

Upsizing the carton business

CKL set to become Australia's largest folding carton player

CKL has completed the due diligence on CHH's folding carton business and has agreed to purchase certain assets by Mar/Apr 2011. Under the agreement, CKL will acquire most of CHH's folding carton operations for \$5m while continuing to buy board from CHH on competitive terms. According to CKL, the transaction will increase group sales by \$125m and EBITDA by \$4m, making the company the largest player in the domestic folding carton segment with a market share of 30% (followed by AMC, 25%). The transaction is still subject to regulatory approvals.

Earnings accretive from year 1

We expect this debt-funded transaction to be EPS accretive by 2.3% in FY11, 7.9% in FY12 and 11.2% in FY13. The accretion is based on incremental EBITDA of ~\$3m pa from the acquired business. Note that our estimates are more conservative than CKL's. Our more cautious view is due to the highly competitive nature of the high volume, low margin food/beverage folding carton industry in Australasia – CHH's major market.

Acquisition multiples highlight CKL's disciplined approach

CKL believes it can generate an EBITDA of \$4m pa from the acquired business after paying a purchase price of only \$5m. This implies an EV/EBITDA multiple of only 1.25x. While the low multiple paid reflects the more commoditised nature of the segments where CHH operates, it also highlights CKL's strict financial discipline when making acquisitions. Importantly, the balance sheet will remain in good shape with gearing <27% and well within its debt covenants post CHH deal.

Retain Buy, PO raised to \$0.89ps

Trading well below its fundamental value (DCF of \$0.94ps), we believe the stock remains a good defensive, high-yield play with a healthy balance sheet and strong cash generation. Buy retained with a PO of \$0.89ps.

Estimates (Jun)

(A\$)	2009A	2010A	2011E	2012E	2013E
Net Profit b/f Abnormals	5.6	6.4	6.8	7.4	8.0
EPS	0.069	0.079	0.084	0.091	0.098
EPS Change (YoY)	-11.2%	15.5%	5.6%	8.7%	8.2%
Dividend / Share	0.030	0.043	0.033	0.035	0.035
Free Cash Flow / Share	0.055	0.095	0.063	0.065	0.081

Valuation (Jun)

	2009A	2010A	2011E	2012E	2013E
P/E	8.9x	7.7x	7.3x	6.7x	6.2x
Dividend Yield	4.9%	7.0%	5.3%	5.7%	5.7%
EV / EBITDA*	5.8x	5.0x	4.7x	3.9x	3.6x
Free Cash Flow Yield*	9.1%	15.7%	10.4%	10.7%	13.5%

* For full definitions of *iQmethod*SM measures, see page 7.

Merrill Lynch

A subsidiary of
Bank of America Corporation

Mario Maia, CFA >>

+61 2 9226 5766

Research Analyst
Merrill Lynch (Australia)
mario.maia@baml.com

Ramanan Sooriyakumar, CFA >>+61 2 9226 5680

Research Analyst
Merrill Lynch (Australia)
ramanan.sooriyakumar@baml.com

Stock Data

Price	A\$0.610
Price Objective	A\$0.890
Date Established	29-Dec-2010
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	A\$0.412-A\$0.685
Mkt Val / Shares Out (mn)	US\$50 / 80.5
Average Daily Volume	19,482
BofAML Ticker / Exchange	XBVVF / ASX
Bloomberg / Reuters	CKL AU / CKL.AX
ROE (2011E)	7.8%
Net Dbt to Eqty (Jun-2010A)	37.6%
Est. 5-Yr EPS / DPS Growth	3.2% / 11.2%
Free Float	68.0%

Key Changes

(A\$)	Previous	Current
Price Obj.	0.75	0.89
2012E EPS	0.08	0.09
2013E EPS	0.09	0.10
2011E EBITDA (m)	14.5	15.2
2012E EBITDA (m)	14.6	17.7
2013E EBITDA (m)	15.0	18.2

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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 6. Price Objective Basis/Risk on page 6. Link to Definitions on page 6. 11005305

29 December 2010

iQprofileSM Colorpak Ltd.

Key Income Statement Data (Jun)	2009A	2010A	2011E	2012E	2013E
(A\$ Millions)					
Sales	78	80	113	209	214
Associates & Other Revenue	1	1	1	1	1
Operating Expenses	(65)	(66)	(99)	(192)	(196)
EBITDA	13	15	15	18	18
Depreciation & Amortization	(3)	(3)	(3)	(5)	(5)
EBIT	10	12	12	13	14
Net Interest & Other income	(2)	(2)	(2)	(2)	(2)
Pretax Income	8	9	10	11	11
Tax (expense) / Benefit	(2)	(3)	(3)	(3)	(3)
Outside Equity interest in Npat	0	0	0	0	0
Preference dividends	NA	NA	NA	NA	NA
Net Profit b/f Abnormals	6	6	7	7	8
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	6	6	7	7	8

Key Cash Flow Statement Data

EBITDA	13	15	15	18	18
Change in Working Capital	1	(2)	(1)	(1)	NA
Other C'flow Items before int & tax	0	0	0	0	0
Net Interest Paid	(2)	(2)	(2)	(2)	(2)
Tax Paid	(2)	(1)	(3)	(3)	(3)
Other C'flow from Operations	0	0	0	0	0
Cash Flow from Operations	10	9	10	12	13
Capital Expenditure (PP&E)	(6)	(1)	(4)	(6)	(6)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other C'flow from Investing	0	0	0	0	0
Cash Flow from Investing	(6)	(1)	(4)	(6)	(6)
Shares Issue / (Repurchase)	0	0	0	0	0
Dividend paid	(3)	(3)	(3)	(3)	(3)
Other C'flow from Financing	(3)	(5)	4	(2)	0
Cash Flow from Financing	(6)	(7)	1	(4)	(3)
Free Cash Flow	4	8	5	5	7
Net Debt	28	23	21	18	15

Key Balance Sheet Data

Cash Equivalents	0	0	6	7	10
Receivables & Inventories	21	23	23	24	25
Property, Plant & Equipment	30	28	29	30	32
Intangibles	46	46	46	46	46
Other assets	1	1	51	51	51
Total Assets	97	97	155	158	163
Payables	8	9	9	9	9
Provisions	3	3	3	3	3
Short term debt & Long term debt	28	23	27	25	25
Other Liabilities	3	3	3	3	3
Total Liabilities	41	37	41	40	40
Total Equity	56	60	114	119	124

iQmethodSM - Bus Performance*

Return on Capital Employed	8.3%	9.4%	7.2%	6.2%	6.4%
Return on Equity	10.0%	11.0%	7.8%	6.3%	6.6%
Operating Margin	13.4%	14.5%	10.4%	6.1%	6.4%
EBITDA Margin	17.0%	18.0%	13.4%	8.4%	8.5%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.8x	1.4x	1.4x	1.6x	1.6x
Dividend Payout Ratio	43.8%	53.7%	38.9%	38.5%	35.6%
Tax Rate (Reported)	30.1%	29.9%	30.3%	30.3%	30.3%
Net Debt-to-Equity Ratio	49.4%	37.6%	18.5%	15.6%	12.4%
Interest Cover	4.2x	4.7x	5.5x	5.4x	6.0x

Key Metrics

Franking	100%	100%	100%	100%	100%
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* For full definitions of iQmethodSM measures, see page 7.

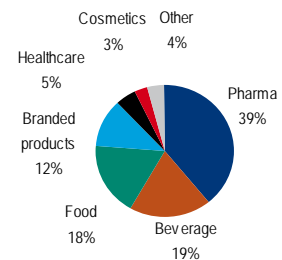
Company Description

Colorpak is a major participant in the A\$600m folding-carton segment of Australia's paper and board packaging industry. The company's products are heavily exposed to the higher margin pharmaceuticals and healthcare industries. The company is based in Melbourne, Australia.

Investment Thesis

Backed by a strong management team, which has a solid track record of sales growth and also own a significant proportion of stock, CKL should enjoy solid sales and earnings growth driven by underlying growth in key markets, continued market share gains and highly accretive acquisitions.

Chart 1: CKL revenues by segment

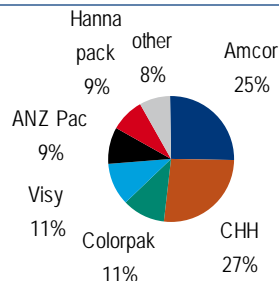


Source: Company reports (FY10)

Stock Data

Price to Book Value 0.4x

Chart 2: The acquisition of most of CHH's carton business will take CKL's carton market share from 11% to ~30%



Source: BIS shrapnel, Company reports, Merrill Lynch Research

Leadership position at a small price

CKL has completed the due diligence on CHH's folding carton business and has agreed to purchase certain assets by Mar/Apr 2011. Back in October, CKL had signed a Heads of Agreement to acquire Carter Holt Harvey's folding carton operations, subject to due diligence and regulatory approval. Under the agreement, CKL will acquire most of CHH's folding carton operations for \$5m, excluding the Smithfield business in NSW. As part of the arrangement, CKL will continue to buy board from CHH on competitive terms.

CKL will become the largest folding carton player in Australia. According to CKL, the transaction will increase group sales by \$125m and EBITDA by \$4m, making the company the largest player in the domestic folding carton segment with a market share of 30% (followed by AMC, 25%). The transaction is still subject to regulatory approvals.

Acquisition will be EPs accretive from year 1. We expect this debt-funded transaction to be EPS accretive by 2.3% in FY11, 7.9% in FY12 and 11.2% in FY13. The accretion is based on incremental EBITDA of ~\$3m pa from cost synergies related to the acquired business. Note that our estimates are more conservative than CKL's (>\$4m pa). Our more cautious view is due to the highly competitive nature of the high volume, low margin food/beverage folding carton industry in Australasia – CHH's major market. While the deal will reduce CKL's margins, this is more than reflected on the low multiple being paid for the assets.

Table 1: ML estimates adjusted for the acquisition of CHH's folding carton operations

	FY09A	FY10A	FY11E		FY12E		FY13E	
			Old	New	Old	New	Old	New
Sales	78.7	80.8	82.6	113.8	83.7	209.5	85.7	214.6
yoy chg %		3%	2%	41%	1%	84%	2%	2%
EBITDA	13.4	14.6	14.5	15.2	14.6	17.7	15.0	18.2
yoy chg %		9%	0%	5%	1%	16%	2%	3%
margin		18.0%	17.6%	13.4%	17.5%	8.4%	17.5%	8.5%
EBIT	10.4	11.6	11.4	11.8	11.6	12.7	11.9	13.6
yoy chg %		11%	-1%	2%	1%	8%	3%	7%
margin		14.3%	13.8%	10.4%	13.8%	6.1%	13.9%	6.3%
EPS (cps)	6.9	7.9	8.2	8.4	8.4	9.1	8.8	9.8
yoy chg %		15%	3%	6%	3%	9%	5%	8%

Source: Company reports, Merrill Lynch estimates

EV/EBITDA multiple of only 1.25x highlights CKL's disciplined approach to expanding the business. While the low multiple paid reflects the more commoditised nature of the segments where CHH operates, it also highlights CKL's strict financial discipline when making acquisitions. Importantly, CKL balance sheet will remain in good shape with gearing <27% and well within its debt covenants post the CHH transaction.

Other key conditions in the agreement. Under the agreement CKL will take on all the carton customers from CHH and will continue to service those using carton board purchased from CHH for a minimum of two years. CHH has also agreed to not compete with CKL in the folding carton market for a four year period, subject to certain exclusions.

Retaining our Buy recommendation, PO increased to A\$0.89ps. We have upgraded our PO to \$0.89ps (from \$0.75ps) to reflect the increased contribution from the CHH carton board acquisition. Trading well below its fundamental value (DCF of \$0.94ps, up from \$0.82ps pre deal), we believe the stock remains a good defensive, high-yield play with a healthy balance sheet and strong cash generation.

Financials

Table 2: Statement of financial performance

Year ending June (A\$m)	2009A	2010A	2011E	2012E	2013E
Trading revenue	77.8	80.2	113.2	208.9	214.0
- change	0.0%	3.0%	41.2%	84.5%	2.4%
EBITDA	13.4	14.6	15.2	17.7	18.2
- change	-6.4%	8.6%	4.7%	15.8%	2.9%
Depreciation	-3.0	-3.0	-3.4	-4.9	-4.6
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	10.4	11.6	11.8	12.7	13.6
- change	-9.3%	11.4%	1.8%	7.9%	7.0%
Net interest	-2.5	-2.5	-2.1	-2.2	-2.2
EBT	7.9	9.1	9.7	10.6	11.4
Tax expense	-2.4	-2.7	-2.9	-3.2	-3.5
OEI	0.0	0.0	0.0	0.0	0.0
NPAT att. to s/hers	5.6	6.4	6.8	7.4	8.0
- change	-10.6%	15.5%	5.7%	8.7%	8.2%
Net significant items	0.0	0.0	0.0	0.0	0.0
Reported NPAT	5.6	6.4	6.8	7.4	8.0
Norm EPS	6.9	7.9	8.4	9.1	9.8
EPS change	-11.2%	15.5%	5.6%	8.7%	8.2%
PER	8.2	7.1	7.3	6.7	6.3

Source: Company reports, Merrill Lynch estimates

Table 3: Ratios

Year ending June (A\$m)	2009A	2010A	2011E	2012E	2013E
Profitability Ratios					
EBIT margin	13.4%	14.5%	10.4%	6.1%	6.4%
NPAT margin	7.1%	8.0%	6.0%	3.5%	3.7%
Effective tax rate	30.1%	29.9%	30.3%	30.3%	30.3%
NOPLAT pre goodwill	7.3	8.1	8.2	8.9	9.5
Invested Capital	91.4	90.4	147.7	151.0	156.1
ROIC (after tax)	8.0%	9.0%	5.6%	5.9%	6.1%
ROE	10.0%	11.0%	7.8%	6.3%	6.6%
ROA	10.6%	11.9%	9.4%	8.1%	8.5%
Gearing / Cashflow Ratios					
Debt / Equity	49%	38%	24%	21%	20%
Debt / Debt+Equity	33%	27%	19%	18%	17%
Debt / EBITDA	2.1x	1.6x	1.8x	1.4x	1.4x
EBITDA / Interest	5.4x	5.9x	7.1x	7.5x	8.0x
EBIT / Interest	4.2x	4.7x	5.5x	5.4x	6.0x
Dividend cover	2.3x	1.9x	2.6x	2.6x	2.8x
Gearing (ND/ND+E)	33%	27.31%	16%	13%	11%
Multiples					
EV/EBITDA	5.7x	4.9x	4.6x	3.8x	3.5x
EV/EBIT	7.4x	6.2x	5.9x	5.3x	4.7x

Source: Company reports, Merrill Lynch estimates

Table 4: Statement of financial Position

Year ending June (A\$m)	2009A	2010E	2011E	2012E	2013E
Cash	0.0	0.0	5.7	6.8	9.9
Receivables	11.7	12.6	12.7	12.9	13.1
Inventories	8.8	10.2	10.7	11.2	11.7
Other	0.7	0.6	0.6	0.6	0.6
Current Assets	21.2	23.5	29.8	31.5	35.3
Property, Plant & Equipment	29.7	27.9	28.9	30.4	31.7
Intangibles	46.1	46.1	46.1	46.1	46.1
Other	0.0	0.0	50.0	50.0	50.0
Non-Current Assets	75.8	74.0	125.0	126.5	127.9
Total Assets	97.0	97.5	154.8	158.0	163.2
Accounts Payable	7.6	8.6	8.6	8.6	8.6
Borrowings	0.3	0.0	0.0	0.0	0.0
Provisions	1.6	1.7	1.7	1.7	1.7
Other	0.6	0.8	0.8	0.8	0.8
Current Liabilities	10.2	11.1	11.1	11.1	11.1
Borrowings	27.5	22.8	26.8	25.3	25.3
Provisions	0.9	0.9	0.9	0.9	0.9
Other	2.1	2.2	2.2	2.2	2.2
Non-Current Liabilities	30.5	25.9	29.9	28.4	28.4
Total Liabilities	40.7	37.0	41.0	39.5	39.5
Net Assets	56.3	60.4	113.8	118.5	123.6
Share Capital	39.2	39.2	39.2	39.2	39.2
Reserves	-0.9	-0.6	49.4	49.4	49.4
Retained Profits	18.0	21.8	25.1	29.9	35.0
Shareholders' Equity	56.3	60.4	113.8	118.5	123.6
Outside Equity Interests	0.0	0.0	0.0	0.0	0.0
Total Shareholders' Equity	56.3	60.4	113.8	118.5	123.6

Source: Company reports, Merrill Lynch estimates

Table 5: Statement of Cashflows

Year ending June (A\$m)	2009A	2010E	2011E	2012E	2013E
EBITDA	13.4	14.6	15.2	17.7	18.2
Working capital	1.4	-2.2	-0.6	-0.7	0.0
Net interest paid	-2.4	-2.3	-2.1	-2.2	-2.2
Tax paid	-2.4	-1.0	-2.9	-3.2	-3.5
Other	0.0	0.0	0.0	0.0	0.0
Operating cashflow	10.0	9.0	9.6	11.6	12.5
Capex	-5.6	-1.3	-4.5	-6.4	-5.9
Sale of Assets	0.0	0.0	0.0	0.0	0.0
Net investments	0.0	0.0	0.0	0.0	0.0
Acquisitions/Divestments	0.0	0.0	0.0	0.0	0.0
Investing cashflow	-5.5	-1.2	-4.5	-6.4	-5.9
Free cashflow (OCF-Capex)	4.5	7.7	5.1	5.2	6.6
Equity raisings	0.0	0.0	0.0	0.0	0.0
Dividends paid	-2.9	-2.6	-3.4	-2.6	-2.8
Net borrowings	-3.4	-4.8	4.0	-1.5	0.0
Other	0.0	0.0	0.0	0.0	0.0
Financing cashflow	-6.3	-7.4	0.6	-4.1	-2.8
Effect of exchange rate	0.0	0.0	0.0	0.0	0.0
Net change in cash	-1.8	0.4	5.7	1.1	3.8

Source: Company reports, Merrill Lynch estimates

Price objective basis & risk

Colorpak Ltd (XBVVF)

Our PO is slightly below our DCF valuation of \$0.94ps, which is based on a WACC of 10.5% and a terminal growth rate of 2.5%. Whilst we consider the DCF valuation to be the most appropriate methodology to value this company, we recognise that the stock also looks attractive on different metrics such as PER.

We apply a mid-cycle multiple for the stock of 10x, a 25% discount to the market multiple of 13.5x. In our view such discount is reasonable, given CKLs inherent liquidity/size issues and the cyclical industry it operates in.

Applying this 10x multiple to FY12E EPS of 9cps (incl 12 months of CHH), we derive a valuation for the stock of A\$0.89ps.

The risks to our recommendation are product substitution, competition, rising raw material costs, contract losses, management instability and customer attrition.

Link to Definitions

Basic Materials

Click [here](#) for definitions of commonly used terms.

Analyst Certification

I, Mario Maia, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Australia-Basic Industries Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Adelaide Brighton	ADBC	ABC AU	Ben Chan, CFA
	Amcor	AMCRF	AMC AU	Mario Maia, CFA
	Colorpak Ltd	XBVVF	CKL AU	Mario Maia, CFA
	Incitec Pivot Limited	ICPVF	IPL AU	Mario Maia, CFA
	James Hardie Ind	JHIUF	JHX AU	Ben Chan, CFA
	James Hardie-ADR	JHX	JHX US	Ben Chan, CFA
	Nufarm Limited	NUFMF	NUF AU	Mario Maia, CFA
	Onesteel Limited	OSTLF	OST AU	Ben Chan, CFA
	PaperlinX	PPXLF	PPX AU	Mario Maia, CFA
NEUTRAL				
	Bluescope Steel Limited	BLSFF	BSL AU	Ben Chan, CFA
	Fletcher Building Limited	YFLBF	FBU AU	Ben Chan, CFA
	Orica	OCLDF	ORI AU	Mario Maia, CFA
	Sims Metal Management Limited	SMUPF	SGM AU	Ben Chan, CFA
UNDERPERFORM				
	Boral Ltd	BOALF	BLD AU	Ben Chan, CFA
	CSR Ltd	CSRLF	CSR AU	Ben Chan, CFA
	DuluxGroup Limited	XDLXF	DLX AU	Mario Maia, CFA

29 December 2010

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

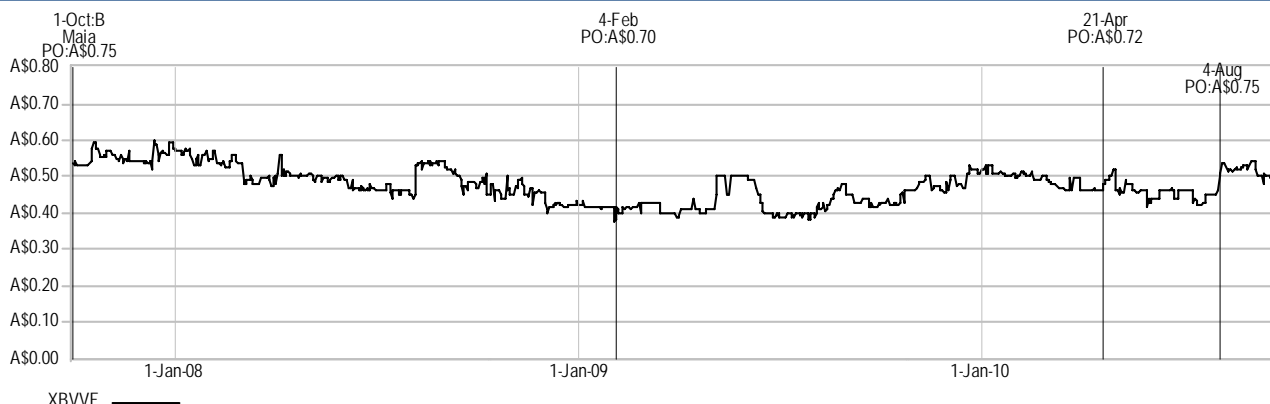
iQmethodSM is the set of BoFA Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

iQdatabase[®] is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by BoFA Merrill Lynch.

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Important Disclosures

XBVVF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

"Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of November 30, 2010 or such later date as indicated. BofA Merrill Lynch price charts do not reflect analysts' coverage of the stock at prior firms."

Investment Rating Distribution: Packaging Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	12	63.16%	Buy	9	75.00%
Neutral	2	10.53%	Neutral	2	100.00%
Sell	5	26.32%	Sell	1	20.00%

Investment Rating Distribution: Global Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1948	54.31%	Buy	821	46.73%
Neutral	891	24.84%	Neutral	397	49.07%
Sell	748	20.85%	Sell	259	37.16%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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