



c o b a s

asset management

Comments on the **Third Quarter of 2018**

In the third quarter we have seen how our funds obtained negative results, mainly being burdened by our investment in **Aryzta** as occurred in the previous quarter. To be more precise, exposure to this company has had a negative effect on the profitability of the international portfolio by approximately 3%, while the total negative profitability of said portfolio in the quarter was about 4%.

Since the beginning of the year the negative impact of Aryzta has been 10%. The performance of the remainder of the International Portfolio has been reasonable and has even surpassed its benchmark index.

The impact of **Aryzta**, which currently accounts for 6% of the International portfolio, should not make us forget the positive characteristics of the remainder of the portfolio, which we continue to value at almost 100% above its current net asset value. Some of these values have already reflected this (**Nevsun** and **GIII** for example with revaluations close to 100%) and the remainder will do so in time. Moreover, time helps us to be firmer in our convictions. In

a large proportion of the companies we have been shareholders for two years, which assumes an additional level of certainty. Our analytical process is continuous and details which escape us when we first come into contact with a business become familiar to us over time. In any case, volatility must be our friend and falls on the markets such as that of October should be considered opportunities to reap the profitability of the future.

Volatility must be our friend and falls on the markets should be considered opportunities

Together with this message of optimism we would also like to transmit one of calm. We believe that our international portfolio is defensive in nature against a possible fall of the cycle and only 20% of the same is exposed to a drop in the demand for consumption (mainly the companies of the car industry and Consumer discretionary goods). The remaining 80% is made up of defensive com-

panies which should not suffer unduly during a fall in the cycle (such as **Babcock**) and also of companies which depend on their own bid phases and which will inevitably obtain better results once the excess capacity of their respective sectors is cleaned up (such as **Teekay** and **International Seaways**). In order to illustrate the foregoing, we will now take a look at our five main positions on the International Portfolio, with the exception of **Aryzta** which we will subsequently analyse separately.

Photo: **Rommel Davila, Unsplash**

Comments on the **Third Quarter of 2018**





Teekay. The **Teekay** Group, by means of **Teekay LNG** and the parent company, **Teekay Corp**, is one of our most significant investments. This investment has a low correlation with the behaviour of the market as it depends on specific actions of the Group. The reasons that made its share price dropped (a cut in dividend to finance its ambitious growth plan) will shortly be the reasons for the market to again appreciate its qualities. **Teekay LNG** is the main source of potential for them both and has perfectly implemented its growth plan, which involves long-term contracts for its LNG transport ships. The execution risk is now very low and it is interesting that the market appears to be in agreement regarding the generation of the expected operating cash flow at **Teekay LNG**, but this is not yet being reflected in the share price. Now we are waiting for the plan of the company so as to reinstate the distribution of cash while they reduce their borrowing. In any case the accumulation of value will be

evident and we hope that this will be reflected by the market, this time sooner rather than later.



Babcock. The Brexit and the inappropriate comparisons made by the market with a company as unique as **Babcock**, which is no. 1 or no. 2 in practically all the businesses and regions in which it operates, give us an extraordinary opportunity to purchase good businesses with unique well-managed assets at very attractive prices (PER 8x; an expected annual profitability of 11%). **Babcock** is particularly strong in the maintenance of nuclear submarines and frigates in the United Kingdom, in emergency helicopter services in Western Europe, and in the support and dismantling of nuclear power stations, all of which are good businesses which are difficult to replicate.



International Seaways. We have a significant investment (almost 10% of the International Portfolio) in the oil shipping business, in which **International Seaways** is one of our favourite companies. The current situation, which is the lowest point of the last 30 years, encourages investment in favour of the recovery of the cycle of maritime transport, in particular of crude oil. Several factors contribute to the current weakness, and we can gradually see how each and every one of them is returning to normal (inventories of crude oil, demolition of the fleet, and the drop in orders for new ships, among others). This means that supply and demand are being adjusted as is shown by the daily freight rates and the price of new ships. With **International Seaways** we moved into position for this recovery through a company with moderate levels of debt and with revaluation potential, even if the company should be liquidated today before the recovery of the cycle.



Renault. This is a clear case of hidden assets, as according to our estimates the value of 43% which **Renault** holds in **Nissan** is higher than the market capitalisation of **Renault** itself. In other words, we are investing “free” in the **Renault** car business (we estimate some 4mn units sold in 2018), its financial business, and the 1.6% it holds in **Daimler**, all of which are undoubtedly of quality according to our analysis. The market does not quite believe this situation, but we believe the current management team has the intention of freeing the value of the company in the medium term.



Dixons. The Brexit has allowed us to purchase **Dixons**, a leader in electronic distribution in the United Kingdom, the northern countries, and Greece, at 5 years minimums (PE 7x), while **Best Buy**, which is operating in exactly the same business but in the United States, is trading at close to its historical maximums (PER 13x). At a time when the shadow of disruption threatens the distribution sector, Dixons has not only shown that it can compete effectively with **Amazon** but has consistently increased its market share over the last 5 years.

To conclude, we have confidence in the strength of our current portfolio and we are taking advantage of the market volatility to improve its quality and revaluation potential even more. It should be remembered that after periods of losses there will always be periods of recovery,

which are stronger than the former.

Once again we are grateful to you all for the confidence you have placed in our business model and in particular to the 672 new co-investors who have taken advantage of the negative profitability in the last quarter to invest with us, together with the 2,679 existing investors who have decided to increase their positions. We are convinced of the high underlying value of the businesses in which we are investing and that if we are patient time will allow us to achieve high revaluations.

Finally, we welcome our new Korean colleague Hwi Soon Chan, who will strengthen our analytical team. He will work from Shanghai together with our colleague Ming-kun Chan, with whom we have been working for ten years.

PORTFOLIOS

Comments on the **Third Quarter of 2018**

Our portfolios

Spanish domiciled funds

Name	Capitalisation
Internacional FI	500 Mn€
Iberia FI	65 Mn€
Grandes Compañías FI	24 Mn€
Selección FI	955 Mn€
Concentrados FIL	29 Mn€

Luxemburg domiciled funds

Name	Capitalisation
Internacional Fund	21 Mn€
Selection Fund	145 Mn€
Concentrated Value Fund SIF	13 Mn€

Assets Under Management	Market Capitalisation	Strategies		Number of holdings
		International	Iberian	
521 Mn€	Multi Cap	●		59
65 Mn€	Multi Cap		●	38
24 Mn€	70% ≥ 4Bn€	●	●	34
1.100 Mn€	Multi Cap	●	●	68
42 Mn€	Multi Cap	●	●	19

As you probably know, at **Cobas AM** we administer three portfolios: the **International Portfolio**, which invests in companies at a world level excluding those listed in Spain and Portugal; the **Iberian Portfolio**, which invests in companies listed in Spain and Portugal or which have their centre of operations in the Iberian Peninsula; and finally the **Large Cap Portfolio**, which invests in companies on a world scale and in which at least 70% are com-

panies with over 4.000mn euros of market capitalisation. With these three portfolios we build the different equity funds which we administer on 30th September:

**Total assets
under
management**

**2,423
Mn€**

International Portfolio

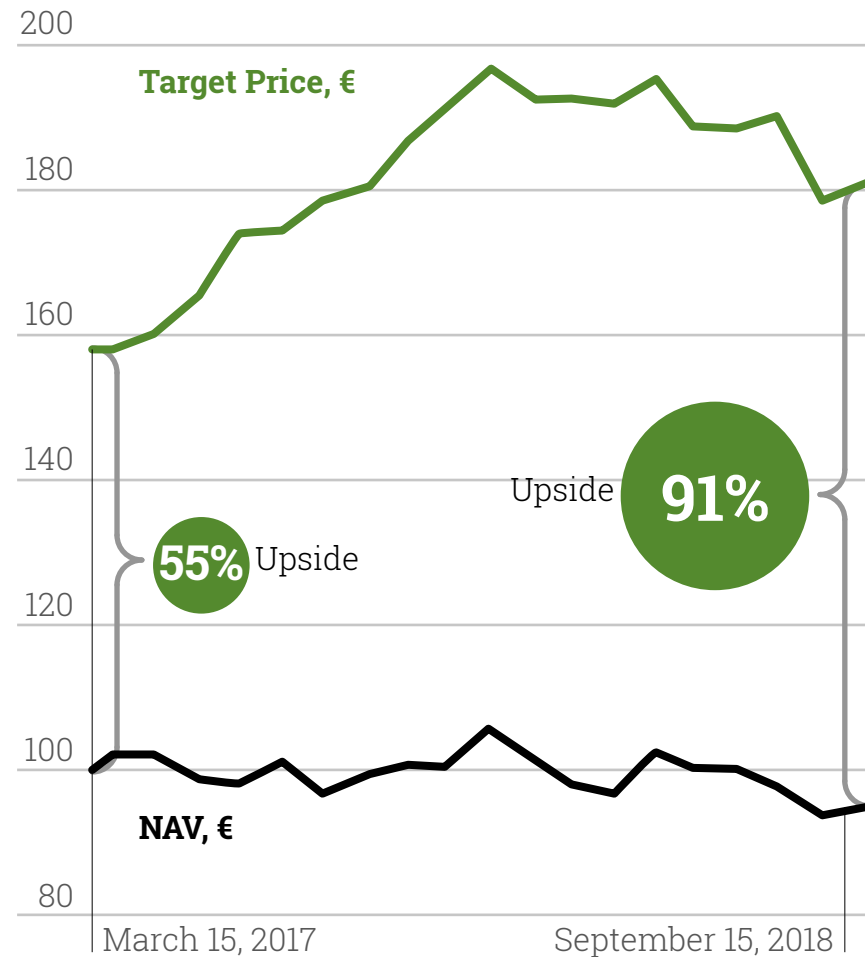
During the third quarter of 2018 the international portfolio has shown a negative profitability of 4.4% compared with a revaluation of 1.3% of the benchmark index, **MSCI Europe Total Return Net**.

Since the **Cobas International FI** fund began to invest in equities in mid-March 2017 it has shown a profitability of -5.1%. The index of reference was revaluated by 7.4%.

The objective value of the portfolio, 181€/holding, shows a revaluation potential of 91%. Our work is to continue to increase the value of the portfolio over time and to wait for this value to be reflected in its Net Asset Value (NAV).

Evidently as a consequence of this potential we are investing at 97%, which is close to the permitted legal maximum of 99%.

The portfolio trades at 8.0x 2018 estimated PE (Price Earnings Ratio) and a 25% ROCE (Return on Capital Employed). The ROCE without shipping companies stands at 36%.



As for the geographical distribution, this has not changed significantly during the quarter and maintains high exposure outside Europe and the Euro zone.

During the quarter the largest contribution to the positive result of the portfolio was generated by **Israel Chemicals** (+1.2%) and **OCI NV** (+0.4%). On the other hand, the negative effect on the profitability of the portfolio by **Aryzta** (-3.2%) and **Teekay Corp.** (-0.7%) stands out.

Despite the negative evolution of the profitability throughout the quarter, burdened mainly by **Aryzta**, the situation of which we will discuss below, we have seen significant revaluations in values such as **ICL** and **OCI**, which have risen 35% and 19% respectively owing mainly to the recovery in the prices of fertilisers. We must also emphasise the offer to purchase **Nevsun Resources** which we received from **Zijin Mining**, which has allowed us to sell our shares at around \$4 per share after having initially invested \$2 per share; this has given us capital gains of over 100%.

In general the portfolio continues to show high potential and still consists of quality businesses with wide safety margins, which therefore offer attractive revaluation potential.

Aryzta

Our position at **Aryzta** regarding the different funds is:

5.80% **Cobas Selección FI**; 6.32% **Cobas Internacional FI**; 6.85% **Cobas Grandes Compañías FI**; and 1.24% **Cobas Renta FI**.

In our letter of the second quarter 2018, we tried to illustrate the contrarian approach of our investment in **Aryzta**, by means of two examples of past investments, **Smurfit Kappa** and **Thales**. It must be stressed that our vision of the business of **Aryzta** has not changed. We continue to believe that there are no justified reasons for thinking that the leader in its sector cannot obtain higher margins than currently and in line with those of their competitors, i.e. between 10% and 15% in comparison with

the 8% it has now. The results recently published by the company support our vision, confirming our opinion that business has stabilised and that the implementation of a medium-term strategic plan to allow the achieving of better margins is perfectly feasible.

Therefore, we did not agree with the recently approved capital increase of €800mn as we consider that said increase is excessively dilutive and harmful to our interests.

It is for this reason that we took an activist stance at the company's General Meeting of the 1st of November last, proposing a more limited capital increase and the sale of other assets to strengthen the company's balance sheet. Unfortunately, we were only supported by 47% of the shareholders, which meant that the proposal of the Board was approved.

We will now subscribe the new shares corresponding to us and will decide on the weighting the investment will have on our international portfolio, based on the invest-

ment alternatives we have, which are numerous. The truth is that, with the capital increase approved, the upside potential is limited but, at the same time, the risk is drastically reduced. We have reduced our objective value owing to the impact of the strength of the balance sheet. What has occurred can be compared to the purchase of a house with a mortgage or without a mortgage. If we think that the value of the house will rise we must purchase it by using a mortgage. As the Aрызta "mortgage" has fallen, the revaluation potential of our capital is also reduced.

On the other hand, the possibility of an additional impact to that already suffered by our funds has become remote owing to the strengthening of the balance sheet and the quality of the assets, which we have confirmed in these months of exhaustive analysis of the business.

Activism

We have always said that we are not activists and that we only invest in well managed companies at which few changes have to be made. Two exceptions to this can be mentioned:

- When a clearly unfair operation occurs such as that which we experienced with **Ciba** in 2008 and which we think is occurring now with **Aryzta**.
- When there is a controversy between two factions of the shareholders that forces us to take sides. When this occurs it normally means that we have made a mistake and that the company is not moving in the right direction.

In any case we initiate "activism" when our holding is relevant. When our holding is small we go along with the most significant shareholders as otherwise we would not be making best use of our time, which is our scarcest resource.

Naturally this is not the first time that we are actively defending the interests of the people who trust us. We always do so discreetly but firmly as we did with **Fasa Renault** and **Citroën** in 1997.

It was at the General Assembly of **Fasa** in Valladolid in 1997 when I stood up to protest for the first time, and indeed the only time until 1st November last. At both assemblies we achieved a rise in the price of their takeover bids of exclusion.

In 1998 when **Endesa** carried out a merger at a price that was damaging to our investments in our subsidiaries, we also had to protest to the Chairman Rodolfo Martín Villa and send a duly attested summons to all the Board members. On this occasion we were unsuccessful.

In 2008, in the midst of the financial crisis, **BASF** presented a takeover bid for **Ciba**, our second largest investment, at a very low price. Our proposal allowed us to receive rapidly the money that was due to us; we were able defensive so as to defend ourselves from what we consider

bad practices. If we look back, in all cases the companies were managed by executives. In future we will beware of this type of company.

It is therefore not the first time that we have taken an activist stand and will probably not be the last. We have already explained the circumstances leading to this action; when they occur, we will defend our rights to the full.

What we have learnt

We have already mentioned that the quality of the assets of **Aryzta**, and the entry barriers to competing with a large proportion of them, were very clear to us but other learnings have also been made in this investment:

- The first was to trust a management team with little share participation in the company. As you know, around 80% of our investments are in family businesses with which we share interests and in which the capital allocation decisions are taken with great care. In the case of Aryzta, we believed that the presence of Gary McGann,

with whom we had had a good relationship in the past, would limit the risk of not having a family as shareholder; this did not occur.

- The level of debt was not originally a problem, but a series of adverse circumstances (increased costs, a delay in selling assets, and a new management team) meant that this debt could become problematical at a delicate moment in this management transition process. On other occasions we have had high investments in non-family-owned businesses (such as Wolters Kluwer) but with a smaller debt.

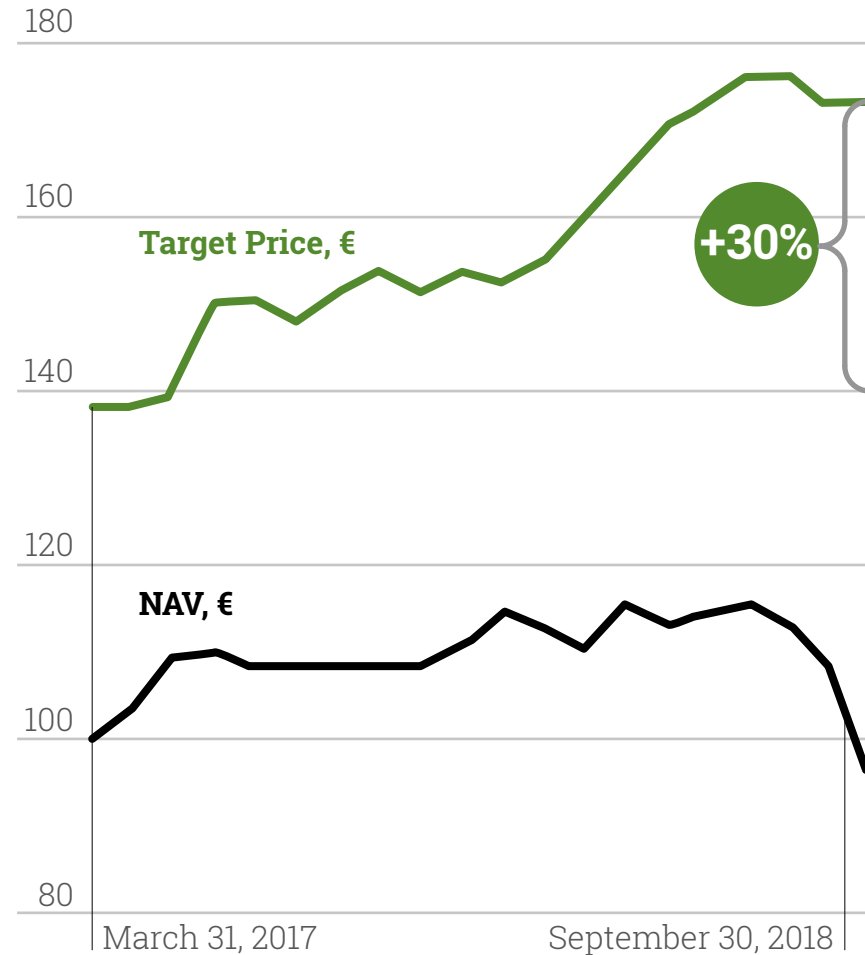
We are self-critical and learn from mistakes, thus; we will get the right conclusions from this case.

In addition, our investment in Aryzta still has potential to recover a high portion of our losses assuming very limited risks.

Iberian Portfolio

The evolution of the NAV in the third quarter of the **Iberian Portfolio** was -5.64%, which compares unfavourably with the evolution of its benchmark index which was -2.01%. Approximately half of our fall is due to **Duro Felguera** as we will later explain. Nevertheless, if we extend the comparison period since we launched the funds to 30th September 2018 we can see that our Iberian Portfolio has been revaluated by 7.91%, a 7.59% improvement over its benchmark index which has only been revaluated by 0.32%.

The most important point about the quarter is that despite the blow of **Duro Felguera** the target price of our Iberian Portfolio has remained stable at 173€ per holding, which is practically the same as that we had at the close of June. It should be stressed that since the launching of the fund we have increased the target value of the Iberian



fund by 30%. This is what our work consists of, and we know from experience that sooner or later the NAV tends to reach our target price.

It has been possible to maintain the target price thanks to active management of our portfolio. During the quarter 4 companies have left the Iberian Portfolio completely and 5 others have entered it.

We have taken advantage of the fall to enter or add to our position with some companies, the most important of which include the following:

1. Prosegur & Prosegur Cash. Companies penalised by the market owing to their exposure to Argentina and the devaluation of its currency. But the market forgets that devaluation generates inflation and that Prosegur can transfer this inflation (faster or slower) to its clients so as to partially compensate the devaluation of the currency. Moreover, in this kind of economic environment the speed of circulation of money accelerates, which also benefits Prosegur.

2. Mota Engil. A company penalised by the market owing to: i) poor half-yearly results (owing to a delay in the executing of its order portfolio); ii) to its exposure to emerging markets; and iii) to the fluctuation of currencies in emerging countries. In this case the market does not appreciate the dominance of **Mota-Engil** in Africa and the importance of Africa in the total valuation of the company.

These purchases, among others, have been financed mainly with the total or partial sale of CTT, Bankia, Logista, FCC, and NOS, which in general have evolved favourably on the stock exchange during the quarter.

Duro Felguera: Why did we participate in the capital increase and what is happening to the company?



Duro Felguera is a Spanish engineering company with a history going back over 150 years with considerable experience in the implementation of turnkey projects, mainly of plants for generating electricity with gas. The company turned to the market because in recent years it had become undercapitalised and the debt had risen significantly. In this context **Duro Felguera** reached an agreement with the banks by which the latter accepted an acquittance of 75% of the bank debt with the following conditions: i) a change in the management team and ii) more investors to inject capital into the company, to be precise 125mn€.

In this process we spoke to several consultants and competitors who confirmed on the one hand the technical

qualities of the company and on the other that the management of recent years could have been better.

We therefore reached the conclusion that if the financial problems were solved, the company could be viable as **Duro Felguera** has the technical capacity to achieve this, and we decided to participate in the capital increase.

However, after a detailed analysis by a consultancy contracted by the new board of directors, only a month after the capital increase losses appeared that the management team had underestimated and had not notified to the market.

This caused a sharp drop in the share price, as in a very conservative scenario, there would be the possibility of an additional injection of capital. But even in this scenario we consider that there would be an interesting revaluation potential. Share price is already recovering (it has gone up by 80% from its minimum during the last month). It should be remembered that after the capital increase the shareholder base and the Board of directors of the company has changed and the latter is firmly resolved to

reverse this situation as the company has the technical qualities to do so. It is for this reason that we maintain a small position of the Iberian Portfolio in **Duro Felguera**.

Large Cap Portfolio

During the third quarter of 2018 the Large Cap portfolio showed a negative profitability of -1.9% compared with a revaluation of 5.5% for the benchmark index, MSCI World Net.

Since **Cobas Grandes Compañías FI** fund began to invest in equities in early April 2017, it has shown a profitability of -3.9%. The benchmark index was revaluated by 11.7%.

The target value of the portfolio, 175€/holding, is considerably higher than the NAV with a revaluation potential of 82%. Our work consists of continuing to increase the value of the portfolio over time and we hope that this value will eventually be reflected in the NAV.

The portfolio is trading at 8.0x 2018 estimated PE and 26% ROCE. As for the geographical distribution, this has not changed significantly during the quarter and a strong exposure outside Europe and the Euro zone is maintained. We maintain 100% of the exposure to the dollar hedged.

During the quarter the largest contribution to the positive result of the portfolio has been generated by **Israel Chemicals** (+1.4%) and **Inpex Corp.** (0.6%). On the other hand, the negative effect on the profitability of the portfolio by **Aryzta** (-3.2%) and **Babcock Int.** (-0.8%) stands out.

NOVELTIES

Comments on the **Third Quarter of 2018**

In our Cobas novelties section the objective is to give you some information in advance on the projects and initiatives of the management committee and also on the most important milestones of the last quarter.

Events

Trani is a town in the south of Italy where for the last 15 years managers and investors from all over the world have met to share investment ideas. They all share a passion for investing and value philosophy. In July for the second consecutive year Cobas AM took part in the **Trani event** with the intervention of our analyst Juan Huerta de Soto.

In the international context one of the most prestigious value forums is **MOI Global**, an event which is habitually held in **London** or **New York** and is a meeting point for value managers from all corners of the globe. At the **London edition** of the 20th of September, the closing session was directed by **Francisco García Paramés** who was invited to present his book "Investing for the Long term"



Photo: **Luke Staackpoole, Unsplash**



and shared with the audience his experience as an investor over the last 25 years and several of the main ideas of the international portfolio of Cobas AM.

Cobas AM intends to hold several events in cities in different parts of Spain as we consider that this is essential to transmit our investment philosophy and to inform all co-investors of the composition of our investment portfolios.

Cobas AM has held two events in the cities of **Valladolid** and **Seville** on 24th September and 29th October respectively with the aim of building a closer relationship with our co-investors.

In Valladolid **Carlos González**, deputy manager of Investors Relations, explained our key figures and our investment and product philosophy, while analyst **Carmen Pérez Baguena** went into detail on the international and Iberian portfolio.

Meanwhile in **Seville** the speakers were **Santiago Cortezo**, Head of Investors Relations, and analyst **Iván Chvedine**.

Photo: **Jacek Ulinski, Unsplash**

VALUE COMMUNITY

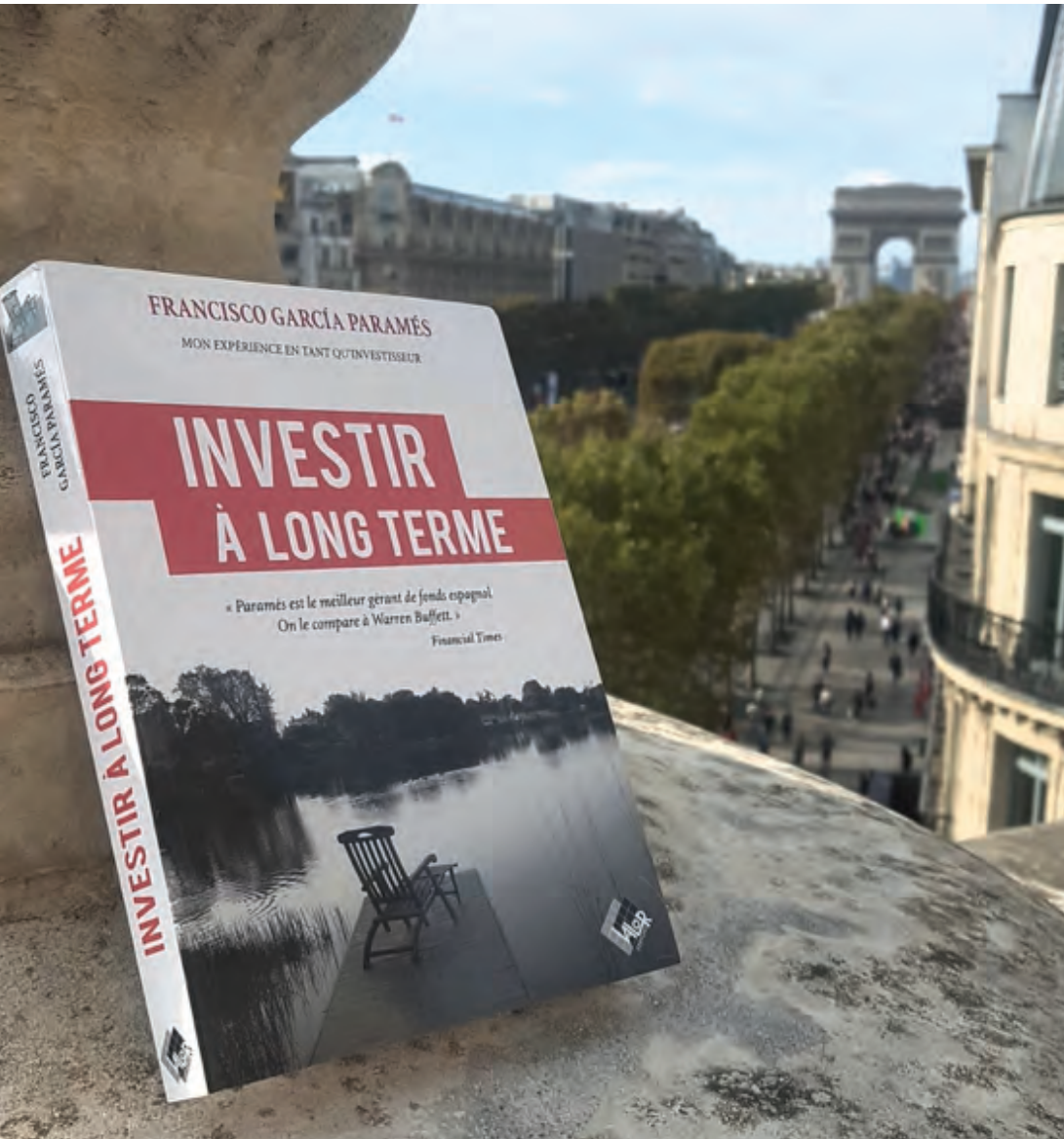
The **National Securities Market Commission** (Comisión Nacional del Mercado de Valores, **CNMV**) has proceeded to update the Key Investors Documents (KIDs) of **Cobas funds** as a consequence of the change of prospectus once the delegation of the administrative duties has been revoked. Up until 30th June 2018 these were carried out by **Inversis Gestión S.A. S.G.I.I.C** but are now administered internally by **Cobas AM**.

In July, **Value School** organised its first value investment summer course for young people. This was a pioneering project in its field for which **Value School** announced 40 grants for young people from all parts of Spain interested in getting to know the fascinating world of value investment.

It was an introductory course to value investing with a programme consisting of classroom sessions covering themes such as: economics applied to financial markets and investment; the history, principles, and main systems



Photo: **Cobas Asset Management**



of value investment; the psychology of investment behaviour; a sectoral analysis of the economy; an introduction to the analysis of companies; and an introduction to financial analysis and the valuation of companies.

The course likewise offered the advantage of the presence of analysts and managers of acknowledged prestige in the field of the management of independent assets in Spain, such as **Francisco García Paramés (Cobas AM)**, **Xavier Brun (Solventis)**, **Iván Martín (Magallanes Value Investores)**, and **Alejandro Muñoz (Equam Global Value Fund)**, among others.

The response from those interested in attending the course was highly satisfactory; Value School received 4 applications candidates for each of the 40 grants offered.

The **French edition of "Investing for the Long term"**, the book by **Francisco García Paramés**, is on sale since the 25th of October. The book was written during his stay in London during the 2 years he spent there before embarking on his current project **Cobas Asset Management**.

Photo: **Veronica Viera, Cobas Asset Management**

ANNEXES

Comments on the **Third Quarter of 2018**

Spanish funds

Fund	Net Asset Value	Target Value*	Upside potential	Q3 Performance		Performance YTD		Perf. since inception ¹		PER	ROCE	AUM mn€	Equity exposure
				Cobas	Benchmark ²	Cobas	Benchmark ²	Cobas	Benchmark ²				
Selección FI	99,8 €	187.6 €	88%	-4.2%	1.3%	-9.3%	0.8%	-0.2%	11.2%	8.1x	27%	955,7	97%
Internacional FI	94,9 €	181.0 €	91%	-4.4%	1.3%	-10.3%	0.8%	-5.1%	7.4%	8.0x	25%	500,2	97%
Iberia FI	107,9 €	172.9 €	60%	-5.6%	-2.0%	-2.1%	-2.2%	7.9%	0.3%	9.6x	27%	65,4	98%
Grandes Compañías FI	96,1 €	175.1 €	82%	-2.0%	5.5%	-9.2%	9.0%	-3.9%	11.7%	8.0x	26%	24,3	96%
Renta FI	96,9 €			-0.9%		-3.6%		-3.1%				19,2	14%

* The **target value** of our funds is based on internal calculations and estimates and Cobas AM does not guarantee that its calculation is correct or that they will be reached.

1. Inception of the funds: Cobas Selección FI: 31-dec-16; Cobas Internacional FI: 15-march-17; Cobas Iberia FI, Cobas Grandes Compañías FI y Cobas Renta FI: 3-april-17.

2. Benchmark: MSCI Europe Total Return Net for Cobas Selección FI and Cobas Internacional FI; MSCI World Net EUR for Cobas Grandes Compañías FI; IGBM Total 80% and PSI 20 Total Return 20% for Cobas Iberia FI.

Luxembourgish funds

Fund	Net Asset Value	Target Value*	Upside potential	Q3 Performance		Performance YTD		Perf. since inception ¹		PER	ROCE	AUM mn€	Equity exposure
				Cobas	Benchmark ²	Cobas	Benchmark ²	Cobas	Benchmark ²				
Internacional EUR	94,4 €	179,3 €	90%	-4,5%	1,3%	-10,8%	0,8%	-5,6%	11,2%	8x	25%	20,3	97%
Internacional USD	109,5 €	208,1 €	90%	-3,8%	1,3%	-9,0%	0,8%	-3,0%	11,2%	8x	25%	1,2	97%
Selection EUR	19.338,7 €	36.356,7 €	88%	-4,2%	1,3%	-9,6%	0,8%	-5,8%	11,2%	8x	27%	133,3	98%
Selection USD	32.150,6 €	60.443,1 €	88%	-3,5%	1,3%	-7,8%	0,8%	-2,6%	11,2%	8x	27%	14,4	98%

* The **target value** of our funds is based on internal calculations and estimates and Cobas AM does not guarantee that its calculation is correct or that they will be reached.

1. Inception of the funds: Cobas International Fund EUR: 1-jun-17 ; Cobas International Fund USD: 6-jun-17; Cobas Selection Fund EUR and USD: 17-abr-17.

2. Benchmark: MSCI Europe Total Return Net for Cobas Selection Fund and Cobas International Fund.

Radiography of our funds

Datos Tercer Trimestre de 2018

	Cobas Internacional FI ES0119199000	Cobas Iberia FI ES0119184002	Cobas Grandes Compañías FI ES0113728002	Cobas Selección FI ES0124037005	Cobas Renta FI ES0119207001																																																																																																																																																																					
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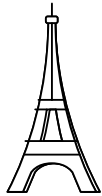
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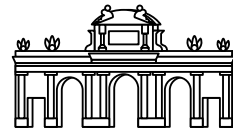
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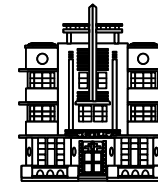
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