

October 1, 2009

NORTH AMERICA

## Best Ideas

### Launching Best Ideas

Best Ideas are our leading stock investment insights — the best combination of highly differentiated research, favorable risk-reward profiles, and clear catalysts.

**Differentiated research.** We seek out-of-consensus thinking that incorporates fresh data and analysis. Analysts are expected to identify "what's in the price" and present a compelling challenge to market assumptions on key investment debates.

**Favorable risk-reward profiles.** Scenario analysis lies at the heart of our disciplined approach to research, so we look beyond single-point estimates and price targets. We examine the full risk-reward profile of the investment, assessing the range of plausible outcomes and the scenario skew as indicators of analyst conviction.

**Clear catalysts.** We require a clear roadmap for upcoming data and events in the following few months that can help corroborate our analysts' investment theses and drive a discernable change in market perceptions.

Additions and removals of stocks are published as part of regular, stock-specific reports. The complete list appears weekly in *Investment Perspectives*.

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Morgan Stanley Research  
Stock Selection Committee

**Baker Hughes**  
**Bank of America**  
**Celgene**  
**Danaher**  
**Hewlett-Packard**  
**Suncor**  
**Textron**  
**Union Pacific**  
**Walt Disney**

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For analyst certification and other important disclosures, refer to the Disclosure Section.

## Best Ideas — North America

<b>Baker Hughes</b>	<p>Baker Hughes announced the BJ Services acquisition and new leadership in the international business, both in the last month. BJS's assets should facilitate international growth, and management changes should improve international execution; both can help close the valuation gap. We expect 2011 EPS of \$4.90, well above the Street, and that places the stock below 9x earnings, compared to a 10.5 multiple for the group. Ultimately, we think an 18.5 multiple on 2011 is appropriate.</p>
	<a href="#">Link to recent reports</a>
<b>Bank of America</b>	<p>Card delinquencies are slowing, and capital markets should be better than most expect in 3Q09. Improvement in the rate of change in early-cycle consumer credit means that reserve build likely peaked in 2Q09, which should cause what was a \$1.36 reserve related EPS headwind in 2009 to vanish in 2010. This puts the stock at under 6x our 2011e EPS, which are 20%-plus above the Street, making it the cheapest of our Overweight-rated large-cap bank stocks.</p>
	<a href="#">Link to recent reports</a>
<b>Celgene</b>	<p>Street estimates for peak sales for 95%+ gross margin Revlimid look low at \$4 billion, as we see likely upside to \$5 billion and beyond. Additionally, Celgene's pipeline could emerge as a driver of longer-term growth. We believe investors underestimate the next generation myeloma drug, pomalidomide; impending Phase II data could surprise to the upside and lead to both an accelerated filing (drug on the market as early as 2012), and the addition of sales for this \$500 million-plus peak sales drug to Street models. We believe that data coming in December will lead to these upward revisions for both drugs.</p>
	<a href="#">Link to recent reports</a>
<b>Danaher</b>	<p>A broad-based "quality trade" should drive DHR, which we recommend as a high-quality midcycle play on economic recovery. The stock currently trades in line with group, versus its historical 20% premium, a premium that we argue is justified by its above-peer-average growth, margins, and FCF generation. Our higher-than-consensus estimates are driven by an expected acceleration in the M&amp;A cycle that Danaher's experienced management team should exploit with its strong balance sheet and deal pipeline. The recently announced acquisition of SCIEX/Molecular devices looks to be accretive and the first of many we expect over the cycle.</p>
	<a href="#">Link to recent reports</a>
<b>Hewlett-Packard</b>	<p>We see an exceptional risk-reward, with the stock trading near our "Bear Case" valuation of \$46; we recently increased our price target. Under CEO Mark Hurd, Hewlett has been a cost-cutting story, with superior and sustainable ROE (20%-plus). We now believe HP is transforming into a growth story driven by higher R&amp;D investment and a multi-year enterprise server cycle. As a result, we are 4% and 5% above consensus on 2010 and 2011 EPS estimates. Revaluation of shares should occur as this plays out. Proprietary inventory checks suggest a rebuilding of high-margin printer supplies providing downside protection until the cycle kicks in.</p>
	<a href="#">Link to recent reports</a>
<b>Suncor</b>	<p>Our 2010 EPS estimate of \$3.71 is 40% above consensus on our more bullish outlook for crude. Beyond 2010, we expect outperformance to be driven by the company's targeted C\$1.3 billion in synergies (conservative, in our view) from the transformative Petro-Canada merger, and our estimate of 6-7% annual production growth through 2016 — 200-300bps above Street numbers. The oil sands project backlog provides greater visibility for internally funded production growth. Our call on SU is further supported by our preference for oil-levered E&amp;Ps over gas-levered names.</p>
	<a href="#">Link to recent reports</a>
<b>Textron</b>	<p>Our three-pronged thesis: (1) Proprietary analysis suggests Textron Financial is on the mend with continued improvement in financial markets, and the division is no longer the \$1-3/share negative value/drag implicit in the share price. (2) The cyclical Cessna business is now expected to trough in 2010, earlier than most expect, driving positive earnings revisions. (3) Bell is a premium asset, currently undervalued by the market by up to \$1 billion, or \$4/share; we believe DoD support for helicopters in the QDR could provide a boost for TXT (one of the few stocks representing a play on helicopters).</p>
	<a href="#">Link to recent reports</a>
<b>Union Pacific</b>	<p>Street numbers for 2010 are at least 10% too low on volumes and productivity, in our view. We assume overall 2010 pricing will rise 3.5%, below recent growth rates, despite work that suggests no erosion in pricing power. We expect Y/Y volumes to finally turn positive again in 1Q10 after three years of declines. Our price target and estimates rise today, yet we see scope for more upside to earnings, particularly on productivity.</p>
	<a href="#">Link to recent reports</a>
<b>Walt Disney</b>	<p>Our regression analysis suggests that advertising will grow 3–5% in 2010, implying \$2.25 in EPS in 2011, 5% above Street estimates. ESPN should benefit from an estimated 16% increase in 2010 auto sales, while live sports and an extensive library make it a rare secular story in TV. Skepticism surrounds the Marvel deal, but we like Disney's ability to leverage new characters across film, consumer products, and parks. We believe the Marvel deal is not about making more films, but rather replacing existing Disney live-action projects with Marvel films, which tend to have higher returns with lower volatility. We think the deal is mainly about the high-margin licensing business, where the profit opportunity is underestimated.</p>
	<a href="#">Link to recent reports</a>

## Best Ideas — North America

Analyst	Ticker	Company	Sector	EPS*		Consensus EPS*		Annual Growth	P/E*		P/B	
				2009	2010	2009	2010	in EPS*	2009	2010	2009	2010
Slorer	BHI.N	Baker Hughes	Energy/Utilities	2.09 e	2.25 e	1.93 e	2.01 e	53.2%	20.6	19.1	1.7	1.4
Graseck	BAC.N	Bank of America	Financials	0.31 e	2.12 e	0.45 e	0.96 e	230.1%	56.0	8.1	0.7	0.6
Harr	CELG.O	Celgene Corporation	Healthcare	2.04 e	2.66 e	2.05 e	2.65 e	26.9%	27.0	20.7	5.5	4.6
Davis	DHR.N	Danaher Corp.	Consumer Disc./Indu.	3.40 e	3.75 e	3.38 e	3.72 e	13.0%	19.8	18.0	2.1	1.9
Huberty	HPQ.N	Hewlett-Packard	Technology	3.82 e	4.42 e	3.77 e	4.23 e	11.9%	12.4	110.7	2.6	2.2
Richardson	SU.TO	Suncor	Energy	1.07 e	3.71 e	1.11 e	2.66 e	78.2%	34.9	10.0	1.9	1.6
Wood	TXT.N	Textron Inc.	Consumer Disc./Indu.	0.29 e	0.52 e	0.19 e	0.88 e	103.3%	64.9	36.1	1.7	1.7
Greene	UNP.N	Union Pacific Corp.	Transportation	3.69 e	4.65 e	3.55 e	4.23 e	25.9%	16.0	12.7	1.8	1.7
Swinburne	DIS.N	Walt Disney Co	Media	1.74 e	1.90 e	1.76 e	1.87 e	13.6%	15.8	14.7	1.4	1.3

\*Uses consensus methodology, all other metrics use ModelWare methodology.

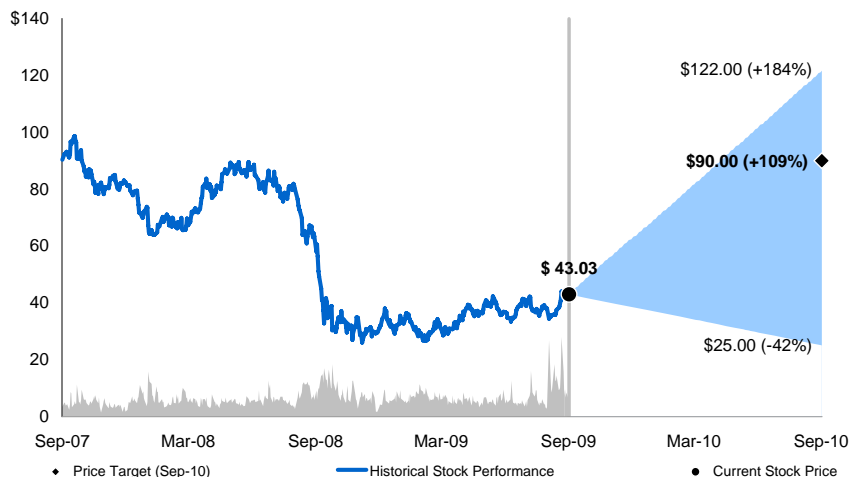
Analyst	Ticker	Company	Dividend Yield		FCF Yield Ratio		RNOA		Net Debt/ EBITDA		Interest Cover	
			2009	2010	2009	2010	2009	2010	2009	2010	2009	2010
Slorer	BHI.N	Baker Hughes	1.4%	1.4%	NM	NM	9.2% e	11.8% e	0.6 e	0.9 e	7.4 e	8.4 e
Graseck	BAC.N	Bank of America	0.2%	0.2%	--	--	2% e	8% e	1.1 e	0.3 e	1.5 e	20.5 e
Harr	CELG.O	Celgene Corporation	0.0%	0.0%	3.7%	4.9%	48% e	63% e	NM	NM	NM	NM
Davis	DHR.N	Danaher Corp.	0.1%	0.2%	6.4%	6.5%	10% e	10% e	1.4 e	1.2 e	14.1 e	13.2 e
Huberty	HPQ.N	Hewlett-Packard	0.7%	0.7%	8.4%	8.2%	21% e	23% e	0.1 e	NM	13.9 e	18.1 e
Richardson	SU.TO	Suncor	1.1%	1.1%	NM	6.9%	7% e	15% e	1.8 e	0.7 e	3.3 e	11.4 e
Wood	TXT.N	Textron Inc.	0.5%	0.5%	8.4%	8.9%	0% e	2% e	17.6 e	7.8 e	0.1 e	2.4 e
Greene	UNP.N	Union Pacific Corp.	1.8%	1.9%	4.2%	4.7%	8% e	10% e	2.1 e	1.8 e	3.9 e	4.7 e
Swinburne	DIS.N	Walt Disney Co	1.3%	1.4%	5.2%	5.1%	7% e	8% e	1.3 e	1.0 e	8.7 e	10.9 e

## Energy

### Baker Hughes (BHI, \$43.03, Overweight, PT \$90)

Analyst: Ole Slorer

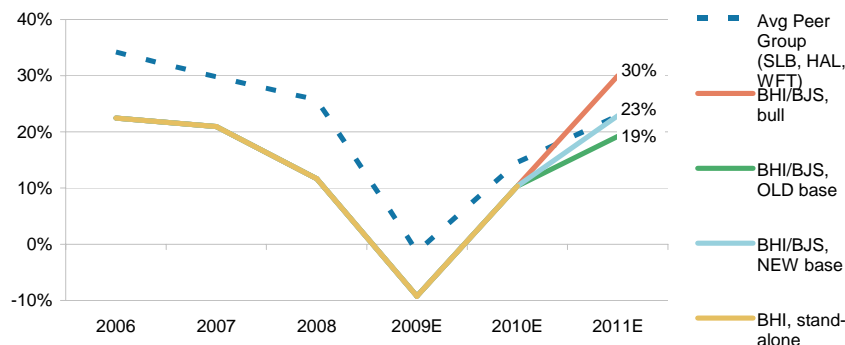
#### Street Underestimates Int'l Improvement and US Pressure Pumping



Price Target \$90		Derived from base-case scenario
<b>Bull Case</b>	23x 2011e Pro-forma EPS of \$5.30	<b>\$122</b> <b>Baker becomes a key player in integrated project management (IPM); V-shaped US recovery.</b> Baker stays on track to grow IPM to 10-20% of its business in five years. 2011 int'l revenue growth exceeds peers. North America nat gas demand and tightening supply spur v-shaped recovery in NAM margins.
<b>Base Case</b>	18.5x 2011e Pro-forma EPS of \$4.90	<b>\$90</b> <b>Baker Hughes catches up with peers' int'l growth/margins.</b> Baker Hughes' int'l growth rate and margins improve markedly, closing the gap with its large-cap service peers. NAM pumping capacity tightens by end-2010, improving margins and earnings on remaining NAM-based pressure pumping assets. Price target represents 18.5 times EPS, still a ~20% discount to lg-cap peers.
<b>Bear Case</b>	10x 2011e Pro-forma EPS of \$2.50	<b>\$25</b> <b>Some revenue synergies in 2011; muted NAM recovery.</b> 2011 Baker Hughes's stand-alone EPS decline more than 50% vs. the run rate of \$5.00/sh in 2008. Lackluster improvement in NAM pressure pumping drive BJS's stand-alone EPS to just \$1 in 2011. No revenue synergies. Cost savings take longer to materialize. Weak sentiment keeps valuation in check.

#### Experienced Emerging Markets Leadership Should Help Baker Hughes Close International Growth Gap with Peers

Int'l Revenue Growth (YoY)



Source: Morgan Stanley, FactSet, Company Data E = Morgan Stanley Research Estimates

#### Pivotal Investment Debates

- **Will Baker's international performance continue to lag peers'?** After adding pressure pumping assets (BJ Services) and experienced emerging markets leadership, and restructuring its organization by geography, not product line, Baker should close its historical international growth/margin gap with its peers by 2011.
- **What will the US pressure pumping recovery look like?** We expect pressure pumping utilization to recover to ~90% by end-2010, driving heritage-BJS EPS to over \$2 in 2011 (consensus is at \$1.16).

#### Where We Differ

- **Our 2011 EPS estimate of \$4.90 is 48% above consensus.**
- Consensus appears to be discounting higher risk to: (1) int'l growth, and (2) Baker's US pressure pumping business. However: (1) we are already familiar with most of Baker's recent additions and believe they substantially mitigate its int'l execution risk, and (2) our analysis suggests that US pressure pumping could quickly tighten into end-2010 as equipment transfers and obsolescence reduce US capacity.

#### Upcoming Catalysts

- **IPM project awards:** Up next are South Ghawar (Saudi Arabia, by year end) and Chicontopec (Mexico, over the next 12 months).
- **Iraq's second licensing round by end-2009:** We think Baker stands to gain significant share of what we expect to be a \$15 billion market.

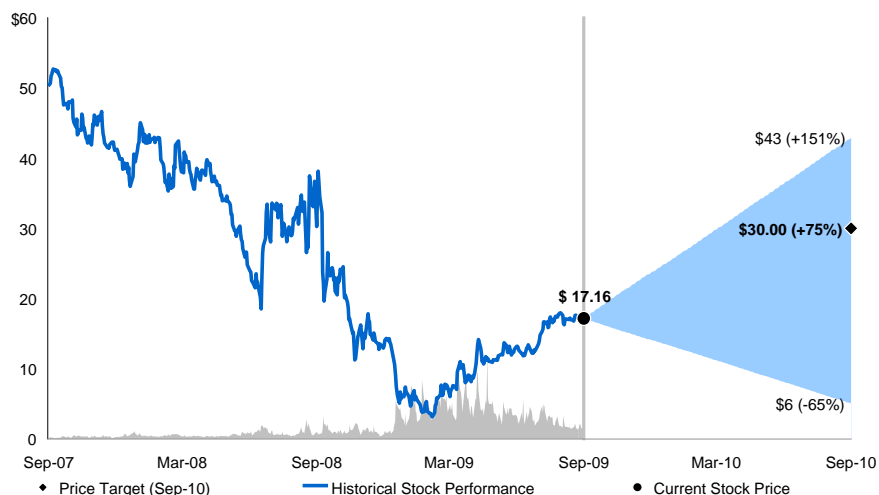
#### Risks

- Natural gas prices remaining depressed, deal integration/execution, and material drop in oil prices.

## Financials

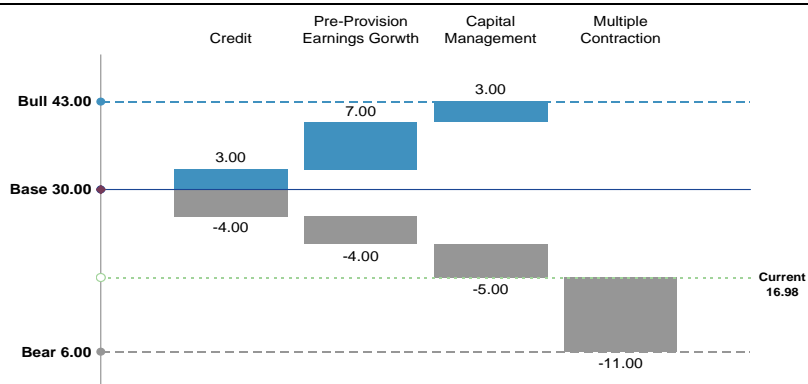
### Bank of America (BAC, \$17.16, OW, PT \$30)

#### Consensus Is Too Cautious on Improvement in Capital Markets and Consumer Loan Book, Which Should Drive BAC Stock



<b>Price Target \$30</b>		Derived from residual income valuation using a normalized beta and cost of equity capital. We assume a 5.5% risk-free rate and a 4.5% equity market risk premium. Implies a P/E of 9.5 on the present value of normalized earnings, below BAC's historical median forward P/E of 11.5. We use 2012 for normalized earnings.
<b>Bull Case \$43</b>	3.6x 2009e Bull Case Tang. BV	<b>Sharp economic recovery.</b> Credit improves more rapidly than in our base case. Valuation based on bull case residual income
<b>Base Case \$30</b>	2.6x 2009e Base Case Tang. BV	<b>Shallow 'U' Recovery.</b> Nonperforming loan growth begins to moderate in 4Q09/1Q10. Unemployment rises to 10% in 1Q10.
<b>Bear Case \$6</b>	0.5x 2009e Bear Case Tang. BV	<b>Double-dip recession.</b> Stimulus and inventory restock are not replaced by corporate reinvestment or consumer demand. Unemployment rises to 12%. Market does not look through to normalized EPS or discount strategic options. Valuation based on tangible book, assuming all preferred converts to common.

#### Earnings to Grow as BofA Exits Credit Cycle Earlier than Peers



Source: Morgan Stanley, FactSet

Analyst: Betsy Graseck

#### Pivotal Investment Debate

- **Sustainable trading revenues.** We believe BofA's normalized trading revenues will be higher than consensus expects, as BofA executes on the Merrill Lynch acquisition and drives improved trading efficiency.
- **Peaking credit costs, which means the end of reserve build.** We expect credit card losses to peak in 3Q09 and total losses to peak in 4Q09/1Q10. Eliminating reserve build in 2010e adds \$1.36 to EPS.

#### Where We Differ

- **Lowest valuation in our group.** BAC is trading at 5.5 times normalized (2012e) EPS; JPM, WFC, and PNC are at ~7.5x normalized EPS.
- **Further through cum losses.** With a skew to early cycle consumer loans (70% of managed loans vs. 50% large cap group median), we expect BofA to exit the credit cycle earlier than peers. We expect consumer credit costs to peak in 2H09 and mortgage in 1Q10; we forecast no further reserve build after 4Q09.
- **Proprietary trading analysis.** Pre-Merrill, BofA's trading operations were inefficient at an average multiple of 1.0x investment banking (IB) fees; Merrill averaged 3.5x. With Merrill management and practices, we believe BofA can lift its trading efficiency to a 2.0–2.5 multiple.

#### Upcoming Catalysts

- **Continued improvement in credit card master trust data** (released around the 15th of each month). Charge-offs lag early-stage delinquencies by 6 months.

#### Risks

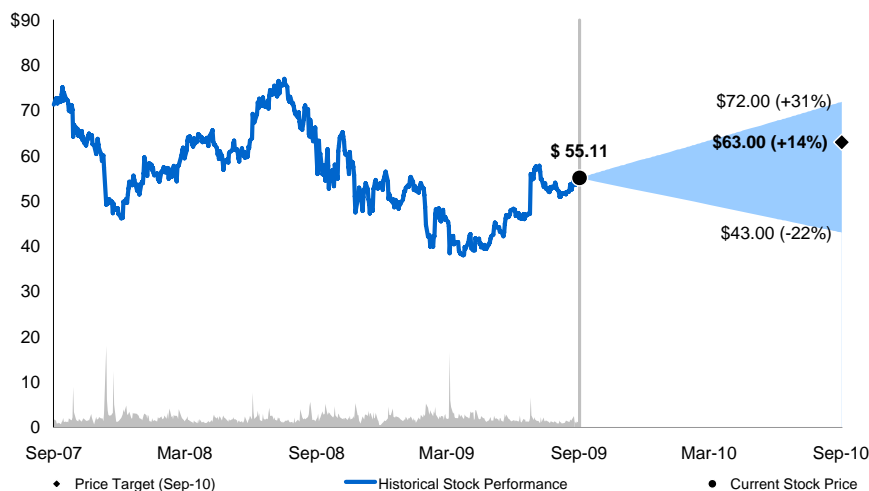
- Higher cumulative losses; dilution from capital raises/preferred conversions; Merrill integration challenges; leadership challenges.

## Healthcare

### Celgene (CELG, \$55.11, Overweight, PT \$63)

Analyst: Steven Harr

#### Approximately \$1 Billion of 95%-plus Gross Margin Revenue Not in Most Street Models



#### Pivotal Investment Debate

- We believe the Street underestimates the benefit Revlimid will have in the front-line myeloma population as well as probability of success for pomalidomide. Success in both should drive multiple expansion.

#### Where We Differ

- We model 5 years of 25%+ CAGR, vs. consensus of 3 years growth at this level.
- We expect Revlimid's benefit in front-line treatment of myeloma to be greater than the Street's high expectations, driving up forecasts of share and treatment duration.
- We model peak sales \$1bn above consensus for this 95%+ gross margin drug.
- Phase II data at American Society of Hematology (ASH) for next generation myeloma drug, pomalidomide, could surprise to the upside and lead to an accelerated filing (could be on the market in 2012, ahead of the most bullish estimates). We estimate \$500mn-plus peak sales potential, gross margins greater than 95%, and EBIT margins similar to gross margins as infrastructure is already in place — none of this is in models.

#### Upcoming Catalysts

- **Dec. 2009:** ASH – frontline (MM-015) Revlimid data and Phase II data for pomalidomide in refractory myeloma
- **Oct. 2009** – Apremilast Phase II data in psoriatic arthritis at American College of Rheumatology

#### Risks

- Limited opportunity for upward revisions to 2010 estimates, meaning stock upside rests on expansion of already-high P/E.
- Street looks optimistic about Vidaza
- Thalomid litigation risk
- MM-015 data could disappoint
- Pipeline agents could fail
- Generic Thalomid or Revlimid before we currently expect.

<b>Price Target \$63</b>		Derived from base-case scenario and DCF analysis (WACC of 9.3%, intermediate growth rate of 5% from 2016-2018, terminal growth of -2.5% as patent risk increases, Revlimid growth slows).
<b>Bull Case \$72</b>	DCF based intrinsic value	<b>MM-015 data and front-line growth in the EU exceed our expectations.</b> Our bull case scenario models the impact of a better than expected MM-015 result or better than expected uptake in the EU (potentially replacing a portion of the bone marrow transplant market). In this scenario, EU front-line penetration is similar to what we expect in the US (~50%). Duration of use also continues to grow substantially in this scenario as physicians treat to progression. Revlimid sales peak at >\$6 bn.
<b>Base Case \$63</b>	DCF based intrinsic value	<b>MM-015 shows 2-3x PFS increase over control; Revlimid's front-line penetration and duration of therapy grow.</b> Our base case assumes MM-015 shows a PFS significantly >24 months (benefit likely ~2-3x control arm). Given Revlimid's easy to administer oral regimen and solid side effect profile, we believe the consensus expectation of 40% peak front-line share is too low under this scenario. We expect front-line share in the US to approach 50% and peak penetration in the EU of ~36%. Furthermore, we expect physicians will evolve to "treat to progression," with a potential for average duration in front-line setting to exceed two years. With these assumptions, WW Revlimid sales grow to \$5bn. The key to visibility on this scenario is the quality and acceptance of the MM-015 data at the ASH meeting in December.
<b>Bear Case \$43</b>	DCF based intrinsic value	<b>Duration and front-line penetration grow little from current levels.</b> Our bear scenario assumes that MM-015 data disappoint and are not sufficient to drive meaningful changes in either duration of use or front-line penetration. In this scenario, Revlimid sales peak at ~\$3.5bn worldwide, with medium-term growth driven by ex-US with little changes in mature markets.

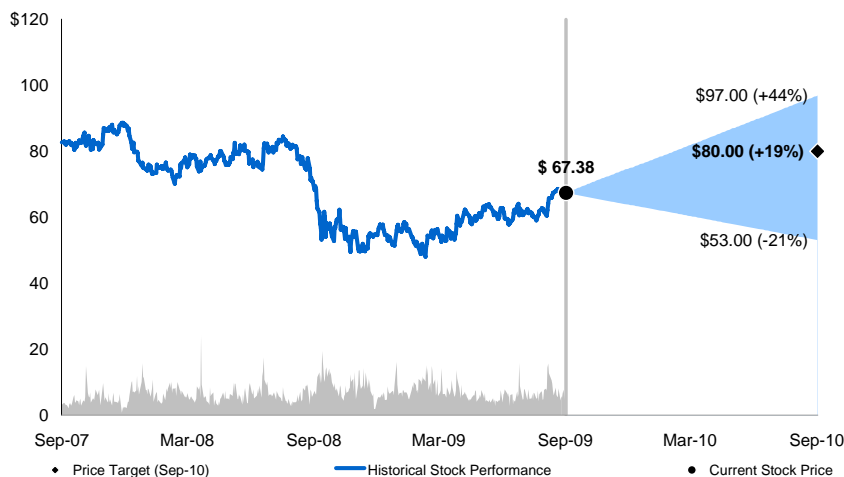
Source: Morgan Stanley, FactSet

## Consumer Discretionary/Industrials

### Danaher Corp. (DHR, \$67.38, OW, PT \$80)

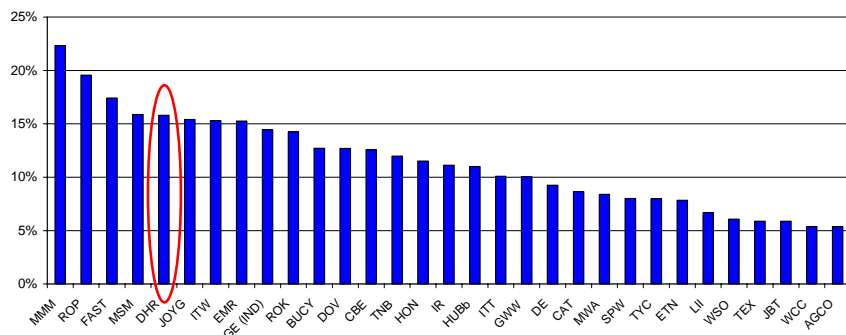
Analyst: Scott Davis

#### Best-in-Class Industrial at Inflection Point: Improving Orders Plus Substantial M&A Kicker Should Drive DHR Back to Historical Premium Valuation



<b>Price Target \$80</b>		Based on 18.5 times our 2011 EPS estimate; assumes DHR returns to its typical premium to its high-end peers. We think this premium is justified by Danaher's structurally high margins, above-peer growth, and best in class management.
<b>Bull Case \$97</b>	18.5x Bull Case 2011e EPS of \$5.27	<b>Danaher is able to make quality acquisitions at attractive prices with integration beyond expectations.</b> Med Tech margins reach 13.7% by 2010e from 12.1% in 2008 as AB SCIEX integration goes better than expected. Higher deal flow and sharp mid-cycle recovery drive DHR to bull case valuation.
<b>Base Case \$80</b>	18.5x Base Case 2011e EPS of \$4.35	<b>Prudent cash reinvestment, primarily via acquisitions at fair prices.</b> Flattish 2010 revenues on book/bill ~1.0, improving to 6% core growth recovery in 2011. Assumes modest macro recovery and good execution.
<b>Bear Case \$53</b>	15.0x Bear Case 2011e EPS of \$3.55	<b>M&amp;A markets stall and deal flow is limited, subpar execution on previous deals.</b> Macro doesn't recover and book/bill falls below 1.0 again in 2010.

#### Danaher: Quality Assets – Amongst the Highest Margins in Industrials



Source: Company data, FactSet, Morgan Stanley Research Cycle Average margins, 2004-2009E.

#### Pivotal Investment Debates

- Amid “unfreezing” of M&A, Danaher's ability to continue to grow profitably via acquisition as it gets larger.
- Magnitude of snap-back in key mid-cycle businesses.

#### Where We Differ

- We see a sharp acceleration in M&A markets as a catalyst. We argue that Danaher is the best positioned Industrial to take advantage of this theme due to a strong balance sheet, financing capabilities and deal pipeline that are superior to its peers', and better-than peer integration abilities through DBS (Danaher Business System).
- Mid-cycle has reached an inflection point and we think cycle timing now favors rotation. Danaher's book/bill should surpass 1.0 by end-2009.
- We consider Danaher's management best in class, and view the portfolio as highest quality amongst industrials, with above-peer core growth, structurally higher margins, and higher FCF generation.
- **DHR is trading in line with the group vs. its historical ~20% premium.** We believe “quality” in Industrials is undervalued post-“Beta rally.”

#### Upcoming Catalysts

- Closing of recent AB SCIEX/Molecular Devices deal, expected in 4Q09.
- M&A announcements in 4Q09, 1H10; restructuring; margin performance.
- Order book improvement in 3Q09.

#### Risks

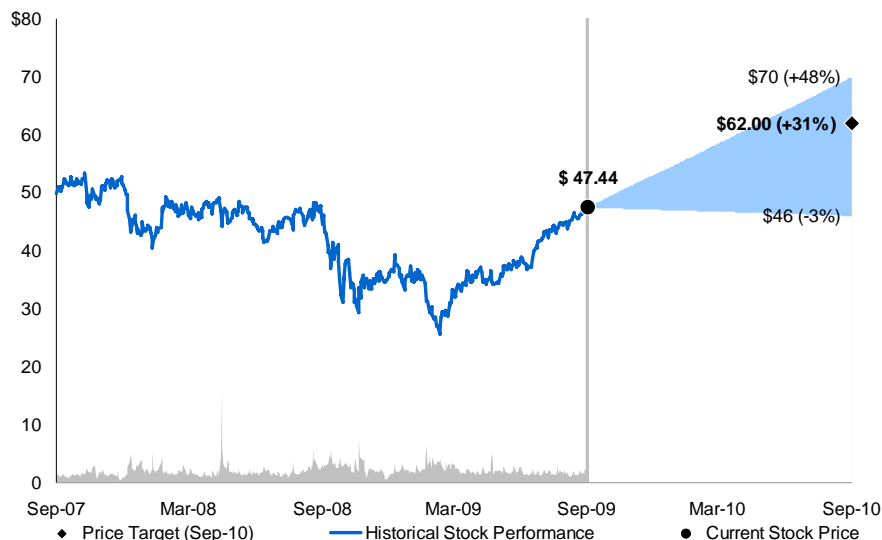
- Ability to make attractive acquisitions; sharper-than-expected deterioration of dental end markets; inability to maintain margins could bring into question the efficacy of the DBS in a downturn.

## Technology

### Hewlett Packard (HPQ, \$47.44, OW, PT \$62)

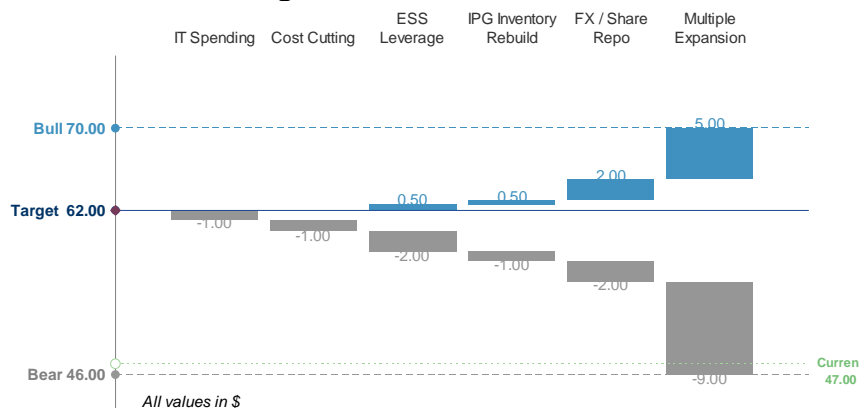
Analyst: Kathryn Huberty

#### Proprietary Checks Point to Rebuild in High-Margin Printer Inventory; Upside from Underappreciated Enterprise Server Cycle



<b>Bull Case</b> <b>\$70</b>	14x F2011 EPS of \$5 (15x GAAP EPS)	<b>Secular spending cycle combined with stronger cyclical recovery and inventory rebuild.</b> We also credit HP for the weaker dollar and more aggressive share buybacks. F2010 EPS rises to \$4.75 and F2011 to \$5. With a strong growth/ROE outlook, we believe HPQ will trade closer to a market multiple.
<b>Base Case/Price Target</b> <b>\$62</b>	12.8x F2011 EPS of \$4.85 (13.8x GAAP EPS)	<b>Cyclical recovery in servers and printers.</b> Higher than expected ESS revenue growth (8% vs. 2-4% guidance) and mild recovery in printer inventory drives upside to consensus EPS. Our price target applies HPQ's 5-year historical relative P/E (86% of current S&P 500 P/E of 14.9x = 12.8x).
<b>Bear Case</b> <b>\$46</b>	11x P/E on F2011 EPS of \$4.20 (12x GAAP EPS)	<b>Mild and protracted revenue recovery.</b> Low-single-digit IT spending growth combined with less flow through of cost-cutting in light of investments for long-term growth. We assume no multiple expansion from the current below-average level.

#### HPQ Stock Is Trading Near Our Bear-Case Valuation



Source: Morgan Stanley, FactSet

#### Pivotal Investment Debate

• **HP is more than a cost-cutting story**, in our view. Strong growth in HP's Enterprise Server and Storage (ESS) segment combined with low printer channel inventories set up for stronger revenue growth and operating leverage in F2010 and F2011. Our F2010 and F2011 EPS estimates are 4% and 5% above consensus due to these earnings levers.

#### Where We Differ

- **We believe HP's exposure to a server and storage spending recovery is underappreciated.** While many investors view HP's business as less transactional due to its Services/Printer exposure, we expect that HP's ESS segment will account for nearly half of the consensus EBIT growth next year.
- **Our proprietary inventory data point to a potential rebuild.** HP's printer channel inventory stabilized over the past month, after a 39% decline YTD, and could prove a strong EPS driver as high-margin printer supplies inventory increases.

#### Upcoming Catalysts

- **Strong C3Q results from server supply chain** — companies to watch include Seagate, Emulex, Qlogic.
- **Printer inventory rebuild** — Morgan Stanley publishes weekly proprietary data. Unemployment and GDP are also important indicators.
- **Improving PC ASP trends.** August data pointed to initial stabilization; easy compares in C4Q09.
- **Dollar weakness.** Current spot rates suggest \$0.10-plus incremental upside to our F2010e EPS.

#### Risks

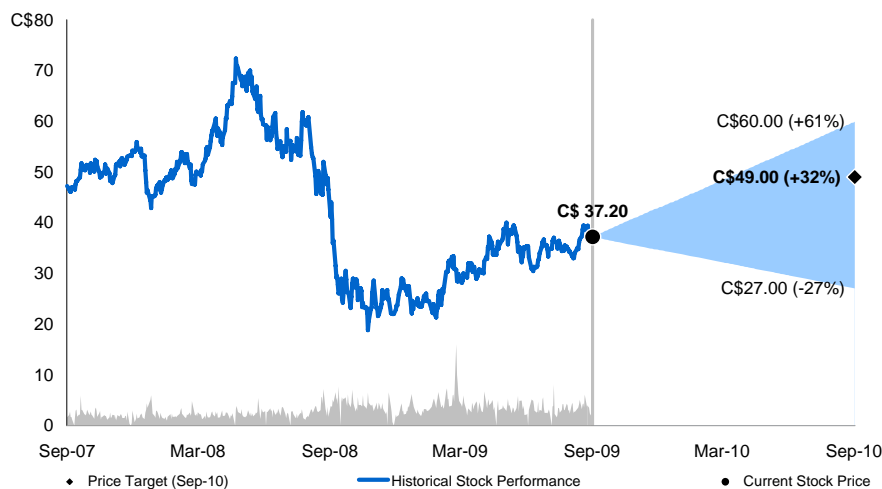
- Margin pressure in PCs; structurally lower growth in printing; weak enterprise IT spending rebound in C2010.

## Energy

### Suncor (SU.TO, C\$37.20, OW, PT C\$49)

Analyst: Stephen Richardson

#### The 'New' Suncor: Underappreciated Production Growth Profile and Renewed Focus on Execution following Petro-Canada Merger



#### Pivotal Investment Debate

- **The pace of development and shape of the company post-PetroCanada merger.** We believe that the market underappreciates Suncor's production growth outlook and optionality. We see 6-7% growth in our base case, with the optionality to target total shareholder returns contingent on crude price. Suncor's merger synergy target of C\$1.3 billion appears conservative to us, and offers further upside.

#### Where We Differ

- **Our project analysis reinforces our belief that Suncor can grow 6-7% annually through 2016,** while consensus likely expects ~4%, in line with the global integrated comps. Suncor's inventory of oil sands growth projects is ~120% of its current oil sands production. We anticipate Suncor will divest non-core business segments, reach synergy targets, and refocus on oil sands. We expect management can deliver these projects largely on time and on budget; consensus is more conservative.

#### Upcoming Catalysts

- **Post-merger strategy expected by mid-November.** Further clarity on the oil sands project backlog, capital efficiency, and pace of development should be a positive catalyst.
- **Further updates on integration synergies and operations:** Upcoming asset rationalizations (especially in natgas), cost-cutting, improved reliability of existing oil sands assets.

#### Risks

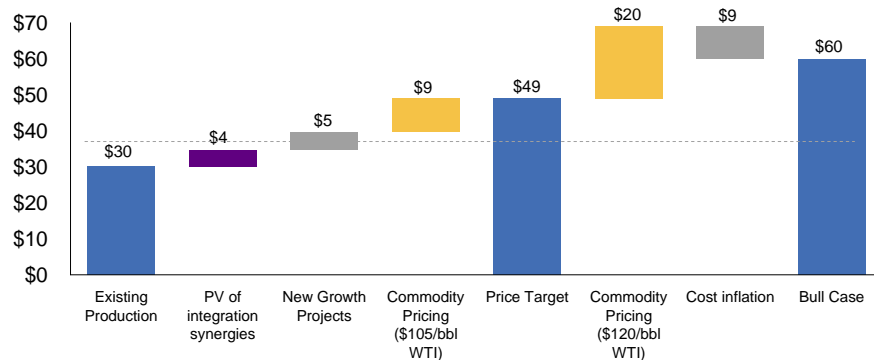
- We estimate Suncor's backlog of oil sands projects needs a US\$55-65/bbl crude oil price to make double-digit returns. Redressing past challenges and delivering on production commitments are key, in our view.

#### Price Target C\$49

Derived from our 8-year DCF model, which uses a terminal year multiple of 12.5x; a discount rate of 8%; and our base case oil and natural gas estimates.

<b>Bull Case</b> C\$60	10.4x 2010e EV/EBITDA at the strip	<b>Higher Commodity &amp; Superior Execution.</b> Long-term (2012+) oil price of US\$120/bbl accelerates growth outlook to 7%+ per year through 2016e. Merger integration synergies fully realized.
<b>Base Case</b> C\$49	8.8x 2010e EV/EBITDA at the strip	<b>Oil Sands-Focused Growth.</b> Long-term (2012+) oil price of US\$105/bbl allows SU to focus on oil sands growth, fully funding development of additional production phases brought on-line every 12-18 months, with implied 6-7% annual production growth.
<b>Bear Case</b> C\$27	5.2x 2010e EV/EBITDA at the strip	<b>Lower Crude Price Constrains Growth.</b> Long-term crude price assumption of US\$70/bbl slows organic funding, limiting growth to 3-4% annually in the coming decade. Cost deflation and weak CAD provide a natural offset.

#### Strong Production Growth Outlook, Higher Commodity Pricing



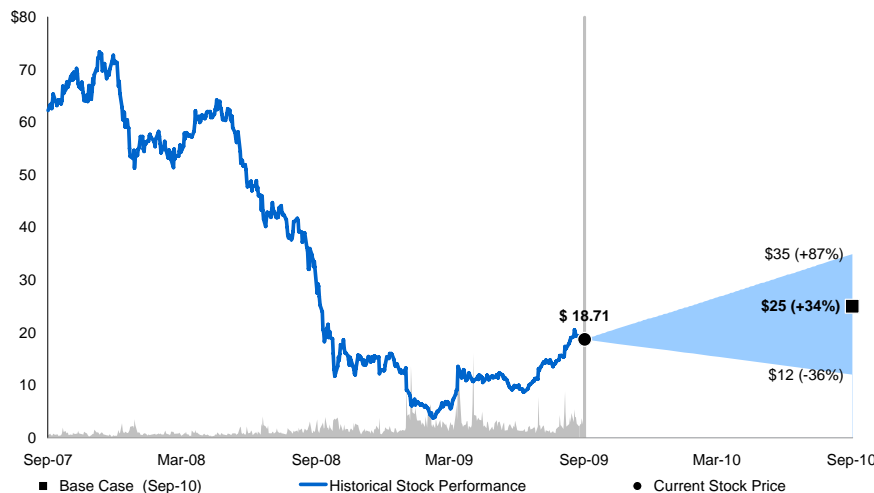
Source: Morgan Stanley, FactSet

Consumer Discretionary/Industrials

Textron (TXT, \$18.71, OW, PT \$25)

Analyst: Heidi Wood

Cessna Trough Likely in 2010, Earlier than Most Expect; Bell Intrinsically Undervalued, DoD Support in QDR for Helicopters Could Offer Upside



Pivotal Investment Debate

• **Textron Financial (TFC) overhang, timing of Cessna trough.** Our Overweight is based on (1) too great an assumed TFC overhang (the market appears to assume \$1-3/share in negative value; we estimate \$0 value), and (2) increasing likelihood/anticipation of a Cessna trough in 2010 and recovery thereafter, apt to be accompanied by a rising multiple.

Where We Differ

- **Our proprietary analysis of TFC's risk gives us comfort in our long-term valuation of TXT.** We believe the valuation gap with peers should close as this risk moderates.
- **Our research indicates that helicopter platforms should be strongly supported in the upcoming Quadrennial Defense Review (QDR released 1Q10).** Our Base Case values Bell at 7-8 times EBITDA but we could argue that this is a defense "crown jewel" that could warrant as high as a 10 multiple, adding up to \$1 billion of incremental value (\$4/sh.).

Upcoming Catalysts

- National Business Aviation Association Annual Meeting, October 20-22
- 3Q earnings October 27
- Investor conferences: Management speaks Nov. 4/5, Nov. 11, and Dec. 7
- The QDR in 1Q10 (this often leaks in the preceding fall)

Investment Risks

- Liquidity concerns resurface in 2010 if Cessna's performance and the TFC unwind disappoint; Cessna is unable to reduce costs and realizes negative margins in the 2H09 and into 2010; business jet declines accelerate and Cessna inventory builds on the balance sheet.

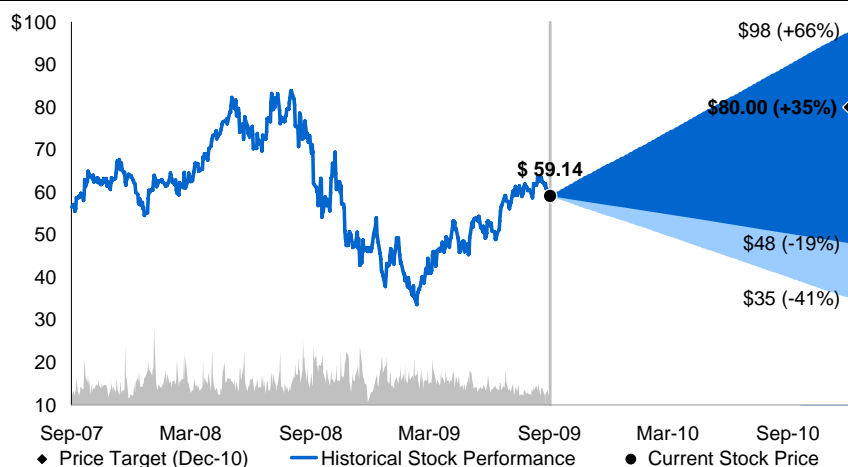
<b>Price Target \$25</b>	Derived from base-case scenario. Looking ahead to mid-2010, we see a reasonable case that the market may start to value 2011 earnings closer to 14–16 times if evidence surfaces that 2010 represented the trough for Cessna.	
<b>Bull Case \$35</b>	Normalized mid- to high-teens P/E; Peer EV/Sales	<b>Liquidity plan ahead of schedule, Cessna production cuts reflected in improved margins.</b> TFC collection exceeds expectations as general market conditions improve. Cessna inventory build concerns are mitigated and operating margins improve ahead of schedule. Manufacturing business exceeds cash flow expectations, with Bell continuing to perform well.
<b>Base Case \$25</b>	2010 Sum-of-the-Parts Valuation (SOTP), midpoint of 5-year DCF, mid-teens 2010 P/E	<b>Liquidity plan remains on track, Cessna production levels continue to decline, 'white tails' (planes without customers) minimal:</b> Textron's liquidity plan remains on track as deterioration at TFC stabilizes. TFC's drag on earnings is reduced in 2010 as portfolio charge-offs exceed loss provisions. Cessna right-sizes the business via announced headcount reductions and halts the deterioration of margins. Bell continues to perform well, providing cash flow to Textron and offsetting some of the declines in the other businesses. Base case assumes zero value for TFC.
<b>Bear Case \$12</b>	Significant negative value for TFC; Cessna recovery pushed out; P/E ex-TFC of ~10x	<b>Liquidity fears play out.</b> Liquidity concerns rise as the TFC unwind lags expectations and the manufacturing business, specifically Cessna, becomes a large drag on free cash flow. Increased inventory at Cessna, including white tails, and poor operating performance eats into cash reserves. Cessna margins turn negative, further weighing on the stock. Market sentiment on financial exposure turns negative once again and 2010 liquidity outlook becomes increasingly uncertain.

Source: FactSet, Morgan Stanley Research

## Transportation

### Union Pacific (UNP, \$59.14, OW, Yr-End 2010 PT \$80) *Analyst: William Greene*

#### Pricing, Productivity Result in Best L-T Growth Outlook in Rails



#### Pivotal Investment Debates

- **Recovery priced in? We don't think so.** UNP trades below mid-cycle multiples, on our estimates.
- **Size of pricing opportunity.** Most "re-pricing" potential: UNP was historically the biggest discounter. Legacy contracts (17% of rev., more than twice closest peer's) up to 50% below market pricing.
- **Volume outlook.** Volumes at UNP should improve most among rails given easy comps and new business wins.
- **Leverage to recovery.** Productivity offers substantial leverage. We estimate UNP could grow volume 5-10% without adding resources.

#### Where We Differ

- **Emerging FCF Story:** We are 11% above consensus EPS for 2010 and expect FCF to increase 2-3x by 2013.
- **Street too conservative on volume:** Off easy volume comps, current run-rate implies 5-10%+ volume growth in 1H10.
- **Powerful productivity story:** Recent meetings and metrics suggest rails used the recession to redesign networks, giving strong leverage in a recovery. UNP's productivity opportunity is arguably the largest among rails.
- **Rail legislation shouldn't lead to a wholesale change in economics:** This is an overhang on the stock, but we expect compromise and time pressures to result in a less onerous bill.

#### Upcoming Catalysts

- Volume growth by late 4Q and early 2010 off easy comps and recovery
- New Hub Group business: Good for volume, de-risks Pacer renewal in 2011
- Evidence of cost control during recovery

#### Potential Risks

- Regulatory changes
- Disappointing recovery or cost control
- Re-pricing can lead to volume losses
- Lower fuel surcharge coverage limits upside to higher fuel prices

Bull Case \$98		14.8x Bull Case 2011e EPS of \$6.65				
<b>Power of productivity and recovery.</b> Fiscal and monetary stimulus revive consumer spending, leading to a V-shaped recovery. Fuel prices rise, driving greater demand for rail. Productivity and cost cutting produce strong op. leverage.	<b>Assumptions</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>
	Volume Growth	-4.8%	-16.0%	9.3%	6.6%	3.6%
	Rev per Unit	16.2%	-4.9%	7.4%	5.2%	6.3%
	Op. Ratio	77.3%	76.1%	72.5%	70.1%	68.1%
	<b>EPS</b>	<b>\$4.54</b>	<b>\$3.68</b>	<b>\$5.18</b>	<b>\$6.65</b>	<b>\$8.25</b>
	YoY % Chg	31.5%	-18.9%	40.8%	28.2%	24.2%
Base Case \$80*		13.5x Base Case 2011e EPS of \$5.92				
<b>Tepid recovery, but pricing doesn't collapse.</b> Modest recovery in volumes, but growth still strong on easy comps — yet still below peak by 2013. Pricing slows, but stays above inflation. Expenses grow at a slower pace than volume.	<b>Assumptions</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>
	Volume Growth	-4.8%	-16.5%	5.8%	5.1%	4.6%
	Rev per Unit	16.2%	-5.0%	6.9%	4.9%	6.0%
	Op. Ratio	77.3%	76.3%	73.3%	70.8%	68.3%
	<b>EPS</b>	<b>\$4.55</b>	<b>\$3.60</b>	<b>\$4.68</b>	<b>\$5.92</b>	<b>\$7.49</b>
	YoY % Chg	31.5%	-21.0%	30.1%	26.4%	26.6%
Bear Case \$48		11.4x Bear Case 2011e EPS of \$4.24				
<b>'Head fake' on recovery – longer downturn cracks pricing discipline.</b> Recovery disappoints in 2010 and 2011. Volumes erode again, rails struggle to maintain pricing discipline. Cost control disappoints.	<b>Assumptions</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>
	Volume Growth	-4.8%	-17.0%	-0.2%	2.1%	5.6%
	Rev per Unit	16.2%	-5.3%	5.4%	3.4%	6.0%
	Op. Ratio	77.3%	76.7%	75.4%	74.2%	71.4%
	<b>EPS</b>	<b>\$4.54</b>	<b>\$3.45</b>	<b>\$3.75</b>	<b>\$4.24</b>	<b>\$5.50</b>
	YoY % Chg	31.4%	-24.1%	8.8%	13.2%	29.5%
Super Bear Case \$35		7.5x Base Case 2010e EPS of \$4.68				
<b>Legislation destroys rail pricing.</b> Unlikely, but use trough trailing P/E to value the stocks.						

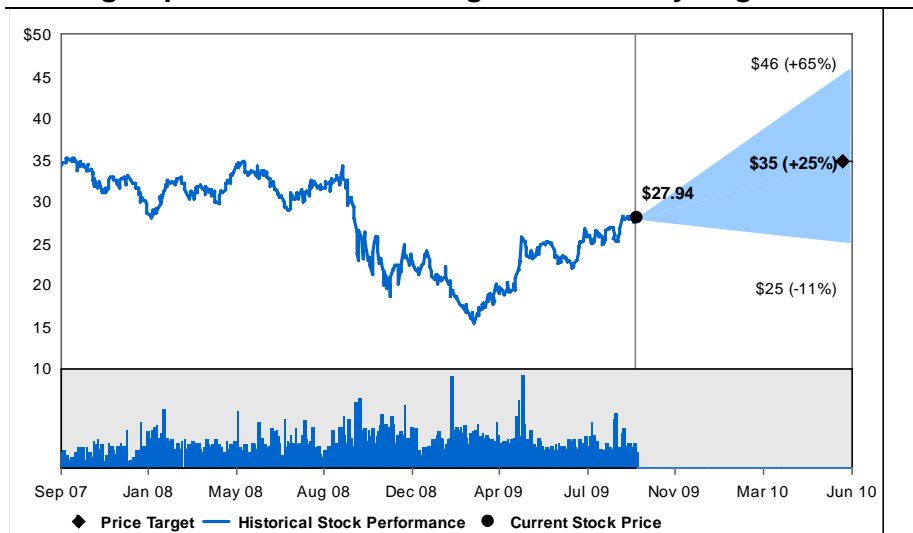
\*Base Case represents price target and is derived from our residual income analysis (required rate of return of 11.5%)  
Source: Morgan Stanley, FactSet

## Media

### Walt Disney (DIS, \$27.94, OW, PT \$35)

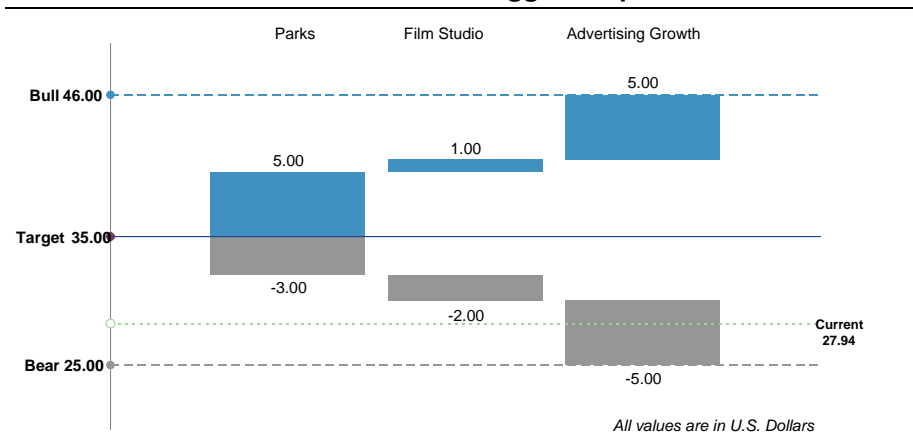
Analyst: Benjamin Swinburne

#### Even if Late-Cycle Parks Business Remains Depressed, We See Earnings Upside from Advertising and Marvel Synergies



<b>Price Target \$35</b>	Derived from base-case scenario.	
<b>Bull Case \$46</b>	18x Bull Case F2011e EPS	<b>V-Shaped ad recovery in 2010.</b> Advertising grows 5%. Film EBIT is \$610m vs. \$290m in F2009. Parks attendance increases by 4%. Stock returns to recent (2003 to present) average forward P/E.
<b>Base Case \$35</b>	15x Base Case F2011e EPS	<b>Steady advertising recovery in 2010.</b> Advertising grows 1.5% driven by ESPN advertising up 5%. Film EBIT is \$550m vs. \$290m in F2009. Parks attendance is down 2%. Year end 2011 price target assumes multiple expansion to just over 15x 2011e EPS, below DIS's recent (2003 to present) average of 18.
<b>Bear Case \$25</b>	13x Bear Case F2011e EPS	<b>Advertising budget cuts continue in 2010</b> Advertising declines 3%. Film EBIT is \$440m vs. \$290m in F2009. Parks attendance is down 5%.

#### Bear to Bull: Bull Case Ad Forecast Suggests Upside to \$40



Source: Company data, Morgan Stanley Research

#### Pivotal Investment Debate

- **Possibly the best cyclical recovery play in media; price target raised to \$35 from \$30 on Oct. 1.** We believe DIS is undervalued vs. its public comps. While the pending Marvel transaction should cause near-term dilution, we see 15-20% annual EPS growth from Disney through F2011, driven first by an advertising recovery in 2010 and then by a theme parks recovery in 2011. Finally, Marvel should prove accretive to EPS by F2012.
- **We think Disney returns to normalized EPS of \$2.25 by F2011 (consensus: \$2.14)** and that DIS can trade to its post-2003 avg. P/E of 18.

#### Where We Differ

- **Auto advertising could grow in 2010.** We expect auto could grow in 2010, benefiting ESPN, where auto is 15% of ad revenue.
- **We believe the Marvel deal is not about making more films,** but rather replacing existing Disney live-action projects with Marvel films, which tend to have higher returns and less earnings volatility. We think the deal is primarily about the high-margin licensing business, where Disney's profit opportunity is underestimated.

#### Upcoming Catalysts

- **Improving ad environment, higher consumer confidence data.** Disney is more cyclical than its peers, given its advertising, theme park, and consumer products exposure.
- **Closing of Marvel deal (late 2009),** when Disney could provide more clarity on its plans for Marvel.

#### Risks

- If auto advertising remains depressed our ESPN estimates could prove high. Parks business exposed to concerns about swine flu.

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	Count	% of Total	Count	Total IBC	% of Rating Category
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<b>Underweight/Sell</b>	<b>434</b>	<b>19%</b>	<b>88</b>	<b>14%</b>	<b>20%</b>
<b>Total</b>	<b>2,305</b>		<b>645</b>		

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October 1, 2009  
Best Ideas

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