

Bruised but not beaten

Bank of America
Merrill Lynch

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Valuation captures short term challenges

Bharti's stock is available at ~12x PE on our FY11E forecasts which assume no YoY earnings growth; our forecasts are unchanged post 2Q. On its post results call, management emphasized its brand value and execution skills but investors seemed skeptical. We think the next two quarters will be challenging for the industry and Bharti, but think risk to our FY11 forecasts is likely on the upside. We recommend that long term investors accumulate at current levels

Operating results in line; pressure on wireless as expected

Bharti reported 2Q FY10 net profit at Rs23.2bn, up ~13% YoY, but down ~8 % QoQ. 2Q EBITDA stayed flat QoQ in line with our expectations, but net profit was a tad higher (3%) on lower taxes. The Co's wireless business saw revenue & margin pressure as expected but non-wireless posted strong margin improvement thereby lifting consolidated margins.

Mgt. emphasizes unsustainability of current tariffs

Co. acknowledged possible temporary setback to rev. & profit due to heightened competition & irrational pricing. However, it expects to command a brand premium and doesn't feel the need to match the lowest price/tariff points. Non-viability of new-operator business plans is expected to drive natural consolidation in the ind'try. The co. maintained FY10E standalone capex guidance at ~US\$2.2bn.

Competition to peak in 4Q; growth to resume thereafter

Assuming an end-CY09 reaction from Bharti to competition, we f'cast margin pressures to peak in 4Q FY10 & believe growth will resume thereafter. Earnings growth should recover to ~10-15% beyond 1H FY11 led by ~10% rev growth and margin stability. Wireless penetration at ~57% by Mar'11E will still have headroom for growth and new subscribers are consuming a healthy level of minutes.

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	67,008	84,699	93,675	93,659	104,871
EPS	17.66	22.31	24.67	24.67	27.62
EPS Change (YoY)	57.2%	26.3%	10.6%	0%	12.0%
Dividend / Share	0	1.00	0	6.17	6.91
Free Cash Flow / Share	(4.56)	(5.41)	8.86	12.36	19.86

Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	16.54x	13.09x	11.84x	11.84x	10.58x
Dividend Yield	0%	0.342%	0%	2.11%	2.36%
EV / EBITDA*	10.69x	8.02x	7.33x	7.07x	6.42x
Free Cash Flow Yield*	-1.56%	-1.85%	3.03%	4.23%	6.80%

* For full definitions of *iQmethod*SM measures, see page 8.

Stock Data

Price	Rs292.15
Price Objective	Rs395.00
Date Established	9-Oct-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs270.55-Rs518.00
Mrkt Val / Shares Out (mn)	US\$23,496 / 3,796.5
Average Daily Volume	21,389,490
ML Symbol / Exchange	BHTIF / BSE
Bloomberg / Reuters	BHARTI IN / BRTI.BO
ROE (2010E)	26.9%
Net Dbt to Eqty (Mar-2009A)	22.2%
Est. 5-Yr EPS / DPS Growth	14.0% / 50.0%
Free Float	32.9%

Key Changes

(Rs)	Previous	Current
2010E Rev (m)	402,421.3	397,009.7
2011E Rev (m)	439,160.6	439,305.4
2012E Rev (m)	484,750.0	485,067.4
2010E EPS	24.66	24.67
2011E EPS	24.31	24.67
2012E EPS	27.51	27.62

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Refer to important disclosures on page 9 to 11. Analyst Certification on Page 7. Price Objective Basis/Risk on page 7.

31 October 2009

iQprofileSM Bharti Airtel

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	270,250	369,615	397,010	439,305	485,067
Gross Profit	113,715	151,679	165,864	172,065	189,442
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	76,455	104,097	106,347	107,993	118,657
Net Interest & Other Income	82	(10,311)	3,781	443	1,366
Associates	0	0	0	0	0
Pretax Income	76,537	93,786	110,128	108,436	120,024
Tax (expense) / Benefit	(8,378)	(6,615)	(15,477)	(15,239)	(18,068)
Net Income (Adjusted)	67,008	84,699	93,675	93,659	104,871
Average Fully Diluted Shares Outstanding	3,794	3,796	3,796	3,796	3,796

Key Cash Flow Statement Data

Net Income	67,008	84,699	93,675	93,659	104,871
Depreciation & Amortization	37,260	47,582	59,517	64,072	70,785
Change in Working Capital	15,519	(18,500)	(9,537)	(6,203)	(4,521)
Deferred Taxation Charge	(36)	0	0	0	0
Other Adjustments, Net	2,373	8,361	6,882	2,902	3,190
Cash Flow from Operations	122,124	122,142	150,537	154,429	174,325
Capital Expenditure	(139,436)	(142,677)	(116,902)	(107,506)	(98,934)
(Acquisition) / Disposal of Investments	74	(20)	0	0	0
Other Cash Inflow / (Outflow)	0	0	(35,000)	0	0
Cash Flow from Investing	(139,362)	(142,697)	(151,902)	(107,506)	(98,934)
Shares Issue / (Repurchase)	21,147	(3,636)	0	0	0
Cost of Dividends Paid	0	(3,796)	0	(23,415)	(26,218)
Cash Flow from Financing	62,633	14,763	1,366	(46,923)	(75,392)
Free Cash Flow	(17,312)	(20,535)	33,634	46,923	75,392
Net Debt	42,200	69,731	71,097	47,588	(1,585)
Change in Net Debt	(793)	27,531	1,366	(23,508)	(49,174)

Key Balance Sheet Data

Property, Plant & Equipment	313,407	409,136	467,155	511,224	541,757
Other Non-Current Assets	45,454	50,732	80,871	80,251	77,881
Trade Receivables	15,986	18,262	19,755	21,948	24,295
Cash & Equivalents	54,863	49,070	49,070	49,070	49,070
Other Current Assets	42,933	76,747	82,457	91,242	100,746
Total Assets	472,643	603,947	699,309	753,735	793,750
Long-Term Debt	77,715	53,993	55,359	31,850	47,485
Other Non-Current Liabilities	15,195	18,120	22,936	23,804	24,743
Short-Term Debt	19,348	64,808	64,808	64,808	0
Other Current Liabilities	134,787	152,377	150,043	154,818	162,149
Total Liabilities	247,045	289,298	293,146	275,280	234,377
Total Equity	225,598	314,649	406,163	478,454	559,373
Total Equity & Liabilities	472,643	603,947	699,309	753,735	793,750

iQmethodSM - Bus Performance*

Return On Capital Employed	25.5%	24.8%	19.0%	16.8%	17.0%
Return On Equity	37.4%	32.2%	26.9%	21.9%	20.8%
Operating Margin	28.3%	28.2%	26.8%	24.6%	24.5%
EBITDA Margin	42.1%	41.0%	41.8%	39.2%	39.1%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.8x	1.4x	1.6x	1.6x	1.7x
Asset Replacement Ratio	3.7x	3.0x	2.0x	1.7x	1.4x
Tax Rate (Reported)	10.9%	7.1%	14.1%	14.1%	15.1%
Net Debt-to-Equity Ratio	18.7%	22.2%	17.5%	9.9%	-0.3%
Interest Cover	24.8x	6.4x	NM	22.1x	30.0x

Key Metrics

* For full definitions of iQmethodSM measures, see page 8.

Company Description

Bharti Airtel (Formerly Bharti Televentures) is India's largest private sector provider of integrated telecom services, especially wireless. The wireless business accounts for nearly three-fourth of the company's revenues. The company is a market leader with pan-India presence.

Investment Thesis

We expect Bharti's earnings growth trajectory to remain healthy at approx. 14% CAGR for the next 5 years. While growth will be slower than before, we believe valuations have adjusted to reflect this. We foresee upside from potential margin surprises if competition is weaker than expected. Stronger than expected tower-sharing and higher visibility on Indus profits could also provide stock upside

Stock Data

Price to Book Value 2.8x

1Q FY10 highlights

- **Operating results in line, PAT slightly higher on lower tax:** Bharti reported 2Q FY10 net profit at Rs23.2bn, up ~13% YoY, but down ~8 % QoQ. 2Q EBITDA stayed flat QoQ, in line with our expectations, but net profit was a tad higher (3%) on lower taxes. The Co's wireless business saw revenue & margin pressure as expected but non-wireless posted strong margin improvement, thereby lifting consolidated margins.
- **Core wireless performance witnessed pressure:** In 2Q, Bharti's wireless revenue fell 2% QoQ & wireless EBITDA declined ~5% QoQ. Wireless EBITDA margin stood at 31.9%, down 110bps QoQ. 2Q ARPU stood at Rs252/month, down 9.4% QoQ dragged by 6% QoQ fall in MoU/sub and ~3.7% QoQ fall in revenue per minute. ARPU, MoU, rpm & wireless margin weakness is largely in line with that for Idea.
- **Non-wireless margins improve strongly:** Bharti's non-wireless revenues grew only 1% QoQ, but EBITDA grew 7% QoQ. Non-wireless EBITDA margin improved ~250bps QoQ, reflecting improvements across the passive-infra sharing, enterprise & fixed line segments

Table 1: 2Q FY10 segment performance summary

(Rs mn)	2Q FY09	1QFY10A	2QFY10A	YoY chng	QoQ chng
Wireless subs (mn)	77.5	102.4	110.5	43%	8%
Net adds (mn)	8.1	8.4	8.1		
Wireless Revenues	72,843	82,285	80,994	11%	-2%
Wireless EBITDA	22,009	27,183	25,860	17%	-5%
Wireless EBITDA Margin	30.2%	33.0%	31.9%	6%	-3%
Wireless Capex	15,834	9,257	11,464	-28%	24%
Non-wireless Revenues	42,343	37,903	38,461	-9%	1%
Non-wireless EBITDA	17,056	17,488	18,710	10%	7%
Non-wireless EBITDA Margin	40.3%	46.1%	48.6%	21%	5%
Non-wireless Capex	11,078	9,679	8,367	-24%	-14%
Passive infrastructure service Revenues	11,983	8,020	8,586	-28%	7%
Passive infrastructure services EBITDA	3,991	3,557	4,020	1%	13%
Passive infrastructure services EBITDA margin	33.3%	44.4%	46.8%	41%	6%
Passive infrastructure Capex	7,562	3,780	3,564	-53%	-6%
Fixed Line Revenues	8,486	8,550	8,544	1%	0%
Fixed Line EBITDA	3,696	3,463	3,667	-1%	6%
Fixed Line EBITDA Margin	43.6%	40.5%	42.9%	-1%	6%
Fixed Line Capex	2,815	4,095	1,790	-36%	-56%
Enterprise services - Revenue	21,874	21,333	21,331	-2%	0%
Enterprise services - EBITDA	9,369	10,468	11,023	18%	5%
Enterprise services - EBITDA margin	42.8%	49.1%	51.7%	21%	5%
Enterprise services - Capex	4,271	1,804	3,013	-29%	67%
Others - Revenue	911	1,027	1,290	42%	26%
Others - EBITDA	(1,284)	(2,136)	(2,334)	82%	9%
Others - Capex	1,385	8,155	2,957	114%	-64%
Consolidated Revenues	90,203	99,416	98,455	9%	-1%
Consolidated EBITDA	36,993	41,518	41,416	12%	0%
Consolidated EBITDA Margin	41.0%	41.8%	42.1%	3%	1%
Total Capex	31,867	27,091	22,788	-28%	-16%

Source: Company

- **Indus Towers retraces to a loss in 2Q:** Both Indus and the passive-infra segment of Bharti reported higher sharing factors in 2Q. However, Bharti's results factor a loss of Rs8mn (due to one-off revenue reversal) towards its Indus stake versus a profit of Rs240mn reflected in 1Q FY10.
- **Capex continues to trend down; net debt down sharply:** Bharti's overall capex fell 16% QoQ to ~US\$474mn, marking the third consecutive quarter of lower capex. The Co's net debt fell 12% QoQ to Rs42bn and net debt/EBITDA was ~0.25x.
- **Mgt. says no compulsion to match irrational pricing:** In its media interview post results, Bharti's top management said that they do not feel the need to match the lowest price points in the industry. The Co emphasized that it will continue to invest strongly in the business. Also, Bharti highlighted a 35% EBITDA contribution from non-wireless as a key strength.

Table 2: Bharti - Key performance indicators

	2Q FY09	3Q FY09A	4Q09A	1QFY10A	2QFY10A	YoY chng	QoQ chng
Share of industry net adds	28.5%	25.9%	18.4%	23.7%	18.4%	-35%	-22%
Churn	3.2%	2.8%	3.2%	3.4%	4.5%	42%	30%
Revenue per minute (Rs/min)	0.63	0.64	0.63	0.58	0.56	-11%	-4%
Wireless ARPU (Rs/month)	331	324	305	278	252	-24%	-9%
Wireless MoU (minutes/month)	526	505	485	478	450	-14%	-6%

Source: company

Table 3: 2Q FY10 results summary

Yr to March (Rs mn)	2Q FY09	1Q FY10	2Q FY10	YoY chng	QoQ chng
Gross revenues	90203	99,416	98,455	9%	-1%
Access & interconnect charges	12902	11,371	10,699	-17%	-6%
<i>% of gross revenues</i>	14.3%	11.4%	10.9%		
Adjusted gross revenues	77301	88045	87756	14%	0%
License fees	9096	10,126	10,222	12%	1%
<i>% of adjusted gross revenues</i>	11.8%	11.5%	11.6%		
Revenues net of regulatory charges	68205	77919	77534	14%	0%
Network Operating expenses	14392	18,165	18,638	30%	3%
<i>% of net revenues</i>	21.1%	23.3%	24.0%		
Personnel expenses	4209	4,662	4,232	1%	-9%
<i>% of net revenues</i>	6.2%	6.0%	5.5%		
Other operating expenses	12611	13,574	13,248	5%	-2%
<i>% of net revenues</i>	18.5%	17.4%	17.1%		
Total Operating expenses	31212	36401	36118	16%	-1%
EBITDA	36993	41518	41416	12%	0%
EBITDA Margin	41.0%	41.8%	42.1%		
Depreciation	11549	14,330	14,796	28%	3%
Other Income	274	186	409		
Other costs	253	131	4		
EBIT	25465	27243	27025	6%	-1%
Interest expense/(income)	5741	-2,605	428	-93%	-116%
PBT	19724	29848	26597	35%	-11%
Tax expense/(income)	-1247	4,442	2,873	-330%	-35%
Minority Interest	508	479	506	0%	6%
Income from associate		240	-8	na	na
Net Profit	20463	25167	23210	13%	-8%

Source: Company

Table 4: Key assumptions

Yr to March	FY08	FY09	FY10E	FY11E	FY12E
Bharti - wireless subs ('000)	61,985	93,923	127,709	160,345	191,349
% market share	24%	24%	23%	22%	22%
Blended ARPU (Rs/month)	366	324	245	202	179
% change in ARPU	-12%	-11%	-25%	-18%	-11%
Bharti - fixed-line subs ('000)	2,283	2,726	3,109	3,433	3,696
ARPL (Rs/month)	1,143	1,115	987	957	927
% change in ARPL	-2%	-2%	-11%	-3%	-3%

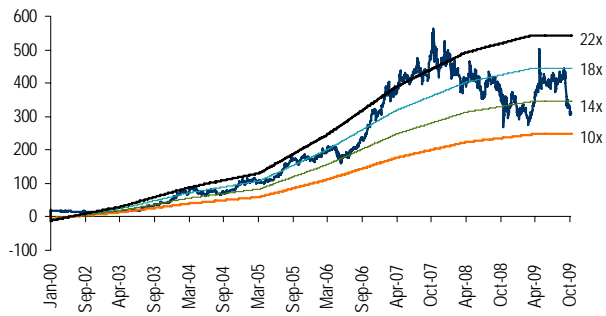
Source: BofA Merrill Lynch

Management call highlights

- Management acknowledged the current irrational pricing environment and expects it to continue in the short term. Using Indonesia as an example, management highlighted the fact that various markets across regions have witnessed this phenomenon at some point of time but have turned back to viable pricing in the long term.
- Management emphasized its brand value and its ability to charge premium vs other players. Bharti highlighted that it will remain competitive but will not try to match the lowest prevailing tariff. Co will continue to focus on maintaining its leadership position in revenue market share.
- Management emphasized growth in non-wireless business, which now makes 35% of its consolidated EBITDA and commands superior margins.
- Standalone capex guidance was maintained at US\$2-2.2bn. Tower capex (including 42% stake in Indus) may come down to \$700-800mn from \$1bn earlier as many new players are scaling back capex.
- Management is optimistic of Indus' margins matching Bharti Infratel's margins in the long term.
- Flat revenues in the non-wireless segment were attributed to global slowdown affecting the enterprise division, and fixed to mobile substitution in the wire-line division.
- Management talked about monetization of both tower businesses (Indus & Bharti-Infratel) over the next 2-3 years.
- Notwithstanding its failed M&A discussion with MTN, Bharti said it will continue to look for opportunities in emerging markets.

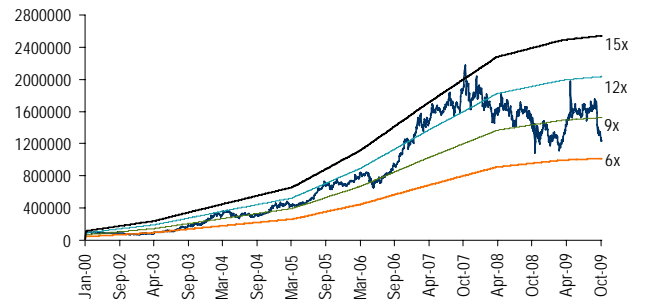
31 October 2009

Chart 1: Bharti – 1 year forward PE bands



Source: BofA Merrill Lynch

Chart 2: Bharti – 1 year forward EV/EBITDA bands



Source: BofA Merrill Lynch

Price objective basis & risk

Bharti (BHTIF)

We have a price objective of Rs395/sh for Bharti. This is a sum of 1) Bharti's estimated standalone value at Rs360/sh based on 10% discount to DCF using 12% WACC and 5% terminal growth, and 2) Rs35/sh towards Bharti's 42% stake in Indus at 20% discount to DCF. Bharti's current PE multiple is on par with AsiaPac avg but EV/EBITDA is at 35-40% premium. This narrows to 20-25% if one factors the value of Indus Towers. However, we think multiples are unlikely to revert to peak levels due to YoY slowdown in market growth and uncertain policy environment. Stronger-than-anticipated tower-sharing would present upside. Possible dramatic regulatory changes would pose risks.

Analyst Certification

I, Reena Verma Bhasin, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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31 October 2009

APR - Telecommunications Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY				
	Advanced Info	XVDIF	ADVANC TB	Thititthep Nophaket
	Bharti	BHTIF	BHARTI IN	Reena Verma Bhasin, CFA
	China Unicom	CHUFF	762 HK	Cynthia J.H. Meng
	China Unicom - A	CHU	CHU US	Cynthia J.H. Meng
	Indosat	PTITF	ISAT IJ	Chen Hsung Khoo, CFA
	Indosat - A	IIT	IIT US	Chen Hsung Khoo, CFA
	SingTel	SNGNF	ST SP	Reena Verma Bhasin, CFA
	Total Access	TACJF	DTAC SP	Thititthep Nophaket
	Total Access Communication	TACPF	DTAC TB	Thititthep Nophaket
NEUTRAL				
	China Mobile	CHLKF	941 HK	Cynthia J.H. Meng
	China Mobile - A	CHL	CHL US	Cynthia J.H. Meng
	China Telecom	CHA	CHA US	Cynthia J.H. Meng
	China Telecom-H	CHJHF	728 HK	Cynthia J.H. Meng
	Idea Cellular	IDEAF	IDEA IN	Reena Verma Bhasin, CFA
	MobileOne	MBOFF	M1 SP	Chen Hsung Khoo, CFA
	RCVL	RLCMF	RCOM IN	Reena Verma Bhasin, CFA
	Telekom Malaysia	MYTEF	T MK	Reena Verma Bhasin, CFA
UNDERPERFORM				
	DiGi.com Bhd	DIGBF	DIGI MK	Reena Verma Bhasin, CFA
	MTNL	MTE	MTE US	Reena Verma Bhasin, CFA
	MTNL	XMTNF	MTNL IN	Reena Verma Bhasin, CFA
	StarHub	SRHBF	STH SP	Chen Hsung Khoo, CFA
	Tata Communications Limited	TCL	TCL US	Reena Verma Bhasin, CFA
	Tata Communications Limited	VLSLF	TCOM IN	Reena Verma Bhasin, CFA
	Telkom	TLKMF	TLKM IJ	Reena Verma Bhasin, CFA
	Telkom - A	TLK	TLK US	Reena Verma Bhasin, CFA
	TRUE Corp	TCPJF	TRUE TB	Thititthep Nophaket

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

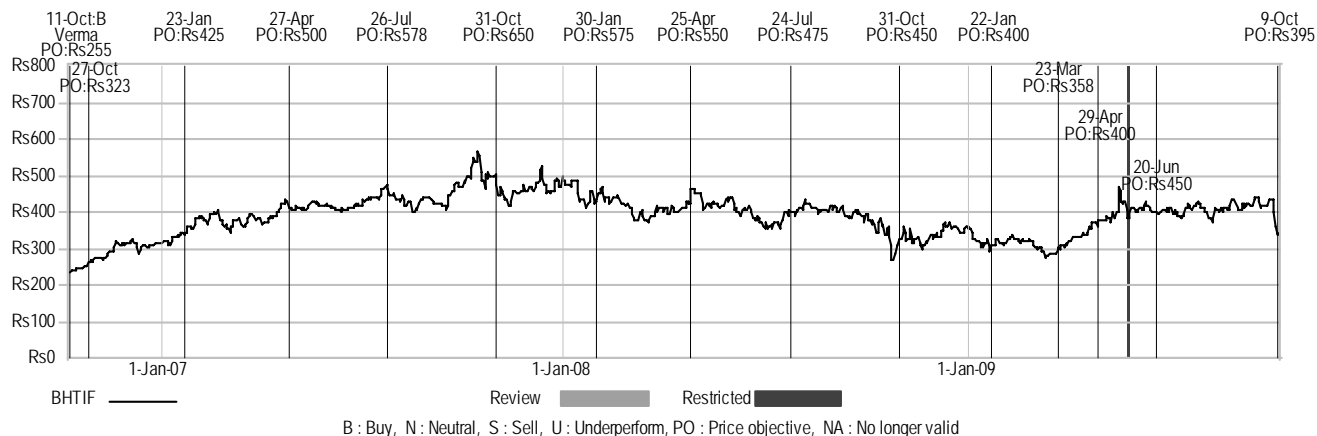
iQmethodSM is the set of BofA Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

iQdatabase[®] is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by BofA Merrill Lynch.

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Important Disclosures

BHTIF Price Chart



*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of September 30, 2009 or such later date as indicated.

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Investment Rating Distribution: Telecommunications Group (as of 01 Sep 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	87	45.79%	Buy	40	56.34%
Neutral	57	30.00%	Neutral	27	60.00%
Sell	46	24.21%	Sell	22	55.00%

Investment Rating Distribution: Global Group (as of 01 Sep 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1528	47.19%	Buy	740	53.86%
Neutral	815	25.17%	Neutral	436	60.39%
Sell	895	27.64%	Sell	378	45.99%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofAML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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