

Equity Research

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CUDA **\$26.75**

12 month target \$35.00

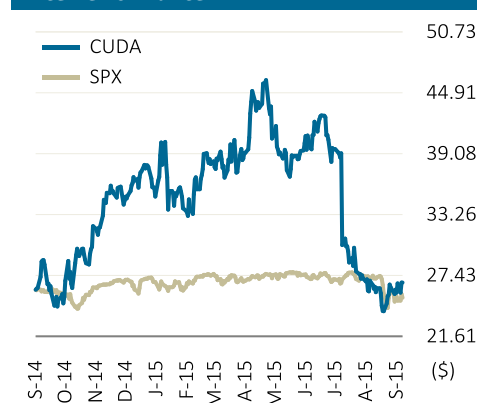
Upside 30.8%

BUY

52 week range \$24.01 - \$46.12

Market Cap (m) \$1,472

Price Performance



Source: IDC. As of September 9, 2015.

Estimates

	1Q15 A	2Q15 A	3Q15 A	4Q15 A	FY15 A	1Q16 A	2Q16 E	3Q16 E	4Q16 E	FY16 E	FY17 E
Sales	66	69	70	72	277	78	79	82	85	324	379
Diluted EPS (Adj.)	0.07	0.08	0.06	0.07	0.28	0.09	0.09	0.08	0.10	0.36	0.50
FCF	4	13	9	16	42	4	15	18	22	59	67
EV/Sales (x)	-	-	-	-	4.60	-	-	-	-	3.94	3.37
P/FCF (x)	-	-	-	-	34.41	-	-	-	-	25.52	23.46

Source: BTIG Research Estimates and Company Documents (\$ in millions, except per share amount)

Adjusted EPS excludes stock-based comp and amortization and acquisition related costs.

Software and Cloud Technology

Barracuda Networks, Inc.

Well-Positioned Mid-Market Vendor at Attractive Entry Point – Initiate at Buy Rating with \$35 PT

We believe Barracuda has hit a sweet-spot in the underserved middle-market. The company's security and storage solutions solve traditionally complicated IT challenges with an easy to install, manage and use product from a single vendor.

A large addressable market and cost-effective go-to-market model should continue to support healthy mid-teens growth over the next several years.

We like the profitable growth model and the mix of subscription. The Total Threat Protection and Data Protection Plus initiatives are starting to resonate with customers, in our opinion, and could lead to re-accelerated billings.

Customer lifetime value plus new customer adds are propelling comfortable double digit growth. We estimate that the average customer buys roughly 3x their original purchase over the course of six years, a number which we wouldn't be surprised to skew higher if the company maintains its product release cadence

Expectations have come down meaningfully (although management left guidance unchanged) and the risk/reward looks favorable post disappointing May quarter results. We initiate with a Buy rating and a \$35 price target.

- **Risks.** The security and storage spaces are highly competitive and the company faces competition from well established players. Secondly, as the threat environment intensifies, investors have pushed up valuations for security companies, including Barracuda.
- **Valuation:** Our DCF analysis yields a \$35 price target, and assumes a 10-year revenue CAGR of 14%, FCF CAGR of 14% and 18x terminal FCF multiple. This implies a terminal EV/EBITDA multiple of ~16x.

Company Description

Barracuda designs and delivers cloud-connected solutions that help users address security threats, improve network performance and protect and store their data with a focus on three distinct markets: 1) content security, 2) networking and application delivery and 3) data storage, protection and disaster recovery.

Investment Thesis

We believe Barracuda has hit a sweet-spot in an underserved market. The company's security and storage solutions solve traditionally complicated IT challenges with an easy to install, manage and use product from a single vendor. Barracuda has best-of-breed products for the mid-market, bringing enterprise functionality at attractive price points to customers that have limited ability to manage and operate large scale IT operations.

We also think that a large addressable market and cost effective go-to-market model should continue to support healthy mid-teens growth over the next several years. We like the model, as it balances growth and profitability as well as benefits of a growing mix of subscription revenues, and see FCF growth of 25%+ over the next couple of years.

We believe that the Total Threat Protection and Data Protection Plus initiatives are starting to resonate with customers and could lead to re-accelerated billings. Valuation looks attractive post May Quarter 2015 results. We believe that expectations have come down meaningfully and that the risk/reward is favorable. We initiate with a Buy rating and a \$35 price target.

Barracuda Offers Strong Products in Three Key Markets...

Barracuda targets the mid-market with solutions with enterprise-type functionality designed to solve mainstream IT problems efficiently and cost effectively with high levels of customer support. Barracuda has products in three main areas—1) content security, 2) networking and application delivery, 3) and data company offers a flexible range of deployment options including physical appliances, virtual appliances and cloud-based solutions.

These products leverage continuous cloud connectivity to ensure protection against security threats, improve network performance, and store and protect data. Further, this model provides continuous software updates, offsite redundancy, easier management and support, and distributed capacity.

Figure 1: Product and Market Categories

Barracuda Networks Products	2014	'12-17 CAGR	
Security			
	TAM	Growth Rate	Competitors
Barracuda Web Security	\$2,386	7.9%	Cisco, Blue Coat, Websense, Zscaler, McAfee, Symantec, Trend Micro, Sophos, Phantom Tech, EdgeWave, Optenet
Barracuda Spam & Virus FW	1,757	1.9%	Cisco, Symantec, Proofpoint, Microsoft, Google, McAfee, Trend Micro, Sophos, Websense
Barracuda SSL VPN	522	-7.7%	
Barracuda Web app FW	NA		Imperva, F5, Qualys
Barracuda Firewall	7,431	9.9%	CheckPoint, Palo Alto, Stonesoft, Fortinet, Cisco,
Barracuda NGFW	NA		Juniper, McAfee, Dell SonicWall, HP, Huawei, Sophos
TOTAL	\$12,096		
Application Delivery			
	TAM	Growth Rate	
Barracuda Load Balancer ADC	\$3,501	7.1%	F5, Citrix, Radware, Riverbed, Strangeloop, A10 Networks,
Barracuda Link Balancer			Brocade, Array, Cisco, Sangfor
Storage			
	TAM	Growth Rate	
Barracuda Backup	\$5,079	8.3%	CommVault, Symantec, EMC, IBM, NetApp, Veeam, HP, CA, Dell, Asigra, Evault, Acronis, Syncsort, FalonStor
Barracuda Message Archiver	2,128	14.9%	Symantec, Proofpoint, IBM, Global Relay, Sonian, Bloomberg, Smarsh, EMC, CommVault, HP
Copy SignNow	3,365	6.9%	
TOTAL	\$10,572		

Source: BTIG Research, Gartner.

The company's core product is in security, and the company has built a loyal installed base of over 200,000 customers. Security products include firewall, email security, web filtering, and malware detection. This market has matured and is now at single digit growth, but Barracuda's storage and networking products are driving impressive double digit growth.

CEO BJ Jenkins, who joined in 2012, is a former 10+ year veteran of EMC and knows the storage business well. Storage products include backup and offsite replication, email archiving, cloud-based file storage, and eSignature. Networking products include SSL VPN and load balancing (application delivery controller, or ADC) appliances.

...To the Mid-Market, Which is Underserved

We believe that there are roughly 2.5 million companies worldwide with fewer than 5,000 employees, the majority of those employing less than a hundred people. Historically, it's been challenging for enterprise-focused IT vendors to reach smaller firms because direct sales to them are not cost effective. Furthermore, while channel distribution can help, smaller firms are more sensitive to product pricing and have limited staff and expertise to install and manage complicated enterprise class IT products. Barracuda has focused its product offering around attractive price points and designed them to be easy and less costly to manage.

The company has an effective go-to-market strategy based on a high velocity sales team and channel and distribution partners.

We Like the Balance Between Profitability and Growth

Barracuda has built a large and loyal customer base of more than 252 thousand subscribers. This, in combination with a significant degree of recurring subscription revenue (~70% of revenue, with appliances sales making up the balance), provides a strong revenue base with good top line visibility.

A key driver thus far and going forward is Barracuda's ability to cross-sell into its customer base. Many Barracuda customers that bought the company's security solutions for its attractive price point, ease of use, and strong feature set will likely find a similar value proposition in the company's storage products. This strategy is paying off, as the company has more than 35,000 multi-product customers.

As the product portfolio continues to grow, we expect increasing customer lifetime value plus new customer adds to propel comfortable double digit growth. We estimate that the average customer buys roughly 3x their original purchase over the course of six years, a number which we wouldn't be surprised to skew higher if the company maintains its product release cadence. With more than 12 distinct product categories, through better sales/marketing leadership, and execution, we could see the 3x figure accelerate significantly.

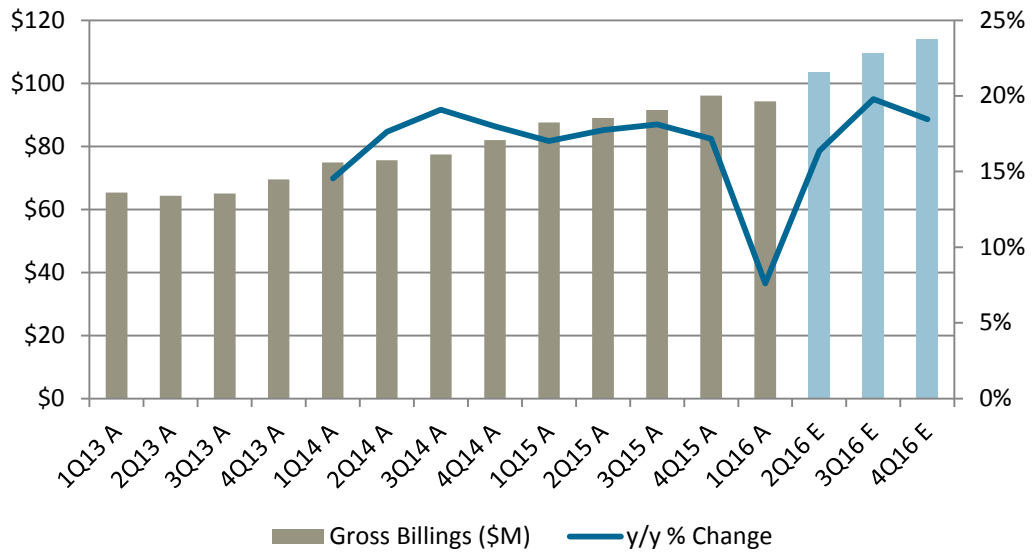
Our model calls for gross margins of 80%, operating income margins of 17%-23%, EBITDA margins of 38%-43%, and FCF margins of 28%-31%. The company has been showing modest but steady leverage since its IPO in Nov '13, with operating margins of 8% in F2015, up from 3% in F2014. FCF margins were 15% in F2015. We expect to see operating margins of 9% and 11% in F16 and F17.

We like the combination of growth and profitability, supported by a strong revenue base with growing recurring subscription revenue. This leads to high visibility and better margins, as well as strong cash flow.

May Quarter 2015 Saw Weak Billings, but We're Seeing Reacceleration

Barracuda posted weak billings growth for its May-Q (see Figure 2), from 20%+ the quarter before to 12% constant currency (7% reported). In addition to a stronger than expected currency headwind, the company noted weakness related to the transition to more virtual appliances as well as lower storage sales, specifically as the company didn't close as many large deals as expected. Consequently, storage billings growth, which was 30%+ in F15, was in the low double digits in the May quarter.

Figure 2: Billings Deceleration



Source: BTIG Research, Company Filings.

While the company noted increased activity in June and reported strong metrics in terms of renewal rates and subscriber growth, billings deceleration does give us some pause. However, our checks thus far suggest good momentum at Barracuda. For example, we believe that Total Threat Protection and Data Protection Plus initiatives are starting to resonate with customers, and could help contribute to the acceleration of billings.

Furthermore, Barracuda now offers all of its security products as virtual appliance live on AWS. Our recent industry checks suggest that AWS is growing in popularity as a deployment option, with strength in web application firewall, email security, and next generation firewall. Additionally, we believe deployments through Microsoft Azure are growing nicely off a small base with a strong and growing pipeline. We note that these deals tend to be bigger in size, as Microsoft (MSFT, Not Rated) is bringing Barracuda into larger accounts.

While we are comfortable that the pace of business is strong, we do note that there is possibility for a drag to revenue as cloud and virtual appliances ramp. Overall revenue is lower for virtual instances versus the company's traditional appliance form factor, although margins are much higher so it's not impactful to the bottom line.

Valuation — Volatile at Times, Even Though Fundamentals Have Been Consistent

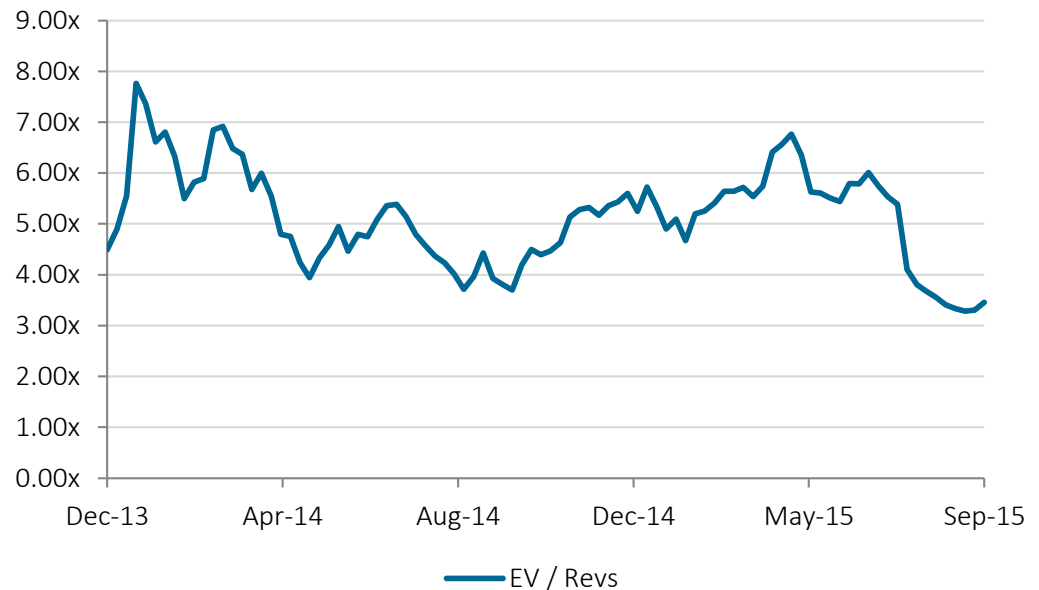
From October 2014 through the first half of 2015, shares of Barracuda outperformed the market meaningfully as a result of rising sentiment in security or security related stocks. An almost daily cadence of headline breaking cyber security breaches has fuelled investor excitement and continues to do so. We believe Barracuda’s multiple benefitted from this surge in sentiment.

While we like Barracuda’s product positioning at attractive price points addressing a large underserved market, we don’t believe Barracuda should be categorized as a cyber security stock because we don’t see the company benefitting from a major uplift in enterprise and government security spending.

Rather, we believe Barracuda is more closely tied to mid-market trends, where customers are deploying security and storage products from Barracuda as a way to upgrade functionality cost effectively. We still categorize this as a secular growth trend, since many of Barracuda’s customers are benefiting from feature/functionality at price points that have not historically been available.

We believe Barracuda is a sustainable mid-teens grower, an assumption which we believe should underpin the stock’s valuation.

Figure 3: CUDA’s Historical Valuation, EV/Revenues



Source: BTIG Research, FactSet.
 Note: Market data as of September 9, 2014.

The stock was re-rated following the May quarter billings shortfall, selling off 30%. Compounding this downdraft has been the late summer market correction, which has left shares at levels not seen since before the rally began

a year ago. The stock's revenue multiple is now at much more reasonable ~3.5x versus the 6-7x seen earlier in the year.

Valuation looks attractive post 2Q15 results, in our view. We believe that expectations have come down meaningfully and that the risk/reward is favourable. Our DCF analysis yields a \$35 price target, and assumes a 10-year revenue CAGR of 14%, FCF CAGR of 14% and 18x terminal cash flow multiple. This implies a terminal EV/EBITDA multiple of ~16x.

Figure 4: Estimate Summary

Barracua BTIG Est. Summary (\$ in millions, except per share)	Feb-16 FY16 E	Feb-17 FY17 E	Feb-18 FY18 E
Revenue	\$324	\$379	\$438
Billings	384	447	514
Operating income	29	43	56
EPS	0.36	0.50	0.62
FCF	59	67	87
Capex	15	17	20
<u>Year over year growth</u>			
Revenue	16.7%	17.1%	15.6%
Billings	14.1%	16.3%	15.0%
Operating income	33.5%	46.1%	30.5%
EPS	28.6%	37.4%	24.7%
FCF	41.5%	14.6%	29.0%
Valuation Summary			
EV/Revenues	3.9x	3.4x	2.9x
P/E	73.8x	53.7x	43.1x
P/E ex cash	64.0x	46.6x	37.4x
EV/FCF	21.7x	18.9x	14.7x

Source: BTIG Research, FactSet.

Note: Market data as of September 9, 2015.

Barracuda Networks Income Statement

Barracuda Networks Income Statement <i>(\$ in millions, except per share)</i>	FY12 A	FY13 A	FY14 A	May-14 1Q15 A	Aug-14 2Q15 A	Nov-14 3Q15 A	Feb-15 4Q15 A	FY15 A	May-15 1Q16 A	Aug-15 2Q16 E	Nov-15 3Q16 E	Feb-16 4Q16 E	FY16 E	FY17 E
Non-GAAP Income Statement														
Appliance	\$43.3	\$59.5	\$71.9	\$20.8	\$20.7	\$20.7	\$20.9	\$83.1	\$23.7	\$23.0	\$23.5	\$24.3	\$94.4	\$108.9
Subscription	117.7	139.4	161.9	45.4	48.0	49.7	51.2	194.3	54.3	56.1	58.2	60.7	229.3	270.0
Total Net Revenues	160.9	198.9	233.8	66.2	68.7	70.4	72.2	277.4	78.0	79.1	81.7	85.0	323.7	378.9
Non-GAAP Cost of Revenues	29.8	39.6	47.3	13.0	12.5	13.0	14.3	52.8	14.3	15.4	15.5	15.7	61.0	70.1
Non-GAAP Gross Profit	131.1	159.3	186.5	53.2	56.1	57.4	57.9	224.6	63.7	63.7	66.1	69.3	262.7	308.9
Non-GAAP Operating Expenses														
Sales & Marketing	82.3	98.1	110.1	28.6	29.7	32.0	30.0	120.3	32.7	33.6	35.4	34.9	136.6	154.3
R&D	26.8	31.2	43.0	11.7	12.4	13.6	14.5	52.2	14.9	14.2	15.1	16.6	60.8	70.3
General & Administrative	13.2	15.5	22.4	6.6	6.2	5.9	6.5	25.1	7.1	7.5	7.3	7.9	29.8	34.1
Depreciation	1.8	2.9	4.0	1.1	1.2	1.3	1.5	5.2	1.6	1.4	1.6	1.8	6.3	7.4
Total Non-GAAP Operating Expenses	124.1	147.7	179.4	47.9	49.5	52.8	52.5	202.8	56.3	56.8	59.4	61.1	233.5	266.2
Non-GAAP Operating Income	7.0	11.6	7.0	5.3	6.6	4.6	5.4	21.9	7.4	6.9	6.8	8.2	29.2	42.7
<i>(*) Depreciation</i>	1.8	2.9	4.0	1.1	1.2	1.3	1.5	5.2	1.6	1.4	1.6	1.8	6.3	7.4
Non-GAAP EBITDA	8.8	14.5	11.0	6.4	7.8	6.0	6.9	27.1	9.0	8.3	8.3	9.9	35.5	50.1
Other income	0.1	(0.3)	(0.6)	(0.1)	(0.1)	(0.1)	(0.0)	(0.3)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.6)
Non-GAAP Earnings Bef. Taxes	7.1	11.3	6.5	5.1	6.5	4.6	5.3	21.5	7.3	6.9	6.7	8.1	29.1	42.1
Provision for Income Taxes	4.6	2.5	1.4	1.5	2.0	1.4	1.6	6.5	2.2	2.1	2.0	2.4	8.7	12.6
Non-GAAP Tax Rate	64.1%	22.6%	21.6%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Non-GAAP Net Income ⁽¹⁾	\$2.6	\$8.7	\$5.1	\$3.6	\$4.6	\$3.2	\$3.7	\$15.1	\$5.1	\$4.8	\$4.7	\$5.7	\$20.3	\$29.4
Non-GAAP EPS	\$0.19	\$0.10	\$0.10	\$0.07	\$0.08	\$0.06	\$0.07	\$0.28	\$0.09	\$0.09	\$0.08	\$0.10	\$0.36	\$0.50
Avg. Diluted Shares Outstanding		45.8	49.0	53.6	53.7	54.0	52.6	53.5	55.0	55.8	56.5	57.3	56.2	59.2

(1) Non-GAAP excludes: amortization, restructuring, impairments, settlements, and stock-based comp.

Income Statement Ratios														
Adjusted EBITDA (company definition)														
EBITDA	\$8.8	\$14.5	\$11.0	\$6.4	\$7.8	\$6.0	\$6.9	\$27.1	\$9.0	\$8.3	\$8.3	\$9.9	\$35.5	\$50.1
Plus: change in deferred revs	56.5	44.0	51.9	15.3	15.2	14.6	14.9	60.0	8.1	15.4	18.3	18.8	60.7	68.0
Less: change in deferred COGS	(10.9)	(10.2)	(10.8)	(2.3)	(2.1)	(1.7)	(2.1)	(8.2)	(1.3)	(0.8)	(2.0)	(2.5)	(6.7)	(11.4)
Non-Controlling Income/(Expense)	(0.9)	(0.8)	(0.8)	-	-	-	-	-	-	-	-	-	-	-
Adjusted EBITDA	\$55.2	\$49.1	\$52.9	\$19.4	\$20.9	\$18.9	\$19.6	\$78.9	\$15.8	\$22.9	\$24.7	\$26.2	\$89.6	\$106.7
Adjusted EBITDA margin (off revs)	34.3%	24.7%	22.6%	29.3%	30.4%	26.9%	27.2%	28.4%	20.3%	28.9%	30.2%	30.9%	27.7%	28.2%
Revenue Analysis:														
Appliance	26.9%	29.9%	30.8%	31.5%	30.1%	29.4%	29.0%	30.0%	30.4%	29.0%	28.8%	28.6%	29.2%	28.7%
Subscription	73.1%	70.1%	69.2%	68.5%	69.9%	70.6%	71.0%	70.0%	69.6%	71.0%	71.2%	71.4%	70.8%	71.3%
Expense Analysis:														
Cost of Revenues	18.5%	19.9%	20.2%	19.6%	18.3%	18.4%	19.8%	19.0%	18.4%	19.5%	19.0%	18.5%	18.8%	18.5%
R&D	16.6%	15.7%	18.4%	17.6%	18.0%	19.3%	20.1%	18.8%	19.1%	18.0%	18.5%	19.5%	18.8%	18.6%
Sales & Marketing	51.1%	49.3%	47.1%	43.1%	43.3%	45.4%	41.6%	43.4%	41.9%	42.5%	43.4%	41.0%	42.2%	40.7%
General & Administrative	8.2%	7.8%	9.6%	10.0%	9.0%	8.4%	9.0%	9.1%	9.1%	9.5%	8.9%	9.3%	9.2%	9.0%
Depreciation	1.1%	1.4%	1.7%	1.7%	1.8%	1.9%	2.1%	1.9%	2.0%	1.8%	1.9%	2.1%	2.0%	2.0%
Margin Analysis:														
Gross Margin	81.5%	80.1%	79.8%	80.4%	81.7%	81.6%	80.2%	81.0%	81.6%	80.5%	81.0%	81.5%	81.2%	81.5%
Operating Margin	4.4%	5.8%	3.0%	7.9%	9.6%	6.6%	7.4%	7.9%	9.5%	8.7%	8.3%	9.6%	9.0%	11.3%
EBITDA Margin	5.5%	7.3%	4.7%	9.6%	11.4%	8.5%	9.5%	9.8%	11.5%	10.5%	10.2%	11.7%	11.0%	13.2%
Tax Rate	64.1%	22.6%	21.6%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
Net Margin	1.6%	4.4%	2.2%	5.4%	6.6%	4.5%	5.2%	5.4%	6.6%	6.1%	5.8%	6.7%	6.3%	7.8%
Q/Q Growth Rates:														
Appliance				13.7%	(0.8%)	0.1%	1.2%		13.1%	(3.1%)	2.3%	3.4%		
Subscription				8.0%	5.7%	3.6%	3.1%		6.0%	3.4%	3.6%	4.4%		
Total Revenue				9.7%	3.7%	2.6%	2.5%		8.0%	1.4%	3.2%	4.1%		
Gross Profit				9.9%	5.5%	2.4%	.8%		10.0%	.0%	3.9%	4.8%		
Non-GAAP Operating Income				60.0%	25.9%	(29.8%)	15.2%		37.7%	(6.5%)	(2.0%)	20.9%		
Net Income				19.9%	26.3%	(29.9%)	16.6%		38.0%	(6.5%)	(2.0%)	21.0%		
Y/Y Growth Rates:														
Appliance	(17.6%)	37.6%	20.8%	19.0%	15.5%	13.9%	14.2%	15.6%	13.7%	11.0%	13.5%	16.0%	13.5%	15.4%
Subscription	31.2%	18.5%	16.1%	17.0%	20.3%	20.6%	22.0%	20.0%	19.7%	17.0%	17.0%	18.5%	18.0%	17.7%
Total Revenue	13.2%	23.6%	17.5%	17.6%	18.8%	18.6%	19.6%	18.7%	17.8%	15.2%	16.0%	17.8%	16.7%	17.1%
Gross Profit	13.5%	21.5%	17.1%	19.0%	21.7%	21.6%	19.5%	20.5%	19.7%	13.5%	15.1%	19.7%	17.0%	17.6%
R&D	16.8%	16.4%	37.9%	17.3%	18.1%	19.7%	29.8%	21.4%	27.5%	14.9%	11.1%	14.4%	16.6%	15.7%
Sales & Marketing	21.9%	19.2%	12.2%	2.0%	8.1%	15.3%	11.8%	9.3%	14.5%	13.0%	10.9%	16.0%	13.6%	13.0%
General & Administrative	7.9%	17.8%	43.8%	32.5%	6.0%	6.8%	7.0%	12.4%	7.4%	22.1%	23.5%	22.0%	18.6%	14.5%
Total Non-GAAP Operating Expenses	19.0%	19.0%	21.5%	9.6%	10.8%	15.0%	16.4%	13.0%	17.4%	14.7%	12.5%	16.3%	15.2%	14.0%
Non-GAAP Operating Income	(37.4%)	65.8%	(39.4%)	436.8%	355.5%	252.8%	63.0%	210.9%	40.3%	4.2%	45.5%	52.6%	33.5%	46.1%
Non-GAAP Net Income	(66.9%)	242.4%	(41.8%)	408.8%	421.3%	547.5%	23.9%	196.7%	42.6%	5.5%	47.5%	53.0%	35.0%	44.7%
Non-GAAP EPS				343.2%	354.2%	484.1%	26.1%	171.5%	38.9%	1.6%	40.9%	40.6%	28.6%	37.4%

Source: BTIG Research, Company Filings.

Appendix: Analyst Certification and Other Important Disclosures

Analyst Certification

I, Joel P. Fishbein, Jr., hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Edward Parker, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

I, Abhinav Kapur, hereby certify that the views about the companies and securities discussed in this report are accurately expressed and that I have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

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For purposes of FINRA ratings distribution rules, BTIG's stock ratings of Buy, Neutral and Sell fall into Buy, Hold and Sell categories, respectively.

Company-Specific Regulatory Disclosures

Barracuda Networks, Inc. (CUDA)

Valuation

Our DCF analysis yields a \$35 price target, and assumes a 10-year revenue CAGR of 14%, FCF CAGR of 14% and 18x terminal FCF multiple. This implies a terminal EV/EBITDA multiple of ~16x.

Risks

The security and storage spaces are highly competitive and the company faces competition from well established players. Secondly, as the threat environment has grown more severe, investors have pushed up valuations for security companies, including Barracuda.

Other Disclosures

Additional Information Available Upon Request

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