



Incorporating **FRK**, the Global FIG Specialist

INDIA

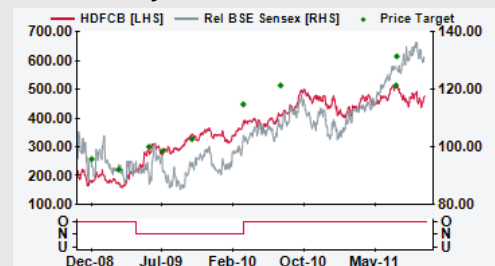
HDFCB IN Outperform
Price 18 Oct 11 Rs476.80

12-month target	Rs	615.00
Upside/Downside	%	29.0
Valuation	Rs	615.00
- Gordon growth		
GICS sector		Banks
Market cap	Rsbm	1,115
Market cap	US\$m	22,617
Number shares on issue	m	2,338

Investment fundamentals

Year end 31 Mar		2011A	2012E	2013E	2014E
Net interest Inc	bn	105.4	123.4	151.2	182.7
Non interest Inc	bn	43.4	57.5	73.1	91.2
PBT	bn	58.2	73.7	93.5	116.1
PBT growth	%	35.7	26.6	26.9	24.1
Reported profit	bn	39.3	50.8	64.5	80.1
EPS rep	Rs	16.88	21.86	27.74	34.43
EPS rep growth	%	31.0	29.5	26.9	24.1
PER rep	x	28.2	21.8	17.2	13.8
Total DPS	Rs	3.85	3.04	3.26	3.26
Total div yield	%	0.8	0.6	0.7	0.7
ROA	%	1.6	1.7	1.7	1.8
ROE	%	16.7	18.4	19.8	20.5
Equity to assets	%	9.2	8.8	8.6	8.5
P/BV	x	4.4	3.7	3.1	2.6

HDFCB IN rel BSE Sensex performance, & rec history



Note: Recommendation timeline - If not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, October 2011
(all figures in INR unless noted)

Suresh Ganapathy, CFA

+91 22 6720 4078 suresh.ganapathy@macquarie.com

Mudit Painuly

+91 22 6720 4083 mudit.painuly@macquarie.com

Yuvaraj Bhole

+91 22 6720 4098 yuvaraj.bhole@macquarie.com

19 October 2011

Macquarie Capital Securities India (Pvt)

Ltd

HDFC Bank

Will you ever disappoint?

Event

- **2QFY12 - 30% for the umpteenth time, as expected provisions used to smoothen:** HDFC Bank's net profit numbers hardly surprise in any way as they continue reporting ~30% YoY growth. As expected they smoothed the numbers through the provisions line item which was down 19% YoY and 17% QoQ. In 1QFY12, they made floating provisions of Rs2.5bn, which was less this quarter. Maintain Outperform with TP of Rs615.

Impact

- **Loan growth slows down but due to higher base:** HDFC Bank funded the telecom sector for 3G financing in 1HFY11, which was absent this quarter. Hence loan growth on a reported basis was 20% YoY; however adjusted for the short-term one-off loans of last year, loan growth was healthy at 25%.
- **Moving up the risk curve, credit costs unsustainable at these levels:** Looking at HDFC Bank's retail portfolio, which registered 34% YoY growth, segments like personal loans, credit cards, business banking, etc, have been growing at a very rapid pace. However if we look at credit costs, they are just at 80-90bps for 1HFY12, which is clearly unsustainable in our view.
- **Sharp decline in CASA a worry – just watch out for other banks:** HDFC Bank, as the best bank in the country with respect to liabilities franchise, saw a sharp 170 bps QoQ decline in CASA to 47.3%. Management attributed this to higher traction in term deposits relative to savings deposits due to elevated interest rate levels and migration from savings to term. Consequently margins also declined by 10bps QoQ to 4.1% inline with our expectations. We believe even other banks are likely to see a sharp decline in CASA going ahead.
- **Stable asset quality remains the biggest positive:** Asset quality remained stable with the slippage ratio at less than 100bps. The NPL coverage ratio including floating provisions is highest in the sector at 125%+. Restructured standard advances at 10bps are also among the lowest in the sector.
- **Key conference call takeaways:** 1) Retail loan demand remains good despite high interest rates because of increases in wages and, hence, affordability is good. The bank is gaining market share across several retail loan categories. 2) Despite an increase in retail assets and 15bps increase in investment yields, a lower CASA and higher mobilisation of term deposits affected NIMs. NIMs are expected to be in a range of 3.9-4.2%. 3) Floating provisions are created not to smooth out earnings but to create a counter cyclical cushion and they are included as a part of Tier-II capital.

Earnings and target price revision

- No change.

Price catalyst

- 12-month price target: Rs615.00 based on a Gordon growth methodology.
- Catalyst: Continued strong earnings growth and asset quality improvements

Action and recommendation

- **HDFC Bank is one of our top financials picks in India:** Reiterate Outperform.

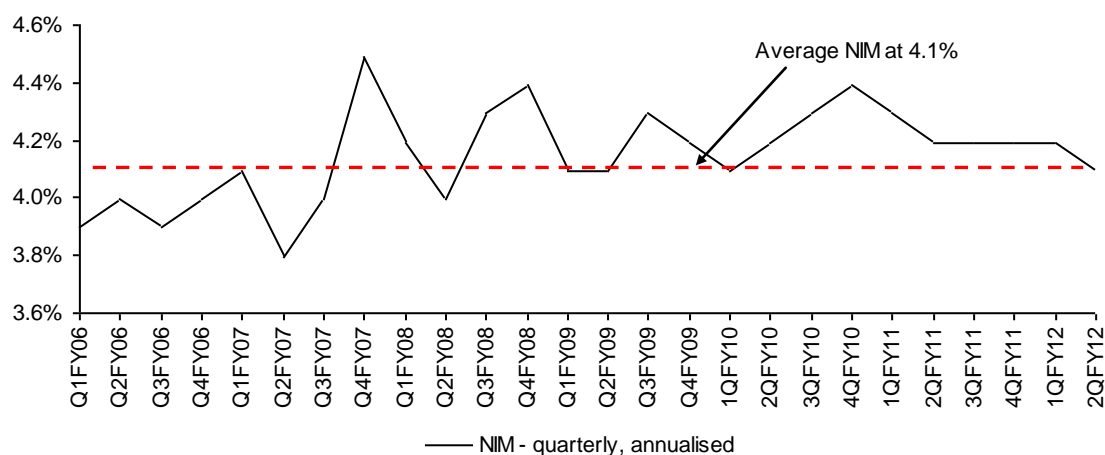
Key charts and tables

Fig 1 HDFC Bank – Loan mix across quarters

	4QFY10	1QFY11	2QFY11	1QFY12	2QFY12	YoY	QoQ
Car loans	179,680	195,030	207,610	232,170	246,060	19%	6%
CV loans	60,250	63,360	69,570	90,550	113,480	63%	25%
2 W loans	16,490	16,890	17,800	20,670	21,730	22%	5%
Total Auto loans	256,420	275,280	294,980	343,390	381,270	29%	11%
Personal loans	87,330	88,850	93,240	109,800	120,040	29%	9%
Business Banking	109,800	105,820	114,900	153,910	168,470	47%	9%
LAS	8,610	9,790	10,230	10,670	9,800	-4%	-8%
CC	38,460	39,500	41,340	54,050	58,550	42%	8%
Home loans	87,250	95,640	91,760	110,410	123,440	35%	12%
Others	43,740	37,060	45,590	56,400	67,210	47%	19%
Total Retail Loans	631,610	651,940	692,040	838,630	928,780	34%	11%
Wholesale Loans	626,696	810,544	878,866	916,530	956,242	9%	4%
Total Loans	1,258,306	1,462,484	1,570,906	1,755,160	1,885,022	20%	7%

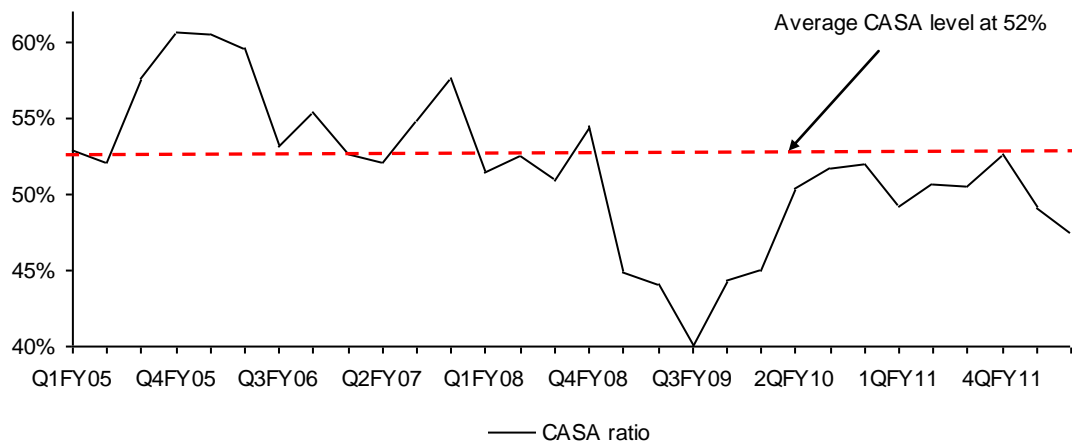
Source: Company data, Macquarie Research, October 2011

Fig 2 Margins consistently maintained at close to 4% levels



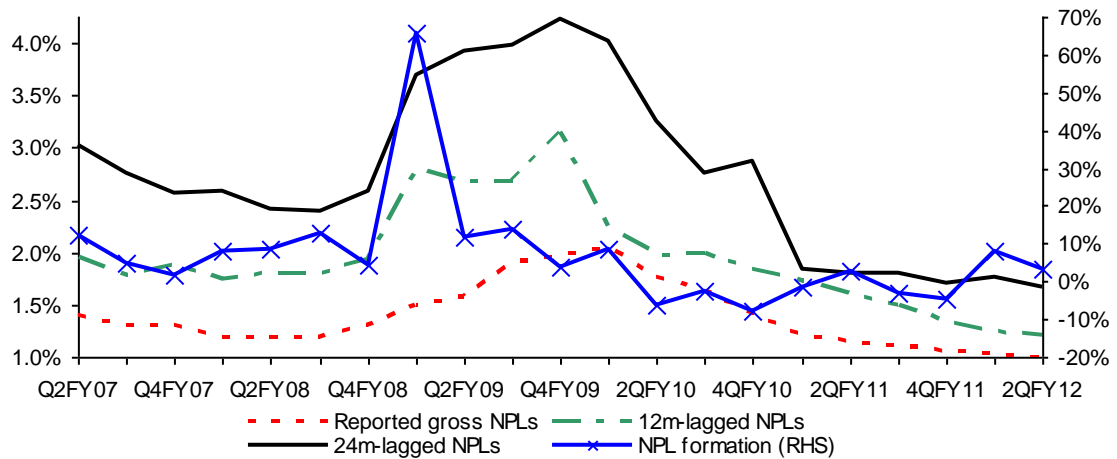
Source: Company data, Macquarie Research, October 2011

Fig 3 HDFC Bank: CASA under pressure



Source: Company data, Macquarie Research, October 2011

Fig 4 HDFC Bank: Asset quality stable



Source: Company data, Macquarie Research, October 2011

Fig 5 HDFC Bank: 2Q12 results snapshot

Income Statement (Rs mn)	2QFY11	1Q FY12	2QFY12	YoY	QoQ
Net Interest Income	25,263	28,480	29,445	17%	3%
Non Interest Income	9,607	11,200	12,117	26%	8%
Fees	8,570	9,227	9,879	15%	7%
FX	1,523	2,301	2,180	43%	-5%
Trading Profits	(521)	(413)	(13)	NM	NM
Others	35	85	71		
Total Income	34,870	39,680	41,562	19%	5%
Core Revenues	35,391	40,093	41,575	17%	4%
Staff expenses	7,106	7,810	8,231	16%	5%
Other expenses	9,693	11,536	12,073	25%	5%
Total Operating Expenses	16,799	19,346	20,304	21%	5%
Operating profit	18,071	20,334	21,258	18%	5%
Core Operating Profit	18,592	20,747	21,271	14%	3%
Total provisions	4,545	4,437	3,661	-19%	-17%
PBT	13,526	15,897	17,598	30%	11%
Tax	4,405	5,047	5,604	27%	11%
PAT	9,121	10,850	11,994	31%	11%
Balance Sheet (Rs mn)					
Loans	1,570,906	1,755,160	1,885,022	20%	7%
Deposits	1,953,209	2,111,512	2,306,764	18%	9%
CASA ratio	50.63%	49.06%	47.33%	-3.3%	-1.7%
LDR	80.43%	83.12%	81.72%	1.3%	-1.4%
Margin Components					
Reported NIM	4.2%	4.2%	4.1%	-0.1%	-0.1%
Key Ratios					
Cost/Income	48%	49%	49%	0.7%	0.1%
Core Cost/Income ratio	47%	48%	49%	1.4%	0.6%
Tax rate	33%	32%	32%	-0.7%	0.1%
Asset Quality					
Gross NPAs	18,412	18,331	18,949	3%	3%
Net NPAs	4,085	3,185	3,553	-13%	12%
Coverage Ratio	78%	83%	81%	3.4%	-1.4%
Gross NPA ratio	1.16%	1.04%	1.00%	-0.2%	0.0%
Net NPA ratio	0.30%	0.20%	0.20%	-0.1%	0.0%
LLP/Advances	1.30%	1.03%	0.86%	-0.44%	-0.17%
Fees to Avg Assets	1.51%	1.39%	1.40%	-0.11%	0.01%
Capital Adequacy Ratios					
Tier-I Ratio	12.7%	11.4%	11.4%	-1.3%	0.0%
Tier-II Ratio	4.3%	5.5%	5.1%	0.8%	-0.4%
Total CAR Ratio	17.0%	16.9%	16.5%	-0.5%	-0.4%

Source: Company data, Macquarie Research, October 2011

Valuations and TP

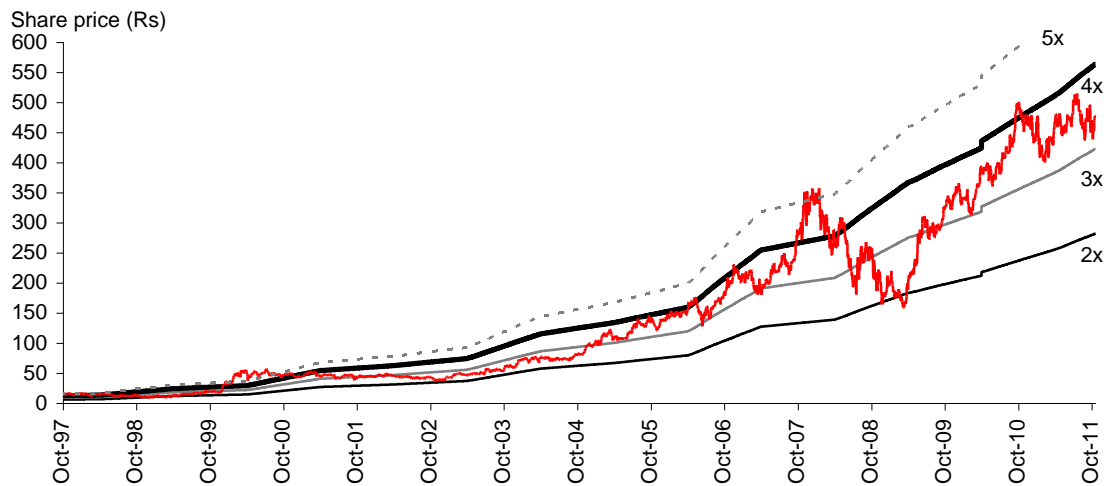
We value HDFC bank on a two-stage Gordon growth method as the bank continues to be at a high growth stage and a single-stage Gordon growth model cannot capture its high growth aspect.

$P/BV = RoE * \{ (p(1+g) * (1 - (1+g)^n / (1+r)^n) + (pn(1+g)^n(1+gn)) / ((r-gn)(1+r)^n) \}$, where g =growth rate for the first n (high-growth period) years, p =payout ratio in the first n years, gn =perpetual growth rate, pn =perpetual payout ratio.

Fig 6 HDFC Bank – Valuation methodology

Two-stage GGM	
RoE (Normalised RoE)	20.0%
Target P/BV – Two stage GGM	4.05x
FY13E adjusted book value per share	152
Target Price based on two stage Gordon growth model (Rs)	615
Source: Macquarie Research, October 2011	

Fig 7 1 yr fwd P/BV Band chart



Source: Company data, Macquarie Research, October 2011

HDFC Bank (HDFCB IN, Outperform, Target Price: Rs615.00)

Quarterly Results					Profit & Loss						
	4Q/11A	1Q/12E	2Q/12E	3Q/12E		2011A	2012E	2013E	2014E		
Net Interest Income	m	26,552	25,486	28,907	34,417	Net Interest Income	m	105,431	123,430	151,185	182,686
+ Loan Fees	m	12,475	9,283	10,529	12,536	+ Loan Fees	m	43,878	44,959	56,199	70,248
+ Trading Income	m	87	2,583	2,930	3,488	+ Trading Income	m	-526	12,511	16,888	20,985
+ Insurance Income	m	0	0	0	0	+ Insurance Income	m	0	0	0	0
+ Other Income	m	0	0	0	0	+ Other Income	m	0	0	0	0
Non Interest Income	m	12,562	11,866	13,459	16,025	Non Interest Income	m	43,352	57,470	73,087	91,234
Total Operating Inc	m	39,114	37,352	42,366	50,441	Total Operating Inc	m	148,783	180,900	224,272	273,919
+ Staff expenses	m	7,334	6,852	7,772	9,253	+ Staff expenses	m	28,360	33,186	38,417	44,363
+ Other expenses	m	12,650	10,669	12,101	14,408	+ Other expenses	m	43,169	51,671	61,755	75,693
Total Operating Exp	m	19,984	17,521	19,873	23,661	Total Operating Exp	m	71,529	84,857	100,172	120,056
Pre-Provision Profit	m	19,131	19,831	22,493	26,780	Pre-Provision Profit	m	77,254	96,043	124,100	153,863
Loan Provisions	m	4,307	4,618	5,237	6,236	Loan Provisions	m	19,061	22,363	30,588	37,792
Post Provision Profit	m	14,823	15,214	17,255	20,545	Post Provision Profit	m	58,193	73,680	93,512	116,071
Other Profit	m	0	0	0	0	Other Profit	m	0	0	0	0
- Amortisation	m	0	0	0	0	- Amortisation	m	0	0	0	0
- Non Recurring Items	m	0	0	0	0	- Non Recurring Items	m	0	0	0	0
- Associates	m	0	0	0	0	- Associates	m	0	0	0	0
Pre-Tax Profit	m	14,823	15,214	17,255	20,545	Pre-Tax Profit	m	58,193	73,680	93,512	116,071
- Taxation	m	5,514	4,717	5,350	6,369	- Taxation	m	18,929	22,842	28,990	35,984
Net Profit After Tax	m	9,309	10,497	11,906	14,175	Net Profit After Tax	m	39,264	50,838	64,521	80,088
- Minority Interests	m	0	0	0	0	- Minority Interests	m	0	0	0	0
Reported Profit	m	9,309	10,497	11,906	14,175	Reported Profit	m	39,264	50,838	64,521	80,088
Adjusted Profit	m	9,309	10,497	11,906	14,175	Adjusted Profit	m	39,264	50,838	64,521	80,088
Attributable Profit	m	9,309	10,497	11,906	14,175	Attributable Profit	m	39,264	50,838	64,521	80,088
EPS (rep)		4.00	4.51	5.12	6.09	EPS (rep)		16.88	21.86	27.74	34.43
EPS growth pcp (rep)	%	9.5	29.3	54.8	0.2	EPS growth yoy (rep)	%	31.0	29.5	26.9	24.1
EPS (adj)		4.00	4.51	5.12	6.09	EPS (adj)		16.88	21.86	27.74	34.43
EPS growth pcp (adj)	%	9.5	29.3	54.8	0.2	EPS growth yoy (adj)	%	31.0	29.5	26.9	24.1
DPS		0.96	0.76	0.76	0.76	DPS		3.85	3.04	3.26	3.26
						Payout ratio	%	22.8	13.9	11.8	9.5
						Book Value p.s (wgted)		109.1	127.9	152.4	183.6
						Tangible Book Value p.s (wgted)		109.1	127.9	152.4	183.6
						Weighted average shares	m	2,326	2,326	2,326	2,326
Key Ratios					Key Ratios						
	4Q/11A	1Q/12E	2Q/12E	3Q/12E		2011A	2012E	2013E	2014E		
Interest Spread	%	2.13	1.83	1.89	2.25	Interest Spread	%	4.25	4.03	4.04	4.00
Net Interest Margin	%	2.26	1.94	2.00	2.38	Net Interest Margin	%	4.48	4.27	4.26	4.18
Non Int Inc / Total Inc	%	32.1	31.8	31.8	31.8	Non Int Inc / Total Inc	%	29.2	31.8	32.6	33.3
Cost to Income	%	51.1	46.9	46.9	46.9	Cost to Income	%	48.1	46.9	44.7	43.8
Cost to Assets	%	1.44	1.04	1.18	1.40	Cost to Assets	%	2.58	2.51	2.44	2.39
Provisions / Loans	%	0.53	0.46	0.52	0.62	Provisions / Loans	%	1.18	1.11	1.22	1.20
Tax Rate	%	37.2	31.0	31.0	31.0	Tax Rate	%	32.5	31.0	31.0	31.0
Loan Deposit Ratio (LDR)	%	76.7	77.0	77.0	77.0	Loan Deposit Ratio (LDR)	%	76.7	77.0	77.2	77.2
NPLs	%	1.05	0.75	0.75	0.75	NPLs	%	1.05	0.75	0.60	0.48
Reserve Cover	%	82.5	84.7	84.7	84.7	Reserve Cover	%	82.5	84.7	84.7	84.7
Tier 1 Capital Ratio	%	12.2	11.0	11.0	11.0	Tier 1 Capital Ratio	%	12.2	11.0	10.6	10.3
Total Capital Ratio	%	16.3	13.4	13.4	13.4	Total Capital Ratio	%	16.3	13.4	12.6	12.0
Equity to Assets	%	9.2	8.8	8.8	8.8	Equity to Assets	%	9.2	8.8	8.6	8.5
ROA (ave)	%	0.75	0.68	0.77	0.92	ROA (ave)	%	1.57	1.65	1.72	1.76
ROE (ave)	%	7.9	7.6	8.6	10.3	ROE (ave)	%	16.7	18.4	19.8	20.5
ROTE (ave)	%	7.9	7.6	8.6	10.3	ROTE (ave)	%	16.7	18.4	19.8	20.5
					Growth rates						
						2011A	2012E	2013E	2014E		
Income Growth	%					20.3	21.6	24.0	22.1		
Cost Growth	%					20.4	18.6	18.0	19.8		
Pre-Prov Profit Growth	%					20.2	24.3	29.2	24.0		
PBT Growth	%					35.7	26.6	26.9	24.1		
Loan Growth	%					27.1	25.0	25.0	25.0		
Ave Int Earning Assets	%					18.4	22.7	22.9	23.1		
					Valuation data						
						2011A	2012E	2013E	2014E		
P/E (rep)	x					28.2	21.8	17.2	13.8		
P/E (adj)	x					28.2	21.8	17.2	13.8		
P/B (wgted)	x					4.4	3.7	3.1	2.6		
P/TB (wgted)	x					4.4	3.7	3.1	2.6		
Dividend yield	%					0.8	0.6	0.7	0.7		
					Balance Sheet						
						2011A	2012E	2013E	2014E		
Cash & Equivalent	m					251,008	254,607	259,419	264,461		
Net Loans to Customer	m					1,599,827	1,999,783	2,499,729	3,124,661		
Other Interest Earning Assets	m					754,974	888,739	1,050,685	1,245,748		
Other Assets	m					167,717	239,495	298,354	382,641		
Total Assets	m					2,773,526	3,382,624	4,108,187	5,017,512		
Customer Deposits	m					2,085,864	2,597,095	3,239,790	4,049,140		
Other Int Bearing Liab	m					143,941	153,774	164,379	175,824		
Other Liabilities	m					289,929	334,186	349,511	365,536		
Total Liabilities	m					2,519,733	3,085,055	3,753,680	4,590,500		
Ordinary Equity	m					4,652	4,652	4,652	4,652		
Retained Earnings	m					0	0	0	0		
Reserves	m					249,140	292,917	349,855	422,360		
Minority Interests	m					0	0	0	0		
Total S/H's Funds	m					253,793	297,570	354,507	427,012		

All figures in INR unless noted.

Source: Company data, Macquarie Research, October 2011

Important disclosures:

Recommendation definitions**Macquarie - Australia/New Zealand**

Outperform – return >3% in excess of benchmark return
 Neutral – return within 3% of benchmark return
 Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie First South - South Africa

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
 Neutral – return within 5% of benchmark return
 Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
 Neutral (Hold) – return within 5% of Russell 3000 index return
 Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 September 2011

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	57.35%	65.88%	56.94%	46.54%	74.68%	47.85%	(for US coverage by MCUSA, 11.63% of stocks covered are investment banking clients)
Neutral	31.99%	20.68%	31.94%	50.00%	23.42%	34.66%	(for US coverage by MCUSA, 9.30% of stocks covered are investment banking clients)
Underperform	10.66%	13.45%	11.11%	3.46%	1.90%	17.49%	(for US coverage by MCUSA, 0.47% of stocks covered are investment banking clients)

Company Specific Disclosures:

Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/disclosures.

Analyst Certification:

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John O'Connell (Global Co – Head)	(612) 8232 7544
David Rickards (Global Co – Head)	(612) 8237 1159
Chris Hunt (Asia – Head)	(852) 3922 1119
Tim Smart (Asia – Deputy Head)	(852) 3922 3565

Automobiles/Auto Parts

Amit Mishra (India)	(9122) 6720 4084
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Dan Lucas (Japan)	(813) 3512 6050
Michael Sohn (Korea)	(82 2) 3705 8644

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Chan Hwang (Korea)	(822) 3705 8643
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Alex Pomento (Philippines)	(632) 857 0899
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Alex Pomento (Philippines)	(632) 857 0899

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Best Waiyanont (Thailand)	(662) 694 7993

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Makoto Egami (Japan)	(813) 3512 7879

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Daniel Chang (Taiwan)	(8862) 2734 7516
Kylie Huang (Taiwan)	(8862) 2734 7528

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Best Waiyanont (Thailand)	(662) 694 7993

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Angus Kent (Thailand)	(662) 694 7601
Michael Newman (Tokyo)	(813) 3512 7920
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Regional Head of Distribution

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Yat Quan Tan (Hong Kong)	(852) 3922 2028
Phil Sellaroli (Japan)	(813) 3512 7837
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Transport & Infrastructure

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Nicholas Cunningham (Japan)	(813) 3512 6044
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Prem Jearajasingam (Malaysia)	(603) 2059 8989
Alex Pomento (Philippines)	(632) 857 0899

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Duncan Hobbs	(4420) 3037 4497
Bonnie Liu	(65) 6601 0144
Graeme Train	(8621) 2412 9035
Rakesh Arora	(9122) 6720 4093

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Eric Yeung	(852) 3922 4077

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Paul Cavey (China)	(852) 3922 3570
Renee Chen (Hong Kong, Taiwan)	(852) 3922 3597
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Rakesh Arora (India)	(9122) 6720 4093
Nicolaos Oentung (Indonesia)	(6121) 2598 8366
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Chan Hwang (Korea)	(822) 3705 8643
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