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Americas / United States
Equity Research
Global Product Marketing

CREDIT SUISSE

FIRST EDITION – U.S. ALERT

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Select Upcoming Events

Credit Suisse Conferences:

Jun 28
CS Commodities Day - New York

Jun 29
Basics Conference - Boston Day 1

Jun 30
- Basics Conference - Boston Day 2

Economic Calendar:

Jun 24
- Durable Goods Orders (May) (CS Est 0.5%; Mkt Est 2.0%; Prior -3.6%) - 8:30am
- -Excl Transportation (May) (CS Est 0.5%; Mkt Est 1.0%; Prior -1.6%) - 8:30am
- -Cap Goods Orders Nondefense Ex Air (May) (CS Est 1.0%; Mkt Est NA; Prior -2.3%) - 8:30am
- -Cap Goods Shipments Nondefense Ex Air (May) (CS Est NA; Mkt Est NA; Prior -1.5%) - 8:30am
- GDP (Q1-3rd) (CS Est 2.0%; Mkt Est 1.9%; Prior 1.8%) - 8:30am
- GDP Price Index (Q1-3rd) (CS Est 1.9%; Mkt Est 1.9%; Prior 1.9%) - 8:30am

Field Trip:

Jun 24
- Cytec (CYT) - Newark - Chairman, President & CEO, IR

Jun 28
- Kansas City Southern (KSU) - Houston Day 1 - David Starling (CEO)

Jun 29
- Kansas City Southern (KSU) - Houston Day 2 - David Starling (CEO)
- Dollar General (DG) - Nashville - Richard Dreiling (Chairman & CEO), David Tehle (CFO)

Non Deal Roadshows:

Jun 27
EnCana Corp. (ECA) - London, Zurich, Frankfurt, Geneva, Edinburgh - EVP & President, USA Division

Jun 28
Best Buy (BBY) - San Francisco Day 1 - Chairman & CEO, VP, IR, GM/SVP CSG, Computing

Jun 29
Kraton Polymers LLC (KRA) - New York - Stephen Tremblay (CFO), Gene Shiels (IR)

Packaged foods & Agribusiness Food Sales Tracking Update - The Top 6 Things You Need To Know About The Nielsen Data	**R. Moskow (Pg. 14)**
Automobiles Data on the Go- Platform Monitor: Suppliers Tracking Well on Favorable NA/EUR Mix	**C. Ceraso (Pg. 15)**
China Banks Sector SHIBOR spiked, funding probably gets tougher in 2H11	**S. Jain (Pg. 15)**

- Best Buy (BBY) - San Francisco Day 2 - Chairman & CEO, VP, IR, GM/SVP CSG, Computing

Jun 30
- Huntington Ingalls Industries, Inc. (HII) - New York - Mike Petters (President & CEO)

ECONOMICS

US Weekly Data Cycle — **N. Soss**

Data and events for the week starting June 27, 2011 **+**

- MONDAY JUNE 27 8:30am - Income/Spending/Saving Rate (May): 0.3%/0.0%/5.1% Headline/Core PCE Price Index: 0.1%/0.3%: We expect the headline PCE price index to post its smallest increase in six months (0.1%) as energy prices softened over the month. Conversely, the core could post its biggest gain in forty-two months. This run-up is partially due to an increase in prices for autos, a ramification from supply disruption in Japan. While still benign, YoY inflation for both the headline and the core should pick up respectively to 2.4% and 1.2%. Personal income should advance 0.3% in May, supported by a gain in labor income. Nominal consumer spending should be flat in May. The gains in "control group" retail sales and service spending should be offset by the large decline in auto sales. The gain in income and flat spending rate should push the saving rate up nicely on the month to 5.1% from 4.9%.
- TUESDAY JUNE 28 10:00am - Consumer Confidence (June): 55.0: We expect Consumer Confidence to reach a seven-month low in June. Economic data have deteriorated over the month. Specifically, news heard on employment and business conditions from the University of Michigan Surveys of Consumers both worsened in June. May's employment report (reported in June) revealed a softer snapshot of the labor market. Lower stock prices could also weigh on confidence.
- FRIDAY JULY 1 10:00am - ISM (June): 51.0: Our preliminary estimate for June's ISM is 51.0. If our forecast were realized, this would mark the softest reading since the end of the Great Recession. The two June regional surveys we have so far on the month (Philadelphia and New York) turned negative, but we are waiting for five other regional surveys to make a final forecast. We expect a ramp-up in auto production to show up in other regional surveys.
- Regional PMIs : Dallas, Richmond, Chicago, Kansas City: June regional manufacturing surveys are on watch because of the slippage in the May ISM Manufacturing report and the disappointing results from the June Empire and Philly surveys. Here are a few key points to note:
- Versus ISM Mfg - Chicago 9, Dallas 9, Richmond 9, Kansas City 7. That's the number of months each headline index has moved in the same direction as the ISM Mfg headline index over the last 12 months. To break the three-way tie, Chicago is on a seven-month winning streak, while Dallas and Richmond are on four-month winning streaks.
- Versus ISM Mfg New Orders - Richmond 9, Chicago 8, Dallas 7, Kansas City 4. That's the number of months each headline index has moved in the same direction as the ISM Mfg New Orders index over the last 12 months. Richmond has the best percentage, but Chicago has the longest current streak (six straight months).

European Economics — **European Economics Team**

German consumer back on board

- We have been confident that the German consumer would come back on board and indicators seem to suggest that this is under way. Furthermore, fundamentals endorse stronger household spending to be sustainable.
- This is not only good news for Germany, which has waited over a decade for household spending to make more of a contribution and growth becoming more balanced as a result, but also for the periphery.
- A strong Germany and strong German domestic demand help the periphery to start exporting its way out. Export data from the periphery show that this is under way. Exports to Germany have increased strongly.
- Ireland exports over one third of its GDP in goods and services to core Europe followed by Portugal and Spain which export just over and just under one tenth of their respective GDPs to the core while Greece exports nearly 6%. A buoyant Germany and importantly, strength in core Europe, are therefore vital to the periphery.

RATING CHANGES

Southern Company (SO)	**OUTPERFORM**		**D. Eggers**
CP: US$ 39.34	**TP: US$ 45**	**CAP: US$ 33.4b**	

Growth, Yield, Quality; UPGRADING to OUTPERFORM (from Neutral); Raising Target Price to $45 (from $40)

- Our take: We are upgrading SO to Outperform with (from Neutral) a $45 (from $40) price target. We see SO as a premier Electric Utility with a compelling combination of better than group EPS growth, a 4.8% dividend yield, strong regulatory relationships, and deep management team. Using our new rate of return valuation framework (see A Thought…Evolution-izing Regulated Utility Valuation, 6/24/11), SO ranks favorably with projected 9.6% annualized returns through 2014.
- SO is poised for 6% EPS growth, which is the best of the large-cap names and top quartile for the group. The growth will come through a well designed capex program to meet system needs particularly around environmental compliance goals, add new generation (including the Vogtle nuclear plants), and meet underlying system demand growth.
- SO is a best of breed electric utility, warranting a premium position in the group given: (a) the quality of utility operations and regulatory relationships that allow SO to consistently earn at or above its allowed ROEs, (b) management depth provides stability and repeatability, giving confidence in their ability to sustain high earned returns, and (c) SO operates utilities in geographically desirable markets where core growth should structurally outpace the broader US over time.
- The challenge with recommending SO is perpetually the valuation conversation - "how much of a premium does the stock sustainably warrant"? We think our new annualized rate of return framework best highlights the full value proposition by marrying SO's better than group growth rate, strong dividend yield, and modest premium (we hold at the historic 10%), which translates into an annualized rate of return of ~10% (notable in a 0.6 beta stock). Our updated 2011-2013 EPS estimates are $2.52, $2.70, and $2.90.

INITIATING / ASSUMING / REINSTATING COVERAGE

KKR Co LP (KKR)	**NEUTRAL**		**H. Chen**
CP: US$ 15.86	**TP: US$ 18**	**CAP: 10.8b**	

INITIATING Coverage with a NEUTRAL Rating and Target Price of $18

- An industry pioneer well positioned to benefit from secular tailwinds and improving capital markets. KKR is a long-standing leader within the private equity industry-we believe the firm is well positioned to benefit from strong secular growth dynamics (LP portfolio diversification, appetite for superior returns amidst funding pressures) and healthier market conditions. While we see upside to KKR shares, we initiate with a Neutral rating as we advocate being more selective within the alternative asset management sector. We currently favor exposure to those firms best positioned to benefit from both superior AUM growth and outsized cash distribution from here.
- Fund raising pipeline in focus post period of strong performance. KKR's funds have returned a 19% net IRR since inception and the firm managed well through and exiting the financial crisis. Nearly all of KKR's funds are now accruing performance fees and the firm has experienced a strong uptick in realization activity (40-50% of gains converted to cash over the past year). As more of fund AUM is returned to LPs, we believe the importance of fund raising comes into particular focus for KKR and view their fund raising pipeline and trajectory of AUM growth as a key driver over the intermediate-term. We expect the firm to deliver 6-7% annual organic AUM growth (slightly below peers) largely driven by KKR's next flagship PE fund.
- Potential risks. Pace of economic recovery, capital markets conditions (asset prices, M&A, underwriting, financing), success in future fundraising.
- Establishing 2011-2013 economic net income estimates of $2.45, $2.40, and $2.60 per share implying relatively stable earnings through 2011-2012 before rebounding in 2013 post the launch of firm's next major PE fund. We estimate a dividend of $0.80 this year (5% yield). While we see 14% upside potential in the shares based on our $18 DCF-derived target price in addition to a healthy dividend, we see greater upside in Outperform-rated APO and BX.

Pepco Holdings Inc. (POM)	**NEUTRAL**		**D. Eggers**
CP: US$ 19.30	**TP: US$ 20**	**CAP: US$ 4.3b**	

Good Yield, OK Total Return; REINSTATING Coverage with a NEUTRAL Rating and Target Price of $20

- Our take: We are reinstated coverage of POM with a Neutral rating and $20 target price. POM is a stock that offers a good T&D utility reinvestment story underpinned by a rich (and secure) dividend yield, but at current valuations using our new Rate of Return framework we see POM as middle of the pack at a 7% annualized return which is less exciting of an entry point.
- We see several issues worth watching at POM over coming months:
- An updated decision by PJM on the timing of (and maybe again need for) the MAPP transmission line which represents a significant capex opportunity for POM ($1.1 BN); our estimates assume in-service in 2017.
- Approval for (and implementation of) regulatory mechanisms that allow for more timely recovery of distribution capex; POM is focused on a range of tools (we might argue too broad) to support investment while earning closer to allowed ROEs. We are optimistic POM will make progress on these initiatives (we assume improving earned ROEs over time) but also think improvements will take several regulatory cycles rather than getting done in the current 2011 / 2012 planned cases.
- Reliability issues particularly in MD and DC have gathered attention and will likely demand an elevated level of operating / capital investment to address relatively visible problems; we worry these issues will redirect rate case focus away from a more speedy adoption of real time recovery tools.
- Our updated 2011-13 estimates are $1.20, $1.29, and $1.37 (old: $1.34, $1.37) and our $20 target price (old $16). reflects a combination of comparable group multiples

FOCUS LIST

CVS Caremark Corporation (CVS)	**OUTPERFORM [V]**		**E. Kelly**
CP: US$ 37.45	**TP: US$ 44**	**CAP: US$ 50.8b**	

Another Down Year for PBM Earnings Unlikely, But Not According to Street Estimates

- Credit Suisse View: The 2012 consensus expectation of 13-14% earnings growth for CVS looks conservative in our view. Our analysis suggests that street estimates actually embed another decline in organic earnings for the PBM segment next year, despite the epic generic wave. While poor execution has hampered Caremark's performance over the last few years and some amount of caution is warranted, it's clear that street estimates have built in a substantial margin of safety. We project earnings growth in 2012 for CVS of 15-20% and continue to rate the stock Outperform.
- Street seems to be embedding another down year for the PBM in 2012. We believe the 2012 consensus EPS estimate of $3.16 embeds a mid-single digit decline in organic PBM profits, a stark contrast to the high-teens growth expected at MHS and ESRX. Our analysis considers retail growth, share repurchase, and removes one time items (Aetna, UAM, streamlining) to reverse engineer the true underlying growth rate expected for the PBM. While it's certainly reasonable to assume a sizable step-down in profitability on $20 billion of current contracts renewals given CVS' history, it seems unlikely that this margin compression will more than offset accretion from the $30 billion generic wave and recent contract wins.
- We project 15-20% EPS growth. We project 2012 EPS of $3.25, up 17% YoY. Our estimate assumes 10-12% EBIT growth in retail, 8-10% EBIT growth in the PBM, and 3-6% accretion from share repurchases (each roughly in line with the company's long-term targets). We estimate, based on our proprietary analysis, that the generic wave will add 8%+ to earnings in 2012.
- Reiterate Outperform as risk/reward remains compelling. Despite recent strength, we continue to see upside in CVS' stock and believe investors will be rewarded as the company begins to stabilize the PBM business ahead of the 2012 generic wave. If we are wrong, the potential for a value-accretive breakup provides downside protection.

Oracle Corporation (ORCL)	OUTPERFORM		P. Winslow
CP: US$ 32.44	TP: US$ 42	CAP: US$ 164.2b	

Exalove Lives, Software Rocks, But Sun Sets; Lowering Estimates

- Results. Oracle reported Q4 results of EPS of $0.75 on $10.81 billion in revenue versus consensus estimates of $0.71 on $10.754 billion.
- Analysis. Oracle posted strong overall results with new software license increasing 12% year over year in constant currency versus guidance of 4%-14%. As we highlighted in our preview note, applications and DB&M license revenue exceeded consensus expectations. However, hardware products revenue missed consensus expectations for the second consecutive quarter. Although management stated that they continue to exit the less profitable low-end hardware business (with hardware gross margins increasing to 56% from 55% in the prior quarter), Oracle undoubtedly experienced some core Sun hardware weakness in Europe, as hardware systems products revenue declined 21% year over year in constant currency in that region.
- Exalove Lives & Now Extends to "Exadoop" and "ExaTimes"! The shortfall in hardware products sales clearly had nothing to do with Exadata and Exalogic, as management indicated greater than 50% sequential growth in Exaseries for the second consecutive quarter, which should alleviate recent concerns (which we have disagreed with) that Exadata/Exalogic have been losing momentum. Oracle's guidance for a tripling of the Exadata installed base in fiscal 2012 is consistent with our forecast, which has been more than $1 billion greater than consensus. Also, confirming our expectations from prior notes, management announced the launch of a Hadoop appliance, which we have dubbed "Exadoop" as well as an in-memory database appliance for later this fall at Oracle OpenWorld.
- Estimates. For fiscal 2012, we are adjusting our revenue outlook from $39.87 billion to $39.92 billion and our EPS estimate from $2.47 to $2.45. Our 2013 EPS estimate is also lowered to $2.75 (from $2.76).
- Our #1 Pick. Combining our belief that Wall Street continues to underappreciate how disruptive a force Oracle's integrated appliance strategy-from Exadata to Exalogic-could be with our positive outlook for the company's software business, Oracle remains our top pick.

ESTIMATE / TARGET PRICE CHANGES

Electric Utilities **D. Eggers**

A Thought...Evolution-izing Regulated Utility Valuation; Revising Estimates and Target Prices

- Our take: Regulated utility equities offer a more compelling investment opportunity than most give credit with 3 year annualized return potential of 7-13%, which seems quite attractive in a painfully low interest rate environment from a group with a 0.6-0.8 beta. Our favorite ideas are PCG, CMS, and upgraded SO; we see the least compelling opportunities in PGN, NVE, and TE.
- We think investors need to approach Regulated Utilities on a multi-year investment horizon where the combination of EPS growth and dividend yield can generate 7-13% annualized returns (or 8-15% if grossing up to a 1.0 beta). We like the annual rate of return perspective as it seems to better capture the full value proposition versus just looking at prompt price targets that tend to be less differentiated relative to total value potential.
- Rethinking Utility Valuation: Growth, Yield and Multiple. Regulated Utility target valuations consistently seem to overweight the importance of prompt (or near prompt) P/E multiples while typically underweighting the value impact of differentiated dividends / earnings growth. After much thought, we are evolution-izing our target price framework (and targets themselves) to better incorporate growth, yield, and P/E.
- Growth. We now base our targets (discounted back) using 2014 EPS estimates which allows us to incorporate much of the known / visible growth that will come through identified capex programs as well as significant regulatory events as applicable; the out year approach reduces the subjective 'tweaking' of prompt target multiples for higher growth.
- Yield. The power of the dividend - and the compounding impact of dividend reinvestment - is significant and a key element to the overall utility value proposition, yet inconsistently thought about when buying the group. Extending our time horizon better captures the economic benefit of the dividend, increasing the group's annualized return over three years by 4-5%.
- Multiple. We see no consistent basis for premium / discount P/E multiples today. With our approach we assume the stocks mostly revert to a common multiple in 2014 (yield and growth are already captured in this exercise) and then discount this value back to a 2012 price target.
- We are updating our target prices and ratings to reflect this new valuation methodology. We are upgrading SO to outperform, reinstating coverage of POM, and updating target prices and 2011-13 EPS estimates for AEP, AWK, BKH, CMS, ED, D, DTE, ITC, NVE, PCG, PNW, PGN, TE, and UNS
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Company	Price ccy	Price 22 Jun 11	Rating* Prev.	Rating* Cur.	Target Price Prev.	Target Price Cur.	Year End	EPS Ccy	EPS FY1E Prev.	EPS FY1E Cur.	EPS FY2E Prev.	EPS FY2E Cur.	EPS FY3E Prev.	EPS FY3E Cur.
American Electric Power Co. (AEP)	US$	37.58	—	O	40.00	42.00	Dec 10	US$	—	3.13	—	3.24	—	3.38
American Water Works Co. (AWK)	US$	29.30	—	N	29.00	32.00	Dec 10	US$	1.71	1.70	1.88	1.84	2.10	2.05
Black Hills Corporation (BKH)	US$	30.30	—	O	—	33.00	Dec 10	US$	—	1.66	—	2.31	—	2.53
CMS Energy (CMS)	US$	19.57	—	O [V]	22.00	24.00	Dec 10	US$	—	1.45	—	1.55	—	1.65
Con Edison (ED)	US$	52.71	—	N	48.00	57.00	Dec 10	US$	3.50	3.55	3.60	3.66	—	3.83
Dominion Resources (D)	US$	47.14	—	N	39.00	51.00	Dec 10	US$	3.21	3.12	3.23	3.28	3.58	3.52
DTE Energy (DTE)	US$	49.22	—	N	50.00	55.00	Dec 10	US$	—	3.55	—	3.72	3.90	3.92
ITC Holdings Corp (ITC)	US$	70.22	—	O	72.00	75.00	Dec 10	US$	—	3.29	4.03	4.04	4.71	4.68
NV Energy Inc (NVE)	US$	15.10	—	N	15.00	16.00	Dec 10	US$	—	0.95	—	1.21	—	1.29
PG&E Corporation (PCG)	US$	41.49	—	O	—	50.00	Dec 10	US$	3.55	3.54	3.80	3.67	3.70	3.66
Pinnacle West Capital Corp. (PNW)	US$	43.73	—	O	47.00	48.00	Dec 10	US$	—	3.15	3.42	3.41	3.46	3.47
Progress Energy (PGN)	US$	47.28	—	N	40.00	46.00	Dec 10	US$	3.28	3.15	3.29	3.18	3.32	3.26
TECO Energy (TE)	US$	18.49	—	N	16.00	19.00	Dec 10	US$	1.46	1.32	1.48	1.63	1.50	1.57
Unisource Energy Corp (UNS)	US$	36.74	—	N	34.00	37.00	Dec 10	US$	2.75	2.77	2.79	2.76	2.80	3.00

**O – Outperform, N – Neutral, U – Underperform, R – Restricted* *[V] = Stock considered volatile (see Disclosure Appendix).*

Source: Company data, Credit Suisse estimates.

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Cardinal Health (CAH)	OUTPERFORM		G. Santangelo
CP: US$ 44.51	TP: US$ 53	CAP: US$ 15.6b	

Accretion from Acquisitions & F12 Guidance Should Drive Continued Outperformance; Raising Estimates and Target Price to $53 (from $51)

- Bottom Line: While outperforming the broader market, shares of CAH have lagged its primary competitors YTD, and we believe the shares are poised to move higher. Greater than expected accretion from recent acquisitions in C10 as well as a potential move to cash EPS when the company issues F12 guidance in July represent near-term catalysts, while the generic pricing environment & positive industry fundamentals offer long-term opportunity. We are increasing our estimates & PT. Reiterate Outperform.
- Recent Acquisitions Likely Offer Greater Than Expected Accretion: Our checks indicate that the Kinray deal is proceeding better than initial conservative guidance of $0.12. Stronger customer retention at Kinray coupled with contributions from Yong Yu & P4 could drive upside to current estimates.
- Potential Move to Cash EPS & Guidance Represent Next Catalyst: CAH will provide initial F12 guidance on its next earnings call, & with MCK recently deciding to report an adjusted (cash) EPS, we believe CAH is likely to also move to reporting a cash EPS. We estimate that intangible amortization represents $0.17 in F12. Current consensus of $3.01 represents only 13.1% y/y growth, which strikes us as conservative given the potential accretion from recent acquisitions & numerous upcoming generic launches. Ignoring the transition to cash EPS, we anticipate the company's guidance will very conservatively bracket consensus, leaving ample room for upside throughout F12.
- Generic Pricing Thesis Continues to Represent Tailwind: We highlighted in our 4/24 note (Stabilization of Generic Pricing Could Be Underappreciated Trend) moderating generic price deflation as a positive for the distributors. Recent public comments by distributors & generic manufacturers continue to offer support to this view.
- Estimates & PT: We are maintaining our F11 EPS estimate of $2.67, while increasing our F12 & F13 estimates to $3.05 and $3.40 from $3.00 and $3.33, respectively. We are increasing our TP to $53 (from $51) pegging a 16-17x multiple on our C12 estimate of $3.24.

Agrium Inc. (AGU)	OUTPERFORM		E. Yip
CP: US$ 83.71	TP: US$ 111	CAP: US$ 13.2b	

Investor Day Highlights; Raising Estimates and Target Price to $111 (from $108)

- Reiterate Outperform. Following AGU's annual investor day in Denver, CO, we are raising our 2Q EPS estimate from $3.66 to $4.14 to reflect rising fertilizer prices during the quarter as well as slightly better nitrogen volumes than previously expected due to the strong pace of corn plantings at the end of the season. The outlook remains extremely favorable, as strong crop fundamentals, tightening fertilizer markets, and the company's advantaged cost positions should drive robust margins this year and next. We are raising our 2011, 2012, and 2013 EPS estimates to $8.70, $8.40, and $7.60 (from $8.11, $8.27, and $7.46) respectively primarily to reflect lower potash royalty tax rates tied to AGU's brownfield capital expenditures. We raise our target price from $108 to $111.
- Medium-term target of $3 billion of EBITDA by 2015. Assuming current nutrient price levels, management believes the company has the potential to earn over $3 billion of EBITDA by 2015, driven by its capacity expansions in wholesale and growth initiatives in retail and advanced technologies. In the wholesale business, the MOPCO nitrogen expansions and the Vault potash project are on track while the company has also identified new debottlenecking nitrogen opportunities. In the phosphate business, management has been in discussions with several rock suppliers and believes it may secure long-term rock supply by year-end. In the retail business, AGU continues to target $1 billion of EBITDA through acquisitions, organic growth, and synergies tied to the AWB Landmark integration. The Advanced Technologies business is expected to grow to $100 million of EBITDA, driven by product innovation, increased controlled-released nitrogen sales, and international growth.
- Valuation. AGU is currently trading at 10.0X P/E and 6.9X EV/EBITDA on our 2012 estimates, compared to its historical multiples of 11.9X NTM P/E and 7.4X FY1 EV/EBITDA.

Discover Financial Services (DFS)	NEUTRAL		M. Orenbuch
CP: US$ 23.59	TP: US$ 28	CAP: US$ 12.9b	

Improving Credit Quality and Solid Revenues; Raising Estimates and Target Price to $28 (from $25)

- Earnings. DFS reported 2Q EPS of $1.09 versus our estimate of $0.71 and the consensus at $0.70. The earnings beat was attributable to $0.08 of stronger revenues (net of expenses), $0.24 of additional reserve release, $0.02 of lower charge-offs, and $0.04 difference in the tax rate. We are increasing our 2011, 2012 and 2013 estimates to $3.75, $2.85 and $3.00, respectively (from $2.85, $2.65, and $2.90) to reflect reduced credit costs. Our model projects moderating charge-offs and reserve release into 2012, and stabilization of losses in 2013. Upside to our forecast lies within the company's ability to stabilize its card yield and continue to deploy capital, potentially by increasing the share repurchase program. We are raising our target price to $28 from $25, which represents 10x 2012 earnings (ex. reserve release) and 1.8x forward TBV.
- Maintain Neutral Rating. Discover maintained better credit quality than the industry average over the most recent cycle; however, there are risks to achieving ROA targets both from the competitive environment in the card business as well as the consumer lending product extensions that are expected to source much of the growth going forward.

Paychex (PAYX)	NEUTRAL		K. Flynn
CP: US$ 30.57	TP: US$ 29	CAP: US$ 11.1b	

Q4 Follow-up: Inline Q; Maintain Neutral On Tepid New Business Sales/Inline Guidance, Lowering Estimates

- $0.33 EPS Missed $0.34 CSE/Matched Consensus On Modest Rev Upside/Slight Margin Downside. Total revenue of $522.7M rose 5.3% YoY (better than 5.0% CSE, and vs. Q3's 4.6%, Q2's 3.1% YoY and Q1's 3.6%), and beat $521.0M CSE/$515.1M consensus. 33.4% op margin, ex. float, rose 30 bps YoY (worse than CSE 171 bps, Q3's 101 bps, Q2's 122 bps, Q1's 107 YoY).
- Segment Revenue Trends Mixed; Checks/client Growth Slowed Sequentially, New Business Sales Growth Flat. Payroll revenue of $356.9M rose 4.6% YoY/3.0% organically (better than CSE 3.0%/2.0%, and vs. Q3's 2.3%, Q2's 1.1% YoY and Q1's 1.8%). Checks/client rose 2.0% YoY (better than 1.5% CSE, but slower vs. Q3's 2.8%, Q2's 2.5% and Q1's 1.2%); management noted that new business sales were flat YoY due primarily to sluggish new business starts which we expect could hold back future topline growth. HRS revenue of $153.5M rose 8.7% YoY (worse than CSE 12%, and vs. Q3's 13.1%, Q2's 9.8% YoY and Q1's 10.2%). Interest on Client Funds of $12.3M fell 10.4% YoY (better than CSE -16%, and vs. Q3's -16.6%, Q2's -11.5% YoY and Q1's -11.8%).
- FY12 Guidance Largely Inline and Incorporates Acquisition Impact. Mgmt provided implied guidance for 7-9% YoY total revenue growth/5-7% organic growth ex-SurePayroll/ePlan acquisitions, or $2.22-2.27B (Payroll: +5-7%, HRS: +12-15%, Combined Interest on Client Funds/Investment Income: -11% (vs. prior -8% guidance)), with organic growth guidance largely inline with prior consensus; they also guided to 5-7% net income growth, implying ~$1.49-1.52 in EPS (includes ~$0.01 hit from acquisition-related amort. expense), with the midpoint matching prior $1.51 consensus.
- Lowering FY12-FY13 Estimates Slightly. We are trimming our FY12E EPS by $0.01 to $1.52, to reflect acquisition-related dilution and slightly more pessimistic earnings growth assumptions, which offset the impact of acquisition-driven incremental revenue; we are also lowering our FY13E EPS by $0.03 to $1.66. Our estimates compare with prior $1.51/$1.64 consensus respectively.
- Maintain Neutral, $29 TP.

Micron Technology Inc. (MU)	OUTPERFORM [V]		J. Pitzer
CP: US$ 8.43	TP: US$ 10	CAP: US$ 8.4b	

Mix Leverage Showed Up, Demand Didn't; Lowering Estimates and Target Price to $10 (from $15)

- Bottom line. MU reported disappointing F3Q results; revenue and EPS of $2.14bn and $0.05, versus consensus of $2.36 and $0.16. While GM expanded 310 bps q/q on DOWN revenue, NAND ASPs (+15% q/q) beat our est of -1%, and DRAM ASPs (-1%) were in-line, bit production and shipments missed the mark, the latter on continued subdued demand for consumer PCs, tablets and smartphones. The bright spot in the quarter continues to be server DRAM, now 20% of overall revenue - DSG OPM increased from $51m to $110m, +116% q/q. We see continued mix leverage and margin expansion based on further growth of server DRAM as % of total revenue, start-up costs from NAND fab declining, mix towards more trade NAND and improved costs in the NOR business. The missing element is end demand - which we expect will improve along seasonal lines in late July early August. The pre-market is indicates the stock is trading at 0.9x times book value of $8.24 - implying the stock is embedding greater than $900m in losses - an extremely unlikely scenario in our opinion. Favorable seasonal patterns should support at least a $10 PT.
- MayQ Results and AugQ Guide Below. MayQ revs of $2.14bn (-5.2% q/q) were below CS/Street ests. of $2.33bn (+3.3% q/q)/$2.36bn (+4.8% q/q) on weaker PC DRAM and NAND shipments. GM of 22.3% was up 300bps q/q on a mix shift towards Server DRAM but below our est. of 24.2% as costs-down disappointed. Pro-Forma EPS (w/ options) was $0.05, below CS/Street ests of $0.15/ $0.16. Relative to the AugQ, MU guided DRAM bit production up low to mid single digits, vs. our prior model of +6% and noted that QTD ASPs are down-high single digits vs. prior -4%. NAND production was guided up in the double digits, in-line with our prior est. of +13% - QTD pricing is down in the low double digits vs. our prior model -6%.
- Cutting Estimates, Price Target. Decrease FY11 revs from $9.25bn (+9.1% y/y) to $8.68bn (+2.3%) and EPS from $0.53 to $0.29. For FY12, we cut revs from $10.17bn (+9.9% y/) to $8.97bn (+3.4%) and EPS from $1.13 to $0.71. Valuation is attractive with shares trading at 0.9x P/B in the pre-market below historical range of 1-2x. Note that MU's current valuation implies that the market is pricing in $930m in losses. While we remain positive on the stock, we decrease our PT to $10 (from $15), representing 1.2x P/B.

Rackspace Hosting Inc. (RAX)	OUTPERFORM [V]		G. Dunham
CP: US$ 40.84	TP: US$ 50	CAP: US$ 5.3b	

Expecting Another Strong Enterprise Quarter; Raising Estimates

- Enterprise Performance Should Continue To Be Strong: Our research at industry conferences this quarter illustrates noticeably higher interest from larger corporations to consider managed hosting and IaaS. IT departments are particularly keen on Rackspace's Connect offering that enables the capability to connect environments in a hybrid approach. While Enterprise remains less than 20% of the business, we expect this mix to increasingly contribute to growth and see Enterprise revenues having the potential to drive upside to our $244m revenue estimate in 2Q (consensus of $242m).
- Replicating Services Stack In Cloud World: Rackspace is aggressively adding service layers atop its Cloud offering. With Managed Cloud in North America in December and the U.K. last month, the company is driving toward higher SLAs and pricing atop its IaaS platform. We expect services layers to expand beyond Managed and Load Balancing-as-a-Service, also released in 2Q, to other layers with time. While the evolution to a more lightweight CapEx model requires investments in capitalized software (up nearly 80% y/y over the TTM), we believe the transition over time drives a better margin profile and higher capital efficiency.
- Estimates: We are slightly raising revenues and EPS given strong data points and an adjustment to our depreciation expense forecast. Non GAAP EPS for 2011 increases to $0.70 from $0.63 (GAAP increases to $0.47 from $0.40). Our EPS estimates for 2012/2013 have also slightly raisied to $0.95/$1.31 (from $0.89/$1.29). 2011 revenues increase to $1,005m from $1,000m.
- Outlook: While our $50 price target is based on a DCF analysis that reflects a ten-year time horizon, a 11.8% WACC, and Beta of 1.2x, we note that $50 embeds that Rackspace's current forward multiple of 16x compresses below 15x despite our view that the company's growth, margin outlook and positioning in IaaS is more likely to improve than deteriorate.

TreeHouse Foods (THS)	NEUTRAL		R. Moskow
CP: US$ 54.10	TP: US$ 53	CAP: US$ 1.9b	

2Q Pricing Delay Is An Air Pocket, Not A Black Hole; Maintain Neutral; Lowering Estimates

- In our view, TreeHouse's earnings miss in second quarter reflects a temporary mismatch between rising commodity costs and their efforts to raise prices. We do not think it represents a structural problem with TreeHouse's ability to manage commodity cost volatility or its negotiating power with customers. However, despite the stocks' tempting sell-off, it is still too expensive for us to recommend given that it is trading in-line with our 12-month target price of $53/share and a P/E multiple of 15.5x our 2012 EPS estimate.
- Retailer pushback. We expect packaged foods companies like General Mills, Campbell, Kraft, and Kellogg to echo the same theme that TreeHouse and ConAgra struck yesterday about pricing delays. Wal-Mart publicly stated that they were requiring more documentation from their customers before allowing a second round of pricing to go through. But unlike TreeHouse, investor expectations for the large cap stocks aren't particularly high. In addition, we believe that the branded companies have more cushion in their budgets to mitigate the pressure from higher commodity costs by cutting advertising or shifting the timing of trade funds.
- Visibility for 3Q is good. The main reason for the negative surprise in 2Q was that packaging costs spiked rapidly almost immediately after TreeHouse announced their first round of pricing. The second round of pricing covered these problems. Going forward, the company is vulnerable to big spikes in oil, resin, and tinplate if they occur.
- Revising estimates. We are lowering our 2011 EPS estimate by $0.10 to $2.95 (from $3.08), (versus new guidance of $2.90-$3.10) and our 2012/2013 EPS estimate to $3.40/$3.65 (from $3.50/$3.75). Recall that 2011 includes $0.15 of incrementally higher information systems spending that will decline in 2012. We maintain our Target Price at $53.

Rite Aid Corporation (RAD)	NEUTRAL [V]		E. Kelly
CP: US$ 1.17	TP: US$ 1	CAP: US$ 1b	

EBITDA Stabilizes on Cost Cuts; but Fundamental Outlook Remains Challenged; Raising Estimates

- Credit Suisse view: Rite Aid's Q1 EBITDA of $263 million was slightly ahead of our estimate of $243 million, as continued cost cuts offset a weaker than expected gross margin. While the company's two most recent quarters point to some stabilization, we believe these results were mainly driven by cost cuts and easy sales comparisons rather any material change in underlying business fundamentals. Management has launched various initiatives to drive sales (loyalty card, store remodels, Save-A-Lot partnership), however, we believe the visibility on a fundamental turnaround remains low, and we continue to project EBITDA to be down in 2011. The one positive catalyst for the company is the upcoming generic wave which should drive earnings growth in 2012, and may buy the company more time to try and improve operations. We rate the stock Neutral.
- The Quarter: Q1 EBITDA increased 5% to $263 million, above our estimate of $243 million. Sales were flat, reflecting a +0.8% comp, offset by store closures. EBITDA margin increased 20 bps, as gross margin contraction (down 30 bps on a FIFO basis) was offset by an improvement in the SG&A ratio.
- Our Estimates and Target Price: We adjusted our FY '11 EBITDA estimate to $835 million from $827 million, at the lower-end of management guidance of $800-900 million. We maintained FY '12 at $875 million and FY '13 at $888 million. We maintained our $1 Target Price, which is 8.7X FY '11 EBITDA. We are raising our FY2012/FY2013/FY2014 EPS estimates to $-0.55/$-0.42/$-0.35 (from $-0.56/$-0.44/$-0.36) respectively.
- Derivative Implications: Rite Aid is struggling with its own internal issues and its Q1 results are not a fair reflection of improving industry trends. Management's commentary on gross margin upside from generics in 2012 is positive read-through for CVS and WAG, although there is still uncertainty around the magnitude of the upside given ongoing reimbursement rate pressure from PBMs.

European Staffers	MARKET WEIGHT	A. Grobler

Don't forget the growth; TP & EPS estimates revised

- Stocks discounting a significant and sustained slowdown in the rate of recovery: The staffing stocks are now discounting a sharp slowdown in economic growth in 2012, a lack of margin expansion and significantly lower long-term growth than has been the case historically. We think Randstad and Adecco are discounting weighted Real GDP growth falling to 1.6-1.8% in 2012E compared with our estimates of 2.9-3.0%. The professional staffers are discounting gross profit growth rates lower than they have historically generated in years without recessions or sharp economic slowdowns. We rate the stocks within the staffing sub-sector as Outperform.
- Growth and margin: Ongoing recovery from the depths of the 2008/2009 recession, network expansion in new geographies and disciplines (for the professional staffers), good cost control and further market share gains should drive 20-50% EPS CAGR growth for the sub-sector between 2011E and 2014E. We think the stocks can at least hold current 12-month forward ratings (with re-rating potential for the generalists) with share price appreciation driven by EPS growth.
- Economic sentiment remains downbeat: We reduce our EPS estimates by 1-11% (2012E) to reflect the latest market data and a weaker economic outlook in many markets. With financial markets still focused on the short term and the denouement of the debt issues in Greece still unclear, lead indicators may need to stabilise before the market reacts in the short term but we see substantial upside potential in share prices over the next 12 months.
- Stocks: We see 30%+ upside potential for Adecco, Randstad, Hays, RWA and STHR with 23% upside potential for MPI on our updated price targets. Adecco: Resilient end markets and good cost control should continue to drive strong EPS growth for the business yet the price is reflecting 3-4% revenue growth in 2012E and beyond and no margin benefit from already completed acquisitions and cost reduction programmes. We believe Hays should derive 90% of GP growth and 80% of EBITA growth from its international businesses (FY11E-14E) yet the UK business continues to be the focus of investor attention. We expect UK profits to reach a trough in FY11E, the public sector business to begin to stabilise in FY12E and believe many of the concerns on its RPO business are overdone.

COMPANY UPDATES

PepsiCo. Inc. (PEP)	**OUTPERFORM**		**C. Laboy**
CP: US$ 67.98	**TP: US$ 85**	**CAP: US$ 107.5b**	

More on PepsiCo's Beverage Restructuring

- Earlier this week we reported on PepsiCo's beverage restructuring and offer some incremental insights. For PepsiCo, it was overdue for management to move its core brands from a multiregional marketing platform to a global platform. Industry feedback has been that this is allowing PepsiCo to attract a new caliber of marketers to the beverage company and that it is also allowing some of the best internal talent to go global. It is no accident that the management changes announced this week coincide with the structure change. This is accelerating exits from PepsiCo and it is also causing some of the sharper second tier managers to step up. We view this change and the infusion of fresh talent favorably.
- Industry trade press has been mixed. When an organization has to endure the turnover that goes with nonperformance followed by the turnover that goes with a new direction, mixed press is to be expected. We draw comfort from how this process went first at Gatorade and later at Tropicana. Turmoil and bad press on turnover was followed by the strong results at Gatorade. Signs of stabilization at Tropicana are encouraging. But in the next few months, we expect more noise on soft drink management turnover.
- Going into quarter-end at PepsiCo, commodity costs remain worry #1. Cost inflation going into 2012 is concerning, as per industry executives. We believe that PepsiCo's stepped up marketing/ brand investments and its rising commodity costs may be putting more COGS pressure on PEP than on KO which does not have to step up brand and marketing investments as much. Coke may also have more levers this year for offsetting COGS. We are most worried about DPS on this score, as it is smaller and does not have currency exposures or the same levers to help offset commodities.
- Valuation: We believe KO merits more multiple expansion than PEP.

Praxair Inc. (PX)	**NEUTRAL**		**J. McNulty**
CP: US$ 103.51	**TP: US$ 110**	**CAP: US$ 32b**	

PX Outlines 2015 Targets, Solid Hydrogen Growth Opportunity

- Investor Day Debrief-At their Global Hydrogen Growth Investor day, PX reiterated the long-term view on 2015 growth targets, including 8-12% top line growth and 12-18% EPS growth per year. The focus of the day was centered on their hydrogen business, which they see growing over 20% per year through 2015 driven by a growing need for hydrogen volumes across end markets but primarily in the refining industry, greater outsourcing of hydrogen projects particularly in the emerging markets, and several major projects currently under construction. Overall, we came away impressed with the opportunities in this market and the outlook for the company long term, and think the name should be viewed as a core holding for longer-term investors. However, looking out over the next 12 months, with the stock already at 10.1x our 2012 EBITDA, the valuation is full and we see greater risk/reward profiles in the Chemical space.
- Below are some of our key takeaways from the investor day:
- Current Business Strength-PX continues to see strong new project activity, with a backlog that continues to grow. The backlog currently stands at $2.7 bil up from $2.5 bil as of 1Q11, and is likely to grow further near-term.
- 2015 Targets-PX expects organic sales growth of 8-12% (which at its midpoint would grow their revenues to ~$16 bil by 2015), operating profit growth of 10-15%, and EPS growth of 12-18% per year. They expect returns on capital of 15+%, roughly in line with historical levels and our expectations. In terms of cash generation and usage, they see total cash flow from operations of $18 bil through 2015, of which $11 bil will be used for capital spending and the rest roughly split between dividends and share repos.
- Hydrogen Opportunity-PX sees their hydrogen business growing at over 20% per year over the next 5 years, and being a major driver of their overall growth target. In this report, we detail the key end uses for hydrogen, its main drivers over the next 5 years, and management's strategy for taking advantage of the attractive prospects in this market.

Mylan Inc. (MYL)	OUTPERFORM		M. Faerm
CP: US$ 22.92	TP: US$ 28	CAP: US$ 10.1b	

Entocort Adds Confidence to 2011 Estimates

- MYL's unanticipated court win and launch of Entocort EC add confidence, and potentially upside, to 2011 EPS. We estimate Entocort is worth about $0.03-$0.07 of 2011 EPS, the low end assumes Teva obtains approval and launches, and the high end assumes only MYL. The launch adds confidence to our belief in MYL's ability to hit its $2.00 guidance midpoint in 2011, and adds the potential for upside to that figure.
- MYL's guidance assumed a 2H 2011 launch of Entocort EC, thus the news implies $0.00-$0.05 potential upside to guidance. If we assume that guidance included a launch at the start of 4Q11, worth about $0.02-$0.04 in 2011, then our total Entocort estimate of $0.03-$0.07 implies approximately $0.00-$0.05 of potential upside to guidance.
- Entocort builds on possible Doryx 150 mg upside to help address concerns about 2H11 earnings. After MYL guided to a flat 2Q11 and a back-end loaded 2H11 on its 1Q11 earnings call, investor concerns were stimulated about MYL's ability to hit its $2.00 guidance midpoint. In addition to the Entocort news, MYL could benefit by up to $0.04 in 2H11 if it is able to launch alone in 4Q11 in the wake of Impax's FDA issues. However, the Doryx patent litigation continues with little visibility, an at-risk launch is uncertain, and IPXL could still obtain approval this year.
- Our model has not explicitly included 2011 revenues for Entocort EC or Doryx. We incorporate revenue for unanticipated product wins such as these, but Entocort (and to a lesser degree Doryx) adds confidence to our estimates. We will further analyze the effects of these events along with refinements around 2Q11 earnings.
- Entocort EC background: See the full report regarding the case, approvals and competition, as well as our detailed estimates.

Fortis Inc. (FTS.TO)	NEUTRAL		A. M. Kuske
CP: C$ 31.64	TP: C$ 34	CAP: C$ 5.6b	

Valuing Vermont

- Competing bid: Roughly three and a half weeks after Central Vermont Public Service Corporation (CVPS) agreed to be purchased by Fortis Inc. for US$35.10 per share, Northern New England Energy Corp. (NNEEC), a wholly owned subsidiary of Gaz Métro Limited Partnership made an unsolicited offer for CVPS. CVPS announced its board of directors "will review the unsolicited offer in due course based on its fiduciary responsibilities and contractual commitments to Fortis." We believe FTS is a very disciplined buyer of assets. The recent equity offering, CV deal and Belize issues have weighed on the stock.
- Deal differences: Selected differences between the NNEEC and FTS offers include: (a) NNEEC bid US$35.25 per CVPS share vs. FTS at US$35.10/sh; (b) under NNEEC's bid, CVPS shareholders will receive quarterly dividend payments of US$0.23/sh until closing versus FTS's offer capping dividends at US$0.46; (c) NNEEC stated the transaction will create roughly US$144m over 10-year customer savings to CVPS and, wholly-owned subsidiary, Green Mountain Energy (GMP) rate payers versus US$21m in the FTS transaction; and (d) the NNEEC deal will see CVPS and GMP contribute roughly 30% ownership interest in VELCO to a "permanent trust under public direction". As with many utility transactions, the potential for greater customer benefits may be critical in the regulatory approval process.
- Improving capital market conditions: Historically, Fortis has been very adept at acquisitions. Corporate growth has benefited from the company's ability to successfully acquire and integrate selected assets. In our view, the company is well positioned in the current market for acquisition opportunities.
- Valuation: Our C$34 target price and Neutral rating are obtained utilizing multiple valuation approaches, including: an 18.5x P/E multiple of 2012 earnings; a 1.8x book value multiple; and, a DCF based valuation.

INDUSTRY UPDATES

Healthcare Facilities and Providers	MARKET WEIGHT	R. Giacobbe

No More Bad Debt "Expense"

- Bottom Line: Yesterday, the FASB's Emerging Issues Task Force (EITF) discussed a new policy that would require hospitals to report bad debt as a reduction to revenue rather than an expense line item beginning Jan 1, 2012, pending ratification. Hospitals will also have to release additional disclosures regarding their revenue recognition and bad debt policies. While most of the changes predominantly impact the optics of company financial statements, we are encouraged that the new format will provide greater comparability between the publicly traded hospitals, and should be well received by investors given historical volatility of bad debt expense.
- New Revenue and Bad Debt Presentation: The new policy will require all hospitals to report patient bad debt expense as a reduction to revenue rather than an expense line item. Bad debt associated with non-patient revenue (a small percentage of revenue for the hospital group) will remain an expense line item. In the full report, we illustrate how the income statement would look in the new format (assuming all bad debt expense is reclassified as a reduction to revenue).
- Greater Disclosure: Hospitals will have to provide additional qualitative disclosures regarding their revenue recognition and bad debt timing policies. Companies will also have to disclose significant events that have impacted their accounts receivables.
- Benefits of Change: Though the changes mostly affect the optics of the financial statements, we believe the new policy improves the comparability of the performance within the hospital group. Margin profiles and growth rates should better reflect true operating performance as revenue less provision more accurately reflects the true "collectible" amount as opposed to current inflated revenue and corresponding large bad debt expense. The new standard should also put the hospital industry more in-line with other industries that already reduce revenue by portions deemed uncollectible.
- Timing: Based on our conversations with Credit Suisse Accounting analyst David Zion and his team, the precise text of the policy will now be drafted and presented to the FASB board during a ratification meeting on July 13. If ratified (which we expect), the changes are slated to come into effect for the first quarter of 2012 for the publicly traded hospitals, with the option for early adoption. Historical financial statements will be provided in the new format retrospectively, while any qualitative disclosures will be provided on a go-forward prospective basis.

Packaged foods & Agribusiness	MARKET WEIGHT	R. Moskow

Food Sales Tracking Update - The Top 6 Things You Need To Know About The Nielsen Data

- Branded foods price increases are slowly passing through. Pricing rose 2.2% in the 4-week period compared to 1.9% in the 12-week period. Volume held flat.
- General Mills' sales were weak. Total sales declined 3.9% in the 12-week period as the company's pullbacks on promotional spending severely hurt volume. The results were bad enough to raise concerns about fourth quarter results.
- Kellogg's sales were excellent. Sales rose 7.2% in the 4-week period compared to 5.8% in the 12-week. Market share gains in cereal came mainly at the expense of General Mills.
- Hershey sales were good. Sales rose 3.7% in the 4-week period.
- Mead Johnson market share slipped. Infant formula share fell 40 bps sequentially, Similac's grew 40 bps, and Nestle's held flat.
- Kraft sales were surprisingly good. Sales rose 3.8% in the 12-week largely due to strong results in cookies, lunchmeat, and dry dinners.
- Implications:
- Industry. As we indicated in our June 9 industry report, food pricing is accelerating slower than originally expected, partly due to resistance from certain grocers to accept price hikes. However, with P/E valuation multiples in the group now a full 1.0x turn lower than where they were two months ago, we think investors are largely prepared for the bad news.
- Mead Johnson. This is our top pick heading into 2Q earnings. We think the strong emerging market sales trends will drive a top-line beat and that the market share declines in the U.S. are already factored into management guidance.
- Kraft. We think this is a safe place for short-term investors to hide. Investors will be pleasantly surprised to see that the U.S. is regaining some momentum behind the launches of new products like Mio and some effective promotions behind Nabisco. That said, the stock is no longer trading at the valuation discount it once did.
- Kellogg. The U.S. cereal trends are encouraging. We think the company's top-line guidance is overly conservative given the easy comparisons to last year's product recall.
- Hershey. We think the company's strong business momentum from 1Q continued into 2Q, and we think new CEO J.P. Bilbrey will raise guidance at some point this year. But we are not sure that it will happen next month.
- General Mills. We think the company is going to report a very weak volume result next week, but guide FY 12 EPS in line with consensus. Investor expectations for this stock are already quite low.

Automobiles **C. Ceraso**

Data on the Go- Platform Monitor: Suppliers Tracking Well on Favorable NA/EUR Mix

- Based on QTD production trends in NA & EUR along with the current EUR:USD exchange rate, almost all the suppliers we cover are on track to post sequential revenue increases in the second quarter that are well above current consensus estimates (>5%). We think this reflects strong output of high-volume premium vehicles in Europe, a surge in Ford Focus output in both North America & Europe (as that platform moves into ramp-up mode) & sharp cuts to 2Q Street revenue forecasts made immediately post-the Japan disaster (when the outlook for industry production was more grim).
- In particular, the sequential changes in LEA's production-implied revenues are well ahead of consensus estimates (+13% vs consensus of -5%). The company appears to be on track to post strong revenue gains in North America, driven by an expected surge in output on the Ford Focus (+150%) & Hyundai Santa Fe/Kia Sorrento (+63%), along with an expected 7% increase in GM's full-size pickups trucks (all numbers relative to 1Q11 output).
- Even if LEA does print a strong 2Q revenue (and margin) number, the company is still at risk of posting weaker 3Q number due to the expected slowdown in GM's T900 truck production (as the automaker is significantly overstocked on those vehicles). The same can be said for MGA & AXL, which also have high GM T900 exposure.
- Our analysis does suggest that HAR is also poised to put up strong q/q revenues in CY2Q11 relative to consensus (+14% vs est consensus of -4%), driven by strong output on its main European platforms. However, it's important to note that HAR does have significant branded-audio exposure to Lexus platforms built in Japan (including the ES and IS), which do not show up in our NA or EUR build numbers. Our Japanese autos team is expecting Toyota's wholesale volumes in Japan to be down 32% vs CY1Q11 (at 291k vs 425k), which we estimate could knock-off 200-250 bps off our production-implied revenue increase. HAR may also be wrestling with higher procurement costs. But all that said the quarter seems to be shaping up well for HAR.

China Banks Sector **UNDERWEIGHT** **S. Jain**

SHIBOR spiked, funding probably gets tougher in 2H11

- China's money market rate SHIBOR saw another spike since 20 June (primarily due to one more 50 bp RRR hike affected that day). More interestingly, SHIBOR seems to advance higher after Monday with 7D and 14D rates both exceeding 9% yesterday (up more than 400-500 bp vs that in the beginning of the month).
- Major Chinese banks saw interbank funding grow another 10-12% during 1Q11. If interbank rate keeps high, it could lead to a negative margin impact for net borrowers (primarily smaller banks), but big banks could probably benefit. LDR at BOC, BCOM, CMB and Minsheng were all close to 75% level by 1Q11.
- SHIBOR has trended higher since early this year given a rising rate environment. This, indeed, is a result of higher RRR, but could have been further supported by a slowdown in M2/deposit growth. Anecdotally, we also heard that banks are feeling increasingly pressured from deposit competition.
- We believe the stunning WM products sold (Rmb8 tn YTD according to jrj.com) will ultimately divert some retail deposits off balance sheet mid-term. Banks will have to renew those products quickly and offer competitive yield before losing them to competitors (including fund managers and insurers).
- We suspect funding will probably get tougher for Chinese banks (particular smaller banks) 2H11 onward if a negative real rate persists, though near-term fee momentum could surprise on the upside. We maintain UNDERWEIGHT.

All headline prices are as of the previous day's close unless otherwise noted.

Companies Mentioned *(Price as of 23 Jun 11)*
China Minsheng Banking Corporation (1988.HK, HK$7.23, UNDERPERFORM, TP HK$6.37)
Bank of Communications (3328.HK, HK$7.23, NEUTRAL, TP HK$7.51)
China Merchants Bank - H (3968.HK, HK$18.16, NEUTRAL, TP HK$18.96)
Bank of China Ltd (3988.HK, HK$3.74, NEUTRAL, TP HK$4.09)
Adecco (ADEN.VX, SFr51.50, OUTPERFORM, TP SFr70.00, MARKET WEIGHT)
American Electric Power Co., Inc. (AEP, $37.30, OUTPERFORM, TP $42.00)
Agrium Inc. (AGU, $84.19, OUTPERFORM, TP $111.00)
Apollo Global Management LLC (APO, $16.10, OUTPERFORM [V], TP $23.00)
American Water Works Co. (AWK, $29.41, NEUTRAL, TP $32.00)
American Axle & Manufacturing Holdings Inc. (AXL, $10.83, NEUTRAL [V], TP $16.00)
Black Hills Corporation (BKH, $30.19, OUTPERFORM, TP $33.00)
Blackstone Group (BX, $16.26, OUTPERFORM, TP $22.00)
ConAgra Foods, Inc. (CAG, $25.37, RESTRICTED)
Cardinal Health (CAH, $44.31, OUTPERFORM, TP $53.00)
CMS Energy (CMS, $19.35, OUTPERFORM [V], TP $24.00)
Campbell Soup Company (CPB, $33.11, NEUTRAL, TP $35.00)
Central Vermont Pub Serv (CV, $34.41)
CVS Caremark Corporation (CVS, $36.82, OUTPERFORM [V], TP $44.00)
Dominion Resources (D, $47.14, NEUTRAL, TP $51.00)
Discover Financial Services (DFS, $23.89, NEUTRAL, TP $28.00)

DTE Energy (DTE, $48.69, NEUTRAL, TP $55.00)
Con Edison (ED, $52.24, NEUTRAL, TP $57.00)
Express Scripts (ESRX, $54.06, OUTPERFORM [V], TP $67.00)
Fortis Inc. (FTS.TO, C$31.64, NEUTRAL, TP C$34.00)
General Mills (GIS, $37.19, OUTPERFORM, TP $40.00)
Harman International Industries (HAR, $44.04, NEUTRAL [V], TP $58.00)
Hays (HAYS.L, 99.00p, OUTPERFORM, TP 140.00p, MARKET WEIGHT)
The Hershey Company (HSY, $55.72, OUTPERFORM, TP $64.00)
Impax Laboratories, Inc. (IPXL, $20.59)
ITC Holdings Corp (ITC, $70.22, OUTPERFORM, TP $75.00)
Kellogg Company (K, $54.12, NEUTRAL, TP $64.00)
Kraft Foods, Inc. (KFT, $34.26, OUTPERFORM, TP $37.00)
KKR & Co LP (KKR, $15.86, NEUTRAL, TP $18.00)
The Coca-Cola Company (KO, $64.98, OUTPERFORM, TP $95.00)
McKesson Corporation (MCK, $82.04, OUTPERFORM, TP $95.00)
Magna International (MGA, $49.80, NEUTRAL, TP $61.00)
MedcoHealth Solutions (MHS, $54.42, OUTPERFORM, TP $70.00)
Mead Johnson Nutrition Co. (MJN, $65.22, OUTPERFORM, TP $74.00)
Micron Technology Inc. (MU, $8.43, OUTPERFORM [V], TP $10.00)
Mylan Inc. (MYL, $22.92, OUTPERFORM, TP $28.00)
Nestle (NESN.VX, SFr51.45, NEUTRAL, TP SFr55.00, OVERWEIGHT)
NV Energy Inc (NVE, $15.10, NEUTRAL, TP $16.00)
Oracle Corporation (ORCL, $32.44, OUTPERFORM, TP $42.00)
Paychex (PAYX, $30.57, NEUTRAL, TP $29.00)
PG&E Corporation (PCG, $41.49, OUTPERFORM, TP $50.00)
PepsiCo, Inc. (PEP, $67.98, OUTPERFORM, TP $85.00)
Progress Energy (PGN, $47.28, NEUTRAL, TP $46.00)
Pepco Holdings Inc. (POM, $19.30, NEUTRAL, TP $20.00)
Praxair Inc. (PX, $103.51, NEUTRAL, TP $110.00)
Rite Aid Corporation (RAD, $1.17, NEUTRAL [V], TP $1.00)
Randstad (RAND.AS, Eu 31.44, OUTPERFORM, TP Eu 42.00, MARKET WEIGHT)
Rackspace Hosting Inc. (RAX, $40.84, OUTPERFORM [V], TP $50.00)
Robert Walters (RWA.L, 300.00p, OUTPERFORM, TP 420.00p, MARKET WEIGHT)
Southern Company (SO, $39.34, OUTPERFORM, TP $45.00)
SThree (STHR.L, 372.90p, OUTPERFORM, TP 510.00p, MARKET WEIGHT)
TECO Energy (TE, $18.49, NEUTRAL, TP $19.00)
Teva Pharmaceutical Industries (TEVA, $47.99, RESTRICTED)
TreeHouse Foods (THS, $54.10, NEUTRAL, TP $53.00)
Unisource Energy Corp (UNS, $36.57, NEUTRAL, TP $37.00)
Walgreen Co. (WAG, $42.59, OUTPERFORM, TP $51.00)
Wal-Mart Stores, Inc. (WMT, $53.29, NEUTRAL, TP $58.00)

Disclosure Appendix

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