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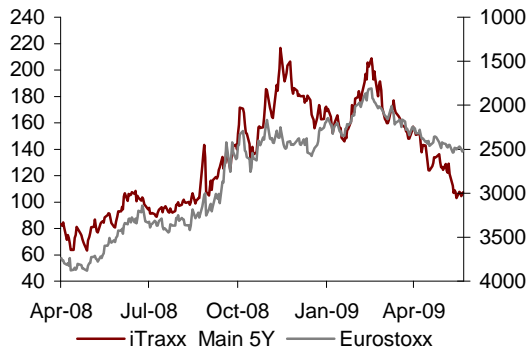
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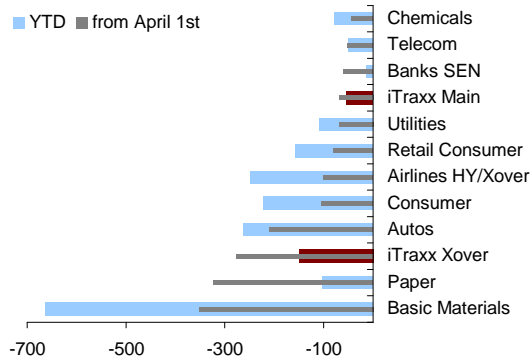
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## Q309 Update

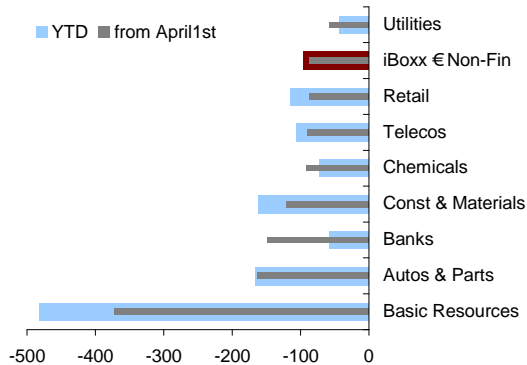
### iTraxx Main versus Eurostoxx



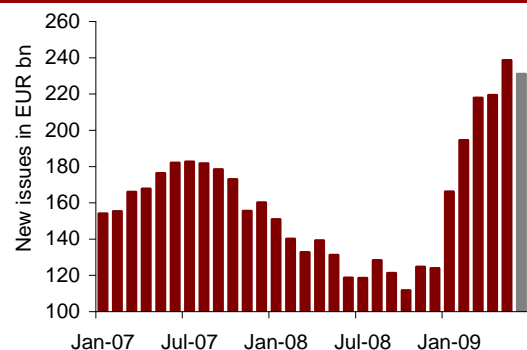
### CDS YTD and Q2 performance



### Cash YTD and Q2 performance



### Non-financials EUR issues (cumul. 12 mths)



Sources: Bloomberg, Calyon as at 18 June 2009

## Too far, too fast

### ■ Spreads ignore underlying weakness of economic environment

Credit markets have benefited strongly from an improvement in sentiment in equity markets, which are focusing on economic 'green shoots', as a sign that we have hit a bottom. Indeed, equity-credit correlation is around 58%, although down from recent highs of 71% in April. In spite of this we remind investors that default rates are expected to rise at an alarming pace in 2009, and that the underlying fundamental backdrop (including GDP, employment) is also expected to weaken further. Not all of the market confidence is misplaced; a massive wave of new investment-grade issuance, fund inflows and the re-opening of the high-yield market are taking some pressure off near-term default expectations and adding support to spread tightening.

### ■ Mixed Industrials performance in Q2, to weaken in coming quarters

Industrials had a mixed performance in Q2. Outperformance favoured Basic Materials in both cash and CDS indices, while others, like IG Chemicals, Pulp & Paper and Airlines underperformed the relevant indices. The better-than-expected performance in Basic Materials was a result of a few large single-name shifts in Q2; in particular, Glencore (683bp tighter) and ArcelorMittal (555bp tighter), on which we have Outperform ratings. With regard to the Airlines and Pulp & Paper sectors, which are predominantly high-yield, we also observed some strong single-name improvements, notably M-Real where CDS is now very illiquid.

### ■ Sector recommendations unchanged

Given recent tightening we remain Underperform in both CDS and cash on Industrials.

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

### ■ What to expect in Q3?

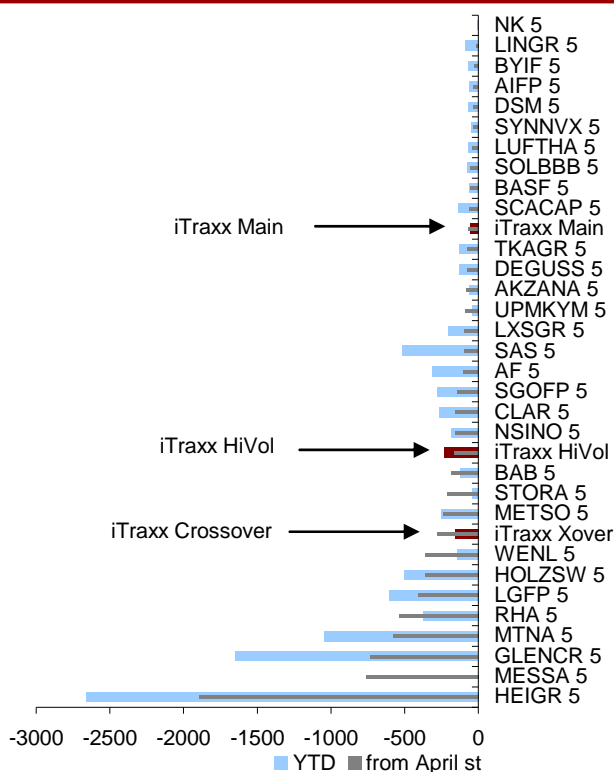
The macro environment (eg, unemployment and demand) should remain weak, which combined with rising default levels should reverse the positive impact of increased issuance on spreads in the coming quarters. In addition, we believe that the summer lull, where trading activity falls substantially and liquidity is low, could lead to increased volatility and resetting of short positions given that tightening appears to have gone 'too far, too fast' in Q209.

### In this issue:

	Page
Sector recommendations .....	2
Issuer recommendations .....	3
Primary activity and outlook .....	5
Credit trend .....	7
Issuer snapshot .....	14
Industrials earnings calendar .....	29

# Sector recommendations

## CDS YTD and Q2 performance



## Recommendation performance

### CDS: Euphoria set to end

The performance of Industrials CDS since the start of Q2 has been exceptional, particularly given rising credit risk and continuing uncertainty about when credit quality will hit a bottom. Large issuance, from predominantly good-quality credits, and an increase in consensual restructurings have in part masked the problems growing at the lower end of the credit chain. Moody's expects defaults to continue to rise and in Europe to reach levels in Q409 reminiscent of the Great Depression (1933: 15.4%).

### Calyon Basic Materials CDS index strongly outperforms

HeidelbergCement led the tightening following the agreement reached with banks on a refinancing of facilities. Additionally, it was likely that fewer banks were looking to hedge their loan positions than in Q4. Glencore, ArcelorMittal and Lafarge saw similar sharp tightening on successful partial refinancing, equity issues and generally improved liquidity and refinancing risk.

### Calyon Pulp & Paper CDS index mixed

M-Real CDS led the index to tighten although it remains very illiquid and has been widening strongly over recent days. Excluding this name the index underperformed iTraxx Crossover as can be seen from the Pulp & Paper names in the chart opposite (particularly SCA and UPM).

### Underperformance of Calyon Chemicals CDS index

Calyon Chemicals CDS index (excluding HY) has been the worst-performing index since end-Q1, having tightened only 45bp compared with 55bp for the iTraxx Main. Outside of the IG space, Rhodia (Ba3 neg/BB-NR) was the best-performing chemical name (-620bp). We remain Underperform the sector, but Outperform on the safer industrial gas names (ie, Air Liquide).

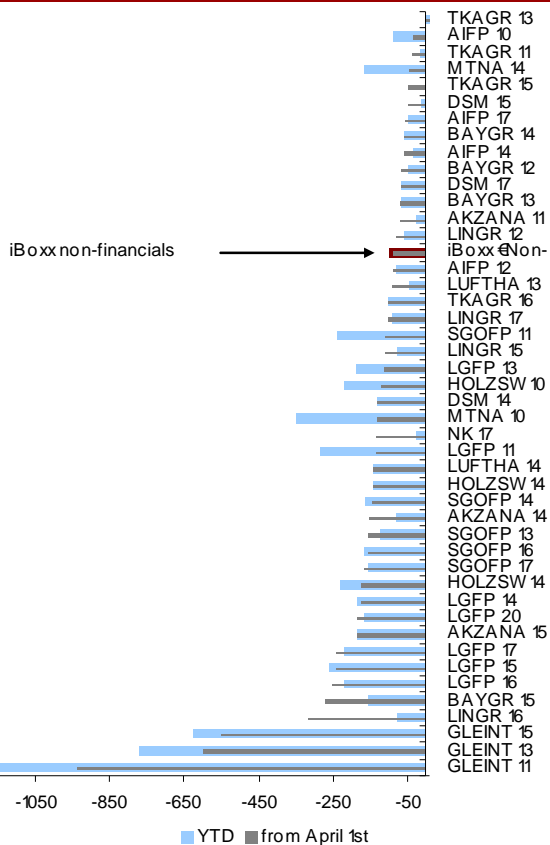
### Underperformance of Calyon Airlines CDS index

Each name in the Airlines CDS index underperformed the Crossover index, particularly Lufthansa and SAS, where we have Underperform recommendations.

### Cash indices: Glencore outperforms...as expected

Overall cash industrials outperformed iBoxx non-financials on higher risk and yield appetite. The big performer was Glencore (Outperform), where the 2011 (c.946bp), 2013 (c.577bp) and 2015 (c.544bp) bonds tightened on successful syndicated loan refinancing news and the prospect that rising commodity prices would have a positive impact on earnings in the coming quarters.

New equity issues saw Lafarge and Saint-Gobain bonds perform well. ArcelorMittal short-term bonds benefited more from refinancing actions than longer-term bonds, which generally underperformed the index. At the other end of the scale ThyssenKrupp bonds were the weakest performers of the quarter, driven by a combination of large new issuance and concerns that the credit may shortly be downgraded to junk.



Source all charts: Bloomberg

## Issuer recommendations

### Recommendation performance

The table below illustrates the performance of our trade recommendations year-to-date, based on a EUR10m notional trade. We have generated a positive EUR2.4m in P&L for our closed trades, while open trades are currently positive EUR1.4m.

#### 2009 trade track record

<b>Maturing Strategies</b>	<b>Entry Date</b>		<b>Entry Spread</b>	<b>Last Spread</b>		<b>Maturity</b>	<b>MtM (EUR)</b>
Sell STORA CDS EUR SR 1Y	16/12/2008		502	405		16/12/09	91,983
Sell SCACAP CDS EUR SR 1Y	16/12/2008		308	103		16/12/09	196,822
Sell BAB CDS EUR SR 1Y	16/12/2008		734	646		16/12/09	80,999
Sell AFFP CDS EUR SR 1Y	16/12/2008		656	406		16/12/09	232,662
Sell NSINO CDS EUR SR 6M	06/12/2009		800	NA		12/12/09	377,967
Sell SAS CDS EUR SR6M	06/12/2009		850	NA		12/12/09	400,496
							<b>1,380,929</b>

<b>Closed Strategies</b>	<b>Entry Date</b>	<b>Selling Leg</b>	<b>Entry Spread</b>	<b>Last Spread</b>	<b>Buying Leg</b>	<b>Entry Spread</b>	<b>Last Spread</b>	<b>Closing Date</b>	<b>P&amp;L (EUR)</b>
Sell XOVER S11 5Y - Buy TKAGR 5Y CDS	02/04/2009	ITRX XOY	922	870	TKAGR	481	447	19/04/09	183,728
Sell SAS CDS 1Y - Buy LUFTHA CDS 5Y	16/12/2008	SAS	1651	1037	LUFTHA	273	155	14/05/09	415,146
Sell NSINO CDS EUR SR 6M	16/12/2008		1200	NA				16/06/09	555,017
Sell MESSA CDS EUR SR 6M	16/12/2008		2900	NA				16/06/09	1,240,093
									<b>2,393,984</b>

<b>Open Strategies</b>									<b>MtM (EUR)</b>
Sell HIVOL S11 5Y - Buy METSO CDS 5Y	28/05/2009	HIV	244	221	METSO	265	244	Open	11,677
Sell BAB CDS EUR SR 6m	28/05/2009		638	627					10,120
									<b>21,797</b>

Closed Trades	2,393,984
Open Trades	1,402,726
<b>Total</b>	<b>3,796,710</b>

Source: Calyon

In our *Pulp and Paper 2009 Outlook* and *European Airlines 2009 Outlook* (published December 2008) we highlighted that our preferred way to trade these sectors in 2009 was via 'survival' trades, ie, selling short-term CDS for a period of 6 to 12 months where investors were absolutely certain that there would be no liquidity issues. This was because we were concerned that market volatility and wide bid/offer spreads would make pair trades difficult to put in place for lower-rated credits, particularly as it was not clear if there would be sufficient market liquidity to exit the trades. Above you will see that the strategy has performed extremely well, generating substantial P&L on some trades.

### Changes to issuer recommendations

We change our recommendation on Saint-Gobain from Outperform to Sectorperform and now set a Sectorperform recommendation on Lafarge, following a period of strong tightening post recent capital increases, which improved refinancing risk, liquidity and leverage.

At this stage we make no changes to our published Pulp & Paper sector recommendations. During the quarter, post a very sharp tightening in 5Y CDS, we moved our recommendation on Metso from Sectorperform to Underperform given that the fundamental order-book-related credit issues at Metso have not changed.

## Summary of our CDS recommendations

Basic Materials			Spot CDS	Variation			Expected Trend	Spot vs Index			CDS Recommendation		
Issuer	S&P/Moody's	Calyon		1 Week	1 Month	YTD		Ratio	Fair Value	Spot - FV	Previous	Since	New
ArcelorMittal Finance	BBB neg / Baa3 stable	Low-BBB	509	-8	-50	-976	→	104%	480	29		22/06/09	Outperform
Compagnie de Saint Gobain	BBB+ neg / Baa1 neg	High-BBB	175	5	23	-282	↘	36%	191	-16	Outperform	08/04/09	Sectorperform
Glencore	BBB- stable / Baa2 neg	Low-BBB	623	-44	-151	-1647	→	128%	637	-14	Outperform	01/10/08	Outperform
HeidelbergCement	WR / B1 CWneg	NR	900	-53	-261	-2664	↗	184%	1131	-231	Sectorperform	14/01/09	NR
Holcim	BBB stable / Baa2 stable	NR	263	-12	-65	-503	→	54%	295	-32	Sectorperform	09/04/09	NR
Lafarge	BBB- stable / Baa3 neg	Low-BBB	273	-13	-88	-603	→	56%	344	-71		22/06/09	Sectorperform
ThyssenKrupp	BBB- Wneg / Baa3 neg	NR	432	-10	77	-125	↘	88%	272	160	Underperform	12/06/09	NR
Wendel	BB neg / NR	NR	755	-20	-75	-153	↘	155%	611	144	NR	-	NR
<b>Index Basic Materials</b>			<b>488</b>	<b>-20</b>	<b>-73</b>	<b>-839</b>	<b>→</b>						

Chemicals			Spot CDS	Variation			Expected Trend	Spot vs Index			CDS Recommendation		
Issuer	S&P/Moody's	Calyon		1 Week	1 Month	YTD		Ratio	Fair Value	Spot - FV	Previous	Since	New
Air Liquide	A stable / NR	Mid-A	52	-2	-9	-58	→	31%	57	-5	Outperform	04/08/08	Outperform
Akzo Nobel	BBB+ neg / Baa1 neg	NR	79	-7	-21	-63	↗	47%	87	-8	Underperform	22/12/08	NR
BASF	A+ neg / A1 stable	NR	77	-3	-10	-65	↗	46%	81	-4	NR	-	NR
Bayer AG	A- neg / A3 stable	NR	58	-2	-6	-73	→	35%	63	-5	Sectorperform	22/12/08	NR
Clariant AG	BBB- neg / Ba1 Stable	NR	280	1	27	-262	↗	167%	283	-3	NR	-	NR
Evonik Degussa	BB stable / Baa3 Wneg	NR	160	-5	-11	-133	→	96%	157	3	Underrperform	25/03/09	NR
DSM	A- stable / A3 stable	NR	66	-6	-4	-69	→	39%	69	-3	Sectorperform	18/02/09	NR
Lanxess	BBB stable / Baa2 stable	NR	170	-12	-10	-205	→	102%	181	-11	NR	-	NR
Linde AG	BBB+ Pos. / Baa1 stable	NR	77	-2	0	-86	→	46%	70	7	Outperform	18/12/08	NR
Rhodia	BB- stable / B1 neg	NR	867	57	-16	-368	→	519%	822	45	NR	-	NR
Solvay	A neg / A2 Wneg	NR	83	-5	-11	-74	→	50%	88	-5	NR	-	NR
Syngenta AG	A stable / A2 stable	NR	68	-2	-6	-50	→	41%	67	1	NR	-	NR
<b>Index Chemicals</b>			<b>167</b>	<b>0</b>	<b>-7</b>	<b>-124</b>	<b>→</b>						

Airlines			Spot CDS	Variation			Expected Trend	Spot vs Index			CDS Recommendation		
Issuer	S&P/Moody's	Calyon		1 Week	1 Month	YTD		Ratio	Fair Value	Spot - FV	Previous	Since	New
Air France - KLM	NR/NR	Mid-BB	389	-11	9	-317	→	78%	400	-11	Underperform	20/05/09	Underperform
British Airways	BB neg / Ba3 neg	Mid-BB	625	1	-50	-125	→	126%	609	16	Sectorperform	15/04/08	Sectorperform
Lufthansa	BBB neg / Baa3 stable	Low-BBB	163	-3	19	-70	→	33%	163	0	Underperform	02/06/08	Underperform
SAS	B stable / B2 neg	High-B	821	-4	-35	-515	→	166%	826	-5	Underperform	07/11/08	Underperform
<b>Index Airlines</b>			<b>496</b>	<b>-5</b>	<b>-14</b>	<b>-254</b>	<b>→</b>						

Paper			Spot CDS	Variation			Expected Trend	Spot vs Index			CDS Recommendation		
Issuer	S&P/Moody's	Calyon		1 Week	1 Month	YTD		Ratio	Fair Value	Spot - FV	Previous	Since	New
Metso Corp	BBB neg / Baa2 neg / NR	Low-BBB	250	0	-32	-244	↗	28%	339	-89	Underperform	28/05/09	Underperform
M-Real Corp	CCC+ neg / Caa1 neg / NR	High-CCC	3474	410	249	588	→	388%	3167	307	Underperform	16/12/08	Underperform
Norske Skogindustrier	B+ neg / B2 stable / NR	High-B	1051	50	60	-214	→	117%	1115	-64	Underperform	16/12/08	Underperform
Svenska Cellulosa (SCA)	BBB+ neg / Baa1 neg / NR	Mid-BBB	106	-3	-15	-136	↗	12%	161	-55	Sectorperform	16/02/09	Sectorperform
Stora Enso	BB neg / Ba2 neg / BB+ neg	Mid-BB	470	15	8	-43	→	53%	491	-21	Underperform	16/12/08	Underperform
UPM Kymmene	BB+ neg / Ba1 stable / BB+ neg	Mid-BB	360	16	60	-42	→	40%	368	-8	Underperform	16/12/08	Underperform
<b>Index Paper</b>			<b>895</b>	<b>62</b>	<b>40</b>	<b>-41</b>	<b>→</b>						

Key: ↘ Outperformance expected; → No trend reversal is expected; ↗ Underperformance expected. NR: Not Rated

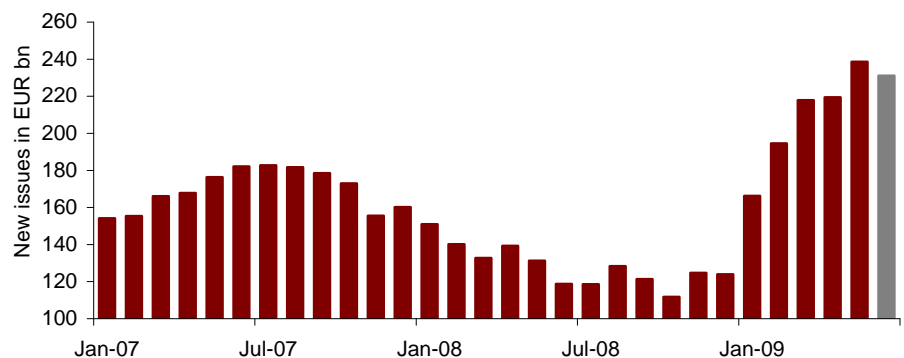
Source: Bloomberg, Calyon as at 18 June 2009

## Primary activity and outlook

The second quarter has continued to see a very active primary market with much of our coverage taking forward new issuance. The year to date has been categorised by three main themes. Firstly, a gradual re-opening of the (repriced) corporate bond market to steadily weaker credits, including cyclical sectors. This was driven by good fund inflows and returning risk appetite, and has culminated in the recent re-opening of the European high-yield market, principally for 'fallen angel' names. Secondly, 2009 has seen a gradual tightening of spreads as the refinancing risk premium built into spreads for most investment-grade credits has reduced, which in turn has made the bond market more attractive to issuers. Lastly, we are now seeing a flow of issuer debt move from bank loans to the bond market as bridge and standby credit facilities are repaid from bond issuance.

Corporate issuance continues to dominate the market, with EUR180bn issued year-to-date, compared with EUR160bn in 2007 and EUR124bn in 2008. The bulk of the issuance (56%) has been in three sectors: Utility & Energy sector (25%), followed by Chemicals (16%) and Autos (15%), and in names rated BBB+ and above (79%).

### Non-financials Euro market new issues (cumul. 12M)



Source: Calyon, Bondware

Industrial primary issuance in Q1 reached EUR10.3bn, compared with EUR9.9bn so far in Q2. With around two weeks remaining in the quarter, we would not be surprised to see a figure higher than in Q1, as frequent issuers take advantage of investor appetite. Industrial issuers that came to the market this quarter were also present in Q1, including: ArcelorMittal, BASF, Holcim, Saint-Gobain and ThyssenKrupp.

### Industrial euro primary issues in Q209

Issuer	Date	Moody's	S&P	Maturity date	EUR (bn)	Spread <sup>1</sup> (bp)	Coupon
Air Liquide	26-May	NR	A	03/06/2015	400	135	4.4%
ArcelorMittal	26-May	Baa3	BBB+	03/06/2016	1,000	622	9.4%
ArcelorMittal	26-May	Baa3	BBB+	03/06/2013	1,500	583	8.3%
BASF	1-Apr	A1	A+	08/10/2012	350	145	3.8%
BASF	1-Apr	A1	A+	08/10/2012	1,000	160	3.8%
BASF	18-May	A1	A+	09/06/2015	500	145	5.1%
Holcim	1-Apr	Baa1	BBB	26/03/2014	650	565	8.0%
Lafarge	18-May	Baa3	BBB-	27/05/2014	1,000	512	7.6%
Lafarge	15-May	Baa3	BBB-	24/11/2016	750	430	7.6%
Lanxess	2-Apr	Baa2	BBB	09/04/2014	500	510	7.8%
Saint-Gobain	7-May	Baa1	BBB+	20/05/2013	750	350	6.0%
ThyssenKrupp	22-Apr	Baa3	BBB-	25/04/2013	500	335	6.8%
ThyssenKrupp	8-Jun	Baa3	BBB-	18/06/2014	1,000	515	8.0%
<b>Total</b>					<b>9,900</b>		

<sup>1</sup> versus mid-swaps

Source: Bloomberg, Calyon

### Building materials

As can be seen from the table, ArcelorMittal, Saint Gobain, ThyssenKrupp, Holcim and Lafarge have been active with new issuance. ArcelorMittal and Lafarge have had particularly large short-term debt maturities to refinance and potential covenant issues, which resulted in the introduction of debt-reduction plans. Saint Gobain, Lafarge and Arcelor have all issued equity to improve balance sheet strength, which has made it easier to gain further access to the bond market. Very strong demand was seen for the recent new issues from these credits. Looking at debt-maturity profiles, liquidity and rising government bond yields, we would expect each company to return with further benchmark new issues as the year progresses.

### Pulp & Paper

It was no surprise to see new issues from the strongest credits, ie, SCA and Metso, and both new issues will add to already reasonable debt-maturity profiles alongside other debt instruments raised. We had previously identified that Stora Enso desperately needed to improve its debt-maturity profile, but in truth we were a little surprised to see Stora Enso come to the market as the first European high-yield deal since July 2007, excluding the Calyon-led Fresenius deal. The Stora Enso tap highlighted to us that management was being realistic about the need to act quickly, which we found encouraging. UPM has a much stronger debt-maturity profile but we would be surprised if it does not take the opportunity to come to the market over the next few months. M-Real remains desperate to issue, but the market is unlikely to open this year for CCC-band credits. Over the last few days Norske Skog announced plans for a new bond, probably benefiting from the Norwegian Corporate bond fund, part of Norway's stimulus package.

### Airlines

The sector started the recession with significantly more cash on balance sheet than most crossover credits (eg, around ten times the Pulp & Paper sector). For this reason there was no immediate need for Airlines to come to the bond market, nor in truth a great deal of investor appetite given strong subordination driven by high levels of secured aircraft debt. Our discussions reveal that group treasurers would generally rather raise cheaper secured finance on unencumbered planes. Lufthansa may be an exception, where there could be scope to undertake a 7Y deal, on top of the EUR850m 5Y March issue, which would avoid increasing already high refinancing risk in 2014. Over the last few days Air France has announced that it will come to the market with a new EUR575m convertible issue.

### Chemicals

Year-to-date chemical issuance (excluding Pharma) was EUR7.95bn, representing 4.4% of total EUR corporate issuance. The bulk of this, EUR3.5bn or 44%, was raised by BASF, which acquired CIBA in April. For the rest of 2009, issuers are likely to remain opportunistic.

**In conclusion, we believe that issuance for the rest of the second quarter is likely to rise and reach similar levels to the previous quarter; whether we see an increase in lower-rated names is yet to be seen. This said, given that the default rate is expected to increase for the rest of the year, we do not rule out the possibility that equity issuance in this space is increased as issuers look to avoid breaching bank covenants.**

## Credit trend

### Outlook and credit trend

Our economists expect global GDP to shrink by 1.3% in 2009. In particular, GDP in the Eurozone is expected to be -4.5%, revised further from the -2.9% expected in our previous quarterly document. The prognosis for 2010 remains subdued, with only marginal GDP growth expected for the Eurozone (+0.2%).

Industrial production, a key indicator of growth in the sector, continues to decline in the Eurozone, and particularly in Germany. German industrial production fell by 21.6% YoY in April (-18% Jan, -21% Feb, -20% March). UK and French industrial production was also not immune, down by 12.3% and 18.8% YoY, respectively, in April. The automotive industry, which accounts for a large proportion of economic growth, 3.5% of EU GDP/employment and 62% of OECD steel end-use (according to ArcelorMittal), is under extreme pressure to cut output and jobs. Our Autos Analyst forecasts 2009 US and European auto sales could fall by 18.2% and 13%, respectively, with auto production down more than 25% to align inventories with sales.

### Steel

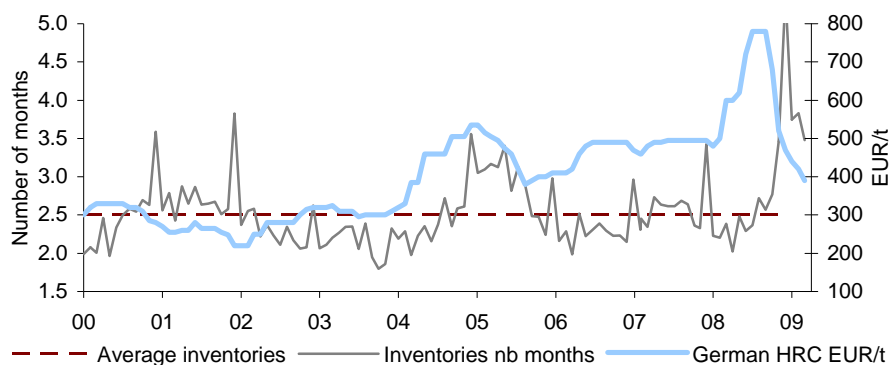
Worldsteel Association crude steel production data for YTD April showed a 22.7% drop versus the same period last year, a decline also reflected in the month of April (-23.6% YoY). In Europe (EU27), the YTD decline was 44.2% (France -42.5%, Germany 43%). For the full year we estimate that 2009 world crude production will fall by around 20% YoY, before rebounding in 2010. The dramatic drop in demand in the construction and autos sectors continues to be the key driver, with the former a bigger driver for ArcelorMittal and the latter a bigger driver for ThyssenKrupp.

Given that steel production is closely correlated to GDP growth, the size and timing of the recovery is key for the industry and credit quality of the issuers. The downturn, which has been driven by a severe decline in real demand and subsequent de-stocking since last September, is expected to show some recovery in the latter part of 2009. Inventories for flat and long carbon steel products have now started to reduce (see chart below) leading to a stabilisation of prices over recent weeks and even the announcement by ArcelorMittal of some price increases.

With regard to the pricing environment, hot-rolled coil (HRC) in Europe has fallen to around EUR385/t, compared with EUR810/t in August 2008 (-52%), keeping pressure on iron ore producers to cut prices in contract negotiations. While prices have been fairly flat recently in Europe, we were concerned to see that US prices have edged downwards by a further c.10% in recent weeks, implying that we have not hit the low point for US inventories yet.

Nippon Steel's annual iron ore contract price settlement of -33% was weaker for steel companies than the -40% consensus, highlighting the continued strong pricing power the miners have. This agreement would normally have set world benchmark levels but there remains resistance from other steel groups to settle at this level, particularly in China. This represents the first decline in seven years for iron ore prices, on the back of recession-led lower demand, but means prices still look very high compared with historical trends.

### German inventories of flat steel products



Source: Cheuvreux, CRU

### Building Materials

On 15 June Holcim announced it was buying Cemex's Australian operations for c.USD1.6bn, via a fully equity-financed deal (c.USD1.8bn), which will actually be positive for credit metrics. At 6.6x EBITDA the acquisition looks reasonable value for this point in the cycle (Hanson 9.9x) given that it is mainly a ready-mixed concrete and aggregates business; but does this mean that we are about to see a deluge of Cement sector M&A ?

While we have certainly seen a great deal of sector M&A over recent years (see below) we do not now expect to see any major M&A, ie, one company taking over another, as the larger players have generally been spending substantial amounts of cash on acquisitions and investment capex over the past three years, and it is now time to get balance sheets back in order.

#### Sector M&A deals above USD1bn, 2006-09

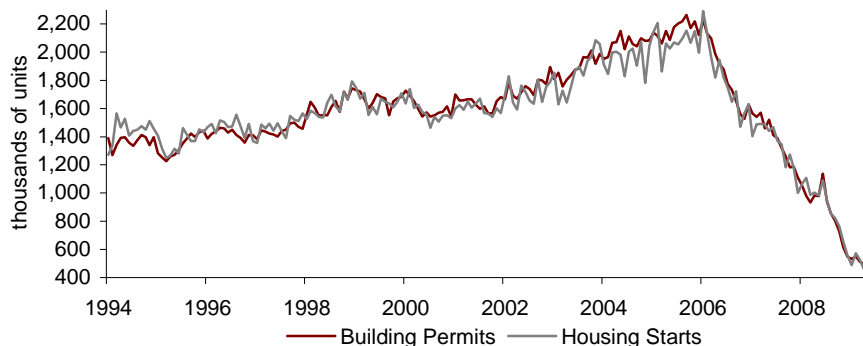
Date	Target	Acquirer	USDm
15/06/2007	Hanson	HeidelbergCement AG	18,289
10/12/2007	OCI cement group (Orascom)	Lafarge SA	14,998
27/10/2006	Rinker Group	Cemex	14,627
06/02/2006	Lafarge North America inc	Lafarge SA	2,946
10/12/2007	Hi Mart	Eugene Corp	2,111
05/06/2006	Uniland Cementera s.a.	Cementos Portlandvalderrivas	1,416
21/08/2006	Ashland paving and construction	CRH plc	1,300
20/02/2006	Materis	Various	1,207

Source: Bloomberg

Instead, we expect to see a mixture of small disposals – for example, Lafarge currently targets EUR1bn of disposals this year (EUR232m in place so far) – and forced sellers similar to the Holcim transaction, which was no doubt driven by Cemex's need to raise cash to refinance. We think another example would be HeidelbergCement, which looks like it will be forced to sell quality assets to get debt levels down. The company has finalised the refinancing with its banks, whereby it looks likely that new loans are structured to force HeidelbergCement to deleverage from asset sales over a period of (say) two years.

The natural acquirers in a recession tend to be the stronger players or those that are not having so many issues to contend with. In this case it would probably be those that have undertaken less M&A/investment in recent years. CRH (BBB+ neg/NR/BBB+ neg) therefore looks like a natural acquirer. However, most balance sheets look stretched, so we do not expect to see players undertake several deals each.

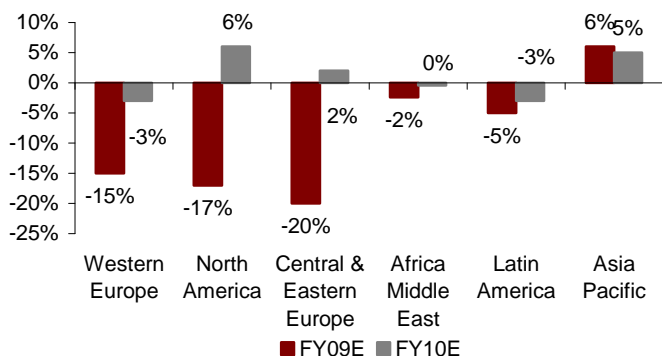
US housing starts and building permits



Source: US Census Bureau

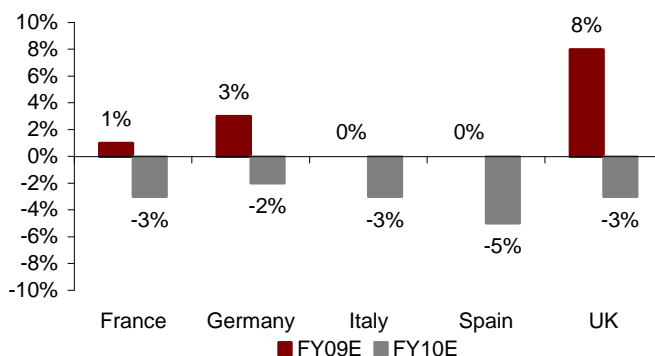
Data for building permits and housing starts has continued to deteriorate (see chart above) in the main mature markets, such as the US, although we saw a slight pick-up in the latest data. Cheuvreux's estimates (See *Building materials: From cost deflation to pricing risk*, 1 June 2009) for the expected changes in cement volumes and prices in FY09 can be found below, where it looks like Eastern Europe will be hardest hit. It appears that producers have successfully managed to cut volumes enough to protect or in some cases even increase prices in Europe.

Expected change in cement volumes (YoY)



Source: Cheuvreux

Expected change in price (YoY)

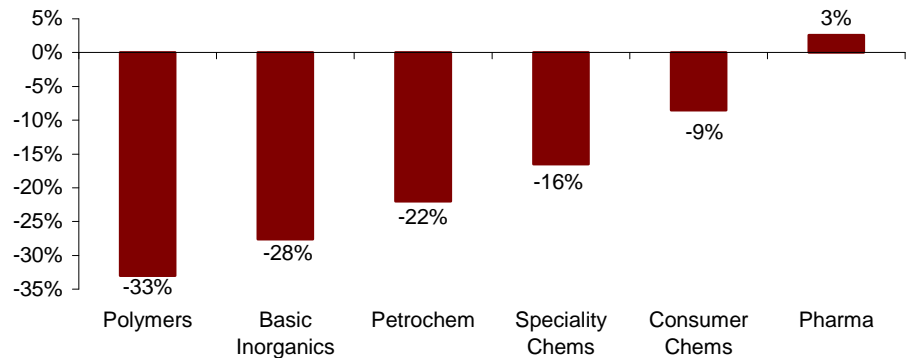


Source: Cheuvreux

Chemicals

Overall the European Chemistry Industry Council (Cefic) expects that production in Europe, excluding the Pharma sector, will shrink by 11% in 2009. In contrast, 2010 production is expected to grow by 5%. In the chart below we show the development of Q109 production (EU27), which was quite severe for some sectors (notably Polymers); this said, we believe that Q1 was likely to be the weakest point in the cycle. Our view is that we are not yet entering a period of growth, but a receding of the decline. In general, chemical companies should start to benefit from a large reduction in inventories among end-users, despite the fact that capacity utilisation should remain historically low. We continue to favour the less cyclical, industrial gases sector (Air Liquide, Linde) and are cautious on names impacted by the autos sector, which is in a large phase of restructuring, and also commodity-like segments (petrochemicals and coatings).

European production trends, Q109 (YoY %ch)

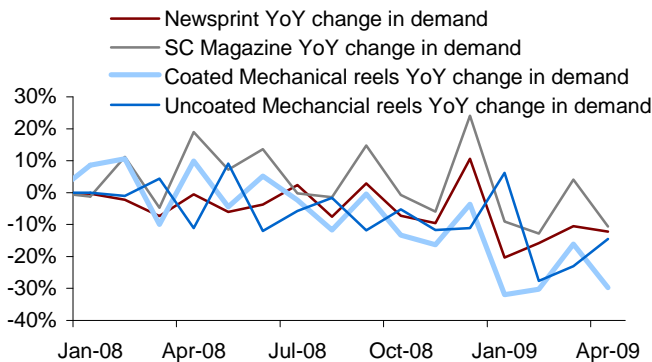


Source: Calyon, Cefic

Pulp & Paper

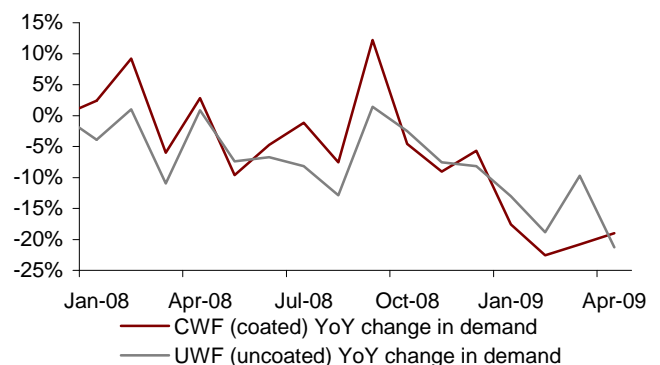
This year has broadly seen a 20% downturn in worldwide demand for paper, depending on paper grade, which has been driven by a mixture of clients de-stocking, the cyclical downturn and continuing secular changes. While some producers have been quick to cut capacity the overall situation is that production has not been cut as quickly as demand has fallen, leading to greater oversupply and the start of pressure on prices. It remains clear to us that greater restructuring and more capacity closures are needed, so we expect further announcements of this nature as we move through the year.

Publishing paper: Slight restocking but downward trend still visible



Source: CEPIPRINT

Fine paper volumes continue downward trend



Source: CEPIFINE

To address the downturn and attempt to keep net cash flow at least neutral to avoid increases in debt, most companies have continued to announce more capex cuts. We would not be surprised to see further dividend cuts announced over the rest of the year as the need for cash preservation is strong, given that most of the companies within our Pulp & Paper coverage started the recession with only EUR200-400m of cash.

There are not many industries experiencing both a cyclical and secular downturn at this time, so this latter aspect should not be ignored. For example, in the US in 2007 – at the time a flat economy – demand for newsprint fell by as much as 10%. The switch to online media is fast becoming more of an issue as technology such as mobile internet access is improved, and the recently launched faster, cheaper iPhone 3G S will continue to push this trend. A further factor is that ‘free’ newspapers, which rely totally on advertising for revenue, are seeing their business model destroyed by the advertising downturn and consequently switching to online-only versions avoiding the need for paper.

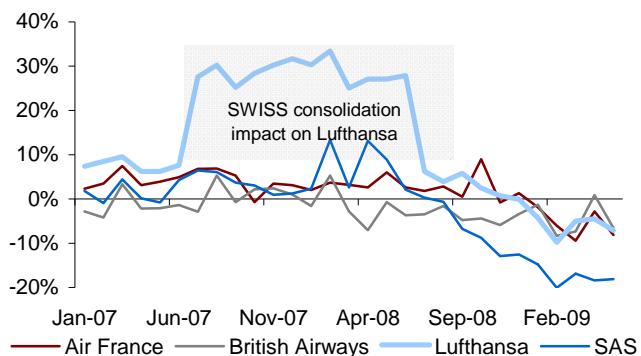
More cuts to credit ratings continue to look highly feasible given the speed at which FFO is decreasing, although any covenant breaks look to be restricted to

very weak entities rather than the investment-grade or fallen-angel names which generally do not have any financial covenants.

### Airlines

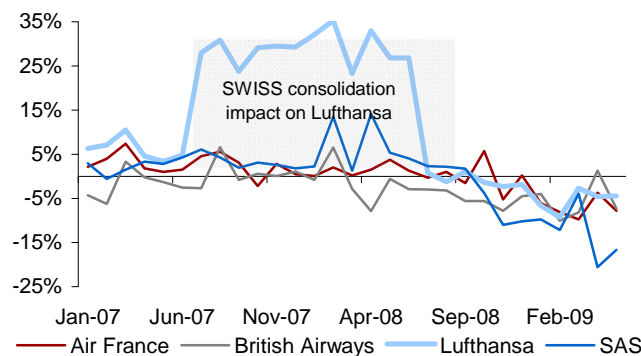
Airline data has been a little mixed with AEA (Association of European Airlines) traffic growth actually briefly returning to positive levels in April due to the timing of Easter in 2009. As highlighted below, the trend in traffic data for our coverage continues to fall rapidly since the middle of 2008, in terms of both 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 continued to see much weaker SAS traffic, but stronger BA load factors.

RPK growth (YoY)



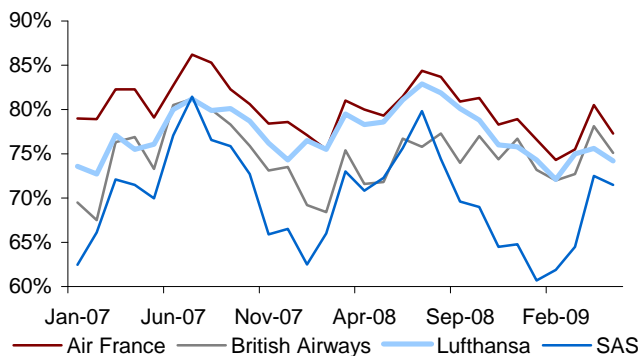
Source: Calyon, Company data

Passenger growth (YoY)



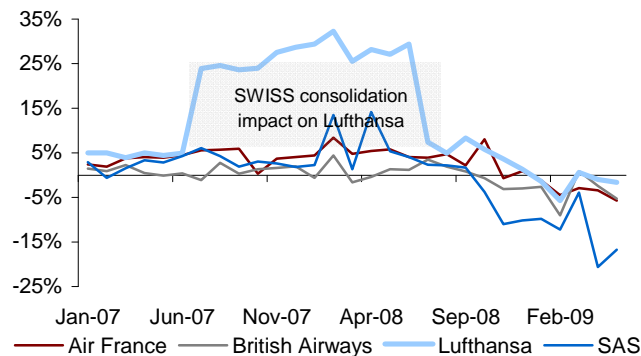
Source: Calyon, Company data

Load Factor (%)



Source: Calyon, Company data

ASK growth (YoY)



Source: Calyon, Company data

IATA has recently revised its 2009 industry loss estimate to -USD9.0bn from its March estimate of a USD4.7bn loss on the back of recession-driven lower traffic, with USD3.0bn of the losses expected to be at Asia-Pacific carriers and USD1.8bn expected in Europe.

The big threat during Q2 was the advent of swine flu, and whether the impact would be similar to SARS, which in spring 2003 led to international air traffic declining sharply over a six-month period, falling 20% over two months and as much as 50% in May for the Asia-Pacific region. The initial reaction was a sharp sell-off, particularly in equities, but in credit the move was quickly discounted as premature, with spreads returning to relatively unchanged levels and in truth having very little effect over the quarter to date.

It is still relatively early days for the new virus and thus it is difficult to predict how the situation might develop as we head into different seasonal animal migration phases and influenza seasons in the Northern Hemisphere. The swine flu virus can travel more easily from human to human than SARS, as confirmed by its

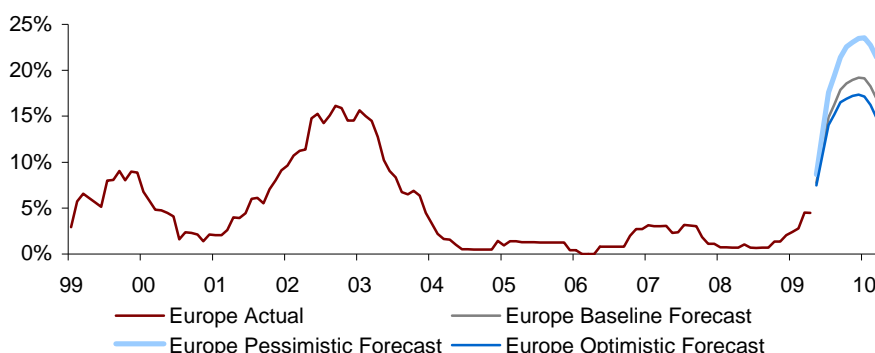
ability to travel further and more quickly around the world, but it appears that fatality rates are much lower. At the time of writing the total number of recorded cases was 44k, located mainly in the US (40%), Mexico (17%) and Canada (11%) with a total of 180 fatalities, which were located mainly in Mexico (63%) and the US (24%). As expected, US airlines have been affected more than European airlines to date given the higher numbers of cases in the US/Mexico and more direct traffic to Mexico.

However, with the World Health Organisation officially declaring the situation as a 'pandemic', ie, its highest state of alert, comes the acknowledgement that it is no longer possible to contain the influenza, which now looks set to spread worldwide leading to "widespread human infection". Consequently, consumers in areas affected by influenza are likely to take action to limit the risk to their families and themselves, particularly during flu seasons, with one of these actions simply being to cancel, delay or reduce the number of flights they take. The flu season in Europe starts in around four to five months so we expect general newsflow leading up to this period and increasing cases in Europe to result in a prolonging of the downturn in Airlines relative to other sectors.

## Downgrades continue, defaults to rise

Moody's latest default report (3 June 2009) forecasts that the global speculative default rate will peak at 13.8% in Q4, and then fall to 8% by May 2010, versus 9.2% experienced in May (1.9% May 2008). There is a large variance between what is expected in the US, where Moody's predicts defaults will peak at 13.5%, and in Europe (17.9%). In the US the sector most likely to be impacted is the auto sector, while in Europe it is the durable consumer goods sector. In 2010 the US default rate is expected to recede quickly, falling to 6.7% by May, while in Europe the default rate is expected to fall only to 15.8%. According to Moody's the speculative grade default rate reached 15.4% in the US Great Depression (1933).

### Europe trailing 12M issuer-weighted spec-grade default rate forecasts



Source: Calyon, Moody's

Rating migration below the BBB+ area continues downwards, a reflection of a weak operating environment, notably for the Airline and Pulp & Paper sectors.

## Q209 credit rating changes

S&P		Moody's		Fitch	
Date	Action	Date	Action	Date	Action
<b>Building Materials / Construction</b>					
		9/4	Baa1 to Baa2 stable		
Holcim				27/3	BBB to BBB- neg
Lafarge					
<b>Steel / Metals</b>					
ArcelorMittal	29/4	7/4	Baa2 on dwgrd. review	20/5	BBB+ to BBB stable
	6/5	20/5	Baa2 to Baa3 stable		
ThyssenKrupp	6/5	27/5	Baa2 to Baa3 neg	20/5	BBB+ to BBB- neg
<b>Airlines</b>					
British Airways	8/5	28/5	Ba1 to Ba2 neg		
SAS	6/5		B CW neg to B stable		
<b>Pulp &amp; Paper</b>					
Norske Skog	19/5				
Stora Enso	24/4	8/5	Ba2 CW neg to Ba2 neg		
	14/5				
UPM	1/4				

Source: S&P, Moody's, Fitch

## What to expect from Q209 earnings results

Generally, YTD demand in industrial sectors has dropped rapidly through a combination of reduced demand and de-stocking. For some industrial sectors (eg, chemicals, commodities) we expect Q2 results to highlight that we hit a bottom in Q1, so we will be looking at this closely for names such as Air Liquide and Glencore – growth will still be negative, but just not as negative as Q1. However, in other sectors, eg, Paper, we think that there is more deterioration still to come.

In the investment-grade world there now appears to be ample liquidity, even for names on the edge of high-yield, eg, Lafarge, Imperial Tobacco, despite banks being in deleveraging mode. Therefore, near-term liquidity-driven risk should continue to reduce, even though YoY growth will be negative and free cash flows may remain flat or negative. Additionally, with other markets also re-opening it should bring additional financial flexibility. Regardless though, credit ratings should continue to drop as it becomes clearer that financial ratio targets for ratings will not be met. Capex and dividends have been cut rapidly to attempt to limit FCF losses and further cuts here look likely. However, a lot of rating methodologies are based on gross cash flow, ie, FFO.

The large drop in demand and consequent rapid change in volumes and prices are proving to be an issue for working capital. This will continue as the year progresses, where we think we could still see some large negative swings. In the Pulp & Paper sector, end-users have been in destocking mode, leaving manufacturers with larger inventories. Airlines are similar to a retail business with growing turnover often generating cash, as consumers pay up-front and creditors are paid over a 30- to 60-day period. However, given traffic is falling we now expect the situation to reverse and working capital to become a drain on cash flow (particularly BA). The chemical sector is still seeing destocking by clients; however, the bulk of this already occurred in Q1 in our view.

**Overall, the perception of the depth of the recession for each sector and the level of fund inflows should remain the key drivers of absolute spreads in Q209.**

## Issuer snapshot

Where feasible we have included a liquidity analysis for issuers where the full detail of debt maturities has been disclosed. In the liquidity analysis tables we try to estimate the cash position for FY09-10 year-end assuming the following: (1) short-term bank debt is rolled over; (2) commercial paper is not refinanced; (3) the minimum level of cash needed to run the business is 2% of sales (or similar). The analysis takes into account new bonds, loans or capital issues completed since the beginning of FY09 plus planned asset sales.

### Air France (NR/NR)

A significant deterioration in passenger and cargo unit revenues, driven by the decline in business traffic and lower international trade, has led to several profit warnings over the past six months and operating losses over the past quarter that were actually worse than BA's. We suspect Air France may have curtailed its hedging programme more slowly than BA when oil prices fell rapidly last year.

Air France's seasonally weak Q409 (March) provided a massive operating loss of -EUR574m, albeit better than guidance for -EUR650m. Post currency and fuel fair value adjustments, the Q409 loss before tax was as much as -EUR1.2bn with no dividend proposed. Overall, a weak H209 led to a small FY09 loss of -EUR0.13bn (guidance EUR0.2bn) versus a EUR1.4bn profit in FY08. The fuel bill rose 25% to EUR5.7bn. The cash impact was a huge 78% drop in FFO, which, compared with debt levels, would now be weak for the 'BB' rating category. Shorter-term liquidity continues to look reasonable with cash and equivalents of EUR4.3bn and available credit facilities of EUR1.2bn easily covering short-term debt maturities of EUR800m pa for the next three years. However, another similar year of trading without actions to help cash flow could well burn a further EUR1.0-1.5bn of cash as FY09 FFO/capex cover was really very weak at 0.24x (0.97x), leading to material cash burn.

Consequently, Air France is now taking stronger remedial action, increasing its cost-saving target to EUR600m (from EUR530m), reducing capacity by 4.5% in Passenger and 11% in Cargo for summer 2009, cutting headcount by 3% and reducing its FY10 (March) capex investment plan by a further EUR100m to EUR1.4bn (originally EUR2.9bn). Additionally, the fuel bill should fall by USD1.9bn in FY10. Air France continued to say that trading was challenging and visibility limited (particularly for H210) repeating guidance for a limited loss in FY10 (March).

We remain of the view that Air France will be one of the survivors in Europe, despite other failures elsewhere, and have no doubt that the French government would regard it as a national champion if support were needed (current equity stake 16%). Company liquidity remains solid for selling short-term CDS but 1Y spreads have tightened by around 200bp since we published this idea in December.

**One year rating target: Mid-BB (maintained)**

**Relative value: Underperform (maintained since 20/05/09)**

### Air Liquide (A/NR/A)

The company updated the market on revenue figures at the end of April, and lowered its guidance for FY09. Despite this, we consider the company to be a relatively safe industrial company in the current downturn, given strong product and regional diversity. In Q109 revenues declined 3% (LfL -3.4%), which was weaker than what the market had expected (LfL -2.3%). With regard to the two main divisions, Industrial Merchant (42% of sales) proved to be more resilient than expected, with organic sales down 7.7%, versus an expected 14% decline, albeit still buffeted by weaker demand from the auto and materials sectors. Large Industries division (33% of sales) sales rose 2.2%, weaker than the 12% rise expected, but confirmed start-ups should support business going forward. FY guidance was revised downwards also, and now calls for revenue and net income to be close to 2008 levels from an earlier target of 0-5% growth in these metrics.

Debt levels are still expected to remain unchanged, following a planned cut in capex to EUR1.6bn.

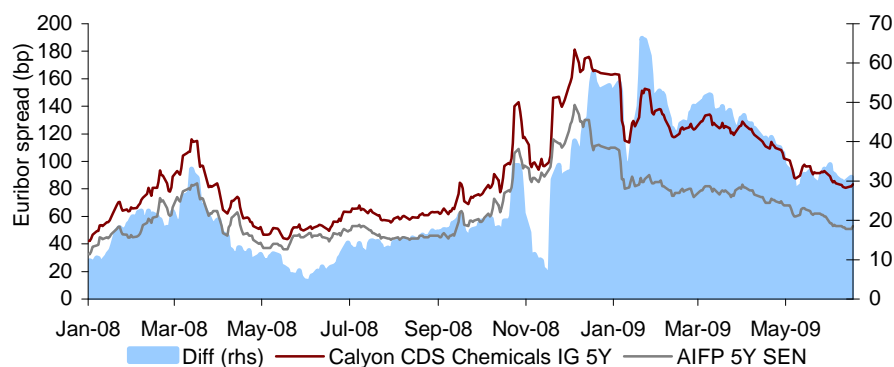
Q2 results, due out 30 July, should show some improvement with Q1 being the worst quarter.

With regard to relative value, we maintain our Outperform stance, as we believe that the recent rally was overdone and the company's strong fundamental foundation is a relative safe haven in a weakening market.

**One year rating target: Mid-A (maintained)**

**Relative value: Outperform (maintained since 04/08/08)**

#### Air Liquide 5Y CDS (bp over asw)



Source: Bloomberg, Calyon

### ArcelorMittal (BBB neg/Baa3/ BBB)

Over recent months ArcelorMittal has shown that it is prepared to act quickly to avoid any liquidity issues by rapidly taking forward its FYE09 USD10bn net debt reduction plan (compared with USD32.5bn at 30 September 2008 at). Q408 saw net debt reduce by USD6.0bn (USD1.6bn working capital release, USD2.5bn unwinding of a currency hedge) but Q109 saw little change with proforma net debt at USD26.7bn. Since then the company has issued USD3.2bn of equity, leaving proforma net debt at USD23.5bn so the FYE09 net debt target of USD22.5bn is well within reach, but not really driven by trading.

So far this year ArcelorMittal has raised USD17.7bn of new cash inflows, helping to ease liquidity, improve debt maturity and start to reduce refinancing risk. However, regardless of these extensive actions, the rapid drop in volumes, prices and thus EBITDA means that loan covenant concerns still remain, particularly the FY09 3.5x debt/EBITDA test. Current consensus suggests it will meet this with an FY09 level of 3.0x (0.5x), but a pick-up in trading could quickly absorb cash into the working capital cycle given it would bring a need for increased inventories/debt.

#### Summary of new cash sources

##### Equity / equity linked

Convertible (March)	EUR1.25bn
New equity issue	USD3.2bn
USD0.8bn convertible	USD0.8bn
<b>Total equity / equity linked raised</b>	<b>USD5.7bn</b>

##### Debt raised

2015/19 USD bonds	USD2.25bn
Forward start loans	USD6.3bn
EUR bond	EUR2.5bn
<b>Total debt raised</b>	<b>USD12.0bn</b>

<b>Grand total</b>	<b>USD17.7bn</b>
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Source: Bloomberg

Liquidity is reasonable with proforma cash and committed available facilities of as much as USD16.4bn (including the recent equity issue), but this just about covers remaining 2009-10 debt maturities of around USD13bn. Accordingly, we would not rule out further bond issuance from the company this year.

Q109 EBITDA before exceptionals was below expectations but in line with (USD1bn +/-15%) guidance at USD883m. Exceptional items of -USD1.2bn, mainly relate to inventory write-downs. Guidance was provided for Q209 EBITDA of USD1.2-1.5bn with capacity utilisation likely to remain at a very low c.50%. It still expects 2009 rotation days to fall to 75-85, raising c.USD5bn cash via lower raw material inventories (ie, potentially exceeding its USD22.5bn debt target), but acknowledged that a pick-up in business would make this tougher to achieve, ie, the funding source is unsustainable.

It would not have been a surprise for investors to see S&P, Moody's and Fitch all downgrade ArcelorMittal over the past month or so to BBB neg/Baa3/BBB, post weak Q109 results. Rating pressure certainly remains, eg, Moody's had assumed debt reduction would come from trading rather than an equity issue so we think a negative outlook is looking likely here.

Given Q2 guidance ArcelorMittal clearly needs to have a much stronger H2 for it to meet its 3.5x debt/EBITDA covenant test. Assuming both Q2 EBITDA and FY09 net debt guidance are met we calculate that H209 EBITDA needs to be at least 70-115% better than H109 to meet the covenant test, which looks tough. We think that banks would be supportive of waivers/amendments against, say, a large cut to their commitments, but any renegotiation would also probably bring increased borrowing costs and negative rating actions. The alternative is a further equity issue in late Q4, which would be unpalatable to the family given probable dilution. For now we are tactically Outperform ahead of Q209 results.

**One year rating target: Low-BBB**

**Relative value: Outperform**

#### ArcelorMittal: liquidity analysis (forward start facilities signed in February 2009 factored in) (USDm)

Reporting date: 31 December 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>debt due</b>	<b>7,333</b>	<b>5,399</b>	<b>3,799</b>	<b>8,200</b>	<b>1,900</b>	<b>6,420</b>
including bonds	100	835	0	0	1,500	5,655
including loans	3,200	4,599	3,799	8,200	400	800
including short-term bank debt	1,800					
including commercial paper	2,200					
including securitisation	0					
cash	3,979	21,662	16,262			
<b>FOCF after dividends/acquisitions/disposals</b>	<b>5,516</b>	<b>0</b>	<b>0</b>			
<b>new bonds/new loans/equity</b>	<b>17,700</b>					
<b>cash position before rollover of ST debt/securit</b>	<b>19,862</b>	<b>16,262</b>	<b>12,463</b>			
rollover of short-term bank debt & securitisation	1,800					
<b>cash position after rollover of ST debt/securit.</b>	<b>21,662</b>	<b>16,262</b>	<b>12,463</b>			
<b>Cash after drawdown on committed facilities</b>	<b>21,662</b>	<b>16,262</b>	<b>12,463</b>			
	<b>Dec-09</b>	<b>Dec-10</b>	<b>Dec-11</b>	<b>Dec-12</b>	<b>Dec-13</b>	<b>&gt; Dec-13</b>
Committed & undrawn facilities (1)	7,532	7,532	7,532	0		
Drawdown under committed available facilities	0	0	0			
Available committed & undrawn facilities left	7,532	7,532	7,532			

Source: Company, Calyon

## British Airways (BB neg/Ba2 neg)

FY09 results were worse than expected delivering a -GBP220m operating loss (GBP878m), post restructuring costs of GBP78m. Excluding exchange impacts revenues were actually down 3.7%, but fuel was still up as much as 27% (higher prices plus out-of-the-money hedging) with BA losing more than GBP400m in H209 on fuel hedging. BA has now elected not to provide guidance because of the lack of visibility but did reaffirm its GBP1.0bn cash target and that it feels the downturn will last longer than it originally expected, with no sign of any upturn yet. Clearly, we can still expect BA to be loss-making in the next 12 months along with Air France. BA is confident it could sell and lease back unencumbered aircraft to fund any shortfall in the GBP1.0bn FY10 cash target, but this is not from trading.

Q409 cash flow continued to be weak absorbing another GBP0.2bn of cash. With cash of GBP1.4bn and GBP3.0bn of available credit facilities, liquidity looks reasonably solid and adequate to meet short-term maturities despite restricted facility availability and probable negative cash flow post capex. Note that only USD270m of the GBP3bn facilities are general purpose, with the remainder solely for new planes. See *Credit Focus BA: Making P&L from a deteriorating situation* published 28 May, for a detailed liquidity assessment. While BA will benefit from a GBP400m lower fuel bill in FY10, the continued drop in business traffic suggests further FFO deterioration. Capex over the next two to three years "will get slightly smaller" with a full review of potential cuts now being undertaken. Finally, interest received will all but disappear this year. Detailed guidance for debt maturities and capex was provided at the recent investor day and is summarised in the note mentioned above, which also includes a BA trade idea.

There were no new merger or co-ordination developments viz the potential Iberia merger or the BA/AA/Iberia transatlantic JV, other than BA admitting the pension deficit was a concern for Iberia with a significant deterioration expected in the actuarial revaluation. BA reiterated that putting in place a governance structure that would enable all synergies to be extracted was the main concern but clearly the shareholder split must also be a concern for Iberia. If the merger is called off then BA spreads should widen, but if the deal goes ahead we would still expect some spread tightening, given that a merger would bring Iberia's strong South American franchise and good revenue/cost synergies. Elsewhere, the US DOT will respond on the AA/BA/Iberia JV by the end of October.

**One year rating target: Mid-BB (maintained)**

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

## Glencore (BBB-/Baa2 neg/NR)

Q109 results showed YoY weakness as expected, but recent commodity price rises bode well for Q3 in our view. In all, adjusted EBITDA was down 71% YoY to USD363m (Q108: USD1,264m) on the back of lower Marketing activities (77% of reported EBIT), in which volumes related to the Metals division, and particularly in the supply of steel to the automotive and construction sectors, declined. In addition, Industrial activities (23% of reported EBIT) suffered from lower commodity prices and shrinking margins. Commodity prices have, however, shown some improvement in May, with spot prices (1 June) in copper, zinc and nickel rising 28%, 32% and 32%, respectively, versus Q408 averages. FFO also showed a substantial decline YoY, with adjusted FFO falling to USD270m versus USD1,179m a year ago, although an improvement on Q408 (USD68m). In terms of credit metrics, the company reported 12-month FFO to net debt at 24.3% (31.6% end December 2008) and net debt to EBITDA of 1.97x (1.69x end December 2008). The current ratio was 1.17x versus 1.19x at end 2009.

Results aside, the main driver for the credit continues to be its strong liquidity position, which was recently supported by the renewal of its syndicated credit lines until 2012. The company confirmed (15 May) it had reached an agreement with lenders on a USD6.65bn forward start agreement, expiring in 2012, which comes into effect when the current USD8.2bn syndicated loans expire in May 2011 (ie, line reduced and extended by one year). In addition, Glencore gained an USD815m, 364-day revolving credit line, with the possibility of a one-year extension, which refinanced the company's USD925m 364-day revolving facility

that expired on 13 May. The firm had originally sought USD5bn and USD500m, respectively, but gained increased liquidity on strong demand, which shows good bank support in our view.

The company has USD3.8bn of cash and committed credit facilities available at end-Q109, above its internal USD3bn target. In addition, the sale of its Cartagena oil refinery (USD549m) to Ecopetrol SA was concluded in Q2, which should further support debt reduction.

Elsewhere, Xstrata announced it had begun preliminary discussions with Anglo American about a possible merger of equals (market capitalisation c.USD68bn combined). It is still early days yet, and a final deal is far from certain. That said, given Glencore has a 35% stake in Xstrata, this news will fuel reports in the *Financial Times* (19 June) about an initial IPO by Glencore. As yet, Glencore has made no public comment, although we believe it may be premature to be talking about an IPO. If the deal were to proceed we see Glencore benefiting in two ways: Firstly, it could improve the company's level of market intelligence and marketing arrangements with the larger group, and secondly it could benefit from potentially higher commodity prices.

**One year rating target: Low-BBB (maintained)**

**Relative value: Outperform (maintained since 01/10/08)**

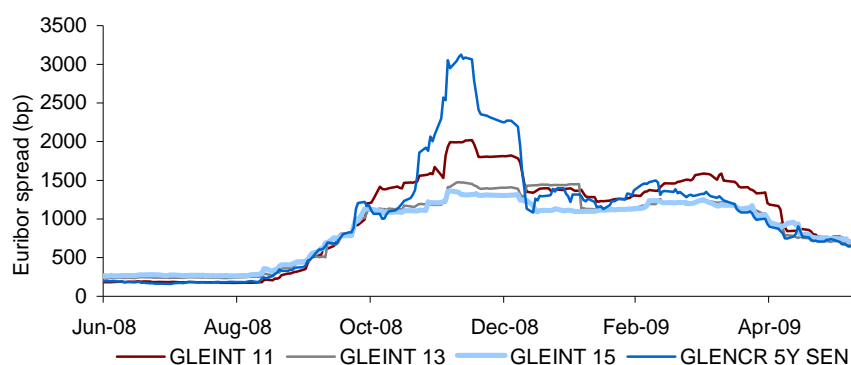
#### Glencore: liquidity analysis (USDm)

Reporting period	Q2-Q409	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>debt due</b>	<b>4,565</b>	<b>1,631</b>	<b>2,173</b>	<b>5,896</b>	<b>1,431</b>	<b>3,490</b>
including bonds	0	0	764	0	1,067	3,490
including loans	1,302	1,020	946	5,650	203	0
including short-term bank debt	1,155	0	0	0	0	0
including commercial paper	0	0	0	0	0	0
including securitisation	1,563	0	0	0	0	0
including profit participation scheme	545	611	463	246	161	0
Cash (beg. of period)	706	1,349	93			
<b>FOCF after dividends/acquisitions/asset sales</b>	<b>1,740</b>	<b>0</b>	<b>0</b>			
<b>New Bonds/Loans</b>	<b>0</b>	<b>0</b>	<b>0</b>			
<b>Cash position before rollover of ST debt/securit.</b>	<b>-2,119</b>	<b>-282</b>	<b>-2,080</b>			
Rollover of short-term bank debt & securitisation <sup>1</sup>	3,468					
<b>Cash post rollover of ST bank debt/securit.</b>	<b>1,349</b>	<b>-282</b>	<b>-2,080</b>			
<b>Cash after drawdown on committed facilities</b>	<b>1,349</b>	<b>93</b>	<b>66</b>			

1. Assume USD900m Xstrata loan partially repaid with USD750m drawdown of USD1.5bn facility, expiry Sept. 2010.

Source: Company, Calyon estimates

#### Glencore 5Y CDS and cash bonds (bp over asw)



Source: Bloomberg, Calyon

## Lafarge (BBB-/Baa3 neg/BBB- neg)

In February Lafarge announced a total of EUR4.5bn of measures to strengthen its financial structure and avoid a covenant breach; chiefly an underwritten EUR1.5bn rights issue, EUR1bn of asset sales in FY09 and a new EUR1bn two-year bank facility. In addition, it increased FY09 cost-cutting plans from EUR120m to EUR200m (within its EUR400m 2009-11 programme), cut capex by a further EUR200m to EUR1.8bn and targeted another EUR200m cash inflow from working capital.

As expected, Q109 results were weak delivering a 9% drop in sales to EUR3.6bn with the largest decline seen in Central and Eastern Europe (-45% YoY). Operating income fell 35% to EUR335m with Cement and Gypsum remaining profitable but Aggregates & Concrete loss-making. Lafarge did not provide any outlook for FY09; however, it indicated that its cement volumes are likely to be down by 2-5% YoY overall. Free operating cash flow was negative at -EUR253m due to seasonal working capital absorption of EUR311m, helping net debt to rise to EUR17.7bn (FY08 EUR16.9bn). The EUR1.5bn rights issue funds were not received until 28 April, which will have helped net debt to move lower since Q109 as will the sales of the Marmara, West Black Sea, Canadian and Swiss operations announced on 4 May for a total of EUR232m.

The rights issue was used to repay tranche A1 (EUR300m) and EUR1.15bn of tranche A2 of the Orascom loan, extinguishing the need to meet the related financial covenant (net debt/EBITDA <4x as at 30 June 2009), which otherwise may have been breached.

Overall, the actions taken over the past few months should make credit investors much more comfortable with the credit, regardless of whether Lafarge hangs on to its investment-grade rating, given the strong improvement in liquidity. We believe that the targeted EUR1bn asset sales will be needed to stabilise credit metrics in FY09. Our liquidity analysis below highlights that there is no longer any refinancing urgency for the company in 2009.

**One year rating target: Low-BBB**

**Relative value: Sectorperform**

### Lafarge: liquidity analysis (EURm)

Reporting date: 31 Dec 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>debt due</b>	<b>2,702</b>	<b>1,093</b>	<b>2,405</b>	<b>4,530</b>	<b>1,380</b>	<b>6,799</b>
including bonds	299	843	1,181	367	801	6,306
including loans	0	250	1,224	4,163	500	149
including short-term bank debt	1,379	0	0	0	0	0
including commercial paper	1,024	0	0	0	0	0
including securitisation	0	0	0	0	0	0
including other debt	0	0	0	0	79	344
<b>cash</b>	<b>1,591</b>	<b>4,715</b>	<b>381</b>			
<b>FOCF after dividends/acquisitions/asset sales</b>	<b>719</b>	<b>462</b>	<b>0</b>			
<b>new bonds/new loans</b>	<b>3,728</b>	<b>0</b>	<b>0</b>			
<b>cash position before rollover of ST debt</b>	<b>3,336</b>	<b>4,085</b>	<b>-2,024</b>			
rollover of short-term bank debt	1,379	0				
<b>cash position after rollover of ST bank debt</b>	<b>4,715</b>	<b>4,085</b>	<b>-2,024</b>			
<b>Cash after drawdown on committed facilities</b>	<b>4,715</b>	<b>381</b>	<b>-1,368</b>			
Committed & undrawn facilities (1)	2,054	2,054	5,758			
Drawdown under committed available facilities	0	3,704	-656			
Available committed & undrawn facilities c/f	2,054	5,758	3,898			
	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>		
(1) Maturity date of committed & undrawn facilities			1,204	850		

Source: Company, Calyon

## Lufthansa (BBB neg/Baa3)

Credit spreads remain surprisingly tight given adjusted net debt levels and a probable EBIT reduction of c.50% in 2009 on lower passenger traffic and high fuel costs. While Lufthansa may be the only profitable major airline in Europe this year, it also 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 170 planes including 15 A380s and 20 747-800s on order, where it intends to spend c.EUR14bn over the next four years on fleet capex. In 2009 fleet capex will be 3.5x that of similar sized peer Air France, and in 2010 it will 3.1x higher.

As identified in our December 2007 Airlines Outlook, Polskie Linie Lotnicze LOT SA (LOT), the struggling 93.1% Polish state-owned Star Alliance airline, may be an acquisition target for Lufthansa. BA and Air France will compete for the deal but Lufthansa looks the favourite as both are Star Alliance members and there may be a cost to LOT for exiting the Star Alliance. Certainly, the equity cost at, say, less than EUR250m is affordable for Lufthansa and Air France but debt levels are not clear. BA is not in a position to acquire struggling companies. Nonetheless, it reinforces Lufthansa's aggressive acquisition strategy and makes us wonder whether it is considering a rights issue at some point.

Q109 was stronger than anticipated with an operating loss of -EUR44m (EUR172m). At the time Lufthansa confirmed FY09 guidance for a fall in revenue and a "considerable reduction in the operating result", which would still be "clearly positive" but operating cash flow will now no longer cover capex, and net debt will rise to EUR1bn at the end of FY09. BA's CEO said recently that Lufthansa and Air France were being too positive on guidance and he may now have been proved to be correct as on 19 June Lufthansa issued a profit warning where it is now trying to "avert an operating loss" rather than its previous guidance. The mix of travellers is changing from Business to Leisure, which is weakening profits but has been providing a working capital boost (Q109 EUR380m) as Leisure clients pay for tickets earlier. FY09 capex guidance is EUR3.1bn, split EUR2.1bn fleet and other capex plus EUR1.0bn of 'financial capex' including acquisitions, ie, BMI (EUR0.4bn), Austrian (EUR0.35bn) plus Brussels Airlines. Liquidity remains solid with gross cash and available credit facilities of c.EUR4.8bn at Q109, very solid for 2009/2010 debt maturities of c.EUR900m. Our only concern is that Lufthansa does not pre-fund fleet commitments, unlike BA for example.

Lufthansa has been a frequent short for investors via CDS over the past 12-18 months, which has not really performed due to a combination of reasonably illiquid (retail-focused) bonds, the crowded nature of the trade and a strong retail bid. The recent new bond has not really changed this nor recent acquisitions or speculated deals. We believe banks have been selling credit-linked notes, eg, first-to-default baskets, that include Lufthansa, to German retail investors who focus on brand, helping to keep spreads tight. Fundamentals still clearly point to spreads moving wider but the strength of the technicals viz the strong German retail bid for credit-linked notes means that the technicals are the stronger driver at the moment for this name. We think that this will continue until German newspapers start publishing very negative Lufthansa headlines, whereupon we may see the retail bid start to subside. Regardless, when the above aspects are coupled with the currently weaker market, now would seem like a good time for any professional investors to be taking the c.170bp profit on the recent new bond issue.

**One year rating target: Low-BBB (maintained)**

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

## Metso (BBB neg/Baa2 neg/NR)

The market remains focused on order book deterioration, since Q408 orders fell by 41% and Q109 by 38%, driven by Metso's exposure to the paper and mining sectors (43% and 22% of sales to end-market, respectively). The paper sector is cutting capex sharply and the mining supercycle is over so naturally orders are dropping. Q109 delivered a 32% drop in underlying operating profit and Metso reaffirmed its guarded FY09 outlook for weaker FY09 revenues and profits where it sees sales "greater than EUR5bn" (-22%) and "satisfactory" profit. The Paper segment (-172%) was responsible for most of the operating profit deterioration. The order book saw minimal cancellations in Q109 and the backlog is down 9% on FY07 levels, which at roughly nine months of turnover provides some visibility.

Cash flow has mirrored the weakness with Q109 FFO down 38%. Recent growing inventories had resulted in a huge (EUR437m) working capital drain on FY08 cash flow. Thankfully these problems are starting to be resolved with Q109 working capital generating EUR94m of cash albeit from lower trade debtors rather than inventories, which remain stubbornly high. Lower capex in line with the previous guidance helped to result in positive net cash flow before finance and a stronger cash position. FY09 capex guidance is EUR150m (EUR255m). Metso had cash of EUR436m and committed undrawn credit facilities of EUR500m at Q109, which looks solid against a debt-maturity profile that has few maturities until 2011. However, unless Metso can monetise inventories, undertake a rights issue (unlikely) or cut dividends further we expect FY09 to be marginally cash flow negative before financing, implying a minimal drawing on the EUR500m RCF. In this scenario it is unlikely that Metso could hang on to its BBB neg/Baa2 neg ratings so we expect a one-notch cut this year.

On 28 May we changed our 5Y CDS relative value recommendation from Sectorperform to Underperform following a period of excessive tightening that had seen Metso CDS tighten by more than -24% over the last month, well ahead of other Paper-related names, eg, SCA (-16%) and Stora (-10%).

**One year rating target: Low-BBB (maintained)**

**Relative value: Underperform (maintained since 28/5/09)**

### Metso: liquidity analysis (EURm)

Reporting date: 31 December 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>debt due</b>	<b>242</b>	<b>160</b>	<b>386</b>	<b>160</b>	<b>68</b>	<b>315</b>
including bonds	83	124	332	92	0	362
including loans	15	34	51	67	66	150
including short-term bank debt	101					
including commercial paper	141					
including securitisation	0					
cash at start of year	314	554	361			
<b>FOCF after dividends/net acquisitions/disposals</b>	<b>16</b>	<b>-33</b>	<b>-3</b>			
<b>new bonds/new loans</b>	<b>365</b>	<b>0</b>	<b>0</b>			
<b>cash position before rollover of ST debt/securit.</b>	<b>453</b>	<b>361</b>	<b>-28</b>			
rollover of short-term bank debt & securitisation	101					
<b>cash position post rollover ST bank debt/securit.</b>	<b>554</b>	<b>361</b>	<b>-28</b>			
<b>Cash after drawdown on committed facilities</b>	<b>554</b>	<b>361</b>	<b>99</b>			
Committed & undrawn facilities (1)	650	650	650			
Drawdown under committed available facilities	0	0	-127			
Available committed & undrawn facilities remaining	650	650	23			
	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
(1) Maturity date of committed & undrawn facilities	0	0	500	0	0	0

Source: Company, Calyon

## M-Real (CCC+ neg/Caa1 CW neg/NR)

Investors remain focused on refinancing risk, particularly the undrawn EUR500m revolver due to be repaid in December 2009. Reasonable bond negative pledge clauses should stop banks from taking most security. Banks will be deciding whether or not to refinance their exposure through to, say, 2012, ie, for a deteriorating CCC+ credit, where they can take no security/priority over bondholders nor other unsecured creditors, which may result in 2010 noteholders being redeemed by drawing down on the RCF, leaving banks fully drawn to a company with no liquidity in 2010. Alternatively, they will simply try to walk away, ie, a high drop-out rate on any refinancing attempt looks likely, particularly if the facility remains undrawn. Our liquidity assessment suggests the business has a very good chance of running out of cash in 2010, even if the loan is extended, so a refinancing looks very unpalatable for banks without a solid workable plan.

The company has options (see our Credit Focus *M-Real: Does M-Real have options for survival?*, 3 June 2009) but none are concrete. First, it is no doubt trying to sell its small PVO stake and 30% stake in Metsa-Botnia (UPM offered EUR500m for 15% in 2006), but asset values have fallen sharply, there are few cash buyers (including UPM) nor many willing lenders. M-Real could continue to buy back the 2010 FRN at a discount, highlighting to lenders it is not bailing out bondholders, but this would be false as it needs to draw down on the bank facility to do this, ie, unpopular with banks looking to exit. Alongside Metsaliitto it could make a cash call on members (but many are struggling themselves) or there is the potential sale of the EUR220m Sappi vendor loan note. M-Real believes it has access to EUR320m of pension loan headroom but this looks questionable given that it requires a bank guarantee (very unlikely) or valuable asset security, while PVO and Metsa-Botnia stakes may have the usual JV issues.

We highlight the continuing risk of a consensual debt exchange (including a haircut for bondholders) with banks taking security, bondholders getting second priority security and M-Real seeing a material cut to its nominal debt level. Either way we see a big negotiation ahead over the next six months, which adds to uncertainty and thus more risk. During Q408 M-Real repurchased EUR44m of the FRN at 45c and during Q109 EUR15.95m at 62c. Q109 results were weak as expected, with an EBITDA loss of –EUR48m (EUR96m). It sees lower volumes for H1 and will try to defend prices. Debt was reasonably unchanged (but only because of the sub-par buybacks) but cash was down around EUR250m from FY08, despite a cash inflow from working capital and very low capex.

**One year rating target: High-CCC (maintained)**

**Relative value: Underperform (maintained since 16/12/08)**

### M-Real: liquidity analysis (EURm)

Reporting date: 31 December 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>drawn debt due</b>	<b>322</b>	<b>440</b>	<b>110</b>	<b>190</b>	<b>546</b>	<b>228</b>
including bonds	240	358	52	102	494	118
including loans	55	56	57	87	48	38
including short-term bank debt	0					
including pension loan	20	33				
including finance leases	2	3	3	2	2	22
cash at start of year	550	66	-484			
<b>FOCF after dividends/net acquisitions/disposals</b>	<b>-350</b>	<b>-250</b>	<b>-100</b>			
<b>new bonds/new loans</b>	<b>-30</b>	<b>0</b>	<b>0</b>			
<b>cash position before rollover of ST debt/securit.</b>	<b>-152</b>	<b>-624</b>	<b>-694</b>			
rollover of short-term bank debt & securitisation	0					
<b>cash after rollover of ST bank debt/securit.</b>	<b>-152</b>	<b>-624</b>	<b>-694</b>			
<b>Cash after drawdown on committed facilities</b>	<b>66</b>	<b>-484</b>	<b>-694</b>			
Committed & undrawn facilities (1)	901	140	-43			
Drawdown under committed available facilities	-218	-140	0			
Committed & undrawn facilities remaining available	140	-43	-86			
	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
(1) Maturity date of committed & undrawn facilities	543	43	43	100	43	129

Source: Company, Calyon

## Norske Skog (B+ neg/B2/NR)

The sale of two Korean mills in late 2008 generated NOK3.8bn of cash to improve liquidity, reduce debt, avoid probable 2009 covenant breaks and provide sufficient cash to meet 2009 maturities. However, 2011 reveals challenging debt maturities of NOK3.4bn. In an economic downturn this level of cash flow is unlikely to come from trading over the period, so further asset sales or restructuring will be required before 2011, unless it is possible to negotiate a consensual refinancing in a high-yield market that is starting to re-open for solid BB-band credits.

Norske Skog has a welcome focus on improving cash, liquidity and debt maturity/reduction. Cash is king in a recession, but recent actions such as fully drawing on an unsecured cheap 2012 EUR400m revolver to help fund debt buybacks (eg, Oct 2011 USD bond at 75c) and terminating 'in the money' hedges (NOK460m Q109 gain) may have negative long-term impacts, eg, it was no surprise that Norske Skog could not refinance its 2010 bank loan. The shift towards this type of action suggests the scope for further asset sales (eg, Chinese mills) is reducing. Short-term liquidity is solid with cash of NOK5.3bn and, while there are few available credit lines, this remains adequate for 2009/10 debt maturities of NOK2.3bn, with headroom for significant cash burn in case of need. Liquidity would also be helped by a new high-yield bond, which is currently in the book-building phase, if it is successfully placed.

With the Q109 results management withdrew guidance for higher EBITDA in 2009 due to high market uncertainty, confirming lower 2009 capex of c.NOK900m. EBITDA rose slightly but a sharp (advertising-led) c.20% drop in worldwide demand for newsprint and magazine paper led to a sequential EBITDA drop of 45% (underlying FFO -39%). Production was cut by 15% to address the c.20% drop in demand, but this was not enough to stop capacity utilisation from falling to a low 76% (from 90% in Q408). Overall, the actions saw Q109 net debt reduce to c.NOK12.8bn, suggesting LTM net debt/EBITDA of around 4.7x. Over the quarter S&P cut Norske Skog from BB- to B+ neg, bringing the rating in line with our own High-B and closer to Moody's B2 stable. S&P still expects positive free cash flow. The negative rating outlook has been maintained as the 10-15% FFO/net debt rating target looks challenging (Q109 LTM was 9.2%).

**One year rating target: High-B (maintained)**

**Relative value: Underperform (maintained since 16/12/08)**

See *Trade Idea: Sell 6m CDS Norske Skog at c.800bp* (published 12 June)

### Norske Skog: liquidity analysis (NOKm)

Reporting date: 31 December 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>debt due</b>	<b>2,339</b>	<b>342</b>	<b>3,395</b>	<b>4,662</b>	<b>0</b>	<b>7,336</b>
including bonds	722	0	3,066	902		7,245
including loans	1,617	342	329	3,760	0	121
including short-term bank debt	0					
including commercial paper	0					
including securitisation	0					
cash at start of year	5,209	3,412	3,868			
<b>FOCF after dividends/acquisitions/asset sales</b>	<b>542</b>	<b>798</b>	<b>989</b>			
<b>new bonds/new loans</b>	<b>0</b>	<b>0</b>	<b>0</b>			
<b>cash position before rollover of ST debt/securit.</b>	<b>3,412</b>	<b>3,868</b>	<b>1,462</b>			
rollover of short-term bank debt & securitisation	0	0	0			
<b>cash after rollover of ST bank debt &amp; securit.</b>	<b>3,412</b>	<b>3,868</b>	<b>1,462</b>			
<b>Cash after drawdown on committed facilities</b>	<b>3,412</b>	<b>3,868</b>	<b>1,462</b>			
Committed & undrawn facilities (1)	150	0	0			
Drawdown under committed available facilities	0	0	0			
Available committed & undrawn facilities c/f	0	0	0			
	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
(1) Maturity date of committed & undrawn facilities	150	0	0			

Source: Company, Calyon

## Saint-Gobain (BBB+ neg/ Baa1 neg/BBB+ CW neg)

Saint-Gobain's credit metrics will remain stretched for a High-BBB credit in 2009, despite the EUR1.5bn rights issue, given S&P's requirement for FFO/adjusted net debt to be above 25%. This explains why both S&P and Moody's left the negative outlook unchanged after the announcement of the rights issue.

Liquidity and refinancing risk has, however, improved this year helped by the rights issue, two new bond issues totalling EUR1.75bn and (on 15 June) the announcement that it had signed a new EUR2.5bn 3Y RCF, which the company is confident will enable it to refinance all of its 2009 and 2010 maturities.

Q109 saw a sharp drop in sales down 14.8% YoY or 14.9% LfL with a similar story across all divisions except Packaging (+0.5%). This was due to volumes (down overall by 17.2% YoY) while prices increased by 2.3% overall. Flat Glass sales were down 21% LfL due to the collapse of the automotive market and to a lesser extent the slowdown in construction. No guidance was provided for FY09 with Saint-Gobain indicating, as it did in February, that H109 will be "extremely challenging" but sounding confident that it could maintain a positive trend for selling prices. The company said that it would intensify cost-saving programmes with FY09 cost savings "closer to EUR700m" compared with the EUR600m previously suggested.

**One year rating target: High-BBB (maintained)**

**Relative value: Sectorperform (previously Outperform)**

### Saint-Gobain: liquidity analysis (EURm)

Reporting date: 31 Dec 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	>Dec-13
<b>debt due</b>	<b>3,251</b>	<b>1,563</b>	<b>1,209</b>	<b>1,358</b>	<b>1,611</b>	<b>4,340</b>
including bonds	999	1,452	1,098	1,247	1,500	4,260
including loans						
including short-term bank debt	798					
including commercial paper	690					
including securitisation	462					
including other debt	302					
<b>cash</b>	<b>1,937</b>	<b>3,965</b>	<b>3,089</b>			
<b>FOCF after dividends/acquisitions/asset sales</b>	<b>769</b>	<b>687</b>				
<b>new bonds/new loans</b>	<b>3,250</b>					
<b>cash position before rollover of ST debt/securit.</b>	<b>2,705</b>	<b>3,089</b>	<b>1,881</b>			
rollover of short-term bank debt & securitisation	1,260					
<b>cash after rollover of ST bank debt/securit.</b>	<b>3,965</b>	<b>3,089</b>	<b>1,881</b>			
<b>Cash after drawdown on committed facilities</b>	<b>3,965</b>	<b>3,089</b>	<b>1,881</b>			
Committed & undrawn facilities (1)	2,500	2,500	2,500			
Drawdown under committed available facilities	0	0	0			
Available committed & undrawn facilities remaining	2,500	2,500	2,500			

	2009	2010	2011	2012
(1) Maturity date of committed & undrawn facilities	0	0	0	2,500

EUR680m : total of 7 bilateral lines with maturities in 2009-2010

Source: Company, Calyon

## SAS (B/B2 CW neg)

The SEK6bn 50% government-funded bailout rights issue has been completed, Spanair has been sold and the 'Core SAS' restructuring plan is proceeding according to plan. The programme targets a SEK15bn drop in adjusted net debt driven by the SEK6bn rights issue and SEK9bn from disposals and fleet reductions, with predicted cost savings of SEK7.3bn less restructuring costs. All non-core activities/airlines are being closed or sold and SAS will cut 40% of routes, 37% of staff and 10% of fleet, which in total would have saved SEK800m in FY08. Additionally, the maturity of SEK6.5bn of loans is being extended.

Q109 was weak with operating losses continuing to widen, as would be expected given the current economic downturn and out-of-the-money fuel hedging positions that SAS holds. It continues to cut capacity to meet the downturn in demand and ensure that load factors do not fall further. Q1 is normally a seasonally weak period for European airlines; however, operating income managed to generate a loss for the quarter that was equivalent to the operating loss for the entire last 12-month period, highlighting the extent of the problem. SAS said that the market is "extremely unpredictable and uncertainty regarding the time of a recovery commencing remains high". However, the rights issue means SAS's short-term future is assured and a precedent has been established for government support.

During the quarter S&P reaffirmed its long-term credit rating at B, despite the recent credit watch positive placement. The B rating factors in the assumption that SAS will hit FFO/adjusted debt of around 10% (Q109 only 4%) and already takes into account recent improvements to liquidity and debt maturity plus the execution risks attached to 'Core SAS'.

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 its problems.

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 it had a few months ago. However we still 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 previous acquisition strategy for Austrian Airlines.

**One year rating target: High-B (maintained)**

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

See *Trade Idea: Sell 6m CDS SAS at c.850bp* (published 12 June).

## SCA (BBB+ neg/Baa1 neg/NR)

SCA reported resilient, better-than-expected Q109 results driven by its lesser-cyclical business profile relative to the other companies in our Pulp & Paper sector coverage. Net sales rose 3% and, while operating profit was down 14%, it was well ahead of consensus. Results were boosted by SEK weakness in Q109 where EUR/SEK had widened by a further 15-25% having a positive impact on sales (+11%) and profit (+3%). Most divisions performed well, though Packaging was awful with operating profit -49% and severe margin pressure. Here, SCA will take residual action via capacity closures and a 14% cut in staff.

FFO fell -13%, much stronger than the mid-double-digit drops in the rest of the Paper sector, and it was good to finally see some working capital improvement. Maintenance and strategic capex were broadly in line with last year, ie, weaker than the target to reduce capex in FY09. The impact was that FFO/total capex cover deteriorated from 1.64x to 1.35x. No outlook was provided. Around 70% of Q109 EBIT came from its Personal Care and Tissue segments, ie, products like nappies (global No.3), incontinence products (global No.1) and of course tissues.

At the end of Q109 SCA had cash of SEK4.9bn and available credit facilities of SEK20.5bn providing available liquidity of SEK25.4bn, more than adequate to cover debt maturities in 2009 and 2010, so liquidity looks solid until at least 2011 following successful refinancing. A new 2014 SEK5bn loan was put in place at the end of May which will be an additional boost to liquidity. SCA currently relies on the Swedish CP market, where the Swedish government will repo CP, but even if this market were to close suddenly we do not see SCA having any liquidity issues until 2011/12.

Good market shares, low cost positions, high vertical integration and the low cyclicity of the hygiene product market means that there is no doubt that SCA would survive even a tough recession. At these very tight spread levels, however, we do not see much more upside so maintain our Sectorperform recommendation.

**One year rating target: Mid-BBB (maintained)**

**Relative value: Sectorperform (maintained since 16/02/09)**

### SCA: liquidity analysis (SEKm)

Reporting date: 31 December 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>debt due</b>	<b>13,579</b>	<b>5,232</b>	<b>8,421</b>	<b>5,961</b>	<b>4,710</b>	<b>15,257</b>
including bonds	0	2,000	7,696	0	0	5,732
including loans	3,272	1,929	687	5,922	4,690	9,510
including short-term bank debt	0					
including commercial paper	10,201	49				
including securitisation / other	0	1,254	38	39	19	16
cash at start of year	5,738	2,209	2,209			
<b>FOCF after dividends/acquisitions/asset sales</b>	<b>-468</b>	<b>300</b>	<b>521</b>			
<b>new bonds/new loans</b>	<b>0</b>	<b>0</b>	<b>0</b>			
<b>cash position before rollover of ST debt/securit.</b>	<b>-8,309</b>	<b>-2,723</b>	<b>-5,691</b>			
rollover of short-term bank debt & securitisation	0					
<b>Cash after rollover of ST bank debt/securit.</b>	<b>-8,309</b>	<b>-2,723</b>	<b>-5,691</b>			
<b>Cash after drawdown on committed facilities</b>	<b>2,209</b>	<b>2,209</b>	<b>-4,496</b>			
Committed & undrawn facilities (1)	17,684	7,166	1,578			
Drawdown under committed available facilities	-	-4,932	-1,195			
	10,518					
Available committed & undrawn facilities remaining	7,166	1,578	0			
	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
(1) Maturity date of committed & undrawn facilities	0	656	383	6,684	4,961	5,000

Source: Company, Calyon

## Stora Enso (BB neg/Ba2 neg/BB+ neg)

Q109 results were weak with operating profit excluding non-recurring items down 128% to a loss of -EUR35m and all segments recording falls. Only Consumer Board and Newsprint are now profitable. OCF was hugely flattered by working capital with a better measure FFO growth falling -48% to EUR121m (EUR235m), barely covering capex at 1.15x (despite a 23% drop in capex). To address the weak performance it aims to save EUR250m pa by end-FY10 by cutting up to 2,000 staff. Stora Enso sees costs declining by 4% in FY09 and aims to cut dividends and capex where it guides for EUR400m (EUR704m). Management expects demand to remain weak until the economic environment improves given poor trends in advertising, newspaper circulation and wood products. It said it was increasingly clear that falling volumes were being driven by a drop in demand rather than de-stocking. The CEO recently described the European industry situation as "traumatic" and sees cash preservation as a top priority.

May saw Stora Enso tap its 2014 bond for EUR232.4m at a yield of 12.25%, ie, mid-swaps plus c.980bp, providing a new issue premium of c.180bp and a basis c.500bp wide of CDS. The tap is encouraging as it proves that there is a market for new Stora Enso debt issues at the right price in the high-yield market and suggests a small US HY issue now looks feasible. However, the 12.25% cost of financing is well in excess of EBIT margins. S&P recently downgraded Stora Enso by one notch from BB+ CW neg to BB neg, in line with Moody's Ba2 neg, citing challenging market conditions. The negative outlook factors in that metrics are weak even for a BB rating, so a further downgrade this year is feasible. During the quarter Stora Enso announced the acquisition of the majority of Group ENCE's operations in Uruguay on a 50/50 basis with Arauco for USD344m in cash, including 130,000 hectares of forest, ie, EUR127m for Stora Enso's share.

Unless Stora Enso is planning disposals it would appear that FY09 cash flow post dividends and acquisitions will now be negative. Taking into account the recent bond issue and the remaining EUR600m availability of the pension fund loan, liquidity is now starting to look a little stronger, with total cash and unused credit facilities of EUR2.7bn against maturing debt of c.EUR1.3bn in the next 12 months. Regardless, we would think that Stora Enso must be actively trying to refinance debt at the moment in case trading should deteriorate further. We remain Underperform given weak trading and better relative value in other BB credits.

**One year rating target: Mid-BB (maintained)**

**Relative value: Underperform (maintained since 16/12/08)**

### Stora Enso: liquidity analysis (EURm)

Reporting date: 31 December 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>debt due</b>	<b>472</b>	<b>823</b>	<b>434</b>	<b>152</b>	<b>133</b>	<b>1,466</b>
including bonds	339	526	381	0	0	1,558
including loans	90	270	57	129	92	98
including short-term bank debt	43					
including commercial paper	0					
including finance leases / other	11	32	26	26	42	133
cash at start of year	416	222	222			
<b>FOCF after dividends/acquisitions/asset sales</b>	<b>-200</b>	<b>-50</b>	<b>-50</b>			
<b>new bonds/new loans</b>	<b>232</b>	<b>0</b>	<b>0</b>			
<b>cash position before rollover of ST debt/securit.</b>	<b>-24</b>	<b>-651</b>	<b>-262</b>			
rollover of short-term bank debt & securitisation	43	0	0			
<b>cash post rollover of ST bank debt /securit.</b>	<b>19</b>	<b>-651</b>	<b>-262</b>			
<b>Cash after drawdown on committed facilities</b>	<b>222</b>	<b>222</b>	<b>222</b>			
Committed & undrawn facilities (1)	2,000	1,797	924			
Drawdown under committed available facilities	-203	-873	-484			
Available committed & undrawn facilities remaining	1,797	924	440			
	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
(1) Maturity date of committed & undrawn facilities	0	0	0	1,400	0	600

Source: Company, Calyon

## UPM (BB+ neg/Ba1/BB+ neg)

Q109 was much weaker than the market expected where on an underlying basis EBIT fell -141%, sales -23% and FFO -63%. EBIT before exceptionals came in at a loss of -EUR78m (EUR188m) recording the second consecutive quarterly EBIT loss. In particular, the -4.2% (7.8%) operating margin before exceptionals highlights the rapid deterioration driven by the high operational leverage within the business. Q408 EBIT margin was -2.0% so results continue to deteriorate on a sequential basis. UPM painted a depressing FY09 outlook where it expects weaker consumer, construction and advertising demand to lead to 'markedly lower' volumes. It sees pricing pressure due to excess supply, does not expect to benefit from lower raw material costs until late 2009 and sees Q2 volumes higher than Q1, probably due to recent customer de-stocking, but there is low visibility.

Working capital was the biggest driver of cash flow (+EUR216m) but will not be repeated as it was driven by taking extra credit from trade creditors, which increased from 50 days' credit to 69 days over the three-month period. FFO fell -63% to just EUR58m (EUR156m) and compares badly to lower-rated Stora Enso where FFO fell -48%. FFO/capex cover was also weaker at 0.7x (0.9x) despite capex cuts where FY09 guidance is now EUR300m (previously EUR400m, FY08 EUR558m). Without the cash from working capital UPM looks FOCF negative for FY09, but we suspect working capital can be squeezed to make FOCF neutral. Liquidity remains solid to at least 2011, subject to unknown loan covenants, as UPM has been successfully addressing debt maturity and no longer has any big debt maturities until 2012. Our liquidity model suggests that the combination of lower capex and weaker trading should still result in a reasonable liquidity position in 2011.

UPM is taking the right actions to ensure liquidity and has strong market positions that will see it perform better than the sector average, but lower demand will outstrip restructuring savings and lower raw-material prices. Regardless of recent dividend and capex cuts UPM's current ratings still look under pressure as a big driver will be FFO/net debt rather than working capital or capex cuts. With its recent downgrade to BB+ neg S&P confirmed that UPM could be downgraded again if it is clear that it cannot reach a 20% FFO/debt level. Our view is it will need to improve FFO to reach these levels, which looks very tough given that FFO is currently falling fast. UPM is the short of choice for Pulp & Paper sector investors and the underlying position within the Q109 numbers underlines the rationale.

**One year rating target: Mid-BB (maintained)**

**Relative value: Underperform (maintained since 16/12/08)**

### UPM: liquidity analysis (EURm)

Reporting date: 31 December 2008	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
<b>debt due</b>	<b>344</b>	<b>197</b>	<b>287</b>	<b>828</b>	<b>226</b>	<b>1,905</b>
including bonds	250	138	0	636	0	1,071
including loans	46	29	43	724	72	211
including short-term bank debt	74					
including commercial paper	0					
including pension loans	39	22	156	148	148	410
cash at start of year	330	188	188			
<b>FOCF after dividends/acquisitions/asset sales</b>	<b>22</b>	<b>-78</b>	<b>43</b>			
<b>new bonds/new loans</b>	<b>0</b>	<b>0</b>	<b>0</b>			
<b>cash before rollover of ST debt/securit.</b>	<b>8</b>	<b>-87</b>	<b>-56</b>			
rollover of short-term bank debt & securitisation	74					
<b>cash after rollover of ST bank debt/securit.</b>	<b>82</b>	<b>-87</b>	<b>-56</b>			
<b>Cash after drawdown on committed facilities</b>	<b>188</b>	<b>188</b>	<b>188</b>			
Committed & undrawn facilities (1)	1,138	1,032	757			
Drawdown under committed available facilities	-106	-275	-244			
Available committed & undrawn facilities left	1,032	757	513			
	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	> Dec-13
(1) Maturity of committed & undrawn facilities	0	0	0	1,138		

Source: Company, Calyon

# Industrials earnings calendar

## July

29	Monday	30	Tuesday	1	Wednesday	2	Thursday	3	Friday
								British Airways Traffic data	
6	Monday	7	Tuesday	8	Wednesday	9	Thursday	10	Friday
		SAS Traffic data				Lufthansa Traffic data Air France AGM			
13	Monday	14	Tuesday	15	Wednesday	16	Thursday	17	Friday
		British Airways AGM							
20	Monday	21	Tuesday	22	Wednesday	23	Thursday	24	Friday
						Saint Gobain M-Real SCA, Stora Enso Q209 Results		Metso Q209 results	
27	Monday	28	Tuesday	29	Wednesday	30	Thursday	31	Friday
		DSM Q209 Results		AkzoNobel/Bayer ArcelorMittal, Rhodia Q209 Results		Imerys/Lufthansa AirFranceQ1/BASF Solvay/AirLiquide Q209 Results		British Airways Q110 Results Lafarge Q209 results	

## August

3	Monday	4	Tuesday	5	Wednesday	6	Thursday	7	Friday
Linde Q209 Results		UPM, DSM HeidelbergCement Q209 Results		British Airways Traffic data		NorskeSkog Q209 Results		SAS Traffic data	
10	Monday	11	Tuesday	12	Wednesday	13	Thursday	14	Friday
		Lufthansa Traffic data		SAS, Lanxess Q209 Results Evonik H109 results				ThyssenKrupp Q309 Results	
17	Monday	18	Tuesday	19	Wednesday	20	Thursday	21	Friday
						Holcim Q209 Results			
24	Monday	25	Tuesday	26	Wednesday	27	Thursday	28	Friday

## September

31	Monday	1	Tuesday	2	Wednesday	3	Thursday	4	Friday
Wendel H109 results						British Airways Traffic data			
7	Monday	8	Tuesday	9	Wednesday	10	Thursday	11	Friday
SAS Traffic data				Lufthansa Traffic data					
14	Monday	15	Tuesday	16	Wednesday	17	Thursday	18	Friday
				ArcelorMittal Investor Day					
21	Monday	22	Tuesday	23	Wednesday	24	Thursday	25	Friday
						DSM Investor day		DSM Investor day	
28	Monday	29	Tuesday	30	Wednesday	1	Thursday	2	Friday
		Solvay Investor day							

## 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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**Stuart James, Eric Sharper**

**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 17th Apr 2009)

	All covered companies		Companies where Calyon provided Investment Banking Services in past 12 months	
	Count	Percentage	Count	Percentage
Outperform	16	18%	4	25%
Sectorperform	43	48%	11	26%
Underperform	31	34%	3	10%

**Disclosures**

Company Name	Disclosure
Air France – KLM	None
Air Liquide	E, G
Akzo Nobel	None
American Airlines	None
ArcelorMittal	G
BASF	None
Bayer AG	G
British Airways	None
Cemex	None
Clariant AG	None
Co de Saint Gobain	E, G
CRH	G
DSM	None
Ecopetrol SA	None
Evonik Degussa	None
Glencore	None
HeidelbergCement	None
Holcim	None
Iberia	None
Imperial Tobacco	None
	Lafarge
	Lanxess
	Linde AG
	LOT
	Lufthansa
	Metsa-Botnia
	Metso Corp
	M-Real Corp
	Nippon Steel
	Norske Skogindustrier
	PVO
	Rhodia
	Sappi
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	UPM Kymmene
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A	NOT IN USE
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