

# Balance sheet concern removed

## Raise PO but maintain Underperform

We raise our PO to NT\$8.5/shr by removing the discount we gave to Taishin's fair value as our concerns on its stretched balance will lessen after Taishin sells its securities business for NT\$29bn (announced 15 May). However, we maintain U/P as we expect slow improvement in earnings. The stock is fully priced at 1x P/BV (on pro-forma basis) vs. LT RoE of ~6%. The 1x P/BV prices in the inclusion of the gain from this deal and also takes out the goodwill on the investment in CHB.

## Selling securities business to KGI for NT\$29bn

The transaction will strengthen Taishin's capital position and increase its bank tier one ratio to >9% from 7% currently. Management indicated, with the proceeds, it will look for some M&A opportunities in and outside of Taiwan. We think it could also: 1) make debt repayments (NT\$8bn due in 2010 & NT\$14bn due in 2011) or 2) buy more CHB shares (already holds ~22%), but this is politically sensitive.

## Needs to strengthen long-term competitiveness

The sale of the securities business will take away 25-35% of Taishin group's annual earnings. We expect Taishin's ROE to improve slowly, similar to other smaller players, as they face more difficulties to become customers' primary banks. It will go a long way to enhance its long-term competitiveness.

## Estimates (Dec)

(NT\$)	2006A	2007A	2008E	2009E	2010E
Net Income (Adjusted - mn)	(16,280)	2,654	(1,239)	2,181	2,904
EPS	(2.99)	0.465	(0.217)	0.382	0.509
EPS Change (YoY)	-384.8%	NM	NM	NM	33.2%
Dividend / Share	0	0	0.180	0	0.158
Pre-exceptional EPS	(2.97)	0.716	(0.113)	0.633	0.771
Pre-exceptional EPS Change (YoY)	420.8%	-124.1%	-115.8%	-661.2%	21.7%
Book Value / Share	11.28	11.19	10.63	11.22	11.57

## Valuation (Dec)

	2006A	2007A	2008E	2009E	2010E
P/E	NM	18.3x	NM	22.3x	16.8x
Dividend Yield	NA	NA	NA	NA	NA
Pre-exceptional PE	NM	11.90x	NM	13.46x	11.06x
Price / Book	0.793x	0.762x	0.802x	0.759x	0.736x
RoE / PB	NA	5.56x	NA	4.60x	6.06x
Price / Pre-Provision Profit	1.47x	1.78x	2.12x	1.83x	1.62x

Equity | Taiwan | Financial Services-  
Consumer/Commercial  
18 May 2009



## RESEARCH

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## Stock Data

Price	NT\$8.52
Price Objective	NT\$5.00 to NT\$8.50
Date Established	18-May-2009
Investment Opinion	C-3-8 to C-3-9
Volatility Risk	HIGH
52-Week Range	NT\$3.64-NT\$15.90
Mrkt Val / Shares Out (mn)	US\$1,477 / 5,710.3
Average Daily Volume	142,813,200
ML Symbol / Exchange	TSHFF / TWO
Bloomberg / Reuters	2887 TT / 2887.TW
ROE (2008E)	NA
Total Dbt to Cap (Dec-2008A)	NA
Est. 5-Yr EPS / DPS Growth	5.0% / 5.0%
Free Float	50.0%



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Refer to important disclosures on page 9 to 11. Analyst Certification on Page 7. Price Objective Basis/Risk on page 7.

18 May 2009

## iQprofile<sup>SM</sup> Taishin

Key Income Statement Data (Dec)	2006A	2007A	2008E	2009E	2010E
<b>(NT\$ Millions)</b>					
Net Interest Income	44,873	35,964	31,805	34,269	37,033
Net Fee Income	12,414	15,668	13,830	15,108	16,577
Securities Gains / (Losses)	1,465	2,533	1,122	2,357	2,794
Other Income	4,733	5,749	7,149	6,808	7,308
<b>Total Non-Interest Income</b>	<b>18,611</b>	<b>23,950</b>	<b>22,101</b>	<b>24,273</b>	<b>26,679</b>
Total Operating Income	63,484	59,914	53,906	58,542	63,712
Operating Expenses	(31,879)	(32,612)	(30,943)	(31,999)	(33,592)
<b>Pre-Provision Profit</b>	<b>31,605</b>	<b>27,302</b>	<b>22,962</b>	<b>26,544</b>	<b>30,120</b>
Provisions Expense	(42,439)	(11,948)	(16,932)	(14,927)	(14,563)
<b>Operating Profit</b>	<b>(10,834)</b>	<b>15,354</b>	<b>6,030</b>	<b>11,617</b>	<b>15,557</b>
Non-Operating Income	742.71	0	0	0	0
<b>Pre-Tax Income</b>	<b>(10,091)</b>	<b>15,354</b>	<b>6,030</b>	<b>11,617</b>	<b>15,557</b>
Net Income to Comm S/Hold.	(16,280)	2,654	(1,239)	2,181	2,904
<b>Adjusted Net Income (Operating)</b>	<b>(16,280)</b>	<b>2,654</b>	<b>(1,239)</b>	<b>2,181</b>	<b>2,904</b>

### Key Balance Sheet Data

Total Assets	2,330,591	2,338,947	2,399,911	2,472,697	2,566,353
Average Interest Earning Assets	1,846,298	1,865,008	1,913,455	1,961,650	2,028,479
<b>Weighted Risk Assets</b>	<b>1,331,069</b>	<b>1,430,367</b>	<b>1,455,764</b>	<b>1,505,770</b>	<b>1,562,762</b>
Total Gross Customer Loans	1,406,553	1,485,974	1,531,154	1,581,314	1,632,902
Total Customer Deposits	1,628,076	1,669,016	1,722,772	1,804,586	1,890,258
<b>Tier 1 Capital</b>	<b>122,351</b>	<b>132,756</b>	<b>146,585</b>	<b>153,023</b>	<b>159,490</b>
Tangible Equity	39,844	43,860	41,679	46,060	48,060
<b>Common Shareholders' Equity</b>	<b>61,388</b>	<b>63,877</b>	<b>60,679</b>	<b>64,060</b>	<b>66,060</b>

### Key Metrics

Net Interest Margin	2.43%	1.93%	1.66%	1.75%	1.83%
<b>Tier 1 Ratio</b>	<b>9.2%</b>	<b>9.3%</b>	<b>10.1%</b>	<b>10.2%</b>	<b>10.2%</b>
Effective Tax Rate	27.9%	32.3%	40.3%	27.5%	26.2%
Loan / Assets Ratio	59.2%	62.7%	63.0%	63.1%	62.7%
<b>Loan / Deposit Ratio</b>	<b>84.8%</b>	<b>87.8%</b>	<b>87.7%</b>	<b>86.5%</b>	<b>85.1%</b>
Oper Leverage (Inc Growth - Cost Growth)	-20.1%	-7.9%	-4.9%	5.2%	3.9%
Gearing (Assets / Equity)	38.0x	36.6x	39.6x	38.6x	38.8x
Tangible Common Equity / Assets	1.7%	1.9%	1.7%	1.9%	1.9%
Tangible Common Equity / WRAs	3.0%	3.1%	2.9%	3.1%	3.1%
Revenue Growth	6.7%	-5.6%	-10.0%	8.6%	8.8%
Operating Expense Growth	26.8%	2.3%	-5.1%	3.4%	5.0%
Provisions Expense Growth	15.1%	-71.8%	41.7%	-11.8%	-2.4%
Operating Revenue / Average Assets	2.7%	2.6%	2.3%	2.4%	2.5%
Operating Expenses / Average Assets	1.4%	1.4%	1.3%	1.3%	1.3%
<b>Pre-Provision ROA</b>	<b>1.4%</b>	<b>1.2%</b>	<b>1.0%</b>	<b>1.1%</b>	<b>1.2%</b>
ROA	NM	0.1%	NM	0.1%	0.1%
<b>Pre-Provision ROE</b>	<b>51.1%</b>	<b>43.6%</b>	<b>36.9%</b>	<b>42.6%</b>	<b>46.3%</b>
ROE	NM	4.2%	NM	3.5%	4.5%
RoTE	-40.9%	6.1%	-3.0%	4.7%	6.0%
RoWRAs	-1.2%	0.2%	-0.1%	0.1%	0.2%
Dividend Payout Ratio	NA	0%	NA	0%	31.1%
<b>Efficiency Ratio (Cost / Income Ratio)</b>	<b>51.4%</b>	<b>56.8%</b>	<b>58.6%</b>	<b>57.0%</b>	<b>55.1%</b>
<b>Total Non-Interest Inc / Operating Inc</b>	<b>29%</b>	<b>40%</b>	<b>41%</b>	<b>41%</b>	<b>42%</b>
Market-Related Revenue / Total Revenues	4.3%	6.6%	4.5%	7.3%	7.9%
Provisioning Burden as % of PPP	134.3%	43.8%	73.7%	56.2%	48.4%
NPLs plus Foreclosed Real Estate / Loans	2.0%	1.8%	1.5%	1.5%	1.5%
<b>Loan Loss Reserves / NPLs</b>	<b>94.7%</b>	<b>74.6%</b>	<b>85.0%</b>	<b>88.7%</b>	<b>100.6%</b>
Loan Loss Reserves / Total Loans	1.9%	1.3%	1.3%	1.3%	1.5%
Provisions Expense / Average Loans	3.1%	0.8%	1.1%	1.0%	0.9%

### Other Metrics

Income / Employee	3.90	3.70	3.32	3.60	3.89
(Operating Expenses) / Employee	(1.96)	(2.01)	(1.90)	(1.97)	(2.05)
Pre-Provision Profit / Employee	1.94	1.69	1.41	1.63	1.84
Net Profit / Employee	(0.999)	0.164	(0.076)	0.134	0.177

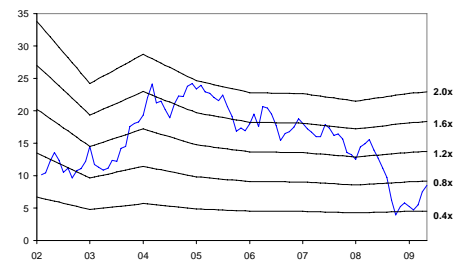
### Company Description

Taishin Financial is a mid-sized FHCs consisting of Taishin Bank (a strong consumer franchise), Taiwan Securities (top-5 broker) and Taishin Bills Finance. In 2H05, Taishin acquired 22% of Chang Hwa Bank (2801 TT), which can boost its loan market share to 8% if a merger takes place. In May 09, Taishin announced to sell Taiwan Securities to strengthen the group capital position

### Investment Thesis

We have turned more cautious on the speed of Taishin FHC earnings recovery as slow fundamental recovery. Post the sale of its securities business, the stock is fully priced at 1x P/BV (on pro-forma basis) vs. LT RoE of 6%. The 1x P/BV prices in the inclusion of the gain from this deal and also takes out the goodwill on the investment in CHB

### Chart 1: Taishin P/B band



Source: Banc of America Securities - Merrill Lynch

### Stock Data

Price to Book Value 0.8x

## Strengthening capital position

Taishin FHC on 15 May announced the sale of its securities business, i.e., Taiwan Securities to KGI Securities (6008 TT) for NT\$29bn (implying KGI is paying 1.5x P/BV for Taiwan Securities). The transaction will be mainly in cash (NT\$28bn), and the remainder will be in KGI's shares (NT\$1bn). The transaction is expected to complete in 3Q-4Q.

We consider the disposal of its securities entity as positive for Taishin as it removes investors' concerns about Taishin's relatively stretched balance sheet, and also offers funding for future expansion or debt repayments.

### Lowers leverage

After the disposal, Taishin will have NT\$44bn cash on hand (NT\$28bn from KGI and NT\$16bn existing cash). It plans to inject cash into its bank subsidiary (~NT\$12bn) to boost its bank tier one ratio to >9% from 7% currently.

Table 1: Balance sheet improvement post the sale of Taiwan Securities

	Pre-sale	Pro-forma post sale of Taiwan Securities			Note
		no cash injection to bank	NT\$9bn inject to bank	NT\$12bn inject to bank	
FHC					
FHC CAR	113%	150%	145%	142%	Minimum requirement 100%
Double leverage	127%	95%	105%	108%	DLR =FHC parent's LT equity investment / equity
D/E	48.8%	44.0%	44.0%	44.0%	
Bank Tier 1	7.1%	7.1%	8.7%	9.2%	

Source: Taishin FHC

### Pro-forma valuation

We calculate the post-sale valuation for Taishin based on the following assumptions: 1) outstanding shares after recent capital reduction have decreased to 5.3mn shares; 2) equity book increase is from the NT\$8.5bn disposal gain (the sale of Taiwan Securities) after preferred dividend payment of NT\$1.4bn; 3) Taishin currently carries ~NT\$20bn goodwill on its 22.5% holding in Chang Hwa Bank (CHB).

On a pro-forma basis, Taishin is currently trading at 0.7x P/BV (post the sale), but if we also deduct CHB's N\$20bn goodwill from Taishin's book (i.e., the potential loss Taishin could suffer if it disposes of CHB below cost), the stock is trading at 1x P/BV. We consider the current valuation has fully priced in the company's long-term achievable RoE of ~6% after the disposal of the securities business.

Table 2: Taishin is fully priced at 1x P/B (pro-forma basis)

NT\$bn	Taishin FHC	Taiwan Securities	Pro-forma post-sale	
			Post the sale	If exclude CHB goodwill
Total equity (1Q09)	85	20	92	
Common equity (1Q09)	56	20	63	43
Net income (normalized level)	5.0	1.4	3.6	
RoE (normalized level)	9%	7%	6%	
Shares (after capital reduction recently)	5,323		5,323	5,323
BVPS	10.58		11.90	8.15
P/B	0.80		0.72	1.05

Source: Banc of America Securities - Merrill Lynch estimates

### PO adjusted to NT\$8.5/shr

We adjust our PO to NT\$8.5/shr by removing the discount we applied to Taishin's fair value before, as our BS concerns have lessened. The discount was to reflect: 1) uncertainties from potential share dilution (rights issues) and earnings volatility; 2) market concerns about liquidity issues facing Taishin Bank.

Table 3: PO of NT\$8.5/shr

Subsidiaries	Multiple	Value	% of Total	Per Share
Taishin Bank	0.9x P/B	42,616	86%	7.5
Taishin Bills Finance	1x P/B	6,562	13%	1.1
Chang Hwa Bank	1x P/B	19,428	39%	3.4
Others & FHC Net detbs		(19,050)	-38%	(3.3)
<b>Total Value</b>		<b>49,556</b>	<b>100%</b>	<b>8.7</b>
Per Share Value		8.68		
Target Price		8.50		

Source: Banc of America Securities - Merrill Lynch estimates

### How will Taishin use the proceeds?

Besides the NT\$9-12bn cash injection to the bank subsidiary to boost its tier one capital, Taishin's management indicated it will look for some M&A opportunities – to deepen its banking footprint in and outside of Taiwan or acquire asset management companies/small insurance companies to enhance product manufacturing capabilities.

We think Taishin could also use the cash to repay its debts due in 2010 (NT\$8bn) and 2011 (NT\$14bn), as smaller players may struggle to raise funds in the equity market when major leading players all have fundraising plans in 2009-10.

Taishin could also increase its holding in CHB, since it intends to deepen its banking footprint and already holds 22.5% of CHB. However, the Taishin-CHB deal has become politically sensitive.

We think it is less likely Taishin will use the proceeds to call back preferred shares (NT\$14bn) held by Newbridge and Nomura, as it would immediately ramp up its leverage ratio.

Taishin could also consider opportunities to invest in China, but we believe it would struggle to compete with Chinatrust, Fubon and Mega, given its relatively small balance sheet and lagging regional platform development. Taishin may prefer to be a target for Chinese investment, but we consider its relatively complicated shareholding structure could discourage potential investors.

## 1Q09 analyst meeting highlights

Taishin reported net profits of NT\$870mn (before prefer dividend) for the first four months of 2009. The results achieved 24% of our 2009 forecast, slightly behind our numbers.

Table 4: Taishin FHC 1Q09 operating performance vs. BAS-ML forecast

	1Q08	1Q09	YoY%	BAS-ML 2009E	%
Net interest income	8,410	5,771	-31%	34,269	17%
Fee income	3,828	2,481	-35%	15,108	16%
Trading & others	1,078	2,476	130%	9,165	27%
Operating revenue	13,316	10,728	-19%	58,542	18%
Operating expenses	(7,862)	(6,740)	nm	(31,999)	21%
Pre-provision profits	5,454	3,988	-27%	26,544	15%
NPL provisions	(3,791)	(2,021)	nm	(14,927)	14%
Net profits before tax	1,663	1,967	18%	11,617	17%
Net profits before minority interests	1,082	1,499	39%	8,422	18%
Net income (before prefer dividend)	(10)	777	nm	3,616	21%

Source: Taishin FHC, Banc of America Securities - Merrill Lynch estimates

### Growth guidance

Taishin is relatively conservative on loan growth and overall macro conditions into 2H, likely partly because its relatively thin capital constrains business growth. After the capital enhancement, Taishin will start to re-grow.

It is looking to focus more on overseas lending for corporate banking due to better margins. It will also marginally grow its unsecured personal loan portfolio. Management expects fee income to gradually recover with improving momentum for wealth management.

### Loan growth

Taishin's 1Q09 total loan portfolio declined -11% QoQ (-3% YoY). Its loan-to-deposit ratio declined to 75.1% in 1Q09 from 79.5% in 4Q08. Corporate loans contracted -16% YoY (-3% QoQ), while consumer loans also declined -7% YoY (-3% QoQ).

### NIM to pick up from May

NIM contracted 40bp to 1.39% as of 1Q09 and another 7bp to 1.32% in April. Management expects NIM to bottom out in 2Q and gradually pick up from May. It guided 2009 average NIM at 1.5-1.6%.

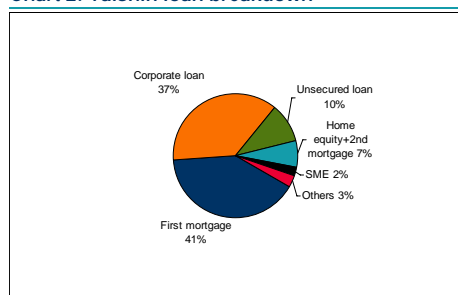
### Fee income recovered from the 4Q bottom

Taishin's net fee income declined -35% YoY but improved 19% QoQ. Its wealth management fees increased 70% QoQ from the bottom in 4Q08 with strong Bancassurance growth (+196% QoQ) and recovering equity-related fund sales (+21% QoQ). Management is positive on fee income with improving momentum for wealth management and increasing Taix turnover.

### Improving asset quality

Overall asset quality remained stable in 1Q09 with its NPL ratio down to 1.22% from 1.38% in 4Q08, while its coverage ratio improved to 144% as of 1Q09. Its corporate loan NPL ratio was 1.17%, and its mortgage NPL ratio remained at 0.49%. Management indicated that the inflow of unsecured NPLs has remained stable and returned to a normalized level.

Chart 2: Taishin loan breakdown



Source: Taishin FHC

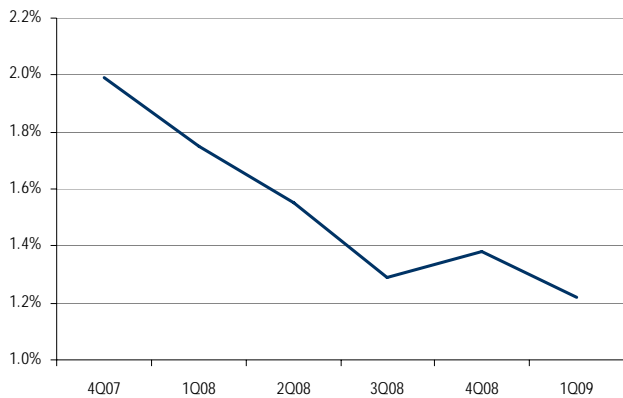
### TSC merges with KGI

Taishin announced to sell its 100% stake in TSC to KGI for NT\$29bn (including NT\$28bn cash and NT\$1bn KGI common stock). Taishin will reap disposal gains of NT\$8.5bn and inject NT\$9-12bn capital into its bank subsidiary. The deal is expected to close in 3Q/4Q 2009. After selling TSC, Taishin will acquire a smaller broker to continue serving its banking clients.

### Cooperation with Aegon

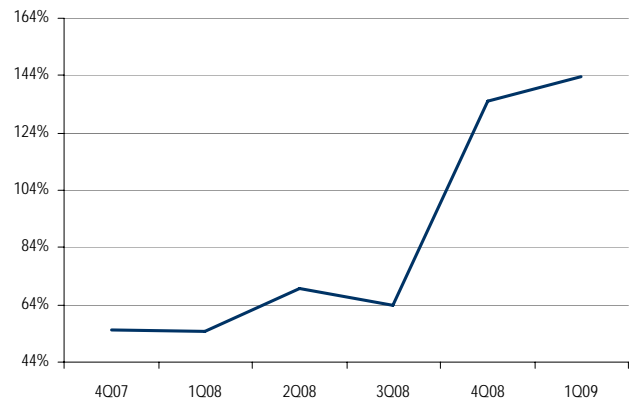
Taishin didn't rule out the possibility of continuing with the joint venture life insurance company with Aegon group but is still evaluating the appropriate timing to enter the life market. Management sees the formation of a joint venture with a life or asset management company to enhance its product underwriting capability as important for its wealth management growth.

Chart 3: Taishin bank's NPL ratio



Source: Taishin FHC

Chart 4: Taishin bank's coverage ratio increased significantly



Source: Taishin FHC

## Price objective basis & risk

### Taishin (TSHFF)

Our PO of NT\$8.5/shr is based on sum of the parts (SOTP) valuation, in which we applied P/BV multiples to each subsidiary based on our view of 2008 to 2011 industry positions. Our SOTP valuation includes: (1) 0.9x 2009E P/BV for Taishin Bank, given slow RoE that may not recover to 10pct by 2011, (2) 1x 2009E P/BV for Taishin Bills, given the low interest rate environment favors bills finance business, (3) 1x 2009E P/BV for Chang Hwa Bank for ROE of 7 to 10pct during 2008E to 2010E and (4) 1x 2008E P/BV for other subsidiaries and FHC net debts. Upside risks: faster ROE enhancement. Downside risks: Unexpected trading gains/losses and influx/recovery of NPLs.

## Analyst Certification

I, Katherine Hu, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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18 May 2009

Taiwan Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	China Life	CHLJF	2823 TT	Katherine Hu
	Chinatrust	CTFHF	2891 TT	Katherine Hu
	Fubon FHC	FUISF	2881 TT	Katherine Hu
	SinoPac Financial Holdings	SPACF	2890 TT	Katherine Hu
<b>NEUTRAL</b>				
	Cathay FHC	CHYYF	2882 TT	Katherine Hu
	E.Sun FHC	ESUFF	2884 TT	Katherine Hu
<b>UNDERPERFORM</b>				
	Shin Kong FHC	SKFHF	2888 TT	Katherine Hu
	Taishin	TSHFF	2887 TT	Katherine Hu

*iQmethod*<sup>SM</sup> Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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### TSHFF Price Chart



TSHFF —

B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

\*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of April 30, 2009 or such later date as indicated. BAS-ML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of April 30, 2009 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website."

### Investment Rating Distribution: Financial Services Group (as of 01 Apr 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	126	45.49%	Buy	56	45.53%
Neutral	78	28.16%	Neutral	31	43.06%
Sell	73	26.35%	Sell	26	36.62%

### Investment Rating Distribution: Global Group (as of 01 Apr 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1243	38.21%	Buy	520	46.39%
Neutral	841	25.85%	Neutral	349	47.04%
Sell	1169	35.94%	Sell	388	36.30%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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18 May 2009

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18 May 2009

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