

**COMPANY NOTE**

Target | Estimate Change

India | Healthcare | Pharmaceuticals

3 August 2017

Jefferies

# Lupin Ltd. (LPC IN)

## 1Q18: Worse than Expectations

**Key Takeaway**

**Lupin reported weak 1Q18 and guided for further decline in US business in 2Q. FY18 margin guidance was cut by 500bps and mgmt. expects single digit revenue decline (10%+ in US). FY19 should see some recovery but higher than expected price erosion lead to 17/14% cut in EPS, bringing FY19 earnings back to FY15 levels. The stock still trades at premium to peers despite weak near-term growth and medium term outlook. Retain Underperform with revised TP of Rs 850.**

**Another weak quarter** - LPC reported another weak quarter with EPS of Rs 7.9/sh, down 40% YoY and 30% below expectation. Revenues were 10% lower and margins came 200bps below expectation. US business was down 14% QoQ. Mgmt indicated that this was led largely by price erosion in Glumetza. Japanese and EM business also disappointed and came 15-20% below expectation.

**Guidance indicates not the bottom yet** - Despite sharp decline, mgmt. indicated that US revenues could see further decline in 2Q led by remaining impact of gGlumetza and end of exclusivity for gMinastrin. It expects US revenues to decline in double digits in FY18 over FY17 and full year revenues to see single digit decline. Mgmt. highlighted cost control through reduction in R&D spend (c150bps) and stable employee cost. Despite this lower gross margins has led to cut in margin guidance by 500bps to 21-23% (vs 26-28% earlier). The commentary on "stable pricing QoQ" was perplexing given the price erosion seen by peers and the decline seen over past 2 quarters.

**Cut FY18/19 EPS by 17/14%** - We cut our lower than consensus earnings by another 17/14% for FY18/19 led by the much higher than anticipated price erosion in US and disappointment in other businesses. The cut would have been sharper but for the reduction in R&D indicated by the mgmt.

**Earnings reset by 4 years; Retain Underperform** - Despite a 40% stock price correction Lupin still trades at 18.5x FY19 PE, a premium to sector. The valuations do not appear to factor the structural erosion in business. Our FY19 EPS expectation are now similar to FY15 actual EPS. In addition to weak near term earnings, we remained concerned on the medium term outlook given the weak R&D execution and lag to peers in filing. We retain our Underperform rating with revised DCF based TP of Rs 850.

**Valuation/Risks**

Lupin given its weak earnings growth and concern on medium term, should trade at discount to sector. Our TP of Rs 850 implies FY19 PE of 15.8x. Key risk: Approval of key products, M&A

INR	Prev.	2016A	Prev.	2017A	Prev.	2018E	Prev.	2019E
Rev. (MM)	--	142,555	--	174,943	183,665	169,766	213,541	199,312
EBITDA (MM)	--	36,853.0	--	46,491.0	41,940.0	36,507.0	50,296.0	44,915.0
EV/EBITDA		13.5x		10.7x		13.6x		11.1x
Net Profit	--	22,607.0	--	25,575.0	23,472.0	19,506.0	28,140.0	24,247.0
Dividend	--	7.50	--	7.50	7.80	6.50	9.30	8.00
Div. Yield		0.75%		0.75%		0.65%		0.81%
BV/Share	--	247.75	--	298.90	343.10	335.60	396.10	381.30
P/B		4.0x		3.3x		3.0x		2.6x
EPS Growth	--	(5.9)%	--	20.0%	(13.5)%	(28.1)%	19.9%	24.3%
<b>EPS</b>								
FY Mar	--	50.29	--	60.10	52.00	43.20	62.30	53.70
FY P/E		19.8x		16.5x		23.0x		18.5x

**UNDERPERFORM**

Price target INR850.00  
(from INR1,000.00)  
Price INR993.40^

**Financial Summary**

Net Debt (MM): INR51,306.0

**Market Data**

52 Week Range: INR1,734.00 - INR985.40

Total Entprs. Value (MM): INR497.8BN

Market Cap. (MM): INR446.5BN

Shares Out. (MM): 449.5

Float (MM): 218.9

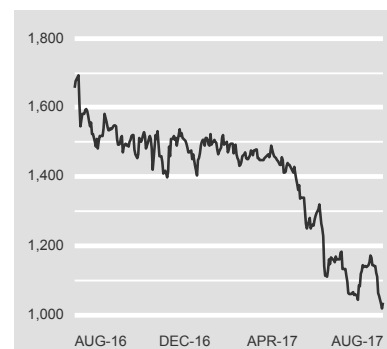
Avg. Daily Vol.: 2,075,234

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**Price Performance**

^Prior trading day's closing price unless otherwise noted.

# LPC IN

Target | Estimate Change

3 August 2017

[Lupin Ltd]

**Underperform: INR 850 Price Target**

## Scenarios

### Target Investment Thesis

- Domestic FY17-19 growth at industry level 12%
- Emerging markets FY17-19 growth at 12%
- US revenues growth FY17-19 at 3%
- Margins at 22.5% in FY19
- R&D spend at 12/13% in FY18/19
- USDINR at 68 in FY19
- 2019 EPS: 53.7; Target Multiple: 15.8x; Target Price Rs850

### Upside Scenario

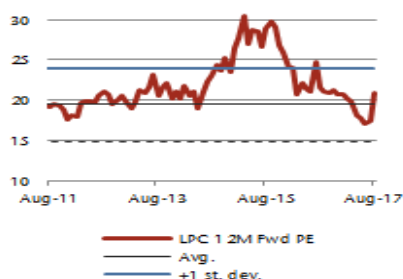
- Domestic FY17-19 growth at industry level 14%
- Emerging markets FY17-19 growth at 15%
- US revenues growth FY17-19 at 5%
- Margins at 24.5% in FY19
- R&D spend at 12% in FY18/19
- USDINR at 68 in FY19
- 2019 EPS: 62.8; Target Multiple: 17x; Target Price Rs1060

### Downside Scenario

- Domestic FY17-19 growth at industry level 10%
- Emerging markets FY17-19 growth at 10%
- US revenues flat over FY17-19
- Margins at 21.1% in FY19
- R&D spend at 12/13% in FY18/19
- USDINR at 64 in FY19
- 2019 EPS: 45; Target Multiple: 16x; Target Price Rs720

## Long Term Analysis

### 1 Year Forward P/E



Source: Factset, Jefferies estimates

### Long Term Financial Model Drivers

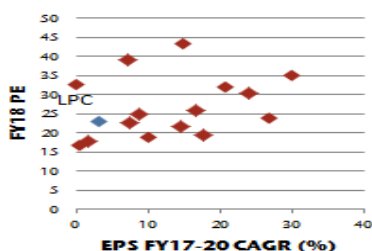
<b>LT Earnings CAGR (3 yr)</b>	<b>3%</b>
Organic Revenue Growth	<b>13%</b>
Operating Margin Expansion	<b>0bps</b>

### Other Considerations

Lupin has strong presence in US markets with a branded business presence. It is focussing on the US markets and has aggressive launch plans which would drive growth. India growth has been boosted by marketing of Lily products

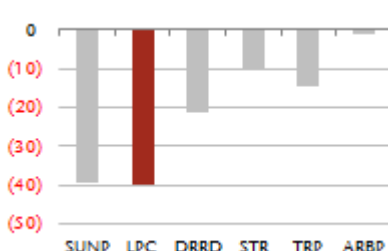
## Peer Group

### Group P/Es vs Growth



Source: Company Data, Jefferies estimates

### 12m stock performance



Source: Bloomberg

### Recommendation / Price Target

Ticker	Rec.	PT
SUNP	Hold	535
<b>LPC</b>	<b>Underperform</b>	<b>1,350</b>
DRRD	Underperform	2,150
STR	Buy	1,220
ARBP	Buy	780
GNP	NC	NA
TRP	NC	NA

## Catalysts

- INR/USD exchange rate
- Acquisition in US branded business
- Significant acquisition in the generic space
- Pick-up in approvals in US

## Company Description

Lupin is a global pharmaceutical company. It has presence in 70 countries with its major markets being India, US, Japan and South Africa. In USA it has presence both in branded and generic markets..

**Other highlights**

- Management cut FY18 margin guidance to 21-23% from 26-28%
- It expects to focus on cost control and consequently cut its R&D guidance to c12% from 13.5% earlier
- It expects employee cost to be contained at current levels
- Gross margins are expected to be at current levels of 67-68%
- US business could see further decline in 2Q led by full Glumetza impact and end of Minastrin exclusivity (5m sales booked)
- It indicated that decline in US business was led by largely price erosion in gGlumetza. Ex Glumetza US revenues were up 9% QoQ.
- It expects price erosion to remain in single digit going forward
- The key product expected over the next 12m are
  - Tamiflu – in 2H18
  - Lantham carbonate – FY18
  - Levothyroxin – FY19
  - Multiple controlled substance products
- On the respiratory filings, it expects to file Spiriva DPI in end FY18
- Advair PD studies are delayed by couple of month
- On Mesalamine products – Aspiro and Lialda, the company has queries on both and expects to respond by end FY18. It believes that it can launch both in FY19
- It plans to file 35-40 ANDA per month
- Branded business sales in 1Q was 23mn USD vs 19mn in 4Q

**Exhibit 1: Another muted quarter**

	1QFY18	1QFY17	YoY (%)	4QFY17	1QFY18E	vs. Est (%)
<b>Revenues</b>	<b>38,696</b>	<b>44,677</b>	<b>-13.4</b>	<b>42,533</b>	<b>42,954</b>	<b>-9.9</b>
Raw Material	12,326	12,719	-3.1	11,851	11,851	4.0
<b>Gross Profit</b>	<b>26,370</b>	<b>31,957</b>	<b>-17.5</b>	<b>30,682</b>	<b>29,543</b>	<b>-10.7</b>
Employee Cost	7,180	7,059	1.7	7,078	7,553	-4.9
Other operating Exp	11,506	11,818	-2.6	14,232	12,543	-8.3
<b>EBITDA</b>	<b>7,684</b>	<b>13,080</b>	<b>-41.3</b>	<b>9,373</b>	<b>9,447</b>	<b>-18.7</b>
EBITDA Margin (%)	19.9	29.3	-942 bps	22.0	22.0	-214 bps
EBIT	5,079	11,053	-54.1	6,698	7,038	-27.8
PBT	4,959	11,560	-57.1	6,746	7,085	-30.0
Tax	1,368	2,734	-50.0	1,367	1,913	-28.5
<b>PAT</b>	<b>3,581</b>	<b>8,820</b>	<b>-59.4</b>	<b>3,802</b>	<b>5,154</b>	<b>-30.5</b>

Source: Jefferies estimates, company data

**Exhibit 2: US revenues down over 14% QoQ**

	1QFY18	1QFY17	YoY (%)	4QFY17	QoQ (%)	1QFY18E	vs. Est (%)
<b>Revenues (in Rs mn)</b>	<b>38,068</b>	<b>43,419</b>	<b>-12.3</b>	<b>41,619</b>	<b>-8.5</b>	<b>42,275</b>	<b>-10.0</b>
Formulation Sales	35,275	40,453	-12.8	38,804	-9.1	39,319	-10.3
<b>US</b>	<b>16,018</b>	<b>21,886</b>	<b>-26.8</b>	<b>19,007</b>	<b>-15.7</b>	<b>18,327</b>	<b>-12.6</b>
EU	1,018	1,033	-1.5	997	2.1	1,018	0.0
Japan	4,981	4,255	17.1	4,680	6.4	5,690	-12.5
India	9,324	9,499	-1.8	8,788	6.1	9,311	0.1
EM	3,934	3,780	4.1	5,332	-26.2	4,739	-17.0
SA	1,020	912	11.9	1,646	-38.0	1,298	-21.4
API	2,793	2,966	-5.8	2,815	-0.8	2,955	-5.5

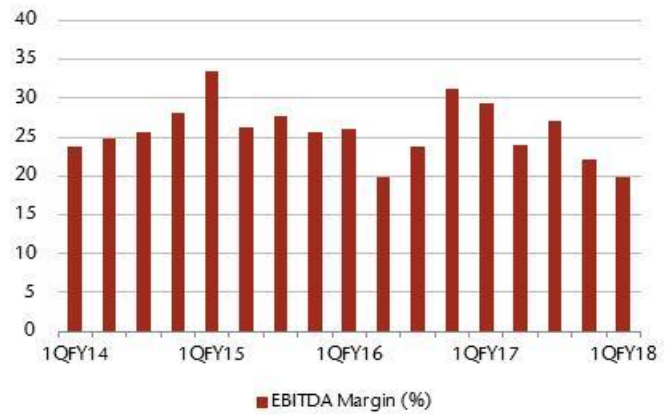
Source: Jefferies estimates, company data

**Exhibit 3: Gross margins decline sharply...**



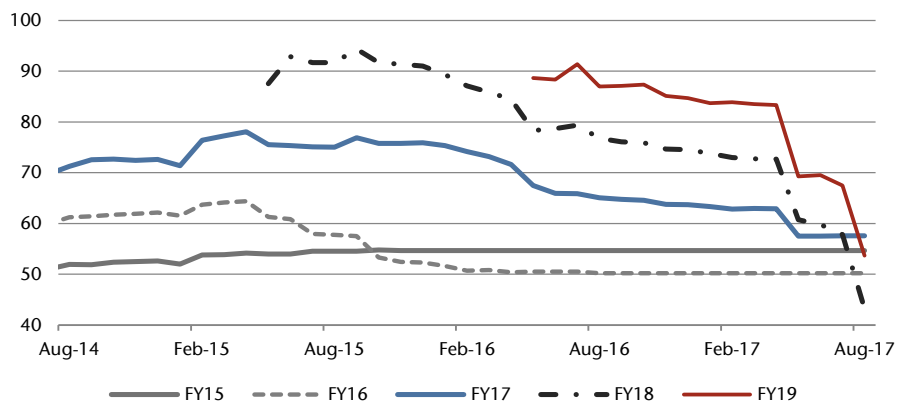
Source: Jefferies estimates, company data

**Exhibit 4: ... EBITDA margins at the lowest level in 4 years**



Source: Jefferies estimates, company data

**Exhibit 5: Lupin has seen 30%+ cut in EPS over past 12m**



Note: Latest data point is our EPS estimates; Source: Factset, Jefferies estimates

**LPC IN**

Target | Estimate Change

3 August 2017

**Exhibit 6: Valuation Table**

Company	BB Ticker	Market Cap (USD bn)	TP (Rs)	CMP (Rs)	Rating	P/E (x)			P/B (x)			FY17-20 CAGR (%)	
						FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	Sales	EPS
Sun Pharma	SUNP IN	23.8	535	516	HOLD	17.8	17.8	22.3	3.4	3.0	2.6	6.4	1.7
<b>Lupin</b>	<b>LPC IN</b>	<b>8.9</b>	<b>850</b>	<b>993</b>	<b>UNPF</b>	<b>16.5</b>	<b>23.0</b>	<b>18.5</b>	<b>3.0</b>	<b>2.6</b>	<b>2.3</b>	<b>9.4</b>	<b>3.2</b>
Cipla	CIPLA IN	6.8	480	557	HOLD	44.5	35.0	28.3	3.5	3.1	2.8	12.0	29.9
Dr Reddy's	DRRD IN	6.7	2,150	2324	UNPF	32.2	32.0	28.3	3.1	2.8	2.5	6.3	20.7
Aurobindo	ARBP IN	5.3	780	741	BUY	18.8	18.9	17.1	4.6	3.7	3.0	9.5	10.0
Torrent	TRP IN	3.4	NC	1252	NC	22.8	22.8	23.2	4.9	4.2	3.6	8.1	7.4
Glenmark	GNP IN	2.9	NC	702	NC	21.6	21.6	17.1	4.0	3.3	2.7	6.8	14.5
Natco	NTCPH IN	2.5	950	969	BUY	34.8	39.0	35.6	10.1	8.3	6.7	8.3	7.2
Divi's Lab	DIVI IN	2.5	NC	670	NC	16.8	16.8	17.9	3.3	3.2	2.9	2.1	0.5
Alembic	ALPM IN	1.7	NC	531	NC	24.8	24.8	23.8	5.3	4.4	3.7	7.7	8.8

Source: Jefferies estimates, company data

**Exhibit 7: Changes to estimates**

	Old		New			% change	
	FY18E	FY19E	FY18E	FY19E	FY20E	FY18E	FY19E
Sales	183,665	213,541	169,766	199,312	224,313	-7.6	-6.7
Operating profit	41,940	50,296	36,507	44,915	52,642	-13.0	-10.7
OP margin (%)	22.8	23.6	21.5	22.5	23.5	-130 bps	-106 bps
Net profit	23,472	28,140	19,506	24,247	29,789	-16.9	-13.8
NP margin (%)	12.8	13.2	11.5	12.2	13.3	-131 bps	-103 bps
EPS	52	62.3	43.2	53.7	66.0	-16.9	-13.8
EPS growth (%)	-13.5	19.9	-28.1	24.3	22.9	-1461 bps	440 bps
DPS	7.8	9.3	6.5	8.0	9.9	-17.2	-13.7
ROE (%)	15.1	15.7	12.9	14.1	15.1	-223 bps	-162 bps

Source: Jefferies estimates, company data

## Financials

### Exhibit 8: Profit and Loss Statement

Rs mn	2016	2017	2018E	2019E	2020E
<b>Net Sales</b>	<b>142,555</b>	<b>174,943</b>	<b>169,766</b>	<b>199,312</b>	<b>224,313</b>
<i>Change (%)</i>	11.6	22.7	-3.0	17.4	12.5
Material Cost	43,326	50,014	54,947	62,243	69,308
Employee Cost	21,416	28,495	29,920	34,408	37,848
SG&A	24,922	26,842	28,403	32,325	35,902
R&D Expenses	16,038	23,101	19,989	25,422	28,613
<b>EBITDA</b>	<b>36,853</b>	<b>46,491</b>	<b>36,507</b>	<b>44,915</b>	<b>52,642</b>
<i>% of net sales</i>	25.9	26.6	21.5	22.5	23.5
Depreciation	4,871	9,122	10,531	12,237	13,264
Interest	595	1,525	1,627	1,627	1,627
Other Income	1,852	1,065	2,400	2,150	2,492
EO Income / (Exp)	0	-1,559	0	0	0
<b>PBT</b>	<b>33,239</b>	<b>36,909</b>	<b>26,749</b>	<b>33,201</b>	<b>40,242</b>
Tax	10,593	9,785	7,222	8,964	10,463
<i>Rate (%)</i>	31.9	26.5	27.0	27.0	26.0
Minority Interest	39	-10	21	-10	-10
PAT	22,607	25,575	19,506	24,247	29,789
Adjusted PAT	22,607	27,134	19,506	24,247	29,789
<i>change (%)</i>	-5.9	20.0	-28.1	24.3	22.9

Source: Jefferies estimates, company data

### Exhibit 9: Balance Sheet Statement

Rs mn	2016	2017	2018E	2019E	2020E
Share Capital	901	903	903	903	903
Minority Interest	321	345	335	325	315
Reserves	110,733	134,073	150,663	171,285	196,621
<b>Net Worth</b>	<b>111,955</b>	<b>135,321</b>	<b>151,901</b>	<b>172,514</b>	<b>197,840</b>
Deferred Tax Lia	3,267	3,949	3,949	3,949	3,949
Loans	71,775	79,661	79,661	79,661	79,661
<b>Capital Employed</b>	<b>186,997</b>	<b>218,930</b>	<b>235,511</b>	<b>256,123</b>	<b>281,449</b>
Gross Fixed Assets	92,120	123,953	145,547	158,547	168,547
Less: Depreciation	4,951	13,624	24,155	36,392	49,657
<b>Net Fixed Assets</b>	<b>87,169</b>	<b>110,329</b>	<b>121,392</b>	<b>122,155</b>	<b>118,890</b>
Capital WIP	27,024	21,331	12,737	12,737	12,737
Investments	164	21,361	21,361	21,361	21,361
Deferred Tax Asset	4,036	6,434	6,434	6,434	6,434
<b>Current Assets</b>	<b>107,855</b>	<b>106,618</b>	<b>117,957</b>	<b>142,827</b>	<b>175,829</b>
Inventory	32,737	36,423	39,768	45,048	50,161
Debtors	45,488	43,073	41,799	46,961	52,852
Cash & Bank Balance	8,218	6,994	18,008	26,546	44,902
Loans & Advances	21,414	20,128	18,382	24,272	27,914
<b>Current Liabilities</b>	<b>39,252</b>	<b>47,143</b>	<b>44,369</b>	<b>49,391</b>	<b>53,802</b>
Creditors	19,888	25,889	26,765	31,077	34,660
Other Liabilities	16,107	15,560	13,059	13,059	13,059
Provisions	3,257	5,694	4,546	5,254	6,083
<b>Net Current Assets</b>	<b>68,603</b>	<b>59,476</b>	<b>73,587</b>	<b>93,437</b>	<b>122,027</b>
<b>Appl. Of fund</b>	<b>186,996</b>	<b>218,930</b>	<b>235,511</b>	<b>256,123</b>	<b>281,449</b>

Source: Jefferies estimates, company data

**Exhibit 10: Cash Flow Statement**

(Rs mn)	2016	2017	2018E	2019E	2020E
PAT	22,607	25,575	19,506	24,247	29,789
Depreciation	4,871	9,122	10,531	12,237	13,264
Interest Exp	595	1,525	1,627	1,627	1,627
Other Income	1,852	1,065	2,400	2,150	2,492
Change in Wkg Capital	-34,551	-8,221	-3,098	-11,311	-10,234
<b>CF from Op Activities</b>	<b>-11,420</b>	<b>41,346</b>	<b>26,166</b>	<b>24,649</b>	<b>31,955</b>
Change in Fixed Assets	-69,623	-26,588	-13,000	-13,000	-10,000
Change in Investments	16,421	-21,198	0	0	0
Other Income	1,852	1,065	2,400	2,150	2,492
<b>CF from Investing Activities</b>	<b>-51,351</b>	<b>-46,721</b>	<b>-10,600</b>	<b>-10,850</b>	<b>-7,508</b>
Change in equity	82	0	0	0	0
Changes in debt	66,404	7,886	0	0	0
Interest Exp	-595	-1,525	-1,627	-1,627	-1,627
Dividend paid	-3,379	-4,064	-2,916	-3,624	-4,453
Others	3,663	1,917	-10	-10	-10
<b>CF from Financing Activities</b>	<b>66,175</b>	<b>4,214</b>	<b>-4,553</b>	<b>-5,262</b>	<b>-6,090</b>
<b>Net change in Cash</b>	<b>3,404</b>	<b>-1,162</b>	<b>11,014</b>	<b>8,538</b>	<b>18,356</b>

Source: Jefferies estimates, company data

**Exhibit 11: Key Ratios**

	2016	2017	2018E	2019E	2020E
<b>Basic (Rs)</b>					
EPS	50.2	60.1	43.2	53.7	66.0
BPS	247.8	298.9	335.6	381.3	437.4
DPS	7.5	7.5	6.5	8.0	9.9
Payout (%)	14.9	12.5	14.9	14.9	14.9
<b>Valuation (X)</b>					
P/E	19.7	16.4	22.8	18.4	14.9
P/B	4.0	3.3	2.9	2.6	2.3
EV/EBITDA	11.9	9.4	12.0	9.8	8.3
EV/Sales	3.1	2.5	2.6	2.2	2.0
Dividend Yield (%)	0.8	0.8	0.7	0.8	1.0
<b>Profit Ratios (%)</b>					
RoE	20.3	20.1	12.9	14.1	15.1
RoCE	12.2	13.0	8.7	10.4	12.3
<b>Turnover Ratios</b>					
Debtor Days	116	90	90	86	86
Inventory Days	276	266	264	264	264
Creditor Days	86	95	95	95	95
Net Debt to Equity	0.6	0.4	0.3	0.2	0.1

Source: Jefferies estimates, company data

## Company Description

Lupin is an global pharmaceutical company. It has presence in 70 countries with its major markets being India, US, Japan and South Africa. In USA it has presence both in branded and generic markets.

## Analyst Certification:

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## Investment Recommendation Record

### (Article 3(1)e and Article 7 of MAR)

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Recommendation Distributed , 10:49 ET. August 3, 2017

## Company Specific Disclosures

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## Explanation of Jefferies Ratings

Buy - Describes securities that we expect to provide a total return (price appreciation plus yield) of 15% or more within a 12-month period.

Hold - Describes securities that we expect to provide a total return (price appreciation plus yield) of plus 15% or minus 10% within a 12-month period.

Underperform - Describes securities that we expect to provide a total return (price appreciation plus yield) of minus 10% or less within a 12-month period.

The expected total return (price appreciation plus yield) for Buy rated securities with an average security price consistently below \$10 is 20% or more within a 12-month period as these companies are typically more volatile than the overall stock market. For Hold rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is plus or minus 20% within a 12-month period. For Underperform rated securities with an average security price consistently below \$10, the expected total return (price appreciation plus yield) is minus 20% or less within a 12-month period.

NR - The investment rating and price target have been temporarily suspended. Such suspensions are in compliance with applicable regulations and/or Jefferies policies.

CS - Coverage Suspended. Jefferies has suspended coverage of this company.

NC - Not covered. Jefferies does not cover this company.

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Jefferies' methodology for assigning ratings may include the following: market capitalization, maturity, growth/value, volatility and expected total return over the next 12 months. The price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow (DCF), EBITDA, EPS, cash flow (CF), free cash flow (FCF), EV/EBITDA, P/E, PE/growth, P/CF, P/FCF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of the parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

### Jefferies Franchise Picks

Jefferies Franchise Picks include stock selections from among the best stock ideas from our equity analysts over a 12 month period. Stock selection is based on fundamental analysis and may take into account other factors such as analyst conviction, differentiated analysis, a favorable risk/reward ratio and investment themes that Jefferies analysts are recommending. Jefferies Franchise Picks will include only Buy rated stocks and the number can vary depending on analyst recommendations for inclusion. Stocks will be added as new opportunities arise and removed when the reason for inclusion changes, the stock has met its desired return, if it is no longer rated Buy and/or if it triggers a stop loss. Stocks having 120 day volatility in the bottom quartile of S&P stocks will continue to have a 15% stop loss, and the remainder will have a 20% stop. Franchise Picks are not intended to represent a recommended portfolio of stocks and is not sector based, but we may note where we believe a Pick falls within an investment style such as growth or value.

## Risks which may impede the achievement of our Price Target



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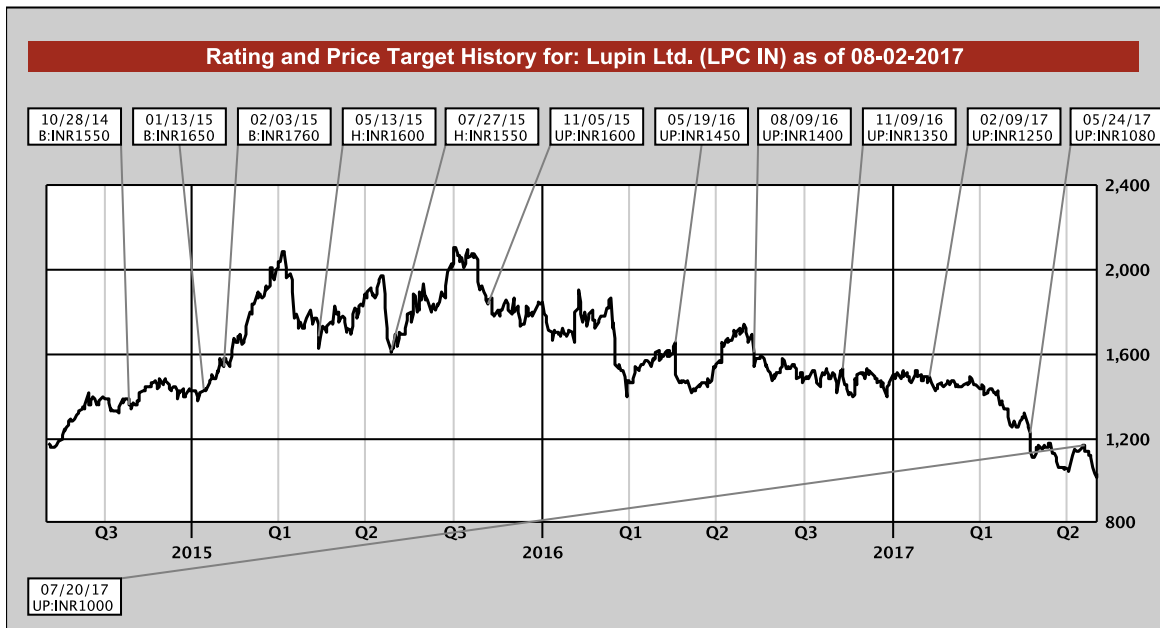
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**Other Companies Mentioned in This Report**

- Aurobindo Pharma (ARBP IN: INR741.35, BUY)
- Cipla (CIPLA IN: INR557.15, HOLD)
- Dr. Reddy's Laboratories (DRRD IN: INR2,323.95, UNDERPERFORM)
- Natco Pharma Limited (NTCPH IN: INR968.65, BUY)
- Strides Arcolab Ltd (STR IN: INR1,016.05, BUY)
- Sun Pharmaceutical Industries Ltd (SUNP IN: INR515.85, HOLD)



**Notes:** Each box in the Rating and Price Target History chart above represents actions over the past three years in which an analyst initiated on a company, made a change to a rating or price target of a company or discontinued coverage of a company.

Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

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**Distribution of Ratings**

Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY	1092	50.79%	336	30.77%
HOLD	904	42.05%	180	19.91%
UNDERPERFORM	154	7.16%	17	11.04%

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