

Good things come in small packages

Equity | Australia | Packaging
29 January 2010

Merrill Lynch 

A subsidiary of
Bank of America Corporation

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Solid 1H10 driven by sales growth and margin expansion

CKL reported 1H10 NPAT of A\$3.7m, up 12.9% on the pcp. The strong result was underpinned by a 5.6% rise in sales with volumes growing across CKL's key segments (pharma, healthcare and beverage). Margins expanded 60bps to 18.9% driven by an improved product mix, operational efficiencies and lower imported RM costs. Free cashflow was strong at A\$4.2m, allowing the company to reduce gearing from 33% to 30% and also to declare a record interim 1.5cps ff div.

Earnings up 9% as +ve momentum continues into 2010

We have raised our earnings estimates by 9% in FY10 and 3% in FY11 to incorporate higher volume growth assumptions, improved margins and lower interest expense. Our DCF valuation (WACC 10.7%, TGR 2.5%) has increased marginally from \$0.75ps to \$0.79ps.

Astra contract poses some risk to sales growth in 2011

Astra's decision to move some of its manufacturing capacity to the US could reduce CKL sales by \$3.5m pa from late 2010. While this contract "loss" represents ~5% of group sales, we believe that CKL will be able to secure replacement business for some of its products, particularly as manufacturing activity continues to recover in Australia in the next 12 months.

Market continues to ignore the value of CKL - BUY

Despite a still challenging operating environment, CKL has managed to post a robust 1H result driven by margin expansion and strong organic growth - highlighting the strength of its business platform. Trading well below its fundamental value, we believe the stock remains a good defensive, high-yield play with corporate appeal. Buy retained with a PO of \$0.70ps.

Stock Data

Price	A\$0.510
Price Objective	A\$0.700
Date Established	4-Feb-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	A\$0.385-A\$0.530
Mrkt Val / Shares Out (mn)	US\$37 / 80.5
Average Daily Volume	25,871
BofAML Ticker / Exchange	XBVVF / ASX
Bloomberg / Reuters	CKL AU / CKLAX
ROE (2010E)	10.7%
Net Dbt to Eqty (Jun-2009A)	49.4%
Est. 5-Yr EPS / DPS Growth	2.8% / 5.7%
Free Float	68.0%

Key Changes

(A\$)	Previous	Current
2010E EPS	0.07	0.08
2010E EBITDA (m)	14.0	14.3
2011E EBITDA (m)	14.4	14.0
2012E EBITDA (m)	14.9	14.3

Estimates (Jun)

(A\$)	2008A	2009A	2010E	2011E	2012E
Net Profit b/f Abnormals	6.2	5.6	6.3	6.5	6.8
EPS	0.077	0.069	0.077	0.080	0.083
EPS Change (YoY)	22.9%	-11.2%	12.9%	3.5%	4.3%
Dividend / Share	0.030	0.030	0.033	0.034	0.033
Free Cash Flow / Share	0.073	0.055	0.102	0.071	0.063

Valuation (Jun)

	2008A	2009A	2010E	2011E	2012E
P/E	6.6x	7.4x	6.6x	6.4x	6.1x
Dividend Yield	5.9%	5.9%	6.5%	6.7%	6.4%
EV / EBITDA*	5.0x	5.2x	4.5x	4.4x	4.1x
Free Cash Flow Yield*	14.3%	10.9%	20.1%	14.0%	12.6%

* For full definitions of *iQmethod*SM measures, see page 9.

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Refer to important disclosures on page 9 to 11. Analyst Certification on Page 7. Price Objective Basis/Risk on page 7.

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*iQprofile*SM Colorpak Ltd.

Key Income Statement Data (Jun)	2008A	2009A	2010E	2011E	2012E
(A\$ Millions)					
Sales	78	78	82	83	85
Associates & Other Revenue	1	1	1	1	1
Operating Expenses	(64)	(65)	(68)	(69)	(71)
EBITDA	14	13	14	14	14
Depreciation & Amortization	(3)	(3)	(3)	(3)	(3)
EBIT	11	10	11	11	11
Net Interest & Other income	(3)	(2)	(2)	(2)	(2)
Pretax Income	9	8	9	9	10
Tax (expense) / Benefit	(3)	(2)	(3)	(3)	(3)
Outside Equity interest in Npat	0	0	0	0	0
Preference dividends	NA	NA	NA	NA	NA
Net Profit b/f Abnormals	6	6	6	6	7
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	6	6	6	6	7

Key Cash Flow Statement Data

EBITDA	14	13	14	14	14
Change in Working Capital	(3)	1	0	0	(1)
Other C'flow Items before int & tax	0	0	0	0	0
Net Interest Paid	(3)	(2)	(2)	(2)	(2)
Tax Paid	(1)	(2)	(2)	(3)	(3)
Other C'flow from Operations	0	0	0	0	0
Cash Flow from Operations	8	10	10	10	9
Capital Expenditure (PP&E)	(2)	(6)	(1)	(4)	(4)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other C'flow from Investing	0	0	0	0	0
Cash Flow from Investing	(2)	(6)	(1)	(4)	(4)
Shares Issue / (Repurchase)	0	0	0	0	0
Dividend paid	(2)	(3)	(3)	(3)	(3)
Other C'flow from Financing	(2)	(3)	(4)	(2)	0
Cash Flow from Financing	(5)	(6)	(7)	(5)	(3)
Free Cash Flow	6	4	8	6	5
Net Debt	29	28	22	19	17

Key Balance Sheet Data

Cash Equivalents	1	0	2	3	6
Receivables & Inventories	23	21	23	22	24
Property, Plant & Equipment	27	30	28	29	30
Intangibles	46	46	46	46	46
Other assets	2	1	0	0	0
Total Assets	99	97	99	101	106
Payables	9	8	9	9	9
Provisions	3	3	3	3	3
Short term debt & Long term debt	31	28	24	22	22
Other Liabilities	2	3	3	3	3
Total Liabilities	45	41	39	37	37
Total Equity	55	56	60	64	68

*iQmethod*SM - Bus Performance*

Return on Capital Employed	9.3%	8.3%	9.1%	8.8%	8.8%
Return on Equity	11.7%	10.0%	10.7%	10.4%	10.2%
Operating Margin	14.7%	13.4%	13.9%	13.4%	13.4%
EBITDA Margin	18.2%	17.0%	17.3%	16.8%	16.7%

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	1.2x	1.8x	1.5x	1.5x	1.3x
Dividend Payout Ratio	38.9%	43.8%	42.7%	42.5%	38.9%
Tax Rate (Reported)	30.2%	30.1%	30.2%	30.3%	30.3%
Net Debt-to-Equity Ratio	53.6%	49.4%	36.6%	29.6%	24.2%
Interest Cover	4.4x	4.2x	4.7x	6.0x	6.5x

Key Metrics

Franking	100%	100%	100%	100%	100%
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* For full definitions of *iQmethod*SM measures, see page 9.

Company Description

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

Investment Thesis

Backed by a strong management team, which has a solid track record of sales growth and also own a significant proportion of stock, CKL should enjoy solid sales and earnings growth driven by underlying growth in key markets, continued market share gains and a focus on higher margin segments (pharma). Trading below its fundamental value, the stock has corporate appeal and could be a prey in the ongoing rationalisation of the Australian carton board market.

Stock Data

Price to Book Value 0.7x

Buy retained post strong 1H10 result

CKL reported 1H10 NPAT of A\$3.7m, up 12.9% on the pcp and inline with our estimates. The positive result was underpinned by a 5.6% rise in sales with volumes growing across CKL's key segments (pharma, healthcare and beverage >60% of sale). Margins expanded to a record 18.9% driven by an improved product mix, operational efficiencies and lower imported RM costs. FCF (OCF-Capex) was strong at A\$4.2m, allowing CKL to reduce gearing from 33% to 30%.

A solid effort in a challenging operating environment. Despite still difficult trading conditions in Oz, CKL has managed to post a strong result driven by positive organic growth and margin expansion - highlighting the strength and resilience of its business model. In our view, this is not reflected in the share price as the market continues to ignore the intrinsic value of this compelling business.

Post the 1H10 result, we remain comfortable with our Buy recommendation and PO of A\$0.70ps. Our positive stance on the stock is premised on (1) attractive valuation - the stock trading 35% below our DCF of A\$0.79cps; (2) a solid focus on the higher margin segments; (4) strong management team, who own a significant proportion of stock; and (5) corporate appeal- could be prey to the future rationalisation of the Australian carton board market. Trading well below its fundamental value, the stock remains a good defensive, high-yield play.

Result at a glance

Below we summarise the key financial highlights from CKL's result:

Table 1: 1H FY10 result vs pcp

	1H FY09	1H FY10	Chg %
Sales Revenue	40.3	42.6	5.6%
EBITDA	7.4	8.1	9.4%
D&A	-1.4	-1.5	3.1%
EBIT	6.0	6.6	10.3%
Net Interest	-1.2	-1.3	4.7%
EBT	4.8	5.3	11.7%
Tax Expense	-1.4	-1.6	9.0%
NPAT	3.3	3.9	12.9%
EBITDA Margin	18.3%	18.9%	60bps
EBIT Margin	14.8%	15.5%	70bps
EPS (A\$ cents)	4.1	4.63	12.9%
DPS (A\$ cents)	1.25	1.50	20.0%

Source: CKL, Merrill Lynch

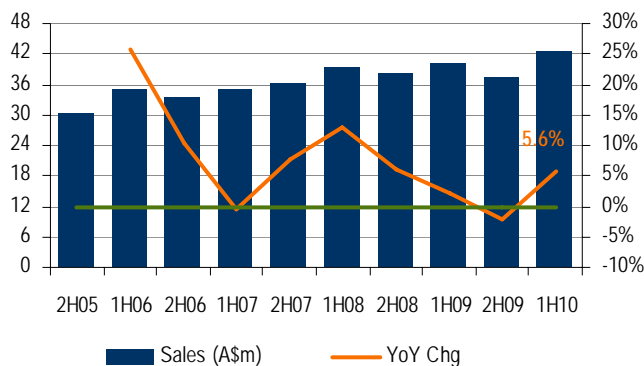
- **NPAT:** CKL reported a net profit of A\$3.7m, up 12.9% on the pcp. The result was driven by higher volume sales across all key segments, operational efficiencies, the turnaround of the foil operation and margin expansion.
- **Revenue drivers:** Sales rose 5.6% on the pcp with volumes growing across the pharma, healthcare and beverage sectors (~60% of CKL sales). Revenues have also benefited from higher prices, improved capacity utilisation ratios and the introduction of new products to larger customers.
- **Cost drivers:** CKL's cost base rose 3.7% on the pcp, driven by higher raw material (+5.4%), employee (+0.6%) and occupancy (+8.9%) costs.
- **Cash flow:** FCF came at \$4.2m, benefiting from a capex "holiday" and solid earnings growth. Operating cashflow totaled \$4.5m.
- **Gearing (D/D+E):** CKL has used some excess cash (\$2.75m) to pay down debt, reducing gearing from 35% to 29.8% in the past 12 mths, which is below CKL's target of 30-50%. Interest cover rose from 4.8x to 5.1x.
- **Financial position:** CKL remains well within its banks covenants with Debt/EBITDA at 1.77x (vs covenant of <3.0x) and financial charges ~5.6x (vs covenant of 2.5x).
- **Interim dividend:** CKL declared a fully franked div of 1.50cps. The record date is 05 March 10, and the div will be paid on 01 April 10.
- **Outlook:** CKL expects full year earnings to grow inline with 1H, which implies FY10 net profit of \$6.2m (+12% on the pcp). Cash generation is expected to total \$8-9m.

Highlights

▪ Solid sales growth despite soft economic conditions

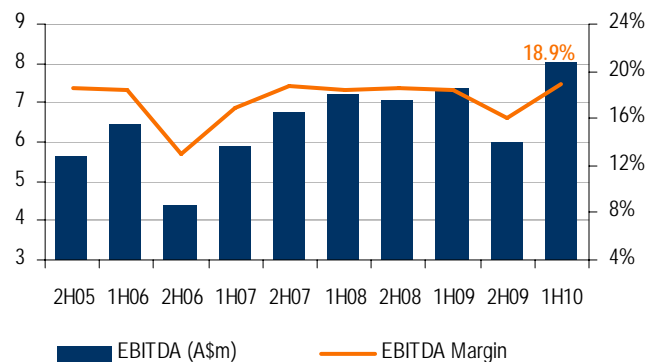
Sales rose 5.6% vs pcp and 13.5% vs 2H09, driven primarily by continuous volume growth into more defensive, high-margin segments such as pharmaceuticals and healthcare. Sales to the beverage sector also posted some improvement versus 2009, benefiting from a recovery in ready-to-drink (RTD) volumes. These segments are expected to continue to drive CKL's vols in 2H10. Despite still uncertain market conditions, CKL's customer base is expected to remain relatively stable with the top 10 clients secured under supply contracts for the next 2 years.

Chart 1: Sales rose 5.6% in 1H10 driven by pharma/beverage segments



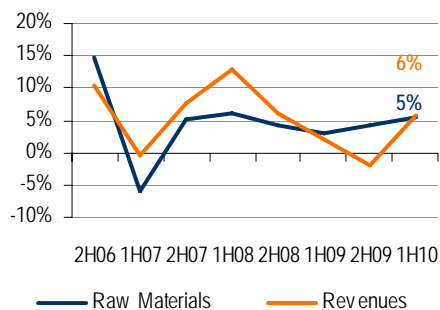
Source: CKL, Merrill Lynch estimates

Chart 2: EBITDA margin at record levels



Source: CKL, Merrill Lynch estimates

Chart 3: Revenues vs RM costs - YoY change



Source: CKL, Merrill Lynch estimates

▪ EBITDA margin expand to record levels

Operating margins rose 60bps over pcp to 18.9% in 1H10. The solid improvement in margins (to record levels) can be attributed to an improvement in product mix, operational efficiencies and lower imported RM costs (see comments below). While this is a commendable achievement, the competitive nature of the industry makes it difficult for the company to maintain margins near 19%. We anticipate EBITDA margins to reverse back to the 16-18% range in the next 12 months.

▪ AUD appreciation a positive for raw material imports

CKI's key raw material is carton board, which is sourced from local manufacturers or imported through local paper merchants. While the cost of board sourced domestically has remained relatively stable, the price of imported carton board feed has fallen on the back of a stronger AUD.

Going forward the focus will be on the domestic market. While AMC, CKL's major supplier (~50% of its board needs) has not implemented any price increases since July 08, we expect the company to push for higher prices as the domestic economy recovers.

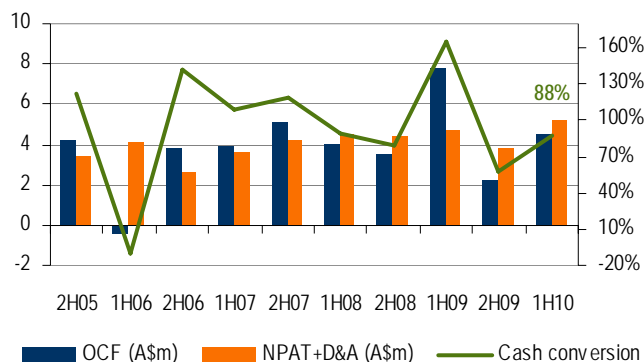
▪ Cash conversion remains at acceptable levels

Despite generating a stronger EBITDA of \$8m in 1H10 (compared to \$7.4m in 1H09), CKL's operating cash flow declined by 59% over pcp. This was primarily driven by a \$2.2m or 18% rise in trade receivable.

However, the overall free cash flow increased by \$0.6m or 17% as investing cash flows were significantly lower when compared to pcp. Investing cash outflows

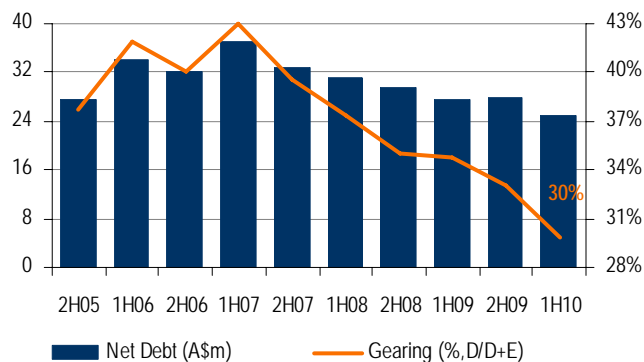
were higher in 1H09 as CKL purchased a new press and die-cutting machine for the Sydney operation taking advantage of the government's investment allowance program.

Chart 4: Cash realisation - OCF vs NPAT+D&A



Source: CKL, Merrill Lynch estimates

Chart 5: Gearing down from 34% to 30% in the past 12 months



Source: CKL, Merrill Lynch estimates

▪ **Debt retirement pushes gearing below 30%**

CKL's gearing (debt / debt + equity) fell from 33.4% in FY09 to 29.8% in 1H10, as CKL repaid \$3m or 10.7% of the total debt outstanding. Due to CKL's size and concentrated earnings stream, we are encouraged to see gearing falling below 30%. Given the low capex burden forecast for the next 6 months, we expect CKL to continue to pay down debt. Under this likely scenario, we will see the interest cover ratio rising from 4.2x in FY09 to 4.8x in FY10 and 6.2x in FY11.

Outlook

▪ **FY10 earnings anticipated to rise by 12%**

CKL expects FY10 earnings growth to be inline with the 1H, implying net profit growth of 12-13%, to be at least inline with the pcp despite the difficult economic environment in Australia. This implies a net profit of at least \$6.3m this financial year, which is in line with our forecasts.

Given the lack of visibility in the current economic climate, CKL is expected to focus on reducing its debt levels and minimizing capital expenditure in the second half of this financial year. Total capex is estimated to be around A\$1.5m.

▪ **Replacement business for the Astra contract a priority**

Astra's decision to move some of its manufacturing capacity to the US could reduce CKL sales by \$3.5m pa from DQ10. While this contract "loss" represents ~5% of group sales, we believe that CKL will be able to secure replacement business for some of its products, particularly as manufacturing activity continues to recover in Australia.

Financials

Table 2: Statement of Financial Performance

Year ending June (A\$m)	2008A	2009A	2010E	2011E	2012E
Trading revenue	77.8	77.8	81.8	82.9	84.8
- change	9.5%	0.0%	5.1%	1.3%	2.3%
EBITDA	14.3	13.4	14.3	14.0	14.3
- change	13.0%	-6.4%	6.4%	-1.8%	2.0%
Depreciation	-2.9	-3.0	-2.9	-2.9	-2.9
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	11.5	10.4	11.4	11.1	11.4
- change	17.0%	-9.3%	9.2%	-2.2%	2.5%
Net interest	-2.6	-2.5	-2.4	-1.8	-1.7
EBT	8.9	7.9	9.0	9.3	9.7
Tax expense	-2.7	-2.4	-2.7	-2.8	-2.9
NPAT att. to s/hers	6.2	5.6	6.3	6.5	6.8
- change	22.9%	-10.6%	12.9%	3.6%	4.3%
Net significant items	0.0	0.0	0.0	0.0	0.0
Reported NPAT	6.2	5.6	6.3	6.5	6.8
Norm EPS	7.7	6.9	7.7	8.0	8.3
EPS change	22.9%	-11.2%	12.9%	3.5%	4.3%
PER	6.6	7.4	6.6	6.4	6.1

Source: CKL, Merrill Lynch estimates

Table 3: Ratios

Year ending June (A\$m)	2008A	2009A	2010E	2011E	2012E
Profitability Ratios					
EBIT margin	14.7%	13.4%	13.9%	13.4%	13.4%
NPAT margin	8.0%	7.1%	7.7%	7.8%	8.0%
Effective tax rate	30.2%	30.1%	30.2%	30.2%	30.3%
NOPLAT pre goodwill	8.0	7.3	7.9	7.7	7.9
Invested Capital	93.1	91.0	91.7	93.5	97.7
ROIC (after tax)	8.6%	8.0%	8.6%	8.3%	8.1%
ROIC - WACC	-2.1%	-2.7%	-2.0%	-2.4%	-2.5%
ROE	11.7%	10.0%	10.8%	10.4%	10.2%
ROA	11.7%	10.6%	11.6%	11.1%	11.0%
Gearing / Cashflow Ratios					
Debt / Equity	56%	50%	40%	34%	32%
Debt / Debt+Equity	36%	33%	28%	26%	24%
Debt / EBITDA	2.2x	2.1x	1.7x	1.6x	1.5x
EBITDA / Interest	5.5x	5.4x	5.9x	7.6x	8.1x
EBIT / Interest	4.4x	4.2x	4.7x	6.0x	6.5x
Dividend cover	2.6x	2.3x	2.3x	2.4x	2.6x
Gearing (ND/ND+E)	35%	33%	27%	23%	19%
Multiples					
EV/EBITDA	4.9x	5.1x	4.4x	4.2x	4.0x
EV/EBIT	6.1x	6.6x	5.5x	5.3x	5.0x

Source: CKL, Merrill Lynch estimates

Price objective basis & risk

Colopak Ltd (XBVVF)

Our DCF for CKL is \$0.79ps, based on a WACC of 10.7% and a terminal growth rate of 2.5%. Whilst we consider the DCF valuation to be the most appropriate methodology to value this company, we recognise that the stock also looks attractive on different metrics such as PER. We apply a mid-cycle multiple for the stock of 8.5x, a 35% discount to the market multiple of 13x. In our view such discount is reasonable, given CKLs inherent liquidity/size issues and the cyclical industry it operates in.

Applying this 8.5x multiple to FY10E EPS of 7.8cps, we derive a valuation for the stock of A\$0.65ps. Importantly, were the stock to reach our price objective of A\$0.70ps in 12 months time, CKL would be trading on a 12-mth forward PER of 8.0x, which we do not view as demanding. The risks to our recommendation are product substitution, competition, rising raw material costs, management instability and customer attrition.

Analyst Certification

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

29 January 2010

Australia-Basic Industries Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
BUY				
	Adelaide Brighton	ADBCF	ABC AU	Ben Chan, CFA
	Amcor	AMCRF	AMC AU	Mario Maia, CFA
	Colorpak Ltd	XBVVF	CKL AU	Mario Maia, CFA
	Crane Group Ltd	CRAHF	CRG AU	Ben Chan, CFA
	James Hardie Ind	JHIUF	JHX AU	Ben Chan, CFA
	James Hardie-ADR	JHX	JHX US	Ben Chan, CFA
	PaperlinX	PPXLF	PPX AU	Mario Maia, CFA
NEUTRAL				
	Boral Ltd	BOALF	BLD AU	Ben Chan, CFA
	Incitec Pivot Limited	ICPVF	IPL AU	Mario Maia, CFA
	Orica	OCLDF	ORI AU	Mario Maia, CFA
UNDERPERFORM				
	CSR Ltd	CSRLF	CSR AU	Ben Chan, CFA

iQmethodSM Measures Definitions

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

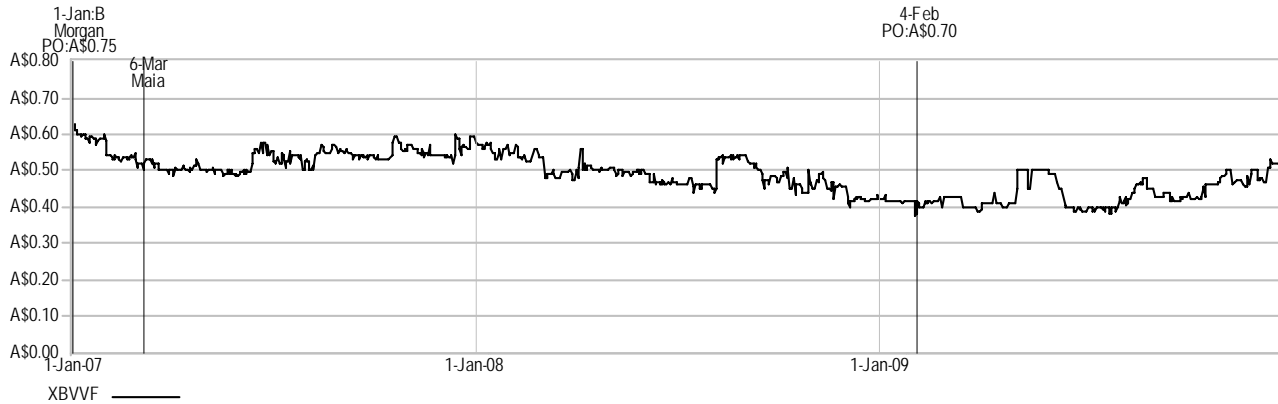
iQmethodSM is the set of BofA Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines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

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

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Important Disclosures

XBVVF Price Chart



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

*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 December 31, 2009 or such later date as indicated.

BofAML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of December 31, 2008 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website.*

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	13	68.42%	Buy	11	84.62%
Neutral	1	5.26%	Neutral	1	100.00%
Sell	5	26.32%	Sell	2	40.00%

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

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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

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29 January 2010

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