

Developing assets on multiple fronts

Investment Highlights

We are initiating coverage on Guildford Coal Limited (GUF) with a BUY recommendation and price target of \$2.25/share. GUF is a coal exploration company that has spent less than 12 months as a listed entity on the ASX. In that time it has secured multiple targets in major Queensland and Mongolian Coal Basins. This has been reflected in the strong performance of the share price since listing.

- **A Simple Objective** has been pursued by the management team - to secure prospective tenements close to infrastructure. They have achieved this objective with their 3 primary targets in Queensland, the Hughenden project on the Mt Isa - Townsville rail line, the Kolan project close to rail to Gladstone and the Sierra project on the main rail line west of Rockhampton.
- **The Hughenden project** - is one of the largest coal exploration tenement portfolios on the Galilee Basin. The drilling program has been significantly delayed by the extraordinary wet season and flooding last year. 4 drill rigs are now drilling to establish GUFs maiden JORC compliant resource. The project is located near Pentland and the main rail line to Townsville and GUF signed MOUs for a planned feasibility study to develop rail coal and export facilities from the Port of Townsville.
- **Seizing the opportunity** - The board has agreed to exercise an option to be the majority shareholders in a Mongolian company, Terra Energy, which originally had a project in South Gobi of 4 exploration licences over prospective coking and thermal coal targets and another 2 exploration licences over prospective thermal coal targets in Middle Gobi. Its portfolio has now expanded with additions assets in, South Gobi and Middle Gobi provinces as well as licenses in Northern Mongolia close to the Russian boarder.
- **Focus of South Gobi** - The project covers large coal prospects located in the South Gobi desert 50km north of the Chinese border and adjacent to two operating coal mines. There are 4 drill rigs on site to establish a JORC compliant resource. The mining lease on the South Gobi Project is expected to be issued in Q3 CY2011.

14 July 2011

12mth Rating

BUY

Price	A\$	1.21
Target Price	A\$	2.25
12m Total Return	%	86.0

RIC: **GUF.AX**

BBG: **GUF AU**

Shares o/s	m	413.5
Free Float	%	26.0
Market Cap.	A\$m	500.4
Net Debt (Cash)	A\$m	-34.7
Net Debt/Equity	%	na
3m Av. D. T'over	A\$m	1.30
52wk High/Low	A\$	1.32/0.18
2yr adj. beta		na

Valuation:

Methodology		DCF
Value per share	A\$	2.22

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Disclosure:

12 Month Share Price Performance



Performance %	1mth	3mth	12mth
Absolute	1.7	9.6	na
Rel. S&P/ASX 300	1.1	21.3	na

Year End June 30	2010A	2011F	2012F	2013F	2014F
Reported NPAT (\$m)	(13.5)	(1.1)	7.9	12.2	(20.1)
Recurrent NPAT (\$m)	(13.3)	(1.0)	5.5	11.1	(24.3)
Recurrent EPS (cents)	(3.2)	(0.2)	1.3	2.7	(5.9)
EPS Growth (%)	na	na	na	100.6	na
PER (x)	(38.1)	(501.7)	90.5	45.1	(20.6)
EBITDA (\$m)	(3.8)	(1.0)	8.6	17.4	(20.4)
EV/EBITDA (x)	(128.0)	(466.9)	51.1	25.5	(23.9)
Capex (\$m)	0.0	0.0	5.3	12.4	21.2
Free Cashflow	17.1	(21.4)	(2.9)	(5.2)	(43.5)
FCFPS (cents)	4.1	(5.2)	(0.7)	(1.3)	(10.5)
PFCF (x)	29.7	(23.4)	(173.9)	(96.2)	(11.5)
DPS (cents)	0.0	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0	0.0
Franking (%)	100.0	100.0	100.0	100.0	100.0

Background

GUF is a coal exploration company that has spent less than 12 months as a listed entity on the ASX. In that time they have secured multiple targets in major Queensland and Mongolian coal basins. The Queensland portfolio has assets in the Galilee, Bowen and Maryborough coal basins. This will allow the company to explore for coking coal, thermal coal and PCI. GUF will exercise an option to be the majority shareholders in Terra Energy (TE). TE primarily had two Mongolian Projects however this recently expanded to 6 projects across the northern Tuv, South Gobi and Middle Gobi provinces.

Queensland, Australia

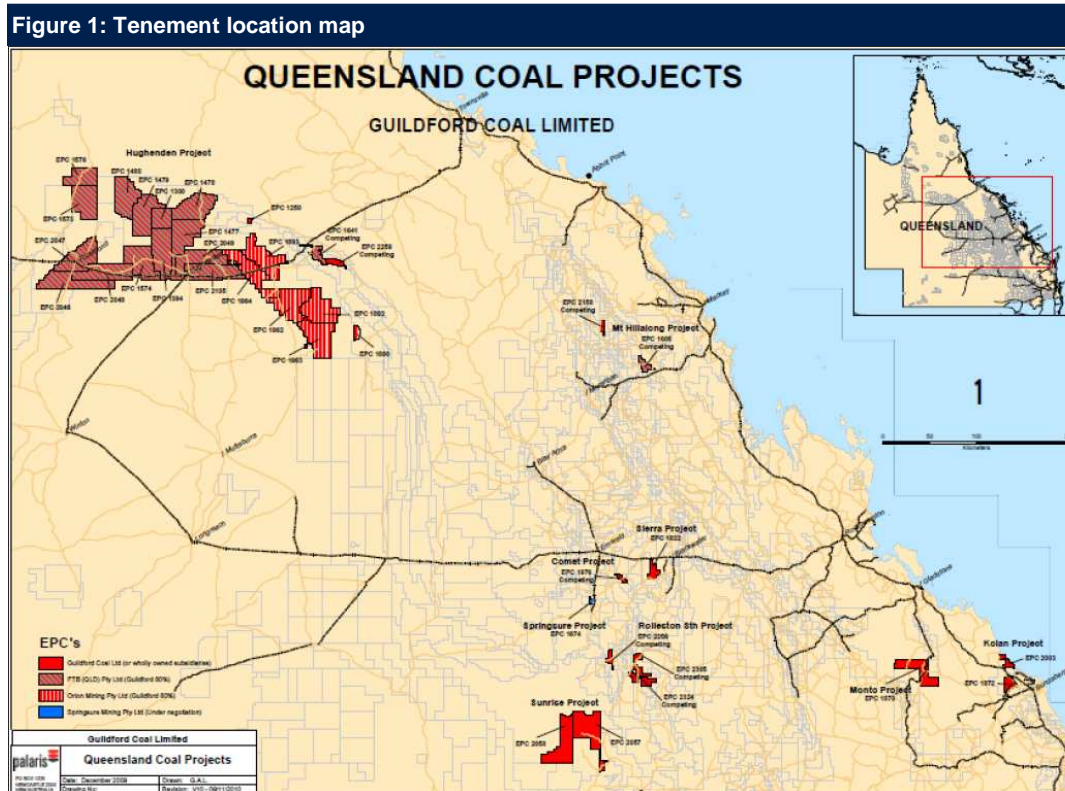
GUF's coal exploration tenements in Queensland cover an estimated area of in excess of 21,000 km².

Priority projects

- Hughenden Project (Galilee / Eromanga Basins)
- Sierra Project (Bowen Basin)
- Kolan Project (Maryborough Basin)

Other projects

- Sunrise Project (Surat/Bowen Basin)
- Monto Project (Nagoorin Graben and Mulgildie Basin)



Source: GUF

Hughenden Project – Galilee/Eromanga Basin

The Hughenden project covers an area of approximately 16,500km² at the northern extremity of the Galilee basin. 11,500km² of coal exploration permits have been granted and applications lodged for 5,000km² to a number of joint venture companies where GUF is the majority partner. GUF owns 80% of Orion Mining and FTB (Qld) which own the majority of the EPCs. The remaining 20% of Orion Mining and FTB (Qld) is held by a private company and another ASX listed entity, Carpentaria Exploration Limited (CAP). GUF also acquired a 51% interest in EPC 1260 which will be joined with the 100% owned EPC 1250 to form the White Mountain Project.

The drilling program, being managed by Palaris an independent contractor, is targeting thermal coal with open cut and underground mining potential. The wet season last summer delayed the drilling program significantly and GUF currently has no JORC compliant resource.

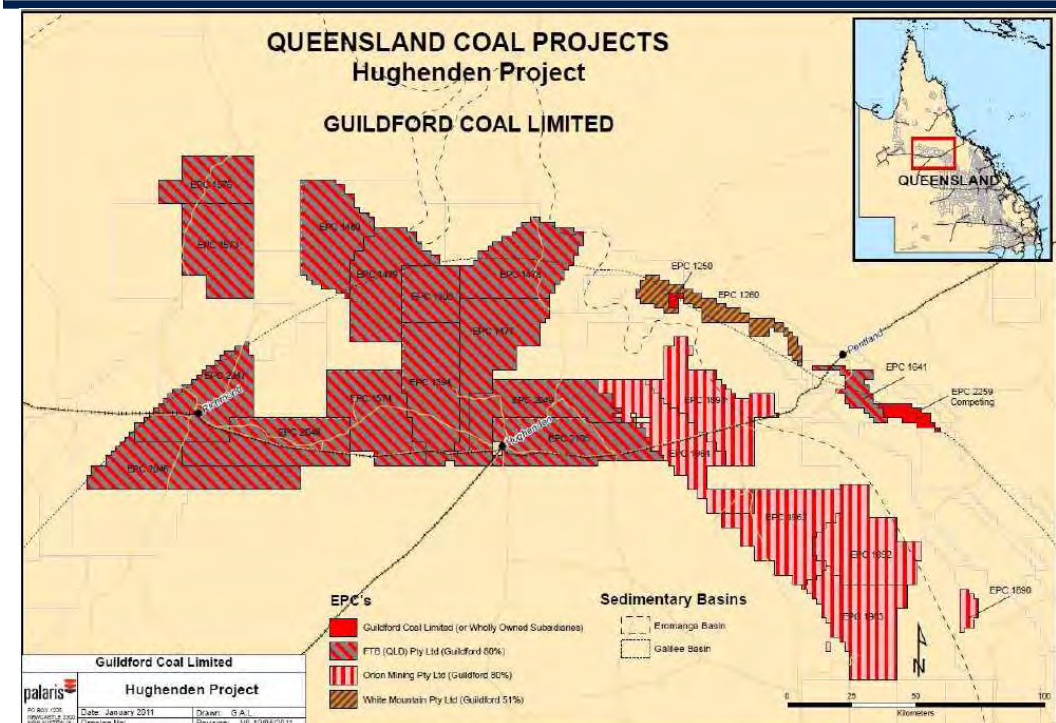
There are 4 drill rigs currently exploring the project. Drilling has identified deep coal seams in the north east corner of EPC 1477 first intersecting them at a depth of 354.3m through to 407m. The interpreted coal seams totalled 11.9m of net coal with multiple individual seams up to 5.5m in thickness. However, drilling on subsequent holes has progressed slower than initially expected due to difficult conditions in the overlying Triassic sandstones.

Drilling is planned to the north on EPC1300 and EPC1478 in lower lying areas not accessible during the wet season. Drilling to define a potential open cut resource will begin following the completion of the current pattern of holes on EPC1477.

Two drill rigs are being mobilised to EPC1260 on the White Mountain Project where there is a known sub-crop line visible from surface. This sub-crop is located where the north-eastern edge of the Galilee Basin runs through the EPC.

The quality of the coal is expected to be of export thermal coal although proximate estimates, washability and energy will not be known until the drilling program is completed in CY 2011. GUF's maiden JORC compliant inferred resource is expected at the same time. The potential size of the resource is in excess of 1bt of export quality thermal coal, which is more than enough to support the proposed stage 1 production of 10Mtpa ROM.

Figure 2: Hughenden project tenement plan



Source: GUF

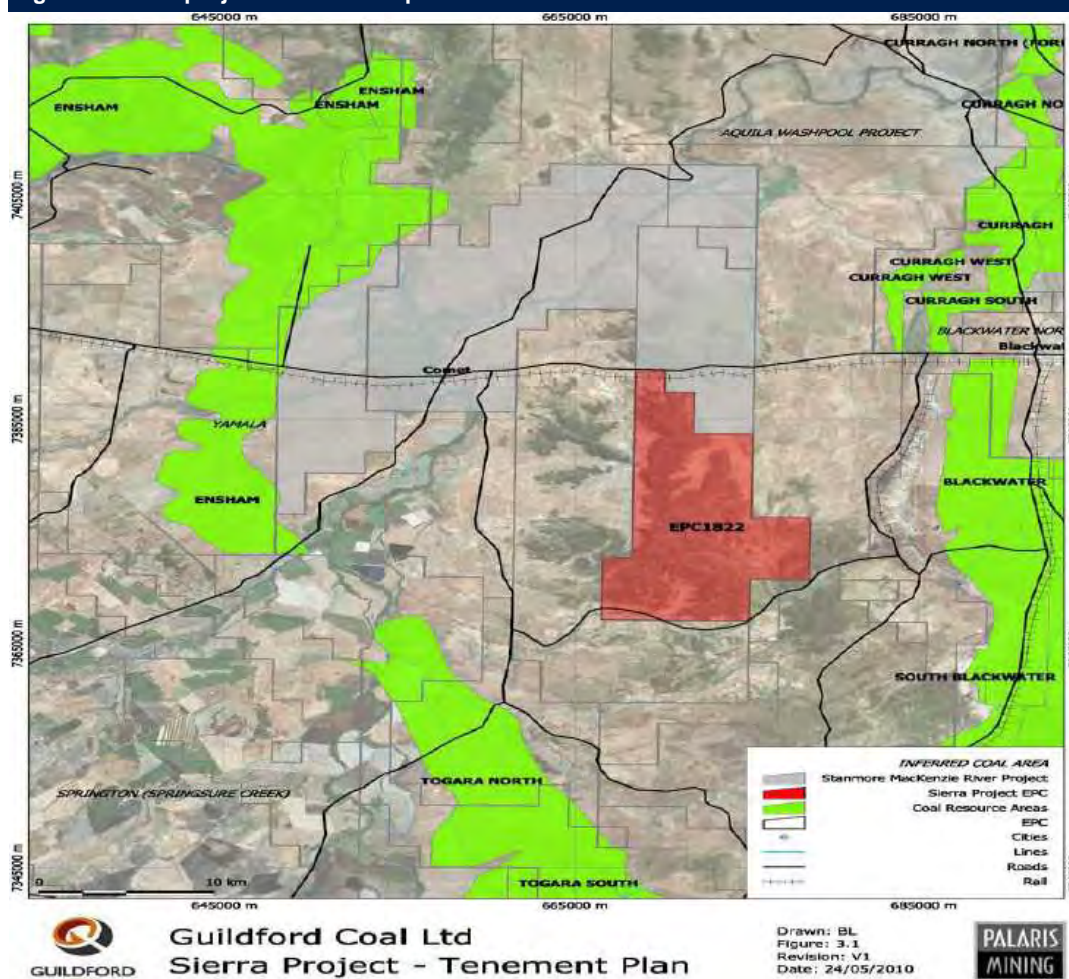
Another drill rig has been secured to specifically target an extension of the Eromanga Basin Blantyre coal sequence which is the secondary target on the project. This sequence was mined in the 1960's and the coal has shown some preliminary metallurgical coal potential.

GUF are looking to develop vital infrastructure through the Mt Isa – Townsville rail line and the Port of Townsville (POT). POT is the closest port to the Hughenden project and GUF have been a first mover in executing a Memorandum of Understanding with the POT. This will ensure GUF does not have to compete for allocation at Abbots Point. A Feasibility Study will evaluate the logistics of exporting coal through the Townsville Port and will include the design and construction of necessary export infrastructure. The feasibility study will be jointly funded by the Port of Townsville and GUF.

Sierra Project – Bowen Basin

The Sierra project is a metallurgical coal target in a proven region and the GUF tenement is in an ideal location for transport infrastructure. There have been some delays in granting the exploration license, which is expected to be completed this month and drilling will commence shortly after. The Fair Hill, Burngrove and Crocker Formations of the Bowen Basin will be targeted for an open cut resource target with an estimated 20km of strike of the Fair Hill Formation sub crop running north-south across EPC 1822. Directly to the north, the Stanmore MacKenzie River project has an inferred resource of 99Mt with an additional exploration target of 70-80Mt.

Figure 3: Sierra project tenement map



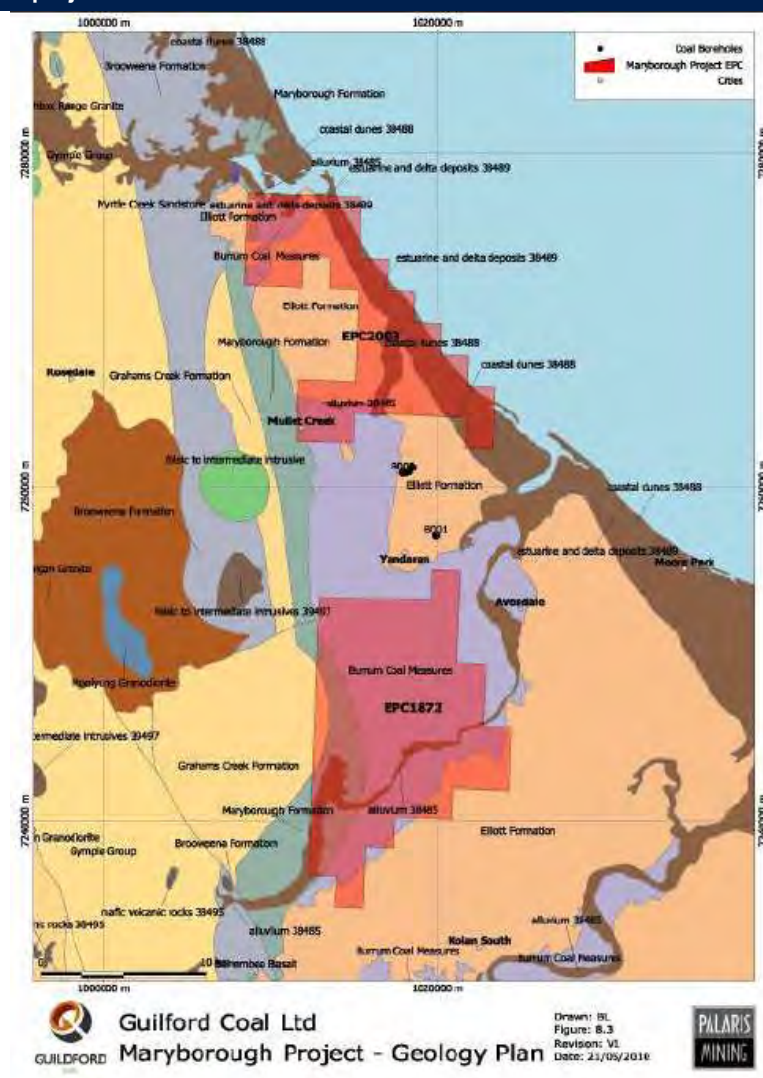
Source: GUF

Kolan Project –Maryborough Basin

Kolan is another metallurgical coal target covering 237km², located 20km North West of Bundaberg and 160km south of Gladstone. The project contains two EPC's, 1872 and 2003. Drilling has recommenced on EPC 1872 after being held up by wet weather. The drilling program is targeting the Tiaro and Burrum Coal measures. NEC is currently drilling in the Maryborough basin and it is understood that the project requires beneficiation to produce a saleable product due to the high sulphur content of the coal. The Kolan Project is a proponent for 1Mtpa of capacity in the Wiggins Island Coal Expansion Terminal Stage 2 at Gladstone.

The Kolan project is the most environmentally sensitive of GUF's priority projects with one EPC, potentially the more attractive, located on the coastline. NEC had to resubmit their Environmental Management Plan to address additional environmental issues including potential noise, rehabilitation, water management and discharge.

Figure 4: Kolan project



Source: GUF

Mongolia

GUF has gained exposure to a number of assets in Mongolia through the acquisition of a 20% stake in Terra Energy LLC (TE). TE initially held a 100% interest in 6 exploration licenses that are prospective for thermal and coking coal in the South Gobi and Middle Gobi regions. TE recently announced it had expanded its portfolio by entering into a heads of agreement for the acquisition of a Mongolian based company that holds mining licences and exploration permits across four potentially significant projects, including the Javkhant Project in the Northern Tuv Province, the Deliin Shand and the Mandal Ovoo Project in the South Gobi and the Khuut Project in the Middle Gobi.

GUF holds an option to increase its shareholding to 70% with an exercise price of \$10m. The GUF Board at the recent EGM elected to exercise this option. GUF also issued an option over 25% of TE with an exercise price of \$25m to one of GUF's substantial shareholders Och-Ziff Capital Management Group LLC (Och-Ziff). Upon exercising both these options GUF holding in TE will be 52.5%.

As with GUF Australian assets Palaris is being used as an independent contractor. Palaris comments on the South Gobi Project are *"There is no estimation of coal quantities that can be reported that comply with the JORC Code. However, Palaris is of the opinion that the Mongolian tenements have potential to contain coal amenable to open-cut mining techniques if further exploration can identify a suitable coal deposit."*

Projects

- South Gobi
- Middle Gobi

Figure 5: Location Map



Source: GUF

South Gobi Project

The South Gobi Project is located in the South Gobi Basin which is known to host premium thermal and coking coal deposits of Permian age. The Project is located approximately 50km east of two operating mines and 50km north of the Chinese boarder.

- The Nariin Sukait Mine is owned and operated by MAK-Qin Hua (a Mongolian and Chinese Joint Venture). The mine is also known as the MAK mine.
- The Ovoot Tolgoi mine, located adjacent to the south of the MAK Mine and is owned and operated by SouthGobi Energy Resources (SGS) which is listed on the Hong Kong Stock Exchange

GUF is planning on selling the coal from the South Gobi Project in the same manner as these two mines. The highly volatile bituminous coal, a mixture of both thermal and coking coal, is sold ROM (unwashed) at the mine gate to Chinese traders. Prices are currently around US\$50/t. The traders transport the coal by truck over the Chinese border, approximately 50km due south, to a coal stockpile at Ceke. It is then washed separated and transferred by rail to Chinese power stations and steel mills.

GUF is planning a very streamlined operation using a contract miner, limited capital expenditure and the ROM sales to generate a near term cash flow. GUF have been in discussions with contractors for some time and are already developing a mine concept. The concept is for a main mine site and stockpile with 3 – 4 satellite pits. The estimated mining costs are in the range of \$20-\$25/t. Initial production is estimated to be 2Mtpa however, resource size and mining economics could potentially support a 3-4Mtpa operation.

Drilling on the South Gobi project has commenced with 4 rigs currently on site to quantify coal tonnages and qualities according to the JORC Code. Over 1.5km of outcropping coal has already been mapped by the geological team and the first hole intersected approximately 8m of net coal contained in three coal seams with the deepest seam estimated at 87m. The next hole on another license intersected approximately 21m of net coal at potentially open cut mineable depths. This included a seam of 13.7m. The intersection thicknesses are to be confirmed by geophysical logging at the completion of drilling.

Figure 6: Coal outcrop



Source: GUF

Figure 7: Drilling core trays



Source: GUF

Middle Gobi Project

The Middle Gobi Project consists of two licences located in the Dundgovi Province which is approximately 200km south of Ulaanbaatar and less than 200km north of the Tavan Tolgoi Project. The two Middle Gobi Project exploration licences are located in the coal bearing Ongi Gol Basin. GUF believes there is potential for large shallow thick seam thermal coal deposits suitable for open cut mining.

Drilling has commenced with 1 drill rig on the Middle Gobi project and 3 bore holes have intersected coal seams with net thicknesses ranging from 1.8m to 9.3m adjacent to an estimated 4km of mapped coal outcrop.

Valuation

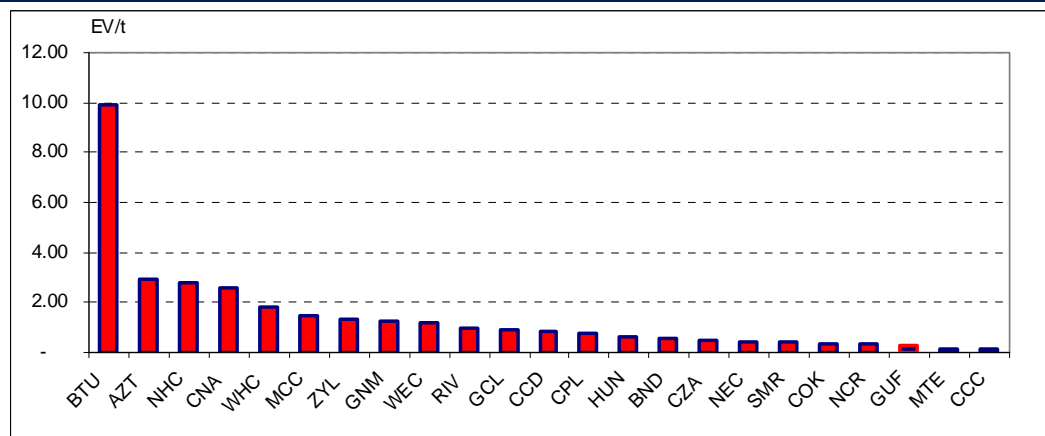
GUF is at the early stage of developing JORC compliant resources on a number of their projects however the South Gobi and Hughenden projects have been developed enough for management to give guidance on expected operating expenses and capital requirements.

We have modelled the South Gobi project to have a 20 year life of mine and provide a positive cash flow in Q1 CY2012. We expect a small amount of capital expenditure, \$10m, to establish workshop, offices and central campsite. The capital expenditure should equate to a lower contract mining rate of \$20/t. Revenue from ROM sales at the mine gate has been based on 40% of our export thermal coal assumption which currently equates to \$45/t. GUF's 52.5% of the DCF NPV equals \$189m or \$0.46/sh.

Conceptual studies of the Hughenden project deduced stage 1 ROM production of 10Mtpa is achievable and the coal could be delivered FOB Townsville at a cost of \$65/t. The project is expected to have minimal capital expenditure - we have modelled \$40m for a washplant, rail siding, and other plant to bring the project on line. We are not including the capital requirement to develop the proposed port and rail infrastructure as we are assuming it is NPV neutral at this stage. The quality of the coal is yet to be established therefore we have used the same assumptions as our valuation of Bandanna's South Galilee project - a 5% price discount to future export thermal coal prices and a yield of 85%. GUF's 80% of the DCF NPV equals \$659m or \$1.59/sh.

There is considerable exploration upside in GUF's current portfolio of assets. In excess of the 50Mt to support the South Gobi project assumption and 250Mt to support the Hughenden assumptions we estimate the definition of 600Mt of inferred resource is achievable. These potential resources have been valued at \$0.20/t which is in the middle of the bottom quartile of the valuation of resources on the ASX. This provides \$120m or \$0.29/share to our valuation.

Figure 8: Enterprise value per ton of total resource



Source: PSL Estimates

Corporate Overview

Market Capitalisation

GUF currently has 413.5m shares on issue listed on the Australian Stock Exchange (ASX) with a market cap of \$442.5m. There are no options issued and 200m of the shares issued are held in escrow until 22 July 2012. The company is in a very strong financial position with \$35M in the bank and it is utilising those on an intensive drilling program in both Mongolia and Australia.

Major Shareholders

Figure 9: Major shareholders

Significant Shareholders	Shares (m)	%
The Chairman 1 Pty Ltd	200.0	48.4
Och-Ziff Capital Management	52.1	12.6
UBS AG	34.9	8.4
Credit Suisse AG	25.3	6.1

Source: Bloomberg

Management Fee

The company has a management agreement with The Chairman 1, the major shareholder and original owner of the assets in the Galilee, Maryborough and Bowen Basins. The Chairman 1 will receive \$2.5m pa for 5 years to manage Guildford. A success fee of \$20m will be paid to The Chairman 1 up to a maximum of \$100m and for every 100Mt of JORC compliant indicated resources defined on the original Queensland assets. The success fee may be satisfied by a cash payment, the issue of fully paid ordinary shares in GUF or a combination of cash and shares. In terms of impact on the current valuation the maximum success fee paid in cash at the end of the 5 years reduces the price target by \$0.10/share.

Board of Directors

Craig Ransley Non-Executive Chairman

Mr Ransley has extensive experience in the mining labour hire and services industries. He founded TESA Group Pty Limited and ResCo Services. The later was involved in acquiring and integrating 8 companies over an eighteen month period. The culmination was the only true Pit to Port privately owned mining services provider.

Mr Ransley commenced the development Australia's first training mine and successfully built the management team and complete the back door listing of NuCoal Resources. Mr Ransley is currently the non-executive Chair of Guildford, the Chairman of The Chairman 1 and Non-Executive Chairman of Humanis Group Ltd.

Tony Bellas Non-Executive Deputy Chairman

Mr Bellas is an experienced company director who currently serves as Chairman of CTM Travel Limited, Non-Executive Director of ERM Power Limited, Watpac Limited and Australian Water (Qld) Pty Ltd. Mr Bellas has held the position of Chief Executive of the Seymour Group, CS Energy and Ergon Energy after a long career with Queensland Treasury, reaching the position of Deputy Under Treasurer.

Michael Avery Managing Director

Mr Avery has worked in the coal industry for over 25 years. He has performed senior management and technical roles for a number of blue-chip mining companies at operations throughout Australia and around the world. Michael's experience spans the full life cycle of coal assets from resource exploration and evaluation to conceptual design, pre-feasibility, feasibility, construction and operation

Mr Avery has a Masters in Business Administration from Mt Eliza Business School, a NSW Open Cut Coal Mine Managers Certificate of Competency, and a Bachelor of Mining Engineering from the University of New South Wales with First Class Honours. Michael is also a member of the Australian Institute of Mining and Metallurgy

Mike Chester Non-Executive Director

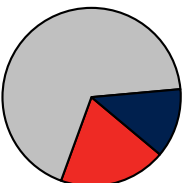
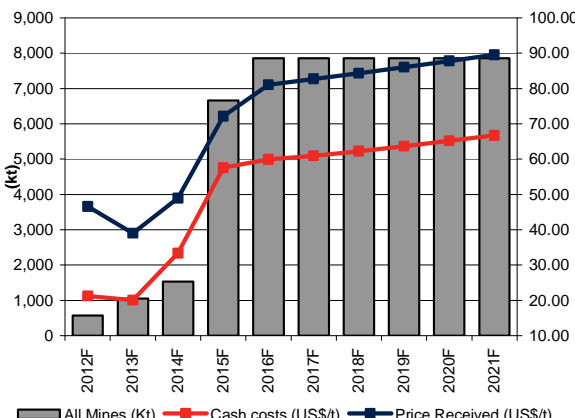
Mr Chester has more than 25 years experience in the areas of investment banking, mining company research and analysis, and funds management. He currently holds non-executive directorships in NuCoal Resources NL, Carpentaria Exploration Limited and Black Fire Minerals Limited.

Hon. Alan Griffiths Non-Executive Director

The Hon. Alan Griffiths established and was the principal of the highly awarded Quantum Ltd in 2001, now the global category leader in optimised road and rail corridor and route alignment selection for road and rail. He has achieved business success as an IT entrepreneur, hotelier, developer and investor. He served five terms in the Australian House of Representatives and held various Ministerial and Cabinet positions in the Australian Government (including as Minister responsible for the resources and energy sector).

Norah St. George Chief Financial Officer and Company Secretary

Norah has held a series of senior financial and commercial positions in industry, professional firms and during fourteen years tenure in the Australian Black Coal industry with Peabody Resources, BHPB, BMA, Thiess and Peabody Australia. She is a Qualified CPA and Longstanding CPA member.

Guildford Coal Limited			1.18							
Valuation			A\$m	A\$/sh	Commodity Assumptions					
South Gobi	188.8	0.46			US\$/A\$	2012F	2013F	2014F	2015F	2016F
Hughenden	658.6	1.59			Hard Coking Coal	303	211	176	155	173
Resources	120.0	0.29			Semi-soft Coking Coal	228	153	123	102	111
					PCI	233	158	128	108	117
					Export Thermal Coal	123	98	88	83	92
					Domestic Thermal Coal (A\$/t)	49	50	51	53	57
FX Hedging	0.0	0.00			Production Summary					
Corporate	(84.0)	(0.20)			Attributable Saleable Coal Production	2012F	2013F	2014F	2015F	2016F
Unpaid Capital	0.0	0.00			South Gobi (kt)	569	1,050	1,050	1,050	1,050
Cash	34.7	0.08			FOB costs (US\$/t)	21.27	20.07	19.10	18.79	18.91
Debt	0.0	0.00			Price Received (US\$/t)	46.57	39.01	34.99	33.14	36.99
NPV	918.2	2.22								
Price Target		2.25								
Valuation Summary of Operating Assets										
										
					Hughenden (kt)			476	5,610	6,800
					FOB costs (US\$/t)			64.71	64.79	66.21
					Price Received (US\$/t)			79.57	79.37	87.85
Coal Production Summary										
										
					All Mines (Kt)	569	1,050	1,526	6,660	7,850
					Cash costs (US\$/t)	21.27	20.07	33.32	57.54	59.88
					Price Received (US\$/t)	46.57	39.01	48.90	72.08	81.04
Resources 100% Basis (Mt)					Profit & Loss (A\$m)					
Mine	Target				2012F	2013F	2014F	2015F	2016F	
	Min	Max			Sales Revenue	23.9	42.0	80.2	524.7	701.0
South Gobi	0	460			Other Income	2.0	3.5	3.1	2.5	4.0
Middle Gobi	30	150			Operating Costs	10.9	21.6	54.7	418.8	518.0
Hughenden	40	1,000			Exploration Exp.	0.0	0.0	2.3	4.7	4.8
Kolan	0	75			Corporate/Admin	6.4	6.5	46.7	46.8	26.9
Sierra	0	75			EBITDA	8.6	17.4	(20.4)	56.8	155.3
					Depn & Amort	0.5	1.1	1.8	9.3	11.1
					EBIT	8.1	16.3	(22.1)	47.5	144.2
					Interest	0.2	0.5	2.1	2.0	(1.3)
					Operating Profit	7.9	15.8	(24.3)	45.5	145.5
					Tax expense	0.0	3.6	(4.2)	16.6	43.6
					Abnormals + Minorities	0.0	0.0	0.0	0.0	0.0
	Potential Resources	70	1,760		NPAT	7.9	12.2	(20.1)	29.0	101.8
Directors										
Name	Position				Normalised NPAT	5.5	11.1	(24.3)	31.9	101.8
Craig Ransley	Non Executive Chairman				Cash Flow (A\$m)					
Tony Bellas	Non Executive Deputy Chairman				2012F	2013F	2014F	2015F	2016F	
Michael Avery	MD and Joint Company Secretary				Adjusted Net Profit	7.9	12.2	(20.1)	29.0	101.8
Mike Chester	Non-Executive Director				+ Interest/Tax/Expl Exp	0.2	4.1	0.3	23.2	47.2
Hon. Alan Griffiths	Non-Executive Director				- Interest/Tax/Expl Inc	6.2	10.2	4.2	24.9	48.9
Mark Turner	Chief Operating Officer				+ Depn/Amort	0.5	1.1	1.8	9.3	11.1
Norah St. George	CFO and Joint Company Secretary				+/- Other (Associates)	0.0	0.0	0.0	0.0	0.0
					Operating Cashflow	2.4	7.2	(22.3)	36.6	111.2
					- Capex (+asset sales)	5.3	12.4	21.2	0.9	0.9
					- Working Capital Increase	0.0	0.0	0.0	0.0	0.0
					Free Cashflow	(2.9)	(5.2)	(43.5)	35.7	110.3
					- Dividends (ords & pref)	0.0	0.0	0.0	0.0	0.0
					+ Equity raised	0.0	0.0	0.0	0.0	0.0
					+ Debt drawdown (repaid)	20.3	12.4	21.2	(11.7)	(65.6)
					Net Change in Cash	32.4	7.2	(22.3)	24.0	44.8
					Cash at End Period	67.1	74.3	52.0	76.0	120.8
					Net Cash/(Debt)	61.9	56.7	13.2	48.9	159.2
Significant Shareholders					Balance Sheet (A\$m)					
The Chairman 1 Pty Ltd	Shares (m)	%			2012F	2013F	2014F	2015F	2016F	
Och-Ziff Capital Management	52.1	12.6			Cash	67.1	74.3	52.0	76.0	120.8
UBS AG	30.6	7.4			Total Assets	132.7	160.4	177.2	344.0	452.0
Credit Suisse AG	25.3	6.1			Total Debt	5.3	17.6	38.8	27.1	-38.4
					Total Liabilities	16.3	31.7	68.6	206.4	212.6
					Shareholders Funds	116.4	128.7	108.6	137.6	239.4
Ratios										
					Net Debt/Equity (%)	na	na	na	na	na
					Interest Cover (x)	52.0	33.2	na	24.1	-114.9
					Return on Equity (%)	6.8%	9.5%	na	21.1%	42.5%

Recommendation History



Date	Type	Target Price	Share Price	Recommendation	Return
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Stock recommendations: Investment ratings are a function of Patersons expectation of total return (forecast price appreciation plus dividend yield) within the next 12 months. The investment ratings are Buy (expected total return of 10% or more), Hold (-10% to +10% total return) and Sell (> 10% negative total return). In addition we have a Speculative Buy rating covering higher risk stocks that may not be of investment grade due to low market capitalisation, high debt levels, or significant risks in the business model. Investment ratings are determined at the time of initiation of coverage, or a change in target price. At other times the expected total return may fall outside of these ranges because of price movements and/or volatility. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. This Document is not to be passed on to any third party without our prior written consent.



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