MOODY'S
INVESTORS SERVICE

CREDIT OPINION
19 December 2022

Update

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RATINGS

Sparebanken Oest

Domicile	Drammen, Norway
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Sparebanken Oest

Update to credit analysis

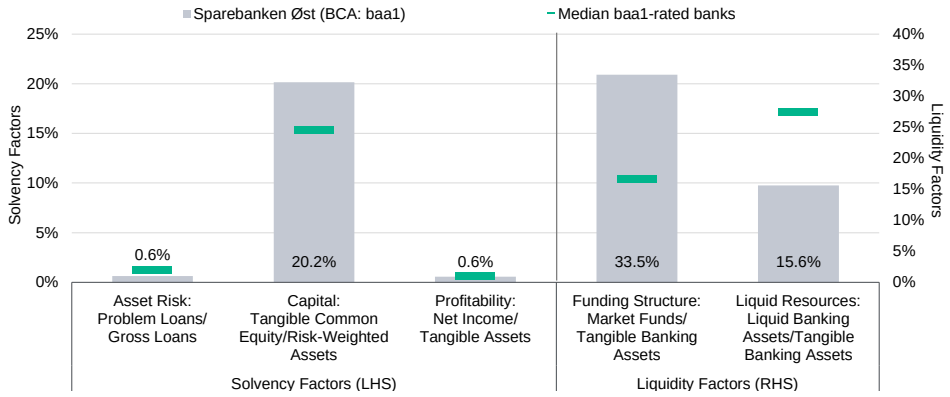
Summary

We assign a baa1 Baseline Credit Assessment (BCA) and A1 long-term deposit and issuer ratings to Sparebanken Oest. Sparebanken Oest's BCA of baa1 primarily reflects its good asset quality with low level of problem loans (0.6% of total loans in September 2022), underpinned by its predominantly mortgage loan book (approximately 91% of total loans in September 2022), as well as its solid capitalization with a tangible common equity (TCE) ratio of 20.2% in September 2022. We expect the bank's core profitability performance to remain satisfactory for the foreseeable future, supported by higher net interest margins.

The bank's BCA is also supported by its adequate liquidity, with a ratio of liquid resources relative to tangible banking assets of 15.6%, a liquidity coverage ratio (LCR) of around 274%, and a net stable funding ratio (NSFR) of 135% in September 2022. The BCA also reflects the bank's relatively high market funding dependence through covered bonds, a common feature for all local banks, and some mortgage margin pressure from strong competition.

The bank's A1 deposit and issuer ratings take into account our Loss Given Failure (LGF) analysis of the bank's large volume of deposits and substantial layers of subordination, resulting in three notches of rating uplift from its BCA. Sparebanken Oest's ratings do not benefit from any government support uplift.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

» Good asset quality mainly driven by predominant exposure to retail mortgages

» Solid capital buffers, which compare well with those of similarly rated banks

» Adequate profitability on the back of increasing interest rates and low impairments

Credit challenges

» Sparebanken Oest maintains a high reliance on confidence-sensitive market funding

» Strong competition in retail mortgages exerts some pressure in Sparebanken Oest's market share and franchise

» Relatively high contribution from interest income on mortgages

Outlook

The bank's deposit and issuer ratings carry a stable outlook balancing its robust financial performance with downside risks stemming from its dependence on market funding and real-estate and home prices in its home region. The outlook also reflects Moody's expectation that the bank will issue sufficient volumes of junior senior debt to support the senior unsecured rating.

Factors that could lead to an upgrade

The ratings and assessments of Sparebanken Oest could be upgraded if the bank improved its funding profile through a reduction of confidence sensitive market funding or reduced its geographic, sector, and single borrower concentration while maintaining good asset quality and adequate coverage of problem loans.

Factors that could lead to a downgrade

The ratings and assessments of Sparebanken Oest could be downgraded if its credit risk profile worsens through elevated sectoral or borrower concentration, its franchise weakens reducing its earnings capacity, funding conditions become more difficult that would challenge the bank's refinancing capacity, or the bank issues a significantly lower volume than expected of junior senior securities.

Key indicators

Exhibit 2
Sparebanken Oest (Consolidated Financials) [1]

	09-22[2]	12-21[2]	12-20[2]	12-19[2]	12-18[2]	CAGR/Avg.[3]
Total Assets (NOK Billion)	45.1	48.1	44.1	42.0	42.0	1.9[4]
Tangible Common Equity (NOK Billion)	3.9	3.9	3.7	3.5	3.3	4.4[4]
Problem Loans / Gross Loans (%)	0.6	0.8	0.6	0.6	0.6	0.6[5]
Tangible Common Equity / Risk Weighted Assets (%)	20.2	18.3	17.9	17.8	16.6	18.1[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.3	7.5	5.3	6.0	5.9	6.0[5]
Net Interest Margin (%)	1.4	1.3	1.4	1.5	1.4	1.4[5]
PPI / Average RWA (%)	1.6	2.1	2.8	2.2	2.4	2.2[6]
Net Income / Tangible Assets (%)	0.6	0.8	1.0	0.8	0.8	0.8[5]
Cost / Income Ratio (%)	47.8	40.8	34.5	38.5	39.1	40.1[5]
Market Funds / Tangible Banking Assets (%)	31.7	33.4	36.5	37.5	38.8	35.6[5]
Liquid Banking Assets / Tangible Banking Assets (%)	14.9	15.6	18.2	18.2	15.2	16.4[5]
Gross Loans / Due to Customers (%)	220.5	223.2	237.2	229.3	234.1	228.8[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

Sparebanken Oest is a savings bank based in Drammen with a good market positioning in southeastern Norway. Traditional banking services including deposit accounts, mortgage loans and money-transfer services are provided to retail customers and small and medium-size enterprises (SMEs). Through agreements with external suppliers, the bank also distributes pension insurance, life and general insurance, and asset management services. As of September 2022, the bank reported total consolidated assets of NOK45.1 billion (approximately €4.3 billion).

Recent developments

To curb rising inflation Norges Bank has been gradually increasing its reference rate since September 2021, resulting in a reference rate of 2.75% as of December 2022. Norges Bank expects the policy rate to be around 3% in 2023.

The counter cyclical buffer (CCyB) requirement has been increased to 1.5% currently and will increase further to 2.0% by the end of December 2022 and to 2.5% effective from end of March 2023. Russia's invasion of Ukraine (Caa3 NEG) and the economic sanctions that the US (Aaa stable), European governments and other allies have subsequently imposed on Russia have increased risks to the global economic outlook. Heightened geopolitical risks are unambiguously negative for economic activity. The magnitude of the effects will depend on the length and severity of the crisis.

Norway's trade flows with Russia are very limited as they export the same type of goods with the production of oil and gas among the most significant to the Norwegian economy. As European countries are looking to reduce imports from Russia, Norway is likely to be positively affected by increased demand in Europe.

Detailed credit consideration

Norway's 'Very Strong-' Macro Profile remains supportive towards the bank's stand alone credit profile

Sparebanken Oest operates only in Norway and thus its operating environment is reflected through the 'Very Strong -' Macro Profile we assign for Norway. Norwegian banks benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as well as a very low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrated resilience to the last weakening in the oil sector in 2014-15.

The main risks to the banking system stem from the high level of household debt, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are mitigated by the strength of households' ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared with the total size of the economy.

Nonetheless, we expect the Norwegian mainland economy (excluding any oil-related activity) to expand by 3.1% in 2022, down from 4.1% in 2021. Unemployment rose to around 10.6% in March 2020, but falling back to 1.6% as of October 2022.

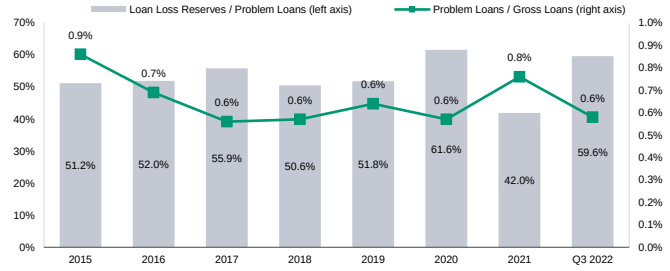
Good asset quality mainly driven by predominant exposure to retail mortgage

We expect Sparebanken Oest's problem loans to remain low, reflecting its focus on mortgage lending and limited lending to business customers. The bank's corporate loans declined to 9.4% in September 2022 from a peak of around 24% of gross loans back in 2011, while its top 20 exposures amount to less than 5% of total loans, demonstating the granularity of its loan book.

As of September 2022, the bank's problem loan ratio (measured as impaired loans as a percentage of total loans) stood at 0.58% (0.76% as of year-end 2021) with the bulk of the nonperforming loans related to car loans to individuals. At this low level, it compares favorably to rated domestic peers, with the increase from 2020 being attributable to updated definitions of default implemented in 2021. Sparebanken Oest's coverage of problem loans improved to 59.6% as of September 2022 (see Exhibits 3-4).

Exhibit 3

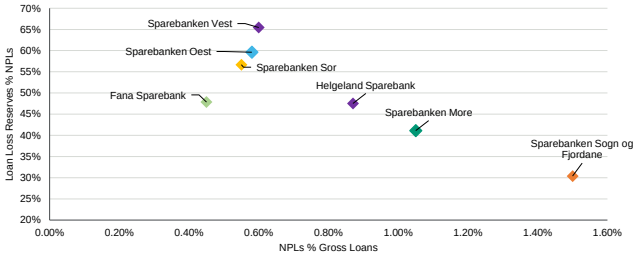
Sparebanken Oest's asset quality has held up in recent years...



Source: Moody's Banking Financial Metrics

Exhibit 4

... and compares well with its Norwegian peers



Source: Moody's Banking Financial Metrics (September 2022)

Although Sparebanken Oest's concentration level in the commercial real estate (CRE) sector has declined, it remains significant. Loans to the real estate and construction sector accounted for around 7.1% of its gross loans as of September 2022. The exposure to the CRE sector makes its asset quality vulnerable in case the sector faces difficulties, particularly given that many of the bank's large customers are active in this sector. However, Sparebanken Oest's CRE portfolio has been decreasing since 2011, while both residential and commercial real estate prices have illustrated growth, particularly in the Oslo metropolitan area. Growth in real estate prices has also started to fall as of Q4 2022, following strong growth in 2021 and beginning of 2022.

As of September 2022 gross lending decreased by 7% year-on-year. Lending to retail customers decreased by 4.9% year-on-year while the bank's gross lending to corporate customers decreased by 24.5% over the same period. The overall decrease in lending came as a result of fierce competition in digital lending channels and bank's defensive approach to business customers, which resulted in larger pricing margins than competitors.

The bulk of Sparebanken Oest's lending is in retail loans, mostly in the form of mortgages with very low average LTVs (the average LTV within the security pool was around 44% at the end of third quarter of 2022), accounting for around 91% of total loans as of September 2022. Sparebanken Oest is based in Drammen, which is located on the outskirts of Oslo and where residential property prices have increased significantly over the past several years, which pose some downside risks for the bank. Nonetheless, we expect the bank to maintain its high asset quality within its portfolio over the medium term, even if competition would challenge its positioning in the market.

Solid capital buffers, which compare favorably with similarly rated banks

Sparebanken Oest's capital buffers are solid with a Common Equity Tier 1 capital (CET1) ratio of 20.4% in September 2022, an increase from 18.2% as of year-end 2021. Concurrently, the bank had a Tier 1 ratio of 21.8% and a total capital adequacy ratio of 23.8% as of September 2022, combined with a leverage ratio of 9.1% indicating the ample room it has for credit growth and loss absorption buffer. We expect the bank's capital ratios to come down once lending growth picks up or when the bank distributes excess capital, but they should still remain strong with a target on CET1 of 16.8%.

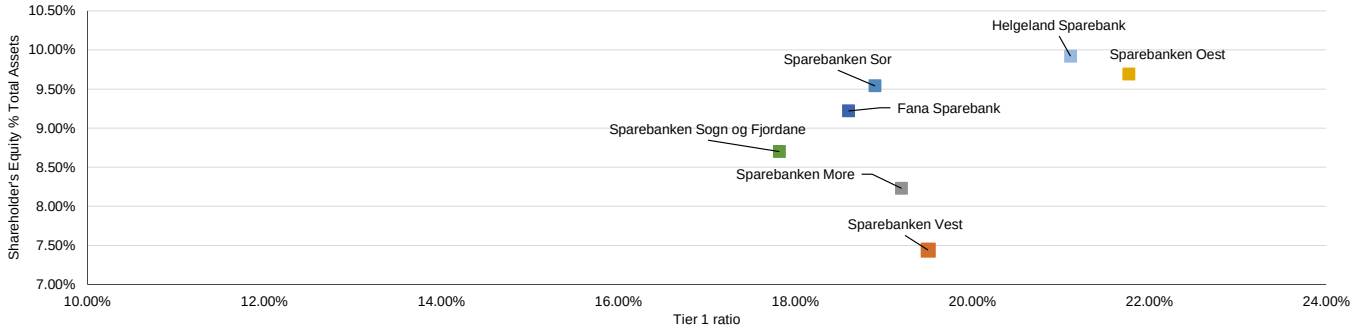
The bank's capital levels compare favorably both with other similarly rated banks and other Norwegian savings banks (see Exhibit below) and exceed both the current regulatory requirement of 13.3% (including a Pillar 2 requirement of 1.8% for Sparebanken Oest) and the increased requirement of 15.8% which will come into force at the end of the first quarter of 2023, following the increase in systemic risk and countercyclical capital buffers. The bank's internal target will be increased to 16.8% at that point.

Following the implementation of finalised EU bank capital rules (which have yet to be fully agreed) it is likely that the bank's risk-weighted assets (RWAs) could reduce, with lower requirements being applied both to the banks SME exposures and to its retail mortgages. However, the implementation has been delayed from 2023 to 2025. It should be noted that Oest remains on the standardised model in calculating its RWAs and has no intention to start an internal ratings based (IRB) process.

Our capital score for the bank reflects comfortable capital metrics and strong leverage ratio, however, we apply a one-notch negative adjustment to the capital score to reflect our view that raising fresh equity in case of need could prove challenging for the bank given that only 28.6% of capital is in the form of equity certificates.

Exhibit 5

Sparebanken Oest's capital levels compare favorably with that of peers



Source: Banks reports, Moody's Investors Service (September 2022)

Favourable profitability on the back of low impairments although with relatively low contribution from fees and commissions

Sparebanken Oest's annualized return on assets, as adjusted and calculated by Moody's, reached 0.56% in September 2022. Net income decreased in the first nine months of 2022 compared with the same period in 2021 due to turmoil in the financial markets. Recent rate increases by Norges Bank have translated into increased mortgage rates, while deposit rates have remained mostly flat. This is expected to boost the bank's profitability going forward, although a competitive market environment will continue to be a challenge for the bank.

Net interest income from lending operations still constitutes the main income line for Sparebanken Oest with majority of loans being predominantly retail — representing a stable source of income. We note that there is also some margin pressure due to intense competition in the bank's core markets and increased focus on retail mortgages, with net interest income as a percentage of average total assets slightly up to 1.43% in September 2022, from 1.33% as of September 2021. On average, net interest income represents around 80% of the bank's net revenues, while fees and commissions income remains a relatively low contributor to the bank's revenues.

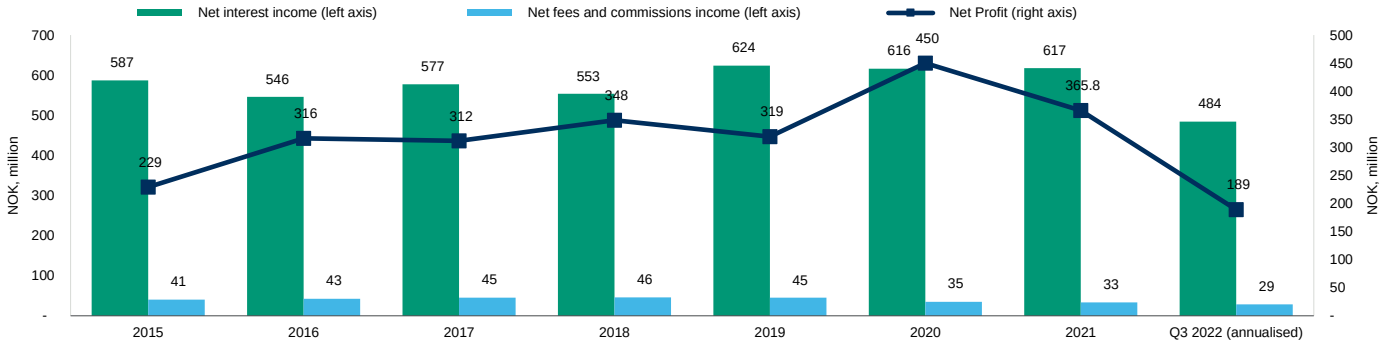
The bank managed to keep good control of its costs with operational efficiency remaining sound and continuing to compare well with that of its domestic peers, with a cost-to-income ratio of 39.6% as of September 2022. The revision of salaries combined with its digitalisation transformation have also helped contain its cost base and be one of the most efficient Norwegian banks, despite a significant IT investment cost in the last two years.

Loan losses remain low but increased to NOK4.3 million in September 2022 from NOK1.5 million a year earlier, indicating an annualised credit loss ratio (loss provisions as a % gross loans) of 0.02%, compared to 0.01% the year before. Sparebanken Oest's low credit loss ratio in September 2022 was one of the lowest among Norwegian banks, supporting its bottom line performance.

Over the next 12-18 months we do not expect any major deviation in the bank's profitability metrics. The bank has good recurring pre-provision income, and higher interest rates will support its profitability. However, the strong competition the bank faces in the greater Oslo and Akershus area where it also operates, mainly from bigger commercial and digital banks with strong pricing power, could pressure margin and constrain its long-term profitability trajectory. In addition, higher costs caused by energy prices, inflation and supply chain constraints could lead to higher provisioning needs by the bank, in addition to higher personnel and IT expenses. We expect higher expenses and competitive pressure to offset positive effect from the increased net interest income.

Exhibit 6

Sparebanken Oest's profitability evolution



Source: Banks reports, Moody's Investors Service

Sparebanken Oest maintains a sizable reliance on market funding...

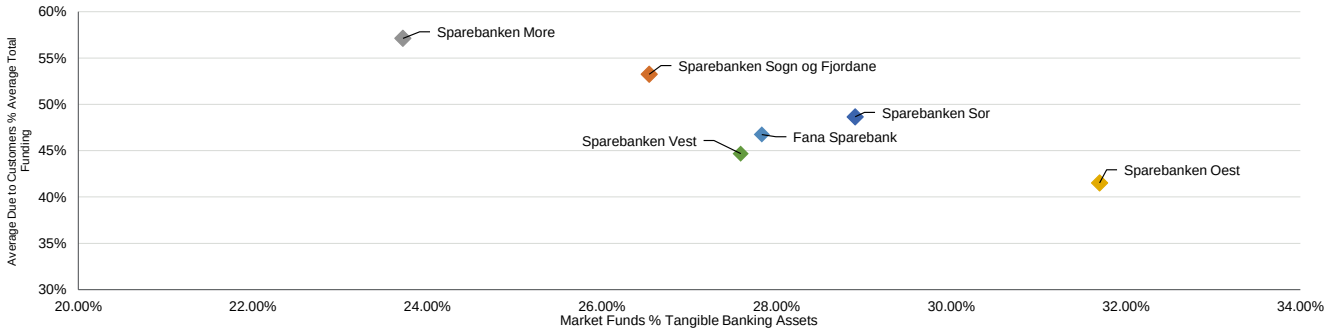
Sparebanken Oest remains more reliant on market funds than most of its domestic peers, as its Moody's-adjusted market funds ratio comprised around 32% of the bank's tangible banking assets as of September 2022. Accordingly, we believe that the bank remains sensitive to fluctuations in investor sentiment, which we view as a potential credit challenge.

A relatively large part of Sparebanken Oest's market funding consists of covered bonds issued via Sparebanken Oest Boligkreditt, with this source of funding representing around 74% of Sparebanken Oest's unadjusted market funds as of September 2022. We view the benefits from diversification and the typically longer maturity of these funding instruments positively, particularly because recent larger issuances are eligible liquid assets under the liquidity coverage ratio (LCR) rules. The bank also had a comfortable net stable funding ratio (NSFR) at 135% at the end of September 2022.

We expect that the bank will continue to refinance part of its senior preferred debt with senior non-preferred (SNP) debt. This is based on the bank's minimum requirement for own funds and eligible liabilities (MREL).

Deposits accounted for about 42% of Sparebanken Oest's non-equity funding as of September 2022 — at the lower end of the range of similarly rated Norwegian savings banks. The 5.9% decrease in total deposits as of September 2022 from a year earlier was largely driven by the deposits from the corporate sector decreasing by 12.4%.

Exhibit 7
A relatively large part of Sparebanken Oest's market funding consists of covered bonds



Source: Banks reports, Moody's Investors Service (September 2022)

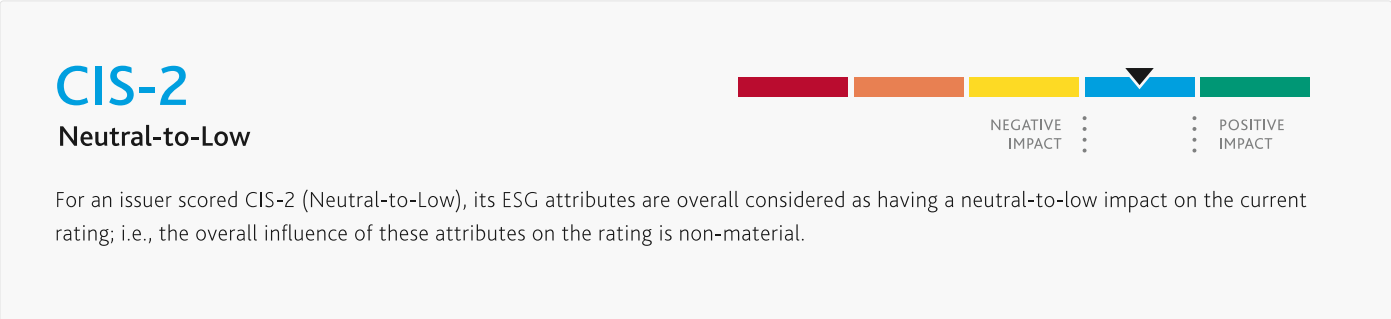
...although mitigated by high liquidity buffers

Mitigating its high reliance on market funds, Sparebanken Oest holds a large liquidity buffer. As of September 2022, liquid assets stood at NOK6.7 billion or 14.9% (15.6% as of December 2021) of total assets and consisted mainly of cash, as well as government-related bonds and covered bonds. Furthermore, according to the bank, liquid assets should be sufficient enough to cover its funding needs for at least the next 12 months without the need for external financing, and its LCR was 274% in September 2022.

ESG considerations

Sparebanken Oest's ESG Credit Impact Score is Neutral-to-Low CIS-2

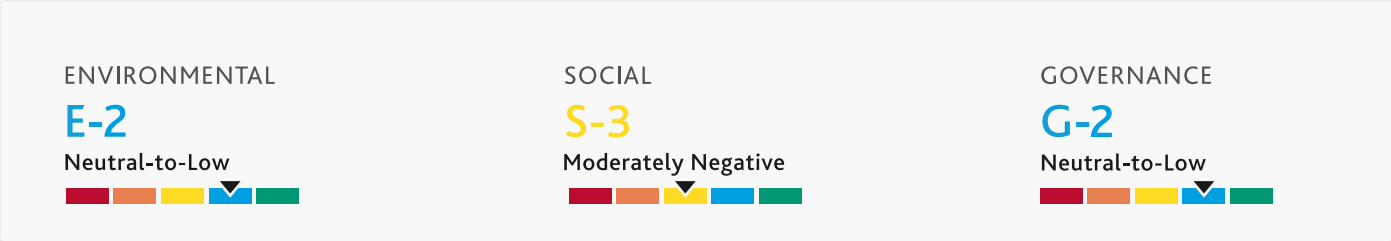
Exhibit 8
ESG Credit Impact Score



Source: Moody's Investors Service

Sparebanken Oest's ESG Credit Impact Score is neutral-to-low (**CIS-2**). This reflects the limited credit impact of environmental and social risk factors on the rating to date, and neutral-to-low governance risks.

Exhibit 9
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

Sparebanken Oest faces low environmental risks, specifically in relation to carbon transition risks. This is because of its loan composition which consists primarily of mortgages and property management and negligible exposure to corporate lending, which typically carries higher carbon transition risk.

Social

Sparebanken Oest faces moderate social risks related to customer relations and associated regulatory and litigation risks, requiring high compliance standards. The exposure to customer relation risks is lower than its international peers, given the bank's untarnished customer conduct track record supported by the social mandate of the Savings Bank's model. Sparebanken Oest is a digitally advanced bank in Norway, with a robust IT infrastructure and strong capabilities to mitigate cyber and personal data risks.

Governance

Sparebanken Oest faces low governance risks. I, and its risk management, policies and procedures are in line with industry best practices. Despite sectoral and geographical concentrations, due to its limited reach, the bank benefits from strong underwriting standards which mitigate some of these concerns. The bank has a track record of sound capital and liquidity management and earnings stability while losses have been low, even at times of market turbulence. Being a regional savings bank, more than 70% of the bank is owned by the community foundation and around 30% by other private investors, in the form of listed equity certificates. The bank's Supervisory Board, comprises of representatives of EC holders, the foundation and employees. Related governance risks are however mitigated by Norway's developed institutional framework

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure and additional nothing

The European Union's BRRD2 has been transposed into Norwegian law which underpinns our current assumptions regarding the LGF analysis. We assume a residual tangible common equity of 3% and post-failure losses of 8% of tangible banking assets, a 25% run-off in junior wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred over senior unsecured debt. These metrics are in line with our standard assumptions.

For Sparebanken Oest's short-term and long-term deposit ratings, we consider the likely impact of loss-given-failure, reflecting the combination of debt and deposit volumes and the amount of debt subordinated to them. We also take into consideration the expected level of MREL eligible debt issuance until the end of 2023. This has resulted in a Preliminary Rating Assessment of three notches above the BCA for the bank's deposit and senior unsecured ratings, reflecting very low loss-given-failure.

Government Support considerations

Given the implementation of the BRRD law in Norway on 1 January 2019 we reconsidered the probability that government support would benefit certain creditors.

Sparebanken Oest benefits from a well-established market position in the lower Buskerud County of southeastern Norway. While its market share in this county is material (we estimate it at around 6% on terms of loans), it falls to around 1.4% if we include the greater Oslo and Akershus areas, in which Sparebanken Oest also operates. We also note that the proximity of the bank's home region to Oslo means that a number of other Norwegian banks are operational in the area. Therefore, we take into consideration the probability of government support for debt and deposits as low, resulting in no rating uplift. Sparebanken Oest's market share in loans on a national basis is around 0.7%.

Counterparty Risk Assessment

Sparebanken Oest's CR Assessment is A1(cr)/P-1(cr)

Sparebanken Oest's CR Assessment is A1(cr)/P-1(cr), three notches above the bank's Adjusted BCA of baa1, based on the buffer against default provided by junior deposits, senior unsecured, subordinated debts and preference shares. The bank's CR Assessment does not benefit from any government support, in line with deposits and senior unsecured debt ratings.

Counterparty Risk Ratings (CRRs)

Sparebanken Oest's CRR is A1/P-1

The CRR is three notches above the Adjusted BCA of baa1 and at the same level as the CR Assessment, reflecting the buffer against default provided by more junior instruments to the CRR liabilities.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 10
Sparebanken Oest

Macro Factors						
Weighted Macro Profile	**Very Strong -**	**100%**				

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.6%	aa1	↔	a3	Geographical concentration	Sector concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	20.2%	aa1	↔	aa2	Access to capital	
Profitability						
Net Income / Tangible Assets	0.6%	baa2	↑	baa3	Earnings quality	
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	33.4%	baa3	↔	ba1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	15.6%	baa2	↓	baa3	Stock of liquid assets	
Combined Liquidity Score		baa3		ba1		
Financial Profile				baa1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				a3 - baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	in-scope (NOK Million)	% in-scope	at-failure (NOK Million)	% at-failure
Other liabilities	20 564	45.6%	22 278	49.4%
Deposits	16 806	37.3%	15 092	33.5%
Preferred deposits	12 437	27.6%	11 815	26.2%
Junior deposits	4 370	9.7%	3 277	7.3%
Senior unsecured bank debt	4 740	10.5%	4 740	10.5%
Junior senior unsecured bank debt	900	2.0%	900	2.0%
Dated subordinated bank debt	400	0.9%	400	0.9%
Preference shares (bank)	350	0.8%	350	0.8%
Equity	1 353	3.0%	1 353	3.0%
Total Tangible Banking Assets	45 114	100.0%	45 114	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	24.4%	24.4%	24.4%	24.4%	3	3	3	3	0	a1
Counterparty Risk Assessment	24.4%	24.4%	24.4%	24.4%	3	3	3	3	0	a1 (cr)
Deposits	24.4%	6.7%	24.4%	17.2%	2	3	2	3	0	a1
Senior unsecured bank debt	24.4%	6.7%	17.2%	6.7%	2	2	2	3	0	a1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1(cr)	
Deposits	3	0	a1	0	A1	A1
Senior unsecured bank debt	3	0	a1	0	A1	A1

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 11

Category	Moody's Rating
SPAREBANKEN OEST	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A1

Source: Moody's Investors Service

REPORT NUMBER 1349929

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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