



## **Research study (Update)**

**KPS AG**



**Further dynamic growth from the ongoing internationalization is expected. Additional margin improvements from industrialization are possible.**

-

**Prognoses for FY 2016/17 reiterated**

**Price target: € 18.00**

**Rating: Hold**

### **IMPORTANT NOTE:**

**Please take note of the disclaimer/risk warning, as well as the disclosure of potential conflicts of interest as required by section 34b of the Securities Trading Act (WpHG) from page 14**

## KPS AG<sup>\*5a;6a;7;11</sup>

**Rating: Hold**

**Target price: € 18.00**

Current price: € 17.28

14/06/2017 / ETR

Currency: EUR

**Key information:**

ISIN: DE000A1A6V48

WKN: A1A6V4

Ticker symbol: KSC

Number of shares<sup>3</sup>: 37,28\*

Market Cap<sup>3</sup>: 652.84

Enterprise Value<sup>3</sup>: 640,23

<sup>3</sup>in million / in mEUR

\* after issuance of bonus shares

Free float: 21.20 %

**Transparency level:**

Prime Standard

**Market segment:**

Reguliert Market

**Accounting standard:**

IFRS

Financial year: 30/9

**Designated Sponsor:**

Oddo Seydler Bank AG

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\* List of possible conflicts of interest on page 15

**Company profile**

Sector: Services

Focus: consulting for business transformation and process optimisation

Employees: 459 as of 31/03/2017

Established: 2000

Registered office: Munich

Board of Management: Leonardo Musso



KPS is Europe's leading management consulting firm for business transformation and process implementation in the retail/wholesale trade. The company offers end-to-end strategy and process consulting, with long-standing implementation expertise in ERP, e-commerce and CRM. KPS customers profit from the vast project experience and deep sector knowledge of its consultants, enabling them to drive omnichannel and digital transformation projects in particular to rapid success. With its proprietary Rapid Transformation® methodology, KPS has cut project turnaround times by up to 50 percent and set new standards in efficiency and transparency. Founded in 2000, KPS employs about 800 consultants at its corporate headquarters in Munich, its five additional locations throughout Germany and its branch offices in Denmark, the Netherlands, Switzerland and the US. KPS plans to expand its market position in the retail and consumer goods sectors in the coming years through pioneering projects in all aspects of digital transformation

P&L in mEUR, financial year-end	30/9/2014	30/9/2015	30/9/2016e	30/9/2017e
Sales	122.92	144.93	164.25	189.49
EBITDA	19.65	23.26	26.77	31.48
EBIT	18.61	22.26	25.77	30.38
Net income	17.93	19.28	21.82	25.70

**Key figures in EUR**

Earnings per share**	0.53	0.52	0.59	0.69
Dividend per share	0.30	0.33	0.35	0.39

\*\* issuance of bonus shares with a ratio of 10:1 already considered

**Key Figures**

EV/Sales	5.26	4.42	3.90	3.38
EV/EBITDA	32.89	27.53	23.92	20.34
EV/EBIT	34.73	28.76	24.84	21.07
P/E	36.41	33.87	29.92	25.41
P/B		9.61		

**Finanztermine**

11/08/2017: 9M-report 2015/16

31/01/2018: FY-report 2015/16

**\*\* Last research by GBC:**

Date: publication/target price in EUR/rating

14/02/2017: RS / 18.00 / BUY

18/08/2016: RS / 11.60 / BUY

06/06/2016: RS / 9.80 / BUY

\*\* The research studies indicated above may be viewed at [www.gbc-ag.de](http://www.gbc-ag.de), or requested from GBC AG, Halderstr. 27, D86150 Augsburg

## EXECUTIVE SUMMARY

- In the first half of 2016/17, KPS AG was able to continue its dynamic growth and achieve a new revenue record. Revenue increased by 20.3% to €82.83 million and was therefore well on track in terms of the full-year forecast.
- On the one hand the dynamic growth was due to the growth in business with existing customers in the transformation consulting sector, and on the other hand to the increasing international expansion. At segment level, revenue in the transformation consulting sector increased by 24.4% to €74.96 million. The most important customers continue to be from the consumer and trade sectors, which have been heavily affected by the megatrend of digitalisation. Due to the high demand in these sectors for KPS solutions, the consulting team has virtually had a full workload for years and a large number of freelancers have also been engaged.
- On the earnings side, a new record was also achieved and EBIT increased by 17.8% to €12.49 million. Due to the international expansion and the larger organisational structures, costs were incurred which prevented even stronger earnings growth. However, the increasing industrialisation of the consulting approach should allow for significant scaling effects and margin improvements in the future.
- To this end, we confirm our forecast and expect revenue of €164.25 million for financial year 2016/17 and €189.49 million for financial year 2017/18. We also expect KPS to achieve an EBIT of €25.77 million for 2016/17 and €30.38 million for 2017/18. In our view, KPS will continue to grow very dynamically and will be able to further develop its position as a European market leader in the field of transformation consulting for the consumer and trade sectors. The megatrend of digitalisation also plays a major role here and we expect excessive demand in this area in the future. In terms of margins, we assume that the industrialisation of the consulting approach will lead to further margin improvements and that the costs of further projects can be gradually reduced. In addition, we expect that the service and maintenance business in the products/licences segment will increase, which has exceptionally high margins due to the high proportion of recurring revenue.
- **KPS AG is generally very well positioned in the current market environment and uses its market position for further expansion purposes. More customers should be won by strategic branches abroad; in particular, the USA should produce significant revenue and earnings contributions in the next few years. In addition, we expect that the industrialisation of the consulting approach will lead to a disproportionate increase in earnings. On the basis of our DCF model, we have determined a target price of €18.00 per share and allocated a HOLD rating, given the current price of €17.28 per share.**

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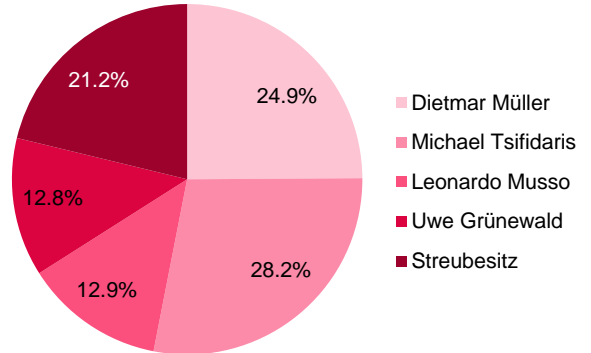
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## COMPANY PROFILE

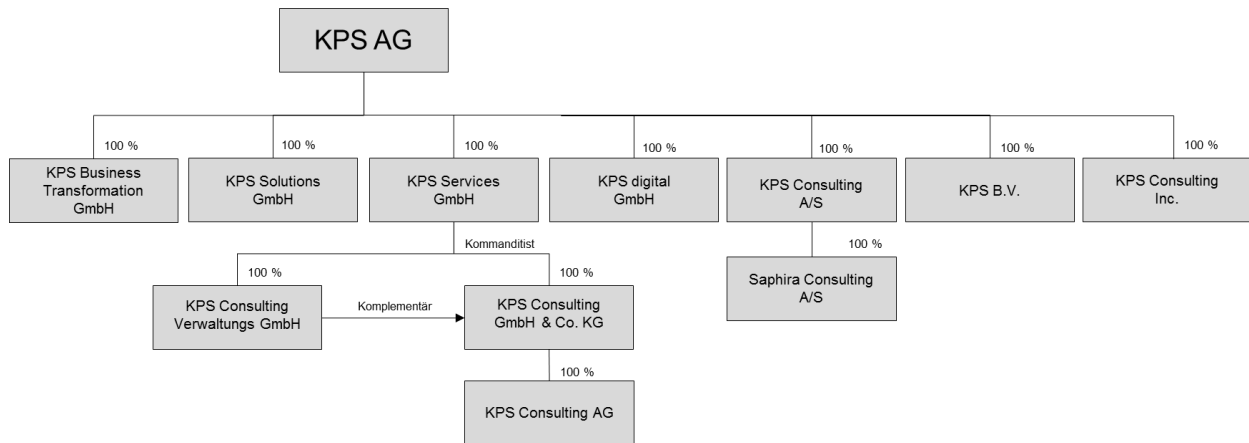
### Ownership structure

Dietmar Müller	24.9%
Michael Tsifidaris	28.2%
Leonardo Musso	12.9%
Uwe Grünewald	12.8%
Streubesitz	21.2%
Summe	100.0%

Source: KPS AG



### Group structure



Source: KPS AG

### Important Customers

The KPS AG's customer base encompasses a range of renowned companies. The focus is on the retail and consumer goods sectors. In the following selected references are displayed:



Source: KPS AG

## Business Development HY1 2016/17

in €m	HY 2015/16	Δ in %	HY 2016/17
Sales	68.83	20.3%	82.83
EBITDA	11.18	17.3%	13.11
EBITDA margin	16.2%		15.8%
EBIT	10.60	17.8%	12.49
EBIT margin	15.4%		15.1%
Net profit	9.34	10.3%	10.30
EPS in €**	0.28	0.3%	0.28

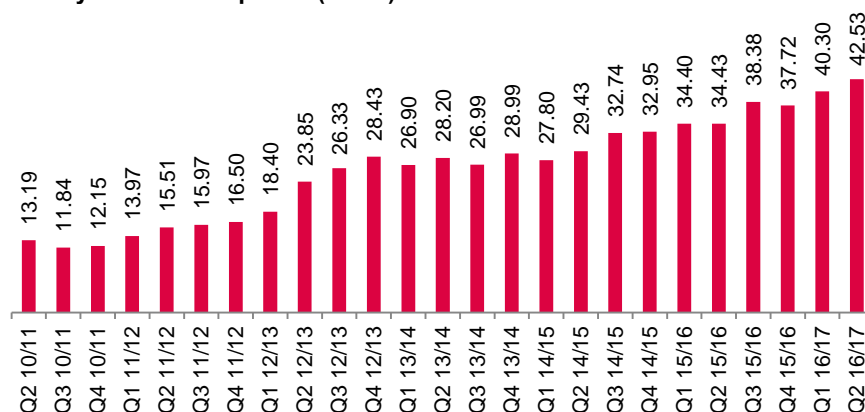
\*\* Number of shares HY 15/16: 33.89m; HY 16/17: 37.41m

Source: KPS, GBC

### Revenue performance

KPS AG (KPS) was able to successfully continue the dynamic growth of the first quarter and once again achieved a new revenue record in the second quarter of 2016/17. KPS recorded an increase in revenue of 23.5% to €42.53 million (previous year: €34.43 million). Likewise, a new revenue record of €82.83 million was also achieved in the first half of 2016/17.

### Quarterly sales development (in €m)



Source: KPS, GBC

This continued dynamic in revenue growth is due to the increasing internationalisation of KPS. In addition to the growth in business with existing customers, the company is expanding thanks to strategic acquisitions, particularly in neighbouring countries. For example, the recent acquisition of the Danish consultancy firm Saphira Consulting A/S (Saphira) has already contributed €1.91 million to group revenue. Similarly, the Dutch company KPS B.V. has generated revenue of €3.31 million.

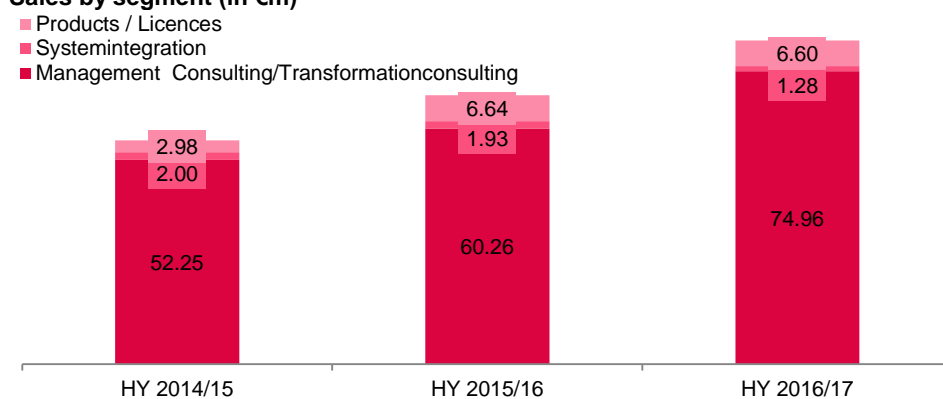
KPS's global expansion strategy involves the establishment of local branches, either in the form of subsidiaries with an existing local customer contact, or through the strategic acquisition of small, but well connected consultancy firms. This allows the branches to be profitable immediately and KPS can simultaneously offer the local support to customers. This concept of small local subsidiaries leads to cost savings by developing the software in Germany, which is largely generated by the industrialised transformation approach at the SmartFactory in Dortmund. KPS therefore combines a scalable consultancy approach with direct customer contact, and can therefore expand while gradually reducing costs.

KPS also considers the large US market to be material and has already established a branch there within the framework of customer cooperation. The revenue achieved is

currently invoiced in Germany and is therefore not yet visible in segment reporting. According to KPS management, the next financial publication (11 August 2017: publication of the nine-month report) could include the revenue achieved in the USA. The plan is to hire up to 30-40 employees in the USA, which would be a rather significant number for KPS. In comparison, as at 31 March 2017, KPS employed around 460 people in Europe (excluding freelancers).

At segment level, transformation consulting continued to represent the largest share of revenue by far. Here, revenue increased by 24.4% to €74.96 million. The customer base of the management consulting/transformation consulting segment mainly consists of customers from the consumer and trade sectors. Here, KPS has already established its leadership in the European market and is able to win new customers in addition to expanding its business with existing customers. Transformation consulting also increasingly benefits from the industrialisation of the consulting approach. Against this background, KPS doubled its office space in Dortmund in May 2017.

### Sales by segment (in €m)



Source: KPS, GBC

While the products and licences segment remains at the same level as the previous year at €6.60 million (previous year: €6.64 million), an exceptionally high segment margin of 26.0% could be achieved. This development is due to the high proportion of recurring revenue from the service and maintenance business. Here, contracts are usually concluded for three years and it is generally difficult for customers to find maintenance of the same level of quality as that offered by KPS.

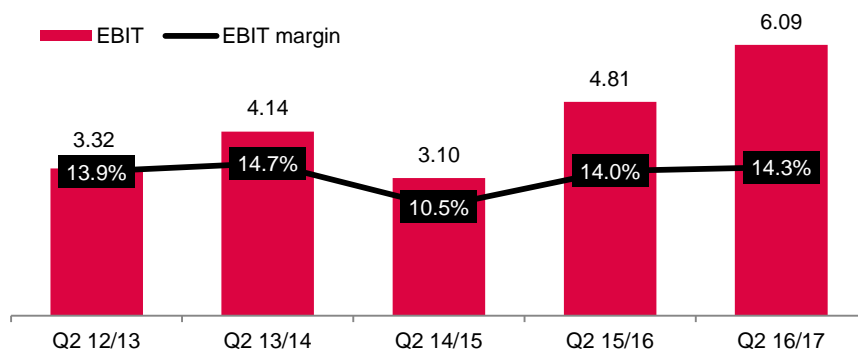
### Earnings performance

The very dynamic revenue performance in the first half of 2016/17 was also reflected in earnings, and EBIT therefore increased by 17.8% to €12.49 million (previous year: €10.60 million). At 15.1%, the EBIT margin remained at almost the same level as the previous year (previous year: 15.4%).

In contrast, EBIT rose in the second quarter by 26.6% to €6.09 million (previous year: €4.81 million) and a new record was achieved again. Similarly, the EBIT margin in the second quarter reached a three-year high of 14.3%. Nevertheless, the second quarter is historically the weakest quarter of the financial year for KPS due to the settlement periods of the project business. Due to the staggered invoicing of transformation consulting projects, linear settlement is not possible. We expect that the third and fourth quarters will have stronger earnings and margins, and will therefore meet – and perhaps exceed – the forecasts.

In terms of costs, material expenses increased in particular, and mainly consisted of freelancers for consulting projects. KPS has historically always engaged a significant proportion of freelancers due to the very high, almost full workload of its own employees and because specialist staff are sometimes required for individual projects. Accordingly, temporally ambitious objectives may also be guaranteed by increasing the number of freelancers engaged, allowing KPS to provide customers with key project solutions even at short notice.

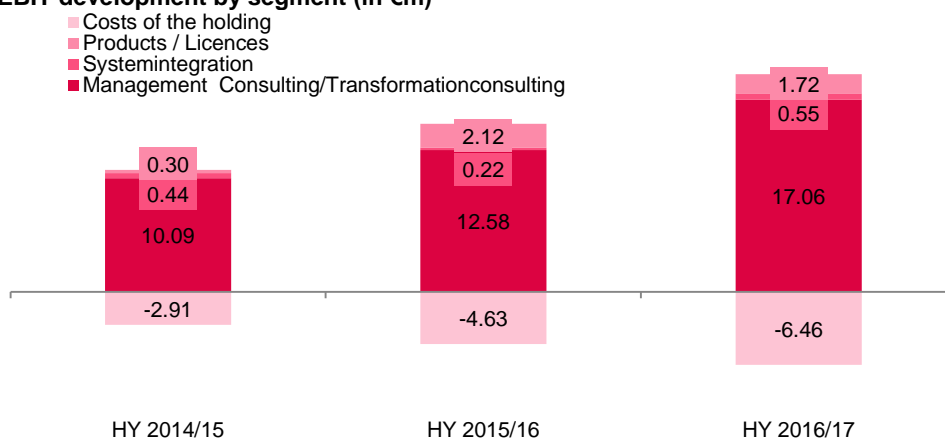
### Earnings performance in Q2 (in €m)



Source: KPS, GBC

Further cost drivers were the increasing internationalisation and the expansion of organisational structures. For example, holding costs rose to €6.46 million (previous year: €4.63 million), but remained stable relative to revenue. In our view, this is perfectly reasonable given the growth of the organisation, especially as these costs are extremely low compared to the rest of the sector.

### EBIT development by segment (in €m)



Source: KPS, GBC

Costs are offset in particular by a disproportionate increase in EBIT in the transformation consulting segment. Here, EBIT rose by 35.7% to €17.06 million (previous year: €12.58 million); similarly, the EBIT margin rose from 20.9% to 22.8%. This dynamic development is due to the increasing industrialisation of KPS's consulting approach. As a result, an increasing number of modular solutions are being developed at the SmartFactory in Dortmund, which allows the consulting business to be scaled successively.

Furthermore, in the products/licences segment, EBIT of €1.72 million was achieved (previous year: €2.12 million), which results in a slight margin decline from 32.0% to 26.0%. Nevertheless, the margin remains at an extremely high level. The reason for this is the high proportion of recurring revenue from the service and maintenance business.



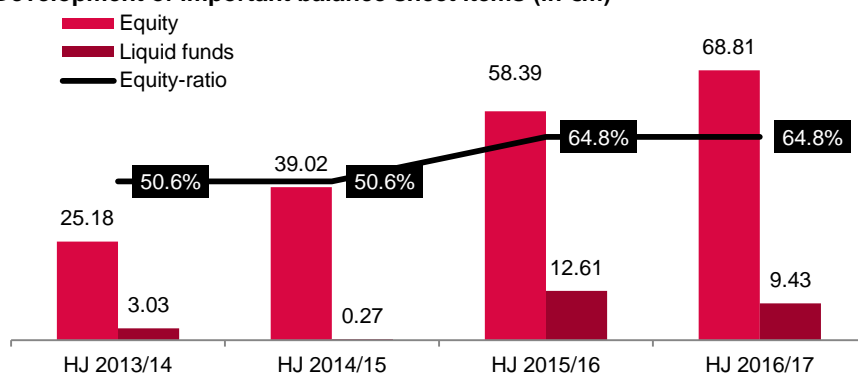
Overall, the first half year has made a good contribution to the forecast for the whole year. In particular, the expansion of margins in the transformation consulting segment shows that the industrialisation approach is working and that further scaling effects are possible.

### **Balance sheet and financial situation**

We believe that KPS AG is still very well positioned financially. Equity capital increased in the first half of 2016/17 to €68.81 million owing to the company's good earnings situation (previous year: €58.39 million). The equity ratio remained stable at an extremely high level of 64.8%. In addition, KPS does not have any bank liabilities.

It should be noted that in the context of dividend payments, outflows of €12.30 million (€0.33 per share) are still expected. This effect was also felt in the previous year, meaning that comparability is not affected.

#### **Development of important balance sheet items (in €m)**



Source: KPS, GBC

In addition to the dividend payment, the General Meeting also resolved on a share option programme worth €2.00 million in order to retain and further motivate employees below Executive Board level in the long term. Further details on this programme are still to be announced. Nevertheless, we expect this measure to add value in the long term as qualified employees in the IT sector are very much in demand.

## SWOT-analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• Strong market position with customers in the consumer products and retail sectors</li> <li>• Solid balance sheet ratios with a 58% equity ratio and €6.5 million net liquidity</li> <li>• Full utilisation of consulting staff and extensive order book</li> <li>• Rapid Transformation Method represents a competitive advantage</li> <li>• High level of tax loss carryforwards will also ensure a reduced tax burden in future years</li> </ul>	<ul style="list-style-type: none"> <li>• Low free float restricts tradability of the share</li> <li>• Currently still a high level of dependency on present management</li> <li>• The rising number of projects and project volumes require a sharp increase in the number of employees, which could lead to bottlenecks depending on the availability of personnel resources</li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>• SAP service partner status allows KPS to conclude SAP licensing and maintenance agreements which can have an additional impact on sales</li> <li>• The increasing expansion into foreign markets, in particular Scandinavia, harbours new revenue potential</li> <li>• Exploiting new customer sectors can generate additional potential sales</li> <li>• Additional growth potential through the internationalization. Especially the US-market has great potential.</li> </ul>	<ul style="list-style-type: none"> <li>• Increasing price pressure in the consulting industry could bring consultants' daily rates under pressure</li> <li>• Competitors could copy Rapid Transformation and reduce the competitive advantage of KPS AG</li> <li>• A decline in winning assignments could result in sub-optimal capacity utilisation of the consulting staff</li> <li>• The loss of a major customer could have a negative impact on the revenue and earnings situation of KPS AG</li> </ul>

## Estimates and model assumptions

P&L (in €m)	FY 2015/16	FY 2016/17e	FY 2017/18e
Sales	144.93	164.25	189.49
EBITDA	23.26	26.77	31.48
EBITDA-Margin	16.0%	16.3%	16.6%
EBIT	22.26	25.77	30.38
EBIT-Margin	15.4%	15.7%	16.0%
Net profit	19.28	21.82	25.70
EPS in €	0.52	0.58	0.69

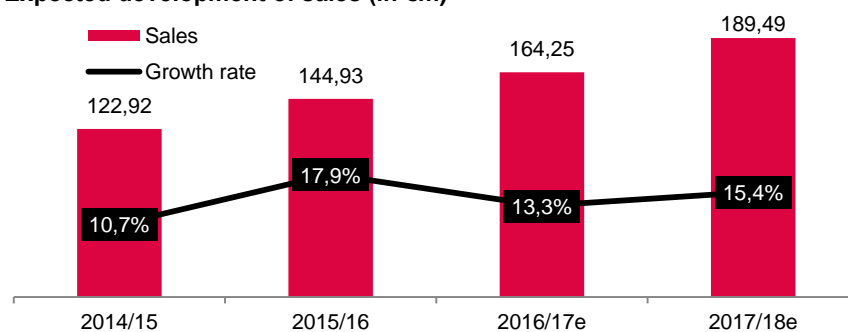
Source: GBC

### Revenue forecasts

On the basis of the figures for the second half of the year, we can confirm our forecasts and expect continued dynamic growth for KPS AG. One of the reasons for this is the almost full workload of KPS employees which places the company well above the industry average and also improves planning security. Furthermore, the company started to carry out public relations work in order to attract more attention from potential customers and employees.

For many years, KPS has achieved an extremely high level of growth which, in our opinion, can still be increased as demand tends to exceed supply in the market for high-quality transformation consulting. KPS increasingly applies the industrialization approach the transformation consulting so that it can manage with the high demand and also increase scalability at the same time. Hence, modular solutions, some of which can be used several times, are created in the SmartFactory. That this concept works and is promising is also proven by the fact that the SmartFactory doubled its office space in Dortmund in May 2017. At the same time, the SmartFactory is increasingly becoming the central development site which also develops solutions for branches abroad. The company has therefore found a cost-efficient way of advancing the global expansion. The successful implementation can also be seen in the Dutch and Danish subsidiaries, which made important revenue and earnings contributions in the first half of 2016/17. Likewise, we are assuming that the US branch will also provide significant earnings in the future.

### Expected development of sales (in €m)



Source: GBC

In addition to the global expansion, KPS is also an SAP value-added reseller and has a comprehensive maintenance and service business in the products and licences segment. This segment is particularly characterised by recurring revenue and achieves correspondingly high margins. We assume that in addition to transformation consulting, it will be possible to further expand the service business in the future and this high-margin segment will also have a very positive effect on earnings.

Company guidance currently stands at €160 million; however, KPS AG's own company forecasts are generally conservative. We assume that the company will achieve revenue of €164.25 million in financial year 2016/17 and €189.49 million in 2017/18.

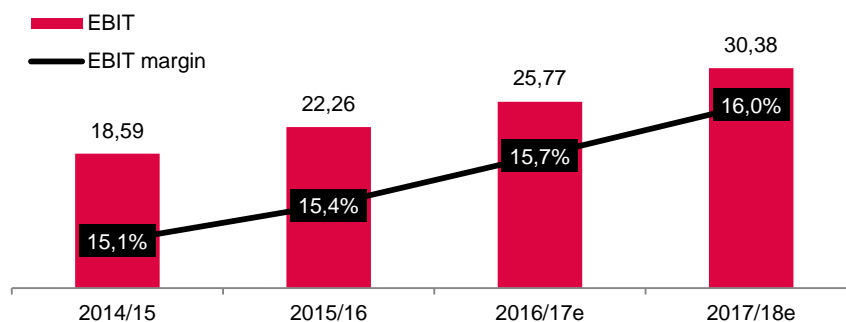
### Earnings forecasts

On the earnings side, the company expects EBIT of €25 million, which is slightly below our forecast of €25.77 million. We are confident that KPS guidance is still conservative, not only because the past forecasts made by the company have always been exceeded.

An important earnings driver is the industrialisation of the consulting approach, which should allow successive margin increases. The development of an extensive product portfolio allows individual elements to be adapted quickly and cost-efficiently so that additional development costs can be saved. As the product portfolio expands, this leads to a gradual reduction in costs. Accordingly, the Executive Board has also indicated a medium-term EBIT margin of 17-18%.

As part of the industrialisation approach, KPS is also able to cost-effectively manage internationalisation. Only small advisory teams are deployed locally to serve as contacts and to facilitate customer access. At the same time, a large proportion of the development activity continues to be carried out in Germany. Similarly, there are plans to tap into other countries if suitable opportunities arise. Possible expansion targets in this respect could be the United Kingdom and Spain.

### Expected development of EBIT (in €m) and EBIT margin (in %)



Source: GBC

In addition to industrialisation and internationalisation, KPS is also increasingly relying on its own employees as opposed to freelancers. This operational shift also leads to cost savings, because although freelancers work more flexibly, their services are considerably more expensive.

We therefore expect that KPS AG will continue to grow dynamically and expect that a disproportionate increase in earnings should be possible.

## VALUATION

### Model assumptions

We rated KPS AG using a three-stage DCF model. Starting with the concrete estimations for 2016/17 and 2017/18 in phase 1, in the second phase, from 2018/19 to 2023/24, our forecast uses value drivers. Here we expect a sales increase of 12.0 %. We have assumed an EBITDA margin target of 17.0%. We have taken into account tax rates of 15.0-30.0 % due to the outstanding losses carried forward in phase 2. Additionally, a residual value is determined in the third phase by using the perpetual annuity by the end of the forecast horizon. As the final value, we assume a growth rate of 2.0%.

### Determination of capital costs

The weighted average cost of capital (WACC) of KPS AG is calculated using equity costs and debt costs. The market premium, the company-specific beta, as well as the risk-free interest rate have to be determined in order to determine the equity cost.

The risk-free interest rate is derived in accordance with the recommendations of the expert committee for company valuations and business administration (FAUB) of the IDW (Institut der Wirtschaftsprüfer in Deutschland e.V.) from the current interest rate yield curves for risk-free bonds. The zero bond interest rates according to the Svensson method published by the German Federal Bank form the underlying basis. To smooth out short-term market fluctuations, we use the average yields over the previous three months and round up the result to 0.25 basis points. **The value of the currently used risk-free interest rate is 1.25% (before: 1.00%).**

We set the historical market premium of 5.50% as a reasonable expectation of the market premium. This is supported by historical analyses of stock market returns. The market premium reflects the percentage by which the stock market is expected to be more profitable than low-risk government bonds.

According to GBC estimates, we have determined a beta of 1.18 (unchanged).

Based on these assumptions, equity costs are calculated to amount to 7.5 % (previously: 7,5%) (beta multiplied by the risk premium plus the risk-free interest rate). Since we assume a sustainable weighting of the equity costs of 100 %, the resulting weighted average costs of capital (WACC) amount to 7.7 % (previously: 7,5%).

### Evaluation result

The discounting of future cash flows is based on the entity approach. In our calculation, the result for the corresponding weighted average costs of capital (WACC) is 7.7%. The resulting fair value per share at the end of the 2017/18 financial year corresponds to the target price of € 18.00.

## DCF-Modell

### KPS AG - Discounted Cashflow (DCF) model scenario

Value driver of the DCF - model according to the estimate phase:

consistency - Phase		final - Phase	
Sales growth	12.0%	Eternal growth rate	2.0%
EBITDA-Margin	17.0%	Eternal EBITA - margin	17.0%
Depreciation to fixed assets	3.0%	Eternal effective tax rate	30.0%
Working Capital to sales	3.0%		

#### Three phases - model:

phase in €m	estimate		consistency						final Terminal value
	GJ 17e	GJ 18e	GJ 19e	GJ 20e	GJ 21e	GJ 22e	GJ 23e	GJ 24e	
Sales	164.25	189.49	212.13	237.48	265.86	297.63	333.20	373.02	
Sales change	13.3%	15.4%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	2.0%
Sales to fixed assets	4.65	5.11	5.44	5.82	6.24	6.71	7.23	7.82	
EBITDA	26.77	31.48	36.08	40.40	45.22	50.63	56.68	63.45	
EBITDA-margin	16.3%	16.6%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	
EBITA	25.77	30.38	34.99	39.25	44.02	49.37	55.37	62.09	
EBITA-Margin	15.7%	16.0%	16.5%	16.5%	16.6%	16.6%	16.6%	16.6%	17.0%
Taxes on EBITA	-3.87	-4.56	-5.25	-5.89	-8.80	-12.34	-16.61	-18.63	
Taxes to EBITA	15.0%	15.0%	15.0%	15.0%	20.0%	25.0%	30.0%	30.0%	30.0%
EBI (NOPLAT)	21.90	25.82	29.74	33.36	35.22	37.03	38.76	43.46	
Return on capital	62.0%	65.9%	69.8%	73.7%	73.6%	73.4%	72.9%	77.8%	77.1%
Working Capital (WC)	3.84	5.51	6.26	7.01	7.84	8.78	9.83	11.00	
WC to sales	2.3%	2.9%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	
Investment in WC	-2.14	-1.67	-0.75	-0.75	-0.84	-0.94	-1.05	-1.17	
Operating fixed assets (OAV)	35.33	37.07	38.98	40.83	42.63	44.37	46.06	47.70	
Depreciation on OAV	-1.00	-1.10	-1.09	-1.15	-1.20	-1.26	-1.31	-1.36	
Depreciation to OAV	2.8%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	
Investment in OAV	-2.70	-2.84	-3.00	-3.00	-3.00	-3.00	-3.00	-3.00	
Capital employed	39.17	42.58	45.24	47.84	50.47	53.15	55.89	58.71	
EBITDA	26.77	31.48	36.08	40.40	45.22	50.63	56.68	63.45	
Taxes on EBITA	-3.87	-4.56	-5.25	-5.89	-8.80	-12.34	-16.61	-18.63	
Total investment	-4.84	-4.51	-3.75	-3.75	-3.84	-3.94	-4.05	-4.17	
Investment in OAV	-2.70	-2.84	-3.00	-3.00	-3.00	-3.00	-3.00	-3.00	
Investment in WC	-2.14	-1.67	-0.75	-0.75	-0.84	-0.94	-1.05	-1.17	
Investment in Goodwill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Free cashflows	18.07	22.41	27.08	30.76	32.58	34.35	36.02	40.65	769.40

Value operating business (due date)	620.58	646.15
Net present value explicit free cashflows	163.77	154.02
Net present value of terminal value	456.81	492.13
Net debt	-18.23	-27.40
Value of equity	638.81	673.54
Minority interests	0.00	0.00
Value of share capital	638.81	673.54
Outstanding shares in m	37.41	37.41
Fair value per share in €	17.07	18.00

#### Cost of Capital:

Riskfree rate	1.3%
Market risk premium	5.5%
Beta	1.18
Cost of Equity	7.7%
Target weight	100.0%
Cost of Debt	2.5%
Target weight	0.0%
Taxshield	28.7%
WACC	7.7%

Return on Capital	WACC				
	6.7%	7.2%	7.7%	8.2%	8.7%
76.1%	21.48	19.47	17.83	16.46	15.30
76.6%	21.59	19.57	17.92	16.54	15.37
77.1%	21.70	19.67	18.00	16.62	15.45
77.6%	21.81	19.77	18.09	16.69	15.52
78.1%	21.92	19.87	18.18	16.77	15.59

## ANNEX

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