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Initial Public Offerings and Long-Term Returns: A Sector-Based Evaluation

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ABSTRACT- The initial public offering (IPO) is a critical milestone in a company's transition from private to public ownership, offering increased capital access and liquidity. However, the long-term performance of IPOs remains debated, with many firms underperforming market benchmarks over extended periods. While initial IPO returns often reflect investor enthusiasm which highlights consistent underperformance over three to five years, attributed to over-optimism, information asymmetry, and risks inherent in young firms. Sector-specific dynamics also play a role, with technology and biotech sectors experiencing higher volatility, while more established industries like financial services and utilities show stable, yet slower growth. Timing and market conditions further influence IPO outcomes, with firms launched in "hot markets" facing long-term corrections. Firm-specific factors, such as governance and insider ownership, also impact performance. This study examines the long-term IPO performance across various sectors, focusing on key industries and identifying factors driving success or failure, offering insights for investors and policymakers navigating IPO challenges and opportunities.

KEYWORDS- Initial Public Offerings (IPOs); long-term performance; sector-specific dynamics; market conditions; corporate governance.

I. INTRODUCTION

The initial public offering (IPO) represents a pivotal event in a company's lifecycle, marking its transition from private ownership to becoming publicly traded. This transformation provides firms with greater access to capital, enhanced visibility, and increased liquidity. Yet, the long-term performance of IPOs has been a subject of considerable debate, particularly regarding whether these companies can sustain their early momentum or if they eventually underperform in the market. While short-term IPO returns are often marked by substantial investor enthusiasm, long-term performance has been shown to be inconsistent, with numerous studies documenting significant underperformance relative to benchmarks. Understanding these long-term dynamics across different industry sectors remains a key area of inquiry for financial economists and investors alike.

One of the most influential studies in this area is by Ritter [20], who analysed a large dataset of IPOs and found that, on average, they underperform the market by 23% over a three-year period. This phenomenon, often referred to as "IPO underperformance," has been confirmed by subsequent studies, such as those by Loughran and Ritter [14], who extended the time horizon to five years and found persistent underperformance. The reasons for this are varied but often attributed to the over-optimism of initial investors, information asymmetry between insiders and the market, and the inherent risks associated with young, growth-oriented firms. Ritter and Welch [21] argue that while IPOs can deliver substantial short-term returns, many firms struggle to maintain consistent profitability in the long term, leading to deteriorating stock prices.

The long-term performance of IPOs, however, is not uniform across all sectors. Industries with rapid technological advancements, such as the technology and biotech sectors, tend to show higher volatility and greater fluctuations in post-IPO performance. For example, research by Ljungqvist and Wilhelm [10] [11] highlights the significant risks and rewards of investing in technology IPOs, where the potential for high returns is offset by the tendency for greater failure rates. In contrast, more established industries, such as financial services and utilities, tend to exhibit more stable, albeit slower, long-term growth. This variation can be attributed to differing industry dynamics, such as regulatory environments, capital intensity, and innovation cycles. A study by Helwege and Liang [4] found that IPO firms in regulated sectors like utilities and financial services typically exhibit more stable performance due to stricter oversight and less exposure to market fluctuations, compared to their counterparts in the high-tech sector.

Another crucial factor influencing the long-term success of IPOs is market timing. Research has consistently shown that IPOs launched during "hot markets," characterized by high investor demand and often inflated valuations, tend to underperform over the long run. Loughran and Ritter [12] describe this as the "hot issue market" phenomenon, where overvaluation during bullish periods leads to significant corrections as market expectations normalize. On the other hand[13], companies that go public in "cold markets" tend to be more conservatively priced and may offer better long-term returns. This has been corroborated by studies such as those by Pástor and Veronesi [18], who argue that the timing of an IPO plays a critical role in its long-term performance due to the interaction between market sentiment and firm-specific factors.

Furthermore, firm-specific characteristics, such as governance structure, size, and ownership concentration, play a significant role in post-IPO performance. Jain and Kini [6] found that firms with higher levels of insider ownership at the time of the IPO tend to perform better in the long run, as insider holdings signal confidence in the firm's future prospects. Additionally, companies with strong corporate governance mechanisms, including independent boards and clear management accountability, are more likely to deliver sustained performance. In their study on corporate governance and IPO performance, Bradley, Jordan, and Ritter [2] observed that firms with more independent board structures tend to outperform their peers over the long term, as effective governance can mitigate agency problems and improve decision-making.

This paper aims to build upon the existing body of literature by providing a detailed analysis of the long-term performance of IPOs across diverse industry sectors. By examining how sector-specific dynamics interact with broader market conditions and firm characteristics, this study seeks to uncover the underlying drivers of IPO performance. Key sectors under consideration include technology, healthcare, industrials, and financial services, each of which presents unique challenges and opportunities for newly public firms. Specifically, this research will focus on long-term return patterns, volatility, and the role of external factors such as market cycles and regulatory environments. The findings will provide valuable insights for investors, policymakers, and corporate managers seeking to navigate the complexities of the IPO process and the challenges of sustaining long-term growth in a competitive market.

A. Types of IPO

Major types of IPOs help to provide a deeper understanding of the mechanisms that companies use to go public, as well as the strategic considerations involved. Each type of IPO has distinct characteristics, making them suitable for different corporate needs, market conditions, and investor preferences. This section outlines the primary types of IPOs, explaining their mechanics and relevance to corporate finance and long-term performance.

- Traditional or Book-Building IPO- The **traditional IPO**, also known as the **book-building process**, is the most commonly used method for companies going public. In this type of IPO, the company hires one or more investment banks to act as underwriters. The underwriters play a critical role in the process by helping the company set the offering price, marketing the shares to institutional and retail investors, and ensuring the success of the IPO.

During the book-building process, the underwriter conducts a "roadshow," where company executives present their business to potential investors to gauge interest. Based on investor feedback, the underwriter determines the demand for the shares and sets a final price. This price is critical, as it must balance the company's desire to raise capital with the need to attract investors.

Studies such as Sherman [5] highlight the advantages of the traditional IPO model, which include price discovery and the ability to adjust the offer based on investor demand. However, this method is also subject to significant under-pricing, where the IPO price is deliberately set below the market value to ensure demand, leading to an initial "pop" in the stock price on the first day of trading. While under-pricing benefits early investors, it represents a cost to the company as they raise less capital than they might have. The degree of under-pricing varies across sectors, with high-tech firms typically experiencing greater price volatility.

- Fixed Price Offering- In contrast to the book-building process, a fixed price offering involves the company and its underwriters setting a fixed price for the IPO shares before the public offering. Investors know the price in advance and can subscribe to the shares at that price. This method is simpler and involves less price discovery than the book-building process, which can be appealing to companies with less market visibility or in markets where the demand is more predictable.

Fixed price offerings were more common historically but have declined in use due to their rigidity. One of the main criticisms is the potential mismatch between the price and demand, as the company cannot adjust the price based on investor interest. This often results in higher volatility on the first day of trading, as the market reacts to mispriced shares. Despite this, fixed price offerings remain popular in emerging markets where regulatory frameworks might limit the use of more complex pricing mechanisms.

B. Key terms

In order to understand the concept of IPO in detailed manners various key terms associated with it are given below:

- IPO (Initial Public Offering)- The process where a private company offers shares to the public for the first time, becoming publicly traded on a stock exchange.
- Underwriter- An investment bank or group of banks that manages the IPO process, helps set the offer price, and markets the shares to investors.
- Book-Building- The process where underwriters gauge demand for the IPO by collecting bids from institutional investors, helping to determine the final offer price.
- Prospectus- A legal document issued by a company during an IPO that provides detailed information about the company's financial health, business model, and risks to potential investors.
- Roadshow- A series of presentations made by company executives and underwriters to potential investors, aimed at generating interest in the IPO shares.
- Offer Price- The price at which the company's shares are sold to the public during the IPO, determined based on market demand and company valuation.
- Listing- The process of a company's shares being officially traded on a public stock exchange, such as the NYSE or NASDAQ, after the IPO.
- Lock-Up Period- A specified period (usually 90 to 180 days) post-IPO during which insiders, such as executives and early investors, are restricted from selling their shares.
- Flipping- The practice of selling IPO shares quickly after they begin trading in the secondary market to capture initial price gains, often contributing to post-IPO volatility.
- Greenshoe Option- A provision in an IPO agreement allowing underwriters to sell more shares than initially planned (usually 15%) if there is strong demand, helping stabilize the stock price.
- Oversubscription- Occurs when the demand for IPO shares exceeds the number of shares available, often leading to an increase in the offer price.

- Under-pricing- When an IPO is priced below its true market value, often leading to a significant rise in stock price on the first day of trading, benefiting initial investors.
- Aftermarket- The period following the IPO when the stock begins trading on the open market and can be bought and sold by any investor.
- Direct Listing- A method for companies to go public without raising new capital by listing existing shares directly on an exchange, bypassing underwriters.

II. LITERATURE REVIEW

Jay R. Ritter [21] provides a comprehensive analysis of the patterns and determinants influencing IPO activities, pricing, and allocations. The study delves into the pervasive phenomenon of IPO under-pricing and investigates how market conditions and issuer characteristics contribute to this outcome. Furthermore, it examines the long-term performance of IPOs and highlights the critical role played by investment banks in the overall process.

Alexander Ljungqvist [10] offers an extensive exploration of IPO under-pricing, a widely observed occurrence where newly issued stocks are priced below their market value. The work draws on theoretical frameworks, including asymmetric information, signalling, and behavioral theories, supported by empirical evidence. Ljungqvist's examination also considers the broader implications of under-pricing for issuers, investors, and market efficiency.

In her study, Michelle Lowry [15] investigates the underlying causes of significant fluctuations in IPO volumes over time. Her findings suggest that market-wide factors such as investor sentiment and economic cycles are primary drivers of these fluctuations. Additionally, the research acknowledges the influence of regulatory changes and firm-specific attributes in shaping IPO activity.

Rajesh Aggarwal [1] focuses on the impact of fundamental financial metrics on IPO valuation n. Through extensive dataset analysis, the study reveals that firm-specific fundamentals—such as earnings, assets, and growth potential—exert substantial influence on IPO pricing. Aggarwal[1] emphasizes the critical importance of accurate financial reporting and investor due diligence in ensuring fair valuation and mitigating the risks of overvaluation or undervaluation in the IPO market.

Elizabeth Demers [3] investigates the risk factors leading to IPO failure, which is defined as marked underperformance or delisting within three years post-IPO. Demers [3] identifies key failure predictors such as high underwriter turnover, aggressive accounting practices, and poor financial health. The study underscores the importance of rigorous due diligence in financial analysis and underwriter selection as pivotal factors for mitigating IPO risks and enhancing long-term performance.

Zheng Qiao [19] explores the role of corporate hedging strategies in enhancing IPO firm valuation. The study presents evidence suggesting that firms employing hedging practices typically achieve higher valuations compared to their non-hedging counterparts. This valuation premium is attributed to increased cash flow stability and reduced financial distress costs, highlighting the strategic significance of risk management in boosting investor confidence during the IPO process.

Supriya Katti [7] conducts a literature review on IPO under-pricing, offering a broad exploration of both theoretical and empirical perspectives. The study investigates the reasons behind IPO under-pricing, considering various contributing factors, and analyzes the implications for both the market and investors.

Josip Kotlar [8] examines the intersection of socioemotional and financial wealth considerations for family-owned businesses approaching an IPO. Utilizing a two-stage gamble model, the study suggests that family businesses may deliberately underprice IPOs as a means of preserving control and safeguarding long-term family legacies, while still achieving financial objectives.

Tim Loughran [14] analyses the temporal dynamics of IPO under-pricing, highlighting how the degree of under-pricing fluctuates in response to investor behaviour, market conditions, and regulatory changes. Loughran's empirical analysis demonstrates the interplay between these factors and their influence on IPO pricing, with broader implications for issuers and investors.

Scott Latham [9] explores the decision-making process companies undergo when contemplating whether to go public or remain private. The study outlines key factors influencing this decision, including market conditions, firm-specific traits, and the potential risks and benefits associated with an IPO. Latham [9] presents a comprehensive framework for understanding the complexities of the IPO decision.

Lastly, Michelle Lowry [16] investigates the effectiveness of the IPO pricing process, evaluating whether IPO prices accurately reflect the underlying value of companies going public. The study integrates empirical data to assess how underwriters, market conditions, and investor sentiment influence IPO pricing accuracy, providing insights into the efficiency of the pricing mechanisms.

Based on the above points, the primary objective of this study is to evaluate the long-term stock performance of Initial Public Offerings (IPOs) across diverse industry sectors, providing a comprehensive understanding of how different industries fare post-IPO. By examining performance patterns, the study seeks to enlighten investors on the potential long-term gains associated with IPO investments, offering insights into how these gains may vary depending on industry-specific factors[17][22]. Furthermore, the study aims to formulate policy recommendations that could enhance the overall environment for IPOs, particularly in underperforming or failing industries. These recommendations will focus on addressing structural inefficiencies and market conditions to improve the prospects of companies entering public markets, ultimately fostering a more favorable IPO climate in struggling sectors.

III. METHODOLOGY

The methodology for analysing data related to IPOs, specifically focusing on Total Capital Inflow and Capital Inflow across various sectors. The first step involves gathering comprehensive data on IPOs, including information on total capital raised through IPOs and the distribution of capital inflows across different industry sectors. The data is sourced from websites, financial platforms, periodicals, and other online sources. This data includes the total amount raised, sectoral breakdowns, offering prices, and post-IPO performance as presented.

IV. RESULTS AND DISCUSSIONS

Table 1, by analysing the data below, it is possible to see the total amount of capital inflow through IPOs over the last six years, including both Mainline and Small & Medium Enterprises IPOs. In 2021, IPOs saw a significant capital investment i.e., ₹ 1,24,680.9 Crores, as IPOs at the time had high valuations in relation to their actual prices. Due to concerns about the COVID-19 pandemic, just ₹ 31,004 Crores were raised through initial public offerings (IPOs) in 2020. Lastly, the total capital invested in initial public offerings (IPOs) over the previous six years was ₹ 3,05,689.6 Crores.

Table 1: Total Capital Inflow in the form of IPO from Last Six years

Years	Total Capital Inflow in the form IPO (₹ Crores) [Mainline + Small & Medium Enterprises IPO]
2019	₹ 17,763.60
2020	₹ 31,004.60
2021	₹ 1,24,680.90
2022	₹ 61,933.80
2023	₹ 57,913.30
2024*	₹ 12,393.40
Total	**₹ 3,05,689.60**

**As on 10-07-2024*

Once collected, the data is segmented based on industry classifications. Each IPO will be assigned to its respective industry sector, such as technology, healthcare, manufacturing, or financial services. This segmentation allows for a focused analysis of capital inflows into each sector as displayed in Table 2. It displays the IPO capital inflow by sector wise over the past six years. It is evident from examining the table below that the maximum capital inflow is ₹ 23,759.4 Crores from the IT Services and Consulting Sector as a result of the development of artificial intelligence and machine learning-based businesses during the past five years, which have done well in the stock market. The second sector from the table is Banking, Insurance, and Finance. This sector also raised nearly ₹ 22,882.8 crores in IPO capital because the banking industry is a key factor in the establishment of small finance banks and the raising of capital for other industries. Transport and logistics are the final industry in the table, with a capital inflow of just ₹ 132,77 crores. There are not many companies in this industry, and investors are not keen to invest in these businesses.

To examine trends and patterns, the study track IPO data over a period of 6 years. This approach helps to identify sectoral trends in IPO capital inflows and the total volume of capital raised in each time frame.

Table 2: IPO Capital Inflow to Different Sectors from Last Six Years

Industry Sectors	Amount (₹ Crore)
IT Services & Consulting	₹ 23,759.40
Banking, Insurance & Finance	₹ 22,882.80
Hospitality (Hotels) & Real Estate	₹ 19,258.30
Pharmaceuticals	₹ 16,298.30
Consumer Goods	₹ 16,033.60
E-Commerce	₹ 10,572.60
Healthcare Sector	₹ 9,987.40
Infrastructure & Power	₹ 9,720.30
Industrial Manufacturing	₹ 8,763.80
Automobiles	₹ 8,218.90
Railway	₹ 6,578.90
Food & Beverages	₹ 5,534.60
Petro Chemicals & Chemicals	₹ 5,490.90
FMCG	₹ 4,126.60
Solar & Energy	₹ 2,280.80
Electrical & Electronics Goods	₹ 2,061.00
Défense Sector	₹ 1,214.60
Agro Based	₹ 364.30
Transport & Logistics	₹ 132.70

Descriptive statistics, including mean, median, and standard deviation of various sectors are calculated to summarize the capital raised in each sector and the results are as highest mean is in Banking, Insurance & Finance sector at ₹768, whereas lowest mean is in Energy sector at ₹32. Highest mean gain (listing gain) is in Energy sector 87.5% and lowest mean gain (listing gain) is in Banking, Insurance & Finance sector 11.85%. However, the highest mean gain (current gain) is in Railway sector (1334.03%) and lowest mean gain (current gain): Défense sector (35.96%). Apart from that the Railway sector shows high fluctuations in the current gain percentage with a standard deviation of 1554.89, indicating significant variability. The data is derived from Table 3, which lists the 15 most successful Initial public offerings (IPOs) from 2019 onward. It is evident from examining the table above that Mazagon Dock Shipbuilders Ltd. from the Défense sector, which provided investors with an exceptional return and currently stock price is ₹ 5,360, almost 3600 % of its initial issue price of ₹ 145. The Railway industry, IT services, Banking & Finance Initial public offerings (IPOs) were all thriving and providing investors with excellent returns.

Table 3: Top Successful 15 IPOs List from Different Sector [Mainline IPOs]

Company name	Business sector	Issue price	Listing open (₹)	Listing gain %	Ltp (₹)	Current gain %
Mazagon Dock Shipbuilders Ltd.	Défense	₹ 145	₹ 216.30	19.30%	₹ 5,360.00	3596.60%
Rail Vikas Nigam Ltd.	Railway	₹ 19	₹ 19.00	0.30%	₹ 610.00	3110.30%
Polycab India Ltd.	Electrical Goods	₹ 538	₹ 633.00	21.70%	₹ 6,358.30	1081.80%
IRFC Ltd.	Railway	₹ 26	₹ 25.00	-4.40%	₹ 200.90	672.50%
IREDA Ltd.	Energy	₹ 32	₹ 50.00	87.50%	₹ 242.70	658.50%
Angel One Ltd.	Banking, Insurance & Finance	₹ 306	₹ 275.00	-9.80%	₹ 2,225.00	627.10%
Kaynes Technology India Ltd.	IT Services & Consulting	₹ 587	₹ 778.00	17.50%	₹ 4,172.90	610.90%
Maotech Developers Ltd.	Infrastructure	₹ 486	₹ 439.00	-4.70%	₹ 1,530.80	530.00%
Kalyan Jewellers India Ltd.	Consumer Goods	₹ 87	₹ 73.90	-13.40%	₹ 503.20	478.40%
Netweb Technologies India Ltd.	IT Services & Consulting	₹ 500	₹ 947.00	82.10%	₹ 2,588.30	417.70%
Electronics Mart India Ltd.	Consumer Goods	₹ 59	₹ 90.00	43.20%	₹ 232.60	294.20%
Global Health Ltd.	Healthcare	₹ 336	₹ 401.00	23.60%	₹ 1,254.00	273.20%
CAMS Ltd.	Banking, Insurance & Finance	₹ 1,230	₹ 1,535.00	13.90%	₹ 4,120.00	235.00%
IRCTC Ltd.	Railway	₹ 320	₹ 644.00	127.70%	₹ 1,021.90	219.30%
JSW Infrastructure Ltd.	Infrastructure	₹ 119	₹ 143.00	32.20%	₹ 342.30	187.70%

In our study, further we conduct a comparative analysis of percentage share over the last six years as presented in Figure 1 of different sectors, identifying which sectors attract higher capital inflows and which are underfunded as shown in Figure 2.

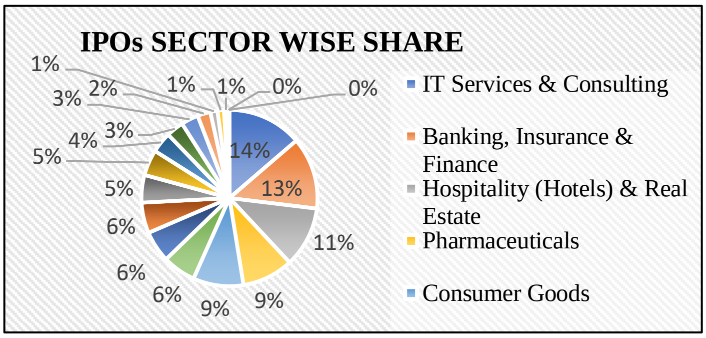

Figure 1: IPOs Percentage Share from different Sectors over Last Six Year

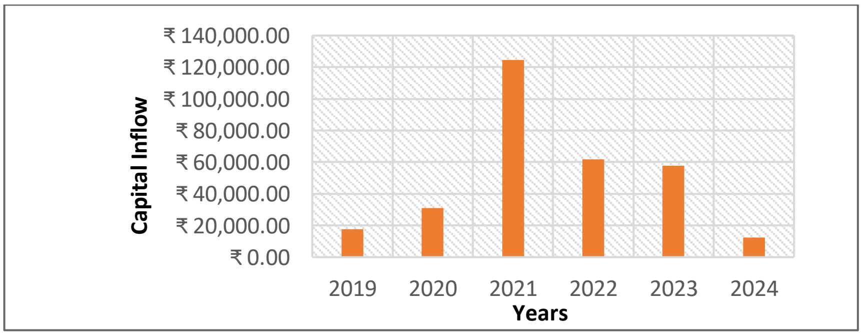

Figure 2: Total Capital Inflow in the form IPO (₹ Crores)

Finally, the list of top 13 unsuccessful initial public offerings (IPOs) from 2019 onward is presented in Table 4.

It is evident from the table that One97 Communications Ltd. (Paytm) was one of the worst IPOs ever, with an issue size of ₹18,300 crores from the Banking, Insurance & Finance sector. The IPO was listed at a lower price than the issue price and the stock price fell by nearly 78% from its actual issue price of ₹ 2,150 to its current price of ₹ 471. The majority of underperformed IPOs had larger Issue size.

Table 4: Top Failed 13 IPOs List from Different Sector [Mainline IPOs]

COMPANY NAME	Business Sector	ISSUE PRICE	LISTING OPEN (₹)	LISTING GAIN %	LTP (₹)	CURRENT GAIN %
One97 Communications Ltd. (Paytm)	Banking, Insurance & Finance	₹ 2,150	₹1955	-27.70%	₹471.3	-78.10%
AGS Transact Technologies Ltd.	IT Services & Consulting	₹ 175	₹176	-7.80%	₹80.3	-54.10%
CarTrade Tech Ltd.	Automobiles	₹ 1,618	₹1600	-7.30%	₹827.3	-48.90%
Credo Brands Marketing Ltd.	Consumer Goods	₹ 280	₹282.4	11.50%	₹168	-40.00%
Nuvoco Vistas Corporation Ltd.	Infrastructure	₹ 570	₹471	-6.80%	₹356.3	-37.50%
Star Health Insurance Company Ltd.	Banking, Insurance & Finance	₹ 900	₹903	0.80%	₹574.1	-36.20%
Chemcon Speciality Chemicals Ltd.	Petro Chemicals & Chemicals	₹ 340	₹731	72.00%	₹261.1	-23.20%
Sai Silks (Kalamandir) Ltd.	Textiles	₹ 222	₹231	10.30%	₹173.2	-22.00%
Delhivery Ltd.	E-Commerce	₹ 487	₹495.2	10.10%	389.7	-20.00%
ESAF Small Finance Bank Ltd.	Banking, Insurance & Finance	₹ 60	₹71	15.10%	₹51.4	-14.30%
Spandana Sphoorty Financial Ltd.	Banking, Insurance & Finance	₹ 856	₹825	-1.00%	₹736.5	-14.00%
Sterling and Wilson Renewable Energy Ltd.	Energy	₹ 780	₹700	-7.00%	₹685	-12.20%
SBI Cards and Payment Services Ltd.	Banking, Insurance & Finance	₹ 755	₹658	-9.50%	₹730	-3.30%

The study concludes that Initial Public Offerings (IPOs) tend to underperform market benchmarks over the long term across various industry sectors. There are significant differences in sector performance, with the technology and healthcare sectors demonstrating superior long-term outcomes compared to others.

When compared to IPOs issued during bear markets, those launched in bull markets generally underperform over time. Furthermore, larger IPOs tend to outperform smaller ones, with large-cap IPOs showing relatively stable long-term returns.

The findings suggest potential overvaluation during the IPO stage, as higher initial returns are often followed by weaker long-term performance.

The study's primary limitations include the exclusion of IPOs with issue sizes below ₹10 crore, potentially affecting the accuracy of performance assessments. Selection bias may distort results if only IPOs from specific regions or time periods are considered. Additionally, the variability in market conditions over time makes it difficult to generalize findings across different economic cycles, as these fluctuations impact IPO performance. Incomplete data across various industries also presents analytical constraints, and the study's failure to account for industry-specific factors may lead to overgeneralization. Lastly, the analysis may be prone to survivorship bias if only active IPOs are considered, disregarding those that have failed or been delisted.

V. CONCLUSION

The proposed research indicates that IPO performance varies significantly across sectors, influenced by factors such as market conditions, industry growth rates, and company-specific characteristics. Certain sectors, such as Défense and Railways, demonstrate extraordinary gains, while Banking & Finance show greater declines, reflecting their cyclical nature and competitive pressures. In contrast, industries like technology and healthcare exhibit strong long-term growth due to rapid innovation and high market demand. The analysis also finds that initial under-pricing is common across industries, with IPOs often experiencing significant price increases on their first day of trading. However, a correction phase typically follows, leading to underperformance relative to the broader market over the next three to five years.

The study suggests that investors should consider industry trends and macroeconomic factors when evaluating IPO opportunities, highlighting the importance of sector-specific dynamics in assessing IPO performance. While IPOs can offer substantial short-term gains, their long-term performance is highly variable and dependent on the sector, requiring careful evaluation of risks and growth potential unique to each industry.

CONFLICTS OF INTEREST

The authors declare that they have no conflicts of interest.

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