J.P.Morgan CAZENOVE

Europe Equity Research
30 September 2010

EMEA First to Market

Top Research for Thursday, 30 September 2010

European Autos

Constructive view from Paris; top pick PSA, may take time for confidence in '11 to build *(Ranjit Unnithan)*

- Comments for Paris imply stable European car market, some growth in US, while China expected to remain strong (high single digit growth).
- This is above worst fears going into Paris of 4-5% decline in European mkt, implies 15-25% upside pot'l to EPS at key names such as PSA. JPMCe +25% vs cons.
- Mass market OEMs still trading at 5-6x '11E P/E, vs hist avg 7-8x. On current JPMC numbers, PSA trades at 4.5x.
- Mass OEM stocks (+2-4% YTD) have lagged premium OEMs (BMW +61%, DAI +24%) but this may continue as newsflow may be soft. Catalysts shd turn +ve early 1Q ahead of financial results. Short term PSA, RNO may have gone too far but our central premise is mkt too low for '11, main call on operational leverage in '11 PSA.

UK Leisure

Thomas Cook Group: OW; TP 220p (235) => 25% upside

Attractive risk reward profile. First catalyst 1 Dec *(Richard Stuber)*

- Share –4.4% since FY trading statement disappointed mkt 28 Sep (£10m cost overrun UK biz, 2.5% EBIT). Now –6% (TSR) vs mkt since 11 Aug (3Q) having disappointed twice in 2m. Note JPMC '11E EPS –10% since Aug.
- JPMC cuts '10E, '11E EPS 6%, 8% => 23.2p, 24.2p. Key changes to '11E: UK ASP +2% from +3% and capacity flat from +1%.
- Trades at 7.3x '11E P/E, with over 2x covered 6.2% DY, 22% P/E d/c to TUI Travel (vs 20% historically). TP cut to 220p (235p) but still offers 25% upside.
- 28 Sep warning cost- not rev-led. Bookings still robust for Summer '10, in line or ahead for Winter '10/11, Summer '11 See bulk of £10m cost overrun reversed in '11 + material upside pot'l from 'substantial cost saving' opps to be announced Dec. JPMCe up to £33m savings from staff and central costs => +11% '11E EPS.
- Next price catalyst 1 Dec when announce FY prelims, cost savings. But rerating unlikely until delivery of multiple solid trading updates, ie, not before cal-1Q11.

European Utilities

GDF Suez

Integrating International Power into forecasts, maintaining a cautious view on mid-stream gas *(Nathalie Casali)*

- Integrating International Power into ests, see transaction 2-3% earnings accretive, results in 10-11% upgrades to JPMCe EBITDA from '11.
- At earnings level, JPMC cut '11-14E recurrent EPS 1.5% as lower European power price assumptions (LT power €60/MWh vs €65 prev) + higher underlying minorities and higher underlying net debt (integration of our latest SEV numbers) offset accretion from IPR deal.
- Despite narrowing of oil-gas spreads and LT contract renegs we maintain f/cs at low end of guidance: remain cautious on 12m outlook for gas mkts, see more downside than upside risk to our assumption LT gas contracts can be passed through to regulated customers in France. Analysis of co procurement and trading portfolio suggests 100TWh of LT contracted gas at risk of renegotiation before end-11; JPMCe '11 gas EBITDA –€0.8bn vs '09, in line with lower end of co guidance (–€0.3-0.8bn).
- See gas biz better placed vs E.ON's due to a) more flexible and diversified procurement portfolio, b) higher direct exposure to retail and commercial customers.

Head of European Equity Research

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J.P. Morgan Securities Ltd.

Price Target Changes

		Price Target	
Company	**Rating**	**New**	**Old**
Increases			
DSM	N	€45.00	€40.00
Smiths Group	OW	1,500p	1,400p
Decreases			
Iberdrola Renovables	OW	€3.50	€3.90
Thomas Cook Group	OW	220p	235p
Introductions			
Omega Insurance	OW	125p	NA

J.P. Morgan EPS Estimate Changes

	Current FY		Next FY	
Company	**New**	**Old**	**New**	**Old**
Increases				
GDF SUEZ	€1.92	€1.89	€2.13	€2.12
Marks & Spencer	30.97p	29.85p	*34.98p*	
Smiths Group	84.63p	76.48p	94.94p	84.54p
Decreases				
DSM	*€3.09*		€2.96	€2.98
Omega Insurance	$0.01	$0.23	$0.22	$0.31
Thomas Cook Group	23.21p	24.63p	24.16p	26.36p
Revisions				
Iberdrola Renovables	€0.10	€0.11	€0.13	€0.11

Note: Italicized figures represent unchanged data.

The extracts are from recently published research. For additional information on each stock's investment thesis, including full disclosure, please contact your sales person, the covering analyst's team or MorganMarkets

European Chemicals

DSM: N; TP €45.00 (40.00) => 21% upside

Co targets imply 28% upside, however JPMC question delivery given poor track record combined with cyclical risk *(Heidi Vesterinen)*

- Co targeting 5-7% med-term org growth vs JPMCe 4%. Co target wd be realistic as demand environment normalized driven by new capex (Chinese CPL, pre-mix, 6-APA), focus on high-growth mkts (32% of sales); but see toughening comps and 35% of EBIT exposed to pot'l cyclical risk '11E. JPMC '10/11E EPS 4%/10% < cons.
- Co guiding to €1.4-1.6bn EBITDA '13, implies 16% group margin vs sector 19%, JPMCe 15%. Cautious: on a) Pharma (target 15-20% vs JPMCe 13.5%) given uncertainty over long-awaited low cost partnership; b) Materials (target >17% vs JPMCe 16.5%) given limited track record despite investment in innovation.
- See 28% potential upside if co achieves 16% ROCE by '13e. JPMC see 14.9%, implied fair value €42 (12% upside). YTD stock +2% vs sector, trades on 5.6x '11E EV/EBITDA, 24% discount to sector.
- Next catalyst: 3Q results (2 Nov). Preferred stock vs Akzo, but on greater growth, margin, returns upside prefer Symrise (OW).

UK Non-Life Insurance

Omega Insurance: OW; TP 125p => 29% upside

Finding stability – merits re-rating *(Andreas de Groot van Embden)*

- Since Jan-09, equity rights issue, shareholder intervention, mgmt change, have seen share –38% vs sector/mkt. Since end-07 de-rated from 1.5x TNAV to 0.9x.
- Internal review requested by major SH has given confidence that Omega has solid platform with good underwriting track record, but which needs modernisation.
- While catastrophe driven (41% premiums), underwriting record good even in recent turmoil. JPMCe cut to reflect 1H10 loss, softening rates '11E => 12%, 15% cuts to '10E, '11E TNAV. See FCF, est capital release $90-100m supporting stable divi (yld 8%).
- Trades at '10E 0.9x TNAV vs RTNAV 13% ('11E), '11E P/E 6.9x, DY 8%. Should trade at c1.2x TNAV, 125p supported by FCFe, assuming normalised CR 81%, RTNAV 12% over time.
- Next catalyst: update on capital management decisions after hurricane season (ie, Nov) plus outlook for '11 rate and syndicate capacity development.

J. P. Morgan Cazenove Conference Call replay

Oilfield Services: Early cyclical growth themes emerging

- Hosted by: Andrew Dobbing, European Oil & Gas Equity Research Analyst
- Replay available until Monday 4th October
- Dial-in numbers: 020 7031 4064 (UK); 1-954-334-0342 (US); +65 66221306 (Singapore); +852 30114552 (Hong Kong) Passcode: 876467

J. P. Morgan Cazenove Conference Call replay

Global Integrateds: Upstream - the shape of things to come – performance assessment

- Hosted by: Fred Lucas, Head of European Oil & Gas Equity Research; Nitin Sharma, European Integrated Oils analyst
- Replay available until Thursday 30th September
- Dial-in numbers: 020 7031 4064 (UK); 1-954-334-0342 (US); +65 66221306 (Singapore); +852 30114552 (Hong Kong) Passcode: 876351

J. P. Morgan Cazenove Conference Call replay

European Corporate Hybrids - origins, uses and implications for equity investors

- This will be especially pertinent to utilities investors given that all three of the hybrids issued in the last month have been in this sector (SSE, RWE, SEV). Hybrids have interesting implications for utility financing and thus capital structure and capex/dividend policies.
- Hosted by: Olek Keenan, JPM Credit Research; Peter Elwin, JPMC Head of European Pensions, Valuation, & Accounting Research
- Replay available until Monday 4th October
- Dial-in number: 020 7031 4064 (UK); Passcode: 876302

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Stacy Pollard (44-20) 7155 6124
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Topps Tiles 56p Neutral
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European Analyst Focus List

29 September 2010

Key:
▲ = Upgrade; ▼ = Downgrade

J.P.Morgan CAZENOVE

European Autos

Constructive View From Paris - ALERT

European Autos

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- **Feeling good.** At the Paris auto show, we felt auto OEMs and suppliers conveyed a constructive message − which we suspect surprised a few investors. Our sense was that in 2011, most companies expect a stable European car market, some growth in the US, while China is expected to remain strong (high single digit growth). Many auto companies learned some hard lessons from the crisis on labor flexibility (many suppliers now have temporary workers comprise ~15-20% of total manufacturing headcount), capital structure (less leverage, high gross cash levels, and investment grade rating now a goal for most OEMs/suppliers) and the need to move faster to secure a bigger footprint in emerging markets. The impression we came away with was that management teams seemed more confident and better prepared to deal with post crisis car markets.

- **Expecting Stable 2011 European Outlook.** Our view is that the WE passenger car market is 12.8MM this year, and 13MM next year and we came away feeling fairly comfortable with these expectations. It is our view that 2011 Street estimates are baking in WE car market at least 0.5MM lower (i.e. 12.5MM or lower), which we think may be too pessimistic. Therefore, our bias is to think 2011 estimates for the mass OEMs are well supported and could even have 15-25% upside (JPMe for RNO/PSA are +14%/25% vs. Street) even as multiples screen as low (PSA/RNO at 4.5-5.5x 2011 PE).

- **View on sector post show**: Newsflow/catalysts on French OEMs looks decidedly mixed – good sales numbers next week now look largely anticipated (given supplier commentary on production), while complete financial results will only be available in Feb 2011 – as such there may be near-term pressure on these stocks. German premium OEMs look better supported into earnings given that Q3 results promise to remain strong and the volume outlook (steady growth in most markets look set to continue) – we prefer DAI here given well supported Mercedes earnings (see below) and tailwind from truck recovery. On 12-18 month view, we remain OW PSA on prospects for significant consensus earnings upgrades (+25%) and multiple expansion (1-2x on PE) if European sales remains flat y/y as we currently expect.

- **OEM Commentary - DAI – Not Worried About the Product Cycle:** DAI sounded positive on the rest of 2010 for Mercedes − our sense is that 2010 Mercedes EBIT guidance (€4B) looks easily achieved. Daimler also sounded positive about growth and profitability in 2011, and did not seem overly worried about its weaker product cycle (vs. BMW). We interpret this to mean that EBIT margins could be at least stable through 2011 vs. current JPMe of a decline (7% vs 8% in 2010). If we held our Mercedes margins stable in 2011, it would imply 5% upside to our 2011 EPS ests. Is this a realistic scenario? We think yes. Product cycles amplify margins during

* Registered/qualified as a research analyst under NYSE/NASD rules

J.P.Morgan CAZENOVE

Europe Equity Research
30 September 2010

Thomas Cook Group

Risk reward upside but no clear catalyst until December

Overweight

TCG.L, TCG LN

Price: 175p

▼ **Price Target: 220p**
Previous: 235p

Leisure

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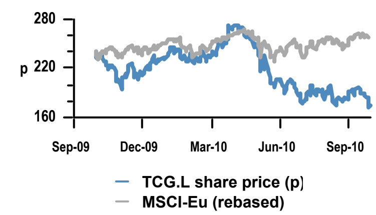
- Thomas Cook disappointed the market on Tuesday, with trading in Q4 dominated by an unexpected cost overrun of £10m in the UK business. Although this is only 2.5% of EBIT, it was the second time in 2 months that TCG has guided the market lower. It is therefore understandable that the share price reacted disproportionately to the earnings downgrade but we believe that the risk reward balance is now on the upside.
- Bookings remained robust for Summer 2010 and are in line or ahead of expectations for Winter '10/11 and Summer '11, albeit that both seasons are in the early stages of bookings. In our view, this demonstrates that there remains structural demand for mainstream holidays. The silver lining in our view to Tuesday's profit warning was that it was cost-led, not revenue-led and therefore in our view, should be more easily controllable.
- We expect the majority of the £10m cost over-run to be reversed next year. In our view it was unfortunate timing that four extra planes were needed to be leased at the height of peak season. Going forward, management should be able to de-risk a repeat of this problem by better scheduling of aircraft maintenance. We also see upside from TCG's substantial cost saving programme, which could provide material upside to our 2011 and 2012 forecasts. Although the downside with a low margin business is that there is little margin for error on the cost base, the reverse holds true during a successful rationalisation exercise.
- Thomas Cook is now trading on 7.3x 2011E PER and offers a 6.2% dividend yield (over twice covered). Although market sentiment may take some time to recover, we do not believe it justifies a 22% discount to TUI Travel, which is trading on 9.3x PER. We are reducing our target price for Thomas Cook to 220p (235p) but this still offers 25% upside to the current share price.
- We believe the shares should appeal to value and income investors although we do not see clear catalysts before 1 December, when it will report full year results and outline details about its cost cutting initiatives.

Price Performance



	YTD	1m	3m	12m
Abs	-23.9%	-4.6%	-4.5%	-27.2%
Rel	-26.9%	-9.0%	-8.8%	-34.6%

Thomas Cook Group Plc (TCG.L;TCG LN)

FYE Sep	2009A	2010E (Old)	2010E (New)	2011E (Old)	2011E (New)
Adj. EPS FY (p)	26.40	24.63	23.21	26.36	24.16
Adj P/E FY	6.6	7.1	7.5	6.6	7.3
Revenue FY (£ mn)	9,269	9,056	9,086	9,420	9,318
EBITDA FY (£ mn)	573	599	591	630	616
EBIT FY (£ mn)	415	405	390	436	415
EBIT margin FY	4.5%	4.5%	4.3%	4.6%	4.5%
DPS (Net) FY (p)	11	11	11	12	11
Net Yield FY	6.1%	6.3%	6.1%	6.8%	6.2%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (p)	175
Date Of Price	29 Sep 10
Price Target (p)	220
Price Target End Date	30 Sep 11
52-week Range (p)	277 - 168
Mkt Cap (£ bn)	1.50
Shares O/S (mn)	859

GDF SUEZ

Integrating IP into our forecasts, maintaining a cautious view on the midstream gas business

GSZ.PA, GSZ FP
Price: €26.29

- **We update our estimates** to reflect the consolidation of International Power (IP) from January 1st 2011. We estimate the transaction itself to be slightly accretive to GDF Suez's earnings. However, a higher share of profits attributable to minorities, the integration of our updated Suez Environnement forecasts and lower power price assumptions (long term power at €60/MWh vs. €65/MWh previously) **lead us to make a 1.5% cut to our 2011-14 recurrent EPS forecasts**. For 2010 we have integrated the impact of positive H1 one-offs (cold weather in France and provision reversal in Belgium), leading to 3.9% and 1.5% upgrades to EBITDA and recurrent EPS for the year, respectively. As a result of these changes, our EBITDA for 2010/11 is 3.3%/7.9% above (recurrent EPS 3.3%/4.3% below) latest Bloomberg consensus, which we believe does not yet reflect the consolidation of IP.

- **Integrating new IP into our forecasts**. Our estimates for new IP remain broadly unchanged (undiluted EPS of 23.1, 27.7, 31.7p/share in 2011, 12, 13). The transaction should bring GSZ's leverage up to 2.4x ND:EBITDA in 2011, normalizing to 2.2x in 2014. We go into more detail about the key earnings drivers of GSZ's international assets in the note.

- **Maintaining a cautious view on mid-stream gas.** Our analysis suggests that 100 TWh of long term gas volumes are at risk of margin erosion in 2010-11 (vs. guidance of 50-80 TWh) assuming (a) no benefit from contract renegotiations but (b) the full pass through of long term contract costs to regulated customers. Despite the narrowing of the oil-gas spread (€5-6/MWh currently vs. guidance of a €6-10/MWh hit) and potential upside from renegotiations with long term suppliers we maintain our forecasts at the lower end of the guidance range (JPMC -€820m '11 EBITDA impact vs. -€300-800m range) to reflect (1) weak gas market fundamentals, (2) risks on the pass through of long term contract costs to regulated customers and (3) weak H1 results, particularly in storage.

- **Nevertheless, we continue to see GSZ's gas business as better placed than EON's** due to (a) a more flexible and diversified procurement portfolio and (b) higher direct exposure to final customers.

Electric Utilities

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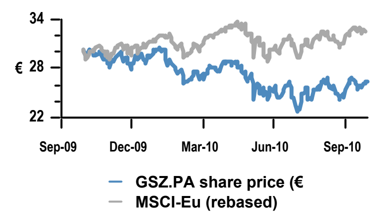
Price Performance



	YTD	1m	3m	12m
Abs	-13.2%	6.7%	11.8%	-13.0%
Rel	-16.2%	2.3%	7.5%	-20.4%

J.P.Morgan plc is acting as a financial adviser to International Power Plc on its preliminary discussions with GDF Suez SA regarding a possibly combination of International Power and GDF Suez's Energy International Business Areas (outside Europe) and certain assets in the UK and Turkey ("GDF Suez Energy International"), to create an enlarged International Power which would be listed on the Official List of the Financial Services Authority ("Official List") and traded on the Main Market of the London Stock Exchange as announced on 19 July 2010.

GDF SUEZ (GSZ.PA;GSZ FP)

FYE Dec	2009A	2010E (Old)	2010E (New)	2011E (Old)	2011E (New)	2012E
Adj. EPS FY (€)	1.98	1.89	1.92	2.12	2.13	2.14
EBITDA FY (€ mn)	14,007	14,824	15,406	16,214	17,965	18,745
Headline EPS FY (€)	2.03	2.19	2.38	2.09	2.12	2.14
Adj P/E FY	13.3	13.9	13.7	12.4	12.3	12.3
EV/EBITDA FY	7.6	7.0	7.2	6.5	6.6	6.3
Gross Yield FY	5.6%	5.7%	5.7%	5.9%	5.8%	5.9%
DPS (Net) FY (€)	1.47	1.50	1.50	1.54	1.53	1.56
EBITDA margin FY	17.5%	18.4%	19.2%	19.6%	19.6%	19.2%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (€)	26.29
Date Of Price	28 Sep 10
52-week Range (€)	30.80 - 22.64
Shares O/S (mn)	2,261
Mkt Cap ($ bn)	59,441.7

DSM

Improvement in ROCE key to future re-rating

- **Above-average growth potential, but not immune to macro risks.** DSM is targeting 5-7% medium-term organic growth – which we view as realistic in a normalized demand environment, driven by new capex (Chinese CPL, pre-mix, 6-APA) as well as DSM's focus on high-growth markets (32% sales) & innovation. Yet with toughening comps and c.35% of EBIT exposed to potential (demand-driven) cyclical risk into 2011e, we anticipate a more modest sales CAGR of 4%.

- **New ambitious margin targets rely on improvement in Pharma and Performance Materials**. DSM is guiding to c.€1.4-6bn of EBITDA in 2013e, which implies a group margin of c.16% – closing the gap vs the wider sector (19%). We however remain cautious over Pharma (15-20% target, JPMCe 13.5%), given uncertainty over the (long-awaited) partnership with a low-cost player. We also remain cautious over Performance Materials (target >17%, JPMCe 16.5%) given its limited track record so far, despite significant investment in innovation. We forecast group 15e EBITDA margin of 15.2%.

- **Achievement of ROCE target could warrant material potential upside.** DSM has continued to suffer from a low returns profile vs its peers (10e ROIC 32% below sector), and is targeting ROCE >15% by 2013e. If DSM achieves a ROCE of 15% (JPMCe ROIC 9.8%) by 2013, we calculate an implied fair value of €44/share (17% upside). A further improvement to 16% (10.4% JPMCe ROIC) would imply €48/share (28% potential upside). Based on our more conservative growth and margins into 2013e, our estimates assume a ROCE of 14.9% (ROIC 9.5%), implying a fair value of €42/share (12% upside).

- **Valuation**. DSM shares have gained 9% YTD (+2% vs sector). The shares trade on a modest 5.6x 11e EV/EBITDA (-24% vs sector). Our near-term estimates are largely unchanged, but we raise our l-term estimates to reflect new investments projects highlighted at the Capital Markets day. With our revised DCF-based Dec-11 TP of €45/sh offering 21% potential upside, on a relative basis we remain Neutral.

Neutral

DSMN.AS, DSM NA

Price: €37.26

▲ **Price Target: €45.00**
Previous: €40.00

European Chemicals

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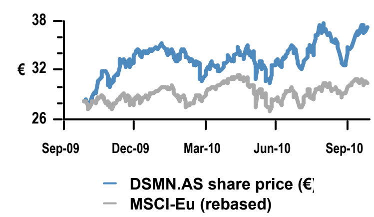
Price Performance



	YTD	1m	3m	12m
Abs	5.7%	14.3%	8.0%	32.1%
Rel	2.7%	9.9%	3.7%	24.6%

Koninklijke DSM N.V (DSMN.AS;DSM NA)

FYE Dec	2008A	2009A	2010E	2011E	2012E
Adj. EPS FY (€)	3.93	1.15	3.09	2.96	3.29
Revenue FY (€ mn)	9,297	7,732	8,487	8,507	8,901
EBITDA FY (€ mn)	1,356	837	1,250	1,214	1,302
EBIT FY (€ mn)	903	370	806	762	835
EV/Revenue FY	0.6	0.7	0.8	0.8	0.8
EV/EBITDA FY	3.8	6.1	5.5	5.6	5.3
Adj P/E FY	9.5	32.4	12.0	12.6	11.3
FCF Yield FY	10.1%	17.7%	6.7%	8.0%	7.5%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (€)	37.26
Date Of Price	28 Sep 10
Price Target (€)	45.00
Price Target End Date	31 Dec 11
52-week Range (€)	38.18 - 27.23
Mkt Cap (€ bn)	6.1
Shares O/S (mn)	163

Omega Insurance

Finding stability

Overweight

OIH.L, OIH LN

Price: 97p

Price Target: 125p

- Omega is **starting to stabilize after encouraging initial conclusions from an internal review.** In the Spring, Omega's main shareholders requested an internal review from a newly installed management team, which recently updated on progress and confirmed that Omega's underwriting practices were sound. This should now give some comfort that Omega has **a solid platform with a good underwriting track record but which needs modernization**.
- **Omega is a pure play on the Lloyd's market.** It is still very much a traditional Lloyd's vehicle with a 51% economic stake in Syndicate 958 and a Bermuda and US platform. The portfolio is focused on property (re)insurance and 84% is short tail. Despite being fairly catastrophe driven (41% of premiums), the underwriting track record has been good, even during the recent turmoil. Underwriting is focused and not diluted by geographic or segment diversification.
- **The shares have underperformed** the market following a series of events that started with an equity rights issue in January 2009, followed by a shareholder intervention and ended with new management announcing a pre-tax loss of $34m for 2010H1. We have cut our 2010e PBT to $2m and 2011e $ 59m (-32%) factoring in the 2010H1 loss and a 5% softening of rates in 2011e. The impact of TNAV is a more modest -12% and -15% respectively. We nevertheless estimate that FCF and an estimated capital release of $90m-$100m will support a stable dividend.
- **Since the end of 2007 the stock has de-rated from 1.5x TNAV to 0.9x and we believe current valuation, a positive streamlining of the business and capital releases should lead to a re-rating of the shares**. A re-rating of the stock should be supported by a return to 13% RTNAV in 2011e (vs 1.0% in 2010e) and a stable dividend of 8.0p (8% yield). This would justify a P/TNAV of 1.2x rather than the current 0.9x (non life sector 1.3x). The 2011e P/E of 6.9x looks attractive (non life sector 7.7x) and we have set our DCF-based Oct. '11 target price at 125p offering c.30% upside.

Insurance - Non-life

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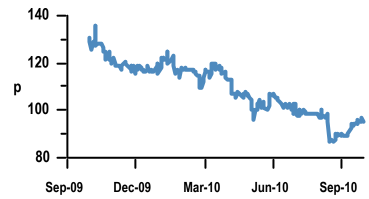
J.P. Morgan Securities Ltd.

Price Performance



	YTD	1m	3m	12m
Abs	-17.6%	5.0%	-3.6%	-27.5%

Omega Insurance Holdings Ltd (OIH.L;OIH LN)

FYE Dec	2009A	2010E *(Old)*	2010E *(New)*	2011E *(Old)*	2011E *(New)*	2012E
Adj P/E FY	8.6	6.5	172.0	5.0	7.0	7.0
EPS FY (p)	11.23	0.58	0.58	13.91	13.91	13.94
Adj. EPS FY ($)	0.18	0.23	0.01	0.31	0.22	0.22
Combined Ratio FY	81.3%		100.3%		82.2%	80.8%
NAV/SH (price currency) FY (p)	111.54		106.17		112.37	118.60
P/NAV FY	0.8		0.9		0.9	0.8
ROE FY	11.0%		0.5%		12.7%	12.0%
Dividend (Net) FY (p)	8	0	8	0	8	8
Gross Yield FY	8.0%		8.3%		8.3%	8.3%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (p)	97
Date Of Price	28 Sep 10
Price Target (p)	125
Price Target End Date	01 Oct 11
52-week Range (p)	136 - 85
Mkt Cap (p bn)	0.23
Shares O/S (mn)	243

Iberdrola Renovables

Very cheap, but uncertain outlook for the US weighs near term

- We are fine-tuning our estimates and are moving our DCF-based PT from end-2010 to end-2011. Our new PT is €3.5 (vs €3.9 before), as we are no longer including the NPV of any pipeline beyond 2013E (consistent with our valuation of peer EDPR).
- Our 2010E estimates are edged down at the EBITFDA level due to the low load factors in UK in H1. At the net income level, the reduction is a more substantial 7% cut, but this is largely due to one-off derivative, hedging and treasury stock losses booked in H1.We are estimating 20% EBITDA growth and 15% net income growth (guidance is for c. 20% growth in both lines).
- For 2011E we are upgrading our EBITDA estimates by 5.7% and are now above Bloomberg consensus by the same margin. However, this is just cosmetic, as we are now including the expected one-off margin on the build-to-sell Manzana project (California), which should be booked as incremental EBITDA and which we believe consensus is not yet factoring in. This fully feeds through to net income.
- We believe that the valuation is very cheap, as the stock is trading at an estimated 14% discount versus the value of its existing assets at end-11. We believe this is too harsh for a company that has proven to be disciplined in cutting capex if projects do not look likely to generate attractive returns. In fact, we continue to expect 800MW/yr of capacity additions in the USA in 2011%12E, vs guidance of 1,000MW7yr.
- However, we cannot find the catalysts for out-performance near term. First, we struggle to see any progress in US Federal regulation. Second, we do not anticipate any easing in competitive pressures in the US PPA market. Thirdly, while very cheap in our view, headline multiples are unlikely to capture the attention from generalist investors.
- We continue to see pockets of value in IBR at this price, but the stock would probably need to see first an improvement in the US news flow before it gets re-rated by the market in our view.

Overweight

IBR.MC, IBR SM

Price: €2.49

Price Target: €3.50
Previous: €3.90

European Utilities

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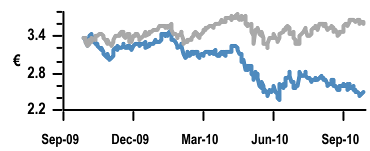
J.P. Morgan Securities Ltd.

Price Performance



	YTD	1m	3m	12m
Abs	-24.3%	-3.4%	-5.9%	-25.9%
Rel	-27.3%	-7.8%	-10.2%	-33.4%

Iberdrola Renovables (IBR.MC;IBR SM)

FYE Dec	2009A	2010E *(Old)*	2010E *(New)*	2011E *(Old)*	2011E *(New)*	2012E
EBITDA FY (€ mn)	1,325	1,603	1,592	1,848	1,953	2,231
EV/EBITDA FY	12.1	12.3	10.9	11.6	9.3	8.5
Net Income FY (€ mn)	371	461	427	484	540	605
Adj. EPS FY (€)	0.09	0.11	0.10	0.11	0.13	0.14
Adj P/E FY	28.3	22.8	24.7	21.7	19.5	17.4
Gross Yield FY	1.2%	1.7%	1.6%	2.1%	2.3%	2.9%
Bloomberg EBITDA FY (€ mn)	1,319		1,587		1,850	2,163
DPS (Gross) FY (€)	0.0	0.0	0.0	0.1	0.1	0.1

Source: Company data, Reuters, J.P. Morgan estimates.

Company Data	
Price (€)	2.49
Date Of Price	28 Sep 10
Price Target (€)	3.50
Price Target End Date	31 Dec 11
52-week Range (€)	3.53 - 2.30
Mkt Cap (€ bn)	10.5
Shares O/S (mn)	4,224

KCOM Group Plc

H1 trading statement in-line. Continued focus on return to growth, pension deficit clarity and refinancing

Neutral

KCOM.L, KCOM LN
Price: 52p

UK Telecoms

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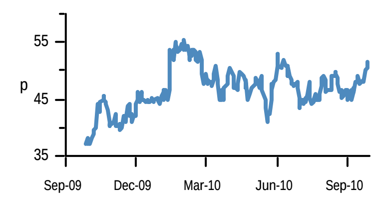
J.P. Morgan Securities Ltd.

- **Trading statement in-line**. Key points: "trading is in line with market expectations"; "build on progress made during the last two years"; "securing future growth"; "strengthen the overall financial position".
- **Explicit financial H1 commentary**. "Net profitability at the half year expected to be ahead of the previous year" (JPMe PAT pre-exceptionals +23% YoY); "revenue for the first half of the year will be lower" than H1 09/10 (JPMe -3.6% (New), -2.1% (Old)).
- **2010/11 priorities remain**. Aims continue to be "returning to growth" and "to provide medium term certainty with regard to our pension funding". KCOM has already agreed pension deficit payments of £21m over three years including £9.2m this year and closed the defined benefit scheme to future accrual. KCOM is also looking to renew its banking facility, with further clarity to be given with the H1 results. KCOM's current £250m revolving credit facility expires in February 2012, so a new facility in the coming months is likely.
- **Minimal changes to estimates**. We believe government austerity may impact local council spending. KCOM's total government and related revenues are c. £60m (<15% of group revenues). Reflecting this, we reduce revenue forecasts by -1%. However, these revenues are typically lower margin so KCOM should easily be able to offset any effect with cost control. As such, we make no changes further down the P&L.
- **Valuation and recommendation**. For 10/11E, KCOM trades on 5.6x EV/EBITDA, 7.8x EV/OpFCF and 3.9% dividend yield (assuming pension deficit of £80m). Given its exposure to government telecoms spend and broader market movements (c. 60% of pension scheme assets are in equities), we remain comfortable with our Neutral recommendation. Whilst business division Kcom is well placed to benefit from future outsourcing opportunities and Executive Chairman Bill Halbert has talked about quadrupling market share in certain areas, we believe this will take years to filter through in contract wins. KCOM will report its H1 results on 23 November.

Price Performance



	YTD	1m	3m	12m
Abs	13.2%	10.8%	7.3%	38.3%

KCOM Group Plc (KCOM.L;KCOM LN)

FYE Mar	2010A	2011E *(Old)*	2011E *(New)*	2012E *(Old)*	2012E *(New)*
Adj. EPS FY (p)	4.14	5.04	5.04	5.28	5.28
Revenue FY (£ mn)	413	416	410	424	418
Adj EBITDA FY (£ mn)	70	73	73	75	75
OpFCF FY (£ mn)	52	52	52	54	54
Net Debt FY (£ mn)	117	106	106	85	85
DPS (Net) FY (p)	2	2	2	2	2
Adj P/E FY	12.4	10.2	10.2	9.8	9.8
EV/EBITDA FY	5.9	5.6	5.6	5.3	5.3
EV/OpFCF FY	7.8	7.8	7.8	7.3	7.3
Net Yield FY	3.4%	3.9%	3.9%	4.3%	4.3%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (p)	52
Date Of Price	28 Sep 10
Price Target (p)	–
Price Target End Date	–
52-week Range (p)	56 - 36
Mkt Cap (£ bn)	0.26
Shares O/S (mn)	510

Marks & Spencer

Q2 update: Watching Brief

Underweight

MKS.L, MKS LN

Price: 384p

General Retailing

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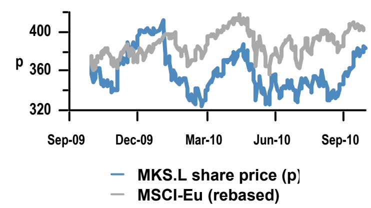
J.P. Morgan Securities Ltd.

Price Performance



	YTD	1m	3m	12m
Abs	-4.5%	10.8%	16.3%	2.4%
Rel	-7.5%	6.4%	12.0%	-5.0%

- M&S' Q2 update is due on 7th October. Expectations are generally high. A combination of relatively resilient general clothing data from the BRC and the CBI and generally good M&S-specific food data from TNS has led to the conclusion that M&S is probably outperforming peers in terms of trading. As a consequence, FY11E estimates have been moving steadily upwards over the last month or so and at £655m PBT, 29.9p EPS we now sit towards the bottom of a wide range of £649m to £780m PBT (source: M&S) with consensus at £695m PBT (31.6p EPS).
- Post a review of our estimates in the context of the market data, we have increased our FY11E LFL estimate from 1.5% to 2.3% for General Merchandise (GM); which drives a 4% increase in our FY11E PBT from £655m to £682m, 31p EPS. This still puts us below consensus, but we are a little more cautious than most in terms of our outlook for H2 as we suspect some of M&S' growth in the last three quarters has been driven by a relative step up in advertising versus peers, the annualisation of which in H2 could stall the sequential improvement in trend somewhat. There is also the longer-term question of what impact, if any, the sector-wide increase in input costs will have on S/S margin (current ests are for H1/H2 margin to be flat yoy in both food and GM). In terms of Q2 sales, we are now looking for a LFL of +5% in GM and +1.8% from food, both of which assume an improvement in underlying trend against tougher comparatives. Overall Q2 LFL is expected to be c. 3.3%.
- Marks & Spencer's shares have performed strongly in the last few weeks in anticipation of good trading and improved guidance at the Q2 update. On our revised EPS estimates, the shares are trading on a PER of 12.4x 11E, a 10% premium to its large cap UK peers and a 20% premium to Next. On one hand this looks expensive given our concerns over the longer-term prospects, but on the other with a strategy update due in November the near-term rating is likely to be driven more by optimism over the possible outcome and hence in the absence of a disappointment in trading next week, we see little chance of a de-rating ahead of that date.

Marks & Spencer (MKS.L;MKS LN)

FYE Mar	2009A	2010A	2011E *(Old)*	2011E *(New)*	2012E
Adj. EPS FY (p)	28.03	29.66	29.85	30.97	34.98
Revenue FY (£ mn)	9,062	9,348	9,635	9,590	10,035
EBIT FY (£ mn)	769	780	780	802	888
Pretax Profit Adjusted FY (£ mn)	604	632	655	682	768
DPS (Net) FY (p)	18	15	15	15	16
EV/EBITDA FY	6.8	6.6	10.1	6.3	5.7
Adj P/E FY	13.7	12.9	12.9	12.4	11.0
Net Yield FY	4.6%	3.9%	3.9%	3.9%	4.2%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (p)	384
Date Of Price	29 Sep 10
Price Target (p)	–
Price Target End Date	–
52-week Range (p)	413 - 322
Mkt Cap (£ bn)	6.07
Shares O/S (mn)	1,582

Smiths Group

2011E EPS raised by 12%

Overweight

SMIN.L, SMIN LN

Price: 1,207p

▲ **Price Target: 1,500p**
Previous: 1,400p

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- The operating profit and margin in 2010 were well ahead of our expectations. The strong performance was largely attributable to the benefits of the recent restructuring programmes, particularly at John Crane. On the back of the better than expected margins, the prospect of further cost saving and lower net financial costs we are raising our 2011E EPS forecast to 94.9p from 84.5p, an increase of 12%. We are maintaining our **Overweight** recommendation.

- Based on our revised forecasts, the group is trading on 2012E (July year end) EV/sales, EV/EBIT and PE multiples of 1.86x, 9.6x and 12.2x respectively. Given the premium margins and returns at Smith's we believe a significant premium to the UK sector is justified. On the back of the increase in our profit forecasts we are raising our price target to 1,500p from 1,400p. The price target is base on an unchanged 2012E EV/EBIT multiple of 11.5x.

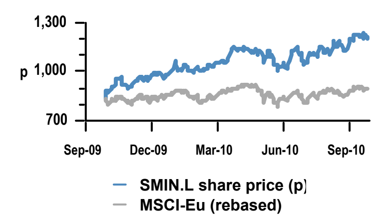
- In 2010, the benefits of the cost cutting measures were running well ahead of management's expectations. While the overall cost saving target from the original programmes remains unchanged at £50m, additional cost savings of £20m have been identified and are set to be delivered over the next few years.

- The combination of improving demand in H2 and the cost savings helped push the operating profit margin of **John Crane** to a record 20.7%. We expect this margin to be at least maintained in the near-term.

- **Medical** – operating profit margin increase by 180bps y/y on the back of cost savings and an improvement in underlying growth. The launch of new products should help underpin an improvement in organic growth in the medium term.

- With a proposed dividend of 34p, dividend cover has recovered to ~2.5x. Going forward we expect the board to adopt a progressive dividend policy while maintaining this level of cover.

Price Performance



	YTD	1m	3m	12m
Abs	13.6%	6.0%	9.3%	46.3%
Rel	10.6%	1.6%	5.0%	38.8%

Smiths Group Plc (SMIN.L;SMIN LN)

FYE Jul	2009A	2010E	2011E *(Old)*	2011E *(New)*	2012E *(Old)*	2012E *(New)*
Adj. EPS FY (p)	72.35	84.63	84.54	94.94	92.92	99.18
Adj P/E FY	16.7	14.3	14.3	12.7	13.0	12.2
Revenue FY (£ mn)	2,665	2,770	2,908	2,920	3,102	3,090
EBIT FY (£ mn)	429	436	486	498	546	556
Pretax Profit Adjusted FY (£ mn)	371	435	454	500	509	523
Net Income adjusted FY (£ mn)	282	356	338	370	376	387
EV/Revenue FY	1.9	1.8	1.7	1.7	1.6	1.6
EV/Operating Profit FY	12.23	10.26	9.72	9.31	8.41	8.11

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (p)	1,207
Date Of Price	27 Sep 10
Price Target (p)	1,500
Price Target End Date	31 Dec 11
52-week Range (p)	1,253 - 814
Mkt Cap (£ bn)	4.73
Shares O/S (mn)	392

J.P.Morgan CAZENOVE

Europe Equity Research
29 September 2010

Ageas

MCS newsflow, or no newsflow depending on who you ask - ALERT

Overweight

AGES.BR, AGS BB
Price: €2.17

28 September 2010

Insurance

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J.P. Morgan Securities Ltd.

- **Contradictory press releases being issued by Ageas and ABN Amro on the MCS.** Ageas announced that it had received *indications* that the Dutch State or ABN Amro Bank are *considering* to buy back the MCS (Mandatory Convertible Securities) issued in 2007. However, at the same time, ABN Amro has issued a press release saying that it does not intend to buy-back the MCS and "acknowledges that all outstanding MCS will be mandatorily converted into a number of Ageas shares".
- **We at this stage do not understand the differences in the press releases, but just outline below what our base assumptions are for the MCS**.
- **In our base valuation we assume that Ageas issued shares for the MCS (107mn) but receives compensation equivalent to the share price multiplied by the shares issued**. Thus in our base case we assume no negative nor positive from the MCS. If the MCS were to be bought back, therefore, we would have to make no change to our base case because on the one hand Ageas would not receive a compensation payment (a negative) but on the other would not need to issue the shares (a positive).
- **In our bull case we assume a payment of €500mn from the Dutch State for the MCS and assume the shares are issued**. Ageas states that if the Dutch Government does announce a buy-back then it would initiate legal proceedings for €2bn – but we believe that this would take some time (i.e. years rather than months) to reach a conclusion. Note however that the impact on the bull case would be small (i.e. just €0.1 per share) given we only assumed a €500mn payment (as a positive) but also issuance of the MCS shares (a negative).
- **Hence we can conclude that the only real scenario** that would vary from our assumptions would be if a €2bn payment were made from the Dutch State to Ageas.
- **We note that the press release by Ageas also states**: "Ageas and the Dutch State intend to examine whether it is still possible to find an amicable settlement to these issues".
- **We will try to understand better what is going on here** – why two different press releases, why this has come out with no real news yet.

Avocet Mining

Inata Mineral Reserve Increased by 25% on Increased Gold Prices - ALERT

Overweight

AVM.L, AVM LN

Price: 160p

28 September 2010

Mining

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J.P. Morgan Securities Ltd.

- Avocet Mining has announced an increase in gold reserves at its Inata mine in Burkina Faso by 25% to extend the life of mine to 8 years to 2018. Inata started commercial production in 2010 and is Avocet's largest operating mine, constituting 55% of total attributable gold production and 67% of EBITDA in 2010E. The Proven and Probable Ore Reserve at the mine now stands at 16.3 Mt at 2.06 g/t giving c. 1.1 Moz of gold, at a cut off grade of 0.7 g/t. This is actually a 16% increase in reserves over the previously announced figures as of Dec 2009, but factoring in depletion since then gives a 25% increase.
- Whilst this is positive news, it appears to be the result of an economic analysis and changes to the pit design following the increase in Mineral Resources announced on 7th September 2010. The company has also increased its gold price assumption from US$800/oz to US$1000/oz, and slightly increased its operating cost assumption; the net result is a 149 koz increase in economic reserves over the figures stated in the interim results presentation, without lowering the cut-off grade.
- We should also point out that we are already factoring in production at Inata to last until 2018/19 based on the assumption that some resources would be converted to reserves over the life of the mine. As a result we do not expect his announcement to impact our NPV estimate for the company.
- Avocet stated that they are commencing a further 200,000m drilling program to delineate further resources around the Inata site. This follows the increase in resources announced on 7th September, and the release on 17th September of positive drilling results at the Souma Trend, 20km ENE of Inata. The company is also stated that it is conducting preliminary work on a potential increase in capacity at the Inata plant to further benefit from the expanded reserve base.
- **Recommendation and valuation:** overall this is positive news for the stock and further underlines the company's compelling organic growth prospects in an exciting gold region. Meanwhile valuations remain un-stretched with 1.17x P/NPV and spot PERs of 15.7x for 2010e and 12x for 2011e. With the gold industry currently in a consolidation phase we also increasingly feel Avocet's expansion and exploration potential could attract the attention of larger peers as an acquisition target.

Babcock International

Pre close flags trading in line with expectations - ALERT

Overweight

BAB.L, BAB LN

Price: 552p

28 September 2010

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J.P. Morgan Securities Ltd.

- Babcock released its pre close trading statement this morning for the period to 30 September 2010. Trading is flagged as being in line with expectations with cash flow stronger than flagged and net debt better than expected.
- The order book stands at £12bn and the pipeline at c. £5bn. The release carries the statement that "we are confident that in this environment the need for more efficient delivery of technical and support services will lead to increased demand for outsourcing."
- As with the other large suppliers to the government, Babcock has been in discussions with the government as to how it can save costs and it has been able to supply a number of suggestions as to how that might be achieved. It seems that these suggestions are more around new areas that could be outsourced to the private sector rather than taking cost cuts on existing contracts.
- The outcome of the CSR is clearly still unknown, however, and it may be that there is a focus on some of the group's existing contracts as well as identifying new areas for savings.
- The integration of VT continues in line with expectations and the group reiterated its comfort with the £50m cost savings target for 2013.
- For the first time, the group has given some more detail on the new reporting structure post consolidation of VT, giving historical revenue and profit numbers under the previously announced new divisional structure of Marine, Defence & Security, Support Services and International, along with commentary on the performance along similar divisional lines.
- Marine is performing strongly across "all its business segments", where the group provides maintenance and support to the UK's nuclear submarine and surface ship fleets in the UK, and with sizeable contracts in Canada. The aircraft carrier contract continues on without any interruptions and in our view, it seems that it would be extremely difficult, complicated and costly for the government to 'pull the plug' on either carrier. Even downgrading one of the ships could have negative implications for the pricing of the other ship, which would have been priced based on the economies of scale relating to two ships. The statement flags that in the year to March 2010, the group found £50m of cost savings for the MoD and this gives some insight into the nature of Babcock's involvement with the MoD – it is a cost cutter, running services better for less money than the MoD can do itself. For that reason, we believe that the impact on Babcock's business model of

J.P.Morgan CAZENOVE

Europe Equity Research
29 September 2010

FirstGroup

H1 trading update in line with expectations; confident message on cashflow

Neutral

FGP.L, FGP LN
Price: 350p
Price Target: 430p

Railroads

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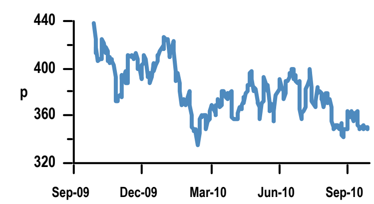
J.P. Morgan Securities Ltd.

- FGP's H1 update suggests that trading is in line with management's expectations. Encouragingly, revenue trends have improved slightly in most divisions, with the exception of Greyhound. Previous guidance of "moderate earnings growth" is retained and we are not changing our estimates, although we expect to tweak the mix marginally from Greyhound to UK Rail.
- UK Bus: lfl passenger revenues grew by 1.3% in H1. This compares to 0.9% in Q1 and suggests that Q2 growth was closer to 1.7%. As the trading environment remains 'challenging' FGP continues to adjust mileage operated in order to protect revenue per mile.
- UK Rail: the volume-led recovery in rail has continued. Revenues increased by 4.4% in H1 vs 3.7% in Q1. All franchises have reported volume growth and demand for first class and flexible fare tickets is recovering. However, EBIT in this division in 2011 is likely to be held back by the profile of premium payments at FGW, one of the group's largest franchises.
- North America Student's revenues remain broadly in line with the prior year. As pressure on school board budgets is expected to continue during the year, FGP remains focused on cost reductions in the division.
- Revenue growth at North America Transit remains relatively strong at +4.5% (+5.5% in Q1). The growth reflects a number of new business wins during the period.
- Greyhound is the only disappointing division in our opinion. H1 passenger revenue growth was +1.6% vs +3% in Q1, suggesting a flat Q2. Equally, the comparator in H1 2010 was undemanding at -20%. We believe this reflects ongoing weak consumer confidence in the US.
- Balance sheet: FGP is confident of achieving its 2.5x net debt/EBITDA target by the year end. This compares to 3.0x in FY10 and implies FCF of approximately £250m. We believe the market will be reassured that the group can finance capex of c.£300m, grow its dividend by 7% and continue to de-gear the balance sheet relatively quickly.

Price Performance



	YTD	1m	3m	12m
Abs	-17.3%	0.5%	-10.3%	-20.2%

With this note coverage of FGP is transferred to Tim Barrett.

FirstGroup plc (FGP.L;FGP LN)

FYE Mar	2010A	2011E	2012E	2013E
Adj. EPS FY (p)	39.48	41.22	45.22	48.46
EBIT FY (£ mn)	428	469	486	496
EBIT margin FY	6.8%	7.3%	7.3%	7.3%
Pretax Profit Adjusted FY (£ mn)	264	284	311	324
Earning Before tax FY (£ mn)	180	249	276	289
DPS (Net) FY (p)	21	22	24	25
Net Yield FY	5.9%	6.3%	6.8%	7.2%
Adj P/E FY	8.9	8.5	7.7	7.2

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (p)	350
Date Of Price	28 Sep 10
Price Target (p)	430
Price Target End Date	08 Jul 11
52-week Range (p)	443 - 331
Mkt Cap (£ bn)	1.68
Shares O/S (mn)	481

Liontrust Asset Management

Pre close statement - ALERT

Underweight

LIO.L, LIO LN

Price: 90p

28 September 2010

Brokers & Asset Managers, Specialty Finance

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J.P. Morgan Securities Ltd.

Liontrust has this morning released a preclose statement covering trading in the period to 28 September 2010. Interim results will be announced on 24 November 2010.

- AUM at 28 September was £1,123m compared with our marked to market estimate of £1,087m.
- Net inflows since 1 July were £6m, in line with our estimate.
- The difference between our estimated AUM and the outcome reflects slightly better than expected investment returns at £104m compared with our estimate of £67m, with half of the difference explained by Credit performance.
- Performance fees of £153,000 were earned in the period, but we had assumed £1.0m.
- The (revised) plan for Long-term Equity Incentivisation is still being considered by the Board. What form (and magnitude) this plan takes will have implications for estimates in due course, we assume.

The prospects for Liontrust remain unclear, we believe. The rebuilding process is at an early stage, and the economics of any recovery remain difficult to assess. We retain our Underweight recommendation.

London Stock Exchange

Pre-close statement - ALERT

Neutral

LSE.L, LSE LN

Price: 699p

28 September 2010

General Financials

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J.P. Morgan Securities Ltd.

The London Stock Exchange (LSE) has this morning released a pre-close statement covering trading in the five-month period to August 2010. Interim results will be announced on 18 November 2010.

- With the company reporting monthly trading statistics (and indeed daily too) there are no real surprises in comments about trading. Average daily value traded in the UK was £5.0bn for the first five months of the financial year, but £4.2bn in Q2. Trading volumes at Borsa Italiana were 2% lower year on year. New issues on the company's markets have doubled year on year but amount of capital raised was lower.
- Market share in UK equities has stabilised, but there has been (as expected) a reduction in yield to 0.71bps following the introduction of a pilot tariff scheme in May 2010.
- By contrast fixed income trading, and volumes on IDEM were well ahead (IDEM +26%, MTS Cash +25%, MTS Repo +78%).
- In Post Trade equity and derivative clearing, volumes were +1% and +26%, but open interest is lower. Settlement instructions are 25% lower due to a fall in OTC trading volumes.
- Professional terminal numbers are in line with last year, and demand for Information and for Technology Services is described as “good overall”.
- Prevailing consensus adjusted EPS for the year to March 2011 is 64.3p (range 58.5p-72.4p) according to the company’s website, with our own estimate at 61.6p.

As per the company's own statement "performance for the year to date reflects the continuation of generally variable market conditions". With no clear sign of an end to those market conditions we do not expect any material changes to estimates at this stage. At the current price the stock trades at 11.3x current year estimated EPS. We retain our Neutral recommendation.

Micro Focus

Feedback from analyst day

Overweight

MCRO.L, MCRO LN

Price: 370p

Price Target: 420p

Enterprise Software Applications

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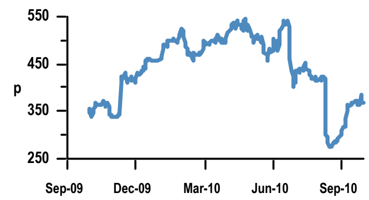
J.P. Morgan Securities Ltd.

Micro Focus held an analyst and investor meeting yesterday. We highlight the key takeaways in this note.

- Management remains confident around the mid term growth prospects, more specifically double digit top line growth. While market forecasts support at least 9% growth, Micro Focus is determined to take market share and accelerate the modernization and migration deals in order to achieve double digit growth.
- The company acknowledged sales execution issues, and the new head of sales discussed drivers for improvement, such as a telesales force focused on the medium and small customers, a group in sales which is incentivised around maintenance renewal (the Testing division lags the core business), and adjusting sales compensation to drive cross sales (e.g. of testing into modernisation/migration deals) and better utilisation of professional services.
- **We maintain our Overweight rating.** Even on our below guidance estimates, the shares are trading on 9.2x calendarised 2011 earnings and 5.9x EV/EBITDA vs. the software sector on 13.8x and 7.9x respectively. We expect shares to gradually climb as investors become more comfortable with the new management team, and once Micro Focus is able to show better sales execution.

Price Performance



	YTD	1m	3m	12m
Abs	-18.9%	26.3%	-7.9%	6.6%

Upcoming events:

- 10 November – H1 pre-close statement
- 8 December – H1 results announcement

Micro Focus (MCRO.L;MCRO LN)

FYE Apr	2009A	2010A	2011E	2012E
Adj. EPS FY ($)	0.41	0.56	0.60	0.66
Revenue FY ($ mn)	275	433	467	488
Adj EBITDA FY ($ mn)	119	173	179	193
Adj EBITDA Margin FY	43.2%	40.1%	38.3%	39.4%
EBIT FY ($ mn)	91	105	158	171
Pretax Profit Adjusted FY ($ mn)	106	143	153	171
Net Income adjusted FY ($ mn)	85	117	125	139
Net Income FY ($ mn)	66	76	112	125

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price (p)	370
Date Of Price	29 Sep 10
Price Target (p)	420
Price Target End Date	01 Aug 11
52-week Range (p)	550 - 272
Mkt Cap (£ bn)	0.75
Shares O/S (mn)	204

Misys

Feedback from conference call - ALERT

Overweight

MSY.L, MSY LN

Price: 290p

28 September 2010

Enterprise Software Applications

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J.P. Morgan Securities Ltd.

Key messages from the Q1 IMS conference call:

- Divestiture of MDRX largely complete and company is on target to return cash to shareholders (expected in November). Misys is now a pure play financial services software company.
- Momentum building in new product areas, and expect acceleration in the take-up of BankFusion and other new solutions like Mobile Banking and Business Intelligence, through the year. Already, 70% of ILF order intake in Banking was from new products.
- Pipelines remain solid in TCM, and maintenance should turn positive again in H2 as the negative impact in H1 was the lag effect from consolidations or bankruptcies in the recent recession.
- At the Group level, no change to mid term targets of 5-8% revenue growth and 17-20% operating margins.
- We maintain our pro forma full year estimates. See our earlier alert from this morning (see below):

Q1 revenues were flat yoy, order intake increased 1%, and operating profit increased (although not quantified). The company did not comment on full year guidance, but we feel fairly comfortable with our estimates. We are modeling £45m in adjusted net profits (pro forma for Banking and TCM only). At today's price of 290p, we estimate the pro forma EPS after the tender offer would be c.15.1p.

- **Disposal proceeds from the sale of Allscripts shares were approximately £780m**, and Misys plans to return to shareholders substantially all of the disposal proceeds after advisory fees and paydown of net debt. The tender offer is expected in November. As we have mentioned before, the company is awaiting a private letter of ruling from the IRS, which they expect to confirm that Misys will not need to pay the capital gains tax on its disposal of Allscripts shares. Misys retains ownership of 19.0m shares, or 10%, of the outstanding shares of Allscripts common stock.
- **Treasury & Capital Markets division grew revenues 4% and order intake 15%,** driven by a significant new release of Summit which spurred good growth during the period. ILF order intake was up 13% and global services order intake was up 17%. Revenue growth on the other hand was somewhat weaker in the quarter as ILF and maintenance revenues fell, but global services grew strongly.

Petropavlovsk

IPO Offer details for non-precious metals division - ALERT

Overweight

POG.L, POG LN

Price: 1,191p

28 September 2010

Mining

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J.P. Morgan Securities Ltd.

Petropavlovsk (POG) has announced the offer details of its proposed IPO of its Non-Precious Metals Division on the Hong Kong Stock Exchange (HKSE). The division has been reorganized under a new subsidiary, IRC Ltd, which is expected to list on the HKSE on 14 October 2010. The offer price range of HK$2.2/sh to HK$3.0/sh implies a pre-new-money market cap of $660m-$898m which compares favourably to the price of c.$220m (ex-cash) POG paid for Aricom in the all-paper deal back in April 2009 and our estimate of capex of $320m POG since spent on the assets. Key points:

- IRC will essentially comprise the former Aricom assets which POG acquired in April 2009, the most significant of which are the Kuranakh mine and the K&S projects in the Russian Far East, which we estimate could generate a combined EBITDA of c. US$192m by 2013 and have a combined NPV of c. US$840m (10% WACC).
- IRC is offering 1,325m shares (1,070m primary and 255m secondary) pre-greenshoe (15%) at a price range of HK$2.2-3.0/sh and expected gross proceeds of $303-414m to IRC and $72-99m to POG.
- IRC is expected to announce the offer price on 13 October 2010 and trading is expected to commence on 14 October 2010.
- Anticipated post new-money market capitalization on listing is between $962m and $1,312m in which POG will retain 57.5% interest ($553-754m). The implied pre-new-money market cap range is $660-898m vs our NPV of $840m and the see-through value of $860m from the $60m equity investment in June (GEMS Ltd and CEF investment funds).
- The proceeds from the proposed IPO would assist POG in its development of Malomir and Albyn over the next two years (capex of $140m), although we wouldn't rule out a special dividend given the company's unstretched balance sheet - net debt of $125m at 1H2010 which we forecast will move to net cash position by year-end. We note that our current NPV for POG only includes Kuranakh which we value at $263m. Incorporating the secondary proceeds (mid-point of $85m) and remaining equity interest (mid-point of $654m) in IRC into our POG valuation would increase our NPV estimate by 28% to 951p (P/NPV of 1.22x).
- Overall we believe a successful IPO would be a positive outcome for Petropavlovsk as it will enable the company to realise value which we think the market has not credited to the current share price. The disposal of the non-precious assets should also, in our view, remove any doubts around being valued as a precious metals stock (although we note POG

RD Shell

When powerpoint aspirations and reality may just meet (briefly) - ALERT

Integrated Oils

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J.P. Morgan Securities Ltd.

RDSa.L, RDSA LN
Overweight
1,914p

28 September 2010

RDSb.L, RDSB LN
Overweight
1,856p

28 September 2010

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RD Shell's investor field trip to Canada (Calgary & Jackpine Mine) is underway (28-30 Sep). There is a specific focus on its oil sands and tight gas positions - both unconventional resources that are important portfolio pieces long term for RD Shell; both also located in the OECD with good price upside capture capabilities.

- **Summary** - RD Shell is in one of those 'good performance' windows that Integrateds typically pass in and out of - with the stock market effects positively amplified by BP's problems. Costs have been brought down - Transition 2009 completed with $3.5bn pre-tax savings done at end H1 2010 relative to 2008 base (8% thereof). A new organisational structure and leadership, in place for just over a year, is in that 'honeymoon' period when it is more clearly focused on performance and delivery – the business has clear momentum. Underlying returns are rising as abnormally high levels of inert capital employed (approx 25% of group $163bn YE 2009 and 60% of Upstream Americas capital employed) turn revenue bearing. Better than peer group production growth looks sustainable 2010-12 following seven years of consecutive declines. Thereafter the portfolio's slower average decline rate (due to more resilient streams in gas-LNG-GTL and oil sands) should facilitate headline growth. Reserve replacement looks set to remain above the last decade's sub-par average – especially if all the LNG projects in Australia can be efficiently matured – and backed by improved exploration results. We believe it’s a shame management didn't downsize the downstream much sooner and more emphatically, but no IOC is ever picture perfect. Present valuation metrics (2010E PER 10x and yield 6.0%) should not stand in the way of a higher share price; nor should the potential macro effects of quantitative easing (weaker dollar, higher oil price). We maintain our Overweight in to Q4.

Key points

- **No changes to key guidance parameters** - (i) 2009-12 cash flow ex-working capital to grow 50% at $60 per bbl and 80% at $80 per bbl; (ii) 2009-12 production growth 11% to average 3.5 million boepd (coincidentally the same level that BP may downsize to). 2014 potential is 3.7 million boepd of which the Americas has potential for 1 million boepd (40% growth from 2009 714 kboepd, underscoring Upstream Americas as an important growth driver). The deep water Gom has the potential to grow from 250 kboepd. Pearl GTL and Qatargas 4 LNG are both on schedule to ramp up in 2011; (iii) dividend covered at $60 per bbl; (iv) organic capex $25-30bn pa 2011-14 (80%+ upstream) and $28bn 2010; (v) management still believes in a $50-90 per bbl oil price world and a $4-8 per mmbtu US gas price.

J.P.Morgan

Europe Equity Research
30 September 2010

Tesco

H1 Earnings Preview - ALERT

Neutral

TSCO.L, TSCO LN
Price: 432p

28 September 2010

Food Retailing

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J.P. Morgan Securities Ltd.

- Tesco will report its interim results on Tuesday 5th October. We expect these results to be robust despite the market recognising that the UK remains stagnant in growth terms. We expect LFL of 0.4% ex fuel ex VAT for the half year implying 0.6% for Q2, which would represent a small underlying improvement in trading. Whilst the UK volumes remain no better than flat and inflation not yet feeding into shelf prices, we expect a cautious outlook on the UK consumer. However, given Tesco's peers are largely investing in "stepped" expansion, we expect the incumbents of the UK market to be cash focused and therefore in competition terms, it will likely remain rational. In margin terms, we forecast a flat >6% margin and a 28% margin at Tesco Bank despite pressure on investment income.

- Tesco's International businesses are emerging from recession, with the bounce more keenly felt in Asia at this time (+27%). Ironically, this will likely reverse in the second half as the 2nd year of the Homever LFL annualises in South Korea, making comparatives a little tougher still after a very strong sales uplift post the deal. In Europe, Hungary looks to be the only outlier to a broad based recovery in Europe, where we expect Ireland to post broadly flat LFL's. In the United States, we expect Tesco to re-iterate its guidance for losses similar to last year but will likely also highlight a strong LFL trend in store. We continue to believe that the tipping point for profitability is now <400 stores and with only 166 stores at the half year, in store trading offers the best indicator of long term success until that is critical mass is reached. Certainly a leaner "Tesco International" is strongly levered into any International recovery.

- Tesco should continue to show progress on its recently publicised returns target where returns move to 14.5%. We expect Tesco's net debt to fall to £7.3bn at the half year with the forthcoming trip to Asia to showcase how capital intensity can be kept lighter moving forwards than perhaps many believe. Convenience stores and franchising appear to offer a glimpse into a new less capitally intensive Tesco which when added to c10% growth per annum in EBITA should see the returns target reached in the not to distant future. We believe Tesco may expand on the principles it will adopt to achieve this at the half year. At the full year, we would expect nearly half of the returns target to be achieved, at a time when peers are investing heavily for future growth thereby depressing returns, Tesco should show a strong positive movement in both ROCE and ROIC.

- In outlook terms, lower fuel prices should drive a marginal improvement in spending for the UK consumer, the Bank remains on course for guided product launches in 2010 and many International markets are emerging strongly from recession with Asia driving Tesco's recovery.

Topps Tiles

FY pre-close update - ALERT

Neutral

TPT.L, TPT LN
Price: 56p

27 September 2010

Broadlines/Department Stores

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J.P. Morgan Securities Ltd.

- Topps Tiles has issued its pre-close trading update for the year to September. FY sales are up 1.7% on an LFL basis compared to our top of the range estimate of +2%. Q4 sales are +4% LFL vs our estimate of +5% and compared to a Q3 LFL rate of -1.2%. This reflects a strong improvement in underlying trend against a much tougher comparative. (Q4 comp is -6%, Q3 comp was -11%) and will, we believe, be viewed as encouraging.

- No comment has been made on margin, but the company has reassured that it expects pre-tax profit for the 53 week period to be within the current analyst range of estimates, which it gives as £14.5m to £17.1m. We are at the top of that range with a 53 week PBT estimate of £17m, EPS of 6.1p. Consensus has been moving down over the last few weeks and Bloomberg consensus stands at PBT of £15.6m, EPS of 5.8p, although this is skewed by one or two very conservative estimates.

- In terms of next year's estimates, currently Bloomberg consensus is for £17.6m PBT and 6.5p EPS, essentially assuming very little progression in performance. We estimate a FY11E PBT of £17.8m, EPS of 6.4p. This is predicated on a recovery in LFL to +5%, which may be overly ambitious in the context of a weak housing market and generally cautious consumer environment. We also remain concerned about the potential impact of increased competition, such as the, in our view, vastly improved tile offer available in B&Q's refurbished stores and via its catalogue. Such competition particularly on tile peripherals is likely we believe to continue to drive down pricing in the market place and place Topps' incredibly high (c. 60%) gross margin under pressure in the longer-term.

- Despite these, in our view, structural challenges, the shares are not expensive on 9.4x our FY11 estimates and 4.5x EV/EBITDA on a pre lease adjusted basis. Given profit estimates remain considerably below the peak level of £38m, the share price is likely to continue to be driven primarily by news flow on trading. Comparatives are much tougher in the new financial year, which combined with the weak housing market, may well make for uninspiring headlines, hence we see very little to stimulate a re-rating.

European Analyst Focus List

Daily Update:

The European Analyst Focus List (AFL) comprises Overweight-rated stocks that our analysts believe will provide an annualised return of more than 20% over the next 6, 12 or 18 months. If you have questions regarding stocks on the AFL, please contact your salesperson or the covering analyst. Past performance may not be indicative of future performance. Full details of previous AFL recommendations and performance are available on request.

Head of European Equity Research

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J.P. Morgan Securities Ltd.

J.P. Morgan AFL — 29th September 2010

Company Name	Ticker	Sector	Analyst	Rating	Ccy	Focus List Add Price	Latest Closing Price	Price Target	Potential Upside/Downside*	Abs. Perf since Addition to AFL	Price Target End Date	Focus List Add Date
Anh.-Busch InBev	ABI BB	Beverages	Mike Gibbs	OW	€	24.41	43.30	51.0	18%	77.4%	Jul-11	22-May-09
Brit. American Tob.	BATS LN	Tobacco	Rae Maile	OW	p	1668	2381.50	n/a	n/a	42.8%	n/a	11-Jun-09
Arcelor Mittal	MT NA	Metals & Mining	Ben Defay	OW	€	23.39	24.81	39.0	57%	6.0%	Dec-11	25-Jun-09
Societe Generale	GLE FP	Banks	Kian Abouhossein	OW	€	48.845	44.75	58.0	30%	-8.4%	Dec-11	09-Nov-09
Ageas	AGS BB	Insurance	Duncan Russell	OW	€	2.54	2.18	3.84	76%	-14.3%	Dec-11	22-Jan-10
Credit Suisse	CSGN VX	Banks	Kian Abouhossein	OW	Sfr	48.38	42.90	59.0	38%	-11.3%	Dec-11	03-Feb-10
Taylor Wimpey	TW/ LN	House Builders	Emily Biddulph	OW	p	33.86	28.87	58.0	101%	-14.7%	May-11	24-May-10
HSBC	HSBA LN	Banks	C. Antunes Silva	OW	p	619.5	659.50	900.0	36%	6.5%	Dec-11	25-May-10
Schneider Electric	SU FP	Capital Goods	Andreas Willi	OW	€	78.35	93.10	125.0	34%	18.8%	Dec-11	26-May-10
Air Liquide	AI FP	Industrial Gases	Neil Tyler	OW	€	81.05	91.17	104.0	14%	12.5%	Dec-11	01-Jun-10
Elekta	EKTAB SS	Medtech & Services	David Adlington	OW	SKr	193.5	255.00	300.0	18%	31.8%	Dec-11	03-Jun-10
Symrise	ST1 GY	Chemicals	Heidi Vesterinen	OW	€	17.9	20.85	25.0	20%	16.5%	Dec-11	10-Jun-10
Centrica	CNA LN	Utilities	Edmund Reid	OW	p	307.3	328.10	390.0	19%	6.8%	Dec-11	24-Jun-10
BG Group	BG/ LN	Energy	Fred Lucas	OW	p	1055	1152.00	1,540.0	34%	9.2%	Jun-11	23-Jul-10
InterContinental Hotels	IHG LN	Hotels & Lodging	Tim Barrett	OW	p	1121	1142.00	1,420.0	24%	1.9%	Aug-11	3-Aug-10
Brenntag	BNR GR	Business Services	Robert Plant	OW	€	58.5	59.51	78.80	32%	1.7%	Sep-11	9-Aug-10
Erste Bank	EBS AV	Banks	Paul Formanko	OW	€	29.24	29.05	50.0	72%	-0.6%	Dec-11	11-Aug-10
United Business Media	UBM LN	Media	Mark O'Donnell	OW	p	557	621.50	790.0	27%	11.6%	Dec-11	24-Aug-10
JC Decaux	DEC FP	Media	Filippo Lo Franco	OW	€	20.47	19.80	25.80	30%	-3.3%	Jun-11	21-Sep-10

Source: Bloomberg, J.P. Morgan estimates. Share price data as at COB 28th September 2010. *From Latest Closing Price.

Companies Recommended in This Report (all prices in this report as of market close on 29 September 2010)
Akzo Nobel (AKZO.AS/€45.96/Neutral), Daimler AG (DAIGn.DE/€46.30/Overweight), Peugeot (PEUP.PA/€24.58/Overweight), Renault (RENA.PA/€36.82/Neutral), Symrise (SY1G.F/€20.60/Overweight)

Analyst Certification:
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Important Disclosures

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- **Market Maker/ Liquidity Provider:** J.P. Morgan Securities Ltd. is a market maker and/or liquidity provider in Akzo Nobel, Daimler AG, Peugeot, Renault, Symrise.
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