

# Monthly Update on Reverse Convertibles Equity Derivatives Research

May 15<sup>th</sup> 2009

## Update on our single stocks selection

We have updated our selection of European stocks which are the best candidates for a Reverse Convertible for several reasons:

- Low downside risk
- CA Cheuvreux has a positive view
- High volatility, granting a high coupon
- Not far from their recent minimum

We would recommend 1Y Reverse Convertibles with US barrier on the following stocks:

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**Saint Gobain:** Barrier 60%, Yield Euribor 1Y + 20.7%

**Bouygues:** Barrier 60%, Yield Euribor 1Y + 14.4%

**Zurich Financial:** Barrier 60%, Yield Euribor 1Y + 13.4%

**Vinci:** Barrier 60%, Yield Euribor 1Y + 12.7%

**Munich Re:** Barrier 60%, Yield Euribor 1Y + 10.6%

**Lagardère:** Barrier 70%, Yield Euribor 1Y + 13.5%

**France Telecom:** Barrier 70%, Yield Euribor 1Y + 11.3%

**Deutsche Telekom:** Barrier 70%, Yield Euribor 1Y + 11.2%

**Repsol:** Barrier 70%, Yield Euribor 1Y + 10.7%

**E.On:** Barrier 70%, Yield Euribor 1Y + 10.6%

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## Single Stocks Selection

We are looking for stocks which deliver attractive option premium and limited downside risk:

- With low P/E (under 12) and a high dividend yield (over 4%) indicating a low downside risk
- On which CA Cheuvreux has a positive view (1 or 2)
- With 1Y ATM Implied Volatility over 30%, granting high option premium
- On which the 2Y minimum is over 60% of today's spot value
- Which have underperformed the market over the last month, limiting the short term downside potential risk of a future underperformance

We obtain the following selection:

Name	Ticker	Sector	Rating	P/E	Div. Yield	ATM 1Y IV	5Y CDS
SAINT GOBAIN	SGO FP	Industrial	2/Outperform	11.4	4.0	56.2%	157
BOUYGUES	EN FP	Industrial	1/Selected List	9.1	5.4	46.1%	137
ZURICH	ZURN VX	Financial	1/Selected List	7.3	5.7	42.0%	146
VINCI	DG FP	Industrial	1/Selected List	11	4.9	41.8%	134
MUNICH RE	MUV2 GR	Financial	2/Outperform	9.2	5.7	39.7%	57
LAGARDERE	MMB FP	Communications	1/Selected List	6.4	5.8	38.4%	314
FRANCE TELECOM	FTE FP	Communications	1/Selected List	8.4	8.2	32.4%	64
DEUTSCHE TELEKOM	DTE GR	Telecommunications	2/Outperform	11.3	9.3	36.7%	121
REPSOL	REP SM	Energy	2/Outperform	9.9	7.3	34.1%	162
E.ON	EOAN GR	Utilities	2/Outperform	8.7	6.3	34.7%	80

Source: CA Cheuvreux for rating and P/E, Bloomberg for CDS and div yield, Calyon for 1Y IV

For this selection, we have priced ATM Put Down & In with 3 different US barrier levels, for a 1Y maturity:

Name	Bid Prices*			60% of today's Spot	Last time 60% barrier was hit	2Y Min
	Barrier @ 60%	Barrier @ 70%	Barrier @ 80%			
SAINT GOBAIN	20.7%	22.1%	22.6%	15.00	Oct-02	70%
BOUYGUES	14.4%	17.0%	18.2%	17.72	Jul-04	74%
ZURICH	13.4%	16.1%	17.4%	116.58	Apr-09	66%
VINCI	12.7%	15.3%	16.4%	19.95	Nov-04	69%
MUNICH RE	10.6%	13.7%	15.4%	58.03	Apr-03	83%
LAGARDERE	10.4%	13.5%	15.3%	13.45	Sep-96	86%
FRANCE TELECOM	7.5%	11.3%	13.6%	10.20	Nov-02	95%
DEUTSCHE TELEKOM	7.7%	11.2%	13.5%	5.05	Never	97%
REPSOL	7.2%	10.7%	12.8%	8.80	Oct-96	79%
E.ON	7.3%	10.6%	12.6%	14.37	Dec-09	77%

\*All prices are indicative only

Source: Calyon

**We would recommend 60% barrier on: Saint Gobain, Bouygues, Zurich Financial, Vinci and Munich Re.**

This is the safest barrier choice on these stocks, as the high volatility makes us consider any possible scenario.

**We would recommend 70% barrier on: Lagardère, France Telecom, Deutsche Telekom, Repsol and E.ON.**

This is justified by a lowest price over the last 2 years which is over 70% of the current price. None of these stocks is a financial. These stocks also have a lower volatility and have underperformed the market over the last month.

## CA Cheuvreux on our Single Stocks Selection

### SAINT GOBAIN 2/ Outperform

#### Q1 trends in line with expectations

Extract from CA Cheuvreux Europe Today, 30<sup>th</sup> of April 2009

#### 14.8% decline in Q1 sales to EUR8,782m

Sales were 4% below our forecast, with wrong estimates of currency and scope effects. On a I-f-I basis, they were down 14.9%, in line with our expectation. All the divisions, except packaging (-3.7%) and exterior solutions (-8.5%), showed double-digit organic sales declines, the worst being high performance materials (-22.3%). All regions also experienced double-digit declines ranging from -19.1% in Europe excl. France (-13.2%) to -12.6% in the US. Numbers confirm the fall of industrial production and a more predictable trend in construction markets. Eastern Europe and Asia were the most difficult areas in Q1, with more than a 20% fall in I-f-I sales.

#### Volumes down 17.2%, prices up 2.3%

Deflation did not materialize in Q1 with a +2.3% contribution from price/mix on sales, vs. +1.2% in our forecasts. As expected, flat glass explains most of the slowdown vs. the Q4-08 pace (+3,8%). However, despite a collapse in float (-44%), prices were stable for this division in Q1. There was also price pressure in Eastern Europe, where interior products experienced 5.3% price cuts. The group's message is still satisfactory on prices, the contribution of which will decline as the year moves forward but should remain positive (our forecast is +0.9%).

#### Cautious outlook but higher cost reductions

Management has not yet seen any evidence that the economic crisis has bottomed out. It is only seeing stabilization in US housing, improvement in China and a positive trend in German construction. On the cost side, it is ahead of schedule on its action plan. Savings could be close to EUR700m, above the EUR600m initially targeted.

#### Encouraging signs should support share rebound

At this point we keep unchanged our earnings estimates and TP at EUR30. Further upside is bound to materialize only if we get higher probability that the current recession has bottomed out.

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## **BOUYGUES 1/ Selected List**

### **Good Q1 revenues with lower profitability**

Extract from CA Cheuvreux Europe Today, 14<sup>th</sup> of May 2009

### **Q1 sales down 2.3% at EUR6,655m**

This was above our forecast of EUR6,361m (down 6.7%). The numbers for Colas (down 10% to EUR1,972m) and TF1 (down 18% to EUR538m) were already known. Performance was better than expected for Bouygues Construction (up 4% at EUR2,291m) on which we were expecting a 5% decline. Bouygues Immobilier (real estate development) and Bouygues Telecom also did better than expected at +11% to EUR628m and +6% to EUR1,272m respectively. We were expecting -7.0% in real estate and +2.0% in telecoms. On a I-f-I basis, total group sales were down 3% with some small changes in construction scope and a negative currency impact.

### **Modest decline in the order book**

For Bouygues Construction, order intake was down 30% on a Q1- 08 that was exceptional. At EUR12.2bn, the order book was stable vs. end-December 2008. For Colas, the order book at 31 March was down 5%, stripping out exceptional projects which were not renewed, compared to end-March 08.

### **Cautious guidance on Q1 margins (due on 2 June)**

According to the group, Q1 profitability was negatively affected by: difficulties in construction with a railway contract in South Africa (already the case in Q4-09), lower margins due to promotional efforts in real estate development and cost cutting measures not yet materialized poor activity for Colas and TF1 and commercial costs for Bouygues Telecom.

### **Q1 reading difficult as usual**

It is difficult to draw strong conclusions at this stage as Q1 is usually not representative of FY trends especially on Colas.

### **No change to estimates, rating and TP at this stage**

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## ZURICH FINANCIAL 1/ Selected List

### Hit by economic slowdown

Extract from CA Cheuvreux Europe Today, 7<sup>th</sup> of May 2009

### Q1 results overall below expectations

Zurich Financial reported Q1 09 results that were overall disappointing but underlying numbers look good. The top-line was weaker as the nonlife business in particular was hit by the economic slowdown. As equity impairments were higher and reserve releases lower than expected, bottom line disappointed: BOP USD1.1bn (CAC USD1.4bn) and net income USD362m (CAC USD929m).

### Non-life seeing good renewal price increases in US

While the non-life top-line (-3% in local currencies) was hit by recessionary forces, Zurich Financial was able to achieve renewal price increases of more than 5% in the US and 4% in the UK. The combined ratio of 95.8% (CAC 95%) points to continued good cash flows especially as reserve releases were lower at USD70m (CAC USD300m).

### Life maintaining strong new business margin

Life insurance continued to show resilience with new business margins at 20% and APE up 16% in lc. Zurich Financial benefited from the acquisition in Spain but also saw growth in UK and Latin America.

### Shareholders' equity in line, solvency unchanged

Shareholders' equity was in line and the recent capital raising to finance the AIG US personal lines acquisition should lift solvency 1 to 160% - comfortable in a sector context.

### Focus on underlying earnings

We think the underlying numbers (ex reserve release and equity impairments) look good with non-life price increases pointing to improving fortunes in non-life. The resilience in life and the comfortable capital base should further underpin the company's relative strength versus peers.

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## VINCI 1/ Selected List

### Ready for the upturn in infrastructure

Extract from CA Cheuvreux Flash Note, 5<sup>th</sup> of May 2009

#### Business activity – World No.1 in construction

With a market capitalization of close to EUR13bn and sales of nearly EUR34bn, Vinci is the world's leading construction group. Its integrated construction/concession-holder model gives it a balanced business mix. On the construction side (42% of operating profit), Vinci is active in general contracting, more specialized multi technical installation (Vinci Energies) and road building (Eurovia). As an infrastructure operator (58% of operating profit), 90% of its earnings is generated by its two French motorway network concessions, ASF and Cofiroute, and 7% stems from its car parks subsidiary. The group also operates a portfolio worth an estimated EUR1.5bn of more modest concessions (airports in France, bridges in Portugal and the UK, etc.) and construction assets (motorways in Greece, etc.). Active in more than 90 countries, Vinci generates 63% of its revenues in France and has a major presence in central Europe (7%), the UK (7%) and Germany (5%).

#### Outlook – A recession that is heralded but not definite

At end 2008, Vinci's order book reached EUR23.2bn, showing an increase of 7% versus end 2007. There is a strong likelihood that forthcoming publications will highlight a sharp decline for the construction activities and downward pressure on their margins. However, the prospect of the economic stimulus plans, which comprise a major portion of investment in infrastructure projects, could cushion this decline significantly. With regard to concessions, the most worrying risk at present, which we have factored into our estimates, is a further decline in motorway traffic after a very negative trend already in 2008. Conversely, the prospect of deflation leading to a cut in toll tariffs, has to be put more into perspective. All in all, we expect a 4.5% decline in net profit in 2009, followed by a sharper 13% drop in 2010E. However, Vinci is set to continue to generate substantial cash flow, which we expect at EUR1.2bn in 2010E. This amount is high enough to enable the group to reduce debt or seize further external growth opportunities.

#### Investment recommendation – No premium for quality!

The Vinci share is trading on attractive multiples again (a EV/EBITDA for 2009E of 6.0x). At such a low level, a worst case scenario, giving no value to the contracting businesses, is already factored in. The financial situation is solid with no liquidity issues in the short term. For this reason, the dividend yield (6.1%) appears secure given that the group raised by 7% its 2008 dividend to EUR1.55 per share. Our SOP, which is based on the same negative assumptions as for its peers, points to a value of EUR39 per share that we retain as our target price at EUR39.

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## MUNICH RE 2/ Outperform

### Driver for the stock: reinsurance

Extract from CA Cheuvreux Europe Today, 7<sup>th</sup> of May 2009

### 2/OP rating maintained; earnings and TP under review

Following yesterday's release of Q1-09 figures we maintain our 2/OP rating. Our TP and earnings estimates are under review. The prospects in reinsurance should be the driver for the stock, while a disappointing result at ERGO Insurance Group was largely driven by special items.

### April renewals with strong price increases (+7.2%)

In the April renewals (EUR1.2bn up for renewal), Munich Re cancelled unattractive business and expanded into attractive lines of business. The 7.2% price increases achieved on the total book of renewed business are strong. Looking towards the July renewals, Munich Re expects to take advantage of its strong capitalization (SR258%) and is likely to expand its exposure to natural catastrophies, where tighter capitalized competitors will be unable to compete.

### Life Re: nine large transactions, EUR2bn premiums

In Life/Health reinsurance, as a consequence of its strong capitalization, Munich gained nine major surplus relief contracts, mainly in North America, with an annualized premium volume of >EUR2bn. These quota-share contracts essentially transfer mortality and morbidity risks and are expected to yield an IFRS pretax margin of 3-5%. With an estimated risk capital of EUR300m these contracts should yield a RoRAC of >20%. We estimate at least EUR0.2bn value creation for Munich Re's shareholders.

### ERGO result mainly driven by special items

ERGO results were weak, but not a drama. The EUR72m net loss includes EUR81m goodwill impairments (e.g. BACAV) and a EUR234m write-down on interest rate swaptions (EUR50m for shareholders). Note that higher interest rates are beneficial to Munich Re (higher EV) from an economic perspective. The sharp drop in new business in life (-33% APE total, -43% in Germany) was no surprise, but includes a basis effect (Riester) and is an industry problem.

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## **LAGARDERE 1/ Selected List**

### **Q1-09 revenues in line on PF basis**

Extract from CA Cheuvreux Europe Today, 13<sup>th</sup> of May 2009

### **Q1-09 revenues down 2.6% organically to EUR1,778m**

Lagardère reported Q1-09 revenues down 2.6% organically to EUR1,778m (down 2% reported), slightly above our EUR1,754m, due solely to the scope of consolidation effect. WSG, following a shareholder agreement change, is fully integrated since beginning of 2009 (~EUR30m contribution). Main points to retain by division are: 1) Lagardère Publishing: EUR463m in revenues (up 14% org.) completely in line with our EUR463m estimate, thanks to the Stephanie Meyer success; 2) Lagardère Services: EUR782m revenues (down 3.4% org.), in line with our EUR784m estimate; 3) Lagardère Active: EUR399m in revenues (down 17.5% org.), in line with our EUR409m estimate. Magazines are down 20% as expected to EUR310m (EUR312m exp.) impacted by the advertising and circulation drop, and broadcasting is down 9.5% organically to EUR89m (EUR93m exp.) due to the weakness of radio business, mainly in Eastern Europe; and 4) Lagardère Sports: EUR134m in revenues (up 7.9% org.), above our EUR102m estimate due to the consolidation of WSG. Overall, excluding the WSG impact, Q1-09 revenues are fully in line.

### **FY-09 guidance reiterated**

The group has reiterated its FY-09 guidance: 1) Divisions excluding Active: a 0% to -10% EBITA trend globally; and 2) Lagardère Active: no EBITA bracket due to lack of visibility on advertising revenues, but gross global savings of EUR90m.

### **1/Selected List reiterated, EUR34 TP**

We reiterate our 1/SL rating with a EUR34 target price. Implied EV/EBITA media multiple (excl. Canal+ and EADS stakes) is 5.2x, an attractive level base in a depressed scenario for 2009.

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## FRANCE TELECOM 1/ Selected List

### Feedback from conf call

Extract from CA Cheuvreux Europe Today, 29<sup>th</sup> of April 2009

### Top line growth for 09E

In Q1-09, difference of 2.1% between France Telecom's top line growth (0.4%) and GDP trend in underlying regions (-1.7%). Based on IMF forecast (GDP down 2.5%, o/w down 4% in Europe) & maintaining the same gap would lead to target roughly flat sales l-f-l. No revenue guidance given so far.

### Margin trend for 2009E

1) Q1-09 impacted by forex impact (EUR123m), lower revenue contribution (EUR46m) and full impact of content & interconnection (EUR244m). 2) 09E EBITDA margin erosion confirmed for the year (not quantified), with however normally a better situation in H2-09 as base of comparison will already discount opex in content + i-Phone subsidies (70-100bp impact), which is not the case in H1-09.

### Capex flexibility

Additional flexibility confirmed on growth capex, can be postponed as long as peers doing it. Moreover, behavior of some clients (less consumptions) lowering the pressure to increase capacity.

### Ongoing actions to secure organic FCF

1) EUR8bn org. FCF for 09E reiterated, 2) to secure that performance, following actions: 1) sales: specific marketing offers, 2) opex: reduction programs launched to limit EBITDA erosion, 3) capex slightly below 12% of sales (lower traffic growth, prioritization of spending), 4) rollout of Orange 2012 in all countries to transform processes & optimize the cost structure.

### Buy reiterated

Solid positions in France & well balanced risks at the other divisions, 2) capacity to maintain a high FCF generation. 45%+ payout policy maintained, leading to FCF yield of 16.9% and dividend yield of 8.8%.

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## DEUTSCHE TELEKOM 2/ Outperform

### Q1-09 results: no surprises

Extract from CA Cheuvreux Europe Today, 7<sup>th</sup> of May 2009

### No surprises versus preliminary results announcement

DT's Q1-09 results contain few surprises versus the preliminary results published on 21 April. Revenues of EUR15,902m (+6% yoy) are in line with our estimate of EUR15,921m and adj. EBITDA of EUR4,812m (+3% yoy) is in line with our EUR4,822m forecast. Excluding OTE revenues are EUR15bn (stable yoy) and EBITDA is EUR4.5bn (-5% yoy) as previously announced. A EUR1.8bn (anticipated) goodwill write-down on T-Mobile UK means Q1 net loss of EUR1.1bn vs our forecast of EUR0.6bn, though adjusted net profit of EUR655m is in line with forecast of EUR615m. Free cash flow of EUR0.3bn is diluted by high capex and restructuration payments.

### 2009 guidance reiterated. FCF of EUR7.0bn expected

DT reiterates its full year 2009 guidance for revenues excl. OTE of 2- 4% below 2008 (EUR19.5bn) and free cash flow of around EUR6.4bn. OTE will contribute around EUR2.0bn to EBITDA (consolidated 11 months in 2009) and free cash flow including OTE is expected at EUR7.0bn. As such, the EBITDA contribution from OTE is marginally below our estimate. We expect OTE to reduce its full year guidance this morning. DT maintains its commitment to attractive dividend policy for 2009.

### Synergy targets for OTE

DT has announced synergy targets for the integration of OTE (25% owned). DT expects to realize EUR200m in annual synergies of which one-third is capex, and 70% from mobile. In addition, DT targets further synergies. The EUR200m per year is in line with previous indications (Net Present Value of EUR2bn). Full effect will be reached in 2011. DT has not included synergies in its 2009 guidance.

### No major changes to forecasts or valuation

We do not expect to make material changes to our forecasts or price target post the full Q1-09 results.

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## REPSOL 2/ Outperform

### Highlights from c/c. Q1 recurrent EBIT in line

Extract from CA Cheuvreux Europe Today, 11<sup>th</sup> of May 2009

### Highlights from management conf. call

- 1) Capex target for FY09 reduced from EUR4.7bn to EUR4.3-4.4bn (not including the GasNat rights issue) on renegotiation of contracts.
- 2) EUR100m operating cost savings achieved in Q1 as part of the EUR500m target for the full year.
- 3) EBIT guidance for YPF of 80-90% of FY08's EBIT, which compares with our 90% estimate (EUR1.05bn, -9% vs. FY08).
- 4) For YPF, management is thinking of alternatives to sell 20% of YPF apart from the IPO (e.g. a private local or international investor).

### Q1 recurrent EBIT in line with estimates

Q1 09 recurrent EBIT was EUR722m (-56%), in line with our EUR720m estimate. All the businesses were roughly in line with estimates: 1) Upstream EUR185m (-69%), in line; 2) Downstream EUR288m (-45%), in line, or EUR311m (+26%) ex-inventory effect, also in line; 3) YPF EUR152m (-63%), 2% below our estimates; 4) Gas EUR169m (+6%), 4% above; 5) LNG EUR11m (-66%), vs. our EUR13m estimate; and 6) Corporate adjustments were negative by EUR83m, vs. our expectation of -EUR85m.

Total EBIT of EUR940m (down 41.5%), including EUR274m positive non-recurring items. Q1 recurrent net profit of EUR401m (-58.9%), 6% above estimates on lower financials and a lower tax rate (38% vs. our 40%). Q1 net profit EUR516m, down 57.4%.

Net debt rose from EUR6.9bn at YE08 to EUR8.9bn in Q109 including: 1) EUR1.08bn for GasNat's capital increase; 2) EUR0.7bn higher debt consolidated from Gas Natural's investment in Fenosa; and 3) EUR0.2bn from Repsol's daily operations (we expect debt to increase by cEUR0.4bn during the year).

### We keep our 2/Outperform rating

The stock is trading at 2.7X09E P/CF & 9.9X09E P/E, vs. c5.5X & c12X respectively for the sector.

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## **E.ON 2/ Outperform**

### **Feedback from the conference call**

Extract from CA Cheuvreux Europe Today, 13<sup>th</sup> of May 2009

### **Q1 not indicative of full-year**

Q1 09 results were negatively impacted in the region of EUR170m by the decline in economic activity. However, according to management, the majority of this impact is related to just two customers in the Central Europe division, and a large portion is non cash as it relates to the build-up of bad debt provisions already for the full-year. As such, we think these numbers are indicative neither of the full year nor of the overall market.

### **Adjusted divisional split improves**

Excluding positive transfer effects, the Energy Trading division's EBIT would have been lower by about EUR200m. As Energy Trading Division's EBIT came in some EUR160m above our forecast and consensus, this would imply that, on a constant basis, an additional c.EUR40m would have to be attributed to the remaining divisions. This improves the disappointing reported divisional split; however, the transparency of this kind of reshuffles is extremely limited and certainly a point of criticism.

### **Confident to close Yuzhno Ruskoje deal**

With regards to the never-ending story of the swap of a 24.9% stake in Yuzhno Ruskoje in exchange for a 2.9% stake in Gazprom (of E.ON's total stake of 6.4%), management seemed to be very confident of closing the deal soon. The EBIT impact for the full-year 2009, which will likely be booked retroactively from 01 January 2009, should be above EUR100m.

### **Estimates left unchanged**

We see little reason to change our estimates, and we maintain our 2/Outperform recommendation.

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### Applicable disclosures for the following quoted stocks

COMPANY NAME	DISCLOSURE
SAINT GOBAIN	A, E, G
BOUYGUES	J
ZURICH FINANCIAL	E
VINCI	A, E, G
MUNICH RE	E
LAGARDERE	E, J
FRANCE TELECOM	E
DEUTSCHE TELEKOM	E
REPSOL	E
E.ON	E, G

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