

CSC Research – Credit to Equity Insight

Weekly C2E Insight

iTraxx wider over the week, closing at the 50DMA as the Stoxx 500 finds some support at its own 50DMA. A break through these levels would suggest the bullish trend is under threat.

Financials led the move wider, with regulatory issues and profits warnings hitting Banks' CDS particularly hard. We still see positive C2E divergence here, but believe sentiment could weigh on the sector for a while now.

Our C2E analytics still support an overall bullish stance, with a bias towards the cyclicals. We see most upside in Industrials and IT and good value in Consumer Discretionary too. Downside is most apparent in Energy and Utilities.

Sovereign CDS spreads suggest peripheral Europe continues to improve, with most potential equity upside now implied in the FTSEMIB. German CDS widening is a concern, with the sovereign now implying downside in the DAX. Recent macro data has also hardly been inspiring.

We maintain a positive stance on the bullish single name C2E analytics; though look to Thursday's ECB policy meeting in the hope that the apparent lack of urgency to add further stimulus measures over the rest of the summer has been altered by recent data releases and a slackening equity market.

- European CDS spreads were wider last week as the Stoxx 600 dropped close to 2% to trade in line with its 50DMA for the first time since mid April. The iTraxx had traded out to 62.25bps by Monday's close, above mid June's wides and broadly in line with its own 50DMA. A break above this level in the iTraxx (and below Monday's close in the Stoxx 600) will add to the negative pressure, though for now we are still inclined to suggest the tightening trend will hold, and there is enough evidence elsewhere to support a buy-the-dip mentality.
- One concern we have is that the major driver of this widening in credit was the financial sector. The iTraxx Snr Fins index was out 9%, reflecting a 3.4% decline in the European Financials index. Major banks dominated the biggest wideners in the single names space over the week as regulatory issues and profits warnings hit the sector.
- Despite this sharp hike in financial risk spreads, however, the iTraxx Snr Fin remains better over the month than both the iTraxx main and the Xover, whilst the financials equity index is a 2% laggard to the Stoxx 600. This has pushed C2E divergence in the financial sector higher. EPS momentum is also amongst the strongest in Europe and valuations, though slightly more expensive than their RAAVGES, are more attractive than elsewhere. We do have to be careful of negative sentiment, however, and the regulatory issues that have beset BNP and Barclays (amongst others) recently will likely hang over the sector for some time. We have therefore closed our Buy call on Soc Generale at a near 10% loss. We maintain a more constructive view in the insurance sector, however.
- Other sectors where C2E divergence is meaningfully bullish is in the Industrials, IT and Consumer Discretionary sectors, suggesting there has been little change to the pro-cyclical bias our C2E analytics have been advocating over recent weeks. This stance is further supported by the fact that we see bearish C2E divergence in just the Energy and Utilities sectors. Our valuation analysis also suggests the most attractively valued sectors are Financials, Consumer Discretionary and Industrials, with the most expensive being Utilities and Telecoms.
- Sovereign CDS spreads remains supportive of an overall bullish view. Over the week they bucked the trend of widening corporate risk to tighten across the board. Spain led the move, in 7% on the week, extending the monthly gains to nearly 23%, helping to support the IBEX, which is now the only European index to post gains on the month. The C2E relationship between the Spanish Sov and IBEX is now back in sync – having in indicated small downside a week ago. Valuation is perhaps a concern (16x BY01E PE is the highest in Europe and the largest premium to RAAVGE at 33%). This suggests we

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look for the equity index to stabilise above the 50DMA at 10800 before suggesting buying the correction.

- We see better upside implied in the FTSEMIB by the Italian Sov CDS. Indeed, C2E divergence here is nearly 0.7SD bullish, closing in on the previous peak of 0.9SD seen in mid May, prior to a 10% rally in the index over the next month. The near 6% correction from June's highs is starting to look overdone. With the index back at is 100DMA (a level it rallied off in early February and barely got below in mod May) we believe that the index is well set to recover from here. Outright valuations are also better than in Spain (BY01E PE of 14.1x vs 16x) and the premium to RAAVGE is 11% (vs. 33%). Indeed, the 11% premium to RAAVGE is the cheapest we have seen the index since the start of October last year.
- Finmeccanica remains one of our favourite buy calls in the European universe (we are raising our price target to €7.30). Elsewhere in Italy we also see decent upside in Generali, UniCredit and Intesa Sanpaolo. We see most downside in the smaller Italian banks and Enel.
- Overall in Europe our C2E analytics are skewed positively. Indeed, aggregate single name C2E divergence is the most bullish we have seen it since mid December last year. There are twice as many names indicating bullish C2E divergence than bearish and 30 names indicating meaningful (greater than 1SD) bullish divergence. Furthermore, there are just as many companies whose C2E divergence is in the most bullish third of their 1yr range as there are companies in the more bearish two thirds.
- Whilst the single name analytics point definitively to a bullish outlook for equities, the macro picture is more mixed. C2E divergence between the iTraxx and the Stoxx 600 is at neutral, whilst the sovereigns are broadly bullish in the peripheral economies and France and negative in Germany and Sweden. Furthermore, recent economic surveys have had a negative bias – keeping the Eurozone CESI at its lowest level since early 2013. With CDS spreads close to multi-year tight, and equity valuations near multi-year highs, we can understand the reticence to add risk whilst the macro picture hangs in the balance.
- Of course this soft macro data could well encourage the ECB into QE style asset purchases, which may well be the catalyst for the next leg higher in European equities and the next leg tighter for the iTraxx. Though there is no expected change to central bank policy to come from July's meeting this Thursday, it will be interesting to see whether the apparent lack of urgency to add further stimulus measures over the rest of the summer has been altered by recent data releases and a slackening equity market.
- We believe that potential for the ECB to back stop flagging economic growth, particularly with indications that inflation is well below target, cannot be underestimated, and with our C2E analytics broadly supporting the view that this equity market correction should be bought, we are happy holding on to our positive view.

Key sector C2E analytics

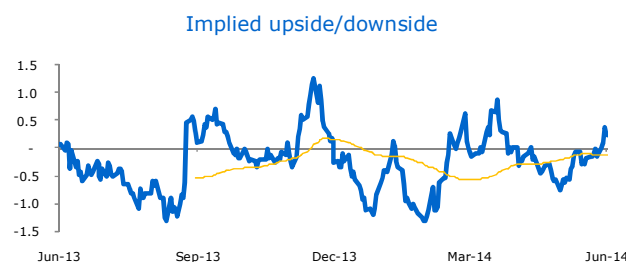
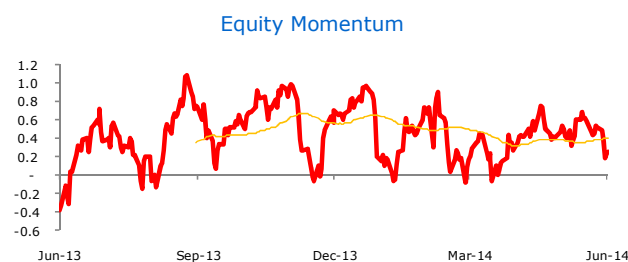
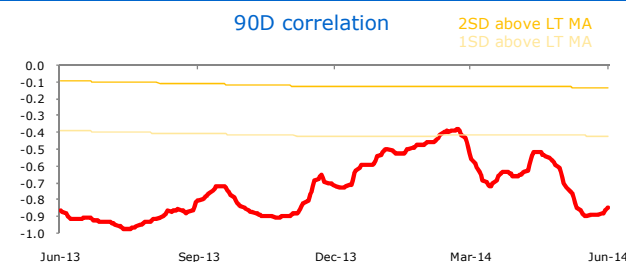
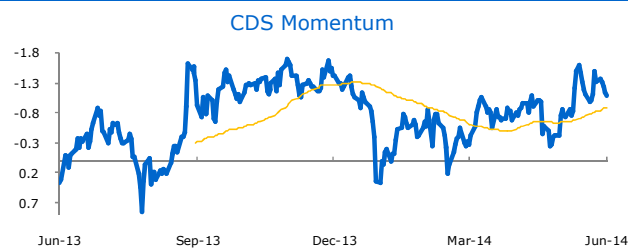
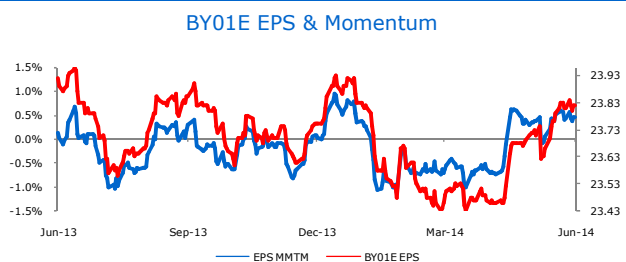
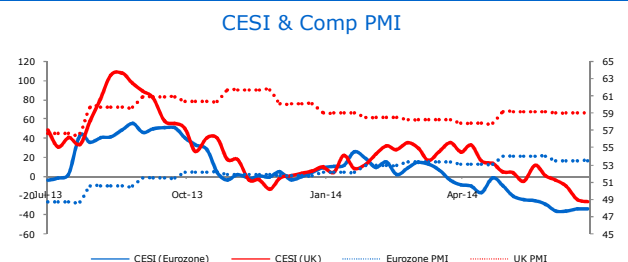
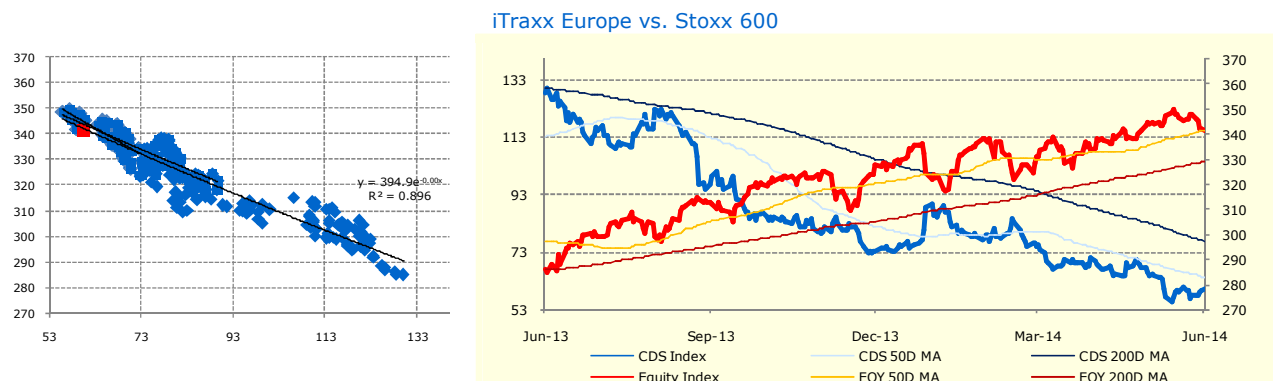
Sector	Average CDS	Average CDS vs HISTORY	Average C2E DIVERGENCE (SD)	Average CDS IMPLIED UPSIDE (%)	Average CDS IMPLIED UPSIDE RANK vs. HISTORY	Average CDS MMTM (%)	Average PE (x)	Average Rank vs HISTORY	Average PREM/DISC TO RAAVGE PE (x)	Average PREM/DISC TO RAAVGE PE vs HISTORY
Consumer Discretionary	90	0.3	0.4	3.3%	0.7	-6.9%	14.2	0.2	15.7	2.5%
Consumer Staples	63	0.3	0.5	4.0%	0.6	-5.6%	16.4	0.1	15.1	8.0%
Energy	48	0.3	-1.4	-9.0%	0.2	-4.9%	13.0	0.1	11.4	16.1%
Financials	105	0.3	0.3	4.6%	0.7	-11.1%	13.9	0.2	16.2	4.5%
Health Care	40	1.0	0.1	0.4%	0.6	-8.1%	15.6	0.1	15.1	4.1%
Industrials	77	0.3	0.5	4.3%	0.8	-9.7%	14.3	0.3	13.8	5.0%
Information Technology	131	0.3	0.5	5.1%	0.8	-7.9%	26.8	0.3	34.3	2.6%
Materials	112	0.3	0.2	2.0%	0.6	-10.6%	15.8	0.2	14.1	13.6%
Telecommunication Services	84	0.3	0.4	3.3%	0.7	-8.0%	17.4	0.0	14.3	20.6%
Utilities	65	0.3	-0.4	-2.8%	0.4	-10.3%	15.7	0.1	13.1	21.4%

- **Rentokil (RTO LN) – BUY – 125p:** We are adding Rentokil to our Buy Recommended List with a 125p price target. The stock has struggled since its FY results at the end of February, underperforming the FTSE100 and Stoxx 600 by nearly 16% in constant currency terms. Over the same period the CDS has tightened from 115bps to 77bps now. This is not only a reflection of the improving credit environment in Europe, but also the improving outlook for RTO as a business. Indeed, S&P has recently upgraded their rating for the company to BBB from BBB- following the sale of the facility management business and the repayment of €500m of MT notes. Not only has this improved the company's Debt/EBITDA ratio, it has also refocused the portfolio of businesses to higher margin operations, where RTO has stronger and more defensible positions (usually as market leader). This should, we believe, lead to higher and more stable cash flow generation in the future.
- The stronger balance sheet also leaves management scope to add to its portfolio and we would expect acquisition led growth to come increasingly to the fore this year. Indeed, management has stated that it would be disappointing to spend only the forecast €50m in the current year and we would expect this to counterbalance the translational currency losses that have been driving EPS downgrades for much of H1.
- With EPS momentum already starting to inflect positively and C2E divergence at its highest level since early 2012, we believe there is plenty to be positive about.
- The recent correction in the stock has brought valuations multiples back to more reasonable levels, in our opinion. Currently trading at a BY01E PE multiple of 13.6x, RTO is on a 10% discount to RAAVGE, the first time the stock has traded at a discount to RAAVGE since late 2013.
- The yield too has been creeping higher, to 2.4%, 60bps above the RAAVGE yield, broadly in line with the previous peak premium seen in December last year. This came prior to a near 15% outperformance of the stock vs the Stoxx 600 to the end of February.
- Our price target of 125p is based on our C2E divergence model and would support a forward PE of close to 15.3x. This is slightly ahead of our RAAVGE calculation of 15.1x.
- **Soc Generale (GLE FP) – Close:** We are closing our buy call on Soc Gen as the CDS has now moved above its 50DMA, shifting momentum negatively. The stock has also closed below its second review level, so despite the fact that C2E divergence remains very positive, we believe momentum in both asset classes is against the call.

CDS indices vs. Equity indices: Europe

iTraxx Europe: The iTraxx main is holding at its 50DMA, suggesting the tightening trend is about holding. The SXXP, similarly, is holding at 50DMA. A hold here would, we believe, set the index up for a recovery to 350, though were the indices to break support we could see the iTraxx moving out to 73bps, with further weakness in the Stoxx 600 to just above 330.

C2E divergence is now skewed slightly positively again, suggesting the equity correction has run a touch ahead of the iTraxx. Valuations have also improved and now look slightly better than risk adjusted averages.

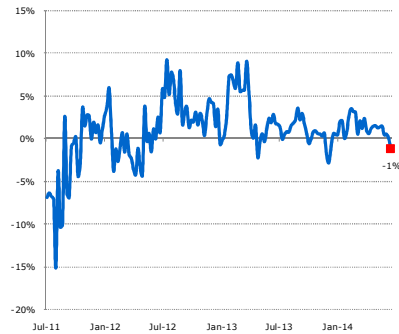


Risk Adjusted Valuations – BY01E PE & BY01E Dividend Yield & PBR

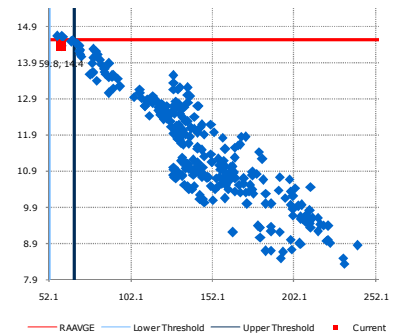
Stoxx 600 PE vs. RAAVGE & 5YR AVGE



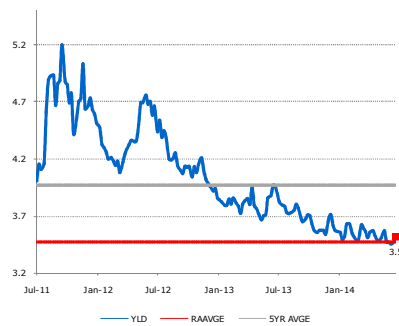
Premium/Discount to RAAVGE (%)



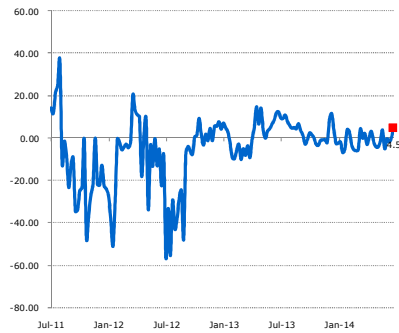
PE Range at current risk levels



Stoxx 600 YLD vs. RAAVGE & 5YR AVGE

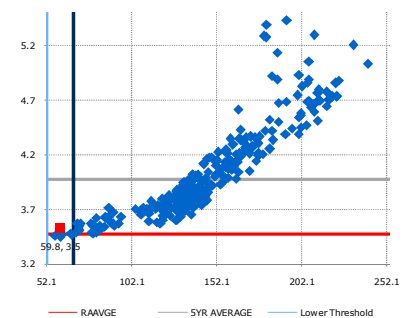


Premium/Discount to RAAVGE (BPS)



YLD Range at current risk levels

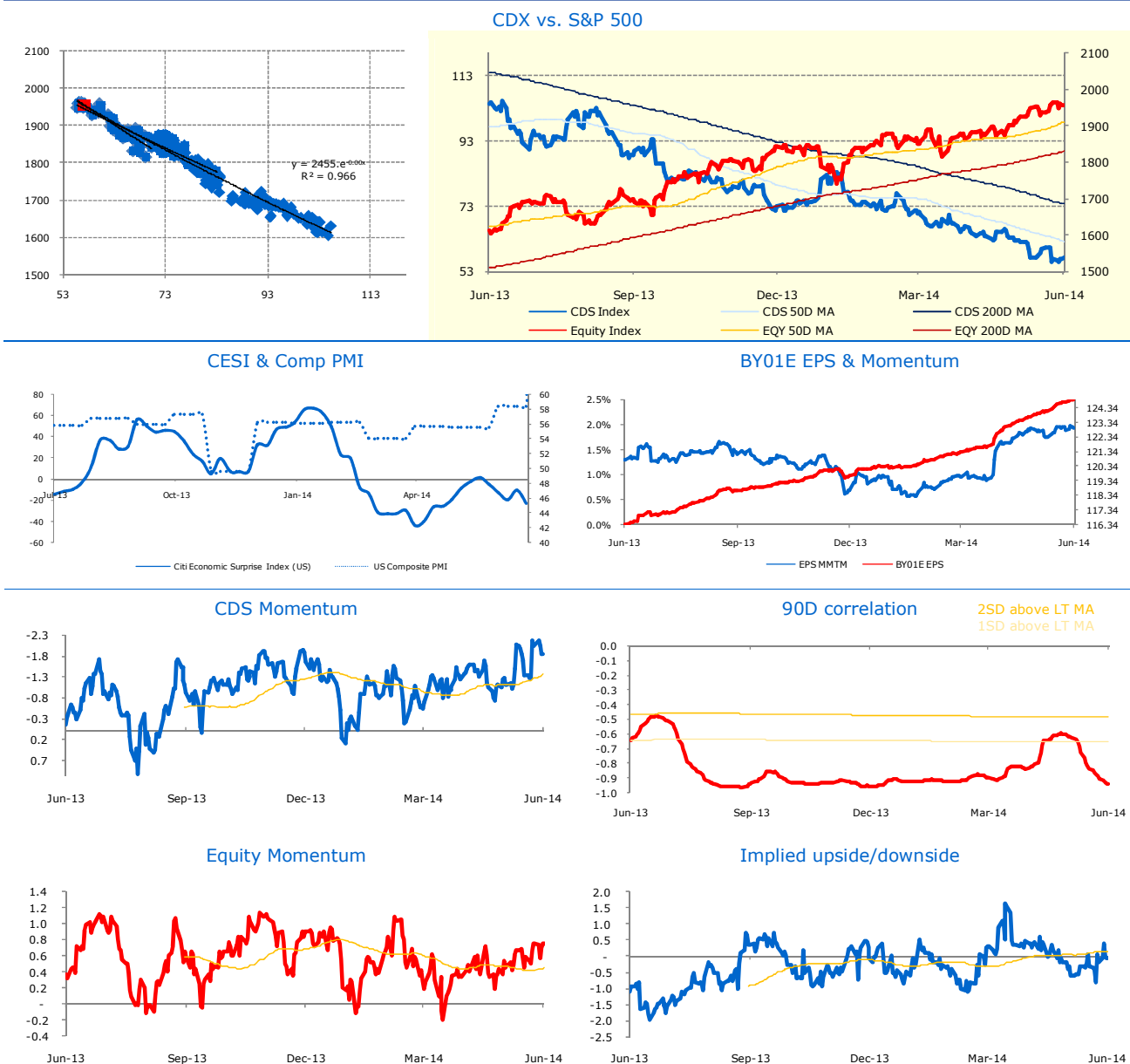
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Source: CSC research, Bloomberg

CDS indices vs. Equity indices: United States

US CDX: The CDX is holding comfortably below its 50DMA and below mid June wides, keeping on track with the S&P 500 as it holds near 2014 highs. Momentum remains strong, though valuations are starting to edge higher relative to their risk adjusted averages, which makes us think that there is limited further upside whilst the CDX holds above 55bps.



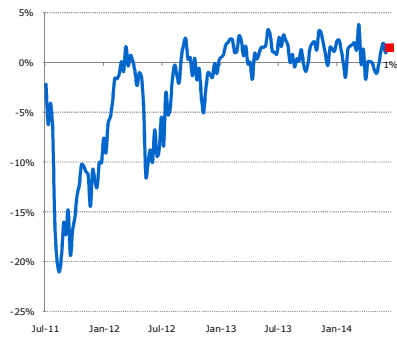
Source: CSC research, Bloomberg

Risk Adjusted Valuations – BY01E PE & BY01E Dividend Yield & PBR

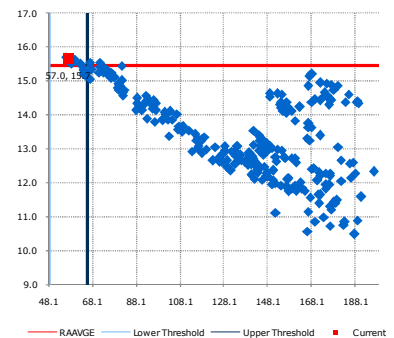
S&P 500 PE vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (%)



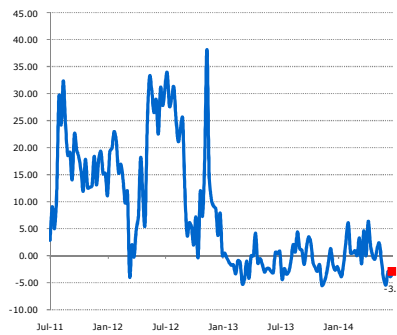
PE Range at current risk levels



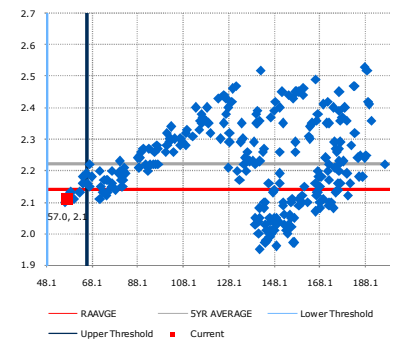
S&P 500 YLD vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (BPS)



YLD Range at current risk levels



Source: CSC research, Bloomberg

CDS, Equity & EPS movers: Europe

Index and country CDS, Equity & EPS change (5D)

Index	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
iTraxx Main	3.55	-1.76	-0.17
iTraxx Crossover	3.85	-1.76	-0.17
iTraxx Senior Financials	9.15	-3.39	0.13
FRANCE SOV	-2.03	-2.30	-0.09
GERMANY SOV	-2.42	-1.72	-0.18
ITALY SOV	-0.82	-3.04	0.16
SPAIN SOV	-6.99	-1.75	0.15
UK SOV	-1.06	-0.99	-0.38
SWEDEN SOV	-5.53	-0.51	0.16

Index and Country CDS, Equity & EPS change (1M)

Index	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
iTraxx Main	-7.67	-0.66	0.38
iTraxx Crossover	-6.99	-0.66	0.38
iTraxx Senior Financials	-10.44	-2.66	0.91
FRANCE SOV	-9.29	-1.83	-2.23
GERMANY SOV	-12.71	-1.29	0.21
ITALY SOV	-19.63	-1.43	3.60
SPAIN SOV	-22.68	1.49	1.76
UK SOV	-16.02	-1.27	-0.85
SWEDEN SOV	-11.54	-1.64	1.21

Sectors CDS, Equity & EPS change (5D)

Sector	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
Consumer Staples	0.82%	-0.63%	0.12%
Consumer Discretionary	0.96%	-0.19%	0.11%
Health Care	2.66%	-0.44%	0.18%
Industrials	2.91%	-0.57%	0.26%
Telecommunication Services	3.36%	-1.05%	-0.24%
Materials	3.38%	-1.23%	0.14%
Energy	3.45%	-1.08%	0.04%
Information Technology	4.77%	-2.93%	1.04%
Utilities	5.98%	-0.92%	-0.01%
Financials	11.32%	-2.49%	0.79%
Overall	4.89%	-1.23%	0.30%

Sectors CDS, Equity & EPS change (1M)

Sector	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
Health Care	-15.37%	2.18%	0.80%
Consumer Staples	-10.53%	-1.18%	0.67%
Energy	-9.24%	2.63%	0.55%
Consumer Discretionary	-7.73%	-2.07%	2.49%
Industrials	-7.68%	-1.72%	0.62%
Utilities	-7.12%	2.22%	0.29%
Materials	-6.78%	-2.82%	1.41%
Telecommunication Services	-6.64%	-0.83%	-0.75%
Information Technology	-4.35%	-4.46%	-11.98%
Financials	-1.94%	-2.76%	-15.90%
Overall	-6.56%	-1.50%	-3.85%

Single name Tighteners (5D)

Company	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
ADIDAS AG	-73.21%	-1.52%	0.04%
INVESTOR AB-B	-11.66%	-0.55%	0.14%
DIXONS RETAIL PL	-7.97%	3.09%	0.77%
3I GROUP PLC	-5.96%	0.87%	0.09%
DELHAIZE GROUP	-5.62%	1.68%	-0.15%
TELENOR ASA	-4.25%	-2.09%	-0.04%
WM MORRISON SUP	-4.14%	-1.45%	0.61%
WOLTERS KLUWER	-4.11%	-1.62%	0.00%
HENKEL AG -PFD	-3.93%	-1.72%	0.24%
TELIASONERA AB	-3.66%	-0.85%	-0.16%

Single name Tighteners (1M)

Company	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
ADIDAS AG	-73.37%	-6.25%	0.82%
COVIDIEN PLC	-68.06%	25.89%	0.72%
RIO TINTO PLC	-32.19%	-3.49%	-4.28%
AIR FRANCE-KLM	-24.41%	-12.76%	5.23%
PORSCHE AUTO-PRF	-22.28%	-5.66%	-0.50%
SEB AB-A	-21.52%	0.50%	0.98%
ACCOR SA	-21.43%	-0.16%	1.28%
TECHNIP SA	-20.88%	0.64%	2.42%
NORDEA BANK AB	-20.81%	-3.37%	0.71%
HENKEL AG -PFD	-18.64%	-1.02%	0.89%

Single name Wideners (5D)

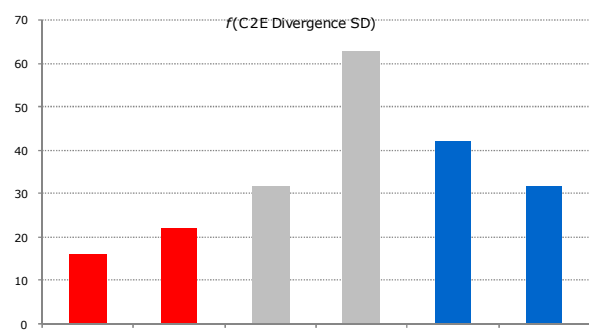
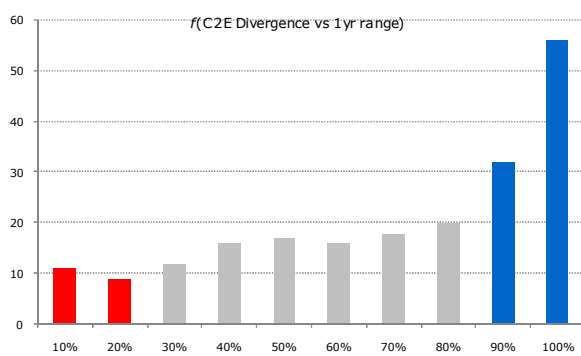
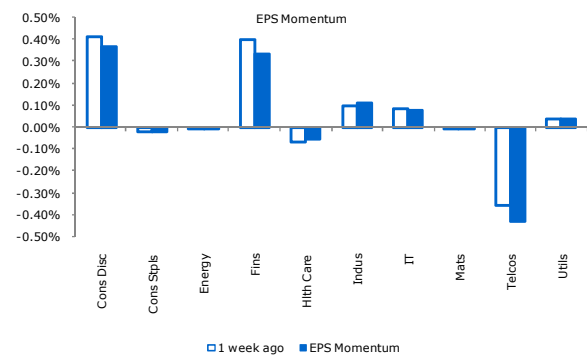
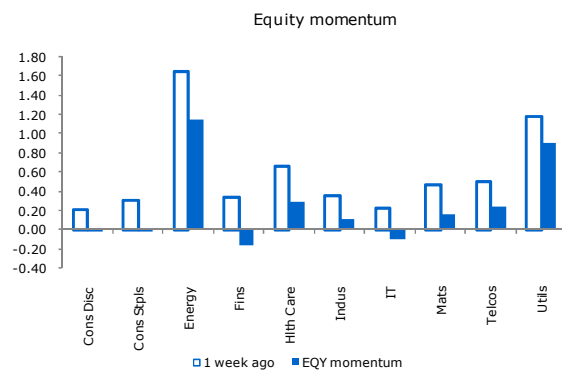
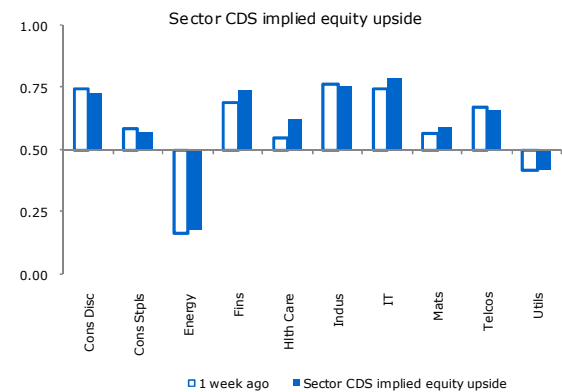
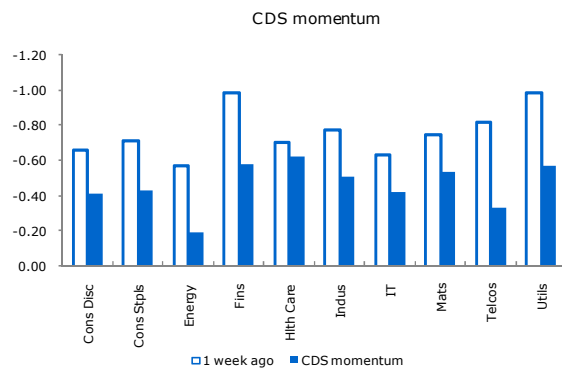
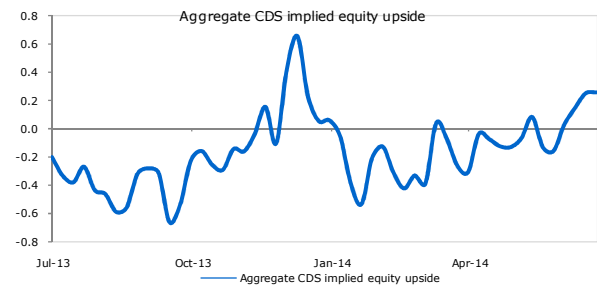
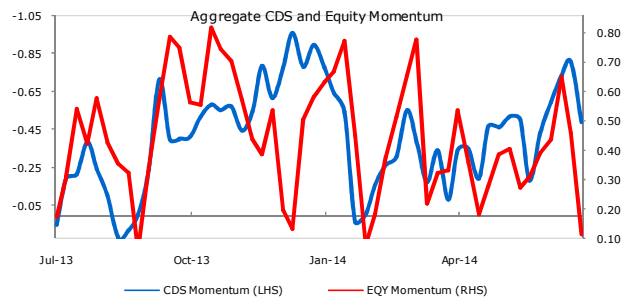
Company	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
BANCO ESPIRITO-R	73.80%	-15.38%	4.10%
STANDARD CHARTER	43.29%	-11.87%	-1.36%
BANCO COM PORT-R	42.58%	9.48%	-2.24%
DEXIA SA	26.68%	-11.11%	-0.23%
RHEINMETALL AG	22.24%	-0.68%	0.61%
CREDIT AGRICOLE	20.23%	-3.85%	0.28%
BARCLAYS PLC	19.04%	-7.79%	-0.01%
UBS AG-REG	18.24%	-3.47%	0.52%
BANCO POPOLARE S	16.80%	-5.84%	1.10%
DEUTSCHE BANK-RG	16.56%	-3.86%	-0.66%

Single name Wideners (1M)

Company	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
BANCO ESPIRITO-R	65.79%	-23.54%	12.76%
DEXIA SA	30.85%	-17.95%	-1.15%
BRITISH SKY BROA	28.75%	2.12%	0.32%
BANCO COM PORT-R	27.26%	-5.46%	23.39%
MAN GROUP PLC	12.11%	8.78%	2.36%
DEUTSCHE BANK-RG	11.70%	-10.12%	-0.42%
BANCA MONTE DEI	10.99%	-0.28%	-843.54%
BANCO POPOLARE S	10.98%	-7.04%	7.10%
RHEINMETALL AG	9.86%	5.06%	2.04%
ARCELORMITTAL	9.72%	-5.03%	0.61%

Source: CSC research, Bloomberg

Credit to Equity analytics: Europe



CDS, Equity & EPS movers: US

Index and country CDS, Equity & EPS change (5D)

Index	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
CDX IG	2.22	-0.10	0.13
US SOV	-2.85	-0.10	0.13
MEXICO SOV	-1.98	-0.87	0.25
BRAZIL SOV	-0.25	-2.71	-0.19

Index and Country CDS, Equity & EPS change (1M)

Index	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
CDX IG	-7.52	1.94	0.86
US SOV	-0.24	1.94	0.86
MEXICO SOV	-10.57	2.74	1.10
BRAZIL SOV	-3.44	3.74	-0.20

Sectors CDS, Equity & EPS change (5D)

Sector	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
Health Care	1.84%	0.09%	0.23%
Consumer Staples	2.10%	-0.36%	0.06%
Consumer Discretionary	2.33%	1.10%	0.24%
Industrials	2.59%	-0.28%	-0.09%
Materials	2.76%	0.13%	0.43%
Energy	3.75%	-1.66%	0.08%
Financials	4.49%	-0.63%	0.14%
Utilities	5.05%	1.17%	0.02%
Telecommunication Services	5.33%	-0.74%	-0.01%
Information Technology	8.90%	0.34%	0.18%
Overall	3.40%	0.03%	0.13%

Sectors CDS, Equity & EPS change (1M)

Sector	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
Health Care	-7.82%	2.38%	1.06%
Energy	-7.51%	7.87%	1.03%
Industrials	-6.30%	2.08%	3.55%
Consumer Discretionary	-4.34%	2.29%	1.28%
Utilities	-4.12%	4.26%	0.74%
Consumer Staples	-3.76%	1.15%	0.65%
Financials	-2.27%	2.09%	1.15%
Materials	-0.53%	4.31%	0.95%
Telecommunication Services	1.43%	-1.39%	-1.16%
Information Technology	2.70%	2.55%	0.72%
Overall	-4.01%	2.84%	1.29%

Single name Tighteners (5D)

Company	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
RADIOSHACK CORP	-22.87%	17.19%	0.00%
EMERSON ELEC CO	-10.88%	-1.31%	0.18%
HERSHEY CO/THE	-9.43%	-1.89%	0.16%
CAMERON INTERNAT	-8.64%	-0.78%	0.36%
TRAVELERS COS IN	-6.56%	-1.08%	-0.03%
JOHNSON&JOHNSON	-6.45%	0.23%	0.12%
CIGNA CORP	-5.48%	0.50%	0.19%
BALL CORP	-5.10%	2.04%	0.14%
ARCHER-DANIELS	-4.87%	-2.58%	0.19%
CONOCOPHILLIPS	-4.68%	-0.12%	-0.03%

Single name Tighteners (1M)

Company	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
RADIOSHACK CORP	-87.00%	-25.38%	31.05%
APACHE CORP	-26.80%	10.40%	1.04%
CAMERON INTERNAT	-22.88%	5.18%	1.45%
COLGATE-PALMOLIV	-22.70%	2.58%	0.85%
ANADARKO PETROLE	-22.22%	8.06%	2.09%
PFIZER INC	-21.82%	0.20%	0.01%
BRISTOL-MYER SQB	-20.75%	0.33%	-0.44%
CONOCOPHILLIPS	-18.68%	8.81%	1.19%
LOCKHEED MARTIN	-18.37%	-0.15%	0.64%
AK STEEL HLDG	-17.32%	21.13%	-2.42%

Single name Wideners (5D)

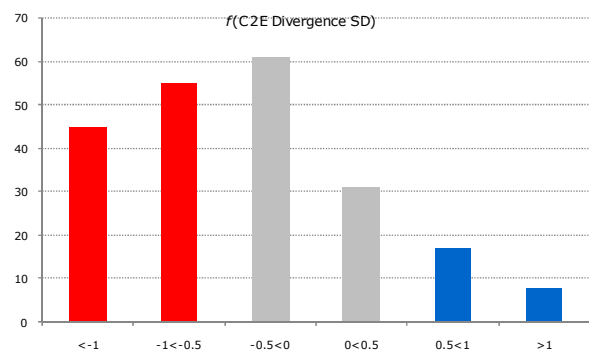
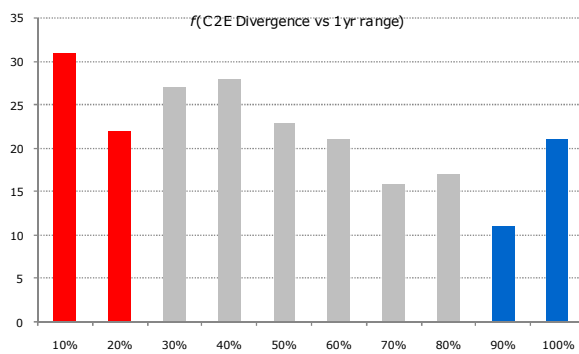
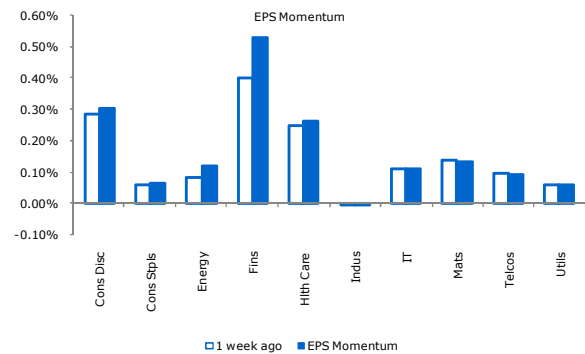
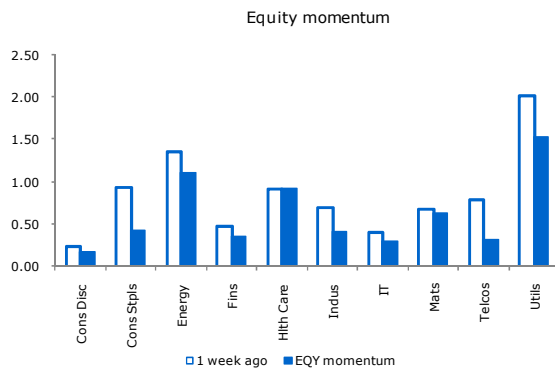
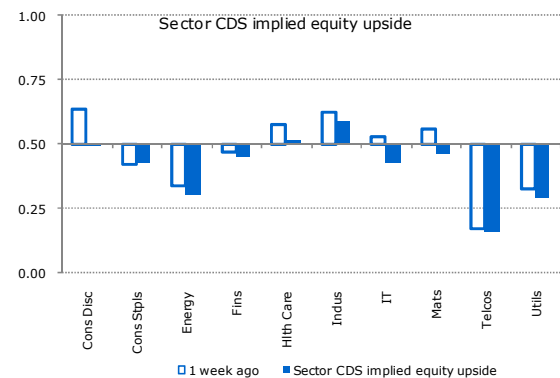
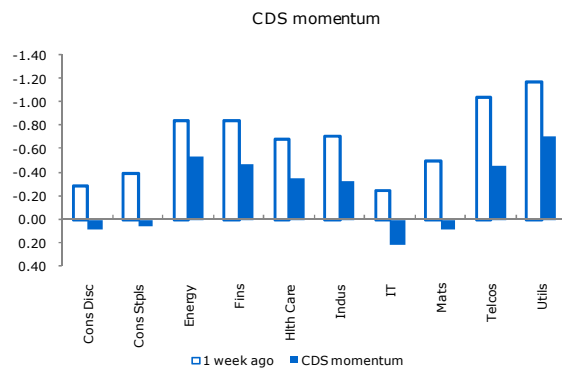
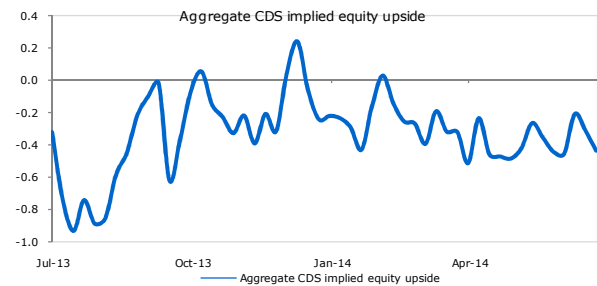
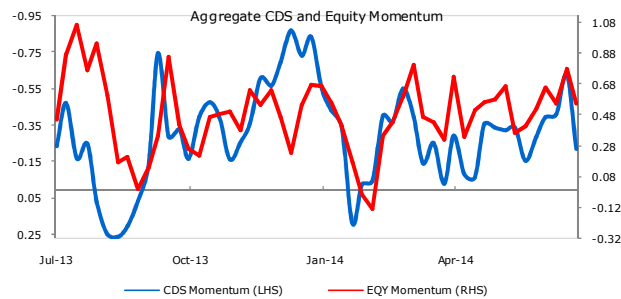
Company	5D CDS MOVE (%)	5D EQUITY MOVE (%)	5D EPS MOVE (%)
MONSANTO CO	48.13%	2.38%	2.28%
PEPCO HOLDINGS	32.29%	-0.04%	0.11%
INTUIT INC	23.59%	2.07%	0.17%
MURPHY OIL CORP	19.50%	-0.21%	0.46%
MERCK & CO	17.60%	-1.66%	0.06%
VALERO ENERGY	16.80%	-9.84%	-1.19%
XEROX CORP	16.48%	-0.08%	0.13%
MOTOROLA Solutio	16.11%	-0.48%	0.12%
COMPUTER SCIENCE	15.05%	-1.73%	0.19%
CONAGRA FOODS	14.63%	2.77%	-1.48%

Single name Wideners (1M)

Company	1M CDS MOVE (%)	1M EQUITY MOVE (%)	1M EPS MOVE (%)
MOLSON COORS-B	50.57%	14.83%	0.12%
MONSANTO CO	44.65%	4.00%	3.18%
INTUIT INC	29.13%	1.47%	0.80%
INTL GAME TECH	28.30%	28.42%	0.45%
WELLS FARGO & CO	19.80%	4.65%	0.25%
DARDEN RESTAURAN	19.47%	-6.21%	-14.23%
CENTURYLINK INC	18.35%	-4.13%	-0.05%
CONAGRA FOODS	17.19%	-6.12%	-3.40%
PEPCO HOLDINGS	15.05%	-0.44%	0.28%
MOTOROLA Solutio	13.85%	-0.36%	-0.38%

Source: CSC research, Bloomberg

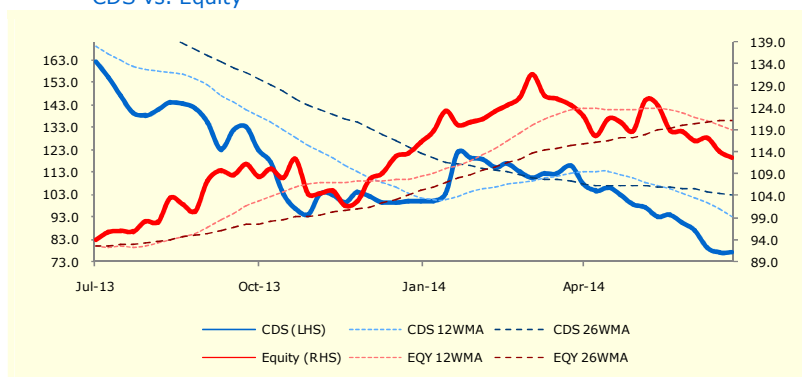
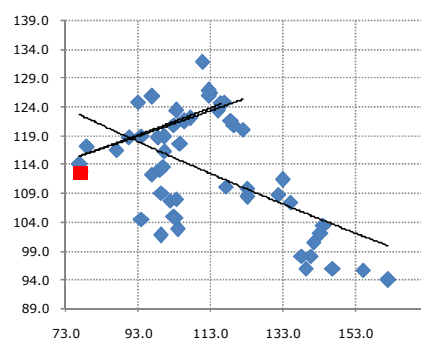
Credit to Equity analytics: US



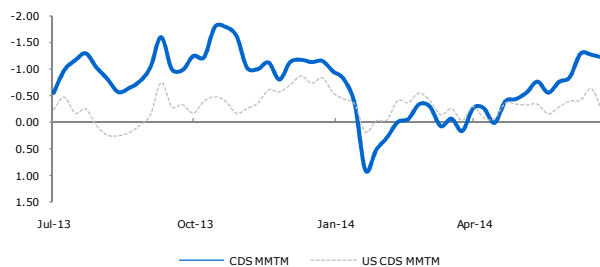
Credit to Equity tear sheet

- Rentokil (RTO LN) – BUY – 125p:** We are adding Rentokil to our Buy Recommended List with a 125p price target. The stock has struggled since its FY results at the end of February, underperforming the FTSE100 and Stoxx 600 by nearly 16% in constant currency terms. Over the same period the CDS has tightened from 115bps to 77bps now. This is not only a reflection of the improving credit environment in Europe, but also the improving outlook for RTO as a business. Indeed, S&P has recently upgraded their rating for the company to BBB- following the sale of the facility management business and the repayment of €500m of MT notes. Not only has this improved the company's Debt/EBITDA ratio, it has also refocused the portfolio of businesses to higher margin operations, where RTO has stronger and more defensible positions (usually as market leader). This should, we believe, lead to higher and more stable cash flow generation in the future.
- The stronger balance sheet also leaves management scope to add to its portfolio and we would expect acquisition led growth to come increasingly to the fore this year. Indeed, management has stated that it would be disappointing to spend only the forecast €50m in the current year and we would expect this to counterbalance the translational currency losses that have been driving EPS downgrades for much of H1.
- With EPS momentum already starting to inflect positively and C2E divergence at its highest level since early 2012, we believe there is plenty to be positive about.

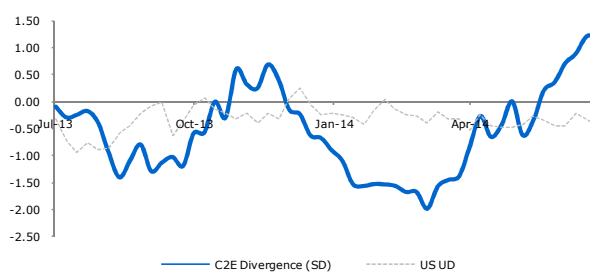
CDS vs. Equity



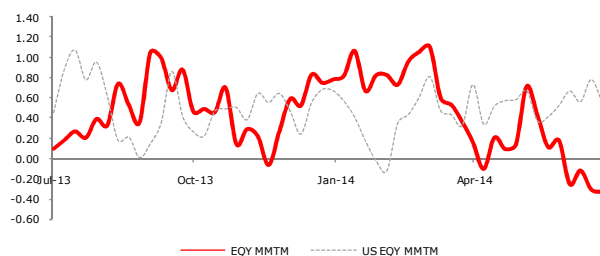
CDS Momentum



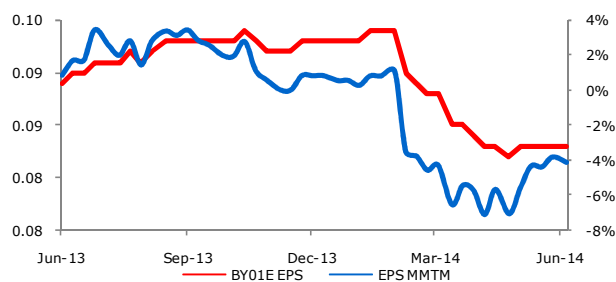
Implied upside/downside



Equity Momentum



BY01E EPS & Momentum



Source: CSC research, Bloomberg

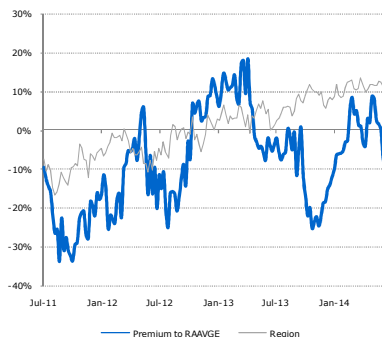
Risk Adjusted Valuations – BY01E PE & BY01E Dividend Yield

- **Rentokil (RTO LN) – BUY – 125p:** The recent correction in the stock has brought valuations multiples back to more reasonable levels, in our opinion. Currently trading at a BY01E PE multiple of 13.6x, RTO is on a 10% discount to RAAVGE, the first time the stock has traded at a discount to RAAVGE since late 2013.
- The yield too has been creeping higher, to 2.4%, 60bps above the RAAVGE yield, broadly in line with the previous peak premium seen in December last year. This came prior to a near 15% outperformance of the stock vs the Stoxx 600 to the end of February.
- Our price target of 125p is based on our C2E divergence model and would support a forward PE of close to 15.3x. This is slightly ahead of our RAAVGE calculation of 15.1x.

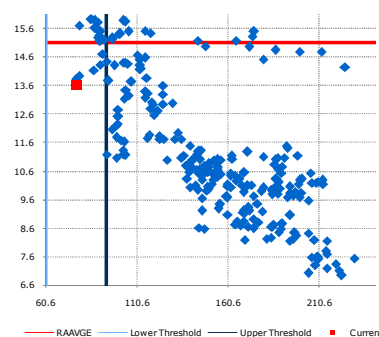
BY01E PE vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (%)



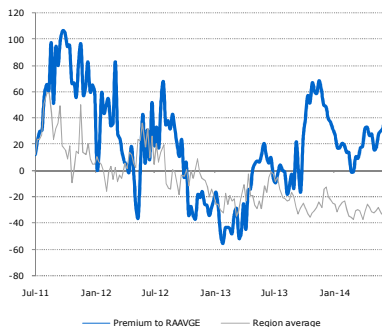
Range at current risk levels



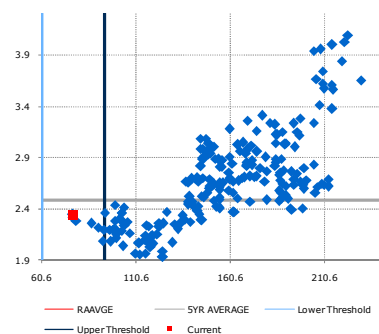
BY01E YLD vs. RAAVGE & 5YR AVGE



Premium/Discount to RAAVGE (BPS)



Range at current risk levels



Source: CSC research, Bloomberg

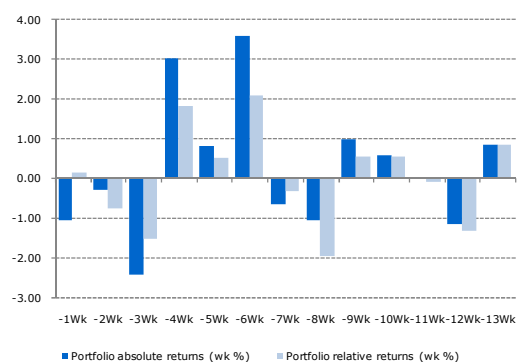
Credit to Equity Research – European Portfolio

Portfolio

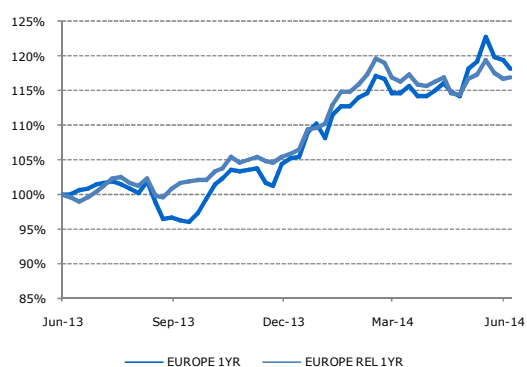
Soc Generale (GLE FP) – Close: We are closing our buy call on Soc Gen as the CDS has now moved above its 50DMA, shifting momentum negatively. The stock has also closed below its second review level, so despite the fact that C2E divergence remains very positive, we believe momentum in both asset classes is against the call.

Company Name	Rating	Open	Close	Duration	Absolute	Relative	Price Target	Stop Loss
GKN PLC	Buy	24/06/14		6	0.5	2.0	400.0	355.0
KONINKLIJKE PHIL	Buy	16/06/14		14	1.3	2.3	26.0	22.0
ITV PLC	Buy	10/06/14		20	1.1	2.8	200.0	170.0
FINMECCANICA SPA	Buy	03/06/14		27	14.8	15.1	7.5	6.8
SOC GENERALE SA	Buy	27/05/14		34	-9.8	-9.1	48.0	42.4
INTL CONS AIRLIN	Buy	19/05/14		42	1.8	1.5	420.0	370.0
CENTRICA PLC	Buy	12/05/14		49	0.2	-0.5	350.0	310.0
AXA	Buy	07/05/14		54	-0.5	-2.8	30.0	17.5
VALEO SA	Buy	28/04/14		63	3.4	-0.1	106.0	96.0
ING GROEP NV	Buy	14/04/14		77	5.3	0.4	11.0	10.5
STORA ENSO OYJ-R	Buy	24/03/14		98	1.0	-7.2	6.0	7.1
TELEVISION FRANC	Buy	17/03/14		105	-1.5	-9.8	13.8	11.8
TELENOR ASA	Sell	07/05/14		54	-1.6	0.7	127.0	145.0

Weekly Portfolio Returns (rolling quarter %)



1YR Portfolio Performance (abs/rel %)



Source: CSC Research, Bloomberg

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