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AI-Powered Chatbots in E-Commerce Customer Service

Vanshika Vats[1], Sagar Chaudhary[2], Dr. Ankur Rana[3]

[1] B. Tech Student, Computer Science and Engineering, Quantum University, Roorkee, India;
[2] Assistant Professor, Computer Science and Engineering, Quantum University, Roorkee, India;
[3] Assistant Professor, Computer Science and Engineering, Quantum University, Roorkee, India;

ABSTRACT

AI-powered chatboats have emerged as crucial tools in modern e-commerce customer service, leveraging advances in natural language processing (NLP) and machine learning (ML) to provide instant, scalable, and personalized support. These systems can handle high volumes of queries across digital channels while reducing wait times and operational costs. In the e-commerce domain, chatbots enable interactive product searches, order tracking, and post-sales assistance, enhancing user satisfaction and sales. This paper explores the technical implementation (NLP models, dialogue management, backend integration), user experience (UX) design, and business impacts (ROI, customer retention, cost reduction) of chatbots in e-commerce. We present an extensive methodology for building such systems, compare leading chatbot platforms (Dialogflow, Watson Assistant, Azure Bot, etc.), and review real-world case studies demonstrating successful deployments. Our analysis reveals that well-designed chatbots can resolve the majority of routine inquiries instantly, drive customer engagement, and yield significant cost savings (e.g., Alibaba saved >¥1B annually, Sephora cut support costs by 20%).

Introduction

Conversational AI agents, or chatbots, simulate human dialogue to assist customers with tasks such as product selection, order tracking, and issue resolution. In recent years, **conversational commerce** has rapidly grown: consumers increasingly shop via messaging apps and expect quick, personalized interactions. Chatbots combine Natural Language Processing and Machine Learning to interpret user input and generate contextually appropriate responses. Unlike static FAQ pages or scripted menus, AI chatbots use intent classification and entity extraction to handle free-form queries. For example, a customer asking "When will my shoes ship?" triggers an intent (TrackOrder) and an entity (order number), which the bot then processes to provide an answer.

In a typical chatbot architecture, the system includes: **Natural Language Understanding (NLU)** (intent classification, entity recognition), **Dialogue Management** (keeping track of conversation state and deciding actions), and **Response Generation** or retrieval (either via predefined templates or ML-generated text). Crucially for e-commerce, the chatbot must integrate with backend services (product catalogs, inventory systems, payment gateways, CRM) so it can perform real tasks like placing orders or updating accounts.

Businesses deploy chatbots because they enable 24/7 support, handle many customers simultaneously, and capture user data. Well-designed chatbots improve customer experience by reducing wait times and providing instant responses for common queries. From an enterprise perspective, chatbots free human agents for complex issues and gather insights on customer needs. For instance, an IBM study notes that two-thirds of millennials expect real-time service and industry leaders predict chatbots will resolve 80% of routine issues by 2029. Early adopters are already seeing results: Alibaba's AI chatbots boosted customer satisfaction by 25% and saved the company ~¥1 billion (≈US$150M) annually compared to all-human support; Sephora's bot resolved 75% of inquiries automatically, cutting labor costs by 20%.

This paper is organized as follows: Section II presents a detailed methodology for building an e-commerce chatbot (covering data preprocessing, NLP models, dialogue flow, and integration). Section III provides a comparative analysis of major chatbot platforms (Dialogflow, Watson Assistant, Azure Bot, etc.), highlighting their features and trade-offs. Section IV reviews real-world case studies (Domino's, Alibaba, Sephora, etc.) that quantify the impact of chatbots in retail. Section V discusses user experience design principles specific to conversational agents. Section VI analyzes the business metrics (ROI, retention, cost) associated with chatbot deployment. We conclude with a summary and future outlook on AI chatbots in e-commerce.

Methodology and Technical Implementation

The development of an AI-driven e-commerce chatbot involves several stages: data collection and preprocessing, NLU model training, dialogue management design, backend integration, and iterative evaluation. Each stage combines AI techniques with software engineering to ensure the chatbot is accurate, robust, and aligned with business needs.

- **Data Collection & Preprocessing:** We begin by gathering conversational data relevant to the e-commerce domain. This includes historical customer support transcripts, live chat logs, and FAQs. For example, logs may contain typical user queries about orders, refunds, product specs, or promotions. These text data are *cleaned* by normalizing (converting to lowercase, removing punctuation) and tokenized into words

or subwords. Domain-specific synonyms and abbreviations (e.g. "ctx" → "context") are standardized. Preprocessing may also involve filtering out irrelevant messages and anonymizing sensitive information to protect privacy. The output is a corpus of utterances labeled with the user's intent (e.g. "cancel order", "check status").

- **Natural Language Understanding (NLU):** The NLU module identifies user intents and extracts entities from the message. Modern chatbots often use deep learning for this. For instance, we might fine-tune a pretrained transformer (e.g. BERT or RoBERTa) on our dataset: one classifier predicts the intent category, while a sequence tagger (or another classifier per slot) finds entity spans. Alternately, platforms like Dialogflow provide built-in intent/entity recognition. The essential features in NLU are:
    1. *Intent classification:* matches user input to predefined actions. The model is trained on example utterances for each intent, so it learns patterns (e.g. "where is my order" → TrackOrder). Using a neural network with embeddings yields high accuracy for diverse phrasing.
    2. *Entity extraction:* identifies parameters (dates, product names, order IDs). A conditional random field (CRF) or BERT-based token classifier can label words as entities (e.g. "12345" as order_id). In e-commerce, common entities are product names, SKUs, quantities, and user identifiers.
    3. *Context & Session:* To interpret ambiguous queries, the system tracks context. For example, if the user says "Yes, please," we need to know which prompt it refers to. The dialogue manager maintains a session state (using cookies or server-side memory) to carry over relevant data (user's name, cart contents, current transaction) between turns.
- **Dialogue Management:** The dialogue manager (DM) is the "brain" that decides what to do given the NLU output. In rule-based designs, each intent triggers a scripted action or response. In more advanced frameworks, the DM could be a finite-state machine or a policy network. For example, if intent=AddToCart, the DM calls the e-commerce API to add an item. If no intent is detected, it might trigger a clarification. Rasa's dialogue engine or Microsoft's LUIS+Bot Framework allow stateful, multi-turn conversations: they use domain-specific policy rules or reinforcement learning to manage flow. Key design choices include:
    - *Flow structure:* Many bots use a hierarchical flowchart: for example, an outer state "Order Support" may contain sub-states for "Track Order", "Return Item", etc. Tools like Dialogflow CX provide visual flow designers.
    - *Context-awareness:* The DM should handle context switching and interruptions. For instance, if the user veers off-topic mid-checkout ("By the way, do you have this in blue?"), the bot can navigate nested intents. NN/g guidelines suggest programming flexibility so users can jump around in the conversation.
    - *Fallback and Handoff:* If the user asks something outside scope (e.g. a complaint that the bot cannot resolve), the DM should gracefully say it cannot handle it and offer to connect to a human agent. This ensures no dead ends.
- **Backend Integration:** A distinguishing aspect of an e-commerce chatbot is connecting to business systems. We implement APIs or webhooks for tasks like querying inventory, processing payments, or retrieving order history. For instance, after TrackOrder intent and extracted order number, the bot's backend calls the order-management service to fetch shipment status. Integration typically uses RESTful APIs or GraphQL. Middleware (e.g. Cloud Functions on Google Cloud, Azure Functions, or AWS Lambda) can securely mediate between the chatbot platform and enterprise databases. Importantly, business logic enforces constraints: checking user authentication before showing order details, validating promotions, etc.

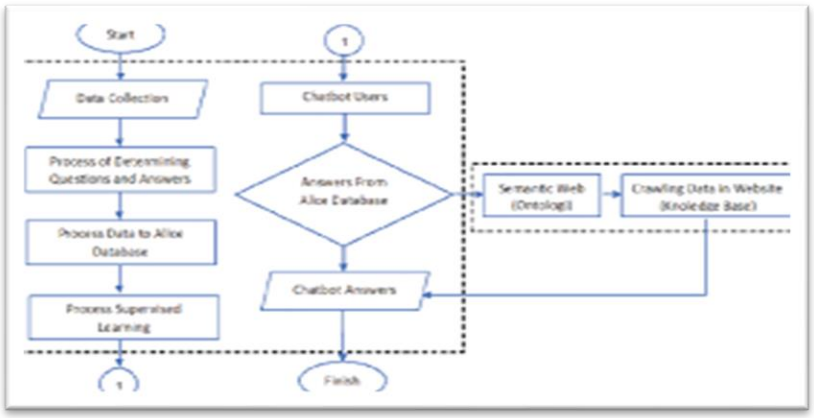

Figure 1. A user interacting with an AI chatbot on a smartphone. The virtual assistant (DeepSeek) processes the user's request in real time.

- **Training and Iteration:** After initial deployment, the chatbot is continuously improved. We log conversation transcripts and outcomes, then review misfires. Common practice is to use metrics like intent accuracy (e.g. F1-score on test queries), resolution rate, and user feedback scores to guide training. For example, if many users rephrase a query in an unexpected way, we add that utterance to the training set. We also perform A/B tests: offer live chat vs chatbot and compare metrics (resolution times, satisfaction). Over time, the models are retrained with new data, dialogues are refined, and the system's knowledge base is expanded (e.g. adding new FAQs).
- **Evaluation:** Quantitative evaluation uses metrics relevant to chatbots: **Session Success Rate** (percentage of conversations ended successfully), **Average Response Time** (often seconds vs minutes for humans), **Fallback Rate** (how often bot fails), and **User Satisfaction Score (CSAT)**. Studies and industry benchmarks guide targets: a well-tuned chatbot might achieve 70–80% first-contact resolution. For example, Vodafone's TOBi resolves ~70% of user issues immediately. We also measure business KPIs: conversion uplift (did users who interact with the bot buy more?), retention rates (did bot users come back more often?), and cost metrics (hours saved by support team).

Comparative Analysis of Chatbot Platforms

Developers often leverage existing platforms to accelerate chatbot projects. We compare several leading frameworks/platforms: **Google Dialogflow**, **IBM Watson Assistant (watsonx)**, **Microsoft Azure Bot Service/Bot Framework**, **Amazon Lex**, and **Rasa**. Each platform provides intent/entity recognition and integration capabilities, but differs in deployment model and advanced features.

- **Google Dialogflow:** Dialogflow (by Google Cloud) offers an easy-to-use NLU engine. It comes in two editions: Essentials (ES) and Customer Experience (CX). CX is designed for complex, large-scale use cases with a visual flow builder and multi-agent support. Recently, Dialogflow CX integrated Google's Gemini models to enable generative playbooks, allowing more natural multi-turn conversations. The platform supports 20+ languages out of the box and channels like Google Assistant, WhatsApp, Messenger, etc. Importantly, Dialogflow integrates seamlessly with Google Cloud services: for instance, it can call Cloud Functions for custom logic, use BigQuery for logging and analytics, and tap Vertex AI for training custom models. This makes end-to-end management (from data to model tuning) quite convenient. Its user interface and agent training are considered developer-friendly.
- **IBM Watson Assistant:** IBM's watsonx Assistant is aimed at enterprise scenarios. It provides a visual builder for conversation flows and supports integration with Watson's LLMs. Watson Assistant touts "no-code" features and tight security/compliance (important for retail chains handling sensitive data). It has pretrained dialog skills for sectors like retail. A key advantage is built-in multi-channel support and analytics. The platform emphasizes scaling: "Watson Assistant fuels the hybrid shopping experiences that today's customers want, with omni-channel support at scale". Watsonx Assistant also offers advanced features like intent disambiguation using generative AI and lineage tracking of conversation flows.
- **Microsoft Azure Bot Service / Bot Framework:** Microsoft provides both a low-code service (Azure Bot Service) and an open-source SDK (Bot Framework). Developers use Azure Bot Service to create bots that can be deployed on Azure or on-prem. The Bot Framework SDK (in C# or Node.js) and Bot Framework Composer allow for highly customized dialog design. NLU is typically handled by LUIS (Language Understanding), now part of Azure Cognitive Services. The Microsoft stack integrates tightly with Azure's ecosystem (Azure Functions, Cosmos DB, Microsoft Teams channels, etc.). For example, a Vodafone case study notes using Azure Bot Framework to deliver a "personal expert into our customers' pockets" via a mobile app. The framework supports complex multi-turn dialogs, state management, and fallback to human handoff. Its advantage is flexibility and integration with enterprise Microsoft environments, but it may require more coding effort compared to fully managed services.
- **Amazon Lex:** Lex is Amazon Web Services' chatbot service (the same tech behind Alexa). It provides intent classification and built-in speech recognition/text. Lex integrates natively with AWS Lambda for backend code, making it easy to connect to databases like DynamoDB, or services like Amazon Pinpoint for notifications. It also integrates with Alexa Skills, so a bot can be deployed as a voice assistant. Amazon's pricing is pay-per-request, which is attractive for variable traffic. However, Lex is somewhat platform-locked (AWS-centric) and has historically had a less user-friendly UI for creating complex conversation paths. Its strength is voice capability and deep AWS integration.
- **Rasa:** Rasa is an open-source chatbot framework (Python). It offers full transparency and control over the NLU models and the dialog policies. Rasa includes an NLU pipeline component and a Core dialogue engine. For e-commerce, Rasa is useful when companies need on-premise deployment or custom ML (e.g. using a proprietary language model). It requires more initial setup, but allows custom pipelines (transformers, LLM endpoints) and arbitrary actions. Unlike the cloud platforms, Rasa is self-hosted and often used for highly specialized bots. Its trade-off is that it doesn't come with prebuilt analytics dashboards or no-code editors — everything is code-driven. However, it ensures data privacy (since everything stays in-house) and avoids vendor lock-in.

Case Studies in E-Commerce

To ground our analysis, we examine real-world examples where AI chatbots have been implemented in retail and e-commerce companies, highlighting quantitative outcomes.

- **Domino's Pizza (USA):** Domino's has been a pioneer in conversational ordering. In 2016–17, they adopted Google's Dialogflow to revamp their ordering bot. Domino's *"Dom"* bot (accessible via their app or Google Assistant) can take pizza orders by natural language. The Domino's team appreciated Dialogflow's ability to scale to many intents (all the ways to order pizza) and its intuitive training interface. By reusing 50+ years of menu knowledge and quick Dialogflow training, they "spun up a solid customer experience pretty quickly". The result was that Domino's consistently met project milestones and received positive user feedback. Domino's executives view conversational commerce as "the next evolution in e-commerce" and continue to iterate on the bot to match user behavior. While exact sales figures are proprietary, Domino's reports that the bot usage and user satisfaction have only grown, underscoring a smooth integration of AI ordering into their omni-channel strategy.
- **Alibaba Group (China):** Alibaba's scale is immense: nearly 1 billion active users on its Taobao platform, with hundreds of millions of daily transactions. To handle customer service load, Alibaba deployed multiple AI chatbots since 2015. By 2021, during the massive "Double 11" shopping festival, humans alone could not possibly handle the volume of queries. Alibaba's solution was a suite of **five specialized chatbots** serving different roles:
    1. *Wanxiang-bot* (for Taobao merchants needing platform support),
    2. *Alibee Shop bot* (bridging merchants and consumers),
    3. *Alime bot* (customer-facing, multi-modal with voice and rich UI) – this bot alone handles 75% of online queries and 40% of hotline calls,
    4. *AI-bot* (proactively mediates merchant-consumer disputes using transaction data),
    5. *Dahuang-bot* (internal training bot for CS staff).

  Today, Alibaba's chatbots handle over **2 million daily sessions** and **10 million conversation lines**. The deployment has driven a 25% lift in customer satisfaction scores and saved the company over ¥1 billion per year by replacing equivalent human agent workload. A key part of Alibaba's success was their "fast-fail" approach: they ran continuous A/B tests of AI vs. human responses on subsets of traffic. These tests quickly proved the AI's effectiveness (higher satisfaction and resolution scores), which justified full-scale adoption. Alibaba's case highlights that in two-sided marketplaces, bots can simultaneously support shoppers and sellers, vastly amplifying customer engagement at scale.

- **Sephora (Global):** Sephora, the beauty retailer, implemented a smart chatbot to handle product inquiries and support across channels. In early 2020s, Sephora's bot was integrated into Facebook Messenger, the Sephora app, web chat, and in-store kiosks. The AI was trained on beauty-specific data (product features, skin profiles) and used NLP for contextual understanding and sentiment detection. The chatbot can recommend products, match foundation shades by asking follow-up skin questions, check loyalty points, and track orders. Crucially, it escalates to a human agent for complex issues. By asking clarifying questions and showing relevant tutorials, the bot provides an *educational* shopping experience. Sephora reports that the chatbot now **resolves over 75% of daily inquiries without human help**, reducing average wait times from minutes to under 10 seconds. This quick assistance led to measurable gains: cart abandonment dropped by 18% among users who used the bot, and

overall customer support costs fell by 20%. Customers appreciated the immediate, personalized help, improving retention and loyalty. (Separately, Sephora's AI try-on tool showed users are 3× more likely to purchase products after using it, underscoring that AI features boost engagement.)

- **Other Examples:** Many companies have reported success. Vodafone's "TOBi" chatbot in telecom handles ~1 million interactions per month, with a first-contact resolution around 70%. Carrefour's grocery bot "Hopla" offers meal ideas and waste-reduction tips using product data. E-commerce platforms like eBay and fashion brands like H&M have deployed bots to guide shoppers and process returns. Research surveys generally find that chatbots decrease average response times by ~99% (from minutes to seconds) and improve satisfaction and repurchase rates.

User Experience Design and Interaction Quality

Beyond algorithms, the *user experience* (UX) of a chatbot is critical. Even a powerful NLP engine will fail if users find the bot frustrating. Research and best practices offer guidance for designing effective chatbot interactions in e-commerce:

- **Transparency:** Always make it clear to users they are chatting with a bot. Nielsen Norman Group advises: *"Be upfront about using a bot and not a human"*. E-commerce chat windows often do this by naming the bot ("Sephora Assistant") or including a bot icon. Transparency helps set user expectations. Studies show that once users know they're talking to a bot, they adapt their language accordingly (using more direct, keyword-like queries), which can actually improve success. Hiding bot identity can backfire; users may feel deceived if an encounter turns impersonal or fails.
- **Scope & Clarity of Capabilities:** Clearly communicate what the bot can help with. For example, the initial greeting might say "Ask me about orders, products, or store info." This aligns with the UX guideline: "Clearly tell people what tasks the bot can do. Make sure you don't create false expectations". In practice, effective bots often present buttons or quick-replies like "Track Order" or "Return Item". This reduces misunderstanding and guides the user down supported flows. E-commerce bots should avoid promising full general chat; they're built for specific tasks (tracking, searching, FAQs). The NN/g guidelines explicitly caution: *"Don't be overly ambitious: create bots for simple tasks."* Complex queries should prompt a graceful handoff or fallback.
- **Conversational Tone and Language:** A friendly, conversational style improves user engagement. Chatbots are often given persona traits (e.g., helpful, polite, sometimes playful) that align with the brand. However, care must be taken: overly "humanizing" a bot can raise expectations. Use natural, concise language and avoid industry jargon. Error messages should be helpful. For instance, if the bot doesn't understand, it should say so honestly and offer alternatives ("I'm sorry, I didn't get that. You can try asking about your order status or see our FAQs").
- **Flexibility and Input Methods:** Provide both free-text input and structured options. The NN/g UX guidelines highlight allowing users to choose between typing or clicking buttons. This combination speeds up input and reduces user effort (especially on mobile). For example, after a user asks "Show me shoes under $50", the bot might display buttons to filter by size or brand. Rich media (images, carousels) is common in e-commerce bots: displaying product pictures in chat can help customers make choices. Multi-modal support (e.g. voice interaction) is growing, so designing voice-friendly dialogs is also beneficial.
- **Memory and Context:** Good bots maintain context across turns. If a user says "Do you have it in blue?", the bot should remember the product mentioned earlier. Saving context not only improves efficiency (avoiding repeated info requests) but feels more natural. It's recommended to program context inheritance and to save data from one step to the next. For instance, once a user identifies as a loyalty program member, the bot should recall this for tailored responses.
- **Error Handling and Human Handoff:** No chatbot is perfect. Users should never feel trapped. NN/g suggests *"Be honest about not understanding. Offer an escape hatch in the form of a real human"*. In e-commerce, this means seamlessly transferring to a live agent or providing contact info when the bot hits its limit. For example, if a refund query is too complex, the bot might respond: "I can't complete that request. Would you like to talk to a support agent?" This reassurance maintains trust.
- **Speed and Performance:** One major UX advantage of chatbots is instant response. A survey found that speed is often more important to customers than human warmth. Indeed, cases show average bot response times of a few seconds instead of minutes on hold. Minimizing typing lag, quick replies, and immediate answers significantly boost satisfaction. Load times and availability are therefore part of UX design.

Business Impact: ROI, Retention, and Cost Reduction

Beyond technology and UX, chatbots must be justified by business outcomes. Key metrics to consider are **return on investment (ROI)**, **customer retention/satisfaction**, and **operational cost**.

- **Cost Reduction:** A primary ROI factor is the reduction in customer service expenses. Chatbots operate 24/7 without incremental staffing costs and can handle many conversations in parallel. Industry analyses predict that conversational AI could resolve up to 80% of routine issues by 2029, slashing support costs by ~30%. Real-world figures support this: Alibaba's shift to chatbots saved them >¥1B (≈US$150M) yearly. Sephora reports a 20% drop in customer support costs after its bot implementation. This comes from deflecting simple queries (tracking, FAQs) from agents. The labor savings are significant, especially during peak shopping seasons. Startups and SMBs also benefit: even automating 40–50% of chats can justify the development cost of a chatbot within a year, given reduced ticket volume.
- **Customer Retention and Satisfaction:** Faster, accurate support tends to improve satisfaction (CSAT) and loyalty. Salesforce found that 81% of customers now expect faster service, and chatbots provide this *"instant support"*. When queries are answered without wait, users stay happier. For example, after introducing chatbots, 25–30% of surveyed companies saw measurable improvements in customer satisfaction metrics. Alibaba noted a 25% jump in satisfaction scores following their AI rollout. Additionally, chatbots can boost loyalty by providing consistent, personalized service. For instance, by using data from previous interactions, a bot can offer tailored recommendations or promotions, subtly increasing customer lifetime value (CLV).
- **Sales and Conversions:** Chatbots can influence sales directly. By engaging users proactively and cross-selling relevant products, bots help increase average order value. For example, Sephora's AI virtual try-on resulted in users being **3× more likely to complete a purchase**. While that example is an AR tool, it underscores the effect of interactive experiences. Even support bots can upsell: a customer asking about shirt sizes might receive suggestions for matching pants or accessories, seamlessly within the chat. Some retailers integrate promotions into chat

(e.g. "By the way, this item is on sale in blue"). Tracking such lift is part of ROI analysis. A reduction in cart abandonment also drives revenue: Sephora saw an 18% decrease in abandonment among bot-users, as immediate assistance solved user doubts.

- **Quantitative Measures:** Companies should track metrics like **Deflection Rate** (percentage of inquiries handled by bot vs routed to humans), **NPS/CSAT scores**, **Repeat Visits**, and **Time on Service Desk**. The Indonesian study [55] found that well-designed chatbots increased customer satisfaction by 18 percentage points while slashing response time by 99.6%. Such figures directly translate into ROI: happier customers cost less to retain. Ultimately, a simple ROI formula is (savings from staff + revenue gained from improved service) ÷ chatbot costs. Given reported results, many deployments report payback periods under 12 months.

Discussion and Conclusion

Our exploration of AI chatbots in e-commerce reveals a maturing landscape. Technically, the core pipeline (NLU → dialogue → integration) is well-understood, and platforms/tools have emerged to simplify development. The **methodology** section detailed how practitioners combine NLP models with careful flow design and system connectivity to build effective bots. The **comparative analysis** highlighted that mainstream platforms (Dialogflow, Watson, Azure Bot, etc.) now incorporate advanced features like generative AI support and rich analytics, making it easier for retailers to select a solution aligned with their existing tech stack and scale requirements.

The **case studies** underscore that large retailers gain substantial benefits: Alibaba's example demonstrates cost savings at scale, while Sephora's showcases improved user satisfaction and sales. Yet each success story also stresses that implementation is organizational as much as technical. Alibaba's "fast-fail" culture and specialized bots for different user segments were key to success. Domino's close collaboration between product experts and bot builders enabled rapid training of intents. These real-world lessons remind us that a chatbot project must be a cross-functional effort, involving customer experience, operations, and engineering teams.

From the **UX perspective**, clear and user-friendly design is non-negotiable. Our discussion on UX principles (transparency, scope clarity, context, etc.) shows that simply having NLP capability is not enough. Poor UX can negate the benefits: for example, a bot that misleads users or traps them in loops can worsen frustration. Adhering to guidelines like those from Nielsen Norman Group ensures that e-commerce chatbots feel intuitive. The goal is to make users feel guided, not manipulated by technology.

Finally, the **business impact** analysis confirms that chatbots can deliver strong ROI in e-commerce. The combination of faster support, higher engagement, and lower labor costs can significantly boost a retailer's bottom line. However, the data also suggest careful measurement: KPI tracking (response times, deflection rates, sales lift) is essential. The cited studies quantify potential gains, but each company must validate these in their own context.

In conclusion, AI-powered chatbots are poised to become a standard channel in e-commerce customer service. They offer scalability and personalization that complement human teams. As technology evolves, chatbots will likely become more versatile (e.g. multimodal interfaces, integration with AR/VR shopping) and intelligent (leveraging LLMs for more natural dialogue). Retailers aiming to stay competitive should consider chatbots as part of their digital strategy. This paper has provided a thorough overview – from methodology to examples – to guide practitioners and researchers in understanding and deploying chatbots effectively.

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