IM of EGD. Directors or employees of Evans Dixon and/or its related bodies corporate are directors of the RE and/or IM of EGD. A Director of Evans and Partners is a member of the EGD Investment Committee and an employee of Evans and Partners is a Portfolio Consultant to the EGD Investment Committee. Each individual receives remuneration from Evans Dixon and/or its related entities.</p> |
| EGF | <p>The Responsible Entity (RE) and the Investment Manager (IM) of Evans & Partners Global Flagship Fund (EGF) and Evans and Partners Pty Ltd are wholly owned subsidiaries of Evans Dixon Ltd and related bodies corporate. The RE and IM will receive fees for acting as RE and IM of EGF. Directors or employees of Evans Dixon and/or its related bodies corporate are directors of the RE and/or IM of EGF. Each individual receives remuneration from Evans Dixon and/or its related entities.</p> |
| FSREC IV | <p>The Responsible Entity (RE) and Fund Administrator of Fort Street Real Estate Capital Fund IV (FSREC IV), the Trustee of FSREC IV's primary underlying investment, Fort Street Real Estate Capital Trust IV (the Trust) and Evans and Partners Pty Ltd are wholly owned subsidiaries of Evans Dixon Ltd and related bodies corporate. The Investment Manager (IM) of FSREC IV is partially owned by a related body corporate of Evans and Partners. Each of the RE, Fund Administrator, Trustee and IM will receive fees for services provided to FSREC IV and/or the Trust. Directors or employees of Evans Dixon and/or its related bodies corporate are directors of the RE, Fund Administrator and/or Trustee of FSREC IV and/or the Trust. Each individual receives remuneration from Evans Dixon and/or its related entities.</p> |
| JLG | <p>Evans and Partners has arranged, managed or co-managed an offering of securities of the company or its affiliates in the past 12 months, for which it received a fee.</p> |
| LE.US | <p>A director of Evans Dixon Limited, the ultimate holding company of Evans and Partners Pty Ltd, is a director of Lands' End Inc.</p> |
| LLC | <p>A director of Evans Dixon Limited, the ultimate holding company of Evans and Partners Pty Ltd, is a director of Lendlease Group.</p> |
| LSF | <p>Evans and Partners has arranged, managed or co-managed an offering of securities of the company or its affiliates in the past 12 months, for which it received a fee.</p> |
| MGP | <p>Evans and Partners has arranged, managed or co-managed an offering of securities of the company or its affiliates in the past 12 months, for which it received a fee.</p> |

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| MQG | Evans and Partners has arranged, managed or co-managed an offering of securities of the company or its affiliates in the past 12 months, for which it received a fee. |
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| PMV | A director of Evans Dixon Limited, the ultimate holding company of Evans and Partners Pty Ltd, is a director of Premier Investments Limited. |
| SOHS.US | A director of Evans Dixon Limited, the ultimate holding company of Evans and Partners Pty Ltd, is a director of Sears Hometown & Outlet Stores Inc. |
| SUN | A director of Evans Dixon Limited, the ultimate holding company of Evans and Partners Pty Ltd, is a director of Suncorp Group Limited. |
| SWM | A director of Evans and Partners Pty Ltd is a director of Seven West Media Limited. |
| S32 | A director of Evans Dixon Limited, the ultimate holding company of Evans and Partners Pty Ltd, is a director of South32 Ltd. |
| URF | <p>The Responsible Entity (RE) and Investment Manager (IM) of US Masters Residential Property Fund (URF), other entities that provide services to URF and Evans and Partners Pty Ltd are wholly owned subsidiaries of Evans Dixon Ltd and related bodies corporate. Each of the RE, IM and other related entities will receive fees for services provided to URF. Directors or employees of Evans Dixon and/or its related bodies corporate are directors of the RE, IM of URF and/or other related entities that provide services to URF. A director of Evans and Partners Pty Ltd is a director of URF's primary underlying investment, US Masters Residential Property (USA) Fund (US REIT). Each individual receives remuneration from Evans Dixon and/or its related entities.</p> |
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