Are the Islamic Banks Earning more in Bangladesh?

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Abstract

The concept of Islamic Banking is not new. The coexistence of Islamic banking and conventional banking system is common in many countries of the world. This paper aims at finding whether Islamic banks are earning more profit compared to traditional banks in Bangladesh while investigating the overall trends in bank profitability. Islamic banks' profitability is compared to the profitability of conventional banks' over a period of 5 years (2009-2013). Nineteen conventional banks and Six Islamic banks were randomly selected. Data was collected from audited annual reports of the selected banks. Ratio analysis and parametric tests were performed using the software STATA. The study found that overall profitability of the banks has experienced a decreasing trend. It is also found that earning ability of Islamic Banks and Conventional Banks in Bangladesh are almost same. From relative measure it is revealed that there is no significant difference between profitability of Islamic banks and conventional non-Islamic banks of Bangladesh.

Keywords: Islamic Banks, Conventional Banks, Profitability, ROE, ROA

Introduction

Bangladesh is one of the largest Countries in the world where majority are Muslims by belief. The people of this country are intensely committed to Islamic way of life as narrated in the holy Qur'an and Sunnah. In line with this, it remains an ordeal aspiration in their hearts to blueprint their economic lives in accordance with the purview of Islam. With this end in view, Bangladesh signed the charter of Islamic Development Bank (IDB) and committed itself to recognize its economy and financial system as per Islamic Shari'ah in August, 1974.

Islamic banking system started operation in Bangladesh in 1983 with the establishment of first Islamic bank "Islami Bank Bangladesh Limited". The banking sector of Bangladesh is incessantly growing with new banks coming into operation. The remarkable shifting or the introduction of Islamic banking wings by traditional banks signal high acceptance of the interest-free banking by the community in general. The Islamic banking industry continued to show strong growth since its inception in 1983 with the growth in the economy, as reflected by the increased market share of the Islamic banking industry in terms of assets, financing and deposits of the total banking system. Presently, there are 08 Islamic banks and 40 commercial non-Islamic banks including 09 foreign banks operating in Bangladesh. In 2014, the Islamic banking deposits accounted for 18.91% of the total banking deposits and its advances represented 22.05% of total investments in the banking sector of Bangladesh (BB Statistics, 2014).

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The modes of operations between Islamic banks and conventional banks are not same. The conventional banking operates on pre-fixed interest rate whilst Islamic banking is based on profit sharing. Islamic banking refers to a system of banking or banking activity that is consistent with Islamic principles and guided by Islamic economics. In particular, usury (riba), the collection and payment of interest, is completely prohibited. Moreover, Islamic law also prohibits trading in financial risk which is considered as a form of gambling. Investing in businesses that provide goods or services which are contrary to Islamic principles is also sinful and prohibited.

The traditional banks earn profits by attracting deposits from the depositors at a low interest rate and then reselling those funds to the borrowers for higher interest rate, based on its competitive advantage at gathering information and underwriting risk. Therefore, conventional banks make profits from the spread between the interest rate paid to depositors and the interest rate received from borrowers (Mohamad, Hassan & Bader 2008).

The rapid growth of Islamic banks and their better performance are also being questioned. Can we say that Islamic banks are doing well compared to the conventional banks? This has been a debatable issue. Some argued that it is wrong to compare Islamic banks and conventional banks by saying that both system of banking have been in existence for decades. In this regard, conventional banks enjoy several advantages over Islamic banks such as conventional banks have very long history and experience, interest which is a major source of bank revenues is accepted, do not share loss with clients and ask for guaranteed collaterals in most transactions, have very huge capital, widely spread, have well developed technologies, and even they can enter Islamic banking market (Mohamad, Hassan & Bader 2008).

According to Samad (2004), many are skeptical about Islamic banks' performance as newcomers to the market. There are several reasons behind this skepticism. Firstly, Islamic banks are non-conventional financial institution where Interest is completely prohibited under Islamic banking. Secondly, Islamic banks are required to follow both conventional business laws and the Islamic laws. The conventional banks are at liberty to enter any transactions as they like. It is interesting to look at the current performance of Islamic banks and compare it to the conventional ones. Are they still lagging behind the long established conventional banks or they are earning more? This triggers the current study to compare Islamic banks earning ability with that of conventional banks.

Literature review

In many studies, the researchers have attempted to measure the productivity and efficiency of the banking industry using outputs, costs, efficiency and performance. Performance of a bank provides signal to depositors and investors to take decision on whether to invest or to withdraw funds from the bank and whether to buy or sell the bank's securities.

Ahmed (2011) in his study conducted in Jordan measured the financial performance of some selected commercial banks for the period 2005-2009. The study used simple regression analysis.

The study found that banks with higher total deposits, credits, assets, and shareholders' equity does not always result in better profitability.

Ashraf and Rehman (2011) analyzed and compared the performance of Islamic banking and conventional banking system in Pakistan. They analyzed the financial performance of some selected banks from five dimensions namely Profitability, Earnings, Liquidity, Credit risk and Asset activity for a period covering 2007 to 2010. The study surmized that the performance of Islamic Banks in Pakistan is lagging behind on the basis of performance because of increased operating cost and inefficiency on the part of the management.

Khandker (2011) in his study evaluated the performance of private commercial banks considering the impact of the economic environment of Bangladesh on the performance of the banks. The study concludes that operating a banking business in the economic environment of a developing country like Bangladesh requires full understanding of the changing economic situations, sound strategy-making for tackling adverse situations, effective short term planning and efficient risk management.

Kouser and Saba (2012) later compared the performance of Pure Islamic banks, mixed banks and conventional banks in Pakistan using CAMEL rating. The paper divulged that the Islamic banks have adequate capital and have strong asset quality compared to other banks. The study also found that Islamic banks in general have more competent management compared to conventional banks and the earnings of Islamic branches of conventional banks are greater than other banks.

Chowdhury (2002) in his study revealed the state of banking industry of Bangladesh. He mentioned that performance of banks requires knowledge about the profitability and the relationships between variables like market size, bank's risk and bank's market size with profitability. The study concluded that the banking industry in Bangladesh is experiencing major transition for the last two decades. The study recommended that the banks should endure the pressure arising from both internal and external factors and prove to be profitable.

In a study of seven Jordanian commercial banks Ahmad (2011) used the ROA as a measure of banks' performance and the bank size, asset management and operational efficiency as three independent variables affecting ROA. The study revealed a strong negative correlation between ROA and banks' size, a positive strong correlation between ROA and asset management ratio, and a negative weak correlation between ROA and operational efficiency.

Ali et al. (2011) in their study in Pakistan found that there is significant relation between asset management ratio, capital and economic growth and with ROA. They found that operating efficiency, asset management and economic growth are significant with the ROE.

According to Al-Shamrnari and Salirni (1998), profitability ratios, especially return on equity (ROE), signals the earning capability of the organization.

Jafar and Irfan (2011) in their study used ROA and ROE to measure the earning ability according to camel test. The return on equity ratio or ROE is a profitability ratio that measures the ability of a firm to generate profits from its shareholders investments in the company. In other words, the return on equity ratio shows how much profit each dollar of common stockholders' equity generates.

Rosley and Abu Bakar (2003) analyzed the profitability ratios to determine the relative profitability of Islamic Banking Scheme (IBS) which provides Islamic services in Malaysia.

According to Kakakhel et al. (2011), only through financial ratio analysis tool, one accounting figure can be easily measured and compared with another accounting figure. He also noted that yearly comparison of both Islamic and conventional banks can be properly done by using ratios.

Objectives of the Study

The major objective of this study is to know about the profitability of Islamic banks and conventional non-Islamic private commercial banks of Bangladesh. The following are the specific objectives of the study.

1. To make a comparative analysis on earning ability of Islamic Banks and Conventional Banks in Bangladesh.
2. To find out whether Islamic banks or Traditional banks are earning more.
3. To know whether there exist significant difference between profitability of Islamic banks and the profitability of conventional banks of Bangladesh.

Research questions

i. Are Islamic banks earning more than the conventional banks in Bangladesh? Or

ii. Are Conventional banks earning more than the Islamic banks in Bangladesh?

iii. Is there any significant difference between profitability of Islamic banks and the profitability of conventional banks of Bangladesh?

Hypothesis's of the Study

For achieving the objective no.03 the hypothesis is:

H0: There is no significant difference between profitability of Islamic banks and conventional non-Islamic banks of Bangladesh.

HA: There is significant difference between profitability of Islamic banks and conventional non-Islamic banks of Bangladesh.

Research Methodology

The population of this research study is based on the entire Islamic and conventional banking sector in Bangladesh where the conclusion will be generalized. The sample of study consists of 6 Islamic and 19 conventional banks, listed on DSE, that were selected on random basis. The two group's selected financial ratios (ROE & ROA) were then analyzed based on their respective

audited financial statements for the last five years (2009 - 2013). The most commonly used measures of profitability, ROE and ROA, were considered for this study. Ratio analysis was done to find which group has better earning ability. T-test is performed to examine any significant differences on profitability between these two groups of banks. Software version of STATA-12 was used in analyzing data. Finally, we presented the result findings. The list of banks that were selected is as follows.

Conventional Banks:

1. Bank Asia Limited
2. BRAC Bank Limited
3. Dhaka Bank Limited
4. Dutch Bangla Bank Limited
5. Eastern Bank Limited
6. IFIC Bank Limited
7. Jamuna Bank Limited
8. Mercantile Bank Limited
9. Mutual Trust Bank Limited
10. National Bank Limited
11. NCC Bank Limited
12. Prime Bank Limited
13. Southeast Bank Limited
14. Standard Bank Limited
15. The City Bank Limited
16. The Premier Bank Limited
17. Trust Bank Limited
18. United Commercial Bank Limited
19. Uttara Bank Limited

Islamic Banks:

1. Islami Bank Bangladesh Limited
2. Al-Arafah Islami Bank Limited
3. Export Import Bank of Bangladesh Limited
4. Social Islami Bank Limited
5. Shahjalal islami Bank Limited
6. First Security Islami Bank Limited

Analysis and discussion

The profitability ratios of the banks indicate that all of the banks included in the sample were profitable over the period 2009-13, since none of them indicate losses. The descriptive statistics would give a clearer picture of the distribution of the values of the ratios, which are shown in the following tables:

Table 01: Summary statistics of ROE over the period of 2009 to 2013

Name of the Banks	Mean (%)	Median	Std. Dev.	Min	Max
Al-Arafah Islami Bank Limited	18.04	18.34	4.379218	13.51	24.1
Bank Asia Limited	20.284	19.61	11.69208	7.11	32.12
BRAC Bank Limited	14.594	17.9	6.002019	5.47	19.19
The City Bank Limited	12.56	13.7	6.834325	4.3	21.3
Dutch Bangla Bank Limited	26.6	27	6.92712	17	35.3
Dhaka Bank Limited	18.356	19.32	7.18994	7.24	25.52

Table 01 (Contd.)

Name of the Banks	Mean (%)	Median	Std. Dev.	Min	Max
Eastern Bank Limited	18.73	19.03	4.253328	14.44	23.64
IFIC Bank Limited	19.84	15.98	8.322028	12.15	33.12
Jamuna Bank Limited	19.312	19.43	6.890114	13.2	30.06
Mutual Trust Bank Limited	15.518	11.15	9.348929	6.47	26.61
Mercantile Bank Limited	17.37	17.95	2.468076	13.42	19.84
National Bank Limited	24.474	27.53	17.22795	6.78	48.96
NCC Bank Limited	18.642	18.98	8.514909	8.58	28.49
The Premier Bank Limited	15.528	9.84	9.603576	7.66	28.23
Prime Bank Limited	18.782	20.19	8.31806	8.35	30.19
Southeast Bank Limited	14.202	16.2	4.577157	8.42	19.41
Standard Bank Limited	19.754	20.01	5.547475	12.51	27.83
Trust Bank Limited	13.236	11.68	10.55742	3.02	29.04
United Commercial Bank Limited	20.136	18.49	8.770198	9.29	32.28
Uttara Bank Limited	15.568	17.13	2.872345	12.27	18.02
EXIM Bank of Bangladesh Limited	17.84	13.87	8.17949	9.28	27.86
First Security Islami Bank Limited	12.71	12.75	1.055367	11.41	13.99
Islami Bank Bangladesh Limited	15.626	16.93	3.137193	11.36	19
Shahjalal islami Bank Limited	19.574	17.01	8.12018	11.25	30.71
Social Islami Bank Limited	12.822	12.13	1.832845	11.01	15.31
Total	**17.60392**	**16.93**	**7.739987**	**3.02**	**48.96**

In the table, it is shown that the Dutch Bangla Bank Limited is most profitable bank having average ROE of 26.6% with the lowest average ROE of 12.56% is achieved by the City Bank Limited. Eleven conventional banks and three Islamic banks has the average ROE of more than the average total ROE of 17.60%.

Table 02: Summary statistics of ROA over the period of 2009 to 2013

Name of he Banks	Mean (%)	Median	Std. Dev.	Min	Max
Al-Arafah Islami Bank Limited	1.796	1.77	0.591802	1.2	2.65
Bank Asia Limited	1.556	1.72	0.697338	0.7	2.22
BRAC Bank Limited	1.108	1.36	0.545041	0.35	1.56
The City Bank Limited	1.34	1.2	0.733485	0.6	2.2

Table 02 (Contd.)

Name of he Banks	Mean (%)	Median	Std. Dev.	Min	Max
Dutch Bangla Bank Limited	1.72	1.7	0.370135	1.2	2.2
Dhaka Bank Limited	1.498	1.39	0.642783	0.59	2.22
Eastern Bank Limited	2.29	2.34	0.62498	1.68	3.19
IFIC Bank Limited	1.448	1.09	0.646158	0.93	2.49
Jamuna Bank Limited	1.572	1.69	0.541729	1.01	2.3
Mutual Trust Bank Limited	1.034	0.61	0.695471	0.39	1.79
Mercantile Bank Limited	1.446	1.33	0.334186	1.02	1.86
National Bank Limited	2.868	2.52	2.206098	0.8	6.05
NCC Bank Limited	1.926	2.12	0.861789	0.92	2.84
The Premier Bank Limited	1.438	0.87	0.932427	0.68	2.6
Prime Bank Limited	1.728	2.05	0.695176	0.76	2.37
Southeast Bank Limited	1.566	1.64	0.483715	0.95	2.26
Standard Bank Limited	1.742	1.83	0.46192	1.1	2.37
Trust Bank Limited	1.006	0.92	0.839899	0.21	2.27
United Commercial Bank Limited	1.48	1.41	0.495732	0.84	1.98
Uttara Bank Limited	1.426	1.54	0.414886	0.99	1.91
EXIM Bank of Bangladesh Limited	1.978	1.65	0.963572	1.06	3.54
First Security Islami Bank Limited	1.284	1.56	0.628872	0.53	1.89
Islami Bank Bangladesh Limited	1.278	1.34	0.191755	0.96	1.47
Shahjalal islami Bank Limited	1.762	1.44	0.800762	1.02	3.01
Social Islami Bank Limited	2.322	2.39	0.455489	1.67	2.75
Total	**1.62448**	**1.57**	**0.803275**	**0.21**	**6.05**

The average ROA is 1.62%, while the average ROE is 17.60% for the twenty five banks under study. National Bank Limited has the highest return on assets (ROA) of 2.89%, followed by Social Islamic Bank Limited. National Bank Limited also has the second highest Return on Equity (ROE). Hence, among the twenty five banks considered, National Bank Limited is the most profitable.

Now if we see year by year record of average ROE and ROA, it is observed that there is declining trend in both of the ratios. Figure 01 shows that both average ROE and average ROA peaks in 2010 at 25.30% and 2.43% respectively. Afterwards there was a dramatic fall in 2011 followed by hitting a low ROE of 11.47% in 2012. ROA observes similar picture. However, in 2013 the trend reversed in case of ROE while ROA was hovering at around 1.05%.

Table 03: Average ROE and ROA, year by year comparison.

Year	ROE	ROA
2009	22.084	1.8248
2010	25.3028	2.43
2011	17.1352	1.7612
2012	11.4688	1.0636
2013	12.0288	1.0428

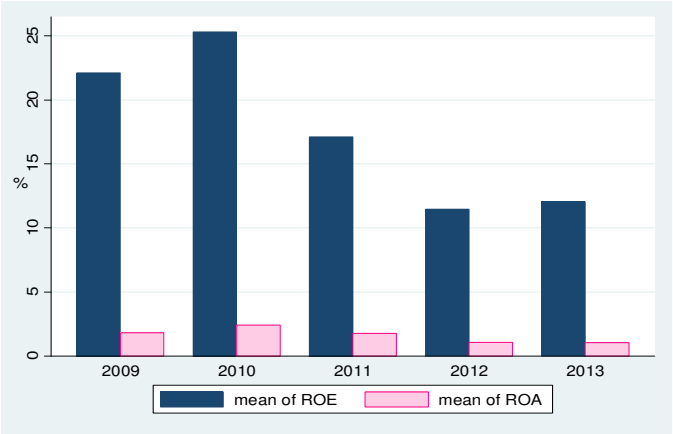

Figure 01 : Year by Year comparison of Avg. ROE and Avg. ROA

The overall average of ROE of the period under study for conventional banks is 18.07% which is more than 16.10%, the average ROE of Islamic banks for the same period. This implies that conventional banks earning more for its shareholders. However, the average ROA reveals the opposite picture with 1.74% and 1.59% for the Islamic banks and Conventional banks respectably as shown is figure 02. This indicates that Islamic banks are more efficient in assets utilization.

Table 04: ROE & ROA

	Group	Mean
ROE	Islamic	16.102
	Conventional	18.07821
ROA	Islamic	1.736667
	Conventional	1.589053

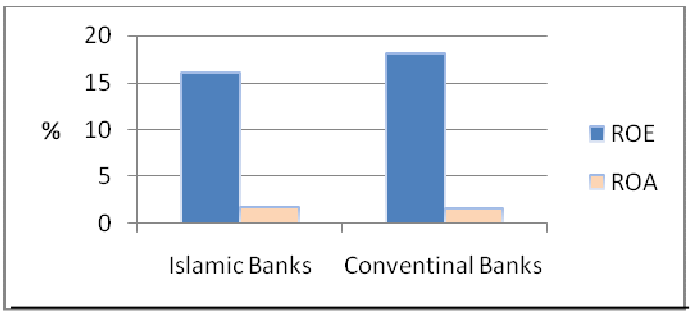

Figure 02: Average ROE & ROA

The average and mean ROE over the time for both Islamic and Conventional banks are shown on table 05 and displayed in the figure 03.

Table 05: Year by Year average ROE

	Year	Islamic	Conventional
ROE	2009	19.14833	23.01105
	2010	21.16167	26.61053
	2011	14.615	17.93105
	2012	14.085	10.64263
	2013	11.5	12.19579

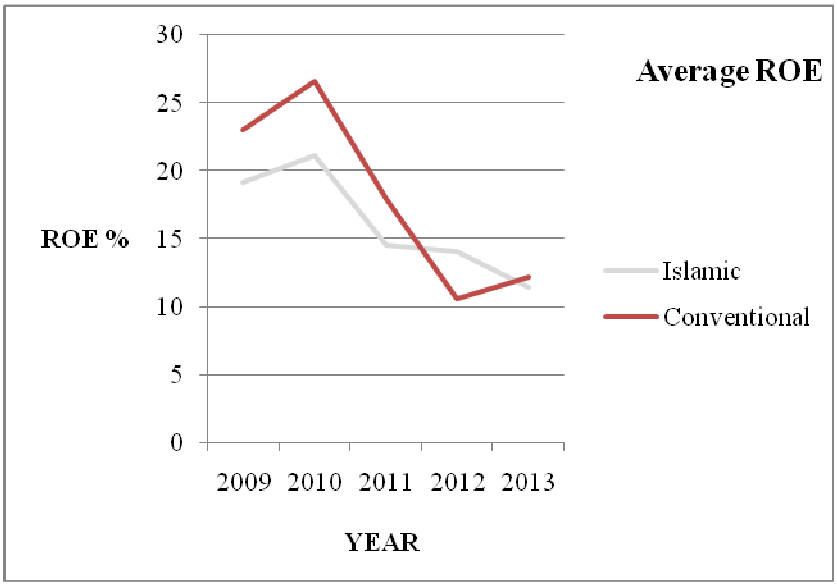

Figure 03: Year by Year average ROE

The figure 03 shows that in 2009 the conventional banks' average ROE ratio was 26.61% which was the maximum in the period under study. However, the ROE of conventional banks plummeted to 10.46% in 1012 before recovery in 2013. The Islamic banks, on the other hand, starting with 19.14% the ROE raised to 21.16% before starting to fall and reaching at low ROE of only 11.5% in 2013 while showing a decreasing trend over the last four years.

The mean ROA over the time for both Islamic and Conventional banks are shown on table 06.

Table 06: Year by Year average ROA

	Year	Islamic	Conventional
ROA	2009	1.836667	1.821053
	2010	2.491667	2.410526
	2011	1.798333	1.749474
	2012	1.483333	0.9310526
	2013	1.073333	1.033158

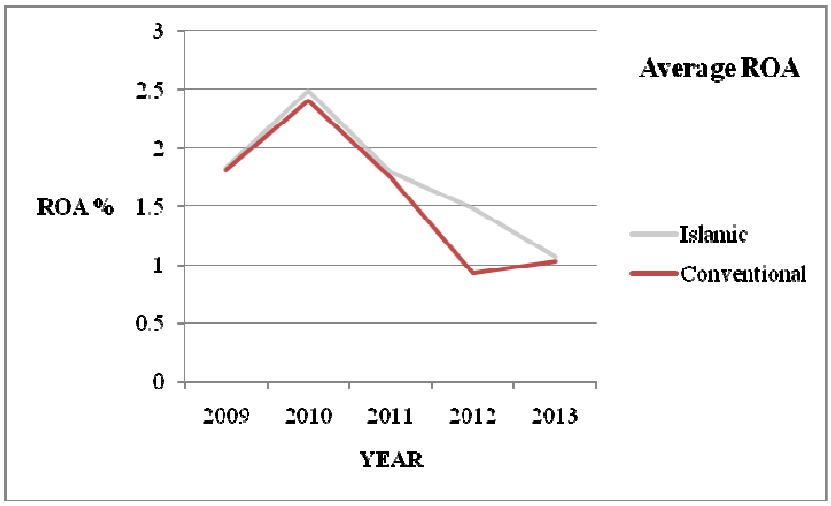

Figure 04: Year by Year average ROA

Exhibited in figure 04, Islamic banks mean return on asset ratio was poor enough with the highest 2.49% in 2010 and the lowest 1.07% in 2013. In 2009 Islamic banks have earned only 1.83 Taka of each 100 Taka invested on assets. This value drastically fell to 1.07% recording the worst earning ability in 2013. Furthermore, Islamic banks are focused on growth and expansion strategies which deviates them from profit- oriented strategies. Yet, Islamic banks lead the way in earning on their invested assets.

The Conventional banks average ROA could not surpass 2.41% during the period 2009 to 2013 while it drops to 0.93% in 2012. This result for Conventional banks is comparatively worse. Lack of management effectiveness on utilization of assets is the main reason for this poor performance.

Noticeably, the profitability of both the groups are tantamount in 2013, the last year of the period under study. But, the year before the conventional banks showed worse performance compared to the Islamic banks. However, on average it is observed that there are differences in earning ability of the said groups of banks. Is the difference significant? This significant test was done on the basis of both ROE and ROA.

Table 07: STATA Output of Two Sample t-Test based on ROE

Group	Obs	Mean	Std.Err.	Std.Dev.	[95% Conf. Interval]	
Islamic	30	16.102	1.001118	5.483347	14.05448	18.14952
Conventional	95	18.07821	0.851027	8.294787	16.38848	19.76794
combined	125	17.60392	0.692285	7.739987	16.23369	18.97415
diff		-1.97621		1.617754	-5.17846	1.226034
Ho: diff= 0					t = -1.2216	
Pr(T < t) = 0.1121		Pr(|T| > |t|) = 0.2242			Pr(T > t) = 0.8879	
				degrees of freedom= 123		

From table 07, it has been seen that the significance value (Pr-value) is 0.2242 which is greater than 0.05; As a result null hypothesis (H_0) is not rejected. So, there is no significant difference between profitability of Islamic banks and conventional non-Islamic banks of Bangladesh.

Table 08: STATA Output of Two Sample t-Test based on ROA

Group	**Obs**	**Mean**	**Std.Err.**	**Std.Dev.**	**[95% Conf. Interval]**	
Islamic	30	1.736667	0.128386	0.703196	1.474089	1.999244
Conventional	95	1.589053	0.08543	0.832672	1.419429	1.758677
combined	125	1.62448	0.071847	0.803275	1.482274	1.766686
diff		0.147614		0.168385	-0.18569	0.480921
Ho: diff= 0					t = 0.8766	
Pr(T < t) = 0.8088		Pr(|T| > |t|) = 0.3824			Pr(T > t) = 0.1912	
				degrees of freedom= 123		

In table 08, it has been seen that the significance value (Pr-value) is 0.3824, which is greater than 0.05; As a result null hypothesis (H_0) is not rejected. So, there is no significant difference between profitability of Islamic banks and conventional non-Islamic banks of Bangladesh.

Year by year average profit of each group of banks presented in table 09 and the pictorial representation is given in figure 05. As we see, the average profit was almost same for both Islamic banks and Traditional banks from 2009 to 2011.

Table 09: Average profit compared

	Year	Islamic Banks	Traditional Banks
Average profit (in million Tk.)	2009	1297.83	1204.44
	2010	2193.67	2051.61
	2011	1980.00	1963.61
	2012	2229.17	1227.94
	2013	2076.17	1609.28

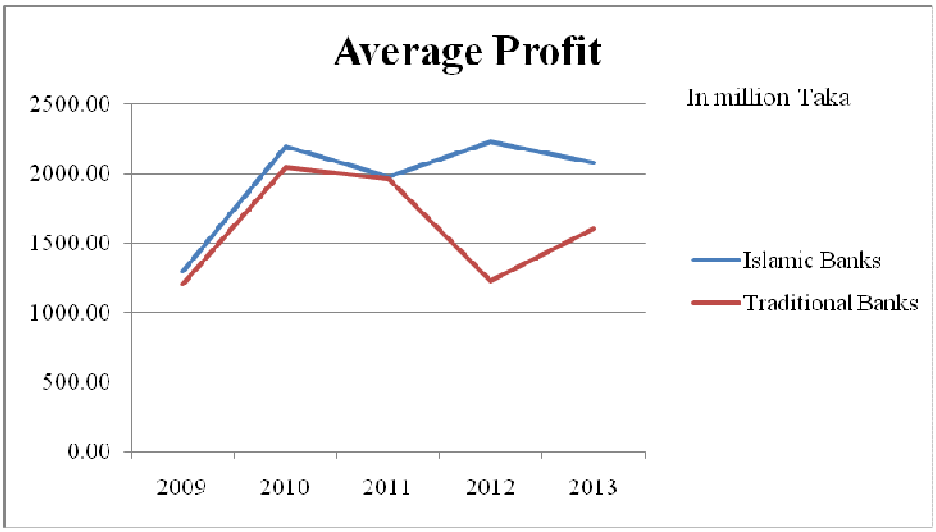

Figure 05: Year by Year average profit compared

However, the average profit of traditional banks was less than the average profit of Islamic banks all over the period under study. In 2012, a reverse trend is observed; the average profit of traditional banks fell sharply to Tk. 1227.94 million from Tk. 1963.61 in 2011 while the average profit of Islamic banks increased to Tk. 2229.17 million from Tk. 1980.00 million in 20011. However, in 2013 the profit of traditional banks increased to Tk.1609.28 million and the profits of Islamic banks decreased slightly to Tk. 2076.17 million.

The table-10 shows the average spread for both group of banks for the year 2013, the last year of the period under study. The interest/profit rates on deposit for both groups of banks are almost same. However, the interest rate on advance of traditional banks is higher than the profit rate on advance of Islamic banks and thus ultimately results in higher spread for the traditional banks.

Table 10: Average spread for 2013

	Mean	Std.Err.	[95%Conf.Interval]	
Rate on Deposit				
Traditional	9.420725	0.090698	9.241749	9.5997
Islamic banks	9.14619	0.356612	8.442487	9.849894
Rate on Advances				
Traditional	15.06355	0.063385	14.93847	15.18863
Islamic Banks	13.45238	0.502325	12.46114	14.44362
spread				
Traditional	5.642826	0.102007	5.441535	5.844118
Islamic banks	4.30619	0.160658	3.989163	4.623218

Summary of the findings

1. The profitability of the banks has experienced a decreasing trend since 2010.
2. By comparing means it is found that earning ability of Islamic Banks and Conventional Banks in Bangladesh are almost same.
3. There exist no significant difference between profitability of Islamic banks and conventional non-Islamic banks of Bangladesh.
4. The average profit of Islamic banks is slightly higher than that of Traditional banks.
5. Traditional banks have higher spread compared to the Islamic banks.

Conclusion and Recommendations

The study tried to explore whether the profitability of Islamic banks and traditional banks differ. Secondary data for a period of five years (2009-2013) were used. The study concludes that the Islamic bank have the similar profitability as of traditional banks which shows that Islamic banks are not lagging behind in Bangladesh. Average ROA of Islamic banks is observed better as compared to conventional banks while conventional banks are in a good position in case of ROE. Overall conclusion is that both Islamic banks and conventional banks have good performance. However, analysis exhibited a declining trend in recent years.

The study is considered to make significant contribution, not only in the field of academic research, but also in helping the respective bank managers in efficient and effective strategic decision making. From the academic point of view the research findings of this study will enrich the present literature and will help researchers in their future research.

As there is no significant difference in the profitability of both Islamic and non Islamic bank in Bangladesh, we better concentrate on how the viability of the banking industry as a whole can be accelerated rather than merely focusing on a particular form of banking practice. In that regard the following recommendations can be outlined-

1. Both groups of banks should try to identify the factors influencing the profitability so as to increase the profitability of the respective banks.
2. Islamic should try to increase the spread by attracting more profitable investment opportunities.
3. General public can choose either type of banks without resorting to the profitability rather considering some other factors which they may think relevant.
4. The government of Bangladesh can use the findings of the study for better controlling and regulating the banks.
5. The Bangladesh Bank can consider the findings in their policy making.

Limitations of the Study

The sample size includes 19 traditional private banks and 6 Islamic banks and the study covers only a period of five years. Increasing the sample size could reveal a much better picture of state of the concerned banks. Moreover, the research is based on secondary sources only. So, the accuracy of the research depends completely on the accuracy of the secondary data used. In addition to the fund and time constraints the unavailability of some data led the research not to be conducted more rigorously.

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