

July 28, 2019

## Q1FY20 Result Update

Change in Estimates |  Target |  Reco

### Change in Estimates

	Current		Previous	
	FY20E	FY21E	FY20E	FY21E
Rating	HOLD		HOLD	
Target Price	520		621	
Sales (Rs. m)	34,674	37,562	35,351	38,587
% Chng.	(1.9)	(2.7)		
EBITDA (Rs. m)	5,284	5,726	6,143	6,869
% Chng.	(14.0)	(16.6)		
EPS (Rs.)	45.5	47.8	49.8	57.1
% Chng.	(8.6)	(16.3)		

### Key Financials - Standalone

Y/e Mar	FY18	FY19	FY20E	FY21E
Sales (Rs. m)	30,336	33,658	34,674	37,562
EBITDA (Rs. m)	4,688	5,807	5,284	5,726
Margin (%)	15.5	17.3	15.2	15.2
PAT (Rs. m)	3,230	3,518	3,599	3,784
EPS (Rs.)	40.4	44.5	45.5	47.8
Gr. (%)	7.2	10.1	2.3	5.1
DPS (Rs.)	9.6	10.9	11.4	12.0
Yield (%)	1.7	1.9	2.0	2.1
RoE (%)	16.0	15.7	14.6	13.9
RoCE (%)	15.4	18.9	15.3	15.2
EV/Sales (x)	1.2	1.0	0.9	0.8
EV/EBITDA (x)	7.8	5.9	6.0	5.1
PE (x)	13.9	12.6	12.3	11.7
P/BV (x)	2.1	1.9	1.7	1.6

### Key Data

PERS.BO | PSYS IN

52-W High / Low	Rs.915 / Rs.532
Sensex / Nifty	37,883 / 11,284
Market Cap	Rs.45bn / \$ 647m
Shares Outstanding	80m
3M Avg. Daily Value	Rs.129m

### Shareholding Pattern (%)

Promoter's	34.41
Foreign	20.00
Domestic Institution	21.83
Public & Others	23.76
Promoter Pledge (Rs bn)	-

### Stock Performance (%)

	1M	6M	12M
Absolute	(8.6)	(0.2)	(33.9)
Relative	(4.5)	(5.1)	(35.4)

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## Ongoing transition to weigh on performance

Persistent reported weak numbers in Q1FY20 due to a sequential decline in its Digital (-6% QoQ; ~23% of sales) and Accelerite (-40% QoQ; ~4% of sales) businesses. Overall, revenues in USD terms grew 1.1% QoQ, while normalized EBIT margins fell 190bps QoQ to 11.0%. EBIT margins declined due to visa costs (-70bps), utilization drop (-50bps) and INR appreciation (-30bps). Going ahead, it expects a 250-275bps wage hike headwind in Q2FY20.

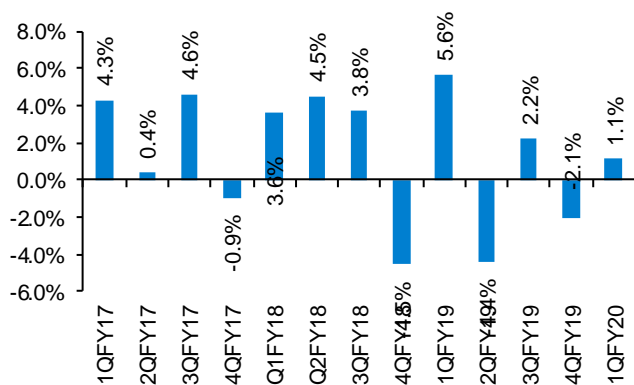
Persistent has not been able to scale up its digital business as compared to others midcap IT players. For a firm that was prompt in identifying the Digital opportunity and signed a promising IOT deal, is witnessing a slow down to single digits while other larger peers are accelerating- this is a sign of severe execution weakness. We believe its project based nature & lack of strong sales engine has led to poor sales performance. Quarterly fluctuations are inherent in products & IP led business. Management sees revenue trajectory improving in FY20E. We expect the IBM/IP segment to see revenue acceleration from FY21E. Although the new leadership is expected to take measures to revive the company's growth, FY20 could continue to be a year of transition. Persistent is currently trading at 12.2x & 10.9 FY20/21E EPS respectively. Due to volatility in revenue performance, Persistent will continue to trade on lower multiples. We expect revenue CAGR of 5% from FY19-FY21E & our revised TP stands at Rs. 520 (11x FY21E EPS) (earlier: Rs. 618). We have Hold rating on Persistent & stock trades at 12.2X/ 10.9X on EPS of Rs. 45/ Rs. 47 for FY20E/21E.

- Weak Revenue performance led by IBM/IP business:** Persistent reported flat growth in revenues of 1.1% QoQ, -3.2% YOY to USD 119. We saw a weak growth momentum from digital & Accelerite business declining at 6% & 40% QoQ respectively. ISV/Enterprise/IP revenue grew flat by -0.4%/ +3.0% / +0.6% QoQ. Vertical-wise, BFSI revenue rose by a healthy 3.7% QoQ and Tech & Emerging Verticals by 1.1% QoQ, while Healthcare & Life Sciences declined by 2.5% QoQ.
- Margins remained under pressure:** EBIT margins declined due to visa costs (-70bps), utilization drop (-50bps) and INR appreciation (-30bps). Going ahead, it expects a 250-275bps wage hike headwind in Q2FY20, while the absence of visa costs and utilization improvement scope should act as tailwinds. However, the absence of visa costs and scope of utilization improvement should help protect margins to some extent in Q2FY20E, in our view.
- Digital revenue growth continues to disappoint:** Digital revenues for the June quarter declined 5.9% QoQ in dollar terms, a sharp contrast to the industrywide trend of strong digital growth. Moreover, revenue growth was limited to the top 5 clients, with the top 6 to 10 accounts declining 20.7% QoQ and non-top 10 client revenues down 3.8% QoQ (in dollar terms). Decline in Digital revenue was a major disappointment.

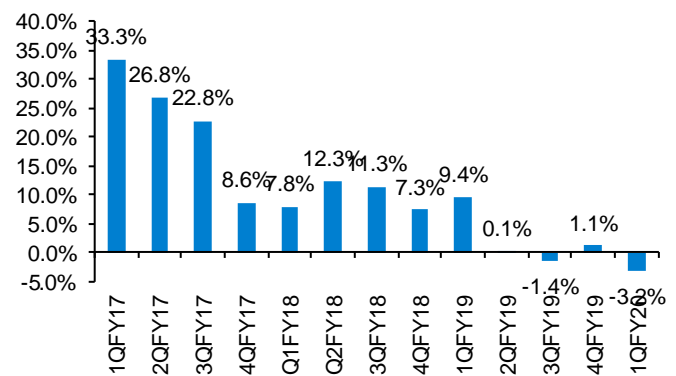
**Exhibit 1: Q1FY20: Quick view on results**

Particulars (Rs mn)	1QFY20	4QFY19	QoQ gr.	1QFY19	YoY gr.	Ple	Var (ACT. Vs. Est)
Sales (USD mn)	119.6	118.3	1.1%	123.6	-3.2%	122.0	-2.0%
Sales	8321	8319	0.0%	8342	-0.3%	8482	-1.9%
EBITDA	1202	1265.5	-5.0%	1400.8	-14.2%	1442	-16.6%
<i>EBITDA Margins</i>	<i>14.4%</i>	<i>15.2%</i>	<i>-77bps</i>	<i>16.8%</i>	<i>-235bps</i>	<i>17.0%</i>	
PAT	825	845	-2.4%	873.9	-5.6%	908	-9.1%
EPS (diluted)	10.3	10.6	-2.4%	10.9	-5.6%	11.3	-9.1%

Source: Company, PL

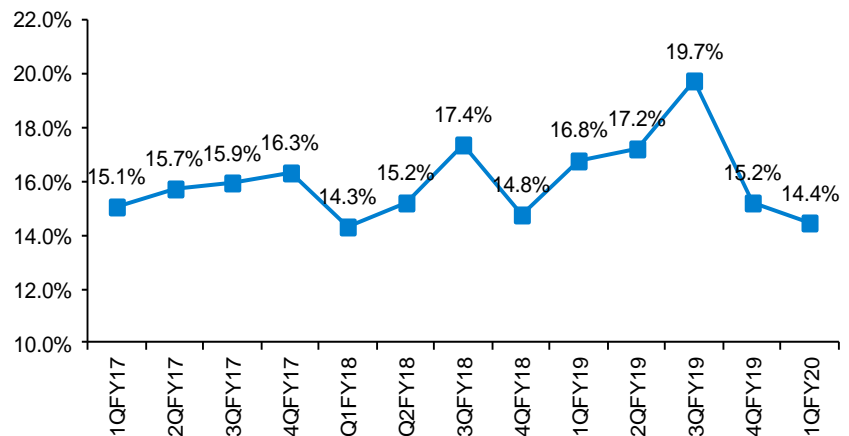
**Exhibit 2: USD revenue growth QoQ (%)**


Source: Company, PL

**Exhibit 3: USD revenue growth YoY (%)**


Source: Company, PL

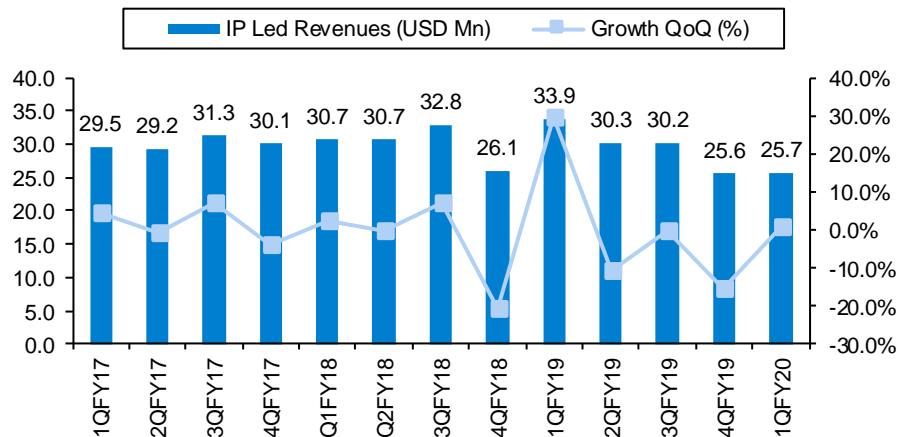
EBITDA margin for Q1FY20 came at 14.4% down 77bps QoQ and 235bps YoY (Ple: 17%). Management cited that margins were impacted by tepid growth in IP led business. Headwinds from Visa cost (-70bps), Lower utilisation (-50bps) & INR appreciation (-30bps)

**Exhibit 4: Steep fall in margins**


Source: Company, PL

IBM/IP revenues came at \$25.7mn up 0.6% QoQ and down 24% YoY.

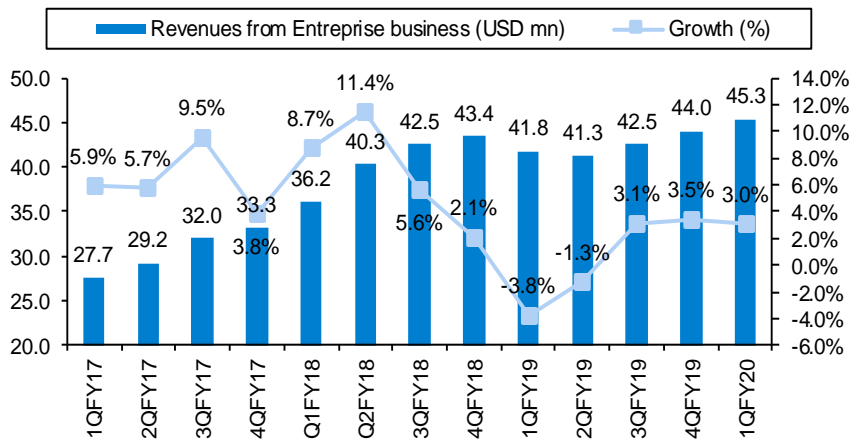
**Exhibit 5: IP revenue dragging growth**



Source: Company, PL

One of the few Tier-II companies with the potential to grow revenues above the industry given the focus on Enterprise Digital Transformation.

**Exhibit 6: Consistent performance in Enterprise business**



Source: Company, PL

**Exhibit 7: Segmental revenue mix**

Segmental growth (USD mn)	1QFY20	4QFY19	QoQ gr.	1QFY19	YoY gr.
Services	54.8	52.8	3.8%	51.3	6.8%
Digital	27.2	28.9	-5.9%	26.5	2.7%
Alliance	33.3	29.3	13.3%	39.7	-16.2%
Acceleraite	4.4	7.3	-39.7%	6.2	-28.4%
<b>Total Revenues</b>	<b>119.6</b>	<b>118.3</b>	<b>1.1%</b>	<b>123.60</b>	<b>-3.2%</b>
<b>As a % of Total revenues</b>					
Services	45.8%	44.6%	120bp	41.50%	430bp
Digital	22.7%	24.4%	-170bp	21.40%	130bp
Alliance	27.8%	24.8%	300bp	32.10%	-430bp
Acceleraite	3.7%	6.2%	-250bp	5.00%	-130bp
<b>Total Revenues</b>	<b>100.0%</b>	<b>100.0%</b>		<b>100.0%</b>	

Source: Company, PL

**Exhibit 8: Geography-wise revenues**

USD in Mn	1QFY20	4QFY19	QoQ gr.	1QFY19	YoY gr.
America	98.7	95.7	3.1%	98.5	0.2%
Europe	10.2	9.3	8.8%	14.8	-31.4%
APAC	10.8	13.2	-18.7%	10.3	4.9%
<b>Total</b>	<b>119.6</b>	<b>118.3</b>	<b>1%</b>	<b>123.6</b>	<b>-3.2%</b>
<b>-as a % of sales</b>					
America	82.5%	80.9%	160bp	79.7%	280bp
Europe	8.5%	7.9%	60bp	12.0%	-350bp
APAC	9.0%	11.2%	-220bp	8.3%	70bp

Source: Company, PL

**Exhibit 9: Revenue by Industry classification**

USD in Mn	1QFY20	4QFY19	QoQ gr.	1QFY19	YoY gr.
ISV	48.6	48.7	0%	48.0	1.3%
Enterprise Digital Transformation	45.3	44.0	3%	41.8	8.5%
IP led	25.7	25.6	1%	33.9	-24.1%
<b>Total</b>	<b>119.6</b>	<b>118.3</b>	<b>1%</b>	<b>123.6</b>	<b>-3.2%</b>
<b>-as a % of sales</b>					
ISV	40.6%	41.2%	-60bp	38.8%	180bp
Enterprise Digital Transformation	37.9%	37.2%	70bp	33.8%	410bp
IP led	21.5%	21.6%	-10bp	27.4%	-590bp

Source: Company, PL

**Exhibit 10: Revenue contribution by Geography (%)**

Revenue by geography (%)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
America	87.0%	85.2%	86.6%	86.5%	85.5%	83.4%	84.4%	80.9%	79.7%	82.6%	83.7%	80.9%	82.5%
Europe	5.2%	6.1%	5.3%	5.3%	5.9%	8.5%	7.3%	8.2%	12.0%	7.5%	7.6%	7.9%	8.5%
APAC	7.8%	8.5%	8.1%	8.2%	8.6%	8.1%	8.3%	10.9%	8.3%	9.9%	8.7%	11.2%	9.0%

Source: Company, PL

**Exhibit 11: Client Metrics**

Revenue by clients (%)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Top Client	29.0%	28.4%	29.5%	26.5%	27.9%	25.9%	28.0%	21.7%	23.8%	25.7%	26.3%	20.2%	23.6%
Top 5 Clients	44.7%	44.3%	46.0%	43.3%	45.7%	43.8%	46.3%	40.9%	43.8%	43.3%	45.0%	40.0%	44.6%
Top 10 Clients	52.7%	52.8%	54.6%	52.4%	55.2%	53.5%	55.3%	49.9%	53.7%	52.4%	54.6%	50.2%	52.6%
Non Top 10 Clients	47.3%	47.2%	45.4%	47.6%	44.8%	46.5%	44.7%	50.1%	46.3%	47.6%	45.4%	49.8%	47.4%

Source: Company, PL



**Exhibit 12: Other Operating Metrics**

Billing rates (USD/p.p.m)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Rest of the world	15,437	16,101	15704	15917	16037	16023	16314	16662	16360	15787	16204	16846	16742
India	4,325	4,288	4,257	4244	4212	4148	4220	4349	4333	4372	4392	4385	4427
<b>Billed person months</b>													
Rest of the World	1,786	1,720	1867	1907	2104	2,346	2,413	2,391	2,348	2,221	2,232	2,206	2,179
India	11,030	11,246	11,610	11,459	11507	11,994	11,922	11,728	11,857	12,097	12,402	12,674	12,962
<b>TOTAL</b>	<b>12,816</b>	<b>12,966</b>	<b>13,478</b>	<b>13,366</b>	<b>13,366</b>	<b>14,340</b>	<b>14,335</b>	<b>14,119</b>	<b>14,205</b>	<b>14,318</b>	<b>14,634</b>	<b>14,880</b>	<b>15,141</b>
Others													
DSO Days	63	66	70	65	64	66	66	66	68	63	61	63	65

Source: Company, PL

## Financials

### Income Statement (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
<b>Net Revenues</b>	<b>30,336</b>	<b>33,658</b>	<b>34,674</b>	<b>37,562</b>
YoY gr. (%)	5.4	11.0	3.0	8.3
Employee Cost	19,703	21,377	22,607	24,324
Gross Profit	10,633	12,281	12,068	13,238
Margin (%)	35.1	36.5	34.8	35.2
SG&A Expenses	-	-	-	-
Other Expenses	5,945	6,475	6,784	7,512
<b>EBITDA</b>	<b>4,688</b>	<b>5,807</b>	<b>5,284</b>	<b>5,726</b>
YoY gr. (%)	3.3	23.9	(9.0)	8.4
Margin (%)	15.5	17.3	15.2	15.2
Depreciation and Amortization	1,585	1,572	1,493	1,578
<b>EBIT</b>	<b>3,103</b>	<b>4,234</b>	<b>3,791</b>	<b>4,148</b>
Margin (%)	10.2	12.6	10.9	11.0
Net Interest	-	-	-	-
Other Income	1,189	630	1,082	1,000
<b>Profit Before Tax</b>	<b>4,292</b>	<b>4,865</b>	<b>4,873</b>	<b>5,148</b>
Margin (%)	14.1	14.5	14.1	13.7
Total Tax	1,062	1,346	1,273	1,364
Effective tax rate (%)	24.7	27.7	26.1	26.5
<b>Profit after tax</b>	<b>3,230</b>	<b>3,518</b>	<b>3,599</b>	<b>3,784</b>
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
<b>Adjusted PAT</b>	<b>3,230</b>	<b>3,518</b>	<b>3,599</b>	<b>3,784</b>
YoY gr. (%)	7.2	8.9	2.3	5.1
Margin (%)	10.6	10.5	10.4	10.1
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>3,230</b>	<b>3,518</b>	<b>3,599</b>	<b>3,784</b>
YoY gr. (%)	7.2	8.9	2.3	5.1
Margin (%)	10.6	10.5	10.4	10.1
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	3,230	3,518	3,599	3,784
<b>Equity Shares O/s (m)</b>	<b>80</b>	<b>79</b>	<b>79</b>	<b>79</b>
<b>EPS (Rs)</b>	<b>40.4</b>	<b>44.5</b>	<b>45.5</b>	<b>47.8</b>

Source: Company Data, PL Research

### Balance Sheet Abstract (Rs m)

Y/e Mar	FY18	FY19	FY20E	FY21E
<b>Non-Current Assets</b>				
<b>Gross Block</b>	<b>13,730</b>	<b>14,174</b>	<b>14,974</b>	<b>15,774</b>
Tangibles	7,324	7,390	7,790	8,190
Intangibles	6,406	6,784	7,184	7,584
<b>Acc: Dep / Amortization</b>	<b>8,685</b>	<b>10,248</b>	<b>11,741</b>	<b>13,318</b>
Tangibles	4,743	5,059	5,582	6,134
Intangibles	3,943	5,189	6,159	7,185
<b>Net fixed assets</b>	<b>5,045</b>	<b>3,927</b>	<b>3,234</b>	<b>2,456</b>
Tangibles	2,581	2,331	2,209	2,057
Intangibles	2,464	1,595	1,025	400
Capital Work In Progress	52	316	316	316
Goodwill	77	81	81	81
Non-Current Investments	3,061	4,859	4,959	5,059
Net Deferred tax assets	372	405	405	405
Other Non-Current Assets	92	68	68	68
<b>Current Assets</b>				
Investments	5,916	3,296	3,296	3,296
Inventories	-	-	-	-
Trade receivables	4,847	4,923	5,700	6,175
Cash & Bank Balance	2,414	6,724	9,283	12,032
Other Current Assets	1,677	1,573	1,623	1,673
<b>Total Assets</b>	<b>26,589</b>	<b>28,556</b>	<b>31,505</b>	<b>34,358</b>
<b>Equity</b>				
Equity Share Capital	800	791	791	791
Other Equity	20,472	22,656	25,172	27,817
<b>Total Network</b>	<b>21,272</b>	<b>23,447</b>	<b>25,963</b>	<b>28,608</b>
<b>Non-Current Liabilities</b>				
Long Term borrowings	17	12	12	12
Provisions	160	253	253	253
Other non current liabilities	-	-	-	-
<b>Current Liabilities</b>				
ST Debt / Current of LT Debt	-	-	-	-
Trade payables	1,673	1,517	1,900	2,058
Other current liabilities	3,197	3,327	3,377	3,427
<b>Total Equity &amp; Liabilities</b>	<b>26,589</b>	<b>28,556</b>	<b>31,505</b>	<b>34,358</b>

Source: Company Data, PL Research

**Cash Flow (Rs m)**

Y/e Mar	FY18	FY19	FY20E	FY21E
PBT	4,293	4,863	4,873	5,148
Add. Depreciation	1,585	1,573	1,493	1,578
Add. Interest	(162)	(288)	(601)	(600)
Less Financial Other Income	1,189	630	1,082	1,000
Add. Other	(346)	(131)	-	-
Op. profit before WC changes	5,370	6,018	5,765	6,126
Net Changes-WC	56	(290)	(649)	(674)
Direct tax	(1,214)	(1,405)	(1,273)	(1,364)
<b>Net cash from Op. activities</b>	<b>4,213</b>	<b>4,323</b>	<b>3,842</b>	<b>4,088</b>
Capital expenditures	(1,060)	(522)	(800)	(800)
Interest / Dividend Income	272	508	601	600
Others	(2,686)	(2,245)	-	-
<b>Net Cash from Inv. activities</b>	<b>(3,474)</b>	<b>(2,259)</b>	<b>(199)</b>	<b>(200)</b>
Issue of share cap. / premium	-	-	-	-
Debt changes	(5)	(5)	-	-
Dividend paid	(800)	(879)	(900)	(946)
Interest paid	(2)	(4)	-	-
Others	(150)	(137)	(184)	(193)
<b>Net cash from Fin. activities</b>	<b>(956)</b>	<b>(1,025)</b>	<b>(1,083)</b>	<b>(1,139)</b>
<b>Net change in cash</b>	<b>(217)</b>	<b>1,039</b>	<b>2,560</b>	<b>2,749</b>
Free Cash Flow	3,150	3,795	3,042	3,288

Source: Company Data, PL Research

**Key Financial Metrics**

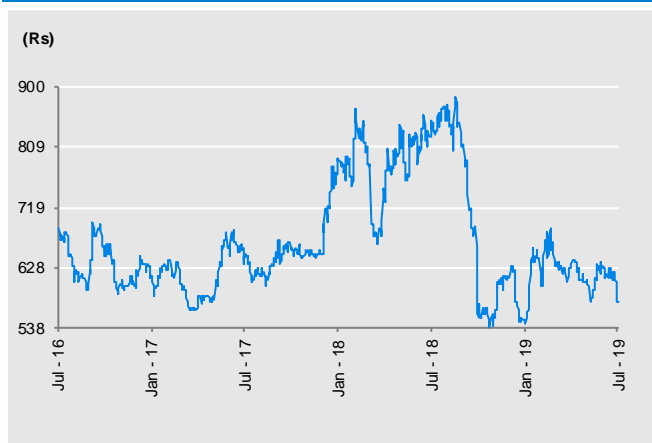
Y/e Mar	FY18	FY19	FY20E	FY21E
<b>Per Share(Rs)</b>				
EPS	40.4	44.5	45.5	47.8
CEPS	60.2	64.3	64.4	67.8
BVPS	265.9	296.3	328.1	361.6
FCF	39.4	48.0	38.4	41.6
DPS	9.6	10.9	11.4	12.0
<b>Return Ratio(%)</b>				
RoCE	15.4	18.9	15.3	15.2
ROIC	18.0	22.8	20.9	22.9
RoE	16.0	15.7	14.6	13.9
<b>Balance Sheet</b>				
Net Debt : Equity (x)	(0.4)	(0.4)	(0.5)	(0.5)
Debtor (Days)	58	53	60	60
<b>Valuation(x)</b>				
PER	13.9	12.6	12.3	11.7
P/B	2.1	1.9	1.7	1.6
P/CEPS	52.6	56.2	56.2	59.2
EV/EBITDA	7.8	5.9	6.0	5.1
EV/Sales	1.2	1.0	0.9	0.8
Dividend Yield (%)	1.7	1.9	2.0	2.1

Source: Company Data, PL Research

**Quarterly Financials (Rs m)**

Y/e Mar	Q2FY19	Q3FY19	Q4FY19	Q1FY20
<b>Net Revenue</b>	<b>8,355</b>	<b>8,642</b>	<b>8,319</b>	<b>8,321</b>
YoY gr. (%)	9.8	9.1	10.5	(0.3)
Raw Material Expenses	5,409	5,341	5,255	5,434
Gross Profit	2,946	3,301	3,064	2,887
Margin (%)	35.3	38.2	36.8	34.7
<b>EBITDA</b>	<b>1,437</b>	<b>1,703</b>	<b>1,266</b>	<b>1,202</b>
YoY gr. (%)	24.1	24.0	13.9	(14.2)
Margin (%)	17.2	19.7	15.2	14.4
Depreciation / Depletion	399	396	377	386
<b>EBIT</b>	<b>1,039</b>	<b>1,307</b>	<b>889</b>	<b>816</b>
Margin (%)	12.4	15.1	10.7	9.8
Net Interest	-	-	-	-
Other Income	231	(12)	224	282
<b>Profit before Tax</b>	<b>1,270</b>	<b>1,296</b>	<b>1,113</b>	<b>1,098</b>
Margin (%)	15.2	15.0	13.4	13.2
Total Tax	387	378	268	273
Effective tax rate (%)	30.5	29.2	24.1	24.9
<b>Profit after Tax</b>	<b>882</b>	<b>917</b>	<b>845</b>	<b>825</b>
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
<b>Adjusted PAT</b>	<b>882</b>	<b>917</b>	<b>845</b>	<b>825</b>
YoY gr. (%)	6.8	0.2	14.5	(5.6)
Margin (%)	10.6	10.6	10.2	9.9
Extra Ord. Income / (Exp)	-	-	-	-
<b>Reported PAT</b>	<b>882</b>	<b>917</b>	<b>845</b>	<b>825</b>
YoY gr. (%)	6.8	0.2	14.5	(5.6)
Margin (%)	10.6	10.6	10.2	9.9
Other Comprehensive Income	-	-	-	-
<b>Total Comprehensive Income</b>	<b>882</b>	<b>917</b>	<b>845</b>	<b>825</b>
Avg. Shares O/s (m)	80	80	80	80
<b>EPS (Rs)</b>	<b>11.0</b>	<b>11.5</b>	<b>10.6</b>	<b>10.3</b>

Source: Company Data, PL Research

**Price Chart**
**Recommendation History**


No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	4-Jul-19	Hold	621	621
2	10-Jun-19	HOLD	618	611
3	30-Apr-19	Hold	618	636
4	5-Apr-19	Hold	653	627
5	28-Jan-19	Accumulate	725	565
6	7-Jan-19	Accumulate	725	570
7	22-Oct-18	Accumulate	725	560
8	5-Oct-18	BUY	860	717
9	30-Jul-18	BUY	900	828

**Analyst Coverage Universe**

Sr. No.	CompanyName	Rating	TP (Rs)	Share Price (Rs)
1	Cyient	Hold	500	544
2	HCL Technologies	BUY	1,186	1,041
3	Hexaware Technologies	Hold	339	373
4	Infosys	Accumulate	782	727
5	L&T Technology Services	Accumulate	1,693	1,599
6	Larsen & Toubro Infotech	Accumulate	1,701	1,576
7	Mindtree	Reduce	755	750
8	Mphasis	Accumulate	1,111	994
9	NIIT Technologies	Accumulate	1,445	1,354
10	Persistent Systems	Hold	621	621
11	Redington (India)	BUY	114	107
12	Sonata Software	Accumulate	400	352
13	Tata Consultancy Services	BUY	2,291	2,133
14	TeamLease Services	Hold	3,203	3,079
15	Tech Mahindra	Hold	690	701
16	Wipro	Reduce	238	260
17	Zensar Technologies	Accumulate	260	257

**PL's Recommendation Nomenclature (Absolute Performance)**

<b>Buy</b>	: > 15%
<b>Accumulate</b>	: 5% to 15%
<b>Hold</b>	: +5% to -5%
<b>Reduce</b>	: -5% to -15%
<b>Sell</b>	: < -15%
<b>Not Rated (NR)</b>	: No specific call on the stock
<b>Under Review (UR)</b>	: Rating likely to change shortly





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