

Vermilion Energy

Forecast update

Dividend and growth comfortably covered

Vermilion Energy offers a geographically diverse production base, the ability to fund an 8.1% dividend yield and a forecast FY19 c C\$530m capital programme, all achievable even at realised commodity prices c 3% below our base case (WTI US\$56.1/bbl, Brent US\$62.8/bbl). We adjust our FY19 and FY20 forecasts to reflect lower short-term commodity price expectations (based on the latest EIA forecasts of 12 March 2019). EIA's FY19 WTI moves from US\$64.9/bbl to US\$56.1/bbl (-14%), driving down our forecast FY19 FFO from C\$1,200m to C\$982m (-18%), comfortably above the \$954m we estimate is required to cover dividend, maintenance and growth capex. Our valuation falls from C\$54.5/share to C\$47.5/share, based on a blend of P/CF, EV/EBIDAX, DDM, and FCF (plus growth) multiples. The valuation remains highly sensitive to commodity price assumptions. We provide a sensitivity to these key inputs in this note.

Year-end	Revenue (C\$m)	EBITDA* (C\$m)	Operating cash flow (C\$m)	Net (debt)/cash** (C\$m)	Capex ex acquisitions (C\$m)	Yield (%)
12/17	1,024.4	673.5	593.9	(1,223.8)	320.4	5.7
12/18	1,526.0	1,036.5	816.0	(1,768.9)	518.2	8.0
12/19e	1,730.4	1,045.4	945.2	(1,801.6)	533.4	8.1
12/20e	1,803.5	1,114.3	1,007.6	(1,803.5)	564.1	8.1

Note: *Reported EBITDA includes hedging and FX gains/losses. **Net debt = long-term debt, plus short-term debt minus cash and equivalents.

Dividend and growth capex comfortably covered

Underlying oil and gas prices remain volatile. However, Vermilion's diverse asset mix ensures that exposure is not over-concentrated in specific geographic regions or differentials. Canadian heavy crudes continue to trade at a material discount to WTI, whereas Vermilion's average oil realisation in March 2019 stood at a US\$1.25/bbl premium to WTI. Stress testing our price assumptions and assuming all commodities show a correlation of 1.0, we conclude that even at c 3% below our base case, the company's FFO fully covers forecast dividend, maintenance and growth capex.

Three-year average recycle ratio of 3.8x

Organic capex is a key driver of reserves replacement, and with a three-year average recycle ratio of 3.8x, returns are robust. Exploration wells in early 2019 include the Burgmoor Z5 well in Germany targeting an undrained flank of the existing gas field (50bcf gross, Vermilion 45.8% interest). A discovery here could be easily tied into existing infrastructure. The Dombiroto-1 exploration well in Hungary is also planned to be drilled in Q119, targeting a fault-bounded 5bcf prospect close to the Mh-Ny-07 discovery, which was put into production in 2018.

Valuation: Blended valuation stands at C\$47.5/share

Relative to peers, Vermilion trades at a premium of 5.4x FY19e P/CF vs a global peer group average of 3.8x, reflecting above average growth and a sustainable, top decile dividend yield. Our blended valuation (P/CF, EV/EBIDAX, DDM and FCF plus growth) is C47.5\$/share, down from C\$54.5/share previously.

Oil & gas

19 March 2019

Price **C\$34.02**

Market cap **C\$5,195m**

US\$/C\$1.31

Net debt (C\$m) at 31 December 2018 1,769.4

Shares in issue 152.7m

Free float 94%

Code VET

Primary exchange TSX

Secondary exchange NYSE

Share price performance



% 1m 3m 12m

Abs 4.4 26.0 (15.6)

Rel (local) 1.8 11.7 (18.4)

52-week high/low C\$48.9 C\$27.0

Business description

Vermilion Energy is an international E&P with assets in Europe, North America and Australia. Management expects FY19 production to average 101–106kboed after incorporating the acquisition of Spartan.

Next events

Q119 results 25 April 2019

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Estimate changes

Vermilion's FY18 results were broadly in line with our expectations, as highlighted in our [results note](#) published on 28 February 2019. We have reviewed our forecasts for FY19 and FY20. Key changes include:

1. Lower commodity short-term price forecasts. These include a reduction in FY19 Brent to US\$62.8/bbl (-14%) and WTI to US\$56.1/bbl (-14%). Our FY19 and FY20 commodity price forecasts are based on EIA estimates (12 March 2019).
2. We increase our production forecasts by c 1% for FY19 and forecast 1.2% growth in FY20. Our marginally improved FY19 production, at 103kboed, is within the company's guidance range of 101–106kboed. For FY20, we forecast organic growth to 104.4kboed.
3. We include slightly higher unit costs than previously forecast, at a group level of C\$10.6/boe from C\$10.5/boe for FY19.
4. We update growth projects to reflect Vermilion's latest disclosure of net wells to be drilled in 2019.

The net impact of these changes on FFO is largely driven by commodity price forecasts, with our forecast FFO for FY19 falling 18% to C\$982m and FY20 down 12% to C\$1,056m. These figures are highly leveraged to underlying commodity prices, as we discuss later in this note.

Exhibit 1: Edison changes to forecasts

	Edison new			Edison old		Change	
	2018	2019e	2020e	2019e	2020e	2019e	2020e
Production (kboed)	86.9	103.2	104.4	101.1	101.0	2%	3%
Revenues (C\$m)	1,526.0	1,730.4	1,803.5	1,856.6	1,879.4	(7%)	(4%)
Adj EBITDA (C\$m)	1,065.2	1,139.0	1,207.9	1,261.9	1,285.0	(10%)	(6%)
EBIDAX (C\$m)	856.5	1,099.3	1,175.5	1,237.2	1,264.5	(11%)	(7%)
FFO (C\$m)	833.5	981.8	1,056.2	1,200.6	1,210.0	(18%)	(13%)
CFPS (C\$/share)	5.3	6.2	6.5	7.0	7.2	(12%)	(9%)
Capex ex acquisitions (C\$m)	518.2	533.4	564.1	527.6	560.4	1%	1%

Source: Edison Investment Research

Our FFO forecasts for FY19 are 1% ahead of consensus and 3% below for FY20.

Exhibit 2: Edison versus consensus

	Edison			Consensus		Change	
	2018	2019e	2020e	2019e	2020e	2019e	2020e
Production (kboed)	86.9	103.2	104.4	102.8	105.9	0%	(1%)
Revenues (C\$m)	1,526.0	1,730.4	1,803.5				
Adj EBITDA (C\$m)	1,065.2	1,139.0	1,207.9				
EBIDAX (C\$m)	856.5	1,099.3	1,175.5				
FFO (C\$m)	833.5	981.8	1,056.2	971.8	1,090.0	1%	(3%)
CFPS (C\$/share)	5.3	6.2	6.5				
Capex ex acquisitions (C\$m)	518.2	533.4	564.1	514.0	565.0	4%	0%

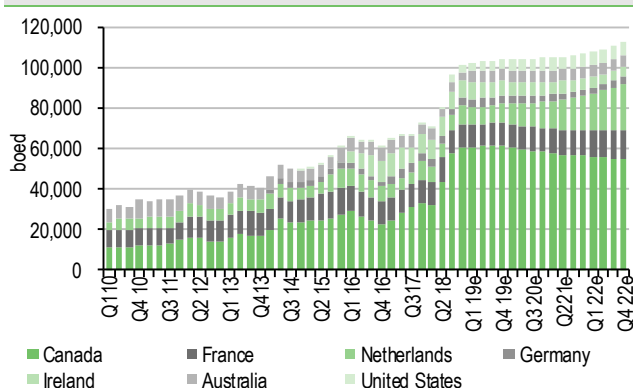
Source: Edison Investment Research

Forecasting FY19e 18% y-o-y production growth to 103.2kboed

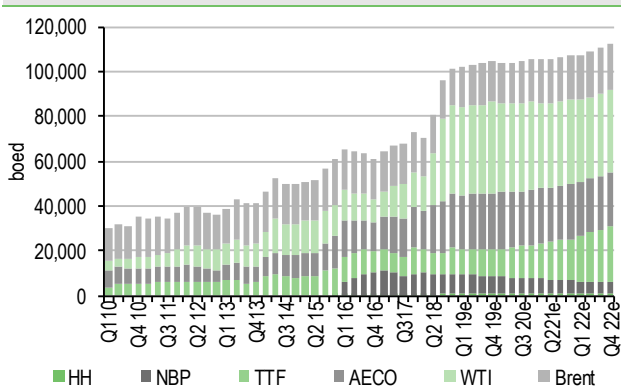
Our production forecasts by country and commodity are provided below. For FY19, we forecast output of 103.2kboed, which is within management's guidance range of 101–106kboed. The key moving parts in our forecast include:

1. **Canada:** we include production performance and decline rate from acquired Spartan assets, new well completions and the pace at which new wells (126.9 net wells planned for 2019 in southeast Saskatchewan and 17.7 net in Alberta) are brought on stream. Vermilion estimates that south-east Saskatchewan light oil will make up c 41% of its Canadian crude oil mix in 2019, with reference prices currently at a US\$3.25/bbl discount to WTI.

2. **US:** we include the benefit from the acquisition of assets in the Powder River Basin in Q318, and infill drilling at the Turner sandstone Hilight asset. Vermilion has had recent success with the use of rod pump artificial lift as an alternative to electronic submersible pumps (ESPs), with higher operational uptime and reduced sand flowback. Higher uptime and reduced ESP replacement costs should enable Vermilion to manage unit operating costs as base production declines and in-fill wells are drilled.
3. **Netherlands:** production should benefit from the Eesveen-02 well that was brought on stream in Q318. Vermilion has c 21 wells at various stages of the planning process, which should help underpin FY19 production growth.
4. **Australia:** should demonstrate strong y-o-y growth with the addition of two new producers in Q119.

Exhibit 3: Edison production forecasts by country


Source: Edison Investment Research

Exhibit 4: Edison production by commodity type


Source: Edison Investment Research

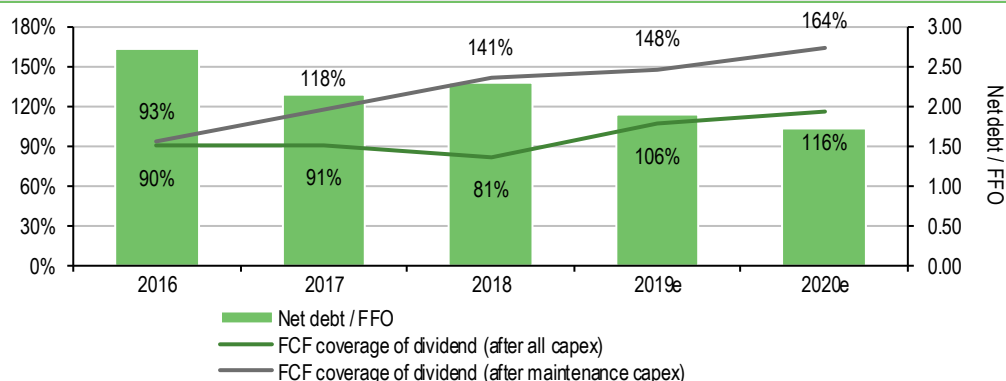
Dividend and growth cash flow coverage

The key sensitivity to our forecasts and valuation lies in the prices of key commodities. Our base case oil price forecasts for FY19 and FY20 are based on EIA forecasts. We calculate the sensitivity to these in Exhibit 5 below. If, for example, we were to assume all key commodities (WTI, Brent, NBP, AECO and TTF) are 10% below our base case forecasts, FFO would fall by c 10% post-hedge (after inclusion of the impact of realised hedges to FY19).

Exhibit 5: FY19 FFO sensitivity to commodity price

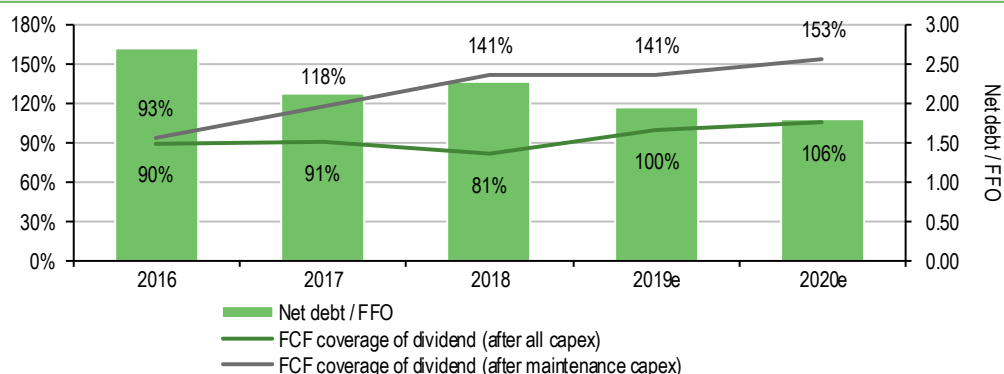
Brent /(US\$/bbl)	43.9	50.2	56.5	62.8*	69.1	75.3	81.6
WTI/(US\$/bbl)	39.3	44.9	50.5	56.1	60.3	65.7	71.2
NBP (C\$/mmbtu)	7.0	8.0	9.0	10.0	11.0	12.0	13.0
AECO (C\$/GJ)	1.1	1.3	1.4	1.6	1.8	1.9	2.1
TTF (C\$/GJ)	7.0	8.0	9.0	10	11.0	12.0	13.0
Realisation vs base %	-30%	-20%	-10%	0%	10%	20%	30%
FY19 FFO C\$m	678.0	783.8	887.1	981.8	1078.8	1169.1	1259.0
Valuation C\$/share	33.3	38.2	43.1	47.5	52.1	56.4	60.6

Source: Edison Investment Research. Note: *Column represents Edison base case forecasts for FY19.

Exhibit 6: Base case FCF coverage of dividend (before and after growth capex)


Source: Edison Investment Research

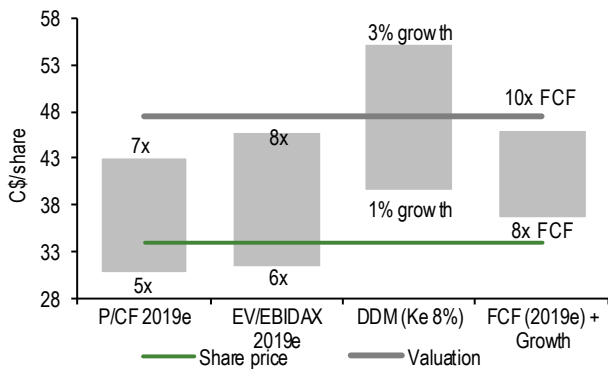
In Exhibit 7 below, we show that even at c 3% below our base case price forecasts, capex and dividend are fully covered. Under lower commodity price scenarios, where cash outflow to fund dividend and capex is not fully covered, Vermilion retains numerous options. These include taking on debt, which can be achieved while maintaining gearing well below current covenant limits (consolidated total debt to consolidated EBITDA stood at 1.7x as of end FY18 relative to a covenant limit of 4.0 times). If a reduction in cash outflows is required, we expect management to prioritise the payment of dividends, followed by maintenance capex over growth capex.

Exhibit 7: c 3% below base case – FCF coverage of dividend (before & after growth capex)


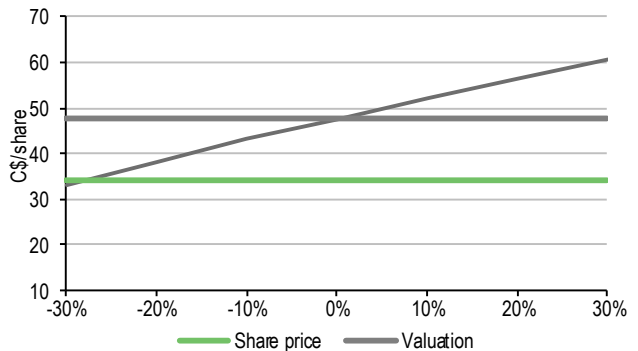
Source: Edison Investment Research

Valuation: Blended C\$47.5/share

We continue to use a blended approach when valuing Vermilion. This includes a combination of FY19e P/CF, EV/EBIDAX, DDM and FCF (plus growth projects). We arrive at a valuation range of C\$41.0/share to C\$47.5/share and, based on Vermilion's peer-leading dividend yield, growth rate and low historical F&D costs, we believe that a valuation at the top end of this range is justified.

Exhibit 8: Edison valuation


Source: Edison Investment Research

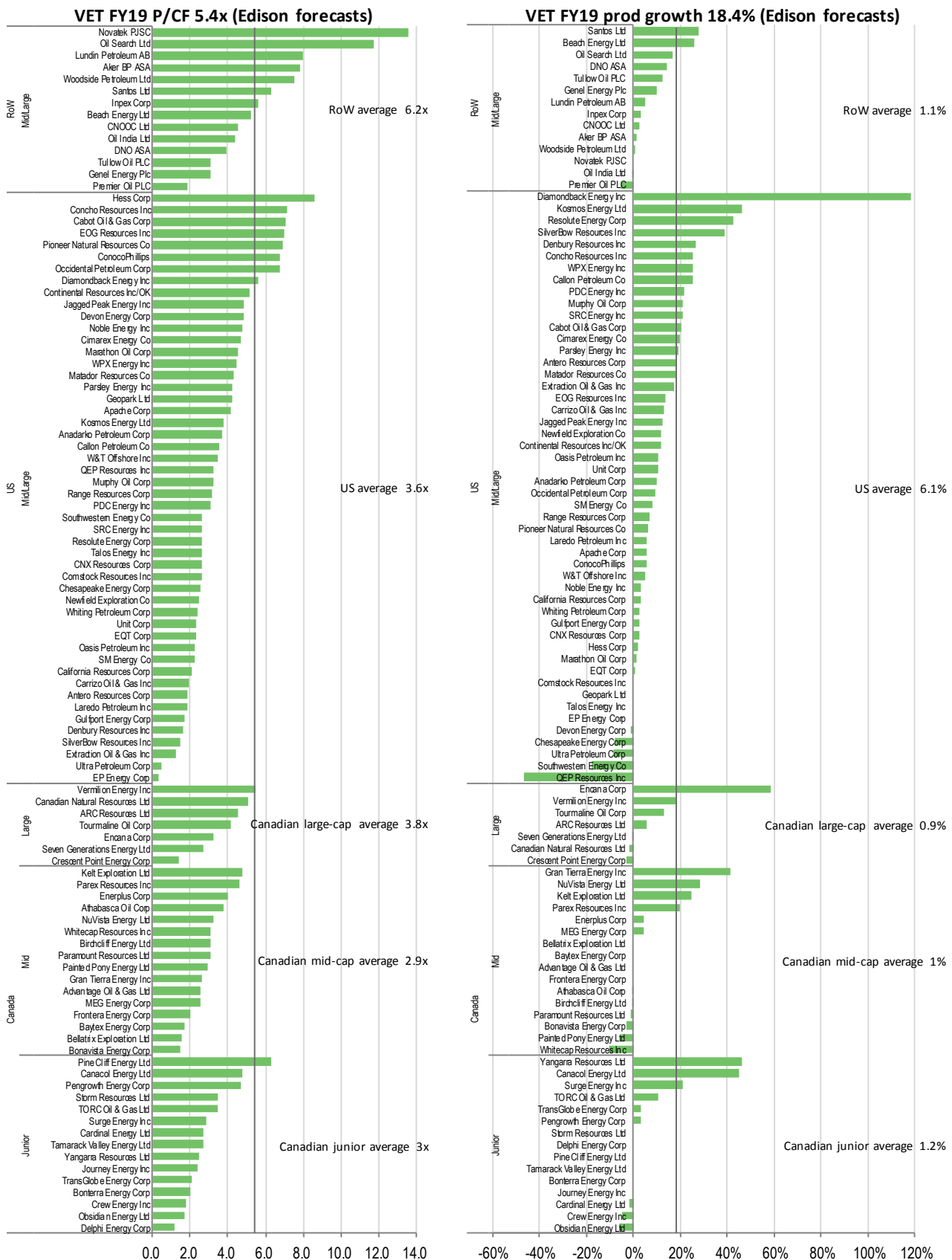
Exhibit 9: Valuation sensitivity to commodity price assumptions relative to base case*


Source: Edison Investment Research. Note: *See Exhibit 5 for realisations.

Relative to peers, as shown in Exhibit 11, Vermilion trades at 5.4x and 5.1x P/CF for FY19e and FY20e respectively. We believe Vermilion's premium valuation on the basis of P/CF reflects materially higher growth and dividend yield than its peers.

Exhibit 10 shows Vermilion's FY19e P/CF multiple and production growth rates versus global peers as well as Canadian. The valuation is more in line with our 'rest of the world' group average, which trades at 6.2x FY19e P/CF, while production growth is significantly higher at 18.4%. Production growth in FY19e relative to FY18 is largely inorganically driven, and growth for FY20e relative to FY19e is likely to be more in line with the peer group at c 1.2%.

Exhibit 10: Vermilion P/CF FY19e and production growth versus global peers



Source: Edison Investment Research, Refinitiv, Bloomberg. Note: Prices as at 19 March 2019.



Exhibit 11: Peer group valuation table

Company	Mrk Cap (US\$m)	EV (US\$m)	EV/EBITDA FY19e	EV/EBITDA FY20e	FCF Yield FY19e	FCF Yield FY20e	P/CF FY19e	P/CF FY20e	ND/EBITDA FY18	Div yield FY19e	EV/1P FY18	EV/kboed FY19e	Prod FY19e	Prod growth FY19e	Netback \$/boe FY18
Edison forecast	3,906	5,302	6.62	6.21	8.0%	8.6%	5.44	5.12	1.71	8.2%	12.0	51.4	103.2	18.4%	26.3
Canada	3,906	5,302	6.62	6.21	8.0%	8.6%	5.44	5.12	1.71	8.2%	12.0	51.4	103.2	18.4%	26.3
Vermilion Energy	3,906	5,302	6.62	6.21	8.0%	8.6%	5.44	5.12	1.71	8.2%	12.0	51.4	103.2	18.4%	26.3
Canada	2,028	2,997	4.64	4.24	4.6%	5.2%	3.11	2.68	2.02	1.5%	5.6	63.8	100.8	10.5%	19.4
Junior E&P <30kboed	245	437	4.46	4.04	5.5%	8.8%	2.96	2.45	2.12	1.0%	4.8	58.7	19.5	13.0%	20.6
Bonterra Energy Corp	150	369	5.70	4.00	12.5%	15.5%	2.04	1.70	3.41	2.0%	4.7	78.1	13.0	0.0%	-
Canacol Energy Ltd	613	867	3.90	3.15	2.2%	7.8%	4.74	3.69	1.07	0.0%	-	100.7	23.6	45.2%	19.8
Cardinal Energy Ltd	204	383	5.56	5.29	23.7%	39.5%	2.68	2.18	2.76	8.0%	4.9	51.3	20.5	-1.8%	13.8
Crew Energy Inc	130	391	4.43	4.31	2.5%	-6.3%	1.77	1.78	2.98	0.0%	2.3	47.1	22.7	-4.8%	11.1
Delphi Energy Corp	50	170	3.21	3.14	-6.9%	3.0%	1.15	1.16	2.28	0.0%	6.3	45.7	10.2	0.0%	-
Journey Energy Inc	59	151	4.59	4.09	4.5%	11.5%	2.37	2.17	2.83	0.0%	4.1	43.4	9.6	0.0%	-
Obsidian Energy Ltd	145	453	4.23	3.31	1.7%	16.0%	1.67	1.21	2.90	-10.8%	5.0	45.7	27.1	-6.3%	15.2
Pengrowth Energy Corp	255	804	6.70	8.14	17.7%	9.3%	4.66	3.91	4.61	0.0%	4.2	96.9	22.7	3.2%	38.0
Pine Cliff Energy Ltd	60	97	6.42	5.93	4.4%	-1.9%	6.34	5.31	2.49	0.0%	1.9	14.2	18.7	0.0%	-
Storm Resources Ltd	216	280	3.87	2.99	-14.8%	1.4%	3.49	2.32	0.90	0.0%	-	35.5	21.6	0.0%	-
Surge Energy Inc	314	643	4.92	4.46	0.8%	1.8%	2.82	2.40	2.55	7.6%	8.0	80.4	21.9	21.3%	17.3
Tamarack Valley Energy Ltd	421	539	3.15	2.68	9.2%	7.5%	2.66	2.15	0.71	0.0%	10.4	60.5	24.4	0.0%	-
TORC Oil & Gas Ltd	705	951	4.43	3.87	11.0%	10.9%	3.46	3.01	1.17	6.0%	10.5	92.9	28.1	10.7%	25.8
TransGlobe Energy Corp	158	158	2.36	2.40	10.8%	6.8%	2.09	1.84	0.01	2.7%	5.9	29.0	14.9	3.5%	23.3
Yangarra Resources Ltd	196	295	3.40	2.87	3.6%	9.2%	2.46	1.93	1.16	0.0%	3.9	58.5	13.8	46.4%	21.2
Intermediate E&P>30kboed	886	1,442	4.72	4.31	3.8%	1.6%	2.97	2.59	2.18	1.1%	5.2	60.5	63.8	7.5%	18.5
Advantage Oil & Gas Ltd	320	515	3.73	2.94	-9.2%	-2.7%	2.52	1.94	1.43	0.0%	1.7	31.2	45.1	0.0%	-
Athabasca Oil Corp	342	718	5.72	4.39	32.9%	-0.6%	3.81	2.90	3.03	0.0%	1.6	50.3	39.1	-0.2%	6.2
Baytex Energy Corp	966	2,510	3.87	4.03	9.2%	11.4%	1.72	1.65	2.40	0.0%	9.8	71.9	95.7	0.0%	-
Bellatrix Exploration Ltd	36	346	6.03	6.44	-31.6%	-46.4%	1.54	2.08	5.42	0.0%	2.0	27.7	34.2	0.0%	-
Birchcliff Energy Ltd	772	1,247	4.42	4.34	7.8%	8.0%	3.08	2.87	1.64	2.8%	1.8	44.4	76.9	-0.2%	10.2
Bonavista Energy Corp	236	825	4.33	4.14	17.9%	14.2%	1.46	1.47	3.15	3.4%	2.8	33.7	67.0	-3.1%	9.0
Enerplus Corp	2,040	2,285	4.45	4.05	3.2%	4.6%	4.03	3.56	0.49	1.6%	7.7	64.3	97.3	4.4%	18.7
Frontera Energy Corp	897	755	1.23	1.61	8.5%	-3.6%	2.04	2.26	(0.40)	0.0%	5.9	31.6	65.5	0.0%	-
Gran Tierra Energy Inc	959	1,274	2.56	2.11	-0.1%	12.7%	2.63	2.20	0.64	0.0%	23.5	86.0	40.6	41.3%	45.1
Kelt Exploration Ltd	759	935	5.51	4.72	-4.9%	-3.8%	4.76	3.81	1.06	0.0%	-	75.8	33.8	25.0%	17.6
MEG Energy Corp	1,130	3,654	7.14	7.66	19.6%	20.4%	2.51	2.12	4.97	0.0%	2.7	109.5	91.4	4.2%	22.6
NuVista Energy Ltd	766	1,114	4.37	3.58	1.4%	-7.8%	3.26	2.62	1.39	0.0%	-	58.8	51.9	28.7%	17.9
Painted Pony Energy Ltd	235	853	6.98	7.60	1.9%	1.9%	2.90	2.96	5.09	0.0%	1.6	42.6	54.9	-5.1%	8.4
Paramount Resources Ltd	738	1,322	4.97	3.73	-11.9%	-10.9%	3.08	2.27	2.23	0.0%	3.4	42.7	84.9	-1.2%	10.1
Parex Resources Inc	2,469	2,006	3.07	2.85	10.3%	9.9%	4.63	3.65	(0.71)	0.0%	16.5	103.3	53.2	19.8%	41.5
Peyto Exploration & Development Corp	951	1,795	7.31	5.31	3.7%	8.7%	3.40	3.20	3.48	4.5%	-	56.8	86.7	-5.8%	8.5
Whitcap Resources Inc	1,445	2,367	4.61	3.84	6.1%	10.7%	3.09	2.46	1.82	6.9%	6.7	97.3	66.6	-10.5%	24.1
Large E&P>100kboed	8,625	12,258	4.85	4.48	4.7%	6.4%	3.78	3.39	1.42	3.5%	8.6	82.7	364.7	13.0%	19.4
ARC Resources Ltd	2,588	3,065	5.06	4.59	-6.1%	-2.8%	4.53	4.14	0.80	6.2%	6.1	59.9	140.3	5.7%	12.9
Canadian Natural Resources Ltd	33,811	48,489	6.51	6.08	10.5%	11.0%	5.07	4.62	2.01	4.0%	4.9	125.1	1,062.3	-1.5%	19.6
Crescent Point Energy Corp	1,697	4,825	3.35	3.22	16.2%	17.3%	1.35	1.25	2.19	3.5%	7.8	76.6	172.5	-3.2%	26.7
Encana Corp	11,250	14,390	4.07	3.69	0.4%	4.3%	3.25	2.72	0.89	0.9%	11.8	68.8	572.8	58.6%	19.8
Seven Generations Energy Ltd	2,738	4,244	3.68	3.42	5.2%	3.5%	2.66	2.41	1.33	0.0%	5.0	57.4	202.4	-0.1%	23.1
Tourmaline Oil Corp	4,384	5,488	4.94	4.44	4.3%	7.5%	4.14	3.64	1.00	1.9%	6.6	50.3	298.9	12.8%	7.5
Vermilion Energy Inc	3,906	5,302	6.31	5.92	2.4%	3.9%	5.47	4.94	1.69	8.1%	17.8	140.5	103.4	18.5%	26.3
US	8,716	12,004	5.18	4.49	0.0%	0.0%	3.62	3.03	2.06	0.7%	13.1	116.4	255.4	12.9%	27.2
Intermediate/Large E&P>30kboed	8,716	12,004	5.18	4.49	0.0%	0.0%	3.62	3.03	2.06	0.7%	13.1	116.4	255.4	12.9%	27.2
RoW	16,098	18,547	5.51	4.91	2.3%	4.0%	6.20	5.23	1.11	2.9%	24.9	189.2	235.0	8.7%	39.0
Intermediate/Large E&P>30kboed	16,098	18,547	5.51	4.91	2.3%	4.0%	6.20	5.23	1.11	2.9%	24.9	189.2	235.0	8.7%	39.0
Grand Total	7,170	9,467	5.04	4.47	0.0%	0.0%	3.79	3.21	1.92	1.4%	11.9	106.0	194.0	11.6%	26.1

Source: Edison Investment Research, Thomson Reuters, Bloomberg. Note: Prices as at 19 March 2019.

Exhibit 12: Financial summary

	C\$m	2016	2017	2018	2019e	2020e
Dec		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		829	1,024	1,526	1,730	1,803
Cost of Sales		(262)	(286)	(409)	(543)	(548)
Gross Profit		567	739	1,117	1,188	1,256
EBITDA		362	673	1,037	1,045	1,114
Operating Profit (before amort. and except.)		(166)	182	427	294	368
Intangible Amortisation		0	0	0	0	0
Exceptionals		0	0	0	0	0
Other		0	0	0	0	0
Operating Profit		(166)	182	427	294	368
Net Interest		(57)	(57)	(73)	(83)	(85)
Profit Before Tax (norm)		(223)	124	355	211	284
Profit Before Tax (FRS 3)		(223)	124	355	211	284
Tax		63	(62)	(83)	(21)	(28)
Profit After Tax (norm)		(243)	104	318	190	255
Profit After Tax (FRS 3)		(160)	62	272	190	255
Average Number of Shares Outstanding (m)		116	121	141	153	154
EPS - normalised (C\$/share)		(2.1)	0.9	2.3	1.2	1.7
Dividend per share (C\$/share)		2.6	2.6	2.7	2.8	2.8
Gross Margin (%)		68	72	73	69	70
EBITDA Margin (%)		44	66	68	60	62
Operating Margin (before GW and except.) (%)		(20)	18	28	17	20
BALANCE SHEET						
Fixed Assets		3,861	3,713	5,841	5,622	5,440
Intangible Assets		275	293	303	344	364
Tangible Assets		3,433	3,338	5,317	5,058	4,856
Investments		153	82	221	221	221
Current Assets		226	262	430	398	396
Stocks		15	17	28	28	28
Debtors		132	166	260	260	260
Cash		63	47	27	(5)	(7)
Other		17	32	115	115	115
Current Liabilities		(291)	(363)	(563)	(563)	(563)
Creditors		(218)	(258)	(487)	(487)	(487)
Other short-term liabilities		(73)	(105)	(76)	(76)	(76)
Long Term Liabilities		(2,218)	(2,069)	(2,890)	(2,791)	(2,694)
Long term borrowings		(1,362)	(1,270)	(1,796)	(1,796)	(1,796)
Other long-term liabilities		(856)	(798)	(1,094)	(994)	(898)
Net Assets		1,578	1,543	2,817	2,666	2,579
CASH FLOW						
Operating Cash Flow		510	594	816	945	1,008
Capex		(242)	(320)	(518)	(533)	(564)
Acquisitions/disposals		(99)	(28)	(276)	0	0
Financing		(17)	(4)	37	(43)	(43)
Dividends		(105)	(200)	(330)	(401)	(403)
Net Cash Flow		47	41	(272)	(32)	(2)
Opening net debt/(cash)		1,346	1,299	1,224	1,769	1,802
HP finance leases initiated		0	0	0	0	0
Other		0	34	(273)	0	0
Closing net debt/(cash)		1,299	1,224	1,769	1,802	1,804

Source: Company accounts, Edison Investment Research

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