

Ramping-up to 3.5Mt target; haulage risk diminishing

FY11 maiden profit A\$1m misses market on ramp-up costs

BC Iron's (BCI) FY11 accounts are largely immaterial, given that the company only commenced production in early 2011 and shipped just 0.25mt of product. NPAT of A\$1.0m missed consensus of \$3.4m (range \$-1m to \$8m) and our estimate of A\$5.9m. Higher-than-anticipated operating ramp-up costs (\$2.5m), non-recurring corporate costs (\$2m) and non-cash D&A (\$0.5m) were the key contributors to the miss. We expect to gain a better reflection of underlying cash operating costs with BCI's Sep Q production report. Our Buy rating and \$3.30 price objective are maintained.

Revenue marginally ahead; grade sticky @ 57-57.5% Fe

Sales revenue of A\$17.1m was slightly higher than our A\$16.4m estimate, due to better-than-expected grade (close to 58%). Going forward, ore grade is expected to range 57-57.5% Fe. Long-term 10% discount on offtake to Henghou comprises roughly half of total reserves or ~20Mt over the life of mine.

FY12E prodn maintained; NPAT down 9%, NPV -2% on costs

We maintain our shipment forecast for FY12E at 3.2Mt, which is below BCI's target of 3.5Mt, building in operating slack as ramp-up continues. We adjust FY12E NPAT down 9% on higher operating costs and D&A assumptions on the back of FY11 results. NPV is reduced by 2% to A\$3.22/share. (Table 1)

Road ready for 3.5Mtpa; FMG reclaimer timing key risk

The private haul road (dirt) is complete, which boosts the daily haulage rate from 7kt to >10kt. However, bitumen surfacing over late September/early October will cause a reduction in haulage. With road surfacing taking wet weather risk out of the equation, the potential bottleneck moves from haulage to commissioning of Fortescue's reclaimer. Currently under construction, the reclaimer at this stage is expected to be operational early November.

Estimates (Jun)

(A\$)	2010A	2011A	2012E	2013E	2014E
Net Profit b/f Abnormals	(1)	1	74	77	98
EPS	(0.017)	0.013	0.712	0.745	0.940
EPS Change (YoY)	13.3%	NM	NM	4.6%	26.1%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(0.171)	(0.414)	0.992	0.816	1.12

Valuation (Jun)

	2010A	2011A	2012E	2013E	2014E
P/E	NM	192.58x	3.48x	3.33x	2.64x
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	-57.44x	185.90x	1.44x	0.657x	-0.297x
Free Cash Flow Yield*	-6.13%	-17.76%	43.99%	36.16%	49.57%

* For full definitions of *iQmethod*SM measures, see page 6.

Equity | Australia | Non-Ferrous-Mining
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Merrill Lynch 

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Stock Data

Price	A\$2.48
Price Objective	A\$3.30
Date Established	6-Jul-2011
Investment Opinion	C-1-9
Volatility Risk	HIGH
52-Week Range	A\$1.73-A\$3.29
Mrkt Val / Shares Out (mn)	US\$248 / 94.4
Market Value (mn)	A\$234
Average Daily Volume	230,764
BofAML Ticker / Exchange	BIRNF / ASX
Bloomberg / Reuters	BCI AU / BCI.AX
ROE (2012E)	70.8%
Net Dbt to Eqty (Jun-2011A)	2.2%
Est. 5-Yr EPS / DPS Growth	21.2% / NA
Free Float	60.0%

Key Changes

(A\$)	Previous	Current
2012E EPS	0.86	0.71
2013E EPS	0.86	0.75
2014E EPS	1.07	0.94
2012E EBITDA (m)	112.0	109.7
2013E EBITDA (m)	114.5	112.1
2014E EBITDA (m)	140.9	141.1

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 11086845

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*iQprofile*SM BC Iron Limited

Key Income Statement Data (Jun)	2010A	2011A	2012E	2013E	2014E
(A\$ Millions)					
Sales	0	17	223	233	341
Associates & Other Revenue	0	4	3	3	6
Operating Expenses	(4)	(20)	(117)	(124)	(206)
EBITDA	(3)	1	110	112	141
Depreciation & Amortization	0	(1)	(6)	(7)	(11)
EBIT	(3)	0	104	105	130
Net Interest & Other income	1	0	2	6	9
Pretax Income	(2)	1	106	110	139
Tax (expense) / Benefit	1	0	(32)	(33)	(42)
Outside Equity interest in Npat	0	0	0	0	0
Net Profit b/f Abnormals	(1)	1	74	77	98
Non-Recurring Items	0	0	0	0	0
Net Income (Reported)	(1)	1	74	77	98
Adjustments (net of taxes)	NA	NA	NA	NA	NA
Net Income (Adjusted)	2	1	74	77	98

Key Cash Flow Statement Data

EBITDA	(3)	1	110	112	141
Change in Working Capital	NA	NA	NA	NA	NA
Other C'flow Items before int & tax	0	0	0	0	0
Net Interest Paid	1	1	3	6	10
Tax Paid	1	0	0	(32)	(33)
Other C'flow from Operations	1	1	0	0	0
Cash Flow from Operations	(1)	3	112	87	118
Capital Expenditure (PP&E)	(13)	(45)	(10)	(2)	(2)
(Acquisition) / Disposal of Investments	1	(1)	0	0	0
Other C'flow from Investing	NA	NA	NA	NA	NA
Cash Flow from Investing	(12)	(46)	(10)	(2)	(2)
Shares Issue / (Repurchase)	13	22	0	0	0
Dividend paid	0	0	0	0	0
Other C'flow from Financing	17	12	(5)	(5)	(5)
Cash Flow from Financing	30	34	(5)	(5)	(5)
Free Cash Flow	(14)	(42)	103	85	116
Net Debt	(15)	1	(101)	(185)	(300)

Key Balance Sheet Data

Cash Equivalents	29	18	115	195	306
Receivables & Inventories	4	16	16	16	16
Property, Plant & Equipment	4	37	36	33	30
Intangibles	0	0	0	0	0
Other assets	18	32	38	35	29
Total Assets	55	103	205	279	381
Payables	2	16	16	16	16
Provisions	0	0	0	0	0
Short term debt & Long term debt	14	19	15	11	6
Other Liabilities	0	1	33	34	43
Total Liabilities	16	36	64	61	65
Total Equity	39	67	141	219	316

*iQmethod*SM - Bus Performance*

Return on Capital Employed	-3.7%	2.0%	61.0%	40.2%	35.4%
Return on Equity	8.1%	1.9%	70.8%	43.0%	36.5%
Operating Margin	NA	2.9%	46.5%	45.0%	38.1%
EBITDA Margin	-696.0%	6.3%	48.5%	47.4%	40.7%

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	-0.4x	3.2x	1.5x	1.1x	1.2x
Dividend Payout Ratio	0%	0%	0%	0%	0%
Tax Rate (Reported)	42.5%	-6.7%	30.0%	30.0%	30.0%
Net Debt-to-Equity Ratio	-38.0%	2.2%	-71.3%	-84.5%	-94.9%
Interest Cover	NA	0.8x	125.3x	149.8x	231.5x

Key Metrics

Franking	100%	100%	100%	100%	100%
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* For full definitions of *iQmethod*SM measures, see page 6.

Company Description

BC Iron (BCI) is an emerging iron ore player, operating a sole asset, the Nullagine Project, in a 50-50 joint venture with Fortescue Metals Group (FMG). BCI first listed on the ASX in December 2006 and identified their maiden resource ore body at Nullagine in May 2007. With construction underway, the first shipment of ore at 1Mtpa is scheduled FY11 ramping up to 3Mtpa by FY12.

Investment Thesis

BC Iron recently joined the ranks of Australian iron-ore producers, and production is forecast to ramp up to 3mtpa in FY12 (100% basis) and then to 5mtpa by FY13, at which time BCI could be vying to be Australia's No.5 listed iron-ore producer. The resource base should support a mine life greater than the current 8.5 year budget. BCI's valuation metrics sit comfortably at the "cheapest" end of the range for both earnings-based and intrinsic metrics vs. the local and international peer group.

Key Drivers

	2012E	2013E	2014E
AUDUSD	1.02	0.97	0.94
Iron ore fines (US\$/t)	142	138	129
Iron ore lump (US\$/t)	160	162	155
Cash costs (A\$/t)	67	69	77

Stock Data

Price to Book Value	1.7x
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Earnings change summary

Table 1: We cut FY2012-14 NPAT by 3-9% on higher operating cost and D&A assumptions

A\$m	2012			2013			2014		
	Current	Previous	% chg	Current	Previous	% chg	Current	Previous	% chg
Sales revenue	223	223	0%	233	233	0%	341	341	0%
EBITDA	110	112	-2%	112	115	-2%	141	141	0%
EBIT	104	109	-5%	105	110	-5%	130	134	-3%
NPAT	74	81	-9%	77	82	-5%	98	101	-3%
EPS A\$/share (Basic)	78	86	-9%	82	86	-5%	103	107	-3%
EPS A\$/share (Diluted)	71	86	-18%	75	86	-15%	94	107	-13%
NPV A\$/share	3.22	3.28	-2%						

Source: Merrill Lynch Research estimates

Figure 1: BCI Financial Summary

BC Iron Limited (BCI)						ML ANALYST Peter O'Connor							
ASX code	BCI					Current Price	\$2.48	Rating	BUY			+61 2 9226 5728	
Industry	Iron Ore					Price Objective	\$3.30					peter.oconnor@baml.com	
Free float	60%					Potential Upside	33%						
Turnover (mth)	\$10m					Market Cap	\$234m						
Year End 30 June	2010A	2011A	2012F	2013F	2014F	Year End 30 June	2010A	2011A	2012F	2013F	2014F		
PROFIT & LOSS A\$m						KEY VALUATION METRICS & FINANCIAL RATIOS							
Sales revenue	0	17.1	223.1	233.0	341.2	PER - Pre-exceptionals	x	NM	225.5	3.2	3.0	2.4	
+Other revenue	0	4.1	3.2	3.4	5.8	EV/EBITDA	x	NM	175.9	1.2	0.4	-0.5	
-Operating costs	-4	-19.9	-116.6	-124.3	-205.9	PCF	x	NM	70.3	2.1	2.7	2.0	
EBITDA	-3	1.3	109.7	112.1	141.1	FCF yield	%	-7%	-19%	43%	34%	47%	
-D&A	0	-0.8	-6.0	-7.2	-11.2	Dividend yield	%	0%	0%	0%	0%	0%	
EBIT	-3	0.5	103.7	104.9	129.9	Franking	%	0%	0%	0%	0%	0%	
+/- Net interest	1	0.4	1.8	5.5	9.5	Payout ratio	%	0%	0%	0%	0%	0%	
Pre tax profit	-2	0.9	105.5	110.4	139.3	RATIOS & RETURNS							
-Tax expense	1	0.1	-31.7	-33.1	-41.8	ROE (NPAT/Equity)	%	-4%	1%	52%	35%	31%	
Profit pre-exceptionals	-1	1.0	73.9	77.3	97.5	Capital Productivity	x	0.0	0.2	1.4	1.0	1.1	
-Minority interest after tax	0	0.0	0.0	0.0	0.0	ROCE (EBIT/Debt+Equity)	%	-14%	1%	255%	309%	810%	
-Exceptional items after tax	0	0.0	0.0	0.0	0.0	EBIT margin	%	0%	3%	46%	45%	38%	
Reported NPAT	-1	1.0	73.9	77.3	97.5	EBITDA margin	%	0%	8%	49%	48%	41%	
PER SHARE						Effective Tax Rate	%	0%	-7%	30%	30%	30%	
EPS - Pre-exceptionals	€	-1.7	1.1	78.3	81.9	103.4	Net Profit Growth	%	NM	NM	7402%	5%	26%
EPS - Reported (diluted)	€	-1.7	1.1	71.2	74.5	94.0	Net debt/equity	%	-38%	2%	-71%	-84%	-95%
Operating CFPS	€	-1.1	3.5	119.2	91.8	125.1	Net debt/(debt+equity)	%	-61%	2%	-248%	-544%	-1872%
Free CFPS	€	-18.3	-47.4	107.1	85.1	115.5	Interest cover	x	0.0	0.8	125.3	0.0	0.0
DPS	€	0.0	0.0	0.0	0.0	0.0	WACC CALCULATION						
BVPS	€	47.8	75.3	149.7	231.6	334.9	Ke	15.7%	5.5%	Rolling ASNPV		\$3.22	
EBIT BY DIVISION A\$m						Kd (1-t)	6.0%	0%	Price/NPV		0.77		
Nullagine	-3	7	105	107	130.0	MRP	6.0%	30%					
Other operations	0	0	0	0	0.0	Beta	1.7	12.8%					
Other EBIT	0	-7	-2	-2	-0.2	NPV VALUATION							
Total EBIT	-3	0	104	105	129.9	Nullagine			256	222	171	93	
CASH FLOW A\$m						Other / corporate			8	-25	-29	-41	
Cash from operations	-1	3	112	87	118	Total Operations			264	197	142	51	
Asset sales	2	0	0	0	0	Cash			18	115	195	306	
Purchase of PP&E	-4	-31	0	0	0	Debt			19	15	11	6	
Purch of Equity Investments	0	-1	0	0	0	Base NPV valuation			263	298	327	351	
Purchase of Exploration Assets	-9	-14	-10	-2	-2	NPV/shr			2.79	3.15	3.46	3.72	
Other investing activities	0	0	0	0	0	EARNINGS SENSITIVITY %							
Cash Flow from Investing	-12	-46	-10	-2	-2	AUDUSD	(+/-10%)	0%	-128%	-22%	-22%	-25%	
Equity issues/(buybacks)	14	22	0	0	0	Iron Ore price	(+/-10US\$)	0%	85%	14%	14%	18%	
Net borrowings	17	12	-5	-5	-5	KEY PRICE ASSUMPTIONS							
Dividend paid/Others	-1	-1	0	0	0	AUD	US\$	0.88	0.99	1.02	0.97	0.94	
Cash Flows from Financing	30	34	-5	-5	-5	Iron Ore - Fines	US\$/t	54.6	162.0	178.4	173.3	162.3	
Net Cashflow	17	-9	98	80	111	Iron Ore - Lumps	US\$/t	97.4	188.8	201.6	203.6	194.7	
Free Cashflow	-14	-42	103	85	116	Iron Ore - Pellets	US\$/t	78.6	153.9	171.9	167	155	
BALANCE SHEET A\$m						PRODUCTION/SALES (100%)							
Cash	29	18	115	195	306	Magnetite	mt	0.00	0.00	0.00	0.00	0.00	
Receivables	2	7	7	7	7	DSO	mt	0.00	0.59	3.20	3.30	5.00	
Inventories	2	9	9	9	9	Total Production:	mt	0.00	0.59	3.20	3.30	5.00	
Fixed assets	20	67	70	65	56	Magnetite	mt	0.00	0.00	0.00	0.00	0.00	
Other assets	2	3	3	3	3	DSO	mt	0.00	0.25	3.20	3.30	5.00	
Total assets	55	103	205	279	381	Total Sales:	mt	0.00	0.25	3.20	3.30	5.00	
Total debt	14	19	15	11	6								
Total liabilities	16	36	64	61	65								
Net assets	39	67	141	219	316								
Net debt	-15	1	-101	-185	-300								

Source: Merrill Lynch Research estimates

Price objective basis & risk

BC Iron Limited (BIRNF)

Our PO of \$3.3/share represents 1.0x NPV, with consideration of other valuation metrics - both intrinsic and earnings based - including NPV, PE, PCF, EV/EBITDA, EV/sales, dividend yield, FCF yield and price/book. The valuation ranges that we have applied for each metric represent a broad group of comparable peer companies. The PO selected sits comfortably in the "overlap" range of all these metrics although we have specifically anchored the PO outcome to a Price/NPV of 1x (base case NPV). The NPV valuation applies a WACC of 12.78% (RfR 5.5%, ERP 6% and Beta of 1.7x for a CoE of 15.7%) to life of mine cash flows.

The risks faced by BCI are, (i) Successful commissioning and ramp-up of the Nullagine iron ore JV to 3mtpa, (ii) exploration success in adding more resources thereby increasing the mine life, (iii) delays in expanding the project to 5mtpa (iv) A\$US\$ currency and (v) iron ore price risk. Commodity risk is much skewed to the demand profile of the major global buyer, China. Upside risks are (i) additional exploration success, (ii) earlier commitment to, and development of, the 5mtpa expansion case, and (iii) iron ore price outlook which is buoyed by a favorable forward price curve.

Link to Definitions

Basic Materials

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

Analyst Certification

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

Australia - Metals, Mining & Steel Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY	Ampella Mining	APMZF	AMX AU	Stephen Gorenstein
	Atlas Iron Limited	ATLGF	AGO AU	Peter O'Connor
	BC Iron Limited	BIRNF	BCI AU	Peter O'Connor
	Extract Resources Limited	EXRLF	EXT AU	Glen Chipman
	Fortescue Metals Group Ltd.	FSUMF	FMG AU	Peter O'Connor
	Gindalbie Metals Ltd	GDBGF	GBG AU	Peter O'Connor
	Gloucester Coal Ltd	GCRLF	GCL AU	Peter O'Connor
	Grange Resources	GRRLF	GRR AU	Peter O'Connor
	Iluka Resources Limited	ILKAF	ILU AU	Peter O'Connor
	Intrepid Mines	IAUFF	IAU AU	Stephen Gorenstein
	Mount Gibson Iron Limited	MTGRF	MGX AU	Peter O'Connor
	Newcrest Mining Limited	NCMGF	NCM AU	Stephen Gorenstein
	OZ Minerals Limited	OZMLF	OZL AU	Stephen Gorenstein

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Australia - Metals, Mining & Steel Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
	Paladin Energy Limited	PALAF	PDN AU	Glen Chipman
	PanAust Limited	PNAJF	PNA AU	Stephen Gorenstein
	Rio Tinto Ltd	RTNTF	RIO AU	Peter O'Connor
	Saracen Minerals Holdings	XRHSF	SAR AU	Stephen Gorenstein
NEUTRAL				
	Alumina Limited	AWCMF	AWC AU	Stephen Gorenstein
	BHP Billiton Ltd	BHPLF	BHP AU	Peter O'Connor
	BHP Billiton-ADR	BHP	BHP US	Peter O'Connor
	Independence Group NL	IPGDF	IGO AU	Stephen Gorenstein
	Kingsgate Consolidated Limited	KSKGF	KCN AU	Stephen Gorenstein
	Western Areas NL	WNARF	WSA AU	Stephen Gorenstein
UNDERPERFORM				
	Alacer Gold	ALIAF	ASR CN	Stephen Gorenstein
	Alacer Gold	XCWTF	AQG AU	Stephen Gorenstein
	Energy Resources of Australia Limited	EGRAF	ERA AU	Glen Chipman
	Perseus Mining	PMNXF	PRU AU	Stephen Gorenstein
RSTR				
	Macarthur Coal Limited	MACDF	MCC AU	Peter O'Connor

iQmethodSM Measures Definitions

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

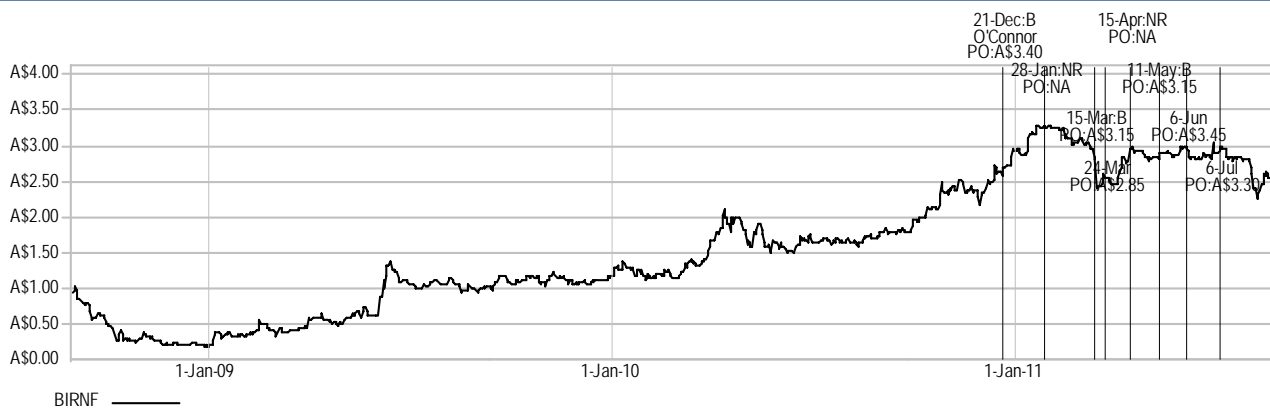
iQmethodSM is the set of BofA Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines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

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Important Disclosures

BIRNF Price Chart



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

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [August 31, 2011] or such later date as indicated.

Investment Rating Distribution: Non-Ferrous Metals/Mining & Minerals Group (as of 01 Jul 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	113	66.47%	Buy	36	36.36%
Neutral	35	20.59%	Neutral	13	40.63%
Sell	22	12.94%	Sell	1	5.00%

Investment Rating Distribution: Global Group (as of 01 Jul 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2024	53.94%	Buy	935	50.68%
Neutral	944	25.16%	Neutral	442	51.64%
Sell	784	20.90%	Sell	273	37.24%

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

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of a stock's: (i) absolute total return potential and (ii) attractiveness for investment relative to other stocks within its *Coverage Cluster* (defined below). There are three investment ratings: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

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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