

Tax Services

Tax Benchmarking Survey for the Metal Industry

2008/2009



Introduction

The current regulatory environment clearly requires that companies follow strict guidelines as they determine their income tax provision for interim and year-end reporting purposes. Gone are the days when a company could identify a rate at the beginning of the year that it could retain through year-end. Despite these changes, including general acceptance by financial analysts and bankers, many companies continue to experience the discomfort that can be associated with the more significant changes that many times appear when one evaluates a company's overall tax impact on the financial statements.

The challenge that tax professionals must face is to identify the proper balance when planning for income taxes. On one side of the coin, taxes are a significant cost to the corporation. Accordingly, tax costs should be properly controlled and managed in the quest to create shareholder value and maximize earnings per share. On the other side, many companies believe there is a social responsibility to pay their "fair share" of taxes in the jurisdictions in which they operate.

Tax disclosures in annual reports offer important insight into a company's tax affairs, and a number of key tax ratios can be derived from publicly available information. The effective tax rate (ETR) is the headline figure commonly quoted by chief financial officers when discussing their company's tax affairs in the annual report. The cash tax rate, which is a measure of the actual cash tax paid, is an important factor of analyst valuations, feeding directly into investment decisions.

Tax is increasingly found on board room agendas. Directors are taking a greater interest in their company's tax strategy and how it is being identified and managed. This study will give insight into tax departments as they review their tax strategy and provide information on where they stand compared with their peer group. It will allow a metal company to benchmark itself against its peer group, and a bespoke presentation can be prepared for any company on request.

Our financial analysis was based on a number of tax ratios derived from publicly available information. Using information that was publicly available allowed us to include any listed company, giving us a good overview from which to draw our conclusions. It is important to note that our study shows a high-level picture of key tax ratios. The data are sourced from a data provider and checked to annual reports for quality assurance. We have not adjusted for one-off distorting items or losses. (Our in-depth tax benchmarking studies carried out on smaller peer groups drill down to underlying or adjusted ETR). In this study, losses, tax refunds, and exceptional items can be drivers of the individual company ETR, although by taking a statistically trimmed sample, the impact of these on the study conclusions are minimized.

This study included 49 of the leading global metal companies. Within the sample, six companies were based in China, five were from North America, five were from Japan, five from Russia, four from India, three from Brazil, three from South Africa, two from Australia, two from Canada, two from Mexico, and one each from Austria, Germany, Sweden, France, Finland, Korea, Poland, Spain, Taiwan, the United Kingdom, Argentina, and Luxembourg.

This report summarizes the findings from benchmarking key financial indicators for tax for the past three years. All information is taken from publicly available financial statements spanning the period from March 2005 to June 2008. The charts show the year-ends to be 2005, 2006, and 2007. Eight companies within our sample had already filed accounts for their 2008 year-ends, and these results have been included in our 2007 averages.

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Key findings

- The average ETR for the years 2005 to 2007 for the 49 companies included in this study was 27.6 percent. The average ETR moved from 26.8 percent in 2005 to 27.8 percent in 2006 and marginally increased to 28.1 percent in 2007.
- The iron and steel sector (33 companies) had a stable ETR of about 27 percent, and the nonferrous metals sector (11 companies) showed an increase of 2.3 percentage points in the three years.
- Japanese companies, which face the highest statutory corporate income tax rate of 40 percent, experienced the highest ETR in each of the three years (average of 35.9 percent). Chinese companies experienced a drop in their ETR from 27.3 percent in 2005 to 23.8 percent in 2007. A favorable tax driver for Chinese companies was special credits obtained. Indian companies also showed a drop from about 29 percent in 2005 and 2006 to 25.6 percent in 2007, while Russian companies experienced the most stable ETR (average 26.3 percent).
- Domestic companies' ETR is lower than international companies' ETR, which contradicts the picture seen in other sector studies, as the latter usually has more scope for cross-border planning. An explanation of this could be that domestic companies include the six Chinese companies and four out of the five Russian companies, all of which are territories with low ETRs.
- The average cash tax rate is relatively constant for 2005 and 2006 but increases by 6 percentage points to 30.1 percent in 2007.
- Foreign operations are a significant favorable driver in this industry, together with legislation changes, investments in subsidiaries and associates, and tax credits. Permanent differences/nondeductible expenses and other taxes are unfavorable drivers.
- Corporate income tax is only part of the total tax contribution (TTC) made by companies. Other business taxes include property taxes, employment taxes, environmental taxes, and industry taxes. This has implications for internal management of business taxes and transparency over reporting of business taxes paid.

In this study, we analyzed four key tax ratios:

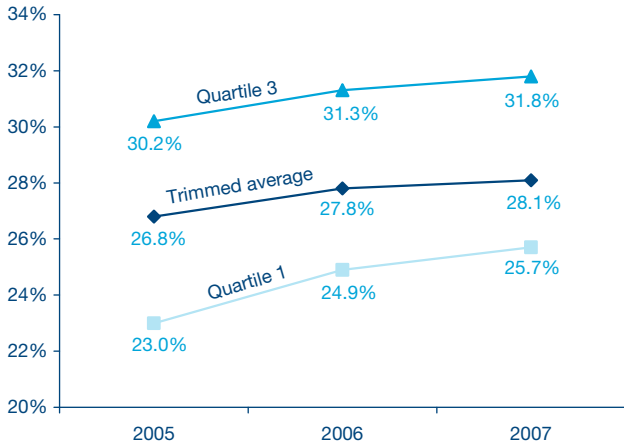
- **Effective tax rate (ETR):** This is the tax provision as a percentage of income before tax taken from the face of the income statement. It gives a basic analysis of the impact of tax on results.
- **Current tax rate:** This is the current tax provision as a percentage of income before tax where current tax is that element of the total tax charge that is not deferred. Comparing this ratio with the ETR gives an indication of the impact of deferred tax.
- **Cash tax rate:** This is the cash tax paid as a percentage of income before tax where cash tax paid is the amount of corporation tax paid during the period. It gives an indication of the true cost of tax to the company.
- **Cash tax paid as a percentage of current tax provision:** this ratio may give an indication of the level of tax reserves included in the current period tax provision. Assuming fairly constant profits, cash tax paid during the year should be approximately equal to the current tax provision recorded during the same period. A lower ratio indicates that the current tax provision is higher than the cash tax paid during the year and, as a result, there may be an element of tax reserves within the current tax provision.

Effective tax rate

The average ETR of the companies taken over the three-year period is 27.6 percent. Eight companies with a 2008 year-end (two with June 2008 year-ends and six with March 2008 year-ends) are included in the 2007 average.

For further detail on the trimmed average and the quartiles, see the appendix.

Effective tax rate



The trimmed average represents the average ratio for companies (excluding outliers) in the sector for the last 3 financial periods.

Quartile 3 and Quartile 1 represent the resulting ratio where 75% and 25% of companies lie below that point respectively.

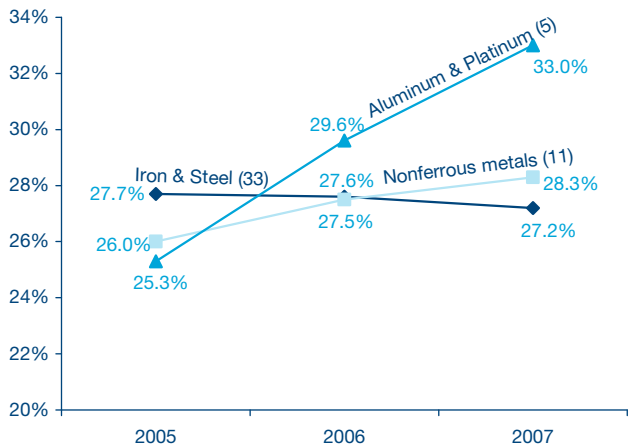
The average ETR moved only from 26.8 percent in 2005 to 27.8 percent in 2006 and marginally increased to 28.1 percent in 2007. From 2005 to 2007, the upper quartile showed an upward movement of 1.6 percentage points, and the lower quartile moved upward by 2.7 percentage points. Further analysis of a variety of other tax ratios reveals interesting trends. We note an increase of the ETR in all the trimmed averages, the upper and lower quartiles. This is particularly interesting given the general trend of the decreasing statutory tax rates across the globe.

Three companies in the sample incurred a loss before tax/tax benefit in the three years under review. Although losses can distort the ETR in sectors where many companies have either losses or tax refunds, there was little impact in this study, in which only three companies reported a loss.

ETR by segment

This comparison splits the 49 companies into three segments within the wider sector of the metal sector.

Effective tax rate by segment



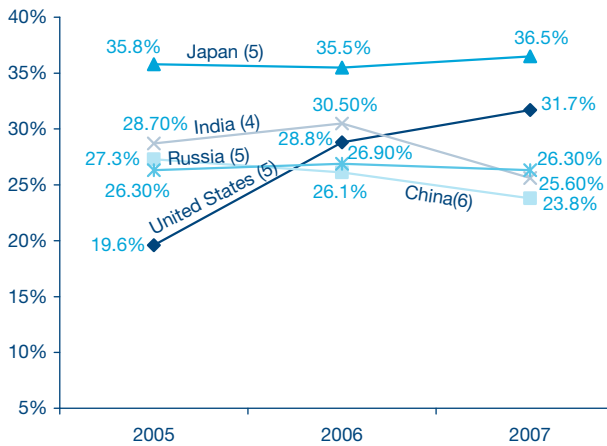
Thirty-three companies in the study were classified as iron and steel, 11 as nonferrous metals, and five as aluminum and platinum. The iron and steel sector had a stable ETR of about 27 percent, and the nonferrous metals sector showed an increase of 2.3 percentage points in the three years studied.

The aluminum and platinum sector showed a big movement from 25.3 percent in 2006 to 33 percent in 2007 due to the small number of companies in the sample. However, we noted that four out of the five companies in the aluminum and platinum sector showed an increasing trend in their ETRs over the years. Further investigation revealed that two South African companies saw an increase on secondary tax on companies from 2006 to 2007.

ETR by territory

The following comparison shows the ETRs for the 49 companies based on where their headquarters are located.

Effective tax rate by territory



The graph shows that the six companies whose headquarters are based in China experienced a drop in their ETR over the three years from 27.3 percent in 2005 to 23.8 percent in 2007. We noted that this drop could not be attributed to a drop in the corporate income tax rate of China. It will be interesting to see the ETR trends including 2008, as there was a drop of the Chinese corporate income tax rate from 33 percent to 25 percent as of January 1.

Japanese firms experienced the highest ETR in each of the three years.

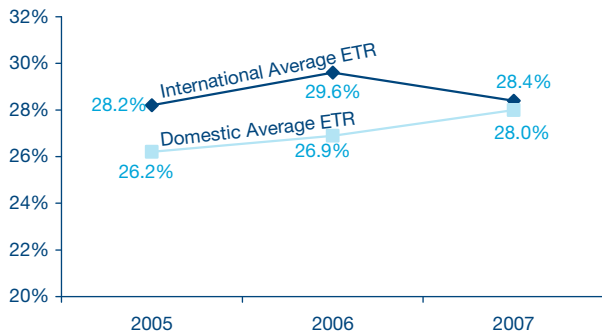
Russian companies experienced the most stable ETR, about 26 percent (i.e., 2 percent above the statutory corporate income tax rate) across the three years.

US companies showed the biggest rise in ETR from 19.6 percent in 2005 to 31.7 percent in 2007. However, we noted that the low 2005 ETR of 19.6 percent was driven by one US company's negative ETR of 17 percent, a result of an income tax benefit due to reversal of remaining valuation allowance for US federal net deferred tax assets. If we omit the negative ETR in 2005, the US average ETR for the other four companies is 28.8 percent (not materially different from the 2006 ETR).

ETR of companies classified as international versus domestic

The graph below shows the average ETR for the 33 domestic companies and the 16 international companies. Companies are classified as international when more than 50 percent of their sales revenue is outside of their headquarters' country.

Effective tax rate of international and domestic companies

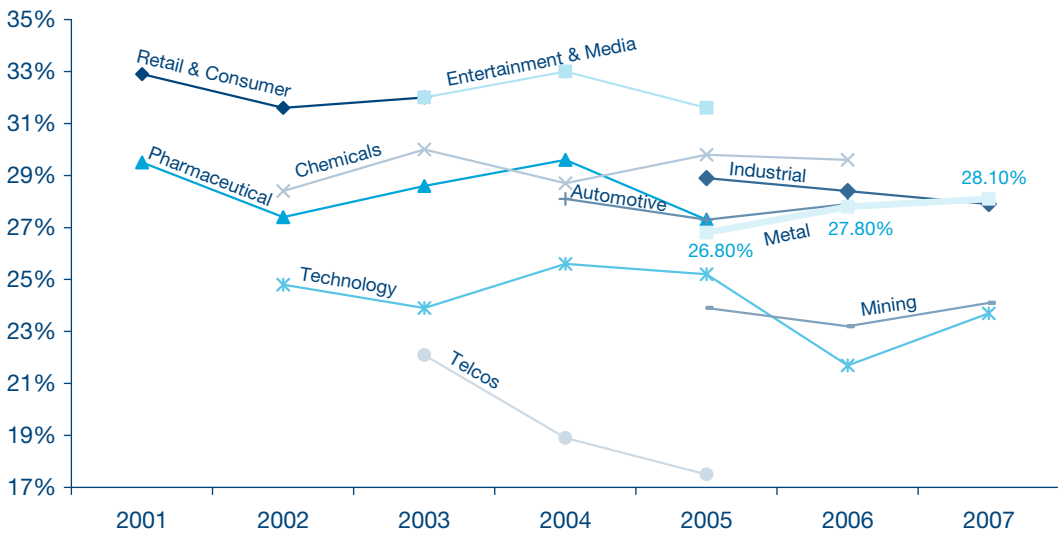


Domestic companies' ETR was lower than international companies' ETR, which contradicts the picture seen in other sector studies. Usually international companies have more opportunity/scope for cross-border planning and hence have a lower ETR than domestic companies. An explanation of this could be that domestic companies included the six Chinese companies and four out of the five Russian companies in territories with lower ETRs.

Metal industry versus other industries

PwC has performed benchmarking studies for various industries, and the chart below shows the ETRs of the metal companies versus companies in other industries, studied to date.

Industrial vs other industries



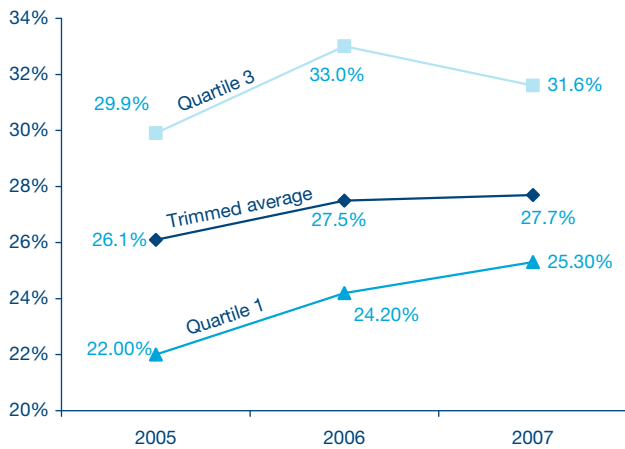
Losses in the technology and Telco industries have a downward influence on the ETR. The retail sector has less opportunity for cross-border planning, and this may result in a higher ETR.

Current tax as a percentage of income before tax

The current tax rate is the current provision as a percentage of income before tax where current tax is the portion of the total tax provision that is not deferred. Comparing this ratio with the ETR gives an indication of the impact of deferred taxes. The current tax rate is effectively the ETR excluding the effect of deferred taxes.

The graph below shows this ratio for 49 companies.

Current tax as a percentage of income before tax



There was a small increase in the average over the three years.

Difference between current tax rate and ETR

The graph below allows us to compare the ETR with the current tax rate given above.

Difference between current and effective tax rates

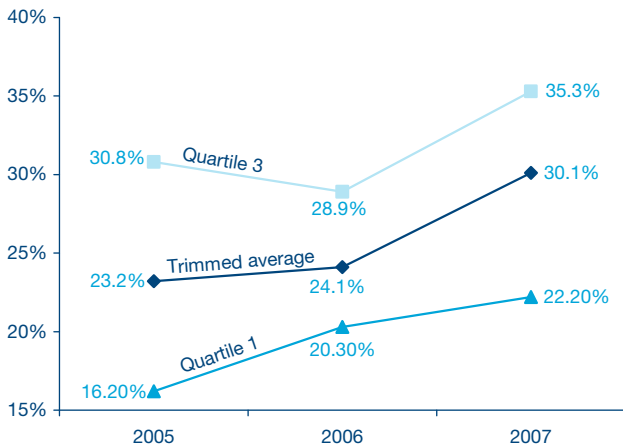


The graph shows that the impact of deferred tax was relatively small but remained relatively constant over the three years.

Cash tax paid as a percentage of income before tax

While the ETR gives a basic indication of the impact of tax on results, some consider the cash tax rate, that is, the cash tax paid in the year (as disclosed in the cash flow statement or supplementary information to the cash flow statement) as a percentage of income to be a better measure of the true cost of tax to the company. Although there will be an element of timing mismatch (for example, in some territories 50 percent of tax due on profits is not paid until after the year-end) on a trend basis the ratio gives a good picture of a company's tax cost.

Cash Tax Paid as a percentage of Income before tax

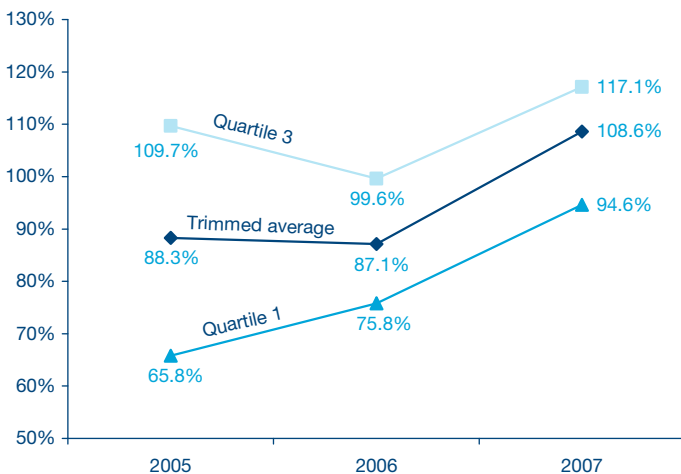


The average cash tax rate for the 42 companies was relatively constant for 2005 and 2006 but increased 6 percentage points in 2007. The average cash tax rate was approximately 3 percentage points lower than the ETR in 2005 and 2006 and 2 percentage points higher in 2007.

Cash tax paid as a percentage of current tax provision

An interesting trend is observed from the ratio of cash tax paid as a percentage of current tax provision. This ratio may give an indication of the level of tax reserves included in the current period tax provision. Assuming fairly constant profits, cash tax paid during the year should be approximately equal to the current tax provision recorded during the same period. A lower ratio indicates that the current tax provision is higher than the cash tax paid during the year. This could imply that the company may be recording reserves in its tax provision over and above the tax paid to the tax authorities. Companies adopting aggressive tax strategies would be more likely to book current year reserves to allow for the possibility of a successful challenge from the tax authorities. This reflects the impact of FIN 48, *Accounting for Uncertain Tax Positions*, adopted and implemented January 1, 2007.

Tax paid as a percentage of current tax provision



The trimmed average represents the average ratio for companies (excluding outliers) in the sector for the last 3 financial periods.

Quartile 3 and Quartile 1 represent the resulting ratio where 75% and 25% of companies lie below that point respectively.

The graph shows that, for the 42 companies, the trimmed average was less than 100 percent for 2005 and 2006, which may indicate that companies were building tax reserves. However, in 2007 the trimmed average was 108.6 percent, indicating that reserves were not built this year but released.

A number of factors account for the discrepancy of the ETR from the statutory rate. The reconciling items, as disclosed in the statutory/effective rate reconciliations, were analyzed, collated, and averaged over the sample. The annual reports of 12 companies did not contain sufficient detail, so our analysis is based on 37 companies. Eight companies within our sample had already filed accounts for their 2008 year-ends, and these results have been included in our 2007 averages.

The result of the different drivers and their effect on the 37 metal companies can be seen below. These values have been averaged in two ways.

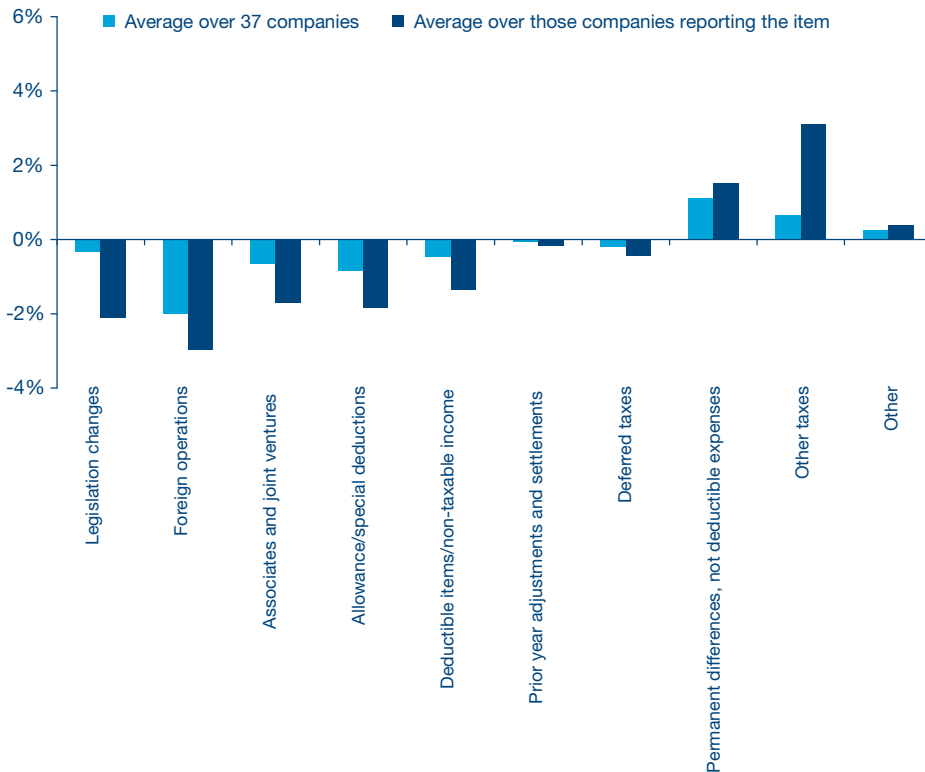
- Averaging over only those companies that reported the reconciling item.

- Averaging over all companies. Using this method, reconciling items reported by most companies in the sample will show more of an impact than those items reported by only a few companies in the sample.

Foreign operations are a significant favorable driver in this industry, together with legislation changes, investments in subsidiaries and associates, and tax credits. Permanent differences/nondeductible expenses and other taxes are unfavorable drivers. Further detail on the nature of some of the reconciling items is given below.

The chart below shows the average impact of the drivers, but this can be the net of both favorable and unfavorable reconciling items for different companies.

Impact of reconciling items on statutory rate 2007



We therefore averaged each driver over those companies reporting a positive and those reporting a negative impact.

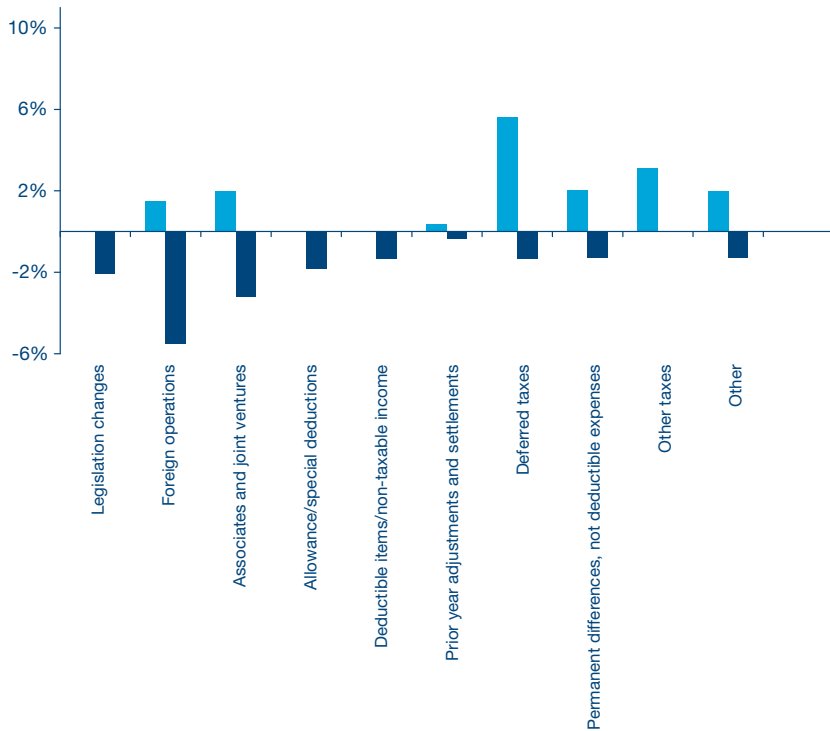
Foreign operations/international rate differences

This reconciling item was reported by 25 companies in the sample, showing the benefit to the industry of increasing globalization. Sixteen of the 25 showed a decrease in their ETR as a result of foreign operations.

Tax credits

Credits are offered by jurisdictions as incentives and may affect a company's behavior. This category primarily included business credits and incentives such as manufacturing credits. Eighteen companies reported a decrease in their ETR as a result of tax credits. Three out of the five US companies and the three Brazilian companies reported a tax credit driving down their ETR.

Impact of reconciling items on statutory rate 2007



Legislation changes

Six companies reported a lower ETR as a result of legislation changes. Changes mainly relate to a drop in corporate income tax in various jurisdictions worldwide. The tax notes of the accounts made reference to the drop in corporate income tax in the following jurisdictions: Germany, Colombia, Mexico, Canada, Czech Republic, Morocco, and Italy. The drop of corporate income tax is the most common reform. This is supported by the World Bank/PwC study showing a high number of countries reducing their corporate income tax rate in 2006-07 and in 2007-08.¹

Associates and joint ventures

Ten of the 14 companies reporting this item showed a drop in their ETR as a result of investments in associates and subsidiaries.

Deductible expenses/nontaxable income

Thirteen of the companies reported a drop in their ETR as a result of nontaxable income and deductible expenses.

¹ For further details refer to <http://www.pwc.com/extweb/home.nsf/docid/AC1461DB5FD10619852574F700143523>

Deferred tax movements

Losses arising in a business can, subject to restrictions, be used when they arise, carried back to offset previous taxable income, or carried forward to offset future taxable income. A deferred tax asset is created when losses are carried forward for future use, and a valuation allowance is recorded where future use is uncertain. This reconciling item reflects the existence of losses in the metal businesses. Ten of the 17 companies reporting timing differences reported a change in their valuation allowance/recognition of deferred tax, and five companies reported the nonutilization of losses.

Permanent differences/nondeductible expenses

Twenty-three of the 27 companies reporting this item showed an increase of their ETR.

Other taxes

Of the eight companies reporting “other taxes” the three South African companies showed an average increase of 6 percentage points in their ETR, and three out of the five US companies showed an average increase of 2.2 percentage points in their ETR.

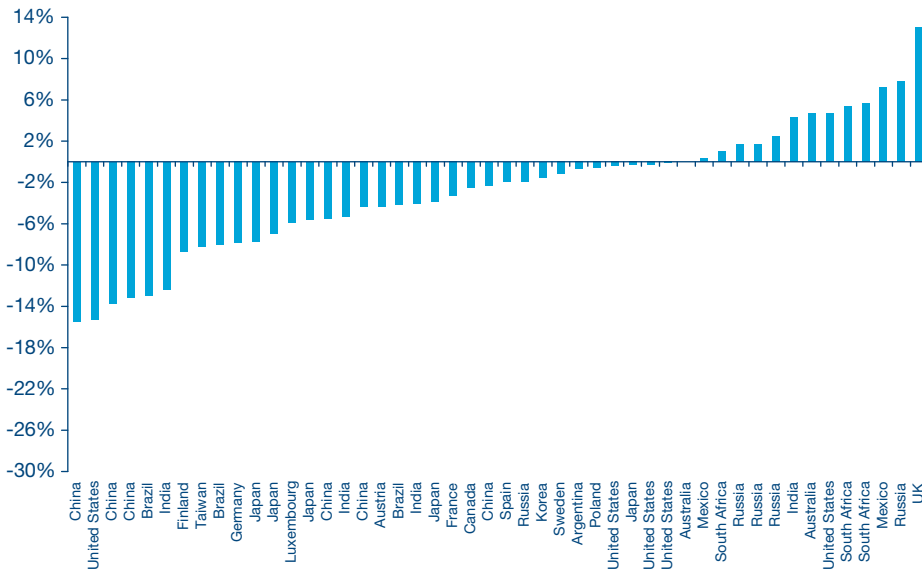
Effect of drivers on the ETR for individual companies

The following graph shows, on an individual company basis, the effect of the reconciling items. These figures, when combined with the statutory tax rate for that company, will result in the ETR. The graph contains information for 49 companies.

It can be seen that most companies have an ETR lower than the statutory rate. The statutory rate varies from territory to territory and we compared the average effective rate for some territories with their statutory rate.

In the graph below, we see that the Chinese companies have tax drivers that are decreasing their statutory corporate income tax rate of 33 percent, and Russian companies have moderate unfavorable tax drivers increasing their statutory corporate income tax rate by 2 percent.

Impact of reconciling items on statutory rate 2007



The following graph takes the average ETR for a number of countries, and compares it with the statutory rate for that country. Only those countries with more than three companies were included in the chart to prevent distortions from a small number of companies.

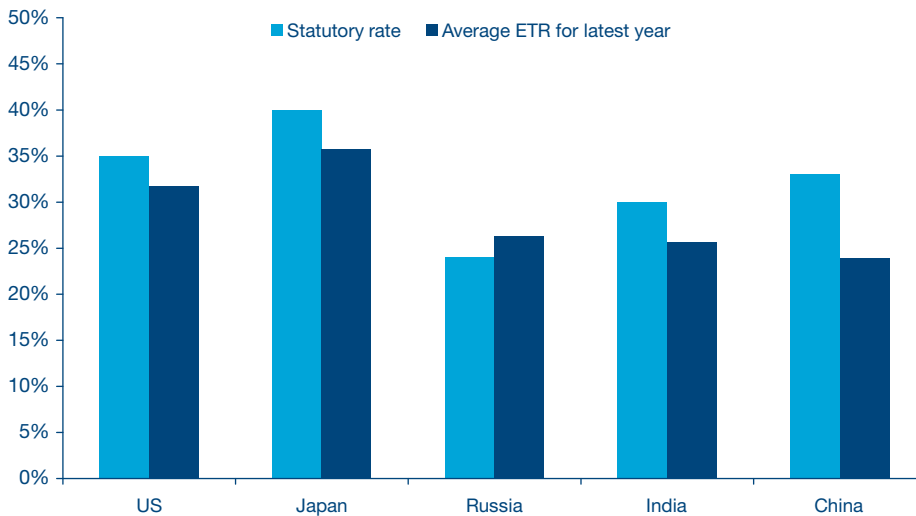
In all cases, except for Russia, the effective rate was below the statutory rate, but the differential was greater in some countries than others.

Japan had both a high statutory rate and high effective rate (the highest statutory and ETR in our sample). The result for Japan was driven by three out of the five companies in our sample as a result of their investments in subsidiaries and associates.

The result for the United States was driven by one of the five companies in our sample that showed an 11 percent drop in its ETR as a result of its foreign operations.

Four of the five companies from Russia reported a moderate increase in their ETR.

Three of the six Chinese companies reported a drop of 13.2 percent to 15.5 percent while the other three reported a drop from 2.3 percent to 5.5 percent. Only one of the Chinese companies provided an effective tax reconciliation where it could be seen that the high drop of the ETR was the result of an enterprise income tax credit obtained from purchase of domestically manufactured production equipment. The particular company saw a drop of 5.5 percent in its ETR from 2006 to 2007.



Total tax contribution

This study focused entirely on corporate income tax. However, companies pay many other business taxes that are not generally visible in their financial statements. Greater transparency over all taxes paid (the company's TTC) will help disclose the impact of tax on the business and its stakeholders.

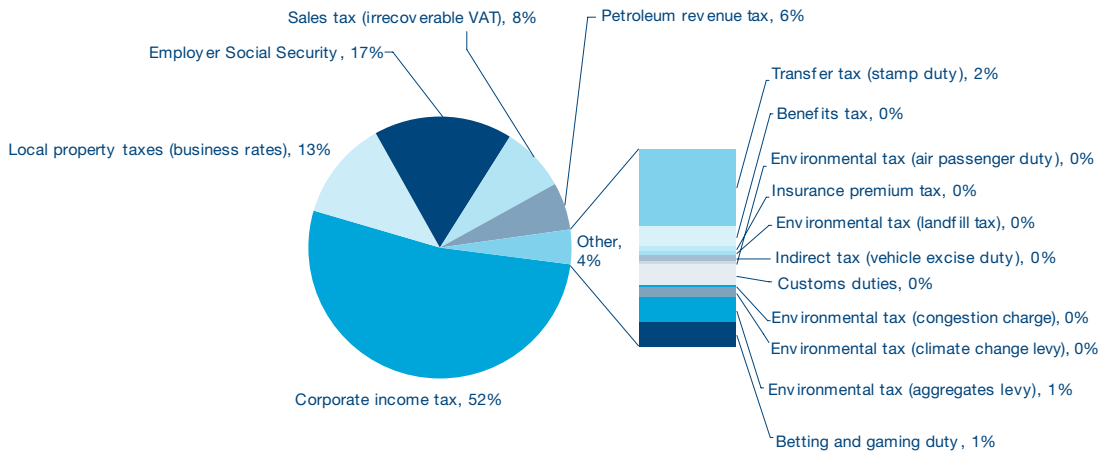
The tax landscape is changing. Companies are coming under increasing scrutiny for their corporate income tax planning, and wider groups of stakeholders are becoming more interested in companies' tax payments. High-profile corporate failures, such as Enron, have moved tax up the risk priorities and placed it firmly on the board room agenda. Campaigning groups are calling for companies to pay their fair share in tax, and tax is now firmly on the agenda of the corporate responsibility movement. To quote Jeffrey Owens, the senior tax official at the Organization for Economic Cooperation and Development: "Tax is where the environment was [as a corporate responsibility issue] ten years ago." The implication is that if companies pay less due to their corporate income tax planning, poorer sections of society are asked to pay more.

An appreciation of the full extent of the business taxes companies pay in addition to corporate income taxes will inform the debate on what companies contribute. A recent study in the United Kingdom has identified 21 business taxes in addition to corporation tax paid by

companies, and in Australia there are in excess of 50. Total Tax Contribution studies have been conducted in a number of countries around the world to gain greater insight regarding the impact of various taxes on corporations. There is a lack of transparency about these taxes. In many cases, the only information on taxes in the public domain is what is disclosed in a company's financial statements within its annual report, which often provides information only on corporate income taxes. There is often no information included on all the other taxes, duties, and payments, which are deductible in computing business profits and are often called "above the line" taxes.

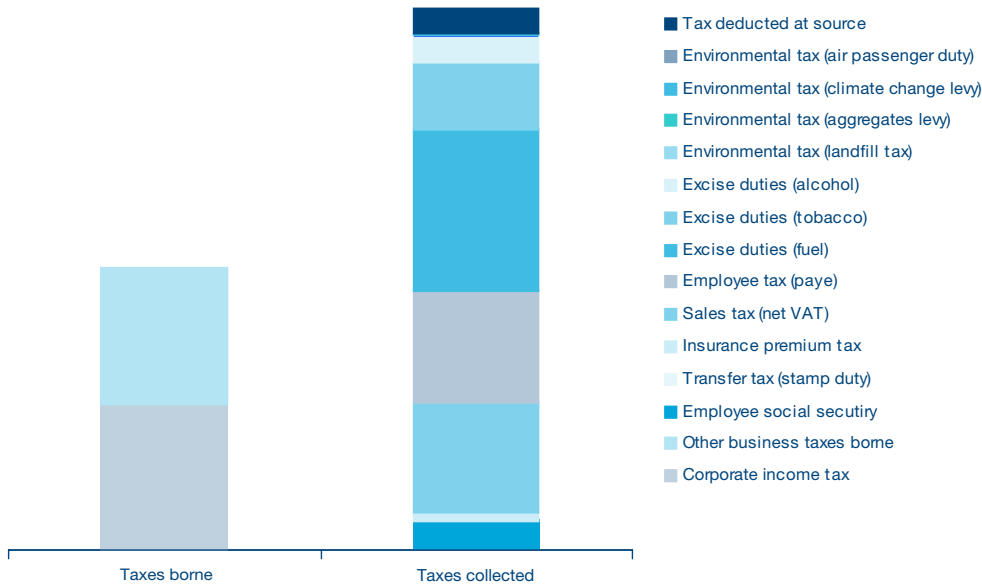
Studies of the TTC of companies in the United Kingdom and Australia have highlighted the importance of other taxes borne, such as employer Social Security payments, customs duty, local property taxes, and sector-specific taxes. The profile of taxes borne varies by industry sector as many of these taxes are sector-specific.

In the United Kingdom, a survey has shown that across all industry sectors, corporate income tax payments are matched by an equal amount of other business taxes that have to be paid. The pie chart below illustrates this. It can clearly be seen that corporate income tax represents only 52 percent of the taxes borne. To put the figures into context, on average, total taxes borne represent 40 percent of profit before all these business taxes for these companies.



Source: PwC UK Total Tax Contribution surveys for The Hundred Group

The pie chart covers the taxes that are a cost to the company—taxes that have an impact either on the profit and loss account or on a capital account. However, companies also have responsibility for collecting other taxes on behalf of government, and this can represent a significant compliance and administrative burden. Again, the results vary significantly by sector, but our work shows that companies collect almost twice as much again in taxes collected when compared with taxes borne.



Source: PwC UK Total Tax Contribution survey for The Hundred Group

To put the figures into context, on average, an amount equivalent to 18 percent of turnover of these companies is paid to UK government in both taxes borne and taxes collected.

While the charts shown above relate to a cross sector group of companies, the picture for metal companies is also very interesting. TTC work with metal companies has shown that these companies bear many taxes other than corporate tax, including royalties, license fees, and resource rents. In addition, mining taxes and production taxes can also be a significant part of the TTC.

For internal management, TTC information is important to ensure that investment decisions are taken on the basis of full information considering all business taxes borne and collected. Many other business taxes are significant in size, and if not adequately controlled, they can represent a material risk.

Externally, increased transparency around the full amount of the TTC made by the metal sector can help to meet the needs of a variety of stakeholders, such as investors, governments, and consumers. These different stakeholders have different needs. For example, investors need clarity on tax risk position, governments need information on attracting and retaining investments, and nongovernment organizations need to understand the contribution made by companies. TTC is a relatively straightforward, easy-to-understand framework to communicate to stakeholders what a company contributes in taxes.

Total tax offers the potential for a more constructive conversation facilitated by a standard method of measurement that can be consistently applied globally.

Source of information

Our financial analysis was based on a number of ratios that can be derived from publicly available information. The use of publicly available information allowed us to include a large sample size of 49 companies without the need to contact each company, giving us a good overview from which to draw our conclusions.

Statistical analysis

Trimmed average

Our conclusions are based on a statistical analysis of the ratios. In a tax benchmarking exercise of this nature, particular ratios may be distorted due to one off, nonrecurring items. Exceptional items, for example, often attract associated tax at rates far from the statutory rate.

It was necessary to exclude these extreme values, and this was done on a consistent basis by taking a trimmed average of a particular sample. The trimmed average is the average result of the data, set by excluding 15 percent of the data points from both the top and bottom of the data set. It is a robust estimate of the location of a sample, excluding outlying data points.

Quartiles

These record the ratio where 75 percent and 25 percent of the sample companies lie below that point respectively. By displaying results in this manner, it is possible to identify the range in which the results of the majority of companies fall.

The terms used in the charts to represent the upper (above the trimmed average) and lower (below the trimmed average) quartiles are Q3 and Q1.

List of companies

Company name	Headquarters	Company name	Headquarters
Tenaris SA	Argentina	Sumitomo Metal Industries Ltd	Japan
Bluescope Steel Ltd	Australia	Sumitomo Metal Mining Company Ltd	Japan
Fortescue Metals group DEF	Australia	Posco	Korea
Voestalpine AG	Austria	Arceromittal	Luxembourg
Companhia Siderurgica Nacional SA	Brazil	Grupo Mexico Sab De CV	Mexico
Usinas Siderurgicas Minas Gerais SA	Brazil	Industrias Penoles Sab De CV	Mexico
Vale (Companhia Vale Do Rio Doce SA)	Brazil	KGHM Polska Miedz	Poland
Cameco	Canada	Magnitogorsk Metal	Russia
Teck Cominco	Canada	Mechel	Russia
Aluminum Corporation Of China Ltd	China	MMC Norilsk Nickel	Russia
Angang	China	Novolipetsk Steel	Russia
Baoshan Iron & Steel Company Ltd	China	Severstal	Russia
Shanxi	China	Anglo Platinum	South Africa
Western Mining Company Ltd	China	Arceromittal South Africa	South Africa
Wuhan	China	Impala Platinum	South Africa
Outokumpu OYJ	Finland	Acerinox SA	Spain
Eramet	France	SSAB AB	Sweden
Salzgitter AG	Germany	China Steel Corp	Taiwan
Jindal Steel & Power Ltd	India	Lonmin plc	UK
Steel Authority of India Ltd	India	Alcoa Inc	United States
Sterlite Industries (India) Ltd	India	Allegheny Technologies Inc	United States
Tata Steel Ltd	India	Nucor Corp	United States
JFE Holdings	Japan	Southern Copper Corporation	United States
Kobe Steel Ltd	Japan	United States Steel Corp	United States
Nippon Steel Corporation	Japan		

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