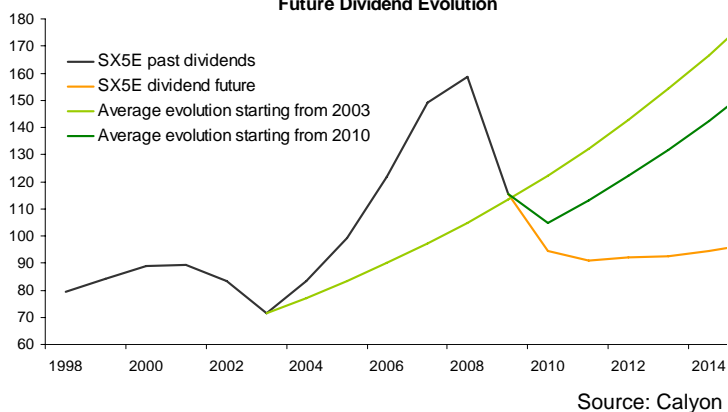


# Trade Idea

## Equity Derivatives Research

September 1st 2009

Future Dividend Evolution



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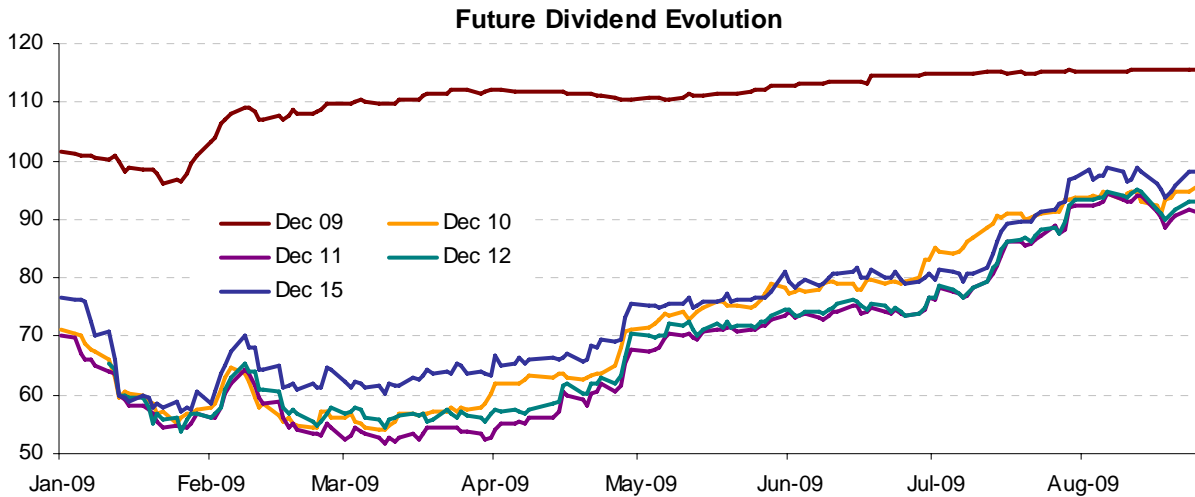
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## European dividends: normalization

- We have updated our dividend forecasts following SX5E reshuffle and H1 results.
- The heavy discount that we had identified in January has clearly been corrected with a performance of 60% for Dec 10 Future.
- We still think that there is some upside on Dec 10 dividends, however this is now limited (96.8 worst case and 115.5 best case).
- On longer maturities the implied dividend growth is still low and does not integrate the earnings recovery that should materialize in the coming years.
- Even on single stocks most of dividend forecasts have normalized.
- **We then have the following recommendations:**
  - **Neutral on 2010 Div swaps/futures on SX5E.**
  - **Keep our long positions on SX5E Div swaps/futures on 2011 and beyond.**
  - **Go long on Deutsche Telekom 2010 dividend.**

## European dividends: where are we now?

European dividends recovery is going on with an average +25% on each maturity since our last publication of the 29<sup>th</sup> of May. This also represents an average recovery of +60% since the 20<sup>th</sup> of January, more than twice the recovery on the index (SX5E's performance since the 20<sup>th</sup> of January 2009: +25.4%).



Source: Bloomberg

	Dec 09	Dec 10	Dec 11	Dec 12	Dec 13	Dec 14	Dec 15
31-Aug-09	115.7	94.7	90.9	92.2	92.5	94.6	96.7
29-May-09	112.7	78.9	73.7	74.7	74.1	76.4	77.7
20-Jan-09	98.4	58.8	56.7	55.0	58.8	59.0	59.6
Variation since the 05/29/09	2.7%	20.0%	23.3%	23.4%	24.8%	23.8%	24.5%
Variation since the 01/20/09	17.6%	61.1%	60.3%	67.6%	57.3%	60.3%	62.2%
1Y Div Growth today		-18.2%	-4.0%	1.4%	0.3%	2.3%	2.2%
1Y Div Growth @ 29th May		-30.0%	-3.6%	-3.0%	6.9%	0.3%	1.0%

Source: Bloomberg

Dividends futures are mainly driven by the market on longer maturities, but restructuring and refinancing stories lead to the revival of many dividend expectations. They have outperformed the market, recovering partially from the large underperformance which followed the Lehman crash.

Despite this recovery, the expected dividend growth is still very conservative (**less than +1% per year on average, starting on 2011**).

## 2010 Future SX5E Dividends: update of the bottom-up analysis Is there some upside left?

Post SX5E reshuffle and H1 results, we have updated our bottom up analysis. We have updated our model in order to determine whether there is upside left on SX5E dividends.

The following reshuffle has been announced the 1st of September and will be effective on the 21st of September: The following companies will be added to the Dow Jones EURO STOXX 50 Index: **ANHEUSER-BUSCH INBEV N.V.** (Belgium, Food & Beverage, ABI.BT) and **CRH PLC** (Ireland, Construction & Materials, CRH.DB).

The companies exiting the index are: **FORTIS N.V.** (Netherlands, Insurance, FORSY) and **RENAULT S.A.** (France, Automobiles & Parts, RNO.FR).

We have done all our calculations with the new composition of the index.

For **EPS assumptions**, we chose to retain CA Cheuvreux estimates, which integrate H1 09 results on most stocks.

Concerning our **payout ratios assumptions**, we first take a **pure quantitative cautious approach**: we have selected the lowest payout ratio between 2008 (if positive) and CA Cheuvreux estimates for 2009, capped at 50%.

We have excluded negative payout ratio corresponding to companies which have paid dividends despite negative earnings. One of our assumptions was: no dividend if results are negative.

We have capped payout ratios at 50% in order to amplify the worst case aspect of our scenario.

Then, we had a **qualitative approach** challenging each component's dividend obtained by our previous method. We have taken into account the company's dividend policy (i.e. traditionally very high payout for example), the resulting dividend evolution, the representativeness of S1 09 results in Y 09 results, etc...

We have increased some dividend forecasts since our May publication, however, the total for Dec10 is slightly lower (96.8 vs 97.4).

This is explained by the reshuffle which leads to lower weightings for high dividend payers: telecom, oil, utilities.

	EPS 09E	Quantitative Payout Ratio	Div 09 Cheuvreux	Quantitative Div 09E	Qualitative Div 09E	Comment	Retained Div 09€	Div 09E pts
AEGON	-0.19	0.00	-	-			0.00	0.00
AIR LIQUIDE	4.40	45.20	2.25	1.99			1.99	0.97
ALLIANZ	8.06	43.40	3.50	3.50			3.50	2.97
ALSTOM	3.76	29.70	1.15	1.12			1.12	0.42
ARCELORMITTAL	-0.50	-149.20	0.75	-			0.00	0.00
AXA	1.50	22.40	0.40	0.34			0.34	1.05
BASF	1.38	50.00	0.80	0.69			0.69	1.19
BAYER	2.09	50.00	1.20	1.05	1.20	CA Cheuvreux's estimate on 09 div	1.20	1.86
BBVA	1.26	30.10	0.38	0.38			0.38	2.67
BNP PARIBAS	4.20	28.60	1.20	1.20			1.20	1.96
CARREFOUR	1.35	50.00	1.03	0.68			0.68	0.77
CREDIT AGRICOLE SA	0.47	50.00	0.45	0.23			0.23	0.45
DAIMLER	-1.63	0.00	-	-			0.00	0.00
DANONE	2.68	37.40	1.00	1.00			1.00	1.13
DEUTSCHE BANK	4.15	0.00	1.00	-	1	Cheuvreux's estimate on 09 dividend (increase)	1.00	1.16
DEUTSCHE BOERSE	3.76	38.80	2.05	1.46			1.46	0.53
DEUTSCHE TELEKOM	0.70	50.00	0.78	0.35	0.78	Poor results but solid balance sheet, we keep a flat div	0.78	4.35
E.ON	2.86	50.00	1.50	1.43	1.50	Cheuvreux's estimate on 09 dividend (flat div)	1.50	5.62
ENEL	0.71	38.20	0.27	0.27			0.27	3.25
ENI	1.59	47.00	1.00	0.75	1.00	High dividend policy & safe balance sheet	1.00	4.57
CRH	1.01	50.00	0.69	0.50	0.621	Div maintained in spite of lower EPS, safe balance sheet	0.62	0.82
FRANCE TELECOM	1.76	50.00	1.45	0.88	1.45	High dividend policy & safe balance sheet	1.45	5.16
GDF SUEZ	2.12	50.00	1.54	1.06	1.54	High dividend policy & safe balance sheet	1.54	3.85
GENERALI	0.81	12.40	0.10	0.10			0.10	0.22
IBERDROLA	0.51	50.00	0.33	0.25			0.25	1.64
ING	0.56	0.00	-	-			0.00	0.00
INTESA-SANPAOLO	0.15	0.00	-	-			0.00	0.00
LVMH	3.31	37.60	1.50	1.24			1.24	0.60
MUNICH RE	12.46	44.10	5.50	5.49			5.49	2.03
NOKIA CORPORATION	0.31	37.90	0.20	0.12	0.20	Poor results but solid balance sheet, we keep half of 08 div	0.20	1.40
OREAL	3.22	41.30	1.33	1.33			1.33	0.59
PHILIPS	0.11	50.00	0.70	0.05	0.35	Poor results but solid balance sheet, we keep half of 08 div	0.35	0.64
INBEV	1.84	19.80	0.35	0.36	0.35		0.35	0.46
REPSOL YPF	1.59	45.30	0.72	0.72			0.72	1.07
RWE	6.82	50.00	3.75	3.41		We remain cautious, we keep CA Cheuvreux estimates on 09 div (lower than 2008)	3.41	2.60
SAINT GOBAIN	0.91	32.50	1.00	0.29			0.29	0.22
SANOFI AVENTIS	5.82	39.90	2.32	2.32			2.32	4.56
SANTANDER	1.03	50.00	0.59	0.52			0.52	7.90
SAP	1.55	31.50	0.50	0.49			0.49	0.80
SCHNEIDER ELECTRIC	3.52	50.00	2.10	1.76			1.76	0.86
SIEMENS AG	4.61	25.00	1.60	1.15			1.15	1.76
SOCIETE GENERALE	2.44	34.70	1.00	0.85	0.90	Poor results, we take the div of SocGen's worst year (2007)	0.90	0.98
TELECOM ITALIA	0.09	43.80	0.05	0.04			0.04	0.71
TELEFONICA	1.65	50.00	1.15	0.82	1.15	High div policy & safe balance sheet, we keep CA Cheuvreux's estimate on 09 div (increase)	1.15	8.84
TOTAL SA	3.42	40.30	2.28	1.38	2	High dividend policy & safe balance sheet, we go back to 07 dividend (decrease)	2.00	7.88
UNICREDIT	0.11	0.00	-	-			0.00	0.00
UNILEVER N.V.	1.14	43.00	0.76	0.49			0.49	1.43
VINCI	3.06	50.00	1.62	1.53			1.53	1.41
VIVENDI	1.80	50.00	1.45	0.90	1.45	High dividend policy & safe balance sheet, we keep a flat dividend	1.45	3.33
VOLKSWAGEN	2.97	16.10	1.00	0.48			0.48	0.08

Source: CA Cheuvreux for EPS09E and Div 09 Cheuvreux, Calyon for all other fields

**Total Div 09E : 96.8**

Our new GED scenario for SX5E 2010 dividend stands at 96.8. This does not leave much upside compared with today's future on 2010 div (94.3, leading to 2.7% upside).

We have computed 2007 and 2008 SX5E EPS and dividends with today's SX5E's composition and weights. We want to compare historical EPS growth with dividend growth, for "today's index".

### Worst case scenario

We have inputted GED scenario for 2010 SX5E's dividend (96.8). The resulting payout for 2010 is 48.2%, a little under the previous year's payout of 50.6%. This seems highly improbable as EPS and payout are negatively correlated. A negative EPS growth should lead to an increase of the payout ratio.

This means that this scenario is rather conservative and represents the low boundary of our possible scenarios (2.7% upside compared with today's future dividend).

	2007	2008	2009	
Index EPS*	375.5	228.1	201.0	2007-09 Cumulative growth*
EPS growth		-39.3%	-11.9%	
	2008	2009	2010	
Index Div*	158.8	115.5	<b>96.8</b>	2007-09 Div Cumul*
Div growth		-27.3%	-16.2%	
Resulting Payout	42.3%	50.6%	<b>48.2%</b>	

\* calculated with today's composition and weights

Source: Calyon

### Best case scenario

Another scenario would be a flat dividend between 2009 and 2010. The resulting payout for 2010 is 57.5%; the highest payout ratio ever recorder on the index was 59%. With 22.5% upside compared with today's future dividend, this scenario is by all means the best we could expect.

	2008	2009	2010	
Index Div*	158.8	115.5	<b>115.5</b>	2007-09 Div Cumul*
Div growth		-27.3%	0.0%	
Resulting Payout	42.3%	50.6%	<b>57.5%</b>	

\* calculated with today's composition and weights

Source: Calyon



Source: Datastream

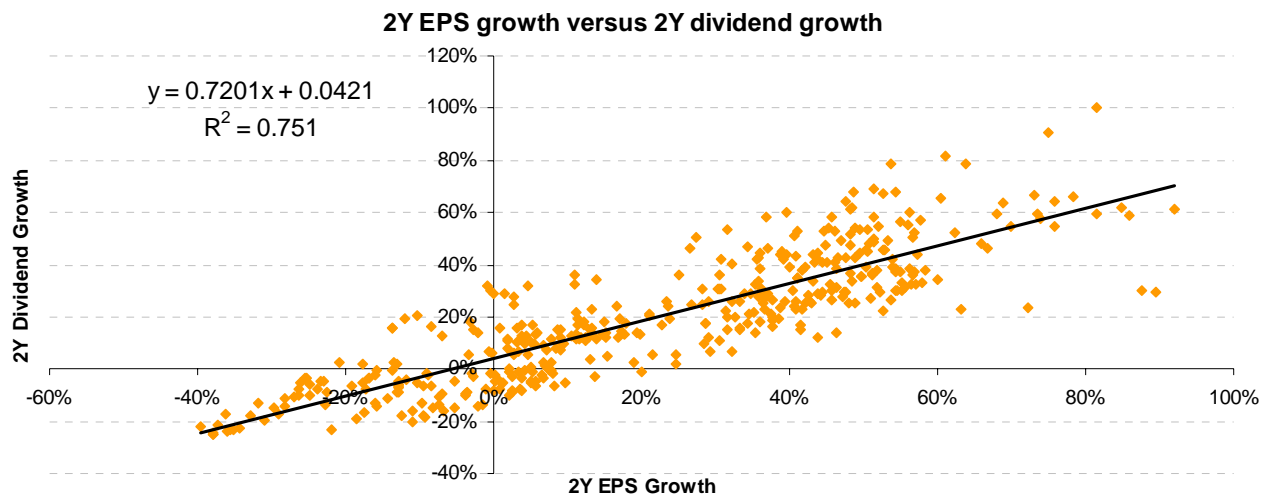
## Average scenario

Our last simulation represents the mid range scenario. We have made a linear regression between 2Y EPS growth and 2Y dividend growth ( $R^2 = 75\%$ ) in Europe since 1973. Considering the -46.5% 2Y EPS growth we are anticipating, the regression predicts a 2Y dividend growth of -33.4%. This leads to a very realistic payout ratio of 52.1% and a 2010 dividend of 105.7 (11% upside compared with today's future dividend).

	2008	2009	2010		
Index Div*	158.8	115.5	<b>105.7</b>	2007-09 Div Cumul*	
Div growth		-27.3%	-8.5%		<b>-33.4%</b>
Resulting Payout	42.3%	50.6%	52.6%		

\* calculated with today's composition and weights

Source: Calyon



Source: Datastream

## Recap:

Bear scenario (2010 SX5E dividend 96.9) -> +2.3% upside  
 Mid range scenario (2010 SX5E dividend 105.7) -> +11% upside  
 Bull scenario (2010 SX5E dividend 115.5) -> +22.5% upside

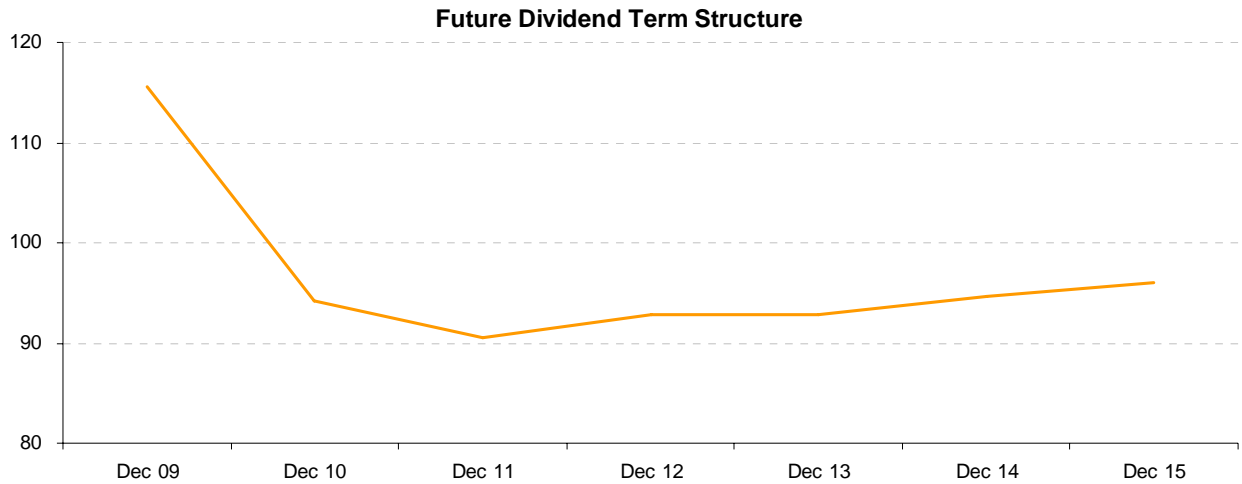
The impressive dividend performance we have witnessed since the 20<sup>th</sup> of January 2009 was a recovery following the sell off at the end of 2008. This generated a huge discount that has now disappeared.

We think there is still some upside, but this is much more speculative. We are not looking for a technical adjustment any more, but for an economical recovery leading to higher EPS and thus to higher dividends.

We are definitely still buyer of dividend on SX5E, but we will show in the next part of this publication why we would rather go long on longer maturities, 2011 and beyond.

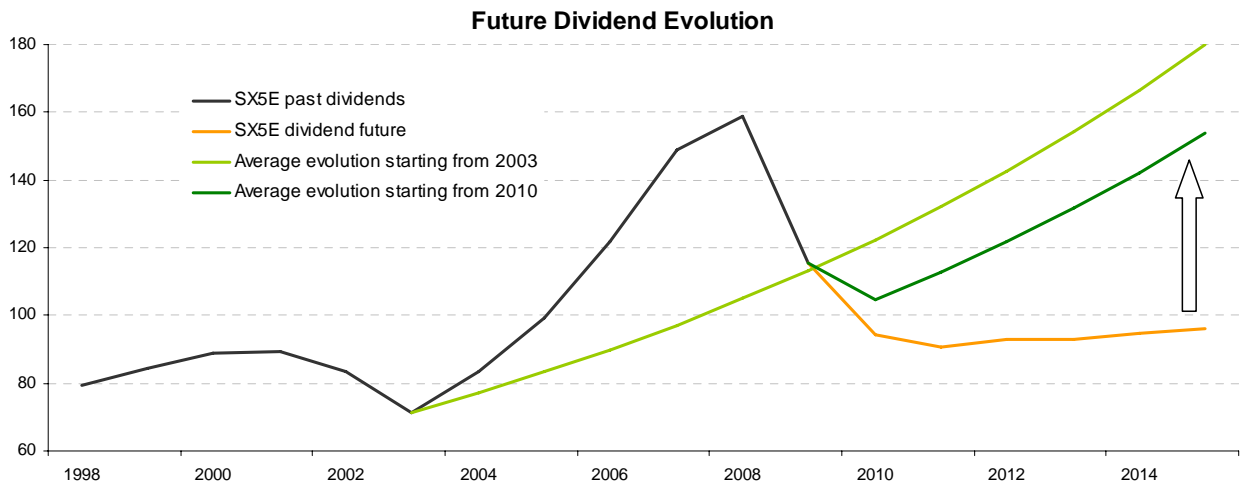
## More upside on longer maturities?

Despite the recovery dividends have experienced, their term structure is still quite flat with an average 1Y dividend growth of less than 1% on the 5 coming years (priced by the market). This may be too pessimistic on long term.



Source: Bloomberg

We have calculated the average 1Y dividend growth over the last 35 years in Europe; it stands at +8% (+6% on the S&P). Then, we have chosen the lowest dividend of the last 10 years (2003: 71.4) and applied the average growth factor in order to get an average projection. We have repeated the same process, but starting from our median scenario for 2010 dividend (105.7).



Source: Bloomberg for SX5E dividend future and past dividends, Calyon for average evolution starting from 2003 and 2010

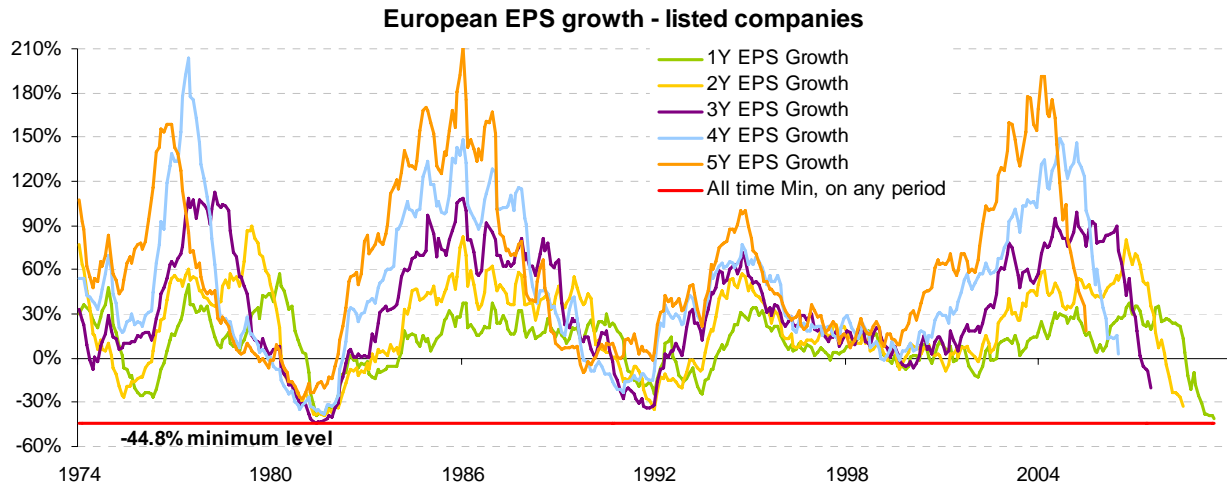
Two main observations:

- From the 2003 perspective (light green), the dividend bubble seems completely erased on 2009 dividend as the projected average level fits with the perception of the market (the implied level).

- Even the more conservative projection (dark green) which integrates an EPS decrease in 2009 is far above current market expectations.

Long term dividends should benefit from the short coming EPS growth turn (first phase) while short term dividend would have to wait for positive EPS growth (second phase).

As we have hit the lowest level of 1Y EPS growth, the first phase should begin soon.



Source: Datastream

## Any single stock recommendation?

We have confronted our bottom-up approach on single stocks dividends with each of their implied level (taking into account their bid-ask / liquidity) in order to detect any opportunity.

The bottom up aggregated level for the Index is at **96.2**. This is not really different from the dividend future level on the index. **This would mean that there are limited opportunities on single stocks.**

This is confirmed by a stock by stock analysis.

It appears there is only one main good candidate for a buy recommendation on the dividend: Deutsche Telekom.

We anticipate a dividend of 0.78€ (this level is anticipated by most analysts) while the market prices 0.66, representing a potential 20% upside.

## Recommendations

**We move to neutral on our recommendation on 2010 SX5E dividend** as the upside is much more limited now.

**We keep our long positions on SX5E dividends 2011 and beyond** as we think the EPS growth turn to come and the margin of maneuver left on payout ratios should lead to greater dividend performances.

**Go long on Deutsche Telekom 2010 dividend.** Looking at implied dividend levels of all stocks in the index, it appears that Deutsche Telekom is the main opportunity (cf. our last Trade Flash on Deutsche Telekom published the 31<sup>st</sup> of August).

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