Apparel Retail & Brands

Christian Buss
+1 212 325 9667
christian.buss@credit-suisse.com

Sara Shuler
+1 212 325 7643
sara.shuler@credit-suisse.com

Pallavi Bakshi
+1 212 538 8434
pallavi.bakshi@credit-suisse.com

Christine Lee
+1 212 538 8120
christine.lee@credit-suisse.com

Apparel Retail & Brands
Making Sense Of Softlines Following A Tumultuous Twelve Months

Approved For External

May 2017

DISCLOSURE APPENDIX AT THE BACK OF THIS REPORT CONTAINS IMPORTANT DISCLOSURES, ANALYST CERTIFICATIONS, LEGAL ENTITY DISCLOSURE AND THE STATUS OF NON-US ANALYSTS. US Disclosure: Credit Suisse does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.
Team

**Christian Buss** – christian.buss@credit-suisse.com - 212-325-9667
ThinkEquity LLC (2010-2011)
- Senior Analyst, Active and Healthy Lifestyles

Thomas Weisel Partners/Stifel Nicolaus (2006-2010)
- VP, Analyst – Hardlines Retail and Automotive

- Junior Equity Analyst – Semiconductor and Semi-Cap

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**Sara Shuler** – sara.shuler@credit-suisse.com - 212-325-7643
Alexander Wang (2012-2013)
- Senior Production Manager – Women’s and Men’s RTW

Michael Kors (2006-2012)
- Production and Merchandising Manager – Women’s Collection RTW

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**Pallavi Bakshi** – pallavi.bakshi@credit-suisse.com - 212-538-8434
University of Pennsylvania (2011-2015)
- Bachelor of Science in Economics, Concentrations in Finance and Marketing

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**Christine Lee**– christine.lee@credit-suisse.com - 212-538-8120
Columbia University (2012-2015)
- Bachelor of Science in Operations Research, Minor in Entrepreneurship and Innovation
## OUTPERFORM RATED STOCKS

<table>
<thead>
<tr>
<th>We Like These Stocks</th>
<th>Mkt. Cap.</th>
<th>Price</th>
<th>Price Target</th>
<th>FY18 P/E</th>
<th>FY18 P/E On TP</th>
<th>Upside to TP</th>
<th>FCF Yield</th>
<th>Investment Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GOOS.TO</strong></td>
<td>C$ 2,667</td>
<td>C$ 24.26</td>
<td>C$ 26</td>
<td>53.4x</td>
<td>57.2x</td>
<td>7.2%</td>
<td>1.2%</td>
<td>A unique brand in our universe which combines highly functional product with appeal to a luxury consumer, we expect long-term mid-teens topline growth and high-teens-to-low-20% EPS growth.</td>
</tr>
<tr>
<td><strong>BURL</strong></td>
<td>$6,929</td>
<td>$98.62</td>
<td>$97</td>
<td>25.9x</td>
<td>25.4x</td>
<td>(1.6%)</td>
<td>4.7%</td>
<td>A self-help story in a fundamentally well-positioned group, with levers to pull in more attractive merchandising, productivity, margin expansion, and inventory turns.</td>
</tr>
<tr>
<td><strong>NKE</strong></td>
<td>$86,612</td>
<td>$52.35</td>
<td>$67</td>
<td>19.8x</td>
<td>25.4x</td>
<td>28.0%</td>
<td>6.2%</td>
<td>Benefits from margin recapture in Europe and China, increasing DTC revenue, and longer-term retailer disintermediation are likely to lead to sustained mid-teens earnings growth.</td>
</tr>
<tr>
<td><strong>PVH</strong></td>
<td>$8,345</td>
<td>$106.98</td>
<td>$114</td>
<td>14.4x</td>
<td>15.4x</td>
<td>6.6%</td>
<td>5.7%</td>
<td>International opportunity for Calvin Klein and Tommy Hilfiger outweighs our concerns about the domestic market, suggesting teens EPS growth can be sustained.</td>
</tr>
<tr>
<td><strong>COH</strong></td>
<td>$12,952</td>
<td>$46.07</td>
<td>$55</td>
<td>19.4x</td>
<td>23.1x</td>
<td>19.4%</td>
<td>11.8%</td>
<td>Stabilization in the core Coach business (signs of return to pricing integrity and positive store comps) plus an acquisition narrative has the potential to drive sustained earnings power long-term.</td>
</tr>
<tr>
<td><strong>JWN</strong></td>
<td>$6,974</td>
<td>$41.80</td>
<td>$52</td>
<td>13.7x</td>
<td>17.0x</td>
<td>24.4%</td>
<td>6.7%</td>
<td>One of the best franchises in the retail sector, making appropriate investments in speed of execution, eCommerce, and brand access which we expect will lead to outsized earnings growth.</td>
</tr>
<tr>
<td><strong>GIL.TO</strong></td>
<td>C$ 8,782</td>
<td>C$ 38.24</td>
<td>C$ 39</td>
<td>14.9x</td>
<td>15.2x</td>
<td>2.0%</td>
<td>6.7%</td>
<td>Dominant leader in printwear with the opportunity to expand product penetration while driving growth of new branded basics apparel business (given acquisition of American Apparel brand).</td>
</tr>
<tr>
<td><strong>PLNT</strong></td>
<td>$2,113</td>
<td>$21.48</td>
<td>$26</td>
<td>23.1x</td>
<td>28.0x</td>
<td>21.0%</td>
<td>6.3%</td>
<td>We remain confident in the low-double digit top-line/ mid-teens EBITDA growth story given solid momentum in the business and significant unit growth potential for PLNT's differentiated model.</td>
</tr>
<tr>
<td><strong>HBI</strong></td>
<td>$7,392</td>
<td>$20.30</td>
<td>$28</td>
<td>9.3x</td>
<td>12.8x</td>
<td>37.9%</td>
<td>11.7%</td>
<td>Strong and steady free cash flow generator with opportunity to catalyze EPS growth via recent acquisitions (Pacific Brands, Champion Europe) and mix shift towards premium priced products.</td>
</tr>
</tbody>
</table>

Source: Company Data, Credit Suisse Estimates
# NEUTRAL RATED STOCKS

**We Could Be More Constructive On These Stocks**

<table>
<thead>
<tr>
<th>Stock</th>
<th>Market Cap.</th>
<th>Price</th>
<th>Target</th>
<th>FY18 P/E</th>
<th>Upside to TP</th>
<th>FCF Yield</th>
<th>Investment Summary</th>
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<tbody>
<tr>
<td>LB</td>
<td>$14,317</td>
<td>$50.27</td>
<td>$55</td>
<td>15.1x</td>
<td>16.5x</td>
<td>9.4%</td>
<td>5.6%</td>
</tr>
<tr>
<td>ADS</td>
<td>€ 35,812</td>
<td>€ 171</td>
<td>€ 174</td>
<td>11.9x</td>
<td>12.1x</td>
<td>1.7%</td>
<td>18.8%</td>
</tr>
<tr>
<td>VFC</td>
<td>$21,300</td>
<td>$53.19</td>
<td>$53</td>
<td>16.3x</td>
<td>16.2x</td>
<td>(0.4%)</td>
<td>6.7%</td>
</tr>
<tr>
<td>COLM</td>
<td>$3,716</td>
<td>$53.35</td>
<td>$60</td>
<td>17.3x</td>
<td>19.4x</td>
<td>12.5%</td>
<td>4.9%</td>
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</table>

We are encouraged by ramp up of international expansion and positive early signs from restructuring at VSS, but believe domestic square footage growth adds risk as consumers move online.

**We See Opportunity For These Stocks**

<table>
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We see opportunity for international and owned retail to drive margin-accretive margin growth, but we are concerned by a softening consumer landscape, increased competition, and valuation.

**We Remain On The Sidelines**

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We are encouraged by disciplined management of a mature business, low risk growth opportunities (China JV), and an innovative product cycle, but valuation and seasonal exposure give us pause.

**We Have Some Concerns About These Stocks**

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We are encouraged by ramp up of international expansion and positive early signs from restructuring at VSS, but believe domestic square footage growth adds risk as consumers move online.

**Investment Summary**

- **LB**: We are encouraged by ramp up of international expansion and positive early signs from restructuring at VSS, but believe domestic square footage growth adds risk as consumers move online.
- **ADS**: Strength in the Originals business, particularly in North America, suggests consumer demand is strong, but FX and minimal margin expansion keep us on the sidelines.
- **VFC**: We see opportunity for international and owned retail to drive margin-accretive margin growth, but we are concerned by a softening consumer landscape, increased competition, and valuation.
- **COLM**: We are encouraged by disciplined management of a mature business, low risk growth opportunities (China JV), and an innovative product cycle, but valuation and seasonal exposure give us pause.

**Source**: Company Data, Credit Suisse Estimates
## UNDERPERFORM RATED STOCKS

We Have Concerns About These Stocks

<table>
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<tr>
<th>Mkt. Cap.</th>
<th>Price</th>
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<th>Upside to TP</th>
<th>FCF Yield</th>
<th>Investment Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>UAA</td>
<td>$8,232</td>
<td>$19.49</td>
<td>$17</td>
<td>40.7x</td>
<td>35.5x</td>
<td>(12.8%)</td>
<td>-1.4%</td>
</tr>
<tr>
<td>JCP</td>
<td>$1,438</td>
<td>$4.66</td>
<td>$5</td>
<td>-19.6x</td>
<td>-21.0x</td>
<td>7.3%</td>
<td>3.0%</td>
</tr>
<tr>
<td>GPS</td>
<td>$8,813</td>
<td>$22.02</td>
<td>$23</td>
<td>11.1x</td>
<td>11.6x</td>
<td>4.5%</td>
<td>20.1%</td>
</tr>
<tr>
<td>KSS</td>
<td>$6,699</td>
<td>$38.87</td>
<td>$39</td>
<td>10.7x</td>
<td>10.7x</td>
<td>0.3%</td>
<td>13.8%</td>
</tr>
</tbody>
</table>

*Source: Company Data, Credit Suisse Estimates*
What We’ve Learned From 1Q17 Results

More Constructive
- PVH (Upgrade to Outperform)
- COH (Solid price for a tricky acquisition allows US rationalization)
- PLNT (Continued store productivity improvement)
- GIL (Branded business optionality is starting to play out)
- LB (Nearing the end of a long string of bad news)

More Concerned
- Footwear Retail Sector (DSW, FL, FINL)
  - Growth is moderating thus accelerating the point of deleverage
- Off Price (particularly TJX)
  - Sector share capture from department stores is slowing
- LULU (Pricing data suggests persistent markdown pressure)
- RL (Sales stabilization seems a long way off)
- TIF (Not participating in sector recovery)
- M (FY guidance seems aggressive)
Cyclical And Secular Headwinds Are Daunting

Cyclical Headwinds
- Consumer spending on non-durables is slowing in the United States
- Leverage is starting to pick up, putting pressure on spending in future periods
- International growth is set to moderate further, while currency headwinds persist

Secular Headwinds
- Brick and mortar traffic declines are structural
- eCommerce share shift accelerating
- “Deep Value” retailers are creating a deflationary environment for apparel
- Share capture for handbags, fashion footwear and beauty has moderated
Retail Traffic Declines Are Structural

Retail traffic declines moderated but remain down 5-7%

Source: Prodco Weekly Retail Data
eCommerce Share Capture Accelerating

- eCommerce now responsible for all of sector growth – we estimate eCommerce will reach ~40% penetration in Softlines by 2030

**Source:** US Census Bureau, Credit Suisse research
The End Result Is Likely To Be Continued Store And Mall Closing

- Store closings have accelerated, even in tier-one markets

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**Metro Market Square Footage Losses**

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</tr>
</thead>
<tbody>
<tr>
<td>Philadelphia, PA</td>
<td>1,975</td>
<td>3,081</td>
<td>2,645</td>
<td>2,795</td>
<td>2,795</td>
<td>4,442</td>
<td>6,163</td>
<td>4,442</td>
<td>3,917</td>
<td>2,480</td>
<td>2,140</td>
<td>3,084</td>
<td>5,077</td>
<td>3,084</td>
<td>5,077</td>
<td>3,084</td>
</tr>
<tr>
<td>Charlotte, NC</td>
<td>2,003</td>
<td>1,704</td>
<td>1,343</td>
<td>1,766</td>
<td>2,140</td>
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<td>2,140</td>
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<td>2,140</td>
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<td>2,140</td>
<td>1,766</td>
<td>2,140</td>
<td>1,766</td>
</tr>
<tr>
<td>Minneapolis, MN</td>
<td>4,475</td>
<td>3,081</td>
<td>2,645</td>
<td>2,795</td>
<td>2,795</td>
<td>4,442</td>
<td>6,163</td>
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<td>5,077</td>
<td>3,084</td>
<td>5,077</td>
<td>3,084</td>
</tr>
<tr>
<td>St. Louis, MO</td>
<td>1,975</td>
<td>3,081</td>
<td>2,645</td>
<td>2,795</td>
<td>2,795</td>
<td>4,442</td>
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<td>5,077</td>
<td>3,084</td>
<td>5,077</td>
<td>3,084</td>
</tr>
<tr>
<td>Des Moines, IA</td>
<td>1,975</td>
<td>3,081</td>
<td>2,645</td>
<td>2,795</td>
<td>2,795</td>
<td>4,442</td>
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</tr>
<tr>
<td>Green Bay, WI</td>
<td>1,975</td>
<td>3,081</td>
<td>2,645</td>
<td>2,795</td>
<td>2,795</td>
<td>4,442</td>
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<td>5,077</td>
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<td>3,084</td>
</tr>
<tr>
<td>Cincinnati, OH</td>
<td>1,975</td>
<td>3,081</td>
<td>2,645</td>
<td>2,795</td>
<td>2,795</td>
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<tr>
<td>Madison, WI</td>
<td>1,975</td>
<td>3,081</td>
<td>2,645</td>
<td>2,795</td>
<td>2,795</td>
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</tr>
<tr>
<td>Binghamton, NY</td>
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<td>Los Angeles, CA</td>
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</table>

Source: Company reports, Credit Suisse research, ICSC Research and PNC Real Estate Research
Fashion Apparel - The Rise Of Deep Value Retail

Off-Price has taken 700bp of market share since 2007

Within Specialty Retail – Share Continues To Shift To Fast Fashion

Specialty Retail Share Capture And Loss 2007-2015

Source: Company reports, Credit Suisse research, Thomson ONE Research Analyst
Off Price Share Capture Continues, But Pace Is Slowing

Source: Company reports, Credit Suisse research, Thomson ONE Research Analyst
4 Keys For Survival

1) Real Estate Rationalization
   - 20-25% of malls will close, fixed expenses must come down

2) eCommerce Investment
   - eCommerce will grow from 17% of industry sales to 35%-plus

3) Supply Chain Transformation
   - Deep value will grow from 25% of industry sales to 35%

4) Brands Win Over Multi-Brand Retail Selling Ubiquitous Product
   - Expect continued brand disintermediation of traditional retailers, emphasis on unique brand crucial
Key For Survival I: Real Estate Rationalization

Takeaway: We expect 20-25% of All Malls To Close Over The Next 5 Years

CS Analysis: “Most Valuable Property” and “Least Valuable Property”
Best Positioned: JWN, Worst Positioned: JCP

Source: Credit Suisse Research, Google
Key For Survival 2: Build eCommerce Expertise

Takeaway: We expect eCommerce to grow from 17% to 35%+ of industry sales

CS Analysis: Investment in mobile commerce a crucial test of company capabilities

Source: Credit Suisse Research, Google
Key For Survival 3: Drive Speed To Market

Takeaway: Deep value will grow from 25% of industry sales to 35%

CS Analysis: Off-Price Share Capture in Part Predicated On Faster Inventory Turnover Versus Department Stores
Key For Survival 3: Speed Reduces Inventory Risk Allowing Lower Prices At Similar Margin

H&M and Zara are likely passing on benefits from favorable sourcing due to their shorter lead-times.
Key For Survival 3: U.S. Retailers Are In Need Of Supply Chain Transformation

Responsive Supply Chains Can Reduce Lead Times By 6 Months

Source: Credit Suisse research
Key For Survival 4: Brand Value Wins

Takeaway: Brands with scale will disintermediate traditional multi-brand retail

**CS Analysis:** Athletic sector brand guidance implies 800bp of share capture from traditional retail accounts by 2020.

![Big 3 Athletic DTC - Wholesale Mix Shift](chart)

Source: Credit Suisse research
There Are Pockets Of Outsized Growth Potential

**Category Share Capture**
- Athletic Footwear and Apparel (NKE)
- Intimates (HBI)
- eCommerce (NKE, URBN)

**Restructuring**
- Supply chain restructuring is crucial for long-term competitiveness (RL, LULU)
- Disintermediation of 3rd party retail (NKE, VFC)

**Acquisitions**
- Share consolidation in fragmented categories (HBI, COH, possibly VFC)
Cyclical and Macroeconomic Factors
Industry Sales-Inventory Growth Exiting 4Q16 Is 0.6%; Could Benefit Retailer Gross Margin Recapture

- Vendor inventory positions are 0.1% below expected sales
- Retailer inventory positions are 3.3% below expected sales
Underlying Income Conditions Healthy But Spending Is Shifting To Durable Goods

- Personal income growth remains healthy at 3%

- Durable goods spending has been up 3-4%, non-durable goods spending growth at 3%

Source: Bureau of Economic Analysis, Credit Suisse research
End Result: Softlines Sector Spending Growth Continues To Lag

- Growth rates for the Apparel sector are well below Hardlines and even Broadlines spending

![Total Spending Growth (2010-2018)]

Source: Bureau of Economic Analysis, Credit Suisse research
Athletic Apparel and Footwear Continue To Take Share Of Global Softlines Spend

Athletic Footwear Share

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<tr>
<td>Share</td>
<td>3.7%</td>
<td>4.0%</td>
<td>4.1%</td>
<td>4.3%</td>
<td>4.7%</td>
<td>5.1%</td>
<td>5.1%</td>
<td>5.3%</td>
<td>5.7%</td>
<td>6.2%</td>
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Athletic Apparel Share

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<tbody>
<tr>
<td>Share</td>
<td>8.3%</td>
<td>8.6%</td>
<td>9.1%</td>
<td>9.4%</td>
<td>9.6%</td>
<td>9.9%</td>
<td>10.2%</td>
<td>10.6%</td>
<td>10.8%</td>
<td>11.2%</td>
<td>11.6%</td>
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Intimates is a category with relative momentum.

Category growth has been steady over the past 24 months at 4%-plus.

Global Growth Y/Y
Men's Intimate Apparel

Source: Credit Suisse estimates, Euromonitor data
Valuation
Timing Of Investment In Group Is Starting To Look More Compelling As Valuation Has Compressed Dramatically…

Softlines Index - Forward P/E Multiple(2011-2017)

Multiples for the group are at 15.4x, below the historical median of 17.9x, and down from peak of 20.6x in July 2016
Consensus Estimate Revisions For FY17, FY18 Have Moved Downwards

Consensus estimates for FY17 and FY18 have declined by ~12% over the C1Q17 reporting period
S&P Retail Index Performance

Relative Performance Of S&P Retail Index
May 2014 - May 2017

- S&P 500 Performance
- "SPSIRE Retail Index Performance"

Source: Thomson ONE Research Analyst
S&P Retail Index Performance

Relative Performance Of S&P Retail Index
YTD Performance

6.5%  
-2.7%

2017 YTD

S&P 500  S&P Select Retailing Index (SPSIRE)
Year To Date Performance

Apparel Retail & Brands YTD Performance

- COH: 32%
- PVH: 19%
- BURL: 16%
- ADSGN: 14%
- GOOS: 13%
- GIL: 12%
- TO: 11%
- TIF: 7%
- PLNT: 3%
- K: 0%
- TX: 0%
- VFC: -2%
- GPS: -4%
- ROA: -5%
- GOL: -5%
- K: -6%
- HBI: -8%
- AVERAGE: -8%
- COL: -13%
- M: -15%
- KRS: -15%
- O: -16%
- FL: -21%
- KSS: -24%
- LB: -25%
- LU: -25%
- FN: -26%
- SW: -26%
- RL: -33%
- UAA: -34%
- U: -35%
- M: -44%
- JCP: -50%
Coverage Universe Multiples

CY18 Forward P/E Multiple
Apparel Retail & Brands Coverage
**Companies Mentioned (Price as of 25-May-2017)**

Acushnet Holdings Corp. (GOLF.N, $18.66)

Adidas AG (ADS.GN, €171.12)

Burlington Stores, Inc. (BURL.N, $98.62)

Coach Inc. (COH.N, $46.57)

Columbia (COLUM.OQ, $20.35)

Finish Line Inc (FNFL.OQ, $14.67)

Faulkner, Inc. (FNLY, $53.66)

Gildan Activewear Incorporated (GILD.TO, C$38.24)

Hanesbrands Inc. (HBI.N, $20.30)

Hudson's Bay Company (HBC.TO, C$30.46)

J.C. Penney Company, Inc (JCP.N, $4.04)

Kohls Corp (KSS.N, $36.87)

L Brands, Inc. (LB.N, $60.27)

Macy's Inc. (M.N, $23.38)

Michael Kors (KORS.O, $26.63)

Nike Inc. (NKE.N, $82.56)

Nordstrom, Inc. (NORD.OQ, $53.19)

Phillips-Van Heusen (PVH.N, $106.98)

Planet Fitness, Inc. (PLNT.N, $21.48)

Ralph Lauren (RL.N, $263.52)

Ross Stores, Inc. (ROST.O, $63.03)

The Gap, Inc. (GPS.N, $20.70)

The TJX Companies, Inc. (TJX.N, $75.37)

Tiffany & Co (TIF.N, $83.82)

Under Armour, Inc. (UAA.N, $19.49)

Urban Outfitters (URBN.OQ, $18.60)

VF Corporation (VFC.N, $53.19)

With an effective range of 0-10, the security's rating is determined on a relative basis. (Please refer to definitions above.)

**Global Ratings Distribution**

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<th>Rating</th>
<th>Versus universe (%)</th>
<th>Of which banking clients (%)</th>
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<td>Outperform/BUY*</td>
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<td>[54% banking clients]</td>
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<tr>
<td>Restricted</td>
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*For purposes of the KYSE and FINRA ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively. However, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor’s decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.

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