

## Equities

9 June 2011 | 36 pages

# European Portfolio Strategist

## UK/ Pan European — Phones 4 Dividends

- **Never cheaper** — Telecoms trade on a record DY relative of over 200, ie 2x market's dividend yield. This is rare but tends to be a good time to buy a sector.
- **Magic 7%** — Telecom's trailing DY is nearing 7%. Average 12m total returns when sectors have done this since 1980 = +30%. Suggests support for the sector.
- **Seasonality** — Since 1995, European Telecoms have had a poor 1H and a good 2H in relative performance terms. The sector has underperformed YTD. 2H is near.
- **Dividend model** — We combine DY with cover, free cash flow, dividend growth and DY revisions. Autos, Insurance and Telecoms score best. Utilities score poorly.
- **Risk** — High DYs can imply risk to dividends. Our analysts see this as broadly balanced. Vodafone up, Telefonica downside. Operational trends remain weak, too.
- **Telecoms vs Utilities** — Prefer Telecoms to Utilities. Both have big DYs; Telecoms scores better on growth, FCF and revisions. Our analysts Buy Vodafone/Sell RWE.

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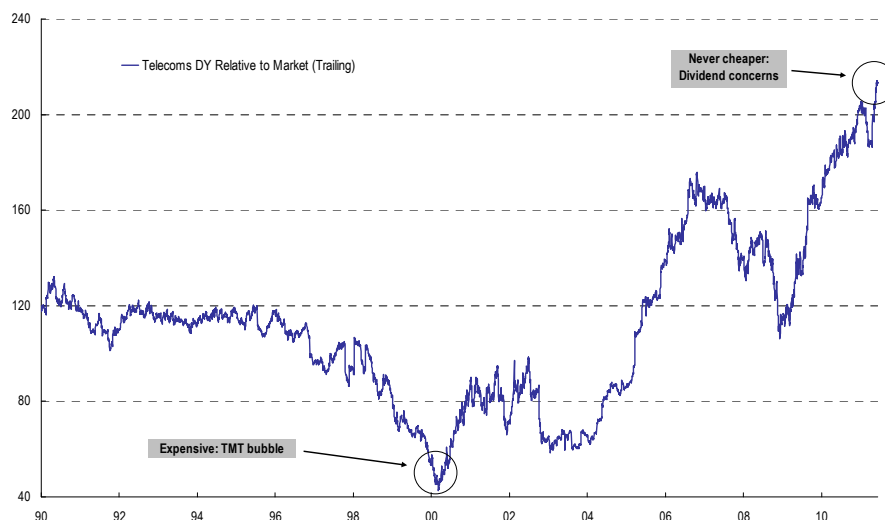
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Figure 1. European Telecoms DY Relative to European Market — Record Highs



Source: DataStream

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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## Contents

UK/ Pan-European — Phones 4 Dividends	3
<b>Market Outlook &amp; Citi Research</b>	<b>13</b>
The Point — Top Calls	14
Report of the Week	16
International Corner	17
Market Outlook	19
<b>Valuation Tables</b>	<b>21</b>
Appendix A-1	32

## UK/ Pan-European — Phones 4 Dividends

Crossover again. European dividend yields are back above European bond yields, as we showed last week<sup>1</sup>. Previously, this has often been a support for share prices. Equity is also closing in on multi-decade record cheaps relative to investment-grade (IG) credit. This also suggests reasonable valuation support for equities, providing fresh recession and earnings collapse are not around the corner. Not our central scenario. Additionally, dividend yields above corporate bond yields suggest greater value in equity relative to IG credit in a growing number of stocks. Our credit strategy team, Matt King and Hans Lorenzen, agree<sup>2</sup>.

### Telecoms on all-time high DY

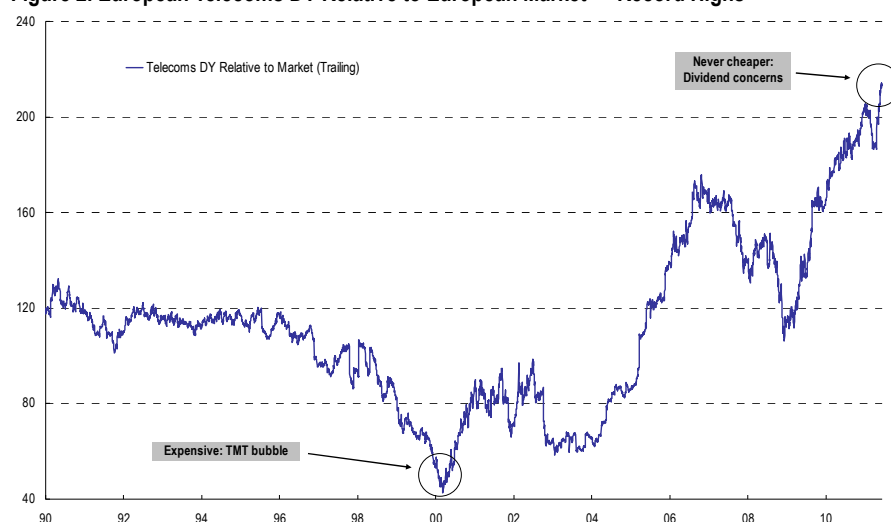
In this week's note, we continue the dividend theme. In particular we dig down to the sector level in Europe and focus on Telecoms. Telecom companies feature heavily on screens showing stocks' dividend yields above corporate bond yields. The sector also currently trades at an all-time high dividend yield relative to the market. On a dividend basis, Telecoms have never been cheaper. Should investors buy a cheap sector or remain concerned about operational weakness and potential dividend cuts?

Ongoing operational concerns and a modest growth outlook continue to present downside risks for European Telecoms. However, we conclude that there is decent valuation support for the sector. This should limit downside risk. Telecoms also enjoy strong seasonality. The sector tends to underperform in 1H and outperform in 2H. We would buy into weakness, but do not expect near-term outperformance.

## Never cheaper

It has been quite a decade for European Telecom companies and anyone associated with them. Figure 2 shows the (trailing) dividend yield of European Telecoms relative to the market since 1990.

**Figure 2. European Telecoms DY Relative to European Market — Record Highs**



Source: DataStream

Telecoms traded on a 60% discount to the market, at record expensive levels, in 2000. Now, it trades close to a 120% premium to the market. Record cheap.

<sup>1</sup> European Portfolio Strategist — Equities in the Asset Mirror — 2 June 2011.

<sup>2</sup> Crossover vs EuroStoxx – Which is more fun? — Hans Lorenzen, 1 June 2011.

Few sectors have ever traded on more than a 100% DY premium to the market in the past 40 years — Oil & Gas (1985), Basic Resources (1998 & 2000), Real Estate (1998 & 2000) and Banks (2008-2009). See Figure 3.

**Figure 3. European Sectors Breaching a DY Relative of 200 (ie Twice Market DY), Total Rtn (%)**

Sector	DYR >200 Breach	+3m Abs	+12m Abs	+3m Rel	+12m Rel
Oil & Gas	29/11/1985	-6	16	-12	-3
Basic Resources	27/08/1998	1	58	-3	31
Basic Resources	29/02/2000	-3	18	0	34
Banks	13/11/2008	-22	44	-18	14
Real Estate	29/07/1998	-10	12	9	10
Real Estate	29/05/2000	12	14	6	22
<b>Average</b>		<b>-5</b>	<b>27</b>	<b>-3</b>	<b>18</b>

Source: DataStream, Citi Investment Research and Analysis

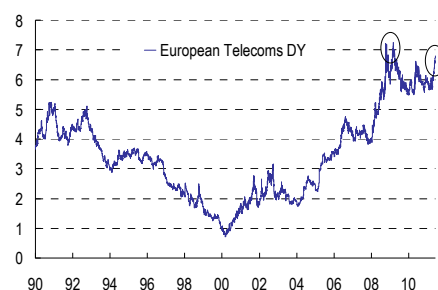
This would have been a bad 3-month, but good 12-month, buy signal for all of these sectors. On average, an investor who bought each sector as the DY relative moved above 200 would have seen a 12-month total return of +27% (+18% relative). This does not suggest that investors should dive headlong into Telecoms, but we think they should think about warming to the sector over the coming months.

## Magic 7

### Too good to be true?

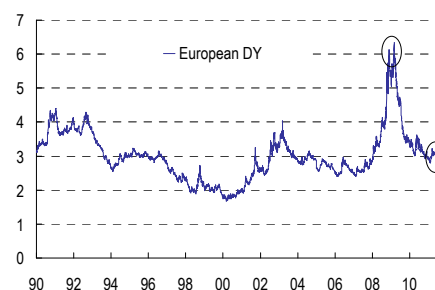
Figure 4 and Figure 5 show the historical DY for Telecoms and the European equity market. The sector's DY was below 1% in 2000. In the 2008-09 financial crisis, the DY breached 7% and it is once again close to that level now. By comparison, the market's dividend was close to twice that of the Telecom sector in 2000, peaked above 6% in the 2008-09 financial crisis and is now just above 3%. On a dividend basis, European equities have been sharply re-rated since the lows of 2009. Telecoms have not.

**Figure 4. European Telecoms Historical DY**



Source: DataStream

**Figure 5. European Market Historical DY**



Source: DataStream

There are few occasions over the past 30 years when a European sector has yielded more than 7% (on a trailing basis) — 11 in all. Figure 6 shows the sector performance in the 3 and 12 months following breach.

**Figure. 6 Sector Performance Post DY Rising Above 7%**

Sector	Date	Absolute		Relative	
		3m	12m	3m	12m
Oil & Gas	20/05/81	-1	-4	-4	-6
Oil & Gas	23/09/85	-2	20	-12	-8
Con & Mat	02/03/09	46	66	11	6
Food & Bev	28/09/81	17	51	3	15
Media	30/03/09	11	57	-9	-1
Telecom	10/10/08	17	26	15	1
Telecom	25/02/09	3	26	-15	-14
Banks	01/07/08	-3	-30	8	-9
Insurance	10/10/08	4	27	2	3
Real Estate	24/07/92	-1	45	-1	18
Real Estate	20/11/08	-8	43	-4	5
Average		8	30	-1	1
Average ex Construction		4	26	-2	0

Source: DataStream, Citi Investment Research and Analysis

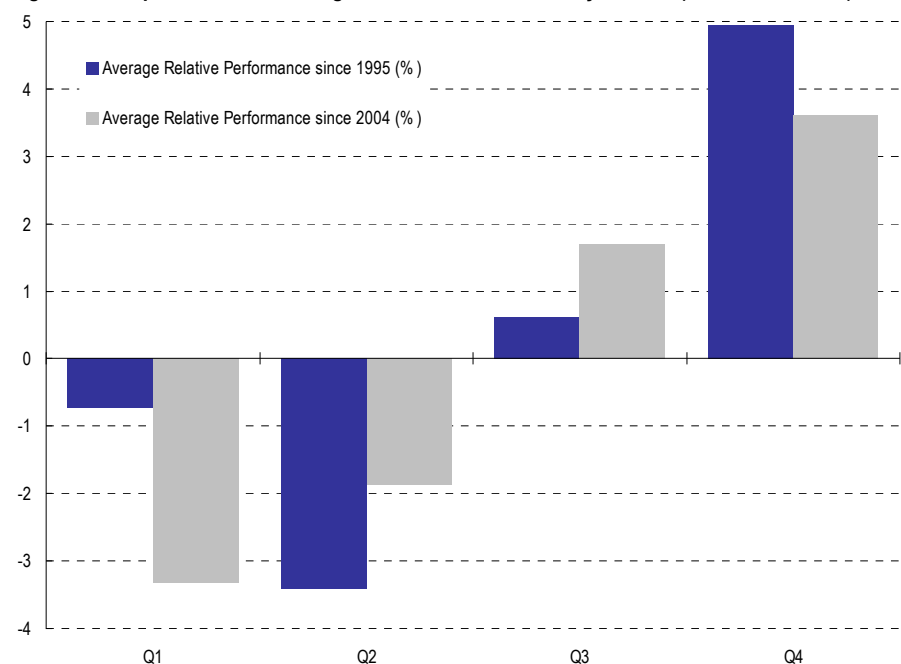
DY > 7% = positive performance

On average, it has paid investors to buy sectors breaching the 7% DY level on both a 3- and 12-month horizon. Average total returns have been 8% and 30%, respectively.

## Seasonality

History supports investors who buy sectors trading on a dividend yield relative above 200 or sectors with a dividend yield above 7%. Telecoms is there on the relative and close on the absolute. This could offer support into 2011.

**Figure 7. European Telecom Average Relative Performance, By Quarter (1995 & 2004-Now)**



Source: DataStream

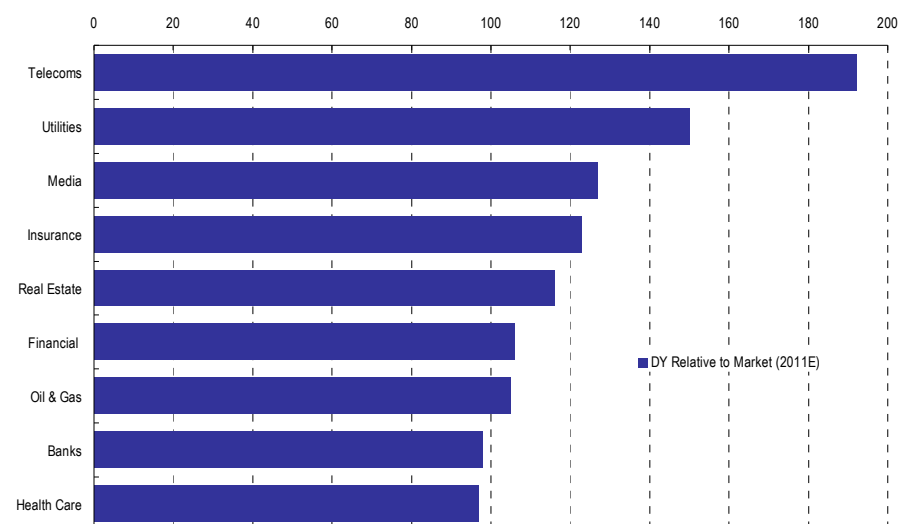
Telecoms has also enjoyed (or endured) a strong seasonal pattern of relative performance over the past 15-20 years. Poor 1H followed by strong 2H has been the general rule, with average 4Q performance being especially strong. This seasonal pattern is still there for 2004-now, ie excluding the TMT years. This suggests that it is still a little too early for investors to get excited about Telecoms but that they should start thinking about warming up to the sector.

No single theory explains perfectly why this seasonality is attached to Telecoms. Our analysts suspect that it has something to do with management tending to guide cautiously at results for the fourth or first quarters. The 2Q or 3Q results have also tended to show better trends.

## Telecoms vs. the rest

How does Telecoms compare to other sectors. Should income investors be falling over themselves to get exposure to European Telecom companies?

**Figure 8. European Sectors 2011E DY Relative to European Market**



Source: Citi Investment Research and Analysis and DataStream

### 6 sectors on yield premium

Figure 8 shows the highest-yielding sectors in Europe, based on 2011E dividend yields relative to the market. Telecoms is on a DYR of 190 (using 2011E forecasts). Only six other sectors offer investors a dividend yield above the market. Choice is limited. Banks and Health Care offer close to market yields. Telecoms trades on a big 2011E yield premium to the second- and third-highest yielding sectors — Utilities (150%) and Media (127%).

Telecoms is not only a high yielder, it is also a big yielder. In 2010, the sector is expected to have paid over €21bn in dividends. This puts it second to the Bank sector (€24bn in 2010), in terms of total dividend pay-out. Telecoms accounts for over 11% of Europe's dividend base, ahead of Oil & Gas and Healthcare on 9-10% and behind Banks on 13%, all based on 2010-11E CIRA dividend estimates.

But, is big beautiful? High yields can often highlight the market's concern over sustainability of dividends. In Figure 9, we have built a Sector Dividend Attribution Model (SDAM) to assess European sectors on a variety of factors, rather than just dividend yields. We include dividend cover, dividend growth (2 year), FCF yield less dividend yield (ie a measure of post-dividend cashflow) and dividend revisions, and also compare current DYs to average levels over the past five years.

Figure 9. Sector Dividend Attribution Model

	DY	DY vs Avg	Cover	11E 2Yr Ann Growth	FCF-DY	Revisions	Final
Factor Weight	20%	15%	20%	20%	15%	10%	Rank
Automobiles & Parts	12	5	2	1	1	1	4.00
Insurance	4	9	8	3	8	6	6.15
Telecommunications	1	1	18	8	10	11	8.15
Industrial Goods & Services	16	10	7	4	7	3	8.25
Banks	8	19	4	2	8	19	8.75
Basic Resources	18	18	1	6	2	10	9.00
Chemicals	17	13	5	9	6	2	9.25
Personal & Household Goods	15	11	11	7	5	4	9.40
Financial Services	6	8	15	10	8	8	9.40
Media	3	6	16	13	4	16	9.50
Health Care	9	3	9	16	3	18	9.50
Travel & Leisure	13	14	10	5	9	12	10.25
Oil & Gas	7	17	6	12	14	7	10.35
Retail	10	4	12	14	12	14	11.00
Construction & Materials	11	12	13	11	13	9	11.65
Utilities	2	2	17	19	15	15	11.65
Real Estate	5	16	19	18	8	5	12.50
Food & Beverage	14	7	14	15	8	17	12.55
Technology	19	15	3	17	11	13	13.00

Source: Datastream, CIRA estimates

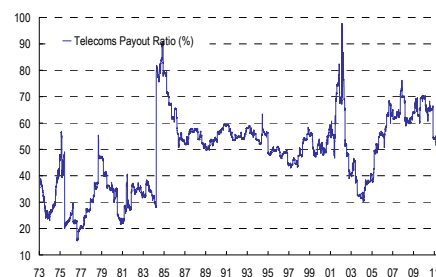
#### SDAM buys Autos, Insurance + Telcos

Our SDAM's top picks, based on these criteria, would be Autos, Insurance and Telecoms. Industrials and Banks also score highly. Telecoms scores well on DY metrics, poorly on dividend cover (only Real Estate is lower, which is not exactly comparable anyway) and average compared with other sectors on growth, revisions and FCFY less DY. At the other end of SDAM, Technology, Food & Beverage and Utilities are among the bottom five sectors. Utilities, like Telecoms, scores well on DY metrics, but then scores poorly on all other metrics.

## 7% = risk?

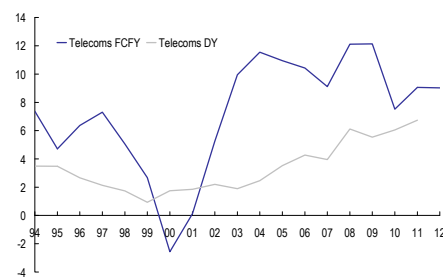
The obvious come-back to the attractive dividend yields arguments is that they will prove to be illusory. High yields may mean the dividend will be cut. As we have looked at above, previous sector moves above a 7% yield have tended to see strong absolute performance (and in line relative performance), so subsequent changes to dividends (if any) have not mattered. However, even if it hasn't mattered what do the key financial metrics for sustainability of dividends look like? Are cuts around the corner?

Figure 10. Telcos Payout Ratio, 1973-2011E



Source: Datastream

Figure 11. Telcos FCFY and DY, 1994-2012E



Source: Datastream, CIRA estimates (2011-12)

### Reasonable cash cover

The payout ratio using earnings (Figure 10) is in the 50% to 60% corridor that was the norm between 1987 and 2000. This suggests there is headroom. Figure 11 looks at the FCF yield and DY yield. The gap between the two lines is the cash cover. While this is falling, there is still room for slippage on profits and dividends in aggregate are still covered.

**Figure 12. Telco Sector Dividend Payers, 2010-12E (Euros millions)**

Stock	Dividend 2010 (€m)	Divi 2010 % of Total	Divi 2011E (€m)	Divi 2011E % of Total	Divi 2012E (€m)	Divi 2012E % of Total	Divi Cover 2011E
Telefonica	5,572	25.7	6,368	27.3	6,965	27.1	1.1
Vodafone Group	5,298	24.4	5,521	23.6	6,576	25.6	1.8
France Telecom	2,672	12.3	2,672	11.4	2,672	10.4	1.2
Deutsche Telekom	2,085	9.6	2,085	8.9	2,234	8.7	1.3
KPN	1,223	5.6	1,299	5.6	1,375	5.3	1.5
BT Group	692	3.2	939	4.0	1,267	4.9	2.2
Telecom Italia	602	2.8	692	3.0	796	3.1	1.9
TeliaSonera	612	2.8	652	2.8	665	2.6	1.6
Portugal Telecom R	442	2.0	442	1.9	460	1.8	1.1
Swisscom R	340	1.6	428	1.8	472	1.8	1.5
Telenor	362	1.7	389	1.7	448	1.7	1.8
Belgacom	343	1.6	343	1.5	346	1.3	1.1
Tele2 B	192	0.9	329	1.4	352	1.4	1.1
Telekom Austria	238	1.1	238	1.0	112	0.4	0.1
TDC*	0	0.9	195	0.9	206	0.8	0.9
Elisa	251	1.2	174	0.7	188	0.7	0.9
Cable & Wireless Comms.	168	0.8	150	0.6	145	0.6	0.6
Cable & Wireless WWd.	129	0.6	137	0.6	135	0.5	1.3
Inmarsat	127	0.6	129	0.6	139	0.5	2.0
Mobistar	122	0.6	114	0.5	110	0.4	0.9
Hellenic Telecom	29	0.1	42	0.2	46	0.2	3.2
<b>Sector Total</b>	<b>21694</b>	<b>100.0</b>	<b>23349</b>	<b>100.0</b>	<b>25712</b>	<b>100.0</b>	<b>1.4</b>

\*Estimates are consensus estimates from Datastream Source: Datastream, CIRA estimates

Figure 12 looks at the contributors to the sector dividend. Telefonica and Vodafone dominate, each paying around a quarter of the sector's total dividend base. After that FT and DT combined contribute close to another quarter. Of the big 4, our sector analysts are confident about the dividend from all bar Telefonica, where they see downside risk. Telefonica's 2011E dividend is currently only just covered by 2011E earnings, which suggests that the company may have to rely on asset sales or increased leverage to maintain pay-outs. However, our analysts also see upside risk to the Vodafone dividend, as well as some upside risk at BT and Deutsche Telekom, so the risks to the dividend base look more balanced.

Overall, sector dividend cover looks supportive to dividends. The next question is therefore are companies changing their use of cash or are earnings disappointing?

## Running to stand still

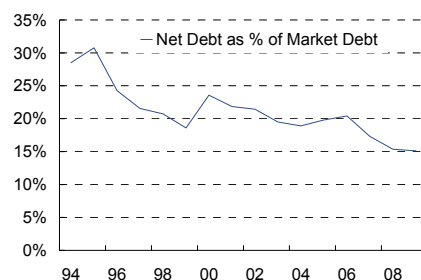
So what are the main drivers for the Telecoms sector from a strategy perspective? Are they positive or negative? Compared to history we look at three metrics:

- Balance sheet
- Earnings performance
- 'De-megatisation'



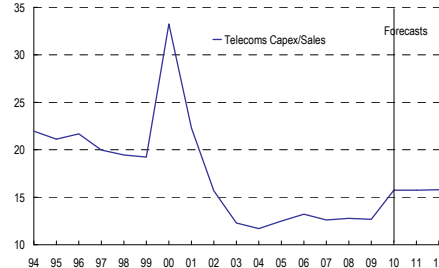
The TMT bust revealed the Telcos sector to be overlevered as a capex and M&A binge played out against collapsing revenues and profits. Looking at Telcos debt as a proportion of the market (Figure 13), we can see that the relative strength of the balance sheets has been improving since then. Today the Telcos sector enjoys a much more robust financial position. This reflects improving capital discipline, as can be seen in the capex to sales ratios (Figure 14).

Figure 13. Telcos Net Debt/ Market Debt, 1994-11



Source: DataStream, CIRA

Figure 14. Capex/Sales, 1994-12E

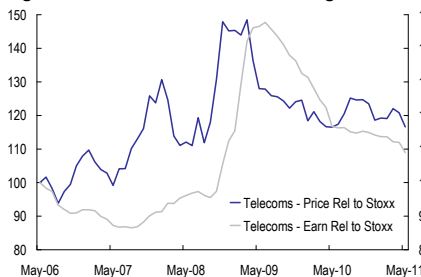


Source: DataStream, CIRA estimates

#### Improved capital discipline

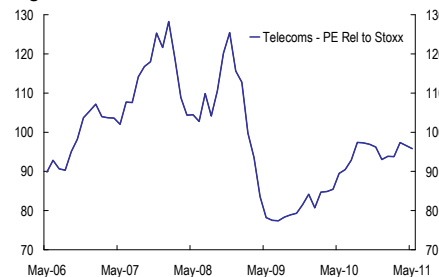
The reduction in capex/sales is forecast to peter out over the next couple of years, but with capex/sales remaining well below levels seen in the mid to late 1990s. This is a positive. However, the sector earnings performance relative to the market continues to be disappointing. Operational performance is weak.

Figure 15. Telcos Price and Earnings Rel



Source: DataStream, CIRA

Figure 16. Telcos Rel PE



Source: DataStream, CIRA

Overall we continue to believe the world economy and the equity market to be in a mid-cycle period. Historically, mid-cycle tends to lend itself to outperformance from earnings momentum strategies. Telcos scores as one of the weakest European sectors on earnings mo trends (Figure 15). The weaker trends are in part reflected in a discount PE rating to the market.

So one positive, one negative. The final factor: size. Telcos have been at the vanguard of getting bigger over the 1990s and most of the 2000s. "Leveraging the widening geographic footprint" scores well on management-speak bingo. Telcos has been a high scorer in this game. Mega-caps have lagged for a decade.

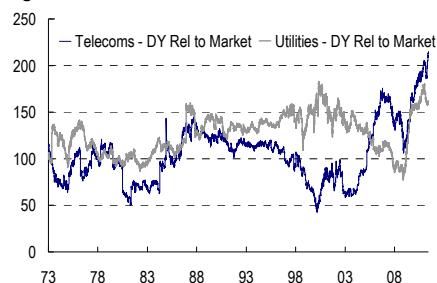
#### Seeds of change

However, 2010 and 2011 has started to see some change. Vodafone has sold off some minority stakes and DT is in the process of selling its US business. Both are getting smaller and have returned, or plan to return, money to shareholders. In a world where there is little demand for mega cap equity, this provides an incremental buyer. With both Vodafone and DT having outperformed the sector post these changes, it could encourage other companies to do the same, in our view. This is a potential benefit for the sector overall.

## Telcos vs. Utilities

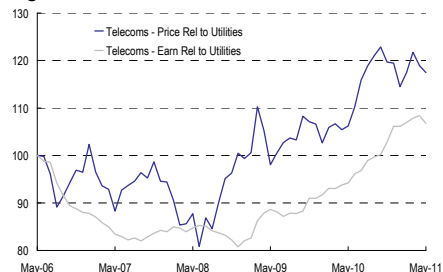
Before the TMT boom Telcos were the dull end of utilities. More excitement was in water and electricity stocks. The boom years saw the growth 'fairy dust' sprinkled on Telcos and valuations responded. We are now back in the pre TMT world where Telcos are again utilities rather than growth stocks. The question that follows is how do the two compare?

Figure 17. Telcos vs. Utilities DY Rel



Source: DataStream

Figure 18. P and E Rel Telcos vs Utilities



Source: DataStream, CIRA

As we started off with in this note, the dividend yield of Telcos is at all-time highs relative to the market at c7%. Utilities' yield attractions lag behind (Figure 17). However, this more attractive valuation does not reflect weaker earnings trends. Figure 18 illustrates that for the last two years the earnings trends for the Telcos sector have been much better than those for Utilities. After an initial re-rating in 2008 Telcos has merely tracked its earnings outperformance of the Utilities sector.

While, as we detailed above, the earnings trends of Telcos are weak relative to the market they are better than those of Utilities. Furthermore, while balance sheets are strong and our sector analysts are confident that dividend forecasts are reasonable the same cannot be said for our Utilities analysts. Here balance sheets remain under pressure and the cost of investment, the trillion dollar decade<sup>3</sup>, presents a material headwind. Dividends could be at risk for some to fund these huge capex programmes.

## Strategy outlook

European Telecoms have joined a rare club — sector dividend yield 2x the overall market. Few sectors have been here before in the past 30 years. History suggests decent absolute and relative 12-month gains for investors buying sectors at such points. Telecoms is also close to a 7% dividend yield.

Seasonality joins valuation as a key cheerleader for European Telecoms. It has paid investors to be underweight the sector during 1H and overweight during 2H since 1995. The seasonality effect is strong. This suggests that investors should start thinking more about one of 2010's and 2011's laggards as we head into 2H11.

So far, so good. Operational trends, however, remain soft. The growth outlook remains generally weak and is unlikely to improve materially in the next 6-12 months, in our view. Our base case of no double-dip from the global economy, no fresh recession and no earnings collapse suggests that Telecoms will struggle to enjoy strong relative performance over the coming 6-12 months.

<sup>3</sup> The Trillion Dollar Decade – Peter Atherton et al – October 2009

Overall, we think that valuation and seasonality should limit absolute and relative downside risks for the sector. We would buy into weakness, but do not expect near-term outperformance versus the market. Our analysts' preferred stocks are Vodafone, Deutsche Telekom and Virgin Media. Please contact/speak to Simon Weeden and team for more in-depth views on the European Telecom sector.

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## Market Outlook & Citi Research

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## The Point — Top Calls

### Europe ex-UK

#### **Coca-Cola Hellenic Bottling Co. SA (HLBr.AT) — Lost its Valuation Premium But Not its Fizz - Upgraded to Buy**

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GREECE | BEVERAGES | BUY/MEDIUM RISK

CCH is the world's largest Coca Cola bottler, with significant exposure in growing emerging markets like Russia and Nigeria and developing markets like Poland. It has performed poorly recently, but we expect further dividend/capital returns given its comfortable balance sheet. CCH should achieve operational and restructuring benefits when consumption and volumes recover. We believe the shares could re-rate to a 15x multiple, the basis of our new €22 price target (from €19.50). We upgrade our rating to Buy (1M).

#### **Endesa SA (ELE.MC) — Hidden Value in Spain, Re-gearing Option Still Not Factored In**

Antonella Bianchessi +39-02-8906-8715

SPAIN | UTILITIES | BUY/MEDIUM RISK

Endesa, deep value and optionality. Buy, target price €27. Despite remaining cautious on the Spanish regulatory and market outlook, we believe that Endesa represent a low risk entry point in the Spanish market. On our estimates, the stock trades at ~25% discount to sector EV/EBITDA (average 2011-2013) and at a 5% discount on sector P/E which we believe is unjustified considering the low gearing of the group and the double than average EPS growth rate (2011-2015e adjusted EPS growth at 6.6% for Endesa, 3-4% for the sector). With this report we transfer coverage to Antonella Bianchessi and update our rating, target price and estimates.

#### **ENEL SpA (ENEL.MI) — Fully Valued; Regulatory Review & Cost of Debt Raise Concerns**

Antonella Bianchessi +39-02-8906-8715

ITALY | UTILITIES | HOLD/MEDIUM RISK

Assuming coverage of ENEL with a Hold (2M) recommendation and €4.50 TP. Our sum-of-the-parts based valuation suggests the stock is now fully valued following 25% sector outperformance YTD. We see downside risk to consensus EPS forecasts from 2012, which would suggest little or no EPS growth through 2013. With this report we transfer coverage to Antonella Bianchessi and update our rating, target price and estimates.

#### **Commerzbank (CBKG.DE) — Looking Ahead – Upgrade to Hold**

Andrew Coombs +44-20-7986-4053

GERMANY | BANKS | HOLD/HIGH RISK

The recent capital increase has helped to repair the balance sheet and enabled the company to take a major step forward in establishing a long-term business model, no longer reliant upon state aid. We conclude that the outstanding risks are manageable and following recent share price declines, now adequately reflected in current valuation multiples. Correspondingly we upgrade to Hold/High Risk from Sell/Speculative, new target price €3.30 (from €4.49).

## UK

### IMI PLC (IMI.L) — Moving to the Top of the Class

Mark Fielding +44-20-7986-4018

UNITED KINGDOM | ENGINEERING | BUY/HIGH RISK

IMI is our top pick in the UK Engineers. We see it as an attractive multi-year investment driven by accelerated growth and margin expansion. We expect margin targets to be achieved by 2013E and see further upside potential. On our forecast of c20% margins in 2013E (and c18% this year, c19% in 2012E), an EV/sales of 1.5x11E falling to 1.3x13E appears very attractive. We are raising our Target Price to £13.50 based on an EV/sales of 1.9x12E in line with our c19% margin expectation in 2012E (previously we assumed 1.8x in line with our 18% margin forecast).

### UK Bookmakers — Turning more positive on retail

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UNITED KINGDOM | GAMING

The bookmakers have outperformed, driven by a stabilisation of retail revenues and continued strong online growth. Recent trading updates reinforce our view that the OTC retail declines seen over the last few years are cyclical, not structural, in nature. We upgrade EBIT estimates 3-8%, driven by taking a more positive view on retail and strong growth in online sportsbook. We move from SOTP to DCF valuation methodology to calculate our target prices, which better captures upside from online growth.

## Report of the Week

### European Airports and Airport Operators

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#### Increasing Sector Interest Expected from 2H11

- Passenger volume and revenue outlook relatively resilient — We continue to expect c.4.5% volume growth in 2011 (3% ex-disruptions in 2010) – with most growth expected at Fraport and TAV and least at London Stansted and Gemina. We think the main risk to volume is possible airline capacity cuts from 4Q11, given high oil prices. We expect retail concession revenue per pax to grow by 3-4% in 2011 and by 7% p.a. in 2012-13 as new retail space is rolled out. We have raised our earnings forecasts slightly for Fraport, SAVE and Zurich but have lowered them for Gemina and Vienna, which we see as being most at risk from MENA and Japan traffic declines.
- Regulatory clarity expected in 2H11 — In compliance with the EU Directive on Airport Charges, we expect announcements of medium-term tariff mechanisms. While there is risk of more stringent regulation, in practice we expect limited risk to earnings because the airports under our coverage are generally not earning excessive returns over their costs of capital. In our view, the biggest beneficiary is likely to be Gemina but a favourable outcome is already priced in after a c.50% share price increase YTD.
- Increasing airport trade sale activity could benefit listed airports' valuations — We believe most airport disposals are likely to be via trade sales because they are likely to offer higher multiples than IPOs would, as evidenced by the c.50% difference between trade sale multiples and listed airport multiples historically. We think proposed sales by Ferrovial of a 10% stake in BAA and by Hochtief of its airport stakes could have positive value implications for listed airport stocks, especially ADP and Fraport.
- Top picks of the airports: ADP, Fraport, TAV and Zurich — We like ADP and Zurich for sustainable free cash flow generation and Fraport and TAV for growth. Our target price for Fraport rises from €55 to €66 on improved cash flow forecasts. Despite a slightly higher target price, we downgrade Gemina from 1S to 2S on valuation. We cut our target price for Vienna Airport from €50 to €41 due to reduced expected cash flows.
- Ferrovial and Hochtief well placed to benefit from airport disposals and our target prices imply c.30-35% upside potential — We think Ferrovial and Hochtief could sell their airport stakes at higher multiples than their own, while ADP and Fraport may be most at risk of paying for airport stakes at higher multiples than their own.



## International Corner

*Each week we use this section to highlight the key news, views, analysis and recommendations from our colleagues around the world.*

Tobias Levkovich  
US Equity Strategist

### Jumpy in June

The Street has become spooked given five consecutive weeks of tough markets amidst a series of data points that have to be considered less than positive. Global purchasing manager indices have slipped similar to last spring and Citi's economic surprise index has dropped sharply. But, these two factors imply that investors may have become too positively inclined in term of expectations even as seasonal factors suggested that sluggishness was likely. For example, weekly leading indicators often soften up heading into the summer and so do industrial commodity prices. Add in likely supply disruptions from the Japanese earthquake and one can see a pattern that may be excessively misinterpreted as something more sinister.

Nonetheless, it is perfectly legitimate to wonder if sentiment has become drastically fearful or some reality has set in versus more bullish previous projections. Back in April, our quarterly institutional client survey showed cash holdings as a percent of assets under management dropping back to slightly above the 6% level registered the prior April, implying that investor complacency had returned. Indeed, investor comfort could be found in our Panic/Euphoria Model as well and despite some financial media headlines that have been somewhat sensationalist, no "panic" readings are yet evident. Qualitatively, too many people see the current pullback as another buying opportunity, which is different than the views expressed during last year's double-dip fright or the latter 2009 market rally when few believed recovery from the so-called Great Recession was even plausible. As such, we suspect that it may be too early to step up aggressively to the market especially in the face of uncertainties around QE2 ending and a potentially nasty fight in Washington surrounding the debt ceiling at the same time that margins come under pressure and analysts are forced to scale back some 2H11 and 2012 estimates. Note that EPS estimate revisions have been climbing despite the economic data

Investors arguably could be encouraged by micro analysis as company management teams have indicated a better environment. Planned capital spending is on the rise as a study looking at more than 700 US publicly traded non-financial companies covered by Citi's equity research analysts shows that capex should climb better than 11% in 2011, almost twice the growth rate of the prior year. Moreover, CEO confidence has rebounded, but that has not necessarily been a good 12-month lead indicator for stock prices. Indeed, when CEO confidence is most upbeat, investors should be sellers and when management is depressed, investors should be stepping up for the most part.

The investment community recently has used currencies as a risk measure as well; essentially stocks go up when the dollar weakens and they go down when it strengthens although a longer history provides far less clarity on such inverse relationships. In the past, we have looked at the US dollar relative to the Swiss Franc, highlighting the notion that the "Swissie" arguably is the ultimate safe haven currency and there had been a relationship with equity price direction historically, but even that can break down badly as was the case in 1986-87 and 2008-09.

Money flows can be a useful coincident gauge also with the notion of people putting their money where their mouths are as being more meaningful than just asking for an opinion about their level of bullishness or bearishness. Individual investors have not been that bullish irrespective of pure survey data and we have witnessed only brief periods of money moving into domestic-oriented equity mutual funds. Intriguingly, US-focused inflows only occurred during both the March/April time

frames this year and last year and both seemed to coincide with markets topping out. Yet, for the big rallies off of the March 2009 low and even the July/August 2010 bottom, the individual investor was nowhere to be found. And, while one can look to other sentiment metrics such as the State Street Investor Confidence Index, it has not been a dependable indicator of forward S&P 500 trends, such that it cannot provide much of a signal to investors as to future market direction.

In essence, the Panic/Euphoria Model was designed expressly for the purpose of defining moments where markets should be bought and/or sold given probability confidence intervals. When panic has registered, there has been an almost 90% chance that stocks would be higher six months later and a 97% likelihood that they would be up 12 months in the future (versus a random outcome of approximately 70%) using roughly 20 years of back testing its various components. When in euphoria, there is a strong case to be made that share prices have substantial downside risk and this was seen again in 2008 and 2009 after the model generated worrisome signs in 2007 and again in 2008. Given current neutral readings, we do not perceive an allegedly “freaked out” investment community that some pundits talk about anecdotally. Institutional investors certainly are worried and struggling but not panicked, in our opinion. It is very difficult to suggest that everyone is deeply concerned if there are so many calls to buy the dips. Even, the terminology of “soft patch” alone is far different than the words “double dip” engendered a year ago. A soft patch suggests a fleeting development while double dip meant something more pernicious. Too many investors are arguing cheap valuations and a need for pension funds to swap out of bonds and into stocks as a reason for market support, not to mention M&A potential given cheap funding costs and the poor returns available on cash sitting in the bank or a money market account. That kind of talk just does not signal that there is genuine fear in investor-land. In contrast, it argues that investors are looking for excuses to get long stocks and not to run away from equities.

Accordingly, we prefer building more robust measurement instruments than simply relying on easy and most commonly used sentiment trackers such as the VIX Volatility index and put/call ratios in that both of these provide very little investable “edge” and they also can sometimes give conflicting signals. For instance, the VIX is very modestly above its long time average while short interest is below its average. In fact, we are more interested in the premiums investors are paying for a put versus a call, since that is more indicative of an underlying willingness to possibly pay up for the comprehensive particular views of many investors. Thus, Panic/Euphoria picks up many factors and does not become a slave to one indicator that could become less relevant as it potentially loses its historical correlation.

As a final note, retail money market fund assets as a percent of the equity market is down to levels last seen at market peaks, not at market bottoms, which suggests that investors keep talking about the cash on the sidelines without thinking things through. Admittedly, household deposits (which comprise far more than just money market funds) still are a large component of the NYSE market cap but even they are not where they were earlier on, thus we consider this “dry powder” argument to be somewhat suspect. Overall, we do not believe that sentiment is that dire and therefore it is not yet sending us that coveted buy signal that we have seen in the past.

***Please contact us if you would like more on the above article. You can also access all Citi Investment Research and Analysis from around the world through our Global Equities Online internet site. Please contact us for further details.***

## Market Outlook

Winners and losers. Mind the gap. Emerging markets = long growth/short debt. Good. Advanced countries = short growth/long debt. Not good. Uneven global recovery looks set to continue in 2011. Policy becoming less accommodative, especially in Europe, although real rates remain negative across much of the world. Cheap money. European companies look in good shape. Strong balance sheets. Record margins. Not record valuations. Decent growth. We stay bullish on equities. We expect 15-20% returns in 2011. Sell-side consensus = bullish. But, no one buying. We say, take growth over value, emerging over domestic.

### Macro – sustained but uneven

Our economists back 6%+ global nominal GDP growth in 2011. Multi-speed economic recovery. Emerging markets look strong. Sub-par in industrial countries, but firming in the US and diverging in Europe. The Fed is likely to keep policy rates on hold in 2011, but the ECB recently hiked with the UK a possibility soon. EM rates are heading higher. Money looks set to stay cheap. Little debt and low deficit for haves — EM and selective industrial countries. Too much debt and high deficits for have-nots — pain.

### Profits – slowing not collapsing

Balance sheets strong. Margins back to peak levels. Operational leverage to fade from high levels. We expect 10-20% earnings growth in 2011. Net upgrades.

### Valuation – not expensive

European equities look good value in absolute terms, unless earnings collapse. Relative valuations look more supportive. But, still few buyers. Where are you?

### Themes – growth, quality, reflation, size, country

Emerging markets (EM) & earnings momentum (EM) is our EM<sup>2</sup> strategy. Back growth, quality, reflation (de-equitisation), size & country as key 2011 themes.

### Sectors — emerging over domestic

Back growth over value, earnings mo & strong over weak balance sheets. Overweight Industrials, Basic Resources, Food & Bev. Underweight Utilities, Retail, Health Care.

### Risks — sovereigns, over-heating, policy, re-rating

Debt poses biggest risk. Europe in driving seat (sovereign risk). Emerging market over-heating, policy error and equity re-rating are other risks.

GDP	2010	2011E	2012E
Euro zone	1.6	2.1	1.6
UK	1.3	1.8	2.6
Global	4.1	3.5	3.9
US	2.9	2.7	3.1
Japan	4.0	-0.6	3.2
CPI	2010	2011E	2012E
Euro zone	1.6	2.7	2.2
UK	3.3	4.6	3.4
Global	2.7	3.9	3.3
US	1.6	2.9	1.7
Japan	-0.7	0.5	0.5
Interest Rates	Now	2Q11E	2Q12E
ECB	1.25	1.25	2.25
UK Base	0.50	0.50	1.50
US Fed Funds	0.25	0.25	0.75
Japan Call	0.10	0.10	0.10
10Yr Yield	Now	2Q11E	2Q12E
Euro zone	3.03	3.30	3.80
UK	3.15	3.60	4.35
US	2.97	3.30	3.85
Japan	1.14	1.25	1.80
Ex Rates	Now	2Q11E	2Q12E
US\$/€	1.45	1.38	1.49
US\$/£	1.64	1.61	1.73
€/£	1.13	1.16	1.16
Y/US\$	80	81	85
End Year Targets	Now	End-11E	% Rtn
DJ Stoxx	272	315	15.8
FTSE 100	5855	6750	15.3

Source: Reuters and CIRA forecasts

Figure 19. European Sector Strategy (Latest Changes Marked with Arrows)

Overweight	Neutral	Underweight
Basic Resources	Autos	Construction
Banks	Financial Services	Health Care
Chemicals	Oil & Gas	Insurance
Food & Bev	Telecoms	Media
Industrial G&S	Travel & Leisure	Real Estate
Personal & Household Goods		Retail
Technology		Utilities

Source: Citi Investment Research and Analysis

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## Valuation Tables

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Figure 20. Pan-European Sector Weightings & Returns

As at Close 07 Jun 11 Sector (No of Stocks)	Mkt Cap (Euros m)	% of Stoxx	Return Relative to Stoxx				Absolute Return			
			1m	3m	12m	Ytd	1m	3m	12m	Ytd
Oil & Gas (33)	491,392	9.1	-1	-8	-3	-2	-4	-9	12	-2
Chemicals (23)	257,099	4.7	0	7	19	5	-3	5	37	5
Basic Resources (31)	294,964	5.4	-1	-6	5	-12	-4	-8	21	-12
Construction & Materials (24)	142,096	2.6	-2	0	0	0	-5	-1	15	1
Industrial G&S (97)	553,084	10.2	1	3	10	1	-2	1	27	2
Automobiles & Parts (14)	133,783	2.5	-2	5	25	0	-5	4	44	1
Food & Beverage (27)	413,994	7.6	3	9	-2	1	1	7	13	2
Personal & H'hold Goods (29)	286,397	5.3	1	5	3	0	-1	4	19	1
Health Care (34)	538,234	9.9	4	9	-1	7	1	7	14	7
Retail (24)	179,174	3.3	2	6	-9	0	-1	5	5	0
Media (30)	122,827	2.3	1	-3	-2	-2	-2	-4	13	-1
Travel & Leisure (21)	64,553	1.2	0	0	-7	-7	-3	-1	8	-6
Telecommunications (21)	319,087	5.9	0	-3	-1	-1	-2	-4	14	0
Utilities (32)	287,437	5.3	-1	-1	-7	0	-4	-2	7	0
Banks (51)	731,207	13.5	-2	-7	-10	-3	-5	-8	4	-2
Insurance (32)	294,098	5.4	-3	-3	5	7	-5	-5	21	7
Real Estate (21)	67,081	1.2	4	6	17	8	1	4	34	9
Financial Services (30)	81,588	1.5	0	-1	6	0	-3	-2	22	0
Technology (26)	171,503	3.2	-3	-4	-2	1	-6	-5	13	2
Stoxx - Pan Europe (600)	5,429,597	100.0	—	—	—	—	-3	-2	15	1
Pan Euro - Large Cap	4,394,404	80.9	0	0	-1	0	-3	-2	14	1
Pan Euro - Mid Cap	714,862	13.2	1	0	4	-1	-2	-2	20	0
Pan Euro - Small Cap	320,331	5.9	1	1	8	1	-1	0	24	1
Stoxx ex UK (430)	3,703,193	68.2	—	—	—	—	-3	-1	18	2
EuroStoxx - Eurozone (313)	2,574,270	47.4	—	—	—	—	-4	-2	16	2

Source: Citi Investment Research and Analysis & DataStream

Figure 21. Pan-European Sector Relative Ratings

As at Close 07 Jun 11 Sector	P/E Relative to Stoxx				Yield Relative to Stoxx			
	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
Oil & Gas	82	83	82	87	138	101	105	100
Chemicals	133	115	111	114	68	72	74	72
Basic Resources	141	90	76	86	40	59	63	62
Construction & Materials	99	115	127	118	104	93	94	90
Industrial G&S	127	123	123	119	62	76	76	78
Automobiles & Parts	-	91	75	69	20	71	90	100
Food & Beverage	112	137	146	149	73	83	85	80
Personal & H'hold Goods	126	133	136	136	76	80	82	80
Health Care	76	103	103	112	102	104	97	92
Retail	94	114	125	126	94	97	95	92
Media	83	100	104	105	127	124	127	122
Travel & Leisure	176	134	121	111	83	85	89	93
Telecommunications	59	78	90	97	196	192	192	189
Utilities	58	87	108	113	194	167	150	138
Banks	120	90	81	71	92	95	98	111
Insurance	71	76	78	75	116	119	123	135
Real Estate	305	152	168	181	134	125	116	107
Financial Services	81	101	117	110	125	112	106	105
Technology	138	125	134	137	63	61	54	53
Stoxx - Pan Europe	100	100	100	100	100	100	100	100
Pan Euro - Large Cap	93	96	96	97	105	104	104	104
Pan Euro - Mid Cap	167	117	119	114	76	80	83	80
Pan Euro - Small Cap	107	130	139	122	86	87	85	83
Stoxx ex UK	100	101	103	101	100	103	102	102
EuroStoxx - Eurozone	95	95	97	95	111	111	109	108

Source: Citi Investment Research and Analysis & DataStream

Figure 22. Pan-European Sector Growth

Sector	Earnings Growth %			Net Dividend Growth %		
	2010E	2011E	2012E	2010E	2011E	2012E
Oil & Gas	38.5	14.1	5.2	-17.6	13.1	5.9
Chemicals	61.8	17.6	8.5	19.8	10.3	8.9
Basic Resources	120.4	34.3	-0.9	64.7	16.1	10.9
Construction & Materials	20.4	1.7	21.0	1.0	9.8	6.8
Industrial G&S	44.7	13.3	15.4	37.7	8.4	14.5
Automobiles & Parts	-	37.1	21.6	291.7	38.2	23.9
Food & Beverage	15.2	5.7	9.7	27.9	10.8	4.8
Personal & H'hold Goods	33.6	10.3	11.6	19.4	10.4	9.6
Health Care	3.5	11.9	3.7	15.1	1.7	6.4
Retail	16.4	3.1	11.0	16.4	6.3	7.6
Media	16.2	8.4	10.5	10.1	11.7	6.9
Travel & Leisure	84.7	25.1	21.5	16.4	13.4	16.3
Telecommunications	6.8	-2.4	3.2	10.6	8.6	10.2
Utilities	-6.1	-9.1	7.2	-2.9	-2.7	2.7
Banks	87.4	25.1	27.7	15.7	11.8	27.2
Insurance	31.7	10.3	15.5	15.3	12.1	22.5
Real Estate	181.6	1.9	4.3	5.1	0.2	3.5
Financial Services	12.2	-2.3	19.0	1.2	2.7	10.3
Technology	55.0	4.9	9.5	8.2	-3.8	9.2
Sbxx - Pan Europe	40.4	12.7	12.0	12.6	8.6	11.7
Pan Euro - Large Cap	36.6	13.3	10.6	11.8	8.3	12.3
Pan Euro - Mid Cap	99.3	11.3	17.2	18.8	11.7	8.6
Pan Euro - Small Cap	15.6	5.2	28.0	13.7	6.7	9.3
Sbxx ex UK	38.6	10.8	14.1	15.5	7.5	11.5
EuroSbxx - Eurozone	39.4	10.5	14.1	12.3	6.4	10.9

Source: Citi Investment Research and Analysis & DataStream

Figure 23. Pan-European Sector Ratings

Sector	Price/Earnings				Net Dividend Yield			
	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
Oil & Gas	14.2	10.2	9.0	8.5	4.30	3.54	4.01	4.24
Chemicals	23.1	14.3	12.1	11.2	2.12	2.54	2.80	3.05
Basic Resources	24.6	11.1	8.3	8.4	1.25	2.05	2.38	2.64
Construction & Materials	17.1	14.2	14.0	11.5	3.24	3.27	3.60	3.84
Industrial G&S	22.1	15.3	13.5	11.7	1.93	2.66	2.88	3.30
Automobiles & Parts	-	11.3	8.2	6.7	0.64	2.49	3.44	4.26
Food & Beverage	19.5	16.9	16.0	14.6	2.28	2.91	3.23	3.38
Personal & H'hold Goods	21.9	16.4	14.9	13.3	2.36	2.82	3.11	3.41
Health Care	13.1	12.7	11.3	10.9	3.16	3.64	3.70	3.93
Retail	16.4	14.1	13.7	12.3	2.93	3.41	3.62	3.90
Media	14.4	12.4	11.4	10.3	3.94	4.34	4.85	5.18
Travel & Leisure	30.6	16.6	13.3	10.9	2.57	2.99	3.39	3.95
Telecommunications	10.3	9.6	9.8	9.5	6.09	6.74	7.31	8.06
Utilities	10.1	10.8	11.8	11.0	6.04	5.86	5.70	5.85
Banks	20.8	11.1	8.9	7.0	2.87	3.33	3.72	4.73
Insurance	12.4	9.4	8.5	7.4	3.62	4.17	4.68	5.73
Real Estate	52.9	18.8	18.4	17.7	4.18	4.39	4.40	4.55
Financial Services	14.0	12.5	12.8	10.8	3.88	3.93	4.03	4.45
Technology	23.9	15.4	14.7	13.4	1.98	2.14	2.06	2.25
Sbxx - Pan Europe	17.4	12.4	11.0	9.8	3.11	3.51	3.81	4.25
Pan Euro - Large Cap	16.2	11.9	10.5	9.5	3.27	3.65	3.95	4.44
Pan Euro - Mid Cap	28.9	14.5	13.0	11.1	2.37	2.82	3.15	3.42
Pan Euro - Small Cap	18.6	16.1	15.3	11.9	2.68	3.04	3.25	3.55
Sbxx ex UK	17.4	12.5	11.3	9.9	3.13	3.61	3.88	4.33
EuroSbxx - Eurozone	16.4	11.8	10.7	9.3	3.47	3.89	4.14	4.60

Source: Citi Investment Research and Analysis & DataStream

Figure 24. Pan-European Country Weightings & Returns

	Mkt Cap (Euros m)	% of Stoxx	Relative Return to Stoxx*				Absolute Return*			
			1m	3m	12m	YTD	1m	3m	12m	YTD
Austria (10)	30,900	0.6	2	0	11	-4	-1	-2	28	-3
Belgium (16)	75,795	1.4	1	3	-6	3	-2	1	8	3
Denmark (17)	94,587	1.7	0	-3	-2	-2	-3	-4	13	-1
Finland (21)	89,865	1.7	-6	-2	-9	-11	-8	-4	5	-10
France (84)	840,120	15.5	0	2	3	4	-2	0	19	5
Germany (60)	703,722	13.0	-2	1	5	2	-5	-1	21	3
Greece (8)	17,209	0.3	-2	-20	-23	-11	-4	-21	-12	-10
Ireland (9)	29,534	0.5	-3	2	-23	3	-5	1	-11	4
Italy (33)	243,223	4.5	-1	-3	1	4	-4	-4	17	5
Netherlands (32)	237,685	4.4	-2	-4	-7	-2	-5	-5	7	-1
Norway (15)	78,728	1.4	4	-3	9	-2	1	-4	26	-2
Portugal (8)	22,609	0.4	3	2	1	4	0	1	16	5
Spain (32)	283,608	5.2	-1	0	4	5	-4	-2	20	6
Sweden (38)	258,233	4.8	0	5	12	1	-2	3	29	1
Switzerland (47)	697,376	12.8	3	6	2	2	0	4	17	3
UK (170)	1,726,404	31.8	0	-2	-4	-3	-2	-4	10	-3
Stoxx - Pan Europe	5,429,597	100								

Source: Citi Investment Research and Analysis & DataStream. \*Note: Country returns use MSCI indices.

Figure 25. Pan-European Country Relative Ratings

Country	Price/Earnings				Net Dividend Yield			
	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
Austria	-	114	109	101	81	80	84	79
Belgium	125	108	143	118	74	93	87	84
Denmark	185	160	146	133	26	32	48	52
Finland	97	106	134	122	148	143	117	110
France	97	97	97	96	115	111	109	107
Germany	114	96	98	95	86	94	92	92
Greece	30	85	103	69	163	91	133	106
Ireland	254	288	240	146	68	61	58	53
Italy	79	100	93	89	119	111	113	114
Netherlands	121	96	86	92	78	84	84	98
Norway	94	113	96	97	86	112	112	106
Portugal	74	100	112	113	143	146	136	131
Spain	58	78	89	92	184	179	174	166
Sweden	138	121	120	120	74	95	98	96
Switzerland	106	115	120	118	81	85	84	87
UK	100	97	94	97	99	94	96	96
EuroStoxx - Eurozone	95	95	97	95	111	111	109	108
Stoxx ex UK - Europe ex U	100	101	103	101	100	103	102	102
Stoxx - Pan Europe	100	100	100	100	100	100	100	100

Source: Citi Investment Research and Analysis & DataStream



**Figure 26. Pan-European Country Growth**

As at Close 07 Jun 11 Country	Earnings Growth %			Dividend Growth %		
	2010E	2011E	2012E	2010E	2011E	2012E
Austria	-	18.2	20.5	11.1	13.5	5.3
Belgium	62.9	-15.2	36.3	40.5	1.5	8.6
Denmark	62.3	23.6	23.5	40.2	60.0	21.1
Finland	29.7	-11.5	23.5	8.9	-11.6	5.4
France	40.6	12.6	12.8	8.2	6.7	10.0
Germany	67.0	10.4	15.8	22.2	6.9	11.4
Greece	-51.1	-7.1	66.7	-37.0	57.9	-11.0
Ireland	23.9	35.2	84.4	1.3	2.2	2.4
Italy	11.8	21.2	17.0	5.6	10.1	12.4
Netherlands	78.2	24.6	5.7	21.3	9.5	30.1
Norway	17.5	32.6	10.2	46.1	8.7	5.6
Portugal	4.0	0.9	11.5	14.6	1.1	7.7
Spain	4.7	-1.2	7.9	9.8	5.6	6.5
Sweden	59.9	13.5	12.1	43.7	11.7	10.5
Switzerland	30.1	7.5	14.0	17.5	7.9	15.2
UK	44.1	16.6	8.1	6.4	11.1	12.2
EuroStoxx - Eurozone	39.4	10.5	14.1	12.3	6.4	10.9
Stoxx ex UK - Europe ex UK	38.6	10.8	14.1	15.5	7.5	11.5
Stoxx - Pan Europe	40.4	12.7	12.0	12.6	8.6	11.7

Source: Citi Investment Research and Analysis & DataStream. \*Note: Country returns use MSCI index

**Figure 27. Pan-European Country Ratings**

As at Close 07 Jun 11 Country	Price/Earnings				Net Dividend Yield			
	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
Austria	-	14.1	12.0	9.9	2.53	2.81	3.19	3.35
Belgium	21.7	13.3	15.7	11.5	2.31	3.25	3.30	3.58
Denmark	32.2	19.8	16.1	13.0	0.81	1.13	1.82	2.20
Finland	16.9	13.1	14.8	11.9	4.61	5.03	4.44	4.68
France	16.8	11.9	10.6	9.4	3.59	3.89	4.14	4.56
Germany	19.8	11.8	10.7	9.3	2.69	3.29	3.52	3.91
Greece	5.1	10.5	11.3	6.8	5.09	3.20	5.06	4.50
Ireland	44.1	35.6	26.3	14.3	2.13	2.15	2.20	2.25
Italy	13.8	12.3	10.2	8.7	3.70	3.91	4.30	4.84
Netherlands	21.1	11.8	9.5	9.0	2.42	2.93	3.21	4.18
Norway	16.4	13.9	10.5	9.5	2.69	3.93	4.27	4.51
Portugal	12.9	12.4	12.3	11.0	4.45	5.10	5.16	5.56
Spain	10.1	9.6	9.7	9.0	5.73	6.29	6.64	7.07
Sweden	23.9	15.0	13.2	11.8	2.31	3.32	3.71	4.10
Switzerland	18.4	14.2	13.2	11.6	2.53	2.97	3.20	3.69
UK	17.3	12.0	10.3	9.5	3.09	3.28	3.65	4.09
EuroStoxx - Eurozone	16.4	11.8	10.7	9.3	3.47	3.89	4.14	4.60
Stoxx ex UK - Europe ex UK	17.4	12.5	11.3	9.9	3.13	3.61	3.88	4.33
Stoxx - Pan Europe	17.4	12.4	11.0	9.8	3.11	3.51	3.81	4.25

Source: Citi Investment Research and Analysis & DataStream

Figure 28. UK Sector Weightings & Relative Returns

As at Close 07 Jun 2011	Mkt Cap £m	% of AllShare	% of Group	Relative return				
				1m	3m	12m	Qtd	Ytd
OIL & GAS (25)	303,397	16.7		-2	-6	0	-5	-1
Oil & Gas Producers (18)	291,311	16.1	96	-2	-6	-1	-6	-1
Oil Equip, Serv and Distrib (5)	11,774	0.6	4	1	0	27	-1	1
Alternative Energy (2)	312	0.0	0	-4	-6	-	-12	-23
BASIC MATERIALS (34)	236,121	13.0		-1	-4	10	-6	-10
Chemicals (7)	10,283	0.6	4	4	10	33	10	5
Forestry & Paper (1)	2,257	0.1	1	3	11	35	4	21
Industrial Metals (3)	1,782	0.1	1	-1	-3	22	-9	-10
Mining (23)	221,799	12.2	94	-1	-5	9	-6	-10
INDUSTRIALS (110)	137,589	7.6		1	4	5	3	4
Construction & Materials (10)	4,143	0.2	3	-5	-5	4	-3	2
Aerospace (10)	32,145	1.8	23	0	3	-10	1	0
General Industrials (6)	11,632	0.6	8	2	0	17	1	6
Electronic & Electrical Equip (11)	7,107	0.4	5	5	6	63	10	15
Industrial Engineering (13)	15,759	0.9	11	1	9	36	5	6
Industrial Transportation (8)	2,287	0.1	2	1	3	-4	3	1
Support Services (52)	64,516	3.6	47	2	4	1	4	5
CONSUMER GOODS (34)	215,775	11.9		2	10	3	7	5
Automobiles & Parts (1)	3,307	0.2	2	-1	6	50	7	-4
Beverages (4)	60,473	3.3	28	2	8	2	4	3
Food Producers (11)	35,856	2.0	17	2	9	-5	5	2
Household Gds & Home Cons (11)	32,538	1.8	15	0	8	-6	5	1
Leisure Goods (2)	192	0.0	0	21	-2	18	20	-14
Personal Goods (3)	6,822	0.4	3	1	6	44	8	9
Tobacco (2)	76,588	4.2	35	2	14	7	9	12
HEALTH CARE (16)	132,807	7.3		2	9	-2	9	9
Health Care Equip & Services (5)	6,646	0.4	5	-2	-6	-10	-5	-3
Pharmaceuticals & Biotech (11)	126,161	7.0	95	2	10	-2	10	9
CONSUMER SERVICES (94)	175,849	9.7		0	3	-6	5	-1
Food & Drug Retailers (8)	49,775	2.7	28	2	5	-10	9	0
General Retailers (27)	28,176	1.6	16	2	12	-4	15	3
Media (24)	49,846	2.7	28	0	-2	4	0	3
Travel & Leisure (35)	48,052	2.6	27	-2	0	-12	0	-8
TELECOMMUNICATIONS (9)	107,664	5.9		2	-3	4	-3	1
Fixed-Line Telecoms (7)	20,100	1.1	19	4	4	13	5	4
Mobile Telecoms (2)	87,563	4.8	81	2	-5	2	-5	0
UTILITIES (9)	68,341	3.8		3	6	7	4	5
Electricity (2)	14,716	0.8	22	8	16	23	11	14
Gas, Water & Multi-Utilities (7)	53,625	3.0	78	2	3	3	3	3
TECHNOLOGY (31)	32,126	1.8		2	1	12	3	10
Software & Computer Serv (20)	20,289	1.1	63	5	5	1	5	6
Technology Hardware & Equip (11)	11,838	0.7	37	-2	-5	41	0	19
TOTAL NON-FINANCIAL (362)	1,409,669	77.7		0	1	2	0	0
FINANCIALS (252)	404,659	22.3		-1	-3	-7	-1	-1
Banks (5)	206,139	11.4	51	-3	-7	-18	-5	-7
Non-Life Insurance (11)	16,953	0.9	4	3	6	9	8	12
Life Insurance (10)	55,336	3.0	14	-3	0	14	0	11
Real Estate Investment Svs (27)	6,733	0.4	2	5	8	3	6	8
REITS (17)	27,234	1.5	7	4	6	14	9	14
Financial Services (30)	36,895	2.0	9	1	-3	6	-1	-5
Equity Inv. Instruments (152)	55,370	3.1	14	1	3	2	1	0
FTSE ALL SHARE (614)	1,814,328	100.0		0	0	0	0	0
FTSE 100 (100)	1,526,414	84.1		0	-1	-1	-1	-1
Mid 250 (250)	245,288	13.5		2	3	8	4	3
Small Cap (264)	42,625	2.3		2	1	2	2	1

Source: Citi Investment Research and Analysis & DataStream

Figure 29. UK Relative Ratings

As at Close 07 Jun 2011	P/E Relative				Yield Relative			
	2009	2010	2011E	2012E	2009	2010	2011E	2012E
OIL & GAS	85	84	87	88	136	90	99	94
Oil & Gas Producers	83	82	85	86	139	91	100	96
Oil Equip, Serv and Distrib	141	150	179	169	45	58	57	61
Alternative Energy	204	1,760	275	162	56	57	45	39
BASIC MATERIALS	118	89	78	86	30	56	60	60
Chemicals	156	150	151	150	53	65	59	58
Forestry & Paper	210	122	103	92	45	88	113	127
Industrial Metals	-	225	112	88	12	13	13	11
Mining	115	87	76	85	29	56	60	60
INDUSTRIALS	87	113	122	120	75	83	84	82
Construction & Materials	55	81	94	93	131	132	123	115
Aerospace	63	89	99	101	107	110	110	109
General Industrials	97	103	111	111	68	86	93	91
Electronic & Electrical Equip	195	154	149	149	57	61	60	59
Industrial Engineering	129	136	133	130	64	74	67	64
Industrial Transportation	70	89	105	105	141	134	121	111
Support Services	95	128	137	132	61	69	73	71
CONSUMER GOODS	104	125	136	138	90	104	102	98
Automobiles & Parts	601	91	106	104	0	74	119	113
Beverages	114	141	153	153	80	86	84	81
Food Producers	90	116	129	132	74	107	98	92
Household Gds & Home Cons	133	130	140	139	77	87	87	84
Personal Goods	198	217	213	203	34	44	49	50
Tobacco	90	113	125	129	119	131	129	124
HEALTH CARE	57	106	95	107	134	139	132	126
Health Care Equip & Services	84	107	130	129	47	50	46	45
Pharmaceuticals & Biotech	57	106	94	106	138	144	137	130
CONSUMER SERVICES	85	104	116	114	88	96	97	96
Food & Drug Retailers	88	109	122	124	102	109	105	101
General Retailers	71	93	106	107	99	108	108	105
Media	82	107	118	117	83	87	91	90
Travel & Leisure	94	104	113	108	73	84	88	90
TELECOMMUNICATIONS	59	79	94	98	159	163	160	172
Fixed-Line Telecoms	65	80	88	91	137	139	158	176
Mobile Telecoms	58	79	96	100	164	168	160	170
UTILITIES	70	101	120	121	162	160	148	139
Electricity	66	94	113	112	147	172	154	143
Gas, Water & Multi-Utilities	71	104	122	124	166	157	147	138
TECHNOLOGY	133	166	184	176	35	38	37	37
Software & Computer Serv	104	137	151	149	43	45	45	45
Technology Hardware & Equip	260	259	289	259	20	24	24	23
TOTAL NON-FINANCIAL	85	98	101	104	100	99	100	98
FINANCIALS	382	109	97	86	100	104	100	108
Banks	-	112	87	73	79	85	85	103
Non-Life Insurance	46	91	103	94	176	184	151	144
Life Insurance	70	82	95	97	132	142	137	128
Real Estate Investment Svs	-	340	400	292	35	44	44	44
REITS	129	198	230	248	116	109	100	90
Financial Services	247	114	113	108	133	120	108	114
FTSE ALL SHARE	100	100	100	100	100	100	100	100
FTSE 100	102	98	97	98	103	102	102	103
Mid 250	90	117	124	119	77	89	83	82
Small Cap	81	103	109	98	97	94	88	86

Source: Citi Investment Research and Analysis & DataStream

Figure 30. UK Earnings Growth

As at Close 07 Jun 2011	Earnings Growth %			Net Dividend Growth %		
	2010	2011E	2012E	2010	2011E	2012E
OIL & GAS	44.8	15.6	10.0	-30.7	22.7	8.3
Oil & Gas Producers	45.1	15.9	9.8	-31.6	23.1	8.0
Oil Equip, Serv and Distrib	34.1	1.3	17.9	34.0	9.3	20.8
Alternative Energy	-83.4	670.4	88.6	6.0	-10.1	-3.7
BASIC MATERIALS	89.3	36.8	1.3	93.6	20.5	13.2
Chemicals	48.4	19.8	12.2	29.6	1.9	10.1
Forestry & Paper	145.6	43.2	24.0	102.8	43.8	26.7
Industrial Metals	-	141.3	41.8	6.0	15.2	-2.6
Mining	89.2	36.8	0.6	99.1	21.2	13.1
INDUSTRIALS	10.8	11.7	13.1	14.7	13.7	10.6
Construction & Materials	-3.0	3.1	12.5	5.0	4.5	5.7
Aerospace	1.7	7.3	9.8	7.5	12.6	12.0
General Industrials	35.3	11.5	11.0	32.8	20.8	10.7
Electronic & Electrical Equip	80.4	24.5	11.9	12.0	10.7	10.3
Industrial Engineering	35.8	22.4	14.0	21.6	0.9	9.2
Industrial Transportation	13.0	2.3	10.4	-1.1	1.2	4.5
Support Services	6.4	12.5	15.9	18.2	18.5	10.6
CONSUMER GOODS	19.8	10.0	10.0	21.1	10.2	8.7
Automobiles & Parts	840.3	3.8	14.1	-	80.0	7.8
Beverages	15.5	11.3	11.7	11.8	9.3	9.5
Food Producers	11.3	8.2	8.6	51.6	2.7	6.3
Household Gds & Home Cons	46.3	12.0	11.8	17.9	12.6	8.6
Personal Goods	30.9	22.3	17.3	34.7	24.1	17.0
Tobacco	13.2	9.1	8.2	15.0	10.7	8.9
HEALTH CARE	-22.7	34.3	-0.7	8.8	6.2	7.8
Health Care Equip & Services	11.4	-0.8	12.5	11.3	3.2	11.9
Pharmaceuticals & Biotech	-23.9	36.1	-1.2	8.7	6.2	7.7
CONSUMER SERVICES	16.0	8.5	12.9	13.4	13.1	12.0
Food & Drug Retailers	15.1	7.5	10.2	11.9	7.5	9.8
General Retailers	9.4	5.3	11.4	14.0	12.8	10.1
Media	10.0	8.9	12.5	9.4	16.5	12.3
Travel & Leisure	29.4	11.3	16.9	19.8	17.1	15.9
TELECOMMUNICATIONS	6.5	1.4	6.9	7.0	10.2	21.6
Fixed-Line Telecoms	16.3	9.1	8.3	6.3	27.2	26.5
Mobile Telecoms	4.5	-0.4	6.5	7.2	6.9	20.5
UTILITIES	-1.8	1.8	10.4	3.0	3.7	6.1
Electricity	0.5	-0.2	12.7	21.9	0.5	4.8
Gas, Water & Multi-Utilities	-2.5	2.4	9.7	-1.6	4.7	6.5
TECHNOLOGY	15.1	8.7	16.1	12.6	11.1	12.6
Software & Computer Serv	8.4	9.0	13.5	9.1	11.6	13.5
Technology Hardware & Equip	43.6	7.8	24.5	25.6	9.6	9.9
TOTAL NON-FINANCIAL	23.4	17.2	7.5	3.4	13.2	10.9
FINANCIALS	399.6	34.9	27.0	7.8	7.6	23.3
Banks	-	53.7	34.3	11.9	12.3	37.4
Non-Life Insurance	-26.9	6.3	21.7	8.6	-8.0	8.2
Life Insurance	20.8	4.9	9.2	12.1	8.4	5.7
Real Estate Investment Svs	-	2.4	52.3	33.5	11.6	12.2
REITS	-6.8	3.8	3.0	-2.7	2.9	2.8
Financial Services	209.4	21.0	16.6	-6.6	1.5	19.6
FTSE ALL SHARE	43.0	20.4	11.5	4.3	12.1	13.4
FTSE 100	48.6	21.2	10.8	2.6	13.1	13.6
Mid 250	9.7	14.1	16.1	21.4	4.5	11.3
Small Cap	13.5	13.6	23.3	1.4	5.2	10.0

Source: Citi Investment Research and Analysis & DataStream

Figure 31. UK Sector Ratings

As at Close 07 Jun 2011	Price/Earnings				Net Dividend Yield			
	2009	2010	2011E	2012E	2009	2010	2011E	2012E
OIL & GAS	15.3	10.5	9.1	8.3	4.11	2.84	3.49	3.78
Oil & Gas Producers	15.0	10.3	8.9	8.1	4.22	2.89	3.55	3.84
Oil Equip, Serv and Distrib	25.4	19.0	18.7	15.9	1.37	1.84	2.01	2.43
Alternative Energy	36.9	222.2	28.8	15.3	1.69	1.79	1.61	1.55
BASIC MATERIALS	21.3	11.2	8.2	8.1	0.92	1.77	2.14	2.42
Chemicals	28.2	19.0	15.8	14.1	1.59	2.06	2.10	2.31
Forestry & Paper	37.8	15.4	10.8	8.7	1.38	2.79	4.02	5.09
Industrial Metals	-	28.4	11.8	8.3	0.37	0.40	0.46	0.45
Mining	20.7	11.0	8.0	8.0	0.88	1.76	2.13	2.41
INDUSTRIALS	15.8	14.3	12.8	11.3	2.28	2.62	2.98	3.29
Construction & Materials	9.9	10.2	9.9	8.8	3.96	4.16	4.35	4.60
Aerospace	11.4	11.2	10.4	9.5	3.23	3.47	3.90	4.37
General Industrials	17.5	12.9	11.6	10.5	2.05	2.73	3.30	3.65
Electronic & Electrical Equip	35.2	19.5	15.7	14.0	1.72	1.92	2.13	2.35
Industrial Engineering	23.2	17.1	14.0	12.3	1.93	2.35	2.37	2.58
Industrial Transportation	12.7	11.2	11.0	9.9	4.27	4.22	4.27	4.46
Support Services	17.2	16.2	14.4	12.4	1.84	2.17	2.58	2.85
CONSUMER GOODS	18.8	15.7	14.3	13.0	2.71	3.29	3.62	3.93
Automobiles & Parts	108.6	11.5	11.1	9.7	0.00	2.34	4.22	4.55
Beverages	20.6	17.9	16.0	14.4	2.42	2.70	2.96	3.24
Food Producers	16.3	14.6	13.5	12.5	2.23	3.38	3.47	3.68
Household Gds & Home Cons	24.0	16.4	14.7	13.1	2.33	2.75	3.10	3.36
Personal Goods	35.8	27.4	22.4	19.1	1.04	1.40	1.73	2.03
Tobacco	16.2	14.3	13.1	12.1	3.60	4.14	4.58	4.99
HEALTH CARE	10.4	13.4	10.0	10.1	4.05	4.40	4.67	5.04
Health Care Equip & Services	15.1	13.6	13.7	12.2	1.42	1.58	1.63	1.82
Pharmaceuticals & Biotech	10.2	13.4	9.9	10.0	4.19	4.55	4.83	5.21
CONSUMER SERVICES	15.3	13.2	12.1	10.8	2.67	3.03	3.42	3.83
Food & Drug Retailers	15.9	13.8	12.8	11.6	3.08	3.45	3.70	4.07
General Retailers	12.9	11.8	11.2	10.0	2.99	3.40	3.84	4.22
Media	14.8	13.5	12.4	11.0	2.52	2.76	3.21	3.60
Travel & Leisure	17.1	13.2	11.8	10.1	2.21	2.65	3.11	3.60
TELECOMMUNICATIONS	10.7	10.0	9.9	9.2	4.80	5.14	5.66	6.89
Fixed-Line Telecoms	11.7	10.1	9.3	8.5	4.14	4.40	5.59	7.07
Mobile Telecoms	10.4	10.0	10.0	9.4	4.96	5.31	5.68	6.84
UTILITIES	12.6	12.8	12.6	11.4	4.92	5.06	5.25	5.57
Electricity	11.9	11.8	11.9	10.5	4.46	5.44	5.46	5.73
Gas, Water & Multi-Utilities	12.8	13.1	12.8	11.7	5.04	4.96	5.19	5.53
TECHNOLOGY	24.1	20.9	19.3	16.6	1.05	1.19	1.32	1.48
Software & Computer Serv	18.7	17.3	15.9	14.0	1.31	1.43	1.60	1.81
Technology Hardware & Equip	47.0	32.7	30.3	24.4	0.61	0.76	0.84	0.92
TOTAL NON-FINANCIAL	15.3	12.4	10.6	9.8	3.03	3.13	3.54	3.93
FINANCIALS	68.9	13.8	10.2	8.0	3.04	3.28	3.52	4.35
Banks	-	14.1	9.2	6.8	2.39	2.67	3.00	4.12
Non-Life Insurance	8.4	11.5	10.8	8.9	5.34	5.80	5.34	5.78
Life Insurance	12.6	10.4	9.9	9.1	4.00	4.49	4.86	5.14
Real Estate Investment Svs	-	42.9	41.9	27.5	1.05	1.40	1.57	1.76
REITS	23.3	25.0	24.1	23.4	3.53	3.43	3.53	3.63
Financial Services	44.6	14.4	11.9	10.2	4.04	3.78	3.83	4.58
FTSE ALL SHARE	18.1	12.6	10.5	9.4	3.03	3.16	3.54	4.01
FTSE 100	18.4	12.4	10.2	9.2	3.13	3.21	3.63	4.12
Mid 250	16.2	14.8	13.0	11.2	2.32	2.82	2.94	3.28
Small Cap	14.7	13.0	11.4	9.3	2.93	2.97	3.13	3.44

Source: Citi Investment Research and Analysis & DataStream

Figure 32. Stocks Mentioned

Stock	RIC Code	Rating	Price	Currency
ADP	ADP.PA	1M	64.3	EUR
Belgacom	BCOM.BR	3L	24.005	EUR
BT Group	BT.L	1M	1.956	£
Cable & Wireless Comms.	CWC.L	2M	0.4116	£
Cable & Wireless Wwd.	CWP.L	2H	0.5095	£
Coca Cola Hellenic Bottling	HLBr.AT	1M	18	EUR
Commerzbank	CBKG.DE	2H	3.13	EUR
Deutsche Telekom	DTEGn.DE	1L	10.03	EUR
Elisa	ELI1V.HE	3L	14.9	EUR
Endesa	ELE.MC	1M	22.84	EUR
Enel	ENEI.MI	2M	4.552	EUR
Ferrovial	FER.MC	1M	8	EUR
France Telecom	FTE.PA	2L	15.255	EUR
Fraport	FRAG.DE	1M	53.83	EUR
Gemina SpA	GEMI.MI	2S	0.716	EUR
Hellenic Telecom	OTEr.AT	2H	6.3	EUR
Hochtief	HOTG.DE	1M	57.95	EUR
IMI	IMI.L	1H	10.05	£
Inmarsat	ISA.L	1M	6.03	£
KPN	KPN.AS	1L	9.99	EUR
Mobistar	MSTAR.BR	2L	52.22	EUR
Portugal Telecom R	PTC.LS	2M	7.302	EUR
RWE	RWEG.DE	3H	38.63	EUR
SAVE (Aeroporto di Venezia)	SAVE.MI	1M	7.695	EUR
Swisscom R	SCMN.VX	2L	388.2	SF
TAV (Havalimanlari)	TAVHL.IS	1M	8.7	TRY
Tdc	TDC.CO		47.18	DK
Tele2 B	TEL2b.ST	2M	119.4	SK
Telecom Italia	TLIT.MI	1M	0.9565	EUR
Telefonica	TEF.MC	2M	16.375	EUR
Telekom Austria	TELA.VI	2M	8.7	EUR
Telenor	TEL.OL	1M	87.00	NK
TeliaSonera	TLSN.ST	3M	46.15	SK
Vienna Airport	VIEV.VI	2H	35.92	EUR
Virgin Media	VMED.O	1M	31.78	USD
Vodafone Group	VOD.L	1L	1.6165	£
Zurich Airport	FHZN.S	1M	381.25	CHF

Note: Prices as at 8 June 2011 close. Source: Powered by dataCentral  
dataCentral is CIRA's proprietary database, which includes Citi estimates, data from company reports, and feeds from Reuters, Datastream, Firstcall, IBES and Toyo Keizai.

## **Notes**

## Appendix A-1

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