January 31, 2019

Zacks Small-Cap Research

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O2Micro International Ltd (OIIM-NASDAQ)

OIIM: Despite Industry Inventory Corrections, O2Micro Still Grows Q4 Revenues 9%

Using an industry average value to trailing 12-month sales of 5.5 times and OIIM's $62.7 m trailing 12-month revenue, we would calculate an enterprise value of $345 million, a market cap of $383 million and a price of **$14.74 per share**, if the company could reach breakeven.

OUTLOOK

O_2Micro International is a fabless semiconductor firm that designs, develops and markets high performance integrated circuits primarily for power management and battery management for TV backlighting, LED lighting, and portable tools and appliances, and smartphones. It has struggled to reach profitability and cash flow breakeven. The company trades at an **enterprise value of $5.3 million**, well below the value of its non-cash assets.

Current Price (01/30/19)	$1.53
Valuation	**$14.74**

SUMMARY DATA

52-Week High	**$2.37**
52-Week Low	**$1.33**
One-Year Return (%)	**1.3**
Beta	**0.7**
Average Daily Volume (sh)	**25,089**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$39**
Short Interest Ratio (days)	**1.0**
Institutional Ownership (%)	**42**
Insider Ownership (%)	**8**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-3.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/M**
P/E using 2018 Estimate	**N/M**
P/E using 2019 Estimate	**N/M**

Risk Level	**Above Average**
Type of Stock	**Small-Value**
Industry	**Elec Comp-Semis**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2017	15.0 A	14.5 A	15.5 A	15.2 A	60 A
2018	14.1 A	15.2 A	16.8 A	16.6 A	63 A
2019	14.6 E	16.0 E	17.8 E	18.7 E	67 E
2020					74 E

Earnings Per Share
(non-GAAP EPS before non-recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2017	-$0.04 A	-$0.04 A	-$0.04 A	-$0.06 A	-$0.18 A
2018	-$0.09 A	-$0.05 A	-$0.05 A	-$0.05 A	-$0.24 A
2019	-$0.09 E	-$0.06 E	-$0.02 E	-$0.01 E	-$0.15 E
2020					-$0.14 E

Zacks Projected EPS Growth Rate - Next 5 Years % **8**

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WHAT'S NEW

O2Micro is Still Growing Despite Industry Inventory Correction

O2Micro reported Q4 2018 revenues of $16.6 million, down slightly sequentially, but still up 9.0% year over year and within the range of guidance. Guidance for revenue for the fourth quarter of 2018 was sequentially flat plus or minus 5% from Q3 2018.

For Q1 2019, the company is guiding to midpoint revenues of $14.7 million, which would be up 4% over last year. The range is down 12%, plus or minus 4% sequentially. Despite the industry suffering an inventory correction as supplies catch up to demand after shortages last year, O2Micro still expects to grow throughout 2019 with acceleration in the latter half as design wins convert to ramping production.

Gross margin was 50.3%, down sequentially from 50.5%, and year over year from 50.5%, due to product mix.

R&D declined to $5.0 million in the quarter, from $5.2 million in Q3 when spending ramped due to a push to complete new battery management products. In last year's quarter O2Micro spent $4.8 million.

SG&A was high at $5.4 million versus $4.7 million last year and $4.9 million in Q3. In Q4 2018, the company had an extra one time expense of $200,000-$250,000 for logistics for the accelerated deliveries of orders.

Total operating expenses in the quarter were $10.4 million, a million more than last year, and compared with $10.2 million in Q3 2018.

Operating losses in Q4 were $2.1 million versus $1.8 million last year and $1.7 million in Q3. Most of the increase is explained by the one-time logistics expense.

In the quarter, the company had an unrealized loss of $1.4 million on a long-term investment from its stock ownership of Excelliance MOS Corp. (5299.TWO) marked to market. During the quarter it sold $1.3 million of this stock (360,000 shares) and now owns 2.8 million shares. In Q1 it plans to sell another 300,000 to 500,000 shares, which at today's price would be $1.1 million to $1.9 million.

There was also $530,000 of other income comprised of its normal rent of $101,000, cash dividend income from long-term investment $290,000, and some government subsidizes of $138,000.

Taxes were $330,000 of which $105,000 was paid for gains on the sale of stock.

The company reported GAAP net loss of $3.1 million versus a loss of $1.9 million last year. This yielded a GAAP loss per share of $0.12 versus a loss of $0.07 a year ago.

Non-GAAP net loss was a loss of $1.4 million, versus a loss of $1.0 million last year. The company reported a **non-GAAP EPS loss of $0.05, versus a loss of $0.06 last year**.

On December 31, 2018, the company had $38.6 million in cash and equivalents (or $1.49 per ADS), down $2.2 million sequentially. During the quarter EBITDA was a negative $1.3 million. The company burned $3.3 million in the quarter and spent $406,000 on capital expenditures.

The company believes it can be EBITDA positive between $17 million to $19 million in quarterly revenues, and profitable between $19 million to $20 million in revenues.

2018 Year

For the full year O2Micro reported revenues of $62.7 million versus $60.2 million, up 4.2% from 2017. Gross margin was 50.1% virtually flat with last year.

R&D increased to $19.8 million from $18.2 million in 2017 due to a push to complete new battery management products.

SG&A came in at $20.3 million versus $19.0 million last year.

Total operating expenses for the year were $40.1 versus $37.0 million, a year ago.

Operating losses for the year were $8.1 million versus $6.2 million last year and $1.7 million in Q3. Clearly spending outpaced revenue gains leading to higher losses.

During the year the company had an unrealized gain of $9.8 million from the IPO of Excelliance MOS Corp. (5299.TWO). During the year it sold $1.3 million of this stock and now owns 2.8 million shares.

With this one time gain, the company reported GAAP net income of $2.1 million versus a loss of $6.1 million last year. This yielded GAAP earnings per share of $0.08 versus a loss of $0.24 a year ago.

Non-GAAP net loss was a loss of $6.3 million, versus a loss of $4.6 million last year. The company reported a **non-GAAP EPS loss of $0.24 for the year, versus a loss of $0.18 last year**.

Business Units

I**ntelligent lighting** is seeing growth, which is expected to accelerate in the second half of the year as the industry shifts to 4K TVs and 8K volumes increase. 8K is being gated by the lack of content available. Higher-end TVs and HDR monitors are adding more highly integrated application-specific devices, including O2Micro's local dimming products. According to Futuresource Consulting, 2018 will be the year 4K UHD moves mainstream and will account for nearly 50% of all TVs shipped worldwide by year-end. HDR monitors are gaining traction with prices ranging from $200 to $2000 and targeted toward gaming.

Figure 1. HDR Monitor



Battery management is the company's second largest sector and is growing double digits as the industry continues to move to lithium ion batteries as they become ever cheaper and more powerful. Customers selling products such as e-bikes, e-vehicles, and vacuums and UPS power supplies are making the business less cyclical than when most of the product went to power tools. The company is providing the industry with more cost effective products, as well as more complex patent protected products for high-end solutions. Customers have evaluated and are now beginning to design in O2Micro's new ARM based chips with allows connectivity for IoT. In particular it is being used for construction equipment for owners to locate missing tools and machines and is also being incorporated into UPS power supplies and solar installations to allow users to remotely access the devices for status information. There are many other applications; for example, the company indicated on new customer was planning to put connectivity into its robotic vacuum cleaner.

Power Products continue to expand its product line, increase its design wins, and serve a broader array of customers. The company expects accelerating sales as new power products continue to gain wider acceptance in the smartphone and tablet market including higher end customers. O2Micro's new power products have ramped into production through Q3 and Q4, however legacy products suffered a shortfall as there still are shortages of processors for notebooks. The company had further design wins for our smart phone and tablet products include new charger ICs, on-the-go charger booster, and accurate gas gauge.

VALUATION

Company Has Significant Upside If It Can End Cash Burn

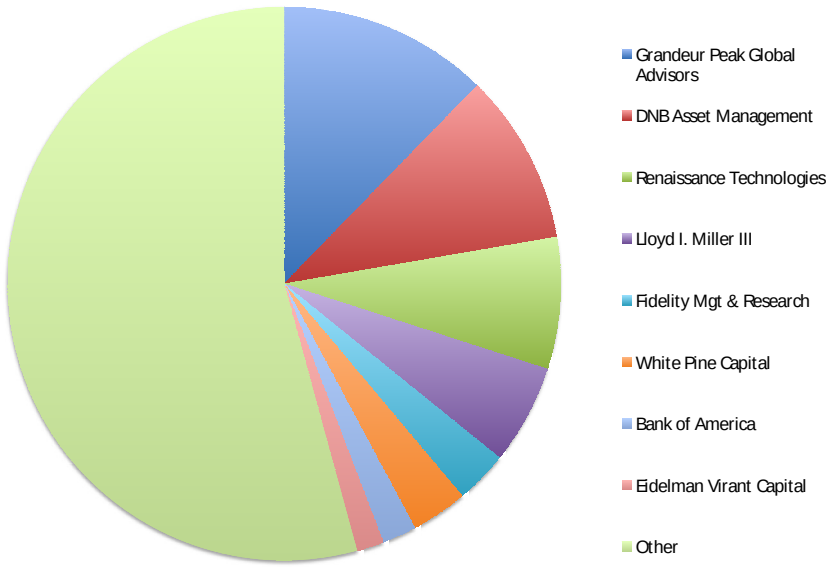
The company trades at an **enterprise value of $5.3 million**. Last year the company looked as if it had turned the corner and was approaching profitability but panel shortages for TVs nixed that progress and the valuation of the company slipped. It looks like panel shortages have ended and business has been mostly normalized except for processor shortages for notebooks. At the end of 2018, the company had $38.6 million (or $1.49 per ADS) in cash and equivalents, no debt, and valuable real estate in China and California. In California it owns a 37,180 square foot building where it has its USA operations, which was bought for $4.6 million in May 2004 and believe it is now worth at least $7 million. Plus it also owns other real estate in China. Also on the balance sheet are long-term investments in other companies, including approximately 2.8 million shares of stock in Excelliance MOS (worth $3.9 million.) The company has a very high liquidation as well as acquisition value. Activists had tried to encourage a transaction with an acquirer, but the company has no interest in a sale and due to restrictions, it is difficult to force one.

In May, Microchip Technology bought Microsemi for $10.15 billion, which was a valuation of 5.5 times its trailing twelve-month revenues of $1.845 billion. Two other comparable companies we had been using, Intersil and Linear Technology, were acquired at very high valuations. Intersil was acquired by Renesas for $3.2 billion at a valuation of 5.9xs the company's trailing $542.1 million in revenue. Analog Devices acquired linear Technology for $14.8 billion. This was 9.9 times its trailing four quarters of revenue of $1.5 billion.

Were we to use the average enterprise value to trailing twelve-month sales of 5.5 times and apply it to OIIM's trailing 12-month $62.7 million revenues, we would calculate an enterprise value of $345 million. Adding to it $38.6 million in cash gives us a market cap of $383 million or **$14.74 per share**. We believe that once the company shows sustainable revenue growth and cash breakeven, the market should afford it a valuation closer to this price.

	Competitors	EV	TTM Sales	EV/Sales
Monolithic Power Systems	**MPWR**	5,200	558	9.3
Cree Inc.	**CREE**	5,036	1,587	3.2
Microchip Technology	**MCHP**	29,490	4,640	6.4
Maxim	**MXIM**	14,520	2,540	5.7
Texas Instruments	**TXN**	96,630	15,780	6.1
Cirrus Logic	**CRUS**	2,776	1,248	2.2
	Average			5.5

OWNERSHIP



RISKS

- O_2Micro has high exposure to the global demand for TVs, which can be hurt in recessions. It is depending on free dimming and high power LED lighting, 4K and 8K and other high end TVs, battery management, and successful penetration of and volume sales to the smartphone market to give it revenue and margin growth.

- It may be difficult for the company to capture market share in smartphones and tablets as a new entrant in an established field competing primarily with giant Texas Instruments and other larger firms.

- The firm is currently not at GAAP breakeven, is still cash flow negative, and has recently been unable to grow revenues faster than low single digits.

- Given its large number of patents, litigation risk is a possibility as the company enforces its patents.

- It also has geopolitical risk as countries move to adjust tariffs for various products.

INCOME STATEMENT

	March Q1 17	June Q2 17	Sept Q3 17	Dec Q4 17	March Q1 18	June Q2 18	Sept Q3 18	Dec Q4 18	March Q1 19E	June Q2 19E	Sept Q3 19E	Dec Q4 19E	2015	2016	2017	2018	2019E	2020E
REVENUE																		
Net Revenue	15.0	14.5	15.5	15.2	14.1	15.2	16.8	16.6	14.6	16.0	17.8	18.7	54.8	56.6	60.2	62.7	67.1	73.8
Yr-to-yr Gr.	15%	10%	7%	-4%	-6%	5%	8%	9%	3%	5%	6%	13%	-14%	3%	6%	4%	7%	10%
OPERATING EXPENSES																		
Cost of goods sold	7.1	7.1	7.7	7.5	6.9	7.3	8.3	8.2	7.3	8.0	8.8	9.1	27.1	27.3	29.4	30.7	33.2	36.0
Gross Margin	7.9	7.4	7.8	7.7	7.2	7.9	8.5	8.3	7.3	8.0	9.0	9.6	27.7	29.2	30.8	32.0	33.9	37.8
% of Sales	52.7%	50.9%	50.3%	50.5%	51.2%	52.1%	50.5%	50.3%	50.0%	50.0%	50.6%	51.3%	50.5%	51.7%	51.1%	51.0%	50.5%	51.2%
R&D	4.1	4.5	4.7	4.8	4.8	4.7	5.2	5.0	5.0	5.0	5.0	5.1	17.8	15.6	18.0	19.8	20.1	20.5
SG&A	5.1	4.4	4.9	4.7	5.0	5.0	4.9	5.4	5.1	5.0	5.1	5.2	23.3	19.5	19.0	20.3	20.4	21.0
One-time expenses & Adj.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.1	0.0	(0.0)	(0.0)	0.0	1.1
Tot Operating Exp.	9.1	8.9	9.5	9.4	9.8	9.7	10.2	10.4	10.1	10.0	10.1	10.3	42.3	35.1	37.0	40.1	40.5	42.6
Operating Income	(1.2)	(1.6)	(1.7)	(1.8)	(2.5)	(1.8)	(1.7)	(2.1)	(2.8)	(2.0)	(1.1)	(0.7)	(14.6)	(5.9)	(6.2)	(8.1)	(6.6)	(4.8)
Interest income	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7	0.3	0.3	0.4	0.3	0.3
Unrealized fair value on LT Investment	0.0	0.0	0.0	0.0	9.8	3.1	(1.7)	(1.4)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	9.8	0.0	0.0
Foreign exchange loss	(0.2)	0.1	0.3	(0.0)	(0.2)	0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.7	0.1	0.1	0.1	0.0	0.0
Gain on sale of real estate	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8	1.7	0.0	0.0	0.0	0.0
Other (rent) - net	0.1	0.2	0.2	0.2	0.3	0.1	0.1	0.5	0.3	0.3	0.3	0.3	0.7	0.9	0.7	1.0	2.1	0.4
Total other Income	0.0	0.4	0.6	0.2	10.0	3.6	(1.5)	(0.7)	0.4	0.4	0.4	0.4	(2.0)	3.9	1.1	11.4	2.4	0.7
Pretax Income	(1.2)	(1.2)	(1.1)	(1.6)	7.5	1.7	(3.2)	(2.8)	(2.3)	(1.7)	(0.7)	(0.3)	(16.6)	(1.9)	(5.1)	3.3	(4.2)	(4.2)
Pretax margin	-8.3%	-8.3%	-7.4%	-10.2%	52.8%	11.5%	-18.9%	-16.6%	-16.1%	-10.3%	-4.0%	-1.8%	-30.3%	-3.4%	-8.5%	5.2%	-6.2%	-5.6%
Taxes	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2	4.6	1.1	1.0	1.1	1.3	1.1
Tax Rate	-18.0%	-19.1%	-20.0%	-21.2%	3.6%	15.2%	-8.9%	-12.0%	-14.0%	-13.6%	-31.5%	-68.6%	-28.0%	-54.9%	-19.7%	34.9%	-31.5%	-26.5%
GAAP Net Income	(1.5)	(1.4)	(1.4)	(1.9)	7.2	1.5	(3.5)	(3.1)	(2.7)	(1.9)	(0.9)	(0.6)	(21.2)	(3.0)	(6.1)	2.1	(5.5)	(5.3)
Non-GAAP Net Income	(1.0)	(1.1)	(1.0)	(1.5)	(2.2)	(1.3)	(1.4)	(1.4)	(2.3)	(1.5)	(0.6)	(0.2)	(9.7)	(4.4)	(4.6)	(6.3)	(3.9)	(3.7)
GAAP EPS-Basic	($0.06)	($0.06)	($0.05)	($0.07)	$0.28	$0.06	($0.13)	($0.12)	($0.10)	($0.07)	($0.04)	($0.02)	($0.82)	($0.12)	($0.24)	$0.08	($0.22)	($0.21)
GAAP EPS-Fully dil.	($0.06)	($0.06)	($0.05)	($0.07)	$0.27	$0.06	($0.13)	($0.12)	($0.10)	($0.07)	($0.04)	($0.02)	($0.82)	($0.12)	($0.24)	$0.08	($0.22)	($0.21)
Non-GAAP	**($0.04)**	**($0.04)**	**($0.04)**	**($0.06)**	**($0.08)**	**($0.05)**	**($0.05)**	**($0.05)**	**($0.09)**	**($0.06)**	**($0.02)**	**($0.01)**	**($0.37)**	**($0.16)**	**($0.18)**	**($0.24)**	**($0.15)**	**($0.14)**
Share Out	25.8	25.9	25.7	25.7	26.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	25.6	25.8	26.0	25.6	25.2
Fully diluted shares	25.8	25.9	25.7	25.7	26.5	26.5	26.5	26.6	26.6	26.5	26.5	26.5	26.0	25.6	25.8	26.6	25.6	25.2
Yr-to-yr Gr.	1%	1%	-1%	-1%	2%	2%	3%	4%	0%	0%	0%	0%	-4%	-1%	1%	3%	-4%	-2%

BALANCE SHEET

	Dec 31, 2018	Sept 30, 2018	Dec-Sept % Change	Dec 31, 2017	Yr-to-Yr % Change
CURRENT ASSETS					
Cash and cash equivalents	$32,414	$33,856	-4.3%	$28,520	13.7%
Restricted cash	34	34	0.0%	35	-2.9%
Short-term investments	6,172	7,331	-15.8%	17,601	-64.9%
Accounts receivable, net	11,388	11,291	0.9%	9,184	24.0%
Inventories	10,288	9,960	3.3%	9,330	10.3%
Prepaid expenses and other current assets	2,276	2,326	-2.1%	1,245	82.8%
Total current assets	**62,572**	**64,798**	-3.4%	**65,915**	-5.1%
LONG-TERM INVESTMENTS	10,445	13,104	-20.3%	3,112	235.6%
PROPERTY AND EQUIPMENT, NET	13,714	13,703	0.1%	13,755	-0.3%
OTHER ASSETS	2,578	2,132	20.9%	2,300	12.1%
Total other assets	26,737	28,939	-7.6%	19,167	39.5%
TOTAL ASSETS	89,309	93,737	-4.7%	85,082	5.0%
CURRENT LIABILITIES					
Notes and accounts payable	4,582	5,138	-10.8%	2,460	86.3%
Income tax payable	413	435	-5.1%	341	21.1%
Accrued expenses and other current liabilities	4,181	4,654	-10.2%	4,379	-4.5%
Total current liabilities	9,176	10,227	-10.3%	7,180	27.8%
OTHER LONG-TERM LIABILITIES					
Accrued pension liabilities	321	333	-3.6%	355	-9.6%
Deferred tax liabilities	681	1,099	-38.0%	906	-24.8%
Other liabilities	85	86	-1.2%	86	-1.2%
Total long-term liabilities	1,087	1,518	-28.4%	1,347	-19.3%
Total liabilities	10,263	11,745	-12.6%	8,527	20.4%
SHAREHOLDERS EQUITY					
Ordinary shares	33	33	0.0%	33	0.0%
Additional paid-in capital	143,115	142,794	0.2%	142,946	0.1%
Retained earnings (accumulated deficits)	(45,912)	(42,780)	7.3%	(47,517)	-3.4%
Accumulated other comprehensive income	4,674	4,759	-1.8%	5,337	-12.4%
Treasury stock	(22,864)	(22,814)	0.2%	(24,244)	-5.7%
Total shareholders equity	79,046	81,992	-3.6%	76,555	3.3%
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	89,309	93,737	-4.7%	85,082	5.0%
Cash and equivalents	$38,586	$41,187	-6.3%	$46,121	-16.3%
Change in cash and equivalents	(2,226)	375	-693.6%	(55)	3947.3%
Market value	43,935,480	43,425,560	1.2%	42,434,700	3.5%
Enterprise value	5,315,480	2,204,560	141.1%	(3,721,300)	-242.8%
DSO	62	60	3.3%	54	14.8%
Inventory Days	111	108	2.8%	119	-6.7%

ANNUAL CASH FLOW

	12 Months Ended December 31,				
	2017	2016	2015	2014	2013
OPERATING ACTIVITIES					
Net loss	$ (6,145)	$ (2,986)	$ (21,095)	$ (15,057)	$ (19,099)
Adjustments to reconcile net loss to net cash used in operating activities:					
Depreciation and amortization	1,667	1,682	2,446	3,718	4,685
Stock-based compensation	1,589	1,606	1,912	2,120	2,609
Loss on asset write-off	0	0	0	82	
Inventory write-downs	642	1,527	913	1,538	900
Gain on sale of long-term investments	(20)	(948)	(8)	(436)	
Impairment loss on long-term investments	0	0	4,953	83	
Gain on disposal of property & equipment, net	(137)	(1,726)	(738)	(428)	(106)
Deferred income taxes	40	(1,231)	1,989	78	41
Other, net	0	0	0	(36)	(1)
Changes in operating assets and liabilities:					
Accounts receivable, net	(1,979)	(2,008)	1,592	3,235	(1,251)
Inventories	(697)	(1,140)	(1,933)	(2,963)	(200)
Prepaid expenses and other current assets	(139)	(6)	191	130	510
Deferred charges	(553)	(375)	(416)	(985)	(1,366)
Notes and accounts payable	(1,869)	996	1,202	(2,038)	413
Income tax payable	161	(2,065)	1,595	412	(124)
Accrued expenses and other current liabilities	186	(1,064)	(1,039)	577	(1,083)
Accrued pension liabilities	13	(4)	(11)	(12)	(25)
Other liabilities	3	(56)	(168)	(346)	(8,893)
Net cash used in operating activities	(7,238)	(7,798)	(8,615)	(10,328)	(22,990)
Acquisition of:					
Short-term investments	(8,505)	(28,797)	(7,128)	(22,346)	(15,496)
Long-term investments	0	0			(250)
Property and equipment	(704)	(673)	(724)	(1,004)	(743)
Decrease (increase) in:					
Restricted assets	0	0			10,000
Restricted cash	0	0	132	(1)	1
Other assets	22	40	82	116	108
Proceeds from:					
Sale of short-term investments	12,635	18,331	16,755	34,333	52,131
Sale of long-term investments	0	5,982	167	1,304	0
Return of capital from LT investment	1,163	17	370	0	
Disposal of property and equipment	145	3,837	3,205	1,982	166
Net cash provided by investing activities	4,756	(1,263)	12,859	14,384	45,917
FINANCING ACTIVITIES					
Acquisition of treasury stock	(708)	(619)	(3,233)	(4,965)	(8,279)
Proceeds from:					
Exercise of stock options	29	2	31	44	25
Issuance of ordinary shares under the Employee Stock Purchase Plan	84	73	180	258	335
Net cash used in financing activities	(595)	(544)	(3,022)	(4,663)	(7,919)
EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATE	265	(262)	(1,092)	(617)	(613)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,812)	(9,867)	130	(1,224)	14,395
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR	31,332	41,199	41,069	42,293	27,898
CASH AND CASH EQUIVALENTS AT END OF THE YEAR	28,520	31,332	41,199	41,069	42,293
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS					
Cash paid for tax	$ 818	$ 4,349	$ 1,068	$ 697	$ 1,064
Cash Flow	(2,364)	(2,076)	(9,628)	(8,338)	(10,971)
Free cash flow	(3,068)	(2,749)	(10,352)	(9,342)	(11,714)

HISTORICAL STOCK PRICE



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