

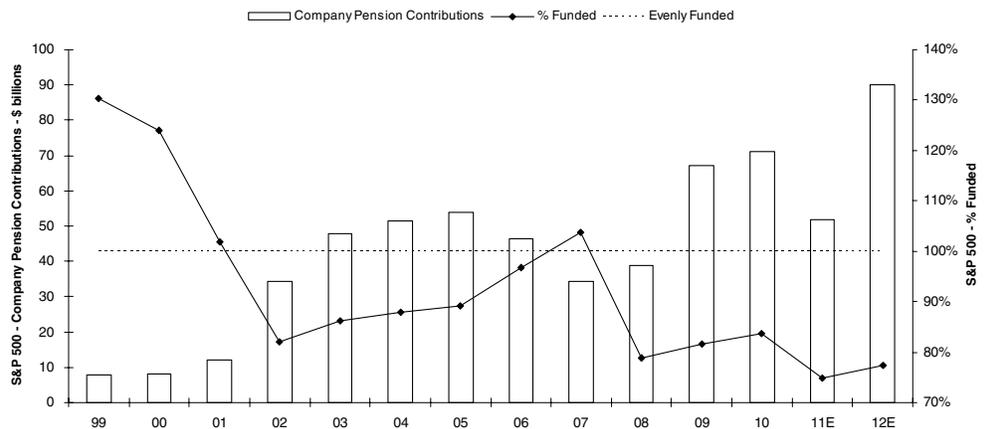
Pensions Punished

ACCOUNTING

Look for Pension Contributions to Go Up

Exhibit 1: Pension Plan Funded Status and Company Contributions, S&P 500

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Note: The 2011 company contribution and funded status include actual amounts for companies with January to June fiscal year ends and estimates for July to December fiscal year ends.

Source: Company data, Credit Suisse estimates

- **Pensions punished last year, like Jason Pierre-Paul has been punishing quarterbacks.** Back in 2002 (after three rough years) pension underfunding for the S&P 500 hit \$164 billion (82% funded), then in 2008 the financial crisis caused pension underfunding to reach \$274 billion (79% funded), now we are estimating that low rates (assuming a 100 bps drop in pension discount rates for most companies) have pushed pension underfunding to a new year-end high (or low) of \$458 billion (74% funded).
- **Behavior should continue to change.** We would expect to see more plans frozen, an increase in lump sum payments (especially with the corporate bond discount rate fully phased-in), continued attempts to de-risk (including synthetically with derivatives), new borrowing to fund the plans and more companies switching to mark-to-market pension accounting (depending upon how the market reacts to the large fourth quarter charges we're expecting to see from the companies that have already adopted it).
- **Don't be surprised to hear more about increased pension contributions during fourth quarter earnings calls.** Using our *S&P 500 Pension Forecast Model* we found 114 companies where the estimated pension contribution in 2012 is more than 10% of trailing cash flow from operations. In addition to higher contributions this year, it looks like pension funding may become more of an ongoing drain on cash than it has been in the past. A lack of information leads us to believe that may not be well factored into the market's expectation for future cash flows.

DISCLOSURE APPENDIX CONTAINS IMPORTANT DISCLOSURES, ANALYST CERTIFICATIONS, INFORMATION ON TRADE ALERTS, ANALYST MODEL PORTFOLIOS AND THE STATUS OF NON-U.S. ANALYSTS. FOR OTHER IMPORTANT DISCLOSURES, visit www.credit-suisse.com/researchdisclosures or call +1 (877) 291-2683. U.S. Disclosure: Credit Suisse does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Pensions Punished

Falling interest rates punished defined benefit pension plans last year (like Jason Pierre-Paul has been punishing quarterbacks) while mediocre asset returns weren't good enough to keep pace with growing pension obligations especially when that growth was turbocharged by lower discount rates (we assume a 100 basis point drop in pension discount rates for calendar year companies). We estimate that in the aggregate the pension plans of the companies in the S&P 500 ended 2011 \$458 billion underfunded (74% funded), a \$212 billion decline from the \$246 billion in underfunding (84% funded) as of the companies' most recent reported year-end. On the bright side, that's an improvement from the \$477 billion of underfunding that we had estimated last October (see our October 10, 2011 report, *From Bad to Worse, S&P 500 Pension Underfunding Hits \$477 Billion*) as a fourth quarter rally in the stock market helped to alleviate some of the pain.

Weaker pension plans can cause some problems for the companies that sponsor them, including, lower earnings from higher pension costs, hits to the balance sheet from larger pension liabilities, a drain on cash due to increased pension contributions (we expect to hear more about this during fourth quarter earnings calls) and in theory a drop in the stock price since the plan has a larger claim on the company leaving less for the shareholders.

As a result don't be surprised to hear more companies discuss making changes to their pension plans. We would expect to see: more plans being frozen (e.g., RR Donnelly recently announced that it was freezing its pension plan starting this year), an increase in lump sum payments (especially this year since the discount rate used to calculate lump sums is now tied to corporate bonds resulting in smaller lump sums), companies continuing to de-risk by trying to better match their pension assets with the pension obligation (which some plans are pursuing synthetically by using derivatives) and more companies making the switch to mark-to-market pension accounting (depending upon how the market reacts to the large fourth quarter charges we expect to see announced by the companies that have already adopted this approach).

Pension Contributions Headed Higher

With most pension plans underfunded (we estimate 97% of the S&P 500 companies' pension plans are underfunded) and many in bad shape (the median plan is only 72% funded) investors have two questions about pension contributions: 1. When will companies have to fund their plans? And 2. How much will they need to contribute? We take a shot at answering those questions (after making some simplifying assumptions) in our *S&P 500 Pension Forecast Model*, where we provide five year forecasts of required contributions for each company in the S&P 500 along with estimates of funded status and pension costs.

https://doc.research-and-analytics.csfb.com/doc?sourceid=em&document_id=x430338

With the health of defined benefit pension plans deteriorating companies will eventually have to contribute more cash (or other assets) to their plans (unless the U.S. Congress or the markets bail them out). We estimate that the companies in the S&P 500 would have to contribute \$90 billion to their pension plans in 2012 that's \$38 billion or 74% higher than the \$52 billion of pension contributions they expected to make in 2011 (per their most recent 10-K). More than half of the increased contributions are in the Industrials and Telecommunication Services (e.g., Verizon just announced that it would contribute \$1.2 billion to its pension plan in 2012 up from \$500 million last year, our model estimates 2012 contributions of \$1.5 billion) sectors. Taking a look at each company in the S&P 500, we find the median increase in estimated contributions from 2011 to 2012 is 35%, with 42 companies where the contribution to the pension plan could jump by more than \$250 million and 87 companies where the increase in pension contributions would eat up more than 5% of their trailing pre-pension cash flow from operations.

In addition to higher contributions in 2012 we are estimating that companies will have to continue contributing significant amounts to their pension plans for the foreseeable future. Assuming companies didn't take advantage of pension funding relief, we estimate that the companies in the S&P 500 will contribute \$69 billion to their pension plans in 2013, \$61 billion in 2014 and \$61 billion in 2015 (that assumes from 2012 to 2015 discount rates don't change from 2011 levels and that each year equities are up 7%, other assets up 7%, fixed income earns 4% and real estate 4%). The Society of Actuaries is also expecting a "significant increase in the level of future contributions" through 2017, as noted in a study released late last year titled, *The Rising Tide of Pension Contributions Post-2008: How much and when?* It looks like pension funding may become more of an ongoing drain on cash than it has been in the past. The question is whether that has been factored into the market's expectations, but, with the limited disclosures around future pension funding requirements and lack of information that we highlight below, we expect it hasn't.

Focusing on the estimated 2012 contributions, we compare them to trailing five year average pre-pension cash flow from operations (that's cash flow from operations before pension contributions adjusted for taxes using a 35% tax rate) to measure how significant they are for each company. We found that for 114 companies the estimated pension contribution in 2012 after-tax is more than 10% of trailing cash flow from operations, including the seven companies in Exhibit 2 where it's more than half of trailing cash flow (keep in mind that contributions to U.S. qualified pension plans are tax deductible, as a result companies contributing to their pension plan would see a reduction in their tax bill). In other words, these companies may have to allocate a significant portion of their cash flow to fund their pension contributions. Companies could also turn to other sources of financing to fund the pension plan, like cash on hand or the proceeds from selling assets or issuing debt / stock. Another option is to contribute the company's stock or other assets directly into the pension plan.

Exhibit 2: Estimated 2012 Pension Contribution More than Half of Trailing Five-Year Average Pre-Pension Cash Flow from Operations¹

US\$ in millions

Company	Ticker	A	B	B / A
		Trailing 5-Year Avg. Pre-Pension Cash Flow from Ops.	Pre-Tax Pension Contribution 2012E	2012E Pension Contribution / Trailing 5-Year Avg. Cash Flow from Ops.
AK Steel Hldg Corp	AKS	\$ 289	\$ 244	84%
Goodyear Tire & Rubber Co	GT	776	618	80%
Weyerhaeuser Co	WY	353	278	79%
Boeing Co ²	BA	5,470	3,955	72%
Northrop Grumman Corp ^{2,3}	NOC	2,953	2,069	70%
Lockheed Martin ²	LMT	4,487	2,787	62%
United States Steel Corp	X	1,054	609	58%

¹Pre-Pension cash flow from operations represents cash flow from operations before pension contributions adjusted for taxes assuming a 35% tax rate.

²Certain large government contractors applied the funding requirements from the Pension Protection Act to determine required pension contributions for the first time in 2011.

³Effective as of March 31, 2011, the company completed the spin-off to its shareholders of Huntington Ingalls Industries, Inc. (HII), a wholly owned subsidiary. Information in the table does not reflect the spin-off. Note: We make a number of simplifying assumptions in our pension forecast model, including combining U.S. and non-U.S. pension plans along with qualified and non-qualified plans when estimating pension contributions, we have also not factored in ERISA funding credits (see our September 21, 2010 report, *Pension Headwinds, Low Interest Rates & Weak Stock Market Are Bad News for Pension Plans*, for a further discussion) as a result required pension contributions may vary considerably from the forecast. Source: Company data, Credit Suisse estimates

Now before you get too excited about the estimated 2012 pension contributions above, take note of one of our key simplifying assumptions: We have combined the U.S. and non-U.S. pension plans (along with qualified and non-qualified plans) when estimating the contributions. However, U.S. pension funding requirements only apply to qualified U.S. pension plans. Of the seven companies in Exhibit 2 only Goodyear Tire provides a breakdown between their U.S. and non-U.S. pension plans (the other companies may have non-U.S. plans and/or non-qualified plans but don't disclose them separately). If we apply the U.S. funding requirements to just the U.S. plans for Goodyear, we estimate that the required contributions to the pension plan would be \$444 million down from our initial estimate of \$618 million and more in line with the range of \$400 to \$450 million the company expected to contribute to its U.S. plan this year per its 2010 10-K.

Having more detailed disclosures for the other companies in Exhibit 2 would help us fine tune our estimates, especially since it appears as if most have non-U.S. and/or non-qualified pension plans (e.g., Weyerhaeuser's pension footnote lumps all of its plans together, however, if the plans were reported separately we might get a different picture as the CFO, Patricia Bedient noted at a conference back in September that the "U.S. pension plans are fully funded"). However, just because the plans aren't subject to U.S. funding rules, let's not forget that these companies have made pension promises to their foreign workers and to the employees in the non-qualified plans that will, at some point, need to be funded too.

Another reason why our estimates may differ from the actual pension funding requirements is that we don't factor in ERISA funding credits. For example, searching through the 5500 filings for U.S. Steel we found \$702 million in ERISA funding credits as of the 2009 plan year (there could be more). If those credits are still available and the company can keep the U.S. pension plan above 80% funded on an ERISA basis, U.S. Steel could use them in the future to offset required contributions. We expect that's one of the reasons why Gretchen Haggerty the U.S. Steel CFO mentioned during the Q&A of their third quarter earnings call that the company was not anticipating having to make a required contribution to its pension plan in 2012.

Keep in mind that if the companies in Exhibit 2 had elected to use the pension funding relief provided by Congress it could reduce the required contributions to their pension plans. In fact in Goodyear's 2010 annual report, the company said that it was anticipating using funding relief in 2011, "which is expected to reduce [its] total U.S. pension contributions in 2011 to 2014 by approximately \$275 million to \$325 million." However, this is just kicking the can down the road as the company has stated that it expects increased contributions in years after 2014.

Certain large government contractors had to apply the pension funding requirements in the Pension Protection Act for the first time in 2011 which impacted three of the companies in Exhibit 2; Boeing, Lockheed Martin and Northrop Grumman. For example, back in December at the Credit Suisse Aerospace and Defense Conference Lockheed Martin's CFO, Bruce Tanner, stated that he expects the company's pension contributions to go up to \$2.1 billion in 2012 from \$1.3 billion in 2011.

At least our estimate of pension contributions (\$2.8 billion) is in the ballpark for Lockheed Martin relative to management's expectations (\$2.1 billion). It looks like we can't say the same for Boeing. During its third quarter earnings call Boeing's CFO, James Bell, noted that the "required pension funding remains minimal in 2012." We're not sure how exactly to quantify "minimal" but we'd guess that it's less than our estimate of nearly \$4 billion in pension contributions for 2012. Differences between our estimate and what the company is saying could be due to us including foreign or non-qualified plans in our estimate that Boeing does not breakout separately or the company having ERISA funding credits that we're not aware of. Maybe we're not making big enough adjustments to the GAAP view of the pension plan when trying to estimate the funding requirements for Boeing, as the differences appear to be quite large: when its pension plans were \$9,854 million underfunded at the end of 2010 on a GAAP basis Boeing disclosed that "on an ERISA

basis our plans are more than 100% funded.” That said the company does admit that “absent increases in interest rates and/or higher asset values, we may be required to make significant contributions to our pension plans in the future.”

Government Contractors Have a Third Set of Books for Their Pension Plans

Remember that to the extent these companies do business with the U.S. government they are reimbursed for pension costs as measured under the Cost Accounting Standards (CAS) and depending upon the type of contract (estimated costs under a fixed price contract and actual costs under a cost plus contract). The cost accounting view of the pension plan differs from both GAAP and the funding rules in the Pension Protection Act. Pension costs under cost accounting are based off the old pension funding requirements that allowed for more smoothing, longer amortization periods and different assumptions (e.g., the discount rate is based on the expected return on plan assets). However, the Office of Federal Procurement Policy, Cost Accounting Standards Board released a new rule on December 27, 2011 that brought the ERISA funding rules and CAS pension costs closer together, by reducing some of the smoothing in CAS, though differences still exist.

As a result of the U.S. government’s involvement some investors ignore the pension plans for these companies. There are a few reasons why you probably shouldn’t ignore them: (1) the company may not get reimbursed the same amount that its required to contribute to its pension plan as the rules were not fully harmonized, (2) there may be a time lag between when the companies are required to fund their pension plans and when they get reimbursed, (3) companies may have pension costs associated with their commercial business that are not reimbursable (i.e., non Department of Defense business, and (4) for fixed price contracts where there is competition, companies run the risk of higher pension costs not getting reimbursed in a new contract if the higher costs make the contractors bid unattractive, especially if the Pentagon truly gets serious about saving money (or if taxpayers get fed up of being on the hook for the risks that these companies decide to take in their pension plans).

Why Contribute More Than What’s Required?

There are a few reasons why we might see companies contribute more than what’s required to their pension plans, including: it provides a boost to earnings (if the expected rate of return is higher than the cost of funds), it provides a tax shield, it reduces PBGC premiums and it can help a company avoid benefit limitations that are triggered when certain funding levels are reached. For instance, if a plan drops below 80% funded on an ERISA basis, it can’t pay full lump-sum benefits and among other restrictions it can’t use its ERISA funding credits. As a result some companies may have a policy to fund their pension plan so that it remains above 80% funded. Some companies might even view funding the pension plan as one step toward improving their credit rating, for example, Goodyear Tire’s CFO, Darren Wells, stated at a conference back in August that “a big part of our journey back to investment grade [. . .] is funding the pension plan.” That said don’t be surprised if more companies borrow (at low current rates) to fund their pension plans (of course it’s trading one piece of debt for another, but it can boost earnings). There should be plenty of demand from other pension plans looking to get their hands on long duration fixed income assets.

Lack of Information Makes it Difficult to Estimate Pension Contributions

Estimating required pension contributions is a painful process for a number of reasons (most of which are the result of a lack of information), including:

- Pension funding requirements use different measurements and assumptions than those used for accounting (i.e., there are two sets of books). So the amount of the underfunding that drives how much a company has to contribute to its pension plan is different than the amounts disclosed in the footnotes and reported on the balance sheet. You can find the funding view of the pension plan in something called a Form 5500 filing (check out <http://freeerisa.benefitspro.com>), however, the data is stale (2009 data is the most recent available) and because companies can have multiple

pension plans there are multiple 5500 filings making it difficult to tell whether you have captured all of the plans. So instead we adjust the accounting information to try and make it look more like the funding view of the plan.

- Also keep in mind that U.S. pension funding rules only apply to U.S. qualified pension plans. The problem is that most companies don't separate out their U.S. qualified plans from the rest (in fact most don't even separate their U.S. plans from their non-U.S. plans; the SEC would like to see that change). So instead, our S&P 500 model estimates required pension contributions by applying the U.S. pension funding requirements to all of a company's pension plans which may result in our overestimating a company's required contributions.
- Then there's the mysterious ERISA funding credits, "excess" contributions that companies have made over the years which can be carried forward and used to offset their pension funding requirements. Most companies don't disclose the amount of their ERISA funding credits in a 10-Q or 10-K but you can find them in the 5500 filings (though they might be outdated and incomplete). As a result we have not factored in the ERISA funding credits into our S&P 500 pension contribution estimates.
- The list goes on and on, for example, in many cases we have no idea whether or not the company elected to use pension funding relief (see our March 10, 2010 report, *Pension Funding Relief, Again, Kicking the Can Down the Road*), which would impact how much they have to contribute to the plan in the future, past contributions are a poor indicator of future funding requirements and most companies provide very little guidance about future contributions to their pension (in fact most only tell you how much they expect to contribute to their pension plan in the next year, because that's what is required).

With that laundry list of problems you may be wondering, why even bother with our forecast? Think of it as a starting point, it's meant to get you in the ballpark. If we are estimating a large contribution relative to the cash that the business is generating you may want to dig deeper; analyze the U.S. qualified plans separate from the nonqualified and foreign plans (if the company provides enough disclosure), take into account ERISA funding credits, etc. All of these finer details can be factored into our separate more flexible version of the pension model. (Just give us a call if you would like to see it.)

U.S. Pension Funding Requirements – A Brief Review

With more and more pension plans in bad shape we thought a quick review of the funding requirements for U.S. qualified pension plans might be helpful. Under the Pension Protection Act (see our August 14, 2006 research report, *Pension Protection Act, Pension Funding Rules, Basketballs, and Camel Hair, Too*) companies are required to contribute the normal (i.e., service) cost of the plan plus the amount of any "funding shortfall" (i.e., underfunding) amortized over seven years with interest. Required contributions are typically due 20.5 months after the pension plan is measured which is at the beginning of the plan year (e.g., the contribution is not due until September 15, 2013 for a plan that was measured on January 1, 2012). However, a company may have to start making quarterly contributions earlier if the pension plan is underfunded two years in a row. For example, a company with a pension plan that is underfunded on both January 1, 2011 and January 1, 2012 would make quarterly contributions on April 15, July 15, October 15, 2012 and on January 15, 2013 (with a catch-up contribution due September 15, 2013). The amount of the quarterly contribution is based on 90% of the current years' required contribution or 100% of the prior year, whichever is smaller.

Pension Underfunding Hits \$458 Billion

Back in 2002 (after three rough years) the underfunding for the defined benefit pension plans of the S&P 500 companies reached \$164 billion (82% funded), which was surpassed at the end of 2008 when the underfunding topped \$274 billion (79% funded), and

according to our estimates it's now worse, underfunding of \$458 billion (74% funded). In fact, of the 342 companies in the S&P 500 with defined benefit pension plans (and that provide detailed disclosures about them), we estimate there are 272 companies with pension plans less than 80% funded (on a GAAP basis), that's 80% of the S&P 500 companies that offer them.

For some companies the change in the health of the pension plan is more significant than for others. In theory, a deteriorating pension plan should drive the stock price down, all else equal, as the pension plan has a larger claim on the company, leaving less for the shareholders'. We found 40 companies where the estimated after-tax (assuming a 35% tax rate) drop in the funded status of the pension plan last year ex-contributions (stripping out same year contributions provides a better reflection of the real losses incurred by the plan) was more than 5% of the company's market cap at the beginning of 2011. Exhibit 3 shows 12 companies where the drop was more than 10% of market cap.

Exhibit 3: Estimated After-Tax Drop in Funded Status Ex-Contributions During 2011 Was More than 10% of

Market Cap

US\$ in millions

Company	Ticker	A Estimated Drop in Funded Status During 2011	B Estimated Pension Contribution 2011	C = A - B Estimated Drop in Funded Status Excluding Contributions	D Market Cap Beginning of 2011	(1 - 35%) x C / D After-Tax Drop in Funded Status Ex- Contributions / Market Cap
Goodyear Tire & Rubber Co ¹	GT	\$ (1,027)	\$ 275	\$ (1,302)	\$ 2,879	(29%)
AK Steel Hldg Corp	AKS	(326)	170	(496)	1,801	(18%)
Lockheed Martin	LMT	(5,448)	1,300	(6,748)	25,177	(17%)
Supervalu Inc ⁵	SVU	(410)	70	(480)	1,831	(17%)
Northrop Grumman Corp ²	NOC	(3,786)	562	(4,348)	19,409	(15%)
Raytheon Co	RTN	(2,412)	1,073	(3,485)	16,893	(13%)
Boeing Co	BA	(9,160)	500	(9,660)	47,873	(13%)
Donnelley, R.R. & Sons	RRD	(650)	46	(695)	3,604	(13%)
United States Steel Corp ³	X	(1,472)	104	(1,576)	8,390	(12%)
Ford Motor Co ⁴	F	(8,781)	1,600	(10,381)	58,306	(12%)
Textron Inc	TXT	(845)	220	(1,065)	6,499	(11%)
Computer Sciences ⁵	CSC	(1,041)	179	(1,220)	7,558	(10%)

¹Goodyear Tire & Rubber expected to contribute approximately \$250 million to \$300 million to its funded U.S. and non-U.S. pension plans in 2011, we used the midpoint, \$275 million.

²Effective as of March 31, 2011, the company completed the spin-off to its shareholders of Huntington Ingalls Industries, Inc. (HII), a wholly owned subsidiary.

³Estimated 2011 pension contribution obtained from U.S. Steel's contractual obligation table includes an expected contribution of \$94 million to its USSC plans as well as an additional \$10 million to other pension plans.

⁴Does not include Volvo's pension plan.

⁵Supervalu's market capitalization is as of 2/28/11 and Computer Sciences' market capitalization is as of 3/31/11.

Note: Estimates through December 30, 2011 for all companies except those with July – November year ends, where the estimate is through the fiscal year end (e.g., July 2010 – July 2011).

Source: Company data, Credit Suisse estimates

The analysis in Exhibit 3 implies that the estimated deterioration in the health of the pension plan during 2011 could have been responsible for a more than 10% drop in the stock price for these companies last year. The difficult to answer question is whether the market has priced in the weakening of the pension plan. For six of the companies in Exhibit 3 (AK Steel, RR Donnelley, US Steel, Ford Motor, Textron and Computer Sciences) the stock price dropped in 2011 by more than what the estimated deterioration in the pension plan would imply. Of course there are lots of reasons why a stock price would fall in addition to a weakening pension plan, maybe the market's expectations for cash flows, growth and/or risk of these companies deteriorated or maybe the market thinks the pension plan is in even worse shape than what we forecast.

On the other hand, the stock prices for the remaining six companies (Goodyear Tire, Lockheed Martin, Supervalu, Northrop Grumman, Raytheon and Boeing) all performed better than what the deteriorating pension plan would imply. Maybe the plans aren't in as bad shape as we estimate (e.g., there could be hedges in place we have not factored in) or the market has simply decided to ignore the deterioration in the health of the pension plan, which may be the case with some of the defense contractors as they can eventually bill the U.S. government for some of their increased pension costs. Or the market's expectations for cash flows, growth and/or risk have improved for these companies to more than offset the deterioration in the health of the pension plan.

Comparing our estimate of the pension plans funded status (after-tax) to market cap, we find 90 companies where the pension underfunding is now more than 5% of the companies' market cap, including the 14 companies in Exhibit 4 where it is more than 25%. That's down from 105 and 17 companies respectively from our estimates last October.

Exhibit 4: Estimated Pension Underfunding (After-Tax) More than 25% of Market Cap

US\$ in millions

Company	Ticker	A		B		$(1 - 35\%) \times A / B$
		Estimated	Funded Status	Market Cap ¹	After-Tax Funded Status / Market Cap	
AK Steel Hldg Corp	AKS	\$	(1,383)	\$	911	(99%)
ITT Corporation	ITT		(2,283)		1,793	(83%)
Goodyear Tire & Rubber Co ²	GT		(3,576)		3,463	(67%)
United States Steel Corp ³	X		(3,447)		3,810	(59%)
Sears Holdings Corp	SHLD		(2,372)		3,592	(43%)
Lockheed Martin	LMT		(15,876)		26,177	(39%)
Supervalu Inc	SVU		(1,029)		1,723	(39%)
Computer Sciences	CSC		(2,073)		3,675	(37%)
Whirlpool Corp	WHR		(1,814)		3,627	(33%)
Ford Motor Co ⁴	F		(20,238)		41,651	(32%)
Alcoa Inc	AA		(4,329)		9,239	(30%)
Donnelley, R.R. & Sons	RRD		(1,203)		2,710	(29%)
Textron Inc	TXT		(2,163)		5,143	(27%)
Raytheon Co	RTN		(6,451)		16,744	(25%)

¹As of December 30, 2011

²Goodyear Tire & Rubber expected to contribute approximately \$250 million to \$300 million to its funded U.S. and non-U.S. pension plans in 2011, we used the midpoint, \$275 million.

³Estimated 2011 pension contribution obtained from U.S. Steel's contractual obligation table includes an expected contribution of \$94 million to its USSC plans as well as an additional \$10 million to other pension plans.

⁴Does not include Volvo's pension plan.

Note: Estimates through December 30, 2011 for all companies except those with July – November year ends, where the estimate is through the fiscal year end (e.g., July 2010 – July 2011).

Source: Company data, Credit Suisse estimates

Earnings Headwind

We are estimating that pension costs on the income statement could rise by 22% in the aggregate from \$42 billion this year to \$51 billion in 2012 (that's assuming no companies use the mark-to-market approach); nearly 45% of that increase is coming from the companies in the Industrials sector. Higher pension costs could cause an earnings headwind for 246 companies, including 82 companies where pension costs could jump by more than \$0.05 per share after-tax (see our *S&P 500 Pension Forecast Model* for estimated pension costs over the next five years for each company). We estimate there are 14 companies where the increase in pension costs could cut 2012 earnings by more than 5%.

Keep in mind that we are estimating pension costs will increase without making any changes to the expected return assumptions (unless specifically disclosed by a company). If expected rates of return were reduced, the hit to earnings would be even larger. For example, if we were to take the expected rates of return down 100 basis points for 2012 we find that pension costs would jump by 54% to \$65 billion in the aggregate. The combination of poor equity performance over the past decade and more importantly low yields could continue to put pressure on these assumptions. The median expected rate of return among the S&P 500 companies was still 7.79% as of the most recent reported year-end.

The Assumptions

Our estimates are highly dependent upon the assumptions used and reflect different assumptions for company's with different fiscal years (remember the pension plan year-end is the same as the company's). For example, for a calendar year company in 2011 we assume equities were down 2.5%, fixed income up 7.5%, real estate up 11% and "other" (hedge funds, private equity, cash, etc.) assets are up 3% while discount rates are down 100 basis points (based on the *Credit Suisse Pension Discount Curve*). As a point of reference the median discount rate across all of the companies in the S&P 500 as of the most recent reported year-end was 5.38%.

Change the assumptions and you will change our estimates. Of course you may disagree with our assumptions or you might need to update them as markets continue to bounce around or you might want to run various different scenarios. No matter the reason, we make our *S&P 500 Pension Forecast Model* available to Credit Suisse clients so you can use your own set of assumptions.

We make a number of simplifying assumptions in our pension forecast model (see our September 21, 2010 report, *Pension Headwinds, Low Interest Rates & Weak Stock Market Are Bad News for Pension Plans*, for a further discussion) as a result actual pension results may vary considerably from the forecast.

Analysis includes the S&P 500 constituents as of May 2, 2011.

Companies Mentioned (Price as of 09 Jan 12)

AK Steel Holding Corp. (AKS, \$8.67, NEUTRAL [V], TP \$7.00)
 Alcoa Inc. (AA, \$9.43, RESTRICTED)
 Boeing (BA, \$74.53, OUTPERFORM, TP \$85.00)
 Computer Sciences Corp. (CSC, \$23.37)
 Ford Motor Co. (F, \$11.80, NEUTRAL, TP \$14.00)
 Goodyear Tire & Rubber (GT, \$15.28)
 ITT Corporation, Inc. (ITT, \$20.57)
 Lockheed Martin (LMT, \$80.04, NEUTRAL, TP \$75.00)
 Northrop Grumman Corporation (NOC, \$57.91, NEUTRAL, TP \$49.00)
 Raytheon Company (RTN, \$48.16, OUTPERFORM, TP \$50.00)
 RR Donnelley & Sons (RRD, \$14.55)
 Sears Holding Corp. (SHLD, \$29.69, UNDERPERFORM [V], TP \$20.00)
 SUPERVALU INC. (SVU, \$8.39, NEUTRAL [V], TP \$10.00)
 Textron (TXT, \$19.07, NEUTRAL, TP \$22.00)
 United States Steel Group (X, \$26.78, NEUTRAL [V], TP \$24.00)
 Weyerhaeuser Company (WY, \$18.79)
 Whirlpool Corp (WHR, \$50.49)

Disclosure Appendix

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