

Sonata Software (SSOF IN)

Rating: BUY | CMP: Rs858 | TP: Rs1,011

January 18, 2022

Q3FY22 Result Update

☑ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY23E	FY24E	FY23E	FY24E
Rating	BUY		BUY	
Target Price	1,011		994	
Sales (Rs. m)	66,743	79,574	63,241	75,842
% Chng.	5.5	4.9		
EBITDA (Rs. m)	6,036	7,147	6,020	7,086
% Chng.	0.3	0.9		
EPS (Rs.)	44.1	52.2	43.5	51.2
% Chng.	1.4	1.9		

Key Financials - Standalone

Y/e Mar	FY21	FY22E	FY23E	FY24E
Sales (Rs. m)	42,281	54,518	66,743	79,574
EBITDA (Rs. m)	3,794	4,865	6,036	7,147
Margin (%)	9.0	8.9	9.0	9.0
PAT (Rs. m)	2,440	3,729	4,583	5,422
EPS (Rs.)	23.5	35.9	44.1	52.2
Gr. (%)	(11.9)	52.8	22.9	18.3
DPS (Rs.)	11.7	17.9	22.1	26.1
Yield (%)	1.4	2.1	2.6	3.0
RoE (%)	31.0	38.0	40.0	40.3
RoCE (%)	38.8	41.1	45.6	47.0
EV/Sales (x)	2.0	1.5	1.2	1.0
EV/EBITDA (x)	21.8	16.7	13.2	10.8
PE (x)	36.5	23.9	19.4	16.4
P/BV (x)	9.8	8.5	7.2	6.1

Key Data

SOFT.BO | SSOF IN

52-W High / Low	Rs.1,030 / Rs.354
Sensex / Nifty	60,755 / 18,113
Market Cap	Rs.90bn / \$ 1,210m
Shares Outstanding	105m
3M Avg. Daily Value	Rs.306.43m

Shareholding Pattern (%)

Promoter's	29.36
Foreign	16.79
Domestic Institution	11.86
Public & Others	41.99
Promoter Pledge (Rs bn)	-

Stock Performance (%)

	1M	6M	12M
Absolute	2.8	9.7	118.5
Relative	(3.6)	(4.0)	74.7

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Strong revenue growth trajectory intact

Quick Pointers:

- Share of Digital revenue in IITS business has consistently increased over last several quarters and now accounts to 72% (vs 70% in 2Q22 and 64% in 3Q21)
- Segmental IITS EBITDA margin at 28%, -70bps QoQ led by wage increases in Q3, and will remain under pressures due to wage hikes in 4Q22 and 1Q23.

Sonata reported strong beat in International IT Services (IITS) revenue growth of +8.1% QoQ USD (Ple: 4.9% QoQ USD). Organic growth was strong at 5% QoQ USD, while inorganic business contributed \$4.4 mn in revenue. Growth in IITS was driven by digital based competencies like Managed Cloud Services, Microsoft and open source platform based services. Digital revenue has grown at strong 10% CQGR over last 4 quarters. Deal pipeline continues to be healthy with multiple new digital wins. Growth is likely to remain flattish on QoQ basis in Travel in next quarter because of impact of COVID third wave and it may pick up from 1Q23. Domestic Product Services (DPS) business grew by +33% YoY aided by strong seasonality and cloud-based annuity deals.

IITS EBITDA margin came at 28%, -70bpsQoQ led by salary increases and ramp up of new hires amidst higher attrition (22-23%). Company will do another round of salary corrections in Q4FY22 and Q1FY23 which are expected to weigh on IITS EBITDA margins. Sonata did net-addition of 175 employees this quarter (lower than their target to add ~300 resources per quarter). However, consistent ramp up in hiring since last 3 quarters and addition of inorganic business has led to 26% YoY growth in total headcount. Management mentioned that attrition is flattening since last few weeks. DPS EBITDA came at INR 369 mn (+9.5% QoQ, 35.2% YoY). Management expects DPS EBITDA to grow at 10-15% per year. Consolidated EBITDA margins stood at 7.1%, -86bps YoY below our estimate (Ple: 7.7%).

Our EPS estimates increase by 1.4%/1.9% in FY23/FY24 led by increase in revenue growth estimates, partially offset by cut in margins. We value Sonata on 21x Sep23 EPS of INR 48 to arrive at changed TP of INR 1011 (earlier: 994). Sonata is currently trading at 19x/16x on FY23/24 earnings of INR 44/52 with Revenue/EPS CAGR of 18%/20.6% over FY22-24E. Maintain Buy.

- Strong growth momentum in IITS since last two quarters:** International IT Services (IITS) revenue came at \$53.4 mn, +8.1% QoQ USD, 30.2% YoY USD (Ple: 4.9% QoQ USD). Organic revenue growth was 5% QoQ USD and inorganic business contributed \$4.4 mn in revenue.
- Growth in IITS was driven by digital based competencies like Managed Cloud Services (+16.1% QoQ USD), Data & Analytics (+12% QoQ USD), Microsoft Dynamic Services (+10.4% QoQ USD) and Microsoft Digital Platformation Services (+8.0% QoQ USD). Digital revenue continued strong growth momentum and now accounts to 72% of total revenue (vs 64% in 3Q21). Share of Platformation revenue also increased to 23% (vs 22% in 2Q22).

In IITS, share of digital revenue has consistently improved for last several quarters from 38% in 4Q20 to 72% in 3Q22. Higher share of digital revenue has helped maintain IITS Segmental EBITDA margin above 28%.

In IITS business, Sonata added 11 new clients in this quarter. (vs 8 in 2Q22). Revenue growth was strong across Top 20 clients +7% QoQ, +30% YoY

- In terms of verticals, growth was strong across all verticals led by ISV (+8.4% QoQ USD), Retail Non-Essential (+38% QoQ USD) and Distribution and Manufacturing (+9% QoQ USD). Growth in Travel has slowed (+5% QoQ) and is expected to be flattish in Q4FY22 due to impact of COVID third wave and pick up from Q1FY23.
- Strong growth in DPS led by seasonal strength:** Domestic Product Services (DPS) business grew by +33% YoY much higher than average 25% YoY growth for last four quarters. Growth was driven by multiyear cloud-based annuity deals. Share of cloud led revenue further increased to 78% (vs 77% in 2QFY22 and 68% in 3QFY21). Annuity revenue remained stable at 75%, flat on QoQ basis. Work with new alliances AWS and GCP is also progressing well.
- IITS EBITDA margins will be impacted by supply side cost pressures:** IITS EBITDA margin came at 28%, -70bpsQoQ led by salary increases driven by efforts to retain talent amidst higher attrition. Company will do another round of salary corrections in Q4FY22 and Q1FY23 which are expected to weigh on IITS EBITDA margins. Utilization remained at elevated levels of 81%, +100bps QoQ. Attrition is at 22-23%, management mentioned that attrition is flattening since last few weeks.
- DPS EBITDA margin is at 2.5%, flat YoY basis. DPS EBITDA came at INR 369 mn (+9.5% QoQ, 35.2% YoY). Management expects DPS EBITDA to grow at 10-15% per year.
- Consolidated EBITDA margins stood at 7.1%, -86bps YoY below our estimate (Ple: 7.7%). Consolidated PAT is at INR 976.6 mn +7.1% QoQ, +81.4% YoY (Ple: INR 923 mn).
- Ramped up hiring:** Sonata ramped up hiring in last three quarters with net-addition of 175 employees this quarter (lower than their target to add ~300 resources per quarter). Total headcount is up 3.6% QoQ and 26% YoY. They plan to increase fresher intake by 40% YoY in FY23, wherein freshers will account for 20% of their total new hires. Pace of scaling up its near shore development centres in Canada and Ireland has slowed due to COVID, but the company expects to scale them as travel restrictions ease of.
- Consolidated DSO increased to 38 days, +3days QoQ led by increased in IITS DSO to 43 days (vs 38 days in 2Q22) because of slowdown in collections during holiday season in Dec. This is expected to improve in Q4.

Exhibit 1: Q3FY22 Result Summary

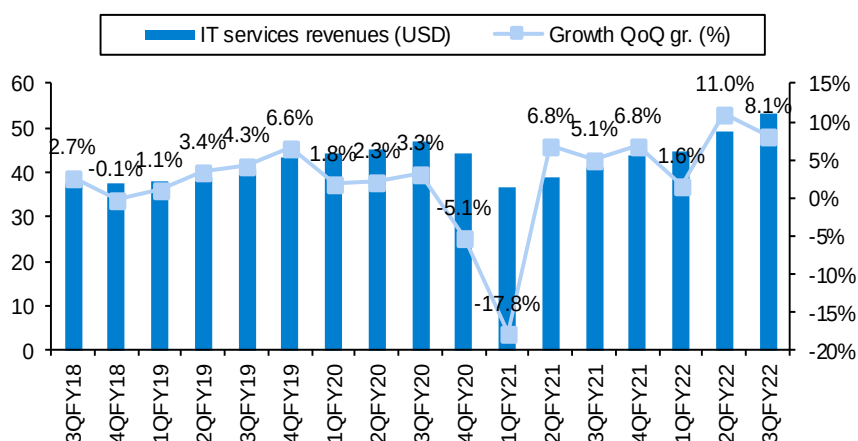
Particulars (Rs mn)	3QFY22	2QFY22	QoQ gr.	3QFY21	YoY gr.	PL Est	Var (Act vs Ple)
IT services Revenues (USD mn)	53.4	49.4	8.1%	41.0	30.2%	51.8	3.0%
IT services Revenues (INR mn)	3952	3608	9.5%	3009	31.3%	3835	3.0%
Domestic Products (USD mn)	198	83	138.6%	150	32.1%	164	20.9%
Domestic Products (INR mn)	14642	6055	141.8%	10994	33.2%	12110	20.9%
Total consol Revenues(INR mn)	18580	9632	92.9%	13962	33.1%	15945	16.5%
Consol EBITDA	1317	1231	7.0%	1110	18.7%	1231	6.9%
Consolidated EBITDA Margins (%)	7.1%	12.8%	-569 bps	7.9%	-86 bps	7.7%	-64 bps
PAT	977	912	7.1%	538	81.4%	923	5.8%
EPS	9.4	8.8	7.1%	5.2	81.2%	8.9	5.8%

Source: Company, PL

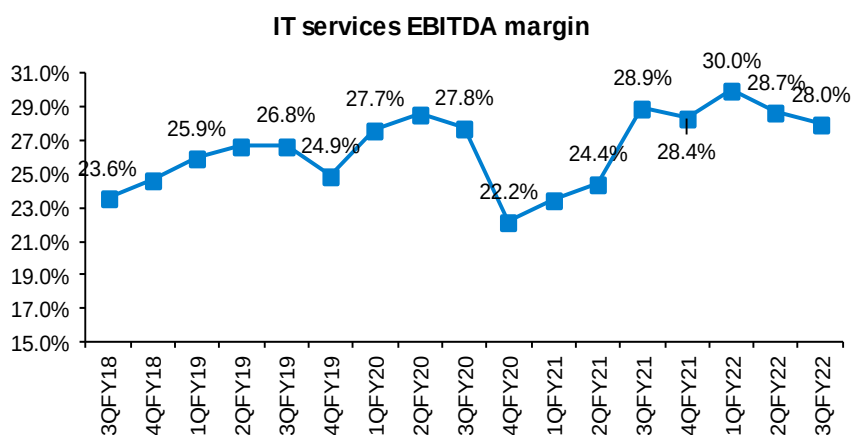
Exhibit 2: Change in Estimates

	FY22E	FY23E	FY24E
USD revenues (US\$ m)			
- New	742	878	1,033
- Old	707	832	985
<i>Change (%)</i>	<i>4.9%</i>	<i>5.5%</i>	<i>4.9%</i>
EBIT Margin			
- New	8.1%	8.5%	8.5%
- Old	8.4%	8.9%	8.8%
<i>Change (%)</i>	<i>-35 bps</i>	<i>-44 bps</i>	<i>-34 bps</i>
Recurring EPS - Fully diluted (Rs)			
- New	35.9	44.1	52.2
- Old	35.5	43.5	51.2
<i>Change (%)</i>	<i>1.2%</i>	<i>1.4%</i>	<i>1.9%</i>

Source: PL

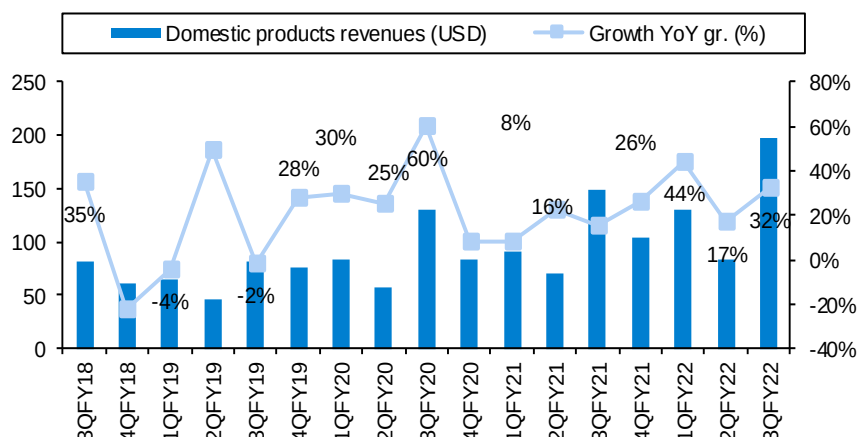
Exhibit 3: Strong growth momentum in IT services


Source: Company, PL

Exhibit 4: IT services segmental EBITDA margin maintained above 28%


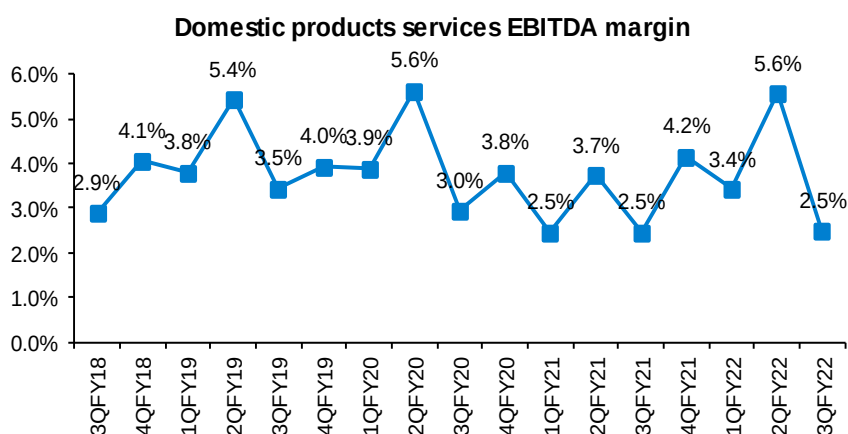
Source: Company, PL

Exhibit 5: Strong growth in domestic products business due to seasonal strength



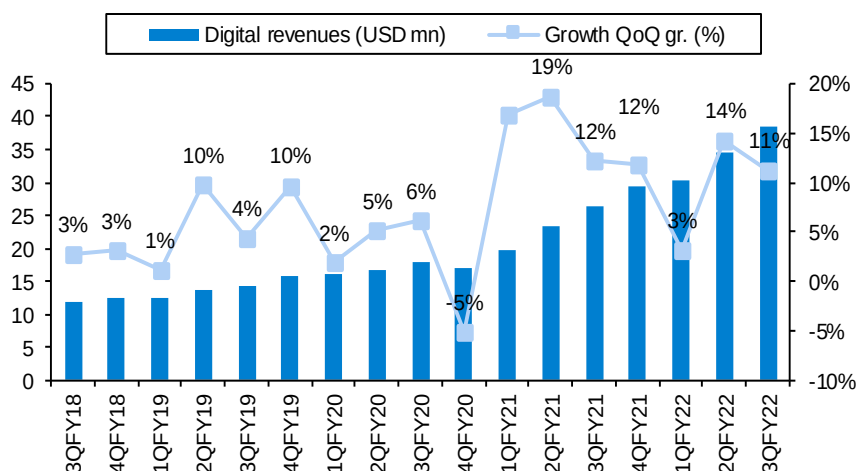
Source: Company, PL

Exhibit 6: Lower DPS EBITDA margins led by seasonality

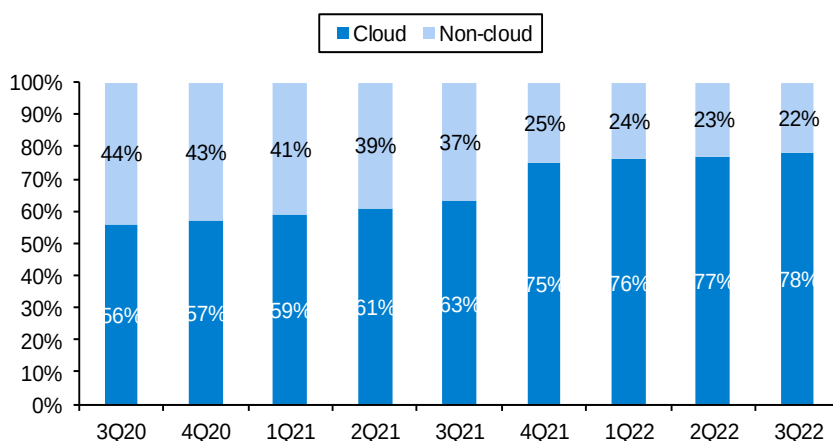


Source: Company, PL

Exhibit 7: IITS digital revenue continues to grow at strong pace



Source: Company, PL

Exhibit 8: Increasing share of cloud in DPS revenues


Source: Company, PL

Exhibit 9: IITS vertical wise revenues

USD in Mn	3QFY22	2QFY22	QoQ gr.	3QFY21	YoY gr.
ISV	16.8	15.5	8.4%	13.1	27.8%
Travel	5.0	4.8	5%	4.1	22%
Others	8.2	8.2	0.9%	8.7	-5%
Distribution & Manufacturing	10.7	9.8	9%	8.4	27%
Retail (Essential)	4.8	4.4	9%	3.3	47%
Retail (Non-essential)	1.7	1.2	38%	0.5	221%
Commodity business and Service industry	4.6	4.1	12%	2.9	62%
Healthcare	1.5	1.4	12%	-	NA
Total	53.4	49.4	8%	41.0	30%
-as a % of sales					
ISV	31%	31%	10 bps	32%	-60 bps
Travel	9%	10%	-30 bps	10%	-60 bps
Others	15%	17%	-110 bps	21%	-580 bps
Distribution & Manufacturing	20%	20%	10 bps	21%	-50 bps
Retail (Essential)	9%	9%	10 bps	8%	100 bps
Retail (Non-essential)	3%	3%	70 bps	1%	190 bps
Commodity business and Service industry	9%	8%	30 bps	7%	170 bps
Healthcare	3%	2.8%	10 bps	0	290 bps

Source: Company, PL

Exhibit 10: International IT business service line wise revenues

USD in Mn	3QFY22	2QFY22	QoQ gr.	3QFY21	YoY gr.
Data & Analytics	7.3	6.52	12%	4.92	49%
Managed Cloud Services	6.1	5.29	16%	3.73	65%
IMS & Cloud	2.3	2.22	4%	2.01	16%
Microsoft Digital Platformation Services	10.8	9.98	8%	8.16	32%
Microsoft Dynamic Services	16.1	14.52	11%	11.52	40%
Modern Validation and Dev Eng Mgmt Ser	4.8	4.89	-2%	4.80	0%
Open Source Digital Platform Services	5.7	5.38	5%	4.35	30%
Other ERP Services	0.2	0.30	-46%	0.70	-77%
Other Services	0.2	0.30	-46%	0.82	-80%
Total	53.4	49.4	8%	41.0	30%
-as a % of sales					
Data & Analytics	14%	13%	50 bps	12%	170 bps
Managed Cloud Services	12%	11%	80 bps	9%	240 bps
IMS & Cloud	4%	5%	-15 bps	5%	-55 bps
Microsoft Digital Platformation Services	20%	20%	0 bps	20%	30 bps
Microsoft Dynamic Services	30%	29%	70 bps	28%	200 bps
Modern Validation and Dev Eng Mgmt Ser	9%	10%	-90 bps	12%	-270 bps
Open Source Digital Platform Services	11%	11%	-30 bps	11%	0 bps
Other ERP Services	0.3%	1%	-30 bps	2%	-140 bps
Other Services	0.3%	1%	-30 bps	2%	-170 bps

Source: Company, PL

Exhibit 11: IITS Revenue contribution by Geography (%)

Revenue mix geography (%)	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22
America	56	55	56	53	54	54	64	51	52	51	51	53	55
Europe	32	32	30	30	30	30	16	26	26	25	25	24	23
RoW	12	13	14	17	16	16	20	23	22	24	24	23	22

Source: Company, PL

Exhibit 12: IITS Client Metrics

Revenue mix by clients (%)	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22
Top 5 Clients	61	61	59	59	57	57	53	55	54	53	58	57	64
Top 10 Clients	69	68	66	65	66	64	59	61	62	61	65	64	63
Top 20 Clients	78	76	75	73	75	73	69	71	71	71	73	72	72

Source: Company, PL

Exhibit 13: Headcount metrics

Headcount	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22
IT Services	3812	3886	4000	4036	4028	4066	3966	3744	3851	3956	4101	4693	4868
Products	155	156	150	143	149	145	145	141	146	146	149	157	157
Total	3967	4042	4150	4179	4177	4211	4111	3885	3997	4102	4250	4850	5025
DSO Days													
International Services	40	41	41	44	42	47	57	47	36	36	37	38	43
Domestic Products	42	47	33	43	47	52	59	63	57	49	39	32	33
Total DSO Days	41	44	37	44	45	50	58	55	47	43	38	35	38

Source: Company, PL

Financials

Income Statement (Rs m)

Y/e Mar	FY21	FY22E	FY23E	FY24E
Net Revenues	42,281	54,518	66,743	79,574
YoY gr. (%)	13.0	28.9	22.4	19.2
Employee Cost	29,916	39,273	47,236	56,729
Gross Profit	12,365	15,245	19,507	22,845
Margin (%)	29.2	28.0	29.2	28.7
SG&A Expenses	-	-	-	-
Other Expenses	2,317	2,971	3,806	4,377
EBITDA	3,794	4,865	6,036	7,147
YoY gr. (%)	1.8	28.2	24.1	18.4
Margin (%)	9.0	8.9	9.0	9.0
Depreciation and Amortization	396	470	396	396
EBIT	3,398	4,395	5,640	6,751
Margin (%)	8.0	8.1	8.5	8.5
Net Interest	154	183	180	180
Other Income	277	722	611	611
Profit Before Tax	3,522	4,934	6,071	7,182
Margin (%)	8.3	9.1	9.1	9.0
Total Tax	1,082	1,206	1,487	1,760
Effective tax rate (%)	30.7	24.4	24.5	24.5
Profit after tax	2,440	3,729	4,583	5,422
Minority interest	-	-	-	-
Share Profit from Associate	-	-	-	-
Adjusted PAT	2,440	3,729	4,583	5,422
YoY gr. (%)	(11.9)	52.8	22.9	18.3
Margin (%)	5.8	6.8	6.9	6.8
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	2,440	3,729	4,583	5,422
YoY gr. (%)	(11.9)	52.8	22.9	18.3
Margin (%)	5.8	6.8	6.9	6.8
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	2,440	3,729	4,583	5,422
Equity Shares O/s (m)	104	104	104	104
EPS (Rs)	23.5	35.9	44.1	52.2

Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY21	FY22E	FY23E	FY24E
Non-Current Assets				
Gross Block	1,477	1,567	1,657	1,747
Tangibles	1,000	1,072	1,144	1,216
Intangibles	477	495	513	531
Acc: Dep / Amortization	-	-	-	-
Tangibles	-	-	-	-
Intangibles	-	-	-	-
Net fixed assets	1,477	1,567	1,657	1,747
Tangibles	1,000	1,072	1,144	1,216
Intangibles	477	495	513	531
Capital Work In Progress	1	1	1	1
Goodwill	1,759	1,759	1,759	1,759
Non-Current Investments	301	401	501	601
Net Deferred tax assets	189	189	189	189
Other Non-Current Assets	1,050	1,050	1,050	1,050
Current Assets				
Investments	654	704	754	804
Inventories	-	-	-	-
Trade receivables	6,158	7,940	9,721	11,589
Cash & Bank Balance	6,771	8,124	9,819	11,854
Other Current Assets	383	383	383	383
Total Assets	19,469	22,844	26,560	30,704
Equity				
Equity Share Capital	104	104	104	104
Other Equity	8,951	10,442	12,275	14,444
Total Network	9,055	10,546	12,379	14,548
Non-Current Liabilities				
Long Term borrowings	-	-	-	-
Provisions	-	-	-	-
Other non current liabilities	-	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	897	897	897	897
Trade payables	6,510	8,394	10,276	12,251
Other current liabilities	1,987	1,987	1,987	1,987
Total Equity & Liabilities	19,469	22,844	26,560	30,704

Source: Company Data, PL Research



Cash Flow (Rs m)

Y/e Mar	FY21	FY22E	FY23E	FY24E
PBT	3,521	4,934	6,071	7,182
Add. Depreciation	396	470	396	396
Add. Interest	146	183	180	180
Less Financial Other Income	277	722	611	611
Add. Other	(145)	(722)	(611)	(611)
Op. profit before WC changes	3,919	4,865	6,036	7,147
Net Changes-WC	1,840	102	102	107
Direct tax	(1,332)	(1,206)	(1,487)	(1,760)
Net cash from Op. activities	4,426	3,761	4,650	5,494
Capital expenditures	(523)	(90)	(90)	(90)
Interest / Dividend Income	95	722	611	611
Others	(713)	(150)	(150)	(150)
Net Cash from Invt. activities	(1,141)	482	371	371
Issue of share cap. / premium	-	-	-	-
Debt changes	(181)	-	-	-
Dividend paid	(407)	(2,237)	(2,750)	(3,253)
Interest paid	(34)	(183)	(180)	(180)
Others	(611)	-	-	-
Net cash from Fin. activities	(1,232)	(2,420)	(2,930)	(3,433)
Net change in cash	2,054	1,823	2,091	2,432
Free Cash Flow	3,903	3,671	4,560	5,404

Source: Company Data, PL Research

Key Financial Metrics

Y/e Mar	FY21	FY22E	FY23E	FY24E
Per Share(Rs)				
EPS	23.5	35.9	44.1	52.2
CEPS	27.3	40.4	47.9	56.0
BVPS	87.1	101.5	119.1	140.0
FCF	37.6	35.3	43.9	52.0
DPS	11.7	17.9	22.1	26.1
Return Ratio(%)				
RoCE	38.8	41.1	45.6	47.0
ROIC	93.2	127.0	157.5	182.9
RoE	31.0	38.0	40.0	40.3
Balance Sheet				
Net Debt : Equity (x)	(0.7)	(0.8)	(0.8)	(0.8)
Debtor (Days)	53	53	53	53
Valuation(x)				
PER	36.5	23.9	19.4	16.4
P/B	9.8	8.5	7.2	6.1
P/CEPS	27.3	40.4	47.9	56.0
EV/EBITDA	21.8	16.7	13.2	10.8
EV/Sales	2.0	1.5	1.2	1.0
Dividend Yield (%)	1.4	2.1	2.6	3.0

Source: Company Data, PL Research

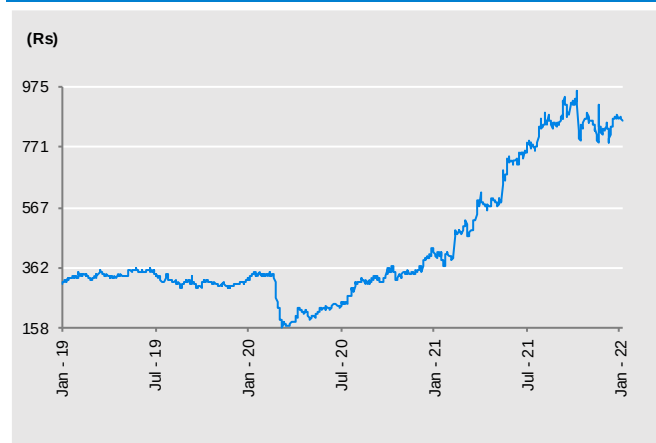
Quarterly Financials (Rs m)

Y/e Mar	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Net Revenue	10,757	12,685	9,632	18,580
YoY gr. (%)	15.8	33.2	19.8	33.1
Raw Material Expenses	7,434	9,346	5,956	14,568
Gross Profit	3,323	3,339	3,676	4,012
Margin (%)	30.9	26.3	38.2	21.6
EBITDA	1,031	1,010	1,231	1,317
YoY gr. (%)	24.1	29.4	41.0	18.7
Margin (%)	9.6	8.0	12.8	7.1
Depreciation / Depletion	94	99	117	127
EBIT	937	911	1,114	1,190
Margin (%)	8.7	7.2	11.6	6.4
Net Interest	36	44	47	47
Other Income	189	282	135	153
Profit before Tax	1,091	1,148	1,202	1,296
Margin (%)	10.1	9.1	12.5	7.0
Total Tax	260	281	290	319
Effective tax rate (%)	23.8	24.5	24.1	24.6
Profit after Tax	831	867	912	977
Minority interest	-	-	-	-
Share Profit from Associates	-	-	-	-
Adjusted PAT	831	867	912	977
YoY gr. (%)	34.3	73.8	59.4	81.4
Margin (%)	7.7	6.8	9.5	5.3
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	831	867	912	977
YoY gr. (%)	34.3	73.8	59.4	81.4
Margin (%)	7.7	6.8	9.5	5.3
Other Comprehensive Income	-	-	-	-
Total Comprehensive Income	831	867	912	977
Avg. Shares O/s (m)	104	104	104	104
EPS (Rs)	8.0	8.3	8.8	9.4

Source: Company Data, PL Research

Price Chart

Recommendation History



No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	4-Jan-22	BUY	994	869
2	20-Oct-21	BUY	994	918
3	5-Oct-21	BUY	936	883
4	7-Aug-21	BUY	927	842
5	6-Aug-21	BUY	834	842
6	2-Jul-21	BUY	834	757
7	18-Jun-21	BUY	834	711
8	13-May-21	BUY	674	586
9	5-Apr-21	BUY	537	522
10	8-Feb-21	BUY	503	406

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Affle (India)	BUY	1,530	1,194
2	Coforge	BUY	5,708	5,973
3	Cyient	BUY	1,301	1,065
4	HCL Technologies	BUY	1,398	1,337
5	Infosys	BUY	2,234	1,877
6	L&T Technology Services	BUY	5,705	5,729
7	Larsen & Toubro Infotech	BUY	7,239	7,533
8	Mindtree	BUY	5,249	4,744
9	Mphasis	BUY	3,772	3,423
10	Persistent Systems	BUY	4,808	4,872
11	Redington (India)	BUY	215	147
12	Sonata Software	BUY	994	869
13	Tata Consultancy Services	BUY	4,468	3,860
14	TeamLease Services	Reduce	4,366	4,187
15	Tech Mahindra	BUY	1,945	1,722
16	Wipro	BUY	737	691
17	Zensar Technologies	BUY	528	533

PL's Recommendation Nomenclature (Absolute Performance)

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

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