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Investment potential of the Crimea region

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1 Introduction

Ukraine with her 603,700 sq km territory provides a variety of regional opportunities for doing business and investments. Being one of largest country in Europe, Ukraine is subdivided into twenty four oblasts (regions), two cities Kyiv and Sevastopol with special legal status and the Autonomous Republic of Crimea. Each of the regions has its own specific investment climate as well as regional peculiarities. The eastern regions boasts well-developed industrial sector, which include steel producing, coal mining, metallurgy, chemistry and petroleum refining. The western regions are more focused on agriculture, light industry, trade and wood processing. Central and northern regions' economies are concentrated around the Kyiv city which is financial centre of Ukraine's economy and wealthiest consumer market. Last but not least, southern regions are the heart of Ukraine's recreation resources with economies dominated by agriculture and service sectors.

The purpose of this report is to familiarize a reader with the investment potential of the Autonomous Republic of Crimea and provide an assessment of the region's relative attractiveness to foreign investors. Autonomous Republic of Crimea is situated on the Crimean peninsula, in the southern part of Ukraine. Crimea is characterized by the favorable geographic position, unique natural landscape and environment. Furthermore, region has developing transport infrastructure, light and processing industries, winemaking and agricultural sectors, significant labor and intellectual resources. Moreover, those who seek to gain ground in the region should be encouraged by the plenty of successful examples of, for instance, foreign companies which have established themselves in Crimea and growing investments into the region.

Chapter two exposes Crimea's overall economic conditions as well as benchmarks region's overall competitiveness in comparison with other Ukraine's regions. Chapter three will provide an insight to foreign economic activity of Crimea and current investment features. While chapter four focuses more specifically on most attractive for investment segments of the region's economy. The report concludes with SWOT analysis as it is an easy and flexible method to identify and conclude regional strengths and weaknesses and opportunities and threats.

2 Overview of Crimea

Autonomous Republic of Crimea occupies a territory of the Crimean Peninsula in the south of Eastern Europe. Area is a part of Ukraine, being the important resort, industrial and transit region of the country. Crimea due to its beneficial position between Black Sea and Sea of Azov, has unique position in transport and tourism sectors. Hence, it makes an important contribution to the infrastructure of Ukraine.

Crimea is granted political autonomy by the Constitution of Ukraine and this status is confirmed in the Constitution of the Autonomous Republic of Crimea. It is the only region of Ukraine which has such arrangement. Crimea has its own parliament, which appoints and designates a prime minister with the consent of the President of Ukraine.

The most spoken language is Russian, which the Crimean Constitution grants official status. In fact, Russian language is used in the public administration, the media and the educational system in Crimea. Even though Ukrainian and Crimean Tatar have the same status these are rarely used.

Crimea is one of the most diverse and complicated region of Ukraine due to its history, ethnic diversity, cultural differences as well as special constitutional status. With the collapse of the Soviet Union, Crimea became part of the newly independent Ukraine, a situation largely unexpected by its population that was ethnically and culturally Russian for the most part. It is the only region of Ukraine where Russians nowadays form the major ethnic group representing 58% of the population. Following minorities are Ukrainians (24%) and Crimean Tatars (12%) who had been forcibly banished to Central Asia by Stalin in 1940s and began to return back to their native lands since 1990s. The Crimea is one of multinational regions and is characterized by a large variety of nationalities: Belarusians, Armenians, Jews, Azeris, Greeks, Karaites, Krimchaks (together around 5%) keep original cultural community. Such population diversity often raises some tension in the region. Loyalty to Russia among Crimeans is still strong and this has increased during the last few years. According to Think-Tank Razumkov Centre, 32% of Crimeans do not consider Ukraine as their native country, while 48% would like to change their citizenship, mostly to Russian. Moreover, around 63% of Crimea's population would support the idea of Crimea joining Russia. Such population support raises the influence the Russian has over Crimean peninsula, which is stronger than that of Ukraine.

Land resources of Crimea region are accounting 26 thousands km². The great part of the land is in the intensive state circulation. The agricultural area amounts 18 thousands km², which includes 12 thousands of plague land.

The coast side is the main land resource, which includes for about thousand km² of recreational and health-resort lands, situated near the Black Sea. The total area, on which situated recreational, historic-and-cultural establishments is about 95 km². The south coast is the one third of these lands.

The water resources consist of the local steam flow which is formed with rainfalls and snow melting. The North-Crimea Channel is the source of water delivery of the industries (especially agricultural industry). Additionally, there are for about 100 mineral water springs in Crimea, with near 2% reserves used of total volume. Furthermore, there are for about 12 therapeutic mud minefields and only 3 of them are used (Chokraskoe, Sakscoe, Uzunlarskoye).

Table 1 indicates basic information about the region and the following chapters describe the particularities.

Table 1 Key facts about Crimea

Land area	26 100 km ²
Population	1 967 000
Consumer price index	23.3 %
Unemployment rate	4.7 %
Average monthly wages	243.0 USD
GDP	1 373 mln USD
Exports	586 mln USD
Imports	431 mln USD
FDI	807 mln USD

2.1 Human resources

The population as it is common for Ukraine is comparatively highly skilled and educated, but it may perhaps be difficult to find particularly trained labor force with

many years of experience. This may concern difficulties in finding personnel to handle modern technologies and machinery as well as experienced managers. Such staff has limited experience with complex procedures and personal initiative is needed for the reason that most of the work force is used to be oriented by strongly formulated instructions. One can assume that country as well as a region lacks skilled workers and managers.

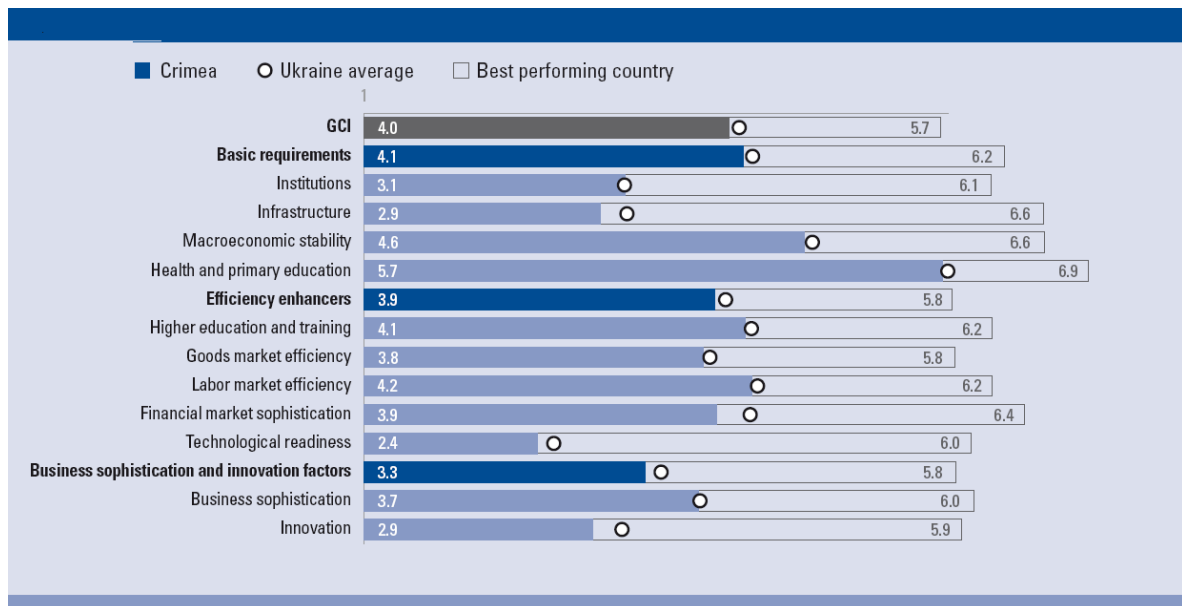
The unemployment rate in the region reached 4.7% during the 2008. As for Crimea it may vary during the year since the region is blooming in the summer due to the tourist season and many people are self employed in the markets or in service sector.

Gross wages in Ukraine are among the lowest in a whole Europe. Currently, Ukraine's average monthly wages are at the level of 243 USD per month. In comparison to Ukraine's average wage level, in Crimea monthly earnings are lower and make 208 USD per month. This creates a possibility for European companies to have a ground with vast amounts of inexpensive human resources closer to the target markets.

2.2 Crimea's position in a comparative perspective

The World Economic Forum report "The Ukraine's Competitiveness report 2008" presents as part of Ukraine's competitiveness analysis performance of Ukraine's regions. According to the report Crimea's Global Competitive Index score places region 9th among other regions and 81st in the international ranking behind Philippines and Romania. Crimea also received principally low scores in terms of financial market sophistication (12th within Ukraine), innovation (11th) and technological readiness. Nevertheless, there are positive sights such as first place among Ukraine's regions in relative impartiality of government officials in dealing with the public. General Crimea's performance according to the report is indicated in Figure 1, where can be seen strong and weak sights of the region.

Figure 1 Crimea’s competitiveness performance



Source: WEF “The Ukraine’s Competitiveness report 2008”

Table 2 specifies the results of the “Investment Rating of Ukraine’s regions” report that had been completed by Russian Rating Agency Expert. According to the analysis made by the Agency Crimea is one of the regions that form economical basis of Ukraine. The region is characterized by average investment risk and investment potential that is present in the country and the interest of the foreign investors in the region is increasing.

Table 2 Crimea’s investment potential ranking

Ranking index	Rank of Crimea out of 27 Ukraine’s regions
Ranking of investment potential	13
Ranking of investment risk	16
Labour potential	10
Consumption potential	5
Production potential	19
Financial potential	9
Institutional potential	7
Innovation potential	12
Infrastructure potential	19
Natural resource potential	23

3 Business environment

The economy of the Autonomous Republic of the Crimea has been shaped by the peculiarities and riches of its nature, as well as beneficial geographical location of the peninsula. The Crimea has advantageous natural conditions for development of agriculture, recreational industry, and certain extractive industries, such as gas extraction, iron ore and fluxing limestone mining, construction materials, soda and bromide production. In terms of economic structure Crimea can be defined as an agricultural and industrial region of Ukraine, yet one of the most promising from investments point of view Southern regions. With GDP 1373 mln USD, the Crimea produces 2,8% of the Ukrainian GDP.

3.1 Industry and the leading companies in the region

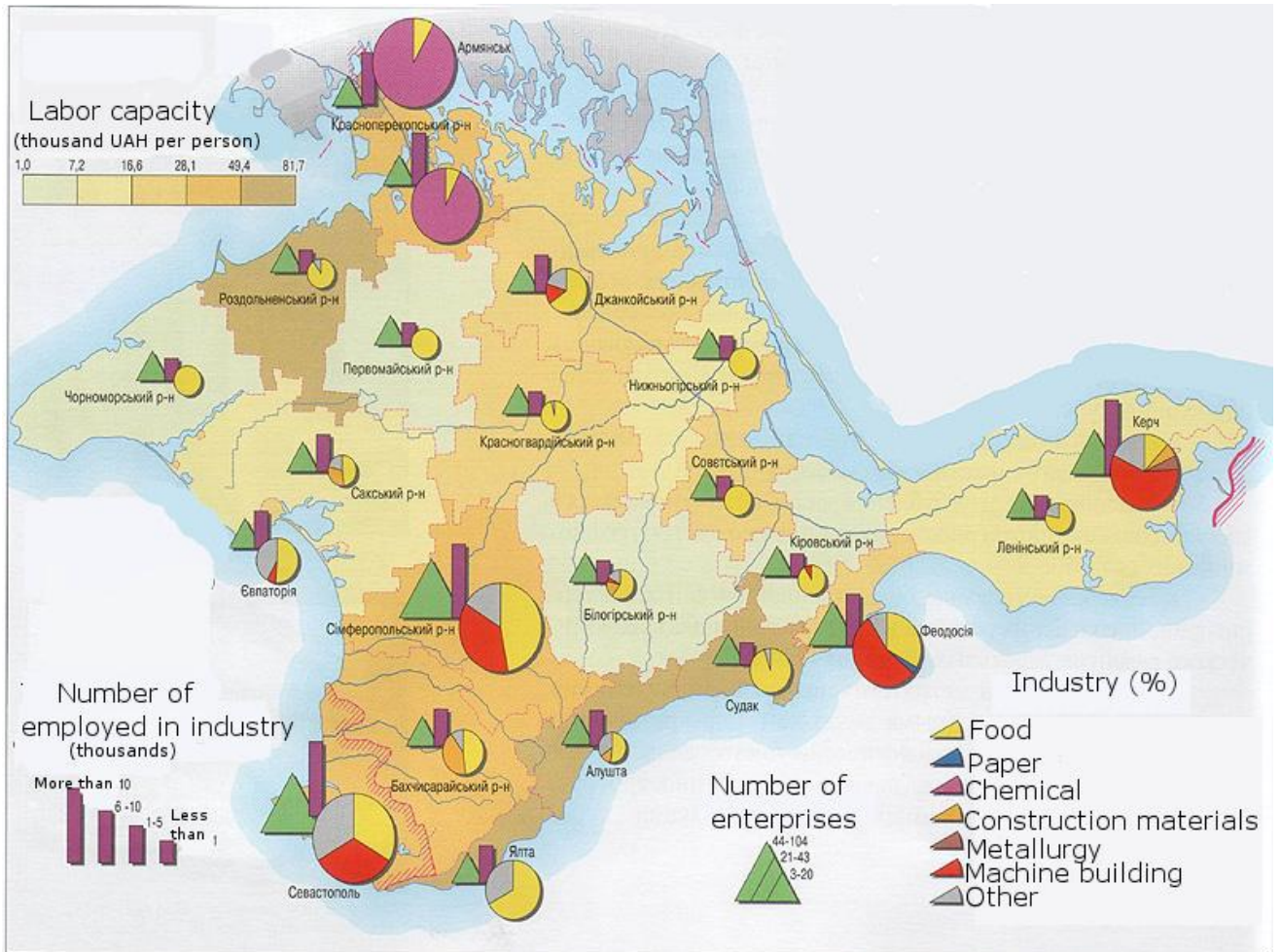
Industry is one of the leading branches of the Crimean economy nowadays. It makes one sixth from GDP of the region. In industrial production of the Crimea there are more than 2000 large, middle and small enterprises with more than 70 000 employees. The industry of Crimean Autonomous Republic has the wide spectrum of types of economic activity, thus main sectors are processing industry (73,5%), production and distribution of power, gas and water (21,1%), mining industry (5,4%).(Map 1)

Machine building plants staffed with stable and skilled workforce are highly technology-intensive. They supply, abroad included, the shipbuilding products, equipment for food-processing industry, electrical and pneumatic devices, electric welding equipment, and agricultural machinery.

The Feodosiya Production Association More has launched the production of an innovative design of the high-speed 200-seat catamaran Superfoil-30 with titanium hydrofoils and a system of interceptors.

The Company SELMA is persistently working towards improving the competitiveness of its products. The performance of its welding equipment conforms to international standards and is exported to many countries throughout the world. The company has introduced and certified the quality-assurance system ISO 9001. In order to develop state-of-the-art and perspective technologies in electric welding, the company is collaborating closely with the leading foreign manufacturers of welding equipment, including Polish OZAS, Swedish ESAB Concern, and Finnish KEMPPI.

Map 1 **Crimea's Industry**



Source: Invest Crimea

The Company Factory Fiolent is the leading Ukraine's and CIS producer of control systems for the technical and navigational facilities for commercial and naval vessels, precision micro-machinery, sensors and indicators, controlling security systems for nuclear power industry, and the leading Ukrainian manufacturer of household and industrial power tools.

The Crimea's most promising industries are related to the use of its natural resources. The scope of reserves and the share of the fields prospected allows to use only natural gas as technological fuel at present. Natural gas fields began to be explored in the Crimea from mid-80s at the Tarkhankut peninsula, on the Arabat point, and near the city of Dzhankoi. The fields on the continental part of the Crimean peninsula were joined in the late 70s, by the shelf reserves of natural gas at the Black Sea and Azov Sea reservoirs. The Golitsyn gas condensate field is the largest supplier of organic fuel.

The field is located at the Black Sea, 72 km off the Tarkhankut peninsula at depths of 40 m. In general, the recoverable reserves of gas and gas condensate in the Crimea are as follows: gas – 8,948 bn m³; gas condensate – 2.12 bn tonnes.

The oil deposits in the Black Sea and Azov Sea aquatory, as well as in the vicinity of the Kerch peninsula present a promising group of Crimean resources. The prospected oil reserves amount to 1.492 mn tonnes.

The Saky State Chemical Plant and Open-end Research and Production Association Iodobrom use local raw materials. Two plants in the town of Krasnoperekopsk – The Crimean Soda Plant and Bromine use the brine drawn from the Syvash bay and from salt lakes. These enterprises are monopolists on the Ukrainian and CIS markets, and produce unique products, being quite competitive on the European and world markets.

The Mining and Concentration Works Titan produces more than a half of the country's titanium dioxide and ammophos. The Crimean Soda Plant produces 90% of soda salt in Ukraine. The OSC Brom is the only domestic producer of liquid bromine, iron bromine, dipropanebromide, and bromine salts. The Saky State Chemical Plant occupies the monopoly position on the CIS market in the production of potassium permanganate and methyl bromine.

The metallurgy in the Crimea is represented by the OSC The Kerch P. Voikov Metallurgical Plant, which manufactures steel enameled kitchen utensils, and railway points.

The construction materials industry in the Crimea is represented by well-developed facilities based on abundant reserves of non-ore raw materials (about 200 deposits): saw limestone (45% of Ukrainian reserves), cement stock, including marls. The annual output of construction materials approaches 13 mn m³. The leading role in the industry is occupied by the production of wall materials made of the saw limestone mined at the Inkerman, Bodrak, and other deposits.

The Crimean cement industry is based on well-explored marls of the Bakhchysarai deposit, which features significant reserves and uniformity of composition. The production of facing tiles is concentrated at the Alminsk, Inkerman, and Prymorsk Plants. The production reject is used to make gravel, shall-and-concrete wall panels, and asphalt concrete.

Agricultural complex of the Autonomous Republic of Crimea could be estimated as extremely attractive branch for investment. The basic components of investment appeal of agro-industrial complex of Crimea are:

- the fertile soils;
- the inexpensive and qualified labor resources;
- availability of processing branch capacities;
- favorable geographical location for exports.

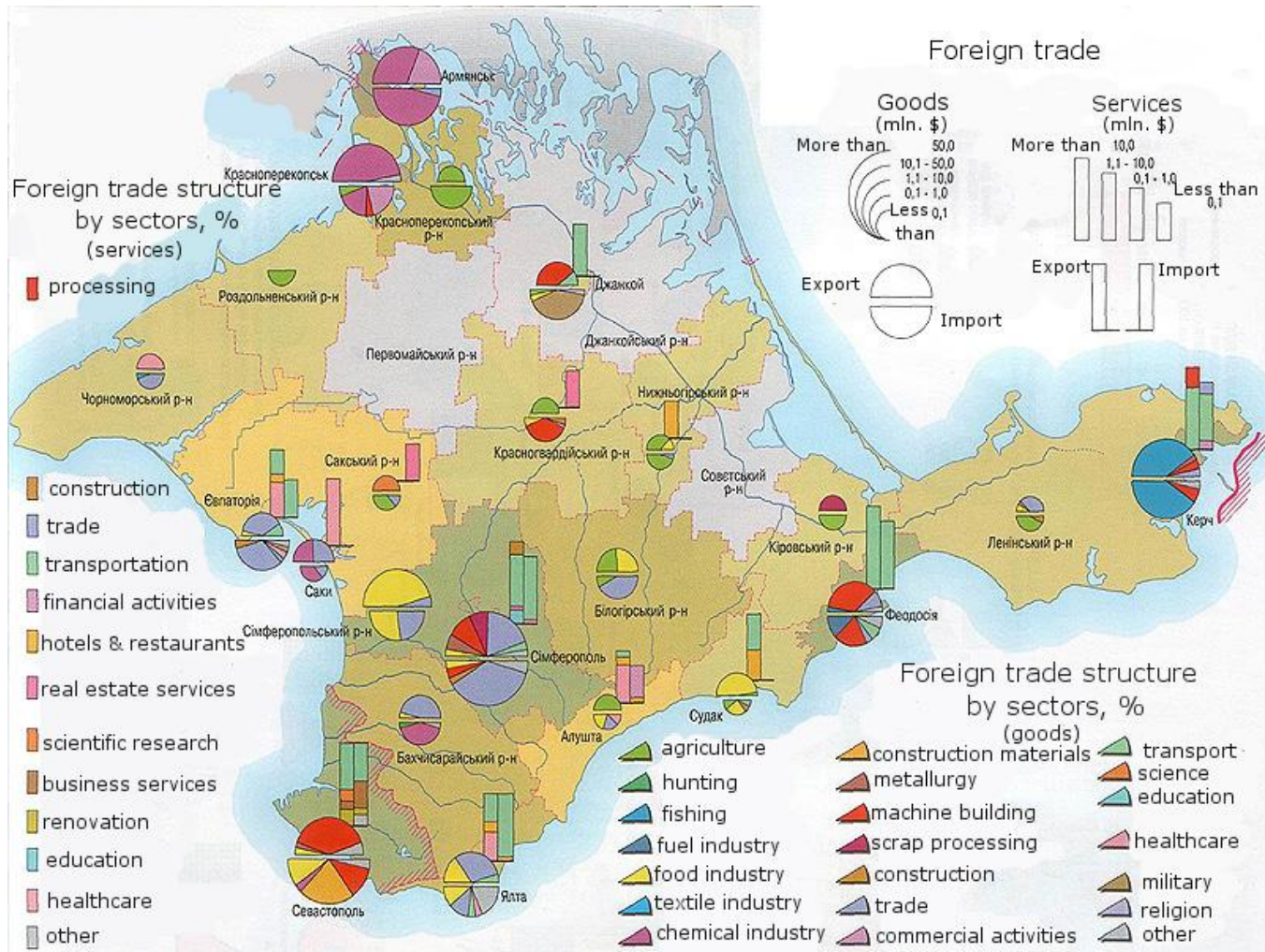
3.2 Foreign trade

Volumes of export of goods in the Autonomous Republic of Crimea in 2008 constituted 581 million USD, import - 429 million USD. In comparison with 2007 volumes of export increased by 25,5%, import - by 60%. Positive balance of foreign trade in the goods 151,7 million USD (in 2007 – 196,2 million USD).

The Autonomous Republic of Crimea maintained foreign trade relations with 111 countries of the world. Map 2 indicates major information about foreign economic activity of the region.

Ukraine became a member of the World Trade Organization in February 2008. The European Union had agreed upon membership in order to negotiate a free trade agreement with the country. Ukraine had until 4 July 2008 to ratify the membership protocol and, thirty days later, it became a full member of the organization.

Map 2 Crimea's foreign economic activity



Source: Invest Crimea

4 Investment environment and potential of the region

The Autonomous Republic of Crimea is a very difficult territory for the attracting and mastering of foreign investments due to the beneficial economic and geographical position of the peninsula, natural resource availability, its health resort, industrial and scientific potential, well-developed transport infrastructure and banking system, and the easy access to the markets of Ukraine, the countries of the CIS, Europe and Asia.

For the investments into region are relative same challenges as for the whole country. It is worth to mention that politically country is divided into EU supporters and Russia sympathizers. Crimea is known for being one of the regions that highly support Russian side. As a whole, even though Ukraine has already been independent for eighteen years both democracy and the market economy are young and immature. Unfortunately country's political instability highly effect economic situation and reforms and improvements are needed.

To some extent, one of the primary factors of the Crimean investment climate development is the investors' degree of confidence to the governmental agencies, the stability of the economical and political situation, a clear market and structure adjustments, as well as the availability of a market infrastructure and developed economy.

Today a single legal terrain for the investment in the Autonomous Republic of Crimea has been already created. In particular, Ukrainian Laws On Investing Activity and On Foreign Investing Regulation guarantee equal rights of all subjects of the investing activity, independently of their forms of ownership and management, for their investing activity, unless otherwise stipulated by the Ukrainian legislative acts, the same terms and conditions under which the investing has been made, as well as the investments' protection guarantees are also provided.

The other factor for the improving of the Autonomy's investing climate is the creation of a stable fiscal system, which must provide a sufficient volume of incomings into budgets of all levels, the effective economic performance, and the creation of further conditions for the integration of the Autonomous Republic of Crimea and Ukraine in whole into the international economy.

The changes in taxation system, which have happened during the last years, promoted the taxation base extension, the reduction of tax suppression on taxpayers, and the

further adaptation of the Ukrainian legislation to the European Union Laws, which in its turn, had a positive effect upon terms and conditions of the investing processes in the country.

In order to implement radical transformation in the national economy a comprehensive long-term program of socioeconomic development and restructuring of the economy of the Autonomous Republic of the Crimea has been developed covering the period until 2010. Proceeding from the problems of republic's socioeconomic development, its climatic and resource potential, peculiarities and specialization of the region, and its place in the social division of labor, and approaches to structuring the economy, the program identifies the following long-term priorities:

- development of the resort and recreational complex, it is shaping as the key industry within the economic complex;
- development of the fuel, energy, and water economy sectors to the levels that would allow to provide for the needs of the population and the whole economy;
- reforming and developing the agricultural and processing sector in order to satisfy the needs of residents and guests in foodstuffs, and provide the processing industry with raw materials, so as to increase the traditional Crimean exports;
- further development of all means of transportation, including sea ports, and expanding the transport and distribution functions;
- creating a high-tech competitive industrial complex, adapted to market conditions and capable of satisfying the needs of the region and participate in economic relations of Ukraine and other countries;
- reception and resettlement of the deported peoples returned to the Crimea for permanent residence.

The measures applied to all areas include the requirement of establishing environment-friendly production, minimizing technological pressures on the environment, assuring the transition to a balanced use and restoration of recreational and other natural and resource factors for providing basic services.

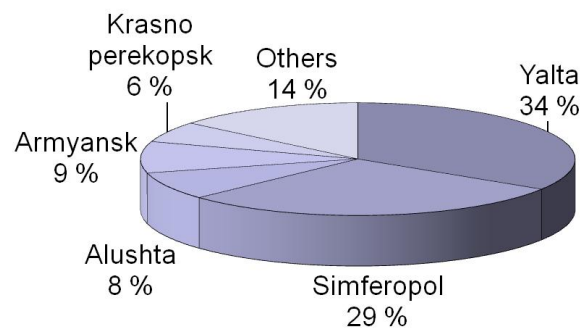
Investment activity is one of the defining indicators when it comes to outline of the economic potential of the region. As for Crimea, investments in its economy during

2008 have amounted 807 mln. USD, enlarged 39% in comparison with previous year. Furthermore, Crimea obtained its place in "top 10" regions of Ukraine that most actively attract foreign investments. The share of Crimea in Ukraine's total investments is 2.7%. During 2008 on the territory Crimea were working 26 investment projects with the total cost 296 million dollars. From the beginning of working the projects on the territory of the peninsula were realized 10 projects with the cost of 81 million dollars: by territory of priority development (TPD) Alushta – 37 mln USD, TPD Big Yalta – 18 mln USD TPD Sivash – 18 mln USD, TPD Kerch - 7 mln USD, TPD Feodosiya - 7 mln USD. Unfortunately, by different causes including cancellation of privileged order of taxation was closed 33 investment projects with the cost 140 mln USD. From the whole bulk of investments which are foreseen by projects, investments to main fund are 91%.

From the beginning of realization of investment projects to the Crimea's economy preceded 89% (265 mln USD). Ukrainian investments have the main part of investments to working projects – 194 mln USD (73% total bulk), foreign investments – 71 mln USD (27%).

Foreign investors have been interested in those economic areas of Crimea that showed highest capital turnover and those regions that possessed a growing and developed infrastructure. The leading centers of investments are Yalta, Simferopol and Armyansk (Figure 2). Development of investments in those cities is also tightly connected with special investment policy as they are defined by government as priority development regions of Crimea. Government is implementing various stimulating and supporting policies to ease investment processes and develop the regional environment.¹

1 For more detailed information reader is advised to familiarize with material available on government investment portal <invest-crimea.gov.ua>. There are published consultative collections named "Ten steps towards..." about Crimea's business development as well as all necessary information about how to start business in Crimea. (available in English)

Figure 2 Foreign direct investments into regions of Crimea, 2008

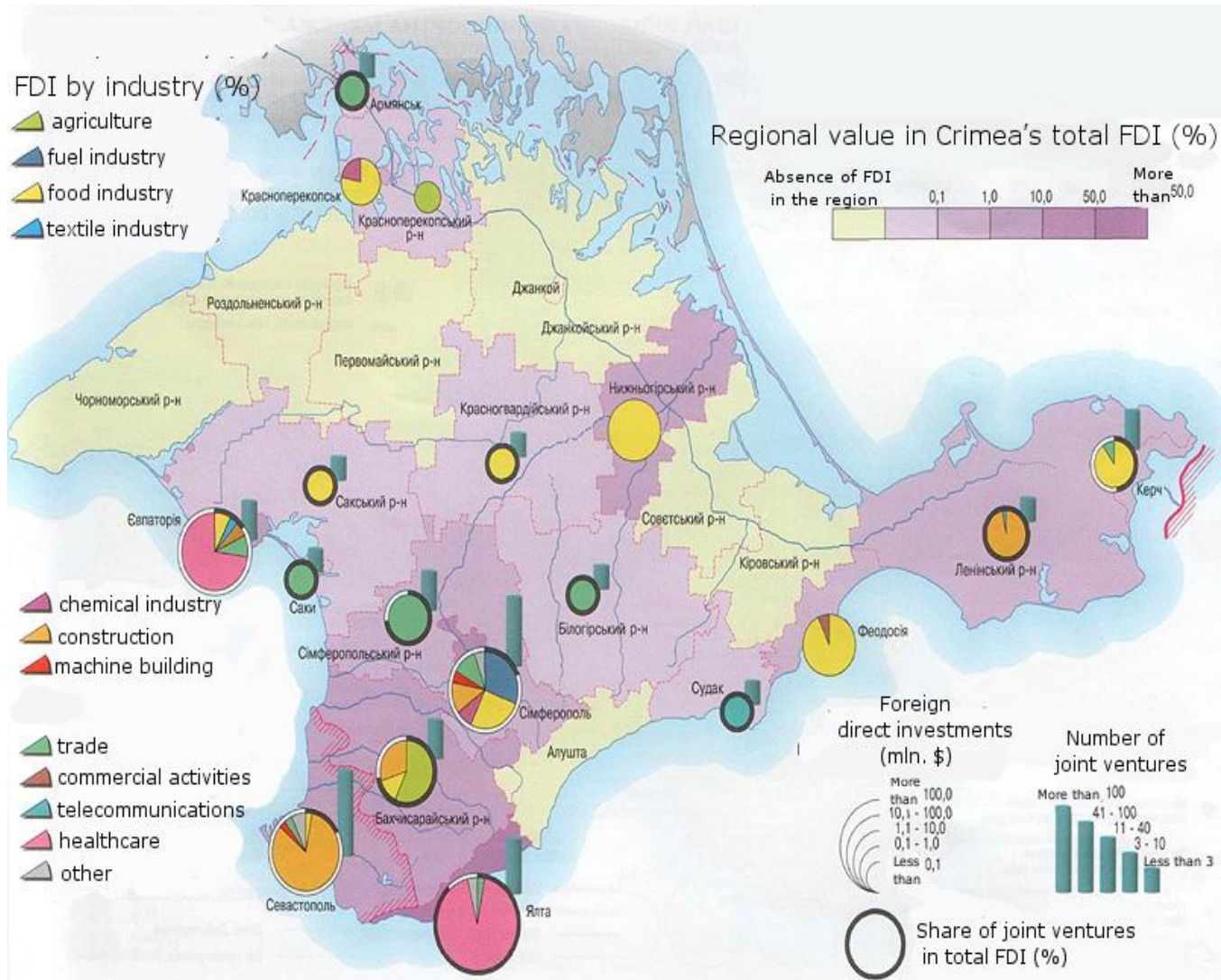
Source: Statistical office of Autonomous Republic of Crimea

The main sectors of foreign capital concentration are industry (amount of investments in 2008 reaches 175.5 mln USD), construction (149.1 mln USD), healthcare and recreation (135.6 mln. USD) (Map 3).

Most attractive areas for investments in recreation are western, southern eastern and southeastern parts of Crimea. During 2008 the largest amount of investments was put into enterprises:

- construction - 22,9 million USD;
- real estate activities, rent, engineering – 22,5 million USD;
- culture and sport - 3,1 million USD;
- transport and communications – 2,6 million USD;
- agriculture, hunting and forestry – 1,0 million USD.

Map 3 Foreign direct investments in Crimea



Source: Invest Crimea

On the regional level following areas of economy require vast investment in a first place:

Table 3 Development activity required, by industry

Industry	Type of activity
Leisure and tourism	Construction and renovation of hotels Development of a modern hotel complex; the maintenance and development of systems aimed at rehabilitation Development of a network of spa and rehabilitation (wellness), as well as other tourist, structures
Agro-industrial complex	Introduction of highly-efficient breeding technologies; renewal and Modernisation on the basis of new technology of processing and food production companies which provide and preserve agricultural products Mechanisation of the existing and the creation of new capacities in the production of packaging and packaging materials Development of agricultural mechanical engineering; production of facilities for the canning industry
Light industry	Production of yarns, textiles, clothes, shoes and leatherwear
Power engineering	Mining and the extraction of gas and oil Development of innovative energy producing and saving techniques Development of non-traditional modes of energy supply Creation of geothermal power objects Construction, modernization and reconstruction of main and distributive electric networks
Construction	Production of cement, bricks and blocks, paving slabs Development of the modern production of new construction materials and products Renovation and reconstruction of industrial objects Building and reconstruction of industrial objects
Transport system	Construction of high-quality traffic routes Construction and modernisation of pipelines aimed at different purposes Development of an environmentally-friendly oil terminal Development of ports for sea commerce
Industry	Manufacture of elec

During 2009 Crimea received foreign investment worth 712.3 mln USD, including direct investments - 652.9 mln USD and credits - 59.4 mln USD.

Foreign firms have particular difficulties in gaining ground in Ukraine. Bureaucracy plays a large role hereby because it leads to very long waiting times. The degree of bureaucracy in Ukraine is very high and, for some foreign companies, the procedures become an ordeal. In this area, comprehension should not go missing. The authorities are very concerned about new enterprises, but they give only little support. Bargaining with the government is difficult, too, because it does not necessarily stand by an agreement.

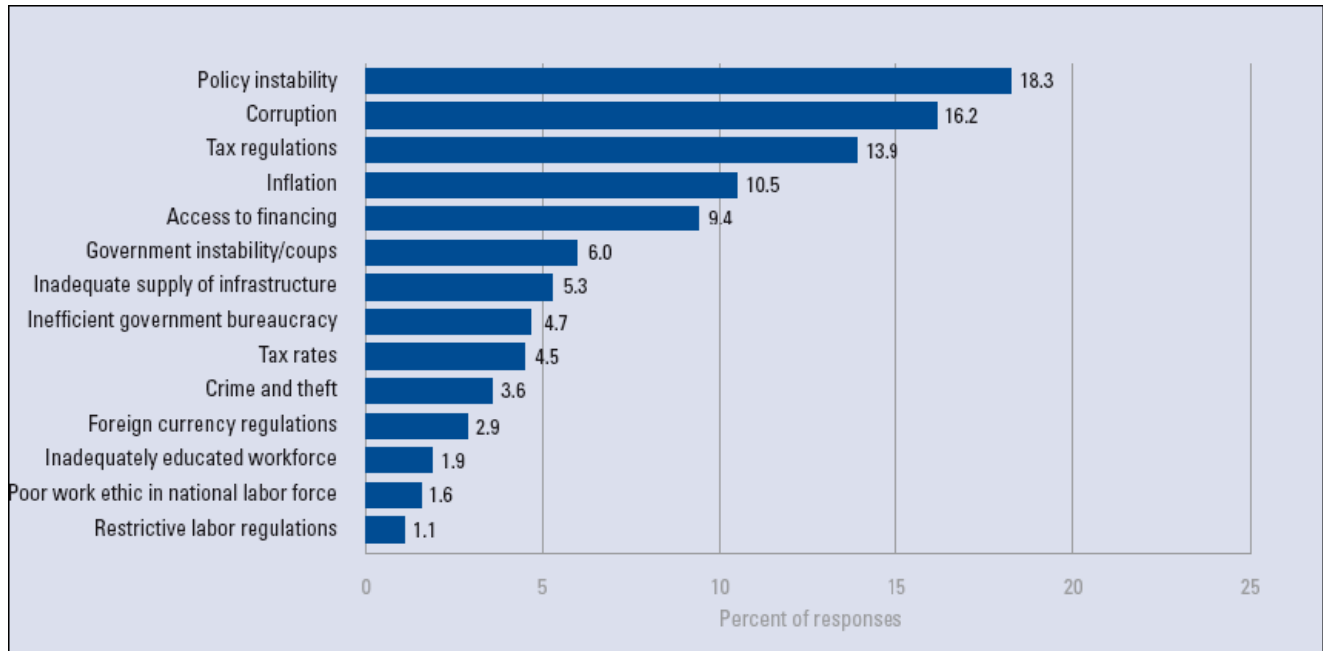
The search for the right co-operation partner can be made difficult by several factors: the non-transparent organizational structures of Ukrainian firms, in which a request might not find a responsible person and end up in the wastebasket; the complex and, from a Ukrainian perspective, non-comprehensive requests of foreign companies the translation of which would be too time-consuming, to say nothing of the subsequent adjustment to technical norms; and the unrealistic expectations about price on both sides.

General risks as regards the investment climate result from the macroeconomic framework of Ukraine:

- unstable legislation
- difficulties with implementing the law
- little protection of investment and economic interests
- risks of infrastructure deficiency
- unreliable transportation network, especially for transit freight
- insecurity with debt payments
- delay in bank transfers
- unstable tariff regulation and resultant difficulties with border and tariff services
- incalculable corruption payments
- difficulties in finding qualified on-site managerial staff

As a practical meter it is necessary to provide research results highlighted in “The Ukraine’s Competitiveness report 2008” concerning most problematic factors companies indicated about doing business in Crimea (Figure 4).

Figure 3 Problematic factors for doing business in Crimea



Indeed, the Ukrainian government has declared its intentions to reduce investment risks and improve the framework for foreign business partners. However, one needs to face up to the difficulty that intention and reality often diverge in Ukraine. Hence, it is important to bear in mind the interaction of the numerous economic, fiscal and legal factors and the need to integrate country-specific peculiarities into planning right from the beginning.

5 SWOT analysis of the region

Strenghts:

- Advantageous geopolitical location suitable for transport and tourism utilization, access to markets;
- Unique recreational potential, ensuring development of practically all types of tourism and recreation
- Important agricultural and climate resources; a variety of natural resources, to in conjunction with high development areas to minimize expenses during realization of investment projects;
- High population density, availability of skilled labor; high share of graduates
- Dynamic legal framework of economic and investment development of the Autonomous Republic of Crimea; Active development of the financial and credit system

Weaknesses:

- Excessive regulation of business activities
- A large number of industrial companies have ceased production
- Long-lasting process of economic reforms
- Large intra-regional differences in socio-economic development
- Crucial concentration of the economic potential in few cities in the oblast
- Considerable share of the population with very low income levels
- Low internal energy security
- High interest rates
- Large intra-regional differences in the workforce
- Limited employment opportunities in the periphery
- Insufficient development of the motorway network in the periphery
- Unsatisfactory water supply and disposal
- Low level of development of the social infrastructure

Opportunities:

- Strategic location at the crossroads of East-West and North-South trade routes, Ideal platform for manufacturing and exporting both to Russia and to the EU
- Employees of international
- Consultants in the education sector of regional business representatives
- Transition of the oblast territory
- Agroclimatic potential, fertile agricultural lands, to grow the entire spectrum of cultures and separate temperature zones subtropical culture;
- Existence of particular business zones
- Active modernization and development of the port industry

Threats:

- Unsatisfactory level of development of the transportation network for transit journeys
- Difficulties with border and tariff services of the transit freight
- Peripheral position of the region compared to the capital of Ukraine
- Dependence on deliveries of mineral and energy resources
- Dependence on external energy suppliers
- Unsatisfactory structure of external investments
- Potential partners are badly informed about the opportunities of the region
- Distrust of foreign business partners towards guarantee promises regarding protection of investments and business interests.

6 Conclusion

After looking at economic and market advantages offered by Crimea, it is obvious that the region could be on the top of Ukraine's regions investment receivers. Unfortunately, investment potential and attractiveness of Crimea region as well as of many other regions of Ukraine is underdeveloped due to several reasons. First, a number of factors indicate that Crimea is very difficult region for foreign investors. Internally, the territory suffers governance inefficiency, unresolved economic and social problems and increased tensions in relations between the Slavic majority and the Tatar minority. Externally, Russia is expanding its influence in the region. Furthermore, along with economic potential, social and ecological factors need a vast investments and regulation. Second, investment projects initially need significant amounts of capital to raise capacity of the existing companies to necessary production level and possibility to operate effectively. In addition, investing in new businesses is restrained by high level risks and absence of assurance to receive acceptable profits from invested capital because of low purchasing power of population majority. Crimea, with all advantages of the region whose tourist revenues could have made it one of the Ukraine's wealthiest regions, remains underdeveloped.

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