Morgan Stanley

MORGAN STANLEY RESEARCH

December 15, 2009

NORTH AMERICA

Key Surprises for 2010

Plausible Scenarios That the Market is Underpricing

The Way We Do Research

If there is a lesson the markets keep telling us, it is the persistence of uncertainty. Unlike risks, which are known and measurable, uncertainty is difficult to calibrate. We can never know the exact payoff distribution for any given investment.

A single-point forecast may be simple and easily communicated. It may look bold. But it can never capture the multiple facets of reality as it might unfold. And it can never convey the full range of insights of a thoughtful analyst who has delved deeply into the relevant issues.

Morgan Stanley Research has taken a harder path and is providing more than just single-point estimates. As always, we state clearly our basic expectations and our central theme. We have a clear point of view. But our reports also articulate Bull and Bear cases for a range of potential outcomes. They also describe our analysts' thinking behind alternative projections for top-line growth, operating earnings, and capital intensity. Our scenarios enrich the conversation with a full range of possibilities.

We see value in a disciplined effort to understand the market consensus. Our analysts use a variety of analytical tools to identify what assumptions are "in the price." More importantly, they use their dialogue with investors to help define and drive the key investment debates. Progressively, we are comparing our subjective ranges of outcomes with the risk and reward trade-off implied by the options market. We think this approach yields a far better representation of the market consensus than the usual "sell-side" consensus data. And it helps you identify calls where we really differ.

Finally, we have formalized a disciplined approach through Morgan Stanley AlphaWise, a bridge between conventional research and primary research. AlphaWise delivers the best available solutions to help validate investment hypotheses with primary evidence. Our analysts and AlphaWise have already collaborated on over 700 research projects around the world. Client feedback and the success of their recommendations tell us that we need to pursue this path.

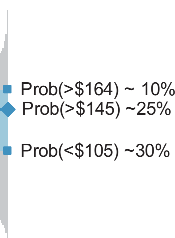
Our goal is to provide the best possible value-added information to our clients as they make – and live with – their investment decisions.

Linda Riefler
Global Head of Research

Juan Luis Perez
Global Director of Research

Our View — **Derived from analysis of fundamental value drivers**

Market View — **Derived from probabilities implied by the options market**



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For analyst certification and other important disclosures, refer to the Disclosure Section, located at the end of this report.

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Morgan Stanley is currently acting as financial advisor to Verizon Wireless with respect to the proposed acquisition of certain of its wireless assets by AT&T, Inc. and Atlantic Tele-Network, as required by the conditions of the regulatory approvals granted for Verizon Wireless' purchase of Alltel Corporation earlier this year.

The proposed acquisitions are subject to customary regulatory approvals, as well as other customary closing conditions.

Verizon Wireless has agreed to pay fees to Morgan Stanley for its financial services.

Please refer to the notes at the end of the report.

Morgan Stanley is currently acting as financial advisor to a number of investors, led by First Republic's existing management, and including investment funds managed by Colony Capital, LLC and General Atlantic LLC with respect to their acquisition of First Republic Bank from Bank of America Corporation.

The proposed transaction is subject to customary regulatory approvals, as well as certain customary closing conditions. Morgan Stanley expects to receive fees for its financial services that are subject to the consummation of the proposed transaction.

Please refer to the notes at the end of the report.

Apple

iPhone Growth Accelerates with Broader Distribution and Product Footprint

Morgan Stanley & Co. Incorporated
Kathryn Huberty
Kathryn.Huberty@morganstanley.com

Our View

Bull Case: iPhone growth accelerates with broader carrier distribution, product introductions and/or price cuts for devices and service plans. A key debate is whether iPhone growth will slow as competitive products enter the market. We believe investors under-estimate Apple's advantage from tight hardware/software integration; a well-established iTunes platform with 200 million-plus user accounts; and a cost advantage from follow-on revenue streams (accessories, apps, content, services). We view the fight for smartphone market share as a "Platform" rather than "Product Cycle" battle, and Apple has a healthy lead. We can envisage a scenario in which iPhone growth accelerates as Apple adds new carriers/ distribution partners, broadens the product portfolio, and finds new ways to lower the device's cost. Indeed, we saw a similar growth inflection point for the iPod business in 2004.
We see a 25% or greater chance of our Bull Case playing out over the next year.

Market View

The market continues to view the handset market as a product cycle bet — iPhone vs. DROID vs. BlackBerry — much too near-sighted, in our view. The market also worries that as Apple adds new carriers in key geographies, like the US, iPhone average selling prices (ASPs) and gross margins may suffer — a concern that has not proved out so far. Net, consensus models 35 million iPhones and $10.63 adjusted EPS in C2010, below our Base Case forecast by 16% and 8%, respectively.
The options market is pricing in just a 5% chance our Bull Case plays out over the next year.

Market Assigns ~ 5% Probability to AAPL Surpassing Our Bull Case; We Estimate 25%

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

Derived from our analysis of fundamental value drivers

Derived from probabilities implied by the options market *

APPLE INC.

Price Target : $ 230
AAPL.O Rating : Overweight
MS Industry view : Attractive

~ 30% probability AAPL will reach above $230 price target in 12 months

Prob(>$325) ~ 5%
Prob(>$230) ~30%
Prob(<$150) ~30%

The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$150 15x P/E on Bear Case C2010 Adj. EPS of $10.00
Bear Case

iPhone unit growth and gross margins come under pressure as new competitors enter the market. iPhone units rise to 35mn in C2010, 40mn in C2011. We assign a market multiple on C2010 Adj. EPS of $10.00.

$230 20x P/E on Base Case C2010 Adj. EPS of $11.50
Base Case

Broadening iPhone distribution accelerates International growth. We assume 42mn and 59mn iPhone shipments in C2010/11. We assign a 20x multiple (low-end of AAPL's historical range) on C2010 Adj. EPS of $11.50.

$325 25x P/E on Bull Case C2010 Adj. EPS of $13.00
Bull Case

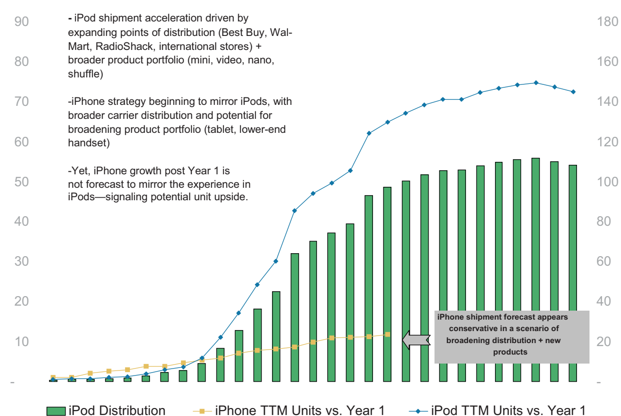
Broadening iPhone distribution in the US and W. Europe accelerates global growth. We assume 51.5mn/66mn iPhone shipments in C2010/11. AAPL reaches historical average P/E of 25x C2010 Adj. EPS of $13.00.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

We disagree with the market view that competitive pressures will likely slow iPhone growth from current rates. Similar to the strong adoption of iPods in 2004–06, we see the combination of broadening distribution, expanding product portfolio, and lower prices as growth drivers for the iPhone over the next several years. While our Base Case C2010 iPhone shipment forecast of 41.7 million is well above the consensus view of 35 million, the iPhone ramp we forecast is far more conservative than the ramp iPod experienced post its inaugural year.

Exhibit 1

iPhone Growth Looks Conservative if Distribution + Product Portfolio Expansion Follow Path of iPod



Source: Morgan Stanley Research

We see multiple paths to our Bull Case of $325-plus:

(1) Apple broadens distribution for global market coverage, reaching 10% global handset market share — roughly one-third of the smartphone market — by the September 2012 fiscal year. iPhone's leading software and app/content store helps Apple maintain its current carrier subsidy of $400-plus. This scenario produces iPhone F2012 EPS of around $32.

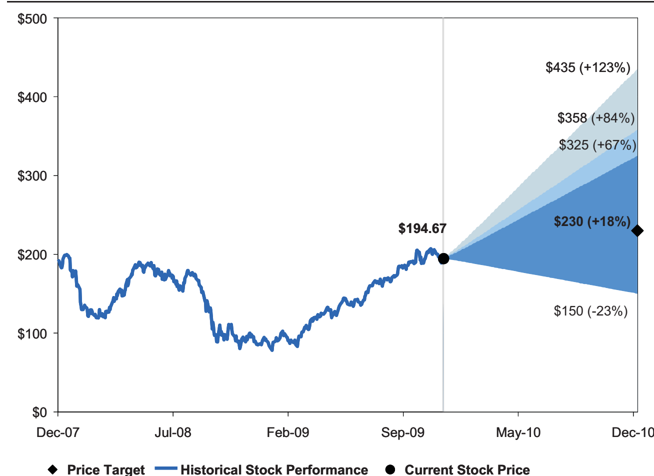
(2) In addition to greater high-end smartphone penetration, Apple introduces products with more affordable hardware/ service plans, increasing its handset market share further to 15% (roughly 50% of the smartphone market) in F2012. The average iPhone subsidy drops to $200 given increasing mix of lower-end devices, and EPS reach approximately $26 by F2012.

(3) Apple drives for handset market leadership by forgoing carrier subsidies and shifting the iPhone profit pool to content, services, accessories. Apple's increasing scale allows it to lower the iPhone bill-of-materials at a similar rate to the last two years (roughly 33% annually), and the iPhone delivers nearly $23 EPS in F2012, despite lower gross margins.

If we apply a 12x P/E multiple on the above iPhone EPS scenarios and a 10x multiple on the $5 EPS run-rate of Apple's core Mac business, our bull case scenarios point to a share price of $325–435 (67–123% above the current price).

Exhibit 2

Apple: We See Several Paths to a Bull Case

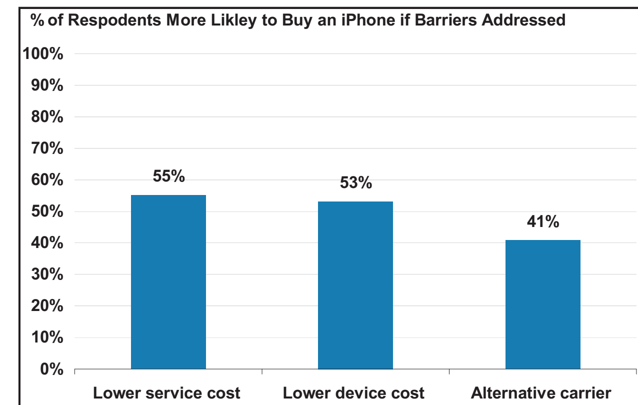


Bull Case Scenarios: (1) Broader carrier distribution; maintain subsidy (F2012 market share 10%). (2) Lower service plan cost/lower subsidy (F2012 market share 15%). (3) 'Razor & Blade' model — no subsidy (F2012 market share 33%).
Base Case Scenario: iPhone success limited to high-end (F2012 market share 4%).
Bear Case Scenario: iPhone loses its luster, open ecosystems win (F2012 market share 2-3%).
Source: FactSet (historical prices), Morgan Stanley Research Estimates

Key events/catalysts over the next 12-months that would support our Bull Case view: (1) Lower cost service plans as multiple carriers compete for new iPhone subscribers. (2) New products including the expected tablet and a lower-priced iPhone. (3) New carrier relationships — Apple has already announced multiple carriers in France, UK, and Canada, but Germany, Spain, US, and China could follow.

Exhibit 3

Potential US iPhone Demand Catalysts



Source: Morgan Stanley Research; AlphaWise[SM]

Bank of America

One Catalyst Down, Two Remain: New CEO, Declining Consumer Credit Costs

Morgan Stanley & Co. Incorporated
Betsy L. Graseck
Betsy.Graseck@morganstanley.com

Our View

Two more catalysts for our Overweight rating: Appointment of new CEO and consumer credit peaking. BofA checked the box of its first catalyst, repaying its $45 billion of TARP upon completion of a $19 billion capital raise. The possibility of an external CEO may have increased (an announcement is expected by year-end) now that the search is not subject to pay czar oversight. Declines in jobless claims (down 30%-plus vs. peaks) and better-than-expected unemployment bode well for card charge-offs, which we believe have peaked at BofA — Master Trust net charge-offs (NCOs) declined 132bps during past 2 months.
We assign a 70% probability to our Base Case outcome.

Market View

Market appears to be discounting continued uncertainty and an economic double dip into BAC shares. We think the market is factoring in prolonged credit deterioration and discounting any improved efficiency in the investment bank from the Merrill acquisition.
Options market data indicate that the market is assigning less than 5% probability to BAC surpassing our $30 price target in the next 12 months.

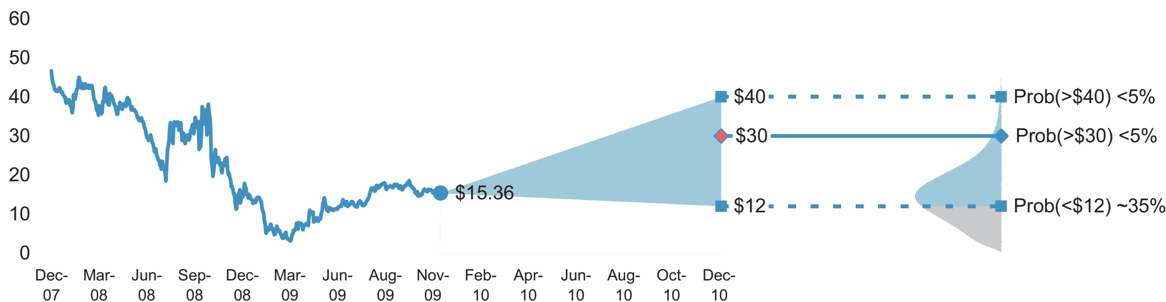
We See 70% Probability BAC Attains Our $30 Target in 12 Months; Market Sees Below 5%

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

BANK OF AMERICA CORPORATION

Price Target : $ 30
BAC.N Rating : Overweight
MS Industry view : Attractive

<5% probability BAC will reach above $30 price target in 12 months



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$12
Bear Case

P/TB = 1.0x 2009 Bear Case Tangible BV, with all non-gov't preferred converted to common

Double-Dip Recession. Current stimulus and inventory restock not replaced by corporate reinvestment or consumer demand. Unemployment increases to 12%. Market does not look through to normalizing EPS, nor does it discount strategic options.

$30
Base Case

2.4x 2009 Base Case Tangible BV

Shallow 'U' Recovery. Nonperforming loans (NPLs) peak in 4Q09/1Q10. Unemployment remains above 10% in 1Q10. Valuation based on residual income valuation, using the normalized cost of capital (assuming a 5.5% risk-free rate and a 4.5% equity market risk premium).

$40
Bull Case

3.2x 2009 Bull Case Tangible BV

Sharp Economic Recovery. Credit improves more rapidly than our base case. Valuation based on bull case residual income.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

TARP repayment boosts Common Tier 1 capital ratio to 8.5% (pro forma), in line with our expectations for new regulatory capital requirements. We forecast 7–9% Common Tier 1 for our large-cap coverage group subsequent to the new regulations, and we expect BofA will be on the higher end of the range as a systemically important bank with a large trading book. We had assumed 8.3% Tier 1 for BofA in 2012.

Exhibit 1
TARP Repayment Boosts Common Tier 1 to 8.5%

Proforma Tier 1 Impact	Total Tier 1	Common Tier 1	Tier 1 Ratio	Common Tier 1 Ratio
3Q09	193,073	112,357	12.5%	7.3%
Repay Tarp + Pref Discount	(49,500)	(8,600)	-3.2%	-0.6%
Issue Common Equivalent	20,990	20,990	1.4%	1.4%
Issue Common Shares	1,900	1,900	0.1%	0.1%
Asset Sales	4,400	4,400	0.3%	0.3%
3Q09 Proforma	170,863	131,047	11.0%	8.5%

Source: Company data, Morgan Stanley Research

Impact of TARP repayment largely neutral to our earnings outlook. We estimate that the 2010 EPS impact is $0.05 dilutive, as the higher share count is mostly offset by a lower annual preferred dividend.

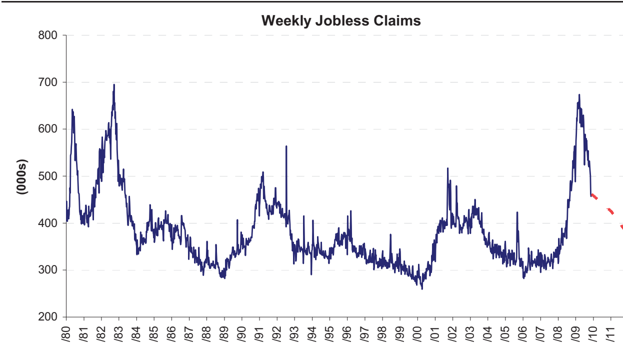
Exhibit 2
Expect $0.05 Dilution to 2010 EPS from Capital Raise and TARP Repayment

Impact to 2010 EPS	Old	New
Operating Income	21,037	21,238
Preferred Dividend	2,174	683
Operating to Common	18,863	20,555
Diluted Shares	9,200	10,254
EPS	$2.05	$2.00

Source: Morgan Stanley Research estimates. New 2010 diluted share estimate includes in-the-money warrants.

Loan book, which is skewed to early-cycle consumer credit, is set to benefit from declines in jobless claims. Two-thirds of BofA's loan book is consumer (39% residential mortgage, 16% credit card, 12% other consumer). Initial jobless claims, historically the largest single driver of consumer credit losses, have declined 32% from their March 2009 peak levels. Continued improvement in jobless claims should drive lower credit losses into 2010.

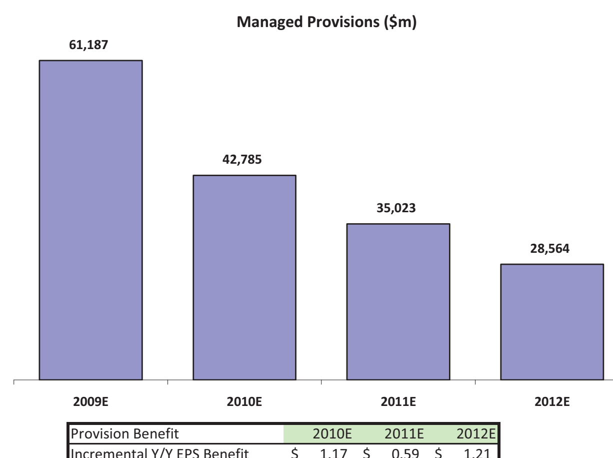
Exhibit 3
Jobless Claims Down 32% vs March Peak



Source: US Department of Labor.

Declining provisions set to drive earnings growth over next several years. Credit quality has just begun to improve at BofA, as evidenced by 3Q09 credit trends and recent Master Trust results. Growth in nonperforming loans (NPLs) decelerated from 22% Q/Q growth in 2Q09 to 9% Q/Q growth in 3Q09, new additions to consumer and corporate NPLs declined for the second consecutive quarter, and card delinquencies declined to 7.35% from 7.64%. We see improving credit manifesting itself in a two-step process: 2010 earnings improve as a result of reserve build going away, and 2011-12 earnings benefit from lower credit loss levels. We estimate that the cessation of reserve build will drive $1.17 of EPS growth in 2010, and lower credit losses drive another $0.59 in 2011 and $1.21 in 2012.

Exhibit 4
Cessation of Reserve Build Should Drive $1.17 of Incremental EPS in 2010



Provision Benefit	2010E	2011E	2012E
Incremental Y/Y EPS Benefit	$ 1.17	$ 0.59	$ 1.21

Source: Company data, Morgan Stanley Research E = Morgan Stanley Research estimates

Best Buy

Internet Price Disintermediation and Migration to Online Sales

Morgan Stanley & Co. Incorporated
Gregory Melich
Gregory.Melich@morganstanley.com

Our View

We believe growth will be harder to come by for traditional consumer electronics (CE) retailers, as online penetration is reaching 20% of CE sales today (vs. 4% of overall US Retail Sales). We advocate dramatically slowing square-footage expansion to focus on eCommerce, using physical retail space as a "show room" where consumers can touch and feel the product. The show room approach means smaller stores, and less square footage growth. As online retailers like Amazon gain scale, they are leveraging low-cost positioning to raise the cost to compete. Free shipping/home setup offered by Amazon has pressured Best Buy to offer installation as a standard service. Best Buy had previously touted service installation as a high-margin growth engine.

Market View

Market seems to be ignoring potential Internet price dis-intermediation, thus overestimating Best Buy's margins, we believe. Our work indicates that the market discounts 4.5-5% EBIT margins for Best Buy vs. our sub-4% estimate, seemingly rewarding the stock for 4-6% square footage growth. The market assigns a 25% probability of BBY shares falling below our Base-Case scenario, and a 5% probability of a decline below our Bear Case.

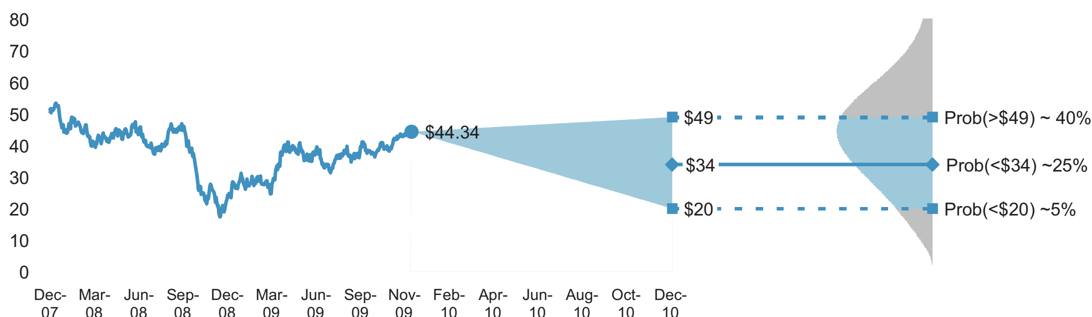
Mobile Internet: An Under-Recognized Threat

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

BEST BUY CO., INC.

Price target : NA
BBY.N Rating : Underweight
MS Industry view : In-Line

~ 25% probability BBY will reach below $34 fair value in 12 months



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$20 — 10x P/E on Bear Case 2010e EPS of $2.00

Bear Case

Mobile Internet accelerates online migration; eCommerce grabs 40% of CE sales. EBIT margins fall to 2.5%, comps fall 5%. Best Buy grows square footage by 6%, adding big box (40,000 sq ft) stores just as mobile Internet-enabled real-time, location-specific price comparisons accelerate online migration. eCommerce penetration grows from 20% today toward 40% for electronics, a natural target given tech savvy customers.

$34 — 12x P/E on Base Case 2010e EPS of $2.80

Base Case

Structural headwinds mount in 2010. Margins fall 40bps to 3.9% in 2010 when Best Buy has to cycle the exit of Circuit City, and faces 20%+ declines in TV ASPs. Electronics deflation makes attachments more important, and more challenging than ever. P/E falls to 12x on concerns 2010 could be a down year as the benefits of Circuit City's exit fade, and Best Buy's earnings contract while Hardline Retail peers grow 18-20%.

$49 — 14x P/E on Bull Case 2010e EPS of $3.50

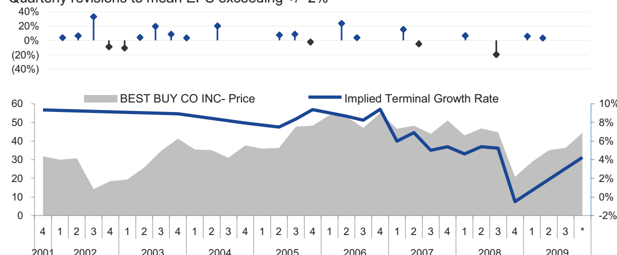
Bull Case

Differentiating with service. Best Buy leverages "last man standing" status to grow gross margins over 25% while winning over 40% of Circuit City's sales. EBIT margins reach 5%, driven by attachments and enhanced vendor leverage. Best Buy focuses investment spend away from floor area growth and into its web portal. It implements a "show room" strategy: rationalizing area/assortment and encouraging customers to experience products in stores.

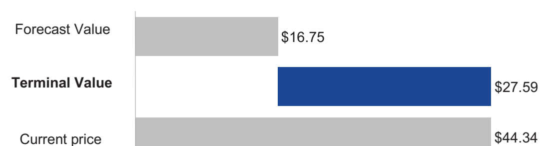
Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

Exhibit 1
Consensus Implied — What's in the Price?

Price implies 4.24% earnings growth rate post-2011, compared to 8-year historical average of 6.81%



Price implies a terminal value of $27.59



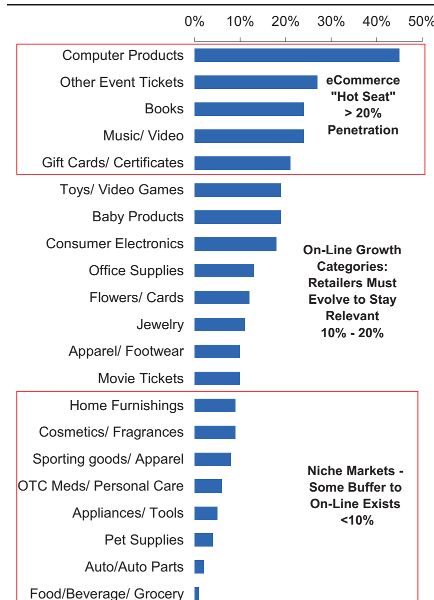
Source: Company data, FactSet, Morgan Stanley Research

Accelerate eCommerce strategy, rationalize footage. Best Buy recently reiterated it believes the future in CE retailing is focused on connectivity and service, yet Best Buy is growing square footage by 4-6% per year. Tech-savvy consumers and digital content are fostering online migration. As consumer mobility accelerates, expanding Internet presence while leveraging the existing store base could turn a risk into a growth opportunity for Best Buy.

We advocate using physical retail space as a "show room" where consumers can touch and feel the product. The show room approach means smaller stores, and less square footage growth. As online retailers like Amazon gain scale, they are leveraging low cost positioning to raise the cost to compete. Free shipping/home setup offered by Amazon has pressured Best Buy to offer installation as a standard service. Best Buy had previously touted service installation as a high-margin growth engine.

Our bull case scenario of $49 (10–11% upside from current levels) reflects what we view as capped upside for the stock based on the risk of Internet price disintermediation, and migration to online sales, which is more pronounced in the CE space than other areas of retail given CE's generally tech savvy, early-adopter customers and connectivity. We believe companies like Amazon.com are better equipped to profit from these trends than Best Buy.

Exhibit 2
Online Penetration: CE (Nearly 20%) in Crosshairs



Source: Company data, Morgan Stanley Research

Where we differ: Our proprietary 2009 TV survey suggests flat panel TV sales will be down 9% in 2009 and down 10% in 2010. TVs account for 20% of Best Buy's sales, but closer to 40% of profit when including attachments. Attachments (i.e., service contracts) are highly correlated with ASPs. We also believe the demise of Best Buy's top competitor (Circuit City) aided 2009 comps by 700-900bps; this goes away in 2010.

For BBY, the market implies that ~$28, or 62% of today's value, is derived from growth in earnings post-2011. The terminal growth rate implied by the current price is 4.24% compared to an eight-year historical average of 6.81%. This implies BBY could be undervalued compared to history, or the market could believe the company will have weaker future growth than in the current period.

What does the current price imply about revenue and margins? Using the calculation for terminal value, we assumed two growth scenarios into the terminal period:

- Sales growth at 3%: In this scenario, the EBIT margin will need to average 4.8% annually to grow into the implied terminal growth.
- EBIT margins remain flat to the 2011 consensus forecast: This implies revenues would need to average 4.3% annually to grow into the terminal growth rate.

Energizer Holdings

Expect EPS Upside, Regained Credibility, and Multiple Expansion

Morgan Stanley & Co. Incorporated
Dara Mohsenian
Dara.Mohsenian@morganstanley.com

Our View

We have high visibility on EPS upside versus consensus at Energizer, which should drive subsequent multiple expansion as the company regains credibility after a large EPS miss in the recent fiscal 4Q. We see 2.3% and 5.7% EPS upside versus consensus for fiscal 2010 (September) and F2011, respectively, and our bias is to the upside, as we assume no revenue benefit from a 26% F2010 marketing spending increase and no macro rebound. While we expect that ENR's valuation will continue to be limited by muted battery category growth, we believe higher marketing and a potential macro rebound in batteries (half of mix), could drive an acceleration in long-term revenue growth. Given low expectations after the September-quarter miss, reflected in a valuation of 10.1 times our 2011 EPS estimate — at the low end of the peer group and 25% below ENR's five-year average — we expect above-consensus results to drive P/E expansion.

Market View

Stock price implies negative long-term earnings growth, well below our high-single-digit forecast. We believe the market views near-term EPS visibility as very low at Energizer after a recent 4Q miss, given confusion over a number of abnormal and non-operating items in 4Q results and the F2010 outlook. Morgan Stanley ModelWare's "What's in the Price" tool indicates that the current valuation implies only +1% terminal earnings growth beyond 2012 (Exhibit 4, next page), materially below our high-single-digit long-term EPS growth forecast and the mid-single-digit growth range the market has historically priced into ENR's valuation.

ENR Risk-Reward Snapshot: We See Substantial Upside Potential, and Limited Downside

Risk-Reward Scenarios

$51 — 9 times Bear Case F2011e EPS of $5.69

Bear Case

Organic sales slow. 2% top-line downside on continued battery category weakness and softer pricing. P/E on F2011e EPS compresses to 9 times and incremental margin drops to 20%.

$74 — 12 times Base Case F2011e EPS of $6.15

Base Case

Organic revenue growth averages 3% in F2010 and F2011, driven by macro rebound and higher A&P spending. Operating margins stay relatively flat in F2010–11 (+10 basis points) as A&P ramps up. P/E expands to 12 times, below ENR's five-year average of 13.4 times next-12-months earnings.

$92 — 13 times Bull Case F2011e EPS of $7.10

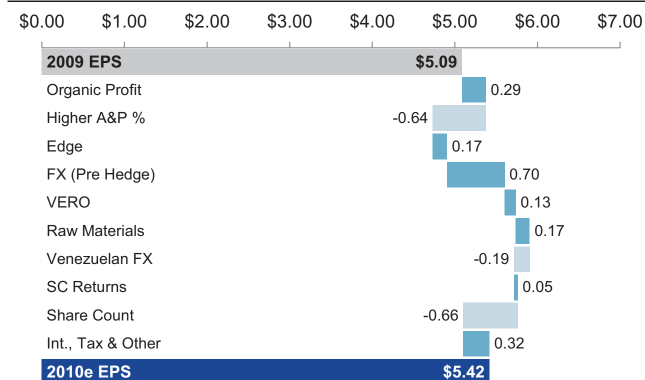
Bull Case

Organic sales upside on strong innovation and a greater-than-expected macro rebound. 5% average organic revenue growth in F2010 and F2011 (200 bps) boosted by higher marketing and a macro rebound. Incremental margins of 35% push F2011 EPS to our Bull Case estimate of $7.10. P/E expands to 13 times.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

We have high visibility on EPS upside versus consensus at Energizer… Following a large 4Q EPS miss, we believe consensus EPS moved too low. While a number of abnormal and non-operating items have clouded Energizer's EPS outlook, our detailed EPS walks point to 2.3% F2010 upside to consensus EPS (Exhibit 1) and 5.7% in F2011.

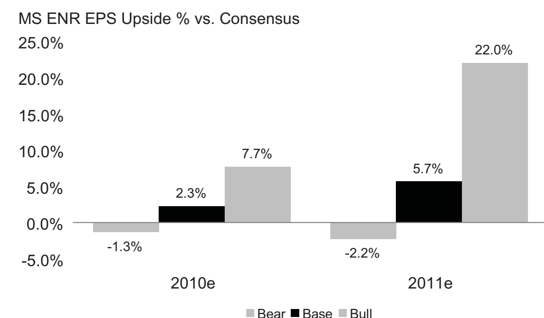
Exhibit 1
F2010 EPS: We Expect 2.3% Upside vs. Consensus



Source: Company data, Morgan Stanley Research

…and several other factors could push EPS ahead of our above-consensus estimates. Management is incentivized to exceed our above-consensus F2010 EPS estimate of $5.42, as, should EPS reach $5.52, senior management will receive 200% of its full-year bonus target attributable to company performance. We do not assume above-trend organic sales growth despite a 26% increase in marketing spending. We also do not assume a macro-related rebound in Energizer's battery top line. We also think share repurchases could occur in 2H10, as we expect Energizer's debt leverage should approach levels at which it has historically purchased shares. Our Bull Case scenario assumes 5% organic sales growth in F2010-11 and 35% incremental margins, and points to 22% potential EPS upside versus consensus (Exhibit 2). EPS downside should be limited by A&P spending flexibility.

Exhibit 2
We Expect EPS Upside vs. Consensus

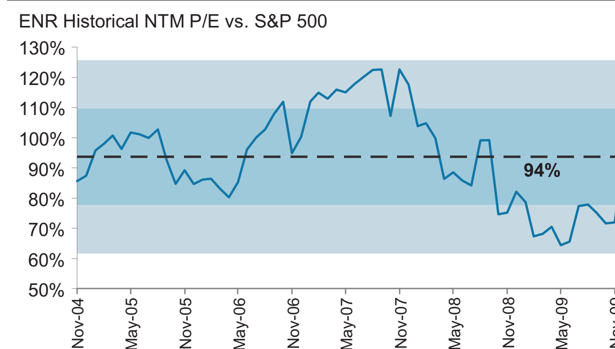


Source: FactSet, Morgan Stanley Research

Two industry risks are not big issues for ENR: price/cost risk as commodities re-inflate, and shelf space. (1) Energizer's raw material costs will likely be down in fiscal 2010 given contract lags. (2) Energizer is a clear No. 2 player (with a wide gap versus the No. 3 brand) in most of its key categories, so loss of shelf space due to increased private label penetration is not likely a major risk, as retailers are more likely to cut No. 3 and No. 4 brands.

We expect multiple expansion with EPS upside as ENR is trading well below typical historical levels (Exhibit 3). ENR also currently trades at a 21% discount to the S&P 500, well below its 6% historical five-year average, and its C2011e P/E of 10.0 is at the bottom end of our small- and mid-cap coverage universe.

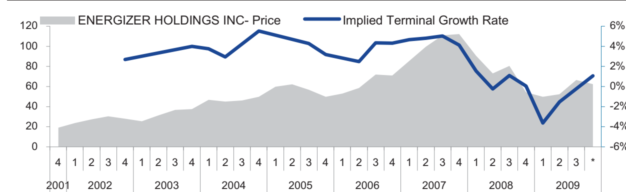
Exhibit 3
Relative Valuation vs. S&P is Near Historical Low



Source: Company data, FactSet, Morgan Stanley Research

The current stock price implies only 1% terminal earnings growth after the next three years (Exhibit 4), according to Morgan Stanley's "What's in the Price" valuation tool. We believe this is too low given our expectation for 3% long-term organic sales growth (below the 4% two-year trend in fiscal 2007–08) and the market's historical tendency to price mid-single-digit terminal earnings growth into ENR shares. Based on Energizer's potential EPS upside and multiple expansion, we believe current prices offer investors an attractive entry point into the shares.

Exhibit 4
Market Implies Just 1% Terminal Earnings Growth



Source: FactSet, Morgan Stanley Research

General Dynamics

Market Currently Not Pricing In a Gulfstream Recovery

Morgan Stanley & Co. Incorporated
Heidi Wood
Heidi.Wood@morganstanley.com

Our View

If a business jet recovery plays out, Gulfstream could warrant a mid/high-teens multiple, pointing to an $80-plus valuation for GD. Why we believe Aerospace could surprise: (1) Gulfstream's portfolio is heavily weighted to large-cabin business jets, and we expect a recovery to occur first in the high end. (2) Management recently indicated deliveries for 2010 will remain flat at sold-out levels with potential upside if demand stays strong. (3) Order volume could return faster than expected driven by foreign buyers, including China, and new rollouts of the G250 and G650 expected to deliver in 2011. (4) Anticipated recovery in air traffic provides upside to the spares and service business.

Market View

Current trading levels imply no recovery at Gulfstream, which we estimate will account for ~25% of segment operating income in 2011. General Dynamics' equity currently trades in line with its defense peers at ~9 times our 2011 EPS estimate, which implies an equivalent 9 P/E on the Gulfstream business. We believe the market fails to appreciate upside potential from the Aerospace segment. Hence, while the options market is currently pricing a ~30% likelihood of surpassing our $80 price target and ~5% to meeting/beating our Bull Case, we believe there is a better than 50% probability GD reaches our price target and greater than 10% chance of reaching our Bull Case of $100 over 12–18 months.

Market Assigns Too-Small Probabilities of <5%/30% to Eclipsing Our Bull/Base Cases

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

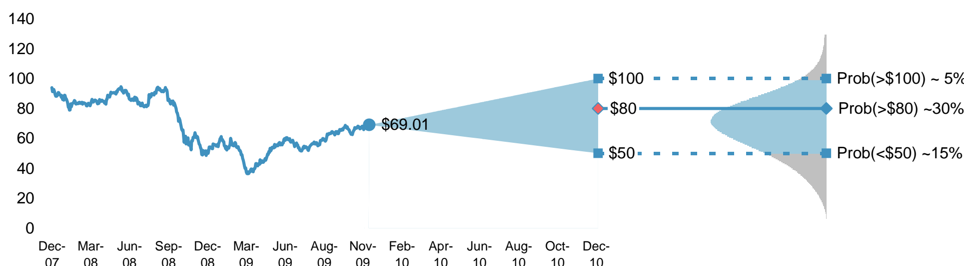
Derived from our analysis of fundamental value drivers

Derived from probabilities implied by the options market *

GENERAL DYNAMICS CORPORATION

Price Target : $ 80
GD.N Rating : Overweight
MS Industry view : In-Line

~ 30% probability GD will reach above $80 price target in 12 months



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$50 ~8x Bear Case 2011e EPS of $6.50
Bear Case

Double-dip recession and enduring caution prompt further bizjet cancellations, resulting in "white tails" (planes in inventory without customers) at Gulfstream. The division's margins (generally the company's highest) are lowered to high single digits. Washington undergoes a fiscal pullback and the Department of Defense's budget outlook is below already-low expectations. Relative Defense valuations retreat to levels seen in previous budget cutback periods.

$80 ~11x Base Case 2011e EPS of $7.00
Base Case

Gulfstream deliveries go as planned in 2010 as credit markets free up and the global economy recovers. Proactive cost action preserves high-teen margins at Gulfstream. Quadrennial Defense Review essentially preserves GD's Marine outlook and Combat Systems growth is flattish in 2010. Robust balance sheet and lower property prices/increased availability leads GD to engage in either accretive deals or stepped-up share repurchases.

$100 Low-teens 2011e P/E
Bull Case

Gulfstream recovery surprises with demand far stronger than anticipated. Lifting of Chinese flight scheduling restrictions and easing of taxes on purchases dramatically accelerates demand for business jets. GD's major defense programs escape significant cuts with defense investors outlook turning positive. Foreign sales and the Littoral Combat Ship provide further growth upside. Defense multiples recover from historically low levels as investors rotate into the sector.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

GD's valuation could sizably improve over 12-18 months as the market re-prices Gulfstream's growth outlook, in our view. GD currently trades in line with other Defense primes despite ~25% of its operating income contribution (2011e) deriving from non-Defense Aerospace business, whereas its Defense peers have closer to 80-100% Defense exposure.

Why Gulfstream could surprise in 2010: Its skew toward the high end of the market, which should recover first, in our view. Gulfstream's portfolio is heavily skewed toward the large-cabin segment, with midsize aircraft contributing only a small portion of Gulfstream profits. We believe the large-cabin market is poised to recover first — signs that a recovery is under way are already surfacing, including (1) GD management comments that large-cabin deliveries are expected to be flat, with potential upside; (2) competitor Bombardier's indication that third-quarter (ended October) business jet orders are positive for the first time since 3Q08; (3) signs at the recent National Business Aviation Association (NBAA) bizjet conference that buyer interest was returning to the high end of the market, with private customer showings apparent; and (4) new product offerings, including the G650 and G250

Exhibit 1

GD Trades In-Line with Defense Primes…

	P/E		EV/EBITDA	
	2010	**2011**	**2010**	**2011**
Lockheed Martin	8.8x	7.8x	5.2x	4.8x
Northrop Grumman	9.5	9.1	5.5	5.1
Raytheon	9.4	8.9	5.4	5.3
Average	**9.2x**	**8.6x**	**5.3x**	**5.0x**
General Dynamics	**9.6x**	**9.0x**	**6.0x**	**5.6x**

Source: FactSet, Morgan Stanley Research

Exhibit 2

…though We Estimate Non-Defense Aero Will Contribute ~25% of GD's Operating Income by 2011

	$		Contribution %	
	2010e	**2011e**	**2008**	**2009e**
Revenues				
Aerospace	$5,550	$6,800	17%	19%
Combat Systems	9,950	10,100	30%	29%
Marine Systems	6,630	7,070	20%	20%
IST	11,100	11,200	33%	32%
Total	**$33,230**	**$35,170**	100%	100%
Operating Income (Excl. Corporate)				
Aerospace	$860	$1,020	22%	25%
Combat Systems	1,194	1,182	31%	30%
Marine Systems	643	693	17%	17%
IST	1,143	1,109	30%	28%
Total	**$3,841**	**$4,003**	100%	100%

Source: Company data, Morgan Stanley Research; e = Morgan Stanley Research Estimates

Exhibit 3

Risk-Reward Profile Is Attractive at Current Levels

Defense 2011 P/E Multiple	Aerospace 2011 P/E Multiple 14.0x	15.0x	16.0x	17.0x	18.0x
8.0x	$66.88	$68.68	$70.49	$72.30	$74.11
9.0x	72.07	73.88	75.69	77.49	79.30
10.0x	77.27	79.07	80.88	82.69	84.50
11.0x	82.46	84.27	86.08	87.89	89.69
12.0x	87.66	89.47	91.27	93.08	94.89

Source: Morgan Stanley Research

Why the Gulfstream business deserves a premium: A significant bizjet rebound in 2011 and beyond should flow into valuation in 2010. We believe there's a convincing case to be made that the Gulfstream business is now healthier following its decade-long ownership at GD, and is now more valuable than when it traded publicly. When a public entity, Gulfstream had only 2 aircraft models vs. today's richer family of 7 aircraft (with more in the pipeline), and the stock's valuation ranged from 12-16 times forward earnings. This makes today's implied multiple for Gulfstream of roughly 9 times earnings, according to our work, appear extraordinarily inexpensive, especially contrasted to the attractiveness of our 3-5 year outlook.

We project 2009-10 will mark the trough for business jet deliveries, followed by a significant rebound in 2011. We think that the ramp up of new products G250 and G650 which are slated to begin delivering in 2011/2012, coupled with the potentially significant addition of Chinese and Asian-based demand entering the picture (see below) argue for a Gulfstream re-valuation. We'd also argue that the revenue growth outlook of 20% for several years starting in 2011 and potential for margin expansion from 15% toward 20% over time provides a foundation for a re-rating for Gulfstream to 16-18 times earnings, which would put GD shares north of $80, all else equal.

Sea change ahead for bizjets in China: Positive implications for Gulfstream. The Chinese government announced in September a substantial reduction in advance filings of flight plans from 1-3 weeks to just 3 hours, slashing filing fees and aircraft purchase tariffs (6%, down from the prior 23% of the purchase price). We've picked up that this was in response to insistent pressure from Chinese business leaders arguing the restrictions were prohibiting growth. There are only ~100 officially registered business jets in China at present, but now that looks poised to change.

Monsanto

Market Pricing in Bear Case; F2010–12 Earnings Growth to Surprise

Morgan Stanley & Co. Incorporated

Vincent Andrews
Vincent.Andrews@morganstanley.com

Our View

The F2012 earnings power and value of Monsanto's pipeline will become apparent. The market appears to have priced in our fiscal 2012 (August) Bear Case earnings scenario. We view Monsanto as the best-positioned company in global agriculture, with significant technology advantages and continued pricing power. Our work indicates that MON's current share price imputes a negative value to the technology pipeline — but we argue that Monsanto's pipeline holds the key to unlocking one of the greatest bottlenecks in global agriculture: The need to be more productive with existing land.

Market View

The market believes Monsanto's F2012 guidance is too high and too reliant on price increases. However, recent incremental production disclosure from the company indicates material flexibility around three levers (volume, price, and mix) rather than just one (price).

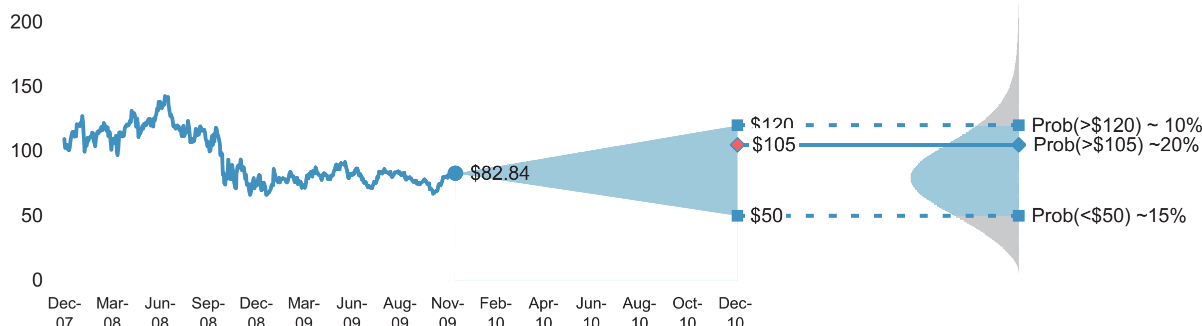
We See a 70% Chance of $105 Base Case; Market Implies Just 20% Chance of Exceeding It

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

MONSANTO COMPANY

Price Target : $ 105
MON.N Rating : Overweight
MS Industry view : Attractive

~ 20% probability MON will reach above $105 price target in 12 months



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$50
Bear Case
18-times F2010 Bear Case EPS of $2.75

Corn reverts to $2-3/bushel. RU2 commands a slight premium to RU1. Competitors commercialize corn refuge several years early. SmartStax and RU2 fall well short of acreage estimates. US corn and soybean market share are flat. Int'l corn gross profit grows only marginally F2009–12; Roundup gross profit (GP) stays < $700 million.

$105
Base Case
Sum of the Parts: $88 for Core Business + $17 Pipeline

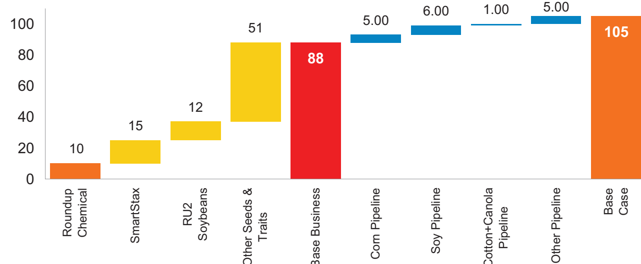
Corn averages $4/bushel. Current SmartStax or RU2 prices are maintained through F2012. SmartStax and RU2 are unconstrained in F2012 and Monsanto sells 39 million and 33 million acres, respectively. US Soybean market share remains flat and corn market share grows ~1%/year. Int'l corn GP doubles F2009–12.

$120
Bull Case
Sum of the Parts: $103 for Core Business + $17 Pipeline

Corn averages $5/bushel. Monsanto is able to increase seed and trait prices at mid-to high-single-digit rates annually. Monsanto sells 40 million and 35 million acres of SmartStax and RU2. US soybean market share increases 1.5%/yr and corn market share grows 2%/yr. Int'l corn GP doubles F2009–12.

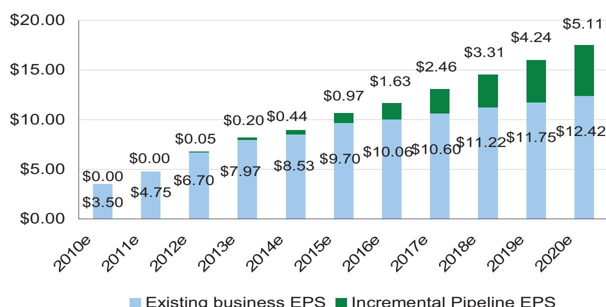
Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

Exhibit 1
Building to our $105 Base Case Price Target
SmartStax & RU2 Launches are Key Valuation Drivers



Source: Morgan Stanley Research, FactSet

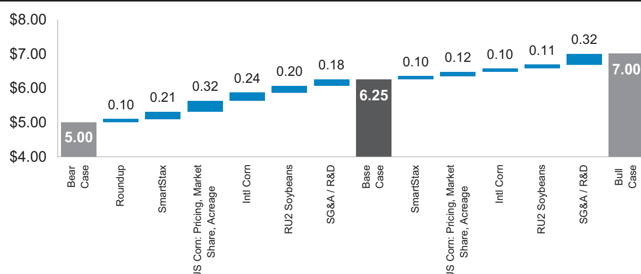
Exhibit 2
Pipeline Adds Incrementally to Our EPS Forecasts



Source: Morgan Stanley Research e = Morgan Stanley Research estimates

We prefer to be leveraged to the substantial long-term growth and visibility of Monsanto's seeds & biotech franchise heading into 2010. While we cannot predict when investors will look through the lack of EPS growth in F2010 and into both the material and visible upside of F2011 and thereafter, we expect investor focus to ultimately revert to the substantial and secular impact of both Roundup 2 Soybeans and SmartStax corn on F2011 and beyond rather than the cyclical impact of Roundup Chemical on F2010.

Exhibit 3
F2012 Bear, Base, and Bull Case EPS



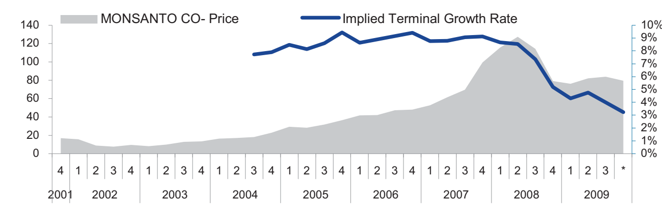
Source: Company data, Morgan Stanley Research

We foresee solid visibility into the growth trajectories of expected game-changers Roundup Ready 2 Yield Soybeans and SmartStax (in soybeans and corn, respectively). Further, with each August field visit and January pipeline update, we have building conviction in many of Monsanto's other pipeline products such as drought-tolerant corn. We believe that Monsanto has a sustainable competitive advantage in Ag biotech and continue to expect investors to look beyond the disappointment of Roundup earnings in F2009/F2010 and into the earnings growth that will come from the accelerated ramp up of Roundup 2 Soybeans and SmartStax in F2011 and beyond.

Potential near-term catalysts: Sales of 4 million-plus SmartStax acres and 8 million-plus RU2 acres in F2012, near current list prices. Other drivers include: (1) The movement of corn prices over the balance of the year (new crop prices are over $4); (2) Monsanto's overall F2010 order book (we expect greater insight by F1Q10 reporting in early January), and (3) the company's annual R&D update in January. We still expect F2Q10 (reported in April) to be the first material opportunity for Monsanto's "beat and raise" pattern of 2007–08 to return.

We do not believe that the market is assigning any value to Monsanto's pipeline. Similar to a conventional pharmaceutical or biotech business, we believe that Monsanto is best valued by separating out its existing business from its pipeline (though to be clear, we believe that the risks associated with Monsanto's pipeline are *far* less than the average healthcare pipeline's). Despite expensing ~$1.50 of R&D as EPS annually (and historically earning significant returns on its investment), Monsanto's current valuation prices in just 3% growth post-2012, according to Morgan Stanley ModelWare's "What's in the Price" analytical tool.

Exhibit 4
Stock Currently Prices In a ~3% Terminal Growth Rate vs. a Historical Average of ~8%



Source: Company data, FactSet, Morgan Stanley Research

NVIDIA

Chipset and GPU Share Losses Likely to Surprise the Market

Morgan Stanley & Co. Incorporated

Mark Lipacis
Mark.Lipacis@morganstanley.com

Our View

Investors underestimate: (1) PC chipset risk, (2) discrete PC GPU risk, (3) transition risk, and (4) inventory risk. We believe that a new integrated MPU+GPU bundle from Intel, and strong GPU products from AMD are likely to pressure NVIDIA's chipset (30% of revenue) and discrete GPU (50% of revenue) businesses in 2010. We expect revenue growth from NVIDIA's new Tegra and Tesla businesses to carry execution risks, and barely offset revenue declines in chipsets and GPUs. We also believe that GPU supply constraints translate to excess inventory builds in the supply chain.

We are modeling NVIDIA's C2010 chipset revenues to decline by 25% and GPU revenues to decline by 8%. We forecast a 5% decline in C2011 EPS.

Market View

Investors assume that NVIDIA can overcome its chipset and GPU challenges in 2010. We maintain that the market does not recognize that Intel's new MPU+GPU products eliminate an interface required to connect NVIDIA's chipsets. The market also does not appear to comprehend the new ramp timing for Intel's new products in 1Q10 — historically, Intel ramped new products in 3Q/4Q. We expect Intel to ramp its new products aggressively, leading to share losses for NVIDIA.

Morgan Stanley's 'What's in the Price' analysis implies the stock is baking in a 74% increase in C2011 EPS. Further, the market appears to be pricing in a 50% probability NVDA will exceed our Bull Case valuation — overly optimistic, in our view — but just a 10% chance the stock falls below our Bear Case of $7.

Market Assigns Only 10% Probability to NVDA Going Below $7; We Think It's More Likely

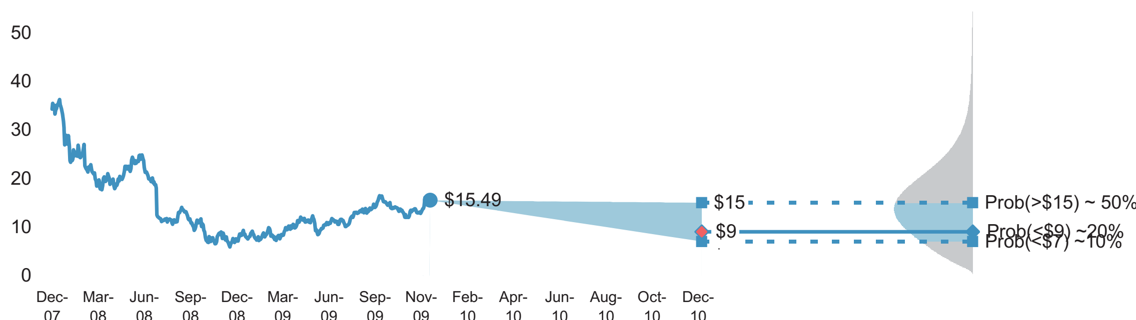
Derived from our analysis of fundamental value drivers

Derived from probabilities implied by the options market *

NVIDIA CORPORATION

Price Target : $ 9
NVDA.O Rating : Underweight
MS Industry view : Cautious

~ 20% probability NVDA will reach below $9 price target in 12 months



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$7
Bear Case
EV/Sales of 1.0 on Bear Case C2010e Revenues

Intel share gains faster than expected: New MPU+GPU products from Intel take share from NVIDIA faster than expected.

$9
Base Case
EV/Sales of 1.2 on Base Case C2010e Revenues

Revenue profile in transition: NVIDIA's GPU and chipset business decline. Tegra and Tesla are slow to ramp.

$15
Bull Case
EV/Sales of 2.2 on Bull Case C2010e Revenues

Weaker-than-expected competition: Competition mis-executes. Tegra and Tesla grow faster than expected.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

We argue that NVIDIA's chipset business is under threat from Intel. Our non-consensus Underweight thesis on NVDA is based on our proprietary analysis of NVIDIA, Intel, and AMD's product cycles, including interviews with industry experts. Due to the absence of a broadly licensed bus replacing the current Front Side Bus (FSB) in Intel's MPUs, we think it becomes very difficult and expensive — if not impossible — to connect a non-Intel chipset (e.g. NVIDIA's Ion chipset) to Intel's next-generation MPU+GPU products, putting direct and growing pressure on NVIDIA's chipset business, as Intel's new "2-Chip" platforms (Arrandale and Clarkdale) ramp starting in 1Q10. Additionally, we believe that Intel's Arrandale and Clarkdale products are likely to deliver more than two times the performance of Intel's prior-generation integrated graphics offerings, improving Intel's value proposition and making NVIDIA's advantage less obvious.

In addition to an ongoing decline in NVIDIA's chipset business for AMD platforms (since AMD's acquisition of ATI in 2006), we expect Intel's next-generation integrated MPU+GPU products (due 1Q10) to pressure NVIDIA's chipset business for Intel platforms, and we think it's unlikely that NVIDIA's leadership support for OpenCL within its chipsets can stem rapid share loss. We forecast NVIDIA's quarterly media and communications processor (MCP) revenue run-rate to decline by 40% exiting C2010, relative to its level in C2Q09.

Management argues that its chipset business will grow through 3Q010 because users will demand better integrated graphics capabilities from NVIDIA combined with older (non-bundled) discrete MPUs from Intel, and the market appears to be crediting this view.

NVIDIA losing share in discrete GPU to AMD. According to Mercury, NVIDIA lost 200 bps of share in desktop discrete GPU, and 300 bps of share in notebook discrete GPU, to AMD in 3Q09, after losing 200 bps and 1,300 bps of share to AMD in 2Q09. We believe that NVIDIA's continued share losses are driven by its relatively weaker GPU product cycles, lagging AMD both in timing of product introductions, and product attributes. We are modeling NVIDIA's share of desktop discrete GPU at 57% exiting C2010, down from 64% in C3Q09, and its share of notebook discrete GPU at 38% exiting C2010, down from 43% in C3Q09. Consequently, we are forecasting NVIDIA's GPU revenues to decline by 8% in C2010 to 47% of total revenues.

Our view is significantly different from the market, which bakes in 74% EPS growth and 10% probability of NVDA falling below our Bear Case. Assuming a terminal growth rate of 4%, our "What's in the Price" analysis implies the stock is baking in a 74% increase in consensus EPS for C2011. Our EPS estimate is 73% below the consensus estimate, after incorporating our bottom-up view of NVIDIA's deteriorating business fundamentals. Additionally, our proprietary analysis based on the options market indicates that investors are assigning a very low 10% probability to NVDA falling below our Bear Case scenario. When combined, both analyses indicate investors are relatively bullish on NVDA, and our Underweight thesis appears to differ significantly from the market view.

We believe that NVIDIA is in the midst of navigating a changing revenue profile, driven by competitive pressure from Intel and AMD in its chipset and discrete GPU businesses, and emerging growth in its Tegra and Tesla businesses. We are concerned that NVIDIA will find it difficult to achieve gross margins in the neighborhood of its previous gross margin peak of 46%, given delays in its new GPU products, AMD/ATI's aggressive pricing, a mix shift to the low end, and severe competitive pressure from Intel.

'What's in the Price' Analysis Implies NVDA Stock Is Baking in a 74% Increase in Consensus EPS — Our EPS Estimate Is 73% Below the Consensus Estimate

Part 1							Part 2			
Factset Consensus							Morgan Stanley			Signal
	12/10/2009 Price	Current FY3 EPS	Implied Terminal Growth Rate Current	Target TGR	FY3 EPS for TGR	Implied EPS chg.	Current FY3 EPS	Var from Cons	Var from Implied EPS	
NVDA	$15.41	0.78	8.4%	4.0%	1.35	74%	0.21	-73%	-84%	Neg

Source: FactSet, Morgan Stanley Research

Oracle

Clean Execution on Sun Deal and Recovery in Core Business to Surprise

Morgan Stanley & Co. Incorporated
Adam Holt
Adam.Holt@morganstanley.com

Our View

The proposed Sun deal closes in current form, or with modest changes, and Oracle meets or exceeds its $0.15 accretion target, and the core database business recovers in C2010, driving positive estimate revisions and multiple expansion. Based on our diligence, we believe the EU is likely to approve the Sun deal with no remedies, or with only modest remedies related to MySQL's licensing. Our conversations with industry experts and our proprietary analysis give us confidence that Oracle can drive $1.2–1.9 billion in operating expense reductions at Sun, enabling Oracle to achieve at least $0.15 of accretion. Finally, we expect to see a recovery in the technology business, driven by a middleware cycle, improving renewals of Enterprise license agreements (ELA), and a return to application spending.

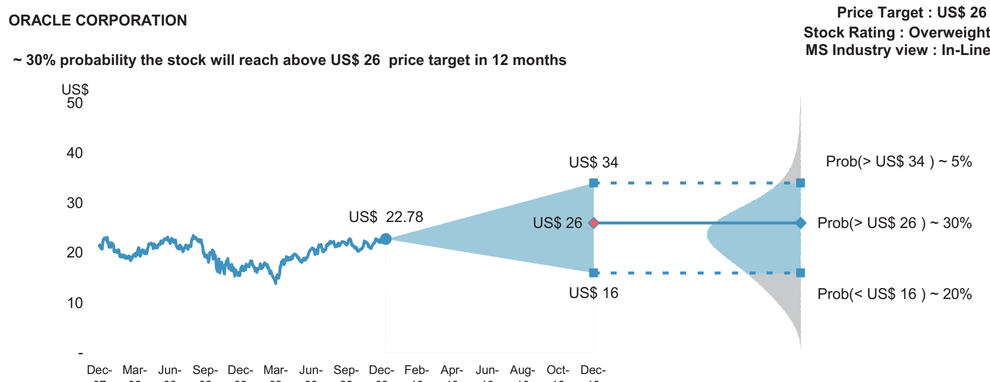
Market View

Mis-execution on the Sun deal, a material deceleration in the core database business, or both are priced into the stock at 12 times our fiscal 2011 (May) EPS estimate, in our view. The options market assigns only ~30% probability to ORCL surpassing our $26 Base Case, which we believe is readily achievable if the deal closes and Oracle executes well on the Sun merger. Our analysis of likely cost savings and the revenue opportunity point to a higher probability of Oracle exceeding its accretion target while we expect to see stability in the core business over the next few quarters.

Market Assigns only ~30% Probability to ORCL Surpassing Our $26 Base Case

Derived from our analysis of fundamental value drivers

Derived from probabilities implied by the options market *



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 11,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$16 — 10x P/E on Bear Case C2010 EPS of $1.56

Bear Case

Recession impacts linger through C2010. Multi-year global recession drives continued high-single-digit declines in organic constant-currency license revenues in C2010, severely limiting EPS growth, despite the strong recurring contribution of the customer base. Forward P/E stays at 10-year trough level.

$26 — 15x P/E on Base Case C2010 EPS of $1.76

Base Case

Increasing confidence in core business; little credit for acquired growth. As IT spending begins to recover in C2010, Oracle returns to modest organic growth (3% for license revenue, 5% total revenue growth). The Sun acquisition materially raises EPS estimates, yielding greater than 20% growth, but investors give ORCL little credit for acquired growth, and multiples remain in line with the S&P at 15X.

$34 — 16.5x P/E on Bull Case C2010 EPS of $2.08

Bull Case

Market gives credit for acquired growth. Quick and efficient integration of Sun, a strengthening IT spending environment, and positive currency headwinds are all built into consensus expectations, increasing EPS to $2.08 for C2010. 40% plus earnings growth, while inorganic, drives multiple back in line with ORCL'S 5-year median forward P/E of 16.5X.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

At 12 times our F2011e EPS, ORCL is pricing in mis-execution on the Sun deal, a material deceleration in the core database business, or both, according to our work. Options data ibndicate that the market assigns only ~30% probability to the stock exceeding our $26 Base Case. We assess a higher probability of the deal closing and Oracle successfully integrating Sun, driving at least $0.15 of EPS accretion. As the market comes to our view, we expect the stock to trade to 15 times our C2010 EPS estimate of $1.76, or $26.

Our diligence on the regulatory proceedings leads us to believe that the EU will likely approve the deal with no remedies, or only modest remedies pertaining to the licensing of MySQL. We believe it is highly unlikely that Oracle restructures the deal or walks away (see our note "EC Objects to Sun, Risk-Reward Still Favorable", published November 10, 2009). The actual blocking of a transaction by the EU is relatively rare — just two times out of 1,665 cases in the past five years, with the last US-based transaction blocked being GE/Honeywell in 2001.

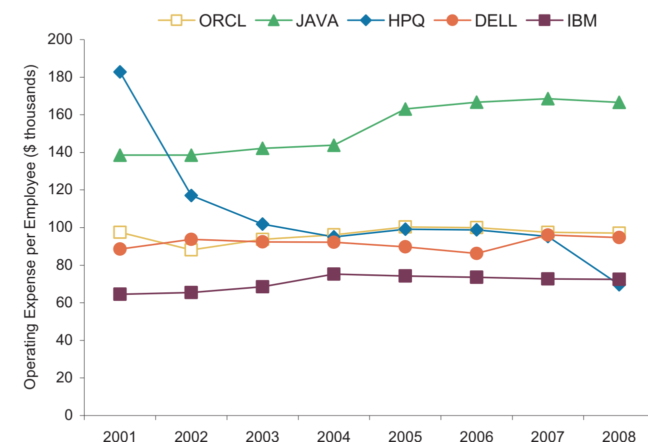
Exhibit 1
Sun Acquisition Timeline (Condensed)

Date	Event	Stock Price ORCL	Stock Price JAVA	Spread to Deal
4/19/2009		$19.06	$6.69	
4/20/2009	Oracle to acquire Sun for $9.50/share	$18.82	$9.15	3.7%
11/9/2009	EU files formal Statement of Objections. Oracle issues a statement in response, as does the Dept of Justice	$21.83	$8.24	13.3%
12/14/2009	Deadline for Oracle to propose remedies			
1/27/2010	Deadline for EU decision (extended on 11/20/09)			

Source: Company data, Morgan Stanley Research

Oracle should be able to drive $1.2–1.9 billion in opex reductions, enabling it to meet or exceed its accretion target, provided Sun's revenues stay within 10% of September levels — which we deem achievable. We have analyzed Sun's cost structure from three angles: (1) by benchmarking Sun's segments to peers, (2) by looking at the cost per employee and excess costs it can eliminate, and (3) by analyzing individual line items of operating expense. By triangulating the results, we conclude that Oracle should be able to drive sufficient cost savings to drive EPS accretion of at least $0.15, if revenue stays within 5-10% of its September levels.

Exhibit 2
Sun's Opex per Employee Far Exceeds Peers, Revealing Much Room for Improvement



Source: Company data, Morgan Stanley Research
Note: Operating expenses exclude one-time charges.

Recovery in the core database business and product cycles could drive low-teens organic growth in C2010 and further multiple expansion. Oracle's core database results disappointed in the August quarter, but ELA renewals, improvement in the Federal vertical, and recovery in the applications business should drive database improvement next year. Database license revenues fell 21% YoY in the August quarter and the stock came under pressure. However, we suspect this was a temporary setback due to delays in purchasing ahead of major product launches in the database and middleware suites, and the recent weakness at SAP.

We believe that several factors will help drive a recovery in C2010: (1) database sales tend to be driven by the applications business, which reaccelerated in the August quarter, (2) the September release of Database 11g R2 should boost C2010 license revenues from the sale of database options, (3) the July release of Middleware 11g could be a multi-billion dollar license driver over the next three years, (4) our recent conversations with Oracle partners representing 60,000-plus consultants indicated signs of headcount growth (a leading indicator) and signs of improvement in the Federal vertical, and (5) the expected launch of Fusion Applications in C2010 may help drive middleware sales.

Philip Morris International

20-25% 2010 EPS Growth From Continued Pricing Power and Favorable F/X

Morgan Stanley & Co. Incorporated
David Adelman
David.Adelman@morganstanley.com

Our View

PM can generate above-consensus 20-25% EPS growth, approaching $4.00 despite challenging economic conditions. The market is concerned that PM's pricing will moderate next year, but our AlphaWise[SM] survey suggests the industry retains substantial pricing power, particularly in emerging markets. Under our Bull Case, PM would be valued at ~10.5x 2010e EV/EBITDA, or $70, near the high end of the premium Staples peer group, driven by 6–8% organic operating profit growth, incremental US dollar weakness, the absence of material excise tax shocks, the persistency of the attractive competitive pricing environment, continued aggressive share repurchases (e.g., ~$4 billion during 2010), and signs of improving tobacco consumption. ***We assign a 60% probability to the scenario that PM will trade at or above our $57 Base Case during 2010, and a 20% probability to our Bull Case of $70/share.***

Market View

Skepticism as to the sustainability of PM's pricing and net revenue growth, although consensus currently forecasts ~16% EPS growth in 2010. PM's current valuation implies only 1% long-term operating profit growth (based on Morgan Stanley's "What's in the Price" analytic tool), well below our expectation of 6–7% mid-term annual EBIT growth. In our view, the market has overreacted to the scale of recent organic volume declines (e.g., 4% in 3Q09) and the modest Germany pricing skirmish, and may be assuming consumers will be resistant to further pricing following widespread retail price increases during 2009. In addition, we believe that the capital markets are unduly concerned with the prospect of an outsized excise tax increase in Japan.
The market assigns a 75% chance that PM will trade below our Base Case valuation.

Market Sees 25% Chance of Exceeding Base Case, and 5% of Moving Above Bull Case

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

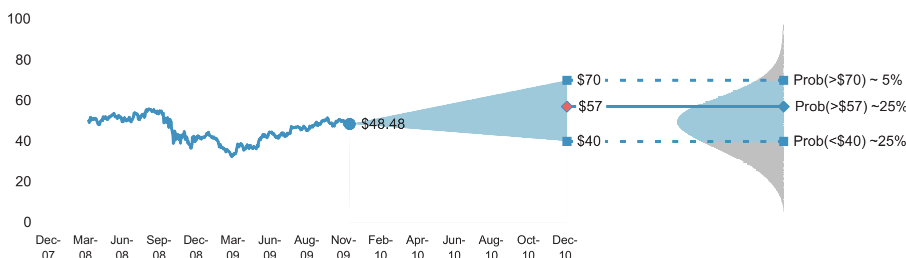
Derived from our analysis of fundamental value drivers

Derived from probabilities implied by the options market *

PHILIP MORRIS INTERNATIONAL INCORPORATION

Price Target : $ 57
PM.N Rating : Overweight
MS Industry view : In-Line

~ 25% probability PM will reach above $57 price target in 12 months



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9, 2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios: Outlook Remains Strong Despite Challenging Environment

$40
Bear Case
8.5x 2010e EV/EBITDA (implies 10.3x 2010e P/E)

Slower growth and renewed currency headwinds. During 2010, local-currency operating income slows to low single-digit growth, the US dollar rallies 15% from current levels, and PM trades at 8.5x 2010e EV/EBITDA on "depressed" earnings.

$57
Base Case
~9.5x 2010e EV/EBITDA (implies 14.7x 2010e P/E)

Moderation in sequential results. Following an exceptional 2008/09, the rate of local currency operating income growth slows from ~9% to ~6% over the intermediate-term as global economic growth moderates. The US dollar is unchanged from current levels.

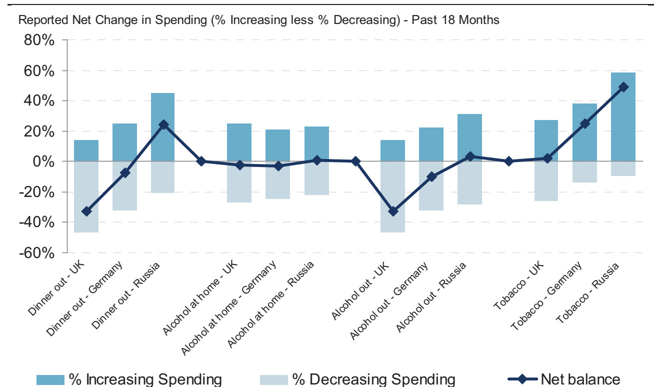
$70
Bull Case
10.5x 2010e EV/EBITDA (implies 18.0x 2010e P/E)

Global consumer environment rapidly improves. Emerging market concerns dissipate, the US dollar weakens an additional ~10% versus current levels, share repurchases accelerate, and valuation expands to 10.5x 2010e EV/EBITDA.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

We believe the market is underestimating the sustainability of PM's pricing power and remains too conservative with respect to 2010 EPS expectations. While consensus currently forecasts 2010 EPS of $3.80 (+16%), we believe EPS could ultimately approach $4.00 (20-25% growth), with stronger-than-expected results driven by: (1) Continued industry-wide price/mix improvement, supported by recent price increases in key developed markets (e.g., France, Germany) and tobacco products' relative affordability in EMs; (2) Greater rates of product innovation, which could lead to improved Marlboro volume performance; (3) Aggressive cost reductions and working capital management; (4) Additional share repurchases beyond PM's existing two-year, $13 billion program; (5) Favorable macro operating conditions (including a benign competitive and excise tax environment); and (6) The tailwind of a weakening US Dollar.

Exhibit 1
Tobacco Spending Resilient in EMs vs. Other Mkts



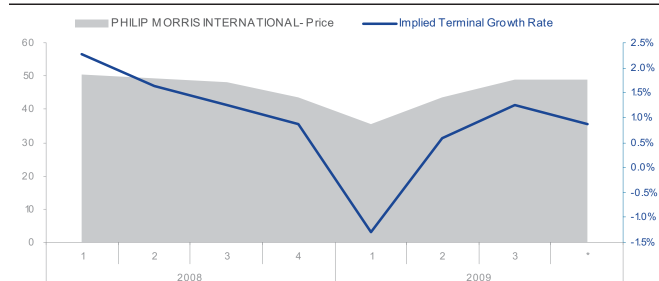
Source: AlphaWise[SM], Morgan Stanley Research

Our recent AlphaWise consumer survey suggests significant untapped pricing power for PM and other cigarette manufacturers, particularly in Emerging Markets (Exhibit 1), and increases our confidence that manufacturer pricing should be more than sufficient to offset expected modest volume declines during 2010. We forecast 2010 net revenue growth of 9.3% (3.6% organic, including price/mix of 4.7%), versus consensus growth of 7.6%. In our view, consensus' more conservative view underestimates the relative affordability of cigarettes, and fails to capture the impact of PM's growing innovation on Marlboro (which could slow the impact of negative mix on PM's revenue growth).

We expect the market to become more bullish on PM's growth prospects as the company sustains strong underlying results (we forecast 6.1% organic operating profit growth in 2010, a figure we view as conservative) and cigarette industry volumes begin to improve sequentially throughout the course of the year. We expect incremental price increases across all regions, and note the potential for additional pricing in Japan (which has not had a manufacturer price increase since early 2006) to offset what will likely ultimately prove to be only a moderate excise tax increase (mid-2010). Finally, further weakening of the US dollar could provide additional EPS upside.

PM is currently discounting only ~1% long-term operating profit growth (see Exhibit 2), according to Morgan Stanley's "What's in the Price" analytical methodology. This appears overly conservative, in our view. In contrast, our Base Case and Bull Case valuation of $57 and $70 imply long-term earnings CAGRs of 2.2% and 3.6%, respectively, which in our view are more reasonable in light of tobacco's stable fundamentals and PM's consistent track record.

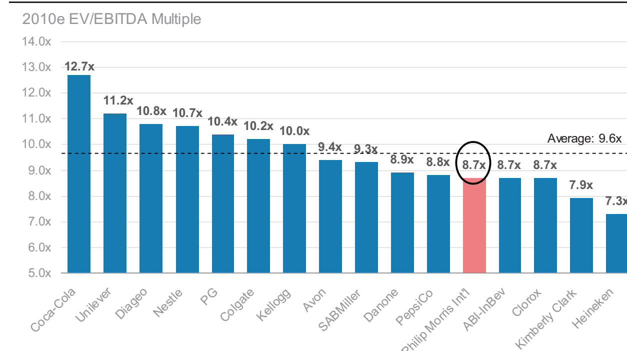
Exhibit 2
Market Implying Only ~1% L-T Earnings Growth



Source: Company data, Morgan Stanley Research

As market concerns subside, we expect PM's multiple to expand toward our Base Case of 9.5x 2010e EV/EBITDA, in line with the average valuation of premium Staples peers such as Diageo, Colgate-Palmolive, and Nestlé. We think our Bull Case of $70 (10.5x 2010e EV/EBITDA) is also reasonable, as our scenario assumes PM is valued at parity with other premium Staples category leaders.

Exhibit 3
We Expect Re-Rating In Line with Staples Peers



Source: FactSet, Morgan Stanley Research; Reflects consensus estimates for KO, PG, CL, AVP, PEP, CLX and KMB.

Telecom Services

High-Yielding Telecom Stocks Revert to Normal Spreads over Bonds

Morgan Stanley & Co. Incorporated

Simon Flannery
Simon.Flannery@morganstanley.com

Our View

Sentiment has pressured Telecom equity valuations, but we think the more sanguine credit markets are correct. There is a disconnect between the way the credit market and the equity market view risks associated with high yielding telecom names. We believe that the credit markets can be a leading indicator for the equity markets and individual stocks.

Market View

Many investors are wary of the sector's dividend and FCF sustainability, arguing that the dividends are at risk given top-line pressures due to line loss, slowing broadband growth, and wireless price wars. Savings (both capex and opex) are seen as unsustainable. Concerns also exist that financial stress in the sector could prompt regulators to demand dividend cuts prior to approving new deals.

Within a view of a gradual recovery, the Telecom sector offers a more appealing risk-reward profile than stocks leveraged to a rapid economic turnaround, in our view. Sentiment toward the sector is poor, as worries about wireless saturation, price wars, secular and cyclical pressure, and new regulation have all contributed. We, however, are constructive on the sector, believe that much of the concern is already discounted in the stocks, and see valuations at very attractive levels. Appetite for high-beta stocks can be blamed in part for Telecom's underperformance in 2009.

We believe one camp remains wary of the sector's dividend and FCF sustainability. We do not. Profitability is sustainable in the medium term, in our view, although future productivity initiatives will likely have less emphasis on headcount; the levels of layoffs in 2009 are unlikely to be replicated. Weak housing markets and business demand should continue to ease capex needs, at least until 2H10. Cost synergies should partly offset top-line pressure at most rural carriers given ongoing consolidation (which we think could continue). Consumer line loss is troughing, but business line loss still depends on abating unemployment. In wireless, we believe the Bells have key tailwinds (for Verizon, Alltel synergies; for AT&T, strong iPhone activations in 2009 and lower subsidies in 2010) that should boost profitability. We think the risk of price wars in the high end of the market is low.

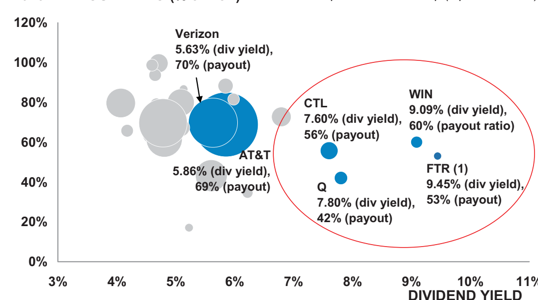
Balance sheets strengthened further this year through debt buybacks, debt paydown, or M&A. Two of our three Overweight-rated high-dividend-yielding names, AT&T and CenturyLink, have investment-grade balance sheets, while the third, Windstream, is levered at 3.1 times EBITDA but has no major debt maturities until 2013.

We think the credit markets can serve as a leading indicator. Our colleagues in Credit Strategy highlighted in September that "trusting high dividend yields was a risky game to play" earlier in the year but that the "desire to de-lever is slowly fading, in favor of slightly more favorable shareholder activity."[1] The dividend-bond spread has since narrowed somewhat for some blue chip stocks we cover (e.g., AT&T), but we see further room to go.

Telecom bonds have reverted to pre-credit crisis levels; telecom dividend yields, for the most part, haven't. Given this dynamic, the dividend-bond spread for the largest high-yielding Telecom names has widened to 111 bps. Prior to September 15, 2008, the sector's average dividend yield was 100 bps below the average bond yield, a startling 210 bps difference from current levels. Telecom is one of only two sectors in the S&P 500 with a dividend yield above 3% (Utilities is the other). The sector has a 350 bps spread over the market's 1.95% dividend yield, compared to 107 bps prior to September 15, 2008. AT&T's dividend yield is 117 bps over its comparable bond, reverting to the pre-credit crisis 98 bps discount implies 58% equity upside to $44. Assuming a 3% dividend hike the upside would be 63%. Looking at a basket of the largest high-yielding stocks in our coverage (next page), we estimate that tightening of dividend-bond yield spreads through decreasing dividend yields would imply a 56% return on the equities.

Exhibit 1

Top 4 Dividend Yields in the S&P 500 Are Telcos

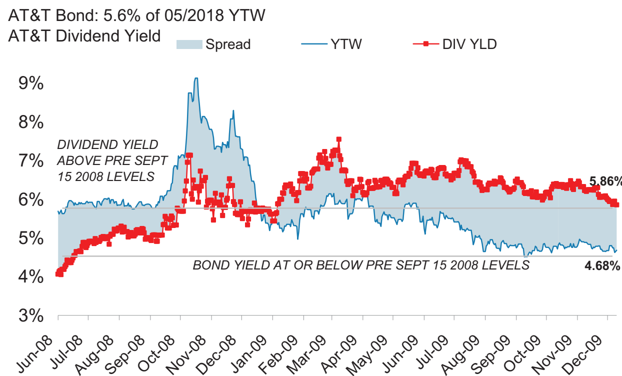


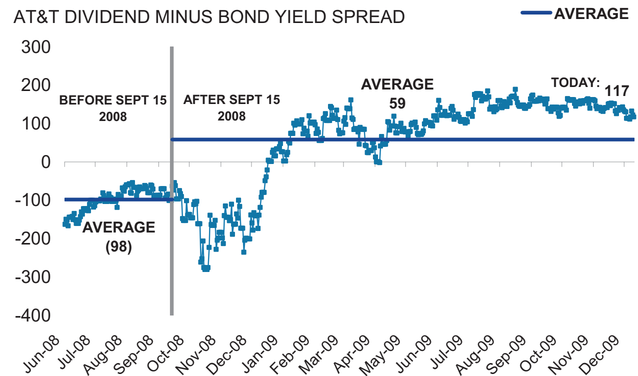
Source: Company data, Morgan Stanley Research (1) Using pro-forma Frontier dividend yield (reducing dividend by 25% post acquisition of Verizon lines). Payout of FCF based on management's proforma estimates pre synergies using 2008 data

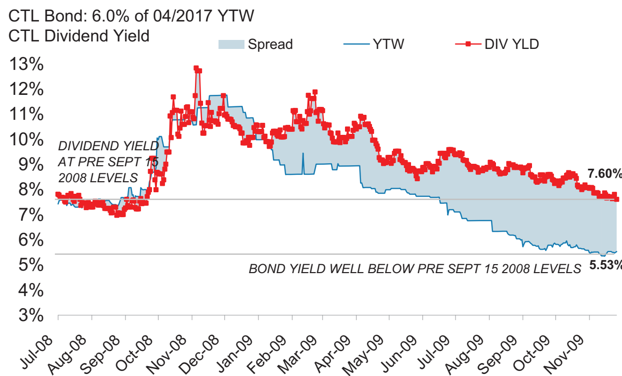
[1] See "*Yield to Dividends*" by Gregory Peters et al., 09/25/2009

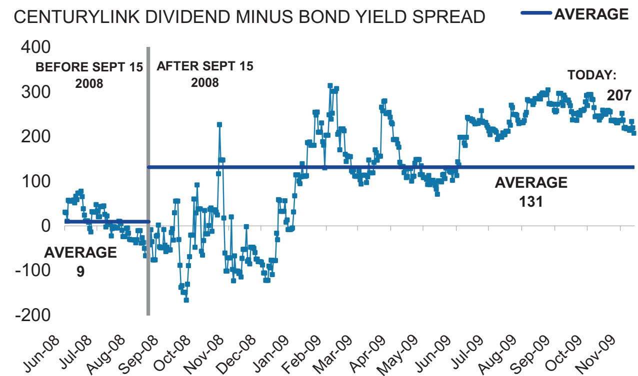
Dividend Yield Minus Bond Yield Should Revert to Normal as Telecom Stocks Climb

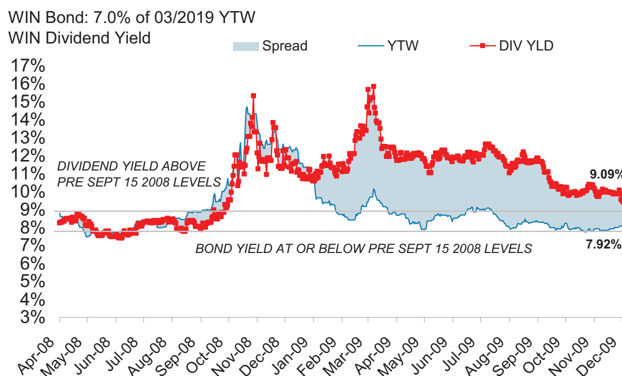
			Dividend Yield less Bond YTW			Reverting to Before Sept 15 2008 Average				
COMPANY	Dividend Yield Today	Bond Yield to Worst (YTW) Today	Today	Before Sept 15	After Sept 15	Price	Return	Total Return	Leverage 2010	Divivded Payout of FCF
T	5.86%	4.68%	117 bps	-98 bps	59 bps	44.28	58.1%	64.0%	1.4x	69%
VZ	5.63%	4.73%	90 bps	-120 bps	13 bps	53.76	59.4%	65.0%	1.8x	70%
Q	7.80%	7.09%	72 bps	-59 bps	-8 bps	4.93	20.2%	28.0%	2.9x	42%
FTR pf (1)	9.45%	8.14%	131 bps	-205 bps	-31 bps	12.33	55.3%	64.7%	2.6x	53% *
WIN	9.09%	7.92%	117 bps	-10 bps	208 bps	12.78	16.2%	25.3%	3.1x	60%
CTL	7.60%	5.53%	207 bps	9 bps	131 bps	49.78	35.2%	42.8%	1.9x	56%
Bells Weighted Avg.	5.83%	4.76%	106 bps	-105 bps	41 bps		57.6%	63.4%	1.6x	68%
RLEC Weighted Avg. (1)	8.25%	6.52%	173 bps	-25 bps	129 bps		32.9%	41.2%	2.3x	56%
Overall Weighted Avg. (1)	5.98%	4.88%	111 bps	-100 bps	46 bps		56.0%	62.0%	1.7x	68%

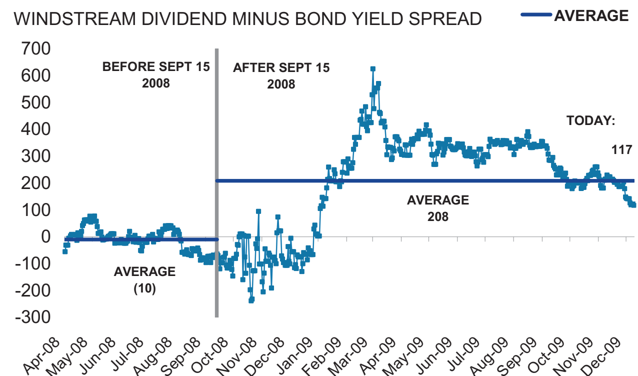












Source: Company data, FactSet, Morgan Stanley Research, (1) Using pro-forma Frontier dividend yield (reducing dividend by 25% post acquisition of Verizon lines).
* Based on management's pro forma estimates pre synergies using 2008 data

Prices of stocks mentioned (12/11/09): AT&T ($28.01), CenturyLink ($36.82), Frontier ($7.94), Qwest ($4.10), Verizon ($33.73), and Windstream ($11.00).

Toronto-Dominion Bank

Expect US CRE Portfolio to Perform Better Than the Market Anticipates

Morgan Stanley & Co. Incorporated

Cheryl Pate
Cheryl.Pate@morganstanley.com

Our View

TD's CRE portfolio should outperform its peers' due to superior credit management and geographic footprint. The key debate on the stock concerns the potential negative impact of deterioration in TD's US commercial real estate (CRE) exposure. We expect TD's US CRE portfolio to perform better than the market anticipates due to the company's better geographic footprint and strong credit management. TD operates in the Northeast/Mid-Atlantic US, where credit costs have been lower than the US average — and TD's portfolio has performed better than that region as a whole. Additionally, the CRE book looks well diversified; and we conservatively estimate a 10% cumulative loss for the portfolio, in line with TD's US large cap peers.

We assign a 70% probability to this outcome.

Market View

Market expects higher losses on TD's US exposure, as it fails to recognize TD's favorable geographic exposure, in our view. We believe the market is not recognizing the impact of geographic region on credit losses. TD's operational footprint has been stronger than the national average. Additionally, while commercial real estate comprises 24% of the US portfolio, it is a manageable 5% of total loans for TD.

Even if losses on the portfolio are substantially higher than our 10% cum loss forecast, we estimate the impact to EPS would be small (10% impact to EPS for a 50% increase in CRE losses).

The market is only assigning a 10% probability of TD exceeding our Base Case scenario valuation— much too low, in our opinion.

Market Over-Discounts CRE Risk: 10% Implied Probability of Exceeding C$85 Base Case

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

Derived from our analysis of fundamental value drivers

Derived from probabilities implied by the options market *

Price Target : CAD 85
TD.TO Rating : Overweight
MS Industry view : In-Line

Prob(>CAD95) <5%
Prob(>CAD85) ~10%
Prob(<CAD55) ~25%

* The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of December 9, 2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

C$55 12.4 P/E on Bear Case 2010e EPS of C$4.45
Bear Case

Double-Dip Recession. Current stimulus and inventory restock is not replaced by corporate reinvestment or consumer demand. Valuation based on Bear Case residual income.

2010e PCL Ratio: 1.00%
2010e ROE: 10%
2010e ROA: 0.67%

C$85 14.2 P/E on Base Case 2010e EPS of C$6.00
Base Case

Shallow U-Shaped Recovery. Credit costs begin to moderate 1H10. Valuation based on residual income valuation, using a normalized cost of capital.

2010e PCL Ratio: 0.74%
2010e ROE: 13%
2010e ROA: 0.82%

C$95 14.9 P/E on Bull Case 2010e EPS of C$6.42
Bull Case

Sharp Economic Recovery. Credit improves more rapidly than our base case. Valuation based on Bull Case residual income.

2010e PCL Ratio: 0.67%
2010e ROE: 14%
2010e ROA: 0.84%

Source: FactSet (price data), Morgan Stanley Research * PCL = Provision for Credit Losses. For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

The market is overestimating the size and impact of TD's US CRE portfolio, in our view. The CRE portfolio, while 24% of the US loan portfolio, constitutes just 5% of TD's entire loan book and is well diversified (26% residential, 26% office, 20% retail, 9% industrial, and 7% hotel loans). TD also benefits from having a predominantly Northeast/Mid-Atlantic footprint, and has had a better credit experience than its peers, with better than regional average nonperforming loans (NPLs) and net charge-offs (NCOs) in almost all asset classes, and most importantly better trends in commercial-related loan classes (CRE and Commercial & Industrial).

Exhibit 1

TD's US CRE Exposure Looks Well Diversified

US CRE Exposure (4Q09)		
	$ Billions	% of Total
Residential	$ 3.5	26%
Office	3.6	26%
Retail	2.8	20%
Industrial	1.2	9%
Hotel	0.9	7%
Other	1.7	12%
Total	**$ 13.7**	**100%**
Total US Loans & Acceptances	**$ 57.4**	**24%**
Total Loans & Acceptances	**$ 254.3**	**5%**

Source: Company data, Morgan Stanley Research

Exhibit 2

TD's Credit Experience Better Than Regional Average

	NCO Ratio			NPL Ratio		
	TD	Northeast / Mid-Atlantic	U.S.	TD	Northeast / Mid-Atlantic	U.S.
HELOC	1.01%	1.54%	3.79%	0.96%	0.88%	1.65%
Resi Mtg	0.24%	0.60%	1.59%	1.74%	2.27%	4.83%
C&I	0.59%	1.40%	2.25%	0.86%	2.00%	2.75%
Comm'l Mtg	0.57%	0.62%	0.82%	1.52%	2.25%	2.89%
Construction	3.33%	3.31%	5.26%	11.90%	11.39%	13.20%
Card	8.55%	17.77%	10.28%	2.80%	1.74%	0.49%
Cons ex-Card	1.40%	1.13%	3.10%	0.30%	0.61%	0.48%
Total/Avg.	0.93%	1.20%	2.72%	1.84%	2.48%	3.47%

Source: SNL Financial as of 3Q09, Company data, Morgan Stanley Research
Note: NE/MA Region includes states where TD has more than 32 branches: CT, ME, MA, NH, VT, NJ, NY, PA

Our sensitivity analysis highlights TD's resiliency to potentially worse-than-expected US CRE losses. We forecast a 10% cum loss for TD's US CRE, in line with its US Large Cap peers. Even in a more bearish scenario, assuming a 50% increase in cum losses, or 5% points, and assuming all incremental losses are incurred in 2010, the impact to EPS is relatively small at 10%.

Exhibit 3

We Model 10% Cum Loss for TD's US CRE, in Line with US Lg-Cap Bank Median, Despite TD's Better Footprint

Base Case	% Loss			
Cum Losses	Canada / Other	US	Total	US Large Cap Peers
Resi Mortgage	0.11%	2%	0.3%	9%
HELOC	0.39%	8%	1%	13%
Other Consumer	4%	5%	4%	11%
Credit Card	13%	25%	14%	36%
Other Commercial	2%	6%	3%	8%
Construction	NM	15%	NM	19%
Commercial Real Estate	6%	10%	9%	10%
Total	2%	8%	3%	13%

Source: Morgan Stanley Research

Exhibit 4

Sensitivity Analysis: *Even Assuming 50% Higher Cum Losses, All in 2010, EPS Impacted by Only 10%*

$ Millions, except per share data

	Incremental Loss on US CRE Portfolio		
Sensitivity Analysis	2%	3%	5%
Incremental PCL	264	396	660
Earnings Impact	(198)	(297)	(495)
EPS Impact	($0.23)	($0.35)	($0.58)
2010E EPS Impact	-4%	-6%	-10%
Book Value Impact	-1%	-1%	-1%
Tang. Book Value Impact	-1%	-1%	-2%

Source: Morgan Stanley Research

Potential catalysts: Look for 1H10 earnings announcements to show lower-than-expected provisions and improvement in impaired loan formations in the US portfolio to bring the market view more in line with our base case scenario. On a macro level, improving trends in economic indicators such as industrial production and capacity utilization (released monthly on or about the 15th) should lead to stabilization of commercial loan portfolios. We expect commercial credit losses will peak 2H10.

US Steel

Looking for a Robust Recovery in the Struggling Tubular Steel Market in 2010

Morgan Stanley & Co. Incorporated

Mark Liinamaa
Mark.Liinamaa@morganstanley.com

Our View

We believe US Steel's Tubular segment could stage a 2010 recovery well above current expectations. US Steel's Tubular segment directly accounts for about one-third of EBITDA in a normal year and indirectly boosts profits in the company's Flat-rolled segment, which produces the steel inputs for tube operations. Business conditions for tubular products are currently weak, with tube mills running near 30% operating rates. However, we believe the current oil country tubular goods (OCTG) inventory overhang will dissipate by spring of 2010, ahead of consensus expectations, due to a rising rig count, more OCTG-intensive shale projects, and negligible imports. New duties should structurally improve Tubular margins.

Market View

The market's view that Tubular will struggle through 2010 is too pessimistic, we believe. Many investors are not yet willing to pay for a recovery. Fears are high that inventories will keep volumes and pricing at loss-producing levels for all of 2010. We estimate that US Steel's current share price implies only a 4x multiple on normalized Tubular EBITDA; the peer group trades near 7x, on our estimates.

Market Sets Only 35% Chance to X Clearing Our $53 Base Case – We See a 75% Chance

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

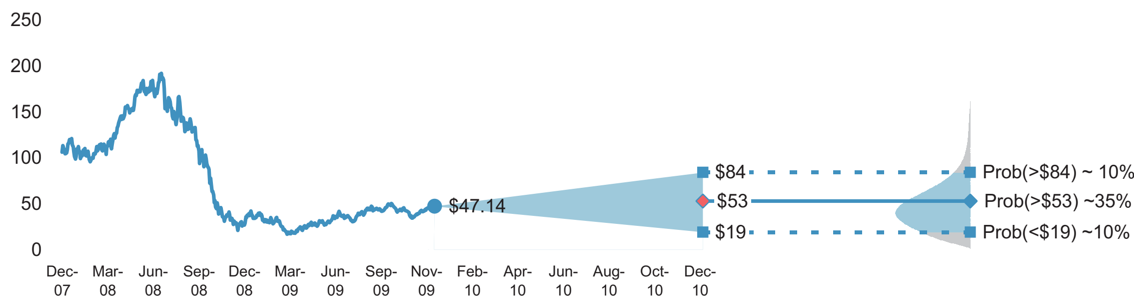
Derived from our analysis of fundamental value drivers

Derived from probabilities implied by the options market *

UNITED STATES STEEL CORPORATION

Price Target : $ 53
X.N Rating : Overweight
MS Industry view : In-Line

~ 35% probability X will reach above $53 price target in 12 months



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$19 1.0x 2009e Tangible Book Value of $19/Sh.

Bear Case

Slowdown continues through 2010. The hot-rolled coil price per ton falls to $530 in 2010. Operating rates average 67% for the year and the Tubular segment earns only $140 million in operating profit.

$53 7.9x 2010e Base Case EBITDA of $1.5b

Base Case

Mild rebound in real demand in 2010. The hot-rolled coil price per ton averages $540 in 2010. Operating rates average 72% for the year and the Tubular segment earns $255 million in operating profit.

$84 6.0x 2010e Bull Case EBITDA of $2.7b

Bull Case

Healthy rebound in real demand in 2010. The hot-rolled coil price per ton rises to $600 in 2010. Operating rates average 77% for the year and the Tubular segment earns $350 million in operating profit.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

We believe the market is not assigning proper value to US Steel's Tubular segment. Assuming historical mid-cycle multiples for other segments, the current share price implies the Tubular segment is worth 4x mid-cycle EBITDA, while the tubular peer group trades at 6.7x mid-cycle EBITDA. This discrepancy is consistent with conversations we have been having with investors. Very few seem willing to assign much value to the Tubular business given weak natural gas fundamentals and an OCTG inventory overhang.

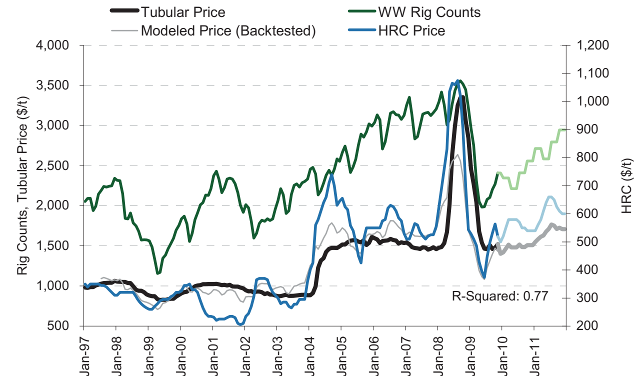
We think OCTG fundamentals will improve sooner than many expect… We believe a large portion of inventory is commodity-grade Chinese OCTG, which is unusable for the directional drilling projects that we expect to dominate in the current environment. We believe there is less of an inventory overhang for US Steel's higher-grade products. In addition, the rig count has been climbing faster than expected in recent months, which should help firm the market. Our bullish outlook on OCTG and the rig count is in line with the view of Ole Slorer, Morgan Stanley's Oil Services, Drilling & Equipment analyst.

…and investors are overlooking longer-term structural improvement in profitability due to recent trade cases. Recent trade cases brought by the International Trade Commission and the US Department of Commerce on Chinese OCTG and seamless line pipe have been moving forward in favor of domestic producers. We have already seen Chinese imports of OCTG fall to negligible levels as a result. In the past few years, Chinese OCTG producers have supplied between 25–40% of the market; and we expect a structural improvement in US Steel's Tubular segment as it retakes market share. However, we believe that the market has to date ignored this structural change due to the inventory overhang.

We expect 2010 US apparent demand to rise to 90 million tons from 65 million, benefiting US Steel's Flat-rolled segment. While this would represent a 38% Y/Y climb, it would still be 32% lower than the peak in 2006. To arrive at our forecast, we assume a gradual improvement in real demand augmented by major improvement on the inventory front. Our assessment of real demand is based on our economic team's forecast for 2.8% US GDP growth, which seems to be tracking well based on the latest PMI data and auto sales data. In addition, we believe normal seasonal improvements in the spring will be aided by long-waited arrival of stimulus projects dollars.

Exhibit 1

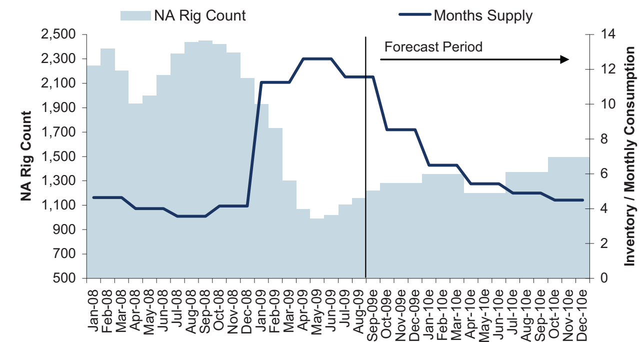
A Gradually Rising Rig Count and Higher Hot-Rolled Coil Prices Should Support OCTG Prices



Source: Company data, Morgan Stanley Research

Exhibit 2

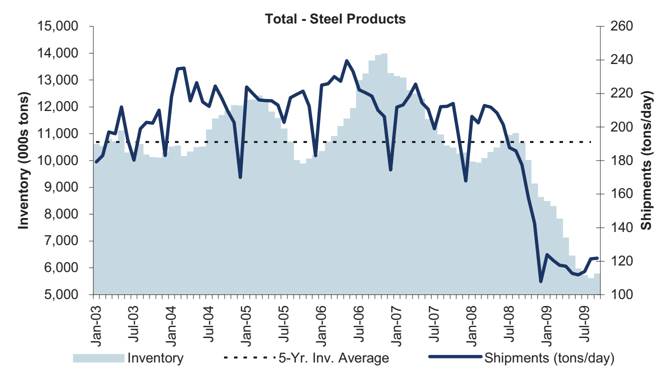
The OCTG Inventory Issue Should Fade in 1H10



Source: Company data, Morgan Stanley Research
e = Morgan Stanley Research estimates

Exhibit 3

Inventory Destocking Depressed Apparent Demand in 2009 — but Now Levels Have Stabilized



Source: MSCI, Morgan Stanley Research

Vertex Pharmaceuticals

We Believe Street 2012 EPS Estimates Will Increase at Least 50% by End-2010

Morgan Stanley & Co. Incorporated
Steven Harr
Steve.Harr@morganstanley.com

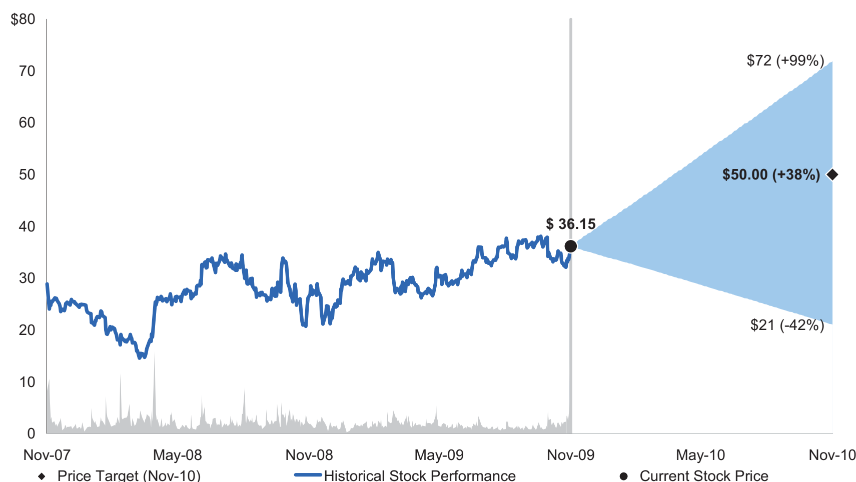
Our View

We expect 2012 EPS to exceed $9 as telaprevir's peak sales surprise the Street, but sustainability is a risk. The two key controversies for Vertex are: (1) the peak earnings from telaprevir, and (2) the sustainability of the earnings given telaprevir's less-than-ideal dosing profile and numerous competitors. We see greater peak earnings than the market — our 2012 EPS estimate is $9 vs. Street consensus of $4.40 — but we also see greater risk to the sustainability of the business. We believe Phase III data and discussion with physicians next year will lead to substantial upgrades to consensus EPS in 2012/2013, with at least 50% of the gap between our number and consensus closing in 2010.

Market View

We believe that the Street significantly underestimates telaprevir's potential and that estimates will rise sharply. While the market is generally optimistic on Vertex ($7 billion market cap despite burning significant cash), we believe that the Street significantly underestimates the earnings potential of telaprevir, in terms of price, the market share it will capture, and the pace of uptake.

Competition and Telaprevir's Commercial Success Determine Risk-Reward



Risk-Reward Scenarios

$21
Bear Case

DCF valuation uses a 5% intermediate growth rate, 3% terminal growth rate and 11% discount rate

This scenario differs from the base case in two significant ways: (1) peak telaprevir sales are ~25% lower, as "warehoused" patients wait for the launch of combination direct anti-virals; and (2) competition erodes telaprevir's share more rapidly than in the base case. Peak sales assume that the market does not grow much beyond its current run rate (but almost all patients do get a protease inhibitor).

$50
Base Case

Based on multiple analysis (11x fully taxed 2012e EPS discounted back at a 15% rate)

Telaprevir launches in 2011 in the US and EU and rapidly penetrates both the treatment naïve and treatment refractory market. In this scenario we assume a price of ~$30,000 (on par with cost/cure for standard of care) and that telaprevir peaks with worldwide sales of more than $4 billion in 2012/2013. This scenario assumes superior second-generation compounds begin to launch in 2014, rapidly taking share from telaprevir. Profitability erodes rapidly after 2013.

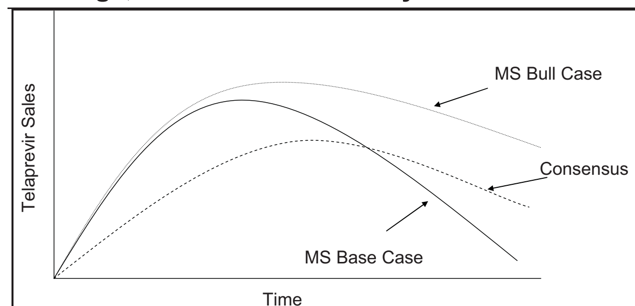
$72
Bull Case

DCF valuation uses a 5% intermediate growth rate, 3% terminal growth rate and 11% discount rate

The key drivers to this scenario are: (1) greater uptake in the 2012/2013 timeframe and (2) maintenance of a significant (but not all) portion of peak sales through the development of combination treatment with VX222 + telaprevir.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

Exhibit 1
Key Drivers Are the Size of Telaprevir's Peak Earnings, and the Sustainability Thereafter



Source: FactSet, Morgan Stanley Research

Exhibit 2
Our Estimates Are Now Meaningfully Above Consensus Through 2013 but Well Below Thereafter

Consensus	2011	2012	2013	2014	2015
Total revenue ($bn)	$1.16	$2.13	$2.25	$2.05	$1.85
EPS, diluted	$1.42	$4.40	$4.54	$3.62	$3.26
EPS, diluted, fully taxed	$0.91	$3.87	$3.97	$3.08	$2.46
Morgan Stanley	2011	2012	2013	2014	2015
Total revenue ($bn)	$1.44	$2.97	$2.74	$2.09	$1.46
EPS, diluted	$2.95	$9.33	$6.16	$3.49	$2.15
EPS, diluted, fully taxed	$1.95	$6.19	$5.13	$3.49	$2.15

Source: FactSet, Morgan Stanley Research

We currently estimate 2012 EPS at $9.33 versus Street consensus of ~$4.50. Our above-consensus estimate is significantly higher for the following reasons: (1) we expect near universal uptake of telaprevir, the company's potential hepatitis C virus (HCV) treatment after approval (current annual market of 70,000 patients); (2) a large number of patients are waiting for a better treatment option than is currently available (>350,000 "warehoused" patients); (3) low operating leverage — the HCV market only requires ~100 sales people; (4) at the time of telaprevir's launch we estimate the company will have ~$3 billion in net operating losses (NOLs) to apply against future profits.

We are more confident in telaprevir's uptake post-launch given recent data as well as conversations with physicians on capacity and wait lists for treatment at the recent American Association for the Study of Liver Diseases (AASLD) meeting and on diligence calls. There is little competitor data coming over the next 6–9 months (sustainability is still a key long-term concern), providing a clear runway to Phase III data. Finally, development of competitor agents is slower than we anticipated.

We expect Positive Phase III data in 2010 plus a better understanding of the economics to be the catalysts that drive the stock toward our price target. We see two key drivers of upside for VRTX over the next 6–12 months: (1) a clear path for telaprevir to strong Phase III data with minimal competitor data reported in the interim, and (2) upward estimate revisions, as we believe the Street currently underestimates the earnings power telaprevir can have very soon after launch.

Over the next 12 months we expect there will be increased visibility on the peak earnings power of the HCV business but little change to the view on sustainability. We expect SVR rates (cure rates) in the Phase III trials to be ~75% for treatment naïve patients (late 1Q/early 2Q), which is ~30% better than the current standard. Data in treatment failures in mid-2010 should define telaprevir as the standard in this population. With a six-month review, telaprevir could launch in 1H2011.

We see a high probability that at least 50% of the gap between our 2012 EPS estimate of $9.33 and Street's ~$4.40 will close in 2010. We believe that data plus discussions with physicians will lead to substantial upgrades to consensus estimates next year.

We remain concerned about the long-term sustainability of the business, as we still view telaprevir as a first generation drug that will be replaced as early as 3–4 years after launch and the earnings potential of the company's pipeline assets in Cystic Fibrosis is unclear (no substantial data demonstrating clinical benefit), but with little in the valuation for them, positive data or significant declines in R&D associated with them would represent upside.

Warner Chilcott

Upside EPS Surprises on Pricing and New Formulations of Asacol, Actonel

Morgan Stanley & Co. Incorporated
David Risinger
David.Risinger@morganstanley.com

Our View

Sell side materially underappreciates Warner Chilcott's earnings power. Consensus, while positive, under-appreciates management's experience in extending duration of revenue via 'next generation' products, in our view. Our 2010 EPS estimate is 6% above consensus ($3.27 vs. $3.09). We believe the market is underestimating: (1) revenue upside from Asacol (Warner Chilcott's second largest product, which treats ulcerative colitis) from a price increase and conversion to high dose; (2) duration of revenue from Actonel (Warner Chilcott's largest product, for osteoporosis), assuming approval of new Actonel in 2H10 and subsequent cessation of old Actonel; and (3) lower spending in the acquired P&G Pharma business.

Market View

The market is concerned about competition to Asacol and doesn't fully appreciate Warner Chilcott's pricing power despite the company's 10% increase in Asacol pricing in September. Many investors believe that some patients will switch to Actonel once-weekly follow-on when it becomes available, but it is unclear how much of the US Actonel franchise will be protected from generics by 2014.

Material Upside to Consensus EPS Expectations Should Drive WCRX Shares

Risk-Reward Scenarios

$22 Bear Case — DCF assuming 8.5% WACC and –9% growth in perpetuity post-2015

Warner Chilcott struggles to convert Asacol prescriptions to new HD formulation. Roxane launches generic Asacol when 30-month stay ends in March 2010. FDA does not approve Actonel follow-on in 2010. Integration challenges are more formidable and expenses are higher than we expect, and 2010 EPS misses our estimate of $3.27.

$32 Base Case — DCF assuming 8.5% WACC and –2% growth in perpetuity post-2015

Successful launch of low dose oral contraceptive in 1H10; FDA approves Actonel follow-on in 2H10. Roxane does not launch generic Asacol when 30-month stay is over in March 2010. We assume 2010 SG&A expense of $1.4 billion.

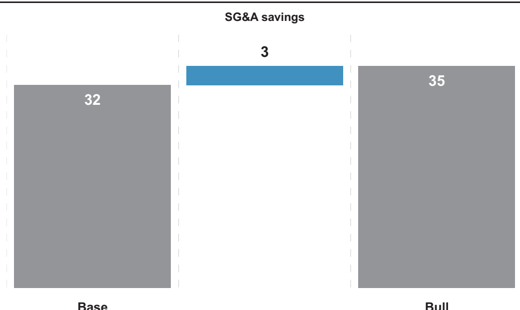
$35 Bull Case — DCF assuming 8.5% WACC and –2% growth in perpetuity post-2015

Beyond Base Case: SG&A spending of $1.3 billion (vs. base case assumption of $1.4 billion) increases 2010 EPS by 10% to $3.63 (vs. our Base Case of $3.27). Management announces filing of new formulations of Doryx and/or Asacol to further extend revenue duration.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

Exhibit 1

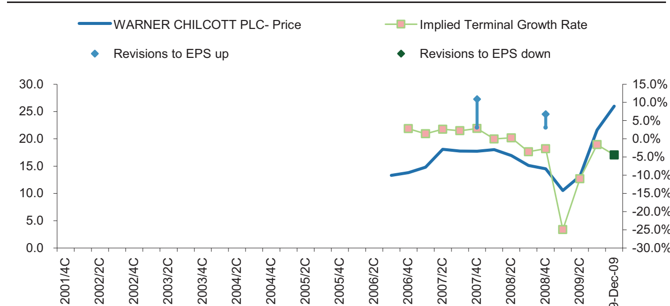
From Base to Bull Case: SG&A savings of ~$100 Billion vs. Base Case Should Lift 2010e EPS by 10% to $3.63



Source: Company data, Morgan Stanley Research

Exhibit 2

We Think Consensus Underappreciates Warner Chilcott's Ability to Reinvigorate/Streamline P&G Pharma



Source: Company data, FactSet, Morgan Stanley Research

Leverage from P&G acquisition and new Actonel should drive consensus EPS higher. Greater leverage from the P&G pharma acquisition (via strong Asacol sales and cost-cutting) quarter-by-quarter in 2010 should drive near-medium term EPS higher. FDA approval of new Actonel once-weekly in 2H10 and subsequent withdrawal of existing Actonel that goes off patent in 2014 should cause long-term consensus estimates to gap up in 2H10.

Opportunities exist for Warner Chilcott to drive higher sales with Asacol HD. The average Asacol patient takes 1.8-1.9 grams/day, and Warner Chilcott revenue will step up as patients adopt HD, which is 4.8 grams/day since the product is priced per gram. We expect the company to drive Asacol sales by: (1) shifting the mix of compensation toward more incentive/bonus (and away from high base salaries), (2) rolling out a new specialty salesforce (former Warner Chilcott dermatology reps) to target gastroenterologists, and (3) stopping sampling of the 400 mg dose (which may have been restraining ramp of new 800 mg HD launch).

We expect the new Actonel formulation to extend revenue duration past existing Actonels 2014 patent expiry. Assuming the new formulation is approved in 2010, we believe Warner Chilcott should pull existing Actonel from the market and reduce 2014 patent expiration pressure. We anticipate that this new formulation should be rapidly adopted by physicians and patients because it is more convenient, helps with patient compliance, and yields better patient outcomes.

Assuming approval, we see two key reasons that would support US market withdrawal of the existing formulation: (1) the new formulation could improve patient compliance and therefore outcomes; and (2) both formulations are 35 mg and the risk for confusion by pharmacists/patients is significant (taking the existing formulation with food would reduce drug absorption and efficacy).

Management can drive higher margins at acquired P&G Pharma, in our view. P&G Pharma's F2009 adjusted operating margin was 34% vs. Warner Chilcott's 53%. We expect the company to increasingly streamline the P&G business during 2010, which should offset Actonel's ex-US patent expiration starting in December 2010. Warner Chilcott has a highly efficient operating structure, and we expect management to drive a combined operating margin in the low 40% range in 2011.

We expect Warner Chilcott to maintain a beneficial tax structure. We calculate that Warner Chilcott has reported a non-GAAP adjusted tax rate in the 13-15% range in recent years. There are three aspects of its beneficial tax rate. First, Warner Chilcott negotiated a beneficial tax structure with Puerto Rico (~2%) until 2019. Second, Warner Chilcott re-domiciled from Bermuda to Ireland in mid-2009, which will hopefully allow the company to maintain a low tax rate long-term. Finally, Warner Chilcott has an APA (Advance Pricing Agreement) with the US IRS, but this will need to be renegotiated in 2010 and could increase in 2011–12. We model a tax rate of 15% in 2010, rising to 16% in 2011 and 17% in 2012.

Weatherford International

LatAm, Russia, and Middle East to Drive 25% Int'l Growth and FCF Generation

Morgan Stanley & Co. Incorporated
Ole Slorer
Ole.Slorer@morganstanley.com

Our View

We believe 2Q09 marked the trough of this cycle. A combination of (1) pricing stabilization, (2) improved activity on the back of a constructive oil tape, and (3) continued cost saving initiatives should result in higher earnings going forward. We are of the view that Weatherford will be able to fund its growth without raising equity, and provide near-20% return on investment. A large portion of the company's 2010 growth target is comprised of already-committed projects, and while terms in Mexico's Chicontepec project may be renegotiated, we expect this to be partly offset by growth in the rest of Latin America.

Market View

Street estimates are not taking into account margin improvement as the next leg of the cycle matures. Consensus is currently 25% below our estimate for 2010 and 30% below our estimate for 2011. The market does not believe that the company will be able to fund growth internally, and thinks it may need to access the equity markets. The market is also skeptical of the company's ability to grow 25% internationally, given PEMEX's preliminary guidance to a flat 2010 capex budget.

Market Assigns <5% Probability WFT Moves Above our Base Case — Too Low, in our View

Morgan Stanley Risk-Reward View (Left) vs. Probabilities Implied by Options Prices (Right)

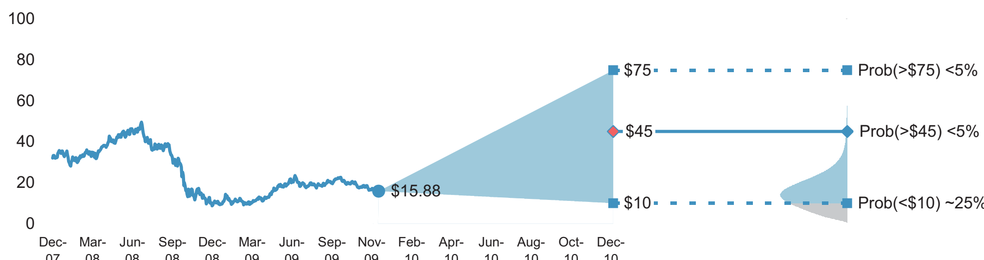
Derived from our analysis of fundamental value drivers

Derived from probabilities implied by the options market *

WEATHERFORD INTERNATIONAL LTD

Price Target : $ 45
WFT.N Rating : Overweight
MS Industry view : Attractive

<5% probability WFT will reach above $45 price target in 12 months



The probabilities of our Bull, Base, and Bear case scenarios playing out were estimated with implied volatility data from the options market as of Dec 9,2009. All figures are approximate risk-neutral probabilities of the stock reaching beyond the scenario price in one-year's time.

Risk-Reward Scenarios

$10 10x 2011e Bear Case EPS of $1.00
Bear Case

W-shape recovery. Premature recovery in drilling activity in the US and a surge in oil prices prove to be a false positive. Deeper and longer global recession resumes, commodity prices collapse further driving lower capex in 2010 and beyond. A strengthening of the global recession poses a risk to commodity prices (natural gas in the US and oil internationally). Against this backdrop, 2010 shapes up as another year of massive capex cuts by the oil and gas industry after an abysmal 2009.

$45 21–22x 2011e Base Case EPS of $2.10
Base Case

Rig count recovery, Foreign momentum. Int'l margins rebound from 3Q09 trough. North America pricing improves. Top-line growth continues to outperform peers. Further improvement from washed-out 2010 contracts and efficiency gains via improved utilization. Increased momentum in Russia, Mexico, and Iraq lead to improved top line in 2010. In Russia, recent acquisition of TNK-BP oilfield services could add $400mn. In Mexico, 3 out of 5 awarded ATG Integrated projects contracts could add $1.4bn to top line. Iraq contributes $400mn in 2010.

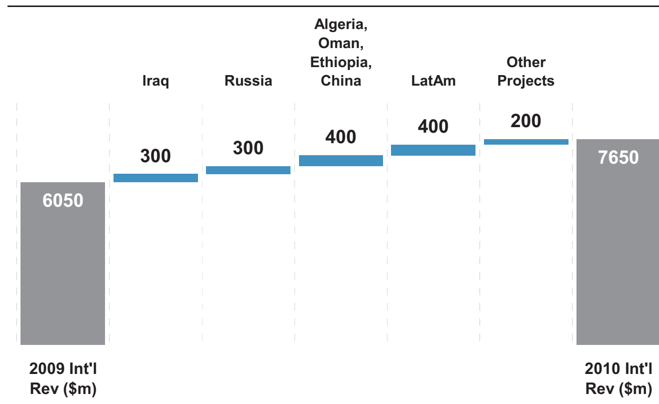
$75 30x 2011e EPS of $2.50
Bull Case

V-shape recovery, Higher oil prices. Global GDP recovers in 2010 led by China and Emerging Market economies. In US, land drilling and services industry rebalances; equipment and people are tight, boosting prices and margins in 2H10. Higher oil prices lead to double-digit capex improvement in international markets. The Middle East, North Africa and Russia mobilize more rigs and launch a flurry of IPM tenders. Weatherford regains its high organic growth profile of +30% and makes opportunistic acquisitions in selected markets.

Source: FactSet (price data), Morgan Stanley Research For more detail on our valuation methodology and risks associated with price targets mentioned, please see pages 33-34.

Discount to peers unwarranted, in our view; market too pessimistic about Weatherford's international growth. Much of the company's projected 2010 growth can, in our view, be accounted for by existing contracts. However, the market is not pricing in Weatherford's growth prospects, as the shares are currently trading at a 20% discount to its peers using 12-month forward P/E. We have therefore dissected the sources of 2010 growth including Latin America, Iraq, Russia, etc. While we have meaningfully reduced our 2010 growth estimate in Mexico to $1.4 billion from $2 billion, we believe that revenue growth in the rest of Latin America could make up for this $600 million shortfall.

Exhibit 1
Much of Weatherford's International Growth OutLook Attributable to Specific, Known Projects



Source: Company data, Morgan Stanley Research

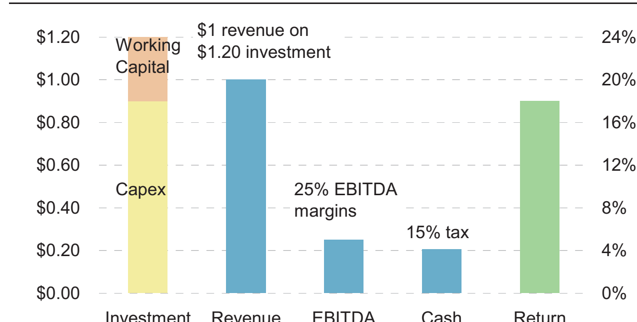
The 'true' surprise should be Weatherford's pickup in Latin America outside of Mexico compensating for lower-than-expected growth in Chicontepec, as well as a pickup to the extent of $200 million for the rest of the world, which equates to 5% of the other international regions (excluding LatAm) — a conservative forecast, in our view.

We expect LatAm to grow 20%, which is predicated on a number of key assumptions around the globe. We expect Weatherford to gain market share in Mexico, as the company entered 2009 running 24 strings and exited the year running 48 strings, while we expect the conclusion of ATG I & II and startup of ATG IV to contribute a meaningful portion to 2010 revenue. We also expect a pickup in Colombia, where we have seen signs of improving drilling activity. Other areas that are likely to help drive LatAm growth include Venezuela, Ecuador, and Brazil. Outside of LatAm, we expect Iraq to contribute $300 million to 2010 revenue growth if no new projects are added, while Russia is expected to provide an incremental $300 million from a full year contribution from the acquired TNK-BP business. Several other countries that should contribute around $100 million each in 2010 include Algeria, Oman, Ethiopia, and China.

Another potential major surprise: Positive FCF in 2010, whereas the market may be pricing in equity issuance. The market may be factoring in additional dilution from a potential equity raise; however, we do not expect Weatherford to raise equity in order to fund 2010 growth. We analyzed the capital requirements for Weatherford's growth expectations, which include $0.30 of working capital and $0.90 of capex to fund each $1 of growth. This suggests that to grow $1.6 billion internationally, the company would need to spend $1.9 billion ($1.4 billion capex + $0.5 billion working capital) plus another $0.5 billion for maintenance capital versus $1.6 billion of free cash in 2010. However, Weatherford should already have the equipment to comfortably deliver 2010 growth (financed with 2009 capex). Therefore, its capital requirement to achieve 2010 growth consists of $600 million of working capital (gradual in next year) and $500 million in maintenance capital — comfortably achievable, according to our analysis. However, we believe the working capital assumption is conservative and expect the company to benefit from a tightening of payment terms, which were stretched during the down cycle. This may ultimately result in positive free cash flow generation in 2010, which would likely be another major surprise.

Further, the market is skeptical about the quality of growth, but we estimate near-20% ROIs on new projects. There has also been concern about the quality of the company's growth and the potentially high cost, but after looking at the company's capital requirements, we believe that Weatherford is generating near 20% returns on investment. We assume each $1 of growth requires $1.20 of investment. We then assumed a 25% EBITDA margin (in line with our overall company estimate) and a 15% tax rate. This generates a 10% return, suggesting any improvement in working capital can raise this figure north of 20%.

Exhibit 2
Weatherford is Generating Near 20% ROI



Source: Company data, Morgan Stanley Research

Stock	Valuation Methodology	Risks
Apple (AAPL, $194.67) Rating: Overweight Industry View: Attractive	Our $230 price target is derived by assigning a 20x multiple (the low end of AAPL's historical range) to our C2010 adjusted EPS estimate of $11.50.	Key risks include pricing and gross margin pressure if carriers push back on high iPhone subsidies in the face of exclusivity expirations, competition, and network congestion; and increased competition in the Smartphone market from An-droid-based devices, RIM, Palm, etc.
Bank of America (BAC, $15.63) Rating: Overweight Industry View: Attractive	Our $30 target is based on residual income valuation, using a normalized beta and cost of equity capital. We expect that the market will start to value banks based on longer-term, normalized earnings as nonperforming loans peak, likely in 2H09. Our Bull Case intrinsic value uses residual income. Our Bear Case intrinsic value is based on 2009, bottom-of-cycle, Bear Case, price-to-tangible book, assuming all nongovernment preferred is converted to common shares. We use a 5.5% risk-free rate and a 4.5% equity risk premium.	Downside risks to our thesis and price target include delays in naming a CEO; higher cumulative losses, particularly in consumer asset classes; and insufficient staff in M&A and non-US investment banking. Upside risks include lower consumer losses, realization of the China Construction Bank investment, and earlier- and larger-than-expected accretion from the Merrill and Countrywide acquisitions.
Best Buy (BBY, $44.34) Rating: Underweight Industry View: In-Line	Our $34 Base Case valuation assumes a P/E of 12x, or more than a 3-multiple-point contraction from the stock's current 15.7x 2010e P/E. This is based on our view that 2010 could be a down earnings year for Best Buy (we forecast –4% EPS growth) vs. the market implied scenario of 10% EPS growth, and 22% growth for the S&P 200. Continued pressure on average selling prices (ASPs) and cycling the benefits of Circuit City's exit give us two reasons to expect down earnings for Best Buy while most retailers are likely to post higher earnings.	Downside risks include: Mobile Internet accelerates on-line migration as Best Buy pursues aggressive square footage growth; price pressure compresses overall margins, including in high-margin services. Upside risks: If attachments hold and Best Buy takes 40%-plus of Circuit City's sales, EPS could grow. With the stock below its long-term average P/Sales and EV/Sales multiples, a renewed cyclical trade could take the share price higher.
Energizer Holdings (ENR, $62.38) Rating: Overweight Industry View: In-Line	Our $74 price target represents 12 times our F2011e EPS estimate of $6.15, which is conservatively below the stock's 13.4 average next-12-months P/E over the past five years.	Procter & Gamble's pipeline of battery innovation, particularly given P&G's technology contract with lithium-ion battery systems maker A123. Currency is a large risk factor (46% pro forma international revenue mix) — on an annualized basis, we estimate that a 5% weighted change in the US dollar would be worth 8.8% to fiscal 2010 EPS. Macro and battery industry conditions could remain depressed. Commodity prices remain volatile; we estimate that each 5% weighted change in total raw material costs would drive a 12.4% EPS impact. Increased promotional activity could affect impact pricing and organic top-line growth.
General Dynamics (GD, $69.01) Rating: Overweight Industry View: In-Line	GD currently trades in line with Defense peers, but if a business jet recovery plays out, Gulfstream could warrant a mid-to-high-teens multiple (adds $13–17 per GD share) excluding China upside, pointing to $80 or higher. We'd argue the revenue growth outlook of 20% for several years starting in 2011 and potential for margin expansion from 15% toward 20% over time provides a foundation for a re-rating for Gulfstream to 16-18x, which would place GD shares above $80.	Risks: W-shaped recovery and/or unexpectedly unfavorable Quadrennial Defense Review; a double-dip recession and enduring caution prompt further business jet cancellations, resulting in "white tails" (planes built without firm orders) at Gulfstream; US Defense budget outlook is lowered; or Defense valuations retreat to levels seen amid previous budget cutbacks.
Monsanto (MON, $82.84) Rating: Overweight Industry View: Attractive	Our Base Case valuation is $105 per share. For the core business, we look at earnings power excluding R&D, which we estimate will approximate $5.17 per share during F2010 and $8.39 in F2012. We believe that from F2010 through F2015, this franchise will compound at a ~30% rate, with EPS excluding R&D estimated at approximately $6.75 in F2012. Assuming that Roundup is worth ~$10 per share ($1 of EPS and a P/E of 10) and that Seeds & Traits should trade at 26 times F2010 earnings implies an $88 per share value. We think this multiple is conservative given the high-quality growth potential of the existing operations due to its pricing and acreage-penetration opportunities. For the technology pipeline, discounting our revised forecast back to the present (using a 2.5% terminal growth rate and a 16.2% discount rate) provides us with a $17 per share value.	There is no certainty regarding the viability of Monsanto's technology pipeline. Pioneer, Syngenta, and others will be aggressively introducing new trait technology in coming years. As Monsanto's technology penetrates more international markets risk exists that its patents will not be respected. Monsanto is also dependent on USDA, FDA, and EPA approval of both current and future biotechnology. Foreign governments could impose restrictions on certain agribusiness activities. Finally, commodity prices affect Monsanto's business.
NVIDIA (NVDA, $15.21) Rating: Underweight Industry View: Cautious	Our price target of $9 represents an EV/Sales multiple of 1.2x applied to our C2010 revenue estimate of $3.3 billion. NVDA has traded at an EV/S of 0.5 to 2.5 over the last 12 months, with an average EV/S of 1.3x. Our DCF-based intrinsic value calculation is $8, based on a 10-year risk-free rate of 3.5%, beta of 1.8, equity risk premium of 4%, and long-term growth rate of 4%, resulting in a cost of equity capital of 10.8%.	We believe that the greatest risk likely resides in our estimates for NVIDIA's Tegra revenues. Valuation downside vs. our price target could come from PC chipset risk from Intel's integrated MPU+GPU products, discrete PC GPU risk, transition risk, and inventory risk. Valuation upside vs. our price target could derive from a slower-than-expected ramp of Intel's new MPU+GPU, and strong consumer demand environment leading to above-expectations GPU sales.

Stock	Valuation Methodology	Risks
Oracle (ORCL, $22.78) Rating: Overweight Industry View: In-Line	We expect the proposed acquisition of Sun Microsystems to close. As the market comes to our view, we'd expect ORCL to trade to a multiple of 15 times our C2010 EPS estimate of $1.76, or $26, in line with the S&P500.	Exposure to a weak IT spending environment, and increased integration risks from the pending Sun acquisition.
Philip Morris Internat'l (PM, $48.48) Rating: Overweight Industry View: In-Line	Our 12-month price target of $57 is derived from DCF analysis (using an 8.2% WACC and what we view as a conservative assumption of 0.5% terminal growth in FCF) and implies a 9.5x EV/EBITDA multiple and ~14.5x P/E multiple, based on our 2010 forecasts.	The principal risks to the achievement of our price target include: (1) A prolonged slowdown in unit volume growth, which could raise questions regarding the long-term sustainability of PM's overall improved business algorithm; (2) An excise tax shock in a high-profile market, which would adversely impact profitability and could damage the market's confidence that governments have become less aggressive on this front; (3) The competitive introduction of lower-priced brands, the downward price repositioning of existing brands in certain markets, and/or a significant increase in unemployment (which could drive consumer downtrading); and (4) Significant strengthening of the US dollar versus the major currencies in which PM operates.
Toronto Dominion Bank (TD.TO, C$65.98) Rating: Overweight Industry View: In-Line	Our C$85 price target is based on residual income valuation, using a normalized beta and cost of equity capital. Our Bull Case intrinsic value is based on residual income valuation, using a typical bull market beta and our Bear Case intrinsic value is based on residual income valuation, using a typical bear market beta. We use a 5.25% risk-free rate, a beta of 1.15 and a 4.5% equity market risk premium. We use price-to-normalized EPS as a secondary gauge of valuation.	General risks include slower-than-expected economic recovery, which would drive slower loan growth and fee income and higher provisions for credit losses (PCLs) than we are currently forecasting. Downside risks specific to TD Bank include higher credit losses, particularly on the commercial loan book in TD's US subsidiary. Upside risks include greater-than-expected synergies from the Commerce Bancorp acquisition.
US Steel (X, $47.14) Rating: Overweight Industry View: In-Line	Our $53 price target assumes a mid-cycle tubular price of $300/ton, versus the 10-year average of $221/ton, and flat-rolled mid-cycle profitability is now $50/ton, versus the 10-year average of $40/ton.	As a high-beta name, the stock is vulnerable to a broad market sell-off. Overcapacity in the US market could limit pricing. Imports may tick up as struggling international competitors attempt to dump steel.
Vertex Pharmaceuticals (VTRX, $39.90) Rating: Overweight Industry View: In-Line	Our $50 price target is based on a multiple analysis that employs an 11x multiple on our 2012 fully taxed diluted EPS of $6.19 discounted back at a 15% rate.	Risks include: (1) strong data from competitors; (2) any delay in getting telaprevir to market limits first-mover advantage and telaprevir's commercial opportunity; (3) potential safety signal in Phase III trials that has not been observed to date; (4) Vertex's high cash burn rate likely resulting in a need for additional financing. Our upside thesis is based on the market recognizing the medium-term upside, but downplaying the long-term risks. If the long-term risks become clearer or if the market overlooks near-term upside because of long-term risks, the stock may fail to reach our target.
Warner Chilcott (WCRX, $26.97) Rating: Overweight Industry View: In-Line	DCF-based $32 price target assumed a WACC of 8.5% (source: Bloomberg) and a –2% growth rate in perpetuity post-2015.	Slower-than-expected conversion to newer formulations of Asacol than we expect, FDA non-approval of Actonel in 2010, difficulties integrating the P&G Pharma acquisition, risk of higher tax rates than we project if management cannot come to APA agreement with IRS for 2011 and beyond, risk of earlier-than-expected Asacol generic introduction (we assume January 2014), and risk of government investigations into commercial practices. We also note the risk of stock volatility, if there are additional stock offerings (impossible to predict), given that private equity funds still own over 50% of WCRX shares.
Weatherford Internat'l (WFT, $15.88) Rating: Overweight Industry View: Attractive	Price target of $45 is based on 21–22x 2011 EPS of $2.10, ~25% lower than WFT's historical average of 28x to reflect (1) the imminence of trough EPS and the start of the multiple expansion phase which typically precedes earnings upgrades, and (2) the company's superior growth profile relative to its large peers. Multiple expansion from current levels is consistent with prior trough multiples.	Risks include (1) a fragile economic backdrop could result in project delays and margin compression; (2) a lingering weak natural gas tape in North America beyond 2010 could pressure margins; (3) Chicontepec cost overruns or delays could add another layer of uncertainty to earnings; (4) US Dept. of Justice Foreign Corrupt Practices Act investigation could distract management; and (5) poor execution of the company's eastern hemisphere expansion, principally in Russia.

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North America

Director of Research
Stephen Penwell 1+212-761-1466
Associate Director of Research
Sharon Pearson 1+212-761-3159
Michael Eastwood 1+212-761-8015
Management
Isabelle Halphen 1+212 761-5183
Aaron Finnerty 1+212 761-0064
Accounting
Gregory Jonas 1+212 761-7345

MACRO

Economics
Richard Berner 1+212-761-3398
David Cho 1+212 761-0908
David Greenlaw 1+212-761-7157
Ted Wieseman 1+212-761-3407
U.S. Strategy
Jason E. Todd 1+212-761-7991
Naseh Kausar 1+212-761-8059
Phillip Neuhart 1+212-761-8584
Sivan Mahadevan 1+212-761-1349
Christopher Metli 1+212-761-7550
Matthew Evans 1+212-761-5990
Commodities
Hussein Allidina 1+212-761-4150
Christopher Narayanan 1+212-761-8647
Seth Kleinman 1+212-761-6126

Sectors

CONSUMER DISCRETIONARY/RETAIL

RETAIL
Autos & Auto-Related
Ravi Shanker +1 212 761-6350
Branded Apparel
Chi Lee 1+212-761-0214
Haruka Miyake 1+212-761-3708
Rodney Singleton 1+212-761-7072
Discounters
Gregory Melich, CFA 1+212-761-6917
Michael Montani 1+212-761-7567
Kavita Narayanadas 1+212-761-3501
Food & Drug
Mark Wiltamuth 1+212-761-8589
Joseph Parkhill 1+212-761-0766
Justin Van Vleck 1+212-761-0332
Hardlines & Home Vendors
Gregory Melich, CFA 1+212-761-6917
Oliver Wintermantel 1+212-761-6284
Matthew McGinley 1+212-762-1533
Restaurants
John S. Glass 1+617-856-8752
Jon M. Tower 1+617-856-8750
David Dorfman 1+617-856-8751
Softlines
Michelle Clark 1+212-761-4018
Jay Sole 1+212-761-5866
Scott Feiler 1+212-761-6360
Christopher Cuomo 1+212-761-3265
Sharyn Uy 1+212-761-5156

CONSUMER STAPLES

Food & Food Service
Vincent Andrews 1+212-761-3293
Alison Lin 1+212-761-7250
Jaclyn Inglesby 1+212 761-3667
Greg Van Winkle 1+212 761-4968
Tobacco
David J. Adelman 1+212-761-6382
Matthew Grainger 1+212-761-8023
Agricultural Products
Vincent Andrews 1+212-761-3293
Megan Davis 1+212-761-0031
Beverages/HPC
Dara Mohsenian 1+212-761-6575
Ruma Mukerji 1+212-761-6754
Kevin Grundy 1+212-761-3645
Scott Shapiro 1+212-761-4907
Alison Lin 1+212-761-7250

ENERGY & UTILITIES

Exploration & Production
Stephen Richardson 1+212-761-3741
Sameer Uplenchwar 1+212-761-4487
Stuart Young 1+212-761-8194
Brian Lasky 1+212-761-7249
Integrated Oil
Evan Calio 1+212-761-6472
Ryan Todd 1+212-761-3023
Ben Hur 1+212-761-7827
MLPs
Stephen J. Maresca 1+212-761-8343
Dale Santiago 1+212-761-4896
Robert Kad 1+212-761-6385
Spencer McIntosh 1+212-761-4573
Oil Services & Equipment
Ole Slorer 1+212-761-6198
Paulo Loureiro 1+212-761-6875
Igor Levi 1+212-761-3232
Alfred Castaneda 1+212-761-6266
Utilities
Greg Gordon 1+212 761-7201
Jonathan Cohen 1+212-761-6851
William Ap picelli 1+212-761-8518
Geoffrey Lambert 1+212-761-3136
Rudy Tolentino 1+713-512-4483

FINANCIALS

Banks/Large/Mid Cap Banks
Betsy Graseck, CFA 1+212-761-8473
Matthew Kelley 1+212-761-8201
Timothy Skiendzielewski 1+212-761-0930
Ken Zerbe 1+212-761-7417
John J. Dunn 1+212-761-2601
Yoana Koleva 1+212-761-0474
Banks/Canadian
Cheryl Pate 1+212 761-3324
Justin Kwong 1+212-761-6983
Insurance/Life & Annuity
Nigel Dally 1+212-761-4132
Hayley Busell 1+212-761-6271
John O'Connor 1+212-761-3640

Non-Bank Financials
Celeste Brown 1+212-761-3896
Andy Bernard 1+212-761-7880
Rohit Goenka 1+212-761-6148
David Brown 1+212-761-0531
Thomas Allen 1+212-761-3356
REITs Strategy
Paul Morgan 1+415-576-2627
Samir Khanal 1+415-576-2696
Ryan Meliker 1+212-761-7079
Swaroop Yalla 1+415-576-2361
Chris Caton 1+415-576-2637

HEALTHCARE

Biotechnology
Steven Harr 1+212-761-3805
Colin Bristow 1+212-761-6672
Sara Slifka 1+212 761-3920
Hosp. Supplies & Medical Tech
David Lewis 1+415-576-2324
Andrew Olsen 1+212-761-6209
James Francescone 1+212-761-3222
Ryan Bachman 1+415-576-2019
Marshall Urist 1+212-761-8055
Jennifer Liu 1+212-761-5120
Neha Sahni 1+212-761-0259
Managed Care
Doug Simpson 1+212-761-7323
Melissa McGinnis 1+212-761-8535
Colin Weiner 1+212 761-6184
Pharmaceuticals
David Risinger 1+212-761-6494
Thomas Chiu 1+212-761-3688
Dana Yi 1+212-761-8713
Christopher Caponetti 1+212-761-6235

INDUSTRIALS

Aerospace & Defense
Heidi Wood 1+212-761-4407
Kevin Boone 1+212-761-4130
Michael A. Brown 1+212-761-3354
Business & ITServices
Vance Edelson 1+212-761-0078
Suzanne Stein 1+212-761-0011
Vikram Malhotra 1+212-761-7064
Peter Park 1+212 761-3555
Cristina Colón Garcia 1+212-761-4453
Toni Kaplan 1+212-761-3620
Ryan Cain 1+212-761-4143
Industrial Conglomerates
Scott Davis, CFA 1+212-761-7670
Robert Wertheimer 1+212-761-6334
Michael Stein 1+212-761-4717
Matt Gugino 1+212-761-7144
John Chappell 1+212-761-6172
Joseph O'Dea 1+212-761-0271

MATERIALS

Nonferrous Metals & Mining, Coal
Mark Liinamaa 1+212-761-3537
Paretosh Misra 1+212-761-3590
Wes Sconce 1+212-761-6004
Steel
Mark Liinamaa 1+212-761-3537
Evan Kurtz 1+212-761-7583

MEDIA

Cable & Satellite
Benjamin Swinburne 1+212-761-7527
David Gober 1+212-761-6616
Ryan Fiftal 1+212-761-3005
Micah Nance 1+212-761-7688
Cynthia Rupeka 1+212-761-7151
Entertainment & Broadcasting
Benjamin Swinburne 1+212-761-7527
Kristi Bonner 1+212-761-7226

TECHNOLOGY

Enterprise Software
Adam Holt 1+415 576-2320
Jennifer A. Swanson 1+212-761-3665
Keith Weiss 1+212-761-4149
Munish Jain 1+415 576-8728
Kelvin Wu 1+212-761-3501
Melissa Gorham 1+212-761-3607
Enterprise Systems & PC Hardware
Kathryn Huberty 1+212-761-6249
Jerry Liu 1+212-761-3735
Scott Schmitz 1+212-761-0227
Mathew Schneider 1+212-761-3483
Internet & PC Application Software
Mary Meeker 1+212-761-8042
Scott Devitt 1+212-761-3365
Collis Boyce 1+212-761-6578
Liang Wu 1+212-761-6320
Colter J. Van Domelen 1+212-761-7678
Joseph Okleberry 1+212-761-8094
Semiconductors/Capital Equipment
Mark Lipacis 1+415-576-2190
Sanjay Devgan 1+415-576-2382
Nihal Godambe 1+415 576-2195
Sundeep Bajikar 1+415-576-2388
Lacey Higgins 1+415-576-2614
Matthew Nerlinger 1+415 576-2610
Atif Malik 1+415-576-2607
Michael Chu 1+415 576-2359

TELECOM

Wireline & Wireless Telecom Services
Simon Flannery 1+212-761-6432
Daniel Gaviria 1+212-761-3312
Sean Ittel 1+212-761-7220
Edward Katz 1+212-761-3244
Philip Nanney 1+212-761-3270

TRANSPORTATION

Airlines & Freight Transportation
Bill Greene 1+212-761-8017
Adam Longson 1+212-761-4061
John Godyn 1+212-761-6605
Edward Gilliss 1+212-761-7748

Asia/Pacific

Director of Asia/Pacific Research
Marcus Walsh +852 2848 5912
Associate Director of Korea Research
Chanik Park +82 2 399 4940
Associate Director of Greater China Research
Dickson Ho +852 2848 5020
Associate Director of Australia Research
Martin Yule +61 2 9770 1582
Associate Director of ASEAN/India Research
Ridham Desai +91 22 2209 7790

MACRO

Strategy
Australia
Toby Walker +61 2 9770 1589
Antony Conte +61 2 9770 1544
China
Jerry Lou +852 2848 6511
Allen Gui +86 21 6279 7309
James Cao +86 21 2326 0037
India
Ridham Desai +91 22 2209 7790
Sheela Rathi +91 22 2209 7730
S. Korea
Chanik Park +82 2 399 4940
Jason Pyo +82 2 399 1408
Taiwan
Jesse Wang +886 2 2730 2861
Angel Lin +886 2 2730 2995

Economics
Asia/Pacific
Chetan Ahya +65 6834 6738
Sumeet Kariwala +91 22 2209 7929
ASEAN
Chetan Ahya +91 22 2209 7940
Deyi Tan +65 6834 6703
Shweta Singh +65 6834 6739
Australia
Gerard Minack +61 2 9770 1529
Greater China
Qing Wang +852 2848 5220
Steven Zhang +86 21 2326 0029
Denise Yam +852 2848 5301
India
Chetan Ahya +65 6834 6738
Tanvee Gupta +91 22 2209 7927
S. Korea
Sharon Lam +852 2848 8927
Katherine Tai +852 2848 8191

Commodities
Peter Richardson +61 3 9256 8943

Country Sub-industry

AUSTRALIA
Banks
Richard Wiles +61 2 9770 1537
Glen D'Souza +61 2 9770 1658
David Shi +61 2 9770-1187
Consumer
Martin Yule +61 2 9770 1582
Richard Barwick +61 2 9770 1684
Thomas Kierath +61 2 9770 1578
Diversified Financials/Insurance
Scott Russell + 61 2 9770 1536
Healthcare
Sean Laaman +61 2 9770 1559
Media
Andrew McLeod +61 2 9770 1591
Ben Holgate +61 2 9770 1671
Metals & Mining
Craig Campbell +61 3 9256 8936
Cameron Judd +61 3 9256 8904
Oil & Gas / Utilities
Stuart Baker +61 3 9256 8929
Philip Bare +61 3 9256 8932
Mark Blackwell +61 3 9256 8959
Property
Lou Pirenc +61 3 9770 1569
Todd McFarlane + 61 2 9770 1316
Chhai Ung +61 2 9770 1317
Telecommunications
Navin Killa +852 2848 5422
Yvonne Chow +852 2848 8262
Vincent Wu +852 2848 5657
Transportation & Infrastructure
Philip Wensley +61 2 9770 1583
Michael Rudland +61 2 9770 1136
Andrew Moller +61 2 9770 1148

CHINA/HONG KONG
Automobiles
Kate Zhu +852 2848 6843
Bin Wang +86 21 2326 0024
Kevin Luo + 852 2239 1527
Banks
Anil Agarwal +852 2848 5842
Daniel Shum +852 2848 8168
Minyan Liu +852 2848 6729
Eric Mak +852 2239 1568
Edmond Law +852 2239 1830
Capital Goods / Shipbuilding
Kate Zhu +852 2848 6843
Andy Meng +852 2239 7689
Kevin Luo + 852 2239 1527
Consumer / Agriculture
Angela Moh +852 2848 5405
Penny Tu +852 2848 5874
Dennis Tao +852 2848 7136
Robert Lin +852 2848 5835
Lillian Lou +852 2848 6502
Dan Wang +86 21 2326 0021
Jessica Wang +852 2848 5887
Clean Tech / Fertilizer
Sunil Gupta +65 6834 6732
Sophie Lu +65 6834 6718
Pey Herng Yap +65 6834 6742
Conglomerates / Macau Gaming
Praveen Choudhary +852 2848 5068
Xin Jin Ling +852 2239 7597
Corey Chan +852 2848 5911
Healthcare
Bin Li +852 2239 7596
Sean Wu +852 2848 5649
Christopher Lui +852 2239 1883
Insurance
Minyan Liu +852 2848 6729
Eric Mak +852 2239 1568
Edmond Law +852 2239 1830
Internet / Media
Richard Ji +852 2848 6926
Jenny Wu +852 2848 6708
Philip Wan +852 2848 8227
Lisa Yuan +852 2239 7107
Carol Wang +86 21 6279 8494
Candy Lin +86 21 2326 0153
Materials
Charles Spencer +65 6834 6825
Mean Phil Chong +65 6834 6194
Sandy Niu +852 2239 1520
Kevin Shi +852 2848 6947
Mid Cap
Lin He +86 21 6279 7041
Ying Guo +86 21 2326 0018
Oil & Gas
Wee-Kiat Tan +852 2848 7488
Sara Chan +852 2848 5292
Property
Derek Kwong +852 2848 7221
Angus Chan +852 2848 5259
Coral Ching +852 2848 1735
Daphne Liang +852 2848 5614
Theo Cheng +852 2848 5973
Technology
Jasmine Lu +852 2239 1348
Grace Chen +886 2 2730 2890
Tim Hsiao +852 2848 1975
Bill Lu +852 2848 5214
Charlie Chan +852 2848 5636
Telecommunications
Navin Killa +852 2848 5422
Yvonne Chow +852 2848 8262
Vincent Wu +852 2848-5657
Transportation
Chin Y. Lim +65 6834 6858
Edward Xu +852 2239 1521
Tommy Wong +852 2239 1523
Sophie Loh +65 6834 6823
Utilities
Simon Lee +852 2848 1985
Joseph Lam +852 2848 8210
Chapman Deng +852 2239 1588
Helen Wen +852 2848 5438

INDIA
Agriculture
Nillai Shah +91 22 2209 7157
Automobiles
Binay Singh +91 22 2209 7819
Anosh Koppikar +91 22 2209 7062
Banks
Anil Agarwal +852 2848 5842
Mihir Sheth +91 22 2209 7073
Mansi Shah +91 22 2209 7820
Building Materials / Capital Goods
Akshay Soni +91 22 2209 7151
Ashish Jain +91 22 2209 7156
Pratima Swaminathan +91 22 2209 7158
Arunabh Chaudhari +91 22 2209 7159
Consumer / Textiles / Retail
Hozefa Topiwalla +91 22 2209 7808
Nillai Shah +91 22 2209 7157
Girish Achhipalia +91 22 2229 7170
Hotels / Shipping / Industrials / Utilities
Parag Gupta +91 22 2209 7915
Saumya.Srivastav +91 22 2209 7084
Metals & Mining / Steel / Media
Vipul Prasad +91 22 2209 7807
Ketaki Kulkarni +91 22 2209 7925
Oil & Gas / Telecom / Chemicals
Vinay Jaising +91 22 2209 7780
Mayank Maheshwari +91 22 2209 7821
Surabhi Chandna +91 22 2209 7149
Pharmaceuticals / Property
Sameer Baisiwala +91 22 2209 7830
Saniel Chandrawat +91 22 2209 7810
Software Services
Vipin Khare +91 22 2209 7765
Gaurav Rateria +91 22 2209 7160

S. KOREA
Automobiles
Sangkyoo Park +82 2 399 4846
Banks/Insurance
Joon Seok +822 399 4934
Sara Lee +82 2 399 4836
Gil Woo Lee +82 2 399 4935
Chemicals
Harrison Hwang +82 2 399 4916
Consumer
Kelly Kim +82 2 399 4837
Jenna Mok +82 2 399 4938
Hardware Components
Sung Hee Lim +82 2 399 4937
Materials
Charles Spencer +65 6834 6825
Hyunjae Lee +82 2 399-4850
Semiconductors
Keon Han +82 2 399 4933
Young Suk Shin +82 2 399 9907
Shipbuilding
Sangkyoo Park +82 2 399 4846
Telecommunications
HyunTaek Lee +82 2 399 9854

SINGAPORE/ASEAN
Banks
Matthew Wilson +65 6834 6746
Samantha Horton +65 6834 8975
Roger Lum +65 6834 6743
Conglomerates
Conrad Werner +65 6834 6744
Miang Chuen Koh +65 6834 6169
Consumer
Angela Moh +852 2848 5405
Dennis Tao +852 2848 7136
Penny Tu +852 2848 5874
Consumer / Textiles / Retail
Hozefa Topiwalla +91 22 2209 7808
Divya Gangahar +65 6834-6438
Kalpesh Makwana +91 22 2209 7171
Materials
Charles Spencer +65 6834 6825
Mean Phil Chong +65 6834 6194
Property
Melissa Bon +65 6834 6745
Brian Wee +65 6834 6731
Industrials
Conrad Werner +65 6834 6744
Miang Chuen Koh +65 6834 6169
Telecommunications
Navin Killa +852 2848 5422
Transportation
Chin Y. Lim +65 6834 6858
Sophie Loh +65 6834 6823

TAIWAN
Banks
Lily Choi +852 2848 6564
Bruce Chou +886 2 2730 2875
Consumer
Angela Moh +852 2848 5405
Dennis Tao +852 2848 7136
Hardware Components
Jasmine Lu +852 2239 1348
Tim Hsiao +852 2848 1975
Sharon Shih +886 2 2730 2865
Grace Chen +886 2 2730 2890
Terence Cheng +886 2 2730 2873
Industrials
Jeremy Chen +886 2 2730 2876
Yunchen Tsai +886 2 2730 2871
Property
Jenny Tsai +886 2 2730 1724
Steel
Charles Spencer +65 6834 6825
Mean Phil Chong +65 6834 6194
Telecommunications
Navin Killa +852 2848 5422
Gary Yu +852 2848 6918
TFT-LCD
Frank Wang +886 2 2730 2869
Jerry Su +886 2 2730 2860
Transportation
Chin Y. Lim +65 6834 6858
Sophie Loh +65 6834 6823

Sector by Country

CONSUMER DISCRETIONARY

Agriculture
India
Nillai Shah +91 22 2209 7157
Automobiles
China
Kate Zhu +852 2848 6843
Bin Wang +86 21 2326 0024
Kevin Luo + 852 2239 1527
India
Binay Singh +91 22 2209 7819
Anosh Koppikar +91 22 2209 7062
S. Korea
Sangkyoo Park +82 2 399 4846
Hyunjae Lee +82 2 399 4850
Consumer/Retail
ASEAN
Hozefa Topiwalla +91 22 2209 7808
Divya Gangahar +65 6834-6438
Kalpesh Makwana +91 22 2209 7171
Australia
Martin Yule +61 2 9770 1582
Richard Barwick +61 2 9770 1684
Thomas Kierath +61 2 9770 1578
India
Hozefa Topiwalla +91 22 2209 7808
Nillai Shah +91 22 2209 7157
Girish Achhipalia +91 22 2229 7170
Greater China
Angela Moh† +852 2848 5405
Penny Tu +852 2848 5874
Dennis Tao +852 2848 7136
Robert Lin +852 2848 5835
Lillian Lou +852 2848 6502
Dan Wang +86 21 2326 0021
Jessica Wang +852 2848 5887
S. Korea
Kelly Kim +82 2 399 4837
Jenna Mok +82 2 399 4938
Hotels
India
Parag Gupta +91 22 2209 7915
Saumya.Srivastav +91 22 2209 7084
Media
Australia
Andrew McLeod† +61 2 9770 1591
Ben Holgate +61 2 9770 1671

ENERGY

Clean Tech / Fertilizer
China / Hong Kong
Sunil Gupta† +65 6834 6732
Sophie Lu +65 6834 6718
Pey Herng Yap +65 6834 6742
Oil & Gas
Australia
Stuart Baker† +61 3 9256 8929
Philip Bare +61 3 9256 8932
Mark Blackwell +61 3 9256 8959
China
Wee-Kiat Tan +852 2848 7488
Sara Chan +852 2848 5292
India
Vinay Jaising† +91 22 2209 7780
Mayank Maheshwari +91 22 2209 7821
Surabhi Chandna +91 22 2209 7149

FINANCIALS

Banks
ASEAN
Matthew Wilson† +65 6834 6746
Samantha Horton +65 6834 8975
Roger Lum +65 6834 6743
Australia
Richard Wiles +61 2 9770 1537
Glen D'souza +61 2 9770 1658
David Shi +61 2 9770-1187
China
Minyan Liu +852 2848 6729
Eric Mak +852 2239 1568
Edmond Law +852 2239 1830
Hong Kong
Anil Agarwal† +852 2848 5842
Daniel Shum +852 2848 8168
India
Anil Agarwal +852 2848 5842
Mihir Sheth +91 22 2209 7073
Mansi Shah + 91 22 2209 7820
S. Korea
Joon Seok +822 399 4934
Sara Lee +82 2 399 4836
Gil Woo Lee +82 2 399 4935
Taiwan
Lily Choi +852 2848 6564
Bruce Chou +886 2 2730 2875
Insurance
Australia
Scott Russell + 61 2 9770 1536
China
Minyan Liu +852 2848 6729
Eric Mak +852 2239 1568
Edmond Law +852 2239 1830

HEALTH CARE

Australia
Sean Laaman +61 2 9770 1559
Greater China
Bin Li +852 2239 7596
Sean Wu +852 2848 5649
Christopher Lui +852 2239 1883
India
Sameer Baisiwala +91 22 2209 7830
Saniel Chandrawat +91 22 2209 7810

INDUSTRIALS

Capital Goods / Shipbuilding
China / Hong Kong
Kate Zhu +852 2848 6843
Andy Meng +852 2239 7689
Kevin Luo + 852 2239 1527
Capital Goods
India
Akshay Soni +91 22 2209 7151
Pratima Swaminathan +91 22 2209 7158
Arunabh Chaudhari +91 22 2209 7159
Singapore
Conrad Werner +65 6834 6744
Miang Chuen Koh +65 6834 6169
Cement / Glass / Auto Components / Property / Steel
Akshay Soni +91 22 2209 7151
Ashish Jain +91 22 2209 7156
Pratima Swaminathan +91 22 2209 7158
Arunabh Chaudhari +91 22 2209 7159
Taiwan
Jeremy Chen +886 2 2730 2876
Jenny Tsai +886 2 2730 1724
Yunchen Tsai +886 2 2730 2871
Mid Cap
China
Lin He +86 21 6279 7041
Ying Guo +86 21 2326 0018
Transportation & Infrastructure
Regional
Chin Y. Lim† +65 6834 6858
Sophie Loh +65 6834 6823
China
Edward Xu +852 2239 1521
Tommy Wong +852 2239 1523
Australia
Philip Wensley +61 2 9770 1583
Michael Rudland +61 2 9770 1136
Andrew Moller +61 2 9770 1148

INFORMATION TECHNOLOGY

Hardware Components
China / Hong Kong
Jasmine Lu +852 2239 1348
Grace Chen +886 2 2730 2890
Tim Hsiao +852 2848 1975
Bill Lu +852 2848 5214
Charlie Chan +852 2848 5636
S. Korea
Sung Hee Lim +82 2 399 4937
Taiwan
Jasmine Lu +852 2239 1348
Sharon Shih +886 2 2730 2865
Tim Hsiao +852 2848 1975
Grace Chen +886 2 2730 2890
Terence Cheng +886 2 2730 2873
Internet / Media
China
Richard Ji +852 2848 6926
Jenny Wu +852 2848 6708
Philip Wan +852 2848 8227
Lisa Yuan +852 2239 7107
Carol Wang +82 61 6279 8494
Candy Lin +86 21 2326 0153
Semiconductors
S. Korea
Keon Han +82 2 399 4933
Young Suk Shin +82 2 399 9907
Software & Services
India
Vipin Khare +91 22 2209 7765
Gaurav Rateria +91 22 2209 7160
TFT-LCD
Taiwan
Frank Wang +886 2 2730 2869
Jerry Su +886 2 2730 2860

MATERIALS

Building Materials
India
Akshay Soni +91 22 2209 7151
Pratima Swaminathan +91 22 2209 7158
Chemicals
India
Vinay Jaising† +91 22 2209 7780
Mayank Maheshwari +91 22 2209 7821
Ketaki Kulkarni +91 22 2209 7925
S. Korea
Harrison Hwang +82 2 399 4916
Materials
China, Taiwan
Charles Spencer† +65 6834 6825
Mean Phil Chong +65 6834 6194
Sandy Niu +852 2239 1520
Kevin Shi +852 2848 6947
S. Korea
Charles Spencer +65 6834 6825
Hyunjae Lee +82 2 399 4850
Metals & Mining
Australia
Craig Campbell +61 3 9256 8936
Cameron Judd +61 3 9256 8904
India
Vipul Prasad +91 22 2209 7807
Ketaki Kulkarni +91 22 2209 7925

PROPERTY

Australia
Lou Pirenc +61 2 9770 1569
Todd McFarlane +61 2 9770 1316
Chhai Ung +61 2 9770 1317
China / Hong Kong
Derek Kwong +852 2848 7221
Angus Chan +852 2848 5259
Coral Ching +852 2848 1735
Daphne Liang +852 2848 5614
Theo Cheng +852 2848 5973
India
Sameer Baisiwala +91 22 2209 7830
Saniel Chandrawat +91 22 2209 7810
ASEAN
Melissa Bon +65 6834 6745
Brian Wee +65 6834 6731

TELECOMMUNICATIONS

Australia
Navin Killa† +852 2848 5422
China / Hong Kong / Taiwan
Navin Killa† +852 2848 5422
Yvonne Chow +852 2848 8262
Gary Yu +852 2848 6918
Vincent Wu +852 2848-5657
India
Vinay Jaising +91 22 2209 7780
Mayank Maheshwari +91 22 2209 7821
Surabhi Chandna +91 22 2209 7149
S. Korea
HyunTaek Lee +82 2 399 9854

UTILITIES

Australia
Mark Blackwell +61 3 9256 8959
China / Hong Kong
Simon Lee +852 2848 1985
Joseph Lam +852 2848 8210
Chapman Deng +852 2239 1588
Helen Wen +852 2848 5438
India
Parag Gupta +91 22 2209 7915
Saumya.Srivastav +91 22 2209 7084

DATABASE

Asia/Pacific
Corey Ng +852 2848 5523
Crystal Ng +852 2239 1468

† Regional Team Leader

Europe

Director of Research
Rupert Jones +44 (0)20 7425 4271
Associate Director of Research
Jose Maria Saiz +44 (0)20 7425 8560
Juliet Estridge +44 (0)20 7425 8160
Product Development & SSC
Ben Britz +44 (0)20 7425 3055
Fergus O'Sullivan +44 (0)20 7425 6404
Management
Mitzi Frank +44 (0)20 7425 8022
Sarah Waugh +44 (0)20 7425 8154
Media Relations
Sebastian Howell +44 (0)20 7425 5324

MACRO

Equity Strategy
Teun Draaisma +44 (0)20 7425 6600
Ronan Carr +44 (0)20 7425 4944
Edmund Ng +44 (0)20 7425 1449
Matthew Garman +44 (0)20 7425 3595
Graham Secker +44 (0)20 7425 6188
Catharina Luebke-Detring +44 (0)20 7425-1437
Jonathan Garner +44 (0)20 7425 9237
Michael Wang +44 (0)20 7425 5534
Economics
Joachim Fels +44 (0)20 7425 6138
Manoj Pradham +44 (0)20 7425 3805
Spyros Andreopoulos +44 (0)20 7677 0528
Elga Bartsch +44 (0)20 7425 5434
Melanie Baker +44 (0)20 7425 8607
Cath Sleeman +44 20 7425-1820
Daniele Antonucci +44 (0)20 7425 8943
Oliver Weeks +44 (0)20 7677 6302
Alina Slyusarchuk +44 20 7677-6869
Pasquale Diana +44 (0)20 7677 4183
Tevfik Aksoy +44 (0)20 7677 6917
Mohamed Jaber +971 4 709 7105
Michael Kafe +27 11 507 0891
Andrea Masia +27 11 507 0887
Valuation and Accounting
Juliet Estridge +44 (0)20 7425 8160
Derivatives and Portfolios
Guy Weyns +44 (0)20 7425 7979
Neil Chakraborty +44 (0)20 7425 2571
Christian Kober +44 (0)20 7425 2025
Praveen Singh +44 (0)20 7425 7833

Sectors

CONSUMER DISCRETIONARY/ INDUSTRIALS

Aerospace & Defence
Rupinder Vig +44 (0)20 7425 2687
Autos & Auto Parts
Adam Jonas +44 (0)20 7425 2177
David Cramer +44 (0)20 7425 7944
Edoardo Spina +44 (0)20 7425 0664
Business & Employment Services
Jessica Flounders +44 (0)20 7425 8985
David Hancock +44 (0)20 7425 3752
Mikko Ervasti +44 (0)20 7425 3893
Capital Goods
Scott Babka +44 (0)20 7425 8750
Guillermo Peigneux +44 (0)20 7425 7225
Vidya Adala +44 (0)20 7425 2044
Kasedith Vardhanabhuti +44 (0)20 7425 6235
Leisure/Hotels
Jamie Rollo +44 (0)20 7425 3281
Vaughan Lewis +44 (0)20 7425 3489
Audrey Borius +44 (0)20 7425 7242
Alex Davie +44 (0)20 7425 9867

CONSUMER STAPLES

Beverages
Michael Steib +44 (0)20 7425 5263
Eveline Varin +44 (0)20 7425 5717
Food Producers/HPC
Michael Steib +44 (0)20 7425 5263
Mark Christensen +44 (0)20 7425 5392
Erik Sjogren +44 (0)20 7425 3935
Tobacco
Eileen Khoo +44 (0)20 7425 4754

ENERGY/UTILITIES

Oil & Gas
Theepan Jothilingam +44 (0)20 7425 9761
James Hubbard +44 (0)20 7425 0749
Matthew Lofting +44 (0)20 7425 5915
Haythem Rashed +44 (0)20 7425 4405
Matt Thomas +44 (0)20 7425 5387
Katya Shiro +44 (0)20 7425 7049
Sasikanth Chilukuru +44 20 7425-3016
Oil Services
Martijn Rats +44 (0)20 7425 6618
Rob Pulleyn +44 (0)20 7425 4388
Utilities
Bobby Chada +44 (0)20 7425 5238
Nicholas Ashworth +44 (0)20 7425 7770
Arsalan Obaidullah +44 (0)20 7425 4267
Igor Kuzmin +44 (0)20 7425 8371
Emmanuel Turpin +44 (0)20 7425 6863
Sean Lee +44 (0)20 7425 6230
Antonella Bianchessi +44 (0)20 7425 7857
Clean Energy
Allen Wells +44 (0)20 7425 4146
Andrew Humphrey +44 (0)20 7425 2630

FINANCIALS

Banks/ Diversified Financials
Huw van Steenis +44 (0)20 7425 9747
Steven Hayne +44 (0)20 7425 8332
Bruce Hamilton +44 (0)20 7425 7597
Carlos Egea +44 (0)20 7425 6247
Chris Manners +44 (0)20 7425 3917
Hubert Lam +44 (0)20 7425 3734
Eva Hernandez +44 (0)20 7425 2138
Maxence Le Gouvello +44 (0)20 7425 6942
Ronny Rehn +44 (0)20 7425 8808
Per Lofgren +44 (0)20 7425 9094
Magdalena Stoklosa +44 (0)20 7425 3933
Hadrien de Belle +44 (0)20 7425 4466
Samuel Goodacre +44 (0)20 7677-0759
Insurance
Jon Hocking +44 (0)20 7425 2307
Adrienne Lim +44 (0)20 7425 6679
Maciej Wasilewicz +44 (0)20 7425 9104
Andrew Broadfield +44 (0)20 7425 2449
Farooq Hanif +44 (0)20 7425 1830

HEALTHCARE

Biotech & Medical Technology
Karl Bradshaw +44 (0)20 7425 6573
Diana Na +44 (0)20 7425 4394
Pharmaceuticals
Andrew Baum +44 (0)20 7425 6647
Nick Nieland +44 (0)20 7425 2272
Charles Chugbo +44 (0)20 7425-0704
Liav Abraham +44 (0)20 7425-8273

MATERIALS

Building & Construction
Alejandra Pereda +34 91 412 1747
Michael Watts +44 (0)20 7425 7515
Robert Muir +44 (0)20 7425 1838
Chemicals
Paul Walsh +44 (0)20 7425 4182
Wesley Brooks +44 (0)20 7425 0640
Peter J. Mackey +44 (0) 20 7425 4657
Metals & Mining
Ephrem Ravi +44 (0)20 7425 2127
Carsten Riek +44 (0)20 7425 3075
Markus Almerud +44 (0)20 7425 9870
Alain Gabriel +44 (0)20 7425-8959

MEDIA

Media & Internet
Patrick Wellington +44 (0)20 7425 8605
Edward Hill-Wood +44 (0)20 7425 9224
Julien Rossi +44 (0)20 7425 9755

PROPERTY

Property
Bart Gysens +44 (0)20 7425 5862
Bianca Riemer +44 (0)20 7425 2646
Chris Fremantle +44 (0)20 7425 5761

RETAIL

Retailing/Brands
Louise Singlehurst +44 (0)20 7425 7239
Pallavi Verma +44(0)20 7425 2644
Retailing
Geoff Ruddell +44 (0)20 7425 8954
Fred Bjelland +44 (0)20 7425 3612
Edouard Aubin +44 (0) 20 7425-3160
Charlie Muir-Sands +44 (0)20 7425 5207

TECHNOLOGY

Technology
James Dawson +44 (0)20 7425 9646
Patrick Standaert +44 (0)20 7425 9290
Ashish Sinha +44 (0)20 7425 2363
Guillaume Charton +44 (0)20 7425 2686

TELECOMS

Telecommunications Services
Nick Delfas +44 (0)20 7425 6611
Luis Prota +34 91 412 1217
Frederic Boulan +44 (0)20 7425 6830
Terence Tsui +44 (0)20 7425 4399
Tope Adegun +44 (0)20 7425 5413
Alexander Vassiouk +44 (0)20 7425 8846

TRANSPORTATION

Transport
Menno Sanderse +44 (0)20 7425 6148
Jose Arroyas +44 (0)20 7425 3831
Jaime Rowbotham +44 (0)20 7425 5409
Penny Butcher +44 (0)20 7425 6698
Antonio Rodriguez +44 (0)20 7425 5816

EMERGING MARKETS

Equity Strategy (Global)
Jonathan Garner +44 (0)20 7425 9237
Michael Wang +44 (0)20 7425 5534
Economics
Pasquale Diana +44 (0)20 7677 4183
Banks/ Diversified Financials
Magdalena Stoklosa +44 (0)20 7425 3933
Ronny Rehn +44 (0)20 7425 8808
Hadrien de Belle +44 (0)20 7425 4466
Telecommunications Services
Sean Gardiner +971 4 709 7120
Alexander Vassiouk +44 (0)20 7425 8846
Consumer
Daniel Wakerly +44 (0)20 7425 4389
Albina Sadykova +44 (0) 20 7425 7502

MIDDLE EAST NORTH AFRICA

Head of Research
Sean Gardiner +971 4 709 7120
Economics
Mohamed Jaber +971 4 709 7105
Financials
Dan Cowan +971 4 709 7165
Infrastructure
Muneeba Kayani +971 4 709 7117
Property & Building Materials
Menna Shams El Din +971 4 709 7110
Telecoms
Sean Gardiner +971 4 709 7120
Madhvendra Singh +971 4 709 7122

RUSSIA

Economics
Oliver Weeks +44 (0) 20 7677 6302
Alina Slyusarchuk +44 (0) 20 7677 6869
Metals & Mining
Dmitriy Kolomytsyn +7 495 589 9942
Marina Zavolock +44 (0)20 7425 5354
Oil & Gas
Matt Thomas +44 (0)20 7425 5387
Katya Shiro +44 (0)20 7425 7049
Telecommunications Services
Sean Gardiner +44 (0)20 7425 2175
Alexander Vassiouk +44 (0)20 7425 8846
Polina Ugryumova +7 495 589 9944
Utilities
Bobby Chada +44 (0)20 7425 5238
Igor Kuzmin +44 (0)20 7425 8371

SOUTH AFRICA - RMB MORGAN STANLEY

Economics
Michael Kafe +27 11 507-0891
Andrea Masia +27 11 507-0887
Financials
Magdalena Stoklosa +27 11 282 1082
Louis Chetty +27 11 282 4228
Derinia Chetty +27 11 282-8553
Industrials
Anthony de la Cour +27 11 282 8139
Roy Campbell +27 11 282 1499
Retail
Natasha Moolman +27 11 282 8489
Danie Pretorius +27 11 282 1082
TMT
Phihlelo Matjekana +27 11 282 1087
Mining
Albert Minassian +27 11 282 1154
Leigh Bregman +27 11 282 8969
Food Producers
James Easterbrook +27 11 282 1704

TURKEY

Sayra Can Antuntas +44 (0)20 7425 2365
Suha Urgan +44 (0)20 7425 3346
Erol Danis +44 (0)20 7425 1123
Economics
Tevfik Aksoy +44 20 7677-6917
Banks
Magdalena Stoklosa +44 (0)20 7425 3933
Telecommunications Services
Sean Gardiner +971 4 709-7120
Alexander Vassiouk +44 (0)20 7425 8846

Japan

Director of Research Division
Neil Perry +813-5424-5305

Economic Research

Director of Economic Research
Robert A. Feldman +813-5424-5385
Economics
Takehiro Sato +813-5424-5367
Takeshi Yamaguchi +813-5424-5387
Maki Uchikoga +813-5424-5344
Chie Takita +813-5424-5913

Equity Research

Director of Japan Research
Neil Perry +813-5424-5305
Associate Director of Research
Dennis Yamada +813-5424-5397

Macro

Equity Strategy
Alexander Kinmont +813-5424-5337
Maki Uchikoga +813-5424-5344

Sectors

CONSUMER DISCRETIONARY/ INDUSTRIALS

Autos
Noriaki Hirakata +813-5424-5307
Ryosuke Hoshino +813-5424-5916
Umi Togasawa +813-5424- 5308
Auto Parts
Shinji Kakiuchi +813-5424-5914
Naoko Hosaka +813-5424-5388
Machinery and Capital Goods
Yoshinao Ibara +813-5424-5302
Junji Sakurada +813-5424-5927
Masako Kusano +813-5424-5917
Services: General Services / Internet Services
Naoshi Nema +813-5424-5320
Atsuko Watanabe +813-5424-5338
Trading Companies
Tomokazu Soejima +813-5424-5345
Michiko Sekiya +813-5424-5329

CONSUMER STAPLES

Food
Taizo Demura +813-5424-5333
Haruna Sakai +813-5424-5918
Asaka Hano +813-5424-5313

ENERGY/UTILITIES

Oil & Coal Products
Lalita Gupta +813-5424-5909
Keiko Haruyama
Kaori Ikeda +813-5424-5921
Utilities
Yuka Matayoshi +813-5424-5910
Junko Yamamoto +813-5424-5334

FINANCIALS

Banks
Graeme Knowd +813-5424-5349
Takaaki Nishino +813-5424-5907
Ayako Kubodera +813-5424-5323
Aya Kurita +813-5424-5366
Financial Services, Insurance
Hideyasu Ban +813-5424-5381
Atsushi Shinoda +813-5424-5922
Ayako Kubodera +813-5424-5323
Naoko Hatakeyama +813-5424-5348

HEALTHCARE

Healthcare/Pharmaceuticals
Mayo Mita +813-5424-5319
Shinichiro Muraoka +813-5424-5926
Ayako Fukuda +813 5424-5928
Kaoru Wada +813 5424-5382

MATERIALS

Chemicals
Yoshihiro Azuma +813-5424-5311
Kayo Sano +813-5424-5332
Construction
Atsushi Takagi +813-5424-5380
Shoko Yamakami +813-5424-5925
Glass & Ceramics
Lalita Gupta +813-5424-5909
Keiko Haruyama
Kaori Ikeda +813-5424-5921
Steel / Nonferrous Metals/ Wire & Cable
Harunobu Goroh +813-5424-5343
Akira Morimoto +813-6422-8650
Emiko Ishikawa +813-5424-5376

MEDIA

Media
Hironori Tanaka +813-5424-5336
Nami Okayasu +813-5424-5379

PROPERTY

Housing
Hiroko Kubota +813-5424-5383
Atsushi Takagi +813-5424-5380
Shoko Yamakami +813-5424-5925
Real Estate
Tomoyoshi Omuro +813-5424-5386
Tadashi Okamoto +813-5424-5312
Makiko Matsuki +813-5424-5304

RETAIL

Retailing: Specialty, Restaurants
Yukimi Oda +813-5424-5328
Sai Aoyama +813-5424-5331

TECHNOLOGY

Information Technology
Masaharu Miyachi +813-5424-5321
Hiroko Ando +813-5424-5324
Technology: Consumer Electronics
Masahiro Ono +813-5424-5362
Takumi Kakazu +813-5424-5929
Yusuke Yoshida +813-6422-8652
Sachie Uchida +813-5424-5369
Technology: Japan Semiconductors
Kazuo Yoshikawa +813-5424-5389
Ryotaro Hayashi +813-5424- 5327
Midori Takeuchi +813-5424-5315

TELECOMS

Telecommunications
Hironori Tanaka +813-5424-5336
Nami Okayasu +813-5424-5379

TRANSPORTATION

Transportation
Takuya Osaka +813-5424-5915
Shino Takahashi +813-5424-5314

Latin America

Director of Research
Dario Lizzano 1+212-761-3936

Macro

Economics
Gray Newman 1+212-761-6510
Luis A. Arcentales, CFA 1+212-761-4913
Marcelo Carvalho +55 11 3048-6272
Daniel Volberg 1+212-761-0124
Giuliana Pardelli +55 11 3048-6195
GEMs Equity Strategy
Jonathan Garner 44+207-425-9237
Guilherme Paiva 1+212-761-8295
Vinicius Silva 1+212-761-7674
Michael Wang 44+207-425-5534

Sectors

AEROSPACE & DEFENSE

Heidi Wood 1+212-761-4407

CONSUMER STAPLES/BEVERAGE

Lore Serra 1+212-761-7954
Jerônimo De Guzman 1+212-761-7084

FINANCIALS

Financial Services
Jorge Kuri 1+212-761-6341
Jorge Chirino 1+212-761-0324

MATERIALS

Homebuilders & Real Estate
Jorge Kuri 1+212-761-6341
Jorge Chirino 1+212-761-0324
Nonferrous Metals & Mining, Coal
Carlos de Alba 1+212-761-4927
Cesar Medina 1+212-761-7027
Bruno Montanari +55-11-3048-6225

RETAIL

Retail
Lore Serra 1+212-761-7954
Jeronimo De Guzman 1+212-761-7084

SMALL AND MID CAPS

Javier Martinez de Olcoz Cerdan 1+212 761-4542
Esteban Schreck 1+212 761-8151
Alessandro Baldoni +55 11 3048-6226

TELECOMS & MEDIA

Telecom
Vera Rossi 1+212-761-4484

TRANSPORTATION & INFRASTRUCTURE

Nicolai Sebrell, CFA +55-11-3048-6133
Augusto Ensiki +1 212 761-3914

ENERGY & UTILITIES

Oil, Gas, Petrochemicals & Clean Energy
Subhojit Daripa +55-11-3048-6112
Oil Services
Ole Slorer 1+212-761-6198
Igor Levi 1+212-761-3232
Paulo Loureiro 1+212+761-6875

Fixed Income Research - Global

Credit Strategy

North America

Gregory Peters	1+212 761-1488
Rizwan Hussain	1+212 761-1494
Adam Richmond	1+212 761-1485

Europe

Andrew Sheets	44+20 7677-2905
Phanikiran Naraparaju	44+20 7677-5065
Serena Tang	44+20 7677-1149
Carlos Egea	+44 (0)20 7425 6247

Japan

Hidetoshi Ohashi	81+3 5424-7908
Tomoyuki Hirose	81+3 5424-7912

Asia Pacific

Viktor Hjort	+852 2848-7479
Kelvin Pang	+852 2848-8204

Structured Credit Strategy

Sivan Mahadevan	1+212 761-1349
Ashley Musfeldt	1+212 761-1727
Vishwanath Tirupattur	1+212 761-1043
James Egan	1+212 761-4715

Leveraged Finance Strategy

Jocelyn Chu	1+212 761-1470

Currency Strategy

North America

Sophia Drossos	1+212 761-2786
Ron Leven	1+212-761-3413
Yilin Nie	1+212-761-2886

Europe

Rashique Rahman	44+20 7677-7295
Emma Lawson	44+20 7677-7574
Regis Chatellier	44+20 7677-6982
Gracie Chen	44+20 7677-7887

Asia Pacific

Stewart Newnham	852+2848-5320
Yee Wai Chong	852+2239-7117

Economics

North America

Richard Berner	1+212 761-3398
David Greenlaw	1+212 761-7157
Ted Wieseman	1+212 761-3407
David Cho	1+212 761-0908

Europe

Joachim Fels	44+20 7425-6138
Manoj Pradhan	44+20 7425-3805
Spyros Andreopoulos	44+20 7056-8584

Pan-Africa

Michael Kafe	27+11 507 0891
Andrea Masia	27+11 507-0887

Emerging Markets Economics

Oliver Weeks	44+20 7677-6302
Tevfik Aksoy	44+20 7677-6917
Pasquale Diana	44+20 7677-4183
Alina Slyusarchuk	44+20 7677-6869

Interest Rate Strategy

North America

Jim Caron	1+212-761-1905
Paul Alston	1+212-761-0914
Subadra Rajappa	1+212-761-2983
Bill McGraw	1+212-761-1445
Janaki Rao	1+212-761-1711
Corentin Rordorf	1+212-761-1909
Bernard Gordon	1+212-761-2647
Igor Cashyn	1+212-761-1696
George Azarias	1+212-761-1346
Zofia Koscielniak	1+212-761-1307
Jonathan Marymor	1+212-761-2056

Europe

Laurence Mutkin	44+20 7677-4029
Mayank Gargh	44+20 7677-7528
Michelle Bradley	44+20 7677-3702
Anton Heese	44+20 7677-6951
Owen Roberts	44+20 7677-7121
Elaine Lin	44+20 7677-0579

Japan

Freddy Lim	81+3 5424-7909
Noriyuki Fukuda	81+3 5424-7926
Atsushi Ito	81+3 5424-7913
Sandeep Arora	81+3 5424-7698

Asia Pacific

Rohit Arora	+852 2848-8894

Credit Research

Europe -- Financials

Jackie Ineke	41+44 220-9246
Marcus Rivaldi	44+20 7677-1464
Lee Street	44+20 7677-0406
Fiona Simpson	44+20 7677-3745

Commodities Strategy

Hussein Allidina	1+212-761-4150
Jeremy R. Friesen	1+212-761-8531
Seth M. Kleinman	1+212-761-6126
Katherine Ragolsky	1+212-761-6253

Morgan Stanley

The Americas
1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1)212 761 4000

Europe
20 Bank Street, Canary Wharf
London E14 4AD
United Kingdom
Tel: +44 (0)20 7425 8000

Japan
4-20-3, Ebisu , Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0)3 5424 5000

Asia/Pacific
International Commerce Center
1 Austin Road West,
Kowloon, Hong Kong
Tel: +852 2848 5200

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