

Solutions for A Transforming World: Australia equity primer



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The BofAML case for Thematic Investing

In [A Transforming World](#), which introduced BofAML Global Research's enterprise-wide global investment themes, Michael Hartnett wrote – “we believe that thematic investing can outperform in the brave, new, post-QE world; that early, contrarian theme adopters can benefit from its low frequency investment style; and that capital flows are increasingly theme driven”. We assess that only about 30% of the Australian equity market cap offers meaningful exposure to our five global themes. In this primer, we highlight companies with medium-to-high exposures to them.

Theme 1. People: Longevity, Globesity and Education

By 2020, an incremental 2.2% of Australia's population will be 65+ yrs and an additional 50k international students will undertake higher education in Australia (highest absolute growth globally). Today, over 63% of Australian adults and one in four children are overweight or obese. Companies that are solution providers: Blackmores, Challenger Financial, Navitas, Primary, Ramsay and Resmed.

Theme 2. Innovation: eCommerce and Safety

eCommerce is rampant with 59% of Australians using internet banking monthly. But nearly 58% of Australian firms have made minimal progress on Big Data. The solution providers include Carsales.com, NextDC, REA Group and Seek. The market for testing and workplace safety is growing high-single digits, with ALS Ltd and Ansell providing solutions.

Theme 3. Markets: Savings race and recycling public capital

Australia has the fourth-largest pension assets pool (A\$1.8tn), and assets in DIY funds have doubled since 2000. Challenger Financial, IOOF, Macquarie and Perpetual provide solutions. Fiscal issues are driving privatisation in Ports and Utilities and provide inorganic growth options for AGL Energy and Asciano.

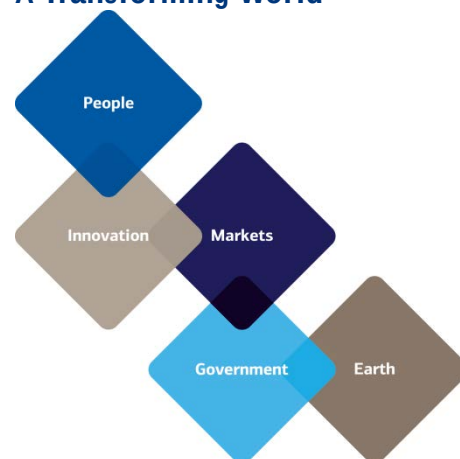
Theme 4. Government: Participation & housing affordability

Challenges of rising income inequality are likely to be addressed through improving Female participation in employment and growing affordable housing stock. Solution providers include Affinity Education and G8 Education.

Theme 5. Earth: Energy efficiency and energy independence

Australia is set to become the second-largest LNG exporter by 2015 – a key driver of reduced CO2 emissions (50% less emissions than coal) and source of manufacturing competitive advantage. Solution providers include Oil Search, Santos, Woodside and WorleyParsons.

A Transforming World



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Refer to important disclosures on page 38 to 40. Link to Definitions on page 37.

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Australian facts – Thematic context

1. Australia has the fourth-largest (A\$1.8tn) and fastest growing pension fund market. The market is expected to grow to A\$3tn by 2020 due to compulsory retirement saving.
2. 31% of Australian pension assets are in DIY self-managed superfunds.
3. By 2020, an additional 2.2% of Australia's population will be over 65yrs old.
4. 63% of Australian adults and one in four children are overweight or obese.
5. By 2020, an additional 50,000 international students per annum will study higher education in Australia– the highest absolute growth of any country.
6. The total size of student debt is A\$20bn and could grow by 2x-4x by 2020 as university funding cuts and ability to set fees are introduced in 2016.
7. Australians spend \$15.2bn on online retail (6.6% share), nearly 60% of Australians use electronic banking and 34% of advertising spend is online.
8. Cyber-crime costs \$2bn pa, with an estimated 5.4m Australian victims.
9. Real Australian labour income has grown by 38% and household income by 64% (higher participation, capital income) over past 20 yrs.
10. Female participation in the labour force has grown by 5% between 2000-2014 to 59% but gender gap in participation is 13%.
11. The median price of a house in 5 capital cities is \$596,000 (up 11% yoy).
12. Infrastructure Australia has identified need for \$300bn of infrastructure project. Federal and State Governments are actively considering recycling assets (ie privatisation) in a bid to retain/reclaim AAA credit rating.
13. Australia ranked 21st in WEF's Global Competitiveness Ranking in 2013-14.
14. By 2015, Australia is projected to be the world's second largest LNG exporter, after Qatar and by 2017 it may be the largest. There is approx. 140 PJ of proven and probably gas reserves in Australia.
15. Australians emit 24.4tonnes of CO2 equivalent per capita, highest among OECD nations

.... and for trivia fans, Australia has won 535 medals in the Olympic Games.

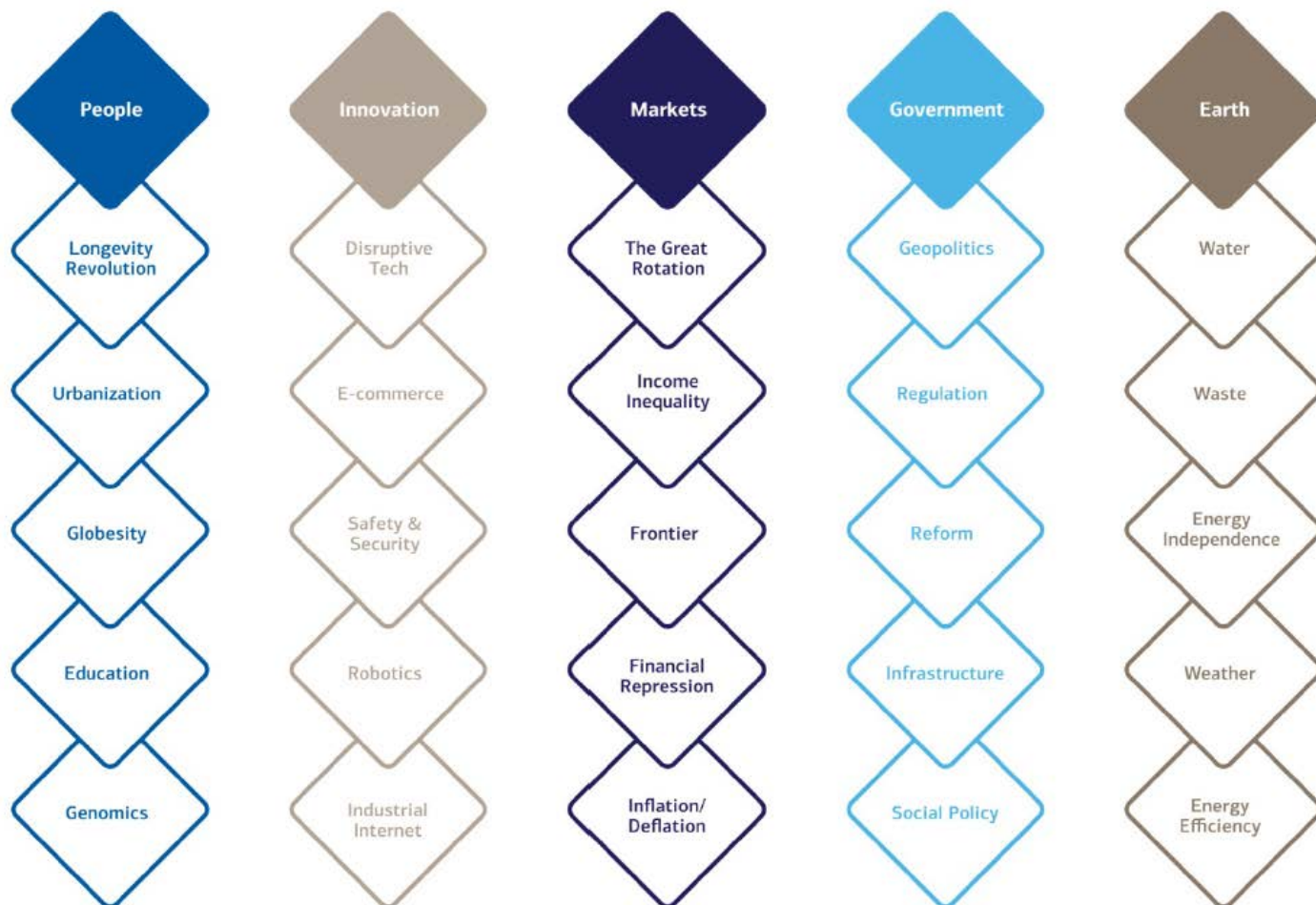
For full report, please see
[A Transforming World](#)

We're better when we're connected

Both cyclical and secular trends are currently transforming at a faster and more meaningful pace than in the past. In a transforming world, a framework that links multiple investment themes is required, in our view, to identify the major trends that will likely influence asset markets in coming years and identify the biggest winners and losers. The new BofAML Research framework connects the world using five clusters as follows:

- People – the allocation of scarce human resources
- Innovation – the disruptive role of technology
- Markets – the allocation of scarce financial capital
- Government – the role of public policy
- Earth – the allocation of scarce natural resources

Exhibit 1: Thematic investing framework



Source: BofAML Global Research

- The **People** theme encompasses anything related to the size, health and productivity of the world's human resources, such as the ageing of the population, urbanization, obesity and other health issues, and of course, education. Note how Innovation (and more specifically Technology) via education and Government via social policy clearly connect with People themes.
- **Innovation** and the disruptive role of technology is a theme-rich cluster as the corporate and government world shifts from one of "too big to fail" to one of "too big to succeed" via eCommerce, eSecurity, robotics and genomics. Today's technological disruption is universal, and trends in data transportability, cloud wars, the generational shift away from ownership towards experience, wearable tech, and crowd funding will create substantial divergence in investment winners and losers in coming years, in our view.
- **Markets** are concerned with the allocation of assets, savings and investment, as well as the distribution of income and wealth. Market themes can be cyclical, such as the future effects of rising interest rates as an era of financial repression, maximum liquidity and minimal growth ends. They can also be secular and connected to the Government theme, and could involve the new Japanese corporate desire to increase return on equity, reform in China and other Emerging Markets, as well as the reflation of the European real estate market.
- The **Government** cluster of themes explores the role of public policy, the increasing role of the state via regulation in the economy, as well as geopolitics.
- **Earth** themes are related to the finite supply of natural resources clashing with the increasing demand for food, water, and fossil fuels. One example is the issue of US energy independence and the impact that has on energy diplomacy and geopolitics.

Australian companies in a thematic context

We assess that only ~30% of the Australian equity market cap offers solutions to our Transforming World themes

For each theme, together with our BofAML Global Research sector analysts, we have estimated the level and materiality of companies' exposure to the themes. We have characterised each company's exposure as follows:

- Low – theme-related products, services, and solutions are not material to global revenues and/or growth but are one factor, among others, for the business model, strategy and R&D of the company.
- Medium – theme related products, services, and solutions are an important factor for the business model, strategy and R&D of the company; material to sales and/or growth.
- High – theme-related products, services, and solutions are core to the business model, strategy and R&D of the company; material sales and/or growth driver; pure play (i.e., 100% of sales from products, services or solutions which help to promote the theme).

Exhibit 2: Australian companies exposure to Transforming World themes

	People	Innovation	Markets	Government	Earth
High	Blackmores Ltd Challenger Financial Navitas Primary Ramsay Healthcare Resmed Inc	ALS Ltd Ansell Ltd Carsales.com Ltd NextDC REA Group Seek	Challenger Financial Henderson IOOF Macquarie Group Perpetual	Affinity Education G8 Education SAI Global	Nufarm OilSearch Santos Woodside WorleyParsons
Medium	AMP Aveo Japara Select Harvest Sonic Healthcare Tassal Group	Hills Ltd Netcomm Wireless OzForex SAI Global Telstra Corp	AGL Energy AMP Spark SP AusNet	Downer EDI Leighton Holdings	BHP Incitec Pivot Leighton Holdings Origin Energy
Low	Goodman Fielder Flight Centre Super Retail Grp Seek Sigma Wotif	Freelancer iiNET TPG Telecom	Asciano Stockland Transurban Westpac	Arena REIT Leighton Holdings Stockland	AGL Energy Downer EDI Harvey Norman Mirvac UGL

Source: BofAML Global Research

People

The People theme encompasses anything related to the size, health and productivity of the world's human resources, such as the ageing of the population, urbanization, obesity and other health issues, and of course, education.

Longevity

We estimate that there are 1.6m Australians aged 65+ whose annual personal expenditure is \$54bn or 15% of private household expenditure.

Three categories of companies offer exposure to this theme: 1) Pharmaceuticals & Healthcare (incl. tackling age-related diseases and conditions such as cancer, cardiovascular disease, Alzheimer's, diabetes, osteoporosis, as well as hearing aids, dental care, and incontinence); 2) Financials (incl. insurance, asset & wealth management); and 3) Consumer (incl. senior living, care, managed care, healthcare REITs, death care, pharmacies & drug stores, travel & leisure, beauty & cosmetics, fashion, retail, and technology).

Table 1: Australia stocks with exposure to Longevity theme

Company	Longevity exposure
Aveo	High
Challenger	High
Japara	High
AMP	Med
Primary Healthcare	Med
Ramsay Healthcare	Med
Sonic Healthcare	Med
API	Low
Flight Centre	Low
Sigma	Low

Source: BofAML Global Research

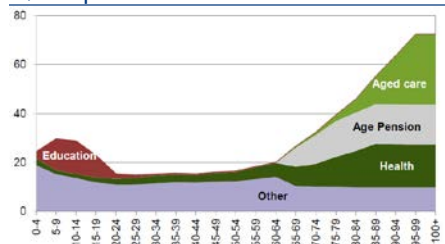
By 2020 an additional 2.2% of Australia's population will be 65+

Table 2: The population shares of the very old will rise dramatically

	2012	2020	2030	2040	2050	2060	2100
0-14	18.9%	18.9%	18.2%	17.1%	16.7%	16.5%	15.4%
15-49	48.8%	46.8%	45.3%	43.7%	42.5%	41.7%	39.2%
50-64	18.1%	17.9%	17.1%	17.6%	17.5%	16.8%	16.5%
65-74	7.8%	9.2%	9.8%	9.8%	10.0%	10.5%	10.2%
75-84	4.5%	5.1%	6.8%	7.8%	8.1%	8.5%	9.4%
85+	1.9%	2.1%	2.7%	4.0%	5.1%	5.9%	9.3%
100+	0.0%	0.0%	0.1%	0.1%	0.2%	0.3%	1.3%
65+	14.2%	16.4%	19.4%	21.6%	23.2%	25.0%	28.9%

Source: Productivity Commission - An Ageing Australia

Exhibit 3: Age-related Government spending A\$ '000/person



Source: Productivity Commission, Nov 2013

The Productivity Commission in its report An Ageing Australia: Preparing for the Future stated that a female (male) born in 2012 will on average live for an estimated 94.4 (91.6) years. They also project that Australian governments will face additional pressures on their budgets equivalent to around 6 per cent of national GDP by 2060, principally reflecting the growth of expenditure on health, aged care and the Age Pension.

1. Pharmaceuticals & Healthcare

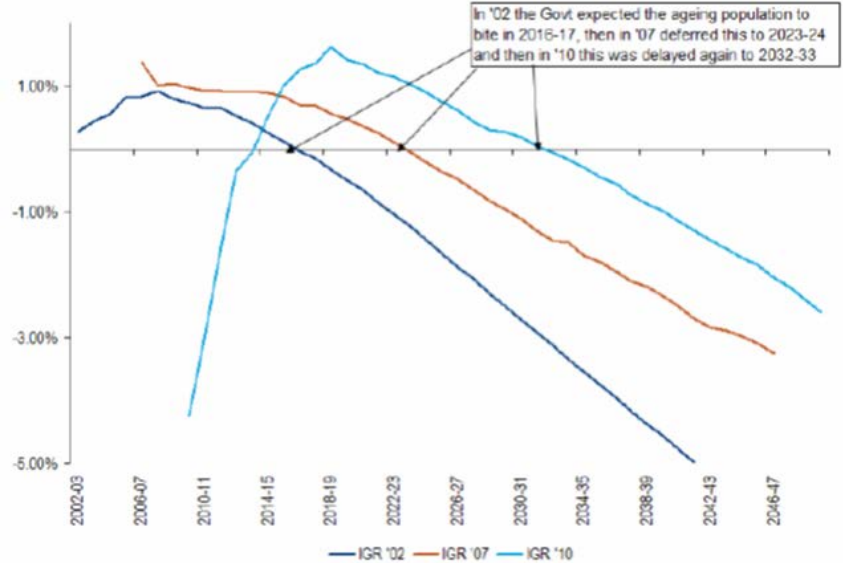
Life expectancy gains mean a major shift in the cause of mortality from infectious diseases and acute illness to chronic diseases and degenerative illnesses. Some 80% of older adults have one chronic condition, and 50% have at least two (Source: CDC). Ageing-associated diseases or "diseases of the elderly" are the primary cause including cardiovascular disease, cancer, and Alzheimer's. The incidence of all of these diseases increases rapidly with ageing, and sometimes exponentially, as in the case of cancer.

The Australian Institute of Health and Welfare estimates that 15.8% of 65–69 year olds have been diagnosed with Diabetes, compared to 2.1% of 35–39 yrs old.

It is intuitive to assume that demand for healthcare across all facets will rise with an ageing population. However, as the health of the older cohorts improves with preventative healthcare technology and pharmaceuticals this relationship may not remain comparable to prior years.

Preventative care is a key driver of postponing "fiscal gap" in healthcare costs from longevity.

Exhibit 4: Comparison of Intergenerational Report estimates of Projected Fiscal Gap



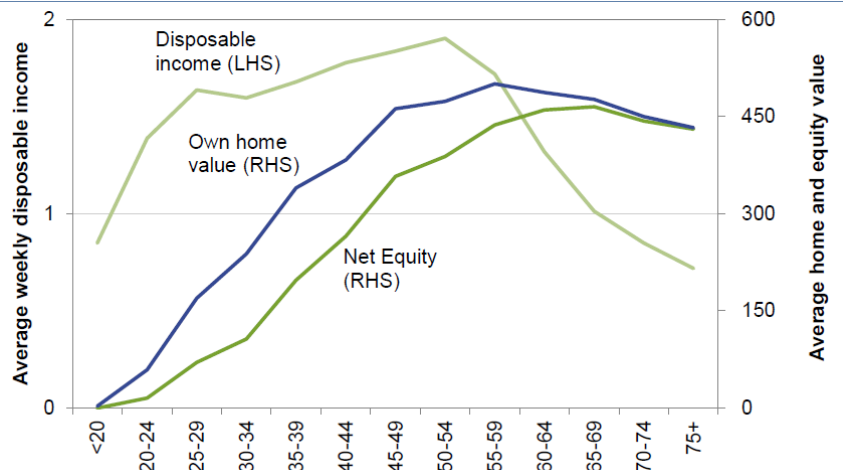
Source: Australian Treasury projections reported within Intergenerational reports. Also see

2. Financials

Longevity risk is the risk that, on average, people live longer than expected, or “too long”. For individuals who have not secured an income for life, the risk is that they outlive their savings. For providers of pensions and annuities, the risk is that payments are made for longer than anticipated. Longevity risk will likely be one of the most significant challenges facing retirement systems over the next 50Y.

The shifts from state to private pension provision and from defined benefit to defined contribution pension savings place an increasing onus on the individual, creating vast opportunities for wealth managers that are able to manage assets during the accumulation phase and risk during the post-retirement decumulation phase.

Exhibit 5: Income, equity and home value, by age groups, 2009-10 \$'000 in constant 2011-12 prices \$'000, all households



Source: ABS 2012 Household Expenditure Survey, Productivity Commission

People aged more than 65yrs spend \$54bn annually, accounting for 15% of household spend in Australia.

This demographic is increasingly important for online retail and leisure segments.

3. Consumer

In our view, a number of stocks have exposure to the theme of longevity via older consumers through their involvement in areas such as aged care living, hospitals, death care, pharmacies and drug stores, travel and leisure, beauty and cosmetics, fashion, retail, and technology, among other areas.

We see changes in consumption patterns from a more active aged population:

- The National Australia Bank Online Retail Index (April 2014) highlighted that over 65s are the fastest growing segment of online shoppers. The survey highlighted that those aged 65+ spend less on Fashion and Department and Variety Stores and more on Groceries and Liquor.
- The Swinburne Institute of Technology survey of cinema habits in 2011 identified that 56 per cent of over-50s visited the cinema an average of seven times each (vs just 1/3rd in 1984 seeing an average of 2 films each).

Table 3: Australian stocks with exposure to Longevity theme

Company	Description
AMP	Investment management, financial advice and retirement income. Also life insurance
API	Wholesale pharmacy and beauty products
Aveo Group	Owner, operator and manager of retirement communities
Challenger	Annuities and guaranteed retirement income solutions. Also funds management
Flight Centre	Travel agent
Invocare	Owns and operates funeral homes, cemeteries and crematoria
Japara	Residential aged care operator
Primary Healthcare	Network of medical and pathology centres
Ramsay Healthcare	Private hospital provider and day surgery clinics
Sigma	Distribution of pharmaceutical products through the pharmacy and grocery channels
Sonic Healthcare	Pathology and Radiology services

Source: BofAML Global Research

Table 4: Australia stocks with exposure to
Globesity theme

Company	Globesity exposure
Blackmores Ltd	High
F&P Healthcare	High
Ramsay Healthcare	High
Resmed	High
Select Harvest	Med
Tassal Group	Med
Goodman Fielder	Low
Super Retail Grp	Low

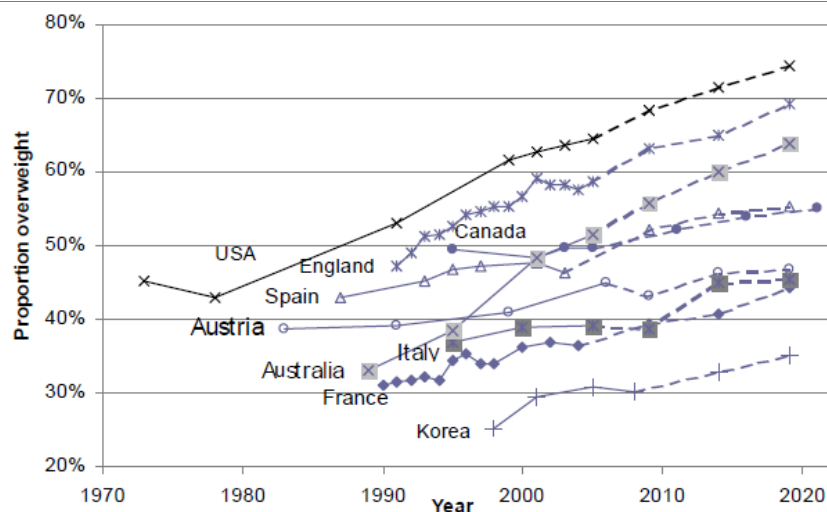
Source: BofAML Global Research

Over 63% of Australians – or one in four children – are overweight or obese.
Healthcare costs for obese patients are 40% higher

Globesity

We believe that this epidemic may be the most pressing health challenge facing the world today because of both its direct impacts and ripple effects on chronic diseases, such as diabetes. Obesity rates have doubled over the past 30 years, and globally 1.4bn people are overweight and 500mn obese, according to WHO. By 2030, 50-60% of the population in many countries are on target to be classified as obese.

Exhibit 6: Projected rates of overweight population including obesity in OECD countries



Source: OECD, BofA Merrill Lynch Global Research

Total health care costs are more than 40% higher for obese patients than normal weight patients (see Finkelstein et al., Health Affairs) and work-comp claims are seven times as high (Ostbye et al., Arch Intern Med). But obesity also impacts employers and corporates. A former chief economist for Qantas has calculated that the average weight of adult passengers on the company's planes has increased 2kg since 2000. For a plane like the Airbus 380, this means an extra US\$472 of fuel on a Sydney to London flight. Assuming three flights a day, this means an additional US\$1mn in fuel costs per year, or c.13% of the airline's profit from operating the route.

Today, over 63% of Australian adults and one in four children are overweight or obese (source: Shape Up Australia). The Australian Government has promoted a number of campaigns to address obesity including:

"Get set 4 Life - Habits for Healthy Kids"

"Get Active. Eat Good Tucker. Live Longer!"

The following types of companies fit into our obesity theme: 1) Pharmaceuticals & Health Care; 2) Food; 3) Commercial Weight Loss, Diet Management & Nutrition; and 4) Sports Apparel & Equipment.

1. Pharmaceutical and Health Care

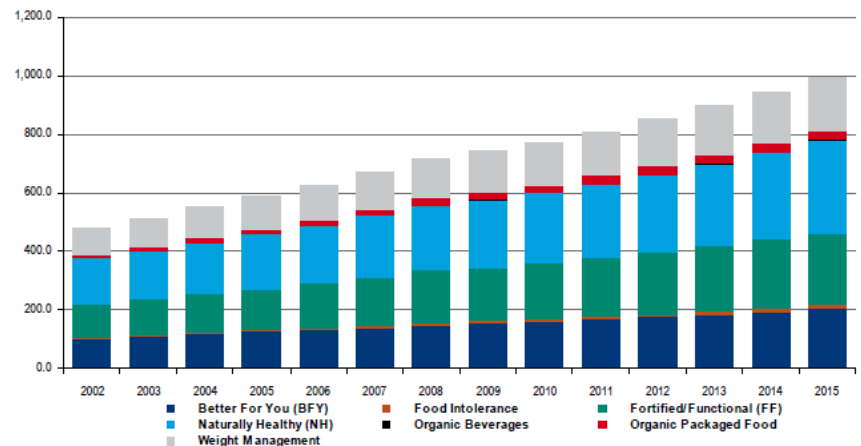
Health care and medical device companies are most exposed to the obesity theme. They are playing an increasingly important role in dealing with the impact of obesity-related co-morbidities, including heart disease and failure, type 2 diabetes, kidney failure, respiratory complications (e.g. obstructive sleep apnea), osteoarthritis and incontinence.

Australasia comprises US\$17.4bn health and wellness food and beverage market

2. Food: part of the problem and part of the solution

The industry is becoming increasingly influenced by growing consumer awareness of the links between diet and health, including obesity. This has meant a growing push on health and wellness (H&W) via healthy product options.

Exhibit 7: Health and wellness food and beverages market (retail sales, US \$000mn)



Source: Euromonitor, BofA Merrill Lynch Global Research

3. Commercial weight loss, diet management & nutrition

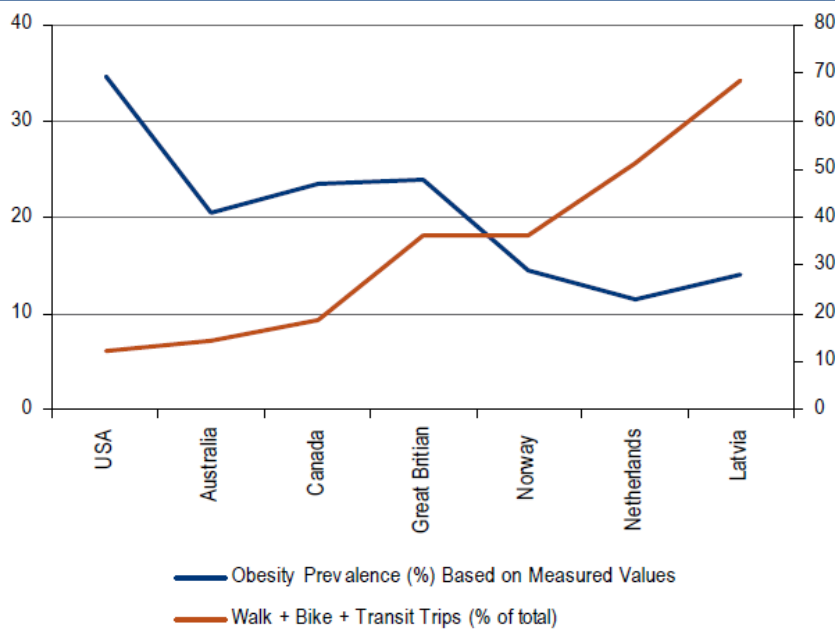
Surveys suggest 42-54% of US adults are dieting at any one time (Source: Gallup, Calorie Control Council, Marketdata). Australia's national science agency CSIRO developed the Total Wellbeing Diet in 2005, which has sold over 600,000 copies. A number of Australian companies also produce vitamins for the local retail market including Blackmores and Swisse.

4. Sports apparel & equipment

The WHO estimates that 31% of adults are considered to be insufficiently physically active, with women at highest risk. Governments are thus setting targets to tackle physical inactivity and increasing funding to promote physical fitness and improve built infrastructure in ways that encourage physical activity. This is likely to result in growing numbers engaging in sports and demand for affordable equipment and apparel to engage in physical activity or sports.

A strong case exists for greater social infrastructure (eg cycle lanes, walkways) aimed at encouraging active lifestyles.

Exhibit 8: Obesity (BMI ≥ 30 kg · m⁻²) prevalence and rates of active transportation (defined as the combined percentage of trips taken by walking, bicycling, and public transit)



Source: Journal of Physical Activity and Health, BofA Merrill Lynch Global Research

Table 5: Australia stocks with exposure to Globesity theme

Company	Description
Blackmores Ltd	Vitamins, herbal and mineral nutritional supplements
Goodman Fielder	Consumer branded food, dairy products, small goods, flour & edible oils
Ramsay Healthcare	Private hospital provider and day surgery clinics
Resmed Inc	Sleep apnea products
Super Retail Grp	Specialty retailer in Sports, Leisure and Auto spare parts
Select Harvest	Grows and distributes almonds and natural foods
Tassal Group	Farming & processing Atlantic salmon

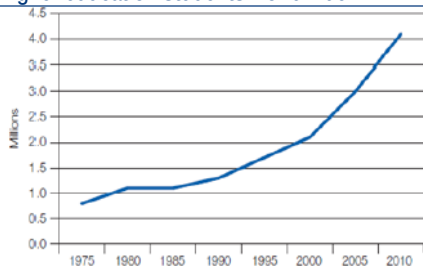
Source: BofAML Global Research

Table 6: Australia stocks with exposure to Education theme

Company	Education exposure
Navitas	High
News Corp	Low
Seek Limited	Low

Source: BofAML Global Research t

Exhibit 9: Number of internationally mobile higher education students worldwide



Source: OECD

Australia is likely to see the largest absolute growth in international higher education students through this decade

Global e-learning market estimated at US\$91bn in 2012 and is expected to reach US\$167bn in 2015 and US\$256bn in 2017 – a 23% CAGR from 2012 to 2017 (source: GSV Advisors)

Education

The global education sector is currently worth US\$4.5-5.1tn, encompassing schools, university, corporate and government learning, e-learning, child care and language learning. Education is undergoing two major structural shifts.

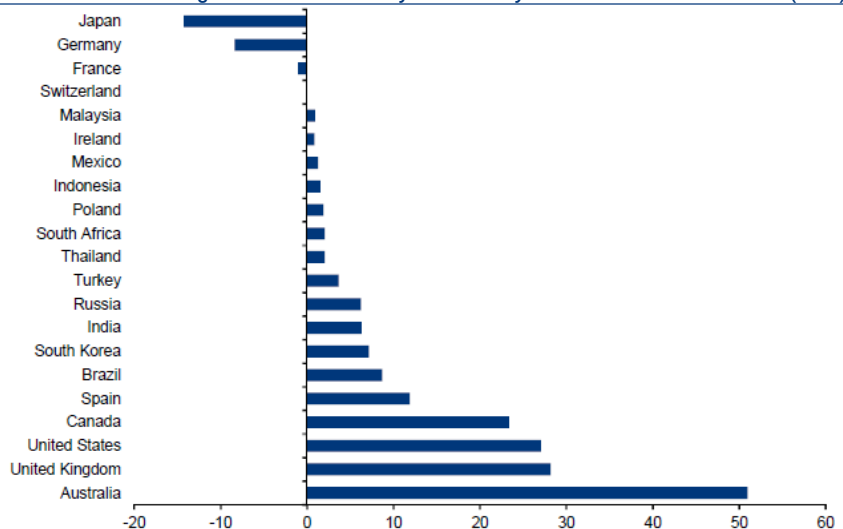
- A growing role for for-profit education companies, and an increasing focus on affordability and results, due to the high cost of education leading to greater dependence on private spending.
- The growing integration of game-changing ICT and the shift to EdTech (i.e., from print to digital and from classroom to online learning).

More internationally mobile students

Demographic change and rising incomes in EMs is increasing the number of internationally mobile students. In 2011, there were 4.3m internationally mobile higher education (HE) students (vs. 0.8m in 1975, 2.1m in 2000 and 4.1m in 2010). Nearly one-fifth of internationally mobile students were Chinese, with Indian and German students the next biggest groups.

The British Council estimates that 2.1% of the additional 21m students enrolling in HE by 2020 (vs. 2011) will be internationally mobile with the largest numbers going to the US, UK, Australia, Canada, Germany, France and Japan). (Source: UK Department for Business, Innovation and Skills).

Exhibit 10: Growth in global inbound tertiary students by destination market 2011-20 (000s)



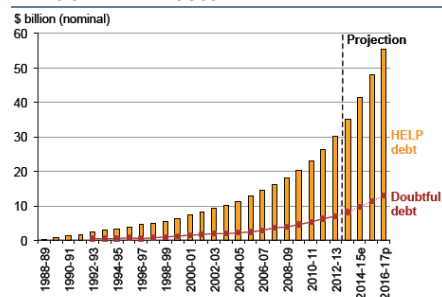
Source: Oxford Economics

The EdTech revolution

The growing use of information and communication technologies (ICT) is a long term structural game changer for education – with the two biggest shifts being from print to digital and from classroom to online learning

BWM Books estimates Australian market size for textbooks is circa A\$820m, with eBooks share potentially rising to 25% by 2014.

Exhibit 11: HELP debt



Source: Grattan Institute, 2014

Funding gap

The Higher Education Loan Program (HELP) lends more than \$6 billion a year to Australian students undertaking higher education. The Australian Bureau of Statistics data suggests student debt in Australia is \$20bn (avg student loan per household \$2400, 8.6m homes). The 2014/15 Federal Budget has proposed reducing Government subsidies by 20%, extending subsidies to include “sub-degree” courses and set January 2016 as the start date for a fully competitive market in higher education when all providers – universities, private colleges and TAFEs – will be able to set their own course fees.

Taken together, the new measures could have the impact of increasing average student debt by 2x - 4x, say by 2020 when the cohort impacted by the Budget changes start to graduate.

Table 7: Australia stocks with exposure to the Education theme

Company	Description
Navitas	Pre-university & managed campus courses. Vocational training
News Corp	News & information services, books, PayTV and digital education
Seek	Employment classifieds, marketing education and training courses

Source: BofAML Global Research

Innovation

Innovation and the disruptive role of technology is a theme-rich cluster as the corporate and government world shifts from one of “too big to fail” to one of “too big to succeed” via eCommerce, eSecurity, robotics and genomics. Today’s technological disruption is universal, and trends in data transportability, cloud wars, the generational shift away from ownership towards experience, wearable tech, and crowd funding will create substantial divergence in investment winners and losers in coming years, in our view.

Table 8: Australia stocks with exposure to Industrial Internet theme

Company	Industrial Internet exposure
NetComm	High
Telstra	Low

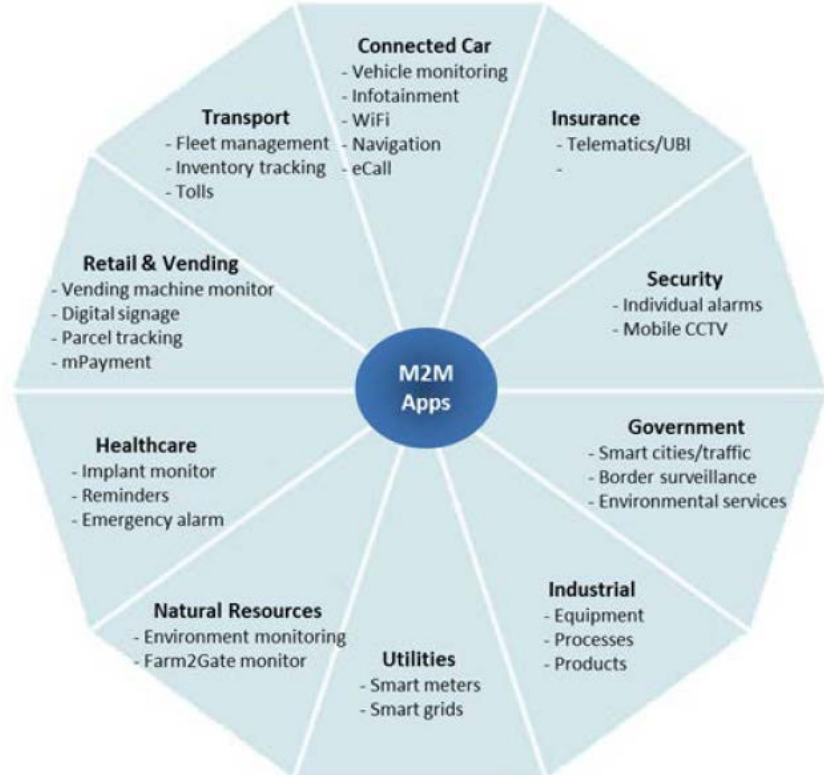
Source: BofAML Global Research

Industrial internet: Internet of Things/M2M

In our [Primer on Machine to Machine \(M2M\)](#), BofAML highlighted that M2M deployments are now occurring on a large scale, and revenues are becoming more visible. We believe the pace of deployment could surprise investors, with M2M revenue growth making a meaningful contribution to telecom operators. M2M can bring a host of benefits, and these vary by application:

1. Brand/product differentiation (e.g. automotive and consumer segments);
2. Process efficiency (e.g. for industrial applications, fleet management, usage based insurance and security applications);
3. Government regulation (e.g. in smart meters/and auto safety); and
4. ESG requirements including energy efficiency and food and water security.

Exhibit 12: M2M applications map



Source: BofAML Global Research

In our [M2M primer](#), we highlighted 100 examples of large-scale deployments across multiple sectors, applications and regions

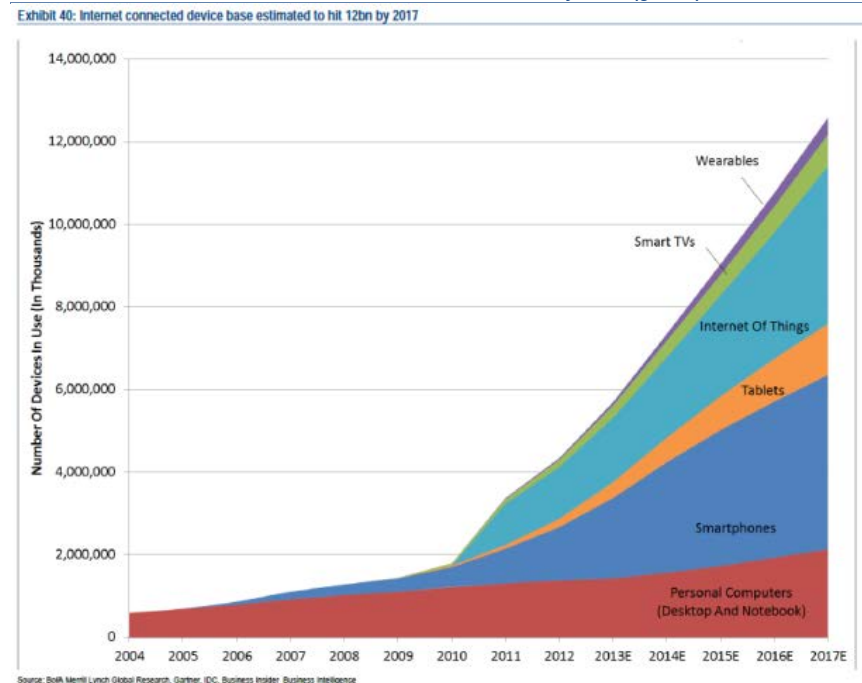
Like the shift to the Cloud, IoT comes with security/privacy and other concerns like battery life, but we believe the benefits outweigh the challenges and over time IoT will become a vital part of society and technology. The key technologies include:

- Low cost and low power sensors and actuators that can be embedded in machines and devices in consumer and industrial products, providing real-time monitoring and data communication.
- Universal connectivity enabled by ubiquitous IP networks over wired or wireless channels, connecting machines, devices, facilities, fleets, people and social networks to each other and to the Cloud.
- Software technologies for data processing, advanced analytics, and decision support, integrated with domain specific or industry specific automation, control and optimization systems.

As Corporates and Regulators recognize the benefits of M2M/IoT in product differentiation, process efficiency and health and safety, IoT devices could hit 12bn by 2017

In Australia, Telstra has deployed M2M solutions for Nissan (Leaf), Coca Cola Amatil, Australia Post and Reid Stockfeeds.

Exhibit 13: Internet connected device estimate to hit 12bn by 2017 (global)



Source: BofAML Global Research, Gartner, IDC, Business Insider Business Intelligence

Table 9: Australia stocks with exposure to Industrial Internet theme

Company Description

NetComm Supplier of wireless devices, incl M2M modems

Telstra Telecommunication services including mobile, internet access, phone and network applications

Source: BofAML Global Research

Table 10: Australia stocks with exposure to eCommerce and Big Data

Company	eCommerce exposure
CarSales.com	High
NextDC	High
OzForex	High
REA Group	High
Seek	High
Telstra	Med
Freelancer	Low
iiNET	Low
TPG Telecom	Low

Source: BofAML Global Research

About 72% of internet users in the US have looked for health information online within the past year

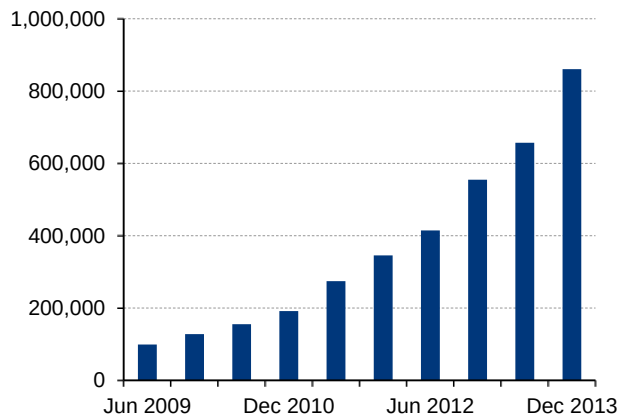
E-commerce & big data

E-commerce

The Australian Bureau of Statistics (ABS) estimates that the total value of online sales in Australia was \$237bn in FY12. At a sector level:

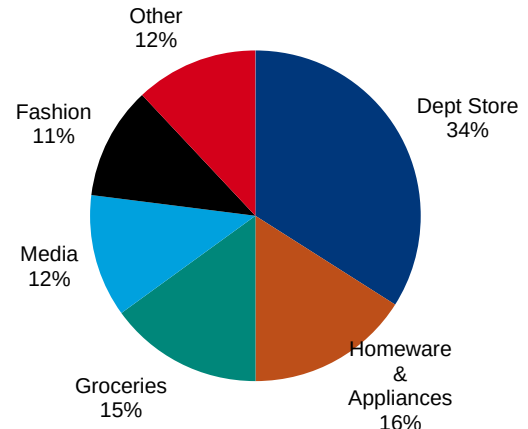
- **Retail:** In the year to March 2014, Australians spent \$15.2 billion on online retail. This level is equivalent to 6.6% of spending with traditional bricks & mortar retailers and compares to \$13.3bn in year to March 2013. (Source: NAB Online Retail Index).
- **Banking:** 12.86mn people used online banking or bill paying in the six months to May 2013, up 10% since May 2012 (source: ACMA Dec 2013). Roy Morgan estimates that in an average 4-week period in 2013, 59% (11.2mn) of Australians aged 14+ used internet banking at any financial institution. In their submissions to the Financial Services Inquiry (Murray Inquiry), Westpac noted a five-fold increase in customers using its mobile channels in the past two years (59mn sessions in FY11 up to 253mn in FY13). The Commonwealth Bank of Australia highlighted that it had processed more than 400mn transactions via the internet in FY13 with more than 60% of NetBank logins via mobile devices.
- **Media:** BofAML estimates that online's share of total advertising spend in Australia will be 34% by end-June 2014, up from 19% three years ago.
- **Healthcare:** According to a January 2014 Pew survey, 72% of internet users in the US say they looked online for health information within the past year. In fact, 35% of US adults say that at one time or another they have gone online specifically to try to figure out what medical condition they or someone else might have.
- **Gambling:** Australians spent A\$1.6bn on interactive (online) gambling in 2010 (source: Department of Broadband, Communication and the Digital Economy, 2013). A research report by Gambling Research Institute (2014) suggests that 8% of the population participates in interactive gambling (primarily sports betting).

Chart 1: Volume of data downloaded in Australia (TB)



Source: Australian Bureau of Statistics

Chart 2: Australian online retail spend by category



Source: NAB Online Retail Index March 2014, BofAML Global Research

Amount of information collected by corporates and Government is growing at 40% CAGR and the data is increasingly hosted and analyzed in the cloud

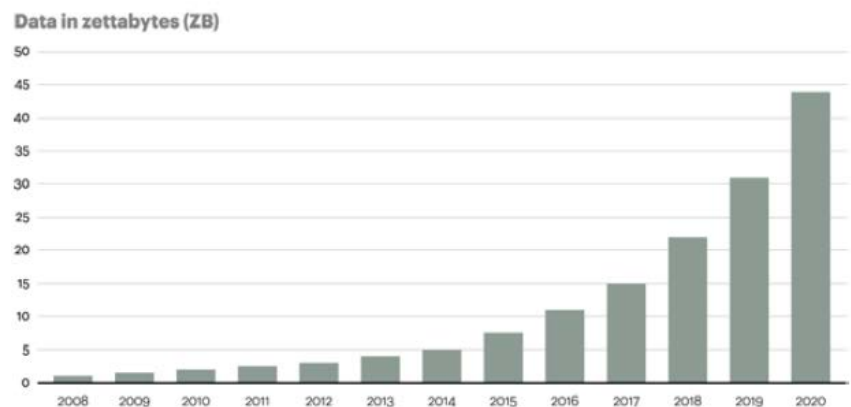
Big data & cloud computing

The first revolution in data processing happened with the invention of relational databases in 1970s, where businesses tried to capture and process business transactions with digital computers. With the onset of IoT, we are living in the second data revolution of Big Data, driven by the massive digitization of media, web and social networks, and the proliferation of mobile devices and smart machine. We believe IoT will increase the data generated by intelligent devices by multiple folds. If transaction datasets are in terabytes, web and social data are in petabytes, we think the Internet of Things will be measured in Exabytes.

Exhibit 14: the amount of information collected growing 40% CAGR, according to ORCL

Figure 1

Data is growing at a 40 percent compound annual rate, reaching nearly 45 ZB by 2020



Source: Oracle

About 58% of Australian companies have made little/no progress on Big Data strategy (source: EIU)

A recent survey by the Economist Intelligence Unit highlighted that Big Data adoption is still at very nascent stage in Australia (source: EIU, The road to big data adoption in Asia-Pacific, 2013).

- About 58% of Australian companies have not made much progress or started on Big Data initiatives.
- Over half of all companies with revenue of US\$5bn or more anticipate a revenue boost of 26% or more from greater business agility.

The Australian data centre services market is forecast to hit revenues of over \$1.5 billion by 2019 (Source: Frost & Sullivan).

Table 11: Australia stocks with exposure to eCommerce and Big Data

Company	Description
CarSales.com	Online automotive classifieds advertising and data research
Freelancer	Outsourced marketplace for small businesses, start-ups and Corporates
iiNET	Internet service provider
NextDC	Data-Centre-as-a-Service (DCaaS) provider
REA Group	Online advertising of residential and commercial properties
Seek	Employment classifieds, marketing education and training courses
Telstra corp	Telecommunication services including mobile, internet access, phone and network applications
TPG Telecom	Internet service provider
OzForex	Online international payment services for consumer and business clients

Source: BofAML Global Research

Table 12: Australia stocks with exposure to Safety & Security theme

Company	Safety & Security Exposure
ALS Ltd	High
Ansell Ltd	High
SAI Global	High
Hills Ltd	Medium
Telstra Corp	Low

Source: BofAML Global Research

Cyber-crime costs Australians \$2bn pa and recent attacks on eBay and Target suggest that we're seeing greater proliferation

Safety & security

Within Safety and Security, we see three segments being addressed by mid/large cap Australian companies:

1. Cyber-security

A rapidly changing cyber "threatscape" means that we are seeing greater attack surface area, the proliferation and sophistication of attack models, increasing complexity of threats and solutions – and ensuing erosion of trust of the cyber world (Source: Cisco).

Greg Medcraft, the chairman of Australian Securities and Investments Commission, said in Dec 2013 that advancements in technology had led to a significant growth of cyber-crime and had an estimated global cost of \$110bn a year. CSIRO, in its May 2014 report on cyber security trends and implications, said "non-government estimates put the cost of cybercrime in Australia as high as \$2bn annually. Defence estimates that in 2012, 5.4mn Australians were victims of cyber-crime.

Exhibit 15: Sector spend most on security

Average rate of increase (net number of companies reporting increase)	Average current security spend (as % of IT spend)		
	Below average (less than 6%)	Average (6% to 8%)	Above average (more than 8%)
High (more than +50%)	Travel, leisure and entertainment		Telecommunications
Average (between +30% and +50%)	Retail and distribution	Utilities, energy and mining Government, health or education	Financial services, Technology, Manufacturing
Low (less than +30%)	Property and construction		

Source: PWC, BofA Merrill Lynch Global Research

2. Testing, Inspection & Certification (TIC)

TIC is a €100bn global market (Source: Bureau Veritas), and encompasses similar activities conducted internally by companies or public authorities and which could be outsourced. The in-house and outsourced addressable market represents total revenue of over €70bn. TIC has averaged 9.2% growth since 1995, a 2.2% premium to global nominal GDP. Long-term structural growth drivers should remain supportive: increasing outsourcing, legislation (consumer and environmental), emerging EM middle classes, intra-EM trade, a potential opening up of the Chinese consumer testing market, growing consumer awareness on HSE, ageing industrial infrastructure, high barriers to entry, fragmented markets and industry consolidation.

Exhibit 16: Long-term demand drivers for testing & inspection services



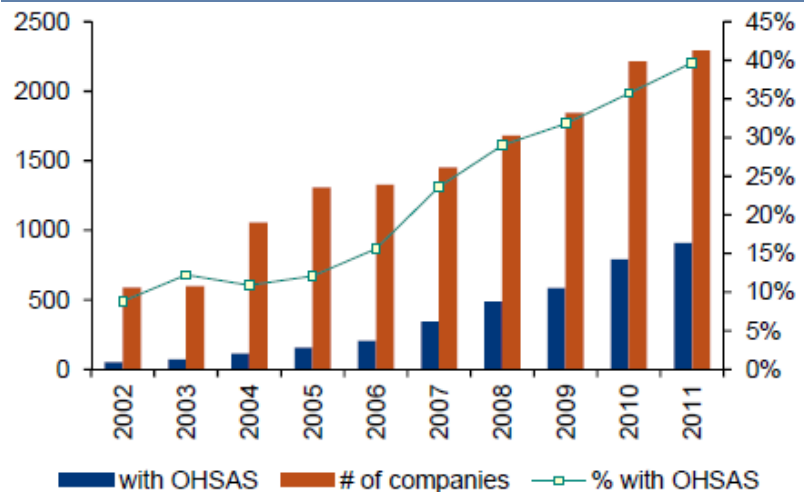
Source: Intertek, BofA Merrill Lynch Global Research

The global market for personal and protective equipment is estimated to become US\$30-35bn by 2015

3. Workplace safety

The market for personal and protective equipment (PPE) is estimated to become a US\$30-33bn addressable market by 2015 (source: 3M) and is expanding at a CAGR of 7.5% over 2014-18 (Source: Research and Markets). Why? Globally, 2.3mn people are killed and 270mn are injured every year, with 160mn suffering from diseases as a result of occupational health and safety issues. (Source: ILO).

Exhibit 17: OHSAS certified companies in MSCI AC World index



Source: Asset 4/ Datastream (as at 03/12/13), BofA Merrill Lynch Global Research

Table 13: Australia stocks with exposure to Safety and Security theme

Company	Description
ALS Ltd	Testing service across Minerals, Life Sciences, Energy and Industrial
Ansell Ltd	Gloves, protective clothing and condoms
SAI Global	Assurance (food), compliance and information services
Hills Ltd	Mainly Industrial Products. Also electronic security systems and CCTV
Telstra Corp	Mainly telco (mobile, fixed line). Also cyber-security services to Corp. & Government

Source: BofAML Global Research

Markets

Markets are concerned with the allocation of assets, savings and investment, as well as the distribution of income and wealth. Market themes can be cyclical, such as the future effects of rising interest rates as an era of financial repression, maximum liquidity and minimal growth ends. They can also be secular and connected to the Government theme, and could involve the corporate desire to increase return on equity, financial reform and reflation of real assets.

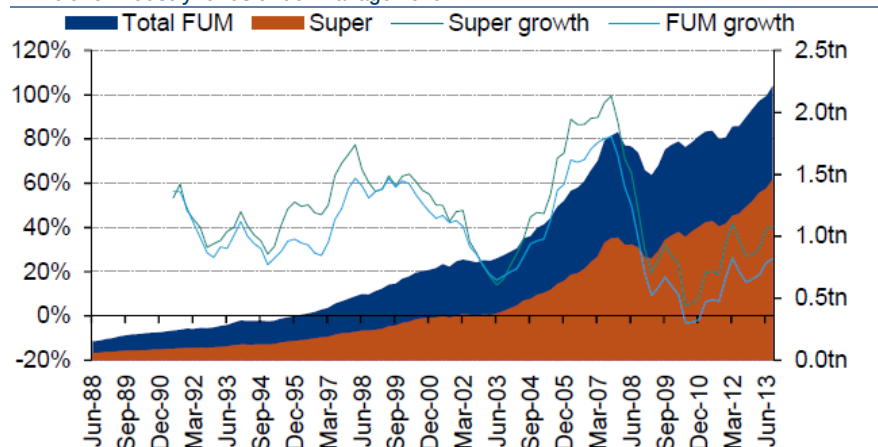
Great Rotation: savings boom & privatisation

We see scope for at least four Great Rotation themes playing out concurrently in Australia: 1. The Savings race inspired by superannuation contributions; 2. Asset privatisations to allow government de-leveraging; 3. Retail investor empowerment through self-managed superannuation and 4. Search for stable returns (infrastructure assets vs equities).

1. Saving race

The Australian wealth management growth story is appealing. The A\$2.1tn funds management industry has witnessed a compound annual rate (CAGR) of 10.5% over the past 20 years. Deloitte predicts this to more than triple to A\$7.6tn by 2035. The introduction of a compulsory superannuation charge in 1992 proved the catalyst for significant growth. Since then, superannuation assets have grown to A\$1.8tn, a 13% CAGR. Australia is the fourth-largest such pool in the world.

Exhibit 18: Industry funds under management



Source: BofA Merrill Lynch Global Research, ABS, APRA, RBA

On 1 July 2013, the superannuation guarantee increased 25bp to 9.25%. It will rise incrementally to 12% by 2022 (including the two-year delay pledged by the new government during the election). The increase is projected to add more than A\$400bn to the superannuation pool by 2035.

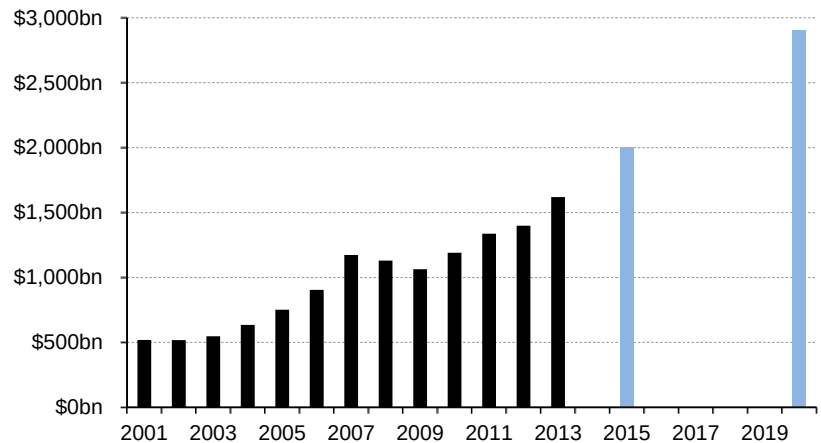
Table 14: Australian stocks with exposure to the Great Rotation theme

Company	Great Rotation exposure
Challenger Financial	High
Henderson	High
IOOF	High
Macquarie Group	High
Perpetual	High
AGL Energy	Low
AMP	Low
Asciano	Low
Ramsay Healthcare	Low
Spark	Low
SP AusNet	Low
Transurban	Low
Westpac	Low

Source: BofAML Global Research

Australia has 4th largest pension asset base in the world at A\$1.8tn. Market estimates project the asset base to grow to A\$3tn by 2020 and A\$7.6tn by 2035

Chart 3: Australian superannuation assets (A\$bn)



Source: APRA, Deloitte, BofAML Global Research

DIY self-managed super now comprises 31% of total assets, double the level in early 2000s

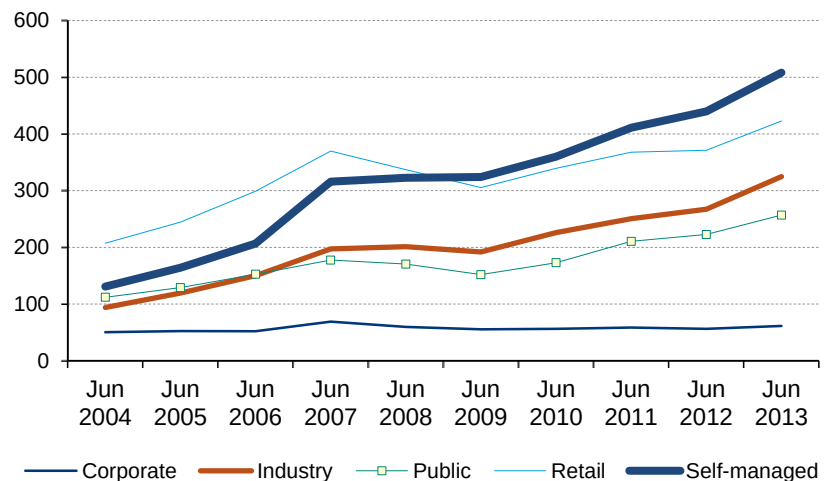
The major players in Australia's A\$1.6tn superannuation system are self-managed (31%), retail (26%), industry (20%) and public sector funds (16%). SMSFs and industry funds have gained significant ground from retail funds recently, although we think the market share loss is now largely done.

While the volume growth backdrop is favourable, the cost of retail products has fallen in recent years, with the new breed of MySuper offerings near 90bp. Unbundling commissions, using passive investment options, and squeezing asset managers and custodians have done much of the work.

Empowerment: DIY self-managed superannuation

The financial services sector in Australia has seen strong demand for DIY or self-managed superannuation. Self-managed superannuation now accounts for 31% of total industry assets. This boom in DIY provides a positive backdrop for retail brokerages, retail investment managers and financial planners, in our view.

Chart 4: Superannuation assets (A\$bn, by fund type)



Source: APRA

DIY is likely to continue providing a positive backdrop for retail brokerages, retail investment managers and financial planners, in our view

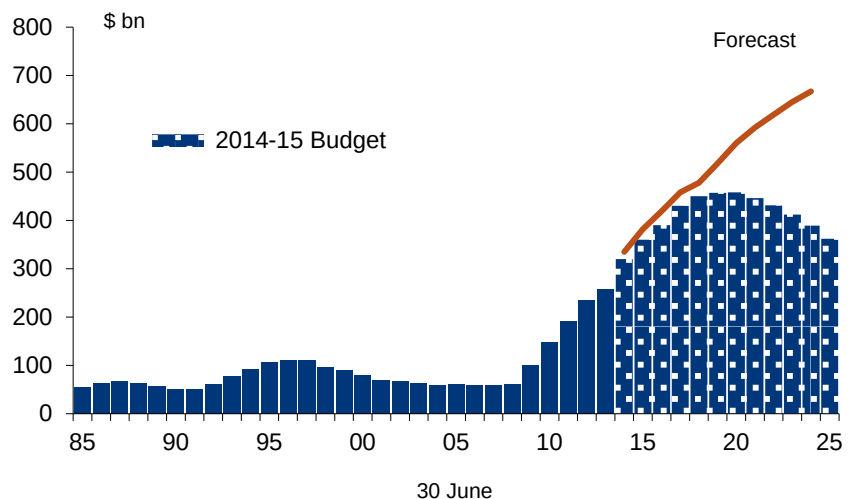
De-leveraging government: Public to private rotation

Both Federal and state governments in Australia are likely to actively pursue asset privatisations, in our view:

- **Address fiscal issues.** Australian governments are subject to a self-imposed debt limit, in part driven by their desire to achieve (or retain) an AAA credit rating. The latest Federal Budget estimates that the Government's net debt should peak as a proportion of GDP at 14.6% at the end of 2016-17, and in dollar terms at A\$264bn at the end of 2017-18. The Federal government announced a number of spending reduction measures incl. foreign aid, Family Tax Benefits, co-payment for GP visits and 20% cut to new student higher education fees. We also note that in addition to the previously announced sale of Medibank Private, the government will also consider the sale of the Defence Housing Authority, the registry functions of the Australian Securities and Investments Commission, and the Royal Australian Mint. However it has baulked at the sale of Snowy Hydro or Australia Post, as recommended by the Audit Commission.
- **Re-investment in infrastructure.** Infrastructure Australia estimates that the extent of "Infrastructure Deficit" in Australia is A\$300bn. In March 2014, the Federal Treasurer announced a proposal to establish a Federal fund that would be used to pay each state 15 cents for every dollar that the state receives from privatisations and 'recycles' into new public works such as roads and railway.
- **Pursue structural reform.** The Productivity Commission (Public Infrastructure, Draft Report, March 2014) noted state-owned network businesses appear to be less efficient than their private sector peers. This is not surprising given their multiple objectives, political intervention and the imposition of non-commercial restrictions.

The privatization agenda is likely to be active in coming years as Federal and State governments focus on fiscal issues (AAA rating), the need to re-invest in ageing infrastructure (estimated A\$300bn demand) and structural reform.

Chart 5: Commonwealth Government securities on issue



Source: Australian Government budget papers

Demand for privatised infrastructure appears to be robust. KPMG estimates that the 100 largest global institutional investors have committed A\$204bn towards infrastructure investment through listed, unlisted and direct investment (Source: KPMG, The Infrastructure Short Report, 2012).

Press reports on potential privatizations from State Governments in NSW and Queensland suggest a strong pipeline of Electricity and Ports infrastructure. This should be supportive of inorganic growth options for the listed Utilities and Transport companies.

Press reports suggest that Transport (ports) and Energy (electricity) are likely to be amongst the most active sectors

Table 15: Sample of privatization of government assets

Federal Government		State Governments	
Sector	Asset	Sector	Asset
Health	Medibank Private	Energy	Ausgrid
REITs	Defence Housing	Energy	CS Energy
Retail	Royal Australian Mint	Energy	Delta Electricity
Transport	Comcar	Energy	Energex
		Energy	Ergon
		Energy	Endeavour energy
		Energy	Essential Energy
		Energy	Stanwell Corporation
		Energy	Transgrid
		Gaming	TAB WA
		Health	NSW State Hospitals
		Transport	Port of Melbourne
		Transport	Port of Gladstone
		Transport	Port of Townsville
		Transport	Mt Isa rail freight line

Source: Press reports

The allocation to domestic equities has been down-weighted by ~20% over the past 15 years

Rotation away from Domestic Equities: Premium for alternatives

Across the seven largest pension markets globally, there is a clear sign of reduced home bias in equities, as the weight of domestic equities in pension assets portfolios has fallen, on average, from 64.7% in 1998 to 44.1% in 2013. (Source: Towers Watson Global Pension Assets Study 2014).

Table 16: Asset allocation by investor class

	Corporate	Industry	Public sector	Retail	Total
Proportion of assets					
Australian shares	30%	29%	22%	26%	26%
International shares	28%	25%	27%	22%	25%
Listed property	1%	1%	4%	4%	2%
Unlisted property	7%	10%	6%	2%	7%
Australian fixed interest	14%	6%	7%	15%	9%
International fixed interest	6%	5%	7%	7%	6%
Cash	6%	6%	9%	14%	8%
Other assets	8%	19%	18%	9%	16%
Total	100%	100%	100%	100%	100%

Source: APRA

Table 17: Australia stocks with exposure to Great Rotation theme

Company	Description
AGL Energy	Electricity and gas retail, power generation and gas investments
AMP	Investment management, financial advice and retirement income. Also life insurance
Asciano	Rail and Port provider
Challenger Financial	Annuities and guaranteed retirement income solutions. Also funds management
Henderson	Global fund manager
IOOF	Financial advice, investment management, portfolio administration and estate services
Macquarie Group	Corporate advisory, securities trading, funds management and banking services
Perpetual	Investment manager of funds, financial advice and corporate trust
Ramsay Healthcare	Private hospital provider and day surgery clinics
SP AusNet	Electricity transmission and distribution in Victoria. Gas distribution.
Spark	Electricity distribution in Victoria and SA
Transurban	Development and operation of toll roads in Australia and US
Westpac	Banking and financial services. Wealth mgmt highest among Australia banks

Source: BofAML Global Research

Income inequality: Rising participation and housing affordability

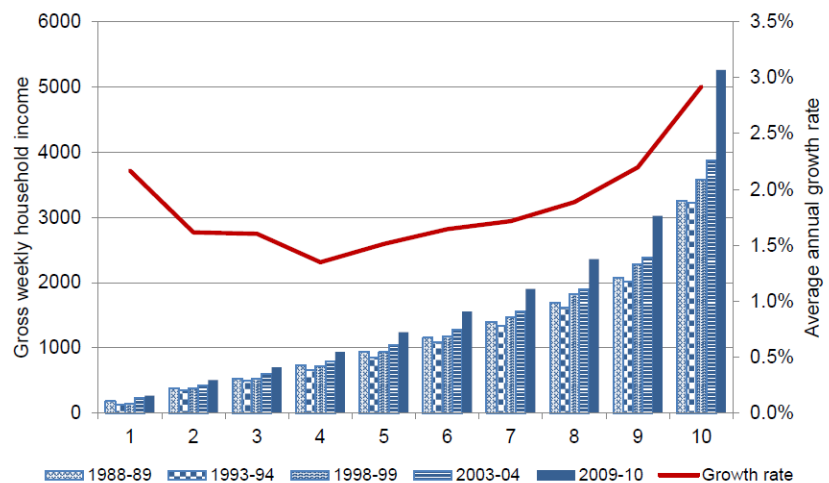
Thomas Piketty in "Capital in the Twenty-First Century" asserts the power of compound interest, and the rising gap between investment returns (r) and economic growth (g) is likely to have dramatic consequences for income inequality. He projects the global private wealth to national income ratio to rise from 440% in 2010 to record highs of 500% by 2030.

Real Australian labour income has grown by 38% over the past 20yrs

However, the rate of growth has been higher at the 'top end' of the distributions than the 'bottom end'

The Productivity Commission notes that between 1988-89 and 2009-10, the incomes of individuals and households in Australia have risen substantially in real terms and in comparison to trends in other OECD countries. However, the rate of growth has been higher at the 'top end' of the distributions than the 'bottom end' (Source: Productivity Commission, Trends in the Distribution of Income in Australia, March 2013).

Exhibit 19: Real incomes by gross income deciles, 1988-89 to 2009-10
2011-12 dollars, 1 lowest decile, 10 highest



Source: Australian Bureau of Statistics, Productivity Commission

Social policy is likely to be addressed by increasing gender equality (eg via participation rate) and by encouraging housing affordability – see Government theme

We see income inequality continuing to grow and potentially fewer direct Government options to intervene through direct payments due to Australia's fiscal position (eg FY14/15 budget includes cutbacks in Family Tax Benefits). However, social policy is likely to be addressed by increasing gender equality (eg via participation rate) and by encouraging housing affordability. These issues are further explored under Government theme below.

Government

The Government cluster of themes explores the role of public policy, the increasing role of the state via regulation in the economy, as well as geopolitics.

Geopolitical names in energy

In our view, the Geopolitical theme is best translated into an Australian context via energy trade (LNG exports). Firstly, American businesses and individuals are currently effectively paying average prices of US\$4.50/MMBtu, capturing a US\$6.50 discount relative to an average world gas price of US\$11/MMBtu on a market of 71 bcf/d. This low natural gas price is of course doing a number of things for the US economy: providing a much needed "tax cut" to US consumers and sharpening a competitive edge for manufacturers. Increased competitiveness is particularly the case for industries which have very energy intensive manufacturing processes, such as chemical and fertilizer producers.

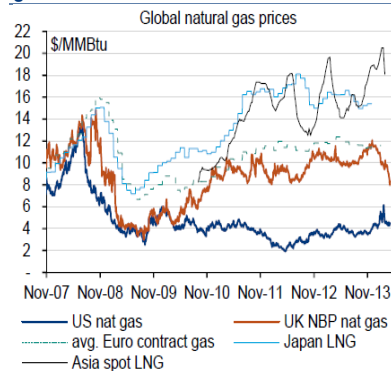
Secondly, energy produced in Australia is perceived by market participants as much safer from a security of supply perspective than energy produced in Libya, Iran, or say Russia. Although difficult to quantify, Australia's trading partners do value this highly, particularly more so after the recent events in the Ukraine.

Table 18: Australia stocks with exposure to Geopolitics theme

Company	Geopolitics exposure
Oil Search	High
Santos	High
Woodside	High
BHP	Medium
Origin Energy	Low

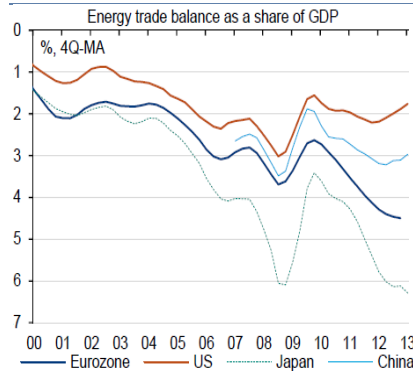
Source: BofAML Global Research

Exhibit 20: American consumers benefitting from a tremendous discount on the natural gas that is consumed at home



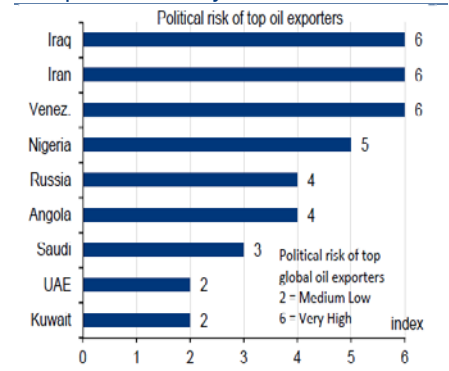
Source: Bloomberg, BofA Merrill Lynch Commodities Research

Exhibit 21: Japan, Europe, and even China have faced surging oil & natural gas import bills, but America has not



Source: Bloomberg, BofA Merrill Lynch Commodities Research

Exhibit 22: Energy produced in the US seen much safer from security of supply angle than produced in Libya, Iran, or Russia



Source: AON, BofA Merrill Lynch Commodities Research

Table 19: Australia stocks with exposure to Geopolitics theme

Company	Description
BHP	Diversified resources incl oil and gas in Gulf of Mexico and Australia
Oil Search	Exploration and production of natural gas in Papua New Guinea
Origin Energy	Gas production, power generation and energy retail
Santos	Exploration and production of natural gas in Australia, PNG, Indonesia and Vietnam
Woodside	LNG production in Western Australia

Source: BofAML Global Research

Table 20: BofAML Australian stock list with Regulatory exposure

Company	Regulation exposure
SAI Global;	High
ALS Ltd	Low

Source: BofAML Global Research

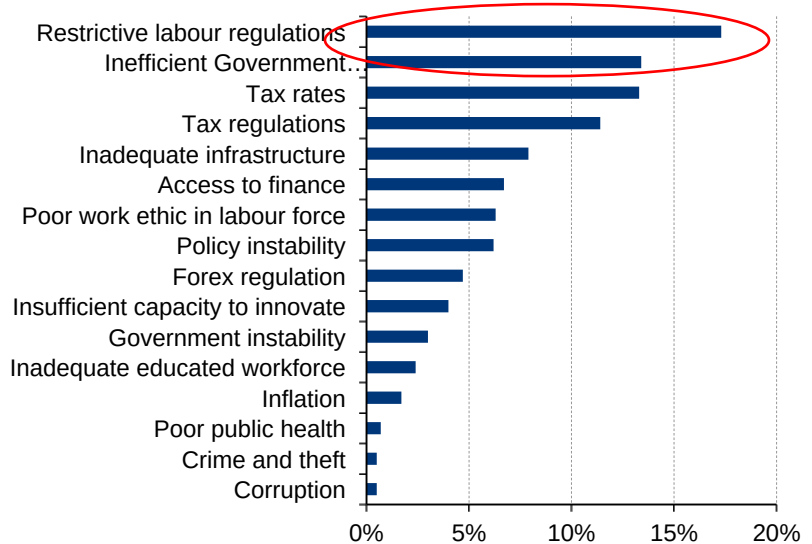
Regulation: Addressing rising compliance

The Business Council of Australia (BCA) estimates that at last count Australia had well over half a million pages of regulation and the federal government over the last decade has introduced around 6,000 pages of new legislation on average each year. The BCA's analysis on growth in Government spending on the four main regulatory agencies (ACCC, APRA, ASIC and ATO) between 2003-2013 has been 5-9%pa. While acknowledging that regulation has an important role to play in upholding critical rights and providing legitimate safeguards, it recommends regulation must be properly thought-through and applied sensibly.

The main areas which are recommended for streamlining by the BCA are: 1) Planning and zoning; 2) Retail sector; 3) Environmental assessment; 4) workplace relations and 5) Corporate governance.

World Economic Forum's Global Competitiveness Index for 2013/14 ranked Australia 128th out of 148 nations for regulatory burden. In comparison, Singapore ranked 1st, New Zealand 13th, Canada 52nd and USA 80th.

Chart 6: The most problematic factors for doing business in Australia (% respondents)



Source: WEF Global Competitiveness Report 2013/14.

From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings

In our view, while there are initiatives underway to streamline regulation, the overall requirement for compliance and adherence is likely to grow as citizens demand that their rights and safety are protected.

Table 21: BofAML Australian stock list with Regulatory exposure

Company	Description
ALS Ltd	Testing service across Minerals, Life Sciences, Energy and Industrial
SAI Global;	Assurance (food), compliance and information services

Source: BofAML Global Research

Table 22: Australia stocks with exposure to Income inequality theme

Company	Income inequality exposure
Affinity Education	High
G8 Education	High
Arena REIT	Med
Stockland	Low

Source: BofAML Global Research

Female participation in the labour force has grown to 59% but lags male participation by 13%

Further social policy initiatives are likely, aimed at increasing the volume and affordability of childcare centers

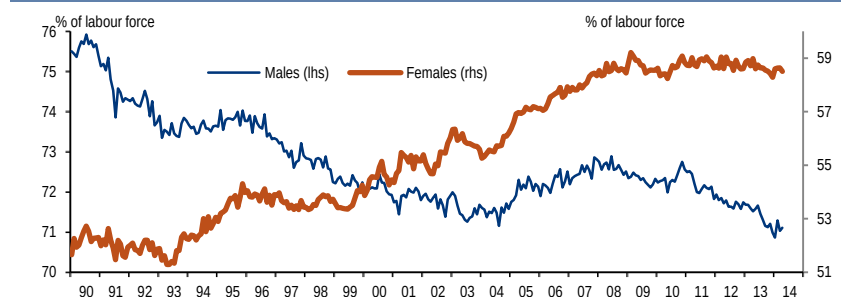
Social policy to address participation and affordability

We see income inequality continuing to grow and potentially fewer direct Government options to intervene through direct payments due to Australia's fiscal position (eg FY14/15 budget includes cutbacks in Family Tax Benefits). However, social policy is likely to be addressed by increasing gender equality (eg via participation rate) and by encouraging housing affordability.

Rising female participation rate

The most obvious change in the lifecycle pattern of participation over the past three decades is the flattening of the 'M' profile with women being far less likely to leave the labour force (or they are likely to stay out for a shorter time) during child caring years than in the past (Source: Productivity Commission, Trends in Labour Force Engagement, Jan 2011). The Australian government has asked the Productivity Commission to undertake a public inquiry into future options for childcare and early childhood learning, with a focus on developing a system that supports workforce participation and addresses children's learning and development needs.

Chart 7: Labour force participation rates



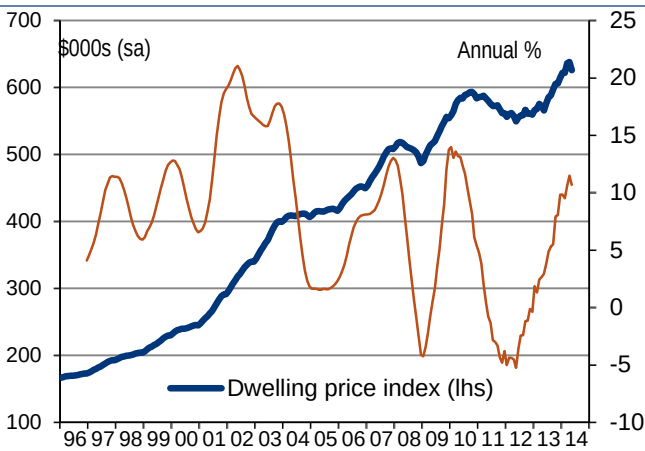
Source: ABS, BofAML Global Research

Measures to increase affordable housing stock

Home ownership is the great Australian dream. House prices in Australia have risen faster than average household incomes since 1970. In 2007-2008, 49.3% of low income households with a mortgage in NSW were found to be in mortgage stress. According to Shelter NSW, in September 2010, 1% of home purchase stock was found to be affordable for very low income households, 6% for low income households. (Source: NSW Parliament Library Services, Housing Affordability, 2011). In 2011-12, nearly 41,000 Australian households received support under the Home Purchase Assistance Program. Additionally, 104,000 people received a First Home Owner Grant (Source: Australian Institute of Health and Welfare, 2013).

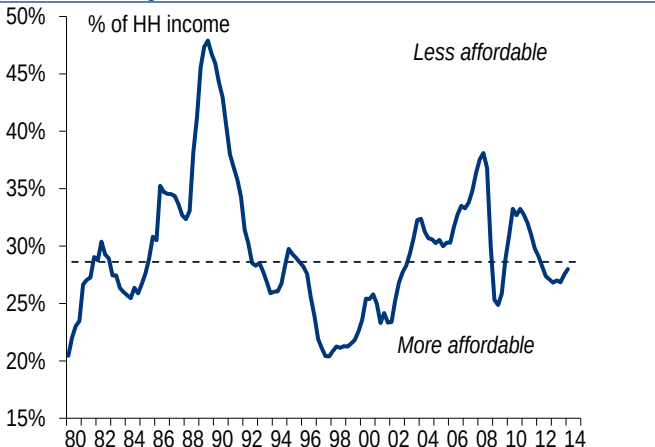
We see scope for the government to tackle income inequality and affordable housing via land bank sales, changes to planning laws and direct measures to promote affordable housing construction. The Reserve Bank of Australia noted that more than 40% of new residential building approvals are currently for medium-density or higher-density housing; this compares with around one-quarter in the 1970s and 1980s (Source: RBA, Submission to the Inquiry into Affordable Housing, Feb 2014).

Chart 8: House prices and annual growth



Source: BofA Merrill Lynch Global Research, RPDData-Rismark

Chart 9: Proportion of average income to purchase a median priced home, assuming 80%



Source: BofA Merrill Lynch Global Research, ABS, RBA

Table 23: Australian stocks with exposure to the Social policy theme

Company	Description
Affinity Education	Childcare centre operator
Arena REIT	REIT with exposure to childcare, education, healthcare and government facilities
G8 Education	Childcare centre operator
Stockland	Developer of residential communities, retirement villages, retail centres, office/industrial space

Source: BofAML Global Research

Earth

Earth themes are related to the finite supply of natural resources clashing with the increasing demand for food, water, and fossil fuels.

A perfect storm is brewing: food-water-energy security

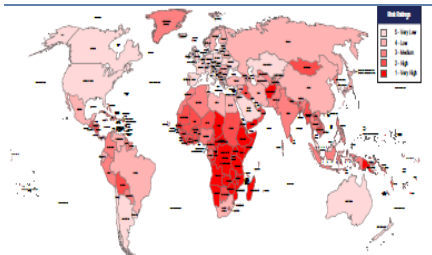
By 2030, global food demand is set to increase by up to 50%, water demand by up to 40% and energy demand by up to 50%. Given how closely food, water and energy security are connected, this will mean increasing trade-offs and resource rationing. It also threatens to create a “perfect storm” of global events, which poses key questions for governments, stakeholders, corporates and investors as to how to meet these demands while adapting to and mitigating climate change.

Exhibit 23: Global water needs



Source: BofA Merrill Lynch Global Research (WDWW (Who Does What Where) Geographical Risk Screening Model)

Exhibit 24: Global food needs



Source: BofA Merrill Lynch Global Research (WDWW (Who Does What Where) Geographical Risk Screening Model)

Exhibit 25: Global energy needs



Source: BofA Merrill Lynch Global Research (WDWW (Who Does What Where) Geographical Risk Screening Model)

Table 24: Australia stocks with exposure to the Water theme

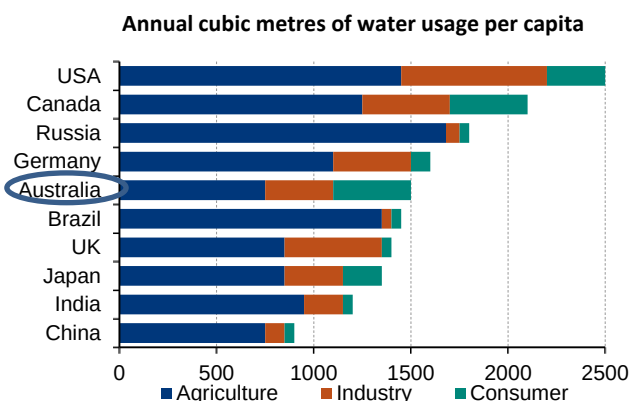
Company	Water exposure
Downer EDI	Low
UGL	Low
WorleyParsons	Low

Source: BofAML Global Research

Water stress

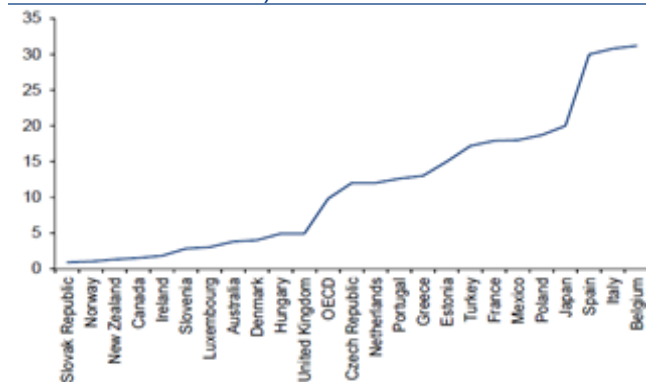
An estimated 35%+ of the OECD’s population is living in areas under “severe water stress” with large parts of Europe, North America, and Australia facing considerable water stress problems. The extent of water stress is illustrated in the graph below which lists the intensity of water use of OECD countries as measured by the total abstractions relative to total renewable resources. Australia has a high dependence on surface water relative to other bulk water sources for its urban water supply.

Chart 10: Farming accounts for the bulk of water use



Source: UN, BofA Merrill Lynch Global Research

Exhibit 26: Water stress in OECD countries (abstractions as % of renewable water resources)



Source: OECD, BofA Merrill Lynch Global Research

Globally there is a requirement for US\$11.7tn of water and sanitation infrastructure investment

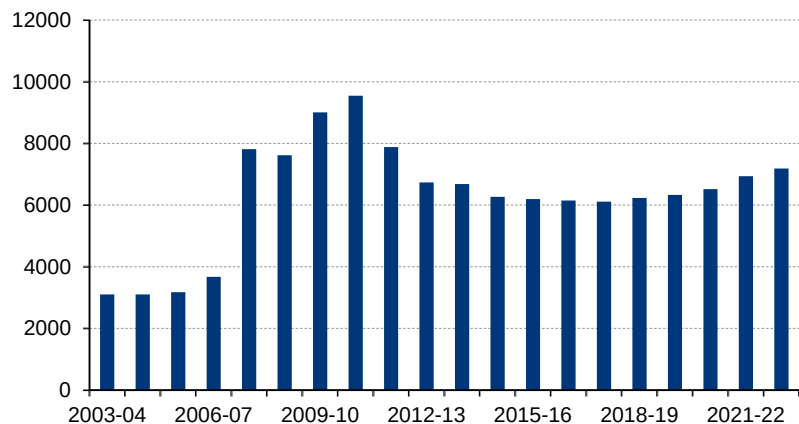
In Australia, a three-fold investment in water infrastructure via construction of desalination plants in 2007-2012 has provided alternative supply

Longer-term we see scope for greater investment in re-cycled water and improvements to irrigation facilities

We believe that the global dynamics of water supply and demand mean that the water sector offers numerous growth opportunities for those with exposure to the value chain. By 2020, we estimate that the water industry could be worth well over US\$1tn, with the fastest growth coming from the lowest-hanging fruits (water treatment and recycling), countries incentivising private sector actors, the more “crop per drop” theme, smart metering and “big data”/technology-based solutions, and water-friendly forms of energy (wind and solar).

Water and sanitation infrastructure requires US\$11.7tn in global investment to 2030 (Source: McKinsey, E&Y). Crumbling and incomplete infrastructure in developed markets are a primary cause of this.

Chart 11: Australia water engineering construction forecasts (\$mn, real terms)



Source: ACIF, BofAML Global Research

Table 25: Australia stocks with exposure to the Water theme

Company	Description
Downer EDI	Engineering services in Resources, Power, Transport and Water segments
UGL	Engineering, property services and infrastructure asset management
WorleyParsons	Engineering services in Oil & Gas, Power and Minerals segments

Source: BofAML Global Research

Table 26: Australian stocks with exposure to the Food theme

Company	Food exposure
Nufarm	High
Incitec Pivot	Medium

Source: BofAML Global Research

Global food demand is expected to rise by 40% by 2030 and double by 2050

Climate change: Food security issues

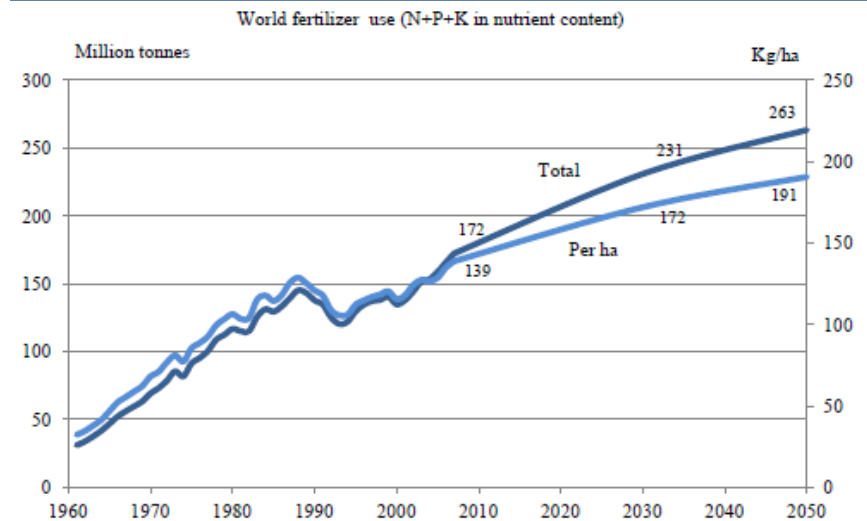
Going forward, global food demand – as reflected by total crop and livestock demand and production – could rise by 40% by 2030 and double by 2050 – meaning that a 70% increase in production output would be needed to feed the world (Source: UN FAO). Maintaining adequate food and agricultural output in the face of increasing population and rising levels of income will become an increasingly important global challenge – especially given an environment of extreme weather and climate change.

There is ever increasing competition for arable land – notably from urbanisation and biofuels – which is set to increase in a climate change constrained world. Other factors which could further reduce productivity include declines in nutrient availability (e.g. phosphorus), the spread in pests and weed, and geographical shifts in production patterns resulting from the effects of global warming (Source: World Bank). This will necessitate an intensification of agriculture on the same or reduced quantities of land (Source: Godfray, Beddington et al. 2010; Smith et al. 2010, World Bank) – and more yield per acre globally through improved productivity.

Approximately 40-60% of the world's food production is made possible through the effective use of fertilizers and nutrients

Today, approximately 40-60% of the world's food production is made possible through the effective use of fertilizers and the impact of their primary plant nutrients and secondary nutrients on soil. The FAO estimates that demand for fertilizers (N+ 166 million tonnes in 2005/2007 to 263 million tonnes in 2050.

Exhibit 27: World fertilizer consumption



Source: UN FAO

Table 27: Australia stocks with exposure to the Food theme

Company	Description
Incitec Pivot	Fertilizers (phosphate, urea, ammonia) and industrial explosives
Nufarm	Crop protection and seed technology

Source: BofAML Global Research

Energy efficiency offers largest potential to contribute to CO2 emission abatement by 2030-35

Table 28: Australian stocks with exposure to the Energy efficiency theme

Company	Energy efficiency exposure
Oil Search	High
Santos	High
Woodside	High
Worley Parsons	High
BHP	Medium
Harvey Norman	Low
Mirvac	Low
Origin Energy	Low

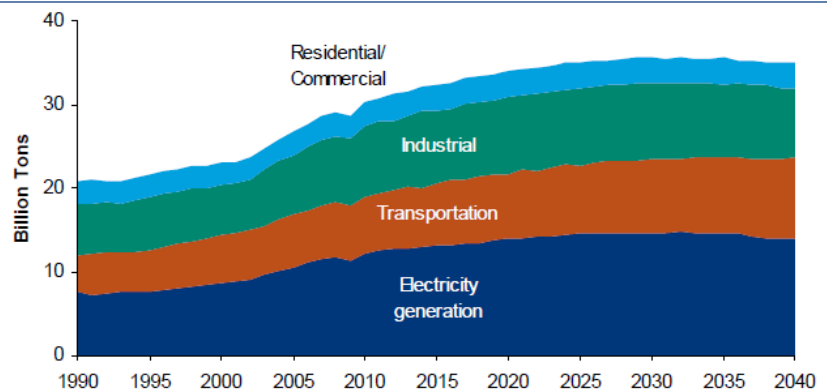
Source: BofAML Global Research

Energy efficiency

In a fossil fuel and resource-constrained world, energy demand inevitably has to adjust to limited supplies. The rationale is multi-fold, from supply-demand balance, to energy and infrastructure costs, to energy security, to environmental sustainability, to access to energy and fuel poverty. Barring an outright, long-term economic downturn – we believe that this process needs to occur through a combination of energy efficiency improvements and gradual substitution of oil and fossil fuels.

Assuming that actual implementation of intended global policies and measures is undertaken in a cautious manner – under the IEA's World Energy Outlook's central New Policies scenario – primary energy demand is expected to increase by 35% between 2010 and 2035. End-use energy efficiency offers the largest greatest potential of any current technology to contribute to CO2 emissions abatement by 2030-35, accounting for over 50% of the total CO2 savings in the IEA's 450 Scenario.

Exhibit 28: Energy-related CO2 emissions by sector



Source: Exxon Mobil, BofA Merrill Lynch Global Research

Buildings

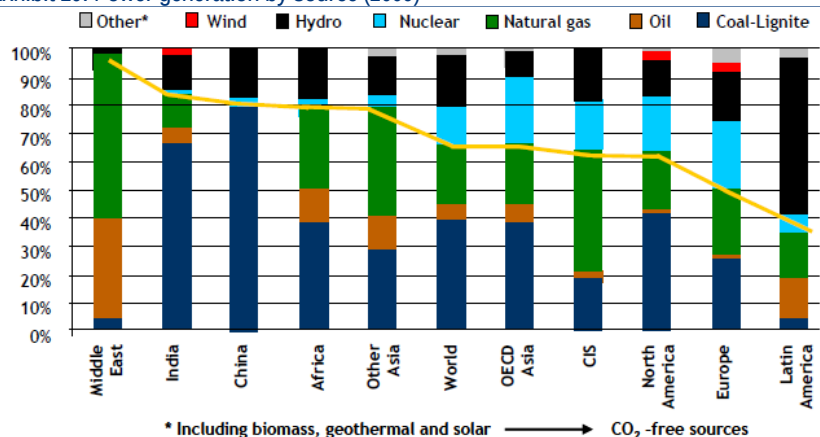
Residential and commercial buildings (including installed equipment and appliances) consumed the equivalent of 114 EJ (extrajoules) worldwide in 2005. Making use of simple energy-efficient solutions in new and existing buildings could save as much as 34% of the projected primary energy consumption by the world's buildings by 2020.

Power generation

The last decade has seen improvements in the energy efficiency of the global power sector, but there is still significant work to be done in terms of energy mix, T&D losses and CO2 emissions:

- Coal is still king, but low-CO2 sources are 1/3 of the energy mix - Globally, thermal sources represented 60%+ of total electricity production in 2009. Natural gas accounted for 20%. Low / "zero" CO2 sources represent about a third of the power mix.
- Global efficiency of thermal plants stood at 35% in 2009.

Exhibit 29: Power generation by source (2009)



Source: ABB based on Enerdata

Because combusting natural gas yields fewer greenhouse gas emissions than coal or petroleum, the expanded use of natural gas offers significant opportunities to help address global climate change (Source: C2ES Centre for Climate and Energy Solutions, June 2013).

Similarly, the US Environmental Protection Agency notes “*The average emissions rates in the United States from natural gas-fired generation are: 1135 lbs/MWh of carbon dioxide, 0.1 lbs/MWh of sulfur dioxide, and 1.7 lbs/MWh of nitrogen oxides. Compared to the average air emissions from coal-fired generation, natural gas produces half as much carbon dioxide, less than a third as much nitrogen oxides, and one percent as much sulfur oxides at the power plant*”

Table 29: Australian stocks with exposure to the Energy Efficiency theme

Company	Description
BHP	Diversified resources incl oil and gas in Gulf of Mexico and Australia
Harvey Norman	Retailer of electrical goods, furniture, computers, bedding and flooring
Mirvac	Residential and commercial developer
Oil Search	Exploration and production of natural gas in Papua New Guinea
Origin Energy	Gas production, power generation and energy retail
Santos	Exploration and production of natural gas in Australia, PNG, Indonesia and Vietnam
Woodside	LNG production in Western Australia

Source: BofAML Global Research

BofAML Thematic Research

BofA Merrill Lynch Global Research also is increasingly theme driven. This report highlights actionable research on the various themes and subcategories such as Japan's return revolution, M2M mobile, Water & Waste, Sino-Russian energy diplomacy, Frontier Markets and Genomics.

The BofAML Research team has 700 analysts, publishing 60,000 reports annually, with over 100 thematic primers between 2013 and 2014. Additionally, the Thematic Investing Strategy team addresses long-term thematic issues from opportunity and risk perspectives – including megatrends such as education, extreme weather and climate change, energy efficiency, obesity and health and wellness, safety and security, waste, water – as well as via portfolio screening tools such as the Global Megatrend Primer Picks, Stylish Themes, CO2 Screener, Geographic Risk, and the ESG Consensus models.

People (Longevity, Urbanization, Globesity, Education, Genomics)

Globesity: the global fight against obesity - Sarbjit Nahal, Aug '13

Education: Stay in school - Sarbjit Nahal, Nov '13

Urbanization: The CEWC and urbanization conference - Ting Lu, Dec '13

Genomics: Tools for a better tomorrow - Derik de Bruin, Jul '13

Longevity: Managed Care Primer - Kevin Fischbeck, Apr '14

Longevity: Significant improvement for US pensions - Matt Trapp, Feb '14

Longevity: Demographic Divide & Peaks - Hak Bin Chua, Aug '13

Markets (The Great Rotation, Income Inequality, Frontier, Financial Repression, Inflation/Deflation)

The Great Rotation: New dawn for growth - Naoki Kamiyama, Apr '14

The Great Rotation: Life on Planet Yellen - Michael Hartnett, Nov '13

The Great Rotation: Japan's return revolution, Naoki Kamiyama, Dec '13

Frontier: An equity investor's guide to Frontier Markets - Wesley Fogel, Nov '13

Best of Breed: Global BoB +72% since inception - Michael Hartnett, Mar '14

Inflation/Deflation: The Longest Pictures - Michael Hartnett, Aug '13

Inflation/Deflation: Where did inflation go? - Laurence Boone, Mar '14

Inflation/Deflation: Tracking deflation - Laurence Boone, Apr '14

Income Inequality: Minimum wage back on the table - Joe Buckley, Feb '14

Innovation (Disruptive Tech, E-commerce, Safety/Security, Robotics, Industrial Internet)

Disruptive Tech: Innovation nation – Vivek Arya, Dec '13

Disruptive Tech: M2M - Third wave of mobile growth – Sameer Chopra, Mar '14

Disruptive Tech: Automation for the people – Mark Troman, Sep '13

Disruptive Tech: Is American innovation dead? – Savita Subramanian, Mar '13

Robotics: Medical Technology, Upcoming catalysts – Bob Hopkins, Feb '14

E-Commerce: Bitcoin, a first assessment – David Woo, Dec '13

Safety/Security: Safer World - Sarbjit Nahal, Feb '14

Government (Geopolitics, Regulation, Reform, Infrastructure, Social Policy)

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Reform: Buying unloved SOE boredom – Ajay Kapur, Nov '13

Regulation: Navigating regulatory constraints - Priya Misra, Jan '14

Regulation: Standouts in round 1 of stress test – Erika Najarian, Mar '14

Regulation: Basel leverage eased – Erika Najarian, Jan '14

Regulation: Volcker Rule: Early Read – Michael Carrier, Dec '13

Regulation: All you may need to know about ECB QE - Alex Batchvarov, Apr '14

Policy: Looking to the East: Russian gas prospects in China – Karen Kostanian, Apr '14

Earth (Water, Waster, Energy Independence, Weather, Energy Efficiency)

Weather: Weathering the perfect storm - Sarbjit Nahal, Sep '13

Weather: Turning weather into an advantage – David Woo, Feb '14

Water: Blue Revolution - Sarbjit Nahal, Feb '14

Waste: No time to waste - Sarbjit Nahal, Feb '14

Energy Efficiency: less is more - Sarbjit Nahal, Feb '14

Energy Independence: Exporting Ame

Link to Definitions

Macro

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

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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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