The Green Deal - 11/24 (EN) #responsiblebanking

Raiffeisen Research

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So far, European regulation seemed to be the biggest hurdle for the European ESG market. With Trump, the headwind for sustainable transformation is likely to increase again. On the market side, Greeniums are already a rarity, as the German twin bonds recently demonstrated again. Europe's EV battery darling and issuer of Europe's largest green loan, Northvolt, is once again drawing attention to the credit risk embedded in ESG products. In addition, Hurricanes Helene and Milton are putting the niche asset class of catastrophe bonds in the spotlight, which offer a direct link to hedging physical ESG risks.

Highlights	**1**
Excursus: What does Trump 2.0 mean for the European ESG market?	**1**
Primary market	**2**
Secondary market	**2**
Hot Topic I: CAT bonds show why physical ESG risk matters	**5**
Hot Topic II: CE/SEE has clear advantages over other EMs when it comes to ESG	**9**
Deals of the month	**9**
Good to know - Europe's EV battery hopeful Northvolt struggles	**10**
Appendix	**11**
Disclaimer	**14**
Analyst	**17**

Highlights

- Primary market in October slightly above expectations – sustainability bonds surprise with strong supply
- Normalization on the ESG secondary market continues
- CAT bonds show why physical ESG risks matter
- CE/SEE region with top scores for ESG parameters in the emerging markets
- voestalpine priced first green bond of an European steel producer
- Struggles of Europe's EV battery hopeful Northvolt show why credit risk also matters for ESG debt products and why greeniums are non existent

Excursus: What does Trump 2.0 mean for the European ESG market?

Short answer: nothing good. Donald Trump could become a problem for asset managers with an ESG focus in particular. That he definitely does not pursue sustainable approaches seems to be set in stone. Thus, investments in renewable energies are likely to fall further behind compared to the oil and gas industry, as has already been the case recently. Nevertheless, thanks in part to the “incentives” provided by the Inflation Reduction Act (IRA) enacted under Joe Biden, most patents and innovators for sustainable technologies are based in the US. The USA, like China, will certainly continue to use this technological advantage under Trump. “Cheap” energy from solar or wind power will continue to play an important role under Trump 2.0 because it is positive for the USA as an industrial location, and thus fits perfectly with “America First”. The biggest question will be how the EU responds to this challenge. The EU's “excessive” regulation of sustainability has already disadvantaged Europe in global competition as a business location. For example, the EU's sustainability reporting (CSRD) comes into force just in time for Trump's inauguration, and the next reporting phase under the EU taxonomy is also imminent. If Europe or the EU does not quickly return to a more rational, simplified and incentive-driven approach, Europe could lose its appeal as a competitive business location at an increasingly rapid rate over the next few years. It is undisputed that a sustainable change is necessary, but this can only succeed if the measures and steps are taken in such a way that they can be implemented with a reasonably manageable scope. If one just looks at the ESG regulations that European banks currently have to comply with and the costs involved,

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they are no longer on a competitive footing with the major international banks in the US and the UK.

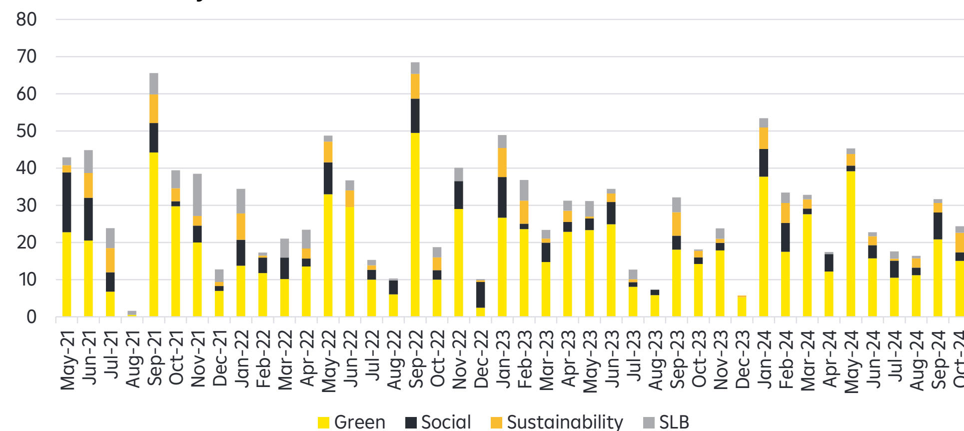
Primary market

So far, 2024 has seen EUR 315 bn of ESG new issues, already exceeding the previous year's level by EUR 7 bn. However, the record volume from 2021 (EUR 427 bn) is not expected to be reached this year. That said, while other ESG bond classes are weakening, green bonds are currently very popular with investors and thus also with issuers. Green bonds could well break the 2021 record level (EUR 234 bn) in 2024; only EUR 9 bn of new issues are still needed for this.

While September issuance volumes fell short of expectations, October issuance volumes moderately exceeded expectations, with EUR 24.4 bn. In October, the share of sustainability bonds stood out. These accounted for 22% of all ESG EUR issuance in the previous month, which is equivalent to the highest monthly share of this ESG bond class in history. Deals by Austrian and German federal states (Lower Austria and North Rhine-Westphalia) were partly responsible for this. The share of corporate bonds in EUR ESG new issues is remarkable in the year to date, currently at 34%, with only 2016 seeing a higher figure (albeit significantly higher at 45%). The main reasons for this are, on the one hand, the extremely active utilities sector, which, with EUR 48.5 bn, has already set a new annual EUR ESG issuance volume. The second driver is the surprisingly strong comeback of real estate issuers, with a volume of EUR 12.8 bn placed so far. After an almost complete absence from the primary market in 2023, they are now almost back to the issuance volumes of 2022.

Otherwise, banks and government issuers continue to dominate the ESG market. At EUR 135 bn of issuances placed, sovereign issuers are well below the record years of 2020-2022, but they already exceed the previous year's level. On the banking side, the high level of the last four years is being maintained, with EUR 74 bn in new issues to date. Thus, EUR ESG bank issues are likely to just miss the record level of the previous year (EUR 84 bn) – nevertheless, 2024 is already the second strongest year for EUR ESG issuances in the history of the financial sector.

Chart 1 - Monthly Issuance Volume - EUR ESG Market (EUR bn)



Source: LSEG, RBI/Raiffeisen Research

Secondary market

Green bonds, SLBs and sustainability bonds continue to trade at a (spread) premium to the overall market. We attribute the general moderate spread widening over the last few weeks mainly to the lower swap spread levels. That is because when looking at spreads vs government bonds, the IG overall market narrowed despite declining Bund yields. The euphoria surrounding the **Trump trade** that could be observed in many other parts of

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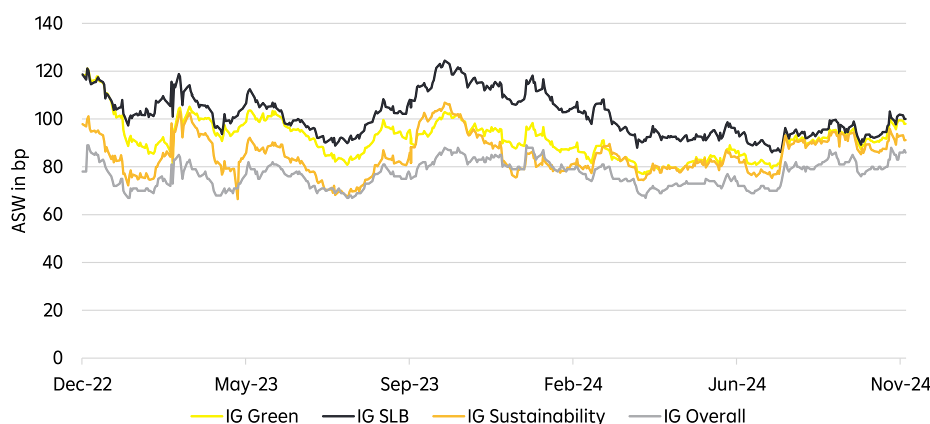
the financial market (equities, currencies, crypto) had hardly any impact on the IG ESG credit market. From an ESG perspective, the Trump trade can be seen as negative anyway (see excursus above). Pure EV (with the exception of Tesla) and renewables players came under pressure on the stock markets. The former have no EUR index exposure, unlike the latter, with issuers such as RWE, Orsted, Iberdrola, Vestas and Siemens Energy. With the exception of Vestas, which has issued exclusively SLBs, the renewables exposure is focused exclusively on green bonds. The renewables share of the respective asset classes is 3% (SLB) and 8% (green). In the days following the US election, both asset classes demonstrated a slightly more pronounced spread widening than the index as a whole, but one cannot speak of a broad based sell-off. Broken down to individual issuers, Orsted, due to its high offshore exposure (the area in which Trump is most likely to have influence), is seen as the loser and also showed the highest aggregated spread movements. Meanwhile, however, the respective index levels have converged again. The total return is thus still driven by the volatile Bund movements and remains at around 4% ytd per asset class (SLBs are clearly the outlier with 5%).

It should be noted that the **greenium** for IG BBB corporate bonds is again identical both including and excluding real estate. This marks the completion of the convergence we mentioned in previous issues of the Green Deal. In addition, the weighted Greenium for German twin bonds moved into positive territory for the first time in September and has remained there ever since. As the ESG fixed income market continues to mature, pricing normalization continues. This is in contrast to the financials segment, where we continue to see a Greenium across the entire curve.

Chart 2 - IG corporate credit risk premia per ESG asset class*



**EUR denom. senior bonds based on ICE BofA Euro Non-Financial Index*
Source: LSEG, RBI/Raiffeisen Research

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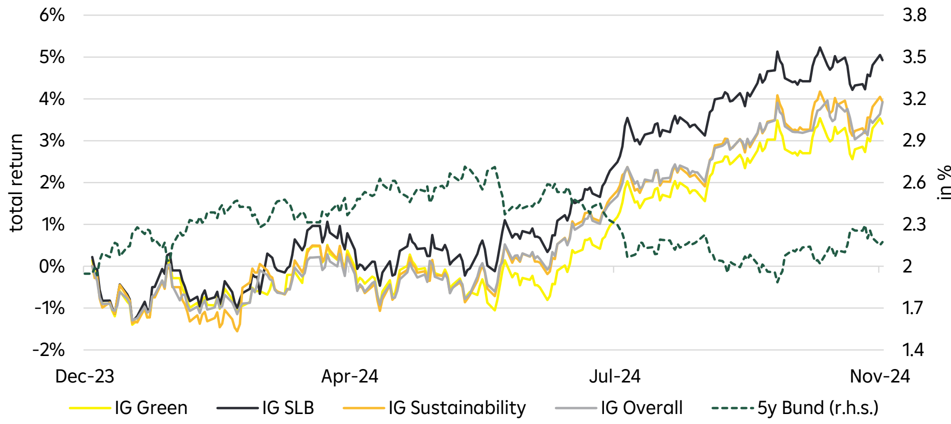
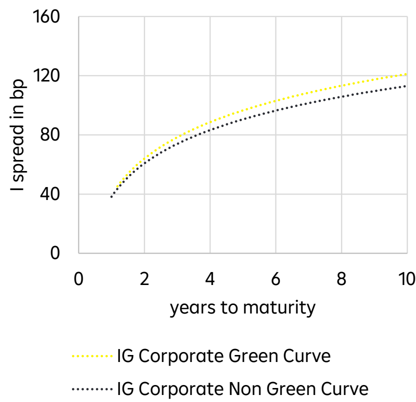
Chart 3 - IG total return per ESG asset class*



*EUR denom. senior bonds based on ICE BofA Euro Non-Financial Index

Source: LSEG, RBI/Raiffeisen Research

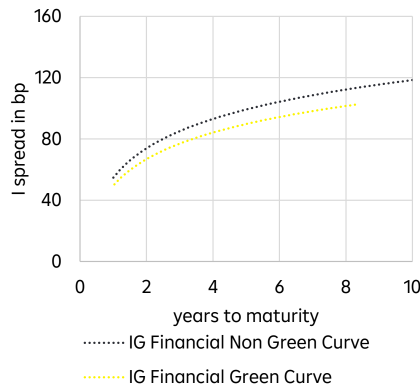
Chart 4 - Corporate Green vs Non Green*



*EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon

Source: LSEG, RBI/Raiffeisen Research

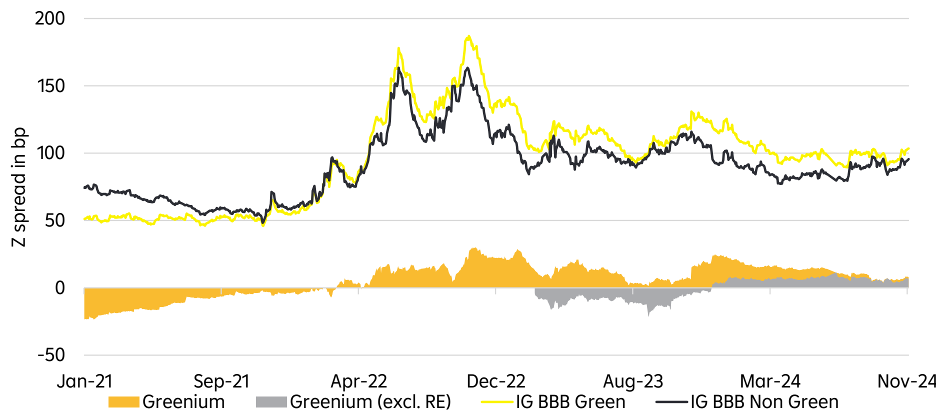
Chart 5 - Financials Green vs Non Green*



*EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon

Source: LSEG, RBI/Raiffeisen Research

Chart 6 - Corporate green vs non green index spread development*



*BBB rating bucket; EUR denom.; > EUR 250 mn; > 1y to maturity; Plain vanilla fixed coupon

Source: LSEG, RBI/Raiffeisen Research

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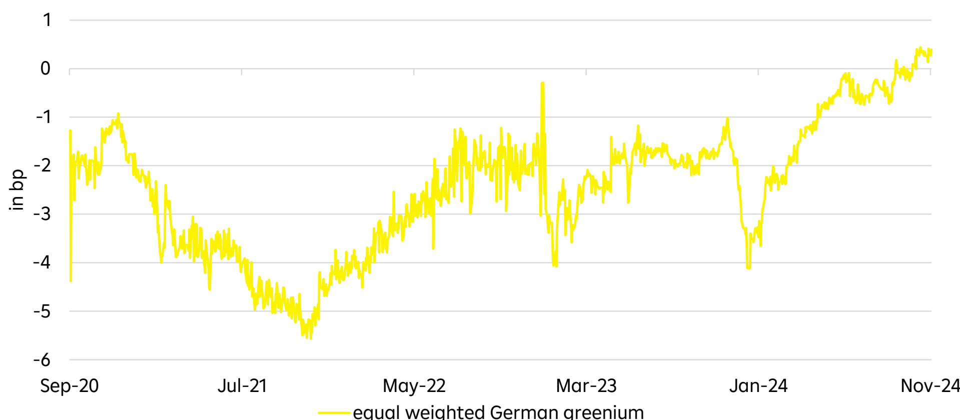
Chart 7 - Aggregated greenium of German twin bonds*

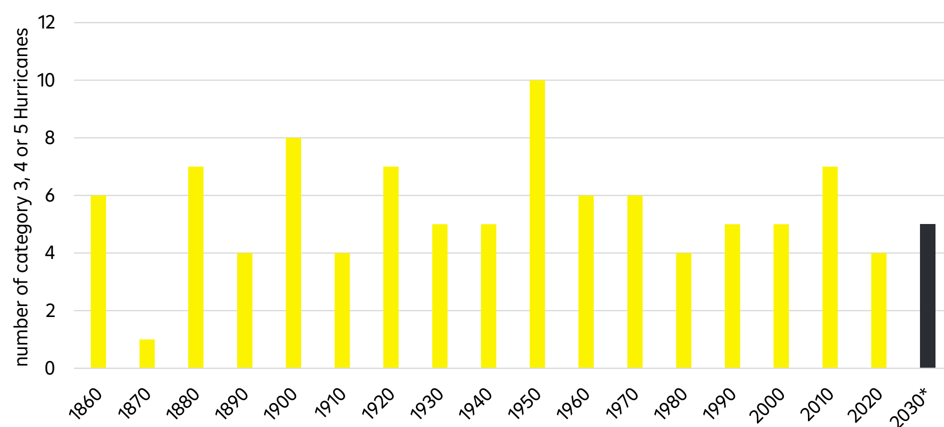


**equal weighted across maturities (2025,2027,2029, 2030,2031,2033,2050,2053)*
Source: LSEG, RBI/Raiffeisen Research

Hot Topic I: CAT bonds show why physical ESG risk matters

With the second Hurricane hitting the US within a few weeks, physical ESG risks - (financial) losses from damages to physical structures resulting from storms, earthquakes and wildfires due to the growing effect of climate change - move into the spotlight. After category 4 Hurricane Helene hit the US east coast at the end of September with estimated losses in the USD 30-48 bn area (though "only" USD 10-18 bn insured) according to CoreLogic, category 3 hurricane Milton made landfall in Florida only a few weeks later in early October. US President Joe Biden said damages are estimated at around USD 50 bn. This number would be just shy of Hurricane Ian in 2022 - the second largest US catastrophe loss on record following Hurricane Katrina in 2005. The increasing density of severe Hurricanes highlights the increasing number of climate related natural catastrophes and therefore the importance of ESG risk management. Up to 2024 to date, this decade has seen five major (category 3 or higher) Hurricanes in the US already, which puts the decade on pace to reach the 1950 decade high. That said, there is no clear increasing tendency in the decades before evident.

Chart 8 - Number of major Hurricanes in the US per decade



**2030 up to 2024 including Milton and Helene*
Source: NOAA, RBI/Raiffeisen Research

Nevertheless, catastrophes such as Hurricanes are a **major financial risk** among others for **insurance companies**. In 2022, the state of Florida had to provide financial help to insurers following a number of storms and lawsuits, which eventually led to new restrictions on lawsuits against insurers. Especially regional insurance players with a geographical focus on Florida are highly exposed. According to Moody's the largest 10 regional players in Florida have a premium concentration of 94% in the region. Insurers

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tend to manage their own exposure via reinsurers though liquidity crunches could still occur due to the time lag between insurance claims and reimbursement from reinsurers.

An instrument to support insurers is the **Florida Hurricane Catastrophe Fund** (FHCF), which collects mandatory premia from Florida based insurers in exchange for reimbursements if the latter exceed a certain loss treshold. The FHCF was set up following Hurricane Andrew which hit the US in 1992 and caused eight insurance companies to default, while pushing many others on the brink of default. The FHCF provides USD 17 bn in reimbursement coverage to 145 insurance companies in Florida. It relies on liquidity from accumulated premiums, reinsurance and pre-event bonds such as **CAT bonds (catastrophe bonds).**

CAT bonds pay the issuer (e.g. the insurance company or the FHCF) a fixed amount if a predefined catastrophe event occurs - both determined at the issuance of the bond. The issuance proceeds are placed in an SPV and are invested in highly rated and liquid money market securities (e.g. treasury bills). The investors receives the interest earned on the collateral as well as fixed premium paid by the issuer on top of the variable return to compensate for the risk of such an catastrophe event occuring. Hence, the bond is effectively a variable rate debt instrument carrying almost no duration risk. In case the predefined event occurs over the term of the bond, the issuer will receive parts or all of the funds placed in the SPV, leading to an equivalent loss for the investors. There are different types of triggers which could cause the fund payout.

- Indemnity triggers: payouts are based on the actual losses experienced.
- Industry loss triggers: payouts are based on the aggregate losses of the insurance industry
- Parametric triggers: payouts are based on the strength of the covered catastrophe such as the magnitue of a earthquake or the category level of a Hurricane

Indemnity triggers are the most common as they make sure losses incurred by a single issuer are fully covered and are therefore the most used trigger from insurance companies. However, as losses need to be calculated and verified, it takes on average two to three years for actual payouts to occur, resulting in a funding gap in the meantime. For reinsurers, the industry loss trigger is more common as their portfolio tends to be based on a broad cross section of the insurance industry rather than reflective of a single insurers losses. Insurers, reinsurers and state catastrophe funds make up the majority of the CAT bond market. Also the market is almost exclusively USD dominanted.

In general, insurers benefit from CAT bonds as they can transfer tail risks to capital markets, there is no counterparty risk (as is the case with reinsurers) as the bonds are 100% collateralized and the coverage of the specific event lasts over the term of the bond which is about 3-4 years on average (while reinsurance contracts are for a one year term).

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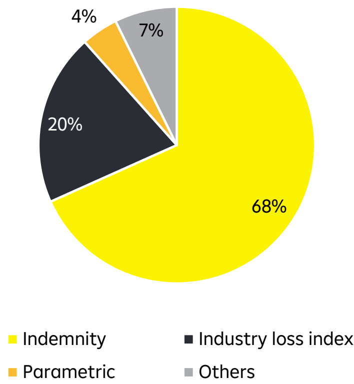
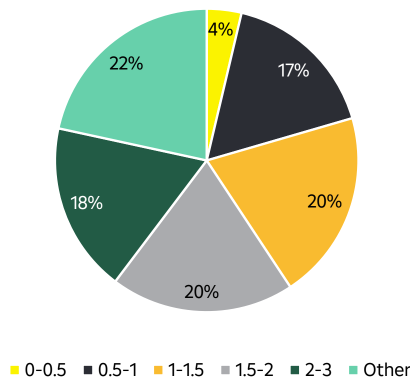
Chart 9 - CAT bonds by trigger



Indemnity | Industry loss index | Parametric | Others

Source: Artemis.bm, RBI/Raiffeisen Research

Chart 10 - CAT bonds by expected loss

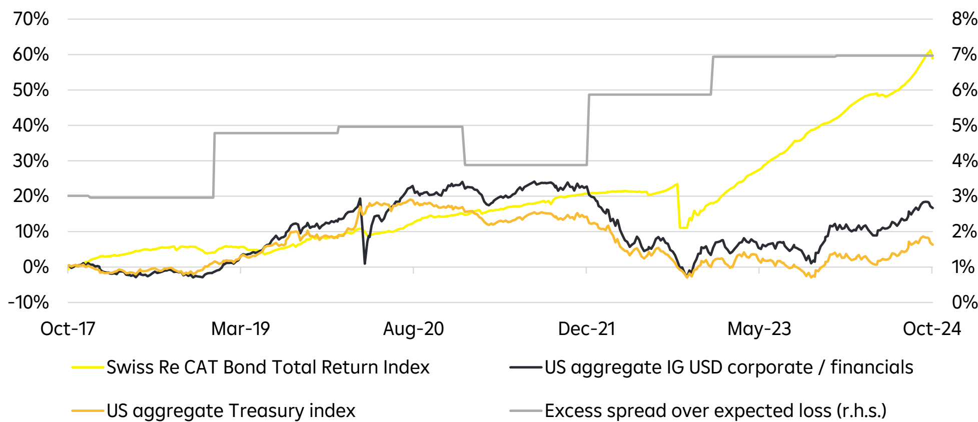


0-0.5 | 0.5-1 | 1-1.5 | 1.5-2 | 2-3 | Other

Source: Artemis.bm, RBI/Raiffeisen Research

For investors, such as hedge funds, pension funds or asset manager, the advantage is uncorrelated returns, and comparably higher yields/coupons. E.g. the average coupon of USD CAT bonds issued by P&C insurer in 2024 ytd is 12.6% vs 6.3% for the average coupon of traditional USD bonds issued from P&C insurers. However, this comes at the cost of a substantial credit cliff in case the event is triggered as the coupon received over the term will not even out the losses. Secondly, liquidity could be an concern as there is no active secondary market. Yet, CAT bonds - as measured via the Swiss Re CAT bond total return index - have massively outperformed other asset classes such as treasuries or corporate and financial bonds. Over the last seven years, CAT bonds returned close to 60% vs 17% for corporate and financial bonds and 6% for treasury securities. This holds true even though the CAT bond market saw a setback when Hurricane Ian hit landfall in 2022 and most recently the market is also seeing some pressure due to Helene and Milton. However, the higher excess spread over the estimated expected loss for the insured events has risen substantially since 2022 as well, which means coupons on average increased, which supports total return.

Chart 11 - CAT bond returns supercharged following Hurricane Ian in 2022*



Swiss Re CAT Bond Total Return Index | US aggregate IG USD corporate / financials | US aggregate Treasury index | Excess spread over expected loss (r.h.s.)

**rebased as of October 2017*
Source: Artemis.bm, Bloomberg, RBI/Raiffeisen Research

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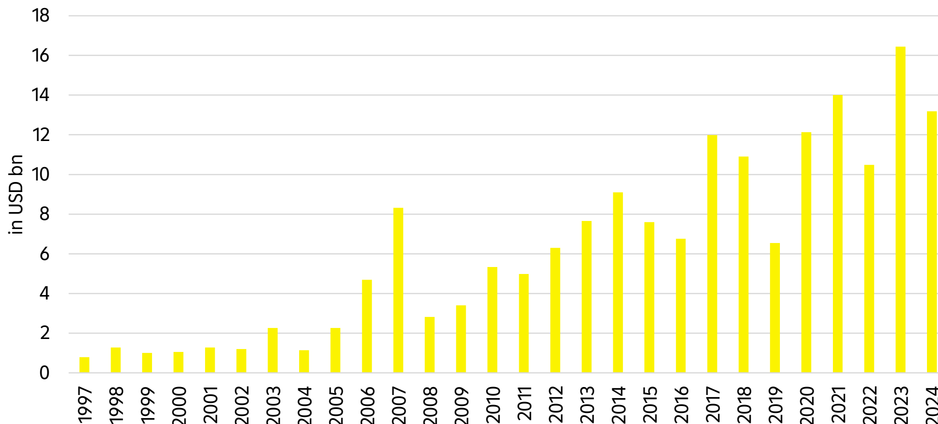
Chart 12 - CAT bond index price performance influenced by major hurricanes

Source: Bloomberg, RBI/Raiffeisen Research

In line with returns, issuance activity has picked up as well over the last years. Especially since 2020, when the expansive monetary policy and resulting low interest rate environment in the US left investors scrambling for alternative sources of return. Yet, the overall market is still quite small at about USD 48 bn. That said annual issuance volumes amounted to USD 0.8 bn when the market saw the light of the day in 1997. This compares to USD 13 bn in 2024 ytd. The CAT bond market finally caught track following Hurricane Katrina in 2005, when a substantial increase in reinsurance premia resulted in insurers looking for an alternative risk managment option. The financial crisis in 2008 caused another temporary setback as Lehman Brothers defaulted, which had acted as counterparty in some major deals. This led to the now typical fully collateralized SPV structure. Since then the market has seen continous growth rates on the back of diversification and return benefits over other asset classes.

Chart 13 - CAT bond issuance activity



Source: Artemis.bm, RBI/Raiffeisen Research

The potential effect that hurricanes Helene and Milton might have on CAT bond holders have yet to be clarified and as mentioned before can take years to be finalized. According to data from Artemis, at least USD 4.1 bn of risk capital (roughly 9% of the total outstanding volumes) is tied to Florida related natural catastrophes, of which USD 3 bn for storms specifically. This might explain why some investors seem to have lost their nerves and tried to sell their holdings, leading to the recent price correction as shown before.

The increasing number and intensity of hurricanes might lead investors to demand a further increase in the excess spread for CAT bonds going forward. Hence, CAT bonds could remain an attractive alternative for many institutional investors. From an ESG perspective, the bonds are interesting as their risk/return profile is directly tied to physical

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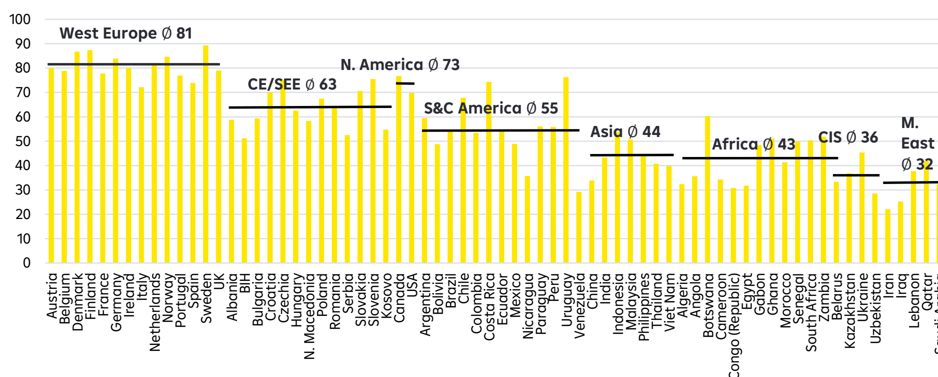
ESG risks. With assumed growing natural catastrophes stemming from global warming, the demand for such bonds should be well supported.

Hot Topic II: CE/SEE has clear advantages over other EMs when it comes to ESG

The CE/SEE countries' ESG score by Raiffeisen Research's ESG scoring model continues to show that, in an emerging markets comparison, this region has by far the best score. The CE/SEE region is well ahead of South America. Here, Chile, Costa Rica and Uruguay in particular distort the average rating upwards, while Nicaragua and Venezuela are significantly below average. The Asian EMs and Africa follow at a considerable distance. The CIS region and the Middle East are even further behind.

Chart 14 - CE/SEE to be prefered for ESG Score vs other EMs

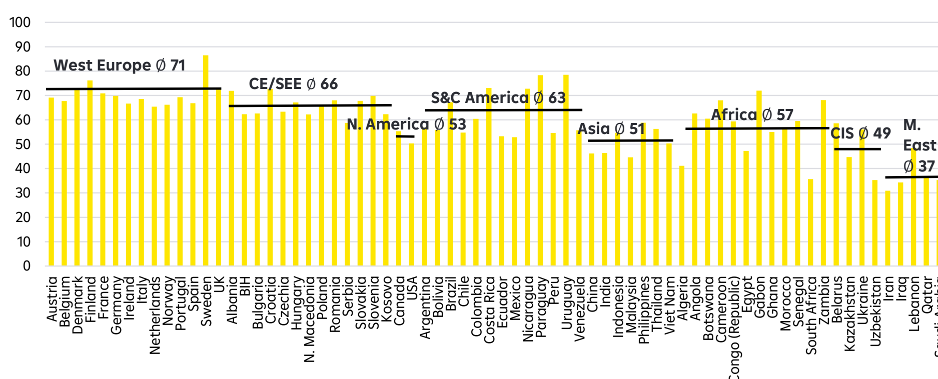


100 best score, CIS exclusive Russia

Source: Raiffeisen Research ESG data-base

For investors who are increasingly targeting the environmental factor, the CE/SEE region seems even more interesting. Here, the region is only just behind Western Europe and even performs better than North America. When it comes to environmental, however, there are also very positive examples in South America and Africa. The starting point for a sustainable transformation definitely seems to be in the CE/SEE region, though.

Chart 15 - CE/SEE also in pole position for E score



100 best score; CIS exclusive Russia

Source: Raiffeisen Research ESG data-base

Deals of the month

- **voestalpine** issued its **inaugural green bond** at the end of September. It is the **first green bond issued by an European steel** producers. Pricing indications for the 5y EUR 500 mn paper started at 175bp over mid swaps with the final pricing coming in at ms+155bp, which translates into a coupon of 3.75% an issuance yield of 3.8% (re-

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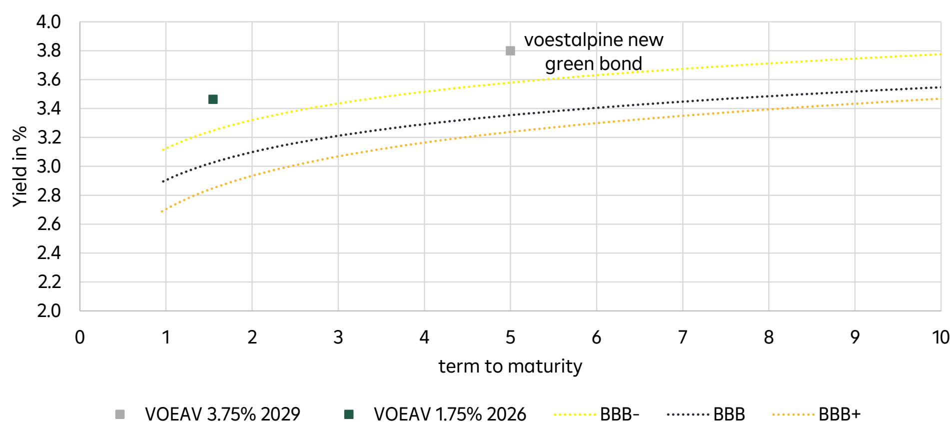
offer 99.731%). Books were above EUR 850 mn with one large anchor investor taking up a substantial share. As voestalpine does not have a secondary market curve with only one additonal bond due in 2026, a greenium or new issue premium can not be derived, however, the bond prices roughly in line with its shorter peer. The yield is also roughly 20-40bp over the BBB- and BBB curves. Proceeds will be used to finance the Group's greentec Steel program, wich aims to reduce CO_2 emissions by 30% from 2027 onwards (vs 2019 base year). Specifically, the Group will replace two blast furnaces (used to produce steel via iron ore and coking coal) via two electric arc furnaces. The latter uses renewable energy, scrap and direct reduced iron among others rather than coking coal and iron ore. voestalpine estimates a capex budget of EUR 1.5 bn for the two EAFs, most to be incurred in FY 24/25 and FY 25/26. The two EAFs are expected to increase voestalpines EU taxonomy aligned revenues from currently 27% as both EAFs should meet the EU Taxonomy GHG intensity treshold of 0.266 t CO2/t steel for high-alloy steel. In the second phase of the greentec steel program, two further blast furnaces are replaced by one EAF, which should reduce emissions by 50% vs 2019 base year. The EUR 500 mn estimated to be needed for phase two could lead to further green bond placements and since the projects are aligned with the EU taxonomy the EUGBs could also be an option from December of this year onwards.

Chart 16 - voestalpine green bond pricing



Source: Bloomberg, RBI/Raiffeisen Research

Good to know - Europe's EV battery hopeful Northvolt struggles

Europe's hope to improve their independency in the EV battery supply chain has in parts also rested on Swedish battery maker Northvolt. The Group currently accounts for about 7% of the EU's battery production capacities at 16 GWh and is one of the few active European owned producers together with BMZ and Automotive Cells. The majority of EU based production capacities is still in foreign hands with LG Energy (49%) and Samsung SDI (13%) taking up roughly two thirds. Based on currently announced plans or ongoing constructions, Northvolts European capacities were expected to reach 120 GWh by 2030, challenging LG Energy, Automotive Cells and CATL for the crown as largest domestic producer. Among them was a planned 44 GWh expansion of its Northvolt Ett operations from the 16 GWh currently. Only in January of this year, Northvolt secured USD 5 bn via Europe's largest green loan raised to date (at that time) from 23 commercial banks as well as the EIB and NIB to finance the Northvolt Ett expansion. Discussion's about an IPO as early as 2024, though pushed back to 2025 in the meantime, have been floating around as well supported by an USD 50-55 bn order book from the likes of BMW, Scania, Volvo and Volkswagen - the latter even being among the main shareholders with an stake of 21% at YE 23.

The IPO might have to wait much longer as the Group announced in September it will no longer pursue the expansion project Northvolt Ett as it has to streamline operating costs,

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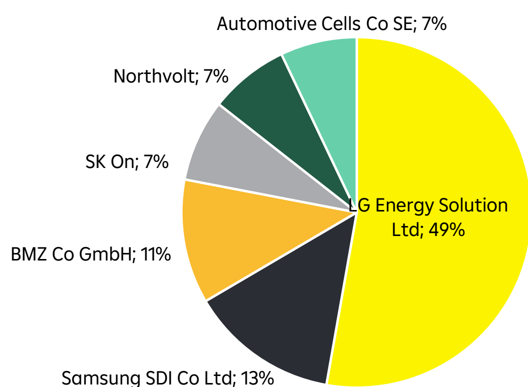
and more recently the subsidiary managing the expansion construction project has filed for bankruptcy. With the expanion project cancelled, the 44 GWh are off the table as well. Northvolt remains committed for the Northvolt Drei project in Germany where it started construction of a 60 GWh factory in March of this year. Construction is expected to be finished by 2026. This puts the 2030 capacities at 76 GWh rather than the 120 GWh, with the difference reflecting about 3% of the EU's estimated capacities by 2030.

As for the USD 5 bn green loan, the structure was set up as non-recourse project financing, which means creditors are unlikely to recover their investments. This shows that green loans - or ESG debt instruments for that matter - still do carry credit risk regardless of their green assessment. The loan was issued in line with Northvolts green finance framework and received the highest "dark green" rating attainable from external rating company CICERO. Yet, when its all said and done what matters is credit risk, which shows that ESG investors still have to conduct a proper credit analysis before investing. This might also explain why we currently do not see a greenium on the market for corporate bonds or Germany's twin bonds. Why would investor accept a lower risk premium for financing a project / company if credit risk is equal? Northvolt had secured a total of USD 15 bn in debt, equity and grant financing at YE 23, but gross profit was negative in FY 22 and FY 23. Operating cash flow and due to the high investments free cash flow even more so were substantially negative financed via massive debt intake.

The struggles seem to extent even beyond the new expansion though, with the Group seeminlgy in a cash crunsh as they are looking for USD 920 mn in fresh long term funding on top of USD 300 mn in short term financing needs. Northvolt also just sold a US battery plant to a US based battery start-up. This also calls into questions as to whether the factory in Germany will be put into operations. For now, the governments of Sweden and Germany continue to support the Group.

Clearly this is an extreme case and cancellations or strategic re-alignments could happen to any other (non ESG) project as well, but specifically because it could happen to any other project it actually underlines why one would be willing to accept a lower return for the same potential risk? One would not.

Chart 17 - EU battery capacities by company



Source: Bloomberg, RBI/Raiffeisen Research

Appendix

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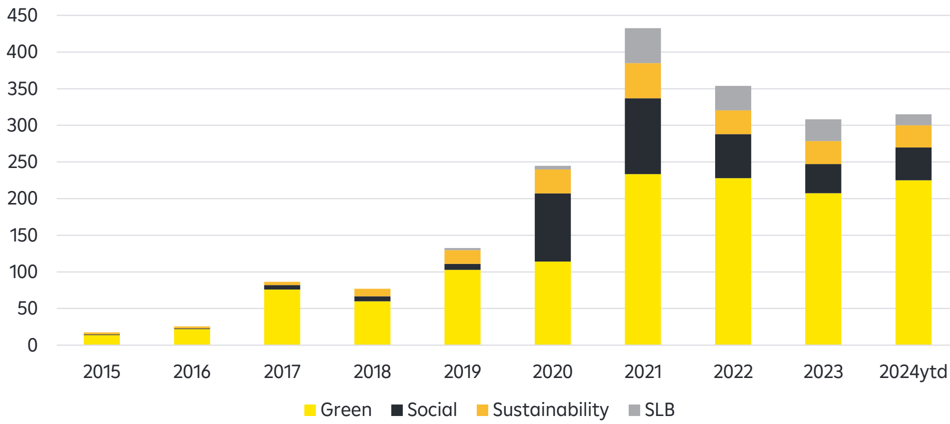
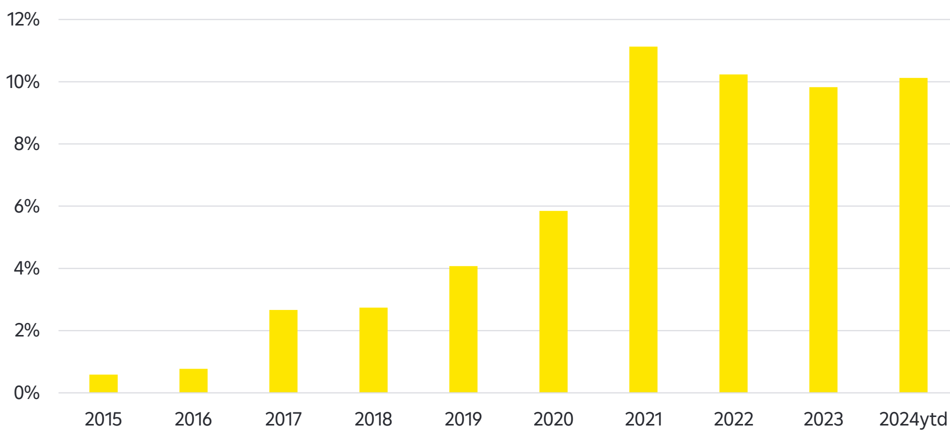
Chart 18 - Yearly Issuance Volume - EUR ESG Market (EUR bn)



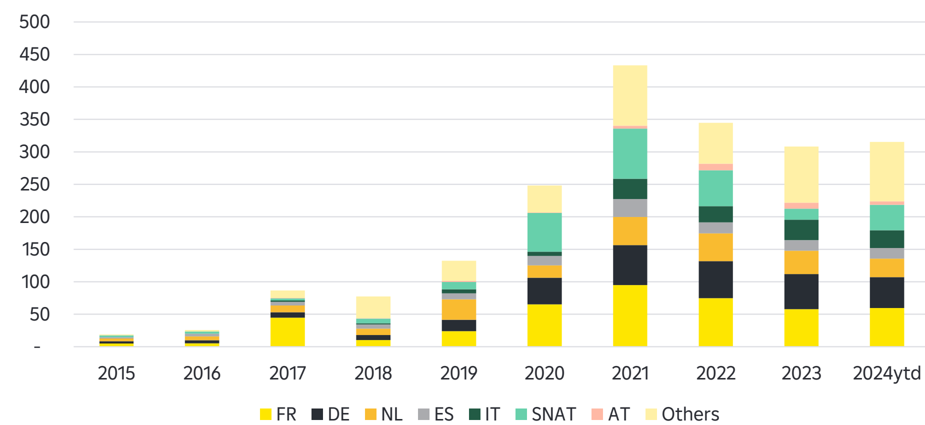
Source: LSEG, RBI/Raiffeisen Resarch

Chart 19 - Share of ESG bonds in the EUR primary market



Source: LSEG, RBI/Raiffeisen Research

Chart 20 - Country Overview EUR ESG Market (EUR bn)



Source: LSEG, RBI/Raiffeisen Research

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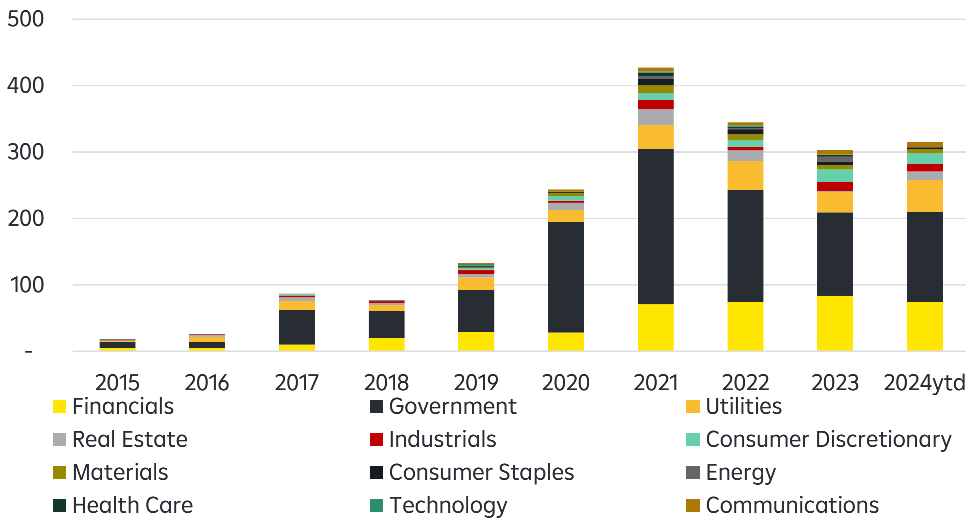
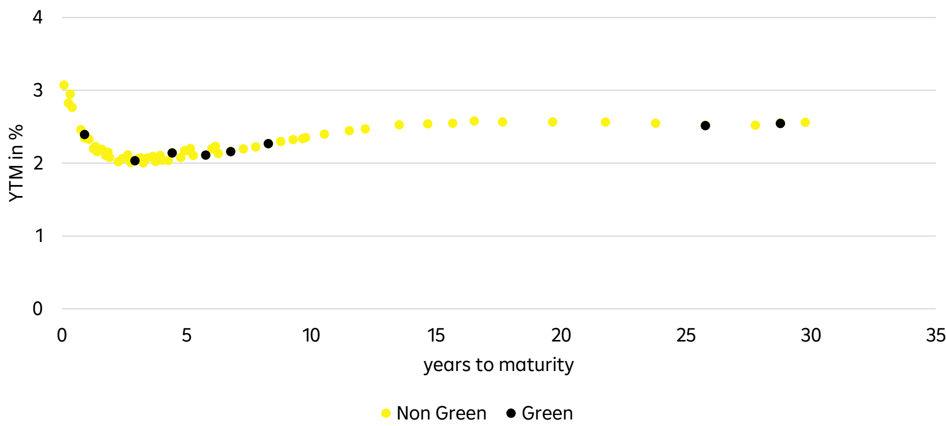
Chart 21 - Industry overview - EUR ESG primary market (EUR bn)



Source: LSEG, RBI/Raiffeisen Research

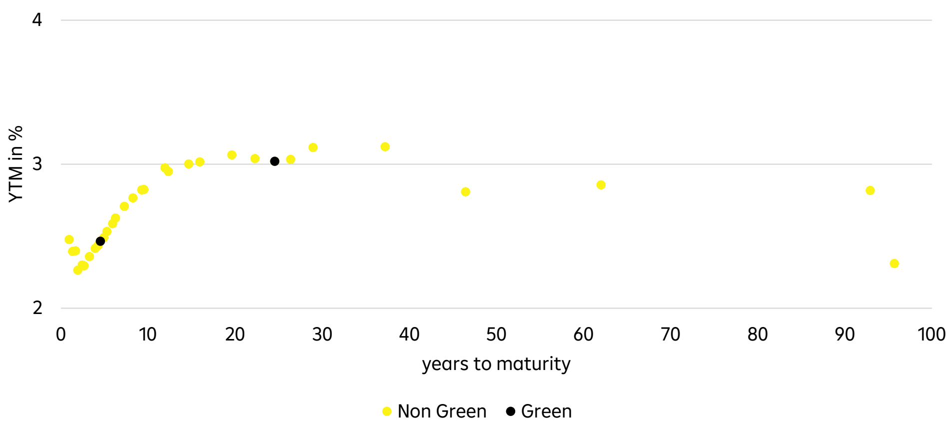
Chart 22 - Yields of German government bonds*



**EUR denom.; > EUR 250 mn; Plain vanilla fixed coupon*

Source: LSEG, RBI/Raiffeisen Research

Chart 23 - Yields of Austrian government bonds*



**EUR denom.; > EUR 250 mn; Plain vanilla fixed coupon*

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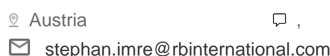

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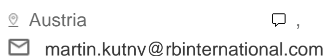

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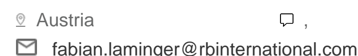

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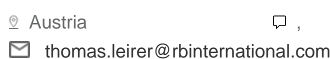

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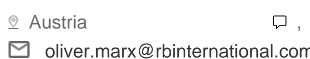

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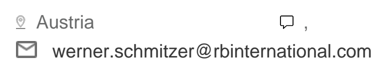

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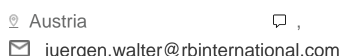

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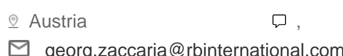

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