

# Meridian Energy

## Joining the Development Train – 1H21 Result

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### UNDERPERFORM

There were no surprises in Meridian Energy's (MEL) 1H21 result and even the announcement it is progressing its Harapaki wind farm was expected. The result itself was strong, albeit EBITDAF of NZ\$422m is -9% lower than the record prior period. The interim dividend of 5.7cps was flat on 1H20 and investors should not expect significant dividend growth as MEL (and the sector generally) moves into a development phase. From a value perspective, rising interest rates is a headwind for yield investments such as MEL and we have cut our target price -8% to NZ\$5.10. We retain our UNDERPERFORM rating.

NZX Code	MEL	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$5.50	NPAT* (NZ\$m)	510.3	391.3	419.9	435.6	PE	27.6	36.0	33.6	32.4
Target price	NZ\$5.10	EPS* (NZc)	19.9	15.3	16.4	17.0	EV/EBIT	28.8	39.9	36.2	35.1
Risk rating	Low	EPS growth* (%)	5.9	-23.3	7.3	3.7	EV/EBITDA	18.3	22.4	21.2	20.8
Issued shares	2563.0m	DPS (NZc)	19.3	16.9	17.1	17.4	Price / NTA	2.8	2.9	3.0	3.2
Market cap	NZ\$14,097m	Imputation (%)	75	85	80	80	Cash div yld (%)	3.5	3.1	3.1	3.2
Avg daily turnover	2,051k (NZ\$11,415k)	*Based on normalised profits					Gross div yld (%)	4.5	4.1	4.1	4.1

### What's changed?

- **Earnings:** FY21/FY22/FY23 EBITDAF down -NZ\$13m/-NZ\$1m/-NZ\$2m to NZ\$701m/NZ\$741m/NZ\$756m
- **Target price:** Reduced -45cps (-8%) to NZ\$5.10

### Harapaki gets the green light as MEL joins the generation development bandwagon

As expected, MEL has decided to push go on its 176MW, NZ\$395m Harapaki wind farm development option. Whilst the metrics do not appear as attractive as Turitea and Waipipi (refer Fig. 2), the Hawkes Bay location is better and given the consent expires in the near future it is understandable MEL is pushing ahead. The project is value accretive (we estimate 3cps to 6cps), albeit it has already been incorporated into our forecasts. MEL has also indicated it has a battery and wind farm development option in Australia that it is progressing. All of these investments are designed to support MEL's retail businesses in New Zealand and Australia.

### Result a good one in historic terms, but down on the record 1H20

MEL's 1H21 EBITDAF of NZ\$422m was -9% lower than the record 1H20 period, due mainly to lower New Zealand hydro generation volumes. It is, however, the second best 1H for MEL, +8% better than 1H19. The result was also impacted by lower Australia wholesale electricity prices lowering the Australian contribution. The main upside came from lower transmission costs, down -NZ\$24m. MEL declared an 86% imputed interim dividend of 5.7cps, the same as 1H20. With MEL commencing a new development and contemplating a dividend reinvestment plan, we assume modest dividend growth going forward, linked to earnings growth.

### Minor forecast changes, but rising interest rates hurt MEL's value proposition

With conditions getting drier, we have trimmed our FY21 EBITDAF forecast -NZ\$13m (-2%) to NZ\$701m. Longer dated forecasts are largely unchanged. The more substantive change we have made is to our target price, cut -45cps to NZ\$5.10. Cost of capital changes due to higher interest rates impact negatively on yield based stocks such as MEL. Our DCF is -10% lower to NZ\$4.54. The spot valuation changes are summarised in Figure 5.

## Meridian Energy Limited (MEL)

Priced as at 24 Feb 2021 (NZ\$)

5.50

<b>12-month target price (NZ\$)*</b>	<b>5.10</b>	<b>Spot valuations (NZ\$)</b>										
Expected share price return	-7.3%	1. DCF										4.54
Net dividend yield	3.1%	2. Market multiple										5.11
Estimated 12-month return	-4.2%	3. Dividend yield										5.34
<b>Key WACC assumptions</b>		<b>DCF valuation summary (NZ\$m)</b>										
Risk free rate	2.30%	Total firm value										13,289
Equity beta	0.81	(Net debt)/cash										(1,655)
WACC	5.5%	Less: Capitalised operating leases										
Terminal growth	1.5%	Value of equity										11,634
<b>Profit and Loss Account (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Valuation Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	
Sales revenue	4,104.0	4,102.0	4,121.4	4,200.3	3,925.8	EV/EBITDA (x)	18.5	18.3	22.4	21.2	20.8	
<b>Normalised EBITDA</b>	<b>838.0</b>	<b>855.0</b>	<b>700.6</b>	<b>740.9</b>	<b>756.0</b>	EV/EBIT (x)	27.6	28.8	39.9	36.2	35.1	
Depreciation and amortisation	(276.0)	(312.0)	(306.9)	(306.8)	(307.7)	PE (x)	29.2	27.6	36.0	33.6	32.4	
<b>Normalised EBIT</b>	<b>562.0</b>	<b>543.0</b>	<b>393.7</b>	<b>434.1</b>	<b>448.3</b>	Price/NTA (x)	2.6	2.8	2.9	3.0	3.2	
Net interest	(83.0)	(84.0)	(80.2)	(77.9)	(82.5)	Free cash flow yield (%)	4.0	3.8	2.2	2.5	2.3	
Associate income & other	(7.0)	(219.0)	77.0	(24.0)	(12.0)	Net dividend yield (%)	3.9	3.5	3.1	3.1	3.2	
Tax	(133.0)	(63.0)	(109.1)	(93.0)	(99.1)	Gross dividend yield (%)	4.9	4.5	4.1	4.1	4.1	
Minority interests	0	0	0	0	0							
<b>Reported NPAT</b>	<b>339.0</b>	<b>177.0</b>	<b>281.3</b>	<b>239.2</b>	<b>254.8</b>	<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	
Abnormals/other	143.0	333.3	109.9	180.7	180.8	Interest cover EBIT (x)	6.7	3.9	5.9	5.3	5.3	
<b>Adjusted normalised NPAT</b>	<b>482.0</b>	<b>510.3</b>	<b>391.3</b>	<b>419.9</b>	<b>435.6</b>	Interest cover EBITDA (x)	10.1	10.2	8.7	9.5	9.2	
Normalised EPS (cps)	18.8	19.9	15.3	16.4	17.0	Net debt/ND+E (%)	76.9	96.6	106.1	120.2	135.0	
DPS (cps)	21.3	19.3	16.9	17.1	17.4	Net debt/EBITDA (x)	1.7	1.9	2.3	2.3	2.4	
<b>Growth Rates</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>	<b>Key Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	
Revenue (%)	24.5	0.0	0.5	1.9	-6.5	Return on assets (%)	5.7	3.4	5.1	4.5	4.9	
EBITDA (%)	25.8	2.0	-18.1	5.7	2.0	Return on equity (%)	6.1	6.3	4.3	4.9	5.4	
EBIT (%)	41.2	-3.4	-27.5	10.3	3.3	Return on funds employed (%)	5.9	5.8	4.3	4.8	5.1	
Normalised NPAT (%)	33.6	5.9	-23.3	7.3	3.7	EBITDA margin (%)	20.4	20.8	17.0	17.6	19.3	
Normalised EPS (%)	33.6	5.9	-23.3	7.3	3.7	EBIT margin (%)	13.7	13.2	9.6	10.3	11.4	
Ordinary DPS (%)	10.9	-9.2	-12.6	1.1	1.8	Capex to sales (%)	1.7	1.5	2.2	3.7	5.2	
<b>Cash Flow (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	Capex to depreciation (%)	28	22	31	54	72	
<b>EBITDA</b>	<b>838.0</b>	<b>855.0</b>	<b>700.6</b>	<b>740.9</b>	<b>756.0</b>	Imputation (%)	66	75	85	80	80	
Working capital change	(36.0)	49.0	(58.5)	9.0	6.7	Pay-out ratio (%)	113	97	111	104	102	
Interest & tax paid	(200.0)	(251.0)	(255.4)	(215.0)	(225.5)	<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	
Other	33.0	(48.0)	10.0	(24.0)	(12.0)	Hydro generation	12,326	12,758	11,257	11,701	11,701	
<b>Operating cash flow</b>	<b>635.0</b>	<b>605.0</b>	<b>396.7</b>	<b>510.9</b>	<b>525.3</b>	Wind generation	1,244	1,466	1,446	1,430	1,430	
Capital expenditure	(69.0)	(63.0)	(89.2)	(153.8)	(204.6)	<b>Total NZ generation (GWh)</b>	<b>13,570</b>	<b>14,224</b>	<b>12,703</b>	<b>13,131</b>	<b>13,131</b>	
(Acquisitions)/divestments	0	(2.0)	0	0	0	GWAP (\$/MWh)	123	89	148	146	123	
Other	0	0	0	0	0							
<b>Funding available/(required)</b>	<b>566.0</b>	<b>540.0</b>	<b>307.5</b>	<b>357.1</b>	<b>320.6</b>	Overseas generation (GWh)	730	642	753	810	810	
Dividends paid	(500.0)	(546.0)	(433.1)	(433.1)	(441.8)	Overseas GWAP (\$/MWh) (NZD)	269	381	297	296	308	
Equity raised/(returned)	(2.0)	(2.0)	0	0	0	Overseas customer numbers (000)	110	136	148	161	169	
<b>(Increase)/decrease in net debt</b>	<b>64.0</b>	<b>(8.0)</b>	<b>(125.5)</b>	<b>(76.0)</b>	<b>(121.2)</b>							
<b>Balance Sheet (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	NZ electricity customers (000)	<b>302</b>	<b>324</b>	<b>333</b>	<b>333</b>	<b>333</b>	
Working capital	(24.0)	(64.0)	(55.5)	(40.5)	(35.2)	Average usage per cust (MWh/yr)	13.2	13.9	14.4	14.3	14.3	
Fixed assets	8,825.0	8,594.0	8,349.9	8,198.6	8,096.8	Mass market volumes	3,901	4,342	4,727	4,752	4,757	
Intangibles	59.0	65.0	85.4	83.7	82.4	Time of use volumes	2,338	3,034	3,400	3,417	3,434	
Right of use asset	0	0	0	0	0	<b>Total fixed price volumes (GWh)</b>	<b>6,239</b>	<b>7,376</b>	<b>8,127</b>	<b>8,169</b>	<b>8,191</b>	
Other assets	383.0	441.0	381.0	357.0	345.0	NZAS sales	5,310	5,431	5,011	5,011	5,011	
<b>Total funds employed</b>	<b>9,243.0</b>	<b>9,036.0</b>	<b>8,760.8</b>	<b>8,598.8</b>	<b>8,489.0</b>	Sell CFDs	2,239	2,527	2,000	1,600	1,600	
Net debt/(cash)	1,424.0	1,616.0	1,638.5	1,714.5	1,835.7	Buy CFDs	(1,965)	(2,731)	(3,739)	(2,500)	(2,250)	
Lease liability	0	0	0	0	0	<b>Total Sales (GWh)</b>	<b>11,823</b>	<b>12,603</b>	<b>11,399</b>	<b>12,280</b>	<b>12,551</b>	
Other liabilities	2,362.0	2,337.0	2,195.0	2,150.9	2,107.0	Average FPV price (\$/MWh)	105	108	112	115	115	
Shareholder's funds	5,457.0	5,083.0	4,927.3	4,733.4	4,546.3							
Minority interests	0	0	0	0	0	LWAP (\$/MWh)	132	95	158	152	130	
<b>Total funding sources</b>	<b>9,243.0</b>	<b>9,036.0</b>	<b>8,760.8</b>	<b>8,598.8</b>	<b>8,489.0</b>	LWAP/GWAP	1.07	1.06	1.07	1.04	1.05	
						Lines losses (%)	5.9	4.8	5.3	5.5	5.5	

## Forecast changes

Changes to forecasts are relatively minor, but reflect:

- Stronger wholesale electricity prices, as per the ASX futures curve (to the end of 2024)
- Weaker generation outlook in the short-term (trimmed FY21 generation assumption ~180GWh). Our FY21 hydro generation assumption is 11,260GWh, -4% lower than average
- Modest changes to opex assumptions in light of 1H21 result and guidance

We have not changed our dividend forecast.

**Figure 1. Forecast changes**

	FY21 Old NZ\$m	FY21 New NZ\$m	Chg %	FY22 Old NZ\$m	FY22 New NZ\$m	Chg %	FY23 Old NZ\$m	FY23 New NZ\$m	Chg %
NZ Energy Margin	960	957	0%	978	988	1%	1,004	1,006	0%
Australia Energy Margin	108	108	-1%	111	110	0%	111	111	0%
<b>Energy margin</b>	<b>1,068</b>	<b>1,065</b>	<b>0%</b>	<b>1,089</b>	<b>1,098</b>	<b>1%</b>	<b>1,115</b>	<b>1,118</b>	<b>0%</b>
Other revenue	27	26	-4%	27	25	-6%	16	19	23%
Transmission & metering costs	(124)	(127)	3%	(121)	(124)	3%	(116)	(119)	3%
Operating costs	(256)	(263)	2%	(254)	(259)	2%	(258)	(262)	2%
<b>EBITDAF</b>	<b>714</b>	<b>701</b>	<b>-2%</b>	<b>742</b>	<b>741</b>	<b>0%</b>	<b>758</b>	<b>756</b>	<b>0%</b>
Depn & amort	(308)	(307)	0%	(305)	(307)	1%	(307)	(308)	0%
<b>EBIT</b>	<b>406</b>	<b>394</b>	<b>-3%</b>	<b>437</b>	<b>434</b>	<b>-1%</b>	<b>450</b>	<b>448</b>	<b>0%</b>
Net interest	(79)	(80)	1%	(80)	(78)	-3%	(89)	(82)	-8%
FV mvmts, assoc inc, other	(22)	77	-450%	(24)	(24)	0%	(12)	(12)	0%
<b>Pre-tax profit</b>	<b>305</b>	<b>390</b>	<b>28%</b>	<b>333</b>	<b>332</b>	<b>0%</b>	<b>349</b>	<b>354</b>	<b>1%</b>
Tax	(85)	(109)	28%	(93)	(93)	0%	(98)	(99)	1%
<b>NPAT</b>	<b>220</b>	<b>281</b>	<b>28%</b>	<b>240</b>	<b>239</b>	<b>0%</b>	<b>251</b>	<b>255</b>	<b>1%</b>
<b>Normalised NPAT</b>	<b>220</b>	<b>211</b>	<b>-4%</b>	<b>231</b>	<b>231</b>	<b>0%</b>	<b>243</b>	<b>246</b>	<b>2%</b>
<b>FB depreciation/capex adjusted NPAT</b>	<b>404</b>	<b>391</b>	<b>-3%</b>	<b>411</b>	<b>420</b>	<b>2%</b>	<b>424</b>	<b>436</b>	<b>3%</b>
Dividend (cps)	16.9	16.9	0%	17.1	17.1	0%	17.4	17.4	0%
Normalised EPS	8.6	8.5	-1%	9.0	9.0	0%	9.5	9.6	2%
<b>Operating statistics</b>			<b>Diff</b>			<b>Diff</b>			<b>Diff</b>
NZ generation (GWh)	12,887	12,703	-1.4%	13,131	13,131	0.0%	13,200	13,131	-0.5%
FPVV sales (GWh)	8,127	8,127	0.0%	8,169	8,169	0.0%	8,191	8,191	0.0%
Customer numbers (000)	333	333	0.0%	333	333	0.0%	333	333	0.0%
GWAP (\$/MWh)	\$128.0	\$147.5	15.3%	\$119.0	\$146.1	22.8%	\$99.8	\$123.0	23.3%

Source: Forsyth Barr analysis

**Figure 2. Harapaki headline metrics vs. Turitea and Waipipi**

Wind farm name	Turitea	Waipipi	Harapaki	Comment
Owner	MCY	TLT	MEL	
Location	Manawatu	Taranaki	Hawkes Bay	
Expected completion date	Mid 2023	Jan 2021	Mid 2024	Stage 2 of Turitea is ~18 months late
Capacity (MW)	221.4	133.3	176.3	Harapaki will be the second largest wind farm in NZ after Turitea
Number and size of turbines	60 x 3.8MW	31 x 4.3MW	41 x 4.3MW	The Harapaki machines are the same as the Waipipi machines
Annual generation (GWh)	840	455	542	
Capacity factor	43.2%	39.0%	35.2%	Harapaki has a comparatively low capacity factor, common with large machines
Capex (NZ\$m)	464	277	395	
Capex/MW (NZ\$/MW)	2.1	2.1	2.2	Similar headline capex costs, but there are variances in what is included in capex total
Capex/MWh per annum (NZ\$)	552	609	729	Harapaki's low capacity factor impacts this metric
<b>Earnings metrics</b>				
EBITDAF per annum (NZ\$m)	55	22	35	Per company stated metrics — depends heavily on assumed electricity price received
EBITDAF/MWh (NZ\$/MWh)	65	48	65	
Levelised cost of energy (NZ\$/MWh)	54	57	65	FB estimated LCOE metric assumes 6% WACC, and a 30 year life

Source: MEL, MCY, TLT, Forsyth Barr analysis

Note: Care needs to be taken with the comparisons above. We have taken company reported information but there are some variances. For example, Turitea capex excludes capitalised interest, whereas Harapaki includes it and Waipipi doesn't disclose the basis. In addition, Turitea delays may yet result in increased capex costs.

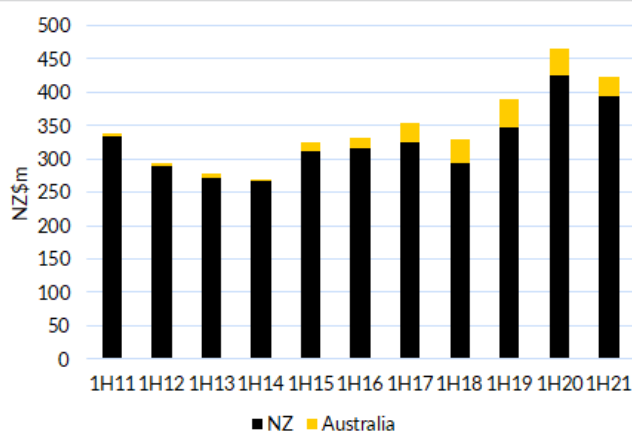
## Result summary

Figure 3. 1H21 result summary

6 months ending 31 December	1H20 NZ\$m	1H21 NZ\$m	% Chg	FB NZ\$m	Diff NZ\$m	Comments
NZ Energy Margin	598	540	-10%	538	2	Decline in Energy Margin mainly due to lower generation volumes
Australia Energy Margin	65	59	-9%	60	(1)	Lower wholesale electricity prices impacted Australia profitability
<b>Energy Margin</b>	<b>663</b>	<b>599</b>	<b>-10%</b>	<b>598</b>	<b>1</b>	
Other revenue	13	12	-8%	13	(1)	
Transmission & metering costs	(85)	(63)	-26%	(61)	(2)	-NZ\$24m decline in transmission costs due to lower charges from 1 April 2020
Operating costs	(126)	(126)	0%	(127)	1	Flat opex
<b>EBITDAF</b>	<b>465</b>	<b>422</b>	<b>-9%</b>	<b>422</b>	<b>0</b>	
Depn & amort	(157)	(153)	-3%	(155)	2	
<b>EBIT</b>	<b>308</b>	<b>269</b>	<b>-13%</b>	<b>268</b>	<b>1</b>	
Net interest	(43)	(42)	-2%	(40)	(2)	Net interest cost decline not as significant as expected
FV mvmts, assoc inc, other	-	88		(11)	99	Swaption fee was NZ\$10m, rest is non-cash accounting adjustments
<b>Pre-tax profit</b>	<b>265</b>	<b>315</b>	<b>19%</b>	<b>217</b>	<b>98</b>	
Tax	(74)	(88)	19%	(61)	(27)	
<b>NPAT</b>	<b>191</b>	<b>227</b>	<b>19%</b>	<b>156</b>	<b>71</b>	
<b>Normalised NPAT</b>	<b>184</b>	<b>156</b>	<b>-15%</b>	<b>156</b>	<b>0</b>	NPAT decline consistent with lower EBITDAF
EPS (cps)	7.2	6.1	-15%	6.1	0.0	
Dividend (cps)	8.14	5.70	-30%	5.7	0.00	Flat 1H20 dividend as expected. 86% imputed.
<b>Operating statistics</b>						
Generation (GWh)	7,186	6,676	-7%			Lower hydro generation volumes vs. 1H20, but only -1% below average
FPV sales (GWh)	3,661	4,119	13%			MEL continued strong retail sales growth
Customer numbers (000)	314	333	6%			
GWAP (\$/MWh)	101	113	12%			Higher wholesale electricity prices linked to lower generation volumes
<b>Summary cashflow</b>						
Operating cash flow	431	362	-16%			Significant negative working capital movement impacted headline operating cash flow
Interest paid	(41)	(41)	0%			
Tax paid	(124)	(134)	8%			High tax payments due to strong FY20
Maintenance capex	(24)	(20)	-17%			
<b>Free cash flow</b>	<b>242</b>	<b>167</b>	<b>-31%</b>			
Free cash flow (cps)	9.4	6.5	-31%			
Net debt	1,557	1,557	0%			

Source: MEL, Forsyth Barr analysis

Figure 4. Historic 1H MEL EBITDAF

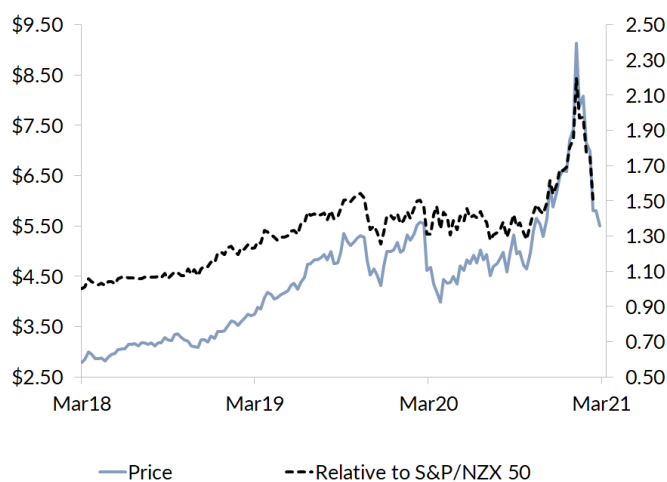


Source: MEL, Forsyth Barr analysis

Figure 5. Spot valuation changes

	Old \$/share	New \$/share	Change \$/share	%
DCF	\$5.06	\$4.54	-\$0.52	-10.3%
Market multiple	\$5.37	\$5.02	-\$0.35	-6.5%
Dividend yield	\$5.68	\$5.34	-\$0.34	-6.1%
<b>Target price</b>	<b>\$5.55</b>	<b>\$5.10</b>	<b>-\$0.45</b>	<b>-8.1%</b>

Source: Forsyth Barr analysis

**Figure 6. Price performance**


Source: Forsyth Barr analysis

**Figure 7. Substantial shareholders**

Shareholder	Latest Holding
NZ Govt	51.0%
BlackRock Investment Management	7.1%

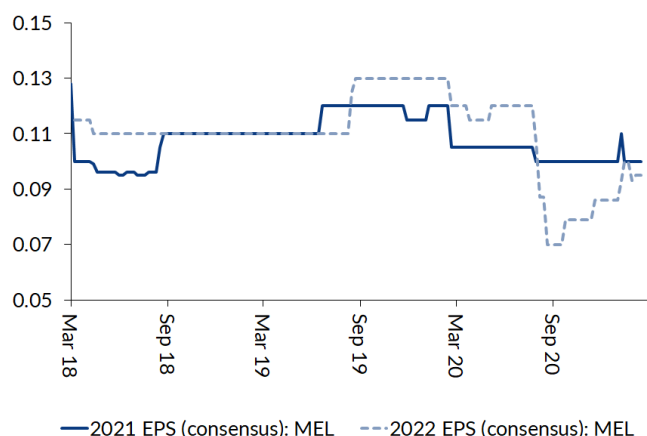
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 8. International valuation comparisons**

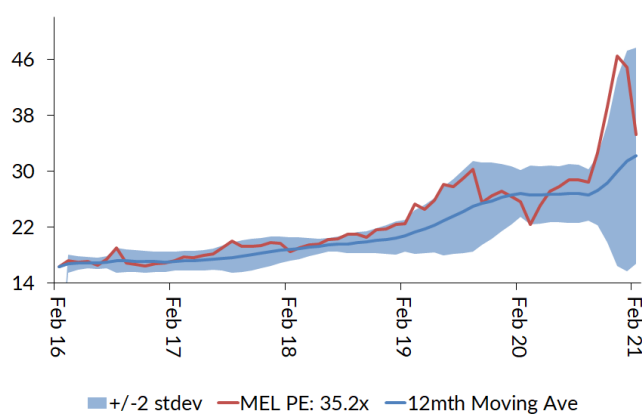
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect MEL's balance date - June)										
Meridian Energy	MEL NZ	NZ\$5.50	NZ\$14,097	36.0x	33.6x	22.4x	21.2x	39.9x	36.2x	3.1%
CONTACT ENERGY *	CEN NZ	NZ\$6.96	NZ\$5,324	20.0x	19.2x	13.2x	13.0x	25.4x	24.6x	5.2%
GENESIS ENERGY *	GNE NZ	NZ\$3.44	NZ\$3,590	18.7x	16.2x	11.8x	11.1x	24.8x	22.5x	5.1%
MERCURY *	MCY NZ	NZ\$6.15	NZ\$8,378	28.8x	26.0x	18.6x	16.1x	31.5x	26.1x	3.0%
TRUSTPOWER *	TPW NZ	NZ\$8.27	NZ\$2,588	30.3x	26.3x	16.4x	14.8x	21.3x	18.9x	4.1%
AGL ENERGY	AGL AT	A\$10.07	A\$6,274	11.6x	15.6x	5.4x	6.1x	9.7x	12.7x	6.2%
ORIGIN ENERGY	ORG AT	A\$4.63	A\$8,154	25.9x	17.2x	6.6x	6.0x	25.6x	22.0x	4.8%
Compco Average:				22.6x	20.1x	12.0x	11.2x	23.0x	21.1x	4.8%
MEL Relative:				60%	67%	87%	90%	73%	71%	-35%

EV = Current Market Cap + Actual Net Debt

Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (MEL) companies fiscal year end

**Figure 9. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 10. One year forward PE (x)**


Source: Forsyth Barr analysis

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