

UBS Investment Research

Verastem

4Q Update; Pipeline Expanding by Three

■ Verastem FY11 financial results in line; 3 new chemical families identified

Verastem reported FY11 results, highlighting recent accomplishments as well as details around financial spend and guidance. The company expects to have sufficient cash to fund research and clinical programs into 2016, which allows them to own their compounds through phase II. Additionally, Verastem in-licensed three families of novel compounds from the Broad Institute, further expanding the CSC-targeted platform.

■ VS-507 well characterized from previous experience, IND on track

The IND-enabling toxicology studies for VS-507 are progressing as planned, and given the breadth of pre-clinical and *in vivo* data, the IND is shaping up to have some NDA-like qualities. What's known is extensive animal tox data from Japan, limited human exposure data, and well-known species-specific tox. Verastem is manufacturing VS-507, which will likely improve the formulation of salinomycin.

■ Thoughts: New paradigm in cancer therapy, many ways to win

Verastem highlighted the competitive landscape in targeting CSCs, with many pharma and biotech companies working in the space. However, we agree with the company's view that there are many ways to win, including [1] their proprietary scientific platform, [2] breadth of IP, [3] growing interest in the space and [4] 4 years of cash to develop compounds through phase II. Importantly, the back-up FAK compounds use different chemical scaffolding than VS-4718 and VS-5095.

■ Valuation: Buy; \$20 price target by DCF and discounted multiple on sales

We have updated our model to reflect FY11 results, which is outlined on page 2.

| Highlights (US\$m) | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|---------------------------|---------------|---------|--------|--------|--------|
| Revenues | 0 | 0 | 0 | 0 | 0 |
| EBIT (UBS) | (1) | (14) | (18) | (23) | (30) |
| Net Income (UBS) | (1) | (14) | (18) | (23) | (30) |
| EPS (UBS, US\$) | (0.92) | (10.58) | (0.82) | (1.06) | (1.17) |
| Net DPS (UBS, US\$) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Profitability & Valuation | 5-yr hist av. | 12/11 | 12/12E | 12/13E | 12/14E |
| EBIT margin % | - | - | - | - | - |
| ROIC (EBIT) % | - | >500 | >500 | >500 | >500 |
| EV/EBITDA (core) x | - | - | -7.6 | -5.7 | -3.9 |
| PE (UBS) x | - | - | NM | NM | NM |
| Net dividend yield % | - | - | 0.0 | 0.0 | 0.0 |

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.

Valuations: based on an average share price that year, (E): based on a share price of US\$11.20 on 13 Mar 2012 19:40 EDT

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Global Equity Research

Americas

Biotechnology

12-month rating **Buy**
Unchanged

12m price target **US\$20.00**
Unchanged

Price **US\$11.20**

RIC: VSTM.O BBG: VSTM US

14 March 2012

Trading data

| | |
|--------------------------|-----------------|
| 52-wk range | US\$11.70-10.82 |
| Market cap. | US\$0.22bn |
| Shares o/s | 19.2m (COM) |
| Free float | 29% |
| Avg. daily volume ('000) | 47 |
| Avg. daily value (m) | US\$0.5 |

Balance sheet data 12/12E

| | |
|----------------------|------------|
| Shareholders' equity | US\$0.09bn |
| P/BV (UBS) | 2.6x |
| Net Cash (debt) | US\$0.09bn |

Forecast returns

| | |
|-----------------------------|--------|
| Forecast price appreciation | +78.6% |
| Forecast dividend yield | 0.0% |
| Forecast stock return | +78.6% |
| Market return assumption | 5.3% |
| Forecast excess return | +73.3% |

EPS (UBS, US\$)

| | 12/12E | | 12/11 | |
|--------|--------|--------|--------|--------|
| | From | To | Cons. | Actual |
| Q1E | (0.16) | (0.20) | (0.37) | (1.69) |
| Q2E | (0.17) | (0.20) | (0.19) | (1.98) |
| Q3E | (0.17) | (0.21) | (0.20) | (2.25) |
| Q4E | (0.18) | (0.21) | (0.27) | (4.64) |
| 12/12E | (0.68) | (0.82) | (0.98) | |
| 12/13E | (0.98) | (1.06) | (1.14) | |

Performance (US\$)



Source: UBS

www.ubs.com/investmentresearch

This report has been prepared by UBS Securities LLC

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5.

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Table 1: UBS Verastem Model Changes: 2012e-2016e

| | 2012E | 2013E | 2014E | 2015E | 2016E |
|---------------------------------|-----------|----------|----------|----------|----------|
| Total revenues - New | - | - | - | 15,000 | 15,000 |
| Total revenues - Old | - | - | - | 15,000 | 15,000 |
| Change | - | - | - | - | - |
| Operating Expenses | | | | | |
| Cost of Goods Sold - New | - | - | - | - | - |
| Cost of Goods Sold - Old | - | - | - | - | - |
| Change | - | - | - | - | - |
| Research & Development - New | 13,500 | 17,550 | 23,166 | 35,212 | 38,734 |
| Research & Development - Old | 11,100.00 | 16,428 | 22,999 | 34,959 | 38,455 |
| Change | 2,400 | 1,122 | 167 | 254 | 279 |
| General & Administrative - New | 4,550 | 5,688 | 7,109 | 8,887 | 12,441 |
| General & Administrative - Old | 3,905.00 | 5,077 | 6,599 | 8,579 | 12,440 |
| Change | 645 | 611 | 510 | 307 | 1 |
| Total Operating Expenses - New | 18,050 | 23,238 | 30,275 | 44,099 | 51,175 |
| Total Operating Expenses - Old | 15,005 | 21,505 | 29,599 | 43,538 | 50,895 |
| Change | 3,045 | 1,733 | 677 | 561 | 280 |
| Operating Income - New | (18,050) | (23,238) | (30,275) | (29,099) | (36,175) |
| Operating Income - Old | (15,005) | (21,505) | (29,599) | (28,538) | (35,895) |
| Change | (3,045) | (1,733) | (677) | (561) | (280) |
| Net Income (Loss) for EPS - New | (17,582) | (22,877) | (29,654) | (27,840) | (35,230) |
| Net Income (Loss) for EPS - Old | (14,507) | (21,101) | (28,933) | (27,235) | (34,903) |
| Change | (3,075) | (1,775) | (721) | (605) | (327) |
| EPS (GAAP - diluted) - New | (\$0.82) | (\$1.06) | (\$1.17) | (\$1.09) | (\$1.37) |
| EPS (GAAP - diluted) - Old | (\$0.68) | (\$0.98) | (\$1.14) | (\$1.07) | (\$1.35) |
| Change | -\$0.14 | -\$0.08 | -\$0.03 | -\$0.02 | -\$0.01 |

Source: Company reports and UBS research

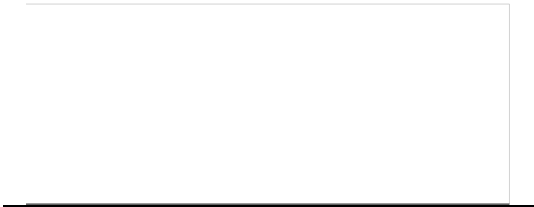
| Income statement (US\$m) | | 12/09 | 12/10 | 12/11 | 12/12E | % ch | 12/13E | % ch | 12/14E | % ch |
|---------------------------------------|---|-------|--------|---------|--------|----------|--------|-------|--------|-------|
| Revenues | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Operating expenses (ex depn) | - | - | - | - | - | - | - | - | - | - |
| EBITDA (UBS) | - | - | (1) | (14) | (18) | 31.8 | (23) | 28.7 | (30) | 30.3 |
| Depreciation | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Operating income (EBIT, UBS) | - | - | (1) | (14) | (18) | 31.8 | (23) | 28.7 | (30) | 30.3 |
| Other income & associates | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Net interest | - | - | 0 | 0 | 0 | 467900.0 | 0 | -22.9 | 1 | 72.0 |
| Abnormal items (pre-tax) | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Profit before tax | - | - | (1) | (14) | (18) | 28.4 | (23) | 30.1 | (30) | 29.6 |
| Tax | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Profit after tax | - | - | (1) | (14) | (18) | 28.4 | (23) | 30.1 | (30) | 29.6 |
| Abnormal items (post-tax) | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Minorities / pref dividends | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Net income (local GAAP) | - | - | (1) | (14) | (18) | 28.4 | (23) | 30.1 | (30) | 29.6 |
| Net Income (UBS) | - | - | (1) | (14) | (18) | 28.4 | (23) | 30.1 | (30) | 29.6 |
| | | | | | | | | | | |
| Tax rate (%) | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Pre-abnormal tax rate (%) | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| | | | | | | | | | | |
| Per share (US\$) | | 12/09 | 12/10 | 12/11 | 12/12E | % ch | 12/13E | % ch | 12/14E | % ch |
| EPS (local GAAP) | - | - | (0.92) | (10.58) | (0.82) | -92.2 | (1.06) | 28.8 | (1.17) | 10.6 |
| EPS (UBS) | - | - | (0.92) | (10.58) | (0.82) | -92.2 | (1.06) | 28.8 | (1.17) | 10.6 |
| Net DPS | - | - | 0.00 | 0.00 | 0.00 | - | 0.00 | - | 0.00 | - |
| Cash EPS | - | - | (0.92) | (10.58) | (0.82) | -92.2 | (1.06) | 28.8 | (1.17) | 10.6 |
| BVPS | - | - | 2.49 | 45.76 | 4.28 | -90.7 | 3.25 | -24.0 | 4.80 | 47.9 |
| | | | | | | | | | | |
| Balance sheet (US\$m) | | 12/09 | 12/10 | 12/11 | 12/12E | % ch | 12/13E | % ch | 12/14E | % ch |
| Cash and equivalents | - | - | 4 | 62 | 94 | 51.4 | 72 | -23.2 | 123 | 70.8 |
| Other current assets | - | - | 0 | 0 | 0 | 31.8 | 0 | 28.7 | 0 | 30.3 |
| Total current assets | - | - | 4 | 62 | 94 | 51.4 | 72 | -23.2 | 123 | 70.8 |
| Net tangible fixed assets | - | - | 0 | 1 | 1 | 104.3 | 2 | 54.5 | 3 | 39.7 |
| Net intangible fixed assets | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Investments / other assets | - | - | 0 | 0 | 0 | 19.2 | 0 | 19.2 | 0 | 21.9 |
| Total assets | - | - | 4 | 63 | 95 | 51.9 | 74 | -21.9 | 126 | 69.6 |
| Trade payables & other ST liabilities | - | - | 0 | 2 | 3 | 43.3 | 4 | 25.3 | 5 | 22.1 |
| Short term debt | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Total current liabilities | - | - | 0 | 2 | 3 | 43.3 | 4 | 25.3 | 5 | 22.1 |
| Long term debt | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Other long term liabilities | - | - | 0 | 1 | 1 | -14.1 | 1 | -34.9 | 0 | -53.5 |
| Total liabilities | - | - | 0 | 3 | 4 | 22.6 | 4 | 10.1 | 5 | 10.8 |
| Equity & minority interests | - | - | 3 | 59 | 91 | 53.5 | 70 | -23.3 | 121 | 73.4 |
| Total liabilities & equity | - | - | 4 | 63 | 95 | 51.9 | 74 | -21.9 | 126 | 69.6 |
| | | | | | | | | | | |
| Cash flow (US\$m) | | 12/09 | 12/10 | 12/11 | 12/12E | % ch | 12/13E | % ch | 12/14E | % ch |
| Net income | - | - | (1) | (14) | (18) | 28.4 | (23) | 30.1 | (30) | 29.6 |
| Depreciation | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Net change in working capital | - | - | 0 | 2 | 1 | -62.6 | 0 | -23.2 | 1 | 63.3 |
| Other (operating) | - | - | 0 | 1 | 1 | 0.0 | 1 | 0.0 | 1 | 0.0 |
| Net cash from operations | - | - | 0 | (11) | (16) | 43.0 | (22) | 33.4 | (28) | 29.9 |
| Capital expenditure | - | - | 0 | (1) | (1) | -0.5 | (1) | 6.7 | (1) | 12.5 |
| Net (acquisitions) / disposals | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Other changes in investments | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Cash from investing activities | - | - | 0 | (1) | (1) | -0.5 | (1) | 6.0 | (1) | 11.3 |
| Increase/(decrease) in debt | - | - | 4 | 60 | 0 | - | 0 | - | 0 | - |
| Share issues / (repurchases) | - | - | 0 | 0 | 57 | - | 0 | - | 79 | - |
| Dividends paid | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Other cash from financing | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Cash from financing activities | - | - | 4 | 60 | 57 | -5.6 | 0 | - | 79 | - |
| | | | | | | | | | | |
| Cash flow chge in cash & equivalents | - | - | 4 | 48 | 40 | - | (23) | - | 50 | - |
| FX / non cash items | - | - | - | 10 | (8) | - | 1 | - | 1 | 51.2 |
| Bal sheet chge in cash & equivalents | - | - | - | 58 | 32 | - | (22) | - | 51 | - |
| | | | | | | | | | | |
| Core EBITDA | - | - | (1) | (14) | (18) | 31.8 | (23) | 28.7 | (30) | 30.3 |
| Maintenance capital expenditure | - | - | 0 | (1) | (1) | -0.5 | (1) | 6.7 | (1) | 12.5 |
| Maintenance net working capital | - | - | 0 | 0 | 0 | - | 0 | - | 0 | - |
| Operating free cash flow, pre-tax | - | - | (1) | (14) | (19) | 30.1 | (24) | 27.9 | (31) | 29.7 |

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Note: For some companies, the data represents an extract of the full company accounts.

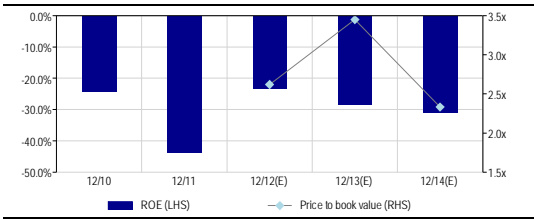
Company profile

Verastem is a Cambridge, Massachusetts-based early-stage biotechnology company focused on the discovery and development of novel small molecule drugs and companion diagnostics targeting cancer stem cells. The proprietary EMT screening platform, licensed from the Whitehead Institute at MIT, has helped select and identify the company's 3 leading candidates (VS-507, a Wnt inhibitor, and two FAK inhibitors VS-4718 and VS-5095). The company plans to begin human trials over the next 12-15 months for VS-507 and one of the two FAK inhibitors, and could be in phase II trials as early as 2015.

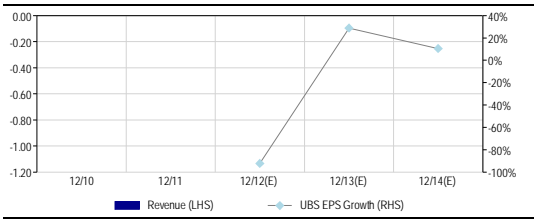
Profitability



ROE v Price to book value



Growth (UBS EPS)



| Valuation (x) | 5Yr Avg | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|-------------------------|---------|-------|-------|--------|--------|--------|
| P/E (local GAAP) | - | - | - | NM | NM | NM |
| P/E (UBS) | - | - | - | NM | NM | NM |
| P/CEPS | - | - | - | NM | NM | NM |
| Net dividend yield (%) | - | - | - | 0.0 | 0.0 | 0.0 |
| P/BV | - | - | - | 2.6 | 3.4 | 2.3 |
| EV/revenue (core) | - | - | - | - | - | - |
| EV/EBITDA (core) | - | - | - | -7.6 | -5.7 | -3.9 |
| EV/EBIT (core) | - | - | - | NM | NM | NM |
| EV/OpFCF (core) | - | - | - | NM | NM | NM |
| EV/op. invested capital | - | - | - | NM | NM | NM |

| Enterprise value (US\$m) | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|---------------------------------|-------|-------|--------|--------|--------|
| Average market cap | - | - | 215 | 215 | 215 |
| + minority interests | 0 | 0 | 0 | 0 | 0 |
| + average net debt (cash) | (4) | (33) | (78) | (83) | (97) |
| + pension obligations and other | 0 | 0 | 0 | 0 | 0 |
| - non-core asset value | 0 | 0 | 0 | 0 | 0 |
| Core enterprise value | - | - | 138 | 133 | 118 |

| Growth (%) | 5Yr Avg | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|--------------|---------|-------|-------|--------|--------|--------|
| Revenue | - | - | - | - | - | - |
| EBITDA (UBS) | - | - | NM | 31.8 | 28.7 | 30.3 |
| EBIT (UBS) | - | - | NM | 31.8 | 28.7 | 30.3 |
| EPS (UBS) | - | - | NM | -92.2 | 28.8 | 10.6 |
| Cash EPS | - | - | NM | -92.2 | 28.8 | 10.6 |
| Net DPS | - | - | - | - | - | - |
| BVPS | - | - | NM | -90.7 | -24.0 | 47.9 |

| Margins (%) | 5Yr Avg | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|----------------------------|---------|-------|-------|--------|--------|--------|
| EBITDA / revenue | - | - | - | - | - | - |
| EBIT / revenue | - | - | - | - | - | - |
| Net profit (UBS) / revenue | - | - | - | - | - | - |

| Return on capital (%) | 5Yr Avg | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|-----------------------|---------|--------|--------|--------|--------|--------|
| EBIT ROIC (UBS) | - | - | NM | NM | NM | NM |
| ROIC post tax | - | - | NM | NM | NM | NM |
| Net ROE | - | (24.2) | (43.7) | (23.3) | (28.4) | (31.0) |

| Coverage ratios (x) | 5Yr Avg | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|---------------------------------|---------|-------|-------|--------|--------|--------|
| EBIT / net interest | - | - | - | - | - | - |
| Dividend cover (UBS EPS) | - | - | - | - | - | - |
| Div. payout ratio (% , UBS EPS) | - | - | - | - | - | - |
| Net debt / EBITDA | - | 4.6 | 4.5 | 5.2 | 3.1 | 4.1 |

| Efficiency ratios (x) | 5Yr Avg | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|--------------------------------|---------|-------|-------|--------|--------|--------|
| Revenue / op. invested capital | - | - | 0.0 | 0.0 | 0.0 | 0.0 |
| Revenue / fixed assets | - | - | 0.0 | 0.0 | 0.0 | 0.0 |
| Revenue / net working capital | - | - | 0.0 | 0.0 | 0.0 | 0.0 |

| Investment ratios (x) | 5Yr Avg | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|-----------------------|---------|-------|-------|--------|--------|--------|
| OpFCF / EBIT | - | 1.0 | 1.1 | 1.0 | 1.0 | 1.0 |
| Capex / revenue (%) | - | - | - | - | - | - |
| Capex / depreciation | - | - | - | - | - | - |

| Capital structure (%) | 5Yr Avg | 12/10 | 12/11 | 12/12E | 12/13E | 12/14E |
|--------------------------------|---------|-------|-------|--------|--------|--------|
| Net debt / total equity | - | NM | NM | NM | NM | NM |
| Net debt / (net debt + equity) | - | NM | NM | NM | NM | NM |
| Net debt (core) / EV | - | - | - | (56.5) | (62.4) | (82.5) |

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement.
Valuations: based on an average share price that year, (E): based on a share price of US\$11.20 on 13 Mar 2012 19:40 EDT Market cap(E) may include forecast share issues/buybacks.

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■ Verastem

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■ Statement of Risk

We see several risks to our Buy rating on VSTM shares. We see risk to our Buy rating if VS-705, VS-4718 and/or VS-5095 have unforeseen safety, tolerability or toxicity signals or fail to yield positive phase 1b clinical results. We also see downside risk if the companion diagnostic fails to identify the appropriate population or biomarkers to better quantify benefit/risk. Finally, we see further downside risk if competition shows better data with CSC-targeting therapies, which would potentially lessen the strategic value of Verastem's assets.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers and were prepared in an independent manner, including with respect to UBS, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

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UBS Investment Research: Global Equity Rating Allocations

| UBS 12-Month Rating | Rating Category | Coverage ¹ | IB Services ² |
|-----------------------|-----------------|-----------------------|--------------------------|
| Buy | Buy | 57% | 36% |
| Neutral | Hold/Neutral | 37% | 35% |
| Sell | Sell | 7% | 17% |
| UBS Short-Term Rating | Rating Category | Coverage ³ | IB Services ⁴ |
| Buy | Buy | less than 1% | 0% |
| Sell | Sell | less than 1% | 12% |

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2011.

UBS Investment Research: Global Equity Rating Definitions

| UBS 12-Month Rating | Definition |
|-----------------------|---|
| Buy | FSR is > 6% above the MRA. |
| Neutral | FSR is between -6% and 6% of the MRA. |
| Sell | FSR is > 6% below the MRA. |
| UBS Short-Term Rating | Definition |
| Buy | Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event. |
| Sell | Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event. |

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

Equity Price Targets have an investment horizon of 12 months.

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| Company Name | Reuters | 12-mo rating | Short-term rating | Price | Price date |
|------------------------------------|---------|--------------|-------------------|-----------|-------------|
| Verastem ^{2, 4, 5, 6, 16} | VSTM.O | Buy | N/A | US\$11.00 | 14 Mar 2012 |

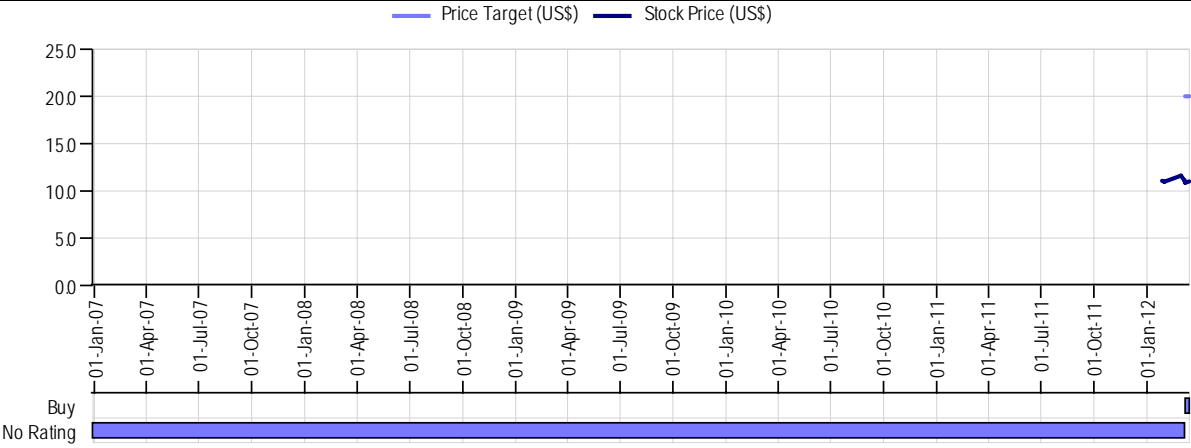
Source: UBS. All prices as of local market close.

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Verastem (US\$)



Source: UBS; as of 14 Mar 2012

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