

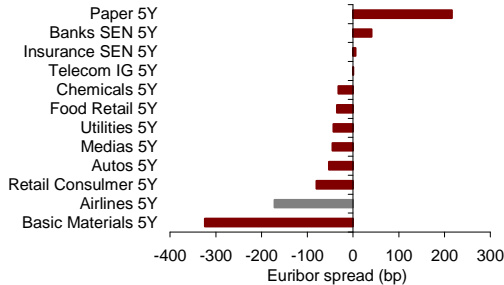
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Q2 Update

Calyon CDS Index YTD performance

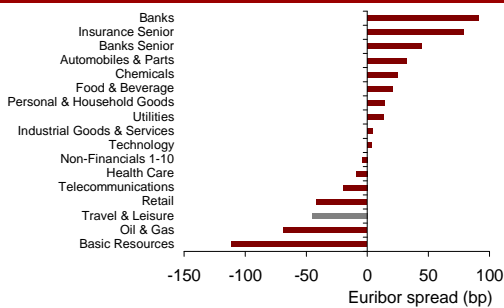


Now its time to get ugly

■ CDS spreads surprisingly positive

Given the weakening in the global economy and the fact that airlines are still hedged at very high oil prices with deteriorating financials it was surprising to see Airline spreads perform so positively during the quarter. Granted liquidity is actually reasonable, relative to similarly rated sectors, but the first six months of 2009 will be a period of extremely weak trading. We do not expect the spread tightening trend to continue, with the catalyst likely to be the coming quarterly results which will make ugly reading.

IBoxx YTD performance



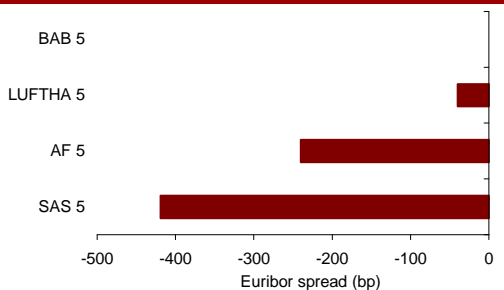
■ Fundamentals drive ratings lower

As expected further negative rating actions were seen during the quarter driven by weakening fundamentals, such as the rapid drop in traffic data and a weaker outlook. Ratings already factor in an element of cyclicity but not the extreme downturn that is being seen. SAS, Air France and British Airways (BA) are all likely to be lossmaking in 2009 so further negative rating actions can not be ruled out.

■ Sector recommendations unchanged

- CDS recommendation: Underperform
- Cash recommendation: Underperform

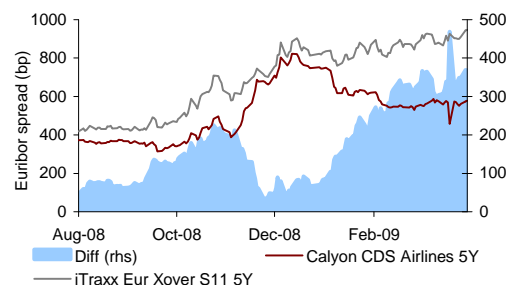
Under/outperformers in Airlines CDS



■ What to expect from Q1 (calendar year) earnings releases?

We expect Q109 (calendar year) results to reveal a disastrous quarter with losses rising to more than EUR500m for some of the airlines. Accordingly we expect to see more focus on capacity reductions both in terms of route cuts and grounded planes. We will also be looking very closely at the working capital situation given our concerns that this may be impacted by the slump in revenues (see page 5).

Airlines CDS Index vs. iTraxx crossover



Sources: Markit, Calyon

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EUROMONEY CREDIT RESEARCH SURVEY 2009

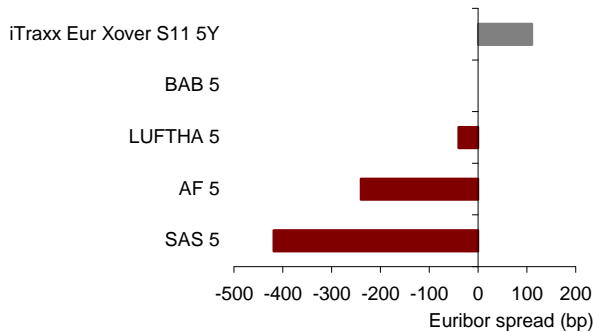
Euromoney's annual survey of the world's Fixed Income Investors/Credit Research & Primary Debt Polls is now underway and closes 24 April 2009.

<http://www.euromoney.com/FixedIncome2009>

www.calyon.com

Sector recommendations

Issuer CDS YTD performance

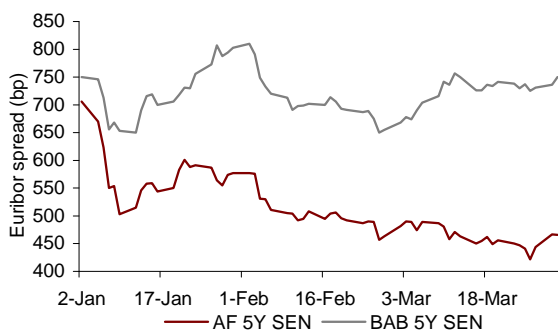


Recommendation performance

CDS: sharp outperformance of SAS

SAS spreads moved tighter over the quarter although the timing of the actual tightening was not entirely led by fundamental based news. We put the move down to a mix of market technicals at the time and increasing speculation that SAS would be acquired by Lufthansa. Thereafter, once most of the spread tightening had already occurred, the Nordic governments agreed to subscribe alongside other investors to a new SEK6bn rights issue consolidating the spread gains.

Air France vs. British Airways - CDS diverging

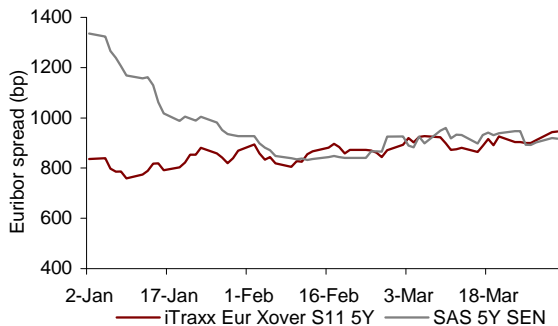


Air France and BA CDS diverges.

Over the last quarter Air France has strongly outperformed BA CDS despite results and guidance for both companies being poor as anticipated. At the beginning of the quarter it was fair to say that Air France had better liquidity and, assuming that both airlines had deteriorated at an equal trend, Air France would post stronger results in the 2009 calendar year.

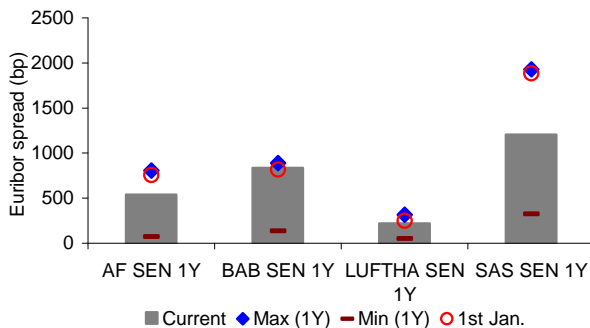
However, during the quarter it has become clearer that the rate of deterioration in results at Air France has been stronger than at BA. Indeed current consensus suggests that BA and Air France have Q409 (March) operating losses of -GBP316m and -EUR661m respectively.

SAS CDS vs. iTraxx Crossover convergence



Consequently, while some outperformance was warranted, we were surprised to see Air France spreads materially outperform BA over the quarter and put the reason for this down to the gradual realisation that France will fully support its national champions. However, with the CDS basis now at around 300bp we do not expect the divergence trend to continue.

6 month and 1Y CDS remains attractive



Mixed trend in cash

The secondary cash bond market continues to trade by appointment only with very little liquidity apart from the new LUFTA6.75 14 bond which has tightened by around 50bp since issue, in line with many other new issues.

The data that we have suggests LUFTHA4.625 13 widened by around 80bp in secondary post the new primary issue, in line with our concerns expressed in the 2009 Airlines outlook. BAB7.25 16 continued to move wider over the period finishing the quarter with a spread of around 1300bp, albeit we cannot confirm this has been traded. Finally AFFP4.75 14 appeared to move 75bp tighter to ms+425bp.

Recommendation CDS and Cash

Our cash and CDS recommendation for Airlines is unchanged.

- **CDS recommendation:** Underperform
- **Cash recommendation:** Underperform

Source all charts: Markit

Issuer recommendations

Recommendation performance YTD

Performance relative to Calyon's industrial indices

	Current reco.	Live perf.	Closed	Total YTD
SAS	Underperform	-115	0	-115
BAB	Sectorperform	0	0	0
AF	Underperform	14	0	14
LUFTH	Underperform	-39	0	-39
Total		-140	0	-140

Source: Markit, Calyon. Spreads as at 15 April 2009

Q1 saw rapid tightening for SAS which was in line with our recommendation to sell short term SAS CDS. In December we were confident that SAS had reached a point where something would need to happen to the company in the short term given the poor trading and short term liquidity of SAS.

Accordingly we recommended a trade idea to sell 6m CDS and buy 5Y CDS on Lufthansa to benefit from a possible Lufthansa takeover of SAS. The trade has worked well with a P&L of nearly GBP400k to date. In hindsight we should have also moved SAS to Sectorperform at the same time but were reluctant to do so given the possibility of further credit and spread deterioration, and this has worked against us.

In December we recommended that investors sell 1Y CDS in Air France and British Airways where we felt that trading would be weak but company liquidity was easily strong enough to avoid a default situation. The trade now looks more compelling in BA than in Air France.

Changes to issuer recommendations

During the quarter we made one change to our issuer recommendations, which was to change Air France from Sectorperform to Underperform on 27 March.

Summary of our recommendations on CDS

Issuer	S&P/Moody's	Calyon	Spot CDS	Variation			Expected Trend	Spot vs Index			CDS Recommendation		
				1 Week	1 Month	YTD		Ratio	Fair Value	Spot - FV	Previous	Since	New
Air France - KLM	NR/NR	High-BB	492	48	2	-214	→	82%	498	-6	Sectorperform	27/03/09	Underperform
British Airways	BB+ /Ba1	High-BB	785	54	107	35	→	131%	700	85	Sectorperform	15/04/08	Sectorperform
Lufthansa	BBB neg /Baa3	Low-BBB	197	12	30	-36	→	33%	204	-7	Underperform	02/06/08	Underperform
SAS	B dev/B2 neg	Mid-B	939	37	49	-397	→	157%	1014	-75	Outperform	07/11/08	Underperform
Index Airlines			600	38	46	-150	→						

Key: ↓ Outperformance expected; → No trend reversal is expected; ↗ Underperformance expected

Source: Markit, Calyon

Primary activity and outlook

As suggested in our **European Airlines 2009 Outlook – Cash is King** it was Lufthansa that tested the bond market first for airlines issuing a EUR850m 5Y bond in mid-March, priced at a surprisingly tight ms+410bp ie a negative basis of 240bp and new issue premium of around 220bp, no doubt driven by a focus on retail investors where there is strong brand recognition.

We continue to regard new issuance for the sector as very difficult despite the Lufthansa issue. No doubt Air France will have looked at issuing off the back of the Lufthansa deal. Here we are conscious that CDS spreads have been grinding tighter, the French government maintains a direct equity stake and general investor perception seems to be that France will support Air France as a national champion if necessary. However Air France is unrated, it will be lossmaking over the next 12 months and the German retail investor market is larger than in France. On balance we still think that Air France would struggle to come to the market at the moment.

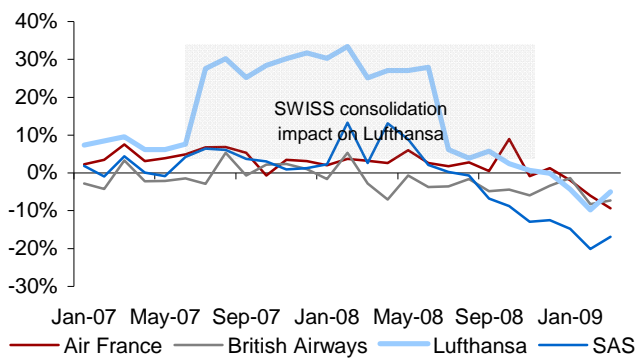
More generally, apart from the Calyon led Fresenius deal, the European high yield market has remained closed since July 2007, dramatically reducing financial flexibility for high yield credits. At this stage we would need to see some more BBB-/BB+ credits come with new issuance before we can be more confident that other airline credits could issue new bonds.

Credit trend

Outlook and credit trend

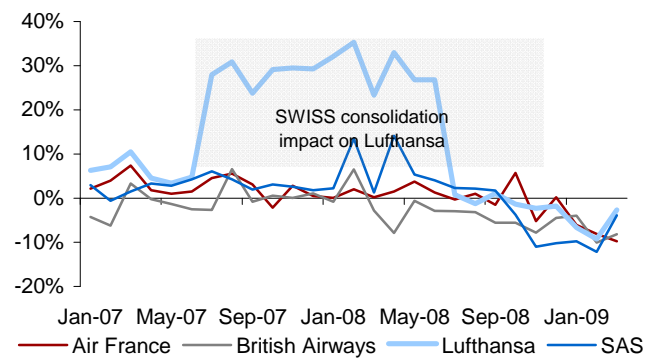
Macroeconomic news flow kept on deteriorating in Q109. Our economists recently revised downwards their December 2008 estimate for FY09 Global GDP growth from 0.4% to -1.0%. In particular FY09 GDP Eurozone growth was revised from -0.8% to -2.9%. Prospects for a recovery in 2010 have reduced. Our economists are now looking at Eurozone growth of 0.4% in FY10 (vs. 1.1% last December).

RPK growth (YoY)



Source: Calyon, Company data

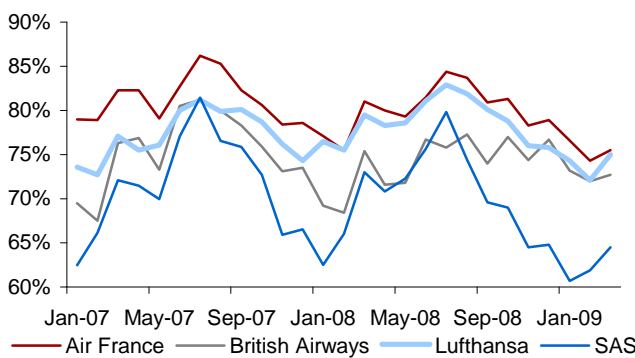
Passenger growth (YoY)



Source: Calyon, Company data

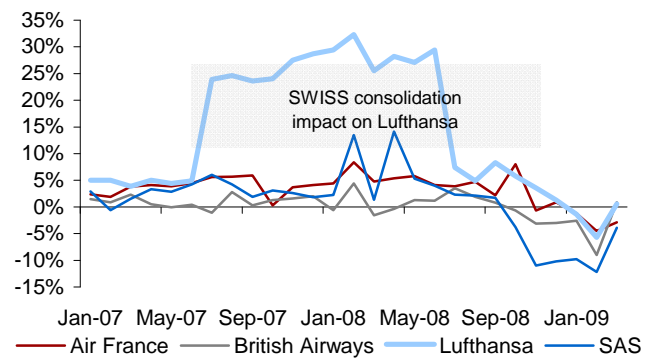
As highlighted above and below traffic data continues to fall rapidly both in terms of passenger numbers and revenue per passenger, but cuts in capacity (ASK) are helping to ensure that load factors remain reasonably close to 2008 levels. Relative to peers recent months have seen weaker SAS traffic and stronger BA load factors.

Load Factor (%)



Source: Calyon, Company data

ASK growth (YoY)



Source: Calyon, Company data

SAS, BA, Air France and Lufthansa continue to sit on a glut of out-of-the-money fuel hedges that currently results in them paying broadly an additional 50% for the cost of kerosene beyond the spot price. When coupled with falling demand and lower yields (switching to lower class) it is clear that the next couple of quarters will make awful reading, until YoY trends possibly start to improve in the second half of 2009, which will bring lower average hedged fuel prices. The one exception will be for airlines that have utilised a good level of options for hedging rather than outright contracts. Here relative disclosure is not good but recent results suggest that SAS may have a reasonable level of options in place.

The market is still focused on the biggest risk to non-financials being liquidity, but we see few liquidity risks in our Airlines coverage given the high levels of cash already held by the issuers. The perception of the depth of the recession and ability to refinance should remain the key drivers of absolute spreads in 2009. The short term liquidity position of Air France, BA and Lufthansa is actually remarkably strong compared to many similar rated industrial credits (eg airlines have around ten times the amount of cash that paper companies have on balance sheet) which presents interesting opportunities to sell short term CDS in Air France and British Airways.

Given the deterioration in late 2008 and worsening outlook it is not surprising that we have seen more negative rating actions in Q109.

Rating actions in Q109

	S&P	Moody's
SAS	Single B rating to CW pos on Feb 3	
BA	BBB- rating to CW neg Jan 27 BBB- rating to BB+ CW neg March 6	Baa3 rating to Ba1 CW neg on Feb 11

Source: S&P, Moody's

What to expect from Q109 earnings results

The sharp drop in demand will continue to have a negative effect on cashflows leading to disastrous results that are drastically weaker than Q108. Current guidance suggests that Q409 (March) results for Air France and BA and Q109 (March) results for SAS and Lufthansa will yield combined losses of as much as EUR1.6bn. Accordingly we expect to see more focus on capacity reductions both in terms of route cuts and also grounded planes.

The traffic data on page 4 suggests the greatest YoY growth deterioration will be at SAS, particularly as it is likely to use the timing of the SEK6bn rights issue proceeds to 'clear the decks' in terms of any write downs that might be needed, ie this would ensure that FY10 has a better chance of achieving positive EBIT growth over FY09. Lufthansa has been surprisingly resilient so far but the downturn in results must be just around the corner. However, the market clearly believes that it is Air France that will show the weakest results.

Company guidance for calendar Q109

	Operating profit guidance	Calendar Q109 consensus EBIT
Air France	-EUR200m FY09 (March) operating loss	-EUR661m
BA	-GBP150m FY09 (March) operating loss	-GBP316m
Lufthansa	FY09 (Dec) "clearly below" FY08 but "distinctly positive"	-EUR521m
SAS	none	-SEK669m

Source: Company statements

Finally, as airlines are similar to cash retail businesses in working capital terms (many customers pay for tickets upfront), we will be watching closely to see the impact of lower turnover on the working capital cycle, which we expect will be a drain on cashflow. This could be particularly true for BA which appears to be the airline that 'stretches' the working capital cycle the most relative to its peers.

Issuer snapshot

Air France (NR/NR)

A significant deterioration in early March passenger and cargo unit revenues, driven by the decline in business traffic and lower international trade, led to Air France issuing a further disappointing profit warning in late March. It now expects an operating loss of EUR200m for FY09 (March) implying a shocking Q409 operating loss of c.EUR650m. It said that the FY09 cash position would be EUR3.5-4.0bn, which would be down EUR0.3-0.8bn from the December 2008 cash position of EUR4.3bn, ie no doubt driven by losses. Guidance was provided for a limited loss in FY10 (March) but it sees little visibility, and therefore we are not placing a big reliance on this outlook at this stage. It sees a drop in revenues of 6%, ie to around EUR23bn. Air France will partially offset this drop via capacity cuts and a FY10 fuel bill that will be around 20% lower than FY09 (March) given the lower volume of fuel to be utilised (in USD terms).

Air France continues to struggle from the impact of out of the money fuel hedges. However in comparison to say British Airways, where the relative performance deterioration has not been so quite severe, anecdotal evidence suggests that BA may have curtailed its hedging programme quicker than Air France when oil prices fell rapidly last year. Calendar Q109 results should underline this issue.

During the quarter it announced and completed the purchase of a 25% stake in 'new Alitalia' for EUR323m which should not be confused with Air France's prior attempt to buy 'old Alitalia'. The Italian government has since engineered a restructuring whereby it kept the weaker parts of Alitalia with the stronger parts being sold to CAI for c.EUR425m plus debt assumed of c.EUR625m. The new deal distances Air France from the necessary redundancy hassle, cost and inevitable union issues, limits the upfront capital investment and should ensure that it only takes control of a satisfactorily performing business at a later date. Overall, we see the deal as credit neutral and much more palatable from a credit perspective than last years bid for 100% of Alitalia.

Bloomberg reports suggest Air France is one of at least three potential bidders for the privatisation of Czech airlines where the Czech government hopes to raise EUR176m for its 91.5% stake by 30 September. This would not be a big transaction for Air France so at this stage we view any potential deal as fairly credit neutral.

There is no doubt Air France will be one of the survivors in Europe, despite numerous failures elsewhere and no doubt that France would regard it as a national champion if government support were needed (current equity stake 16%). Company liquidity remains solid for selling short term CDS but 1Y spreads have tightened since we published this idea in December by more than 120bp, so we suspect there may be a better entry point post very weak upcoming results.

One year rating target: High-BB (maintained)

Relative value: Underperform (maintained since 27/03/09)

British Airways (BB+ CW neg/Ba1 CW neg)

During the quarter BA provided an unsurprising profit warning followed by in line Q309 (December) results which resulted in credit ratings being downgraded. The BA-Iberia merger issues have still not been resolved despite comments that an announcement was due at the end of March. In FY08 BA produced outstanding operating margins in excess of 10%. Now it is lossmaking, credit metrics are deteriorating, yields and traffic are falling and out-of-the-money fuel hedging means that for much of 2009 it will not benefit fully from recent fuel price drops. Without the merger 2009 will be a tough year given BA's reliance on the struggling financial sector.

BA reported a weak set of Q309 results (Dec), in line with the revised guidance within its January profit warning, with a Q3 operating loss of -GBP51m reducing YTD operating profit to just GBP89m (GBP744m). It reaffirmed guidance for a

FY09 operating loss of -GBP150m (GBP875m), implying a large loss of GBP239m for Q409 (March). A weak sterling helped boost turnover by 6.2%, exceeding the negative impact of sterling on costs (fuel) by c.GBP200m. Guidance was reaffirmed for a FY09 fuel bill of GBP3bn, capex of GBP550m (GBP680m), revenue growth of at least 4% and an 8% increase in non fuel costs. Since the results the downward trend has continued with data for the month of March highlighting that RPK traffic continues to fall with a concerning 13% decrease in premium traffic and 12% drop in Asian traffic.

It appears that Iberia wanted more than 40% of the combined BA-Iberia group, probably because of the likely increase in BA's pension deficit, but this has been resisted by BA. Officially the remaining discussions are relating to governance issues. We still expect the merger to go ahead shortly, although on revised terms perhaps with Iberia shareholders gaining slightly more than the originally proposed 40% split of the merged group. For example, at the end of February Economista reported that BA would accept a 55%/45% merger ratio. The merger with Iberia, and its EUR3bn cash pile, is coming at a good time for BA and will result in good revenue and cost synergies.

During the quarter the corporate ratings for BA were downgraded from investment grade back into high yield territory, highlighting an increasingly challenging environment, the negative impact of a weak GBP on costs and the likely weakening of BA's financial profile. Forced bond sellers or hedging from investment grade investors is unlikely given that the bonds were already rated sub investment grade. If, as we expect, the merger does go ahead, it should lead to an investment grade rating for the new combined holding company given the EUR3bn of cash and strong South American franchise that Iberia brings to the combined group. The rating at standalone BA will be driven by support from the new parent and thus the details within merger documentation where there may be restrictions on Iberia providing support across the structure to BA. It follows that the existing BA bond, and therefore the standalone BA CDS contract, is likely to remain sub-investment grade and with only one small bond in place till 2016 there could eventually be an orphan event.

In the unlikely event that the merger is called off we would expect BA spreads to widen but an announcement that the deal is going ahead should lead to spread tightening given the improved business and financial profile that a merger would bring. 2009 will be weak year but liquidity is better than many similarly rated credits, so we continue to believe that selling 1Y or 6M CDS offers attractive risk reward characteristics.

One year rating target: High-BB (maintained)

Relative value: Sectorperform (maintained since 15/04/08)

Lufthansa (BBB neg/Baa3)

Lufthansa reported FY08 results that were broadly in line with recent guidance so market focus was on FY09 and FY10 guidance. Group sales rose 11% to EUR24.9bn on higher fares and the Swiss consolidation. Operating profits were heavily affected by higher average oil prices and oil price surcharges. Lufthansa expects FY09 operating result to be "clearly below" FY08 but "distinctly positive", which is rather vague, and it will no longer provide specific targets in the current climate. Lufthansa is "bracing itself for a decline in sales and profit in 2009" and, assuming a 2010 economic recovery, it expects a gain in revenue and profit for FY10. This last statement was taken very positively by the market but in reality is very conditional and is of course something that would be replicated for the entire sector if there is a recovery, along with many other sectors.

Liquidity remains adequate with gross cash and available credit facilities of c.EUR4bn. Our only concern is that Lufthansa does not pre-fund fleet commitments, which we would view as essential in the current environment. Elsewhere the US DoT has given approval for antitrust immunity approval for Lufthansa, United, Continental, Air Canada, SAS, Austrian and BMI.

Lufthansa spreads are still surprisingly tight, relative to peers. On a balance sheet basis Lufthansa has zero net debt but this is around 2x EBITDA on an adjusted basis, and 3x if it were to go ahead with an acquisition of SAS. However, EBIT

looks likely to reduce by around 40% in 2009 on lower passenger traffic and Lufthansa still has the most aggressive acquisition strategy in European Airlines, where more M&A cannot be ruled out. Additionally, it has the most aggressive capex programme by a long way, with over 180 planes including 15 A380s and 20 747-800s on order, where it intends to spend c.EUR11bn over the next four years on fleet capex. This includes a recently announced order for 30 CSeries model CS100 Bombardier planes (list price reportedly USD1.53bn). In 2009 fleet capex will be more than four times that of Air France and in 2010 it will be more than three times higher. Lufthansa recently said that its fleet capex would be funded by cash flow. This looks very challenging with operating cash flow extremely unlikely to reach this level in FY09 given that the trend now can only be downwards. FY08 OCF/capex cover was just 1.1x. Consequently, we expect Lufthansa to be cash flow negative before financing over the next two years.

Lufthansa CDS has been a frequent short for investors over the past year that has not really performed due to a combination of one illiquid bond, the crowded nature of the trade and a strong retail bid. However, CDS has now started to move a little wider post the new bond and should move wider post weak Q109 results.

One year rating target: Low-BBB (maintained)

Relative value: Underperform (maintained since 02/06/08)

SAS (B CW neg/B2 CW neg)

Alongside weak Q408 results SAS unveiled 'core SAS' a new restructuring programme that included a heavily discounted SEK6bn rights issue, a maturity extension of SEK6.5bn of loans, the sale or closure of all non-core activities/airlines, a 40% cut in routes, 37% cut in staff and a 10% cut in fleet which would have saved a total of SEK800m in FY08. The programme targets a SEK15bn drop in adjusted net debt driven by the SEK6bn rights issue and SEK9bn from disposals and fleet reductions. Finally the programme predicted cost savings of SEK7.3bn less restructuring costs. The rights issue has now been successfully placed with existing and new shareholders including the Nordic governments that owned a combined 50% of SAS. Five bank loans totalling SEK6.5bn will be extended until at least June 2012 which, coupled with the rights issue, provides better liquidity. Revised covenants are not disclosed.

Q408 results were weak, as expected, delivering a 5% increase in revenues but the loss before tax weakened sharply to SEK2.77bn (EUR596m), due to the combination of a SEK712m impairment charge and losses at Spanair, as well as weaker traffic and out-of-the-money oil price hedges. For FY08 income before non recurring items fell 132% to a loss of SEK395m. Spanair is shown as a discontinued operation, where for FY08 the total negative impact on earnings was SEK4.9bn leading to a net loss of SEK6.3bn. SAS expects FY09 growth to be negative.

Spanair has now been sold for just EUR1 and the small Air Baltic disposal has also completed. SAS will convert loans it provided to Spanair into equity and keep a 20% de-consolidated stake. Spanair is heavily lossmaking so the disposal is positive for fundamentals.

SAS has hedged 45% of its anticipated revised fuel need for 2009 but strike prices remain hugely in excess of market prices, with a small amount of options which could reduce the level of hedging.

Over recent months our view has been that SAS would be unable to remain independent in 2009, with Lufthansa being the obvious purchaser. However, the new restructuring programme provides SAS with good cost savings, lower adjusted debt, stronger liquidity and thus better credit metrics and it also reaffirms government support for SAS. These factors suggest that SAS now has a better chance of remaining independent than a few months ago. At this stage we cannot rule out that the governments took these actions to maintain liquidity at SAS ahead of a sale to Lufthansa to avoid a distressed price, particularly given Lufthansa's acquisition strategy for Austrian.

While the equity issue is clearly positive for fundamentals it is offset by the fact that there is now perhaps less of a chance of a deal with Lufthansa in the short term. With underlying fundamentals continuing to deteriorate rapidly we see it providing badly needed breathing space for liquidity, rather than a long term solution to the problems of SAS.

One year rating target: Mid-B (maintained)

Relative value: Underperform (maintained since 07/11/08)

Airlines / Industrials earnings calendar

April

		1 Wednesday Stora Enso AGM	2 Thursday SCA AGM	3 Friday British Airways Traffic data
6 Monday	7 Tuesday SAS Traffic data	8 Wednesday	9 Thursday Lufthansa Traffic data	10 Friday
13 Monday	14 Tuesday	15 Wednesday	16 Thursday	17 Friday
20 Monday	21 Tuesday	22 Wednesday M-Real Q109 Results	23 Thursday Akzo Nobel, Stora Enso Q109 Results Lufthansa NorskeSkog AGM	24 Friday Lufthansa AGM
27 Monday	28 Tuesday SAS, Metso, SCA Q109 Results Air Liquide Q109 Sales	29 Wednesday ArcelorMittal Bayer, UPM Imerys Saint Gobain Q109 Results	30 Thursday Lufthansa Q109 Results	1 Friday

May

4 Monday Linde Q109 Results	5 Tuesday Holcim, Lafarge Q109 Results	6 Wednesday HeidelbergCement Q109 Results British Airways Traffic data	7 Thursday SAS Traffic data Norske Skog Q109 Results	8 Friday
11 Monday	12 Tuesday ThyssenKrupp Q208/09 Results Lufthansa Traffic data	13 Wednesday	14 Thursday	15 Friday
18 Monday	19 Tuesday Air France FY09 Results	20 Wednesday	21 Thursday	22 Friday British Airways FY09 Results
25 Monday	26 Tuesday	27 Wednesday DSM Q109 Results	28 Thursday	29 Friday

June

1 Monday	2 Tuesday	3 Wednesday British Airways Traffic data	4 Thursday	5 Friday SAS Traffic data
8 Monday	9 Tuesday	10 Wednesday Lufthansa Traffic data	11 Thursday	12 Friday
15 Monday	16 Tuesday	17 Wednesday	18 Thursday	19 Friday
22 Monday	23 Tuesday	24 Wednesday	25 Thursday	26 Friday
29 Monday	30 Tuesday	1 Wednesday	2 Thursday	3 Friday

Appendix: Summary of CDS recommendations

Issuer Issuer's Names	Ratings		Spot CDS	Variation			Expected Trend (1)	Spot vs Index			Perf. Expectation vs Sector Index		
	S&P/Moody's	Calyon		1 Week	1 Month	YTD		Ratio	Fair Value	Spot-FV	Previous	Since (3)	New

Expected trend

According to our quantitative model, this column indicates the expected trend for each single name (sector) relative to its sector index (the iTraxx Main):

↗ The single name (resp. sector) should underperform its sector (resp. iTraxx Main) in the month following. Indeed, the single name CDS over sector index ratio has tightened a lot in the past few days and so the model anticipates a trend reversal. This means that it is a good time to play the underperformance (but not necessarily the widening as we are in relative value)

→ No trend reversal is expected

↘ The single name (resp. sector) should outperform its sector (resp. iTraxx Main) in the month following. The ratio single names CDS/sector index has widened a lot in the past few days and so the model anticipates a trend reversal. This means that it is a good time to play the outperformance (but not necessarily the tightening as we are in relative value)

Fair value model

The **ratio** corresponds to the single name spread divided by its sector index (or sector index divided by iTraxx Main).

The historical fair value model has been developed to enhance our recommendation on every issuer of the coverage list. Its principle is based on a historical observation of the positioning of the 5Y CDS spread over the sector index. The average between the 3M, 6M and 12M ratios is considered to be the fair positioning of the 5Y CDS over the sector index. Therefore, with the spot value of the index, we can compute the historical fair value of the CDS.

The calculation of the historical fair value is achieved in several steps.

- **Step 1:** Using Calyon prices, we compute the ratio: '5Y CDS spread/index' for every trading day. It is worth noting that the computation of the index takes into consideration the PV01 weighting method (the wider the name, the less impact it has upon the fair value calculation for the index).
- **Step 2:** Once step 1 has been achieved, we compute the average value of the ratios over three months (3M), six months (6M) and one year (12M).
- **Step 3:** The average between the 3M, 6M and 12M ratios is considered to be the fair positioning of the 5Y CDS over the sector index. Therefore, with the spot value of the index, we can compute the historical fair value of the CDS. Comparing the spot price of the CDS and its fair value according to our model gives the analyst a quantitative tool to appreciate the potential future performance of an issuer vs the sector.

Performance expectation vs sector index

This represents the view of our analysts based on a fundamental analysis. It also indicates how long a particular recommendation has been held.

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Certification

The views expressed in this report accurately reflect the personal views of the undersigned analyst(s). In addition, the undersigned analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report.

Stuart James

Recommendation System:

Fundamental credit assessment: We evaluate the fundamental credit quality trend of an issuer for the next 12 months.

Calyon's Credit Research evaluates the potential changes of an issuer for the next 12 months and assigns a one year forward rating based on S&P's scale. This rating is to be compared with the average long-term rating assigned by S&P and Moody's.

Internal credit rating: We assign a rating to a company which reflects the assessment of the credit quality by the credit analyst. The timeframe for the rating is one year. As a rating scale we use a scale similar to the one of S&P and Fitch, however, we substitute the rating agencies plus or minus by high and low, ie. the Calyon scale uses AAA, High-AA, Mid-AA, Low-AA, High-A, Mid-A etc.

Performance of credit instruments: We express our expectation of how the 5 year CDS is going to perform vis-à-vis its sector. The timeframe of that recommendation is one month. When the analyst changes a recommendation he/she should indicate in the analysis when the last recommendation was made.

Outperform: CDS spreads should outperform the sector performance.

Sectorperform: CDS spreads should perform in line with the sector performance.

Underperform: CDS spreads should underperform the sector performance.

Credit products rating distribution table:

(as of 16th Jan 2009)

	All covered companies		Companies where Calyon provided Investment Banking Services in past 12 months	
	Count	Percentage	Count	Percentage
Outperform	21	20%	3	14%
Sectorperform	44	41%	5	11%
Underperform	42	39%	4	10%

Disclosures**Company Name Disclosure**

Air Baltic	None
Air Canada	None
Air France	None
Alitalia	None
Austrian Airways	None
British Airways	None
BMI	None
Continental	None
Iberia	None
Lufthansa	None
SAS	None
Spanair	None
United Airways	None

A	NOT IN USE
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