

## Precious Shipping

Results hurt by one-off charge; profitable at core level; still one of our top picks

We maintain our positive view on the sector. We expect freight rates to improve as sector demand-supply growth returns to balance with potential supply shortage in 2015-16, driving earnings recovery. PSL provides a low-risk play. Its counter-cyclical strategy to acquire cheap vessels should provide a significant cost advantage over peers.

- Turned loss-making in 2Q14 due to absence of novation gains this quarter; profitable at the recurring level:** Net loss was Bt53MM vs net profit of Bt161MM in 2Q13 and Bt140MM in 1Q14. Net margin fell 19ppts y/y, 17ppts q/q to negative 4.7%. Net profit includes one-time write-off of Bt75MM for the upfront fees paid earlier on Credit Facilities obtained by PSL to finance second hand vessels, which are no longer required and hence cancelled. Excluding this, PSL booked a recurring profit of Bt22MM compared to recurring loss of Bt106MM in 2Q13 but 81% lower q/q. Recurring profit margin was 1.9%, 11ppts higher y/y. **This resulted in 1H14 net profit of Bt87MM, 80% lower y/y, and recurring profit of Bt136MM vs the recurring loss of Bt239MM in 1H13.** Annualized recurring ROE was 1.8% vs 2.8% in 2013.
- Key 2Q14 highlights:** Net vessel operating income rose 30% y/y but fell 4% q/q to Bt989MM. The average earnings per day per vessel rose 16% y/y but fell 6% q/q in 2Q14 to US\$8,687 driven by higher freight rates and higher number of vessels during 2Q14 (43 vs 39 2Q13). Opex rose 5% y/y to US\$4,769 in 2Q14, driven by higher number of vessels. Op profit fell 50% y/y, 47% q/q to Bt125MM. OP margin fell 11ppts y/y, 10ppts q/q to 11.2%. Net debt-equity rose 9ppts q/q to 53% in end June 2014 but remains lower than the sector average. June-14 BV/share fell 1% y/y to c.Bt14.75. Interim DPS Bt0.10 (based on 1Q14 results), steady y/y implying a yield of 0.4%.
- Substantial earnings upside when rates recover:** PSL's current and forward four year (2014 to 2017) rolling book is at 16% with a visible revenue stream of \$167MM as at 30th June 2014. Fixed 36% of revenue days in 2014 (contract value \$60MM), 14% in 2015 (\$36MM), and 10% from 2016 to 2017 (\$35MM) which provide substantial upside when rates recover. Mgmt said "it will commence employing (its) strategy to lock in longer term contracts in the near future once the Market starts to clearly move in an upward direction".

## Overweight

PSL.BK, PSL TB

Price: Bt23.00

▼ **Price Target: Bt27.00**  
Previous: Bt29.00

### Thailand

#### Transportation

Corrine Png <sup>AC</sup>

(65) 6882-1514

corrine.ht.png@jpmorgan.com

Bloomberg JPMA PNG <GO>

J.P. Morgan Securities (Asia Pacific) Limited

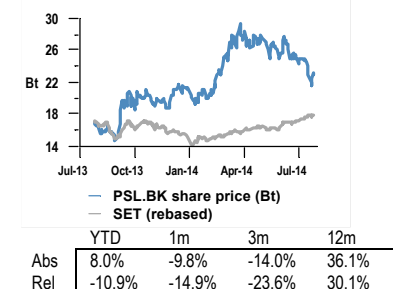
Anne Jirajariyavech, CFA

(66-2) 684-2684

anne.x.jirajariyavech@jpmorgan.com

JPMorgan Securities (Thailand) Limited

#### Price Performance



#### Precious Shipping (Reuters: PSL.BK, Bloomberg: PSL TB)

Bt in mn, year-end Dec	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue (Bt mn)	3,828	4,829	5,097	7,110	9,934
Net Profit (Bt mn)	141	528	487	1,475	2,568
EPS (Bt)	0.14	0.51	0.47	1.42	2.47
DPS (Bt)	0.40	0.40	0.40	0.40	0.40
Revenue growth (%)	11.5%	26.1%	5.6%	39.5%	39.7%
EPS growth (%)	(80.4%)	274.2%	(7.7%)	202.7%	74.1%
ROCE	1.2%	0.2%	3.9%	7.2%	10.1%
ROE	0.9%	3.5%	3.1%	9.1%	14.4%
P/E (x)	169.5	45.3	49.1	16.2	9.3
P/BV (x)	1.7	1.5	1.5	1.4	1.3
EV/EBITDA (x)	26.1	25.8	13.7	9.1	6.6
Dividend Yield	1.7%	1.7%	1.7%	1.7%	1.7%

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

#### Company Data

Shares O/S (mn)	1,040
Market Cap (Bt mn)	23,909
Market Cap (\$ mn)	751
Price (Bt)	23.00
Date Of Price	25 Jul 14
Free Float(%)	29.5%
3M - Avg daily vol (mn)	1.98
3M - Avg daily val (Bt mn)	49.14
3M - Avg daily val (\$ mn)	1.5
SET	1543.85
Exchange Rate	31.84
Price Target End Date	30-Jun-15

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

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<p><b>Key catalysts for the stock price:</b> Vessel delivery deferrals, locked-in long term time charters, stable management team, limited asset impairment risks.</p>	<p><b>Upside risks to our view:</b> Rebound in dry bulk shipping volumes and freight rates, Handysize segment faces less industry oversupply than the larger vessel segments, stronger balance sheet versus peers.</p>	<p><b>Downside risks to our view:</b> Longer-than-expected industry overcapacity, weaker-than-expected global dry bulk shipping demand, counter-party risks, political risks.</p>
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Key financial metrics	FY13A	FY14E	FY15E	FY16E
Revenues (Bt MM)	4,829	5,097	7,110	9,934
Revenue growth (%)	26.1%	5.6%	39.5%	39.7%
EBITDA (Bt MM)	2,108	2,444	3,741	5,178
EBITDA margin (%)	43.7%	47.9%	52.6%	52.1%
Tax rate (%)	1.5%	1.5%	1.5%	1.5%
Net profit (Bt MM)	528	487	1,475	2,568
EPS (Bt)	0.51	0.47	1.42	2.47
EPS growth (%)	4.8%	28.3%	40.3%	39.7%
DPS (Bt)	0.40	0.40	0.40	0.40
BVPS (Bt)	15.03	15.10	16.12	18.19
Operating cash flow (Bt MM)	1,013	2,366	3,253	4,484
Free cash flow (Bt MM)	2,213	(2,489)	(524)	488
Interest cover (x)	2.6	3.9	5.6	6.8
Net margin (%)	10.9%	9.6%	20.7%	25.8%
Sales/assets (X)	0.2	0.2	0.2	0.3
Debt/equity (%)	59.3%	78.1%	85.0%	85.7%
Net debt/equity (%)	40.5%	58.8%	60.7%	53.4%
ROE (%)	3.5%	3.1%	9.1%	14.4%
Key model assumptions	FY13A	FY14E	FY15E	FY16E
Average TC Rate (US\$/Day)	7,508	8,409	9,670	10,637
Revenue Days	16,723	18,396	22,443	28,502

Source: Company and J.P. Morgan estimates.

Sensitivity analysis	EBIT	EPS
Sensitivity to	FY14E	FY14E
1% chg in Average TC rate (US\$/day)	+/-3%	+/-3%
1% chg in Revenue days	+/-2%	+/-2%

Source: J.P. Morgan estimates.

**Comparative metrics**

	CMP LC	Mkt Cap \$Mn	P/E (x)		P/BV (x)		ROE		YTD Stock perf.
			FY14E	FY15E	FY14E	FY15E	FY14E	FY15E	
Pacific Basin Shipping	4.64	1,160	nm	12.0	0.9	0.9	(3.7)	8.1	-16.4
Precious Shipping	23.00	751	49.1	16.2	1.5	1.4	3.1	9.1	8.0
<b>Sector Average</b>			<b>29.4</b>	<b>19.6</b>	<b>1.0</b>	<b>0.9</b>	<b>1.9</b>	<b>5.8</b>	<b>-2.0</b>

Source: Bloomberg, J.P. Morgan estimates. Prices are as of 25th July, 2014.

**Valuation and price target basis**

Our Jun-15 price target of Bt27 is based on 1.7x P/BV, in line with PSL's historical average valuation since listing as we expect the industry's demand-supply growth balance to improve, driving a significant earnings recovery in the next 2 years.

**P/BV Trading Range Since Listing**



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

**JPMe vs. Consensus estimates, change in estimates**

EPS (Bt)	FY14E	FY15E
JPMe old	0.58	1.60
JPMe new	0.47	1.42
% chg	-19%	-11%
Bloomberg	0.61	1.28

Source: Bloomberg, J.P. Morgan.

## 2Q14 Results Review

### **Turned loss making in 2Q14 due to absence of novation gains this quarter; profitable at the recurring level**

PSL turned loss making in 2Q14 reporting net loss of Bt53MM vs net profit of Bt161MM in 2Q13 and Bt140MM in 1Q14. Net margin fell 19ppts y/y, 17ppts q/q to negative 4.7%. Net profit includes one-time write-off of Bt75MM of the upfront fees paid earlier on Credit Facilities obtained by PSL to finance second hand vessels, which are no longer required and hence cancelled.

Excluding this, PSL turned profitable in 2Q14 reporting recurring profit of Bt22MM compared to recurring loss of Bt106MM in 2Q13 but 81% lower q/q. Recurring profit margin was 1.9%, 11ppts higher y/y.

This resulted in 1H14 net profit of Bt87MM, 80% lower y/y and recurring profit of Bt136MM vs recurring loss of Bt239MM in 1H13. Annualized recurring ROE was 1.8% vs 2.8% in 2013.

Balance sheet remains healthy. Net debt-equity rose 9ppts q/q to 53% at the end of June 2014 but remains lower than sector average. June-14 BV/share fell 1% y/y to c.Bt14.75. Interim DPS Bt0.10 (based on 1Q14 results), steady y/y implying a yield of 0.4%.

### **Key 2Q14 highlights**

Net vessel operating income (vessel operating income net of voyage disbursements and bunker consumption) rose 30% y/y but fell 4% q/q to Bt989MM.

The average earnings per day per vessel rose 16% y/y but fell 6% q/q in 2Q14 to US\$8,687 driven by higher freight rates and higher number of vessels during 2Q14 (43 vs 39 2Q13). Opex rose 5% y/y to US\$4,769 in 2Q14 driven by higher number of vessels. Operating profit fell 50% y/y, 47% q/q to Bt125MM. Operating margin fell 11ppts y/y, 10ppts q/q to 11.2%.

### **Substantial earnings upside when rates recover**

PSL's current and forward four year (2014 to 2017) rolling book is at 16% with a visible revenue stream of \$167MM as at 30th June 2014. Fixed 36% of revenue days in 2014 (contract value \$60MM), 14% in 2015 (\$36MM), and 10% from 2016 to 2017 (\$35MM) which provide substantial upside when rates recover. Management commented that "it will commence employing (its) strategy to lock in longer term contracts in the near future once the Market starts to clearly move in an upward direction".

### **Stay OW**

We reduce our FY14-16 earnings forecasts, mainly to factor in more conservative time-charter rates assumptions following the recent pullback in spot market freight rates and the one-time write-off of the upfront fees paid. Notwithstanding this, we still expect PSL's recurring earnings to rebound significantly as the industry demand-supply growth balance improves, particularly in the smaller vessel segment, after six years of industry oversupply.

Consequently, we trim our Jun-15 price target to Bt27 (from Bt29) which is still based on 1.7x P/BV, in line with PSL's historical average valuation since listing as we expect the industry's demand-supply growth balance to improve, driving a significant earnings recovery in the next two years.

We maintain our positive view on the sector and continue to favor the small bulkcarrier segment. We expect average freight rates in 2014 to surpass 2013 levels as sector demand-supply growth returns to balance with potential supply shortage in 2015, driving earnings recovery. PSL provides a low-risk play on the sector recovery, given its cost-efficient fleet and strong balance sheet. PSL's counter-cyclical strategy to acquire cheap vessels should provide a significant cost advantage over peers and substantial profit upside from future disposals. Our preferred play is the Handysize segment as it has the lowest order book-to-fleet ratio and highest scrap rate and PSL remains one of our top picks on this theme, along with Pacific Basin Shipping.

**Key positive drivers:** rebound in dry bulk shipping volumes and freight rates, vessel delivery deferrals, locked-in long term time charters, Handysize segment faces less industry oversupply than the larger vessel segments, stable management team, stronger balance sheet versus peers, limited asset impairment risks.

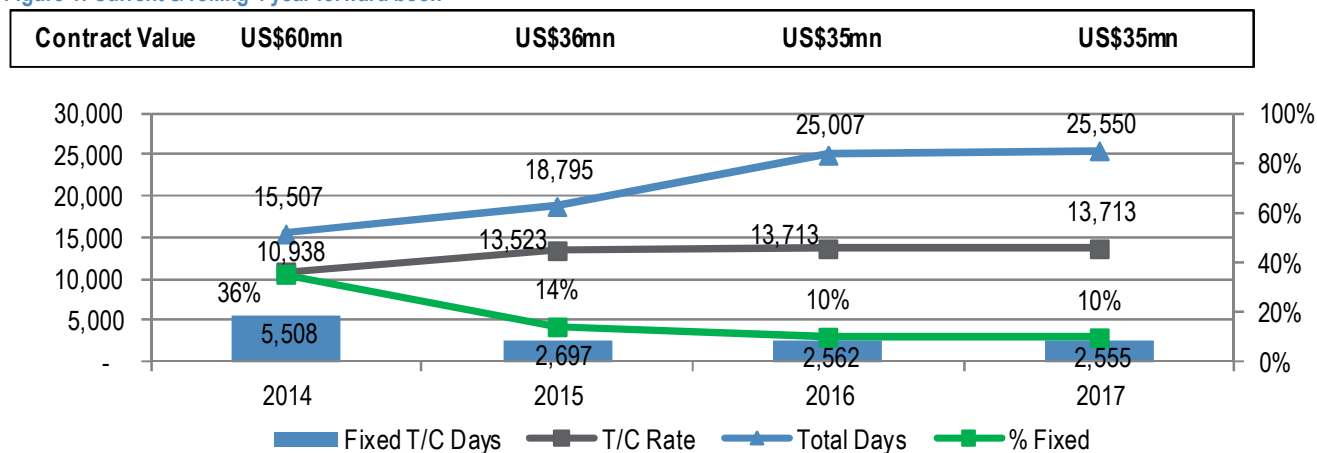
**Key risks:** longer-than-expected industry overcapacity, weaker-than-expected global dry bulk shipping demand, counter-party risks, political risks.

Table 1: Precious Shipping 2Q14 & 1H14 Results Review

	2Q14	2Q13	Y/Y Chg	1Q14	Q/Q Chg	1H14	1H13	Y/Y Chg
<b>Revenues</b>								
<b>Vessel operating income</b>								
Hire income	887	674	32%	894	-1%	1,781	1,246	43%
Freight income	227	209	9%	225	1%	451	516	-12%
<b>Total vessel operating income</b>	<b>1,113</b>	<b>882</b>	<b>26%</b>	<b>1,119</b>	<b>-1%</b>	<b>2,233</b>	<b>1,761</b>	<b>27%</b>
Service income	1	1	-46%	3	-70%	3	6	-48%
Gains on sale of vessels/sale of new shipbuildings under Novation Agreements	-	260	-100%	27	-100%	27	673	-96%
Interest income	3	2	27%	1	145%	4	4	3%
Exchange gains	0	7	-95%	-	nm	0	4	-90%
Other income	0	1	-99%	0	-70%	0	1	-97%
<b>Total Revenues</b>	<b>1,117</b>	<b>1,154</b>	<b>-3%</b>	<b>1,150</b>	<b>-3%</b>	<b>2,268</b>	<b>2,449</b>	<b>-7%</b>
<b>Expenses</b>								
<b>Vessel operating costs</b>								
Vessel running expenses	487	403	21%	451	8%	938	767	22%
Voyage disbursements	37	35	7%	30	23%	67	83	-20%
Bunker consumption	87	88	-1%	64	36%	151	255	-41%
<b>Total vessel operating costs</b>	<b>611</b>	<b>526</b>	<b>16%</b>	<b>545</b>	<b>12%</b>	<b>1,156</b>	<b>1,105</b>	<b>5%</b>
Depreciation	302	278	8%	297	2%	599	531	13%
Cost of services	2	2	10%	1	111%	3	3	0%
Administrative expenses	51	61	-17%	46	11%	97	116	-16%
Management remuneration including perquisites	27	31	-14%	21	25%	48	57	-16%
Bad debts and doubtful accounts	(0)	3	nm	0	nm	(0)	(11)	-99%
Exchange losses	-	-	-	2	nm	2	-	nm
<b>Total Expenses</b>	<b>992</b>	<b>901</b>	<b>10%</b>	<b>912</b>	<b>9%</b>	<b>1,904</b>	<b>1,800</b>	<b>6%</b>
<b>EBIT</b>	<b>125</b>	<b>253</b>	<b>-50%</b>	<b>238</b>	<b>-47%</b>	<b>364</b>	<b>649</b>	<b>-44%</b>
<b>Margin</b>	<b>11.2%</b>	<b>21.9%</b>	<b>-10.7ppt</b>	<b>20.7%</b>	<b>-9.5ppt</b>	<b>16.0%</b>	<b>26.5%</b>	<b>-10.5ppt</b>
Share of income from investment in associate held by a subsidiary	2	12	-86%	0	975%	2	17	-89%
Finance cost	(180)	(103)	75%	(104)	73%	(284)	(228)	25%
<b>PBT</b>	<b>(53)</b>	<b>162</b>	<b>-132%</b>	<b>135</b>	<b>nm</b>	<b>82</b>	<b>439</b>	<b>-81%</b>
Corporate income tax	0	(1)	nm	3	-100%	3	(1)	nm
<b>Net Profit</b>	<b>(53)</b>	<b>161</b>	<b>nm</b>	<b>138</b>	<b>nm</b>	<b>85</b>	<b>438</b>	<b>-81%</b>
Profit attributable to:								
<b>Equity holders of the Company</b>	<b>(53)</b>	<b>161</b>	<b>nm</b>	<b>140</b>	<b>nm</b>	<b>87</b>	<b>438</b>	<b>-80%</b>
<b>Margin</b>	<b>-4.7%</b>	<b>14.0%</b>	<b>-18.7ppt</b>	<b>12.1%</b>	<b>-16.9ppt</b>	<b>3.8%</b>	<b>17.9%</b>	<b>-14.0ppt</b>
Non-controlling interests of the subsidiaries	0	0	-70%	(2)	nm	(2)	0	nm
<b>Basic earnings per share (baht)</b>	<b>(0.05)</b>	<b>0.16</b>	<b>-133%</b>	<b>0.13</b>	<b>nm</b>	<b>0.08</b>	<b>0.42</b>	<b>-80%</b>

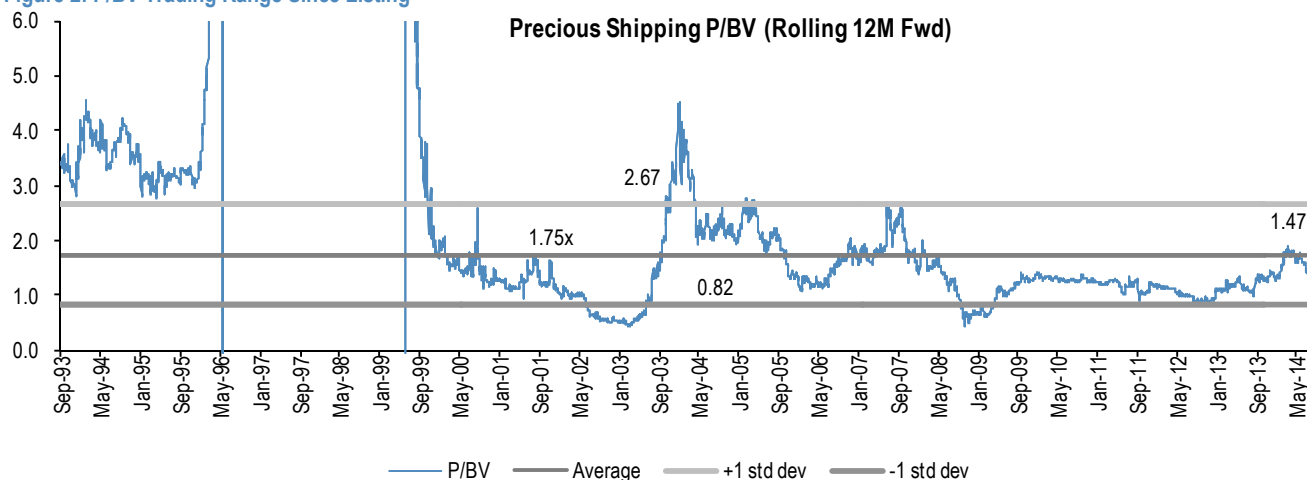
Source: Company reports.

Figure 1: Current & rolling 4 year forward book



Source: Company reports. As at 31 March, 2014.

Figure 2: P/BV Trading Range Since Listing



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

## Investment Thesis, Valuation and Risks

### Precious Shipping (Overweight; Price Target: Bt27.00)

#### Investment Thesis

We maintain our positive view on the sector and continue to favor the small bulkcarrier segment. We expect average freight rates in 2014 to surpass 2013 levels as sector demand-supply growth returns to balance with potential supply shortage in 2015, driving an earnings recovery. We believe PSL provides a low-risk play on the sector recovery, given its cost-efficient fleet and strong balance sheet. PSL's counter-cyclical strategy to acquire cheap vessels should provide a significant cost advantage over peers and substantial profit upside from future disposals.

#### Valuation

Our Jun-15 price target of Bt27 is based on 1.7x P/BV, in line with PSL's historical average valuation since listing, as we expect the industry's demand-supply growth balance to improve, driving a significant earnings recovery in the next two years.

#### Risks to Rating and Price Target

**Key downside risks:** Longer-than-expected industry overcapacity, weaker-than-expected global dry bulk shipping demand, counter-party risks, political risks.

## Precious Shipping: Summary of Financials

Income Statement						Cash flow statement					
Bt in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	Bt in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenues	3,828	4,829	5,097	7,110	9,934	EBIT	584	972	1,086	2,156	3,383
% change Y/Y	11.5%	26.1%	5.6%	39.5%	39.7%	Depr. & amortization	920	1,146	1,357	1,585	1,795
EBITDA	1,494	2,108	2,444	3,741	5,178	Change in working capital	(320)	(63)	(61)	(454)	(637)
% change Y/Y	(19.9%)	(1.3%)	106.1%	54.8%	38.4%	Taxes	-	-	-	-	-
EBIT	584	972	1,086	2,156	3,383	Cash flow from operations	751	1,013	2,366	3,253	4,484
% change Y/Y	(49.6%)	66.4%	11.8%	98.4%	56.9%	Capex	(6,285)	(3,125)	(4,251)	(3,251)	(3,251)
EBIT Margin	7.3%	0.7%	20.8%	30.3%	34.1%	Disposal/(purchase)	1,729	4,709	0	126	0
Net Interest	(434)	(459)	(614)	(664)	(764)	Net Interest	(434)	(459)	(614)	(664)	(764)
Earnings before tax	148	545	503	1,522	2,649	Other	19	31	(604)	(652)	(745)
% change Y/Y	(79.6%)	268.4%	(7.7%)	202.7%	74.1%	Free cash flow	(3,786)	2,213	(2,489)	(524)	488
Tax	(4)	(8)	(7)	(22)	(38)	Equity raised/(repaid)	-	-	-	-	-
as % of EBT	2.8%	1.5%	1.5%	1.5%	1.5%	Debt raised/(repaid)	2,285	(558)	3,000	2,000	2,000
Net income (reported)	141	528	487	1,475	2,568	Other	(387)	(316)	0	0	0
% change Y/Y	(80.4%)	274.2%	(7.7%)	202.7%	74.1%	Dividends paid	(468)	(415)	(416)	(416)	(416)
Shares outstanding	1,040	1,040	1,040	1,040	1,040	Beginning cash	4,375	1,901	2,942	3,037	4,097
EPS (reported)	0.14	0.51	0.47	1.42	2.47	Ending cash	1,901	2,942	3,037	4,097	6,168
% change Y/Y	(80.4%)	274.2%	(7.7%)	202.7%	74.1%	DPS	0.40	0.40	0.40	0.40	0.40
Balance sheet						Ratio Analysis					
Bt in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E	Bt in millions, year end Dec	FY12	FY13	FY14E	FY15E	FY16E
Cash and cash equivalents	1,901	2,942	3,037	4,097	6,168	EBITDA margin	31.1%	24.3%	47.4%	52.6%	52.1%
Accounts receivable	217	1,074	1,134	1,581	2,209	Operating margin	7.3%	0.7%	20.8%	30.3%	34.1%
Inventories	147	102	108	151	210	Net margin	(4.3%)	(8.4%)	9.0%	20.7%	25.8%
Others	677	818	818	818	818	Sales per share growth	11.5%	26.1%	5.6%	39.5%	39.7%
Current assets	2,941	4,936	5,096	6,646	9,406	Sales growth	11.5%	26.1%	5.6%	39.5%	39.7%
LT investments	8	9	9	9	9	Net profit growth	(80.4%)	274.2%	(7.7%)	202.7%	74.1%
Net fixed assets	16,213	18,670	21,569	23,109	24,565	EPS growth	(80.4%)	274.2%	(7.7%)	202.7%	74.1%
Total Assets	24,030	25,510	28,599	31,720	35,966	Interest coverage (x)	2.7	2.6	3.9	5.6	6.8
Liabilities						Net debt to equity	49.5%	40.5%	58.8%	60.7%	53.4%
Short-term loans	802	654	654	654	654	Sales/assets	0.2	0.2	0.2	0.2	0.3
Payables	2	22	23	32	44	Assets/equity	157.4%	164.6%	172.8%	185.9%	189.8%
Others	316	302	305	333	371	ROE	0.9%	3.5%	3.1%	9.1%	14.4%
Total current liabilities	1,119	977	982	1,018	1,069	ROCE	1.2%	0.2%	3.9%	7.2%	10.1%
Long-term debt	8,265	8,619	11,619	13,619	15,619						
Other liabilities	-	-	-	-	-						
Total Liabilities	9,545	9,879	12,884	14,920	16,971						
Shareholder's equity	14,484	15,631	15,716	16,800	18,995						
BVPS (Bt)	13.93	15.03	15.10	16.12	18.19						

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

**Other Companies Discussed in This Report** (all prices in this report as of market close on 25 July 2014)  
 Pacific Basin Shipping (2343.HK/HK\$4.64/Overweight)

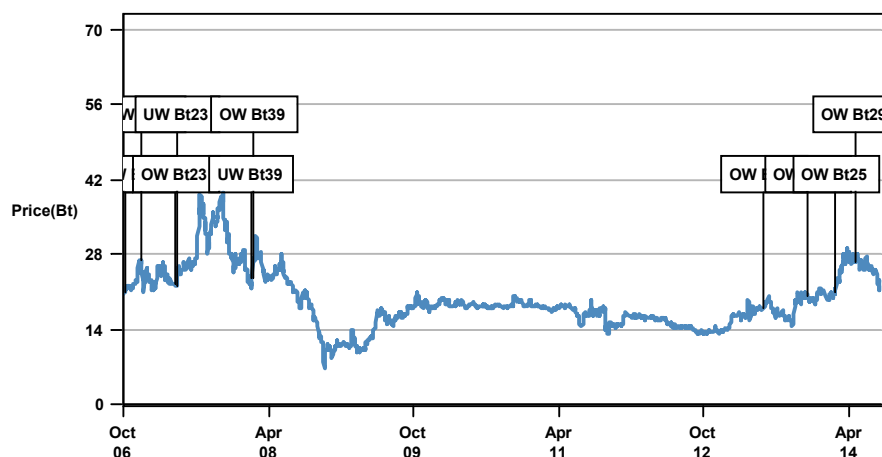
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Precious Shipping (PSL.BK, PSL TB) Price Chart

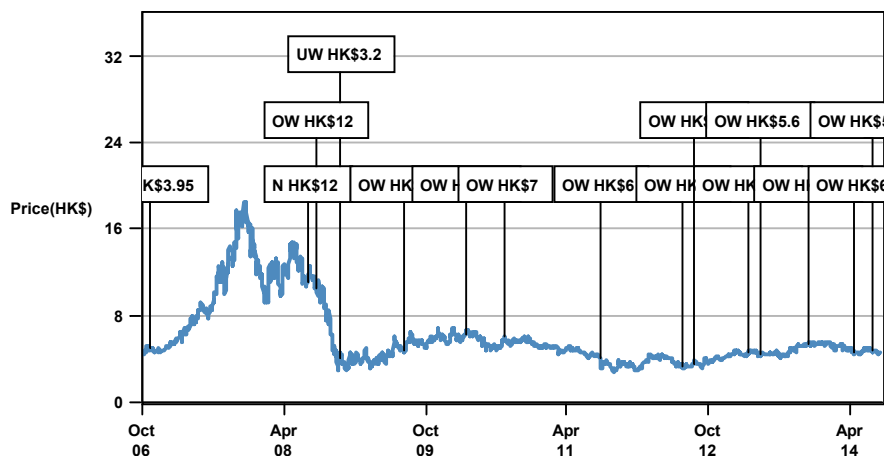


Date	Rating	Share Price (Bt)	Price Target (Bt)
05-Oct-06	OW	21.00	50.00
07-Dec-06	OW	27.00	59.00
16-Apr-07	OW	22.40	23.00
19-Apr-07	UW	22.20	23.00
30-Jan-08	UW	23.60	39.00
31-Jan-08	OW	23.60	39.00
14-May-13	OW	17.80	22.00
28-Oct-13	OW	20.30	23.00
08-Feb-14	OW	21.00	25.00
25-Apr-14	OW	26.75	29.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Oct 05, 2006.



Pacific Basin Shipping (2343.HK, 2343 HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
02-Nov-06	UW	4.98	3.95
03-Jul-08	N	11.10	12.00
05-Aug-08	OW	10.60	12.00
05-Nov-08	UW	4.15	3.20
07-Jul-09	OW	4.78	6.30
02-Mar-10	OW	6.36	7.20
03-Aug-10	OW	6.01	7.00
03-Aug-11	OW	4.11	6.00
19-Jun-12	OW	3.25	5.00
02-Aug-12	OW	3.45	4.50
01-Mar-13	OW	4.57	5.30
18-Apr-13	OW	4.36	5.60
18-Oct-13	OW	5.43	6.50
15-Apr-14	OW	4.69	6.00
26-Jun-14	OW	4.72	5.80

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
Initiated coverage Nov 02, 2006.

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IB clients*	55%	49%	34%
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IB clients*	75%	66%	54%

\*Percentage of investment banking clients in each rating category.

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