



Stock Note

Pokarna Limited

September 16, 2024



Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Granites & Marbles	Rs 1079	Buy in Rs 1069-1092 band and add on dips in Rs 945-968 band	Rs 1182	Rs 1260.5	2-3 quarters

HDFC Scrip Code	POKLTDEQNR
BSE Code	532486
NSE Code	POKARNA
Bloomberg	POKR:IN
CMP Sep 13, 2024	1079
Equity Capital (Rs Cr)	6.2
Face Value (Rs)	2.0
Equity Share O/S (Cr)	3.1
Market Cap (Rs Cr)	3339
Book Value (Rs)	191.0
Avg. 52 Wk Volumes	159586
52 Week High	1099
52 Week Low	421

Share holding Pattern % (Jun, 2024)	
Promoters	56.7
Institutions	18.4
Non Institutions	24.9
Total	100.0



* Refer at the end for explanation on Risk Ratings

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Our Take:

With over 30 years of expertise in the stone industry, Pokarna Ltd. (Pokarna) has established a robust global footprint, spanning over 20 countries. The company's strength lies in its vertically integrated operations, encompassing captive quarries and state-of-the-art mining and processing infrastructure. Pokarna's Granite division's offers a collection of over 75 varieties of granite sourced from India and around the world. The division is backed by advanced technology and a strong distribution network, ensuring the global delivery of high-quality products. However, the key piece of the business is the Quartz surface division, which is operated through Pokarna's wholly-owned subsidiary Pokarna Engineered Stone Limited (PESL). The division specializes in the manufacturing and export of premium quartz surfaces. Pokarna's Board in its meeting held on March 23, 2024, approved the potential transfer, sale, lease, exchange, hive-off, or other disposal of the company's Apparel Business on a going concern basis. Ultimately the division was closed wef March 31, 2024.

The company aims to distinguish its quartz surfaces in the market by creating distinctive products with premium features and a superior value proposition. This advantage is reinforced by PESL's investments in state-of-the-art production technology and strategic marketing resource allocation. During FY25, PESL will commercialize two cutting-edge technologies from BRETON S.p.A of Italy: the KREOS and CHROMIA lines. Both in the short and long term, the company anticipates strengthening its market position, diversifying its operations, and enhancing profitability.

Demand for countertops is expected to be driven by rising installations of countertops – which continue to be selected over freestanding or wall-mounted fixtures in kitchens and bathrooms – for both residential and nonresidential applications. Within the overall bouquet of countertops, the demand for Engineered Stone (primary offering of PESL) is expected to grow at an above average pace of 9.3% p.a. Over the past decade, engineered stone has significantly increased its market share, from 7% of global countertop sales in 2012 to 14% in 2022.

Pokarna continues to face operational challenges in terms of escalated ocean freight rates in terms of its imported procurements. While the international shipping situation influences its procurement expenses, the company's sales are generally protected as they are typically conducted on an FCA/FOB basis. For sales on a CIP basis, the company is able to pass the increased freight rates on to its customers. The company has remained resilient in an otherwise challenging environment, delivering double-digit revenue growth as it remains steadfast in continuing to improve its sales mix through differentiated offerings. We believe this approach will help Pokarna mitigate pricing pressures and position itself for incremental growth.

Valuation & Recommendation:

Despite operational challenges in recent years such as slowdown in US residential remodeling sector, sharp increase in international freight prices and downturn in the granite business, Pokarna has delivered resilient performance through product innovation and focus on high-end products, especially in the Quartz Surfaces segment. Quartz segment has delivered an above average CAGR of 19.7% between FY20-24. While sales in the Granite segment are expected to be subdued in FY25, due to the ongoing challenges in the U.S. housing market, we remain optimistic about the growth in both revenues and profitability of the company's engineered stone subsidiary, PESL. The engineered stone market continues to show strong potential and is expected to grow at 9.3% p.a. up to 2028. The management continues to strategically optimize its product-mix, reducing the reliance on low margin products. The company has also received encouraging demand for its quartz products from new geographies like Canada, France, Mexico and Russia.

Pokarna has also been able to reduce its total debt over the past 2 years from Rs 515 cr in FY22 to Rs 400 cr in FY24. The management aims to further reduce debt levels, resulting in improved cash flows in upcoming years. The company's net debt/EBITDA has improved from 2.8x in FY22 to 1.6x in FY24. The sale of its loss-making Apparels division is expected to further bolster cash flows for the company. Cost cutting efforts and exploring new avenues for revenue generation in the Granite segment is expected to bring the segment back to profitability. The management's renewed focus to drive revenue and improve mix in its core Quartz segment, bodes well for the company's future.

We believe investors can buy the stock in Rs 1069-1092 band (24.0x FY26E EPS) and add on dips in Rs 945-968 (21.25x FY26E EPS) band for a base case fair value of Rs 1182 (26.25x FY26E EPS) and bull case fair value of Rs 1260.5 (28.0x FY26E EPS) over the next 2-3 quarters.

Financial Summary:

Particulars (Rs cr)	Q1FY25	Q1FY24	YoY-%	Q4FY24	QoQ-%	FY22	FY23	FY24	FY25E	FY26E
Operating Income	193	162	19%	162	19%	650	725	688	780	874
EBITDA	61	46	32%	41	49%	175	170	210	230	260
APAT	33	18	85%	16	113%	78	66	87	113	138
Diluted EPS (Rs)	10.7	5.8	85%	5.0	113%	25.3	21.2	28.2	36.6	44.4
RoE-%						19.4	13.9	15.9	17.5	17.9
P/E (x)						42.7	50.8	38.3	29.5	24.0
EV/EBITDA (x)						21.9	22.2	17.5	16.0	13.6

(Source: Company, HDFC sec)

Segment Mix:

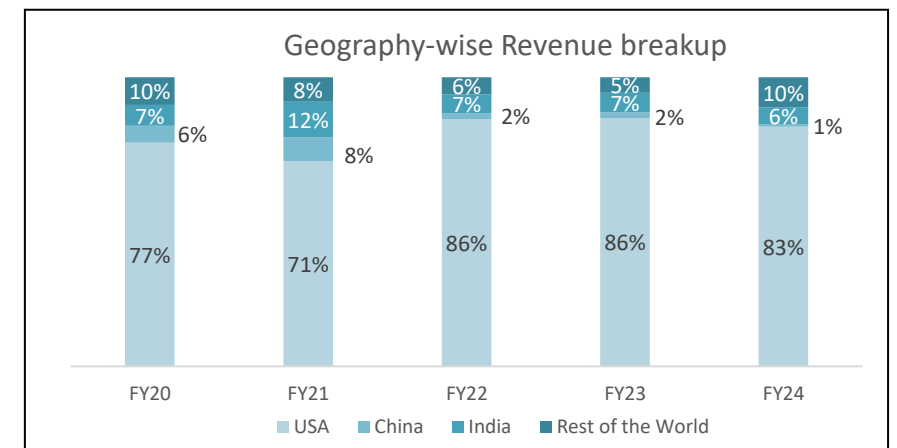
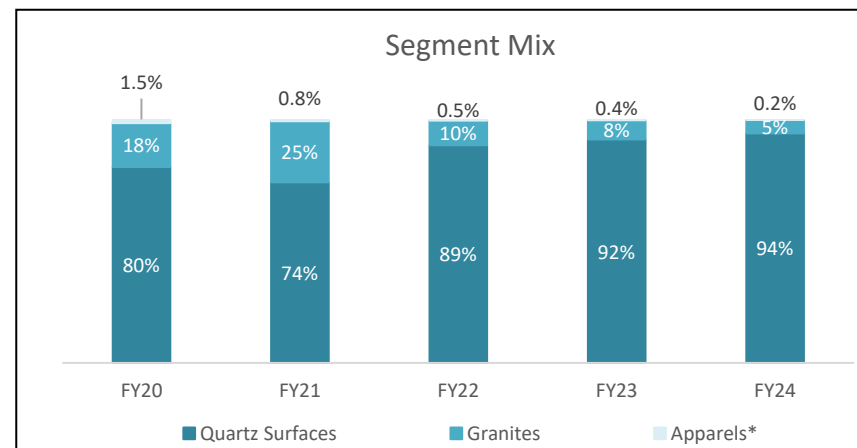
	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25
Revenue (in Rs Cr)													
Granites	25	20	16	12	20	12	8	19	17	10	5	6	6
% of net sales	24%	8%	8%	6%	8%	6%	7%	12%	10%	5%	3%	4%	3%
Quartz Surfaces	80	219	175	192	219	201	105	143	145	190	159	155	187
% of net sales	76%	91%	91%	94%	91%	94%	92%	88%	90%	95%	96%	96%	97%
EBIT (in Rs Cr)													
Granites	7	4	3	-1	4	4	-1	6	3	0	-3	-1	-2
EBIT Margin	29%	20%	21%	-6%	20%	36%	-17%	30%	17%	-4%	-60%	-13%	-31%
Quartz Surfaces	16	55	59	51	58	52	29	29	46	74	59	45	68
EBIT Margin	20%	25%	33%	26%	26%	26%	27%	21%	32%	39%	37%	29%	36%

(Source: Company, HDFC sec)

Charts in Focus

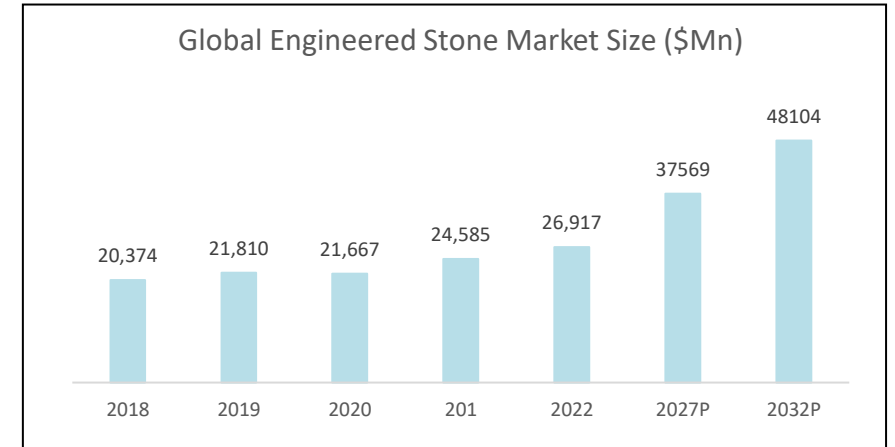
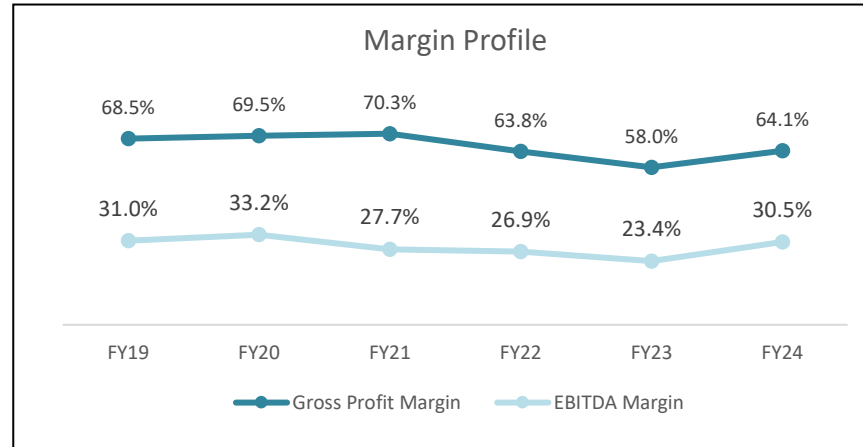
Focus on its key Quartz Surfaces segment

US market remains key revenue driver, while diversification away from China post-COVID continues



Margin Profile has improved but remains below pre-COVID levels

Growing global Engineered Stone industry provides potential for growth



(Source: Company, HDFC sec)

Q1FY25 Result Update

Pokarna reported robust growth in Q1FY25 with revenue up by 19.0% YoY (+19.2% QoQ) to Rs 193 cr, with management indicating double-digit growth in sales volume sequentially. The company's efforts over the past few quarters to focus on high-value realization products and significantly reducing reliance on low margin products, yielded in 519 bps YoY improvement in gross margin to 67.6% as against 62.4% in Q1FY24. In absolute terms, gross margin increased by 28.9% YoY. The gains in gross profit margin was partly off-set by increase in employee costs as the company has increased headcounts and linked certain KMP's compensation with the performance of the company. Resultantly, EBITDAM improved by 308 bps YoY to 31.7% YoY (28.6% Q1FY24/25.4% Q4FY24). In absolute terms, EBITDA grew by 31.9% YoY to Rs 61 cr.

In terms of segmental performance, the **Quartz surfaces** segment grew by 28.5% YoY despite economic headwinds and demand related challenges in the US. Revenue and profitability for the segment was driven by differentiated offerings and improved product-mix, respectively. The company has received encouraging response from its expansion in other regions such as in Canada, France, Mexico, and Russia. EBITDA margin for the segment stood at 36.3% v. 31.7% in Q1FY24 and 28.7% in Q4FY24. Performance in the **Granite segment** continued to be impacted from strain in demand in the US, resulting in 64% YoY de-growth in Granite revenues to Rs 6 cr as compared to Rs 17 cr in Q1FY24. The segment posted an EBITDA loss of Rs 2 cr as against profit of Rs 3 cr in Q1FY24. The management remain cautious in its outlook for the segment and is taking steps to cut costs and explore new avenues of revenue within the segment, to get the segment back to profitability in FY25.

New developments update

As a part of its ongoing capex, the company has invested in 2 new technological developments:

1. KREOS - The Kreos system, developed by Breton, enhances Pokarna's production capabilities by enabling the creation of ultra-thin slabs, in addition to the unique designs and various thicknesses that it currently offers. This advanced mixture extrusion and distribution system is being installed and is on track for commercialization in Q3FY25. The technology is not only expected to enhance the company's ability to produce ultra-thin slabs but also complements its existing product lines with innovative designs. While the management expects to close the development of Kreos by Sept 2024, the commercialization of the technology is expected to start from Q3.
2. CHROMIA - Chromia, also from Breton, focuses on high-definition digital printing for quartz surfaces. Part of the Chromia machinery has been shipped by Breton and is expected to arrive late in Q2 or in early Q3. Once operational, Chromia will enable the company to offer precise, high-resolution decoration on slabs with intricate patterns and vibrant colors, further differentiating its product offerings.

Pokarna continues to face operational challenges in terms of escalated ocean freight rates in terms of its imported procurements. While the international shipping situation influences its procurement expenses, the company's sales are generally protected as they are typically conducted on an FCA/FOB basis. For sales on a CIP basis, the company is able to pass the increased freight rates on to its customers. The company is also facing delay in arrival of its raw materials, impacting its delivery timelines. As a result, the management expects pricing pressure to continue in the market, driven by lower demand, constrained consumer spending on large purchases, and a tendency for consumers to trade down. However, the company has remained resilient in an otherwise challenging environment, delivering double-digit revenue growth as it remains steadfast in continuing to improve its sales mix through differentiated offerings. We believe this approach will help Pokarna mitigate pricing pressures and position itself for incremental growth.

Key Triggers

Established global presence in the quartz business

Pokarna manufactures and exports premium quartz surfaces through its private label products and the Quantra brand, through its wholly-owned subsidiary Pokarna Engineered Stone Limited (PESL). Pokarna is the largest exporter of quartz in India. The quartz manufactured by the company is used in countertops, wall cladding, furniture, and flooring. The company operates through its two state-of-the-art manufacturing facilities, equipped with advanced Bretonstone® technology from Italy, which enables the production of quartz surfaces of exceptional quality. The segment constituted 94.3% of the company's revenue in FY24 as compared to 80.4% in FY20. The segment has grown at a CAGR of 19.7% between FY20-24.

The company aims to distinguish its quartz surfaces in the market by creating distinctive products with premium features and a superior value proposition. This advantage is reinforced by PESL's investments in state-of-the-art production technology and strategic marketing resource allocation. During FY25, PESL will commercialize two cutting-edge technologies from BRETON S.p.A of Italy: the KREOS and CHROMIA lines. Both in the short and long term, the company anticipates strengthening its market position, diversifying its operations, and enhancing profitability.

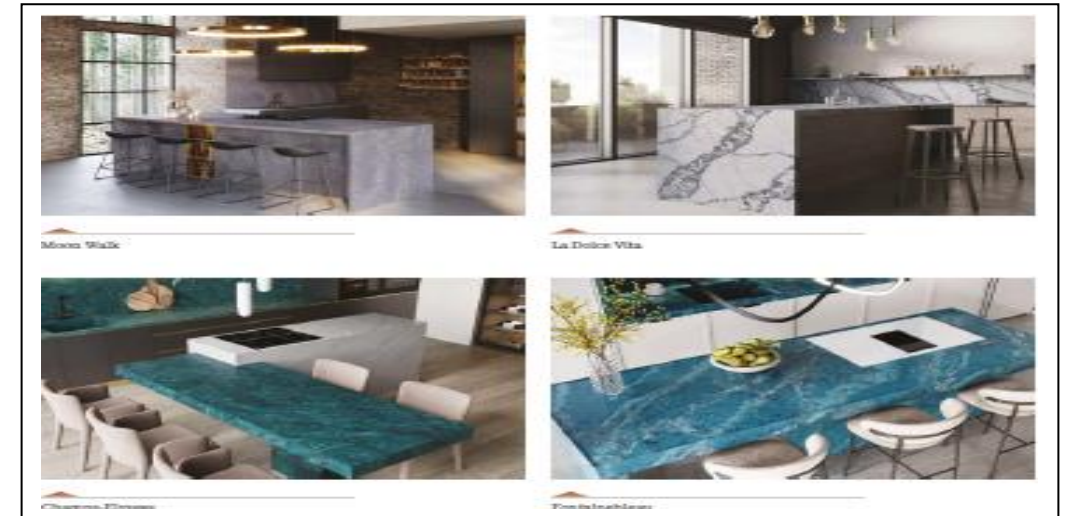
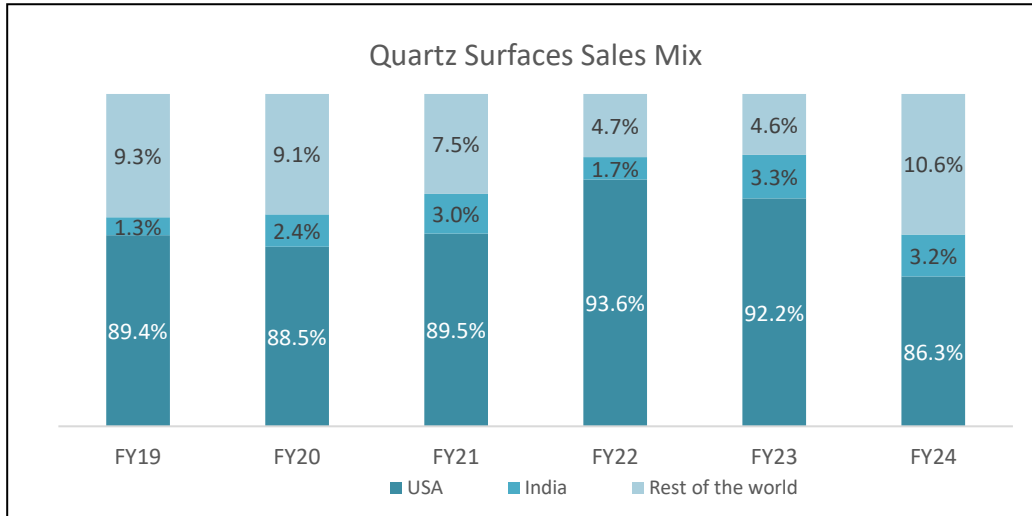
The company's focus of optimizing product mix with a strategic focus on increasing the share of high margin products in the quartz segment resulted in EBIT margin improvement for the segment to 28.8% in FY24 from 20.3% in FY23. However, margin still remain below the pre-COVID levels. The management has alluded to further optimizing the product mix, with a focus on offering differentiated product mix in the quartz segment, which can result in improved margin profile, going forward.

The segment has also received encouraging responses from customers in newer geographies like Canada, France, Mexico and Russia. In recent quarters, the company has witnessed encouraging results from its U.S. quartz sales channels, which include a pickup in consumer optimism and a potential rebound in the housing market. The forecast for new home and existing home sales

suggests a gradual recovery, which is expected to benefit Pokarna’s quartz business. The management’s plans to drive improvement in product-mix through technological investments (Kreos and Chromia), continuous development of innovative products and expansion of its client base in new geographies bodes well for its high-growth quartz stone business.

Increasing salience of newer geographies in Quartz sales

Investment in developing differentiated product offerings



(Source: Company, HDFC sec)

Focus on new technology investment to drive innovation

To enhance its quartz offerings, the company has invested in 2 advanced technologies from Breton, Italy – KREOS and CHROMIA. The Kreos line introduces a new-generation mixture extrusion and distribution system. This technology will facilitate the production of full-body, ultra-thin slabs with unique aesthetics, further improving its offerings. Kreos is expected to be commercialized in Q3FY25. The Chromia line on the other hand will enable high-definition digital printing on quartz slabs. The technology is not only expected to enhance the company’s ability to produce ultra-thin slabs but also complements its existing product lines with innovative designs. This technology allows for intricate patterns and vibrant colors, significantly enhancing the visual appeal and customization options of its products. Chromia is expected to be commercialized in Q4FY25. While Chromia has not been commercialized by any another player yet, Kreos has been commercialized by a player in Korea. The management expects realization from Kreos-based products to be marginally higher than the medium range products it currently offers in the market.

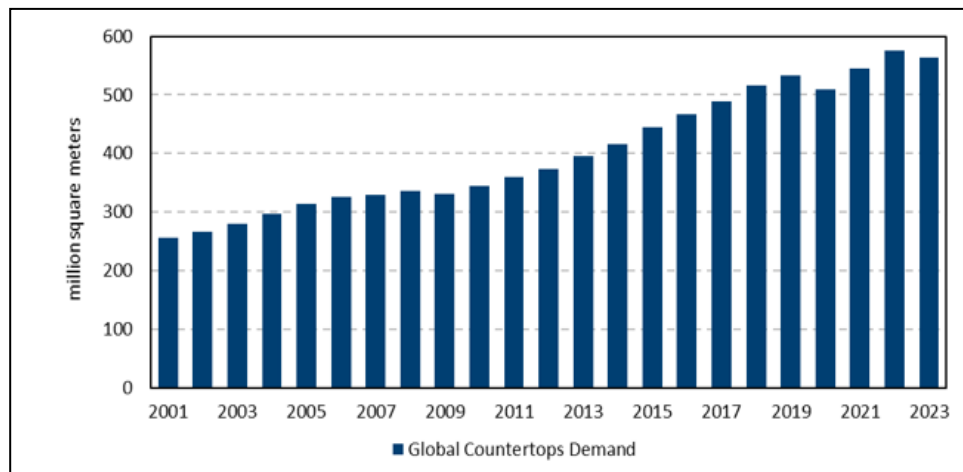
The KREOS and CHROMIA technologies are expected to drive significant advancements in the company’s product range, positioning it for improved performance in FY25 and beyond.

High growth in the global engineered stone countertop industry beckons a significant growth potential for PESL

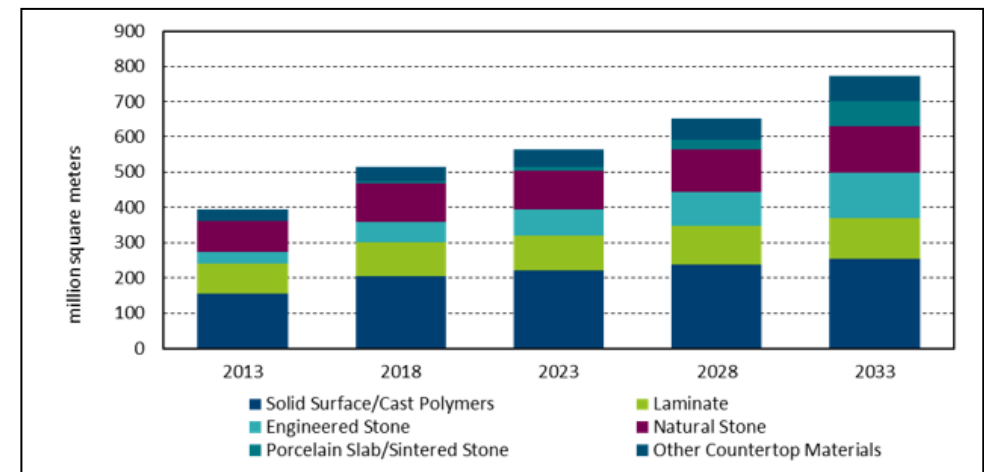
The global demand for countertops is expected to grow at 3.0% CAGR to 652 mn sq. meters by 2028, valued at \$49.5 bn. Demand for countertops is expected to be driven by rising installations of countertops – which continue to be selected over freestanding or wall-mounted fixtures in kitchens and bathrooms – for both residential and nonresidential applications, increased residential remodeling and rapidly rising demand in developing countries.

Within the overall bouquet of countertops, the demand for Engineered Stone (primary offering of PESL) is expected to grow at an above average pace of 9.3% p.a. due to expanding manufacturing capacity and its wide range of aesthetic options and favorable performance properties. Over the past decade, engineered stone has significantly increased its market share, from 7% of global countertop sales in 2012 to 14% in 2022. This momentum underscores a growing preference for engineered stone, especially in key markets such as the USA, where it is favoured for its superior aesthetics, durability and low maintenance compared to natural stone. In 2022, North America led the global demand for engineered stone countertops, holding a 35% market share. The Asia/Pacific region followed, accounting for 26% of global sales. PESL, through its design innovation and superior quality is well placed to benefit from the high demand growth rate in the segment.

Countertops have been favored in remodeling over the past decade



Demand for engineered stone countertops expected to outstrip other materials



(Source: Company, HDFC sec)

Risks & Concerns:

- Pokarna has been facing challenges in the demand environment as the US residential remodeling sector continues to experience strain on the back of high inflation leading to delayed discretionary purchases. Any persistent strain in demand may adversely impact the company's revenues. Beginning of rate cuts by the US Fed may lead to improvement in consumer sentiments.
- The company is dependent on import for procurement of raw material. The company has faced severe ramp up in freight costs, resulting in increased procurement prices and impact on operational efficiencies. Continued higher freight cost may have an impact on the company's margin and product mix.
- Due to ongoing geopolitical events across the globe and war in Russia, the company is witnessing delays in receiving raw material shipments and also delayed delivery of shipments to countries like Russia.
- Operating margin varies based on the prices of key raw materials such as quartz lumps, resin binders, pigments and additives. Of these, the prices of resins and pigments are linked to crude prices and are hence highly volatile. Fluctuations in forex rates also impact margin.
- Capacity utilization of granite processing units has been low in the past few years because of heightened competition from Brazil and China. Demand for quartz is also exposed to concentration risks with more than 85% of the company's revenue coming from the US.
- Pokarna operates at close to the optimum capacity. The topline growth in the near future will come from value add products or if the ocean freight situation improves.

Company Background

Founded in 1991, under the vision of Mr. Gautam Chand Jain, Chairman and Director, who recognized the need to offer premium products and services using top-of-the-line infrastructure, Pokarna is one of the leading exporters of granite and the largest exporter of quartz in India. The company's product range includes tiles, slabs, and cut-to-size natural quartz and granite. The quartz manufactured by the company is used in countertops, wall cladding, furniture, and flooring. The company has a start-to-end procedure which involves extracting, cutting, shaping, and polishing granite. Pokarna operated through 2 quartz manufacturing units in Telangana and Andhra Pradesh and 10+ captive Granite Quarries located in Andhra Pradesh, Telangana and Tamil Nadu. The company also operates 2 granite manufacturing units in Telangana.

The granites business which sources majority of the raw material from captive quarries, offers a collection of over 75 varieties of granite sourced from India and around the world. Pokarna offers both raw granite blocks and finished products, meeting varied market needs. Its products are exported to over 20 countries worldwide, supported by a strong distribution network. The Quartz surface division (~94% revenue in FY24) is operated through its wholly-owned subsidiary PESL. The company's manufacturing facilities are equipped with advanced Bretonstone® technology from Italy. Pokarna's Board in its meeting held on March 23, 2024, approved the potential transfer, sale, lease, exchange, hive-off, or other disposal of the company's Apparel Business on a going concern basis.

Peer Comparison

Company	Mcap (Rs cr)	Revenue				EBITDA Margin				APAT				RoE (x)			
		FY21	FY22	FY23	FY24	FY21	FY22	FY23	FY24	FY21	FY22	FY23	FY24	FY21	FY22	FY23	FY24
Pokarna	3339	295	650	725	688	27.7	26.9	23.4	30.5	28	78	66	87	8.0	19.4	13.9	15.9
Global Surfaces	985	176	190	178	225	27.0	22.0	19.5	15.5	33	35	24	20	41.8	30.7	17.6	6.7

(Source: Company, HDFC sec)

Financials

Income Statement

Particulars (in Rs Cr)	FY21	FY22	FY23	FY24	FY25E	FY26E
Net Revenues	295	650	725	688	780	872
Growth (%)	-25.1	120.4	11.6	-5.2	13.5	11.7
Operating Expenses	213	475	555	478	556	615
EBITDA	82	175	170	210	225	257
Growth (%)	-37.4	114.0	-2.8	23.3	7.2	14.4
EBITDA Margin (%)	27.7	26.9	23.4	30.5	28.8	29.5
Depreciation	21	39	40	43	47	50
Other Income	6	7	11	12	15	16
EBIT	66	143	141	179	193	223
Interest expenses	21	41	48	39	38	32
PBT	45	102	93	140	155	191
Tax	17	24	25	48	42	52
PAT	28	78	68	91	113	140
Share of Asso./Minority Int.	0	0	0	0	0	0
Adj. PAT	28	78	66	87	113	140
Growth (%)	60.0	176.8	-16.0	32.7	29.6	23.3
EPS	9.1	25.3	21.2	28.2	36.5	45.0

Balance Sheet

Particulars (in Rs Cr) - As at March	FY21	FY22	FY23	FY24	FY25E	FY26E
SOURCE OF FUNDS						
Share Capital	6	6	6	6	6	6
Reserves	359	437	501	586	697	835
Shareholders' Funds	366	443	507	592	704	841
Minority Interest	0	0	0	0	0	0
Total Debt	312	515	459	401	351	301
Other Non-Curr. Liab	192	15	10	52	57	64
Net Deferred Taxes	8	12	21	44	44	44
Total Sources of Funds	878	985	996	1090	1156	1250
APPLICATION OF FUNDS						
Net Block & Goodwill	699	758	733	710	743	758
CWIP	65	1	1	65	35	20
Investments	0	0	0	0	0	60
Other Non-Curr. Assets	31	15	14	24	27	30
Total Non-Current Assets	795	774	748	798	805	868
Inventories	111	183	182	164	192	215
Debtors	43	143	109	120	136	152
Cash & Equivalents	12	23	19	68	92	93
Other Current Assets	42	48	46	65	74	83
Total Current Assets	208	398	356	417	494	542
Creditors	46	108	59	75	86	96
Other Current Liab & Provisions	79	78	48	51	57	64
Total Current Liabilities	125	186	108	126	143	160
Net Current Assets	83	212	249	292	351	383
Total Application of Funds	878	985	996	1090	1156	1250

Cash Flow Statement

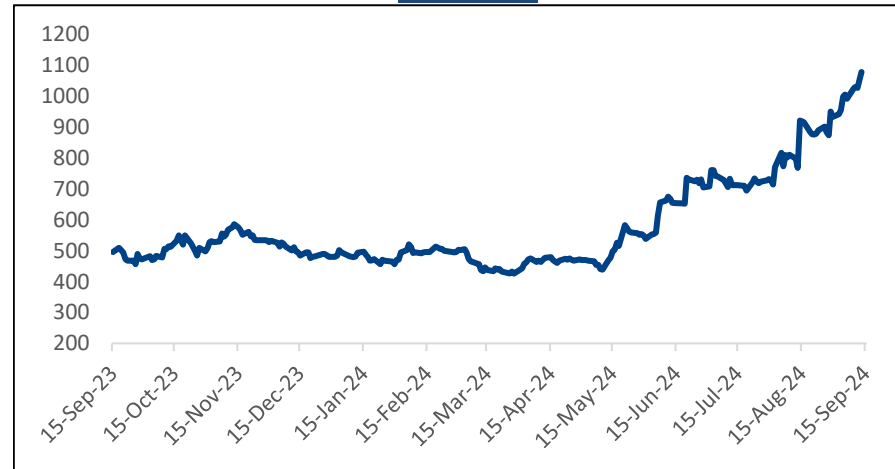
Particulars (in Rs Cr)	FY21	FY22	FY23	FY24	FY25E	FY26E
Reported PBT	45	102	93	140	155	191
Non-operating & EO items	-2	-9	1	-8	1	2
Interest Expenses	21	40	47	39	38	32
Depreciation	21	39	40	43	47	50
Working Capital Change	23	-96	-18	7	-36	-29
Tax Paid	-10	-15	-28	-30	-42	-52
OPERATING CASH FLOW (a)	98	59	136	188	163	194
Capex	-87	-215	-33	-39	-50	-50
Free Cash Flow	11	-156	103	149	113	144
Investments	0	0	0	0	0	-60
Non-operating income	1	1	1	1	0	0
INVESTING CASH FLOW (b)	-86	-215	-32	-38	-50	-110
Debt Issuance / (Repaid)	11	197	-74	-68	-50	-50
Interest Expenses	-21	-35	-37	-37	-38	-32
FCFE	2	7	-7	45	25	3
Share Capital Issuance	0	0	0	0	0	0
Dividend	-2	-2	-2	-2	-2	-2
Others	0	0	-1	-1	0	0
FINANCING CASH FLOW (c)	-13	161	-114	-108	-89	-83
NET CASH FLOW (a+b+c)	0	6	-10	42	23	1

Key Ratios

Particulars	FY21	FY22	FY23	FY24	FY25E	FY26E
Profitability Ratios (%)						
EBITDA Margin	27.7	26.9	23.4	30.5	28.8	29.5
EBIT Margin	22.5	22.0	19.4	26.0	24.7	25.6
APAT Margin	9.6	12.0	9.1	12.7	14.5	16.0
RoE	8.0	19.4	13.9	15.9	17.5	18.1
RoCE	10.3	17.5	14.6	18.2	18.8	20.3
Solvency Ratio (x)						
Net Debt/EBITDA	3.7	2.8	2.6	1.6	1.2	0.8
Net D/E	0.8	1.1	0.9	0.6	0.4	0.2
PER SHARE DATA (Rs)						
EPS	9.1	25.3	21.2	28.2	36.5	45.0
CEPS	16.0	37.7	34.3	41.9	51.6	61.2
BV	117.9	142.9	163.6	191.0	227.0	271.4
Dividend	0.6	0.6	0.6	0.6	0.6	0.6
Turnover Ratios (days)						
Debtor days	48	52	64	61	60	60
Inventory days	124	83	92	92	83	85
Creditors days	49	43	42	36	37	38
Valuation (X)						
P/E	118.2	42.7	50.8	38.3	29.5	24.0
P/BV	9.1	7.6	6.6	5.6	4.8	4.0
EV/EBITDA	44.6	21.9	22.2	17.5	16.0	13.6
EV / Revenues	12.4	5.9	5.2	5.3	4.6	4.0
Dividend Yield (%)	0.1	0.1	0.1	0.1	0.1	0.1
Dividend Payout (%)	6.6	2.4	2.8	2.1	1.6	1.3

(Source: Company, HDFC sec)

Price chart



(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. These stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicalities of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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