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Lupin Ltd.

EBITDA miss on higher R&D and FX loss; Focus on base business growth in a tough US market

Lupin reported in-line revenue (Rs43bn, +29% YoY) in 2Q FY17 but an EBITDA miss (Rs10.3bn vs. Rs11.6-11.8bn estimate) was driven by higher R&D and FX loss (Rs450Mn). The 100+bp gross margin moderation was due to the decline in US revenue (weaker than expected), which was disappointing given company commentary on flat gGlumetza sales. Management indicated marginal base business erosion, Mylan entry in gFortamet and seasonality led to the \$30Mn QoQ decline in US revenue. While we have factored in the higher new launch run-rate into Mar quarter, we expect US revenue to moderate further over the next two quarters. We estimate 15% EPS CAGR (FY17-19), which is factored into the valuation but does not price in downside from sharp erosion in key products.

- US revenue MT guidance of 20% growth seems tough, in our view.** LPC reported US revenue \$292Mn (vs. JPMe \$310Mn) with management highlighting 8-9% base business erosion and competition in gFortamet in Sept. While approval run-rate has been strong (16 vs guidance of 25), launches have lagged expectation. Management highlighted 10 launches from India with the clearance of Goa (Minastrin, Paxcil CR, Wellbutrin XL, etc.) and Somerset facility. The company indicated doubling launch run-rate into next year (30+ launches in FY18/19), improving quality of launches (derma, controlled substances) and ramp-up in Gavis (that has been lagging due to capacity expansion) should support 20+% revenue growth over 2-3 years. We believe this could be difficult given further erosion in two key products, 8-9% base business erosion continuing, and overall competitive pressure to reduce the opportunity size of the pipeline.
- Margins in FY18-19 likely to be at the lower end of the management guidance range.** Lupin indicated that the ramp-up in US business and quality of the pipeline should help the company sustain a 25-28% margin (vs. 27% in 1H FY17). We believe margins are likely to moderate from current levels to 25% or lower despite a higher number of launches drive by three key factors: a) further erosion in gGlumetza and gFortamet in next few quarters; b) high-single-digit base business erosion continuing to impact gross margin; c) new launches likely to have lower profitability than existing large products; and d) elevated R&D spending (12-14% of sales) particularly given investment in respiratory pipeline and specialty business.

Lupin Ltd. (Reuters: LUPN.NS, Bloomberg: LPC IN)

Rs in mn, year-end Mar	FY15A	FY16A	FY17E	FY18E	FY19E
Revenue (Rs mn)	125,997	137,016	168,078	194,324	223,385
EBITDA (Rs mn)	36,196	37,535	45,500	49,706	55,449
Net Profit (Rs mn)	24,032	22,707	28,556	31,111	35,509
EPS (Rs)	53.20	50.15	63.07	68.71	78.42
DPS (Rs)	7.46	7.46	8.86	9.65	11.02
EPS Growth	30.4%	(5.7%)	25.8%	8.9%	14.1%
EBITDA Margin	28.7%	27.4%	27.1%	25.6%	24.8%
ROCE	26.8%	15.8%	14.3%	13.7%	14.0%
ROE	30.4%	22.9%	23.5%	21.2%	20.4%
P/E (x)	28.8	30.5	24.3	22.3	19.5

Source: Company data, Bloomberg, J.P. Morgan estimates.

Neutral

LUPN.NS, LPC IN

Price: Rs1,529.65

▼ **Price Target: Rs1,500.00**

Previous: Rs1,650.00

India

Pharmaceuticals

Neha Manpuria ^{AC}

(91-22) 6157-3589

neha.x.manpuria@jpmorgan.com

Bloomberg JPMA MANPURIA <GO>

Keayn H Kadakia, CFA

(91-22) 6157-3250

kevyn.h.kadakia@jpmorgan.com

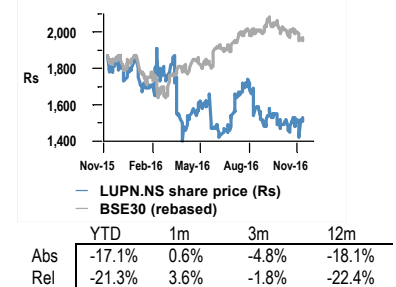
Pinakin Parekh, CFA

(91-22) 6157-3588

pinakin.m.parekh@jpmorgan.com

J.P. Morgan India Private Limited

Price Performance



Company Data

Shares O/S (mn)	453
Market Cap (Rs mn)	692,591
Market Cap (\$ mn)	10,396
Price (Rs)	1,529.65
Date Of Price	09 Nov 16
3M - Avg daily vol (mn)	1.24
3M - Avg daily val (\$ mn)	28.6
BSE30	2,7252.53
Exchange Rate	66.62
Price Target End Date	31-Dec-17

See page 8 for analyst certification and important disclosures, including non-US analyst disclosures.

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Neha Manpuria
(91-22) 6157-3589
neha.x.manpuria@jpmorgan.com

Asia Pacific Equity Research
10 November 2016

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Key catalysts for the stock price:	Upside risks to our view:	Downside risks to our view:
<ul style="list-style-type: none"> Approval pace for Gavis pipeline Progress of new launches in the US and pricing trend in key products Improvement in growth trend in Japan 	<ul style="list-style-type: none"> Faster approval of the Gavis pending ANDA pipeline Big-ticket approval for the US Generic business Growth from Japan exceeding expectations given the drugs going off-patent in the medium term 	<ul style="list-style-type: none"> Delay in approvals of products in the US Protracted slowdown in the domestic pharma market Regulatory/Litigation risks Continued weakness in its Japanese business INR appreciation could hurt non-INR revenue

Key financial metrics	FY16	FY17E	FY18E	FY19E
Revenues (LC)	137,016	168,078	194,324	223,385
Revenue growth (%)	8.7	22.7	15.6	15.0
EBITDA (LC)	37,535	45,500	49,706	55,449
EBITDA margin (%)	27.4	27.1	25.6	24.8
Tax rate (%)	33.6	25.0	25.0	25.0
Net profit (LC)	22,707	28,556	31,111	35,509
EPS (LC)	50.2	63.1	68.7	78.4
EPS growth (%)	-5.7	25.8	8.9	14.1
DPS (LC)	7.5	8.9	9.7	11.1
BVPS (LC)	242.6	295.0	352.1	417.3
Operating cash flow (LC mn)	-5,491	21,319	28,469	32,252
Free cash flow (LC mn)	-1,239	4,369	11,469	17,252
Interest cover (X)	84.1	39.3	27.5	36.2
Net margin (%)	16.6	17.0	16.0	15.9
Sales/assets (X)	0.8	0.7	0.7	0.8
Debt/equity (%)	0.6	0.6	0.5	0.3
Net debt/equity (%)	0.6	0.6	0.4	0.3
ROE (%)	23.0	23.5	21.3	20.5

Key model assumptions	FY16	FY17E	FY18E	FY19E
USD/INR	65.5	67.0	67.0	67.0
US Revenue Growth	-0.4	30.9	12.0	13.9
Japan Revenue Growth	5.7	22.5	32.3	11.7

Source: Company data and J.P. Morgan estimates.

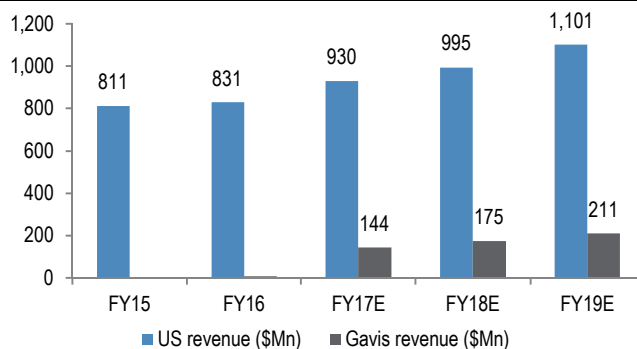
Sensitivity analysis	EBITDA		EPS	
	FY17E	FY18E	FY17E	FY18E
Sensitivity to				
1% chq in US Generic Revenue	0.4%	0.5%	0.4%	0.5%
1% chq in Japan Revenue	0.1%	0.1%	0.1%	0.1%
1% chq in R&D Expense	0.3%	0.4%	0.3%	0.4%

Source: J.P. Morgan estimates.

Valuation and price target basis

Our Dec-17 PT of Rs1500 is based on a P/E of 20x (vs. 22x previously as we factor in a tougher operating environment in the US), in-line with the long-term average of large-cap peers. Key risks include earlier-than-expected/delay in approvals in the US, regulatory risk, currency and execution of M&A.

LPC – US Generic growth driven by Gavis and opportunities in ex-Gavis



Source: Bloomberg, Company data and J.P. Morgan estimates.

JPM vs. consensus, change in estimates

EPS	FY17E	FY18E
JPM old	62.6	71.8
JPM new	63.1	68.7
% chg	1%	-1%
Consensus	66.1	76.8

Source: Bloomberg, J.P. Morgan.

Table 1: Indian Pharma: Valuation summary

	CMP	MCap \$Mn	P/E		EV/EBITDA		P/BV		RoE	
			FY17	FY18	FY17	FY18	FY17	FY18	FY17	FY18
Sun Pharma	661	23,937	21.9	19.3	13.9	12.3	4.3	3.6	24.4	23.0
Lupin	1,530	10,380	24.3	22.3	16.8	15.2	5.2	4.3	23.5	21.3
Dr Reddy's	3,283	8,187	34.1	21.8	19.9	14.1	4.3	3.8	12.6	18.5
Aurobindo	760	6,691	18.0	15.2	12.0	9.8	4.8	3.7	30.0	27.4
Cipla	526	6,366	27.4	21.7	21.2	17.4	3.2	2.8	12.6	14.1
Cadila	384	5,917	25.0	20.1	18.0	14.5	6.0	4.3	25.8	26.4
Glenmark	900	3,820	17.7	17.8	11.7	11.6	4.5	3.7	29.0	22.7
Alkem	1,655	2,978	24.0	21.1	19.3	15.9	4.8	4.1	21.6	20.9

Source: Bloomberg, J.P. Morgan estimates. Note: Consensus estimates used for Cadila.

Takeaways from conference call

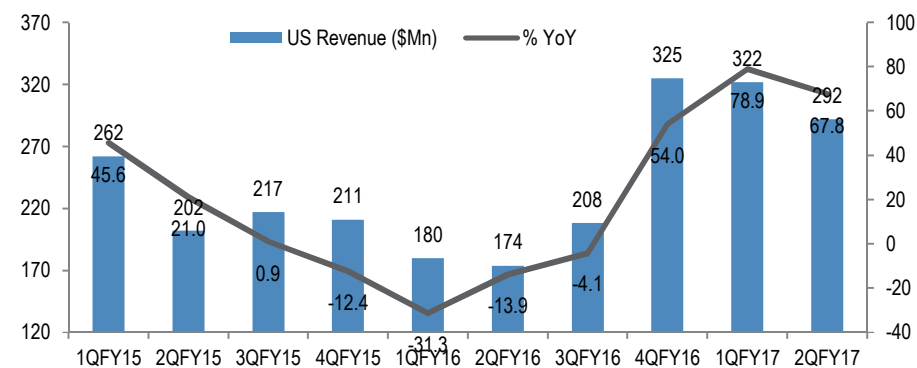
US – Launch trajectory to improve: US revenue at \$292Mn declined \$30Mn QoQ due to seasonality (weakest qtr for Cephs), some generic price erosion and competition in gFortamet (6% market share loss and lower but rational pricing). gGlumetza sales remained unchanged and company impacted that any further delay in competition for a few months should support this revenue. On generic pricing, management indicated 8-9% base business erosion, which is likely to continue given the McKesson – Walmart deal and pressure on customers. In terms of pipeline, key opportunities discussed were Tamiflu (FY18 launch), Welchol (CRL pending so 2HFY18), Renvela/Renegal (CRL pending so 2HFY18 launch), Pervacid ODT and Forsenol (next year launches). LPC guided to 15-16 launches this year and doubling it in FY18/19 (including Gavis), which should support 20+% revenue growth including base business erosion.

Gavis ramp-up delayed as expected: LPC pointed that Gavis portfolio was up marginally aided by Methergine with stable generic business. While LPC indicated a six-month delay in Gavis ramp-up (revenue revised down to \$250Mn vs. \$300Mn previously), it expects generic business to ramp up over the next few months, with the recent capacity addition and new launches (particularly CS products). On Methergine, it has stabilized the decline and now booking some Rx/unit at brand value with peak sales potential \$70Mn (assuming all Rx/units at brand value).

R&D – Likely to remain elevated: LPC reiterated guidance for R&D 12-14% of sales (~13% in 1H FY17) with the filing rate in the US to be ~30 ANDAs pa. The company indicated filing for Albuterol In the current quarter and trials for Etanercept for EU/Japan/India market. On the DPI products, LPC indicated that Advair development is taking time to scale-up and then start trials given the investment size and remains on track with timelines on Tiotropium (taking conservative approach).

Other details: a) India - While growth in 2Q was aided by seasonality, expect to maintain growth at 15-20% from increasing Rx, new division and product launches (8-9 new launches in 2H and in-licensed opportunities); b) Japan – LPC expects to maintain 10-15% growth ex. Shinogi acquisition that should contribute in 2H FY17; c) Tax rate expected at 25% vs. 27% previously; d) capex at \$250-300Mn but decline in FY18 (~\$225Mn); e) On M&A, management indicated deal capacity of \$1bn (based on 2x debt/EBITDA) but indicated that sweet spot is lower than this number focusing on specialty assets.

Figure 1: US revenue declined sequentially in 2Q FY17



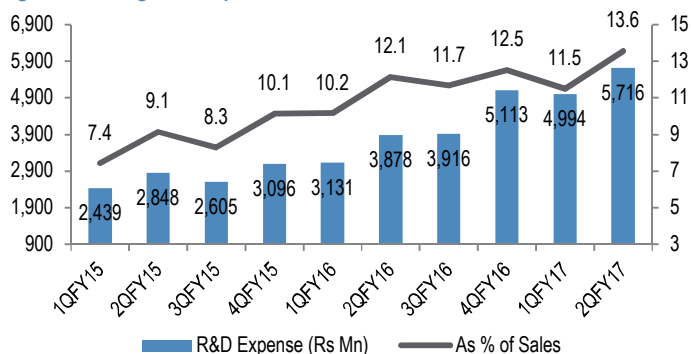
Source: Company reports

Neha Manpuria
(91-22) 6157-3589
neha.x.manpuria@jpmorgan.com

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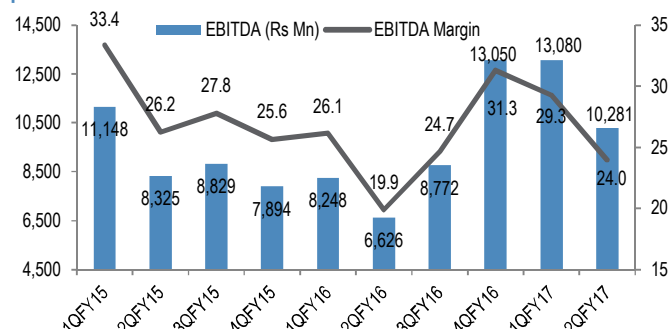
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Figure 2: Rising R&D expense...



Source: Company reports

Figure 3:impacting EBITDA margins along with base business pressure



Source: Company reports

Table 2: LPC: Quarterly Summary

Rs MM, YE Mar.	2QFY17	2QFY16	% YoY	1QFY17	% QoQ	1HFY17	1HFY16	% YoY
India	9,958.0	8,881.0	12.1	9,499.0	4.8	19,457.0	17,730.0	9.7
US	19,978.0	11,539.0	73.1	21,886.0	(8.7)	41,864.0	23,543.0	77.8
APAC	5,520.0	4,462.0	23.7	5,416.0	1.9	0.0	2,014.0	(100.0)
EMEA	2,355.0	2,218.0	15.4	2,194.0	7.3	8,600.0	6,465.0	33.0
LatAm	986.0	1,082.0	(8.9)	1,089.0	(9.5)	914.5	1,814.0	(49.6)
RoW	396.0	414.0	(4.3)	368.0	7.6	764.0	584.0	30.8
API	2,919.0	3,330.0	(12.3)	2,966.0	(1.6)	5,885.0	6,605.0	(10.9)
Net Revenues	42,111.8	31,926.1	31.9	43,418.0	(3.0)	85,529.8	62,734.8	36.3
Total income	42,905.1	33,296.7	28.9	44,676.5	(4.0)	87,581.6	64,857.3	35.0
Gross Profit	30,476.6	22,047.5	38.2	31,957.2	(4.6)	62,433.8	43,773.4	42.6
Gross Margin (%)	72.4	69.1	(1.2)	73.6		71.3	67.5	
EBITDA	10,280.7	6,626.0	55.2	13,080.4	(21.4)	23,361.1	14,874.3	57.1
EBITDA Margin (%)	24.0	19.9		29.3		26.7	22.9	
PBT	8,176.9	5,808.6	40.8	11,559.6	(29.3)	19,736.5	13,730.0	43.7
PBT Margin (%)	19.1	17.4		25.9		22.5	21.2	
Tax Expense	1,589.4	1,590.7	(0.1)	2,734.1	(41.9)	4,323.5	3,849.0	12.3
Tax Rate (%)	19.4	27.4		23.7		21.9	28.0	
Profit after tax	6,621.9	4,197.5	57.8	8,819.5	(24.9)	15,441.4	9,883.0	56.2
PAT Margin (%)	15.4	12.6		19.7		17.6	15.2	
Key Costs								
Cost of sales	12,428.5	11,249.2	10.5	12,719.3	(2.3)	25,147.8	21,083.9	19.3
as % of revenues	29.5	35.2		29.3		29.4	33.6	
Employees cost	7,123.9	5,328.0	33.7	7,059.0	0.9	14,182.9	10,300.5	37.7
as % of revenues	16.9	16.7		16.3		16.6	16.4	
R&D Expenses	5,716.0	3,878.0	47.4	4,994.0	14.5	10,710.0	7,008.5	52.8
as % of revenues	13.6	12.1		11.5		12.5	11.2	

Source: Company reports. Note: Margins calculated on total income and EBITDA excludes other income.

Investment Thesis, Valuation and Risks

Lupin Ltd. *(Neutral; Price Target: Rs1,500.00)*

Investment Thesis

We believe LPC is trading at a premium valuation given its strong U.S. generics business and higher return profile. The current multiple fairly values the earnings growth trajectory, in our view, but not the risk related to sharp erosion in key products. Further, there could be risks to growth beyond FY18 from delay in key approvals, Gavis execution and evolving long-term organic growth drivers.

Valuation

Our Dec-17 price target of Rs1500 is based on a 20x P/E (inline with long-term sector average) despite superior margins to sector given the high product concentration and tough pricing environment in the US.

Risks to Rating and Price Target

Key upside risks include accretive business development opportunity, faster-than-expected ramp-up of approvals in the U.S. and Japan. Downside risks include delays in approvals for the U.S. generics business, regulatory risk and slow ramp-up of sales in Gavis.

Lupin Ltd.: Summary of Financials

Income Statement						Cash flow statement					
Rs in millions, year end Mar	FY15	FY16	FY17E	FY18E	FY19E	Rs in millions, year end Mar	FY15	FY16	FY17E	FY18E	FY19E
Revenues	125,997	137,016	168,078	194,324	223,385	PBT	34,148	34,330	38,203	41,622	47,500
% change Y/Y	13.6%	8.7%	22.7%	15.6%	15.0%	Depr. & amortization	4,347	4,635	8,139	9,279	10,419
Gross Profit	84,427	93,922	120,175	138,456		- Change in working capital	(949)	(23,546)	(16,630)	(13,831)	(15,322)
% change Y/Y	16.1%	11.2%	28.0%	15.2%		- Other	680	(38)	96	106	117
EBITDA	36,196	37,535	45,500	49,706	55,449	Cash flow from operations	27,330	(3,690)	21,319	28,469	32,252
% change Y/Y	20.5%	3.7%	21.2%	9.2%	11.6%	Capex	(8,676)	(11,681)	(16,950)	(14,000)	(10,000)
EBIT	31,849	32,900	37,361	40,427	45,030	Other	4,425	593	0	0	0
% change Y/Y	16.2%	3.3%	13.6%	8.2%	11.4%	Free cash flow	18,725	(15,074)	5,238	15,823	23,400
EBIT Margin	25.3%	24.0%	22.2%	20.8%	20.2%	Equity raised/(repaid)	2	2	0	0	0
Net Interest	(98)	(446)	(1,158)	(1,805)	(1,530)	Debt raised/(repaid)	(700)	-	-	(5,000)	(11,000)
Earnings before tax	34,148	34,330	38,203	41,622	47,500	Other	302	98	(1,254)	(1,911)	(1,646)
% change Y/Y	20.6%	0.5%	11.3%	8.9%	14.1%	Dividends paid	(1,573)	(4,055)	(4,828)	(5,260)	(6,003)
Tax	(9,704)	(11,536)	(9,551)	(10,406)	(11,875)	Beginning cash	6,066	21,084	8,379	2,034	4,333
as % of EBT	28.4%	33.6%	25.0%	25.0%	25.0%	Ending cash	4,813	8,379	2,034	4,333	7,936
Net income (reported)	24,032	22,707	28,556	31,111	35,509	DPS	7.46	7.46	8.86	9.65	11.02
% change Y/Y	30.9%	(5.5%)	25.8%	8.9%	14.1%						
Shares outstanding	452	453	453	453	453						
EPS (reported)	53.20	50.15	63.07	68.71	78.42						
% change Y/Y	30.4%	(5.7%)	25.8%	8.9%	14.1%						
Balance sheet						Ratio Analysis					
Rs in millions, year end Mar	FY15	FY16	FY17E	FY18E	FY19E	Rs in millions, year end Mar	FY15	FY16	FY17E	FY18E	FY19E
Cash and cash equivalents	4,814	8,379	2,034	4,333	7,936	Gross margin	67.0%	68.5%	71.5%	71.3%	-
Accounts receivable	26,566	45,498	55,813	64,528	74,178	EBITDA margin	28.7%	27.4%	27.1%	25.6%	24.8%
Inventories	25,036	31,787	38,994	45,083	51,825	Operating margin	25.3%	24.0%	22.2%	20.8%	20.2%
Others	5,350	12,106	14,850	17,169	19,736	Net margin	19.1%	16.6%	17.0%	16.0%	15.9%
Current assets	78,324	97,790	111,711	131,132	153,696	Sales per share growth	13.3%	8.5%	22.7%	15.6%	15.0%
LT investments	25	55	55	55	55	Sales growth	13.6%	8.7%	22.7%	15.6%	15.0%
Net fixed assets	32,961	86,379	105,240	109,961	109,542	Net profit growth	30.9%	(5.5%)	25.8%	8.9%	14.1%
Total Assets	131,377	224,378	259,358	285,360	309,562	EPS growth	30.4%	(5.7%)	25.8%	8.9%	14.1%
Liabilities						Interest coverage (x)	369.0	84.1	39.3	27.5	36.2
Payables	19,561	21,919	26,888	31,086	35,735	Net debt to equity	0.6%	57.5%	56.1%	42.5%	28.1%
Others	13,379	13,918	14,593	15,337	16,154	Working Capital to Sales	32.6%	32.1%	31.4%	34.6%	38.2%
Short-term debt	4,353	18,036	17,454	17,454	16,454	Sales/assets	1.1	0.8	0.7	0.7	0.8
Total current liabilities	37,292	53,872	58,935	63,877	68,344	Assets/equity	1.5	1.8	2.0	1.9	1.7
Long-term debt	1,018	53,739	59,739	54,739	44,739	ROAE	30.4%	22.9%	23.5%	21.2%	20.4%
Other liabilities	2,465	4,702	4,702	4,702	4,702	ROACE	26.8%	15.8%	14.3%	13.7%	14.0%
Total Liabilities	42,396	114,213	125,466	125,617	120,313						
Shareholders' equity	88,741	109,844	133,572	159,422	188,928						
BVPS	196.45	242.60	295.01	352.10	417.26						

Source: Company reports and J.P. Morgan estimates.

Neha Manpuria
 (91-22) 6157-3589
 neha.x.manpuria@jpmorgan.com

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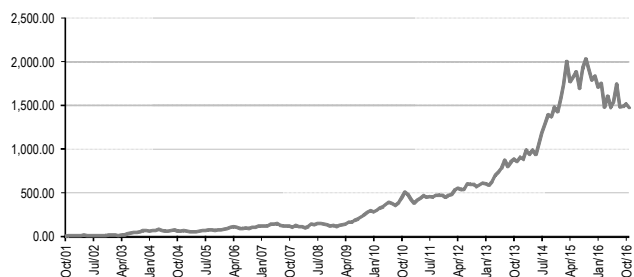
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JPM Q-Profile
Lupin Limited (INDIA / Health Care)
 As Of: 03-Nov-2016

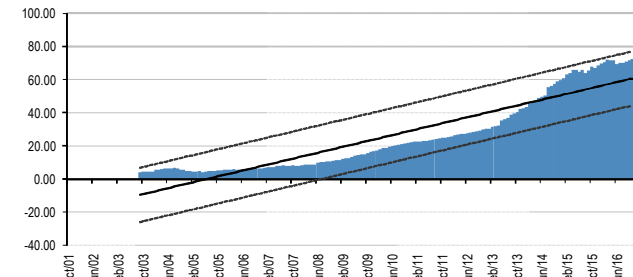
Global Equity Quantitative Analysis

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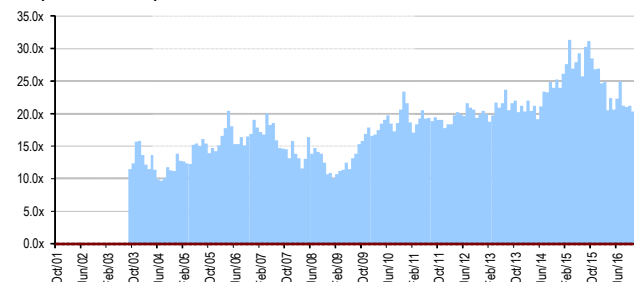
Local Share Price **Current: 1473.55**



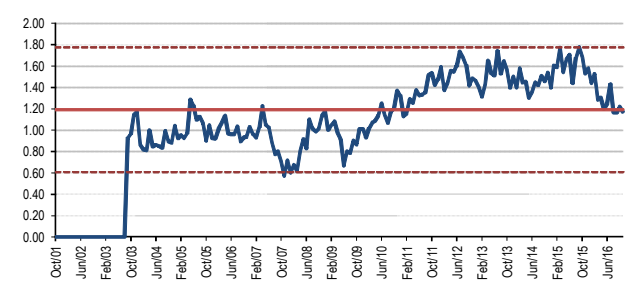
12 Mth Forward EPS **Current: 72.36**



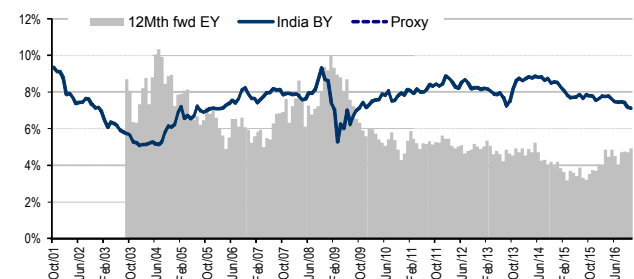
PE (1Yr Forward) **Current: 20.4x**



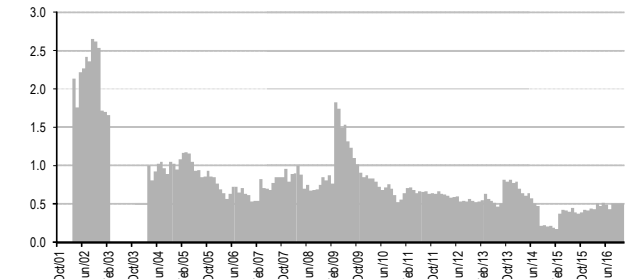
P/E Relative to India Index **Current: 1.17**



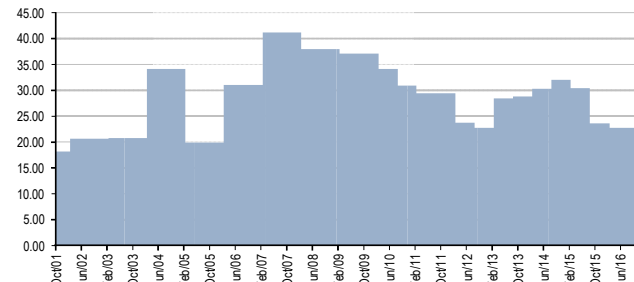
Earnings Yield (& Local Bond Yield) **Current: 4.91%**



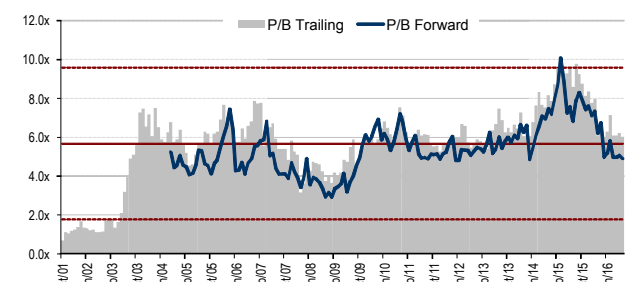
Dividend Yield (Trailing) **Current: 0.50**



ROE (Trailing) **Current: 22.77**



Price/Book (Value) **Current: 6.0x**



Summary

Lupin Limited		TICKER		LPC IN EQUITY		As Of:		03-Nov-16			
INDIA						Local Price:		1,473.55			
Health Care						EPS:		72.36			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	20.36x										
P/BV (Trailing)	6.04x	0.70	10.17	5.95	5.68	9.59	1.77	-88%	68%	-2%	-6%
Dividend Yield (Trailing)	0.50	0.00	2.65	0.67	0.74	1.75	-0.27	-100%	426%	34%	48%
ROE (Trailing)	22.77	18.19	41.24	29.49	28.98	42.53	15.44	-20%	81%	30%	27%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

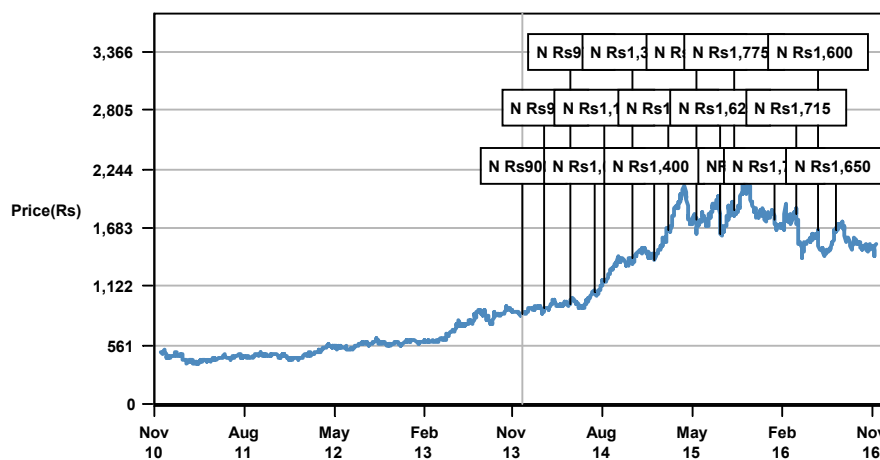
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Lupin Ltd. (LUPN.NS, LPC IN) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
25-Nov-13	N	850.60	900.00
04-Feb-14	N	921.80	950.00
21-Apr-14	N	956.90	975.00
07-Jul-14	N	1078.10	1000.00
04-Aug-14	N	1165.40	1175.00
29-Oct-14	N	1393.25	1300.00
07-Jan-15	N	1377.60	1400.00
18-Feb-15	N	1662.25	1600.00
14-May-15	N	1748.25	1550.00
23-Jul-15	NR	1823.95	--
27-Jul-15	N	1617.55	1625.00
03-Sep-15	N	1862.35	1775.00
06-Jan-16	N	1753.20	1700.00
11-Mar-16	N	1820.95	1715.00
20-May-16	N	1655.45	1600.00
11-Jul-16	N	1669.10	1650.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage Jul 23, 2015 - Jul 27, 2015.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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Neha Manpuria
 (91-22) 6157-3589
 neha.x.manpuria@jpmorgan.com

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J.P. Morgan Global Equity Research Coverage	42%	46%	12%
IB clients*	51%	48%	34%
JPMS Equity Research Coverage	42%	50%	8%
IB clients*	68%	61%	43%

*Percentage of investment banking clients in each rating category.

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Neha Manpuria
 (91-22) 6157-3589
 neha.x.manpuria@jpmorgan.com

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Neha Manpuria
(91-22) 6157-3589
neha.x.manpuria@jpmorgan.com

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