

Lupin Ltd.

EBITDA beat driven by lower other expenses; approval momentum key to offset gGlumetza erosion

Lupin reported significantly higher-than-expected EBITDA at Rs12.2bn (JPMe Rs11.1bn) on a marginally higher revenue base (Rs44.8bn vs. Rs43.3bn estimate). Much of the beat was driven by lower-than-estimated other expenses (up just 4% YoY despite Gavis acquisition). Reported PAT was Rs6.3bn (in line) as the Fx gain in other income was offset by a higher tax rate. The strong U.S. revenue (+8% QoQ) was a positive surprise, aided by 25% growth in branded sales, an increase in gGlumetza share and a limited impact from gFortamet competition. We have factored in new pipeline launches over the next year and estimate a 13% EPS CAGR (FY18E-19E) that is factored into the valuation, but does not price in the downside risk from a sharp erosion in key products (gGlumetza, gFortamet) or a delay in approvals.

- Launch pipeline looks good, but risks from delay in limited-competition approvals increasing.** LPC indicated the Sun/Teva launch of gGlumetza post-mid-2017, which implies continued exclusivity in the near term. Management highlighted that the impact of Mylan's launch of gFortamet would flow into the March quarter, which implies a moderation in U.S. revenue trends. Lupin expects 25+ launches in the next year, including some limited-competition opportunities, Gavis' controlled-substances/derma pipeline and litigated products. However, certain key products (gWelchol, gRenvela) have been delayed to FY19, given the change in FDA guidelines. Generics companies have indicated a delay in limited-competition products by a few quarters, which remains a key risk to LPC's U.S. growth, given the sharp erosion expected in the base business over the next few quarters.
- R&D – Work in progress, but pipeline execution remains key for medium-term growth.** Lupin's R&D expense remains elevated at 12.7% YTD FY17, given the increasing investment in certain long-term projects, like respiratory and biosimilars. The company filed its first MDI (Albuterol) recently. On gAdvair, Lupin highlighted in its conference call that significant progress has been made with pilot study ongoing (and at exhibit batch point), with potential filing in FY18. At the J.P. Morgan Healthcare Conference last month, LPC indicated that it expects two DPIs, suspension product (\$1bn+) filings in FY18 and three MDI filings (\$1-3bn each) over FY19-20. On biosimilars, Etanercept is the most advanced in its pipeline (Ph III for Japan), with filings in Japan and EMA in FY18 and the U.S. thereafter (FY19).

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	171,153	195,582	225,021
EBITDA (Rs mn)	36,196	37,535	45,826	48,978	56,368
Net Profit (Rs mn)	24,032	22,707	27,727	30,002	35,537
EPS (Rs)	53.20	50.15	61.24	66.26	78.49
DPS (Rs)	7.46	7.46	8.56	9.27	10.98
EPS Growth	30.4%	(5.7%)	22.1%	8.2%	18.4%
EBITDA Margin	28.7%	27.4%	26.8%	25.0%	25.0%
ROCE	26.8%	15.8%	13.7%	13.1%	14.0%
ROE	30.4%	22.9%	22.8%	20.6%	20.6%
P/E (x)	28.0	29.7	24.4	22.5	19.0

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

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

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Neutral

LUPN.NS, LPC IN

Price: Rs1,491.35

Price Target: Rs1,500.00

India

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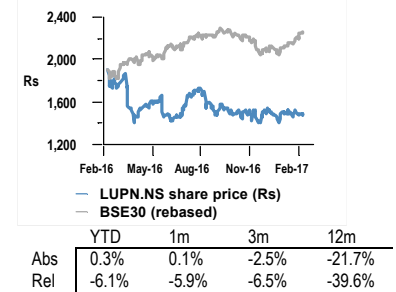
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Price Performance



Company Data

Shares O/S (mn)	453
Market Cap (Rs mn)	675,249
Market Cap (\$ mn)	10,050
Price (Rs)	1,491.35
Date Of Price	09 Feb 17
3M - Avg daily vol (mn)	0.93
3M - Avg daily val (\$ mn)	20.6
BSE30	2,8329.70
Exchange Rate	67.19
Price Target End Date	31-Dec-17

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Asia Pacific Equity Research
09 February 2017

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<p>Key catalysts for the stock price:</p> <ul style="list-style-type: none"> • Approval pace for Gavis pipeline • Progress of new launches in the U.S. and pricing trend in key products • Improvement in growth trend in Japan 	<p>Upside risks to our view:</p> <ul style="list-style-type: none"> • Faster approval of the Gavis pending ANDA pipeline • Big-ticket approval for the U.S. generics business • Growth from Japan exceeding expectations, given the drugs going off-patent in the medium term 	<p>Downside risks to our view:</p> <ul style="list-style-type: none"> • Delay in approvals of products in the U.S. • Protracted slowdown in the domestic pharma market • Regulatory/litigation risks • Continued weakness in Japanese business • INR appreciation could hurt non-INR revenue
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Key financial metrics	FY16	FY17E	FY18E	FY19E
Revenues (LC mn)	137,016	171,153	195,582	225,021
Revenue growth (%)	8.7	24.9	14.3	15.1
EBITDA (LC mn)	37,535	45,826	48,978	56,368
EBITDA margin (%)	27.4	26.8	25.0	25.0
Tax rate (%)	33.6	27.0	25.0	25.0
Net profit (LC mn)	22,707	27,727	30,002	35,537
EPS (LC)	50.2	61.2	66.3	78.5
EPS growth (%)	-5.7	22.1	8.2	18.4
DPS (LC)	7.5	8.6	9.3	11.0
BVPS (LC)	242.6	293.5	348.6	413.9
Operating cash flow (LC mn)	-5,491	19,720	28,679	32,498
Free cash flow (LC mn)	-1,239	790	14,679	22,498
Interest cover (X)	84.1	28.6	32.6	43.9
Net margin (%)	16.6	16.2	15.3	15.8
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	22.8	20.6	20.6

Key model assumptions	FY16	FY17E	FY18E	FY19E
USD/INR	65.5	67.3	67.3	67.3
U.S. revenue growth	-0.4	36.7	9.1	15.7
Japan revenue growth	5.7	19.4	35.8	11.7

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

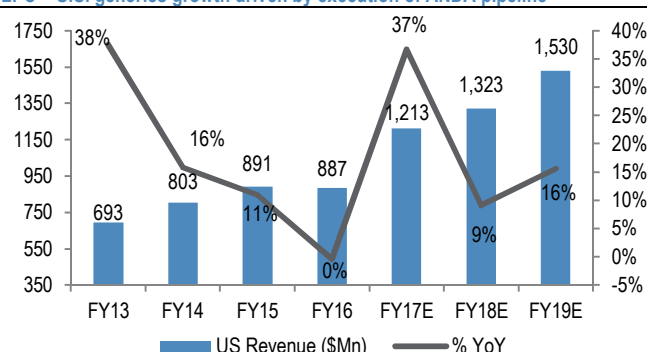
Sensitivity analysis	EBITDA		EPS	
	FY17E	FY18E	FY17E	FY18E
1% chg. in U.S. generics revenue	0.4%	0.5%	0.4%	0.5%
1% chg. in Japan revenue	0.1%	0.1%	0.1%	0.1%
1% chg. in R&D expense	0.3%	0.4%	0.3%	0.4%

Source: J.P. Morgan estimates.

Valuation and price target basis

Our Dec-17 PT of Rs1,500 is based on at a P/E of 20x, in line with the long-term average of large-cap peers. Key risks include earlier-than-expected/delays in approvals in the U.S., regulatory risk, currency and the execution of M&A.

LPC – U.S. generics growth driven by execution of ANDA pipeline



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

JPM vs. consensus, change in estimates

EPS (LC)	FY17E	FY18E
JPM old	63.1	68.7
JPM new	61.2	66.3
% chg.	-1%	-1%
Consensus	66.1	76.8

Source: Bloomberg, J.P. Morgan estimates.

Indian pharma: Valuation summary

	CMP (LC)	Mcap (\$M)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
			FY18	FY19	FY18	FY19	FY18	FY19	FY18	FY19
Sun Pharma	656	23,525	20.4	17.8	13.1	11.3	3.6	3.1	21.1	20.3
Lupin	1,491	10,070	22.5	19.0	15.2	12.9	4.3	3.6	20.6	20.6
Dr Reddy's	3,023	7,491	22.1	16.7	13.8	10.6	3.5	3.0	17.1	19.5
Aurobindo	707	6,186	14.4	13.1	11.2	9.8	3.5	2.8	27.0	23.5
Cipla	588	7,071	24.0	20.1	15.2	12.9	3.2	2.8	14.4	15.1
Cadila	366	5,609	20.9	17.4	14.9	12.4	4.9	4.1	25.3	25.1
Glenmark	956	4,034	18.7	17.5	11.9	10.9	3.9	3.2	23.1	20.2
Alkem	1,812	3,241	21.1	18.2	16.8	13.8	4.4	3.7	22.4	21.9

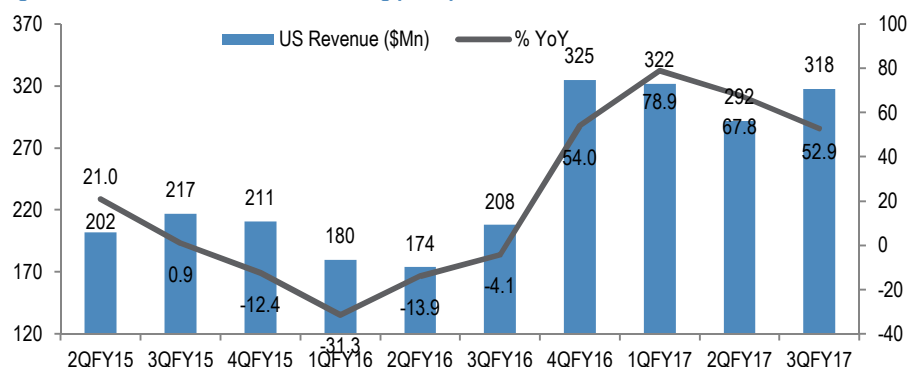
Source: Bloomberg, J.P. Morgan estimates. Note: Consensus estimates used for Cadila.

Takeaways from conference call

- U.S. generics – QoQ growth was surprising:** The strong U.S. revenue (+7% QoQ) was driven by upside from smaller launches, an increase in gGlumetza share (generics share now 75%) and a limited impact from gFortamet competition. We see U.S. generics revenue moderating from the \$294mn reported in the December quarter due to two points highlighted by management (other than the high-single-digit pricing pressure): (1) the impact of Mylan's entry in gFortamet was not reflected fully in 3Q and will flow through from this quarter; and (2) the AG launch in gGlumetza to expand the generics market, which, in our view, could imply market share loss in gGlumetza for Lupin or lower volume in gFortamet. On competition, management indicated expected entries in gGlumetza by Sun in 3QCY17 and Teva in 2QCY17, but does not see incremental competition in gFortamet in the near term despite the recent filing (30-month stay likely to kick in, as the brand had a 50% share before Mylan's entry). Some offset in the near term are the launches from the Gavis pipeline following the expansion of its facility (three launches in 3Q and four more expected this quarter). Management expects 25+ launches in the next month, including some limited-competition opportunities like gMinastrin, gEpzicom, gWellbutrin XL and litigated products like Namenda XR, Restasis, Vigamox, etc. On the Somerset pipeline, LPC indicated controlled substances and derma launches from FY18, but expects full revenue contribution from controlled substances in FY19 (DEA quota based on market share gain and order commitments). On the long-awaited opportunities like Renvela/Welchol, LPC indicated a pointed launch timeline of 4QFY18/early FY19, given the recent queries from the FDA, but highlighted that all players are in the same position.
- U.S. branded business growth strong, but there is risk from generics:** The branded business grew 25% QoQ, aided by Methergine (now at a \$4mn/month run rate). Management highlighted that it has stalled the decline in prescription (down 20%) that was seen when Lupin took over the product and is focusing on growing the brand (50% share) through promotions. LPC indicated that the complexity in API+formulation manufacturing does increase barriers to entry, and Lupin is already working on lifecycle management to address the risk of new generics competition in the future.
- Update on other markets: India** – While growth was 14-15% in Rx, demonetization impacted the quarter by 2-3%, and the company expects the trend to normalize from April onward. LPC indicated that GST implementation will impact domestic growth next year (a quarter or so), but expects revenue growth in the 18-20% range over the medium term. **Japan** – Growth in the quarter was muted (5% vs. 10-11% in 1H) due to government reforms related to generics substitution by pharmacies, which is one-time. Management expects double-digit growth in the business going forward, further augmented by the Shinogi portfolio (a few days in the December quarter, but full impact in the March quarter).
- Other details:** The **SG&A expense decline** QoQ was due to FX loss of Rs560mn in the September quarter vs. an Fx gain (of Rs740mn, included in other income) in the December quarter. Excluding Fx and R&D, SG&A was nearly flat QoQ. **Capex** in FY17 is likely to be Rs19bn, with spending on the Japan facility and Somerset expansion, but will moderate to Rs13-14bn next year. The tax rate was higher in the quarter due to the unwinding of deferred tax asset and subsidiary losses. LPC indicated a FY17 tax rate of 28% (higher than the

previous estimate). **Specialty M&A** – LPC highlighted that M&A in the specialty segment would come down, with fewer deals at current valuations. It pointed out that there are fewer mid-sized commercial assets (\$1bn range) available and more deals happening on the pipeline front.

Figure 1: U.S. revenue witnessed a strong pickup in 3Q



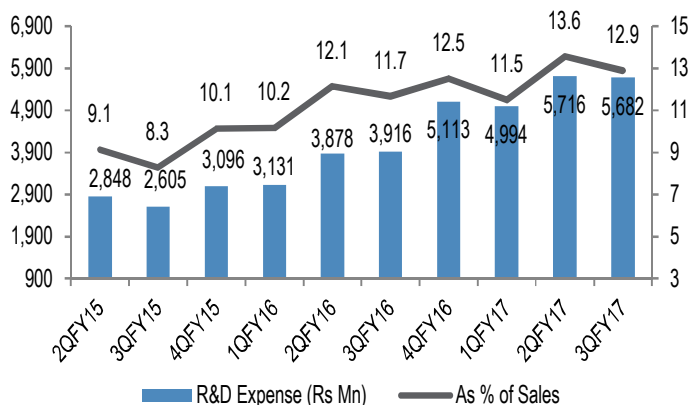
Source: Company reports.

Table 1: LPC quarterly summary

Rs in millions	3QFY17	3QFY16	% YoY	2QFY17	% QoQ	9MFY17	9MFY16	% YoY
India	9,912.0	8,860.0	11.9	9,958.0	(0.5)	29,369.0	26,590.0	10.5
U.S.	21,755.0	13,805.0	57.6	19,978.0	8.9	63,619.0	37,348.0	70.3
APAC	5,601.0	4,634.0	20.9	5,520.0	1.5	3,872.7	3,362.0	15.2
EMEA	2,555.0	2,187.0	42.1	2,355.0	8.5	13,092.0	10,233.5	27.9
LatAm	1,175.0	885.0	32.8	986.0	19.2	3,231.3	2,862.0	12.9
RoW	367.0	297.0	23.6	396.0	(7.3)	1,131.0	881.0	28.4
API	2,684.0	2,835.0	(5.3)	2,919.0	(8.1)	8,569.0	9,440.0	(9.2)
Net revenues	44,049.4	33,503.3	31.5	42,111.8	4.6	129,579.2	96,238.1	34.6
Total income	44,828.7	35,476.6	26.4	42,905.1	4.5	132,410.3	100,333.9	32.0
Gross profit	31,813.0	24,244.5	31.2	30,476.6	4.4	94,246.8	68,017.9	38.6
Gross margin (%)	72.2	72.4	(0.1)	72.4		71.2	67.8	
EBITDA	12,158.3	8,461.1	43.7	10,280.7	18.3	35,519.4	23,335.4	52.2
EBITDA margin (%)	27.1	23.8		24.0		26.8	23.3	
PBT	10,425.7	7,810.5	33.5	8,176.9	27.5	30,162.2	21,540.5	40.0
PBT margin (%)	23.3	22.0		19.1		22.8	21.5	
Tax expense	4,094.8	2,556.9	60.1	1,589.4	157.6	8,418.3	6,405.9	31.4
Tax rate (%)	39.3	32.7		19.4		27.9	29.7	
Profit after tax	6,331.1	5,245.6	20.7	6,621.9	(4.4)	21,772.5	15,128.6	43.9
PAT margin (%)	14.1	14.8		15.4		16.4	15.1	
Key costs								
Cost of sales	13,015.7	11,232.1	15.9	12,428.5	4.7	38,163.5	32,316.0	18.1
as % of revenues	29.5	33.5		29.5		29.5	33.6	
Employees cost	7,311.5	5,434.1	34.5	7,123.9	2.6	21,494.4	15,734.6	36.6
as % of revenues	16.6	16.2		16.9		16.6	16.3	
R&D expenses	5,681.7	3,916.0	45.1	5,716.0	(0.6)	16,391.7	10,924.5	50.0
as % of revenues	12.9	11.7		13.6		12.6	11.4	

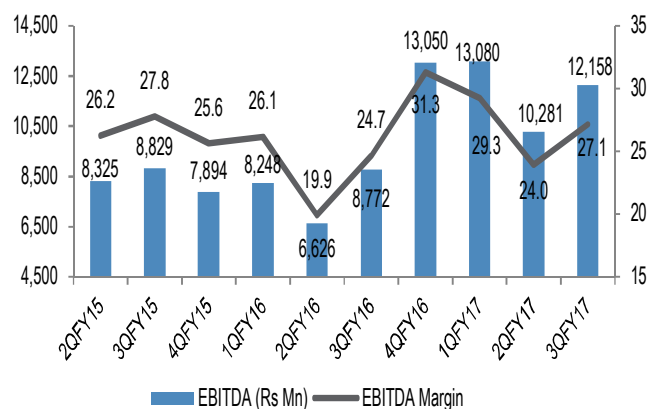
Source: Company reports. Note: Margins calculated on total income, and EBITDA excludes other income.

Figure 2: Rising R&D expense with focus on respiratory and biosimilars



Source: Company reports.

Figure 3: EBITDA margin aided by continued exclusivity in gGlumetza



Source: Company reports.

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 delays in key approvals, Gavis execution and evolving long-term organic growth drivers.

Valuation

Our Dec-17 price target of Rs1,500 is based on a 20x P/E (in line with the long-term sector average) despite superior margins to the sector, given the high product concentration and tough pricing environment in the U.S.

Risks to Rating and Price Target

Key upside risks include accretive business development opportunities and a 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 a slow ramp-up of sales in Gavis.

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09 February 2017

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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	171,153	195,582	225,021	PBT	34,148	34,330	37,941	39,962	47,342
% change Y/Y	13.6%	8.7%	24.9%	14.3%	15.1%	Depr. & amortization	4,347	4,635	8,782	10,012	11,242
Gross Profit	84,427	93,922	122,802	138,863		- Change in working capital	(949)	(23,546)	(18,362)	(12,808)	(15,534)
% change Y/Y	16.1%	11.2%	30.7%	13.1%		- Other	680	(38)	(30)	(30)	(30)
EBITDA	36,196	37,535	45,826	48,978	56,368	Cash flow from operations	27,330	(3,690)	19,720	28,679	32,498
% change Y/Y	20.5%	3.7%	22.1%	6.9%	15.1%	Capex	(8,676)	(11,681)	(18,950)	(14,000)	(10,000)
EBIT	31,849	32,900	37,045	38,966	45,126	Other	4,425	593	20	0	0
% change Y/Y	16.2%	3.3%	12.6%	5.2%	15.8%	Free cash flow	18,725	(15,074)	1,941	15,807	23,461
EBIT Margin	25.3%	24.0%	21.6%	19.9%	20.1%	Equity raised/(repaid)	2	2	0	0	0
Net Interest	(98)	(446)	(1,604)	(1,504)	(1,284)	Debt raised/(repaid)	(700)	-	-	(5,000)	(11,000)
Earnings before tax	34,148	34,330	37,941	39,962	47,342	Other	302	98	(1,574)	(1,474)	(1,254)
% change Y/Y	20.6%	0.5%	10.5%	5.3%	18.5%	Dividends paid	(1,573)	(4,055)	(4,667)	(5,050)	(5,983)
Tax	(9,704)	(11,536)	(10,244)	(9,991)	(11,836)	Beginning cash	6,066	21,084	8,379	1,296	4,452
as % of EBT	28.4%	33.6%	27.0%	25.0%	25.0%	Ending cash	4,813	8,379	1,296	4,452	8,713
Net income (reported)	24,032	22,707	27,727	30,002	35,537	DPS	7.46	7.46	8.56	9.27	10.98
% change Y/Y	30.9%	(5.5%)	22.1%	8.2%	18.4%						
Shares outstanding	452	453	453	453	453						
EPS (reported)	53.20	50.15	61.24	66.26	78.49						
% change Y/Y	30.4%	(5.7%)	22.1%	8.2%	18.4%						
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	1,296	4,452	8,713	Gross margin	67.0%	68.5%	71.8%	71.0%	-
Accounts receivable	26,566	45,498	56,834	64,946	74,722	EBITDA margin	28.7%	27.4%	26.8%	25.0%	25.0%
Inventories	25,036	31,787	39,707	45,375	52,205	Operating margin	25.3%	24.0%	21.6%	19.9%	20.1%
Others	5,350	12,106	15,122	17,280	19,881	Net margin	19.1%	16.6%	16.2%	15.3%	15.8%
Current assets	78,324	97,790	112,959	132,052	155,520	Sales per share growth	13.3%	8.5%	24.9%	14.3%	15.1%
LT investments	25	55	55	55	55	Sales growth	13.6%	8.7%	24.9%	14.3%	15.1%
Net fixed assets	32,961	86,379	106,598	110,586	109,344	Net profit growth	30.9%	(5.5%)	22.1%	8.2%	18.4%
Total Assets	131,377	224,378	262,182	286,994	311,304	EPS growth	30.4%	(5.7%)	22.1%	8.2%	18.4%
Liabilities						Interest coverage (x)	369.0	84.1	28.6	32.6	43.9
Payables	19,561	21,919	27,379	31,287	35,997	Net debt to equity	0.6%	57.5%	59.2%	44.7%	29.6%
Others	13,379	13,918	14,593	15,337	16,154	Working Capital to Sales	32.6%	32.1%	29.5%	33.2%	37.3%
Short-term debt	4,353	18,036	20,454	20,454	19,454	Sales/assets	1.1	0.8	0.7	0.7	0.8
Total current liabilities	37,292	53,872	62,427	67,078	71,605	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%	22.8%	20.6%	20.6%
Other liabilities	2,465	4,702	4,702	4,702	4,702	ROACE	26.8%	15.8%	13.7%	13.1%	14.0%
Total Liabilities	42,396	114,213	128,958	128,818	123,575						
Shareholders' equity	88,741	109,844	132,904	157,855	187,409						
BVPS	196.45	242.60	293.53	348.64	413.91						

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

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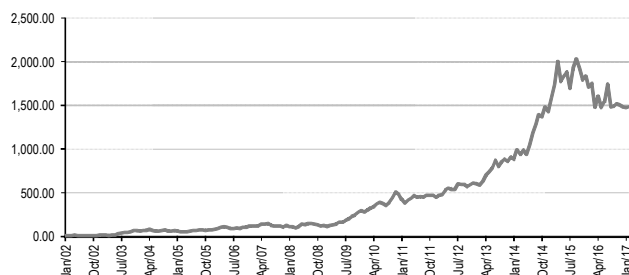
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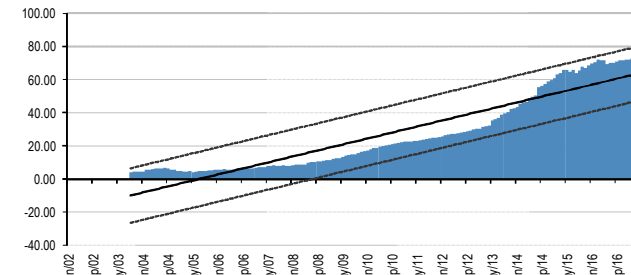
Global Equity Quantitative Analysis

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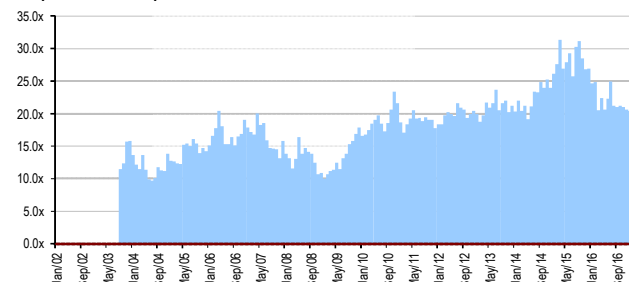
Local Share Price **Current: 1487.45**



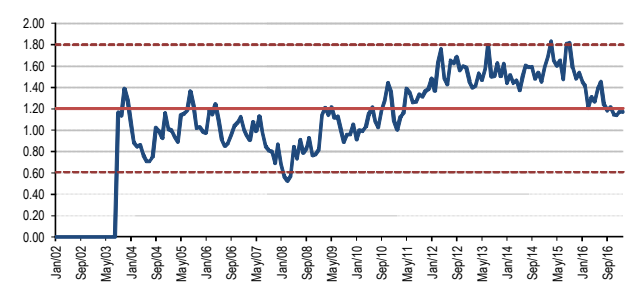
12 Mth Forward EPS **Current: 73.01**



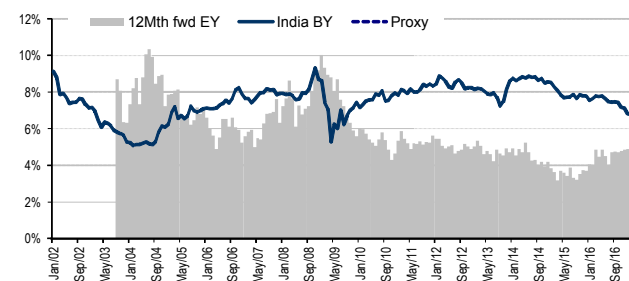
PE (1Yr Forward) **Current: 20.4x**



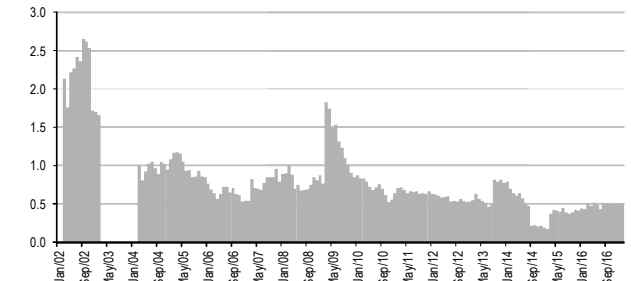
P/E Relative to India Index **Current: 1.17**



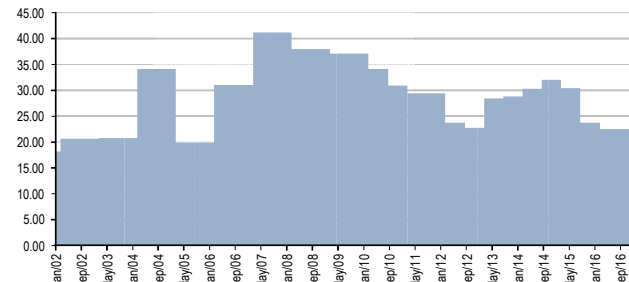
Earnings Yield (& Local Bond Yield) **Current: 4.91%**



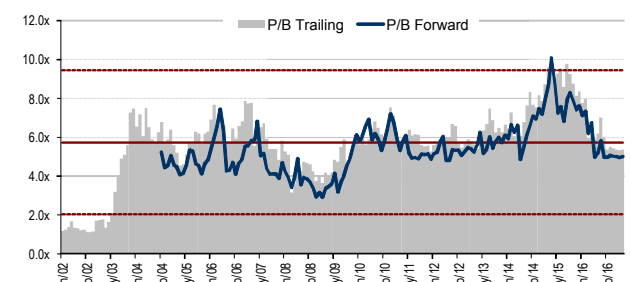
Dividend Yield (Trailing) **Current: 0.50**



ROE (Trailing) **Current: 22.57**



Price/Book (Value) **Current: 5.4x**



Summary

Lupin Limited		TICKER		LPC IN EQUITY		As Of:		03-Feb-17			
INDIA						Local Price:		1,487.45			
Health Care						EPS:		73.01			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	20.37x										
P/BV (Trailing)	5.37x	1.12	10.17	5.92	5.74	9.45	2.03	-79%	89%	10%	7%
Dividend Yield (Trailing)	0.50	0.00	2.65	0.67	0.75	1.75	-0.24	-100%	425%	34%	49%
ROE (Trailing)	22.57	18.19	41.24	29.49	29.05	42.42	15.68	-19%	83%	31%	29%

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

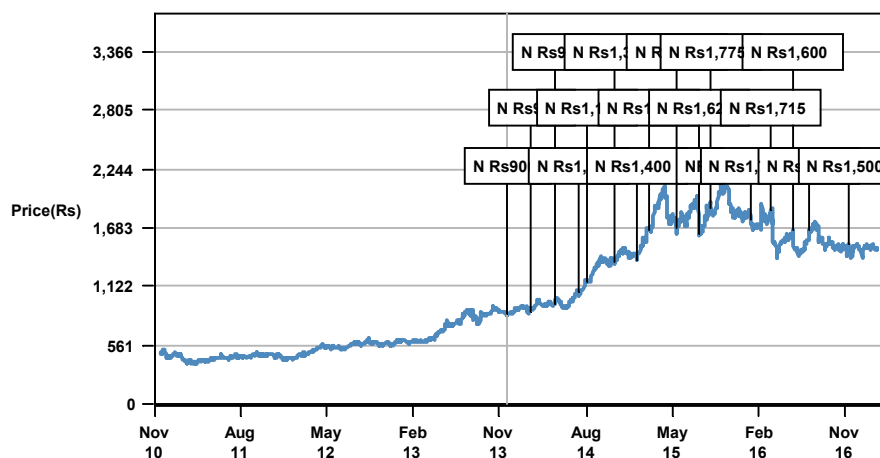
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Lupin Ltd. (LUPN.NS, LPC IN) Price Chart



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

Date	Rating	Share Price (Rs)	Price Target (Rs)
25-Nov-13	N	850.85	900.00
04-Feb-14	N	881.90	950.00
21-Apr-14	N	955.65	975.00
07-Jul-14	N	1078.10	1000.00
04-Aug-14	N	1165.40	1175.00
29-Oct-14	N	1357.55	1300.00
07-Jan-15	N	1377.60	1400.00
18-Feb-15	N	1662.25	1600.00
14-May-15	N	1689.50	1550.00
23-Jul-15	NR	1823.95	--
27-Jul-15	N	1617.55	1625.00
03-Sep-15	N	1880.40	1775.00
06-Jan-16	N	1753.20	1700.00
11-Mar-16	N	1856.15	1715.00
20-May-16	N	1655.45	1600.00
11-Jul-16	N	1669.10	1650.00
10-Nov-16	N	1529.65	1500.00

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Asia Pacific Equity Research
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IB clients*	52%	48%	34%
JPMS Equity Research Coverage	43%	50%	7%
IB clients*	67%	61%	43%

*Percentage of investment banking clients in each rating category.

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