

Demographics: Plan B

Out with Plan A

The Australian government initially focussed on immigration as the main way of alleviating the effects of an ageing population. But there has recently been a backlash by voters against the 'big Australia' policy. We believe the government will be forced to develop other ways to deal with demographic change.

In with Plan B

The government's Plan B will likely be centred around boosting productivity, in our view. Chief among these policies will be serious investment in public infrastructure including roads, rail and ports, from which we believe Downer (DOW), Leighton (LEI), UGL, Boral (BLD) and Asciano (AIO) stand to benefit. The independent Members of Parliament that have balance of power have made it clear they support infrastructure spending. Policies to foster education & training and research & development will also get increased attention under Plan B.

Bye-bye immigration?

There is a risk that immigration could be scaled back significantly, in our view. We assess three main implications:

- Reduced immigration could exacerbate skill shortages and wage pressures in an already tight Australian labour market. This could motivate more outsourcing from which we believe small caps like Oakton (OKN), SMS Technology (SMX) and Technology One (TNE) stand to benefit.
- Lower immigration would also accelerate a structural decline in building activity in the housing market. We view this as a risk to the long-term growth outlook for Stockland (SGP), Lend Lease (LLC) and building materials companies. In the near term residential developers' earnings are underpinned by a shortage of houses and their ability to grow market share.
- House prices already face substantial headwinds from the ageing population, which would be more severe with lower immigration. Hence one unintended consequence of the policy could be to exacerbate the risks to household balance sheets, since Australians have a large share of wealth tied up in housing. Cutting immigration could also have negative consequences for consumption and profits.

Rethinking healthcare

Against the background of increasing government focus on ageing, our healthcare analyst argues that his sector is not defensive, just late cycle. This reflects the government's incentive to seek ongoing efficiency gains. As such, we have a sector preference for health stocks with predominantly offshore earnings.

Three key Buys

Among the stocks that stand to benefit from our thesis, we highlight three with Buy ratings from our analysts: Downer (DOW), Asciano (AIO) and Oakton (OKN).

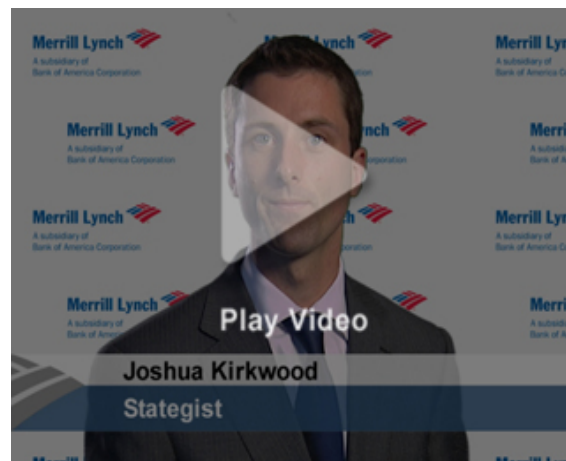
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Think Tank is a regular series looking at major issues affecting stock markets and the economy. In this issue we look at how government policy is grappling with the implications of demographic change.

Previous Think Tank reports:

[#1: A whole new world](#)

[#2: Hitchhiker's Guide to China 2.0](#)

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Demographics: Plan B

Research on demographic change has tended to focus on how the ageing population will affect the economy and stocks, such as increased spending on healthcare and retirees' demands for investments with stable income. In this piece, we take a different tack and look at how government policy is being formulated to deal with the issue.

In this area, Australian policy makers are ahead of the curve. As other countries grapple with the fallout from the global financial crisis (GFC), Australia escaped relatively unscathed and its bureaucrats are devoting significant attention to longer-term issues.

But policy makers appear to be at a turning point. The government's initial plan focussed on immigration as the main way of alleviating the effects of an ageing population. Immigration is now being scaled back, and political pressure could see it cut below what is economically prudent. This could have major implications for the labour market, the housing market and household balance sheets:

- Reduced immigration would exacerbate skill shortages and wage pressures in an already tight Australian labour market. This could motivate more outsourcing from which we believe small caps like Oakton (OKN), SMS Technology (SMX) and Technology One (TNE) stand to benefit.
- Lower immigration would also accelerate a structural decline in building activity in the housing market. This is a risk to the growth outlook for Stockland (SGP), Lend Lease (LLC) and CSR. However, in the near term, residential developers' earnings are underpinned by a shortage of houses and their ability to grow market share.
- House prices already face substantial headwinds from the ageing population, which would be more severe with lower immigration. Hence one unintended consequence of the policy could be to exacerbate the risks to household balance sheets, since Australians have a large share of wealth tied up in housing. Cutting immigration could also have negative consequences for consumption and profits.

The government's Plan B for dealing with ageing will likely be centred around boosting productivity, in our view. Chief among these policies will be serious investment in public infrastructure. Policies to foster education & training and research & development will also get increased attention.

Against the background of increasing government focus on ageing, our healthcare analyst argues that his sector is not defensive, just late cycle. We think this reflects the government's incentive to seek ongoing efficiency gains in the sector that will see further ongoing reform and potential funding cuts. As such we have a sector preference for health stocks with predominantly offshore derived earnings.

Among the stocks that stand to benefit from our thesis, we highlight three with Buy ratings from our analysts: Downer (DOW), Asciano (AIO) and Oakton (OKN).

For a thorough overview of demographics in the Asia-Pac region, see our strategist's [demographics chart book](#).

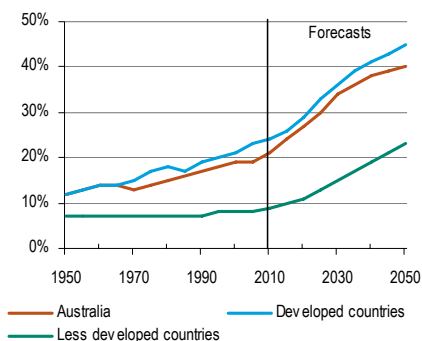
All downhill from here?

With the Australian baby boomers now beginning to commence retirement, we believe the growth of the labour force will slow and economic growth will decline. But Australia's population is slightly younger than the rest of the developed world and consequently the effects of ageing may not be as severe as overseas:

- The median age of Australia's population is currently 38 years and is projected to rise to 43 over the next four decades; other developed countries are a little older (Chart 1). Australia's slightly younger population in part reflects a strong immigration historically, since migrants have tended to be younger than the existing population. One-quarter of Australia's current population was born overseas.
- Old-age dependency ratios – the ratio of the people aged 65 years and over to the working age population – will rise sharply as the baby boomers commence retirement. This reflects both a decline in fertility and a rise in longevity. The UN's central projections are for the Australian dependency ratio to nearly double over the next 40 years to 24 per cent; ratios for the rest of the developed world are higher and projected to increase to 26 per cent (Chart 2).

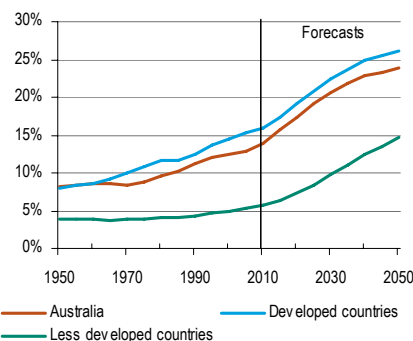
Nevertheless, government spending on pensions and healthcare will pick up sharply over coming decades. Life expectancies have also increased and this will add further pressure to government budgets globally (Chart 3).

Chart 1: Median age



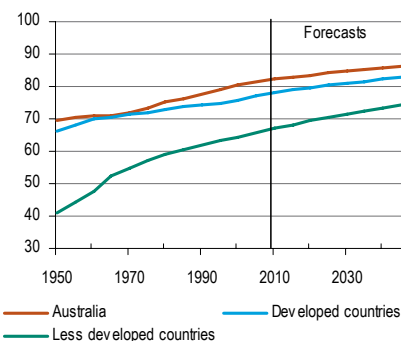
Source: UN Population Database

Chart 2: Old age dependency ratios



Source: UN Population Database

Chart 3: Life expectancy at birth (years)



Source: UN Population Database

By how much?

Over the past four decades real GDP growth averaged 3.3 per cent per year. We expect it will average just 2.3-2.7 per cent over the next four decades as a result of the ageing population. This will weigh on stock returns, as will the withdrawal of baby boomer savings to finance retirement.

At a turning point

There are only a few levers government can pull to alleviate the impact of demographic change, namely policies that boost productivity, workforce participation and population growth. For a small country like Australia, immigration was initially deemed the most attractive lever; it was Plan A.

Plan A: strong immigration. But this is now not a politically appealing way of dealing with the impact of an ageing population...

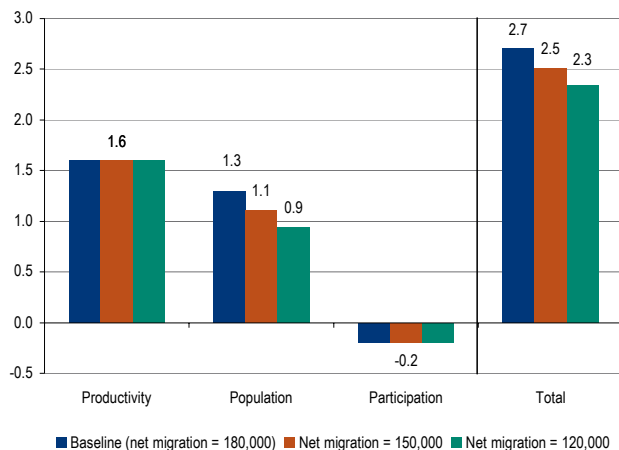
Recently there has been a strong move against the 'big Australia' policy trumpeted by former Prime Minister Kevin Rudd. Strong immigration has placed a great deal of pressure on public infrastructure and pushed up house prices. This turned into a very topical political issue in the recent federal election. We also expect infrastructure to play a major role in the looming state elections for Victoria (27 November 2010) and NSW (26 March 2011).

Scaling back immigration beyond what is economically prudent now appears to be a very real risk. This could have major implications which we outline below. Reduced immigration would cut the economy's long-term potential growth rate (Chart 4).

...the only real alternative is to boost productivity. This is Plan B.

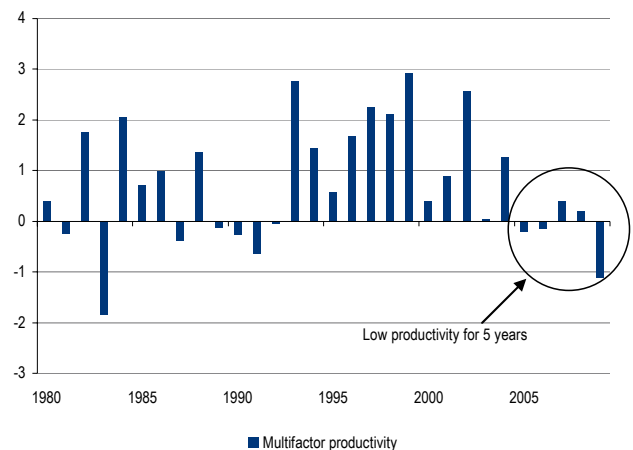
We believe all of this points to an increasing focus by government on boosting productivity – Plan B. In addition to alleviating the effects of the ageing population, policies that boost productivity could be politically attractive. Australia's poor productivity growth for the past 5 years will redouble the resolve of policymakers to address the issue (Chart 5).

Chart 4: Drivers of economic growth over the next 40 years



Source: Treasury; ML Equity Strategy

Chart 5: Australia has recorded very ordinary productivity growth for 5 years



Source: ABS; RBA; ML Equity Strategy

Hello productivity

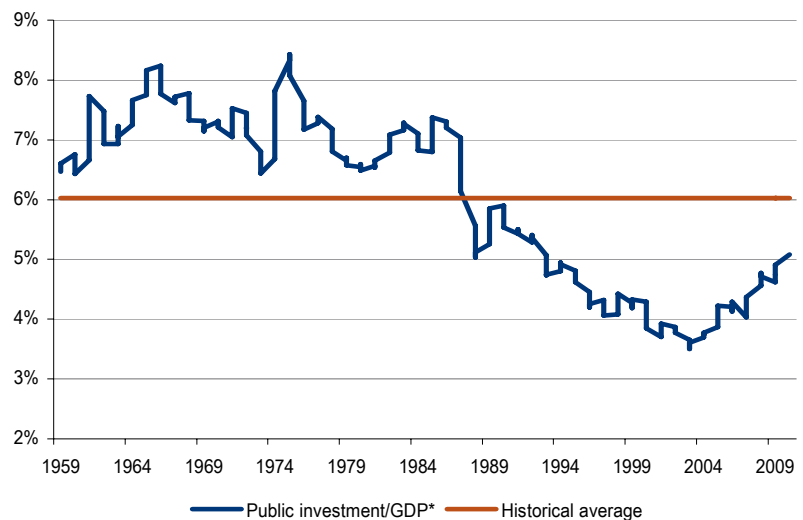
Renewed focus on boosting productivity will include policies about infrastructure, research and development, and education. The first of these has major short-term implications for stocks, with R&D and education more important in the longer run.

We expect a major pick up in investment in infrastructure.

Infrastructure

Australia has under-invested in infrastructure for two decades. This is highlighted by the ratio of public investment to GDP being below its long-run average of 6 per cent (Chart 6). In the past 5 years there has been an increase in spending but much more needs to be done.

Chart 6: Underinvestment in infrastructure for a long time



* excludes investment in defence
Source: ABS; ML

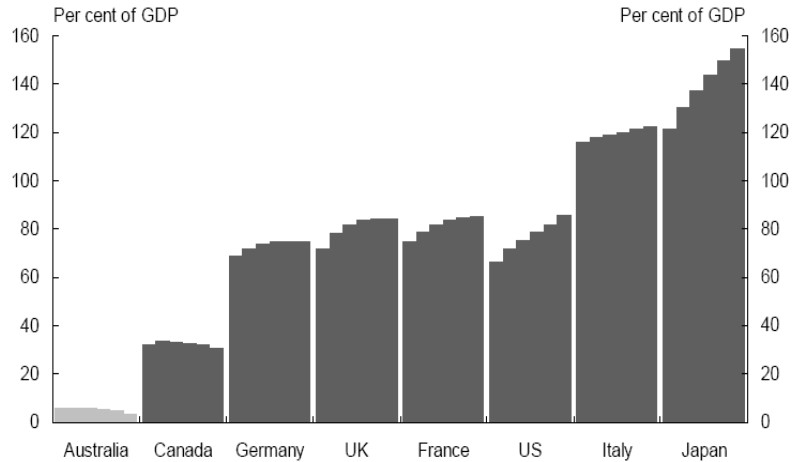
Australian governments can afford to spend...

Governments can afford to spend

The Australian government balance sheet is lowly geared and can support major spending on infrastructure. Net debt is very low by global standards at just 6 per cent of GDP – lower than virtually all G7 countries (Chart 7).¹ Even if Australian government debt were to double from infrastructure spending, the implied future tax liability for Australians would still be very small by global standards. We believe this bodes well for the long-term consumption outlook.

¹ Even accounting for state government debt this only rises to around 15 per cent of GDP.

Chart 7: Government net debt for Australia and the G7 (2010-2015)*



Source: IMF World Economic Outlook April 2010, IMF Fiscal Monitor May 2010 and Treasury.

* excludes state, municipal and local government debt
Source: Treasury

Where to spend?

As we discussed above, major spending on infrastructure also appears to be politically attractive. But spending on what?

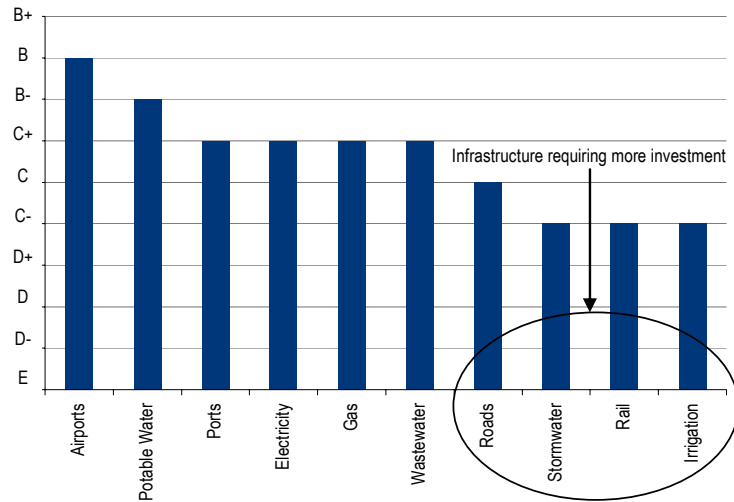
Rail, roads and ports are key areas where infrastructure is needed.

Engineers Australia's *Infrastructure Report Card* identifies the aspects of infrastructure in most need of development. The Report Card assesses adequacy of infrastructure for current and anticipated usage – anything below a 'C' means current infrastructure is inadequate. Roads, stormwater, rail and irrigation have all been identified as being in most need of development (Chart 8). These are also likely to be the largest beneficiaries of additional government investment, as would further spending on ports to alleviate bottlenecks.

Rail is particularly poorly rated, scoring a D- in NSW and a D in Victoria. Looming elections in both states could be the catalyst for the announcement of significant investment rail since congestion is a constant source of angst among residents of Sydney and Melbourne, but also a major impediment to new housing supply with infrastructure burdens levied on developers and new home owners.²

² One issue that may constrain the rollout of additional infrastructure is the difficulty getting workers in a tight labour market. We think part of this can be resolved by transitioning workers from the 'Building the Education Revolution' program as it winds down throughout 2011. (The Building the Education Revolution will deliver 10,550 school construction projects by late 2011 at a cost of \$14 billion.)

Chart 8: Australia's infrastructure report card



Source: Treasury, ML

The stocks that we believe will be affected by renewed government focus on infrastructure include:

- **Downer EDI (DOW):** DOW's core focus is on the maintenance of infrastructure assets rather than their construction; maintenance accounts for about 70 per cent of revenue. The company mainly operates in Australia. Its business is highly diversified, offering products and services across engineering (35 per cent of EBIT), rail (25 per cent), road maintenance, consulting, and contract mining. DOW could benefit from new infrastructure spend as a primary contractor through its activities in the power, asphalt, passenger rail manufacture and telecommunications sectors where it operates in a Greenfield capacity. We currently have a Buy on DOW on valuation grounds.
- **Leighton (LEI):** As Australia's largest contractor LEI will be heavily involved in any increase in infrastructure spend. We view LEI as having a ~60% success rate of winning large infrastructure projects across a wide range of projects including, roads, telecommunications, rail and desalination.
- **UGL (UGL):** UGL's primary focus is on the long term maintenance of infrastructure assets as opposed to Greenfield construction work. That being said, it has a strong presence in the water and power markets where it could have a significant part to play in any new projects. UGL would also benefit from expenditure on rail and roads through its passenger rail manufacturing operations and transport systems capability.

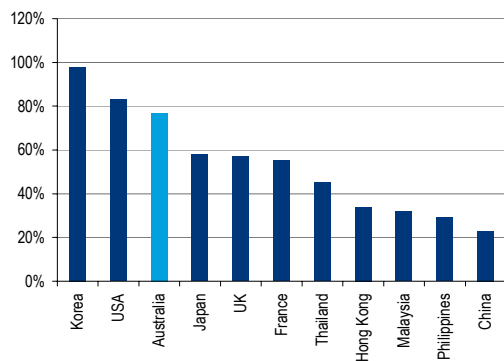
- **Asciano (AIO):** Asciano is in a strong embedded position within Australia's port and rail infrastructure. It is one of two Australian stevedores (3rd entrant Hutch will start in 2013), and is in a duopoly market in coal haulage. Any infrastructure spend is likely to include an expansion of the ports, and particularly a de-bottlenecking of port to rail interface. 23% of NSW's container movements are by rail currently with the Govt targeting 40% by 2015. In Queensland we expect that Queensland Rail will spend circa \$4bn over the next five years expanding the Queensland coal rail network that will assist in the growth of Queensland Rail's and Asciano's coal haulage operations in that state.
- **Transurban (TCL):** As Australia's largest owner of privately operated toll roads, TCL has historically benefited from a lack of spending on the competing free network. Because TCL's assets are located where competing roads are unlikely to be built, any future pick up in government spending is unlikely to draw traffic away from the company's existing roads. TCL may look to expand next year by purchasing toll roads in Brisbane from operators that could encounter financial difficulty.
- **Onesteel (OST):** Onesteel is Australia's only producer of long steel product with about 50 per cent of its end market volume exposure coming from the Engineering and Non-Residential Construction sectors. Whilst Australia imports around 30 per cent of its long steel requirements, we estimate that an increase in infrastructure spending would be a net positive for OST given (1) OST's ability to scale up volumes via its Electronic Arc Furnace production methods (OST utilisation has averaged 79% over the past 4 years) and; (2) the likely push towards Australian manufactured steel (where appropriate) in publicly funded infrastructure projects.
- **Boral (BLD):** Boral's Australian Construction Materials division supplies ~30 per cent of the Australian concrete market, with a predominant concentration on the east coast states of NSW and VIC. Given a relatively high level of competition in the Australian concrete market, prices (and hence earnings) are highly sensitive to volumes. Boral is also a major supplier of aggregates used in construction and asphalt used in roads. We would expect Boral to benefit from any increased Government infrastructure spending through increased volumes, particularly in the materials intensive areas of Construction and Roads and Highways.

Table 1: Infrastructure stocks

	ML Rating	Market Cap (\$mn)	Avg daily turnover (\$mn)	Last Price	Forward PE	Price to Book	Dividend Yield (%)
DOWNER EDI LTD	BUY	1438.5	17.7	4.25	7.1	1.1	3.1
LEIGHTON HOLDINGS LTD	NEUTRAL	9673.3	24.3	32.17	13.1	4.0	3.1
UGL LTD	NEUTRAL	2517.1	8.2	15.17	13.2	2.2	4.7
ASCIANO GROUP	BUY	5135.3	19.2	1.76	16.3	2.0	
TRANSURBAN GROUP	BUY	7264.1	24.5	5.04	53.1	1.8	5.6
ONESTEEL LTD	BUY	3968.1	23.8	2.98	7.4	0.9	3.7
TRANSFIELD SERVICES LTD	BUY	1528.7	5.8	3.69	12.1	1.9	4.5
BORAL LTD	NEUTRAL	3400.2	21.3	4.73	13.7	1.0	2.1

Source: Bloomberg; ML Equity Strategy
Last price as of 6/9/2010

Chart 9: Proportion of school leavers that enrol in tertiary education



Source: UNESCO

Education and training

As the government seeks to boost productivity there will be increased focus on education and training. This is a longer-term trend for stock markets to which a couple of companies have direct exposure:

- **Navitas (NVT)**: any increased government focus on educating/training for the resident population is currently more than offset by slowing student immigration. The company's University Programs division (65% of sales) provides pathway courses to help international students bridge the gap between school and entry into an Australian university. Recent government figures have suggested a marked slowdown in student immigration and our forecasts assume just +1.6% CAGR 2010-13F in student numbers for NVT. Less than 10% of revenue is from workforce training, which could be a direct beneficiary of an increased domestic training focus.
- **Seek (SEK)** is directly impacted by federal government policies for both higher education and immigration. Its main exposure is a 50/50 JV with Australian universities, IDP, which operates international student placement and English language testing businesses. SEK equity accounts IDP. In addition, SEK's consolidated education business, Think, which contributed 25% of group revenue in FY10 (A\$70mn), runs higher education and English language courses. Many English language students go on to further study. Cutbacks in immigration and expected short-term declines in international student enrolments will negatively impact IDP and, to a lesser extent, Think. However, we believe future federal governments will need to support increased higher education services, both public and private, which should benefit SEK's education businesses over the long term. IDP is expanding its student placement business in the US, which will offset local declines.

Table 2: Education and training stocks

	ML Rating	Market Cap (A\$m)	Avg daily turnover (A\$m)	Last Price	Forward PE	Price to Book	Dividend Yield (%)
NAVITAS LTD	NEUTRAL	1496.1	1.6	4.37	17.6	14.2	4.0
SEEK LTD	BUY	2571.5	9.3	7.64	17.1	7.3	1.7

Source: Bloomberg; ML Equity Strategy

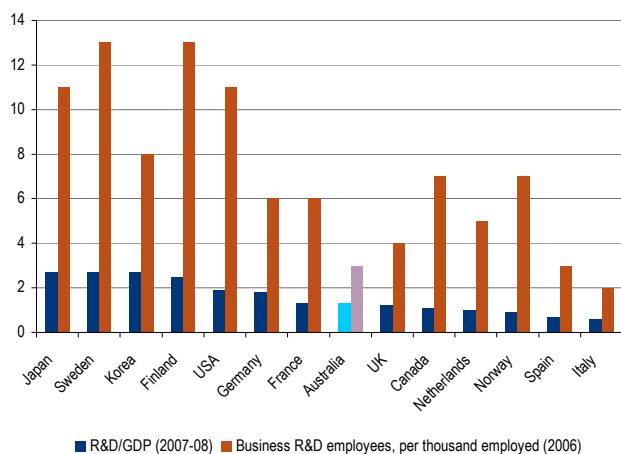
Last price as of 6/9/2010

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Research and development (R&D)

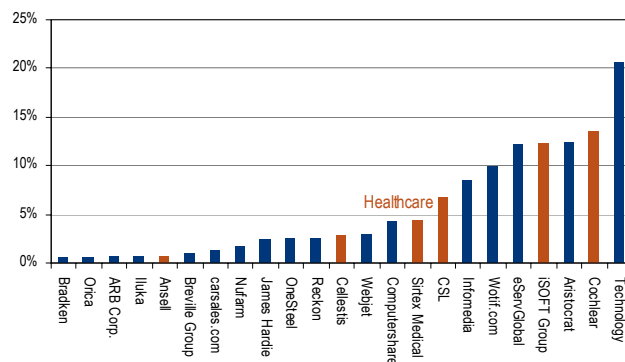
Australia currently ranks around middle of the pack on R&D spending and in our view could do better (Chart 10). We believe the government will seek to boost the amount of R&D undertaken in Australia.³ It has already started moving in this direction by recently announcing simplified tax treatment of R&D; companies with turnover >\$20 million now eligible for a 40 per cent non-refundable credit on R&D. ASX 200 companies that stand to benefit from this – and other incentives to undertake R&D that could be announced – are concentrated in the healthcare sector (Chart 11).

Chart 10: Australia could do more R&D



Source: Semate Economics Legislation Committee, June 2010 report

Chart 11: Companies that stand to benefit from more tax breaks on R&D (R&D/sales)



Source: Bloomberg; ML

Table 3: Selected stocks with high R&D/Sales ratios

	ML Rating	Market Cap (A\$m)	Avg daily turnover (A\$m)	Last Price	Forward PE	Price to Book	Dividend Yield (%)
Technology One	BUY	264.3	0.2	0.88	12.6	4.8	5.5
Cochlear Ltd	NEUTRAL	4055.9	22.2	71.65	20.4	9.2	2.7
Aristocrat	NEUTRAL	1984.2	8.3	3.72	15.8	9.2	1.0
Computershare	N/A	5273.3	0	9.48	13.7	4.6	2.6
OneSteel	BUY	3835.2	24.2	2.87	7.2	0.9	3.7
Wotif.com	UNDERPERFORM	974.8	5.1	4.66	15.0	11.3	4.0
CSL	NEUTRAL	18255.7	70.7	33.17	15.1	4.3	2.5
James Hardie	BUY	2455.9	15.1	5.64	13.6		
Nufarm	NEUTRAL	887.4	9.5	3.4	9.9	0.6	2.7

Source: Bloomberg; ML Equity Strategy
Last price as of 8/9/2010

³ Of course it is not necessary that R&D be undertaken domestically to improve productivity, since technology can be imported.

Bye-bye immigration?

Because there is a very real risk that political pressure could see immigration scaled back beyond what we would view as economically prudent, we assess the risks to the labour market, the housing market and household finances.

Our analysis suggests reduced immigration would see lower growth in retail spending and a long-term decline in building activity in the housing market. Company profits could potentially be lower as wages pick up and the RBA heads off price inflation increases by increasing interest rates.

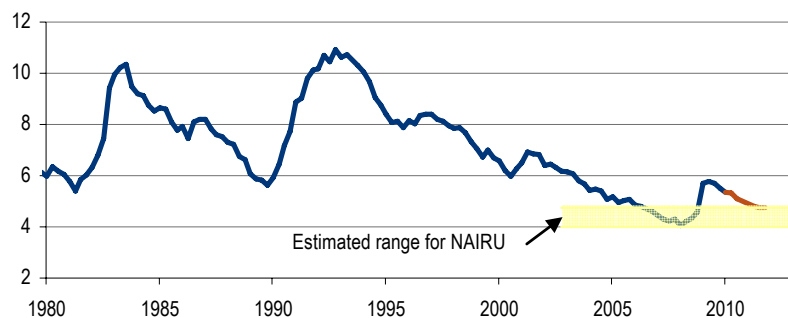
The ageing population is already going to exert downward pressure on asset prices as the baby boomers spend savings in retirement, but the headwinds for house prices will only be more severe if immigration is cut.

Immigration and the labour market

We believe scaling back immigration would exacerbate skill shortages and increase inflationary pressures; it could also cause the RBA to lift rates earlier than would otherwise be the case. The Australian labour market is already tight at this early stage of the global economic cycle, with the unemployment rate close to the estimated non-accelerating inflation rate of unemployment (NAIRU) of 4¾-5 per cent (Chart 12).

Scaling back immigration would exacerbate skill shortages and increase inflationary pressure.

Chart 12: Australia's unemployment rate is already low...



Source: ABS; ML Equity Strategy

The tight labour market (which will get tighter still if immigration is scaled back) already presents major risks to companies. The nature of these risks varies according to whether the company is in the resources sector or not.

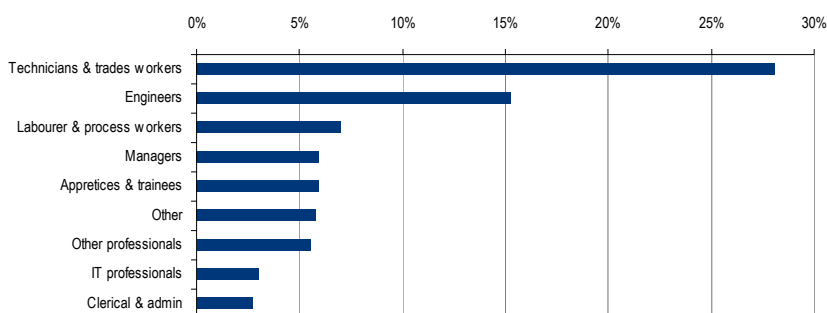
Companies with exposure to mining expect skill shortages to be a constraint on growth from FY2012.

Resource companies' growth constrained by skill shortages

Difficulty finding suitable workers could constrain the growth plans of many companies in the resource sector. Skill shortages are most acute for technicians, trades workers and engineers (Chart 13).

A lack of suitable labour is a risk to the growth outlook for [Monadelphous](#) (MND), UGL Limited (UGL), Transfield Services (TSE), [Santos](#) (STO) and Origin (ORG). ORG's Gladstone LNG project, for example, will require 8,000-9,000 construction personnel at its peak in 2013/14. Several of these companies have mentioned these shortages are expected to come through in FY2012, but could be earlier.

Chart 13: Skill shortages by occupation (percentage of companies)



Source: AIG National CEO Survey - Skilling Business in Tough Times, October 2009

The tight labour market should see companies focus on increasing the efficiency of their workforce.

Non-resource companies' will look to cut costs

The tight labour market provides companies with a major incentive for cost cutting. Serious pruning of employee numbers usually occurs during recessions, but Australia has not had one for 20 years. Some companies are simply carrying too much labour and could be more efficient.

The major banks are moving in this direction, implementing large IT system improvements. Head count reductions could follow as contract staff supporting the IT investment are let go and the new systems improve productivity and efficiency. However, CBA has stated it intends to improve efficiency through revenue rather than costs, and that it has no planned job cuts.

As firms focus on this issue a handful of companies recently identified by our small caps team stand to benefit greatly:

- [Oakton \(OKN\)](#) is an IT services & outsourcing vendor focused on the domestic market providing services across a number of verticals. The group has been an early mover in building an offshore platform (India) enabling the group to tap into labour arbitrage opportunities to reduce costs for clients. The group has also focused on building a long-term annuity stream via outsourcing contracts and has a lot of capabilities in the applications and business process outsourcing arena. OKN is currently our favoured play in the small-cap IT service sector.

- [SMS Technology \(SMX\)](#) is also positioned in the IT services space but has a model that is closer aligned to short-term delivery of personnel for both consulting and systems integration work. We think the group should be well placed to benefit from companies looking to drive efficiency and shift staff to a variable rather than fixed cost basis.
- [Technology One \(TNE\)](#) is a software vendor with a broad portfolio of solutions including accounting & finance, customer relationship software and asset management amongst others. The suite of products enable customers to drive significant efficiency through their organisations. The ROI on investing in TNE products is notably high and enables customers to reduce costs. In a tightened labour market we would expect both public and private sector organisations to leverage third party software to try and stem increasing wage-bills.
- [McMillan Shakespeare \(MMS\)](#) offers workplace benefits such as salary packaging and novated leasing. In an increasingly tight labour market these incentives drive retention and facilitate competition for new workers. We estimate of a labour force of 11 million, 3.6 million people work in organisations that could offer these benefits to employees. Managing workplace benefits is outside the core competency of most employers and it is therefore increasingly outsourced. But penetration is low at this point with just 14 per cent of the target 3.6m market receiving these benefits. In Australia, MMS is the leading provider of work place benefits administration; it is three times the size of its nearest competitor. We expect strong earnings growth for this company due to both structural (more outsourcing) and cyclical factors (more job creation).

Table 4: Immigration and the labour market stocks

	ML Rating	Market Cap (A\$m)	Avg daily turnover (A\$m)	Last Price	Forward PE	Price to Book	Dividend Yield (%)
OAKTON LTD	BUY	279.0	0.5	2.98	9.6	2.8	2.7
SMS MANAGEMENT & TECH LTD	BUY	427.3	1.3	6.36	11.7	4.6	4.6
TECHNOLOGY ONE LTD	BUY	261.3	0.2	0.87	12.4	4.8	5.5
MCMILLAN SHAKESPEARE LTD	BUY	465.6	0.6	6.88	10.3	7.5	5.0

Source: Bloomberg; ML Equity Strategy
Last price as of 6/9/2010

Immigration and housing

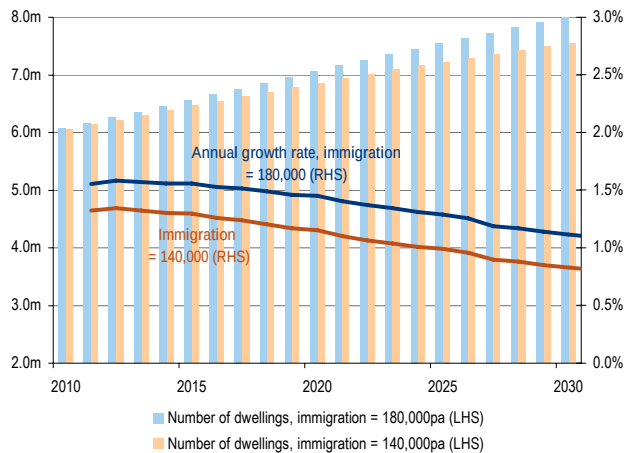
Strong immigration and a lack of new supply in recent years has resulted in excess demand for housing in Australia. Supply has been constrained as smaller developers have struggled to obtain finance, while planning restrictions and infrastructure levies also played a role. There could be a shortage of up to 200 000 dwellings, and as a result Australian house prices have increased in recent years, in contrast to developments overseas.

Scaling back immigration to 140,000 per year will see growth of the housing stock fall by $\frac{1}{4}$ - $\frac{1}{3}$ percentage point. It will also accelerate the structural decline in building approvals.

Looking longer-term, scaling back immigration has major implications for the housing market. There are currently around 8½ million private dwellings in Australia, of which about 6 million are occupied by families and the remainder by people living alone or sharing accommodation (Charts 14 and 15).⁴ We might think of the former group as being more likely to live in houses and the latter in apartments and smaller houses. If immigration was scaled back from 180 000 to 140 000 people per annum, the estimated annual growth rate of the dwelling stock falls by $\frac{1}{4}$ - $\frac{1}{3}$ percentage point over the next 20 years.⁵

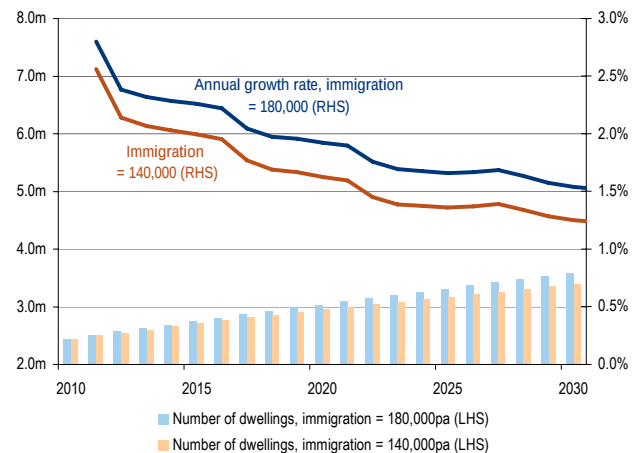
Even without changes to immigration policy, the ageing population will have a major impact on the composition of Australian households. About one-quarter of people currently live alone but this will rise to nearly 30 per cent over the next two decades. As a result, demand for apartments and other small dwellings will rise relative to demand for established houses with 3 or more bedrooms, as will smaller aged accommodation.

Chart 14: Number of family dwellings (proxy for houses)



Source: ABS; ML Equity Strategy

Chart 15: Number of other dwellings (proxy for apartments and small houses)



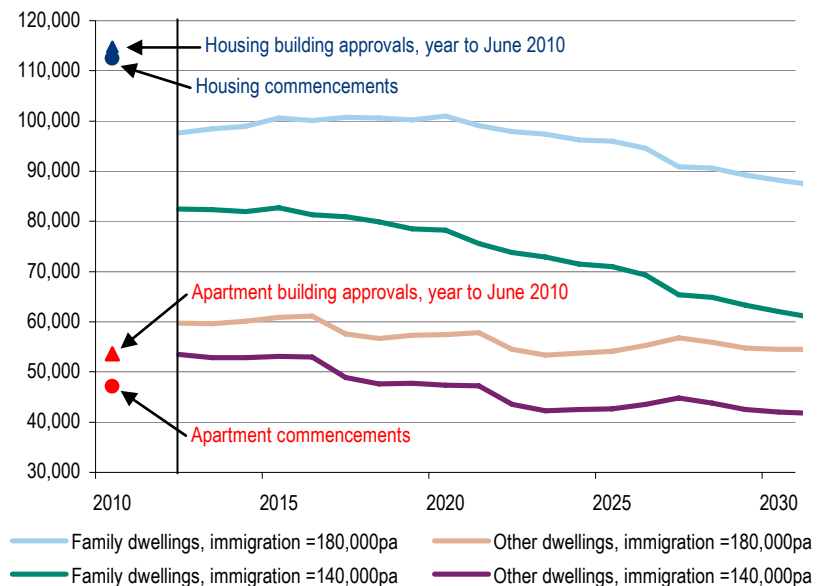
Source: ABS; ML Equity Strategy

⁴ These calculations are based on updated estimates of the ABS population and household projections. They assume a trend decline in fertility rate from 1.9 to 1.8 babies per woman; a slow increase in life expectancy to 83 for males and 87 for females; and the number of persons per household declining from 2.66 to 2.52 over the forecast horizon. Obviously long-dated projections like ours are sensitive to these assumptions.

⁵ This assumes that supply equals demand, and hence construction of new dwellings is equal to what is required from population growth.

We can translate these projections of for the dwelling stock into long-term forecasts of building approvals (Chart 16). Once the current supply-demand imbalance is worked through, the 'equilibrium' number of approvals will fall. Moreover, if immigration was scaled back significantly from 180,000 the long-term structural decline in approvals/commencements for family dwellings would begin in the next few years.

Chart 16: Number of new dwellings constructed each year



Source: ABS; ML Equity Strategy

Obviously this has a range of implications for share market valuation, not least that the assumed terminal value growth rates for companies with exposure to housing should be revised down in light of the likely decline in immigration.

Building materials stocks

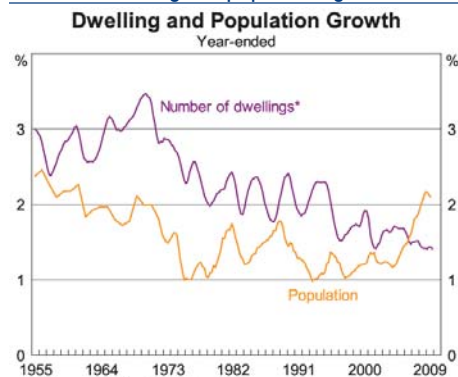
In order of preference, the stocks most exposed to a reduction in Australian housing starts are CSR (60% of EBIT post Sugar sale), Boral (40%), Adelaide Brighton (25%), Fletcher Building (15%) and James Hardie (10%). Our materials analyst Ben Chan estimates that capacity for most building products in Australia is around 160 000 starts.

Property companies

We believe a slowing long-term population growth rate will have the largest adverse impact on the residential developers, while those with retirement operations stand to benefit from an ageing demographic. Over the past 5 years residential developers have diversified into the retirement space because of the attractive long-term demographics and synergies with existing operations.

- **Residential developers:** Any slowdown in Australia's population growth will directly impact demand for new houses, in our view, and therefore the long-term earnings of the listed residential developers. As the table below shows, Stockland, Mirvac, Peet Limited, FKP and Lend Lease all have Australian residential development businesses.

Chart 17: Dwelling and population growth



Source: ABS, RBA, Stockland

However, in the near term the demand-supply fundamentals remain supportive due to a combination of strong immigration, a lack of new supply and finance restrictions for developers. In CY09, net population growth in Australia jumped to 400,000, adding demand for 150,000 new homes and bringing the national housing shortfall to 200,000.

Residential development is highly fragmented with the top three land developers (Lend Lease, Stockland and Peet Limited) having a combined market share of only 17 per cent. Developers which have large land banks, moderate gearing and open lines of financing stand to win market share from indebted counterparts since they can buy new sites and deliver existing projects. We therefore expect earnings growth from the listed residential developers despite slowing population growth. We note too that contracts on hand (a key forward indicator) rose by an average of 85% for the developers under coverage signalling earnings growth in FY11.

The main risk for residential developers is affordability constraints exacerbated by mortgage rate rises. In this regard, we favour the developers who produce more affordable product. Among the residential developers, our pecking order is Stockland, Peet, Australand, Lend Lease and Mirvac.

Table 5: Property companies' EBIT exposures to residential development and retirement

	% EBIT Residential Development or Syndication	% EBIT Retirement
Stockland	30%	5%
Lend Lease	20%	10%
Peet Limited	100%	
Mirvac	20%	
Australand	10%	
FKP (not under coverage)	60%	20%

Source: Company data, Merrill Lynch

- **Retirement operators:** There are currently 2 million people older than 70 in Australia and this is expected to increase by 3.5 per cent each year over the next 16 years. Of those in the over 70 age group, only 5 per cent live in retirement villages. By comparison, other western countries have a much higher retirement village participation rate of about 10 per cent. Australia's low participation is largely due to low-quality retirement village stock, as well as a lack of supply. But the quality of new retirement villages is likely to improve in time as national developers like Stockland and Lend Lease expand. Supply will also increase in previously under-served locations. As a result, participation should move towards 8 per cent in Australia.

By diversifying into retirement, residential developers broaden their target market, enabling faster sales rates and inventory turnover. Adding retirement villages within their larger community developments also facilitates faster government approvals since they favour development for the aged.

On the downside the cash yield generated by retirement operators is low at 3-6 per cent due to the deferred management fee structure and high operating costs. To increase the cash yield, operators need scale and mature villages which will lead to the continuing consolidation of the sector. Consistent with this, Stockland has made a bid for the retirement operator

Aveum and still retains a strategic stake in FKP. Going forward, we expect property companies with strong balance sheets, diversified businesses and land development businesses to dominate this market. We have Buy ratings on Stockland and Lend Lease.

Immigration and household finances

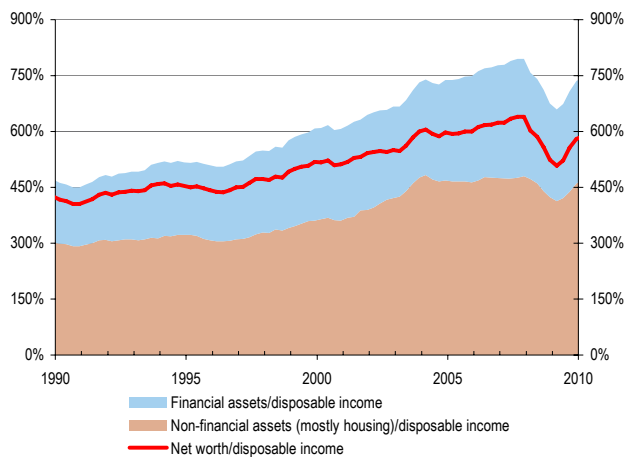
Australian household balance sheets are well placed as the baby boomers commence retirement, but we believe there are risks that could be unintentionally exacerbated if immigration is cut sharply.

Aggregate household net worth amounts to nearly 600 per cent of disposable income (Chart 18). On our numbers a retiree needs 5-8 times their working income to maintain a reasonable standard of living.

Australians have a large share of wealth in housing, and house prices face headwinds from the ageing population.

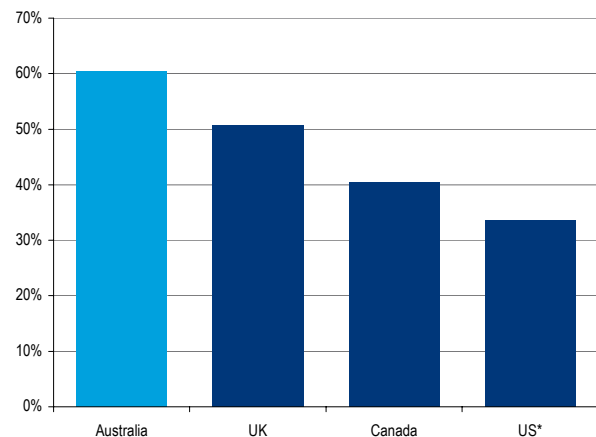
But a large share of Australians' wealth is tied up in housing (Chart 19). The ageing population will produce substantial headwinds for house prices globally. Recently published econometric research suggests demographic factors boosted Australian real house prices by around 30 per cent between 1970 and 2009, or about one-sixth of the overall increase as baby boomers saved for retirement by buying assets.⁶ Sales of these houses to finance retirement will weigh on prices over the next 40 years (Chart 20). These headwinds would be compounded if immigration was cut, since demand for housing is lower than what it otherwise would be.

Chart 18: Household wealth has increased rapidly from saving and asset returns



Source: RBA; ML

Chart 19: Australians store more of their wealth in housing

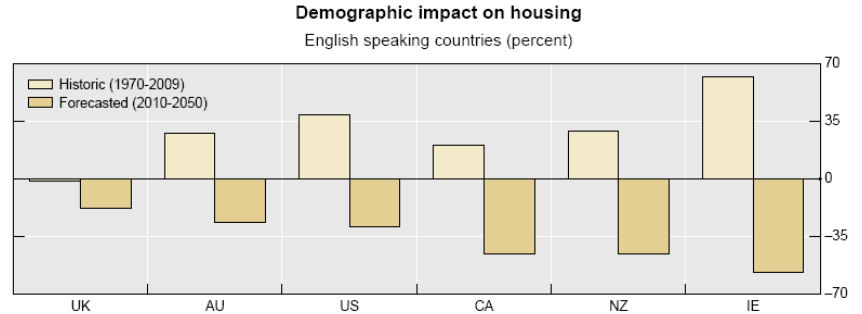


Source: national sources, ML

Our view is that Australian housing is fully valued and that real house prices will be flat for some time. The RBA appears to be targeting this outcome. Longer-term, the ageing population will weigh on house prices and we may see falls in real house prices over an extended period.

⁶ 'Ageing and asset prices' by Elöd Takáts, BIS Working Papers No 318, August 2010. The results in Chart 11 are based on a regression of real house prices against real GDP per capita, and demographic and other factors.

Chart 20: Demographic impact on housing



AU = Australia; CA = Canada; UK = the United Kingdom; IE = Ireland; NZ = New Zealand; US = the United States.

Source: Author's calculations.

Source: 'Ageing and asset prices', BIS Working Papers No 318, August 2010

Reverse mortgages: major growth ahead

Because of the larger share of Australian's wealth accounted for by housing we expect strong demand for reverse mortgages.⁷ Only about \$3 billion of these mortgages are outstanding, less than ½ per cent of housing credit. But the market is on the cusp of significant growth as baby boomers commence retirement. Of the major banks, CBA and Westpac have the largest reverse mortgage books. They have benefited from the inability of non-bank lenders – who had previously been the main promoters of reverse mortgages – to get funding in recent years. This could cement them as the main providers of a product with a large potential market.

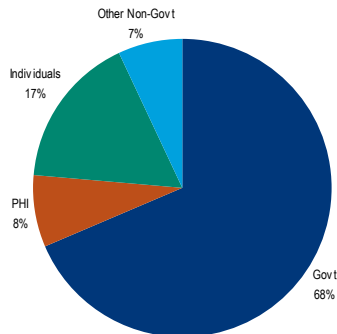
Nevertheless there are a few constraints on growth of the market: (1) potential borrowers are uninformed about the product and the industry is investing in educating financial planners and branch staff; (2) there is uncertainty around the extent of consumer legislation, with the government announcing a commitment to consumer protection and (3) capital requirements are also relatively onerous.⁸

⁷ Reverse mortgages allow retirees that own a home to borrow against the equity in the dwelling without having to move out. Interest payments on the debt are typically capitalised and is repaid along with principal when the owner dies or the home is sold.

⁸ A 50 per cent risk weight applies to reverse mortgages with loan-to-valuation ratios (LVRs) ≤60 per cent; a 100 per cent risk weight applies to reverse mortgages with LVRs up to 100 per cent.

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Healthcare
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Chart 21: Sources of Health funding



Source: Merrill Lynch estimates

Central Thesis:

1) That Healthcare is predominantly funded by Government (68%) and with an Ageing Population there is an incentive to seek savings from the sector against the long term rising cost profile.

2) These savings (cuts) also provide an immediate funding source for fiscal stimulus during a recession.

3) Operators that try and recoup these cuts start to test the price sensitivity of patients...

4) ...who in turn consume less services which fulfils a secondary benefit of this policy approach – to reduce GDP burden and fund stimulus.

Healthcare is not defensive, just late cycle

The healthcare sector is typically regarded as defensive given the intuitive non-discretionary nature of its goods and services. However, as the majority of funding comes from Government (Australia – 68%), we believe the sector is not defensive but instead late cycle.

Our thesis is best reflected in the sales growth of stocks within the sector domestically and internationally over the past two years, as well as the regulatory reforms during this period. We make three key observations:

- **Reimbursement:** companies that sell products or services with strong reimbursement, requiring little or no patient co-payment, performed well during the global recession in developed markets such as the US and Australia.

The best example of this is Resmed (RMD) vs Cochlear (COH) vs CSL. These are all high growth, high P/E names that sell products along the discretionary spectrum. Ironically, CSL's products that are life saving and have the most stringent reimbursement profile saw US market growth fall to ~4 per cent during FY10. COH – whose products restore hearing but also have patchy reimbursement – saw US growth fall to an estimated 8 per cent. RMD's products are more discretionary yet strongly reimbursed; US growth stayed at 11-12 per cent.

- **Price sensitivity:** Companies that attempted to experiment with pricing over the past two years have experienced dramatic losses of market share and lower industry growth.

The best example of this is SHL in QLD. After attempting a price increase in QLD (a market where they had a strong market share position) that would require patients to make a co-payment (to recover a funding cut), SHL lost significant market share and the state saw negative volume growth.

- **Government reform:** Negative funding outcomes for the health service providers and product manufacturers have resulted from government policies globally over the past two years. The justification for much of the reform is preparation for the cost burden of an ageing population.

It is smart politics to source savings from healthcare. This is best illustrated by the government elevating competition at the same time as cutting funding (AU Pathology), so that operators find it more difficult to pass the funding cuts onto patients. Because of the lag with which competition subsidies and price increases are pushed through, the government can avoid blame about cause and effect.

Australia's more proactive forward planning of the Ageing Population fiscal gap is driving greater regulatory (reform) risk in this market for Healthcare than other international markets which are presently more stable (in a regulatory sense).

Timing issue in Government estimates

The central projection of when the ageing population will 'hit' is summarised in the Inter Generational Report's (IGRs) projected 'fiscal gap'. The fiscal gap is based on Treasury projections of 'total Australian government receipts minus payments'. The chart below shows the three projected fiscal gap from successive IGRs; their variance emphasises the difficulties in modelling but also the influence of policy assumptions. Over the course of 8 years between IGR 1 (2002) and IGR 3 (2010) there has been a forward projection revision of 16 years.

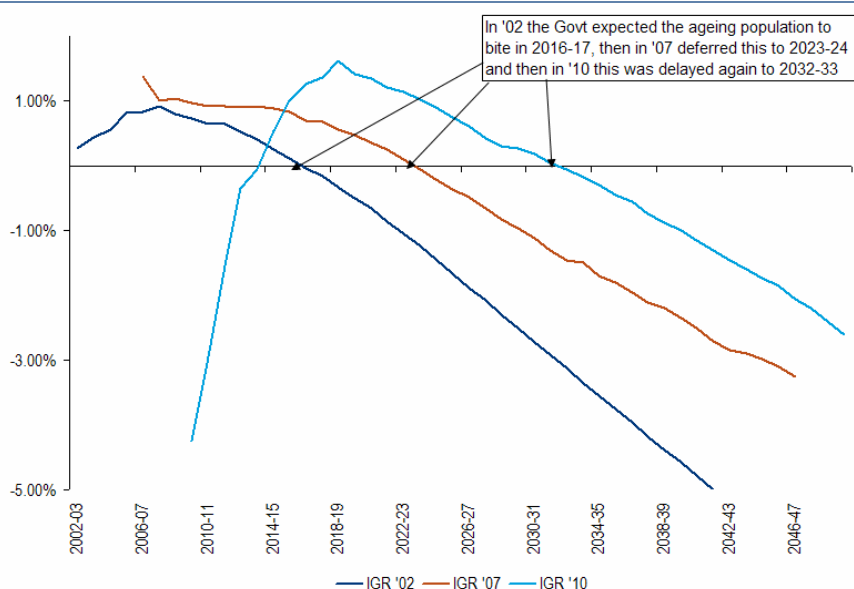
Revisions to the assumptions about immigration policy and GDP that underpin the projections of IGR 3 will probably see the fiscal gap brought forward (from 2032 presently). This will provide further impetus for the Government to continue to seek savings from Healthcare. As these savings have traditionally involved funding cuts for the private operators, it supports our preference for stocks that derive the majority of their earnings from offshore markets; their Governments are not necessarily as proactive as Australia in addressing ageing and pursuing healthcare reform.

The decrease in total projected spending between the IGR reports is driven by two key factors:

- (i) the fiscal strategy; and
- (ii) the more gradual pace of ageing in IGR 2010 compared to IGR 2007 due to immigration policy at the time.

A future variable to the modelling and realisation of this gap will be the health of the aged population as advances in pharmaceuticals is seeing a less GDP burdensome 65-85 cohort than what was previously anticipated.

Chart 22: Comparison of IGR estimates of Projected Fiscal Gap



Source: Treasury projections reported within Intergenerational reports

Strong preference for AU healthcare companies that derive the majority of their earnings from overseas markets which are have less reform risk than Australia.

Healthcare investment strategy

With the Australian regulatory reform profile not yet stable relative to the other international markets we have a strong preference for the listed companies with the majority of their earnings derived overseas. In order of preference:

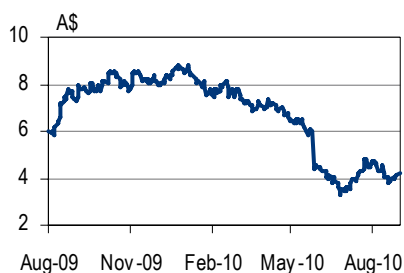
- **Ansell** [Buy] – momentum of operational success with conservative guidance and upside risk to the FY11 outlook and consensus.
- **ResMed** [Buy] – strong reimbursement supporting industry growth with new product success driving 1Q and 2Q11 performance.
- **CSL** [Neutral] – solid demand profile for products that will grow with awareness and affordability and best in industry competitive positioning.
- **Cochlear** [Neutral] – easy 1H10 comp and momentum from 2H10 with a new product should see a strong 1H11 although FY12 growth remains uncertain.
- **Sonic** [Neutral] – timing of a pathology recovery difficult to forecast which maintains risk to the downside for FY11 / FY12 consensus.
- **Primary** [Neutral] – downgrade risk to FY11 Guidance irrespective of a recovery in pathology volumes per SHL's projected timings (Nov-10).
- **Ramsay** [Underperform] – fully priced with limited further upside for a well performing business. Health Insurance reform remains a sleeping risk.
- **Sigma** [Underperform] – challenging valuation until earnings post pharmaceuticals divestment are reset and growth options become clear.

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Stock Data

Price	A\$4.25
Price Objective	A\$5.42
Date Established	19-Aug-2010
Investment Opinion	B-1-7
Volatility Risk	MEDIUM
52-Week Range	A\$3.33-A\$9.44
Mrkt Val / Shares Out (mn)	US\$1,263 / 325.1
Average Daily Volume	2,892,558
BofAML Ticker / Exchange	DNERF / ASX
Bloomberg / Reuters	DOW AU / DOW.AX
ROE (2011E)	15.4%
Net Dbt to Eqty (Jun-2010A)	40.6%
Est. 5-Yr EPS / DPS Growth	6.0% / NA
Free Float	NA

Price Chart



Source: Bloomberg

Downer EDI Ltd (DOW AU)

What the company does

DOW's business is highly diversified offering products and services across engineering, road maintenance, rail, consulting, and contract mining. The common theme running through the business is DOW's focus on recurring maintenance work, with 70 per cent of contracts being for longer duration activities. DOW predominately operates within Australia but also has significant exposure to New Zealand through its Works and Engineering businesses.

Why you should buy

DOW's core focus is on the maintenance of infrastructure assets rather than their construction; maintenance accounts for about 70 per cent of revenue. The company mainly operates in Australia. Its business is highly diversified, offering products and services across engineering (35 per cent of EBIT), rail (25 per cent), road maintenance, consulting, and contract mining. While DOW is primarily a secondary contractor, it could benefit from new infrastructure spend as a primary contractor through its activities in the power, asphalt, passenger rail manufacture and telecommunication sectors where it operates in a Greenfield capacity. We currently have a Buy on DOW on valuation grounds.

At our valuation \$5.42, DOW would be trading on an FY12 P/E of 7.9x versus its average one year forward P/E of 10.7x. With our expected return to growth in FY12 and with a clear potential catalyst in the practical completion of the first Waratah set by December 31st probable in our view, we think DOW shares offer compelling value.

Estimates (Jun)

(A\$)	2009A	2010A	2011E	2012E	2013E
Net Profit b/f Abnormals	189	197	201	238	280
EPS	0.577	0.591	0.592	0.689	0.800
EPS Change (YoY)	12.4%	2.5%	0.1%	16.5%	16.0%
Dividend / Share	0.290	0.292	0.292	0.340	0.395
Free Cash Flow / Share	(0.139)	0.879	(0.298)	0.386	0.413

Valuation (Jun)

	2009A	2010A	2011E	2012E	2013E
P/E	7.36x	7.19x	7.18x	6.16x	5.31x
Dividend Yield	6.81%	6.87%	6.88%	8.01%	9.29%
EV / EBITDA*	4.33x	4.13x	3.94x	3.46x	3.08x
Free Cash Flow Yield*	-3.31%	21.24%	-7.31%	9.64%	10.47%

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Stock Data

Price	A\$1.76
Price Objective	A\$2.20
Date Established	30-Jun-2010
Investment Opinion	B-1-7
Volatility Risk	MEDIUM
52-Week Range	A\$1.44-A\$1.94
Mrkt Val / Shares Out (mn)	US\$4,549 / 2,835.2
Average Daily Volume	10,969,140
BofAML Ticker / Exchange	AANOF / ASX
Bloomberg / Reuters	AIO AU / AIO.AX
ROE (2011E)	8.9%
Net Dbt to Eqty (Jun-2010A)	81.7%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	100.0%

Price Chart



Source: Bloomberg

Asciano (AIO AU)

What the company does

Asciano owns and operates transportation infrastructure. The company owns and operates container terminals in Melbourne, Sydney, Brisbane and Fremantle, as well as bulk ports across Australia. It also owns rail asset Pacific National which is one of the two dominant national rail providers operating in the inter-modal, grain and coal industries.

Why you should buy

Asciano is in a strong embedded position within Australia's port and rail infrastructure. It is one of two Australian stevedores (3rd entrant Hutch will start in 2013), and is in a duopoly market in coal haulage. Any infrastructure spend is likely to include an expansion of the ports, and particularly a de-bottlenecking of port to rail interface. 23% of NSW's container movements are by rail currently with the Govt targeting 40% by 2015. In Queensland we expect that QR will spend circa \$4 billion over the next five years expanding the Queensland coal rail network that will assist in the growth of QR's and Asciano's coal haulage operations in that state.

AIO's forward EV/EBITDA is 8.7x and EV/EBIT is 13.2x, but our 3-year EBIT CAGR is 17 per cent. Coal haulage is the most structurally attractive business we analyse given (1) likely system growth, (2) take-or-pay contracts, (3) limited pre-committed capex, & (4) targeted equity IRRs of 14-16%. Management advised that it is comfortable with EBIT consensus for FY11 which stands at around \$578 million (30 per cent growth).

Estimates (Jun)

(A\$)	2009A	2010A	2011E	2012E	2013E
Net Profit b/f Abnormals	(1)	161	241	283	323
EPS	(0.001)	0.055	0.082	0.097	0.110
EPS Change (YoY)	NM	NM	49.5%	17.5%	14.3%
Dividend / Share	0	0	0.025	0.034	0.044
Free Cash Flow / Share	(0.197)	(0.051)	(0.054)	0.054	0.083

Valuation (Jun)

	2009A	2010A	2011E	2012E	2013E
P/E	NM	31.9x	21.3x	18.1x	15.9x
Dividend Yield	0%	0%	1.4%	1.9%	2.5%
EV / EBITDA*	9.6x	11.4x	9.6x	8.7x	8.1x
Free Cash Flow Yield*	-4.8%	-3.0%	-3.2%	3.1%	4.9%

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Stock Data

Price	A\$2.98
Price Objective	A\$3.67
Date Established	10-Aug-2010
Investment Opinion	A-1-7
Volatility Risk	LOW
52-Week Range	A\$2.09-A\$4.30
Mrkt Val / Shares Out (mn)	US\$249 / 91.5
Average Daily Volume	205,236
BofAML Ticker / Exchange	XOKTF / ASX
Bloomberg / Reuters	OKN AU / OKN.AX
ROE (2011E)	23.6%
Net Dbt to Eqty (Jun-2010A)	9.4%
Est. 5-Yr EPS / DPS Growth	22.7% / 78.1%
Free Float	69.2%

Price Chart



Source: Bloomberg

Oakton Limited (OKN AU)

What the company does

Oakton Limited (OKN) provides business focused IT solutions, and business consulting, financial services and assurance services. These services are provided through three main business streams of Consulting Services, Delivery Services, and Operational Services. The company is headquartered in Melbourne and has offices in Sydney, Canberra, Brisbane and India.

Why you should buy

The group has been an early mover in building an offshore platform (India) enabling the group to tap into labour arbitrage opportunities to reduce costs for clients. OKN has also focused on building a long-term annuity stream via outsourcing contracts and has a lot of capabilities in the applications and business process outsourcing area.

The near-term and mid-term outlook seems robust for OKN. Recent management contact has indicated a solid pipeline of opportunities in both the public and private sector. The group seems well placed to continue to drive spend out of the government sector regardless of any election outcome. Further, the strategy is heavily focused on driving growth out of the NSW practice which has been hitherto under-represented from a market share perspective.

The group trades at a discount to global and domestic peers and is set to deliver solid cash-backed EPS growth which supports our Buy call.

Estimates (Jun)

(A\$)	2009A	2010A	2011E	2012E	2013E
Net Profit b/f Abnormals	14	20	24	29	33
EPS	0.158	0.218	0.260	0.310	0.358
EPS Change (YoY)	-49.3%	38.3%	19.1%	19.0%	15.6%
Dividend / Share	0.023	0.065	0.139	0.184	0.226
Free Cash Flow / Share	0.172	0.201	0.284	0.286	0.323

Valuation (Jun)

	2009A	2010A	2011E	2012E	2013E
P/E	18.87x	13.64x	11.45x	9.62x	8.32x
Dividend Yield	0.755%	2.18%	4.65%	6.19%	7.60%
EV / EBITDA*	12.29x	9.17x	7.73x	6.49x	5.51x
Free Cash Flow Yield*	5.70%	6.84%	9.70%	9.76%	11.02%

Price objective basis & risk

Asciano Group (AANOF)

Our PO of A\$2.20 is based on a blended valuation methodology involving (1) DCF valuation with a WACC of 8.5 pct, (2) and a multiples based method where we ascribe multiples of between 8-12x for the company, in line with global peers. Downside risks to our valuation are the following. (1) Revenues are expected to be cyclical in nature so if the economic conditions and consumer discretionary remain weak, the outlook for the stock could soften. This would impact container port volumes, intermodal volumes, as well as the Autocare business. (2) Port competition is an issue, and if the 3rd operator gains greater than expected market share, AIO could be negatively impacted. Upside risks are (1) stronger than expected turnaround in port volumes. and (2) PN Coal winning greater market share in QLD and NSW.

Downer EDI (DNERF)

Our valuation of \$5.42 places DOW on an FY12 P/E of 7.9x, a 27% discount to DOW's historical average of 10.7x which we see as appropriate given the ongoing management and contractual difficulties DOW has been experiencing.

The PO is also at a 20% discount to our DCF (WACC of 10%, terminal growth rate of 3%) of \$6.78. We believe this discount is reasonable given the ongoing risk around DOW's \$1.87bn Waratah contract and as a result now believe DOW should trade at a discount to our DCF.

The downside risks we see to our PO are:

- 1) DOW is required to take further write downs on \$1.87bn Waratah contract which could jeopardise its chances of winning future passenger contracts.
- 2) The mining business is hit by lower volumes and margins if global commodity volumes and prices fall increasing competition for new contract mining work.
- 3) The upside from the expected boom in capex from the LNG, resources and infrastructure markets in Australia does not materialise.

Oakton Limited (XOKTF)

Our Price Objective has been set at A\$3.67 which represents a 50%:50% blended average between our DCF model and a PER peer group comparison. DCF model assumes 7.5% CAGR sales growth, 19.0% peak EBIT margins and a WACC of 11.5%. Terminal growth has been set at 4.5%. Our PER peer group comparison has been struck at 13x 2011f PER which is slightly below the global peers which seems conservative given the expected earnings growth is significantly above the peer group.

Downside risks to our forecast are: transactional & reputation risks, contingent liability from the Tenix dispute, offshore expansion up scaling risks, and competitive risks.

Link to Definitions

Industrials

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

Macro

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

Technology

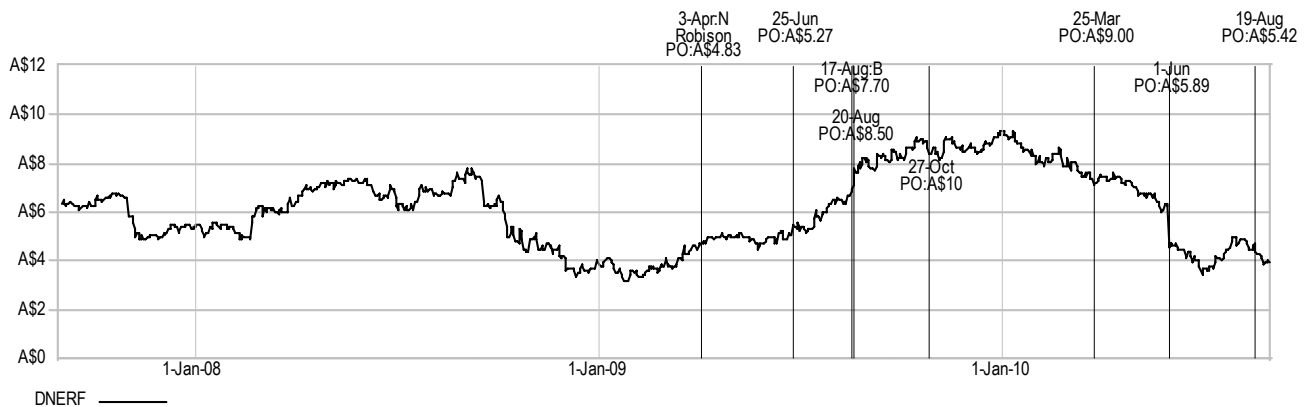
Click [here](#) for definitions of commonly used terms.

Analyst Certification

We, Mark Bryan, Matthew Spence and Nicholas Robison, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Important Disclosures

DNERF Price Chart

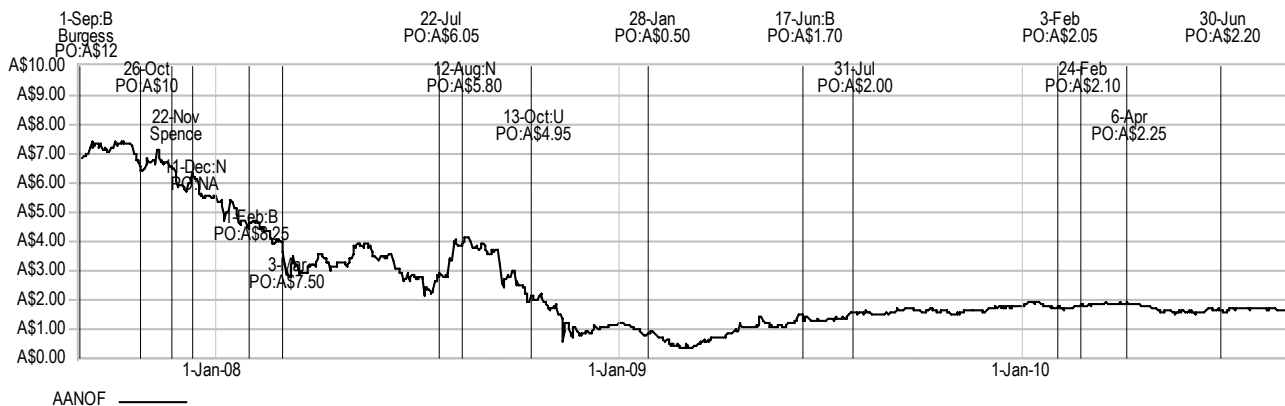


B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR : No Rating

"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 August 31, 2010 or such later date as indicated.

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AANOF Price Chart



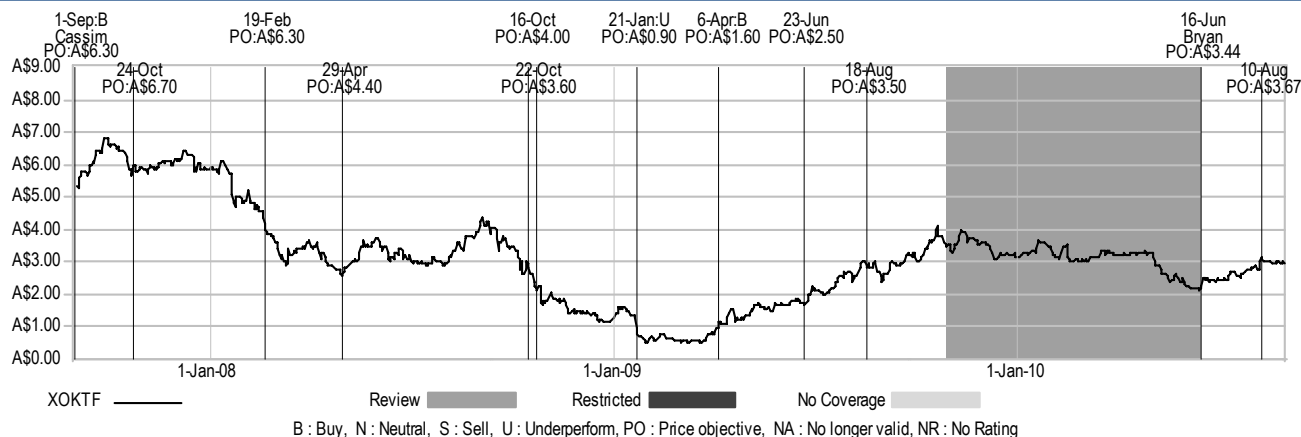
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XOKTF Price Chart



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Investment Rating Distribution: Engineering & Construction Group (as of 01 Jul 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	28	66.67%	Buy	9	37.50%
Neutral	4	9.52%	Neutral	2	50.00%
Sell	10	23.81%	Sell	7	70.00%

Investment Rating Distribution: Technology Group (as of 01 Jul 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	118	49.37%	Buy	68	61.26%
Neutral	50	20.92%	Neutral	39	84.78%
Sell	71	29.71%	Sell	30	47.62%

Investment Rating Distribution: Transport/Infrastructure Group (as of 01 Jul 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	94	64.38%	Buy	44	49.44%
Neutral	19	13.01%	Neutral	11	57.89%
Sell	33	22.60%	Sell	11	34.38%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1922	54.14%	Buy	1042	59.85%
Neutral	874	24.62%	Neutral	496	62.78%
Sell	754	21.24%	Sell	362	51.86%

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

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

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